Publications

Fisher v. Department of Revenue and the Aftermath

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HISTORICAL PERSPECTIVE

Historically, local law has allowed taxpayers (for Oregon income tax purposes) tax deferral upon completion of a like kind exchange of property or an involuntary conversion of property, provided the requirements of IRC §§ 1031 or 1033 were met, and:

- The relinquished property and the replacement property were both located within Oregon; or
- The relinquished property was located outside Oregon. See ORS 314.290(1)(a) and (b).

Until recently, if the relinquished property was located within Oregon, and the replacement property was located outside of Oregon, tax deferral, for Oregon income tax purposes, was only allowed if:

- The taxpayer was a resident individual, estate, or trust; and
- The taxpayer made a separate Oregon election which met the requirements set forth in OAR 150-314.290(1)(d).

If a resident individual made a proper election, but later became a non-resident, the deferred gain became taxable, for Oregon income tax purposes, upon becoming a non-resident. ORS 314.290(2)(b)(A). See also, OAR 150-314.290(1)(d)(A). Likewise, if a resident individual made a proper election, but the deferral, for federal income tax purposes, ceased for any reason (e.g. a disposition of property within two years of a related party like kind exchange), it would also cease for Oregon income tax purposes. ORS 314.290(2)(b)(B).

An election was a statement which was attached to the taxpayer's Oregon income tax return for the year in which the exchange or conversion occurred. The statement contained:

- The taxpayer's name;
- The taxpayer's social security number;
- The tax year in which the exchange or conversion occurred;
- The amount of deferred gain;
- The location of the relinquished property;
- The location of the replacement property; and
- The taxpayer's agreement to report the deferred gain in the tax year in which the taxpayer's status changes from resident to non-resident.

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If Oregon property owned by a partnership or an S corporation was exchanged for or converted into property located outside of Oregon, provided the requirements of IRC §§ 1031 or 1033 were met, the partnership or S corporation could make the Oregon deferral election under ORS 314.290 for each consenting resident partner or resident shareholder. See ORS 314.290(5). *See also* OAR 150.314-290(2). The entity was required to attach a separate election for each resident partner or resident shareholder to its Oregon Form 65 or Form 20S. Electing resident partners or resident S corporation shareholders who later became non-residents, however, were required to report their respective share of the deferred gain in the year in which they became non-residents of Oregon.

Non-resident partners and non-resident shareholders were ineligible for the Oregon deferral election. Also, C corporations were ineligible for the Oregon deferral election.

Because a limited liability partnership is generally considered to be a partnership for federal income tax purposes and is a partnership under Oregon law, its resident partners presumably qualified for the Oregon deferral election. Using this logic, it was presumed that the non-resident partners of a limited liability partnership did not qualify for the Oregon deferral election. Unfortunately, Oregon law did not directly address these issues.

A limited liability company is generally a partnership for federal income tax purposes under the check the box regulations, but it is neither a partnership nor a S corporation for state law purposes. Consequently, it was not clear under Oregon law whether the resident members of a limited liability company qualified for the Oregon deferral election. Most practitioners believed, even though the law was silent, that resident members of a limited liability company qualified for the Oregon deferral election, while non-resident members did not qualify for the election.

FISHER V. DEPARTMENT OF REVENUE,

MAGISTRATE DIVISION OF THE OREGON TAX COURT,

No. 99033ZC (February 13, 2001)

In *Fisher*, the taxpayers challenged the constitutionality of Oregon residency election for tax deferral contained in ORS 314.290. Specifically, the taxpayers alleged that ORS 314.290 violated:

- The Privileges and Immunity Clause of the United States Constitution (Article IV, Section 2);
- The Commerce Clause of the United State Constitution (Article I, Section 8);
- The Equal Protection Clause of the United State Constitution (XIV Amendment);
- Article I, Section 32 of the Oregon Constitution; and
- Article IX, Section 1 of the Oregon Constitution.

The taxpayers, while residents of Colorado, completed an exchange of real property which otherwise qualified for tax deferral under IRC § 1031. The relinquished property was located in Oregon, but the replacement property was located outside of Oregon. The taxpayers took the position that ORS

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314.290(2)(b), despite its clear language, was *not* limited to Oregon residents. The Oregon Department of Revenue ("Department") disagreed with the taxpayers and issued a notice of delinquency. The taxpayers filed a complaint in the Magistrate Division of the Oregon Tax Court.

The court agreed with the taxpayers that the election to defer the gain given to Oregon residents under ORS 314.290(2)(b) violated the United States Constitution and the Oregon Constitution. The court's remedy, however, was not to allow non-residents the benefit of ORS 314.290(2)(b), but rather to strike this section from the statute as unconstitutional. Consequently, if the court's decision was allowed to stand, neither residents nor non-residents of Oregon who exchanged property located in Oregon for property located outside of Oregon, or who replaced involuntarily converted property located in Oregon with property located outside of Oregon, would qualify for deferral of Oregon income taxes.

The court noted in its decision that this remedy, by itself, would be ineffective to alleviate the harm that had already been caused by the history of disparate treatment of residents and non-residents since the enactment of ORS 314.290 in 1991. Consequently, to help resolve this harm, the court enjoined the Department from pursuing the deficiency against Mr. and Mrs. Fisher until it could demonstrate that it had remedied this pattern of disparate treatment. The court suggested that the available options to remedy the disparate treatment would be to either: (i) allow non-residents who exchanged Oregon property for or converted Oregon property into non-Oregon property to file amended returns and elect to defer their gain (and presumably receive refunds of taxes paid); or (ii) collect tax from residents who exchanged Oregon property for or converted Oregon property into non-Oregon property and elected to defer their gain.

DEPARTMENT OF REVENUE RESPONSE TO *FISHER*

The Department indicated that it would not appeal *Fisher*, but would instead seek redress in the Oregon Legislature. One can only suspect that the Department's analysis was that, as a result of Fisher, the Department simply lost the tax revenue from the disposition of one property by one pair of non-resident taxpayers. While other similarly-situated non-resident could now possibly file suit to claim a refund of taxes paid because ORS 314.290 was stricken as unconstitutional, it would be unlikely that many of them would do so before the running of any applicable statute of limitation. Even if a few taxpayers did actually file a suit for refund, defending the suits would probably be less expensive for Oregon than either of the options offered by the court.

The Department kept its promise. It did not appeal *Fisher*. Rather, it presented a bill before the 2001 Oregon Legislature to extend the Oregon deferral election to both residents and non-residents of Oregon.

HB 2206 -THE AFTERMATH OF FISHER

HB 2206 is the legislative response to *Fisher*. It repeals ORS 314.290. HB 2206 became law on October 6, 2001.

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In accordance with §15 of the bill, resident and nonresident individuals, estates, trusts, partnerships, and limited liability companies may elect to defer the gain for Oregon income tax purposes on transactions meeting the requirements of IRC §§ 1031 or 1033 even though the qualified replacement property is located outside of Oregon. This new provision is contained in Chapter 316 of the Oregon Revised Statutes.

In accordance with § 17 of the bill, corporations may elect to defer the gain for Oregon income tax purposes on transactions meeting the requirement of IRC §§ 1031 or 1033 even though the replacement property is located outside of Oregon. Unlike the old law, both S and C corporations are now eligible for the Oregon deferral election. This new provision is contained in Chapter 317 of the Oregon Revised Statutes.

Under the new law, taxpayers who exchange Oregon property for, or convert Oregon property into, non-Oregon property may qualify for Oregon income tax deferral. To obtain the deferral, however, taxpayers must prepare and file a separate Oregon deferral election. At the present, however, no tax form for the Oregon deferral election exists. The Department will undoubtedly create and circulate deferral election forms in the near future.

Insuring compliance may be problematic for the Department. It is quite possible that the Department will require taxpayers who make the election to annually provide it with a written update showing current ownership status of the replacement property. This type of post transaction reporting will assist the Department with compliance. It will not, however, alleviate the Department's multi-jurisdictional collection difficulties which will likely result from the new law.

CONCLUSION

The new law applies to tax years beginning on or after January 1, 1998 and any tax year for which an amended return may be filed on or after October 6, 2001. Practitioners need to consider whether clients may be able to amend returns in order to take advantage of the new law. If a taxpayer, who was ineligible for the Oregon deferral election under old law, completed a transaction which otherwise qualified for tax deferral under IRC §§ 1031 or 1033, the taxpayer may now be able to file an amended Oregon return and obtain an Oregon income tax refund. Consequently, practitioners should promptly review the files of all of their clients who have entered into transactions qualifying for tax deferral under IRC §§ 1031 or 1033. Prompt action, to avoid the expiration of the statute of limitations, is necessary.

Related Areas

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