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Date prior to or same as filing date
150

Department of Revenue, Business Division

Agency and Division

Administrative Rules Chapter Number

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to become effective [7/31/2010]. Rulemaking Notice was published in the [June 2010] Oregon Bulletin.**
Date upon filing or later Month and Year

RULE CAPTION

Inheritance Tax Natural Resource Credit; Capital loss carrybacks; Farm capital Gain; Information Returns

Not more than 15 words that reasonably identifies the subject matter of the agency's intended action.

RULEMAKING ACTION

List each rule number separately (000-000-0000)

Secure approval of new rule numbers (Adopted or Renumbered rules) with the Administrative Rules Unit prior to filing.

ADOPT: 150-118.NOTE; 150-317.063

AMEND: 150-118.140; 150-118.160-(B); 150-314.360; 150-317.013

REPEAL: 150-118.NOTE (Temp)

RENUMBER: 150-316.216 renumbered to 150-316.223

AMEND & RENUMBER:

Stat. Auth.: ORS 305.100; 314.360; 2010 Oregon Laws, chapter 107

Other Auth.:

Stats. Implemented: ORS 118.140, 118.160, 314.360, 316.223, 317.013, 317.063, 2010 Oregon Laws chapter 107.

RULE SUMMARY

150-118.NOTE explains the procedure for filing claims for refund of inheritance tax paid on natural resource property as provided in 2010 Oregon Laws chapter 107 (HB 3696). Sections 86 and 87 direct the Department of Revenue to adopt rules that explain how claims for refund may be filed with the department.

150-118.140 explains how and when additional tax is reported when a person disposes of property for which an estate claimed a natural resource property tax credit against Oregon inheritance tax.

150-118.160-(B) is amended to delete language that states an Oregon inheritance tax return is not required unless a federal return is required, as the rule language does not reflect statutory changes.

150-314.360 specifies the requirements for electronic submission of information returns to the department.

150-317.013 clarifies that corporations are required to carry back capital losses.

150-317.063 clarifies definitions and requirements related to claiming a reduced rate of tax on certain dispositions of farm capital gain property.

Elizabeth Harchenko

7/23/2010

Authorized Signer

Printed name

Date

*With this original, file one photocopy of certificate, one paper copy of rules listed in Rulemaking Actions, and electronic copy of rules. **The Oregon Bulletin is published the 1st of each month and updates rules found in the OAR Compilation. For publication in Bulletin, rule and notice filings must be submitted by 5:00 pm on the 15th day of the preceding month unless this deadline falls on a weekend or legal holiday, when filings are accepted until 5:00 pm on the preceding workday.

ARC 930-2005

150-118.NOTE

Natural Resource Property Inheritance Tax Refund

(1) Application for refund of inheritance tax authorized by 2010 Oregon Laws, chapter 107 must be made on a form prescribed by the department.

(2) Refund applications must be postmarked by the later of the following:

(a) December 31, 2010; or

(b) The expiration of the statute of limitations period described in ORS 118.227.

Stat. Auth.: ORS 305.100, 2010 Oregon Laws, chapter 107

Stats. Implemented: 2010 Oregon Laws, chapter 107

150-118.140

Inheritance Tax Credit for Natural Resource or Commercial Fishing Property

(1) Definitions. The following definitions apply for purposes of ORS 118.140 and this rule:

(a) “Active Management” is defined by Internal Revenue Code (IRC) Section 2032A(e)(12) and means the making of the management decisions of a business (other than the daily operating decisions). Treasury Regulations 20.2032A-3(e) through (g) provide additional examples of active management.

(b) “Adjusted gross estate” means the value of the gross estate reduced by the sum of the amounts allowable as a deduction under either IRC sections 2053 or 2054, or both. The amount is determined on the basis of the facts and circumstances in existence on the date (including extensions) for filing the return of tax imposed by chapter 118 (or, if earlier, the date on which the return is filed).

(c) “Cessation of qualified use” means the natural resource property or fishing business property use has changed and the property no longer qualifies as natural resource property or fishing business property.

(d) “Current assets” means the sum of cash and cash equivalents, accounts receivable, inventory, marketable securities, prepaid expenses and other assets of the qualified natural resource business that can be converted to cash within one year. Current assets do not include assets not used in the qualified natural resource business, long-term assets such as capital or sinking funds, or personal assets.

(e) “Current liabilities” means the sum of all money owed to the qualified natural resource business that is required to be paid within one year.

(f) “Disposition of property” means to sell, exchange, or otherwise dispose of natural resource property or fishing business property that was used to compute the natural resource credit, if such disposition results in the property no longer qualifying for the credit.

(g) “Domestic partner” means an individual who has entered into a domestic partnership as defined in the Oregon Family Fairness Act; Chapter 99, Oregon Laws 2007 (notes following ORS 106.990).

(h) “Member of family” means, with respect to a decedent:

(A) An ancestor of the decedent;

(B) The spouse or domestic partner of the decedent;

(C) A lineal descendant of the decedent, of the decedent’s spouse or domestic partner, or of a parent of the decedent, or

(D) The spouse or domestic partner of any lineal descendant described in paragraph (C). For purposes of the preceding sentence, a legally adopted child of an individual is treated as the child of such individual by blood.

(i) “Working capital” means current assets less current liabilities.

(j) “Working capital of a farm, natural resource-based business or fishing business” means working capital in an amount that represents the funds needed to operate the business annually.

(2) Federal Elections Binding for Oregon. Because ORS 118.007 ties Oregon inheritance tax law to the Internal Revenue Code (IRC) as it existed on December 31, 2000, elections that were available on December 31, 2000, and that are made for federal estate tax purposes are binding for Oregon inheritance tax purposes unless specifically provided otherwise by statute or rule. Property that is excluded from the estate due to claiming a marital deduction under IRC §2056 cannot be included in the Oregon estate in order to claim a tax credit under this section.

Example 1: Edwina passed away on July 1, 2007; her husband survives her. The value of her gross estate is \$8,000,000, made up entirely of natural resource property. For federal estate tax purposes, the estate elects a marital deduction of \$6,000,000. The unified credit offsets tax otherwise due on the balance of the estate, \$2,000,000, and there is no federal tax due. For Oregon purposes, the \$6,000,000 marital deduction election applies. In addition, the estate may elect to establish a Special Oregon Marital property trust as provided in ORS 118.016 to shelter \$1,000,000 of the value of the estate (the difference between the \$1,000,000 Oregon taxable estate and the \$2,000,000 federal taxable estate). Alternatively, the estate may use any portion of the \$2,000,000 in value to claim a natural resource credit against tax imposed on the estate.

(3) Active Management by a Member of Family. If natural resource property or a commercial fishing business is owned indirectly by the decedent or a member of the family, the following requirements must be met to qualify for a credit under ORS 118.140:

(a) At least one member of the family must engage in active management of the natural resource property or commercial fishing business after the transfer.

(A) The determination of whether active management occurs is factual, and the requirement can be met even though no self-employment tax is payable by the member of the family with respect to income derived from the farm or other trade or business operation.

(B) Among the farming activities, various combinations of which constitute active management, are inspecting growing crops, reviewing and approving annual crop plans in advance of planting, making a substantial number of the management decisions of the business operation, and approving expenditures for other than nominal operating expenses in advance of the time the amounts are expended.

(C) Examples of active management decisions are what crops to plant or how many cattle to raise, what fields to leave fallow, where and when to market crops and other business products, how to finance business operations, and what capital expenditures the trade or business should make.

(b) An otherwise qualifying natural resource property or commercial fishing business qualifies for the credit without active management if it is the subject of a net cash lease or percentage lease from the decedent or a member of the decedent’s family.

(c) The property also qualifies for the credit if it is held in trust for a member of the family or if the property is transferred directly to a member of the family.

(d) If an indirect interest is held in trust for a member of the family, it qualifies as long as a member of the family is engaged in the active management of the business.

(e) The trustee does not have to be engaged in active management if these requirements are met.

(4) Prior Use Requirement.

(a) An estate that otherwise qualifies for the commercial fishing business property credit is not required to meet the aggregate use period of five out of eight years ending on the date of the decedent’s death.

(b) Active management of the natural resource property is not a requirement prior to death.

Example 2: Kelly died on April 3, 2007. Kelly owned and operated Kelly's Fishing Boat business starting in February 2005. The estate files the tax return with the department on June 17, 2008, claiming the commercial fishing business credit, and pays the inheritance tax due. The estate may claim the commercial fishing business credit providing all other requirements to qualify for the credit are met.

(5) Future Use Requirement. In order for the estate to meet the requirements of ORS 118.140(7)(a) the following apply.

(a) Cash and like cash assets that are included in the credit calculation as working capital must be spent on the operation of the business either during the year of death or any of the eight calendar years following the decedent's death. Current assets remaining unspent on January 1 of the ninth calendar year following the decedent's death are subject to recapture of tax under ORS

118.140(7)(a).

(b) Payment of federal estate taxes or state inheritance taxes is not considered to be an expense incurred in operation of the natural resource business. Thus, use of cash or other assets to pay those taxes results in recapture of the credit to the extent the cash or asset was used as the basis for the credit.

Example 3: The Smith estate claimed a credit in 2007 based on farming assets worth \$1,000,000. In 2009, the estate sold a combine for \$100,000 to pay additional federal estate tax resulting from an audit. Sale of the combine results in recapture of the tax credit because the combine was not used in the farming business for 5 of the 8 years following the decedent's death.

(6) Claiming a Partial Credit. In determining whether the value of the credit property is at least 50 percent of the total estate, all of the eligible property must be considered, regardless of an election to claim only a partial credit under ORS 118.140(2)(b)(C).

(7) Working Capital. The determination of whether an amount qualifies as "working capital of a farm, natural resource-based business or fishing business" is based on the facts and circumstances existing at the decedent's death. However, the department will presume that working capital that does not exceed the highest amount of working capital present at any time during the five years prior to the year of the date of death qualifies as "working capital of a farm, natural resource-based business or fishing business." This presumption may be overcome by the facts in a particular case, including, but not limited to, the growth rate of the business, the length of the business cycle or the proximity of the date of death to the harvest date.

(8) Interest and Penalty. The department will not charge penalty or interest if an estate claims a natural resource property or commercial fishing business property credit or if the estate is directly affected by the changes made to ORS 118.140 by chapter 28, Oregon Laws 2008 and the return is filed and tax is paid before September 1, 2008. This provision applies to estates of decedents dying on or after January 1, 2007, and before December 1, 2007.

Example 4: John died on June 23, 2007. The regular due date of the inheritance tax return is March 23, 2008. The estate files the return with the department on August 29, 2008, claiming the natural resource credit, and pays the inheritance tax due. Because the return is filed and the tax is paid before September 1, 2008, the interest and penalty which would otherwise result from late filing and late payment is cancelled.

(9) Disposition or Disqualified Property. Upon the disposition or cessation of use of natural resource property or fishing business property for which the estate claimed a natural resource credit, additional inheritance tax becomes due. The additional inheritance tax is due and payable within six months after the date of the disposition or cessation of use occurs and must be reported on a form prescribed by the department.

(10) Interest and penalties under ORS 118.260 apply for a failure to file the return or failure to pay the tax on or before the due date prescribed in section (9).

[Publications: The publication(s) referred to or incorporated by reference in this rule is available from the Department of Revenue pursuant to ORS 183.360(2) and ORS 183.355(1)(b).]

Stat. Auth.: ORS 305.100 & 118.140

Stats. Implemented: ORS 118.140

150-118.160-(B)

Inheritance Tax Return; Extension of Time to File

(1) This rule is effective July 31, 2010 and applies to estates of decedents dying on or after January 1, 2003.

(2) The executor shall, not more than nine months after the date of the decedent's death, file with the Department an inheritance tax return, Form IT-1. A complete copy of the federal estate tax return and schedules must be filed with the Oregon Form IT-1. If the estate is not required to file a federal estate tax return, the executor must prepare a federal estate tax return and schedules reflecting federal estate tax law in effect December 31, 2000 and file that return and schedules with the Oregon inheritance tax return.

(3) If the executor cannot file a return within nine months, the Department may allow additional time, usually not to exceed six months, to file the return. A copy of the federal extension request must be attached to the front of the Oregon return when filed and will serve as evidence of a granted extension by the Department.

(4) If the Internal Revenue Service denies the extension request, but grants a period of time from the date of denial in which to file the federal return without imposition of delinquency charges, the Department will not impose delinquency charges if the Oregon return is received by the Department within one month from the last date on which the Internal Revenue Service would accept the federal return without imposition of delinquency charges. A copy of the denied extension request must be attached to the front of the Oregon return at the time of filing.

(5) An extension of time to file does not relieve the estate from the five percent penalty for failure to pay the tax on or before the original due date. Interest accrues during the extension period.

[Publications: Publications referenced are available from the agency.]

Stat. Auth.: ORS 305.100

Stats. Implemented: ORS 118.160

150-314.360

Information Returns

(1) Information returns are required to be filed electronically with the department as set forth in section (3) of this rule and using federal due dates. For purposes of this rule, information returns required to be filed electronically include:

(a) 1099-MISC *Miscellaneous Income*

(b) 1099-G *Certain Government Payments*

(c) 1099-R *Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, etc.*

(d) W2-G *Certain Gambling Winnings*

(2) Exceptions for Salaries and Wages. See ORS 316.202 and related rules.

(3) Information returns listed in section (1) of this rule, where the recipient, winner, or the payer has an Oregon address must be filed electronically as follows:

- (a) For payers that issue 250 or more of any one type of information return, electronic filing begins with 2011 forms due in 2012.
 - (b) For payers that issue 100 or more but less than 250 of any one type of information return, electronic filing begins with 2012 forms due in 2013.
 - (c) For payers that issue more than 10 but less than 100 of any one type of information return, electronic filing begins with 2013 forms due in 2014.
 - (4) The department may grant an exception to this filing requirement upon a showing of undue hardship. Undue hardship is based on the facts and circumstances specific to each payer and determined on a case-by-case basis.
- Stat. Auth.: ORS 305.100, 314.360
Stats. Implemented: ORS 314.360

150-317.013

Capital Losses—Carrybacks and Carryovers

- (1) This rule is effective July 31, 2010 and is applicable to all tax years beginning on or after January 1, 1986 that are open to examination.
 - (2) Federal law applies to capital losses occurring in tax years beginning on or after January 1, 1986.
 - (a) Capital losses are deducted to the extent of capital gains in the same tax year.
 - (b) Capital losses in excess of capital gains must be carried back three tax years. Capital losses that do not fully offset capital gains for a year to which the losses are carried back may be carried forward for up to five tax years after the tax year in which the capital losses were incurred.
 - (c) Capital loss carrybacks and carryovers can only be used to reduce capital gains in the tax years to which they are carried.
 - (d) A capital loss carryback cannot be used to create or increase a net loss in the tax year to which it is carried.
 - (e) If a capital loss is not carried to tax years in the order provided in subsections (1)(b) through (1)(d), the amount of net capital loss that should have been utilized to decrease capital gain net income cannot be used to offset capital gains in other taxable years.
 - (3) Oregon provisions, such as the requirement that corporations be unitary to be included in the consolidated Oregon return and the apportionment provisions, may result in differences between the Oregon and federal capital loss deductions and carryovers.
 - (a) Capital losses in excess of capital gains in tax years beginning prior to January 1, 1986, cannot be carried forward since those losses were deductible in full in the tax year they occurred.
 - (b) When a corporation or consolidated group of corporations is taxable within and without this state, its Oregon net capital loss carryback and carryover must be computed using the apportionment provisions. The Oregon capital loss is computed using the apportionment factor for the tax year of the loss. The capital loss is applied to the Oregon capital gains for the year of carryback or carryover. Oregon capital gains are computed using the apportionment factor for the tax year of the gain.
- Example 1: Corporation X has a federal net capital loss of \$3,000 for 2009. X's apportionment factor for 2009 is 40 percent. In 2006, X had a federal net capital gain of \$1,000 and its Oregon apportionment factor was 50 percent. X has a \$1,200 ($\3000×40 percent) Oregon net capital loss available for carryback to 2006. X will deduct \$500 ($\1000×50 percent) on the 2006 return and must carry the remaining \$700 forward to other tax years.
- (c) Oregon net capital losses that are attributed to corporations that continue to be included in the same consolidated Oregon return may be deducted fully against the Oregon consolidated net

capital gain of the tax years to which such losses are carried.

Example 2: Corporations X and Y filed a consolidated Oregon return in 2009 reporting a net capital loss of \$5,000 that is attributable to Y. The consolidated apportionment factor for 2009 is 40 percent. In 2006, X and Y filed a consolidated Oregon return reporting a net capital gain of \$10,000 attributable to X. The consolidated Oregon apportionment factor in 2006 was 25 percent. The Oregon capital loss carryback of \$2,000 ($\$5,000 \times 40$ percent) from 2009 is fully deductible in 2006 because it does not exceed the Oregon consolidated net capital gain of \$2,500 ($\$10,000 \times 25$ percent).

(4) If a corporation is included in a combined return, separate return or in a different consolidated return in the year of the capital loss and the capital loss is carried into a year when a consolidated Oregon return is filed, the Oregon capital loss carryover may be subject to the federal separate return limitation year (SRLY) limitations in Treas. Regs. 1.1502-22.

(a) If a net capital loss is reported on a separate Oregon return by a corporation doing business only in Oregon, the SRLY limitation applies if the loss is carried to a tax year in which a consolidated return is filed, apportionment is not required, and the corporation with the loss (the limited member) is not the parent corporation. To compute the Oregon SRLY limitation, first recompute the consolidated net capital gain by excluding the capital gains and losses and the IRC section 1231 gains and losses of the limited member. Then subtract the recomputed consolidated net capital gain from the total consolidated net capital gain (computed without regard to any net capital loss carryover or carrybacks).

Example 3: Corporation R filed a separate Oregon return for 2008 reflecting an Oregon net capital loss of \$3,000. Corporation R did not have net capital gains in any of the prior three years. For 2009, Corporation R was included in a consolidated Oregon return with Corporations S and T. The consolidated group was not subject to the apportionment provisions.

	Example 1	Example 2	Example 3
2009 net capital gains or losses:			
Corporation R	\$8,000	\$2,000	\$3,000
Corporation S	(6,000)	(6,000)	(4,000)
Corporation T	3,000	5,000	5,000
Consolidated	\$5,000	\$1,000	\$4,000
R's SRLY limitation:			
Consolidated net capital gain	\$5,000	\$1,000	\$4,000
Less recomputed consolidated net capital gain without R*	<u>0</u>	<u>0</u>	<u>(1,000)</u>
R's SRLY limitation	<u>\$5,000</u>	<u>\$1,000</u>	<u>\$3,000</u>

* If the remaining corporations have a consolidated net capital loss after excluding the gains and losses of the limited member, the consolidated net capital gain is not reduced.

(b) If a corporation is included in a consolidated Oregon return in the year of the consolidated net capital loss and files a separate Oregon return or is included in a different consolidated Oregon return in the year to which the net capital loss is carried, the Oregon consolidated net capital loss is attributed to the corporations with net capital losses for purposes of determining the allowable net capital loss carryover. The portion of an Oregon consolidated net capital loss

attributable to a member of a consolidated group is an amount equal to such Oregon consolidated net capital loss multiplied by a fraction, the numerator of which is the net capital loss of such member and the denominator of which is the sum of the net capital losses of those members of the consolidated group having net capital losses.

Example 4: X Corp. and unitary subsidiaries Y and Z filed a consolidated Oregon return for 2008, their first year in business. X had a \$3,000 capital loss, Y had a \$2,000 capital gain and Z had a \$1,000 capital loss (consolidated net capital loss of \$2,000). The 2008 Oregon apportionment factor for the consolidated group is 75 percent. On December 31, 2008, X Corp. sold 100 percent of Z's stock to an outside investor. The capital loss that can be carried forward to the 2009 consolidated return of X and Y is computed as follows:

Tax Year 2008:

X's net capital loss		(\$3,000)	
Y's net capital gain		2,000	
Z's net capital loss		(1,000)	
Consolidated net capital loss		<u>(\$2,000)</u>	
Oregon apportionment factor for consolidated group		.75	
Oregon consolidated net capital loss			<u>(\$1,500)</u>
X's share of Oregon consolidated net capital loss carryover available for 2009:	$3,000/4,000 = .75 \times 1,500$		(\$1,125)
Y's share of Oregon consolidated net capital loss carryover available for 2009:	$0/4,000 = .00 \times 1,500$		(\$0)
Total carryover available for consolidated return for X and Y for 2009			\$1,125
Z's share of Oregon consolidated net capital loss carryover available for 2009:	$1,000/4,000 = .25 \times 1,500$		(\$375)

(c) If corporations carry their net capital losses to a tax year in which separate tax returns are filed, the net capital losses can be deducted by each corporation only if a net capital gain is shown on the separate tax return. The net capital loss deduction is further limited by the amount of the net capital gain attributable to Oregon based on the Oregon apportionment factor.

Example 5: Assume the same facts as in Example 4. The 2009 separate Oregon return of Z shows a net capital gain of \$200 with an Oregon apportionment factor of 50 percent. The net capital loss deduction allowed is \$100 (\$200 x 50 percent). Z has a net capital loss carryover to 2010 of \$275.

(d) If a group of unitary corporations, taxable within and without this state, filed a consolidated return for the year of the net capital loss and carries the net capital loss after apportionment back to a year in which a combined return is filed, the net capital loss must be allocated among the corporations as provided under the SRLY limitations in Treas. Reg. 1.1502-22. The net capital gain of the unitary group in the combined year must be apportioned among the corporations based on each corporation's Oregon apportionment percentage.

(5) If a corporation, taxable within and without this state, filed a separate return or was included in a different consolidated return for the year of the net capital loss and carries the net capital loss after apportionment to a year in which a consolidated return is filed, the net capital loss can be deducted only to the extent that the same corporation has a net capital gain which is attributed to Oregon. If the consolidated group in the carryover year is subject to the apportionment

provisions, the net capital gain of the member must be attributed to Oregon based on the consolidated Oregon apportionment factor.

Example 6: In its first tax year 2008, B Corporation had a net capital loss of \$6,000. Because of its 50 percent Oregon apportionment factor, \$3,000 of the loss is apportioned to Oregon. On January 1, 2009, 100 percent of B's stock was purchased by P Corporation. Because they were unitary, P and B file a 2009 consolidated Oregon return that includes B's net capital gain of \$1,000 and P's net capital gain of \$3,000. The consolidated return apportionment factor is 35 percent. On the 2009 consolidated return, only \$350 of B's \$3,000 net capital loss carryover can be deducted (the lesser of $\$1,000 \times .35$ or $\$4,000 \times .35$).

(6) If a corporation participated in Oregon's tax amnesty program pursuant to Oregon Laws 2009, chapter 710 (SB 880), the capital loss carried from another year is applied to the total Oregon capital gains reported as if the taxpayer had not participated in the amnesty program. A refund may be paid when a capital loss is applied to a year in which the taxpayer participated in the amnesty program only to the extent that the taxpayer paid taxes for that year other than under the amnesty program and in excess of the statutory minimum tax. Whether or not a refund is paid, the capital loss carried to subsequent years is reduced by the amount applied to the amnesty year as if the taxpayer had not participated in the amnesty program.

Example 7: Corporation X has a federal net capital loss of \$3,000 for 2009. X's Oregon apportionment factor for 2009 is 40 percent. X has a \$1,200 ($\$3,000 \times 40$ percent) Oregon net capital loss available for carryback to 2006. For tax year 2006, X filed an original Oregon corporate tax return under Oregon's amnesty program. The 2006 return reported a federal net capital gain of \$1,000 and an Oregon apportionment factor of 50 percent, resulting in an Oregon net capital gain of \$500. X must carry back the capital loss to tax year 2006 but cannot receive a refund for any taxes paid because all taxes paid for tax year 2006 were paid under the amnesty program. X must reduce the capital loss carried to subsequent years to \$700. The \$500 capital loss that would have been allowed to offset against the capital gains had the 2006 return not been filed under the Oregon amnesty program is eliminated.

Example 8: Corporation Y has a federal net capital loss of \$5,000 for 2009. Y's Oregon apportionment factor for 2009 is 30 percent. Y has a \$1,500 ($\$5,000 \times 30$ percent) Oregon net capital loss available for carryback to 2006. For tax year 2006, Y filed a timely Oregon corporate tax return showing no capital gain income and paying \$50 Oregon net excise tax. During Oregon's amnesty program, Y filed an approved amnesty amended return claiming previously unreported federal net capital gain of \$3,000 and a revised Oregon apportionment factor of 60 percent, resulting in Oregon capital gains of \$1,800. Additional Oregon taxes paid were \$119.

All of the \$1,500 capital loss carryback is offset against the \$1,800 capital gain income for tax year 2006. Any resulting refund is limited to taxes paid outside the amnesty program that exceed the statutory minimum tax. Y is entitled to a refund of \$40 ($\50 tax paid outside the amnesty program minus the $\$10$ minimum tax for tax year 2006). Y does not have a remaining capital loss to carry to subsequent years.

[Publications: The publication(s) referred to or incorporated by reference in this rule is available from the Department of Revenue pursuant to ORS 183.360(2) and ORS 183.355(1)(b).]

Stat. Auth.: ORS 305.100

Stats. Implemented: ORS 317.013

150-317.063 Farm Capital Gain

- (1) This rule is effective July 31, 2010 and applies to all tax years open to examination.
- (2) Definitions. For purposes of ORS 317.063 and this rule:
 - (a) “Substantially complete termination” means the taxpayer is:
 - (A) No longer involved, directly or indirectly, in a trade or business engaged in farming, or
 - (B) No longer owns, directly or indirectly, property used in the trade or business of farming.
 - (b) “A trade or business engaged in farming” means a distinct farming operation separately run from the taxpayer’s other businesses. Businesses that share employees, equipment, buildings, or land are not separate businesses. Businesses that share records, accounts, registration, identification numbers, or a business name are also not separate businesses.
- (3) A taxpayer’s net long-term capital gain qualifies for the reduced tax rate if all four of the following tests are met:
 - (a) Asset Test. The gain is derived from either IRC section 1231 assets or an ownership interest of at least 10 percent in an entity.
 - (b) Use Test. The property that was sold consisted of:
 - (A) An ownership interest in an entity engaged in the trade or business of farming; or
 - (B) Property that was predominantly used in the trade or business of farming.
 - (c) Relationship Test. The assets are not sold to a related taxpayer as defined under IRC section 267.
 - (d) Termination Test. The sale is a substantially complete termination of all of the taxpayer’s ownership interests in:
 - (A) A trade or business engaged in farming; or
 - (B) Property that is predominantly used in the trade or business of farming.
- (4) Asset Test. The part of the taxpayer’s net long-term capital gain that is eligible for the reduced rate must be from capital assets under IRC section 1231 or a 10 percent or more ownership interest in an entity engaged in the trade or business of farming.

Example 1: Forty years ago, Corporation A purchased an orchard next to the company’s row crop farm. The company did not regularly harvest the fruit or care for the trees but allowed its employees and their families to use the fruit. Last year, the urban growth boundary moved to include the company’s parcel. Corporation A wanted to sell the property to developers so it had all the trees removed and sold the property. The sale of the orchard does not qualify for the reduced rate because it was not held as a trade or business; thus, it was not an IRC section 1231 asset. It was land held for investment and personal use.
- (5) Use Test. The asset sold must be predominantly used in the trade or business of farming. Any other use of the asset must be incidental to, and not interfere with, the primary purpose of being engaged in the trade or business of farming.
 - (a) Property used 80 percent or more in the trade or business of farming is considered and presumed to be predominant use. Accepted farming practices common to the type of farming activity and region, such as land lying fallow for one year, are included in the trade or business of farming.
 - (b) Property used more than 50 percent but less than 80 percent in a farming trade or business, qualifies as predominant if the difference between the actual percentage use in a farming trade or business and 80 percent use in a farming trade or business is incidental. Incidental use does not include holding property as an investment, using property for personal (non-business) use, or using property for another business. Incidental use includes, but is not limited to:
 - (A) Farmland that is bordered by or contains a waterway;
 - (B) Land that consists of terrain that cannot be farmed (i.e. marshland, desert);
 - (C) Land that contains a utility easement that makes farming impractical or impossible; or

(D) The period of the time when the farm property or business was “actively for sale” immediately prior to the sale. A property was “actively for sale” if the property was listed and advertised for sale for a price comparable to similar properties and the seller did not reject any reasonable offers.

(c) Property used for personal or business activities that take place on the land concurrently and do not interfere with the primary farming trade or business use are considered incidental use.

(d) Allocation. Property that is used less than 80 percent in a farm trade or business may be allocated between the actual portion that is predominantly used in the business of farming and the portion not predominantly used in the business of farming.

Example 2: BJ Farms raised corn and beans on 500 acres the entire time it owned the acreage. BJ Farms used the cornfields as a corn maze after the corn was harvested. BJ Farms sold the 500 acres to CJ Farms and recognized a capital gain. Assuming the gain from the sale meets the other three tests, the gain from the sale qualifies for the reduced tax rate because BJ Farms used the property predominantly (80 percent or more) in the trade or business of farming even though the company used the farmland for an incidental purpose after the harvest.

Example 3: D & D, Inc owned and operated a 30 acre farm. The farm had a waterway and riparian land that was not farmed, which took up 10 acres of the farm. Assuming the company meets the other three tests, D & D, Inc qualifies for the reduced tax rate because the property was predominantly used in the business of farming. The farm use qualifies as predominant for the entire 30 acres because the farm use was more than 50 percent, but less than 80 percent and the 33 percent (10 acres/30 acres) not used for farming was incidental.

Example 4: John B. Dairy, Inc sold 20 acres of land. The company owned the land and leased out 15 acres to a farmer who grew crops. The remaining 5 acres was made into baseball fields where the company allowed local Little League teams to use it for practices and games. Assuming John B. Dairy, Inc meets the other three tests, the 15 acres used for farming qualifies for the reduced tax rate.

(6) Relationship test. The gain from the sale of an asset does not qualify for the reduced tax rate if the asset is sold to a related taxpayer under IRC section 267 even if all of the other three tests are met.

Example 5: Green Beans Inc and Sweet Corn Inc own a farm together as a partnership. The partnership decides to sell the business to BJ Farms, (the parent company). Assume the sale meets the other three tests. The Green Beans Inc and Sweet Corn Inc capital gain does not qualify for the reduced tax rate because Green Beans Inc and Sweet Corn Inc are related to BJ Farms under IRC section 267.

(7) Termination Test. If a taxpayer sold an interest in a trade or business that is engaged in farming, the taxpayer may not be directly or indirectly engaged in that farming trade or business after the sale. The sale of the taxpayer’s interests through an installment sale constitutes a substantially complete termination for purposes of ORS 317.063 and this rule. A taxpayer has substantially terminated its interests in the trade or business of farming even though the taxpayer retained a portion of the farm for personal use.

Example 6: Happy Cow Dairy Inc, (Parent Corporation) owned two subsidiaries, a dairy operation and a hop farm. The two businesses were completely separate. They had separate employees, equipment, and records. The two businesses also had different names, records, and federal identification numbers. Happy Cow Dairy Inc sold the dairy farm. After selling all of the dairy equipment and dairy cows, the company realized a capital gain of \$350,000. The company decided not to sell the hop farm. The gain on the sale of the dairy operation qualifies for the

reduced tax rate. Even though the company still owned the hop farm, it had sold the entire dairy business.

(8) Depreciation Recapture. IRC section 1231 gain may be treated as ordinary income under IRC sections 1245 and 1250 recapture rules. If the capital asset is subject to depreciation recapture under IRC sections 1245 or 1250, the portion of the gain that is treated as ordinary income does not qualify for the reduced tax rate.

Example 7: JD Inc sold its farm, which included three silos. All four tests were met. The silos are capital assets subject to IRC section 1245 recapture. The part of the gain from the sale of the silos that is treated as ordinary income is not eligible for the reduced tax rate. However, the part of the gain from the sale of the silos that is treated as long-term capital gain on the federal return is eligible for the reduced tax rate on the Oregon return.

(9) Capital loss. If all four tests are met and the taxpayer is reporting a capital loss, it could affect the capital gain eligible for the reduced tax rate. Compute the net capital gain or loss from all other property sales or exchanges for the year that are taxable to Oregon. If it results in a net capital loss, the amount eligible for the reduced tax rate is the qualifying farm capital gain minus the net capital loss from other property sales or exchanges that are taxable to Oregon.

Example 8: B Inc sold a farming business for a net long-term capital gain of \$800,000. During the year, the company also sold other property for a net capital loss of \$150,000. Assuming the sale of the farm business meets all four tests, B Inc is only eligible for the reduced tax rate on \$650,000 (net farm long-term capital gain minus other net capital loss) of the taxable income.

(10) Installment Method under IRC section 453. Installment sales are eligible for the reduced tax rate if the sale meets all four tests as explained in section (2) of this rule. The amount of capital gain eligible for the reduced tax rate must be determined each year. The percentage of gain eligible for the reduced tax rate is equal to the qualifying farm long-term capital gain from the sale divided by all capital gain from the sale. Apply this percentage to the capital gain from the sale reported each year to determine the amount that qualifies for the reduced tax rate. If there is capital loss from the sale of other property as described in section (8) of this rule, during a tax year that the installment sale is reported, this may reduce the gain eligible for the reduced tax rate.

Example 9: Green Acres Inc sells its row crop farm in 2007 and meets all four tests to receive the reduced tax rate. The company elects to recognize the income from the sale using the installment method under IRC section 453. Green Acre Inc will receive half of the sale price in 2007 and one-fourth of the sale price each in 2008 and 2009 plus interest. Of the capital gain from the sale, \$300,000 qualifies for the reduced tax rate and \$100,000 does not. The company's percentage eligible for the reduced tax rate is \$300,000 of eligible capital gain divided by \$400,000 of total capital gain, or 75 percent. The buyer also paid interest to Green Acres Inc, which is reported separately on the return. In 2007, the company will claim the capital gain from the sale of \$200,000. Of that amount, 75 percent or \$150,000 is eligible for the reduced tax rate. In 2008 and 2009, the company will claim the farm capital gain rate for \$75,000 (\$100,000 x 75 percent) of capital gain from the sale reported each year.

(11) Like-kind Exchanges. Like-kind exchanges may be eligible for the reduced tax rate when the gain is recognized, assuming all four tests are met. The taxpayer must keep detailed records to show that the property would have qualified for the reduced tax rate if it had been a sale instead of an exchange.

Example 10: Dee Farms decided to exchange farmland for investment property. The exchange meets all four tests. Dee Farms deferred \$400,000 of capital gain. Later, Dee Farms sells the investment property and reports capital gain of \$700,000. Of this amount, \$400,000 is eligible

for the reduced tax rate for farm capital gain, because it would have been eligible if the company had not deferred it.

(12) Sale in more than one tax year. Prior-year sales of farm property, or a farming business sold over more than one year, may be eligible for the reduced tax rate. It can take more than one year to sell a farming business or all of a taxpayer's property used in farming because the property is sold to more than one buyer. To qualify for the reduced tax rate, the taxpayer must be actively trying to sell all farm property (or all property from a farming business) from the year of the first sale until the year of the final sale. Each sale is separately considered to see if it meets the requirements to qualify for the reduced tax rate, but all farm property or property from a farming business must be sold within a reasonable amount of time (usually no more than three tax years from the first sale to the final sale of qualifying farm property) for any of the prior year sales to qualify. The reduced tax rate on the prior year sales cannot be claimed until the taxpayer has sold all farm property or all property from a farming business. A property is "actively for sale" if the property was listed and advertised for sale for a price comparable to similar properties and the seller did not reject reasonable offers.

Example 11: Sunshine Grass Seed Inc owns 1,000 acres of farmland in four different locations. The properties are treated as one business and all of the property is actively for sale. The company sells 200 acres to a neighboring farmer in 2006. Sunshine Grass Seed Inc files its 2006 tax return but cannot claim the reduced tax rate on the gain because it is not out of the business of farming. In November 2007, the company sells the remaining 800 acres of farmland to Dees Farms (an unrelated party). Sunshine Grass Seed Inc, files its 2007 tax return and the long-term capital gain from the sales qualifies for the reduced tax rate because the property was actively for sale the entire time. Sunshine Grass Seed Inc may now amend its tax return for 2006 and claim the reduced tax rate on the qualifying capital gain from the earlier sale.

(13) If a taxpayer sells farm property and then buys other farm property, the taxpayer may qualify for the reduced tax rate. The taxpayer must meet all four tests described in section (3) of this rule with the sale of farm property before purchasing other farm property to qualify for the reduced tax rate.

Example 12: JB Farms, sold the company's farm and equipment to start a retail business. After some difficulty in getting started, the company decides to go back to farming and purchased another farm. JB Farms qualifies for the reduced tax rate because the company had completely terminated its interest in property used in farming at the time of the sale and met the other tests.

[Publications: Publications referenced are available from the agency.]

Stat. Auth.: ORS 305.100, 317.063

Stats. Implemented: ORS 317.063