2014

Oregon Department of Revenue

Out-of-State Tax Shelters Report

HB 2460 (2013 Regular Session)

Executive Summary

January 2014

150-800-550 BN Tax Shelters (Rev. 01-14)

Executive Summary

Section (1) of HB 2460 from the 2013 regular legislative session provides:

> "[n]o later than February 1, 2014, the Department of Revenue shall make a report on the use of out-of-state tax shelters to the Seventy-seventh Legislative Assembly. The department shall use all data available to the department to prepare the report, which shall:
>
> (1) Describe methods by which taxpayers shift income otherwise taxable by this state to outside the state; and
>
> (2) Make recommendations for addressing noncompliance attributable to out-of-state tax shelters."

The focus of this report is on corporation income tax shelters (abusive and legitimate) and the discussion is divided into two categories: international tax shelters that impact both federal and state income tax liabilities; and domestic (United States) tax shelters that generally only impact state income tax liabilities. The tax shelters discussed in this report involve transactions with related corporations and are therefore realistically not available to all corporations but instead limited to large corporations with resources available to create or relocate an affiliate in a low-tax or no-tax jurisdiction.

International tax shelters

Based on a review of SEC filings for 83 of the largest U.S. corporations, Bloomberg reported the combined total of accumulated offshore profits for these multinational corporations is $1.46 trillion. The Wall Street Journal reported the trend was most pronounced among high-tech and health-care corporations with valuable (and mobile) intellectual property such as patents and trademarks that is easily transferred to related corporations located in low-tax or no-tax foreign countries. The OSPIRG Foundation released a report in January of 2013 that estimates Oregon loses $283 million in corporate tax revenues annually to offshore tax havens. The U.S. Senate Permanent Subcommittee on Investigations released findings from its two-part review of the offshore tax avoidance strategies used by three of the largest U.S. based multinational corporations: Microsoft, Hewlett-Packard, and Apple. The subcommittee identified provisions in the federal tax code that allow these corporations to:

- Shift intellectual property and profits offshore to a related affiliate in a low-tax or no-tax foreign country in part to avoid or reduce U.S. taxes on the profits generated by these intangible assets;
- Defer U.S. taxation on offshore passive income that is generally prohibited from deferral under Subpart F provisions of the federal tax code; and
- Effectively repatriate foreign profits back to the United States to run U.S. operations without subjecting the foreign profits to U.S. tax—through use of a short-term loan exception.

Domestic (United States) tax shelters

The domestic tax shelters addressed in this report involve transactions with unitary affiliates incorporated in a tax haven state (Delaware, Nevada or Wyoming). Nevada and Wyoming do not impose a corporation income tax and Delaware does not tax the income of a corporation whose only activity in the state is the ownership, maintenance, and management of intangible assets. Domestic tax shelters are used by multistate corporations to shift income out of the tax base, or to reduce income apportionment percentages and minimize their state tax liabilities. Two common domestic tax shelter strategies involve:

- Passive investment companies (or trademark holding companies); and
- Asset management companies.

Impact on Oregon corporation income tax revenues

There is a fine line between abusive and legitimate tax shelters but the tax implications are very different. Abusive shelters are illegal and potentially subject to increased penalties while legitimate shelters are statutorily allowed and viewed as effective tax planning. Unless a transaction is found to conflict with a specific statutory provision, the determining factor often falls to a review of the transaction under anti-abuse common law doctrines. This review requires a detailed analysis of each specific transaction. Because of this, we are unable to determine the impact of abusive tax shelters on Oregon corporation tax revenues.

The greatest impact of these transactions with unitary affiliates is on the states that impose a separate reporting filing method. Since 2004, several separate reporting states have switched, or considered a switch to the combined reporting filing method. The tax base for a combined return includes the taxable income of all unitary affiliates therefore the domestic income shifting transactions are largely negated. The Oregon filing method can be similar to either separate reporting or combined reporting (or fall anywhere in between) depending on how the corporation files at the federal level.

Recommendations for addressing non-compliance

The following are intended as possible policy options for consideration to address non-compliance attributable to abusive out-of-state corporation tax shelters:

- Uniformity with anti-abuse federal legislation;
- Uniformity with Multistate Tax Commission recommendations; and
- Codify the economic substance doctrine in statute.

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Introduction

Black's Law Dictionary defines a tax shelter as a financial operation or investment strategy—such as a partnership or real estate investment trust—created primarily for the purpose of reducing or deferring income tax payments. The term 'tax shelter' can be misconstrued to include only abusive (illegal) tax transactions but not all tax shelters are abusive. Legitimate transactions allowed under federal or state tax law that are intended to reduce taxable income or income tax liabilities are also considered tax shelters. As required by HB 2460, this report on out-of-state tax shelters identifies methods by which taxpayers shift income otherwise taxable by Oregon to outside the state and provides recommendations to address non-compliance. The focus of this report is on out-of-state corporation income tax shelters and the discussion is divided into two categories: international tax shelters that impact both federal and state corporation income tax liabilities; and domestic (United States) tax shelters that generally only impact state corporation income tax liabilities.[1] Understanding how these transactions impact state tax liabilities requires an understanding of two fundamental corporation income tax concepts—formulary apportionment, and the unitary business principle—and how these concepts relate to the Oregon filing method.

Formulary apportionment (UDITPA)

A multistate corporation is a corporation that does business in more than one state and as a result has income that is, or could be, taxed by more than one state. When a corporation does business in more than one state the question arises how to determine the portion of the corporation's income that is attributable to each state. The U.S. Supreme Court requires the income to be fairly apportioned among the taxing states.[2] States take different approaches to meet this requirement but all use some form of apportionment. Apportionment is the process of dividing a corporation's income among the states in which it conducts business. The intent of apportionment is to attribute to each state its fair share of the total business net income of the multistate corporation. The apportionment formula is a ratio(s) consisting of a corporation's in-state factor(s) divided by the total everywhere factor(s).

In 1957, a group of state tax officials promulgated the Uniform Division of Income for Tax Purposes Act (UDITPA) to provide uniformity among the states with respect to the taxation of multistate corporations. UDITPA is a model law for apportioning the income of a corporation that is taxable in two or more states. Oregon adopted the UDITPA provisions in 1965 and of the forty-seven or so states that impose a corporate income tax, thirty-seven follow all or parts of the act.[3] Formulary apportionment should ensure 100-percent (no more, no less) of a multistate corporation's income is fairly attributed to the states that it conducts business in. That seldom occurs however because states have different apportionment formulas and different methods for determining the sales factor. UDITPA provides for the use of an equal-weighted three-factor formula that includes a sales factor, property factor, and a payroll factor. In recent years many states have moved away from the equal-weighted three-factor formula and have adopted formulas that are either comprised of a heavier weighted sales factor or a single sales factor. Oregon shifted from the equal-weighted three-factor formula to a heavier weighted sales factor in 1991 and has required the use of a single sales factor since 2005.

Oregon apportionment formula history

Equal-weighted factor (prior to 1991): 33% property; 33% payroll; 33% sales
Double-weighted sales (01/01/1991–04/30/2003): 25% prop; 25% payroll; 50% sales
Super-weighted sales (05/01/2003–06/30/2005): 10% prop; 10% payroll; 80% sales
Single sales factor (July 1, 2005–present): 0% property; 0% payroll; 100% sales

Oregon's shift away from the UDITPA recommended equal-weighted three-factor formula is consistent with several other states. Only nine states still require use of an equal-weighted three-factor apportionment formula.[4] The application of different formulas combined with the different approaches states require for determining the sales factor make it nearly impossible to attribute exactly 100-percent of a multistate corporation's income to the states that it conducts business in.[5] The total amount of income attributed to the states in which it conducts business is likely to fall short of, or exceed, 100-percent. When the sum of the income amounts attributed to the states in which it conducts business falls short of 100-percent, the difference is considered "nowhere income."

The unitary business principle

The theory underlying the unitary business principle was developed during the 1870s in the field of property taxation as a way that local governments could tax railroads operating within their jurisdictions. The courts recognized that the value of the railroad system was more than the cost of rails and ties located within a particular state. The system connected two distant points and represented an integrated economic unit, of which each state could claim its appropriate share. All of the railroad's property was valued as a single unit and a portion of the unit's value was assigned to each state by a mathematical formula. The application of the unitary approach evolved when states started to impose a tax measured by the income of corporations.

The U.S. Supreme Court has noted "'the linchpin of apportionability in the field of state income taxation is the unitary business principle."[6] Under the unitary business principle groups of corporations that are a unitary business are treated as a single economic enterprise. The principle establishes that if income arises from transactions or operations of a single economic enterprise, parts of which are carried out in the state, the state can apply formulary apportionment to determine the share of that enterprise's income attributable to the state. Stated another way, if a corporation is carrying on a single business enterprise through multiple entities within and without the state, under the unitary principle the state has the necessary connection to the out-of-state activities to apply formulary apportionment to the taxable income of the entire unitary group. There are well established tests to determine unity and considerable case law not discussed here because the unitary principle is not the focus of this report. It is important though to understand the unitary business principle and how it relates to the corporation filing method required in Oregon.

The Oregon corporation filing method history

In 1984, Oregon legislation was enacted that changed the filing method for corporations doing business in the state.[7] The legislation adopted a filing method that is tied to the federal corporation income tax return. The federal return includes only those corporations that are incorporated in the United States and therefore the tie to the federal return established the "water's edge" filing method for Oregon.[8] This was a significant change. Prior to the 1984 legislation, Oregon law required corporations doing business in this state to file tax returns on a worldwide combined basis. Using the worldwide combined method meant the Oregon return generally included the income and apportionment factors of the Oregon taxpayer and the income and apportionment factors of all of its unitary affiliates located worldwide—with specific common ownership requirements.

Corporations challenged the combined reporting filing method, but the Oregon Supreme Court upheld the application of combined reporting and the U.S. Supreme Court twice upheld the application of worldwide combined reporting.[9] Under the Oregon combined report, the entire unitary business's income was included in the pool of income to be apportioned and the entire unitary business's factors were included in the denominators of the apportionment factors—everywhere amounts. The numerators of the apportionment factors—Oregon amounts—included only the factors of corporations that were subject to tax in Oregon.

Filing methods generally, and Oregon's filing method

There are two primary filing methods for corporations. States that impose a corporation income tax generally require the use of separate reporting or combined reporting. Under the separate reporting method, each corporation subject to tax in the state files on a separate basis and the tax base for that return consists only of the corporation's income. Under the combined reporting method, each corporation subject to tax in the state files on a combined basis and the tax base for that return consists of the total income of all unitary corporations that meet certain ownership tests.[10] The Oregon filing method is often referenced nationally as a combined reporting method but that is not entirely accurate.[11] The Oregon method is tied to the federal filing method and can be similar to either separate reporting or combined reporting depending on how the corporation files at the federal level. For federal purposes, a corporation can elect to file either a separate return or a consolidated return. If a corporation doing business in Oregon files a separate federal return, the corporation is required by Oregon law to file a separate Oregon return.[12] Likewise, if a corporation files as part of a federal consolidated return with related entities the taxable income amount from the consolidated federal return will be the starting point for the Oregon return.[13] Under the Oregon water's edge filing method, a corporation's Oregon net tax liability is generally computed using the following steps:

1. <u>Oregon tax base</u>: Begin with the federal taxable income amount—computed on either a separate or consolidated basis depending on the taxpayer's federal filing election. Add or subtract the Oregon modifications—for example, subtract the income of non-unitary affiliates included in the consolidated federal return. The resulting amount is the **Oregon tax base**.

2. <u>Income subject to apportionment</u>: If applicable, subtract from the Oregon tax base the total net non-business income that per Oregon law—consistent with UDITPA—is allocated and not subject to apportionment.[14] The resulting amount is the **income subject to apportionment**.

3. <u>Income apportioned to Oregon</u>: Multiply the income subject to apportionment by the Oregon apportionment percentage—for most corporations the Oregon apportionment percentage is determined by dividing the Oregon sales by the total everywhere sales. The resulting amount is the **income apportioned to Oregon**.

4. <u>Oregon taxable income</u>: Add to the income apportioned to Oregon the total net non-business income that is allocated to Oregon. The resulting amount is the **Oregon taxable income**.

5. Oregon tax liability: Multiply the Oregon taxable income by the corporate tax rate to determine the **Oregon tax liability** before credits.
6. Oregon net income tax liability: Subtract the Oregon tax credits from the tax liability to arrive at the **Oregon net income tax liability**.

International Tax Shelters

The obvious objective of corporation income tax planning is to minimize tax liability. For multinational corporations subject to tax in several countries, the objective is to minimize its total global tax liability. One way to accomplish this is to structure business activities so that the maximum amount of taxable profits are located in low-tax, or no-tax, countries and the maximum amount of expenses are allocated to high-tax countries where deductions are more valuable, like the United States. United States based multinational corporations are taxed on all of their worldwide earnings at the statutory U.S. tax rate of up to 35 percent. Therefore, a business deduction is generally worth 35 cents on the dollar in the U.S. but is worth only one-third as much in Ireland where the corporation income tax rate is 12.5-percent. It is worthless in countries that do not impose a corporation income tax. International tax shelters are not realistically available to all corporations. These opportunities are limited to large multistate and multinational corporations that have resources available to create or relocate an affiliate in a foreign country or that already have related corporations doing business in a foreign country.

Offshore profit shifting and the U.S. tax code

U.S. corporations are subject to the statutory tax rate of up to 35 percent on all income, including worldwide income; a rate among the highest in the world. However, under current federal law, U.S. based multinational corporations generally can defer U.S. tax on active business income earned through a controlled foreign corporation (CFC) until that income is brought back to the United States, i.e., repatriated as a dividend to the U.S. parent corporation.[15] Deferral creates incentive for U.S. corporations to shift earnings offshore to low-tax, or no-tax, countries to avoid U.S. taxes, reduce its global tax liability, and increase its after tax profits. Although deferral of U.S. tax is permissible for active business income earned through a CFC, deferral is generally prohibited for passive—inherently mobile—income such as dividends, interest, royalties, rents, and annuities under the Subpart F provisions of the Internal Revenue Code.[16] Income reportable under Subpart F is subject to U.S. tax regardless of whether the earnings have been repatriated. The U.S. shareholder of the CFC is required to treat its pro-rata share of the Subpart F income as a deemed dividend in the year the income was earned. The Subpart F provisions have been undercut by certain federal regulations and temporary statutory changes.[17] Check-the-box regulations issued by the Treasury Department in 1997 and the CFC look-through rule enacted by Congress as a temporary measure in 2006 have reduced the effectiveness of the anti-deferral Subpart F provisions and facilitated the increase in offshore profit shifting.

International tax shelters have received significant attention recently with national headlines focused on the profits maintained offshore in low-tax, or no-tax countries by U.S. based multinational corporations. In March of 2013, the Wall Street Journal reported their analysis of SEC filings for 60 U.S. based multinational corporations. They found these businesses maintained a combined total of $166 billion of 2012 profits offshore.[18] It reported the trend was most pronounced among the 26 technology and health-care corporations in the survey—

stating many tech and health-care companies have shifted intellectual property, such as patents and marketing rights, to subsidiaries in low-tax countries allowing sales and profits to be recorded in the low-tax jurisdictions. The analysis showed those 26 corporations collectively reported $120 billion of profits overseas for 2012 alone, accounting for nearly three-quarters of the 2012 total. The report did not address whether the offshore profit shifting transactions were abusive but instead generally referred to the transactions as allowed under current federal tax code.

Bloomberg conducted a similar analysis in 2013. Based on a review of SEC filings for 83 of the largest U.S. corporations, it reported the combined total of accumulated offshore profits for these 83 corporations is $1.46 trillion.[19] The analysis points to the ability for corporations to defer U.S. taxes until profits are brought home, the ease of shifting profits to low-tax countries, and the world's highest statutory corporate tax rate as contributors to the increase in offshore profits. The report specifically addressed the technology and health-care industries stating, "[t]he incentive to accumulate profits in cash is acute for technology and pharmaceutical companies that generate income from intangible assets such as patents. They can sell the patents to their foreign subsidiaries and then shift them to low-tax jurisdictions and book the profits there." Similar to the Wall Street Journal report, the Bloomberg analysis did not address whether the offshore profit shifting transactions were abusive. The analysis also generally referred to the transactions as allowed under current federal tax code.

The OSPIRG Foundation released a report in January of 2013 (*The Hidden Cost of Offshore Tax Havens: State Budgets Under Pressure from Tax Loophole Abuse*) that addresses the revenue impact of offshore tax havens used by U.S. corporations.[20] The report estimates Oregon loses $283 million of corporate tax revenues annually to offshore tax havens. The report however does not address what portion of the estimate is attributable to abusive offshore tax shelters.

U.S. Senate case study (Microsoft, Hewlett-Packard, and Apple)

The Permanent Subcommittee on Investigations of the U.S. Senate Homeland Security and Governmental Affairs Committee has the responsibility of studying and investigating the efficiency and economy of operations relating to all branches of the government. The subcommittee has had a long investigative interest in tax shelters, including the movement of corporate funds offshore and the treatment of those funds under the U.S. tax system.[21] In 2009, the subcommittee initiated a bipartisan review of the consequences of the one-time "repatriation tax holiday" provision from the American Jobs Creation Act of 2004.[22] That provision permitted U.S. based multinational corporations to repatriate income held offshore at a reduced tax rate near 5 percent. The intent of the provision was to encourage U.S. corporations to return cash to the United States with the belief that the repatriated funds would prompt investment in the U.S. economy and spur job growth. The subcommittee's review found the provision failed to achieve its goal and did little more than provide an estimated $3.3 billion tax windfall for some of the largest U.S. based multinational corporations. Continuing on its investigation of offshore profit shifting, the subcommittee undertook a review of the offshore tax avoidance schemes used by three of the largest U.S. based multinational corporations: Microsoft, Hewlett-Packard, and Apple. The following findings and recommendations were taken directly from the subcommittee's memorandums for its two-part case study.[23]

U.S. Senate case study findings: Part 1 (Microsoft and Hewlett-Packard)

- Tax incentives to shift profits offshore. Current weaknesses in the tax code's transfer pricing regulations, Subpart F, and Section 956, and in the Financial Accounting Standards Board's (FASB) accounting standard, APB 23 relating to deferred tax liabilities on permanently or indefinitely invested foreign earnings, encourage and facilitate the shifting of intellectual property and profits offshore by multinational corporations headquartered in the United States.
- Ambiguity in accounting standard APB 23. Ambiguities in accounting standard APB 23 create the potential for companies to manage their earnings by avoiding reporting U.S. tax liabilities for foreign profits, thereby improving the appearance of their financial statements to shareholders and investors. The financial reporting benefits of APB 23 encourage MNCs to move and keep their businesses and earnings offshore.
- Aggressive transfer pricing. Microsoft Corporation has used aggressive transfer pricing transactions to shift its intellectual property, a mobile asset, to subsidiaries in Puerto Rico, Ireland, and Singapore, which are low or no-tax jurisdictions, in part to avoid or reduce its U.S. taxes on the profits generated by assets sold by its offshore entities.
- Offshoring profits. From 2009 to 2011, by transferring certain rights to its intellectual property to a Puerto Rican subsidiary, Microsoft was able to shift offshore nearly $21 billion, or almost half of its U.S. retail sales net revenue, saving up to $4.5 billion in taxes on goods sold in the United States, or just over $4 million in U.S. taxes each day.
- Check-the-box and the CFC Look-Through Rule undermine Subpart F. In FY2011, Microsoft Corporation excluded an additional $2 billion in U.S. taxes on passive income at its offshore subsidiaries, relying on the "check-the-box" regulations and the controlled foreign corporation (CFC) "look-through" rule, which have undermined the intent of the tax code's Subpart F to prevent the shifting of passive CFC profits to tax havens to avoid U.S. tax.
- Short-term offshore loans. Since at least 2008, Hewlett Packard Co. has used billions of dollars of intercompany offshore loans to effectively repatriate untaxed foreign profits back to the United States to run their U.S. operations, contrary to the intent of U.S. tax policy.
- Auditor reliance. HP's auditor, Ernst & Young, knew that the company had set up a structured loan program to obtain billions of dollars in continual, alternating loans each year from two offshore entities and used those offshore funds to run its U.S. operations, but continued to support HP's view that those offshore funds had not been repatriated to the United States and were not subject to taxation.

U.S. Senate case study recommendations: Part 1 (Microsoft and Hewlett-Packard)

- Reform tax provisions that encourage offshoring of profits. Reform tax code Sections 482 and 956 regarding transfer pricing and offshore loan practices, and the check-the-box and CFC look-through rules that encourage U.S. multinationals to transfer and keep profits offshore and untaxed.
- Issue APB 23 guidance. FASB should re-evaluate whether the indefinite reversal exception to ABP 23 is being used by multinationals to manipulate their earnings reports, and issue additional guidance or restrictions to clarify how the standard should be applied.
- Use anti-abuse rules. The IRS should make greater use of its anti-abuse rules to stop

offshore schemes and transactions that substantively violate the intent of the code, but are structured to appear to meet the most technical reading of, the tax code rules governing the taxation of offshore income.

U.S. Senate case study findings: Part 2 (Apple)

- Shifting profits offshore. Apple has $145 billion in cash, cash equivalents and marketable securities, of which $102 billion is "offshore." Apple has used offshore entities, arrangements, and transactions to transfer its assets and profits offshore and minimize its corporate tax liabilities.
- Offshore entities with no declared tax jurisdiction. Apple has established and directed tens of billions of dollars to at least two Irish affiliates, while claiming neither is a tax resident of any jurisdiction, including its primary offshore holding company, Apple Operations International (AOI), and its primary intellectual property rights recipient, Apple Sales International (ASI). AOI, which has no employees, has no physical presence, is managed and controlled in the United States, and received $30 billion of income between 2009 and 2012, has paid no corporate income tax to any national government for the past five years.
- Cost sharing agreement. Apple's cost sharing agreement (CSA) with its offshore affiliates in Ireland is primarily a conduit for shifting billions of dollars in income from the United States to a low-tax jurisdiction. From 2009 to 2012, the CSA facilitated the shift of $74 billion in worldwide sales income away from the United States to Ireland where Apple has negotiated a tax rate of less than 2%.
- Circumventing Subpart F. The intent of Subpart F of the U.S. tax code is to prevent multinational corporations from shifting profits to tax havens to avoid U.S. tax. Apple has exploited weaknesses and loopholes in U.S. tax laws and regulations, particularly the "check-the-box" and "look-through" rules, to circumvent Subpart F taxation and, from 2009 to 2012, avoid $44 billion in taxes on otherwise taxable offshore income.

U.S. Senate case study recommendations: Part 2 (Apple)

- Strengthen Section 482. Strengthen Section 482 of the tax code governing transfer pricing to eliminate incentives for U.S. multinational corporations to transfer intellectual property to shell entities that perform minimal operations in tax haven or low-tax jurisdictions by implementing more restrictive transfer pricing rules concerning intellectual property.
- Reform check-the-box and look through rules. Reform the "check-the-box" and "look-through" rules so that they do not undermine the intent of Subpart F of the Internal Revenue Code to currently tax certain offshore income.
- Tax CFCs under U.S. management and control. Use the current authority of the IRS to disregard sham entities and impose current U.S. tax on income earned by any controlled foreign corporation that is managed and controlled in the United States.
- Properly enforce same country exception. Use the current authority of the IRS to restrict the "same country exception" so that the exception to Subpart F cannot be used to shield from taxation passive income shifted between two related entities which are incorporated in the same country, but claim to be in different tax residences without a legitimate business reason.

- Properly enforce the manufacturing exception. Use the current authority of the IRS to restrict the "manufacturing exception" so that the exception to Subpart F cannot be used to shield offshore income from taxation unless substantial manufacturing activities are taking place in the jurisdiction where the intermediary CFC is located.

Abusive versus legitimate tax shelters

The line between abusive and legitimate tax shelters is often unclear although one is illegal and the other is allowed under federal and state tax law and can be viewed as effective tax planning. For federal and Oregon purposes, both provide corporations with opportunities to shift income out of the tax base. The specific international transactions identified in the U.S. Senate case study were not labeled as abusive but rather referred to generally as transactions allowed under federal law. Written testimony suggests, however, that some of the specific transactions reviewed as part of the study appeared on the surface to conflict with the substance-over-form common law doctrine.[24]

Unless a transaction is found to conflict with a specific statutory provision, the determining factor often falls to a review of the transaction through the lens of anti-abuse common law doctrines. Even in the case of specific marketed transactions that have been found by federal courts to be abusive international tax shelters, such as the STARS (structured trust advantage repackaged securities) transaction discussed below developed by KPMG and Barclays Bank, each transaction needs to be evaluated independently to determine whether it conflicts with a common law doctrine. The same is true for the more widely used leveraged lease transactions known as LILOs (lease-in, lease-out) and SILOs (sale-in, lease-out) discussed below that have been found by federal courts to be abusive international tax shelters for several taxpayers.[25] Each lease transaction needs to be evaluated independently—the transaction cannot be found to be abusive based upon its title even though only one LILO/SILO case has been decided in favor of the taxpayer—and that 2009 U.S. Court of Federal Claims decision was recently reversed by the U.S. Court of Appeals for the Federal Circuit.[26]

Anti-abuse common law doctrines

Anti-abuse doctrines for tax law purposes have been created by the courts to uphold the integrity of the law and trace back to the U.S. Supreme Court case Gregory v. Helvering, 293 U.S. 465 (1935). These doctrines are used to evaluate transactions where the language of the law does not directly address a specific scenario, or where a scenario is addressed but there is question as to whether the transaction complies with the purpose of the statute. Historically, there are three common judicial doctrines that the IRS has used to address transactions that produce unreasonable or unwarranted tax benefits: the substance-over-form doctrine that includes the step transaction doctrine, the business purpose doctrine, and the economic substance doctrine.[27]

Under the substance-over-form doctrine, a transaction may be recharacterized in accordance with its substance, if the substance of the transaction is found to be contrary to the form. The step transaction doctrine is a relatively common application of the substance-over-form doctrine, under which formally separate steps may be treated as one transaction for tax purposes rather than giving tax effect to each separate step, if integration more accurately reflects the underlying substance. The business purpose doctrine requires that a taxpayer have a business reason, other than the avoidance of taxes, for undertaking a transaction or series of transactions. In the Supreme Court's decision in Gregory v. Helvering, the Court articulated the doctrine: "The legal right of the taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. But the question for determination is whether what was done, apart from tax motive, was the thing which the statute intended." Finally, under the economic substance doctrine—sometimes also called the "sham transaction doctrine"[28]—tax benefits may be denied if the tax benefits arise from a discrete set of transactions that do not meaningfully alter the taxpayer's economic position.

Recent federal case law—STARS and LILO/SILO transactions

The STARS transaction was developed and marketed by international accounting firm KPMG and Barclays Bank PLC (Barclays), a financial institution headquartered in the United Kingdom (U.K.). Beginning in 1999, KPMG and Barclays marketed the transaction to banks and non-banks in the United States and ultimately entered into STARS transactions with six U.S. banks between 2001 and 2005. The STARS structure is labeled by the IRS as a large-scale foreign tax credits generator. Simplified, the transaction called for the U.S. financial institution to establish a trust containing revenue-producing bank assets. The monthly revenue generated by the trust was then cycled through a U.K. trustee, which resulted in U.K. taxation. Although the revenue was immediately returned to the U.S. trust, the assessment of U.K. taxes generated foreign tax credits that were shared equally between Barclays and the U.S. bank. A loan from Barclays to the U.S. bank was also part of the structured transaction. The six U.S. banks that entered into STARS transactions with Barclays were First Union National Bank (June 2001), Bank of New York (November 2001), BB & T Corporation (August 2002), Wells Fargo (November 2002), Sovereign Bancorp, Inc. (November 2003), and Washington Mutual (June 2005).[29] At least four of the six transactions have been disallowed by the IRS and appealed to federal tax court.

Three decisions have been issued recently for STARS appeal cases: *Bank of New York Mellon Corp v. Commissioner,* 140 T.C. No. 2 (February 11, 2013); *Salem Financial, Inc v. United States,* No. 10-192T (September 20, 2013); and *Santander Holdings USA, Inc & Subs v. United States,* No. 09-11043-GAO (October 17, 2013). Each of these STARS decisions hinged on application of the economic substance doctrine. There is a split among the Courts as to the proper application of the economic substance doctrine, but a common interpretation views two prongs or a two-factor test: (1) whether the transaction had economic substance beyond tax benefits (objective prong), and (2) whether the taxpayer had shown a non-tax business purpose for entering into the disputed transaction (subjective prong).[30] The first two decisions (*Bank of New York Mellon Corp v. Commissioner*, and *Salem Financial, Inc v. United States*) ruled in favor of the IRS as the Courts found the transaction failed to meet either of the two prongs and therefore invalidated the transaction. The third and most recent decision ruled in favor of the taxpayer. In October, the U.S. District Court of Massachusetts issued an opinion holding that the STARS transaction entered into by Santander Holdings (formerly known as Sovereign Bancorp, Inc.) was not a sham, but rather had objective economic substance as a result of a payment Sovereign received from Barclays which was included in Sovereign's pre-tax profit.

For LILO and SILO transactions, the Courts have consistently ruled in favor of the IRS with the exception of one lower federal court decision, which was recently overturned on appeal.[31] The tax years under appeal are primarily older years occurring prior to the IRS designation of these as "listed transactions" (LILOs were designated by the IRS in 2000, and SILOs in 2005). Simply stated, LILOs and SILOs are large, complicated leveraged lease transactions in which

U.S. investors seek tax benefits from large assets, such as public transportation systems,[32] owned by a tax-exempt third party which is often a foreign entity not subject to U.S. tax. In a SILO transaction, an investor corporation takes advantage of these unusable tax benefits by purchasing property from the tax-exempt entity and then immediately leasing the property back to the tax-exempt entity. The investor deducts depreciation on the asset it now claims to own, and also claims significant interest expense deductions because it acquires the asset primarily with borrowed funds. In a LILO transaction, instead of purchasing the property, the investor corporation first leases the property from the tax-exempt entity and then immediately leases the property back to the tax-exempt entity. The investor corporation claims deductions for rent, and interest expense for any related financing.

Two decisions have been issued recently in LILO and SILO appeal cases: *Consolidated Edison Co. of New York, Inc. & Subs v. United States*, No. 2012-5040 (January 9, 2013); and *John Hancock Life Insurance Co. & Subs v. Commissioner*, 141 T.C. No. 1 (August 5, 2013). Both were issued in favor of the IRS. The Courts have consistently ruled in favor of the IRS on these appeals and recharacterized the transaction under application of the substance-over-form doctrine, even though in some of the cases the Courts have found the transaction to pass the economic substance doctrine test. Congress prospectively put an end to tax benefits generated from these transactions in 2004 by adopting specific anti-abuse provisions as part of the American Jobs Creation Act.[33]

Impact on Oregon corporation tax revenues

Prior to the 1984 legislative change to the water's edge filing method, international tax shelter opportunities via transactions with unitary affiliates were not as readily available for corporations doing business in Oregon. Under the worldwide combined filing method that dates back to the early 1960s in Oregon, income shifted to a unitary affiliate in a foreign country was not removed from the tax base.[34] The filing method required the income to remain in the tax base upon which the Oregon net income tax liability was computed. However, in response to significant opposition from foreign governments in the early 1980s, and U.S. government encouragement for states to eliminate worldwide combined reporting, states in large part switched to the water's edge method.[35] Currently, every state that imposes a corporate income tax either requires water's edge reporting or allows corporations to elect water's edge reporting.[36]

As a result of Oregon's statutory connection to the federal taxable income amount, income shifted offshore via international tax shelters reduces federal and Oregon corporation income tax liabilities.[37] The SEC filing analyses addressed above provide the total amount of profits that large U.S. based multinational corporations maintain offshore as reported by those corporations. The analyses also list common methods by which corporations shift profits out of the United States. One study suggests about half the difference between profitability in low-tax and high-tax countries, which could arise from artificial income shifting, is due to transfers of intellectual property—or intangibles—and most of the rest through the allocation of debt.[38] The reports do not, however, provide a breakdown of the amounts attributable to abusive tax shelters. A breakdown would require a detailed analysis of each transaction. As noted above, there is a fine line between abusive and legitimate tax shelters and often times it requires an analysis through the lens of one or more common law doctrines to distinguish a transaction.

Abusive international tax shelters undoubtedly impact Oregon corporation tax revenues, but we are not able to determine the extent of that impact. We rely on IRS enforcement efforts and our audit activity to identify abusive offshore profit shifting. Written testimony of Samuel M. Maruca, IRS Director of Transfer Pricing Operations, dated May 21, 2013 and submitted to the U.S. Senate Permanent Subcommittee on Investigations as part of the examination of how multinational corporations move profits offshore, outlined the IRS efforts to improve tax compliance by multinationals. The testimony provided four areas of focus: transfer pricing, cost sharing, repatriation of earnings, and casework—examinations and litigation.

To address the transfer pricing challenges, the IRS has recruited dozens of transfer pricing experts and economists with substantial private sector experience and created a new executive position to oversee all transfer pricing related functions. For the cost sharing transactions, temporary IRC Section 482 regulations were issued effective January 5, 2009 and finalized in 2011 to clarify a number of contentious issues and better define the scope of intangible property contributions that are subject to taxation in connection with international business restructurings. Regarding repatriation strategies used to return offshore profits back to the United States without paying U.S. tax—such as the short-term loan exception described in the Hewlett-Packard study—the IRS has over the past few years issued several anti-abuse notices and has recently developed and delivered specialized training to its employees. As for current casework, the IRS estimates as of May 9, 2013 they are considering income shifting issues associated with approximately 250 taxpayers involving approximately $68 billion in potential adjustments to income.

Stop Tax Haven Abuse Act (S. 1533)

In addition to the increased IRS enforcement actions targeted at abusive international tax shelters, proposed federal legislation was recently introduced that would close loopholes in the tax code that allow U.S. based multinational corporations to move profits offshore and avoid taxation when returning profits to the United States. Senator Carl Levin introduced the Stop Tax Haven Abuse Act on September 19, 2013 that would in part amend the Internal Revenue Code to address the offshore tax avoidance transactions identified by the U.S. Senate Permanent Subcommittee on Investigations.

Domestic (United States) Tax Shelters

Based on Oregon's tie to the federal corporation income tax filing method and the unitary business principle, the Oregon tax base includes the income of only the unitary affiliates that file as part of the same federal return. The income of unitary affiliates that do not file as part of the same federal return is excluded. For Oregon purposes, this provides opportunity to shift income that would otherwise be included in the tax base to a unitary affiliate within the United States that is not included in the same federal consolidated return. The unitary affiliate likely is required to report the shifted income on their federal return; therefore in contrast to international tax shelters, the impact of domestic tax shelters is primarily on state corporation income tax liabilities.

The domestic tax shelters addressed in this report involve transactions with unitary affiliates incorporated in Nevada or Wyoming, states that do not impose a corporation income tax, or Delaware that does not tax the income of a corporation whose only activity in the state is the ownership, maintenance, and management of intangible assets.[39] These transactions are used by multistate corporations to shift income out of the tax base, or to reduce their income apportionment percentages and minimize their state tax liabilities. These domestic tax sheltering opportunities are not available to all corporations. Smaller corporations that conduct business only in Oregon and that are not part of a unitary group of corporations are unable to utilize the tax shelters addressed in this report. Smaller Oregon corporations that do not apportion income will be subject to Oregon tax on 100-percent of their taxable business income. These out-of-state domestic tax sheltering opportunities are limited to larger multistate corporations and as a result provide larger corporations with a competitive advantage.

Greatest impact on separate reporting states

The revenue impact of the domestic tax shelters addressed in this report is greatest on states that require a separate reporting filing method. Under the separate reporting method each corporation subject to tax in the state files on a separate basis and the tax base for that return consists only of the single corporation's income. Therefore income shifting transactions and structuring strategies between unitary affiliates directly reduce the tax base of corporations filing returns in the separate reporting states. For those states using the water's edge combined reporting method these strategies are largely negated and there is little tax base impact of these income shifting transactions. Under the water's edge combined reporting method, each corporation subject to tax in the state files on a combined basis and the tax base for that return consists of the total income of all unitary corporations that meet certain ownership tests.[40]

As previously noted, the Oregon filing method is often referenced nationally as a combined reporting method but that is not entirely accurate.[41] The Oregon method is tied to the federal filing method and as for the income required to be included in the tax base, the Oregon method can have the same result as either separate reporting or combined reporting, or fall somewhere in between, depending on how the corporation files at the federal level. Inclusion in a federal consolidated return requires 80-percent ownership; whereas inclusion in a state combined reporting return in most cases requires 50-percent ownership. Because of Oregon's tie to the federal return, this difference can result in corporations being excluded from the Oregon return that would be included under the water's edge combined filing method. This difference, along with Oregon's tie to the filing of the federal return, makes Oregon more susceptible to these domestic tax shelters than states that impose the water's edge combined reporting method.

In recent years, states have moved away from separate reporting in favor of the water's edge combined reporting method. In 2004, Vermont became the first state in almost 20 years to enact combined reporting.[42] Since that time, several states have followed suit and several other states have considered switching from separate reporting to the water's edge combined reporting method. Consistent with the recent trend by several separate reporting states, the Multistate Tax Commission adopted a combined reporting model statute on August 17, 2006. See Appendix A for charts of the nationwide combined reporting trends from 2001 and 2012.

Domestic (United States) tax havens

The principal objective of effective tax planning is to minimize liabilities. For state tax purposes, large corporations can accomplish this through transactions with affiliates incorporated in a tax haven state like Nevada, Delaware, or Wyoming. The New York Times reported in 2012 that nearly half of all public corporations in the United States are incorporated in Delaware and that a single Delaware office building is the legal address of no fewer than 285,000 separate businesses. That single address is home, in the form of a drop box, to some of the largest companies in the world and at last count, Delaware has more corporate entities than people —945,326 to 897,934. At a time when many states are being squeezed by a difficult economy, Delaware collected roughly $860 million in taxes and fees from its absentee corporate residents in 2011.[43]

The article further stated, Delaware regularly tops lists of domestic and foreign tax havens because it allows corporations to lower taxes in another state (for instance the state in which they conduct business or have their headquarters) by shifting royalties and similar revenues to holding companies in Delaware, where they are not taxed. The article reports over the past decade the Delaware loophole has enabled corporations to reduce the taxes paid to other states by an estimated $9.5 billion.

Passive investment companies

Two common domestic tax shelter strategies that rely on the creation of an affiliate in a state that does not subject the entity to tax are transactions with a related entity such as passive investment companies (or trademark holding companies) and asset management companies. The passive investment company (PIC) strategy typically involves transferring an operating company's trademarks or trade names to a separately incorporated subsidiary, which then licenses the trademarks back to the operating company for a royalty. The subsidiary is incorporated in a state like Nevada or Wyoming, which does not have a corporate income tax, or Delaware, which does not tax the income of a PIC. The operating company is entitled to a royalty expense deduction for payments made to the PIC for use of the trademarks, and if the PIC does not have nexus in any other state the royalty income is sourced entirely to the domestic tax haven state. The term "nexus" refers to the level of activity or presence that a taxpayer has established within a taxing jurisdiction. In order for a state to impose a tax, the Due Process and Commerce Clauses of the U.S. Constitution require that the out-of-state corporation have a certain minimum connection, or nexus, within the state.

For Oregon purposes, if the PIC files as part of the same consolidated federal return with the operating company the transaction has no impact on the tax base or the Oregon apportionment percentage. The income of the PIC is included in the Oregon tax base and per administrative rule the sales factor must be computed by eliminating transactions between members of the affiliated group filing the consolidated Oregon return.[44] However, if the PIC is not included in the same federal return the impact to Oregon would be the same as that of a separate reporting state; the royalty expense paid to the PIC would directly reduce the tax base of the corporation subject to tax in this state. Separate reporting states have challenged trademark holding company transactions a couple of different ways; asserting economic nexus for the PIC and disallowing the transaction based on the economic substance doctrine. Both paths have received mixed results

Asset management companies

The asset management company (AMC) strategy typically involves a transfer of income producing intangible assets such as mortgaged-backed securities from a financial institution as part of a loan participation agreement to a unitary affiliate incorporated in a tax haven state. For Oregon purposes, if the AMC is not included in the same federal return, the interest income received following the transfer is excluded from the base. If the AMC is included in the federal return, the tax base is not impacted however the Oregon apportionment percentage is reduced. The interest income received by the financial institution prior to the transfer that is associated with Oregon property is included in the Oregon sales factor numerator—sourced to

Oregon. Following the transfer, no interest income is sourced to Oregon if the AMC claims to not have nexus with Oregon. The loans in these transactions are typically transferred, not sold, following a short period after origination. After the transfer, the loans continue to be serviced by the financial institution and any late payment or early payoff fees are owed to the financial institution not the AMC.

There is a fine line between abusive and legitimate tax shelters and obviously not all transactions with AMCs are abusive; and AMCs are legitimate entities typically with a valid business purpose. However the following example uncovered in audit highlights the results of transactions between a large multistate corporation and two unitary AMCs located in a tax haven state. The corporation filed an Oregon consolidated return that included two AMCs headquartered in Nevada. The AMCs reported significant taxable income but little or no rent or payroll expense. The taxable income reported by the two AMCs exceeded $93 million, yet the AMCs reported less than $40,000 of rent expense, and zero payroll expense. The AMCs in this example claim to have nexus only in Nevada and therefore did not source any of the taxable income (interest income) to Oregon even though a portion of the interest income was associated with Oregon property. For this example, audit must determine under application of the business purpose and economic substance doctrines whether entering into the loan participation agreement with the AMCs was a legitimate transaction.[45]

Concluding Remarks

There are a wide range of tax shelters available to most corporations, such as statutory deductions (charitable contributions, depreciation, etc.) and tax credits. The out-of-state corporation tax shelters addressed in this report involve transactions with unitary affiliates located in a low-tax, or no-tax jurisdiction and therefore are limited to larger multinational or multistate corporations. For Oregon purposes, transactions with a unitary affiliate provide large corporations the opportunity to shift income out of the Oregon tax base (if the affiliate is not included in the federal consolidated return) or to reduce the Oregon apportionment percentage (if the affiliate is included in the federal return). These out-of-state tax sheltering opportunities provide larger corporations with a competitive advantage over small corporations. For example, smaller Oregon corporations that do not apportion income will be subject to Oregon tax on 100-percent of their taxable business income.

There is a fine line between abusive and legitimate tax shelters but the tax implications are very different. Abusive shelters are illegal and potentially subject to increased penalties while legitimate shelters are statutorily allowed and viewed as effective tax planning. Separate reporting states are much more susceptible to the domestic tax shelters addressed in this report than are combined reporting states. Oregon's filing method can be similar to either separate reporting or combined reporting (or fall anywhere in between) depending on how the corporation files at the federal level.

Recommendations for Addressing Non-Compliance

HB 2460 asks that this report include recommendations for addressing non-compliance attributable to out-of-state tax shelters.[46] Legitimate out-of-state tax shelters are transactions allowed under Oregon law so addressing these would likely require legislation. With regard to the transactions, corporations that utilize legitimate tax shelters are in compliance. Although there could be some other reason for non-compliance for these corporations, use of a legitimate tax shelter alone isn't cause for non-compliance. The recommendations in this section are intended as possible policy options for consideration to address non-compliance attributable to abusive out-of-state corporation tax shelters.

Uniformity with federal legislation

According to estimates from the Joint Committee on Taxation, the proposed Stop Tax Haven Abuse Act would provide about $220 billion in additional U.S. revenue over 10 years, and includes provisions that do not impact taxable income.[47] If adopted at the federal level there would not be an automatic Oregon tie to all provisions. To the extent provisions are adopted that do not impact taxable income, such as provisions regarding penalties, disclosure, and the statute of limitations, Oregon could consider uniform provisions.

Uniformity with Multistate Tax Commission recommendations

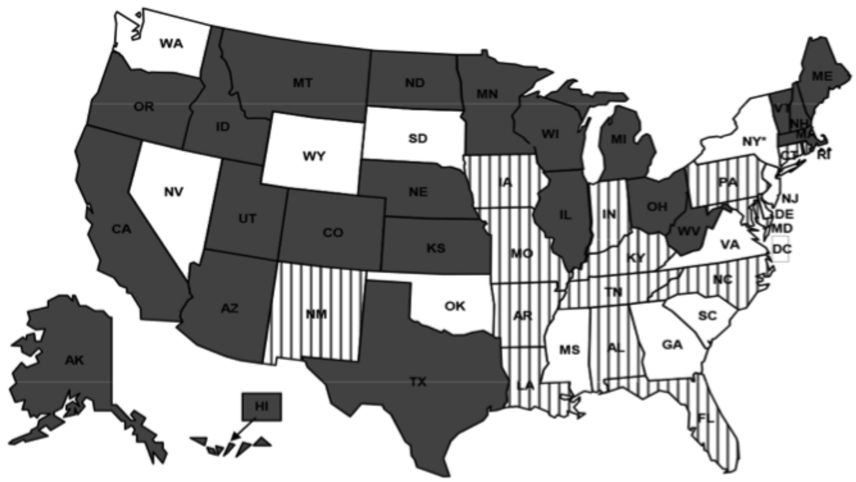
The Multistate Tax Commission (MTC) is an intergovernmental state tax agency that works on behalf of states and taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational corporations. Oregon is a Compact member of the MTC and should carefully consider uniformity proposals, particularly those related to abusive international and domestic tax shelter transactions.

Codify the economic substance doctrine in statute

As previously noted, there is a split among the Courts as to the proper application of the economic substance doctrine.[48] Other states and the IRS have codified a conjunctive test that requires a taxpayer to establish: (1) the transaction had economic substance beyond tax benefits (objective component), and (2) a non-tax business purpose for entering into the disputed transaction (subjective component).[49]

Appendix A: Combined v. Separate Reporting

Nationwide Trends - Combined Reporting – 2012



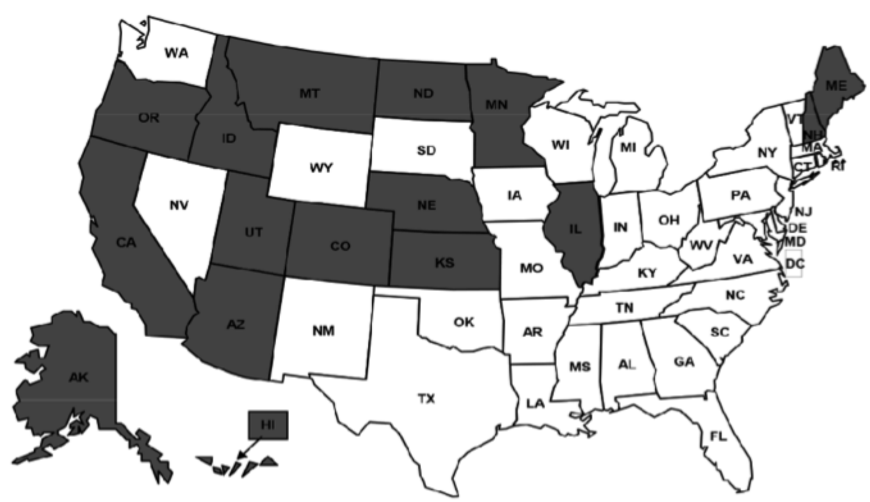
Combined Reporting Proposals Considered Recently and/or Currently Proposed

Unitary/Combined States *(now including the Ohio CAT, Texas Margin Tax and Michigan Business Tax)*

Remaining Separate Entity or Elective Consolidated Reporting/Other

**New York requires related corporations to file a combined report upon the existence of substantial intercorporate transactions*

Nationwide Trends - Combined Reporting - 2001



Combined Reporting Proposals

Unitary/Combined States

Remaining Separate Entity or Elective Consolidated Reporting/Other

Endnotes

[1] All references to "corporation income tax" in this report for Oregon purposes include both the corporation excise tax imposed under ORS chapter 317 and the corporation income tax imposed under ORS chapter 318.

[2] *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

[3] Shirley Sicilian, Multistate Tax Compact Article IV Recommended Amendments, *Multistate Tax Commission*, May 3, 2012 (fn11 Commerce Clearing House, ¶ 11-505, April 25, 2012).

[4] Federation of Tax Administrators, January 2013 (states that require use of an equal-weighted three factor apportionment formula for tax year 2013: Alaska, Delaware, Hawaii, Kansas, Montana, New Mexico, North Dakota, Oklahoma, and Rhode Island)

[5] Examples of different approaches that states require for determining the sales factor include a market based sourcing method for receipts from services and intangibles versus the UDITPA costs of performance sourcing method.

[6] *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980).

[7] HB 3029, 1984 Special Legislative Session.

[8] The water's edge filing method was a significant change in Oregon corporation tax law affecting multistate and multinational apportionment. Arguably, the most significant change since the 1965 enactment of the Uniform Division of Income for Tax Purposes Act (UDITPA) in ORS 314.605 to 314.675. The majority of states that require or make available an election for the water's edge filing method have done so specifically in statute. Oregon is unique. The water's edge method is not specifically addressed in Oregon statute. The method is required by default due to Oregon's tie to the federal corporation income tax return that excludes foreign corporations.

[9] *Coca Cola Co. v. Oregon Department of Revenue*, 533 P.2d 788 (Ore., 1975); *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), and *Barclays Bank PLC v. Franchise Tax Board*, 512 U.S. 298 (1994).

[10] Typically the combined reporting group includes corporations with at least 50 percent common ownership. Council on State Taxation - Robert Cline, Ernst & Young, LLP, "Combined Reporting – Understanding the Revenue and Competitive Effects of Combined Reporting," May 27, 2008, p. 10.

[11] Walter Hellerstein provides insight to the classification of Oregon as a combined reporting state… "Oregon law provides that '[i]f two or more corporations subject to taxation under this chapter are members of the same affiliated group making a consolidated federal return and are members of the same unitary group, they shall file a consolidated state return.' Although denominated a 'consolidated' return, Oregon essentially requires what we have denominated as 'combined' rather than 'consolidated' reporting because it is both mandatory and limited to unitary affiliates. The Oregon state consolidated return is therefore distinguishable from most state consolidated returns, which typically are elective and require only common ownership (as distinguished from a unitary relationship)."

(FN1272) Walter Hellerstein, *State Taxation: Third Edition*, Current through 2013, Part IV, Chapter 8, Part B, 8.11 – Application of the Unitary Principle to Multicorporate Enterprises.

[12] See subsection (3) of ORS 317.710.

[13] See subsection (2) of ORS 317.710 and subsection (1) of ORS 317.715.

[14] See ORS 314.625 to 314.650.

[15] See Internal Revenue Code section 957. A controlled foreign corporation is a foreign corporation that is more than 50-percent owned by vote or value, directly or indirectly by attribution, by United States shareholders on any day during the taxable year of such foreign corporation.

[16] See Internal Revenue Code sections 951 through 965, Subpart F—Controlled Foreign Corporations.

[17] U.S. Senators Carl Levin and Tom Coburn, Memorandum to Members of the U.S. Senate Permanent Subcommittee on Investigations, September 20, 2012, page 10.

[18] Scott Thurm and Kate Linebaugh, "More U.S. Profits Parked Abroad, Saving on Taxes," *Wall Street Journal*, March 10, 2013.

[19] Richard Rubin, "Offshore Cash Hoard Expands by $183 Billion at Companies," *Bloomberg*, March 8, 2013.

[20] OSPIRG Foundation is a 501(c)(3) organization. "OSPIRG's mission is to deliver persistent, result-oriented public interest activism that protects consumers, encourages a fair, sustainable economy, and fosters responsive, democratic government." Website: ospirgfoundation.org

[21] United States Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, "What is the U.S. Position on Offshore Tax Havens?," July 18, 2001; United States Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, "U.S. Tax Shelter Industry: the Role of Accountants, Lawyers and Financial Professionals," November 18, 2003; United States Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, "The Role of Professional Firms in the U.S. Tax Shelter Industry," April 13, 2005; United States Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, "Tax Haven Abuses: The Enablers, The Tools and Secrecy," August 1, 2006.

[22] United States Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, "Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals," October 11, 2011.

[23] United States Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, "Offshore Profit Shifting and the U.S. Tax Code – Part 1 (Microsoft and Hewlett-Packard)," September 20, 2012; United States Senate Permanent.

Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, "Offshore Profit Shifting and the U.S. Tax Code – Part 2 (Apple, Inc)," May 21, 2013.

[24] Statement of Senator Carl Levin, Chairman – U.S. Senate Permanent Subcommittee on Investigations, September 20, 2012; and Written Testimony of Stephen E. Shay, Professor – Harvard Law School, September 20, 2012.

[25] Not all SILO/LILO structures include international transactions. The transactions can be with a domestic third party that is not subject to U.S. tax, however the unrelated third party is often located overseas. Robert W. Wood, "ConEd Gives IRS Last Laugh in SILOs and LILOs," Tax Notes, April 1, 2013.

[26] Robert W. Wood, "ConEd Gives IRS Last Laugh in SILOs and LILOs," Tax Notes, April 1, 2013; Consolidated Edison Company of New York, Inc. & Subsidiaries v. United States, No. 06-305T (October 21, 2009); Consolidated Edison Company of New York, Inc. & Subsidiaries v. United States, 2012-5040 (January 9, 2013).

[27] U.S. Department of the Treasury, "The Problem of Corporate Tax Shelters – Discussion, Analysis and Legislative Proposals," July 1999.

[28] U.S. Court of Federal Claims, Union BanCal Corp. v. U.S., No. 1:06-cv-00587, October 23, 2013 (citing footnote 29).

[29] U.S. Court of Federal Claims, Salem Financial, Inc v. United States, No. 10-192-T, September 2013 (Salem Financial, Inc is successor-in-interest to BB & T Corporation).

[30] Bank of New York Mellon Corp. v. Commissioner, 140 T.C. No. 2, February 11, 2013… "There is a split among the Courts of Appeals, however, as to the proper application of the economic substance doctrine, and alternative approaches have emerged. Some Courts of Appeals require that a valid transaction have economic substance or a non-tax business purpose. See, e.g., Horn v. Commissioner, 968 F.2d 1229, 1236-1238 (D.C. Cir. 1992), rev'g Fox v. Commissioner, T.C. Memo. 1988-570; Rice'sToyota World, Inc v. Commissioner, 752 F.2d 89, 91 (4th Cir. 1985), aff'g in part, rev'g in part 81 T.C. 184 (1983). Other Courts of Appeals require a valid transaction have both economic substance and a non-tax business purpose. See Dow Chem. Co. v. United States, 435 F.3d 594, 599 (6th Cir. 2006); Winn-Dixie Stores, Inc. v. Commissioner, 254 F.3d 1313, 1316 (11th Cir. 2001), aff'g 113 T.C. 254 (1999); United Parcel Serv. of Am., Inc. v. Commissioner, 254 F.3d 1014, 1018 (11th Cir. 2001), rev'g T.C. Memo. 1999-268. Still other Courts of Appeals adhere to the view that a lack of economic substance is sufficient to invalidate a transaction regardless of the taxpayer's subjective motivation. See, e.g., Coltec Indus., Inc. v. United States, 454 F.3d 1340, 1355 (Fed. Cir. 2006). And still other Courts of Appeals treat the objective and subjective prongs merely as factors to consider in determining whether a transaction has any practical economic effects beyond tax benefits. See, e.g., ACM P'ship v. Commissioner, 157 F.3d 231, 248 (3d Cir. 1998), aff'g in part, rev'g in part T.C Memo. 1997-115."

[31] Consolidated Edison Company of New York, Inc. & Subsidiaries v. United States, 2012-5040 (January 9, 2013).

[32] Robert W. Wood and Steven E. Hollingworth, "SILOs and LILOs Demystified," *Tax Notes*, October 11, 2010 (fn2 citing: "See Sheryl Stratton, "SILOs: Abusive Tax Scams or Real Business Deals?" *Tax Notes*, Jan. 19, 2004, p. 301, *Doc 2004-863*, or *2004 TNT 10-5*; and B. Cary Tolley III, "Leasing to Tax-Exempt Entities: Setting the Record Straight," *Tax Notes*, Apr. 12, 2004, p. 244, *Doc 2004-6670*, or *2004 TNT 71-37*."

[33] See IRC section 470.

[34] Legislative Revenue Office, Research Report #3-84 (July 23, 1984) submitted for HB 3039 from the 1984 Special Legislative Session on the history of the worldwide combined reporting method in Oregon…"[w]hile there is no specific milestone from which to measure the beginning of combined reporting for multistate and multinational corporations, there is evidence of it at least from the early 1960s."

[35] R.N. Mattson, "Setting Straight the Unitary Working Group Record," *Tax Notes*, January 6, 1986, p.57; The Working Group

on Worldwide Unitary Taxation that was appointed by President Ronald Reagan provided the foundation for resolution between the states, the federal government and taxpayers on the worldwide combined filing method. The recommendation was made for the states to adopt water's edge unitary combined filing method. After more than a year's effort by the parties to implement the water's edge filing method at the state level, President Reagan issued a statement on November 8, 1985 supporting preemptive federal legislation. "Since states have not universally accepted these principles, I am instructing the Secretary of the Treasury to initiate the process of crafting federal legislation to incorporate these principles into law…"

[36] Currently, four states (California, Idaho, Montana, and North Dakota) require worldwide combined reporting but allow corporations to elect the water's edge combined reporting method (2013 Multistate Tax Guide, CCH). This approach is similar to the Multistate Tax Commission's combined reporting model statute approved by the Commission on August 17, 2006.

[37] The Oregon tax liability is only impacted if the corporation that shifted the income has an Oregon filing requirement, or if the corporation files as part of a consolidated return with a unitary affiliate that has an Oregon filing requirement. See ORS 317.715.

[38] Jane Gravelle, "Tax Havens: International Tax Avoidance and Evasion," *Congressional Research Service*, January 23, 2013, page 8 (citing Harry Grubert, "Intangible Income, Intercompany Transactions, Income Shifting and the Choice of Locations," *National Tax Journal*, vol. 56, March 2003, Part 2, page 221-242).

[39] See Delaware Code Section 1902(b)(8).

[40] See endnote 10.

[41] See endnote 11.

[42] Joe Huddleston and Shirley Sicilian, "History and Considerations for Combined Reporting: Will States Adopt a Model Combined Reporting Statute?," Accepted for publication in *The Tax Lawyer – The State and Local Tax Edition and The State and Local Tax Lawyer – Symposium Edition*, p.16.

[43] Leslie Wayne, "How Delaware Thrives as a Corporate Tax Haven," *The New York Times*, June 30, 2012.

[44] See subsection (3) of OAR 150-317.715(3)(b).

[45] The transaction will also be evaluated under the authority provided in ORS 314.295; "[i]n any case of two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Department of Revenue may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such organizations, trades or businesses, if it determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses."

[46] Section 1 of enrolled HB 2460 provides, "[n]o later than February 1, 2014, the Department of Revenue shall make a report on the use of out-of-state tax shelters to the Seventy-seventh Legislative Assembly. The department shall use all data available to the department to prepare the report, which shall: (1) Describe methods by which taxpayers shift income otherwise taxable by this state to outside the state; and (2) Make recommendations for addressing noncompliance attributable to out-of-state tax shelters."

[47] Dan Smith, "538 Organizations Call on U.S. Senators to Support the Stop Tax Haven Abuse Act," US PIRG News Release, November 6, 2013.

[48] See endnote 30. Also, see Pacificare Health Systems, Inc v. Oregon Department of Revenue, TC 4762, July 1, 2008, page 8 of 21.

[49] *Massachusetts General Laws*. Ch. 62C, Sec. 3A In applying the laws referenced in section 2, the commissioner may, in his discretion, disallow the asserted tax consequences of a transaction by asserting the application of the sham transaction doctrine or any other related tax doctrine, in which case the taxpayer shall have the burden of demonstrating by clear and convincing evidence as determined by the commissioner that the transaction possessed both: (i) a valid, good-faith business purpose other than tax avoidance; and (ii) economic substance apart from the asserted tax benefit. In all such cases, the taxpayer shall also have the burden of demonstrating by clear and convincing evidence as determined by the commissioner that the asserted nontax business purpose is commensurate with the tax benefit claimed. Nothing in this section shall be construed to limit or negate the commissioner's authority to make tax adjustments as otherwise permitted by law.

Internal Revenue Code section 7701(o) Clarification of economic substance doctrine. (1) Application of doctrine. In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if— (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.