

Oregon enacts “Corporate Activity Tax,” imposed on modified gross receipts

Overview

On May 16, 2019, Oregon Governor Kate Brown (D) signed House Bill 3427 (H.B. 3427), legislation that creates Oregon’s first modified gross receipts tax, the “Corporate Activity Tax” (the “Oregon CAT”).¹ Intended to raise approximately \$1 billion in new annual revenue² to fund state investments in education (extensive education provisions are also included in H.B. 3427 and are not severable from the revenue provisions), the Oregon CAT will go into effect for tax years beginning on or after January 1, 2020.³ The Oregon CAT will apply in addition to Oregon’s existing taxes – the Oregon CAT does not directly affect the state’s corporate excise/income tax system – although H.B. 3427 includes a slight reduction in certain personal income tax rates.⁴

Despite the Governor’s signature, H.B. 3427 will not become effective until the 91st day after the date of adjournment *sine die* of the Oregon legislative session.⁵ The Oregon Constitution provides that Oregon voters may reject H.B. 3427 through their referendum power.⁶ If sufficient signatures are gathered during this 90-day period, H.B. 3427 will be sent to the Oregon voters for approval in a subsequent election.⁷

This Tax Alert summarizes the Oregon CAT and highlights its major provisions.

Oregon CAT imposed on taxable commercial activity

The Oregon CAT will be imposed on “taxable commercial activity” in excess of \$1 million at the rate of 0.57 percent, plus a flat tax of \$250 on the taxpayer’s first \$1 million of taxable commercial activity.⁸ Taxpayers whose taxable commercial activity does not exceed \$1 million are exempt from the Oregon CAT.⁹ The tax is imposed on the person receiving the commercial activity and is not imposed directly on the purchaser.¹⁰

The bill defines “taxable commercial activity” as the “total amounts realized” by the taxpayer arising from transactions and activity in the regular course of the taxpayer’s trade or business that are sourced to Oregon.¹¹ Oregon excludes a number of specific items from the definition of commercial activity, including but not limited to:

- Receipts from the sale, exchange or other disposition of an asset described in IRC Sections 1221 and 1231;
- Contributions to capital;
- Sales of motor fuel;

¹ H.B. 3427-A, Section 63.

² See Revenue Impact of HB 3427-A, 80th Oregon Legislative Assembly, 2019 Regular Session, prepared by Chris Allanach, state economist (April 29, 2019).

³ *Id.*, at Sections 79 – 80;

⁴ *Id.*, at Section 56 (the Oregon personal income tax rates imposed on the three lowest tax brackets are reduced by 0.25%, resulting in a maximum potential reduction of annual personal income taxes of \$312 for Oregon personal income taxpayers with income over \$125,000).

⁵ *Id.*, at Section 84. This date is set at June 30, 2019

(<https://www.oregonlegislature.gov/calendar/Lists/Session%20Deadlines/DispForm.aspx?ID=51>). Accordingly, unless a referendum is required, H.B. 3427 would become effective on September 29, 2019.

⁶ Or. Const. art. IV, Section 1(3).

⁷ It does not appear that an Oregon statewide election is currently scheduled for the fall of 2019.

https://ballotpedia.org/Oregon_elections,_2019. Accordingly, the Oregon Legislature may need to call for a special election to provide the Oregon voters the opportunity to vote on this issue in 2019.

⁸ H.B. 3427, at Section 65(1).

⁹ *Id.*, at Section 65(2).

¹⁰ *Id.*, at Section 63(1).

¹¹ *Id.*, Section 58(1)(a), (17).

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- Dividends;
- Distributive income received from a pass-through entity;
- Receipts from sales to a wholesaler in Oregon if the seller receives certification at the time of sale that the wholesaler will sell the purchased property outside of Oregon;
- Receipts from the wholesale or retail sale of groceries; and
- Receipts from transactions among members of a unitary group.¹²

Sourcing of commercial activity

The Oregon CAT only applies to “taxable commercial activity,” which is commercial activity sourced to Oregon as detailed in the bill.¹³ While the Oregon CAT refers to “sourcing” of commercial activity rather than the apportionment of commercial activity, the Oregon CAT’s sourcing rules closely resemble common apportionment concepts:

- Receipts from the sale, rental, lease or license of real property will be sourced to Oregon to the extent the property is located in Oregon;
- Receipts from the rental, lease or license of tangible personal property (“TPP”) will be sourced to Oregon to the extent the property is located in Oregon;
- Receipts from the sale of TPP will be sourced to Oregon to the extent the TPP is delivered to a purchaser in Oregon;
- Receipts from the sale of services will be sourced to Oregon to the extent the service is delivered to a location in Oregon; and
- Receipts from the sale, rental, lease or license of intangible property will generally be sourced to Oregon to the extent the intangible is used in Oregon or, in certain circumstances, to the extent the receipts are based on the right to use the intangible in Oregon.¹⁴

If these provisions do not fairly represent the taxpayer’s amount of commercial activity in Oregon, the taxpayer may request, or the Department of Revenue may require or permit, the use of an alternate sourcing method.¹⁵

Subtraction from gross receipts

The Oregon CAT is a tax on modified gross receipts because it provides taxpayers with a subtraction from taxable commercial activity of 35 percent of the greater of the taxpayer’s annual:

- Cost inputs; or
- Labor costs.¹⁶

The Oregon CAT defines “cost inputs” as “the cost of goods sold as calculated under” IRC Section 471.¹⁷ “Labor costs” are defined as the “total compensation of all employees, not to include compensation paid to any single employee in excess of \$500,000.”¹⁸

The subtraction must also be apportioned to Oregon “in the manner required for apportionment of income under ORs 314.605 to 314.675 [Oregon’s corporate excise tax apportionment provisions, currently modeled on a single sales

¹² The full list of exclusions is found in H.B. 3427, Section 58(1)(b). “Groceries” are defined for this purpose as “food” by the federal Supplemental Nutrition Assistance Program pursuant to 7 U.S.C. Section 2012(k). *Id.*, at Section 58(11).

¹³ H.B. 3427 at Section 58(17).

¹⁴ *Id.*, at Section 66(1).

¹⁵ *Id.*, at Section 66(2).

¹⁶ *Id.*, at Section 64(1).

¹⁷ *Id.*, at Section 58(4).

¹⁸ *Id.*, at Section 58(13).

factor methodology].”¹⁹ In addition, the subtraction from commercial activity cannot exceed 95 percent of the taxpayer’s commercial activity in Oregon.²⁰

Taxpayers and unitary groups

While the Oregon CAT is a “corporate activity tax,” the Oregon CAT is imposed on persons with taxable commercial activity and substantial nexus with Oregon.²¹ Accordingly, there is a broad definition of “taxpayer,” which includes corporations (both S and C), partnerships, limited liability companies (LLCs), entities treated as disregarded for U.S. income tax purposes, trusts, and individuals and combinations of individuals “in any form.”²² Several entities are specifically exempt from the Oregon CAT, including organizations described in several subsections of IRC Section 501; governmental entities; state 529 plans; certain hospitals, long-term health care facilities and health insurance organizations; and taxpayers with commercial activity of less than \$1 million (excluding taxpayers who are members of a unitary group with commercial activity in excess of \$1 million).²³

The Oregon CAT also defines a “taxpayer” to include a “unitary group.”²⁴ Specifically, the Oregon CAT provides that a “unitary group shall register, file and pay” the Oregon CAT “as a single taxpayer and may exclude receipts from transactions among its members.”²⁵ The Oregon CAT definition of a “unitary group” is straightforward:

- A group of persons with more than 50 percent common ownership, either direct or indirect; that
- Is engaged in business activities that constitutes a unitary business.²⁶

Accordingly, a unitary business may include a variety of persons, not just C corporations. The Oregon CAT is imposed on the unitary group and the members are jointly and severally liable for the Oregon CAT.²⁷

Nexus

The Oregon CAT applies an extremely broad definition of substantial nexus, which includes any of the following:

- Owning or using a part or all of the taxpayer’s capital in Oregon;
- Holding a certificate of existence or authorization to do business in Oregon issued by the Oregon Secretary of State;
- Having “bright-line nexus” with Oregon, defined as one of the following:
 - Owning property in Oregon with an aggregate value of at least \$50,000 (valued at original cost or, for rental property, at 8 times net annual rental charge);
 - Having payroll in Oregon of at least \$50,000;
 - Having commercial activity in Oregon of at least \$750,000;
 - Having at least 25 percent of the taxpayer’s total property, payroll or sales in Oregon; or
 - Maintaining residency or commercial domicile in Oregon.
- Otherwise establishing nexus with Oregon “to the extent that the person can be required to remit” the Oregon CAT.²⁸

¹⁹ *Id.*, at Section 64(2).

²⁰ *Id.*, at Section 64(3).

²¹ *Id.*, at Section 63(1).

²² *Id.*, at Section 58(15), (18).

²³ *Id.*, at Section 58(6), (18)(b).

²⁴ *Id.*, at Section 58(18)(a).

²⁵ *Id.*, at Section 60.

²⁶ *Id.*, at Section 58(20).

²⁷ *Id.*, at Section 62.

²⁸ *Id.*, at Section 63(2).

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These tests are defined in reference to a “person,” not a unitary group. Nothing in the Oregon CAT explicitly requires the taxpayer establish a physical presence in Oregon as part of the nexus tests. The Oregon CAT also provides that it is not subject to Public Law 86-272.²⁹

Other provisions

Any person or unitary group with commercial activity (not limited to such activity in Oregon) exceeding \$750,000 must register with the Oregon Department of Revenue.³⁰ Taxpayers doing business in Oregon with commercial activity for the tax year in excess of \$1 million (not limited to such activity in Oregon) must file an annual return not later than April 15th of the following year an annual Oregon CAT return.³¹ Further, the Oregon CAT “is due and payable . . . on or before the last day of January, April, July and October of each year for the previous calendar quarter.”³² For 2020, taxpayers must pay at least 80 percent of the balance due for any quarter or the Department of Revenue may impose penalties, starting at 20 percent.³³

H.B. 3427 explicitly provides that the state pre-empts the authority of cities, counties, districts, and other political subdivisions of the state to impose a tax either upon commercial activity or on receipts from grocery sales.³⁴ The bill exempts certain legislation previously in effect, which would include the Portland Clean Energy Surcharge, approved by the Portland voters in November, 2018.³⁵

Considerations

The Oregon CAT is a new business tax in addition to Oregon’s corporate income tax and, while applying certain similar concepts such as market-sourcing for sales of services and unitary groups, the Oregon CAT is a separate, independent, and new tax for Oregon taxpayers to consider. In addition to the provisions detailed above, the Oregon CAT contains numerous other items that are not addressed in this brief Alert. It is anticipated that extensive administrative rules will be promulgated to clarify the provisions.

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²⁹ *Id.*, at Section 63(1).

³⁰ *Id.*, at Section 68(1).

³¹ *Id.*, at Section 70(1).

³² *Id.*, at Section 70(2).

³³ *Id.*, at Section 77(2), citing ORS 314.400(3); *Id.*, at Section 78 providing Section 77 is applicable to tax years beginning on or after January 1, 2020, and before January 1, 2021, and to returns filed on or before April 15, 2021.

³⁴ H.B. 3427, at Section 67(1).

³⁵ *Id.*, at Section 67(2).

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