

Oregon DOR Issues Final Market-Based Sourcing Rule

Overview

On July 3, 2017, Governor Kate Brown signed legislation, effective January 1, 2018, which replaced the cost-of-performance methodology for sourcing sales of items other than tangible personal property for Oregon corporate income tax apportionment purposes with a market-based sourcing methodology.¹ On December 22, 2017, the Oregon Department of Revenue ("DOR") filed amended Administrative Rule 150-314-0435 that includes administrative provisions for market-based sourcing.

In this tax alert, we summarize the Oregon market-based sourcing rule and offer some taxpayer considerations.

Background

Oregon has historically applied a greater cost of performance rule for sourcing sales of items other than tangible personal property for sales factor apportionment purposes. Due to changes in the economy as well as the perception that a cost of performance rule discourages service providers from locating operations in a state, numerous states have adopted market-based sourcing provisions in the last decade. Oregon is the most recent state to adopt such a rule, though Oregon's market-based sourcing statute – Or. Rev. Stat. 314.665(4) – provides limited details regarding how to source sales of services or intangibles, generally providing that such items are sourced to Oregon if the 'market' for the service or intangible is in Oregon.²

Final Oregon Rule

Oregon's new administrative rule provides an extensive set of provisions – approximately 16,000 words – clarifying how Oregon's new market-based sourcing regime should be applied. The Oregon Department of Revenue based its rule on the model regulation adopted by the Multistate Tax Commission.³ While a thorough examination of the provisions of this new rule is beyond the scope of this Alert, the following provides a brief overview of the primary concepts addressed by the new rule.

The new rule starts with an extensive recitation of general principles. The overall purpose of the market-based sourcing rule is to provide standards for taxpayers to use when:

1. Determining whether and to what extent the market for a sale other than sale of tangible personal property is in Oregon;
2. Applying a "reasonable approximation" standard where the state cannot be determined; and
3. Excluding receipts from the sale of intangible property from numerator and denominator of the sale factor under certain circumstances.⁴

The new rule generally bifurcates services and intangibles into separate categories and then applies different sourcing rules to each category. For example, "services" are generally sourced to "Oregon if and to the extent the service is delivered to a location in Oregon," defined as "the location of the taxpayer's market for the service, which may not be the location of the taxpayer's employees or property."⁵ The rule proceeds to subdivide services into the following categories and apply specific sourcing rules for each sub-category:

- In-person services;

¹ Laws 2017, Regular Session (SB 28; July 3, 2017). For additional information on SB 28, please see our July 5, 2017 External MTS Alert available [here](#).

² Or. Rev. Stat. 314.665(4).

³ Or. Admin. R. 150-314.0435(1).

⁴ Or. Admin. R. 150-314-0435(1)(a).

⁵ Or. Admin. R. 150-314-0435(4)(a).

- Services delivered to the customer or on behalf of the customer, or delivered electronically to the customer; and
- Professional services.⁶

While a thorough review of the sourcing rules for each of these three sub-categories of services is beyond the scope of this Alert, these rules are detailed and may vary depending on the nature of the taxpayer's customer.

By way of example, the rule provides that for professional services, "it is generally possible to characterize the location of delivery in multiple ways by emphasizing different elements of the service provided, no one of which will consistently represent the market for the services. Therefore, the location of delivery in the case of professional services is not susceptible to a general rule of determination and *must be reasonably approximated.*"⁷ This "reasonable approximation" approach generally depends on whether the customer is an individual or a business, as outlined below:

- **Professional Services Delivered to Individual Customers:** For such sales, the "reasonable approximation" of the sale means that the taxpayer must assign the receipts from a sale to the customer's state of primary residence, or, if that is not reasonably identifiable, to the state of the customer's billing address.⁸ However, in any instance where the taxpayer derives more than 5% of its receipts from sales of all services from an individual customer, the taxpayer must identify the customer's state of primary residence.⁹
- **Professional Services Delivered to Business Customers:** For these sales, the "reasonable approximation" of the sale means applying the following tiered sourcing hierarchy:
 - **First**, the taxpayer must assign the receipts to the state where the contract of sale is principally managed by the customer;
 - **Second**, if the place of customer management is not reasonable determinable, to the customer's place of order; and
 - **Third**, if the customer's place of order is not reasonably determinable, to the customer's billing address.¹⁰

Oregon's market-based sourcing rule applies the "reasonable approximation" concept to several different categories of sales, including intangibles. The sourcing provisions for intangibles also provide specific rules for various sub-categories of revenues generated from the sale, license, rental, etc., of intangibles and can vary based on the nature of the intangible asset at issue. For example, different sourcing rules apply to the license of an intangible asset if the intangible is:

- A marketing intangible;
- A production intangible;
- A mixed intangible; or
- A license of intangible property where substance of transaction resembles a sale of goods or services.¹¹

The new rule contains more than forty different examples that apply these new provisions to specific hypothetical situations, including both services and intangibles.

Considerations

The application of market-based sourcing regime for the apportionment of sales of items other than tangible personal property will impose a significant change for Oregon taxpayers who make such sales effective January 1, 2018. In general, taxpayers making sales to customers in Oregon that arise from service or intangible transaction originating outside of Oregon may find their Oregon sales factor significantly increases under this

⁶ Or. Admin. R. 150-314-0435(4)(b) – (d).

⁷ Or. Admin. R. 150-314-0435(4)(d)(C).

⁸ Or. Admin. R. 150-314-0435(4)(d)(C)(i)(I).

⁹ *Id.*

¹⁰ Or. Admin. R. 150-314-0435(4)(d)(C)(i)(I) – (II).

¹¹ Or. Admin. R. 150-314-0435(5)(b) – (e).

new market-based sourcing regime. Given the extensive range of this new rule, affected taxpayers should make a careful review of these provisions to confirm that they are accurately applying them.

Contacts:

If you have any questions regarding the Oregon market-based sourcing provisions or other Oregon tax matters, please contact any of the following Deloitte Tax professionals:

Doug Andersen

Partner

Deloitte Tax LLP, Seattle

+1 206-716-7430

douandersen@deloitte.com

Scott Schiefelbein

Managing Director

Deloitte Tax LLP, Portland

+1 503 727 5382

sschiefelbein@deloitte.com

Anne-Marie Gorbett

Manager

Deloitte Tax LLP, Seattle

+1 503 727 5269

agorbett@deloitte.com

For further information, visit our website at www.deloitte.com

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