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**External Multistate Tax Alert**
June 16, 2017

# Oregon Legislature Considering Gross Receipts Tax Replacement to Corporate Income Tax

## Overview

The Oregon Legislature's Joint Committee on Tax Reform recently commenced hearings to discuss a legislative concept that would, if reduced to legislation and enacted, repeal the state's corporate income tax regime and replace it with a gross receipts tax modeled closely on the Ohio Commercial Activity Tax.[1]

In this Tax Alert, we summarize these developments and offer some taxpayer considerations.

## Background

In 2016, Oregon voters defeated a ballot measure – Measure 97 – that would have amended the state's minimum tax on C corporations doing business in Oregon to impose a 2.5% tax on Oregon gross receipts in excess of $25 million.[2] Currently, Oregon's corporate minimum tax is based on Oregon gross receipts and is capped at $100,000 for C corporations with Oregon-sourced sales of $100 million or more (an affiliated group filing a consolidated Oregon return is subject to one minimum tax based on the group's Oregon sales).[3] This proposal would have raised, by one estimate, approximately $2.7 - $3.1 billion per year in additional tax revenues had it been approved.[4] Due to the state's budget shortfall – currently projected at approximately $1.4 billion[5] – and the state's dependence on what is perceived as relatively unstable net income tax revenues,[6] the Oregon Legislature formed a Joint Committee on Tax Reform to consider structural changes to Oregon's tax regime.

Since holding its first meeting on May 2, 2017, the Joint Committee has been considering the option of repealing the state's corporate income and corporate excise taxes and replacing those taxes with a gross receipts tax modeled on Ohio's Commercial Activity Tax. The initial proposal has been prepared as a "legislative concept," which is a preliminary step before the drafting of actual legislation. This proposal, LC 3549, provides the broad outline for a gross receipts tax, referred to as the "Corporate Activities Tax" (the "Oregon CAT") but leaves several significant provisions undefined.

## Primary Provisions of Oregon CAT Proposal

The primary provisions outlined in the Oregon CAT proposal as embodied in LC 3549 would apply as follows:

- Effective for tax years beginning on or after January 1, 2018[7]
- Reduce personal income tax rates by 0.5% at the $2,000 (to 4.5%), $5,000 (to 6.5%) and $125,000 (to 8.5%) thresholds[8]
- Repeal Oregon's corporate income and excise taxes[9]
- Impose the Oregon CAT on a fairly broad array of "persons," including:

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[1] LC 3549, 2017 Regular Session, Oregon Legislature, Joint Committee on Tax Reform (May 23, 2017), available here. The decision to base Oregon's gross receipts tax on the Ohio Commercial Activity Tax was based on extensive discussions among the Oregon legislators. See opening remarks of Senator Mark Hass to the Joint Committee on Tax Reform (May 2, 2017), available here.
[2] Hillary Borrud, "Oregon Corporate Tax Measure 97 Defeated: Election 2016 Results," OregonLive (November 8, 2016, available at: http://www.oregonlive.com/politics/index.ssf/2016/11/oregon_corporate_tax_measure_9.html).
[3] Or. Rev. Stat. § 317.090(2).
[4] See our previous Alert on this topic, available here.
[5] Kristena Hansen, "Oregon 'Kicker Law' Triggered Amid Budget Shortfall," Associated Press (May 16, 2017, available at https://www.usnews.com/news/best-states/oregon/articles/2017-05-16/oregon-kicker-law-triggered-amid-budget-shortfall).
[6] Oregon Legislative Revenue Office Report, "Revenue Reform in Oregon," LRO: 5-2-17.
[7] LC 3549, Section 2.
[8] LC 3549, Section 1.
[9] LC 3549, Sections 34 – 117. Currently Oregon imposes a corporate excise tax, measured by net income, on C corporations that are doing business in Oregon, and also imposes a corporate income tax on C corporations that are not doing business in Oregon but have income from Oregon sources. See generally Oregon Revised Statutes Chapters 316 and 317, respectively.

  - Individuals
  - C and S corporations
  - Partnerships
  - Limited liability companies, including single-member limited liability companies disregarded for federal income tax purposes
  - Qualified subchapter S subsidiaries and qualified subchapter S trusts
  - Joint ventures
  - Business trusts
  - Estates[10]
- All persons with taxable gross receipts would be subject to the tax including, but not limited to, persons with substantial nexus with Oregon[11]
- Taxpayers subject to the Oregon CAT would not be able to claim protection under Public Law 86-272[12]
- A unitary group would be considered a single taxpayer[13]
- Taxable gross receipts would not include receipts from transactions among members of the same unitary group[14]
- The Oregon CAT would not be billable to another person[15]
- Exclude certain tax-exempt entities, state tuition plans, insurance companies, and other entities from taxation[16]
- Adopt a destination-based approach for measuring Oregon gross receipts subject to tax, including sourcing sales of most services according to the proportion that the purchaser's benefit of the service in Oregon bears to the purchaser's benefit everywhere[17]
- Taxable Oregon gross receipts would include the value of property the person transfers into Oregon for the person's own use within one year after the person receives the property outside of Oregon unless the Department of Revenue ascertains that the property's receipt outside of Oregon followed by its transfer into Oregon within one year was not intended to avoid the Oregon CAT[18]
- A separate gross receipts tax would be imposed on financial institutions (the "Oregon FIT")[19]
- Taxpayers would be allowed to carry forward corporate income/excise tax credits that exist for a tax year beginning before January 1, 2018 that are intended to be claimed over multiple years or that include a carryforward provision, but in no event may any credit be claimed for any tax year beginning on or after January 1, 2022. Otherwise, corporate income/excise tax credits are repealed.[20]

## Significant Outstanding Items of the Oregon CAT Proposal

LC 3549 does not address several significant elements of the Oregon CAT proposal, including but not limited to:

- While the Oregon CAT imposes distinct tax rates on the following categories of business activities, the rates are not specified:
  - Taxpayers doing business in the service sector;
  - Taxpayers not doing business in the service sector, including taxpayers engaged in a manufacturing or retail sector[21]
- The Oregon CAT proposal does not define how a taxpayer's business activity should be determined, although testimony indicates that it would be determined based on NAICS codes, which would be subject to audit by the Department of Revenue[22]

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[10] LC 3549, Section 3(4).
[11] LC 3549, Section 8(1).
[12] *Id.*
[13] LC 3549, Section 3(6)(a).
[14] LC 3549, Section 3(3)(b)(AA).
[15] LC 3549, Section 8(2).
[16] LC 3549, Section 3(2).
[17] LC 3549, Sections 3(5) and 10; special provisions for sourcing sales of transportation services are also provided (LC 3549, Section 10(1)(f)).
[18] LC 3549, Section 6.
[19] LC 3549, Section 32.
[20] LC 3549, Section 33.
[21] LC 3549, Section 9(1). Note that the Oregon Legislative Revenue Office has prepared simulations using four different tax rates for the following categories: a) retailing (0.35%); b) wholesaling (0.25%), c) services (0.85%), and d) "other" (0.48%). Legislative Revenue Office, Joint Committee on Tax Reform Simulation 11 (May 22, 2017) and corresponding testimony of Paul Warner before the Joint Committee on Tax Reform on May 25, 2017, available here [http://oregon.granicus.com/MediaPlayer.php?clip_id=23763]. Using these rates, the Oregon CAT would increase net state revenues by $403 million in 2018.
[22] Catherine Tosswill, testimony before the Joint Committee on Tax Reform on May 23, 2017, http://oregon.granicus.com/MediaPlayer.php?clip_id=23729.

- Unclear what tax rate will be applied to a unitary group of businesses that engage in business activities subject to different rates
- The minimum tax rate is $250, but the Oregon taxable gross receipts threshold under which it applies is not specified[23]
- Lack of a transition or "phase-in" period
- The Oregon CAT proposal includes references to resale certificates, but it is not clear how resale certificates would be relevant to a gross receipts tax as resale certificates are generally used in sales tax administration and compliance[24]
- The tax rate for purposes of the Oregon FIT is not specified[25]
- The proposal provides that the Oregon CAT would apply to taxpayers "including but not limited to" those with substantial nexus with Oregon, but does not explain the basis for how taxpayers without a substantial nexus in Oregon would be subject to tax.[26]

### Considerations

The change from a tax regime based on corporate income taxes to a gross receipts tax imposed on a wider range of taxpayers including both pass-through entities and entities disregarded for federal income tax purposes would impose sweeping changes on Oregon taxpayers. This legislative concept is expected to remain a primary focus of the Oregon Legislature through the remainder of the current legislative session, which is scheduled to adjourn by Monday, July 10th.[27] While it is an open question whether the Oregon CAT could be enacted during the 2017 session, this proposal's potential for dramatically altering Oregon's corporate tax regime mandates close monitoring by taxpayers and practitioners.

It should be noted that on June 13, 2017, the Oregon Joint Committee on Tax Reform incorporated LC 3549 into draft legislation, HB 2830, that is substantively consistent with the elements of LC 3549 outlined in this Alert. A supplementary Alert will be released if legislation is ultimately enacted.

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[23] LC 3549, Section 9(2).
[24] LC 3549, Section 16.
[25] LC 3549, Section 32(3).
[26] LC 3549, Section 8.
[27] See the Oregon Legislative Calendar at https://www.oregonlegislature.gov/calendar/Lists/Session%20Deadlines/DispForm.aspx?ID=28.
03