

Oregon Governor Signs Market-Sourcing Legislation

Overview

On July 3, 2017, Oregon Governor Kate Brown signed Oregon's market-sourcing legislation into law, replacing the state's current cost-of-performance apportionment methodology for sales of items other than tangible personal property.¹ This provision applies to Oregon's corporate income tax.² Note that as described in our previously issued Tax Alert dated June 16, 2017, the Oregon Legislature has been considering repealing the state's corporate income tax and replacing it with a gross receipts tax; however, recent amendments to this legislation indicate that Oregon will likely not replace the corporate income tax this term.³

In this Tax Alert, we summarize this new market-sourcing law and offer some taxpayer considerations.

Market-sourcing provisions

Oregon's market-sourcing legislation closely follows the model provisions as adopted by the Multistate Tax Commission ("MTC").⁴ In general, Oregon will source sales of items other than tangible personal property to Oregon "if the taxpayer's market for sales is in" Oregon.⁵

For sales of services, Oregon provides that the sales will be sourced to Oregon "if and to the extent the service is delivered to a location" in Oregon.⁶ The Oregon legislation does not provide any further explicit guidance regarding how taxpayers or the state should interpret this standard. If Oregon follows the example of Massachusetts as another state that has adopted the "where the service is delivered" standard⁷, Oregon would adopt extensive administrative rules clarifying this standard.⁸

The market-sourcing legislation does contain some detailed provisions for sourcing the sales of intangibles:

- When intangibles are sold, the taxpayer's market is in Oregon if and to the extent the intangible is used in Oregon⁹;
 - A contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is deemed to be used in Oregon if the geographic area includes all or part of Oregon¹⁰;

¹ Laws 2017, Regular Session (SB 28; July 3, 2017). A copy of the adopted law is accessible [here](#). Under current law, Oregon generally applies an "all-or-nothing" cost-of-performance test to sales of items other than tangible personal property. Or. Rev. Stat. § 315.665(4). However, Oregon already applies market-sourcing principles to its sourcing of revenues derived from "the rental, lease, franchising, or licensing of . . . intangible personal property." Or. Admin. R. 150-314-0435(5)(b)(B).

² As a technical matter, Oregon imposes a corporate excise tax on the net income of corporations that are doing business in Oregon and applies a separate corporate income tax on the net income of corporations that are not doing business in Oregon but have income from Oregon sources. Effectively, the Oregon corporate excise tax is an income tax and this Alert will refer to it as such.

³ See Multistate Tax Alert "Oregon legislature considering gross receipts tax replacement to corporate income tax" (June 16, 2017), accessible [here](#). House Bill 2830-8, the most recent version of the 2017 legislation that would repeal Oregon's corporate income tax and replace it with a gross receipts tax, has been amended to delete the gross receipts tax provisions. Instead, the most recent version of House Bill 2830-8 raises revenue by making such changes as increasing corporate income tax rates from 6.6% on the first \$1 million of Oregon net income and 7.6% on the excess over \$1 million to 8% and 9%, respectively.

⁴ See, e.g., Model General Allocation & Apportionment Regulations with Amendments Submitted for Adoption by the Commission, pp. 5-6 (February 24, 2017) (discussing regulatory changes required by the MTC's adoption of new market-sourcing provisions in Article IV, Section 17 of the Multistate Tax Compact).

⁵ SB 28, § 3.

⁶ SB 28, § 2(1)(c).

⁷ Mass. Gen. Laws ch. 63, § 38(f).

⁸ See 830 Mass. Code Regs. 63.38.1(9)(d) for Massachusetts's extensive administrative guidance for the sourcing of sales of items other than tangible personal property; the rules provide detailed guidance and illustrative examples for such disparate transactions as in-person services, transportation services, services delivered electronically, and professional services.

⁹ SB 28, § 2(3).

¹⁰ SB 28, § 2(3)(a).

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- Intangible property sales that are contingent on the productivity, use or disposition of the intangible will be treated as the rental, lease or licensing of such intangible for apportionment purposes¹¹;
- When intangibles are rented, leased or licensed, the taxpayer's market is in Oregon if and to the extent the intangible is used in Oregon;
 - Intangible property utilized in marketing a good or service to a consumer is deemed to be used in Oregon if that good or service is purchased by a consumer that is in Oregon;
- All other intangible property sales shall be excluded from the sales factor.¹²

For receipts generated either through services or intangibles, if the sales cannot be assigned to a particular state or states, "the state or states of assignment shall be reasonably approximated."¹³

These general market-sourcing provisions will not apply to taxpayers with income from certain business activities such as a financial institution or as a public utility (as both terms are defined in Oregon law);¹⁴ this legislation also does not affect the power of the state to adopt administrative rules for apportionment for such taxpayers.¹⁵ Accordingly, it appears that the Oregon Legislature did not intend to repeal any of its special industry apportionment rules promulgated under Or. Rev. Stat. § 314.280.

Effective Date

These changes to Oregon's apportionment rules apply to tax years beginning on or after January 1, 2018.¹⁶ The enacted legislation takes effect on the 91st day after the date on which the 2017 Regular Session of the 79th Legislative Session adjourns *sine die*, which is currently scheduled for July 10, 2017 (although the session may adjourn *sine die* before the currently-scheduled date).¹⁷ This 90-day period generally allows Oregon registered voters the opportunity to approve or reject this legislation through the referendum process¹⁸, but currently no referendum is anticipated in this instance.

Considerations

Although it is likely that the Oregon Department of Revenue will draft administrative rules that provide additional guidance regarding the application of Oregon's new market-sourcing law, taxpayers should nevertheless evaluate the impending impact of Oregon's new market-sourcing regime on their Oregon sales factor calculations. In general, the shift from a "greater-cost-of-performance" sourcing regime to a market-sourcing sourcing regime increases the tax burden to out-of-state companies that make sales to customers in that state, particularly for states such as Oregon that have economic nexus standards.¹⁹ As a result, a taxpayer that has a material Oregon customer base for services or intangibles may see an increase in its Oregon apportionment percentage as a direct result of this recent law change.

Additionally, taxpayers that have negotiated alternative apportionment agreements with the Oregon Department of Revenue may want to closely review those agreements and consult with their tax advisers regarding the effect of this new law on those agreements to determine whether they may have been superseded by this law change.

¹¹ SB 28, § 2(3)(b).

¹² SB 28, § 2(3)(c).

¹³ SB 28, § 2(4).

¹⁴ SB 28, § 4.

¹⁵ *Id.*

¹⁶ SB 28, § 5.

¹⁷ See Oregon Legislature Calendar posting [here](#); the 91st day after July 10, 2017 would appear to fall on Monday, October 9, 2017.

¹⁸ Or. Const., Article IV, § 1(3)(a).

¹⁹ Oregon provides that "substantial nexus exists where a taxpayer regularly takes advantage of Oregon's economy to produce income for the taxpayer and may be established through the significant economic presence of a taxpayer in the state." Or. Admin. R. 150-317-0020(2). Oregon has not adopted any bright-line nexus standards measured by a specific threshold of gross receipts.

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