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TaxNewsFlash

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Oregon: Corporate activity tax bill is signed into law

Oregon's governor on May 16, 2019, signed House Bill 3427 into law—legislation that:

- Establishes a "Fund for Student Success" that is separate and distinct from the state's general fund
- Adopts a new Corporate Activity Tax (CAT) imposed on all types of business entities at a rate of 0.57%

The new CAT is in addition to the state's current corporate income tax, and revenues from the CAT will be transferred to the Fund for Student Success to be used for education spending.

KPMG observation

The Oregon CAT is a hybrid between the Ohio Commercial Activity Tax and the Texas franchise (margin) tax and is imposed on the person engaging in taxable commercial activity and not on a purchaser. Although irrelevant to the determination of whether the CAT is considered an income tax for financial statement purposes, House Bill 3427 includes a statement that the CAT is not subject to Public Law 86-272. Details on the Oregon CAT are below.

Imposition of CAT, taxpayers subject to CAT

Effective for tax years beginning on or after January 1, 2020, a corporate activity tax (CAT) is imposed on each person with taxable commercial activity for the privilege of doing business in Oregon.

The term "person" is broadly defined and includes, but is not limited to, individuals, partnerships, LLCs, C corporations, S corporations, and entities that are disregarded for federal income tax purposes. As such, the new CAT is imposed on all types of business entities, not just corporations.

Similar to the corporate income tax, a unitary group will register, file, and pay taxes as a single taxpayer and may exclude receipts from intercompany transactions among group members. "Unitary group" means a group of "persons" with more than 50% common ownership, either direct or indirect, that is engaged in business activities that constitute a unitary business. Because of the reference to "persons," it appears that the unitary group for CAT purposes includes all types of business entities, not just corporate entities.

Substantial nexus threshold

The Oregon CAT is imposed on persons that have "substantial nexus" with Oregon. The legislation sets forth conditions outlining when persons will be considered to have "substantial nexus" with Oregon, including, but not limited to: owning or using part or all of the person's capital in Oregon; holding an authorization to do business from the Oregon Secretary of State; or being a resident or domiciliary of Oregon.

"Substantial nexus" also exists when a person has a "bright-line" presence in Oregon. A "bright-line" presence is when a person, during the calendar year, has rented or owned property in Oregon with an aggregate value of at least $50,000, has payroll in Oregon of at least $50,000, or has commercial activity (i.e., receipts) sourced to Oregon under the CAT market-based sourcing statute of at least $750,000. A bright-line presence also exists when the person, during the calendar year, has at least 25% of its total, property, payroll, or commercial activity in Oregon.

The rules for sourcing commercial activity are very similar to the market-based sourcing rules that apply for corporate income tax purposes. For example, receipts from sales of tangible personal property will be sourced to Oregon if the tangible personal property is delivered in the state. Receipts from sales of services will be sourced to Oregon to the extent the service is delivered to a location in the state.

Persons not subject to CAT

Under the legislation, the term "taxpayer" means any person or unitary group required to register, file or pay CAT. The definition of a taxpayer specifically does not include "excluded persons."

"Excluded persons" include, but are not limited to, various IRC section 501 entities, certain hospitals, governmental entities, and any persons with commercial activity that does not exceed $1 million for the calendar year, other than a person that is part of a unitary group with commercial activity in excess of $1 million dollars. As such, a single person that meets the $750,000 threshold of Oregon-sourced commercial activity, but that does not have in excess of $1 million of commercial activity sourced to Oregon, will nevertheless be considered an "excluded person" and not a "taxpayer." However, House Bill 3427 specifically requires each person or unitary group with commercial activity in excess of $750,000 to register with the Department of Revenue, or be subject to penalties.

CAT base and rate

The CAT is imposed on a person's commercial activity sourced to Oregon. "Commercial activity" means the total amount realized by a person, arising from transactions and activity in the regular course of the person's trade or business, without deduction for expenses incurred by the trade or business. There are 43 specific types of receipts excluded from the definition of "commercial activity." Some of the excluded receipts represent amounts (taxes, surcharges) that are paid over to the government, amounts that if included in commercial activity would potentially lead to double taxation (distributive income received from a pass-through entity), or amounts that are required per contracts to be paid over to third parties. Other types of exclusions apply to receipts that may not arise from a taxpayer's regular trade or business activity, such as proceeds from pension revisions, contributions to capital, and damages received in the course of litigation in excess of amounts that would have been considered commercial activity without litigation. Interest, except for interest from credit sales, is excluded from commercial activity, as are dividends received. An exclusion also applies to receipts from the wholesale or retail sale of groceries. Note, there are 43 specific exclusions, so the discussion above does not capture each and every specific exclusion.

Interestingly, specific provisions require the value of certain property to be included in the measure of "taxable commercial activity." Specifically, a person must include as taxable commercial activity the

value of property the person transfers into Oregon for the person's own use in the course of a trade or business within one year after the person receives the property outside this state.

In the case of a unitary group, the taxpayer must include as taxable commercial activity the value of property that any member of the taxpayer transfers into Oregon for use in the course of a trade or business by any member of the group within one year after the taxpayer receives the property outside Oregon. Property brought into Oregon within one year after it is received outside Oregon by a person or unitary group may not be included as taxable commercial activity if the Department of Revenue ascertains that the property's receipt outside this state by the person or unitary group followed by its transfer into this state within one year was not intended in whole or in part to avoid the CAT.

House Bill 3427 specifically defines the "commercial activity of a financial institution" and the "commercial activity of an insurer."

- The "commercial activity" of a financial institution" includes all items of income without deduction for expenses. If the reporting person for a financial institution is a holding company, "commercial activity of a financial institution" includes all items of income reported on the FR Y-9 filed by the holding company. If the reporting person for a financial institution is a bank organization, "commercial activity of a financial institution" includes all items of income reported on the call report filed by the bank organization. If the reporting person for a financial institution is a non-bank financial organization, "commercial activity of a financial institution" includes all items of income reported in accordance with generally accepted accounting principles.

- "Commercial activity of an insurer" includes all items of income without deduction for expenses and all items of income reported on the statement of income accompanying the annual statement required under Ore. Rev. Stat. section 731.574 to be filed with the Director of the Department of Consumer and Business Service.

After determining the commercial activity sourced to Oregon under the market-sourcing rules, a taxpayer is allowed a subtraction for 35% of the greater of the following amounts paid or incurred by the taxpayer in the tax year: (1) the amount of cost inputs (defined as costs of goods sold under IRC section 471; or (2) labor costs (defined as the total compensation of all employees not including any compensation paid to any single employee in excess of $500,000). The amount deducted must be apportioned to Oregon "in the manner required for apportionment of income under Or Rev. Stat. sections 314.605 to 314.675" (the statutory provisions governing the allocation and apportionment of income for the corporate income tax). This subtraction cannot exceed 95% of the taxpayer's commercial activity in Oregon. Note that the definition of cost inputs does not include costs under IRC section 263A.

Once the amount of "commercial activity" sourced to Oregon is determined, the CAT imposed is equal to $250 plus the product of the taxpayer's taxable commercial activity in excess of $1 million for the calendar year multiplied by 0.57%. No tax is owed if the person's taxable commercial activity does not exceed $1 million.

Administrative provisions

House Bill 3427 also provides guidance on the due date of the annual CAT return (April 15th) and the procedures for making CAT payments for the previous calendar quarter on or before the last day of January, April, July, and October of each year. For the first year the CAT is imposed, the Department cannot impose penalties or interest for underreporting CAT if the taxpayer pays at least 80% of the balance due for any quarter.

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