TaxNewsFlash

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Oregon: Corporate activity tax, effective January 1, 2020

Oregon's corporate activity tax is effective beginning January 1, 2020.

Background

The governor in May 2019 signed into law **House Bill 3427** that, among other measures, adopts a new corporate activity tax (CAT) to fund education spending. Subsequently enacted legislation (**House Bill 2164**) made certain technical corrections to the CAT.

The Department of Revenue in recent weeks has been actively soliciting input from CAT stakeholders; issued a list of CAT-related **FAQs**, and sent to the Oregon **temporary CAT rules**. As justification for the temporary rules, the Department noted that "…promulgating temporary rules effective January 1, 2020 will provide guidance for taxpayers as of the effective date of the new Corporate Activity Tax and before the first quarterly estimated tax payment deadline of April 30, 2020."

Oregon's CAT regime is in addition to the current corporate income tax, and taxpayers (even if already registered for corporate tax purposes) must separately register for the CAT through the Department of Revenue's online system. Businesses must register when they meet the economic nexus threshold of "commercial activity" sourced to Oregon in excess of $750,000. Once that threshold is met, a business must register within 30 days, which means for many larger companies, registration will likely be required early in 2020.

KPMG observation

The Oregon CAT regime is viewed as something of a hybrid between the Ohio commercial activity tax and the Texas franchise (margin) tax. Importantly, the Oregon CAT is not a transactional tax and is not imposed on purchasers.

Imposition of CAT and persons subject to the CAT

Effective for tax years beginning on or after January 1, 2020, the CAT is imposed on each person with **taxable commercial activity** for the privilege of doing business in Oregon. In other words, the new tax under the CAT regime is imposed on "commercial activity." 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.

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Similar to the corporate income tax, a unitary group will register, file, and pay the tax under the CAT regime 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. This is in contrast to the corporate income/excise tax, which uses an 80% test for determining a unitary business. Because of the reference to "persons," the CAT unitary group includes all types of business entities—not just corporate entities.

One of the temporary rules recently sent to the Oregon Secretary of State provides guidance on determining whether a group of "persons" is engaged in a unitary business and clarifies that traditional tests and criteria, such as centralization of management, economies of scale and functional integration, will be applied for CAT regime purposes.

CAT nexus standard and filing requirements

Persons that have "substantial nexus" with Oregon must register with the Department of Revenue for CAT purposes. A person will be considered to have "substantial nexus" with Oregon under various circumstances, 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
- 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.

KPMG observation

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.

The term "taxpayer" means any person or unitary group required to register, file or pay the tax under the CAT regime. The definition of a taxpayer specifically excludes "excluded persons" defined as including but not limited to, various IRC section 501 entities, certain hospitals, governmental entities, and any persons with commercial activity that does not exceed $750,000 for the calendar year, other than a person that is part of a unitary group with commercial activity in excess of $750,000 dollars.

Accordingly, each person or unitary group with commercial activity in excess of $750,000 must register with the Department of Revenue, or be subject to penalties. However, only businesses or unitary groups with commercial activity sourced to Oregon of $1 million or more must file a return and pay the levy under the CAT regime. Although tax-exempt entities are generally "excluded persons," if a tax-exempt entity has unrelated business income taxable under the IRC, it will be considered a CAT taxpayer.

KPMG observation

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House Bill 3427 includes a statement that the CAT is not subject to Public Law 86-272. As such, companies protected under Public Law 86-272 for Oregon corporate income tax purposes will need to consider whether they have a CAT filing obligation.

CAT base and rate

The CAT liability 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 over 40 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 reversions, 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 on credit sales and interest income (including service charges) received by a financial institution, is excluded from commercial activity, as are dividends received. An exclusion also applies to receipts from the wholesale or retail sale of groceries.

There are provisions in the CAT law that require the value of certain property brought into Oregon to be included in the measure of "taxable commercial activity." A person or unitary group that intended to avoid the CAT must include the fair market value of property transferred into Oregon in its taxable commercial activity for the tax year the property was transferred into 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 Oregon within one year was not intended in whole or in part to avoid in whole or in part to avoid the CAT.

KPMG observation

Although there is a temporary rule addressing property brought into Oregon, it does not provide meaningful guidance on how a taxpayer can establish that CAT avoidance was not intended.

The CAT law 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 CAT market-sourcing rules, a taxpayer subtracts 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 as calculated in arriving at federal taxable income); or (2) labor costs (defined as the total compensation of all employees not

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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," which are 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. A temporary rule provides guidance (including examples) on calculating and apportioning the 35% cost inputs or labor cost subtraction. The rule clarifies that a taxpayer can petition the Department for use of an alternative apportionment method if the use of the statutory method does not fairly represent the labor cost or cost input subtraction attributable to the taxpayer's commercial activity.

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 for the calendar year in excess of $1 million multiplied by 0.57%. No tax is owed if the person's taxable commercial activity does not exceed $1 million.

Administrative provisions

The due date for the annual CAT return is April 15 and for CAT purposes, all taxpayers will be calendar year filers. A taxpayer expecting more than $5,000 of CAT liability for the calendar year must make estimated payments. Tax-exempt persons are subject to tax on their "unrelated business income"—such persons must also make estimated payments if their expected Oregon CAT tax liability will be more than $5,000. Estimated CAT payments for the previous calendar quarter will be due on or before the last day of January, April, July, and October of each year and must be made by electronic funds transfer (EFT).

For the first year the CAT is imposed (tax years beginning on or after January 1, 2020, and ending before January 1, 2021), underpayment penalty charges will not be imposed if each estimated tax payment is equal to or more than 25% of 80% of the tax for the tax year. For years beginning on or after January 1, 2021, penalties will not be imposed if each estimated payment is 25% of 100% of the tax; 100% of the tax shown on the return for the preceding 12-month tax year (after credits); or 100% of the tax computed on annualized taxable commercial activity.

Another temporary rule provides that the time for filing an annual CAT return may be extended for six months after the due date if the taxpayer files an application for an extension of time to file in accordance with the draft rule. A taxpayer must have a "good cause" for requesting an extension, which can include that the information needed to complete the return is not available. "Good cause" does not include relying on a tax professional or an employee to prepare the return on time.

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