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SHOP TALK

Oregon's New Corporate Activity Tax: Impact of Agent Exception on Construction Contractors (And Election Update for Portland, Oregon Area)

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The Oregon corporate activity tax (the "Oregon CAT") that went into effect on January 1, 2020 and codified in Chapter 317A of the Oregon Revised Statutes raises several open issues. Although the administrative rules issued by the Oregon Department of Revenue (the "Department") resolve some of these issues, they also often raise others. This is not meant as a criticism of the Department. Rather, it is the inevitable result for some of the guidance for complicated statutory schemes with several moving parts.

The May 2020 *Shop Talk* article discussed, in part, an open question arising from the subtraction for costs inputs and labor costs. As described in that article, the Department's rule, OAR 150-317-1200, applied a default method (the "commercial activity ratio"), but allowed taxpayers to opt out by using "separate accounting." ¹ This high-level summary glosses over flaws and ambiguities in OAR 150-317-1200, discussed in the prior article. Similar questions and issues arise with OAR 150-317-1100, the Department's rule for the agent exception for commercial activity.

Oregon CAT: general summary.

In drafting the Oregon CAT, the Oregon legislature started with the text of the Ohio commercial activity tax (the "Ohio CAT"), and then made significant changes.

The Oregon CAT is imposed on a person's "taxable commercial activity for the privilege of doing

business" in Oregon. **2** Taxable commercial activity is defined as a taxpayer's Oregon-source gross "commercial activity," less a subtraction of 35 percent of the greater of (a) "cost inputs," or (b) "labor costs," apportioned to Oregon. **3** The Ohio CAT does not contain this subtraction.

As with the Ohio CAT, the Oregon legislature broadly defined commercial activity for the Oregon CAT as receipts from transactions and activity in the regular course of the taxpayer's trade or business (*i.e.*, so-called "transactional test" gross receipts). **4** However, the statute lists *forty-seven* different types of gross receipts excluded from commercial activity. **5** These exclusions include "[p]roperty, money and other amounts received or acquired by an agent on behalf of another in excess of the agent's commission, fee or other remuneration" (the "agent exclusion"). **6** The Ohio CAT contains an identical exception. **7**

Department's rule for agent exclusion.

The scope of the agent exclusion is unclear. For the agent exclusion, the Department broadly defined agent as "a person who is acting on behalf of another and is subject to that other person's control." **8** The Department's rule also requires taking into account all facts and circumstances. **9** The rule also includes five examples to provide additional guidance.

Other than the examples, the final rule adopted by the Department is identical to the draft temporary rule issued by the Department on December 9, 2019. With respect to the examples, the Department made two changes:

- First, the Department deleted its confusing example about the agent exclusion applying to property received by a taxpayer for repair. Many questioned whether a taxpayer would have included such property in commercial activity in the first place. For example, no one would have thought to include such property in the taxpayer's Oregon sales factor. An entire *Shop Talk* article could have been dedicated to this example. The deletion renders this moot.
- Second, the Department added two examples specific for the construction industry. Many questioned the absence of such examples from the draft temporary rules. Guidance from the Department was needed.

The construction examples are:

Example 4: Jones Corporation owns a plot of land in Oregon and enters into a fixed-price \$10 million contract with a general contractor, Strong-R Construction, to construct a mixed-use building on the land. Strong-R Construction agrees to provide specified services for the \$10 million contract and bears all risks involved in completing the project in a cost-effective manner. Strong-R Construction may perform the necessary services itself, or it may bid out some or all the work to subcontractors. According to the terms of the contract, Strong-R Construction is solely responsible and liable for completing the project as agreed and does not need to inform or disclose to Jones Corporation any

details as to the costs or the manner in which the work is conducted or completed. Based on the totality of the facts and circumstances, Strong-R Construction does not qualify as an agent for purposes of the agency exclusion and includes the entire \$10 million in Oregon commercial activity.

Example 5: ABC Corporation (ABC) enters into a cost-reimbursable contract with DEF Construction (DEF) to construct an office building in Oregon. ABC agrees to pay DEF for all costs incurred for completed work by subcontractors, plus a fee equal to five percent of the total project costs. Under the terms of the contract, DEF must act on behalf of and under the direction and control of ABC related to the use of subcontractors. Such direction and control includes, but is not limited to, the bidding and awarding of subcontracts, the setting of a schedule of activities and deliverables, and the management of project costs. DEF acts as a conduit regarding any payments made to the subcontractors, by remitting monies received from ABC to the subcontractors, provided that project deliverables are completed according to the terms of the subcontracts. ABC pays \$10 million of project costs to DEF. If DEF turns around and remits the entire \$10 million to the subcontractors for the total costs of the project work completed by the subcontractors, that amount may be excluded from commercial activity. However, any portion of the \$10 million not remitted directly to the subcontractors that is used instead for other expenses such as materials or other labor must be included in commercial activity. Assume that DEF remits the entire \$10 million directly to the subcontractors and collects a \$500,000 fee ($\$10,000,000 * 5\%$) from ABC as compensation for the services provided to ABC. Based on the totality of facts and circumstances, DEF includes only the \$500,000 fee in its commercial activity.

These examples generally describe the two end points of the construction contracting spectrum: Example 4 generally describes a lump sum contract (agent exclusion does not apply) and Example 5 generally describes a cost-plus contract (agent exclusion applies).

Although not identical, the Department largely conformed to the examples provided by the Ohio Department of Revenue. That is, Ohio Admin. Code §5703-29-13(C)(2)(b) contains an example providing that the agent exclusion does not apply to a lump sum contract and Ohio Admin. Code §5703-29-13(C)(2)(c) contains an example providing that the agent exclusion applies to a cost plus contract.

The position that the agent exception does not apply to lump sum contracts may make sense as a policy matter. However, it likely will have unintended consequences. As a general matter, public works construction contracts must be done on a lump sum basis. Subjecting all payments under these contracts to the Oregon CAT generally will increase the cost of these public works projects. An increase in construction costs for schools and other public works projects likely was part of the motivation for Portland, Oregon to exempt construction contractors from its one percent clean energy surcharge. **10** The Oregon legislature may need to create some type of CAT exemption to protect city and county

budgets for public works projects.

Open questions for construction contracts.

Examples for the two possible extremes provide only limited guidance. These examples demonstrate factors taken into account, such as sole responsibility for completing the work, nondisclosure of information about subcontractors, limited discretion, etc. However, there is no guidance for balancing these factors for construction contracts that contain some features of a lump sum contract and some features of a cost plus contract.

Further, the Department did not provide an example for the most common type of construction contract for commercial property: a guaranteed maximum price ("GMP") contract. Like snowflakes, no two GMP contracts are identical. However, the American Institute of Architects has its "A102-2017 Standard Form of Agreement Between Owner and Contractor where the basis of payment is the Cost of the Work Plus a Fee with a Guaranteed Maximum Price." ¹¹ There are other entities that also provide standard cost plus to a GMP contract (each, a "Model GMP Contract"). Owners and contractors generally start with a Model GMP Contract, and then make revisions. In revising OAR 150-317-1100 to provide examples for the construction industry, the Department could have added an example using an unchanged Model GMP Contract. This would have informed the construction industry: (1) whether GMP contracts generally qualify for the agent exclusion; and (2) if the Model GMP Contract did not qualify for the agent exclusion, the provisions that caused this result.

Absent definitive guidance, owners and contractors will need to determine whether the Oregon CAT applies to all amounts paid under a GMP contract or only the contractor's fee. It generally appears that, until the GMP is reached, a GMP contract is equivalent to a cost plus contract (except that owners generally do not provide direction on "the setting of a schedule of activities and deliverables"). Further, the author is not aware of any GMP contract where the contractor does not provide the owner with "any details as to * * * the manner in which the work is conducted or completed." Accordingly, it generally appears that the agent exclusion applies to GMP contracts. Of course, the contract at issue would have to be analyzed before making a determination. Also, change orders increasing the GMP, especially ones late in the project, could constitute a change in the facts and circumstances. That is, although the agent exclusion generally may apply to amounts paid towards the original GMP, the agent exclusion may not apply to additional payments allowed by the change order. Again, the details for the change order would need to be analyzed before reaching a conclusion.

The availability of the agent exclusion for construction contracts remains unclear. Although the Department's examples for lump sum contracts and cost plus contracts provide some guidance, an example based on a Model GMP Contract is still needed. Until then, owners and contractors taking the position that the agent exclusion applies to GMP contracts should build in provisions in case the Department successfully challenges the position.

1 Flipping these so that separate accounting is the default, with the commercial activity ratio as an elective safe harbor, generally would be a more favorable system.

2 Or. Rev. Stat. §317A.116(1).

3 Or. Rev. Stat. §317A.100(16).

4 Or. Rev. Stat. §317A.100(1)(a). Ohio Rev. Code Ann. §5751.01(F) provides a similar definition, except it uses the term "gross receipts," rather than "commercial activity." As discussed in the September 2019 *Shop Talk*, the Oregon legislature's use of "commercial activity" instead of gross receipts may demonstrate the legislature's awareness that, because of the subtraction for 35 percent of cost inputs or labor costs, the Oregon CAT is not a gross receipts tax.

5 Or. Rev. Stat. §317A.110(1)(b).

6 Or. Rev. Stat. §317A.100(1)(b)(M).

7 Ohio Rev. Code Ann. §5751.01(F)(2)(l).

8 OAR 150-317-110(1). This differs from the statutory definition for the Ohio CAT. See Ohio Rev. Code Ann. §5751.01(P) (defining agent as "a person authorized by another person to act on its behalf to undertake a transaction for the other.") Although the Ohio statute omits references to control, the Ohio Department of Revenue included control in its rule for the agent exclusion. See Ohio Admin. Code §5703-29-13(B)(1).

9 OAR 150-317-110(2) *available at*
https://www.oregon.gov/dor/about/Rules/CAT/permanent/150-317-1100_Agent_Exclusion.pdf.

10 See Portland Ordinance 189794, *available at*
<file:///C:/Users/KodeschE/Downloads/City%20Auditor%20-%20City%20Recorder%20-%20Council%20Ordinance%20->

11 *Available at* <https://www.aiacontracts.org/contract-documents/25111-owner-contractor-agreement>.

