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Oregon Enacts Gross Receipts Tax

Tax Legal Update

On May 16, 2019, Governor Brown signed Oregon's new gross receipts tax (the "Oregon CAT") into law. 2019 Or Laws Ch. 122 (HB 3427). Although modeled on the Ohio commercial activity tax (the "Ohio CAT"), the Oregon CAT includes a substantial expense deduction. The tax is effective for tax years beginning on or after January 1, 2020.

The Tax

The tax is a 0.57 percent gross receipts tax that generally applies to all businesses with Oregon-source receipts over $1 million. In computing their taxable receipts, taxpayers may generally subtract the greater of (i) cost inputs (cost of goods sold), or (ii) labor costs.

Key Take-Aways

1. Although Titled a "Corporate Activity Tax," the Tax Applies to All Businesses and Business Gross Receipts, Not Specifically Excluded. The tax is a commercial activity tax. It applies not only to c-corporations, but also to pass-through entities (such as partnerships, LLCs, joint ventures, and s-corporations) and sole proprietorships.

2. The Tax Is an Entity-Level Tax. The tax is paid at the business entity level, even if the entity is a pass-through entity for income tax purposes.

3. Limited Expense Deduction. In computing taxable gross receipts, the statute provides a subtraction for 35 percent of the greater of apportioned (i) cost inputs (cost of goods sold), or (ii) labor costs. "Labor costs" include only compensation paid to employees and are capped at $500,000 per employee. There is no subtraction for payments to independent contractors, although certain payments received by a taxpayer as an agent on behalf of a third party may be

excluded from the taxpayer's taxable gross receipts.

4. Businesses With Global Business Receipts over $750,000 Are Generally Required to Register With the Oregon Department of Revenue, Even if They Do Not Owe Any Tax. Businesses that do not register within twenty-nine days of crossing the $750,000 threshold may be subject to penalty.

5. The Tax Is in Addition to All Existing Oregon State and Local Taxes. Unlike the Ohio CAT, the Oregon CAT does not replace other Oregon taxes.

6. P.L. 86-272. The Oregon CAT statute states that the tax is not subject to the limitations on state taxation in P.L. 86-272. However, given the 35% expense subtraction, whether the tax should be classified as a net income tax (and thus subject to P.L. 86-272), or a true gross receipts tax, is an open question. The issue is one of federal law, based on the objective characteristics of the tax.

Key Details

1. Tax Imposed on "Taxable Commercial Activity." The Oregon CAT is imposed on "taxable commercial activity," which is generally defined as a taxpayer's Oregon–source business gross receipts less a subtraction equal to 35 percent of the greater of (a) "cost inputs," or (b) "labor costs," apportioned to Oregon.
2. Taxpayers. Generally, the Oregon CAT applies to all persons and business entities that have (a) substantial nexus with Oregon, and (b) taxable commercial activity in excess of $1 million per year. Excluded entities include health insurance companies subject to certain other excise taxes, certain hospitals and care facilities, and organizations that are tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Excluded entities are not "taxpayers" under the statute and are not subject to the tax at all.
3. Tax Rate. The Oregon CAT is $250 plus 0.57 percent of taxable commercial activity over $1 million.
4. Exclusions From the Tax Base. The law includes *forty-three types* of receipts that are excluded from the tax base for businesses otherwise subject to the tax. The exclusions include: interest income (other than interest on credit sales), proceeds from the repayment or redemption of

the principal of a loan or bond, proceeds from the issuance of the taxpayer's own stock, contributions to capital, proceeds from the issuance of stock, dividends, gains from the disposition of capital assets, the distributive share of income from a pass-through entity, rebates, receipts from transactions among members of a unitary group, amounts received by an agent on behalf of another in excess of the agent's remuneration, and revenue required by contract to be distributed to another person or entity as a sales commission (provided the person is not an employee of the business making the distribution). Special rules apply to receipts from transactions subject to certain other Oregon excise taxes, such as receipts from the sale of cigarettes and tobacco, marijuana, alcoholic beverages, bicycles at retail, and motor vehicle fuel.

5. Addition for Property Transferred to Oregon. The law requires a taxpayer include, in its taxable commercial activity, the value of property the taxpayer transfers into Oregon for the taxpayer's own use in the course of a trade or business, within one year after the taxpayer received the property. It does not apply if the Department of Revenue (the "Department") "ascertains" that the taxpayer's receipt of the property outside Oregon was not intended to avoid the tax.

6. Subtraction for 35 percent of Cost Inputs or Labor Costs. To compute its taxable commercial activity, a taxpayer subtracts 35 percent of the *greater of* apportioned (a) "cost inputs," *or* (b) "labor costs." "*Cost inputs*" are defined as the cost of goods sold ("COGS") as calculated under Section 471 of the Internal Revenue Code. "*Labor costs*" means the total compensation of all employees, but does not include compensation paid to (i) any single employee in excess of $500,000, or (ii) independent contractors. The amount of the subtraction is the Oregon-apportioned share of cost inputs or labor costs, using the apportionment method for income under the Oregon Uniform Division of Income for Tax Purposes Act ("UDITPA"). The subtraction may not exceed 95 percent of the taxpayer's Oregon commercial activity.
7. Receipt Sourcing. Generally, commercial activity (i.e., business receipts) is sourced to Oregon using a market-based sourcing method. A sale of tangible personal property is sourced to Oregon if the property is delivered to a purchaser in Oregon. In the case of a service, the receipt is sourced to Oregon if and to the extent the service

is "delivered" in Oregon. In the case of intangible property, the receipt is sourced to Oregon if and to the extent the property is used in Oregon. If receipts are based on the right to use the property, rather than on actual use, the receipts are sourced to Oregon to the extent the receipts are based on the right to use the property in Oregon. Special rules apply to determining the Oregon-source receipts of financial institutions and insurance companies.

8. Unitary Group. Unitary groups must register and pay the tax as a single taxpayer. The law applies a "more than 50 percent" ownership threshold for a unitary group, rather than the 80 percent threshold used for determining which corporations are included in an Oregon consolidated corporation excise tax return. In addition, unlike the corporation excise tax, the unitary group for the Oregon CAT tax includes non-U.S. entities and non-corporate entities.
9. Return and Registration Requirements. Only businesses with "taxable commercial activity" in excess of $1 million are required to pay the Oregon CAT. However, businesses with "commercial activity" (i.e., total business receipts in and outside of Oregon) in excess of $1 million are generally required to file returns, and those with "commercial activity" in excess of $750,000 are generally required to register with the Department of Revenue. The Department is authorized to impose a penalty if a business fails to register within 29 days after the date on which the business exceeds the $750,000 threshold for registration. The penalty may not exceed $100 per month or a total of $1,000 per calendar year.
10. Economic Nexus. The tax applies to businesses that have substantial nexus with Oregon. "Substantial nexus" is defined by "bright-line" rules and a catch-all provision, under which a business is deemed to have substantial nexus if the business can be constitutionally required to pay the Oregon CAT. In terms of jurisdiction, the Oregon CAT is intended to reach all income that Oregon is permitted to tax.

Next Steps

The Oregon CAT statute contains a number of material provisions that are vague or susceptible to a variety of interpretations. Affected taxpayers may seek clarification through either legislation or the administrative rulemaking process.

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- **Technical Corrections Bill Possible.** The legislature is expected to consider a technical corrections bill to amend the Oregon CAT statute before the current legislative session ends on June 30, 2019. The bill could also include substantive amendments.

- **New Administrative Rules.** The Oregon CAT statute gives the Department broad authority to adopt administrative rules regarding the new tax. The Department and the Department of Justice are seeking a number of new staff positions to implement the tax, examine returns, and litigate issues regarding the tax. A substantial number of new rules will likely be adopted. It is anticipated that the Department will adopt a number of temporary rules initially while permanent rules work their way through the rulemaking process.

- **Referendum Possible.** If opponents of the Oregon CAT submit 74,680 qualified voter signatures to the Oregon Secretary of State within 90 days after the end of the legislative session, the Oregon CAT will be referred to the voters for an up-or-down vote. The implementation of the statute will be suspended until the vote is held. The referendum vote would be held in November 2020, unless the legislature, by statute, designates a different date. There are currently discussions in the legislature of accelerating the date of any referendum, possibly to January 2020.

If you would like to know more about the proposed tax, how it might affect your business, or options to plan for it, please contact one of our Oregon tax partners: John Gadon(503.778.2130) or Eric Kodesch (503.778.2107).