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Oregon Amends Recently Enacted Commercial Activity Tax

Tax Legal Update

We previously issued a legal update about Oregon's new commercial activity tax (the "CAT"). The Oregon legislature recently passed a bill amending certain provisions of the CAT, which Governor Brown is expected to sign. The CAT is imposed on a business's Oregon business gross receipts, less a deduction for a percentage of cost inputs or labor costs. Business gross receipts are defined in the statute as a business's "commercial activity." The CAT is effective for tax years beginning on or after January 1, 2020.

Key Changes to the Oregon CAT

1. **New exclusions.** Certain business receipts are excluded from the CAT. The legislature added exclusions for (a) receipts from hedging transactions, and (b) compensation received by an employee (including deferred compensation, equity compensation, benefits, and reimbursements).

2. **Financial institutions taxable on interest income.** Interest income is generally not subject to the CAT. However, the legislature modified the exclusion to provide that financial institutions *will* be taxed on interest income, including service charges.

3. **Expansion of exclusion for pass-through governmental fees.** The legislature expanded an exclusion for money collected or recovered from customers to include (a) fees payable under ORS 756.310 (Oregon Public Utilities Commission fees), and (b) right-of-way fees. The exclusion is also no longer limited to "utilities."

4. **Definition of "cost inputs" revised.** In computing the tax base, a taxpayer subtracts 35% of the *greater of* apportioned (a) "cost inputs," *or* (b) "labor costs." "Cost inputs" have been redefined as "the cost of goods sold as calculated in arriving at federal taxable income." The legislature deleted the reference to "Section 471 of the Internal Revenue Code."

5. **Taxpayer has right to show that the receipt of property out of state, followed by its transfer into Oregon, was not done to avoid the CAT.** As originally enacted, the CAT statute required that a taxpayer include, in its taxable commercial activity, the value of property transferred into Oregon, for the taxpayer's own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, unless "*the Department of Revenue ascertain[ed]*" that the taxpayer's actions were not intended to avoid the tax. The legislature revised the statute to provide that the inclusion also does not apply if the taxpayer can show the receipt and transfer were not intended to avoid the tax.

6. **Vehicle dealers may collect the CAT from vehicle purchasers.** The CAT is imposed on the business with the commercial activity and not directly on a purchaser. However, a vehicle dealer is now permitted to collect, from vehicle purchasers, the estimated portion of the dealer's CAT attributable to receipts from the sale.

7. **As intercompany payments among members of a unitary group are excluded from the CAT, the "subtraction" for labor costs or cost inputs excludes costs from those transactions.** Receipts from transactions among members of a "unitary group" are not subject to the CAT. The legislature clarified that, in computing the 35% subtraction for labor costs or cost inputs, a taxpayer may not include expenses from those transactions.

8. **Pre-emption of local taxes clarified.** The CAT statute generally bars new local taxes on commercial activity (i.e., local gross receipts taxes). The legislature clarified that the bar does not apply to (a) local taxes that are "not measured by commercial activity," or (b) local "right-of-way fees." The legislature also deleted "franchise taxes" from the types of local taxes that would be permitted.

9. **Partial exclusion for payments by general contractors to subcontractors pursuant to a contract for single-family residential construction.** The CAT does not include a general exclusion for payments received by a general contractor where the general contractor is required to pay subcontractors. The legislature has now provided a limited exception for residential construction. A general contractor may exclude, from its taxable commercial activity, 15% of the total amount paid to subcontractors for labor (but not material, land, or permits), pursuant to a contract for single-family residential construction in Oregon.

Possible Referendum Shelved

On July 16, 2019, the backers of a proposed referendum on the CAT announced they were abandoning their efforts to place the tax before the voters. There is therefore unlikely to be a referendum, and the tax is expected to go into effect as scheduled.

Administrative Rules

The Department of Revenue has formed an internal work group to guide the implementation of the CAT. The group is currently identifying issues on which to provide administrative guidance, Both temporary rules and proposed permanent rules are anticipated.

If you would like to know more about the CAT, 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).