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Oregon Department of Revenue Issues Temporary Administrative Rules for the Corporate Activity Tax

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Oregon's new corporate activity tax (the "CAT") went into effect on January 1, 2020. We issued a legal update in May 2019 and a legal update in July 2019 regarding the CAT statutes. The CAT is imposed on a business's Oregon "taxable commercial activity," which is generally its Oregon-source business gross receipts, less a deduction for a percentage of apportioned cost inputs or labor costs. Other than businesses and receipts specifically excluded, the CAT generally applies to all businesses, whether incorporated or not, that have taxable commercial activity in excess of $1 million per year. The tax rate is $250 plus 0.57 percent of taxable commercial activity over $1 million.

On January 2, 2020, the Oregon Department of Revenue issued 12 temporary administrative rules regarding the CAT. These rules, which address a number of threshold issues, are summarized below. The Department anticipates issuing additional temporary and proposed rules for the CAT in February and March 2020.

Temporary Rules

Temp. OAR 150-317-1000. "Commercial activity." The rule defines "commercial activity," which is the starting point for computing the CAT,

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as "the fair market value of all amounts realized in the regular course of a taxpayer's trade or business that meets the 'transactional test'" for apportionable income under the Oregon version of the Uniform Division of Income for Tax Purposes Act ("UDITPA"). "Amounts realized" are defined to include money, property, debt forgiven and services rendered. The definition is not tied to the definition of "gross income" under Internal Revenue Code Section 61. Commercial activity is realized when the taxpayer realizes the amount under the method of accounting the taxpayer uses for federal income tax purposes.

Temp. OAR 150-317-1010. "Substantial nexus." The rule provides that "substantial nexus" exists if the connection between the person and Oregon is sufficient to establish nexus under the U.S. Constitution. Substantial nexus exists when a person regularly takes advantage of the Oregon economy to realize commercial activity in the state and may be established through a significant economic presence in the state, even if the person has no physical presence in the state. The rule lists a number of factors that the Department may consider in determining whether a person has substantial nexus. The rule is substantially similar to OAR 150-317-0020, which provides substantial nexus guidelines for the corporation excise tax.

Temp. OAR 150-317-1020. "Unitary business." A "unitary group" is required to file a combined CAT return. For purposes of the CAT, a "unitary group" is a group of persons with more than 50 percent common ownership, either direct or indirect, that is engaged in business activities that constitute a unitary business. A unitary group generally includes any persons meeting this definition, including (a) noncorporate entities, such as limited liability companies and partnerships, and (b) foreign entities.

The rule provides guidance for determining when a group of persons are engaged in a unitary business. The rule is substantially similar to OAR 150-317-0510, which provides similar guidance for determining when corporations are engaged in a unitary business for corporation excise tax purposes. The rule applies the same three factors as OAR 150-317-0510: centralization of management, economies of scale and functional integration. The rule provides that the presence of any one factor may be sufficient for a group of persons to be engaged in a unitary business. The rule also provides guidance on the filing requirements for a unitary group.

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Temp. OAR 150-317-1030. Sourcing commercial activity from the sale of tangible personal property. This rule provides that receipts from sales of tangible personal property are sourced to Oregon if the property is delivered to a purchaser within Oregon regardless of the f.o.b. point or other conditions of sale. The rule is substantially similar to OAR 150-314-0429, which is the sourcing rule for sales of tangible personal property under Oregon's version of UDITPA, except that the CAT does not include a "sales throwback" rule.

Temp. OAR 150-317-1040. Sourcing commercial activity from sales other than the sale of tangible personal property (i.e., intangible property and services). The rule is substantially similar to OAR 150-314-0435, which provides a market-based sourcing rule for such sales pursuant to Oregon's version of UDITPA. The rule does not address the sourcing of receipts of financial institutions or insurers, for which the CAT statutes provide separate rules.

Temp. OAR 150-317-1100. Agent exclusion. "Commercial activity" does not include amounts received by an agent on behalf of another in excess of the agent's remuneration. The rule provides guidance in broad terms. It defines an "agent" as a person who is acting on behalf of another and who is subject to that other person's control. The rule further provides that whether a person is acting as agent is to be determined based on "all facts and circumstances." The rule provides a number of examples, which generally apply Oregon common-law agency principles.

Temp. OAR 150-317-1130. Property brought into Oregon within one year of acquisition. The CAT statutes generally require a taxpayer to include the value of property transferred into Oregon for use in its trade or business if (a) the person or unitary group received the property outside Oregon and transferred it into the state for use in the person's or unitary group's business within one year of the person's or unitary group's receipt of the property, and (b) the receipt of the property outside Oregon and its transfer into Oregon were intended to avoid the CAT.

This rule provides guidance regarding when the value of such property should be included in a taxpayer's "commercial activity." The rule provides that a person should <u>not</u> include the fair market value of property transferred into Oregon within one year of its receipt outside of Oregon if the transfer was <u>not</u> intended to avoid the CAT, in whole or in

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part. The rule further provides that a person or unitary group who omits the fair market value of such property from the CAT is required to include it "upon a showing by the department that the taxpayer intended to avoid the CAT in whole or in part." The latter provision suggests that the Department has the burden of proof of showing that the inclusion applies. The rule does not address as of what date the fair market value of the property is determined.

Temp. OAR 150-317-1200. Subtraction of 35 percent of the greater of cost inputs or labor costs apportioned to Oregon. A taxpayer's "taxable commercial activity" is generally determined by subtracting, from the taxpayer's Oregon commercial activity, 35 percent of the greater of (a) cost inputs (generally, cost of goods sold), or (b) the taxpayer's labor costs, apportioned in either case "in the manner required for apportionment of income" under the Oregon version of UDITPA.

The rule provides that the apportioned subtraction is generally to be computed as follows. First, all labor costs or cost input expenses are summed, regardless of where the costs incurred; then the resulting sum is apportioned to Oregon, using the "commercial activity ratio."

The "commercial activity ratio" is defined as a fraction, (a) the numerator of the ratio is the taxpayer's commercial activity sourced to Oregon, and (b) the denominator of which is the taxpayer's total commercial activity, plus amounts excluded from commercial activity. The rule provides no guidance as to what amounts are considered to be "excluded" from "commercial activity" and therefore included in the denominator of the fraction. The term appears to refer to the over 40 types of receipts specifically excluded from the definition of "commercial activity" under the CAT.

By adding receipts not subject to the CAT to solely the denominator of the fraction, the rule will, where the taxpayer has such excluded amounts, reduce the amount of the subtraction and thereby increase the taxpayer's "taxable commercial activity" and tax due.

Further, the rule applies to taxpayers whose "commercial activity" is solely from Oregon sources. These taxpayers are not required to apportion their income for Oregon income tax purposes. However, under the rule, these

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taxpayers' "commercial activity ratio" would be reduced if they had any business receipts that were excluded from the CAT.

There are a number of grounds on which the temporary rule might be challenged, including whether it is consistent with the statutory requirement that the subtraction be apportioned "in the manner required for apportionment of income" under the Oregon version of UDITPA.

Temp. OAR 150-317-1300. Estimated tax payments. The rule provides guidance for determining when estimated tax payments are required.

Temp. OAR 150-317-1310. Underpayment of estimated taxes; interest and penalties. The rule provides guidance for determining an underpayment of estimated taxes and interest charged on an underpayment of estimated tax. A transitional rule is provided for tax years ending before January 1, 2021.

Temp. OAR 150-317-1320. Estimated tax: unitary groups and apportioned returns. The rule provides that members of a unitary group are jointly and severally liable for the payment of any required estimated tax and that estimated tax payments are to be made on a combined basis for the group. NB: The CAT differs from the Oregon corporation excise tax in that it requires a combined return, rather than a consolidated return. The rule also provides guidance for the computation of a taxpayer's estimated tax payment obligations for taxpayers who are required to apportion their cost input or labor cost subtraction.

Temp. OAR 150-317-1330. Extension to file return. The CAT return is due on April 15 of the following year. A taxpayer's CAT liability is determined on a calendar-year basis, regardless of the taxpayer's fiscal year. This rule provides guidance for extensions to file. Under the rule, a taxpayer can receive a six-month extension to time to file, upon a showing of "good cause." The rule defines what does, and does not, constitute "good cause." "Good cause" includes the required information not being available or not in the proper form. The extension is not automatic. A taxpayer must file an extension request before the due date of the return and certify that it has "good cause."

A complete set of the rules may be found at: www.oregon.gov/DOR/about/Pages/rules.aspx. As this legal update is a

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summary, it does not cover all of the provisions, limitations, or exceptions in the new rules.

If you would like to know more about the CAT, the temporary administrative rules, or how the CAT might apply to your business, please contact one of our Oregon tax partners: John Gadon, (503.778.2130) or Eric Kodesch (503.778.2107).

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