

*SHOP TALK*

## Oregon's New Corporate Activity Tax: Open Questions About P.L. 86-272 and Oregon's Privilege Tax on Sales of New Vehicles

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On May 16, 2019, Governor Brown signed Oregon's new corporate activity tax (the "Oregon CAT") into law.<sup>1</sup> On the last day of the legislative session, the Oregon legislature also passed a bill which makes technical changes and substantive revisions to the Oregon CAT.<sup>2</sup> Opponents of the Oregon CAT have begun the process to challenge it by referendum. Accordingly, the status of the Oregon CAT remains unclear and likely will not be known until after the referendum.<sup>3</sup> This article discusses two open issues with the Oregon CAT: (1) whether the federal Interstate Income Act of 1959 ("P.L. 86-272") applies to the Oregon CAT, and (2) whether the Or. Rev. Stat. §320.405 "privilege tax" imposed on Oregon vehicle dealers is subject to the Oregon CAT when collected from a vehicle purchaser.

### Oregon CAT: general summary

The Oregon legislature modeled the Oregon CAT on the Ohio commercial activity tax (the "Ohio CAT"), but also made significant modifications. The Oregon CAT is imposed on "taxable commercial activity."<sup>4</sup> Taxable commercial activity generally is defined as a taxpayer's Oregon-source gross receipts from transactions and activity in the regular course of the taxpayer's trade or business (i.e., so-called "transactional test" gross receipts), less a subtraction of 35 percent of the greater of (a) "cost inputs," or (b) "labor costs," apportioned to Oregon.<sup>5</sup> Cost inputs generally are the taxpayer's cost of goods sold

("COGS").<sup>6</sup> "Labor costs" include only compensation paid to *employees* and are capped at \$500,000 per employee.<sup>7</sup>

Although titled a "Corporate Activity Tax," the tax generally applies to "each person with taxable commercial activity."<sup>8</sup> Accordingly, pass-through entities (such as partnerships, LLCs, joint ventures, and S corporations) and sole proprietorships are subject to the Oregon CAT. However, certain entities are excluded from the tax (e.g., IRC Section 501(c)(3) entities, health insurance companies subject to certain other Oregon excise taxes, and certain hospitals and care facilities).<sup>9</sup>

A taxpayer owes the Oregon CAT if the taxpayer has taxable commercial activity in excess of \$1 million.<sup>10</sup> The tax is \$250 plus 0.57 percent of taxable commercial activity in excess of \$1 million.

## Impact of P.L. 86-272

Generally, P.L. 86-272 "restricts a state from imposing a *net income tax* on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property."<sup>11</sup> The 2019 Law specifically provides that the Oregon CAT "is not subject to" P.L. 86-272.<sup>12</sup> It is axiomatic, however, that states lack authority to unilaterally exempt a state net income tax from a federal limitation on tax. For example, *Graphic Packaging Corp. v. Hegar*, 538 S.W.3d 89 (Tex. 2017) concerned, in part, whether the Texas franchise tax was a net income tax. Texas law contained a provision similar to 2019 Law, §63(1): "The *franchise tax* imposed by Chapter 171, Tax Code, as amended by this Act, *is not an income tax* and Pub. L. No. 86-272 does not apply to the tax."<sup>13</sup> The Texas Supreme Court, however, stated: "But of course the Legislature's stated intent not to create an income tax cannot alter the facts. If the franchise tax is indeed a tax on net income as chapter 141 defines income tax, the Legislature's disclaimer is for naught."<sup>14</sup> Instead, P.L. 86-272 generally should apply to the Oregon CAT, notwithstanding the statutory text providing otherwise, if the Oregon CAT constitutes a "net income tax."

P.L. 86-272 §383 provides a circular definition of net income tax: "any tax imposed on, or measured by net income." Generally, however, "net income" is distinguished from "gross income," which IRC Section 61 broadly defines as "all income from whatever source derived." As described above, "taxable commercial activity" starts with gross income (Oregon-source transactional activity gross receipts), but then allows a substantial subtraction for 35 percent of cost inputs or labor costs.<sup>15</sup> In other words, taxable commercial activity is an amount net of a substantial deduction.<sup>16</sup>

As a final matter, although the Oregon legislature modeled the Oregon CAT on the Ohio CAT, the Oregon legislature used a different term for the tax base on which it imposed the Oregon CAT. The Oregon legislature imposed the Oregon CAT "on each person with *taxable commercial activity*."<sup>17</sup> The Ohio legislature, on the other hand, imposed the Ohio CAT "on each person with *taxable gross receipts*."<sup>18</sup> As described above, taxable commercial activity is Oregon-source gross receipts, net of a subtraction for 35 percent of cost inputs or labor costs. The decision by the Oregon legislature to use a different term for the tax base for the Oregon CAT generally indicates that the legislature understood that it imposed the Oregon CAT on an amount other than gross receipts.

## Taxable commercial activity arising from Privilege Tax collections

The Oregon legislature enacted a comprehensive transportation law in 2017.<sup>19</sup> As part of this law, the legislature "imposed on each vehicle dealer for the privilege of engaging in the business of selling taxable motor vehicles at retail in this state" a tax (the "Privilege Tax").<sup>20</sup> Like a sales tax, however, vehicle dealers can collect the Privilege Tax from purchasers.<sup>21</sup> The Oregon legislature also created a corresponding use tax (the "Use Tax") "to protect Oregon vehicle dealers from losing business to non-Oregon vehicle dealers, who are not subject to the Section 90 [privilege] tax."<sup>22</sup> The Oregon legislature imposed the Use Tax "on the storage, use or other consumption in this state of taxable motor vehicles purchased at retail from any seller."<sup>23</sup> The Use Tax "is a liability of the purchaser of the taxable motor vehicle."<sup>24</sup> Nonetheless, out-of-state dealers can collect and pay the Use Tax for the purchaser as part of registering and titling the car.<sup>25</sup>

As the Oregon Supreme Court explained, the Privilege Tax and the Use Tax "work together, so that the Section 90 privilege tax can be imposed on in-state vehicle dealers without placing them at a competitive disadvantage to out-of-state vehicle dealers."<sup>26</sup> Accordingly, although both taxes apply to the purchase of a new car from an Oregon dealer for use in Oregon, the Use Tax owed by the purchaser is reduced by the Privilege Tax paid by the Oregon dealer.

The Oregon CAT excludes from commercial activity:

Registration fees or taxes collected by a vehicle dealer certified under ORS 822.020 at the sale or other transfer of a motor vehicle, as defined in ORS 801.360, that are owed to a third party by the purchaser of the motor vehicle and passed to the third party by the dealer.<sup>27</sup>

It appears that this would exclude from an out-of-state dealer's commercial activity Use Tax collected from a purchaser. After all, because the Use Tax is imposed on the purchaser, it is a tax "collected by a vehicle dealer . . . at the sale or other transfer of a motor vehicle . . . that are owed to a third party [Oregon] by the purchaser . . . and passed to the third party by the dealer."

It is unclear, however, whether this exclusion applies to Privilege Tax collected by an Oregon dealer. Because the Privilege Tax is imposed on the Oregon dealer, it is not a tax "owed . . . by the purchaser." However, the Privilege Tax eliminates the Use Tax owed by the purchaser. Arguably, this could mean that the Oregon dealer paying the Privilege Tax satisfies the tax owed by the purchaser.

The Oregon legislature presumably did not intend to provide a benefit to out-of-state car dealers vis-à-vis Oregon dealers. Hopefully, the Oregon Department of Revenue will broadly interpret the exclusion so that it applies equally to Oregon dealers and out-of-state dealers.

With any new tax regime, there are open questions for the impact of specific matters. With respect to the Oregon CAT, these include whether P.L. 86-272 applies and whether the tax applies to Privilege Tax collected by Oregon dealers from customers. Guidance will be necessary to resolve these and other issues.

<sup>1</sup> 2019 Or. Laws ch. 122 (H.B. 3427).

<sup>2</sup> H.B. 2164. Oregon's governor is expected to sign the bill. This article refers to 2019 Or. Laws ch. 122 (H.B. 3427), as amended by H.B. 2164, as the "2019 Law."

<sup>3</sup> Assuming the opponents of the Oregon CAT gather sufficient signatures (which is likely to be the case), a special election will be held on January 21, 2020. See S.B. 116. Oregon's governor is expected to sign the bill. [Ed. Note: After this went to press, the effort to challenge the Oregon CAT by referendum was dropped.]

<sup>4</sup> 2019 Law §63.

<sup>5</sup> *Id.* at §58(17) (defining "taxable commercial activity"); §58(1)(a) (defining "commercial activity"). However, there are over forty types of gross receipts excluded from the tax base. See *id.* at §58(1)(b).

<sup>6</sup> *Id.* at §58(2).

<sup>7</sup> *Id.* at §58(12).

<sup>8</sup> *Id.* at §63

<sup>9</sup> *Id.* at §58(6).

<sup>10</sup> *Id.* at §65(2). However, pursuant to 2019 Law §68(1), a taxpayer must register for the Oregon CAT if the taxpayer has commercial activity (i.e., worldwide transactional test gross receipts) in excess of \$750,000. In addition, pursuant to 2019 Law §70(1), a taxpayer with over \$1 million of commercial activity must file a return. Accordingly, taxpayers with no Oregon CAT liability may have to register and file returns. Presumably, the Oregon Department of Revenue will issue administrative rules clarifying that the registration and filing obligations do not apply to taxpayers with no Oregon receipts.

<sup>11</sup> Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272, available at [http://www.mtc.gov/uploadedFiles/Multistate\\_Tax\\_Commission/Uniformity/Uniformity\\_Projects/A\\_-\\_Z/StatementofInfoPublicLaw\\_86-272.pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/StatementofInfoPublicLaw_86-272.pdf). (Emphasis added.). A discussion of P.L. 86-272 and the various issues related to P.L. 86-272 are beyond the scope of this article.

<sup>12</sup> 2019 Law at §63(1).

<sup>13</sup> Act of May 2, 2006, 79th Leg., 3d C.S. ch. 1, §21, 2006 Tex. Gen. Laws 1, 38. (Emphasis added).

<sup>14</sup> *Graphic Packaging*, 538 S.W.3d at 95.

<sup>15</sup> In *Graphic Packaging*, for example, the Texas Supreme Court described how "deductions for the cost of goods or wages are perhaps sufficiently close to" cause a tax to be a net income tax. *Graphic Packaging*, 538 S.W.3d at 95. Ultimately, the court concluded that other methods for calculating the tax base meant that "some ambiguity exists" as to whether the Texas margins tax was an income tax and ruled for the state on other grounds. *Id.*

<sup>16</sup> In fact, the definition of cost inputs, as revised by H.B. 2164, links cost inputs to COGS used "in arriving at federal taxable income." IRC Section 63 defines "taxable income" as "gross income minus the deductions allowed by this chapter." This further indicates that taxable commercial activity is a net income amount.

<sup>17</sup> 2019 Law at §63 (emphasis added).

<sup>18</sup> Ohio Rev. Code Ann. §5751.02(A) (emphasis added).

<sup>19</sup> 2017 Or. Laws ch. 750 (H.B. 2017) (the "2017 Transportation Act").

<sup>20</sup> Or. Rev. Stat. §320.405(1). The tax rate is 0.5 percent of the retail sales price of a new vehicle. Or. Rev. Stat. §320.405(2). Taxable motor vehicles generally are defined as new vehicles. See Or. Rev. Stat. §320.400(6).

<sup>21</sup> Or. Rev. Stat. §320.405(3).

<sup>22</sup> *AAA Oregon/Idaho Auto Source, LLC v. State of Oregon*, 363 Or. 411, 425, 423 P.3d 71 (2018).

<sup>23</sup> Or. Rev. Stat. §320.410(1).

<sup>24</sup> Or. Rev. Stat. §320.410(3).

<sup>25</sup> See Or. Rev. Stat. §320.420.

<sup>26</sup> *AAA Oregon/Idaho Auto Source, LLC v. State of Oregon*, 363 Or. at 425.

<sup>27</sup> 2019 Law at §58(1)(b)(X). [§58(1)(b)(S) if H.B. 2164 is not enacted].

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