

What You Need to Know about Oregon's New Business Sales Tax

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In 2019, the Oregon legislature created the CAT—a new tax on commercial activity to fund education.

The tax passed in HB 3427 and was quickly amended in HB 2164.

The tax started January 1, 2020 and is estimated to raise over \$1.4 billion per year.

Why call it a “CAT?”

- The legislature titled the tax the “Corporate Activity Tax,” but the tax actually applies to more than just corporations (e.g. LLCs, LLPs, individuals)
- The CAT is actually a hybrid tax similar to a “commercial activity tax” or “modified gross receipts tax”
- This presentation uses the commonly used “CAT” abbreviation, which is more fun.



Why should I care about the CAT?

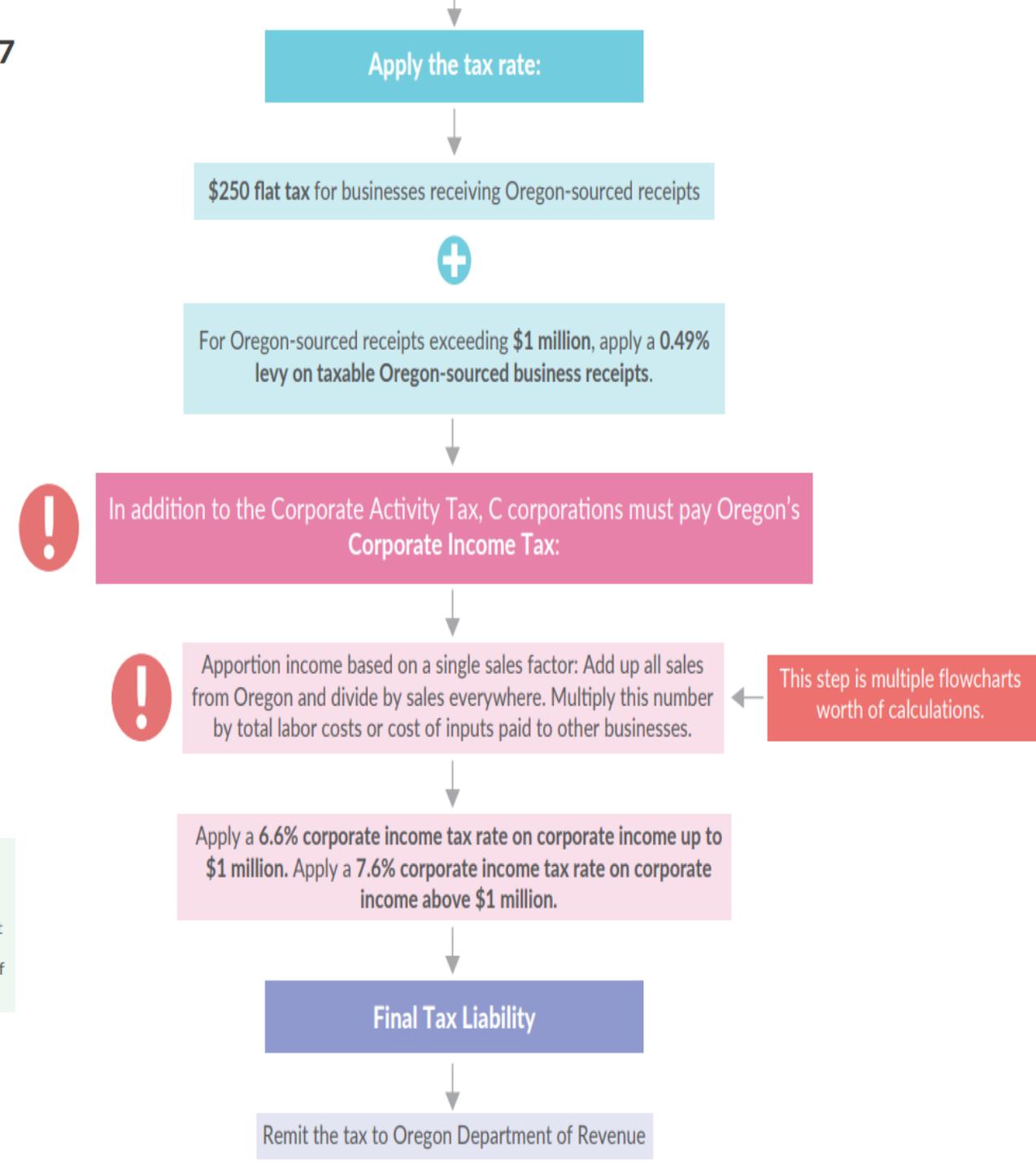
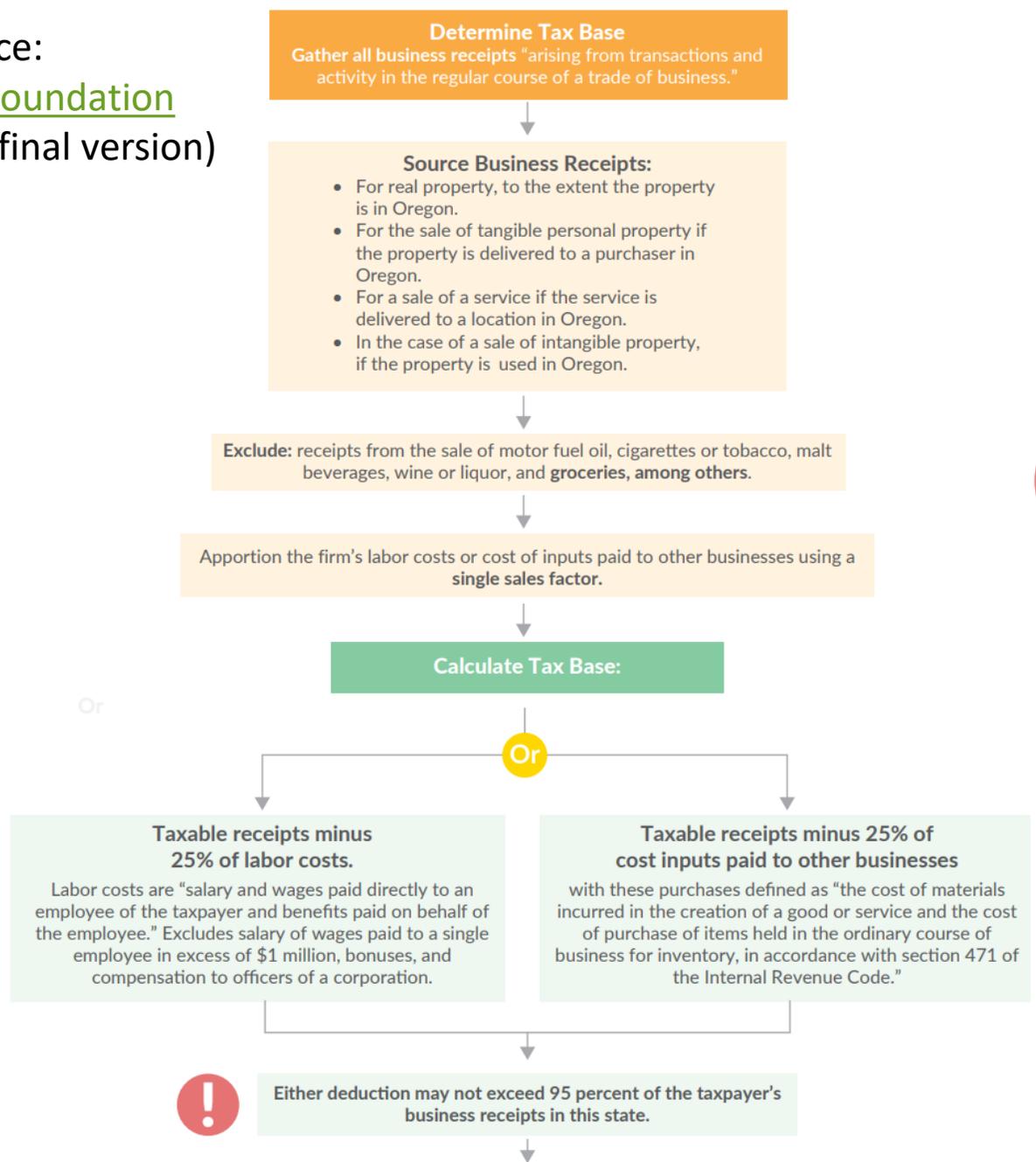
- The CAT will directly impact:
 - Many businesses
 - Owners of those businesses
 - Oregon education funding
- The CAT will indirectly impact
 - Contract provisions for many other businesses
 - Reporting obligations for many other businesses
 - Most Oregon economic activity
 - Costs of most consumer goods
 - Most small businesses



How CAT Works

FIGURE 1:
How to Calculate Oregon's Proposed Corporate Activity Tax Under HB 3427

Source:
Tax Foundation
 (not final version)



Tax Base – Commercial Activity



- Broad Definition

“The total amount realized by a person, arising from transactions and activity in the regular course of the person’s trade or business, without deduction for expenses incurred by the trade or business.”

- Many exceptions from definition

- 47 specific exemptions

- Groceries (defined) (e.g. bottle of water – may depend on whether grocery store, movie theater, restaurant, take-out, etc.)
 - Motor vehicle fuel

- Different definitions for financial institutions and insurers

- Excludes most nonprofit entities, hospitals, long-term care facilities, farmers co-ops, governments

See ORS 317A.100

Tax Base – Commercial Activity Notable Exceptions

- Many state/local taxes and fees collected by businesses for government
- Repayment of loan principle and some interest
- Tips or gratuities for food establishment passed on to employees
- Some sales of capital assets (section 1221 or 1231 of the Internal Revenue Code)
- Split-fee real estate commissions and certain other commissions
- “Dividends received” and “Distributive income received from a pass-through entity”
 - Impacts business owners
- Forgivable PPP Loans

Tax Base – Commercial Activity Notable Exceptions – Food/Agriculture

- Wholesale groceries
- Tips or gratuities for food establishment passed on to employees
- “Receipts from sales to a wholesaler in this state, if the seller receives certification **at the time of sale** from the wholesaler that the wholesaler will sell the purchased property outside this state”
 - Big deal for many farmers and agricultural businesses in the Willamette Valley
- Farmer sales to agricultural cooperative (defined)



Tax Base - Sourcing

Tax only applies to commercial activity sourced to Oregon under ORS 317A.128:

- Real property located in OR (sale, rental, lease, license, etc.)
- Tangible personal property located in OR or **delivered to a purchaser in OR**
- Service delivered to location in OR
- Intangible property used in OR or right to use in OR
- Financial institution or insurer – from business conducted in OR

See ORS 317A.128

Unitary Groups



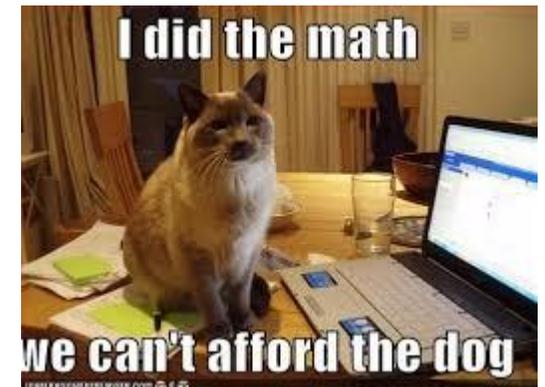
- A “unitary group” shall register, file and pay taxes as a single taxpayer
 - May exclude transactions between members from tax
 - Some businesses may be able to avoid tax as unity group by going under threshold; some businesses may have to pay more overall as part of unitary group because individual businesses in group would not have otherwise qualified.
- “Unitary group” – “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 business” means a business enterprise in which there exists directly or indirectly between the members or parts of the enterprise a sharing or exchange of value as demonstrated by:
 - (A) Centralized management or a common executive force;
 - (B) Centralized administrative services or functions resulting in economies of scale; or
 - (C) Flow of goods, capital resources or services demonstrating functional integration.
 - (b) “Unitary business” may include a business enterprise the activities of which:
 - (A) Are in the same general line of business, such as manufacturing, wholesaling or retailing; or
 - (B) Constitute steps in a vertically integrated process, such as the steps involved in the production of natural resources, which might include exploration, mining, refining and marketing.

See ORS 317A.106; ORS 317A.100

Subtraction

- A taxpayer receives a 35% subtraction for one of the following two options:
 - “Cost inputs” - “the cost of goods sold as calculated in arriving at federal taxable income under the Internal Revenue Code”
 - “Labor Costs” – “total compensation of all employees, not to include compensation paid to any single employee in excess of \$500,000”
 - Note: that “employees” do not include certain partners in a partnership, LLC members, independent contractors
 - Labor costs include salary, benefits – not payroll taxes
- Does not apply to transactions within unitary group or for non-commercial activity
- Subtraction may not exceed 95% of taxpayer’s commercial activity in OR

See ORS 317A.119



Exclusion

- A general contractor receives a 15% exclusion for labor costs to a subcontractor for single-family residential construction.
- Various restrictions apply.

See ORS 317A.122

Tax Rate

- \$250 flat tax +
- 0.57% of Oregon-sourced business receipts over \$1 million



See ORS 317A.146

Passing on CAT to Customers

A business may pass on CAT costs to customers, but what they receive from customers then becomes part of their taxed commercial activity.

Example: business earning \$10 million tacks 0.57% fee onto all sales. This nets an additional \$57,000, which counts as additional commercial activity. Thus, \$324.90 of that is taxed, so business is still slightly below pre-CAT position.

SPECIAL REPORTS

Cost of Student Success Act catches schools by surprise

One of Oregon's largest districts has "sought legal counsel"



Accounting

Must use same accounting methods as use for federal income tax purposes for the same year.

See ORS 317A.103

Registration

- Any person or unitary group with commercial activity in excess of \$750,000 in the tax year shall register with the Department of Revenue.
- 30 days to register without penalty



See ORS 317A.131

Records

Every person doing business in this state shall keep records, receipts, invoices and other pertinent papers related to the corporate activity tax imposed under ORS 317A.116 in a form required by the Department of Revenue.

See ORS 317A.134

Quarterly Payments

- Estimated payments for prior quarter due last day of January, April, July, and October
- “A taxpayer shall pay at least 80 percent of the balance due for any quarter or the department may impose a penalty”
- Applies if over \$5,000 total CAT liability for year

See ORS 317A.137; ORS 317A.161

Tax Due Upon Business Sale

- Tax due mid-year when ending or selling business, or disposes of stock of good – 45 days to pay
- Successor/buyer potentially liable for unpaid tax of prior owner
 - “Any person obligated to fulfill the terms of a contract shall be considered a successor to any contractor defaulting in the performance of any contract as to which the person is a surety or guarantor.”



See ORS 317A.146

Administrative Rules and Future Changes

Administrative Rules

- Currently a number of permanent and temporary rules in place
- Agency still developing more administrative rules
- Next public hearing June 23
 - 150-317-1050 Sourcing of Commercial Activity for Financial Institutions.
 - 150-317-1060 Farmers Sales to Agricultural Cooperatives.
 - 150-317-1140 Wholesale sale of groceries exclusion.
 - 150-317-1400 Determining property resold out of state and methods of determining.

Additional Legislative Amendments?

- Numerous additional changes have been proposed
- Consensus changes were included HB 4009-A.
 - Passed committee unanimously in February.
 - Never received floor vote in failed 2020 session.
- On March 25, the Joint Coronavirus Response Committee recommended passage of HB 4009-A consensus changes in a special session.

HB 4009-A Changes

Committee Staff Summary

- Changes one reference of 'business revenue' to 'commercial activity';
- clarifies tax refunds are not commercial activity;
- clarifies that manufactured dwelling park nonprofit cooperatives are not taxable;
- ties unrelated business income to the Internal Revenue Code;
- excludes from a unitary group entities that have no connection to Oregon;
- attributes returns and allowances to the year they occur;
- clarifies the 35% subtraction calculation;
- reduces penalties to 5% and adds a safe harbor;
- extends the 80% threshold for quarterly payments through tax year 2021;
- excludes crop insurance payments;
- excludes certain dairy sales of milk;
- provides an alternative definition of 'cost inputs' for certain farm businesses;
- allows farmers to either (1) receive a certificate detailing the portion of their product that is exported, or (2) apply an industry average to estimate exports of their product.



Hypotheticals

Hypothetical 1 – Accounting Firm

- \$2 million receipts
- \$200,000 non-labor costs (building, utilities, insurance, etc.)
- \$1.8 million labor costs
- (\$1,050,000 to partners in a partnership who receive guaranteed payments or distributive income) = \$750,000 in CAT labor costs
- \$750,000 in CAT labor costs x 35% = \$262,500 subtraction
- -\$1 million threshold
- \$737,500 taxable x 0.57% + \$250 = \$4,453.75 CAT liability

Hypothetical 2 – Pizza Restaurant

- \$2 million receipts
 - (\$1 million home delivery or take out and \$1 million on-site consumption)
- Due to groceries exemption and \$1 million threshold, no CAT liability
- Still above \$750,000 in OR commercial activity so must register

Hypothetical 3 – Hardware Store

- \$3 million receipts
- Lost money this year
 - \$1.5 million products costs
 - \$1.5 million labor costs
 - \$200k other costs (facilities, utilities, insurance, etc.)
- Profitability irrelevant to CAT
- \$1.5 million products or labor x 35% = \$525,000 subtraction
- -\$1 million threshold
- \$1,475,000 taxable x 0.57% + \$250 = \$8,657.50 CAT liability

Resources

Oregon Department of Revenue (FAQs; administrative rules, etc.)

<https://www.oregon.gov/dor/programs/businesses/Pages/corporate-activity-tax.aspx>

Background on CAT Legislation

<https://olis.oregonlegislature.gov/liz/2019R1/Measures/Exhibits/HB3427>

CAT Codification

https://www.oregonlegislature.gov/bills_laws/ors/ors317A.html

CAT Likely Changes – HB 4009-A

<https://olis.oregonlegislature.gov/liz/2020R1/Downloads/MeasureDocument/HB4009>

Disclaimer

- This presentation is an overview of the CAT and is not tax advice.
- There are multiple variations, exceptions, and other nuances that were not covered in the presentation due to time limitations.
- Please consult an attorney or other tax professional with questions or to plan for how the CAT may impact your specific situation.

Questions?

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