Understanding Oregon's Cost of Performance Method of Apportioning Corporate Income

House Committee on Revenue

January 14, 2016

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What is “apportionment”?

Apportionment is a method of attributing income to the states in which a multi-state or multi-national corporation is doing business.

UDITPA – Uniform Division of Income for Tax Purposes Act

- Model law for apportioning income between states
  - Created in 1957 by state taxing official
  - MTC adopted rules interpreting UDITPA
- Oregon adopted UDITPA in statute in 1965
  - Market-based sourcing for tangible personal property
  - Cost of performance for intangible property

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What is “apportionment”?

1957 UDITPA provided for apportionment of income based on three equal factors:

Sales
Payroll
Property

Many states, including Oregon, have moved away from three-factor apportionment in favor of a heavily weighted sales factor formula.

Oregon's Apportionment Formula

Tax Year Beginning:	Factor presence	Sales	Payroll	Property
Prior to 1991	"Equal-weighted"	33%	33%	33%
01-Jan-91 to 30-Apr-03	"Double-weighted"	50%	25%	25%
01-May-03 to 30-Jun-05	"Super sales"	80%	10%	10%
01-July-05 to present	"Single sales"	100%	0%	0%

Applies only to multi-state corporations

One exception to single-sales factor

- Utilities and Telecommunication companies

What IS an Oregon sale?

Goods and other tangible items

- Sourced based on where the tangible item is sold
- Throwback sales

Services or other intangible items

- Sourced where the greatest proportion of income producing activity occurs

Sourcing Sales of Goods

Goods (tangible product) is Oregon sale if

- Delivered to customer in Oregon, or
- Shipped from Oregon to customer outside Oregon and company not subject to tax where the customer is located

Reflects market of corporate taxpayer

Generally easier to identify sale of goods

Sourcing Sales of Services

Service is an Oregon sale if the greater "Cost of Performance" (COP) is in Oregon

All or nothing – State with greater COP gets all sales sourced to their state

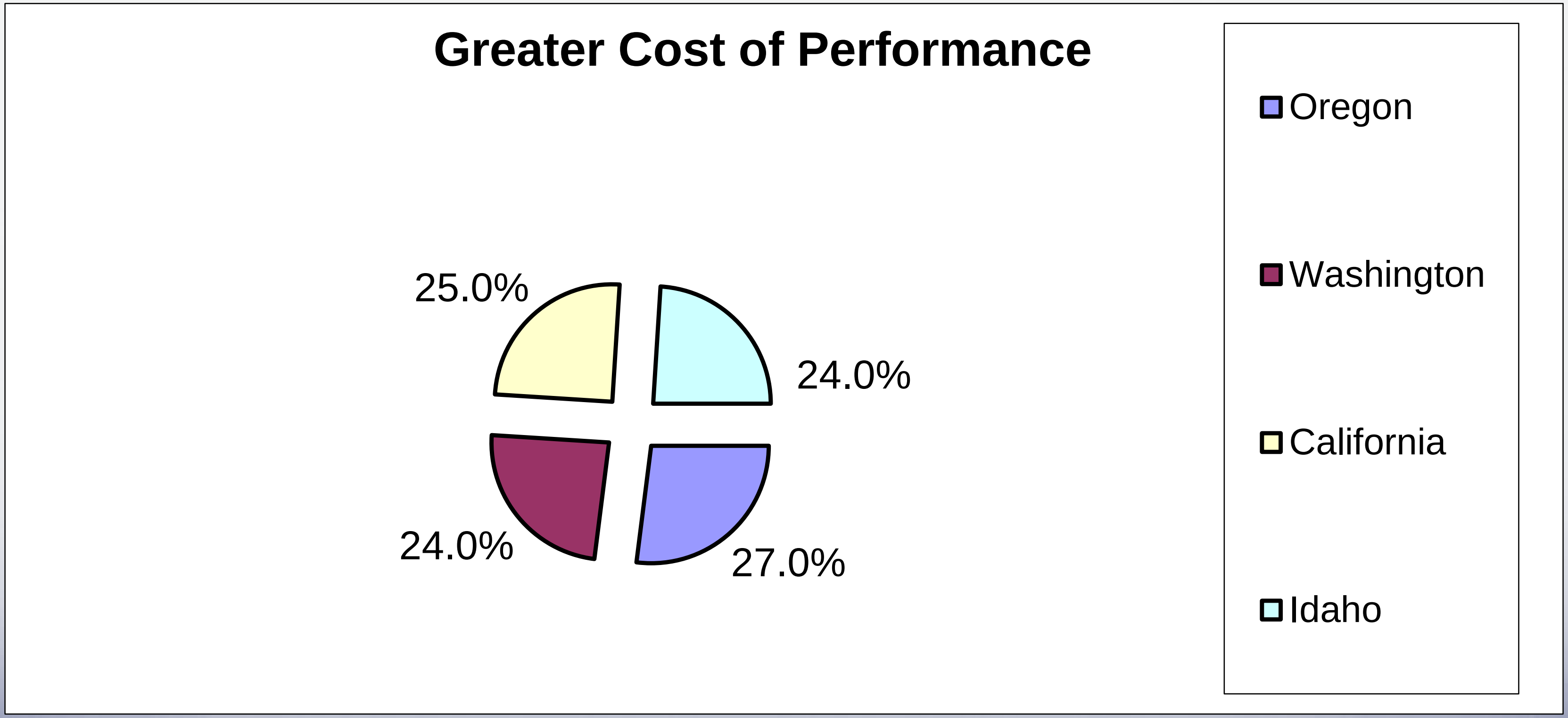
Generally reflects property/payroll activity

Sourcing Oregon Sales

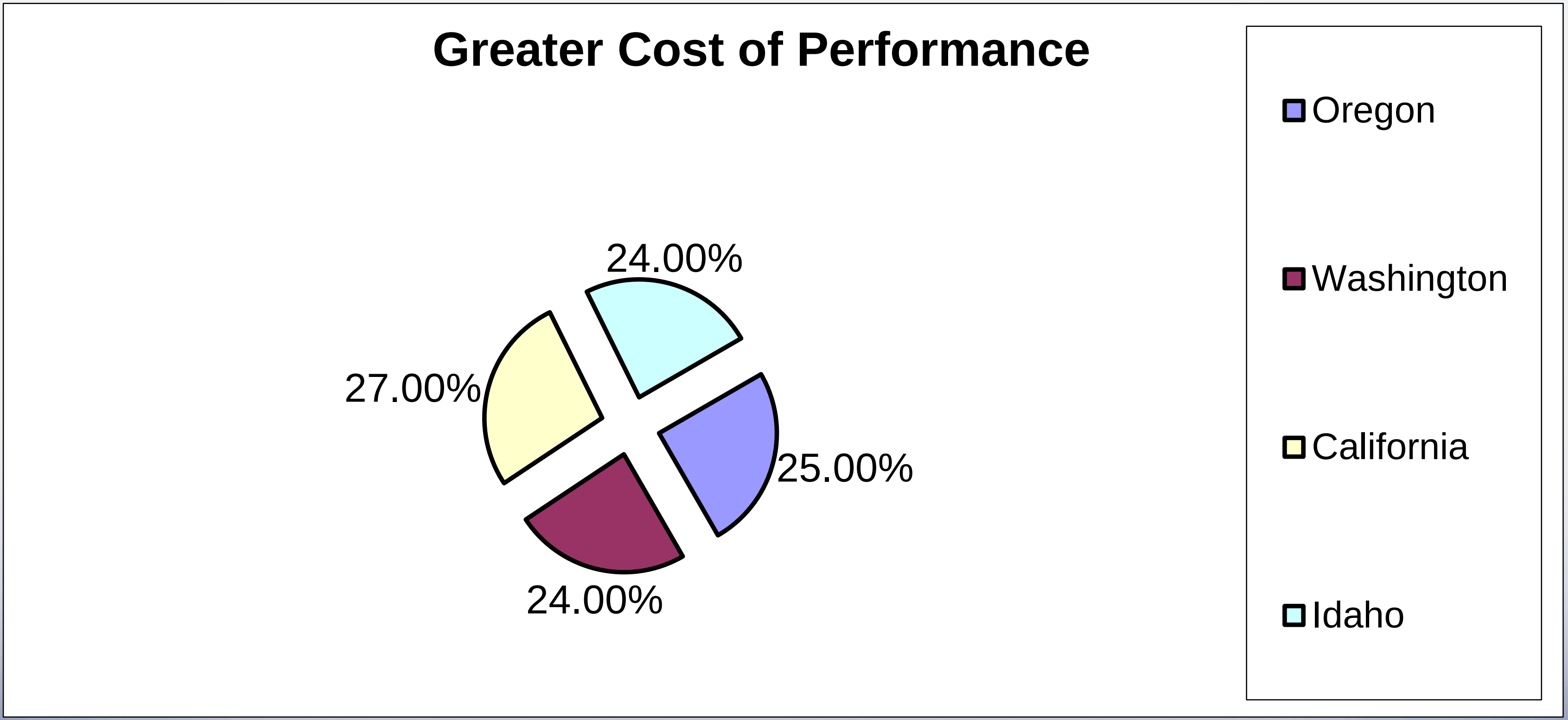
Unequal treatment between goods vs. service sectors

- Creates unequal treatment for determining excise and minimum tax due to Oregon
- Impacts tax compliance efforts
  - Different treatment provides legitimate tax planning opportunities
- Single Sales Factor magnifies impact
  - All or nothing sourcing for services/intangibles

Example 1


Greater Cost of Performance
25.0%
24.0%
24.0%
27.0%
Oregon
Washington
California
Idaho

Example 2


Greater Cost of Performance
24.00%
27.00%
25.00%
24.00%
Oregon
Washington
California
Idaho

Example 3

Two Oregon-based corporations

Similar sales levels nationally and in Oregon

- Corporation ABC sells goods nationwide
  - Only 5% of customers are in Oregon
  - All goods are made in Oregon in a large plant employing 10,000 people.
- Corporation XYZ sells services nationwide
  - Only 5% of customers are in Oregon
  - Greater cost of performance is in Oregon due to the presence of a large call center employing 10,000 people.

Example 3

	Corp ABC	Corp XYZ
Net Income	-0-	-0-
Total Sales	$100 M	$100 M
OR Customer Sales	$5 M	$5 M
OR Sales - Min. Tax	$5 M	$100 M
Oregon Minimum Tax	$4 K	$100 K

(All figures in dollars)

- XYZ pays minimum tax on all sales nation wide because of how services are sourced (COP).

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Impact of Cost of Performance

- When UDITPA was drafted in the mid-50s, Single-sales factor apportionment not contemplated
- Globalization, services performed remotely
- Shift in economy from goods-driven to service-driven
- Full impact of change to Single-sales factor not fully realized
- Taxpayers increasingly attempting to source sales to other states based on COP

Impact of Cost of Performance

Non-Oregon Corporation with Oregon Sales

- May have substantial Oregon Sales
- Using COP may result in no Oregon sales for tax purposes because all sales sourced to another state
- Pays $150 minimum tax regardless of amount of Oregon sales

Impact of Cost of Performance

Oregon based Corporation with National Sales

- May have relatively small percentage of Oregon sales
- Reports all sales as Oregon sales using COP
- Pays minimum tax based on all sales for company including all sales outside of Oregon

States Responses

States are changing their laws to remove COP and source services/intangible sales based on market sourcing methods

- Where the service is delivered
- Where the benefit is received
- Location of the customer
- 18 states use market based sourcing

MTC Activity

Multistate Tax Commission Activity

- Adopted a model statute in 2014 that replaced COP with market based sourcing.

Special industry apportionment regulations

Financial institutions

Public utilities

Interstate Broadcasters

Measure 67

- Measure 67 created a “minimum tax”
  - Lowest: $150 for C-corporations with less than $500,000 in Oregon sales
  - Highest: $100,000 for C-corporations with Oregon sales of $100 million or more.

IP 28

Initiative petition currently circulating

- November 2016 Oregon ballot
- Amends minimum tax provisions
- Would magnify distortions caused by the Cost of Performance standard

Summary

Sourcing corporate tax receipts is unequal

- Goods/Tangible products – market based
- Services/Intangible property – COP based

Creates fairness issues for excise and minimum tax

- Oregon based companies can pay tax on all sales including sales outside Oregon
- Non-Oregon based companies with Oregon sales can pay no tax ($150 minimum tax)

Sales factor intended to reflect market

- Cost of Performance does not reflect market
- States and MTC are moving to market sourcing

Questions?

If you have additional questions after today please contact:

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