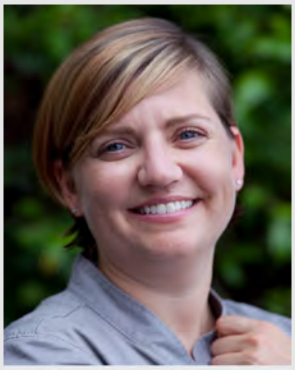
Oregon CAT Part I: Legislative Fixes Necessary for Administration

by Nikki E. Dobay



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In this article, Dobay cites issues with Oregon's new corporate activity tax, advocating that the legislature enact technical corrections such as a fiscal-year filing option and a water's-edge election to avoid significant compliance and administrative challenges.

I. Introduction

In 2019 the Oregon Legislative Assembly enacted a new corporate activity tax (CAT) to tackle education funding. Name notwithstanding, the CAT applies broadly to individuals as well as passthrough entities (and several other entity types). The tax will take effect January 1, 2020, and corporate taxpayers will be required to pay it in addition to the state's corporate excise tax.[1]

The legislature's long and winding road to the CAT is the result of an extraordinary political compromise,[2] which yielded a one-of-a-kind modified gross receipts tax incorporating elements of both the Ohio commercial activity tax and the Texas margins tax. This hybrid approach is sure to create new complexities not seen in either Ohio or Texas.

In conceiving this new and different tax, the legislature provided the Oregon Department of Revenue with less than eight months to implement it. By comparison, Ohio provided a five-year phase-in period, so the DOR has an incredibly heavy lift to meet this aggressive deadline. Nonetheless, the department has diligently worked on several fronts, opening up registration and releasing draft rules prior to January 1, 2020.

Because the legislature is slated to take up a technical corrections bill in 2020 (and likely future years as well), this article analyzes two critical issues that must be addressed during the 2020 session for the tax to be administrable: The state must provide a fiscal year filing option and a water's-edge election. To lay the foundation for the discussion of those issues, the article starts with a detailed overview of the Oregon CAT in its current form. Of course, there are still many other issues that must be addressed by rule or additional legislation. When this article was drafted, however, the DOR was still working on rules that are likely to address many of those

[1] Oregon's general corporate income tax is statutorily referred to as the Oregon corporate excise tax. *See* chapter 317 of the Oregon Revised Statutes.

[2] Although political compromise is not all that unusual and is in many cases desirable, the Oregon CAT is an imperfect hybrid of two competing proposals brought forth during the legislative session. On one side interested parties were advocating for an Ohio-style commercial activity tax, and on the other side were strong advocates for a business activity tax with a value-added tax base. The resulting CAT starts with Oregon-sourced receipts (like the Ohio tax) to which an apportioned subtraction is applied.

issues. Thus, this article is only one of many expected on the new Oregon CAT.

II. Overview of the Oregon CAT

A. Enactment of Legislation

On May 16 Gov. Kate Brown signed into law H.B. 3427, which established the CAT. Again, the term "corporate activity tax" is inaccurate since the tax applies to all entity types, including individual taxpayers.[3] Despite a topsy-turvy legislative session,[4] a technical corrections bill (H.B. 2164) was also approved and signed into law by the governor on July 23.

Although a ballot measure challenging the Oregon CAT was filed in May, its proponents abandoned their efforts following the passage of a trio of bills at the end of the session that would have made a successful challenge difficult.[5] Ultimately, no other challenges were filed and both bills went into effect on September 29, 2019 — 91 days after sine die.

B. Calculation — Taxable Commercial Activity

Considering H.B. 3427 and H.B. 2164 together (hereinafter referred to as the Oregon CAT legislation), the following is a high-level overview of the Oregon CAT calculation:

- The tax base is equal to a taxpayer's Oregon-sourced commercial activity less the statutory subtraction.[6]
- The statutory subtraction is equal to 35 percent of the greater of a taxpayer's cost inputs or labor costs apportioned to the state using Oregon's Uniform Division of Income for Tax Purposes Act provisions.[7]
  - Cost inputs are generally defined as federal costs of goods sold.[8]
  - Labor costs are capped at $500,000 per employee.[9]
  - The statutory subtraction includes some additional caps/exclusions, which will be discussed in more detail later.
- Tax is imposed at a rate of 0.57 percent on taxable commercial activity above $1 million plus $250.[10]

Each of these components is discussed in more detail later — in addition to nexus and reporting requirements provided by the Oregon CAT legislation.

As noted, the starting point for purposes of determining the CAT is Oregon-sourced commercial activity — much like Ohio's commercial activity tax.[11] This concept involves a two-step analysis. The first question is whether a receipt meets the definition of commercial activity. If the answer is yes, then a taxpayer must next determine whether that commercial activity will be sourced to Oregon.

Starting with the definition of commercial activity, the Oregon CAT legislation broadly defines the term as "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."[12] Although commercial activity is broadly defined, the Oregon CAT legislation includes a list of 47

[3] In all likelihood, the name "corporate activity tax" was chosen because it sounded more palatable to voters in a ballot initiative challenge.

[4] During Oregon's 2019 legislative session, Senate Republicans left the state twice to block various bills and proposals.

[5] On May 30, 2018, the Oregon Manufacturers and Commerce (OMC) filed ballot initiative 301, which would have put the Oregon CAT provisions before voters in November 2020. Note that H.B. 3427 also included personal income tax cuts and $1 billion in annual school funding. Those provisions were not included in OMC's ballot initiative. During the last two days of the 2019 session, however, the legislature passed the following bills: S.B. 116 (created a special election in January of 2020 for purposes of any ballot initiative related to the CAT); S.B. 212 (reconnected the personal income tax cuts with the CAT provisions for purposes of any ballot initiative); and S.B. 761 (altered signature requirements by prohibiting electronic signature sheets).

Finally, with the passage of technical corrections bill H.B. 2164, OMC would have likely needed to refer it to the ballot as well. Based on the uphill battle OMC was likely to face, it withdrew initiative number 301 in July of 2019.

[6] *See* definition of taxable commercial activity (H.B. 2164 section 50).

[7] H.B. 2164 section 53. Oregon's corporate excise (income) tax similarly adopts UDITPA. However, the excise tax apportions income, whereas the CAT apportions subtractions from gross receipts.

[8] *See* definition of cost inputs, which "means the cost of goods sold as calculated in arriving at federal taxable income under the Internal Revenue Code." (H.B. 2164 section 50.)

[9] *See* definition of labor costs, which "means total compensation of all employees, not to include compensation paid to any single employee in excess of $500,000." H.B. 2164 section 50.

[10] H.B. 3427 section 65.

[11] In fact, the definition of commercial activity — as well as the applicable exclusions — appear, for the most part, cut and pasted from the Ohio commercial activity tax statutes.

[12] H.B. 3427 section 58; H.B. 2164 section 50.

specific exclusion provisions. Some of the more noteworthy exclusions include:

- specific interest income;
- IRC 1221 or 1231 income (generally, capital gains);
- specific hedging transactions;
- principal loan repayments;
- trust contributions;
- compensation;
- proceeds from the issuance of the taxpayer's own stock;
- insurance proceeds or litigation damages unless for loss of business receipts;
- gifts or charitable contributions received;
- payments from an agent;
- specific tax refunds or reimbursements;
- contributions to capital;
- receipts from the sale of motor vehicle fuel, cigarettes, alcoholic beverages, etc. (that is, items otherwise subject to Oregon excise taxes);
- specific Medicare or medical assistance payments;
- dividends;
- distributions from passthrough entities;
- receipts to Oregon wholesalers that certify the property will be sold outside the state;
- wholesale or retail sales of groceries;
- specific fees, taxes, or charges being collected and remitted by utilities, telecoms, and other companies; and
- sales by farmers to an agricultural co-op.[13]

The Oregon CAT legislation further provides specific commercial activity definitions for financial institution and insurers.[14]

Assuming a taxpayer's receipts fall within the purview of the general definition of commercial activity and are not specifically excluded, then the taxpayer must determine where the commercial activity will be sourced. The Oregon CAT legislation specifically provides that commercial activity should be sourced as follows:

> "(a) In the case of the sale, rental, lease or license of real property to the extent the property is located in this state.
>
> (b) In the case of the rental, lease or license of tangible personal property to the extent the property is located in this state.
>
> (c) In the case of the sale of tangible personal property to the extent the property is delivered to a purchaser in this state.
>
> (d) In the case of the sale of a service to the extent the service is delivered to a location in this state.
>
> (e) In the case of the sale, rental, lease or license of intangible property, if and to the extent the property is used in this state."[15]

The CAT sourcing provisions generally align with the excise tax sourcing provisions for purposes of sourcing sales. For excise tax purposes, Oregon in 2018 moved to market sourcing for the sales of services and intangibles. Thus, several taxpayers have asked the DOR whether the market-sourcing rules for corporate excise tax purposes can be relied upon regarding the CAT. The department has indicated that it will use the excise tax sourcing rules (including the market-sourcing rules) where applicable. The DOR has not, however, provided guidance as to any specific rules that could be relied upon. Rather, the DOR has indicated that it intends to incorporate any applicable rules into the CAT rules — as opposed to merely incorporating any of those rules by reference. As of this writing, the department's timing regarding this rule was unclear but generally expected in early 2020.

Finally, a taxpayer may petition to use an alternative sourcing method if the general sourcing provisions do not "fairly represent the extent of a person's commercial activity attributable to the state."[16] Similar to the corporate excise tax alternative apportionment rules, an alternative apportionment request may be made by the taxpayer or the DOR. The CAT legislation provides the DOR with rulemaking authority

[13] *Id.*

[14] H.B. 3427 section 58; H.B. 2164 section 50. Specific issues related to financial institutions and insurers will not be covered in this article.

[15] H.B. 3427 section 66; H.B. 2164 section 54. The sourcing rules for financial institutions and insurers are particularly vague, providing that "commercial activity not otherwise described is sourced to Oregon if it is from business conducted in this state." *Id.*

[16] *Id.*

specifically related to the process by which a taxpayer can request alternative apportionment.[17]

C. Calculation — The Statutory Subtraction

Next, a taxpayer is required to calculate the statutory subtraction to determine whether there's a CAT liability. Again, the statutory subtraction is equal to 35 percent of the greater of a taxpayer's cost inputs or labor costs apportioned to the state using Oregon's UDITPA provisions.[18] As noted, cost inputs are generally defined as "the cost of goods sold as calculated in arriving at federal taxable income under the Internal Revenue Code."[19]

This definition was amended in the technical corrections bill (H.B. 2164). The specific reference to IRC section 471 was deleted and replaced with the general reference to cost of goods sold (COGS) as determined under the IRC. This change was made based on a recognition that only some taxpayers can claim a COGS deduction under IRC section 471, and that other IRC provisions provide deductions similar to the COGS deduction in IRC section 471. The reference to the federal COGS number does seem to indicate that the legislature intended a taxpayer to pull that number directly from its federal return — at least as a starting point — to ease compliance and administration. This helpful concept, however, quickly becomes ineffective because a large taxpayer's Oregon filing group will typically differ from its federal consolidated return group.

Labor costs are defined as "total compensation of all employees, not to include compensation paid to any single employee in excess of $500,000."[20] The CAT legislation does not provide a definition of who is an employee, and the DOR has not specified whether a deduction may be taken for indirect employee compensation. The department has indicated it will broadly interpret compensation to include fringe benefits and 401(k) expenses.

The cost inputs or labor costs amount is subject to a reduction for exclusions or capped by the taxpayer's Oregon commercial activity. First, the statutory subtraction may not include any expenses related to items excluded from the definition of commercial activity.[21] While understandable in theory, the practical implementation of this exclusion is extremely challenging in many situations and nearly impossible in others. And finally, the CAT legislation provides that a taxpayer's statutory subtraction may not exceed 95 percent of its Oregon commercial activity.[22] Although this last restriction seems unnecessary since the statutory subtraction is capped at 35 percent and is then apportioned, it may be mathematically possible for a significant loss company to potentially hit this 95 percent cap.[23]

Finally, once the taxpayer has determined its cost inputs or labor costs (subject to all exclusions and/or the 95 percent cap), it must then apportion that amount to determine its final statutory subtraction. The CAT legislation references Or. Rev. Stat. sections 314.605 through 314.675, which provide corporate excise tax apportionment rules. Under these provisions, Oregon generally requires a taxpayer to use a single-sales-factor apportionment formula, and as of 2018 has implemented market sourcing for purposes of sourcing services and intangibles. Considering the plain language of the CAT legislation, it appears a taxpayer must use the apportionment factor calculated to determine its corporate excise tax liability.

Interestingly, the DOR recently said publicly that it believes a different apportionment factor should be used: a factor equal to Oregon commercial activity over everywhere commercial activity. That requirement seems beyond the clear statutory language. Further, this particular rule seems designed to ease compliance by using the existing factor where applicable, as opposed to recomputing the factor calculation. Thus, the

[17] *Id.* Also, the DOR is authorized to provide specific alternative sourcing methods that might apply to financial institutions and insurers.

[18] H.B. 2164 section 53.

[19] H.B. 3427 section 58; H.B. 2164 section 50.

[20] *Id.*

[21] The exclusion of cost inputs or labor costs related to non-commercial activity was added with H.B. 2164 section 53.

[22] H.B. 3427 section 64; H.B. 2164 section 53.

[23] For example, a taxpayer with $100,000 in Oregon-sourced commercial activity and a 10 percent Oregon apportionment factor ($1 million in total sales) would hit the 95 percent cap when its cost inputs or labor costs exceed $2.72 million.

DOR's position seems beyond the scope of its authority.

D. Calculation — Oregon CAT Liability

To determine its CAT liability, the taxpayer is required to reduce the amount of its Oregon commercial activity by its statutory subtraction. The CAT legislation refers to the resulting amount as "taxable commercial activity."[24] Assuming the taxpayer's taxable commercial activity exceeds $1 million, the CAT is determined by applying a 0.57 percent rate to the amount in excess of $1 million, and then adding $250.[25]

E. Administration — Who Is Subject to the CAT?

The CAT legislation provides that the CAT "is imposed on each *person* with taxable commercial activity for the privilege of doing business in the state."[26] The term "person" is broadly defined to include all entity types including but not limited to individuals, "combinations of individuals in any form," passthrough entities, limited liability companies, joint ventures, etc.[27] — essentially, everyone!

F. Administration — Nexus

To determine nexus, the Oregon CAT legislation essentially borrowed the factor presence provisions from Ohio's commercial activity tax laws.[28] Thus, a taxpayer is deemed to have nexus where a person owns or uses capital within the state, has registered with the secretary of state to do business in the state, has "bright-line" factor-presence nexus in the state, or otherwise has nexus to the extent allowed by the U.S. Constitution.[29] Bright-line factor-presence nexus will apply to a person with at least $50,000 of property or payroll within the state, or at least $750,000 of Oregon-sourced commercial activity.[30]

G. Administration — Who and What Is Required to Be Reported

Note that the Oregon CAT economic nexus provision provides that a taxpayer has nexus for purposes of the CAT with only $750,000 of Oregon-sourced commercial activity, but that a taxpayer does not have a CAT liability until its taxable commercial activity exceeds $1 million. This disparity complicates the CAT reporting requirements, resulting in three potential situations.

First, a taxpayer is required to register with the DOR if it has Oregon commercial activity of at least $750,000.[31] A taxpayer with this level of commercial activity is nonetheless required to register *annually* even if no CAT liability is due, and the failure to register could result in a monthly penalty of $100 per month — capped at $1,000 per year.[32]

Next, a taxpayer with more than $1 million of Oregon commercial activity is, in addition to registering, required to file an annual return by April 15 each year.[33] As with the registration requirement, this return filing requirement is imposed regardless of whether the taxpayer actually has a CAT liability for the year. DOR staff have indicated they intend to provide by rule an extension of at least six months, and that they may be willing to provide a seven-month extension.[34]

Finally, a taxpayer with a CAT liability — meaning its Oregon commercial activity less its statutory subtraction exceeds $1 million (that is, the taxpayer has taxable commercial activity in excess of $1 million) — is required to make quarterly estimated payments of the tax in

[24] H.B. 3427 section 58; H.B. 2164 section 50.

[25] *See* Appendix A for a simple example of the Oregon CAT liability calculation for a multistate taxpayer.

[26] H.B. 2164 section 52.

[27] H.B. 3427 section 58; H.B. 2164 section 50.

[28] Ohio Rev. Code Ann. section 5751.01(H) (2009).

[29] H.B. 2164 section 52.

[30] *Id*. Also, a resident or domiciled corporation as well as a person with at least 25 percent of the person's total property, payroll, or commercial activity within the state will also be deemed to have nexus under the factor presence provision.

[31] H.B. 3427 section 68.

[32] *Id*.

[33] H.B. 3427 section 70; H.B. 2164 section 56.

[34] Although a six-month extension is generally sufficient, with the federal corporate filing extended due date moving to October 15, a seven-month extension would be more appropriate. Specifically, because the Oregon CAT does incorporate federal COGS concepts as well as the requirement that the statutory subtraction be apportioned.

addition to its other registration and return filing requirements.[35] Those payments are statutorily scheduled for January, April, July, and October.[36]

H. Administration — Group Filing Requirements

The Oregon CAT must be calculated on a mandatory unitary combined basis for affiliated entities.[37] A unitary group is defined as "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."[38] The definition of a unitary business appears to be modeled after the Multistate Tax Commission's model definition that specifically references centralized management, centralized administrative functions that result in economies of scale, as well as functional integration.[39] Note that the Oregon CAT legislation includes an "or" — as opposed to an "and" — as the conjunction as it relates to the these concepts, meaning a unitary relationship will be found where only one of the three exists.[40]

Further, the CAT legislation contains no specific provisions that limit the application of the CAT to the water's edge. The DOR has also verbally stated that they interpret the CAT legislation to require mandatory unitary worldwide combined filing. Although requiring the Oregon CAT to be computed on a worldwide basis is a disturbing policy position for the state to take generally, it is difficult to disagree with the DOR's position based on the lack of specific statutory language limiting the CAT's application to the water's edge. Assuming that was the legislature's intent, Oregon would be the only state to require worldwide combined filing without offering a water's-edge election for all types of taxpayers. This position will also create significant technical challenges for taxpayers and the department as they try to comply with and administer the CAT, respectively, which will be discussed in more depth below.

When a group of affiliated entities is determined to be unitary, intercompany transactions or "receipts from transactions among [the group's] members" will be excluded.[41] Also, a unitary group's statutory subtraction cannot include expenses related to receipts from transactions that are otherwise excluded under this intercompany exclusion provision.[42]

I. Miscellaneous — Use Tax Provision

The CAT legislation also requires a taxpayer to "include as taxable commercial activity the value of property the person transfers into [the] state for the person's own use in the course of a trade or business within one year after the person receives the property outside of the state" — unless the DOR or the taxpayer shows the transfer was not intended to avoid the Oregon CAT.[43] Essentially, this provision acts as somewhat of a "use" tax — an odd concept for an entity-level tax, as opposed to a transaction-based tax. This provision, however, is taken directly from the Ohio commercial activity tax statutes.[44]

As the CAT legislation went through the Oregon legislature, this provision got a lot of attention, including an unsuccessful push to remove it. The issue continues to cause taxpayers significant consternation as they anticipate how the DOR might administer the provision. The DOR has said publicly that it intends to use it as an antiavoidance provision, which is consistent

[35] H.B. 3427 section 70; H.B. 2164 section 56. Note: The Department's draft OAR 150-317-1300 provides that estimated payments will only be required if a taxpayer's estimated CAT liability is $5,000 or more.

[36] H.B. 3427 section 70; H.B. 2164 section 56.

[37] H.B. 3427 section 60.

[38] H.B. 3427 section 58; H.B. 2164 section 50.

[39] H.B. 3427 section 58; H.B. 2164 section 50.

[40] Although this may seem odd and potentially unconstitutional to some, Oregon has previously sidestepped this issue in *Rent-a-Center Inc. v. Department of Revenue*, TC-MD 111031D (May 12, 2014). The court in *Rent-a-Center* provided that "ORS 317.705(3)(a) was amended in 2007 . . . the word 'and' was replaced by 'or' in the list of requirements that explain how the 'sharing or exchange of value' was demonstrated." *Id*. at 11. The court noted that where previously an "and" had been used, all three factors were required to be present; however, with the amendment of "and" to "or," only one factor is required. Because the tax year at issue in the case was 2003, the question whether requiring only one factor is constitutional was not at issue in the *Rent-a-Center* case, and to date that issue has not been the subject of litigation in another Oregon case.

[41] H.B. 3427 section 60.

[42] The exclusion for expenses related to intercompany transactions that are otherwise excluded was added with H.B. 2164 section 53.

[43] H.B. 3427 section 61; H.B. 2164 section 51.

[44] Ohio Rev. Code Ann. section 5751.013 (2009).

with how Ohio administers its statutory provisions.[45]

III. Critical Issues Requiring Legislation in 2020

Since the adoption of the Oregon CAT legislation, two technical issues have risen to the top of the Council On State Taxation's priority list of issues that will cause significant compliance and administrative problems. The first relates to the lack of uniform terminology in the CAT legislation regarding the period when the CAT will be calculated, while the second involves lawmakers' failure to include a water's-edge election.

A. Fiscal Year Filing Issue

The plain language of the CAT legislation is ambiguous as to whether the tax must be calculated and reported on a calendar-year basis. This issue has two components: first, whether the CAT legislation allows a taxpayer to calculate and report its CAT liability on a fiscal-year basis; and, second, what consequences might taxpayers face if they are required to file on a calendar-year basis.

Turning to the second issue first, taxpayers that file on a fiscal-year basis for federal income tax purposes are concerned they will not be able to use their fiscal-year information to calculate and report their Oregon CAT liability. This is a practical compliance/administration issue as opposed to a policy or legal issue.

Practically, taxpayers that file their federal returns on a fiscal-year basis do not prepare, maintain, or keep tax information on a calendar-year basis. Although there may be some information that can be obtained for different filing periods (that is, monthly, quarterly, or a calendar year), the information required to calculate the CAT — specifically the statutory subtraction information — does not fall within that category.

Because the statutory subtraction is based on federal COGS and requires Oregon apportionment information, taxpayers that calculate their federal and state income taxes on a fiscal-year basis do not have that information until their fiscal year ends — when they have closed their books for financial accounting purposes. Thus, a fiscal-year taxpayer is unable to calculate a calendar-year tax for a return due in April. Even if an extension is provided until October or November for purposes of preparing the return, a fiscal-year taxpayer will still not have the necessary information to prepare an accurate return until the close of its fiscal year, which will likely happen at a later date.

Aside from the practical issue, the Oregon CAT legislation seems sufficiently ambiguous to allow a taxpayer to take a position that it could use its fiscal-year information to calculate and report its CAT liability. Unfortunately, the DOR adamantly disagrees and has consistently hardened its position that the CAT must be calculated and reported on a calendar-year basis.

The DOR's intransigence on this issue is difficult to understand. Again, the CAT legislation is ambiguous at best. First, the bills vacillate between the use of "calendar year" and "tax year." To illustrate, H.B. 3427 section 65 requires the calculation of the CAT on a calendar-year basis, while section 59 requires a "taxpayer's method of accounting for commercial activity, cost inputs and labor costs for a *tax year* shall be the same as the taxpayer's method of accounting for federal income tax purposes for the taxpayer's *federal tax year* that includes the *tax year*" (emphasis added). Also tax year is not defined in the CAT legislation, and H.B. 3427 section 74(2) provides that any term not defined in the CAT legislation shall have the same meaning as provided in Or. Rev. Stat. chapters 305, 314, 316, or 317. Or. Rev. Stat. section 314.085 provides that "the taxable year of a . . . taxpayer shall be the same as its taxable year for federal income tax purposes." Further, Or. Rev. Stat. section 314.011 references the IRC for any term not specifically defined. None of these provisions were amended with H.B. 2164.

The use of both terms muddies the water. And while the DOR's desire to take a conservative position is understandable, it's impractical. As noted, fiscal-year taxpayers simply will not have the information necessary to calculate their Oregon CAT properly even at the time the extended return is due. Thus, those taxpayers will

[45]Note: The Department's draft OAR 150-317-1130 does not explicitly provide that this provision is only to be used on audit. COST has provided comments urging the Department to amend its rule to explicitly provide as such.

likely be required to file amended returns to calculate the proper amount of CAT due after their books have closed.

Although the state and DOR may not have much sympathy for taxpayers being required to do twice the work, this issue will arguably create twice the administrative work for the department and will raise a host of unintended consequences on audit. Regarding administration, assuming fiscal-year taxpayers will file amended returns annually to ensure the CAT computation is correct, the DOR in turn will be required to process those original and amended returns as well.

What's more, if a calendar-year calculation is required, the DOR will have nothing to cross reference a fiscal-year taxpayer's COGS deduction or apportionment information to. Cross referencing the COGS deduction to the federal return is a key element of this tax. If the department is not able to tie fiscal-year taxpayers' COGS numbers to their federal returns, they will also need additional expertise to audit the federal COGS number. Forcing DOR employees to separately audit a number intended to be derived from the federal COGS number on a calendar-year basis is incongruent and ineffective. This is especially true since there is an easy and effective solution to the issue.

Assuming the DOR believes its hands are tied on this issue, it is incumbent upon the legislature to address this issue in a technical corrections bill. The amount of additional effort required by both taxpayers and DOR employees to properly calculate the CAT on a calendar-year basis for fiscal-year taxpayers is staggering — and for what? Allowing a taxpayer to use prior-year information or aligning the estimated payment and return due dates with the taxpayers' Oregon corporate excise tax due dates should not affect the amount of CAT due. It would simply make the calculation of that tax much simpler and more accurate. Voluntary compliance is the backbone of our U.S. tax system, so why make that more difficult for taxpayers?

And finally, a legislative fix is very simple, and the Texas margins tax provides a model to follow. In Texas, fiscal-year taxpayers are able to use their fiscal-year information for the fiscal year ended during the prior calendar year period to calculate their Texas margins tax liability. To illustrate, an 11/30 fiscal-year filer would use its 11/30/2019 fiscal-year information to file its 2020 Oregon CAT return. Allowing fiscal-year filers to use prior-year information would be a significant improvement to the currently daunting filing requirements these taxpayers face. It would also provide greater efficiencies for the DOR in administration and subsequent audits. Thus, it is imperative for the legislature to make this much-needed change in 2020.

B. Failure to Provide a Water's-Edge Election

The second issue that must be addressed in 2020 is the apparent requirement to calculate the Oregon CAT on a worldwide basis. As noted, it is difficult to argue with the DOR's position on this issue. Unlike the significant ambiguity of the fiscal-year filing issue, the Oregon CAT legislation's failure to reference the water's edge or provide any type of election makes it difficult to assert that the scope of this tax is limited as such.

However, the failure to include either a water's-edge election or a required limitation would seem to be an oversight — as opposed to a conscious imposition of mandatory unitary worldwide combined filing.[46] Further, the requirement to file on a worldwide combined basis makes considerably less sense as applied to a gross receipts tax.

To illustrate this point, consider a multinational company with several hundred affiliates: If all those entities meet the ownership requirement threshold and are unitary for Oregon purposes, then all those entities will be included in the CAT return if just one has Oregon nexus.[47] From a practical perspective, what if

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[46]That position would seem especially egregious as a policy matter when considering Oregon's requirement that only one of the three unities must be met for determining when a unitary relationship exists.

[47]It is important to note that while COST is advocating for a water's-edge election, it does not concede that Oregon's current statutory provisions would pass constitutional muster if challenged. Essentially, the Oregon CAT legislation relies on the unitary concept to create nexus in many situations. Although the unitary concept makes sense conceptually for corporate income tax purposes, it breaks down when applied in the gross receipts tax context. Also, it was never meant to be applied for purposes of determining when affiliated entities would otherwise have nexus with a state. Thus, it is COST's position that the current unitary filing requirements are likely problematic on several levels.

within this multinational group only a handful of entities filed U.S. federal income tax returns and the majority did not? And what if the non-U.S. entities did not sell into the United States, which would be a typical multinational structure? Assuming these are a taxpayer's facts, it appears that entities that do not file a U.S. federal income tax return would be required to calculate a federal COGS number and Oregon apportionment factor to determine the group's statutory subtraction. This is yet another compliance issue that taxpayers and the DOR (which would be required to audit that number) will face without a legislative fix.

In addition to the added administrative burdens, it is unclear whether worldwide filing will result in any significant additional state tax revenue. Again, considering the multinational company example above, if properly structured it is likely that the non-U.S. entities will have no U.S. sales. If that is the case, then the company's starting point for purposes of determining the Oregon CAT would remain the same (that is, it would include the Oregon-sourced commercial activity of the domestic affiliates only). For purposes of determining the statutory subtraction, the group's cost inputs (that is, federal COGS) or labor costs would increase based on its worldwide information; however, the group's apportionment factor would be diluted based on the inclusion of the non-U.S. affiliate's sales going into the denominator of the group's factor. In most cases this convergence is likely to result in either a minimal increase or decrease in the statutory subtraction.

In other words, although this could benefit the state in some situations (that is, the statutory subtraction would decrease based on the apportionment-factor dilution), it seems equally probable that the statutory subtraction might rise based on the increased inputs or labor costs when calculated on a worldwide basis. Thus, if the inclusion of non-U.S. affiliates is unlikely to increase the starting point for the Oregon CAT, and if it is plausible that the inclusion of the non-U.S. affiliates may increase a taxpayer's statutory subtraction, the increased compliance/ administration costs make little to no sense. Why would the state ask taxpayers or its own DOR to jump through these significant additional compliance hoops for little or no additional revenue?[48]

Further, the inclusion of a water's-edge election would not preclude Oregon from asserting that a non-U.S. entity (either affiliated to a group otherwise subject to the CAT or a non-affiliated entity) that otherwise meets the economic nexus provisions would be separately subject to the tax. Inclusion of a water's-edge election does not prevent the state from otherwise arguing that a foreign or non-U.S. taxpayer that makes sales into Oregon that meet the nexus threshold (above $750,000) is subject to the CAT.[49] Rather, the inclusion of a water's-edge election both aligns Oregon with other states that provide such an election, and eases the administrative burdens taxpayers will experience if required to calculate the statutory subtraction on a worldwide basis.

Even if the practical implications were not so daunting, mandating worldwide combined filing in some situations may violate constitutional requirements. Although mandatory worldwide combined reporting has been upheld as constitutional,[50] that was in a corporate income tax context. And depending on a taxpayer's facts and circumstances, a court could find that a modified gross receipts tax imposed on a worldwide basis distinguishable. This could be exacerbated in Oregon's case, where the state's position is that only one of the three unities is required to create a unitary relationship. Again, considering the aforementioned multinational company example, it seems astonishing that several hundred entities might be required to file a CAT return based on merely one entity within the group meeting the state's nexus threshold. Putting aside the potential tax liability for non-U.S. companies, the potential compliance burden would be significant. While the Oregon CAT legislation is not likely to be found unconstitutional per se, there is a

48 *See* Appendix B for a detailed calculation and further discussion of this issue.

49 The state's ability to enforce the collection of the tax may be another matter, but that issue exists for all states attempting to assert nexus over non-U.S. entities for various taxes. While this area has yet to be substantially developed, one might assume that is likely to change as more states adopt economic or factor-presence nexus standards for taxes other than retail sales taxes.

50 *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

significant risk that, as applied to some taxpayers, the tax is unconstitutional.

Finally, without a water's-edge election, Oregon would be an extreme outlier among states since it would be the only state mandating worldwide unitary combined filing for all taxpayers. And none of the other states that impose a gross receipts or modified gross receipts tax require worldwide combined filing.[51] Moreover, all states that impose a corporate income tax on a worldwide basis (in which combined filing at least makes conceptual sense) provide a water's-edge election for most taxpayers.[52] The states and the water's-edge election have a long history, which ultimately ended with the states conceding on the issue based on pressure from the federal government following proposed retaliation by the some of the United States' closest trading partners.[53]

To avoid potential risks of litigation and backlash from our nation's trading partners and the federal government, as well as to ease the administrative burdens faced by multinational companies and the DOR, Oregon legislators should prioritize amending the CAT in 2020 to provide for a water's-edge election. Considering the legislature's unitary filing mandate appears to be modeled after the MTC's combined filing model, this change could be implemented by adopting the MTC model's water's-edge election.[54] The MTC water's-edge election is binding for seven years and provides the state taxing agency with the general authority to reject a taxpayer's election when it believes the ability to collect the tax would be impeded. Thus, the state would still have significant discretion to preclude the use of such an election when it concludes that a taxpayer attempted to make such an election to avoid tax.

IV. Conclusion

The new Oregon CAT will likely spark endless discussion in the state and local tax world in 2020 and beyond. For taxpayers trying to comply with this new tax, however, the ability to calculate it in a reasonably efficient manner is particularly important. This is especially true for large multijurisdictional (and multinational) taxpayers. Thus, it is critically important for the legislature to enact technical corrections in 2020 to allow for a fiscal-year filing option and a water's-edge election to avoid significant compliance and administrative challenges for taxpayers and the DOR. While these are by no means the only issues that require legislative fixes and administrative guidance, they should be front and center on the legislature's 2020 priority list.

Appendix A

Facts: Company selling tangible personal property in Oregon and Washington.

- $100 million (total commercial activity)
  - $75 million in Oregon sales
  - $25 million in Washington sales
- $50 million cost inputs
- $25 million labor costs

[51] Nevada and Washington require separate filing. Although Ohio allows a taxpayer to make federal consolidated elections, separate filing is the default rule. Texas required combined unitary filing but excludes some foreign entities (80/20 companies).

[52] There are exceptions in states such as Alaska and Montana, where companies in some industries (e.g., oil and gas) are required to file on a worldwide basis.

[53] In the 1980s, worldwide combined reporting became a national issue following the *Container Corp.* case. From foreign nations' perspective, worldwide combination was viewed as states attempting to tax overseas activities, and to place on foreign companies doing business within the United States a burden that was not placed on U.S. companies operating abroad. In 1985 the United Kingdom approved legislation that would have allowed the U.K. Treasury to penalize multinational groups of companies with operations in any U.S. state that employed worldwide unitary combination. Similarly, many Japanese businesses announced that they would not locate or expand operations in any state that applied worldwide combination.

As a result, worldwide combination was thoroughly analyzed (in the 1980s) by the Department of the Treasury's Worldwide Unitary Taxation Working Group, which was commissioned by President Ronald Reagan. The working group included representatives of the federal government, state (both legislative and executive branches), and the business community. In the working group's final report to the president (July 31, 1984), Treasury Secretary Donald Regan noted that the panel agreed on principles that should guide state taxation of the income of multinational corporations, including that states should provide a water's-edge election for both U.S.- and foreign-based companies. Also, Regan recommended that federal legislation be enacted to preclude mandatory worldwide combined reporting should the states fail to resolve the issue on their own.

[54] *See* section 5 of the MTC Proposed Model Statute for Combined Reporting, as approved on August 17, 2006, and amended on July 29, 2011. Note that subsections ii through vii should be analyzed in relationship to the Oregon CAT to ensure they make sense in this context.

Oregon-sourced commercial activity	$75,000,000
Statutory subtraction calculation — 35% of COGS	$17,500,000
Statutory subtraction calculation — apportionment factor	35%
Total statutory subtraction	$13,125,000
Taxable commercial activity	$61,875,000
CAT liability — 0.57% x all taxable commercial activity > $1 million	$346,987.50
CAT liability —+ $250	$250
Total CAT liability	$347,237.50

Appendix B

An example of a calculation of the Oregon CAT liability with and without a water's edge election. Considering our multinational company above, assume the following additional facts:

- The company's sales information:

Oregon sales	$10 million
U.S. sales	$150 million
Worldwide sales	$2 billion

- All of the company's U.S. sales are made through U.S. affiliates.
- The U.S. affiliate's federal COGS is $25 million.
- Assuming the company's federal COGS determined on a worldwide is on par with its U.S. COGS, the total worldwide COGS would be approximately $333 million.[55]
- The Oregon consolidated filing group apportionment factor for corporate excise tax purposes is 7 percent ($10 million (Oregon sales)/$150 million (everywhere U.S. sales)).
- The company's Oregon apportionment factor determined on a worldwide basis would be 0.5 percent ($10 million (Oregon sales)/ $2 billion (everywhere worldwide receipts)).

[55] This number was extrapolated by taking the company's federal cost of goods sold number over its total U.S. sales ($25 million/$150 million), which equals 17 percent, and applying that percentage by the company's worldwide sales of $2 billion. This of course is a rough estimation for purposes of this example, and a company's specific information is likely to vary widely.

- The company's statutory subtraction calculation:

	Water's-Edge	Worldwide
COGS	$25 million	$333 million
35% cap	$8.75 million	$116.6 million
Apportionment factor	7%	0.5%
Total subtraction	$583,333	$583,333

- The Oregon CAT liability calculation comparison:

	Water's-Edge	Worldwide
Oregon source commercial activity	$10 million	$10 million
Statutory subtraction	$583,333	$583,333
Oregon CAT base	$9.4 million	$9.4 million
Oregon CAT base less $1 million	$8.4 million	$8.4 million
Oregon CAT rate	0.57%	0.57%
$8.4 million x Oregon CAT rate	$47,975	$47,975
Additional Oregon CAT	$250	$250
Total Oregon CAT liability	$48,225	$48,225

In this example, neither the starting point for the CAT nor the statutory subtraction changes. The math to get to the statutory subtraction under the two circumstances did change. For purposes of the water's-edge election calculation, the subtraction was equal to $25 million (federal COGS) x 35 percent x 7 percent (group's Oregon apportionment factor). For purposes of the worldwide calculation, the subtraction was equal to $333 million (federal COGS determined on a worldwide basis) x 35 percent x 0.5 percent (group's Oregon apportionment factor recalculated on a worldwide basis).

For most taxpayers, facts and circumstances would result in either a positive or negative variation to the statutory subtraction. Nevertheless, this example clearly illustrates the flaws in requiring a gross receipts-based tax to be calculated on a worldwide basis. Thus, the increased compliance and administrative issues are simply not worth the state's or taxpayers' time or money. ■

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February 5, 2020

VIA EMAIL

Re: COST's Letter re: H.B. 4009 before the House Committee on Revenue

Dear Chair Nathanson, Vice-Chairs Marsh and Werner Reschke, and Members of the Committee:

I am writing on behalf of the Council On State Taxation (COST)[1] regarding H.B. 4009, which if enacted would make technical corrections to the newly enacted Oregon Corporate Activity Tax (Oregon CAT). As passed in 2019, the Oregon CAT requires technical fixes to provide for ease of compliance and administration. It is our understanding that H.B. 4009 as introduced continues to be a work in progress; thus, we offer the following preliminary comments to the Committee as it considers technical corrections to the Oregon CAT:

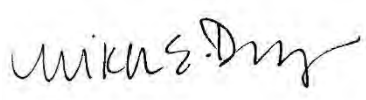
- The ratio for apportioning the statutory subtraction (*i.e.*, subtraction for a portion of cost inputs or labor costs) in H.B. 4009 section 3 should be rejected, as it is administratively burdensome and may dilute the statutory subtraction available for wholly in-state taxpayers.
- The penalty provisions in H.B. 4009 section 5 should be amended to provide clear penalty relief for taxpayers during the 2020 tax year based on the significant uncertainties faced by taxpayers as they determine their Oregon CAT liability and, for future years, penalty provisions should be aligned with the general penalty provisions found in O.R.S. § 314.400.
- A fiscal year filing option should be added to H.B. 4009, because requiring the calculation of the Oregon CAT, which includes an apportioned subtraction for many taxpayers based on federal cost of goods sold (COGS), is a significant burden and has received significant attention since the Oregon CAT legislation was passed last year.

[1] COST is a nonprofit trade association based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce, and today COST has an independent membership of approximately 550 major corporations engaged in interstate and international business representing every industry doing business in every state. COST members conduct substantial business in the state of Oregon, employ a substantial number of Oregon citizens, and own extensive property within the State. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities—a mission it has steadfastly maintained since its creation.

COST has been and will continue to work the Department of Revenue and other stakeholders on these as well as other issues and looks forward to providing more detailed comments and insights on technical amendments as H.B. 4009 develops.

COST fully supports the Committee's work on this bill, and please do not hesitate to reach out if you have any additional comments.

Sincerely,



Nikki Dobay

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director

February 11, 2020

Chair Nancy Nathanson
House Revenue Committee
900 Court Street NE
Salem, OR 97301

RE: Support for the -13 Amendment to HB 4009 (Modified Group Election)

Chair Nathanson and Members of the Committee,

Thank you for the opportunity to submit these comments on behalf of the Smart Growth Coalition. We are grateful for the efforts of the Oregon Department of Revenue and committee staff to resolve this technical issue to the Corporate Activity Tax. We urge the adoption of the -13 amendment.

About the Smart Growth Coalition

Our coalition was formed in 1999 to add technical expertise to state legislative proceedings regarding proposed reforms to state tax laws affecting businesses who have made investments in jobs and capital projects in the state. Our members are unified in their commitment to sound tax policies that encourage investment in Oregon and provide technical simplicity and clarity to the state tax code.

Need for a Modified Group Election

There have been issues identified in the interaction between the definition of a unitary group (group of entities treated as a single taxpayer) and the statutory subtraction for taxpayers with entities outside the United States. Since ORS 317A.106 contains no language limiting the reach of the unitary group to entities with a connection to Oregon and the United States, the plain language of the statute appears to require worldwide combined filing on a mandatory basis. **This means entities without any connection to Oregon or the United States would be required to maintain books and records for the tax, despite not being subject to it.** This issue would be less concerning in a traditional gross receipts tax—a taxpayer would only need to account for the tax if they had taxable sales into the state—but the apportionment of the statutory subtraction creates substantial layers of complexity.

Consider, as an example, a taxpayer with an entity incorporated in Oregon and related entities incorporated and operating outside the United States. If the Oregon entity is the only unitary member with commercial activity sourced to Oregon, the other members of the unitary group would still be required to maintain a record of their commercial activity (as defined by Oregon) in their local jurisdiction to calculate the group's statutory subtraction. This is complicated further by the possibility those foreign entities may not be required to file a federal income tax return because of their structure. In that case, the foreign entity would be required to maintain books and records for the federal income tax, despite not being subject to it, for the sole purpose of accounting for a state tax it does not owe.

-13 Amendment Eases Tax Administration and Compliance While Maintaining Policy Intent

The -13 amendment is the byproduct of meetings between the Oregon Department of Revenue and taxpayers to address the administrative and compliance concerns of a worldwide unitary group. The amendment allows an election for the filing group to remove foreign entities without a connection to Oregon. If a foreign entity does not have any activity connected to Oregon, the law will allow an election for the group to remove the entity from the accounting requirements of the tax. If an entity does have activity connected to Oregon, the entity will remain in the unitary group. The election does not change the starting point for the tax (commercial activity sourced to Oregon) and **maintains the state's ability to try to collect tax from foreign entities selling into Oregon** while simplifying the process for computing and auditing the amount of tax to be paid.

We want to thank the committee staff, department, and other stakeholders involved in the process of addressing this technical issue. We encourage the committee to adopt the -13 amendment.

Sincerely,

Jeff Newgard

Jeff Newgard

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February 11, 2020

VIA EMAIL

Re: COST's Letter in Support of -10 and -13 Amendments to H.B. 4009 before the House Committee on Revenue

Dear Chair Nathanson, Vice-Chairs Marsh and Werner Reschke, and Members of the Committee:

On behalf of the Council On State Taxation (COST), I am writing in support of the -10 and -13 amendments to H.B. 4009. Both amendments make modifications to H.B. 4009, the Oregon Corporate Activity Tax (Oregon CAT) technical corrections bill, that would greatly ease administration for taxpayers subject to this new tax. These amendments are the result of a group effort by COST, the Department of Revenue, Committee staff, and other industry stakeholders -- an effort focused primarily on two specific issues, the Oregon CAT statutory subtraction and the required unitary filing group. COST is appreciative of the efforts of all involved, and the -10 and -13 amendments are a direct result of those efforts. Both amendments will ease the compliance burden of taxpayers subject to the Oregon CAT; thus, COST urges the committee to adopt both.

About COST

COST is a nonprofit trade association based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce, and today COST has an independent membership of approximately 550 major corporations engaged in interstate and international business representing every industry doing business in every state. COST members conduct substantial business in the state of Oregon, employ a substantial number of Oregon citizens, and own extensive property within the State. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities—a mission it has steadfastly maintained since its creation.

The -10 and -13 Amendments Address Much Needed

COST has previously pointed out that the Oregon CAT as passed in 2019 requires technical fixes to provide for ease of compliance and administration. Further, I addressed in depth two very specific technical issues in a State Tax Notes Article published on January 13, 2019 (see attached). COST is extremely pleased that both issues are addressed by the -10 and -13 amendments.

The -10 amendment specifically provides technical changes to the statutory subtraction (*i.e.*, 35% of the greater of cost inputs or labor costs) which address ambiguities and procedures that are unduly burdensome. The -13 amendment provides a solution to the provision requiring taxpayers to calculate the Oregon CAT on a worldwide basis, which is a significant burden without any significant benefit to the State. Because each amendment addresses a significant compliance burden for taxpayers, COST is fully supportive of both.

Conclusion

Again, COST thanks all stakeholders who were engaged in the process that led to these revisions, and urges the committee to adopt both amendments.

Sincerely,

Nikki Dobay

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director

Oregon CAT Part II: Fixes Still Needed to Ease Administration

by Nikki E. Dobay and Jeff Newgard

Nikki E. Dobay

Jeff Newgard

Nikki E. Dobay is senior tax counsel with the Council On State Taxation. She is a key member of COST's advocacy team covering 13 states, including Oregon, and regularly provides written comments to and in-person testimony before the legislatures of those states. She can be reached at ndobay@cost.org. Jeff Newgard is a lobbyist specializing in state and local tax in Oregon. He can be reached at jeff@peakpolicy.com.

In this article, the authors provide an update on technical issues regarding the Oregon corporate activity tax and discuss legislative activity on those issues during the 2020 short legislative session. They also provide political history and context to the discussion regarding these issues.

I. Introduction

Part I of this series on the Oregon corporate activity tax (CAT) urged lawmakers to address two specific technical corrections — the fiscal year filing issue and the worldwide filing requirement. Both issues were given consideration and ultimately addressed in H.B. 4009-A. Although that bill made it out of the House Committee on Revenue and had a strong chance of passing both chambers, it ultimately fell by the wayside when both chambers failed to obtain a quorum to conduct business. With the failure to H.B. 4009-A, the CAT continues to be extremely challenging for taxpayers to comply with and needs immediate technical fixes to function as intended by the legislature.

It is also worth noting that the impact of COVID-19 is casting even more uncertainty as to both the expected revenues and the process by which taxpayers may see these issues addressed. While understanding that the path forward is unclear, we nonetheless want to reiterate the significant administration and compliance issues that taxpayers face. Thus, this article is not meant to rehash the issues discussed in Part I, but rather to provide an update on the technical issues raised in that article, the legislative activity regarding those issues during the 2020 short legislative session, the need for the Department of Revenue to provide guidance, and the continuing need for lawmakers to enact corrective legislation.

II. Mechanics of the Oregon CAT

The Oregon CAT is now out of the bag! The CAT took effect January 1[1] and the first round of

[1] H.B. 3427 section 79 (2019); H.B. 2164 section 60 (2019).

estimated quarterly payments is due April 30.[2] As discussed in "Oregon CAT Part I: Legislative Fixes Necessary for Administration," the CAT is a modified gross receipts tax that incorporates features of both the Ohio commercial activity tax and the Texas margins tax.[3]

At a high level, the CAT is generally equal to 0.57 percent of a taxpayer's taxable commercial activity[4] over $1 million, plus $250.[5] Taxable commercial activity is equal to commercial activity[6] sourced to Oregon,[7] less 35 percent of the greater of a taxpayer's apportioned cost inputs or labor costs (referred to as the statutory subtraction).[8] Commercial activity is broadly defined to include all business receipts in the regular course of a taxpayer's trade or business without deduction;[9] however, the CAT provisions do include approximately 47 exclusions.[10]

The amount of a taxpayer's cost inputs equals a taxpayer's cost of goods sold (COGS) as determined for federal income tax purposes,[11] and a taxpayer's labor costs are limited to $500,000 per employee.[12] Finally, the statutory subtraction provision references Oregon's Uniform Division of Income for Tax Purposes Act provisions (Or. Rev. Stat. sections 314.605 to 314.675) for purposes of apportioning the statutory subtraction.[13]

Although the Oregon CAT is called a corporate activity tax, it applies broadly to all entity types[14] and is required to be filed and computed on a mandatory unitary combined basis.[15] Individuals, partnerships, and other entities specified in the definition of a "person" and not otherwise excluded are also required to be included in the combined filing group, assuming they are unitary.[16] Finally, because the CAT provisions do not distinguish between domestic (U.S.) and foreign (non-U.S.) entities, that calculation appears to be required on a worldwide basis.

III. Need for Technical Corrections

A. Preparing for Technical Corrections

Over the days, weeks, and months since the enactment of the Oregon CAT, the taxpayer community has been trying to make sense of its statutory provisions. Discovering substantial statutory irregularities unintended by the legislature, we quickly approached the governor's office, legislature, and the DOR to highlight the most pressing concerns (as outlined in Part I) and began working on a resolution.

In Oregon, the legislature convenes for only a 35-day short session in even-numbered years. These sessions are an opportunity for lawmakers to meet to balance the budget and make technical corrections to previously enacted policies. In practice, however, these have become abbreviated sessions featuring the same, if not more, of the political pressures of the regular five-month session. Because there would be a narrow window of time to craft a thoughtful response for any technical corrections, we knew we would have to work quickly.

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2 Or. Rev. Stat. section 317A.137(1). Since the publication of our first installment on this topic on January 13, 2020, chapter 8, Revenue and Taxation, of the Oregon Revised Statutes has been updated to include the corporate activity tax provisions in chapter 317A. *See* Nikki E. Dobay, "Oregon CAT Part I: Legislative Fixes Necessary for Administration," *Tax Notes State*, Jan. 13, 2020, p. 167.

3 For an in-depth discussion of the mechanics of the Oregon CAT, see Dobay, *supra* note 2, Section II.

4 Or. Rev. Stat. section 317A.100(16).

5 Taxpayers with less than $1 million of taxable commercial activity are not liable for the CAT but are required to register for and file an annual CAT return. Or. Rev. Stat. section 317A.125(2); Oregon Department of Revenue, "Corporate Activity Tax FAQ: Who is subject to the CAT?"

6 Or. Rev. Stat. section 317A.100(1)(a).

7 Or. Rev. Stat. section 317A.128.

8 Or. Rev. Stat. section 317A.119.

9 Or. Rev. Stat. section 317A.100(1)(a).

10 Or. Rev. Stat. section 317A.100(1)(b).

11 Or. Rev. Stat. section 317A.100(2). The DOR recently announced that a taxpayer that does not otherwise calculate COGS for federal purposes may nonetheless calculate a COGS number for purposes of the statutory subtraction in accordance with IRS Publication 538. (*See* Mar. 10 meeting video.) The DOR noted that labor expenses included in the federal COGS calculation were not required to be excluded for purposes of the CAT. *Id.*

12 Or. Rev. Stat. section 317A.100(12). Note: The DOR has issued guidance providing that a partnership's guaranteed payments do not constitute compensation for purposes of determining a taxpayer's labor costs. *See* Temporary Or. Admin. R. section 150-317-1220.

13 Or. Rev. Stat. section 317A.119(2).

14 Or. Rev. Stat. section 317A.100(14).

15 Or. Rev. Stat. section 317A.106.

16 Or. Rev. Stat. section 317A.100(4) and (17)(a).

B. Administrative Guidance and Rulemaking

Meanwhile, the DOR was required to rely on the existing statutory language to draft its regulatory guidance. Starting on January 1, the DOR began releasing a series of temporary administrative regulations outlining its interpretation and methods for administering the CAT.[17] Much of the guidance was noncontroversial. For example, the DOR used definitions like those from the Oregon corporate income[18] tax regime for substantial nexus and unitary groups, and from the market-based sourcing regime for purchases other than tangible personal property.

Other rules, however, were a surprise. In particular, the DOR's temporary rule for computing the statutory subtraction (Temporary Or. Admin. R. section 150-317-1200 — Cost Input or Labor Cost Subtraction) requires an apportionment method referred to as the "commercial activity ratio" to be used by all taxpayers. This ratio is calculated as a fraction, in which the numerator is equal to a taxpayer's taxable commercial activity sourced to Oregon and the denominator is equal to a "taxpayer's total commercial activity everywhere plus exclusions from commercial activity."[19]

This commercial activity ratio is perhaps the most perplexing deviation from our understanding of the tax as enacted. During the 2019 session, the legislature outlined the mechanics for the statutory subtraction as being "simple" because of its connection to the rules governing corporate income tax apportionment.[20] In other words, a taxpayer would *simply* multiply either its cost inputs or labor costs by its corporate income tax apportionment factor to determine the taxpayer's statutory subtraction. This was, at least for most who participated in the 2019 legislative process, the common understanding of the law.

The current nonconformity between the apportionment factor being used for purposes of a taxpayer's corporate income tax and the CAT creates a compliance nightmare for many taxpayers. For corporate income tax purposes, Oregon apportions income using a single sales factor method and market-based sourcing. Both concepts are commonly understood, and while still complex, most corporate taxpayers have devised a method to comply with such a regime. With this new "commercial activity ratio" a taxpayer would be required to keep an entirely new set of books and records based on Oregon's specific definitions of commercial activity, which, although similar to the sourcing rules for gross receipts for purposes of the corporate income tax, are not the same.

The DOR's temporary regulation also results in a potential reduction of the statutory subtraction for taxpayers selling solely intrastate (that is, non-multijurisdictional businesses). For such taxpayers, the reference to Oregon's UDITPA provisions would seem to indicate apportionment of the statutory subtraction was not required.[21] The DOR's temporary regulation, however,

[17] On January 1, 2020, the DOR released the following temporary regulations. All references in this footnote are to sections of Or. Admin. R. Section 150-317-1000: Definition of Commercial Activity; section 150-317-1010: Substantial Nexus Guidelines for Corporate Activity Tax; section 150-317-1020: Factors Used in Determining Whether a Group of Persons Forms a Unitary Group; section 150-317-1030: Sourcing Commercial Activity to Oregon from Sales of Tangible Personal Property; section 150-317-1040: Sourcing Commercial Activity Other Than Sales of Tangible Personal Property in This State; section 150-317-1100: Agent Exclusion; section 150-317-1130: Property Brought into Oregon; section 150-317-1200: Cost Input or Labor Cost Subtraction; section 150-317-1310: Estimated Tax Payments Delinquent or Underestimated Payment or Both, Constitutes Underpayment; section 150-317-1320: Estimated Tax Unitary Groups and Apportioned Returns; section 150-317-1330: Extension of Time to File. On February 1, 2020, the DOR released the following temporary regulations: section 150-317-1140: Wholesale Sale of Groceries Exclusion; section 150-317-1150: Retail Sale of Groceries Exclusion; section 150-317-1400: Determining Property Resold Out of State and Methods of Determining; and section 150-317-1410: Motor Vehicle Resale Certificate Documentation Required. On March 6, 2020, the DOR released the following temporary regulations: section 150-317-1120: Definition of Single-Family Residential Construction; and section 150-317-1220: Employee Compensation Labor Cost Subtraction.

These temporary regulations will be effective for 180 days unless amended, revoked, or rescinded by the DOR. At the time this article went to print, the DOR has said publicly that it plans to move these temporary rules through the permanent rulemaking process in either May or June. That process requires each rule to go through the notice and public comment period. The DOR has said it will release additional regulations as either temporary rules or as part of the permanent rulemaking process over the next several months.

[18] All references to the Oregon income tax are shorthand for Oregon's corporate excise tax provisions in chapter 317 of the Revised Statutes.

[19] Or. Admin. R. section 150-317-1200(2). The DOR pointed to Or. Rev. Stat. section 317A.119(3)(b), which excludes from cost inputs or labor costs expenses not attributable to the production of commercial activity for purposes of the statutory subtraction, as the rationale for requiring a different apportionment method.

[20] During the March 5, 2019, hearing of the Joint Committee on Student Success Subcommittee on Revenue, the Legislative Revenue Office described the apportionment mechanism as being like the corporate income tax by attributing activity using the single sales factor. The approach was outlined in the committee materials for the meeting.

[21] *See* Or. Rev. Stat. section 314.615.

provided no such guidance for intrastate taxpayers. And, because of the required addback to the denominator for "exclusions from commercial activity," wholly intrastate taxpayers could wind up with a ratio of less than 1 percent if those businesses had sales from excludable commercial activity. Also, taxpayers primarily engaged in the sale of excluded commercial activity, for example the sale of groceries, might experience significantly higher effective tax rates because of the dilution of the statutory subtraction.

Furthermore, the administrative guidance did not address the worldwide unitary group or fiscal year issues identified in our first installment on this topic, and the compliance concerns relating to the statutory subtraction further compound the already complicated situation.

C. Leadup to the 2020 Session

After the publication of Part I and a series of discussions with elected officials, the governor's office convened a technical working group to identify the immediate statutory concerns and craft a response to clarify the policy intent. Like any political process, we started worlds apart, with everyone claiming the statute supported their interpretation of the policy intent. The standoff on the different interpretations was perhaps enough for group members to realize the issue was not a matter of right and wrong but, rather, a profoundly confusing statute.

Over a few short days, the differences were discussed. It is customary for lawmakers to rely on the taxing agency to fine-tune any technical issues in regulation. This is generally an acceptable way to address administrability issues. Here, however, some provisions that were key to the core function of the tax needed to be addressed. Thus, the mission was to minimize statutory ambiguities and craft a proposal that would allow the DOR move forward with implementation of the CAT without having to make its own policy decisions.

The focus was on three crucial clarifications to the law to simplify the administration and compliance — the statutory subtraction, mandatory worldwide unitary filing, and accounting year challenges. We noted these issues would not cover all the technical complexities of the new tax but would at least address the most pressing concerns arising from taxpayers in virtually every business sector.

IV. Oregon's 2020 Session H.B. 4009

A. Introduced Bill

Several weeks before the 2020 short session began, Legislative Concept (L.C.) 249 was being circulated as a placeholder bill for CAT technical corrections. L.C. 249 was introduced as H.B. 4009 just a few days before the session officially started. It was the understanding of those involved in the technical working group that H.B. 4009 was a starting point.

As introduced, H.B. 4009 included the following proposed amendments (listed in the order they appear in the bill):

- add statutory reference regarding registration fees and taxes collected by vehicle dealers;[22]
- clarify that returns and allowances are allowed as an offset to commercial activity in the year in which the return or allowance is received;[23]
- amend the statutory subtraction apportionment ratio provision to require taxpayers to use the "commercial activity ratio" provided by the DOR in its temporary regulation;[24]
- dispose of the annual registration requirement;[25] and
- amend the penalty provision, authorizing the DOR to impose penalties when

[22] *See* H.B. 4009 (as introduced) section 1, at 3.

[23] *See* H.B. 4009 (as introduced) section 2, at 7.

[24] *See* H.B. 4009 (as introduced) section 3, at 8. As introduced the H.B. 4009 provision making this change stated that "the denominator . . . is commercial activity in the United States." Although this language seems to indicate that for purposes of the apportionment ratio only domestic sales could be included even for taxpayers required to file on a worldwide basis, the reference to the United States appears to have been an oversight and not intentional.

[25] *See* H.B. 4009 (as introduced) section 4, at 8.

taxpayers fail to meet payment thresholds for quarterly payments.[26]

The language of H.B. 4009 as introduced did not address the fiscal year issue or the worldwide filing group issue — the technical corrections that were advocated for in Part I. Nevertheless, the technical working group continued to discuss those issues and it was understood H.B. 4009 would be the vehicle through which those issues would be addressed.

B. Process and Politics

There was a cloud of uncertainty hanging over the legislature as the session began. Carbon policy has quickly become one of the most divisive forces in Oregon politics, and the legislature has spent the past several years crafting and debating legislation imposing strict market limits to the state's greenhouse gas emissions. During the 2019 session, Senate Republicans left the capitol — and the state — after the carbon measure was scheduled for a final vote, denying the quorum necessary for the chamber to conduct any business.[27] The absent members only returned on the final day of the session after a deal was reached to carefully maneuver the passage of budget bills and noncontroversial legislation.

Needless to say, the 2019 session adjourned without the legislature's customary end-of-session celebrations, and the scars of the walkout never completed faded. Democrats in both chambers had committed to reconsidering the carbon measure for the next session and Republicans were unyielding in their threats to take any means to stop them, including walking out again or even not participating in the session. To onlookers, it was perhaps a matter of when, not if, the legislature would find itself in another shutdown.

The threat of another walkout was a pressing concern throughout the development of H.B. 4009. There was significant pressure to advance bills out of committee before carbon politics consumed the session. Any realistic hope for CAT corrections required the legislature to move quickly on the bill.

On February 20 Oregon's House Committee on Revenue introduced and unanimously adopted amendments to H.B. 4009. In addition to the core structural clarifications, the committee authorized the DOR to impose penalties for noncompliance and changed the tax treatment of taxpayers in agricultural sectors, which is discussed below.

C. A-Engrossed

H.B. 4009 A-Engrossed (hereinafter A-Engrossed) was the result of the House Committee on Revenue's work throughout the first three weeks of February and was unanimously adopted by the committee February 20. During the committee's work in early February, it reviewed approximately 20 amendments, some but not all of which made it into A-Engrossed. Specifically, A-Engrossed included the following:

- Technical amendments to address administrability:
  - Add a provision that allows taxpayers to make a modified group election to exclude some foreign members and provide the DOR with rulemaking authority regarding administrative issues related to elections;[28] and
  - Rearrange and make amendments to the statutory subtraction provision, including addressing the fiscal year filing issue.[29]

[26] *See* H.B. 4009 (as introduced) section 5 and 6, at 8-9. Sections 7 and 8 of H.B. 4009 (as introduced) corrects effective date issues found in the penalty provision in Or. Rev. Stat. section 317A.161. As in place, section 317A.161(1) provides that the DOR "may not impose interests or penalties" when a taxpayer underreports or underpays its CAT liability. And, section 317A.161(2) authorizes the DOR to impose penalties under section 314.400 when a taxpayer fails to pay 80 percent of its quarterly estimated payments. The effective date provision related to section 317A.161 provides that it applies "to tax years beginning on or after January 1, 2020, and before January 1, 2021, and to returns filed on or before April 15, 2021." In theory that effective date language was supposed to apply only to section 317A.161 subsection (1); however, due to an apparent drafting error it is written to apply to both subsections. Thus, as codified, the DOR is prohibited from imposing penalties and interest, but also seems to have the authority to do so.

[27] Oregon is one of four states requiring two-thirds of all members in attendance for a chamber to conduct its regular business.

[28] *See* H.B. 4009 A-Engrossed section 1a, at 7.

[29] *See* H.B. 4009 A-Engrossed section 3, at 8-9.

- Amendments related to the agricultural sector:
  - Specify that crop insurance is an exclusion for payments from insurance policies;[30]
  - Add exclusion from commercial activity for receipts from the sale of milk by dairy farmers that are not members of a cooperative;[31]
  - Add definitions for agricultural commodity, broker (for purposes of agriculture), and farming operation;[32] and
  - Define cost inputs for taxpayers engaged in farming operations.[33]
- Other miscellaneous amendments:
  - Clarify that all tax refunds (regardless of the program) are excluded from commercial activity;[34]
  - Add statutory reference regarding registration fees and taxes collected by vehicle dealers;[35]
  - Add "manufactured dwelling park nonprofit cooperative" for definition of excluded persons;[36]
  - Clarify language in the definition of a taxpayer;[37]
  - Clarify that returns and allowances are allowed as an offset to commercial activity in the year in which the return or allowance is received;[38]
  - Dispose of the annual registration requirement;[39]
  - Authorize the DOR to impose a 5 percent penalty when a taxpayer fails to pay at least 80 percent of its estimated quarterly payment and clarifies penalty provisions for the failure to file and pay annually;[40] and
  - Clarify penalty provision effective dates.[41]

The remainder of our discussion focuses on the technical amendments to address administrability, including the modified group election and the changes to the statutory subtraction.

The modified group election provision was added to address the worldwide filing group issue. As passed in 2019, the Oregon CAT seems to require mandatory unitary worldwide filing.[42] And although the worldwide filing method may make theoretical sense when applied to a corporate income tax, the logic of such a filing method breaks down when applied to the CAT.[43] Specifically, a multinational taxpayer would likely be required to include tens, if not hundreds, of foreign entities with no commercial activity sourced to Oregon, assuming those entities are unitary. Oregon would receive no additional financial benefit from including foreign entities without Oregon source commercial activity, and the taxpayer would be required to go through the administrative burden of calculating amounts not required for any other corporate tax return filing, which the DOR would have to address on audit.

As an issue that was identified long before the session began, the technical working group came to a solution that worked for taxpayers and kept intact the underlying policy implemented by the legislature. When passed in 2019, the legislature intended to include in the Oregon CAT base commercial activity from foreign (non-U.S. entities) sourced to Oregon (Oregon sales). With that in mind, the technical group developed a modified group election as opposed to a pure water's-edge election.

The modified group election in A-Engrossed provides that, notwithstanding the general unitary group filing requirement, a taxpayer may elect to exclude from the group non-U.S. members

[30] *See* H.B. 4009 A-Engrossed section 1, at 2.

[31] *See id.*

[32] *See* H.B. 4009 A-Engrossed section 3b, at 9.

[33] *See id.* at 5.

[34] *See id.* at 2.

[35] *See id.* at 3.

[36] *See id.* at 5.

[37] *See id.* at 7.

[38] *See* H.B. 4009 A-Engrossed section 2, at 8.

[39] *See* H.B. 4009 A-Engrossed section 3b, at 9.

[40] *See* H.B. 4009 A-Engrossed sections 5 and 6, at 10-11.

[41] *See* H.B. 4009 A-Engrossed sections 7 and 8, at 11.

[42] For an in-depth discussion of this issue, see Dobay, *supra* note 2.

[43] The acknowledgment of mandatory worldwide combined filing making theoretical sense does not in any way concede our strong opposition to a worldwide filing requirement in the context of the Oregon corporate income tax. Rather, we are pointing out that putting aside the otherwise flawed conceptual and policy reasons for a state to consider worldwide filing, the questionable mathematical reasons (that is, to increase the tax base or starting point) are completely lost when applied to a tax based on gross receipts being sourced to a particular state like the CAT.

that have either no commercial activity sourced to the state or no "amounts realized but by definition excluded from commercial activity" sourced to the state.[44] The second prong of the modified group election is meant to capture entities with sales that fall within the general definition of commercial activity that would be sourced to Oregon but are excluded pursuant to the statutory provisions (*i.e.*, Or. Rev. Stat. section 317A.100(b)).

To illustrate the mechanics of the modified group election, consider a multinational business with the following entities:

- 300 entities in its global structure, all of which are unitary;
- of the 300 total entities, 75 are U.S. entities and 225 are non-U.S. entities; and
- of the 225 foreign entities, only 10 have commercial activity sourced to Oregon.

If this business were to make the modified group election contemplated in A-Engrossed, it would include the 75 U.S. entities and the 10 non-U.S. entities that have commercial activity sourced to the state in its Oregon combined CAT return. The 225 non-U.S. entities with no connection to Oregon would be excluded. If the business did not make a modified group election, the taxpayer would include all 300 entities in the Oregon CAT return, requiring the taxpayer to calculate its statutory subtraction on a worldwide basis.

Turning to the statutory subtraction, as passed in 2019, the CAT included a subtraction of the greater of 35 percent of either a taxpayer's cost inputs (generally COGS) or labor costs (up to $500,000 per employee) multiplied by the taxpayer's apportionment factor as determined under Oregon UDITPA provisions.[45] As noted, most taxpayers interpreted the 2019 legislation to mean that a corporate taxpayer would apply its apportionment factor as determined on its Oregon Form OR-20[46] to either its cost inputs or labor costs amount. The DOR, however, in its temporary regulation required taxpayers to use a separately computed commercial activity ratio for purposes of the CAT.

That ratio, as set forth in the DOR's temporary rule and included in H.B. 4009 as introduced as a replacement to using the single sales factor, was ultimately abandoned in A-Engrossed. Rather, section 3 of A-Engrossed clarifies that a "taxpayer having commercial activity both within and without the state" may use any of the following methods to determine its apportionment factor for purposes of the CAT:

1. the single sales factor provisions provided in Or. Rev. Stat. sections 314.650 and 314.655;
2. if the taxpayer is required to use a special industry apportionment formula or uses alternative apportionment[47] for purposes of determining its corporate income tax apportionment factor, then the taxpayer may use that factor for CAT purposes; or
3. a manner described in rule by the department.[48]

This amendment would have made clear that taxpayers with solely Oregon commercial activity (that is, non-multijurisdictional) would not be required to apportion their statutory subtractions. And multijurisdictional taxpayers, for purposes of the CAT, may generally use the same apportionment factor used for corporate income tax purposes unless a taxpayer chooses to use the commercial activity ratio or some other ratio provided by the DOR in regulation.[49] Taxpayers could continue to use an alternative apportionment method for purposes of the CAT, because that provision was not amended by A-Engrossed.

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[44]It is important to note that based on Oregon's drafting conventions, the language that includes "or amounts realized by definition excluded from commercial activity" is offset by commas in section 1a of A-Engrossed. Although the inclusion of these commas has created some confusion, we have confirmed with the DOR that it reads this provision to mean that foreign sellers with intercompany transactions cannot be excluded under this election. In other words, foreign affiliates selling into Oregon through intercompany transactions will be required to be included in the filing; however, the intercompany transactions will nonetheless be excluded under Or. Rev. Stat. section 317A.100(FF).

[45]The Oregon UDITPA provisions can be found at Or. Rev. Stat. sections 314.605 through 314.666.

[46]A taxpayer's Oregon apportionment factor for the corporate excise tax is calculated on Form OR-AP, and that factor follows line 8 on the Form OR-20.

[47]The DOR has said that it broadly interprets the reference to "alternative apportionment" to include any other apportionment method provided by statute as well as an alternative apportionment method petitioned for by a taxpayer under Or. Rev. Stat. section 314.667.

[48]*See* H.B. 4009 A-Engrossed section 3, at 9 (lines 11-17).

[49]A taxpayer would be required to recompute its single sales factor for purposes of the CAT if the taxpayer's filing group differed from its corporate income tax return filing group.

Another amendment to this section provided that a taxpayer would be able to use its own fiscal year information for purposes of calculating its statutory subtraction.[50] This amendment provided a partial fix to the fiscal year filing issue, and although not perfect, it was a step in the right direction as it would significantly ease the fiscal year issue for taxpayers.[51]

D. Caught in the Crosshairs

States are tackling many contentious issues, but none may be more provocative than carbon legislation, especially in the rural communities along the West Coast. Oddly enough, the controversy is much less a reflection of the politics of global warming and climate change than it is about the politics and industries of the urban-rural divide. In Oregon, the politics of carbon were, by and large, the defining issue of the recent session, and those politics reached a breaking point.

The legislature was on a collision course for several weeks, scheduling, postponing, and rescheduling the carbon measure in part to buy time for other pressing issues to advance before the looming politics of the session ultimately played out. On February 24 Democrats scheduled the carbon bill for its final vote out of a budget committee and, as promised, Republicans left the building never to return.

As a result, the session ended without the legislature passing any meaningful legislation. It enacted only three measures — increasing some license plate fees, recognizing the disincorporation of a city, and requiring schools to use a form to outline academic accommodations for students diagnosed with concussions. This is not to minimize the legitimacy of any of these enacted bills; just to highlight that more consequential legislative business was left unfinished.

Upon the constitutional adjournment at midnight March 8, the technical corrections to the CAT laid somewhere in the graveyard of abandoned measures. Coincidentally, it was the first bill on the third reading list on the day Republicans left the building, although the scheduled vote had no bearing on the decision to leave. Unfortunately, H.B. 4009 became a casualty of the unrelated political warfare of the legislative session, leaving taxpayers and the state worse off.

V. Political Uncertainty and Complexities of COVID-19

Oregon lawmakers have been reeling from the consequences of their session. The legislature was unable to balance hundreds of millions of dollars in agency budgets and abandoned many other crucial bills. In the days after calling the session "functionally over," the House speaker and Senate president asked the governor to call the legislature back into special session within the next 30 days for lawmakers to finish their work. Nonetheless, the outlook for a special session remained uncertain because of the impasse over carbon politics.

The legislature's inability to find common ground to pass any legislation is an unfortunate outcome. The DOR has said it will soon launch its process for promulgating permanent rules and additional CAT guidance. Thus, there may be some room for the DOR to assist in clarifying the policy intent of the statute. In the absence of legislation, however, taxpayers and practitioners remain in limbo. In our view, legislative action is required to adequately address the technical corrections and to provide the necessary level of certainty to taxpayers.

Looking ahead, there may be opportunities for the legislature to provide the clarity and certainty taxpayers need to comply with the intent of the law. On March 16 the legislature announced the formation of a committee to lead the policy response to the coronavirus outbreak. Later, the committee co-chairs recommended the technical corrections to the CAT as an action the legislature should take to ease uncertainty felt by

[50] *See* H.B. 4009 A-Engrossed section 3, at 9 (lines 27-30).

[51] Although a general fiscal year filing option would have been the preferred fix to include in A-Engrossed, the inclusion of the election to use a taxpayer's fiscal year information for purposes of the statutory subtraction was a significant win for taxpayers. Because the revenue forecasts were based on the CAT taking effect on January 1, 2020, there was some fear in adjusting the period during which the commercial activity receipts were being counted. Thus, the preference was to not adjust the period for determining a taxpayer's commercial activity (that is, keep that on a calendar-year basis) while recognizing the administrative burden of calculating COGS and apportionment on a calendar-year basis for fiscal-year filers.

businesses.[52] This high-level legislative support is encouraging for the prospects of the CAT technical corrections.

Another policy change the legislature could and, perhaps, should consider in its response to the coronavirus crisis is the CAT estimated payments schedule. Employers of all sizes and regions in Oregon are facing a cash flow crisis because of the economic stoppage and dire outlook for the weeks and months ahead. While these issues are present for practically all employers, they are ever more dire for Oregon's small businesses, many of whom are suppliers and vendors for larger businesses.

Oregon can provide immediate relief to employers subject to the tax without undermining the revenue the tax would otherwise generate. Oregon could achieve meaningful relief for employers by following the lead of the Nevada commerce tax and Texas margins tax by eliminating the estimated quarterly payments and requiring annual payments. If Oregon is concerned about government cash flows, the legislature could encourage early payment by allowing a discount for early or quarterly payments of the annual tax.[53]

To be clear, the technical corrections to the Oregon CAT included in H.B. 4009 (specifically A-Engrossed) even if enacted, are not a panacea for every policy and administrative problem with the tax. There will continue to be other administrative and policy glitches identified and requiring the attention of the legislature. Nonetheless, these initial corrections would reduce administrative burdens, facilitate taxpayer compliance with the CAT, and are critical steps forward that should be taken sooner rather than later. ■

[52]The co-chairs of Oregon's Joint Special Committee on Coronavirus Response recommended the contents of H.B. 4009 be redrafted and included in the legislative response to the viral outbreak. Letter from Rep. Paul Holvey and Sen. Arnie Roblan to Sen. Peter Courtney and Rep. Tina Kotek (Mar. 25, 2020).

[53]Or. Rev. Stat. section 311.505(3) provides a discount for early payments of property taxes of 2 percent on two-thirds of taxes paid and 3 percent on taxes paid in full. The legislature could provide a similar discount to encourage early payments of the CAT.

Comments to the
Oregon Department of Revenue

Concerns with Proposed Draft OAR §§ 150-317-1025 and 150-317-1200

Nikki E. Dobay
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Council On State Taxation (COST)
May 26, 2020

On behalf of COST, I am writing to express concerns with the above-referenced draft regulations, currently proposed as permanent rules as provided in the Notice of Proposed Rulemaking dated April 26, 2020. I would first like to thank Department of Revenue staff members for their willingness to engage with COST and other stakeholders throughout the 2020 legislative session and the current notice and comment period on issues related to the newly enacted Oregon Corporate Activity Tax (Oregon CAT). The staff's willingness to engage was key to obtaining consensus on H.B. 4009-A, which was on track to pass during the 2020 legislative session and which was supported by COST and the broader business community. Unfortunately, for reasons beyond our control the session ended without the passage of H.B. 4009-A. And, while COST appreciates the Department's attempt to incorporate some of the key concepts from H.B. 4009-A, as currently drafted OAR §§ 150-317-1025 and 150-317-1200 fall short of achieving the goals in that bill. Thus, for the reasons outlined below, COST urges the Department to consider edits to OAR §§ 150-317-1025 and 150-317-1200 that were provided to the Department on May 23 (*see* attached Exhibit A) as well as the examples in Exhibit A to the practitioners' letter submitted by Valerie Sasaki on May 26 (*see* attached Exhibit B) in place of the examples currently included on OAR § 150-317-1200.

About COST

COST is a nonprofit trade association based in Washington, D.C. and Portland, Oregon. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 550 major corporations engaged in interstate and international business. COST members conduct substantial business in the state of Oregon, employ a substantial number of Oregon citizens, and own extensive property within the State. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities—a mission steadfastly maintained since our creation.

OAR § 150-317-1200, as Drafted, Fails to Comply with the Oregon Statute; Alternative Apportionment Provisions Need Further Clarification

The General and Specific Rules Provided in the Proposed Draft are Flawed

In its current form, OAR § 150-317-1200 is at odds with ORS § 317A.119, which provides the statutory authority for the Oregon CAT subtraction. Specifically, § 317A.119 provides:

> (1) A taxpayer shall subtract from commercial activity sourced to this state 35 percent of the greater of the following amounts paid or incurred by the taxpayer in the tax year:
> (a) The amount of cost inputs; or
> (b) The taxpayer's labor costs.
> (2) The amounts in subsection (1)(a) or (b) of this section shall be apportioned to this state in the manner required for apportionment of income under ORS 314.605 to 314.675.
> (3) A subtraction under this section is not allowed for any amount of:
> (a) Expenses from transactions among members of a group, as excluded under ORS 317A.106; or
> (b) Cost inputs or labor costs that are attributable to a person's receipts from an item that is not commercial activity.
> (4) Notwithstanding subsection (1) of this section, the subtraction under this section may not exceed 95 percent of the taxpayer's commercial activity in this state.

Based on the statutory language, the CAT subtraction statute requires a taxpayer to determine whether the taxpayer has any expenses from transactions among members or costs that are attributable to items excluded from commercial activity or included in cost inputs or labor costs as provided in ORS § 317A.119(3) before applying the 35 percent limitation pursuant to ORS § 317A.119(1) and apportioning the subtraction amount pursuant to ORS § 317A.119(2). Finally, a taxpayer's overall subtraction is subject to the 95 percent limitation based on the taxpayer's Oregon sourced commercial activity pursuant to ORS § 317A.119(4).

Considering this analysis, as currently drafted OAR § 150-317-1200 is flawed for several reasons. First, the general rule provided in subsection (2) of the proposed rule requires the use a commercial activity ratio, which is contrary to the requirements of ORS § 317A.119. Although COST understands the Department intends the general rule or commercial activity ratio to apply in lieu of the requirement to exclude certain expenses, that is not explicit in the current draft. Specifically, the feedback from COST members regarding this section has been that the commercial activity ratio appears to be required in place of a taxpayer's apportionment factor as determined under ORS §§ 314.605 to 314.675. And, most members have assumed they will nonetheless be required to reduce their expenses related to excluded commercial activity from either their cost inputs or labor costs prior to application of the commercial activity ratio. Thus, at best, the current draft rule fails to provide clear guidance.

More troubling, however, is the fact that the rule fails to comply with the statute (ORS § 317A.119), which *requires* a taxpayer to subtract certain expenses related to receipts specifically excluded from commercial activity. Thus, as currently drafted the general rule exceeds the Department's rulemaking authority as it is contrary to the specific statutory authority that requires a taxpayer to apportion its subtraction pursuant to ORS §§ 314.605 to 314.675. In line with the redlined draft attached in Exhibit A, COST strongly urges the Department to allow taxpayers to use the commercial activity ratio as a safe harbor in lieu of the requirement to reduce a taxpayer's cost inputs or labor costs for excludable commercial activity and re-compute a taxpayer's apportionment under ORS §§ 314.605 to 314.675. Where the commercial activity ratio can be used to streamline the calculation of the subtraction, allowing a taxpayer to utilize this process makes sense. The attempt to mandate a rule contrary to the statute, however, is beyond the scope of the Department's authority.

Next, the special rule provided in subsection (3) of the proposed draft is an extremely narrow interpretation and fails to comport with the intent of the statute. Again, ORS § 317A.119(2) requires a taxpayer to apportion the subtraction "in a manner required for apportionment of income under ORS 314.605 to 314.675." These provisions provide specific direction as to how taxpayers must apportion their income. Thus, it is unclear why the Department has determined a taxpayer would be precluded from using anything but the commercial activity ratio, which is the default apportionment methodology provided in the general rule as currently drafted, unless the taxpayer's corporate income/excise tax filing group mirrors the taxpayer's CAT filing group exactly.

In fact, the special rule as currently drafted will almost certainly preclude most if not all COST members from using their apportionment factor as calculated under ORS §§ 314.605 to 314.675. Because the Oregon corporate income/excise tax and the Oregon CAT have different definitions of a unitary group and the Oregon CAT applies more broadly, any COST member with even a single non-U.S. entity in its structure, a partnership, or a domestic unitary corporation that it owns between 50 and 79 percent will be precluded from using the Department's special rule. Thus, the Department's special rule as currently drafted seems not only overly narrow but extremely punitive. Although COST understands a taxpayer should not be able to use the exact apportionment factor (*i.e.*, the taxpayer's factor as it appears on its Form OR-20) where the taxpayer's Oregon income/excise tax group differs from its Oregon CAT filing group, the statute does not preclude a taxpayer from re-computing its apportionment factor under ORS §§ 314.605 to 314.675 using the entities included in its CAT filing group.

Considering the significant flaws with the current draft rule, COST strongly urges the Department to adopt the proposed edits to OAR § 150-317-1200 included in Exhibit A. Those edits clearly delineate the way a taxpayer is required to calculate the subtraction in accordance with ORS § 317A.119 while maintaining the commercial activity ratio as a safe harbor. Again, COST appreciates the Department's attempt to create a streamlined process for calculating the subtraction where a taxpayer has items excluded from commercial activity; however, it lacks the authority to require all taxpayers to utilize such a procedure where it fails to comport with the statutory language. Finally, COST would also urge the Department to incorporate the examples provided in Exhibit B into OAR § 150-317-1200, which were drafted to illustrate the statutory analysis laid out above.

The Alternative Apportionment Provisions Need Further Clarification

COST would also urge the Department to provide additional guidance in OAR § 150-317-1200 regarding alternative apportionment. Specifically, sections (6) through (8) of the proposed draft rule provide guidance regarding a taxpayer's ability to request alternative apportionment for purposes of apportioning its Oregon CAT subtraction. The Department's guidance requires a taxpayer seeking alternative apportion to make its request in writing prior to filing a return. Although this information is helpful, COST members have requested further guidance be provided. In particular, the proposed draft fails to address the timeframe in which the Department is required to respond to a taxpayer's request. Thus, taxpayers are completely without guidance as to how far in advance of the return due date they might be required to file a petition for alternative apportionment. Thus, COST would urge the Department to include the following in subsection (7):

> If the Department fails to respond within 45 days to the taxpayer's request, it will be deemed accepted and the taxpayer may only change its apportionment methodology if it receives approval by the Department.

OAR § 150-317-1025, as Drafted, Fails to Provide Adequate Relief for Multinational Taxpayers

COST has on several occasions identified significant issues with the apparent worldwide filing requirement for the Oregon CAT. Fundamentally, where a foreign entity does not have commercial activity sourced to the state (directly or indirectly), it makes little sense to include that entity or its information in the Oregon CAT group return. Specifically, requiring a taxpayer to calculate the subtraction required under ORS § 317A.119 for non-U.S. entities with no commercial activity sourced to the state is a significant compliance burden on the taxpayer and an audit burden on the State.

This is an issue that H.B. 4009-A would have addressed; thus, COST appreciates the Department's attempt to provide relief for such taxpayers in OAR § 150-317-1025. Nevertheless, the proposed rule as currently drafted is significantly flawed. H.B. 4009-A included a modified group election that would allow a taxpayer to elect to exclude entities with no commercial activity sourced to Oregon and no commercial activity sourced to Oregon that was otherwise excluded pursuant to ORS § 317A.100(1)(b).

Subsections (2)(a) and (2)(b) of OAR § 150-317-1025 capture the essence of the election provided in H.B. 4009-A. The proposed draft, however, goes astray with subsections (2)(c) and (2)(d). To start, it is unclear how subsection (2)(c) differs from subsection (2)(b). Regardless of whether an entity was selling to a related affiliate or an unrelated third-party, a transaction would occur; thus, any transaction between unitary group members would appear to also fall under the purview of (2)(b). Thus, subsection (2)(c) seems completely unnecessary.

More concerning, however, is (2)(d), which requires the inclusion of any member of the unitary group that has cost inputs or labor costs "attributable to" the group's receipts from items of commercial activity. First, the use of the term "attributable to" is vague and subject to a variety of interpretations. Even assuming that term could be clarified, the inclusion of this requirement eviscerates any compliance relief offered by this provision generally. Because of the nature of the unitary relationship it is extremely likely that most groups would have certain cost sharing arrangements in place or share certain centralized services. This provision would require a taxpayer to scour every foreign entity within the unitary group to determine whether any such expenses exist, which is an extremely burdensome task. And, the result to the State will be the inclusion of an entity with no Oregon-source commercial activity (*i.e.*, no additional receipts in the tax base) and the inclusion of that entity may even increase the amount of the taxpayer's subtraction. Subsection (2)(d) adds to the compliance burden of all multinational groups and provides no additional benefit to the State. This is exactly the situation from which taxpayers were seeking legislative relief during the 2020 short session.

Thus, COST would strongly urge the Department to adopt the proposed edits to OAR § 150-317-1025 provided in Exhibit A. Specifically, those edits strike subsections (2)(c) and (2)(d) and clarify that all financial information, including an entity's subtraction information, would be omitted from the group's Oregon CAT return.

Finally, COST would highlight an issue specifically related to multinational taxpayers who also qualify as financial institutions. Specifically, ORS § 317A.100(1)(a)(B)(ii), which defines commercial activity for certain financial institutions, requires holding companies to include all items of income required on the FR Y-9. The income reported on the FR Y-9, however, is a worldwide income number. Because a taxpayer's commercial activity is required to be sourced to Oregon pursuant to ORS § 317A.128, COST would urge the Department to clarify that although ORS § 317A.100(1)(a)(B)(ii) specifically cites to a form that includes worldwide information, a holding company is only required to include income information from domestic group members and those foreign entities that are not otherwise excluded under OAR § 150-317-1025.

Conclusion

Based on the foregoing, COST urges the Department to adopt the proposed amendments to OAR §§ 150-317-1025 and 150-317-1200 provided in Exhibit A. In addition, COST urges the department to incorporate the examples provided in Exhibit B and the specific proposed language above to subsection (7) of OAR §150-317-1200 to that rule.

Again, COST thanks the Department for its ongoing collaboration and commitment to consideration and addressing issues raised by COST members. Please do not hesitate to reach out if you have any questions or would like further clarification.

Exhibit A

OREGON DEPARTMENT OF REVENUE

ADMINISTRATIVE RULE REVIEW	Rule No. 150-317-1200	
	Page: Page 1 of 11	Last Revised Date: April 15, 2020
Adopt Rule	NOTICE OF INTENDED ACTION	
Permanent Rule	Bulletin Dated: May 2020	Hearing Scheduled: May 26, 2020

PURPOSE: Provides guidance to assist taxpayers in how to compute the cost input or labor cost subtraction for purposes of the Oregon Corporate Activity Tax (CAT).

150-317-1200

Cost Input or Labor Cost Subtraction

(1) The subtraction provided in ORS 317A.119 includes all labor cost or cost input expenses of a taxpayer, whichever is greater, regardless of the place the labor cost or cost input is incurred. For purposes of the subtraction, a unitary group will include the labor costs or cost inputs of all members of the Unitary Group, regardless were incurred, except as provided in OAR 150-317-1025(3).

Commented [ND1]: This is a reference to the edited version of -1025

~~(2) General Rule: A taxpayer must apportion the labor cost or cost input subtraction, computed as provided in section (1~~(2) Exclusion for Expenses Related to Excludable Commercial Activity: Prior to applying the 35 percent limitation provided in ORS 317A.119(1), a taxpayer or unitary group that has excludable transactions among group members pursuant to ORS 317A.106 or cost inputs or labor costs attributable to items excluded from commercial activity under ORS 317A.100(1)(b) is required to determine what, if any, costs are attributable to the excludable transactions or excluded commercial activity and subtract such amounts, if any, from the taxpayer or unitary group's labor costs or cost inputs amounts determined under section (1) to calculate the taxpayer or unitary group's net subtraction. A taxpayer or unitary group may use a separate accounting methodology or reasonably approximate the excludable expenses under this section.

(a) A taxpayer or unitary group that has no excludable transactions among group members pursuant to ORS 317A.106 or no cost inputs or labor costs attributable to items excluded from commercial activity under ORS 317A.100(1)(b) is not required reduce its labor costs or cost inputs as determined under section (1). Any amounts eliminated as intercompany transactions on the taxpayer's federal and Oregon consolidated corporate income/excise tax returns shall not be construed as excludable or excluded from commercial activity for purposes of this section (3).

Example: Corporations P and S file a consolidated federal income tax return and a consolidated Oregon corporate excise tax return. P is a manufacturer of items of tangible personal property and sells 100% of its products to S. S sells those products at retail to third party customers. On the federal consolidated federal income tax return, P and S eliminate P's sales to S from federal gross receipts and also eliminate P's costs of goods sold as intercompany transactions pursuant to the federal consolidated return returns. Oregon conforms to those eliminations for Oregon corporate excise tax purposes and also eliminates these intercompany sales from apportionment. If P and S have no other exclusions from commercial activity under ORS chapter 317A, P and S are not required to reduce its labor costs or cost inputs as determined under section (1) of this rule.

Commented [ND2]: This example shows the interco issue, but not sure if this is the proper placement for an example.

(3) Application of 35 percent Limitation: A taxpayer or unitary group shall determine 35 percent of the greater of either its the labor costs and cost inputs subtractions as determined under section (1) or net labor costs or cost inputs subtractions as determined under section (2).

(4) Apportionment of Subtraction: A taxpayer or unitary group is required to apportion the amount determined under section (4) in the following manner:

(a) A taxpayer or unitary group must determine its apportionment in the manner required under ORS 314.605 to 314.675, including but not limited special and/or alternative apportionment methodologies pursuant to ORS chapter 314 and underlying regulations.

(i) If a corporate activity taxpayer is identical to the entity, or made up of a group of entities that is identical to the group of entities, reporting on the apportionment schedule filed for purposes of Oregon income or excise taxation under ORS Chapters 314, 316, 317 or 318, that taxpayer or unitary group must use the apportionment factor percentage from the taxpayer's or unitary group's Oregon apportionment schedule filed under ORS Chapters 314, 316, 317 or 318 to calculate the subtraction amount. The taxpayer or unitary group must use the most recent return covering a 12-month period filed with the department.

(ii) If a corporate activity taxpayer is not identical to the entity, or made up of a group of entities that is identical to the group of entities, then the taxpayer or unitary group must recompute its Oregon apportionment factor percentage using the method required for purposes of ORS 314.605 to 314.675, including special apportionment methodology, and the group of entities included in the corporate activity taxpayer's filing group.

(5) Safe Harbor: A taxpayer or unitary group may in lieu of calculating the reduction required in section (2) and/or use of the apportionment of the subtraction as provided in section (4) apportion its labor cost or cost input subtraction, as computed in section (4), by means of a commercial activity ratio. The commercial activity ratio is a fraction, the numerator of which is the taxpayer's commercial activity sourced to Oregon and the denominator of which is the sum of the taxpayer's total commercial activity everywhere and exclusions from commercial activity everywhere other than amounts excluded under ORS 317A.100(1)(b)(FF). ~~A~~For purposes of the safe harbor, a taxpayer determines the costs apportioned to Oregon by multiplying the total labor costs everywhere or total cost inputs everywhere by the taxpayer's commercial activity ratio without regard for any otherwise applicable exclusions from commercial activity.

~~(3) Special Rule for a Taxpayer or Unitary Group that apportions between states. If a corporate activity taxpayer is identical to the entity, or made up of a group of entities that is identical to the group of entities, reporting on the apportionment schedule filed for purposes of Oregon income or excise taxation under ORS Chapters 314, 316, 317 or 318, that taxpayer or unitary group may elect to use the single sales factor apportionment percentage from the taxpayer's or unitary group's Oregon apportionment schedule filed under ORS Chapters 314, 316, 317 or 318 to calculate the subtraction amount. The electing taxpayer or unitary group must:~~

~~(a) Use the most recent return covering a 12-month period filed with the department; and~~

~~(b) Demonstrate that substantially all the receipts included in the sales factor on the Oregon income or excise tax return are attributable to receipts included in~~ (6) Wholly Intrastate Taxpayers: A taxpayer or unitary group not otherwise required to apportion its taxable income pursuant to ORS 314.615 is not required to apportion its subtraction calculated under section (4). Such taxpayer may, however, utilize the safe harbor in section (5) in lieu of calculating any reduction as required by and in accordance with section (2).

(7) Application of 95 percent Limitation: A taxpayer or unitary group may subtract from its Oregon commercial activity~~.~~

~~(c) For purposes of this section, "substantially all" means the receipts included in commercial activity are not less than 95 percent of the receipts included in the sale factor.~~

~~(4) The~~ the amount determined under section (4) or (5); however, its final subtraction ~~is 35 percent of the taxpayer's costs apportioned to Oregon, but~~amount may not exceed 95 percent of the taxpayer's Oregon commercial activity.

~~(5) As an alternative to the methods described in sections (2) and (3), a taxpayer may elect the use of separate accounting to remove all cost inputs or labor cost from the subtraction that are attributable to a person's receipts from an item that is not commercial activity, if the costs attributable to receipts from an item that is not commercial activity are readily identified in the taxpayer's books and records maintained in the ordinary course of business as amounts separate from costs attributable to receipts from an item that is commercial activity.~~

Example 1: Grocery & TV Mart has $10 million of Oregon commercial activity and $70 million of everywhere commercial activity plus exclusions ($50 million in commercial activity and $20 million in exclusions from commercial activity). Grocery & TV Mart has an everywhere labor cost of $28 million and everywhere cost input of $26 million.

Grocery & TV Mart computes the Oregon subtraction as follows:

Step 1: Determine the commercial activity ratio.

Oregon commercial activity of $10 million / $70 million everywhere commercial activity plus exclusions = 14.2857% commercial activity ratio.

Step 2: Determine the cost subtraction. In this example, labor costs are greater than cost inputs. Total labor cost of $28 million x commercial activity ratio of 14.2857% x 35% = $1,399,999 cost subtraction.

Example 2: Unitary Group A, a group of domestic corporations with common ownership of 80 percent or more and filing a federal consolidated income tax return, files an Oregon corporate excise tax return under ORS chapter 317. Unitary Group A is in the business of selling specialized cookware around the world. The Oregon apportionment ratio on Schedule OR-AP filed with Form OR-20 calculated by using Oregon Sales as the numerator and U.S. Sales Everywhere as the denominator is 1.7527 percent. Unitary

Commented [ND3]: Examples no reviewed.

Group A applied that percentage to its Oregon taxable income to determine its Oregon corporate excise tax obligation under ORS chapter 317. Unitary Group A's fiscal year ends August 31.

Unitary Group A also files an Oregon corporate activity tax return for the calendar year, and no entities are included in the unitary group for purposes of the corporate activity tax that are not also included in the computation of Oregon taxable income on Form OR-20. 95 percent of the receipts included in the denominator of Schedule OR-AP for the fiscal year that ended August 31 before the annual corporate activity tax return is due are attributable to amounts included in commercial activity under ORS 317A.100(1)(a). Because Unitary Group A is made up entirely of entities that are identical to the entities reported on the corporate excise tax return under ORS chapter 317 and it has demonstrated that substantially all of its receipts in the sales factor reportable on Schedule OR-AP are from sources that are commercial activity under ORS chapter 317A.100, Unitary Group A may use the corporate apportionment percentage of 1.7527 percent reportable on Schedule OR-AP when calculating Unitary Group A's subtraction.

Example 3: Unitary Group B files its Oregon corporate excise tax returns made up of domestic entities each with common ownership of 80 percent or more. Unitary Group B is in the business of selling women's apparel around the world. Unitary Group B also includes two partnerships and another corporation that meets the more-than-50 percent ownership requirement for the corporate activity tax under ORS chapter 317A.100(19). Because the unitary group for purposes of ORS chapter 317A is not identical to the unitary group included in the corporate excise tax return under ORS chapter 317, Unitary Group B may not use the apportionment percentage from the corporate excise tax return.

Example 4: Unitary Group C is made up entirely of domestic corporations with common ownership of 80 percent or more and files a federal consolidated income tax return. Unitary Group C is in the business of selling groceries and household goods. Groceries are excluded from the definition of commercial activity. Because Unitary Group C cannot demonstrate that substantially all of its sales included in the sales factor on Schedule OR-AP are attributable to sales included in commercial activity, Unitary Group C may not use the apportionment percentage from its corporate excise tax return.

Example 5: Partnership 1 and Partnership 2 each file separate Oregon partnership income tax returns and conduct business within and without Oregon. Partnership 1 is in the business of providing engineering services. Partnership 2 is in the business of providing construction services. A unitary relationship exists between Partnership 1 and Partnership 2, and they meet the more-than-50 percent ownership requirement under ORS 317A.100(19). Because the unitary group for corporate activity tax purposes includes both Partnership 1 and Partnership 2 and each partnership must file a separate partnership return under ORS chapter 314, the unitary group may not use the apportionment percentage from the partnership returns filed under ORS chapter 314.

Example 6 South Street operates an automotive repair shop. Most of South Street's receipts are commercial activity. South Street's books and records separate the labor costs attributable to commercial activity from labor costs that were not attributable to commercial activity. Because labor costs attributable to commercial activity was separately accounted for South Street may elect to use separate accounting for determining their available labor cost subtraction.

Example 7: Corner Market operates a convenient store and sells motor vehicle fuel. The majority of the convenient store's receipts are commercial activity but motor vehicle fuel is excluded from commercial activity. Corner Market's books and records do not separate labor costs attributable to operating the convenient store from labor costs attributable to the sale of motor vehicle fuel. Because labor cost attributable to operating the convenient store was not separately accounted for Corner Market cannot use elect to use separate accounting for determining their available labor cost subtraction.

(6) Notwithstanding section (1), a taxpayer may petition the department for alternative apportionment, or the department may require alternative apportionment if the application of sections (2) or (3) does not fairly represent the labor cost or cost input subtraction attributable to the taxpayer's commercial activity.

(7) A petition to use an alternative method of apportionment of costs for the subtraction under ORS 317A.119(2) must be filed in writing with the department. The request must be signed by the taxpayer or the taxpayer's authorized representative and must be filed separately from the taxpayer's return. The request must include a complete explanation of the alternative method as well as an explanation why the

application of sections (2) or (3) should not be used. Upon receipt of the request, the department will review the request and issue a letter either authorizing or denying the request. If denied, the taxpayer can appeal that action as provided in ORS 305.275. An alternative apportionment method may be used only after receiving written authorization from the department. The authorization may be revoked if, upon audit, the department determines that the alternative method does not fairly represent commercial activity in Oregon. Once an alternative method has been authorized, that method must be used until a request to change is made and approved by the department or until the authorization is revoked after audit.

(8) Examples of alternative methods of apportionment include:

(a) A modification to the ratio which will fairly and accurately reflect the taxpayer's costs attributable to receipts from commercial activity in Oregon; or

(b) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's costs attributable to receipts from commercial activity.

Stat. Auth.: ORS 305.100, ORS 317A.119, ORS 317A.143

Stats. Implemented: ORS 317.119

150-317-1025

Corporate Activity Tax: Unitary Groups with Non-U.S. Members – Reporting Requirements

(1) General Rule: For purposes of the Corporate Activity Tax (CAT), a unitary group is defined as being 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. Unitary group members may include entities formed in the United States (“domestic members”) and entities formed outside the United States (“non-U.S. members”). Generally, a unitary group must file a group return that includes all ~~entities~~members that are part of the unitary group.

(2) Special Rule: Certain unitary groups may file a modified group return ~~that omits~~omitting from the return a non-U.S. member’s information as provided in section (3) if that member:

(a) Has no commercial activity sourced to Oregon under ORS 317A.128; or

(b) Has no commercial activity excluded under ORS 317A.100(1)(b) that would ~~not~~otherwise be sourced to Oregon if it were included in commercial activity~~;~~

~~(c) Has no transactions with another unitary group member in which the other member would realize commercial activity sourced to Oregon but for an exclusion in ORS 317A.100(1)(b),~~, including but not limited to ORS 317A.100(1)(b)(FF) (~~regarding~~ receipts from transactions among members of a unitary group~~); and~~).

~~(d) Has no cost inputs or labor costs that are attributable to the unitary group’s receipts from an item that is commercial activity for purposes of ORS 317A.119 and the non-US member’s other financial information may be omitted when computing the subtraction under section (4) of this rule.~~

~~(3)~~(3) Exclusion of Information and Relationship to Subtraction Under ORS 317A.119: If a unitary group has one or more non-U.S. members described in section (2) of this rule, the group may omit all financial information ~~about financial transactions~~ of or relating to that member from the group’s ~~CAT~~commercial activity tax return that would otherwise be required to be reported on the return according to the department’s forms and instructions.

~~*(4) Relationship to subtraction under ORS 317A.119.*~~

~~(a) If a unitary group omits transactions and information of non-U.S. group members from the CAT return under sections (2) and (3) of this rule, the group may not include other financial information, such as (but not limited to) eligible costs, commercial activity, amounts generally excluded from commercial activity, or sales factor receipts from omitted members when calculating~~ The unitary group's labor costs or cost inputs for purposes of the subtraction provided under ORS 317A.119 and apportioning of such costs under OAR 150-317-1200~~.~~ may not include any financial information from a member that is omitted under section (2).

(~~b~~4) If the omission of the non-US group member's information does not fairly represent the extent of commercial activity in Oregon under ORS 317A.119, the unitary group may not omit the non-U.S. member's information from the return.

(5) If a unitary group omits the ~~transactions and~~financial information of non-U.S. group members from the CAT return under ~~sections (2) and~~section (3) of this rule, the group must maintain a list of omitted members and keep the list in the unitary group's records. The list must include the name of the entity, the tax identification number of the entity (including federal tax identification number, if applicable) and any other identifying information related to the entity omitted from the return, including contact information for the entity. The list must be made available to the department upon request of the department.

(6) Upon examination of the return that is filed, the department may determine the omission of the non-U.S. member's information is not proper under sections (2) and (3) of this rule and may include the financial ~~transactions~~information of that member in whole or in part in the unitary group's Oregon return as required under ORS 317A.100 to 317A.158.

(7) Notwithstanding sections (2) and (3) of this rule, if property is transferred into Oregon under ORS 317A.109(1)(b) that is included in taxable commercial activity of the unitary group, information about any member that transferred property to or received property in a location outside this state within one year before the transfer of the property into this state must be included on the return~~.~~ unless the property brought into the state was not intended in whole or in part to avoid tax as provided in ORS 317A.109(b)(2).

ADMINISTRATIVE RULE REVIEW	Rule No. 150-317-1200	
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Permanent Rule	Bulletin Dated: May 2020	Hearing Scheduled: May 26, 2020

PURPOSE: Provides guidance to assist taxpayers in how to compute the cost input or labor cost subtraction for purposes of the Oregon Corporate Activity Tax (CAT).

Stat. Auth.: ORS 305.100, ORS 317A.106, ORS 317A.143

Stats. Implemented: ORS 317A.106, ORS 317A.119, ORS 317A.134, ORS 317A.137

Exhibit B

Example 1: U.S. manufacturer with no foreign entities that has $150 million of Oregon sourced commercial activity, none of which are excludable, $100 million of COGS (which is greater than its labor costs) and an 8% Oregon apportionment factor. The taxpayer's Oregon corporate excise tax group and Oregon CAT filing group are the same.

Because this taxpayer has no excludable commercial activity no expenses will need to be excluded from COGS. Under this scenario, the calculation would be:

35% statutory limitation:	35% x $100 million = $35 million
Apportioned subtraction:	$35 million x 8% = $2.8 million
Total subtraction:	$2.8 million

Because the taxpayer's overall subtraction is less than $142.5 million (95% of $150 million) no further limitation applies

Example 2: U.S. retailer with no foreign entities that has $6.25 billion of gross amounts realized from transactions and activity in the regular course of its trade or business, of which $500 million is sourced to Oregon. Forty percent of these gross and Oregon-sourced numbers are excluded from commercial activity pursuant to one or more of the exclusions contained in ORS 317A.100(1)(b). After application of these exclusions, U.S. retailer has gross non-excludable commercial activity of $3.75 billion and non-excludable Oregon-sourced commercial activity of $300 million. U.S. retailer has total COGS for federal income tax purposes of $5 billion (which is greater than its labor costs) and an 8% Oregon apportionment factor for corporate income tax purposes. U.S. retailer has identical filing groups for Oregon corporate excise tax and Oregon corporate activity tax purposes.

Because U.S. retailer has exclusions from commercial activity, it must reduce the amount of its COGS eligible for the subtraction under ORS 317A.119 by a corresponding amount. Assuming that the U.S. retailer does not separately track its COGS information with respect to specific inventory sold at retail, the U.S. retailer may reduce its total COGS for the subtraction by a pro-rata amount based on the percentage of receipts excluded from commercial activity under ORS 317A.100(b) or 40%. Under this scenario, the calculation would be:

Reduction in COGS for subtraction:	$5 billion * 40% = $2 billion
Net COGS eligible for subtraction:	$5 billion - $2 billion = $3 billion
35% statutory limitation:	$3 billion * 35% = $1.05 billion
Apportioned subtraction:	$1.05 billion * 8% = $84 million
Total subtraction:	$84 million

Because the taxpayer's overall subtraction is less than $285 million (95% of $300 million) no further limitation applies

Example 3: Assume the same facts in Example 2 except that the taxpayer's Oregon corporate excise tax group differs from the taxpayer's Oregon CAT filing group because the taxpayer has two partnerships within its structure. The partnerships' total receipts are $100 million, each have an additional $25 million of commercial activity sourced to Oregon, an additional $75 million of COGS, and when the group's Oregon single sales factor is 9% when recalculated using the Oregon CAT filing group.

The partnerships also have exclusions from commercial activity pursuant to one or more of the exclusions contained in ORS 317A.100(1)(b), which amount to forty percent of their commercial activity. After application of these exclusions, the partnerships have gross non-excludable commercial activity of $60 million and non-excludable Oregon-sourced commercial activity of $15 million.

Again, because U.S. retailer has exclusions from commercial activity, it must reduce the amount of its COGS eligible for the subtraction under ORS 317A.119 by a corresponding amount. Assuming that the U.S. retailer does not separately track its COGS information with respect to specific inventory sold at retail, the U.S. retailer may reduce its total COGS for the subtraction by a pro-rata amount based on the percentage of receipts excluded from commercial activity under ORS 317A.100(b) or 40%. Under this scenario, the calculation would be:

Reduction in COGS for subtraction:	$5.075 billion * 40% = $2.03 billion
Net COGS eligible for subtraction:	$5.075 billion - $2.03 billion = $3.045 billion
35% statutory limitation:	$3.045 billion * 35% = $1.06575 billion
Apportioned subtraction:	$1.06575 billion * 9% = $95,917,500
Total subtraction:	$95,917,500

Because the taxpayer's overall subtraction is less than $229.25 million (95% of $315 million) no further limitation applies

Example 4: U.S. consolidated group with a retail and manufacturing entities and no foreign entities that has $500 million of Oregon sourced commercial activity and $6.25 billion of everywhere sales. The group's only exclusion from commercial activity is an intercompany sale of $2 billion from manufacturer to retailer. The group has $4 billion of COGS (which is greater than its labor costs) and an 8% Oregon apportionment factor for corporate income tax purposes. The taxpayer's Oregon corporate excise tax group and Oregon CAT filing group are the same.

The manufacturer sells its product to the retailer at the manufacturer's cost. Therefore, there are no costs attributable to the intercompany excludable receipts and, thus, no further reduction is required to be made to group's COGS. Under this scenario, the calculation would be:

35% statutory limitation:	$4 billion * 35% = $1.4 billion
Apportioned subtraction:	$1.4 billion * 8% = $112million
Total subtraction:	$112 million

Because the taxpayer's overall subtraction is less than $475 million (95% of $500 million) no further limitation applies

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May 26, 2020

Ms. Katie McCann
Rules Coordinator
Oregon Department of Revenue
955 Center Street Northeast
Salem OR 97301

Sent via email (RulesCoordinator.dor@oregon.gov)

RE: Administrative Rules for the Corporate Activity Tax

Dear Ms. McCann,

The Smart Growth Coalition submits these comments to the Oregon Department of Revenue ("Department") in response to the notice of proposed administrative rules filed on April 26, 2020, relating to the rules and guidance for the corporate activity tax (C.A.T.). Our coalition has worked closely with a technical working group comprised of the Department, governor's office, legislative staff, and other stakeholders to identify statutory ambiguities and resolve administrability and compliance issues through regulation. We appreciate the Department acknowledging some of these concerns in the proposed regulation; however, there are crucial issues still needing to be addressed regarding the apportionment of the cost input or labor cost subtraction ("statutory subtraction") and modified group returns. Our comments will be specific to those areas of regulation.

About the Smart Growth Coalition

The Smart Growth Coalition is a consortium of traded sector businesses with significant operations in Oregon. Our coalition was formed in 1999 to add technical expertise to state legislative proceedings regarding proposed reforms to state tax law affecting businesses who have made investments in jobs and capital projects in the state. Our members are unified in their commitment to sound tax policies that encourage investment in Oregon and provide technical simplicity and clarity to the state tax code.

Legislative History & H.B. 4009-A

Over the days, weeks, and months since the C.A.T. was enacted into law, the taxpayer community has been working to make sense of its statutory and regulatory provisions. We discovered irregularities that, to the best of our knowledge, were unintended by the legislature. In particular, there is significant confusion and complexity regarding the apportionment method for the statutory subtraction and the perceived requirement of mandatory worldwide filing.

In the fall of 2019, we approached the legislature seeking clarity on the statute and, if necessary, to enact corrective legislation. Meanwhile, the Department issued its temporary administrative rule on December 30, 2019,[1] mandating a new apportionment method (the "commercial activity ratio") for all taxpayers, including wholly intrastate taxpayers, to compute their statutory subtraction and did not address the worldwide filing group. The governor's office convened an informal technical working group to discuss both issues and outline appropriate corrective measures.

Stakeholders raised concerns to the technical working group the commercial activity ratio does not comport with the statutory requirements of O.R.S. §§ 317A.119(2) and (3), and could be invalidated if challenged in the courts. O.R.S. § 317A.119(2) specifies the apportionment method for the statutory subtraction shall be in the same manner as Oregon's Uniform Division of Income for Tax Purposes Act (U.D.I.T.P.A.).[2] The temporary administrative rule appeared to overlook this requirement as it prescribed a new apportionment method without any connection to Oregon's U.D.I.T.P.A. provisions. The technical working group also heard concerns the administrative rule did not comport with O.R.S. § 317A.119(3), which prohibits the inclusion of transactions among related group members or cost inputs or labor costs excluded from the definition of commercial activity.

On January 13, the House Committee on Revenue adopted Legislative Concept 249, introduced as H.B. 4009, as the vehicle for corrective legislation. As introduced, the legislation proposed several clarifying and correctional amendments to O.R.S. § 317A. Among those changes was a proposal to replace the reference to Oregon's U.D.I.T.P.A. provisions with the ratio proposed in the temporary administrative order.[3] Through the process of amending the measure, the Committee ultimately rejected the ratio as a statutory method, but expressly allowed the Department to create an alternative approach through regulation.[4] Additionally, the legislation allowed for large filing groups to exclude foreign (i.e., non-U.S.) unitary members if the member had no commercial activity or excludable activity sourced to Oregon.

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[1] See "Temporary rules, guidance for the Corporate Activity Tax, Oregon Laws 2019, chapters 122 and 579."

[2] See ORS §§ 313.605 to 314.666

[3] See H.B. 4009-Introduced section 3(2), at 7-8

[4] For an in-depth discussion on the legislative history and amendments, see Nikki E. Dobay and Jeff Newgard, "Oregon CAT Part II: Fixes Still Needed to Ease Administration," *Tax Notes State,* April 27, 2020, p. 527.

On February 20, the legislative committee unanimously approved these amendments to the tax and there was no known opposition from any legislator or interest group. Unfortunately, the legislature adjourned without enacting H.B. 4009-A or practically any other legislation, and those corrections will need to wait for a future session. Nevertheless, we believe these considerations are crucial to the essential operation of these provisions and the development of the administrative rule.

General Rule for Apportioning the Statutory Subtraction (150-317-1200)

As previously noted, we are concerned the commercial activity ratio, as a mandatory rule, contradicts the apportionment method specified in the statute. More specifically, the rule should reflect the intent of the legislature to align the apportionment provisions with Oregon's U.D.I.T.P.A. provisions. Additionally, the "special rule" outlined in section (3) may only apply in a few situations, given its narrow requirements, and may exclude larger taxpayers.[5] If this narrow approach remains in the rule, the Department would be excluding entire classes of taxpayers, which could be perceived as discriminatory.

We understand the Department has struggled with this alignment because of the requirement in O.R.S. § 317A.119(3) prohibiting a subtraction for certain transactions. However, the response should not be to ignore the statutory directive but, rather, to outline a process for eliminating those expenses from the aggregate amount.

The rule could achieve the requirements of O.R.S. § 317A.119(3) using the following method:

1. Identify the expenses from transactions among members of the unitary group and cost inputs or labor costs attributable to excludable activity.
2. Remove the amount identified in (1) from the amount in O.R.S. §§ 317A.119(1)(a) or (b).
3. Apply the 35 percent subtraction to the net amount in (2)
4. Recompute an apportionment percentage using the Oregon U.D.I.T.P.A. provisions and the C.A.T. unitary group.
5. Apply the apportionment percentage in (4) to the net amount in (3).
6. Make any necessary adjustments to ensure the amount subtracted from taxable commercial activity does not exceed 95 percent of the taxpayer's Oregon commercial activity.
7. Specify that wholly intrastate taxpayers are not required to compute an apportionment percentage outlined in (4).

Since many taxpayers generally do not track the association between cost inputs or labor expenses and commercial activity, the Department must provide an example allowing a taxpayer to use a reasonable approximation to identify an exclusion amount. As an example, the Department could

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[5] The special rule in section (3) allows taxpayers with identical unitary groups and substantially all (95 percent or more) of commercial activity included in the sales factor to use their income tax apportionment percentage. These requirements may be impractical for most taxpayers due to the different ownership thresholds, the water's edge limitation for the income tax, and the nature of the statutory exlcusions.

allow a taxpayer to compute a pro-rata amount based on its proportion of included and excluded activity to fairly reflect the exclusions required in O.R.S. § 317A.119(3).

Although we believe the Department should abandon the commercial activity ratio as the mandatory rule for apportioning the statutory subtraction, we do see a benefit in maintaining it as an elective method. For some taxpayers, the ratio may be simpler to compute than the statutory method. The Department could and, perhaps, should adopt the commercial activity ratio as a safe harbor in the administrative rule.

Modified Group Returns (150-317-1025)

We appreciate the Department's adaptation of the "modified group election" proposed in H.B. 4009-A in regulation.[6] Generally, the ability to exclude foreign (i.e., non-U.S.) entities with no connection to Oregon will simplify the administrability and compliance burden for these complex groups. However, the transactional tests required in section (2)(c) and (d) make the process for identifying excludable entities exceptionally cumbersome. Additionally, many filing groups may be precluded from the exclusion because there are typically shared costs within unitary groups.

The intent of the special rule appears to be to relieve taxpayers (and, arguably, the Department in audit) from the compliance burden of a mandatory worldwide filing regime. However, the transactional tests add significant complexity without producing a material gain for the state or taxpayer. Moreover, the Department should eliminate the requirements in section (2)(c) and (d), and simply allow the tests for determining excludable entities in section 2(a) and (b). This would conform to the intent of H.B. 4009-A by using a bright-line rule for determining excludable entities.

Conclusion

In closing, we appreciate the efforts of the Department to align its regulations with the corrective measures proposed in H.B. 4009-A. We believe the changes outlined in this letter would ease the administrative and compliance burden, and be a positive step in the implementation of the new law.

Sincerely,

Jeff Newgard

Jeff Newgard

cc: Senator Mark Hass, Chair, Senate Committee on Finance & Revenue
Representative Nancy Nathanson, Chair, House Committee on Revenue
Chris Allanach, Legislative Revenue Officer
Christian Gaston, Policy Advisor, Office of Governor Kate Brown

[6] See H.B. 4009-A section 1a, at 7

taxnotes®

Groups Urge Changes to Oregon Gross Receipts Tax Regs

By Paul Jones | June 1, 2020

Business groups are again raising concerns about the Oregon Department of Revenue's proposals for administering the state's new gross receipts tax.

The DOR recently proposed permanent rules for the commercial activity tax (CAT) after issuing temporary rules this year. The draft regulations seek in part to establish how businesses should calculate a subtraction for their cost inputs or labor expenses and when unitary groups can exclude some foreign entities when filing. Business groups argue that those proposals would be burdensome and that the department's subtraction rule conflicts with provisions of the law that enacted the tax.

The Smart Growth Coalition, one of the business groups, wrote in a May 26 letter to the DOR that while it appreciates the staff's efforts, "there are crucial issues still needing to be addressed regarding the apportionment of the cost input or labor cost subtraction . . . and modified group returns" in the draft rule.

Oregon approved the CAT in May 2019. The tax is levied at a 0.57 percent rate on businesses' annual Oregon gross receipts over $1 million; a flat $250 tax is also imposed. Importantly, it allows a subtraction equal to 35 percent of a business's Oregon-apportioned cost inputs or labor expenses, whichever is greater, with the maximum amount of the final subtraction capped at no more than 95 percent of the taxpayer's annual Oregon revenue from commercial activity.

A key question for the state and taxpayers is how the subtractable costs/labor expenses should be apportioned. The proposed regulations, discussed at a May 26 DOR hearing, would establish a "commercial activity ratio" with the taxpayer's Oregon-sourced "commercial activity" — revenue from business activity defined in the CAT statute — as the numerator and the taxpayer's global commercial activity, plus exclusions, as the denominator. The ratio would then be applied to the taxpayer's cost inputs or labor expenses to apportion them.

But business groups argue that that method would be complicated for businesses.

"To go and require this new commercial activity ratio that's not required by any other state . . . requires a new system for every taxpayer," which would be a burden, according to Jeff Newgard of the Smart Growth Coalition.

And according to Nikki Dobay with the Council On State Taxation, the law establishing the CAT requires businesses' subtractable costs/labor expenses to be apportioned using the state's single-sales-factor apportionment method, which businesses currently use to apportion their income for the state's income tax.

"We don't believe the department's rule complies with the statute," Dobay said.

Newgard agreed and suggested that as a result, the proposed rule could be vulnerable to a legal challenge, which would create uncertainty for taxpayers and the state. He also said the rule as proposed could force wholly in-state taxpayers to do an apportionment calculation.

The DOR's proposed rules provide an alternative method that would allow taxpayers to use single-sales-factor apportionment rather than the commercial activity ratio, but only if the taxpayer's CAT filing group is identical to its corporate income tax filing group and the taxpayer can show that at least 95 percent of "the receipts included in the sales factor on the Oregon income or excise tax return are attributable to receipts included in commercial activity."

Dobay told Tax Notes that those requirements are too restrictive — in particular, the CAT is calculated based on a taxpayer's worldwide activity while the state's corporate income tax is a water's-edge tax. As a result, multinational entities would generally not have the same filing group for the CAT as they do for the state's corporate income tax, she said.

"We've pointed out that for taxpayers, this would almost never be an option that's allowed," Dobay said, noting that "most COST members are multinational companies."

COST and the coalition want taxpayers to be able to use the single-sales-factor method to apportion their costs/labor expenses for the subtraction, with adjustments to take into account taxpayers' different filing groups for the CAT, and to exclude costs or labor expenses related to activity exempt from the CAT. Dobay said that using the commercial activity ratio proposed by the DOR should be allowed as an alternative, and a safe harbor protection provided for taxpayers that opt to use it.

The other concern raised by business groups has to do with the ability of taxpayers to exclude some foreign entities from their filing groups. COST and the coalition argue that taxpayers should be able to exclude foreign entities if those entities don't have activity sourced to Oregon.

While the proposed rules try to facilitate such an exclusion, they contain confusing language, including a subsection that "requires the inclusion of any member of the unitary group that has cost inputs or labor costs 'attributable to' the group's receipts from items of commercial activity," COST said in a May 26 letter.

"This provision would require a taxpayer to scour every foreign entity within the unitary group to determine whether any such expenses exist, which is an extremely burdensome task. And, the result to the State will be the inclusion of an entity with no Oregon-source commercial activity," which "may even increase the amount of the taxpayer's subtraction," COST wrote, urging the state to nix the confusing language.

Dobay and Newgard said that despite the ongoing disagreement with the DOR over the proposed rules, the parties involved are working in good faith. Notably, a cleanup bill — H.B. 4009 — was proposed in the 2020 legislative session and included language addressing the groups' two concerns.

However, the legislative session ended after Republicans staged a walkout over a cap-and-trade bill, and H.B. 4009 and many other proposals failed to pass as a result. Lawmakers subsequently recommended that similar legislation be resurrected if Gov. Kate Brown (D) calls a special session to address the fallout from the COVID-19 pandemic and resulting lockdowns. Newgard said such legislation would ultimately be necessary to address issues with the CAT.

Cleanup legislation "is something we need to get across the line," Newgard said. Then "we'll have the certainty that businesses need, and the state will have certainty that businesses know how to comply with the tax."

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Orgs Say Proposed Oregon Corp. Tax Rules Violate State Statute

By Daniel Tay | May 29, 2020

A proposed apportionment rule for Oregon's corporate activity tax violates state statute, and another proposed rule on multinational entities meant to decrease compliance burdens actually increases them, taxpayer representatives seeking amendments told the state tax department.

The state's proposed rule for apportioning a statutory subtraction from the state's corporate activity tax base does not comply with state law, representatives from the Council on State Taxation and the Smart Growth Coalition, an organization representing Oregon-based multinational and multistate businesses, told the state Department of Revenue at a Tuesday hearing.

The hearing was the first of several to allow comment on temporary rules currently implemented by the department as it begins the rulemaking process for permanent rules.

Oregon's Democratic Gov. Kate Brown signed the bill approving the corporate activity tax in May 2019. The law imposes a $250 tax on the first $1 million of a business's gross receipts and a 0.57% tax on gross receipts greater than $1 million, after qualifying subtractions.

Under state law, an entity subject to the tax may take a subtraction for labor cost or cost inputs. The proposed rule for apportioning the subtraction would require a taxpayer to use a "commercial activity ratio": the taxpayer's Oregon-sourced commercial activity divided by the sum of its total commercial activity, with certain statutory exclusions from commercial activity added back in.

This proposed method of apportioning the subtraction is not consistent with the statute that authorizes the subtraction, Nikki Dobay, a representative of COST, and Jeff Newgard, representative for the coalition, told the department Tuesday.

"The commercial activity ratio, as proposed, doesn't comply with the statutory requirements and we think that while that can be offered as a safe harbor, to streamline the process for taxpayers, it should not be the general rule," Dobay said.

The statute requires a taxpayer to subtract certain expenses related to receipts that are specifically excluded from commercial activity, which is not the same as adding the exclusions back into the denominator, Dobay told Law360.

Dobay added that while she had been told by the department that the commercial activity ratio was meant to be a more streamlined way to compute the subtraction, it was unclear if the proposed rule accomplished this goal.

"They've kind of mushed the apportionment piece, and the exclusion of certain expenses, into this commercial activity ratio," Dobay told Law360. "What we've said is, based on the statute, you have to exclude these expenses; we're not really sure this commercial activity ratio gets you there."

Newgard told Law360 that the proposed method could also create compliance burdens for taxpayers, as it would require them to create a new system specifically to compute apportionment for the Oregon tax.

"It's a method no other states use," Newgard said.

He said that in comparison, for computing income tax apportionment, most states use more or less the same formula with slight differences.

"At the end of the day they're working with the same formula, so it's relatively simple from a compliance perspective," Newgard said.

Newgard and Dobay noted that both COST and the coalition supported keeping the current proposed method as a safe harbor, with Newgard saying that some taxpayers might find it easier to use.

Another proposed rule would allow certain unitary groups to omit information on a foreign member from a group return, if the member demonstrates it has no connection to Oregon. According to the rule, the member can be omitted if it has no commercial activity sourced to Oregon under state law, or has commercial activity excluded under state law that would not be Oregon-sourced if it were included.

A member can also be omitted if it has no transactions with another member in which that other member would realize commercial activity sourced to Oregon if it weren't excluded by statute, or if it has no cost inputs or labor costs attributable to the unitary group's receipts from commercial activity.

The tests for whether a member has transactions with another member or has costs attributable to the unitary group's receipts were unnecessary and could create additional compliance burdens, which the proposed rule was meant to avoid, Dobay told Law360. There could also be increased audit burdens on the state, according to Newgard and Dobay.

Dobay and Newgard both said they appreciated the department's attempts to provide taxpayer relief with the proposed multinational rule, noting that there had been a bill, H.B. 4009, that would have provided similar relief. The bill died when the Oregon Legislature adjourned following a Republican walkout over a bill to regulate carbon emissions, which then-Senate

Republican Leader Herman Baertschiger Jr., R-Grants Pass, referred to as a "gas tax disguised as an environmental bill."

Dobay and Newgard both told the department it should remove the transaction tests, saying doing so would ease administrative and compliance burdens for taxpayers.

The department did not respond to requests for comment regarding the suggestions put forward by COST and the coalition.

The state previously raised the threshold for requiring businesses to prepay the corporate activity tax to provide relief to businesses during the coronavirus pandemic. Oregon businesses previously asked a state legislative committee on the coronavirus response to suspend collection of the tax while the state grapples with the pandemic.

From: Nikki Dobay <ndobay@cost.org>
Sent: Friday, June 12, 2020 1:01 PM
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Subject: RE: 150-317-1200 DOJ Feedback 06.11.20 clean copy
Attachments: COST Comments re OR CAT Perm Rulemaking May 26 2020 FINAL.pdf

Hi Deanna,

Thanks again for sending this over. I definitely appreciate your willingness to provide the draft for comments ahead of your deadline, even if we are working under very tight deadlines as well.

After further review, our general sentiment regarding this draft remain largely unchanged from the initial draft to which we provided comments on May 26 (see attached). Although the commercial activity ratio has been moved to a substitute rule, the manner in which the general rule is drafted continues to preclude most taxpayers from being able to utilize that rule. First, the requirement that a taxpayer can only use the general to determine its subtraction where "a taxpayer can readily determine, from the taxpayer's books and records maintained in the ordinary course of businesses, how much of its total labor costs or cost inputs are ineligible costs or that it has no ineligible costs," could only be used if a taxpayer separately accounts for its costs. This concept is simply out of step with Generally Accepted Accounting Principles, with which most companies are required to comply. Although a taxpayer may separately account for different lines of business, costs are generally aggregated for all the revenue streams in an individual business. Because the general rule would appear to be inapplicable to essentially all taxpayers, it ultimately seems to force taxpayers to use the commercial activity ratio as the default. Thus, although the rule has been reordered, it does not seem to operate any differently than the rule as initially drafted.

In addition, I would also point out the following specific items as issues that appear problematic. I would, however, caveat that these may not be the only issues since I've had very limited time to analyze this new draft:

- Including "ineligible costs," "eligible costs," "applicable costs" and "ratio costs" in quotes creates confusion. The inclusion of these items in quotes seems to indicate these are accounting terms of art or references from the statute; however, they do not appear to be either. Thus, the use of these terms appears to create more ambiguity.
- Specifically carving out throwback for purposes of the apportionment formula for subtraction seems beyond the scope of the Department's rulemaking authority. The purpose of the reference to the UDITPA provisions in the CAT statutes was to capture a taxpayer's market in the state, based on the state's general apportionment rules. Because the state's longstanding position apportionment position has included throwback, it would seem to follow that for purposes of apportioning a taxpayer's subtraction that rule should apply here. As has clearly discussed in our prior comments, it is our position the requirement to exclude certain costs is separate from the apportionment of the subtraction. Thus, the general UDITPA apportionment rules apply for this later requirements, which would include throwback.
- Modified substitute rule suffers the same flaws as the general rule—see concerns above.
- Alternative apportionment provisions continue to lack specific guidance regarding the timeframe in which the Department will respond to a request for alternative apportionment. Please see the language suggested in our comments from May 26.

Again, we appreciate the opportunity to provide further feedback. Unfortunately the current draft seems to suffer many of the same infirmities as the prior draft, and we continue to stand by our suggested edits to the draft that were included with our May 26th comments (see attached).

Thanks and happy to discuss further.
Nikki

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Subject: 150-317-1200 DOJ Feedback 06.11.20 clean copy
Importance: High

Here is the version we've been working on in response to the public hearing. Sorry, it's so short before our noon meeting. But we'll go over it in detail when we chat. We haven't shared it with anyone else yet, we wanted to get your thoughts first before we did that. Thanks Nikki! Deanna 😊