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Continue to Keep Your Eyes Peeled and Your Ears Tuned-In for CAT Developments—They Are Rolling In

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Recent Announcements

The Oregon Department of Revenue (the "Department") has made several recent announcements regarding Oregon's new Commercial Activity Tax (the "CAT").

In an email dated December 4, 2019, the Department said it anticipated sharing initial drafts of the first batch of temporary administrative rules on its website in December 2019.

In the same email, the Department also announced that some issues will not be addressed in its rules. For example, the Department has determined that there is no way to provide guidance with respect to how businesses may properly estimate the amount of CAT liability attributable to particular transactions. The Department goes on to tell us, however, that many frequently asked questions will be addressed in forms, instructions, publications and/or FAQs on the Department's website.

Importantly, the Department has made it clear that the CAT "does not prohibit any business subject to the CAT from passing the tax along to its customers."

In an email dated December 5, 2019, the Department announced that taxpayer registration for the CAT for 2020 is now open on its Revenue Online portal.

According to the Department, individuals will need their name and social security number or taxpayer identification number to register, while businesses will need their legal name and federal employer identification number.

Businesses and individuals will also need:

- Their mailing address;
- The date they exceeded or anticipate exceeding $750,000 in Oregon commercial activity;

- A valid email address or a current login to Revenue Online; and
- Their Business Activity Code (which are the North American Industry Classification System codes located in applicable federal income tax return instructions.)

New Rules

On December 6, 2019, the Department published its first set of draft temporary rules. In many respects, the rules repeat or slightly clarify the statute. In some respects, however, the rules take a detour from what we expected to see.

Substantial Nexus Guidelines (OAR 150-317-1010)

On December 6, 2019, the Department issued a draft temporary rule that provides that no physical presence in Oregon is required in order for a taxpayer to have substantial nexus in the state for CAT purposes. The "significant economic presence" is sufficient. According to the Department, if a taxpayer "regularly takes advantage of Oregon's economy to realize commercial activity," substantial nexus exists. Unfortunately, no bright line test has been provided.

Under the draft rule, the Department may consider the following non-exclusive factors in determining whether a person has substantial nexus, to the extent such factors are relevant:

- Maintains continuous and systematic contacts with Oregon's economy or market;
- Conducts deliberate marketing to, or solicitation of, Oregon customers;
- Files or is required to file reports or returns with Oregon regulatory bodies;
- Realizes significant gross receipts attributable to customers in Oregon;
- Realizes significant gross receipts attributable to the use of the person's intangible property in Oregon;
- Receives benefits provided by the state; or
- Any other relevant facts and circumstances.

For purposes of the penultimate bullet point listed above, relevant benefits include:

- Laws providing protection of business interests or regulating consumer credit;
- Access to courts and judicial process to enforce business rights, including debt collection and intellectual property rights;
- Highway or transportation system access for transport of the person's goods or services;

- Access to an educated workforce in Oregon; or
- Police and fire protection for property in Oregon that displays the person's intellectual or intangible property.

The following are based on the examples provided in the draft rule:

Example 1: Distribco, located in Washington, distributes wine and beer throughout Oregon, through Oregon-licensed distributors with whom Distribco has distribution contracts. Distribco must maintain a wholesaler's license from the Oregon Liquor Control Commission (OLCC). Distribco is required to provide monthly reports of sales volumes to the OLCC. Distribco also periodically obtains approval from the OLCC for special activities in Oregon, where no sales are solicited by Distribco. Distribco has substantial nexus in Oregon.

Example 2: Webco, with headquarters in Delaware, operates a website that supports internet sales, mainly to European customers. Webco made around 10,000 sales to residents of Oregon during the year, for which it received $990,000 of commercial activity. Webco contracts with an Oregon mailing service to deliver products in Oregon. Even though Webco's commercial activity is less than the CAT filing threshold, Webco has substantial nexus in Oregon. Therefore, it must register with the Department when its commercial activity exceeds $750,000.

Unitary Group Factors (OAR 150-317-1020)

The Department issued a draft temporary rule on December 9, 2019 relative to unitary groups.

A unitary business is described as "a single economic enterprise" comprised of "separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated, and interrelated through their activities" such that they "provide a synergy and mutual benefit that produces a sharing or exchange of value among them," as well as "a significant flow of value to the separate parts." Such sharing or exchange of value may be present where the operation of one part of a business is dependent upon, or contributes to, the operation of another part of the business.

Determination of a unitary business requires more than merely a flow of funds from a passive investment or "from the financial strength contributed by a distinct business undertaking that has no operational relationship to the unitary business." The Department has asserted that a unitary determination will be made to the fullest extent permitted by the U.S. Constitution.

One entity may have multiple unitary businesses. Where that is the case, the commercial activity with respect to each unitary business must be determined for purposes of sourcing commercial activity and the subtraction.

A unitary business is characterized by "significant flows of value" evidenced by the following factors previously identified in the CAT: centralized management, economies of scale and functional integration. The Department has elaborated on the CAT language in stating that these factors provide evidence of whether the business activities "operate as an integrated whole or exhibit substantial mutual interdependence." Facts should not be considered in isolation, but rather together for their "cumulative effect."

The draft temporary rule provides the following indicators of a unitary business:

- Activities that are generally in the same line of business, such as a grocery chain operating in multiple states, will generally constitute one unitary business.
- Activities that constitute separate steps in a vertically structured enterprise will nearly always constitute one unitary business.
- Activities may be considered one unitary business where there is strong centralized management, together with centralized departments for functions like financing, advertising, research or purchasing. Strong centralized management is present when central management makes substantially all of the business's operational decisions.

The following subsections discuss additional guidance provided in the draft temporary rule with respect to the unitary business factors discussed above:

Centralized Management

The draft temporary rule further delineates what constitutes centralized management for purposes of determining whether a unitary business exists. Under the rule, management is centralized when "officers, directors, partners, members, managers, or others jointly participate in the management decisions that affect the respective business activities and that may also operate to the benefit of the entire economic enterprise."

Centralized management may exist whether one entity or division within an entity effects centralization with respect to another entity or division (including by a parent to a subsidiary, a subsidiary to a parent or between subsidiaries). Where day-to-day management is decentralized, centralized management may still exist if management has an "ongoing operational role" with respect to the activities of the business. An ongoing operational role may exist by virtue of "mandates, consensus building, or an overall operational strategy of the business, or any other mechanism that establishes joint management."

The following facts provide evidence of centralized management:

- Common officers, directors, partners, members, managers or others participate in the decisions relating to the business operations of the business's different segments; and
- Management shares or applies knowledge and expertise among different parts of the business.

Centralized management is not shown merely by the existence of common officers, directors, partners, members, managers or others, but such existence provides evidence of centralized management. Common officers provide more evidence of centralized management than common directors.

Efforts taken to safeguard investments or review the performance thereof ("stewardship oversight"), such as instituting reporting requirements or merely approving capital expenditures, do not provide evidence of centralized management. However, an owner's actions taken to enhance value by integrating operating aspects of multiple business activities are not mere stewardship oversight activities.

Economies of Scale

The Department has described economies of scale in the draft temporary rule as a "relation among and between business activities resulting in a significant decrease in the average per unit cost of operational or administrative functions due to the increase in operational size." Economies of scale may occur from "inherent cost savings" that arise as a result of centralized management or functional integration.

The following provide evidence of economies of scale:

- Centralized purchasing that is designed to achieve savings based on purchase volume, purchase timing or the interchangeability of items among different parts of the business.
- Centralized administrative functions, including legal services, payroll services, pension and other employee benefit administration.

Functional Integration

Functional integration is described in the draft temporary rule as "transfers between, or pooling among, business activities that significantly affect the operation of the business activities." Such integration includes, without limitation, transfers or pooling with respect to:

- Products or services;
- Technical information;

- Marketing information;
- Distribution systems;
- Purchasing; and
- Intangibles, including patents, trademarks, service marks, copyrights, trade secrets, know-how, formulas and processes.

The draft temporary rule provides that the following are evidence of functional integration in business operations:

- Sales, exchanges, or transfers of products, services, or intangibles between business activities, whose significance will be affected by the character of the goods or services and/or the percentage of sales represented thereby. For example, sales among vertically integrated unitary business units are indicative of functional integration. Functional integration may exist notwithstanding the use of a readily determinable market price to affect intercompany sales.
- The sharing of common marketing features when the marketing results in significant mutual advantage. Such marketing exists when a substantial portion of products, services, or intangibles are distributed or sold to a common customer, when a common trade name or other common identification is used, or when entities identify themselves to customers as part of one enterprise. Common marketing is not present merely by use of a common advertising agency or a commonly owned or controlled in-house advertising office.
- Transfers or pooling of technical information or intellectual property, including patents, copyrights, trademarks, service marks, trade secrets, processes, formulas, know-how, research, or development.
- Use of a common distribution system, under which inventory control and accounting, storage, trafficking, or transportation are commonly controlled.
- Common purchasing of substantial amounts of products, services, or intangibles from the same source, particularly if significant cost savings are obtained or where the items purchased are not readily available from other sources and are significant to the entities' operations or sales.
- Significant common or intercompany financing, including guarantees by or pledging of credit of, one or more businesses for the benefit of another business, if the financing activity serves an operational purpose of both borrower and lender. However, this does not include mere lending which serves the lender's investment purpose.

Example

The draft temporary rule provides an example upon which the following is based:

Example: Enco, Salesco, and Consultco are part of one unitary group. Enco is an engineering corporation based in Oregon. Salesco is a partnership headquartered in Washington that sells tangible personal property throughout the country. Consultco is a partnership that sells consulting services to third parties, and it has no property or employees in Oregon. In 2020, Enco has commercial activity of $2.3 million in Oregon from transactions with unrelated customers. Salesco has commercial activity in Oregon of $230,000 from transactions with unrelated customers. Consultco provided one hour of consulting service to a third party in Oregon, resulting in $1,000 of commercial activity. Enco and Salesco each have substantial nexus with Oregon, but Consultco does not. Because each is a member of a unitary group and at least one member has substantial nexus with Oregon, the unitary group must register, file, and pay the CAT as one taxpayer on the total amount of commercial activity realized by all three members of the group.

Agent Exclusion (OAR 150-317-1100)

On December 9, 2019, the Department issued a draft temporary rule to assist taxpayers in determining whether the Agent Exclusion is applicable to them. The temporary rule offers limited guidance, namely:

- "Agent" means a person who is acting on behalf of another and is subject to the other person's control;
- All facts and circumstances must be considered;
- An agent may exclude the fair market value of property, money and other amounts from TCA but only to the extent such property, money and other amounts are received or acquired on behalf of the person who controls the agent; and
- An agent must include its fee, commission or remuneration in its TCA.

The draft temporary rule provides the following examples:

Example 1: On June 30, 2020, York Escrow Company agrees to hold $60,000 for a real estate down payment on behalf of Mr. Thomas. Mr. Thomas has the ability to direct payment of the real estate down payment. York Escrow Company charges Mr. Thomas a three percent fee ($1,800) for the escrow services. York Escrow Company does not include the $60,000 real estate down payment in its commercial activity. However, York Escrow Company must include the $1,800 fee in its commercial activity.

Example 2: On January 1, 2020, Rothko Piano Company (an accrual basis taxpayer) agrees to renovate a concert piano for Mr. Smith. It is intended that the renovated piano will be used for concerts. Mr. Smith retains control of all aspects of the renovation project. Mr. Smith provides a piano with a fair market value of $10 million to Rothko Piano. The renovation period is nine months. Rothko Piano charges a fee of $500,000 due on completion of the piano renovation. In addition, Rothko Piano's fee includes a commission of $1,000 for each concert performed using the piano. Rothko Piano does not include the fair market value of the piano in its commercial activity, as it is holding the piano pursuant to an agency agreement with Mr. Smith. However, Rothko Piano must include the $500,000 fee in its 2020 commercial activity. In addition, Rothko Piano includes the concert commissions in its commercial activity after each concert is performed.

Example 3: Human Resource Services, Inc. (HRS) provides payroll, human resources, and benefits services for small businesses for a fee. As part of its services provided to small businesses, HRS processes employee payroll; assists the businesses with hiring and firing, FMLA and OFLA regulations; and manages employee insurance benefits. The small businesses pay HRS fees for its services in a lump sum with the amounts due the small businesses' employees for wages earned. HRS does not include in its commercial activity the amount it is holding for the benefit of the small businesses' employees, but it must include in its commercial activity the fees small businesses pay HRS for its services.

Example 4: Assume the same facts as Example 3, except that HRS has a contractual obligation with each small business to pay the small business's employees according to the small business's payroll schedule (e.g. weekly, bi-weekly, semi-monthly, or monthly) and is reimbursed by the small business for the amount of wages that HRS paid the small business's employees. The reimbursement amounts paid to HRS for wages that HRS paid the small business's employees on behalf of the business is not includible in HRS's commercial activity.

Property Brought into Oregon (OAR 150-317-1130)

On December 9, 2019, the Department issued a draft temporary rule to assist taxpayers in determining when property brought into Oregon must be included in taxable commercial activity ("TCA"). In addition to repeating the statutory provision dealing with this issue, the rule offers the following example:

Example: Unitary group XYZ purchases motor vehicle fuel in Idaho on January 15, 2020 and transfers the motor vehicle fuel to Oregon on January 18, 2020. Unitary group XYZ would not include the fair market value of the motor vehicle fuel in their Oregon commercial activity because commercial activity excludes receipts from the sale of motor vehicle fuel.

The rule emphasizes that a person or unitary group should not include in their TCA the fair market value of property transferred into Oregon within a year of receipt outside Oregon if the transfer of property into Oregon within a year of receipt outside Oregon was not intended to avoid the CAT in whole or in part.

Estimated Tax Payments: When Payments are Required (OAR 150-317-1300)

Under a draft temporary rule issued by the Department on December 6, 2019, no estimated tax payments will need to be made if a taxpayer does not expect more than $5,000 in CAT liability for the year, not taking into account any credit balance from the prior year. Tax-exempt organizations that have unrelated business taxable income for federal income tax purposes and which will have estimated CAT liability of more than $5,000 must make estimated CAT payments.

Estimated tax payments will be required "regardless of when a taxpayer exceeds $1 million" of TCA. Estimated tax payments will be credited as of the date they are received.

In the case of short-year returns, the draft temporary rules provide the following estimated tax payment schedule:

- For periods of less than four months, only one payment will be required. The payment must equal 100 percent of the estimated tax and will be payable on the return due date.
- For periods of four months or longer, but less than six months, two payments will be required. Half of the estimated tax will be due on the 15th day of the fourth month, and the balance will be due on or before the return due date, not including extensions.
- For periods of six months or longer but less than nine months, three payments will be required. A third of the estimated tax will be due on the 15th day of the fourth month, another third on the 15th day of the sixth month and the balance on or before the return due date, not including extensions.
- For periods of nine months or longer, but less than twelve months, four payments will be required. A fourth of the estimated tax will be due on the 15th day of the fourth month, another fourth on the 15th day of the sixth month, another fourth on the 15th day of the ninth month, and the balance on or before the return due date, not including extensions.

Estimated tax payments will generally not be refunded before the taxpayer files a CAT return for the year. This will be the case even if estimated payments exceed the taxpayer's CAT liability. The Department will consider issuing refunds prior to the end of the year on a case-by-case basis if it determines that the facts warrant a refund. No further guidance was provided on this issue.

A taxpayer that overpays its CAT liability may make an irrevocable election to have the overpayment either: (1) refunded; or (2) applied as an estimated tax payment to the following year (an "elected overpayment"). The election will be made on the CAT return in a space for that purpose.

For the 2021 tax year and beyond, the Department will apply an elected overpayment to the first quarterly payment of the following year to the extent the payment is received prior to the first-quarter due date in such year. Otherwise, a payment will be applied as of the date the payment is received. An elected overpayment that relates to an amended or delinquent return will apply to the later of: (1) the date such return is filed; and (2) the date such payment is received.

The Department has provided that any tax overpayments will be credited first to prior quarter underpayments.

Taxpayers will need to make estimated tax payments by electronic funds transfer ("EFT"), beginning with the 2020 tax year. A taxpayer may request a one-time exemption if it will be disadvantaged by this rule. The request must list the reason why the taxpayer will be disadvantaged. If the Department grants the exemption, it will limited to a 12-month period. The taxpayer is expected to make arrangements during the 12-month period so that future payments will be made by EFT.

The following is based on the example provided in the draft temporary rule:

Example: Flowerco, a retail flower store chain with expected TCA of $2 million for 2020, uses Payco, a local payroll service, for all of its tax payments. Payco does not have the capability to use EFT for tax payments. Flowerco can request an exemption for the 2020 tax year because it would put Flowerco at a disadvantage to have to change payroll service companies by the beginning of 2020. However, the Department expects Flowerco to remedy the situation in time for the 2021 tax year (presumably, by switching payroll companies if Payco does not add EFT functionality by that time). The same result would obtain if Flowerco's bank did not have EFT functionality for Flowerco to make estimated CAT payments.

Estimated Tax Payments: Underpayments (OAR 150-317-1310)

Pursuant to a draft temporary rule issued by the Department on December 9, 2019, a CAT underpayment will exist when estimated tax payments of less than 25 percent (or the applicable percentage specified for short-year returns) are made with respect to the following amounts:

- For the 2020 tax year, 80 percent of the tax for the tax year.
- For 2021 and future tax years, 100 percent of the tax.
- For 2021 and future tax years, 100 percent of the tax shown on the prior year's CAT return (after credits), if the preceding tax year was a 12-month period and the taxpayer filed a CAT return showing a liability for that tax year. If the current taxable year is less than 12 months, the tax for the prior tax year must be reduced by multiplying it by the number of months in the current tax year and dividing the result by 12.
- 100 percent of the tax computed on annualized TCA. Tax credits available on the date of the payment (but not merely estimated or anticipated) may be deducted.
- With respect to any person with seasonal commercial activity, 100 percent of the amount determined by applying Code Section 6655(e)(3)(C) to TCA.

Under the draft temporary rule, annualized TCA will be computed by entering the TCA on an annualized basis:

- For the first three months of the taxable year, in the case of the installment required to be paid in the fourth month;
- For the first three months or for the first five months of the taxable year, in the case of the installment required to be paid in the sixth month;
- For the first six months or for the first eight months of the taxable year, in the case of the installment required to be paid in the ninth month; and
- For the first nine months or for the first 11 months of the taxable year, in the case of the installment required to be paid in the 12th month of the taxable year.

For unitary groups, the draft temporary rule provides that an underpayment will be computed on a combined basis, aggregating the "tax and facts shown" on the prior year's returns, regardless of whether separate or combined returns were filed. If unitary group members file separate returns but pay estimated tax on a combined basis, the members may divide the payments and prior year's tax between the members' liabilities in any manner that the members designate.

The draft temporary rule provides that interest will accrue on CAT underpayments at the rate provided in OAR 150-305-0140 from the payment due date until the earlier of:

- The date the tax is paid, or
- The due date of the tax return.

In accordance with the draft temporary rule, the Department will not impose underpayment interest for any quarter in which annualized TCA will result in a net annualized tax of $10 or less.

Pursuant to the draft temporary rule, underpayment charges will be "assessed on the last return filed and received" before the due date of that return (the "original return"). The tax due on the original return will be used as the basis for computing underpayment charges. In the draft rule, the Department has asserted that an amended return that reduces a tax liability will not reduce underpayment charges based on an original return.

Estimated Tax: Unitary Groups and Apportioned Returns (OAR 150-317-1320).

Pursuant to a draft temporary rule issued by the Department on December 9, 2019, unitary group members have joint and several liability for the CAT, including the filing and payment of estimated tax liability. Estimated CAT payments will be made on a combined basis.

It appears that the Department will allow taxpayers to apportion commercial activity for purposes of the subtraction using either the current period's actual apportionment factor or the prior full-year's apportionment factor, to meet the annualized exception to underpayment of estimated taxes.

Extension of Time to File (OAR 150-317-1330)

Under a draft temporary rule issued by the Department on December 6, 2019, a taxpayer will be allowed a six-month extension of time to file a CAT return if the taxpayer requests such extension on a completed application form provided by the Department. The taxpayer must file the application before the due date of the return and must certify that it has good cause for requesting an extension. Good cause must exist at the time the extension is requested.

"Good cause" is defined as any of the following:

- Death or serious illness of the taxpayer or a member of the taxpayer's immediate family;
- Destruction by fire, natural disaster or other casualty of the taxpayer's home, place of business or records needed to prepare CAT returns;
- Unavoidable and unforeseen absence of the taxpayer from Oregon that began before the CAT return due date; or
- Information required to complete the CAT return is not available or is not in the proper form.

The Department expressly states, however, it will not accept any of the following circumstances as "good cause":

- Reliance on a tax professional to merely prepare the CAT return on time; and
- Reliance on the taxpayer's employee to prepare the CAT return on time.

Arguably, the rule does not limit "good cause" to the aforementioned circumstances. Consequently, other circumstances may constitute "good cause." Be aware—the temporary draft rule is not clear in this regard.

Conclusion

There is a lot to digest from these temporary draft rules. We will continue to analyze these rules as well as any additional rules adopted by the Department.

Tags: Agent Exclusion, CAT underpayment, centralized management, Commercial Activity Tax, corporate activity tax, estimated tax payments, functional integration, gross receipts tax, NEXUS, Oregon, Oregon businesses, Oregon CAT, Oregon Department of Revenue, Oregon Taxpayers, Registration, tax practitioner, taxable commercial activity, unitary groups