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Curiosity Killed the Cat - Unfortunately the Oregon Legislature's Curiosity Has Not Gone That Far With Respect to Our CAT: The Oregon Corporate Activity Tax

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During the special session, the Oregon legislature passed House Bill 4202 ("HB 4202"), which Governor Kate Brown signed into law on June 30, 2020. The legislation, which makes several technical and policy changes to the Oregon Corporate Activity Tax (the "CAT"), becomes effective on September 25, 2020.

The Oregon Legislative Revenue Office estimates that the modifications to the CAT resulting from HB 4202 will cost the state approximately $500,000 per year in lost tax revenue for each of the next six years. The CAT was projected to raise approximately $1 billion per year in tax revenue. Consequently, assuming these projections turn out to be accurate, the revenue losses attributable to HB 4202 should amount to less than one-tenth of 1 percent.

HB 4202 brings good news to farmers and provides some clarity for a small subset of Oregon taxpayers. Unfortunately, the legislature did not repeal the CAT, and our lawmakers' curiosity was not enough to cause them to look closely at the law and make the monumental changes that many taxpayers have been pleading for these past months.

HB 4202
BROAD OVERVIEW

HB 4202 makes numerous changes to the CAT, including:

- excluding crop insurance payments from commercial activity;
- clarifying that tax refunds (with limited exceptions) do not constitute commercial activity;
- giving out-of-state vehicle dealers access to the exclusion of registration fees or taxes from commercial activity;
- excluding certain dairy sales from commercial activity;
- providing an alternative definition of cost inputs applicable only to certain farming businesses;

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- providing that manufactured dwelling park nonprofit cooperatives are not subject to the CAT;
- allowing for the exclusion of certain foreign entities from the unitary group concept;
- attributing allowances and returns to the year in which they occur;
- making certain modifications to the 35-percent subtraction computation;
- allowing farmers to elect to apply an industry average to estimate product exports for purposes of the out-of-state wholesale exclusion;
- eliminating the need for businesses to annually register for the CAT; and
- tweaking the interest and penalty provisions.

Exclusions from Commercial Activity

HB 4202 makes a number of alterations to provisions that contain exclusions from commercial activity (commercial activity is the starting point for determining CAT liability).

Insurance Proceeds

Under the CAT statute, insurance proceeds are excluded from the CAT, except for proceeds received for the "loss of business revenue." HB 4202 expressly provides that crop insurance proceeds (which reasonably might otherwise constitute proceeds received for the loss of business revenue) are excluded from commercial activity.

HB 4202 also changes the reference of "business revenue" to "commercial activity." So, the exclusion now reads:

"Proceeds received on the account of payments from insurance policies, including crop insurance policies, owned by the taxpayer, except those proceeds received for the loss of commercial activity."

Tax Refunds

Under the CAT statute, certain tax refunds are excluded from commercial activity:

"Tax refunds, other tax benefit recoveries and reimbursements for the tax imposed under ORS 317A.100 to 317A.158 made by entities that are part of the same unitary group as provided under ORS 317A.106, and reimbursements made by entities that are not members of a unitary group that are required to be made for economic parity among multiple owners of an entity whose tax obligation under ORS 317A.100 to 317A.158 is required to be reported and paid entirely by one owner, as provided in ORS 317A.106."

HB 4202 changes the initial reference of "tax refunds" to "tax refunds from any tax program." The legislative history reflects that this change is for clarification purposes. We assume that this change was made to avoid a potential interpretation that the provision was limited to CAT refunds. So, it is now clear that any tax refund is not included in commercial activity for computing a taxpayer's CAT liability.

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Vehicle Dealer Registration Fees

HB 4202 extends the application of the commercial activity exclusion for registration fees or taxes collected by vehicle dealers to out-of-state vehicle dealers. Prior to HB 4202, this exclusion was limited to in-state vehicle dealers.

Exclusion for Milk Sales by Farmers

HB 4202 excludes from commercial activity "receipts from the sale of fluid milk by dairy farmers that are not members of an agricultural cooperative."

Practice Alert: As previously discussed, farmer sales to agricultural cooperatives are excluded from commercial activity, as are the wholesale and retail sales of groceries and sales to wholesalers who will resell the products out of Oregon. The Oregon Department of Revenue (the "DOR") by rule announced that the grocery exclusion does not apply when there will be further processing of the groceries. There was concern that milk must always be processed (i.e., pasteurized) before it can be resold, and thus the grocery exclusion would not apply to farmer sales of milk. HB 4202 puts farmers who sell milk to buyers who are not agricultural cooperatives on the same footing as those who sell milk to agricultural cooperatives. However, farmers who sell non-milk products that must be further processed to anyone other than agricultural cooperatives and those who will resell the product out of state will not be as lucky. For them, the exclusion is inapplicable.

Other Changes

Alternate Cost Inputs Definition for Farmers

Taxpayers may subtract from commercial activity sourced to Oregon 35 percent of the greater of cost inputs or labor costs in arriving at taxable commercial activity (the base of the CAT). Cost inputs are defined as the cost of goods sold ("COGS") "in arriving at federal taxable income" under the Code.

HB 4202 creates an additional definition of cost inputs to be used by taxpayers engaged in a farming operation that do not report COGS for federal tax purposes. For such taxpayers, cost inputs means "the taxpayer's operating expenses excluding labor costs." "Farming operation" for this purpose is defined as "an entity doing business in a sector described under codes 111, 112 or 115 of the North American Industry Classification System."

Exclusion of Manufactured Dwelling Park Nonprofit Cooperatives

The CAT excludes numerous entities from its purview, including organizations described in Code Section 501(c).

HB 4202 adds to the list of excluded entities "manufactured dwelling park nonprofit cooperatives organized under ORS chapter 62." The legislative history reflects that this amendment to the CAT was a

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clarifying change. In other words, it was intended by the legislature when the CAT was originally enacted.

Election to Exclude Foreign Members from Unitary Group

Under the CAT, unitary groups register, file, and pay the CAT as a single taxpayer. Additionally, receipts attributable to intergroup transactions are excluded from the CAT.

HB 4202 gives taxpayers the ability to elect to exclude from unitary group membership "all foreign members with no commercial activity, or amounts realized but by definition excluded from commercial activity, that is sourced to Oregon."

HB 4202 directs the DOR to adopt policies and procedures with respect to this election, specifically including the following:

- The time and manner to make or terminate an election;
- The allowed duration of an election;
- The DOR's discretion to disallow an election in whole or in part;
- The withdrawal of an election by a taxpayer before filing;
- The treatment of property of the unitary group transferred into Oregon;
- Filing, payment of fees and registration with respect to the election; and
- Any other policies and procedures that the DOR deems necessary to administer and operate the election.

Practice Alert: Neither HB 4202 nor any other provisions of ORS Chapter 317A define the term "foreign." ORS 317A.149(2) provides that any term not defined in ORS 317A.100 has the meaning given it for purposes of ORS chapter 305, 314, 316, or 317. The term "foreign" is not defined in any of those enumerated chapters. While the legislative history describes this provision as applying to "entities with no connection to Oregon," it is unclear whether it applies only to international entities or out-of-state entities. We suspect it applies to out-of-state entities.

Returns and Allowances

HB 4202 allows "returns and allowances, as those terms are applicable" to Code Section 448, as "an offset against commercial activity in the calendar year when the returns or allowances are made."

Subtraction Revisions

HB 4202 reorganizes and makes some changes to the subtraction provisions in ORS 317A.119. The legislative history characterizes the purpose of this portion of the bill as clarification.

A few of the changes appear to be slight technical tweaks (e.g., adding "unitary" to the exclusion of expenses among "group" members).

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The apportionment provisions are expanded. The prior provisions simply directed taxpayers to apportion cost inputs or labor costs "in the manner required for apportionment of income under ORS 314.605 to 314.675." The new provision directs taxpayers to apportion the subtraction:

- As provided in ORS 314.650 and 314.665;
- By using the alternative apportionment method under ORS chapter 314, if applicable; or
- As provided for by the DOR by rule.

HB 4202 also adds the following provisions that address apportionment for unitary groups:

- A unitary group with members subject to multiple apportionment methods under ORS chapter 314 must apportion the subtraction as provided by the DOR by rule; and
- A unitary group required to apportion the subtraction must include all members of the group for purposes of determining the group's subtraction amount and apportionment ratio.

Finally, HB 4202 provides that a taxpayer or unitary group may elect to use its "most recent fiscal year information" to determine the subtraction under this section.

Practice Alert: Taxpayers who wish to use the new subtraction election must make the election on a timely filed, original return. The election, once made, is binding. **There is no room for second-guessing or late filings!**

Farmer Election for Out-of-State Wholesale Exclusion

As noted above, the CAT excludes sales to wholesalers for resale out of Oregon (the "Out-of-State Wholesale Exclusion"). In order for this exclusion to apply, the seller must receive certification "at the time of sale from the wholesaler that the wholesaler will sell the purchased property outside" Oregon.

Section 6 of HB 4202 adds a new section (yet to be numbered) to ORS Chapter 317A that provides that a taxpayer engaged in a farming operation (discussed above) selling agricultural commodities to a wholesaler or broker "may demonstrate the percentage of the taxpayer's goods sold in this state compared to outside this state, for purposes of determining commercial activity," by doing either of the following:

- Obtaining, from such wholesaler or broker, a certificate stating the percentage; or
- Using an industry average percentage, for sales of the agricultural commodity made the previous tax year, that is based on the most recent information from the USDA National Agricultural Statistics Service and other sources of sales information.

The following definitions apply to this provision:

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- "Agricultural commodity" includes "all agricultural, horticultural, viticultural and vegetable products produced in this state, including bees and honey," but expressly excludes timber and timber products; and
- "Broker" means "any person, other than a dealer, commission merchant or cash buyer, that negotiates the purchase or sale of any agricultural commodity but does not handle the agricultural commodity."

Practice Alert: This new provision does not expressly reference the Out-of-State Wholesale Exclusion. However, it appears clear from the context of the CAT provisions that this provision is intended to apply to that exclusion.

One-Time CAT Registration

The original statute required taxpayers to register for the CAT annually. Not anymore! HB 4202 amends ORS 317A.131 to provide that CAT registration is a one-time event for the first year in which the taxpayer exceeds $750,000 in commercial activity. However, a taxpayer may need to re-register following a merger or reorganization.

Changes to Interest and Penalty Provisions

Prior to HB 4202, ORS 317A.161(1) provided that the DOR "may not impose any interest or penalty that would otherwise apply to taxes due if the interest or penalty is based on underpayment or underreporting that results solely from the operation of ORS 317A.100 to 317A.158."

ORS 317A.161(2) provided that a taxpayer "shall pay at least 80 percent of the balance due for any quarter or the [DOR] may impose a penalty as provided in ORS 314.400."

As discussed in a prior post, these provisions were not the model of clarity and could lead reasonable and intelligent practitioners to reach opposite conclusions. The DOR provided some guidance on these provisions in temporary rules, but not all was clear.

HB 4202 makes welcome changes to the penalty and interest provisions of ORS 317A.161. Specifically, it makes the following amendments, which are retroactive to tax years beginning on or after January 1, 2020 (and before January 1, 2022):

- The word "penalty" has been removed from each reference in ORS 317A.161(1), so that section now applies only to interest;
- The reference in ORS 317A.161(2) to ORS 314.400 has been removed, and in its place the penalty for failure to pay at least 80 percent of estimated payments is clarified as applying to "any quarter" for which the threshold is not met, and the penalty is "five percent of the underpayment amount;"
- The DOR is prohibited from imposing a penalty under ORS 317A.161(2) for any quarter for which a taxpayer paid an amount at least equal to the taxpayer's required installment for the corresponding quarter of the preceding tax year; and

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- ORS 314.400(1) and (2) apply to a taxpayer that does not file an annual return or that does not pay the CAT by the due date of such return.

HB 4202 makes the following additional amendments to ORS 317A.161, which are effective for tax years beginning on or after January 1, 2022:

- ORS 317A.161(1) is removed, so the DOR will be able to impose interest on underpayments or underreporting in such years; and
- The 80 percent threshold is changed to 90 percent.

Practice Alert: The amendments to ORS 317A.161 that are effective for tax years beginning on or after January 1, 2020 and before January 1, 2022 are effective for tax returns filed on or before April 15, 2022, and the amendments that are effective for tax years beginning on or after January 1, 2022 apply to tax returns filed after April 15, 2022. Therefore, the less taxpayer-friendly provisions that take effect in 2022 will apply to any late returns filed in 2022 for the 2021 tax year. **Taxpayers and tax practitioners should be aware of this and plan accordingly!**

CONCLUSION

Changes to the CAT continue to be made, both by the legislature and the DOR. HB 4202 brings some much needed clarification. Farmers, especially dairy farmers, should be pleased with the legislature. It certainly appears that curiosity will not kill this CAT!

We will continue to update you on changes to the CAT.

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