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Larry's Tax Law

The Old Wives' Tale, Curiosity Kills the CAT, Doesn't Seem to Apply to Oregon's New CAT

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On January 6, I presented a new White Paper, *The Oregon Corporate Activity Tax - You Can Run and You Can Hide, but This New Tax Is Effective January 1, 2020*, at the Oregon Society of Certified Public Accountants Annual State and Local Tax Conference. We had a large number of attendees, including representatives of the Oregon Department of Revenue (the "DOR"). Based upon the numerous questions I received (during and after the presentation), it is clear that tax practitioners are busy thinking about this new tax regime and how it applies to their clients. Unfortunately, in this particular case, I do not believe the curiosity will kill the CAT. It looks like it is here to stay.

The questions that were posed by the audience clearly reflect that the CAT has gotten the attention of tax practitioners. For the benefit of our readers, in this post, I have set out some of the key questions that have been asked and the answers I have provided.

Questions & Answers

1. If my Commercial Activity is $1,000,000 or less for the calendar year, do I still have to register for the CAT?

The obligation to register for the CAT has an annual threshold of $750,000. Once your Commercial Activity for the calendar year reaches $750,000, you are required to register.

2. Would the organization of entities described below be considered to meet the common ownership requirement for unitary group purposes under the CAT?

Entity

Ownership

A

50%/50% Owner 1 and 2

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B

100% Owner 1

C

100% Owner 2

No. The ownership threshold for unitary group purposes under the CAT is more than 50% common ownership. It is possible the DOR will issue administrative rules that contains attribution rules (e.g., family attribution). To date, however, we have no such guidance. So, as of now, even if Owners 1 and 2 above are related, they would not meet the common ownership threshold.

3. If common ownership of a group encompasses "excluded persons" are they considered in determining whether the ownership threshold under the unitary group rules for purposes of the CAT are satisfied? For example, if Entity A in the example in question 2 above is an excluded person - would that person be included for purposes of determining if the ownership threshold is met?

The CAT applies to "persons." Person is broadly defined in the CAT to include individuals, combinations of individuals, receivers, trustees in bankruptcy, estates, partnerships, trusts, LLCs, LLPs, JVs, clubs, societies, corporations (S and C), QSSSs, QSSTs, nonprofit organizations and disregarded entities. Six categories of taxpayers, however, are expressly excluded from the definition of a person. They include: tax exempt organizations under Code Section 501(c), (d), (e), (f), (j), or (l) except to the extent of UBTI; farm cooperatives under Code Section 521, qualified state tuition programs under IRC Section 529; governmental entities; persons with Commercial Activity less than $750,000 unless part of a unitary group; and certain hospitals and healthcare facilities.

There is currently no concrete answer to this question. It certainly appears that the correct answer should be that "excluded persons" are not considered in determining if the ownership threshold is met. In fact, the DOR indicated in a recent Town Hall meeting that it tentatively agreed with that conclusion (and we hope that it will publish guidance to that effect). To date, we have not seen any guidance on this issue. Caution is advised until we receive DOR guidance.

4. It appears that single-family general contractors are allowed (until 2026) an additional subtraction of 15% of labor costs paid to subcontractors. What is the definition of “single-family general contractor" for this purpose?

The phrase “single-family general contractor" is not used anywhere in the statute. The 15% subtraction (contained in House Bill 2164, Section 58) only applies to "single-family residential construction located in Oregon." The phrase "single-family residential construction" is not defined in the statute or so far in

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the temporary administrative rules issued by the DOR. Does it apply to both new construction and remodeling of single-family homes? Unfortunately, until and unless we receive guidance from the DOR, the answer is simply that we do not know.

5. I am presented with two single member LLCs, both of which have the same sole member: One LLC solely has construction trade activity which is reported on the Schedule C of its sole member; and the other LLC has real estate activity that is reported on the Schedule E of its sole member. Are they unitary for purposes of the CAT?

They could be unitary. You'll need to walk through the factors provided in Temporary OAR 150-317-1020. You need to determine if there is more than 50% common (direct or indirect) ownership. Then, if there is sufficient common ownership, you need to determine whether the entities are engaged in a unitary business, which requires that you look to see if centralized management, centralized administration or functional integration exists. It is a "facts and circumstances" analysis.

6. Minor children and one of their parents own 54% of one entity and that same parent owns 50% of another entity. The two entities have inter-company sales. Do these entities qualify to file as a unitary business for purposes of the CAT?

No; they do not qualify as a unitary business as described above. The ownership threshold for unitary group status is "more than 50 percent common ownership" (direct or indirect). So, if the parent and/or children owned more than 50% of the second entity, and if family attribution applies (still unknown), the ownership threshold for a unitary group could exist. Of course, as stated above, you also have to look at the unitary factors to determine if there is a unitary business. See Temporary OAR 150-317-1020.

7. The provisions of the CAT allow an exclusion for "membership dues" received by trade associations? Does that mean health club dues for gyms are not subject to the CAT?

No. For this purpose, health clubs or gyms likely do not qualify as trade associations.

8. For construction contractors (non-residential), do the costs of construction for projects (i.e., materials, subcontractor fees, permits and other direct costs) qualify as "costs inputs" eligible for the 35% subtraction.

Yes, provided they constitute cost of goods sold as calculated in arriving at federal taxable income.

9. For purposes of the subtraction for CAT purposes, we get to use the greater of 35% of cost of goods sold or 35% of labor costs. The statute indicates that, for this purpose, the costs of independent contractors are excluded from labor costs. What about amounts paid to an employee leasing

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companies?

For purposes of labor costs, the CAT is clear in that we do not get to use employee compensation to the extent it exceeds $500,000 with respect to any one employee. It also excludes payments to independent contractors and guaranteed payments to partners. With respect to amounts paid to employee leasing companies, there currently is no concrete guidance on the issue. The DOR indicated in a Town Hall meeting that it is aware of the issue and will be looking into the issue (and hopefully issuing guidance).

10. Can persons (other than auto dealers) pass the CAT on to their customers?

The auto dealers lobbied to obtain statutory authority to add a line item to invoices charging an amount equal to the dealer's CAT obligation resulting from vehicle sales. The tax and the liability for the tax is an obligation of the dealer (as is the case of any business with taxable Commercial Activity). Nothing in the laws prohibits any business from passing the tax along to its customers in the form of higher prices. However, no business can shift the burden of the tax to the customer. Again, it is the liability of the business. Reflecting the tax as an obligation of the customer is misleading. Be aware – any such amounts collected from customers will increase the Commercial Activity of the business and thereby increase its CAT liability (resulting in a tax on the tax).

11. If a business has sales allocated across all states, but all wages are for labor performed in Oregon, does the wages subtraction have to be allocated pro rata to the sales or are all wages still Oregon wages for the purposes of the subtraction under the CAT?

Wages are subject to apportionment. For apportionment guidance, please see Temporary Rule OAR 150-317-1200.

12. If a business has $1,300,000 of Commercial Activity, but after the applicable subtraction, its taxable Commercial Activity is $990,000, does it have to register for the CAT and does it have to file a CAT return?

The person has to register for the CAT. Registration must be looked at and completed on an annual basis. The threshold for that purpose is more than $750,000 of Commercial Activity during the calendar year.

Any person with Commercial Activity of more than $1,000,000 for the calendar year must file a CAT return.

If a person's taxable Commercial Activity (after applying the applicable subtraction) is $1,000,000 or less for the calendar year, no tax will be due and owing.

Practice Alert: Over 40 separate items of income are expressly excluded from the definition

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of "Commercial Activity" under the CAT (including interest income in many cases). If an item of income is among these expressly excluded items, it does not constitute "Commercial Activity." Accordingly, the excluded item is not included for purposes of determining if the registration or return filing threshold is met.

I will tackle more questions as they come in. Also, as more guidance from the DOR is published, I will summarize it and report back to you. Stay tuned!

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