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TEMPORARY ADMINISTRATIVE RULES
A Statement of Need and Justification accompanies this form..

I certify that the attached copies* are true, full and correct copies of the TEMPORARY Rule(s) adopted on [7/15/2010] by the
Date prior to or same as filing date

Department of Revenue, Personal Tax and Compliance Division 150

Agency and Division Administrative Rules Chapter Number

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to become effective [Upon filing] through [December 31 2010].
Date upon filing or later A maximum of 180 days including the effective date.

RULE CAPTION

Deduction for severance pay invested in small business.

Not more than 15 words that reasonably identifies the subject matter of the agency's intended action.

RULEMAKING ACTION

List each rule number separately, 000-000-0000.

Secure approval of new rule numbers (Adopted rules) with the Administrative Rules Unit prior to filing

ADOPT:

150-316.ORLAWS2010.CH66

AMEND:

SUSPEND:

Stat. Auth.: ORS 305.100, Oregon Laws 2010, chapter 66

Other Auth.:

Stats. Implemented: ORS Oregon Laws 2010, chapter 66

RULE SUMMARY

To explain requirements for claiming a severance pay subtraction in accordance with Chapter 66, Oregon Laws 2010 (House Bill 3627). The rule further defines statutory terms, including what it means to invest severance pay and to materially participate in a small business.

Elizabeth Harchenko 7/15/2010
Authorized Signer Printed name Date

*With this original and Statement of Need, file one photocopy of certificate, one paper copy of rules listed in Rulemaking Actions, and electronic copy of rules. ARC 940-2005

150-316.ORLAWS2010.CH66

Subtraction for Qualified Investment of Severance Pay

(1) Definitions. For the purposes of Chapter 66, Oregon Laws 2010 (House Bill 3627) and this rule:

(a) “Invest” means to exchange cash for equity, debt, convertible debt, or management responsibilities, accompanied by terms that substantiate ownership or control of an interest in a business. “Invest” does not mean to make a loan to a business.

(b) “Material participation” means regular, continuous, and substantial participation in the small business. A taxpayer is considered to have materially participated in the small business if the taxpayer:

(A) Worked for the small business for more than 500 hours in both of the 12 month periods required under section 2(b) of this rule;

(B) Worked for the small business for more than 100 hours in both of the 12 month periods required under section 2(b) of this rule and at least as much as any other owner or employee; or

(C) Performed substantially all the work in the small business.

(c) “Severance pay” means compensation payable, other than back wages, vacation pay or sick pay, on voluntary termination or involuntary termination of employment based on length of service, a percentage of final salary, a contract between the employer and the employee, or some other reasonable method. “Severance pay” does not include retirement income as defined in ORS 316.127(9).

(d) “Small business” means a corporation, partnership, sole proprietorship or other legal entity formed for the purpose of making a profit, which is independently owned and operated from all other businesses and which has 50 or fewer employees.

(2) Qualifications. Severance pay that a taxpayer receives during the tax year and invests in a new or existing small business in Oregon may be subtracted from federal taxable income if:

(a) The investment occurs on or before the due date of the return, including extensions, for the first tax year in which the subtraction may first be claimed;

(b) The investment continues for at least 24 consecutive calendar months following the termination of employment (for example - July 13, 2010 through July 12, 2012);

(c) The small business is not the employer that paid the severance pay and does not have any owner in common with the employer that paid the severance pay;

(d) No subtraction has previously been claimed under this section;

(e) The taxpayer completes a form provided by the department that is attached to the return of the taxpayer or is otherwise maintained or filed pursuant to form instructions; and

(f) The taxpayer materially participates in the small business for the period required under subsection (b) of this section.

(3) The taxpayer must demonstrate to the department’s satisfaction that the small business is carrying on an activity for profit. If requested, the taxpayer must provide documentation to that effect to the department. In making such a determination, the department may consider the following nonexclusive list of factors:

(a) Whether the small business keeps and maintains a detailed business plan that includes strategies or methods to make a profit or improve profitability;

(b) Whether separate books, records and bank account(s) are maintained for the small business;

(c) Whether the taxpayer carries on the activity in a businesslike manner.

(4) Severance pay received as an annuity. Only cash invested on or before the due date of the return, including extensions, qualifies for this subtraction. Any severance pay invested after the return is filed does not qualify for a subtraction under this section.

(5) Severance pay received as stock options. All stock options must be converted to cash before being invested to qualify for a subtraction under this section.

(6) The subtraction may not exceed the lesser of:

(a) The minimum balance of principal that remains invested by the taxpayer in the small business at the close of any month during the 24 consecutive calendar months following the termination of employment; or

(b) \$500,000.

(7) Interest accrues as provided in ORS 305.220 on any unpaid tax attributable to any disallowance or withdrawal of principal.

Example 1: Maggie was terminated from employment on October 1, 2010, and received severance pay of \$50,000 as a condition of her termination. On April 1, 2011, Maggie filed her personal income tax return, for which she had not requested an extension of time to file. On August 11, 2011, Maggie invested the severance pay in a qualifying small business. Maggie does not qualify for the subtraction because she did not invest the severance pay by the due date of the return.

Example 2: Joe was terminated from employment on July 1, 2010, and received severance pay of \$20,000 as a condition of his termination. Joe invested the entire \$20,000 in Company A, which qualifies as a small business, on September 1, 2010, and took a \$20,000 subtraction on his 2010 return. On January 30, 2012, Joe withdrew the entire \$20,000 he invested. Joe must file an amended return for tax year 2010 to remove the \$20,000 subtraction (and pay any additional tax and interest that may be due) because he did not continue the investment for at least 24 consecutive months following the termination of employment.

Example 3: Alicia was terminated from employment on October 1, 2010, and received severance pay of \$80,000 as a condition of her termination. Alicia invested the entire \$80,000 in Company B, which qualifies as a small business, on December 1, 2010. Alicia took an \$80,000 subtraction on her 2010 personal income tax return. On July 30, 2012, Alicia withdrew \$20,000 of principal from her initial investment for personal use. Alicia must amend her 2010 return to remove \$20,000 of the subtraction (and pay any additional tax and interest that may be due).

Example 4: Ryan was terminated from employment on October 1, 2010. He received severance pay in the form of a \$1,000 a month annuity over 5 years beginning in October of 2010. Ryan accumulated his severance payments for 6 months and invested the \$6,000 in a small business. He claimed a subtraction of \$6,000 on his return he filed on April 1, 2011. Ryan continues to accumulate his severance pay for the next year and invests another \$12,000 in the small business on March 1, 2012. Ryan cannot claim a subtraction for the additional severance pay he invested because it was invested after the return was filed.

(8)(a) If the small business is doing business both in Oregon and some other place outside of Oregon, the amount of the subtraction allowed is generally determined by multiplying the total qualifying amount of severance pay invested by the sales factor determined under ORS 314.665 and associated administrative rules.

(b) The taxpayer may present an alternate method of calculating the amount of the qualified subtraction if the calculation under subsection (a) does not result in a reasonable reflection of the extent of the business activity in Oregon. In order to be considered reasonable, the method of calculation must take into account the business activity taking place within Oregon versus the activity taking place outside of Oregon. The method must be fully described in an attachment to the taxpayer's return on which the subtraction is claimed.

[Publications: The publication(s) referred to or incorporated by reference in this rule is available from the Department of Revenue pursuant to ORS 183.360(2) and ORS 183.355(1)(b).]

Stat. Auth.: ORS 305.100, Chapter 66, Oregon Laws 2010 (House Bill 3627)

Stats. Implemented: Chapter 66, Oregon Laws 2010 (House Bill 3627)