

ADMINISTRATIVE RULE REVIEW

<p>Adopt <u>Amend</u> Rule</p> <p>Permanent Rule</p>	Rule No. 150-317-1200	
	Page Page 1 of 10	Last Revised Date June-September 15 <u>22</u> , 2020
	NOTICE OF INTENDED ACTION	
	Bulletin Dated October 2020	Hearing Scheduled October 27, 2020

PURPOSE: ~~Provides~~ Amends OAR 150-317-1200 to provide guidance to assist taxpayers in how to compute the cost input or labor cost subtraction for purposes of the Oregon Corporate Activity Tax (CAT) after amendments to ORS 317A.119 made by Oregon Laws 2020 (first special session), chapter 2, section 4.

1 **150-317-1200**

2 **Cost Input or Labor Cost Subtraction**

3 (1) The subtraction provided in ORS 317A.119 includes all labor costs or cost inputs ~~expenses~~ of a
 4 taxpayer, whichever is greater, regardless of the place the labor cost or cost input is incurred, except for
 5 cost inputs or labor costs that are attributable to the taxpayer's receipts from an item that is not
 6 commercial activity. For purposes of the subtraction, a unitary group, as determined pursuant to ORS
 7 317A.106, must include the labor costs or cost inputs of all members of the unitary group, regardless
 8 where incurred, except for expenses from transactions among members of the group as provided in ORS
 9 317A.119(32)(a) for which receipts are excluded under ORS 317A.106 ~~and costs omitted as provided in~~
 10 ~~OAR 150-317-1025.~~

11 (2) Determining Costs Eligible for Subtraction. Costs described in ORS 317A.119(2)(a) and (b)
 12 ("ineligible costs") are not eligible for subtraction. "Eligible costs" equals 35 percent of the greater of (A)
 13 the excess of total labor costs over the amount of labor costs that are ineligible costs or (B) the excess of
 14 total cost inputs over the amount of cost inputs that are ineligible costs.

15 (a) If a taxpayer can reasonably determine, from the taxpayer's books and records maintained in the
 16 ordinary course of business, how much of its total labor costs or cost inputs are ineligible costs or that it
 17 has no ineligible costs, the taxpayer may calculate the subtraction using the appropriate method under
 18 section (3), unless otherwise permitted or required under this rule.

19 **Example 1:** South Street operates an automotive repair shop. All but an incidental amount of South
 20 Street's receipts are from commercial activity. South Street's labor costs are greater than its cost inputs.
 21 All South Street's employees perform their activities primarily for the purpose of producing receipts that
 22 are included in commercial activity. Because South Street can reasonably determine from its books and

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- 1 records that all its labor costs are attributable to commercial activity, South Street may use the general
- 2 rule for determining its cost subtraction.
- 3 (b) A taxpayer who cannot reasonably determine how much of either its total labor costs or cost inputs
- 4 are ineligible costs based on its books and records may use a reasonable method to approximate eligible
- 5 costs. The taxpayer must document the approximation method used and retain the documentation in the
- 6 taxpayer’s records. Documentation must be provided to the department upon request. The department
- 7 may disallow the approximation method used under this section if it does not reasonably approximate the
- 8 taxpayer’s eligible costs.
- 9 ~~(23)~~ General Rule. Computation of subtraction for eligible costs after reduction of ineligible costs.
- 10 (a) If all the taxpayer’s commercial activity is sourced to Oregon, the taxpayer’s subtraction equals its
- 11 eligible costs.
- 12 (b) If the taxpayer has commercial activity both within and without Oregon, the taxpayer must apportion
- 13 the taxpayer’s eligible costs as follows, unless the taxpayer elects to use the substitute rule under section
- 14 (4).
- 15 (A) If the corporate activity taxpayer is identical to the entity or group of entities reporting on the
- 16 apportionment schedule filed for purposes of Oregon income or excise tax under ORS chapters 314, 316,
- 17 317, or 318, that taxpayer must multiply its eligible costs by the apportionment factor percentage from
- 18 the taxpayer’s Oregon apportionment schedule filed under ORS chapters 314, 316, 317, or 318 to
- 19 calculate the subtraction amount. The taxpayer must use the apportionment schedule filed with the most
- 20 recent return covering a 12-month period filed with the department.
- 21 (B) If a corporate activity taxpayer is not identical to the entity or group of entities reporting on the
- 22 apportionment schedule filed for purposes of Oregon income or excise tax under ORS chapters 314, 316,
- 23 317, or 318, the taxpayer must compute its Oregon apportionment factor percentage using the applicable

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1 apportionment method under ORS chapters 314 or 317, except as otherwise required or permitted under
2 this rule. The taxpayer must multiply its eligible costs by the computed apportionment factor percentage.
3 (c) Notwithstanding section (3)(b), unitary group taxpayers with members subject to multiple
4 apportionment methods under ORS chapters 314 or 317 must compute the group’s eligible costs as
5 follows, except as otherwise required or permitted under this rule.
6 (A) Separate the unitary group into subgroups. Each subgroup consists of members that use the same
7 apportionment method under ORS chapter 314 or 317.
8 (B) Each subgroup must separately determine eligible costs as required under section (2) of this rule.
9 (C) Each subgroup must separately compute their apportionment factor using the applicable
10 apportionment method under ORS chapter 314 or 317, except that transactions between all unitary group
11 members must be eliminated, regardless of whether transactions are between or among unitary group
12 members subject to sales factor apportionment under ORS 314.650 or those subject to another
13 apportionment method under ORS chapter 314 or 317.
14 (D) Each subgroup must multiply its eligible costs, as determined under section (2) of this rule, by the
15 subgroup’s apportionment factor percentage determined under subsection (3)(c)(C).
16 (E) The unitary group’s subtraction is the sum of the apportioned eligible costs of each subgroup.
17 **Example 2:** Rosslyn Inc., McPherson Corp., Palisades Inc., and Delta Inc. are a unitary group under ORS
18 317A.100(19) and must file as a single taxpayer under 317A.106. For Oregon income tax purposes,
19 Rosslyn Inc., and McPherson are required to apportion using the sales factor under ORS 314.650. Delta
20 and Palisades are telecommunications firms that elect to use the double-weighted sales apportionment
21 factor under ORS 314.650 (1999 Edition) for their Oregon income tax return per OAR 150-314-0060. As
22 the unitary group members are subject to multiple apportionment methods under ORS 314, the group
23 must determine and apportion eligible costs under section (3)(c) of this rule, forming two subgroups:

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- 1 Subgroup A includes sales and eligible costs from Rosslyn and McPherson. Subgroup B includes Delta
 2 and Palisades. After eliminating transactions between all unitary group members, Subgroup A, calculates
 3 its sales factor apportionment factor pursuant to ORS 314.650, to be 11.11%. The eligible costs of
 4 Subgroup A, determined in accordance with section (2) of this rule, are \$2 million. After applying the
 5 apportionment factor percentage to eligible costs, Subgroup A has apportioned eligible costs of \$222,200
 6 (\$2 million x 11.11% = \$222,200).
- 7 Subgroup B, after eliminating all transactions between unitary group members, calculates the double
 8 weighted apportionment factor pursuant to OAR 150-314-0060, to be 41.66%. The eligible costs of
 9 Subgroup B, determined in accordance with section (2) of this rule, are \$1 million. After applying the
 10 double-weighted sales factor apportionment percentage to eligible costs, Subgroup B has apportioned
 11 eligible costs of \$416,600 (\$1 million x 41.66%). The unitary group adds the apportioned eligible costs
 12 from each subgroup to determine the group’s total subtraction (\$222,200 + \$416,600 = \$638,800).
- 13 ~~Costs described in ORS 317A.119(3)(b) (“ineligible costs”) are not eligible for subtraction. If a taxpayer~~
 14 ~~can readily determine, from the taxpayer’s books and records maintained in the ordinary course of~~
 15 ~~business, how much of its total labor costs or cost inputs are ineligible costs or that it has no ineligible~~
 16 ~~costs, the taxpayer may use the general rule in this section (2). A taxpayer who cannot readily determine~~
 17 ~~how much of either its total labor costs or cost inputs are ineligible costs based on its books and records~~
 18 ~~must use the substitute rule in section (3), except as otherwise provided in this rule.—~~
- 19 ~~(a) Reduction of cost inputs and labor costs by ineligible costs. A taxpayer must determine its eligible~~
 20 ~~costs. “Eligible costs” equals the greater of (A) the excess of total labor costs over the amount of labor~~
 21 ~~costs that are ineligible costs or (B) the excess of total cost inputs over the amount of cost inputs that are~~
 22 ~~ineligible costs.—~~
- 23 ~~(b) Computation of subtraction for eligible costs after reduction of ineligible costs.—~~

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1 ~~(A) If all the taxpayer’s property and payroll is located in Oregon and all its commercial activity is~~
2 ~~sourced to Oregon under ORS 317A.128, the taxpayer’s subtraction equals 35 percent of its eligible~~
3 ~~costs.—~~

4 ~~(B) Otherwise, the taxpayer must multiply the taxpayer’s eligible costs by the ratio of the amount of~~
5 ~~commercial activity as would be sourced to Oregon in the manner provided under ORS 314.605 to~~
6 ~~314.675 to the amount of commercial activity as would be sourced everywhere in the manner provided~~
7 ~~under ORS 314.605 to 314.675 (“apportioned eligible costs”), except as otherwise required or permitted~~
8 ~~under this rule. The taxpayer’s subtraction equals 35 percent of its apportioned eligible costs.~~

9 ~~(C) For purposes of apportionment under section (2)(b)(B) of this rule, commercial activity shall be~~
10 ~~sourced as provided in ORS 314.665 determined without regard to 314.665(2)(b), and sales of tangible~~
11 ~~personal property included in commercial activity are in this state under ORS 314.665(2)(a) if the~~
12 ~~property is delivered or shipped to a purchaser within this state, including the United States Government,~~
13 ~~regardless of the f.o.b. point or other conditions of the sale.~~

14 ~~**Example 1:** South Street operates an automotive repair shop. All but an incidental amount of South~~
15 ~~Street’s receipts are from commercial activity. South Street’s labor costs are greater than its cost~~
16 ~~inputs. All South Street’s employees perform their activities primarily for the purpose of producing~~
17 ~~receipts that are included in commercial activity. Because South Street can readily determine from its~~
18 ~~books and records that all its labor costs are attributable to commercial activity, South Street may use the~~
19 ~~general rule for determining its cost subtraction.~~

20 ~~(34) Substitute Rule. If the taxpayer elects, or the taxpayer’s books and records kept in the ordinary~~
21 ~~course of business do not allow one to readily identify labor costs or cost inputs attributable to~~
22 ~~commercial activity, the subtraction shall be calculated using a~~ A taxpayer may, in lieu of calculating and

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apportioning eligible costs as required in sections (2) and (3) of this rule, elect to approximate and apportion eligible costs by means of the commercial activity ratio.

(a) ~~Costs for commercial activity ratio.~~ Costs for commercial activity ratio. A taxpayer's costs under the commercial activity ratio ("applicable costs") equal 35 percent of the greater of total cost of goods everywhere or total labor costs everywhere, as those costs are determined before application of ORS 317A.119~~(32)~~(b). Expenses from transactions among members of a unitary group must be excluded.

(b) ~~Commercial Activity Ratio.~~ 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 plus amounts excluded under ORS 317A.100(1)(b)(Q), ORS 317A.100(1)(b)(Y), ORS 317A.100(1)(b)(AA), ORS 317A.100(1)(b)(DD), ORS 317A.100(1)(b)(EE), ~~and~~ ORS 317A.100(1)(b)(TT) and ORS 317A.100(1)(b)(VV). Receipts from transactions among unitary group members are not included in either the numerator or denominator.

(c) Subtraction. For purposes of the substitute rule, the taxpayer's subtraction is calculated by multiplying the applicable costs under subsection (a) by the taxpayer's commercial activity ratio under subsection (b).

~~(e) Ratio costs. For purposes of the substitute rule, costs attributable to commercial activity that are apportioned to Oregon ("ratio costs") are calculated by multiplying the applicable costs under subsection (a) by the taxpayer's commercial activity ratio under subsection (b). The taxpayer's subtraction equals 35 percent of the ratio costs.~~

~~(d) Modified substitute rule. If a taxpayer can readily determine, from the taxpayer's books and records maintained in the ordinary course of business, how much of its total labor costs or cost inputs are ineligible costs, but not both labor costs and cost inputs, the taxpayer may elect to compute its subtraction~~

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~~as the greater of the subtraction calculated using the general rule for the cost factor for which it is able to readily determine ineligible costs or the subtraction calculated using the substitute rule for the cost factor for which it is not able to readily determine ineligible costs.~~

Example 23: Grocery & TV Mart has \$10 million of Oregon commercial activity and \$70 million of everywhere commercial activity plus exclusions described in section ~~(34)~~ (b) of this rule (\$50 million in commercial activity and \$20 million in receipts from retail sales of groceries, ~~excluded~~ sions from commercial activity under ORS 317A.100(1)(b)(EE)). Almost all Grocery & TV Mart's employees assist in sales of both groceries and televisions. Grocery & TV Mart cannot ~~readily~~ reasonably determine from its books and records how much of its labor costs and cost inputs are attributable to sales of groceries excluded from commercial activity under ORS 317A.100(1)(b)(EE), and elects to use the substitute rule under section (4). Grocery & TV Mart has an everywhere labor cost of \$28 million and everywhere cost inputs of \$26 million.

Grocery & TV Mart computes the Oregon subtraction as follows:

Step 1: Determine costs for commercial activity, ~~the amount of applicable costs~~. In this example, labor costs are greater than cost inputs. Multiply labor costs (\$28 million) by 35 percent to determine applicable costs. \$28 million x 35% = \$9,800,000 ~~Applicable costs are \$28 million.~~

Step 2: Determine the commercial activity ratio.

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

Step 3: Determine Grocery & TV Mart's subtraction ~~ratio costs~~. Total applicable costs for commercial activity of \$9,800,000 of \$28 million multiplied by commercial activity ratio of 14.2857% = \$1,399,999 ~~\$3,999,996~~.

~~Step 4: Multiply the ratio costs by 35% = \$1,399,999 cost subtraction.~~

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~~*Example 3: Corner Market operates a convenience store and sells motor vehicle fuel. The majority of the convenience store's receipts are included in commercial activity, but groceries and motor vehicle fuel are excluded from commercial activity. Corner Market's books and records do not track cost inputs attributable to operating the convenience store; however, they do track labor costs attributable to the sale of groceries and motor vehicle fuel. Because the books and records do not show what cost inputs are attributable to commercial activity, Corner Market must apply the substitute rule for determining their available cost inputs subtraction. Because Corner Market does track labor costs attributable to operating the convenience store, they may use the general rule to determine the subtraction for labor costs. Corner Market may claim the greater of the two calculations.*~~

(5) Fiscal Year Election. For purposes of this rule, fiscal year means a period of 12 consecutive months ending on the last day of any month other than December or any taxpayer or unitary group that has made an election under IRC § 441 for a fiscal year which varies from 52 to 53 weeks. A taxpayer or unitary group may elect to use the taxpayer's or unitary group's most recent fiscal year information for purposes of determining the subtraction under this rule. An election under this section must be made on a timely filed, original return including extensions. An election under this section is binding for and applicable to the tax year in which it is made.

(6) Limitations.

(a) The subtraction may not exceed 95 percent of the taxpayer's Oregon commercial activity.

(b) Labor costs may not include total compensation paid to a single employee in excess of \$500,000.

(c) ~~Receipts~~ Expenses from transactions among members of a unitary group with respect to receipts that are excluded under ORS 317A.106 and ORS 317A.100(1)(b)(FF) are not included in the calculation of the subtraction.

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(d) A unitary group required to apportion the amount of the subtraction shall include all members of the unitary group for purposes of determining the group’s subtraction amount and apportionment ratio, except that the unitary group may not include members excluded from the unitary group pursuant to an election under ORS 317A.106(2).

~~(57) Alternative Apportionment. Notwithstanding sections (2) and (3) of this rule, a~~ taxpayer may petition the department for alternative apportionment, or the department may require alternative apportionment if the application of sections ~~(23) or to (35)~~ (23) or to (35) of this rule does not fairly represent the costs of taxpayer’s commercial activity in Oregon.

~~(6a)~~ A petition to use an alternative method of apportionment under section ~~(57)~~ of this rule 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 section ~~(23) or to (35)~~ 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 the costs of taxpayer’s 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.

~~(7b)~~ Factors considered in approving alternative methods of apportionment include but are not limited to whether a modification:

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- 1 ~~(a)~~(A) Will fairly and accurately reflect the taxpayer’s costs attributable to receipts from commercial
- 2 activity in Oregon; and
- 3 ~~(b)~~(B) ~~Effectuate~~ Will effectuate an equitable ~~allocation and~~ apportionment of the taxpayer’s costs
- 4 attributable to receipts from commercial activity.
- 5 **Stat. Auth.:** ORS 305.100, ORS 317A.106, ORS 317A.119, ORS 317A.143
- 6 **Stats. Implemented:** ORS 317A.119