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The CAT Is Clearly Ruling the Roost in Oregon – It Is Occupying a Large Amount of Time for Tax Practitioners This Busy Season

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Temporary Rules Keep Rolling in

The Oregon Department of Revenue (the "Department") recently issued four new temporary rules relative to the Oregon Corporate Activity Tax (the "CAT"). The new rules went into effect on February 1, 2020.

The new temporary rules provide much needed guidance with respect to three notable exclusions from the fangs of the CAT, namely the Grocery Exclusion, the Wholesale Exclusion and the Vehicle Exclusion.

Grocery Exclusion – OAR 150-317-1140 (Temporary Rule)

Receipts from both the wholesale and the retail sale of groceries (the "Grocery Exclusion") are expressly excluded from the CAT. Groceries, for this purpose, are given the same definition of "food" under the Supplemental Nutrition Assistance Program ("SNAP"), the federal food stamp program. In general, under SNAP, food is limited to items used "for home consumption."

Many products are expressly excluded from the definition of food under SNAP, including:

- Wine, beer, liquor, cigarettes or tobacco;
- Certain nonfood items like:
  - hygiene (soaps, deodorant, menstrual care);
  - paper products, household supplies; and
  - pet foods;
- Hot foods;

- Food items that are consumable in the store; and
- Vitamins and medicines.

Unfortunately, the rules are not entirely intuitive. Thus, a good understanding of SNAP is required.

By way of example, under SNAP, soft drinks, candy, cookies, snack crackers and ice cream are classified as food. While energy drinks that have a nutrition facts label are also eligible foods, energy drinks that have a supplement facts label are classified by the FDA as supplements, making them ineligible.

PRACTICE ALERT: Sellers of pre-prepared hot products (e.g., casseroles or rotisserie chickens sold in the deli section of a grocery store) are required to separately account for these sales. Gross receipts from the sale of these products will be subject to the CAT.

PRACTICE ALERT: Sellers of groceries have to separately track sales of products that meet the definition of "food" under SNAP from the sale of products that do not meet this definition. For small grocery stores (such as convenience stores), this may not be an easy task.

Wholesale Sales of Groceries

The temporary rule provides that, with respect to wholesale grocery sales, a sale must meet four requirements in order to qualify for the wholesale part of the Grocery Exclusion:

1. The transaction is a wholesale sale;
2. The items sold in the transaction are food or food products that meet the definition of groceries under SNAP, in a form that may be resold to the final consumer for home consumption without processing;
3. The sale is made to a purchaser for the purpose of reselling the groceries to the final consumer for home consumption; and
4. The wholesale seller obtains written verification from the purchaser that the purchased groceries will be resold without processing, by a store that typically sells groceries to the final consumer for home consumption.

Definitions

The temporary rule defines the terms "processing," "store," and "wholesale sale."

1. "Processing" is defined as: "Transforming or changing" an item's characteristics, including by incorporating or consuming it as an ingredient or component in producing or manufacturing another item. Processing expressly includes (but is not limited to) a long list of activities: baking, canning, churning, cooking, concentrating, cutting, dehydrating, drying,

extracting, freezing, heating, grinding, mixing, pasteurizing, preserving or otherwise altering, manufacturing or producing an item. Processing does not include a retail store's activities in assembling, cleaning, preparing, storing, handling or displaying groceries for retail sale to a final consumer for home consumption, nor does it include a retail store's activities in preparing filleted or gutted fish, trimming produce and slicing processed meat or cheese.

2. "Store" is defined as: A location, including an online storefront, from which a taxpayer sells retail goods to the final consumer for home consumption.
3. "Wholesale sale" is defined as: The sale of goods to a purchaser for the purpose of resale without further processing in the regular course of the purchaser's trade or business. Such determination is made by analyzing relevant, nonexclusive factors that include, but which are not limited to, the following:

- The sale is of a quantity usable for resale, or materially in excess of the number of goods that are, on average, purchased by a member of the general public;
- Items sold are discounted from the retail value; and
- The sale is made to another business entity.

Documentation

A wholesale seller must keep "sufficient documentation" to demonstrate that a sale is a wholesale sale. Documentation is sufficient if it contains the following:

- The purchaser's name and address;
- The date of purchase, item(s) purchased and quantity purchased; and
- Verification from the purchaser of the amount of the purchase that will be resold, without processing, to the final consumer for home consumption.

PRACTICE ALERT: The temporary rule provides a safe harbor whereby a seller does not need to meet the documentation requirement if the purchaser is a qualified SNAP retailer with a current permit to accept SNAP benefits.

Examples

The temporary rule contains the following examples:

Example 1: Braddock Wholesale LLC ("Braddock") purchases prepackaged frozen vegetables and meals from a food manufacturer and sells the items, without processing them in any way, to its customers. One of Braddock's customers, Harris Grocery ("Harris"), has six stores in Oregon. All six stores are authorized as retail food stores under the SNAP statute. Braddock sells prepackaged frozen vegetables and meals to Harris. Pursuant to the sales agreement, Braddock delivers 1,000 frozen meals and 5,000 10-ounce packages of frozen broccoli directly to each Harris store. Braddock retains records of the sales agreements documenting that the items sold were groceries in a form that may be resold to consumers for home consumption without further processing, and that Braddock delivered the purchased groceries directly to a store that is authorized as a retail food store under the SNAP statute. The sales agreement, with the information specified above, is sufficient to verify that the receipts are excludable under the Grocery Exclusion.

Example 2: Assume the same facts in **Example 1**, except that Braddock's customer is Columbia Cupboards LLC ("Columbia"). Columbia has three stores across Oregon. None of Columbia's stores are authorized as retail food stores under the SNAP statute. As such, Braddock must obtain verification from Columbia that the frozen meals are purchased for the purpose of resale, without processing, and that the meals are typically sold to the final consumer for consumption at home. Under the terms of the sales agreement between Braddock and Columbia, Braddock delivers 100 frozen meals to each of Columbia's stores. The sales agreement specifically states that Columbia is buying the frozen meals for resale without any further processing, and the meals will be sold by three Columbia stores, all of which typically sell groceries to the final consumer for home consumption. The sales agreement, with the information specified above, verifies that the receipts are excludable under the Grocery Exclusion.

Example 3: Assume the same facts as **Example 1**, except that Braddock's customer is Foxtrot Airlines ("Foxtrot"). Foxtrot buys 5,000 frozen meals from Braddock. The meals will be heated and served to the airline's customers during flights. Because Foxtrot will process (heat) the frozen meals before they are served to its passengers, and because Foxtrot does not typically sell directly to the final consumer for home consumption, Braddock cannot exclude the receipts from the transaction as a wholesale sale of groceries. Braddock must include the receipts as commercial activity.

Example 4: Assume the same facts as **Example 1**, except that Braddock's customer is Farragut Corporation ("Farragut"). Farragut operates 144 grocery stores across Oregon, under the name Good Grocery. All Good Grocery stores are authorized as retail food stores under the SNAP statute. In addition, Farragut has 50 separately located restaurants operating under the name Greenbelt Diner. Farragut purchases 500,000 10-ounce packages of frozen broccoli from Braddock. Under the terms of the sales agreement, all items are delivered to a centralized warehouse owned by Farragut. Farragut will then distribute the prepackaged broccoli as needed to their grocery stores and restaurants. The prepackaged frozen broccoli is in a form

that may be resold to the final consumer for home consumption without further processing. However, Braddock cannot determine whether the prepackaged frozen broccoli, after being delivered, will be sold at Good Grocery stores, which typically sell groceries to consumers for home consumption, or used by Greenbelt Diners, where the broccoli will be cooked and incorporated as an ingredient in hot meals served to patrons. Braddock obtains written verification from Farragut, which certifies that of the 500,000 packages of frozen broccoli purchased, 400,000 packages will be sold in Good Grocery stores, which are authorized as retail food stores under the SNAP statute, and 100,000 packages will be used by Greenbelt Diners. Braddock may exclude from commercial activity the receipts from the sale of 400,000 packages of frozen broccoli under the Grocery Exclusion. Braddock must include in commercial activity its receipts from the sale of 100,000 packages of frozen broccoli that will be used by Greenbelt Diners.

Comment: By requiring sellers to obtain and keep documentation related to each sale, and by requiring that sellers obtain verification of certain facts from purchasers, the Department has imposed a significant and likely impractical compliance burden on the parties to wholesale grocery transactions. These specific requirements are found nowhere in the statute. Documentation is likely where many taxpayers will fall short. True, the administrative rule excludes transactions where the purchaser is a SNAP retailer from the documentation requirement, but it nonetheless imposes a significant burden on the seller in all other wholesale grocery transactions.

Retail Grocery Exclusion – OAR 150-317-1150 (Temporary Rule)

As discussed above, the Grocery Exclusion also excludes receipts from the "retail sale of groceries" from the CAT. The definition of groceries is the same as discussed above: "food" for SNAP purposes (which generally includes food "for home consumption," but not hot food).

The temporary rule provides that, with respect to retail grocery sales, the Grocery Exclusion applies only to groceries that are "sold at retail to the final consumer for home consumption." Such determination is based on the type of item sold, the circumstances of the sale and whether the seller "typically expects" that the specific store sells food for home consumption.

The Department lays out the following nonexclusive factors for determining whether a store typically makes retail grocery sales, to the extent they may be relevant:

- Whether the store's average gross receipts from the sale of hot food exceeds the average gross receipts from the sale of groceries;
- Whether the store offers on-site dining facilities, and if so, whether the percentage of floor space allotted to dining facilities exceeds the percentage of floor space dedicated to displaying retail groceries; and

- Whether the store advertises that it sells hot food or ready-to-eat food.

Examples

The temporary rule sets forth the following examples:

Example 1: McPherson's Convenient Coffee Shop ("McPherson's") is located on the first floor of a large office building and is open from 6:00 a.m. to 3:00 p.m., Monday through Friday. McPherson's sells hot coffee and an assortment of baked goods, which are warmed or toasted before being served to the customer. In addition, McPherson's sells a variety of packaged snacks, candy, bottled water and juice. The store has little on-site seating; most customers consume the purchased food off-site. McPherson's markets itself as a convenient place for office workers to buy a cup of coffee or purchase a quick mid-day snack. Seventy-five percent of McPherson's sales are from hot foods. Based on the business's advertising and the fact that the majority of gross receipts are from hot prepared food, McPherson's does not typically intend or expect the food items sold from their store to be consumed at the purchaser's home. Therefore, McPherson's may not exclude any receipts under the Grocery Exclusion.

Example 2: Clarendon's Cupboard ("Clarendon's") is a small neighborhood convenience store open seven days a week from 5:00 a.m. to 11:00 p.m. Clarendon's sells a wide variety of items, including cigarettes, tobacco, bottled soda, candy and some grocery staples, such as bread, eggs, milk and cheese. From noon to 3:00 p.m., Clarendon's also sells hot prepared food for immediate consumption, such as hot dogs, fried chicken and hot pizza by the slice. Clarendon's does not offer any on-site seating. Clarendon's advertises itself as a convenient place to buy cigarettes, purchase a hot lunch or a quick snack and pick up a few groceries on the way home from work. Sales of cigarettes, tobacco and other nonfood items constitute 60 percent of Clarendon's gross receipts. Receipts from the sale of cold food (i.e., grocery staples and various snacks and candy items) constitute 30 percent of Clarendon's gross receipts, while receipts from the sale of hot prepared food (i.e., hot dogs, and hot prepared pizza) constitute less than 10 percent of Clarendon's gross receipts. Based on the business's advertising, and the fact that Clarendon's gross receipts from the sale of cold food outweigh the gross receipts from the sale of hot food, the food items sold by the store are typically intended for the purchaser's consumption at home. Clarendon's may exclude receipts from the sale of grocery staples and snacks, as these items are "groceries" for purposes of the CAT. Clarendon's may not exclude receipts from the sale of hot prepared food such as hot dogs and hot pizza, as these items are not groceries. They will have to account separately for these sales.

Safe Harbor; Exclusion from Retail Grocery Exclusion

The temporary rule provides a safe harbor whereby the sale of groceries by a store authorized as a retail food store that has a current permit as a SNAP qualified retail store (or a store that meets the requirements to qualify for such permit) constitutes the retail sale of groceries for

home consumption.

Additionally, the temporary rule provides that a store whose receipts from the sale of hot food items constitute 80 percent or more of total receipts is not eligible to exclude receipts under the Grocery Exclusion.

Comment: The temporary rule's exclusion of stores whose sales of hot food items constitute 80 percent or more of total receipts seems arbitrary and unfair to such retailers. The CAT speaks in terms of sales of groceries, not "most sales." Whatever the rationale for this part of the temporary rule, the inability for a taxpayer to use the Grocery Exclusion because of the 80 percent threshold seems unwarranted.

Out-of-State Wholesale Exclusion – OAR 150-317-1400 (Temporary Rule)

Another exclusion from commercial activity is receipts from sales to a wholesaler in Oregon, if the wholesaler certifies to the seller that the property will be resold outside of Oregon (the "Wholesale Exclusion"). "Wholesaler," for CAT purposes, means a person primarily in the business of distributing tangible personal property to retailers or other wholesalers.

Certificate

This temporary rule provides guidance with respect to the required certification to be provided by a wholesaler. Under the rule, a wholesaler may satisfy this requirement by providing the seller with an out-of-state resale certificate declaring that the wholesaler will resell the goods outside of Oregon. No required form has been created by the Department. Rather, all that is needed is a written document containing the following:

- The wholesaler's legal name and Oregon address;
- The wholesaler's federal tax identification number;
- The date of the purchase;
- The total amount of purchased property;
- The purchase price paid by the wholesaler;
- The dollar amount of purchased property that the wholesaler will resell outside of Oregon; and
- The signature of the wholesaler, its authorized representative, or employee, certifying that the person is a wholesaler as defined in the CAT.

Determination of Out-of-State Sales; Approximation Ratio

A wholesaler is required to determine which property will be sold out of Oregon based on facts available at the time of purchase. This requirement may be satisfied by use of an approximation ratio if at the time of purchase the wholesaler does not know which property will be sold out of Oregon.

The approximation ratio is the following fraction: The wholesaler's Oregon commercial activity for the year realized from property delivered from Oregon locations / the wholesaler's total commercial activity for the year realized from property delivered from Oregon locations.

Example (Approximation Ratio)

The temporary rule provides the following example:

Example 1: Alpha Corp. ("Alpha") is a wholesaler with one location in Klamath Falls, Oregon. Alpha generally purchases widgets for resale to out-of-state customers. In March 2020, Alpha purchases 5,000 widgets from Indigo LLC ("Indigo"), paying a total of $500,000 for the purchased widgets. At the time of the purchase, Alpha is unable to determine the exact number of widgets that will be sold out-of-state, and, therefore, must approximate using the approximation ratio. In 2019, Alpha realized a total of $2 million of commercial activity from the sale of widgets delivered from their Klamath Falls location to customers everywhere, including $100,000 to Oregon customers delivered from Alpha's Klamath Falls location. Alpha calculates their approximation ratio by dividing Oregon commercial activity by everywhere commercial activity ($100,000 / $2 million), resulting in an approximation ratio of 0.05. Alpha applies the approximation ratio of 0.05 to the purchase price ($500,000 x 0.05 = $25,000). Of the total $500,000 widget purchase, Alpha approximates that $25,000 will be resold in Oregon, and $475,000 will be resold out of Oregon. Alpha provides Indigo with an out-of-state resale certificate documenting that $475,000 worth of the purchased widgets will be sold out of Oregon. While Indigo realized $500,000 of commercial activity from the sale to Alpha, only $25,000 of receipts from the sale will be included in Indigo's commercial activity; Indigo will exclude $475,000 of receipts.

Alternative Method

The temporary rule provides an alternative method if a wholesaler knows or reasonably should know at the time of purchase that the approximation ratio discussed above does not fairly and accurately approximate the wholesaler's in-state and out-of-state sales. In such case, the wholesaler may not use the approximation ratio. However, the wholesaler may use a reasonable alternative method of approximation.

The wholesaler must document its alternative method, including a complete explanation of the method, how it was determined, and why the approximation ratio is not a fair approximation of its sales. Once an alternative method has been used, the wholesaler must continue to use the same method, unless such alternative method no longer fairly and accurately approximates the

wholesaler's in-state and out-of-state sales. The wholesaler must document and retain in its records all changes to the alternative method.

Example (Alternative Method)

The temporary rule sets forth the following example:

Example 2: The facts are the same as **Example 1** above, except that Alpha knows in March 2020 that it expects to sell half its widget inventory from the Klamath Falls location to Oregon customers during 2020. Alpha may not use the approximation ratio, but may use an alternative method to reasonably approximate the ratio of in-state and out-of-state sales. Of the total $500,000 widget purchase, Alpha approximates that $250,000 will be resold to Oregon customers. Alpha provides Indigo with an out-of-state resale certificate documenting that $250,000 of the purchased widgets will be resold out of Oregon. Indigo may exclude $250,000 of receipts from its sale to Alpha from Indigo's commercial activity.

If the Department, upon audit, determines that the wholesaler's approximation ratio or alternative method of does not fairly and accurately reflect its in-state and out-of-state sales, the wholesaler must immediately stop using the ratio or alternative method.

Query: What happens if the seller receives the wholesale certificate, but later learns that the purchaser did not sell the goods out of state? Are the receipts now subject to CAT? Does the mere receipt of the certificate mean that the seller can exclude the receipts? Presumably the seller can rely on the certificate if it meets the requirements set forth in the temporary rule. However, the Department has not made this statement.

Query: What if the seller trades rather than sells goods? Would an exchange qualify as a "sale" for purposes of the Wholesale Exclusion? "Sale" is not defined anywhere in the CAT. However, the term "sales" is defined under UDITPA for Oregon income tax purposes as "all gross receipts" with a few exceptions not relevant here. (See ORS 314.610(7)). If this definition applies, the exchange described above should qualify for the Wholesale Exclusion. Clarity from the Department in this regard is necessary.

Vehicle Exclusion - OAR 150-317-1410 (Temporary Rule)

The fourth temporary rule issued by the Department in this batch of rules addresses the resale or transfer of motor vehicles among dealers.

The temporary rule relates to the exclusion from the definition of commercial activity of "receipts from the sale of a motor vehicle by a vehicle dealer to another vehicle dealer for resale if the sale was made to meet the specific needs of the transferee's customer" (the "Vehicle Exclusion").

Under the temporary rule, motor vehicle dealers are required to retain a resale certificate documenting each such dealer transaction. The document must be provided before or at the time the seller bills the purchaser. The certificate must contain all of the following:

- The seller's name, address, federal identification number and dealer license number from the appropriate licensing jurisdiction;
- The purchaser's name, address, federal identification number and dealer license number from the appropriate licensing jurisdiction;
- A description of the vehicle, including the vehicle identification number, serial number or other identifying number, and the make, model and year of the vehicle;
- A statement, signed by the purchaser, their employee or authorized representative, affirming that the vehicle described in the document is purchased or transferred for resale to meet a specific customer's preference; and
- The date ownership of the vehicle is transferred.

Comment: The CAT statute does not expressly require a certificate to show that the requirements of the Vehicle Exclusion are met, so the temporary rule adds an additional compliance burden on taxpayers. Additionally, the temporary rule provides that the certificate must be provided before or at the time the seller bills the purchaser. Therefore, if the purchaser forgets to issue the certificate to the seller in this time frame, it appears that the seller is out of luck and the Vehicle Exclusion will not apply. That is a strong consequence.

Query: What happens if the purchaser provides the certificate, but the purchaser's customer does not go through with the ultimate purchase of the vehicle? Are the gross receipts received by the seller now subject to CAT? Does the mere receipt of the certificate mean that the seller can exclude the receipts? Presumably the seller can still rely on the certificate because the sale was made specifically to meet the Vehicle Exclusion. However, the rule is not clear in this regard.

Conclusion

The latest temporary rules provide additional, much-needed guidance with respect to some significant exclusions from the CAT. As discussed above, the rules are far from perfect, but at least taxpayers have some additional guidance so that they can structure their affairs with respect to the CAT.

While we will continue to provide updates and our analysis as CAT developments occur, please be assured that we intend to take a break from the CAT to discuss important federal tax developments in the upcoming weeks. The CAT cannot rule the roost for too much longer!

Tags: corporate activity tax, Corporate Tax, documentation, Food and beverage, food processing, Grocery Exclusion, Oregon, Oregon businesses, Oregon Department of Revenue, Oregon DOR, Oregon Taxpayers, Out-of-State Wholesale Exclusion, Retail Grocery Exclusion, rulemaking, Safe Harbor, Supplemental Nutrition Assistance Program (SNAP), tax practitioner, taxable commercial activity, Vehicle Exclusion, Wholesale