



STATE OF OREGON
LEGISLATIVE COUNSEL COMMITTEE

April 21, 2020

Representative Shelly Boshart Davis
900 Court Street NE H389
Salem OR 97301

Re: Tax treatment of loan payments received under federal COVID-19 relief programs

Dear Representative Boshart Davis:

You asked whether payments under various federal programs would be taxable under Oregon law. You also asked, if these payments are taxable, whether passage of a reconnect bill would resolve this. Your questions are:

1. Will federal stimulus loan programs (for example Payroll Protection Program or other COVID related loans) qualify as "income" for Oregon Corporate Income and CAT purposes? Will the loans be treated as "commercial activity" for the purpose of the CAT? For small businesses and sole proprietors will it be considered "income"?
2. If the above answer is YES, is the solution to pass a federal reconnect bill (my understanding is this didn't pass during the 2020 Session—which is why the Fed's won't consider this income but under current laws Oregon may?

We conclude that amounts received under section 1102 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) are not taxable as income under the corporate excise tax or personal income tax and are likely not taxable commercial activity under the corporate activity tax. As Oregon tax laws automatically connect to the federal definition of taxable income, no action is required by the Legislative Assembly.

Loan Programs

Under section 1102 of the CARES Act, businesses with 500 employees or fewer are eligible to receive forgivable loans. This program is known as the Paycheck Protection Program. Under section 1106(b) of the CARES Act, if the recipient of a loan meets certain conditions, the loan may be forgiven. To be eligible for loan forgiveness, the recipient must show that within eight weeks the loan proceeds were used to retain employees or to make certain mortgage interest, lease or utility payments.¹ Ordinarily, under section 61(a)(11) of the Internal Revenue Code, indebtedness that is cancelled or reduced results in what is referred to as cancellation of indebtedness income. The CARES Act provides that the amount of a forgiven paycheck

¹ Section 1102(a)(2).

protection loan will not be treated as income. Under section 1106(i) of the CARES Act, the amount that otherwise would be includible in gross income of the eligible recipient by reason of forgiveness is excluded from gross income.

Taxes Imposed upon Income

The principal tax paid by persons doing business in Oregon is the corporate excise tax imposed under ORS chapter 317. It is imposed on taxable income. Oregon also imposes a corporate income tax, found in ORS chapter 318, but this is not likely an issue for this discussion, as it is imposed on taxpayers that have Oregon-source income but that are not doing business in this state. Certain individuals who ordinarily have business-derived income that is subject to personal income tax may also receive paycheck protection loans under the CARES Act. Examples are sole proprietors and shareholders of S corporations. This analysis applies equally to the personal income tax.

The corporate excise tax and personal income tax both connect to federal tax law and incorporate parts of the Internal Revenue Code. In order to conform to legislative changes that are made to federal tax law, including to the code, the Legislative Assembly must affirmatively act each year to update this connection. This is necessitated by the nondelegation doctrine, embodied in Article I, section 21, of the Oregon Constitution, which provides the state may not delegate its legislative authority to another sovereign. As you note, to this end the Legislative Assembly typically enacts an annual “reconnect” bill, which ties Oregon law retroactively to federal tax law changes in effect as of a certain date, usually December 31 of the previous year. The reconnect bill updates the references to the Internal Revenue Code in a number of state tax laws. However, Article IV, section 32, of the Oregon Constitution, contains an exception to the nondelegation doctrine for the definition of taxable income. Article IV, section 32, permits Oregon statutes that govern taxable income to update automatically to incorporate legislative changes to federal taxable income, which in turn derives from federal adjusted gross income. Thus, Oregon taxable income, upon which the corporate excise tax and personal income tax are both imposed, is automatically tied to federal taxable income. As a result, the amounts of paycheck protection loan moneys that ordinarily would be treated as cancellation of indebtedness income at both the federal and state level will be taxable by neither. You are correct that the Legislative Assembly did not pass its usual reconnect bill in the 2020 regular session, but enactment of this bill is not required to exclude these paycheck protection amounts from Oregon taxable income.

Corporate Activity Tax

The treatment, under the corporate activity tax² (CAT), of amounts received under section 1102 of the CARES Act presents a different question. The CAT is not imposed upon income and does not operate as an income tax. It is imposed upon commercial activity. Consequently, it does not necessarily follow that the exclusion from income of loan amounts forgiven under the CARES Act would render these same amounts exempt from the CAT. However, it also appears likely that these amounts would not be considered commercial activity, and thus should be exempt from taxation under the CAT for reasons discussed below.

² ORS 317A.100 to 317A.158.

Commercial activity for purposes of the CAT is defined as “[t]he total amount realized by a person, arising from transactions and activity in the regular course of the person’s trade or business, without deduction for expenses incurred by the trade or business,” with certain modifications and exclusions.³ Although the CAT was newly enacted in 2019, it does borrow from existing Oregon tax law principles. In particular, the definition of commercial activity mirrors longstanding language in ORS 314.610 that is used to define apportionable income for the purpose of allocation and apportionment of Oregon’s corporate excise tax, that is, establishing what amounts are taxable by Oregon rather than by other states. Examination of what it means for a transaction to occur in the regular course of a person’s trade or business is therefore illustrative, as the principles are analogous.

The test for whether an amount is received in the regular course of a trade or business has two components, a “transactional” test and a “functional” test.⁴ The functional test focuses on the disposition or use of property by the taxpayer and is not relevant to this question. However, the transactional test is significant. This test “focuses on the specific ‘transaction or activity’ that immediately resulted in the [receipt of the disputed amount], rather than the general activities of the taxpayer (or others) that preceded the income producing event.”⁵

The first question under the transactional test is, “[w]hat transaction or activity gave rise to the disputed income?”⁶ The second question is, “did that transaction occur in the regular course of the taxpayer’s trade or business? Under this test, the ‘frequency and regularity’ of a given transaction or activity may be considered, although it is not dispositive.”⁷

In *Pennzoil Company v. Department of Revenue*, amounts received in litigation were considered to be received in the regular course of the taxpayer’s business because the taxpayer’s purpose in entering into the original agreement that led to the litigation was to acquire access to oil reserves; the Oregon Supreme Court held that the taxpayer made the underlying agreement in the regular course of its business, namely extracting, processing and selling petroleum, natural gas and minerals.⁸ By contrast, in *Willamette Industries, Inc. v. Department of Revenue*, royalties on oil and gas reserves received by a timber company from its out-of-state timberlands were not received in the “regular course of taxpayers’ business. Taxpayers’ business is growing timber and making wood products, not producing oil and gas. Receiving

³ ORS 317A.100.

⁴ *Willamette Industries, Inc. v. Department of Revenue*, 331 Or. 311, 316 (2000); *Pennzoil Company v. Department of Revenue*, 332 Or. 542, 546 (2001).

⁵ *Fidelity National Financial, Inc. v. Department of Revenue*, Oregon Tax Court, Magistrate Division, TC-MD 140440D, 11-12, (January 15, 2016), *citing Pennzoil* at 547-548.

⁶ *Id.* at 12.

⁷ *Id.*

⁸ *Pennzoil* at 548.

royalties on mineral rights was not in the regular course of taxpayers' business as a forest products company."⁹

Here, the payments received under section 1102 of the CARES Act do not appear to result from a transaction in a taxpayer's regular course of business. Rather, they are unrelated to a specific transaction and are limited-time government support payments offered in the face of an exceptional national crisis. These payments are incidental, rather than integral, to a taxpayer's transactions in the regular course of business.¹⁰ We do not believe these amounts are commercial activity.¹¹ Thus, they should be exempt from taxation under the CAT. This conclusion is not without doubt, as the CAT is newly enacted and is still being implemented for the first year of its applicability, but we expect that this amount would not be subject to the CAT. This would also align with the policy of providing support payments to businesses that led to the exemption in the CARES Act. Finally, the passage of an annual "reconnect" bill is not significant to this discussion, as the relevant provisions of the CAT are not connected to federal tax law.

Other Provisions of COVID-19 Relief Legislation

This analysis would apply to other programs that provide businesses with loans that are then eligible to be forgiven and excluded from gross income on a taxpayer's federal return. We are unaware of other provisions under COVID-19 legislation already passed by Congress that are structured identically. There are other tax-related provisions in the COVID-19 relief bills, such as provisions that extend relief in the form of refundable credits, including the credits for providing paid sick leave and paid family and medical leave under the Families First Coronavirus Response Act (P.L. 116-127). These amounts are not taxable, either as income or as commercial activity.

The opinions written by the Legislative Counsel and the staff of the Legislative Counsel's office are prepared solely for the purpose of assisting members of the Legislative Assembly in the development and consideration of legislative matters. In performing their duties, the Legislative Counsel and the members of the staff of the Legislative Counsel's office have no authority to provide legal advice to any other person, group or entity. For this reason, this opinion should not be considered or used as legal advice by any person other than legislators in

⁹ *Willamette Industries* at 318. See also *Sperry & Hutchinson v. Department of Revenue*, 270 Or. 329, 331-332, (1974).

¹⁰ *Willamette Industries* at 315.

¹¹ We note that the administrative rules promulgated by the Department of Revenue to implement the CAT specifically incorporate and cite the transactional test discussed above in the rule defining commercial activity. OAR 150-317-1000 (1). This rule also states that "items of value received in a trade or business, including but not limited to money, property received, debt forgiven and services rendered," are commercial activity. OAR 150-317-1000 (2). This reference to "debt forgiven" must be read in the context of the transactional test; in other words, in order to be commercial activity, the amount realized must first be received in a transaction in the regular course of the taxpayer's trade or business, thus meeting the transactional test set out in cases including *Pennzoil* and *Willamette Industries*.

the conduct of legislative business. Public bodies and their officers and employees should seek and rely upon the advice and opinion of the Attorney General, district attorney, county counsel, city attorney or other retained counsel. Constituents and other private persons and entities should seek and rely upon the advice and opinion of private counsel.

Very truly yours,

DEXTER A. JOHNSON
Legislative Counsel

A handwritten signature in black ink, appearing to be 'DJ', with a long horizontal flourish extending to the right.

By
Catherine M. Tosswill
Special Counsel and Chief Editor