

Oregon Challenges California and New York for Tax Supremacy

By Susan F. Sterne

On June 11th, 2009, the Oregon Senate approved two House bills (HB 3405 and HB 2649) significantly increasing taxes on C corporations and individuals, as well as imposing minor increases on other business entities. With these changes, Oregon's highest individual income tax rate will be as high as any other state's; only residents of New York City will pay tax at higher marginal rates. All of the tax increases are effective retroactively to the beginning of 2009.

Although Governor Kulongoski has not yet signed these bills, he is expected to. Barring a successful referendum effort, by December of this year - certainly no later than April 2010 - you should expect to see the effect of these increases on your company's and your individual tax payments.

Increases in Corporate and Other Business Entity Taxes

Oregon's minimum corporate tax of \$10 - in place since 1931¹ - has been a target of criticism for a wide spectrum of policy groups. Even the Oregon Business Association (OBA) recently recommended permanent increases in this minimum tax - although most recommendations, including the OBA's, did not go as far or as fast as HB 3405.

In HB 3405, Oregon does away with the \$10 minimum tax, imposing in its place a new minimum tax of \$150 for all pass-through entities, including S corporations, and a tiered minimum tax based on gross Oregon sales applicable only to C corporations. The minimum tax for C corporations ranges from \$150 for those with gross Oregon sales below \$500,000, to \$100,000 for those with gross Oregon sales of \$100 million or more. (See box for complete table of minimum tax levels.) **While the pace at which the minimum tax increases is alarming – a small company with only \$5 million in gross Oregon sales pays a \$4,000 minimum corporate tax, regardless of profitability – it is some comfort that these graduated minimum taxes do not apply to S corporations.** Instead, S corporation owners will carry their share of the tax increases on their personal income tax returns (more on that below). S corporations will pay only the increased minimum tax of \$150. And, for the first time, Oregon partnerships and LLCs that file Oregon partnership returns will also pay this \$150 minimum tax.

| Minimum Taxes for C Corporations (effective for tax years beginning in 2009) | |
|---|-------------|
| Oregon sales (gross) ² | Minimum tax |
| Less than \$500,000 | \$150 |
| \$500,000 to \$999,999 | \$500 |
| \$1 million to \$1,999,999 | \$1,000 |
| \$2 million to \$2,999,999 | \$1,500 |
| \$3 million to \$4,999,999 | \$2,000 |
| \$5 million to \$6,999,999 | \$4,000 |
| \$7 million to \$9,999,999 | \$7,500 |
| \$10 million to \$24,999,999 | \$15,000 |
| \$25 million to \$49,999,999 | \$30,000 |
| \$50 million to \$74,999,999 | \$50,000 |
| \$75 million to \$99,999,999 | \$75,000 |
| \$100 million or more | \$100,000 |

In addition to increasing the minimum corporate tax, HB 3504 increases the tax rates on corporate net income.

The tax rate increase has three phases:

- 1.) for tax years beginning in 2009 and 2010, the maximum rate, imposed on corporate net income over \$250,000, is 7.9%;
- 2.) for tax years beginning in 2011 and 2012, this rate drops to 7.6%; and
- 3.) for tax years 2013 and later, the 7.6% maximum rate is imposed only on net income over \$10 million.

For all years, the corporate tax rate remains at its current 6.6% for taxpayers with net income below \$250,000.

| Tax Rates on Corporate Net Income | | | |
|-----------------------------------|---------------|---------------|----------------|
| Taxable income | 2009 and 2010 | 2011 and 2012 | 2013 and after |
| Up to \$250,000 | 6.6% | 6.6% | 6.6% |
| \$250,000 to \$10 million | 7.9% | 7.6% | 6.6% |
| Over \$10 million | 7.9% | 7.6% | 7.6% |

C corporations will pay either the minimum tax based on Oregon sales, or income tax based on these rates, whichever is greater.

HB 3504 also raises various state filing fees – such as articles of incorporation or organization – to \$100 from \$50. The law also increases fees for filings under the Uniform Commercial Code (UCC filings) and applications to be a notary public.

Increases in Personal Income Taxes

The Oregon legislature appears to have adopted the Obama administration's position that those earning over \$250,000 are "wealthy," and therefore targeted for tax increases. Staying above this demarcation line, the Oregon legislature approved a tax increase (HB 2649) to 10.8% for households with joint net taxable income of \$250,000 or more (\$125,000 or more for those filing single or separate Oregon returns), with an even higher 11% rate imposed on joint household income over \$500,000 (\$250,000 for single or separate returns). Like the corporate tax increases, the maximum personal income

¹Oregon Center for Public Policy Executive Summary, February 23, 2004 (<http://www.ocpp.org/cgi-bin/display.cgi?page=es040223>)

²Oregon sales for this purpose means sales, net of refunds, sourced to Oregon for state apportionment purposes. The equivalent amount for prior years is reported on your 2007 or 2008 Oregon corporate income tax return on page 1, item N, or on Schedule AP, line 21, column (a).

tax rate increase is highest for only a few years, dropping to 9.9% (still above the current maximum rate of 9%) for joint household incomes over \$250,000 in tax year 2012.

| Individual Tax Rates | | |
|---|---------------------|----------------|
| Taxable income | 2009, 2010 and 2011 | 2012 and after |
| \$10,000 to \$250,000 (joint return) \$5,000 to \$125,000 (single or separate return) | 9% | 9% |
| \$250,000 to \$500,000 (joint return) \$125,000 to \$250,000 (single or separate return) | 10.8% | 9.9% |
| Over \$500,000 (joint return) Over \$250,000 (single or separate return) | 11% | 9.9% |

HB 2649 also phases out the subtraction for federal taxes paid for the those who have joint federal adjusted gross income (AGI) of \$250,000 (\$125,000 for a separate return). The subtraction is eliminated entirely at joint federal AGI of \$290,000 (\$145,000 for a separate return). This phase-out is permanent, and effective beginning in 2009.

HB 2649 does include an individual tax decrease for tax year 2009 only, exempting the first \$2,400 in unemployment compensation received from Oregon tax.

Effect on estimated tax payments?

The higher individual tax rates are effective **retroactively** for all of 2009. This means that those who are making Oregon estimated tax payments based on their actual 2009 income (rather than based on 2008 Oregon tax paid) may abruptly find themselves underpaid through second quarter 2009. HB 2649 recognizes this by eliminating any interest or penalty arising only from the new tax rates for 2009. This means that individual taxpayers can base their estimates for 2009 on

their tax as it would have been under the old rate structure, with a maximum 9% rate. The additional tax will be due by April 15, 2010, but no interest or penalty will be imposed on the shortfall. Even so, some taxpayers may find it beneficial for federal tax purposes to pay all Oregon taxes prior to year end.

A Last Word...

Some or all of these tax increases could be subject to revocation or modification via the referendum process... So stay tuned for further updates!

| | | |
|----------------|---------------|---------------------------------|
| Chris Loughran | (503)221-7565 | cloughran@perkinsaccounting.com |
| Tim Kalberg | (503)221-7511 | tkalberg@perkinsaccounting.com |
| David Uslan | (503)221-7597 | duslan@perkinsaccounting.com |
| Roy Abramowitz | (503)221-7500 | roya@perkinsaccounting.com |
| Keith Meyers | (503)221-7579 | kmeyers@perkinsaccounting.com |
| Susan Sterne | (503)221-7531 | ssterne@perkinsaccounting.com |

This bulletin is a summary and is not intended as tax or legal advice. You should consult with your tax advisor to obtain specific advice with respect to your fact pattern.

Based on the most recent "best practice" standards for tax advisors issued by the Treasury Department, commonly referred to as Circular 230, we wish to advise you that this bulletin has not been prepared to be used, and cannot be used, to provide assurance that penalties which may be assessed by the IRS or other taxing authority (including specifically section 6662 understatement penalties) will not be upheld.