HOW CORPORATIONS ARE TAXED

HISTORY & TAX CALCULATION

Although commonly referenced as the "corporate income tax," corporations are subject to either the corporate excise tax or the corporate income tax.

Corporations "doing business" in Oregon pay the excise tax. Corporations not "doing business," but having income from an Oregon source, pay the income tax. "Doing business" means that a corporation has sales activity and a certain level of physical presence in Oregon.

Although most corporate taxpayers are subject to the excise tax, the two taxes will often be lumped together and casually referred to as the "corporate income tax." In addition, there is an important difference in treatment between corporations that are organized as S corporations and those organized as C corporations. Although this is explained in greater detail later, it is important to note that the income of S corporations is passed through to shareholders, where it is taxed through the personal income tax system. Income of C corporations is taxed through the corporate income tax program.

History

Oregon began taxing corporate net income in 1929, the same year the state began taxing personal income. The amount of corporate income and excise tax paid by corporations is based on their income attributable to Oregon activities.

The personal and corporate income taxes were both initially enacted to offer relief from property taxes. The 1929 law stated "…the revenue derived from the tax shall reduce by corresponding amount the direct tax levy which the tax commission would otherwise apportion to the several counties of the state." (*Corporation Excise of 1929*, Oregon Laws 1929, Cap. 427, sec. 23).

The explicit tie to the property tax was broken by 1951 legislation. At this time, the revenues from the corporate tax were sent to the general fund for general appropriations where they remain to this day.

Tax Calculation

Below is a basic description of how taxes are determined for Oregon corporations. Because the corporation program is so complex, not every detail can be presented here, but this discussion attempts to describe the major components of the computation of this tax. Exhibit 1.1 provides a flowchart of this computation that will be discussed below.

Starting Point

Oregon's definition of taxable income for corporations begins with federal taxable income. Federal taxable income is essentially gross income minus costs of doing business such as salaries, repair and maintenance, employee benefit programs, and depreciation. The Oregon corporate return modifies federal taxable income through additions and subtractions.

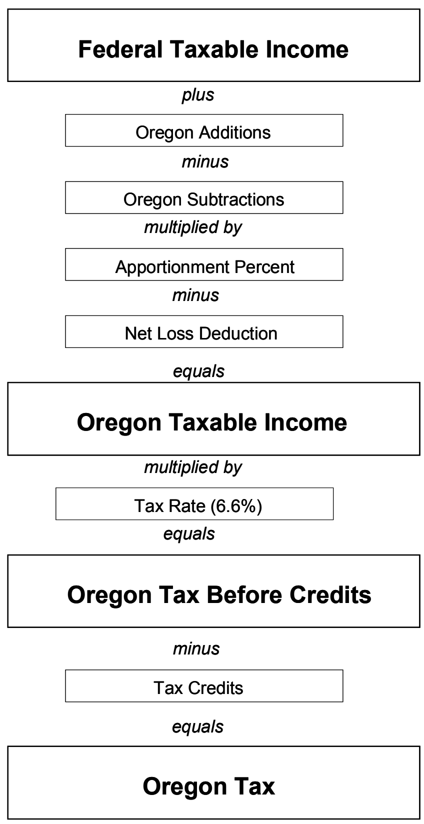
Additions

Additions are sources of gross income that are taxable in Oregon but not by the federal government. Some common Oregon additions include: state or municipal interest income, Oregon excise tax or other state taxes measured by net income or profits, and the income of related foreign sales corporations (FSCs)[1].

Subtractions

Subtractions are sources of gross income that are taxable at the federal level but not by Oregon. Some common subtractions include dividend deductions and the income of non-unitary corporations.

Exhibit 1.1
Components of the Oregon Corporate Income Tax



Additions and subtractions may be any number of adjustments necessary to arrive at the appropriate bottom-line Oregon income.

Apportionment

For the purposes of state taxation, the income of corporations which conduct business exclusively in Oregon is taxed only by Oregon. Corporations doing business in more than one state must determine the share of their income attributable to Oregon activities. For these corporations, the base income is "apportioned" to Oregon by a three factor formula. The factors used in this formula are Oregon payroll relative to total payroll in all states, Oregon property relative to total

[1] In 2000, federal exclusion of income of FSCs was repealed for transactions after 2001 because of a World Trade Organization determination that the exclusion was an illegal export subsidy. Consequently, this Oregon addition is now limited to minor activity relating to contracts that existed prior to 2001.

property in all states, and Oregon sales relative to total sales in all states. An Oregon percentage is calculated for each of these factors and these three percentages are weighted to determine an overall apportionment percentage.

Prior to tax year 1991, the property, payroll, and sales factors were equally weighted when apportioning income for multi-state corporations. In 1991, Oregon switched to a double-weighted sales factor. Tax years beginning after May 2003 will employ a super-weighted sales factor. Sales will comprise 80 percent of the apportionment percentage, property 10 percent, and payroll the remaining 10 percent.

Exhibit 1.2
Contribution of Factors to Apportionment Percentage

	Property	Payroll	Sales
Three Factor (pre-1991)	33%	33%	33%
Double-weighted sales (1991)	25%	25%	50%
Super-weighted sales (2003)	10%	10%	80%

The movement toward a super-weighted sales factor will reduce Oregon taxes for those companies with significant property and payroll within Oregon but with most of their sales outside the state. Taxes will increase for out-of-state companies with sales in Oregon, but with small shares of property and payroll in the state. Overall, this modification is expected to reduce corporate revenues by an estimated $62.5 million in the 2003-05 biennium (estimate from the Legislative Revenue Office 7-2-01 for HB 2281B).

Net Loss Deduction

The current year taxable income may be reduced by losses carried forward from prior years. Oregon law allows an operating loss to be used to offset future tax liability. In Oregon, operating losses may be carried forward for up to 15 years. Operating losses may not be carried back.

Tax Before Credits

The "tax before credits" is calculated by multiplying Oregon taxable income by the tax rate. The tax rate has changed a number of times since the tax was introduced in 1929 with rates ranging from 5 percent to 9 percent. The current rate is 6.6 percent, where it has been since it was reduced from 7.5 percent in 1987. Exhibit 1.3 on the following page provides a history of Oregon corporation rates.

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Exhibit 1.3
Corporate Tax Rates, 1929 to Present

Year	Tax Rate	Type of Corporation
1929	5.0%	All Corporations
1932	8.0%	All Corporations
1955	4.0%	All Corporations
1957	6.0%	Regular Corporations
	7.0%	Public Utilities
	9.0%	Financial Corporations
1959	6.0%	Regular Corporations
	6.0%	Public Utilities
	9.0%	Financial Corporations
1963	6.0%	Regular Corporations
	6.0%	Public Utilities
	8.0%	Financial Corporations
1976	6.5%	Regular Corporations
	6.0%	Public Utilities
	6.5%	Financial Corporations
1977	7.0%	All Corporations
1978	7.5%	All Corporations
1987	6.6%	All Corporations

Credits

A corporation's Oregon tax liability may then be reduced by any of approximately 40 applicable credits claimed by the corporation. None of the credits is refundable, but most allow unused credit amounts to be carried forward and used in later years. These credits are described in detail in the *State of Oregon 2003–05 Tax Expenditure Report* and on pages 3-8 to 3-10 of this report.

Oregon Tax

A corporation's net tax liability is the result of subtracting credits from the tax liability before credits. The minimum tax for excise taxpayers is $10. There is no minimum income tax. When the corporation excise tax was established in 1929, it included a minimum tax of $25. The 1931 Legislature decreased the minimum tax to $10 effective with the 1932 tax year where it has remained ever since.

S corporations and Insurance corporations vary from the general structure. Their variations are described in sections 1B and 1C.

For additional information, please refer to Oregon Department of Revenue's *Corporation Excise/Income Tax, Form 20, 20-I Instructions.*

[1] In 2000, federal exclusion of income of FSCs was repealed for transactions after 2001 because of a World Trade Organization determination that the exclusion was an illegal export subsidy. Consequently, this Oregon addition is now limited to minor activity relating to contracts that existed prior to 2001.

Certain corporations are known as 'pass-through' entities because their income (or loss) is passed through to the individual shareholders. The income is then taxed as personal income. These S corporations (so named because of the section in the IRS Code describing them) must be domestic corporations subject to certain limitations. S corporations must have:

- one class of stock,
- no more than 75 shareholders,
- only U.S. citizens or residents as shareholders,
- only individuals, estates, or certain trusts as shareholders.

In exchange for these limitations, the S corporation receives certain tax advantages. A regular, or C corporation, pays taxes on income first at the corporate level. This income is taxed again when it is received by individual shareholders as dividends. An S corporation avoids this double taxation as the income is not taxed at the corporate level.

Considerations other than tax planning will influence the organizational structure of a business.

Oregon accepts the S corporation election made for federal purposes and allows the corporation to function as a pass-through entity.

S corporations have grown in popularity in recent years. In 1990 fewer than 20,000 S corporation returns were filed in Oregon. By tax year 2000 this number had more than doubled to over 43,000 returns. See Appendix F for additional history of S corporation returns in Oregon.

A small amount of S corporation income is taxed on the corporate side. Only a handful of S corporations have this type of income and it occurs when an S corporation has built-in gains or net excess passive income. This type of income generally occurs when a corporation has converted from a C corporation to an S corporation.

Tax Form 20-S is filed by S corporations that are paying either the income or the excise tax. The excise minimum tax is $10, which most S corporation filers pay.

For additional information, please refer to Oregon Department of Revenue's *S Corporation Tax, Form 20-S Instructions.*

Prior to 1997, foreign insurers paid a retaliatory tax and gross premium tax instead of the corporate excise tax. In response to legal challenges by foreign insurers, the 1995 legislature enacted laws that made both foreign and domestic insurers subject to the same taxes. Starting with tax year 1997, all foreign and domestic insurance corporations are subject to the corporate excise tax. Insurers file on Form 20-INS.

For tax years beginning on or after January 1, 1997, and before January 1, 2002, foreign insurers were required to pay a transition tax to the Department of Consumer and Business Services (DCBS) as the premiums tax was phased out. For tax years after 2001, foreign insurers are no longer subject to the transition tax, but they are still subject to the retaliatory tax that is paid to DCBS[2]. The excise tax is paid to the Department of Revenue.

Insurers use a three factor apportionment formula, as do other corporations, however the factor definition and weighting are unique for 20-INS filers. The three factors are the Oregon share of real estate income and interest relative to total real estate income and interest; the Oregon share of wages and commissions relative to total wages and commissions; and the Oregon share of insurance sales (total premiums written) relative to the total insurance sales. All three factors are equally weighted to produce the overall apportionment percentage.

Title insurers file Form 20 instead of Form 20-INS and use the same apportionment factors as most other corporations. Title insurers begin with federal taxable income, make the same additions and subtractions that non-insurance corporations make, and apportion using property, payroll, and double-weighted sales factors (Note: as of May 2003, the weight of the sales factor changes from 50% to 80%.).

Insurance companies are required to file their excise tax return on a calendar year basis.

For additional information, please refer to Oregon Department of Revenue's *Insurance Excise Tax, Form 20-INS Instructions.*

[2]The retaliatory tax is a comparison of the taxes, fees, assessments, penalties and fines that an Oregon company would pay in the foreign state to the taxes, fees, assessments, penalties and fines that the foreign insurer actually pays in Oregon. If another state heavily taxes Oregon insurance companies that do business in that state, the retaliatory tax applies that level of tax to the foreign state's companies that do business in Oregon.