What Oregon's Proposed Gross Receipts Tax Could Mean for Food Processors

Oregon voters will see a new proposed tax on the ballot this November - measure 97 - one that could have weighty consequences for businesses and residents. Food processors are no exception.

The basics: Measure 97, formerly known as Initiative petition (IP) 28, would have two primary effects. First, it would create a 2.5 percent tax on C corporations' gross receipts if they exceed $25 million per year. It's important to note that the tax would apply on the gross receipts themselves, not net income, meaning businesses with slim margins might be hard-pressed to afford it. Second, measure 97 would remove Oregon's $100,000 minimum tax liability—already the highest in the nation—for companies above the $25 million annual sales threshold. Instead, companies above the threshold would pay the 2.5 percent tax on sales plus a flat $30,001.

Though the tax is aimed at C corporations, its impact would extend much further because any organization (or individual) making a purchase from a C corporation would ultimately cover the increased cost of doing business. In effect, measure 97 would create a hidden sales tax for all consumers within Oregon. The tax also pyramids, so products that change hands multiple times before reaching their final consumer could have the tax applied several times. Among utilities, power is often traded multiple times—which could easily add 5 to 10 percent to the cost of power alone. When you consider the impact of this tax on all a business's inputs, the effect could be staggering.

To demonstrate a few more ways the tax could impact food processors, agribusinesses, and related companies, let's start by debunking a few commonly held misconceptions about the tax.

Misconceptions

False: Agricultural cooperatives are exempt.

First, even though agricultural co-ops aren't technically C corporations, they would be subject to the direct tax, unlike S corporations, partnerships, and B corporations. Still, organizations not subject to the direct tax would pay in terms of increased cost of doing business. Utilities are one area where food processors will feel this tax profoundly: A company that pays $1 million per year in power to a C corporation, once two to four layers of the 2.5 percent tax are added, might end up paying an additional $50,000 to $100,000 in utilities per year.

Other direct inputs would add up as well. Even for smaller organizations that use mostly ingredients from smaller vendors—say, berries sourced from local growers—some materials, such as sugar, may be sourced from large public companies. When you extrapolate this increase across other purchases Oregon companies make, from payroll service providers and labor providers to equipment vendors and more, the effect of measure 97's proposed gross receipts tax is magnified many times over.

False: Only large, out-of-state corporations will pay the tax.

Any organization that files an Oregon tax return as a C corporation must pay the tax—not only those headquartered outside the state.

False: The tax applies only to sales made in Oregon. If you don't have tax nexus in another state but do make sales to customers located there, those sales are typically "thrown back" to Oregon and would be subject to the new tax.

Say, for example, an Oregon-based food distributor ships goods to all 50 states. Sales to out-of-state customers are excluded from the tax only to the extent the company files tax returns in those other states. Tax laws vary by state, so take California: Assuming the distributor doesn't have any employees, real estate, inventory, or other nexus-generating activity in California, its sales to a California wholesale customer wouldn't be taxable in California. Instead, they'd be taxable in Oregon, making them subject to the tax.

Tax May Create Some Winners

Though there's no question the proposed tax would have a profound impact on C corporations with over $25 million in sales or on their business partners, not everyone would be impacted as significantly.

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S corporations, B corporations, and partnerships that aren't dependent on large C corporations as vendors would be able to mitigate some of the impact.

Mitigating the Impact

Reconsider Entity Type

Oregon C corporations that have the ability to restructure to a different entity type may want to consider doing so. S corporations, B corporations, and partnerships are exempt from the direct tax, though restructuring into one of these entity types comes with complications and compliance requirements of its own. Although many publicly traded companies don't have the option of choosing a different entity type, many privately held companies that were originally formed as C corporations would very likely never have made the same decision if they incorporated today. If you have a choice, examine whether restructuring to a S or B corporation would be valuable.

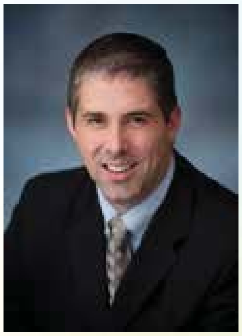
Examine Nexus

Second, it may be worthwhile to have a multistate tax nexus study performed. In many cases, nexus studies set out with the aim of reducing exposure in other states, but if the proposed tax becomes law, it may be worth diverting more income out of Oregon. In some cases, it may even make sense to create taxable nexus in a state—storing and shipping finished goods inventory from the state, for example—because the tax incurred in doing so may present a bargain compared with the incremental Oregon gross receipts tax.

Next Steps

- At this stage, it's important that companies examine their exposure to the tax. A few questions to ask:
- How much would the tax increase your cost of doing business, and how would it impact your margins?
- As your margins tighten, how would future capital projects be impacted? Debt repayments?
- To what extent can you source inputs from vendors that won't be subject to the tax (and therefore won't be passing it on to you)?
- What is your customers' sensitivity to price increases? Is it feasible for your business to pass the tax on—as will inevitably happen—without eroding your customer base? If not, how many customers could you afford to lose?
- Is restructuring as a different entity type feasible, and to what extent would it shelter you from the proposed tax?

Depending on the answers to these questions, you may be able to make adjustments to your business that mitigate the impact of the tax—and shed light on whether to support the tax when it comes to a vote in November.



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