

Senate Committee on Finance and Revenue

April 25, 2017

HB 2275 – Definition of Business Income

HB 2275 adopts a uniform proposal developed by the Multistate Tax Commission (MTC) relating to the definition of business income under the Uniform Division of Income for Tax Purposes Act (UDITPA). UDITPA is a model law for allocating and apportioning income of a business that is taxable in two or more states. Oregon is a member of the MTC, which has an expressed purpose to promote uniformity. The MTC proposal clarifies two issues in the treatment of business income that have arisen in litigation in Oregon and other UDITPA states concerning the definition of business income. The proposal also includes a technical change renaming “business income” as “apportionable income.”

Oregon adopted UDITPA in ORS chapter 314. The definitions of business income and nonbusiness income are codified in ORS 314.610. Generally, business income is apportioned among the states where the corporation is taxable. Nonbusiness income is defined as all income other than business income. Items of nonbusiness income generally are allocated to a single state. Under current law, business income “means income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, the management, use or rental, and the disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.”

The first part of this definition is known as the “transactional test” – it focuses on the frequency and regularity of the transaction that produces the income. The second part is known as the “functional test” – it focuses on the relationship of the property that produces the income to the taxpayer’s regular business operations.

The MTC proposal clarifies two separate issues with the definition of business income that have arisen in litigation in Oregon and other UDITPA states. First, the uniform proposal is intended to clarify that the transactional and functional tests are two separate tests.

A majority of UDITPA states, including Oregon, agree the transactional and functional tests are separate tests. However, courts in some UDITPA states have held that the UDITPA definition only provides for the transactional test and view the functional test as a subset of the transactional test. The uniform proposal explicitly clarifies that the functional test of business income is a separate test.

Second, disputes have arisen about the scope of the functional test in the case of corporate liquidations of all or part of a business. Many state courts, including the Oregon Tax Court, treat gains from the sale of property used in regular business operations as business income under the functional test, whether or not the sale is in liquidation. Some state courts, however, have held the disposition itself must be an essential part of regular business operations, even when the functional test is a separate test. The theory behind these decisions is that income can’t be



Legislative Testimony

“business income” if there is no longer any business. This uniform proposal is intended to clarify gains from the liquidation of all or part of a business is business income. To explicitly address the fact that “business income” includes income from the selling the business, the uniform proposal renames “business income” as “apportionable income” and adds a provision defining apportionable income as all income that is apportionable under the U.S. Constitution, and any income that would be allocable to this state under the U.S. Constitution, but that is apportioned rather than allocated pursuant to the laws of this state.

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