BEFORE THE METRO COUNCIL

FOR THE PURPOSE OF AMENDING METRO CODE CHAPTER 7.07 RELATED TO APPORTIONMENT AND ALLOCATION OF INCOME TO BETTER ALIGN WITH OREGON STATE INCOME TAX APPORTIONMENT LAW FOR CERTAIN BUSINESSES	))))))	ORDINANCE NO. 22-1484 Introduced by Chief Operating Officer Marissa Madrigal in concurrence with Council President Lynn Peterson

WHEREAS, on May 19, 2020, the Metro area voters approved Metro's Supportive Housing Services Ballot Measure ("Measure"); and

WHEREAS, on December 17, 2020, the Metro Council adopted Ordinance No. 20-1454, which established new Metro Code Chapters 7.05 (Income Tax Administration for Personal and Business Taxes") and 7.07 ("Business Income Tax"); and,

WHEREAS, the administration of income taxes often requires code and rule amendments to address issues such as federal and state law changes, as well as technology associated with tax filing and enforcement; and,

WHEREAS, as part of Ordinance No. 20-1454, the Metro Council required "an evaluation of the apportionment methodology for gross business income under Chapter 7.07 no later than December 1, 2022," and Council further required that as part of that evaluation process Metro staff "coordinate with regional governmental partners and engage with stakeholders, including businesses and tax specialists"; and,

WHEREAS, in drafting these proposed Metro Code changes, Metro staff worked closely with both City of Portland and Multnomah County staff that oversee their respective business income tax codes; and

WHEREAS, these proposed Metro Code changes not only align with Oregon Tax Law, but they also align with changes recently adopted by the Portland City Council and the Multnomah County Board of Commissioners to their respective business income tax codes, thus making tax filings easier, less costly, and more efficient for businesses; and

WHEREAS, the proposed business income apportionment code changes for all three jurisdictions involved a public comment process, including involvement with businesses and tax specialists; and

WHEREAS, this update to Metro Code addresses concerns brought to Metro's attention during the implementation of its business income tax and largely aligns with state tax law related to income apportionment for tax purposes for most businesses for which the provision applies; now therefore,

THE METRO COUNCIL ORDAINS AS FOLLOWS:

1. Metro Code Sections 7.07.070 and 7.07.080 are amended, and Metro Code Sections 7.07.071 and 7.07.081 are added to Chapter 7.07 as set forth in Exhibit A. These changes take effect on January 1, 2023.

ADOPTED by the Metro Council this 27th day of October 2022.

Lynn Peterson, Council President

Attest:

Connor Ayers

Connor Ayers, Recording Secretary

Approved as to Form:

Carrie Maclaren

Carrie MacLaren, Metro Attorney

Chapter 7.07 Business Income Tax

New language for Chapter 7.07 is indicated by <u>underlined</u> text.

1. *Amend the title of Section 7.07.070 "Income Determinations" as follows:*

    7.07.070 Income Determination <u>for Tax Years Prior to January 1, 2023.</u>

2. *Amend Section 7.07.070 "Income Determinations" by inserting the following language as the new first paragraph:*

    <u>This section applies to tax years beginning prior to January 1, 2023. For tax years beginning on or after January 1, 2023, see Section 7.07.071.</u>

    The remainder of Section 7.07.070 is unchanged.

3. *Add a new Section 7.07.071 "Income Determinations for Tax Years on or after January 1, 2023" as follows:*

<u>7.07.071 Income Determinations for Tax Years on or after January 1, 2023</u>

<u>This section applies to tax years beginning on or after January 1, 2023.</u>

<u>The net income arising from any business, as reportable to the State of Oregon (State) for corporation, S-corporation, partnership, or trust excise or income tax purposes, before any allocation or apportionment for operation out of state, or deduction for a net operating loss carry-forward or carry-back is subject to the Metro Business Income Tax.</u>

(a) <u>Partnerships, S-corporations, limited liability companies (excluding disregarded entities), limited partnerships, limited liability partnerships, family limited partnerships, estates, and trusts are liable for the business tax and not the individual partners, shareholders, members, beneficiaries, or owners. The income of these entities must include all income received by the entity including ordinary income, interest and dividend income, income from sales of business assets, and other income attributable to the entity.</u>

(b) <u>If one or more persons are required or elect to report their income to the State for corporation excise or income tax purposes in a consolidated, combined, or joint return, a single return must be filed by the person filing such return. In such cases, net income means the net income of the consolidated, combined or joint group of taxfilers before any allocation or apportionment for operation out of the state, or deduction for a net operating loss carry-forward or carry-back.</u>

(c) The absence of reporting income to the Internal Revenue Service or the State of Oregon does not limit the ability of the Administrator to determine the correct income of the taxfiler through examination under Section 7.05.130.

(d) Estates and trusts. In determining income for estates and trusts, income is measured after distribution of profits to beneficiaries. No additional deduction is allowed.

(e) Certain Deductions Not Allowed. In determining income, no deduction is allowed for:

1. Taxes based on or measured by net income;
2. The federal built-in gains tax; or
3. The City of Portland Clean Energy Surcharge.

(f) Ordinary gain or loss. In determining income, gain or loss from the sale, exchange or involuntary conversion of real property or tangible and intangible personal property must be included as ordinary gain or loss.

(g) Net operating loss. In determining income, a deduction is allowed equal to the aggregate of the net operating losses incurred in prior years, not to exceed 75% of the income determined for the current tax year before this deduction but after all other deductions from income allowed by this section and apportioned for business activity both within and without the District.

1. When the operations of the taxfiler from doing business both within and without the District result in a net operating loss, such loss will be apportioned in the same manner as the net income under Section 7.07.080. A net operating loss may not be carried forward from any tax year during which the taxfiler conducted no business within the District or the taxfiler was otherwise exempt from payment of the Business Income Tax unless specifically provided for by administrative rule or written policy.

2. In computing the net operating loss for any tax year, the net operating loss of a prior tax year is not allowed as a deduction.

3. The net operating loss of the earliest tax year available must be exhausted before a net operating loss from a later tax year may be deducted.

4. The net operating loss in any tax year is allowed as a deduction in any of the five succeeding license tax years until used or expired. Any partial tax year will be treated the same as a full tax year in determining the appropriate carry-forward period.

4. *Amend the title of Section 7.07.080 "Apportionment of Income" as follows:*

7.07.080 Apportionment of Income for Tax Years Prior to January 1, 2023

5. *Amend Section 7.07.080 "Apportionment of Income" by inserting the following language as the new first paragraph:*

This section applies to tax years beginning prior to January 1, 2023. For tax years beginning on or after January 1, 2023, see Section 7.07.081.

The remainder of Section 7.07.080 is unchanged.

6. *Add a new Section 7.07.081 "Apportionment of Income for Tax Years Beginning on or after January 1, 2023" as follows:*

7.07.081 Apportionment of Income for Tax Years Beginning on or after January 1, 2023

This section applies to tax years beginning on or after January 1, 2023.

(a) "Jurisdiction to tax" occurs when a person engages in business activities in a jurisdiction that is not protected from taxation by Public Law 86-272 [15 U.S.C. Section 381-384]. The District's standard for jurisdiction to tax, or nexus, is the same as the State of Oregon's found in the Oregon Revised Statutes and Oregon Administrative Rules related to taxation. If a taxfiler's business is based in the District, a taxfiler must have business activity outside the District that results in a jurisdiction to tax outside the District to apportion the income of the business. Without jurisdiction to tax outside the District, all income of a business is taxable by Metro.

(b) "Business activity" means any of the elements of doing business. The income reportable as income earned from business activity within the District will include all business incomes from sources within the District that is taxable income under Oregon tax laws and regulations unless otherwise exempted or excluded in this chapter.

(c) The District adopts the apportionment and allocation provisions found in the Oregon Revised Statutes, Chapters 314, 317, and 318 and related Oregon Administrative Rules unless otherwise provided in this chapter or by administrative rule. All references to Oregon or the state should be read as referring to the District. All business income must be apportioned to the District by multiplying business income by the sales factor only.

(d) In determining the sales factor numerator under subsection (c): Sales of tangible personal property are deemed to take place in the District if the property is delivered or shipped to a purchaser within the District regardless of the f.o.b. point or other conditions of sale. If sales of tangible personal property are shipped from the District to a purchaser located where the taxfiler is not taxable, those sales are not apportioned to the District.

(e) Certain industries or incomes are subject to specific apportionment methodologies. These methodologies are described in administrative rules adopted in accordance with section 7.05.070 or Metro ordinance. Industry specific or income specific apportionment methodologies required by Oregon Revised Statutes and Oregon Administrative Rules for the sales factor, will be used in cases in which the Administrator has not adopted a rule regarding the apportionment of that industry or income. All apportionment methodologies directed under this subsection will be a single sales factor as directed under subsection 7.07.081 (c) and subsection 7.07.081 (d).

STAFF REPORT

IN CONSIDERATION OF ORDINANCE NO. 22-1484, FOR THE PURPOSE OF AMENDING METRO CODE CHAPTER 7.07 RELATED TO APPORTIONMENT AND ALLOCATION OF INCOME TO BETTER ALIGN WITH OREGON STATE INCOME TAX APPORTIONMENT LAW FOR CERTAIN BUSINESSES

Date: October 3, 2022

Department: Finance & Regulatory Services

Meeting Date: October 20, 2022

Prepared by: Josh Harwood
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Presenter: Josh Harwood

Length: 15 minutes (in conjunction with Ordinance No. 22-1485)

ISSUE STATEMENT

In December 2020, the Metro Council adopted Metro Code Chapters 7.05, "Income Tax Administration for Personal and Business Taxes", 7.06 "Personal Income Tax", and 7.07 "Business Income Tax". These chapters codified certain provisions of the Supportive Housing Services Measure approved by the voters, and established code to implement the taxes imposed by the measure in an effective and efficient manner.

After adoption of the income tax code, Metro has worked with the City of Portland and Multnomah County, which share tax collection administration functions housed at the City of Portland Revenue Division, to study and ultimately propose making changes to the formula that some companies are required to use in determining the amount of taxable income that it owes to different levels of government.

In order to determine how much tax a business owes, a business that delivers products and/or services in multiple countries and/or states must apportion income for state and local tax purposes to calculate the portion of a business's overall income that is taxable within the state or locale of interest. During code development, Metro agreed to further study what impacts changing to a market-based income apportionment system for some businesses[1] would have on revenue collections, both in terms of the degree to which total

[1] The current method required by the City of Portland's Revenue Division and Metro code use a "Cost of Performance" methodology that apportions income based on where services are generated, whereas the proposed change to a market-based methodology would apportion income based on where the services are delivered. According to the data provided by the City of Portland, firms in the professional business services sector are most likely to be impacted. A variety of services are delivered by these firms, but among the most common are accounting and law services, and as a group, this sector represents a relatively small proportion of all taxpayers.

revenue could be impacted, as well as evaluating the relative ease of administration for taxpayers and local government administrators. The State of Oregon made similar changes in 2018.

Following extensive study of available data and reviews of many prior similar actions by other states/regions, Metro staff and partners at the City of Portland and Multnomah County have agreed to propose this change.

ACTION REQUESTED

Staff requests adoption of Ordinance No. 22-1484.

IDENTIFIED POLICY OUTCOMES

The proposed amendments to Metro income tax codes clarify the code originally adopted in December 2020. These codes establish rules to administer the taxes imposed by the measure in an effective and efficient manner. This particular amendment addresses concerns brought to Metro's attention during the drafting of the original code.

The amendment impacts a set of companies that are required to apportion income based on a concept called "Cost of Performance," and will now use a different formula known as market-based sourcing. What this means, generally, is that some local companies will pay less in taxes, while some non-local businesses that have revenue originating from the Metro region will pay more. Overall, based on all available data and prior studies from similar actions in other jurisdictions, staff have concluded that total revenue will not be materially impacted by making this change, and that any difference that could occur in a specific-year would be negligible in the context of the regular volatility seen in these revenue streams.

Furthermore, the amendments proposed follow analogous actions already taken by the City of Portland and Multnomah County. Based on all available information, staff agree that this action will not materially impact total tax revenues and that it will ease compliance for taxpayers that also pay other state and federal income taxes.

POLICY OPTIONS FOR COUNCIL TO CONSIDER

• *Adoption of this ordinance.* This results in more clarity in the income tax codes and eases the burden on local taxpayers, while reinforcing actions already completed by the City of Portland and Multnomah County, which guide the tax collection system for all three entities.

• *Adoption of this ordinance with revisions or modifications as described by Council.* This may require additional action to ensure that changes do not conflict with other local government income tax codes.

• *Rejection of this ordinance with other direction to staff.* The existing income tax code would remain in place, but proposed amendments would not be made. This may require additional action to ensure that changes do not conflict with other local government income tax codes, as well as creating an uncertain tax environment for some businesses.

STAFF RECOMMENDATIONS

Staff recommends that Metro Council adopt Ordinance No. 22-1484.

STRATEGIC CONTEXT & FRAMING COUNCIL DISCUSSION

Metro staff formed a tax implementation advisory table in June 2020 to advise on technical aspects of tax implementation, technical issues, and provide recommendations to ensure a smooth, legal and easy tax collection process. Members included experts in taxation, tax policy, tax implementation and business stakeholders. The table met with staff multiple times and provided input on development of the tax codes.

In the context of this ordinance, Metro is more closely aligning its code to that of the state and our local government tax collection partners at the City of Portland and Multnomah County. It addresses concerns brought to Metro by certain stakeholders to ease the administrative burden of tax compliance, while potentially serving to ease the financial impacts of these taxes on some local businesses.

BACKGROUND

In May 2020 Metro voters approved a measure to raise money for supportive housing services for people experiencing homelessness or at risk of experiencing homelessness. Multnomah County, in November 2020, subsequently passed a personal income tax to fund early childhood education. The tax is similar – though with a slightly different structure – to the personal income tax component of Metro's SHS taxes and is also now administered by the City of Portland's Revenue Division.

The program is funded by two separate taxes: a 1% personal income tax on taxable income above $125,000 for individuals and $200,000 for those filing jointly, and a 1% business income tax on net income for businesses with gross receipts above $5 million. Other Metro programs and projects are funded through bond measures or property tax levies. This is the first program at Metro that uses personal and business income taxes, and it is the first local personal income tax in the region since Multnomah County's personal income tax ended in 2006.

Council provided direction on code development at a November 2020 work session, and three Council meetings in December 2020. The code was adopted on December 17, 2020. Tax collection began in April 2021. Collections began slowly, as is normal for a new income tax. However, by the end of FY 2021-22, the taxes collected nearly $240 million in revenue and over $200 million was distributed to our local implementation partners.

Other Metro programs and projects are funded through bond measures or property tax levies. This is the first program at Metro that uses personal and business income taxes, and it is the first local personal income tax in the region since Multnomah County's personal income tax ended in 2006.