

Larry's Tax Law

## **Measure 97 (Formerly Known as Initiative Petition 28) Will Be Presented to Oregon Voters on November 8, 2016: What You Need to Know**

By Larry Brant on 8.12.16 | Posted in Business Taxes, Corporate Tax, Legislation, Oregon Tax Laws, Tax Laws, Tax Planning, Tax Procedure

C Corporations with Oregon annual revenues greater than \$25 million may face a new minimum tax obligation – 2.5 percent of the excess – if Measure 97 passes. If a business falls within this category, there may be ways to mitigate its impact. The time to start planning, however, is now.

### **Background**

Oregon taxes corporations under an excise tax regime. The Oregon corporate excise tax regime was adopted in 1929. The original legislation included what is commonly called a “minimum tax” provision. In accordance with this provision, corporations subject to the Oregon excise tax are required to pay the **greater** of the tax computed under the regular corporate excise tax provision or the tax computed under the “minimum tax” provision. Accordingly, the “minimum tax” is an “alternative” tax; **it is not an “additional” tax** as many commentators have recently asserted.

Originally, the Oregon corporate “minimum tax” was a fixed amount – \$25. As a result of the lobbying efforts of Oregon businesses, the “minimum tax” was eventually reduced to \$10, where it remained for almost 80 years.

In 2010, Oregon voters dramatically changed the corporate “minimum tax” landscape with the passage of Measure 67. The corporate “minimum tax” (beginning with the 2009 tax year), is no longer a fixed amount. Rather, it is now based on Oregon sales (gross revenues). The “minimum tax” is now:

Oregon Sales

Minimum Tax

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\$150

\$500,000 to \$1 million

\$500

\$1 million to \$2 million

\$1,000

\$2 million to \$3 million

\$1,500

\$3 million to \$5 million

\$2,000

\$5 million to \$7 million

\$4,000

\$7 million to \$10 million

\$7,500

\$10 million to \$25 million

\$15,000

\$25 million to \$50 million

\$30,000

\$50 million to \$75 million

\$50,000

\$75 million to \$100 million

\$75,000

\$100 million or more

\$100,000

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S corporations are exempt from the alternative graduated tax system. Instead, they are still subject to a fixed amount “minimum tax,” which is currently \$150.

As an example, under the current corporate “minimum tax” provision, a corporation with Oregon gross sales of \$150 million, but which, after allowable deductions, has a net operating loss of \$25,000, would be subject to a minimum tax of \$100,000. Many corporations operating in Oregon, which traditionally have small profit margins (i.e., high gross sales, but low net income), found themselves (after Measure 67 was passed) with large tax bills and little or no money to pay the taxes. Three possible solutions for these businesses exist:

- Make an S corporation election (if eligible);
- Change the entity to a LLC taxed as a partnership (if the tax cost of conversion is palatable); or
- Move all business operations and sales outside of Oregon to a more tax-friendly jurisdiction.

Several corporations in this predicament have adopted one of these solutions.

### Initiative Petition 28/ Measure 97

Measure 97 will be presented to Oregon voters this November. If it receives voter approval, it will amend the “minimum tax” in **two** major ways:

- The “minimum tax” will remain the same for corporations with Oregon sales of \$25 million or less. For corporations with Oregon sales above \$25 million, however, the “minimum tax” (rather than being fixed) will be \$30,001, **PLUS** 2.5 percent of the excess over \$25 million.
- The petition specifically provides that “legally formed and registered benefit companies” as defined in ORS 60.750 will not be subject to the higher “minimum tax.” Rather, they will continue to be subject to the pre-Measure 97 “minimum tax” regime (as discussed above). **Caveat:** The exception, as drafted, appears to only apply to Oregon benefit companies; it does not extend to foreign benefit companies authorized to do business in Oregon.

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Measure 97 expressly provides that all increased tax revenues attributable to the new law will be used to fund education, healthcare and senior citizen programs. As a result, many commentators believe the initiative has great voter appeal and will likely be approved by voters. If Measure 97 is passed, it is slated to raise over \$6 billion in additional tax revenue per biennium.

Interestingly, drafters of the ballot measure must envision, if passed, the law will be attacked on constitutional and/or other legal grounds. So, they inserted a savings clause in the initiative. It provides: “If any provision of [the initiative] is held invalid for any reason, all remaining provisions of [the Oregon corporate minimum tax] shall remain in place and shall be given full force and effect.” In other words, if the law is stricken on legal grounds, we are back to the 2010 “minimum tax” scheme set forth above. As discussed below, some constitutional grounds likely exist to strike the new law.

Corporate taxpayers may still potentially avoid the impact of Measure 97 by making a valid S corporation election (if eligible), by becoming a partnership or a LLC taxed as a partnership, or by moving all sales and operations outside of the state. In addition, pursuant to the terms of the ballot measure, taxpayers (that qualify) may convert to Oregon “benefit” companies and avoid the impact of the increased tax hit under the initiative (i.e., they would still be subject to the current corporate “minimum tax”).

### **Benefit Companies**

In 2013, the Oregon legislature created the “benefit company.” Oregon now has joined at least 29 other states that have similar statutes.

At the 10,000 foot view, a benefit company is simply a corporation or a limited liability company that (in addition to earning a profit) considers its impact on society and the environment in its decision-making. In other words, the company’s mission includes benefiting the public – making a “material positive impact on society and the environment.” ORS 60.750 (3).

An existing Oregon corporation or LLC may become a benefit company by amending its articles of incorporation or articles of organization. Currently, virtually no obstacles exist for businesses to qualify as benefit companies.

There are several key differences between benefit companies and regular for profit companies, including:

- The articles must set forth one or more public purposes.

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- The board of directors and the officers must consider in their decision-making the material positive impact of decisions on multiple stakeholders (including the company's shareholders, employees, suppliers, customers and the communities it serves), and balance them as they deem best.
- The company must adopt a third-party standard and publically report annually its performance against the standard. For this purpose, many-third party standards organizations exist, including B Lab ([www.bcorporation.net](http://www.bcorporation.net)). The cost of adopting a third-party standard needs to be considered. The annual cost for this service is usually based on annual gross revenues. For a company with gross revenues over \$100 million, the annual fees (based upon current pricing) will be \$25,000 or more.
- The governing documents of the company (e.g., articles, bylaws, etc.) must require a "minimum status vote" on matters. This means, except for a greater vote as provided in the governing documents, a majority vote of each class of stock entitled to vote on actions is required.
- The company must designate one director as its "benefit governor." The bylaws need to provide for the qualifications, election, removal, and the duties of the "benefit governor." The "benefit governor" is elected by the board of directors of the company. In general, the "benefit governor" has the overall responsibility of advising the board of directors on their duties under the benefit company statute and overseeing the public reporting requirements. The governor has no personal liability for any act or omission in his or her capacity as the governor unless the act or omission constitutes self-dealing, willful neglect or a knowing violation of law. ORS 760.762 (5).
- The officers are generally not personally liable for the company's failure to provide public benefit, provided their actions are made in good faith. ORS 60.764 (3).
- The company is not liable for money damages for failing to provide public benefit. ORS 60.766 (3).
- Generally, other than a claim by shareholders or directors to compel the company to provide public benefit, no party may commence a proceeding against the company, or its directors, shareholders or officers for failure to provide public benefit.

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- The company must annually prepare a report describing the public benefit it provided during the past year, its actions and methods to provide the public benefit, any facts that may have hindered its actions, and how well the company performed against its third-party standard. The report must be delivered to the shareholders within 120 days following the close of the company's fiscal year. Also, the company must provide (without charge) a copy of its most recent annual report to persons requesting it or post all of the annual reports on the company's publicly accessible website. The statute does not require any audit or any third-party certification.

### **Measure 97 May Face Constitutional Challenges**

Measure 97 (if passed) will undoubtedly face constitutional challenges.

- As drafted, the benefit company exception in the ballot measure only applies to Oregon benefit companies. Non-Oregon benefit companies may challenge the constitutionality of the initiative if it becomes law.
- There appears to be a “glitch” in the ballot measure as drafted (making it ripe for challenge) in that it actually references and bootstraps a statute that is no longer the law (the minimum tax statute was amended after an Oregon Tax Court case that dealt with certain tax credits and whether they could be used to reduce the minimum tax was decided).
- Governor Kate Brown has spoken loud and clear – she does not want companies avoiding the application of Measure 97 by simply becoming benefit companies. So, it is quite possible, the benefit company exclusion will be removed or amended if the ballot measure passes, or the legislature will enact more stringent requirements for attaining and maintaining benefit status.

### **Avoiding the Application of Measure 97**

In order to avoid the possible application of Measure 97, C corporations with gross revenues in excess of \$25 million have limited options. They should:

- Consider becoming an S corporation if the corporation and its shareholders meet the eligibility requirements.

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- Consider converting to a LLC taxed as a partnership. While this option sounds good in theory, the tax cost of doing so is likely prohibitive in most cases.
- Consider moving all business operations and sales outside of Oregon. In most cases, this is not a viable option.
- Consider converting the corporation to a benefit company. While this seems like a reasonable option, the legislature may limit or totally eliminate it in the future.

Many closely held businesses, such as professional service providers and manufacturer representatives/brokerages, have high gross revenues but low profit margins. These businesses will be negatively impacted by Measure 97 should it obtain voter approval. Planning should start now – not down the road.

**Tags:** benefit companies, C corporation, closely-held business, Measure 97, minimum tax, S Corporations