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# Oregon Should Consider Decoupling From the Pass-Through Deduction

***Written Testimony for the Oregon Senate Committee on Finance and Revenue***

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Chairman Hass and Members of the Committee:

The enactment of federal tax reform has far-reaching implications for the states. In the longer term, states will find themselves competing for economic activity made possible by changes to the federal tax code, particularly those flowing from the removal of certain disincentives to domestic investment. More urgently, however, states are grappling with the immediate revenue impacts of federal tax reform, and it is here that Oregon finds itself an outlier.

Most states will see a revenue increase under the new law. This is because the base-broadening provisions of the new federal tax law often flow through to states, while the corresponding rate reductions do not. Yet Oregon's Legislative Revenue Office anticipates a $40 million revenue loss in fiscal year 2019, for one simple reason: absent legislative action to the contrary, Oregon will adopt the new pass-through deduction, while most other states will not.

That provision provides a 20 percent deduction against qualified pass-through business income for those with incomes below $315,000 (joint filers). For filers above that threshold, the deduction is limited to the greater of (a) 50 percent of wage income or (b) 25 percent of wage income plus 2.5 percent of the cost of tangible depreciable property, and many service businesses are excluded. (The benefit phases out between $315,000 and $415,000.)

There's no question that the pass-through deduction is significant. The Joint Committee on Taxation estimates that it will cost $414.5 billion over the next ten years. Equally significant, however, is that it is structured as a deduction against federal taxable income, not adjusted gross income.

Since most states begin their individual income tax calculations with adjusted gross income, they need not worry about conforming to this base-narrowing deduction. Oregon, however, is

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# Oregon Measure 97: The Threat to Oregon's Tax Climate

April 28, 2016

Nicole Kaeding

## Key Findings

- Measure 97 (M97) would establish a new gross receipts tax on Oregon corporations. The new tax would charge firms 2.5 percent for all sales [illegible] of $2[illegible]illion.
- If adopted, the tax would raise an estimated $6 billion per biennium, a 25 percent increase in the Oregon state budget.
- Gross receipts taxes result in tax pyramiding, the process of taxes stacking on top of other taxes as goods are refined in the struct[illegible] of productio[illegible]
- Oregon would join just five other states in assessing a state-wide gross receipts tax, and Oregon's version would be the [illegible]ost burdens[illegible]. It would b[illegible] the highest rate in the country, save for the tax on radioactive waste in Washington, and the tax would not include provisions to limit its distortio[illegible] eff[illegible] like in other [illegible].
- The gross receipts tax proposed in M97 is in addition to the corporate income tax, not a replacement.
- Oregon would fall from the 11th best to the 17th best ranking in the *State Business Tax Climate Index*, bu[illegible] corporate [illegible] stru[illegible]re w[illegible]ll to 50th. Oregon's corporate tax climate would be the worst in the nation.

## Introduction

A ballot initiative primed for the November 2016 ballot could remake the corporate in[illegible] tax in Oregon. It would assess a 2.5 percent gross receipts tax on corporations with annual sales in excess of $25 million, raising a[illegible]ima[illegible]d $5 billion [illegible] the biennium.

If passed, its effects will be felt by businesses and individuals ali[illegible] The ta[illegible]d complexity to Oregon's code, increase economic distortions, and greatly increase the state's budget.

In terms of tax structure, Oregon already has issue[illegible] mu[illegible]faceted c[illegible]orate income tax, levying a traditional income tax as well as a parallel alternative minimum tax on corporations. The pr[illegible]osed g[illegible] rec[illegible]ts tax [illegible]97 would stack on top of that structure.

Economic research consistently demonstrat[illegible] the [illegible]effects of g[illegible]s receipts taxes both in theory and based on case studies where they have been implemented. Gross receipts taxes vio[illegible] core [illegible]nets [illegible] sound ta[illegible] policy, especially neutrality, as similarly-situated firms would be affected differently by this new tax.

Oregon's proposal would be one o[illegible] the largest gross [illegible]eipts taxes among other states that have gross receipts taxes, and would greatly reduce the state's competitiveness.

## Current Corpora[illegible] Tax Struc[illegible]re [illegible]eady Complex

Oregon's corpora[illegible] inco[illegible] tax has two ta[illegible] brackets: 6.6 percent on corporate income less than $1,000,000 and 7.6 percent on income greater than $1,000,0[illegible]

To ensure th[illegible] all c[illegible]poratio[illegible] have a tax liability after deductions and credits, Oregon is one of just eight states that also assesses a minimum tax on top of its income ta[illegible] firms must complete a second tax calculation and remit the greater of the two amounts.

The minimum tax is ti[illegible]d based on sales within the state of Oregon. The payments range from $150 to $100,000 (Table 1).

**Table 1: Oregon's Corporate Alternative Minimum Tax Structure (2016)**

Current Minimum Tax

| Oregon Sales | Tax Due |
|---|---|
| $0 to $500,000 | $150 |
| $500,000 to $1,000,000 | $500 |
| $1,000,000 to $2,000,000 | $1,000 |
| $2,000,000 to $3,000,000 | $1,500 |