SB 1528

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Oregon's Chance to Limit a Flaw in the Federal Tax Code

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Oregon has been at the center of state tax policy for the last several years: first, Measure 97, then the debate of creating a new business tax in 2017, followed by Measure 101 in January. This legislative session is no different. Oregon's debate on how to tax pass-through businesses is a national flashpoint, and here, Oregon has the chance to lead.

The federal Tax Cuts and Jobs Act provided a generous 20 percent deduction for pass-through businesses. These are businesses that pay taxes on the individual side of the tax code, compared to C corporations. Proponents of pass-throughs argue that they represent small businesses, but that isn't always the case. Some of the largest businesses are organized under this structure.

The deduction was predicated on growing small businesses. Instead, it adds complexity to the tax code, and encourages creative accounting to take advantage of the large deduction. The downsides of providing preferential treatment to pass-throughs became apparent during Kansas's recent experiment, when individuals, including Kansas University men's basketball coach Bill Self, restructured their financial holdings to benefit from the special tax treatment.

So why does this matter in Oregon?

Oregon is one of a few states that "couples" to this unneeded deduction. States like Oregon use the federal tax code as the basis of their tax code. This makes it easier for the tax filers, saving time and energy, and it reduces costs for the state. But Oregon's connection to the federal tax code is unique. Oregon is one of only six states that would include this deduction in their state calculations.

Now, a bill championed by Senator Mark Hass (D), the chairman of the Senate Finance committee, would remove this provision from the Oregon tax code.

Conformity should be the goal of Oregon, but Oregon should not include this deduction—a clear example of bad tax policy—in its tax code.

It puts the state's budget into jeopardy. The Legislative Revenue Office estimates that it would cost the state $192 million in tax year 2019.

Opponents of Senator Hass's plan argue that this is a tax hike on Oregon businesses, an argument that stretches the imagination. No business currently receives this deduction in Oregon; preventing it from existing in the state doesn't cause a tax increase.

Similarly, opponents argue that this would punish or disadvantage small businesses. First, pass-through businesses come in all shapes and sizes. Second, Oregon already provides a tax benefit to pass-throughs through lower tax rates. An individual in Oregon pays the state's top income tax rate at $125,000 in income, while a pass-through doesn't pay the 9.9 percent rate on its income until it has $5 million in income.

Finally, opponents are arguing that the limits on the pass-through deduction are being put in place to finance "corporate handouts." The "corporate handouts" are allowing businesses—including pass-through businesses—to deduct their capital costs immediately. This is one of the best provisions in the Tax Cuts and Jobs Act, which will increase productivity and investment in the state, leading to higher wages and more job opportunities for Oregonians.

Senator Hass's proposal to limit the special pass-through deduction in Oregon is the right choice, protecting the state's budget, while advancing sound tax policy.