

SB 139 -13, -14 STAFF MEASURE SUMMARY

Senate Committee On Finance and Revenue

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Meeting Dates: 2/25, 6/7, 6/9

WHAT THE MEASURE DOES:

Lowers bracket to 415,000 at which qualified non-passive pass-through income is subject to top marginal tax rate of 9.9 percent. Excludes from reduced income tax rates, income attributable to a specified service trade or business, or trade or business of performing services as an employee, as defined and for the purposes of section 199A(d)(2) of the Internal Revenue Code. Applies to tax years beginning on or after January 1, 2021.

ISSUES DISCUSSED:

Feb. 25th

- General discussion of three fifths voting requirement
- Reduced rates apply to pass through income only, do not directly affect businesses with a loss for the year
- Cash flow management of business owners
- Reinvestment of owner distributions
- Business income distributions and reinvestment practices
- Policy options modifying reduced rates
- Employment requirements for business entities to potentially qualify
- Federal qualified business income deduction.

June 7th

- Overview of proposed changes to Oregon's reduced income tax rates for qualified non-passive pass through income (PTE)
- History and context for original enactment of PTE reduced rates and recent inclusion of sole proprietors in PTE program
- Federal limitation on deduction for state and local taxes (SALT)
- Potential outcome of PTE program changes
- Potential net benefit to taxpayer of proposed pass through entity tax through offsetting Oregon tax credit and federal deductibility
- Tax costs and benefits of PTE changes and enhanced deductibility of pass through income, potential net tax change for taxpayer.

EFFECT OF AMENDMENT:

-13 Replaces content of measure.

Reduces marginal tax rates at which non-passive pass-through income is subject. Reduces tax rate from 7.2 percent to 7.0 percent for pass-through income exceeding \$250,000 but not exceeding \$500,000. Reduces tax rate from 7.6 percent to 7.5 percent for pass-through income exceeding \$500,000 but not exceeding \$1 million. Limits reduced rate pass-through income qualification to S corporations and partnerships with ordinary business income not in excess of \$5 million. To qualify for pass-through income reduced rates, requires S corporations and partnerships to meet either an employee to employer ratio, or a three year average limitation on distributions of income as a percentage of ordinary business income. Sets employee to employer ratio based on amount of ordinary business income of the S corporation or partnership. Applies new PTE qualification requirements only to S corporations and partnerships with ordinary business income exceeding \$250,000 in a tax year. Applies to tax years beginning on or after January 1, 2021.

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Creates new entity-level income tax on pass-through entities. The tax is elective and, if paid, the business owners are allowed an offsetting income tax credit claimed on their Oregon personal income tax returns. Each owner would be allowed a tax credit for their pro rata share of the entity tax. The new tax and credit would be effective for tax years 2022 and 2023.

BACKGROUND:

During the 2013 special session, the Legislature made non-passive income received by personal income taxpayers from either a partnership or S-corporation (or an LLC filing as either) taxable at preferential rates. Taxpayers had the choice of opting into the program where non-passive income could be taxed at a rate as low as seven percent. The amount of eligible income was the net non-passive income from all qualifying entities. A qualifying entity is one that employed at least one person who is not an owner, member, or partner; had at least an annual 1,200 of hours work performed in Oregon by qualifying employees; and only hours worked in a week in which an employee worked at least 30 hours count toward the total. In the Special Session of 2018, Oregon expanded its reduced rate tax option, with applicable existing requirements, to taxpayers with income from a sole proprietorship.

Prior to tax year 2018, individuals who itemized their deductions on their federal personal income tax returns where allowed to deduct (with some phase-out limitations) their state and local taxes - primarily property taxes and either income or sales taxes. In 2017, Congress enacted the Tax Cut and Jobs Act and limited this deduction to \$10,000. Since that time, states have explored options for a policy response. Recently, the IRS has allowed some actions by states, such as New Jersey's legislation implementing a business alternative income tax with a corresponding income tax credit.