SB 139 A STAFF MEASURE SUMMARY

Carrier: Sen. Boquist, Sen. Burdick

Senate Committee On Finance and Revenue

Action Date:	06/14/21
Action:	Do pass with amendments. (Printed A-Eng.)
Vote:	4-1-0-0
Yeas:	4 - Boquist, Burdick, Riley, Wagner
Nays:	1 - Findley
Fiscal:	Fiscal impact issued
Revenue:	Revenue impact issued
Prepared By:	Kyle Easton, Economist
Meeting Dates:	2/25, 6/7, 6/9, 6/14

Desk of
Senator Boquist

WHAT THE MEASURE DOES:

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 pass-through entity 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.

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 Replaced content of measure.

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 minimum 1,200 annual hours of 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.

The design of the new PTE reduced rate requirements are intended to focus the tax benefit on relatively smaller business entities that are employing a greater number of individuals working in Oregon. New alternative reinvestment requirement is intended to allow profitable business entities that may not meet employee to owner ratio to continue to benefit from reduced rates reflective of the entity's reinvestment of profits.

REVENUE IMPACT OF PROPOSED LEGISLATION

81st Oregon Legislative Assembly
2021 Regular Session
Legislative Revenue Office

Bill Number:	**SB 139 - A**
Revenue Area:	**Personal Income Tax**
Economist:	**Kyle Easton**
Date:	**6/15/2021**

Only Impacts on Original or Engrossed Versions are Considered Official

Measure Description:

Modifies tax rates and income eligible for elective reduced personal income tax rates allowed for qualified pass-through income. Measure reduces two marginal pass-through entity (PTE) income tax rates, implements more stringent employment requirements of participating pass-through entities, and excludes owners of partnerships and S corporations with ordinary business income (OBI) exceeding $5 million from benefitting from PTE reduced rates.

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. For sole proprietorships, and pass through entities with OBI that does not exceed $250,000, changes to reduced rate qualification requirements made by measure are not applicable.

In addition to existing law PTE qualification requirements, measure requires S corporations and partnerships to meet either an Oregon employee to employer ratio, or a three-year average limitation on distributions of income as a percentage of OBI. Determines employee to employer ratio requirement based on amount of OBI of the S corporation or partnership. For S corporation or partnership with OBI that exceeds $250,000 but does not exceed $500,000, requires pass through entity to employ one employee in Oregon per owner. For entities with OBI of $500,000 to $1 million, entity is required to employ two Oregon employees for every owner. For entities with OBI of $1 million to $2.5 million, entity is required to employ four Oregon employees for every owner. For entities with OBI of $2.5 million to $5 million, entity is required to employ 10 Oregon employees for every owner.

If entity does not meet employee ratio requirements (but does meet existing law requirements), measure allows entity to qualify for PTE reduced rates if the distributions of income of a partnership or S corporation, as a percentage of OBI, does not exceed 25 percent. Percentage is computed based on total distributions and total OBI for current and most recent two tax years.

Changes apply to tax years beginning on or after January 1, 2021.

Revenue Impact (in $Millions):

	Fiscal Year			Biennium		
	2021-22	2022-23		2021-23	2023-25	2025-27
General Fund	$13.4	$28.3		$41.7	$59.9	$64.2

State Capitol Building
900 Court St NE
Salem, Oregon 97301-1347

Phone (503) 986-1266
Fax (503) 986-1770
https://www.oregonlegislature.gov/lro

Impact Explanation:

Modifications to Oregon's reduced income tax rates available to qualifying taxpayers receiving non-passive pass through income are expected to have a net positive revenue impact on General Fund revenue. Reductions to the PTE marginal rates increases the benefit from the PTE program for taxpayers with qualifying PTE income exceeding $250,000. The marginal rate changes cause a reduction in General Fund revenue. However, the new more extensive qualification requirements for S corporations and partnerships with OBI exceeding $250,000 are expected to reduce the number of pass-through entities whose pass-through income qualifies for the PTE reduced rates. The majority of the positive revenue impact results from the exclusion of S corporations and partnership entities with OBI greater than $5 million. In total, fewer than 1,000 S corporations and partnerships are expected to no longer qualify as sources of pass through income subject to Oregon's PTE reduced rates due to modifications to PTE qualifications. Of the roughly 26,000 individual personal income taxpayers benefitting from the PTE reduced rates, about 2,000 are expected to no longer qualify for the reduced rates. The majority of the positive revenue impact resulting from qualification modifications is estimated to originate from taxpayers with total income exceeding $1 million.

Estimates were made through an analysis of tax return data associated with existing taxpayers and pass through entities utilizing the PTE reduced rates. Initial fiscal year estimate reflects timing of tax return filing and the higher propensity of taxpayers utilizing the PTE reduced rates to file a tax return extension.

Creates, Extends, or Expands Tax Expenditure: Yes ☒ No ☐

The policy purpose of this measure is to refine the PTE program to align qualification parameters more closely with the original intent of the policy which is to encourage small business growth and investment. In particular, intent is to focus the tax benefit on relatively smaller business entities that are employing a greater number of individuals working in Oregon and/or profitable business entities that are reinvesting a sizeable amount of their profits back into the business.

State Capitol Building
900 Court St NE
Salem, Oregon 97301-1347

Phone (503) 986-1266
Fax (503) 986-1770
https://www.oregonlegislature.gov/lro