SB 158: Reject extension of the SALT pass-through loophole

Senate Finance and Revenue Committee – Bennett Minton – 3/7/2021

Chair Meek, Vice Chair Boquist, members of the committee:

I'm Bennett Minton, on behalf of Tax Fairness Oregon, a network of volunteers who advocate a rational and equitable tax code. My remarks are largely about equity.

If a friend asked me how Congress and legislatures transfer taxes we all pay to the wealthy among us, I could cite this provision. We opposed it when it was enacted in 2021, and we do so now.

I am joined in our statement by Brenda Gilmer, a former Montana tax administrator, who crafted our technical comments on the bill that created this regime two years ago. The committee incorporated them into what became the law. Brenda also participated in DOR's rulemaking.

The -1 amendment should be rejected, for reasons I'll explain. The -2 amendment appears to be a housekeeping issue and makes sense.

Senators Boquist and Findley were on this committee in 2021 when it approved the law before you. For the benefit of the three new members, I recount how we got here. I think Senator Boquist and I agree on the facts, if not the slant. Perhaps Senator Findley and I agree on the slant. I'll get to that.

In 2017, Congress limited the itemized deduction for state and local taxes to $10,000. The SALT deduction was of greatest benefit to people like me: the lower end of the top quintile of taxpayers. Reading the 2017 federal tax act and section 164(a)(4) and (b)(6) of the Internal Revenue Code, we can see that Congress exempted pass-through owners from the limitation.

But for most individual taxpayers who itemize deductions, the effect of the limitation, along with other changes, was to push them to the standard deduction.

A narrative about the 2017 act was that the Republican-controlled Congress had a political aim: harming taxpayers in blue states. Get their legislatures to cut taxes and the services that fund them.

There is a counter-narrative: Eliminating deductions results in a more progressive tax code, because deductions most benefit taxpayers in higher brackets.

For me personally, because of this and other 2017 changes, my taxes increased by $1,400 from what they otherwise would have been. I don't object. Deductions are regressive, and I, like Adam Smith, the father of capitalism, favor progressive taxation.

We read the bills and follow the money

What angers me is that my tax increase paid for tax cuts for the very richest Americans, among them pass-through owners. The Oregon legislature also was angered. In 2018, it disconnected from the federal pass-through reduction (generally a 20% deduction on qualified business income).

Many states tried SALT workarounds. Over and over, the IRS said: Nope. Until New Jersey devised a regime that passed muster.

That workaround is the basis of the 2021 Oregon law. As I noted, this committee amended the bill as TFO recommended, to exclude multi-tiered partnerships from the regime. We had asserted that sophisticated taxpayers would tie DOR in knots and potentially expose the state to revenue losses.

The Oregon workaround allows certain pass-through entities to elect an alternate regime that enables their owners to claim an unlimited federal SALT deduction. Under the regime, business owners are allowed an offsetting tax credit on their pro rata share of the entity tax. The effect on Oregon revenue is said to be neutral. Thus, the provision allows a small set of taxpayers unlimited federal SALT deductions.

So now, under the federal law that raised taxes on most itemizers to pay for cuts for business owners, those same business owners get another tax cut thanks to this state law.

To which some lawmakers said: Well, it doesn't cost Oregon anything. Chair Burdick said on the floor that she wished all Oregonians could have their unlimited SALT deduction restored. Nevertheless, the legislature was complicit in the federal scheme to exacerbate an income shift from the moderately wealthy to the exorbitantly wealthy.

But not Senator Findley, who said on the floor [6/17/2021 at 1:22:15]:

"I don't know whether there was a lunar eclipse . . . or a sun spot, but I find myself in agreement with Senator Bernie Sanders. I didn't think I would ever say that; out of my lips, it did come. Senator Bernie Sanders thinks this approach is a bad approach, and so do I."

Senator Findley was one of seven no votes, all of them Republicans. TFO aligns with them.

About the amendments. The -1 would expose the regime to the same potential abuse we noted about the original bill. Trusts have all kinds of controlling entities that could take advantage of the regime. As DOR writes, "Including trusts as members may increase the complexity of the program due to the difficulty to trace and verify the tax credit."

If the language were limited to grantor trusts, as defined in the Internal Revenue Code, and passable only to an individual, it would present less of a problem. As the amendment stands, we oppose it.

We have no objection to the -2 amendment.

It's fair to note, especially for the three members who were not on this committee, that this provision was part of a two-bill deal, as Senator Boquist explained on the floor [6/17/2021 at 1:06:12]. The other bill was SB 139, which modified the lower rates for pass-throughs, by placing an upper limit on the benefit but lowering rates for most taxpayers.

TFO supported the compromise on pass-through rates, but not this elective regime. That New Jersey (and other states) does it too is not persuasive. As matter of equity, we oppose the extension.