



Oregon

Department of Revenue

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HB 2488 –Substantial Understatement of Income (SUI) Penalty

Background

Oregon's substantial understatement of income penalty (SUI) was written to follow the Internal Revenue Service's (IRS) SUI penalty almost verbatim. However, Oregon's penalty is based on an understatement of *taxable income* instead of an understatement of *net tax*. Because Oregon is based on understatement of taxable income, we cannot impose this penalty when there is otherwise a substantial understatement of the taxpayer's tax liability. We see this most often on returns with overstated tax credits and part-year returns (because the income is reported in the federal information shown on the part year return but not used in the calculation of Oregon tax). If the statute was changed, the penalty would apply in any case where net tax is understated by a certain threshold (to be determined).

Additionally, the statute has a set income amount that is considered a "substantial understatement;" \$15,000 for personal income tax returns or \$25,000 for corporate tax that is not indexed. In 1987 when this law was enacted, the federal and state minimum wage was \$3.35/hr. For 2015, the minimum wage in Oregon is \$9.25/hr. Given this nearly three-fold increase in the minimum wage for individuals in Oregon, we ask whether \$15,000 is still an appropriate threshold to determine a "substantial" understatement of income.

The proposed solution is to align the SUI penalty with the IRS and other states by defining "understatement" as a substantial understatement of net tax, as opposed to a substantial understatement of taxable income.

To encourage a policy discussion about what is considered a "substantial" understatement, we suggest leaving the "substantial" amounts blank. We also request that the amount be indexed to inflation in the same manner as other tax statutes.

If the statute was indexed to today's numbers, based similar to the way other parameters are indexed, a substantial income understatement for personal income tax would be approximately \$31,000 - \$32,000 (instead of \$15,000) and for corporations \$51,000 - \$53,000 (instead of \$25,000) today. This would equate to roughly \$3,000 as an understatement of net personal income tax.

Stakeholders outreach

We received feedback from the Tax Section of the Oregon State Bar and the Oregon Society of Certified Public Accountants. They would like to see the statute align with the IRC as well and believe that \$15,000 is not a substantial understatement in today's dollars.

We ask for your support of this bill.

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