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Reduced Income Tax Rates for Non-Passive Income

Oregon law (ORS 316.044) requires that if the revenue impact of the Pass-Through Entity tax rates for tax years 2019 and 2020 significantly differ from their initial estimated impact, the tax rates would be increased (reducing the tax benefit) or decreased (increasing the tax benefit) - beginning with tax year 2023. For tax years 2019 and 2020, the original estimated revenue loss as a share of total income was 0.100%. Consequently, the upper and lower bounds for a potential rate change are .125% and .075%, respectively. The actual revenue loss was .082% of total income, so no rate adjustment is required.[1] The rest of this report provides background and additional detail on the analysis leading to this conclusion.

In the 2013 Special Session, the Legislative Assembly passed HB 3601, making several changes to Oregon tax law. One of these policies was the creation of a reduced tax rate structure for certain income from pass-through entities. For qualifying business owners who choose to participate in the program, up to $250,000 of their non-passive income is taxed at 7%. The marginal tax rate then increases as qualified income approaches $5 million. Income above that amount is taxed at the standard 9.9% rate. The table shows the reduced tax rates, as listed in ORS 316.043(2).[2]

Non-Passive Income Tax Rates	
Net Income ($)	Tax Rate
Up to $250,000	7.0%
$250,000 to $500,000	7.2%
$500,000 to $1 Million	7.6%
$1 Million to $2.5 Million	8.0%
$2.5 Million to $5 Million	9.0%
Above $5 Million	9.9%

Included in the law is the requirement that the Legislative Revenue Officer reports the actual revenue impact of this program compared to the estimates made for the 2013 Special Session. If the actual use of the policy is significantly different from the estimated use, then the statutory tax rates are to be proportionately modified. This report is the second of two required reports. The first report was

[1] A rate decrease at this point could only occur if there had been a rate increase implemented in 2019. ORS 316.044(2) states, in part, that the rates will "...in no event...be reduced to lower than the original rate..."
[2] This does not include the changes made by the 2021 Legislature with SB 139, effective beginning with tax year 2021.

provided on June 29, 2018, analyzing usage for tax years 2015 and 2016. The second report (this one) is due by July 1, 2022 and analyzes usage for tax years 2019 and 2020.

The key metric required to compare the estimated and actual use of the policy is the revenue loss divided by total income (as reported on tax returns) for each two-year period: 2015/2016 and then 2019/2020. For 2015/2016, if the ratio for actual use exceeded the ratio for estimated use by more than 15 percent, the tax rates in 316.043(2) would have been proportionately increased to achieve a ratio of five percent above the estimated ratio, but in no event would they have been adjusted above the maximum tax rate of 9.9%. Any change would have been effective with tax year 2019. As reported in 2018, no rate adjustment was required.

For 2019/2020, the reduced rates may be adjusted upward or downward. If the actual ratio is more than 25 percent greater than the estimated ratio, then the tax rates are proportionately increased such that the ratio is approximately 15 percent above the estimated ratio. If the actual ratio is less than 75 percent of the estimated ratio, then the tax rates are proportionately reduced such that the ratio is approximately 85 percent of the estimated ratio. In no event are the rates adjusted above the maximum tax rate of 9.9% or below the original rates provided in ORS 316.043(2). Any change would be effective with tax year 2023.

The two tables below contain the ratio calculations for tax years 2019 and 2020. The table on the left contains the estimates from the 2013 Special Session. The estimated revenue losses for tax years 2019 and 2020 were $129.7 million and $139.2 million; the two-year combined total estimated revenue loss was $268.9 million. The estimated total income for the two years was $268,793 million. The resulting ratio is 0.100%. Statute requires the tax rates to be adjusted if the actual ratio is more than .125% (.100% times 1.25) or if it is less than 0.075% (0.100% times .75).

Estimated Impact, $M

Tax Year	Revenue Loss	Total Income	Ratio
2019	$129.7	$131,316	
2020	$139.2	$137,477	
Total	$268.9	$268,793	0.100%

Actual Impact, $M

Tax Year	Revenue Loss	Total Income	Ratio
2019	$124.0	$151,451	
2020	$128.4	$156,376	
Total	$252.4	$307,827	0.082%

The table on the right contains the actual impacts from the Department of Revenue using return data for tax years 2019 and 2020 (as provided to LRO in June 2022). The actual two-year revenue loss was $252.4 million and total income was $307,827 million, resulting in a ratio of 0.082%. Because the actual ratio from tax return data is within the no-adjustment range, statute does not require any change in the reduced tax rates identified in ORS 316.043(2).