

# OR Pass-Through Entity (PTE) Reduced Rates

House Committee on Revenue – 2/25/2021

Legislative Revenue Office



# Business Entity Types

Concept: Business income (or loss) is passed through from the business entity to the taxpayer

Business income – business expenses = amount passed through

## Types of Pass-Through Entities

- Sole proprietorship
- Partnership
- S-Corporation
- Limited Liability Company (LLC)

Data Source: Department of Revenue, Research Section





# OR PTE Reduced Rates Policy Description & Requirements

- The policy objective is to provide a more favorable rate structure for business income earned by taxpayers who actively manage their own businesses ORS 316.043 & 316.044 – HB 3601 (2013 S.S.), HB 4301 (2018 S.S.)
- Taxpayers can have income from partnerships, S-corporations, sole proprietorships and LLCs taxed at lower marginal rates
- Policy is NOT intended to benefit passive investment or rental income
- Primary requirement is the taxpayer must “materially participate” in the business
- “Taxpayer shall be treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is: regular, continuous, and substantial. (IRC 469)
- Have at least one full-time, non-investor employee
- Qualifying employees must work at least 1,200 hours in Oregon (hours only count if 30+ hours per week)





# 2018 Tax Rates & Brackets

| <b>Joint Income Tax Rates</b> |          |
|-------------------------------|----------|
| Taxable Income (\$)           | Tax Rate |
| ≤ \$6,900                     | 5.0%     |
| \$6,901 to \$17,400           | 7.0%     |
| \$17,401 to \$250,000         | 9.0%     |
| Over \$250,000                | 9.9%     |

| <b>Non-Passive Income Tax Rates</b> |          |
|-------------------------------------|----------|
| Taxable Income (\$)                 | Tax Rate |
| ≤ \$250,000                         | 7.0%     |
| \$250,001 to \$500,000              | 7.2%     |
| \$500,001 to \$1 Million            | 7.6%     |
| \$1 Million to \$2.5 Million        | 8.0%     |
| \$2.5 Million to \$5 Million        | 9.0%     |
| Over \$5 Million                    | 9.9%     |





# Gross Tax Calculation: Taxpayer Opt-In

**Base approach** -- Gross Tax A is calculated under traditional method:

$$(All\ Income - Deductions) \times (Regular\ Rates) = Gross\ Tax\ A$$

**Opt-in approach** -- Gross Tax B is calculated under the new law:

$$(Non-passive\ Income) \times (New\ Rates) = Gross\ Tax\ B.1$$

$$(All\ Other\ Income - Deductions) \times (Regular\ Rates) = Gross\ Tax\ B.2$$

$$(Gross\ Tax\ B.1) + (Gross\ Tax\ B.2) = Gross\ Tax\ B$$

The taxpayer will choose the lesser of the two gross tax amounts:

$$Gross\ Tax = Lesser\ of\ "Gross\ Tax\ A"\ or\ "Gross\ Tax\ B"$$





# Revenue Impact of PTE

| Number of Taxpayers Using Reduced PTE Rates & Tax Change |           |            |                         |            |           |            |
|--|-----------|------------|-------------------------|------------|-----------|------------|
| Tax Year   | Full Year |            | Part Year & Nonresident |            | Total     |            |
|  | Taxpayers | Tax Change | Taxpayers               | Tax Change | Taxpayers | Tax Change |
| 2015   | 13,352    | -\$66.4    | 631                     | -\$3.6     | 13,983    | -\$70.0    |
| 2016   | 22,448    | -\$95.3    | 2,113                   | -\$8.9     | 24,561    | -\$104.2   |
| 2017   | 21,289    | -\$95.9    | 1,459                   | -\$7.4     | 22,748    | -\$103.3   |
| 2018   | 25,192    | -\$110.7   | 1,643                   | -\$7.7     | 26,835    | -\$118.4   |
| 2019*  | 25,956    | -\$116.7   | 1,587                   | -\$7.9     | 27,543    | -\$124.6   |

\* Tax year 2019 numbers are preliminary





# Revenue Impact – Tax Year 2018

| <b>Number of Claimants &amp; Revenue Impact - TY 2018</b> |                  |                  |              |                 |               |
|---|------------------|------------------|--------------|-----------------|---------------|
| <b>Income</b>   | <b>FY Filers</b> | <b>Claimants</b> | <b>Share</b> | <b>Rev Imp.</b> | <b>% Tot.</b> |
| \$0 - \$50k   | 995,802          | 769              | 0.1%         | -\$0.1          | 0.1%          |
| \$50k-\$70k   | 222,545          | 939              | 0.4%         | -\$0.3          | 0.3%          |
| \$70k-\$100k  | 228,892          | 2,138            | 0.9%         | -\$1.0          | 0.9%          |
| \$100k-\$200k   | 275,660          | 7,247            | 2.6%         | -\$6.9          | 6.2%          |
| \$200k-\$500k   | 80,105           | 9,020            | 11.3%        | -\$27.4         | 24.7%         |
| > \$500k  | 16,163           | 5,079            | 31.4%        | -\$75.0         | 67.7%         |
| <b>Total</b>  | <b>1,819,167</b> | <b>25,192</b>    | <b>1.4%</b>  | <b>-\$110.7</b> | <b>100.0%</b> |

FY Filers: 2018 full-year filers

Income: Refers to total income

Source: Department of Revenue - Research, Personal Income Tax Returns





# Revenue Impact – Tax Years 2017 & 2018

## Tax Year 2017 & 2018 Data, Full-Year Filers

| Revenue Impact (\$M) |                |                 |                |
|----------------------|----------------|-----------------|----------------|
| Income               | TY 2017        | TY 2018         | Difference     |
| \$0 - \$50k          | -\$0.1         | -\$0.1          | \$0.0          |
| \$50k-\$70k          | -\$0.2         | -\$0.3          | -\$0.1         |
| \$70k-\$100k         | -\$0.8         | -\$1.0          | -\$0.2         |
| \$100k-\$200k        | -\$5.7         | -\$6.9          | -\$1.2         |
| \$200k-\$500k        | -\$22.5        | -\$27.4         | -\$4.9         |
| > \$500k             | -\$66.6        | -\$75.0         | -\$8.3         |
| <b>Total</b>         | <b>-\$95.9</b> | <b>-\$110.7</b> | <b>-\$14.8</b> |

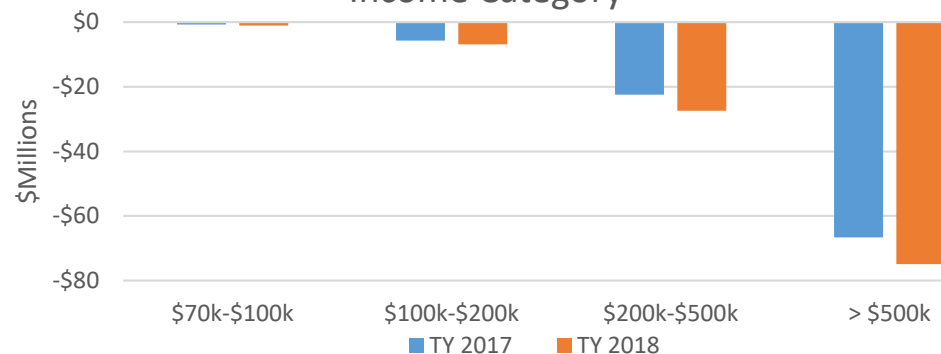
| Number of Claimants |               |               |            |
|---------------------|---------------|---------------|------------|
| Income              | TY 2017       | TY 2018       | % Ch.      |
| \$0 - \$50k         | 527           | 769           | 46%        |
| \$50k-\$70k         | 812           | 939           | 16%        |
| \$70k-\$100k        | 1,675         | 2,138         | 28%        |
| \$100k-\$200k       | 6,165         | 7,247         | 18%        |
| \$200k-\$500k       | 7,569         | 9,020         | 19%        |
| > \$500k            | 4,532         | 5,079         | 12%        |
| <b>Total</b>        | <b>21,289</b> | <b>25,192</b> | <b>18%</b> |

**Means (\$)**      -\$4,504      -\$4,394

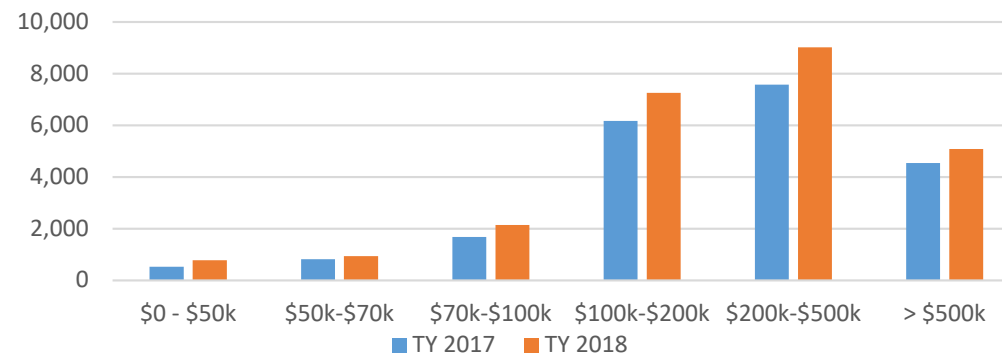
Income: Refers to total income | 2018 Full year filers

Source: DOR - Research, Personal Income Tax Returns

Estimated Revenue Impact (Full Year Filers) by Income Category



Claimants (Full Year Filers) by Income Category

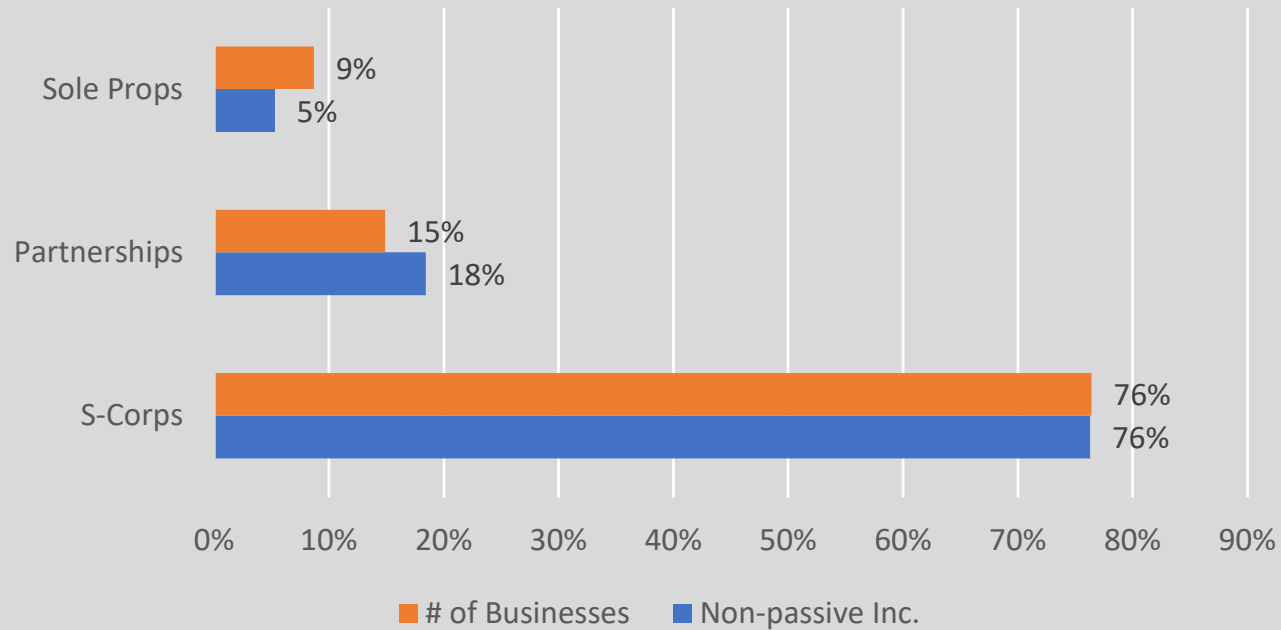






# Entity Type

Share of Total by Entity Type - TY 2018



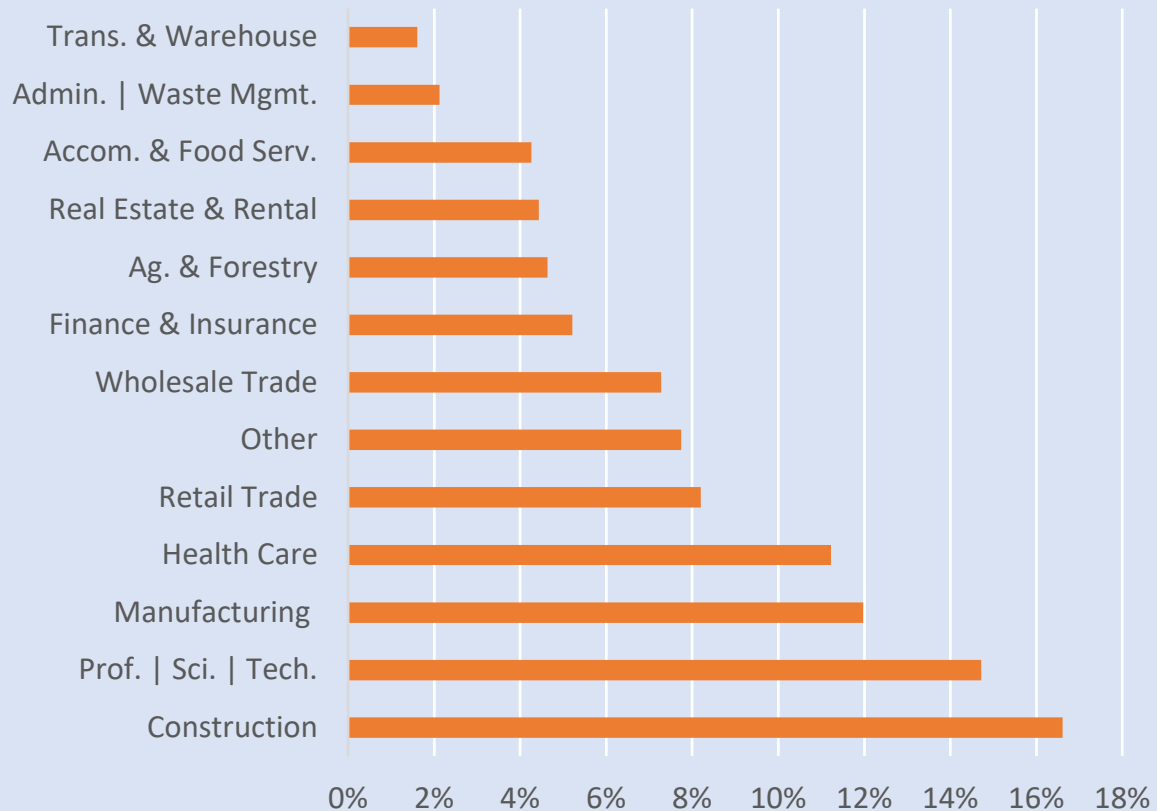
| Tax Year 2018   FY Filers   \$ Millions |        |           |
|---|--------|-----------|
|   | Number | Rev. Imp. |
| S-Corp & Partnerships                   | 23,000 | -106      |
| Sole Proprietorships                    | 2,200  | -5        |



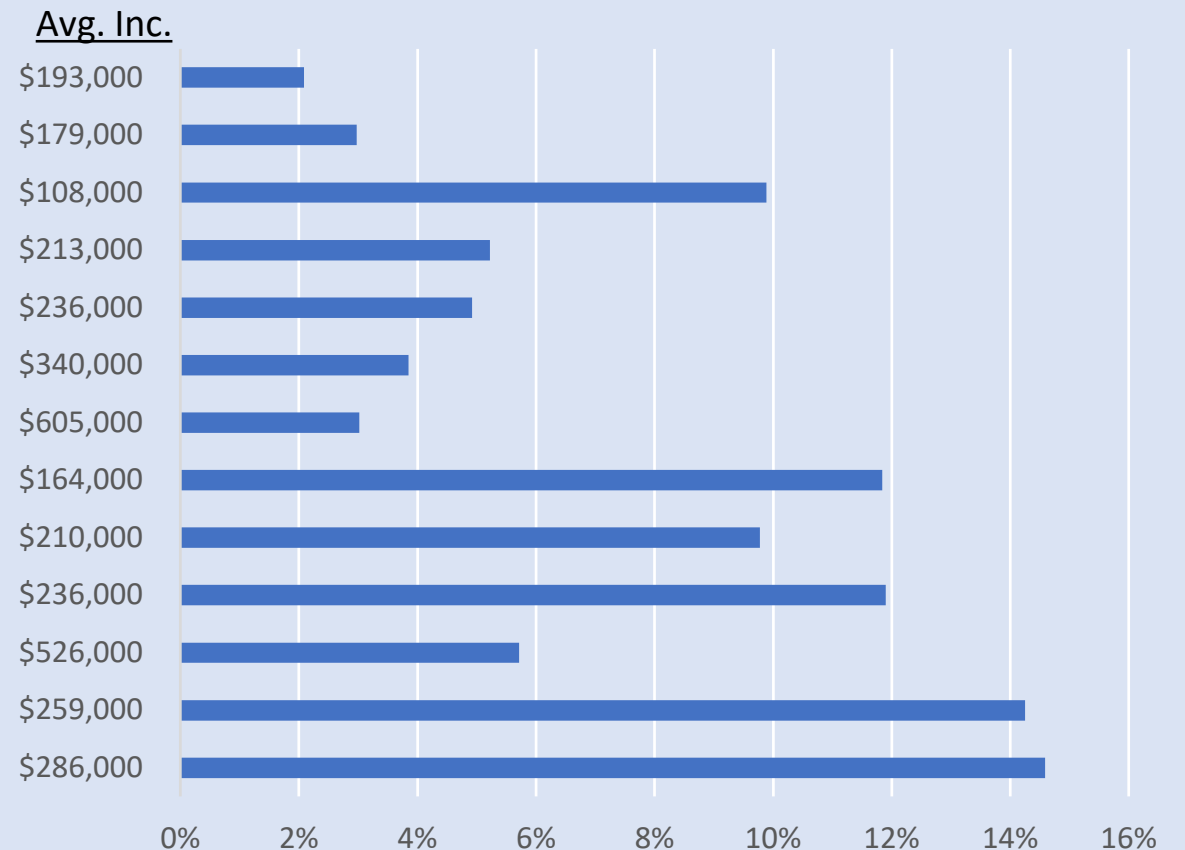


# Oregon PTE by Sector – Tax Year 2018

### Share of Non-Passive Income by Sector



### Share of Businesses by Sector

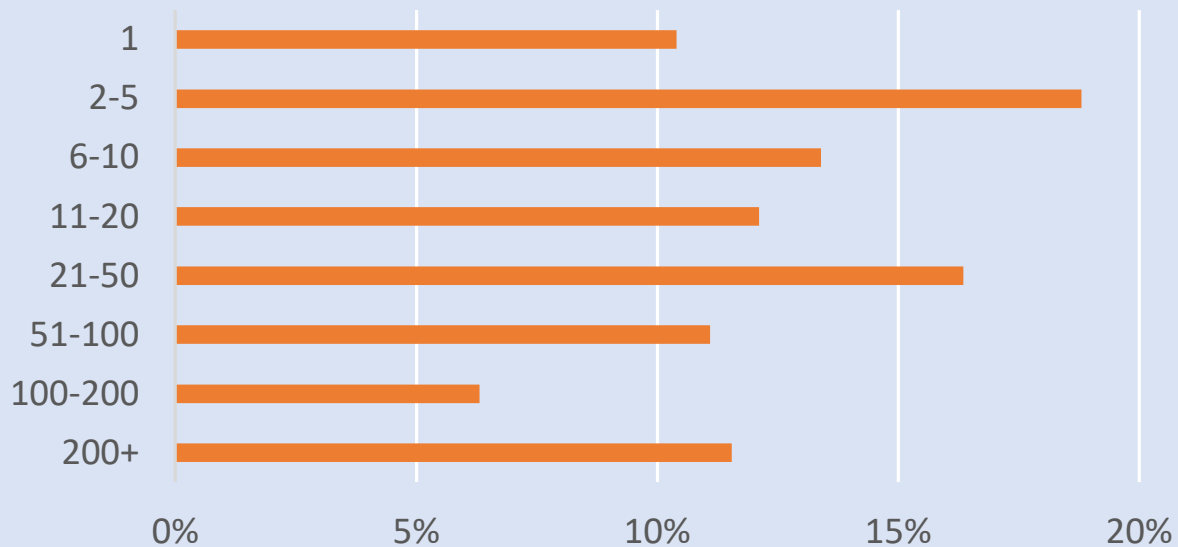




# Oregon PTE by Number of Employees

## Tax Year 2018

### Share of Non-Passive Income by Number of Employees



### Share of Businesses by Number of Employees

Avg. Inc.

