



OR Pass-Through Entity (PTE) Reduced Rates Program Overview & Proposed Changes

Joint Committee on Tax Expenditures – 6/4/2021

Legislative Revenue Office



Overview of Presentation

- Review of existing policy
- Proposed changes
- Effect of individual proposed changes
- Estimated revenue impact



Existing PTE Policy





PIT: Business Pass Through Income

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

Business income – business expenses = amount passed through

- S-Corps: Income/loss to shareholders
- Partnerships: To individual partners
- Sole props: To taxpayer (single entity)





Existing Policy Requirements

- Individual
 - 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)
- Business Entity
 - Have at least one full-time, non-investor employee
 - Qualifying employees must work at least 1,200 aggregate hours of work in Oregon (to count, must be 30 hours per week)





2020 Tax Rates and Brackets

Joint Income Tax Rates	
Taxable Income (\$)	Tax Rate
≤ \$7,200	4.75%
\$7,201 to \$18,100	6.75%
\$18,101 to \$250,000	8.75%
Over \$250,000	9.9%

Non-Passive Income Tax Rates	
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%





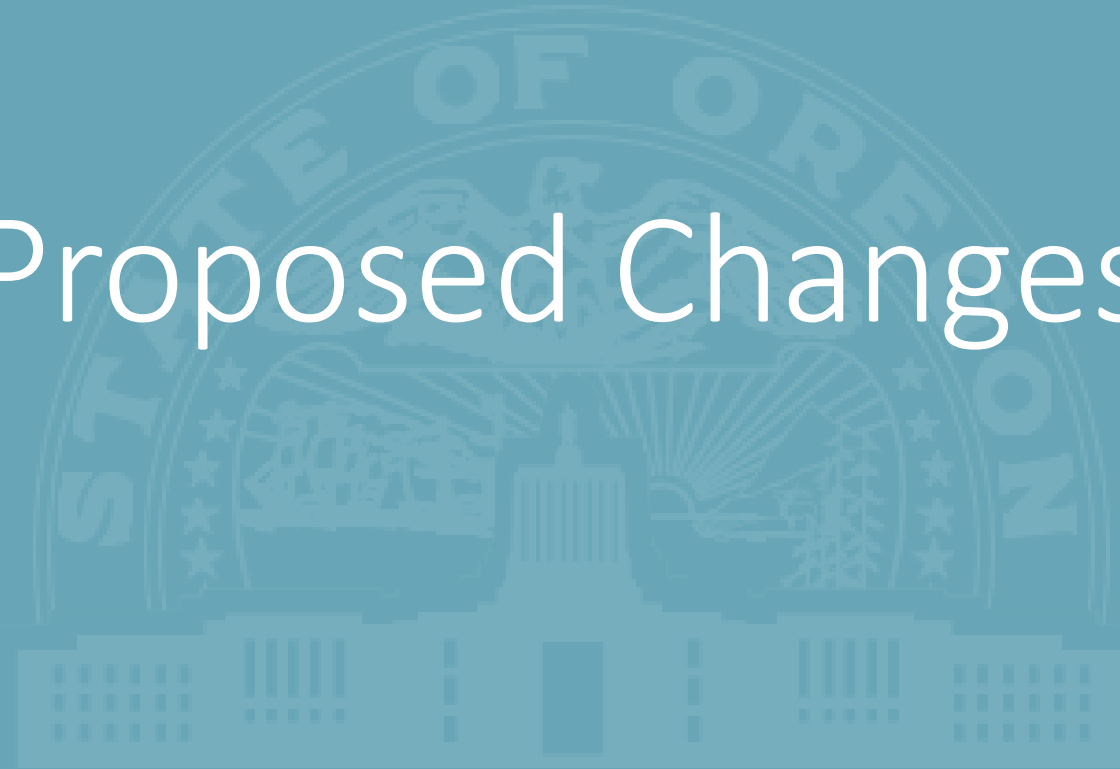
Revenue Impact of PTE

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



Proposed Changes





Proposed Changes

Policy Requirements			
	Individual Taxpayer	S-Corps & Partnerships (entity requirements)	Sole Proprietorships
Current Law	<ul style="list-style-type: none"> Material participation 	<ul style="list-style-type: none"> Employ 1 full-time, non-owner employee, meet 1,200 hours requirement 	<ul style="list-style-type: none"> Employ 1 full-time, non-owner employee, meet 1,200 hours requirement
Proposal	<ul style="list-style-type: none"> Material participation 	<ul style="list-style-type: none"> Employ 1 full-time, non-owner employee, meet 1,200 hours requirement 	<ul style="list-style-type: none"> Employ 1 full-time, non-owner employee, meet 1,200 hours requirement
	<ul style="list-style-type: none"> <i>Reduce rates</i> 	<ul style="list-style-type: none"> <i>Ordinary business income (OBI) (aka - profit) ≤ \$5 million in the year</i> <i>Meet one (or both) of the following:</i> <ol style="list-style-type: none"> <i>Meet or exceed OR employee to OR owner ratio, adjusted based on OBI</i> <i>Distributions of income ≤ 25% of OBI, (reinvest at least 75% of profit)</i> 	<ul style="list-style-type: none"> <i>No change</i>





Rate Changes

Rate Changes

- Widen 7.0% bracket
- Reduce from 7.6% to 7.5% for PTE income \$500K - \$1M
- About 20% of PTE taxpayers benefit from rate changes

Non-Passive Income Tax Rates		
Taxable Income (\$)	Tax Rate	Proposal
≤ \$250,000	7.0%	7.0%
\$250,001 to \$500,000	7.2%	7.0%
\$500,001 to \$1 Million	7.6%	7.5%
\$1 Million to \$2.5 Million	8.0%	8.0%
\$2.5 Million to \$5 Million	9.0%	9.0%
Over \$5 Million	9.9%	9.9%





Limit on Ordinary Business Income (OBI)

Income – expenses = OBI (aka, profit)

- Pass through income from entities with OBI exceeding \$5 million excluded from PTE reduced rates

Entities and PTE Income by OBI Category		
Ord. Bus. Inc.	% of Entities	% of PTE Inc.
LT 500K	87%	35%
500 - 1M	7%	14%
1M - 2.5M	4%	17%
2.5M - 5M	1%	12%
5M+	1%	22%





OR Employee to OR Owner Ratio

- Requirement in addition to existing 1 employee requirement
- OR employee: uses existing ORS PTE language (30 hrs. per week, aggregate 1,200 hours)
- OR owner: Oregon resident owners

Entity OBI	OR Emp. To OR Owner Ratio
≤ 500K	1:1
500K - 1M	2:1
1 - 2.5M	4:1
2.5 - 5M	10:1

Entities Meeting Employee to Owner Ratio		
OBI	% of Tot. Meeting Ratio	
	Meet Ratio	Fail Ratio
≤ 500K	88%	12%
500K - 1M	82%	18%
1 - 2.5M	76%	24%
2.5 - 5M	61%	39%
Total	87%	13%





Profit Reinvestment Requirement

- Entity reinvestment requirement

$$\frac{\text{Distributions}}{\text{Ordinary Business Income}} \leq 25\%$$

- Said another way, 75% of profit must be reinvested in business
- Determined using current tax year plus most recent two full tax years

Entities Meeting Reinvestment		
OBI	% of Total	
	Meet Reinvest	Fail Reinvest
≤ 500K	26%	74%
500K - 1M	12%	88%
1 - 2.5M	9%	91%
2.5 - 5M	6%	94%
Total	24%	76%





Effect of All Proposed Changes

- Table compares S-corps and partnerships qualifying under existing PTE law and qualification under proposed
- About 90% of entities overall continue to qualify
- Entities that continue to qualify represent about 66% of PTE income (S-corps & partnerships) subject to reduced rates

Entities that Qualify or Fail to Qualify under New Proposal				
Ord. Bus. Income	Continue to Qualify		Fail to Qualify	
	N %	PTE Inc. %	N %	PTE Inc. %
≤ 500K	92%	92%	8%	8%
500K - 1M	86%	86%	14%	14%
1 - 2.5M	78%	78%	22%	22%
2.5 - 5M	71%	72%	29%	28%
5M+	0%	0%	100%	100%
Total	90%	66%	10%	34%





Upshot

- About 20,000 S-corps & partnerships have income qualifying for PTE reduced rates
- About 2,000 S-corps/partnerships expected not to qualify under proposal
- Majority of impact (66%) on PTE income expected from excluding entities with OBI exceeding \$5 million
- Expected to affect about 3,500 – 4,500 PIT taxpayers
- Net impact on revenue estimated at positive \$30 - \$40M per year over next three biennia

