



# Legislative Revenue Option: Undo lower PTE tax rate

## *End lower tax rates for pass-through entities*

### Introduction

A lower personal income tax rate for “small” business was passed in 2013 as part of the “Grand Bargain” to increase school funding negotiated by Governor John Kitzhaber. This is a classic “trickle down” provision that simply taxes some higher income people at lower rates than other taxpayers. It is estimated to reduce state revenues by \$253 million in the current biennium. Joint tax filers normally pay 9.9% on income above \$250k while income from PTE (Pass-Through Entities) are taxed at 7% up to incomes of \$500k and then increase, but do not get to 9.9% until incomes exceed \$5 million.

### History/Issues

The claim of the proponents of this tax benefit is that businesses that organize as partnerships, LLC’s, etc. (PTEs) pay a premium in Oregon personal taxes that go up to 9.9% vs. Oregon C corporations that pay 7.6% on income above a million dollars. However, this claim ignores the fact that in addition to the corporate tax, owners of a C corporation must pay standard Oregon personal rates on any dividend they receive. The combination of the two is much higher than the 9.9% rate.

For businesses that are owned by a small group of investors or by a family, their PTE pays much lower combined taxes than a C-Corp. There is no justification for a lower rate to compete with companies structured as C-Corps.

Furthermore, while the PTE tax break was sold as helping small businesses, 95% of the benefits flow to those with incomes greater than \$200k and 71% to those above \$500k according to LRO’s study of 2022 data. Given the median family income of \$87,000 at the time, this tax break mainly helps higher-income families.

Another justification for this tax break was to provide working capital for small businesses. Yet LRO’s 2018 report calculated that the average investment for incomes under \$200k was less than a \$1,000 and for those incomes over \$500k only about \$15k. Clearly this is not meaningful as a financing tool for small businesses.

### Recommendation/Justification

The special tax rate discount for pass through entities should be eliminated. Only 1% of Oregon taxpayers receive this lower rate and the bulk of the benefits go to those with incomes above \$500k. It serves little to no value for the Oregon economy and does not drive economic behavior. At the same time the total lost revenue is significant and could help meet budget goals.

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