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MULTISTATE INCOME/FRANCHISE TAX

Oregon enacts modifications to the elective reduced personal income tax rates for certain pass-through income

Tax Alert

Overview

Oregon Senate Bill 139 ("SB 139"), signed into law on July 19, 2021, reduces the elective reduced personal income tax rates applicable for certain pass-through income by modifying the tax brackets and clarifying the types of pass-through entities whose income is eligible for this election. The amendments under SB 139 are effective the 91st day after the legislature adjourned sine die on June 27, 2021 and applicable to tax years beginning on or after January 1, 2021.

This Tax Alert summarizes some of the changes in SB 139.

Oregon bill modifies the elective reduced income tax rates for income from certain partnerships and S corporations

Oregon statute ORS 316.043 provides individual taxpayers an election for certain pass-through income to be taxed under specified tax brackets and rates. SB 139 modifies the tax brackets and provides requirements for pass-through entities to qualify for their income to be eligible for the reduced income tax rate election.

SB 139 modifies the tax brackets applicable for the elective reduced personal income tax rates.

- Under current law, at the election of the taxpayer, the taxpayer's income up to $250,000 is taxed at the rate of 7%. SB 139 increases the income threshold of the first-tier bracket to $500,000.

- Under current law, the taxpayer's income exceeding $250,000 but not exceeding $500,000 is taxed at the rate of 7.2%. That bracket has been deleted, effectively absorbed by the expanded first bracket.

- Under current law, the taxpayer's income exceeding $500,000 but not exceeding $1 million is taxed at the rate of 7.6%. SB 139 decreases the rate to 7.5%.

SB 139 provides the requirements for the pass-through entities for which taxpayers can make the reduced income tax rate election.

- SB 139 added conditions to the types of pass-through entities from which the pass-through income is eligible for the reduced income tax election. These rates apply to partnerships, S corporations, or sole proprietorships if:

    - The taxpayer materially participated in the trade or busines;

    - The partnership or S corporation ordinary business income is not in excess of $5 million; and

    - The partnership or S corporation complies with either an employee ratio requirement or income distribution requirement.

- The bill requires that for an entity to be eligible, that partnership, S corporation, or sole proprietorship must employ one person who is not an owner, member, limited partner, or the sole proprietor. Additionally, the entity must have at least 1,200 working hours in Oregon by persons described in the preceding sentence and who are employed by the partnership, S corporation, or sole proprietorship. Only hours worked in a week in which a worker works at least 30 hours can be counted toward the 1,200 hour threshold.

- As noted above, SB 139 requires a partnership or S corporation to meet either the employee ratio or the income distribution requirement.

    - Employee ratio: The employee ratio requires that eligible partnerships or S corporations meet certain owner (i.e. owner, member, or limited partner) to employee ratios based on ordinary business income thresholds. The thresholds and ratio requirements are as follows:

        - Partnerships or S corporations with ordinary business income of more than $500,000 but less than $1 million are required to employ two other people who are not owners and have at least 2,400 working hours in Oregon while considering not more than 1,200 hours worked by any one employee.

        - Partnerships or S corporations with ordinary business income of more than $1 million but less than $2.5 million are required to employ four other people who are not owners and have at least 4,800 working hours in Oregon while considering not more than 1,200 hours worked by any one employee.

        - Partnerships or S corporations with ordinary business income of more than $2.5 million but less than $5 million are required to employ ten other people who are not owners and have at least 12,000 working hours in Oregon while considering not more than 1,200 hours worked by any one employee.

    - Income distributions requirement: If a partnership or S corporation has ordinary business income in excess of

$250,000, the distributions of the income by the partnership or S corporation cannot exceed 25% as a percentage of ordinary business income. This percentage is calculated based on the total distributions over total ordinary business income for the current tax year, plus the percentages for the two most recent tax years. If the entity has been in operation for less than two full years, then the percentage is calculated based on as many tax years for which the partnership or S corporation has been operating. Amounts less than zero are considered zero for that tax year.

Get in touch

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