The Legislature is considering ending the Schedule E tax break, which was created during the “grand bargain” special session in 2013. Though billed as a tax break for small business, tax analyses show that the Schedule E tax cut disproportionately benefits the wealthiest Oregonians.

Some kinds of “pass through” business income are taxed as part of business owners’ personal income taxes. Income from rental real estate, royalties, partnerships, S corporations, and trusts is reported using the Schedule E form, so this is often referred to as Schedule E income.

About 70% of the top 1% of income filers report Schedule E income. In the bottom 60% of filers, less than one in 10 file a Schedule E. The top 1% claims 59% of Schedule E income; 83% goes to the top 5%. Because higher income taxpayers get nearly all of the benefit of this cut, the Schedule E tax break has made Oregon’s tax system more regressive.

A little history: In 2013, Governor Kitzhaber called a special session of the legislature to pass a package of bills — the so-called “grand bargain.” Five bills were passed during the 3-day session. HB 3601 made a number of tax changes, including cutting personal income tax rates on Schedule E income from partnerships and S corporations that have at least one employee. (LLCs can elect to pay taxes like an S corporation.)

At the time, the tax break was controversial because its chief proponent, then-State Senator Larry George, appeared to benefit from the tax break. Major Republican backers like Stimson Lumber, A-DEC, and even Loren Parks appeared to benefit as well. Despite concerns about conflicts, the bill passed as part of a broad legislative compromise.

But the controversy around the tax break grew when companion bills in the compromise were rejected by the Oregon Supreme Court. Without the companion budget cuts that were originally proposed in the grand bargain, the state simply could not afford the added large tax break created by the Schedule E pass through.

Now, many are calling for a closure of the loophole to help bring the budget back into balance and fund schools and family service programs. The only roadblock? Potential personal conflicts in the Legislature, as tax reports show a majority of Oregon’s legislators may be eligible to benefit from the Schedule E tax break created just four years ago. According to the 2017 Statements of Economic Interests filed with the Oregon Government Ethics Commission, at least 62% of the members of the Oregon Legislature have pass through business income. A much higher share of Republicans than Democrats may have Schedule E pass through income (79% vs. 50%). The Schedule E debate deserves additional scrutiny because of this potentially unprecedented level of personal conflicts.
The Schedule E tax break is significant, too: It was expected to cost $205 million in 2015-17, and $239 million in 2017-19. So it could easily become a runaway tax break, as projections show it continues to grow over time. As legislators struggle to fund schools and essential services, tax breaks that mostly benefit the wealthy — and were parts of already failed deals — are obvious targets for reform. What’s more, there’s no evidence that the Schedule E reduction has created new jobs or bolstered the economy.

Repealing the pass through tax break would save hundreds of millions of dollars and make Oregon’s tax system less regressive, but only if Oregon Legislators are willing to sacrifice their own potential tax breaks along the way.

**Percentage of legislators who have pass through business income**

1. Oregon Department of Revenue, 2014 Personal Income Tax data
5. Oregon Legislative Revenue Office projections