

IN CONSIDERATION OF ORDINANCE 23-1503, FOR THE PURPOSE OF AMENDING METRO CODE CHAPTERS 7.05 (INCOME TAX ADMINISTRATION) AND 7.06 (PERSONAL INCOME TAX) TO ADD CERTAIN CLARIFICATIONS AND MAKE HOUSEKEEPING UPDATES.

Date: October 9, 2023
Department: Finance & Reg. Services
Meeting Date: October 26, 2023

Presenter(s), (if applicable): Justin Laubscher, Tax Compliance Program Manager; Josh Harwood, Fiscal & Tax Policy Director
Length: 20 minutes

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ISSUE STATEMENT

Through the course of 2022 and 2023 Metro has continued work on implementation of the Supportive Housing Services tax collection system with the tax administrator, the City of Portland. As part of the ongoing maintenance of the income tax system, staff works to identify portions of the tax code and administrative rules that could be clarified or to help more efficiently collect the taxes. Because the current code does not explicitly address these issues or provide guidance to tax practitioners, staff is proposing code amendments to codify these items. Three sections of the tax code have prompted discussions and comments.

- **E-Filing Mandate.** Metro would like to increase the number of tax returns filed electronically by implementing a mandate for electronic filing to expedite processing of tax returns, reduce data entry errors, and allows issuance of refunds sooner. This ordinance will authorize Metro to implement a mandate by administrative rule. The administrative rules would allow the Administrator to phase-in in a manageable manner that accommodates taxpayers, tax preparers, tax software vendors, and City of Portland resources. This aligns with how the State implemented its electronic filing mandate. Metro has been working closely with the City of Portland and Multnomah County with the intent to implement this mandate uniformly with all three tax entities. It is Metro's intent to implement these requirements beginning with the 2024 tax year (tax returns generally due in April of 2025).
- **Employer Penalties for Incorrect Withholding.** Currently, neither Metro's withholding tax code nor administrative rules specify that employers must submit accurate annual wage and tax statements (Form W-2s). Without specifying that employers may be penalized for submitting incorrect information, the administrator lacks a tool to enforce requests made to employers to provide accurate and/or corrected wage statements (Form W-2Cs).

- **Pass-Through Entity Deduction.** Metro and Multnomah County personal income tax programs allow a deduction for previously taxed income from pass-through entities (PTEs). However, the code and rules do not provide clear and complete guidance for all tax situations. The proposed amendment will provide further clarification for both tax preparers and tax filers.

ACTION REQUESTED

Staff requests that Metro Council adopt Ordinance No. 23-1503.

IDENTIFIED POLICY OUTCOMES

The Metro income tax codes (Chapters 7.05, 7.06, and 7.07 collectively) codify certain provisions of the Supportive Housing Services Measure approved by the voters. The proposed amendments to the Metro income tax codes will further clarify the intent of the code adopted in December 2020. These chapters established code requirements to implement the taxes imposed by the measure in an effective and efficient manner.

POLICY OPTIONS FOR COUNCIL TO CONSIDER

- Adopt this ordinance. This results in more clarity in the income tax codes, which guide the tax collection system.
- Adopt this ordinance with revisions or modifications as described by Council.
- Reject this ordinance with other direction to staff. The existing income tax code would remain in place, but proposed amendments would not be made.

STAFF RECOMMENDATIONS

Staff recommend that Metro Council adopt Ordinance No. 23-1503.

STRATEGIC CONTEXT & FRAMING COUNCIL DISCUSSION

E-Filing. Most federal and Oregon tax returns are prepared electronically as it facilitates the ease of tax return preparation and filing. An e-file mandate will encourage tax software developers to write software that accommodates the electronic filing of Metro tax returns which in turn will provide taxpayers with the same ease of tax return preparation and filing.

Not all Metro tax returns are available from software providers to tax filers and tax preparers which impacts the ability to file electronic tax returns. The federal government and the State of Oregon (State) both experienced this issue when they began accepting electronically filed tax returns. They implemented mandates requiring that certain taxpayers and tax preparers file tax returns electronically. Over time, this resulted in more federal and state tax returns and forms being filed electronically.

Employer Penalties for Incorrect Withholding. The Administrator reports seeing employers submit W-2s along with their annual reconciliation withholding return (AWR) reporting the number of W-2s issued. Later in the following year, the business will amend their prior year quarterly return and AWR but will not include the updated form W-2Cs. Without supplying the Form W-2Cs, there is no precise way to determine the accuracy of the

withholding claims. Requiring accurate and complete W-2s to be filed when the annual reconciliation is due and additionally when the return is amended addresses this concern. These proposed withholding enforcement penalties would not have a material impact on Metro collections revenue or expenses.

Pass-through entity deduction. Unlike the federal government and Oregon's tax treatment of pass-through entities, Metro, Multnomah County, and the City of Portland impose their business income taxes on pass-through entities doing business within our jurisdictions. Metro and Multnomah County adopted personal income taxes by tying to Oregon's personal income tax law as the starting point. This tie means that pass-through entity income is initially included in income reported on these returns. Adjustments are allowed to avoid double taxation.

While developing rules for the personal income tax programs Metro, Multnomah County, and the City of Portland determined that for pass-through entities (PTEs) that were subject to the business income taxes, net operating losses (NOL) incurred remained with the business entity. Since the PTE carries over and uses the loss the individual owner is not entitled to use the same loss. To the extent a PTE's loss is reported on the federal and state personal income tax returns, it must be added back to zero out the loss. It is not allowed to reduce any other income of the individual.

Prior to, and throughout the tax filing season, tax professionals inquired about the proper treatment. Some have suggested not allowing the use of NOLs and NOL deductions by the owner results in double taxation. Others have expressed concern that they receive no benefit of an NOL or the NOL deductions use. The latter reflects what actually occurs.

Data to determine PTE deduction revenue collection impacts is not available because the deduction occurs on the state return and then "flows through" to the Metro return as part of Metro taxable income. Staff considered options and determined that the best course of action was codifying the allowance of a deduction with adjustments to avoid double taxation when multiple tiers of PTEs are involved. Staff also ensured that the deduction should not exceed the individual taxpayer's share of distributive income from the PTE included in the return.

