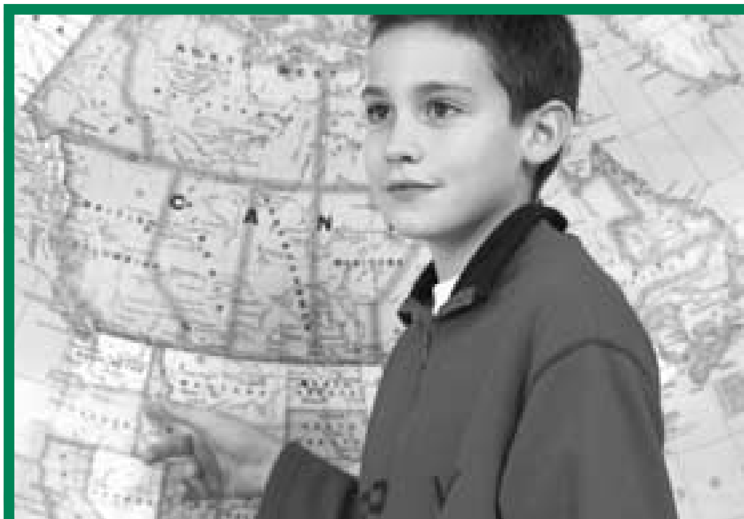

FUNDING OREGON:

The Ins and Outs of State Finance

LEAGUE OF WOMEN VOTERS® OF OREGON EDUCATION FUND

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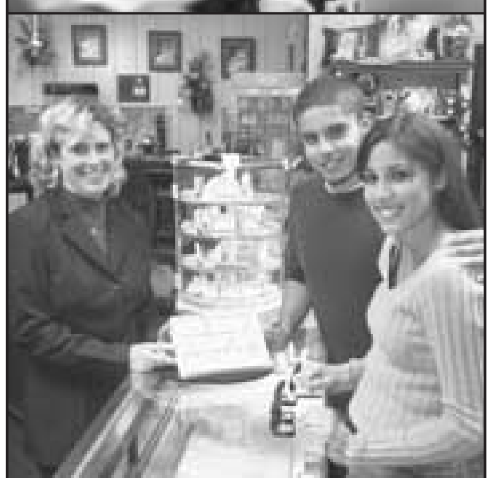
This booklet by the League of Women Voters of Oregon Education Fund is an effort to help interested Oregon citizens better understand the state's taxation system. The report explains what taxes and fees you pay, how that money is used, and options for tax reform. It does not include every tax that you may pay, but focuses on the larger tax sources and expenditures. This primer is limited to the Oregon tax system and does not include what you pay to the federal government and how those funds are used.

Throughout this report, we have used the most up-to-date, accurate revenue and budget figures available. Some recent figures are based on estimates because revenue for the 2003-05 biennium is still being collected. Other data is still being audited. Amounts and percentages may change slightly when more data becomes available. However, these figures still give an accurate overall picture of Oregon's financial system and allow useful comparisons with previous years.



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We wish to thank The Ralph L. Smith Foundation, and the members and friends of the League of Women Voters of Oregon for contributing the money to print this booklet and to produce other materials for the *Funding Oregon* project. We are also grateful to the volunteers listed on the back cover who contributed many hours to researching and checking the facts, and writing this explanation of our state's financial system.

FUNDING OREGON:
THE INS AND OUTS OF STATE FINANCE

WHERE DOES THE MONEY COME FROM?

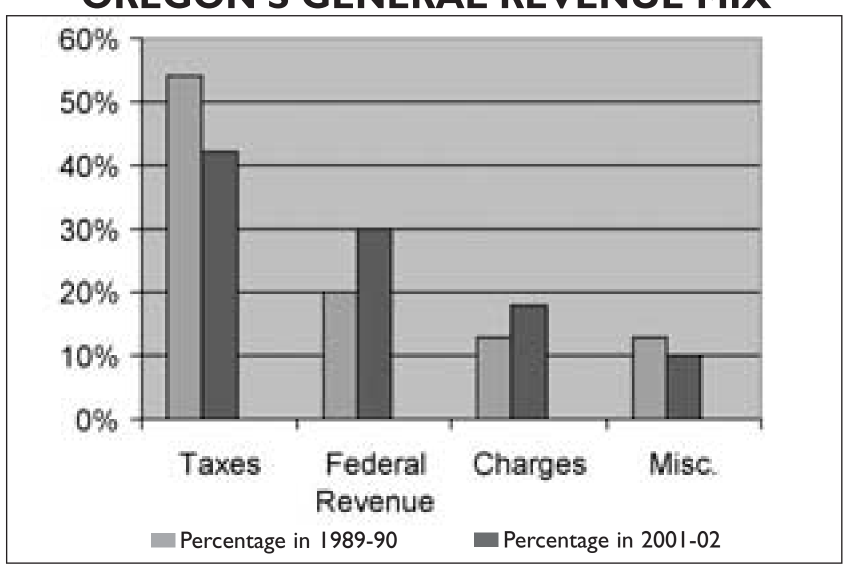
The State of Oregon and local city and county governments receive revenue from citizens and businesses to support the services their citizens consider important. This revenue is made up of:

- income and property taxes
- selective sales taxes such as those on gasoline, alcohol, and tobacco products
- fees and charges such as tuition and fees at colleges and universities
- licensing fees paid by businesses
- money shared with the state by the federal government
- other miscellaneous sources such as the lottery and interest on investments

Local units of government–including cities, counties, and special districts–are primarily funded by property taxes. Property taxes do not support the state budget. Other local taxes vary by local governmental units and may include a local income tax, self-employment taxes, hotel-motel taxes, licensing fees, and/or business taxes in specific areas such as Portland and Multnomah County.

In 2001-2002, taxes made up 42% of Oregon's general revenue mix; federal grants, 30%; fees and charges, 18%; and miscellaneous revenue, including lottery funds, 10%. General revenue is all revenue, including property taxes, received by state and local governments except revenue from trust funds and public enterprises. As the chart shows, taxes as a percentage of the revenue mix have decreased since 1989-90, while fees and Federal revenues have increased.

OREGON'S GENERAL REVENUE MIX



Source: Legislative Revenue Office

According to the latest data available in 2004, the Legislative Revenue Office has characterized Oregon's tax system, in comparison to those of other states, as follows:

- Oregon is less reliant than other states on state and local taxes as a revenue source – 42% for Oregon; 54% average nationally.
- Oregon's total combined state and local tax burden, i.e., taxes as a percentage of personal income, is relatively low.
- Oregon's personal income tax burden is 3rd highest in the nation.
- State government is highly dependent on the personal income tax as a source of revenue.
- Oregon's property tax is about average.
- Oregon's consumption tax burden (general sales taxes plus selective sales taxes) is the lowest in the nation.

You, as an individual taxpayer, are most familiar with the "ouch taxes"–the income tax you pay to the state and the property tax you pay to your local government. Even if you rent, you are paying property taxes, as your landlord has included that cost in your rent. You also pay taxes indirectly whenever you buy gasoline, cigarettes, and alcohol. Even business and employer taxes paid by corporations and businesses may be included in the price of some goods and services as a business cost.

All these taxes combine to be what is called *tax burden*. Tax burden is calculated by adding up the taxes paid by all the residents in the state and dividing by the total amount of personal income received by those residents. In 2001-02, Oregon ranked 46th nationally in tax burden and was the lowest of any western state.

The money received by the State from income taxes, lottery funds, user fees, federal funds, and other sources is deposited into four different funds:

General Fund: Most unrestricted funds are within the state's General Fund and provide for human services, public safety, and schools; these are primarily funded by income taxes.

Lottery Funds: A relatively small amount of funding is derived from the net proceeds of the state lottery games and is used for education, parks, debt service on bonds, and economic development.

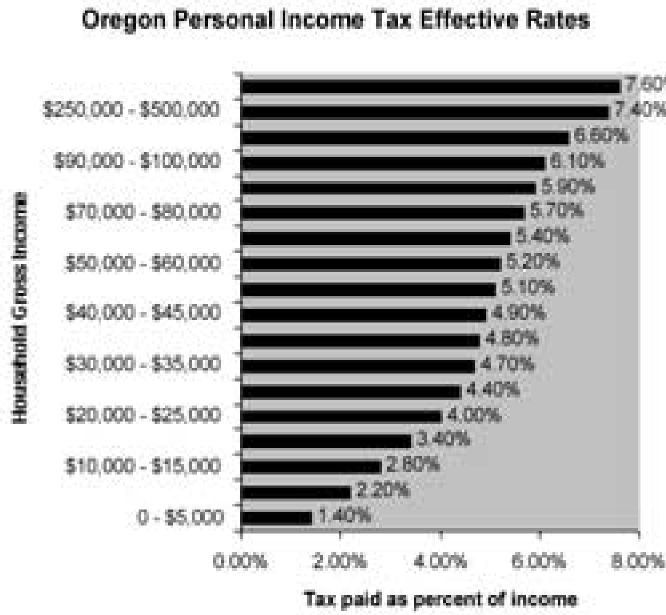
Other Funds: Most fees and charges are in this fund, including the Highway Fund that receives money from the gasoline tax. Expenditures from this fund are usually designated to specific programs rather than being available for expenditure elsewhere in the budget.

Federal Funds: This fund receives its money from the federal government for reallocation to specific programs such as transportation and the Oregon Health Plan. How the money can be used is highly restricted.

PAYMENTS BY INDIVIDUALS

INCOME TAXES. Personal income tax collections are the largest source of state tax revenue, providing about 82% of state General Fund revenue in 2001-03. No other state is as dependent on a single tax source as Oregon is on the personal income tax.

Tax rates range from 5% to 9% of Oregon taxable income. However, the average *effective* tax rate in 2001 was 5.7% of adjusted gross income due to deductions and credits. The effective tax rate is the percent of gross income a taxpayer actually pays in state income taxes. The personal income tax is progressive. In the 2001 tax year, households earning less than $5,000 paid an average effective rate of 1.4% of annual gross income. Households earning $40,000 to $45,000 paid an effective rate of 4.9% of annual gross income. Households earning over $500,000 paid an effective rate of 7.6% of annual gross income.



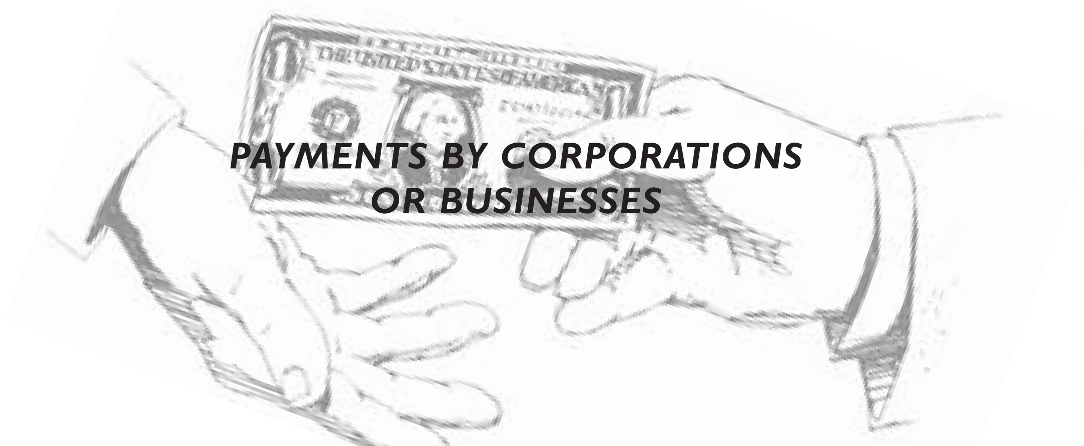
Source: Citizens for Oregon's Future
How Does the Oregon Income Tax Work? March, 2004

PROPERTY TAXES. Goods and possessions are generally considered property, but individuals usually pay property taxes only on land and buildings. Property taxes are levied by local jurisdictions to support services such as schools, police, and fire departments. Voters usually approve the amount of property tax to be levied, subject to the limitations established by Measures 5 and 50 (see the section on Changes in the System). Some property owners, such as government, religious, charitable, nonprofit, and educational organizations, are exempt from all or part of property taxes.

GAS TAX is a selective sales tax—that is, it applies only to one type of product. It and other transportation taxes all go into the Highway Fund and come from motor fuel taxes (gas tax), driver and vehicle license fees, weight-mile truck taxes, and other licenses and fees.

CIGARETTE TAX is one of the taxes levied on tobacco products and included in the retail price a person pays at the store.

BEER AND WINE TAXES. Taxes (or markups) are also levied on alcohol products. The Oregon Liquor Control Commission (OLCC) revenue comes from the tax on alcohol. As of January 2003, Oregon ranked 50th among states and D.C. for excise and retail sales taxes on beer and 47th for taxes on wine.



PAYMENTS BY CORPORATIONS OR BUSINESSES

CORPORATE INCOME TAX. Oregon taxes both individual and business income through the personal income tax. Owners of sole proprietorships and partnerships pay personal income taxes on the profits from their businesses. *S-corporations* (see box) do not pay income tax directly, but pass their earnings to the shareholders in the form of dividends. Shareholders then pay taxes on their dividend income through their personal income tax. On the other hand, the income of *C-corporations* is subject to the *corporate excise tax*.

Corporations doing business in Oregon pay the corporate excise tax on net income attributable to Oregon. The corporate tax rate is 6.6%. Corporations with zero or minimal taxable income must pay a minimum tax. The corporate minimum tax has been $10 since 1932. In tax year 2000, 65% of C-corporation taxpayers paid the minimum tax. Most corporate taxpayers that paid the minimum tax (95%) reported zero taxable income or a loss. However, some corporations in higher income categories also paid the minimum tax because of tax credits that reduced their tax liability to $10. S-corporations doing business in Oregon are also subject to the corporate excise tax. However, since S-corporation income is taxed as personal income, most S-corporations pay only the minimum tax.

Oregon's corporate excise tax is highly concentrated. Of the nearly 37,000 C-corporations that filed corporate taxes in 2000, 36 companies paid nearly half (46%) of all corporate excise taxes. About 3% of corporate taxpayers (1100) accounted for 90% of taxes paid. Corporate excise taxes provided 4.5% of state General Fund revenue in 2001-03.

Corporate excise tax is a tax imposed on corporations for the privilege of doing business in Oregon.

C-corporations are regular corporations that pay tax at the corporate level.

S-corporations are "pass through" entities where the corporation's income and losses are passed through to its shareholders. An S-corporation is limited to one class of stock and 75 shareholders. Each shareholder must be a U.S. citizen or resident and must be an individual, estate, or trust.

PROPERTY TAX. Corporations pay local property taxes on the assessed value of land, buildings, and fixed machinery and equipment as well as personal property used in a business. There is no property tax on business inventories. Assessments may be reduced for certain types of property such as open space, farmland, and forest land.

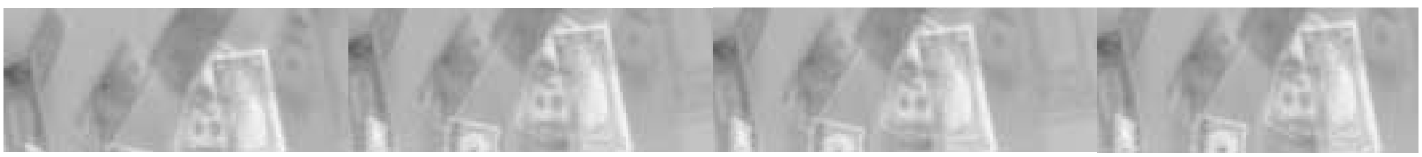
For the 2002-03 fiscal year, the share of both state and local taxes paid by Oregon businesses is estimated to have been 31.7%. The proportion of state and local taxes paid by businesses versus individuals has declined since 1979 when it was about 50%.

OTHER SOURCES OF REVENUE

LOTTERY FUNDS are managed by the Lottery Commission, an independent agency, which is responsible for running all aspects of the lottery and transferring the profits to the Lottery Fund, a separate fund within the total state budget. Only the net profits, after prizes and operating expenses, are included in the state budget. Lottery receipts are expected to provide about 2% or $757 million of the total state budget in 2003-05. The funds are allocated to specific purposes as set forth in the Constitution (the Education Stability Fund, parks and natural resources), as well as to debt service on lottery-backed bonds, with the balance allocated by the Legislature for economic development and education purposes.

RESERVE FUNDS. Oregon has no General Fund reserve or "rainy day" fund. The closest is the Education Stability Fund that accumulates from a percentage of lottery proceeds and is a separate entity. It was significantly spent down as a result of Legislative Special Sessions in 2002 , and it also has some limits on how the dollars can be expended. There are reserve funds established both by statute and the Constitution, but these do not fit the definition of a general reserve fund.

FEDERAL FUNDS are monies from the federal government to pay for specific programs and activities. Federal funds are restricted and cannot be used to support other portions of the state budget. In the 2003-05 legislatively approved budget, the Federal Fund totaled $8.150 billion or 21.9% of the total state revenue budget for that biennium. Most, 72.3% or $5.890 billion, is allocated to Human Services: in large part to the agency's Health Services (the Oregon Health Plan or Medicaid); Seniors and People with Disabilities; and Children, Adults and Families. Some federal programs require the state to match a portion of the money received.

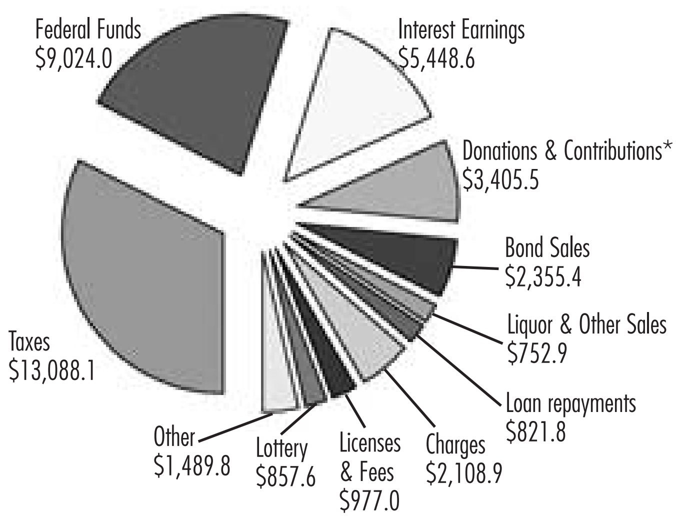


The pie chart shows the revenues from all sources that go into the state budget.
Local property taxes and other local revenues are not shown on this chart.

ALL FUNDS REVENUE (IN MILLIONS)

2001-2003 ESTIMATES

Source: Oregon Department of Administrative Services.



*Donations & Contributions include PERS (retirement fund) contributions

TAX BREAKS: EXCLUSIONS, DEDUCTIONS, CREDITS AND EXEMPTIONS

Tax breaks are laws, referred to by the State of Oregon as "tax expenditures," that exempt persons, income, goods, services, or property from the impact of established taxes, usually to provide an incentive for specific kinds of expenditures. Tax breaks include, but are not limited to, tax deductions, tax exemptions, tax deferrals, preferential tax rates, and tax credits. Because Oregon's income tax is linked to the federal income tax, most deductions and credits allowed on a federal return also are allowed on an Oregon return. In addition Oregon permits some deductions and credits beyond those allowed for federal taxes. Altogether Oregon allows almost as much in income tax breaks as it collects in taxes. It is estimated that only 55% of the potential revenue from income taxes is collected. Estimated personal and corporate income tax breaks in 2001-03 totaled nearly $7 billion. The largest are for the personal exemption credit ($810 million), the deduction of home mortgage interest ($787 million), and the deferral of taxes on pension (IRA, 401K) contributions and earnings ($612 million). These three tax breaks total $2.2 billion and are approximately 31% of the total of all tax breaks.

Income tax breaks reduce state General Fund revenue. Tax breaks are growing faster than tax revenues, as indicated by their 27% increase between the 1997-99 biennium and the 2001-03 biennium, compared to a 15% growth in revenue during the same period. If tax breaks had been held to a constant percentage of total taxes levied between the periods 1999-01 and 2001-03, the state would have had $1.443 billion in additional tax revenue in the 2001-03 biennium. Estimated state tax revenue and the amount of related tax breaks are shown below.

OREGON REVENUES AND TAX BREAKS BY STATE TAX PROGRAM

(Millions of Dollars)

Tax Program	Number of Tax Breaks	Estimated Revenues 2001-03	Estimated Revenue Loss From Tax Breaks 2001-03	2003-05
Income (Total)	192	$8,456.7	$6,949.8	$7,714.4
Gas and Use Fuel	5	$ 791.7	$ 10.6	$ 13.1
Weight Mile	7	$ 360.5	$ 11.5	$ 12.3
Insurance	7	$ 112.3	$ 11.1	$ 4.5
Cigarette/Tobacco	5	$ 415.6	$ 1.2	$ 2.3
Beer and Wine	2	$ 25.1	$ 1.6	$ 1.9
Other State Taxes	15	$ 1,665.1	$ 4.4	$ 4.6
Total	233	$11,827.0	$6,990.2	$ 7,753.1

Adapted from a chart in State of Oregon 2003-05 Tax Expenditure Report, Office of the Governor

PROPERTY TAX BREAKS. In addition, significant tax breaks occur in the local property tax program, where the estimated tax breaks of over $18.1 billion for the 2001-03 biennium are nearly three times the revenue actually raised. The largest property tax breaks are the exemption of intangible personal property, like stocks and bonds ($10.2 billion), the exemption of federal property ($3.5 billion), and the exemption for state and local government property ($0.905 billion). Losses in property tax revenue resulting from tax exemptions affect the state budget since part of the revenue lost to school districts is replaced with funding from the state General Fund.

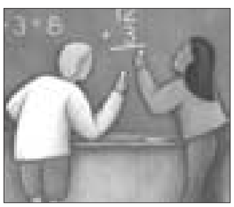
WHERE DOES THE MONEY GO?

As with service industries in the private sector, a large portion of the costs of state government is in the people who deliver the services citizens want and expect. In some instances the services are delivered directly by state agencies like the State Police. For some other services, such as K-12 education, the money is passed down to the local districts where it is spent.

Although taxes represent 42% of combined state and local revenue in Oregon, personal and corporate income taxes only fund about 27% of the state's budget. The remaining money comes from fees and charges, federal funds, and miscellaneous sources, (including other taxes) which are usually dedicated to specific programs. This is called *dedicated spending*. Two examples are the gas tax for highways and federal funds that must be spent as directed by the federal government (such as the Oregon Health Plan/Medicaid funds). Thus, only a relatively small proportion of the money in the budget can be allocated according to the Legislature's choice or discretion. This is called *discretionary spending*. Most of the discretionary spending goes to education, human services and public safety.

The state budget can be grouped into ten program areas that contain the approximately 100 agencies that make up the budget. Each of these areas is supported in varying degrees from your taxes and from federal and dedicated funds.

When we look at where tax money goes, we need to consider primarily the General Fund. The General Fund is 27.4% of the All Funds budget. (The 2003-05 legislatively approved General Fund budget was $10.2 billion, with a total state budget of $37.2 billion.) Three program areas – Education, Human Services, and Public Safety – use most of the tax dollars available from the General Fund. Over 92% of the 2003-05 General Fund is allocated to these three programs. The following shows what programs your income tax dollar supports in 2003-05 and some of the services provided.

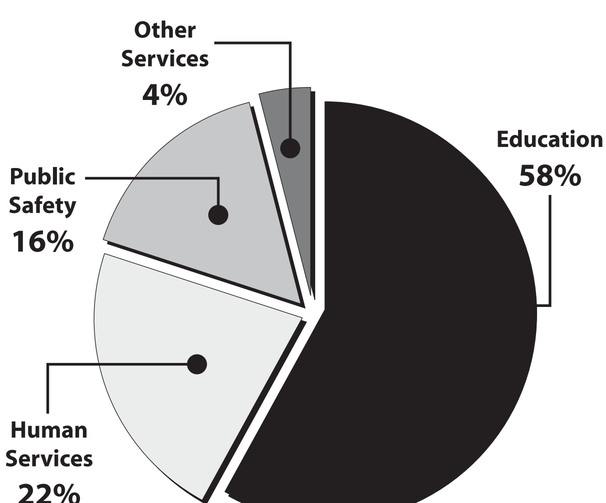


Education - 58 cents
- K-12 System
- Community Colleges
- Universities

Human Services - 22 cents
- Medicaid/Oregon Health Plan
- Child Protective Services
- Senior Services
- Mental Health
- Food Stamps

Public Safety - 16 cents
- Adult Corrections
- Juvenile Corrections
- Dept. of Justice
- State Police

Other Services - 4 cents
- Agriculture/forestry
- Environmental Quality
- Economic Development
- Transportation



WHERE YOUR INCOME TAX DOLLAR GOES
2003-05 BIENNIUM

Source: Oregon Department of Revenue.

EDUCATION is the program area that includes the Department of Education, the Oregon School for the Blind and the Oregon School for the Deaf, K-12 public schools and education service districts, the community colleges and state universities, and the Oregon Health and Science University. The 2003-05 Legislatively Approved Budget for this program area is $11.1 billion, of which $5.9 billion comes from the General Fund–our income tax dollars. Most of these tax funds ($4.4 billion or approximately 75%) are allocated back to local districts to support K-12 public education and community colleges. According to the Oregon Department of Revenue, 45% of your local property tax dollars also are used to fund K-12 public schools and community colleges. Decisions about how to allocate the dollars available are made at the local level.

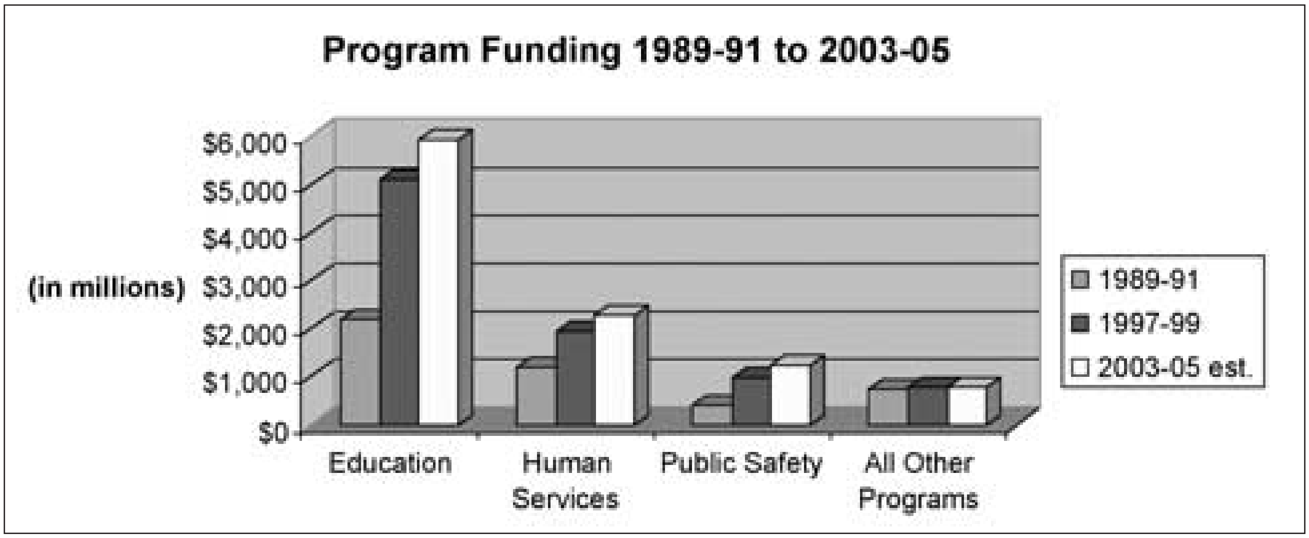
In Oregon approximately 550,000 students per year attend K-12 public schools. The Oregon University System (OUS) educates over 100,000 students. (Nearly one quarter of the graduates from Oregon high schools continue their education at an OUS college.) In addition, Oregon has 17 community colleges, which serve almost 380,000 students per year. The OUS and community colleges depend significantly on other sources of funding beyond tax dollars, including tuition and fees.

HUMAN SERVICES includes programs for helping low-income families, protecting children and adults from abuse and neglect, providing health care through the Oregon Health Plan and other health programs, assisting seniors and people with disabilities, and protecting the public health. As one of the largest program areas in the state, its 2003-05 budget is $9.362 billion, of which only 24.5% comes from the state General Fund. Nearly 63% of the budget comes from federal funds, primarily for physical and mental health services— including services for seniors, the disabled, children and families, and community health services—as well as for federal food stamps. In 2002, the Department of Human Services served 1,000,005 Oregonians, about one quarter of the state's population.

PUBLIC SAFETY provides services in four major areas: 1) community safety and law enforcement, 2) prosecution and defense services through the adult and juvenile court system, 3) corrections or the incarceration of adult and youth offenders, and 4) crime prevention. There are 10 agencies in this program area, including the Department of Corrections, the Oregon Youth Authority, the Department of Justice, the State Police and the National Guard. The 2003-05 budget for the entire program is $1.926 billion, with almost half of that being for the Department of Corrections. As of May 2004, Oregon's inmate population was about 13,000.

About 63% of the total state public safety budget comes from the General Fund–primarily your income taxes. A portion of the budgeted public safety money is passed down to local governments for local courts and corrections systems. Local property tax dollars also support city police, county sheriffs, and jails.

The chart below shows the changes in the General Fund tax support for these three major programs over the period 1989-91 to 2003-05. Amounts are shown in millions and not adjusted for inflation.



Source: Legislative Revenue Office

OTHER PROGRAMS

TRANSPORTATION consists of two agencies, the Oregon Department of Transportation (ODOT) and the Department of Aviation. ODOT is responsible for Oregon's system of highways and bridges, some public transportation services, rail passenger and freight systems, and bicycle and pedestrian paths, in addition to driver licensing and vehicle registration programs, motor carrier operations, and transportation safety programs. Aviation oversees the public and private airports in the state and operates 29 airports directly. The 2003-05 transportation budget of $2.634 billion comes primarily from gas taxes (the Highway Fund), federal funds, and other fees and charges, with only $3.915 million (less than1%) coming from the General Fund.

ECONOMIC & COMMUNITY DEVELOPMENT

This program is responsible for a wide range of services including general economic development, cultural development, workforce related matters including unemployment compensation, the State Fair, benefits counseling for veterans, and financing and development of multi-family affordable housing. Less than one percent of this program's 2003-05 budget of $4.776 billion is funded from the General Fund ($18 million). The remainder of the budget for this program comes primarily from Other Funds, such as fees and charges.

NATURAL RESOURCES. Services of this program area cover a wide range, including technical assistance to farms; advice, policies, and regulations regarding food production; geologic information; protection and enhancement of forests, scenic areas, and parks; fish and wildlife; our statewide land-use program; and the regulation of the disposal of radioactive waste. Of its $1.359 billion current budget, 8.7% or $117.8 million comes from taxes through the General Fund, 8% ($109 million) from Lottery Funds, 17.7% ($241 million) from Federal Funds, and 65.6% ($891 million) from Other Funds.

CONSUMER & BUSINESS SERVICES deals with consumer protection as well as workers' compensation, building codes, and occupational safety. About one percent of the program's $784.6 million budget is from the General Fund and all of that is in the Bureau of Labor and Industries. The Department of Consumer and Business Services and the Public Utility Commission are the only departments that receive federal funds. The 26 other departments are licensing boards and are funded mainly by fees and licenses.

ADMINISTRATION provides support services to state agencies and has management oversight of all executive branch agencies. Agencies budgeted under this program area include the Governor's Office, Department of Revenue, Secretary of State, State Library, and State Treasurer. The program area is budgeted at $4.726 billion if the state retirement plans, funded by employer/employee contributions, are included. If the retirement plans are removed, the Administration program budget is $428.5 million, of which 30% ($129.5 million) comes from the General Fund.

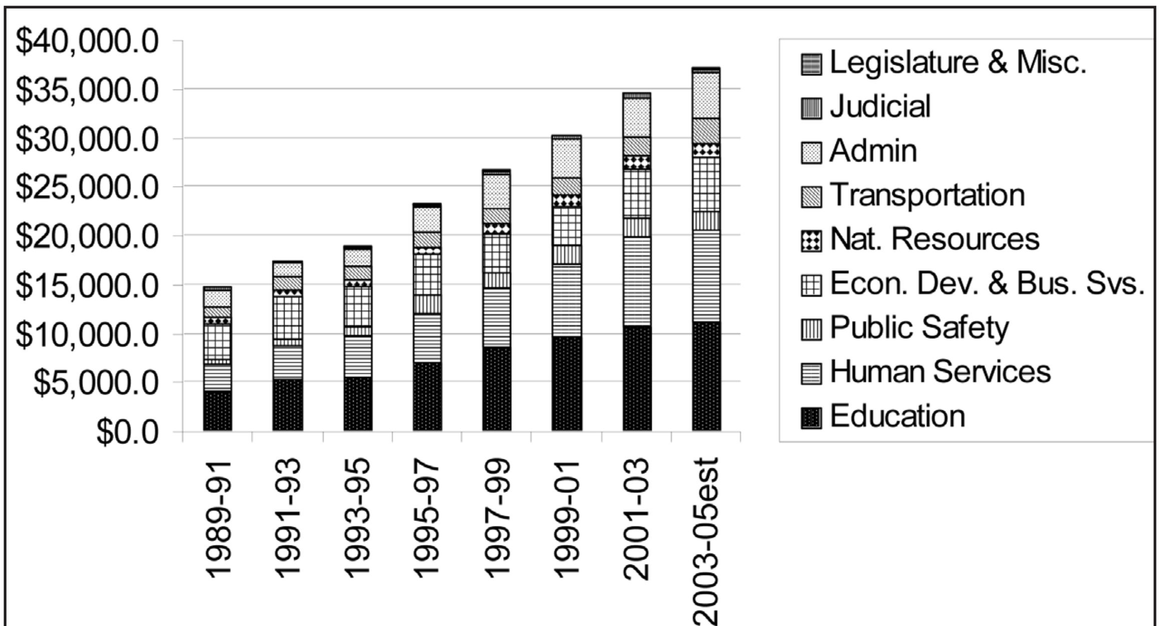
LEGISLATIVE BRANCH includes the Legislature and its support functions. Budgeted at $61.581 million for 2003-05, almost all ($56.6 million or 91%) of this agency's funding comes from the General Fund.

JUDICIAL BRANCH is an independent branch of government that provides legal services to the citizens of Oregon through its appeal courts and through public defense services. The Judicial Branch includes the Supreme Court and the Circuit Courts, but also includes three commissions - Public Defense Services, which provides court-appointed attorney representation for indigent defendants; Court Procedures; and Judicial Fitness and Disability. The approved budget for 2003-05 was $436.4 million, which is predominantly (90.8%) general fund dollars.

THE EMERGENCY FUND is budgeted as "Miscellaneous Total" and consists of money set aside for future allocation between the biennial sessions of the Legislature. Decisions are made by the Emergency Board, which consists of 19 members from the House and Senate. The Emergency Fund for 2003-05 was originally $49 million, some of which has been allocated as needed.

The following bar chart is a view of how the various program budgets have changed over time since the 1989-91 biennium.
Note that the Administration budget includes the state retirement plan (PERS).

All Funds 1989 to 2003-05 (in Millions)



Source: Legislative Revenue Office

STATE SPENDING LIMIT

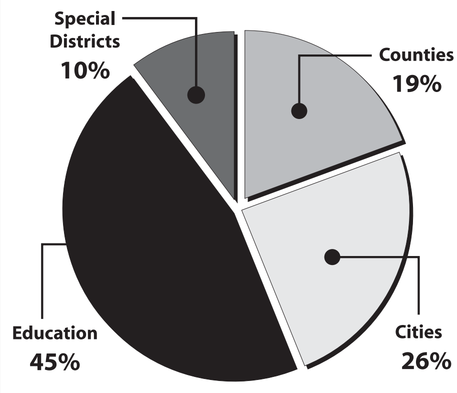
Oregon has a statutory spending cap that limits state appropriations for general governmental purposes to no greater than 8% of projected personal income in Oregon for the same biennium. Twenty-six other states have some form of tax or expenditure limits. Of those, 21 have limits to appropriations or expenditures, four states limit revenue, and Colorado, like Oregon, limits both.

LOCAL EXPENDITURES

Local units of government, including cities, counties, and special districts, are primarily funded by property taxes. Property tax revenues are divided among the various taxing districts that provide services to that property. The chart shows how your property taxes are used. This chart includes amounts spent for debt service on capital project bonds as well as for operating expenses.

In 2001-02 Oregon had more than 1400 taxing districts, categorized as educational and governmental. More than 800 of these districts are special districts for specific purposes such as fire, police, or library services that are provided in other communities by a city or county. Seventeen percent of all districts are cities and 14% are K-12 school districts.

Services provided by local governments include, but are not limited to, libraries, police and sheriffs, jails, fire protection, water, sewers, roads, mental health services, public health services, elections, tax collection, building inspections, ports, hospitals, and parks. Local governments also receive revenue from other taxes (e.g., motel/hotel taxes, local business taxes, a temporary local income tax in Multnomah County), fees, and funding from the state and federal governments.



Source: Oregon Department of Revenue

Important Dates

1979 Kicker and spending limit

1990 Measure 5 — Property Tax limit

1997 Measure 50 — Property Tax limit

2000 Kicker in Constitution

2001 New 8% Spending Limit

CHANGES IN THE SYSTEM

Taxes in Oregon have changed a lot in the last 15 years. This is due to many factors: Oregon's demographics, voter initiatives, economic climate, social and regulatory environment, and the public finance system itself.

Between 1990 and 2002 our population grew from 2.8 million to 3.5 million persons, driving a demand for increased state, local, and school services.

The relative importance of property and income taxes has shifted. The property tax system has been fundamentally altered since the passage in 1990 of Measure 5, which limited the combined local tax rate to $15 per $1000 of each property's real market value. (Bonding for capital projects is exempt from the Measure 5 limits.) Measure 5 caused a decline in property tax collections between 1990 and 1996.

Measure 50, passed in 1997, established a maximum assessed value of a property at 90% of its 1995 real market value and limited future growth in assessed property value to 3% a year. Local voters may change their combined tax rate, by voting for bonds, local option taxes or even new taxing districts. Voter-approved new rates are still subject to the limits established by Measures 5. A double majority vote is required to pass a property tax measure; that is, 50% of the eligible voters must vote, and 50% plus one of those voters must vote to approve. The only exception to this *double majority* rule is a vote during the state general election held in November of every even-numbered year.

The changing tax structure has led to a basically altered relationship between state and local governments. Decisions at the state level about local revenue, such as the property tax limitations, result in greater state control of such programs as education. Measure 5 required the Legislature to compensate for losses in school funding caused by property tax limits for five years (until 1995-96). Afterward, the state continued to take responsibility for funding schools and, at the same time, for equalizing school funding among the districts. Before 1990, local revenues covered about 70% of K-12 school operating costs; now they cover about 30% and the state covers almost 70%. As the state has continued its commitment to fund school needs, less General Fund money has been available to other programs. The result has been that agencies, such as the State Police and the Department of Environmental Quality, have received a smaller proportion of General Fund dollars, forcing changes in these programs.

KICKER. The 1979 Legislature enacted and voters approved the 2% kicker statute along with a spending limit and a major tax-relief plan. In 2000, voters approved a measure to put the kicker into the Constitution. The kicker directs that at the end of each biennium, if actual tax revenue collections are more than 2% above the amount that the state estimated in the adopted budget two years earlier, a refund (for individual taxpayers) or credit (for corporate taxpayers) of all the unanticipated revenue must be paid.

ECONOMY. The General Fund had grown significantly between the 1987-89 budget and the legislatively adopted 2001-03 budget. A major factor for the increase was the rapid rise in personal income tax revenue between 1990 and 2001, caused by both the population growth and the positive economy. A significant growth in capital gains tax revenue from the stock market "bubble" was well above long-term average levels and supported higher budget growth during these years.

Since 2001, due to the recession, the General Fund has shown its vulnerability to the reliance on personal and corporate income taxes. *A Review of Oregon's Tax System*, published in 1998 by the Governor's Tax Review Technical Advisory Committee commented, "We have no experience with economic weakness or recession under the current mix of revenues, but it is likely that a major recession will have a large impact on the General Fund, and, therefore, education funding." That prophecy was fulfilled when the General Fund declined 4.2% from 1999-01 to 2001-03.

GENERAL FUND REVENUE SOURCES (MILLIONS)

Revenue Source	1987-89 Biennium	% of Total	2001-03 Biennium	% of Total	Change in % 1987-89/2001-03
PERSONAL INCOME	$3,009.0	79.2	7,699.5	82.2	+3.0
CORPORATE INCOME	324.5	8.5	420.1	4.45	-4.0
INSURANCE TAX	108.4	2.9	112.8	1.21	-1.7
INHERITANCE TAX	23.2	0.6	116.6	1.25	+0.65
CIGARETTE TAX	128.0	3.4	95.9	1.03	-2.3
OTHER TOBACCO	10.0	0.2	21.9	0.25	+0.05
OTHER TAXES	5.1	0.1	3.4	0.0001	-0.009
NON-TAX REVENUE	193.5	5.1	275.7	9.5	+4.4

OTHER CHANGES. Between 1989 and 1996, the revenue system became more dependent on non-tax revenue sources as property taxes decreased. Federal aid increased from 20% of general revenue to 25% during this period. State and local government charges, such as tuition and fees, increased from 13% to 17% and have accelerated rapidly since 2000. Interest earnings as a share of revenue declined while state lottery funds increased due to the introduction of video poker.

IS TAX REFORM NEEDED?

Given the size of the budget, why do we seem to be short of money for education and other vital programs?

Many Oregonians believe that tax reform (particularly if it involves raising taxes) is not the key to solving Oregon's financial problems, but that the problem is spending. Numerous proposals for cutting costs have been made and one organization has even supported doing away with taxes and depending entirely on user fees.

Changing the tax system does not necessarily mean raising additional revenue. Some tax reform proposals raise more revenue, but others may be *revenue-neutral*. A revenue-neutral reform leaves revenue unchanged. Some people want tax reform to simplify the system, to make it more stable, or to lower tax receipts in order to control the size of government. Some believe that tax reforms could stimulate economic growth and benefit the state in the long run, even if they are revenue-neutral or decrease revenues initially.

Many who call for tax reform feel that criteria of *stability, adequacy, and fairness* must be met in the tax system. Instability is built into Oregon's revenue system by the heavy dependence on the income tax: when incomes go down, state revenues go down by a proportionally greater amount. (Other forms of taxes, such as property taxes, are more stable and must be paid even when business or personal income declines.) In order to judge whether revenues are adequate to fund services, there needs to be agreement on what services are necessary and how much they should cost. If providing agreed-upon services means increasing taxes, there needs to be a willingness to do so, even if this implies that higher-income taxpayers will be subsidizing lower-income taxpayers. This leads into the fairness issue. Should higher-income earners bear more of the burden than lower-income earners?

The concept of fairness brings up the issue of whether taxes should be *progressive.* Taxes are considered progressive if the tax rates increase as the taxable amount increases or as the taxpayer's income increases. If the rate goes down when the taxable amount increases, the tax is *regressive*. Progressive taxes, which require higher-income taxpayers to pay a larger share, are usually considered fairer. Some people think that a *"flat tax"* would be fairest, because everyone would be charged the same percentage. Most sales taxes are flat taxes, because the same percentage is charged no matter what the cost or whether the buyer is rich or poor. However, many people think that flat taxes are less fair. With a flat tax, people with less money have less left to use for essential expenses, after paying the taxes. Flat taxes can be made more progressive by exempting certain items or income levels from the tax.

The following charts show some of the major tax reform proposals that have been made publicly by various organizations. New revenue raised by any of these changes could be used to offset decreases in other taxes. For example new sales taxes could allow decreases in property or income taxes, making the reform revenue-neutral.

In addition to these changes, proposals have been made to increase or decrease tax rates, to add more tax brackets or to have fewer, and to limit tax exemptions and deductions or add more. It is often argued that increasing taxes, while it raises more revenue for government programs, may inhibit economic growth. The Oregon Business Plan White Paper advocates lowering capital gains taxes, tax brackets and income tax rates to encourage economic growth, which itself might produce necessary revenue.

Proposals For Tax Reform

Establish Sales Tax	
Description	**Estimated two-year revenue**
Retail sales tax ranging from 1% to 5%, with and without exemptions	From $1 billion to $6 billion depending on percentage and exemptions
Advantages	**Disadvantages**
Picks up taxes from unreported incomes (e.g. tips, illegal activities)	General price increase would decrease buying power, especially for lower income people
Expands tax base to out-of-state visitors	Would hurt Oregon retailers at state borders
Potentially raises more revenue than other options and is a more reliable source of revenue than income tax although revenue falls during a recession	Relatively expensive to set up and collect (in the tens of millions of dollars: new systems, new audits, collection mechanisms, etc.)
Discourages consumption rather than productive income generating activity	Has been voted down nine times
Taxes paid over time in small amounts	Sales tax base eroding due to growth of services and remote sellers (states with sales taxes have not devised fool-proof means of collecting taxes for online sales)
Disadvantage of regressivity could be offset by rebates and/or exemptions such as food and medicine. Regressivity can be reduced by including services (such as CPAs, hairdressers, car repairs)	Sales tax proposals often coupled with income tax cuts, which would shift advantage to upper-income groups
Property and/or income taxes could be reduced. This could stimulate economic growth.	Lower property or income taxes would mean higher federal taxes, because sales taxes are not currently deductible from federal taxes, whereas property and income taxes are.

Increase corporate income or commercial property taxes	
Description	**Estimated two-year revenue**
Increase corporate income tax rate from 6.6% to 7.6%	$100 million
Increase to 9%	$250 million
Minimum tax from $10 to $500	$70 million
1% surtax	$8 million
Alternative minimum tax (combines higher minimums and alternative tax based on gross receipts or sales)	$250 million
Statewide property tax on commercial/industrial properties (split roll tax)	$600 million
Advantages	**Disadvantages**
Shifts tax burden back to corporations	Potential adverse impact on small businesses
Corporate income or excise tax cannot easily be passed on to consumers because it is applied after total revenues and expenses are calculated	Costs of split-roll tax probably passed on to tenants and customers
Those with greatest ability to pay are taxed the largest amount, thus more equitable to small businesses if the increased minimum tax applies only to C-corporations	Difficult to enforce–creates incentive to find loopholes
	May encourage corporations to leave Oregon

Proposals For Tax Reform

Establish gross receipts tax	
Description	**Estimated two-year revenue**
Business and Occupation Tax (like Washington's)	$490 million
Business Activity Tax (1% rate, first $25,000 exempt)	$900 million
Advantages	**Disadvantages**
Broadens the tax base thus tax rate small	Not well known or understood
Stable because of its broad base	Expensive to administer
May be less regressive than sales tax	Costs may be passed on to consumers

Cut tax breaks (expenditures)	
Advantages	**Disadvantages**
Uses existing tax structure, thus minimal administrative costs	If low-income credits are cut, regressivity increases
Makes system more accountable	Some breaks implement social policy
Raises additional revenue without major reform	Could mean increased dependence on personal income tax
	Reverses past policies based on equity and economic development goals
	Could mean political battle for each tax break change

The following proposals have no direct effect on revenue.

Create reserve (rainy day) fund	
Description	**Estimated two-year revenue**
Abolish "kicker" refunds and invest them in a rainy-day fund.	Doesn't change revenue, just holds on to it.
Advantages	**Disadvantages**
Adds stability to tax system	Requires constitutional change
Improves bond rating standing	Strong voter attachment to "Christmas fund"
If kicker had been banked during 1990s, 2003-05 biennium would have $1.7 billion to use during recession	But may have more support in declining revenue periods when no refund is expected and State needs are high

Require corporate tax disclosure	
Description	**Estimated two-year revenue**
Require corporations to disclose all taxes and exemptions	No effect on revenue
Advantages	**Disadvantages**
Would enable public monitoring of tax breaks	Raises no revenue
Would show shifts in tax burden	Corporations would resist it

WHAT CAN YOU DO?

There are many ways that concerned citizens can have a voice in the fiscal process. The first step is to care about the issue, then learn about it in depth, develop an opinion, and be well informed enough to be able to distinguish between a true remedy and "snake oil." The Internet has numerous sites of every political stripe. (A search on "tax reform Oregon" brings up hundreds of Web addresses.) Newspapers, meetings, forums, and lectures are other sources. People can join organizations supporting a particular cause, contact legislators to advocate for an issue or to ask questions, testify at government hearings, and/or serve on a citizen budget advisory committee. Government budget documents are open to public scrutiny and comment.

WHERE TO GET MORE INFORMATION

League of Women Voters of Oregon:	www.lwvor.org
Oregon Legislative Revenue Office:	www.leg.state.or.us/comm/lro
Oregon Legislative Fiscal Office:	www.leg.state.or.us/comm/lfo
Oregon Department of Revenue:	www.dor.state.or.us
Citizens for Oregon's Future:	www.fororegon.org
Association of Oregon Counties:	www.aocweb.org
League of Oregon Cities:	www.orcities.org
Special Districts of Oregon:	www.sdao.com
Oregon School Boards Association:	www.osba.org
Oregon Education Association:	www.oregoned.org
Portland City Club:	www.pdxcityclub.org
Oregon Center for Public Policy:	www.ocpp.org
Oregon Business Council:	www.orbusinesscouncil.org
Oregon Business Association:	www.oba-online.org
Cascade Policy Institute:	www.cascadepolicy.org
Oregon AFL-CIO:	www.oraflcio.unions-america.com
Utah State Tax Commission:	www.tax.utah.gov
Citizens for Tax Justice:	www.ctj.org
Institute on Taxation and Economic Policy:	www.itep.org
The Center on Budget and Policy Priorities:	www.cbpp.org
Oregon Tax Research:	www.oregontaxes.org
Oregon Governmental Issues Survey:	www.oregonstate.edu/dept/polsci/pgre/oregon00.pdf
Oregon Business Plan	www.OregonBusinessPlan.org

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