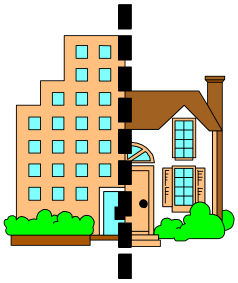
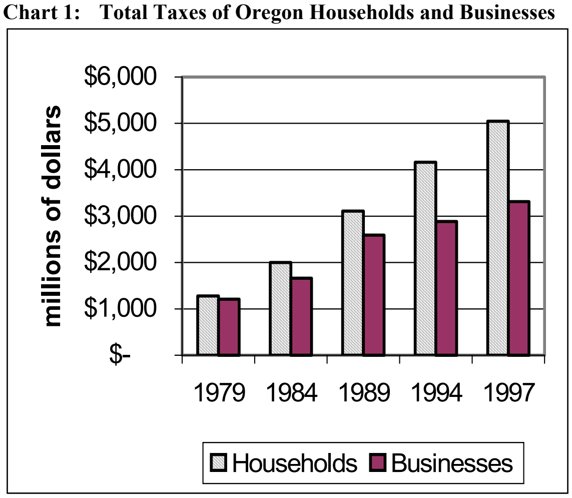
SHIFT IN OREGON HOUSEHOLD AND BUSINESS TAX BURDENS



Twenty years ago, households and businesses each paid roughly half of Oregon's total state and local taxes. Today, households pay over 60% of taxes and businesses less than 40%. Chart 1 shows that during good times (e.g. the 1990s) and bad (the recession in the early 1980s) the tax burden of households has increased faster than that of businesses.

This shift in tax responsibility would be easy to understand if voters or the legislature had voted to reduce business tax rates relative to household tax rates. But no one made that decision. Instead multiple factors have been at work. Voters approved a property tax limitation, Measure 5, in 1990 that produced tax relief primarily for businesses because a strong housing market resulted in rapid increases in home values. The legislature also ended homeowner and renter property tax relief programs that had reduced household tax burdens during the 1980s. In addition, the strong economy of the 1990s boosted income tax collections. As shown in Chart 2, the personal income tax now produces more revenue than the property tax.

Chart 1: Total Taxes of Oregon Households and Businesses



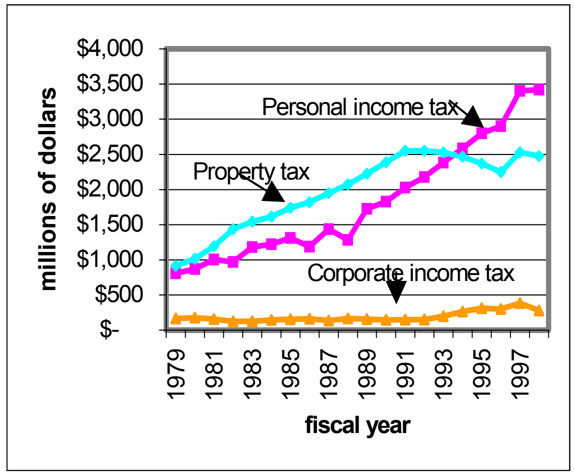
Source: Legislative Revenue Office

Households and businesses pay a variety of state and local taxes as listed in Chart 3. Property taxes are the largest source of tax revenue for cities, counties, and special districts. Property taxes also partially fund schools. Personal income taxes are the main source of state tax revenue. This report focuses on changes in those taxes and in the corporate income tax during the last two decades.

PROPERTY TAX BASICS

Current property tax policy has been shaped by three major pieces of state legislation: the 1979 Tax Reform Package, Measure 5 (1990), and Measure 47 as amended by Measure 50 (1997).

Chart 2: Oregon Major Tax Collections, 1979-1998



Source: Governor's Tax Review Technical Advisory Committee

1979 Tax Reform Package

The 1979 reform package was a response to sharp increases in state population and national inflation as well as California's Proposition 13 and an Oregon property tax limitation measure that had failed in the previous election. The major parts of the package were:

- Limiting General Fund appropriations to an amount tied to the growth of Oregon's personal income;
- Establishing the 2% surplus kicker which refunds personal and corporate income tax collections if revenues are more than 2% higher than the amount the state forecast when the budget was adopted; and
- Creating a property tax relief program that used state revenue to refund up to 30% of the property taxes on owner-occupied homes and to provide renter relief.

The property tax relief portion of the package was rescinded in 1985 because state revenues declined when a recession hit Oregon in the early 1980s. In addition, a separate property tax relief program for low-income households was repealed in 1991.

Chart 3: Total State and Local Taxes in 1997-98

	Tax Revenue (millions)	Share of Revenue
Local Taxes		
Property tax	$2,368	79%
Transit, franchise, and other local taxes	615	21%
Total	$2,983	100%
State Taxes		
Personal income tax	$3,420	65%
Corporate income tax	278	5%
Gas, alcohol, tobacco, and other state taxes (most dedicated to specific purposes)	1,566	30%
Total	$5,264	100%
Total State and Local Taxes	**$8,247**	

Source: Legislative Revenue Office

Measure 5

In 1990 Voters approved Measure 5, a constitutional amendment, designed to limit property taxes. The measure shifted school funding responsibility to the state by phasing in a maximum $5 per $1000 of real market value tax rate for schools and requiring the state to make up lost revenue. In addition, it limited property taxes for non-school purposes to $10 per $1000. Both limits allowed exemptions for capital projects.

As a result of this measure, property tax collections declined by 11.9% between 1990 and 1996. However, these reductions were not shared equally by all classes of taxpayers. In the early 1990s there was a strong surge in residential property values but less increase in commercial and industrial property prices. Since tax bills were determined by multiplying the tax rates (now limited) times the market value of the property (not limited by the measure), homeowners frequently found they received small, if any, reductions in their tax bills. Overall, the property tax bills paid by homeowners increased by 3% between 1990 and 1996, while the bills of landlords and second home owners went down by 3%. The property tax bills paid by businesses decreased by 29%.

Measures 47 and 50

Voters continued to seek property tax relief by approving Measure 47 in 1996 and a revised version, Measure 50, in 1997. Under Measure 50, property taxes are limited by controlling assessed values. The first year, 1997-98, each property was assessed at its 1995-96 real market value, less 10%. This assessed value is allowed to grow by a maximum of 3% a year and cannot exceed real market value. Measure 50 introduced a variety of other tax changes including the “double majority” requirement. Under that requirement, property tax levies may only be approved at a general election or at another election at which at least half of the registered voters cast a ballot.

Chart 4: Shift in Property Tax Payments

	1978-79	1996-97
Households		
Property taxes	$430	$1,392
State relief	-100	-5
Total Households	$330	$1,387
Share of payments	*40%*	*60%*
Businesses	$486	$1,136
Share of payments	*60%*	*40%*
Total Property Taxes	**$816**	**$2,523**
	Dollar figures in millions	

Source: Legislative Revenue Office

Resulting Changes in Household and Business Tax Burdens

Chart 4 shows that in 1978-79, households paid 40% of the property taxes and businesses 60%. By 1996-97, these proportions were reversed. Measure 50 should alter this trend because owners of residential property benefited more from the rollback in assessed values and will receive a greater benefit in the future from the 3% limitation on growth in assessed value.

INCOME TAX BASICS

Oregon relies on personal and corporate income taxes to fund education, human services, public safety, the legislative and judicial branches of government, and other General Fund functions. In 1997-99, 85% of the $8,504 million in General Fund revenues came from the personal income tax, 8% from the corporate income tax, and 7% from other sources. With less property tax funding for schools, the income tax has become the primary source of funds for K-12 education.

Personal Income Tax

Oregonians and non-residents who work in Oregon pay personal income taxes at rates that range from 5 to 9% of taxable income. The personal income tax is considered a progressive tax since it taxes higher income households more than lower income households.

Corporate Income Tax

Corporations are assessed a 6.6% Corporate Excise Tax, payable on operations within Oregon. About 70,000 corporations submit tax returns yearly. Of these, about 32,000 are S corporations, which pay only an annual $10 charge. These small businesses with a limited number of shareholders pass their earnings to the shareholders who then pay taxes on the earnings as part of their personal incomes.

Oregon’s corporate income tax is highly concentrated. Of the 37,000 corporations that paid corporate taxes in 1995, the largest ten companies paid 30% of the total. Furthermore, about 2% of the payers (778 firms) accounted for 78% of the revenue.

Most businesses do not pay corporate income tax because they are not incorporated. Sole proprietors and partners, for example, pay the personal income tax on their business incomes. (This type of business tax payment was taken into account in the analysis of the tax shift shown in Chart 1. In that analysis the income reported on the business schedules of the personal income tax returns was separated from other personal income. The tax on business income was assigned to the business category while the tax on other personal income was assigned to households.)

The 2% Surplus Kicker

The 2% surplus kicker provides personal and corporate income taxpayers a tax refund or credit if actual revenues are more than 2% higher than the amount the state forecast at the end of the legislative session. The original goal of the kicker was to give priority to tax reduction if revenues exceed the forecast. Before its enactment many taxpayers felt that surplus revenues were automatically spent without considering tax cuts.

This law divides all General Fund money into two categories: 1) corporate taxes, and 2) all other revenues including personal income taxes. At the conclusion of each biennium, if actual collections in either category are more than 2% above the amount the state forecast, then a refund or credit must be paid. The kicker may be triggered in either category and, if triggered, all money in that category in excess of the forecast, including the surplus 2%, must be returned to taxpayers. Corporations receive their kicker as tax credits and personal income taxpayers as refund checks in early December.

As Chart 5 shows, the personal kicker has been triggered in all but one biennium since 1983-85, and the corporate kicker nearly as often. Corporate profits are especially difficult to predict, and, as the chart shows, actual revenues often vary greatly from the close of session forecast. The legislature suspended the personal kicker in 1991 and the corporate kicker in 1993 to help meet its increased responsibilities for funding schools under Measure 5. Because the kicker law divides the money into two pots, refunds can exceed the surplus. This year the total surplus is $98 million, but $167 million is being refunded to personal income taxpayers.

Chart 5: History of Surplus Kicker

	PERSONAL KICKER		CORPORATE KICKER	
Biennium	Surplus/ Shortfall ($ million)	Credit/ Refund (% of liability)	Surplus/ Shortfall ($ million)	Credit (% of liability)
1979-81	-141	None	-25	None
1981-83	-115	None	-110	None
1983-85	89	7.7%	13	10.6%
1985-87	221	16.6%	7	6.2%
1987-89	175	9.8%	36	19.7%
1989-91	186	Suspended	-23	None
1991-93	60	None	18	Suspended
1993-95	163	6.27%	167	50.1%
1995-97	432	14.4%	203	42.2%
1997-99	167	4.57%	-69	None

Source: Legislative Revenue Office and Office of Economic Analysis

Resulting Changes in Household and Business Tax Burdens

Oregon's increasing reliance on the income tax, which is predominately paid by households, is one of the factors increasing the tax burdens of households. Personal income tax collections have risen because of the growth in wages and salaries and the surge in capital gains. Corporate tax collections also rose rapidly from 1993 to 1997, but a substantial part of the increased revenue was returned to corporations because of the surplus kicker law.

COMPARISON WITH OTHER STATES

Oregon has the distinction of being one of the few states without a sales tax, which taxpayers pay in small increments. Instead, Oregon relies on income and property taxes with highly visible large payments. As a result, some feel we are a high tax state. In reality in 1995-96, Oregonians paid less total taxes as a percentage of personal income than residents of many other states. Oregon ranked #37 out of 51 states (counting the District of Columbia) on taxes paid. Oregon's personal income tax burden, however, was second only to that of New York state residents. The corporate income tax ranked at #29. Oregonians paid property taxes at about the same percentage of personal income as the national average, ranked #25 in 1995-96; ten years ago we ranked #7.

Households do pay a large share of Oregon's taxes. Oregon ranked #5 in 1995-96 in the share of total taxes paid by households while the share paid by businesses was low at #43. Washington state had nearly the opposite rankings—the share of taxes paid by households ranked #45 and the share paid by businesses ranked #4.

ADVANTAGES OF LOW AND HIGH BUSINESS TAX SHARES

Ultimately all taxes are paid by individuals. Taxes that are initially paid by businesses are paid by owners as lower profits, workers as lower wages, or consumers as higher prices. It is not clear who finally pays Oregon's business taxes. We do not know how much is paid by Oregonians and how much by others. The legislature has appropriated funds to carry out a tax incidence study that should help sort who ultimately pays these taxes. Without a study of this sort, the arguments for and against low business taxes are mostly about perceptions.

Low business taxes help create a favorable business climate that attracts new firms and encourages existing firms to expand. However, taxes make up only a small portion of business costs and may be less important than factors such as a skilled work force and good transportation systems.

When businesses pay a high share of taxes, individual taxpayers feel they get more value for their tax dollar. Government services don't seem to cost as much.

PROPOSALS TO INCREASE THE BUSINESS SHARE OF TAXES

Split-Roll Property Taxes

When it became apparent that households and businesses were not receiving equal benefits from Measure 5, the idea of taxing business property at a higher rate than residential property emerged. A split-roll property tax initiative made the ballot in 1992. This measure would have kept the Measure 5 limit of $5 per $1,000 of real market value for schools on primary residences, but would have raised the limit to $20 per $1,000 of real market value for all other properties. The measure was soundly defeated—only 30% of the voters approved the measure.

Equal Personal and Corporate Income Tax Rates

In 1997 several initiatives were drafted that proposed equalizing corporate and personal income tax rates and limiting the corporate kicker percentage to the rate personal payers were receiving. Legal challenges delayed signature collection, and none of the measures made it to the ballot.

Temporary Increase in Corporate Tax Rates

During the 1999 legislative session, Governor Kitzhaber proposed a two-year temporary boost in corporate income tax rates from 6.6 to 8.6% to help fund schools. The legislature did not seriously consider the idea.

CRITERIA FOR EVALUATING TAX SYSTEMS

The distribution of the tax burdens of businesses and households is only one of many criteria for evaluating Oregon's tax system. Other criteria one might consider include:

- Equity among classes of taxpayers (e.g. households with similar incomes);
- Stability;
- Ease and cost of administration and compliance;
- Benefits received;
- Ability to pay; and
- Flexibility during times of economic and population change.

Recently Governor Kitzhaber asked a Tax Review Policy Advisory Committee to examine tax policy changes that might improve the stability of Oregon's tax system and help in meeting other goals of the state. Stability is a major concern because the state is highly dependent upon income taxes that fluctuate with the economy. An economic downturn could force the legislature to make some hard choices about raising taxes or cutting spending. The issue is especially acute because Oregon is one of five states which does not have a stabilization fund, where money is put in reserve in good times to maintain services during lean years. The review committee also looked at ways that tax policy could be made more consistent with goals to improve the environment, to help people move from welfare to work, and to promote job training and education.

CURRENT TAX PROPOSALS

None of the tax measures currently being discussed for the November 2000 elections directly address the share of business and household tax burdens. The legislature has referred a constitutional amendment to the voters that would put the surplus kicker law into the constitution. The legislature has also referred a measure to increase the amount of federal income taxes that can be deducted on personal income taxes, and an initiative is circulating that would raise the deduction more. Governor Kitzhaber has launched an initiative campaign to put on the ballot constitutional amendments that comprise his school finance plan. The main change proposed is the creation of a stabilization ("rainy day") fund for schools.

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October 1999

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Editing: Natalie Crom, Judy Davis, Paula Krane, Margaret Noel, Dee Ratsch

Contributions were also made by the following people
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