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GOVERNOR

Review of Oregon's Tax System

Prepared by the
Governor's Tax Review
Technical Advisory Committee

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EXECUTIVE SUMMARY

Oregon's economy, demographics, social, and regulatory environment, as well as its overall public finance system, have changed in fundamental ways since 1980. In 1980 the timber industry was the state's dominant economic force. Oregon's economy is now more balanced with high technology manufacturing and services playing a prominent role. Its citizens have grown in numbers while aging and becoming more ethnically and racially diverse. The children of the large baby boom generation fill the state's education system. New residents have brought new ideas and raised the overall education level. Deregulation has swept through major industries such as utilities, transportation, and banking. At the same time the timber and agriculture industries have become more constrained by environmental regulations. These forces have indirectly brought major changes in the state's public finance system. Oregon's voters have brought even more fundamental change directly through the initiative process.

KEY FINDINGS

1. The Oregon tax system has changed significantly over the past decade as a result of voter initiatives and the changing economy. The most important change is a shift in the relative importance of the property and income taxes, the two main taxes which account for approximately 75 percent of state and local tax revenue. While the property tax was once the largest tax, we now rely more on the state-collected income tax. We also increasingly rely on income taxes to fund our educational system. Further, the property tax system itself has been fundamentally altered. Measure 5 caused property tax collections to decline between 1990 and 1996. Measure 50 will limit future property tax revenue growth through a cap on value increases. We have little experience under this new system, but some trends are apparent, and are the subject of many of the findings and policy issues.
2. While Oregon's economy is more diverse and stable than it was a decade ago, the revenue system is now more sensitive to changes in the economy. Oregon's economy is evolving from a resource based economy to one based more on high technology and services. Historically, the state's General Fund has been sensitive to economic changes because it relies heavily on income taxes. We have no experience with economic weakness or recession under the current mix of revenues and responsibilities, but it is likely that a major recession would have a large impact on the General Fund and, therefore, education funding. We also have no experience with an environment of higher inflation. It seems likely that local government revenue will grow more slowly than the economy, particularly in times of inflation. These issues lead the Committee to identify revenue stability as the key policy issue for the tax system.
3. The changing tax structure leads to a fundamentally altered relationship between state and local governments. Local government revenues are limited. Decisions made at the state level about local revenue sources, such as the property tax, directly affect local revenues. With local revenues declining, the state has increasing control over education funding. The separation between revenue decisions and expenditure decisions changes the balance of power and can lead to tensions between state and local governments.
4. The tax system has become less regressive with the shift in the relative importance of income and property taxes. While the overall tax burden as a share of income has decreased, the impact is not the same for all groups. The declining property tax, rising property values for residential property, and the shift to the income tax all contribute to a rising tax burden for households compared to businesses. Oregon relies more on "direct taxes" paid by individuals and less on taxes paid by

businesses (which are ultimately passed on to individuals). The final impact, or incidence, of taxes is unknown.

5. The new property tax system may also present future equity issues. Specifically, the separation of assessed values from market values may lead to “horizontal inequities” with similar properties being taxed differently. Further, these inequities will be more difficult to correct than under the pre-Measure 50 system.

KEY POLICY QUESTIONS

1. Should state government have a policy mechanism to protect against downside revenue risk? Currently state law returns unanticipated General Fund revenue collections (those in excess of forecast levels) to taxpayers. Should there be a mechanism, such as a reserve fund, in case of unanticipated revenue shortfalls?
2. Should local governments and schools be given more revenue flexibility for responding to changing short-term economic conditions and public service demands?
3. Should Oregon’s tax code be made more consistent with work force quality, business competitiveness, environmental, and growth management policy goals as outlined in *Oregon Shines II*?
4. Should steps be taken to counter potential horizontal inequities created by Measure 50? The complex system established by Measure 50 is likely to generate situations in which home owners living in similarly valued properties in the same community pay different taxes. Should policies be designed to mitigate the inequities caused by these situations?

COMMITTEE RECOMMENDATIONS

To better address the policy questions raised in this document, now and in the future, the Committee recommends the following actions:

1. Improve the tools for tax analysis. The establishment of a biennial tax expenditure report in 1995 was a positive step. This report should be complemented by a periodic tax incidence report. Such a report would give policy makers a better understanding of equity and business competitiveness issues surrounding the state’s tax system.
2. Establish separate processes to examine forest land taxation and the taxation of intangible property. These processes should include a broad based group of interested parties.
3. Periodic comprehensive reviews of the tax system should be carried out. With Oregon’s economy and tax system sure to change in unpredictable ways, these reviews are important for establishing the context in which tax policy decisions are made.

GOVERNOR'S CHARGE

Governor Kitzhaber charged the Committee with the task of making a detailed examination of the state's overall tax system. The Governor cited dramatic changes in the state's economy, demographic structure, and public finance system over the past 15 years. He directed the Committee to assess the implications of these changes on Oregon's tax system. Specifically, the Governor told the Committee, "...I am interested in knowing if we need to change our system in terms of fairness, stability, and economic incentives."

The Governor instructed the Committee to report on a set of findings reflecting changes in the state's public finance system since 1980. Based on these findings, the Committee was further charged with developing a set of policy questions to be pursued by a subsequent committee.

SCOPE OF STUDY

This report is designed to meet the charge issued by the Governor. It addresses each of the major issues specified in the charge: stability, equity, and social policy. At the request of the Governor, the report also addresses the issues of timber and intangibles taxation. The report provides a list of "findings" on each major issue. These findings are observations by the Committee of tax system experts. They represent a consensus among these experts on a set of facts. A set of policy questions developed by the Committee follows the findings. The findings or trends imply the policy questions.

The overall purpose of the report is to provide context for the policy recommendation group, which will follow. The Committee hopes that the findings and policy questions on the key issues surrounding the tax system will provide the policy committee a sound starting point for developing specific policy recommendations for consideration by the 1999 Legislature.

Although the task undertaken in this study is a complex one, it is important to point out limits of the report. Perhaps this can best be done by specifying what the report is *NOT* intended to do:

1. Make policy recommendations.
2. Comprehensively examine the variations among local governments.
3. Conduct original research.
4. Investigate new revenue sources.
5. Examine the political dynamics surrounding the tax system.

The Committee also excluded two important revenue sources: transportation taxes and the Lottery. The Committee decided to focus on broad based revenue sources, thereby leaving out these unique funding sources. Transportation taxes are explicitly tied to the state's transportation infrastructure. They warrant a specific analysis concentrated on transportation issues. Though not a tax, the Oregon Lottery has played a significant role in the Oregon education funding system in the 1990's. Growing revenue from the Lottery has reduced the need for general purpose funding sources such as the income tax. Despite its importance, the Committee concluded that unique issues surrounding the Lottery made it more suited for a separate analysis.

CHAPTER 1: OREGON'S CHANGING PUBLIC FINANCE SYSTEM

INTRODUCTION

Oregon's public finance system has changed dramatically since 1980. The restructuring of Oregon's economy and its changing demographic composition explain part of the change. However, Oregon voters have made the biggest impact on the public finance system, through the initiative process.

Oregon's two largest taxes have taken radically different paths, especially in the 1990s. Income taxes, both personal and corporate, increased significantly in response to a rapidly growing economy. Property taxes, on the other hand, have been restricted by voter initiatives. The different growth patterns for Oregon's two major taxes caused significant shifts in funding responsibilities between the levels of government. This is most pronounced in the area of school finance.

A changing federal government role shaped the shifts in responsibilities between state and local governments within Oregon. Many federal government responsibilities have shifted to state and local governments since 1980.

This chapter sets the context for the detailed analysis of the tax system contained in the rest of the document. The first section of the chapter is an overview of taxation and the use of taxes. This is followed by an overview of the state's changing economy and highlights of Oregon's changing demographics. The next two sections focus on the state's changing revenue system and the changes resulting from the Measure 50 property tax limitation. The final section assesses the impact of the changing revenue system on the service responsibilities of the different levels of government.

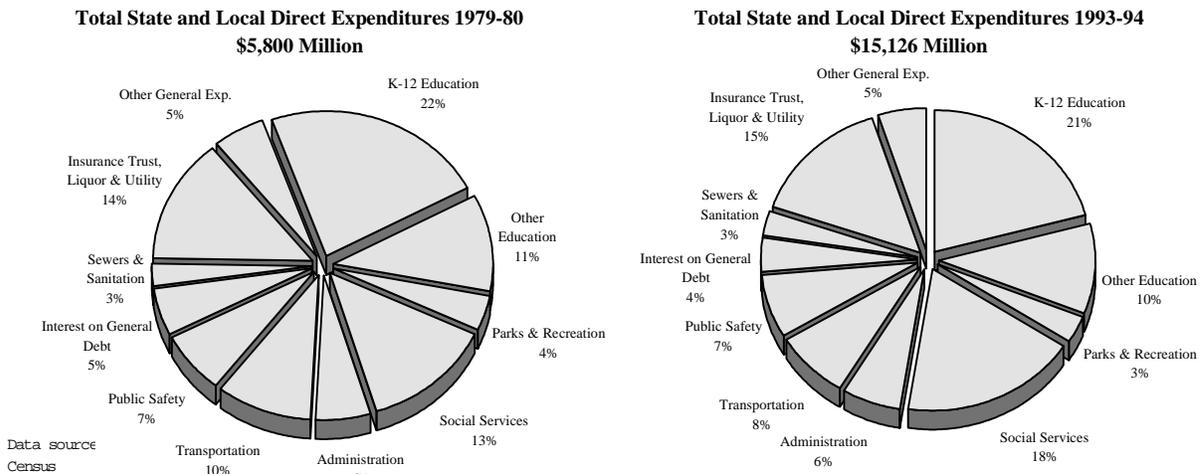
USES OF TAXES

First and foremost, taxes exist to fund services. People are willing to pay taxes to government because they desire the outcome or service funded by tax revenues. Governments provide a wide array of services. These range from core services such as education and public safety to targeted services such as public assistance. Both the level and the efficiency with which these services are delivered have a major impact on a state's overall social and economic environment.

Between 1980 and 1994, combined state and local expenditure patterns point out the increasing share of revenues absorbed by social services (see Figure 1.1 on the next page). Transportation, parks and recreation, and education spending have all shown slight reductions as a proportion of total expenditures.

What Figure 1.1 does not show is the shift from local funding to state funding for many of these expenditures. Measure 5 reduced the amount of education funded by local property tax revenues and increased the level of state funding. In addition, Measure 50 limited the ability of local governments to raise revenues. Clearly, changes to the tax system change the relative power of state and local governments. This in turn changes what, how much, and how efficiently government services are provided. City, county, and other non-school taxes are set locally. The revenues associated with these taxes provide different levels of service in different areas. Substituting a statewide source for these local revenues shifts power to the state. It also changes spending incentives in two fundamental ways: 1) local officials are spending "state money" rather than taxes from local taxpayers; and 2) the amount of revenue and services available in each local area reflects the state's idea of a "fair" distribution of funds rather

Figure 1.1



than local choices to pay for a self selected level of service. The shift from local funding revenue sources to state revenue sources is discussed further throughout this document.

THE CHANGING ECONOMY

Two major forces have shaped Oregon's economy since 1980. First, high technology and services now play a more important role in the economy. Timber is less dominant. Second, the economy grew rapidly, especially during the 1990s. Key changes and forces within the economy are outlined below:

- Total nonfarm employment increased 41.2 percent between 1980 and 1997.
- Since 1988, Oregon's per capita income grew much faster than average per capita income across the United States. It increased from 90 percent of the U.S. average in 1988 to over 95 percent of the U.S. average in 1996.
- Service-producing sectors (which include business services and health services) are now a larger segment of the economy than goods producing sectors (which include manufacturing and agriculture) (see Table 1.1).

Table 1.1
Changes in Gross State Product (GSP) by Industry
1980-1994 (Current Dollars)

	1980	1994	% Chg 1980-94
Total Gross State Product (Millions)	\$ 30,655	\$ 74,366	143%
Composition of GSP			
Industry Detail	1980	1994	% Chg
Agriculture, forestry, fish	1,141	2,215	94%
Mining	90	96	7%
Construction	1,583	3,447	118%
Manufacturing	6,974	14,814	112%
Durable goods	5,431	11,260	107%
Lumber & wood	2,626	3,705	41%
Metals	868	1,110	28%
Industrial machinery	499	946	90%
Electronic equipment	339	3,472	924%
Transportation Equip.	292	706	142%
Instruments and Rel. Prod	560	701	25%
Other Durables	247	620	151%
Nondurable goods	1,543	3,554	130%
Food & kindred products	584	1,188	103%
Paper products	468	968	107%
Printing & publishing	234	750	221%
Other Nondurables	257	647	152%
Transportation & Utilities	2,914	5,909	103%
Transportation	1,216	2,720	124%
Comm. and Utilities	1,698	3,189	88%
Wholesale trade	2,407	5,888	145%
Retail trade	2,780	6,773	144%
Finance, Ins., & Real Estate	5,029	12,464	148%
Services	3,933	13,248	237%
Business services	548	2,596	374%
Health services	1,338	4,381	227%
Other Services	2,049	6,305	208%
Government	3,804	9,511	150%

Note: GSP is the sum of all goods and services produced in the state.
Office of Economic Analysis, Department of Administrative Service
Data Source: Department of Commerce, Bureau of Economic Analysis

- Within goods producing industries, electronics is rapidly growing while lumber and wood products declines (see Table 1.1 on the previous page).
- Eight of the top 15 industries (in terms of payroll) in 1980 declined after adjustment for inflation. In 1980, timber-related industries dominated the payroll rankings. In 1996, the top two payroll contributing industries were semiconductors and health services. Help supply services emerged as a major component of the economy in the 1990s. In 1980, this sector was very small (see Table 1.2).

Table 1.2
Top 15 Standard Industrial Classification (SIC) Codes in 1980
Ranked by 1980 Total Payroll (Payroll in Millions of 1996 Dollars)

Industry Description	1980	1996	Percent
	Total Payroll	Total Payroll	Chg
2421 Sawmills and planing mills	896.8	466.4	-48%
2436 Softwood veneer and plywood	789.7	317.2	-60%
8062 General medical and surgical hospital	626.4	1,132.0	81%
5812 Eating places	591.5	927.2	57%
3825 Instruments to measure electricity	545.1	264.0	-52%
5311 Department stores	507.7	464.1	-9%
5411 Grocery stores	492.8	625.7	27%
4811 Telephone communication *	469.0	289.5	-38%
2411 Logging camps and logging contractors	459.3	265.6	-42%
4213 Trucking, except local	456.7	396.5	-13%
8011 Offices and clinics of medical doctors	426.6	1,076.3	152%
5511 New and Used Cars	306.1	500.5	64%
4911 Electric services	295.5	322.4	9%
6025 National commercial banks *	253.7	413.5	63%
2621 Paper mills, except building paper	252.8	167.2	-34%

* In 1996 SIC 4813 and SIC 6021 were used instead.

Top 15 Standard Industrial Classification Codes in 1996
Ranked by 1996 Total Payroll (Payroll in Millions of 1996 Dollars)

Industry Description	1996	1980	Percent
	Total Payroll	Total Payroll	Chg
3674 Semiconductors and related devices	1,157.0	124.2	832%
8062 General medical and surgical hospital	1,132.0	626.4	81%
8011 Offices and clinics of medical doctors	1,076.3	426.6	152%
5812 Eating places	927.2	591.5	57%
5411 Grocery stores	625.7	492.8	27%
7363 Help supply services *	587.2	48.3	1115%
5511 New and Used Cars	500.5	306.1	64%
5311 Department stores	464.1	507.7	-9%
2421 Sawmills and planing mills	466.4	896.8	-48%
1711 Plumbing, heating, air-conditioning	434.9	242.6	79%
6021 National commercial banks *	413.5	253.7	63%
1731 Electrical work	410.4	223.4	84%
4213 Trucking, except local	396.5	456.7	-13%
8711 Engineering services *	360.4	224.4	61%
4911 Electric services	322.4	295.5	9%

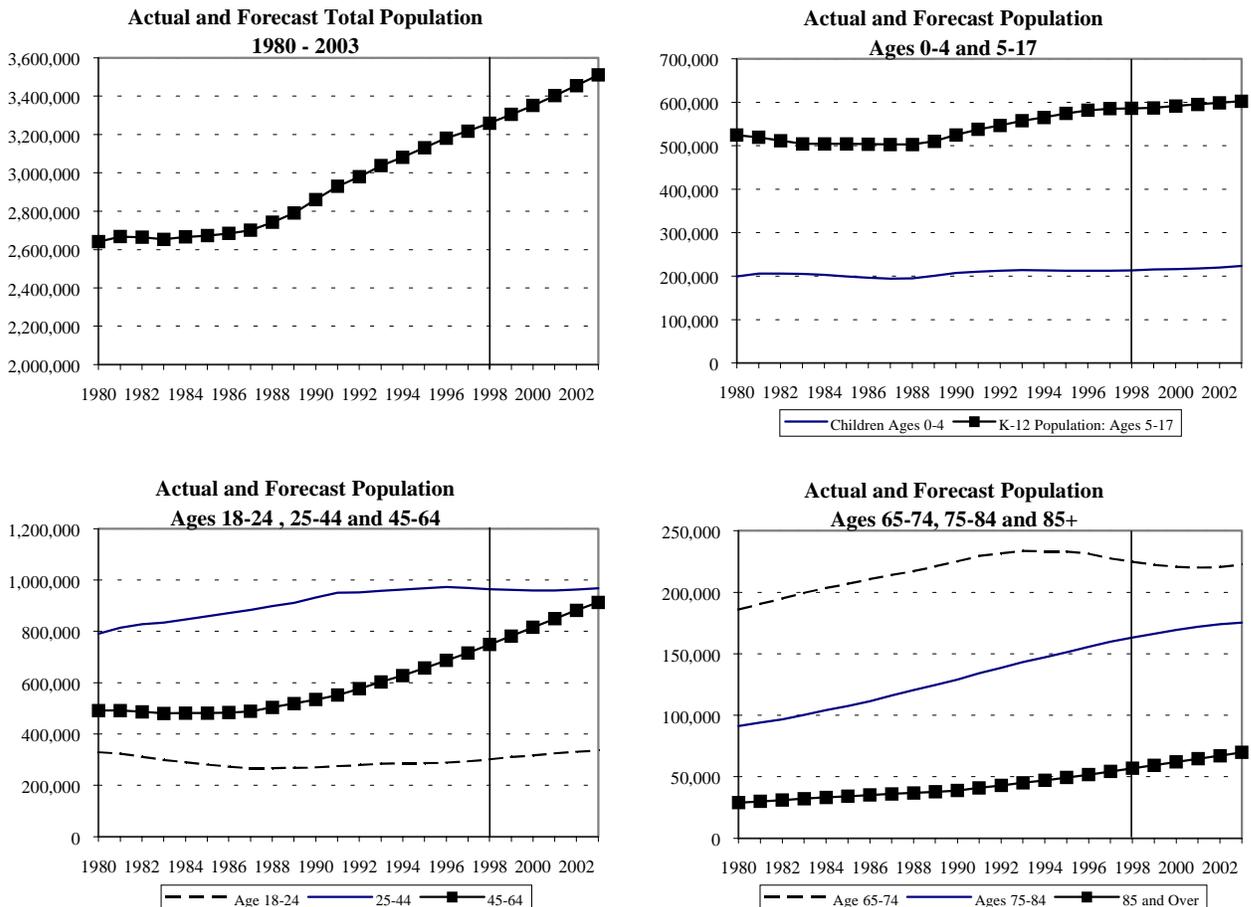
* In 1980, SIC 7362, SIC 6025, and SIC 8911 were used instead.

CHANGING DEMOGRAPHICS

Between 1980 and 1997, Oregon's population increased from 2.64 million to 3.22 million, an increase of 21.9 percent. It is likely to continue to grow faster than the U.S. as a whole over the next 50 years. Some of the key forces shaping Oregon's population are listed below and are shown graphically in Figure 1.2:

- Over the next five years, rapid growth is expected for 18-to-24-year-olds, 45-to-64-year-olds, and those over 75.
- Slower growth is expected for the school age population (5-17 years), 25-to-44-year-olds, and 65-to-74-year-olds.
- The number of people in their prime working years is increasing in the state. These workers tend to have higher incomes and pay more taxes than other age cohorts.
- After 2010, the retirement age population will grow rapidly.
- Strong in-migration from other states characterized the 1990s. Recent migrants tend to be younger, better educated and over-represented in professional occupations. They have lower incomes than longer term residents (see Table 1.3 on the next page).

Figure 1.2



- The percentage of adults participating in the labor force continues to increase. Women are responsible for much of the increase. Labor force participation for this group has increased from 50 percent in 1980 to 60 percent in 1990. This may be linked to the fact that child care is easier to obtain and that many households are finding they need two incomes to maintain or improve their standard of living. An additional factor increasing the overall labor force participation rate is older workers remaining in the labor markets longer or returning to the labor markets after retirement.

Table 1.3
Characteristics of Recent In-migrants, 1996 Oregon Population Survey

Residency Five Years Ago		Place of Origin for In-migrants		Destination: Oregon	
Residency	Percent	State/Country	Percent	Region/County	Percent
Same house	52%	California	37%	Clackamas, Multnomah,	
Different house, same county	24%	Washington	14%	Washington, Yamhill	44%
Different county, Oregon	11%	Other States	41%	Benton, Lane, Linn, Marion, Polk	25%
Other state	13%	Abroad	7%	Coos, Curry, Douglas, Jackson, Josephine	15%
Abroad	1%			Other Counties	16%

Migration Status	Completed Education (25 years and older)			Occupation (Ages 18-64)		
	< High School	High School	Bachelors +	Professional	Manager/Owner	Other
Resident	9%	63%	28%	19%	13%	69%
In-migrant	6%	51%	42%	32%	14%	54%
Total	9%	61%	30%	21%	13%	67%

Migration Status	Age Group		Race Ethnicity		Home Ownership Status	
	18-64	65 & Over	White	Non-White	Owner	Renter/Other
Resident	78%	22%	96%	4%	71%	29%
In-migrant	89%	11%	94%	6%	42%	58%
Total	80%	20%	96%	4%	67%	33%

Migration Status	Annual Household Income						Poverty Level	
	<\$10,000	\$10-\$20,000	\$20-\$30,000	\$30-\$45,000	\$45-\$75,000	over \$75,000	Above	Below
Resident	11%	17%	16%	21%	23%	11%	89%	11%
In-migrant	11%	20%	18%	22%	19%	10%	88%	12%
Total	11%	17%	17%	22%	22%	11%	89%	11%

Source: 1996 Oregon Population Survey

OTHER INFLUENCES ON THE ECONOMY

Changing Technology

Changes in technology affect both individuals and corporations in Oregon. The booming economy in the 1990s is in large part due to the rapid expansion of high technology firms. However, this is not the only impact of changing technology on the economy. Advances in technology alter the internal dynamics of organizations throughout the state. Computers facilitate productivity improvements, reducing the need for additional employees. The Internet facilitates communication through e-mail, reduces information access time, and provides new methods of commerce. The use of just-in-time manufacturing cuts inventory costs, waiting times, and as a result, improves the global competitiveness of firms.

New technologies also change the nature of businesses. Historically, companies could be valued largely based on tangible goods such as equipment, buildings, and land. Today, more and more of a firm's worth, especially those in the software and communications industries, is based on intangible goods such as intellectual property and licenses. The value attributed to them is difficult to measure, especially when the value or cost of these intangibles changes dramatically over time or is valued differently between firms.

Changing Regulatory Environment

Significant changes in the regulatory climate have accompanied the changing economy. For some industries, deregulation has been a major force. For other industries, increased government regulations have had major effects on private decision making.

The energy, communication, and transportation industries have gone through a period of deregulation since 1980. This process often triggers a reassessment of tax policy in light of the new less-regulated environment.

Regulatory constraints have increased in other areas. This is particularly true of activities affecting the natural environment. Growing environmental restrictions designed to protect the air, water, and wildlife influence both the state's timber and agriculture industries.

The Governor directed the Committee to examine two specific tax issues that were the subject of significant discussion during the 1997 Legislative session. The first issue is the inclusion of intangible assets held by public utilities, which are currently subject to the property tax. The second issue is the taxation of timber. Regulatory changes since 1980 have significantly altered the competitive environment for both of these industries. In the case of public utilities, deregulation is the trend. For the timber industry, environmental regulations play an important role.

The specific issues of timber taxation and the taxation of public utility intangible property are discussed in Chapter 5.

REVENUE SOURCES

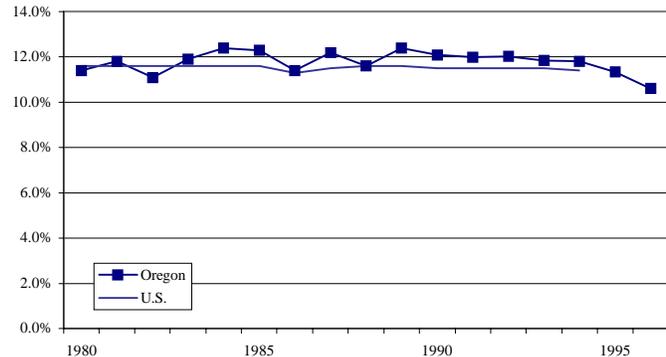
Ballot measure initiatives passed by voters, a changing economy, and changing demographics have altered Oregon's tax system.

The total state and local tax burden, measured by dividing tax collections by personal income, declined in the 1990s after remaining essentially flat throughout the 1980s (see Figure 1.3). The implementation of Ballot Measure 5 over the 1991 to 1996 period was the primary reason for the decline.

The mix of total revenue sources, including charges, fees, and federal government transfers, has changed since 1980 (see Figure 1.4 below and Table 1.4 on the next page).

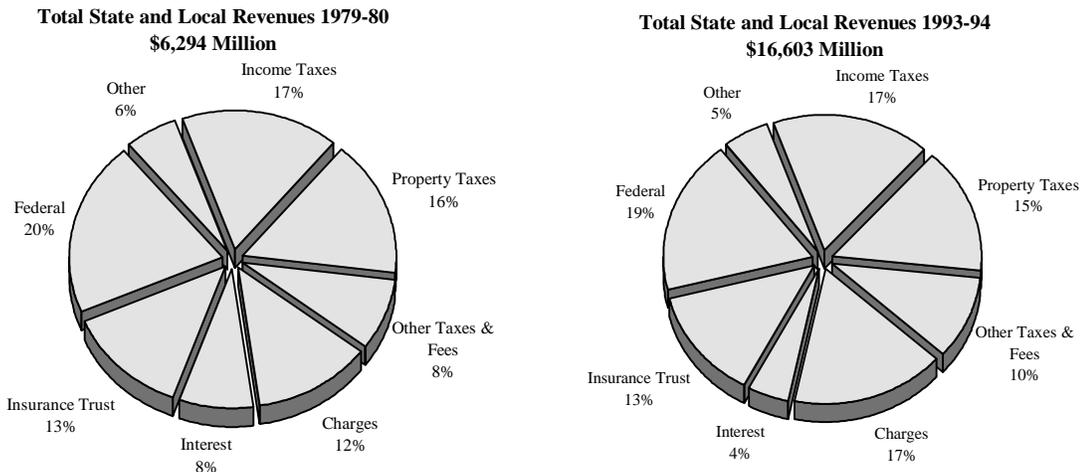
Figure 1.3

Total Taxes as a Percent of Personal Income



Source: Legislative Revenue Office, 1998

Figure 1.4



Insurance Trust revenues include: Unemployment compensation, employee retirement and workers compensation

Data Source: Census

Table 1.4
Oregon Tax Revenue
Fiscal Years 1985 vs 1996, Millions of Current Dollars

	CY 1985	CY 1996	% Change
Total Personal Income (Billions of \$)	\$ 34,998	\$ 73,922	111.2%

	FY 1985 Collections	FY 1996 Collections	% Change FY '85-96
State Taxes			
Personal Income Tax	1,310.7	2,901.7	121.4%
Gasoline and Use Fuel Taxes	118.6	373.4	214.9%
Corporate Income Taxes	153.8	300.5	95.3%
Unemployment Insurance Taxes	269.7	277.1	2.8%
Weight-Mile Tax	89.1	205.0	130.1%
Cigarette Tax	58.7	109.2	86.0%
Insurance Taxes	37.8	69.7	84.3%
Other Employer-Employee Taxes	54.8	67.4	23.2%
Timber Severance Taxes	28.9	55.1	90.8%
Gift and Inheritance Taxes	29.1	41.3	42.1%
Workers Compensation Insurance Taxes	54.0	33.3	-38.3%
Telephone Exchange Access Tax (911)	7.9	17.6	121.9%
Real Estate Recording Tax (Assessors)	-	12.0	N/A
Other Tobacco Products Tax	-	11.0	N/A
Beer and Wine Taxes	10.9	10.6	-2.7%
Forest Products Harvest Taxes	3.3	8.0	139.4%
Phone Access Surcharge	-	5.9	N/A
Electric Cooperative Taxes	2.2	2.6	18.7%
Hazardous Substances Taxes	-	2.4	N/A
Amusement Device Tax	1.0	2.2	123.5%
Petroleum Loading Fee	-	1.2	N/A
Aviation Gas and Jet Fuel Tax	0.5	0.9	80.1%
Dry Cleaners Tax	-	0.4	N/A
Oil and Gas Severance Tax	0.4	0.2	-56.2%
Boxing Tax	-	0.1	N/A
Private Rail Car Tax	0.2	0.1	-49.3%
Replacement Tire Tax	-	0.0	N/A
Rural Telephone Exchange Tax	0.1	(0.0)	N/A

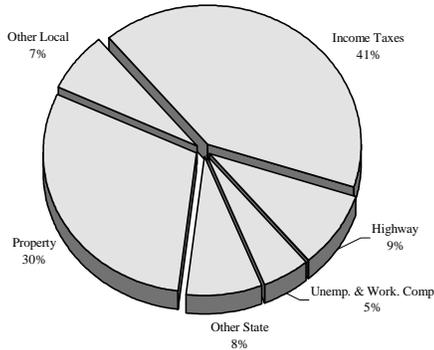
* New Tax in 1986

	FY 1985 Collections	FY 1996 Collections	% Change FY1985-96
Local Taxes			
Property Taxes	1,740.1	2,248.1	29.2%
Transit Payroll & Self-Employment Taxes	48.5	119.8	147.0%
Franchise Taxes	39.7	82.8	108.4%
Hotel-Motel Taxes	10.8	45.3	320.9%
Portland Business License Tax	-	42.7	N/A
Multnomah County Business Income Tax	3.8	28.2	642.2%
Motor Fuel Taxes	-	14.1	N/A
Washington County Real Estate Transfer Tax	-	2.6	N/A
Other Taxes	20.0	123.5	517.6%

Source: Legislative Revenue Office, Basic Tax Packet

Figure 1.5

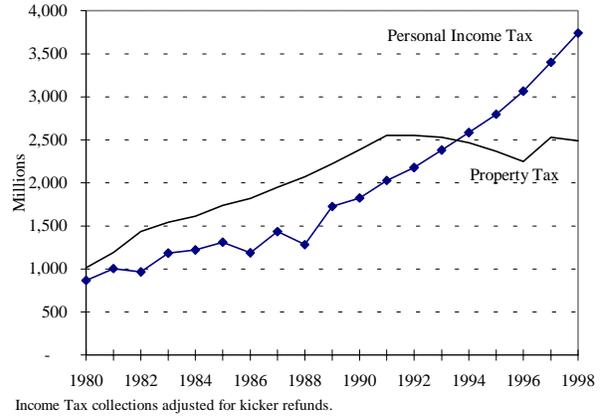
**Total State and Local Taxes and Fees
FY 1995-96 = \$7,600 Million**



Source: Legislative Revenue Office, 1998

Figure 1.6

**Personal Income Tax Collections vs.
Property Tax Levies Imposed**



- Oregon’s revenue system is highly dependent on income taxes. Income taxes accounted for 41 percent of total state and local taxes and fees in fiscal year 1996. State and local taxes and fees include employment taxes, workers compensation taxes, and an estimate of fees. The next largest source is property taxes at 30 percent (see Figure 1.5). The combined income and property tax account for over 70 percent of total Oregon state and local tax revenue.
- In the 1990s, personal income taxes surpassed property taxes as the major source of tax revenue in the state and local revenue systems (see Figure 1.6).

Trends in Major Taxes:

Personal Income Tax

- The personal income tax base has grown rapidly, especially since 1990 (see Table 1.5). Personal income taxes have grown even faster than overall income because of its progressive rate structure. The result is an increase in the percentage of personal income collected as personal taxes.
- Wages and salaries, and interest and dividend income declined as a share of the tax base over the past 10 years. Business income, property sales (capital gains), taxable pensions (partly due to law change), and rent, partnerships, and S-Corp income all rose as a proportion of the base (see Table 1.6).

**Table 1.5
Summary of Major Oregon Tax Revenues
(Millions of Dollars)**

Fiscal Year	Income Tax Collections		Property Tax Levies Imposed	Tobacco Excise Taxes	Motor Vehicle Tax Revenue
	Personal	Corp.			
1980	868.0	177.4	1,014.4	33.3	198.4
1981	1,005.1	155.5	1,191.3	33.3	198.4
1982	968.3	124.2	1,435.6	47.1	199.5
1983	1,181.7	125.1	1,543.6	61.9	213.7
1984	1,220.8	144.8	1,612.3	59.0	235.4
1985	1,310.7	153.9	1,740.0	58.7	262.4
1986	1,188.0	161.8	1,819.2	75.4	292.7
1987	1,435.8	149.1	1,946.5	82.6	327.1
1988	1,283.7	167.0	2,072.9	83.6	364.9
1989	1,725.3	163.8	2,223.7	83.5	419.6
1990	1,827.6	146.8	2,386.0	81.7	473.8
1991	2,026.3	174.1	2,550.6	84.8	512.8
1992	2,178.7	162.1	2,549.9	87.5	569.1
1993	2,383.2	198.0	2,529.0	86.2	584.4
1994	2,583.5	262.8	2,466.4	104.7	647.4
1995	2,797.6	312.9	2,369.8	117.1	671.1
1996	3,065.4	350.1	2,248.2	120.2	689.6
1997	3,401.7	486.4	2,527.9	151.1	
1998			2,491.3		

Note: Personal & Corporate income tax collections are adjusted for kicker credits and refunds

Corporate Income Tax

- After being relatively flat for 15 years, corporate income tax collections more than doubled between 1992 and 1996 (see Table 1.5 on the previous page). The increase is due to both rapidly growing national corporate profits and an increasing share of profits allocated to Oregon.
- Linked to the high technology boom in Oregon, electronics emerged as the largest taxpaying industry in the state.
- The share of corporate income taxes paid by individual industries shows considerable volatility over the past 10 years (see Table 1.7).

Property Tax

- Measure 5 led to an 11.9 percent decline in property tax collections between 1990 and 1996.
- Following a sharp increase in collections during the 1996-97 fiscal year, the first year under Measure 50 (1997-98) resulted in an estimated 1.6 percent decline in property tax collections. Because of Measure 5 and Measure 50, 1997-98 property tax collections are \$59 million below 1990-91 collections (see Table 1.5 on the previous page).
- The market value of taxable property in Oregon increased 98 percent between 1990-91 and 1996-97.

Table 1.6

Changes in Adjusted Gross Income by Source 1985 to 1995

Source of Income	1985		1995		Percent Change 1985-1995
	\$ Millions	% of Total	\$ Millions	% of Total	
Wages, Salaries, Tips	16,867	80.2%	31,036	68.8%	84.0%
Taxable Dividends & Interest	2,439	11.6%	2,923	6.5%	19.8%
Net Business Income	816	3.9%	2,264	5.0%	177.5%
Property Sales	557	2.6%	2,178	4.8%	291.0%
Taxable Pensions	1,144	5.4%	3,585	7.9%	213.4%
Rent, Partnership, S-Corp	101	0.5%	2,313	5.1%	2190.1%
Net Farm Income	(187)	-0.9%	(174)	-0.4%	-7.0%
Other Income	118	0.6%	1,527	3.4%	1194.1%
Adjustments	(824)	-3.9%	(540)	-1.2%	-34.5%
Total Adjusted Gross Income	21,031	100%	45,113	100%	114.5%

Office of Economic Analysis, Department of Administrative Services

Data Source: Department of Revenue, Personal Income Tax Annual Statistics Tax Year 1995

Table 1.7

Oregon Corporate Income Tax by Industry

Top 10 Income Tax Industries in 1994

SIC Industry	Income Tax After Credits (Millions)		Percent Change in Income Tax
	1994	1985	
36 Electric & electronic equipment	36.2	2.1	1610.8%
60 Depository institutions	33.0	6.2	433.4%
51 Wholesale nondurable goods	22.6	11.1	103.4%
50 Wholesale durable goods	22.3	12.3	81.6%
49 Electric, gas and sanitary svcs	14.4	9.1	58.3%
24 Lumber and wood products	12.9	4.8	170.3%
48 Communication	11.7	3.6	225.4%
67 Holding & other invest. offices	6.7	8.9	-25.0%
27 Printing and publishing	5.5	3.2	70.9%
53 General merchandise stores	5.3	4.2	27.1%

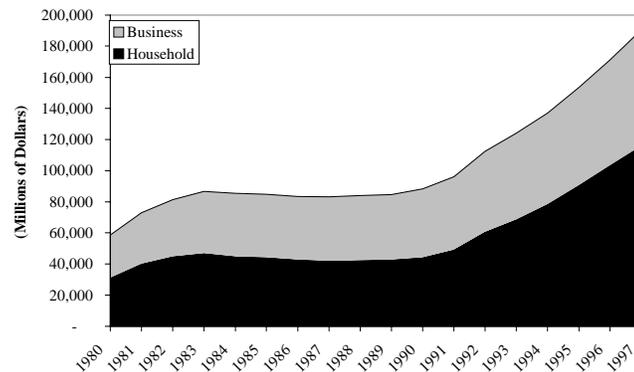
Top 10 Income Tax Industries in 1985

SIC Industry	Income Tax After Credits (Millions)		Percent Change in Income Tax
	1994	1985	
50 Wholesale durable goods	22.3	12.3	81.6%
51 Wholesale nondurable goods	22.6	11.1	103.4%
83 Social services	0.1	9.7	-98.9%
49 Electric, gas and sanitary svcs	14.4	9.1	58.3%
67 Holding & other invest. offices	6.7	8.9	-25.0%
20 Food and kindred products	4.4	6.8	-36.1%
60 Depository institutions	33.0	6.2	433.4%
24 Lumber and wood products	12.9	4.8	170.3%
53 General merchandise stores	5.3	4.2	27.1%
63 Insurance carriers	3.2	4.1	-21.9%

Source: Department of Revenue, Research Section and Office of Economic Analysis

- Real market value of household property grew considerably faster than the rest of the property tax base between 1990 and 1997. Household property was 60.7 percent of the property tax base in 1996-97 compared to 50.6 percent in 1990-91. Business property declined from 49.4 percent of the property tax base to 39.3 percent over this same period (see Figure 1.7). However, Measure 50 may have provided somewhat more relief to owners of residential property, which may mitigate this trend.

Figure 1.7
Total Oregon Real Market Value



Other Taxes

- Tobacco and motor vehicle tax collections have risen over the past 15 years solely due to rate increases and population increases (see Table 1.5 on page 13). These tax revenues are essentially flat unless rates or population increase.

Measure 50

- In response to implementation problems associated with the voter-approved Measure 47, the 1997 Legislature developed Measure 50. Its intent was to provide property tax relief comparable to that anticipated under Measure 47.
- Measure 50 is a constitutional amendment that limits both the value of property and the property tax rate. It also poses other restrictions on local government's ability to raise revenue such as requiring a majority voter turnout for levy increase approvals.
- Measure 50 was designed to reduce statewide operating property taxes by 17 percent in its first year of implementation (compared to what they would have been under previous law). This establishes a "permanent" rate to be applied in future years. For each subsequent year, the measure limits value growth for each individual property to 3 percent per year.
- There are a number of value limit exceptions. The most significant are new construction, re-zoning, and subdivisions. For new construction, value is set at the average ratio of assessed to market value of existing property in the same area and class.
- Levies outside the permanent rate limit may be approved in local general elections. Operating levies outside the limit are restricted to five years while capital levies are limited to 10 years. All levies are still subject to the rate limits imposed by Measure 5.
- Fiscal year 1997-98 is the first year under Measure 50. Preliminary data from the Department of Revenue indicate that operating taxes fell 13 percent compared to what they would have been under previous law. This is less than the 17 percent reduction anticipated during the 1997 Legislative session. A key factor reducing the expected impact of the new rate limit was the passage of local

levies by voters. When compared with 1996-97 property tax collections for operating purposes, revenue fell 5.2 percent.

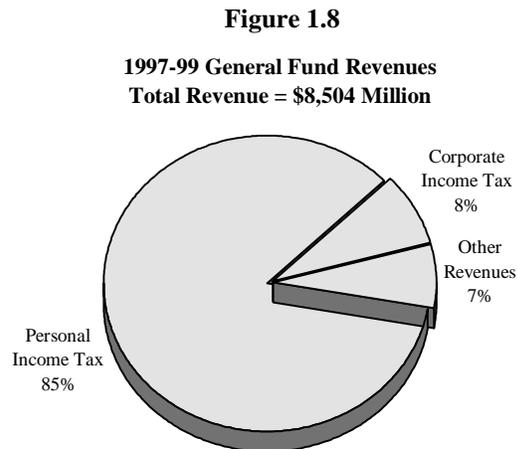
- Total property tax collections in 1997-98, including urban renewal, Measure 5 exempt bonds, and other exemptions, were an estimated \$310 million or 11.1 percent less than they would have been under Measure 5. Compared to total 1996-97 collections, revenue fell by \$39 million or 1.6 percent.

Shifting Responsibilities

Shifts in funding sources have led to significant changes in service responsibilities and decision making among the levels of government in Oregon. This is especially evident in the shift from local property tax funding for schools to state funding brought about by Measure 50. This shift has dramatically reduced local input and control over the level of funding.

State Government

The state's General Fund is composed primarily of income taxes (see Figure 1.8), which grew rapidly in the 1990s. Strong revenue growth coincided with increased service responsibilities. This is particularly the case for schools, which rose from 41 percent of the General Fund budget in the 1989-91 biennium to 57 percent in the 1997-99 biennium (see Figure 1.9 on the next page). The implementation of Measure 50 will likely continue this trend. Public safety expenditures also rose rapidly in response to a voter initiative for longer prison sentences.



Schools

The shift from local control to state control of funding is very apparent in K-12 education funding. Historically, the property tax funded local schools. Local voters made choices about the level of service they wanted through passage of school levies. Measure 5 triggered a major shift away from local property tax funding to state funding of education. The state now funds an increasingly larger share of schools through the General Fund and allocates school funds through an equalization formula.

The State School Fund appropriation, funded primarily by income taxes, accounted for 35 percent of Oregon school operating revenue in 1991-92. By 1995-96, the State School Fund represented 66 percent of school operating revenue (see Figure 1.10 on the next page).

Local Governments

Local governments consist of counties, cities, and special districts (see Figure 1.11 on the next page). While revenue shifts affect most local governments, it is impossible to generalize within or across these categories.

Figure 1.9

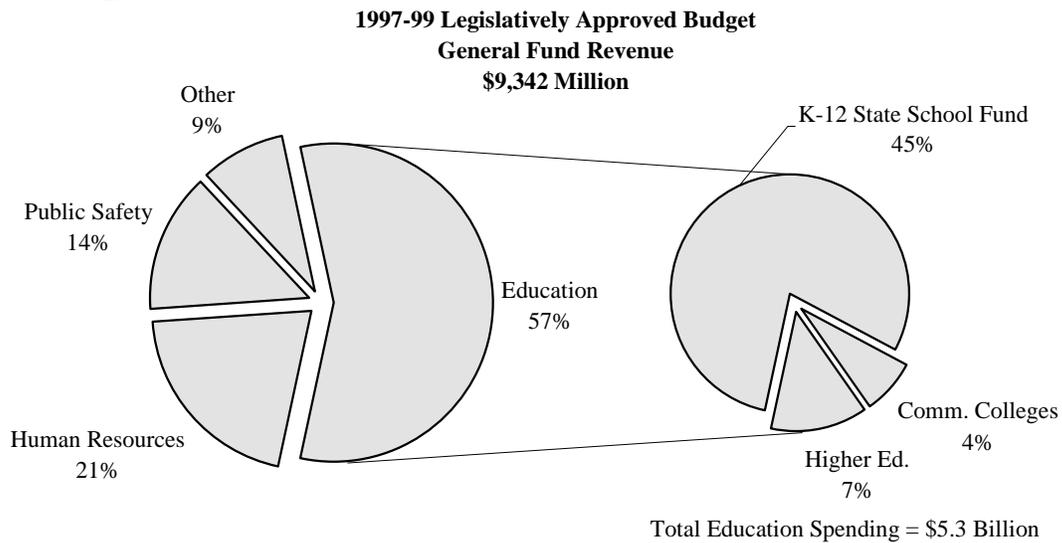
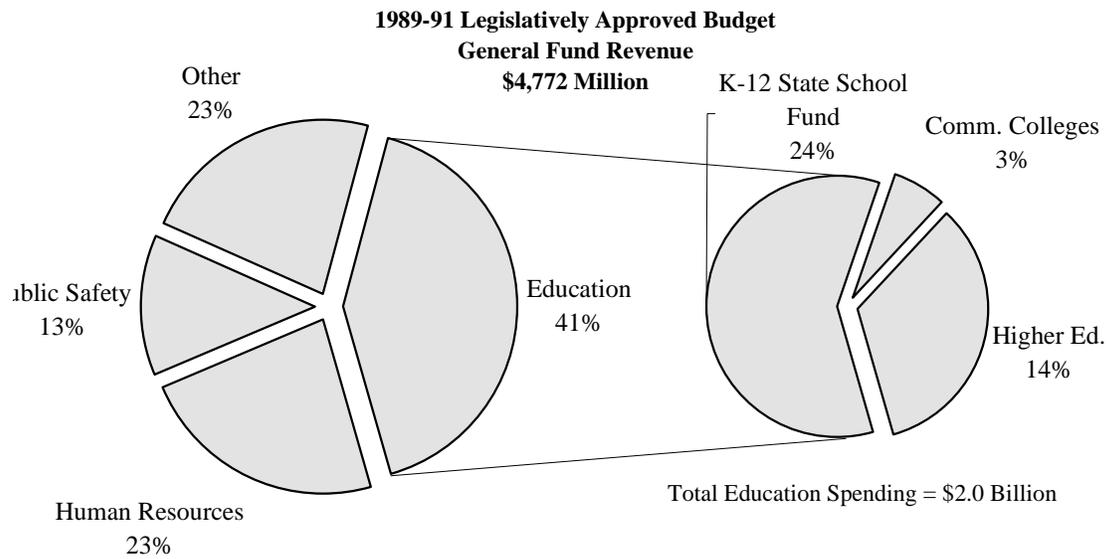


Figure 1.10

K-12 School Revenue

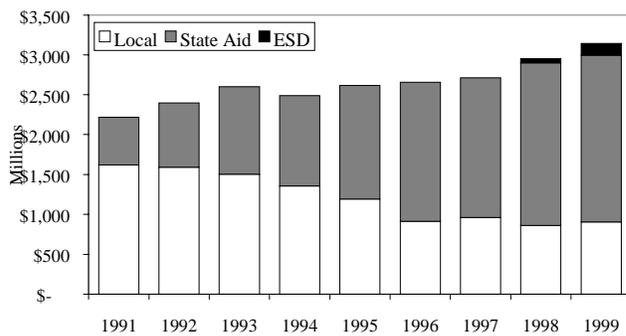
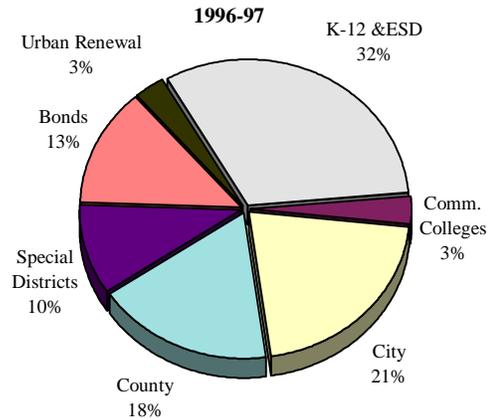


Figure 1.11

Distribution of Property Tax Revenues



As the revenue generating capacity continues to shift away from local governments and toward the state, the interaction between state and local governments will continue to evolve. Changing of funding sources results in a changing responsibility for providing services. In addition, with local governments' ability to raise revenue severely limited, legislation or initiatives that impact the property tax base will have more dramatic effects than under the levy based system.

The impact of Measure 50 is also likely to vary considerably among local governments. Key factors that will play a role in determining the impact on individual local governments are:

1. Proportion of total revenue that comes from the property tax.
2. The extent of new construction in the community.
3. Trends in other non-property tax revenue sources.
4. Willingness of local voters to pass levies outside the Measure 50 limits.
5. Extent to which governments can move to user charges.

In order to gain a better understanding of variations in revenue trends among local governments, examples of individual counties, cities, and special districts are provided in Appendix A.

CHAPTER 2: STABILITY

INTRODUCTION

Stability is one of three fundamental criteria Governor Kitzhaber directed the Committee to use when evaluating changes in Oregon's tax system. The concept of stability revolves around the magnitude of year-to-year variations in revenue.

In the context of short-term budget policy, an unstable revenue system tends to generate excessive revenue when the economy is performing well and insufficient revenue when the economy weakens significantly. The degree to which instability is a major issue for the tax system largely depends upon the consequences of sudden downside adjustments of "core" public services (as defined by policy-makers and the public). It also depends on the mechanisms set up by governments for dealing with times of excess revenue or revenue shortfalls. During periods of economic growth, a highly responsive revenue system automatically tends to produce revenue growth at a faster rate than economic growth, thereby expanding the relative size of government over time. When the economy is weak and revenues fall short of expectations, needs-based service demand rises, forcing governments into cutting services and/or raising tax rates.

There is no clear definition of what constitutes core public services, but the two largest areas of state/local expenditures are K-12 education and social services. These two functions made up 39 percent of Oregon's total state/local spending in 1993-94 (see Figure 1.1). Oregon's property tax limits and federal devolution mean that an increasing share of the responsibility for these functions now resides in Oregon's state General Fund. Therefore, General Fund revenue shortfalls pose increasing risk to these functions. K-12 education services have a unique role because of their widespread direct consumption across both regions and income classes, and their complex links to economic growth. Unstable provision of education services has significant implications for both the long and short term. Although social service spending is not as clearly identified with economic growth, it is particularly vulnerable to downside revenue risk because demand for such services tends to rise during periods of economic weakness.

STABILITY DEFINITIONS

For policymakers there are two distinct aspects to the stability issue. The first is economic stability. The tax base for major revenue sources used by state and local governments across the country is linked to changes in income, sales, or property values. Large changes in the economy generally produce large changes in these tax bases. Secondly, the structure of the tax system determines how tax collections change in response to changes in economic activity. The magnitude of a change in revenue in response to a given change in the overall economy can be used as a measure of revenue stability. From this perspective, an unstable revenue system is one in which tax revenue changes by a greater proportion than the change in income. A more stable revenue system is one in which tax revenue changes by a smaller proportion.

Figure 2.1
Annual Percent Change in Employment 1980-2003

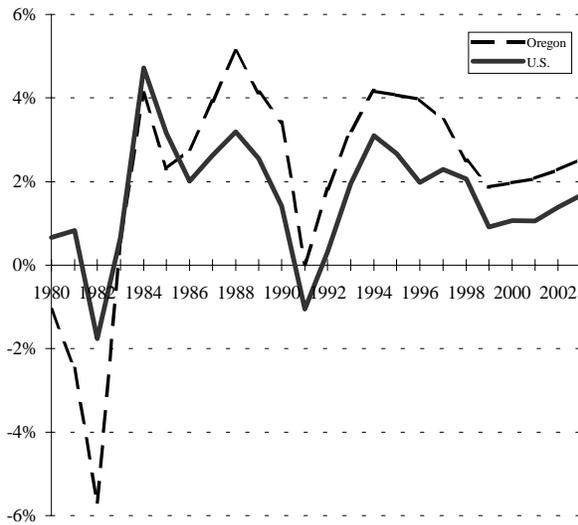


Table 2.1
Percent Change in Total Employment
Forecast vs. Actuals

Year	Forecast	Actuals	Difference
1982	-0.4%	-5.7%	-5.3%
1983	-0.6%	0.6%	1.2%
1984	2.1%	4.1%	2.0%
1985	2.2%	2.3%	0.1%
1986	0.8%	2.8%	1.9%
1987	1.5%	3.9%	2.4%
1988	2.6%	5.1%	2.5%
1989	2.9%	4.1%	1.2%
1990	1.5%	3.4%	1.9%
1991	0.2%	0.0%	-0.2%
1992	2.0%	1.8%	-0.2%
1993	1.7%	3.2%	1.5%
1994	2.3%	4.2%	1.9%
1995	2.7%	4.1%	1.4%
1996	3.0%	4.0%	1.0%
1997	2.9%	3.4%	0.5%

Source: Office of Economic Analysis

Note: Forecasts are taken from prior year's Dec. Forecast.

Economic Stability

Economic stability is concerned with the year-to-year variability in the rate of economic growth or decline. There are two approaches to analyzing economic stability. The first approach is historically based or backward looking. It is concerned with changes over time in overall income, employment, or specific tax bases such as property value or retail sales. Figure 2.1 shows the annual percentage change in Oregon and U.S. employment since 1980.

The second aspect of economic stability is the predictability of changes in economic activity. This approach is forward looking. Predictability is linked to a number of factors, the most important of which is the structure of the economy. An economy with a diverse structure tends to be more stable and therefore more predictable. However, more important than the structure at any point in time is the rate at which the structure is changing. An economy with little structural change is easier to predict because historical relationships are a better guide to the future. If the structure of an economy is undergoing a period of significant change, short-term prediction accuracy is usually reduced. Table 2.1 displays the variation between the predicted change in Oregon employment and the actual change.

Both the actual variation in economic activity and the predictability of variation are important for policy purposes. Variation in economic activity usually means variation in the rate of revenue growth. This complicates efforts to maintain a consistent level of services since unpredictable changes in the economy are problematic for the planning process. If sudden unexpected negative changes in economic activity occur, core services could be threatened or tax rates raised at a time of economic weakness.

Revenue Stability

Revenue stability is dependent upon the major tax sources in the system. Policymakers have more control over revenue stability because the structure of the tax system, rather than the structure of the

economy, determines it. As with economic stability, revenue stability can be considered from the perspective of how revenues change over time in response to economic activity or the predictability of the relationship between revenue and economic activity.

A system dependent upon income tax tends to be highly responsive to changes in the economy, though the degree of responsiveness will depend on how the income tax is structured. A property tax dominated system tends to be less responsive to changes in economic activity and, therefore, has greater revenue stability.

The predictability of revenue is reduced when changes occur in the relationship between economic activity and revenue collections. A number of factors can cause unanticipated changes. Changes in the distribution of income and the sources of income have been particularly important for the personal income tax in recent years.

Revenue Stability as a Policy Goal

Revenue stability means greater certainty in the public sector planning process and more consistency in the provision of government services. However, it can have detrimental consequences if taken to an extreme. A tax system would be perfectly stable, in a revenue stability sense, if revenue did not change regardless of changes in economic activity. Such a system is not practical and probably not desirable. Perfect revenue stability is impractical because nearly all major revenue sources are linked to the economy. The desirability of such a system can also be questioned on the grounds that recessions impose a necessary discipline on governments just as they do for private businesses.

A system in which revenue is relatively unresponsive to economic growth over time can also be problematic for state and local governments. Under such a system, revenue will not grow as fast as the economy, thereby making it harder to meet the infrastructure and service demands of a growing state or locality.

Although there is not a clearly desirable degree of revenue stability for policy purposes, many state and local governments address the issue of revenue instability by developing automatic mechanisms for periods of revenue shortfalls. These mechanisms can be either a formal reserve or “rainy day” fund, or an informal practice of budgeting a significant ending balance to meet contingencies. Oregon’s state government does not currently have a formal reserve fund mechanism for periods of less than expected revenue. It is unique among states in having a formal mechanism in place for periods when revenue growth exceeds expectations. The 2 Percent Surplus Kicker Law, established in 1979, provides temporary tax cuts for individual and corporate taxpayers when state General Fund revenue growth exceeds the projections made during the biennial legislative session by more than 2 percent.

Revenue stability must be balanced against other goals of the revenue system. In many cases, other goals may take precedence. For example, revenue stability is also linked to fairness or equity. A progressive tax system is one in which the tax rate rises as an individual’s income (ability to pay) rises. Highly progressive tax systems tend to produce an unstable stream of revenue because they are sensitive to changes in income growth. This means that the goal of a progressive tax system may have to be balanced against the goal of a more stable tax system.

MEASURING STABILITY

Economic Stability Measures

Two ways to measure economic stability are: 1) variations in the rate of job growth (or decline); and 2) the level of industrial diversity. The first method measures variations over time; the second focuses on the structure of the economy in order to provide some guidance for future predictions. For states or local regions, these two measures can be compared with the national economy. Employment variability can be defined as the percentage change in state or local employment from year-to-year compared to changes in U.S. employment for the same period. Similarly, the industrial composition of a state or local economy can be compared with the U.S. industrial composition, the latter representing the highest possible level of diversity for comparison with less diverse smaller economies.

Regional Financial Associates calculates an employment volatility index and an industrial diversity index. The employment volatility index is defined as the standard deviation in a state's year-over-year nonagricultural employment percentage growth relative to the standard deviation in the U.S. nonagricultural employment growth over the 1987 to 1996 period. A volatility index reading of 100 means that employment volatility in a state or locality is equal to the employment volatility in the nation. Industrial diversity is defined as the extent to which the industrial structure in a state or local region approximates the overall U.S. industrial structure. The diversity measure falls between 0 and 1. A value of 1 means the state or locality has the same industrial structure as the U.S.; 0 means it has a totally different industrial structure. It is important to recognize that a highly diversified economy by this measure is very similar to the U.S. as a whole and therefore subject to national fluctuations.

Revenue Stability Measures

Revenue stability is usually measured as a relationship between changes in tax revenue and changes in income. Specifically, income responsiveness is the percentage change in tax collections divided by the percentage change in income over a certain period, usually a year. This is the definition of income elasticity, a concept widely used in economic analysis.

There are three types of income elasticity (see Table 2.2). For a particular tax, if the percentage change in revenue is greater than the percentage change in income, it has an elasticity of greater than 1. This means that a 1 percentage change in income will generate a change in tax revenue of greater than 1 percent. A tax with this characteristic is said to be elastic. Similarly, a tax with an elasticity less than 1 (inelastic tax), would change by a smaller percentage than income. The revenue from a tax with an elasticity of 1 (unitary elastic) would change by the same percentage as income.

Table 2.2
Income Elasticity Summary

Type of Tax	Change in Tax Revenue
Elastic	The percentage change in revenue is greater than the percentage change in the tax base.
Unitary	The percentage change in revenue is the same as the percentage change in the tax base.
Inelastic	The percentage change in revenue is less than the percentage change in the tax base.

COMMITTEE FINDINGS

Summary

The Committee recognized that Oregon's economy, the characteristics of its people, and its revenue system, have changed dramatically since 1980. These shifts have implications for the tax system, though the net effect of these shifts on overall stability is not clear. Oregon's economic stability has improved in terms of year-to-year variability because of a more stable national economy; the diversification of Oregon's economic structure should increase predictability. However, the emergence of high technology manufacturing, particularly semiconductors, means that the state is still subject to cyclical fluctuations. Moreover, the fact that the state has experienced only one fairly minor recession since 1982 makes it difficult to predict the impact of the next national recession.

Revenue stability has declined since 1990. The elasticity of the entire system has increased as the relative importance of the income tax has increased and the property tax has decreased. This means that the overall system is now more sensitive to changes in economic activity. Further, the shift of the education funding base to the income tax makes this "core" function more vulnerable to downside risks.

The Committee discussed the potential consequences of downside revenue risk for government services. The greatest concern was expressed for basic K-12 education services because of their links to the long-term health of the economy and ultimately growth in the tax base. The two-edged pressures on social services during an economic downturn were also discussed. Demand for these services tends to rise at the same time as revenue shortfalls begin to occur. The Federal government's shift to block grant funding of public assistance potentially complicates this problem further.

The Committee also recognized that revenue trends are quite different for the different levels of government in Oregon. While the stability of state government revenue has been enhanced by reduced variability in state economic growth, the state government is now responsible for providing more services. School districts now rely on state funding, through the income tax and lottery revenues, for two-thirds of their revenue. This is double the proportion that prevailed in 1980. County and city governments remain highly dependent on the property tax, though they have diversified their revenue base toward fees and charges. Some special districts, especially fire districts, are up to 100 percent financed by property tax. This core revenue base is generally more stable than the state's income tax dependent revenue base, but there are also significant differences among individual cities and counties. For example, counties long dependent upon federal forest receipts are experiencing a steady decline in revenue from this source. The City of Portland, though dependent on the property tax, also receives considerable revenue from business tax receipts, an elastic revenue source. Finally, the Portland and Eugene metropolitan areas are dependent upon payroll taxes, an income sensitive revenue source, to support transit services.

The Committee spent a great deal of time discussing Measure 50 and its implications on the stability of the property tax system. The general conclusion is that the property tax, while more stable than the income tax, is likely to be more unstable under Measure 50 than it was under the levy based system of the 1980s. The addition of new construction to the local tax base will allow growing areas to experience higher revenue growth, while districts that do not grow will be limited to the 3 percent growth cap on individual property tax bills. The Committee expressed concern for the problems local governments would experience if higher rates of inflation were to reemerge. Under such a scenario, their revenue growth would be limited to 3 percent plus new construction, while costs would rise near the rate of inflation.

A structural change in the relationship between state and local governments brought on by changes in the property tax also raised concerns among Committee members. In contrast to the pre-Measure 5 levy based system, local government revenue is now directly affected by legislative changes in the property tax base. Under the levy based system, property tax exemptions redistributed the tax burden among property tax payers but did not directly affect local revenue. Since the adoption of Measures 5 and 50, property tax exemptions granted by the Legislature directly reduce local revenue. This introduces a form of instability for local policy-makers because their revenue stream can be affected by state government decisions.

Identification of risks to the revenue system was an important concern for the Committee. These risks can take the form of economic changes, both predictable and unpredictable, or changes emanating from the revenue system itself. The most prominent risks discussed:

1. The stability of Oregon's economy, given its changing economic structure and its dependence upon high technology manufacturing.
2. Economic globalization and the state's vulnerability to external shocks.
3. Oregon's changing age distribution and its implications for income tax revenue.
4. The unpredictable consequences of establishing a new property tax system under Measure 50.
5. The growing dependence of school finance on volatile personal and corporate income taxes.

Key Findings

Economic Stability

- 2.1 **Oregon's economy is more stable than it was in 1980.** Oregon has a diversity index rating of .70 (compared with the U.S.=1), which is almost as diverse as the much larger California economy (.71). Washington, also a considerably larger economy, has a diversity index of .67. Oregon's level of diversification increased considerably since 1980, when the state was much more dependent upon the timber industry. Oregon's employment volatility index over the past 10 years is 113, compared to the base national index of 100. Oregon's index reading has dropped considerably since peaking at 186.9 in 1985. Oregon's economic stability has also been enhanced by the stability of the U.S. economy. There has been only one relatively mild recession, by historical standards, over the past 15 years.
- 2.2 **Oregon's economy is still subject to business cycle fluctuations.** Though more diverse than in 1980, Oregon's economy is highly dependent upon durable goods manufacturing industries such as computer equipment, lumber and wood products, transportation equipment, and metals. These industries tend to experience significant fluctuations over the course of the business cycle, thereby increasing the variability in Oregon's overall employment growth. The state's dependence on high technology manufacturing means that swings in this industry will have significant revenue implications.
- 2.3 **Structural change makes Oregon's economy less predictable.** The dramatic change in Oregon's economic structure reduces the usefulness of historical economic relationships for forecasting purposes. This makes predicting future changes in the economy more difficult.

Overall Revenue System

2.4 **Oregon’s revenue system is more sensitive to changes in the economy than it was in 1980.** The shift away from property taxes to income taxes has made the state-local revenue system more unstable as a whole. The growth of elastic income taxes and the decline of inelastic property taxes have increased the overall income elasticity of the system. A second reason for increased instability, compared to the 1980s, is the property tax itself. Under Measure 50, property tax collections are likely to be more sensitive to changing economic conditions than they were in 1980.

2.5 **Oregon’s public finance system is becoming more centralized.** The state government collects a growing share of taxes. Income taxes, collected primarily by the state, have grown in response to Oregon’s strong economic growth in the 1990s. On the other hand, local governments are dependent upon property taxes. Under Measure 50 they are likely to grow more slowly than income taxes. This is expected to lead to continued centralization of Oregon’s public finance system.

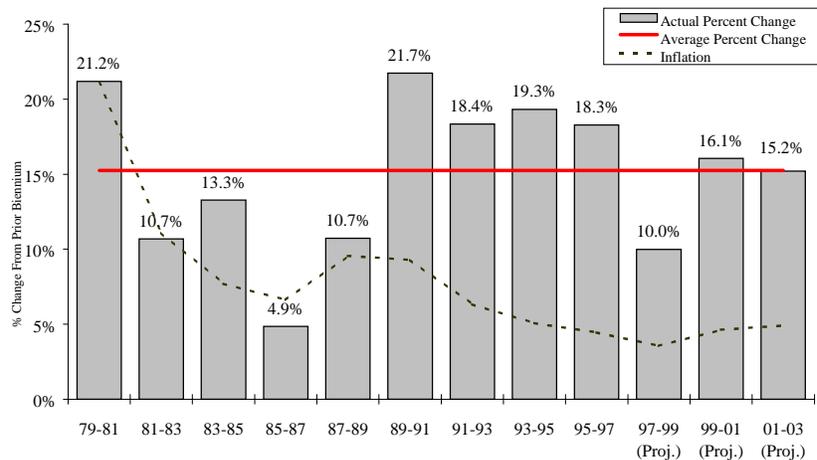
State General Fund/ Schools

2.6 **The General Fund is subject to short-term fluctuations.** The General Fund grows rapidly during economic expansions, but slows sharply during recessions because income taxes (personal and corporate) make up 95 percent of revenue to the General Fund. A “medium” depth recession would reduce the rate of General Fund revenue growth by approximately 5 percent from its long-term average. This would translate into \$500 million in the 1999-2001 biennium. The impact of a recession on Oregon is highly speculative because the nation has not experienced a downturn since the rapid growth of Oregon’s high technology sector in the mid-1990s.

2.7 **General Fund revenue growth has varied widely from biennium to biennium.** The rate of growth in General Fund revenue has varied from a high of 21.7 percent in the 1989-91 biennium to a low of 4.9 percent in the 1985-87 biennium (see Figure 2.2). Variations in General Fund revenue are due to a variety of factors. They include changes in economic growth, highly responsive personal and corporate income taxes, changes in both the distribution of income and the sources of income, changes in federal and state tax law, and the temporary tax reductions through the 2 Percent Surplus Kicker Law.

Figure 2.2

**Percent Change in General Fund Revenues
1979-81 Through 2001-03**



March 1998 Economic and Revenue Forecast

2.8 **Periods of unanticipated strong economic growth have been accompanied by temporary tax cuts through the 2 Percent Surplus Kicker Law.** The 2 Percent Surplus Kicker Law divides the General Fund into corporate (8.9 percent in 1995-97) and all other revenue (91.1 percent in 1995-97). If actual collections for the biennium exceed the Close of Session forecast for these components, personal, corporate taxpayers, or both receive a tax credit in the subsequent biennium. Since passage of the 2 Percent Surplus Kicker Law in 1979, the surplus credit has triggered six times for both personal and corporate income taxes. However, it was suspended in 1989-91 for personal and in 1991-93 for corporate (see Table 2.3). The Kicker Law provides a mechanism for temporary tax cuts when revenue exceeds expectations.

It is designed to address the issue of unanticipated revenue collections and has had the effect of reducing the rate of General Fund revenue growth. However, when revenue falls short of expectations as it did during the 1979 to 1983 period, the 2 Percent Surplus Kicker Law has no effect, the state must either reduce budgets or raise tax rates.

**Table 2.3
2 Percent Surplus Kicker History**

<u>Biennium</u>	<u>Tax Year</u>	<u>Personal</u>		<u>Corporate</u>	
		<u>Surplus Shortfall</u>	<u>Credit Refund</u>	<u>Surplus Shortfall</u>	<u>Credit</u>
1979-81	1981	-\$141.0	none	-\$25.1	none
1981-83	1983	-115.2	none	-109.9	none
1983-85	1985	88.7	7.7%	13.4	10.6%
1985-87	1987	22.7	16.6%	6.8	6.2%
1987-89	1989	175.2	9.8%	36.2	19.7%
1989-91	1991	185.9	suspended	-23.0	none
1991-93	1993	60.1	none*	17.9	suspended
1993-95	1994/5	162.8	6.3%	167.0	50.1%
1995-97	1996/7	431.5	14.4%	202.7	42.2%

Dollar figures in millions

*1991-93 personal surplus was less than 2%

Data Source: Legislative Revenue Office, Office of Economic Analysis

2.9 **General Fund revenue has had a high degree of unpredictability on a biennial basis.** Since 1977, the difference between the Close of Session forecast and actual General Fund collections has varied between -7.2 percent in 1981-83 (despite significant tax increases passed in special legislative sessions) and +11.1 percent in 1995-97 (see Table 2.4 on the next page). The average biennium deviation for these periods is +2.4 percent.

2.10 **General Fund revenue will grow with the economy in the long-term.** Because the General Fund is made up almost exclusively of income taxes, it is income elastic. This means that as the economy grows over time, General Fund revenue will tend to grow faster than income.

2.11 **The education funding base is more unstable than it was in 1980.** Measure 5 and Measure 50 have made K-12 school budgets far more dependent on unstable income taxes. This means that school funding is more exposed to revenue shortfalls.

2.12 **Changes in federal tax law could affect General Fund revenue.** Oregon's income tax code closely parallels the federal personal and corporate income tax code. State policy-makers have varied between formal and informal linkage over the years, but have maintained a high degree of conformity in order to minimize administrative costs and maximize taxpayer compliance. Oregon's heavy reliance on income taxes, which are closely linked to the federal base, does make the state's tax system subject to instability from potentially significant changes in the federal system.

Table 2.4
Forecast vs. Actual General Fund Revenue
1977-79 through 1995-97 Biennia
(Millions of Dollars)

Biennium		Close of Session	Actual	Percent Diff.	Biennium		Close of Session	Actual	Percent Diff.
1977-79	Personal Income Tax	1.44	1.493	3.7%	1987-89	Personal Income Tax	2.842	3.009	5.9%
	Corporate Income Tax	0.214	0.292	36.4%		Corporate Income Tax	0.288	0.324	12.5%
	Other Revenues	0.335	0.37	10.4%		Other Revenues	0.46	0.468	1.7%
	Total	1.989	2.155	8.3%		Total	3.59	3.801	5.9%
1979-81	Personal Income Tax	1.994	1.873	-6.1%	1989-91	Personal Income Tax	3.676	3.854	4.8%
	Corporate Income Tax	0.358	0.333	-7.0%		Corporate Income Tax	0.320	0.297	-7.2%
	Other Revenues	0.426	0.406	-4.7%		Other Revenues	0.468	0.477	1.9%
	Total	2.778	2.612	-6.0%		Total	4.464	4.628	3.7%
1981-83	Personal Income Tax	2.344	2.15	-8.3%	1991-93	Personal Income Tax	4.580	4.562	-0.4%
	Corporate Income Tax	0.359	0.249	-30.6%		Corporate Income Tax	0.337	0.355	5.3%
	Other Revenues	0.412	0.491	19.2%		Other Revenues	0.482	0.561	16.4%
	Total	3.115	2.89	-7.2%		Total	5.399	5.478	1.5%
1983-85	Personal Income Tax	2.458	2.532	3.0%	1993-95	Personal Income Tax	5.201	5.381	3.5%
	Corporate Income Tax	0.285	0.299	4.9%		Corporate Income Tax	0.409	0.576	40.8%
	Other Revenues	0.429	0.444	3.5%		Other Revenues	0.595	0.579	-2.7%
	Total	3.172	3.275	3.2%		Total	6.205	6.536	5.3%
1985-87	Personal Income Tax	2.454	2.623	6.9%	1995-97	Personal Income Tax	5.909	6.303	6.7%
	Corporate Income Tax	0.291	0.298	2.4%		Corporate Income Tax	0.428	0.684	59.8%
	Other Revenues	0.46	0.512	11.3%		Other Revenues	0.624	0.744	19.2%
	Total	3.205	3.433	7.1%		Total	6.961	7.731	11.1%

Local Governments

- 2.13 **Measure 50 will provide stability and certainty for individual taxpayers, but less revenue stability for local governments than under the pre-1990 system.** By capping the growth in individual property tax bills at 3 percent per year, Measure 50 will reduce fluctuations in individual tax bills. New construction varies greatly across tax districts, but it is expected to average 2 percent per year over the long-term. This means that total statewide property taxes are likely to vary over a narrow range (1 to 7 percent), but individual districts could experience considerably more variation.
- 2.14 **Measure 50 makes local governments dependent on the property tax vulnerable to a re-emergence of inflation.** Measure 50's 3 percent cap on property value growth means that property tax revenue will not respond to acceleration in the rate of inflation. Though not expected in the short run, a significant increase in inflation would leave local governments facing rapidly rising costs without a corresponding rise in tax revenue.
- 2.15 **Overall, local government revenue is likely to grow more slowly than income over the long-term.** With relatively inelastic property taxes at its core, the local government revenue system is expected to grow more slowly than the state economy. However, the revenue trends among local governments will differ greatly depending on the amount of new construction, dependence on federal timber receipts, and the use of other revenue sources such as the payroll tax and fees. Another important factor determining local revenue growth over time will be the willingness of voters to pass levy increases in local elections.

- 2.16 **Local governments vary widely in their ability to respond to economic and revenue instability.** With different tax structures, different reserve fund levels, and different service demands, local governments vary greatly in their capacity to manage unstable revenue flows.
- 2.17 **Local governments are more likely to compete for tax base increases under Measure 50.** There appears to be a greater incentive for intergovernmental competition under the Measure 50 structure. With increases restricted to 3 percent per year on existing property, districts may feel pressure to develop policies designed to attract more construction in order to expand the tax base in the district.
- 2.18 **Changes in the property tax base have a direct impact on local revenue.** Beginning with the implementation of Measure 5 in 1991, legislative actions to change the property tax base translate into changes in local revenue. This was not the case in the pre-1990 levy-based property tax system. This increases the potential instability for local revenue due to legislative actions such as new property tax exemptions.

Major Taxes

- 2.19 **Oregon's personal income tax is relatively elastic.** The long-term income elasticity of the personal income tax is estimated to be between 1.1 and 1.2. The elasticity of the income tax has moved well outside this range for short periods of one or two years. Key factors affecting elasticity are shifts in the distribution of income and changes in the sources of income.
- 2.20 **Since 1980, indexation has reduced the elasticity of the personal income.** Oregon's personal exemption credit and tax brackets now adjust to account for changes in the price level. This has had the effect of reducing the overall elasticity of the personal income tax.
- 2.21 **More of the personal income tax base is coming from volatile sources of income.** An increasing share of the personal income tax base comes from business income and capital gains. This suggests that the personal income tax base itself is becoming more unstable. Rapid growth in these two components has been a major factor accelerating revenue growth in the 1990's. However, these sources of income are likely to slow sharply or even decline during recessions.
- 2.22 **Rapid growth in the elderly population and a change in tax law is making pension income an increasingly larger part of the personal income tax base.** The aging of the state's population and taxation of government pensions has caused taxable pension income to grow rapidly. This trend will accelerate greatly when the baby boom generation begins reaching retirement age in 2010.
- 2.23 **The rapid growth in corporate income taxes has been fueled by a very large jump in tax payments from the electronics industry.** The electronics industry has been extremely profitable in the 1990s as spending on information technology grows. However, a downturn in this industry would have major implications for the state's corporate income tax collections.
- 2.24 **The overall property tax under Measure 50 is likely to be income inelastic over the long-term.** Although local property tax collections will vary with the extent of local construction activity, statewide property tax revenue is likely to grow slower than income over time. The income elasticity of the property tax will also depend upon inflation. If inflation accelerates above the 2 to 3 percent rate characteristic of recent years, the elasticity of the property tax will decline because of the 3 percent cap upon existing property tax bills established by Measure 50.

2.25 **Corporate income taxes are the most unpredictable of Oregon’s major taxes.** Corporate income taxes vary widely with the profitability of corporations (see Table 2.5). Personal income taxes are more predictable on a percentage basis, but the dollar range for plausible annual projections is much larger than corporate income taxes. Statewide property tax collections have the smallest percentage range because of the lower elasticity of the property tax. However, variations for individual tax districts are greater than the statewide average.

**Table 2.5
Plausible Range of Annual Growth Rates for
Oregon’s Major Taxes**

Scenario	Personal	Corporate	Property
High	10%	30%	7%
Base	6%	5%	5%
Low	2%	-20%	1%
Range	8%	50%	6%

POLICY QUESTIONS

- 2.1 **Should state government have a policy mechanism to protect against revenue shortfalls?** Currently state law returns unanticipated General Fund revenue collections (those in excess of forecast levels) to taxpayers. Should there be a mechanism, such as a reserve fund, in case of unanticipated revenue shortfalls?
- 2.2 **Is the current education funding system sufficiently stable?** What is an acceptable level of downside risk for funding of the state school system? The K-12 education budget is highly dependent on income taxes. Should the funding system be made more stable through adopting alternative, more stable, revenue sources?
- 2.3 **How responsive should the General Fund be to changing economic conditions?** Currently, the General Fund is highly responsive to changes in the economy because it consists mainly of income taxes. General Fund revenue could be made less responsive through decreasing the importance of income taxes or by altering income taxes to make them less sensitive to changes in economic conditions. This can be done through changing the rate structure or through other changes such as more fully indexing credits and subtractions.
- 2.4 **How responsive should local revenue be to changing local economic conditions?** Measure 50 is likely to make overall local property collections grow more slowly over time because of the 3 percent growth cap on individual property taxes. The local revenue system could be altered to be more responsive to changes in economic conditions through greater dependence on revenue sources more closely linked to economic conditions and less dependence on the property tax. However, such a policy would reduce short-term stability.
- 2.5 **How much flexibility should local government have in responding to changing economic conditions?** State and local conditions will vary widely over the long-term. Should cities, counties and special districts have more revenue options for responding to these changing conditions? In particular, should these local governments have more flexibility in responding to the reemergence of inflation? Property tax dependent governments are especially vulnerable to this risk under Measure 50.

CHAPTER 3: EQUITY

INTRODUCTION

Equity is the second of the three fundamental criteria that the Governor directed the Committee to use when evaluating the change in Oregon’s tax system. Evaluating “equity” in Oregon’s tax system involves making judgments about how well the distribution of the tax burden among and within groups corresponds to some criterion of “fairness”. It involves comparing tax burdens across and within relevant groups such as high income, low income, businesses, households, Oregon taxpayers, taxpayers in other states, retirees, and workers.

EQUITY DEFINITIONS

The Committee relied on the following concepts to help examine the equity of Oregon’s tax system:

1. **There are two concepts of equity: benefits received and ability-to-pay. Both are used to evaluate tax fairness.**

a. *Ability-to-Pay Principle:* Under the ability-to-pay principle, each taxpayer is asked to contribute, not according to specific benefits received, but according to his or her income or wealth level. The ability-to-pay principle is used to evaluate taxes where benefits cannot easily be linked back to specific taxpayers or where the purpose is to redistribute income. Within the ability-to-pay principle, there are the concepts of horizontal and vertical equity:

Horizontal and Vertical Equity: According to these concepts, those in similar circumstances should be taxed equally (horizontal equity). Those with greater income or wealth should pay more (vertical equity). “Similar circumstances” are most often defined in terms of income, although other characteristics could be used. It should be noted that features of a tax system that increase vertical equity may decrease horizontal equity. The term progressivity describes the degree to which taxpayers with higher incomes pay higher rates of taxes.

b. *Benefits Received Principle:* Under the benefits received principle, an equitable tax system is one in which each taxpayer contributes in line with the benefits he or she receives from public services. This principle is mainly used to evaluate taxes for narrow purposes, such as the gasoline tax. However, it is often difficult to link the true value of benefits back to specific taxpayers.

2. **Equity is evaluated after indirect (business) taxes have been shifted to households.** Households ultimately pay all taxes. They pay taxes directly on their incomes, purchases, and property. They also indirectly pay the taxes initially levied on businesses, since businesses pass on or shift their taxes to workers (through lower wages), consumers (through higher prices), or owners (through lower profits or dividends). Since there are so many factors that affect a business’ ability to shift taxes, it is difficult to determine precisely how taxes are shifted.

3. **Equity is a “system concept”, relating to the whole tax system, not just to individual taxes.** Viewed in isolation, individual taxes may or may not appear equitable. Since most systems rely on more than one tax, focusing on the equity characteristics of a specific tax would produce an incomplete picture of the equity of the total system.

4. **Equity is ultimately a value judgement.** To a certain extent, a tax system can be examined to understand which groups of people pay different taxes. This analysis, however, does not shed any light on whether or not those tax burdens are “fair” without some prior notion as to what those burdens should be. Efficient tax design requires setting the desired effective tax rates (i.e., tax burdens) and then looking at the alternative tax mechanisms for achieving the desired rate structure. However, as noted in the previous chapter, adjustments that are intended to increase fairness can make the tax system more complicated, difficult to administer, and/or more unstable.
5. **Equity is one of several important criteria for judging tax systems.** Fairness is one of several goals of a tax system. Changes in a tax system that increase fairness may lead to greater instability, as noted above, or create incentives or distortions that hinder achievement of other social goals.

BACKGROUND

Overall Level of State and Local Taxes

- Total Oregon state and local taxes have been declining as a share of Oregon personal income since 1990, primarily due to reductions in property taxes. Personal income taxes and corporate income taxes have stayed relatively constant as a share of personal income during the last 15 years, at about 4 percent and .5 percent respectively. Property taxes, however, have fallen from over 5 percent in the late 1980s to just over 3 percent in 1997-98.

Comparisons with Other States

- Prior to Measure 5, Oregon ranked tenth among states in total taxes as a share of personal income. In fiscal year 1993-94, midway through the implementation of Measure 5, Oregon ranked 18th. With the full phase-in of Measure 5 and the passage of Measure 50, Oregon has likely fallen further. Although a number of other states lowered tax rates during the long economic expansion, Legislative Revenue Office estimates that Oregon would rank number 40 in 1999-2000 if other states held at the 1993-94 level. State-by-state data beyond 1993-94 are not available.
- Compared to other states, Oregon ranks in the middle for its reliance on state and local user fees. While all states on average have increased their reliance on user fees, Oregon has increased its reliance slightly more than average.

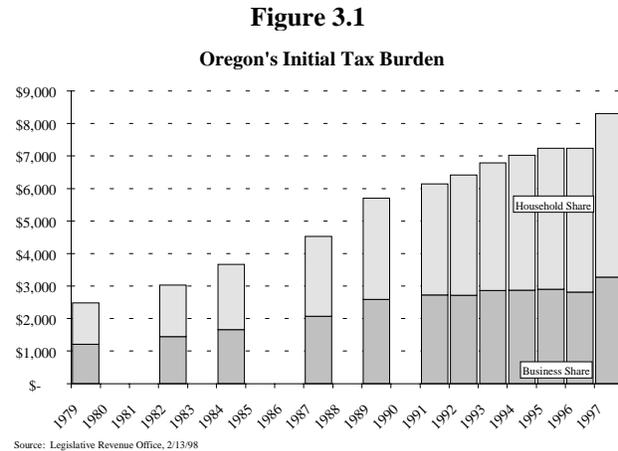
Direct and Indirect Taxes: Initial Burdens of Households and Businesses

Every state imposes a combination of direct taxes and indirect taxes on households (taxes paid initially by business and shifted to households). The share of taxes paid initially by business is an important feature of the tax system. This is because indirect taxes can be shifted to nonresident households (workers, consumers, and business owners and shareholders outside Oregon). They are also less visible to taxpayers and paid in smaller increments.

- The initial share of state and local taxes on households in Oregon increased from 51 percent in 1978-79 to 61 percent in 1996-97 (see Figure 3.1). Conversely, the business share over this period decreased from 49 percent to 39 percent. This is a result of income taxes representing a larger share of total taxes, and households paying a larger share of property taxes. There are two primary reasons for this shift. The first is a rise in residential property values relative to commercial and industrial

property. Second, rapid growth in personal income tax collections brought on by strong wage and salary growth and a surge in capital gains from the booming stock market.

- While the overall tax burden declined between 1990 and 1997, the household burden remained roughly constant. The factors cited above: rising home values and surging income tax collections; essentially offset the effects of Measure 5's property tax rate reductions.



- The shift in the tax burden from business to households reflects only the initial incidence of taxes, not any passing through of taxes from business to individuals. An economic incidence study would more fully address the equity implications of this shift.

Personal Income Taxes

- Using income subject to federal taxation as the base, Oregon's personal income tax is progressive. Average effective rates in 1995 ranged from 1.8 percent for the lowest 10 percent of taxpayers to 6.8 percent for the 10 percent of taxpayers with highest incomes (see Table 3.1). The distribution of effective tax rates by income level is approximately the same in 1995 as it was in 1983.
- Personal income taxpayers with incomes above \$40,000 accounted for 29 percent of returns but paid 75 percent of personal income taxes. Taxpayers with incomes above \$60,000 paid 55 percent of taxes while accounting for only 14 percent of returns (see Table 3.2).
- Nearly 27 percent of all personal income tax filers reported business income from

Table 3.1
1995 Oregon Personal Income Tax
Distribution by Decile

Decile	Percent of Total Tax	Effective Tax Rate
Lowest 10%	0.1%	N/A
Second 10%	0.6%	1.8%
Third 10%	1.4%	2.6%
Fourth 10%	2.6%	3.4%
Fifth 10%	4.3%	4.2%
Sixth 10%	6.3%	4.6%
Seventh 10%	8.8%	5.0%
Eighth 10%	12.2%	5.4%
Ninth 10%	17.3%	5.8%
Top 10%	46.6%	6.8%
Total	100.0%	5.6%

Source: Oregon Department of Revenue, Research Section

Table 3.2
1995 Oregon Personal Income Tax
Distribution by Income Level

Income Level	Percent of Returns	Percent of Tax Due
Negative	0.7%	0.0%
\$0-\$10,000	23.0%	1.0%
\$10,000-\$20,000	20.8%	5.3%
\$20,000-\$30,000	15.0%	8.5%
\$30,000-\$40,000	11.2%	9.8%
\$40,000-\$60,000	15.1%	20.6%
\$60,000-\$100,000	10.1%	23.2%
More than \$100,000	4.1%	31.4%
Totals	100.0%	100.0%

Source: Oregon Department of Revenue, Research Section

proprietorships, partnerships, S-corporations, rental and royalty income, or farm income in 1995, roughly the same share as in 1980. Income from these sources represents a growing portion of Oregon taxable income.

- There are approximately 70 subtractions, deductions, and credits in Oregon’s personal income tax. They all affect vertical and horizontal equity of the tax system to varying degrees.

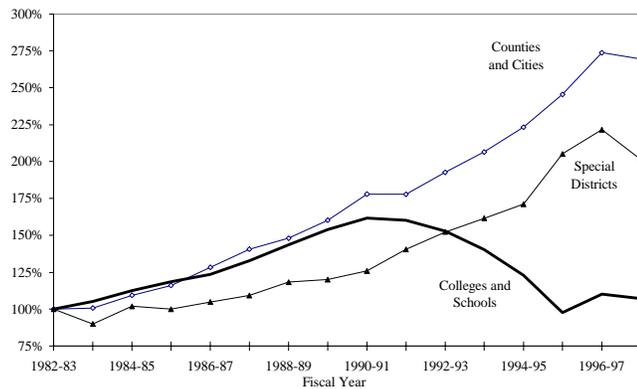
Corporation Income Taxes

- Corporations with 75 shareholders or fewer may elect to file tax returns as an S-corporation or a C-corporation. An S-corporation provides the same limited liability as a C-corporation, but its net income passes through to shareholders, who pay taxes through the individual income tax. Nearly half of all corporation filers are S-corporations. The Tax Reform Act of 1986 lowered the federal individual income tax rates relative to corporation rates, which resulted in an increase in the number of S-corporation elections. This incentive was reduced in 1993.
- Oregon’s corporation income tax exhibits strong concentration. Of the 37,000 C-corporation returns filed in 1995, the largest 10 corporations paid 30 percent of the tax. Nearly 60 percent of the C-corporations reported no taxable income and paid the minimum tax of \$10.

Property Taxes

Property tax revenues to schools increased an average of 5.5 percent per year between 1983-84 to 1990-91. However, under Measure 5, property tax revenues fell significantly. They declined about 6 percent per year from 1991-92 through 1996-97. Measure 50 brought an additional 2.7 percent reduction in 1997-98. Measure 5 impacted cities, counties, and special districts substantially less than schools. Property tax revenues to local governments increased an average of 6.7 percent per year from 1983-84 to 1990-91, and 7.6 percent per year from 1991-92 through 1996-97. However, in 1997-98 Measure 50 reduced property tax revenues to local governments by 3.2 percent from the prior year (see Figure 3.2).

Figure 3.2
Property Taxes Imposed by District Type
(1982-83 = 100%)



Between 1973 and 1991, the Homeowner and Renter Refund Program (HARRP), which was paid out of the state General Fund, provided property tax relief to homeowners and renters with the lowest household incomes (below \$17,500 for most of this program’s existence). During 1983-84, 343,000 low-income Oregon households received refunds totaling \$73.2 million or an average of \$213 per household. The total HARRP refund of \$73.2 million represented only 4.5 percent of total property taxes paid that year. However, it represented a significant share of property taxes paid by low-income households. For all participants in the program, HARRP refunds amounted to 42 percent of property taxes paid. For the lowest income categories (below \$10,000), refunds represented 65 percent of property taxes paid.

COMMITTEE FINDINGS

Summary

The Committee recognized that the overall state and local tax burden (when measured as a percentage of income) of Oregonians has been falling. While overall tax burden is falling, businesses are paying less of the initial tax burden and households are paying more. This is because of the increasing importance of the personal income tax as a revenue source and the households paying a greater share of property taxes. The Committee spent a great deal of time discussing the issue of incidence. While recognizing that initial incidence data are useful, the Committee feels that it needs a study based on final incidence in order to accurately address the issue of equity. A good example of this type of study is the *1997 Minnesota Tax Incidence Study*. This study provides estimates on the final resting place of taxes after they are shifted from business to households. It also looks at the distribution of the final burden among income classes.

Evidence points out that Oregon's tax system is nearly proportional and less regressive than many states. Oregon has a low reliance on consumption based taxes and a high reliance on income taxes, which tend to be progressive in nature. Regressive property taxes have become a smaller component of total taxes because of the passage of Measure 5 and Measure 50.

Committee members expressed concern about the horizontal equity implications of Measure 50. The mechanics of Measure 50 suggest that properties with similar market values could be paying significantly different taxes. This is a basic violation of the horizontal equity principle. It is clearly a potential source of voter disenchantment with the new property tax system.

Finally, the Committee discussed the implications of shifting much of the responsibility for funding schools from the property tax to the income tax. The resulting scaled down property tax system is more benefits received oriented. The property tax burden in the future will more closely approximate the benefits to property owners from government services such as fire and police protection.

Key findings

- 3.1 **The overall state and local tax burden of Oregonians has been falling.** Personal income is a broad measure of Oregon citizens' ability to pay taxes. The share of personal income devoted to state and local taxes has declined since the early 1980s. While individual and corporate income taxes have remained relatively constant as a share of personal income, property taxes and other state and local taxes now comprise a smaller share of personal income than 15 years ago.
- 3.2 **The tax burden for households as measured by initial incidence has not declined.** Property tax relief from Measure 5 rate reductions has been offset by rising property values and growth in personal income tax collections. As a result, the household tax burden has remained roughly constant in the 1990's. The equity implications of this trend are difficult to discern without establishing who bears the ultimate burden of various taxes.

Ability to Pay

- 3.3 **Oregon's overall tax structure is less regressive than many states.** Oregon has a low reliance on consumption taxes and a higher reliance on somewhat progressive income taxes (see Table 3.3).
- 3.4 **The regressivity of the overall tax system has probably decreased.** Progressivity of the income tax has remained constant and the regressive property tax is decreasing as a share of taxes. However, a progressive feature of an earlier tax system (HARRP) was eliminated in 1991. This program provided property tax refunds to homeowners and renters with the lowest household incomes. During the 1980s, roughly 300,000 low-income Oregon households annually received property tax relief through this program. Its elimination probably limited the increase in overall progressivity.
- 3.5 **The implementation of Measure 50 may lead to horizontal inequities in the property tax system.** Measure 50 may have reduced the horizontal equity in the property tax system through the separation of assessed values from market values. Initial inequities in assessments may be harder to correct, and assessed values will not reflect differences in market value growth rates between properties.
- 3.6 **Favorable treatment of retirement income raises the issue of horizontal equity.** Oregon's personal income tax favors retirement income through the exclusion of social security income and a pension tax credit.
- 3.7 **Taxes overall, and school funding in particular, have shifted more toward the income tax.** The income tax has become a larger share of total taxes. Education funding relies more on the income

Table 3.3
Distributional Analysis of Selected State Tax Systems
Shares of family income for non-elderly married couples, 1995

	Lowest 20%	Second 20%	Mid 20%	Fourth 20%	Next 15%	Top 20% Next 4%	Top 1%	Comments
California								
Sales and Excise Taxes	7.3%	5.6%	4.3%	3.5%	2.5%	1.7%	1.0%	Very progressive income tax made California's tax system one of the nation's least regressive (by some measures slightly progressive) in 1995. But top income tax rate will fall in 1996.
Property Taxes	4.6%	2.9%	2.9%	2.9%	2.9%	2.5%	1.9%	
Income Taxes	0.2%	0.7%	1.7%	2.6%	3.9%	5.6%	8.7%	
Total Taxes	12.1%	9.2%	8.9%	9.0%	9.3%	9.8%	11.6%	
Oregon								
Sales and Excise Taxes	1.2%	0.9%	0.7%	0.5%	0.4%	0.2%	0.1%	Low reliance on consumption taxes and high reliance on somewhat progressive income taxes results in a tax system less regressive than many.
Property Taxes	6.9%	3.8%	3.8%	3.9%	3.8%	3.4%	2.3%	
Income Taxes	2.8%	4.8%	5.5%	6.2%	6.5%	6.6%	7.8%	
Total Taxes	10.9%	9.5%	10.0%	10.6%	10.7%	10.2%	10.2%	
Washington								
Sales and Excise Taxes	12.6%	9.1%	7.6%	6.3%	4.9%	3.4%	2.0%	Heavy reliance on consumption taxes and lack of personal income tax makes for the most regressive tax system in the country.
Property Taxes	4.5%	3.3%	3.0%	2.9%	2.8%	2.7%	1.9%	
Income Taxes	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Total Taxes	17.1%	12.4%	10.6%	9.2%	7.7%	6.1%	3.9%	
U.S. Average								
Sales and Excise Taxes	6.7%	5.2%	4.2%	3.5%	2.6%	1.8%	1.1%	
Property Taxes	4.5%	2.9%	2.8%	2.8%	2.8%	2.6%	1.9%	
Income Taxes	1.3%	2.3%	2.8%	3.2%	3.6%	4.1%	5.0%	
Total Taxes	12.5%	10.4%	9.8%	9.5%	9.0%	8.5%	8.0%	

Note: Total taxes does not reflect Federal Deduction Offset which will tend to lower the total tax rate

Source: *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*
 Citizens for Tax Justice and The Institute on Taxation & Economic Policy

tax, largely because the two property tax limitation measures of the 1990s significantly altered the

primary funding sources for schools. In 1997-98, K-12 education districts imposed roughly 44 percent of all property taxes. Seven years ago, these schools imposed roughly 66 percent of all property taxes. Viewed another way, the State School Fund appropriation, which is funded primarily by income taxes, represented 66 percent of total Oregon school operating revenue in 1995-96, up from 35 percent in 1991-92.

Tax Incidence

- 3.8 **The relative share of taxes paid by households is increasing.** This is because households directly pay a larger share of property taxes, and income taxes represent an increasing share of total taxes. This is similar to what has happened elsewhere as state and local governments compete for firms in a global economy. The final incidence of business taxes is not clear. The initial share of taxes on business is generally lower in Oregon than in a number of other states. This share varies throughout Oregon as certain communities impose local business taxes such as the Multnomah County Business Income Tax, the Portland Business License tax, and transit district taxes in the Portland metropolitan area and Lane County. Ultimately, individuals pay these taxes as they are shifted to shareholders, employees, and customers. In order to assess who bears the ultimate burden of business taxes, a study on economic incidence is needed.

Benefits Received

- 3.9 **The funding of Oregon public services overall (through taxes and fees) has shifted towards a “benefits received” basis.** From 1988 to 1994, the share of own-source revenue represented by user charges grew from 17 percent to 20 percent. Within this total, user charges by the state grew from 13 percent to 16 percent. User charges by local governments grew from 21 percent to 26 percent of own-source revenue. User fees more closely follow the benefits principle, where individuals pay according to the benefits they receive. The use of user fees is consistent with the movement towards operating government more like a business and with the search for new funding sources in the context of property tax limitations.
- 3.10 **Oregon’s property tax may have become more benefit-related.** Education and community colleges currently depend less on the property tax and more on state General Fund appropriations (primarily income tax). Remaining government services funded through the property tax are for such purposes as parks, police, and fire protection. The benefits of these services are more related to the ownership of property than are the benefits of education.

POLICY QUESTIONS

- 3.1 **How progressive do we want the overall tax system to be?** Should the system continue to shift toward a more progressive system? What effective tax rates are desirable for different income groups?
- 3.2 **Should steps be taken to counter potential horizontal inequities created by Measure 50?** The complex system established by Measure 50 is likely to generate situations in which owners of similarly valued properties are paying different taxes. Should policies designed to mitigate the inequities caused by these situations be developed?

- 3.3 **Should retirement income continue to receive preferential treatment?** If so, since retirement income represents a growing share of total income, raising a given amount of income tax revenue will require higher taxes on other sources of income.
- 3.4 **Should the basis of taxation of wealth change to reflect the changing attributes of wealth?** Intangibles are a greater source of wealth in a modern economy and receive inconsistent tax treatment. This leads to inequities among equally wealthy groups based on how much of their wealth is taxable real property.
- 3.5 **Is there an optimal distribution of initial tax burden between households and businesses?** Direct taxes are more visible and make the cost of government more apparent. It may be possible to export some indirect taxes to residents of other states.
- 3.6 **Should Oregon's tax system move toward a benefit approach? If so, for what services?** A tax system that links benefits received from government to taxes paid follows the market concept of consumers "getting what they pay for." However, for a number of government services, it is difficult to determine the benefit that each taxpayer receives. In addition, shifting to a benefits approach has significant implications for the progressivity of the overall system.

CHAPTER 4: ECONOMIC, SOCIAL, AND ENVIRONMENTAL GOALS

INTRODUCTION

As noted in Chapter 1, taxes are tools for achieving society's goals. Taxes are mainly thought of as funding programs designed to achieve policy goals. However, taxes also influence individual and business behavior. Sometimes these behavioral effects are unintentional and potentially inconsistent with objectives. In other cases, the tax system is deliberately used to either encourage or discourage particular behaviors. This chapter focuses on the compatibility of Oregon's tax system with the economic, social, and environmental goals described in *Oregon Shines*, the state's strategic plan.

THE BEHAVIORAL EFFECTS OF TAXES

Taxes can be thought of as influencing two broad areas of behavior. The first influence is on owners of economic resources, including labor. In the case of labor, taxes influence the trade-off between work and leisure. They can influence where people choose to live or how much they are willing to invest in their education and training. State and local tax policies can also affect owners of capital and natural resources. The impact of taxes on the location of business capital has long been a subject of policy debate and research. Natural resource owners are not geographically mobile like capital owners, but decisions as to when to harvest or mine natural resources can be influenced by the tax consequences of these decisions.

A second broad area where taxes can change behavior is through favoring or discouraging certain types of behavior that have secondary effects outside the normal functioning of a market. Economists call these secondary effects "externalities" because they are external to private markets. These effects are not reflected in the prices of goods and services. This means that services with positive externalities, such as education and health care, tend to be under-produced unless the government intervenes directly or through the tax system. There is no economic incentive for businesses to account for negative externalities such as air or water pollution. The tax system can be used to "internalize" these externalities by posing taxes or charges on pollution or other negative externalities.

It is important to recognize that the basic structure of the tax system has the strongest effect on behavior. Although policy discussions often focus on credits or other specific tax incentives or disincentives, the overall structure of the system has a far greater impact. For example, a system heavily weighted toward income taxes without a sales tax implicitly favors consumption. A system heavily weighted toward property taxes discourages capital-intensive investment.

Although states have used tax incentives to attract business since the 1930s, evidence on the effectiveness of these policies is mixed. Experts agree that a system with taxes relatively higher than the services provided repels business investment. However, it also appears to be the case that a system that under-invests in education and infrastructure impedes economic growth. The consensus view is that businesses analyze both the state-local tax system and the level of services provided when making location decisions. Where taxes alone appear to have the most impact is when there are large differences within a small region such as state border areas. Another key factor affecting business location decisions is the certainty surrounding the tax system. A high degree of uncertainty tends to discourage investment.

Finally, the tax system influences the relationship between state and local government and voter interaction with the two levels of governments. The property tax is traditionally a local tax. In most

states, city, county, and other non-school taxes are set locally and provide different service levels in different areas. Substituting a statewide source for these local revenues, such as Oregon has done in the 1990s, shifts decision power to the state. It also changes incentives in two important ways: 1) local officials are spending “state money” rather than taxes from local taxpayers; and 2) state government has the final say on distribution of funds for different areas and priorities.

OREGON SHINES

First drafted in 1989 and substantially revised in 1996, *Oregon Shines* is a detailed analysis of the socio-economic trends facing our state and a set of economic, social, and environmental goals for Oregon’s future. The Committee used the *Oregon Shines* goals and objectives shown in Table 4.1 as a framework to evaluate whether Oregon’s tax system helps or hinders our progress towards a better economic, social, and environmental future for the state.

Table 4.1
***Oregon Shines* Goals and Objectives**

<u>Goal</u>	<u>Objective</u>
Quality Jobs for All Oregonians	<ul style="list-style-type: none"> • Quality Workforce • Competitive Businesses
Safe, Caring, Engaged Communities	<ul style="list-style-type: none"> • Low Social Costs • Strong State and Local Partnerships
Healthy, Sustainable Surroundings	<ul style="list-style-type: none"> • Effective Growth Management • Sustainable Natural Environment

The economic goals center on two approaches for creating quality jobs: 1) creating a quality workforce through education and training; and 2) increasing the competitiveness of Oregon business in the global economy. More than ever before, incomes and opportunities link to education. Oregon will be competitive only if our education system is preparing Oregonians for tomorrow’s jobs and if economic conditions foster the growth of Oregon businesses and firms.

The social goals focus on: 1) minimizing preventable social costs; and 2) addressing social problems through local, targeted projects with shared responsibility for improved outcomes. A healthy, well-functioning community is safe, caring, and engaged. This means that Oregonians will feel safe in their homes and on their streets. They will provide humane care for the aged, infirm, and others who are the least capable of caring for themselves. Finally, they will participate in and tackle issues at the community level.

The environmental goals include two objectives: 1) effective growth management; and 2) creating and maintaining a sustainable natural environment. Growth and natural resource use affect Oregon differently all over the state. While some communities are growing rapidly, others are growing slowly or not at all. They are united by the desire for healthy, sustainable surroundings that include quality development, productive resource lands, and environmental integrity.

COMMITTEE FINDINGS

Summary

Committee discussion focused on the key policy issues under each of the three *Oregon Shines* goals. State government policy experts were invited to lead the discussion as the Committee considered each goal. The Committee discussion was stimulated by presentations from: Bill Scott, Director, Economic Development Department; Dick Benner, Director, Department of Land Conservation and Development; Jim Nealy, Deputy Administrator, Adult and Family Services Division; and Langdon Marsh, Director, Department of Environmental Quality.

The first area of discussion began with the acknowledgement that the economic objectives of a quality workforce and a competitive business environment receive the most help from the resources generated by the tax system. Public education, especially K–12, is supported strongly by both the income and property tax systems. However, currently employed Oregonians, and those transitioning from one career to another, receive little or no support from the tax system when investing in human capital.

The issue of higher education funding, which is a form of human capital investment, received attention. Although state government spends a large amount on public higher education, the trend in the 1990s has been toward a smaller General Fund commitment and higher tuition for students. With growing demand for a more educated labor force, the Committee pointed to the policy issue of how to finance this service in the future.

The Committee recognized that Oregon's tax climate for manufacturing investment is competitive relative to other western states as evidenced by the state's investment boom in the mid-1990s. Oregon's traditional reliance on property taxes may have been a deterrent to capital intensive investment at one time. However, it appears that lower tax rates and the use of the Strategic Investment Program for very large investments such as semiconductor plants, have eliminated this competitiveness issue.

The Committee also discussed the implications of the state's heavy dependence on the income tax. In some ways, the state's tax system has provided competitive advantages. For example, Oregon's retail trade sector has thrived, especially in border areas because the high income tax has substituted for a sales tax. The income tax also tends to favor business start-ups because they usually incur losses in their early years.

Oregon's relatively high personal income tax also presents some competitive issues. First, it discourages high income producing activities such as computer software and other business services. It also taxes most realized capital gains at 9 percent, thereby encouraging business owners to change their residence prior to selling large assets.

The Committee expressed concern about the potential conflict between high income tax rates and the Oregon Shines vision of a high productivity/high wage economy. It was recognized that there would always be certain advantages and disadvantages with respect to Washington's sales tax dependent system.

The Committee also noted that the advent of electronic commerce will have a long-term and essentially unknown effect on Oregon's tax system. The same technology that drives Oregon's economic transformation could erode Oregon's income and property tax bases by fundamentally changing the way consumers do business. It could also encourage the development of major new businesses that sell goods and services over the Internet.

The discussion of social objectives centered around the disincentive effects of combining rising taxes with reduced benefits as low income individuals work their way out of poverty. The key discussion points included:

- Many families transitioning from welfare, especially those with child care expenditures, actually lose spendable income as they move up the wage scale because tax credits and benefits are phased out as income rises.
- Welfare recipients still make more by working than they would if they remained solely on welfare.
- Oregon’s low income ceiling for triggering taxation means that Oregon’s tax system does not encourage work at the lower end on the spectrum.

Committee members further discussed how the changing Oregon tax system has altered the state-local partnerships needed to maintain strong Oregon communities. The committee also discussed at length the effect of separating school funding decisions from school expenditure. Committee members were concerned that without local control of school finance, community commitment to a quality school system would erode over time.

The third broad area of discussion centered on environmental objectives, including land use. The major points that emerged from the discussion are:

- While tax law has been instrumental in allowing Oregon to manage growth, there appears to be a great deal more that could be done. Examples include: changes in farm value assessment with urban growth boundaries; improvements in annexation procedures; and encouragement of transit oriented development.
- Industrial emissions and overflowing city sewers used to be considered the main threats to Oregon’s environmental quality. To some extent, the focus has shifted to forest and agricultural practices and individual behaviors of everyday life.
- Pollution control tax credits, the strongest taxation tool available for pollution control, in their current form do not reward innovative investment in a cleaner environment.
- The Department of Environmental Quality is experimenting with regulatory incentives and recognition for companies that show significant accomplishments in environmental performance. The taxing of “bads”, such as pollution, is theoretically sound, but administrative issues remain.

The Committee concluded that the state’s tax system generally helps Oregon’s environmental goals, but much more seems possible. Oregon’s property tax differentials to encourage appropriate land use are the most powerful tool. However, the state has not made a systematic effort to make the tax system consistent with environmental goals.

Key Findings

Economic Objectives:

Quality Workforce:

- 4.1 **Measure 5 dramatically changed the source of education funding.** In 1997-99, 70 percent of K-12 education funding comes from the General Fund, compared to 27 percent prior to the passage of

Measure 5. K-12 education funding now makes up 50 percent of total General Fund expenditures, compared to 25 percent prior to Measure 5. The large share of general fund dedicated to K-12 education limits the resources available for pre-kindergarten programs, community colleges and the higher educational system.

- 4.2 **Oregon provides only limited subsidies and no tax incentives for workforce training.** A quality workforce and a tax system that promotes high wage companies leads to increased incomes and reduced poverty. Some states are increasingly aggressive in providing employer and employee incentives and subsidies. Although Oregon has not developed specific tax incentives aimed at work force quality, the state's overall public finance system devotes a substantial portion of resources toward education and a quality workforce.

Business Competitiveness:

- 4.3 **A competitive business environment is one that balances overall tax rates with needed public investment in education and infrastructure.** While taxes may not be the most important factor in business location decisions, an inordinately high rate can repel investment by signaling an anti-business climate. The reduction in Oregon's property taxes over the past decade has improved the competitiveness of the overall tax structure.
- 4.4 **The tax system should be examined relative to the changing economy.** The current tax structure was built decades ago when the industrial economy produced tangible goods. The shift to a more service oriented economy is the best documented challenge to the current tax structure, but other social, demographic, and technological trends pose difficult challenges as well. These include: the changing nature of work; the shift to electronic commerce; firm mobility and inter-jurisdictional tax competition; deregulation of the telecommunications and electric industries; and the aging of America.¹
- 4.5 **Oregon's mix of taxes favors consumption over income producing activities.** Oregon's heavy reliance on personal income tax compared to other states, including Washington and California, discourages activities that produce high levels of taxable personal income. These activities include the professional services and software sectors. Oregon's heavy reliance on property taxes theoretically discourages capital-intensive businesses compared to other states, including Washington and California. This tends to be offset by the absence of taxes based on gross revenues and the availability of property tax incentives for manufacturing. Oregon's absence of a general sales tax encourages retail trade, recreation, and some service industries.
- 4.6 **There is a high degree of uncertainty surrounding Oregon's tax climate.** The initiative process has brought many major tax proposals before voters. Although most have been rejected, the prospect of sudden radical changes in the tax system raises uncertainty. Even the 2 Percent Surplus Kicker Law which provided significant temporary tax cuts for business in recent years, is too unpredictable to encourage business formation or expansion.
- 4.7 **Oregon's high rate of personal income tax on capital gains discourages business owners from remaining Oregon residents.** Sale of a business or exercising large stock options generally means a large tax liability for Oregon residents. This may have the effect of discouraging successful

¹ *Is the New Global Economy Leaving State-Local Tax Structures Behind?* National League of Cities, National Conference of State Legislatures, National Governor's Association

business owners from staying in the state. The tax differential is particularly stark when compared to Washington's sales tax based system. The Legislature did pass a capital gains deferral law in 1995 in which business owners can defer capital gains taxes as long as they reinvest in Oregon. It is too early to assess the effectiveness of this law.

Social Objectives:

Minimize Preventable Social Costs:

- 4.8 **Income tax liability begins at a relatively low income level in Oregon, thereby creating a possible disincentive effect for moving into the workforce.** Although Oregon's personal income tax floor (the income level at which people begin to owe taxes) is now higher because of the passage of an earned income tax credit by the 1997 Legislature, it remains lower than in most states. This reduces the reward from work at low income levels.
- 4.9 **Due to the phase out of public assistance, net spendable income of many households declines as wage income rises.** So-called implicit tax rates, which are equal to additional taxes paid plus benefits lost due to rising income, can rise above 100 percent under certain assumptions. This means that as low income workers receive pay raises they may actually experience a reduction in their spendable income after adjustment for higher taxes and lower benefits. This problem is most severe for families with earners between the minimum wage and \$10 per hour.
- 4.10 **Because refundable tax credits are not allowed under Oregon's income tax laws, tax credits are of limited use to low income taxpayers.** Refundable tax credits mean that individuals are eligible for the full amount of the credit regardless of their tax liability. This means that the size of the credit may exceed the total tax bill resulting in a subsidy to the tax filer. Because many low income individuals would be eligible for credits (such as child care) above the amount taxes they have paid during the year they cannot take full advantage of the credit.

Build Strong State/Local Partnerships:

- 4.11 **Changes to the tax system are substantially altering the relationship between communities and state government.** This is particularly true in terms of school finance. Oregon's system of local school control changed significantly with the passage of Measure 5 in 1990. The passage of Measure 50 will centralize school finance further. This shift risks a reduction in community involvement in local schools. Measure 50 is likely to cause a reduction in local revenue relative to state revenue over time. This is likely to change the state/local partnership in the future.

Environmental Objectives

Manage Growth Effectively:

- 4.12 **Oregon will continue to grow rapidly.** Between 1990 and 1997 Oregon gained about 375,000 new residents, more than enough people to populate three cities the size of Salem. The forecast for the next 10 years is for an additional 16 percent increase in the population of Oregon, nearly double the rate of the nation. While this rapid growth will fuel the economy, it will also strain the infrastructure and natural systems that support communities. Some of the amenities that tend to be

at risk in growing communities include mobility, public facilities, open space, and environmental quality.

- 4.13 **Oregon's tax system is not used to its fullest potential as a tool to influence the development of quality communities.** Oregon is internationally renowned for commitment to developing quality communities. For instance, the state's 25-year-old land use planning law is considered the standard that other state's attempt to emulate. Unfortunately, no systematic attempt has been made to align the state's tax system with Oregon's land use and growth goals. Examples of policies that could be improved include: systems development charges that are not consistent with the differential costs of development; farm value assessments inside urban growth boundaries (UGB) that inhibit development; and non-transit oriented development near areas served by public transit.

Sustain the Natural Environment:

- 4.14 **Oregon's tax system does not reflect the environmental goals contained in Oregon Shines.** There is no systematic effort to tax environmental "bads" used in consumer products, discourage highway use during peak hours, or develop fees based on environmental damage during production. The state's only major significant tax expenditure is the pollution control credit, passed in 1967. This credit has not been adjusted to account for significant changes in environmentally beneficial technology developed over the past 30 years.
- 4.15 **Tax expenditures are aimed at preserving land in agriculture or forest use.** Currently, the tax system is directed at preserving farm and forest land. There is little in the tax system to encourage compact growth.

POLICY QUESTIONS

Economic Objectives:

- 4.1 Should tax incentives be developed for encouraging workforce training? Should these incentives be applied to higher education?
- 4.2 Should there be a more stable system for funding education overall?
- 4.3 Should the tax structure be altered to reduce the disincentive effects of high personal income tax rates on capital gains, high income retirees, and high income generating activities?

Social Objectives:

- 4.4 Should local revenue options be developed for schools? In order to foster greater local control and commitment to school districts, should communities be given flexibility in financing their local schools?
- 4.5 Should tax credits and subsidies be coordinated better so that increased earnings do not result in a lower standard of living and lower spendable incomes?

4.6 Under Oregon's new revenue system, is there an appropriate balance between state and local revenues? If not, how should the system be changed?

4.7 Should tax credits that encourage and support work effort by low income Oregonians be refundable?

Environmental Objectives:

4.7 Should communities be encouraged to utilize taxes and fees that reflect the differential cost of development?

4.8 Should communities be allowed to use tax incentives to encourage desired development patterns such as infill and redevelopment, the creation or enhancement of higher density community centers, transit-friendly development, and affordable housing?

4.9 Should favorable farm use tax assessment be limited to areas outside urban growth boundaries?

4.10 Should Oregon develop a systematic set of tax credits and penalties to encourage positive environmental practices and discourage detrimental practices?

CHAPTER 5: SPECIFIC TAX ISSUES AND INDUSTRIES: TIMBER AND INTANGIBLES

INTRODUCTION

At the request of the Governor, the Committee reviewed two specific, and currently unresolved, tax issues: timber and intangible taxation. The 1997 Legislature passed legislation designed to resolve each issue. The Governor found the Legislature's solutions unacceptable and vetoed them. It is likely that each will be reconsidered during the 1999 Legislative Session.

COMMITTEE FINDINGS

Summary

The Committee recognized that the issues surrounding taxation of forest land and intangible property are more specific than the broader issues dealt with in the rest of the document. Because of the urgency surrounding these tax issues, the Governor asked the Committee to include them in their discussions. However, given the complexity of the issues, the Committee recognized that a separate, focused approach would produce more comprehensive policy questions and findings.

Since the passage of Measure 5 in 1990, the Legislature has tried a variety of ways to reconcile forest land taxation with significant changes in the property tax system as a whole. A discussion of these efforts is contained in Appendix B.

The inclusion of intangible value in the property tax base for centrally assessed industries (communications, energy, railroads, and airlines) makes these industries unique. Intangible property, such as licenses, is excluded from the tax base for other commercial and industrial property. The impacted industries have raised concerns about the competitive implications of this tax treatment in light of deregulation.

The Committee discussed an outline for a separate process to analyze the two issues. These processes should begin with a thorough discussion of the Legislative history for each issue. Both issues should be considered in the context of their respective regulatory environments. For timber, this means more restrictive environmental guidelines. Taxation of intangible assets should be examined in the context of the deregulation trend sweeping the utility industry. Both issues carry significant ramifications for local government revenue. Finally, the framework established for this report could serve as a useful starting point for considering both issues. Proposed changes can be considered in terms of their stability, equity, and social policy implications.

The Committee agreed that the Department of Revenue's issue papers contained in Appendix B serve as a good starting point for further more intensive discussions. The issue papers discuss the history of these issues, examine each in the context of stability, equity, and social policy. Each paper concludes with a suggested set of policy questions.

The Oregon Forest Industries Council also provided an issue paper on timber taxation. This paper is included in Appendix B as well.

Key Findings

- 5.1 **The issues of timber and intangible taxation are complex and deserve a focused effort.** A broad based group consisting of the interested parties is necessary to arrive at an appropriate policy decision.
- 5.2 **State and local government relations need to be considered when examining forest land and intangible taxation issues.** Both of these issues have their roots in the property tax. Any change in the structure of the current system is likely to have revenue implications for local governments.

POLICY QUESTIONS

The Committee deferred defining policy questions to a separate process. A starting point is contained in the white papers included in Appendix B.

APPENDIX A:

STATE, LOCAL AND SPECIAL DISTRICTS FINANCE

1. Letter from Association of Oregon Counties
2. Letter from League of Oregon Cities

APPENDIX B

TIMBER AND INTANGIBLE TAXATION

1. Utilities & Transportation Properties Deregulation Issues, Department of Revenue White Paper
2. Timber Taxation, Department of Revenue White Paper
3. Issue paper on timber taxation, Oregon Forest Industries Council

APPENDIX C

OREGON SHINES AND THE BENCHMARKS

