



STATE OF OREGON

LEGISLATIVE REVENUE OFFICE

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Research Report

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Research Report #6-09 Revised

November 2009

MEASURES 66 & 67¹

Summary

As the result of a citizen's referendum, two measures will go a special election ballot to be held January 26. On the ballot will be two measures approved by the Legislature during the 2009 regular legislative session. A yes vote will confirm the Legislature's passage of the bills. A no vote will overturn the Legislature's vote and prevent the bills from becoming law. The two measures are HB 2649 (Measure 66) and HB 3405 (Measure 67). Both measures have the effect of raising revenue for the state's General Fund.

The report is divided into the following sections followed by a summary of each section.

Budget Context

- Measures 66 and 67 are expected to raise \$727 million in General Fund revenue for the 2009-11 biennium. The two measures are the main components of the Legislature's General Fund revenue raising efforts which totaled \$801 million.
- Measures 66 and 67 are part of the Legislature's plan to fill a projected \$4.0 billion gap between current law revenue and the cost of maintaining public services. The Legislature took the following actions to fill the gap: budget cuts (from the essential budget level) of \$1,994 million (49.5%), use of federal stimulus revenues of \$978 million (24.2%), use of fund shifts and reserves of \$255 million (6.3%) and \$801 million (19.9%) in additional revenue including the revenue from Measure 66 and Measure 67.

Description of Measures

- Measure 66 contains the following elements
 - Establish new tax rate brackets and phase out federal tax subtraction for high income taxpayers

¹ This report is an update from an earlier version released September 30. The report has been revised to include the proper names for the ballot measures, newly released U.S. Census data and the December 2009 revenue forecast. The remainder of the data and analysis are unchanged.

- Phase out federal tax subtraction starting at adjusted gross income of \$250,000 (J) and \$125,000 (S).
 - Establish new marginal tax rate of 10.8% for taxable income between \$250,000 and \$500,000 for joint filers and \$125,000 and \$250,000 for single filers.
 - Establish new 11% marginal tax bracket for taxable income above \$500,000 for joint filers and \$250,000 for single filers.
 - Apply new rates to tax years 2009, 2010 and 2011.
 - Starting with 2012 tax year, apply 9.9% marginal tax rate to taxable income above \$250,000 for joint filers and \$125,000 for single filers.
 - Connect to one-year federal tax exclusion of first \$2,400 of unemployment benefits
 - Applies to 2009 tax year only.
- Measure 67 contains the following elements:
 - New Corporate Minimum
 - \$150 for S-Corps, and Partnerships.
 - C-Corp minimum starting at \$150 for corporations with Oregon sales less than \$500,000 with graduated increases up to \$100,000 for C-Corps with sales greater than \$100 million.
 - New Corporate Income Tax Rate Structure
 - Retain 6.6% rate on first \$250,000 of net income.
 - Apply new marginal rate of 7.9% to corporate net income above \$250,000 for the 2009 and 2010 tax years. For the 2011 and 2012 corporate tax years apply 7.6% rate to net income above \$250,000. Starting with the 2013 tax year, apply 7.6% marginal tax rate to net income above \$10 million and 6.6% for net income below \$10 million.
 - New Secretary of State Filing Fee Structure
 - In addition to current \$50 annual flat rate on all entities:
 - \$50 for domestic corporations.
 - \$225 for corporations based outside Oregon.

Distribution Effects

- Roughly 2.5% of personal income tax filers are expected to have higher state tax liability under Measure 66.
- About 5% of corporate income tax filers are expected to have higher tax liability due to the higher corporate income tax rates contained in Measure 67.
- Most corporations will experience an increase under the new corporate minimum. The new minimum is an alternative tax, meaning that corporations pay either through the tax rates based on net income or the minimum based on Oregon sales, whichever is higher. Corporations paying the minimum tax will have a liability equal to about 0.1% of Oregon sales.

Impact of Measures on State's Tax Burden Compared to Other States

- The measures are expected to have a relatively minor impact on the tax burden compared to other states. Using the 2006-07 Census data and holding other states constant, Oregon's per capita taxes move from 36th highest to 34th highest.

- Oregon's overall business tax burden is the 3rd lowest among the states according to the annual Council on State Taxation Study conducted by Ernst & Young. With the revenue estimates from the measures included and holding other states constant, the state's business tax burden would move to the 5th lowest.

Economic Effects

- In the short term, the states' balanced budget requirements force them to either cut spending or increase revenue during economic downturns. Both actions have the effect of reducing overall demand in the respective state economies, thereby adding to the downward pressures on employment and income. The short-term impact on overall demand is likely to be greater for expenditure reductions because they reduce demand directly while tax increases reduce demand indirectly through reductions in after-tax income. The impact of state spending reductions can also be compounded by reductions in federal matching funds whereas the impact of state tax increases is softened somewhat by federal deductibility.
- Over the longer term, the net effect of the measures on employment and income depends critically on how the revenue is used by the public sector. The measures are expected to have relatively small negative effects on overall income and employment (-0.1%) in the absence of productivity effects from public sector expenditures. Inclusion of productivity enhancing effects of public spending on infrastructure and education can neutralize the negative effects from the tax increases and potentially generate positive results. The ultimate impact of public spending on the economy depends on the precise nature of the spending, how effectively public programs are implemented and the time period under consideration.

Budgetary Consequences

- A yes vote will implement the revenue raising effects of the two measures. The December revenue forecast, which includes the estimated revenue from Measures 66 and 67, shows a projected 2009-11 General Fund ending balance of \$79.2 million. The December forecast also indicates that the conditions spelled out in SB 5520 are projected to be met thereby triggering a \$200 million allocation to the State School Fund in June of 2010.
- A no vote will reduce the General Fund revenue forecast by \$727 million compared to the December forecast. This will give the General Fund a projected deficit of \$647.8 million and negate the \$200 million allocation to the State School Fund. Reserves available in the 2009-11 biennium from the Education Stability Fund and the Rainy Day Fund are estimated at \$312.4 million.

Budget Context

The Legislature's decision to approve HB 2649 and HB 3405 was made in the context of a sharp reduction in state revenue projections and a large estimated gap between current law revenue and the costs of maintaining public services. Legislative leadership set a target of \$800 million in new revenue to help fill an estimated \$4.0 billion budget gap for the 2009-11 biennium. With an estimated revenue impact of \$733 million, the two bills met the bulk of the revenue target. The projected additional revenue was combined with federal stimulus dollars, state reserves and budget cuts to eliminate the projected gap and balance the 2009-11 General Fund/Lottery budget.

The General Fund/Lottery budget is the state's primary discretionary budget. The General Fund is largely funded through income taxes, with the personal and corporate income tax comprising over 90% of General Fund revenue. Earnings from the Lottery, largely from video games, make up 7.5% of combined General Fund/Lottery revenue. The vast bulk of the General Fund/Lottery budget is divided into three general areas of public services: education (52%), human services (25%) and public safety including the court system (17%). The remaining 6% is spread over natural resources and other programs.

Development of the state's biennial budget begins with a detailed budget recommendation from the Governor issued in December of even numbered years followed by the legislatively adopted budget in June of odd-numbered years, just prior to the close of the regular legislative session. Major decisions about the size and components of the budget begin in September of even numbered years and are finalized roughly 9 months later. During this process the Governor and the Legislature receive updates on the projected amount of revenue under current law for the upcoming 2-year period. Between September of 2008 and May of 2009 (the forecast used to balance the legislatively adopted budget), economic and revenue conditions deteriorated sharply with the General Fund revenue projection for the 2009-11 biennium declining from \$15.5 billion to \$12.5 billion, a drop of 19.1%. During this period, the projection for the current 2007-09 biennium was also declining sharply forcing the Legislature to rebalance the budget adopted in June of 2007. Revenue projections for the 2007-09 biennium declined \$1.1 billion or 8.8% between September of 2008 and May 2009.

The declining revenue forecasts were caused by the emergence of the longest, deepest U.S. downturn since 1929-33. The recession began in December of 2007 but became much more severe in September of 2008 with the financial market panic following the collapse of Lehman Brothers. The timing of the recession means that much of its impact on income tax collections will be felt in the coming 2009-11 biennium even if a modest recovery begins in the second half of 2009. The May 2009 revenue forecast, prior to legislative actions, showed projected General Fund revenue of \$12,517 million. This figure is 1.8% below the actual General Fund revenue in the 2005-07 biennium. With the price level expected to rise 8.1% over this 4-year period, the May forecast used to balance the legislative budget put General Fund revenue roughly 10% below the 2005-07 level in inflation adjusted terms.

In addition to forcing large reductions in General Fund revenue, the deep recession triggered sharp increases in the demand for human services from state government. Between June of 2007 and June of 2009, the number of unemployed in Oregon jumped 148%. The more than doubling

of the unemployed not only reflects the economic stress in the state but also is an indicator of the pressures on the spending side of the state budget. Rising unemployment leads to increased demand for the Oregon Health Plan, food stamps and other human resource programs.

The state budget process combines revenue projections with the estimated costs of maintaining the current level of public services plus additional costs resulting from previous legislation. The budget level is referred to as the essential budget level (EBL). Summing up the cost estimates and comparing them with current law revenue projections gives the Legislature an estimated gap. If the cost estimates exceed the projected revenue, the Legislature must fill the gap to meet its constitutional obligation to balance the state operating budget. The gap can be filled through budget cuts (from the EBL), fund shifts including reserves, and/or revenue increases. For details on the state budget see “Budget Highlights: 2009-11 Legislatively Adopted Budget” published by the Legislative Fiscal Office.

Table 1 shows how the 2009 Legislature filled an estimated \$4,028 million gap projected for the 2009-11 budget period. Roughly half (49.5%) of the gap was filled with budget cuts from the essential budget level. American Recovery and Reinvestment Act (ARRA) stimulus dollars from the federal government were used fill about ¼ of the gap (24.2%). The Legislature also used \$255 million in reserves (with \$225 million coming from the Rainy Day Fund) to fill another 6.3% of the gap. It should be noted that the Legislature used \$392 million from the Education Stability Fund and another \$86 million in fund shifts to rebalance the 2007-09 budget after falling revenue estimates indicated a deficit late in the biennium. Finally, the Legislature approved measures that would raise \$801 million in new General Fund revenue, including passage of HB 2649 and HB 3405 which became Measures 66 and 67. New revenue was used to fill about 20% of the projected gap. The two referred measures make up most of the new revenue, accounting for 18.2% of the gap by themselves.

Table 1: Legislative Actions To Fill Projected 2009-11 Budget Gap		
	\$Millions	% of Gap
Total General Fund/Lottery Budget Gap	4,028	100
Federal ARRA Revenue	978	24.2
State Reserves	255	6.3
Additional State Revenue	801	19.9
Budget Cuts	1,994	49.5

When the Legislature ended the regular session in late June, the 2009-11 General Fund budget had a projected ending balance of \$294 million. This relatively large projected ending balance was designed to address the very high level of uncertainty surrounding the economic outlook. The projected ending balance was reduced to \$255 million by the Governor’s vetoes following the session (assuming the Legislature does not over-ride the vetoes). The projected ending balance was further reduced by subsequent revenue forecasts and now stands at \$79.2 million. This estimate is sure to change, given that the biennium is in its very early stages and forecasts are updated every 3 months.

Description of Measures

Key Elements of Measure 66

Measure 66 contains the following three policies designed to add progressivity to the personal income tax while enhancing our tie to current federal tax law: (1) a one-year exclusion from tax for up to \$2,400 of unemployment compensation; (2) a phase-out of the federal tax subtraction for high income filers; and (3) an increase in the top marginal tax rate. The estimated revenue impacts from these policies are shown in Table 2. The General Fund is expected to receive \$472 million during the 2009-11 biennium from these policies. In subsequent biennia, that amount falls to roughly \$380 million as the top tax rate is reduced to 9.9 percent.

Table 2: Revenue Impacts (\$M)			
Policy	2009-11	2011-13	2013-15
Unemployment exclusion	-\$32	\$0	\$0
Federal subtraction phase-out and new marginal rates	\$504	\$375	\$379
Total	\$472	\$375	\$379

The first of these three policies is a 2009 exclusion from taxation of up to \$2,400 of unemployment compensation, which effectively adopts the same policy recently implemented at the federal level. In February of 2009, the president signed into law the American Recovery and Reinvestment Act of 2009, which contains the same exclusion from federal tax. Prior to enactment, the Legislature fixed Oregon's connection to federal law as was in effect on December 31, 2008. Historically, all unemployment compensation has been taxed at both the federal and state levels. This policy is projected to reduce tax liability by \$32 million in 2009.

The second policy in the measure is a phase-out of the maximum federal tax subtraction for single filers with an Adjusted Gross Income (AGI) of at least \$125,000 and for joint filers with an AGI of at least \$250,000.² Under current law, personal income tax filers may subtract up to \$5,850 of their federal income taxes for tax year 2009.³ The maximum subtraction does not depend on the taxpayer's income level. The measure would phase-out the maximum subtraction in steps of 20 percent as income increases until the subtraction is reduced to zero. The phase-out schedule for tax year 2009 is provided in Table 3. The first income group subject to the phase-out would be allowed to subtract 80 percent of the maximum, the second would be allowed 60 percent, and so forth. For example, a joint filer with an AGI of \$255,000 would have their federal tax subtraction limited to \$4,680 rather than \$5,850. The deduction is disallowed for single filers with AGI greater than \$145,000 and joint filers with AGI above \$290,000.

² In the context of this report, "single filer" refers collectively to single and married-filing-separately while "joint filer" includes joint, head-of-household, and surviving spouse filers.

³ This subtraction has been the subject of continued policy discussion recent years. See, for example, our Research Report #2-08, "Measure 59: Full Deductibility of Federal Income Taxes" for more detail on its history.

Table 3: Tax Year 2009 Federal Tax Subtraction Limits		
Single AGI	Maximum Subtraction	Joint AGI
< \$125,000	\$5,850	< \$250,000
\$125,000 to \$130,000	\$4,680	\$250,000 to \$260,000
\$130,000 to \$135,000	\$3,510	\$260,000 to \$270,000
\$135,000 to \$140,000	\$2,340	\$270,000 to \$280,000
\$140,000 to \$145,000	\$1,170	\$280,000 to \$290,000
> \$145,000	\$0	> \$290,000

The third policy in the bill is an increase in the top marginal tax rate for single filers with taxable income of at least \$125,000 and for joint filers with taxable income of at least \$250,000. Table 4 shows the tax rates without the measure, and what the rates would be if it were implemented. The income brackets listed in the first column are for tax year 2009. The second column shows the current three rate structure of 5%-7%-9%. The third column shows that the 10.8% rate would be applied to taxable income between \$250,000 and \$500,000 for joint filers while the 11% rate would be applied to taxable income greater than \$500,000; these rates would be in effect for tax years 2009 through 2011. The fourth column shows the permanent rate increase from 9% to 9.9% for taxable income above \$250,000; this change would begin with tax year 2012. (The taxable income levels for single filers are half of the amounts shown for joint filers.)

Table 4: Joint Filer Tax Rate and Brackets			
Taxable Income	Pre-Measure 66	Tax Years 2009-11	Tax Years 2012+
< \$6,100	5%	5%	5%
\$6,100 - \$15,200	7%	7%	7%
\$15,200 - \$250,000	9%	9%	9%
\$250,000 - \$500,000		10.8%	9.9%
> \$500,000		11.0%	

Since its inception in 1930, the personal income tax has had a variety of tax rate and bracket structures. (See Table 5) Currently, there are three brackets – 5%, 7%, and 9%; when it was first enacted, there were five tax brackets. For most of its history, from 1947 through 1986, there were seven tax brackets. While the top tax rate has been 9 percent since 1987, it was higher from 1955 through 1986. The top marginal tax rate was at its highest level of 11.6 percent during 1955 and 1956. The top tax bracket shown in the table is the level at which the top marginal tax rate is applied. For example, during the first three years of the tax (1930-32), the

Table 5: History of Personal Income Tax Rates			
Tax Years	Top Marginal Rate	Top Tax Bracket (Joint)	Number of Brackets
1930-32	5.0%	\$8,000	5
1933-38	7.0%	\$10,000	6
1939-46	7.0%	\$8,000	
1947-54	8.0%	\$10,000	7
1955-56	11.6%		
1957-68	9.5%	\$16,000	
1969-81	10.0%	\$10,000	
1982-84	10.8%		
1985-86	10.0%		
1987-92	9.0%	\$10,000 *	3
1993-2008	9.0%		

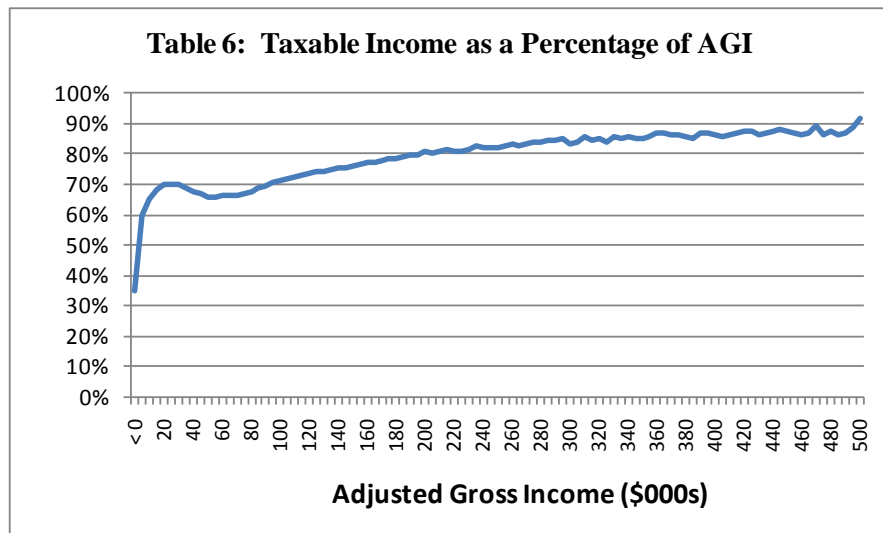
* Indexed for inflation.

top rate of 5 percent was applied to all taxable income above \$8,000. Also, prior to 1993, none of the tax brackets were index for inflation.

The combination of these three policies results in an impact on a given taxpayer that depends on the specifics of their tax return. While the one-year policy regarding unemployment compensation would affect taxpayers from across the income spectrum, the two policies that raise revenue are concentrated among those filers at the top end of the income distribution. Consequently, in the long term taxpayers fall into one of three categories with respect to the potential impact. Taxpayers are unaffected by the revenue raising portion of the bill (97.5% of full-year filers in 2009), affected only by the phase-out of the federal tax subtraction (0.8% of full-year filers), or affected by both the subtraction phase-out and the higher marginal tax rates (1.7% of full-year filers). The reason that some filers could be affected by only the subtraction phase-out is that taxable income is almost always less than AGI.

Adjusted Gross Income is the sum of various sources of income such as wages, net business income, pensions, and capital gains less certain deductions that all taxpayers are allowed to claim, such as student loan interest and moving expenses. These items are reported on the federal tax return and AGI is the starting point on the Oregon tax return for calculating taxable income. Oregon taxable income equals AGI plus additions minus subtractions and deductions. On average, taxable income is 75 percent of AGI; for most taxpayers the percent is roughly 70 percent, but increases to 90 percent for filers with an AGI of more than \$500,000.⁴ For example, a joint filer with an AGI of \$250,000 tends to have, on average, a taxable income of \$205,000.

Table 6 shows the size of taxable income as compared to AGI for all full-year filers.



Key Elements of Measure 67

This measure contains essentially three policies intended to address structural issues within the corporation taxes as well as raise revenue to help address the budget gap: (1) modify the minimum tax paid by corporations, partnerships, LLCs, etc. (but not sole proprietors); (2) add a second corporate marginal tax rate; and (3) increase certain Secretary of State filing fees. Table 7 shows the revenue impacts of the measure. The General Fund is expected to receive \$261 million

⁴ It is possible for additions to be greater than the sum of subtractions and deductions. In these few cases, taxable income is actually greater than AGI.

in 2009-11 as a result of these policies. In 2011-13, the amount is expected to increase slightly to \$269 million. In 2013-15, the revenue impact falls to \$230 million as the top marginal tax rate is applied only to income above \$10 million. Also of note is that the estimated \$69 million in 2013-15 from the marginal tax rate would be directed to the Rainy Day Fund as per HB 2073.

Policy	2009-11	2011-13	2013-15
Minimum Tax			
C-corporations	\$93	\$92	\$90
S-Corporations	\$17	\$18	\$19
Partnerships	\$17	\$18	\$20
Top marginal tax rate	\$108	\$110	\$69
Corporate registry fees⁵	\$26	\$31	\$32
Total	\$261	\$269	\$230

The minimum tax on C-corporations was established in 1929 with the creation of the corporate excise tax and was set at \$25. In 1931 it was reduced to \$10, where it has remained. In 2006, the Attorney General issued an opinion that the \$10 minimum tax should be applied per affiliate instead of per tax return. For example, a corporation with 10 affiliates would be subject to a minimum tax of \$100. Since 2006, this is how the minimum tax has been applied. Over the past several years, the minimum tax has received much attention and there have been significant policy discussions on how to change the tax. The theoretical basis for the change was to emphasize the benefits received principle, which would more closely align tax liability with the benefits received by corporations from public services. One version that received extensive review was to link the amount of the minimum tax to some measure of the company's presence in Oregon. During the 2009 session, this theory was embedded in using a measure of value added by the corporation, which was intended to reflect the amount of business activity in the state and thereby serve as a proxy for the level of benefits received from public services. Ultimately, the Assembly passed a new minimum tax that is based on the amount of Oregon sales the corporation has within the tax year. Table 8 contains the graduated minimum tax effect beginning in tax year 2009.

Oregon Sales (\$)	Minimum Tax
< \$500,000	\$150
\$500,000 to \$1 Million	\$500
\$1 Million to \$2 Million	\$1,000
\$2 Million to \$3 Million	\$1,500
\$3 Million to \$5 Million	\$2,000
\$5 Million to \$7 Million	\$4,000
\$7 Million to \$10 Million	\$7,500
\$10 Million to \$25 Million	\$15,000
\$25 Million to \$50 Million	\$30,000
\$50 Million to \$75 Million	\$50,000
\$75 Million to \$100 Million	\$75,000
\$100 Million or more	\$100,000

⁵ The 2009-11 impact is consistent with the Close of Session forecast. The delayed implementation of the policy resulting from the citizens' referendum reduces the 2009-11 estimate by \$6 million to \$20 million. The measure also contains an increase in the Uniform Commercial Code Filings from \$10 to \$15 and an increase in the Notary Commission Application fee from \$20 to \$40. These fees are not directed to the General Fund so additional detail is not provided here.

In addition to the increase the minimum tax for C-corporations, the Assembly also addressed the issue of the minimum tax for other types of business entities. S-corporations have some significant differences such as having only one class of stock, no more than 100 shareholders, and requiring shareholders to be US citizens; they have also been subject to the \$10 minimum tax since 1989.⁶ Often times, these are smaller businesses as compared to their C-corporation counterparts so the minimum tax was increased to a flat amount of \$150 – the same as for the smallest C-corporations.

In recent years, the rise in popularity of partnerships and LLCs has raised questions about the equity of the minimum tax across non-corporation types of business entities. Prior to the passage of this bill, these entities were not subject to a minimum tax. However, if this measure takes effect they will be treated the same as S-corporations and the smallest C-corporations and be subject to a flat minimum tax of \$150. Sole proprietors are not affected by the measure.

The second policy change in the bill is the creation of a second marginal tax rate. For tax years 2009 and 2010, corporations would be subject to a tax rate of 7.9 percent on net income above \$250,000; the tax rate of 6.6 percent is unchanged for net income up to \$250,000. For tax years 2011 and 2012, the 7.9 percent rate is reduced to 7.6 percent. Then beginning in tax year 2013, the 7.6 percent rate is applicable only to net income in excess of \$10 million. Table 9 summarizes the rate structure.

Taxable Income	Pre-Measure 67	Tax Years 2009-10	Tax Years 2011-12	Tax Years 2013+
< \$250,000	6.6%	6.6%	6.6%	6.6%
\$250,000 - \$10 million		7.9%	7.6%	
> \$10 million				7.6%

The third policy contained in the bill is an increase in the Secretary of State corporate registry filing fees. Prior to the measure, all entities paid an annual flat fee of \$50. The measure increases that amount to \$100 for Oregon corporations and to \$275 for those based outside Oregon.

Distribution Effects

This section of the report discusses the distributional effects of each of the bills. Because each of the bills embodies a long-term policy addressing structural issues as well as a short-term policy addressing the budget gap within that long-term context, an analysis of each is included here. First, a brief description of the unemployment compensation exclusion is provided. Then, to highlight the short-term and long-term impacts, the distributional tables are provided in sets of two. The first is for tax year 2009, the first year of the tax change. The second is for tax year 2013, the first year for which the long-term policies are in effect for both the personal and corporate tax changes.

⁶ These entities were added to the Internal Revenue Code in 1958.

Table 10 shows the estimated distributional impact of the unemployment exclusion for 2009. In total, roughly \$32 million in tax reductions is expected to be distributed as shown in the table. Historically, slightly more than half of the taxpayers who reported this income reported an amount greater than \$2,400. In such cases, only the compensation greater than \$2,400 would be subject to tax. While most of this income tends to be reported by filers with relatively lower income, some amount is reported by higher income filers as well. Given the state's high unemployment rate in 2009, the amount of unemployment compensation received by taxpayers is expected to be higher than in previous years.

Table 10: Unemployment Compensation		
AGI (\$000)	Returns	Revenue Reduction
< 20	28%	\$9.1
20 - 40	30%	\$9.7
40 - 60	19%	\$6.0
60 - 80	11%	\$3.6
80 - 100	6%	\$1.8
> 100	6%	\$1.8
Total	100%	\$32.0

Table 11 shows the distributional impacts on full-year filers for the personal income tax increases – the tax reduction from the unemployment exclusion is not included. The top portion of the table shows the impacts for tax year 2009. In total, roughly \$162 million is raised from the phase-out of the federal tax subtraction and the higher tax rates of 10.8% and 11%. Nearly 37,800 full-year taxpayers will be affected, or about 2.5 percent. Just over 13,100 single filers (1.8%) will be affected while nearly 24,700 joint filers (3%) will be affected. The average tax increase for those affected is \$4,287 but the impact increases with income. Single filers who are affected and have income between \$100,000 and \$200,000 will have their taxes increase an average of \$466, or 5%. Joint filers with an income above \$500,000 will have their taxes increase an average of \$14,969, or 18%. The table also shows a slight reduction in federal taxes due to the deductibility of state taxes.

The lower portion of the table shows similar distributional impacts but for tax year 2013. Nearly 59,500 taxpayers (3.6%) are affected by the tax increase and are expected to incur an average tax increase of \$2,629 (7%). The average increase in 2013 is less than in 2009 because the top tax rate is reduced to 9.9% beginning in 2012. The number of taxpayers affected is expected to increase due in part to the expected economic recovery leading to relatively more taxpayers at the top end of the income distribution. Roughly 2.7% of single filers will be affected and face an average tax increase of \$1,419 (8%) while 4.5% of joint filers will face an average tax increase of \$3,312 (7%).

Table 11: Distributional Impacts of Personal Income Tax Increases (Full-Year Filers)

Tax Year 2009										
Income Class	Returns			Oregon Tax (\$M)					Federal Tax (\$M)	
	Total	Affected	Percent	Current	Proposed	Change	% Change	Average	Base	Change
All Returns										
LESS THAN 100,000	1,325,600	0	0.0%	\$1,842.4	\$1,842.4	\$0.0	0.0%	\$0	\$2,606.8	\$0.0
100,000 TO 200,000	170,716	8,163	4.8%	\$1,145.2	\$1,149.0	\$3.8	0.3%	\$466	\$2,479.8	-\$0.5
200,000 TO 500,000	36,507	20,986	57.5%	\$625.5	\$653.5	\$28.1	4.5%	\$1,337	\$1,898.7	-\$0.4
500,000 AND OVER	8,753	8,646	98.8%	\$719.0	\$849.2	\$130.2	18.1%	\$15,055	\$2,873.6	-\$8.5
TOTAL	1,541,576	37,795	2.5%	\$4,332.1	\$4,494.1	\$162.0	3.7%	\$4,287	\$9,858.9	-\$9.4
Single Returns										
LESS THAN 100,000	702,009	0	0.0%	\$801.7	\$801.7	\$0.0	0.0%	\$0	\$1,499.6	\$0.0
100,000 TO 200,000	20,544	8,163	39.7%	\$140.6	\$144.4	\$3.8	2.7%	\$466	\$434.3	-\$0.5
200,000 TO 500,000	4,080	4,004	98.1%	\$70.5	\$79.4	\$8.9	12.6%	\$2,217	\$252.2	-\$0.2
500,000 AND OVER	997	971	97.4%	\$71.8	\$87.1	\$15.3	21.3%	\$15,737	\$368.2	-\$0.7
TOTAL	727,630	13,139	1.8%	\$1,084.6	\$1,112.5	\$28.0	2.6%	\$2,128	\$2,554.4	-\$1.4
Joint Returns										
LESS THAN 100,000	623,591	0	0.0%	\$1,040.7	\$1,040.7	\$0.0	0.0%	\$0	\$1,107.1	\$0.0
100,000 TO 200,000	150,172	0	0.0%	\$1,004.7	\$1,004.7	\$0.0	0.0%	\$0	\$2,045.5	\$0.0
200,000 TO 500,000	32,427	16,982	52.4%	\$554.9	\$574.1	\$19.2	3.5%	\$1,130	\$1,646.5	-\$0.2
500,000 AND OVER	7,756	7,675	98.9%	\$647.2	\$762.1	\$114.9	17.7%	\$14,969	\$2,505.4	-\$7.8
TOTAL	813,946	24,657	3.0%	\$3,247.5	\$3,381.6	\$134.1	4.1%	\$5,437	\$7,304.5	-\$8.0
Tax Year 2013										
Income Class	Returns			Oregon Tax (\$M)					Federal Tax (\$M)	
	Total	Affected	Percent	Current	Proposed	Change	% Change	Average	Base	Change
All Returns										
LESS THAN 100,000	1,339,415	0	0.0%	\$2,146.2	\$2,146.2	\$0.0	0.0%	\$0	\$3,132.8	\$0.0
100,000 TO 200,000	230,959	12,937	5.6%	\$1,675.7	\$1,681.5	\$5.8	0.3%	\$446	\$3,393.8	-\$0.8
200,000 TO 500,000	53,334	31,769	59.6%	\$994.8	\$1,025.5	\$30.7	3.1%	\$966	\$2,647.3	-\$4.3
500,000 AND OVER	14,926	14,782	99.0%	\$1,369.1	\$1,489.0	\$119.9	8.8%	\$8,112	\$4,875.9	-\$10.4
TOTAL	1,638,634	59,488	3.6%	\$6,185.8	\$6,342.1	\$156.4	2.5%	\$2,629	\$14,049.7	-\$15.5
Single Returns										
LESS THAN 100,000	760,426	0	0.0%	\$1,061.0	\$1,061.0	\$0.0	0.0%	\$0	\$1,833.0	\$0.0
100,000 TO 200,000	32,406	12,937	39.9%	\$240.6	\$246.3	\$5.8	2.4%	\$446	\$626.3	-\$0.8
200,000 TO 500,000	6,877	6,756	98.2%	\$128.6	\$138.2	\$9.7	7.5%	\$1,433	\$396.3	-\$1.1
500,000 AND OVER	1,814	1,783	98.3%	\$150.1	\$165.1	\$15.0	10.0%	\$8,421	\$626.3	-\$0.8
TOTAL	801,522	21,477	2.7%	\$1,580.2	\$1,610.7	\$30.5	1.9%	\$1,419	\$3,481.9	-\$2.8
Joint Returns										
LESS THAN 100,000	578,989	0	0.0%	\$1,085.2	\$1,085.2	\$0.0	0.0%	\$0	\$1,299.7	\$0.0
100,000 TO 200,000	198,553	0	0.0%	\$1,435.1	\$1,435.1	\$0.0	0.0%	\$0	\$2,767.5	\$0.0
200,000 TO 500,000	46,457	25,013	53.8%	\$866.2	\$887.2	\$21.0	3.5%	\$840	\$2,251.0	-\$3.2
500,000 AND OVER	13,112	12,999	99.1%	\$1,219.0	\$1,323.9	\$104.9	17.7%	\$8,069	\$4,249.5	-\$9.5
TOTAL	837,112	38,011	4.5%	\$4,605.6	\$4,731.5	\$125.9	2.7%	\$3,312	\$10,567.8	-\$12.8

Tables 12 and 13 contain estimated distributional impacts of Measure 67 by the amount of Oregon sales and by industrial sector. Also, each table shows the impacts of the minimum tax and new marginal tax rate separately. As with the tables on the personal income tax, there is a table for tax year 2009 that contains the higher, temporary changes and a table for tax year 2013 that shows the lower, permanent tax changes.

Table 12 shows the impacts by category of Oregon sales – these are the same categories identified earlier corresponding to the different levels of the proposed minimum tax. In total, the increase in the minimum tax is expected to raise nearly \$47 million in the first year. The top table shows that 20,417 of the 33,593 C-corporations forecast to file a tax return for 2009 are expected to have less than \$500,000 of Oregon Sales and would be subject to the new minimum tax of \$150, which is generally an increase of \$140 from the current \$10 minimum.⁷ Of these, 81 percent could be affected by the minimum tax and be subject to an average tax increase of \$136. As the amount of Oregon sales increases, the minimum tax increases, which is reflected in the table as the average increase in the minimum tax for those affected moves from the \$136 to \$90,103 for C-corporations with more than \$100 million in Oregon sales. In total, 74% of these corporations will be affected by the higher minimum tax and pay an average tax increase of \$1,887. Also, the proportion affected generally declines as sales increase, falling from the 81 percent to 45 percent for the largest corporations.

Approximately five percent of C-corporations would be affected by the new marginal tax rate in 2009; nearly \$50 million in revenue is expected in the first year of implementation. The share of affected corporations increases with size. Less than 0.5% of the smallest corporations would be affected. Because these corporations have relatively little Oregon sales, the income subject to the marginal tax is generally non-business income. More than half (54 percent) of the largest corporations would be subject to the 7.9% tax rate. The average tax impact for those affected ranges from a few thousand dollars for the smaller corporations to just over \$200,000 for the largest corporations.

The lower table (for 2013) conveys a similar story for minimum tax filers as that for 2009. In total, fewer C-corporations are expected to file tax returns in 2013 than in 2009. With the expected economic recovery, slightly fewer corporations are expected to be affected by the minimum tax. The average tax increase due to the minimum tax is expected to increase slightly to \$1,989. Taken together, the amount raised from the minimum tax is expected to be just over \$45 million.

The more significant difference is for the impact of the tax rate. In 2009, the top tax rate of 7.9% is applied to all taxable income greater than \$250,000; beginning in 2013, the top rate of 7.6% is applied only to taxable income in excess of \$10 million. Roughly 0.5% of C-corporations would be affected by the new tax rate raising nearly \$35 million in 2013. C-corporations with less than \$25 million of Oregon sales are generally not affected; except for a few with non-business

⁷ As mentioned previously, the minimum tax is \$10 per affiliate included in the tax return, as opposed to \$10 per return. So the actual increase in the minimum tax depends on the number of affiliates. In fact, because the proposed new minimum tax is per tax return, it's possible that some corporations could experience a tax reduction. For example, a corporation with 20 affiliates would currently have a minimum tax of \$200; if their Oregon sales were less than \$500,000, their minimum tax would fall \$50 from the \$200 to \$150.

income. For the larger corporations, the share affected increases with size. Slightly more than one-third (37 percent) of the largest corporations are expected to see a tax increase as a result of the new rate. Nearly 90 percent of the revenue raised is from corporations with more than \$100 million in Oregon sales.

Table 12: Distributional Impact by Oregon Sales Category							
Tax Year 2009							
Oregon Sales (\$)	Returns	Minimum Tax			Marginal Tax Rate		
		Amount (\$M)	Average	% Affected	Amount (\$M)	Average	% Affected
< \$500,000	20,417	\$2.3	\$136	81%	\$1.9	\$21,275	0%
\$500,000 to \$1 Million	3,589	\$1.2	\$466	69%	\$0.2	\$5,758	1%
\$1 to \$2 Million	2,585	\$1.6	\$936	65%	\$0.4	\$3,822	4%
\$2 to \$3 Million	1,697	\$1.5	\$1,406	62%	\$0.6	\$4,993	8%
\$3 to \$5 Million	1,693	\$1.8	\$1,841	57%	\$0.7	\$3,932	10%
\$5 to \$7 Million	784	\$1.6	\$3,560	57%	\$0.9	\$5,685	19%
\$7 to \$10 Million	641	\$2.6	\$6,490	62%	\$0.9	\$6,537	22%
\$10 to \$25 Million	1,182	\$9.2	\$13,079	59%	\$4.6	\$11,803	33%
\$25 to \$50 Million	486	\$7.0	\$27,253	53%	\$6.5	\$30,555	44%
\$50 to \$75 Million	159	\$3.8	\$45,446	53%	\$3.5	\$50,767	43%
\$75 to \$100 Million	130	\$4.9	\$71,561	53%	\$4.2	\$78,239	41%
> \$100 Million	231	\$9.4	\$90,103	45%	\$25.1	\$202,201	54%
Total	33,593	\$46.8	\$1,887	74%	\$49.6	\$29,522	5%
Tax Year 2013							
Oregon Sales (\$)	Returns	Minimum Tax			Marginal Tax Rate		
		Amount (\$M)	Average	% Affected	Amount (\$M)	Average	% Affected
< \$500,000	19,074	\$2.1	\$137	80%	\$0.3	\$61,343	0%
\$500,000 to \$1 Million	3,199	\$1.0	\$467	68%	\$0.0	\$11,859	0%
\$1 to \$2 Million	2,772	\$1.7	\$937	64%	\$0.0	\$10,275	0%
\$2 to \$3 Million	1,330	\$1.2	\$1,408	61%	\$0.0	\$0	0%
\$3 to \$5 Million	1,375	\$1.4	\$1,844	56%	\$0.0	\$0	0%
\$5 to \$7 Million	751	\$1.5	\$3,567	57%	\$0.0	\$0	0%
\$7 to \$10 Million	620	\$2.5	\$6,502	61%	\$0.0	\$0	0%
\$10 to \$25 Million	1,096	\$8.4	\$13,105	59%	\$0.0	\$13,537	0%
\$25 to \$50 Million	465	\$6.3	\$27,306	49%	\$0.6	\$63,695	2%
\$50 to \$75 Million	178	\$4.3	\$45,536	53%	\$1.2	\$85,279	8%
\$75 to \$100 Million	107	\$4.0	\$71,702	52%	\$1.7	\$90,352	17%
> \$100 Million	271	\$10.9	\$90,281	45%	\$30.9	\$310,597	37%
Total	31,239	\$45.2	\$1,989	73%	\$34.6	\$231,546	0.5%

Table 13 shows the sector impacts for tax years 2009 and 2013. The 2009 table shows the same 33,593 C-corporations, nearly \$47 million impact from the minimum tax, and nearly \$50 million impact from the marginal rate as shown in Table 12. Nearly half (47%) of the increase from the minimum tax comes from the manufacturing and trade (wholesale and retail) sectors. The average impact across sectors (for those affected) ranges from \$399 for Other Services to \$7,253 for Utilities. The share of companies affected in each sector ranges from 61 percent (Finance and Insurance) to 88 percent (Health Care and Social Assistance). Most of the revenue (60%) from the marginal tax rate comes from the wholesale trade, retail trade, and finance and insurance sectors. The average tax increase for those affected ranges from \$5,512 for Agriculture to \$322,655 for Utilities.

Table 13: Distributional Impact by Industrial Sector

Tax Year 2009							
Industry Sector	Returns	Minimum Tax			Marginal Tax Rate		
		Amount (\$M)	Average	% Affected	Amount (\$M)	Average	% Affected
Agriculture, Forestry, Fishing, and Hunting	1,814	\$1.0	\$753	76%	\$0.1	\$5,512	1%
Mining	97	\$0.1	\$956	75%	\$0.1	\$11,590	7%
Utilities	87	\$0.5	\$7,253	78%	\$2.3	\$322,655	8%
Construction	3,801	\$2.7	\$927	75%	\$1.5	\$14,855	3%
Manufacturing	2,531	\$7.2	\$4,057	70%	\$5.2	\$23,030	9%
Wholesale Trade	3,821	\$9.7	\$3,871	66%	\$12.6	\$34,842	9%
Retail Trade	2,770	\$5.3	\$2,650	73%	\$7.5	\$41,411	7%
Transportation and Warehousing	1,028	\$1.8	\$2,367	75%	\$1.5	\$34,137	4%
Information	970	\$2.5	\$3,119	81%	\$2.2	\$45,299	5%
Finance and Insurance	2,816	\$4.5	\$2,606	61%	\$9.7	\$37,909	9%
Real Estate, Rental, and Leasing	1,950	\$1.2	\$879	71%	\$0.7	\$13,575	3%
Professional, Scientific, and Technical Services	3,712	\$2.0	\$679	79%	\$1.0	\$13,901	2%
Management of Companies and Enterprises	1,010	\$3.9	\$5,625	69%	\$2.5	\$25,873	10%
Administrative, Support, and Waste Management	1,274	\$0.9	\$921	76%	\$0.4	\$11,398	2%
Education Services	207	\$0.1	\$532	76%	\$0.1	\$11,058	3%
Health Care and Social Assistance	2,016	\$1.8	\$1,028	88%	\$1.0	\$43,002	1%
Arts, Entertainment, and Recreation	408	\$0.3	\$869	79%	\$0.0	\$8,673	1%
Accommodation and Food Services	1,020	\$0.6	\$750	73%	\$0.5	\$19,180	2%
Other Services (except Public Administration)	2,261	\$0.7	\$399	82%	\$0.8	\$28,169	1%
Total	33,593	\$46.8	\$1,887	74%	\$49.6	\$29,532	5%

Tax Year 2013							
Industry Sector	Returns	Minimum Tax			Marginal Tax Rate		
		Amount (\$M)	Average	% Affected	Amount (\$M)	Average	% Affected
Agriculture, Forestry, Fishing, and Hunting	1,686	\$1.0	\$794	75%	\$0.0	\$0	0.0%
Mining	90	\$0.1	\$1,008	74%	\$0.0	\$0	0.0%
Utilities	81	\$0.5	\$7,645	77%	\$2.9	\$453,562	7.9%
Construction	3,534	\$2.6	\$978	75%	\$0.7	\$212,323	0.1%
Manufacturing	2,353	\$6.9	\$4,276	69%	\$1.5	\$127,588	0.5%
Wholesale Trade	3,553	\$9.4	\$4,080	65%	\$10.0	\$309,648	0.9%
Retail Trade	2,576	\$5.2	\$2,793	72%	\$6.0	\$329,170	0.7%
Transportation and Warehousing	956	\$1.8	\$2,495	74%	\$1.3	\$290,511	0.5%
Information	902	\$2.4	\$3,287	80%	\$1.3	\$205,086	0.7%
Finance and Insurance	2,619	\$4.3	\$2,746	60%	\$7.7	\$155,455	1.9%
Real Estate, Rental, and Leasing	1,813	\$1.2	\$926	70%	\$0.1	\$49,448	0.1%
Professional, Scientific, and Technical Services	3,452	\$1.9	\$716	78%	\$0.3	\$286,515	0.0%
Management of Companies and Enterprises	939	\$3.8	\$5,928	69%	\$1.3	\$250,812	0.6%
Administrative, Support, and Waste Management	1,185	\$0.9	\$971	75%	\$0.1	\$75,874	0.1%
Education Services	192	\$0.1	\$561	75%	\$0.0	\$0	0.0%
Health Care and Social Assistance	1,875	\$1.8	\$1,084	87%	\$0.8	\$233,389	0.2%
Arts, Entertainment, and Recreation	379	\$0.3	\$916	78%	\$0.0	\$0	0.0%
Accommodation and Food Services	948	\$0.5	\$790	72%	\$0.2	\$78,701	0.2%
Other Services (except Public Administration)	2,103	\$0.7	\$420	81%	\$0.5	\$210,656	0.1%
Total	31,239	\$45.2	\$1,989	73%	\$34.6	\$231,546	0.5%

The 2013 sector table also shows a similar story for the minimum tax as in the 2009 table. And because of the tax rate and bracket differences between 2009 and 2013, the impact of the revenue raised is much more concentrated in 2013. As discussed above, roughly 0.5% of corporations are affected. The average tax increase for those affected from the tax rate ranges from none (Agriculture, Mining, Education Services, and Arts & Entertainment) to just over \$453,000 (Utilities). Correspondingly, the share of corporations affected ranges from none (Agriculture, Mining, Education Services, and Arts & Entertainment) to 7.9 percent (Utilities). The sector with the second largest share of affected corporations is Finance and Insurance at 1.9 percent.

Impact of Measures on State's Tax Burden Compared to Other States

A rough estimate of the impact of the two measures on Oregon's tax burden compared to other states can be calculated by adding the revenue impact estimates for the 2009 tax year to the latest comprehensive Census data on state and local taxes. Table 14 demonstrates how the state's ranking is affected, assuming all other state's taxes stay the same. Oregon's overall tax burden in the 2006-07 fiscal year amounted to \$3,412 per person. As a percentage of total personal income in the state, state and local taxes totaled 9.7%. On a per capita basis, Oregon had the 36th highest tax burden. On a percentage of income basis, Oregon ranked 42nd highest among the states. Overlaying the estimated 2009 tax year revenue from Measure 66 and Measure 67 on the 06-07 Census data pushes Oregon's per capita tax burden to \$3,517 per person. As a percentage of personal income, the tax burden rises to 10.0%. Holding all other states constant, this would move Oregon's per capita tax ranking to the 34th highest tax while its percentage of personal income ranking would remain 42nd highest.

	Historical		With Measures 66 & 67	
	2006-07	Rank	Adjusted 2006-07	Adjusted Rank
<i>Taxes Per Capita</i>				
Total Taxes	\$3,412	36	\$3,517	34
Personal Income Taxes	\$1,502	5	\$1,569	5
Corporate Income Taxes	\$124	35	\$161	24
<i>Taxes As % Of Income</i>				
Total Taxes	9.7%	42	10.0%	42
Personal Income Taxes	4.3%	2	4.5%	2
Corporate Income Taxes	0.4%	33	0.5%	24

Since Measure 66 raises personal income taxes and Measure 67 raises corporate income taxes, those individual taxes are also shown in Table 14. Oregon's tax system is highly dependent on the personal income tax. The 2006-07 data show that Oregon's personal income taxes are the 5th highest on a per capita basis and 2nd highest as a percentage of personal income. Measure 66 would increase Oregon's personal income taxes by an estimated \$67 per person. This would leave the state's per capita tax ranking unchanged. The increase would raise personal income taxes from 4.3% of personal income to 4.5%. This would leave the state's personal income tax rank based on percentage of income at #2. Oregon's corporate income tax burden would rise from 35th highest on a per capita basis to 24th and from 33rd highest to 24th highest on a percentage of personal income basis.

Grafting the revenue impact estimates for the two measures onto the latest Census data indicates that Oregon's overall tax burden will change marginally but remain among the lower half of states, both in terms of per capita taxes and taxes as a percentage of personal income. The state's relative ranking for the personal income tax, already among the highest in the country, would not be affected while the corporate income tax burden would move into the third highest quintile among the states. While this analysis does provide some insight into how the measures will affect Oregon's tax burden relative to other states, it is important to recognize its limitations. First, it assumes that the state and local taxes of other states remain the same on a per capita and as a percentage of personal income basis. This is certainly not true, as indicated by the National Conference of State Legislatures survey showing a \$24 billion increase in state taxes discussed in

the next section. Secondly, even if the tax changes caused a dramatic change in Oregon's relative tax ranking, it does not necessarily follow that the state's relative economic growth rate will be affected because a relationship between overall state and local taxes and economic growth has not been demonstrated on a systematic basis.

Another way to assess how the tax increases under the two measures may affect Oregon's taxes relative to other states is to consider their impact on the state's business tax burden. The Council on State Taxation (COST) contracts with Ernst & Young to conduct an annual study of the business tax burden in all the states. The study examines all business taxes including the commercial and industrial portion of the property tax, sales taxes paid on business-to-business purchases and the portion of the personal income tax based on income from pass through entities such as S-corporations. Table 15 shows the total of all state and local taxes paid directly by business in the 2008 fiscal year. It is interesting to note that corporate income taxes make up less than 10% of the taxes paid by business.

Table 15: Total State and Local Taxes Paid Directly By Business		
Type Of Business Tax	Total (\$Billions)	% Of Business Taxes
Property Taxes On Business Prop.	\$209.3	35.5
General Sales Taxes	130.8	22.2
Corporate Income Tax	56.9	9.6
Business License Taxes	36.8	6.2
Unemployment Insurance Tax	32.5	5.5
Personal Inc. Tax On Bus. Inc.	27.2	4.6
Public Utility Taxes	26.6	4.5
Excise Taxes	26.0	4.4
Insurance Premium Taxes	15.6	2.6
Other Business Taxes	28.4	4.8
Total Business Taxes	590.0	100.0

Source: Council on State Taxation (study of FY 2008 data by Ernst & Young)

The Ernst & Young study places Oregon's business tax burden among the lowest in the country (see Table 16). The study sums all the various business taxes listed in Table 15 and divides them by the private sector Gross State Product of each state (2007 calendar year) to determine the rankings. The states with the ten lowest tax burdens are shown in Table 16. The addition of the corporate tax increases contained in HB 3405 and the estimated business pass through portion of HB 2649, everything else the same, have the effect of increasing Oregon's tax burden on business from 3.7% of private sector gross state product to 3.9%. This increase would move Oregon from the 3rd lowest business tax burden to the 5th lowest. The same caveats expressed with regard to the adjusted overall tax burden calculations apply to the business tax burdens during a period when state tax policy is very much in flux.

Table 16: Impact Of Measures On Oregon's Business Tax Ranking				
	% Of Private Sector Gross State Product 2007 Gross State Product		State Ranking Highest Ranking Means Lowest Tax Burden	
10 Lowest Business Tax States	Current Estimate	Estimate Adjusted For Measures 66 & 67	Current Rank	Rank Adjusted For Measures 66 & 67
North Carolina	3.6%	3.6%	1	1
Connecticut	3.7%	3.7%	2	2
Oregon	3.7%	3.9%	3	5
Delaware	3.8%	3.8%	4	3
Utah	3.9%	3.9%	5	4
Virginia	3.9%	3.9%	6	6
Georgia	4.0%	4.0%	7	7
Maryland	4.1%	4.1%	8	8
Missouri	4.1%	4.1%	9	9
Colorado	4.2%	4.2%	10	10

Source: Council on State Taxation (study of FY 2008 data by Ernst & Young)

Economic Effects

Analysis of the economic impact of the measures depends critically on the time dimension under consideration. In the short term, with the economy in deep recession and well below its productive capacity, overall demand largely determines the level of economic activity. During this period state fiscal policy influences demand but has little effect on the overall productive capacity of the state economy. During an intermediate period, estimated to last 5 to 7 years, taxes begin to affect economic behavior through their impact on wages and prices. Over the longer run (assumed to be greater than 7 years) the supply side or productivity enhancing effects of public spending in programs areas such as education and infrastructure influence the competitive position of the state economy. Table 17 summarizes these time periods for analysis of the economic effects.

Table 17: Timing of Economic Impacts	
Time Period	Expected Effects
<p>Short Term 0 To 5 Years</p> <p>Business cycle effects dominate—economy well below capacity</p>	<p>Demand Side Effects Dominate</p> <ul style="list-style-type: none"> • States must balance operating budgets • Spending reductions & tax increases reduce demand further • Spending reductions tend to decrease economic activity more than tax increases because of leakages & interaction with federal taxes/matching funds • State fiscal policy effects negative but relatively small—economic outlook largely determined by national & international business cycle
<p>Intermediate Term 5 To 7 Years</p> <p>State fiscal policy changes begin to influence the state’s long-term capacity</p>	<p>Supply Side/Capacity Effects Come Into Play</p> <ul style="list-style-type: none"> • Behavioral effects from tax changes cause adjustments to wages, prices which in turn affect employment, income & population growth • Supply side effects of state spending tend to be small because of time lags • Net effects expected to be negative but small
<p>Longer Term >7 Years</p> <p>Both sides of state budget—taxes & spending—influence the state’s economic capacity and long-term growth potential</p>	<p>Supply Side/Capacity Effects Become Fully Developed</p> <ul style="list-style-type: none"> • State spending in program areas such as education & infrastructure affect state economic capacity by influencing the productivity of capital and labor • Productivity effects from state spending can potentially offset negative effects from state tax policy • Net effects can be neutral or positive depending on how effectively revenue is used

State tax policy is typically pro-cyclical—meaning that the states in general raise taxes during economic downturns and lower them during periods of economic growth. The same is true of state spending—it typically grows faster during economic expansions and is cut back during recessions. The reason for this is the constitutional requirement nearly all states have (including Oregon) to balance their annual (or biennial) operating budgets. Based on a July survey by the National Conference of State Legislatures, states approved tax measures raising an estimated \$24.3 billion in the 2009-10 fiscal year. In contrast, the states in aggregate reduced taxes each year from 1997 to 2000, a period of strong economic growth. It is also interesting to note that the modern state tax system was largely established during the catastrophic downturn of the

1930s. Between 1930 and 1940, 24 states enacted sales taxes and 16 states enacted personal income taxes. Oregon's personal income tax was established in 1930.

In the short term, the states' balanced budget requirements force them to either cut spending or increase revenue during economic downturns. Both actions have the effect of reducing overall demand in the respective state economies, thereby adding to the downward pressures on employment and income. The short-term impact on overall demand is likely to be greater for expenditure reductions for two reasons. First, government spending reductions decrease demand directly while tax increases decrease demand indirectly by reducing after-tax income which in turn lowers private sector consumption and investment spending. This difference is especially important for the personal and corporate tax rate increases contained in the measures. The rate increases are expected to have a high degree of leakage from the state spending stream thereby limiting their downside demand effects on the state economy. For the personal income tax rates this is due to a relatively high saving rate (saving is a leakage) of high income households. For the corporate income tax rates this is due to a high degree of corporate income leakage to other states indicated by the fact that 89% of corporate income taxes are paid by corporations who apportion income among multiple states for tax purposes. A second factor causing spending reductions to have greater short-term demand side effects than tax increases is interaction with federal fiscal policy. On the spending side, some state expenditures, especially in the human services program area, are matched with federal funds. A reduction in these expenditures leads to corresponding federal reductions through the matching of funds. The loss of federal matching dollars further reduces demand in the state. On the tax side, the impact of state tax increases is partially offset by reduced federal taxes thereby softening the demand side effects on the state economy. Federal taxes are reduced through increased deductions of state taxes for corporations and individuals, though the ability of personal income taxpayers to deduct state taxes on their federal returns is becoming more limited by the federal alternative minimum tax.

Efforts to balance the state budget through either tax increases or spending reductions have the effect of reducing demand in the short-term and slowing the state economy. However, this relatively small impact is likely to be overwhelmed by the impact of the overall national and international business cycle. Historically, Oregon's short-term economic patterns have been dominated by changes in the national economy, the relatively small demand side effects from these tax measures are not expected to change that historical pattern in a measureable way.

The more significant issue from the state's perspective is the potential impact of the measures on Oregon's long-term economic growth. State economies operate in a large open national (and increasingly international) economy. Labor and capital are free to move to where they would receive the highest expected after-tax return. State economies grow by attracting labor and capital or by increasing the productivity of capital and labor within their borders. The after-tax rate of return to capital and labor is obviously affected by state tax policies but many other factors influence this return as well. The most important of these other factors are the quality and availability of labor and natural resources and the proximity of markets. Empirical studies of state economic growth have confirmed that the location of labor and capital and differentials in growth among the states is a highly complex process with a large number of variables potentially affecting the outcome. Taxes are clearly one of the potential variables but in most cases they are not the dominant factor. Further complicating the impact of state taxes on state economic growth

is their link to state expenditures. Expenditures on education and infrastructure are clearly a factor influencing the location of labor and capital. They also have the potential to increase the productivity of labor and capital already within a state's borders. The tight link between taxes and expenditures makes it very difficult to isolate the relationship between the level of state taxation and the economic growth in the state in a simple and direct way.

For evaluating the potential economic implications beyond the current recession, the Oregon Tax Incidence Model (OTIM) can be used. OTIM is a computable general equilibrium model of the state economy. It is designed to analyze how major tax changes affect the state economy after businesses and households have had time to adjust their behavior to a new set of prices, wages and returns to capital induced by the tax change. The model compares the current equilibrium with a new equilibrium for the economy after these changes have occurred. This is a particularly difficult time to assess long-term changes because the national and state economies are under such duress as evidenced by the state's very high unemployment rate. OTIM is designed to compare one near full employment equilibrium with another near full employment equilibrium in the future. Since the state economy is obviously nowhere near full employment, the timing of the results is difficult to interpret. However, the OTIM results can give insights into how the economy is likely to eventually respond to these policies.

Table 18 summarizes the OTIM results from two simulations. The first simulation incorporates the behavioral effects of the tax changes. The behavioral effects are assumed to be in response to the permanent aspects of the tax measures. The permanent features of the measures, fully in effect starting with the 2013 tax year, are a new 9.9% marginal personal income tax rate, a 7.6% marginal corporate income tax rate starting at \$10 million in net income and the new corporate minimum structure based on Oregon sales. This simulation is assumed to represent a 5 to 7 year time horizon in which behavioral effects of the tax changes have occurred. The demand-side effects of government spending are also incorporated into this simulation accounting for changes in public employment and purchases of government services. However, this simulation is too short of a period to incorporate the supply-side and productivity enhancing effects of government spending. It is therefore labeled an intermediate period. The second simulation incorporates these longer term effects of government spending in program areas such as education and infrastructure. This time horizon is assumed to be greater than 7 years.

Table 18: OTIM Simulation Results				
	<i>Simulation 1</i> No Productivity Gains From Public Spending Intermediate Period 5 To 7 Years		<i>Simulation 2</i> Productivity Gains From Public Spending Incorporated Longer Term >7 Years	
<i>Economic Variables</i>	Estimated Impact % Change	Simulation Level	Estimated Impact % Change	Simulation Level
Personal Income	-0.1%	\$162.1 billion	+0.3%	\$162.1 billion
Employment	-0.1%	2.3 million	0.0%	2.3 million
Population	-0.01%	4.0 million	+0.01%	4.0 million
Investment	-0.1%	\$17.9 billion	+0.1%	\$17.9 billion
Wage Index	+0.2%	100	+0.6%	100
Return To Capital	-0.1%	100	+0.1%	100
Price Level	+0.1%	100	+0.2%	100

Simulation 1 results in relatively small (about 0.1%), generally negative effects on the overall economy. Employment and income fall slightly as population drops due to some out-migration, primarily by high income households. Investment declines slightly (-0.1%) in response to a lower return to capital. The higher income tax rates push up wages as the supply of labor declines in response to higher marginal income tax rates. Prices rise by 0.1% primarily due to the corporate minimum tax. OTIM's distribution block (See Table 19) shows that nearly all of the household income loss occurs in the >\$185,000 income group. The six income groups between \$16,000 and \$185,000 contained in the model all have slight net income gains in Simulation 1. The static revenue estimates for the measures are reduced by about 3% from the dynamic economic effects. This includes both state and local revenue. The dynamic effects do not affect the revenue estimates for the 2009-11 biennium because they are the result of behavioral effects that are expected to occur over a 5 to 7 year period.

Table 19: OTIM Simulation Results By Income Group				
	<i>Simulation 1</i> No Productivity Gains From Public Spending Intermediate Period 5 To 7 Years		<i>Simulation 2</i> Productivity Gains From Public Spending Incorporated Longer Term >7 Years	
<i>Income Groups</i>	Average Net Household Income	Change In Number Of Households (% Change)	Average Net Household Income	Change In Number Of Households (% Change)
< \$17,000	-\$5	-.01	+\$40	-.01
\$17,000-29,000	+\$14	-.01	+\$122	+.02
\$29,000-42,000	+\$29	-.01	+\$212	+.03
\$42,000-60,000	+\$39	-.01	+\$269	+.06
\$60,000-87,000	+\$95	0	+\$532	+.11
\$87,000-117,000	+\$63	-.01	+\$412	+.08
\$117,000-185,000	+\$20	-.03	+\$424	+.06
>\$185,000	-\$1,882	-.53	-\$1,343	-.44

Simulation 2 is identical to Simulation 1 except for relaxation of the assumption that public sector spending has no impact on the productivity of labor and capital in the state economy. OTIM was designed with parameters that link public spending on education and other services to the overall productivity level in the economy. These parameters are turned off in Simulation 1 under the assumption that the time period is too short for these effects to become significant. Simulation 2 should therefore be interpreted as representing a longer time period-- >7 years. Simulation 2 incorporates a statewide estimate of these effects. Allowing for productivity effects results in higher overall income (+0.3%), unchanged employment, positive investment and a small population gain. The mean income level for all household groups increases in Simulation 2 with the exception of the >\$185,000 group. This group also shows some out-migration despite the increase in overall statewide population. The dynamic revenue impact in this simulation turns positive due to the higher income level.

The OTIM simulations lead to several conclusions:

1. The measures are expected to have relatively small negative effects on overall income and employment in the intermediate period (5 to 7 years) before any productivity enhancing effects from public sector spending can take place.
2. Over the longer run (assumed to be greater than 7 years) the productivity enhancing effects of public spending are expected to largely neutralize the negative effects from the tax increases and potentially generate positive results. The productivity impact of public sector spending is expected to increase with time as some expenditures such as early childhood education impact the economy only after a very long lag.
3. Nearly all household income groups are expected to show a rise in average household income under the measures, even in the intermediate simulation when overall income is lower. High income households show a loss in average income under both simulations. Modest out-migration for this group occurs under both simulations.

4. The dynamic revenue effects of the measures are expected to be small and negative in the intermediate period but turn slightly positive over the longer term. The dynamic impact does not affect the revenue estimates for the current 2009-11 biennium.

The OTIM simulations provide some insight into how the measures will affect the state economy and different income groups over time. The OTIM results highlight the interaction between tax measures and public sector expenditures. While the tax measures, viewed separately, can be expected to have negative effects on the state economy, the net impact of the measures over time depends critically on how the additional revenue is spent by the public sector. If this higher level of spending results in higher overall productivity in the economy, the negative effects of the taxes can be more than offset over time. In terms of OTIM, the net effect of the measures on overall economic activity depends on the value of the parameters linking public sector spending with productivity. While there has been considerable research showing the link between education levels and individual income, the channels through which public spending affects long-term productivity at the state level have not been precisely estimated. The ultimate impact of public spending on the economy depends on the precise nature of the spending, how effectively public programs are implemented and the time period under consideration.

Budgetary Consequences

2009-11 Biennium

Impact of yes vote

A yes vote on the measures would confirm the legislative vote and retain the estimated revenue from the measures in the forecast. In effect this will leave the December revenue forecast unchanged until the numbers are updated with the release of a new economic forecast in February 2010. The December forecast reduces the revenue impact of Measure 67 by \$6 million to reflect the later starting date for the increase in Secretary of State filing fees caused by the referendum. The combined revenue impact of the measures is now estimated to be \$727 million.

The state's reserve position in the event that the measures are approved by voters is summarized in Table 20. The Legislature transferred \$392 million from the Education Stability Fund (ESF) at the end of the 2007-09 biennium to balance the General Fund budget. This leaves the ESF essentially empty at the beginning of the 2009-11 biennium. The Rainy Day Fund balance is \$337.5 million at the beginning of the biennium but the Legislature committed \$225 million for the 2009-11 budget. The General Fund showed an estimated beginning balance of \$11.4 million entering the biennium. This balance will be transferred to the Rainy Day Fund after 2007-09 expenditures are finalized on January 1, 2010. Over the course of the biennium, the Education Stability Fund is expected to receive transfers of \$184.9 million from Lottery earnings after deductions for the Oregon Growth Account. In addition to the General Fund ending balance, the Rainy Day Fund is expected to receive \$3.5 million in interest earnings. The General Fund ending balance is projected at \$79.2 million based on the December forecast. The Legislature approved a \$200 million contingent transfer to the State School Fund if certain conditions are met in the June 2010 revenue forecast. These conditions are at least \$300 million in reserve fund balances (as June 2010) plus the projected General Fund ending balance. Based on the

December forecast these conditions are met. Table 20 shows a \$200 million transfer to the State School Fund with the dollars initially coming from the Rainy Day Fund and then the General Fund ending balance as specified in the bill. The State School Fund transfer would leave the Rainy Day Fund ending balance at zero and the projected overall reserve position for the state at \$191.6 million at the end of the 2009-11 biennium.

Table 20: State's Reserve Fund Position Based on Passage of Measures				
2009-11 Biennium September Forecast	Education Stability Fund	Rainy Day Fund	General Fund	Reserves Available
	(In Millions)			
Beginning Balance	\$0.1	\$337.5	\$11.4 (To Rainy Day Fund)	\$349
Approved Transfers		-225	-11.4	-236.4
Projected Revenue	184.9	14.9	79.2	279
Transfer To State School Fund*		-127.4	-72.6	-200
Projected Ending Balance	185.0	0	6.6	191.6

*Conditions for State School Fund transfer are specified in SB 5520.

Impact of No Vote

A no vote on January 26 would reduce the December 2009-11 General Fund revenue forecast by \$727 million, everything else the same. This would have the effect of canceling the triggered transfer to the State School Fund and putting the state's projected General Fund budget into deficit. Table 21 outlines how a no vote would affect the state's reserve position based on the December revenue forecast. Conditions for the State School Fund transfer would no longer be met resulting in a \$200 million reduction in State School Fund revenue compared with the December forecast. The projected General Fund ending balance would show a \$647.8 million deficit. The state would have \$312.4 million in reserves available that could be accessed with a 3/5 vote in each chamber. Assuming all of the reserves were committed would still leave a \$335.4 million shortfall in the General Fund budget. This shortfall would require legislative action to restore balance. If the balance is restored through budget reductions, it would likely come from the following program areas (with the percentage of 2009-11 General Fund/Lottery budget in parenthesis): education (52%), human services (25%) and public safety (17%). Budget reductions would lead to further downward pressure on economic activity through decreases in public sector spending.

Table 21: State's Reserve Fund Position Based on Failure of Measures				
2009-11 Biennium September Forecast	Education Stability Fund	Rainy Day Fund	General Fund	Reserves Available
	(In Millions)			
Beginning Balance	\$0.1	\$337.5	\$11.4 (To Rainy Day Fund)	\$349
Approved Transfers		-225	-11.4	-236.4
Projected Revenue	184.9	14.9	79.2	279
General Fund Revenue Reduction Caused By Defeat Of Measures			-727	-727
Transfer To State School Fund*			0	
Projected Ending Balance	185.0	127.4	-647.8	-335.4

*Conditions for State School Fund transfer as specified in SB 5520 would no longer be met.

The failure of one or both measures is almost certain to lead to legislative actions to restore balance to the budget. The Legislature is planning to come back into session in February, 2010, at which time the outcome of the vote will be known.

Beyond the 2009-11 Biennium

The measures also produce significant revenue going forward beyond the 2009-11 biennium, although the share of total projected revenue declines. The two measures combined are expected to generate \$644 million in the 2011-13 biennium and \$609 million in the 2013-15 biennium. As specified in HB 2073, an estimated \$69 million from corporate income tax collections (out of the projected \$609 million) will go to the Rainy Day Fund. Defeat of the measures will therefore result in a reduction in the General Fund revenue throughout the forecast horizon. The proportional reduction in the forecast, based on the September forecast is 4.2% for the 2011-13 biennium and 3.0% for the 2013-15 biennium.

The measures are also expected to affect the elasticity of the state's revenue system. Elasticity is a measure of how tax revenue responds to changes in income and overall economic activity in the state. In the short run, over the course of the business cycle, an elastic tax is one that rises and falls more than proportionately with income. In recessions, elastic taxes fall sharply but they also rise sharply when economic activity picks up during expansions. Over the long term, beyond cyclical fluctuations, an elastic tax is one that grows proportionately more than the economy over time. An elastic tax is also generally a progressive tax, meaning that high income households pay a higher percentage of their income taxes than lower income households.

Under most state systems, including Oregon's, the personal income tax is an elastic revenue source. Oregon is already more dependent on the personal income tax for state tax dollars than any other state is on any single tax source (about 70% of total tax collections). If Measure 66 becomes law, this dependence will increase. This means that Oregon's state tax system would

become more elastic under the measure. The result would be increased progressivity, as shown in the OTIM results, a higher long-term revenue growth rate and more volatility over the course of the business cycle. Increased volatility in tax revenue would increase the importance of the state's reserve fund policy in the future.

Passage of Measure 67 is expected to have mixed effects on the elasticity of the state's tax system. The corporate income tax is highly elastic in the short term. The corporate tax rate increase contained in the measure will increase the short-term elasticity of the state's revenue system. However, the new corporate minimum, based on gross Oregon sales, is expected to have a relatively low elasticity thereby adding stability and reducing short-term fluctuations in the state's revenue stream. Despite its well known short-term volatility, the state corporate income tax has demonstrated a relatively low long-term elasticity. This is likely due to the complexity of the tax base and state tax incentives and their impact over time. The combined effect of the higher long-term corporate tax rate and the new corporate minimum is expected to reduce the overall elasticity of the state's tax system over the longer term.