Research Brief

Measures 66 and 67:

Frequently Asked Questions

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Prepared by:
Legislative Revenue Office

Inside this Brief

Legislative Revenue Office
State Capitol Building, Rm 143
Salem, Oregon 97301
(503) 986-1266

http://www.leg.state.or.us/comm/lro/

Introduction

The 2009 Legislature filled an estimated $4,028 million budget gap for the 2009-11 biennium by using a combination of budget cuts and additional revenue, as shown in the table below. Roughly half of the gap was filled with budget cuts. The other half was filled using a combination of federal stimulus dollars from the American Recovery and Reinvestment Act (ARRA) – roughly 24 percent of the gap; additional General Fund revenue – roughly 20 percent of the gap; and dollars from state reserves – roughly 6 percent of the gap. Most of the new General Fund revenue (91 percent) is contained within House Bills 2649 and 3405. The former raises personal income taxes while the later raises corporate and other business taxes and fees.

Legislative Actions To Fill Projected 2009-11 Budget Gap		
	$Millions	**% of Gap**
Budget Cuts	1,994	49.5
Federal ARRA Revenue	978	24.3
Additional General Fund Revenue	801	19.9
State Reserves	255	6.3
Total General Fund/Lottery Budget Gap	4,028	100.0

As a result of a citizen's referendum, these two bills have been referred to voters for a special election to be held on January 26, 2010. House Bill 2649 is contained in Measure 66 and House Bill 3405 is contained in Measure 67. 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. This document provides brief answers to commonly asked questions regarding the two measures.

Measure 66: Personal Income Tax

Measure 66 (HB 2649) makes the following three changes to the personal income tax: (1) increases the top marginal tax rate for filers with taxable income above certain levels; (2) phases out the federal tax subtraction for filers with adjusted gross income above certain levels; and (3) exempts some unemployment compensation from taxation.

1. **How do the existing tax rates work and how would this change them?**
Under current law for joint filers in tax year 2009, taxable income below $6,100 is taxed at 5 percent, income between $6,100 and $15,200 is taxed at 7 percent, and income above $15,200 is taxed at 9 percent. This measure would increase the tax rate on taxable income between $250,000 and $500,000 to 10.8 percent and on taxable income above $500,000 to 11%. (For single filers, the effective income levels are half of those for joint filers.) The 10.8 and 11 percent rates would be in effect for tax years 2009 through 2011. In 2013, they would be reduced to 9.9 percent. The table below shows these rates and brackets.

<table>
<tr><th colspan="4">Joint Filer Tax Rates and Brackets</th></tr>
<tr><th>Taxable Income</th><th>Pre-HB 2649</th><th>Tax Years 2009-11</th><th>Tax Years 2012+</th></tr>
<tr><td>< $6,100</td><td>5%</td><td>5%</td><td>5%</td></tr>
<tr><td>$6,100 - $15,200</td><td>7%</td><td>7%</td><td>7%</td></tr>
<tr><td>$15,200 - $250,000</td><td rowspan="3">9%</td><td>9%</td><td>9%</td></tr>
<tr><td>$250,000 - $500,000</td><td>10.8%</td><td rowspan="2">9.9%</td></tr>
<tr><td>> $500,000</td><td>11.0%</td></tr>
</table>

2. **What is the federal tax subtraction and how does this measure change it?**
All taxpayers are allowed to deduct the amount of federal income taxes they paid during the tax year when calculating their Oregon taxable income. The maximum deduction amount is $5,850 for tax year 2009. This measure gradually reduces the maximum allowed deduction for certain taxpayers. For joint filers with an AGI of at least $250,000, the maximum is gradually reduced as income increases until it is disallowed, when AGI reaches $290,000. For single filers, maximum deduction phases out between $125,000 and $145,000 of AGI.

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

3. **How does the exemption for unemployment compensation work?**
Under current law, all unemployment compensation is taxed at the federal and state levels, except for a one-time federal exclusion allowed in 2009. Measure 66 would match the federal treatment of unemployment compensation for tax year 2009 and exempt up to $2,400 per recipient from Oregon taxation.

4. **What is the difference between Adjusted Gross Income (AGI) and taxable income?**
Generally speaking, AGI is income before deductions (standard or itemized) and subtractions while taxable income is after these items. (Business deductions are included in the net business income that is part of AGI.) The changes to the tax rates are effective for certain levels of taxable income while the changes to the federal tax subtraction are effective for certain levels of AGI. On average, taxable income is 75% of AGI but increases with income. It ranges from 35% for AGI below $5,000 to 92% for AGI greater than $500,000. For example, joint filers with AGI of $250,000 have, on average, $205,000 in taxable income. Conversely, joint filers with taxable income of $250,000 have, on average, $305,000 of AGI.

5. **Who is affected?**
Single filers with more than $125,000 of AGI and joint filers with more than $250,000 of AGI would be affected by the changes in the tax rates and/or the federal tax subtraction – roughly 38,000 out of 1,541,000 full-year filers (2.5%). The share of affected filers is expected to increase to 3.6% by 2013.

6. **How much will my taxes increase?**
Most taxpayers (97.5%) will not have an increase in taxes. For those who do (2.5% of filers), the tax increase will depend on the extent to which income is greater than $250,000 for joint filers and $125,000 for single filers. For joint filers with income between $250,000 and $500,000 the average tax increase is projected to be $1,130; for those with income above $500,000, the projected increase is $14,969.

7. **How could my taxes decrease?**
Filers who collected unemployment income in 2009 would see a decrease in taxes because of the $2,400 exemption. The average decrease for these filers is expected to be $120.

8. **How much money is expected to be raised for the state?**
A total of $472 million is expected to be raised during the 2009-11 biennium from the personal income tax changes. This revenue was used to create the balanced budget for the 2009-11 biennium.

9. **How long will the changes last?**
The 10.8% and 11% tax rates will be in effect for three years, 2009, 2010, and 2011. Beginning in 2012, they are replaced with a single rate of 9.9 percent. The changes to the federal tax subtraction are effective in 2009 and are permanent. The exemption for unemployment compensation is only allowed for tax year 2009.

10. **How does the change affect Oregon's personal income tax burden compared to other states?**
Currently, Oregon personal income taxes are $1,502 per capita and 4.3% of personal income. This ranks Oregon as the 5th and 2nd highest compared to other states. Including this measure, personal income taxes would increase to $1,569 per capita and 4.5% of personal income. Assuming no actions by other states, Oregon's rank per capita and as a share of personal income would not change.

11. **How does the tax increase affect small businesses?**
Roughly 10 percent of personal income taxes each year are collected from business income. The businesses that pay income tax through the personal income tax are sole proprietors, partnerships, and S-corporation shareholders. Of the roughly 38,000 taxpayers affected by this measure, about two-thirds of them (25,600) report some form of business income or loss. In total, nearly 419,000 full-year returns are expected to report business income; the 25,600 filers affected by this measure represent roughly 6.1% of the tax returns reporting business income or loss.

12. **How does this affect my federal taxes?**
Filers who itemized deductions on their federal tax return are allowed to deduct their income taxes paid to Oregon. Because most filers are unaffected by the tax increase, there is no impact on federal taxes. For those who are affected, their federal taxes could be reduced as their itemized deduction for state income taxes would increase. Filers paying the federal Alternative Minimum Tax

(AMT) would not be affected because the deduction for state income taxes is disallowed. For tax year 2009, the total increase in Oregon taxes of $162 million is expected to result in a $9.4 million reduction in federal income taxes paid by Oregonians.

13. How is the money going to be spent?
For the 2009-11 biennium, the revenue was not earmarked for specific purposes but was used as General Fund dollars to balance the state budget. The three largest categories within the General Fund / Lottery budget are Education (52%), Human Services (25%), and Public Safety (17%).

Measure 67: Business Taxes and Fees

Measure 67 (HB 3405) makes four changes to business taxes and fees: (1) creates a second marginal tax rate on C-corporations; (2) increases the minimum tax on C-corporations and S-corporations; (3) creates a $150 minimum tax on partnerships; and (4) increases certain fees paid to the Secretary of State.[1]

1. How does the higher C-corporation tax rate work?
For tax years 2009 and 2010, the 7.9% rate is applied to taxable income above $250,000. For tax years 2011 and 2012, the rate is reduced to 7.6% and continues to be applied to taxable income above $250,000. Beginning in tax year 2013, the 7.6% rate is only applied to taxable income above $10 million. The following table shows these changes.

<table>
<tr><th colspan="5">Current and Proposed Corporation Tax Rates and Brackets</th></tr>
<tr><th>Taxable Income</th><th>Pre-Measure 67</th><th>2009-2010</th><th>2011-2012</th><th>2013+</th></tr>
<tr><td>< $250,000</td><td rowspan="3">6.6%</td><td>6.6%</td><td>6.6%</td><td rowspan="2">6.6%</td></tr>
<tr><td>$250,000 - $10 million</td><td rowspan="2">7.9%</td><td rowspan="2">7.6%</td></tr>
<tr><td>> $10 million</td><td>7.6%</td></tr>
</table>

2. How does the C-corporation minimum tax work?
The minimum tax is a fixed dollar amount that depends on the amount of Oregon sales for the corporation during the tax year. (See the table below.) It is an alternative minimum tax and the corporation is required to pay the larger of the minimum tax or the tax from the tax rates.

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

[1] The measure also contains an increase in the Uniform Commercial Code Filings fee from $10 to $15 and an increase in the Notary Commission application fee from $20 to $40. The associated revenue is directed to the Secretary of State for operations, not the General Fund.

3. **What is meant by Oregon Sales?**
   It is the income received by a corporation from the sale of a product or service to an individual or business located in Oregon. For a corporation that only does business in Oregon, this amount is the total sales of the business. If a corporation does business in multiple states, the sales in Oregon would be used to determine the alternative minimum tax.

4. **How are other businesses affected by the minimum tax?**
   The minimum tax on S-corporations would increase from $10 to $150. Other businesses, such as partnerships and limited liability companies (LLCs) taxed as partnerships are not currently required to pay a minimum tax. This measure would require them to pay a flat amount of $150. Sole proprietors (i.e. Schedule C filers) are not currently subject to a minimum tax and this measure would not change that policy.

5. **Is this a gross receipts tax?**
   No. A gross receipts tax is structured as a tax rate multiplied by the amount of gross receipts for a corporation. One example of such a tax is Washington's Business and Occupation tax. This measure would use the level of gross receipts (or sales) for a C-corporation to determine the minimum amount of tax due under the Oregon net income tax. It is an alternative minimum tax for C-corporations.

6. **Do other states use a gross receipts tax?**
   Yes. Washington's Business and Occupation Tax is a gross receipts tax. Other states with a gross receipts tax include Ohio, Texas, and Michigan.

7. **How many C-corporations are affected by the tax changes?**
   Most C-corporations (78%) are affected by either the increase in the minimum tax or the higher marginal tax rate. Roughly 73% of C-corporations (25,000) will be affected by the minimum tax while five percent (1,600) of C-corporations will be affected by the higher marginal tax rate during tax years 2009 through 2012. Beginning with tax year 2013, roughly 0.5% (or 160) of C-corporations would be affected by the rate change on taxable income over $10 million.

8. **How does this measure affect S-corporation taxes?**
   The impact on S-corporations is an increase in the minimum tax from $10 to $150. They are not subject to the graduated minimum tax or the higher tax rates. Nearly 62,000 S-corporations are expected to file a tax return and nearly all of them would be affected by the higher minimum tax.

9. **How are small businesses affected?**
   Assuming that a small business has less than $1 million in Oregon sales, the C-corporation tax increase averages $233 for this group. These businesses account for roughly two-thirds of all C-corporations. Also, S-corporations and businesses that file a partnership tax return (e.g., partnerships and certain LLCs) would become subject to the $150 minimum tax. Roughly 54,000 partnerships are expected to pay the minimum tax.

10. **How does this change affect Oregon's business tax burden compared to other states?**
    Under current law, Oregon's corporation income & excise taxes are $124 per capita and 0.4% of personal income. These levels rank Oregon as the 35th and 33rd highest compared to other states. Including this measure, corporation income & excise taxes would increase to $161 per capita and 0.5% of personal income. Assuming other states don't change their taxes, Oregon's per capita rank and rank as a share of personal income would each move to 24th.

11. Is it fair to tax businesses that don't have a profit?
The issue of fairness can be discussed using two principles: the ability-to-pay principle and the benefits-received principle. Opponents tend to emphasize the ability-to-pay principle, that the level of tax should be tied to the level of income. Proponents tend to emphasize the benefits-received principle, that the tax owed should reflect the level of benefits received by the taxpayer for access to public services. The current income tax is consistent with the ability-to-pay principle while the proposed minimum tax would incorporate the benefits-received principle into the tax structure.

12. Won't businesses just pass this tax increase on to consumers in the form of higher prices?
It is generally argued that taxes imposed on businesses are paid by some combination of three groups: the business owners, the employees, or the customers. Business owners bear part of the final tax burden to the extent they receive less return on the capital they've invested. Employees bear part of the final tax burden in the form of lower wages. Customers bear part of the final tax burden in the form of higher prices. The extent to which the tax burden is shared by these three groups depends on the specific circumstances of the business and the market in which it operates.

13. How do the fees work and how does this measure change them?
Under current law, when businesses file their articles of incorporation or annual reports with the Secretary of State, they are required to pay a fee of $50. This measure would increase these fees to $100 for Oregon businesses and to $275 for businesses headquartered in another state. Most business types are affected by the higher fees, including C-corporations, S-corporations, partnerships, and limited liability companies (LLCs). Because the fee for filing an Assumed Business Name (ABN) was not changed, sole proprietors are not affected.[2] Non-profit companies are also unaffected by the fee increase.

14. How much money is expected to be raised for the state?
A total of $255 million is expected to be raised during the 2009-11 biennium from the business tax and fee changes -- $108 million from the rate increase, $127 million from the minimum tax on corporations and partnerships, and $20 million from the Secretary of State filing fees. This revenue was used to create the balanced budget for the biennium.

15. How is the money going to be spent?
For the 2009-11 biennium, the revenue was not earmarked for specific purposes but was used as General Fund dollars to balance the state budget. The three largest categories within the General Fund / Lottery budget are Education (52%), Human Services (25%), and Public Safety (17%).

16. What is the impact on the Rainy Day Fund?
In conjunction with another bill passed during the 2009 Session, the tax received from the higher marginal tax rate on net income above $10 million would be dedicated to the Rainy Day Fund, beginning in tax year 2013.

For additional information, contact the Legislative Revenue Office at 503-986-1266

[2] The Assumed Business Name (ABN) is sometimes referred to as Doing Business As (DBA).