REVENUE MEASURES PASSED BY THE 74th LEGISLATIVE SESSION FEBRUARY 2008 SPECIAL SESSION

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OVERVIEW

Introduction

At the close of the 2007 regular session, the Legislature committed to returning in February of 2008 to consider a limited number of measures. The two chambers set up separate processes to introduce bills for the February session. Overall the Legislature approved 73 bills in the special session. Two of these bills have a General Fund revenue impact and five others have revenue policy implications. This report summarizes the fiscal environment in which these revenue bills were considered and then outlines the bills themselves. It is intended to serve as a supplement to the “Revenue Measures Passed” document that the Legislative Revenue Office releases following each regular session. It is also intended to complement the “Budget Highlights Update” report released by the Legislative Fiscal Office.

Fiscal Situation

The Legislature ended the 2007 regular session with a projected General Fund ending balance of $184.2 million. An ending balance of $13.2 million was also projected for the Lottery. In addition, the Legislature capitalized the newly created Rainy Day Fund with a $319.3 million transfer from the General Fund in September. These dollars were designated to go out as a 2% surplus kicker credit for corporations. The Legislature suspended the corporate kicker credit on a one-time basis (HB 2707) and redirected the revenue to the new fund. The Rainy Day Fund retains its own interest and is projected to reach an ending balance of $344.8 million in July of 2009. However, the Legislature cannot make withdrawals from the fund in the current biennium without a statutory change because current law limits withdrawals to 2/3 of the beginning balance in the fund. The beginning balance in the fund for 2007-09 is $0. Finally, the Legislature has access to the Education Stability Fund if certain triggers are met and 3/5 of the members in each chamber agree. The Education Stability Fund, funded by 18% of Lottery earnings, is expected to reach an ending balance of $472.5 million by July 1, 2009.

Although General Fund revenue tracked the close of regular session forecast very closely through January, the March revenue forecast (released on February 8), was adjusted down to reflect the new baseline projection of a national recession. The new forecast is based on the assumption of a mild downturn in which Oregon’s economy performs similarly to how it did in the 1990-91 recession. Nothing approaching the sharp revenue decline associated with the 2001 recession is expected. The February forecast for General Fund resources is $153.4 million below the close of regular session forecast. The projected General Fund ending balance prior to February legislative actions is $28.8 million, which is $155.4 million below the close of regular session estimate. Although the Lottery forecast was reduced slightly compared to the December 2007 forecast, it remains modestly above the close of regular session leaving a projected ending balance of $25.8 million before February legislative actions.

The Legislature made minor adjustments to the budget and shifted resources from the Lottery to the General Fund. The net result of these actions is a projected General Fund

ending balance of $36.5 million and a Lottery Fund ending balance of $5.8 million. With financial markets showing considerable weakness and the magnitude of the decline in economic activity still very much in doubt, the risks to the General Fund forecast are substantial. If the revenue forecast were to fall further (reports will be released prior to June 1 and September 1), the Legislature will have essentially three options for rebalancing. These options are using reserves, reducing expenditures or raising additional revenue or some combination of these. The Legislature has a constitutional responsibility to ensure that the General Fund budget is balanced at the end of the biennium.

Revenue Measures Approved by February Session

The Legislature passed two bills that directly affect the General Fund revenue projection. These bills are HB 3618 and HB 3619. HB 3618 modifies the estate tax treatment for natural resource property. The bill is designed to replace legislation approved by the 2007 session as part of HB 3201. As originally passed in 2007, the natural resource property exclusion was deemed to have a series of implementation problems and inconsistencies with the intent of the Legislature. Specifically, HB 3618 establishes a credit against estate taxes otherwise owed on natural resource property. Natural resource property includes property related to forest land, agriculture and commercial fishing. The credit reaches a maximum when the value of eligible property reaches $7.5 million. It is then phased out until natural resource property reaches $15 million. Estates with gross value above $15 million are not eligible for the credit. The negative revenue impact for HB 3618 is slightly greater than the $1 million decrease estimated for the 2007 law it replaces. The incremental revenue impact that will be built into the forecast is -$30,000 for 2007-09 and -$300,000 for 2009-11. HB 3619 does not affect the 2007-09 revenue forecast but it is expected to reduce revenue in 2009-11 and beyond. The bill makes a series of adjustments and clarifications to the business energy tax credit to account for manufacturers of renewable energy equipment. The business energy tax credit was expanded in 2007 as part of HB 3201. HB 3619 also increases the cap on the Oregon affordable housing lenders credit from $13 to $17 million starting with the 2009 tax year. This action is expected to reduce General Fund revenue by $3 million in the 2009-11 biennium and $6 million in 2011-13 biennium.

The Legislature also passed a number of bills that have revenue policy implications but no direct revenue impact. These bills include:

- Reconnection to the federal tax code through December 31, 2007 (SB 1081).
- A required report from the Department of Revenue on taxpayer compliance (SB 1082).
- A required report from the State Treasurer on the Oregon Growth Account (HB 3620).
- Clarification of how the Tri-Care physician's tax credit is calculated (SB 1060).
- Clarification on procedures for withholding for potential taxes on capital gains from real estate sales by non-residents (SB 1101).

PERSONAL AND CORPORATE INCOME TAX

SB 1060 (CH 3)

Clarifies the number of certifications that the Office of Rural Health may issue for the TRICARE tax expenditures in tax years 2008 through 2011. They may issue up to 500 certificates in 2008; 1,000 in 2009; 1,500 in 2010; and 2,000 in 2011. (The credit is scheduled to sunset on January 1, 2012 under current law.) The bill does not change the intended policy implemented by the 2007 Legislature.

Revenue Impact:

Because this bill simply clarifies language and does not change the policy implemented by the Assembly in 2007, there is no impact on income tax revenue. The original revenue impact was included in HB 3201 and is included in current law revenue projections.

SB 1081 (CH 45)

Updates Oregon's date of connection to federal income tax laws from December 31, 2006 to December 31, 2007. Examples of this connection include federal provisions pertaining to the definition of charitable organizations, federal Adjusted Gross Income for the purposes of Oregon's Elderly Rental Assistance and Senior Deferral programs, and rules for S-corporation representation before magistrate, the Department of Revenue, and the Oregon Tax Court. Provides a mechanism for a taxpayer to have interest or penalties canceled for tax deficiencies that are attributable to the federal law connection changes in this Act. Specifies that if a refund is due a taxpayer for a tax year beginning before January 1, 2008 due to any retroactive treatment from these federal tax law connection changes then the refund will not be paid with interest. Clarifies that taxpayers must file an amended return for changes in Oregon's law due to these federal tax law changes for tax years before January 1, 2008. Allows the Department of Revenue to make changes to tax returns that do not file amended returns.

Revenue Impact:

Due to Oregon's permanent tie to the federal definition of taxable income, many changes at the federal level automatically flow through to Oregon. However, a few of the updates could have a slightly positive or negative revenue impact. For example, under the 2007 Small Business Tax Act, a married couple that files a joint tax return and operates an unincorporated business can elect to not be treated as a partnership for federal tax purposes. Instead they would each file a Schedule C to report their business income. This bill would ensure that they could file the same way for Oregon purposes.

SB 1082 (CH 46)

Requires the Department of Revenue to submit a report to the Legislature on individual taxpayer compliance no later than February 1, 2009. The report is to include an estimate of taxpayer compliance with existing law, identify taxpayer behavior that affects compliance and make recommendations to improve compliance.

SB 1082 represents an effort by the Legislature to gather information on how large personal income tax non-compliance is and the behaviors that lead to non-compliance. The ultimate goal of the bill is to identify policies that will reduce the amount of non-compliance in an effective and efficient manner while minimizing costs for the vast majority of citizens who voluntarily comply with state tax laws.

Revenue Impact: None

SB 1101B (CH 54)

Clarifies language pertaining to the withholding of income taxes for certain real estate transactions. Clarifies and modifies definitions of terms used in the bill. Examples include adding attorneys to the definition of authorized agent if no licensed escrow agent is involved in the transaction and clarifying that a conveyance pertains only to a transfer of Oregon real estate. Changes the amount to be withheld to the least of: (1) four percent of the consideration, (2) the net proceeds from the conveyance (changed from four percent of the net proceeds), or (3) eight (instead of ten) percent of the gain includable in the transferor's Oregon taxable income. Modifies the list of cases where withholding is not required by deleting the general reference to foreclosures and specifically listing, for example, conveyances that are pursuant to a judicial foreclosure proceeding, conveyances that are in lieu of a foreclosure of a mortgage or other security instrument with no additional monetary consideration, cases where the transferor is acting under judicial review, and cases where the sale or exchange qualifies for an exclusion of gain as a principal residence. Allows the Department of Revenue to collect interest on the withholding amount if it is not remitted timely by the authorized agent. Imposes a penalty for the greater of either $500 or 10 percent of the amount required to be withheld (up to $2,500) if the authorized agent fails to withhold. Clarifies when the Department of Revenue may not proceed with collections activity: when the amount withheld is remitted timely, when there is no requirement to withhold, or the authorized agent presents to the Department of Revenue the written affirmation indicating no need to withhold. Allows the authorized agent to withhold taxes without written instructions from the transferor. Applies to conveyances occurring on or after January 1, 2008 and declares any transfers or exemptions granted before the effective date of this Act to be in compliance with this Act. Grants the Department of Revenue rule making authority for determining the form, content, and procedures for submitting the written affirmations.

Revenue Impact:

This bill addresses technical and administrative issues that arose during the administrative rules process and generally clarifies terms used and when withholding is or is not required. Provisions that could affect revenue are: (1) limiting the applicability to

licensed escrow agents or attorneys; (2) changing to the options for determining the amount withheld; (3) expanding the list of exempt transfers; and (4) the imposition of interest when amounts withheld are not remitted timely or a penalty if required amount is not withheld. Limiting the applicability to licensed escrow agents (or attorneys) may reduce withholding, but most transfers are expected to be handled by such individuals. The reduction in the amount of gain to be withheld from 10 percent to eight percent would affect the timing of receipts – lower withholding is likely offset by lower refunds when tax returns are filed. The expanded list of exemptions is likely to reduce withholding but these types of transactions are expected to be relatively few in number. The imposition of interest and penalty would lead to a positive revenue impact but is expected to be small. Most of the initial revenue impact from HB 2592 in 2007 is due to improved compliance rather than the timing of tax payments. The changes in this bill are not expected to have a significant effect on the revenue from increased compliance with Oregon income tax laws.

HB 3619B (CH 29)

Requires the Department of Energy to establish by rule certain criteria relating to the credit for renewable energy equipment manufacturing facilities. These criteria include standards relating to employment gains, financial viability, likelihood of long-term success, and the likely impact on location or expansion decisions. The maximum certified cost of a manufacturing facility that receives a preliminary certification is increased from $20 million to $40 million. (Under prior administrative rules, taxpayers could receive two $20 million certifications, but under the new law they would receive one $40 million certification.) Allows the director of the Department of Energy to certify a lesser amount if General Fund revenues are less than expected or if the standards mentioned above are not met. Declares that a preliminary certification remains valid for five years after the date it is issued. Replaces the requirement that the director of the Department of Energy consult with the Public Utility Commission with permissive language that allows such consultation if the applicant is a public utility. Clarifies the revocation, or “clawback”, provisions so that if a certificate is revoked, the person that obtained the final certification from the Department of Energy (or any successor business) is responsible for reimbursing the state for any tax benefit received. If a manufacturing facility tax credit has been sold, the certified credit amount is to be collected by the Department of Revenue. Clarifies that those who purchase these credits through the pass-thru program are held harmless by any certificate revocation. Applies to preliminary certifications approved on or after January 1, 2008.

Expands cap on Oregon Affordable Housing Lenders Credit from $13 million per fiscal year to $17 million. The increased cap first applies to the 2009 corporate tax year. The Housing and Community Services Department uses the credit to reduce finance costs for preserving and constructing housing for low income residents. The program is combined with other grants and federal subsidies to reduce housing costs. Increasing the cap is expected to retain federal subsidies that would otherwise be in danger of ending and stimulating construction activity primarily in the form of preserving existing structures.

Extends the deadline for inheritance tax returns from June 30, 2008 to September 1, 2008.

Revenue Impact:

$ Millions	2007-09 Biennium	2009-11 Biennium	2011-13 Biennium
State General Fund	$0	-$3.0	-$6.0

The revenue impact is due solely to the Affordable Housing Lenders Credit. Increasing the cap can be expected to increase the revenue impact of the credit by $4 million per year. However, the timing of the full impact depends on trends in corporate tax liability. The weaker the outlook for corporate profits the more the credit will be carried forward to future tax years. Under current law the credit can be carried forward 5 years.

The revenue impact estimate does not include anticipated indirect effects. The effects take two forms. The first is the retention of federal subsidies. The units targeted for preservation work with the expanded credit, account for $31 million annually in federal subsidies. The subsidies represent income for Oregon residents, if the projects do not go forward and the units were put to another use, this would mean a loss of income to the state economy. The second indirect effect is through new construction activity stimulated by the credit. Based on previous experience with the credit, the Housing and Community Services Department estimates that the annual $4 million increase in the credit will lead to rough $100 million in new loans. These loans will be used to employ construction companies to rehabilitate existing housing. If the credit cap increase is approved, the increased construction activity is expected to begin in 2009 and continue through 2010. Construction activity associated with the projects is expected to be about $9 million per year for each of the two years.

There is no revenue impact from the changes to the manufacturing facility tax credit. The changes generally address ambiguities in current law or administrative issues. The establishment of criteria for credit eligibility and the modified clawback provisions are not expected to affect income tax revenues. The increase in the maximum certified cost from $20 million to $40 million for eligible facilities does not affect revenue because it codifies current practices as per administrative rules for the Department of Energy. There is also no revenue impact to the change in the filing date for inheritance tax returns.

ESTATE TAX

HB 3618A (CH 28)

Allows for the natural resource and commercial fishing properties to claim credits when filing for estate taxes. The credit schedule is highest at seven and one-half million and lowest at $15 million. It requires material participation, holding of the property in the same classification for five out of eight years prior and following death. Requires that the natural resource property comprises at least fifty percent of the total estate value. Defines other eligibility, legal requirements, and adds domestic partner to the list of eligible individuals.

The policy goal is to preserve small natural resource based businesses by allowing family owners to pass businesses onto future generations.

This bill is a fix and continuation of previous legislation. The 2007 session passed HB 3201 with a number of tax issues. Section 68 of that bill included changes in the estate tax provisions. The resolution of these issues are introduced in this (2008) legislation with the mechanism of relief offered through a credit schedule that equals tax liability up to $7.5 million and then declines until it reaches $0 at $15 million.

Revenue Impact:

The average annual impact is estimated at ($0.27) million a year.

$ Millions	2007-08	2008-09	2007-09 Biennium	2009-11 Biennium
State General Fund		-0.03	-0.03	-0.28

The 2007 session passed HB 3201 with a number of tax issues. Section 68 of that bill included changes in the estate tax provisions. The main issue that section 68 (previously HB 3479) attempted to accomplish, was to increase the exemption of farm, forest and commercial fishing estates to $7.5 million. The bill directed the Department of Revenue (DOR) to establish rules to guide the implementation of the new provisions. However, several issues arose as unforeseen consequences of the new law as it interacts with the federal tax code and to the different previsions of the estate tax. There was a need for inclusion of more refined definitions in order to make the implementation of current law possible. The original impact of HB 3201 of 2007 estimated the revenue reduction at $1 million a biennium. That amount of reduction in revenue is already reflected in the state revenue forecast. However, the allowance for credit above the $7.5 million graduating down to zero at the $15 million level increases the reductions by an annual average of $0.27 million. The implementation, however, is expected to transition to full cost over a number of years. That is mainly due to the nature of filing for this tax and the 10 months extension immediately allowed under the law. Accordingly, the full impact of $0.54 million will not reach its full amount until the 2011-13 biennium.

SCHOOL FINANCE

SB 5556 (CH 16)

Increases the State School Fund distribution to school districts and education service districts by $3 million in 2007-08. Adjusts state expenditure limitations and General Fund appropriations. Effective on passage.

Revenue Impact:

$ Millions	2007-08	2008-09	2007-09 Biennium	2009-11 Biennium
School Districts	$2.862	0	$2.862	0
Education Service Districts	$0.143	0	$0.143	0

Impact Explanation:
The increased distribution from the State School Fund will be about $4.50 per weighted student. The increased funds are from donations of personal income tax kicker refunds to the State School Fund.

BONDING AND OTHER FINANCIAL MANAGEMENT

HB 3620 (CH 9)

Directs the Oregon Growth Account Board (chaired by the State Treasurer) to report to the Legislature on the performance on the Oregon Growth Account. Specifically the bill requires long-term estimates of finances and recommendations about appropriate size of the account, use of earnings and account management.

The Oregon Growth Account was established within the Education Endowment Fund when the latter was amended into the constitution in 1995. The account received 10% of the Lottery revenue flowing into the endowment fund. The voters converted the endowment fund into the Education Stability Fund in 2002. The Oregon Growth Account was retained as a sub-account within the new stability fund. Monies in the account are to be invested by the Oregon Growth Account Board as seed money for Oregon based businesses in emerging industries.

HB 3620 is designed to strengthen the reporting requirement contained in ORS 348.703. The intent is to add specificity to the report and address the role of the growth account in light of rapid growth in overall Lottery revenue (and therefore allocations to the fund) and the potential conflict between the illiquid nature of venture capital investments and the liquidity needs of an effective reserve fund.

REVENUE IMPACT: None