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Oregon Tax Expenditures: Definition and Automatic Sunset

Introduction

The 2019-21 Oregon Tax Expenditure Report highlighted potential conflicts between two separate Oregon laws related to tax expenditures: the definition of a tax expenditure and the automatic sunset of certain tax expenditures. During the 2019 legislative session, the House Revenue Committee discussed the topic over the course of several meetings. Ultimately, the committee concluded additional information was needed and the 2019 Oregon Legislature passed HB 2128, which requires

> The Legislative Revenue Officer, in consultation with the Department of Revenue, [to] conduct a study on the statutory definition of tax expenditures and the operation of automatic sunset provisions applied to tax expenditures. The study may make recommendations for proposed legislation related to tax expenditures.

This report is the result of that research. The core problem is the inability to clearly and transparently administer the automatic sunset provision given the lack of universal agreement on the interpretation (and application) of the tax expenditure definition. For reference purposes, both definitions are provided here. Enacted in 1995, ORS 291.201 defines a tax expenditure as

> ...any law of the federal government or this state that exempts, in whole or in part, certain persons, income, goods, services or property from the impact of established taxes, including but not limited to tax deductions, tax exclusions, tax subtractions, tax exemptions, tax deferrals, preferential tax rates and tax credits.

The automatic sunset was enacted in 2013 (ORS 315.037) and states, in part, that

> [a]ny tax expenditure enacted by the Legislative Assembly on or after January 1, 2014, shall apply for a maximum of six tax years beginning with the initial tax year for which the tax expenditure is applicable, unless the Legislative Assembly expressly provides for another period of applicability.

Despite the statutory definition, there exists room for stakeholders to interpret the language differently. In many cases there is broad agreement on the interpretation of statutory language. However, there are times when interpretations differ and result in a lack of consensus. The purpose of this report is two-fold: to describe situations where these differences of interpretation may occur and to suggest possible solutions for legislative consideration.

The report is organized as follows. Following this introduction, the next section provides a discussion of issues related to the complexities of identifying certain tax expenditures. The paper then turns to a brief discussion of the automatic sunset and then to policy options for legislative consideration. The remainder of the paper is an Appendix that describes considerations made by the DOR when producing the Oregon Tax Expenditure Report (TER) and a listing of definitions used by the federal government and a few, selected states.

Identification Issues

Oregon statute provides a definition of tax expenditure, which serves as a starting point for identifying tax expenditures in Oregon. However, the tax expenditure definition references “established” taxes, which are not defined in statute. Also, in creating a tax, the Legislature has often used language to affirmatively define the tax base and then augment that definition by listing items that are not subject to the tax. Depending on one’s perspective, such listed items may be tax expenditures or simply a clarification of the tax base (i.e., not tax expenditures). There are several circumstances where there is likely to be some level of disagreement about whether a given provision of law meets the statutory definition of a tax expenditure. The section describes some of these cases.

Established Taxes

Oregon’s tax expenditure definition relies on the notion of an “established” tax as the baseline from which tax expenditures are defined. One interpretation is that this simply means commonly used taxes, such as an income tax or property tax. Other interpretations may mean any particular tax created by a government, such as Oregon’s Forest Product Harvest Tax or retail marijuana tax. Regardless of the interpretation, it is clear that the Legislature has the authority to create a tax, including the determination of the tax base and the tax rate(s). Consequently, what one stakeholder considers a tax expenditure, another stakeholder may consider an aspect of a well-defined tax base.

Of particular relevance for Oregon may be the timing related to when a tax becomes “established”. As described above, exemptions from established taxes are considered tax expenditures in Oregon. However, the phrase “established tax” is not defined in statute, leaving room for interpretation by stakeholders. A recent example provides some insight into the potential perspectives. The 2019 Legislature created the Corporate Activity Tax (CAT). The original bill that created the tax was HB 3427 but additional modifications were made that same legislative session with HB 2164. Then, during a 2020 special session, HB 4202 made additional modifications.

One perspective would be that the CAT was “established” with the original bill that created the tax, HB 3427. Any subsequent changes to the CAT that provide an exemption from tax liability would constitute a tax expenditure. A second perspective is that it was “established” by the combination of any related bills enacted during the legislative session that included the original bill creating the tax. From this perspective, the CAT would have been “established” in the 2019 legislative session with HB 3427 and HB 2164.

A third perspective is that it was “established” by any combination of actions taken by a given legislative body. In this case, that would have been the 80th Legislative Assembly through the combination of HB 3427, HB 2164, and HB 4202. Ostensibly, the Oregon Legislature crafts major policy bills during the odd-year, long sessions. The even-year, short sessions are intended for technical corrections or modifications and slight policy adjustments. The 2019 and 2020 sessions, collectively, represent the work of the 80th

Legislative Assembly.[1] Under this perspective, any changes made by the 81st or later Assemblies that reduce tax liability would constitute a tax expenditure.

Tax Base or Tax Expenditure

In simplest terms, every tax program consists of two components: the tax base and the tax rate(s). These two components define that which is being taxed and the rate(s) at which it is being taxed. Perhaps the most common tax bases are income, property, and sales. Other specific taxes, such as tobacco, marijuana, and fuel have their own, product-specific tax bases. A tax expenditure is a provision of law that directly reduces the tax rate, tax base, or tax liability for a specified group of people or businesses. Tax bases are often reduced by the use of an exclusion, deduction, subtraction, or exemption. Tax liability is most often directly reduced through tax credits.

Policies that reduces tax rates or tax liabilities may be the most easily identified tax expenditures, leading to consensus interpretations among stakeholders. On the other hand, policies that reduce the size of the tax base such as exclusions, deductions, and exemptions, are more likely to be subject to differences in interpretation by stakeholders. For example, does a given exclusion constitute a tax expenditure or does it simply define the tax base and clarify which people, income, property, or products are part of the tax base.

As one example, assume the purpose of a fuels tax is to maintain public roads and that off-road vehicles (e.g. farm equipment) are excluded from paying the tax. Some stakeholders may argue the exclusion is a tax expenditure while others may interpret the exclusion as part of the tax base definition. Depending on the relevant tax expenditure definition and its relation to the purpose or structure of a tax, stakeholders may reach different conclusions. This is especially true when neither the purpose of the tax, nor the purpose of the tax exemption is specified in law.

Oregon's property tax system provides other examples of this kind of ambiguity. Many state property tax systems are structured as levy systems. Such systems function by local governments first specifying a budget. This budget amount is divided by the taxable value of property within the government's jurisdiction. The resulting tax rate is used to apportion the tax liability to property owners according to taxable value. Oregon had this system until the 1990s, when two major tax reform policies were passed by voters – Measure 5 and Measures 47/50. These reforms have effectively moved the state to a rate-based system. One could argue that the levy system had effectively set the tax base and corresponding effective rates (according to customary property tax systems). If that were the case, then deviations from the levy system would result in tax expenditures. For Oregon, this would raise the question of whether compression[2] and the move to permanent tax rates constitute tax expenditures.

In-lieu Payments

Another situation with some nuance is when payments are made "in-lieu" of a tax. There are instances in Oregon law where taxpayers are exempted from paying a tax but are, instead, required to make some other payment. These are generally referred to as in-lieu payments. One question is if an exemption with an in-lieu requirement constitutes a tax expenditure. Such a determination may depend on any allocation differences between the in-lieu payments and the related tax payments. A second question is if the value of the in-lieu payments should be considered when estimating the cost of a tax expenditure. For example,

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[1] HB 4202 from Special Session 1 was identical to HB 4009 that was en route to passage during the 2020 regular session.

[2] Compression is the process of reducing taxes as required by the Measure 5 rate limits, which are $5 per $1,000 of real market value for education districts and $10 per $1,000 real market value for all other districts. It is computed on a property-by-property basis, first by reducing local option taxes and then reducing all other non-bond taxes proportionately.

the 2021-23 TER includes a provision related to solar projects (item 2.047 Solar Projects), in which qualified property is exempt from the property tax when the county and the owner of the project reach an agreement regarding a series of payments in-lieu of tax (PiLT). The property tax would result in declining payments over time (due to the taxation of depreciable property) while the PiLT payments would be fixed amounts over time. Businesses may prefer constant tax payments over the life of the solar project, instead of an initially high tax bill that would decline following depreciation. A fixed-level payment schedule may also be advantageous to local taxing authorities. If these policies are tax expenditures, then an annual calculation that offsets the tax foregone by the in-lieu payments may, at least in the above example, result in negative tax expenditure estimates.

Sunset Provisions

At the time the Legislature created the tax credit sunset and review process, they included a provision of law that created a default, automatic lifespan of six years for any tax credit created after 2009. This law is currently found in ORS 315.037. This automatic - or implicit - sunset applies only if implementing legislation is silent on a sunset date or, more specifically, does not "expressly provide[s] for another period of applicability".[3] This policy was subsequently expanded in 2013 to include all tax expenditures created on or after January 1, 2014.

In the case of an explicit sunset the provision will clearly no longer be available to taxpayers after the specified date. In the case of an implicit sunset, however, a determination must first be made as to whether ORS 315.037 applies. If a provision of law is considered a tax expenditure and there is no reference to a sunset date, then ORS 315.037 is likely deemed applicable and the provision is subject to the six-year automatic sunset. Oregon law does not specifically designate the responsibility for making these determinations. Presumably, such determination falls to the administrative agency which, in most cases, is likely the Department of Revenue.

Since 2014 was the year that the 6-year implicit sunset on tax expenditures went into effect, 2020 naturally loomed as a pivotal year. The 2019 Legislature was confronted with the task of addressing the issue of implicit sunsets for tax expenditures created in 2014 or 2015 and therefore "scheduled" to sunset during the 2019-21 biennium. However, as described in the previous section, there are times when stakeholders may disagree if a given provision of law is a tax expenditure. The challenge is how to administer an automatic sunset when there may not be universal agreement as to whether a provision of law is or is not a tax expenditure. If a tax provision were identified as a tax expenditure in error, then the provision could erroneously sunset after the six-year period. The converse could also occur, and certain provisions could erroneously continue after six years.

Policy Options

In summary, the application of the automatic sunset provision carries with it certain complexities associated with the identification of tax expenditures. This section provides some possible legislative policy options for initial consideration. These choices are meant as a starting point for consideration by

[3] This provision does not prevent the Legislature from specifying a specific sunset date or dictate that the automatic sunset provision does not apply.

the Legislature during the 2021 session. The options are not mutually exclusive and a comprehensive approach could involve some combination of approaches.

Assign Authority for Tax Expenditure Determination

The Legislature could specifically assign decision-making authority within the sunset statutes, possibly by granting specific administrative rule-making authority. In this case, that governmental entity would determine on a case-by-case basis which provisions are tax expenditures, and thus subject to an automatic sunset. One potential downside is that this approach could lead to inconsistencies across administrative agencies. Good faith efforts by agencies to determine the applicability of an automatic sunset still carries with it the challenge of interpreting certain aspects of tax law.

Update the Definition of a Tax Expenditure

The Legislature could re-evaluate the existing definition, examining possible ways to clarify legislative intent. It has been roughly 25 years since the definition was placed into statute. As discussed in this report, refining the definition of an “established tax” could be one consideration. Another is articulating in statute the distinction between the analytical value of the TER and the administrative nature of the sunsets. An updated definition could make distinctions between the purpose of the TER and qualifying conditions under which the automatic sunset would apply.

Repeal Automatic Sunset

A third option before the Legislature is to repeal the automatic six-year sunset provision. The Legislature would still have the authority to place a sunset date on any tax provision to ensure an eventual review of the policy. The repeal of the automatic sunset law would resolve the administrative issues. Tax expenditure questions would return to a largely policy debates. While a repeal would not provide clarity on a tax expenditure classification, it would resolve potential challenges to administrative decisions by state agencies. The downside is the potential for any new tax-related proposal to be enacted without a desired sunset date. To avoid that possibility, increased scrutiny by the House and Senate Revenue Committees may be warranted.

Appendix: Tax Expenditure Reports

The primary mechanism for a public discussion and review of tax expenditures is through the publication of what governments refer to as a “tax expenditure report”, “tax expenditure budget”, or something to that effect. While these reports exist at the federal and state levels, there is no single definition of a tax expenditure that is universally accepted. The federal government has its own definition of a tax expenditure and many states do as well. The broad theme of a tax expenditure is that it is a policy – a provision of tax law – that enables a taxpayer to reduce their tax liability. From the taxpayer’s perspective it represents a method of tax reduction. From the government’s perspective it represents a reduction in revenue. As such, tax expenditures may be considered a form of indirect spending. By way of contrast, direct government spending is conducted through the appropriations process with regular, legislative deliberations. This appendix describes the conceptual construction of Oregon’s tax expenditure report and then turns to the definitions used by the federal and other state governments. A simple reading of these definitions will highlight both the similarities and differences.

The Oregon Tax Expenditure Report

Beginning in 1996, the Department of Revenue (DOR) has taken the lead in producing the Oregon Tax Expenditure Report, which is a companion document to the Governor’s Budget each biennium. The initial report covered 15 tax programs and included 288 individual tax expenditures. The 2021-23 report covers 19 tax programs and 377 individual tax expenditures.[4] The report serves as a foundation and reference point for tax policy stakeholders.

With each version the DOR must determine which provisions appear in the report. These decisions weigh the inclusion of policies that may not to be considered tax expenditures by all stakeholders against the omission of policies that some may consider to be tax expenditures. In fact, he 2021-23 report states on page 1 that:

> [i]t’s not always entirely clear which provisions meets Oregon’s definition of tax expenditure. For example, a law could exempt certain persons, income, goods, services, or property from the impact of a tax, but it may not be obvious whether that exemption was meant to be an *exemption from the established tax*, or if it was intended to *define the base of the established tax*.

Given the title of the report it is reasonable for readers to assume that every policy contained in the report is considered a tax expenditure, at least from the DOR’s perspective. However, given those words of caution stakeholders should not necessarily assume that the included provisions could be subject to an automatic sunset. The report appears to lean toward inclusion and transparency so that readers may draw their own conclusions. This approach also facilitates policy analysis by choosing to include, rather than exclude, information. It is important to note that inclusion in the report does not constitute a binding classification.

The Department details the criteria used in determining if a given provision is included in the report.[5] Some of the key points are highlighted here. A given provision of tax law was included if it:

- Is reflected on an official document as a deduction, exclusion, subtraction, exemption, deferral, preferential tax rate, or tax credit
- Applies to a targeted group of taxpayers

[4] The income tax includes 185 tax expenditures, and the property tax includes 136.
[5] https://www.oregon.gov/dor/programs/gov-research/Documents/2020-Identifying-Tax-Expenditures.pdf

- Reduces the tax owed by a taxpayer (not penalties, interest, or fees)
- Is reported by the Joint Committee on Taxation as a reduction in federal taxable income, and that reduction flows through to Oregon

Conversely, a given provision of tax law was not included if it:

- Is a filing status, tax rate, or other mathematical feature of the tax calculation that applies to all taxpayers
- Is an exclusion implemented when the tax was created, thus defining the tax base
- Is a subtraction of ordinary and necessary expenses in a business that operates for profit
- Is a reduction in tax that is necessary to avoid double-taxation
- Is a rebate or other spending program

While inclusion in the TER does not represent a legal determination, stakeholders may understandably draw certain conclusions. The TER is a public report for any individual interested in learning about Oregon's tax system. Examples of the available information include metrics such as the total value of tax expenditures by program type, policy purpose, dollar value, etc. The TER also provides a quick reference for known sunset dates and statute references, along with policy descriptions, and an initial evaluation as to whether it is serving its intended purpose.

A fundamental purpose of the TER is to provide policy makers and other stakeholders with information that is otherwise not as easily accessible, including information on concepts broadly considered tax expenditures. One issue for consideration by the Legislature is whether or not there is value to including provisions that may not meet Oregon's statutory definition. DOR has stated a preference for transparency and the provision of information to promote the public analysis and understanding of tax law. It is a source of information that a variety of stakeholders have found useful in their desire to better understand Oregon's tax system.

Federal Definitions

The tax expenditure concept originated in the 1960s in response to the idea that federal income tax law had become littered with "loopholes". The concept became formalized and was codified in federal law. The Congressional Budget Act of 1974 (Public Law 93–344) defined "tax expenditures" and requires a list of tax expenditures be included in the federal budget.[6] The definition is in 2 U.S.C. § 622(3).

> The term "tax expenditures" means those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability; and the term "tax expenditures budget" means an enumeration of such tax expenditures.

Joint Committee on Taxation

The JCT prepares an annual report on tax expenditures for the House Committee on Ways and Means and the Senate Committee on Finance; The Committee also submits the report to the House and Senate Committees on the Budget.[7] It also relies on the definition provided in Public Law 93–344. The Committee report, in fact, is produced in consultation with the Office of Tax Analysis within the Treasury Department (OTA). Not surprisingly, given the same starting point, the tax expenditure lists produced by the JCT and the OTA overlap significantly; however, differences do exist. The JCT identifies several areas where these

[6] https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures
[7] https://www.jct.gov/publications/2019/jcx-55-19/

differences emerge: estimation methods, definition of the ‘normal’ tax base, baseline economic and revenue forecasts, use of a de minimis threshold for inclusion, and the use of negative tax expenditures.

Congressional Research Service

The CRS produces a compendium of tax expenditures every even year for the U.S. Senate Committee on the Budget.[8] The CRS cites the same federal law (PL 93–344) when providing the basis for the report, which is intended to “...provide an introductory understanding of the nature, effect, and background of each provision.” On page 2 the reports go on to say that

> Tax expenditures are revenue losses resulting from tax provisions that grant special tax relief designed to encourage certain kinds of behavior by taxpayers or to aid taxpayers in special circumstances. These provisions may, in effect, be viewed as spending programs channeled through the tax system. They are, in fact, classified in the same functional categories as the U.S. budget.

This report, perhaps, goes a bit further in drawing a link between indirect spending through tax expenditures and the direct spending of the budget process. For example, it draws comparisons between tax expenditures and entitlement programs in that all eligible taxpayers may benefit from such policies. The report also mentions that when enacted without sunset dates, the importance of at least periodic review is necessary to ensure efficiency in meeting desired goals.

U.S. Treasury

The U.S. Treasury puts together a tax expenditure budget each year for inclusion in the federal budget process, focusing on the individual and corporate income tax programs. They describe tax expenditures as alternatives to policy instruments such as direct spending or regulatory programs. Along with providing current revenue effects for the upcoming ten-year period, they also provide present value effects for the tax deferral provisions. Their introduction goes on to say that

> Identification and measurement of tax expenditures depends crucially on the baseline tax system against which the actual tax system is compared. The tax expenditure estimates presented in this document are patterned on a comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time. [9]

State Definitions

Unsurprisingly, with 50 states and 50 different tax systems, structures, and bases, there is notable variation across states in terms of the definition, use, analysis, and reporting of tax expenditures. In addition, the tax code in many states, and hence the tax expenditure definition, reaches beyond that of the Federal government into areas of local taxation, such as the property tax.

As identified by the Institute on Taxation and Economic Policy, nearly all states produce some form of a tax expenditure report. To provide a flavor of these differences, some examples are provided here. For convenience, Oregon’s definition is repeated here.

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[8] https://www.govinfo.gov/content/pkg/CPRT-115SPRT34119/pdf/CPRT-115SPRT34119.pdf

[9] https://home.treasury.gov/system/files/131/Tax-Expenditures-2021.pdf

Oregon

ORS 291.201 defines a tax expenditure as

> ... any law of the federal government or this state that exempts, in whole or in part, certain persons, income, goods, services or property from the impact of established taxes, including but not limited to tax deductions, tax exclusions, tax subtractions, tax exemptions, tax deferrals, preferential tax rates and tax credits.

California

The California Tax Expenditure Report states

> [t]here is no absolute rule for defining tax expenditures, and the concept of a "tax expenditure" can be defined in several different ways. Section 13305 defines tax expenditure as "a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state." Although this definition is very broad, Finance has interpreted it to mean that aspects of the law that are basic to the tax structure are not tax expenditures. While the term "basic" is still ambiguous, it at least presents a framework for discussion as to what is not a tax expenditure.[10] [11]

Idaho

The Idaho General Fund Revenue Book states the following on page 61.[12]

> The everyday vernacular refers to these departures from the tax base as tax breaks. An analogous term used by fiscal analysts is tax expenditures. The most common forms they take in the codification of taxes are exemptions, credits, exclusions, and deductions. The end result is always the same: a tax that is defined on the basis of a broad economic concept (income, consumption, wealth, etc.) is not applied uniformly against the broad base of the tax. The following pages provide both an inventory and an explanation of Idaho's sales and income tax expenditures. The goal is to facilitate greater understanding of these important elements of Idaho's overall fiscal structure. The definition of a tax expenditure (for the purpose of this report) is any provision of Idaho law that excludes some portion of the tax base on a selective basis.

Minnesota

The Minnesota Tax Expenditure Budget states:[13]

> Not every exemption, deduction, credit, or lower tax rate is a tax expenditure. A conceptual framework governs the identification of tax expenditure provisions. Each provision is evaluated against a list of seven criteria to determine if it is a tax expenditure. Some of the criteria are taken directly from the authorizing statute; some are based on concepts used in the preparation of federal tax expenditure reports; and others are based on what is believed to be a logical application of the tax expenditure concept. A provision must meet all the criteria in order to be a tax expenditure.
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> A provision is a tax expenditure if it:
> - has an impact on a tax that is applied statewide;
> - confers preferential treatment;
> - results in reduced tax revenue in the applicable fiscal years;
> - is not included as an expenditure item in the state budget;
> - is included in the defined tax base for that tax;
> - is not subject to an alternative tax; and
> - can be amended or repealed by a change in state law.

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[10] http://www.dof.ca.gov/Forecasting/Economics/Tax_Expenditure_Reports/documents/Tax_ExpenditureReport_2019-20_B.pdf

[11] https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?lawCode=GOV&sectionNum=13305

[12] https://dfm.idaho.gov/publications/eab/gfrb/gfrb_jan2018.pdf

[13] https://www.revenue.state.mn.us/sites/default/files/2020-02/2020%20Tax%20Expenditure%20Budget_0.pdf

Nebraska

The Nebraska 2019 Interim Tax Expenditure Report states

> A “tax expenditure” is defined as a revenue reduction that occurs in the tax base of the state or a political subdivision as a result of an exemption, deduction, exclusion, tax deferral, credit, or preferential rate introduced into the tax structure. See Neb. Rev. Stat. § 77-381(1).[14]

Texas

The Texas Tax Exemptions and Tax Incidence Reports are prefaced by stating the following.[15]

> As required by Section 403.014, Texas Government Code, these reports estimate the value of each exemption, exclusion, discount, deduction, special accounting method, credit, refund, and special appraisal available under Texas' sales, franchise, gasoline, and motor vehicle sales taxes, as well as under the property tax levied by Texas school districts.

Washington

The Washington 2020 Tax Exemption Study simply states the following[16]

> The term tax exemption includes a variety of preferences that reduce tax liability for taxpayers. Tax exemptions include: Exclusions; Deductions; Credits; Deferrals; Preferential tax rates; and Exemptions.

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14 https://revenue.nebraska.gov/sites/revenue.nebraska.gov/files/doc/research/tax-expenditure/2019_Interim_Tax_Exp_Report.pdf

15 https://comptroller.texas.gov/transparency/reports/tax-exemptions-and-incidence/

16 https://dor.wa.gov/about/statistics-reports/tax-exemptions-2020