STATE OF OREGON

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Research Report

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Research Report #5-12 **October 2012**

MEASURE 84

Summary[1]

Measure 84 statutorily phases out Oregon's estate tax law. The estate tax phase out occurs over a four year period beginning with deaths after January 1, 2013. The tax rate is reduced in annual 25% increments. The estate tax will be completely eliminated for deaths occurring after January 1, 2016.

Currently the estate tax is the fourth largest source of General Fund revenue after personal and corporate income taxes and liquor apportionment revenue. The state is projected to collect $195.6 million in estate tax revenue for the 2011-13 biennium under current law. Phase out of the estate tax under Measure 84 is expected to reduce General Fund revenue by $60 million in the 2013-15 biennium, $190 million in the 2015-17 biennium and $256 million in the 2017-19 biennium.

Passage of Measure 84 would clearly phase out and eventually eliminate Oregon's estate tax. It also clearly prohibits the imposition of a gift tax, which Oregon does not currently have. However, the measure also contains language prohibiting a tax on the "transfer" of property among family members. There is legal uncertainty as to whether or not the term "transfer" would apply to income taxes. This report explores three interpretations and their potential effects on the estimated revenue impacts. If it does apply, the revenue impact of Measure 84 on the General Fund through reduced income tax collections could be greater than the direct impact of phasing out the estate tax.

There are also a number of potential secondary effects that could result from the passage of Measure 84. Among these are:

- *Migration of high wealth households*
  Census data show that Oregon has experienced a net outflow of high income households over the past decade. Theoretically, the elimination of the estate tax could make the state relatively more attractive to these households. However, empirical studies on the effect of state level estate taxes on migration have not found a consistent statistical relationship. So to the extent that net-migration is affected, it is likely to be by a relatively small amount.
- *Revenue stability*
  Historically, estate tax revenue has demonstrated more than twice the variability of overall General Fund revenue over the past two decades. However, comparing the volatility of General Fund revenue with and without the estate tax shows that revenue is slightly more unstable when estate taxes are eliminated. The reason for the greater instability is that estate taxes move in patterns much different from those of personal income tax revenue, which dominates movements in the overall General Fund.
- *Other impacts*
  - Studies at the federal level show that reduced estate taxes have a moderate negative effect on charitable giving.
  - Court fee revenue, which is part of the state General Fund, may be reduced. The measure limits certain court fees to the cost of providing the service.

[1] This version makes technical corrections (none are related to Measure 84), and replaces an earlier version of the report posted on 10-12-12.

This report is divided into three major sections. After the measure description, the first section briefly reviews the history of Oregon's estate tax, the current status of the states and federal estate tax and who is currently paying the tax. The second section discusses the revenue implications of the measure including the direct effect of the estate tax phase out, possible effects on personal income tax revenue depending on how the language in Measure 84 is legally interpreted and the potential secondary effects involving migration, stability, and other effects. Finally, the report concludes with a brief section on the budgetary implications of the measure.

Description of the Measure

Ballot Measure 84 incrementally reduces, and then eliminates the estate tax and any other taxes upon the transfer of property at a person's death. It also prohibits the imposition of such taxes upon transfers of property among family members regardless of when they occur. If approved by voters, the measure takes effect January 1, 2013. The measure first applies to estates of decedents who die during calendar year 2013. For 2013 estates, the tax imposed is 75 percent of the tax that would be due if the death occurred just before passage of the measure. Thereafter, the amount of tax imposed is reduced by an additional 25 percent per year, resulting in a 50 percent reduction for 2014 estates, a 75 percent reduction for 2015 estates and no tax imposed on estates of people dying in 2016 or later.

Except for the amount allowed by the phase-out of any existing estate or inheritance tax, the measure prohibits the imposition, by the state or any other unit of government, of any tax upon transfer of property at a person's death or upon transfers of property among family members. The measure allows the imposition of fees and income taxes upon estates and allows cooperation by this state with other states and the federal government in the collection of estate and inheritance taxes.

Current Oregon law imposes an estate tax if a decedent's taxable estate exceeds $1 million using federal tax code definitions, and does not tax the first $1 million in the estate gross value. The law allows estates to take various additional deductions and exclusions before the tax is imposed. The marginal tax rate is graduated and ranges from 10 percent to 16 percent for Oregon taxable estates that exceed $9.5 million. Current law also allows a credit against estate taxes for property that had been used by the decedent in a farm business, forestry business or fishing business.

History and Current Status of Oregon's Estate Tax

Estate, inheritance and gift taxes (EIG) are different forms of taxes on the transfer of wealth. Estate taxes are imposed when the property transfer is caused by death and is levied on the value of property left by the deceased. The inheritance tax is also imposed after death, but levied on the amounts that each beneficiary receives depending on their income and relationships to the deceased. Gift taxes are imposed on the transfer of property by one individual to another in which the transferor receives less than the fair market value in return. The gift tax is generally considered a complement to the estate and inheritance taxes because without it, the latter taxes could be avoided through lifetime giving.

Oregon first enacted an inheritance tax in 1903. Prior to 1977, Oregon imposed inheritance, gift and estate taxes. The Oregon inheritance tax was calculated as a certain percent of the taxable estate

A Taxonomy of the Taxes

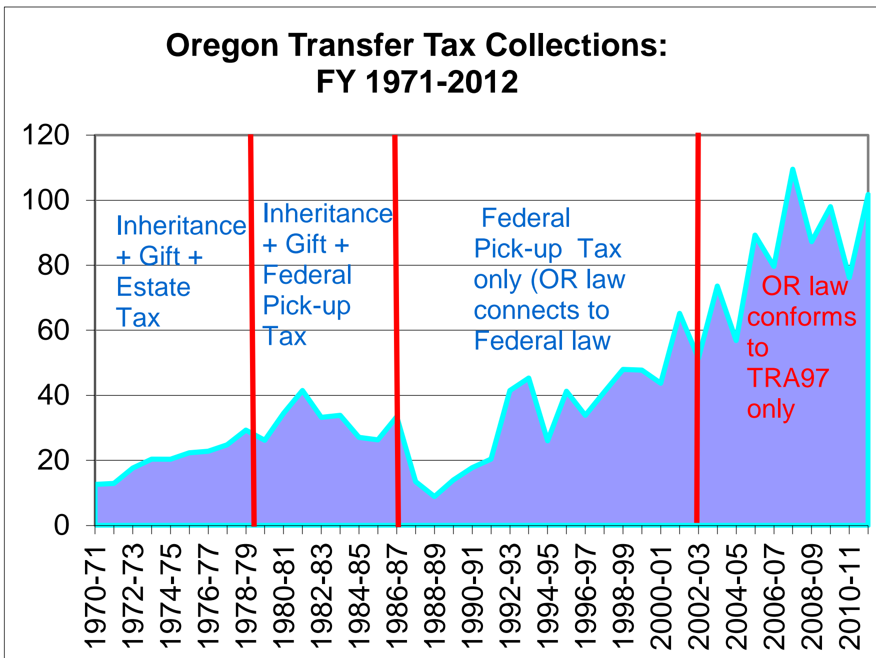
Estate and inheritance taxes are imposed on transfers that occur upon the death of the owner of the property, while gift taxes are imposed on gifts made during the transferor's lifetime ("inter vivos" gifts).

- **Estate taxes** generally apply a single rate schedule to the taxable value of the decedent's total estate (bequests to charities and surviving spouses are typically exempt).
- **Inheritance taxes** apply varying rate schedules to bequests made to different classes of beneficiaries. Bequests to surviving spouses and lineal heirs typically enjoy lower rates or are totally exempt, while bequests to more distant or unrelated heirs (collateral heirs) are usually taxed at higher rates.
- **Gift taxes** complement estate and inheritance taxes, preventing property owners from avoiding tax by making lifetime gifts. Some states impose tax only on gifts made a short time before death or "in contemplation of death." These provisions are administered as part of the estate or inheritance tax.

Source: Joel Michael

value. The tax rates ranged from 12% to 20% depending on who was inheriting the estate, with the closest relationships receiving the lowest tax rates. The estate tax imposed was a graduated tax rate on the gross estate value less deductions. Deductions were allowed for debts owed at the time of death. In 1977, Oregon's inheritance tax was simplified and the tax was based on the value of the property received from a decedent's estate and the tax rate was a flat 12% of the taxable value. In addition, Oregon adopted the federal pick-up estate tax based on the credit allowed under federal law. The federal pick-up tax became a floor on Oregon's own inheritance tax. Beginning in 1978, Oregon started phasing out its inheritance and gift taxes over 10 years. As the phase-out of Oregon's inheritance tax continued, the tax revenues dropped significantly to a low of $8.87 million in fiscal year 1988-89, as the state was only collecting the federal pick-up tax. Since Oregon phased-out its inheritance tax and adopted the federal pick-up tax exclusively, Oregon's estate tax revenue has been tied to federal law as in place on a specific date. As Oregon rapidly became a destination of the elderly population, as well as the growth in property values after 1988-89, the estate tax revenues in Oregon started growing again.

Figure 1



Recent Legislative Changes

Prior to the 2003 Oregon legislative session, legal opinions indicated that Oregon had not technically adopted two major federal law changes: the Taxpayer Relief Act (TRA97) and the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) in 2001. The Legislature responded with passage of HB 3072. The primary purpose of this law was to codify the connection to the Taxpayer Relief Act of 1997 (TRA97) for prior tax years 1998-2001. For deaths occurring in 2002, the gross estate value filing threshold was $1 million, the same as the federal filing threshold under EGTRRA. Another important objective of the 2003 legislation was to clarify that Oregon's estate tax connection was to the federal law under the Taxpayer Relief Act of 1997 for deaths occurring in 2003 and beyond. Oregon did not connect to the 2001 federal estate tax law changes contained in the Economic Growth and Tax Relief Reconciliation Act.

The 2007 legislative session attempted to preserve family owned farms, fishing business and small forest owners, by increasing the threshold for these estates to $7.5 million. However, the resulting legislation (HB 3201) contained ambiguities regarding implementation. The February 2008 session addressed the issue by introducing a credit schedule for small family owned natural resource properties. The credit in HB 3618 increases proportionally to reach the maximum at tax amount due for the $7.5 million properties, then declines gradually to $0 at the $15 million mark. Federal legislation has also provided significant estate tax relief for family natural resource businesses (CBO, 2005, 2009).

Table 1

Tax Year	Total # of Returns	Payable Tax (millions)$	Natural Resource Credit (millions)
2007	1343	119.76	2.42
2008	1281	75.84	1.83
2009	1123	82.90	1.31
2010	1011	64.71	1.31

The 2009 Legislature asked the Oregon Law Commission to design a structure for an Oregon estate tax law independent of the federal uncertainties. Based on the Law Commission's recommendations, the 2011 legislative session approved (HB 2541) a major revamp of the estate tax. Oregon now uses the definitions from the recent federal tax code and adds some of its own while basing the tax on an independent (standalone) schedule found in *ORS 118*[2]. The new law (effective 2012) establishes a threshold for filing an estate tax return of $1 million and still allows for a natural resource credit through a defined formula.

The major goals of the new law are:

- Use of the most up-to-date Federal definitions.
- The new standalone rate schedule builds a smooth ramp up in rates, which avoids the sharp jump in marginal rates caused by increasing the threshold while using the old (federal) pickup schedule that existed for much lower thresholds. The new standalone schedule is shown in the following table. The tax payment is equal to the base tax value plus the marginal rate multiplied by the difference of the estate value minus the least value (marginal step). For example a $1.1 million taxable estate will pay 0 (base) + 100,000 x 10% = $10,000 in state tax.
- The marital deduction allows couples to defer estate tax at the first spouse's death. The new law also clarifies that an estate can take a credit for Oregon natural resource property on the state return for qualifying property, despite using a marital deduction for the same property on the federal return.
- Oregon no longer taxes intangible property held by the estates of nonresident decedents.
- Natural resource property provisions are clarified by using federal definitions when appropriate and introducing state definitions for the operating allowances (up to $ 1 million or 15% of NR portion of the estate value), and other credit eligibility requirements.

Table 2

Taxable Estate Value		**Tax Payment = 3+4**	
(1) At least	**(2) UP TO**	**(3) Base Payment**	**(4)multiply % by (2-1)**
1,000,000	1,500,000	0	10.00%
1,500,000	2,500,000	50,000	10.25%
2,500,000	3,500,000	152,500	10.50%
3,500,000	4,500,000	257,500	11.00%
4,500,000	5,500,000	367,500	11.50%
5,500,000	6,500,000	482,500	12.00%
6,500,000	7,500,000	602,500	13.00%
7,500,000	8,500,000	732,500	14.00%
8,500,000	9,500,000	872,500	15.00%
9,500,000	----------	1,022,500	16.00%

Who Pays the Estate Tax?

The issue of who pays the tax has been examined at length. The Congressional Budget Office (CBO, 2009) reports that since 1977, less than 2 percent of adults who die each year have typically left estates large enough to be taxable. Following federal tax changes, that number declined to about 0.7 percent by 2007. The state taxes (23 states continued to collect either an estate or inheritance tax) on inherited wealth fell from 1.4 percent of their total tax receipts in 2000 to 0.7 percent in 2008. A study analyzing 2004 income and estate tax data (Burman, Gale, and Rohaly, 2005) described the estate tax is highly progressive with 99 percent of the tax falling upon the top 5 percent of taxpayers and over one third paid by the wealthiest 1 in 1000. A detailed study in the Statistics of Income (IRS 2012) was able to correlate estate tax decedents of 2007 with a mean gross reported income of $500,000 in 2006. The study also details sources of income by the different age groups and their wealth components.

Census data show that top wealth holders ($2 million or more) in Oregon are about 1.3 % of the national total and about 1.2% of the state population, thus it is reasonable to extend the national analysis to Oregon tax payers. Moreover, about one-half of Oregon filers pay any tax, which translates to less than 2% of decedents.

[2] Oregon Revised Statutes, chapter 118-Estate Tax, 2011 Edition.

Table 3

Size of Oregon Gross Estate	2002 - 2010 Average Estate Tax Returns With Gross Estate Value # of Returns	% of total returns	OR Payable Tax	% of total OR Payable Tax
Under $1 million	131.6	12%	$2,027,509	3%
$1 million up to $1.5 million	411.6	37%	$9,900,365	13%
$1.5 million up to $2 million	207.4	19%	$8,583,385	11%
$2 million up to $3.5 million	215.6	19%	$13,988,082	18%
$3.5 million up to $5 million	65.0	6%	$8,114,805	11%
$5 million up to $10 million	50.3	5%	$11,381,728	15%
$10 million up to $20 million	15.0	1%	$8,725,908	11%
more than $20 million	9.8	1%	$15,448,984	18%
TOTAL	1106.2	100%	$78,170,765	100%

Source: Oregon Department of Revenue

Impact of Federal Law Changes

The 2001 federal Economic Growth and Tax Relief Reconciliation Act legislation – P.L. 107-16, made significant changes in a number of tax areas, including federal estate taxes. The 2001 federal estate tax law changes included a phase-out of the state death tax credit, an increase in the gross estate value filing threshold, a decrease in the federal highest estate tax rates and a complete elimination of the federal estate tax for the tax year 2010 only. The four year phase-out (25% a year) of the state death tax credit eliminated the states' ability to capture a portion of each estate's federal tax liability by 2005.

Table 4

Increase in gross estate value filing threshold			
2002	$ 1.0 million	2006	$ 2.0 million
2004	$ 1.5 million	2009	$ 3.5 million
2010 No tax	No applicable threshold	2011	$ 1.0 million
Decrease in federal highest estate tax rates			
2002	50%	2006	47%
2003	49%	2007 -2009	45%
2004	48%	2010	No tax
2005	47%	2011	55%

In 2001, all 50 states imposed estate taxes to take advantage of the federal estate tax credit for state death taxes. This credit was essentially a federal revenue-sharing provision for states, allowing a state to impose an estate tax at no cost to its residents. Each dollar of state estate tax (up to the limits of the federal credit) reduced federal tax, dollar for dollar. Federal tax increased by any amount a state's tax was lower than the maximum federal credit. In 2001, 38 states and the District of Columbia only imposed taxes equal to the federal credit. The remaining 12 states imposed estate or inheritance taxes that exceeded the federal credit, although two of these states (Connecticut and Louisiana) had enacted scheduled reductions in their taxes down to the level of the federal credit.

With the repeal of the federal credit for state taxes, many states whose taxes were directly linked to the federal credit allowed their taxes to expire, while other states "decoupled" their taxes from the federal tax

and allowed them to continue, or reenacted the taxes to preserve the state revenues[3]. Table 2 shows the current states that impose estate and other transfer taxes.

Table 5

2011 State Estate and Inheritance Tax Comparison Chart							
Estate				*Inheritance*			
State	Exemption	Basis For Rate	Top Tax Rate	Exemption - Lineal Heirs	Top Rate- Lineal Heirs	Exemption Collateral Heirs	Top Rate- Collateral Heirs
Connecticut	$2,000,000	State Specific	12%				
Delaware	$3,500,000	Federal Credit	16%				
District of	$1,000,000	Federal Credit	16%				
Hawaii	$3,600,000	Federal Credit	16%				
Illinois	$2,000,000	Federal Credit	16%				
Indiana				$100,000	10%	$100	20%
Iowa				unlimited	NA	$25,000	15%
Kentucky				unlimited	NA	$500	16%
Maine	$1,000,000	Federal Credit	16%				
Maryland	$1,000,000	Federal Credit	16%	unlimited	NA	$1,000	10%
Massachusetts	$1,000,000	Federal Credit	16%				
Minnesota	$1,000,000	Federal Credit	16%				
Nebraska				$40,000	1%	$10,000	18%
New Jersey	$675,000	Federal Credit	16%	unlimited	NA	$500	16%
New York	$1,000,000	Federal Credit	16%				
North Carolina	$5,000,000	Federal Credit	16%				
Ohio	$338,333	State Specific	7%				
Oregon	$1,000,000	State Specific	16%				
Pennsylvania				$3,500	4.5%	$0	15%
Rhode Island	$859,350	Federal Credit	16%				
Tennessee				$1,000,000	9.5%	$1,000,000	9.5%
Vermont	$2,750,000	Federal Credit	16%				
Washington	$2,000,000	State Specific	19%				

[3] Washington enacted a standalone tax in 2005 after the Supreme Court held that its pickup tax was eliminated with the repeal of the federal credit. Initiative 920 attempted to repeal the new enacted tax, but only received 40 percent of the vote in November 2006. That vote preserved Washington's Estate tax which has a top rate of 19%.

Revenue Implications

Direct Impact: Estate Taxes and the General Fund:
Phasing out the estate tax will have a direct revenue impact on the state General Fund. The estate tax phase out will reduce General Fund revenue by an estimated $17 million in fiscal year 2013-14, approximately $43 million in 2014-15, and approximately $72 million in 2015-16 as Oregon's existing estate tax is phased out. Thereafter the measure will reduce state revenue by approximately $120 million per average year. On a biennial basis the projected impact of estate tax reductions under Measure 84 are:

2013-15: -$60 million

2015-17: -$190 million

2017-19: -$256 million

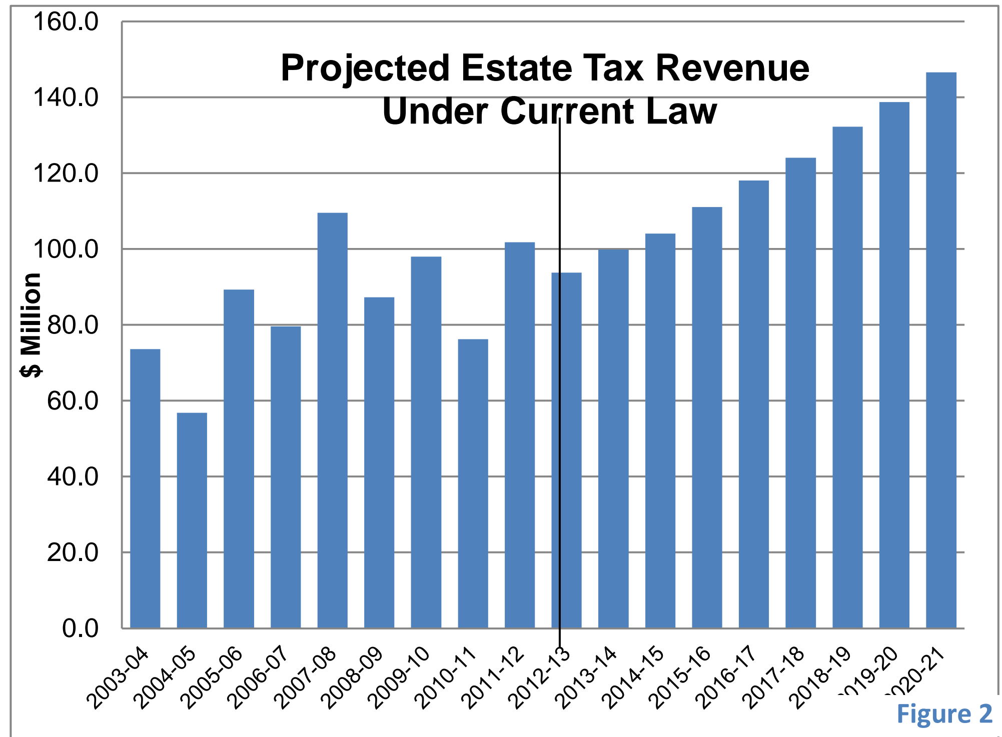


Figure 2

Potential Impact on the Personal Income Tax:
Depending on how expansive the language of Section 4(d) of Measure 84 is interpreted, income tax collections from qualified capital gains may become exempt from Oregon's personal income tax.[4] This potential exemption presents a risk to the estimated revenue impact of the measure. There are at least three interpretations of the potential impact on capital gains: (1) no impact because the measure is about transfer taxes and does not apply to income taxes, including taxes on capital gains; (2) an exemption of qualified transactions from the capital gains tax; and (3) a deferral of capital gains tax.

To better understand why there are different interpretations, recall that the estate, inheritance, and gift (EIG) taxes are generally considered transfer taxes, which are taxes on the passing of title of property from one person to another. In contrast, a capital gains tax is an income tax imposed on the appreciated value of an asset at the time the asset is sold. The federal government currently imposes an estate tax and a gift tax. As described above, Oregon currently imposes only an estate tax. As for capital gains, Oregon law ties to federal law with respect to the amount of net gains that are subject to taxation, but not the tax rates. The federal government has a separate set of tax rates for net capital gains income that is different from the rates imposed on other sources of income. Oregon, however, does not treat net capital gains income differently from other sources of income. With some minor exceptions, all income in Oregon is taxed at the statutory, marginal rates of 5%, 7%, 9%, and 9.9%.[5]

An additional piece of related tax law is a provision within the income tax known as the "step-up in basis". In general, the purchase price of a piece of property is referred to as the "basis". Assuming the property value increases by the time it is sold, the sales price of the property less the basis (i.e., the appreciated value) is considered a capital gain and may be subject to the income tax. However, if a person inherits a piece of property, the basis is increased to the market value at the time of transfer – the basis is "stepped up" to market value, which becomes the new basis for the new owner. Under current law, this increase in

[4] A broad interpretation of the section could also include the exemption of rental income from taxation because lease agreements involve the transfer of the use of property.
[5] For example, Oregon does have a special capital gains tax rate of 5% for certain farm income.

value is not subject to federal or state taxation. Historically, policy discussions that involve the elimination of the estate tax generally include the elimination of the step-up in basis, in part to offset some of the costs. In fact, in tax year 2010 taxpayers had the option of paying no federal estate tax if they chose to forego the step-up in basis.

Interpretation One: No Impact

Under this interpretation, there is no impact because the capital gains tax is not a tax on the transfer of property – it is not a kind of transfer tax. It is a potential tax on any gain that results from the sale of property. In contrast, transfer taxes are due at the time property is transferred and are generally a function of the sales price or value of the property.[6] For purposes of capital gains taxes, it is not known until the end of the tax year whether or not any tax is due. For example, if a taxpayer sells stock for $1,000 – and has a basis of $250 – then there is the potential that $750 is subject to taxation. If the taxpayer has a loss of $800 on another transaction, then the $750 is completely offset and no tax is due.

This interpretation then leaves open the question of the practical impact of Section 4(d). All other sections of the measure pertain to taxable events for a decedent's estate. This section is the only one that is not dependent upon the death of a taxpayer -- it includes transfers made during a taxpayer's lifetime. Also, the measure lacks any reference to the issue of a "step-up in basis" related to the capital gains tax. In light of the current tax landscape of estate, inheritance, and gift taxes, a reasonable interpretation is that this section simply prohibits the creation of a new gift tax. The measure consists of a statutory law change (as opposed to a constitutional change) so it is possible for the Legislature to make modifications. Depending on the interpretation, such a change could require either a simple majority or a super majority vote. Section 4(d) could be interpreted as a statement that the Legislature should not create a gift tax, or other such tax, as a source of replacement revenue.

Interpretation Two: Exemption from the Capital Gains Tax

The second interpretation is that the capital gains tax is a tax on the transfer of property as specified in Section 4(d) of the measure. As such, its elimination presents a risk to the estimated revenue impact of the measure. There are two components of this risk: (1) the direct effect, which is based on the degree to which these kinds of intra-family sales occur under current law; and (2) the behavioral effect, which is based on the change in the level of this activity due to the law change. Unfortunately, data are not available on intra-family asset transfers, so their frequency and magnitude are unknown. Under current law there are no federal or Oregon incentives that would favor intra-family sales over non-family sales. The most prominent such incentive that currently exists is through the estate tax. Depending on a decedent's estate value, property can be transferred tax free by taking advantage of the step-up in basis. Based on these factors, the current frequency of these intra-family sales is assumed to comprise a small share of the total in any given year.

The behavioral component of the revenue impact, which presents the greater risk, is the change in behavior as taxpayers respond to the new law. Taxpayers looking to sell an asset may first consider the option of selling the property to an eligible family member who would, in turn, then sell the property to the intended third party. The revenue impact would range from a reduction in tax collections based on the historical collections (i.e. minimal behavioral response) to a significant reduction in capital gains tax collections (i.e. strong behavioral response).

For context, total capital gains taxes are projected to account for just over six percent of total General Fund revenue, on average, for the 2013-15 through 2019-21 biennia. As of the September 2012 revenue forecast, annual projected capital gains tax collections range from $335 million in 2012 to $696 million in 2021.

The potential for a significant revenue impact lies within the possibility that property sales would be structured to be sold through an eligible family member prior to selling the property to a third party. Due to the lack of reliable information on these kinds of transactions and significant uncertainty regarding the legal

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[6] For example, Washington County has a one tenth of one percent transfer tax on the sale of real property. If a house were to sell for $250,000, then at the time of sale the County is due $250.

and logistical aspects of restructuring these sales, the best analytical approach to making an estimate is to rely on aggregate data available from the Internal Revenue Service. The IRS has conducted occasional studies that identify the types of asset sales that result in capital gains. The most recent federal data available are for tax year 2007. Assuming this distribution of types of gains is similar for Oregon and relatively constant over time, these data can be used to estimate the potential impact on Oregon income tax collections.

The two largest components are from corporate stock and gains from pass-through entities (e.g. partnerships and S-corporations). Some of the other categories include mutual funds, capital gains distributions, interest in a pass-through entity, residential rental property, and depreciable business property. Given these various types of asset sales that result in taxable capital gains, the question becomes how likely is it that each of the different types of sales would be restructured. Some sales, such as a those of closely held corporate stock appear to be amenable to restructuring so as to avoid Oregon capital gains tax. Others, such as capital gains distributions and some gains from pass-through entities, appear to be less amenable to restructured sales.

An important factor to consider in understanding the behavioral response is the impact of transaction costs. Making asset sales under current law is well understood and transaction costs are transparent to the educated seller. Taxpayers incorporate these, and other, costs in determining the timing of their asset sales. Given the uncertainty surrounding this aspect of the measure, it is not clear what the transaction costs of restructuring these sales would be. However, it is safe to say that the greater the capital gain from the sale of an asset, the greater the tolerance of taxpayers to absorb these costs.

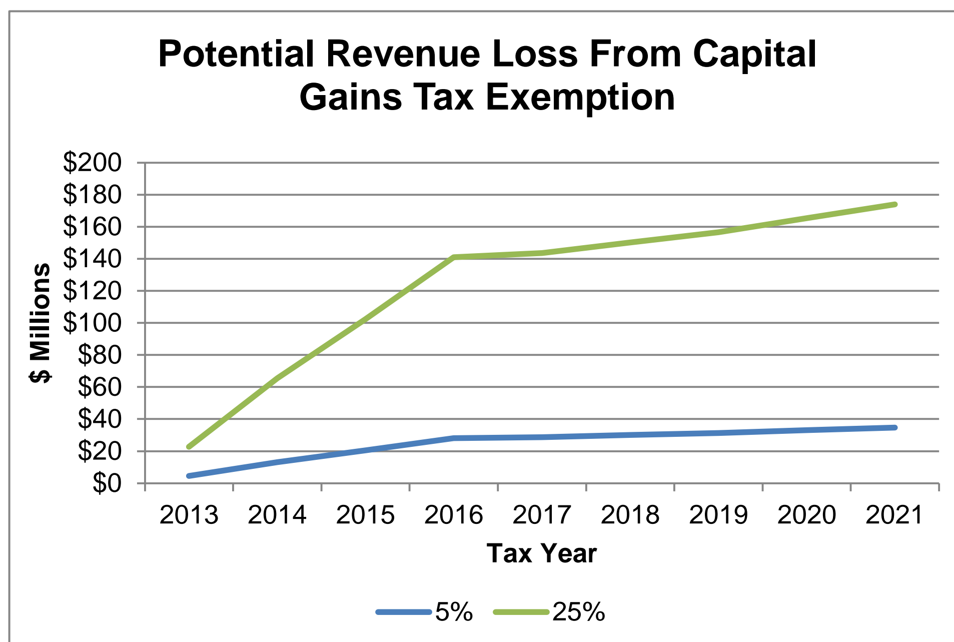

Figure 3

Depending on the assumptions made for each kind of asset sale and the associated transaction costs, the impact on capital gains tax collections can vary significantly. Given that sensitivity, perhaps the best way to describe the impact is in terms of risk to the forecast. Figure 3 shows the annual revenue loss under two different levels of capital gains that would be affected by the measure. The growth shown in tax years 2013 through 2016 is due to the phase-out of the tax. If five percent of gains are affected, then the annual revenue loss approaches $50 million by 2021; if 25 percent of gains are affected the annual revenue loss approaches $175 million—exceeding the direct revenue loss from phase out of the estate tax.

Interpretation Three: Deferral of Tax

The third interpretation of the measure is similar to the second one except that instead of being fully exempt from taxation, the tax on gains from eligible transfers is simply deferred until the asset is sold to an ineligible person. The idea here is that the measure does not explicitly provide for a step-up in basis upon such a transfer and, consequently, would be treated as though it were a gift (i.e. no step-up in basis). If and when that property is sold to an ineligible party, the capital gains tax would be due and would be based on the initial basis. For example, say a grandmother has a piece of property valued at $10,000 and her basis is $2,000. She sells the property to her grandson for $10,000. One year later he sells the property to an impartial third party for $13,000. Under this interpretation, the grandmother has no tax obligation on the gain of $8,000 that she realized. The grandson, however, is required to pay tax on the “technical” gain of $11,000. (Even though he paid $10,000 for the property, the basis was kept at $2,000.)

To the extent there would be a revenue impact under this scenario, it would be a shift in revenue across tax years and biennia. There may also be some leakage in cases where the eligible family member does not live in Oregon; it would become very difficult for the state to keep track of such assets as they are transferred among family members. Compared to current law there would be a reduction in tax collections in the near biennia when property is sold to family members and an increase in tax collections in later biennia when ultimately sold to non-family members.

In summary, how section 4(d) of is interpreted carries significant implications for state General Fund revenue. If 4(d) is interpreted as unrelated to the personal income tax, the revenue impact of the measure is confined to the phase out of the estate tax. If interpretation two prevails, taxes on the capital gains of assets sold to family members is not subject to state income taxes, the revenue impact of Measure 84 could potentially double if a significant number of transactions are modified to avoid the tax. Interpretation three, a deferral of taxes on capital gains, would likely lead to modest timing effects on revenue.

Estate Taxes and General Fund Revenue Stability

Estate tax revenue is a General Fund revenue source. Table 6 shows General Fund revenue with estate tax revenue broken out over the past 20 years.

Biennium	**General Fund Revenue**		**Estate Tax Revenue**		**General Fund Revenue w/o Estate Taxes**	
	(millions)	% Change	(millions)	% Change	(millions)	% Change
1989-91	$4,628	21.7%	$31.8	42.0%	$4,596	21.6%
1991-93	$5,477	18.3%	$61.9	94.7%	$5,415	17.8%
1993-95	$6,536	19.3%	$71.3	15.2%	$6,465	19.4%
1995-97	$7,732	18.3%	$75.2	5.5%	$7,657	18.4%
1997-99	$8,325	7.7%	$88.9	18.2%	$8,236	7.6%
1999-2001	$10,122	21.6%	$91.4	2.8%	$10,031	21.8%
2001-03	$9,366	-7.5%	$116.6	27.6%	$9,249	-7.8%
2003-05	$10,438	11.4%	$130.5	11.9%	$10,308	11.4%
2005-07	$12,742	22.1%	$165.9	27.1%	$12,576	22.0%
2007-09	$11,729	-8.0%	$196.8	18.6%	$11,532	-8.3%
2009-11	$12,521	6.8%	$174.2	-11.5%	$12,347	7.1%
Average		12.0%		22.9%		11.9%
Standard Deviation		10.6%		26.4%		10.7%

Table 6

General Fund revenue has demonstrated a great deal of volatility over the past ten biennia, largely due to fluctuations in personal and corporate income tax revenue. Estate tax revenue, a subcomponent of General Fund revenue, has shown even greater volatility as measured by the standard deviation of biennial percentage changes. The standard deviation is a measure of variability in a time series. By this measure estate taxes have been more than twice as volatile as the overall General Fund. However, when the volatility of General Fund revenue without the estate tax included is compared to the historic volatility of overall General Fund revenue, the standard deviation of the former is slightly higher. The higher standard deviation occurs because estate tax revenue, though more volatile than overall General Fund revenue, fluctuates in patterns much different from the General Fund overall. For example in the 2001-03 biennium, General Fund revenue declined 7.5% but estate tax revenue increased 27.6%. A similar phenomenon occurred in the opposite direction in the 1999-2001 biennium. In other words, estate tax revenue acts to stabilize, albeit small in size and limited in effect, the overall General Fund much as different assets are combined in a diversified financial portfolio to reduce overall volatility.

Estate Taxes and Oregon Migration Patterns

The subject of competition among states to attract the elderly has been a part of different states' policies on estate and inheritance taxes (Michael J., 2006). Elderly migration has been the subject of several studies trying the estimate the impact of estate and other forms of transfer taxes on migration patterns. Conway and Rork (Conway, 2006) examined these studies and found that they do not reach clear, consistent conclusions. The studies of migration that utilize cross sectional data often end up with wrong signs and unreliable conclusions. In a more detailed study, Conway and Rork (Rork., 2006) use (pooled time series

and cross sectional) data from different census periods to explore the relationship between EIG taxes and elderly migration. They find that the elderly migrate for many "life quality" reasons rather than taxes. Moreover, they find that there is empirical evidence to suggest that states tend to change their tax policies as a result of elderly migration, not the other way around. In other words the migrating elderly are able to affect later change in state policies rather than migrating in response to lower transfer taxes. The Manhattan Institute (Gray, 2012) finds that Californians are moving to many places, but the elderly are moving to Oregon and Washington (both with estate taxes) with a high preference, primarily for quality of life purposes. Additional research by Bakija and Slemord (Slemord, 2004) indicates that the top 2 to 4 percent of the estate tax filers are potentially affected by EIG taxes in their migration and domicile decisions. The estimates for the revenue reductions from these effects are in the range of 8% (13% with other taxes effected) of the estate tax revenue. These amounts constitute a minimal amount compared to the direct loss of revenue that will result from repealing the estate tax.

Other Measure 84 Impacts

One impact that is repeatedly mentioned and measured in the literature is the effect on charitable bequests. In analyzing and calculating taxable estates deductions, expenses and contribution to charities, charitable bequests (in dollar terms) were the second largest deduction behind only bequests to the surviving spouse (Brian 2009). IRS analysis found a slight downward trend between 2001 and 2007, correlated to the tax changes on the federal side. The CBO finds a clear link between charitable donations and the estate tax (CBO, 2009). Others have estimated that a repeal of the estate tax would reduce charitable giving between 6 and 12 percent (Burman, Gale, and Rohaly, 2005).

An additional potential impact is on state court fee revenue, which is a part of the General Fund. The measure specifies that these fees can be no more than the cost of providing the service. This will necessitate calibrating fees and costs and may reduce a portion of some existing fees.

Potential Budgetary Implications

Measure 84 directly reduces General Fund revenue through the phase out of the estate tax and potentially reduces General Fund revenue further by restricting income tax collections on capital gains income. Reduction in these revenue sources will affect the state's discretionary budget which consists of General Fund and non-dedicated Lottery revenue. Although the Legislature's budget allocation decisions are influenced by a wide variety of factors each biennium, a rough outline of the future budget implications of the reduced revenue caused by passage of Measure 84 can be derived from the current allocation by major program area. Table 7 shows the 2011-13 General Fund/Lottery budget by broad program area.

Program Area	2011-13 Expenditures (millions)	% of General Fund/ Lottery Budget
K-12 Education	$5,715	38.7%
Other Ed including Higher Ed & CC	$1,680	11.4%
Human Resources	$3,875	26.2%
Public Safety/Judicial	$2,549	17.2%
Other including administrative, Legislature, natural resources, economic development	$965	6.5%
Total General Fund/Lottery Budget	$14,784	100%

Table 7

Approximately half of the state's discretionary budget is allocated to education in its various forms including payments directly to school districts and appropriations to higher education and the community colleges. Human resources, including health care, services to seniors and low income households make up about 26 % of the budget with public safely (including prisons, state police and the court system) comprising about 17% of the total. These percentages can serve as an initial approximation of how future revenue losses will affect state level services funded within the General Fund/Lottery budget.

Appendix A: **Citations and References.**

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