STATE OF OREGON

Research Report

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Measure 41
Changing Oregon's Treatment of Personal Exemptions

Introduction

Measure 41 will appear on the November 2006 general election ballot. It is a statutory measure that changes Oregon's personal income tax law to allow a more favorable treatment of personal exemptions. If the measure passes, personal income tax filers would have the choice of using either the current Oregon personal exemption credit or the federal personal exemption deduction. It is expected to reduce personal income tax revenue by roughly 7 percent per year. In 2007, the first year in which it applies, the reduction would be an estimated $393 million. It would also increase the federal taxes that Oregon filers pay by a total of $40 million.

This report provides a history of Oregon's treatment of personal exemptions and how that treatment compares to that of other states. Using the September 2006 Economic and Revenue Forecast as the basis, the discussion turns to the impacts on General Fund revenue and balances. A distributional analysis is included in the discussion of the revenue impact. Specific taxpayer examples illustrate how the impact of the measure can vary depending on the circumstances of the individual taxpayer. The paper concludes by briefly describing uncertainties about the measure.

Current Law and Measure 41

Under current Oregon law, each taxpayer is entitled to claim one personal exemption credit for himself or herself, one for a spouse, and one for each dependent child. An additional exemption credit may be claimed by each taxpayer and spouse if they are severely disabled and one for each handicapped child. The credit is nonrefundable and is indexed to inflation. For tax year 2006, the credit is $159 per exemption; in 2007 it is projected to be $165. The credit may be claimed by all filers except those who are claimed as a dependent on another filer's return. Typically, these are children who file their own tax return but are claimed as a dependent on their parents' return.

Measure 41 allows taxpayers the option of using either the current personal exemption credit or their federal personal exemption deduction, whichever results in a lower tax liability. The deduction reduces the amount of income that is taxed while the credit directly reduces the amount of tax. Nearly 4 out of every 5 filers would benefit more from the deduction than the credit. No one would pay more tax due to the measure's passage. The measure also allows taxpayers the option of using a larger exemption credit adopted by the Legislature in lieu of the deduction. The measure makes no reference to the additional exemption credits allowed under current law.

The policy choice of using either a deduction or credit touches on issues of tax equity. Generally, a credit has the same value for every similar filer. (In cases where taxable income is sufficiently low, the taxpayer's liability may be reduced to zero before the full amount of the credit is used.) On the other hand, the value of a deduction depends on the taxpayer's tax bracket. For example, the benefit of the $3,400 deduction to a single filer in the 9 percent tax bracket is a tax reduction of $306 ($3,400 x 9%). For a single filer in the 7 percent tax bracket, the tax reduction is $238 ($3,400 x 7%). In Oregon, roughly 70 percent of filers are in the 9 percent bracket.

History of Oregon's Personal Exemption

When Oregon's Personal Income Tax was created in 1929 it originally contained an exemption deduction of $1,500 for single filers, $2,500 for joint filers, and $400 for each dependent. Beginning in 1945 the joint deduction was set to twice the single deduction. The exemption remained a deduction until 1983 and while it was not indexed to inflation, its value changed several times. Between 1929 and 1983, the deduction for single filers ranged in value from a low of $500 (in 1947, 1955, and 1956) to a high of $1,500 (from 1930 to 1932). It was $1,000 from 1979 to 1982.

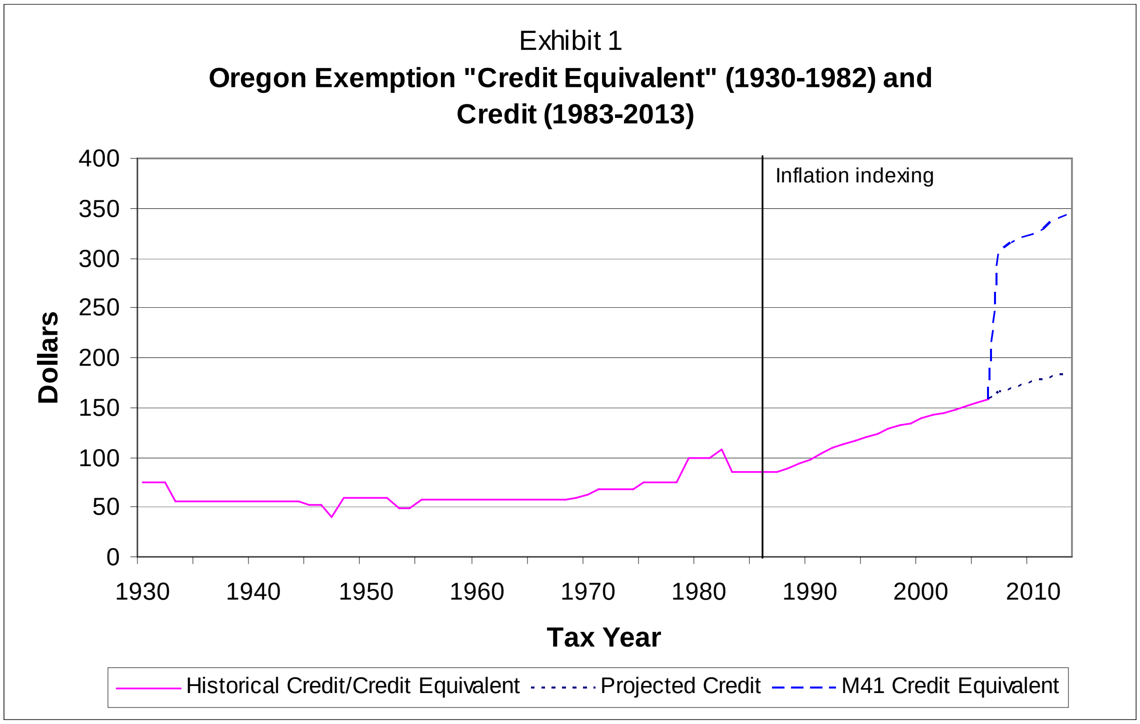
The 1983 Legislature, via HB 2201, temporarily changed the $1,000 deduction to an $85 credit for tax years 1983 and 1984. The bill reverted the credit back to the $1,000 deduction in 1985 and indexed it to inflation with 1984 as the base year. The estimated revenue impact was an increase in revenue of $65 million for the 1983-85 biennium. The 1985 Legislature, via HB 2182, made the $85 credit permanent and delayed indexing until 1987. The estimated revenue impact was an increase in revenue of $83 million for the 1985-87 biennium.

From 1987 to 2001 the base credit was $85 and indexed to inflation, so by 2001 the credit was worth $142. In an effort to align various inflation indexing provisions in Oregon law, the 2001 Legislature, via HB 2272, changed the inflation adjustment factor from the Portland CPI to the U.S. city average CPI. To minimize the impact of this change on the nominal amount of the credit, the base was changed from $85 to $90. Since 2002, the base credit has been $90 and it continues to be indexed to inflation.

One way to see how the value of the personal exemption has changed over the years is to convert the deduction to a "credit equivalent". Exhibit 1 shows the history and the forecasts of the "credit equivalent" (1930 to 1982) and the credit (1983 to 2013). For each year, the "credit equivalent" is determined by multiplying that year's deduction by that year's top marginal tax rate. Consequently, even during periods when the deduction did not change, the "credit equivalent" would change commensurately with any changes in the top marginal tax rate.

From 1930 to 1982, Oregon's top tax rate ranged from 5 percent (1930-1932) to 11.6 percent (1955-1956). As reflected in the solid line, the nominal value of the personal exemption was fairly stable for the first 40 years of Oregon's income tax, worth between $50 and $60 per exemption. The nominal value increased between 1970 and 1983 largely due to direct increases in the deduction amount. After the value was held constant by Legislative action in the mid-80s, the nominal value of the personal exemption has increased steadily due to inflation adjustments. As shown by the small-dashed line, the projected value of the credit under current law continues this trend.

The large-dashed line shows the "credit equivalent" of switching to the federal exemption deduction beginning in 2007. The federal deduction is projected to be $3,400 in 2007, resulting in a "credit equivalent" of $306. This amount is $141 larger than the projected exemption credit of $165. So the 2007 impact of Measure 41 is roughly equivalent to increasing the personal exemption credit by 85 percent. Through 2013, the "credit equivalent" is projected to be roughly 86 percent larger than the current credit, on average.



In 2004, the most recent year for which complete data are available, just over 1.65 million returns were filed and nearly 3.4 million exemptions were claimed – an average of 2 exemptions per return. For full-year, single filers, the average number of exemptions was 0.9. (Dependent filers pull the average below one.) For full-year, joint returns, the average number of personal exemptions was 3. In total, all of the full-year personal exemptions credits claimed reduced tax liability by just over $397 million.

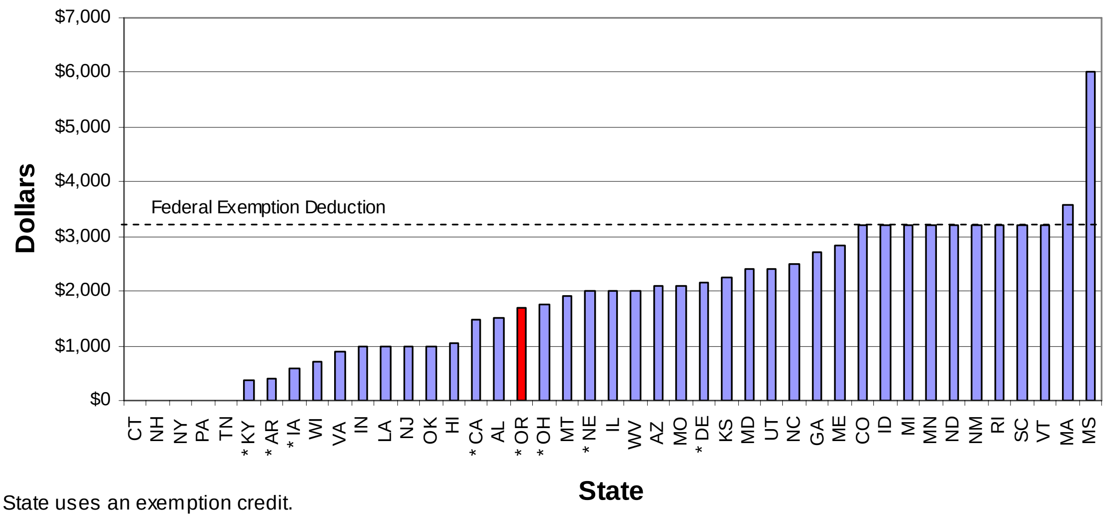
Other States' Personal Exemptions

Of the 43 states that impose an individual income tax, there are significant differences in how state tax liability is calculated. The starting point for most states is either Federal Adjusted Gross Income or Federal taxable income. Each state has its own set of tax rates, tax brackets, deductions, and credits. And most states use a personal exemption (deduction or credit) that is the same for the primary filer, the spouse, and each dependent. In several states, however, the exemption amount may differ for dependents.

Thirty states use an exemption deduction, seven use an exemption credit, and one (Ohio) uses both a deduction and a credit. Five states do not allow personal exemptions of either kind. Of the states using a deduction, 22 use their own deduction, which ranged from $700 to $6,000 for single filers in 2005. (In each of these states, the joint deduction was twice the single amount.) Eight states are tied to the federal deduction amount. The 2005 credit amounts ranged from $21 to $154, with Oregon's credit being the largest. Ohio used a deduction worth $1,350 and a credit worth $20.

Exhibit 2 shows the 2005 single filer deduction or "deduction equivalent" for each state. Similar to the prior exhibit, a "deduction equivalent" is calculated for each state that used an exemption credit. It is determined by dividing the credit amount by the mean tax rate for income ranges roughly equal to Oregon's 9% bracket. In 2005, Oregon's personal exemption was larger than 12 other states (17 including the five states that do not allow personal exemptions). Measure 41 would increase the value of personal exemptions toward the highest among the states. Only two states (Massachusetts and Mississippi) had personal exemptions worth more than the federal amount.

Exhibit 2
2005 State Personal Exemption Deductions and "Deduction Equivalents"



* State uses an exemption credit.

Of the five states that do not allow a personal exemption, some allow a deduction or credit that could be considered similar. Connecticut allows a credit that is up to 75 percent of the pre-credit liability, depending on income level (it reduces to zero for higher income filers). The credit percentage depends on filing status but does not vary with the number of dependents. New Hampshire and Tennessee, which each tax only interest and dividend income, have an exemption amount that also depends only on filing status. New York allows an exemption deduction of $1,000 for each dependent, but not for the primary filer or spouse.

Revenue Impact

Overall, the measure reduces personal income tax liability by roughly 7 percent annually; this amounts to a $393 million reduction in tax year 2007.[1] Exhibit 3 shows the annual and biennial impacts both with and without the interaction with the surplus refund (i.e. kicker). The impact in 2006-07 is largely due to changes in withholding. The revenue reduction is nearly $400 in 2007-08 and grows at an average annual rate of 4 percent through 2012-13. The growth in the impact is slightly less in 2011-12 as certain high

[1] An analysis using the Oregon Tax Incidence Model (OTIM) showed a modest economic stimulus to Oregon's economy, driven by increased demand on the part of Oregon households. The increased demand, however, is insufficient to offset a significant portion of the expected loss in state income tax revenue. In the long-term it is expected to have little impact on the state's competitive position.

income filers switch from using the deduction back to the credit. (The reasons are related to the federal tax cuts of 2001 and are described in more detail in the later section "The Effect on Filers with Income above $200,000").

When considering the interaction with the kicker, the 2006-07 reduction translates into a lower kicker total. The reduction of $157 million means a reduction in 2005-07 ending balance, thereby reducing the surplus refund. The non-corporate kicker, which is refunded to filers in 2007-08, would be reduced by $157 million, from $1,043 million to $886 million. Consequently, the revenue reduction for 2007-08 is $242 ($399 million reduction in collections combined with a $157 million reduction in the kicker). The revenue impact for 2007-09 is also reduced by the same amount, from $813 million to $656 million.

Exhibit 3

Revenue Impact of Measure 41

Fiscal Year	Measure 41 (without kicker)	Measure 41 (with kicker)
Annual Revenue Impacts ($ Millions)		
2006-07	-$157	-$157
2007-08 *	-$399	-$242
2008-09	-$414	-$414
2009-10	-$434	-$434
2010-11	-$452	-$452
2011-12	-$461	-$461
2012-13	-$482	-$482
Biennial Revenue Impacts ($ Millions)		
2005-07 Biennium	**-$157**	**-$157**
2007-09 Biennium *	**-$813**	**-$656**
2009-11 Biennium	**-$885**	**-$885**
2011-13 Biennium	**-$943**	**-$943**

* The projected 2005-07 kicker would reduce the impact by $157 million in fiscal year 2007-08 and in the 2007-09 biennium.

Measure 41 would also affect the amount of federal taxes paid by Oregon filers. Just over 50 percent of Oregon filers itemize their federal deductions and may claim state income taxes as a deduction. For itemizers, a lower Oregon tax means lower federal itemized deductions. This, in turn, results in a higher federal tax. For tax year 2007, Oregon itemizers would pay roughly $40 million more in federal income taxes.

Exhibit 4 shows the impact on General Fund (GF) revenues and the ending balance for 2005-07 and the impact on the beginning balance and GF revenues for the 2007-09 biennium. The first column for the 2005-07 biennium shows the beginning balance of $308.5 million and the current law (September 2006) General Fund forecast of $12,607.4 million. Together, total GF resources are currently estimated to be $12,915.9 million. Based on an expenditure estimate of $11,643.9 million, the projected ending balance for 2005-07 is $1,272 million. Measure 41 would reduce revenue by $157.3 million which translates into a reduction, of that amount, in the ending balance to $1,114.7 million.

Exhibit 4

September 2006 General Fund Forecast

	2005-07			**2007-09**		
	Current Law	Measure 41	Difference	Current Law	Measure 41	Difference
Beginning Balance	308.5	308.5	0.0	1,272.0	1,114.7	-157.3
Revenue	12,607.4	12,450.1	-157.3	12,517.0	11,861.2	-655.8
GF Resources	12,915.9	12,758.6	-157.3	13,789.0	12,975.9	-813.1
Expenditures	11,643.9	11,643.9	0.0			
Ending Balance	1,272.0	1,114.7	-157.3			

As shown in the table, the 2007-09 beginning balance – which is the 2005-07 ending balance – also reflects the impact of the $157 million reduction. Revenue for 2007-09 is reduced from $12,616.8 million to $11,961 million, or $655.8 million ($813 million reduction in tax collections combined with a $157 million reduction in the kicker). Between the reduction in the beginning balance and the reduction in revenue, GF resources for the 2007-09 would be reduced by $813.1 million, or 5.9 percent.

Exhibit 5 shows how the estimated revenue impact of personal exemptions would change under Measure 41. The estimates are for the current and next three biennia and exclude the interaction with the 2005-07 kicker. Under current law, the personal exemption credit is expected to reduce taxpayers' liability by $1,118 million in 2007-09, the first full biennium the measure would affect. In that same year, Measure 41 is expected to have a revenue impact of $813 million, bringing the total revenue impact of personal exemptions to $1,931 million in 2007-09. Over time, Measure 41 would increase the revenue loss to the state from personal exemptions by an annual average of 73 percent.

Exhibit 5

Impact of Oregon's Personal Exemption Credit and Measure 41

Fiscal Year	Current Law	Measure 41 Additional Amount	Total
2005-07 Biennium	-$1,061	-$157	-$1,218
2007-09 Biennium *	-$1,118	-$813	-$1,931
2009-11 Biennium	-$1,205	-$885	-$2,090
2011-13 Biennium	-$1,289	-$943	-$2,232

* The projected 2005-07 kicker would reduce the impact of Measure 41 by $157 million in the 2007-09 biennium.

Another way to view the measure's impact on revenue is to look at the state rankings of both personal income taxes and total taxes as a share of personal income. The most recent data available for such a comparison are state and local revenues for 2003-04. Exhibit 6 shows the top 10 personal income tax rankings and the bottom 10 total tax rankings. Under existing law, Oregon ranks second in personal income tax as a share of personal income (4.4 percent) and ranks 42^{nd} in total taxes as a share of personal income (10.1 percent). Assuming no changes in each other state and a 7 percent cut in Oregon's personal income tax revenue (the magnitude of the Measure 41 reduction), the table shows how Oregon's ranking in these two metrics changes. Oregon drops from second to third in the personal income tax ranking, falling to 3.9 percent. For total taxes, Oregon drops from 42^{nd} to 44^{th}, falling to 9.8 percent.

Exhibit 6

Personal Income Tax as a Share of Personal Income					
Current Law Scenario			Measure 41 Scenario		
State	Rank	Percent	State	Rank	Percent
New York	1	4.4%	New York	1	4.4%
Oregon	2	4.2%	Maryland	2	4.0%
Maryland	3	4.0%	Oregon	3	3.9%
Ohio	4	3.6%	Ohio	4	3.6%
Massachusetts	5	3.5%	Massachusetts	5	3.5%
Kentucky	6	3.4%	Kentucky	6	3.4%
Minnesota	7	3.3%	Minnesota	7	3.3%
North Carolina	8	3.2%	North Carolina	8	3.2%
Wisconsin	9	3.1%	Wisconsin	9	3.1%
Maine	10	3.1%	Maine	10	3.1%

Total Taxes as a Share of Personal Income					
Current Law Scenario			Measure 41 Scenario		
State	Rank	Percent	State	Rank	Percent
Montana	41	10.1%	Montana	41	10.1%
Oregon	42	10.1%	Virginia	42	10.0%
Virginia	43	10.0%	Texas	43	9.9%
Texas	44	9.9%	Oregon	44	9.8%
Missouri	45	9.7%	Missouri	45	9.7%
Colorado	46	9.3%	Colorado	46	9.3%
New Hampshire	47	9.2%	New Hampshire	47	9.2%
South Dakota	48	9.1%	South Dakota	48	9.1%
Tennessee	49	9.0%	Tennessee	49	9.0%
Alabama	50	8.9%	Alabama	50	8.9%

Distributional Impact

In general, the more personal exemptions a tax filer claims, the greater the tax reduction Measure 41 would provide. Measure 41 would reduce tax revenue for tax year 2007 by $393 million, which is roughly 7 percent of the current law liability. Roughly 78 percent of filers would receive at least some degree of reduction in tax. The overall average tax reduction is $226 per filer in 2007. The average reduction for those benefiting from the measure would be $291. Exhibit 7 shows the distributional impact of Measure 41 for all filers and then separately for single and joint filers.[2]

Filers with an income of at least $70,000 account for roughly 21 percent of all filers in 2007 and account for nearly 38 percent of the overall tax reduction. Their average percentage reduction in tax is 4 percent. By way of comparison, filers with an income of less than $20,000 account for 36 percent of filers and 8.5 percent of the tax reduction. These filers would experience an average reduction in tax of 24 percent.

The average reduction for all filers ranges from $12 for filers with less than $10,000 of income to $439 for filers with income between $100,000 and $200,000. The former group of filers claims an average of

[2] As used here, single includes married-filing-separate filers and joint includes head-of-household and qualified widow(er) filers.

just over 1 exemption per return while the latter group claims an average of nearly 3 exemptions per return. Filers with an income above $200,000 have an average tax reduction of only $206 because the federal exemption deduction is gradually reduced for filers above certain income levels. Taxpayers for whom the federal exemption deduction is reduced to zero would receive no benefit from the measure.

Exhibit 7
2007 Revenue Impact of Measure 41

Income	Number of Returns	Percent Affected	Total State Tax Reduction ($M)	Percent Change	Average State Tax Reduction (All Filers)	Average State Tax Reduction (Affected)
All Filers						
< $10K	342,244	22.4%	-4.2	-19.1%	-12	-55
$10K TO $20K	280,639	76.5%	-29.4	-25.1%	-105	-137
$20K TO $30K	222,680	90.3%	-44.0	-19.8%	-198	-219
$30K TO $40K	177,324	95.6%	-46.6	-16.4%	-263	-275
$40K TO $50K	141,353	96.5%	-44.3	-14.3%	-313	-325
$50K TO $70K	211,321	97.6%	-76.5	-11.6%	-362	-371
$70K TO $100K	184,299	98.8%	-77.5	-8.7%	-421	-426
$100K TO $200K	140,939	99.3%	-61.9	-5.1%	-439	-442
> $200K	42,408	57.0%	-8.7	-0.6%	-206	-362
TOTAL	1,743,207	77.5%	-393.2	-7.4%	-226	-291
Single Filers						
< $10K	277,841	26.5%	-4.1	-16.3%	-15	-55
$10K TO $20K	173,920	83.7%	-20.0	-18.3%	-115	-138
$20K TO $30K	119,732	94.7%	-17.3	-10.8%	-145	-153
$30K TO $40K	85,139	97.3%	-12.9	-7.8%	-152	-156
$40K TO $50K	57,898	97.5%	-9.1	-6.2%	-157	-161
$50K TO $70K	62,258	97.0%	-9.8	-4.6%	-158	-163
$70K TO $100K	28,163	98.4%	-4.7	-3.3%	-168	-171
$100K TO $200K	13,336	97.1%	-2.1	-1.8%	-158	-163
> $200K	4,734	32.6%	-0.1	0.0%	-20	-62
TOTAL	823,022	69.8%	-80.2	-6.2%	-97	-140
Joint Filers						
< $10K	64,404	4.4%	-0.1	4.9%	-2	-50
$10K TO $20K	106,719	64.6%	-9.3	-123.4%	-88	-136
$20K TO $30K	102,948	85.2%	-26.7	-43.1%	-259	-304
$30K TO $40K	92,185	94.1%	-33.6	-28.8%	-365	-388
$40K TO $50K	83,455	95.7%	-35.2	-21.6%	-422	-440
$50K TO $70K	149,063	97.8%	-66.7	-15.0%	-448	-458
$70K TO $100K	156,135	98.9%	-72.8	-9.8%	-466	-471
$100K TO $200K	127,603	99.6%	-59.8	-5.5%	-469	-471
> $200K	37,673	60.0%	-8.7	-0.6%	-230	-383
TOTAL	920,185	84.3%	-312.9	-7.8%	-340	-403

Because the impact of Measure 41 depends on the number of personal exemptions claimed, it is helpful to consider the impact on single and joint filers separately. Joint filers generally claim more personal exemptions than do single filers (an average of 3 vs. 0.9), so they receive a larger share of the tax reduction. Joint filers account for 80 percent ($313 million) of the total tax reduction. Also, relatively more joint filers are affected by the measure, 84 percent of joint filers compared to 70 percent of single filers. Although, if dependent filers are excluded, the share of single filers affected increases to roughly 80 percent. In 2007, the average reduction would be $97 for single filers and $340 for joint filers, also reflecting the larger number of exemptions typically claimed by joint filers. Of those filers who are affected, these averages increase to $291 (all filers), $140 (single), and $403 (joint).

The pattern for the percentage of filers affected by the measure is similar for both single and joint filers. For single filers with income between $20,000 and $200,000, the share of those affected ranges from 95 to 98 percent. For joint filers with income between $30,000 and $200,000, the percentage affected ranges from 94 to nearly 100 percent. In general, because the tax reduction is not directly related to the level of income, the percentage reduction in tax decreases as income increases. The exception is that those in the $10,000 to $20,000 income range would have a greater percentage reduction in tax than those with less than $10,000 of income. The primary reason for this is that relatively more filers in the lowest income group currently have no tax liability.

One interesting result is the 123 percent reduction in tax for joint filers in the second to lowest income range. Tax liability can be reduced by more than 100 percent because of Oregon's refundable credits, primarily the working family child care and earned income credits.[3] One of the examples in the next section illustrates how this happens.

While Measure 41 affects nearly 4 out of every 5 filers, the remaining filer falls into one of three groups of filers who are unaffected: (1) dependents, (2) filers with zero liability under current law, and (3) filers for whom the personal exemption credit is more valuable than the deduction. Dependents are filers who can be claimed as a personal exemption on another filer's tax return. Typically, these are children who file their own tax return but are claimed as a deduction on their parents' return. The second group consists of filers who have zero liability under current law and do not claim any refundable credits. Many in this group are low income filers but it includes others who have deductions or subtractions that are large enough to offset their income so they have no tax liability.

The third group is made of filers for whom the current credit is more valuable than the deduction. These taxpayers are high-income filers for whom the deduction has been reduced because of the federal phase out. In 2007, the projected phase out range for single filers is from $156,550 to $279,050 and for joint filers from $234,850 to $357,350. As income increases in these ranges, the exemption deduction is gradually reduced from $3,400 to zero. Once the deduction is reduced to approximately $1,833, Oregon's exemption credit becomes more valuable, so filers would likely choose to use the credit.

Taxpayer Examples

Specific taxpayer examples are helpful in providing a flavor for how the measure would affect taxpayers with different circumstances. Exhibit 8 contains a few such examples. Taxpayers A, B, and C represent relatively simple returns with straight-forward impacts. Taxpayer A is a single individual with $30,000 of income, who is not a dependent and claims one personal exemption. This taxpayer's liability is reduced $141, or 7 percent, from $2,017 to $1,876. Taxpayer B is claimed as a dependent on another taxpayer's return and does not claim any personal exemptions, so does not benefit from the measure. Taxpayer C files a joint return with 4 personal exemptions (2 dependents) and has an income of $65,000. This taxpayer would have a liability reduction of $564 (4 x $141), or just over 15 percent of their current law liability.

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[3] The Oregon earned income credit is refundable for tax years 2006 through 2010.

Taxpayers D, E, and F illustrate how the impact can vary depending on the specific circumstances of the individual taxpayer. Taxpayer D files a joint return and has sufficiently high income so that the exemption deduction amount is partially reduced. As noted above, the 2007 phase out range is projected to be from $234,850 to $357,350. With an income of $275,000 the exemption deduction is of relatively less value for this taxpayer. The phase out reduces it from $3,400 to $2,397 per person. Consequently, their liability is reduced $101, or 0.5 percent, from $22,015 to $21,914.

Exhibit 8

Examples of the Measure 41 Impact

Tax Year 2007

Taxpayer	Filing Status	Personal Exempts	Adjusted Gross Income	Deductions (Standard or Itemized)		Refundable Credits	Current Law Tax	Measure 41 Tax	Tax Change	Percent Change
A	Single	1	$30,000	(I)	$3,550	$0	$2,017	$1,876	-$141	-7.0%
B	Single	0	$9,000	(S)	$1,870	$0	$443	$443	$0	0.0%
C	Joint	4	$65,000	(I)	$12,100	$0	$3,703	$3,139	-$564	-15.2%
D	Joint	2	$275,000	(I)	$22,300	$0	$22,015	$21,914	-$101	-0.5%
E	H-of-Hhold	2	$22,000	(S)	$3,015	$0	$981	$740	-$241	-24.5%
F	H-of-Hhold	3	$27,500	(S)	$3,015	$1,000	$311	-$112	-$423	-136.2%

Taxpayer E files a Head-of-Household return and claims two personal exemptions. Under current law, this taxpayer's circumstances result in him/her being in Oregon's 9 percent tax bracket. Under Measure 41, however, the use of the exemption deduction places the taxpayer in Oregon's 7 percent tax bracket. As a result, the tax reduction of $241 (25 percent) is slightly less than $141 per exemption.

Taxpayer F files a Head-of-Household return and claims the Working Family Child Care Credit, one of Oregon's refundable credits. Under current law, this taxpayer's liability, before application of the refundable credit, would be $1,311. This amount is then reduced by the $1,000 to arrive at a liability of $311. Under Measure 41, the liability prior to the refundable credit would be $888. This amount is then reduced by the refundable credit to arrive at a liability of -$112 ($888 - $1,000 = -$112). The "negative liability" represents the amount to be refunded to the taxpayer. The reduction of $423 ($311 minus -$112 = $423) represents a roughly 136 percent reduction in liability.

The Effect on Filers with Income above $200,000

This measure would further connect Oregon to federal law by creating a personal exemption that is tied to the amount of the federal exemption deduction. If the federal deduction were to increase, the revenue loss would directly flow through to Oregon. Similarly, if the federal deduction were reduced, the Oregon's revenue would directly increase, up to the point where the personal exemption credit is more beneficial for the taxpayer. The interaction between Measure 41 and current federal law pertaining to the phase out of the federal exemption deduction illustrates this point.

Since 1991 the federal personal exemption deduction has been reduced, or phased out, for filers above a certain income level. As described earlier, the amount of the reduction depends on the filing status and the extent to which the filer's income exceeded a threshold level. One provision of the 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA) was to gradually eliminate the phase-out of the exemption deduction. In 2006, the phase-out was reduced by one-third. In 2008 it will be reduced by another one-third, and then fully eliminated for 2010. For tax years after 2010, however, the elimination of the phase-out is repealed. So, under current federal law, the phase-out returns to its pre-EGTRRA form for tax years 2011 and later.

The interaction between Measure 41 and the changes to the phase-out can be seen in Exhibit 9, which contains information on filers with incomes of more than $200,000 in each year from 2007 through 2013. In 2007, 57 percent of these filers benefit from Measure 41. The average reduction for this group of filers is $206; the average is $362 for those who received some benefit. As the phase-out amount is reduced in 2008, the share of high income filers affected by Measure 41 increases to 99.5 percent. The average liability reduction is roughly $300 in 2008 and $310 in 2009. When the phase-out is eliminated in 2010, the average liability reduction increases by over 50 percent from $310 to $480. Under current federal law, the phase out is reinstated in 2011 and the impact for 2011 and beyond more closely resembles the 2007 impact, where closer to only half of these taxpayers are affected.

Exhibit 9
The Effect on Filers with Income above $200,000

Tax Year	Number of Returns	Percent Affected	Total State Tax Reduction ($M)	Percent Change	Average State Tax Reduction (All Filers)	Average State Tax Reduction (Affected)
2007	42,408	57.0%	-8.7	-0.6%	-206	-362
2008	46,501	99.5%	-13.9	-0.8%	-300	-301
2009	50,871	99.5%	-15.8	-0.8%	-310	-311
2010	55,515	99.5%	-26.6	-1.2%	-479	-481
2011	60,436	50.9%	-13.7	-0.6%	-226	-444
2012	65,641	52.3%	-15.8	-0.6%	-240	-459
2013	71,166	53.8%	-18.6	-0.7%	-261	-485

Measure 41 Uncertainties

The text of Measure 41 contains several ambiguities that affect the revenue impact estimates. Three of these uncertainties are the impact on Oregon additional personal exemption credits for severe disability and handicapped children, the impact on non-resident filers, and the impact on filers subject to the federal alternative minimum tax (AMT). For the first issue, Oregon filers are allowed to claim an additional personal exemption credit for each handicapped child (defined by ORS 316.099) and if the primary filer or spouse have a severe disability (defined by ORS 316.758, 316.765). The language of Measure 41 provides taxpayers the option of using the total deduction allowed for all exemptions on the federal return. (One personal exemption each for the primary filer and spouse, and one for each dependent.) The estimates in this paper are based on the assumption that the additional Oregon exemption credits are unaffected by the measure. If these credits are disallowed for those choosing the deduction, then the revenue reduction would be less. If an exemption deduction is also allowed for these additional exemptions, then the revenue reduction would be greater.

The second uncertainty pertains to the treatment of non-resident filers. The language of Measure 41 says that the amount of the deduction "…shall not be less than the total amount of the deduction…on the taxpayer's federal tax return." For non-resident filers, most deductions, including the standard deduction, are apportioned by the share of Oregon income divided by federal income. It is unclear if the intent of the measure is to prohibit the apportioning of this deduction for non-residents. The revenue estimates in this report are based on the assumption that the non-resident treatment of the exemption deduction would be similar to most other deductions (i.e. it would be prorated). If the deduction is not prorated for these filers then the revenue reduction would be greater.

The third case of uncertainty involves those filers subject to the federal AMT. The federal tax system can be described as a dual system of determining federal tax liability consisting of the “regular” tax calculation (those not subject to the AMT, about 98% of filers) and those subject to the AMT (about 2% of filers). Among the differences between the two systems is the treatment of personal exemptions. Under the “regular” system, filers are allowed personal exemptions, which is the basis for Measure 41. Under the AMT system, filers are not allowed any personal exemptions. The estimates in this paper are based on the assumption that Oregon filers would be allowed to use the personal exemption deduction even if they are subject to the federal AMT. If, on the other hand, filers subject to the AMT are considered to have a personal exemption deduction of zero, then the revenue reduction would be less.