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REVIEW OF SPECIAL SESSION V REVENUE ACTIONS: BALLOT MEASURE 28

The 5th special legislative session referred Ballot Measure 28 to a special election on January 28, 2003. This measure increases the tax rate imposed on the top income bracket from 9 % to 9.5 %. The rate increase applies to the 2002, 2003 and 2004 tax years. The top rate then returns to 9 % for the 2005 tax year and beyond. The measure also raises the state corporate income tax rate from 6.6 % to 6.93 % for the same three-year period.

The temporary tax rate increase is a key component of the Special Session V rebalance plan. It is expected to generate $313 million for the 2001-03 biennium and $412 million for the 2003-05 biennium. If voters reject Ballot Measure 28, House Bill 5100 specifies $310 million in cuts to balance the General Fund budget.

Special Session V Rebalance Plan

Following release of the September revenue forecast, the Legislature faced a projected 2001-03 General Fund deficit of $482.4 million. The General Fund gap, which measures the change in circumstances since the previous rebalance plan was approved (Special Session III), was $546.6 million. This includes an additional $14.2 million projected ending balance—the revenue forecast was reduced $496.6 million in September, and a $50 million reduction in the State School Fund caused by the Governor's veto (sustained by the Legislature) of HB 4056.

The Legislature took the following actions to rebalance the General Fund budget in Special Session V:

- Temporary personal and corporate tax rate increase (Ballot Measure 28): $313 million.

- Securitization of a portion of future tobacco Master Settlement Agreement revenue: $150 million.

- Allow the State School Fund reduction caused by Governor's veto to stand: $50 million.

- Additional General Fund budget cuts: $43.7 million.

These actions leave a projected General Fund ending balance of $24.7 million. The Legislature also approved HB 4077 during the special session. This measure phases out Oregon's estate tax over a 3-year period. HB 4077 reduces 2001-03 General Fund revenue by an estimated $5.6 million. The Governor has designated HB 4077 for a potential veto. If this bill becomes law, the projected ending balance would be $19.1 million.

For a description of the Master Settlement revenue stream and the securitization process specified in HB 4073 see Legislative Revenue Office, Research Brief 9-02

Impact of Temporary Rate Increase on Oregon Taxpayers

Since 1987 Oregon's personal income tax has been made up of three brackets. Taxable income in these three brackets is subject to marginal tax rates of 5 %, 7 % and 9 %. Measure 28 increases the top rate to 9.5 % and leaves the 5 % and 7 % brackets unchanged.

The income brackets that the marginal rates apply to change each year because they are indexed to changes in the price level. The index used to adjust the brackets is the U.S. City Average Consumer Price Index. Adjustments are done annually.

Measure 28 also makes a minor adjustment to the rounding process used for the brackets. Instead of rounding to the nearest $50 as current law calls for, Measure 28 would round to the nearest $25 of taxable income for tax bracket purposes.

If voters approve Measure 28, tax brackets for the 2002 tax year would be:
- 5 % for taxable income less than $2,500 ($5,000 for joint filers).
- 7 % for taxable income between $2,500 and $6,275 ($12,550 for joint filers).
- 9.5 % for taxable income above $6,275 ($12,550 for joint filers).

For the 2003 tax year, the temporary 9.5 % rate applies to taxable income above $6,375 ($12,750 for joint filers).

For the 2004 tax year, the temporary 9.5 % rate applies to taxable income above $6,550 ($13,100 for joint filers).

The bracket thresholds are estimates based on the projected inflation rate.

For the 2005 tax year and beyond the top marginal tax rate returns to 9.0 %.

Table 1 shows how the temporary tax increase is expected to be spread among Oregon personal income taxpayers. The table arrays taxpayers according to gross income. Gross income is very close to the adjusted gross income reported on income tax returns. The number of taxpayers in each income group is a projection of 2002 Oregon personal income and how it will be distributed.

TABLE 1
CHANGE IN OREGON TAXES

BASED ON 2002 TAX YEAR

GROSS INCOME	NUMBER OF RETURNS	AVERAGE OREGON TAX IF MEASURE 28 FAILS	AVERAGE OREGON TAX IF MEASURE 28 PASSES	AVERAGE CHANGE IN OREGON TAX	% CHANGE IN OREGON TAX	NET AVERAGE CHANGE AFTER FEDERAL TAX DEDUCTION
< $10,000	298,081	$ 85.40	$ 85.88	$ 0.48	0.6	$ 0.48
$10-20 K	284,613	486.06	502.73	16.67	3.4	16.61
$20-30 K	226,547	1,119.85	1169.62	49.77	4.4	48.77
$30-40 K	173,517	1,775.78	1860.62	84.84	4.8	80.25
$40-50 K	142,215	2,378.40	2,496.69	118.29	5.0	107.07
$50-60 K	201,166	3,342.97	3,512.73	169.76	5.1	147.71
$75-100 K	157,679	5,058.89	5,324.66	265.48	5.2	211.67
$100-200 K	78,126	8,375.67	9,209.43	473.76	5.4	385.08
>$200,000	25,701	35,580.56	37,576.59	1,996.03	5.6	1,686.04
ALL RETURNS	1,587,645	2,601.95	2,735.50	133.55	5.1	114.37

Measure 28 would increase average Oregon tax liability by 5.1 % for the estimated 1.6 million taxpayers expected to file returns for the 2002 tax year. However, the impact varies widely by the income and circumstance of taxpayers. About 390,000 taxpayers will see no impact because they have low gross income. Many of these taxpayers have gross income below $10,000. These filers pay an average Oregon income tax of $85.40 under current law. The temporary rate increase for the top bracket would not apply to most of the income for these filers. Many of these low-income taxpayers are part-time workers who are also students. Many of them are claimed as dependents on higher income tax returns.

The income group most representative of median household income in Oregon based on census data is the $40,000 to $50,000 income group. This group is expected to see their Oregon tax bill rise from $2,378.40 to $2,496.69, an increase of $118.29. These figures apply to the 2002 tax year. They are averages for filers in the $40,000 to $50,000 income group. Single filers in this income group are expected to see an average Oregon tax increase of $136.89 while joint filers experience an average increase of $109.16.

The 2002 Oregon income tax bill for high-income taxpayers in the $100,000 to $200,000 income group is expected to rise by $473.76 on average. These taxpayers have a high proportion of their taxable income in the proposed 9.5 % bracket.

A progressive tax is one in which the effective tax rate (% of income paid in taxes) rises as income rises. Oregon's personal income tax is modestly progressive for two reasons:

1. Some income is not taxable. This is due to deductions (or the standard deduction) and personal exemption credits (available to all taxpayers that are not dependents).

2. Marginal tax rates are graduated, rising as taxable income rises.

If approved by voters, Ballot Measure 28 will temporarily add slightly to the progressivity of the tax. This can be seen in Table 1. The average Oregon tax increase for all taxpayers is 5.1 %. The average increase for higher income taxpayers is more than 5.1%. The average increase for taxpayers with lower incomes is less than the 5.1 % average. This means that Ballot Measure 28 would temporarily increase the progressivity of Oregon's personal income tax.

An important consideration in any state income tax change is interaction with the federal income tax. The last column of Table 1 shows the net effect on taxpayers after the increased federal deduction of higher state income taxes. For individual taxpayers the amount of federal offset is determined by the federal tax bracket the filer is in. Federal tax rates range from 10 % to 38.6 % for the 2002 tax year. The federal tax code also phases out the value of most deductions (including state and local taxes) at certain income levels. For high-income taxpayers, this will reduce the allowable federal deduction and increase the net state-federal tax increase.

Adjusting for federal deductibility of state taxes means the average state-local personal income tax burden for the 2002 tax year will rise an estimated $114.37 if Ballot Measure 28 becomes law. This compares with an average increase of $133.55 for state taxes alone. The $19.18 difference is the estimated reduction in federal taxes due to higher state tax deductions.

Tax implications vary considerably even within income groups. Joint versus single filing status, number of dependents and amount of deductions have a major impact on tax liability. Although Measure 28 will not change any of these factors, the net tax impact of the measure is influenced by taxpayer circumstances.

The following examples are included to show how the tax implications vary with taxpayer circumstances.

Taxpayer Examples

Taxpayer A:
Files jointly
$30,000 in adjusted gross income
2 dependents
Uses standard deduction

Oregon tax under current law: $1,475
Oregon tax if Measure 28 is approved: $1,545
Change in Oregon tax: $70
Change in tax after federal deduction: $70

Taxpayer B:
Files jointly
$75,000 in adjusted gross income
2 dependents
Itemizes (Assumed to have $16,500 in Oregon deductions)

Oregon tax under current law: $4,335

Oregon tax if Measure 28 is approved: $4,564
Change in Oregon tax: $229
Change in tax after federal deduction: $167

Taxpayer C:
Files jointly
$150,000 in adjusted gross income
2 dependents
Itemizes (Assumed to have $24,000 in Oregon deductions)

Oregon tax under current law: $10,410
Oregon tax if Measure 28 is approved: $10,976
Change in Oregon tax: $566
Change in tax after federal deduction: $396

Taxpayer D:
Single
$20,000 in adjusted gross income
0 dependents
Uses Standard Deduction

Oregon tax under current law: $1,332
Oregon tax if Measure 28 is approved: $1,392
Change in Oregon tax: $60
Change in tax after federal deduction: $60

Taxpayer E:
Single/Head of Household
$25,000 in adjusted gross income
1 dependent
Uses Standard Deduction

Oregon tax under current law: $1,372
Oregon tax if Measure 28 is approved: $1,420
Change in Oregon tax: $48
Change in tax after federal deduction: $48

Taxpayer F:
Single
$60,000 in adjusted gross income
0 dependents
Itemizes (Assumed to have $15,000 in Oregon deductions)

Oregon tax under current law: $3,730
Oregon tax if Measure 28 is approved: $3,923
Change in Oregon tax: $193

Change in tax after federal deduction: $141

These examples are intended to be illustrative. They are relatively simple returns without the complexities characteristic of many returns. However, these examples do give a flavor for the impact of Measure 28 on taxpayers in different circumstances.

The Corporate Tax Rate Increase

For corporate taxpayers, the temporary 6.93 % rate applies to corporate tax years beginning on or after January 1, 2002 and continues for the following two corporate tax years. Corporate tax years can start on any month of the calendar year. The corporate increase is expected to raise $ 12 million of the expected $313 million in new tax revenue for the 2001-03 biennium. The projected 2003-05 revenue from the corporate portion of the temporary rate increase is $32 million out of the $412 million revenue impact.

Defeat of Measure 28: Budgetary Implications

If voters defeat Measure 28 on January 28, expenditure reductions spelled out in HB 5100 take effect. HB 5100 identifies $310 million in across-the-board General Fund cuts. These pro-rated reductions are repealed if voters approve Measure 28. The Legislature directed state agencies to prepare these cuts up until the election outcome is known. The cuts would then go into effect if Measure 28 were defeated. The reductions scheduled to be repealed if Ballot Measure 28 is approved are:

- $95 million to the State School Fund for K-12 and ESD distribution.
- $14 million to community colleges.
- $27 million to higher education.
- $90 million to the human services program area.
- $45 million to the public safety program area.
- $6 million to the natural resource program area.
- $33 million to all other areas.

For a detailed discussion of these budget reductions see Budget Highlights: Revised 2001-03 Legislatively Approved Budget Based on September 1-18,2002 Special Session Actions. This report is available from the Legislative Fiscal Office.