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Research Report

Number 1-02

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INTERIM SENATE REVENUE OPTIONS COMMITTEE

COMMITTEE REPORT

INTRODUCTION

In response to less than anticipated tax revenue caused by Oregon's recession, Senate President Derfler appointed three committees to develop a set of options for the Legislature. The Senate President directed the Revenue Options Committee to "hear public and private testimony on revenue options the Governor and Legislature may consider when balancing the state budget." This report contains a summary of the committee's proceedings including revenue options presented to the committee, discussion with state agencies on possible options and revenue issues raised by committee members.

The committee work plan consisted of two primary objectives:

1. Solicit input from agencies and the public on policies and options that affect state revenue.
2. Report committee findings to the Legislature.

In this report, the committee seeks to build a broad list of potential revenue options. The intent is to give the Legislature and the Governor a comprehensive starting point for consideration of revenue options. In serving this role, the committee seeks to "put everything on the table." This report does not contain recommendations nor does it rank the revenue options presented to the committee.

Committee Members:

Senator Ferrioli, Co-Chair

Senator Dukes, Co-Chair

Senator Burdick

Senator Corcoran

Senator Duncan

Senator Hartung

Senator Morrisette

Senator Starr

SUMMARY

The following is a summary of the proposals presented during the committee's proceedings.

SUMMARY OF REVENUE FROM EFFICIENCIES AND TIMING OPTIONS

- Shift Department of Revenue personnel to income tax collections / Administrative. This would raise $6 million in one-time 2001-03 revenue.
- Establish temporary differential between interest received on delinquent taxes and interest rate paid on late refunds / Statutory.
- Disconnect from federal tax base / Statutory.
- Delay implementation of changes scheduled to take effect / Statutory.
- Increase period in which Department of Revenue can pay refunds without incurring interest costs / Statutory.
- Match federal withholding requirements for IRA distributions and gambling winnings / Statutory.
- Establish retailer fee for selling cigarettes. Proceeds go to pay for stepped up cigarette tax enforcement/Statutory. $25 fee generates $250,000 per year in gross revenue.
- Reduce Oregon Liquor Control Commission inventory / Administrative.
- Allow Sunday sales of distilled spirits / Statutory. Revenue impact estimated at $2.8 million to $5 million per year.
- Allocate additional Lottery revenue / Statutory. The December Lottery revenue forecast for non-dedicated transfers is $10.3 million higher than the 2001 close of session estimate.
- Allocate a portion of the Lottery Contingency Fund / Statutory. Lottery estimates $20 million available.
- Establish a tax amnesty program / Statutory. Revenue depends on elements of program.
- Examine process for collecting delinquent accounts. Evaluate role of agencies, courts and private collectors.

SUMMARY OF REVENUE RAISING PROPOSALS

The 2001-03 revenue impact estimates are from the Legislative Revenue Office. These estimates will vary with the implementation dates and the final form of the proposal.

- Expand video poker to include line games (starting 7-1-02) $25 million / Administrative.
- Increase cigarette excise tax (starting 4-1-02) / Statutory—3/5 vote:
  - $ 23.2 million @ 10¢ per pack
  - $ 45.4 million @ 20¢ per pack
  - $ 66.5 million @ 30¢ per pack
  - $ 86.3 million @ 40¢ per pack
  - $104.8 million @ 50¢ per pack.

- Increase excise tax on beer to national median for excise and general sales (starting 4-1-02) / Statutory—3/5 vote. $35.6 million @ new rate of $14.88 per 31 gallon barrel.
- Increase wine excise tax to national median for excise and general sales (starting 4-1-02) / Statutory—3/5 vote. $9.4 million @ new rate of $2.13 per gallon.
- Delay implementation of Measure 88 from 2002 tax year to 2004 tax year. / Statutory—3/5 vote. $133 million.
- Increase and restructure the National Pollution Discharge Elimination System fee. / Statutory—majority vote. Potentially frees $2 million in General Fund revenue.
- Establish $1 fee for auto insurance policies and $5 fee for real and personal property insurance policies (7-1-02) / Statutory—majority vote. $10 million.
- Increase OLCC mark-up by 10% (starting 7-1-02) / Administrative. $7.6 million.
- Impose 2% personal and corporate income tax surcharge for the 2002 and 2003 tax years / Statutory—3/5 vote. $125 million.
- Increase gas tax by 1¢ per gallon with corresponding increase in weight mile tax (starting 7-1-02) / Statutory—3/5 vote. $22 million.
- Establish 2-cent per hour payroll tax dedicated to the Oregon Health Plan (starting 7-1-02)/ Statutory--3/5 vote. $ 60 million.

BACKGROUND

The committee received information on Oregon's revenue system and revenue conditions. The following report on the current state of the economy and the budget situation came from the Legislative Revenue Office.

The Economic Situation

National

- The U.S. economy entered recession in March. The longest expansion in U.S. history ended at that time. The last recession occurred in 1990-91.
- The unemployment rate rose to 5.7% in November, up sharply from a low of 3.9% in October of 2000. Employment declined by 799,000 over the past two months. This is the largest two-month drop since the early 1980's.
- The broad stock market indices have bounced back from their post September 11 lows but remain negative for the year.
- Low mortgage rates and tax refunds have cushioned the recession's impact on consumers. However, a federal stimulus package remains under debate in Congress.

Oregon

- Oregon has been very hard hit by the national recession. Oregon jobs declined 1.8% between October 2000 and October 2001. This is the largest percentage employment decline in the nation over that period. Oregon's unemployment rate was 6.5% in October, second only to Washington (6.6%).
- Job losses from the recession were initially concentrated among the state's manufacturing industries. In recent months, job losses have spread to construction, trade and services.

The December Forecast

- The U.S. economy is expected to begin recovering in the spring of next year. Growth is expected to be fairly strong in the second half of 2002.
- Faster growth is assumed to be driven by tax cuts, lower interest rates, lower energy prices and the beginning of a world economic rebound.
- Oregon employment is expected to turn positive in the second quarter of 2002, following four consecutive quarters of decline.
- Oregon's job growth is forecast to move above the U.S. average in 2003 after five straight years of being below.

The Budget Situation

- The 2001-03 General Fund resource forecast is reduced $720.1 million or 6.3% compared to the forecast used for the 2001 Legislatively Adopted Budget. The reduction is primarily due to lower personal income tax collections ($475.7 million) caused by slower economic growth. The corporate income tax forecast has been reduced even more on a percentage basis. The corporate income tax forecast is $191.8 million or 22.3% lower than the close of session forecast.
- The projected ending balance used for the Legislatively Adopted Budget was $96 million. The December forecast puts the ending balance at -$623.7 million. If across the board cuts of $623.7 million were applied to the 2001-03 General Fund budget, the percentage reduction would be 5.5%.
- The Lottery revenue forecast has not been affected by the state's deepening recession. The December forecast for total transfers to the Economic Development Fund is $15.3 million higher than the close of session forecast.

Risks

The downside risks to the forecast are the greatest since the recessions of the early 1980's.

- The Economy. The impact of excess capacity and deflationary pressures may be underestimated. The current business cycle is clearly different than the post World War II norm. It is more like pre-War cycles in which business investment spending drives the cycle. It was a surge in business capital spending (especially information technology) that drove the unprecedented expansion of the 1990's. Now investment spending is down and suppliers (e.g., semiconductors) have more production capacity than they need. Unlike the consumer led recessions that have marked the post World War II period, business investment led recessions are less sensitive to lower interest rates. This means that the recession may be longer and deeper than currently anticipated.

- The Financial Markets. The stock market surge of the 1990's was both a reflection of and a stimulus to the decade's strong economic performance. It also had a huge impact on personal income tax collections. Capital gains income reported on Oregon tax returns jumped from $2.25 billion in 1995 to $5.5 billion in 1999. Tax collections on capital gains accounted for roughly 10% of personal income tax collections in the 1999-2001 biennium. A sharper than anticipated drop in capital gains income, even if the economy begins recovering, poses a significant risk to Oregon personal income tax collections. The impact of capital gains on income tax revenue will not become clear until the 2001 tax returns are tabulated in the late spring of next year.

The Committee received the following background information on Oregon's revenue system. Table 1 displays current and projected (December 2001 forecast) General Fund revenue by source.

Table 1. GENERAL FUND REVENUE ESTIMATES: 1997-99 THROUGH 2005-07 BIENNIA

(in millions of dollars)

DECEMBER 2001

	1997-99 Biennium	1999-01 Biennium	2001-02 Fiscal Yr	2002-03 Fiscal Yr	2001-03 Biennium	2003-04 Fiscal Yr	2004-05 Fiscal Yr	2003-05 Biennium	2005-06 Fiscal Yr	2006-07 Fiscal Yr	2005-07 Biennium
Taxes											
Personal Income	7,123.1	8,737.0	4,167.8	4,801.8	8,969.6	5,096.6	5,409.6	10,506.2	5,782.0	6,217.9	11,999.9
Corporate Excise & Income	589.1	754.9	295.3	372.4	667.7	395.8	401.4	797.2	442.3	485.3	927.6
Insurance	102.0	102.8	52.7	43.7	96.4	48.3	46.6	94.9	49.2	52.3	101.5
Gift and Inheritance	89.0	91.4	42.0	42.0	84.0	42.0	42.0	84.0	42.0	42.0	84.0
Cigarette	119.7	104.3	49.2	49.6	98.9	50.6	51.7	102.3	52.4	53.1	105.5
Other Tobacco Products	21.2	22.1	11.3	11.3	22.6	11.4	11.6	23.1	11.8	12.0	23.8
Other Taxes	4.9	4.4	2.2	2.1	4.3	2.2	2.2	4.4	2.2	2.2	4.4
Subtotal	8,048.9	9,817.0	4,620.5	5,322.9	9,943.4	5,646.9	5,965.1	11,612.0	6,381.8	6,864.8	13,246.6
Other Revenues											
Licenses and Fees	78.2	91.7	61.1	64.7	125.8	65.6	66.5	132.2	67.5	68.5	136.0
Charges for Services	6.0	6.5	3.0	3.1	6.1	3.2	3.2	6.4	3.3	3.3	6.6
Liquor Apportionment	91.0	103.9	54.7	56.4	111.0	55.5	55.5	111.0	55.5	55.5	111.0
Interest Earnings	88.6	71.2	31.0	34.0	65.0	35.0	35.0	70.0	35.0	35.0	70.0
Others	11.9	31.7	131.3	6.1	137.3	6.3	6.9	13.3	7.4	7.9	15.3
Subtotal	275.7	304.9	281.1	164.3	445.3	165.7	167.2	332.8	168.7	170.2	338.9
Total General Fund	8,324.6	10,121.9	4,901.5	5,487.2	10,388.7	5,812.6	6,132.2	11,944.8	6,550.5	7,035.0	13,585.5

Note: Detailed entries may not add to totals due to rounding.

Table 2 is a complete listing of all Oregon state and local taxes for the 1999-2000 fiscal year. The table designates which revenue sources are part of the General Fund.

Table 2. SUMMARY OF OREGON TAXES

STATE TAXES	General Fund	FY 1999-2000 COLLECTIONS
Personal Income Tax	All	$ 4,197,282,000
Unemployment Insurance Taxes		515,573,900
Corporate Income Tax	All	381,946,539
Gasoline And Use Fuel Taxes		394,167,788
Weight Mile Tax		224,954,955
Cigarette Tax	Part	163,960,272
Other Labor Taxes		104,213,309
Insurance Taxes	Part	54,800,021
Gift and Inheritance Tax	All	47,684,649
Workers' Comp Insurance Taxes		42,293,900
Timber Severance Taxes		32,843,222
Telephone Exchange Access Tax		26,320,757
Real Estate Recording Tax		20,636,689
Other Tobacco Products Tax	Part	20,374,525
Beer & Wine Taxes	Part	12,377,350
Forest Products Harvest Taxes		11,110,002
Electric Coop Tax		6,715,185
Phone Access Surcharge		3,143,941
Hazardous Substance Taxes		2,406,331
Aviation Gas And Jet Fuel Taxes		1,978,104
Amusement Device Tax	Part	1,817,543
Petroleum Loading Fee		1,272,955
Dry Cleaners Tax		695,302
Oil & Gas Severance Tax		128,445
Private Rail Car Tax		100,589
Boxing Tax		69,034
LOCAL TAXES		**FY 1999-2000 COLLECTIONS**
Property Taxes *		2,800,781,460
Transit Payroll & Self Employment Taxes		163,488,288
Franchise Taxes		106,657,000
Hotel-Motel Tax		56,300,000
Portland Business License Tax		50,794,774
Multnomah County Business Income Tax		40,846,593
Motor Fuel Taxes		9,837,758
Washington County Real Estate Transfer Tax		2,840,473
Other Taxes And Licenses		236,000,000

* Property taxes imposed – not collected.

The committee was also provided information on the status of some major non-tax revenue sources available to the state. That information is shown in Table 3.

Table 3. MAJOR NON TAX REVENUE SOURCES

- **Medicaid Upper Payment Limit Funds (MUPL)**

DHS transfers the federal portion of payments to DHS from health districts in this state to the MUPL Account (pursuant to intergovernmental agreements).

Legislative Adopted Budget

Estimated 2001-03 MUPL deposits	$333,563,659
2001 Legislative action	
OHSU	$101,313,769
SSF	99,200,000
Rural Health	14,901,588
Unallocated Balance (Health Related Programs)	$118,148,302

- **Tobacco Settlement Payments**

Under agreements with United States tobacco products manufacturers Oregon is to receive payments, which are deposited to the Tobacco Settlement Funds Account in the General Fund.

Legislative Adopted Budget

Estimated funds available for 2001-03	$ 348,200,000
2001 Legislative Action	
Tobacco Prevention	$ 5,000,000
Oregon Resources and Technology	5,000,000
Family Health Insurance Assistance	20,000,000
General Fund	99,200,000
Oregon Health Plan	124,000,000
Health Care Trust Fund ($100,000 limitation)	95,000,000

(Current estimate: Health Care Trust Fund $ 82,000,000)

- **Oregon Liquor Control Commission (OLCC) Transfers**

OLCC generates revenue through license fees, privilege taxes, and the sale of distilled spirits. The portion transferred to the General Fund is included as "Liquor Apportionment".

1999-00 Transfers	
General Fund	$ 51,364,178
Other Fund	
Mental Health	6,031,686
Wine Board	178,427
Local	
Cities	31,185,394
Counties	9,172,175
Total	$ 97,931,859

- **Oregon Lottery**

Estimated 2001-03 Lottery Transfers (December 2001 Forecast)

Debt Service	$ 89,402,000
Education Endowment Fund	101,508,000
Parks & Recreation	101,508,000
Counties	23,645,000
Sports Action	4,803,000
Gambling Addiction	6,767,000
Other Allocations	357,676,000
Ending Balance	10,700,000
Total Available	$695,999,000

The committee discussed Oregon's revenue system relative to other states. The most comprehensive data on state and local government revenue systems comes from the U.S. Census Bureau. Table 4 shows the four major categories of "General Revenue".

The Census Bureau defines general revenue as all state and local government revenue except revenue from trust funds and government enterprises. General revenue is a comprehensive measure of revenue available for general public purposes.

Table 4. OREGON'S GENERAL REVENUE MIX

	% OF TOTAL 1989-90	% OF TOTAL 1998-99
Taxes	54	46 (57)
Federal Revenue	20	23 (19)
Charges	13	17 (15)
Miscellaneous	13	14 (10)

(1998-99 US Average in Parenthesis)

Compared to other states, Oregon is less dependent on taxes as a general revenue source. It is more dependent than the average state on each of the other three major general revenue categories. Federal revenue makes up 23% of Oregon revenue compared to 19% nationally. Charges for services such as tuition comprise 17% of Oregon's general revenue compared to 15% for state and local governments as a whole. Oregon also shows greater reliance on miscellaneous revenue. This is explained by the state's relatively extensive use of Lottery, including video poker.

A summary of Oregon's 1998-99 fiscal year rankings in the major revenue categories can be seen in Table 5.

Table 5. OREGON'S STATE & LOCAL REVENUE SYSTEM

	OREGON %OF INCOME	US % OF INCOME	OREGON RANK
General Revenue	21.7	19.4	14
Total Taxes	10.0	11.1	45
Personal Income Tax	4.4	2.6	2
Corp. Income Tax	0.4	0.5	27
Sales Tax	1.0	3.9	50
Property Tax	3.0	3.3	28

Based on general revenue from all sources, Oregon ranks 14th among the states on a percentage of total personal income basis. However, Oregon's tax burden ranks 45th among the states. Oregon's unique tax system can be seen in the relative rankings of the major taxes. Oregon's personal income taxes are second highest in the nation while the sales tax burden (including general and selective sales taxes) is the lowest. The passage of Measures 5 and 50 in the 1990's moved Oregon from a relatively high property tax state to essentially an average property tax state.

Finally, the committee requested information on Oregon's tax expenditures. The committee focused on personal & corporate income tax exclusions, deductions, exemptions and credits. The committee divided tax expenditures into those associated with Oregon's connection to the federal tax base and those that result from policy decisions made independently at the state level.

A summary of Oregon's tax expenditures prepared by the Department of Revenue can be found in Appendix A.

EFFICIENCIES AND COLLECTIONS ISSUES

Review of Testimony

The exhibits that accompanied the testimony are contained in Appendix B.

Department of Revenue (DOR)

DOR responded to a committee request for information on Oregon's tax collection process and timing issues. DOR is responsible for administering the state's personal and corporate income tax, a number of excise taxes including the cigarette tax and overseeing the local property tax system. The committee is particularly interested in the outcome of recently approved enforcement efforts concerning the cigarette tax.

DOR provided a list of tax collection related actions taken by the Legislature during the fiscal crisis of the early 1980s:

- Accelerating employers' state tax withholding to match federal requirements.
- Requiring estimated payments for individual and corporate income taxpayers.
- Requiring prepayment of tax, penalty and interest before filing an appeal with the state tax court.
- Enacting a temporary differential between interest paid on refunds and interest received for tax deficiencies.
- Disconnecting from the federal accelerated depreciation methods for corporate taxpayers.

With the exception of the interest rate differential and disconnection from the federal tax base, these changes have remained a part of the Oregon tax code.

DOR also identified an administrative option to speed up income tax collections. This would require movement of personnel from billings activities to tax collection duties. DOR emphasized that this would be a temporary speedup only. It is estimated that this shift in activities would pull about $6 million from the 2003-05 biennium into the 2001-03 biennium.

Finally DOR identified some potential statutory changes that would raise revenue in the current biennium:

- Delay implementation of revenue reducing changes scheduled to take effect in the near future. A complete listing of revenue measures passed by the 2001 Legislature can be found in the Legislative Revenue Office publication: Revenue Measures Passed by the 2001 Legislature.
- Increase period in which DOR can pay refunds without incurring interest costs. Under current law, DOR has up to 45 days to send refunds without interest.
- Match federal withholding requirements for Individual Retirement Account (IRA) distributions and gambling winnings.

DOR also discussed at length its new cigarette tax enforcement program. Working in conjunction with the Oregon State Police, the new program is expected to increase revenue by $9 million per year. However, the program is just beginning and new revenue potential is highly uncertain. The committee chose to wait for evidence of results before concluding any new revenue will be available for the budget.

DOR was asked by the Committee to estimate the potential revenue from a flat license fee charged to sellers of cigarettes. The department estimates that a $25 fee would generate about $500,000 per biennium. This additional revenue could then be used to finance cigarette tax enforcement efforts.

Oregon Liquor Control Commission (OLCC)

OLCC emphasized its role to regulate effectively the sale, distribution and responsible use of alcoholic beverages. The OLCC generates revenue through the sale of distilled spirits, the collection of beer and wine excise taxes and fees from licensing. OLCC contracts with 237 liquor agents to manage stores throughout the state.

OLCC officials characterized the agency as comparatively lean and profitable. They felt there were no opportunities to streamline or speed up collections during the current biennium. They pointed to inventories as the commission's single largest investment, with stock value averaging $10 million at any point in time. OLCC stated that ways to reduce inventory costs would be evaluated by a special task force established by the 2001 Legislature but not yet appointed by the Governor.

Committee members emphasized the importance of the task force. They called on the Governor to make appointments as soon as possible. Committee members recognized that revenue gains resulting from the work of the task force were long run in nature and unlikely to provide relief for the current budget situation.

A proposal to increase OLCC sales was offered by the Distilled Spirits Council of the United States (DISCUS). DISCUS proposed a statutory change allowing state owned liquor stores to be open on Sundays. Current law (ORS 471.750) prohibits the sale of distilled spirits on Sundays. The law was recently changed to allow sales on holidays but this has not yet been implemented by OLCC.

The proposal *allows* liquor agents to open on Sundays, it would not compel them to. However, DISCUS argued that Sunday is the second highest volume shopping day for other products indicating there would be a strong incentive for retailers to open if permitted. DISCUS estimated that net new revenues would rise by $3.5 to $5 million per year. Under the current distribution system, 56% of this revenue would flow to the General Fund.

Legislative Revenue Office independently examined the revenue impact of allowing Sunday sales of distilled spirits. The LRO analysis showed an annual net revenue increase of $2.8 million.

A great deal of uncertainty surrounds these estimates. While about one-half of the control states allow Sunday sales, none has shifted from either permitting Sunday sales or not permitting Sunday sales in recent decades. The only recent evidence comes from Ontario, Canada. The Committee directed Legislative Revenue Office staff to work with OLCC in considering these and other data in order to refine the estimates.

The Oregon Lottery

The Committee requested input from the Oregon Lottery. Lottery officials presented information on the possibility of introducing line games to the current mix of video poker games. This option is discussed in the next section (Revenue Raising Options). Under efficiencies and timing issues, the Committee discussed the Lottery's contingency reserve fund. The fund totals $95 million. Lottery officials proposed transferring $20 million from the fund to the Economic Development Fund. The Legislature could then allocate these monies in an expanded Lottery budget which could also include $10.3 million in unanticipated discretionary revenue growth reflected in the December Economic and Revenue Forecast. This would mean a total increase of $30.3 million above the Lottery budget adopted at the close of the regular 2001 session.

Finally Lottery officials pointed out that changes in the current retailer compensation rules (about 34% of net revenue) would generate very little revenue in the 2001-03 biennium because current retailers are operating under a contract which expires in January of 2004. However, this process would be accelerated in the case of a substantial change in games such as the introduction of line games.

The Controller's Division

The Controller's Division of the Department of Administrative Services presented information on the state's accounting system. The Controller pointed out that the principles used to produce the statewide financial report differ from those adopted for budgetary purposes. The state revenue reporting requirements are based on standards established by the Governmental Accounting Standards Board (GASB). These standards contain certain "revenue recognition principles". These principles are:

- Revenue accrued as of June 30.
- Criteria are measurable and available. Available generally means within 60 days after June 30.
- Fiscal year recognition.

General Fund revenue for budgetary purposes is not based on these principles. General Fund revenue is counted on a strictly cash basis, rather than accrual basis. There is one notable exception to this approach. Starting in 1982, Oregon began counting the first 10 July working days of personal income tax withholding receipts as revenue accruing in the prior fiscal year. The first 10 days was an approximation of taxes accrued in June but paid in July. In the 1990s, this exception was refined to be all withholding receipts received in July that can be traced back to June tax liability. This exception is consistent with GASB standards.

Local Governments

The Committee requested information from local government officials. This included general input from the cities and counties as well as specific property tax information from the assessors and tax collectors. The counties emphasized the blended nature of many public services, especially human resource services. They requested flexibility in dealing with budget reductions in these areas.

A survey of property tax collectors indicated that collections were coming in consistent with the prior year despite the state's faltering economy. However, the Committee expressed a great deal of concern about the prospect of unexpected reductions in collections from industrial and commercial property. This could occur suddenly when businesses close and no longer are able to pay property taxes. The assessors described the system used to protect counties from sudden unexpected drops in revenue due to closures or appeals.

The survey of tax collectors revealed that net assessed value grew 5.9% between January 1, 2000 and January 1,2001. Total property taxes certified increased 7.8% in the 2001-02 fiscal year. Eighty one percent (81%) of these certified taxes were collected in November of 2001. Tax collections were reduced 2% or $64.7 million by taxpayers using the 3% discount early payment option. This is an increase of 8.9% from the prior year. Interest collected from prior years taxes total $6.9 million for a 14.6% increase from the prior year.

Other Input

The committee also received two additional suggestions from the Senate President. The first is examination of a tax amnesty program. The second is modification in the state's collection practices to utilize more private sector collectors. These two suggestions could be more effective if used jointly

A tax amnesty program, also suggested by House members, was examined in Oregon during the 1980's. Though no formal program was adopted, policy concerning delinquent payments and penalties was changed as a result of legislative action. Three states (Ohio, Maryland and New Hampshire) are currently conducting a tax amnesty. The revenue raised from an amnesty depends on current enforcement efforts and taxpayer expectations.

Analysis of the state's current process for collecting delinquent accounts could lead to improved efficiencies and enhanced revenue. Such an analysis involves examination of the role played by state agencies and the courts as well as private sector collection service-providers.

SUMMARY OF REVENUE FROM EFFICIENCIES AND TIMING OPTIONS

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- Establish temporary differential between interest received on delinquent taxes and interest rates paid on late refunds / Statutory.
- Disconnect from federal tax base / Statutory.
- Delay implementation of changes scheduled to take effect / Statutory.
- Increase period in which Department of Revenue can pay refunds without incurring interest costs / Statutory.
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- Reduce Oregon Liquor Control Commission inventory / Administrative.
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- Allocate additional Lottery revenue / Statutory. The December Lottery revenue forecast is $15 million higher than the 2001 close of session estimate.
- Allocate a portion of the Lottery Contingency Fund / Statutory. Lottery estimates $20 million available.
- Establish a tax amnesty program / Statutory. Revenue depends on elements of program.
- Examine process for collecting delinquent accounts. Evaluate role of agencies, courts and private collectors.

Revenue Raising Options

The Committee heard a wide range of revenue option proposals from interest groups and individual citizens. The exhibits accompanying these proposals are contained in Appendix B. Legislative Revenue Office revenue impact estimates for these proposals are summarized at the end of the section.

Oregon Education Association (OEA)

The OEA proposed use of existing revenue sources and new revenue to balance the 2001-03 General Fund budget. Their proposal included use of existing resources from the Medicaid Upper Payment Limit (MUPL) account, the Health Care Trust Fund and unexpended Emergency Board funds. A later section of this report summarizes some of the existing reserve funds potentially available for budget balancing.

OEA also proposed raising revenue through delay of Measure 88. This Legislative referral, passed by voters in 2000, increased the federal tax subtraction allowed under Oregon income tax law from $3,000 to $5,000 per filer. This change is scheduled to go into effect for the 2002 tax year. Revenue could also be raised through a 50 cent per pack increase in the cigarette excise tax and increases in beer and wine excise taxes. These proposals are all statutory requiring a 3/5 vote from both legislative chambers.

Further revenue increases could be attained through the following steps:

- An OLCC price mark-up increase on distilled spirits
- A statutory change allowing Sunday sales of distilled spirits
- Expansion of video poker to include line games
- Reduced retailer compensation for video poker

The OEA recommended that any tax increases be targeted to higher income taxpayers.

Kari McCullough / Past Chair of the Deschutes County Tobacco Free Alliance

Ms. McCullough recommends a 50¢ per pack increase in the cigarette tax. This would increase Oregon's current 68¢ per pack (including a temporary 10¢ surcharge) excise tax up to $1.18 per pack.

The cigarette tax increase proposal prompted a lengthy committee discussion on Washington's recent voter approved increase to $1.425 per pack rate, now highest in the nation. The Committee also discussed the implications of an increase for the new DOR enforcement program just underway. The LRO revenue estimates for increases ranging from 10¢ to 50¢ per pack can be found in the summary table of this section.

Oregon Environmental Council (OEC)

The OEC recommended the establishment of green taxes. These taxes would be designed to incorporate the environmental or non-market costs associated with production and consumption of certain goods.

The recommend green taxes include:

- Industrial air and water pollution
- Pesticides and fertilizers
- Smog fees on automobiles
- Additional water user fees
- Timber taxes
- Mineral tax
- Carbon tax

OEC concluded that these taxes could generate significant revenue over time. However, they recognized the need for lead-time to estimate appropriate rates and address implementation issues.

In addition, OEC offered a specific proposal for increasing the fee for the National Pollution Discharge Elimination System (NPDES) administered by the Department of Environmental Quality. Currently $2 million in General Funds are used for the program. An increase in fees could be used to free up $2 million in General Fund revenue.

Oregon Lottery

In addition to reviewing the Lottery Contingency Fund, Lottery officials presented estimates on the revenue potential associated with expanding the state owned video poker terminals to include line games. At the direction of the Lottery Commission, Lottery has been studying the revenue potential of expanding into line game offerings. In the event of a go ahead from the Commission and the Governor, Lottery would eliminate several current video poker games and replace them with line games. These line games would expand the market to new players and increase the play of existing consumers. The Lottery Commission has the authority to make rules changes that would result in line games. However, Lottery Officials emphasized that the Commission would be extremely unlikely to make the change without agreement from the Governor. The Governor currently opposes expansion to line games.

Mid-Willamette Valley Senior Services Agency

The agency advisory council recommended the following revenue raising steps:

- Use of unallocated MUPL revenue
- Use of Health Care Trust revenue from Tobacco Settlement
- Lottery expansion into line games
- An increase in the excise tax on beer
- An increase in the excise tax on wine

- A 10¢ increase in the per pack excise tax on cigarettes
- An increase in the OLCC mark-up on distilled spirits

Lee Hazlewood, Senior Advocate

Mr. Hazlewood, who presented the Mid-Willamette Valley Senior Services Agency Advisory Council recommendations, also submitted the following additional revenue proposals:

- Postponement of Measure 88
- Increase distribution from the Common School Fund
- Access the Education Endowment Fund
- Sales of state assets including the Elliot State Forest and state automobile fleet
- A 2% personal and corporate income tax surcharge
- Allocation of additional Energy Public Purpose revenue resulting from recent rate increases
- Increase use of existing federal dollars

Oregon Catholic Conference

The Catholic Conference recommended postponement of Measure 88 into the next biennium. The measure is scheduled to take effect in the 2002 income tax year.

Public School Superintendents

The Superintendents of Portland and Beaverton public schools described the financial situation from a large school district's perspective. They discussed the school distribution formula, the local property tax option and the use of private foundation funds. The superintendents emphasized that the long-run performance of the school system is ultimately tied to the resources that are allocated to schools.

Service Employees International Union (SEIU), Local 503

SEIU expressed agreement with proposals offered by the Oregon Education Association. SEIU emphasized the short-term difference between tax increases and spending reductions. Tax cuts have less of an immediate contractionary effect because leakages from savings and imports are greater. SEIU proposed a disconnection from certain changes in the federal tax code associated with a stimulus package. Finally, SEIU recommended a long run shift from taxes in which households bear the initial incidence to taxes that initially fall on business.

Oregon School Employees Association (OSEA)

OSEA presented a list of revenue options similar to those discussed by OEA and SEIU. The list included:

- Use of unallocated MUPL revenue
- Use of Health Trust revenue from the Tobacco Settlement
- Use of unallocated Emergency Fund reserves
- Delay implementation of Measure 88

- Allow Sunday sales of distilled spirits
- Reduce retailer compensation for video poker terminals
- Increase cigarette tax by 50¢ per pack
- Increase beer excise tax
- Increase wine excise tax
- Increase OLCC mark-up on distilled spirits
- Target temporary income tax surcharges

Kathy Thole, Citizen from Grand Ronde

Ms. Thole submitted testimony on tribal gaming activities and the tax status of revenue generated from the tribal casinos.

The Committee requested clarification from the Governor's Office and the Attorney General on the status of Indian gaming casinos in Oregon. The AG's office reviewed the elements of the Indian Gaming Regulatory Act of 1988. This act expressly prohibits state taxation of tribal activities. It does allow a negotiated shared revenue plan if the tribes have the right to offer games not allowed elsewhere or there is a demonstrable local economic impact. Shared revenue plans have been negotiated as part of gaming compacts around the state.

Oregon Business Association (OBA)

OBA provided the committee with a proposal that included general principles, budget reductions and revenue options. The revenue options were confined to the use of existing reserves. The recommendations included:

- Unallocated MUPL revenue
- Unallocated Tobacco Settlement revenue (Health Care Trust Fund)
- An increased distribution from the Common School Fund
- Use of $20 million from the Lottery Contingency Fund

D. Michael Roach, Citizen and Independent Retailer

Mr. Roach recommended passage of a temporary income tax surcharge as a preferred alternative to budget reductions.

Judi James, CPCU, Citizen

Ms. James recommended an assessment on insurance policies as a means of raising revenue. She pointed to the current assessment applied to fire insurance policies that is used to fund the State Fire Marshall. She recommended applying assessments to a broader array of insurance policies such as auto insurance and insurance for real and personal property. Ms. James estimated that $10 million per year could be raised through small fees.

Oregon Film and Video Office

The Film and Video Office presented a proposal to fund an Oregon Production Investment Fund. This same proposal was also given to the Senate Economic and Job Stimulus Committee.

Oregon Brewers Guild

The Brewers Guild informed the committee that they opposed an increase in the beer excise tax.

Committee Discussion

Committee members expressed the need for a complete listing of the proposals that were presented during the public testimony. During the discussion, members added the following options for consideration by the Legislature:

- An increase in the gas tax
- Broad consumption taxes based on gross receipts value added or retail sales.

The Committee agreed that movement to a broad-based consumption tax would require significant time and effort to examine and implement. This means that this is a long-run policy decision unlikely to have relevance for the current biennium revenue shortfall. A gross receipts tax patterned after Washington's business and occupation tax would generate $226 million per .1 % rate if fully implemented for the 2002-03 fiscal year. A retail sales tax with the Washington base would produce $575 million at a 1 % rate if fully implemented for the 2002-03 year.

Other Input

Senator Gordly proposed consideration of a 2-cent per hour payroll tax. The tax rate would be 1-cent on employer and 1-cent on employee. Legislative Revenue Office estimates that a 2-cent per hour payroll tax would generate about $60 million per year. Proceeds from the tax would be dedicated to the Oregon Health Plan.

SUMMARY OF REVENUE RAISING PROPOSALS

The 2001-03 revenue impact estimates are from the Legislative Revenue Office. These estimates will vary with the implementation dates and the final form of the proposal.

- Expand video poker to include line games (starting 7-1-02) $25 million / Administrative.
- Increase cigarette excise tax (starting 4-1-02) / Statutory—3/5 vote:
  - $ 23.2 million @ 10¢ per pack
  - $ 45.4 million @ 20¢ per pack
  - $ 66.5 million @ 30¢ per pack
  - $ 86.3 million @ 40¢ per pack
  - $104.8 million @ 50¢ per pack.
- Increase excise tax on beer to national median for excise and general sales (starting 4-1-02) / Statutory—3/5 vote. $35.6 million @ new rate of $14.88 per 31 gallon barrel.
- Increase wine excise tax to national median for excise and general sales (starting 4-1-02) / Statutory—3/5 vote. $9.4 million @ new rate of $2.13 per gallon.

- Delay implementation of Measure 88 from 2002 tax year to 2004 tax year. / Statutory—3/5 vote. $133 million.
- Increase and restructure the National Pollution Discharge Elimination System fee. / Statutory—majority vote. Potentially frees $2 million in General Fund revenue.
- Establish $1 fee for auto insurance policies and $5 fee for real and personal property insurance policies (7-1-02) / Statutory—majority vote. $10 million.
- Increase OLCC mark-up by 10% (starting 7-1-02) / Administrative. $7.6 million.
- Impose 2% personal and corporate income tax surcharge for the 2002 and 2003 tax years / Statutory—3/5 vote. $125 million.
- Increase gas tax by 1¢ per gallon with corresponding increase in weight mile tax (starting 7-1-02) / Statutory—3/5 vote. $22 million.
- Establish 2-cent per hour payroll tax dedicated to the Oregon Health Plan (starting 7-1-02)/Statutory--3/5 vote. $ 60 million.

Federal Tax Code Connection Issues

The committee discussed at length the relationship between the federal tax code and Oregon's personal and corporate income tax base. The Committee is well aware that a change in the federal tax base will affect Oregon through the state's "rolling reconnect" provision. This raises the policy issue of connecting to changes in the federal code that will reduce Oregon revenue during the current fiscal shortfall. The Committee directed the Legislative Revenue Office to provide a recent history of reconnection and the possible consequences of legislation being discussed in Congress.

Taxable Income Base

Since 1969, Oregon taxable income has been based on Federal Taxable Income as defined in the Internal Revenue Code (IRC). As a result of this connection, increases in federal deductions and exemptions generally directly reduce Oregon taxable income and Oregon tax liability (and vice versa). Changes in federal tax rates and credits on the other hand generally do not have a direct effect on Oregon income tax.

Prior to 1997, Oregon did not automatically adopt federal changes in taxable income. Legislation was required to update Oregon's connection to the IRC. Although the Legislature did generally choose to connect to recent changes, on at least two prior occasions it did not: In 1971 the Legislature disconnected from increases in the federal personal exemption and standard deduction. Oregon reconnected to the federal code in 1975 after establishing a separate personal exemption and standard deduction in Oregon statute. In 1981 the Legislature disconnected from federal accelerated depreciation provisions. Conformity to federal depreciation treatment was not reestablished until 1995.

Since 1997, Oregon has automatically connected to changes in taxable income as they are incorporated in the IRC ("rolling reconnect"). Under rolling reconnect, the revenue impact resulting from changes in federal taxable income, including feedback effects, is periodically estimated and continuously incorporated into the Oregon current law revenue forecast. Legislation is required to avoid adopting federal changes to the Oregon tax base.

Revenue Feedback Effect

The cross-deductibility of Oregon and federal income taxes has some more complicated implications. A limited subtraction up to $3,000 for federal income taxes paid is allowed against Oregon taxable income. Reductions in federal income tax result in a reduced subtraction for some taxpayers, and thereby greater Oregon tax liability (and vice versa). This effect will be amplified beginning in 2002 when the federal tax subtraction limit increases to $5,000 under Measure 88.

Revenue feedback results from Oregonians' ability to subtract some of their federal tax liability from their Oregon taxable income. This feedback occurs whether or not Oregon connects to the federal changes.

Recent Reconnect History

2001: H.R. 1836 "The Economic Growth And Tax Relief Reconciliation Act Of 2001" was passed in May 2001. This was the most significant federal income tax bill since 1986. H.R. 1836 makes several changes to the federal personal income tax, including reducing tax rates and increasing certain deductions, exclusions and credits.[1]

H.R. 1836 was estimated to reduce Oregon income taxes by $21 million in 2001-03 due to reductions in the taxable income base. This occurred because Oregon connected to the federal changes in taxable income. Feedback effects (via the federal tax subtraction) increased revenues by an estimated $61 million. The net result was an increase of about $40 million in 2001-03 revenues due to H.R. 1836.

2000: The tax provisions in H.R. 5662 "The Community Renewal Tax Relief Act of 2000" and H. R. 4986 "The Foreign Sales Corporation Repeal And Extraterritorial Income Exclusion Act Of 2000" had slightly negative net effects on Oregon revenues. Automatic connection to the tax base reductions in these two bills reduced Oregon tax collections by an estimated $3 million in 2001-03.

1999: Connection to the tax provisions in H.R. 1180 "The Tax Relief Extension Act of 1999" reduced Oregon tax collections by an estimated $1 million in 2001-03.

1998: Connection to the tax provisions in H.R. 2676 "The IRS Restructuring and Reform Act of 1998" increased Oregon tax collections by an estimated $1 million in 2001-03.

Future Reconnect

Congress is currently debating a new bill, H.R. 3090 "The Economic Security and Recovery Act of 2001." The House version of the bill includes significant business tax relief and accelerates some of the phased tax rate reductions in H.R. 1836. The Senate (Baucus) version contains more specifically targeted tax provisions and increased spending. The most significant components of the House bill are a three-year bonus depreciation allowance for new capital purchases and retroactive repeal of the corporate Alternative Minimum Tax (AMT). The Senate (Baucus) version includes a smaller bonus depreciation adjustment and retains the corporate AMT.[2]

The estimated impacts on Oregon income taxes of the House and Senate (Baucus) bills are shown in the table below. These impacts are due to the reductions in the taxable

[1] Because of budgetary restrictions all changes sunset 12/31/2010. For tax year 2011 the federal income tax and estate tax system reverts back to its form prior to passage of H.R. 1836.

[2] Latter Senate proposals were reported to include bonus depreciation provisions identical to the House bill.

income base. Since most of the tax changes in H.R. 3090 affect corporate taxes, the feedback effects of both bills will be very small.[3]

Estimated Reconnect Impact of HR 3090 ($ mil)		
Biennium	**House**	**Senate (Baucus)**
2001-03	-169	-41
2003-05	-91	+13

RESERVE FUNDS

The Committee requested a summary of reserve funds that could potentially alleviate a portion of the current estimated General Fund budget shortfall. These funds are in addition to the non-tax revenue sources (MUPL account, Health Trust Fund from the Tobacco Settlement payments) described in Table 3 of the Background section.

Common School Fund

The Common School Fund is a constitutionally established trust fund dedicated to K-12 education. The major revenue source flowing into the fund comes from forestry receipts derived from state lands. These funds are supplemented by statutory sources. The value of the fund increased four-fold during the 1990s as the return on equities jumped to an unprecedented level.

The fund value is $700 million as of 10-31-01. It is expected to generate $50 million in earnings during the 2001-03 biennium. The current school budget anticipates $31.2 million in distribution to schools during the biennium. These dollars flow through the school allocation formula as a local revenue source.

The State Land Board determines distributions from the fund. The Board is comprised of the Governor, the Secretary of State and the Treasurer.

Limits on the amount of the fund that can be distributed at Legislative direction are currently under review by Legislative Council. This question hinges on interpretation of the fund’s role as a trust and the limitations placed on it by the federal Admissions Act of 1859 that directed proceeds from the sale of state land into the fund.

Education Endowment Fund

The Education Endowment fund receives 15% of Lottery transfers. The fund balance was $171.6 million on 7-1-01. It is expected to reach $272.3 million by the end of the 2001-03 biennium.

Earnings from the fund are constitutionally dedicated to education. These earnings are currently being used to pay a portion of the debt service on lottery backed school bonds (75% of earnings) and provide funding to the State Scholarship Commission (25% of earnings).

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[3] Corporations are not able to subtract federal income taxes from Oregon taxable income. The effect of anticipated positive impacts on the Oregon economy will be estimated separately and incorporated directly into future economic and revenue forecasts.

The Oregon constitution states that earnings from the fund are to be used for education purposes only. However, the constitution does not state when and if principal from the fund can be used.

Unemployment Compensation Trust Fund

Unemployment insurance taxes (Oregon's second largest tax) flow into the Unemployment Compensation Trust Fund. These funds are dedicated to providing temporary unemployment benefits for laid off workers. The number of eligible workers rises significantly when Oregon enters a recession.

Employer contribution rates are based on a "self-balancing" system of eight tax schedules. These rates will automatically increase as demand rises and the fund balance declines. The schedules are based on historical experience during previous recessions.

Other Trust Funds

The Committee also received testimony recommending an examination of the Public Employees Retirement System (PERS) fund and the State Accident Insurance Fund (SAIF). Although the Committee agreed that these funds are important for the financial well being of the state, they felt that these were longer run issues that were unlikely to be part of the solution for the state's short-term budget situation.

APPENDIX A

SUMMARY OF PERSONAL AND CORPORATE INCOME TAX EXPENDITURES

AVAILABLE UPON REQUEST

APPENDIX B

EXHIBITS FROM TESTIMONY

AVAILABLE UPON REQUEST