

# A City Club Report on Measure 97: Corporate Tax Increase

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In 2015, Our Oregon, a coalition composed primarily of public sector unions, began collecting signatures to place Measure 97 (then called Initiative Petition 28) on the ballot. The measure proposes implementing a 2.5 percent tax on C-corporations on gross receipts from sales in Oregon more than \$25 million dollars. On June 6, 2016, Oregon’s Secretary of State certified the measure for placement on the November statewide ballot. Your Committee was charged with determining the merit of the proposal and whether to ultimately recommend a “Yes” or “No” vote. The task involved weighing a significant number of complex questions about the state’s need for additional revenue, who will ultimately pay the tax, to what extent these funds will effectively address revenue shortcomings, and to what extent a “No” vote might prolong the state’s revenue problems. Your committee came to a split decision, with the majority recommending a “Yes” vote.

## **Majority summary**

Oregon has faced a consistent revenue shortage for the past 25 years. While Oregon’s economy has grown, voters have placed limits on the state’s ability to impose new taxes, which has caused inadequate funding of schools and public services. Measure 97 presents a long-awaited opportunity to assure adequate investment in the health, education and the well-being of Oregonians. It is imperfect, but the benefits of added revenue that the Legislature could invest in education, healthcare and social services outweigh any potential detriments. It represents the first truly viable solution to more than two decades of revenue shortages in Oregon. Enacting Measure 97 will bring benefits and help to ensure the vitality of Oregon’s educational, healthcare and senior services.

**Recommendation: The majority recommends a “Yes” vote.**

## **Minority summary**

The minority shares the majority’s goal of increasing the revenue available for healthcare, education and senior services. The minority also agrees that Measure 97 could be successful at raising much-needed

revenue and that a gross receipts tax could provide stability to Oregon's overall tax system. However, the minority believes that a more carefully tailored tax could meet the goals of increased revenue and stability without the fundamental flaws and uncertainty of Measure 97. When rated against objective tax system evaluation criteria, the ballot measure falls short in a number of critical areas. Although we recognize the need, Measure 97 is not an effective or sound solution to Oregon's budget problems.

**Recommendation: The Minority recommends a "No" vote.**

*City Club members will debate this report on Wednesday, Aug. 24, 2016 at the Club's Ballot-Palooza event. Club members will vote on the report beginning Thursday, Aug. 25 and finishing Monday, Aug. 29. Until the membership votes, City Club of Portland does not have an official position on this report and Measure 97. The outcome of the vote will be reported on Aug. 30 in the City Club of Portland Bulletin Vol. 99, No. 2 and online at [pdxcityclub.org](http://pdxcityclub.org).*

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## INTRODUCTION

Measure 97 will appear on the Nov. 8, 2016 ballot as follows:

**Increase corporate minimum tax when sales exceed \$25 million;  
funds education, healthcare, senior services.**

**RESULT OF “YES” VOTE:** “Yes” vote increases corporate minimum tax when sales exceed \$25 million; removes tax limit; exempts “benefit companies”; increased revenue funds education, healthcare, senior services.

**RESULT OF “NO” VOTE:** “No” vote retains existing corporate minimum tax rates Based on Oregon sales; tax limited to \$100,000; revenue not dedicated to education, healthcare, senior services.

**SUMMARY:** Current laws requires each corporation or affiliated group of corporations filing a federal tax return to pay annual minimum tax; amount of tax is determined by tax bracket corresponding to amount of corporation’s Oregon sales; corporations with sales of \$100 million or more pay \$100,000. Measure increases annual minimum tax on corporations with Oregon sales of more than \$25 million; eliminates tax cap; benefit companies (business entities that create public benefit) taxed under current law. Applies to tax years beginning on/after January 1, 2017. Revenue from tax increase goes to: public education (early childhood through grade 12); healthcare; services for senior citizens.

## BACKGROUND

Your committee read research reports concerning tax policy, Oregon’s tax history, and the current state of Oregon’s budget and public services. We conducted interviews with the measure’s petitioners, public employee union representatives, current and former state representatives, former Gov. John Kitzhaber, business association representatives, local businesspeople and economists.

Your committee contacted several companies that operate in Oregon, but due to time and scheduling constraints we were not able to interview all that we would have liked. We therefore relied primarily on testimony from the Portland Business Alliance (which has more than 1,850 member companies), the Oregon Business Council (more than 40 business community leaders), and the Oregon Business Association (more than 250 member companies). Your committee is confident that they provided a fair representation of businesses’ views on Measure 97 and its potential impacts. We also interviewed a representative from Powell’s Books.

Evaluating Measure 97's merit raised fundamental questions about tax policy:

- To what extent does Oregon need additional revenue?
- Will Measure 97 effectively address these revenue needs and improve quality of services?
- What will be the aggregate effect on the Oregon economy?
- Who will ultimately bear the burden of the tax – consumers or shareholders?
- Is there any viable revenue-raising alternative that we can expect, given 20 years of legislative inaction?

All these questions involve non-negligible degrees of uncertainty. Your committee does not purport to make here any predictions of the tax's effect, but instead offers a measured assessment of the professional opinions offered to us.

### **Measure 5, 25 & 50 and limits on new revenue**

In your committee's deliberations and interviews, nearly all proponents and opponents of Measure 97 agreed that the state faces a shortage of revenue as a result of Measure 5 and subsequent measures. Oregon voters approved Measure 5 in 1990, which placed limits on property taxes while transferring funding responsibility – but not budgeting – for public schools to the state. Two subsequent ballot measures further decreased the state's available revenue and ability to create additional revenue: Measure 25, which required a three-fifths majority in the Legislature to approve revenue measures, and Measure 50, which limited increases in property tax assessment to 3 percent per year. Property tax revenues declined as a result of Measures 5 and 50, eliminating up to \$6 billion annually in potential state and local revenue.<sup>1</sup>

Due to these three measures, the Oregon Legislature has faced barriers to creating policies that address the revenue shortage. Some Democratic legislators have argued that it will be extremely difficult to raise additional revenue through the legislative process.

Voters however, have categorically opposed imposing a sales tax and have been resistant to other forms of taxation that result in taxes on consumption. In 1993 voters rejected a sales tax of 5 percent by an overwhelming 3-1 vote. In 2003 and 2004 voters rejected two ballot initiatives that would have imposed short-term increases in the state income tax. In 2007, voters rejected Measure 50, which would have increased the cigarette tax to provide additional health care funds for children. It was not until 2010, 20 years after Measure 5, that voters finally agreed to provide additional funds for the state government, approving by referenda a 0.9 percentage point increase to the marginal income tax for high-earning households and individuals as well as a \$250 million increase in corporate taxes. Both measures had been adopted by the Legislature the previous year.

## **Inadequate funding for state services**

Both opponents and proponents of Measure 97 agreed that Oregon's public services face a shortage of funding, although they differed on the extent to which these shortages constituted a crisis. Oregon's state services spending lags nationally in healthcare, education and senior services. Proponents of Measure 97 argued that this revenue shortage has had negative effects on the quality of Oregon's public services. With respect to education, Oregon has the fourth lowest high school graduation rate,<sup>2</sup> the third largest class size<sup>3</sup> and one of the shortest school years in the nation.<sup>4</sup> The Oregon Quality Education Commission recently estimated that an additional \$2 billion (per biennium) is needed to fund Oregon K-12 education at Quality Education Model levels.<sup>5</sup> Although some opponents of the measure point to increased school spending over the past few years<sup>6</sup>, school funding decreased significantly 2008 to 2012<sup>7,8</sup>, and per-student expenditures in 2014-15 (\$10,468)<sup>9</sup> have only recently recovered to their 2008-09 funding levels (\$10,569).<sup>10</sup>

In regard to health care, nearly 10 percent of Oregonians are currently uninsured, many of whom remain uninsured because coverage remains too expensive even with federal subsidies.<sup>11,12</sup> Some services remain too expensive with insurance, most notably reproductive health care.<sup>13</sup> Among seniors, nearly two-thirds of retired Oregonian's have zero income from retirement funds, making them dependent on Social Security, family members and public assistance.<sup>14</sup> Additionally, Oregon will soon have to meet additional funding obligations after accepting billions in Affordable Care Act funding.<sup>15</sup>

Several legislators have argued that the current system of cutting funding for services has produced less effective state services.<sup>16</sup> The consensus among your committee's members was that in 20 years, little action has been taken to address the revenue deficiencies faced by the state. These shortages in revenue have affected the state's capacity to provide effective public services.

## **Oregon's current business tax rates**

Measure 97's chief petitioners chose its relatively high-revenue receipts tax structure from 22 other poll-tested revenue raising proposals, some of which were variations of the current proposal. The bill's petitioners opted to tax high-revenue corporations in part because such a policy polled well with voters who oppose sales taxes and in part because Oregon has relatively low corporate tax rates. Proponents of the measure argued that any new source of revenue in Oregon should target corporations. They were concerned that maintaining high individual taxes and low corporate taxes could be toxic to the civic environment.

Currently, Oregon's "business tax burden" has been ranked as the lowest in the United States by Anderson Economic Group,<sup>17</sup> and Ernst and Young found that Oregon had the lowest "total effective business tax rate" in the nation.<sup>18</sup> Your committee found that increasing corporate taxes in some capacity is likely the most equitable source of new revenue in Oregon.

## **Potential impacts of Measure 97**

Assessments of the ultimate impact of Measure 97 on the economy, business environment, state services and all of Oregon vary.

### **Fiscal assessments of Measure 97**

Two studies were conducted on Measure 97's economic impact as of this writing.

The first was conducted by the Legislative Revenue Office (LRO), a nonpartisan state agency that provides research and analysis on tax policy and finance issues for the Legislature. The LRO used the confidential tax returns of Oregon businesses as well as the Oregon Tax Incidence Model to estimate the impact of Measure 97 on Oregon businesses, tax revenue and overall economy. The LRO estimated that Measure 97 would generate \$548 million in new revenue in the 2015-17 biennium, \$6.1 billion in the 2017-19 biennium and \$6 billion in the 2019-21 biennium.<sup>19</sup>

The second report was commissioned by the measure's chief backers at Our Oregon and was conducted by the Northwest Economic Research Center at Portland State University. The study looked the macroeconomic impact of both implementation of the tax and the expenditure of those funds by the state utilizing a customized version of the Regional Economic Model, Inc. It estimated that Measure 97 would raise \$3.37 billion dollars in 2017 and would increase to \$4.34 billion in 2027.<sup>20</sup>

Measure 97 would directly tax approximately 1,000 corporations in Oregon, i.e., 0.25 percent or one in 400 of all businesses operating in the state.<sup>21</sup> Both studies predicted that Measure 97 would dampen the growth of private sector hiring and the Oregon economy as a whole, while increasing the amount of public sector hiring. When including the federal income tax deduction, both studies predicted that the tax would ultimately have a negative but marginal aggregate effect on the economy, dampening income growth 0.1 to 0.2 percent over the next five to 10 years.

Much of your committee's discussion centered on how corporations might react to the tax and where they ultimately would allocate the cost. To pay for a tax, corporations have four mechanisms to handle the tax burden: (a) exporting it to the Federal Treasury through income deductions, (b) passing it on to shareholders and investors through decreased returns, (c) passing it on to consumers by increasing prices for goods and services, and (d) reducing other expenditures, such as capital investment, salaries or benefits.

### **Some of Measure 97's tax could be offset without passing it on to consumers**

A portion of Measure 97's tax burden might be deductible on federal corporate income filings.<sup>22</sup> If it is, Oregon consumers and businesses would not pay the entirety of the tax, instead passing it on to the federal government.

Companies would not always be able to pass on the entirety of the remaining cost to consumers because of national pricing strategies, internet competition, and competition within industries between C corporations that must pay the new tax and LLCs, B corporations and S corporations that are not subject to Measure 97's tax.<sup>23,24</sup>

The LRO report estimates that the tax would act as a consumption tax and be passed on to consumers through higher prices, but your committee anticipates that at least some businesses would be forced to pass on the cost of the tax upward to shareholders and operating costs.<sup>25</sup> It is possible that some corporations will move operations out of Oregon in order to avoid paying the tax. That would result in job losses and decreased capital investment in Oregon.

### **Potential effects on high-volume, low-margin businesses**

The tax could disproportionately affect high-volume, low-margin businesses. Many such companies, which tend to be retail and wholesale businesses, post large revenue numbers but have profit margins between 1 and 2 percent. That means that they will feel a heavier burden under Measure 97 than a low-volume, high-margin business with similar revenue levels.

Your committee heard testimony from Powell's Books, a local institution that also happens to be a low-margin, high-revenue business that would have difficulty paying the tax. Powell's purchases books from wholesalers at a certain price and is limited by the publisher to charging a certain maximum price. With no flexibility to implement price hikes or dig into operating expenses, Powell's would likely struggle to pay the tax.

Dental and other healthcare providers operate on similarly tight margins, sometimes less than 2.5 percent. They too, often cannot raise the rates they charge because they are set by insurers and the federal government.<sup>26</sup>

### **Cost of consumer goods**

As noted above, some companies would pass the additional tax on to consumers through increased prices. A considerable portion of your committee's discussion centered on to what extent the tax would affect consumers and whether or not this effect would be regressive. The LRO Report on Measure 97 predicted that the tax would ultimately have a regressive effect on consumers, meaning that the increase in prices will disproportionately affect lower-income individuals. The total effective tax rate in Oregon however, would remain progressive.

**Table 1: Impact of Measure 97 on distribution of Oregon’s state and local tax burden**

Income Group (Thousands per year)	Effective Tax Rate under Current Law	Effective Tax Rate under Measure 97	Difference	Change in baseline income in dollars
Less than \$21	9.29%	10.09%	+.80%	-\$372
\$21 to \$34	6.32%	6.86%	+.54%	-\$500
\$34 to \$48	7.52%	8.03%	+.51%	-\$563
\$48 to \$68	8.79%	9.25%	+.46%	-\$613
\$68 to \$103	9.13%	9.54%	+.41%	-\$751
\$103 to \$137	8.93%	9.31%	+.38%	-\$868
\$137 to \$206	8.87%	9.21%	+.34%	-\$1,063
Greater than \$206	9.56%	9.83%	+.27%	-\$1,282
<b>Overall</b>	<b>8.89%</b>	<b>9.28%</b>	<b>+.39%</b>	<b>-\$600</b>

(Source: Legislative Revenue Office)

## Pyramiding

Your committee studied literature on taxes similar to Measure 97 and found mixed results. Measure 97 is a type of Gross Receipts Tax (GRT), a form of taxation widely discouraged by economists. Economists have consistently found GRTs to have regressive and damaging economic effects as a result of tax pyramiding, which occurs when taxes assessed on multiple firms along a supply chain result in a larger compounded tax for consumers and businesses further along the supply chain.<sup>27,28,29,30</sup> Because of the unique structure of this particular tax, some committee members questioned to what degree these issues would occur under Measure 97. While most GRTs studied and implemented are at a low rate (0.1 to 1 percent) and are assessed on a majority of companies in a state’s economy,<sup>31</sup> Measure 97 sets the tax at a much higher rate (2.5 percent) and on a limited number of corporations, affecting approximately 400 of the state’s 400,000 businesses.<sup>32</sup> This made it difficult for your committee to predict to what extent the tax’s impact would be similar to that of other GRTs.

Although we heard a wide variety of anecdotal evidence, your committee lacked the data to answer conclusively to what extent pyramiding will occur. Although the tax might affect one portion of many companies’ supply chains, your committee did not believe that a tax on a small number of businesses could produce a significant amount of pyramiding.

## **Unpredictable impacts**

The percentage tax increase under Measure 97 would be unprecedented. Measure 97 would increase the state's general fund by approximately 25 percent. Although larger tax increases in dollar amounts have occurred in other states, there is little literature on how governments and economies react to such a large percentage change because they rarely occur.<sup>33</sup>

An increase in taxation without a clear plan for expenditure might put pressure on legislators to identify both spending options and to grant exemptions to affected corporations. Additional taxation might increase tension between affected corporations and legislators. Former and current legislators warned that Measure 97 would likely produce heated partisanship within the Legislature, as representatives broker both expenditures and exemptions for the tax.<sup>34,35</sup> Your committee engaged in extensive discussion of how corporations would react to the tax, whether the Legislature will add new exceptions, and how the new tax funds would be spent.

## **Challenges of implementing a tax proposal through the Legislature or ballot box**

Democratic legislators consistently stated the challenge of implementing taxes through the Oregon Legislature. Oregon is one of only three states that require a three-fifths supermajority to enact any new tax. This high threshold for approval has limited the ability of the Legislature to pass new revenue policies. As a result, several of our witnesses and committee members believe that the ballot initiative process is likely the only mechanism for solving the state's revenue shortcomings.

Your committee also recognizes the flaws of implementing complex tax policy through the ballot initiative process. First, the ballot initiative process tends to encourage overly simplistic tax policies that garner popular support but fail to accommodate the full complexity of the taxation scheme. Some committee members likened implementing tax policy through the ballot to using a hammer where a scalpel would be more effective. Additionally, commentators noted that Measure 97 was drafted without sufficient input from all affected parties. Elected legislators, business organizations, and representatives from marginalized communities and people of color criticized petitioners for failing to consider all points of view while designing the tax policy.<sup>36</sup>

## Major assertions made in favor of Measure 97

- **Action is needed.** The severity of Oregon’s revenue shortage and the state of Oregon’s public services necessitates action. Following 25 years of political stalemate in the wake of Measures 5 and 50, the cost of continued inaction in the face of underfunded public services is too high. Measure 97 is a worthwhile and necessary investment in the long-term well-being of Oregon and its citizens.
- **Measure 97 is fair.** Although the tax could potentially have a regressive effect on consumer prices, numerous factors will serve to mitigate this effect and Oregon’s overall tax code would remain progressive.
- **Measure 97 is neutral.** Although some C corporations might suffer, there would be an increase in higher-paying public-sector jobs and Oregon’s economy is predicted to grow at essentially the same rate as it would without the tax.

## Major assertions made against Measure 97

- **Measure 97 is not neutral.** It would have disproportionate and unequal effects on businesses. It targets C corporations while exempting LLCs and S corporations. Also, it would have significant effect on high-volume, low-margin businesses and businesses operating at a loss. Large sales revenue is no guarantee of profitability or ability to pay the tax.
- **Measure 97 is not fair:** It would function as a regressive consumption tax. The majority of the tax burden would be passed on to consumers and would disproportionately affect low-income families.
- **Measure 97 delays Oregon’s budget crisis rather than solving it.** Even with the dramatic tax increases of Measure 97, estimated costs from Oregon’s educational collective bargaining agreements and Public Employee Retirement System (PERS) predict that Oregon’s spending will overtake revenue again within 10 years.
- **A ballot initiative is a poor mechanism for tax policy.** Ballot initiatives are required to impact only one issue. It therefore is impossible to create a nuanced tax reform package that deals with some of the ramifications of implementing a tax policy change as large as Measure 97.

## CRITERIA FOR EVALUATION

In evaluating the merits of the tax, your committee decided to adopt the standards established by the 2002 City Club report “Tax Reform in Oregon.” Your committee also chose to include one additional criterion, political viability, which was established by the 1993 City Club Report of the same name. Your committee determined that this mix of criteria would be the best tools to evaluate Measure 97. They are as follows:<sup>1</sup>

- **Fairness:** A tax system should be progressive. As a taxpayer's income increases, so should the percentage of that income he or she pays in tax. Taxpayers with similar levels of income or assets should generally pay similar amounts of taxes.
- **Sufficiency:** A tax system should produce a flow of revenue adequate to pay for the public services and programs deemed necessary by citizens and the Legislature.
- **Certainty:** A tax system should be subject to only limited changes over time.
- **Political viability:** A tax reform proposal should be acceptable to voters as a reasonable alternative that is preferable to the present system. Any tax reform proposal must be politically viable or its creation will be only a futile exercise.
- **Clarity:** The basic functioning of a tax system should be understandable and capable of being described in clear and simple terms. This allows citizens to comprehend and debate the value of the system and the likely impacts of proposed changes to it.
- **Efficiency:** The cost and complexity of taxpayer compliance should be kept to a minimum, as should the burden of collection and enforcement. The state and local tax system should be complementary with the federal tax system.
- **Neutrality:** A tax system generally should not have a strong impact on economic activities and should minimize interference in private economic decisions. It should not adversely affect the ability of businesses within the state to compete with businesses in other states.

Your committee provided a wide range of evaluations of Measure 97 using these criteria. Several trends stuck out. All members agreed that the tax was sufficient, that its political viability to address a long-standing and challenging issue is an asset, and that by modifying the existing tax code it is efficient. Most of your committee members were troubled to varying degree that Measure 97 is not neutral in its selective taxation of C corporations and not LLCs, B corps or S corps. The relative weight and importance to which the majority and minority favored the tax's benefits and viability over its potential structural shortcomings was the crux of much of your committee's discussion and difference.

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<sup>1</sup> These definitions are taken directly from the respective City Club reports, both of which were adopted by the membership.

## **UNANIMOUS ASSERTIONS & CONCLUSIONS**

### **Measure 97 would provide additional state revenue**

Nearly all of the opponents and proponents of Measure 97 that your committee interviewed agreed that Oregon faces a revenue shortage that has impacted the state's capacity to provide public services.<sup>37,38</sup> This is symptomatic of a problem that has persisted for the past two decades. The state's tax revenue base has been unstable and insufficient since 1990 when Measure 5 and 50 passed. The diminished property tax revenue (approximately \$6 billion annually<sup>39</sup>) has impacted funding for state services. Measure 97 promises to bring in revenue to address these shortcomings and provide revenue that the Legislature could use to increase funding for Oregon's public services.

Measure 97 also promises to improve the state's revenue stability, which would help the state better fund other services.<sup>40</sup> Oregon's revenue has been notably unstable because of its dependence on income taxes that fluctuate with the rise and fall of the economy. Gross receipts taxes, which Measure 97 utilizes, have proven to provide a stable source of revenue through economic turns.

Your committee heard from some current and former state representatives who noted that the current rate of incremental funding increases is unsustainable and that the process of continuous budget cutting decreases the quality of services instead of promoting efficiency.<sup>41</sup> While your committee recognizes the need for reforms and encourages increased spending accountability, it became clear that an increase in state revenue is necessary. Effective additional investment in education and public services is crucial and has the potential to provide long-term benefits to Oregon's economy.

### **Political viability**

Over the course of your committee's deliberations, the political viability of Measure 97 remained one of its chief appeals. While the revenue and structural deficit that has grown in the past 25 years is widely acknowledged, no solution has been enacted.

Then-Gov. John Kitzhaber held meetings with labor and business groups in 2013-14 to address budget shortfalls, but these efforts failed to produce any concrete solutions.<sup>42</sup> Many in the business community oppose Measure 97 and were frustrated with the limited extent to which they were involved in its conception and creation. But when pressed for a viable alternative, they recommended a sales tax or trusting traditional legislative processes, neither of which have proved to be viable solutions over the past two decades.

Some state legislators have attested that the supermajority requirement for procuring new revenue has made it nearly impossible for them to find any way within the Legislature to raise the revenue necessary to overcome the state's structural deficit.<sup>43</sup> Frustration with the Legislature's inability to pass new revenue has prompted some legislators to concede that a ballot initiative is likely the only way a

substantial increase in revenue will be implemented. Measure 97 represents a feasible opportunity to raise a significant amount of funds that could be used to address the state's revenue shortage.

## **Efficiency**

Building off of the state's existing corporate tax code and targeting sales revenue, Measure 97 would be both easy to administer and supply a steady stream of revenue. Measure 97 is a revision to Oregon's existing corporate tax code, and by using the existing definition of Oregon sales, it would be easy to assess. Additionally, sales are more straightforward to calculate than income, making it more difficult for corporations to optimize their accounting practices and obscure profits and other financial metrics to lower their tax burden.

## **Clarity**

For corporations trying to determine whether they would pay the tax and what amount they would pay, Measure 97 is clear. C corps need only to assess their current Oregon sales revenue levels and then calculate percentage on revenue more than \$25 million.

For voters however, Measure 97 is not transparent. Corporations would not need to disclose the amount of tax they choose to pass on to consumers through increased prices. Additionally, there is no publicly available data on which corporations in Oregon have revenue of more than \$25 million dollars, much less exclusively C corps. Therefore, voters are unable to determine who would pay which portion of the tax, making the measure not clear.

## **Lack of neutrality**

Measure 97 taxes only C corps, although many LLCs, B corps and S corps compete in the same sectors with similar levels of revenue. The measure's petitioners said this omission was deliberate for several reasons. First, it helped simplify the measure by allowing them to amend only one portion of the state's corporate tax code reserved for C corps. Second, they believed it helped to encourage companies to pass the cost of the tax on to shareholders. Competition with LLCs, S, and C within the same sector would dissuade affected firms from passing the tax on to consumers through higher and less competitive prices. Third, petitioners found that most large out-of-state corporations operating in Oregon are incorporated as C corps and that limiting the tax to C corps served as an imperfect proxy for targeting out of state corporations.<sup>44</sup> Several committee members objected to this rationale as having no sound basis in tax policy.

Selecting a limited portion of firms from a given sector to carry a disproportionate tax burden is by its nature unequal in its application. Under the law, a C corporation with \$50 million in sales would pay a larger tax than an LLC or S corporation with similar income, and would be placed at a competitive

disadvantage with similar firms in a similar industry. Arbitrarily taxing competing businesses of similar sizes may produce uneven and non-neutral effects within the economy.

## **Uncertainty**

A topic of considerable discussion was the possibility of legislators granting exemptions to corporations in the future and the certainty of Measure 97's eventual tax base. In her proposed implementation plan for Measure 97, Gov. Kate Brown plans to exempt software companies. Some witnesses anticipate that a large number of businesses would seek exemption from the tax.<sup>45</sup> The end result is a tax policy in which voters are unsure about the amount that they will ultimately be taxed and what effect it will have on the Oregon economy.

Your committee, like voters, must weigh this measure based on what appears on the ballot, not speculation about what the Legislature and governor might do in the future to change it.

There is an amount of uncertainty about the effect of the tax. Although economic models have forecasted Measure 97's effects, both studies discussed by your committee used models that are at best comparative, not predictive. No state has a single rate gross receipts tax of this size that applies only to sales revenue in excess of \$25 million for C corps. The proposed tax percentage on corporate sales and the revenue dollars generated relative to existing tax structure is unprecedented. Although your committee can make predictions, neither your committee nor voters can be certain about the long-term effects of the tax.

## **MAJORITY DISCUSSION & ANALYSIS**

### **Need for action**

In the years following Measures 5 and 50, Oregon's public services have faced a shortage of adequate funding. Nearly all of your committee's witnesses argued that the state needs additional revenue to provide adequate services. Despite this consensus, the state has failed to implement a sufficient revenue-raising policy. This 25 years of inaction weighed heavily on the majority's decision, as a "No" vote represents continued inaction on Oregon's revenue shortage. Measure 97 is an opportunity to provide adequate revenue for vital services that enrich the lives of Oregonians. The majority feels that the potential benefit of adequately funded state services outweighed any of the tax's potential detrimental effects and that the consequences of prolonging the state's revenue shortage were too great.

### **Effects on individual taxpayers**

One of the major uncertainties surrounding Measure 97 is who would ultimately pay the tax. We heard a wide variety of suggestions, spreading across a spectrum of predictions ranging from out-of-state

shareholders paying the total tax to Oregon consumers paying the whole of it, and everything in between. Even if a portion is passed through as a consumption tax, Oregon's tax code would remain progressive.

Your committee identified several factors that would mitigate the effect of the tax on consumers. First, corporations might be able to deduct this tax on their federal income tax returns, meaning that the federal government could cover a portion of the cost of Measure 97. Second, internet competition and national pricing strategies discourage price hikes within the state. Many of the large corporations and smaller businesses supplying national products sell goods at a fixed price nationwide. With a fixed price they would be forced to absorb the cost of the tax vertically onto shareholders and operational expenses, meaning that consumers would remain unaffected while shareholder's profits are diminished.<sup>46</sup> Third, many of the corporations taxed as C corps compete within the same industries as S corps and LLCs that would remain untaxed. This competition within industry segments would discourage firms from passing on the tax to customers. The majority concluded that the confluence of these factors would help to limit the portion of the tax being passed on to customers.

The Legislative Revenue Office report predicts that Oregon's tax code would remain progressive under Measure 97, even though the tax itself might be regressive. The LRO model also works under the assumption that Measure 97 would function as a consumption tax. If affected corporations do not pass the tax through in its entirety as we anticipate, then the tax will be less regressive and Oregon's tax code would remain more progressive.

### **Not neutral, but minimal aggregate effect**

In evaluating the merit of a tax policy, particularly a proposal as large as Measure 97, the majority anticipates that any given tax will have a deleterious effect on aspects of the economy. Your committee was reminded several times that there is no such thing as a painless tax and that often evaluating a tax requires weighing its harm against its benefit. Although the discriminatory aspects of the tax concerned members of your committee, the majority believes that positive revenue generating effects and the limited aggregate effect of Measure 97 outweigh its potential detriments.

Data provided to your committee by the LRO report suggest that Measure 97's overall effect would be mild and likely would be outweighed by any larger trend in the Oregon economy. The LRO report estimated that the measure would dampen income, job and population growth by 1 percent over a 5-year period, but in all three metrics did so within the margin of error. While depressed growth is predicted and possible, any economy-wide boom or recession will likely outweigh the effects of the tax. While this might dampen private sector job growth, it would not produce job losses and would in turn produce higher paying public sector jobs.

The metrics suggest that while Measure 97 might have some negative effects, they would be limited. Further, with effective educational and healthcare spending, the measure might have a positive effect on the economy through additional investment in Oregon’s human capital.

## **Majority conclusions**

Measure 97 is imperfect, but the benefits of added revenue that the Legislature could invest in education, healthcare and social services outweigh any potential detriments. As a committee tasked with providing a yes or no vote, your committee was asked not only to evaluate the potential of the bill in its implementation, but also the consequences of inaction. Measure 97 is a rare, promising and feasible solution to Oregon’s 20-year history of continued inadequate investment in public services. The dearth of potential alternatives means the cost of inaction is too high. Measure 97 is a long-term investment not only in the health and education of our citizens, but in our economy and ability to create a thriving and contributing populace.

## **Majority recommendation**

The majority of your committee recommends a “Yes” vote on Measure 97.

## **Signatures**

*Respectfully submitted,*

Lewis May, Lead Writer

Naomi Derner

Stephen Kafoury

Paul Meyer

Stephen Onisko

Dan Riker

Michael Wade

## **MINORITY DISCUSSION & ANALYSIS**

While the minority agrees with many of the facts and arguments included in the majority report, Measure 97 fails in three crucial ways. First, the tax's targeting of C corporations is arbitrary and unequal in its effect. Second, existing systemic issues mean that Measure 97 delays rather than solves budget issues. Third, Measure 97 fails many of City Club's adopted criteria for responsible taxation policy, notably fairness and certainty. The remainder of this report details the minority's recommendation.

### **Setting tax policy by ballot measure**

Numerous experts and members of your committee feel that passing a tax proposal through the ballot initiative process tends to produce unrefined and unmoderated tax policies. Measure 97's lack of neutrality and fairness speak to these shortcomings. The tax fails to accommodate the complexity of Oregon's economy and represents a poorly conceived tax measure that does not represent a suitable solution to the state's revenue shortage.

### **Not neutral in targeting only some businesses**

The minority found that Measure 97's taxation of only C corporations, while excluding LLCs and S corporations, to be a disconcerting omission. Many large businesses are LLCs and S corps, and they often compete with C corps in similar sectors. For example, Fred Meyer (Kroger) and Safeway grocery store chains are C corps and would pay the tax. New Seasons Market, a B corporation,<sup>47</sup> and Albertson's, a limited liability corporation (LLC),<sup>48</sup> would not pay it.

The petitioner's' explanation that the focus on C corps was intentional in an attempt to exempt many Oregon-local companies while taxing out-of-state businesses was unconvincing. A corporation's status is a highly inaccurate proxy for whether a business is Oregon-based.

Additionally, the tax will encourage companies to engage in what the LRO report refers to as "significant tax planning," in which corporations will change their corporate classification in order to avoid paying the tax.<sup>49</sup> Such accounting practices would force businesses to incur unnecessary accounting costs and to adopt corporate structures that are less than ideal for their businesses. Additionally, corporate restructurings and B corporation elections (a relatively simple process under Oregon law) would serve to further reduce the limited pool of taxed businesses under Measure 97, resulting in a more restricted and unstable pool of revenue.

### **High revenue and low margin**

A business's gross receipts are not related to its ability to pay. High-volume, low-margin businesses often run profit margins ranging from 1 to 2 percent while operating in highly competitive pricing markets. That means passage of Measure 97 could result in the loss or reduction of their profits. Other

firms, particularly startups, operate at a loss, yet they might have considerable gross receipts and a disproportionately high tax bill under Measure 97.

This critique doesn't necessarily preclude gross receipts taxes from being implemented. However, a gross receipts tax should be more nuanced to recognize and account for the structural realities of the industries being taxed. It also should be tiered to offset the potential deleterious effects. Measure 97's lack of neutrality with respect to high-volume, low-margin businesses has a capacity to cause undue harm to those businesses.

## **Systemic budget issues remain**

Although the minority agrees that additional revenue is necessary to fund state services, we are concerned that without accompanying reforms to the Public Employee Retirement System (PERS) and education funding, Measure 97 delays Oregon's funding crisis rather than solving it.

According to a recent PERS Board meeting in March, the unfunded PERS liability is \$21-\$22 billion. Even with the influx of funds from Measure 97, the cost of PERS could eclipse the increased revenue within a few years if PERS reforms are not addressed. Some PERS reform doors were closed by the Oregon Supreme Court, but other options for potential reform remain; many of which were recommended by City Club in its 2011 report, "Oregon PERS: Burdened by the Past, Poised for the Future." Additional revenue will decrease lawmaker's incentives to pass the difficult reforms necessary for PERS.

Your committee heard witness testimony regarding education funding similar to the PERS issue above. Since Measure 5 was enacted in 1990, under the collective bargaining system, individual school districts are able to negotiate contracts that exceed the amount the state is capable of paying. For example, a negotiated agreement might provide for a 3 percent step increase and a 2 percent cost of living adjustment, but the state's revenue growth is only 4 percent. This disconnect between the process by which individual school districts' contracts outstrip the state's available and budgeted funding has led to a structural deficit in school funding. Without reforms, the current system may lead to a future deficit even with the added revenue from the passage of Measure 97.

## **Uneven application**

Measure 97 would, according to the LRO Report, be mildly regressive, with low-income Oregonians shouldering a heavier burden, but Oregon's tax system as a whole would remain progressive. Where Measure 97 fails decisively is on horizontal equity, which provides that taxpayers with similar levels of income or assets should generally pay similar amounts of tax.<sup>50,51</sup> A gross receipts tax does not take into account corporate income or assets, and Measure 97 discriminates within sectors among similar market competitors based on type of corporation. Your committee was able to identify several examples of sectors where businesses are providing similar goods or services but are different types of corporation.

Under Measure 97, those corporations would pay potentially radically different amounts of tax despite having similar income and assets.

In the case of utilities, multiple witnesses shared that the rates for those areas served by investor-owned utility companies would increase as the cost of the tax is absorbed into expenses used to calculate utility rates. According to reports, Pacific Power is considering raising rates by 3 to 4 percent,<sup>52</sup> suggesting that the tax for some companies would not be absorbed but rather passed directly on to consumers without distinction between the first \$25 million the corporation sold. Further compounding the unfairness of Measure 97, some Oregon residents are served by utility co-ops, which are not subject to the tax.<sup>53</sup> Whether or not a resident was impacted would be determined by their geographic location as well as the types of utilities they use. For natural gas, 100 percent of customers are served by utilities that would be taxed under Measure 98. For electricity, approximately 73 percent of customers are served by companies that would be taxed under it.<sup>54</sup>

Another more general concern is the potential benefits of Measure 97, and the relative benefits versus the costs for low income Oregonians. It is unclear if there is a net benefit to low income Oregonians and its impact on the greater citizenry, both directly and indirectly.

## **Minority conclusions**

The minority agrees that Measure 97 could raise much needed revenue and that a gross receipts tax could provide stability to Oregon's overall tax system. But when evaluated using objective criteria, Measure 97 falls short. The minority believes that Measure 97's selective nature, uncertain effects and potential to discourage needed reforms make it a poor and ultimately unworthy solution to the state's revenue problems.

## **Minority recommendation**

The minority of your committee recommends a "No" vote on Measure 97.

## **Signatures**

*Respectfully submitted,*

Jennifer Rollins, chair

Brandy Ethridge

George Fogg

Catherine Moore

## **ACKNOWLEDGEMENTS**

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Ryan Fox-Lee, Research Board Adviser

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Christian Trejbal, Interim Research & Advocacy Director

Maggie Zach, Civic Associate

D Bowen, Preliminary Ballot Research Assistant

Daniela Lopez, Preliminary Ballot Research Assistant

## WITNESSES

Rep. Phil Barnhardt, District 11, central Lane and Linn counties, June 2, 2016.

Rep. Peter Buckley, District 5 Ashland, June 2, 2016.

Rep. Knute Buehler, District 54, Bend, June 17, 2016.

Rep. John Davis, District 26 – Wilsonville, June 17, 2016.

Ryan Deckert, Oregon Business Association, May 23, 2016.

Nikki Dobay, Council on State Taxation, June 20, 2016.

Robin Hahnel, Lewis and Clark College, May 16, 2016.

Jo Ann Hardesty, NAACP Portland Chapter 1120B, June 22, 2016.

Sen. Mark Hass, District 14 Beaverton, June 22, 2016.

Tonia Hunt, Children First for Oregon, May 16, 2016.

Rep. Mark Johnson, District 52 – Hood River, June 17, 2016.

Gov. John Kitzhaber, Former Governor, Oregon, June 13, 2016.

Sen. Tim Knopp, District 27, Bend, June 17, 2016.

Sandra McDonough, Portland Business Alliance, May 23, 2016.

Emily Powell, Powell's Books, June 24, 2016.

Charles Sheketoff, Oregon Center for Public Policy, May 31, 2016.

John Topanga, ECONorthwest, June 21, 2016.

Ben Unger, Our Oregon, May 16, June 20, June 23 2016.

Paul Warner, Legislative Revenue Office

Duncan Wyse, Oregon Business Council, June 16, 2016.

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