The Long Journey to Adequacy:

School Funding and the Oregon Tax System

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Executive Summary

Two decades of disinvestment in public education is beginning to erode a system that has historically been recognized as one of the best in the nation. Members of the Oregon Education Association have repeatedly called for fundamental change in the level of resources committed to this most vital of enterprises, and concurrently, have worked to change the underlying revenue system that produces those resources. These ambitions have met with mixed results.

Some efforts have led to the creation of modest new resource streams – such as the Oregon lottery – but over time, other interests have laid claim to those revenues or they have been insufficient to address the full measure of the state's revenue needs. Fundamental efforts to reform what many see as Oregon's broken tax system have failed to materialize, despite the hard work of many state-sponsored task forces as well as ballot measure initiatives focused on the values of fairness and adequacy to fund essential services, including education.

Meanwhile, demographic changes, heightened expectations of public education, and the rise of professional anti-tax interest groups have conspired to further strain the education system. Too much time and money has been diverted to campaigns to stop tax-cut proposals pushed to the ballot by advocates for a decidedly anti-government agenda. The long history of battles to protect the current insufficient revenue system from further loss has depleted organizational resources, lowered the morale of educators, denied students opportunities for advancement in an increasingly globalized information age, and has made some citizens cynical about the ability of the public education system to fully prepare the next generation. That cynicism in turn has led some to turn away from one of the most important elements of a democratic society: universal, free public education for every citizen.

OEA has worked to demonstrate how greater public investment in pre-Kindergarten through post-secondary education will stimulate the economies of individual communities and increase the prosperity and quality of life for all Oregonians for years to come.

Oregon's Education Funding Crisis

How and at what level public education in Oregon ought to be financed are questions that have remained central to governing in this state for many a decade. Prior to the state's entry on the scene as the primary underwriter, funding policy was often focused on district-to-district inequity because local property wealth too often determined the financial capacities of schools. In those days, local operating levies had to be put out to vote on a routine basis, which produced budget instability and uncertainty for some districts, but also led to closer communication between schools and voters. Some property-poor districts ended up closing early or landed in the state "safety net" program created in the 1980s; other districts enjoyed steady support and were able to run rich public school programs, complete with a range of electives and extra-curricular programs, summer schools, small class sizes, and other student supports.

Then, in 1990, after five previous ballot measure failures, property-tax-limitation advocates succeeded in passing Ballot Measure 5, which significantly changed school funding in Oregon. This constitutional measure limited the rate of property tax paid by residential and non-residential owners to no more than $15 per $1,000 of value. A maximum of $5 could go to education (school districts, education service districts, and community colleges), and city and county governments received the rest. Voters in many school districts had previously approved levies well above the $5 level. While Measure 5 mandated that the state backfill the loss in local property tax revenues to schools, it did not expressly contemplate how that would be done. State funding of schools prior to the passage of Ballot Measure 5 was approximately 30 percent of total district receipts; after Measure 5, the state assumed more than 70 percent of the responsibility over a five-year phase-in period. This made education the largest line-item in the income-tax-fed state General Fund. This shift could be absorbed in only one of two ways: either Oregon had to significantly scale back its commitment to other vital services – such as higher education, health care, and public safety – or it had to increase its revenue streams to be able to meet all needs.

Measure 5 had other implications as well. Once the majority of K-12 funding became the state's responsibility, the pressure was on to ensure district-to-district funding equity, particularly after the Deschutes County Circuit Court warned of this legal expectation. In response, the 1991 State Legislature revamped its school funding formula to equalize resource distribution across Oregon school districts while simultaneously consolidating Oregon's 300+ districts into 198 larger districts. The equalization formula accounts for local variation in property wealth and also considers other cost drivers, such as rural transportation and certain student demographic differences. At the same time, the state began implementation of Oregon's new education reform law, despite the fact that the mandate was insufficiently funded. The declining trajectory of funding, married with a rising trajectory of school costs, would have been even more disastrous than it was if not for the fact that Oregon's economy climbed to unprecedented levels of prosperity in the mid- to late-1990s. This boom cycle temporarily softened the blow to the state caused by these simultaneous changes, disguising the time bomb that would only become universally felt once the economy slackened and Oregon's new structural deficit was laid bare.

Changes to Oregon's tax code also impacted overall state resources in this period. The 1980s and 1990s saw a dramatic upsurge in the number of deductions and exemptions available to corporations and businesses operating in Oregon, which reduced their tax liability. Accelerating this decline in corporate share was the switch to a single-sales-factor taxing method in 2005, which

reduced C-corporation taxes to Oregon by approximately $80 million a biennium. According to the Oregon Center for Public Policy, if Oregon's 1973 tax code – absent these changes – were in place in 2007, Oregon's tax system would have yielded $1.7 billion more than it actually took in for the 2007-2009 biennium – enough to have fully funded K-12 at the QEM level for those two years. The share of General Fund that corporations contribute dropped in this period from 18.5 percent to 4.6 percent in 2005-2007.

Today, Oregon's economy has cycled back to bust. Public education's increasing reliance on the state income tax – which is more volatile than the property tax – has increased schools' vulnerability to cyclical downturns. Some of this instability may be remedied by Oregon's newest innovations – its Education Stability Fund and General Rainy-day Fund – but neither of these reserves have strong revenue sources to quickly capitalize the funds so that Oregon is able to avoid funding cutbacks when state revenues plummet. Education funding has also become more of a political football in this period, because resource scarcity exacerbates ideological tensions. Furthermore, because schools pared back most enrichment and support services during the post-Measure 5 years, recession-caused funding reductions now have no place to go but through bone. Even small cuts hurt in large ways.

Political Dynamics

OEA and its allies have worked for many years to find revenue solutions to the insufficiencies of our funding system, but the political environment has been wholly unprepared to enact change. Citizen support for retail sales taxes universally failed – even when tied explicitly to public education (such as the OEA-backed Ballot Measure 1 in 1993). So too have most other proposals to increase revenues statewide. Additionally, previous legislatures either lacked the political will or failed to fully grasp the magnitude of the evolving crisis. In several sessions, they preferred to change the subject, not the system. In this period, the Association found itself in a defensive position, fighting one ill-considered educational policy idea after another, such as vouchers and new curriculum mandates. The closest policymakers came to discussing money at all (beyond formation of several tax-reform task forces) was to propose various changes to the funding formula – thereby concentrating their efforts on how the pie would be sliced, rather than on how big the pie should be.

Public education has suffered, through recessionary times and rebuilding years, from the combination of continuous resource erosion and increasing expectations for student outcomes. In the years of George W. Bush's presidency, the federally mandated Elementary and Secondary Education Act, more commonly known as "No Child Left Behind", focused education policy on testing, high school completion, and "highly qualified" educator status. Sanctions for "non-performing schools" added stresses to students and staff and costs to districts for compliance. The Act requires that all students pass state tests by 2014 and that the dropout rates be reduced to zero in order for districts to avoid punitive federal action. State leaders prior to 2007 added to this pressure by demanding student achievement outcomes whose costs exceeded their willingness to invest in public schools.

Impacting this situation further is Oregon's recent student demographic transformation. More and more students come from families in which English is not the primary language spoken. Some 80+ native languages and dialects are first languages for students in Oregon's largest school district in Portland. English language learners require services designed to aid both their fluency and grasp of educational content, and these interventions are more costly than the regular education program. Likewise, the fastest-growing subgroup of Oregon students is the "high-cost, low-incidence" population

of students with severe disabilities. Special programs, enrollment growth, and new mandates have conspired with funding cuts to present increasingly more difficult budgetary challenges to public schools and education service districts. In this climate, calls for greater accountability, higher student achievement, and proliferation of new program options (charter schools, online education, concurrent-credit programs, full-day Kindergarten, etc.) have complicated the conversation about education funding without providing meaningful solutions. In fact, a minority of policymakers and others have argued that money has no bearing on educational outcomes. Add to this mix the rise of the anti-tax movement nationwide (led by such anti-government players as Grover Norquist, who once famously declared that his goal was to shrink government enough to drown it in a bathtub) and the decline of households that have children in Oregon's public schools. All of these factors have proved to be political barriers to change in the legislative process over the years and have served to confuse the public at large.

On December 7, 2002, Oregon Education Association leaders held a historic, off-cycle special Representative Assembly to contemplate the growing funding crisis. Members voted their resolve that day, declaring that "achieving adequate and stable funding for public education is the top priority of the Oregon Education Association." ***The top priority***. Members rededicated themselves to the goals of promoting and supporting legislation to create revenue sufficiency, of qualifying and supporting ballot measures for that end, of making inroads through public awareness and coalition-building with allies, and of focusing both local and statewide activities on the pursuit of a systemic remedy. The revenue goal, according to the action items adopted that day, was a means to an end. Ultimately, what OEA members resolved to achieve was the assurance that all students in Oregon have access to a high-quality public education.

In mid-2006, OEA and legislative allies formed a Funding Coalition to lobby for incremental increases in school funding over a six-year period. The six-year plan, in which the state would gradually increase the allocation to schools beyond inflation/enrollment growth in order to achieve constitutionally mandated adequacy, was initially embraced by the Governor and legislative leadership but was abandoned once Oregon's economy began its descent. In the end, the coalition's effort yielded a $6.3 billion biennial 2007-2009 budget – the largest dollar allocation in history and one of the largest increases from one biennium to the next – but that appropriation was reduced in the final six months of the biennium due to recession-caused state revenue losses. OEA's successful pursuit of the $6 billion appropriation for 2009-2011 was a giant fiscal step backward, and yet, it was considered a school funding victory in the context of the state's $4.2 billion revenue shortfall.

For a full explanation of the mechanics of K-14 public finance, see Appendix A.

Adequacy Defined

Over the years, it became clear to public education advocates and policymakers on both sides of the political aisle that deliberations about school funding could be improved by a common understanding of the true costs of meeting the state's – and the public's – expectations. The Quality Education Model (QEM) was initially developed in 1999 as a result of the leadership of former Speaker of the House Lynn Lundquist, who sought to establish an objective and research-based link between student achievement and the resources devoted to Oregon schools. His vision, and that of education advocates, was that this effort could be used by policymakers as a guide for defining funding "adequacy" in Oregon's public schools.

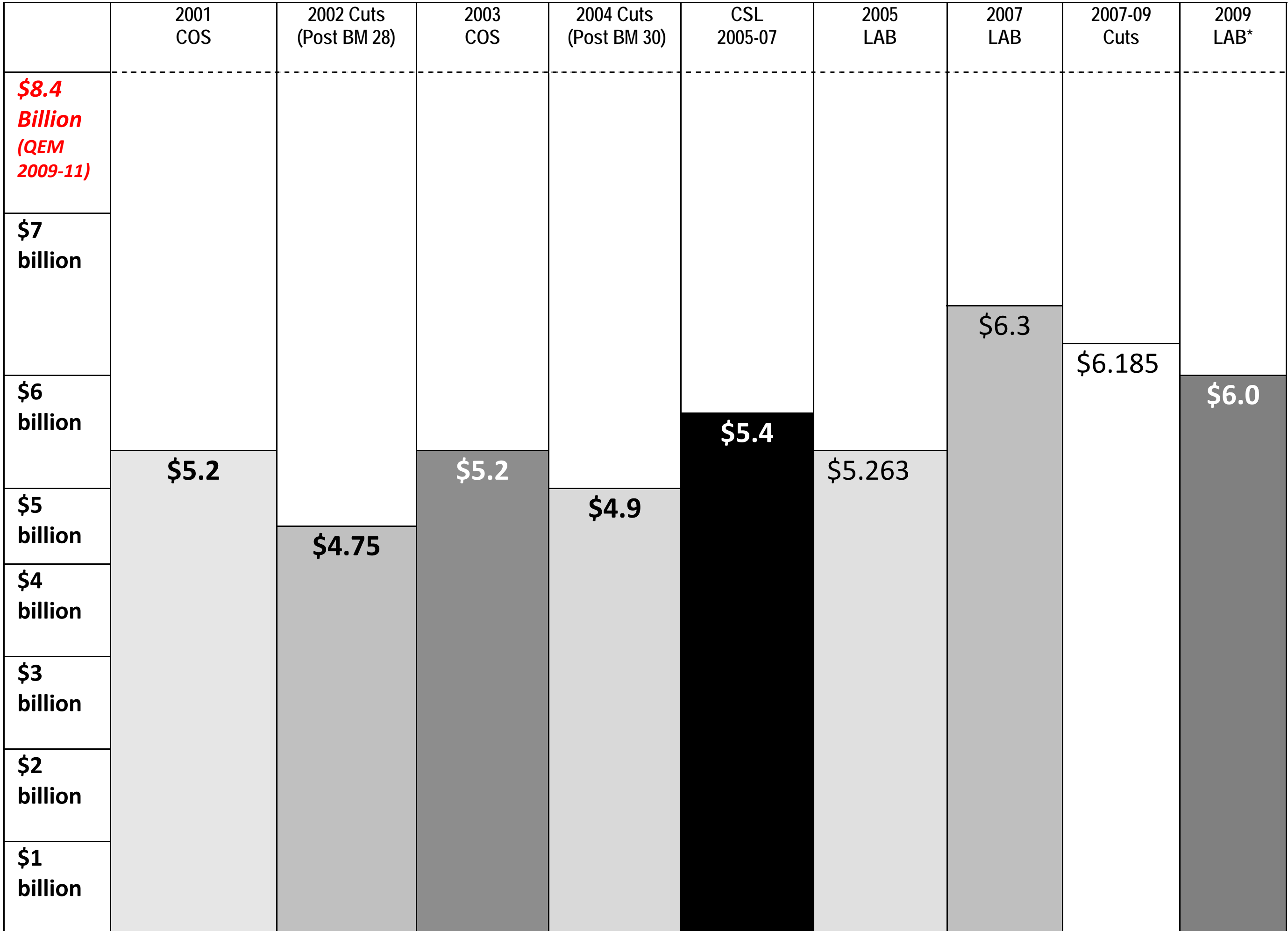
Voters then passed in 2000 Ballot Measure 1, which was championed by Gov. John Kitzhaber as the "Educational Equity and Accountability Act". It passed by a healthy margin in each of Oregon's 36 counties. Measure 1, which is now a part of Oregon's Constitution (Article VIII, Section 8), called for two things. First, it promised state matching resources to low-property-wealth communities that passed local option levies for their schools. Second, it required for the first time that each legislature pass a budget for K-12 that meets the test of adequacy, as defined by state law. In addition to mandating adequate school funding, voters demanded that the governor and legislature produce a biennial report to Oregonians revealing whether they had complied with this mandate, and if not, why not.

In 2001, the Legislative Assembly created the Quality Education Commission (QEC) to serve as a permanent body designated to update and improve the QEM. It is the biennial study of this group that produces the adequacy number against which the Legislature's report is compared. Among its recent accomplishments are the establishment of broad-based panels to examine the best practices in Oregon's most successful schools, research on the level of resources needed to implement the new Oregon Diploma successfully, and a report on the cost implications of proposed revisions to Oregon's model of highly effective schools.

In the several reports published since these laws' enactments, the state has never achieved the required funding adequacy. The closest Oregon came to sufficiency was with the close-of-session K-12 appropriation in 2007 of $6.3 billion, which was 20 percent shy of full funding. The 2009-2011 appropriation is 31 percent short.

In 2006, a group of 18 plaintiff school districts and parents on behalf of their children filed a lawsuit against the state for failure to meet the mandate in Ballot Measure 1. OEA became a key funder of the legal effort to establish the state's obligation for full funding. In February 2009, the Oregon Supreme Court ruled in favor of the plaintiffs, agreeing that a constitutional funding adequacy mandate exists and that legislators had failed to follow it. The Court did not, however, award financial relief because Ballot Measure 1 did not prescribe a remedy for violations or a sanction for failure to comply.

Actual Funding Levels



COS = Close of Session Appropriation
CSL = Current Service Level (*the amount needed to operate from biennium to biennium at the same program level*)
* Depending upon economic forecast holding steady and Tax Fairness package enactment by Jan. 26, 2010.

The chart above reflects the funding for Oregon's public system of K-12 schools and education service districts since 2001. These are expressed in actual, not inflation-adjusted, dollars. This chart also does not reflect enrollment changes that drive costs upward. The actual performance of these erratic budgets would look even more volatile if per-student inflation and enrollment data were edited into the allocation on a per-student basis.

Oregon's Tax System

By the 1960s, most states in the U.S. had evolved their revenue systems to include three major tax sources – commonly referred to in Oregon as "three legs on a stool". These included a general sales tax, an income tax, and a property tax. Each contributes different attributes to the whole, and each mitigates the liabilities of the other (for instance, the stability of the property tax offsets the volatility of the income tax, and the fairness of the income tax offsets the regressivity of both sales and property taxes). After passing an income tax in 1929, Oregon chose not to adopt a general sales tax, as 45 other states ultimately did by the 1930s. That left Oregon's revenue system dependent on comparatively high income and property taxes and, when property tax limitations were enacted, caused a level of extreme volatility (instability) in Oregon's primary revenue source – the income tax.

Prior to 1990, most tax reform efforts sought to add that third leg to the stool – a general retail sales tax – and most such proposals coupled the introduction of this option with a property tax reduction. As the table on pages 17-19 shows, nine such efforts in Oregon since the 1930s have failed at the ballot. After the first of three property tax limitations – Ballot Measure 5 – was passed by voters, then-Governor Barbara Roberts launched an extensive "Conversation with Oregon" to determine what services citizens valued and needed and what revenue reform options they might support. Out of that effort, yet another sales tax plan was referred to the voters as Measure 1 in 1993. OEA invested $1 million in the "yes" campaign to enact this measure dedicated to education and providing property tax relief. In initial polling, the measure was supported by a 75 percent margin. By the time the vote was taken, the measure was defeated by 75 percent. Only three years later, the second of two more property tax reductions passed, without commensurate replacement revenue from another source.

On top of these events were the enactments of various voter-passed mandates, such as Measure 11 (which added significant public safety-related costs to the state budget). As noted in the Revenue Restructuring Task Force report of 2008, "the cumulative effect of these initiatives on state discretionary spending…has been dramatic," leading to an ongoing structural deficit demanding resolve.

Legislators and other policymakers, as well as advocates for a wide range of essential services, have collaborated in various ways, particularly in the past 15 years, to brainstorm ways to improve the Oregon tax system. Advocates for change have come to the table with various motives. In addition to those calling for greater total revenue for more adequate funding, issues such as fairness, simplicity, ease of administration, economic impact, and predictability have been goals of some change agents.

It would be difficult, even starting from scratch, to design a system that could accomplish all of these goals. Simple tax systems are often unfair, because they don't anticipate or account for real-life exigencies. Stable tax systems are also unfair if they achieve stability through over-reliance on property taxes, which do not account for one's ability to pay. Income tax systems – which can generate revenue at a pace faster than the growth of the economy in good times (economists call this "*elasticity*") – are also the fairest when designed with vertically progressive rate structures that place most of the taxpaying responsibility on those with the greatest wealth and incomes. On the other hand, they are the most volatile, because they fall fast and hard in recession. Increasing the share corporations pay makes sense on a fairness basis, but corporate taxes are some of the most volatile of income taxes that flow to the state's General Fund. Supply-side economics advocates also insist that high corporate taxes hurt the economy, dissuading the location and growth of businesses (and jobs)

instate. This last point – that corporate taxes hurt the economy – has been researched and refuted by Nobel-winning economists George Stiglitz (former head of the World Bank) and Peter Orsatz (President Obama's budget director). NEA's economist Richard Sims, who has worked on revenue projects for OEA, has also testified to the Oregon Legislature about the fallacies of this theory. See pages 20-21 for details.

The Task Force on Comprehensive Revenue Restructuring, a blue-ribbon panel appointed by Gov. Ted Kulongoski that met in the 2008 interim, produced a report that led to little substantive policy change in the 2009 legislative session. Like its predecessor task forces – some legislative, some gubernatorial creatures – excellent thinking, testimony, policy ideas, analysis, and recommendations made their way into the final report, but political and economic circumstances conspired to leave the *status quo* relatively untouched. Only a biennium prior, an interim revenue reform task force met and held hearings around the state of Oregon to take citizen testimony. It, too, produced a report in 2006 ("Interim Senate Revenue Options Committee Report"). Another task force populated with stellar thinkers and policymakers met in 2002 and produced a document entitled "Revenue Options, School Funding and Accountability Task Force Report." In all, three pages of reports on the Legislative Revenue Office's publications page list study upon study of what works, what does not, and various options for change.

The 2008 Revenue Restructuring group, on which OEA's Executive Director served, heard from the Association about its ideas. Those concepts, as well as that of others, are spelled out in "The Path Forward" chapter, on pages 20-24.

The most significant task force findings are outlined here:

- The state revenue system, dominated by the personal income tax, remains highly volatile over the short-term. This makes it difficult for the state to maintain an adequate level of public services during economic downturns. State policymakers have taken major strides to offset revenue instability by the creation of the Education Stability Fund (2002) and the Rainy Day Fund (2007) but risks to major programs remain substantial in the event of future recessions. With the state economy now in recession, the adequacy of the state's reserve funds takes on added relevance and urgency.

- Oregon's General Fund budget has been forced out of balance in the past by passage of voter initiatives that either mandate new program expenditures without new revenue or reduce revenue without specifying offsetting revenue increases or desired program reductions.

- Because state revenue makes up roughly two-thirds of K-12 operating revenue, school finance remains especially vulnerable to the volatility of the personal income tax.

- The state has a well-developed system of short-term expenditure and revenue analysis but does not systematically factor long-term trends such as demographic changes and structural revenue changes into the planning process.

- Property tax revenue is largely set by Measure 50 and property tax revenue growth is independent of the rate of inflation. This means that local governments are put under significant stress when the inflation rate rises above 5 percent, such as it has over the 2006-08 period.

- Measure 50 creates inequities in the property tax system by separating assessed property value from market value. Homeowners pay taxes based on their assessed value, not the market value of their property. This means that homeowners in high-growth real estate markets will tend to pay a lower percentage of the value of their home in taxes than those in low-growth real estate markets.

Acknowledging that the 2009 Legislature would have its hands full just coping with the 2008-2009 recession, the task force nevertheless repeated the recommendations that so many others before them have put forth. Noting that the current revenue system is inadequate to fund "needed services such as high-quality education, infrastructure, and the needs of an aging population", the task force urged policymakers to consider the job of at least "settling on an overall level of adequacy" as a critical first step to tax system reform. It also called for meaningful involvement of the public prior to offering changes for the long term. The task force warned:

> "This is a critical time for Oregon. Our ability to continue to provide the level of services and programs from high-quality education kindergarten through university, to a transportation system that is adequate to support economic growth across the state, to a health care system that is ready to meet the demands of an aging population, to police and safety services that keep our communities safe and beyond, is stressed."

So how does Oregon's broken tax system stack up to the systems of other states?

Oregon Revenue: Comparative Data (Pre-2009 Legislative Changes)

Taxes play a particularly important role in state and local revenue systems because they are the primary source of revenue for general public goods such as education and public safety. Taxes also potentially have the largest impact on economic activity (according to the economists of the Legislative Revenue Office) "because they represent a direct extraction of resources from the private sector for use by the public sector".

Oregon's overall state and local tax "burden" (an economic term) ranks 34th on a per-person basis. Anti-tax activists often use different data to reflect a less favorable picture of Oregon's tax climate. To set the record straight, there are other measures that one may also point to. From the Legislative Revenue office, here are a few examples:

According to 2005-2006 data, Oregon's overall state and local revenue ranks ninth-highest among the states at $9,794 per person. This relatively high ranking is due, however, to a large amount of revenue in the insurance trust category. The state's high ranking reflects issuance of pension obligation bonds during this period (revenue from bond sales is included) and the existence of a state-operated workers' compensation fund. When only general revenue is considered (excluding the insurance trust and government enterprise categories), Oregon's revenue totals $6,930 for a ranking of 27th in the nation.

If federal revenue is excluded state and local revenue is $5,462, which puts Oregon in 29th place among states for revenue generation. Approximately 34 percent of these in-state resources come from taxes. Only two states (Alaska and Mississippi) have a smaller percentage of their state revenue derived from taxes. Oregon state and local governments collected $3,360 per person in taxes in the 2005-06 fiscal year. This accounts for the state ranking, mentioned at the outset, of **34th in overall per-person tax share**. Oregon ranks near the middle of the states in federal revenue, receiving $1,468 (this category does not include federal funds going directly to individuals such as Social Security benefits). Oregon is relatively dependent on charges for services, ranking 10th with $1,328 in revenue per person. We also rank relatively high in the miscellaneous and government enterprise categories. The state's extensive use of lottery revenue accounts for the former while the existence of a state-run liquor enterprise is a major factor in the latter.

Because the state is highly dependent on the progressive (fairer) personal income tax, the per-person share is among the nation's highest for this particular element of the revenue system, at $1,500 per person. By contrast, **the ranking for corporate income taxes and property taxes is similar to the overall rank for taxes (34th place)**.

Oregon is one of just five states in the U.S. without a general retail sales tax and ranks 45th in selective sales tax collections per person. Selective sales taxes (or "excise taxes") are levied in Oregon on gasoline, tobacco, alcoholic beverage, real estate transfers, and other specific purchases. One last tax category includes severance taxes and certain transportation taxes such as Oregon's weight-mile tax on heavy vehicles.

Another way to look at this same comparative revenue data is to divide the revenue numbers by total state resident income (a measure of the size of the state's economy), instead of by population. In some cases, the two measures can give very different rankings. In terms of tax burden, Oregon's ranking falls from 34th to 38th when personal income is substituted for population.

Historical Comparisons: Rankings are a Moving Target

Oregon taxes have changed relative to other states over the past 25 years. Oregon's tax burden consistently ranked between #10 and #20 from 1982-1983 through 1993-1994, slightly lower on a per capita basis. The phase-in of lower property tax rates under Measure 5 (passed in 1990) and lower assessed values under Measure 50 (1997) eventually pushed the state's tax burden to #45 in 1998-1999. These measures lowered Oregon's property tax burden rank from #5 in 1989-1990 (as a percent of income) to #28 in 1998-1999.

Two Percent Kicker Law: A Fly in the Revenue Ointment

Another unique feature of Oregon's revenue system is the 2 percent surplus kicker. The kicker was approved by the 1979 Legislature as part of an overall fiscal reform package. The package, which included property tax relief and a spending limit, was approved by voters in the spring of 1980. In 2000, voters passed a legislative referral that put a large portion of the kicker statute into the state constitution (Article IX, Section 14). The kicker has wreaked havoc on legislative attempts to fairly fund essential services and to cope with economic downturns. No other state has this feature, but in past ballot attempts to delete it, Oregonians have resisted the proposition of giving up what too many see as an entitlement.

The kicker law divides all General Fund money into two pots: (1) corporate taxes and (2) personal income taxes plus all other revenues. At the end of each biennium, if the actual income taxes received by the state in either of these two pots are more than 2 percent higher than was predicted at the close of the regular session, then the entire unanticipated overage must be paid to taxpayers associated with that "pot". If a kicker is triggered in the personal income tax pot, all the money in that pot in excess of the close of session forecast, including the 2 percent, is sent to taxpayers by December 15th of the year the biennium ends. Unanticipated revenue in the corporate pot is taken as a tax credit against the next year's tax liability. The credit is calculated as a proportional reduction in the taxes of each corporate taxpayer.

The estimate upon which the kicker calculation is based can be increased, thereby reducing or eliminating the kicker refund/credit, on a one-time basis if an emergency is declared and approved by a

two-thirds vote in each chamber of the Legislative Assembly prior to the end of the biennium upon which the kicker calculation is based.

Faced with Measure 5-related budget problems, the legislature suspended the kicker in 1991 and 1993. Kickers would have triggered in just one of the two pots in each of those biennia. The 1995 personal income tax refund was the first one paid by check. Prior to 1995, the personal kicker was paid through a tax credit like the corporate kicker. Large corporate kicker credits were applied following the 1993-1995 and 1995-1997 biennia. Corporations were not eligible for a surplus credit for the next three biennia after that. Corporate income tax collections exceeded the forecast by $101 million in the 2003-2005 biennium, leading to a 35.9 percent credit on 2005 corporate income tax returns. The excess corporate revenue occurred despite the defeat of the recession-related temporary tax referendum, Measure 30, in January 2004.

Personal income tax kicker refunds were distributed four biennia in a row, starting with the 1993-1995 biennium. These refunds averaged 7.8 percent, with the largest (14.4 percent) following the 1995-1997 biennium. The 2001 recession depressed non-corporate General Fund revenue well below forecast in 2001-2003 and the failure of Measure 30 held non-corporate revenue $401 million below the close-of-session projection for the 2003-2005 biennium.

The largest personal kicker refund was paid to taxpayers following the 2005-2007 biennium. A total of $1.071 billion (18.6 percent) of pre-credit tax liability in the 2006 tax year was sent to taxpayers in the fall of 2007.

Also in 2007, the legislature redirected the corporate kicker credit to the newly established general-purpose Rainy Day Fund. The 2007 Legislature also modified the personal income tax refund process by basing the calculation on before-credit tax liability, rather than after-credit liability. This change affected the distribution of the refund but did not affect the amount. Finally, the legislature changed the tax year upon which the corporate credit is based (from the current year to the prior year, to bring the corporate calculation into line with the personal refund calculation).

For the 15 biennia in which the kicker has been in effect (1979-1981 through 2007-2009), the personal income tax trigger has been exceeded nine times. Kicker refunds/credits were distributed on eight occasions and suspended once. Six times revenue has fallen short of the 2 percent personal income tax trigger. For the corporate calculation, actual collections have exceeded the trigger nine times and fallen below six times. Of the nine times in which the corporate trigger was exceeded, the kicker was credited to corporate taxpayers six times and suspended three times, the last time for the purpose of capitalizing the new general-purpose rainy day fund in 2007.

There are two ways under serious consideration to remedy the problem of the kicker. First, the arbitrarily set trigger of 2 percent does not reflect real-world experience by economists attempting to guess how much money will be produced by Oregon tax policy over a two-year period. The average error rate is closer to 7 percent. Enabling the kicker to trigger only after that threshold would be one way to improve the law without totally abolishing it. A second proposal would capture the difference between the expected revenue as forecasted and the actual revenue received and use those unanticipated dollars to capitalize the general Rainy Day Fund. The kicker could still be sent out if the unanticipated revenues were to exceed the 7 percent trigger. A proposal to revise the kicker law may

be introduced as a legislative referral in the February 2010 Supplemental Legislative Session and would appear on the November 2010 ballot for voter approval.

Tax Loopholes: Another Budget Buster

OEA has long argued for meaningful scrutiny of the 380 tax breaks individuals and corporations may take to reduce the income and property taxes they pay in Oregon as a way to create more state revenue for the General Fund. These deductions, subtractions, credits, and other forms of lessening taxable income are called "tax expenditures" because they essentially "purchase" a policy goal or inducement in the same way a budgeted program seeks to spend resources to pay for services. More than half are based on the federal tax code and Oregon's connection to it by referring to its definition of income as a starting place for Oregon taxation. Our state's dedication to this means of accomplishing its policy objectives far outpaces its use of tax dollars for services. According to the 2009 *Oregon Tax Expenditure Report*,

> "For the 2009–11 biennium, total tax expenditures will result in the 'spending' of about $30.9 billion through Oregon's tax code. Over the same period, the state of Oregon and local taxing districts will collect roughly $26.2 billion in taxes for spending on various state and local programs. This indicates that governments in Oregon 'spend' more through special provisions in the tax code than they do through direct outlays."

In other words, **Oregon collected only 46 cents on every state and local tax dollar levied**. The other 54 cents for the 2009-2011 biennium is dedicated to tax breaks.

Beginning in 2001, the Oregon Education Association teamed up with progressive allies to pursue this issue in the legislature. OEA and its partners at Service Employees International Union (SEIU) and the AFL-CIO created an *ad hoc* coalition dedicated to revenue reform. Among its first work products (in 2003) was a comprehensive analysis of the tax expenditures and the rationale for greater scrutiny and accountability of all. You can read "A Primer on Tax Breaks in Oregon" (March 2003) on the OEA website at http://www.oregoned.org/atf/cf/%7B3F7AF7EC-F984-4631-A411-148CD1FB8421%7D/tax_break_03.pdf.

The 100+ members of the *Oregon Revenue Coalition* have, in five regular legislative sessions, called for the cancellation of some tax breaks and urged the legislature to stop enacting most new ones, given that each new break further erodes the base of total tax payers and increases the tax burden on those who do pay taxes. Fairness and revenue adequacy have been guiding principles of this effort. As a result of ORC's work, legislative revenue committees have in the past two sessions enacted rules for assessing new tax break proposals, have cancelled some tax expenditures, have disconnected from a few large federal tax breaks, and have put Oregon tax credits on a six-year rotating sunset and review process. As each group comes up for policy scrutiny, a high-priority public purpose for the break will have to be demonstrated or else the tax expenditure will expire without reauthorization.

Corporate Tax Transparency

Another of the Oregon Revenue Coalition's successes was to elevate the issue of the low corporate minimum tax in Oregon. Unless the 2009 Tax Fairness Package is defeated, a long-standing unfairness of Oregon's revenue system will finally be corrected – that of the $10 per year tax paid by two-thirds of corporations doing business in Oregon. Originally set at $25 in 1929, Oregon's minimum tax was designed to extract at least a *minimal* payment from businesses, even in unprofitable years, for the

privileges and services they receive from state and local governments – roads, public safety, a well-educated workforce, and so on. Once the Great Depression hit, the $25 minimum was reduced to just $10, where it has stayed for 78 years, never having been adjusted even for inflation. In fact, it costs the state more to collect the tax than the $10 received.

When corporations – especially C corporations that file the corporate excise tax of 6.6 percent on profits from in-state sales only – calculate their Oregon tax liability, they are allowed to deduct all business expenses, salaries, and specialized tax breaks to reduce the final amount upon which the tax rate is assessed. Most – 66 percent – are able to reduce their profits to zero for tax purposes, which enables them to pay Oregon only $10 a year. Because these same corporations continue to do business in this state year after year, and yet record "zero" taxable profits to the state, some tax reform advocates began to ask whether these same enterprises were also claiming to their shareholders that they were unprofitable year after year. This question reached statewide prominence in 2005 when Portland General Electric was found (through federal SEC filings) to have avoided paying nearly $1 billion in taxes during its association with parent company Enron. PGE paid the corporate minimum tax in Oregon and putatively "sent" its profits to Enron's Texas corporate headquarters.

Under Oregon law, tax information is confidential. Only a limited number of tax-related professionals may access corporate filing data. In the effort to redesign the state's tax system to generate adequate revenues and to balance fairly society's tax responsibility among all classes of taxpayers, advocates have long argued that corporations ought to disclose certain information about the taxes they pay.

In 2006, OEA and its allies launched a signature drive to put corporate tax disclosure on the ballot. Oregon's business community strongly opposed this effort. The association ultimately struck a deal with key business leaders to collaborate on the defeat of two tax-cutting measures headed for the same ballot in exchange for withdrawing the disclosure initiative. Nevertheless, several legislative proposals to require corporate accountability and transparency have been introduced in each of the last three legislative sessions. Supporters of this movement argue that Oregonians would be more apt to support a ballot measure reforming Oregon's tax system if they knew how little businesses paid in state taxes compared to individuals and families. This idea remains a viable option for future consideration, though it is regarded by the business community as a "nuclear option".

Revenue System Timeline

Some of the Key Events in Oregon's Tax System and School Funding History

1859	In the early days, public services were funded only by a **statewide property tax**. *(The state property tax is still in the Constitution; it is no longer levied, however.)*
1916	In this year, a tax revolt placed a 6% **limit on** the amount of **property tax** a local body could impose.
1923-1929	In the 1920s, Oregon instituted an **income tax** to fund a greater demand for public services as Oregon shifted from rural to more urban communities. It was enacted legislatively in 1923, repealed in 1924, proposed on the ballot three more times – each time defeated – and then passed once the Depression hit in 1929. It was designed solely **to offset property taxes**.
1933	The first **sales tax** was proposed and was defeated at the polls.
1934	A second **sales tax** proposal was defeated at the polls.
1936	A third **sales tax** proposal was defeated at the polls.
1944	A fourth **sales tax** proposal was defeated at the polls.
1947	A fifth **sales tax** proposal was defeated at the polls.
1953	In this year, the use of the income tax changed. The **income tax was redirected** to the state's General Fund and began funding schools, instead of simply funding property tax relief.
1969	• In this year, the state **income tax** is tied to the calculation of the federal tax – "**connecting**" Oregon's taxable income to the IRS return and its more generous **tax breaks**, which threatened to reduce state revenues. To compensate for this, Oregon adjusted the tax brackets and rates. The brackets were narrowed and the rates were generally adjusted upward, with a heavier burden falling on low-income taxpayers. The rate climbed to about the average household income and then decreased for the higher-end of the range, making the state income tax particularly regressive. • Also in 1969, a sixth **sales tax** was proposed and defeated at the polls.
1973	The legislature passes a school finance program that included a limitation on how much of a taxpayer's **federal tax** could be **deducted** from the state tax return. The limit was set at $3,000 for a joint state income tax return.
1970s	The Homeowners and Renter Relief (HARRP) and the Property Tax Relief programs were passed. The HARRP Act provided **property tax relief** to low-income homeowners and renters. The Property Tax Relief Program limited growth of assessed value of all property in the state to no more than five percent per year and also provided that the state General Fund pay up to 30% of local residential property taxes – capped at $800 per low-income homeowner and $400 per low-income renter. This 1978 measure was part of a three-part deal that also included the **two-percent "kicker"** and the first **state spending limit** law. On the income tax side, the measure increased the **personal exemption** from $750 to $1,000, adjusted it to the Portland CPI, and also increased the maximum **federal deduction** up to $7,000 of taxes paid.
1980s	The expensive three-part tax package fell apart during the 1980s because property taxes continued to grow and the legislature's resources were severely reduced by 1982 recession. In response, the legislature enacted a temporary **income tax surcharge**, which was not challenged by referendum and allowed policymakers to balance the budget. The **property tax relief** payments were discontinued in 1985. (After Measure 5 passed, the 1991 Legislature eliminated the **HARRP** program.)
1984	Oregon **lottery** was created by a vote of the people. Originally, the proceeds were dedicated only to economic development.
1985	A seventh **sales tax** proposal was defeated at the polls.
1986	An eighth **sales tax** proposal was defeated at the polls.
1990	• A **sales tax** "advisory proposal" was referred and defeated at the polls – the ninth such defeat on a retail consumption tax. • **BM 5** passed, however. It placed a rate **limit on property taxes** for corporate and residential property owners. This limit of $15 per $1,000 of assessed value routed $10 to local governments and $5 to schools. The intention of the sponsors was to limit the total amount of taxes collected on property. Two factors conspired to undermine this result. The first was the pre-existing constitutional provision that allowed up to a 6% increase per year in property taxes. The second was a rapid increase in overall property values during the 1990s, as Oregon's economy boomed and the silicon forest industry moved in new high-tech workers, which corrected the housing market upward. Another impact of BM 5 was that it required the legislature to replace schools' revenue losses caused by the rate limit.

1992	A **split-roll property tax**, which would have assessed corporate and residential property at different rates, was defeated at the polls.
1995	Voters pass constitutional amendment allowing **lottery** proceeds to be used to finance public education.
1996-1997	• Voters passed **BM 47**, which **reduced property taxes** by 10% **and limited future increases** to 3% per year. It also created the "**double-majority requirement**". • Because the measure was poorly written, the 1997 legislature rewrote the measure and sent it back to the ballot as **BM 50**, which passed in May of 1997. It **limited the assessed value of all property** to a 1995 level minus 10% and allowed for short-term **local option levies** (for schools) up to the $15 per $1,000 of assessed value level. It retained the **double-majority requirement** for constitutional (property tax-related) revenue measures.
1998	Parks and natural resources are added as **lottery** beneficiaries in a vote of the Oregon electorate.
2000	• Voters passed a ballot measure that **increased** the amount Oregon taxpayers could **deduct of federal taxes** paid to $5,000. Another, more extreme measure sponsored by Bill Sizemore, would have made **all federal taxes deductible**, erasing the ceiling entirely at all income levels. That measure was defeated by voters. • Voters also defeated in the May 2000 primary a constitutional amendment to make certain local taxing districts' **temporary property tax authority permanent**. (LOOK UP M77) • Election 2000 also ushered in a five-year era of **spending limit** proposals. The first of these, BM 86, constitutionalized the **"kicker"** statute of 1979, which in effect enacted a constitutional spending limit in that all unanticipated state revenues beyond a two-percent margin of error must be returned to taxpayers rather than appropriated for programs or put in reserves. A more specific **measure limiting** the state's **appropriations** to a percent of prior personal income levels was defeated. • A measure to **require voter approval** of most tax and fee increases – and **by a supermajority** margin – was defeated in the November 2000 general election. • Ballot Measure 1 (now Article VIII, Section 8 of the Oregon Constitution) passed. This "Educational Equity and Accountability Act" ensured that the **state would match local option levies** that passed in low-wealth communities. It also mandated the **legislature to adequately fund K-12** public education. A report to the people on the biennial appropriation was made part of the funding requirement.
2002	• In a September special election in the middle of the recession of 2001-2002, voters amended the Constitution to create an **Education Stability Fund** and capital subaccount for use in economic downturns on Pre-K through 20 public education budgets. • In that same special election, voters passed an increase in the **cigarette tax**, the proceeds of which were dedicated to health and related programs.
2003	• In the second of four consecutive special elections, a legislative referral to **temporarily increase income tax** rates across the board (all income groups) failed in January of this year by a vote of 575,846 to 676,312. • Legislative **spending limit proposals** (tied to inflation and population) were defeated in both the regular and subsequent special sessions.
2004	A second legislative attempt to rebalance the state budget after five special sessions and a portion of the 2003 session would have enacted a **temporary personal income tax surcharge** and also changed other taxes (including **canceling some tax loopholes**). This legislation was challenged by referendum and was defeated in a February special election by an even larger margin than the 2003 budget proposal had been (481,315 Yes to 691,462 No).
2006	Two ballot measures with state funding implications were defeated in the November general election. • BM 41 would have enabled Oregon taxpayers to **substitute higher federal exemption level** as a substitute for the state exemption credit. • BM 48 would have imposed a Colorado-style "TABOR" **spending limit**. Taken together, these measures would have crippled General Fund resources and investments in vital services.
2007	• General-purpose **rainy-day reserve fund** was created by legislature. It was funded on an ongoing basis with ending balances not to exceed 1% of General Fund. A one-time cancellation of the **corporate "kicker"** was also deposited in the fund. • A second **tobacco tax increase** dedicated to health care is defeated in an off-year special November election.
2008	Two ballot measures that would have reduced revenues for education were again on the general election ballot.

	• BM 59 **erased the ceiling on deductibility of federal taxes** (as in the failed Election 2000 measure). • BM 62 rerouted 15% of **lottery proceeds** to public safety. Those monies – more than $6 billion since 1985 – are constitutionally dedicated to economic development, education, parks and natural resources, and the Education Stability Fund. Voters defeated both measures by nearly a two-to-one margin. • Voters revised the **double-majority** turnout requirement for property tax measures, reinstituting simple-majority as the sole threshold for regular (May and November) elections.
2009	The greatest economic decline since the Great Depression results in the loss of $4.2 billion of General Fund resources. Legislators balance the budget for education, public safety, and health (95% of what GF resources pay for) by making strategic cuts, using increased federal funds, tapping reserves, and creating a modest gap-closing **tax package**. Learning from previous recessionary tax proposal defeats, this tax package was designed to be fairer to middle-class and low-income families and made only modest and in part temporary rate adjustments to high-earning taxpayers and corporations. The package also corrected the unconscionable **minimum corporate tax of $10**, the amount paid by two-thirds of C corporations doing business in Oregon (instead of the annual profit-based rate of 6.6% of in-state sales). The flat fee of $10, set in 1931, was replaced with a sliding scale based on gross receipts. This measure was also challenged through the referendum process.
2010	January 26 is the date for the referendum vote on the legislature's **Tax Fairness package**.

The Path Forward

How will the long journey to state revenue adequacy end? There are many who believe that the goal of school funding adequacy is unattainable, and to that end, they prefer to ratchet down their ambitions for public education. OEA members, however, retain the hope and vision of a significantly improved system that makes good on the promise of educational quality and opportunity for every student.

Several recent studies have demonstrated that a state's investment in public education yields unexpected results for other aspects of the economy, which should give even greater impetus to the movement for meaningful reform. Among these is a study commissioned jointly by the Oregon Education Association and the Oregon School Boards Association in 2002 which demonstrated a 1:9 return on investment in terms of job creation. In that study (which may be found at http://www.econw.com/reports/education4192.pdf or on the OEA website at www.oregoned.org/funding), it was shown that both increases and cuts have immediate fiscal implications for Main Street businesses, particularly in rural and small-town Oregon, where typically the school district is the largest employer. Indeed, Oregon's school districts, taken *in toto*, are the second-largest employer in Oregon. If policymakers care about the financial fortunes of Nike and Intel, they should feel just as passionate about ensuring the fiscal health of our public schools.

Other research validates this point and also refutes an article of faith that raising taxes causes economic harm to a state. Economists George Stiglitz and Peter Orsatz won a Nobel Prize for their work demonstrating that when state governments use the increased tax increment to invest in essential services (such as education), the outcome lands the state in better stead than if the state's budget was resolved by cutting those programs. (The full text of this study is available at http://www.cbpp.org/10-30-01sfp.htm.) The Center on Budget and Policy Priorities excepts the significant arguments made by the authors on this point:

> "[E]conomic analysis suggests that tax increases would *not* in general be more harmful to the economy than spending reductions. Indeed, in the short run (which is the period of concern during a downturn), the adverse impact of a tax increase on the economy may, if anything, be smaller than the adverse impact of a spending reduction, because some of the tax increase would result in reduced saving rather than reduced consumption. For example, if taxes increase by $1, consumption may fall by 90 cents and saving may fall by 10 cents. Since a tax increase does not reduce consumption on a dollar-for-dollar basis, its negative impact on the economy is attenuated in the short run. Some types of spending reductions, however, would reduce demand in the economy on a dollar-for-dollar basis and therefore would be more harmful to the economy than a tax increase….
>
> "The more that … tax increases or transfer reductions are focused on those with lower propensities to consume (that is, on those who spend less and save more of each additional dollar of income), the less damage is done to the weakened economy. Since higher-income families tend to have lower propensities to consume than lower-income families, *the least damaging approach in the short run involves tax increases concentrated on higher-income families.* Reductions in transfer payments to lower-income families would generally be more harmful to the economy than increases in taxes on higher-income families, since lower-income families are more likely to spend any additional income than higher-income families. Indeed, since the recipients of transfer payments typically spend virtually their entire income, the negative impact of reductions in transfer payments is likely to be nearly as great as a reduction in direct government spending on goods and services.
>
> "*For states interested in the impact only on their own economy rather than the national economy, the arguments made above are even stronger*. In particular, the government spending that would be reduced if direct spending programs are cut is often concentrated among local businesses…. By contrast, the spending by individuals and businesses that would be affected by tax increases often is less concentrated among local producers — since part of the decline in purchases

that would occur if taxes were raised would be a decline in the purchase of goods produced out of state. Thus, more of the reduction in purchases that results from tax increases than from government budget cuts falls on out-of-state goods (relative to in-state goods), lessening the adverse impact of a tax increase on the state economy. Reductions in direct government spending consequently could have a larger adverse impact on a state's economy than tax increases, which have a stronger adverse impact on out-of-state goods and services.

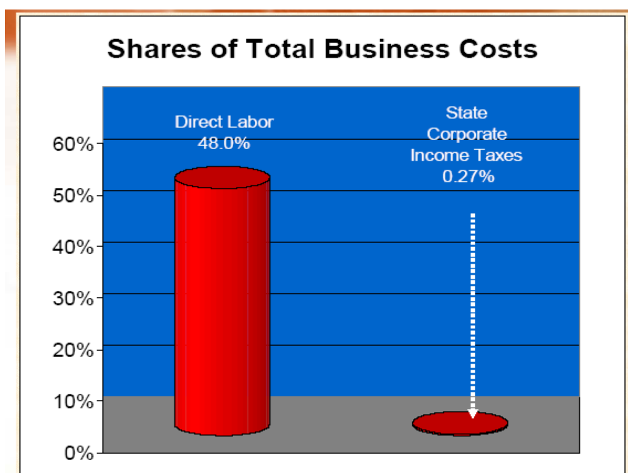
"The conclusion is that, *if anything, tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run*. Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy in the short run than tax increases focused on higher-income families. In any case, in terms of how counter-productive they are, there is no automatic preference for spending reductions rather than tax increases." [emphases added]

Dr. Richard Sims, NEA Economist, reached similar conclusions in research he performed for OEA in 2007 (www.oregoned.org/funding) . He found that

"Education spending creates jobs and income directly, through the employment of educational resources, and indirectly, as the effects of that initial spending reverberates through the economy.

"The results of this analysis, which was conducted using an economic model of the State of Oregon, show that spending $275 million in additional funding for K-12 education would produce an increase of around 12,000 to 13,000 jobs and an increase in Gross State Product of between $326 million and $346 million in each of the next five years."

Sims presented a summation of his research to the 2007 Oregon Legislature on a related question as well: is a low-business-tax state likely to experience a thriving economy, as business lobbyists often suggest, or are the most prosperous states also high-tax states? In his presentation, Dr. Sims showed that the 10 fastest-growing states had an average corporate tax rate of 7.1 percent and the 10 slowest-growing averaged 6.25 percent. Oregon's growth (measured as per-capita personal income growth) landed it at 49th place in the nation. Our corporate excise tax rate is just 6.6 percent, which has caused Oregon to be labeled a "business-friendly" state. Sims pointed out that the two reasons state corporate tax rates don't really influence a business decision to locate or start up here is that the rates across all 50 states are not that far apart, and most importantly, the number-one cost factor in most businesses is labor, not taxes. Most corporate executives are therefore much more interested in locating in a state with good schools for their employees and a highly educated workforce available to hire. (See chart below.)



As research suggests, revenue reform dedicated to support of essential services that themselves have a stimulus effect on the economy can improve the quality of life not only for the education environment, but for communities throughout the state in the private as well as the public sector. If the structural deficit crippling Oregon's ability to fully serve its students throughout the Pre-Kindergarten through higher education enterprise is to be repaired, the knowledge of this added benefit should help to bolster the case for change.

As previously discussed, most attention in this state has been paid to three basic tax sources: income taxes (both personal and corporate), property taxes, and consumption taxes (especially the retail sales tax). Variants of these three have emerged as policy proposals in the legislature and on the ballot over the years, as well. These include the gross-receipts tax, the business activity tax, and the split-roll property tax. More novel still is a proposal that OEA brought to the 2008 Revenue Restructuring Task Force for its consideration. Our target at the time was to improve the state revenue yield by $1 billion per biennium ($500 million per year), but by setting the rate at a different level, more or less revenue could be generated from this approach.

The Franchise Tax

Working with Dr. Sims, OEA developed its proposal to reform corporate taxes and generate new revenue for the state of Oregon. Side-stepping the issue of corporate tax avoidance and use of loopholes, we proposed elimination of the corporate excise tax altogether in favor of a franchise tax, which has been used in at least two other U.S. states. A dozen more were considering a shift to this method in 2008. There are three basic ways to tax corporations. A state may base the tax on business sales volume (*Gross Receipts Tax*), it may base it on profits as Oregon does (*Corporate Income/Excise Tax*), or it may base its tax on investment (*Franchise Tax*).

Our reasoning for recommending the third option is the following:

- Corporate income taxes have been called "voluntary taxes" by economists because it's so easy to avoid paying them by claiming zero profits, by applying tax breaks, and by sending dollars out of state.
- A franchise tax, by comparison, taxes total capital investment (plant and equipment) and therefore encourages job creation (which isn't taxed) and boosts the economy.
- More money is thus spent in Oregon communities and less is paid to stockholders in the global capital market.
- While corporate income taxes have declined by more than 50 percent across the U.S., franchise tax revenue has actually produced a larger share of income for states in the past two decades. Profits-based taxes decline over time; investment-based taxes grow over time. As the economy grows, the franchise tax keeps pace.
- It doesn't "tax success". Businesses can plan, because investment is predictable, and it's neutral across most business types, eliminating industry bias.

How a Franchise Tax Would Work

Businesses would be taxed on their level of investment in any given tax year. The definition of investment is one that varies in the different states that have used this method. Oregon could

carefully craft a definition that favors home-grown industry sectors. To calculate the revenue one could expect from this simple proposal, we applied the following formula:

- Revenue from a franchise tax, based on gross non-residential fixed investment (including structures and equipment), can be roughly estimated to be 10.7 percent of U.S. Gross Domestic Product (GDP).

- Oregon's Legislative Revenue Office (LRO) applied this ratio to Oregon's Gross State Product (GSP), which was estimated to be $158,233 million for 2007.

- LRO then assumed a growth rate for GSP of 5 percent in 2008 and 2009 (not adjusted for inflation) to calculate a total GSP of $174,452 million in 2009.

- Non-residential fixed investment, using the national ratio, would be $18,666 million.

- If a 5 percent tax rate on gross investment were applied, $933 million would be generated for the 2009-2010 fiscal year. Corporate income tax collections are projected to be $425 million for 2009-2010.

NET REVENUE EFFECT: If the franchise tax replaced the corporate income tax, it would generate a net revenue increase of $508 million for the 2009-2010 fiscal year.

The Revenue Restructuring Task Force included this idea among the five proposals described as possibilities for reform in its final report. The Legislative Revenue Office ran all five proposals through its economic analysis tool, OTIM (*Oregon Tax Incidence Model*) to approximate the economic effects of implementation over a five-year period. LRO found that OEA's franchise tax would raise $1 billion a biennium in additional revenue, would increase employment in Oregon, would distribute the tax burden evenly, would be less volatile than the current corporate tax, and would substantially reduce administrative and enforcement costs to the state.

Other tax solutions reviewed by the task force included:

Scenario 1: Replace the state personal income tax with an 8.5 percent retail sales tax. The sales tax would exempt in-home food, shelter, insurance, utilities, manufacturing, agricultural inputs, private education, and items that are already subject to excise tax. **Net Revenue Gain:** None. In fact, because the sales tax is less elastic (grows more slowly) than the economy, over time it would bring in less revenue that the income tax. Furthermore, the sales tax is a regressive tax; the income tax is relatively progressive.

Scenario 2: Reduce the current personal income tax rates of 5, 7, and 9 percent down to 2, 4, 6, and 8 percent. Increase earned income tax credit to 50 percent of the federal. Establish a $50,000 homestead exemption and low-income renter relief program. Impose a 1.31 percent tax on business gross receipts. **Net Revenue Gain:** $150 million in 2011, but slightly less over time, due to lower elasticity of the gross receipts tax. The proposal's chief asset is an improvement in the ***stability***, not the ***adequacy***, of Oregon's tax system, at least at the proposed rate levels.

Scenario 3: Create a property tax homestead exemption for owner-occupied properties under $750,000 of assessed value and double the personal income tax brackets at which point the rates kick in. Impose a 2.7 percent retail sales tax with the same exemptions as those in Scenario 1. **Net Revenue Gain:** Approximately $170 million in 2011, with a slight positive gain over time because sales tax revenue is a bit more elastic than Oregon's "initiative-constrained" property tax. Advantages of this approach include a fall in housing costs, an increase in jobs and investment, and an increase in net household income once all tax-implementation adjustments are in place. This scenario also favors middle-class households. Its chief liability is that it does not generate sufficient revenue to solve Oregon's funding adequacy crisis.

Scenario 4: Replace Oregon's corporate income tax with a .3 percent value-added tax. **Net Revenue Gain:** None. This plan was designed to be revenue neutral. Additional deficits of this plan are that employment and population decline somewhat and the tax is borne primarily by in-state residents (as opposed to corporate, sales, and even some income taxes). Its compelling features are that it adds to system stability and would have some margin of long-run revenue growth (not measured in the five-year period). Only two states impose such a tax, though most other countries of the world use this model at their national levels.

Scenario 5: OEA's franchise tax, as described above.

Conclusion

As Oregon looks to the future, and considering its revenue conundrum, the state must think strategically about how best to serve Oregonians and how best to raise the money to do so. That is a conversation that, mechanics of various approaches aside, must include the engaged involvement of citizens prior to formulating a final plan. As research and many years of experience has shown, all scenarios will fail the ultimate test – political survivability at the ballot box – if the taxpayers of Oregon are not partners in the development of a plan for change.

APPENDICES

APPENDIX A:
Oregon School Finance: Current Status
Edited Excerpt From Oregon Legislative Revenue Office Publication
2009 OREGON PUBLIC FINANCE: BASIC FACTS
Research Report #1-09

Oregon has 197 school districts serving about 565,000 students in Kindergarten through high school. These districts operate with relative autonomy within guidelines specified by both the legislature and the State Department of Education. The federal government also requires certain mandated programs.

K-12 School Districts

Local Revenue
School districts receive general operating revenue from various sources. Property taxes are the primary source. Other sources include federal forest payments, county school funds, the state Common School Fund, and state timber sales. These local revenues are included in the school distribution formula and are about 32 percent of state and local formula operating revenue.

State Support
The Legislature through the State School Fund (SSF) provides about 68 percent of school formula operating revenue. This revenue is mostly from state income taxes and lottery revenue. The state's share increased from about 30 percent before Measure 5 (1990) to about 70 percent after Measure 50 (1997). State revenue replaced reduced local revenue because of these property tax limitations. Along with increased state aid, the school finance distribution method for state support changed dramatically.

Funding Equity
The 1991 Legislature adopted the school equalization formula and phased in its implementation. Equity as measured by the equalization formula applied to all school districts beginning in 2001-02. Past legislatures have also provided some funding outside the equalization formula. The 2007 Legislature provided funds for small high schools, special education, and other programs from the State School Fund outside the formula. Currently state aid and local revenue for school districts equals 95.25 percent of the statewide K-12 school and education service district (ESD) formula revenue for general operating purposes.

Equalization Formula
The SSF equalization formula allocates an amount to each school district based primarily on number of students. The state grant is equal to this formula amount reduced by local revenues. The formula equalizes revenues per student by removing past differentials caused by widely varying local tax rates and property wealth per student. To recognize that some students need more school services and their schools may face higher costs, the formula assigns weights to certain students. For example, special education students count as 2.0 students to recognize their need for special programs. Additional student weights are for English as a second language programs, students from families in poverty, remote small schools, and others. A general purpose grant per weighted student is adjusted for the experience level of teachers and set at a level that allocates available funding. The formula also funds 70 to 90 percent of transportation costs, costs above $30,000 per high cost disability student (limited to $18 million per year statewide) and up to 8 percent of classroom construction costs (limited to $25 million per biennium).

Local Property Tax Option
School districts may ask voters to approve temporary local option levies. Local option revenue is limited to the lesser of (1) the district Measures 5 and 50 tax gap, (2) 20 percent of formula revenue or (3) $1,000 per weighted student (2007-08). The $1,000 is indexed to increase 3 percent per year beginning in 2008-09. The levies may be approved for up to five years for operations and up to 10 years for capital projects. Local option revenue is in addition to equalization formula revenue.

Construction Tax Option
The 2007 Legislature granted school districts new taxing authority. School districts may impose a tax on new construction in the district. The tax rate cannot exceed $1 per square foot for residential use and $0.50 for nonresidential use. The maximum rates are indexed beginning in 2009. The tax on nonresidential use is also restricted to $25,000 per structure or

building permit, whichever is less. The legislation exempts affordable housing, public buildings, agricultural buildings, hospitals, private schools, non-profit senior living facilities, and religious facilities.

Education Service Districts

The school system also includes education service districts (ESDs). Twenty ESDs provide regional educational support services. The ESD share of statewide K-12 school and ESD general operating revenue is 4.75 percent. This includes both state aid from the State School Fund and ESD property tax revenue. Before Measure 5 (1990), ESDs received no state aid. Subsequently, state support helped replace reduced property taxes. The 2001 Legislature adopted a five-year phase-in plan to equalize ESD revenue. Those below the state ESD average revenue per student gradually received more and those above the average gradually received less. Final equalization began in 2005-06. Beginning in 2006-07, ESD revenue is 4.99 percent of the sum of component district formula revenue. This makes the ESD share of total ESD and K-12 school formula revenue 4.75 percent.

Community Colleges

Community college districts also impose property taxes and receive state aid. Unlike school districts and ESDs, community colleges have another major revenue source, tuition. Also, state support is not from the State School Fund. The legislature appropriates community college aid in a lump sum. The community colleges then allocate the state funds by administrative rule.

School Improvement Fund

The 2007 Legislature appropriated $260 million to the School Improvement Fund from the General Fund. School districts and ESDs may apply for funds and were paid $126.6 million in 2007-08. Funds are targeted for a number of uses to improve student achievement. The Department of Education has to evaluate the progress of district programs and report findings to the legislature. Each district's share of funds is its proportionate share of current-year extended average daily membership weighted (ADMw).

APPENDIX B:
History of the Income Tax in Oregon

Edited Excerpt From Oregon Legislative Revenue Office Publication
2009 OREGON PUBLIC FINANCE: BASIC FACTS
Research Report #1-09

In 1917 the Oregon Constitution was amended to allow a progressive income tax. In 1923 an income tax was adopted by the legislature and approved by a statewide vote. The tax was collected for only one year. A successful initiative petition repealed it in 1924. Subsequent to 1924, three initiative petitions and a legislative referral failed at the polls. The 1929 legislature adopted an income tax dedicated to reducing the state property tax. The tax was brought to a vote by referendum. It was approved by the voters in 1930. By 1938, the state property tax was completely offset by income tax collections, and except for 1940, no state property tax has been collected since.

Here are some major changes in the tax since 1929:

1933 First rate and exemption change, designed to offset depression revenue losses, increased bottom rate from 1% to 2% and top rate from 5% to 7%.

1939 Rates changed again, top rate still 7% but hit at $4,000 rather than $5,000.

1943 "Walker Plan" adopted, designed to cope with additional revenue from increased wartime economic activity, reduced tax liability 5% for each extra $1 million in taxes collected. The "Walker Plan" was modified in 1945, suspended in 1947 and repealed in 1949.

1947 Withholding on wages begins. Rates changed, additional bracket added at 8% for income over $8,000.

1953 Income tax placed into general fund rather than property tax relief account. Personal exemption set equal to federal exemption.

1955 45% surcharge imposed, in effect for 1955 and 1956.

1957 Rate structure changed, ranges from 3% at bottom to 9.5% for income over $8,000.

1959 Special capital gains treatment begins.

1969 Federal income tax base adopted. Rate schedule adjusted, 4% to 10% for income over $5,000.

1971 Planned federal increases in the personal exemption and standard deduction threaten Oregon revenue. Oregon freezes to IRC as of December 31, 1971.

1975 Oregon reconnects to federal code but maintains separate standard deduction and personal exemption.

1979 9% income tax refund for 1978 taxes. 2% surplus kicker created. Personal exemption increased and indexed for inflation.

1981 Federal changes threaten state revenue, Oregon freezes to federal code as of December 31, 1980. Personal exemption indexing delayed.

1982 Rates increased, 4.2% to 10.8%.

1983 Federal conformity updated to December 31, 1982, except for ACRS. $85 personal tax credit replaces personal exemption. 1985 Rates revert to 4% to 10% structure. Oregon law fixed to federal code as of December 31, 1984.

1987 Federal conformity updated to December 31, 1986, connects Oregon to the 1986 federal tax reforms (including full taxation of capital gains). Tax rates reduced (5% to 9% over $5,000), standard deduction increased.

1989 Federal conformity updated to December 31, 1988. Double weighted sales in apportionment formula.

1991 Federal conformity updated to December 31, 1990. Tax brackets indexed beginning in 1993. Taxed all pension income, with new retirement credit. Allows nonresident credit for tax paid to other states.

1993 Federal conformity updated to December 31, 1992.

1995 Federal conformity updated to April 15, 1995.

1997 Federal conformity updated to December 31, 1996 and permanently reconnected to future changes. Earned income credit adopted. Lottery jackpots subject to tax.

1998 Federal pensions excluded from taxable income. Credit for long-term care insurance adopted.

2000 Federal tax subtraction increased from 3,000 to 5,000 effective 1/1/2002. Indexed for inflation beginning 2003.

2001 Standard deductions changed to $1,640 for single filers and $3,280 for joint filers effective 1/1/2002. Indexed for inflation beginning 2003. Working Family Childcare credit made refundable effective 1/1/2003.

2002 Phase-in the implementation of the higher federal tax subtraction. In 2002, the federal tax subtraction is $3,250, in 2003 it is $3,500, in 2004 it is $4,000, in 2005 it is $4,500, in 2006 it is $5,000 and in 2007 it is $5,500. Beginning in 2008 it is indexed to inflation.

2003 Federal conformity updated to December 31, 2002, except for changes in depreciation, 179 expensing, deferred compensation plans, pension, employee stock ownership, deferred compensation, individual retirement plans, medical savings accounts, qualified tuition savings accounts or other tax-exempt savings programs. Eliminates the “rolling reconnect” for changes in federal tax law for 3 years until December 31, 2005. Re-establishes the “rolling reconnect” for changes in federal law pertaining to taxable income for federal tax law changes after December 31, 2005.

2005 Oregon’s earned income credit is increased to 6% of the federal credit beginning January 1, 2008. It is also made refundable for tax years 2006 through 2010. The residential energy tax credit is also expanded. New credits are created for volunteer emergency medical technicians and taxpayers who contribute to an individual development account.

2007 New compliance measures were passed pertaining to the use of listed and reportable transactions. A variety of tax credits were either created or modified, including a credit for donations to university venture development funds or the Oregon Production Investment Fund; producer and consumer biofuels credits; the business and residential energy credits; mobile home closure credit; and diesel truck engine credits. The refundability of the earned income credit was extended through tax year 2013 and the credit for donations to the Child Care Division was extended through 2012. Tax provisions pertaining to the military, veterans, and College Savings Accounts were also enacted. The personal exemption credit was reduced for higher income filers. Withholding was established for certain nonresidents who sell Oregon real property.

2008 Clarifying language was added to the ORS for the business energy tax credit, the withholding requirement for nonresidents who sell Oregon real property, and the TRICARE tax credit.

Appendix C:

Six School Finance and Taxation Tables

From LRO Basic Facts Report

TABLE 9
SUMMARY OF OREGON TAXES

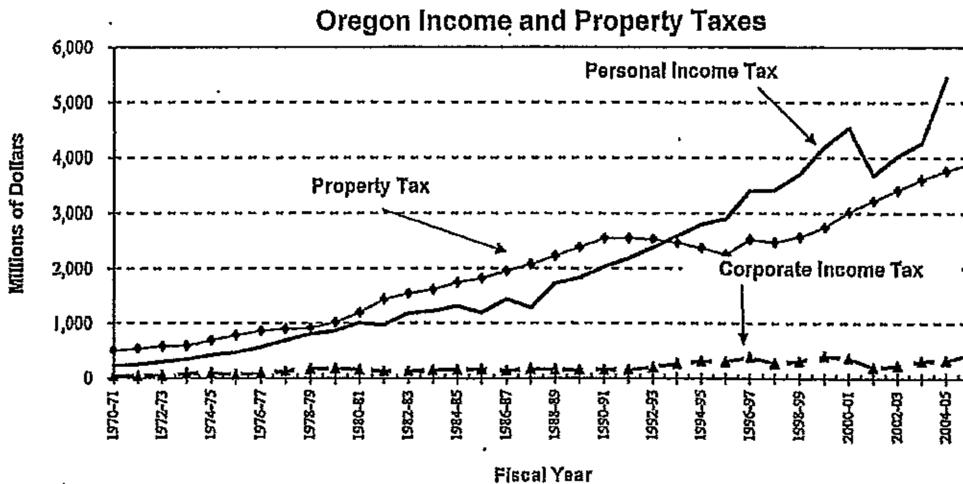
STATE	1999-00 COLLECTIONS	2005-06 COLLECTIONS	2007-08 COLLECTIONS	2006 to 08 % CHANGE
PERSONAL INCOME TAX	$4,126,282,123	$5,443,646,000	$4,973,331,592	-8.6%
UNEMPLOYMENT INSURANCE TAXES	515,573,900	725,549,000	617,409,000	-14.9%
GASOLINE AND USE FUEL TAXES	394,167,788	413,804,582	398,400,000	-3.7%
CORPORATE INCOME TAX	405,220,686	438,225,000	440,732,480	0.6%
WEIGHT MILE TAX	224,954,955	238,866,837	241,202,988	1.0%
CIGARETTE TAX	163,960,272	238,695,926	222,203,100	-6.9%
INSURANCE TAXES	59,602,111	60,945,000	44,412,232	-27.1%
OTHER LABOR TAXES	104,213,309	87,069,432	76,054,010	-12.7%
TIMBER SEVERANCE TAXES	32,843,222	1,059,368	506,613	-52.2%
INHERITANCE TAX	47,684,649	89,283,000	109,548,647	22.7%
WORKERS' COMP INSURANCE TAXES	42,293,900	53,707,630	41,513,471	-22.7%
TELEPHONE EXCHANGE ACCESS TAX	26,320,757	35,988,179	39,430,934	9.6%
OTHER TOBACCO PRODUCTS TAX	20,374,525	31,226,297	32,755,866	4.9%
REAL ESTATE RECORDING TAX	20,636,689	25,841,406	23,854,302	-7.7%
BEER & WINE TAXES	12,377,350	14,840,000	16,086,956	8.4%
FOREST PRODUCTS HARVEST TAXES	11,110,002	12,017,001	10,180,177	-15.3%
ELECTRIC COOP TAX	6,715,185	5,241,431	6,708,415	28.0%
PHONE ACCESS SURCHARGE	3,143,941	4,430,786	2,667,384	-39.8%
AMUSEMENT DEVICE TAX	1,817,543	2,565,471	405,289	-84.2%
HAZARDOUS SUBSTANCE TAXES	2,406,331	2,623,504	2,716,458	3.5%
AVIATION GAS AND JET FUEL TAXES	1,978,104	2,362,240	2,386,120	1.0%
PETROLEUM LOADING FEE	1,272,955	1,051,236	1,106,029	5.2%
BOXING TAX	69,034	123,794	50,256	-59.4%
PRIVATE RAIL CAR TAX	100,589	267,911	292,218	9.1%
OIL & GAS SEVERANCE TAX	128,445	89,819	363,525	304.7%
DRY CLEANERS TAX	695,302	0	0	NM
STATE LODGING TAX	0	9,237,512	11,842,270	28.2%
LOCAL TAXES	**1999-00 COLLECTIONS**	**2005-06 COLLECTIONS**	**2007-08 COLLECTIONS**	**2006 to 08 % CHANGE**
PROPERTY TAXES*	2,800,781,460	3,869,754,503	4,470,400,000	15.5%
TRANSIT PAYROLL & SELF EMPLOYMENT TAXES	163,488,288	207,342,819	239,150,468	15.3%
FRANCHISE TAXES	115,617,000	201,689,265	183,180,260	-9.2%
HOTEL-MOTEL	64,150,000	76,800,000	96,600,000	25.8%
PORTLAND BUSINESS LICENSE TAX	50,794,774	44,418,253	64,531,784	45.3%
MULTNOMAH COUNTY BUSINESS INCOME TAX	40,846,593	50,980,000	65,650,000	28.8%
MOTOR FUEL TAXES	9,837,758	14,819,935	16,011,723	8.0%
WASHINGTON COUNTY REAL ESTATE TRANSFER TAX	2,840,473	6,673,430	4,186,965	-37.3%
OTHER TAXES AND LICENSES	237,878,000	370,221,883	471,949,068	27.5%

Table 8
HISTORY OF TAX COLLECTIONS - BY MAJOR TAX SOURCE

(millions of dollars)

FISCAL	PERSONAL INCOME TAX		CORPORATE INCOME TAX		PROPERTY TAX	
YEAR	Receipts	% Change	Receipts	% Change	Receipts	% Change
1968-69	$204.3		$37.5			
1969-70	213.1	4.3%	39.9	6.2%		
1970-71	226.2	6.2%	36.5	-8.4%	$503.2	
1971-72	251.2	11.0%	40.6	11.1%	541.3	7.6%
1972-73	300.6	19.6%	51.1	25.9%	583.9	7.9%
1973-74	352.4	17.2%	85.7	67.7%	595.3	2.0%
1974-75	424.0	20.3%	90.7	5.8%	687.1	15.4%
1975-76	472.1	11.4%	67.2	-25.9%	778.5	13.3%
1976-77	561.9	19.0%	91.2	35.6%	860.0	10.5%
1977-78	686.2	22.1%	125.6	37.7%	901.0	4.8%
1978-79	807.0	17.6%	166.0	32.2%	916.0	1.7%
1979-80	868.0	7.6%	177.4	6.9%	1,014.4	10.7%
1980-81	1,005.1	15.8%	155.5	-12.4%	1,191.3	17.4%
1981-82	968.3	-3.7%	124.2	-20.1%	1,435.6	20.5%
1982-83	1,181.7	22.0%	125.1	0.8%	1,543.6	7.5%
1983-84	1,220.8	3.3%	144.8	15.7%	1,612.3	4.5%
1984-85	1,310.7	7.4%	153.9	6.3%	1,740.0	7.9%
1985-86	1,188.0	-9.4%	161.8	5.1%	1,819.2	4.6%
1986-87	1,435.8	20.9%	135.7	-16.1%	1,946.5	7.0%
1987-88	1,283.7	-10.6%	167.0	23.1%	2,072.9	6.5%
1988-89	1,725.3	34.4%	157.0	-6.0%	2,223.7	7.3%
1989-90	1,827.6	5.9%	146.8	-6.5%	2,386.0	7.3%
1990-91	2,026.3	10.9%	149.1	1.6%	2,550.6	6.9%
1991-92	2,176.7	7.5%	150.9	1.2%	2,549.9	0.0%
1992-93	2,383.2	9.4%	198.0	31.2%	2,529.0	-0.8%
1993-94	2,583.5	8.4%	262.8	32.7%	2,466.4	-2.5%
1994-95	2,797.6	8.3%	311.6	18.6%	2,369.8	-3.9%
1995-96	2,901.7	3.7%	300.0	-3.8%	2,248.1	-5.1%
1996-97	3,401.7	17.2%	384.4	28.1%	2,527.9	12.4%
1997-98	3,420.7	0.6%	279.2	-27.4%	2,478.5	-2.0%
1998-99	3,702.4	8.2%	309.9	11.0%	2,617.9	5.7%
1999-00	4,197.3	13.4%	405.2	30.8%	2,801.5	7.0%
2000-01	4,539.7	8.2%	373.0	-7.9%	3,014.0	7.6%
2001-02	3,677.7	-19.0%	195.2	-47.7%	3,251.9	7.9%
2002-03	4,021.9	9.4%	224.9	15.2%	3,414.6	5.0%
2003-04	4,266.5	6.1%	317.5	41.2%	3,611.1	5.8%
2004-05	4,723.0	10.6%	323.3	1.8%	3,763.9	4.2%
2005-06	5,443.6	15.3%	438.2	35.5%	3,899.1	3.6%
2006-07	5,596.7	2.8%	405.9	-7.4%	4,077.4	4.6%
2007-08	4,973.3	-11.1%	440.7	8.6%	4,470.4	9.6%

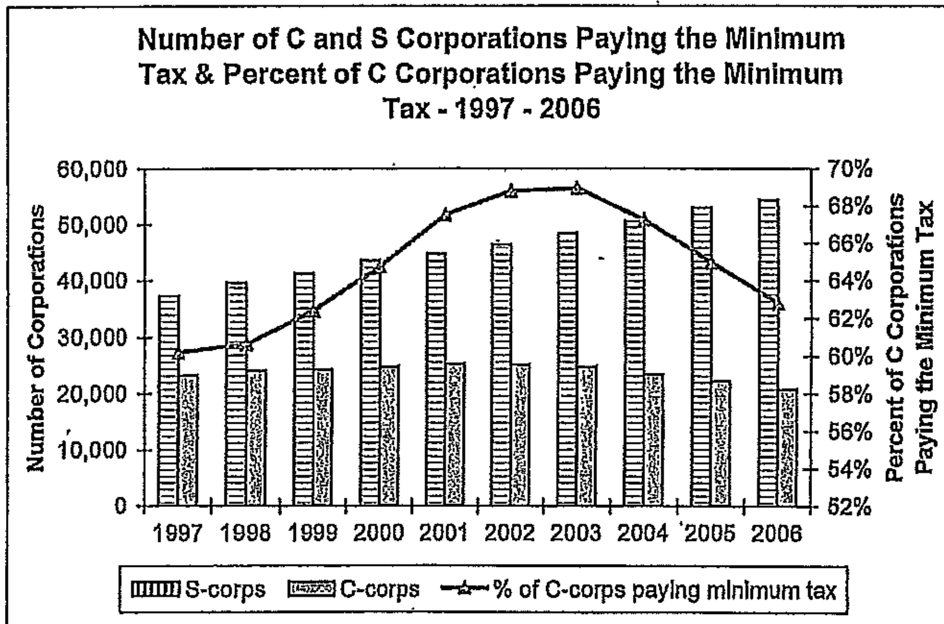
Oregon Income and Property Taxes



Number of C and S Corporations Paying the Minimum Tax & Percent of C Corporations Paying the Minimum Tax

Includes Excise and Income Filers with Tax <= $10

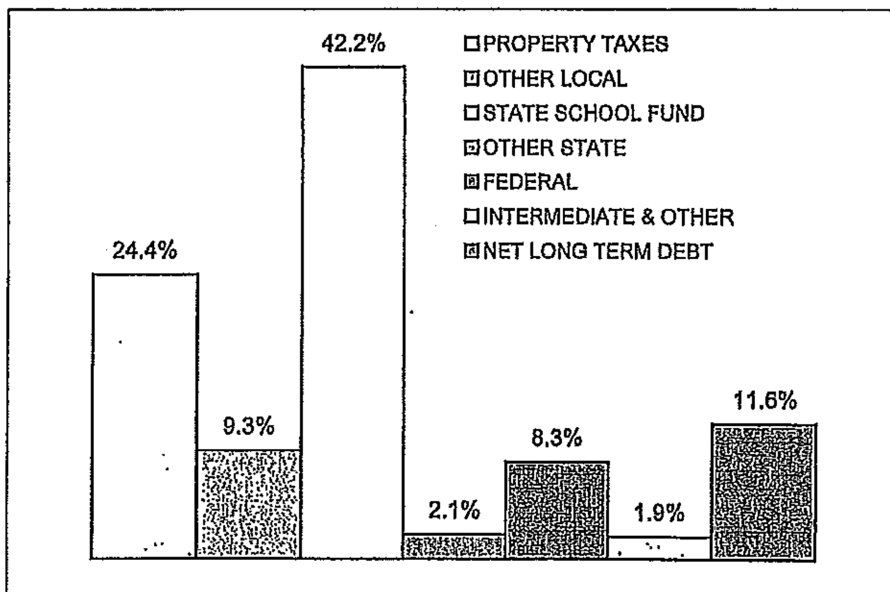
Tax Year	Corporations Paying Minimum Tax		Total C-corps	% of all C-corps paying min tax
	C-corps	S-corps		
1990	21,621	18,253	35,510	61%
1991	21,462	20,879	35,200	61%
1992	21,555	23,494	35,660	60%
1993	21,726	26,483	36,879	59%
1994	22,182	29,454	38,344	58%
1995	23,192	32,362	39,497	59%
1996	22,872	34,984	38,867	59%
1997	23,259	37,334	38,627	60%
1998	24,096	39,686	39,740	61%
1999	24,296	41,309	38,930	62%
2000	24,872	43,605	38,410	65%
2001	25,291	44,804	37,458	68%
2002	25,130	46,399	36,527	69%
2003	24,813	48,506	35,991	69%
2004	23,510	50,610	34,883	67%
2005	22,246	53,036	34,242	65%
2006	20,803	54,409	33,130	63%



SCHOOL RESOURCES

2006-07 Audited ($000)

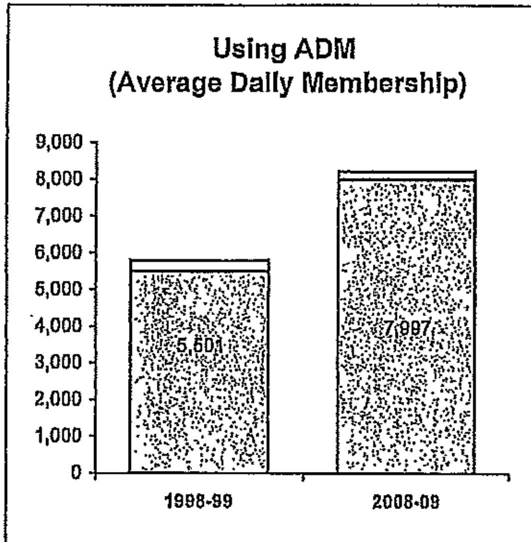
	K-12	ESD	TOTAL
PROPERTY TAXES	1,520,649	82,658	1,603,307
OTHER LOCAL REVENUES	517,731	93,776	611,507
STATE SCHOOL FUND	2,594,375	176,183	2,770,558
COMMON SCHOOL FUND	48,011	0	48,011
OTHER STATE REVENUE	82,003	7,531	89,533
FEDERAL FOREST FEES	33,862	0	33,862
OTHER FEDERAL REVENUE	453,445	60,118	513,563
INTERMEDIATE & OTHER	118,366	7,424	125,790
NET LONG TERM DEBT	759,972	3,420	763,392
TOTAL REVENUE	6,128,414	431,111	6,559,525
PLUS BEGINING BALANCE	1,137,851	100,011	1,237,861
TOTAL RESOURCES	7,266,265	531,122	7,797,387
LESS TOTAL EXPENDITURES	-5,604,882	-421,047	-6,025,929
ENDING BALANCE	1,661,383	110,075	1,771,457



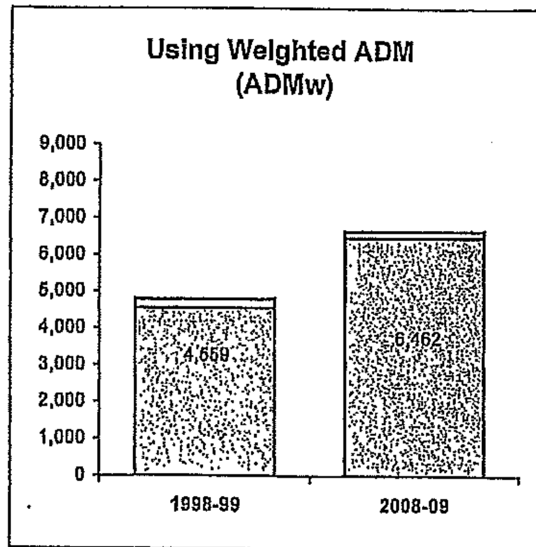
Notes: Capital Projects and Debt Service Funds have a large share of the ending balance.
Excludes Internal Services Funds and Trust and Agency Funds.
Numbers exclude interfund transfers to avoid double counting.

Source: Oregon Department of Education financial data base.

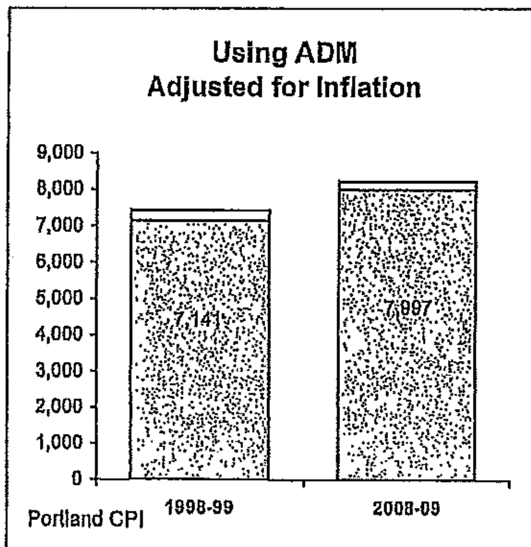
K-12 SCHOOL FINANCIAL TRENDS
STATE AND LOCAL FORMULA REVENUE PER STUDENT
10 Year Comparison



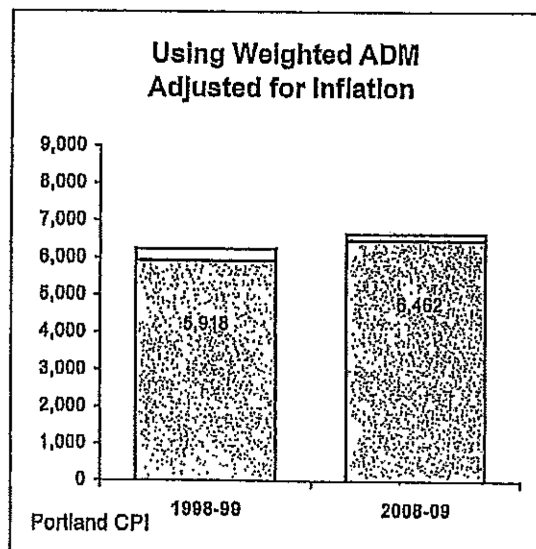
Revenue per student increases about 45%.



Revenue per weighted student increases about 42%.



Revenue per student adjusted for inflation increases about 12%.

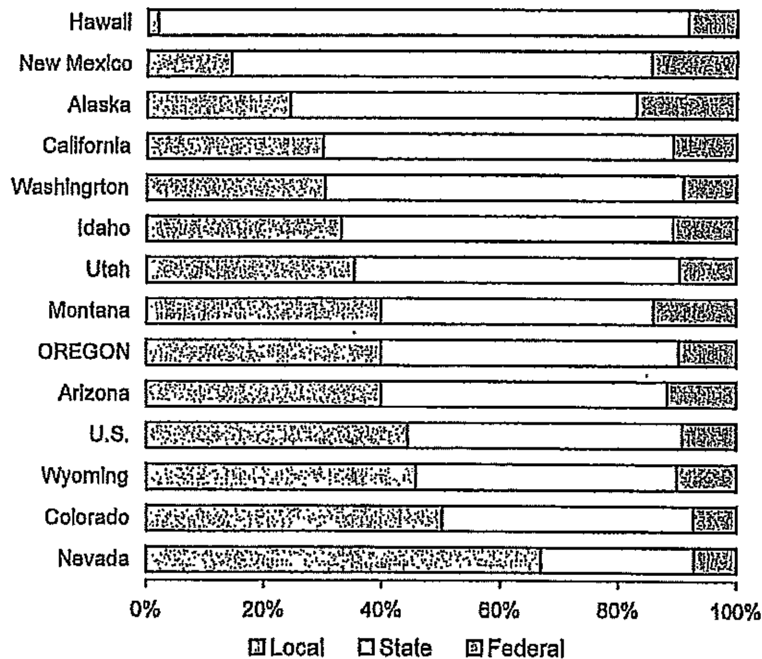


Revenue per weighted student adjusted for inflation increases about 9%.

Note: 2008-09 numbers are estimates of student counts, local revenue and inflation.
The top part of the bar is 1998-99 bond revenue and 2008-09 appropriated School Improvement Fund dollars.

2005-06 REVENUE PER STUDENT WESTERN STATES COMPARISON BY SOURCE

State	Rank	Total	Local	State	Federal
Hawaii	5	14,789	265	13,301	1,223
Wyoming	8	13,614	6,230	6,007	1,378
Alaska	10	12,849	3,123	7,541	2,185
U.S.		10,601	4,702	4,930	968
California	28	9,909	2,959	5,879	1,070
OREGON	**29**	**9,829**	**3,913**	**4,957**	**959**
New Mexico	33	9,636	1,381	6,859	1,397
Washingrton	35	9,457	2,857	5,750	851
Montana	36	9,439	3,755	4,359	1,324
Colorado	37	9,322	4,679	3,962	681
Nevada	41	8,965	6,000	2,325	640
Arizona	46	8,071	3,217	3,904	950
Idaho	50	7,289	2,402	4,099	788
Utah	51	6,769	2,388	3,732	650



Source: National Center for Education Statistics, Revenue, 2005-06

Notes: Numbers may not be completely comparable due to state definitional differences.
Students is fall enrollment.
Includes intermediate in local.

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