Initiative Petition 28: Description and Analysis

Legislative Revenue Office

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Report Outline

- Description
- Hypothetical Examples
- Initial Impact by Corporate Sales and Industry
- Estimated Impact on Oregon's Relative Tax Burden
- Implications of Shifting Toward a Gross Receipts Tax Base
- Economic Effects
- Distribution Effects
- Revenue Impact
- Uncertainties
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Description

- Modifies C-corporation minimum tax schedule established by Measure 67.
- Maintains current corporate income tax definitions for Oregon sales.
- Establishes new marginal rate of 2.5% for Oregon sales in excess of $25 million.
- Applies only to C-corps. Other business entity types such as S-corps, partnerships and proprietorships are not affected.
- Exempts benefit corporations from new marginal rate.
- First applies to 2017 corporate tax year.
- Distributes new revenue to early childhood education, K-12 education, health care and services for seniors.

Implications of Oregon Sales Definition

Goods Producers(Tangible Property)

- Sale determined by location of customer
- Corporate Nexus and Throwback Rule

Service Producers (Intangible Property)

- Sale determined by cost of performance methodology
  - Sale is allocated to state where service is performed or produced—not where customer is located
  - All sales are allocated to state where plurality of service is performed—not allocated proportionately to states

Direct Impact of IP 28 on Hypothetical Corporations

Hypothetical Minimum Taxpayers	Minimum Tax Under Current Law	Minimum Tax Under IP 28	Minimum Tax Difference
S-Corp or Partnership	$150	$150	No Change
C-Corp with Oregon Sales of $6 million	$4,000	$4,000	No Change
C-Corp with Oregon Sales of $20 million	$15,000	$15,000	No Change
C-Corp with Oregon Sales of $70 million	$50,000	$1,155,001	$1,105,001
C-Corp with Oregon Sales of $150 million	$100,000	$3,155,001	$3,055,001
C-Corp with Oregon Sales of $350 million	$100,000	$8,155,001	$8,055,001

Interaction of Corporate Minimum and Tax Rates Under IP 28

Hypothetical C-Corporation	Oregon Sales (millions)	Net Income Apportioned to Oregon (millions)	Tax Under Current Law	Tax Under IP 28	Difference
A	$20	$4	$294,000	$294,000	---
B	$60	$3	$218,000	$905,001	+$687,001
C	$60	$18	$1,358,000	$1,358,000	---
D	$90	$6	$446,000	$1,655,001	+$1,209,001
E	$200	$15	$1,130,000	$4,405,001	+$3,275,001
F	$200	$30	$2,270,000	$4,405,001	+$2,135,001

Distribution of Oregon Corporate Taxes by Sales of C-Corporation

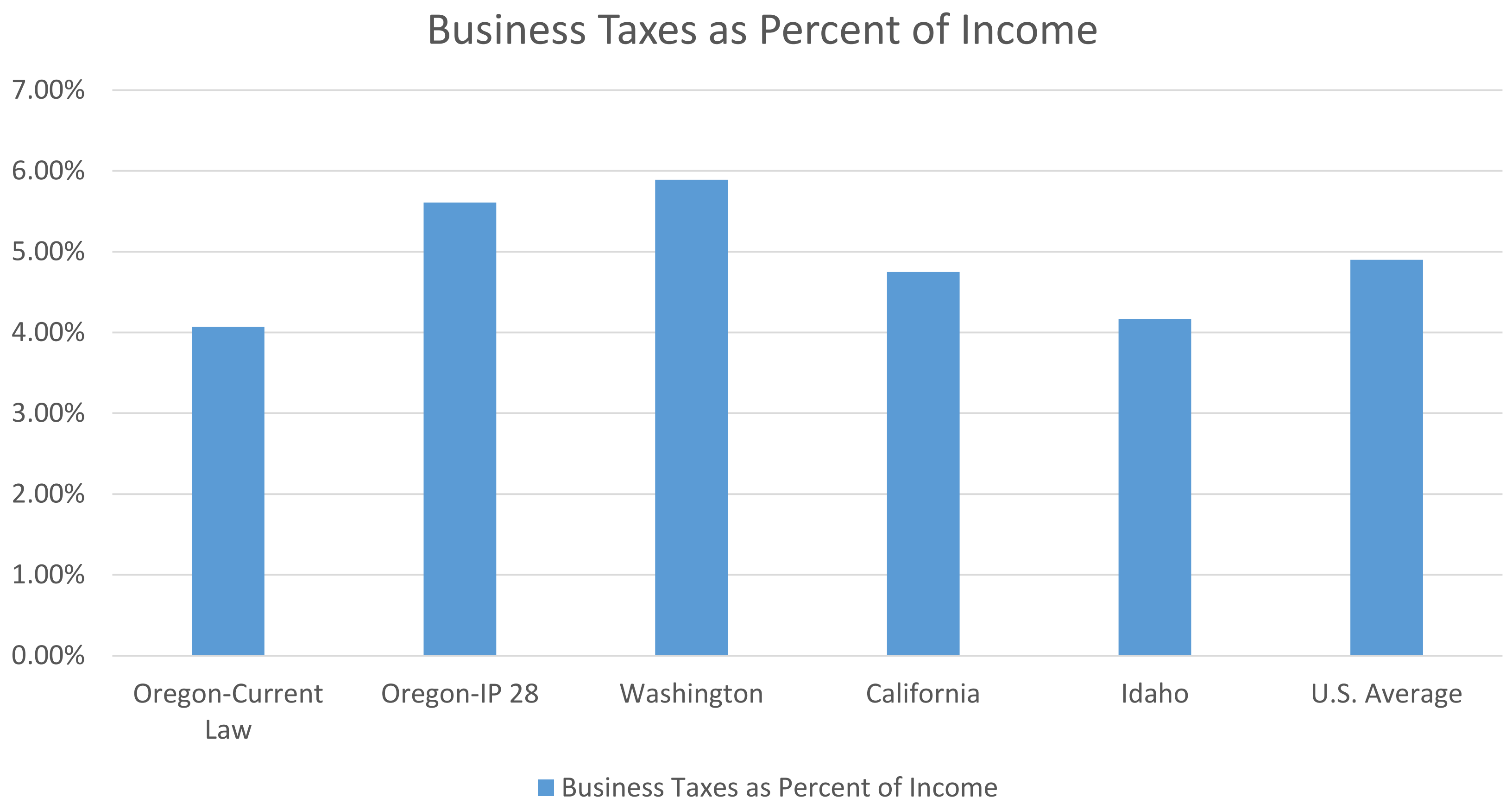
		Current Law		Under IP 28	
Oregon Sales	Number of Filers	Tax (millions)	% of Corp Taxes	Tax (millions)	% of Corp Taxes
<$ 25 million	28,424	$125.5	27.2%	$125.5	4.4%
$25 to $50 million	491	$54.5	11.8%	$148.1	5.2%
$50 to $100 million	286	$68.1	14.8%	$329.5	11.4%
$100 to $250 million	168	$74.1	16.1%	$546.3	19.0%
>$250 million	106	$138.9	30.1%	$1,726.6	60.0%
Total	29,475	$461.1	100%	$2,876.0	100%

Impact of IP 28 on Distribution of Corporate Taxes by Industry

	2013 Returns	Current Law		IP 28	
Industry	Number of Filers	Tax (millions)	% of Corporate Taxes	Tax (millions)	% of Corporate Taxes
Utilities	73	$0.4	0.1%	$104.5	3.6%
Construction	2,280	$12.7	2.8%	$64.0	2.2%
Manufacturing	2,073	$42.2	9.1%	$202.6	7.0%
Wholesale Trade	3,367	$102.1	22.1%	$697.3	24.2%
Retail Trade	1,877	$69.8	15.1%	$604.8	21.0%
Transportation & Warehousing	728	$17.7	3.8%	$79.5	2.7%
Information	997	$26.3	5.7%	$109.6	3.8%
Technical Services	3,735	$16.0	3.5%	$49.6	1.7%
Management	1,376	$48.9	10.6%	$375.2	13.0%
Health Care	1,366	$7.9	1.7%	$103.6	3.6%
All Other	11,603	$117.1	25.4%	$485.3	16.9%
Total	29,475	$461.1	100%	$2,876.0	100%

Impact of IP 28 on Taxes Paid Directly By Business

(Based on 2013-14 Fiscal Year)

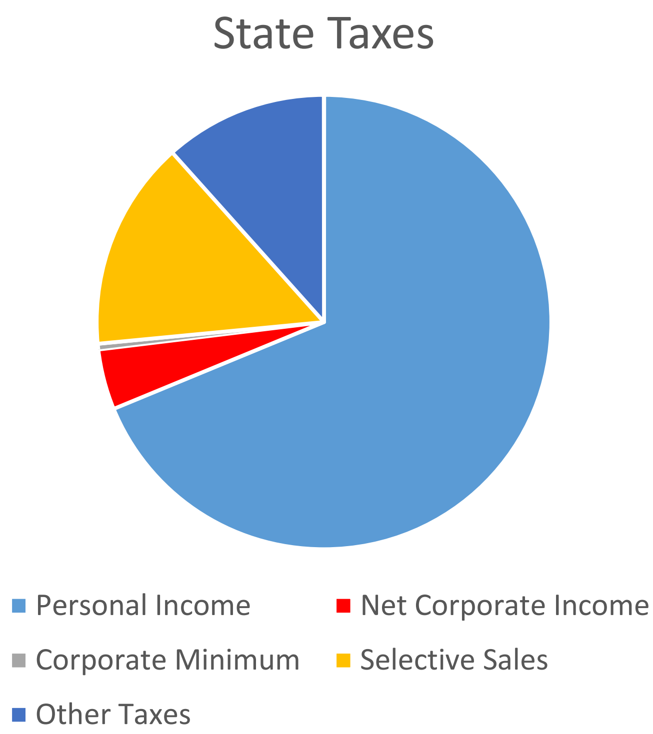


Estimated Impact of IP 28 on Oregon's Overall State and Local Tax Burden

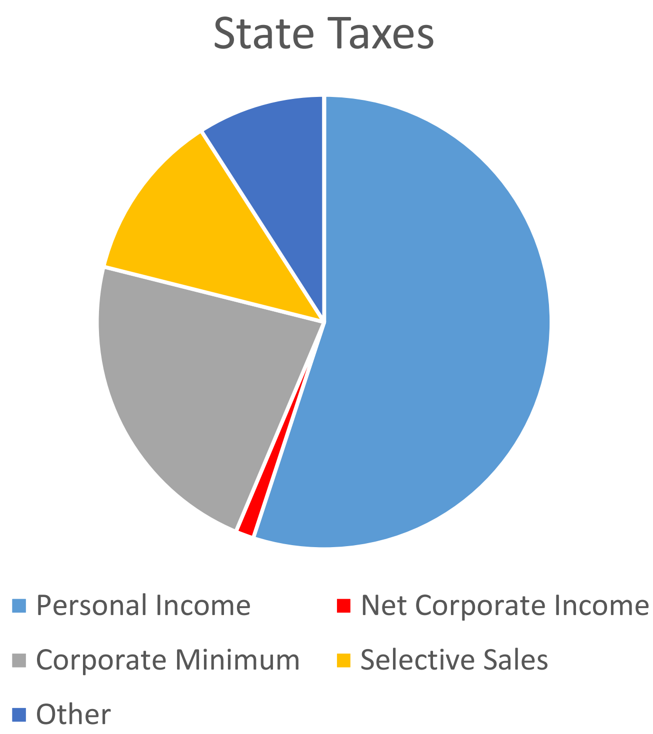
Measure	Actual (2012-13 Fiscal Year)	Estimated Under IP 28
Total Taxes Per Capita	$3,909	$4,501
Rank Among States	#28	#20
Total Taxes as % of Income	10.1%	11.6%
Rank Among States	#26	#9

Impact of IP 28 on Mix of State Taxes

Current Law (2013-14 Fiscal Year)



IP 28 (2013-14 Fiscal Year)



States Currently Imposing Gross Receipts Taxes

State	Tax	Year Enacted	Rates	Revenue Yield as % of State Taxes
Delaware	Gross Receipts Tax System	1913	0.2% to 0.8%	5.6%
Nevada	Commerce Tax	2015	0.11% to 0.253%	----
Ohio	Commercial Activity Tax	2005	0.26%	6.0%
Texas	Margin Tax	2008	0.33% to 0.75%	5.5%
Washington	Business & Occupation Tax	1933	0.14% to 1.5%	18.1%

Simulated Economic Impact of IP 28

	Under Current Law			Under IP 28			Difference: IP 28 – Current law	
Measure	2022	Change from 2017	Percent Change	2022	Change from 2017	Percent Change	Total	Percent
Income (Billions)	$254.7	$66.3	35.2%	$254.3	$65.8	34.9%	-$0.43	-0.17%
Population (Thousands)	4,360	239	5.8%	4,343	222	5.4%	-16.6	-0.38%
Employment (Thousands)	2,705	166	6.5%	2,684	145	5.7%	-20.4	-0.75%
Wages (2017=100)	122.1	22.1	22.1%	122.5	22.5	22.5%	+0.5	+0.37%
Prices (2017=100)	112.5	12.5	12.5%	113.5	13.5	13.5%	+1.0	+0.89%

Simulated Employment Impacts of IP 28

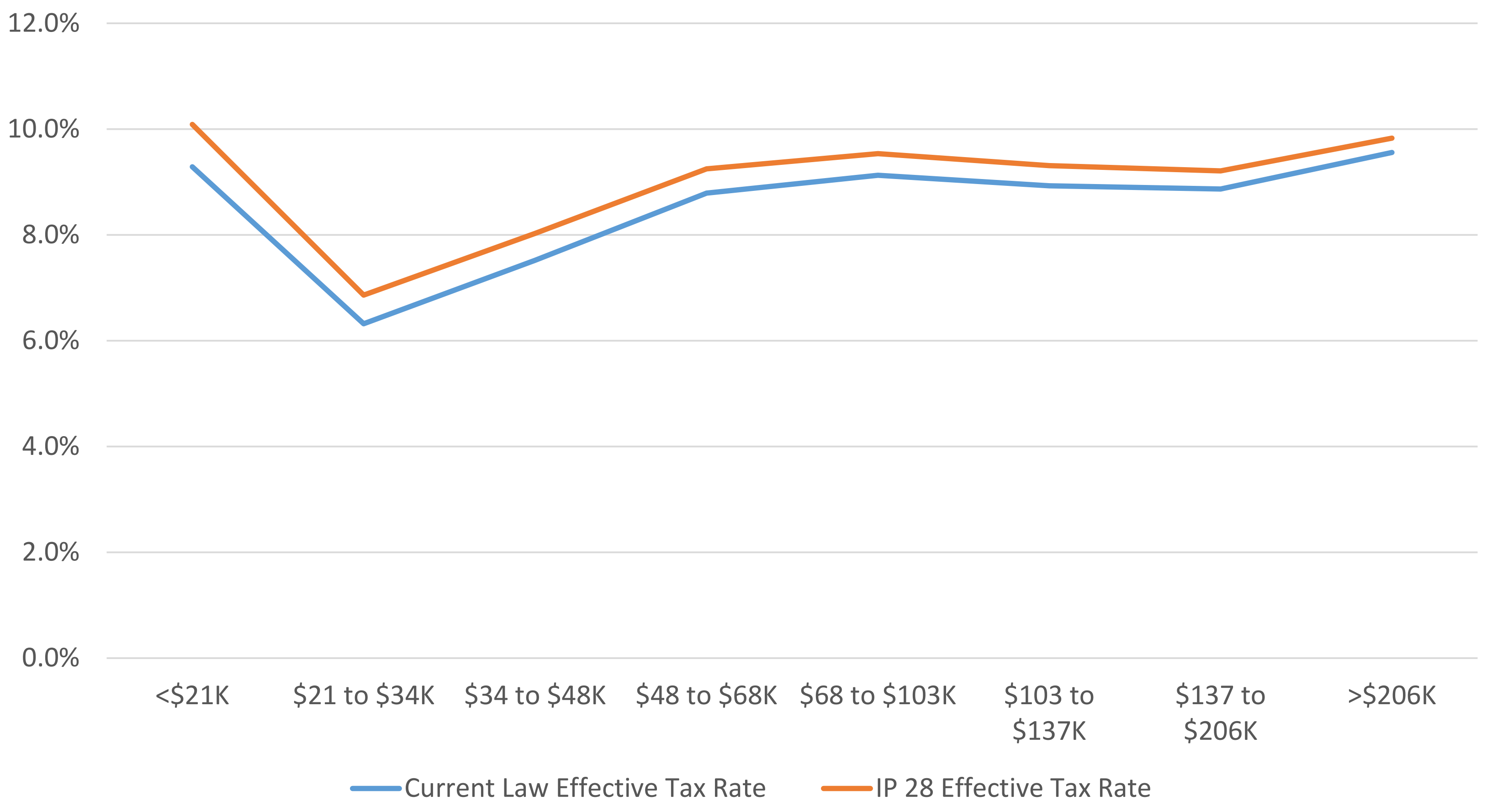
	Under Current Law			Under IP 28			Difference: IP 28 – Current law	
Employment (Thousands)	2022	Change from 2017	Percent Change	2022	Change from 2017	Percent Change	Total	Percent
Private Sector	2,390	148.2	6.6%	2,361	110.1	4.9%	-38.2	-1.59%
Public Sector	305	17.6	6.1%	323	35.3	12.3%	+17.7	+5.8%
Individual Sectors								
Retail Trade	279	16.1	6.1%	265	2.4	0.9%	-13.6	-4.89%
Wholesale Trade	105	4.4	4.4%	98	-0.4	-0.02%	-4.7	-4.59%
Health Services	239	16.6	7.5%	235	13.1	5.9%	-3.5	-1.46%
Other Services	1,626	109.8	7.2%	1,615	99.3	6.5%	-10.6	-0.65%
Manufacturing & Natural Resources	439	19	4.3%	453	13.2	3.0%	-5.7	-1.25%

Simulated Change in Net After-Tax Household Income

(Change from Average for Each Income Group)

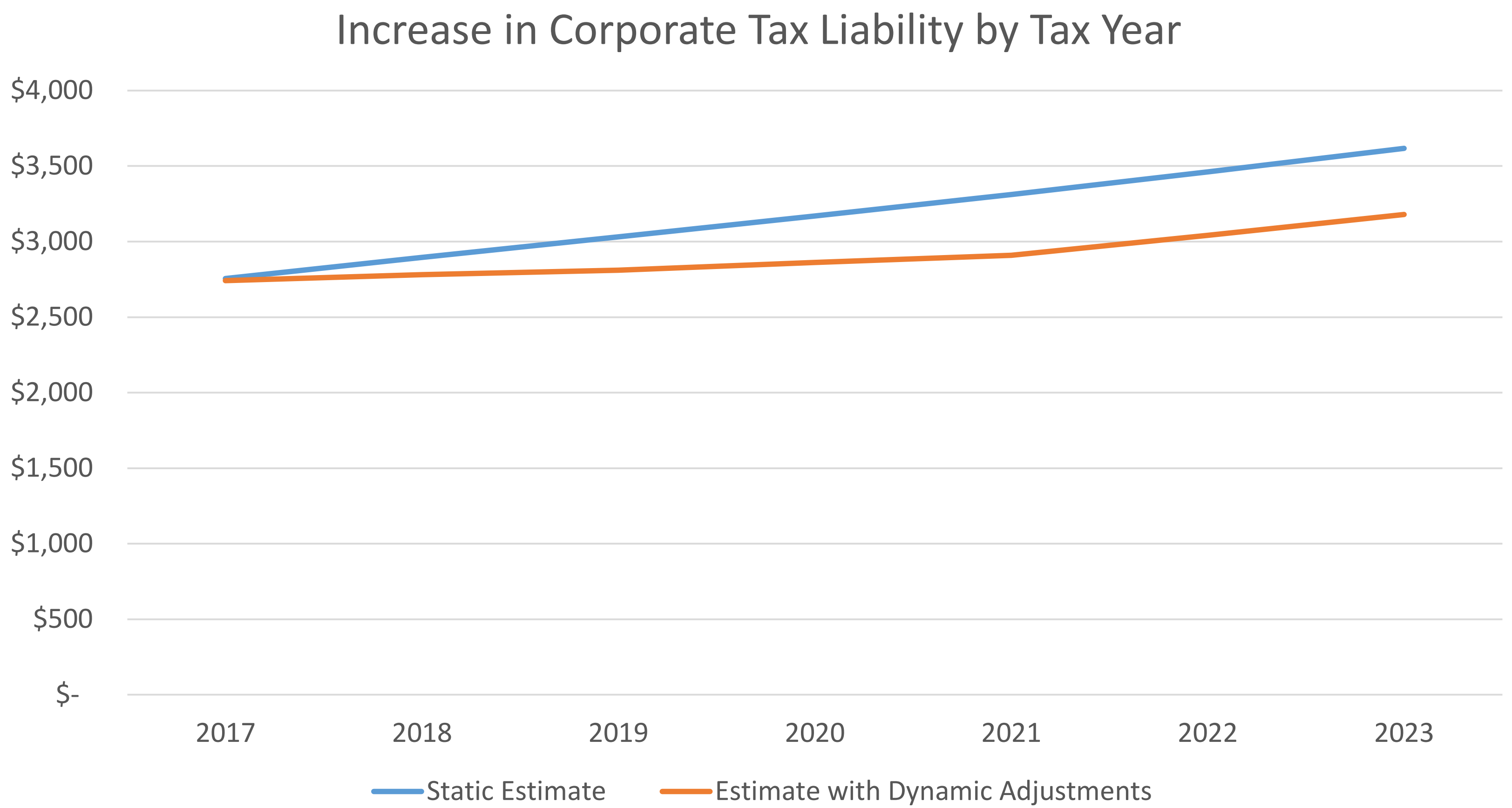
Income Group (Thousands)	Change from Baseline	Percent Change from Baseline
Less than $21	-$372	-0.9%
$21 to $34	-$500	-0.9%
$34 to $48	-$563	-0.9%
$48 to $68	-$613	-0.8%
$68 to $103	-$751	-0.8%
$103 to $137	-$868	-0.7%
$137 to $206	-$1,063	-0.6%
Greater than $206	-$1,282	-0.4%

Impact of IP 28 on Distribution of Oregon's State and Local Tax Burden



Estimated Impact of IP 28 on Corporate Tax Liability

(in millions)



IP 28: Revenue Impact Estimate
(millions)

Biennium	2015-17	2017-19	2019-21	2021-23
Net Revenue Impact	$548	$6,099	$6,002	$6,086

Impact of Tax Mix on Revenue Growth & Stability
(Based on National State Tax Data 1989-2015)

State	Average Tax Revenue Growth (Annual)	Standard Deviation
Oregon—Current Law	5.3%	8.2%
Oregon—Under IP 28	5.1%	6.9%
Washington	4.4%	3.9%
California	5.0%	6.6%
Idaho	4.8%	5.7%

Sources of Uncertainty

- Magnitude of Revenue Impact
  - IP 28 increases state taxes by about 25%
  - IP 28 increases overall state and local taxes by about 15%
  - Little historical experience with revenue changes of this relative magnitude
  - Most recent change of this size was Measure 5-phased in between 1991 and 1996

- Concentration of Direct Revenue Impact
  - 85% of the direct impact falls on 274 corporations
  - 66% of the direct impact falls on 100 corporations
  - 51% of direct impact falls on 50 corporations

Risks to Estimates

Upside Risks

- Public Sector spending impacts on the productive capacity of the economy
  - program specific
  - timing
- Tax exporting under estimates
  - Uniform pricing strategies
  - Federal tax deductibility
  - Sales to out-of-state residents and businesses

Downside Risks

- More pronounced negative investment effects
  - Factor taxes vs. consumption taxes
- Corporate tax planning
  - Shifting to S-Corp or non-corp status
  - Vertical integration
  - Spinning off subsidiaries—no longer part of corporate filing group
  - Merger to manipulate costs of performance apportionment
  - Converting to benefit company

Key Findings

- IP 28 is expected to generate $548 million in revenue for the 2015-17 biennium and $6.1 billion in the 2017-19 biennium.
- IP 28 would increase Oregon state and local taxes by $600 per capita (moving the state from the 28th highest to the 20th highest) and increase the ratio of taxes to income from 10.1% to 11.6% (moving the state from the 26th highest to the 9th highest).
- Because of its initial impact on domestic consumer sectors, IP 28 is expected to largely act as a consumption tax on the state economy.
- Our economic simulation shows that IP 28 will dampen income, employment and population growth over the next 5 years, but all three metrics remain within 1% of the current law projection.
- The impact of IP 28 on consumer prices means that the marginal impact of the tax will be regressive. However, as a whole, Oregon's state and local tax burden is expected to remain roughly proportional.
- Shifting to the gross receipts tax base will increase the stability of state revenue over the course of the business cycle.
- Both the large size of IP 28's revenue impact and its concentrated impact on a small group of large corporations adds considerable uncertainty to the estimates.
- Ultimately the long run impact of IP 28 on the state economy will be determined by both its revenue raising mechanism and the state expenditures funded by the additional revenue.