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FISCAL FACT

July 2009
No. 175

The Dam Bursts in the Beaver State: Oregon’s Wave of Tax Increases and New Spending

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Introduction
Staring at a multi-billion dollar budget shortfall, Oregon state legislators recently approved more than $1 billion in tax increases. Most of the new revenue will come from higher tax rates on personal income. But the legislature's Democratic majority was not content with mere budget patching, instead pushing through large new spending programs and more taxes to fund them.

Higher taxes on gasoline and vehicle registration will fund new transportation projects, while new taxes on hospitals and health insurers will be used to expand the state's health care program. And although proposals to raise "sin" taxes failed to pass, including an astronomical 1,800% rise in the beer tax, legislators did manage to approve a tax increase on all non-cigarette tobacco products.

All of these new tax provisions await Governor Ted Kulongoski's (D) assured approval, but their ultimate fate may rest with the people of Oregon. If citizen groups can collect enough signatures to challenge the legislation, a statewide vote early next year could send lawmakers scrambling back to the chambers to rethink the state's fiscal future.

Top Personal Income Tax Rate Leaps to Highest in the Nation
With the passage of HB 2649, Oregon's high-income earners will find themselves sending a

larger portion of their incomes to the state each year. Oregon's existing tax code features three income tax brackets: 5 percent on taxable income between $0 and $3,050; 7 percent between $3,050 and $7,600; and 9 percent over $7,600 (see Table 1). Under the new structure, two much higher income brackets are tacked on for 2009-11: 10.8% for income between $125,000 and $250,000, and 11% on income over $250,000. In 2012, the top bracket is removed, and a 9.9% rate is imposed on all income over $125,000. Oregon's budget office estimates that these tax increases will raise $472 million for the 2009-11 fiscal biennium.

Table 1: Personal Income Tax Rates and Brackets *

fore Legislation		2009-2011		After 2011	
Rate	Bracket	Rate	Bracket †	Rate	Bracket †
5%	> $0	5%	> $0	5%	> $0
7%	> $3,050	7%	> $3,050	7%	> $3,050
9%	> $7,600	9%	> $7,600	9%	> $7,600
		10.8%	> $125,000	9.9%	> $125,000
		11%	> $250,000		

* All bracket amounts shown are for singles. Brackets are doubled for couples filing a joint tax return.

† The lowest three brackets are adjusted for inflation each year. The new top brackets, however, will not be adjusted, forcing more people into these brackets each year due to inflation alone.

Oregon is one of the five states that levy no general sales tax, so it is not surprising that the state depends more heavily on income taxation. Indeed, even before this tax hike, that dependence was evident. For a single person declaring between $10,000 and $47,000 of taxable income, no state has a higher tax rate.

In terms of collections, Oregon's personal income tax brought in the fourth highest total in 2007: $1,505 per capita.[1] With the passage of HB 2649, Oregon will increase the government's take by joining Hawaii at the inglorious summit of personal income tax rates; only those two states will have an 11 percent tax rate on the books.

In enacting such a high tax rate, Oregon follows the examples of New Jersey, California, and Hawaii in taxing high earners with a double-digit, so-called "millionaires' tax." However, as the recent *Tax Foundation Fiscal Fact* on Hawaii's similar actions brings to light, "With each new millionaire's tax, the tax is kicking in on more and more people who are not millionaires."[2] And Oregon has taken the extra step of decreeing that these new top brackets will not be adjusted for inflation, sending more and more Oregonians into the higher brackets each year solely because of inflation, not because of any increase in real income.

Corporations Face New Brackets, Minimums
Through HB 3405, the corporate component of the income tax increases, Oregon lawmakers plan

to generate $261 million in additional revenue for the 2009-11 budget. The new legislation scraps the flat rate on corporate income in favor of a bracketed system, while also revamping and increasing the minimum tax. HB 3405 will keep the current 6.6 percent rate for corporate income below $250,000, but for income beyond this new threshold, corporations will pay 7.9 percent for the 2009-11 biennium and 7.6 percent thereafter (see Table 2). The minimum corporate income tax would also rise from the 1930s-era $10 to a sliding scale based on gross sales, ranging from $150 for corporations with less than $500,000 in annual sales to a $100,000 minimum tax bill for corporations selling more than $100 million.

Table 2: Corporate Income Tax Rates and Brackets

Before Legislation		2009-2011		After 2011	
Rate	Bracket	Rate	Bracket	Rate	Bracket
6.6%	> $0	6.6%	> $0	6.6%	> $0
		7.9%	> $250,000	7.6%	> $250,000

Gasoline, Vehicle Registration, Health Care, and Tobacco Also See Taxes Rise
Oregon lawmakers passed several other notable tax increases in the rush before the end of the legislative session. HB 2001 looks to raise $300 million per year for transportation projects by increasing the gas tax from 24 cents per gallon to 30 cents per gallon, while simultaneously hiking the charge to renew license plate tabs every two years from $54 to $86. The vehicle titling fee will more than triple from $23 to $78. Of the $300 million in projected revenue, $136 million will flow into the state highway program, while counties and cities will receive $82 million and $55 million, respectively. The remaining $24 million will go towards non-road projects and alternative transportation.

Oregon's legislators are also seeking to expand state-funded health coverage to 115,000 new uninsured children and adults, paid for by a new 1 percent tax on health insurance premiums and a rise in the tax on the state's largest hospitals. HB 2116's tax hikes could raise up to $400 million from Oregonians paying for health care in the 2009-2011 biennium. This is intended to reap nearly $2 billion in corresponding federal dollars over the next four years, following the familiar pattern of the federal government paying states to raise their taxes.

Finally, while proposals of significantly higher beer and cigarette "sin" taxes fizzled in the legislature, lawmakers did manage to approve higher taxes on all tobacco products other than cigarettes. HB 2672 is estimated to raise approximately $5.5 million for the next biennium by imposing a new tax structure for tobacco products based on product weight, with a $2.14 minimum tax for any retail smokeless tobacco container. The minimum tax and the tax rate per ounce will both rise with inflation.

Assessing the Wave of Tax Increases

While Oregon's new tax hikes will help the state close its projected budget shortfall, spend more on transportation infrastructure, and subsidize health insurance for more Oregonians, much of the new legislation drifts away from sound tax policy in favor of short-sighted political patchwork. Echoing the Obama administration's rhetoric calling for high-income earners to "pay their fair share" of the tax burden, Oregon lawmakers are foisting the bulk of the state's budget problems onto the shoulders of a small group of high-income individuals, instead of spreading the burden across more of the beneficiaries of state government or making deeper cuts in state spending. By tacking on two new personal income tax brackets and one new corporate income tax bracket, Oregon will sacrifice simplicity and equity for a politically easy beat on the drums of class warfare.

Beyond the political polarization, these new tax provisions will make the state's revenue stream fluctuate more unpredictably by increasing the state's reliance on unstable sources of tax revenue. Oregon levies no general sales tax, and such a permanent simplification of the state's tax environment is a major plus. As long as the income tax remains a stable revenue source, this revenue formula can thrive; when the income tax code is tilted to weigh heavily on the highly variable incomes of top earners, however, revenue instability is the usual result.

As California has recently demonstrated, such a top-heavy tax structure can damage a state's finances on two fronts. Boom-time revenues from high-income earners often encourage profligate spending commitments with the assumption of further booming revenues, but the inevitable downturns that follow wipe out tax revenue from top income earners much more severely than revenue from more modest earners, leaving the state with massive budget shortfalls. Broad-based, flat-rate income taxes both encourage more production from high-income earners in good times and keep revenues from falling through the floor in bad times. Oregon is moving in the opposite direction, unfortunately, increasing the likelihood of major budget crises down the road.

Significantly higher income taxes on the most mobile group of individuals and corporations may also convince a portion of these key economic actors to say goodbye to the Beaver State, and discourage others from entering. While California's imploding economy and even more onerous tax structure might not lure these Oregonians south, some firms and high-income individuals for whom sales taxes are not a major consideration might regard Idaho's 7.8% top income tax and flat 7.6% corporate tax rate as attractive. Washington and Nevada, meanwhile, both scrap income taxes altogether in favor of broad sales taxes.[3] Now facing the highest state income tax rate in the U.S., Oregon's high-earning individuals have no shortage of greener tax pastures elsewhere.

Conclusion

Oregon legislators have approved more than $1 billion in tax increases for the 2009-11 fiscal period, not only to balance the budget but to expand it as well. The end-of-session recess will be a tense one, however, as lawmakers look to the challenges that lie ahead.

Most visibly, the Democratic majorities in both the House and Senate rammed through these measures with nearly unanimous Republican opposition, revealing the partisan fissure rumbling beneath the state's political foundation. The Democratic lawmakers are also gambling heavily on a robust economic recovery just over the horizon. If the recession grinds on for several more months, hiking taxes in a downturn will have a predictably toxic effect for the state's economy.

Furthermore, in this initiative state, the hard-fought legislative package of tax increases could be headed for trouble if citizen groups are able to amass enough signatures to put the measures on a general ballot early next year. Oregonians have a proud record of striking down tax increases that get referred to statewide ballots, but many supporters of these new tax measures claim that a recent leftward shift in Oregon's political landscape may have rendered this history irrelevant.

In any event, the Oregon legislature is looking to dump the majority of its new tax burden onto a small group of high-income Oregonians. If these individuals move out of state or choose to work less, or if the public casts a vetoing vote next January, Oregon's lawmakers will reap the sour fruit of their reliance on poor tax policy.

Notes

[1] Tax Foundation, "State Individual Income Tax Collections Per Capita, Fiscal Year 2007," http://www.taxfoundation.org/taxdata/show/282.html, based on U.S. Census Bureau data.

[2] Joseph Henchman and Mark Robyn, "The Price of Paradise: Hawaii Becomes Fifth State to Adopt New Income Tax Brackets on High-Earners," *Tax Foundation Fiscal Fact* No. 169 (May 12, 2009), http://www.taxfoundation.org/publications/show/24693.html.

[3] Washington does levy a gross receipts tax, however, ranging from 0.471% for retail sales to 1.5% for services.

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