



FISCAL FACT

January 7, 2010
No. 206

Oregon Referendum Could Reinstate Higher Income Tax Rates

By Kail Padgitt and Joseph Henchman

Introduction

On January 26, 2010, Oregon residents will be deciding whether to approve or reject some of the state's tax increases passed in 2009. Measure 66 will enact two new individual income tax brackets (with rates at 10.8 percent and 11 percent), and Measure 67 will increase corporate income taxes.

If Measure 66 passes, the new 11 percent income state tax rate will combine with local income taxes to give high-income Oregonians the highest state tax bill in the nation. Hawaii is the only other state with an 11 percent rate on the books, but there are no local income taxes there. The new, higher rates would go into effect retroactively to January 1, 2009; if the measure fails, the individual income tax increase is cancelled. Similarly, if Measure 67 passes, the corporate income tax increase will go into effect retroactively to January 1, 2009; if it fails, the corporate income tax increase is cancelled.

This report reviews how the results of the January 26 referendum would affect Oregon's State Business Tax Climate Index ranking.

Tax Increases Dropped Oregon Out of Top Ten on Ranking of Most Business-Friendly States

One of the major stories from our State Business Tax Climate Index this year was the fall of Oregon out of the top ten due to the tax increases in H.B. 2649. Oregon had consistently scored as one of the ten most business-friendly states in terms of tax climate, but the enactment of the tax increases led to its drop from 8th place in FY 2009 to 14th place in 2010.

Prior to the increases, Oregon's individual income tax consists of three brackets: 5 percent on taxable income between \$0 and \$3,050; 7 percent between \$3,050 and \$7,600; and 9 percent over

Kail Padgitt, Ph.D. is Staff Economist and Joseph Henchman is Tax Counsel and Director of State Projects at the Tax Foundation

\$7,600 (see Table 1). Under the new structure, two additional tax rates on higher income brackets are tacked on for 2009-11: 10.8 percent for income between \$125,000 and \$250,000, and 11 percent on income over \$250,000. In 2012, the top bracket is removed and a 9.9 percent 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.

Before 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.
Source: Tax Foundation

On the corporate side, the state scrapped the 6.6 percent flat rate on corporate income in favor of a bracketed system and a new top rate of 7.9 percent (dropping to 7.6 percent after 2011). The minimum corporate income tax also rose from a nominal \$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. (Many corporations have losses this year, leading to them paying only the minimum tax.)

Effect of Referendum on Applicability of Tax Increases

Although the legislature passed the tax changes and Oregon Governor Ted Kulongoski signed them into law in July, opponents launched an effort to gather the 55,179 signatures needed to refer the increases to the ballot as a “veto referendum.” They were successful and in early October, the Secretary of State certified the two measures for the ballot. Under Article IV, Section 1, of the Oregon Constitution and subsequent cases interpreting it, the tax increase measures are suspended until the referendum occurs.¹

Consequently, while the tax increases were technically in effect from July to October, they are not now in effect. If the measures pass, it will be as if the taxes were in effect retroactive to January 1, 2009; if the measures fail, it will be as if the taxes were never enacted. Consequently, the Department of Revenue has requested that Oregon taxpayers not file their 2009 tax returns due in 2010 until after the referendum has either validated or invalidated the new tax rates.

The legislature did pass some tax increases that were not referred to the ballot, including increases to gasoline, vehicle registration, health care and tobacco taxes. These have not been suspended, and they will not be affected by the referendum.

¹ See, e.g., *Bernstein Bros. v. Dep’t. of Revenue*, 661 P.2d 537, 540 (Or. 1983) (“We conclude that the power itself was created to benefit the majority of the people by suspending operation of a statute until the people have an opportunity to approve or reject legislation.”)

Impact on the State Business Tax Climate Index

There are four possible outcomes from the special election:

- Both tax increases are enacted;
- The individual income tax is rejected but the corporate income tax is enacted;
- The individual income tax is enacted but the corporate income tax is rejected;
- Both tax increases are rejected.

The table below illustrates how Oregon would have ranked on the State Business Tax Climate Index ranking this year under each scenario:

Referendum Outcome	Ranking
1. Both tax increases are enacted	14th
2. The individual income tax is rejected but the corporate income tax is enacted	9th
3. The individual income tax is enacted but the corporate income tax is rejected	13th
4. Both tax increases are rejected	8th

Rankings are out of 50 states. The higher the rank, the more business friendly the tax climate.
Source: Tax Foundation

For Option 1, if both tax increases are upheld then the rankings will not change. This simply means that the original Index score and ranking (14th best) will stand.

For Option 2, if the individual income tax hikes are repealed but the corporate income tax increases are upheld, then the ranking would improve from 13th to 9th. This is a substantial gain overall, caused by the move from 45th best to 32nd best on the sub-index devoted to measuring each state's personal income tax.

For Option 3, if the corporate tax increases are repealed but the individual income tax increases are upheld, then the ranking improves one spot to 13th, reflecting an improvement from 31st to 25th in the sub-index devoted to comparing the 50 states' primary business taxes.

For Option 4, if both the increases to individual income and corporate income tax are repealed, then Oregon will return to the top-ten ranking it maintained before the tax hikes of 2009. That is, it would be ranked as having the 8th best tax climate in the nation, this despite the passage of additional taxes on gasoline, vehicle registration, health care and tobacco.

Conclusion

Oregon legislators 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. In doing so, there was an effort 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, both the state budget and the state economy will suffer.

Oregonians have in the past shown their willingness to strike down tax increases on statewide ballots, but many supporters of these new tax measures claim that a recent leftward shift in Oregon's political landscape may preserve the legislature's tax increases. With most states confronting budget situations similar to Oregon's, observers nationwide will be carefully watching the results on January 26.