

Politicians Debate a Plan to Shift

Governor Kitzhaber's influence on the legislature will be tested next session as legislators in both houses consider whether to attempt to override the governor's veto of Senate Bill 1275. The bill is intended to attract businesses to Oregon by offering tax cuts to corporations that have offices or manufacturing facilities in the state and products that are exported out of state. SB 1275, which passed in both the House and the Senate by overwhelming majorities last year, was vetoed by the governor in September. Kitzhaber maintains that the loss of revenue that would result from the bill would put Oregon's public school finance system in jeopardy. Supported by every republican member and the majority of democratic members of both houses, the bill apparently has enough votes to override the governor's veto, but loyalty to the governor may push some democrats to reconsider the issue.

THE BILL

Senate Bill 1275 does not change the rate by which corporations are taxed in Oregon. Instead, it changes the formula

used in determining the income taxes paid by corporations. Most states, including Oregon, use a formula involving three factors to

calculate corporate income tax: sales, property, and payroll factors of their formula. This gives a tax break to corporations with factories or other facilities in the state and a substantial percentage of sales outside the state.



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History of Legislation 1999

SB 1275 was sponsored by the Senate Committee on Rules and Elections. The members of the committee are Charles Starr (R-Hillsboro), Randy Miller (R-Lake Oswego), Lee Beyer (D-Springfield), Senate minority leader Kate Brown (D-Salem), Neil Bryant (R-Bend). The bill was carried on the Senate floor by Lee Beyer and on the House floor by Thomas Butler (R-Ontario).

The bill passed the House the 21st of May in a 48-12 vote. The dissenters included Jo Ann Bowman (D-Portland), Mike Lehman (D-Coos Bay), Jeff Merkley (D-Portland), Bill Morrisette (D-Springfield), House minority leader Kate Piercy (D-Eugene), Floyd Prozanski (D-Eugene), Anita Rasmussen (D-Portland), Diane Rosenbaum (D-Portland), Barbara Ross (D-Corvallis), Jackie Taylor (D-Astoria), Judy Uherbelau (D-Ashland), and Vicki Walker (D-Eugene).

The bill passed the Senate the 15th of July in a 26-4 vote. The dissenters included Ginny Burdick (D-Portland), Tony Corcoran (D-Cottage Grove), Frank Shields (D-Portland), and Cliff Throw (D-Salem).

Governor Kitzhaber vetoed SB 1275 on the 3rd of September.

Oregon currently apportions corporate taxable income using a formula called a double-weighted sales factor. It was one of eight states to change to the formula in 1991 in an effort to encourage economic development. The double-weighted sales factor formula assigns a sales factor of .5, and property and payroll factors of .25 each. (See sidebar on corporate taxation)

Senate Bill 1275 proposes changing the corporate income tax formula from the double-weighted sales factor formula to a super-weighted sales factor formula. The new formula would change the sales factor to .8, the property factor to .1, and the payroll factor to .1. This would further reduce the taxes paid by corporations that manufacture products here in Oregon and export products outside of the state.

The bill would phase in the change over a three year period. In the first year of implementation, the sales factor would be raised to .6, with property and payroll dropping to .2 each. In the second year, the sales factor would become .7, with property and payroll each becoming .15. The third year would see the full implementation of the new formula. The sales factor then would be .8, property .1, and payroll .1. This phasing in process is meant to soften the blow in loss of revenue that

attract corporations to the state. If corporations choose to open factories or offices in Oregon, employment will be created for Oregonians. These corporations would also bring in revenue. Proponents hope to attract high-tech industry, but all industries that export goods out of state would benefit from the bill. This includes automobile manufacturers, textile manufactures, chemical producers, timber and wood-products businesses, etc. But no one is certain how much the bill will affect the

account the economic development that might occur due to the proposed changes. Potential sources of revenue include taxes paid by corporations that move into the state or expand their operations here, as well as the income taxes paid by their employees. It is impossible to know ahead of time exactly how much impact the legislation would have on Oregon's economy.

Many of the Republican supporters of SB1275 are not too concerned about loss of revenue, because they believe that the current level of state government spending is excessive. As Senator Miller pointed out, the state budget in recent years has increased an average of 15 percent each biennium. What is needed in Oregon government is not more revenue, but more discipline, the senator remarked. In his opinion, the costs of many government-funded projects, such as the light rail line now being built to provide transportation to the Portland airport, far outweigh their benefits.

In addition to attracting new businesses, the bill might also help retain the corporate assets and production that are already established in the state. Corporations can easily move some of their assets (and with a little more difficulty some of their employment) to other states, and might decide to do this in order to pay lower taxes. This would mean the loss of jobs and revenue in Oregon.

If corporations set up operations in Oregon, the state economy could further reduce its dependence on logging and wood-products businesses. The timber industry would benefit from the bill, along with other export industries based in the state. But proponents argue that industries moving into the state would help diversify the Oregon economy and offer jobs to displaced workers.

Concern about the lagging economic growth in some areas of Oregon ensures a large legislative support base for SB 1275. Large export corporations already established in Oregon, such as Nike, Intel and Willamette Industries would be the first to receive the financial benefits of the bill. Several of these corporations have been active in lobbying for the bill's passage. On the other hand, the majority of corporations that would lose money as a result of the bill



the General Fund will receive if the bill is passed.

In the long run, SB 1275 may carry a fairly heavy price tag. The Legislative Revenue Office predicts a loss in revenue of \$3.5 million in the first two years of the bill's enactment. This loss of revenue goes up to \$51.9 million in the following two years. In the two years after full implementation, the estimated loss of revenue is \$102.5 million.

Currently, twenty-two states including Oregon use the double-weighted sales factor formula. Minnesota, Ohio and Michigan have super-weighted sales factor formulas. Iowa, Illinois, Nebraska and Texas all have single sales factor formulas, which means that corporate property and payroll are not taxed at all.

THE ARGUMENTS IN FAVOR

The basic purpose of SB1275 is to

decisions of corporations.

While opponents of the bill, including the governor, point out that Oregon's economy is already growing at a healthy rate, supporters argue that the economic development has been largely confined to one section of the Willamette Valley. Senator Randy Miller, vice chairman of the Committee on Rules and Elections, which sponsored the bill, notes that "One doesn't have to stray very far from the I-5 corridor before seeing the other Oregon where unemployment can reach into the double digits. By bringing corporations to the state, SB 1275 could help reduce unemployment in some of the depressed areas."

Proponents of the bill also note that the loss of revenue estimates are based on the current economic situation in Oregon, and do not take into

are based out of state and have little influence on the Oregon legislature.

THE OPPOSITION

Four out of thirty senators and twelve out of sixty representatives voted against Senate Bill 1275. All of them are democrats. The governor joined the opposition with his veto of the bill in September. These legislators and the governor have both ideological and practical concerns about the bill. Their biggest concern is the loss of state revenue.

Although supporters of the bill maintain that an increased level of business will offset the initial loss of revenue, most estimates suggest that it would take at least three years before any significant growth in taxable income would result from companies moving into the state. Meanwhile, Oregon would have to fund the new infrastructure that the economic growth would require.

As Governor Kitzhaber observed in his veto message, Oregon's current

economic prosperity masks our state's dependency on an unstable revenue source. Much of this instability was created in the early 1990s after Measure 5 took away a large amount of school funding by cutting property taxes. The loss of revenue created a tough budget

bill irresponsible legislation, because the job of dealing with the negative effects of the legislation will be left to the new crew. Merkley argues that without a solid plan to compensate for the loss of revenue, Oregon's citizens will eventually end up paying the bill. He

Opponents question what type of businesses, if any, would be attracted by this

balancing act.

SB1275 would phase in the new formula over several years in an effort to buffer its negative impact on the General Fund. Supporters of the bill believe the phasing in process would allow enough time for the state to cope with the loss of revenue. But opponents see the phasing in of the formula as a way of putting off facing the inevitable loss. Representative Merkley calls the

also believes that given Oregon's current high-production economy, the state has more to lose in revenue than to gain by increased production.

The governor also mentioned that an estimated 6,000 businesses would be hurt by changes the bill will bring. These are businesses that have large markets in Oregon. Most have production in Oregon, but they also have a large percentage of their sales in the state.

Corporate taxation in Oregon

The majority of states including Oregon use a formula utilizing three factors to determine the percentage of corporate income taxable by the state. The factors are sales, property and payroll. Oregon current formula has a double-weighted sales factor. Under this formula the sales factor is .5; property and payroll are .25 each. SB 1275 proposes changing to the super-weighted sales factor by changing the sales factor to .8 and the property and payroll to .1 each.

The percentage of income a corporation is taxed by the state is found multiplying the percentages of sales, property and payroll a corporation has within the state to their corresponding factors. The resulting percentages are then added together. The sum of the percentages is the total percentage of a corporation's pre-tax profits that is taxable by the state.

For example, hypothetical corporation QVZ has \$1 million in sales within the state, but a total of \$100 million globally, which means it has 1% of its sales in Oregon. QVZ has production in Oregon. It has \$1 million in property in Oregon and \$2 million globally. It has \$1 million in payroll in Oregon and \$2 million globally. Therefore, QVZ has 50% of its property and 50% of its payroll in Oregon.

These percentages are then multiplied by the factors of the equation. Under the existing formula, the 1% of sales QVZ had in Oregon would be multiplied by the sales factor of .5, making .5%. The 50% of property QVZ had in Oregon would be multiplied by the property factor of .25, resulting in 12.5%. Payroll, being 50%, would also result in 12.5%. These percentages are then added together. The sum of .5% + 12.5% + 12.5% = 25.5%. Under the current

formula, QVZ would pay Oregon taxes on 25.5% of its net pre-taxed profit. Under SB 1275, QVZ would only have to pay 10.8% of its pre-taxed profit.

If QVZ made a profit of \$30 million, under the current formula the corporation would pay Oregon taxes on 25.5% of \$30 million, or \$7.65 million. Oregon taxes corporation at a flat 6.6%, so QVZ would pay Oregon \$504,900 in taxes. Under the super-weighted sales factor formula proposed by SB 1275, QVZ would be taxed on 10.8% of \$30 million, or \$3.24 million. Taxed at 6.6%, QVZ would pay Oregon \$213,840 in taxes. QVZ would save \$291,060 in taxes under the proposed legislation.

Oregon already has a fairly low corporate tax rate compared to other Western states. Corporations are taxed at a flat rate of 6.6 percent. But after credits and deductions, the effective rate of corporate taxation averages 3.2 percent. This figure is low, compared to the income tax rates that individuals and private businesses must pay.

Opponents question what type of



businesses, if any, would be attracted by this legislation. They suggest that the bill might appeal to corporations offering low-paying jobs and with dubious environmental practices, rather than the high-tech corporations that supporters are hoping for. They point out that corporations that are attracted by low tax rates may be more concerned with the bottom line than they are with the human and environmental needs of a community. Senator Corcoran, who recommended that the governor veto the bill, gave the example of warehouses packed full of telemarketers making relatively low wages.

Opponents argue that SB 1275 is gambling on attracting business to Oregon. There is no certainty that businesses will respond to the tax change. Corporations look at many factors besides taxation when considering where to expand. These factors include the cost of property and utili-

ties, presence of a well-trained labor market, and quality of life. A decrease in state revenue could lead to a loss of funding for education, which could adversely affect the quality of schools and cause the well-educated labor force to move elsewhere.

Senator Corcoran suggests that Oregon would benefit by following the example of North Carolina, which made a decision fifteen years ago to

invest in higher education in an effort to attract high-tech industry to the state. The decision paid off, and North Carolina is now enjoying a growing number of high-tech businesses as well as some of the finest schools in the country. The senator proposes that Oregon adopt a similar policy, which would encourage a marriage between higher education and high-tech industry. But with the General Fund currently straining to fund the state's present educational needs, and several tax cut proposals in legislative committees, the political climate would have to change before Oregon would be likely to embark on such a path.

Representative Merkley agrees with Senator Corcoran. He believes that any corporate incentive should target certain cutting-edge industries, such as high-tech and bio-tech. In particular, he favors state support for OHSU in an effort to attract bio-tech industry. From his point of view, SB 1275 has no

strategic plan for encouraging businesses.

Shadowing the SB 1275 debate is a general trend among states to lower corporate taxes to attract business. Proponents of the bill claim that Oregon could gain an edge in the competition by passing the legislation. Opponents argue that the legislation would simply cause other states to follow suit, and in the end, this competition would shift the tax burden to the citizens, while economic benefits would go mainly to the corporations. As Senator Corcoran remarked, What is needed is federal legislation to stop the states from giving out all these tax incentives to corporations. This may be the only way to end

Current Formulas and Loss of Revenue in Super-weighted Sales Factor States

Minnesota has allowed corporations the option of a super-weighted sales factor formula since 1951. The formula the state uses has a sales factor of .7, property and payroll at .15 each. In 1987, the super-weighted formula became mandatory. Because it was already in practice as an option, there was no significant loss of revenue due to the change.

Ohio passed legislation for a super-weighted sales factor formula in 1997. The new formula took effect in 1999. Under the new formula, the sales factor is .6, property and payroll are .2 each. The Ohio Department of Taxation estimated the loss of revenue at \$12 million.

Michigan passed legislation for a super-weighted sales factor formula in 1995. The formula was phased in 1997 and 1998 with the sales factor at .8, property and payroll at .1 each. The formula was fully implemented in 1999 with the sales factor at .9, property and payroll at .05 each.