



# Executive Summary

204 N. First St., Suite C • PO Box 7 • Silverton, OR 97381 • www.ocpp.org • 503-873-1201 • fax 503-873-1947

*April 15, 2001*

## **Clearing the Air on Tax Day Assessing the Tax Burden in Oregon**

By Jeff Thompson

By most measures Oregonians are paying the same share of their income in taxes as they were paying almost twenty years ago. In 1999, all state and local taxes were equivalent to 10.2 percent of Oregon's income. This measure of effective tax rate declined over the last ten years, and has fluctuated between 10 and 12 percent since 1979.

The effective personal income and property tax rate for all Oregon households, excluding those taxes not directly paid by households, was 6 percent in fiscal year 1999. This measure of effective tax burden has been approximately 6 percent since the 1970s, with a low of 5.5 percent in 1987 and a high of 6.5 percent in 1982.

Between 1977 and 1998, the effective income tax rate (tax due as a share of adjusted gross income), of the average Oregon taxpayer fluctuated around five percent, never rising as high as six percent and never dropping to four percent.

The effective tax rate for Oregon businesses declined by more than one-third during the 1990s. Oregon's 1999-2000 effective business tax burden was the lowest among seven Western states. Businesses paid 45 percent of all Oregon taxes in 1983-84 and only 39 percent in 1997-98. Businesses paid 57 percent of all Oregon property taxes in 1983-84 and only 46 percent in 1997-98.

Working poor Oregon families of four had the eighth highest state income tax burden in the nation in 2000. The state income tax burden for families earning slightly more than poverty (125 percent) was third highest. Oregon's income tax threshold was the 13<sup>th</sup> lowest in the nation in 2000.

In 1999, a family in the middle of the income distribution is paying a smaller portion of their personal income in federal taxes now than at any other time in the past thirty years.

The report also dispels some common fallacies. The report notes:

- While Oregon has three marginal income tax rates (5, 7, and 9 percent), no Oregon taxpayer pays 9 percent of his or her income in state income taxes.
- Over the last ten years, total state and local tax collections in Oregon have trailed behind economic growth.
- Middle-income families have had an easier time paying their taxes in recent years than in the past.





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How much we tax ourselves, and the way that we tax ourselves, are two of the most important policy issues citizens in Oregon and around the country face.<sup>1</sup> An accurate understanding of our tax burden is crucial, since the outcome of the debate around tax issues drives funding decisions for public programs that are essential to the livability of our communities and directly impact the lives of vulnerable populations. Unfortunately, misleading and inaccurate information often drives the tax debate.

Sometimes policy makers, the media, and the general public simply misunderstand basic concepts of taxation and state budgets. Surveys by the Oregon Progress Board show Oregonians are not knowledgeable about state government revenue sources and expenses.<sup>2</sup> Anti-government activists have a sad history of disseminating misleading information that overstates the typical Oregonian's tax burden. This often happens in mid-April, with the approach of the filing deadline for state and federal income taxes. These groups seize on tax day and its accompanying anxieties to spread deceptive information about the tax burden on Oregonians.

A review of data from Oregon reveals that over the last ten years taxes have declined as a share of the state's income. Total tax collections have increased, but they have done so more slowly than the state's economic growth, leaving Oregon's tax burden at lower levels. The most problematic aspects of the tax system are its overall regressive nature; related to that are the high levels that Oregon taxes low-income families. Also, compared to other Western states, Oregon's business tax rates are low.

Although Oregon's overall tax burden is at the same level as twenty years ago, this does not necessarily mean that state and local governments have adequate revenues to meet pressing public needs. In fact, state and local government taxes have shrunk over the last ten years when compared to the rest of the economy.<sup>3</sup> While the tax burden has been falling, Oregon has cut valued state programs and put off making important investments. There are widely recognized, unmet public needs in the areas of education, health care, and the environment, and Oregon's current tax burden suggests that we can afford to meet more of them.

## Misrepresenting the Tax Burden

The actual tax burden Oregonians face is often misrepresented and overstated in three ways:

### *1. Oregonians Pay 9 Percent in Income Taxes: Marginal and Effective Tax Rates Are Not That High.*

Oregon has three marginal income tax rates, 5, 7, and 9 percent. Because the income threshold for the top rate is set so low, (\$6,100 for single returns and \$12,200 for joint returns in tax year 2000) most taxpayers have income in the top bracket. No Oregon taxpayer, however, pays 9 percent of his or her income in state income taxes.

The tax rate is only applied to a portion of taxpayers' total income, excluding income such as contributions to and interest earnings from retirement savings plans, deductions for dependents, and subtractions for some federal income tax payments among others.<sup>4</sup> Moreover, even though the top rate kicks in at \$6,100 and \$12,200, all income under that amount is taxed at lower rates. These two factors ensure that no Oregonian pays 9 percent of their income in taxes. While state income taxes paid by the richest 0.3 percent of Oregonians, with incomes over \$500,000, were nearly equal to 9 percent of their "taxable income" before credits, and 8.6 percent after credits, on average their taxes were just 7.7 percent of their unadjusted income in 1998.

### *2. Growing Too Fast?: Taxes Against Inflation, Population, and Income.*

Some activists pushing for tax cuts have argued that taxes are growing out

of control, outstripping even the growth in inflation and population. While inflation-adjusted per-capita tax collections in Oregon have grown in recent years, this should not be cause for concern. Oregonians' ability to pay higher taxes is determined by economic growth, which is influenced by, but not limited to, changes in inflation and population. As Oregon's economy grows, the state collects increased taxes. As Figure 1 (below) shows, over the last ten years, total state and local tax collections in Oregon have actually trailed behind the economy.

### *3. Paying More Than Ever?: "Tax Freedom Day" Overstates Burden and Trend.*

Each year around tax day the Tax Foundation releases a report announcing "Tax Freedom Day." As the Tax Foundation defines it, "Tax Freedom Day" describes how long the average American must work each year to pay taxes. The Foundation claims that Americans must work longer each year just to pay taxes. The methods used by the Foundation, however, are flawed.<sup>5</sup> Because the federal income tax is based on ability to pay, very high-income taxpayers pay considerably higher rates than most other Americans. By including taxes paid by those with very high incomes in their analysis, the Tax Foundation overstates the burden the typical taxpayer faces. The Foundation further overstates the typical tax burden by counting as taxes items that are clearly not taxes, such as optional fees paid by elderly and disabled people for physician coverage under Medicare. The Foundation also inflates the tax burden by ignoring important sources of income, such as

capital gains income, even though it counts capital gains taxes among taxes.

The “Tax Freedom Day” computed by the Tax Foundation overstates how long the typical American family must work to pay their taxes. With stable

state and local tax burdens and declining federal burdens, middle-income families – the “typical” taxpayers -- have had an easier time paying their taxes in recent years than in the past.<sup>6</sup>

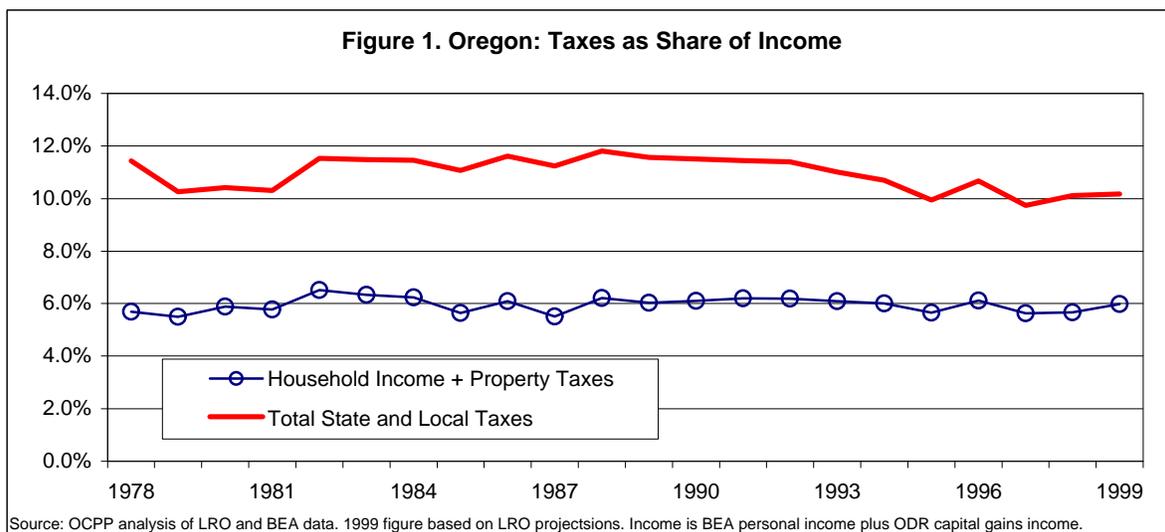
### The Tax Burden in Oregon

Taxes impact the well-being of Oregonians in two basic ways. First, taxes lower spendable income, thereby decreasing private consumption. Second, public goods and services funded by taxes increase consumption and enhance the quality of life of residents of the state. With any investment or expenditure, the amount and quality of the product or service purchased should always be weighed against the expense. The same is true of taxes. This report, however, focuses exclusively on the tax burden and not the accompanying benefits, such as public education, health care, care for the aged and disabled, and job training for the unemployed. Because it does not address these benefits, the discussion will necessarily be incomplete.

#### *Oregon’s Total State and Local Tax Burden*

By most measures Oregonians are paying the same share of their income in taxes as they were paying almost twenty years ago. Figure 1 contains two different measures of the effective tax rate for state and local taxes in Oregon.

The higher of the two measures represents all state and local taxes collected in Oregon divided as a share of the state’s personal income plus capital gains income, which is not included in the personal income measure.<sup>7</sup> In 1999, all state and local taxes were equivalent to 10.2 percent of Oregon’s income.<sup>8</sup> This measure of the effective tax rate declined over the last ten years, and has fluctuated between 10 and 12 percent since 1978.



This measure does not effectively express the Oregon household tax burden because it includes a number of taxes not directly paid by households, such as corporate income taxes and business property taxes. Figure 1 also contains a measure of effective tax burden that only includes personal income taxes and the property taxes paid by households.<sup>9</sup> According to this measure, which excludes a number of taxes not directly paid by households, the effective personal income and property tax rate for all Oregon households was 6 percent in fiscal year 1999. This measure of effective tax burden has been approximately 6 percent since the 1970s, with a low of 5.5 percent in 1987 and a high of 6.5 percent in 1982.

The Tax Commission's research also shows that, while the tax burden of households in Oregon dropped slightly, the effective tax rate for Oregon businesses declined by more than one-third during the 1990s.<sup>12</sup> Oregon's 1999-2000 effective business tax burden was the lowest among the seven states studied by the Commission. These divergent trends in effective tax rates indicate a shift in Oregon taxes away from businesses and toward households. According to the Legislative Revenue Office, Oregon businesses paid 45 percent of all Oregon taxes in 1983-84 and only 39 percent in 1997-98. Businesses paid 57 percent of all Oregon property taxes in 1983-84 and only 46 percent in 1997-98.<sup>13</sup>

*Household and Business Burdens*

A biennial study conducted by the Utah State Tax Commission analyzes the state and local tax burden of households and businesses in seven Western states, and includes all taxes paid by both groups.<sup>10</sup> The Tax Commission's household tax burden figure is broader than the one presented in Figure 1, because it includes excise taxes in addition to income and property taxes. The Tax Commission's findings (Table 1) show that the effective tax burden on all Oregon households has fluctuated little over the last 15 years, ranging between 7 and 8 percent. Preliminary findings for 1999-00 show that Oregon's tax rate for households was in the middle of the seven Western states studied.<sup>11</sup> Oregon's total household tax burden was lower than in Utah, California and Idaho, but higher than Arizona, Colorado, and Washington.

**Table 1. Total effective tax burden in Oregon**

	Household	Business
1984-85	6.9%	3.6%
88-89	7.4%	3.6%
90-91	7.7%	3.4%
93-94	8.0%	3.0%
95-96	7.1%	2.5%
97-98	7.1%	2.3%
*99-00	7.1%	2.2%

\*1999-2000 tax burden figures are preliminary.  
 Source: Utah State Tax Commission  
 Households: State and local taxes as percent of income (excluding capital gains.)  
 Businesses: Taxes as percent of Gross State Product

An important limitation of this kind of tax burden measurement (presenting total taxes as a share of total income) is that it obscures the fact that different taxpayers pay different rates. When taxes and tax rates apply differently to varying groups, per-capita or average measures can overstate the typical taxpayer's tax burden. Income tax statistics available through the Oregon Department of Revenue can be used to calculate the tax burdens of different income groups.

*Personal Income Tax Burden*

The personal income tax is the single largest tax in Oregon. The average effective personal income tax rate has been extremely stable over the last twenty years.<sup>14</sup> Between 1977 and 1998, the effective income tax rate (total tax due as a share of adjusted gross income), of the average Oregon taxpayer fluctuated around five percent, never rising as high as 6 percent and never dropping to 4 percent.<sup>15</sup> Because Oregon's income tax is partially based on the ability to pay (slightly progressive), those with higher incomes have slightly higher marginal and effective tax rates.

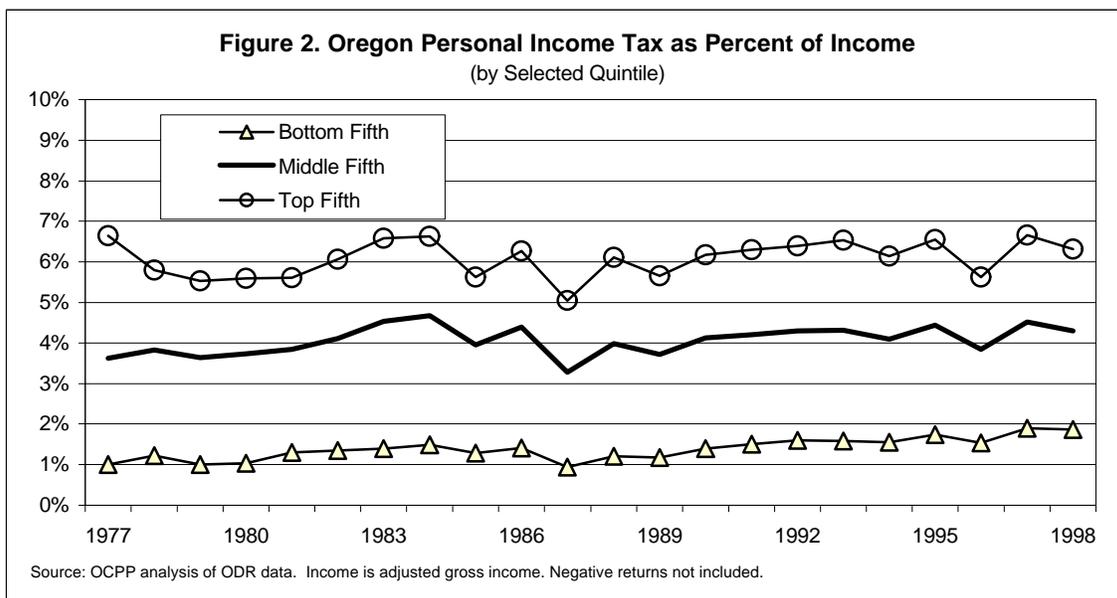
Figure 2 illustrates the effective state personal income tax burdens for high, middle and low-income households in Oregon.<sup>16</sup> While the income tax burden of each group has remained steady, those with lower incomes pay a lower rate.

The middle fifth of taxpayers paid Oregon personal income taxes approximately equal to four percent of

their adjusted gross income in each year since 1977. The richest fifth of taxpayers consistently paid around six percent. The bottom 20 percent of filers in Oregon paid between one and two percent of their adjusted gross income in state income taxes.

*Oregon's Income Tax Threshold for Low-income Families*

The effective state income tax rate of low-income Oregonians held steady over the last 20 years, but compared to other states Oregon has relatively high taxes on low-income working families.<sup>17</sup> The income tax burden borne by working poor families of four was the eighth highest in the nation in 2000. The income tax burden for families earning slightly higher than poverty incomes is especially heavy in Oregon compared to other states. For example, a two-parent family of four earning 125 percent of poverty (\$17,050 in 2000) paid \$720 in state income taxes, an amount exceeded in only two other states.



	Share of Taxes	Average Tax	Share of Income	Average Income	Total Tax Burden
Bottom 20%	4.5%	\$1,354	4.1%	\$10,989	12.3%
Second 20%	7.4%	\$2,247	8.6%	\$22,711	9.9%
Middle 20%	13.8%	\$4,174	14.5%	\$38,487	10.8%
Fourth 20%	22.2%	\$6,715	22.5%	\$59,584	11.3%
Top 20%	52.2%	\$15,798	50.3%	\$133,385	11.8%
Top 5%	26.3%	\$30,158	24.2%	\$243,416	12.4%
<b>Total</b>		<b>\$6,057</b>		<b>\$53,031</b>	<b>11.4%</b>

Source: OTIM findings analysed by OCPP.

Oregon's heavy income tax burden on poor and near-poor taxpayers is due in part to the state's low tax threshold -- the income at which a family starts paying state income taxes. Oregon's income tax threshold was the 13<sup>th</sup> lowest in the nation in 2000 for two-parent families of four. Unlike the majority of states with income taxes, Oregon taxes four-person families with incomes below poverty. The creation of a limited state earned income tax credit in 1997 helped raise the tax threshold, but it remains below the poverty level for three- and four-person working families.<sup>18</sup>

#### *Distribution of Oregon's Total Tax Burden*

While Oregon's income tax is slightly progressive (rates are based on ability to pay), other state and local taxes are regressive (higher effective rates on lower-income tax payers). Even though Oregon does not have a regressive sales tax, Oregonians do pay state and local excise taxes including taxes on gasoline, cigarettes, and other items, as well as local property taxes. None of these taxes are based on the ability to pay.

One recent study in Oregon attempts to determine the distribution of all state and local taxes by income class. The

Legislative Revenue Office's newly developed Oregon Tax Incidence Model (OTIM) goes beyond the "initial incidence" of taxes discussed in previous tax burden measures. Employing assumptions taken from a wide range of economic research and modeling, OTIM assigns all state and local taxes to the groups believed to ultimately bear the costs for the tax.<sup>19</sup>

Using OTIM, the Legislative Revenue Office found that Oregon's tax structure has both regressive and progressive elements (Table 2).<sup>20</sup> Oregon's tax system can be considered regressive because the effective tax burden of the lowest-income households is higher than for most other income groups. The bottom 20 percent of Oregon households pay 12.3 percent of their income in state and local taxes, while the top 20 percent pay just 11.8 percent.<sup>21</sup>

Excluding the poorest Oregonians, however, OTIM shows that for the rest of the population the tax system is slightly progressive, with high-income households paying slightly higher effective rates than middle-income households. The second fifth of households pay an average of 9.9 percent of their income in state and local taxes, while the top five-percent of households pay 12.4 percent.

## The Federal Tax Burden

In addition to state and local taxes, Oregonians also pay federal taxes. Most pay considerably more in federal taxes than they do state and local taxes. Taxes on middle income families at the federal level have been declining over the past five years. According to the Congressional Budget Office (CBO) families in the middle fifth of the income distribution paid a smaller portion of their income in federal taxes in 1999 than at any other time in the past thirty years. In 1995 middle income families, on average, paid 19.7 percent of their incomes to federal taxes, but in 1999 the share of income going to federal taxes dropped to 18.9.

Conservative groups point to rising total federal tax collections as a share of the US Gross Domestic Product as evidence of an increasing tax burden for average Americans. Total federal tax collections have increased in recent years, but, because these taxes have

come predominantly from the soaring incomes of very high-income taxpayers, more tax collections have not translated into higher tax burdens for typical families. The boom in the stock market has helped fuel increases in capital gains, and rising incomes in higher tax brackets all have contributed to the rising collection of tax dollars at the federal level. These factors, however, have had little effect on families in the middle of the income scale.

Middle-income families have actually received tax cuts over the past ten to twenty years, contributing greatly to the decline in the federal tax burden. Families are allowed to make deductions of \$500 per child and to deduct education credits, and this has had the effect of lowering the overall tax burden on middle-income families.

## Conclusion

A review of data from Oregon shows that the overall tax burden has remained relatively constant over the last twenty years, and has declined in the last ten. While the tax burden has not risen, there are some disturbing elements in Oregon's tax structure. Overall, the tax structure places higher effective rates on lower income households, while letting upper-income households pay less despite their ability to pay more. Compared to six other Western states, the Oregon household tax burden is average, but the effective tax rate of Oregon businesses is the lowest.

## Endnotes.

<sup>1</sup> Special thanks to OCPP intern Aileen Clymer.

<sup>2</sup> See Vaidya, Kanhaiya L., *2000 Oregon Population Survey Summary of Findings*, Office of Economic Analysis, Department of Administrative Services, State of Oregon, January 12, 2001 available at <http://www.econ.state.or.us/opb/2000opssummary.pdf>

<sup>3</sup> The trend toward smaller government in Oregon is supported by declining state government employment.

<sup>4</sup> Oregon's income tax rates are applied to "taxable income." Taxable income equals total income minus exempt income (i.e. Social Security and insurance proceeds) and less adjustments to income (i.e. moving expenses and student loan interest payments) and deductions (i.e. the standard deduction allowed all taxpayers and medical costs deductions). Oregon Department of Revenue, *Oregon Personal Income Tax Statistics: Tax Year 1998*, page 22.

<sup>5</sup> Lav, Iris, Joel Friedman, and James Sly, *Tax Foundation Figures Lead to Inaccurate Impression of Middle-class Tax Burden*, Center on Budget and Policy Priorities, 4/11/2001.

<sup>6</sup> Lav, Iris, *Taxes on Middle Income Families Are Declining*, Center on Budget and Policy Priorities, January 10, 2001.

<sup>7</sup> Data on total state and local taxes as well as income are available through the Oregon Department of Revenue and the Legislative Revenue Office. Total state and local taxes include personal income taxes, corporate income taxes, excise taxes, property taxes and more. Personal income data is from the Department of Administrative Services and capital gains income is from the Oregon Department of Revenue personal income tax statistics publications from various years. Capital gains income for 1999 is projected by OCPP.

<sup>8</sup> Figures for total state and local taxes as a share of personal and capital gains income are from the fiscal year (July 1 to June 30).

<sup>9</sup> Household property and income tax burden calculated by OCPP with Oregon Legislative Revenue Office (LRO) and DAS data.

<sup>10</sup> *Western States' Tax Burdens: Fiscal Year 1997-98*, Utah State Tax Commission, Research Publications 99-17. Utah's measure of household tax burden includes a broader range of taxes, including state and local excise taxes.

<sup>11</sup> Other states studied by the Utah State Tax Commission include Arizona, Washington, Utah, Idaho, California, and Colorado. With the publication of its 1999-2000 study, the Commission plans to add tax burdens from several other Western states.

<sup>12</sup> The business tax burden measured by the Utah State Tax Commission is "initial taxes paid by businesses as a percent of gross state product." *Western States' Tax Burdens*, p. 3

<sup>13</sup> Legislative Revenue data provided for the *Review of Oregon's Tax System*, Governor's Tax Review Technical Advisory Committee, June 1998. Updates for 1997-98 provided by Legislative Revenue Office.

<sup>14</sup> Taking federal income taxes into consideration does not change the trend of long-term stability in effective tax rates. A Center on Budget and Policy Priorities analysis of Congressional Budget Office data shows that the effective federal tax rate of middle-income families changed very little between 1977 and 1999. In each year the effective federal tax rate of the middle twenty percent of families was at or less than 20 percent. *Taxes on Middle-Income Families Are Declining*, CBPP, April 1999.

<sup>15</sup> Personal income tax burdens are estimated from data on all returns in *Oregon Personal Income Tax Statistics* publications from the Oregon Department of Revenue over various years.

<sup>16</sup> Personal income tax burden by quintile is calculated by OCPP with ODR tax data following methodology used by the Portland State University Institute for Metropolitan Studies. See *Progress of a Region: the Metropolitan Portland Economy in the 1990s: Technical Report of the Regional Connection Project*, Portland State University, April 1999, p. 2.34.

<sup>17</sup> *State Income Tax Burdens on low-Income Families in 2000: Assessing the Burden and Opportunities for Relief*, March 2001, Center on Budget and Policy Priorities. The data in this report concerns tax year 2000 and taxes paid on 2000 income.

<sup>18</sup> In 2000, for a family of four, income taxes began with income at only 84 percent of poverty.

<sup>19</sup> Using its micro-simulation model, the Institute for Taxation and Economic Policy (ITEP) has also calculated the effective rates of the state and local taxes paid by Oregonians. ITEP's analysis is based on 1995 income data and only looks specifically at the tax burdens of non-elderly married-couple families. ITEP's model showed that even though some elements of Oregon's state and local tax structure are progressive, the overall system is regressive. The richest one percent of non-elderly married-couple families in Oregon paid 7.0 percent of their income in state and local taxes, while the middle fifth of families paid 9.2 percent and the bottom fifth paid 10.8 percent. More information on ITEP's findings can be found in their 1996 publication, *Who Pays?* at [www.ctj.org/itep](http://www.ctj.org/itep).

<sup>20</sup> Table 2 contains results from OTIM that have been adjusted to fit uniform household quintiles by the OCPP. In making this adjustment, OCPP followed the method suggested by PSU Institute for Metropolitan Studies.

<sup>21</sup> The definition of income used in OTIM, "comprehensive income" produces a lower dollar figure than the BEA personal income plus capital gains income measure used in Figure 1.