Executive Summary

August 18, 2008

No Gain, Just Pain

*Most Oregonians would not benefit from Measure 59, but they would lose public services*

by Michael Leachman and Joy Margheim

Measure 59, which would allow an unlimited deduction of federal income taxes on state tax returns, offers no tax break to more than three out of four Oregon taxpayers. And yet the measure’s hefty price tag — more than about 9 percent of General Fund revenues, each budget cycle — would force deep cuts in Oregon’s public structures.

Voters rejected a similar scheme in 2000. This year’s reincarnation of the unlimited federal tax deduction portends no gain, just pain for most Oregonians.

- Measure 59 would cost between $1.1 billion and $2.4 billion each biennium.
- Just the conservative $1.1 billion cost estimate is equivalent to the total funding that Oregon’s public universities will receive from the state in the current biennium or to cutting the salaries of all Oregon K-12 public school teachers by 70 percent.
- Measure 59 would provide a tax break to only 22 percent of Oregon households, and most of it would go to those who are already well off. Households with annual incomes exceeding $83,200 would receive 97 percent of the tax break, leaving just 3 percent of the break to be divided by those with incomes under $83,200.
- The richest 1 percent of Oregonians — those with incomes of at least $405,100 and averaging over $1 million — would get nearly half the tax break set forth in Measure 59. This group of Oregon’s wealthiest households would receive an average tax cut of $15,809. Middle-income taxpayers (with $30,600 to $50,000 in annual income) would receive just two dollars, on average.

The richest 1 percent, with average incomes over $1 million, would get the highest average tax cut from Measure 59

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Average Income</th>
<th>Tax Cut</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest 20%</td>
<td>$10,100</td>
<td>$0</td>
</tr>
<tr>
<td>Second 20%</td>
<td>$23,200</td>
<td>$2</td>
</tr>
<tr>
<td>Middle 20%</td>
<td>$39,600</td>
<td>$46</td>
</tr>
<tr>
<td>Fourth 20%</td>
<td>$64,000</td>
<td>$457</td>
</tr>
<tr>
<td>Next 15%</td>
<td>$111,300</td>
<td>$2,199</td>
</tr>
<tr>
<td>Next 4%</td>
<td>$233,600</td>
<td></td>
</tr>
<tr>
<td>Top 1%</td>
<td>$1,115,200</td>
<td>$15,809</td>
</tr>
</tbody>
</table>

Source: Institute on Taxation and Economic Policy.
No Gain, Just Pain

*Most Oregonians would not benefit from Measure 59, but they would lose public services*

by Michael Leachman and Joy Margheim

Imagine being offered the following deal: in exchange for more overcrowded classrooms, more Oregonians without health coverage and higher college tuition, you get . . . nothing. That is not a hypothetical scenario for most Oregonians. It is the raw deal contained in Measure 59 on the November 2008 ballot.

Measure 59, which would allow an unlimited deduction of federal income taxes on state tax returns, offers no tax break to more than three out of four Oregon taxpayers. And yet the measure’s hefty price tag — more than $1 billion, or more than about 9 percent of General Fund revenues, each budget cycle — would force deep cuts in Oregon’s public structures.

Voters rejected a similar scheme in 2000. Like its earlier version, this year’s reincarnation of the unlimited federal tax deduction portends no gain, just pain for most Oregonians.

**Measure 59 would allow an unlimited federal tax deduction**

Current law allows Oregonians to subtract up to $5,600 of their federal income tax liability when calculating their state taxable income for tax year 2008, although a majority of Oregon taxpayers don’t owe enough in federal taxes to fully utilize the deduction. The Legislative Revenue Office projects the deduction will increase to $5,900 in 2010.1

Measure 59 would remove the $5,900 limit, allowing Oregon taxpayers an unlimited deduction for federal income taxes on their state tax return beginning in 2010. As explained more fully below, fewer than one out of four taxpayers, generally in upper-income households, would see their state tax bill go down.

Measure 59 is an effort to revive an initiative that voters defeated in November 2000, Measure 91.2 At that time, Oregonians could deduct up to $3,000 in federal taxes on their state tax return. Like today’s Measure 59, Measure 91 in 2000 would have allowed an unlimited deduction. Oregonians rejected Measure 91 and instead passed Measure 88, a proposal referred by the legislature, which raised the maximum deduction from $3,000 to $5,000, with subsequent automatic annual increases to account for inflation.3
Measure 59 would cost more than $1 billion

In its current form, the federal income tax deduction is already a significant drain on state revenue. Among the 362 tax breaks outlined in Oregon’s biennial tax expenditure report, it is already the 10th largest. Of tax breaks for personal income taxes, it is already the sixth largest. The current deduction is estimated to cost Oregon $747 million in lost revenues in the current (2007-09) budget period, a 5 percent reduction in General Fund revenues.4

Measure 59 would increase the fiscal impact of the deduction. Oregon’s Legislative Revenue Office (LRO) projects that Measure 59 would cost $2.4 billion in 2011-13 (about $1.2 billion per year), following the measure’s implementation in 2010.5 That projection can be considered the maximum impact, because it assumes no changes to the Alternative Minimum Tax (AMT) and the expiration of the Bush Administration tax cuts in 2010.6 These assumptions push up the cost of the deduction because they increase the amount of federal income taxes Oregonians would pay. In other words, according to LRO, the total cost of the federal tax deduction would quadruple (reaching $3.1 billion) if Measure 59 passes and Congress makes no changes to federal law.

It is more likely, however, that Congress will continue to make short-term adjustments to the AMT as it has in recent years and that Congress will extend some of the 2001 and 2003 Bush Administration tax cuts beyond 2010. OCPP asked the Institute for Taxation and Economic Policy (ITEP) to project the cost of Measure 59 using current federal law (which includes the Bush Administration tax cuts as of 2008) and a temporary, short-term adjustment to the AMT similar to those enacted in recent years.

Using this approach, OCPP and ITEP conservatively estimate that if Measure 59 had been in place in the current biennium it would have added about $1.1 billion in costs, bringing the total tax expenditure to $1.8 billion, or 14 percent of General Fund revenues.7 In other words, Measure 59 would more than double the cost of the tax break, making the federal tax subtraction Oregon’s largest tax break for personal income taxes.

The actual biennial cost of Measure 59 would likely fall somewhere between the $1.1 billion OCPP/ITEP estimate and the $2.4 billion LRO estimate.8
Measure 59 would force major cuts to Oregon’s public structures

Even if its cost is closer to the lower estimate by OCPP and ITEP, Measure 59’s price tag would force significant cuts to vital public structures.

To put just the conservative $1.1 billion cost estimate in perspective, it is:

- More than twice the amount that Oregon counties stand to lose in timber payments over the next two years, which portends fiscal crises in many rural counties;9
- Equivalent to the funding that Oregon’s public universities will receive from the state in the current biennium;10
- Equivalent to cutting the salaries of all Oregon K-12 public school teachers by 70 percent;11
- Roughly the annual cost anticipated by the Oregon Health Fund Board for the state’s effort to ensure access to health care for all Oregonians;12 or
- More than three times total General Fund dollars being spent this budget period for services provided by the Bureau of Labor and Industries, the Secretary of State and the Departments of Administrative Services, Agriculture, Energy, Environmental Quality, Fish and Wildlife, Forestry, Land Conservation and Development, Revenue, Economic and Community Development, Employment, Housing and Community Services, Veterans Affairs and Water Resources, combined.13

Most states do not allow the federal income tax deduction

Oregon is already one of only a handful of states that allow any deduction of federal income taxes. Missouri, like Oregon, allows all taxpayers to deduct a portion of federal taxes, while Montana and North Dakota limit the deduction to certain taxpayers. If Measure 59 passes, Oregon would join Alabama, Iowa and Louisiana as the only states to allow all taxpayers an unlimited deduction for all federal personal income taxes paid.

The remaining 34 states with income taxes and the District of Columbia do not allow any deduction of federal income taxes on the state return. These 35 jurisdictions recognize that allowing a deduction for federal income taxes is an expensive gimmick that serves no compelling public policy purpose.14
More than three out of four Oregonians would get nothing

Measure 59 would provide a tax break to only 22 percent of Oregon households (fewer than one out of four), and most of it would go to those who are already well off. Households with annual incomes exceeding $83,200 would receive 97 percent of the tax break, leaving just 3 percent of the break to be divided by those with incomes under $83,200. In other words, 80 percent of households would get just 3 percent of the tax break.

The wealthiest 20 percent would get virtually all of the tax break, while the remaining 80 percent of taxpayers would get virtually nothing.

Any way you look at the numbers, most Oregonians get little or nothing. The wealthiest 20 percent would get virtually all of the tax break, while the remaining 80 percent of taxpayers would get virtually nothing. The lowest-income 40 percent of Oregonians would receive no tax break whatsoever from Measure 59. Even middle-income taxpayers (with average incomes of $39,600) would see a tax cut of only two dollars on average.\(^{15}\)

The richest 1 percent, with average incomes over $1 million, would get the highest average tax cut from Measure 59

Source: Institute on Taxation and Economic Policy.
Why would so few Oregonians benefit from Measure 59? The majority of Oregonians do not owe enough federal income taxes to reach Oregon’s current federal tax deduction cap ($5,600 in 2008), so they would be no better off if the deduction were unlimited.

Millionaires would get nearly half the tax break

The richest 1 percent of Oregonians — those with incomes of at least $405,100 and averaging over $1 million — would get nearly half the tax break set forth in Measure 59. This group of Oregon’s wealthiest households would receive an average tax cut of $15,809. That is, these high-income households could expect to receive an annual tax cut equal to about the annual income of a full-time minimum-wage worker, while low- and middle-income households would get nothing or next to nothing.

<table>
<thead>
<tr>
<th>2008 income group</th>
<th>2008 income range</th>
<th>Average income in group</th>
<th>Tax cut as percentage of income</th>
<th>Average tax cut</th>
<th>Share of total tax cut</th>
<th>Share of income group that would receive a cut</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest 20%</td>
<td>Less than $16,600</td>
<td>$10,100</td>
<td>0.0%</td>
<td>$0</td>
<td>0.0%</td>
<td>0%</td>
</tr>
<tr>
<td>Second 20%</td>
<td>$16,600 - $30,600</td>
<td>$23,200</td>
<td>0.0%</td>
<td>$0</td>
<td>0.0%</td>
<td>0%</td>
</tr>
<tr>
<td>Middle 20%</td>
<td>$30,600 - $50,000</td>
<td>$39,600</td>
<td>0.0%</td>
<td>$2</td>
<td>0.1%</td>
<td>3%</td>
</tr>
<tr>
<td>Fourth 20%</td>
<td>$50,000 - $83,200</td>
<td>$64,000</td>
<td>0.1%</td>
<td>$46</td>
<td>2.9%</td>
<td>29%</td>
</tr>
<tr>
<td>Next 15%</td>
<td>$83,200 - $165,100</td>
<td>$111,300</td>
<td>0.4%</td>
<td>$457</td>
<td>20.8%</td>
<td>75%</td>
</tr>
<tr>
<td>Next 4%</td>
<td>$165,100 - $405,100</td>
<td>$233,600</td>
<td>0.9%</td>
<td>$2,199</td>
<td>27.0%</td>
<td>87%</td>
</tr>
<tr>
<td>Top 1%</td>
<td>$405,100 or more</td>
<td>$1,115,200</td>
<td>1.4%</td>
<td>$15,809</td>
<td>49.0%</td>
<td>100%</td>
</tr>
<tr>
<td>ALL</td>
<td>—</td>
<td>$64,300</td>
<td>0.5%</td>
<td>$324</td>
<td>100.0%</td>
<td>22%</td>
</tr>
</tbody>
</table>

Note: Figures estimate impact of Measure 59 on 2008 taxes and incomes if it were in place this year. Assumes a basic AMT exemption of $70,200 for married couples and $47,000 for singles/heads of households (6 percent increase over tax year 2007).

Measure 59 would let the wealthy pay a lower tax rate than modest-income households

Should Measure 59 pass, it would tilt the income tax system in favor of the well off, taxing each additional dollar earned by the most well off family less heavily than each additional dollar earned by a family with a modest income.

In other words, Measure 59 would cut the “marginal” rates of upper-income taxpayers. Marginal tax rates are the rates at which each additional dollar of income is taxed.

Today, the highest-income Oregonians pay the top 9 percent income tax rate on each additional dollar of income they collect.\(^\text{16}\)

Under Measure 59, this would no longer be true. Under Measure 59, the more money you make, the lower the share of income that would be taxed.\(^\text{17}\) The highest marginal tax rate for married couples filing jointly with two children under Measure 59 — 9 percent — would be for taxpayers with taxable income between $14,600 and $39,900. Once income exceeded that amount, the tax on each additional dollar of income would be taxed at a lower rate. While there is a small increase in the marginal rate once incomes reach above $661,800, millionaires still would see their additional income taxed at a substantially lower rate than families with modest incomes.

<table>
<thead>
<tr>
<th>Oregon Taxable Income</th>
<th>Marginal Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to $5,800</td>
<td>5.00%</td>
</tr>
<tr>
<td>$5,800 to $14,600</td>
<td>7.00%</td>
</tr>
<tr>
<td>$14,600 to $39,900</td>
<td>9.00%</td>
</tr>
<tr>
<td>$39,900 to $77,400</td>
<td>7.65%</td>
</tr>
<tr>
<td>$77,400 to $146,100</td>
<td>6.75%</td>
</tr>
<tr>
<td>$146,100 to $202,300</td>
<td>6.60%</td>
</tr>
<tr>
<td>$202,300 to $661,800</td>
<td>6.20%</td>
</tr>
<tr>
<td>Over $661,800</td>
<td>6.75%</td>
</tr>
</tbody>
</table>

Source: Institute on Taxation and Economic Policy.

The Measure 59 unlimited deduction is a backhanded way of lowering tax rates for wealthier taxpayers.
Thus, a married-couple family of four with taxable income of $202,300 would be taxed at 6.2 percent on each additional dollar, while a family with taxable income of only one-tenth that amount – $20,230 – would be taxed at 9 percent on each additional dollar earned. In other words, the Measure 59 unlimited deduction is a backhanded way of lowering tax rates for wealthier taxpayers. Such a tax rate schedule is considered regressive because people at higher incomes pay a lower tax rate than people at lower incomes.

**When Oregon loses, the federal government wins**

State income taxes are deductible from federal income taxes. Thus, when state income taxes decline, Oregonians can deduct less at the federal level and must send more money to the federal government. While Oregon’s coffers lose the full cost of Measure 59, the beneficiaries of Measure 59 will send about 13 percent of their savings to the federal government in higher federal income taxes. This increase in federal income taxes diminishes the tax break’s efficiency.

**Conclusion**

Measure 59 offers no gain to three out of four Oregonians and packs pain in the form of at least a billion dollars in cuts to schools, universities, health services and other vital public structures. That the tax break is skewed in favor of Oregon millionaires and helps the federal government at the expense of Oregon adds insult to injury.
Endnotes:

1 Email message from Christopher Allanach, Legislative Revenue Office, to Michael Leachman, July 16, 2008.

2 Measure 59 is slightly different from the earlier initiative. Measure 91 sought to amend the constitution, went into effect for the same tax year as the election, and applied to the corporate as well as the personal income tax. Measure 59 is a statutory measure and does not apply to the corporate income tax.

3 Measure 88 provided for the deduction to be phased in. When the recession hit in 2001 and state revenues fell to levels below which basic services could be provided, legislators established a different schedule for increasing the deduction than was established in Measure 88. Under HB 4054, enacted during the third special session of 2002, the maximum deduction increased to $5,500 for tax year 2007 and was set to grow with inflation for tax years 2008 and later. See Legislative Revenue Office, 2002 Special Session III Revenue Package, research brief 8-02, July 25, 2002, available at www.leg.state.or.us/comm/lro/8_02_special_session_iii_revenue_package.pdf.


6 Email messages from Christopher Allanach, Legislative Revenue Office, to Charles Sheketoff and Michael Leachman, OCPP, June 18 and 20, 2008.

7 Institute on Taxation and Economic Policy, June 2008. Based on 2008 income levels and assuming a basic AMT exemption of $70,200 for married couples and $47,000 for singles/heads of households (roughly a 6 percent increase over AMT exemptions in place for tax year 2007), ITEP estimates an annual reduction in Oregon income tax revenues of $528 million. ITEP’s assumption of 6 percent growth for the AMT exemption is in line with prior “patches.” OCPP doubled the annual figure to get a biennial estimate.

8 The actual biennial cost of Measure 59 after it is implemented in 2010 will likely be higher than the $1.1 billion OCPP and ITEP estimate for the current biennium. Income and population will grow in future biennia, and some of the Bush tax cuts in place this year may not be extended, pushing up federal tax liability for some Oregonians— all of which increase the cost of the tax break. On the other hand, the LRO estimate is likely higher than what will actually occur, because it is unlikely that all of the Bush Administration tax cuts will be allowed to expire and it is unlikely that the AMT will not receive at least another temporary “patch.”

9 Total annual losses to Oregon counties and school districts are estimated at $238 million per year. Governor’s Task Force on Federal Forest Payments and County Services, Initial Report, June 23, 2008, available at www.leg.state.or.us/comm/lro/tffop_index.shtml.


11 Email from Brian Reeder, Oregon Department of Education, to Joy Margheim, OCPP, July 3, 2008. In 2006-07, the state paid $1.6 billion in salary for all licensed non-administrative staff. While teachers make up about 90 percent of such staff, the group also includes library and media specialists, counselors, psychologists, and similar staff.

12 Oregon Health Fund Board, Finance Committee Recommendations to the Oregon Health Fund Board, Part 1: Financing Sources for Reform, June 2008, available at www.oregon.gov/OHPPR/HFB/docs/Finance_recommendations_061908_FINAL.pdf. The committee estimated state costs would range from $900 million to $1.6 billion and developed funding scenarios assuming approximately $1 billion in state revenues would be necessary to fund health care reform.


14 The Measure 59 proponents believe that it is “unjust for one government to impose an income tax on money a taxpayer has been required to pay to another government as an income tax” and couch the measure as “prohibiting double taxation.” In fact, each taxpayer is subject to the federal income tax once and the state income tax once. Moreover, what matters is not the number of times income is taxed, but rather the overall rate of taxation. As noted in this paper, Measure 59 does not change the tax level for low- and middle-income taxpayers and lowers the marginal tax rate for wealthy households. Branding the measure under the rhetoric of “double taxation” is simply a red herring. The unlimited deduction should be evaluated just like any other policy change: on the grounds of its impact on government services, its fairness and its efficiency.

15 This impact is based on 2008 income levels and current tax law. If Measure 59 passes, it will not go into effect until tax year 2010. The impacts then and in future years will not be substantially different for low-income
families. The tax cut will be greater for upper-income families in future years if some of the Bush Administration’s tax cuts are not extended, raising their federal tax liability and thus their state deduction.

For a married couple with two children in 2008, the current, capped deduction for federal income taxes paid reduces the marginal rate on income between $39,900 and $71,600 to 7.65 percent. The same couple’s income above $71,600 is taxed at the top 9 percent rate, because the federal income taxes associated with the additional income are above the $5,600 cap and are not deductible under current law.

This is true up to incomes of $661,800 and above. Because much of the income of households at this top level comes from capital gains, and because the federal tax on capital gains is less than the tax on ordinary income, the federal taxes paid by households at this top level is a smaller share of their income, leaving less to “deduct” under Measure 59 and thus a slightly higher tax rate. They still, however, are taxed below the tax on moderate income households.

In other words, Oregon could accomplish the same results as Measure 59 by changing its current 5-7-9 percent tax rates and brackets to the schedule outlined in the table of marginal tax rates. The table applies to married couples filing jointly with two dependents and assumes either the standard deduction or itemized deductions for both federal and Oregon tax returns where appropriate. The exact income brackets and rates would differ for differing deduction amounts, filing statuses, family sizes, and sources of income, but the pattern and rates would not change significantly.

Based on an analysis by the Institute on Taxation and Economic Policy.