

Oregon Schools Would Pay the Price of Suspending the Corporate Activity Tax

By Daniel Hauser and Juan Carlos Ordóñez

Suspending the Oregon Corporate Activity Tax (CAT), as some in the business community have urged, would undermine school funding at a time when resources for education will already be in short supply. The severe economic downturn triggered by the coronavirus (COVID-19) pandemic will cause a sharp decline in revenue collections that support schools. Suspending the Corporate Activity Tax — a revenue source dedicated to education — would deprive Oregon’s K-12 schools and early education programs of vital funding in favor of a tax cut for businesses. The main beneficiaries of the tax cut would be the largest businesses best able to ride out the economic crash, not small businesses struggling to survive the crisis. Based on past experience, cutting education funding would deepen the recession and undermine educational achievement in Oregon.

For the well-being of Oregon’s children and the state economy, Oregon policymakers should hold firm and reject calls to suspend the Corporate Activity Tax.

Delaying the Corporate Activity Tax means fewer resources for schools

In the absence of new revenue, Oregon’s budget operates as a zero-sum game. Resources spent for one purpose means less money available for other public purposes. This flows from a constitutional requirement that Oregon have a balanced budget.¹ Unlike the federal government, the state cannot deficit spend. It cannot, generally speaking, spend more than it raises.²

This zero-sum dynamic also exists when it comes to new tax cuts or tax subsidies, which shrink the total available revenue. A business tax cut leaves less revenue available for other public purposes, requiring budget cuts or tax increases on someone else to offset the loss of revenue.

Delaying the implementation of the Corporate Activity Tax for one year, as some in the business community have called for, means fewer resources to support education at a time when those funds will be in great need.³ Revenue from the Corporate Activity Tax is dedicated to K-12 education and early childhood education.⁴ The CAT aims to fund a historic investment in Oregon’s childcare system and education system, which had suffered from decades of underfunding. The revenue will allow Oregon to address inequities in early learning, fund student mental and behavioral health, keep teachers teaching, and more.⁵ A significant portion of the revenue from the CAT will go to support the operation of Oregon’s schools.⁶ Thus, postponing this tax is tantamount to a billion-dollar tax cut and a billion-dollar cut to services for Oregon’s children.

What is the Corporate Activity Tax?

The Corporate Activity Tax (CAT) is the vehicle for funding the historic 2019 Student Success Act. The tax, which took effect in 2020, applies to business receipts exceeding \$1 million after certain deductions.⁷ Specifically, a business deducts 35 percent of their labor costs or costs of goods sold, whichever is higher. Any receipts exceeding \$1 million after the deduction are taxed at a rate of 0.57 percent.⁸ The CAT applies to all business forms, including C-corporations, S-corporations, partnerships, limited liability corporations, and sole proprietorships. The law, however, contains numerous exemptions, including exemptions for receipts from the sale of groceries and fuel.⁹

Such a tax cut would hit Oregon schools during a severe fiscal crisis when the traditional sources of funding for education will have weakened. The coronavirus crisis is poised to inflict more damage on state budgets than did the Great Recession.¹⁰ Personal income tax collections, the principal source of funding for Oregon schools, will almost certainly experience a sharp contraction, given the sudden and massive layoffs.¹¹ The other pillar of education funding, property taxes, may prove more stable, but how it will fare during this crisis is unclear.

The Corporate Activity Tax was designed to provide stability to education funding during a recession. Profits-based taxes, such as Oregon's corporate income tax, tend to be volatile, quickly drying up during recessions. The Corporate Activity Tax, however, is based not on profits but overall receipts. This may make it a less volatile source of revenue for schools. Delaying implementation of the Corporate Activity Tax will remove what was intended to serve as the crucial "third-leg" of the education funding stool.

Separate from the loss of funding for schools directly stemming from the coronavirus crisis, delaying the Corporate Activity Tax would transform the Student Success Act — intended to bolster education — into a net drain of state resources. The Student Success Act included not just a tax increase in the form of the CAT, but also a tax *cut* for individuals. Specifically, the act reduced all but the highest personal income tax brackets by 0.25 percentage points.¹² This personal income tax cut, already in effect for the current tax year, was projected to cost about \$250 million per year.¹³ A portion of revenue from the CAT, however, is meant to replace the loss of revenue to the Oregon General Fund due to the personal income tax cut. Thus, keeping the personal income tax cuts in the Student Success Act, but suspending the Corporate Activity Tax, turns the act into a net loss for schools.

In the zero-sum game that is state budgeting, there is no escaping the fact that delaying the Corporate Activity Tax means fewer resources for children in Oregon.

Protecting education funding helps avoid a deeper recession and long-term harm

Past recessions have made clear that budget cuts exacerbate economic downturns. State and local governments employ a significant share of the state's residents.¹⁴ Cuts to budgets result in more people on the unemployment lines, reducing their income and purchasing power. The damage from budget cuts ripples out into the private sector, not only from the loss of purchasing power from laid-off state workers, but also from the fact that a large share of state dollars flows out in the form of contracts to non-profit and for-profit firms for the provision of goods and

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services.¹⁵ By one estimate, the private sector incurs more than half of the jobs and economic activity lost due to state budget cuts.¹⁶

Budget cuts, of course, harm those who benefit most directly from state services — Oregon’s children, in the case of cuts to education. A study of the impact of school funding cuts during the Great Recession found that reductions in per-student spending resulted in worse student achievement and fewer students attending college.¹⁷ Budget cuts are especially harmful for children in poorer school districts. The same study found that, in the states that cut budgets the most, the performance between high- and low-poverty school districts widened.¹⁸

But it’s not only children who pay the price from education cuts: the state as a whole suffers. One study summed it up well in stating,

In the long term, the budgetary savings from recent K-12 funding cuts may cost states much more in diminished economic growth. To prosper, businesses require a well-educated workforce. Deep education funding cuts weaken that future workforce by diminishing the quality of elementary and high schools. At a time when the nation is trying to produce workers with the skills to master new technologies and adapt to the complexities of a global economy, large cuts in funding for basic education undermine a crucial building block for future prosperity.¹⁹

Delaying the CAT mainly benefits companies able to ride out the crisis

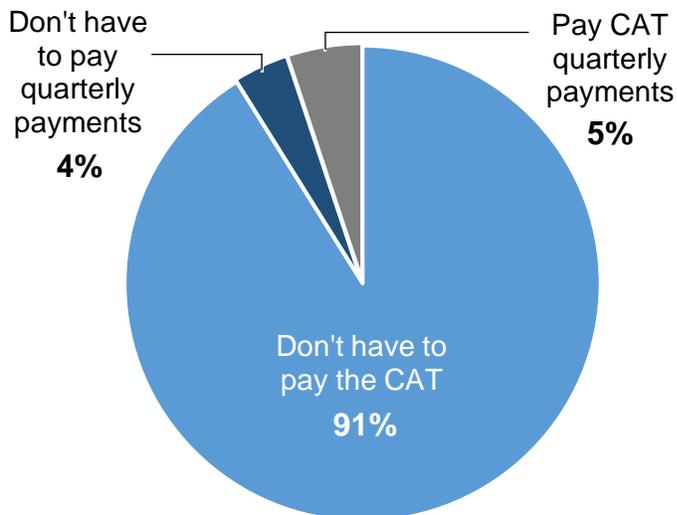
Although proponents of delaying the Corporate Activity Tax argue it will help struggling businesses, it is the businesses doing well — even thriving — during the crisis that would benefit the most.

Even before the coronavirus crisis arose, relatively few businesses were expected to pay the tax. Last year, the Legislative Revenue Office estimated that less than 10 percent of businesses have more than \$1 million in commercial activity, the level needed to trigger the CAT.²⁰ So at the outset, the tax skips over more than 90 percent of businesses. But even fewer businesses would actually be subject to the tax. The tax allows businesses to deduct up to 35 percent of labor costs or costs of goods sold. This deduction would push some businesses with more than \$1 million in actual commercial activity below the \$1 million threshold triggering the tax.

Even fewer businesses will pay the Corporate Activity Tax as a result of the many exemptions the law provides. Besides the 35 percent subtraction of labor costs or costs of goods sold, the law provides an additional 15 percent tax break for residential construction subcontractors.²¹ The CAT omits dozens of business transactions from the definition of “commercial activity,” such as the sale of groceries, fuel, and various financial transactions.²² It excludes whole categories of businesses, such as those that only sell goods outside of the state, non-profits, many hospitals and long term care facilities, and more.²³

Corporate Activity Tax impacts few businesses

Share of businesses in Oregon paying the Corporate Activity Tax



Source: Oregon Legislative Revenue Office.

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The economic crash triggered by the pandemic will further reduce the group of businesses subject to the Corporate Activity Tax. It is tragic that the crisis has forced many businesses to close shop or drastically reduced operations. As a result, some businesses that were expected to have over \$1 million in receipts prior to the crisis — again, a group consisting of less than one in 10 businesses — will no longer have enough receipts to trigger the tax. Many of the businesses most impacted by the crisis will not be subject to the tax.

The benefits of delaying the CAT would mainly accrue to the largest corporations able to thrive during the crisis. Some of the largest corporations in the world, including businesses like Amazon and Walmart, are doing quite well and even hiring thousands of new positions.²⁴ In the zero-sum equation that is state budgeting, these corporations would be getting a tax cut while Oregon's schools lay off teachers.

Delay in quarterly payments of CAT is unnecessary

The call by some in the business community for a delay in quarterly payments due in April is unnecessary. Some companies that had posted strong sales before the onset of the crisis may have since seen business activity dwindle or dry up entirely. According to the Oregon Legislative Revenue Office, businesses that expect to owe less than \$5,000 a year in the Corporate Activity Tax need not make an estimated quarterly payment — a figure that corresponds roughly with about \$2.5 million in yearly commercial activity.²⁵

Thus, an even smaller fraction of businesses need to make a quarterly payment. Estimates before the crisis indicated that less than 5 percent of businesses had commercial activity above \$2.5 million per year. Following the crash, even fewer businesses are likely to need to make an estimated quarterly payment.

Further undermining the need for a delay in quarterly payments, the Oregon Department of Revenue has stated that it will not fine or penalize good faith efforts to make estimated payments.²⁶ Therefore, a business on the edge of the \$2.5 million threshold that has closed due to the crisis could credibly argue it does not expect to end up owing the CAT, and would not need to make a quarterly payment.

The best hope for struggling, small businesses rests with Congress

Congress has already enacted several coronavirus relief measures which include assistance for small businesses. The federal aid includes debt relief, forgivable loans, payroll tax deferrals and credits, and more.²⁷ Businesses with fewer than 500 employees were eligible to apply for part of \$349 billion in loans that are forgiven if a business retains their workers.²⁸ Although the program ran out of money mid-April, Congress is negotiating a package that would add \$300 billion to the fund.²⁹ Further, businesses that have been closed or significantly impacted by the pandemic can receive a 50 percent payroll tax credit, or postpone this year's payments.

More federal action, however, is necessary. Congress is currently considering a fourth package to address the economic crisis. While this package must focus on boosting support for public services and individuals struggling to survive, Congress should take additional steps to keep the small businesses most heavily impacted by this crisis afloat.³⁰

Mindful of its limited resources, Oregon policymakers should explore targeted ways to assist struggling businesses. Governor Brown has already taken an important step in that direction by issuing an executive order halting the eviction of businesses from their storefronts during the crisis.³¹ Oregon should consider additional steps targeted at businesses most at risk of permanent closure.

Conclusion

Suspending the Corporate Activity Tax would deprive schools of vital funding at a time of crisis while failing to achieve the purported reason for the delay – assisting struggling small businesses. Instead, the main beneficiaries of the tax cut would be those businesses able to ride out, and even thrive, during the crisis. The loss of revenue and resulting cuts to the state budget would deepen the recession while leaving lasting damage to student achievement. In short, suspending the Corporate Activity Tax is a mistake that Oregon must avoid.

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Endnotes

- ¹ Oregon Constitution, Article IX, Sec. 2, available at https://www.oregonlegislature.gov/bills_laws/Pages/OrConst.aspx
- ² The state can, as the Constitution provides, borrow — but it must raise enough revenue to finance that debt. The state can also spend funds previously saved into reserve funds like the Oregon Rainy Day Fund.
- ³ COVID-19 Economic Impact on Oregon Hospitality Industry, Oregon Restaurant and Lodging Association testimony to the Joint Special Committee on Coronavirus Response, March, 2020, available at <https://olis.oregonlegislature.gov/liz/2019I1/Downloads/CommitteeMeetingDocument/220418>; letter signed by more than 40 organizations representing businesses, March 26, 2020, available at https://www.oregonbusinessindustry.com/clientuploads/Conronavirus/CAT_Ltr_03-26-2020.pdf.
- ⁴ ORS 327.001, available at https://www.oregonlegislature.gov/bills_laws/ors/ors327.html.
- ⁵ While the Student Success Act was designed to invest in new programs and services for students, the current crisis makes it increasingly likely resources will need to be used to maintain current service levels.
- ⁶ Representative’s Barbara Smith Warner and Dan Rayfield, For the sake of our children, don’t delay the Student Success Act, Opinion Editorial in the Statesman Journal, April 10, 2020, available at <https://www.statesmanjournal.com/story/opinion/2020/04/10/dont-delay-implementing-oregon-student-success-act-opinion/5127759002/>
- ⁷ Statutes governing the CAT are included in ORS 317A, available at https://www.oregonlegislature.gov/bills_laws/ors/ors317A.html.
- ⁸ Technically, the tax is \$250 plus the 0.57 percent applied to taxable commercial activity above the \$1 million threshold.
- ⁹ ORS 317A.100, available at https://www.oregonlegislature.gov/bills_laws/ors/ors317A.html.
- ¹⁰ Elizabeth McNichol, Michael Leachman, and Joshua Marshall, *States Need Significantly More Fiscal Relief to Slow the Emerging Deep Recession*, Center on Budget and Policy Priorities, April 14, 2020, available at <https://www.cbpp.org/research/state-budget-and-tax/states-need-significantly-more-fiscal-relief-to-slow-the-emerging-deep>.
- ¹¹ Mike Rogoway, Oregon coronavirus layoffs approach 300,000, 15% of all Oregon jobs, Oregonian, April 16, 2020, available at <https://www.oregonlive.com/business/2020/04/coronavirus-layoffs-continue-at-record-place-nearly-a-fifth-of-oregon-workers-have-lost-their-jobs.html>.
- ¹² ORS 316.037, available at https://www.oregonlegislature.gov/bills_laws/ors/ors316.html.
- ¹³ The Oregon Legislative Revenue Office estimated that 70 percent of the General Fund revenue loss would be caused by the personal income tax rate reduction included in the Student Success Act. The General Fund revenue loss was estimated at \$423 million in the 2019-21 biennium, \$699 million in the 2021-23 biennium, and \$762 million in the 2023-25 biennium. The estimate of about \$250 million per year is 70 percent of the revenue loss for the two biennia when the Student Success Act has been fully implemented (2021-23 and 2023-25). HB 3427 Revenue Impact Statement, Legislative Revenue Office, April 29, 2019, available at <https://olis.oregonlegislature.gov/liz/2019R1/Downloads/MeasureAnalysisDocument/49779>.
- ¹⁴ OCPP, No Growth in Share of Oregon Jobs Belonging to State and Local Government, May 12, 2017, available at <https://www.ocpp.org/2017/05/12/oregon-share-jobs-state-local-government/>.
- ¹⁵ Ethan Pollack, Dire States: State and Local Budget Relief Needed to Prevent Job Losses and Ensure a Robust Recovery, Economic Policy Institute, November 19, 2009, p. 4, available at <https://www.epi.org/files/page/-/bp252/bp252.pdf>.
- ¹⁶ Ibid.
- ¹⁷ C. Kirabo Jackson, Cora Wigger, and Heyu Xiong, *Do School Spending Cuts Matter? Evidence from the Great Recession*, National Bureau of Economic Research, January 2018, available at <https://www.nber.org/papers/w24203.pdf>.
- ¹⁸ Ibid.
- ¹⁹ Michael Leachman, Kathleen Masterson, and Eric Figueroa, *A Punishing Decade for School Funding*, Center on Budget and Policy Priorities, November 29, 2017, available at <https://www.cbpp.org/research/state-budget-and-tax/a-punishing-decade-for-school-funding>.

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²⁰ LRO Corporate Activity Tax Overview available at

<https://olis.oregonlegislature.gov/liz/201911/Downloads/CommitteeMeetingDocument/221690>.

²¹ An additional exclusion of 15 percent of subcontracting payments for labor costs in the construction of single-family residences is also included in the CAT. See ORS 317A.122 available at https://www.oregonlegislature.gov/bills_laws/ors/ors317A.html.

²² ORS 317A.100, available at https://www.oregonlegislature.gov/bills_laws/ors/ors317A.html.

²³ ORS 317A.100(4), available at https://www.oregonlegislature.gov/bills_laws/ors/ors317A.html.

²⁴ Alina Selyukh, Amazon To Hire 100,000 Workers To Meet 'Surge In Demand', Oregon Public Broadcasting, March 16, 2020, available at <https://www.opb.org/news/article/npr-amazon-to-hire-100000-workers-to-meet-surge-in-demand/>; Rob McLean, Walmart, Dollar Tree and 7-Eleven want to hire nearly 200,000 workers as the coronavirus pandemic continues, CNN, March 20, 2020, available at cnn.com/2020/03/20/business/walmart-hiring-coronavirus/index.html.

²⁵ LRO Corporate Activity Tax Overview, available at

<https://olis.oregonlegislature.gov/liz/201911/Downloads/CommitteeMeetingDocument/221690>.

²⁶ COVID-9 tax relief options, Oregon Department of Revenue, available at

<https://www.oregon.gov/dor/Pages/COVID19.aspx>.

²⁷ Guide to the CARES Act, U.S. Senate Committee on Small Business and Entrepreneurship, available at

<https://www.sbc.senate.gov/public/index.cfm/guide-to-the-cares-act>.

²⁸ Paycheck Protection Program (PPP) Information Sheet: Borrowers, U.S. Treasury, available at

<https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf>.

²⁹ Sheryl Gay Stolberg and Alan Rappaport, "White House and Democrats Near Deal on Aid for Small Businesses,"

New York Times, April 19, 2020, available at <https://www.nytimes.com/2020/04/19/us/politics/coronavirus-small-business-aid-congress.html>.

³⁰ Audrey Mechling and Daniel Hauser, 6 things the fourth federal relief package must do, OCPP, April 10, 2020,

available at <https://www.ocpp.org/2020/04/10/fourth-federal-relief-package-must-do/>.

³¹ Executive Order 20-13, Oregon Governor Kate Brown, April 1, 2020, available at

https://www.oregon.gov/gov/admin/Pages/eo_20-13.aspx.