Executive Summary

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July 1, 2003

On Whose Backs?

Tax Distribution, Income Inequality, and Plans for Raising Revenue

By Jeff Thompson

Oregon's current $3.2 billion revenue shortfall and projected revenue shortfalls over the next few budget periods have prompted discussion of major tax reform. As policy makers address tax reform, they will need to consider who will bear the costs of changes to the tax structure.

This study reviews the distribution of Oregon's current state and local tax system, shifts in the tax burden across the last decade, and trends in income inequality. Low-income households face the highest state and local tax burden, experienced the largest tax increases over the last decade while the wealthy saw their taxes decline, and benefited least from the economic prosperity of the 1990s as income inequality grew.

The study shows:

- The personal income tax is progressive, taking a larger share of the income of affluent households than it takes from those with low incomes. Oregon's property and excise taxes are both regressive, taking a larger share of income from low-income households;
- The combined distribution of Oregon's tax system is regressive, taking 9.4 percent of the income from low-income households and 6.1 percent from the richest one percent of households, including the impact of the federal "offset" for state taxes;
- Over the last decade, the state and local tax burden rose for low-income households, primarily because of increased excise taxes, and fell for affluent households, because of property tax cuts and a more valuable federal offset, and;
- Income inequality increased dramatically over the last two decades. The average adjusted gross income of the richest one percent of households increased 171 percent between 1979 and 2000, while the typical household's income fell by nearly one percent.

One theme present in several tax reform proposals is to scale back the income tax and adopt new consumption taxes. These proposals would raise the tax burden of low-income households while decreasing it for affluent households, furthering skewing the distribution of taxes and exacerbating the problems associated with growing income inequality.

The "ability to pay" principle suggests that tax reform efforts designed to raise more revenue should be targeted to the affluent households who today enjoy the lowest state and local tax burden and who benefited most from the tax cuts and economic prosperity of the 1990s.

The Oregon Center for Public Policy uses research and analysis to advance policies and practices that improve the economic and social prospects of low- and moderate-income Oregonians, the majority of Oregonians.

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Oregon's current $3.2 billion revenue shortfall and projected revenue shortfalls over the next few budget periods have prompted discussion of major tax reform.[1] As policy makers address tax reform, they will need to decide who will bear the costs of changes to the tax structure. A review of Oregon's tax system and the economy shows that low-income households already face the highest tax burden, experienced the largest tax increases over the last decade, and benefited least from the economic prosperity of the 1990s.

The income tax is the only major Oregon tax that takes a larger share of income from upper-income households than those with low incomes, while property and excise taxes both place a higher burden on low-income households. Legislative proposals to scale back the income tax and adopt new consumption taxes -- whether sales, "business activity," or excise taxes -- would further shift the burden of Oregon's tax system onto low-income households, while giving large tax cuts to affluent households.

The "ability to pay" principle suggests that tax reform efforts should be targeted toward the high-income families who today enjoy the lowest state and local tax burden and who benefited most from tax cuts and economic prosperity during the 1990s. Reducing taxes on upper-income households would exacerbate the problems associated with the trend toward greater income inequality in Oregon.

The Distribution of State and Local Taxes in Oregon

The major taxes state and local governments use in Oregon have different impacts on low, middle, and upper-income households (Figure 1). Oregon's personal income tax is progressive, taking a larger share of the income of those with the greatest ability to pay.[2] Excise and property taxes are regressive, taking a larger share of the incomes of low-income households. Personal and corporate income taxes account for 48 percent of Oregon's state and local tax revenue.[3] Property taxes account for 30 percent, and excise taxes 14 percent.[4]

The Personal Income Tax is Oregon's Progressive/Fair Tax

The personal income tax is progressive, taking a larger share of the incomes of high-income households than it takes from those with low incomes. In other words, the tax is based on ability to pay. The richest one percent of Oregon taxpayers pay 7.5 percent of their income to state income taxes, compared to 4.7 percent for middle-income taxpayers and 2.3 percent for low-income taxpayers (Figure 1).

Oregon's personal income tax has three brackets: 5, 7, and 9 percent. While more than 70 percent of taxpayers have some income in the top bracket, credits and deductions from taxable income make the tax progressive. Even the richest Oregonians pay less than 9 percent of their income in income taxes because only a fraction of a household's income is taxed at that highest rate. All taxpayers are able to take advantage of a standard deduction worth $3,280 (married, filing jointly), while a working family child care credit reduces income taxes on many families with children, and many low-income families are eligible for an earned income credit.[5]

The income tax is the progressive component of Oregon's tax system.

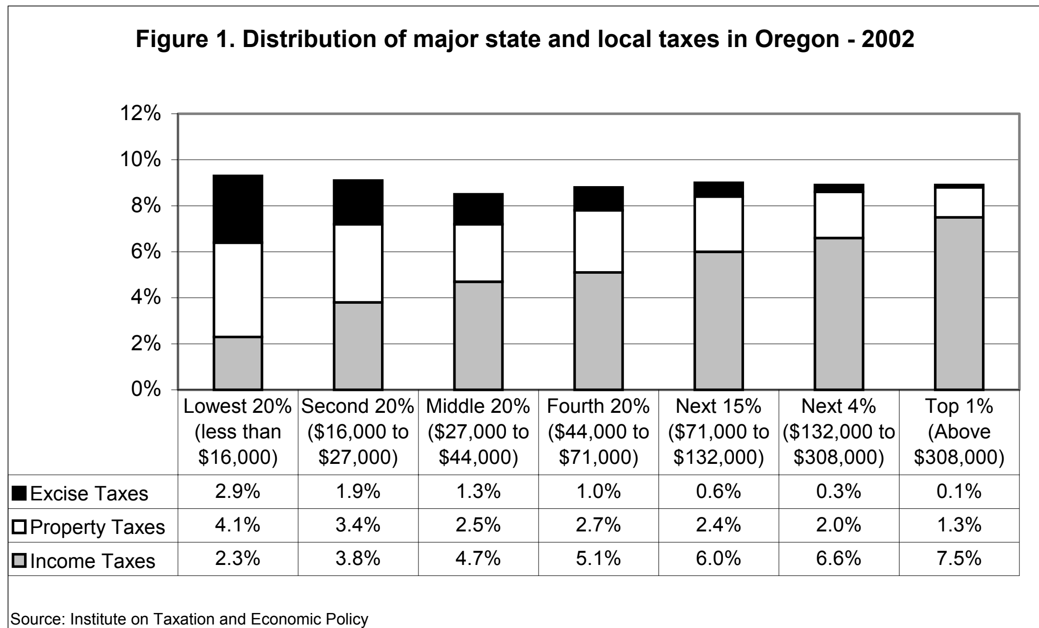


Figure 1. Distribution of major state and local taxes in Oregon - 2002

	Lowest 20% (less than $16,000)	Second 20% ($16,000 to $27,000)	Middle 20% ($27,000 to $44,000)	Fourth 20% ($44,000 to $71,000)	Next 15% ($71,000 to $132,000)	Next 4% ($132,000 to $308,000)	Top 1% (Above $308,000)
Excise Taxes	2.9%	1.9%	1.3%	1.0%	0.6%	0.3%	0.1%
Property Taxes	4.1%	3.4%	2.5%	2.7%	2.4%	2.0%	1.3%
Income Taxes	2.3%	3.8%	4.7%	5.1%	6.0%	6.6%	7.5%

Source: Institute on Taxation and Economic Policy

Excise Taxes Are Regressive/Unfair

Excise taxes are regressive, taking a larger share of income from lower-income taxpayers. In Oregon, excise taxes are levied primarily on cigarettes, gasoline, and alcohol. They take 2.9 percent of the income of low-income taxpayers in Oregon, compared to 1.3 percent of middle-income households and 0.1 percent of the richest one percent. Gasoline is taxed at 24 cents per gallon, beer is taxed at 8.4 cents per gallon, and wine is taxed at 67 cents per gallon.[6] Cigarettes are taxed $1.28 per pack. Because excise taxes are levied at a flat rate and are based on the quantity purchased rather than the price of the good, they tax premium goods at a lower rate than discount-price goods. The excise tax on a $100 bottle of wine is the same as for a $2.99 bottom-end brand; consumers of the less expensive brand end up paying a higher effective tax rate than consumers of the high-end brand. Furthermore, low-income households spend a larger share of their income on taxed items.[7]

Property Taxes Are Regressive/Unfair, Too

Property taxes in Oregon are also regressive, consuming 4.1 percent of the income of low-income taxpayers, 2.5 percent of middle-income households and 1.3 percent of the richest one percent. Property taxes in Oregon are levied at the local level, with rates between $9 and $19 per $1,000 assessed value of real personal and business property.[8] The average property tax rate in Oregon was $15 per $1,000 of assessed value in 2001-02.

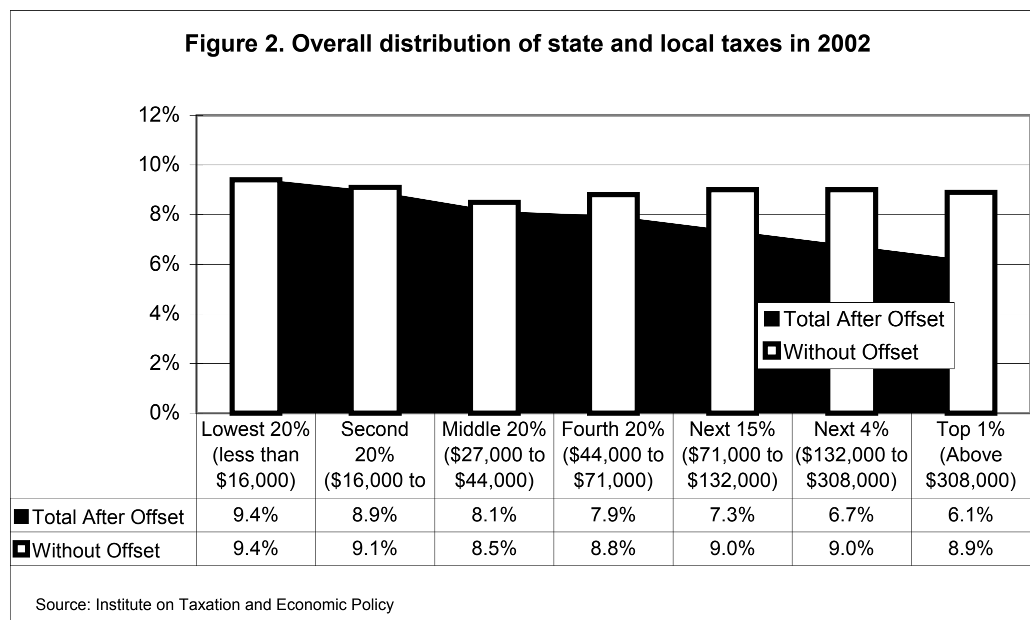
Property taxes take a larger share of the incomes of low-income households because these households spend a larger share of their income on housing, even though higher-income households tend to own more valuable homes. Property taxes are reflected in the rent paid by non-homeowners.

The Bottom Line: The Poor Pay More Than The Wealthy

Oregon's combined state and local tax system takes a larger share of income from poor households than from affluent ones. Including the effects of the federal deduction for state income taxes (the federal "offset"), Oregon's tax system is quite regressive, levying a shrinking effective tax rate as incomes rise. Put another way, as a taxpayer's ability to pay taxes increases the tax burden decreases.

Before including the federal offset, combined state and local taxes in Oregon take 9.4 percent of the income of low-income households, 8.5 percent of middle-income households, and 8.9 percent from the richest one percent (Figure 1 and 2). The system is regressive at the bottom end, taking a larger share of the income of low-income households than from middle-income households, and slightly progressive at the top end, taking a larger share of income from the richest one-percent than from middle income households.

Oregon's tax distribution becomes decidedly regressive when the federal offset is included. Households that itemize deductions on their federal income tax returns can deduct all state income taxes. The federal deduction for state income taxes reduces the effective tax rate of the richest one percent of Oregon households by 2.8 percent. Including the effects of the federal offset, total state and local taxes consumed 9.4 percent of the income of low-income households, 8.1 percent of middle-income households, and just 6.1 percent of the richest one percent in 2002.



	Lowest 20% (less than $16,000)	Second 20% ($16,000 to	Middle 20% ($27,000 to $44,000)	Fourth 20% ($44,000 to $71,000)	Next 15% ($71,000 to $132,000)	Next 4% ($132,000 to $308,000)	Top 1% (Above $308,000)
Total After Offset	9.4%	8.9%	8.1%	7.9%	7.3%	6.7%	6.1%
Without Offset	9.4%	9.1%	8.5%	8.8%	9.0%	9.0%	8.9%

Source: Institute on Taxation and Economic Policy

Including the effects of the federal deduction for state income taxes, Oregon's tax system is quite regressive.

Changes for the Worse Over the Last Decade: Poor Pay More, Wealthy Pay Less

Over the past decade changes to Oregon's tax system lowered taxes on affluent households and raised them on low-income households. Taxes paid by low-income households rose by 2.2 percent of income, primarily due to cigarette tax increases and the elimination of low-income property tax relief programs (Table 1). Property tax reform in Measures 5 and 50 cut and capped property taxes but also led to the elimination and downsizing of property tax relief programs for low-income and elderly Oregonians.[9]

The adoption of a state-level earned income credit in 1997 offset some of the tax increase on low-income households, but the impact was relatively small because the credit is not refundable and is small, only 5 percent of the federal earned income credit. Because it did not rise along with inflation, Oregon's standard deduction lost value between 1989 and 2002, effectively raising income taxes. In 2002, the standard deduction increased but is still not indexed to inflation. Oregon's income tax brackets were indexed to inflation in 1993, but the inflation that occurred between 1989 and 1993 resulted in the top tax bracket kicking in at a lower income level in 2002 than in 1989.

Taxes paid by the richest one percent of Oregonians fell by 0.4 percent of income because of the property tax reductions and limitations in Measures 5 and 50, and because of a more valuable federal offset due to increased federal tax rates in the 1990s. These tax cuts outweighed higher income taxes paid by affluent households. Upper-income households paid higher income taxes only because of their rapidly rising incomes. The average income of the wealthiest one percent of Oregonians almost doubled (it rose 98 percent) between 1989 and 2000.[10] With a larger share of their total income taxed at the nine percent rate, the top one percent paid a slightly higher share of their income in state income taxes. Nevertheless, the property tax reductions and limitations and more valuable federal offset outweighed the increased taxes due to tremendous increased income.

Middle-income households saw little change in their taxes. Higher excise taxes were offset primarily by lower property taxes.

Over the past decade, changes to Oregon's tax system lowered taxes on affluent households and raised them on low-income households.

Table 1. Tax changes 1989 to 2002

	Change in taxes as a share of income						
	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Excise Taxes	1.6%	0.8%	0.5%	0.4%	0.2%	0.1%	0.0%
Property Taxes	0.4%	0.5%	-0.3%	-0.4%	-1.4%	-0.9%	-0.4%
Income Taxes	0.2%	0.0%	0.1%	0.0%	0.2%	0.7%	0.5%
Federal Offset	-	-0.1%	-0.2%	-0.1%	0.0%	0.0%	-0.5%
Overall Change	2.2%	1.2%	0.1%	-0.1%	-1.0%	-0.2%	-0.4%

Source: Institute on Taxation and Economic Policy

Kicker Makes Matters Worse

The changes to Oregon's tax law presented in Table 1 only consider permanent tax changes and do not include the impacts of the temporary income tax cut known as the "kicker." Oregon's personal income tax kicker has gone into effect five times since 1989, giving $1.2 billion in tax cuts primarily to upper-income households.[11] Analysis of the 2001 kicker showed that the richest fifth of Oregonians received

nearly 67 percent of the benefit of the kicker, while the bottom two-thirds received less than 14 percent.[12] The kicker is triggered when actual tax collections are more than two percent higher than what had been forecast by the Office of Economic Analysis two years earlier. Including the impacts of the kicker would make the changes Oregon's tax system even more regressive.

The 1990s: The Best of Times for Only Some Oregonians

Oregon's economy grew rapidly during the 1990s. Oregon had the fastest growing economy in the country in the six years preceding recession. Per-capita Gross State Product grew faster in Oregon than in any other state between 1995 and 2000.

Job growth and new business creation was impressive over the course of the 1990s, but the benefits of that growth accrued mostly to those with high incomes. Over the last two decades income inequality has increased dramatically, transforming Oregon from one of the most equal to one of the most unequal states.

Affluent Families Benefited Most from Economic Prosperity

The highest-income fifth of Oregon families prospered over the last two decades, while most families saw minimal or no gains.[13] Not counting capital gains income, between the late 1970s and the late 1990s the average income of the richest fifth of families rose 52 percent, while the poorest fifth saw their average income decline (Figure 3).[14] If capital gains income were included in the Census data, the disparity would have been significantly greater. The average income of the middle fifth of families grew $4,400, or less than 10 percent, over the 1980s and 1990s. The growth in the average income of the middle fifth is equivalent to $219 per year over twenty years.

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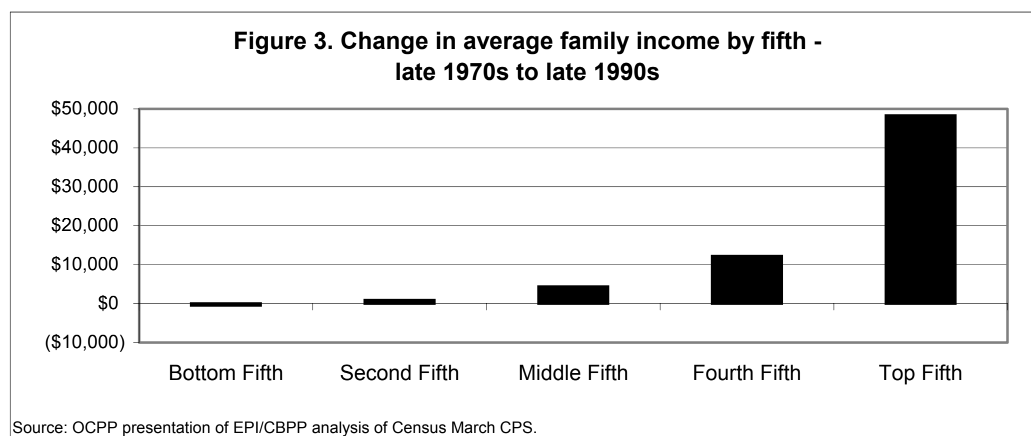


With income rising rapidly at the top of the distribution, declining at the bottom, and changing little in the middle, the gap between the rich and everybody else grew dramatically over the last two decades. In the late 1970s, the average income of the top fifth of Oregon families was 6.4 times as large as the bottom fifth (Table 2). By the late 1990s, the top fifth had an average income ten times as large as the bottom fifth. The gap between the top fifth and the middle fifth of families also grew. In the late 1970s the top fifth made twice as much as the middle fifth of families. By the late 1990s, the top fifth made three times as much.

By the late 1990s, the top fifth made three times as much as the middle-income fifth, and 10 times as much as the lowest income households.

Table 2. Oregon family income distribution by fifth

	Bottom Fifth	Second Fifth	Middle Fifth	Fourth Fifth	Top Fifth
1978-80	$14,582	$31,165	$44,026	$58,205	$93,165
1998-00	$14,148	$32,071	$48,399	$70,463	$141,428
$ change	($434)	$906	$4,374	$12,258	$48,263
% change	-3.0%	2.9%	9.9%	21.1%	51.8%

Income Ratios

	Top - Bottom	Middle - Bottom	Top - Middle
1978-80	6.4	3.0	2.1
1998-00	10.0	3.4	2.9

Source: Economic Policy Institute and Center on Budget and Policy Priorities.
Inflation-adjusted 1999 dollars. Analysis of data from the U.S. Census Bureau's Current Population Survey.

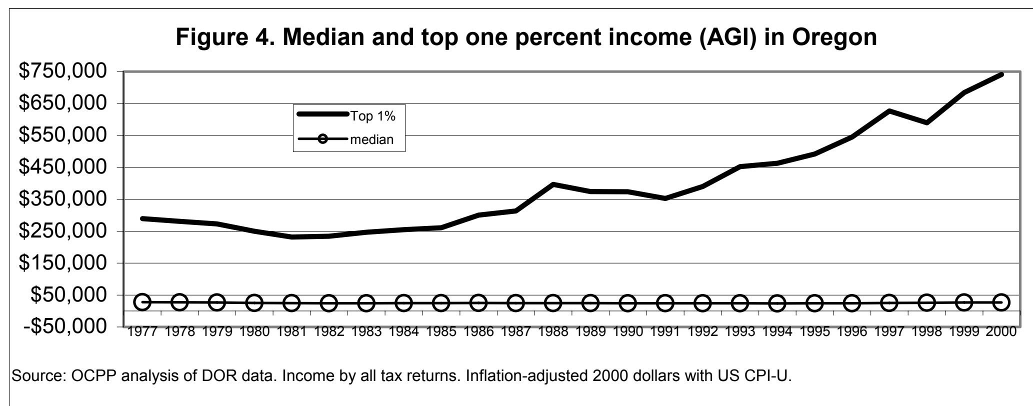
Income of the Richest Households

The Census data analyzed in Figure 3 and Table 2 do not include income from capital gains and cannot be used to show the income trend of the most affluent households. Data from Oregon tax returns include capital gains income, and can be used to show income trends among very high-income households.[15]

These data, which reflect Adjusted Gross Income (AGI), show that the income of the richest one percent of households grew dramatically across the last decade (Figure 4).[16] Between 1989 and 2000, the richest one-percent of Oregon taxpayers saw their average real income grow 98 percent, from $374,000 to $741,000. Over this same period, the income of the typical (median) Oregonian rose just 9 percent, reaching $26,700 by 2000.[17] In 1989, the richest one percent had incomes that were 15 times the typical income. By 2000, the richest one percent had incomes that were 28 times the typical Oregonian's income.

Between 1979 and 2000, the income of the richest one percent rose 171 percent. The median household declined nearly one percent over this period. Incremental gains in the 1990s balanced out losses from the 1980s for the typical Oregon household.

Between 1989 and 2000, the richest one-percent of Oregon taxpayers saw their average real income almost double, while the income of the typical Oregonian rose just 9 percent.



Source: OCPP analysis of DOR data. Income by all tax returns. Inflation-adjusted 2000 dollars with US CPI-U.

Oregon: One of the Most Unequal States

Over the last two decades, inequality grew faster in Oregon than in any other state. The gap between the top fifth and bottom fifth of Oregon families grew more than in all but one other state (Table 3).[18] The gap between the top fifth and the middle fifth of families grew more than every other state.

This rapid growth in inequality took Oregon from a relatively equal state to one of the most unequal in the country. In the late 1970s, 38 of the 50 states had larger gaps between the richest and the poorest families. By the late 1990s, though, the situation was reversed. In 1998-2000, Oregon was ranked high for inequality, and only 10 of the 50 states had larger gaps between the richest and poorest families.

Summary

Oregon's existing state and local tax system places a heavier burden on low-income households than on upper-income households. Low-income households faced tax cuts over the last decade, but benefited little from the economic prosperity.

Proposals to adopt excise or consumption would shift the tax burden even further onto low-income households. The proposals that also lower income tax rates would deliver large tax cuts to the affluent households that benefited most from the economic prosperity and tax cuts across the last decade. All of these proposals would exacerbate the consequences of the trends toward greater income inequality.

Tax reform efforts designed to raise additional revenue should target those households that have benefited most from the economy, reaped the tax cut windfall, and can most afford to pay more.

Endnotes

[1] See *Recovery Will Not Save Vital Programs: Additional Revenue Needed to Pull Oregon Out of Doonesbury*, Oregon Center for Public Policy, May 22, 2003, available at http://www.ocpp.org/2003/issue030522.pdf.

[2] Tax distribution data are from the Institute on Taxation and Economic Policy, *Who Pays?: A Distributional Analysis of the Tax Systems in All 50 States – 2nd Edition*. January 2003. The tax distribution is for all state and local taxes on all non-elderly households.

[3] The corporate income tax accounts for a very small share of state and local tax revenue. Corporate income taxes are levied on profits at a flat rate of 6.6 percent.

[4] State and local tax revenue data for 2000 are from the Census Bureau. Excise taxes are "selective sales taxes" on alcoholic beverages, tobacco products, motor fuel, public utilities, and other items, plus motor vehicle license fees. Miscellaneous "other taxes" account for 9 percent of Oregon's total tax revenue.

[5] The standard deduction for a single filer in 2002 was $1,690.

[6] *Oregon Public Finance: Basic Facts*, Legislative Revenue Office, January 2003, LRO report #1-03, pages I1, I3, and G5.

[7] Cigarette taxes, for example, consume a greater share of the income of low-income households because low-income households spend nearly all of their income and low-income people are more likely to smoke. In one recent study, the Center on Budget and Policy Priorities documents that cigarette expenditures account for 3.2 percent of the income of the bottom quarter of the population and just 0.4 percent of the top quarter. Lav, Iris, *Cigarette Tax Increases: Cautions and Considerations*, Center on Budget and Policy Priorities, July 11, 2002, page 4.

[8] *Oregon Public Finance*, LRO, page D1. According to LRO, "Taxable property includes real property, mobile homes, and some tangible personal property used by business. Prior to the passage of property tax limitation Measure 50, property was generally taxed based on its real market value. Since 1997-98 each property has a real market and assessed value… Major exemptions include intangible property (stocks, bonds), tangible personal property of individuals (household furnishings, sporting equipment), licensed property (cars, trucks), business inventories, government property (unless leased), and property used for religious or charitable purposes."

[9] For example, the Homeowners and Renters Refund Program (HARRP) provided a maximum refund of $750 to households with incomes below $17,500 up through 1990-91, but was reduced in 1991-92 and eliminated in 1992-93. Property tax relief programs provided nearly $75 million in relief as late as 1988-89, but provided no relief by 1997-98. LRO, *Public Finance*, page E2.

[10] Thompson, Jeff and Michael Leachman, *Boom, Bust, and Beyond: The State of Working Oregon 2002*, Oregon Center for Public Policy, November 2002.

[11] LRO, *Oregon's 2% Surplus Kicker: 2001 Update*, September 2001, LRO report #5-01. The kicker was not triggered in 1993 and was suspended by the 1991 legislature. The total value of the personal and corporate income tax kickers between 1993 and 2001 was nearly $1.4 billion. If that money had been invested in bonds earning 5 percent interest, the revenue available to the 2003 legislature would have equaled about $1.7 billion.

[12] OCPP analysis available at http://www.ocpp.org/2001/2001kicker09rev.htm.

[13] The Census data were analyzed by the Economic Policy Institute and the Center on Budget and Policy Priorities. See *Pulling Apart: A State-by-state Analysis of Income Trends,* Center on Budget and Policy Priorities, Economic Policy Institute, April 2002. Available at http://www.cbpp.org/4-23-02sfp.htm.

[14] The income data from the Census Bureau are from the March Current Population Survey. Census' definition of income includes earnings, interest, dividends, pension income, rental income, and cash assistance, but does not include capital gains or non-cash public assistance.

[15] With 1.63 million tax returns filed, the richest one-percent of Oregonians include the highest-income 16,300 income tax returns.

[16] AGI data are based on tax-filing units. Filing units are neither families nor individuals, but can include both. Closer to the Census definition of "household," this is the term adopted here. The Oregon Department of Revenue makes AGI data available in its annual Personal Income Tax Statistics publication. AGI is a calculated field used in tax returns. Shifts in the distribution can be affected by changes in tax laws in addition to trends in income inequality. One relevant portion of the law defines who has to file an Oregon income tax return. Because the cut-off for filers rose considerably (going from $500 to over $2,000), the number of extremely low-income households filing state tax returns likely fell. All else equal, a drop in the number of extremely low-income filers would decrease the share of income held by upper-income filers. Because of this change, it is possible that changes in income distribution are understated.

[17] The median income in Figure 4 was calculated from Oregon Department of Revenue publications using a method adopted from 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.

[18] *Pulling Apart.*

Jeff Thompson is a policy analyst at the Oregon Center for Public Policy. His previous work has focused on the economy, taxes, and labor issues.

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