OREGON CENTER FOR PUBLIC POLICY

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# Executive Summary

*Revised February 23, 2004*

## Time to Raise the Corporate Minimum Tax:
### Top execs get pay raises while Oregon gets just $10

Oregon's minimum corporate income tax is just $10. This minimum tax has not changed since being lowered in 1931.

Companies paying the minimum tax claim no income tax liability, but that does not mean that these companies are failing. Many companies that are profitable pay the minimum tax.

- In 2002, Portland General Electric (PGE) and Louisiana Pacific both paid the minimum amount in state corporate income taxes - $10. That same year both companies also gave their CEOs substantial pay raises. PGE increased CEO Peggy Fowler's total compensation by $211,000 to $979,000 in 2002. Louisiana Pacific increased CEO Mark Suwyn's compensation by $422,000 from $1.5 million to $1.9 million in 2002.

- Since 1931, Oregon's minimum corporate income tax has held steady at $10 while inflation and economic growth have driven up corporate revenues. The ten dollars PGE paid in Oregon income taxes in 2002 equaled just 0.0000005% of the company's operating revenues that year.

- In 2000, more than half of all Oregon corporations with known payrolls over $2 million paid Oregon just $10 in income taxes.

- Twenty percent of corporations paying the minimum $10 income tax in 2000 used losses carried forward from previous years to reduce their taxes to the minimum. In 2000, corporations in Oregon deducted $1.1 billion in previous year losses from their 2000 incomes.

- Some large corporations made heavy use of tax credits. Twenty-six corporations with Oregon *taxable* income over $1 million ended up paying the minimum tax in 2000.

- Businesses which elect to be S-corporations, rather than as C-corporations, avoid paying federal corporate income taxes while still enjoying the privileges of being a corporation, including access to corporate tax credits and personal liability protection. A modest increase in the minimum corporate income tax for these firms will not cause them to convert from S-corporation to C-corporation status.

- In 2000, 316 S-corporations reported more than $1 million in Oregon *taxable income*. Five S-corporations reported Oregon *taxable income* of more than $25 million. All S-corporations pay the $10 minimum tax.

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# Time to Raise the Corporate Minimum Tax:
## Top execs get pay raises while Oregon gets just $10

By Michael Leachman

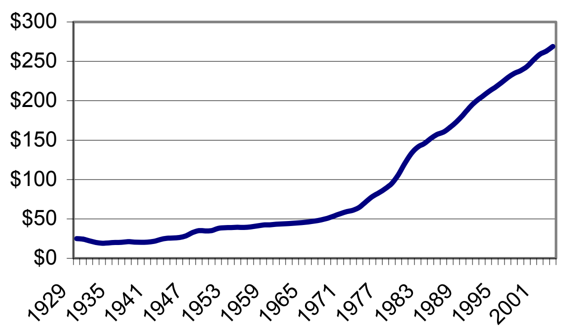
Oregon's minimum corporate income tax is just $10. This minimum tax has not changed since being lowered in 1931.

Companies paying the minimum tax claim no income tax liability, but that does not mean that these companies are failing. Many companies that are profitable pay the minimum tax.

Companies like Portland General Electric (PGE) and Louisiana Pacific (LP) claimed no state income tax liability in 2002, but gave their top executives hefty raises the same year. Some companies were profitable but subtracted losses from earlier years on their current year tax returns. Some profitable firms such as PGE and PacifiCorp took advantage of state tax credits to reach the minimum tax. Meanwhile, companies nationally are increasingly aggressive in using tax-sheltering techniques.

## Background on Oregon's Minimum Corporate Income Tax

**Figure 1: If Oregon's minimum corporate income tax had been adjusted for inflation since 1929, it would have been $269 in 2003.**




Source: OCPP adjustment based on US-CPI.

Oregon corporations pay the minimum tax for the privilege of doing business in Oregon. Businesses incorporate to enjoy certain privileges, principally personal liability protection for the owners. The minimum corporate income tax is not commensurate with the value of these privileges or the state's cost of processing corporate tax returns.

Oregon's corporate minimum tax was first established in 1929 at $25. The stock market collapsed later that year, and in 1931, in the midst of the Great Depression, the next legislature lowered the minimum tax to $10, where it has remained ever since. If the minimum tax had been adjusted for inflation since it was first established in 1929, it would have been $269 in 2003 (Figure 1).

The $10 corporate minimum tax has failed to grow with the rising costs of providing state services beneficial to businesses. Oregon corporations benefit from good roads, good schools, a strong university system, safe neighborhoods, attractive recreational opportunities, a fair and efficiently run judicial system, and an effective social safety net for employees and their families and neighbors. Households must take up the slack when businesses do not pay their fair share. Oregon's corporate income tax paid for just 4 percent of the state General Fund in the last two-year budget cycle, down from 14 percent in 1977-79. Today, Oregon's businesses are under-taxed compared with their counterparts in other states.[1] It is time for the minimum corporate income tax to increase.

## Top executives get raises, but Oregon gets only $10

In 2002, Portland General Electric and Louisiana Pacific both paid the minimum amount in state corporate income taxes - $10.[2] That same year both companies also gave their CEOs substantial pay raises (Table 1).

LP increased CEO Mark Suwyn's compensation in 2002 by $422,000 from $1.5 million to $1.9 million (not including another $1.5 million in stock option grants).[3] Including Suwyn, Louisiana Pacific's top five executives received raises totaling $874,091 in 2002.

Similarly, PGE increased CEO Peggy Fowler's total compensation by $211,000 to $979,000 in 2002.[4] The increase includes the first of two retention payments PGE made to Fowler to encourage her to stay during the company's sale. PGE's top five executives, including Fowler, got raises totaling $707,000 in 2002.

While LP and PGE paid only $10 to Oregon in corporate income taxes, both companies heavily rewarded their top executives with pay increases.

**While LP and PGE paid only $10 to Oregon in corporate income taxes, both companies heavily rewarded their top executives with pay increases.**

**Table 1: CEO compensation changes between 2001 and 2002, two Oregon companies paying the minimum $10 corporate income tax in 2002**

| | Mark Suwyn, LP, 2002 | Change from 2001 | Peggy Fowler, PGE, 2002 | Change from 2001 |
|---|---|---|---|---|
| Salary | $761,539 | + $11,539 | $345,836 | + $16,773 |
| Bonus | $300,000 | + $300,000 | $200,000 | - $200,000 |
| Restricted Stock Awards | $821,745 | + $164,580 | - | - |
| 401(k), medical savings plan, deferred compensation plan, or life insurance | $7,100 | -$ 54,036 | $33,192 | - $5,369 |
| Retention payments | - | - | $400,000 | +$400,000 |
| Total compensation | $1,890,384 | + $422,083 | $979,028 | +$211,404 |

Source: OCPP presentation of information in company SEC filings. Does not include stock option grants.

## Other large corporations also paying only the minimum

Louisiana Pacific and PGE are hardly alone in paying just $10 in state income taxes. PacifiCorp, which merged with the major international energy group ScottishPower in 1999, also paid the minimum in 2002.[5] In fact, nearly two-thirds of Oregon C-corporations pay only the minimum. In 2000, according to the Oregon Department of Revenue, at least 885 C-corporations with payrolls over $2 million paid Oregon just $10 in income taxes. That is, more than half of all Oregon C-corporations with known payrolls over $2 million paid the minimum tax (Table 2).[6]

| Table 2: Oregon C-corporations paying the minimum $10 corporate income tax in 2000 | | | |
|---|---|---|---|
| Oregon payroll* | Total | Number paying $10 | Percent paying $10 |
| Zero | 11,531 | 8,292 | 72% |
| Up to $250,000 | 14,939 | 9,486 | 63% |
| $250,000 - $500,000 | 3,259 | 1,778 | 55% |
| $500,000 - $1,000,000 | 2,051 | 1,094 | 53% |
| $1,000,000 - $2,000,000 | 1,273 | 606 | 48% |
| Over $2,000,000 | 1,739 | 885 | 51% |
| Unknown | 2,254 | 1,806 | 80% |
| TOTAL | 37,046 | 23,947 | 65% |

* For non-apportioned corporations, federal return salaries, wages, and officer compensation is used to estimate Oregon payroll.
Source: OCPP presentation of Oregon Dept of Revenue data.

| Table 3: Losses from Previous Years Carried Forward to Current Tax Year, Oregon C-Corporations, 1998-2000 | | | |
|---|---|---|---|
| Tax year | Filers | Total Losses Carried Forward | Used |
| 1998 | 38,932 | $4,217 million | $543 million |
| 1999 | 37,925 | $5,081 million | $743 million |
| 2000 | 37,046 | $5,720 million | $1,090 million |

Source: OCPP presentation of Oregon Dept. of Revenue data.

## Because of tax loopholes, some profitable corporations claim no tax liability

Just because a company claims no tax liability does not mean it is losing money. Some profitable companies take advantage of a number of tax loopholes to reduce their tax liability to zero.

### *Using losses from previous years*

Some corporations claim no state income tax liability even when they are profitable, because they subtract losses from previous years from their income in the current year. That is, corporations may "carry forward" losses from previous years. In 2000, corporations in Oregon deducted $1.1 billion in previous year losses from their 2000 incomes (Table 3).

**One Proposal for a New Minimum Tax**

One way to raise the minimum corporate income tax would allow it to increase based on company sales revenue. Just such a proposal was contained in legislation enacted in 2003 (House Bill 2152) that was later referred to voters and rejected as part of a larger revenue package (Measure 30). Under the 2003 plan, the new minimum corporate income tax would have varied based on the amount of Oregon sales and on whether the company elected to file taxes as a C-corporation or as an S-corporation.

Businesses elect whether to be C-corporations or S-corporations for tax purposes. C-corporations pay both federal and state corporate income taxes. The shareholders of S-corporations, by contrast, pay income taxes on their corporate profits through federal and state personal income taxes. S-corporation shareholders must pay the $10 minimum tax when they file their corporate return. Both C- and S-corporations enjoy access to corporate tax credits and personal liability protection from the state, as well as other state-provided benefits of being a corporation.

Under the 2003 proposal, the new minimum tax for C-corporations would vary from $250 to $5,000, depending on the level of Oregon sales. For S-corporations, the new minimum would be $250 for businesses with less than $1 million in "in-state" sales, and $500 for companies with $1 million or more in "in-state" sales.

| One proposal for a new Oregon minimum corporate income tax | |
|---|---|
| Oregon sales in tax year | Minimum tax |
| *C-corporations* | |
| Less than $20,000 | $250 |
| $20,000 - $100,000 | $500 |
| $100,000 - $2 million | $1,000 |
| $2 million - $5 million | $2,000 |
| $5 million - $15 million | $3,000 |
| $15 million - $25 million | $4,000 |
| $25 million or more | $5,000 |
| *S-corporations* | |
| Less than $1 million | $250 |
| $1 million or more | $500 |

The Oregon Department of Revenue found that 20 percent of corporations paying the minimum $10 income tax in 2000 used losses carried forward from previous years to reduce their taxes to the minimum.

### *Using tax credits*

In addition, profitable companies sometimes take advantage of tax credits to reduce their tax to the minimum. In 2000, according to the Oregon Department of Revenue, 270 companies still had enough tax liability left after computing their Oregon taxable income to take advantage of tax credits to reduce their tax to the $10 minimum.

Some large corporations made heavy use of tax credits. According to the Department of Revenue, twenty-six corporations with Oregon *taxable* income over $1 million ended up paying the minimum tax in 2000.

### *Using tax shelters*

While some companies paying the minimum tax really did lose money, others have generated "paper losses" using a variety of accounting tricks. In recent years corporations have become more aggressive about finding and exploiting loopholes in state and federal tax law. The Multistate Tax Commission estimates that use of tax sheltering techniques cost Oregon $80 million in 2001.

The Multistate Tax Commission's estimate may be conservative. Over the 1990s, the difference between the profits large corporations report to their shareholders and the profits they report to the IRS grew rapidly. The gap between the income that large corporations reported to shareholders and the income they reported to the IRS grew from $37 billion in 1993 to $247 billion in 1998.[7]

Partly because of the increasing use of aggressive tax avoidance techniques, corporations are paying for a much smaller share of federal and state public services than they were a generation ago. The corporate income tax accounted for nearly 20 percent of federal revenues (excluding revenues earmarked for the social security trust fund) in 1977. By 2001, the figure was just 10 percent.[8] Oregon's corporate income tax paid for just 4 percent of the state General Fund in the last two-year budget cycle, down from 14 percent in 1977-79. Today, Oregon's businesses are under-taxed compared with their counterparts in other states.[9]

## The $10 minimum tax is outdated

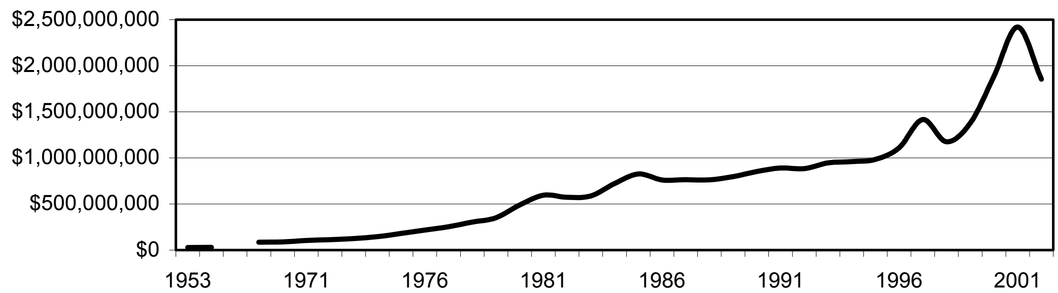
Since 1931, Oregon's minimum corporate income tax has held steady at $10 while inflation and economic growth have driven up corporate revenues.

For instance, since 1953 Portland General Electric's annual operating revenues have grown 68 times over, from $27 million to $1.9 billion in 2002 (Figure 2). The ten dollars PGE paid in Oregon income taxes in 2002 equaled just 0.0000005% of the company's operating revenues that year.

Corporations benefit from good roads, good schools, a strong university system, safe neighborhoods, attractive recreational opportunities, an efficiently run judicial system, and an effective social safety net for employees, their families and neighbors. Successful companies depend on public infrastructure investment, even in years they claim no tax liability. The cost of these services increases year after year, but the minimum corporate income tax has not

**Since 1953 Portland General Electric's annual operating revenues have grown 68 times over, from $27 million to $1.9 billion in 2002. The ten dollars PGE paid in Oregon income taxes in 2002 equaled just 0.0000005% of the company's operating revenues that year.**

**Figure 2: Annual Operating Revenue, Portland General Electric, 1953 - 2002**




Source: Blythe & Co., PGE Annual Reports 1969-95, PGE's SEC 10-K filings

increased since 1931. It is only fair that corporations help bear the burden of paying for public services, rather than push more costs off onto other taxpayers. Further, the cost of processing corporate income tax returns has increased since 1931, yet the minimum cost corporations bear has not budged.

## S-corporations can handle a modest increase, too

Unlike the shareholders of C-corporations, the shareholders of S-corporations pay income taxes on their corporate profits through the personal income tax. Hence, S-corporation shareholders pay both the minimum $10 state corporate income tax and whatever they owe in state personal income taxes on their share of corporate profit.

That's not the whole story, though. Businesses which elect to be S-corporations, rather than as C-corporations, avoid paying federal corporate income taxes while still enjoying the privileges of being a corporation, including access to corporate tax credits and personal liability protection.

A modest increase in the minimum corporate income tax for these firms will not cause them to convert from S-corporations to C-corporations. The tax advantages S-corporations enjoy will remain too powerful an incentive.

Moreover, while S-corporations tend to be smaller businesses, some S-corporations are large companies. In 2000, according to the Oregon Department of Revenue, 316 S-corporations reported more than $1 million in Oregon *taxable income*. Five S-corporations reported Oregon *taxable income* of more than $25 million.

The minimum corporate income tax for S-corporations is in essence a filing fee, and this fee has not changed since 1931 despite the rising costs of processing returns.

## Conclusion

Corporations paying the minimum corporate income tax are not necessarily struggling. The minimum tax assures that corporations pay an appropriate amount for the privilege to do business in Oregon. The costs of processing returns and providing quality state services that benefit business have increased, but the minimum tax has remained at $10, where it has been since 1931. With businesses bearing less of the burden of paying for state services, households are taking up the slack.

**Endnotes:**

[1] Oregon Center for Public Policy. Oregon's Business Tax Burden: Lowest in the Nation? January 23, 2004. Accessible at http://www.ocpp.org/2004/issue040123.htm. See also "Western States' Tax Burdens, Fiscal Year 1999-2000," Utah State Tax Commission, available at http://txdtm01.tax.ex .state.ut.us/esu/BURDENS/westburd00.html. See also Pennsylvania Economy League, "A Comparative Analysis of Major State Business Taxes in Pennsylvania and Other States," June 2001.
[2] Kinsey Hill, Gail, "Corporate Income Tax Collections See a Drop," *The Oregonian*, May 25, 2003, Business p. A01. Rivera, Dylan, "Portland Loses LP's Base," *The Oregonian*, October 1, 2003, Business p. A01.
[3] Compensation amounts based on information provided in Louisiana Pacific's DEF 14A filing with the Securities and Exchange Commission on March 17, 2003. Compensation figures include the value of restricted stock awards, which according to the filing are "rights to receive shares of Common Stock that vest in full at the end of five years, provided that the individual remains an employee of LP or one of its subsidiaries through the end of that period." Also included is the value of company payments to Suwyn's medical savings plan and 401(k).
[4] Compensation amounts based on information provided in PGE's amended 10K filing with the Securities and Exchange Commission on March 17, 2003 and PGE's 10K filing of April 16, 2002. Compensation figures include the first of two retention payments whose purpose according to PGE's amended 10K filing is "to encourage the continued employment of the Named Executive Officers during the negotiation of transactions for the sale of PGE, and to maintain stable operations during the uncertainty that such a process can cause." Compensation figures also include company contributions to Fowler's 401(k) and deferred compensation plan, split dollar term life insurance cost, the dollar value of company-paid split dollar life insurance premiums, and earnings on amounts in the deferred compensation plan which are greater than 120 percent of the federal long-term rate which was in effect at the time the rate was set.
[5] Kinsey Hill, Gail, "Corporate Income Tax Collections See a Drop," *The Oregonian*, May 25, 2003, Business p. A01.
[6] Figures supplied to OCPP by Chris Allanach, Oregon Department of Revenue by email on October 2, 2003.
[7] Desai, Mihir A. "The Divergence Between Book and Tax Income," Harvard Business School and NBER, October, 2002, Figure 2. Accessed at http://www.people.hbs.edu/mdesai/divergence.pdf
[8] Ibid, p. 6.
[9] Oregon Center for Public Policy. Oregon's Business Tax Burden: Lowest in the Nation? January 23, 2004. Accessible at http://www.ocpp.org/2004/issue040123.htm. See also Macdonald, Douglas Aird, "Western States' Tax Burdens, Fiscal Year 2002-2003," Utah State Tax Commission Research Publication 2003-31, December 2003. See also Pennsylvania Economy League, "A Comparative Analysis of Major State Business Taxes in Pennsylvania and Other States," June 2001. Available at http://www.pittsburgh-region.org/public/cfm/library/reports/RptBizTax2000.pdf.

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