On September 17, 1985, Oregonians will have the opportunity to vote on Measure 1, a proposal to restructure the financing of state and local governments. The proposal would (1) impose a retail sales and use tax of 5% on many goods, to begin April 1, 1986; (2) use the proceeds of the tax to reduce property and personal income taxes; and (3) place new restrictions on the ability of local governments to raise property taxes and of the state to increase expenditures. It would also create a new State Economic Stabilization Fund to reduce fluctuations in state General Fund revenues.

This publication is a series of questions and answers, grouped under five sections. The first three correspond to the three points outlined above: sales and use tax (this page), property and income tax reductions (page 2), and limits on state and local government revenue and spending (page 4).

The fourth section (page 4) covers the Economic Stabilization Fund. The fifth section (page 6) discusses some impacts of Measure 1.

Sales and use tax

What is a retail sales and use tax?

A retail sales tax is a tax on the sale of tangible personal property and services imposed at the retail level. Forty-five states currently impose a retail sales tax. Some tax goods and services; others tax goods only.

Since quite a few states don't tax items shipped out of state before use, items purchased out of state may not get taxed. Most states, therefore, impose a use tax on untaxed goods, such as automobiles, boats, and airplanes, purchased out of state.

What would be taxed under the proposed sales and use tax?

The proposed sales and use tax would be a 5% tax on goods (tangible personal property) only. Services would not be taxed, nor would real estate, stocks, or bonds. Since use tax receipts are a very small proportion of total sales and use tax revenues, the term sales tax in this publication means sales and use tax.

Certain goods would be exempt from the sales tax under the proposal. The following exemptions would become part of the state constitution: “food for home consumption, medical or hospital services, prescription medications, utility services, the sale, lease or rental of real property, animal life, animal feed, seed, plants or fertilizer, all to the extent provided by law.”

Certain additional items are specifically excluded in the implementing legislation: gasoline and diesel fuel for on- or off-highway use; newspapers and magazines; used mobile homes; and goods shipped out of state before use.

What types of purchasers would be exempt from the tax?

Goods purchased by the Federal Government would be exempt, as would most purchases by state and local governments. However, state and local government purchases for enterprise activities (those in direct competition with private business financed by user charges or other nontax revenue) would be taxable. Most purchases of churches and certain nonprofit schools and charitable organizations would also be exempt.

What types of sellers would be exempt from the sales tax?

Sales by charitable organizations and “occasional sales” (such as those at garage sales or through noncommercial classified ads) would also be exempt from the sales tax. Sales of motor vehicles, boats, and airplanes are not considered “occasional sales.” The tax on these items would be collected by the Motor Vehicles Division or the Department of Revenue on transfer of title.

What provisions does the proposal make for low-income households?

Households with annual incomes below $17,500 would be eligible for a refund based on family size and income.
level. Persons who apply for this refund would use the same form now used for the Homeowners and Renters Refund Program (HARRP).

For incomes below $5,000, the sales tax low income refund would be $40 per person per year. The refund would decrease for those with higher incomes, so that households with incomes between $15,000 and $17,499 would receive $8 per person.

What types of limits would Measure 1 put on future sales tax increases?

There are three basic ways to increase sales taxes: increasing the rate; broadening the base by making more items taxable; and allowing local governments to impose local sales taxes.

The rate in Measure 1 would be fixed at 5% in the state constitution and could not be changed without a constitutional amendment, approved by a vote of the people.

During the 1987 legislative session, the Legislature could add or remove exemptions other than those set forth in the constitutional amendment. After 1987, however, the Legislature could not change exemptions without a vote of the people.

Local governments under the proposal would be prohibited by the state constitution from imposing general retail sales and use taxes. Selective sales taxes (such as motel taxes) would not be prohibited.

Property and income tax reductions

How would the proposal reduce property and income taxes?

After deductions for administration and low-income refunds, all the proceeds of the sales tax would be used for property and income tax relief. Relief would be provided in three ways—renter relief, reduction of property taxes, and reduction of income taxes.

(1) All residential renters, regardless of income, would be eligible for a relief payment equivalent to the property tax relief provided to homeowners under the proposal.

The remainder of the sales tax proceeds would be used to reduce property and income taxes (points 2 and 3).

(2) State personal income taxes would be reduced an estimated average of 9.6% by a reduction and restructuring of personal income tax rates. The proposed rate structure would be slightly more progressive than the current rate structure. Fifteen percent (15%) of the sales tax proceeds would be put into Basic School Support in the state General Fund, to replace revenues no longer available because of the income tax reduction. This money would become part of the Basic School Support Fund distributed on a formula basis to schools.

(3) The remaining 85% of net sales tax proceeds would be distributed to schools (grade and high schools and certain educational service districts) and community colleges. Property tax revenues in these districts would be reduced by the amount of the sales tax distribution. Statewide property taxes would be reduced an estimated average of 35%.

Figure 1 summarizes how the proposed sales tax would change both the major sources of tax revenue to state and local governments in Oregon and the funding of schools and community colleges.

Timber severance taxes would also be reduced by about one-quarter.

How much relief would renters receive under the proposal?

Since the estimated property tax relief for homeowners under the proposal is 35%, “equivalent relief” for renters would be 35% of their estimated “property tax payment” (the part of rent used by owners of rental units to pay property taxes). An estimated 17% of rent goes to property taxes, so renters would be eligible for a relief payment equal to 6% of annual rent payments (.35 x .17 = .0595, or 6%).

How would the 85% of net sales tax proceeds (an estimated $701.5 million in 1986-87) be distributed?

The money would first be divided between community colleges and school districts. Community colleges would get $50 million. After fully reimbursing each college for reductions in revenue resulting from the change in timber severance taxes, the balance would be distributed in proportion to each college’s 1985-86 net operating levy. This distribution would reduce 1986-87 community college property tax levies by more than half.

The process for high schools and grade school districts begins the same way. Districts would receive an amount equal to the reduction in offsets caused by timber severance tax changes. The remaining revenue would be distributed to school districts in proportion to their 1985-86 net operating levies.

Under this formula, taxpayers in districts with relatively low school taxes would not receive much relief without further adjustment. Therefore, Measure 1 provides that the average property tax relief (and relief in the largest value code area) in each district must be at least 32% of the total property taxes (not just school taxes) for the previous year. In most cases, this provision could not reduce a school’s operating levy by more than 80%.

Generally, however, the sales tax distribution would reduce 1986-87 school property tax levies statewide by more than half.

Suppose sales tax revenues fluctuate from year to year. How would the proposal keep revenues for schools from fluctuating?

The proposal would create a “sales tax leveling account” that would even out sales tax distributions from year to year. If sales tax collections grew faster than personal income, the excess would be put into the leveling account. In years in which sales tax revenues grew more slowly than personal income, the money in the account could be used to keep sales tax distributions to schools growing at the rate of personal income.
Figure 1.—How Measure 1 would restructure Oregon's state-local finance system (* indicates that a major portion of property taxes falls outside the tax base; ** indicates that all such taxes fall within the tax base). This chart does not include those portions of state-local revenues and of school/community college funding that are not affected by Measure 1.
What kinds of limits would the measure impose on local governments?
The measure would place new revenue and election limits on school districts and community colleges, and new election limits on other local governments.

What limits would be placed on school district and community college revenues?
The measure would create new property tax bases for school districts and community colleges and (after 1987-88) would limit tax base growth for these districts to 3% a year and permit one election a year to increase the tax base. A tax base is the amount of property taxes a local government can levy without a vote of the people.

The new tax base for each school district and community college would be determined over a 2-year period. The 1986-87 tax base would equal the 1985-86 total operating levy (including levies outside the tax base), plus 6% of the levy, minus the 1986-87 sales tax offset.

The 1987-88 tax base would equal the 1985-86 operating levy, plus 12%, minus the 1987-88 sales tax offset. (If the 1985-86 operating levy were unusually low, the district would have the option of using the average of the 1984-85 and 1985-86 operating levies to calculate the base.)

The measure would also provide for reduced sales tax offsets for districts that experienced growth during the transition period — allowing the tax bases of these districts to grow more rapidly than the average. Similar provisions would restrict the growth in tax bases in declining districts during the 2-year transition period.

Starting in 1988-89, the tax base could grow at only 3% a year. Voters would have only one opportunity a year (in May) to increase the tax base, and increasing the tax base would generally be the only way voters could increase the tax levy.

The only exception to this would be if the sum of the tax base and other revenues available to the districts were not sufficient to allow the district to maintain total expenditures or expenditures per student at the previous year’s levels. In this case, voters would be allowed one opportunity to vote on a 1-year levy (on the third Tuesday in September) sufficient to bring spending or spending per student up to the previous year’s levels.

Under current law, all districts must provide kindergartens by 1989-90. Over one-third of Oregon’s school districts (serving about one-fourth of Oregon’s public school students) do not presently have kindergartens. The proposed measure allows districts to increase their permanent tax bases by the growth in students associated with new kindergartens (with each kindergarten student counting as one-half a regular student).

What would be the new election limits on other local governments under the proposal?
Under current law, cities, counties, and special districts can seek voter approval for tax levies outside the tax base in six elections a year. Measure 1 would reduce the number of permitted elections to two a year (in May and September, on the same days as the school elections).

Economic Stabilization ("rainy day") Fund

What is a state "rainy day" fund?
This is a reserve into which a state puts unexpected revenues from unforeseen good times, and from which the state draws money needed to cover the shortfalls caused by unanticipated hard times. Its purpose is to stabilize revenues so that drastic cuts in state programs aren’t necessary during recessions. The proposal would create such a fund, called the State Economic Stabilization Fund, for the State of Oregon.
How would this fund work?

As the Legislature goes through the process of establishing the biennial budget, it (a) makes appropriations for agency spending, school support, property tax relief, community college aid, and debt service; and (b) attempts to keep a "prudent person reserve" (an expected ending balance large enough to cover unforeseen occurrences). Appropriations plus the ending fund balance must not exceed the revenue forecast for the biennium.

Actual revenues for the biennium may be greater or less than forecasted revenue. The state is prohibited by the state constitution from running a deficit. Under the present system, therefore, if revenue estimates during the biennium project a revenue shortfall (that is, project that actual revenues will fall short of revenues anticipated at the beginning of the biennium) and if this shortfall exceeds the amount in the "prudent person reserve," the state must either cut expenditures or raise revenues, or both.

Under the proposed measure, if actual revenues were to exceed forecasted revenues, the excess (up to 3% of forecasted revenues) would be deposited in the State Economic Stabilization Fund. See figure 2.

In order to prevent the fund from getting too large over a period of years, the proposal would also require that the fund balance may not exceed 10% of the forecasted General Fund revenue.

Any excess beyond the 3% in any given biennium (or any excess over the fund balance limit of 10%) would be credited to either corporate income and excise taxpayers or personal income taxpayers (or both), depending on which tax source caused the excess.

Money could be removed from the fund only if, first, a deficit were forecast and, second, the appropriation from the fund were approved by a majority of both houses of the Legislature. Appropriations could only be for programs subject to the state spending limit.
Impacts of Measure 1 on Oregon's state-local finance system

How would Oregon's state-local tax structure under Measure 1 compare with that of other states?

Measure 1 would impose a sales tax and would reduce state and local governments' reliance on property and income taxes as revenue sources. Under Measure 1, Oregon's tax structure would more closely resemble the average state's structure. Most states use all of the three major taxes (taxes on property, sales, and income) to obtain revenue for public purposes. Only four other states besides Oregon do not have a general sales tax. Only five states do not have an individual or corporate income tax.

In fiscal 1983, combined revenue from property, general sales, and income taxes represented about 80% of all state and local government tax revenue in ten western states, and in the United States. In Oregon, property and income taxes account for about 80% of state and local government tax revenue.

For all states, property taxes made up 40% of revenue collected from the three taxes, and general sales and income taxes each contributed about 30%. The distribution of the three taxes in the western states was 35% each from property and sales taxes and 30% from income taxes.

In Oregon, property and income taxes each contributed about 50%. If Oregon's sales tax program had been in effect in 1983, overall tax collections would have remained approximately the same. However, property taxes would have represented 35% of the total; income taxes, 40%; and sales taxes, 25%.

Together, Oregon's property and income tax revenue amounted to $996 per capita in fiscal 1983. Among the western states, Oregon ranked sixth out of ten in total state and local government collections per capita from property, sales, and income taxes.

If the sales tax program had been in effect, Oregon's taxes per capita would still have been in sixth place, but property taxes per capita, instead of ranking third, would have been reduced to sixth place. Income taxes per capita would have moved from first to second place (behind California). And sales taxes would have ranked eighth (instead of being tied with Montana, another state with no sales tax, in tenth place).

The distribution and per capita amounts of property, sales, and income taxes in Oregon compared with the western states and with all states are shown in figure 3.

How would passage of Measure 1 affect voter control over state and local government taxing and spending?

Oregon voters already control state and local government taxing and spending in several ways. For example, the state constitution prohibits recurring deficits, such as those that afflict the Federal Government. Other existing controls on the growth of taxing and spending include:

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Figure 3.—Distribution of fiscal year 1983 property, sales, and income tax revenue (Oregon actual and under Measure 1; western states; all states). Source: US Bureau of the Census.
a. constitutional requirements that taxes may be imposed only by vote of the people or their elected representatives and that the people have the opportunity to vote on any taxes proposed by their elected representatives;

b. specific constitutional and statutory limits and prohibitions on particular taxes (such as limits on the amount of property taxes that can be levied without a vote of the people) and prohibitions against certain kinds of taxes, such as the poll tax and local government taxes on insurance, liquor businesses, and telephone service; and

c. the law limiting the growth of most state expenditures to the rate of growth in state personal income (at least one local charter—Lane County’s—also includes an expenditure limitation).

Other provisions of the state constitution, state statutes, and local charters and ordinances establish procedures and requirements that help control the growth of taxing and spending: for example, requirements for preparation of budgets, audit requirements, and provisions for crediting cash balances and surplus revenues against future taxes. Various legal limitations on state and local government bonding also indirectly control the growth of taxing and spending.

Passage of Measure 1 would add to this system of taxing and spending controls in several ways. First, the constitutional amendment itself would set the sales tax rate and establish several exemptions. Second, it would take away the existing authority of cities and counties to levy their own local general sales taxes.

In addition, Measure 1 would:

- Lower the maximum annual increase in school district tax bases from 6% to 3% and allow the people to approve special school district levies outside the tax base only if the levy is needed to bring expenditures up to the level of the previous year. To reduce the restrictiveness of this provision, Measure 1 would also establish new district tax bases pegged to the current level of operating levies. Further, in addition to the growth of local tax bases within the proposed 3% limitation, Measure 1 exempts state school support from the state expenditure limitation, thus allowing for future growth in school funding by legislative action.

- Reduce the number of opportunities to submit special levies for voter approval. At the present time, special levies may be submitted on any of six annual election dates. Under the measure, school districts could submit special levies only once a year, and then only if the levy is needed to support current levels of operating expenditure. Other local taxing units would be limited to only two special levy elections a year (May and September). The frequency of tax base elections would remain the same, although Measure 1 allows school districts to vote on new tax base proposals annually (in May) instead of twice in even-numbered years only, a restriction that continues to apply to nonschool taxing units.

- Make additional changes in taxing and spending "ground rules," including new provisions for limiting state expenditures, a reduction in timber severance tax rates, and repeal of an existing property tax rate limitation that limits elections on levies to increase the tax rate to two a year. Repeal of the rate limitation would have no effect because Measure 1 limits all local governments to two levy elections a year.

Measure 1 continues a system under which voters have substantial control over state and local government taxing and spending. On balance, it somewhat increases the limits on state and local government.

Would Measure 1 make Oregon’s state-local tax system more or less progressive?

Oregon’s current state-local tax system is moderately progressive. A progressive tax system is one in which the effective tax rate (taxes as a percent of income) increases as income increases: in which households with higher incomes have higher effective tax rates than those with lower incomes.

When considering the impact of Measure 1, it’s important to distinguish between the initial impact of a tax (the burden on individuals or firms who initially pay the tax) and the final impact of a tax (the burden on the individuals who end up paying the tax after all the shifting of the tax by firms and individuals has taken place).

The initial impact of Measure 1 on different income classes—considering both the tax and tax relief/refund elements of Measure 1 and ignoring any shifts of taxes or tax relief by businesses to households—would be to lower the effective tax rate of low-income Oregon households and slightly raise the effective tax rate of higher-income households.

Because of the exemption of many necessities from the sales tax, the low-income refund, renter relief, and the increased progressivity of the income tax structure built into Measure 1, the initial impact of Measure 1 would be to make the current tax system slightly more progressive.

The final impact of Measure 1 would depend on how businesses shift their taxes and tax relief. Businesses would pay sales taxes and receive property tax relief under the proposal and would shift this tax and tax relief to stockholders, workers, or consumers. Eventually, the taxes that businesses would pay would end up being paid by individuals: as lower profits for business owners, lower wages for employees, or higher prices for consumers.

Similarly, the property tax relief that businesses would get under Measure 1 would finally be received by individuals: as higher profits for business owners, higher wages for employees, or lower prices for consumers. Because many owners and stockholders of Oregon businesses and consumers of Oregon products live outside the state, some of the taxes and tax relief would be shifted out of state.

Estimating the final impact of Measure 1 on Oregon households is quite complex and involves making assumptions about how businesses would shift the tax and tax relief to owners, employers, and consumers. Which income classes these individuals belong to, and where they live, would determine the final impact of the tax on Oregonians.

Estimates of the final impact of Measure 1 are more subject to error than those of the initial impact because it’s so difficult to know which assumptions about shifting are correct.

Under a plausible set of assumptions about shifting (that businesses would pass half of taxes and tax relief through to owners and half through to consumers), the final impact of Measure 1 would be to lower slightly the tax rate of low-income households, slightly raise the tax rates of middle-income households, and very slightly reduce the tax rate of higher-income households. This would make the
overall system slightly more progressive at the lower end of the income scale and slightly less progressive at the upper end. These are very rough estimates of final impact; they apply not to individuals but to broad income classes. Within any income class, there would be those with higher effective tax rates and those with lower effective tax rates. Under other sets of assumptions about shifting, Measure 1 would make Oregon's state and local tax system more progressive overall or less progressive overall. The initial impact of Measure 1 would be to make Oregon's state-local tax system more progressive. Because it's so difficult to determine how businesses would shift the taxes and tax relief, it's not possible to draw firm conclusions about the final impact of the measure on the overall progressivity of Oregon's state-local tax system. Depending on one's assumptions about shifting, it's possible to conclude that the measure would make the system slightly more progressive or slightly less progressive.

What would be the long-run effects of the measure on economic development in the state?

Again, it's difficult to say with any certainty how Measure 1 would affect economic development. To the extent that high personal income and property taxes hinder business in Oregon, the proposal would improve the prospects for new industry and the retention and expansion of existing industry. To the extent that the prospect of school closures keeps out new firms, the measure would remove this concern since each school district would receive a new tax base.

In the longer run, as business had time to adjust to the lower overall tax burden it would face under Measure 1, it would either have higher profits, pay higher wages, and/or sell at lower prices.

Higher profits would stimulate firms to expand, and might attract new firms, which would create new jobs.

Lower prices would benefit Oregon consumers and make Oregon products more competitive, which would generate pressures for expansion of Oregon business.

The business community is extremely varied, of course. Some businesses would be better off with Measure 1, receiving more in property tax relief than they would pay in sales taxes. Others, with relatively low property taxes and relatively high purchases of taxable goods, would pay higher total taxes. Some firms operate in markets where they would be able to pass the additional taxes on to consumers or employees; others do not.

By reducing overall taxes on business, Measure 1 would set up pressures for business expansion in Oregon. This would be particularly true for businesses with a lot of taxable property and little taxable sales.

Economic development is a complex process. Taxes are only one of the factors affecting business location and expansion—and probably not a major factor. Therefore, it's not possible to say how large an impact Measure 1 would have on economic development in the state.