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FILE

How Would Measure 5 Affect Oregon's Tax System?

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Ballot Measure 5

What is Measure 5?

Measure 5 is a proposed constitutional amendment that would limit total taxes and government charges on each property to a certain percent of the property's market value. Property taxes and charges would be divided into two categories—school taxes and charges and nonschool taxes and charges. For each category, the measure would limit property taxes and charges that could be imposed on any property, beginning in fiscal year 1991-92 (which begins July 1, 1991).

The limits on school taxes would be phased in over a 5-year period. During this period, the Legislature would be required to replace, from the State general fund, revenue that's lost to the school system because of the limitation. The measure was put on the ballot by initiative petition, and it will be voted on in the November 6 general election.

What are the main provisions of Measure 5?

1. Measure 5 would limit school and nonschool property taxes and charges. For fiscal year 1991-92, the measure would limit property taxes for the public school system to 1.5% (or $15 per $1,000) of "real market value" for any property. The schools limit would apply to any property taxes and charges "used exclusively for educational services, including support services, provided by some unit of government, at any level from pre-kindergarten through post-graduate training."

The *public school system* category would thus include property taxes to elementary and secondary schools, education service districts (ESD's), community colleges, Extension Service Districts—and county school funds, if levied separately.

The limit would then be reduced by $2.50 each year until 1995-96, when the rate would be $5 per $1,000, where it would remain for every year thereafter.

For 1991-92 and thereafter, property taxes and charges for nonschool governmental operations by cities, counties, special districts, and (in some cases) State government would be limited to $10 per $1,000.

After 1995-96, the combined limit of the two categories (school and non-school) would be $15 per $1,000 or 1.5%. If the taxes and charges on any property exceeded the limitation in either the school or nonschool category, each tax or charge on the property would be reduced proportionally to bring the total taxes and charges for that category down to the amount of the limit.

The percentages used to reduce the taxes and charges would be calculated separately for the school and nonschool categories. Because the percentage reductions could vary from property to property in a district, similar properties might pay different taxes and charges to the same taxing district.

There is no provision for local voters to override the limit.

2. Measure 5 limits would apply to property taxes and charges for operating expenses, broadly defined. The limit would apply to a broad range of taxes and charges imposed on property, not just *ad valorem* taxes on real estate. It would apply to any charges imposed on property or a property owner "as a direct consequence of ownership of that property."

According to an Attorney General's opinion, it would, for example, limit timber severance taxes, urban renewal revenues, serial levies for capital construction, systems development charges, and registration fees for motor vehicles and aircraft.

The measure would allow three specific exceptions to the limit:

- Incurred charges. These are charges by government for goods and services that can be controlled or avoided by the property owner (such as charges for water or for removing unsightly vegetation).
- Assessments for local improvements. These are charges for improvements that provide special benefits to specific properties, are assessed in a single assessment, and may be paid for over a period of at least 10 years (such as assessments for improvements financed by Bancroft bonds). The costs of the incurred charges and the assessments could not exceed the cost of providing the goods and services or financing the improvements.
- Property taxes to pay principal and interest on bonds authorized by a specific provision of the State Constitution (such as bonds for veterans' homes), existing bonds for capital construction and improvements (for example, to construct a school, build a bridge, or remodel an auditorium), and new bonds for capital construction if approved by voters.

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3. Measure 5 would require limited State replacement of school system losses for 5 years. The measure would require the Legislature, during the first 5 years, to replace property tax revenue lost by the public school system (as defined in #1) because of the limitation, using the State general fund monies.

The Legislature would be authorized to limit the amount of the replacement revenue so that the total revenue from school property taxes within the limitation plus the replacement revenue would not grow more than 6% a year.

These replacement funds would not have to be distributed dollar-for-dollar to districts losing property taxes, but could be allocated by the Legislature anywhere within the public school system. After 1995-96, the requirement that the Legislature replace lost revenue would expire.

There's no requirement that the State continue current State aid to the public school system such as the Basic School Support Fund, community college appropriations, or any other expenditure. There's no requirement to replace revenue lost by nonschool districts.

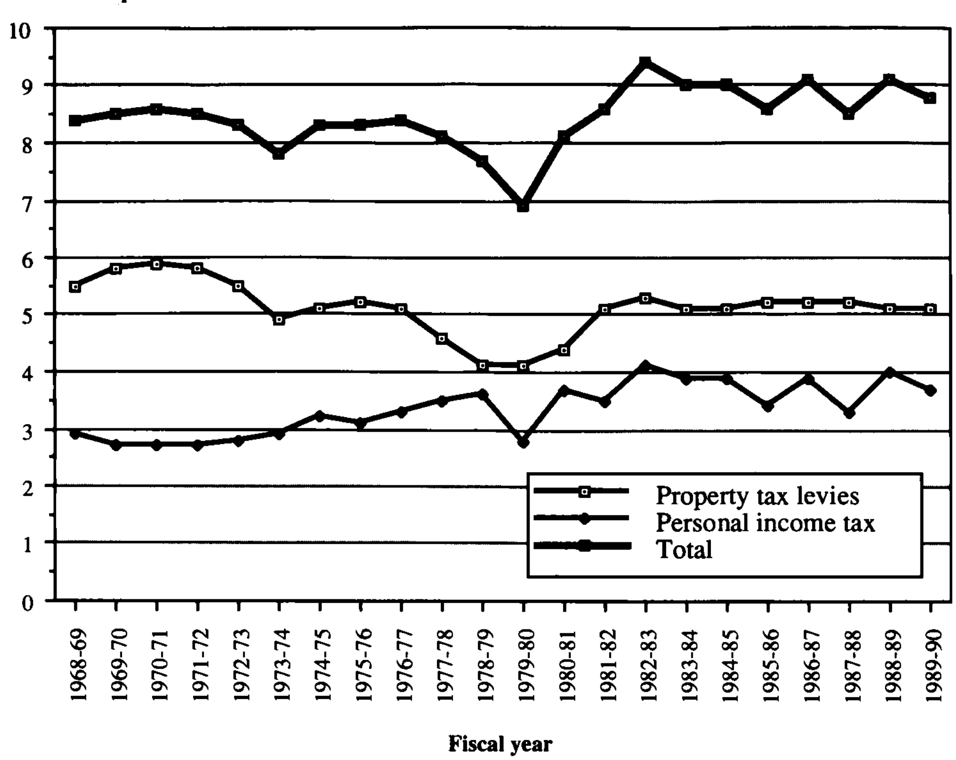

Figure 1.—Oregon's tax burden

Oregon's tax system

How does the Oregon tax system compare with that in other states?

Unlike most states, Oregon relies on only two of the three major kinds of taxes: the income tax and the property tax. The property tax is the main source of tax revenue for local governments; the income tax is the main source of tax revenue for State government. Oregon is one of five states with no general sales tax.

Thus, on a per capita basis, both property taxes and income taxes are high. Oregon's total State-local taxes per capita ($1,602) in 1987-88, however, were 10% lower than the U.S. average of $1,772.

Although State-local taxes *per capita* are below the national average, State-local taxes *per $1,000 of personal income* are right at the national average ($116 for both U.S. and Oregon). This is because Oregon's income per capita is below the national average.

How has Oregon's tax burden changed over time?

Since 1968-69, Oregon's property taxes have increased at an average rate of 9% a year. Over this same period, personal income taxes have increased at an average rate of 11% a year. Personal income over this period has increased at an average rate of 9.4% a year, more rapidly than property taxes, more slowly than income taxes.

Figure 1 shows how property taxes and personal income taxes, as a share of personal income, have changed between 1968-69 and 1989-90. As a share of personal income, the sum of these two taxes has averaged 8.5% over the period. The property tax share has declined over this period, and the income tax share has increased.

What is Oregon's property tax used for?

In Oregon, the property tax provides revenue for local governments only. In 1987-88, 38.6% of the revenues for Oregon local governments came from property taxes. Figure 2 shows the importance of property taxes as a revenue source for different types of local governments. Property taxes provided 55.7% of the total revenue for school districts, 24.4% for cities, 24.6% for counties, and 18.5% for special districts.

Schools also receive revenue from the State and Federal governments and from miscellaneous sources. Cities, counties, and special districts (fire, water, cemetery, library, and park districts) also receive revenue from the Federal and State governments and from fees, charges, and other miscellaneous sources.

Who pays the property tax in Oregon?

According to the Legislative Revenue Office (LRO), homeowners pay, on their principal residences, about 39% of the total property tax collected. Owners of residential rental property pay 16% of the tax, and they presumably pass this on to renters as part of their rent. Owners of unoccupied and second homes pay 3%, and nonresidential property owners pay about 42% of total property taxes.

What kind of property is taxed?

Under current law, taxable property includes real property, mobile homes, and some tangible personal property used by businesses. Property exempt from taxation includes intangible property, tangible personal property of individuals, inventories, government property, property used for religious or charitable purposes, and cemeteries.

How are property taxes determined in Oregon?

Oregon's property tax system is levy-based, with limits placed on the amount

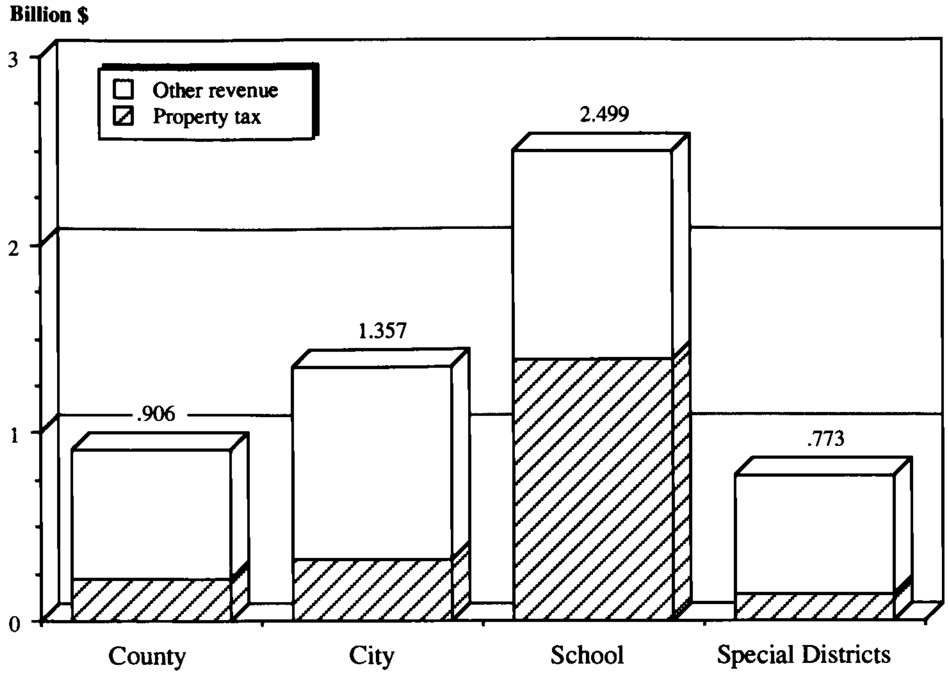

Figure 2.—Oregon local government revenues, 1987-88 (source: U.S. Bureau of Census)

of the levy. Taxing districts are limited in the amount of property tax they can levy by a constitutional provision called the 6% limitation. The levy is limited to an amount called a *tax base,* which is a dollar amount that a taxing district can levy each year and that the district can increase by 6% a year, without further voter approval.

To levy more than the tax base, a taxing district must secure voter approval, for either a new tax base or a temporary levy in excess of the tax base. Districts without tax bases or with low bases must secure voter approval for their levies each year.

If voters refuse to approve school levies, a "safety net" provision in the Constitution permits them to levy the previous year's amount, which cannot grow from year to year.

The tax rate for each taxing district is whatever rate is needed to produce the amount of the approved levy, determined each year by dividing the amount of the levy by the assessed value of all taxable property within the taxing district. With certain exceptions—including farmland, timber land, and open-space land—real property in Oregon is assessed at 100% of market value.

Once determined, the rate is applied to the value of each property in the taxing district. Most property lies within, and is taxed by, several taxing districts. The sum of the tax rates that apply to any piece of property is called the *consolidated rate.* Property taxes on a given property are determined by multiplying the assessed value of the property by the consolidated tax rate.

Impacts of Measure 5

Measure 5 would affect:

- Oregon's tax system (its size, structure, and growth, and the distribution of its burden);
- the amount of property taxes and charges Oregonians pay;
- the revenues available to, and services provided by, Oregon's State and local governments; and
- local control.

Some of the impacts of the measure are unknown, for two reasons:

1. Certain important issues raised in the measure could be determined only by judicial or legislative action or by popular vote.
2. The magnitude of the impacts depends largely on future economic conditions that are difficult to predict, including growth in the economy, inflation, and property values.

How would Measure 5 change Oregon's property tax system?

The current property tax limitation system places limits on the amount of taxes a district can levy. Measure 5 would add new limits on the amount of taxes and charges that can be collected from an individual property.

The limitation imposed by the measure would not affect the tax base of a taxing district. This means that a taxing district's authority to levy taxes within its tax base would not be limited, nor would its power to ask voters to approve a new tax base or a temporary levy outside the tax base.

Under Measure 5, a district could *levy* whatever amount voters have approved; however, the district would collect from any taxpayer only the amount of the levy within the limitations imposed by the measure. For properties subject to the limitation, the actual amount *collected* could increase only if the value of the property increased.

This change would have three major implications for the tax system:

1. Tax rates for operating purposes (excluding debt levies), which now vary widely across the State, would tend to converge toward a $15 effective rate after the 5-year phase-in of the limitation. There could be lower rates, but there would be a $15 maximum effective rate.
2. Under the current levy-based limitation system, overall growth of assessed values does not affect property tax levels. Growth in an individual's assessment affects property taxes only if the value of the property is growing faster or slower than that of neighbors. Under Measure 5, growth in assessed values would become a much more significant determinant of property tax growth, both for the system as a whole and for individual properties. Property taxes would increase rapidly in periods of rapid growth in property values and slowly when property values grow slowly. The 6% limitation on levies would, of course, still apply.
3. Measure 5 would override the existing constitutional requirement that a district's tax rate must be uniform across all properties in the district. To comply with the requirement (see page 1) of proportionally reducing taxes and charges within a tax code area, the effective rates of a taxing district

might have to be reduced by different amounts for different areas within the district. For example, the effective county government tax rate might be different for a property inside city limits than for a property outside the city.

The effects on taxpayers and government described here are based on forecasts made by the Legislative Revenue Office; these forecasts assumed 7% growth in operating levies and 9% growth in property values. These assumptions are consistent with growth in levies and in property values since 1969. A higher growth rate of value would produce more revenue, resulting in less property tax reduction and a smaller amount of replacement revenue needed for schools.

How would Measure 5 affect taxpayers?

The full effect on taxpayers would depend on whether the Legislature instituted (and voters approved) a new nonproperty tax, such as a sales tax, or increased income or other taxes, to offset the reduction in property taxes that would result from passage of the measure.

All property owners whose taxes exceed the limitations in Measure 5 would have a reduction in property taxes. LRO estimates that the measure would reduce property taxes by an average of 12% the first year and by 45% in the fifth year, assuming 9% annual growth in total value of property (figure 3). The amount of reduction for any taxpayer would depend on how much current taxes exceed the limitations.

School property taxes would continue to decrease for 5 years because of the phasing-in of the limitation for schools. The measure would also have the effect of equalizing the effective tax rates for taxpayers across the State.

Taxpayers who itemize dedutions would have a slight increase in income taxes because they would deduct less property tax, and there would be a slight reduction in property tax relief from the Homeowners and Renters Relief Program because of lower property taxes.

What would happen to taxes on specially assessed or partially exempt property?

Under current Oregon law, some property is assessed at less than market value. Examples are farmland, forest land, open-space land, historic property, and property receiving a veteran's exemption. While Measure 5 would not change the assessments, the measure's limits would apply to property's real market value. Since this value is generally much higher than the assessed value, specially assessed or partially exempt property may get little or no tax reduction under the measure.

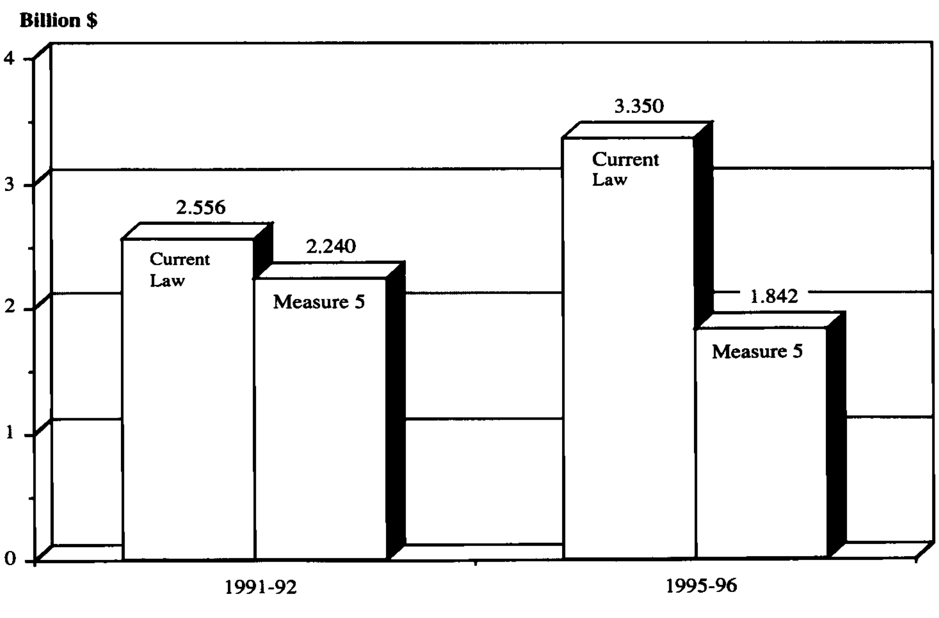

Figure 3.—Impact of Measure 5 on property taxes, assuming 9% value growth and 7% levy growth (source: Legislative Revenue Office)

How would Measure 5 affect the public school system?

The effect on schools, community colleges, ESD's, and Extension Service Districts is highly uncertain. There would be a significant reduction in their property tax revenue.

LRO estimates that total school property tax revenue would be reduced about $231 million (13%) in the first year and by as much as $1.525 billion (67%) by the fifth year. For the first 5 years, however, most, if not all, of the property tax revenue lost because of this reduction would be replaced—for the public school system as a whole—out of the State general fund.

Assuming that levies would grow 7% annually and that the Legislature would limit replacement to the 6% annual growth permitted under Measure 5 (see page 2), LRO has estimated that the statewide reduction in property taxes to the public school system after replacement would be less than 1% in the first year and less than 5% in the fifth year. This replacement would require an increasing share of the State general fund over this period.

There are several major uncertainties about school funding under Measure 5:

1. The measure would not require the replacement revenue to be returned to the same district, or even the same type of district, in which taxes were reduced by the measure. The Legislature would determine both how much of the total replacement revenue would go to each part of the public school system (school districts, community colleges, ESD's, and Extension Service Districts) and how the revenue would be distributed *within* each part. A district or type of district could get more or less than the property tax revenue it lost.

2. Even if districts received the same amount in replacement revenues as they lost in property taxes, there would be no requirement that current school aid—primarily, the Basic School Support Fund (BSSF) for schools and community college appropriations—would continue at current levels. Currently, the BSSF, which funds about 30% of school operating expenditures, takes about 26% of the State general fund. Community college appropriations are about 3% of the general fund.

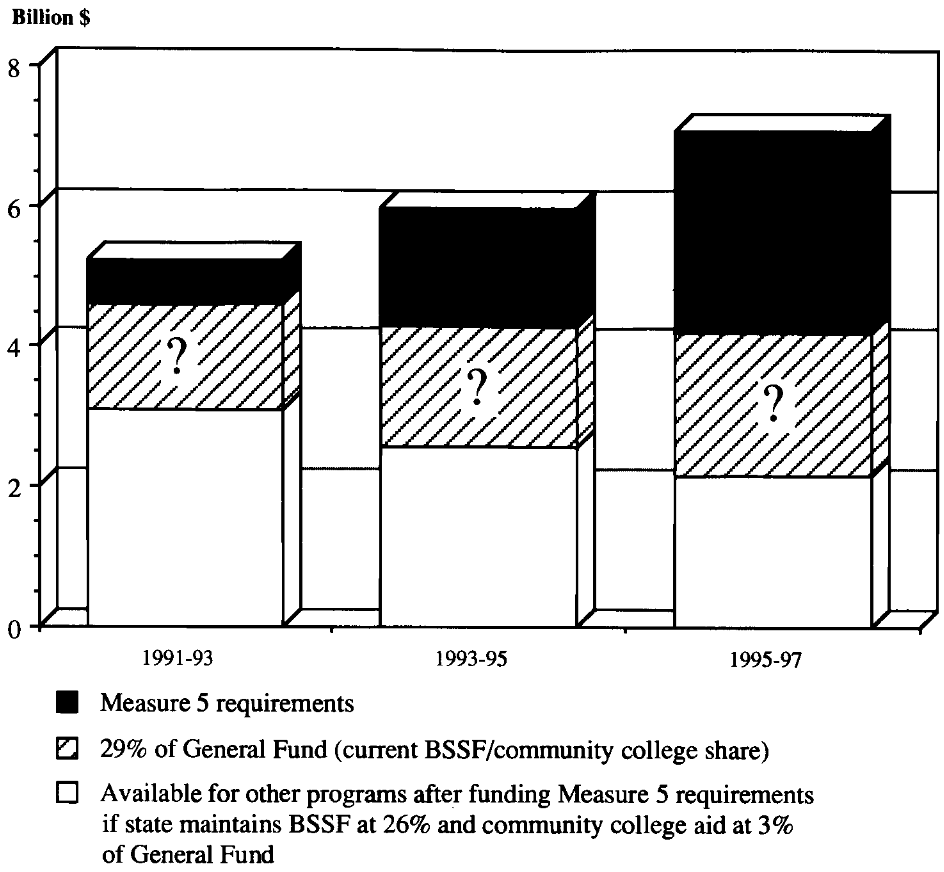

Figure 4.—Impact of Measure 5 on State general fund expenditures, assuming 9% value growth

The Legislature could decide to cut BSSF and community college appropriations to provide the replacement property tax revenue. If this happened, school system revenue would be cut, even though lost property tax revenue would be replaced.

3. The measure doesn't indicate how the public school system should be financed after the fifth year. If the Legislature found no other source of revenue to replace the property tax revenue and decided not to continue the replacement revenue, school districts, which currently depend on property taxes for over half their revenue, would find property taxes reduced by 67%.

How would Measure 5 affect other local governments?

Measure 5 would limit the property taxes that nonschool local governments impose on any property to $10 per $1,000 beginning in 1991-92, and it would provide no replacement revenue.

LRO estimates that in 1991-92, cities would lose a total of $49 million (13%) of their property tax revenue; counties would lose $24 million (9%); special districts would lose $3 million (2%); and urban renewal districts would lose $9 million (20%) in property taxes.

These taxing districts provide roads, fire and police protection, health and mental health services, parks, libraries, planning, and economic development, which are paid for in small or large part out of property taxes. These local governments would have to find new sources of revenue not based on property or cut expenditures.

How would Measure 5 affect State government?

The requirement that school property tax revenue be replaced out of the State general fund would affect the Legislature's ability to fund other State programs. The general fund is that part of the State budget that contains revenue, mostly from income taxes, that is not dedicated to a specific purpose.

It's the fund that is used to pay for State programs such as Basic School Support, public safety, human resources, higher education, the judicial branch, and natural resources.

The LRO estimates that Measure 5 requirements for school-replacement revenue would take 12% of the State general fund in the first biennum and 41% by the third biennum (the black areas in figure 4). In 1995-97, this would leave 59% of the general fund to finance all current programs (shaded and white areas in figure 4). Note that this is based on the LRO analysis that assumes a Measure 5 replacement in 1996-97, even though the replacement requirement ends after 1995-96.

If the State continued to fund BSSF and community colleges at their current share of the general fund (shaded areas), the public school system would receive 41% of the general fund in the first biennum (12% replacement + 29% BSSF/community colleges).

In the third biennum, public schools would get 70% (41% replacement + 29% BSSF/community colleges).

Given the other demands for general fund resources, there's a question whether BSSF or community colleges would continue to receive their current shares of the general fund.

In real terms (adjusting for inflation), 1995-97 general fund revenues are projected to be 17% higher than in 1989-91, according to LRO. Funding the required school tax replacement in the fifth year could require the equivalent of a 31% real cut in appropriations for current programs (including BSSF). To avoid a cut of this magnitude would require an increase in existing State taxes or the enactment of a new nonproperty tax.

How would Measure 5 affect local control?

Under the current system, local voters can authorize property taxes outside the 6% limitation by a simple majority vote. Measure 5 does not allow local voters to authorize property tax levies outside the limitations specified in the measure. Voters could not override the Measure 5 limits.

What are some unresolved issues?

Three unresolved school-funding questions have already been mentioned:

- Would the Legislature continue existing school aid at current levels?

- How would the State allocate the funds it uses to replace property taxes among individual school districts and among schools, community colleges, and other parts of the public school system?
- How would schools be funded after 1995-96?

There are two additional unresolved issues:

- Could taxes on properties below the Measure 5 limits be increased to bring property taxes up to what's allowed under existing levy limits in the Oregon Constitution? There's nothing in the measure to prohibit this.
- Would the Legislature impose new restrictions on the levying authority of districts to reduce competition among taxing districts? Under Measure 5, taxing districts would have an incentive to seek approval for levy increases even if all properties in the district were subject to the Measure 5 limits, since this could increase the district's share of total taxes.

Summary

Ballot Measure 5 would:

- reduce and limit property taxes;
- require the State to replace most, if not all, of the reduced property taxes to the public school system for 5 years without requiring the State to continue existing school aid;
- in the absence of new or increased nonproperty taxes, require significant real reductions in current State general fund expenditures;
- reduce property tax revenues for nonschool local governments; and
- limit local control by not allowing local voters to authorize property tax levies outside the Measure 5 limits.

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