Understanding Oregon's Four 1986 Tax Initiatives

This publication is a slight revision of four news releases recently made available to Oregon newspapers.

Part 1. How Does the Current System Work?
Part 2. What Are the Pressures for Change?
Part 3. What Do the Tax Measures Say?
Part 4. How Would the Tax Measures Change the System?

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Part 1: How Does the Current System Work?

On November 4, Oregonians will vote on proposals to substantially change the state-local tax system. Measure 7 would institute a 5 percent sales tax to fund schools and provide property tax relief. Measure 9 would impose a 1-1/2 percent limit on property taxes and limit growth of assessed value. Measure 11 would exempt half of the value of an owner-occupied principal residence from property taxation (up to a maximum exemption of $25,000), financing this primarily out of the state general fund. Measure 12 (a companion to Measure 11) would restructure the state income tax to finance property tax relief.

To understand how these measures would change the tax structure, it is important to get a perspective on the present system. How does Oregon presently fund its state and local governments? How much have taxes increased relative to income in recent years? What kinds of limits currently exist on state and local taxing and spending? How fair is the system, with regard to ability to pay?

Part 1 offers answers to these questions. Part 2 summarizes the pressures for change in the current system; part 3 explains the four tax initiatives; and part 4 compares their impacts on the current system.

State and Local Tax Revenues

State and local governments in Oregon rely heavily on income taxes and property taxes. Property taxes provided 91 percent of all local government tax revenues in 1984. Personal income and corporate income/excise taxes provided over 70 percent of state government tax revenues in the same year. The state and local tax systems are highly interrelated because the income tax finances much of the general fund, and a large share of the general fund is transferred to local governments and used for property tax relief.

The income tax is the principal revenue source for the state general fund (85 percent in the 1985-87 biennium). Over one-third (37 percent) of the state general fund in the 1985-87 biennium is appropriated for aid to local governments.

Thus local governments, principally schools, are the main users of state-local tax revenues in Oregon. They get all the property tax and about one-third of the state general fund financed primarily by the income tax. An additional one-tenth of the state general fund is funneled into direct property tax relief for homeowners and renters.

Local governments are also beneficiaries of this money to the extent that...
local taxpayers consider this relief in their decisions to approve additional property tax levies for local governments. About one-half of the state general fund is used to finance state agency operations.

Contrary to popular belief, the state-local tax burden on Oregonians has not grown rapidly over the past two decades. The sum of state personal income taxes and all (residential and nonresidential) property taxes (net of tax relief), as a percent of personal income, has remained quite constant (at about 9 percent) over the past 17 years (figure 1).

Limits on Taxing and Spending

The state constitution and statutes impose limits on state and local taxing and spending authority. The Oregon Constitution requires that taxes be imposed only by a vote of the people or their elected representatives and that voters must have the opportunity to refer to themselves any tax measure proposed by their elected representatives.

In addition to this general limitation on tax power, the constitution limits the growth of property tax bases to 6 percent per year unless voters approve additional taxes.

This limit plus the fact that tax bases are considered inadequate for many local governments are the main reasons behind the many local property tax measures facing Oregon voters each year.

The Oregon Constitution exempts Social Security income from any state or local tax. There are also prohibitions on certain kinds of taxes. Poll taxes and local government taxes on insurance, liquor businesses, and telephone service are prohibited.

In addition, there is a law limiting the growth of most state general fund expenditures to the rate of growth of personal income. Under another law, unanticipated general fund revenues are returned to taxpayers if revenues are more than 2 percent higher than expected. This law resulted in a 7.7 percent personal income tax credit for the 1985 tax year.

Figure 1. OREGON PERSONAL INCOME AND PROPERTY TAX BURDEN

1969 - 1985

Taxes as a percent of income

Source: Legislative Revenue Office
Fairness

Fairness in a tax system is often judged by asking whether a system is progressive or regressive. A progressive tax system places a higher tax burden (taxes as a share of income) on higher-income households. A regressive system places a higher burden on lower-income households.

Like most state-local tax systems, Oregon's is regressive. Lower income households bear a somewhat higher burden than middle- and high-income households. Oregon's system is, however, considered one of the least regressive in the country.

To sum up, Oregon's current tax system relies primarily on property and income taxes. The ratio of these taxes to personal income has remained relatively constant (at around 9 percent) for the past 17 years.

Built into the tax system are a number of limits on local taxing and state taxing and spending. And Oregon's state-local tax system is considered one of the most "fair" (least regressive) in the nation. Yet, there is some dissatisfaction with this system.

Part 2: What Are the Pressures for Change?

Why is a relatively slow-growing and "fair" tax system, with a relatively effective set of limits, facing the kinds of challenges posed by Measures 7, 9, 11, and 12? The challenges are coming from many different perspectives.

Some view the existence of effective limits on the property-tax-levying capacity of some school districts, coupled with a school finance system that relies heavily on property taxes, as impairing our ability to adequately finance primary and secondary education.

The fact that 21 school districts in October still do not have voter approval for the levies needed to finance their budgets for the school year already in progress is cited as evidence of a defective system.

Others do not consider the limits on property taxes effective enough. They point to high property taxes in Oregon: The state ranked fourth in 1984 among the states in property taxes as a share of personal income. They also note the erosion of property tax relief under the 1979 relief program.

Some people who are concerned about high property taxes, yet also reluctant to slash public expenditures, suggest replacing property taxes with income taxes. Others are concerned that income taxes are already too high: Oregon ranked fifth in 1984 among states in personal income taxes as a share of personal income. They point out that Oregon's ranking on total state and local taxes is much lower.

Because Oregon does not have a general sales tax and most other states do, Oregon ranked fourteenth in total state and local taxes as a percent of personal income in 1984. By replacing some of Oregon's property tax with a sales tax, they argue Oregon's property taxes could be reduced without reducing levels of public expenditure on schools or increasing an already high income tax.

There is also concern about the shares of property taxes paid directly by households. During the 1970's and early 1980's the share of property taxes paid by owner-occupied residential property increased over 40 percent. There is some recent evidence that this trend has reversed itself. But for some, homeowners still bear a disproportionate share of property taxes.

Finally, some ask why Oregon's tax system, one of the least regressive in
the country, should be regressive at all. Why should we not increase the tax burden on upper-income households and reduce the tax burden on lower-income households?

These diverse concerns about Oregon's state-local tax system have been incorporated in various ways into the four ballot measures affecting the tax system.

Part 3: What Do The Measures Say?

Oregonians face a bewildering choice in the array of tax measures in the November 4 election. Part 3 provides a brief explanation of each of the four major proposals to modify Oregon's tax structure. All four were placed on the ballot by initiative petition.

Measure 7

Measure 7 is a proposed constitutional amendment that would enact a 5 percent retail sales tax, dedicate the net proceeds of the tax to schools and to homeowner and renter property tax relief, and limit homeowner property tax rates to 1.5 percent of true cash value.

The 5 percent tax would be imposed on retail sales (final sales to the consumer and sales to businesses of goods consumed in the production process). It would be on goods (tangible personal property) only. Sales of services, real estate, stocks and bonds would not be taxable.

Specifically exempted by the measure would be food (except in restaurants), prescription medicine, utilities, gasoline, livestock, feed, seed, and certain other agricultural inputs. The measure would require the Legislature to provide low income refunds.

Seventy percent (70%) of the proceeds of the sales tax (after compensation for collection, refunds to low income persons, and administration) would be dedicated to local public schools and community colleges. The remaining 30 percent would be dedicated to property tax relief for homeowners and renters. Relief for homeowners and renters must be equivalent.

Measure 7 would attempt to prevent the use by schools of the additional revenues from the sales tax to substantially increase their budgets. It would do this by reducing the tax bases of some schools and community colleges. A tax base is the amount of property taxes a local government can levy without a vote of the people.

The school tax base would be reduced in cases where the combination of sales tax revenues, the property tax base, and other revenues would yield a budget 6 percent larger than the previous year's budget.

The tax base would be reduced by the amount necessary to bring the budget increase down to 6 percent. The tax base remaining after 2 years of this process would be the new tax base, which would be allowed to increase 6 percent per year thereafter.

Measure 7 would also place a maximum 1-1/2 percent limit ($15 per thousand) on the operating property tax rate for owner-occupied homes. Voters could not approve levies outside this limit, except to repay bonded debt. This limit would apply to the consolidated tax rate for all taxing districts. The rate limit for property other than households would be $15 per thousand plus a rate that would be determined by the rate reduction given homesteads by the 30 percent share of the sales tax going to homestead relief.
The measure would prohibit local governments from imposing a local sales tax on top of the 5 percent state sales tax. It also would require the Legislature to continue to appropriate in future biennia the 1985-87 shares of the General Fund to Basic School Support (28.2 percent) and to Aid to Community Colleges (3.4 percent) and to continue the Homeowners and Renters Refund Program (HARRP) as it existed in 1983.

**Measure 9**

Measure 9 is a proposed constitutional amendment that would repeal existing tax bases and impose a property tax rate limit ($20 per thousand the first year and $15 per thousand thereafter) and limit growth in assessed values to 2 percent per year.

Under the current constitution, there is a limit on the dollar amount of property taxes a governmental unit can levy without voter approval. This amount (the "tax base") may grow 6 percent per year. Voters may approve levies outside this amount or may vote to establish a new dollar limit.

Measure 9 would replace these dollar limits with a rate limit. The total tax rate levied against any property could not exceed 2 percent of assessed value or the 1985-86 tax rate (whichever is less) in 1987-88. Thereafter, the limit would be 1-1/2 percent or the 1985-86 tax rate, whichever is less. The rate limit would not apply to levies for current or future bonded debt or existing serial levies for capital construction.

Voters could approve a tax rate over the limit. Voter approval would be required when a district proposed to increase its rate or impose a new rate or when a proposed rate would cause total tax rates on any property in a district to exceed the 1-1/2 percent (2 percent for 1977-78) limit. Such elections could be held only twice a year, in May and November.

Measure 9 does not make any specific provision for renter relief.

Assessed values would also be limited by the measure. The assessed value of existing property that did not change ownership or special assessment status could grow at a maximum of 2 percent per year from its 1986 value.

For new construction, improvements and property that changes ownership or special assessment status, assessed value could increase at a maximum of 2 percent per year from a 1985 base.

**Measures 11 and 12**

Measure 11 is a proposed constitutional amendment establishing a homestead exemption. It requires the state to pay at least 80 percent of the cost of the exemption and to provide property tax relief to renters equivalent to the relief given homeowners by the homestead exemption. It provides no new funding for this relief.

Measure 12 is a proposed statutory amendment to restructure Oregon's personal and corporate income taxes and use the increased revenues to finance property tax relief. It is not a constitutional amendment.

Measures 11 and 12 could work together, although each could also work independently. Voters could pass one without the other.

Measure 11 would exempt one-half of the value of a homestead (owner-occupied principal residence) from property taxes, up to a maximum exemption of $25,000 in 1987-88. A $60,000 house, for example, would be taxed on $35,000 of assessed value ($60,000 minus the maximum $25,000 exemption). After 1987-88, the maximum exemption would increase or decrease by the change
in assessed value of existing homesteads, except that the maximum exemption could never be less than $25,000.

Renters would be guaranteed relief under the measure for property taxes paid through rent for their principal residence. This relief must be equivalent to that given to homeowners by the homestead exemption.

In order to reduce the shift of property taxes from homeowners to other property owners, the measure would require that the state pay at least 80 percent of the property taxes that would have been paid on the exempted assessed valuation of homesteads. This payment, to be made primarily out of the state general fund, would be applied as an offset to property taxes thus reducing the levy used to compute tax rates.

If the state were to not fully fund the homestead exemption, property tax rates would rise somewhat, thus slightly shifting the burden of taxation to nonhomestead property (or in some cases to more valuable homesteads).

Measure 12 would provide financing for homeowner and renter property tax relief by increasing personal and corporate income taxes. It would do this through changes in tax rates, brackets, deductions, and the method for computing depreciation.

The personal income tax rate would be reduced for the lowest income bracket from 4 percent to zero and increased in the highest bracket from 10 to 15 percent. The maximum Federal income tax deduction allowable in computing one's state income tax would be reduced from $7000 to $5000, which would increase the state taxes of taxpayers with more than $5000 in Federal taxes.

The corporate income tax would be changed from a flat 7.5 percent tax to one that is graduated. The rate would be 5.5 percent on corporations with not over $25,000 of taxable income, increasing in steps to 10.5 percent on corporations with more than $500,000 of taxable income.

The increased revenue from these changes would be dedicated to homeowner and renter property tax relief. It could fund a homestead exemption or other forms of property tax relief.

Part 4: How Would The Tax Measures Change the System?

The four tax initiatives on the November 4 ballot would change Oregon's state-local tax system in very different ways. Part 4 examines and compares the effects of Measures 7, 9, 11, and 12 on five aspects of the system: taxes and services, limits on government, local control, business/household tax shifts, and fairness.

Taxes and Services

The four tax initiatives would affect both the levels of taxes and services and the stability of taxes and services.

Levels. All four measures would reduce property taxes (see figure 2). Measure 7 would do this by instituting a sales tax and using the proceeds to reduce the tax bases of some schools and provide additional relief for homeowners and renters.

Measure 9 would reduce property taxes for owners of both homes and other property by limiting tax rates to $15 per thousand after the first year and limiting assessed value growth to 2 percent per year.
Measure 9 would reduce property taxes by about 40 percent, substantially reducing revenue of many local governments (including schools). It would not provide any replacement revenue for local governments. Without increased property taxes (requiring voter approval) or additional state aid, local services would be reduced. Passage of Measure 9 would probably lead to demands on the legislature for increased state taxes or reduced state programs to "bail out" schools and other local governments whose revenues were reduced by the measure.

Measure 11 would reduce homeowner property taxes by 40 percent through a homestead exemption, and would provide equivalent renter relief. The measure would provide no new funding, but would require the legislature to finance at least 80 percent of the taxes on exempted assessed value. If Measure 11 passed and Measure 12 failed, the legislature would need to increase taxes or cut state programs by an amount equivalent to 16 percent of projected general fund revenues.

Measure 12 by itself does not specify a relief program; it restructures and increases income taxes on high-income persons and corporations and dedicates the proceeds to an unspecified program of homeowner and renter relief.

If Measure 12 passed by itself, the legislature would be required to design a program of property tax relief for homeowners and renters to use the
funds generated by the measure. If Measure 11 passed with Measure 12, Measure 11 would provide this relief through homestead exemptions and direct renter relief.

In summary, all measures would cut property taxes. Measures 7 and 12 would not have any significant immediate effects on service levels because reduced local property taxes would be replaced by state sales and income taxes.

Measures 9 and 11 would not provide replacement revenues. The effect of Measure 9 on local services would depend on the extent to which local voters approved property taxes outside the new limit and the legislature provided increased state aid. If the state increased aid to local governments, the effect of Measure 9 on state services would depend on how the legislature financed the aid—through increased state taxes or through service cuts.

Measure 11 would have no direct effect on local services. Its effect on state services would depend on the extent to which financing for the homestead exemption and renter relief came from increased taxes or service cuts.

Stability. Stability of taxes and services has two meanings. In its most fundamental sense, it means the certainty with which government can assure continuation of essential services. It also means the responsiveness of taxes to upturns and downturns in the economy.

In the first sense, many local governments that rely heavily on property taxes do not have a stable financial foundation under the current system. This is particularly true of many schools without adequate tax bases. Such schools face the threat of closure each year if voters do not approve operating levies.

Measure 9 could increase the amount of property taxes some of these schools could raise without voter approval. However, the 40 percent reduction in property taxes statewide would expose many more schools and other governments that now have stable tax bases to the threat of closing early or eliminating services. Measures 7, 11, and 12 would reduce the exposure of local governments to such threats.

Stability also has the meaning of responsiveness to the business cycle. A stable tax system is one that does not respond much to upswings and downturns in personal income. The property tax is the most stable tax in this sense. Since all the measures decrease the reliance on property taxes and Measures 7 and 12 increase reliance on the more unstable sales and income taxes, all the measures make the state-local system less stable in this sense.

Limits on Government

Measures 7 and 9 would impose new limits on the taxing power of local governments by putting a cap on property tax rates. Measure 7 would limit the operating property tax rate on homesteads to $15 per thousand with no voter override and prohibit local sales taxes. It would also limit the growth of school budgets in districts with large tax bases to 6 percent per year during the first 2 years and reduce their tax bases.

Measure 9 would institute a $15 per thousand limit on property tax rates after 1987-88, and a 2 percent annual growth rate limit on assessed values of existing property, allowing voters two opportunities to override this limit.

All the measures would impose new limits on state government in determining spending priorities and tax alternatives. In addition to its constitutional provisions governing the rate and exemptions of the sales tax,
Measure 7 would put certain restrictions on the use of general fund revenues into the Constitution.

Measure 7 would fix Basic School Support and Aid to Community Colleges at their 1985-87 shares in the state general fund and would require continuation of the 1983 Homeowners and Renters Refund Program (HARRP).

Measure 9 would impose no direct limit on state government flexibility, but would probably generate political pressures on the state legislature for using portions of the state general fund for "bailouts" of local governments.

Measure 11 by itself would require the state to pay at least 80 percent of the tax on exempted assessed valuation. Without Measure 12 or some other substantial tax increases, this could not be done except by greatly reducing other general fund expenditures (state agency operations, aid to schools and other local governments, and property tax relief).

Measure 11 would create an incentive for homeowners to approve new property tax levies, since the measure would, in effect, require the state to pay the property taxes on the exempted portion of the homestead. This payment would have to be made out of the state general fund prior to any expenditures not required by the constitution.

Since with increasing levies this payment could take an increasing share of the state general fund, there would be pressure on the legislature to limit local government spending in order to limit the state's liability under this measure.

Measure 12 would reduce flexibility by requiring the state legislature to spend the additional money generated by the measure on homeowner and renter relief. Measure 12 could be amended by the legislature.

Local Control

Local control usually means that decisions affecting local taxes and services are made by local voters or local governments rather than at the state or national levels. Under the current property tax system, local voters determine the amount of property taxes levied. Because of the heavy reliance on property taxes, particularly for schools, local voters thus determine local services to a major extent.

By reducing the reliance of local governments on property taxes, all the measures would reduce local control. Since Measures 7 and 12 would replace local property taxes with state sales tax and an increased state income tax, respectively, the influence of the state in decisions about local services would probably increase to some extent. The effect of Measures 9 and 11 would depend on whether and how the legislature replaced reduced property taxes or funded property tax relief.

In addition, Measure 7 would reduce local control by limiting the ability of voters to impose taxes on themselves by prohibiting voter overrides of the $15 per thousand property tax limit and local add-on sales taxes.

Measure 9 would reduce the number of tax elections from 6 per year (with emergency elections allowed) to 2 per year (with no emergency elections allowed) and require the legislature to determine the allocation of the property taxes among local jurisdictions after the first year. Voters would have only one chance (in May) to vote on property taxes before the local fiscal year began in July and the school year started in September.

Initial Business/Household Tax Shifts

All of the proposals would shift the initial burden of taxes between
businesses and households, according to the Legislative Revenue Office. Measure 7 could very slightly reduce or increase the burden on businesses depending on how the legislature implemented the measure. Measure 9 would reduce taxes for both businesses and households. Because businesses currently pay more property taxes, this measure would reduce business taxes proportionally more than household taxes.

Measure 11 would provide property tax relief to households but not to business. The impact on business would ultimately depend on the extent to which the legislature increased taxes or cut services in response to the Measure. Measure 11 and 12 together would slightly increase the initial tax burden on business.

Although both businesses and households pay taxes initially, all taxes are ultimately paid by households. Taxes may be shifted to stockholders, proprietors, and wage earners (through lower incomes) or consumers (through higher prices).

Some of those households ultimately paying the increased taxes or receiving the tax relief would live outside of Oregon. Since the process by which businesses shift taxes to households is not well understood by economists, little can be said about who ultimately would bear the tax burden under these measures.

**Fairness**

Fairness in taxation generally means two things: that the rich pay at least as high a share of their income in taxes as the poor, and that people in similar circumstances pay equal taxes.

A progressive tax system places a higher burden (taxes as a percent of income) on high-income taxpayers than on low-income taxpayers. The current state-local tax system is slightly regressive, meaning the poor pay a slightly higher share of their income in taxes than the rich.

By reducing the reliance on the regressive property tax, all measures would make the tax system more progressive than it currently is, according to Legislative Revenue Office estimates. All measures would reduce state-local taxes as a percent of income for taxpayers with lower incomes. Measures 9 and 11 would reduce the tax burden for middle- and upper-income groups as well.

Measure 7 would lower the tax burden of low-income households and very slightly increase the share of income in taxes for middle- and upper-income taxpayers. Measures 11 and 12, if passed together, would reduce the tax burden of both lower- and middle-income groups and increase the burden for upper-income groups.

These estimates consider only the taxes paid directly by households without regard for any taxes shifted from businesses to households.

Measure 9 would also affect the fairness of the system by leading to situations in which properties with very different market values had the same assessed value and paid the same property taxes.

For example, houses in different neighborhoods in a single tax code area that had the same market values in 1986 could have very different market values in future years if one neighborhood kept improving and the other deteriorated. Yet, under the 2 percent assessed value growth limit of Measure 9, the home in the good neighborhood whose market value increased 5 percent per year, for example, would pay the same taxes as the home in the poor neighborhood whose value increased only 2 percent per year.
Summary

Each of the four initiatives would have a major impact on Oregon's existing state-local tax system. All would lower property taxes. Measures 9 and 11 would also reduce services.

All four would decrease the tax burden on low-income households, reduce local control, and place new limitations on state and local government.

The challenge facing the voter is to consider how each initiative would change important aspects of the system in making an overall judgment about whether the measure would improve Oregon's tax system.

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