State of Oregon
2003-05

Tax Expenditure Report

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Budget and Management Division
Department of Administrative Services

Research Section
Department of Revenue

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GOVERNOR'S MESSAGE

To the Citizens of Oregon:

I am pleased to submit the 2003-05 version of the biennial Tax Expenditure Report. This document is an important tool in understanding how government supports the achievement of social, economic, and environmental policies through the use of Oregon's tax structure.

This report is a valuable companion to my biennial Governor's Balanced Budget and contains extensive information that can help policymakers understand the broad scope of spending by Oregon's public sector. We should ensure that the tax expenditures outlined in this report make as much sense for the Oregon today as they did when first enacted, particularly in these fiscally tight times.

Because tax expenditures can be considered "spending" through the tax system, it is important that they receive a thorough examination during the 2003 Oregon Legislative session. In so doing, we can ensure that they are being used effectively to reach our desired goals. Full disclosure of how well the system is working is something all Oregon citizens deserve. This report provides a factual contribution to a healthy debate regarding our public finance system.

Sincerely,

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INTRODUCTION

The 1995 Budget Accountability Act (the Act) requires that the governor, with the assistance of the Department of Revenue and the Department of Administrative Services, produce a tax expenditure report every biennium, along with the Governor's Recommended Budget. The report was first prepared in 1996 for the 1997–99 biennium. This report covers expenditures for the 2003–05 biennium.

Tax Expenditure Defined

The Act defines a tax expenditure as

> any law of the Federal Government or of this state that exempts, in whole or in part, certain persons, income, goods, services, or property from the impact of established taxes, including, but not limited to tax deductions, tax exclusions, tax subtractions, tax exemptions, tax deferrals, preferential tax rates, and tax credits.

The term "tax expenditure" derives from the parallel between these tax provisions and direct government expenditures. For example, a program to encourage businesses to purchase pollution abatement equipment could be structured with an incentive in the form of a tax credit or a direct payment by the state to businesses. Tax expenditures can be viewed as: (1) providing financial assistance to certain groups of taxpayers, (2) providing economic incentives that encourage specific taxpayer behavior, or (3) simplifying or reducing the costs of tax administration. While the third of these policy objectives eliminates inefficiencies within the tax code, the first two *could* be implemented with direct expenditures rather than tax expenditures.

This report describes 350 tax expenditures contained within 15 Oregon tax programs. Since tax expenditures impart special treatment to groups of taxpayers, it is necessary to begin with a clear definition of the "normal" tax base from which that special treatment departs. Descriptions of the tax bases for each of the 15 tax programs begin each chapter. There may be differences of opinion about what this normal tax base ought to be. Where there was uncertainty about whether a particular provision should be considered a tax expenditure, it was included in an effort to be as comprehensive as possible.

In some tax programs, an alternative tax is imposed for recipients of a tax expenditure. In the interest of being comprehensive, this report includes all provisions involving tax relief from a specific tax, even if those taxpayers are subject to an alternative tax. The alternative taxes paid are reported as "In Lieu" payments in the descriptive information about each tax expenditure.

Purpose of the Tax Expenditure Report

The Act declares the necessity of

> a review of the fairness and efficiency of all tax deductions, tax exclusions, tax subtractions, tax exemptions, tax deferrals, preferential tax rates, and tax credits. These types of tax expenditures are similar to direct government expenditures because they provide special benefits to favored individuals or businesses, and thus result in higher tax rates for all individuals.....It is in the best interest of this state to have prepared a biennial report of tax expenditures that will allow the public and policy makers to identify and analyze tax expenditures and to periodically make criteria-based decisions on whether the expenditures should be continued. The tax expenditure report will allow tax expenditures to be debated in

conjunction with on-line budgets and will result in the elimination of inefficient and inappropriate tax expenditures, resulting in greater accountability by state government and a lowering of the tax burden on all taxpayers.

The Act specifies that the report include the following information: a list of the expenditures; the statutory authority for each; the purpose for which each was enacted; estimates of the revenue loss for the coming biennium; the revenue loss for the preceding biennium; a determination of whether each tax expenditure is the most fiscally effective means of achieving its purpose; and a determination of whether each tax expenditure has achieved its purpose, including an analysis of the persons that benefit from the expenditure. Each tax expenditure is to be categorized according to the programs or functions that it supports. Finally, for those expenditures that will sunset next biennium, the report is to include the Governor's opinion on whether the sunset should be allowed to take effect as scheduled or be revised to a different date.

How to Use This Report

Organization

This report has been designed to allow a quick overview of Oregon's current tax expenditures as well as a perusal of more extensive details. There are five main sections: the summary; the Governor's recommendations on tax expenditures scheduled to sunset in the 2003–05 biennium; an index of all tax expenditures by tax program (Table 1); an index of all tax expenditures by program/function (Table 2); and detailed descriptions of each tax expenditure (Chapters 1–15).

The indexes in Tables 1 and 2 are good starting points to identify those expenditures for which more information is desired. Table 1 provides a list of all tax expenditures sorted by tax and numbered sequentially from 1.001 to 15.003. This numbering system can be used as an index to locate the full description of each tax expenditure in Chapters 1–15. Similarly, Table 2 lists all the tax expenditures, but groups them by program/function rather than tax. This categorization has been done so that all tax expenditures related to a particular program area can be viewed together.

The main body of this report, Chapters 1–15, is organized by tax program. Each chapter begins with a description of that chapter's tax, and contains detailed descriptions of the tax expenditures associated with that tax program.

Appendices A to C include the full text of the Budget Accountability Act, a list of agencies that evaluated the tax expenditures, and a list of Oregon tax programs that do not contain tax expenditures. Appendix D lists the tax expenditures that are new, modified, or that have expired since this report was last published. Appendix E lists the corporation income tax expenditures and personal income tax expenditures separately along with their corresponding revenue impacts.

Program/Function Categories

Each tax expenditure has been assigned to one of 10 program/function categories. Wherever possible, an expenditure was categorized as one of the budget program areas used in the Governor's Recommended Budget: Education, Human Resources, Economic and Community Development, Natural Resources, and Transportation. Those that did not fit one of these program areas were assigned to one of five function categories: Insurance and Financial, Tax Administration, Government, Social Policy, and Federal Law. Because some tax expenditures can fit neatly into more than one category, those who wish to sum the revenue impacts by program or function should be careful that they agree with these assignments or change them accordingly. The tax expenditures are listed by program/function in Table 2.

Evaluations

The evaluations of whether these tax expenditures achieve their purpose and if they are a fiscally effective means of doing so were conducted by personnel in over 30 state agencies (see Appendix B). Agencies were asked to evaluate tax expenditures if the expenditure directly related to their program responsibility or if they had appropriate knowledge of the subject matter.

Revenue Impacts

The revenue impact of a tax expenditure is intended to measure what is being "spent" through the tax system with respect to that one provision, or alternatively the amount of relief or subsidy being provided through that provision. The dollar impact is NOT the amount of revenue that could be gained by repealing the tax expenditure. There are three main reasons for this:

- The estimates do not incorporate behavioral changes that may occur if a tax expenditure were eliminated.
- Each provision is estimated independently. A tax expenditure beneficiary may qualify for a tax reduction under more than one law.
- Government may not be able to collect the full liability for some tax expenditures for administrative reasons.

For these reasons, and because tax expenditures interact with each other and the rest of the tax system, summing the revenue impacts may result in misleading totals that should be interpreted with caution.

The tax expenditures reported here represent revenue loss to the state and local governments, and higher tax rates for taxpayers. For example, income tax expenditures reduce state General Fund revenue while property tax expenditures reduce revenue to local governments and may increase property tax rates. The property tax is unique in that exempting property from property taxation may result in both a revenue loss to districts and a shift of taxes to other taxpayers. A complete explanation of revenue loss and shift can be found at the beginning of Chapter 2. The introduction to Chapter 2 also contains a description of the changes to the property tax system brought about by Measure 50 in 1997. For all property tax expenditures, the detailed descriptions report the revenue loss and shift separately. Tables 1 and 2 report the total of the loss and shift.

The revenue impact estimates are generally rounded to the nearest $100,000. For tax expenditures below $50,000 the revenue impact is indicated as "Less than $50,000." Where more precise estimates are available, they are provided in the tax expenditure description.

Several data sources and methods were used to estimate the revenue impacts. For the income tax expenditures, the primary and secondary data sources were Oregon and federal tax returns, respectively. Estimates of federal tax expenditures made by the Joint Committee on Taxation of the U.S. Congress were used to develop estimates of those income tax provisions incorporated in Oregon law through connection to the Internal Revenue Code. For property tax expenditures, the primary data source was information gathered by county assessors. For all tax programs, data from various federal and state agencies were used where available.

Acknowledgments

Although the Department of Revenue coordinated the construction of this report, numerous Oregon state agencies provided important information and analysis regarding the objectives and effectiveness of individual tax expenditures. These agencies are listed in Appendix B. The original report prepared in 1996 relied heavily on the tax expenditure report prepared by the Legislative Revenue Office in 1994 for the House and Senate Committees on Revenue and School Finance. The 2000 Congressional Research Service publication, *Tax Expenditures: Compendium of Background Material on Individual Provisions*, is used extensively throughout this report to describe and evaluate the tax expenditures that result from Oregon's connection to the federal income tax.

SUMMARY

This report describes 350 individual tax expenditures currently specified in Oregon law. Of those, 117 are related to local property taxes and 192 to Oregon's personal and corporation income taxes. The remaining 41 are related to various other state tax programs.

One hundred seven of the 192 income tax expenditures result from Oregon's connection to the federal income tax code. By adopting the federal definition of taxable income, Oregon also adopts all of the exclusions and deductions from income that are part of the federal personal and corporation income taxes. Since 1997, Oregon automatically connects to the federal definition of taxable income. This connection greatly reduces the costs for taxpayers to comply with Oregon tax law and simplifies tax administration. Oregon could "disconnect" from individual provisions in the federal tax code, but doing so would also increase compliance and administration costs and could create confusion.

For the 2001–03 biennium total tax expenditures will result in the "spending" of about $25 billion through Oregon's tax code. Over the same period the state of Oregon and local taxing districts will collect roughly $18 billion in taxes for spending on various state and local programs. This indicates that governments in Oregon "spend" more through special provisions in the tax code than they do through direct outlays.

The table below shows estimates of tax expenditures by tax program for the 2001–03 and 2003–05 biennia. The table also shows estimates of the total revenues raised in 2001–03 by each tax. The largest tax expenditures occur in the property tax program, where aggregate tax expenditures of over $18.1 billion per biennium are nearly three times the amount of revenue actually raised. The largest property tax expenditures are the exemption of intangible personal property ($10.2 billion), the exemption of federal property ($3.5 billion), and the exemption for state and local property ($905 million).

OREGON REVENUES AND TAX EXPENDITURES BY TAX PROGRAM

(Millions of Dollars)

Tax Program	Number of Tax Expenditures	Estimated Revenues 2001-03	Estimated Tax Expenditures 2001-03	Estimated Tax Expenditures 2003-05
Income (Total)	192	$8,456.7	$6,949.8	$7,714.4
Federal Exclusions	64		$3,170.4	$3,515.6
Federal Deductions	43		$1,685.9	$1,929.1
Oregon Subtractions	29		$1,112.3	$1,179.1
Oregon Credits	56		$981.2	$1,090.6
Property	117	$6,633.7	$18,197.8	$19,253.3
Gas and Use Fuel	5	$791.7	$10.6	$13.1
Weight-Mile	7	$360.5	$11.5	$12.3
Insurance	7	$112.3	$11.1	$4.5
Cigarette & Other Tobacco	5	$415.6	$1.2	$2.3
Beer and Wine	2	$25.1	$1.6	$1.9
Other State Taxes	15	$1,665.1	$4.4	$4.6
All Taxes	350	$18,460.6	$25,187.9	$27,006.3

For income taxes (personal and corporation), tax expenditures in 2001–03 total nearly $7.0 billion, roughly 82 percent of actual tax collections. The largest expenditures are for Oregon's personal exemption credit ($810 million), the deduction of home mortgage interest ($787 million), and the deduction for pension contributions and earnings ($612 million).

The remainder of this report provides more detailed descriptions and revenue impact estimates for each tax expenditure currently specified in Oregon law.