State of Oregon

2007–2009

Tax Expenditure Report

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Budget and Management Division
Department of Administrative Services

Research Section
Department of Revenue

Governor's Message

To the Citizens of Oregon:

I am pleased to submit the 2007-09 version of the biennial Tax Expenditure Report. This document is an important tool in understanding how government supports the achievement of education, social, economic and environmental policies through the use of Oregon's tax structure.

This report, which is a valuable companion to my biennial Governor's Recommended Budget, 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 Oregon today as they did when first enacted.

Because tax expenditures amount to approximately 50 percent of spending through our tax system, we must ensure that they receive a thorough examination during the 2007 Oregon Legislative session. In so doing, we can make certain that they help us reach our policy goals. Moreover, Oregon's citizens and taxpayers deserve full disclosure of how well the system is working. This report provides a factual contribution to a healthy debate regarding our public finance system.

Sincerely,

Theodore R Kulongoski

THEODORE R. KULONGOSKI
Governor

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INTRODUCTION

The 1995 Budget Accountability Act (the Act) requires the governor, with the assistance of the Department of Revenue and the Department of Administrative Services, to 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 2007-09 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 362 tax expenditures contained within 16 Oregon tax programs. Because 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. Because there may be different opinions about the normal base for each tax, a description of the tax base for each of the 16 tax programs begins each chapter.

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 for 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 2007–09 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 1–16).

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 16.001. This numbering system can be used as an index to locate the full description of each tax expenditure in Chapters 1–16. 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 1–16, 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 Balanced Budget: Education, Human Resources, Economic and Community Development, Natural Resources, Transportation, and Consumer and Business Services. Those that did not fit one of these program areas were assigned to one of four function categories: 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 31 state agencies (see Appendix B). Agencies were asked to evaluate tax expenditures if the expenditure 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, caution should be used when summing the revenue impacts.

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 local governments 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 brief 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 provide totals of only the loss amount.

The revenue impact estimates are rounded to the nearest $100,000. For tax expenditures below $50,000, the revenue impact is indicated as "Less than $50,000."

Many 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 many federal tax expenditures made by the Joint Committee on Taxation of the U.S. Congress were used as the basis of many estimates. For property tax expenditures, the primary data source was information reported 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 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. Estimates of federal tax expenditures made by the Joint Committee on Taxation of the U.S. Congress were used to estimate many tax expenditures that result from Oregon's connection to the federal income tax.

SUMMARY

This report describes 362 individual tax expenditures currently specified in Oregon law. Of those, 122 are related to local property taxes and 202 to Oregon's personal and corporation income taxes. The remaining 38 are related to various other state tax programs.

About half of the income tax expenditures result from Oregon's connection to the federal income tax code. Oregon is generally tied to the federal definition of taxable income. By adopting the federal definition of income, Oregon also adopts most of the exclusions and deductions from income that are part of the federal personal and corporation income taxes.

SUMMARY OF OREGON TAX PROGRAMS WITH TAX EXPENDITURES (Dollars in Millions)

Tax Program	Number	Estimated Revenues 2007-09	Revenue Impact 2005-07	Revenue Impact 2007-09
Income (Personal and Corporate)	202	$12,963.1	$8,838.7	$9,860.2
Federal Exclusions	60		$4,418.7	$4,865.1
Federal Adjustments/Deductions	51		$2,040.7	$2,368.4
Oregon Subtractions	25		$1,188.7	$1,371.6
Oregon Credits	58		$1,109.4	$1,185.5
Other Oregon Provisions	8		$81.2	$69.6
Property[1]	122	$8,612.5	$17,006.3	$18,732.3
Full Exemption	87		$16,508.6	$18,194.5
Partial Exemption	24		$220.0	$240.0
Special Assessment	11		$277.8	$297.8
Gas and Use Fuel	5	$869.9	$13.2	$14.2
Weight-Mile	7	$510.8	$13.5	$14.9
Cigarette & Other Tobacco	5	$527.8	$2.5	$2.5
Beer and Wine	2	$30.9	$2.3	$2.7
Other State Taxes	19	$221.2	$7.9	$4.5
All Taxes	362	$23,736.2	$25,884.4	$28,631.3

[1] *The estimates include only the loss amounts.*

For the 2007–09 biennium, total tax expenditures will result in the "spending" of about $28.6 billion through Oregon's tax code. Over the same period, the state of Oregon and local taxing districts will collect roughly $23.7 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. However, it is important to note that there are a small number of extremely large tax expenditures that magnify the total revenue impact.

The summary table shows estimates of tax expenditures by tax program for the 2005–07 and 2007–09 biennia. The table also shows estimates of the total revenue to be raised in 2007–09 by each tax. The largest tax expenditures occur in the property tax program, where aggregate tax expenditures of $18.7 billion are more than double the amount of estimated revenue. However, roughly $15.2 billion of this amount is represented by the three largest property tax expenditures: the exemption of intangible personal property ($11.1 billion), the exemption of federal property ($2.5 billion), and the exemption for state and local property ($1.6 billion).

Income tax expenditures (personal and corporation) in 2007–09 will total almost $9.9 billion, about $3 billion less than expected income tax revenues over this period. Although not as extreme as the property tax program, there are also several very large income tax expenditures. The three largest expenditures are each more than $900 million and together account for about $2.8 billion. These are Oregon's personal exemption credit, the exclusion of employer paid medical benefits and the deduction of home mortgage interest.

Composition of Oregon's Income Tax Expenditures

Of Oregon's 202 income tax expenditures, some apply exclusively to individuals, some apply exclusively to corporations, and some may be claimed by both individuals and corporations. The table below provides the numbers of tax expenditures and their revenue impacts in each of these categories.

INCOME TAX EXPENDITURE ESTIMATES BY TYPE OF TAXPAYER FOR 2007-09 (Dollars in Millions)

Expenditure Type	Individuals Only		Corporations Only		Both Individuals and Corporations		
	Number	Revenue Impact	Number	Revenue Impact	Number	Revenue Impact (Individuals)	Revenue Impact (Corporations)
Exclusions	44	$4,551	5	$46	11	$238	$31
Adjustments	8	$285	0	$0	0	$0	$0
Deductions	7	$1,511	10	$52	26	$401	$119
Subtractions	18	$1,371	2	$1	5	$0	$0
Credits	18	$1,082	11	$35	29	$33	$36
Other	3	$2	4	$66	1	$1	$0
Total	98	$8,801	32	$199	72	$674	$187

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