Oregon: Ideas for two new taxes on the table to close $1.8 billion deficit

David M. Kall | Thursday, March 2, 2017

The state of Oregon is one that has been taking unique steps as it grapples with deficits and increasing economic inequality. For instance, we recently described the first-in-the-nation surtax on CEO compensation that Portland's City Council passed on December 7, 2016. Before that, we explained Measure 97 on the November 2017 ballot that would have removed the cap on corporate gross sales tax and imposed an additional 2.5 percent tax on corporate gross sales that exceed $25 million. Had it passed, Oregon would have had the highest top rate in the nation. And earlier last fall, we addressed an initiative that gave eight states, including Oregon, federal grants to test new ways to fund transportation infrastructure. Under the Surface Transportation System Funding Alternatives, Oregon was to receive $3.6 million.

Oregon is once again on the radar of tax policy think tanks. In a piece titled "Another Day, Another Gross Receipts Tax Proposal in Oregon," Tax Foundation economist Nicole Kaeding pointed out that the Beaver State continues to pursue ways to close its $1.8 billion deficit. One measure, HB 2875, would impose an excise tax of 5 cents per pound on coffee beans and ground coffee used to prepare specialty coffee beverages for sale at retail, excluding retailers that use 500 pounds or less of these ingredients. The revenue would be put into the Alternative Education Sustainability Fund, and the Oregon National Guard Youth Challenge Program.

The Washington Times reported prompt denunciation of the "coffee tax," noting that "so far[,] criticism of the bill has been scalding." The paper quoted House Republican Leader Mike McLane, who reasoned that the proposal is "regressive, it is poor public policy, and it deserves to be shelved just as quickly as it was introduced." Acknowledging that "desperate times may call for desperate measures in Oregon," the paper also quoted Kaeding, who characterized the coffee tax as "unprecedented," because Oregon currently does not have any general sales tax. Indeed, McLane quipped, "there are a lot of things Oregonians like with their coffee—a tax is not one of them."

Even so, in her Tax Foundation piece, Kaeding was more concerned about a second money-raising proposal that would create a new business privilege tax, in the form of a gross receipts tax, which would be imposed on businesses in addition to the state's corporate income tax. The business privilege tax rate would be 0.7 percent on all sales in excess of $5 million. Taxpayers with sales of less than $5 million would pay a flat $250 year, and those with sales below $150,000 would be exempt from filing a return. Kaeding noted that the gross receipts tax would apply to all businesses, regardless of their legal structure. This means that pass-through businesses, which generally file under the individual income tax, would also be subject to this new tax.

Kaeding observed that with the failure of Measure 97 last November, this plan for a new gross receipts tax constitutes the state's third effort for an additional corporate tax. But rather than using the more typical legislative process, this one would be in the form of a constitutional amendment to be voted upon in the May 16, 2017, special election. With respect to the tax, she disapproves of the use of this form of "tax pyramiding," whose negative effects include higher prices and few job opportunities. Tax pyramiding comes about when firms or industries have multiple production steps, such that the tax compounds with each one.

To proponents who consider other states' taxing schemes on commercial activity, like Ohio's, to be successful, Tax Foundation economist Jared Walczak opines that "[i]n many ways, gross receipts taxes are a throwback to an earlier era. Once common due to their ease of administration, these taxes were largely abandoned over the course of the 20th century as states sought to modernize their tax codes and jettison their least competitive components."

Even if the revenue is needed because corporate tax revenue is on the decline, Walczak points out that besides the disproportionate taxation on multi-step businesses, a gross receipts tax can be overly burdensome because it taxes a firm's gross income, not profit, and thus has no relationship with that firm's ability to pay. Under Ohio's commercial activity tax, he asserted, a business with a profit margin of just 1 percent faces a 26 percent effective tax rate on corporate net income.

What is more, according to an Ernst & Young (EY) study prepared for the Council On State Taxation in March 2015, effective tax rates vary wildly from one industry to another. The study found that firms engaged in the management of companies were subject to an effective tax rate of .4 percent, whereas that for construction firms was 8.6 percent. Other industries with low profit margins but relatively high effective tax rates are wholesale, at 8.3 percent; retail, at 7.9 percent; and transportation and warehousing, at 7.0 percent.

West Virginia is also considering a gross receipts tax, modeled after Ohio's commercial activity tax, to which Walczak says, "they remain a regressive, economically harmful mode of taxation which increases the cost of goods, encourages inefficient economic activity (like otherwise unprofitable vertical integration to limit the number of stages of production subject to the tax), and levies widely disparate and ultimately arbitrary tax burdens on a state's businesses."

As for Oregon's dalliance, Walczak cautions that the state's lawmakers "continue to flirt with a gross receipts tax, a flawed, outdated type of taxation. In the state's quest for more revenue, legislators should explore other options."

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