

REVENUE RE\$TRUCTURING: “*How and What*”

or

**Lessons from Virginia: Increasing Revenue
in an Anti-tax Environment**

and

What Oregon Might Do to Achieve Revenue Reform



LESSONS FROM VIRGINIA

- In 2004, Virginia was the only state to institute a tax increase on the heels of a national economic downturn.
- The reform plan raised \$1.6 billion in new revenue per year.
- This is a conservative southern state with 30 years of entrenched anti-tax politics.

HOW DID THIS HAPPEN?

Virginia's campaign promised new funding for citizen-valued "core services"



...as well as an improvement in "tax fairness".

VIRGINIA'S POLITICAL REALITIES

- Both houses of the legislature were in Republican control in 2003;
- The Democratic governor was in his first term;
- An anti-tax climate prevailed in state politics;
- The previous governor had led a tax-cutting effort that put the state's General Fund \$6 billion in red ink.

SETTING THE STAGE FOR CHANGE

- Established a need before proposing a solution;
- Agreed that there existed no “quick fixes”;
- Committed to a long-term effort;
- Focused on funding, not on education reforms (though the first dollars would go to education).

THE CAMPAIGN FOR CHANGE

- Extensive polling/focus groups

Determined public's needs, desires, tolerance for change, and funding perceptions.

- Built a collaborative infrastructure

Included a non-profit foundation for advocacy & a super-coalition of groups to pursue action.

- Ran a two-year advertising campaign

Featured state funding needs, reflecting public's values and wants, presented in simple terms.

- Organized various events to educate & mobilize

"Fly-around" news conferences statewide and daily service-sector rallies.

THE SECRETS OF SUCCESS

- We characterized the issue in a way the public could understand and embrace.
- Our message was hopeful, focused on investing in the future.
- We stressed investment in core services, which Virginians highly value.

SAMPLE QUOTES FROM CAMPAIGN

“It is time for us to make investments in core services – beginning with public education – that are essential to our prosperity and success.”

“Virginia is a low-tax state which does not use its revenue resource potential to provide adequate core services for its citizens.”

“The time has come for Virginia to recognize its responsibilities for those essential services, in particular, K-12 education, that the people expect from their government.”

“Virginia has raised the standards for student achievement. Virginia needs to raise the standards for funding that achievement.”

KEY TO VICTORY: TAX FAIRNESS

The public opinion polls identified the need to improve the tax system's fairness.

Some of the campaign's messages:

“Fair Taxes  Quality Schools” (*marrying 2 popular ideas*)

“Tax restructuring should make the system fair [and] the corporate income tax more fair.”

-- Gov. Mark Warner

EDUCATING THE PUBLIC, MAKING THE CASE

- ✓ Identified current, imminent, and long-term shortfalls.
- ✓ **Identified growth of need (FTE, student enrollment, client growth, mandates).**
- ✓ Identified growth of tax expenditures and their effect on the state's revenue.

OTHER CONSIDERATIONS

- **GOALS**: To increase fairness and efficiency, promote economic opportunity, and fund core services.
- **AGREEMENTS**: Not to create new programs or entitlements during effort to restructure.
- **ECONOMICS**: Preserve state's coveted AAA bond rating and likened tax restructuring to rebalancing an investment portfolio.
- **POLITICS**: Our effort was bipartisan and cooperative.

THE FOUNDATION FOR VIRGINIA

Formed in 2003

**Revenue plan was passed
in a special session in 2004**

“Issue Driven and Party Blind”.

A COALITION THAT CROSSED SECTOR & POLITICAL LINES

- The Governor and leaders of both R and D legislative caucuses and committees
- **CEOs of major corporations**
- University presidents and the CC Chancellor
- **Stakeholder organizations**
- College student body presidents
- **Virginia Education Association**

ALIGNING DISPARATE ENTITIES

- Disciplined focus on revenue generation, not ideology, specific plans, or getting credit.
- **Nuts and bolts of tax reform came through negotiation in legislative sessions.**
- Included tax reductions for 65% of citizens.
- **Closed corporate loopholes & boosted reserves.**

COMPARING OUR 2 STATES

Rankings	Virginia then	Oregon now
Personal Income Per Capita	11 th	30 th
Gross State Product Per Capita	15 th	17 th
Employment Growth Ranking	36 th	26 th
Total Taxes (% state share) Per Capita	22 nd	39 th
Total Tax Share Per Capita	40 th	35 th
Corporate Income Tax Per Capita	24 th	32 nd
Property Tax Per Capita	24 th	28 th
K-12 Investment Per Capita	17 th	37 th
Higher Ed. Investment (% state share) Per Capita	27 th	15 th

**THE
'WHAT':**



A PROPOSAL FOR OREGON

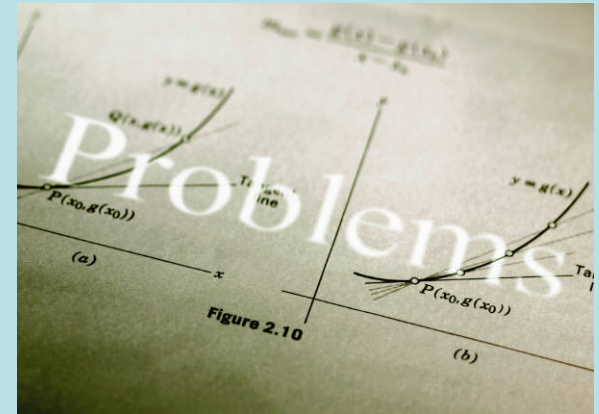
TASK FORCE REFORM GOALS

- Short-term, incremental adjustments to the current fiscal structure (for 2009 Session).
- **Long-term change must include adequate resources for projected needs in coming decades and system as a whole (state/local).**
- Address reserving adequacy.
- **Task force blueprint should recommend major elements of comprehensive reform.**
- “Everything is on the table.”

VALUES OF REFORM

- **Stability:** Protect core services from major cuts in economic cycles.
- **Economic Growth:** Provide adequate revenue without discouraging economic vitality.
- **Equity:** Fairness and statutory equity goals ought to be reflected in system reforms.

PROBLEM STATEMENT



- ✓ Oregon's overall revenue system is inadequate.
- ✓ **Local revenue sources – such as property tax and forest fees – have declined to the point that they are unsustainable.**
- ✓ Corporate share of total taxes is in free fall.
- ✓ **Over the past three decades, more than \$12 billion in corporate income tax revenues have been lost.**
- ✓ Individuals and small businesses shoulder 93% of tax load.

The image shows a handwritten mathematical solution on a piece of paper. The text is as follows:
$$\int \frac{x+5}{x^2-2x-3} dx$$
$$\frac{5}{3} dx = \int \frac{2}{x-3} dx - \int \frac{1}{x+1}$$
$$= 2 \ln(x-3) - \ln(x+1)$$
$$= \ln \frac{(x-3)^2}{x+1} + C$$

PROBLEM STATEMENT

- ✓ Oregon's once-unparalleled public school system has experienced a systematic decline over the past 17 years, with only one biennium of increase (2007-09).
- ✓ **Health care and public safety costs continue to rise.**
- ✓ Public support for schools is matched by worry over the economy and jobs. Any reform effort must reassure voters on both counts.
- ✓ **Many attempts at reform have failed in the past – we need a new paradigm.**

RATIONALE FOR REMEDIES

- ❑ While corporate tax restructuring will not entirely solve the sufficiency problem, it must be a part of any overall solution.
- ❑ Corporations benefit from a highly skilled work force, top-notch universities, and human capital to give their businesses a competitive edge – and to give Oregon a healthy business climate.
- ❑ Polling shows that the public will support a fair rebalancing of the system that brings corporations back into the fold.

CORPORATE TAX SHARE

- In 1973-75, corporations' total share of the General Fund was **18.5%**. In 2005-07, it was **4.6%**.
- **Only because of a \$1.1 billion personal kicker and high corporate profits, that share rose to 7.1% in 2007-09, but it is expected to recede again to 5.7% by 2011.**
- If the corporate share were the same today as it was in 1973, Oregon would have **\$1.7 billion more** than the estimated revenue for the 2007-09 biennium – enough to **fully fund the QEM**.



WHY HAS THE POT EMPTIED?

- 👉 49 tax expenditures (loopholes) favoring corporations – most of which are beyond Oregon's borders.
- 👉 **Single-sales factor apportionment for multi-state corporations have drastically reduced corporate taxes.**
- 👉 Aggressive use of tax sheltering.

The anti-tax argument insists that taxation destroys a business-friendly climate.

Let's answer the following question with some data...



**Do low
business taxes
lead to
economic
growth?**

NO. IN FACT:

- High growth states actually had comparatively high average corporate income tax rates.
- **Slow growth states had corporate tax rates below the U.S. average.**

Chart A: The 10 *Fastest Growth* States have average Corporate Income Tax Rate of 8.9%

10 FASTEST GROWING STATES	PER CAPITA PERSONAL INCOME GROWTH 1995-2005	U. S. RANK (High to Low)	TOP CORPORATE TAX RATE	U. S. RANK (Low to High)
<i>Wyoming</i>	5.4%	1	<i>No tax</i>	<i>Tied 1st</i>
District of Columbia	5.2%	2	9.975%	48
North Dakota	5.0%	3	10.50%	50
Vermont	4.8%	4	9.75%	46
Massachusetts	4.7%	5	9.50%	45
<i>South Dakota</i>	4.7%	6	<i>No tax</i>	<i>Tied 1st</i>
Minnesota	4.6%	7	9.80%	47
Colorado	4.6%	8	4.63%	8
Maine	4.5%	9	8.93%	40
Nebraska	4.5%	10	7.81%	31
			AVERAGE: 8.9%	

NOTE: States in *italic* are "no income tax" states; Rates are in percent and are those in place 1/1/2006.

SOURCE: Income data from U.S. Department of Commerce, Bureau of Economic Analysis; tax rates from Federation of Tax Administrators, www.taxadmin.org.

Richard G. Sims
Sierra Institute on Applied Economics

The 10 *Slowest Growth* States have average Corporate Income Tax Rate of 7.8%

10 SLOWEST GROWING STATES	PER CAPITA PERSONAL INCOME GROWTH 1995-2005	U.S. RANK (High to Low)	TOP CORPORATE TAX RATE	U.S. RANK (Low to High)
Delaware	3.8%	42	8.7%	38
Oregon	3.8%	43	6.6%	21
Indiana	3.7%	44	8.5%	35
Idaho	3.7%	45	7.6%	29
North Carolina	3.7%	46	6.9%	23
Ohio	3.6%	47	8.5%	37
<i>Michigan</i>	3.3%	48	<i>No tax</i>	1
Alaska	3.3%	49	9.4%	44
<i>Nevada</i>	3.1%	50	<i>No tax</i>	2
Hawaii	2.5%	51	6.4%	17
			AVERAGE: 7.8%	

- NOTE: States in italic are "no income tax" states; Rates are those in place 1/1/2006.
- SOURCE: Income data from U.S. Department of Commerce, Bureau of Economic Analysis; tax rates from Federation of Tax Administrators, www.taxadmin.org.

Tax Foundation's Top 10 and Bottom 10 Business Tax Climates States

Tax Rank	TOP 10 STATES	Avg. Growth	Growth Rank
1	Wyoming	5.3%	1
2	South Dakota	4.5%	9
3	Nevada	4.3%	17
4	Alaska	3.5%	49
5	Florida	4.2%	31
6	Montana	4.4%	15
7	New Hampshire	4.3%	21
8	Texas	4.6%	8
9	Delaware	3.9%	46
10	Oregon	4.0%	43

Average growth: 4.3%

Tax Rank	BOTTOM 10 STATES	Avg. Growth	Growth Rank
41	Maine	4.1%	38
42	Minnesota	4.4%	13
43	Nebraska	4.2%	30
44	Vermont	4.5%	10
45	Iowa	4.2%	27
46	Ohio	3.8%	48
47	California	4.1%	39
48	New York	4.2%	35
49	New Jersey	4.3%	23
50	Rhode Island	4.2%	29

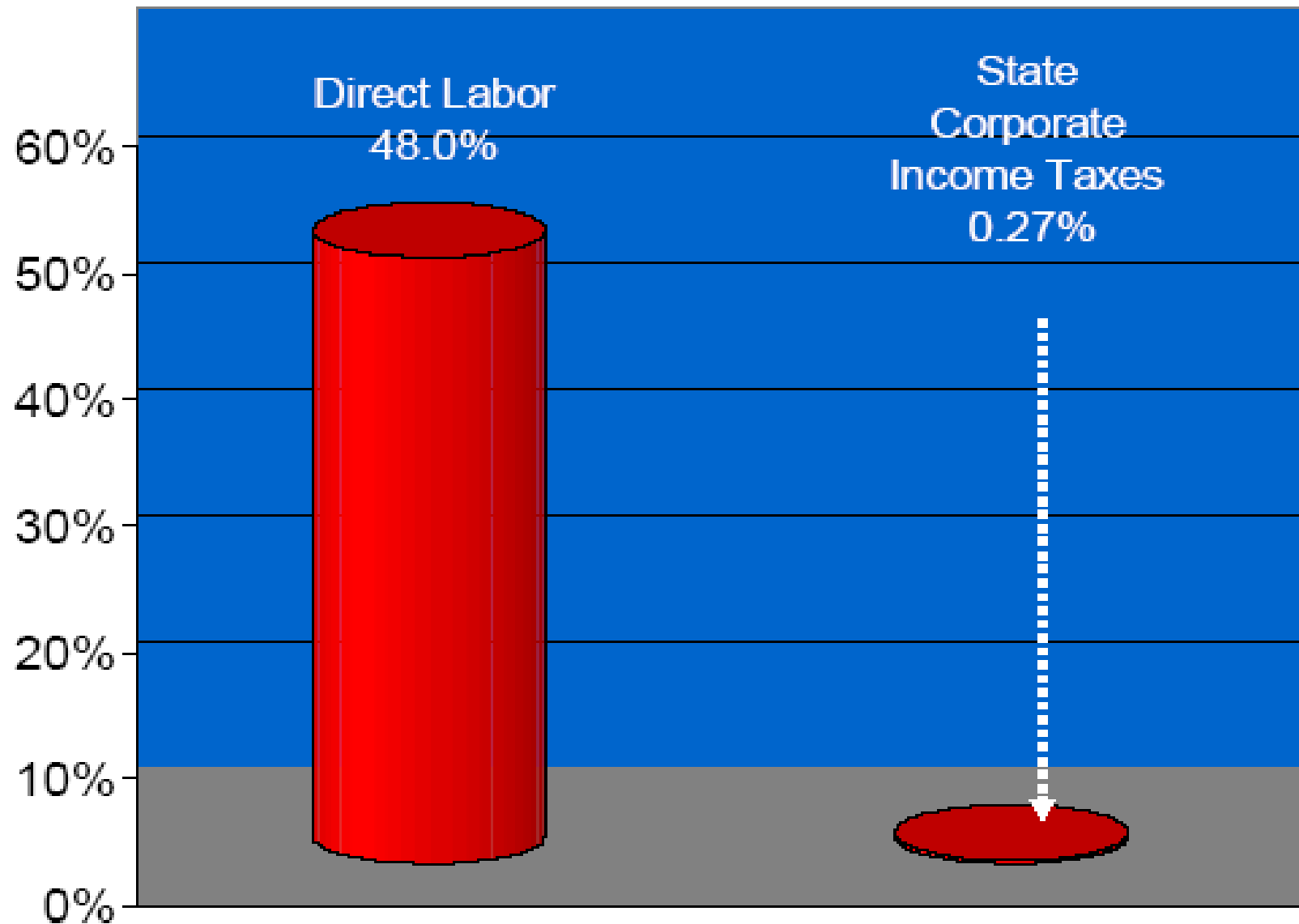
Average growth: 4.2%

Sources: Tax Foundation, 2007 State Business Tax Climate Index; Income data from U.S. Department of Commerce, Bureau of Economic Analysis

REASONS STATE TAXES DON'T INFLUENCE STATE ECONOMIC GROWTH BY MUCH

1. Rates simply don't vary greatly from state to state. (75% of states have rates between 6 and 9 percent.)
2. **State and Local taxes on business earnings represents a very small part of total business expenditures.**

Shares of Total Business Costs



KEEP THE PERSONAL INCOME TAX

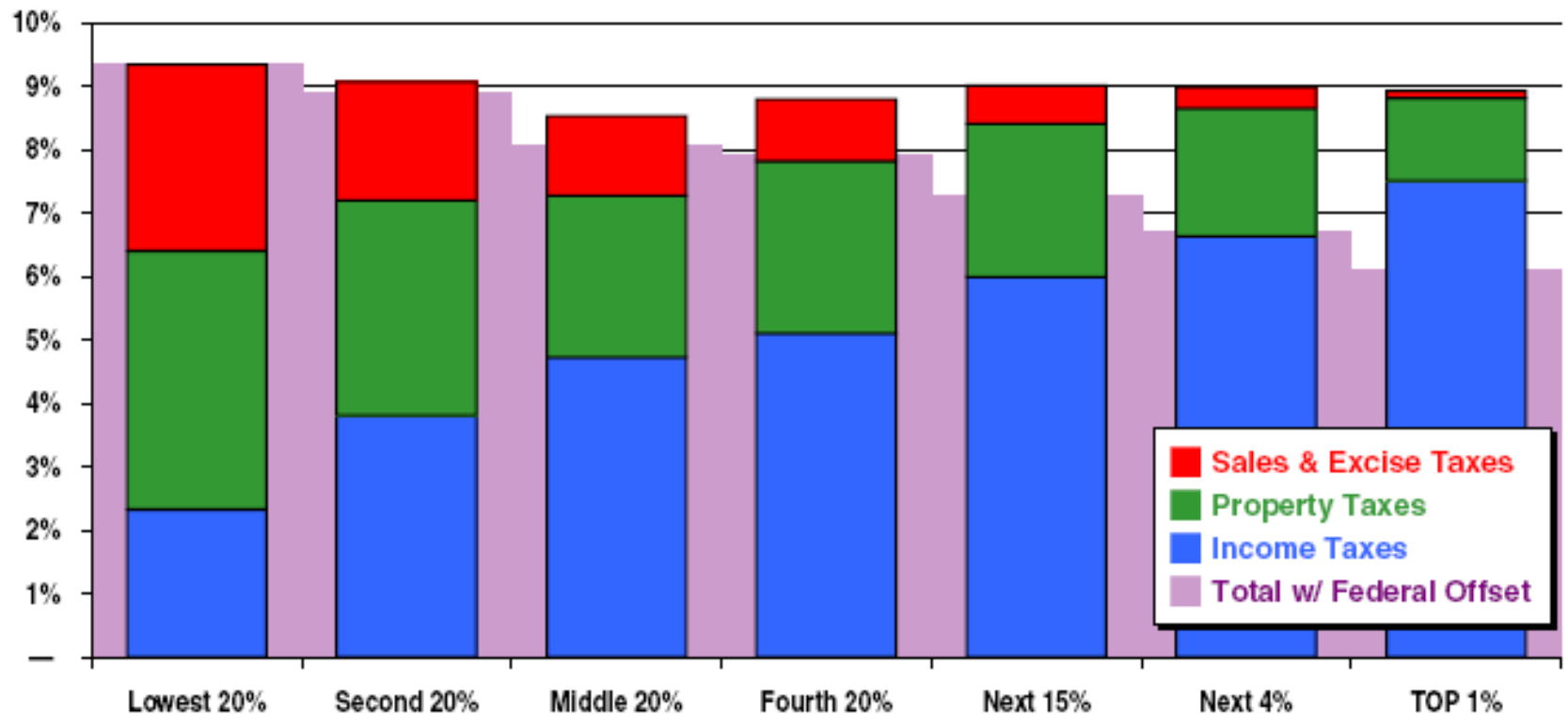
- Oregon's income tax is fair and progressive, making the whole system balanced.
- **Income taxes from individuals and small businesses account for 93% of the General Fund. We can't afford a cut.**
- Income taxes are the most "elastic", meaning they grow with the economy best.
- **Capital gains taxes (counted as income tax) are fairly taxed as regular income...why should someone get a break just because their earnings come from PAST investments instead of work?**

DISTRIBUTION OF OUR TAX LOAD

Oregon

State & Local Taxes in 2002

Shares of family income for non-elderly taxpayers



WHAT'S OUR SOLUTION?



OUR ERODING TAX BASE

(Too few shoulder the load; too many pay little or nothing)

▣ Oregon's kicker law
TIME FOR REFORM

▣ Corporate minimum tax
TIME FOR CORRECTION

▣ Tax subsidies for business
TIME FOR ACCOUNTABILITY



1. KICK THE CORPORATE KICKER

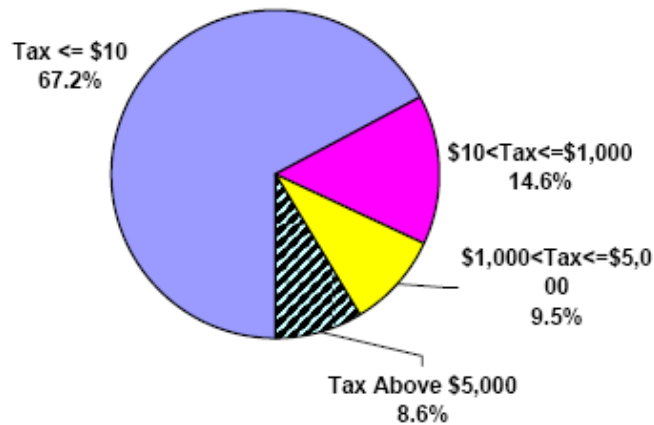
- Repeal the corporate kicker law. Guessing future revenues two years in advance, within a 2% margin of error, is sheer folly.
- Reserve kicker money in the new rainy-day fund.



2. RIGHT-SIZE THE MINIMUM TAX

2004 C-Corporations Tax Returns

By Tax Amount



Even segments of the business community agree that the 1931-set \$10 minimum tax – paid by 2/3rds of corporations – is embarrassingly inadequate.

Follow the plan advocated in 2005 by the Oregon Business Association to implement a sliding scale: \$250-\$5,000.

3. SCRUTINIZE SUBSIDIES



- ◎ Tax breaks that do not deliver promised public benefits – such as economically efficient job creation – should be repealed or sunset.
- ◎ Filers receiving tax breaks must be accountable for spending the windfall as promised or sacrifice the subsidy.

4. CORPORATE TAX REFORM CENTERPIECE

Featuring a Business Franchise Tax
Based
On
Investment



CORPORATE TAX CHOICES

There are three basic ways to tax corporations:

- * Based on business sales volume
(*Gross Receipts Tax*)
- * **Based on profits**
(*Corporate Income/Excise Tax*)
- * Based on investment
(*Franchise Tax*)

WHY REPLACE WHAT WE HAVE?

- Corporate income taxes have been called “voluntary taxes” by economists because it’s so easy to avoid paying them by claiming zero profits, by applying tax breaks, and by sending dollars out of state.
- **A franchise tax, by comparison, taxes total capital investment (plant and equipment) and therefore encourages job creation (which isn’t taxed) and boosts the economy.**
- More money is thus spent in Oregon communities and less is paid to stockholders in the global capital market.

FRANCHISE TAX ADVANTAGES

It's not novel.

Several states – such as Texas and Kentucky – levy a franchise tax on in-state investment. Texas collected **\$22.1 billion** in 2005. (Recent changes to Texas corporate taxes were made, to increase that sector's share.) A dozen states are currently considering this tax in lieu of corporate income taxes.

It's more stable and adequate.

While corporate income taxes have declined by more than 50% across the U.S., franchise tax revenue has actually produced a larger share of income for states in the past two decades. Profits-based taxes decline over time; investment-based taxes grow over time.

FRANCHISE TAX ADVANTAGES

It's elastic.

As the economy grows, the franchise tax keeps pace.

It doesn't "tax success".

Businesses can plan, because investment is predictable, and it's neutral across different business types, eliminating industry bias.

It can raise significant revenue.

Target: \$500 million net revenue per year (\$1 billion per biennium).

MEETING TASK FORCE GOALS

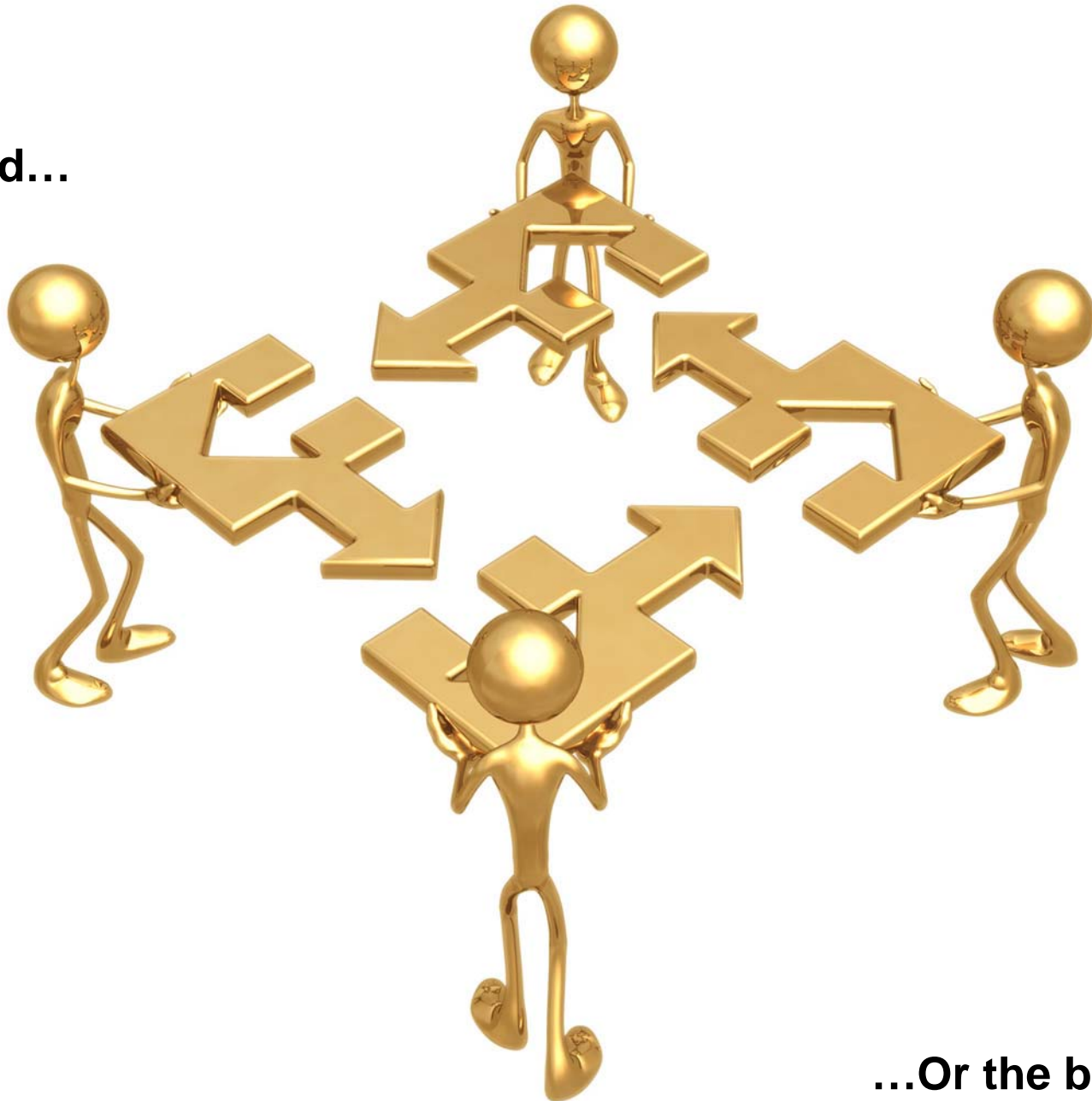


- ⌚ Increase state revenue **adequacy** to invest in vital services and recirculate those dollars in *Oregon's* economy.
- ⌚ **Broaden the tax base, which improves both fairness and stability.**
- ⌚ Enhance stabilization **reserves** for better preparation for the next economic cycle.

STRUCTURING THE FRANCHISE TAX

- Pick a rate that will produce revenue to replace the current corporate income tax and also add \$500 million per year to Oregon's General Fund.
- **It is simple, fair, predictable, elastic, and neutral – qualities that the Revenue Restructuring Task Force has stated that it wants.**

The End...



...Or the beginning?