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February 16, 2010

OREGON VOTERS' APPROVAL OF TAX INCREASE NOTEWORTHY AS FEDERAL TAX DEBATE OPENS

By Chuck Marr and Michael Leachman

Oregonians' decisive vote last month to raise taxes on households making over $250,000 calls into question the conventional wisdom that tax-increase proposals are politically untenable regardless of their merit on economic, budgetary, and equity grounds. This has important implications for Congress, which must decide this year whether to let the Bush-era tax cuts expire. If Congress examines the issue on its merits, it will find that the case for letting the tax cuts for the highest-income Americans expire is solid.

The Oregon Results

On January 26, Oregonians approved two measures to raise income taxes on upper-income households and corporations as part of an effort to close their state's large budget shortfall.[1]

Measure 66 permanently raises the income tax rate for households with incomes over $250,000 and individuals with incomes over $125,000,[2] while eliminating for high-income taxpayers an existing deduction for federal income taxes paid. (Joint filers with incomes over $290,000 will be allowed no deduction.) Measure 67 temporarily increases the marginal corporate income tax rate for corporations with Oregon profits over $250,000 and permanently increases the marginal rate for corporations with over $10 million in Oregon profits.[3] Measure 67 also raises the minimum

[1] In 2009, Oregon's Legislative Assembly enacted by supermajority vote two revenue-raising bills, HB 2469 and HB 3405, to help close a $4 billion state budget shortfall. After opponents gathered the necessary signatures to force a vote of the people, the bills appeared on a January 26, 2010 special election ballot as Measures 66 and 67.

[2] Prior to the legislation that became Measure 66, the state's top income tax rate was 9 percent and applied to all household income over $15,200 in 2009. Under Measure 66, for tax years 2009 through 2011 the rate will be 11.8 percent for households with incomes between $250,000 and $500,000 and 12 percent for those with incomes over $500,000. (For individual filers, these rate increases will begin at $125,000 and $250,000, respectively.) Beginning in 2012, the rate will fall to 9.9 percent for households over $250,000 and individuals over $125,000.

[3] For tax years 2009 and 2010, Measure 67 raises the corporate income tax rate on profits over $250,000 by 1.3 percentage points, to 7.9 percent. For tax years 2011 and 2012, the rate will decline to 7.6 percent. After 2012, the rate will return to its pre-Measure 67 rate of 6.6 percent for most corporations, but the rate on profits over $10 million will remain 7.6 percent. After 2012, revenue from the increased rate will be deposited in Oregon's "rainy day" fund.

corporate income tax from $10 to $150 for small companies (and for larger firms with few in-state sales) and from $10 to about 0.1 percent of Oregon sales for all other corporations.[4]

Several points stand out regarding the Oregon vote.

- *Voters approved both measures by substantial margins.* Measures 66 and 67 each received 54 percent of the vote.[5]
- *Most voters participated.* Fully 62 percent of voters, roughly 1.3 million of the state's 2.1 million registered voters, participated.
- *Opponents' central argument — that the measures would cost jobs— failed to resonate with voters.* The main opposition group called itself "Oregonians Against Job-Killing Taxes" and repeatedly claimed that Measures 66 and 67 would destroy jobs.
- *Oregon voters are not usually supportive of taxes.* Oregon state and local taxes as a share of personal income ranked only *44th highest* in the nation as of 2007. In the previous recession, Oregon voters handily rejected two legislatively approved increases in personal and corporate income taxes. In 2000, they enshrined in the state constitution a provision that requires automatic personal and corporate income tax cuts when revenues exceed projections by 2 percent. In the 1990s, they approved two major property tax cap initiatives and overwhelmingly rejected — for the ninth time in state history — the establishment of a general sales tax.

Many Other States Raising Revenues to Help Balance Budget

Facing huge budget deficits and the legal requirement to balance their budgets, about 30 states have raised taxes since the recession began in order to prevent massive cuts in such high-priority areas as education, health care, and public safety. Oregon is one of nine states since 2008 that have raised personal income taxes on the highest-income households. It is also one of nine states to raise business taxes.

These states have increased revenues as part of a balanced approach to budgeting that avoids relying solely on cuts in public services. A cuts-only approach would not only add to the hardships that families are experiencing because of the recession, but would also undermine states' school systems, universities, health-care systems, and infrastructure, which are important for state economies.

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[4] Prior to the legislation that became Measure 67, C-corporations and S-corporations were subject to a $10 minimum corporate income tax in place since 1931. Under Measure 67, C-corporations with Oregon sales under $500,000 are subject to a $150 minimum. For C-corporations with $500,000 or more in Oregon sales, the minimum tax increases on a sliding scale generally equivalent to about 0.1 percent of Oregon sales, to a limit of $100,000 for corporations with sales of $100 million or more. The minimum for S-corporations increases to $150. Previously, partnerships and limited liability companies taxed as partnerships were not subject to a minimum tax, but such firms will pay $150 under Measure 67.

[5] Vote totals are unofficial, as of February 8, and are posted on the Oregon Secretary of State's web pages at http://egov.sos.state.or.us/division/elections/results/2010S/index.html. The Secretary of State expects to release official vote totals on February 25.

Results Should Inform Debate Over Extending Top Income Tax Cuts

Most of the tax cuts that Congress enacted in 2001 or 2003 are slated to expire at the end of 2010, including those that disproportionately benefit the highest-income Americans. President Obama has proposed to allow various high-end tax cuts, including the cuts in the top two income tax brackets, to expire on schedule. If this occurs, the top rates will return to 36 and 39.6 percent — the rates under President Clinton — from the 33 and 35 percent rates enacted under President George W. Bush. These rates will remain far below the top rates in place in the 1940s, 50s, 60s, 70s, and part of the 80s.

Some members of Congress are pushing to extend the high-end tax cuts, including Senate Republican Leader Mitch McConnell (R-KY), and a group of six House Democrats recently made a similar argument.[6] The results from Oregon suggest that voters are open to tax increases on high-income households and corporations when the situation demands it. Members of Congress should set politics aside and focus on the substance of the issue. Economic, budgetary, and equity considerations all point to letting these tax cuts expire on schedule:

- **Economic considerations: high-income tax cuts are a notably inefficient way to create jobs.** The Congressional Budget Office (CBO) recently rated extending the Bush tax cuts for high-income households the *least effective* of all options it examined for boosting the weak economy and creating jobs. As CBO explains, "higher-income households … would probably save [rather than spend] a larger fraction of their increase in after-tax income." Only if the extra funds are spent promptly will they boost short-term economic growth and job creation.

  A sounder approach would be to let the tax cuts expire and temporarily use the savings for tax or spending measures that would lead to more jobs and economic growth in the next year or two, such as a job-creation tax credit for small and large businesses and additional fiscal relief for states. After that, the saving should go for deficit reduction.

- **Budgetary considerations: the tax cuts are unaffordable.** There is broad consensus among economists and fiscal policy analysts that deficits and debt under current tax and spending policies will ultimately rise to levels that harm the economy. The President's budget shows that allowing the tax cuts to expire for the top 2 percent of households — married filers with incomes above $250,000 and single filers with incomes above $200,000 — would avert $678 billion in revenue losses over the next ten years — and a total of $824 billion in increased deficits and debt when the costs of the added interest payments on the debt are taken into account. It would avert even larger increase in deficits and debt in subsequent decades.

- **Equity considerations: extending the tax cuts would worsen widening income disparities.** In recent decades, incomes have surged at the top of the income scale while stagnating for ordinary Americans. High-income households also have benefited from very large tax cuts.

  Recent IRS data show some stunning results. Between 1995 and 2007, the share of their income that households with incomes of over $1 million paid in federal income taxes

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[6] Peter Cohn, "Six Vulnerable Dems Urge Obama To Reconsider Increases," *Congress Daily AM,* January 28, 2010.

plummeted from 31.4 percent to 22.1 percent.[7] For the nation's highest-income 400 taxpayers, the effective income tax rate fell by nearly half during that period, from 29.9 percent to 16.6 percent.

This occurred at the same time that inequality in *pre*-tax incomes was widening markedly as well. During the last economic expansion (from the end of 2001 to the end of 2007), *two-thirds of the income gain in the country flowed to the 1 percent of Americans with the highest incomes*.[8]

In short, the evidence argues strongly for letting the high-income tax cuts expire on schedule.

[7] Inflation and overall income growth are responsible for part of this decline, but inflation-adjusted estimates show a striking decrease in the effective tax rate for people with incomes over $1 million. See Michael Parisi and Michael Strudler, "Selected Income and Tax Items from Inflation-Indexed Individual Tax Returns, 1990-2004," *IRS SOI Bulletin*, Spring 2007.

[8] See Avi Feller and Chad Stone. "Top 1 Percent of Americans Reaped Two-Thirds of Income Gains in Last Economic Expansion," Center on Budget and Policy Priorities, September 9, 2009, http://www.cbpp.org/cms/index.cfm?fa=view&id=2908.