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Executive Summary

June 14, 2011

The Four Flaws of a Capital Gains Income Tax Cut

It creates favoritism, it's ineffective, it's unnecessary and it's irresponsible

It's unfortunate that some Oregon lawmakers are pushing to cut the tax rate on income from capital gains. Several legislative proposals exist to grant preferential treatment to income generated from the sale of assets such as stocks, bonds and real estate. This misguided policy fails on four fundamental levels: it favors some taxpayers over others, it's ineffective, it's unnecessary and it's irresponsible.

Cutting the income tax on capital gains favors speculators over workers and favors the rich over the rest. It would create a situation where ordinary Oregonians working for paychecks would end up paying a higher tax rate on their income than someone who lives off of investment income. For example, the average salary for a teacher in Oregon in 2010 was about $51,000. An educator earning this amount in 2012 would pay a top rate of 9 percent in income taxes. If that year the tax rate on capital gains income were cut in half, someone who is fortunate enough to live off of investment or trust fund income — be it the same amount as the teacher earns or many times that amount — would pay a top rate of no more than 4.95 percent.

It would also, by and large, constitute a tax cut just for the rich. If Oregon halved the income tax rate on capital gains, the richest 1 percent of Oregonians would get 65 percent of the tax cut. The rest of Oregonians would receive little or nothing.

Cutting the income tax on capital gains is also ineffective as a means to attract investment, contrary to what proponents claim. Research shows that there is no correlation between growth in the economy — real GDP growth — and the tax rate on income from capital gains. Demand for products and services, not the amount of after tax income, is what drives investment. Thus, a general tax cut on income from capital gains will have no real impact on investment. Plus, there's no guarantee that the money would be reinvested in Oregon. And for those who argue for a targeted tax cut for money reinvested in the state, Oregon's own experience demonstrates the futility of such an effort.

Cutting the income tax on capital gains is also unnecessary, since Oregon's economy already tends to outperform the nation as a whole. In recent years, Oregon's economy has grown faster than that of the nation and has attracted more than its share of venture capital, even though, like a majority of states with income taxes, it taxes income from capital gains the same as any other income. Indeed, more taxpayers with capital gains income move to Oregon than move out, and collectively, in the year of their moves, those arriving have more capital gains than those who leave Oregon.

Finally, cutting the income tax on capital gains is irresponsible. During difficult economic times, income from capital gains constitutes an important source of revenue to fund popular and vital public services. During good economic times the income tax on capital gains shines, often generating more revenue than anticipated. If this unanticipated revenue were saved in the Rainy Day Fund, Oregon would be better positioned to weather bad economic times. By giving preferential tax treatment to income from capital gains, the income tax would not shine so brightly in good years, harming Oregon's ability both to fund vital and popular public services and to save for rainy days.

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The Four Flaws of a Capital Gains Income Tax Cut

It creates favoritism, it's ineffective, it's unnecessary and it's irresponsible

By Jason Gettel

It's unfortunate that some Oregon lawmakers are pushing to cut the tax rate on income from capital gains. Several legislative proposals exist to grant preferential treatment to income generated from the sale of assets such as stocks, bonds and real estate. This misguided policy fails on four fundamental levels: it favors some taxpayers over others, it's ineffective, it's unnecessary and it's irresponsible.

Cutting the income tax on capital gains favors speculators over workers and favors the rich over the rest. It would create a situation where ordinary Oregonians working for paychecks would end up paying a higher tax rate on their income than someone who lives off of investment income. It would also, by and large, constitute a tax cut just for the rich. If Oregon halved the income tax rate on capital gains, the richest 1 percent of Oregonians would get 65 percent of the tax cut. The rest of Oregonians would receive little or nothing.

Cutting the income tax on capital gains is also ineffective as a means to attract investment, contrary to what proponents claim. Demand for products and services, not the amount of after-tax income, is what drives investment. Thus, a general tax cut on income from capital gains will have no real impact on investment. Plus, there's no guarantee that the money would be reinvested in Oregon. And for those who argue for a targeted tax cut for money reinvested in the state, Oregon's own experience demonstrates the futility of such an effort.

Cutting the income tax on capital gains is also unnecessary, since Oregon's economy already tends to outperform the nation as a whole. In recent years, Oregon's economy has grown faster than that of the nation and has attracted more than its share of venture capital, even though, like a majority of states with income taxes, it taxes income from capital gains the same as any other income. Indeed, more taxpayers with capital gains income move to Oregon than move out, and collectively, in the year of their moves, those arriving have more capital gains than those who leave Oregon.

Finally, cutting the income tax on capital gains is irresponsible. During good economic times the income tax on capital gains shines, often generating more revenue than anticipated. If this unanticipated revenue were saved in the Rainy Day Fund, Oregon would be better-positioned to weather bad economic times. By giving preferential tax treatment to income from capital gains, the income tax would not shine so brightly in good years, harming Oregon's ability both to fund vital and popular public services and to save for rainy days.

Favoritism: Tax cut would favor speculators over workers, the rich over the rest

Granting preferential tax treatment to capital gains income would benefit speculators at the expense of workers; it would benefit the rich over all other Oregonians; and it would harm the public structures that nurture the middle class.

It would benefit speculators at expense of workers

The state tax structure should not penalize Oregonians who work for a paycheck in favor of those who live off of investments. Yet, that is what would happen if the legislature reduces the income tax on capital gains.

Consider what happens to working Oregonians by giving special treatment to income from capital gains. The average salary for a teacher in Oregon in 2010 was about $51,000.[1] An educator earning this amount in 2012 would pay a top rate of 9 percent in income taxes. If that year the tax rate on capital gains income were cut in half, someone who is fortunate enough to live off of investment or trust fund income — be it the same amount as the teacher earns or many times that amount — would pay a top rate of no more than 4.95 percent.[2]

The special treatment for those with investment income constitutes a "working tax penalty," according to former Vermont Governor Jim Douglas (R).

The special treatment for those with investment income constitutes a "working tax penalty," according to former Vermont Governor Jim Douglas (R). Calling for the elimination of Vermont's preferential treatment of income from capital gains, Governor Douglas said in 2008:

> Our current tax structure taxes earned income – that is, your hourly wage or salary – at a higher rate than it taxes unearned income. What this means is that a working man or woman in Vermont making $50,000 a year pays nearly 50 percent more tax than someone who does not work and simply lives off investment or trust fund capital gains income in the same amount. Our state is one of only a few that has such an unfair penalty for doing an honest day's work. This is grossly unfair. We must close this loophole and eliminate this working tax penalty.[3]

Indeed, most states — Oregon included — treat income from paychecks the same as income from investments. Forty-two states, counting the District of Columbia as a state, levy a broad-based personal income tax. Only nine of them give significant preferential treatment for income from capital gains over income from work.[4]

Treating workers and speculators the same is good economic development policy. Rhode Island recently eliminated preferential treatment for capital gains as part of an economic development strategy to gain competitive advantage in job retention and business recruitment. In 2008, a commission charged with "developing a tax strategy so that Rhode Island's tax structure is a competitive advantage in retaining jobs and recruiting businesses" recommended treating income from capital gains the same rate as income from work.[5] The 2009 Rhode Island General Assembly agreed and enacted legislation to tax all capital gains income at the same rate as ordinary income beginning January 1, 2010.[6]

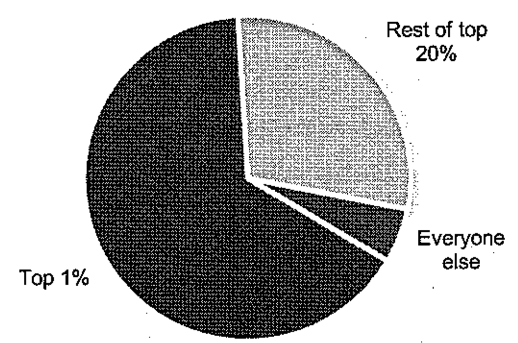
Giving special treatment to income from capital gains would penalize an honest day's work and put Oregon's tax system at odds with a majority of other states.

It would benefit the rich at expense of all other Oregonians

Cutting the tax on income from capital gains would be a boon for rich Oregonians, with everyone else receiving little or nothing. With the income gap between the rich and the rest already at extreme levels, cutting the income tax on capital gains would further unbalance Oregon's economy.

Because the rich disproportionately own capital assets (stocks, bonds and real estate), capital gains — the income from the sale of those assets — mostly flow to the top. In 2009, over half of Oregon's net capital gains income (54 percent) went to those making over $500,000 per year. Those making more than half-a-million dollars per year made up fewer than 1 in 300 taxpayers.[7] For this wealthiest group as a whole, 18 out of every 100 dollars in income came from capital gains, compared to only 1 out of every 100 dollars for all other Oregonians making less than $500,000 a year, combined.[8]

Nearly two-thirds of the benefits of cutting the tax rate on income from capital gains would accrue to the richest 1 percent of Oregonians

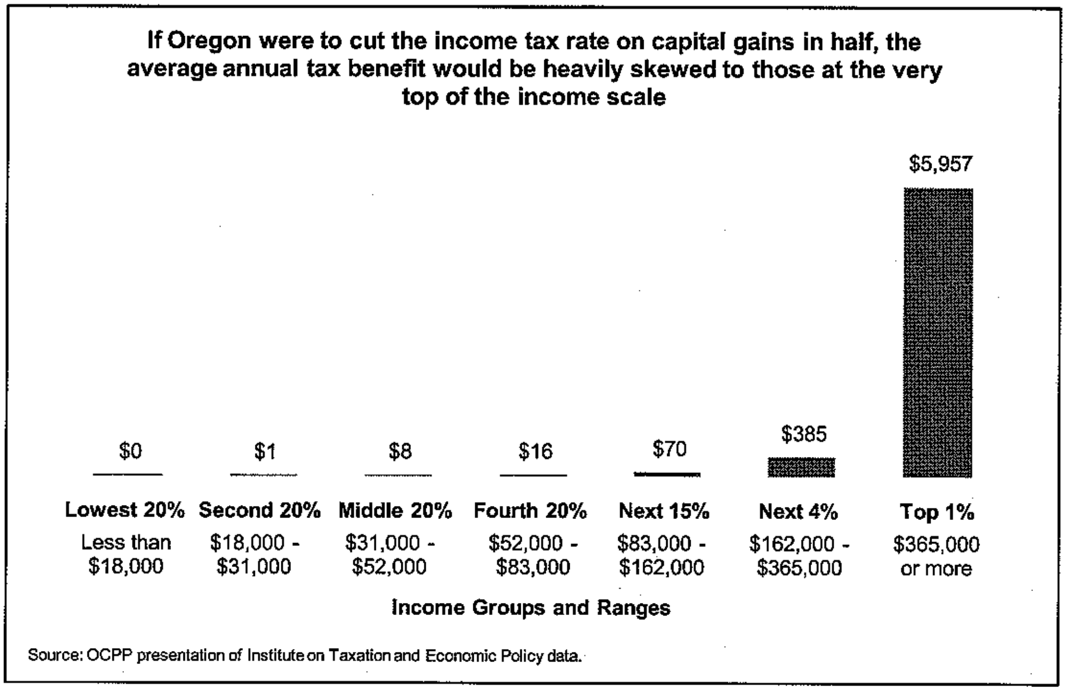


Source: OCPP presentation of Institute on Taxation and Economic Policy data.

If Oregon halved the income tax rate on capital gains, the richest 1 percent of Oregonians would get 65 percent of the tax cut.

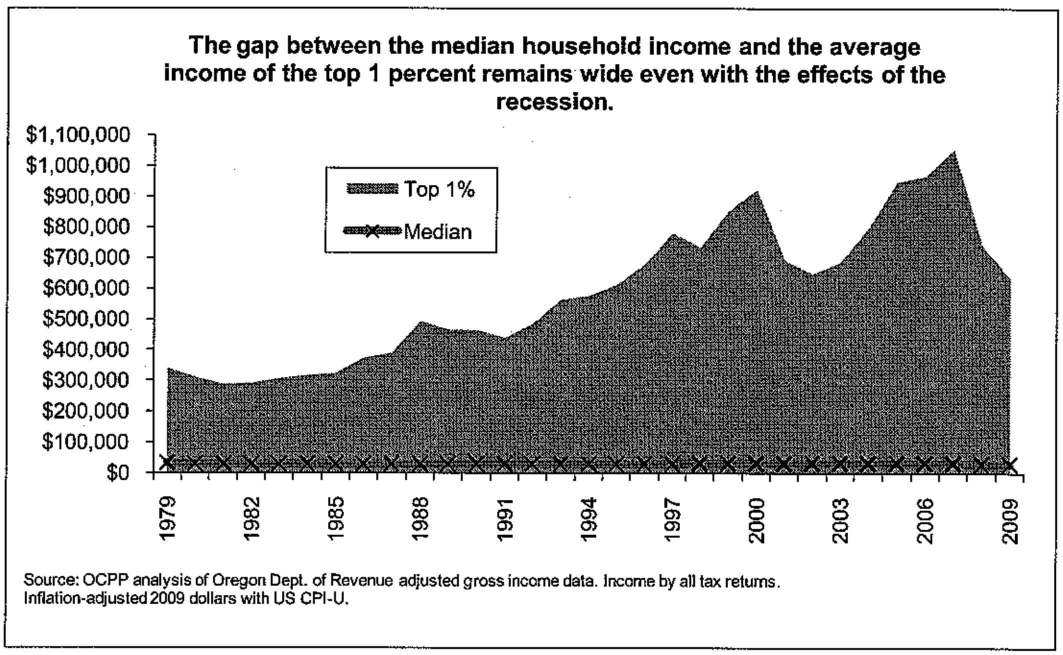
Thus, reducing the tax rate on income from capital gains would by-and-large constitute a tax cut for the rich. If Oregon halved the income tax rate on capital gains, the richest 1 percent of Oregonians would get 65 percent of the tax cut.[9] Among all people in this elite group, the average tax savings would be almost $6,000 per year. The average tax cut for those in the top 1 percent that actually receive a cut would be over $9,000 per year.[10]

By contrast, very little of the benefits would accrue to the remaining 99 percent of Oregonians. Four-fifths of all Oregonians —all but the wealthiest 20 percent — would only get to split among them 5 percent of the total benefits of cutting the tax rate on income from capital gains in half.[11] Even taxpayers with incomes between $83,000 and $162,000 — who earn well above what the middle-income Oregonian makes — would, on average, see a tax savings of only $70.[12]



Only 9 out of every 100 Oregon taxpayers would see a reduction in their income taxes if the tax rate on capital gains income were cut in half.

Apart from the skewed distribution of the tax benefits to the top income group, the majority of Oregon taxpayers would not benefit at all from a cut to the income tax rate on capital gains because they do not own assets that are subject to capital gains taxation. Only 9 out of every 100 Oregon taxpayers would see a reduction in their income taxes if the tax rate on capital gains income were cut in half.[13]



With only rich Oregonians benefiting significantly from it and all others getting little or no benefit, granting preferential treatment to capital gains would tend to exacerbate income inequality. Over the past three decades, the typical household in

Oregon has endured income stagnation, while the wealthiest 1 percent have seen their income soar. Oregon median household income in 2009 ($30,327) was 9.8 percent lower than it was in 1979 ($33,618), after adjusting for inflation.[14] By contrast, the average inflation-adjusted income among the wealthiest 1 percent in Oregon has almost doubled from $340,092 in 1979 to $634,902 in 2009.[15] Thus, cutting the tax rate on income from capital gains would largely benefit the relatively few who, by-and-large, captured the income gains of the past three decades.

It would give the rich a tax cut on top of the one they are already slated to get

When the 2009 legislature adopted what became Measure 66, enacted by voters in January 2010, lawmakers relied on economic forecasts that predicted a less severe recession and a faster and stronger recovery than what has transpired.[16] At that time, the legislature expected that revenue for the 2011-13 biennium would be almost $2 billion more than what the Office of Economic Analysis now predicts.[17] Lawmakers assumed — incorrectly, it turned out — that the state could afford to reduce the top rates for the wealthiest Oregonians starting in January 2012.

Thus, they wrote a tax cut into the law. On January 1, 2012, the top marginal tax rates of 11 percent for income for couples in excess of $500,000 and 10.8 percent for income between $250,000 and $500,000 will fall to 9.9 percent. The Legislative Revenue Office predicts that this scheduled tax cut for the 4 percent of Oregon households with income of $250,000 or more will cost the state budget $134 million in the next two year budget period, and $247 million in the 2013-15 budget period when income from capital gains are expected to have rebounded to pre-recession levels.[18]

This scheduled tax cut for the 4 percent of Oregon households with income of $250,000 or more will cost the state budget $134 million in the next two year budget period.

Because Oregon currently treats all income equally and the bulk of capital gains income flows to Oregon's wealthiest households subject to the Measure 66 rates, the scheduled tax cut already lowers the tax on income from capital gains for the wealthiest Oregonians. Granting capital gains income special tax treatment would pile more benefits on top of the scheduled tax cut that the wealthy are slated to get.

It would harm the public structures that nurture the middle class and protect the vulnerable

Cutting the income tax on capital gains would, of course, result in less revenue for the state. That would mean fewer resources for schools, health and human services and public safety — the public structures that nurture the middle class and protect the vulnerable.

For example, cutting the income tax rate on capital gains to 5 percent would mean a loss of at least $165 million in a single year.[19] Over the course of the 2011-13 budget cycle, the cost would be about $338 million,[20] which would be almost enough to fund a key component of Governor Kitzhaber's plan to focus on early childhood education. The Governor recommended that the Early Learning Council, designed to ensure children enter school ready to learn, receive $361 million from the General Fund in the *2011-13 Governor's Balanced Budget*.[21]

In addition to direct revenue loss, Oregon's economy would likely lose federal funding. Many state programs, particularly health care for the poor, aged and disabled, receive federal matching funds. If the legislature were to make up the lost revenue by cutting these vital services, the amount of federal funds flowing into the state would also be reduced. For example, each dollar of reduced state spending in Medicaid results in about $2 in lost federal matching funds that flow to health care sectors of the economy.

Ineffective: Tax cut would fail to attract investment

Proponents of cutting the income tax on capital gains argue that the special treatment is necessary to attract investment, which in turn will stimulate economic growth and create jobs.[22] This oft-repeated claim doesn't stand up to scrutiny.

Most careful and independent research suggests that effects of capital gains tax cuts on investment and employment are minimal at best. "Capital gains rates display no contemporaneous correlation with real GDP growth during the last 50 years," according to Leonard Burman, the Daniel Patrick Moynihan Professor of Public Affairs at the Maxwell School of Syracuse University and one of the nation's leading experts on capital gains taxation.[23] This is, in part, because significant business investment comes from sources such as pension funds and insurances companies unaffected by capital gains, making the tax rate on capital gains income irrelevant.[24] Likewise, the non-partisan Congressional Budget Office found that increasing after-tax income "typically does not create much incentive ... to hire more workers in order to produce more, because production depends principally on [businesses'] ability to sell their products."[25]

Demand for products and services creates jobs — not tax breaks for the rich.

In other words, demand for products and services creates jobs — not tax breaks for the rich.

The futility of cutting the income tax on capital gains is all the more apparent at the state level. If Oregon were to enact such a tax cut, there is no guarantee that the tax savings reaped by its beneficiaries — largely the richest Oregonians — would be reinvested in Oregon. Capital being highly mobile, those tax savings could just as easily be reinvested with a Wall Street hedge fund or invested in the Shanghai stock market.

While some would argue that Oregon could offer a more targeted tax cut to income reinvested in Oregon, the state's own experience demonstrates the futility of such an effort. In the mid 1990s, Oregon experimented with a program that allowed certain investors, primarily investors in start-up companies, to defer Oregon income taxes on capital gains if the gains were reinvested in Oregon businesses. In a joint report, the Legislative Revenue Office, the Oregon Department of Revenue and the Oregon Department of Economic and Community Development (now Business Oregon) concluded that the program was a failure.[26]

The report found that the program "has not achieved [its] goal," which was to increase investment in Oregon. It further stated, "Given the small amount of investment under Oregon's deferral program in its first two years, and because much of that investment probably would have occurred even without the deferral, the program has created few, if any, new jobs."[27]

Unnecessary: with its current tax rate Oregon does well relative to the nation

In an effort to justify a lower tax rate on capital gains income, proponents paint an ugly picture of Oregon's economy. They claim that Oregon performs badly when compared to other states and that its tax structure drives away wealthy Oregonians.[28] Again, their arguments don't stand up to scrutiny.

Oregon already outpaces the nation in economic growth and in inflow of venture capital

During the last decade, Oregon's economy far outperformed that of the nation as a whole.

Despite experiencing two recessions, Oregon Gross Domestic Product grew 31 percent from 2000 to 2009 in inflation-adjusted terms, faster than the 14 percent gain experienced nationally.[29] That success happened without giving special treatment to speculators and the rich.

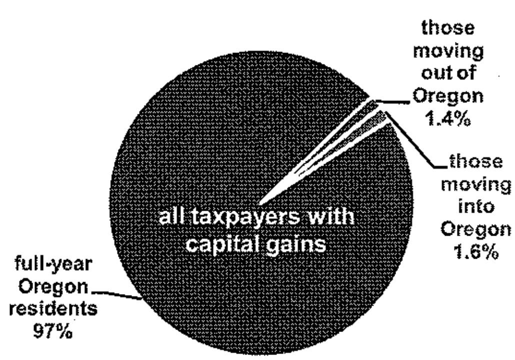
Venture capital investment in Oregon has also been stellar. Oregon's venture capital investment rose from $91 million in 2009 to $196 million in 2010. That amounts to a 115 percent growth rate, far above the increase nationwide of 20 percent. On a per capita basis, Oregon's venture capital ranked 15th highest among all states and the District of Columbia in 2010. That was better than its per capita rank in 2009 (22nd) and better than the average per capita rank of 18th over the previous 15-year period, from 1995 through 2009.[30]

People with capital gains income are migrating to Oregon

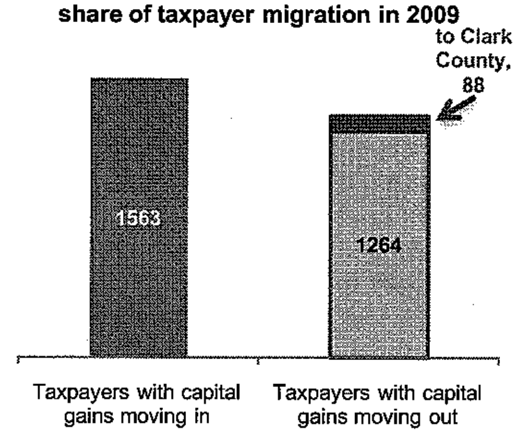
Among taxpayers with capital gains income who move to and from Oregon, more moved to Oregon than moved out.

Among taxpayers with capital gains income who move to and from Oregon, more moved to Oregon than moved out — as evidenced in the most recent 10-year period with available data. And in the year of their moves, those arriving, collectively, had more capital gains than those leaving Oregon. In other words, over those 10 years Oregon had a net inflow of capital gains income.

Analysis of Oregon Department of Revenue data reveals that net inflow. From 2000 to 2009, an average of 3,269 taxpayers reporting $120 million in capital gains income moved out of Oregon each year.[31] During the same time period, an average of 4,357 taxpayers with capital gains income moved *into* Oregon, bringing with them $144 million in capital gains income that year.[32] Thus, each year Oregon had an average net inflow of $24 million in capital gains income.[33] In fact, in all but one of those 10 years (2000), people moving into Oregon have had more income from capital gains during the year of their move than those moving out of Oregon.



Source: OCPP presentation of Oregon Department of Revenue data.



Source: OCPP presentation of Oregon Department of Revenue data.

The fact that Oregon's tax structure is not chasing away taxpayers with capital gain income is evident even in the data concerning Clark County, Washington. Critics of Oregon's tax structure suggest that there is a flood of Oregon taxpayers migrating to Clark County, Washington, to avoid income taxes, including the income tax on capital gains.[34] While stories circulate of wealthy Oregonians moving to Clark County to avoid taxes, anecdotes do not amount to reliable evidence. The data show that, at most, the migration is minimal. Oregon had an average of about 190,000 full-year residents with capital gains income each year between 2000 and 2009. And of that group, on average only 14 of every 10,000 (0.14 percent) moved to Clark County. Among all 1.7 million Oregon taxpayers — those with and without income from capital gains — an average of just 2 of every 10,000 (0.02 percent) had income from capital gains and moved to Clark County each year from 2000-09.[35]

Out of nearly 1.8 million total returns, 97,000 reported income from capital gains. Of those, only 88 taxpayers with income from capital gains moved to Clark County.

The data from 2009 further illustrates the negligible effect of Oregon's tax structure. That year, out of nearly 1.8 million total returns, 97,000 reported income from capital gains. Of those, only 88 taxpayers with income from capital gains moved to Clark County.[36]

Of course, those who packed their belongings and moved across the river may have done so for reasons other than taxes — for example, cheaper housing, job availability and family-related reasons. But whatever the reason for their move, the fact that just 88 taxpayers with capital gains income, out of Oregon's 1.8 million taxpayers, relocated to Clark County is not grounds to grant preferential treatment that would primarily benefit Oregon's richest households.

Investments and jobs stay in Oregon

Even if Oregonians move to Clark County before realizing large capital gains, Oregon does not necessarily lose all of their investment capital as a result. Those who have made money in Oregon may continue investing in Oregon in the future, even if they move a few miles away. Moreover, while Oregon may lose tax revenue because some of the capital gains income of those living outside of Oregon will not be taxed as income here, Oregon does not lose the economic growth or potential jobs created by businesses located here simply because the owner lives in another state.

In fact, just because someone lives in Clark County it doesn't mean they don't work in Oregon and continue to pay Oregon income taxes. In 2009, about one-third of Clark County's resident workforce (roughly 56,000 individuals), some of whom are quite rich, filed Oregon income tax returns. These Clark County filers reported a total adjusted gross income of $2.2 billion in 2009, including $5.4 million in income from capital gains.[37] The percent of Clark County residents filing Oregon income tax returns who made over $500,000 in 2009 was 0.2 percent, not much different than the 0.3 percent of full-year Oregon residents who made that much money.[38]

Across the nation, people don't migrate because of tax policy

The conclusion that Oregon's tax structure is, at worst, causing a miniscule number of Oregonians to relocate to Clark County is entirely consistent with the findings of studies of the impact of state taxes on migration.

"The consensus emerging from the migration literature — and from a range of research designs — is that people do not generally migrate in response to tax increases (or to tax differentials that would be 'easy' to arbitrage)," according to a recent study by Princeton researchers published in the *National Tax Journal*.[39] That study found that the migration effect of New Jersey's so-called "millionaire tax" — a tax bracket for taxpayers with income above $500,000 enacted in 2004 — was "close to zero."[40]

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Likewise, a scholar at the University of Massachusetts, Amherst recently conducted a study of migration among the New England states. It concluded that "taxes do not play any notable role in causing people to leave a state."[41]

Irresponsible: Granting special treatment to rich would make it harder to fund popular and vital services and save for a rainy day

The revenue collapse that followed the onset of the Great Recession demonstrated yet again the need for Oregon to build up its revenue reserves. By saving during the good economic times, Oregon would be in a better position to weather the inevitable economic downturns. Cutting the income tax on capital gains, however, would weaken the best source of revenue for building up Oregon's reserves.

When the economy performs well, Oregon's tax system — led by the income tax on capital gains — tends to bring in more funds than anticipated. That certainly was the case in the 2005-07 budget cycle, the last time that revenue surged beyond expectations, causing the "kicker" to kick.[42] In that instance, income from capital gains accounted for one out of every 11 dollars of income reported in Oregon.[43] In tax year 2005, one of the years contributing to the unanticipated revenue that resulted in a kicker, income from capital gains increased by 59 percent and accounted for over a third of the growth in the adjusted gross income of full-year residents.[44]

That Oregon's revenues surge during good times from the income tax on capital gains is a good thing. To the extent a surge is anticipated, the funds can support vital public services that otherwise would need to be funded from the income tax on paychecks. To the extent a surge is unanticipated, the unexpected revenue can be saved in the Rainy Day Fund, putting Oregon in a better position to weather bad economic times.

Even during difficult economic times, income from capital gains constitutes an important source of revenue to fund popular and vital public services such as schools, the courts, health care and care for the elderly.

Even during difficult economic times, income from capital gains constitutes an important source of revenue to fund popular and vital public services such as schools, the courts, health care and care for the elderly. Following the pummeling of the stock market at the beginning of the Great Recession, full-year Oregon residents still reported $3.8 billion in capital gains in 2008 and $2 billion in 2009.[45] This amounted to 4.5 percent of total income in 2008 and 2.5 percent in 2009.The tax on this income from investment funds vital public services during the difficult times.

Thus, whether enacted during good or bad economic times, cutting the tax rate on the income from capital gains is irresponsible state fiscal policy.

Conclusion

Any proposal to cut the income tax on capital gains fails on four fundamental levels: it would create a tax system that favors speculators over workers and the rich over all other Oregonians; it would be ineffective as a means of attracting investment into the state; it's unnecessary because with its current tax rate on capital gains, Oregon compares favorably to the rest of the nation; and it's fiscally irresponsible in view of the need to strengthen Oregon's reserves and fund vital public services during good and bad economic times.

Endnotes

[1] Oregon Employment Department, Occupational Information Center, available at http://www.qualityinfo.org/olmisj/OIC.

[2] In 2012, the upper-most income tax rate is scheduled to be 9.9 percent. Cutting the rate in half for income from capital gains would result in a top rate of 4.95 percent on income from capital gains.

[3] Governor James H. Douglas, Vermont State of the State Address, January 10, 2008, available at http://www.stateline.org/live/details/speech?contentId=271445. Prior to 2009, Vermont taxpayers were allowed to exclude 40 percent of their income from capital gains and the remainder was treated as regular taxable income. Vermont's 2009 legislature greatly reduced the exemption. However, the 2010 legislature reversed course and, effective January 1, 2011, restored the 40 percent exclusion to some, but not all, types of capital gains income. While the exemption remains more narrowly defined than it was prior to the changes made in 2009, as indicated in endnote 4, Vermont is back in the minority of states with significant special treatment of capital gains.

[4] Thirty-three states, including the District of Columbia as a state, either give no preferential treatment of income from capital gains, or only narrowly defined preferential treatment. Typically, any limited preferential treatment is only available for capital gains on specified in-state investments. For example, Utah offers a deduction for gains used to purchase qualifying stock in a Utah small business corporation. Oregon taxes gains from the sale of certain farm assets at a reduced rate. Of the 9 states with broad-based income taxes that provide preferential treatment to capital gains income, four (Hawaii, North Dakota, South Carolina and Wisconsin) provide special treatment to income from long-term capital gains. The other five (Arkansas, Iowa, Montana, New Mexico and Vermont) offer significant special treatment of at least some forms of both short- and long-term capital gains. See Institute on Taxation and Economic Policy (ITEP), *The ITEP Guide to Fair State and Local Taxes*, Chapter 5 Appendix, 2011, available at http://itepnet.org/state_reports/guide2011.php and ITEP, *A Capital Idea: Repealing State Tax Breaks for Capital Gains Would Ease Budget Woes and Improve Tax Fairness*, January 2011, available at http://www.itepnet.org/pdf/A_Capital_Idea.pdf.

[5] State of Rhode Island and Providence Plantations, *Report of the Governor's Tax Policy Strategy Workgroup*, March 6, 2009, p. 3, available at http://www.dor.ri.gov/Workgroup%20Meetings/Tax%20Report%20Final%203-6-09.pdf

[6] State of Rhode Island and Providence Plantations, Department of Revenue, Office of Revenue Analysis, *Rhode Island Revenue Changes*, 2009 Session, pp. 1-3, available at http://www.dor.ri.gov/Reports/RI%20Revenue%20Changes%202009%20Session.pdf.

[7] OCPP analysis of Oregon Department of Revenue (DOR) data.

[8] OCPP analysis of DOR data.

[9] Estimate of the impact of reducing Oregon's income tax rates on capital gains by 50 percent or fully exempting capital gains from personal income tax prepared by ITEP for OCPP, March 2011 (hereafter ITEP estimate). This analysis is based on assuming the permanent upper income tax rate of 9.9 percent that is scheduled to take effect in 2012 but uses 2011 estimated income levels because of increased accuracy.

[10] ITEP estimate.

[11] ITEP estimate.

[12] ITEP estimate. Not everyone in this income group will realize a tax savings. Among those who will see a reduction in their taxes, the average savings will be $295.

[13] ITEP estimate.

[14] OCPP analysis of DOR data.

[15] OCPP analysis of DOR data.

[16] For an illustration of the difference in employment forecasts, see Office of Economic Analysis, *Economic and Revenue Forecast*, March 2011, presentation to House & Senate Revenue Committees, February 15, 2011, slide 12, available at http://www.oregon.gov/DAS/OEA/revenue.shtml#Other_Reports_and_Statistics.

[17] Calculated from 2011-13 General Fund revenue in May 2009 *Economic and Revenue Forecast* ($15 billion) adjusted using the September close of session forecast to $15.8 billion. 2011-13 General Fund revenues are predicted to be $13.9 billion in the May 2011 *Economic and Revenue Forecast*. Office of Economic Analysis, *Economic and Revenue Forecast*, May 2009, September 2009 and May 2011.

[18] Allanach, Christopher, e-mail to Charles Sheketoff, March 17, 2011.

[19] Legislative Revenue Office (LRO) estimates the cost of reducing the income tax rate on capital gains to 5 percent to be $164.9 million for the 2011-12 fiscal year, $172.6 million in fiscal year 2012-13, $191.7 million in fiscal year 2013-14 and $197 million in fiscal year 2014-15. LRO, *2011 Oregon Public Finance: Basic Facts*, Research Report #1-11, available at http://www.leg.state.or.us/comm/lro/2011_publications_reports/2011_BasicFacts.pdf.

[20] LRO, *2011 Basic Facts.* Also see note 19.

[21] State of Oregon, *2011-13 Governor's Balanced Budget*, p. B-9, available at http://governor.oregon.gov/Gov/docs/priorities/BUDGET_Full_Budget.pdf.

[22] See the following examples: The Oregon Business Plan claims that a cut in the income tax on capital gains would help "spark economic growth and help us achieve our other goals of creating 25, 000 jobs per year and raising Oregon's per capita income above the national average by 2020." Memo to Governor John Kitzhaber from Oregon Business Plan Steering Committee, January 10, 2011, available at http://www.oregonbusinessplan.org/LinkClick.aspx?fileticket=5GXbaxVuzuU%3d&tabid=146. The project manager of the Oregon Business Plan wrote, "The individuals and investors who provide this capital and expertise are highly sensitive to income and capital gains tax rates, and Oregon's highest-in-the-nation rates send these folks packing, or keep them away in the first place." Jeremy Rogers, "The good, the bad and the ugly of Oregon taxes," *The Oregonian*, April 26, 2011. Associated Oregon Industries, Oregon Business Association, Oregon Business Council and the Portland Business Alliance claim that a bill that would tie a tax cut on the income from capital gains to kicker reform would "spur job creation in Oregon." News release, "Oregon business associations release top priorities for job creation: Organizations ask legislature to focus on job creation, getting people back to work," May 10, 2011, available at http://www.oba-online.org/wp/wp-content/uploads/2011/05/5.10.11-Jobs-bills-plus-list.pdf. Oregon House Republican Leader Kevin Cameron reportedly stated, "The current rate serves as a barrier to economic development, and potentially drives companies and investors to other states where capital gains tax rates are lower or even zero. . . A high capital gains tax rate — as we have in Oregon — discourages people from investing and encourages current investors to hold onto their assets. Reducing the rate will encourage investors to realize their gains, reinvest, and create jobs in Oregon." See KZTV.com, "Ore. House GOP Moves to Slash Capital Gains: One Proposal Would Cut Tax in Half to Spur Investment," March 12, 2011.

[23] Kravitz, Troy and Leonard Burman, Tax Policy Center, *Capital Gains Tax Rates, Stock Markets, and Growth*, November 7, 2005.

[24] See Burman, Len, memo to Chuck Sheketoff, Oregon Center for Public Policy, April 18, 2005, available at http://www.ocpp.org/2005/memo050420nesbitt.pdf; Leonard E. Burman, "End the Break On Capital Gains," *The Washington Post*, July 30, 2007.

[25] Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2010 and 2011*, January 2011, p. 25, available at http://www.cbo.gov/ftpdocs/108xx/doc10803/01-14-Employment.pdf.

[26] Oregon Economic Development Department is now Business Oregon.

[27] Oregon Department of Revenue, Legislative Revenue Office and Oregon Economic Development Department, *Oregon's Capital Gains Deferral Program: An Evaluation of the First Two Years*, March 1999, p 1, available at http://www.ocpp.org/blue/19990330_DOR_LRO_OEDD_Capital_Gains_Deferral_Program_Evaluation.pdf.

[28] See examples in note 22.

[29] OCPP analysis of Bureau of Economic Analysis (BEA) data.

[30] OCPP analysis of data from the MoneyTree™ Report by PricewaterhouseCoopers and the National Venture Capital Association, based on data from Thomson Financial.

[31] OCPP analysis of DOR data.

[32] OCPP analysis of DOR data.

[33] OCPP analysis of DOR data.

[34] For example see Smith, Joe, "Activist says Oregonians moving to WA for tax relief", KGW NewsChannel8, February 28, 2011, updated March 8, 2011, available at http://www.kgw.com/news/local/Oregon-Tax-Payers-revolt-and-move-to-Washington-117114253.html and Whelan, Robert and Alex Reed, ECONorthwest, *An Analysis of Average and Marginal Income Tax Rates in Oregon and Effects on Household Location*, June 2009, available at http://www.oregonbusinessplan.org/LinkClick.aspx?fileticket=EbUBv-ZJFKw%3D&tabid=102.

[35] OCPP analysis of DOR data.

[36] OCPP analysis of DOR data. The 88 taxpayers are those who moved from Oregon to Clark County and had capital gains income in the year of the move. We do not know the number taxpayers who moved to Oregon from Clark County who had capital gains income that same year. Thus we do not know the net migration between Oregon and Clark County. The 88 taxpayers represent just 0.005%, or five out of 100,000, Oregon taxpayers that year.

[37] DOR, *Oregon Personal Income Tax Annual Statistics, Tax Year 2009*, Results by County, Other States, and City, available at http://www.oregon.gov/DOR/STATS/101-406-2011-toc.shtml.

[38] OCPP analysis of DOR data.

[39] Young, Cristobal and Charles Varner, "Millionaire Migration and State Taxation of Top Incomes: Evidence from a Natural Experiment," *National Tax Journal*, June 2011, p. 258, available at http://www.stanford.edu/~cy10/public/Millionaire_Migration.pdf.

[40] Young and Varner, "Millionaire Migration and State Taxation of Top Incomes," p. 267.

[41] Jeffrey Thompson, Political Economy Research Institute, *The Impact of Taxes on Migration in New England*, April 2011, p. 16.

[42] The automatic spending of revenue on a tax cut, popularly known as the "kicker," goes into effect when revenue comes in at 2 percent or more than what state economists predicted two years earlier, at the close of session forecast.

[43] OCPP analysis of DOR data.

[44] DOR, *Oregon Personal Income Statistics Tax Year 2005*, p. 11, available at http://www.oregon.gov/DOR/STATS/docs/101_406_07/101-406-07.pdf.

[45] DOR, *Oregon Personal Income Statistics Tax Year 2009*, p. 21, available at http://www.oregon.gov/DOR/STATS/docs/101_406_11/101-406-11.pdf.

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Fact Sheet

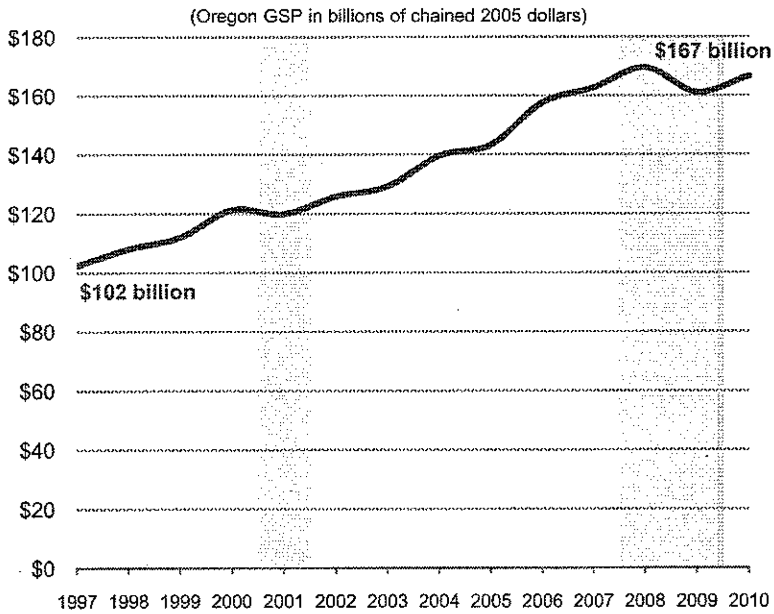
December 14, 2011

If Economic Growth Assured Well-Being, Oregonians Would be Thriving

A View of the State of Working Oregon

If economic growth alone determined the well-being of a state's inhabitants, all Oregonians would be thriving. Relative to the rest of the nation, Oregon's economy has performed exceptionally well for over a decade.

Oregon economy: a long, upward trend



Gray areas indicate National Bureau of Economic Research official periods of recession.
Source: Bureau of Economic Analysis, GDP by state in chained 2005 dollars data series.

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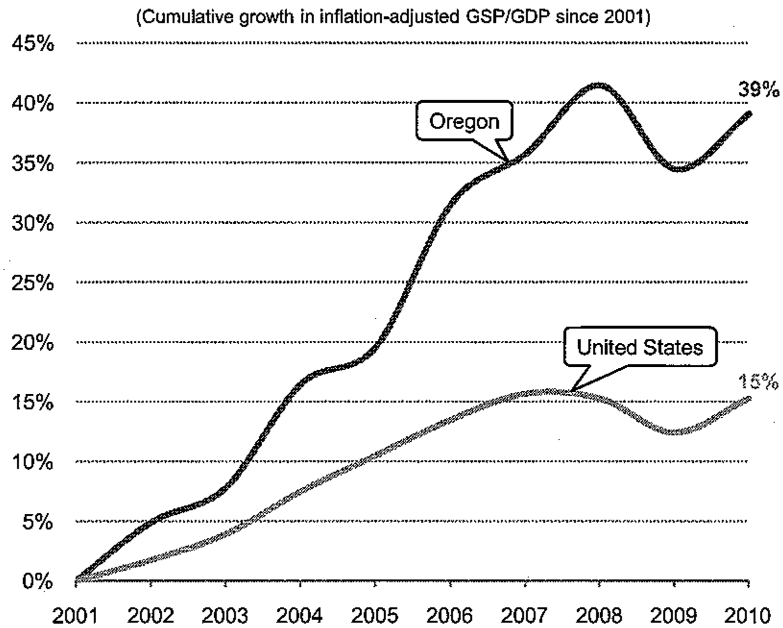
Oregon's economy has grown significantly since 1997, the starting point of the official data series for measuring economic growth.[1]

Oregon's real (inflation-adjusted) Gross State Product (GSP) increased from about $102 billion in 1997 to over $167 billion in 2010, according to the most recent data available.

Thus, Oregon's economy expanded 63 percent during that time period. It grew in all but two of those years — the recessionary years of 2001 and 2009.

A View of the State of Working Oregon is a series of occasional OCPP fact sheets published to help explain Oregon's economy from the perspective of working families.

Oregon economy has outpaced U.S. economy



Source: OCPP analysis of Bureau of Economic Analysis, GDP by state in chained 2005 dollars data series.

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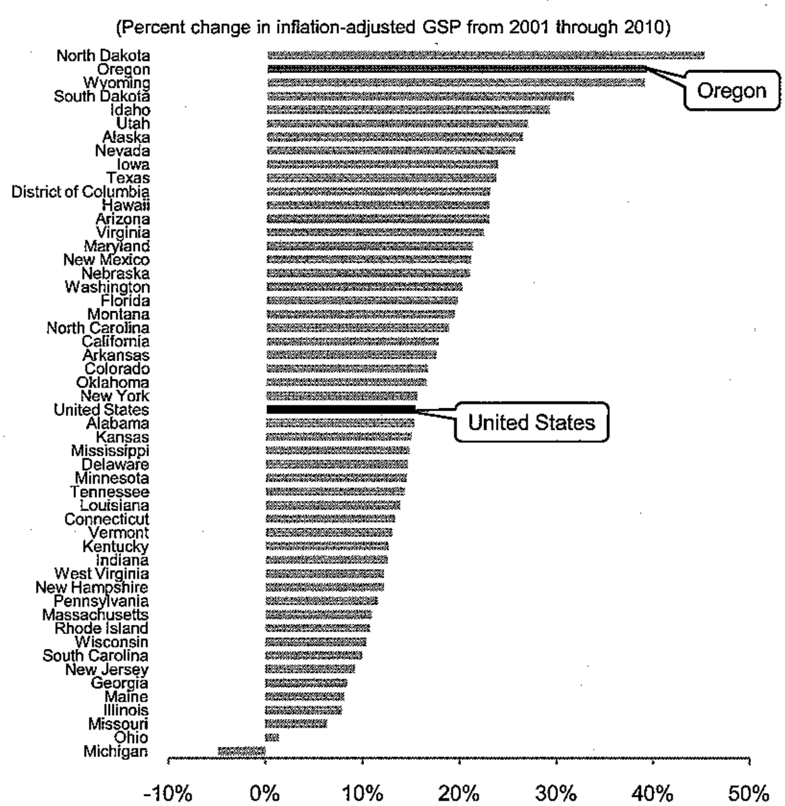
Over the last decade, Oregon's economy grew more rapidly than the nation's economy. Specifically, from 2001 to 2010, a period beginning with the start of the last economic expansion to the most recently available data, Oregon's inflation-adjusted GSP grew 39 percent, while the nation's inflation-adjusted Gross Domestic Product (GDP) expanded 15 percent.

In other words, from 2001 to 2010, Oregon's economy grew more than twice as fast as the nation's economy.

Oregon economic growth tops nearly all states



Source: OCPP analysis of Bureau of Economic Analysis, GDP by state in chained 2005 dollars data series.

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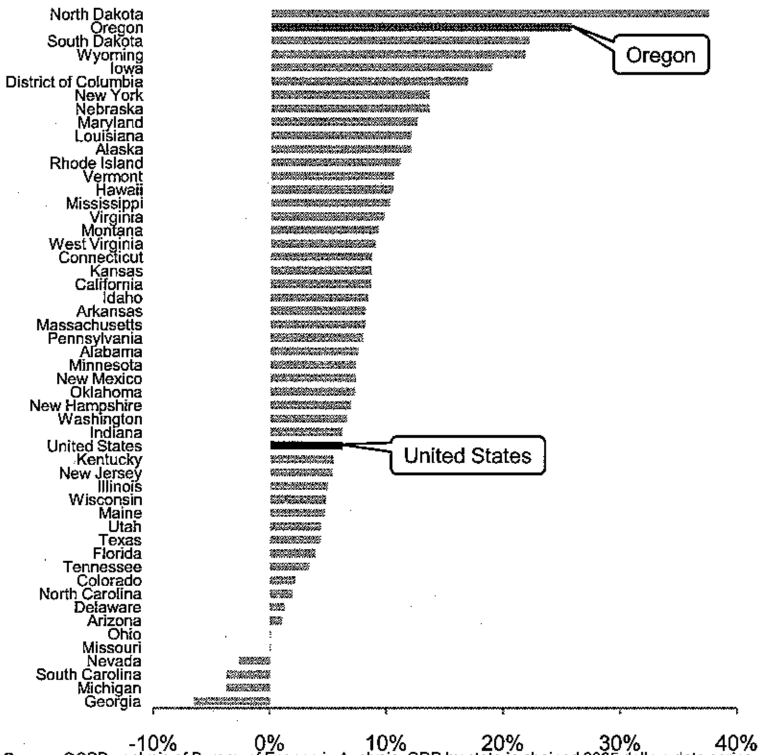
Over the past decade, Oregon enjoyed the second highest level of economic growth, measured by inflation-adjusted GSP, among all states and the District of Columbia. Specifically, from 2001 to 2010, only North Dakota's economy grew faster than that of Oregon.

Oregon's exceptional performance occurred despite the fact that the Great Recession hit Oregon harder than most states. Oregon's GSP growth ranked among the bottom states in 2008-09, during the depths of the recession. However, Oregon has rebounded quickly, posting 3.4 percent growth for 2009-10, eighth highest in the nation.

On per person basis, Oregon economy excels

(Percent change in inflation-adjusted per-capita GSP from 2001 through 2010)



Source: OCPP analysis of Bureau of Economic Analysis, GDP by state in chained 2005 dollars data series.

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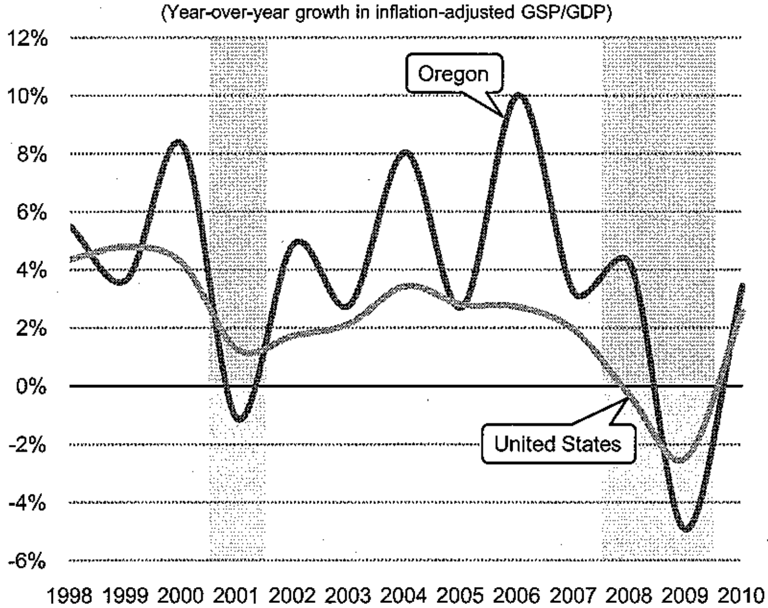
Even when adjusted for population changes within states, Oregon's performance has been exceptional. Oregon ranked second among all states and the District of Columbia during the 2001-10 period in terms of economic growth per person (GSP per capita). By this measure, Oregon's economy expanded 26 percent over this time period, more than four times the 6 percent growth of the national economy.

Thus, despite being hit hard by the Great Recession, Oregon's economic growth over the time period on a per person basis was exceptional.

Oregon economy shines during U.S. expansions

(Year-over-year growth in inflation-adjusted GSP/GDP)



Gray areas indicate National Bureau of Economic Research official periods of recession.
Source: OCPP analysis of Bureau of Economic Analysis, GDP by state in chained 2005 dollars data series.

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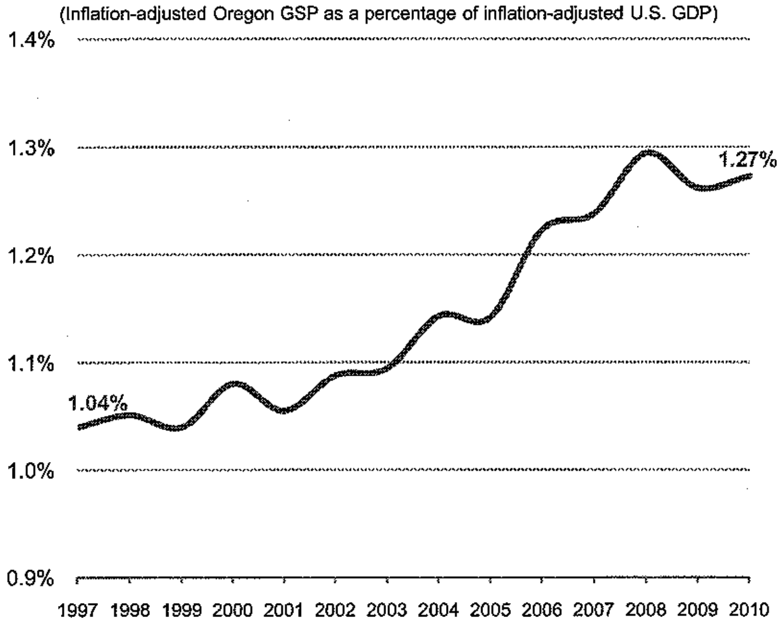
When the nation enjoys good economic times, Oregon has even better times. Oregon's economy outperformed the national economy in all but one year of the most recent expansionary period. In fact, the average yearly growth rate of inflation-adjusted GSP in Oregon from 2002 through 2007 was 5.3 percent, more than double the nation's average growth of 2.5 percent for the same time period.

The most recent recession hit Oregon's economy harder than the national economy, but the initial stages of the recovery began more strongly in Oregon. Oregon's inflation-adjusted GSP decreased 4.9 percent in 2009, versus 2.5 percent nationally. Yet in 2010 Oregon's economy grew 3.4 percent, compared to 2.6 percent nationally.

Oregon's share of national economy grows



Source: OCPP analysis of Bureau of Economic Analysis, GDP by state in chained 2005 dollars data series.

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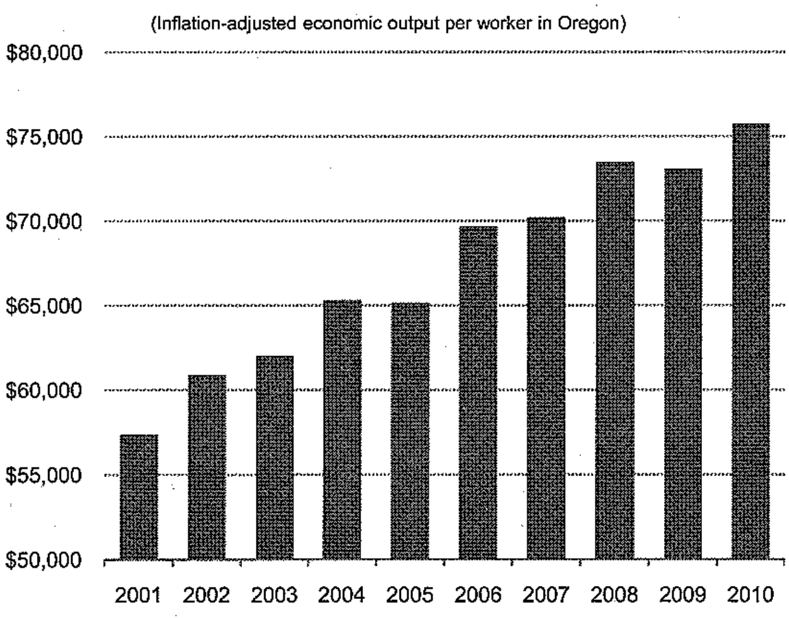
Oregon has increased its share of the national economy.

Although Oregon's economy constitutes only a small portion of the U.S. economy, this is less true now than it has been in the past. In 1997, the beginning of the current data series for measuring economic growth, Oregon's economy made up 1.04 percent of the national economy. By 2010, Oregon's share had increased to 1.27 percent.

While it's still a small portion of the national economic output, Oregon's contribution to the national economy has grown by over 20 percent since 1997.

Oregon led nation in worker productivity gains



Source: OCPP analysis of Bureau of Economic Analysis, GDP by state in chained 2005 dollars data series and employment data.

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Oregon's strong economic performance relative to other states this decade may be explained in part by the fact that Oregon led the nation in terms of increased worker productivity. From 2001 to 2010, Oregon experienced a dramatic increase in the real economic output per worker. In 2001, a typical Oregon worker produced about $57,000 of goods and services in today's dollars. By 2010, productivity had increased to about $76,000. This translates to a growth in productivity of 32 percent — over three times the national increase of 9.8 percent over the same period.

No other state saw a greater increase in worker productivity.

Endnotes

1 In 1997, the official economic arbiter, the United States Bureau of Economic Analysis (BEA) discontinued a state-level data series dating back to 1963. Because the BEA began using new definitions and data sources in 1997 to measure Gross State Product (GSP), the bureau "strongly cautions" against combining the two data series to construct a longer series of data. See http://bea.gov/regional/gsp/.

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Fact Sheet

December 14, 2011

Economic Gains Flow to the Top as Oregon Income Inequality Soars

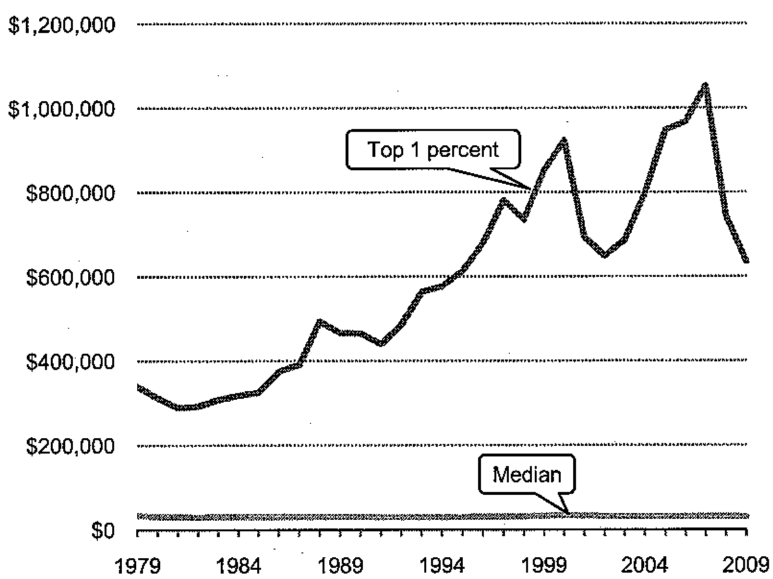
A View of the State of Working Oregon

The past three decades in Oregon, as elsewhere, are in large measure a story of surging income inequality. As the income of the fortunate few at the top has soared, the income of most Oregonians has stagnated or declined. If many Oregonians feel that they are struggling to keep up or falling behind, it is because they are.

The surge in income inequality has occurred even as Oregon's economy has expanded.[1] This shows that economic growth alone does not and will not create economic opportunity and security for many Oregonians. Policymakers need to confront the structures that channel economic gains largely to the wealthy and exclude, in large part, most Oregonians.

Top 1 percent's income soars; middle's erodes

(Average income of the top 1 percent compared to the median income)



All Oregon income tax filers. Adjusted for inflation using CPI-U.
Source: OCPP analysis of Oregon Department of Revenue data.

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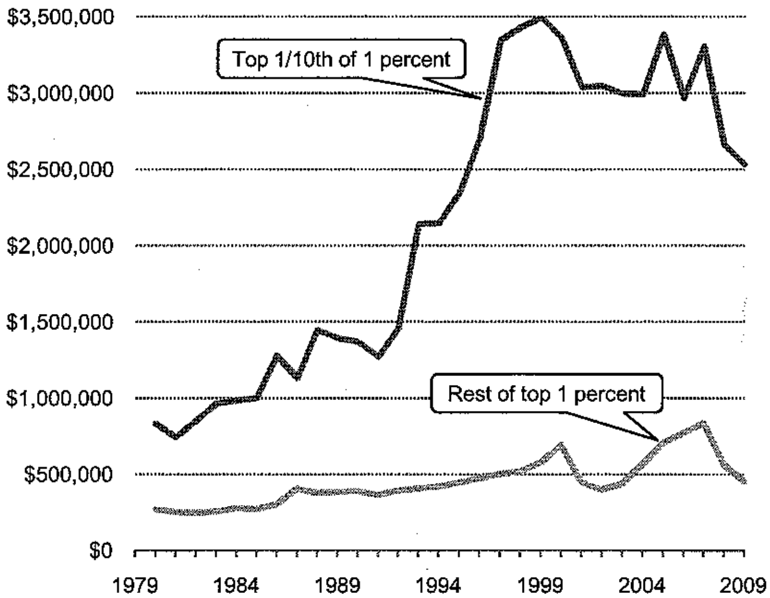
Those at the top of Oregon's income scale — the wealthiest 1 percent of taxpayers — collectively have seen their income soar over the past three decades. Although down from the pre-recession peak in 2007, the average income of the top 1 percent was about $635,000 in 2009, the most recent year with data available.[2] That's nearly double the inflation-adjusted average of about $340,000 for the top 1 percent in 1979. (To belong to Oregon's top 1 percent, you had to make at least $278,150 in 2009.)

By contrast, the typical Oregon taxpayer has endured income erosion by inflation over the past three decades. In 2009, Oregon's median income was $30,327, about 10 percent less than it was in 1979 after adjusting for inflation.

A View of the State of Working Oregon is a series of occasional OCPP fact sheets published to help explain Oregon's economy from the perspective of working families.

Top one-tenth of 1 percent's gains dwarf rest of top 1 percent's gains

(Average income of the top 1/10th of 1 percent compared to the average income of the rest of the top 1 percent)



Full-year resident income tax filers. Adjusted for inflation using CPI-U.
Source: OCPP analysis of Oregon Department of Revenue data.

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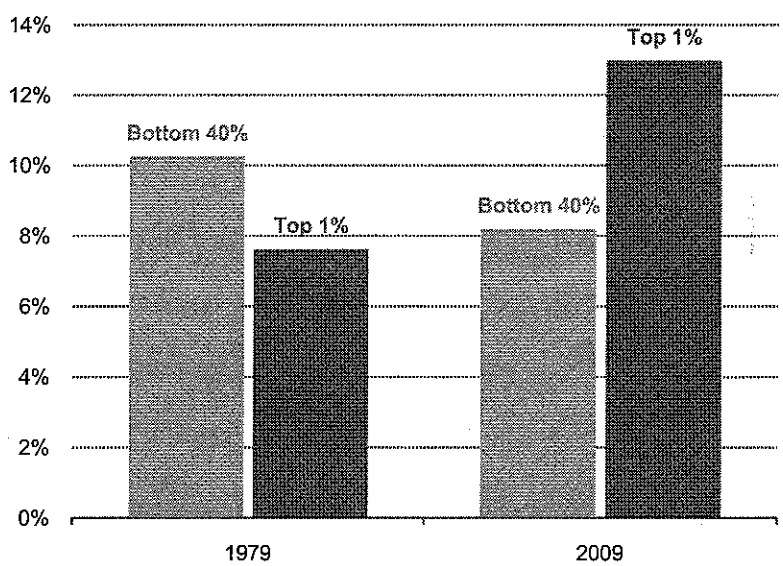
Although as a group the entire 1 percent has done fabulously well over the past three decades, the income gains by the tiny sliver at the top of the heap — about 1,600 of the wealthiest taxpayers — dwarf even the rest of the top 1 percent.

The average income of the top one-tenth of 1 percent, the wealthiest 1 out of every 1,000 Oregon taxpayers, stood at $2.5 million in 2009, more than triple the inflation-adjusted amount of three decades prior. Over the same period, the rest of the top 1 percent saw their average income grow nearly 70 percent, from about $270,000 to about $450,000.

Top 1 percent 's income share overtakes lowest 40 percent's share

(Share of total income in 1979 and 2009)



Source: OCPP analysis of Oregon Department of Revenue data.

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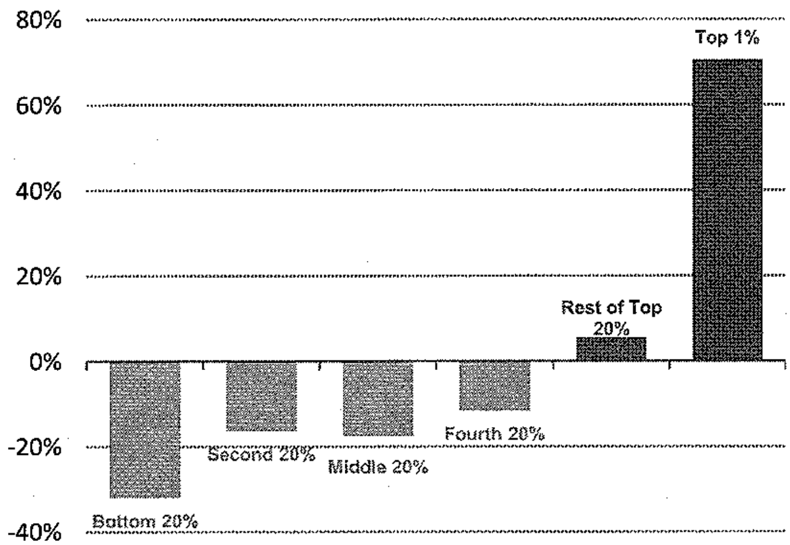
Over the past three decades, the collective income share of the wealthiest 1 percent of Oregon taxpayers shot up well above the collective income of Oregon's lowest earning 40 percent.

In 1979, the bottom 40 percent of Oregon taxpayers together collected 10.2 percent of all income, while the top 1 percent together collected 7.6 percent. But by 2009, the collective share of the bottom 40 percent had dropped to 8.2 percent, while the collective share of the top 1 percent had risen to 13 percent.

As top gains income share others lose share

(Percent change in income share from 1979 through 2009)



Source: OCPP analysis of Oregon Department of Revenue data.

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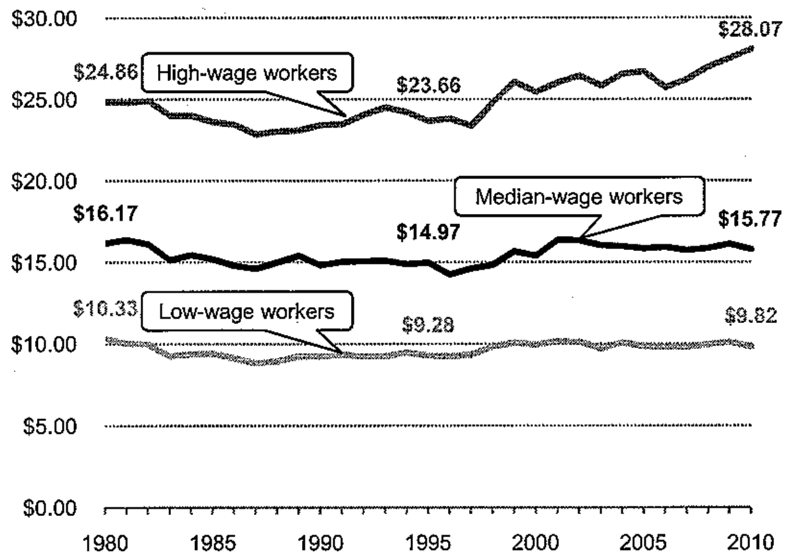
Oregon's wealthiest 1 percent of taxpayers have seen their slice of total state income expand dramatically over the last 30 years, while the slices of nearly all other income groups have shrunk. Specifically, the share of total state income collected by the top 1 percent increased by 70 percent from 1979 to 2009. The only other group to have gained total income share was the rest of the top 20 percent (the top fifth excluding the top 1 percent).

As the share of total income rises for some, it necessarily declines for others. From 1979 to 2009, the bottom 80 percent of Oregon taxpayers saw their income share decline. That was especially the case for the lowest-earning 20 percent, who lost about a third of their income share over the course of the last three decades.

High wages rise; median and low wages do not

(Hourly earnings at the 20th, 50th and 80th percentiles)



Adjusted for inflation using CPI-U.
Source: Economic Policy Institute analysis of Current Population Survey data.

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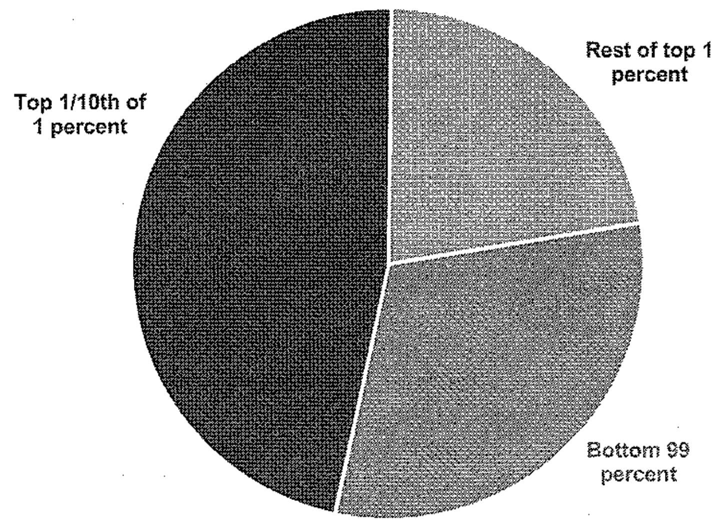
The increase in income inequality is in part explained by the fact that over the past three decades, high-wage workers have seen their paychecks grow, while median and low-wage workers have not.[3] The hourly wage of high-wage workers rose from $24.86 in 1980 to $28.07 in 2010, when adjusted for inflation.

Over the same time period, wages have stagnated, or fallen, for other groups of Oregon workers. For example, in 2010 the median, or typical, hourly wage was $15.77, below the $16.17 inflation-adjusted median wage 30 years earlier. Similarly, low-wage workers earned just $9.82 per hour in 2010, less than the $10.33 they made in 1980 in inflation-adjusted terms.

Top one-tenth of 1 percent take about half of all capital gains income

(Share of Oregon capital gains income by income group)



Full-year resident income tax filers.
Source: OCPP analysis of Oregon Department of Revenue data.

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Capital gains income is concentrated at the very top of the income scale.[4] In 2009, the top one-tenth of 1 percent — the wealthiest 1 out of every 1,000 Oregon taxpayers — collected nearly half (47 percent) of all capital gains income. The rest of the top 1 percent took in another 22 percent. Together, the entire top 1 percent collected a little more than two-thirds (69 percent) of all capital gains income in Oregon.

The rest of Oregon taxpayers were left to share the remaining third (31 percent). In fact, the top one-tenth of 1 percent — consisting of only about 1,600 tax filers — together took in more than the remaining 99 percent.

Endnotes

1 Uniform Gross State Product (GSP) data from the United States Bureau of Economic Analysis (BEA) dates back only to 1997. But while state-level BEA data does not allow for confident comparison of the pre-1997 period, BEA's Gross Domestic Product (GDP) data shows that the national economy has expanded fairly steadily over the course of the past three decades, even if interrupted by intervening recessions. Specifically, U.S. GDP more than doubled over the last 30 years (see data available at http://bea.gov/national/index.htm#gdp); and since 1997, Oregon's GSP has tended to outperform growth in national GDP during economic expansions (see Oregon Center for Public Policy, *If Economic Growth Assured Well-Being, Oregonians Would be Thriving*, Fact Sheet, December 14, 2011, available at http://www.ocpp.org/2011/12/14/if-economic-growth-assured-well-being-oregonians-w/).

2 "Income" here is based on Oregon Department of Revenue data on adjusted gross income.

3 Here, wage levels correspond to percentiles. "High-wage" refers to the 80th percentile, meaning the worker whose wages were higher than 80 percent of all workers (and lower than 20 percent of all workers). "Median" refers to the worker in the 50th percentile, with half of Oregon workers earning more and half earning less. And "low-wage" refers to the 20th percentile, meaning the worker whose wages are higher than 20 percent of all workers (and lower than 80 percent of all workers).

4 Capital gains income comes from the profitable sale of assets such as stocks, bonds and real estate.

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