STATE OF OREGON

Research Report

LEGISLATIVE REVENUE OFFICE

143 State Capitol Building
Salem, Oregon 97301

(503) 986-1266

Research Report #4-12 **October 2012**

MEASURE 85

Introduction and Summary

Measure 85 is a constitutional amendment that will appear on the November 2012 ballot. When actual corporate income and excise tax revenue exceeds the close of legislative session estimate by 2% or more, Measure 85 will allocate the corporate revenue in excess of the forecast to the state General Fund for purposes of funding K-12 public education. When the 2% corporate kicker trigger is met under current law, revenue above the forecast is returned to corporate taxpayers through an income tax credit.

The history of the 2% kicker can provide a means of projecting the potential revenue impact of Measure 85 over time. Based on the entire sixteen biennia history of the corporate kicker, the average revenue impact for the coming four biennia is $124 million per biennium. Using this same period as a guide, there would be excess corporate revenue every other biennium. Based on the more recent seven biennia historic period, the revenue impact and the frequency of excess revenue is somewhat less with revenue averaging $100 million per biennium and excess revenue occurring about 29% of the time.

Although Measure 85 allocates the incremental revenue to K-12 spending, it is uncertain what the net effect of the measure will be on the overall General Fund/Lottery budget, including K-12. There is no guarantee that the Legislature will allocate future budgets such that K-12 spending is increased by the exact amount of revenue sporadically generated by Measure 85 from what it would have been in the absence of the measure. It is likely that K-12 spending will be higher as a result of Measure 85 but the amount of the increase ultimately depends not only on the revenue impact of Measure 85 but also on the forces influencing the various components of the General Fund/Lottery budget in the future.

This report is divided into three sections. The first section provides background on how the 2% surplus corporate kicker works and a brief history of the corporate kicker since its inception. The second section examines the potential state revenue implications of the measure. Section 3 explores the possible impact of the measure on the state budget.

Background

The corporate kicker was first approved by the Legislature in 1979 as part of a major fiscal reform package. It was designed, along with the much larger personal kicker, to serve as a revenue limit. This means that the kicker does not directly affect state spending but rather reduces the revenue available to spend. The fiscal package developed by the 1979 Legislature, also contained a separate spending limit along with a major property tax relief program.

The latter was the primary focus when the package came before voters on the May 1980 primary ballot. The package was overwhelmingly approved.

The concept behind both kickers is to limit revenue when actual collections exceed the level projected when the Legislature approves the 2-year General Fund budget. The Legislature set a threshold or trigger of 2 %, meaning that actual revenue had to exceed projected revenue by 2% or more for the kicker to be triggered. However, when the 2 % threshold is met, the entire amount of collections above the forecast is returned to taxpayers. Since the kicker cannot be calculated until actual revenue for the biennium is known, the revenue impact on the state General Fund occurs in the biennium following the one in which the kicker is triggered.

Table 1 provides a comparison of how the corporate kicker works under current law and how it would change with the passage of Measure 85.

Table 1: Corporate Kicker Calculation under Measure 85

	Current Law	Measure 85
Calculate Base	When legislative session ends, combine latest corporate income tax forecast* for upcoming biennium with any Legislative changes that affect corporate income tax revenue to produce close of session forecast	Same
Compare Actual with Base	Following the end of a biennium, compare forecast with actual corporate income tax collections.	Same
Check 2% Trigger	Is actual corporate income tax revenue 2% or more above the close of regular session estimate? Yes—calculate amount of excess No—Stop, there is no kicker	Same
Allocate Excess Revenue Above Forecast	Divide excess revenue by total corporate income tax liability from the prior year. Corporations use this percentage to calculate their corporate kicker tax credit when they file their next income tax return.	Legislature allocates excess corporate revenue to K-12 public education.

*Excludes certain portion of corporate minimum tax that is a flat amount.

In summary, the corporate kicker calculation will remain the same. However, when the corporate kicker is triggered under Measure 85, the amount above the close of session forecast will be allocated to K-12 public education. This allocation will take place in the biennium following the one in which corporate revenue exceeded the estimate by 2% or more.

Although the corporate kicker was first approved by the 1979 Legislature, the first corporate kicker credits did not get allocated until after the 1983-85 biennium. This is because the Oregon economy entered a deep recession in 1980 and did not begin to recover until 1983. As a consequence, corporate income tax collections came in well below the close of session forecast in both the 1979-81 and 1981-83 biennia. The 2% corporate trigger was then exceeded in six of the next seven biennia. However, in the following seven biennia running through 2009-11, the 2% threshold has been surpassed only twice as the national and Oregon economies have weakened.

A complete history of the corporate kicker running from the 1979-81 biennium through the 2011-13 biennium can be found in Table 2.

Table 2: Corporate Kicker History

Biennium	Close of Session Forecast (millions)	Actual Corporate Collections (millions)	Difference (millions)	% Difference	Allocation of Excess Revenue
1979-81	$358	$333	-$25	-7.0%	No Excess Revenue
1981-83	$348	$249	-$98	-28.3%	No Excess Revenue
1983-85	$285	$299	+$13	+4.7%	Credit Allocated
1985-87	$291	$298	+$7	+2.3%	Credit Allocated
1987-89	$288	$325	+$36	+12.6%	Credit Allocated
1989-91	$320	$297	-$23	-7.2%	No Excess Revenue
1991-93	$337	$355	+$18	+5.3%	Credit Suspended
1993-95	$409	$576	+$167	+40.1%	Credit Allocated
1995-97	$428	$684	+$256	+59.8%	Credit Allocated*
1997-99	$658	$589	-$69	-10.4%	No Excess Revenue
1999-01	$799	$755	-$44	-5.5%	No Excess Revenue
2001-03	$860	$420	-$439	-51.1%	No Excess Revenue
2003-05	$540	$641	+$101	+18.7%	Credit Allocated**
2005-07	$500	$844	+$344	+68.8%	Credit Suspended***
2007-09	$921	$685	-$236	-25.7%	No Excess Revenue
2009-11	$832	$828	-$4	-0.5%	No Excess Revenue

*Credit allocated totaled $203 million. Legislative action reduced the credit by adjusting the calculation through passage of SB 1161 in the 1996 special session.
**The 2003 close of session estimate included $146 million in corporate revenue resulting from passage of HB 2152. However, HB 2152 was referred to the ballot by citizen petition (Measure 30) and defeated. Despite the failure of Measure 30, corporate tax collections still exceeded the close of session estimate by more than 2%.
***The 2007 Legislature allocated $319 million to the Oregon Rainy Day Fund and the remaining $25 million of excess revenue to small corporations based on sales.

The history of corporate tax collections compared to the close of session forecast, upon which the kicker is based, shows the extreme difficulty in accurately forecasting corporate income tax revenue. The standard deviation based on the variability in the percentage difference between the forecast and actual revenue is 31% for the 1979-81 to 2009-11 period. Despite this wide margin of error, the total deviation of forecast from actual corporate revenue is only +$4 million for the entire period. In other words, overestimates and underestimates almost exactly offset over the long term. This indicates that while the forecast for individual biennia are often not very accurate, over time the forecast is unbiased meaning it does not show a systematic tendency to be too high or too low.

Why is corporate income tax revenue so difficult to predict? The corporate income tax is based on net income. Net income, or corporate profits, is the difference between two much larger numbers—total revenue of the corporation minus total costs. This means that relatively small changes in either total revenue or costs can cause a large percentage change in net income. Net income can and often does swing from positive to negative for many corporations (even large ones) over the course of the business cycle. Again the result is large, difficult to predict percentage changes in net income and therefore corporate income tax revenue. Further volatility results from the relative narrowness of the state corporate income tax base. Oregon can only tax those corporations that meet the federal definition of presence in the state. If a corporation does meet these criteria, Oregon bases its tax liability on the proportion of the corporation's national sales that can be attributed to Oregon. In the 2008 corporate tax year, the 29 largest corporations in terms of net income (out of 32,460 C-corporation taxpayers) paid 26% of total corporate income taxes. Changes in the fortunes of these key taxpayers can also be a source of unpredictable swings in corporate tax collections. Finally, the state offers tax credits for activities such as research and development and renewable energy manufacturing facilities to encourage investment in the state. These credits often have carry forward provisions, meaning they can be used in future years. Since the credits directly offset corporate tax payments, their use and timing influences net corporate tax collections and must be accounted for in the forecast.

When reviewing the history of the corporate kicker, actions of the Legislature should also be taken into account. The history of legislative action falls into two distinct periods. During the first period, lasting from 1979 through 2001, the kicker provisions were in statute only. This meant that the Legislature could alter the kicker law through simple majority action. In 1993 the Legislature voted to suspend the corporate kicker credit and retain the money ($18 million) for the General Fund. In 1996 (special session), the Legislature enacted SB 1161 which adjusted the kicker base for General Fund appropriations after the close of the regular session. A payment to the SAIF Corporation by the 1997 Legislature resulted in a $53 million reduction in the size of the corporate kicker credit following the 1995-97 biennium. In 1999, the Legislature referred Measure 86 to the November 2000 ballot. Measure 86 amended the constitution to include the main provisions of the kicker statute. This sharply reduced the flexibility of the Legislature to take action to modify the kicker starting in 2001. However the constitution does have a provision, whereby the Legislature with a 2/3 vote in each chamber can change or suspend the corporate kicker on a one-time basis. This occurred in 2007, when the Legislature redirected $319 million in excess corporate income tax revenue to the newly created Oregon Rainy Day Fund.

One final note regarding the corporate kicker involves historic differences between the amount of excess corporate revenue (above the forecast base) and the amount of credits that were actually returned to corporations. Prior to 2007, the corporate kicker credit percentage was determined by dividing the amount of excess revenue above the forecast by the estimated total corporate tax liability for the **current year.** Since the "current year" was not complete (the estimate is carried out in August and corporate tax returns come in with a long lag), the total liability estimate could be off by a considerable amount. During years when corporate profits were overestimated the credit would be too low to return all the excess revenue through the credit. The opposite occurred in years when corporate profits were underestimated. This disconnect was largely corrected in 2007 with the passage of HB 3048 which changed the calculation so that the percentage credit is based on total corporate liability in the prior year—which is largely known by the time the kicker is calculated.

Measure 85 Revenue Impact Estimate

As a matter of procedure the Legislative Revenue Office begins with the current law revenue forecast as the basis for preparing revenue impact estimates. The reason for this is that the current law forecast is, by design, the best estimate available and historically proven to be unbiased. Since the corporate kicker is based on upward deviations from the current forecast, this approach would lead to no revenue impact for Measure 85. However, a less conventional impact estimate can be prepared based on the history of the corporate kicker. This estimate should not be interpreted as an estimate for any particular biennium but rather as an expected value for the average biennial revenue impact over the long term. Due to the nature of the kicker calculation, the revenue impact will be zero for many biennia but potentially large in some biennia if history is an accurate guide.

Table 3: Measure 85 Revenue Impact Estimates

Historical Period	Percent Frequency	Excess Revenue as % of Corporate Revenue for Period	Average Projected Revenue Impact for Future Biennia: 2013-15 Through 2019-21 (millions)
1979-81 through 2009-11	50%	11.5%	$124
1997-99 through 2009-11	29%	9.3%	$100

Table 3 uses the history of the corporate kicker over two different time periods and then applies those proportions to the average corporate income tax forecast (September 2012 forecast) for the coming four biennia. For the sixteen biennia over the 1979-2011 period, the corporate kicker was triggered eight times with excess revenue totaling $942 million for the entire period. This number includes excess revenue above the forecast that was not ultimately returned as a credit due to legislative action. This is the appropriate number to use for projected estimates because under Measure 85 there is unlikely to be an incentive for the Legislature to make adjustments to the calculation. The total amount of excess revenue divided by the actual amount of corporate revenue collected from 1979 through 2011 was 11.5%. Corporate income tax collections are projected to average $1,073 million over the next four biennia starting with 2013-15. Using the 11.5% historical average produces an average per biennium revenue impact estimate of $124 million. The 2% corporate threshold has been triggered 50% of the time over the long term. Using this average means that revenue will average $248 million when the kicker is triggered.

This calculation is sensitive to the historic time period used. An alternative estimate can be developed using more recent history when surplus revenue has occurred less frequently. Table 3 shows an alternative based on the seven biennia between 1997 and 2011. During this seven biennia period, the 2% threshold was exceeded twice. However, due to the large amount of surplus revenue in the 2005-07 biennium, excess revenue totaled 9.3% of total collections for the period. Using the more recent time frame for the estimates produces a per biennium revenue impact estimate of $100 million and a less frequent but larger per occurrence estimate of $345 million.

In summary, the history of the 2% kicker can provide a means of projecting the potential revenue impact of Measure 85 over time. Based on the entire sixteen biennia history, the average revenue impact for the coming four biennia is $124 million per biennium. Using this same period as a guide, there would be excess corporate revenue every other biennium. Based on the more recent six biennia historic period, the revenue impact and the frequency of excess revenue is somewhat less with revenue averaging $100 million per biennium and excess revenue occurring slightly less than one-third of the time.

Budgetary Implications of Measure 85

Measure 85 amends the constitution by deleting the words “returned to corporate income and excise taxpayers” and replacing them with “retained in the General Fund and used to provide additional funding for public education, kindergarten through twelfth grade.” This language makes it clear that it is the intent of the sponsors of Measure 85 that excess corporate revenue, when it occurs, will be allocated to K-12 education. What is less clear is what will be Measure 85’s net impact on overall K-12 spending in the context of the state budget. To answer this some assumptions have to be made regarding how the addition of excess corporate revenue in certain future biennia will influence the overall budget decisions of the Legislature.

The 2011-13 General Fund/Lottery budget totals $14.785 billion. General Fund/Lottery spending on K-12 totals $5.715 billion or 38.7% of the overall budget. General Fund/Lottery revenue is projected to grow 10.2% per biennium on average over the next four biennia. A simplistic assumption would be for General Fund/Lottery spending on K-12 to grow at the same rate as the overall budget retaining its 38.7% share in future biennia. In this case, the incremental revenue resulting from Measure 85 ($124 million per biennium based on the long term average) would be in addition to a 10.2% average biennial increase in K-12 spending resulting from overall revenue growth.

There will be a wide variety of pressures affecting the budget in coming years and these pressures will influence different programs within the General Fund/Lottery budget in different ways. It is the task of the Legislature to allocate scarce resources among these competing needs. This means that the share of the budget going to K-12 will vary depending on the relative impact of these pressures. An alternative allocation assumption is that the Legislature views the revenue generated by Measure 85 in the context of the overall budget and in effect allocates the incremental revenue in the same proportion as the overall budget by decreasing the base amount. Under this assumption, K-12 would receive a net increase equal to 38.7% (its share of the pre-Measure 85 budget). This leads to a net increase in K-12 spending of $48 million on average (based on the long-term average estimate) over the next four biennia.

In conclusion there is no way to ensure that the Legislature will allocate future budgets such that K-12 spending is increased by the exact amount of revenue sporadically generated by Measure 85 from what it would have been in the absence of the measure. It is likely that K-12 spending will be higher as a result of Measure 85 but the amount of the increase ultimately depends not only on the revenue impact of Measure 85 but also on the forces influencing the various components of the General Fund/Lottery budget in the future.