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FROM	**Randall Pozdena, PhD • *pozdena@quantecon.com***
TO	**The Honorable Members of the Joint Committee on Tax Reform**
SUBJECT	**Taxing Corporations: The Unintended Consequences**

BACKGROUND

The Oregon legislature is looking for ways to fill what it believes is a $1.6 billion deficit forthcoming in the next biennium. Revenues are robust and growing rapidly, but the State has made spending decisions that have caused spending growth to outstrip revenue growth. For example, the State chose to greatly expand Medicaid using federal subsidies that were known at the time to be temporary. Additionally, the market conditions and the design of OPERS have resulted in a large, unfunded actuarial liability. Absent spending reforms, the State lawmakers must consider methods to increase revenues in the next biennium.

Oregon's tax revenues from corporate sources are a smaller share of total State revenues than is the case in many other states. Consequently, the budget discussions have focussed on increasing the tax burdens on corporations. A proposal to tax the gross receipts of large corporations advanced by special interests (Measure 97) failed at the ballot box in November 2016. Nonetheless, the notion of a gross receipts tax—albeit levied at a lower rate but on a larger base than proposed by Measure 97—seems to have appeal among some lawmakers.

THE OVERLOOKED ISSUE: CORPORATE AND INDIVIDUAL TAXATION ARE LINKED

The public discussion to date has largely overlooked the fact that corporate and personal taxation are not independent. Corporate cash flows are distributed, directly or indirectly, to individuals. Thus, increased corporate tax burdens will almost certainly result in lower individual income tax collections than would otherwise be the case.

The reason for this is straightforward. Businesses are not central banks; they cannot print money. Thus, if their tax bill increases, they have only three means of dealing with the resulting decline in cash flow:

- **Reducing the payments to their employees, suppliers, proprietors, and investors.** This reduces the incomes of these individuals, making them poorer. Although not all of these individuals are Oregon residents for income tax purposes, many are. The result is that if corporate tax burdens grow, there will be less income to tax at the individual income tax level. Conversely, if corporate taxes fall, there would be more income collected at the personal level. This is consistent with the fact that, in the past 32 years, the 4-year average correlations between corporate and individual tax collections have been negative over 90 percent of the time during that period.

- **Trying to raise prices to offset the increased cost of doing business.** Doing so is difficult in the increasingly mobile and competitive market for goods and services. Even if businesses succeed in raising some prices within Oregon, however, this *de facto* sales tax reduces the real (inflation-adjusted) incomes of Oregon consumers even for those spared the direct reductions in jobs and income.

- **Moving their businesses to a friendlier tax environment, with the strong likelihood that some of their labor will follow**. In previous work by me of the effect of Oregon taxation on interstate household migration, the corporate tax rate was the a statistically potent motivation for household migration.

THE IMPACT OF BUSINESS TAXATION ON PERSONAL TAX REVENUES: EVIDENCE

I focus on measuring the likely effects of increased taxation of business income on revenues from taxing individuals' incomes. This is done by looking at the historical record of how the corporate and individual income tax revenues have interacted in previous years.

Businesses tend to not react immediately to changes in their tax burdens. Thus, it is necessary to allow the interaction between the corporate and individual tax revenues to play out over time. This requires what is referred to as a *dynamic* model to measure the impacts. I applied such a model to 66 years of Oregon individual and corporate income tax collections, while also controlling for the ebb and flow of other sources of revenue. I found the following effects of increasing corporate taxes for each *one-time* $500 million dollar levy:

- **Within three years of imposing a $500 million tax, individual income tax revenues will decline cumulatively by approximately $55 million, relative to what otherwise would have been the case.** This effect would, of course, be scaled up accordingly if the burden is larger than $500 million. Raising $1.5 billion, for example, would lead to a reduction in individual income tax revenues of $165 million.

- **It appears that the lost personal income tax revenue can continue to accumulate beyond three years**. Indeed, my analysis suggests it is possible for a one-time $500 million tax to have cumulative effects as large as $120 million over a 10-year period. Because the statistical significance of such long-term effects is weak, however, these persistence effects of a *one-time* levy are not certain.

- **The negative impact of increased business taxes on individual income tax revenues is *causal*––i.e., it is not just a happenstance correlation.** Additionally, it should be noted that the share of total taxes that is paid by individual taxpayers declines by more than can be explained by the increased obligations of corporations alone.

- **My estimates are consistent with the job losses forecast by the LRO tax model.** My model forecasts income tax revenue impacts only. However, if the LRO model's estimates of net job losses per dollar of gross receipts revenues are correct, about half of the revenue losses I forecast would come from net job losses. The other half are from reductions in incomes received by those who continue to be employed by the affected corporations.

CONCLUSION

The notion that Oregon corporations have not been paying their "fair share" relative to households is an accounting illusion, since businesses' and households' well-being and incomes are interdependent.

- Oregon corporations are the source of the much of the incomes that households receive, in addition to providing them with affordable goods and services.
- That is why the proposed taking of corporate cash flows will be manifest in lower incomes to Oregonian households, and higher costs of goods and services in the state. It will also create incentives for businesses and individuals to leave the state.
- The State itself will suffer weaker revenues from the tax policy than it anticipates, aggravating the problem it hopes to solve.

Lawmakers have to consider carefully whether the programs that the State hopes to sustain are worth the imposition of these burdens on Oregonians and the future prospects of the state economy.

ABOUT THE AUTHOR

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