Measure Number: IP 17

Subject: Oregon Rebate

Government Unit Affected: State of Oregon, local governments

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This memo is updated after initial discussion from the July 18, 2024 Financial Estimate Committee Meeting. Updates are noted as underlined.

Summary

Initiative Petition (IP) 17 creates the Oregon Rebate program, which will be partially funded with a new corporate minimum tax equal to 3 percent of corporate sales above $25 million. The rebate program will distribute the net revenues from the new tax to Oregon residents in equal amounts annually. (Based on a recent Legislative Counsel opinion, the cost of the rebate program will exceed the net, new revenue raised by the initiative.) The new program will be administered by the Oregon Department of Revenue and will have a financial impact of $1.6 million in the 2023-25 biennium and $12.0 billion to $13.6 billion in the 2025-27 biennium. Based on discussions at the Financial Estimate Committee on July 18, 2024 and updated information from Legislative Council to the Legislative Revenue Office, the biennial impact for 2025-27 is $13.6 billion. And for the 2027-29 biennium, new revenue is estimated at $17.1 billion.

Estimated State Financial Impact:

The new corporate minimum tax of 3 percent on sales above $25 million will increase General Fund revenues by $1.3 billion in 2023-25 and $14.7 billion in 2025-27, and $15.6 billion in 2027-29. This assumes the following:

- The current process for filing and paying the corporate income tax will be used;
- Revenues will be deposited into the General Fund;
- Taxpayers will not fully anticipate their liability for tax year 2025 and will make up the difference with return payments in 2026;
- 1 percent of revenues are taken off the top for administrative expenses;
- The new minimum tax is effective January 1, 2025; and
- S-Corporations will respond to the new minimum tax by lowering pass-through payments rather than by increasing prices or reducing costs to maintain the same level of profitability

The increase in this tax will reduce the availability of General Fund resources due to its interactions with existing tax and transfer programs. This is expected to reduce General Fund resources by $23.0 million in the 2023-25 biennium and $0.2 – 1.8 billion in the 2025-27 biennium, depending on further legal analysis. Based on the updated information and committee discussion, the 2025-27 impact is $0.4 billion. These interactions would reduce payments from the insurance retaliatory tax, the personal income tax, and reduce transfers from the General Fund to statutory reserve funds, the impacts of which are described below:

- The corporate tax consists of a minimum payment structure and a rates-based calculation. After calculating taxable income and applying the appropriate tax rate to the calculation, the resulting amount is compared with the minimum tax and the final tax liability is whichever is the higher. Increases in the minimum tax under IP 17 will result in more taxpayers who would have paid under the rate-based calculation to pay the minimum tax instead. Sections 2(1), 3(1)(a), and 3(2) refer to the "increase in corporate minimum tax revenue" attributable to the measure. Based on the above, there are two competing ways to understand this language. One interpretation would be that this language refers to revenues from only the minimum tax, which would result in a reduction of General Fund resources of $1.6 billion and rebate payments of $13.6 billion. A second interpretation would be to include the revenue effects of IP 17 on both the rates and the minimum tax, in which case the rebates are estimated at $12.0 billion. Per discussion and input at the July 18 meeting, the draft financial impact statement reflects the above $13.6 billion interpretation.

- The increased tax will reduce revenues from Oregon's insurance retaliatory tax and Personal Income Tax to the General Fund. The insurance retaliatory tax is calculated based on non-Oregon based insurers paying the same tax burden in Oregon as Oregon-based insurers would face in those non-Oregon based insurers' home states. When Oregon taxes on insurers increase, including through IP 17, the tax revenues received by Oregon from this tax decrease as a result. The increased corporate minimum tax on S-Corporations may result in reduced Personal Income Tax revenue to the General Fund. This is because the tax at the S-Corporation level will directly result in less income paid to shareholders. The net impact of these changes is expected to be approximately $23 million in the 2023-25 biennium and $348 million in the 2025-27 biennium.

- The expected increase in taxpayers paying the corporate minimum tax will also reduce transfers from the General Fund to the Rainy Day Fund. Under ORS 317.853 and ORS 318.074, 0.4 percentage points of the revenues derived from the 7.6 percent corporate income tax rates are deposited into the Rainy Day Fund. IP 17 will result in more taxpayers paying the minimum tax and will greatly reduce taxpayers paying the 7.6 tax rate. Rainy Day Fund transfers from this source are estimated at approximately $100 million per year. Offsetting this General Fund savings is that the state is expected to transfer 1.0 percent of General Fund expenditures to the Rainy Day Fund in the following biennium. This will modestly increase transfers from the General Fund to the Rainy Day Fund starting in 2027-29. The net of these two effects would be an increase in the amount of available General Fund.

- The increase in tax revenue to the General Fund would also impact Oregon's kicker calculation for the 2023-25 biennium, which will be paid during the2025-27 biennium. This is because the additional revenues from the new tax were not anticipated at the time the 2023-25 biennium end of session revenue forecast was adopted. Starting with the most recent revenue forecast from May 2024, it is estimated that this would result in an additional corporate kicker of $1.3 billion in the 2025-27 biennium where the kicker is retained in the General Fund for K-12 education.

These revenue impacts are assumed to not offset the revenues for the Oregon Rebate but rather to reduce the state's discretionary resources. Another potential revenue impact considered was the impact of Article IX, Section 3a of the Oregon Constitution, which dedicates taxes from the sale of motor fuel to the State Highway Fund. An initial analysis assumed that revenues from the new minimum tax structure derived from the sale of motor fuel would have to be transferred to the State Highway Fund and would be included in the rebate calculation, with an estimated impact of $631 million of revenue during the 2025-27 biennium. Our analysis relies on advice from the Oregon Department of Justice, who argue that Article IX, Section 3a would not apply to revenues from the new minimum tax based. This opinion draws from an Oregon Supreme Court case from 2018 regarding the use of revenues from motor vehicle sales and use taxes passed by the 2017 legislature. Those taxes related to motor vehicles were not deposited into the State Highway Fund. The Supreme Court affirmed their use. Their opinion limits the applicability of Article IX, Section 3a to new general-purpose taxes such as the one proposed by IP 17.

The program is estimated to have a direct financial impact of $1.6 million in the 2023-25 biennium and $12.0 billion to $13.6 billion in the 2025-27 biennium. The measure has four main sources of direct expenditure: 1) the Oregon Rebate payments; 2)'hold harmless' payments for participants in programs with income limits whose eligibility is affected by the payments (Section 4 (2)); 3) distributions to state agencies from declined rebates (Section 2 (4)(e)(A)); and 4) administrative expenses. While not all the expenditures can be directly estimated, the analysis assumes based on the language of the measure that items 1-4 will be limited to the total new corporate minimum tax revenues.

Revenues	$14.7 billion
Oregon Rebate Payments and Hold Harmless Payments	$12.0 - $13.6 billion*
Declined Rebate payments	Indeterminate, but would reduce Oregon Rebate Payments
Administration	Indeterminate, but includes at least $48.0 million in known costs

<u>*Per discussion and input at the July 18 meeting, the draft financial impact statement reflects the above $13.6 billion interpretation. After initial implementation, the costs of the program are expected exceed revenue impacts.</u>

The Oregon Rebate Payments and Hold Harmless Payments

The measure directs the Department of Revenue (DOR) to pay an equal rebate to each individual in Oregon who has lived in the state for 200 or more days (with some exceptions) each year. The rebate may be claimed either on an individual income tax return on a non-tax application made to DOR. The first such rebate payment will be made in 2026 based on revenues collected in calendar year 2025. The estimated fiscal impact of the Oregon Rebate payments is between \$12.0 – \$13.6 billion in the 2025-27 biennium depending on how the language around the size of the rebate pool is interpreted. Per discussion and input at the July 18 meeting, the draft financial impact statement reflects the above \$13.6 billion interpretation.

This assumes the following:

- The cash flow of tax revenues will exceed the total amount of rebate payments made in a given biennium (as long as tax revenues increase year over year) because the revenues are received in a given calendar year and paid out in the next year. Aside from this timing factor, DOR is not assumed to maintain a balance related to implementing the measure, as hold harmless payments and declined rebate payments are indeterminate.
- Rebates claimed on a tax return are counted here as a financial impact even though, consistent with individual income tax refunds and the state's kicker credit, they are not expenditures to the state but are treated as reductions to available revenue.

The measure directs the Oregon Department of Human Services (ODHS) to request federal permission to exclude the Oregon Rebate from calculations of income used to determine participation in Medicaid, Temporary Assistance for Needy Families (TANF), Supplemental Nutrition Assistance Program (SNAP), and other need-based program funded with federal funds. If the federal government does not approve such waivers, DOR is instructed to reimburse those found ineligible in an amount equal to their benefit reduction. The measure says that the hold harmless payments are to be funded by revenues from the new corporate minimum tax. This would reduce the amount available for rebates under the Oregon Rebate program, but the effects are indeterminate.

ODHS reports that the US Department of Agriculture doesn't have the authority to waive SNAP eligibility requirements, meaning that SNAP beneficiaries whose receipt of the Oregon Rebate puts them over income for the program would need to receive a hold-harmless payment. ODHS estimates this could cost up to \$2.5 million per month for those affected, but costs for other programs (and likely outcomes of federal waiver requests) are unknown. The Oregon Health Authority (OHA) reports that federal income qualification rules are not waivable for Medicaid participants, so it is likely hold harmless payments would be needed for those who lose eligibility due to increased income. OHA's Women, Infants and Children nutrition program similarly does not have the ability to request authority to waive income requirements. Timing also makes the effect indeterminate, as Medicaid enrollees are eligible for two-year continuous eligibility, meaning higher income due to the Oregon Rebate might not show up in terms of an adverse eligibility determination until years after the income is first received. As a result, the impact could possibly be pushed into the 2027-29 biennium. It's also not clear how DOR is supposed to value the reduction in benefits for those whose benefits not valued in cash, for instance for those enrolled in Medicaid.

The state provides services to citizens on the basis of income where it is state or local (rather than federal) rules which determine eligibility. The measure exempts Oregon Rebate income from ORS 411.010 (eligibility for ODHS programs) and ORS 414.025 (eligibility for medical assistance programs at OHA) but it is possible there are additional programs not covered by the measure that use income to determine eligibility and program participation. A full legal and programmatic review has not been undertaken, but a preliminary review suggests the Senior Deferral Program administered by DOR and the Employment-Related Daycare Program administered by the Department of Early Learning and Care might not be covered by this provision. This would mean potential increases in a participant's income due to the Oregon Rebate could result in savings to such programs as people who qualified at their previous income become ineligible. The financial impact of these changes is indeterminate and more time would be needed to analyze the full scope of such impacts statewide.

Separate from the ability to waive income requirements to federal programs, it's possible that there would be budgetary savings to the state due to transfers within OHA's Medicaid caseload due to higher federal match rates for some enrollees with higher incomes and lower benefit levels for some enrollees as their incomes increase. These effects are indeterminate at this time due to many unknowns about the implementation of the measure. There also may be state savings to joint state-federal programs where the state provides matching funds due to hold harmless payments. For example, if the federal government pays approximately 60% of the cost of providing Medicaid benefits, with the state paying the rest, and that person loses their eligibility due to the Oregon Rebate, the state would save 40% of the cost (on net), as the hold harmless payments reduce the amount available for Oregon Rebate payments. .

<u>Declined Rebate Payments</u>

Section 2 (4)(e)(A) of the measure allows citizens to decline to receive a rebate they are eligible for. In the case of rebates that are declined, funds are restricted to providing additional funding for services for senior citizens, health care, public early childhood education and public kindergarten through 12th grade education. Funds from declined rebates are supposed to be deposited into a 'program fund' for the rebate program but the measure does not appear to create such a fund. The effect of this provision is indeterminate at this time as it is unknown how many citizens will decline to receive a rebate.

<u>Administrative Costs</u>

DOR, who will collect the tax payments and administer the benefit payments, anticipates its costs will be $1.6 million General Fund and 22 positions in the 2023-25 biennium and $48.2 million General Fund and 199 positions in the 2025-27 biennium to administer IP 17. Other Department impacts are indeterminate at this time but could be significant. For DOR in the costs for the 2023-25 biennium include IT staff to begin to make changes to the Department's tax administration software and website to be able to be able to process rebate applications, policy staff to develop program rules and additional human resources staff to assist with staffing up for the workload anticipated during the 2025-27 biennium. During the 2025-27 biennium, DOR anticipates a significant workload related to processing applications for the rebate, verifying the identity and eligibility of those applying for the rebates, review payments and tax refunds for fraudulent activity, handle appeals, customer service, and processing for this major new program, increasing audit and collections activity for the new tax, and IT project activity to update tax administration software and DOR's website, resulting in a need for 199 total positions. Other major administrative expenses include payments for rebate checks, prepaid debit cards and mailings associated with the program, attorney costs for program reviews, and advertising and outreach to inform the public of the new program.

Major assumptions include:

- Most rebate applications will be made via individual income tax returns or the department's website (Revenue Online).
- 60 percent of rebate payments will be made via direct deposit, with the remainder made via prepaid cards or checks.
- Workload in processing, identity verification, refund reviews, customer service and appeals will all increase substantially due to the workload related to the rebates and hold harmless payments.
- DOR will incur significant costs related to postage and checks as a result of the correspondence required to administer the rebates and hold harmless payments.
- Eligibility determinations for hold harmless payments will be made by DOR and will require self-attestation and the establishment or modification of an information system to handle and review documentation. These costs are indeterminate at this time.

ODHS and OHA both have identified indeterminate costs to implement IP 17. While each agency has identified preliminary costs for modifying information systems to accommodate the hold harmless program, the estimates are preliminary and not comprehensive. Changes to the state's Integrated Eligibility application, which handles eligibility for many income-based state benefits, could be significant. OHA has identified preliminary costs related to modifying the information system supporting the Women, Infants and Children program of $1.0 million for the 2023-25 biennium and $1.6 million in the 2025-27 biennium.

Major assumptions include:

- Hold harmless payments and eligibility determinations will be administered by DOR. Costs to change the information systems administered by ODHS and OHA to support DOR in its eligibility determinations are indeterminate but could be significant.
- Costs for additional eligibility staff for ODHS to provide customer service to individuals with eligibility issues as a result of the Oregon rebate are indeterminate pending additional analysis and information on the success of the waivers requested.
- Administrative costs for OHA and ODHS will reduce the amount available for rebate payments per Section 3(1)(c) of the measure.

Estimated Local Government Financial Impact:

The measure may have a revenue impact on local governments who rely on corporate income taxes. Our office is aware of the City of Portland, Multnomah County and Metro as relying on business taxes based on net income, but there could be other local governments with such taxes. There is no direct revenue impact to local government, as all three taxes are calculated using net income as a starting point and none of the three allow for the deduction of corporate income taxes paid to the State of Oregon in calculating income. The indirect revenue impact to local government is indeterminate. The City of Portland and Metro both noted concerns about the total tax burden to local businesses if IP 17 passes. The direct expenditure impact is also indeterminate and will depend on the extent to which local governments provide services to residents on the basis of income. The additional income provided by IP 17 could result in savings as fewer people would be eligible for those services.

Indirect Economic Effects

The Legislative Revenue Office used an economic model to analyze the effects of the tax changes caused by IP 17 on Oregon's economy. The model compared a baseline scenario assuming no revenue change to a scenario in which IP 17 passes and looks at the expected changes over a five year period to show the expected difference by 2030. The major findings are summarized below:

- Personal income in 2030 will be 0.71% lower than it otherwise would have been without IP 17
- Employment in 2030 will be 0.99% lower <u>than otherwise projected</u>
- Prices in 2030 will be 1.3% higher <u>than otherwise projected</u>
- The measure will have a modest effect on wages (0.05% lower) and population (0.05% lower) <u>than otherwise projected</u>

Draft Estimate of Financial Impact:

The measure establishes a new gross receipts tax as the minimum tax for certain corporations. The tax is estimated to increase prices by 1.3 percent. Corporate tax revenues are estimated to increase by $1.3 billion in 2023-25 and $14.7 billion in 2025-27.

New revenue raised will be used to issue annual rebates to Oregon residents. Administrative costs and any additional payments will be deducted from amount to be distributed. Individuals who lose federal benefits because of the rebate will be held harmless with additional payments. Roughly $12 billion to $13.6 billion will be available for distribution in 2025-2027.

Savings from rebates not claimed will fund services for senior citizens, health care, and education. The impact from the savings is unknown.

Existing General Fund revenue will be reduced by a reduction personal income tax revenue. The corporate kicker will increase and transfers from the General Fund to the rainy day fund will be reduced.

Impact to local governments is unknown.

Updated for July 25, 2024 Meeting

The measure establishes a new gross receipts tax as the minimum tax for certain corporations. According to the Legislative Revenue Office, indirect economic costs of the measure include a 1.3 percent increase in prices of goods and services and reductions in jobs, wages and personal incomes. Corporate tax revenues are estimated to increase by $1.3 billion in 2023-25, $14.7 billion in 2025-27, and $15.6 billion in 2027-29.

New revenue raised will be used to issue annual rebates to eligible individuals in Oregon. An estimated $13.6 billion will be required for rebate distributions in 2025-2027 and an estimated $17.1 billion will be required in 2027-29. Administrative costs and any additional payments will be deducted from the amount to be distributed.

Individuals who lose federal benefits because of the rebate will be held harmless with additional payments. The costs associated with this provision are unknown.

Rebates that are declined by eligible individuals will be available to fund services for senior citizens, health care, and public early childhood education through high school. The impact from these declined rebates is unknown.

Following the initial phase-in, total biennial costs of the rebate program are expected to exceed the new biennial revenue. Estimated indirect impacts on personal income tax revenue are reductions of $12 million in 2023-25, $199 million in 2025-27, and $207 million in 2027-29. Lastly, changes to the economy are projected to reduce state revenue by roughly $11 million in 2023-25, $150 million in 2025-27 and $400 million in 2027-29.

The corporate kicker will increase by an estimated $1.3 billion in 2025-27, and transfers to the Rainy Day Fund from the General Fund will be reduced.

Impact to local governments is unknown.