Speaker 1 (00:01):

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Jared Walczak (00:16):

It's deceptive. It sounds slow, and it's actually something that's unprecedented. We've never seen a tax this high.

Nikki Dobay (00:28):

Hello, and welcome to GeTtin' SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, shareholder in the Portland, Oregon, and Sacramento, California offices. Very pleased today to be joined by a good friend and colleague, Jared Walczak. Jared is the Vice President of Tax Policy at the Tax Foundation. Sorry, I'm like Jared's been on the show so much, and most people know him. He needs no introduction. But he's a wonderful person to listen to in the state tax policy space. So Jared, thank you so much for joining me today.

Jared Walczak (01:07):

Well, thank you for having me again.

Nikki Dobay (01:07):

And Jared, we are going to be talking about a topic we've talked about a few times, Oregon. Being a person that lives in Oregon and does a lot of policy work in Oregon, tax policy work in Oregon, I always feel like at some point we're just going to exhaust all the bad ideas, but turns out we haven't. So we are today going to be talking about a new ballot measure that is very likely to be on the ballot this November, and currently it is known as IP17 or Initiative Petition 17. And so Jared and the Tax Foundation put out a great piece on this and we're going to talk through it. So to get started, I'll just give a brief overview of what IP17 is. This is a measure that will change Oregon's minimum corporate tax. Currently, Oregon has a corporate income, we call it our excise tax, as well as the corporate activity tax, which is a gross receipts tax as well.

(02:12):

And for purposes of the excise tax, a company pays either the greater of their corporate income tax or a minimum tax. Currently, that minimum tax is capped at $100,000 and the amount you pay is based on your gross receipts or gross sales in Oregon. What this measure will do is change that minimum tax structure so that if you are a company with sales in excess of $25 million or more, your minimum tax will now be calculated based on 3% of your Oregon sales. So pretty significant change and there's no cap, so the cap goes away and you pay that 3%. Jared, by my calculations, pretty much any company with more than about $35 million of Oregon sales is going to be flipped from the income tax regime into this minimum tax regime. And those are very rough numbers. I'm sure your numbers are much more precise. So tell me why you think IP17 is such a bad idea?

Jared Walczak (03:22):

Well, it's a really bad idea, and I think that it's easily misunderstood. If you look at some of the language surrounding this, it actually sounds pretty modest, right? The measure itself is called the Oregon Corporate Tax Revenue Rebate for Residence Initiative. And if you look at the website for this, it talks about this modest tax on businesses. There's this language that corporations pay less than 1% in Oregon tax. I think my question would be in what Oregon tax? There's a 7.6% corporate income tax, there's gross receipt tax, what taxes less than 1%? But I think what they're doing is they're taking that existing minimum tax and they're saying, okay, well, that's not actually that significant now, like setting aside all the other taxes the corporations pay, including again, the corporate income tax,. And they're saying, well, the minimum tax, it has these levels where there's dollar amounts and that's not that significant.

(04:11):

So that's less than 1% make it sound like that's the only thing. And now we're going to just raise that a little. But what we're talking about here when we talk about a 3% tax, this isn't like an alternative minimum tax in any other state because there are states that have corporate AMTs and they basically strip away some of the benefits that businesses receive, some of them entirely appropriate. We're talking about net operating loss provisions, we're talking about credits that may be properly earned, but we're still talking about saying, okay, there is a minimum amount that companies need to be able to pay every year on their net, even if ordinarily they get the benefit of the other provisions That's not we're talking about here. We're talking about a percentage on their gross. So this 3%, it sounds reasonable, right? 3%. That doesn't sound like a lot, but when we think about this on gross revenue, not net income, let's take a company that makes say 7% profits every year because sort of an ordinary rate of return.

(05:06):

And now if you have a 3% gross revenue or gross receipts tax on that, that's like the equivalent of a 43% corporate income tax on that business, and that's on top of some of the other taxes that are out there. Now, this would be in lieu of their existing corporate income taxes that swamps it. An additional one. But if you're in Portland, well, Multnomah County, you've got other taxes. You have 6.6% in other business income taxes. You've got your federal one, we're talking it all in 77.2% rate, which is just outlandish. And obviously there'd be a lot of modification, you would see a lot of activity moving out of state, and we can talk more, I'm sure about the reasons and the ways that you see a response to this, but this, it's deceptive. It sounds slow, and it's actually something that's unprecedented. We've never seen a tax this high.

Nikki Dobay (06:00):

Well, let's unpack several things there. One, I want to go back to this idea that the proponents are saying our corporate minimum tax is very low, and I would argue that for a corporate minimum tax, which is just an alternative, again, a company's going to pay this only if their general income tax is below one of these levels that the corporate minimum tax is set at currently, which is capped at $100,000. But that's a pretty significant minimum tax. I mean, when this changed in Oregon, I think it was in 2000, the mid [inaudible 00:06:38], I mean our corporate minimum tax was $10 because it had been set when the corporate tax was put in place. And so, okay, at that point, a $10 minimum tax seems incredibly low, but people were outraged when it went up to $100,000 because that's even a high minimum tax. Again, this isn't the AMTs that you're talking about. This is just an alternative to if a company's in a lost position in Oregon, they're still going to pay a significant chunk of money.

Jared Walczak (07:10):

Yeah, absolutely. And there's this element where this is an unusual provision to begin with. There are only a handful of states that have AMTs and that still requires some sort of profits. There's some net income there. This minimum tax is regardless of profitability, you can have losses. In other states, you might see that almost as like a filing fee, right? We're talking about very small amounts. 100,000 if you are in a negative position is very meaningful. But what you're seeing here is I think some calculations saying, okay, there's a scenario where you're paying 100,000 and you do have some level of profits, so let's yield at a low rate on that. And they're acting as if this is the tax regime, but this minimum tax is sort of the only tax that exists on businesses and making it sound low as opposed to this is one more thing that Oregon imposes that other states generally don't impose in addition to all of the ordinary taxes on business.

Nikki Dobay (08:04):

So let's talk about all those ordinary taxes that Oregon imposes. So at the state level, we currently have our corporate income tax and then this minimum tax, and you pay the higher, the greater of the two. We have the corporate activity tax, and that's a tax paid by all taxpayers, not just corporations, and that is a modified gross receipts tax, but at 0.57%. So when we think about a CAT, we think about the Ohio CAT, that's 0.26%. So Oregon bumped it up. They juiced it up a little bit. And then there's a whole slew of other statewide excise taxes that any business could be subject to. We'll kind of put a pin in those.

(08:46):

But then to your point, in the Portland metro area, there is just a slew of business taxes. So I always like to tell we have three. Three corporate income taxes. If you are doing business in Portland, you are subject to three different corporate income taxes. There's the clean energy surcharge, which the Portland Revenue Division is aggressively asserting against most businesses, and then also a slew of other excise taxes. So I want to go back to that number you highlighted. I think I heard 77%. Come on, that can't be right.

Jared Walczak (09:20):

Yes. It's amazingly correct. So you take what really would be the effective rate of this tax, and then we think about the other taxes that a C corporation in Oregon operating at least partly in say the Portland area would face, and we're going to add a business license tax of 2.6%. There could be a business income tax of 2% supportive housing service tax of 1%, clean energy surcharge of 1%.

Nikki Dobay (09:45):

And that's on gross?

Jared Walczak (09:49):

Yeah, so you've got one on gross, you have the others on net, all of these being imposed. Then again, this tax and the gross receipts tax that you already have, the CAT, and this as you said, is a modified gross receipts tax. It has a 35% deduction for your choice of cost of goods sold or payroll or compensation. So that again, because it's a grocery seat tax also has a much higher effective rate on this business than just 0.57 would suggest and then add in the federal 21%, and we are at 77.2% for a business with 7% returns.

Nikki Dobay (10:27):

So many questions, not sure where to start. This makes me angry, and I'm not an economist, so how angry does this make you as an economist? I don't know if you've ever gotten that question before.

Jared Walczak (10:41):

I think I'm just concerned. If you're a Portland resident, if you're an Oregon resident, this is significant. I think you could go to the ballot and read some vague language about corporate minimum tax, a 3% tax and a rebate and think, "Hey, maybe this is a reasonably good deal for me." Who wouldn't like a rebate? I love rebates, and not realize what the effects are. So let's think of a couple of different effects here. One, because it's a 3% tax on gross, the final sale, when something is sold into Oregon to an Oregon consumer, there's a 3% tax on that. That's functioning pretty much like a sales tax in a state that doesn't have a sales tax and has made a priority not imposing a sales tax.

(11:21):

Because there's very little way to avoid that, most of it will be passed along to the consumer. Maybe pretty much all of it because no matter who you are, if you're a large C corporation, obviously small ones are outside of this, but a lot of things we buy come through large C corporations. If you're selling into Oregon, that's being imposed. So most of the incidents of that, because all the competitions facing the same thing is going to be born by the consumer, so get used to having a 3% sales tax that might not show up on the receipt.

Nikki Dobay (11:48):

On everything.

Jared Walczak (11:48):

But it's a 3% sales tax on everything, like you said. So sales taxes in other states have substantial exemptions. They may be exempt groceries, they exempt fuel, they might exempt clothing, they might exempt all kinds of categories of consumer goods.

Nikki Dobay (12:02):

Insurance, financial products.

Jared Walczak (12:04):

All of it.

Nikki Dobay (12:04):

All of it. Yep.

Jared Walczak (12:05):

Yeah, professional services, things like this. This is all being taxed now. Much broader than that, it's taxing all of the intermediate transactions. So it's not just the consumer element. When a business goes out and purchases any services, maybe you are a small business, you think, "Oh, I'm not part of this. I am not being taxed." But you focus on what you're good at and that's not doing your own accounting and payroll and it's not doing your own marketing or maybe some of your production is outsourced. All of those are points of contact with an outside system. There's a transaction going on that is subject to this. And that's where you get a lot of behavioral modification. If you are producing in Oregon and there are inputs that you are purchasing in Oregon, every layer of transaction is subject to this 3% gross receipts tax.

(13:01):

What this does is it encourages you to move as much of that as possible out of state or, and probably and, not just or, but, and to vertically integrate as much as possible so that more of your activity is in-house. The problem is if you're a large C corporation and you're based in Oregon or you're doing things in Oregon, maybe you can vertically integrate some of this and maybe you'll send a lot of it out of state.

If you are an Oregon business, maybe that's not directly subject to this, you have to buy things that are delivered in state because you are there. You can't easily avoid it other than just moving everything out of state.

Nikki Dobay ([13:37]()):

All your costs just went up.

Jared Walczak ([13:38]()):

All your costs went dramatically up and potentially pyramiding multiple times. And here's the problem, you might sell into a multi-state market and your competitors in other states are not facing these costs. You can't raise your prices commensurate with all of these additional taxes you're paying and expect to be competing with a company that's not facing this. This is unique. Other states don't have things like this, certainly not at this rate. So you're driving a lot of that activity out of state. The sales tax like portion of this, if you're an Oregon consumer, you can't really escape it. And if you're a business selling into Oregon, people are still going to buy goods and services in Oregon.

([14:17]()):

So it's not great. You've got a new sales tax, but probably those sales will continue to happen. But when we're talking about production, when we're talking about at every additional step or layer or chain of production, there's another 3% tax on gross, the more that you can shift that out of state, the better, and you're very likely to do that. For the small businesses that don't have an easy way to do that, I think this is potentially devastating.

Nikki Dobay ([14:43]()):

Well, I also think about all the businesses that are regulated and subject to various approvals for their rates and things like that, or there's other state laws capping what they can charge on various things, and I've heard from companies that they will consider not doing business in Oregon because they just won't be able to afford it. I mean, it won't make economic sense. And that is something that I think it's a hard message to get to voters. I mean, the very difficult thing about this is to you and I, this is a bad idea, we understand, but to voters, as you said, you see, oh, 3%, but I pay 9%. That's what most Oregonians pay. They don't realize that's a net income tax. This is gross. And then they see free money. And what I've been saying a lot is that check you're going to get is going to pale in comparison to the increased prices that Oregonians are going to face because this isn't going to be a 3% sales tax. This is going to be more like a 5%, 7% once the pyramiding happens on most goods.

Jared Walczak ([15:58]()):

Yeah, whenever there's a gross of these tax or a sales tax that's overly broad and includes a lot of business inputs, you have two things that can possibly happen. Either you can have pyramiding where it's embedded multiple times in the price and ultimately that's passed along to the consumer, or you can have a situation where it functionally turns into a production tax and it dramatically increases the cost of production in state in a market that may be multi-state and therefore, you are just making it incredibly difficult for businesses to operate in your state. It's like a capital tax, is a tax on doing business there that can be avoided by moving that production elsewhere.

([16:37]()):

And if you can't move it, well, your competitors have a huge advantage over you and suddenly even for sales in Oregon, it becomes more attractive to buy from an out-of-state firm that didn't have all of that intermediate production taxed because they can sell it to you at a better price or they'll drive the in-state firm out of business. Again, this applies to businesses that might initially look and say, well, I don't have anywhere near the revenue to be subject to IP17's tax. They're the ones that might be hammered the most.

Nikki Dobay (17:06):

So just to make sure this is crystal clear, while this ballot initiative is squarely attacking big, big $25 million or more in Oregon sales companies, it will have a significant impact on small businesses that by the words that are being changed in the statute will have no impact, but they're going to pay more.

Jared Walczak (17:32):

Yeah, absolutely. The modern economy, when we're not living in the 16th or 17th century where a business just sort of is fully self-contained and it's one of the traditional trades and they don't have to buy practically anything except maybe some raw materials. I mean, we are very integrated no matter who you are, you have a marketing campaign, you might, if you're say a small manufacturer, you have to handle packaging and delivery and shipping and processing. You need to have payroll software and you need accounting. You need databases for customer relations management. You might have consultants. There are lots of things that you need to buy to do business. If you have a building, there's facilities management. All of these things are costs that are part of your cost of doing business. You have to do them, and every time you make any of these purchases as part of your cost of doing business, it's subject to a 3% tax and that's going to add up really fast.

Nikki Dobay (18:26):

And what about on the service side? Because you've been very engaged in conversations on a national level on the sales tax and taxation of services and digital products, and the issue with taxing business inputs in that context and the design of the sales tax has various exemptions to try to not impose sales tax on business inputs. We've got a problem here.

Jared Walczak (18:55):

This is a sales tax that falls on basically all business inputs. That's the basic design of a gross receipts tax, and this is one that unlike the existing CAT, doesn't even have a deduction. So it's a very high rate, broad-based gross receipts tax. You mentioned Ohio's CAT, which the Oregon CAT was loosely based on. It's a 0.26% rate, like you said. Now, it doesn't have the deduction, so it's maybe more the equivalent of a 0.3 something if you would host it in Oregon. That said, Ohio does not have a corporate income tax. This was the replacement for that and several other business taxes. Oregon imposes a higher rate gross receipts tax plus a higher rate corporate income tax, plus a plethora of local and regional business taxes, and now we're discussing a 3% gross receipts tax, and that number is just massive. You look elsewhere, Nevada adopted a gross receipts tax a number of years ago.

(19:57):

They don't have a corporate tax, corporate income tax. I wish they didn't have a gross receipts tax, but its retail rate is 0.11%. Washington has what's generally considered one of the most aggressive gross receipts taxes. Also does not have a corporate income tax. This is in lieu of that. The retail rate is 0.484. The wholesale rate is a little lower than that. Basically everything is in that range. There's a few that are higher, but most things are taxed at a little under half a percent rate, and that's still damaging. It's way worse than the corporate income tax. It's been a longstanding problem there, but it's around half a percent. We're talking six times that here. I think the scale of this is mind-boggling and it's getting lost.

3% sounds very ordinary. I mean, states have much higher corporate income taxes. They have much higher individual income taxes. If you don't understand what the base is and how many times it'll be embedded in either the cost of production or in consumption, it can sound very reasonable when in fact, we're talking about a sea change in what state taxation looks like.

Nikki Dobay ([20:59]):

I like to use the word bonkers.

Jared Walczak ([21:02]):

That's the technical term.

Nikki Dobay ([21:04]):

Okay. It's very technical. Okay, so this is a really bad idea. I want to just talk a little bit about for folks where we are in this process and there is an opposition effort, which is really the way to be engaged on this issue right now. So as of July 3rd, the proponents of this measure had gathered almost 169,000 signatures. They need about a little over 117,000 to get on the ballot. So it is looking like this is very, very, very much on track to get certified by our Secretary of State, which will likely happen in the next three to four weeks. So considering that, we definitely expect this will be on the ballot, and as I said, there is an opposition effort by Oregon Business and Industry that has been kicked off that will oppose this measure. We saw this once before in Oregon, so I'm having 2016 deja vu.

([22:01]):

I'm not going to get into all the specifics, but in 2016 there was a similar ballot initiative. Measure 97 was what it was referred to as very similar in structure. It would've changed the corporate minimum tax that was a 2.5% gross receipts tax on those sales over 25 million. And the money, the funding that would've been raised under Measure 97 was earmarked for education. That was defeated by almost a 60% measure. And so I remain optimistic that Oregon voters can do the right thing, but the opposition effort is very, very important. And so I would encourage folks big or small to really engage with that campaign because unfortunately, Jared, what I learned from that is the voters don't like to talk to people like you and me. I don't know why. We're really fun.

Jared Walczak ([22:56]):

Well, I think we're fun, but I also think this is a very complex issue and it doesn't lend itself easily to voter conversations. It doesn't lend itself easily to news coverage. And when voters actually get their ballot and they read that, "Result of yes, vote yes vote increases corporate minimum tax on Oregon sales exceeding 25 million, eliminates tax cap, distributes revenue to eligible individuals, state replaces any reduced federal benefits." Well, what does that mean? How significant is this? Is that a lot? Is it a little? The title itself suggests that it's simply earmarking corporate tax revenue for a rebate, and who wouldn't like to receive a rebate? You could go into this and not have any sense of how significant it is. So I'm sure there be a substantial education effort to talk about what this entails. It is interesting as well that it is earmarked for tax rebates.

([23:55]):

M97 was about raising money for education, like you said. This is to raise money and turn around and give it back. And at some level that's very attractive. I mean, who doesn't want that? And there's a benefit especially for certain individuals, but it's also, it's not really significantly income tested. It's a check. And it's interesting that there's not really some spending goal associated with this. There's not some revenue need. It seems much more driven by a perception that maybe businesses aren't paying enough. And a messaging that in my mind is very much obscuring what businesses pay. I mean, that line about businesses paying less than 1%, it's just not true under any realistic measure. But that seems to be the operative element here. The driving force is wouldn't it be nice if businesses had higher taxes? And I'll be honest, I don't actually think that thing flies very well.

(24:49):

I know that at some level when people are polled, they say, sure, we'd rather raise more of our revenue from higher income individuals and businesses. Although if you ask them what should those rates be, they usually come back with, we think the rates should be higher and the rate that we think it should be is way lower than currently exists. It's kind of amazing how that happens because people don't know how much is currently paid. But the other aspect is I just don't think we have a resentment culture like that. When there have been ballot measures in other states, including states that have generally been very open to higher taxes being told, let's raise taxes for the sake of it has not really flown.

(25:26):

If you say, we have a real revenue need, can you appreciate this need? Do you agree with us on this need? Now here's a solution whether it's good or bad policy, I think people are receptive to that. When it's more, wouldn't it be nice to raise taxes on someone? I think that more skepticism arises and people are asking how much? Why? What is the economic ramification of this? And I hope they're asking that sort of question here because this is, like I said, really unprecedented tax if it were to go into effect. We've never seen something like this in the US.

Nikki Dobay (25:58):

It will definitely take a lot of education. And one thing that Oregonians have a visceral reaction to is sales tax. And the fact that this translates squarely into a sales tax regime, although not transparent at all in that it is going to raise prices on their everyday spending. That's what the voters really need to understand. And that check you're going to get, again, it's going to pale in comparison to the increased prices. And I do think I would agree with you in 2016, there was a lot of skepticism as to whether measure 97 could be defeated. One, it was going for education. To your point, people wanted to do something about education, and that was going to be a big C change.

(26:50):

And so getting voters to understand that, yes, we need to support education, but we think this is not the way to do it. I think voters, especially in the Portland area, have tax fatigue eight years later because of the, I mean, I want to say five of the, well, I guess there's five income taxes in the Portland area, two personal, three corporate. Four of those have come into effect since 2016. So I think we're in a different position. I'm hoping voters are asking more questions about this. And I know the opposition campaign will be out there putting together a lot of really important messages. So final thoughts on this bonkers idea?

Jared Walczak (27:38):

Just that, like you said, it is a sales tax, it's just worse. It is a sales tax on everything that would ordinarily be in a sales tax plus a ton of things that are never in a sales tax. That includes consumer goods that are usually not in a sales tax, even if arguably they could be. And it also includes all of those intermediate transactions that are never supposed to be in a sales tax because of their effect on production and the degree to which they pyramid. You won't see it on a receipt, but it is so much worse. If you don't want a sales tax, you really don't want to get anywhere near a gross receipt tax. And just because it's hidden from you and it's not in a receipt does not make it better. In fact, I'd argue it makes it a whole lot worse.

Nikki Dobay (28:18):

All right, Jared. Well, thank you for your thoughts on this. I want to say, I hope we're not talking about it again. I have a feeling we might talk about it again before the election, but hopefully, this will be defeated at the ballot. And thank you for you and the Tax Foundation's great work on this. All right. So surprise non-tax question. We usually talk about where you're going to go hiking. So I thought, what else does Jared do when he goes on these trips? So besides hiking, what is your other favorite outdoor activity? And I'll start. We're in Bend now, so we're exploring all sorts of different activities. We became mountain bikers, so we bought mountain bikes and we are mountain biking with the dogs. I'm going to go for two. I think I'm going to get a standup paddleboard. So we are going all in on the Bend lifestyle, but what else does Jared do when he's outside?

Jared Walczak (29:12):

Well, I've taken up running. I don't know that I would say that I love it, but I feel that I probably need it. And I've run about 1,000 miles thus far this year trying to keep that up. But I love whitewater rafting. I love really anything that gets me outdoors. I do more indoor climbing than outdoor, but I'm trying to get some outdoor climbing in. So who knows, maybe on some of these trips, especially out west, every time I'm looking at say anywhere, whether it's Oregon or Washington or Utah or Colorado, I look and I see the people climbing outdoors and I think I need to join them.

Nikki Dobay (29:45):

Yeah, the climbing, I'm not there on climbing, but I see them too and they love it. Well, Jared, thank you again for joining me. It's always a pleasure. And thank you to the listeners. There will be contact information for Jared and I in the show notes, and if you have any questions or comments, please feel free to leave them in the show notes as well. Thank you again, and I'll be with you soon on the next GeTtin' SALTy.