OREGON'S 2% SURPLUS KICKER

Research Report #2-07

LEGISLATIVE REVENUE OFFICE

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Introduction

Oregon's 2% surplus kicker revenue limit has been a dominant factor in state fiscal policy over the past 20 years. With record personal kicker refunds and corporate kicker credits projected for the 2007-09 biennium, the impact of the limit appears greater than ever. This report discusses the mechanics and history of the 2% surplus kicker. This is followed by an evaluation of the limit's impact on state revenue and spending, state revenue policy, Oregon's taxpayers and the state economy. The report concludes with a discussion of policy options for modifying the current kicker law.

The key findings in the report are:

- The 2% surplus kicker has proven to be a significant revenue limit throughout much of its history. The Legislature took numerous steps to modify its impact in the 1990s while the kicker remained in statute only. However with placement into the constitution by voters in 2000, modifications to the revenue impact of the kicker become much more difficult.

- Based on history and its constitutional status, kicker refunds and credits are expected to reduce General Fund revenue by about 3% per biennium over the long term. These revenue impacts will occur in an erratic manner with some far exceeding the 3% biennial average. Kicker refunds & credits projected for 2007-09 biennium are expected to equal 10.9% of General Fund revenue.

- Kicker refunds and credits are unlikely to have a significant impact on the state economy because they are temporary and must be offset by reductions in state General Fund spending in order to restore balance to the state budget.

- Surplus kicker refunds and credits are designed to have no impact on the distribution of the tax burden. Taxpayers receive temporary tax reductions equal to a proportion of their tax liability for the relevant year. The distribution of the corporate income tax burden was changed significantly with the recent adoption of a 100% sales factor for apportioning multi-state income. This means that Oregon manufacturers now pay a much smaller share of the state corporate income tax. It also means manufacturers will receive a much smaller share of corporate kicker credits in the future.

- There are a number of ways that either the personal and/or the corporate 2% surplus kicker can be modified but any proposal that permanently changes the revenue impact of the kicker is likely to require voter approval. Such proposals usually involve discussion of what the additional revenue should be used for. Given the instability of the current revenue system, a dedication to a reserve fund has been a top consideration for proponents of kicker modification.

- A statutory modification to the corporate kicker would improve the accuracy of the credit calculation. This could be done by using the prior tax year as the base for determining the percentage credit. Since this is known with more certainty than the current year this change would more closely align the actual credit paid out to corporations with the actual amount corporate revenue exceeded the estimate for the biennium. Such a change would also bring the corporate kicker calculation into line with the current statute regarding the personal income tax refund calculation.

Description

Oregon is one of 6 states with a revenue limit. Revenue limits require a mechanism to return revenue above the designated target to taxpayers in some form. Florida has a constitutional limit tied to the percentage change in state personal income. Michigan and Missouri have revenue limits set at a fixed percentage of total personal income in the state. Missouri also has a constitutional provision requiring that revenue increase proposals that exceed 1% must be approved by voters. Colorado's revenue limit covers a broad array of revenue sources and limits growth in these sources to the rate of growth for the state's population plus inflation. If revenue exceeds this limit, the Colorado legislature must return the excess to taxpayers in some general form such as a sales tax decrease. Voters recently suspended Colorado's revenue limit for a 5-year period.

Oregon's 2% surplus kicker limit is uniquely tied to state revenue forecasts. Surplus kicker calculations begin with a division of the state's General Fund revenue into two separate pots. The first pot consists of corporate income and excise tax revenue including a small amount of collections from the Multi-State Tax Compact. Revenue from this pot made up 6.1% of General Fund revenue in 2003-05. The remaining 94% of General Fund revenue makes up the second pot. It is overwhelmingly comprised of personal income taxes (93%) but also includes other General Fund taxes such as insurance premium taxes, a portion of cigarette taxes and estate taxes. In addition this pot includes non-tax General Fund revenue sources such as Oregon Liquor Control Commission apportionment, criminal fines and assessments and interest income. Lottery earnings are not part of the General Fund and therefore not part of the kicker calculation.

Revenue from these two pots is compared at two points in time. The base is the forecast calculated at the time the regular Legislative session ends. This forecast is made up of the latest quarterly economic and revenue forecast (usually issued in May of odd numbered years) plus and minus estimated revenue impacts from legislative actions. The May forecast adjusted for legislative actions comprises the limit. This forecast is then compared to the actual revenue that comes into the state during the biennium. This amount is known about 45 days following the end of the biennium. Actual revenue is then compared with the amount that was forecast for each pot to see if the 2% trigger has been met. If it has for either pot, the entire amount above the forecast is then returned to taxpayers.

There are differences in the method of returning excess revenue to personal income taxpayers and corporate income taxpayers. If the 2% trigger is exceeded for corporate taxpayers, a credit is calculated. The credit is determined by dividing the amount in which corporate income and excise tax revenue exceeded the forecast by the total corporate income tax liability forecasted for the current corporate tax year. Total liability—the denominator—is forecasted because the calculation is done in August. Moreover, corporations select the timing of their fiscal years, meaning some have just started when the forecast is done. In addition corporate income tax data generally takes two years to be completed. This means that the percentage credit for corporations is partially based on a number that is unknown at the time of the calculation. More on this issue in the policy option section. For personal taxpayers, the credit was changed to a refund in 1995. The first step in this calculation is to subtract estimated Department of Revenue (DOR) refund processing costs (in recent years slightly less than $1 million) from excess revenue. The refund is then calculated by dividing the total amount that revenue (minus administrative costs) from all non-corporate General Fund revenue sources in excess of the close of regular legislative session estimate by the total personal income tax liability in the prior year. The 1995 legislation that changed the personal kicker to a refund also changed the calculation by using the prior year liability rather than the current year. The prior year tax liability is not precisely known at the time the refund is calculated because of lags in data but a very close approximation is available.

The Office of Economic Analysis within the Department of Administrative Services is responsible for carrying out the kicker calculations described above. After completing the calculation the State Economist (who directs the office) certifies the credit and refund percentage estimates for the DOR. The DOR then informs corporate taxpayers that they are eligible for a credit in the current tax year. The DOR then includes the percentage credit on corporate tax returns for that year. For personal income taxpayers, the DOR begins calculating refunds for individuals based on their income tax liability in the prior year. Before processing the refund the DOR checks to see if the taxpayer has any outstanding obligations to the state. If there are outstanding obligations, the refund check is reduced accordingly. Under current law, the checks must be sent out prior to December 1 following the close of the biennium.

Table 1 summarizes mechanics of the kicker process.

Table 1: Kicker Calculation

TAXPAYER	PERSONAL	CORPORATE
CALCULATE BASE	END OF REGULAR SESSION FORECAST FOR PERSONAL INCOME TAXES, INSURANCE PREMIUM TAXES, PORTION OF CIGARETTE TAXES, ESTATE TAXES, OLCC APPORTIONMENT, CRIMINAL FINES AND OTHER GENERAL FUND REVENUE FOR THE COMING BIENNIUM.	END OF REGULAR SESSION FORECAST FOR CORPORATE INCOME & EXCISE TAX REVENUE FOR THE COMING BIENNIUM
COMPARE WITH BASE	ACTUAL RECEIVED FOR BIENNIUM FROM REVENUE SOURCES LISTED ABOVE	ACTUAL RECEIVED FOR BIENNIUM FROM REVENUE SOURCES LISTED ABOVE
CHECK TRIGGER	IS ACTUAL REVENUE 2% MORE THAN FORECAST BASE? YES—CALCULATE REFUND NO—STOP	IS ACTUAL REVENUE 2% MORE THAN FORECAST BASE? YES—CALCULATE CREDIT NO—STOP
CALCULATE % RETURN TO TAXPAYERS	DIVIDE TOTAL AMOUNT ABOVE FORECAST BY ESTIMATED TOTAL PERSONAL INCOME TAX LIABILITY FOR PRIOR TAX YEAR AFTER SUBTRACTION OF ESTIMATED DEPARTMENT OF REVENUE ADMIN COSTS TO GET PERCENTAGE REFUND.	DIVIDE TOTAL AMOUNT ABOVE FORECAST BY FORECASTED AMOUNT OF TOTAL LIABILITY FOR CURRENT TAX YEAR TO GET PERCENTAGE CREDIT
SEND MONEY TO TAXPAYERS	CUT REFUND CHECKS FOR TAXPAYERS AND SEND OUT PRIOR TO DECEMBER 1 FOLLOWING END OF BIENNIUM. ADJUST INDIVIDUAL REFUNDS FOR CURRENT LIABILITIES TO STATE FROM BACK TAXES, CHILD SUPPORT ETC.	INFORM CORPORATE TAXPAYERS THAT THEY ARE ELIGIBLE FOR A CREDIT IN THE CURRENT TAX YEAR. ALLOW CREDIT WHEN TAXPAYERS FILE RETURNS AT END OF TAX YEAR.

The framework for calculating the personal and corporate income tax kicker limit was put into the state constitution in November of 2000. The constitutional provision contains an exception process. Prior to the close of a biennium for which the kicker calculation is being made, the Legislature by a 2/3 majority in each chamber may enact legislation declaring an emergency and raising the close of regular session estimate upon which the kicker calculation is based. This has the effect of eliminating or reducing the corporate and personal income tax kicker refunds/credits. This provision has not been used since the constitutional amendment was adopted.

How the kicker affects the state budget process is often a source of confusion. Here are some guidelines:

- The kicker is a revenue limit. Expenditures do not affect the kicker calculation in any way.
- The kicker calculation is based on two points in time—the close of the regular session forecast and the actual amount of revenue that came in during the biennium. In other words, the period at the beginning of the biennium when the estimate is prepared and the end of the biennium when actual revenue is known. The state issues quarterly revenue forecasts that can project a kicker but these are only estimates until the biennium is complete.
- Kicker refunds and credits affect the revenue stream in the biennium following the one for which revenue exceeded the estimate by more than 2%. For accounting purposes these refunds/credits are treated as a reduction in revenue, not an expenditure. This means that for the biennium in which there is surplus revenue, the state's General Fund will run an unusually large ending balance. However, revenue growth in the following biennium will be reduced by the kicker refunds/credits.

History

Oregon's 2% surplus kicker revenue limit began with the approval of HB 2540 by the 1979 Legislature. This historic legislation was worked out by a conference committee that included both the Speaker of the House and Senate President. At the time, its most notable feature was a substantial property tax relief program. However, the bill also included two limits. The first was an appropriations growth limit linking state General Fund appropriations growth to the change in total state personal income. The second was the 2% surplus kicker revenue limit. The entire package was approved by the Legislature for one-year with a referral to voters in the May 1980 primary election for an extension beyond the first year. The measure was approved overwhelmingly by voters.

The Legislature approved the new revenue limit at a time when General Fund revenue growth had been at historic highs. General Fund revenue grew 54.5% in the 1973-75 biennium, 22.2 % in the 1975-77 biennium and 36.3 % in the 1977-79 biennium. This huge revenue growth was fueled by the rapid inflation gripping the national economy in this period. The surplus kicker was a means of limiting revenue growth to the amount that was anticipated when the budget was approved by the Legislature. Any excess amount of revenue was not necessary for the legislatively adopted budget and therefore returned to taxpayers in the following biennium. The 2% trigger was established to ensure that tax credits would be large enough to be meaningful.

Based on recent discussions with two of the conference committee participants (Gary Wilhelms and John Powell) the primary policy objectives of HB 2540 were to provide tax relief, primarily through the newly created Property Tax Relief program, and to convince voters that state spending would be under control in the future. Legislators were heavily influenced by the passage of California's Proposition 13, which placed severe limits on property taxes, and the rapid state revenue growth throughout the 1970s. HB 2540 was a comprehensive fiscal package designed to provide tax relief and fiscal constraint with the hope of heading off a voter initiative similar to California's Proposition 13.

Ironically the state economy entered a deep recession shortly after voter approval of the fiscal package. The recession had the effect of negating both the revenue limit and the appropriations limit in the first two biennia. General Fund revenue in the personal calculation fell $141 million short of the close of session estimate in 1979-81 while corporate income tax revenue came in $25 million below. The shortfalls were even greater in 1981-83 when non-corporate revenue fell $115 million below the estimate and corporate revenue was $110 million below. Both shortfalls would have been significantly larger had the Legislature not taken steps in special session to increase revenue.

The first surplus kicker credits were applied to tax returns following the 1983-85 biennium. For the personal income tax calculation, revenue exceeded the estimate by $89 million. This led to a 7.7% credit for taxpayers on their 1985 tax returns. For corporations, revenue exceeded the estimate by $13 million. This was sufficient to exceed the 2% threshold and generate a 10.6% credit for the 1985 corporate tax year. Economic expansion and surprisingly strong revenue growth from federal and state base broadening tax reform led to kicker credits for both personal and corporate taxpayers following the 1985-87 and 1987-89 biennia.

A jump in oil prices and rising interest rates caused the economy to weaken in 1990, eventually falling into a mild recession in 1991. Weak corporate profits pushed corporate income tax revenue below the 1989 close of legislative session forecast by $23 million for the 1989-91 biennium, eliminating the possibility of corporate surplus kicker credits. However, personal income tax revenue and the other General Fund components were sufficient to generate revenue $186 million above the kicker base forecast. The 1991 Legislature, reacting to the state's increased school finance role under Ballot Measure 5, suspended the personal kicker credit on a one-time basis. This had the effect of adding $186 million to General Fund revenue for the 1991-93 biennium. Economic growth closely paralleled the 1991 forecast keeping General Fund revenue close to the kicker base estimate. Non-corporate revenue exceeded the estimate by $60.1 million. This was 1.2% above the forecast and therefore insufficient to trigger the 2% kicker credit. Corporate revenue came in $17.9 million above the estimate. This was 5.3% above the forecast, enough to trigger the kicker credit for corporations. However, the 1993 Legislature, as they had done the prior session, suspended the kicker on a one-time basis to help meet the budgetary pressures caused by the phase-in of Measure 5.

In 1995, the Legislature modified the personal kicker in two ways. The mechanism for returning money to taxpayers was changed from a credit to be included at the time taxpayers fill out their returns to a refund check mailed by the Department of Revenue. This had the effect of speeding up when taxpayers received their tax reduction. It also increased the visibility of the kicker by providing taxpayers with a check directly in their mail boxes. The Legislature also improved the accuracy of the kicker calculations by changing the tax year the percentage calculation was based on by moving it from the current year (which was not fully known) to the prior year (which was almost totally known). The corporate kicker calculation and means of returning money to corporations was left unchanged by the 1995 Legislature. The 1993-95 biennium was characterized by economic growth well beyond expectations. This resulted in a personal income tax refund of $163 million and corporate credit of $167 million. The corporate credit was 50.1 %, by far the largest up until that time. Rising Lottery revenue from video poker and unexpectedly strong property value growth allowed the Legislature to absorb the completion of the Measure 5 phase-in and still return large kicker refunds and credits through the 2% kicker process.

During the 1995-97 biennium, the opening of tribal casinos around the state caused video poker revenue to flatten out and fall below predicted growth rates. However, General Fund revenue fueled by the semiconductor investment boom surged well beyond the regular session forecast. In 1996, the Legislature modified the kicker calculation in a special session. General Fund revenue was used to backfill the Lottery shortfall through a bill that shifted General Fund revenue into the State School Fund. This bill (SB 1161) modified the kicker calculation by adjusting the forecast base to include any change in General Fund appropriations. This meant that the General Fund dollars transferred to the State School Fund to backfill the Lottery shortfall were added to the kicker base for purposes of calculating the kicker. This one-time adjustment also was used by the 1997 Legislature in developing the 1997-99 budget. At the time, the state had an outstanding liability to the SAIF Corporation for illegally transferring money from the workers' compensation trust fund in the early 1980s. The Legislature appropriated the final $80 million payment out of the 1995-97 budget. This had the effect of reducing the refunds/credits by $80 million. This is the only time that appropriations have affected the 2% surplus kicker calculation. SB 1161 expired at the end of the 1995-97 biennium. Despite these modifications, the kicker reached historic highs for both personal and corporate income taxpayers following the 1995-97 biennium. Personal income taxpayers received $432 million in refunds while corporations received a credit of $203 million.

Oregon's economy began to slow in 1998 when the Asian financial crisis disproportionately affected the Pacific Northwest. The national economic expansion, fueled by rising stock market prices continued to grow through 2000. A national recession began in March of 2001 and lasted until November of that year. During this period corporate profits weakened significantly. This resulted in corporate income tax revenue falling below the estimate by $69 million in 1997-99 and $44 million in 1999-2001. However, surging capital gains income caused by the stock market bubble continued to generate personal income tax revenue above expectations. This resulted in a kicker refund of $167 million following the 1997-99 biennium and $254 million following the 1999-2001 biennium. The Legislature made two decisions affecting the kicker during this period. The first was a referral by the 1999 Legislature to the voters to put the framework of the kicker into the state's constitution. This was approved by voters (Measure 86) in November 2000. This decision had a major impact on the Legislature's ability to modify the kicker in the future. However, the kicker remained under statute until the 2001-2003 calculation.

The 2001 Legislature modified personal income tax refunds one last time under statute. The Legislature adjusted the calculation by removing Medicaid Upper Payment Limit (MUPL) revenue from the General Fund for purposes of calculating the kicker. These federal dollars had been placed in the General Fund and included in the 1999 close of regular session estimate. With the end of the biennium approaching it was clear that revenue from this source would far exceed the initial estimate and that other revenue used to calculate the personal kicker refund would exceed the 2% threshold. The Legislature voted to remove the MUPL from the General Fund. This had the effect of reducing the personal income tax kicker refund by $106 million leaving a refund of $254 million. The state was sued following the session. The Supreme Court upheld the Legislature's decision in Bobo vs. Kitzhaber.

As the $254 million in refunds was being mailed out in November of 2001, the state's revenue situation was growing decidedly worse. By the time the biennium ended, Oregon's General Fund revenue had experienced its largest percentage drop since the Great Depression. General Fund revenue fell 20.1 % below the close of the 2001 regular session estimate after adjusting for legislative actions taken in special sessions and the 2003 regular session, including issuing $450 million in appropriation credit bonds. Even allowing for these actions, corporate income tax revenue came in $439 million below estimate while non-corporate revenue fell $1,249 million below the kicker base forecast. Still feeling the fiscal effects of recession, the 2003 Legislature approved House Bill 2452. This measure added $778 million to the 2003-05 General Fund revenue forecast. This bill was referred by citizens to the ballot and defeated in a special election in January of 2004. However, the revenue expected to come in from the measure was still part of the close of regular session estimate used to calculate the kicker base. This meant that despite a stronger than expected economic recovery, non-corporate General Fund revenue fell $401 million below the close of session forecast. However, a return of strong corporate profits caused corporate income tax revenue to jump more than 2% above the close of session forecast despite the removal of $145 million in corporate income tax revenue caused by the referral and defeat of HB 2452 (Measure 30). Corporations received an estimated credit of $101 million following the 2003-05 biennium.

The responsiveness of Oregon's General Fund revenue to economic conditions has been confirmed by the state's economic recovery and surging revenue in the 2005-07 biennium. As a consequence, the revenue for calculating both the personal and the corporate kicker is now expected to exceed the forecast base by record amounts. This is true not only in dollar terms but also in percentage terms. Individual taxpayers are expected to receive refunds equal to 21% of their 2006 tax liability in the fall of 2007 (December 2006 forecast) while corporations receive a credit of 67 % based on their 2007 tax liability. The result is a reduction in 2007-09 General Fund revenue of $1.373 billion. General Fund revenue would be 10.9 % greater in 2007-09 in the absence of the constitutional revenue limit.

In summary, for the 13 biennia the kicker has been in effect (1979-81 through 2003-05); the personal income tax trigger has been exceeded eight times. Kicker refunds or credits were distributed on seven occasions and suspended once. Revenue has fallen short of the 2% personal income tax trigger on five occasions. For the corporate calculation, actual collections have exceeded the trigger seven times and fallen below six times. Of the seven times in the past when the corporate trigger was exceeded, the kicker was credited to corporate taxpayers six times and suspended once. Over the 13 biennia, personal income taxpayers have received an estimated $1,501 million in refunds and credits, corporations $527 million in credits, for a total of $2.028

billion in refunds and credits. This amount will increase substantially in 2007-09 if the current (December 2006) revenue projections hold.

Fiscal Impacts

Reviewing Oregon's budget and revenue history for the past 25 years it is clear that the 2% surplus kicker has had a profound impact on the state's fiscal policy. The kicker can be viewed as a strict revenue limit with its impact on state revenue and spending examined. It can also be viewed as a major part of state tax policy. From this perspective its impact on overall tax policy decisions, the state's personal and corporate taxpayers and the state's economy can be considered.

- Revenue Impact

As a revenue limit, the 2% surplus kicker has an asymmetrical impact on the state's revenue stream. It reduces revenue growth on the up side--when revenue exceeds the forecast, but has no effect on the down side—when revenue comes in below expectations. The extent to which the 2% surplus kicker has reduced General Fund revenue can be seen in Table 2.

Table 2: Impact of the 2% Surplus Kicker on General Fund Revenue (Millions of $)

BIENNIUM	ACTUAL GENERAL FUND REVENUE	GENERAL FUND REVENUE IF KICKER REFUNDS/CREDITS RETAINED	DIFFERENCE PER BIENNIUM	% DIFFERENCE
1981-83	2,890.7	2,890.7	0	0
1983-85	3,274.3	3,274.3	0	0
1985-87	3,433.4	3,535.4	102	3.0
1987-89	3,801.7	4,029.7	228	6.0
1989-91	4,628.1	4,839.1	211	4.6
1991-93	5,477.4	5,477.4	0	0
1993-95	6,536.1	6,536.1	0	0
1995-97	7,731.6	8,061.6	330	4.3
1997-99	8,324.6	8,959.6	635	7.6
1999-2001	10,121.9	10,288.9	167	1.6
2001-03	9,366	9,620	254	2.7
2003-05	10,438.2	10,438.2	0	0
2005-07*	12,699.3	12,800.3	101	0.8
2007-09*	12,602.4	13,798	1373	10.9
AVERAGE			243	3.0

*December 2006 forecast

Acting as a limit on General Fund revenue, the 2% surplus kicker has reduced revenue by an average of $243 million per biennium or 3.0% of General Fund revenue. However, these numbers are skewed by the huge projected kicker refunds/credits for the 2007-09 biennium. Removing this last forecast observation, which is still subject to considerable change, reduces the kicker revenue impact estimates to $156 million or 2.3 % per biennium.

To estimate the revenue impact of the kicker going forward, the effect of legislative actions should be removed from the historical series. With the kicker law now in the constitution, this is far less likely in the future. Adjusting for the previous legislative actions to reduce the revenue impact of the kicker (described in the preceding section) adds $445.3 million to the total revenue impact over the 13 biennia period, excluding the current 2007-09 estimate. This makes the average revenue impact 2.7% of General Fund revenue per biennium. If the 2007-09 projected kicker is added, the average per biennium becomes 3.4%. Table 3 shows the projected revenue impact of the kicker beyond the 2007-09 biennium, both with and without the 2007-09 amount included in the average.

Table 3: Projected Revenue Impact of the 2% Surplus Kicker (Millions of $)

BIENNIUM	PROJECTED GENERAL FUND REVENUE	PROJECTED REVENUE IMPACT OF 2% KICKER @ 2.7% (EXCLUDING 2007-09 TO CALCULATE ESTIMATE)	PROJECTED REVENUE IMPACT OF 2% KICKER @ 3.4% (INCLUDING 2007-09 TO CALCULATE ESTIMATE)
2009-11*	15,549	420	529
2011-13*	17,457	471	594
2013-15**	19,377	523	659
2015-17**	21,509	581	731

*December 2006 forecast
**Based on long-term trend projection of 11% per biennium.

The revenue impact estimate in Table 3 is unusual because it implicitly includes a forecast of a forecast. The implied assumption is that General Fund revenue forecasts will hover around a long-term trend. While this trend may be accurate over time, actual revenue will vary considerably around the trend line. During those times when the 2% kicker trigger is surpassed, revenue losses will be equal to what they have been in the past on a proportional basis. The estimates in Table 3 should be considered an expected value because they are based on historical averages. For example, a plausible scenario would be no refunds/credits in 2011-13 and a $1.1 billion refund in 2013-15. This would be consistent with the revenue impact projections on an expected value basis.

- Spending Impact

It is not possible to say what previous Legislatures would spend additional revenue on if it had been available. However the impact can be estimated by looking at the General Fund proportions of the existing budget and assuming that additional General Fund revenue would have been allocated in the same manner. Table 4 provides an estimate of how surplus kicker refund dollars would have been allocated over the past 6 biennia:

Table 4: Historical Simulation with Proportional Spending Impacts

BIENNIUM	EDUCATION	HUMAN RESOURCES	PUBLIC SAFETY	OTHER	TOTAL
	(IN MILLIONS OF $)				
1995-97	184	83	34	29	330
1997-99	368	139	72	56	635
1999-2001	97	38	20	12	167
2001-03	138	63	33	20	254
2003-05	0	0	0	0	0
2005-07	56	23	15	7	101
AVERAGE	141	58	29	20	248

Since the full phase-in of Measure 5 in 1996, the General Fund budget has allocated between 55 and 60% to education (K-12 & higher education). This means that about 57% of the revenue reductions from the 2% surplus kicker came from education under the proportional assumption. Human resources and public spending make up a combined 35% of the reductions.

- Tax Policy

The spending reduction calculations are based on the assumption that the Legislature would have made the same tax and revenue policy decisions even if the 2% surplus kicker was not law. This assumption is realistic for the 1991-93 and 1993-95 biennia because the Legislature chose to suspend the kicker payments. However, for the period following the 1993-95 biennium it is likely that other tax reductions would have been considered in the absence of the temporary tax reduction caused by the kicker. Most states during this period of rapid revenue growth reduced taxes, many on a permanent basis. While it is impossible to quantify, it is likely that the impact of the surplus kicker on tax policy is to eliminate or scale back tax reductions that would have occurred during periods of strong economic growth. In those times when kicker refunds occur when revenue is falling because of timing lags—such as the 2001-03 biennium, the existence of the kicker could force the Legislature to raise taxes or revenue more than they otherwise would.

In summary, the 2% surplus kicker has proven to be a significant revenue limit throughout much of its history. The Legislature took numerous steps to modify its impact in the 1990s while the kicker remained in statute only. However with placement into the constitution by voters in 2000, modifications to the revenue impact of the kicker become much more difficult. While the kicker has been an effective tool limiting General Fund revenue in the past it is likely to be more effective in the future. Given the magnitude of current projections for refunds and credits in 2007-09, the kicker appears likely to have an even greater impact on General Fund revenue and spending in the future.

Impact on the Economy and Individual Taxpayers

Going back to Richard Musgrave's classic public finance text, first published in 1959 (*The Theory of Public Finance)*, state government fiscal policy has been relegated to the allocation component of government activities while the federal government is responsible for stabilization policy. There is good reason for this: states must balance their operating budgets while the federal government has no such requirement. This means when the states reduce taxes—such as a temporary tax refund called for by the kicker—expenditures must be reduced by a corresponding amount to restore balance in the budget. This means that while kicker refunds may provide some stimulus during the period they arrive in mailboxes, over the course of the biennial budget cycle there is little net effect on overall demand in the state economy. For the corporate kicker credits the impact on demand in the state economy is likely to be even less because most corporate income taxes are paid by multi-state corporations who, according to economic theory, invest their net profits where they anticipate the highest net after-tax return.

This is not to say that state fiscal policy does not affect the state's economic performance. Both state tax and expenditure policy have the potential to influence the after tax return to capital and labor. It is the movement of capital and labor in an open economic system that affects the growth of state economies relative to one another. The only way a temporary tax reduction such as the personal and corporate kicker refunds & credits can affect the state's competitive position is if they are built into calculations of expected after tax rate of return. If individuals and corporations carry out an expected value calculation such as that above for long-run state revenue estimates the kicker mechanism could have an affect on resource location. However, there is no evidence that the kicker figures into decisions in this way.

The kicker refund mechanism to individual taxpayers is designed to leave the distribution of the tax burden unchanged. The refund amount for each tax filer is equal to the percentage calculation times the taxpayers liability for that year. This means that the refund will be proportional to the amount of taxes paid in the year the kicker is calculated. Taxpayers with a relatively high tax burden will receive the largest refunds. Table 5 shows the distribution of the projected surplus kicker refund to be paid out in the fall of 2007 based on the December 2006 revenue forecast.

Table 5: Projected Refund Amounts by Income Group (2006 Tax Year)

INCOME CLASS	# OF RETURNS	ESTIMATED AVERAGE LIABILITY	AVERAGE KICKER REFUND
< $10,000	348,440	$ 77	$ 16
$10 K TO 20 K	283,084	449	96
$20 K TO 30 K	223,488	1,021	217
$30 K TO 40 K	177,311	1,063	341
$40 K TO 50 K	140,565	2,180	464
$50 K TO 70 K	208,545	3,131	666
$70KTO 100K	177,056	4,849	1,032
$100KTO200K	130,568	8,733	1,859
> $ 200 K	38,663	39,630	8,435
TOTAL	1,727,720	2,985	635

Table 5 reflects the distribution neutrality of kicker refunds. Taxpayers with a relatively low tax burden, for example those with income between $10,000 and $20,000, pay on average $449 in state personal income taxes but receive a relatively small refund check of $96. At the other end of the income spectrum, taxpayers with income above $200,000 pay $39,630 on average in state income taxes but receive $8,435 in refunds on average.

The distribution of the corporate kicker credit works the same in principle. Corporate taxpayers receive a percentage credit to be applied to their liability for the year the kicker is calculated. Corporations cannot carry forward unused credits to future years. Recent changes to the corporate apportionment formula for taxpayers with liability in multiple states have caused significant changes in the distribution of the tax burden. For corporate tax years beginning on or after July 1, 2005, the proportion of national profits to be attributed to Oregon for tax purposes is determined solely by the proportion of sales that take place in Oregon. The proportion of property and payroll, used as apportionment factors in the past, no longer affect liability. Table 6 is based on 2003 corporate tax data (the last year of complete corporate returns) converted to the single sales apportionment formula. The estimated liability for 2007 is assumed to have the same distribution by net income and industry as it did in 2003 after adjustment for the apportionment formula.

Table 6: Projected Distribution of the 2007 Corporate Tax Credit

INCOME GROUP	PROJECTED TAXABLE INCOME	PROJECTED TAX LIABILITY	PROJECTED 2% SURPLUS KICKER CREDIT	NET TAX LIABILITY AFTER KICKER CREDIT
	(IN MILLIONS OF $)			
ZERO OR LOSS	0	0.3	0	0.3
$1 TO 50,000K	163.4	10.3	6.9	3.4
$50,000 TO $100,000	144.5	9.1	6.1	3.0
$100,000 TO 250,000	252.8	15.7	10.5	5.2
$250,000 TO 500,000	280.4	17.2	11.6	5.6
$500,000 TO 1 MILLION	423.1	26.1	17.6	8.5
$1 MILLION TO 5 MILLION	1,556.6	96.5	65.2	31.3
$5 MILLION TO 10 MILLION	811.8	48.8	32.9	15.9
$10 MILLION TO 25 MILLION	1,326.1	78.8	53.0	25.8
> $25 MILLION	1,778.5	105.8	71.2	34.6
TOTAL	6,739.0	408.6	275	133.6

Although the move to a single sales factor apportionment formula has flattened the distribution of the corporate tax burden, approximately 75 taxpayers are expected to be in the $10 million and above net income category in 2007. These corporations are projected to pay about 45% of the corporate income tax and receive 45% of the corporate kicker tax credits.

Another way of looking at distribution of the corporate income tax burden is to divide the tax burden by industry group. Table 7 is based on the same procedure to incorporate the new apportionment formula used in Table 6. Under the new formula, the share of the taxes paid by taxpayers classified as manufacturing drops significantly. This also means this sector's share of 2% surplus kicker credits also drops significantly. The largest taxpaying industries become financial services, wholesale trade and retail trade. These sectors are projected to pay about 2/3 of corporate tax liability in 2007 and therefore will receive 2/3 of the kicker credits.

Table 7: Projected Distribution of 2007 Corporate Kicker Credits by Industry

INDUSTRY SECTOR	PROJECTED TAXABLE INCOME	PROJECTED TAX LIABILITY	PROJECTED 2% SURPLUS KICKER CREDIT	NET TAX LIABILITY AFTER KICKER CREDIT
	(IN MILLIONS OF $)			
AG, FORESTRY, FISHING & MINING	86	5.2	3.5	1.7
UTILITIES	15.5	0.3	0.2	0.1
CONSTRUCTION	275.2	17.9	12.0	5.9
MANUFACTURING	572.8	33.0	22.2	10.8
WHOLESALE TRADE	1,377.7	85.3	57.2	28.1
RETAIL TRADE	1,188.5	74.6	50.2	24.4
TRANSPORTATION & WAREHOUSING	147.9	9.6	6.5	3.1
INFORMATION	194.4	12.4	8.3	4.1
FINANCE, INSURANCE & REAL ESTATE	1,960.8	115.8	77.9	37.9
HEALTH CARE & SOCIAL SERVICES	60.2	3.8	2.6	1.2
ACCOMMODATION, FOOD & ENTERTAINMENT SERVICES	122.1	8.1	5.4	2.7
MANAGEMENT OF COMPANIES & ENTERPRISES	356.1	18.6	12.5	6.1
OTHER SERVICES	361.2	22.2	14.9	7.3
UNKNOWN	17.2	1.0	0.7	0.3
TOTAL	6,739.0	408.6	275	133.6

Policy options
Under current law the kicker refunds & credits can be modified in a given biennium with a 2/3 vote in each chamber of the Legislature. The Legislature if it acts before July 1, 2007 could reduce or eliminate the kicker refunds and/or credits projected for the 2007-09 biennium through this mechanism. The only other way to alter the 2007-09 revenue impact of the 2% surplus kicker credit is to refer a constitutional amendment to voters—for example in the May 2007 primary elections. Such a measure could suspend either the personal or corporate kicker or both on a temporary or permanent basis. A key related issue is how to allocate the additional revenue in the event of a suspension or elimination.

Before turning to these major policy issues, it is important to note that the mechanism (not the amount) by which excess revenue is returned to personal and corporate taxpayers is determined by statute. As described earlier, the personal and corporate return mechanisms are different. The personal income tax mechanism was converted to a refund in 1995 while the corporate return method remained a credit. This added to administrative costs which are now subtracted from the amount of the refund. Another change made in 1995 was to apply the personal income tax calculation to tax liability in the prior year instead of the current year. This improved the accuracy of the percentage calculation and ensured that the actual amount of revenue above the close of session forecast would be very close to the amount of refund. For corporations this is not the case. The percentage calculation is applied to a forecast of current year total corporate liability. This creates the possibility of wide differences between the amount of corporate revenue above the forecast and the amount that is actually returned through the credit. This difference can be either positive or negative depending on how the forecast for current year compares with what liability actually turns out to be. For example a surplus of $167 million occurred following the 1993-95 bienium while a credit of $224 million was actually credited on corporate tax returns. Following the 1995-97 biennium the opposite occurred with a surplus of $203 million leading to an actual credit of $169 million. This discrepancy could be significantly reduced by changing the year for the liability calculation from the current year to the prior year as is done with the personal kicker refund calculation.

The most straight forward way to change the surplus kicker revenue limit is to submit a referral to voters repealing the relevant provisions in the constitution (Article IX, Section 14). In the absence of accompanying provisions, future surplus revenue would flow into the General Fund and become part of the appropriation process. An often mentioned alternative use of the additional revenue is to place it into a reserve fund. In 2003, the Senate approved SB 5A and SJR 2. This proposal called for placing revenue above the close of session forecast into a newly created reserve fund until it reached 10% of the General Fund budget. Once this threshold was reached, the surplus kicker refund/credit mechanism would be restored. This measure did not receive approval from the House and therefore did not go before voters. Another similar policy option is to place the surplus revenue in the current Education Stability Fund. This fund has a 5% of prior biennium General Fund revenue cap at which time additional revenue would flow into a school capital matching fund sub account. Diverting the projected corporate credit alone for 2007 ($275 million) would push the fund above the 5% cap in the 2007-09 biennium.

Another way in which the impact of the surplus kicker could be modified is through structural revenue reform. The calculation is currently determined by what is defined as "General Fund" revenue for budgetary purposes. This means that the kicker calculation is dominated by personal and corporate income taxes flowing into the General Fund. Any structural reform that reduces income taxes and substitutes another major revenue source could be designed in a way that reduces the revenue impact of the kicker in the future.

Finally, the revenue impact and the distribution of the surplus kicker could be altered in a variety of ways. For example both the size and the distribution of surplus revenue would be affected through capping the amount that could go to individual or corporate taxpayers. Such a proposal would require voter approval.

There are a number of ways that either the personal and/or the corporate 2% surplus kicker can be modified but any proposal that permanently changes the revenue impact of the kicker is likely to require voter approval. Such proposals usually involve discussion of what the additional revenue should be used for. Given the instability of the current revenue system, a dedication to a reserve fund has been a top consideration for proponents of kicker modification. Given the projected magnitude of kicker refunds and credits in 2007, a change in the kicker will potentially have significant revenue implications for the state.

Appendix A

SURPLUS KICKER HISTORY

Biennium	Tax Year	Personal		Corporate	
		Surplus/ Shortfall ($ million)	**Credit/ Refund** (% of liability)	**Surplus/ Shortfall** ($ million)	**Credit** (% of liability)
1979-81	1981	-141	None	-25	None
1981-83	1983	-115	None	-110	None
1983-85	1985	89	7.7%	13	10.6%
1985-87	1987	221	16.6%	7	6.2%
1987-89	1989	175	9.8%	36	19.7%
1989-91	1991	186	Suspended	-23	None
1991-93	1993	60	None	18	Suspended
1993-95	1994/5	163	6.27%	167	50.1%
1995-97	1996/7	432	14.4%	203	42.2%
1997-99	1998/9	167	4.6%	-69	None
1999-01	2000/1	254	6.0%	-44	None
2001-03	2002/03	-1,249	None	-439	None
2003-05	2004/05	-401	None	101	35.9%
2005-07*	2006/07	1,098	21.3%	275	67.3%

* December 2006 Forecast