BIT/BLF REPLACEMENT STRATEGY
& IMPACT ASSESSMENT

Working Draft #2

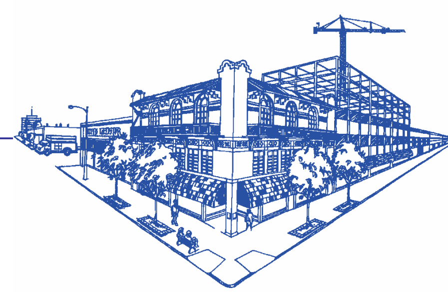
Prepared for:

Portland Business Alliance

January 8, 2003

E. D. Hovee
& Company

Economic and Development Services



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Prepared for:

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January 8, 2003

AT-A-GLANCE SUMMARY

Working with the City of Portland and Multnomah County under a Community Partnership Agreement since October 2001, the Portland Business Alliance (PBA) has taken the initiative to shape a proposal for replacement of the current business tax system in Portland and Multnomah County. What follows is an *at a glance summary* of major findings and recommendations from this *BIT/BLF Replacement Strategy and Impact Assessment* (Working Draft #2).

Rationale for BIT Replacement: Currently, businesses in Multnomah County pay a tax of 1.45% on net business income; a corresponding tax of 2.2% is levied by the City of Portland – for a combined 3.65% rate for Portland businesses. Taken together, these sources raise approximately $80 million per year for the City and County combined.

The charge of the Community Partnership Agreement is to consider changes that could result in a more "predictable tax system that is equitable in allocation, efficient in collection, and that furthers the missions of the City of Portland and Multnomah County without reducing revenues." This statement of purpose highlights critical issues with the current business income tax (BIT) – revenue instability, unfairness in tax incidence, a tax rate that is a disincentive to business growth, and the need to assure revenue neutrality with BIT replacement.

Business Tax Alternatives: Over the course of the past year, a variety of alternatives to the current BIT have been considered and evaluated – including BIT reduction and/or refinements, payroll tax, net income tax with cap, gross receipts tax, registration fee, and real estate transfer tax. The only two revenue sources that appear to meet Community Partnership Agreement and PBA criteria for BIT replacement are payroll tax and net income tax with cap.

BIT Replacement Strategy: After reviewing the alternatives considered, PBA is recommending replacement of the current BIT with an $80 million per year, two-source revenue mix involving:

- ***Payroll Tax –*** targeted to a rate of 0.395% to generate approximately 2/3 of current BIT revenue *plus* out-of-jurisdiction business revenue estimated at an added $5+ million.
- ***Net Income Tax –*** with a $15,000 cap on any individual business payment to the City and County respectively, generating the balance of the revenue of the BIT being replaced.

Also recommended is that future increases above the $80 million target be limited to the rate of inflation plus City/County population growth – with first priority to reduce the income tax rate.

The *competitive* position of the City and County for business investment and employment can be enhanced by altering the tax burden from primary reliance on higher margin businesses with incentive to seek other locations. Tax *fairness* is improved by shifting to better reflect business use of government services, which is more closely correlated to payroll than to business income.

This BIT replacement package could serve either as an interim or long-term source of *tax reform.* If substantive tax reform occurs on a regional or statewide basis, additional revenues generated locally should be applied to reducing or eliminating this interim BIT replacement package.

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I. RATIONALE FOR BIT REPLACEMENT

The City of Portland and Multnomah County have had their respective business tax systems in place since 1974. In recent years, it has become increasingly clear that the current tax system poses a disincentive for both the City and County as a competitive location to do business. At present, the tax also falls most heavily on the types of businesses that represent the greatest potential for high wage job growth.

In response, Multnomah County and the City of Portland entered into a Community Partnership Agreement to examine business tax alternatives in October 2001. This *BIT Replacement Strategy & Impact Assessment* is recommended by the Portland Business Alliance for consideration by the Community Partnership Steering Committee and both jurisdictions, consistent with the charge given for Community Partnership activity over the past year.

CURRENT BIT STRUCTURE

Business taxes in Portland and Multnomah County are based on apportioned business net income. The apportionment factor is based on gross income. Taxpayers located within the City/County pay on the basis of gross income occurring in the same City/County jurisdiction. Taxpayers located outside of the City/County are taxed on that portion of the Company's net income generated based on gross income occurring within the City/County.

Multnomah County Business Income Tax (BIT): The BIT in its current form was established in 1977, taxing apportioned net income derived from business activity within the County. Currently this tax is levied at a rate of 1.45%. As of the 2000 tax year there were roughly 27,600 paying accounts toward Multnomah County BIT revenue. For fiscal year 2001-02, this tax provided an estimated $29 million in Multnomah County general fund revenue.

City of Portland Business License Fee (BLF): The BLF in its current form was established in 1974, taxing apportioned net income derived from business activity within the City. Currently this tax is levied at a rate of 2.2 % with a minimum fee of $100. As of tax year 2000, there were roughly 30,700 paying City BLF revenue accounts. For fiscal year 2001-02, this tax provided approximately $51 million in City general fund revenue.

Combined Tax Rates: For businesses located in the City of Portland, the combined City BLF and County BIT result in a marginal tax rate of 3.65% on net business income. *Note:* For sake of simplicity, both the Portland and Multnomah County business taxes are referred to as BIT through the remainder of this replacement strategy and impact assessment report.

RATIONALE FOR BIT REPLACEMENT

In October 2001, Multnomah County and the City of Portland entered into a Community Partnership Agreement with the Portland Development Commission and local businesses to examine the respective business taxes. Local businesses have been represented by the Portland Metropolitan Chamber of Commerce and the Association for Portland Progress, now merged as the Portland Business Alliance (PBA). The charge of this partnership was to undertake an analysis that would examine the taxes for economic impacts and to:

> … consider changes that may be needed to achieve a predictable tax system that is equitable in allocation, efficient in collection, and that furthers the missions of the City of Portland and Multnomah County without reducing revenues.

Increasingly, businesses have complained that the BIT/BLF is driving business out of the City/County or is deterring business from locating into the City/County. No other city or county within the region imposes a comparable tax. Thus, within the region, the City and the County are at a comparative disadvantage in retaining and attracting businesses.

The business community has leveled other criticisms at the BIT/BLF:

- The combined rate is too high.
- The business tax system bears little connection between the consumption of government services and the tax paid.
- The system taxes similar businesses differently.
- The system is too complex and costly for compliance.

A prime example of a criticism of the BIT/BLF is the owner's compensation deduction. Where a person owns a business and works in that business, that person is essentially both an owner and employee. Amounts paid to the owner could be treated as employee compensation (which would be deductible and reduce the tax) or as owners' profits which would be fully taxable. The BIT/BLF limits the amount of deductible owner's distributions to an inflation adjusted $55,000 per year, per owner.[1] This amount is regarded by many as unrealistically low, thereby creating an unfairly high tax liability. This "unfairness" hits small, closely-held businesses as well as large professional and financial services firms.

Employment Effects: In order to *quantitatively* assess the BIT/BLF, the Community Partnership contracted with the independent economics firm ECONorthwest for a competitive position analysis. The resulting study addressed effects of the BIT on overall job growth and on growth across different industry sectors.

The ECONorthwest analysis concluded that the BIT/BLF typically does not impact a business decision to remain, expand or locate within the Metro region from outside Oregon. However, on an intra-regional basis, the BIT/BLF does impact location decisions for a business that is starting up or has the ability to move elsewhere within the region.

In other words, this tax influences the decision of whether a firm remains, expands or locates in Portland/Multnomah County versus another site elsewhere in the metro area. With tax disparity, the rate of local job growth has been correspondingly dampened.[2] The study points out that:

> The literature would suggest that the existence of the business income tax in the City and County – and its absence in nearby localities – depresses job growth in Multnomah County. If the County were to reduce or eliminate the taxes – without adversely affecting public services that businesses value – the rate of growth would increase. More specifically, the analysis suggests that a 10% decrease in per capita local taxes is associated with a 4% increase in the rate of total job growth.

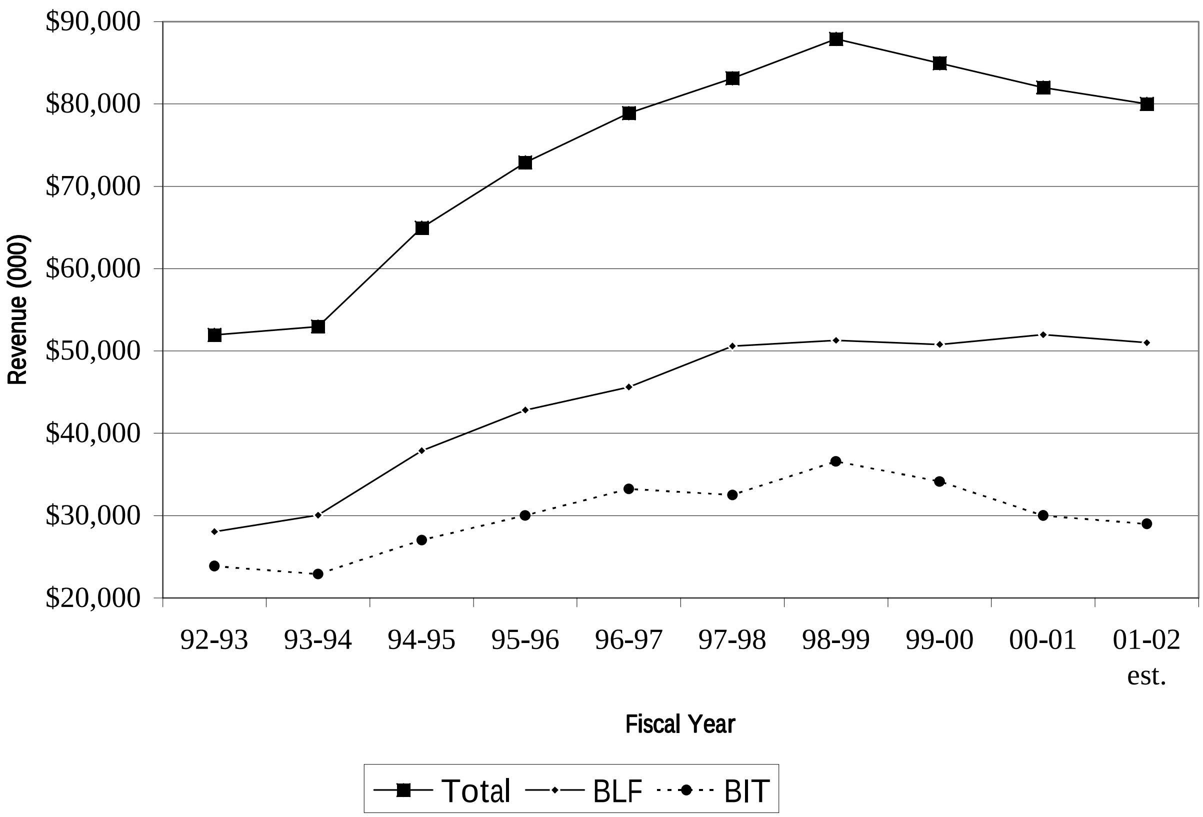
Industry Effects: The ECONorthwest study also found that the current business tax system essentially penalizes local businesses for serving the local marketplace while businesses that serve statewide, national or global markets are not taxed. This is particularly true of the creative and professional services sectors. These sectors are projected to account for significant long-term employment growth and include many small firms and start-ups.

Penalizing firms that are oriented primarily to the local market not only raises questions of tax equity and fairness but potentially undermines the long-term competitiveness of Portland and Multnomah County for high growth businesses that represent much of the future – especially for Portland's Central City.

Revenue Stability & Growth: Because the current tax is based on net income, revenues have proven to be particularly vulnerable to regional and national economic cycles. During the economic boom period extending from 1992-93 to 1998-99, combined City/County revenues increased at an average growth rate of more than 9% per year.

In the succeeding three years, combined revenues declined by more than 3% each year. City BLF revenues have remained flat while County BIT revenues have dropped more rapidly.

Figure 1. BIT/BLF Revenue History



Source: City of Portland and Multnomah County.

City of Portland revenues began to flatten out at just over $50 million as early as 1997-98, well before the current economic downturn. Multnomah County revenues have been somewhat more erratic, dropping in 1997-98, rebounding by 12-13% the next year (due to a temporary tax increase of 0.5%), then dropping again by 21% in the three years since 1998-99.[3]

Flat to declining revenues occurs as the result of a business tax system related 100% to profitability. In today's more troubled economy, income based tax collections can no longer be counted on as a source of continued revenue growth. Rather, the continuation of recent trends will further budget shortfalls and potential service cuts.

Criteria for Business Tax Reform

The Community Partnership and the Portland Business Alliance (PBA) have recognized that the current BIT system is no longer workable from either a business or public finance perspective. For business, the BIT creates an economic disincentive to remain, expand or locate in the City/County and unfairly penalizes some businesses more than others. From a public finance perspective, the BIT is proving inadequate to provide stable revenue growth both for the City of Portland and Multnomah County.

Recognizing the need for fundamental tax reform, the Board of the Portland Business Alliance has adopted the following resolution:

> That a substantial replacement of the local business income taxes and business license fees is necessary in order to significantly reduce the competitive disadvantage such taxes and fees create; and such replacement taxes and/or fees must be fairly and equitably levied or assessed and generate stable revenues for the City of Portland and Multnomah County.

In assessing alternative tax proposals, City/County elected leadership has required that the system be revenue neutral. This means that any replacement business tax system should produce annual combined revenue of approximately $80 million – allocated approximately $50 million for the City and $30 million for the County.

Subject to this requirement, it is important to have a clear set of criteria by which to assess alternative tax proposals. A replacement system should:

- Remove impediments to businesses staying in the City/County, and encourage businesses to remain, expand and locate within the City/County.
- Establish a more rational relationship between business use of government services and the tax being paid by a particular business.
- Create a system perceived as more fair by treating similarly situated companies the same.
- Capture taxes from businesses based outside of the City/County to the extent that those businesses do business within the City/County.
- Be broadly based (spread over the largest number of taxpayers) so as to reduce the burden on each taxpayer.
- Be reasonably simple to comply with, administer and enforce.

- Be consistent with applicable law.
- Be ready for adoption by the City Council and the County Commission without requiring state legislative action or a vote of the people.

This evaluation has considered a variety of BIT replacement alternatives in terms of their ability to address these criteria. The proposal advanced strikes the best balance with the criteria outlined for a suitable alternative.

TECHNICAL SUPPORT

This proposal has been prepared pursuant as a cooperative effort with participation from the City of Portland, Multnomah County, Portland Business Alliance and technical consultant team.

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This is a *preliminary working draft* of a proposed BIT/BLF replacement strategy and impact assessment – intended for review and discussion with the Portland Business Alliance and Community Partnership Steering Committee.

II. BUSINESS TAX ALTERNATIVES

Over the course of the past year, a variety of alternatives to the current City/County business tax system have been considered as part of the Community Partnership process, including:

- BIT reduction and/or refinements
- Payroll tax
- Net income tax with cap
- Gross receipts tax
- Registration fee
- Real estate transfer tax

For each of the revenue alternatives considered, potential features are described, followed by discussion of major issues, economic impact evaluation and then a recommendation. Economic impacts addressed are those of business profitability/competitive position and taxpayer fairness.

A. BIT Reduction & Refinements

In its early deliberations, the Community Partnership examined numerous options for *tweaking* the BIT and BLF – ideally to assure limited, targeted business relief and revenue neutrality for government. Ideas considered have included:

For tax relief:

- Increase in the Owners compensation deduction
- Reduction in the overall rate of each tax

For revenue replacement:

- Institution of penalties for late payment
- Establishment of a minimum fee for the County
- Out of County apportionment adjustments
- Reduction in the residential rental exemption
- Expansion of the BIT to "capture" realtors and insurance agents
- A job creation tax credit
- Reduced ownership test – from 5% to 1%

Discussion: In examining these various reform options, both immediate and long term, some have focused on an increase in the owners compensation deduction. However, the resulting reduction in revenue has made this, as a stand-alone approach, unacceptable under the terms of the agreement despite its apparent simplicity, benefits, and appeal.

Most of the BIT refinement options induce shifting of the business tax burden, creating different sets of "winners and losers," with no particular underlying policy rationale for those adjustments.

As an example, the job creation tax credit, while politically appealing, was deemed cumbersome, economically irrelevant, and likely to create a new costly government program to administer.

Business Impacts: Economic effects of the various BIT *tweaks* suggested would vary depending on the specific mix of BIT reduction and refinement proposed. The competitive position of Portland to do business would continue to be hindered with any proposal that keeps the current BIT system in place – due to both real and perceived negative connotations of the existing system. BIT reduction may or may not be beneficial in real dollar costs – depending on the offsetting new tax source, industry sectors and size of business most affected.

Because the current BIT is most disadvantageous for service-related businesses, it is difficult to expect meaningful relief as long as a BIT net income based mechanism is responsible for the majority of City/County business taxation.

Recommendation: Multnomah County and the Portland Business Alliance, along with a majority of participants in the Community Partnership Agreement, each have concluded these minor *tweaking* options are wholly insufficient to address the fundamental problems of the BIT, in both economic and revenue terms.

At this time, the City of Portland has not reached the same conclusion, but has stated that its "business license taxes provide the City's general fund with a unique revenue mix that was crucial in helping Council deal with the fallout from successive property tax limitations."[4] However, even while the City business tax has proved reasonably stable in recent years, it no longer is providing revenue growth. The City also has not yet clearly addressed the business disincentive and fairness issues associated with the current system.[5]

B. PAYROLL TAX

As a replacement strategy for the current BIT, clear precedent for an alternative is provided by Tri-Met's tax of 0.6218% on payrolls within its service district – comprising portions of the tri-county area.[6] A similar form of new payroll tax could be applied to all businesses located in the City/County and to fee-for-service hospitals, thereby broadening the base of taxation.

Employment payrolls that would not be taxed with this proposal would be federal, state and local governments and IRC 501(c)(3) non-profits. Self-employed employers also would be taxed as they are under the Tri-Met payroll tax.[7]

For discussion purposes, a payroll tax of 0.395% has been reviewed. At this rate, the tax could be expected to generate at least 2/3 of the $80 million in current BIT revenue. At a higher rate of about 0.6% (comparable to the Tri-Met tax), a City/County payroll tax could replace 100% of the BIT on its own.[8]

As proposed, the payroll tax would also tax out-of-jurisdiction payrolls associated with businesses located outside of the City/County that sell goods or services within the City/County. This would be based on an out-of-jurisdiction's total payroll apportioned by the percentage of gross revenues in the City/County jurisdiction. Conservatively, this could yield more than an added $5+ million in annual tax revenue.[9] More detailed legal analysis of the issues associated with proposed out-of-jurisdiction apportionment for a payroll tax is pending.

Discussion: If income does not serve as the most "fair" or reliable tax base for the entire City/County business tax system, then the question becomes what alternative source of taxing authority makes the most sense. The conclusion reached by many of the Community Partnership participants and by the Portland Business Alliance is that payroll is the best candidate for at least a significant portion of BIT replacement. There are several reasons for this conclusion:

- Payroll is viewed as a better indicator of the consumption of government services. Generally, more employees indicate a larger business, and larger numbers of employees indicate a greater utilization of government services.
- Taxes levied on payroll are not generally as volatile as those as those based on net income.
- Businesses that have a substantial number of employees, but make little income in certain years will still be paying their "fair" share, whereas an income base allows them to avoid taxation.
- For large medical non-profits, payroll is a rational basis upon which to assess the "fair" share of the cost of government services they consume.
- Employers are used to paying the Tri-Met payroll tax.
- A payroll-based tax should be relatively easy to calculate and administer, given the Tri-Met payroll tax infrastructure.
- Recent reduction of worker compensation rates leaves "room" for an additional tax on payrolls.

One caveat has to do with the question of whether and how payroll can be applied to tax out-of-jurisdiction firms doing business in Portland – which currently accounts for about 14% of business tax revenue. While out-of-jurisdiction apportionment is proposed with the payroll tax, maintaining some level of tax based on net income may represent the most tested and sure way of capturing revenues from non-local firms.

Business Impacts: Of the BIT replacement alternatives considered, linkage to payroll poses the least challenge for Portland and Multnomah County as a competitive location for business investment and operations. This is because the tax as proposed will represent only a small (less than 0.4%) addition to an existing, readily identifiable cost – business payroll.

Of the alternatives considered, taxing employment likely represents the closest measure of expense for public sector services directly attributable to business. To the degree that public service costs are proportional to employment, this also represents the most equitable mechanism for business taxation.

Services, wholesale/retail trade and finance/insurance/real estate would experience substantial reductions in their share of the total tax burden – from 76% to 57% of business taxes paid. Manufacturing would experience the largest increase – with other increases experienced by transportation/communications/utilities and medical non-profits (taxed for the first time).

Recommendation: A payroll tax is recommended for consideration as the major (but not exclusive source) for BIT replacement.

C. Net Income Tax with Cap

This alternative involves replacement of the BIT with a more streamlined business tax based on net business income but with a maximum tax liability (or *cap*) on total taxes paid by any business. The net income tax could involve features including:

- A minimum flat fee – for example, similar to the $100 minimum currently imposed by the City of Portland BLF.
- A tax set as a percentage of net income – consistent with federal income tax filing.
- A maximum tax liability set on the amount paid by any business – currently evaluated based on a maximum of $15,000 per firm in payment to the City and a separate $15,000 cap in payment to the County.
- A small business exemption of $125,000 – representing a more than two-fold increase from the $55,000 possible in 2002 with the current owners compensation deduction.
- Apportionment of business income for firms that: (a) are out-of-jurisdiction but do business in Portland; or (b) are located in Portland with some portion of sales outside of Portland and/or Multnomah County.

A net income tax with a rate targeted to generate the remaining portion of the $80 million target of revenue not covered by payroll tax could be accomplished with rates that are more than 60% below current BIT rates – and still provide a $15,000 maximum cap each in payments to the City and/or County.

Discussion: There are several reasons to pursue business tax reform that involves a net income tax with cap component:

- Amounts paid are directly linked to what the business tax payer has the ability to pay – in direct proportion to net income.
- In good economic times, City and County government benefit from significant revenue growth – that could be used if needed to stabilize the fund account or applied to reduce/eliminate the remaining income tax.
- The net income approach serves as a tested, legally defensible means to capture a fair share of tax revenue from out-of-jurisdiction firms that do business in Portland.
- Setting a "cap" on income tax eliminates the disincentive for large business payers under the current BIT to disinvest or relocate from the City and County.

Business Impacts: Going exclusively with an income tax would continue many of the inequities of the current BIT, even if accompanied by a tax payment cap of $15,000. Higher profit margin sectors that also comprise a high proportion of smaller businesses such as services and retail are most affected.

From the perspective of tax incidence, the service sector is affected most negatively – increasing from 32% to 38% of total business taxes paid (versus 24% of Multnomah County payroll). In contrast, sectors with higher proportions of larger companies – such as manufacturing, transportation/communications/utilities (TCU), and wholesale trade would tend to benefit, though with few dramatic changes. There could be considerable variation in increased or decreased tax levels between individual firms within a particular business sector depending on individual firm size and profitability.

Overall, while a 100% capped net income tax may correlate with ability to pay, it moves further away from the objective of tax equity between different business sectors. However, a tax based on net income offers the most definitive, tested means of assuring capture of tax revenues from out-of-jurisdiction firms doing business in Portland and Multnomah County.

Recommendation: A net income tax with cap is recommended for consideration as one of two revenue sources for BIT replacement – secondary to the payroll tax option. The combination of the payroll and net income tax approach provides a more balanced business tax system – better relating payment to business use of public services while still maintaining a proportion of the tax based on ability to pay.

D. Gross Receipts Tax

A fourth alternative would be to replace the BIT with a tax on gross receipts. This revenue source would reflect a change in tax policy from taxing profitability to taxing all of a firm's sales volume (irrespective of business profitability or employment).

The closest comparable system is the business and occupation (B&O) tax levied by the state of Washington – with five separate tax rates depending on the type of business.[10] B&O now serves as the second largest revenue source (behind sales tax) in Washington, but is widely viewed as creating a tax climate that has been characterized as "fundamentally hostile to business."[11]

There is no data readily available from City/County sources to reliably assess the amount of gross receipts revenue potentially available to be taxed from firms doing business or domiciled in Portland and Multnomah County.[12] An alternative source of economic modeling data provides an estimate of $53.5 billion in gross business transactions within Multnomah County as of 1999. Excluding government, county-wide gross receipts volume is estimated at $48.5 billion.[13] Full replacement of the current $80 million in BIT could be generated with a flat gross receipts tax estimated at 0.165% of non-governmental revenues, assuming no apportionment of revenues.[14]

Discussion: Advantages of a gross receipts tax relate primarily to relative ease of administration and potential (though as yet untested) capability to also capture revenues from out of jurisdiction businesses that have sales within Portland or Multnomah County.[15]

These potential advantages are offset by a series of disadvantages including:

- Need to set differential rates for different types of business to avoid creating an economic disincentive – particularly for high volume businesses such as wholesale/distribution and some forms of retail.
- Limited allocation for firms selling outside of the local jurisdiction – if the Washington state model is followed.[16] However, allocation might be considered by the City/County..
- Added time required to achieve a mix of rates acceptable politically and to the business community.

- Potential legal issues associated with setting differential tax rates on gross receipts in Oregon.[17]
- Unpopularity and concerns with unfair application of the gross receipts tax – particularly as experienced in neighboring Washington State.
- Lack of data on current business revenues – to reliably forecast revenues that could be realized in Portland/Multnomah County.

Business Impacts: If implemented as a flat percentage rate across all businesses, this alternative would need to average approximately 0.165% of all gross receipts.[18] Compared to the current BIT, this method most negatively affects Portland and Multnomah County's competitive position for high volume, *traded sector* firms doing considerable business outside Portland and Multnomah County – notably manufacturing, construction and transportation/ communications/ utilities (TCU). Their combined share of total business tax payments would increase from 23% to 45%, versus their 34% share of Multnomah County non-governmental payroll.

Recommendation: Not recommended for further consideration.

E. Registration Fee

A "registration fee" generally has been suggested not for total BIT replacement, but possibly as one component of a multi-source business tax system. The fee would target an arbitrary portion of the needed revenue (say $10-20 million) and divide that by the total number of taxpayers in the system.

A business would pay a flat "registration fee" regardless of payroll or income and then pay a tax based on payroll or income or both. The concept is to charge a "tax" so as to be entitled to do business in the City/County. This idea could be either a partial or total revenue source.

With an estimated 23,700 firms in Multnomah County (based on 2000 covered employment records), the fee required to generate $80 million could be as much as $3,380 *per firm.* If the revenue portion to be targeted by this source were reduced to $10 million, the per firm annual fee would drop to about $425. If all 35,100 businesses in the City/County data base were charged (including non-covered businesses), the per business amount could be dropped further to an estimated $285 per business.

Discussion: Whether as a total or partial BIT replacement revenue source, a flat registration fee likely would prove to be politically unacceptable. The tax would be particularly onerous for small including start-up businesses – substantially exacerbating the economic disincentive of Portland for small business. For small and emerging businesses in Portland, the registration fee could be essentially tripled or quadrupled from the current license fee minimum of $100, even with only partial BIT replacement of $10 million.[19]

Business Impacts: From a competitive standpoint, the negative disincentive posed by a flat registration fee occurs both by size of firm as well as by business sector. Small business enterprises would be most negatively affected – at a flat fee averaging as much as $3,380 per firm (to achieve revenue neutrality with 100% replacement). This represents a nearly 34-fold increase for a business currently paying the City of Portland $100 business license fee minimum.

Sectors with high proportions of small firms would also see their proportions of the business tax burden increase. Services, retail and construction would increase from 51% to 68% of total business tax payments versus 42% of Multnomah County payroll.

Recommendation: Not recommended for further consideration.

F. Real Estate Transfer Tax

A real estate transfer tax is used by many governmental entities throughout the U.S. – both states and local jurisdictions. Examples closest to home are Washington County and the state of Washington. The tax can apply to just commercial sales or to both commercial and residential. The tax most commonly is applied to sales transactions, but could also be considered for mortgage financings.

A 2% transfer tax applied to all commercial and residential sales in the City/County, based on the average of 2000 and 2001 sales (excluding mortgage refinancings) could raise an estimated $80+ million annually.[20]

Discussion: Some form of a real estate transfer tax offers many potential advantages including:

- A clear and reasonable connection to the consumption of governmental services – the bigger the building, the bigger the tax.
- Collection of the tax at a time the money is readily available – at the time of sale or mortgage recording.
- Easy, seamless administration – in conjunction with County recording of sales and/or mortgage transactions.
- Broadening the base of taxpayers to include residential as well as commercial and industrial property.
- Nearby examples of successful use – Washington County and the State of Washington.

Despite these advantages, there are compelling reasons for rejecting this alternative at this time. Reasons are essentially two-fold: a) action of the state legislature (to overturn a 1987 statute that appears to prohibit such a tax) would be required; and b) a substantial part of the tax burden would be shifted away from business and toward homeowners.

Business Impacts: Undoubtedly this proposed tax has some differential impact by type of business. Firms in finance, insurance and real estate (FIRE) could be the most directly affected although many of these costs would be passed on to users in other sectors (e.g. as lessees of commercial and industrial building space).

The more significant effect is a shift from what has been a 100% business tax to what would become a tax paid 78% from single family sales transactions – with 22% from multi-family and commercial industrial sales.[21] The business-generated revenue portion of an $80 million replacement package would amount to about $18 million, with $62 million from single family residential sales. This represents what is likely a politically unacceptable shift in tax burden from business to residential taxpayers.

Recommendation: Not recommended for further consideration at this time. If a real estate transfer tax were considered in the future, the commercial/industrial portion might be dedicated to business tax reduction with the residential portion dedicated to net City/County general fund or specific program enhancements.

G. Other Business Tax Alternatives

There are other alternatives that could be considered – including hybrids or combinations of the above described business tax replacement options. One of the possibilities suggested is a stepped rate structure – where the tax is imposed in *steps or brackets* and is a flat dollar amount, not a percentage. A flat dollar cap on the maximum tax payable might also be included.

A stepped system could be applied to a variety of taxation methods: income, gross revenue, or payroll. Proponents argue that this system is "fairer," "simpler," and that the cap will help to stop businesses from leaving the City/County.

The starting point for analyzing a "step" system is to compare it to a percentage system. An example of a "step" system based on number of employees is provided by the following chart.

Stepped System Illustrated (with Payroll Tax)

Number of Employees	Amount of Tax
1-5	$2,000
5-20	$4,000
20-100	$10,000
100 plus	$25,000

Discussion: The fundamental problem with any *stepped system* is that it is inherently less fair than a straight percentage tax system. With the example noted above, the business that has 5 employees sees its tax go from $2,000 to $4,000 when a 6^{th} employee is added. By comparison, if a percentage system was in use, the addition of a sixth employee would cost much less, more in the range of an added $200-$400. In effect, a straight percentage rate represents a fairer system because it constitutes an infinite series of infinitely small step adjustments – more *in synch* with actual business activity.

Business Impacts: The effects of a *stepped system* are more by size than type of business. Businesses most disadvantaged would be those at the threshold required for a step rate increase.

Recommendation: Not recommended for further consideration.

Summary of Alternatives & Impacts

A summary of the alternatives considered and their impacts is provided by the chart on the following page. For each alternative (as applicable), the tax rate required to raise $80+ million in total revenue – assuming 100% BIT replacement – is illustrated. Impacts addressed relate to *competitiveness* of Portland/Multnomah County as a business location and business *taxpayer* fairness.

Figure 2. Business Tax Alternatives & Impacts

Business Tax Alternative*	Tax Rate Required**	Issues & Impacts
A. BIT Reduction & Refinement	No specific proposal	*Legal:* No identified issues to date; depends on specific refinement considered. *Competitive:* Depends on measure considered. Increased owners comp deduction helps sole proprietor, limited partner firms. *Taxpayer:* Generally aimed to reduce burden on professional and service firms, and assist small and/or large businesses.
B. Payroll Tax	0.395% of payroll	*Legal:* Similar to Tri-Met tax; question of taxing out-of-jurisdiction. *Competitive:* As a direct add-on to payroll, may be perceived as a less direct effect on business profit margins. *Taxpayer:* Best links use of public services to funding responsibility.
C. Net Income Tax with Cap	Of net income: 0.55% County 0.84% City	*Legal:* No identified issues due to BIT precedent. *Competitive:* Relatively volatile revenue source and likely disincentive to business if used 100% for BIT replacement. *Taxpayer:* Least fair for creative and professional services; benefits manufacturing, wholesale/distribution and TCU, but provides assured capability for generation of revenues from out-of-jurisdiction firms.
D. Gross Receipts Tax	0.165% of gross receipts (City & County)	*Legal:* No direct precedent in Oregon, though a comparable (B&O) tax is the #2 revenue source in the state of Washington. *Competitive:* Can be significant location disincentive for high volume firms with significant non-local sales. *Taxpayer:* Most negative effect on high volume firms with significant non-local sales – construction, manufacturing and TCU.
E. Registration Fee	Up to $3,380 per business (23,700 covered employers)	*Legal:* No identified issues. Question of whether to tax covered employers only or all firms in the current City/County business license system. *Competitive:* Disincentive for small/startup firms in Portland/Multnomah County – especially services, retail and construction. *Taxpayer:* Most onerous for small/unprofitable firms.
F. Real Estate Transfer Tax	2% on transaction value	*Legal:* Requires amendment or replacement of 1987 state statute. *Competitive:* Links consumption of government services to property use, turnover and new construction. *Taxpayer:* Shifts tax burden from businesses to residential property owners.
G. Other Alternatives – Including Hybrids	Depends on alternative selected	*Legal:* Depends on alternative selected. *Competitive:* Disincentive greatest for firm at lower-end of step category. *Taxpayer:* May shift burden to smaller businesses (depending on specific step structure).

Notes: * **Boldface** type denotes a recommended alternative.

** Indicates rate required to achieve $80 million and revenue neutrality with 100% BIT replacement for the indicated alternative, with the exception of Alternatives B & C, which are proposed in conjunction with each other.

Source: E.D. Hovee & Company. Estimates are preliminary and subject to change.

III. BIT REPLACEMENT STRATEGY

Based on a review of the alternatives considered, the Portland Business Alliance is recommending replacement of the current City/County business tax system with a two-source business revenue mix involving:

- ***Payroll Tax –*** targeted to a rate of 0.395% to generate approximately 2/3 of current BIT revenue from in-County firms *plus* apportioned payroll from out-of-jurisdiction firms.
- ***Net Income Tax –*** at rates about 38% of current levels with a $15,000 cap on any individual business taxpayer each with the City and County respectively.

Line item elements of the proposed BIT replacement strategy and associated revenues generated are as detailed by the following chart.

Figure 3. BIT Replacement Package (Draft Proposal)

Replacement Strategy		Description	Estimated Impact	Comments & Issues
1. Payroll Tax - Set @ 2/3 of Current $80 Million BIT - Before Adding Out-of-Jursidiction Firms				
Rate				
0.395%		Establish payroll tax exempting governments and all non profits	$51,230,000	Payroll tax out of city's charter; precendence set by Tri-Met, who levies a 0.618% tax.
0.395%		Establish payroll tax on medical non-profits	$2,600,000	Draft proposal covers private, non-profit and public hospital facilities.
0.000%		Payroll tax on other non-profits	$0	Not included with this draft proposal.
0.395%		Establish payroll tax on out-of-jurisdiction firms	$5,320,000	Proposed based on payroll apportioned by in-jurisdiction firms. Estimated based on 9% of gross City/County sales vs. 14% of BIT currently. Legal issues currently being reviewed. Actual revenues may vary from estimate.
		Subtotal Payroll Tax	$59,150,000	
2. Net Income Tax with $15,000 Cap/$125,000 Small Business Exemption - For Balance of $80 Million				
Cap Amount	Rate			
$15,000	0.84%	City revenue	$13,010,000	Retains $100 minimum
$15,000	0.55%	County revenue	$7,840,000	
		Subtotal Net Income Tax	$20,850,000	
Total Revenue Target			$80,000,000	

Note: Preliminary payroll tax revenue projections are based on Oregon Employment Department covered payroll data for Multnomah County. Net income tax revenue projections have been prepared using the City/County FY 2000 business license database. This database accounts for approximately 90% of the tax revenue collected in FY2000 and therefore represents a conservative representation of tax generation potential. In effect, required income tax rates may be overstated by as much as 10%.[22]

Source: E.D. Hovee & Company, based on spreadsheet model developed by Multnomah County and utilizing City of Portland business license data. Financial projections are preliminary and subject to change.

As proposed, the *payroll tax* would be similar to that levied by Tri-Met but limited to businesses located in Portland and Multnomah County. As with Tri-Met, private firms, hospitals and self-employed would be subject to the payroll tax. Public agencies and non-profits (except medical) would be tax exempt. Another $5+ million is proposed to be generated in apportioned payroll from out-of-jurisdiction firms – as determined to be legally feasible.[23]

Net income tax rates are proposed to generate the balance of the $80 million BIT revenue being replaced – at approximately 1.39% of net business income for the City/County combined. City/County rates would both be reduced from current levels by *proportionately the same ratios* – to about 38% of current rates. The current $100 in-city minimum fee would be retained with this proposal. Apportionment for out-of-jurisdiction activity also would be maintained.

Floating Rates to Limited Growth Revenue Targets: The projections outlined above constitute potentially conservative representations of revenues that actually may be realized by the City of Portland and Multnomah County for reasons including:

- As yet undetermined potential for added payroll tax from self-employed individuals not included as part of Oregon Employment Department covered employment estimates.
- Scaled back projections for out-of-jurisdiction payroll apportioned by proportion of City/County sales that may be subject to tax – if found to be legally feasible.
- Inclusion only of tax records for which detailed information is currently available in the City of Portland business license database – which appears to understate actual revenue collected.

If revenues realized prove to be greater than projected upon implementation, PBA would recommend that the savings be passed back to the taxpayer – with first priority to reducing or eliminating the income tax portion of the business tax system.

PBA also proposes limiting future increases in total tax amounts to the $80 million 2003/04 revenue target *plus* an annual growth factor based on the rate of inflation plus population growth. Tax rates would be adjusted down to maintain expenditure growth that *does not exceed* this targeted growth formula – with first priority also given to reducing or eliminating the income tax portion of the business tax system.

Impact Evaluation

Impacts and implications of the proposed BIT replacement strategy can be divided into three components:

- *Competitive effects* – focused on the profitability of doing business in the City of Portland and Multnomah County.
- *Taxpayer fairness* – related to the distribution of tax burden relative to employment.
- *Future statewide/regional tax reform* – to further level the "playing field" in the event of major tax restructuring extending beyond Portland and Multnomah County.

Competitive Effects. Critical to the assessment of any BIT replacement strategy is the question of whether or not the tax is perceived as onerous enough to affect a business location decision. From a financial perspective, the decision can hinge on the effects that a particular tax has on business profitability.

The following chart compares profit margins, by type of business, pre-tax followed by the proportions of profit margins represented by the current BIT tax structure versus the proposed replacement strategy.

Figure 4. Competitive Effects of BIT Replacement

Business Sector	2000 Profit Margins (% of Gross)	As % of Multnomah County Profit: Current BIT/BLF Revenue	BIT Replacement Revenue
Agriculture/Forestry/Mining	1.0%	3.5%	5.4%
Construction	3.4%	3.6%	5.8%
Manufacturing	3.6%	5.4%	11.5%
Trans/Comm/Utilities	0.5%	-5.3%	-8.9%
Wholesale Trade	3.1%	7.3%	7.0%
Retail Trade	4.7%	5.3%	5.2%
Finance/Ins/Real Estate	0.4%	5.5%	3.5%
Services	3.6%	11.3%	10.8%
Total (Non-Government)	2.0%	7.8%	8.4%

Note: Profit margin is defined as total adjusted net income (prior to apportionment, after owners compensation deduction) divided by total adjusted gross income, and was calculated from firms reporting both values (about 21,200 firms). Impact of tax revenue on profits reflect those businesses reporting total gross and net income, and gross Multnomah County and City of Portland income (about 18,500 firms).[24] This subset of businesses for which complete information is available is weighted toward larger businesses and businesses located outside of Multnomah County.

Source: E.D. Hovee & Company based on 2000 City of Portland business license data. Estimates are preliminary and subject to change.

Across all businesses for which gross and net income information is available, the average profit margin is in the range of just 2.0%. However, records within the City/County business license database indicate that profit margins vary by business sector. Some of the variation (in any given year) may be attributed to cyclical economic conditions that disproportionately affect certain business sectors. However, there also are differences in the profit structure of various business sectors.

The highest margin business sector in Portland/Multnomah County as of 2000 was retail trade, followed by services and manufacturing. The lowest margin businesses appear to be finance/insurance/real estate (FIRE) and transportation/communications/utilities (TCU) – at less than 1% each. These are sectors for which relatively small changes in tax burden could substantially affect profitability and competitiveness of a City/County location.

As a share of current (allocated) Multnomah County profit, services pay the highest proportion of reported sector profits in local business taxes (at over 11% of adjusted net income).[25] The service tax burden eases somewhat as a result of the BIT replacement package shift. Other sectors that would benefit from the replacement package include retail and wholesale trade and finance / insurance / real estate. Manufacturing would experience an increase in tax incidence relative to profit margin – to a level comparable with services.[26]

Taxpayer Fairness Effects. An overriding objective of BIT replacement is to reduce tax burden on business sectors paying a disproportionate share of tax payments. How this is achieved as a result of the BIT replacement strategy is illustrated, by major business sector, by the following chart.

With the proposed replacement strategy, business sectors that would see their share of the total business tax reduced are finance/insurance/real estate (FIRE), services, wholesale and retail trade. The combined share of business taxes paid by these sectors would drop from 77% to 64% of total revenues collected. These sectors currently account for 55% of total payroll in Multnomah County.

Figure 5. Taxpayer Effects of Proposed BIT Replacement Strategy

Business Sector	% of Covered Payroll	Current BIT Revenue	Current BIT % of Total	BIT Replacement Revenue*	BIT Replacement % of Total
Agriculture/Forestry/Mining	1%	$1,402,000	2%	$515,000	1%
Construction	7%	$4,589,000	6%	$5,404,000	7%
Manufacturing	16%	$7,342,000	9%	$10,561,000	14%
Trans/Comm/Utilities	11%	$6,514,000	8%	$7,825,000	11%
Wholesale Trade	10%	$8,741,000	11%	$7,497,000	10%
Retail Trade	11%	$10,698,000	13%	$9,267,000	12%
Finance/Ins/Real Estate	10%	$16,108,000	20%	$10,254,000	14%
Services	24%	$26,008,000	33%	$20,761,000	28%
Medical non-profits	5%	$0	0%	$2,603,000	4%
All Other non-profits	7%	$0	0%	$0	0%
Total (Non-Government)	99%	$80,000,000	100%	$74,680,000	100%
Out-of-Jurisdiction Firms	NA	(14% non-local incl. in above)		$5,320,000	NA
Total (All Sources)	--	$80,000,000	--	$80,000,000	--

* Note: BIT replacement revenue is comprised of capped net income and payroll tax components. For out-of-jurisdiction firms, capped net income is included in revenue totals by sector; payroll component is reported in aggregate as separate line item. The reduction in revenue indicated for agriculture/forestry/mining is in part due to incomplete tax records for businesses within these sectors. Distribution comparisons are estimates; payroll distribution refers to businesses within Multnomah County, whereas current and replacement tax distribution figures refer to businesses within and outside of the county.

Source: E. D. Hovee & Company, based on City of Portland Business License and Oregon Employment Department covered employment data. A more complete comparison on a *per employee* as well as *% distribution basis* is made for the proposed replacement strategy and other alternatives considered – as described and illustrated in this report Appendix. Estimates are preliminary and subject to change.

In all cases, the tax burden would shift to closer alignment with each sector's share of total payroll in Multnomah County. Industries that are currently underrepresented in taxes paid (relative to total payroll) would see their share of business taxes increase. Sectors that are proportionately high payers would see their share of City/County business tax payments reduced.

In addition, the transition from a tax system dependent on net income to primary emphasis on payroll will improve stability of tax revenues through the business cycle. Both City and County can expect less fluctuation with a payroll-dominant business tax system than with the current BIT.

Future Statewide/Regional Tax Reform: This BIT replacement package could serve as either an interim or long-term source of tax reform. If substantive tax reform occurs on a regional or state-wide basis, the additional revenues generated from businesses in Portland and Multnomah County should be applied to:

- Reducing income tax and then employer tax rates as warranted by new regional/state business taxes levied in the City/County.
- Fully eliminating this interim package if the net business revenue generated from Multnomah County via a statewide or regional tax reform measure equals or exceeds BIT replacement revenues.

NEXT STEPS

As noted at the outset, this is the second *preliminary working draft* of a proposed BIT/BLF replacement strategy and impact assessment – intended for review and discussion with the Portland Business Alliance and Community Partnership Steering Committee. Additional steps suggested by this analysis include the following items:

1. *Testing of business tax revenue projections and proposal refinements* – including mix of proposed revenue sources.

2. *Refinement of the payroll tax option* – particularly to better address self employment and out-of-jurisdiction revenue potentials. For self employment, additional revenue information from Tri-Met could prove useful. For out-of-jurisdiction firms, supplemental business license data together with an assessment of legal issues likely will be needed.[27] Further discussion also may be warranted as to inclusion/exclusion of medical and other non-profits.

3. *Refinement of the business income tax proposal* – addressing such questions as revenue targets, City versus County tax rates, City/County minimum payments and not to exceed payment caps, and income tax phase-out over time.

4. *Greater focus on revenue allocation between the City and County* – going beyond achieving an $80 million total revenue objective to an appropriate allocation similar to the current approximate $50 million City / $30 million County revenue split. Specifically with the payroll tax, this requires consideration of the form of an intergovernmental agreement and revenue allocation mechanism.

Questions and comments regarding any aspect of this *second working draft* are appreciated.

APPENDIX. IMPACTS OF BIT REPLACEMENT FOR ALTERNATIVES CONSIDERED

The following two pages provide detailed charts intended to illustrate potential impacts of various alternatives evaluated for BIT replacement.

Business Sector Effects (Figure 6). The two charts on the following page provide a summary comparison of economic and taxpayer fairness effects for the alternatives considered with this impact assessment. Alternatives shown for each type of impact are:

- Current BIT rate structure (as a baseline for alternative comparison)
- Payroll tax (assuming 100% replacement)
- Net income tax with cap (100% replacement)
- Gross receipts tax (100% replacement)
- Registration fee (100% replacement)
- Real estate transfer tax (100% replacement)
- BIT replacement strategy (74% payroll tax, 26% income tax with cap replacement)

The top chart (part A) depicts tax incidence of each alternative on a *per employee* basis. The second chart (part B) provides a *% distribution* of the tax incidence, by business sector.

It is noted that estimates provided in this draft report are preliminary and subject to further validation and refinement.

11 Businesses Examples (Figure 7). Impacts are outlined for 11 different types of businesses indicative of a cross-section of Portland/Multnomah County firms. Base information for these examples has been provided by the City/County from actual tax records – with each example representing several similar firms so as to avoid disclosing information for any particular company.

Figure 6. Business Sector Impacts of BIT Replacement Alternatives

A. Tax Incidence per Employee

Business Sector	2000 Mult Co. Avg. Payroll	2000 BIT/BLF Revenue	Business Tax Alternative Evaluated (assuming 100% BIT replacement): Payroll Tax	Capped Net Income*	Gross Receipts	Registration Fee	Real Estate Transfer Tax	Recommended BIT Replace Strategy*
Ag/Forestry/Mining	$25,363	$391	$135	$180	$76	$320	NA	$139
Construction	$46,355	$218	$248	$273	$279	$321	NA	$247
Manufacturing	$43,745	$147	$234	$111	$377	$88	NA	$204
Trans/Comm/Utilities	$49,628	$200	$265	$112	$307	$99	NA	$232
Wholesale Trade	$43,884	$281	$234	$203	$210	$258	NA	$233
Retail Trade	$20,869	$150	$111	$147	$87	$195	NA	$125
Finance/Ins/Real Estate	$47,093	$515	$252	$489	$376	$252	NA	$316
Services	$24,614	$193	$131	$219	$133	$236	NA	$148
All Sectors Average	$37,455	$217	$205	$205	$205	$205	$45	$205

*Notes: Excludes out-of-jurisdiction firms for payroll portion of estimate except for totals. Based on Multnomah County covered employment.
Capped Net Income figures assume that owners compensation deduction remains unchanged.

B. % Distribution of Tax Incidence

Business Sector	2000 Mult Co. Payroll	2000 BIT/BLF Revenue	Business Tax Alternative Evaluated (assuming 100% BIT replacement): Payroll Tax	Capped Net Income*	Gross Receipts	Registration Fee	Real Estate Transfer Tax	Recommended BIT Replace Strategy*
Ag/Forestry/Mining	1%	2%	1%	1%	0%	1%	NA	1%
Construction	7%	6%	7%	7%	8%	9%	NA	7%
Manufacturing	16%	9%	17%	7%	24%	6%	NA	14%
Trans/Comm/Utilities	11%	8%	12%	5%	13%	4%	NA	10%
Wholesale Trade	10%	11%	10%	8%	8%	10%	NA	10%
Retail Trade	11%	13%	11%	14%	8%	18%	NA	12%
Finance/Ins/Real Estate	10%	20%	11%	20%	15%	10%	NA	14%
Services	24%	32%	25%	38%	23%	41%	NA	28%
Medical non-profits	5%	0%	5%	0%	0%	0%	NA	3%
All Other non-profits	7%	0%	0%	0%	0%	0%	NA	0%
Total (Non-Government)	100%	100%	100%	100%	100%	100%	22%	100%
Residential Sector							78%	

*Notes: Excludes out-of-jurisdiction firms for payroll portion of replacement strategy.
Capped Net Income figures assume that owners compensation deduction remains unchanged.

Source: E. D. Hovee & Company from City of Portland Business License, Oregon Employment Division and Multnomah County data and worksheet.

Figure 7. Illustrative Impacts of BIT Alternatives to 11 Businesses

	Hypothetical Businesses		Payroll Tax	Net Income Tax with Cap	Gross Receipts Tax	Registration Fee	Current BLF/BIT Collections	BIT Replacement Strategy	Variance
1	**Large manufacturer: $50M net income, $1B gross income**								
	Gross revenue	$1,000,000,000	$26,709	$15,000	$1,652,091	$3,380	$18,250	$26,700	-$8,450
	County/City taxable income (loss)	$500,000							
	County/City payroll	$5,000,000							
2	**Large manufacturer: net loss**								
	Gross revenue	No data	$26,709	($0)	NA	$3,380	$100	$19,750	-$19,650
	County/City taxable income (loss)	($1)							
	County/City payroll	$5,000,000							
3	**Large financial services corporation: $1B net income, $50B gross income**								
	Gross revenue	$50,000,000,000	$53,417	$15,000	$82,604,558	$3,380	$182,500	$69,500	$113,000
	County/City taxable income (loss)	$5,000,000							
	County/City payroll	$10,000,000							
4	**Large financial services corporation: net loss**								
	Gross revenue	No data	$53,417	($0)	NA	$3,380	$100	$39,500	-$39,400
	County/City taxable income (loss)	($1)							
	County/City payroll	$10,000,000							
5	**Small medical practice sole proprieter: $100K net income, $150K gross income**								
	Gross revenue	$150,000	$267	$4,876	$248	$3,380	$1,679	$545	$1,134
	County/City taxable income (loss)	$46,000							
	County/City payroll	$50,000							
6	**Medium sized law firm partnership: $2M net income, $5M gross income**								
	Gross revenue	$5,000,000	$5,342	$15,000	$8,260	$3,380	$43,435	$10,900	$32,535
	County/City taxable income (loss)	$1,190,000							
	County/City payroll	$1,000,000							
7	**Small restaurant sole proprietor: $30K net income, $200K gross income**								
	Gross revenue	$200,000	$534	$795	$330	$3,380	$274	$499	-$226
	County/City taxable income (loss)	$7,500							
	County/City payroll	$100,000							
8	**Large financial/broker corporation: $500M net income, $3B gross income**								
	Gross revenue	$3,000,000,000	$26,709	$15,000	$4,956,273	$3,380	$60,935	$42,946	$17,990
	County/City taxable income (loss)	$1,669,460							
	County/City payroll	$5,000,000							
9	**Small retailer sole proprietor: $30K net income, $1M gross income**								
	Gross revenue	$200,000	$668	$795	$1,652	$3,380	$274	$598	-$324
	County/City taxable income (loss)	$7,500							
	County/City payroll	$100,000							
10	**Commercial building lessor sole proprietor: $200K net income, $1M gross income**								
	Gross revenue	$1,000,000	$267	$15,000	$1,652	$3,380	$5,329	$1,240	$4,089
	County/City taxable income (loss)	$146,000							
	County/City payroll	$50,000							
11	**Business consulting firm sole proprietor: $75K net income, $100K gross income**								
	Gross revenue	$100,000	$0	$2,226	$165	$3,380	$767	$261	$506
	County/City taxable income (loss)	$21,000							
	County/City payroll	$0							

Source: Bureau of Licenses, E.D. Hovee & Company. Estimates are subject to refinement.

ENDNOTES

[1] The owner's deduction of $55,000 is as of the 2002 tax year.

[2] The ECO Northwest study notes that, relative to Portland, a firm locating in Gresham reduces its tax liability by 9%. A firm locating in Washington or Clackamas County saves about 15%.

[3] The temporary tax increase of 0.5% levied during the 1998 tax year was collected over tax years 1998-99 and 1999-2000.

[4] As cited by a City of Portland Financial Planning report dated October 28, 2002 titled "Portland Business License Revenues: Volatile & Hard to Predict or Cyclical and Predictable?"

[5] In its analysis, the City of Portland makes minimal mention of the economic impacts of the tax. The City analysis also appears not to address the long-term revenue impact from reduced competitiveness for a broad spectrum of economic activity – particularly professional and creative services.

[6] Tri-Met payroll tax rate of 0.6218% is as of January 1, 2002.

[7] This is the same tax base as the Tri-Met payroll tax. The payroll data currently available is for covered employment, meaning employment covered by unemployment insurance. So, estimates of revenues calculated include self employed that contribute (voluntarily) to unemployment insurance, but do not include potential revenues associated with self employed that opt out of unemployment insurance coverage.

[8] Additional revenues from out-of-jurisdiction firms (if taxable) and self-employed without unemployment insurance could yield added revenues or lower the tax rate required. Added revenues would be in the range of 14% if apportionment occurred based on proportion of sales within the local jurisdiction similar to the current BIT/BLF.

[9] Apportioned payroll tax projections (for out-of-jurisdiction) firms should be viewed as conservative for two reasons. These reasons are: a) only payrolls for employers covered by unemployment insurance are currently used in tax calculations – additional revenues from non-covered self-employed could be expected; and b) the current 14% BIT add-on has been discounted to 9% for payroll – reflecting added payroll tax from in-jurisdiction firms currently not reporting taxable revenue for BIT purposes.

[10] The State of Washington business and occupation (B&O) tax system was enacted as a bit of an historical accident. In 1933, the Washington State Legislature adopted a state income tax with B&O as a stopgap replacement. The state Supreme Court overturned the income tax, leaving the B&O as the only available alternative.

Washington B&O tax rates currently applied to gross business revenue are:
- 1.5% – services businesses including public and non-profit hospitals
- 0.484% – manufacturing, wholesaling and related activities
- 0.471% – retailing and environmental remediation
- 0.275% – travel agents, stevedoring
- 1.138% – agricultural products and prescription drug warehousing

A number of credits and deductions are also available – as means to reduce B&O tax liability.

[11] As cited in an article "No shortage of critics when it comes to state's burdensome B&O tax," *The Columbian*, December 31, 2002.

[12] Out of roughly 35,100 business license records for Multnomah County, an estimated 23, 450 (67%) provide information on gross receipts – including both firms domiciled in Multnomah County and out-of-jurisdiction firms paying a business tax.

[13] Data is from the proprietary IMPLAN input-output model providing estimates of economic transactions for every county in the U.S. No testing has been conducted at this date of the correlation of IMPLAN economic modeling estimates of business receipts in Multnomah County with what might actually be expected to be generated through the business license system of the City/County.

[14] These preliminary estimates include taxation of medical and other non-profits as well as self-employed.

[15] The method of apportionment for a gross receipts tax could be virtually the same as with the current BIT – with out-of-jurisdiction revenues apportioned on the basis of percentage of sales made within the City of Portland and Multnomah County. However, this mechanism and its applicability to a tax based on gross receipts rather than net income may require formal review.

[16] Some allocation (or apportionment) is possible in Washington, for example, if services by a Washington firm are performed on-site outside the state of Washington. Other sectors provide special allocations or credits on a sector-by-sector basis.

[17] Oregon statute stipulates that financial institutions cannot be charged at a rate different from other business types. This issue would require further legal research if a gross receipts tax were to be more actively considered.

[18] However, the 0.165% rate would be below any of the Washington B&O rates currently in place.

[19] As small as the above absolute dollars may appear to be, it is noted that about 10 years ago, when the City increased its minimum to $100, considerable opposition was expressed.

[20] As a point of comparison, Washington County levies a transfer tax of 0.1% on the selling price of real property located in the county. In the state of Washington, real estate excise tax rates range from 1.28% to 2.53% – depending on exercise of local jurisdiction options. Separate more detailed analyses of the real estate transfer tax option, including comparison with experience of other jurisdictions regionally and nationally, have been made by E. D. Hovee & Company on behalf of the Portland Business Alliance.

[21] The real estate tax calculations assume that the same transfer tax rate is applied to residential as to commercial/industrial real property tax transactions.

[22] Employer tax rates also may be overstated by an amount as yet undetermined, depending on the level of sole proprietor payroll (not covered by unemployment insurance) subject to tax.

[23] The $5+ million in out-of-jurisdiction apportioned payroll revenue should be viewed as an estimate with a considerable margin of error – due to lack of comparable data currently. This revenue source, if proven to be legally feasible, could be viewed as the potential means for funding the increase in the small business exemption from $55,000 (with the BIT as of 2002) to $125,000.

[24] For this reason, adjusted net income figures for fully reporting transportation/communications/utilities (TCU) firms appear negative in 2000, even though the experience of a broader set of firms reporting net income beyond Multnomah County is slightly positive.

[25] For an entire business sector (such as services), BIT/BLF taxes may exceed the nominal *marginal* combined City/County rate of 3.65%. This can occur for two reasons: a) total sector profits include deductions for firms with negative net income with no tax payment (rather than a negative payment); and b) the $100 in-City minimum payment means an effective tax rate in excess of the marginal rate for barely profitable firms.

[26] Transportation, communications and utilities (TCU) represents a bit of an anomaly for 2000. Overall, the sector indicates a relatively thin 0.5% profit margin. Taxes as a % of profit are indicated as negative on a smaller number of reporting firms all data items – for whom profit *before taxes* was negative.

[27] The data base provided by the City of Portland Bureau of Licenses does not distinguish in versus out-of-jurisdiction records. Such distinctions will be necessary to run apportionment estimates for out-of-jurisdiction firms.