PUBLIC HEARING: SB 67

TAPES 087-088, A/B

SENATE REVENUE COMMITTEE

March 28, 2001 — 8:30 A.M. - HEARING ROOM A - STATE CAPITOL BUILDING

Members Present: Senator Lee Beyer, Vice Chair

Senator Susan Castillo

Senator Tony Corcoran

Senator John Minnis

Senator Charles Starr

Members Excused: Senator Ted Ferrioli, Chair

Senator Gary George

Staff: Paul Warner, Legislative Revenue Officer

Ed Waters, Economist, Legislative Revenue Office

Carol Phillips, Committee Assistant

Witnesses: Gary Carlson, Associated Oregon Industries

Steve Palmquist, entrepreneur

Larry Sitz, Associated General Contractors

Dee Burch, Associated General Contractors

Don Schellenberg, Oregon Farm Bureau

Don Cersovski, Oregon Farm Bureau

Debra Buchanan, Department of Revenue

Eric Blackledge, Governors Small Business Council

Steve Lanning, American Federation of Labor-Congress of Industrial Organizations (AFL-CIO)

J. L. Wilson, National Federation of Independent Business (NFIB)

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005	Vice Chair L. Beyer	Meeting called to order at 8:35 a.m.

OPENED PUBLIC HEARING ON SB 67

009	Ed Waters	Gave overview of the bill. SB 67 reduces maximum personal income tax rate for capital gains to 4%. (Currently capital gains are taxed as ordinary income at 5%, 7%, and 9%, depending on taxable income of the taxpayer.) Reduces corporate income tax rate for capital gains to 4%. (Currently corporate capital gains are taxed as net income at 6.6%.) Applies to tax years beginning on or after January 1, 2002. Pointed out that currently capital gains are taxed as ordinary income in Oregon; that is, there is no distinction made from other sources of income.
025	Gary Carlson	Testified in support of the bill. (Exhibit 10.) Quoted Alan Greenspan from testimony made before Congress regarding capital gains tax, "…its major impact…is to impede entrepreneurial activity and capital formation…While all taxes impede economic growth to one extent or another, the capital gains tax is at the far end of the scale. The appropriate capital gains tax rate should be zero." Gave the following information: • Over half of all families own assets subject to the capital gains tax, and nearly 2/3 of all families will own such assets at some time. • Oregon's state capital gains tax is the second highest in the US (only California is higher) and one of the highest rates in the world.

- Venture capital funding for Oregon businesses would increase by 13% to 17% after a cut in capital gains tax.
- Lower tax rates would increase asset values of Oregon's small businesses, farms, and investment property by 4.5%, help seniors reduce the risk of their retirement funds, and provide greater purchasing power to Oregon investors.
- The tax cut "helps most people and hurts no one".
- The middle class would benefit from the cut, in addition to the obvious benefit to people in higher income brackets.

- Senior citizens would benefit, as they now bear a disproportionate share of the tax burden, as well as a large "excess burden" through holding riskier portfolios.

115	Carlson	Discussed page 5 of Exhibit 10: Basic Facts About the Capital Gains Tax in Oregon.
133	Carlson	Discussed page 7 of Exhibit 10: Capital Assets and the People Who Own Them.
148	Carlson	Discussed page 8 Exhibit 10: Ownership of Capital Assets.
159	Carlson	Discussed page 10 Exhibit 10: State Capital Gains Tax Rates. This is a graph showing Oregon has the second highest capital gains rate in the United States. Washington State has no capital gains tax.
169	Carlson	Discussed page 11 Exhibit 10: Capital Gains Tax Rates Around the World.
175	Carlson	Discussed volatility in the two charts on page 12 Exhibit 10.

180	Carlson	Discussed page 13 Exhibit 10: Relative Importance of Capital Gains.
195	Carlson	Discussed page 14 Exhibit 10: How Are Capital Gains Different? Shows how after adjusting for inflation the effective tax rate of capital gains is not 29% on a hypothetical 9% example, but is actually 44% measured against the real return after inflation.
208	Carlson	Discussed page 16 Exhibit 10: Double Taxation of Income.
230	Carlson	Discussed page 20 Exhibit 10: Venture Capital and Capital Gains Tax Rate.
248	Carlson	Discussed page 21 Exhibit 10: Self-Sufficiency in Retirement.
269	Carlson	Discussed page 24 Exhibit 10. Cutting capital gains tax rate increases investment spending, raises labor productivity, raises demand for labor, and raises wages. A capital gains cut helps most people and hurts no one.
279	Carlson	Discussed page 27 Exhibit 10:Asset Values. It is estimated that the market value of Oregon’s small businesses, farms, and investment property would rise by 4.5% after the capital gains tax rate is cut.
289	Carlson	Discussed page 28 Exhibit 10: Listed several effects on tax revenues that could be expected upon a tax cut.
321	Carlson	Discussed page 33 Exhibit 10: Graph showing Revenue Effects of Capital Gains Tax Cut.
354	Carlson	Discussed page 34 Exhibit 10: Income Classes.

Referred to an example of the owner of a beauty salon. Stated that unless a person investigates "under the numbers", it would be easy to assume that lower capital gains taxes benefit only the rich. This is not the case at all. Oregon is the state most dependent on small business in the US. Oregon seems to attract people who want to be independent and run their own business.

386	Carlson	Discussed page 35 Exhibit 10: Estimated Distribution of Individual Capital Gains Tax Relief. People with incomes of below $75,000 generate half of all capital gains in Oregon.
398	Carlson	Stated Oregon is in need of tax code changes to benefit the state economically and its citizens. Would like to see SB 67 considered this legislative session. Amendments have been drafted to offer choices on how to proceed with a tax reduction. Questions and answers followed.
459	Carlson	Explained that Oregon is currently one of nine states estimated to already be in recession. Among the Western states, Oregon has been determined to be the slowest growing. This may be due to the heavy impact of taxation imposed by the state on income, particularly capital gains and investment income.
476	Carlson	In answer to question from Sen. Corcoran as to what areas of the current budget should be cut, Carlson answered the Public Employee Retirement System (PERS) needs some reworking.

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041	Carlson	Continued comments on budget areas that could be cut or adjusted. Explained a bill AOI promoted in previous legislative sessions that will be heard this week in a committee other than Senate Revenue. The premise is a simple

		budgetary tool in which if a state position stays vacant for six months, the position and the dollars revert to the fund from which they were appropriated. When former Gov. Roberts discussed the need to restrain government spending, she announced the cut of about 3,000 positions. In reality, no employees lost their jobs. Vacant positions were cut.
058	Carlson	Added that the State Motor Pool is another area that could use revision. One suggestion is to sell off the vehicles and reimburse employees for using their private vehicles, and possibly contracting out transportation needs of agencies. Stated that Oregon has one of the most expensive corrections systems in the country. There should be savings made somewhere in the system if Oregon is so far out of adjust-ment with other states. Further questions and answers followed.
145	Vice Chair L. Beyer	Stated that simply lowering capital gains tax is no assurance that it will result in higher investment necessarily, as evidenced by Washington's or California's economies. Also, there have been significant increases in venture capital investments in Oregon over the last two years. Believes it has more to do with the quality of opportunities in Oregon and not the tax treatment. Smart money follows smart ideas more than taxes. Further comments, and questions and answers interspersed.
198	Waters	Explained that the capital gains assumptions underlying the revenue impact of this bill are those built into the March 2001 revenue forecast. It uses a figure of around $4 billion in capital gains realizations per tax year, which is considerably under what has occurred in the 1997-98-99 tax years.

235	Steve Palmquist	Testified in support of the bill. Believes the capital gains tax structure in Oregon is resulting in fewer jobs and lower wages. Whether intentional or not, it has a significant impact on the state. Pointed out that figures show lowering capital gains rates benefits all levels of society… including government. Many Oregon entrepreneurs move to Washington to set up businesses because of the more favorable tax situation. Any capital gains tax takes away growth. Extensive questions and answers interspersed.

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017	Palmquist	Continued comments, and questions and answers. Stated that business owners' behavior is driven by what the legislature does. Legislative actions drive decisions that people make. If the legislature makes Oregon a difficult place to grow a business, those business owners will simply go do it somewhere else. There are people who will stay in Oregon no matter what the business climate may be. However, when Mr. Palmquist starts up his next business, he will do it in Vancouver, Washington because Oregon is a very unfavorable place to do it.
095	Palmquist	Stated that over the next decade tens if not hundreds of billions of dollars will probably be invested in high-tech and biotech industries, with nothing going into timber-related industries. The biotech revolution has just barely started. It is now where the PC industry was in 1972. It is something the state should actively pursue to bring in those dollars. Believes the high-tech revolution, too, has just begun. Most people cannot use a computer, and those who do use only a fraction of its capabilities. Believes the interface with computers will be speech rather than keyboards. That will allow virtually everyone to use a computer. Sees tremendous investment to be made in that area.

135	Larry Sitz	Testified in support of the bill. Stated that the construction industry is not one of the "leader" industries in Oregon, but it is definitely a support industry that is highly affected by changes that occur in the economy. The capital gains tax is a huge disincentive for companies that are equipment-heavy like road building and paving. They have a lot of capital investment involved in conducting business. This is true particularly in a falling economy because people have equipped to keep up with a growing economy, but they are now in a position where they own too much iron in a market with a falling capacity. Now they find they have to sell that equipment and pay capital gains tax, and that causes a financial blow. If they do not sell, and with the capital gains tax in place, many companies find themselves with rusting iron equipment sitting and waiting for the next growth period, where that iron can go back to work.
177	Dee Burch	Testified in support of the bill. Exhibit 11. Stated that the capital gains tax is a real disincentive and makes it very difficult for family-owned companies to be handed down to succeeding generations. Questions and answers interspersed.
299	Don Schellenberg	Stated that the Oregon Farm Bureau, the Oregon Cattlemen's Association, Oregon Wheat Growers League, Oregon Dairy Farmers Association, and the Oregon Seed Council support SB 67.
314	Don Cersovski	Testified in support of SB 67. Read Exhibit 12. Questions and answers followed.
485	Schellenberg	Commented that agricultural producers put capital back into their farming operations. They forego making any other kinds of investments,

including investing for retirement…it all goes back into their farming operations. Farmers depend on those farming operations to carry them through to retirement. Upon reaching retirement age, farmers usually sell their farms and use money from the capital gains. Obviously, if the capital gains tax rate were to be lowered, it would mean more money for farmers upon selling their land. Lower capital gains tax rate would also benefit farmers who raise dairy animals and beef breeding stock, which appreciate in value over time.

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023	Schellenberg	Continued comments.
063	Sen. Minnis	Asked LRO staff what the tax treatment is for gains that occur within the Public Employee Retirement System (PERS). Questioned why farmers, for example, are penalized by paying large capital gains taxes, but public employees do not have to pay taxes on investments made in their fund.
066	Waters	Responded that income accruing to retirement plans is generally taxed as ordinary income at the time it is withdrawn.
089	Debra Buchanan	Stated that Mr. Waters' answer was correct. Prior to 1996 states could use pensions earned in a state and then tax those funds even though the person left the state. That is no longer the case. Only the state of residence can tax pensions at this time. Questions and answers interspersed.
112	Eric Blackledge	Testified in support of SB 67. Read Exhibit 9. Supports this bill from two perspectives: one as a small business owner, and another from an economic development perspective. Pointed out that small businesses are the heart of Oregon's economy and account for over 97% of Oregon businesses with employees and over 60% of

total state employment. Most individuals with substantial capital gains also have other taxable income, and probably pay far more in taxes than they use in State services. These are the kind of citizens the state should be trying to attract and keep in Oregon, not drive them away.

Questions and answers interspersed.

230 Sen. Corcoran

Stated that after hearing from farmers and small business owners regarding how the capital gains tax affects their livelihoods, he would be interested in something along the lines of a homestead exemption but relating to a capital gains exemption for people at their time of retirement. Because of the different tax treatment of retirement income available to salaried people versus small business owners or farmers, it bears investigation.

245 Steve Lanning

Testified against SB 67. Exhibit 15. Opposes the bill for three reasons:

- Reducing the capital gains tax rate will provide disproportionate benefit to high income taxpayers and highly profitable corporations;
- Resultant revenue losses will compound the state’s general fund budget shortfalls in 2001-2003 and future biennia; and
- Working families, who will gain little tax relief from this bill, are likely to bear the brunt of cuts in services, since the general fund is the primary source of funds for education and health care service.

260 J. L. Wilson

Testified in support of SB 67. Reiterated comments made in earlier testimony today that small business people accrue assets through their businesses and most income is reinvested back into their businesses. Family business is the family retirement plan. Believes the high capital gains tax rate discourages what should be encouraged, and that is entrepreneurship, risk taking, and asset accumulation, especially in light of how Oregon compares with other states.

301	Vice Chair L. Beyer	Adjourned meeting at 10:15 a.m.

Submitted by, Reviewed by,

Carol Phillips Kim Taylor James

Committee Assistant Revenue Office Manager

<u>Exhibit Summary:</u>

1. SB 67, Waters, Revenue Impact Statement, 1 pp.
2. SB 67, Waters, Fiscal Impact Statement, 1 pp.
3. SB 67, Waters, Table 3: Oregon Taxpayers with Capital Gains Income, 1 pp.
4. SB 67, Waters, (-1) Amendments, (DJ/ps) 2/12/01, 1 pp.
5. SB 67, Waters, (-2) Amendments, (DJ/ps) 3/12/01, 1 pp.
6. SB 67, Waters, (-3) Amendments, (DJ/ps) 3/26/01, 4 pp.
7. SB 67, Waters, (-4) Amendments, (DJ/ps) 3/26/01, 3 pp.
8. SB 67, Waters, (-5) Amendments, (DJ/ps) 3/26/02, 5 pp.
9. SB 67, Waters, Comparison of the 5 Amendments, 1 pp.
10. SB 67, Carlson, Capital Gains in Oregon: Economic Effects of a Tax Cut, 42 pp.
11. SB 67, Burch, Written testimony dated March 28, 2001, 1 pp.
12. SB 67, Schellenberg, Written testimony dated March 28, 2001, 1 pp.
13. SB 67, Cersovski, Written testimony undated, 1 pp.
14. SB 67, Blackledge, Written testimony dated March 28, 2001, 2 pp.
15. SB 67, Lanning, Written testimony dated March 28, 2001, 2 pp.