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Summary

A simple change can dramatically reduce the instability of Oregon's income tax system: repeal the capital gains tax. If the tax on capital gains had been eliminated prior to 1990 revenue would still have risen at a 7 percent average rate between 1990 and 2000, but would not have declined at all during the market bust of 2001.

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“So here is a modest proposal to stabilize revenues for our state government: Repeal the income tax on capital gains.”

How to stabilize Oregon tax revenue

by Michael L. Barton, Ph.D.

The proponents of new or different taxes in Oregon claim that the income tax is unstable because it produces excess revenue in boom times and shows sharp declines in times of recession. This is undeniably true. The aggregate income of Oregonians from which the income tax is extracted does show sharp swings according to Oregon Department of Revenue data.

However, a closer look at the same data reveals a solution to this problem. This solution involves neither income tax surcharges like that passed by the Oregon Legislature—but trounced by voters in Measure 30—nor new taxes of the sales or other variety.

According to the report *Oregon Personal Income Tax Statistics – Tax Year 2001*, published by the Oregon Department of Revenue, in the boom years between 1990 and 2000 the adjusted gross income of Oregonians increased an average of 7.4 percent each year. And the taxes on this income poured into Salem at the same accelerated rate. Then in 2001 the stock market fell, the recession hit and gross income fell 4.4 percent with a like drop in tax revenues.

Here is the interesting thing. During the '90s one component of income rose much faster than others, and then fell most dramatically in 2001. That was capital gains income, which rose at an average rate of 17.6 percent between 1990 and 2000 and then fell 51.3 percent in 2001.

Since the stated goal of the tax reformers is to dampen the swings in state revenue, let's see what happens if we leave capital gains out of the equation. In 2001 capital gains accounted for just 4.6 percent of Oregonians' income. If we leave this piece out we find that between 1990 and 2000 the remaining aggregate income rose at a more modest but still strong 7.0 percent per year. But then in 2001 something wonderful happens. Rather than falling sharply the income figure holds essentially level, actually increasing a bit.

So here is a modest proposal to stabilize revenues for our state government: Repeal the income tax on capital gains. With that one simple change we can

resolve most of what the critics claim is wrong with Oregon's tax system. Want a stable funding source for schools? Absent the tax on capital gains the schools could have weathered the recent recession in decent shape. Revenue would have grown rapidly (perhaps too rapidly) in the 1990s but would not have dropped when the recession hit. Surely the schools can tolerate flat funding in a year when the overall income of Oregonians is dropping.

This proposal has the additional benefit of being good for Oregon's economy. The business activity reflected in capital gains, the buying and selling of assets, is a prime mover in allowing people to create wealth and jobs. By removing the tax on this activity we will see more of it, just what we need in hard times.

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