PORTLAND CLEAN ENERGY COMMUNITY BENEFITS INITIATIVE 2018

TAX IMPACTS ON PORTLAND HOUSEHOLDS

PORTLAND BALLOT MEASURE 26-201

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Summary of conclusions

Portland Ballot Measure 26-201 would require certain retailers operating in the City of Portland to pay a one percent surcharge on gross revenue from retail sales within the city limits. Tax revenues from this gross receipts tax would be placed in a Clean Energy Community Benefits Fund that would distribute the funds to private Oregon nonprofits for renewable energy, energy efficiency, and "green" infrastructure projects as well as job training for traditionally underemployed or economically disadvantaged workers.

This report analyzes the impacts of the proposed gross receipts tax on Portland households by income level.

- If the measure is approved by voters, the average Portland household would face a tax burden of $166 a year.
- The measure's gross receipts tax—like nearly all gross receipts taxes—is an unavoidably regressive tax that burdens lower income households more than higher income households. The tax burden for lowest income residents would amount to approximately one percent of household income, or more than five times the burden faced by the highest income households.
- Through the use of point-of-sale technologies and zone pricing, retailers are likely to pass on some or all of the tax burden to consumers in the form of higher prices or a line item gross receipts tax surcharge.
- To the extent businesses cannot pass on the charge to consumers, the proposed gross receipts tax would have a significant impact on the profits of retail outlets within the City of Portland and increase the likelihood of retail closures within the city limits. The loss of retail employment opportunities would disproportionately affect lower income residents and those without the skills to obtain higher wage employment

The regressiveness of the proposed tax and the potential impact on low income wage earners indicate the net effect of Measure 26-201 would be to harm the communities the measure's proponents intend to help. ■

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PORTLAND BALLOT MEASURE 26-201

ERIC FRUITS, PH.D.

Portland Ballot Measure 26-201 would require certain retailers operating in the City of Portland to pay a one percent surcharge on gross revenue from retail sales within the city limits. This gross receipts tax would be levied on retail businesses with (1) more than $1 billion in total annual revenue and (2) more than $500,000 in retail sales in within the City of Portland. Sales of SNAP-eligible groceries, FDA regulated medicines and medical devices, and health care services would be exempt. Revenues from retail banking services are explicitly included, with the exception of those provided by credit unions.

Tax revenues would be placed in a Clean Energy Community Benefits Fund that would distribute the funds to private Oregon nonprofits for renewable energy, energy efficiency, and "green" infrastructure projects as well as job training for traditionally underemployed or economically disadvantaged workers.

This report analyzes the impacts of the proposed gross receipts tax on Portland households by income level. The analysis in this report is based on our general expertise and knowledge regarding economics, taxation, business practices, and on information derived from government agencies and publicly available information and research.

The author of this report, Eric Fruits, is president of Economics International Corp., a Portland-based consulting firm specializing in economics, finance, and statistics. He is also an adjunct professor of business and economics at Portland State University. His economic analyses have been published in top-tier academic journals as well as *The Economist*, the *Wall Street Journal*, and *USA Today*. Dr. Fruits has been invited to provide analysis to the Oregon legislature regarding the state's tax and spending policies. His expert testimony regarding the economics of Oregon public employee pension reforms was heard by a special session of the Oregon Supreme Court.

1 Tax revenue estimates

Two separate estimates of the projected tax revenues raised under the measure have been published. The City of Portland's estimates were prepared in 2017, based on slightly different wording from the current measure. Estimates calculated by ECONorthwest in July 2018 were recently released.

Analysis performed by the City of Portland Office of Management and Finance estimated an earlier version of the ballot measure would increase tax revenues by $35 million to $51 million, a range the city describes as "conservative."[1] Using information from the city's Business License Tax, the city identified 116 businesses that "would certainly be liable" for the measure's gross receipts tax and another 732 businesses with uncertain liability. The low end of the city's estimates include only the 116 "certain payers," the high end includes all 848 businesses. The city's estimates are based on a relatively narrow definition of "retail sale."

Analysis by ECONorthwest estimates the ballot measure would raise $43 million or $79 million, depending on how broadly the city interprets the definition of "retail sale" in applying the measure's gross receipts tax.[2] A narrow definition provides the low end and a broad definition provides the high end of the two

[1] City of Portland (2017). Portland Clean Energy and Justice measure (gross receipts tax). Office of Management and Finance, Bureau of Revenue and Financial Services, Revenue Division. June 2017. https://assets.documentcloud.org/documents/3883240/Gross-Receipts-Tax-June-2017-Portland-Clean.pdf.

[2] Mastromonaco, R. and Whelan, R. (2018). Clean Energy Community Benefits initiative review: Tax revenue estimates. ECONorthwest. July 2018. https://s3.amazonaws.com/arc-wordpress-client-uploads/wweek/wp-content/uploads/2018/10/09112752/cleanenergyECO.pdf.

estimates. The ECONorthwest estimates are based on information from Claritas and the U.S. Census Bureau's Economic Census.

Across the City of Portland and ECONorthwest estimates, the average estimate of tax revenues is $52 million, which is a reasonable and conservative estimate used in this report.

2 Data and methodology

The Consumer Expenditure Survey provides data on expenditures, income, and demographic characteristics of consumers in the United States.[3] Our analysis focuses on expenditures by income level. The U.S. Census Bureau estimated an average of 256,400 households in the City of Portland over the years 2012 through 2016.[4]

We identified the CES expenditure categories that would likely be subject to the tax, including apparel, food away from home, school supplies, home goods, motor fuel, and other categories.

Average expenditures per household are multiplied by the number of households in each income category to provide the total expenditures across all households in each income category. The expenditure shares are used to estimate the allocation of the $52 million in tax revenues across income categories.

A portion of the retail sales subject to the gross receipts tax will be borne by individuals and households that do not reside in Portland, such as tourists and suburban residents who shop in Portland. Research indicates lower income households are more likely to commute and shop closer to home than higher income households and would be less likely to travel longer difference to avoid higher

[3] U.S. Bureau of Labor Statistics (2018). Consumer Expenditure Survey. Table 3133 (Western region by income before taxes: Average annual expenditures and characteristics). September 2018.

[4] U.S. Census Bureau (2018). QuickFacts: Portland city, Oregon. https://www.census.gov/quickfacts/fact/table/portlandcityoregon/PST045217.

prices or tax levies.[5] We estimate approximately 18 percent of purchases subject to the tax would be made by non-residents of Portland. Thus, of the $52 million the tax is projected to raise, nearly $43 million would be associated with retail sales to Portland residents.

Table 1 provides an estimate of the tax burden on Portland households by income category under an assumption the tax would be passed through to consumers in the form of higher prices or an explicit surcharge on sales.

The average Portland household would face a tax burden of $166 a year. While lower income households would have a smaller burden measured in dollars, they face a bigger burden as a share of household income. For example, the tax faced by lowest income households would represent approximately one percent of household income while the tax faced by the highest income households would represent less than two-tenths of one percent of household income. In this way, the proposed gross receipts tax for Portland—like nearly all gross receipts taxes—is an regressive tax that burdens lower income households more than higher income households.

[5] Carra, G., Mulalic, I., Fosgerau, M., & Barthelemy, M. (2016). Modelling the relation between income and commuting distance. *Journal of the Royal Society Interface*, 13(119), 20160306. http://doi.org/10.1098/rsif.2016.0306.

Access Development (2017). The impact of retail proximity on consumer purchases. https://cdn2.hubspot.net/hubfs/263750/Access_Consumer_Spend_Study_2016.pdf.

Table 1: Tax impacts of Portland gross receipts tax, by household income

	Less than $15,000	$15,000 to $29,999	$30,000 to $39,999	$40,000 to $49,999	$50,000 to $69,999
Share of total consumer units	10.6%	15.7%	9.2%	8.0%	13.6%
Estimated number of Portland households	27,100	40,300	23,600	20,600	34,900
Expenditures in taxable categories, per household	$10,820	$13,520	$19,900	$19,400	$24,120
Expenditures in taxable categories, all households	$293,222,000	$544,856,000	$469,640,000	$399,640,000	$841,788,000
Share of total expenditures	4.3%	8.0%	6.9%	5.8%	12.3%
Estimated tax revenues	$2,236,000	$4,149,000	$3,579,000	$3,049,000	$6,396,000
Less: Tax revenues borne by non-Portland residents	112,000	207,000	358,000	457,000	959,000
Tax revenues borne by Portland residents	$2,124,000	$3,942,000	$3,221,000	$2,592,000	$5,437,000
Tax per household	**$78**	**$98**	**$136**	**$126**	**$156**
Tax as a share of household income	**0.95%**	**0.44%**	**0.44%**	**0.34%**	**0.33%**

	$70,000 to $99,999	$100,000 to $149,999	$150,000 to $199,999	$200,000 and more	Total
Share of total consumer units	15.9%	14.0%	6.3%	6.7%	100.0%
Estimated number of Portland households	41,000	36,100	16,200	17,200	257,000
Expenditures in taxable categories, per household	$29,260	$35,310	$47,450	$60,700	
Expenditures in taxable categories, all households	$1,199,660,000	$1,274,691,000	$768,690,000	$1,044,040,000	$6,836,227,000
Share of total expenditures	17.5%	18.6%	11.2%	15.3%	100.0%
Estimated tax revenues	$9,122,000	$9,695,000	$5,836,000	$7,937,000	$52,000,000
Less: Tax revenues borne by non-Portland residents	1,824,000	1,939,000	1,459,000	1,984,000	9,299,000
Tax revenues borne by Portland residents	$7,298,000	$7,756,000	$4,377,000	$5,953,000	$42,701,000
Tax per household	**$178**	**$215**	**$270**	**$346**	**$166**
Tax as a share of household income	**0.29%**	**0.26%**	**0.26%**	**0.18%**	**0.28%**

3 Dynamic impacts and other considerations

The estimates in Table 1 assume the tax would be passed through to consumers in the form of higher prices or an explicit surcharge on sales. Proponents of this gross receipts tax have asserted that the taxes would not be passed on. They argue the tax targets large and out-of-state corporation whose operations are regional or national in scope. Therefore, it is assumed these retailers have—and will maintain—a uniform pricing strategy and will not pass on the tax to consumers in the form of price increases. However, this argument glosses over the observation that when near-uniform pricing is identified, the prices reported typically *exclude* sales and use taxes.

In contrast to the uniform pricing assertion, many large retailers engage in *zone pricing*, in which the prices charged to consumers vary across geographic zones.

Home Depot, Lowe's, Starbucks, and nearly all gasoline retailers are known to engage in zone pricing.[6] Firms engaging in zone pricing can relatively easily raise prices at stores in the City of Portland.

Thousands of jurisdictions across the U.S. impose sales taxes on goods and services. Bar coding, electronic cash registers, and other point-of-sale technologies aid in the identification of taxable sales and levying the sales taxes. Adding the Portland gross receipts tax to retailers' POS systems would be a relatively straightforward and transparent way of passing the tax to consumers without changing prices for the goods themselves.

Through zone pricing and/or the use of POS systems to levy Portland's gross receipts tax, it is more likely than not that retailers will pass on some or all of the tax to consumers in the form of higher prices and/or a gross receipts tax line item on customers' purchases.

Assuming, for the sake of argument, the entire amount of the gross receipts tax were absorbed in the form of reduced profits by the company subject to the tax. Many retail establishments operate on very small profit margins. For example, information published by the Stern School of Business at New York University indicates that general retail establishes have a net profit margin of 2.32 percent.[7] Consider a hypothetical Portland business with such a margin on $1 million in retail sales subject to the tax.

Taxable sales	$1,000,000
Profit margin	2.32%
Pre-tax profit	$23,200
Gross receipts tax rate	1.0%
Gross receipts tax amount	$10,000
Post-tax profit	$13,200
Post-tax profit margin	1.32%

[6] Adams, B. and Williams, K. R. (2018). Zone pricing in retail oligopoly. *American Economic Journal: Microeconomics*, forthcoming.
Morris, C. (2018). Starbucks quietly raises prices—again. *Fortune*. June 7, 2018. http://fortune.com/2018/06/07/starbucks-raises-coffee-prices-2018/.
Timmerman, L. (2001). Why gas costs so much in this area. *Seattle Times*. December 2, 2001.
[7] Damodaran, A. (2018). Margins by sector (U.S.). January 2018. http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html.

For this hypothetical business, the Portland gross receipts tax would reduce profits from $23,200 to $13,200—a 43 percent drop in profits. While the business would still earn *accounting* profits, the firm's decision whether to remain operating in Portland depends on the firm's *economic* profits: Could the owners redeploy their assets elsewhere to earn a greater return on their investment?

Many brick-and-mortar companies are going out of business or closing stores because the profit margins are not sufficient to remain in business or to keep low performing stores open. For example, Macy's closed its downtown Portland store in 2016 because it was not performing well.[8] Despite rising sales, Macy's most recent quarterly report reported shrinking profit margins, with an average company-wide profit margin of three percent.[9] Retailers who have closed or are in the process of closing Portland area stores in the past year include Toys R Us, Orchard Supply Hardware, and Kmart.

The further loss of retail employment opportunities would disproportionately affect lower income residents and those without the skills to obtain higher wage employment. The potential employment in projects to be supported by the measure's tax revenues are unlikely to be sufficient to offset the potential loss of employment from retail business closures.

4 Conclusion

Portland Ballot Measure 26-201 would require certain retailers operating in the City of Portland to pay a one percent surcharge on gross revenue from retail sales within the city limits. This report analyzes the impacts of the proposed gross receipts tax on Portland households by income level.

If the measure is approved by voters, the average Portland household would face a tax burden of $166 a year. The measure's gross receipts tax—like nearly all gross receipts taxes—is an unavoidably regressive tax that burdens lower income households more than higher income households. The tax burden for lowest income residents would amount to approximately one percent of household

[8] Marum, A. (2016). Macy's closing downtown Portland store: "A bit of Oregon history is lost." *Oregonian*. November 10, 2016.

[9] Macy's Inc. (2018). Form 10-Q. August 31, 2018. Retrieved from SEC EDGAR.

income, or more than five times the burden faced by the highest income households.

Through the use of point-of-sale technologies and zone pricing, retailers are likely to pass on some or all of the tax burden to consumers in the form of higher prices or a line item gross receipts tax surcharge.

To the extent businesses cannot pass on the charge to consumers, the proposed gross receipts tax would have a significant impact on the profits of retail outlets within the City of Portland and increase the likelihood of retail closures within the city limits. The loss of retail employment opportunities would disproportionately affect lower income residents and those without the skills to obtain higher wage employment. ■