W.14.b

AGENDA COVER MEMO

AGENDA DATE: June 14 & 28, 2006
Memorandum Date: June 9, 2006

TO: LANE COUNTY BOARD OF COMMISSIONERS
DEPTARTMENT: LANE COUNTY OFFICE OF LEGAL COUNSEL
PRESENTED BY: Teresa J. Wilson, County Counsel

Teresa J. Wilson

AGENDA ITEM TITLE: Ordinance 1-06 – Lane County Public Safety Income Tax

I. MOTION

June 14: I move the Fifth Reading and Public Hearing on Ordinance 1-06, and setting the Sixth Reading and Public Hearing for June 28 at 6:30 p.m.

June 28: I move to enact Ordinance 1-06 with Option _______
OR
I move Ordinance 1-06 to a Sixth Reading on ___________.

II. AGENDA ITEM SUMMARY

The purpose of this memorandum is to present the highlights of what is contained in Ordinance 1-06, the Lane County Public Safety Income Tax.

III. DISCUSSION

A. Highlights of Ordinance 1-06.

This ordinance was developed with the Board's guidance from its meetings on November 29 and 30, as well from the January 4 and 11 public hearings, and subsequent discussions by the Board on February 8, April 19, May 17, May 31 and June 7. It id different from previous readings, to reflect the changes in the Charter Amendment and comments received during review by two different groups of accountants who graciously met with staff to offer suggestions.

1. LC 4.005-4.015 Differential taxes – this is a component solely for the purpose of moving its location in the Code. The Differential Tax language was adopted in 1995.

2. Broad Outline of the Lane County Public Safety Income Tax:

The Public Safety Income Tax is comprised of 3 tax components, a Personal Income Tax, a Nonresident Income Tax, a Business Income Tax and a General Administration/Collection component. Generally, the Public Safety Income Tax is intended to tax all income activity within the County, whether or not the individual resides in the County. Residents of Lane County will have their income taxed; nonresidents who have income derived from activity within the County will have that taxed, and businesses will have the income from business activity within the County taxed. These are designed to spread the tax over the greatest range of income activity occurring in the County as possible, and at the same time, through the use of credits and deductions, attempt to avoid taxing an individual twice on the same income.

3. General provisions – LC 4.500-4.501

These sections contain the provisions that apply to all 4 components of the Public Safety Income Tax. LC 4.500 describes the components, and reinforces that these income taxes are imposed to support the public safety services as provided in the Charter Amendment. It also connects the "net income" language in the Charter to the specific, more detailed provision of each of the 3 taxes. Lastly, it requires that the portion of property tax revenues that the County receives through the property tax system for which it is providing property tax relief in the income taxes be transferred to the Public Safety Income Tax Fund. This method delivers to the dedicated fund (and thus also dedicates) the property tax revenues that the current programs are receiving; in other words, it "keeps them whole" vis-à-vis the property tax relief. Without the transfer, the income taxes reduced by the property tax relief would be inadequate to fund the programs.

LC 4.501 contains the definitions, which are significant features of the tax. I will point to policy implications of the definitions of certain words when I discuss the relevant sections below.

4. Personal Income Tax - LC 4.520-4.526

The Personal Income Tax is imposed on residents of the County at a rate of 1% of their County taxable income. LC 4.521(1). "County Taxable Income" is defined to be the Oregon taxable income (line 28 on Form 40 (2004)) less deductions. The 1% rate is lower than the maximum rate in the Charter Amendment, in anticipation of receiving revenues under the Secure Rural Schools Act. (The same rate is applied with the Nonresident Income Tax and the Business Income Tax.)

Who files? Generally, all residents and part-year residents must file. Part-year residents can prorate their income.

What deductions are allowed? LC 4.522. Residents who file singly can take a $2,500 deduction; residents who file jointly can take a $5,000 one. Retirees who receive PERS benefits or a federal retirement benefit also can deduct the amount of that retirement income. This deduction is required by state statute (ORS 238.445) for local income taxes; however, the State of Oregon does tax these retirement benefits.

What exemptions are allowed? LC 4.523. Residents who file a joint federal return or who file as head of household, and who have a combined adjusted gross income (AGI), based on the federal law, of $20,000 or less are exempt; other residents whose AGI is $10,000 or less are likewise exempt. These levels were chosen based on the Board's general guidance on May 31, and additional information received by Ron Chastain and David Garnick from the Department of Revenue regarding Oregon 2004 returns. It appears these levels approximate the kind of relief the Board seemed to indicate it wanted. Further refinement would introduce additional complexity in administering the tax, but it can certainly be accomplished in the future.

What credits are allowed? LC 4.524. There are two types of credits, one for property taxes paid and one for Business Income Tax paid. In the property tax credit, the ratio of $0.95/$1.2793 produces a 74.25% reduction. The income taxpayer will apply that percent to the amount of the property tax actually paid to determine what to take as a credit on the income tax return. There is also a credit for a Business Income Tax that was paid in the tax year (note: the first year of the tax, no credit will be available. This "start-up" time lag inevitable, as no Business Income Tax would have been paid in the first year. It is similar to credits for taxes on federal and state income taxes – you actually have to have paid or accrued the credit before you can claim a deduction). Both credits have provisions to address situations where there are refunds or other changes in the tax paid for which a credit is claimed.

What about withholding by employers or estimated tax payments? LC 4.525 & 4.526. The ordinance requires employers who pay wages to residents to withhold these taxes, and to pay them over to the Tax Administrator at the same time they pay over state income tax withholdings. It also requires payment of estimated taxes for anyone whose tax liability beyond the wage withholding will be more than $500.

5. Nonresident Income Tax – LC 4.530-4.536

The Nonresident Income Tax is imposed on nonresidents at the rate of 1% of their taxable income. LC 4.531(1). "Nonresident Taxable Income" is defined to be wages paid to a nonresident for services performed within the County plus "Net County Asset Income." "Net County Asset Income" is further defined as Oregon taxable income resulting from the sale of property located in the County, dividends or other investment income from activity within the County or other net income from assets with sufficient connection ("nexus") to the County that we are legally permitted to tax the income.

Who files? Generally, anyone who has nonresident income over $2,500 is required to file a return.

What deductions are allowed? LC 4.532. The ordinance provides the same type of deductions as are in the Personal Income Tax.

What exemptions are allowed? LC 4.533. The ordinance also provides the same type of low income exemption as is in the Personal Income Tax.

What credits are allowed? LC 4.534. The ordinance also provides the same credit for personal property taxes that are paid and for any Business Income Tax paid as is in the Personal Income Tax.

What about withholding by employers or estimated tax payments? LC 4.535 & 4.536. Employers of nonresident employees who work in Lane County must withhold these taxes, and pay them over to the Tax Administrator, like the Personal Income Tax. Likewise, anyone whose tax liability beyond the wage withholding will be more than $500 must pay estimated taxes.

6. Business Income Tax – LC 4.540-4.548

The Business Income Tax is imposed on each person doing business within the County at a rate of 1% of the person's taxable business income. LC 4.541(1). "Taxable Business Income" is defined to be "Business Income" less deductions. "Business Income" is a critical definition. It is very broadly written – it covers all net income arising from any business activity before apportionment or net operating loss deductions. It includes interest and dividend income, rental income, and gains on sale of property or investment.

The Business Income Tax is modeled after the Multnomah/Portland model for several reasons, not the least of which is we know it works, both legally and practically. It also provides a good resource for local businesses to check with their peers up north as to how to apply the tax at a very practical level. Coupled with the Personal and Nonresident Income Tax and their credit for Business Income Tax paid, this approach provides a very broad and even basis for net income taxes, thus spreading the cost across all who will benefit from the increased public safety that is expected as a result of these taxes.

Who files? Anyone who engages in business in the County and who has gross business income over $25,000 must file a return. (Note: filing is based on a gross income level, but the tax is levied on a net income basis.)

Are there any exemptions? LC 4.543. The ordinance provides exemptions for governments, and for persons who the County cannot legally tax, as well as the same kinds of exemptions that exist in the Multnomah Business License/Portland Business Income Tax. The Board could decide to make different choices than occurred in the Portland area, but after discussion with the Tax Administrator for the City of Portland, it appears prudent to start with the close similarity, and then modify as experience dictates is necessary to fit our own local circumstances, at least where there are not strong apparent reasons to begin with a deviation. The Business Income Tax also contains an exemption for businesses whose gross business income is less than $25,000.

What credits are allowed? LC 4.544. The Business Income Tax contains a property tax credit that is similar to what is provided in the Personal and Nonresident Income Taxes.

What deductions are allowed? LC 4.545. The ordinance permits deductions for net operating losses, up to 75% of the business income. The loss can be carried forward for up to five years. There is also a deduction for any business income the County is prohibited from taxing.

What about estimated taxes? LC 4.547. Anyone whose tax liability beyond the wage withholding is more than $500 must pay estimated taxes.

What if a business has income from both inside and outside Lane County? LC 4.548. A taxfiler in such a case can apportion that income, generally on a percentage basis. This is commonly done on state returns for businesses that have income from two different states, so the concept will be familiar to a lot of businesses. The ordinance allows the Tax Administrator to develop rules for specific apportionment methodologies as needed for certain types of industries or incomes.

7. General Administration and Collection - LC 4.550-4.571

The fourth section of the ordinance relates to general administration and collection. Some basic elements are such things as the rules of construction (LC 4.551) —basically, tax provisions relating to who or what is taxable are to be construed liberally and provisions relating to exemptions, deductions and credits are to be construed narrowly. The Tax Administrator is vested with the necessary authority to administer, collect and enforce the tax, including settlement authority, and the authority to adopt administrative rules (after notice and an opportunity for comment) (LC 4.552-4.553). Tax returns are due of the 15th day of the fourth month of the tax year (for most of us, on April 15) (LC 4.544). Estimated payments are generally due the same time they would be due for state income taxes (LC 4.555).

The administrative provisions also address confidentiality (LC 4.557-4.558), the power of the Tax Administrator to review records (LC 4.561); to assess deficiencies, penalties and interest; and to pay refunds (LC 4.563, 4.566, 4.567-4.571). They provide taxpayers with the opportunity to protest an action of the Tax Administrator, for the Tax Administrator to revise his/her determination, and then for the taxpayer to appeal the decision to an Appeals Board, which the Board of Commissioners will need to create and appoint (LC 4.565).

B. <u>Alternatives/Options</u>

There are a variety of options which the Board could choose. However, if the Board wishes to entertain any that are not already written into the Ordinance, if they are substantive, they will need to be specified and read at two different meetings of the Board, at least 13 days apart.

1. Effective Date. Two options are shown on the face page of the Ordinance. Option 1 makes the ordinance effective January 1, but conditions its going into effect upon the outcome of the election on the Charter Amendment. Option 2 provides for an effective date on July 1, 2007. This assumes that the Board would wait for a period of time before enacting (but it is recommended that the Board enact it, if at all, at least 90 days prior to July 1, 2007, to allow for any potential referendum). If the Board chooses Option 2, I recommend that the income tax rate selected be 50%, as that would provide for effectively a half-year of collection.

2. Income Tax Rate. The Board could choose a different income tax rate than the 1%. The 1% is based on staff's best estimate of the amount necessary to fund the identified programs and assumes one more year of Secure Rural School funding. It is set at a level that we believe accommodates the credits, exemptions and deductions in the various taxes. Any change would vary the level of revenue received.

3. Property Tax Relief Rate. The Board could also choose a different property tax relief rate, which would also vary the amount of funds transferred to the Public Safety Income Tax Fund for the programs.

4. Low Income Exemption level. Like the options, the Board could choose a different low income exemption level in the Personal and Nonresident Income Tax, or could identify other categories to be granted the exemption. A change in the level would affect the revenue received, as potentially would a change in the categories. An increase in the number of categories granted an exemption would also increase the complexity of administering the ordinance.

IV. ATTACHMENTS

Charter Amendment
Ordinance 1-06
Legislative format for the Differential Tax provisions, showing numbering changes. There are no legislative format pages for the Income Tax, as these are all new provisions.