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Arts Education and Access Income Tax Impact Analysis: Excluding Income under $1,000

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City of Portland Revenue Bureau
Office of Management and Finance

Background

On March 27, 2013, the Portland City Council will consider amending PCC 5.73.010 Definitions, a subsection of the Arts Education and Access Income Tax ("Arts Tax").[1] The title of the ordinance describes the change: *Amend the Arts Education and Access Income Tax code to add a definition for "income-earning resident" and include in the definition that a resident must have income of at least $1,000 to be considered "income earning."* This document was prepared to provide City Council with information about the impact of this change.

Summary of Impacts

Excluding individual incomes of less than $1,000 from the definition of "income-earning resident" will have the following impacts:

1. Tax revenues will be reduced by an estimated $277,000 to $700,000. This will result in a reduction in net revenue disbursement to the Regional Arts and Culture Council. Portland area K-5 schools tax revenue will not be impacted.[2]

2. One-time costs of administration will increase by an estimated $140,000. The current one-time budget is capped at $500,000. The Bureau is projecting that the current one-time budget will be under spent by $40,000. Therefore, the one-time net budget gap is $100,000. There is no anticipated material increase to ongoing expenses related to the code change.

3. The new definition of income will place significant stress on the 5% administrative cost cap because the cap is a function of revenues collected.[3] While the cap is not projected to be exceeded by this change alone, the margins will significantly tighten and if other unforeseen revenue reductions or expenses are incurred the cap could be exceeded.

4. The timing of this change impacts collection activities for tax year 2012, previously due April 15, 2013. The Bureau has delayed mailing approximately 250,000 notices to Portland households to ensure that accurate and timely information is received by taxpayers. The Revenue Bureau amended the Arts Education and Access Income Tax Administrative Rules on March 19, 2013[4] making the new filing deadline for tax year 2012, May 15, 2013.[5]

5. As a separate matter, City Council is also considering a resolution on March 27, 2013, directing the Revenue Bureau to review the tax structure and recommend changes by July 31, 2013. This action will impact tax year 2013 (due April 15, 2014) revenue collection because the Bureau can no longer expect third party tax preparation software providers[6] to include the Arts Tax in their products as the deadlines for new tax programming will be surpassed. Our projections for tax years 2013, 2014 and 2015 were adjusted to account for this change in timing.

Revenue Impact Analysis

A new "income-earning resident" definition that establishes a minimum threshold of $1,000 in income means that thousands of taxpayers who previously would have been assessed a $35 tax for "any income" will no longer be assessed the tax. That is, any taxpayer 18 years of age or older who had 2012 income of between 1 cent and $999.99 would have been assessed the tax under the old definition of "income-earning resident", but will no

[1] See PCC 5.73.
[2] See http://www.portlandoregon.gov/revenue/60079 for an overview of disbursement methodology.
[3] The cap is calculated at 5% of gross revenue averaged over five years. See PCC 5.73.090.
[4] The revised Administrative Rules can be found at http://www.portlandoregon.gov/revenue/article/434547.
[5] This extended deadline applies only to tax year 2012.
[6] TurboTax by Intuit is an example.

longer have any assessment under the new definition. The classes of taxpayers most likely to fall into this fact pattern are:[7]

1. spouses and domestic partners where one spouse or partner has minimal income and the other is the "breadwinner;"

2. high school students (18 years old) with minimal income;

3. college students with minimal income, and;

4. young adults (non-high school students), 18 years of age and over with minimal income living with parents or guardians.

The data necessary to directly and narrowly project the revenue impact of the new income definition is largely unavailable from the Internal Revenue Service or the Oregon Department of Revenue. The reason for this may be obvious; many or most of the taxpayers falling into the new income definition are either not required to file an income tax return, or file jointly or as a dependant of another taxpayer, thereby aggregating the lower earner's income data with that of the spouse or domestic partner breadwinner.

As direct income statistics for these taxpayers are not available, the Bureau modeled the revenue impact by reviewing and analyzing data from the U. S. Census Bureau, U. S. Bureau of Labor Statistics and other sources. The analysis indicates the new definition will exclude from taxation an estimated 7,903 to 20,014 taxpayers resulting in a gross revenue loss of between $276,605 and $700,490.[8] The range is broad because the data necessary for a more exacting estimate is not available and assumptions had to be made, particularly with respect to income levels for non-breadwinner spouses and domestic partners.

Figures 1-4 below illustrate the impact for each class of taxpayer. Figure 5 aggregates the combined impact into a single table.

Figure 1. Spouses and Domestic Partners (one with minimal income)[9]

	Estimated Negative Revenue Impact		
	Low	Middle	High
Estimated percentage of joint tax filers where one spouse/partner has less than $1,000 of income	20%	40%	60%
Reduction in number of potential taxpayers	7,582	15,164	22,746
Potential taxpayers in households over the poverty level (84.4%)	6,399	12,799	19,198
Factoring for compliance rate (85%)	5,439	10,879	16,318
Estimated Lost Revenue	**$190,365**	**$380,765**	**$571,130**

[7] Other classes of taxpayers, such as the homeless, also likely fall into this pattern but are already factored out in the compliance rate assumption.
[8] Both numbers are written down by the assumed universal terminal compliance rates discussed in "Arts Education and Access Income Tax," June 2012, Figure 4, Portland Revenue Bureau. See the various figures in this section and the Appendix for details.
[9]See Figure A in the Appendix for additional details on methodology.

Figure 2. High School Students[10]

	Estimated Negative Revenue Impact		
	Low[11]	Middle	High[12]
H.S. seniors without at least a part time or summer job earning over $1,000	555	693	832
H.S. seniors in households over the poverty level (84.4%)	468	585	702
Factoring for compliance rate (85%)	398	497	597
Estimated Lost Revenue	**$13,930**	**$17,395**	**$20,895**

Figure 3. College Students[13]

	Estimated Negative Revenue Impact		
	Low[14]	Middle	High[15]
Potentially eligible for exemption based on income under $1000	1,947	2,434	2,921
College students in households over the poverty level (84.4%)	1,644	2,055	2,465
Factoring for compliance rate (85%)	1,397	1,746	2,096
Estimated Lost Revenue	**$48,895**	**$61,110**	**$73,360**

Figure 4. Other Young Adults 18+ Living at Home[16]

	Estimated Negative Revenue Impact		
	Low[17]	Middle	High[18]
Potentially eligible for exemption based on income under $1000	932	1,165	1,398
Individuals in households over the poverty level (84.4%)	787	984	1,180
Factoring for compliance rate (85%)	669	836	1,003
Estimated Lost Revenue	**$23,415**	**$29,260**	**$35,105**

Figure 5. Total Estimated Portland Adult Residents with Very Low Income No Longer Assessed Tax

	Total Impacted Taxpayers		
	Low	Middle	High
Total Estimated "Lost" Taxpayers	7,903	13,958	20,014
Total Estimated Lost Revenue	**$276,605**	**$488,530**	**$700,490**

[10] See Figure B in the Appendix for additional details on methodology.
[11] 80% of middle estimate.
[12] 120% of middle estimate.
[13] See Figure C in the Appendix for additional details on methodology.
[14] 80% of middle estimate.
[15] 120% of middle estimate.
[16] See Figure D in the Appendix for additional details on methodology.
[17] 80% of middle estimate.
[18] 120% of middle estimate.

Expense Impact Analysis

The new definition will increase the Revenue Bureau's first year costs of administration by an estimated $140,000. As of March 20, 2013, approximately 33,000 taxpayers have filed tax returns or exemptions totaling over $900,000 and up to an additional 80,000 - 125,000 returns may be filed before notification of the change reaches every Portland household. We expect the daily rate of online filing to increase as the traditional and previously publicized filing deadline approaches.

The Bureau cannot expedite taxpayer notification because the City Council's decision will not occur until April 3, 2013; only after that date can the Bureau finalize a notification letter.[19] Printing and Distribution Services requires approximately one week of lead time for a mass mailing.[20] Therefore, we expect to begin mailing notification of the change to households about April 10, 2013, only five days before the previous filing deadline of April 15, 2013.

The mailing must occur in daily batches of no more than 50,000 households because the Bureau must respond to taxpayer telephone calls and has the capacity to handle about 800 - 900 phone calls per day without unacceptable hold times for taxpayers.[21] There is no additional budget available to increase capacity. The first 50,000 letters will be sent about April 10, 2013 and the mailing will continue through about April 16, 2013.

Increased costs are primarily comprised of:

1. mailing notification that a refund may be due to all taxpayers who have already filed or will file incorrectly or without adequate notice of the change in income definition;

2. additional mailings to taxpayers who file for a refund but fail to provide adequate or complete documentation of income in support of the refund request;

3. additional mailings for collection activities associated with reduced compliance owing to taxpayer confusion;

4. Bureau of Technology Services and contractor costs to modify the Arts Tax web application, desktop application, website, form and letter designs, letter automation processes, accounting procedures, increased 1099 processing and other activities that are difficult to foresee with precision,[22] and;

5. The Bureau has been holding the half-time Arts Tax auditor position vacant but will need to fill it earlier than anticipated for compliance work related to refund requests and taxpayer confusion.

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[19] The letter will need to include language that the actual effective date of the retroactive definition change is May 3, 2013 (30 days after the second Council reading). The City Attorney has indicated there is no risk in mailing notification ahead of the effective date so long as the letter is clear.

[20] We will request expedited treatment but we do not anticipate there will be a material change in the lead time.

[21] As of March 20, 2013, the Bureau has answered 7,093 phone calls. The Bureau tracks daily phone call statistics and noted that during the period of time in which postcards were mailed to all Portland households (arriving in mailboxes in batches of about 50,000 from March 1-6, 2013) phone calls increased to a daily average of 790. The Bureau expects the response rate will be significantly higher with an envelope and form mailing and the filing deadline approaching. The average hold time for a taxpayer to speak with a customer service representative is about 20 seconds.

[22] There are dozens of changes needed and detailing them all in advance is not possible on the timeline available.

See Figures 6 and 7 for details about increased expenses and budget. Every effort will be made to mitigate budget impacts wherever feasible. The Bureau will present detailed budget information to the Citizen Oversight Committee at its next meeting on April 23, 2013.

Figure 6. One-Time Cost Increases

Description	Budget
Additional mailing (printing and postage)	$80,000
Information technology, business process automation changes, etc.	$40,000
Half-time auditor hired early	$20,000
Total	**$140,000**

Figure 7. Current and Future Projected One-Time Budget

Description	Budget
Current one-time budget	$500,000
Projected under-expenditure of current one-time budget	-$40,000
Current budget projection of one-time budget	$460,000
Increased one-time expenses due to code change	$140,000
New total requested one-time budget	$600,000
Increase over current one-time budget cap (to be requested by ordinance, March 27, 2013)	**$100,000**

Administrative Expense Cap

The 5% cap on ongoing administrative expenses is a function of gross revenues collected; that is, expenses cannot exceed 5% of revenues. The change to the "income-earning resident" definition will reduce revenues. As a result, the Arts Tax budget may become seriously constrained with virtually no contingency budget available. While the Bureau is not currently projecting that the cost cap will be exceeded, the margin is now narrowed to the point that any further unforeseen expenses or revenue losses may cause the cap to be exceeded. Moreover, the projections themselves are subject to inaccuracy. Using the middle range estimate, the cap will stand at 4.8% or higher in three of the next four years. The outlook worsens using the high range estimate. See Figure 8. Revised cash flow estimates are presented in the Appendix in Figures E, F and G.

Figure 8. Cost Cap Percentages Before and After Change to Definition (using middle range estimate)[23]

Year	FYE 6/30/13[24]	FYE 6/30/14	FYE 6/30/15	FYE 6/30/16	FYE 6/30/17
Costs as a percentage of projected gross revenues **before** change to income definition	8.5%	4.3%	4.5%	4.6%	4.6%
Costs as a percentage of projected gross revenues **after** change to income definition	10.0%	4.9%	4.3%	4.8%	4.8%

Administrative Changes

As a result of the proposed change in the definition of "income-earning resident", the Revenue Bureau extended the tax year 2012 filing deadline by one month to May 15, 2013. The Bureau also believes "gift" income is immaterial to the revenue projection and in any event is likely duplicated under the proposed new definition of

[23] See Figures E, F and G of the Appendix for a full analysis of revised revenues, expenses and the cost cap for low, middle and high ranges.
[24] Year one exceeds 5% because of the one-time budget for start-up costs.

income. For these reasons, gift income is no longer considered income under the Administrative Rules. These changes to the Administrative Rules were adopted by the Director on March 19, 2013.

Appendix

Figure A. Detail of Figure 1: Spouses and Domestic Partners (one with minimal income)

Married-couple families in Portland[25]	92,172
U.S. % of married-couple families where only one spouse is in the workforce[26]	37.3%
Estimated number of married-couple (only one in workforce) families in Portland	34,380
Unmarried domestic partners in Portland[27]	23,534
Estimated % where only one partner is in the workforce[28]	15.0%
Estimated number of unmarried domestic partner (only one in workforce) families in Portland	3,530
Total spouses and partners	37,910
Estimated % where one spouse/partner has less than $1,000 of income	See Figure 1
Reduction in number of potential taxpayers	See Figure 1
Potential taxpayers in households over the poverty level (84.4%)[29]	See Figure 1
Factoring for assumed compliance rate (85%)[30]	See Figure 1
Estimated Lost Revenue	See Figure 1

Figure B. Detail of Figure 2: High School Students

High School Students	
High school students in Portland[31]	22,181
25% (12th grade seniors)[32]	5,545
Seniors 18 years or older by 12/31 (25% estimate)[33]	1,386
Seniors without at least a part time or summer job earning over $1,000[34]	693
Seniors in households over the poverty level (84.4%)	See Figure 2
Factoring for assumed compliance rate (85%)	See Figure 2
Estimated Lost Revenue	See Figure 2

[25] See http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_11_5YR_DP02.
[26] See www.bls.gov/news.release/famee.t04.htm (30.4% where man is sole wage-earner plus 6.9% where woman is sole wage-earner).
[27] http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_11_5YR_DP02 – RELATIONSHIP "Unmarried partner".
[28] Estimate, lower % is based on less likelihood that there are children in the household.
[29] See "Arts Education and Access Income Tax," June 2012, Figure 2; City of Portland Revenue Bureau.
[30] Ibid, Figure 4.
[31] See http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_11_5YR_DP02.
[32] Estimate (4 years of school, 1/4 of students).
[33] Assumed 25% of high school seniors are 18 by 12/31 of their senior year.
[34] Estimated at 50%.

Figure C. Detail of Figure 3: College Students

College Students	
College students[35]	55,642
25% (estimate) of students that are still in parent's household	13,911
30% (estimate) of college students have jobs at least 20 hours per week[36]	4,173
75% (estimate) of remaining students (those w/o 20 hour per week job), earn at least $1000 in a year	7,303
Potentially eligible for exemption based on income under $1000	2,434
College students in households over the poverty level (84.4%)	See Figure 3
Factoring for assumed compliance rate (85%)	See Figure 3
Estimated Lost Revenue	See Figure 3

Figure D. Detail of Figure 4: Other Young Adults 18+ Living at Home

Other Young Adults 18+ Living at Home	
Children 18+ living at home[37]	31,109
High school seniors already included above	5,545
College students (included above)	13,911
Remaining children 18+ living at home	11,653
Unemployed children 18+ living at home (estimated unemployment rate is 20%)[38]	2,331
Unemployed individuals who received at least $1,000 in income during the year (assume 50%)	1,165
Potentially eligible for exemption based on income under $1000	1,165
Individuals in households over the poverty level (84.4%)	See Figure 4
Factoring for assumed compliance rate (85%)	See Figure 4
Estimated Lost Revenue	See Figure 4

[35] See http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_11_5YR_DP02.

[36] Per www.aaup.org/article/understanding-working-college-student, 85% of college students have 20+ hour/week jobs. It is assumed that the college students still in their parent's household will be much lower.

[37] See http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=DEC_10_DP_DPDP1 - RELATIONSHIP "Child" (130,804) less "Own child under 18 years" (99,695).

[38] Estimate based on http://www.bls.gov/cps/cpsaat03.pdf.

Figure E. Revised Combined Deposits and Costs over the First Five Fiscal Years (Ended June 30) of the Arts Income Tax – Low Impact Estimate

Year	FYE 6/30/13	FYE 6/30/14[39]	FYE 6/30/15	FYE 6/30/16	FYE 6/30/17
Projected cost (adjusted by CPI and General Fund overhead)	$862,500	$551,400	$574,972	$589,957	$600,134
Projected gross revenues (**before** proposed change)	$8,994,387	$12,930,066	$12,813,223	$12,898,062	$13,059,680
Decrease (increase) in tax revenues	$207,454	$1,501,782	-$934,742	$276,605	$276,605
Projected gross revenues (**after** proposed change)	$8,786,933	$11,428,284	$13,747,965	$12,621,457	$12,783,075
Projected net revenues (reduced by projected costs)	$7,924,433	$10,876,884	$13,172,993	$12,031,500	$12,182,941
5% of projected gross revenues	$439,347	$571,414	$687,398	$631,073	$639,154
Gap between projected gross revenues and 5% of gross revenues	-$423,153	$20,014	$112,426	$41,116	$39,020
Costs as a percentage of projected gross revenues (**after** proposed change)	**9.8%**	**4.8%**	**4.2%**	**4.7%**	**4.7%**
Costs as a percentage of projected gross revenues (**before** proposed change)	8.5%	4.3%	4.5%	4.6%	4.6%

Figure F. Revised Combined Deposits and Costs over the First Five Fiscal Years (Ended June 30) of the Arts Income Tax – Middle Impact Estimate

Year	FYE 6/30/13	FYE 6/30/14	FYE 6/30/15	FYE 6/30/16	FYE 6/30/17
Projected cost (adjusted by CPI and General Fund overhead)	$862,500	$551,400	$574,972	$589,957	$600,134
Projected gross revenues (**before** proposed change)	$8,994,387	$12,930,066	$12,813,223	$12,898,062	$13,059,680
Decrease (increase) in tax revenues	$366,398	$1,703,111	-$701,624	$488,530	$488,530
Projected gross revenues (**after** proposed change)	$8,627,989	$11,226,955	$13,514,848	$12,409,532	$12,571,150
Projected net revenues (reduced by projected costs)	$7,765,489	$10,675,555	$12,939,876	$11,819,575	$11,971,016
5% of projected gross revenues	$431,399	$561,348	$675,742	$620,477	$628,557
Gap between projected gross revenues and 5% of gross revenues	-$431,101	$9,948	$100,770	$30,519	$28,424
Costs as a percentage of projected gross revenues (**after** proposed change)	**10.0%**	**4.9%**	**4.3%**	**4.8%**	**4.8%**
Costs as a percentage of projected gross revenues (**before** proposed change)	8.5%	4.3%	4.5%	4.6%	4.6%

[39] Fiscal Year End 2014 and 2015 cash flows are decreased and increased, respectively in Figures E, F and G because integrating the Arts Tax into third party tax preparation software will be delayed by at least a year. Compliance rates were previously modeled on the belief that the Arts Tax would be integrated into applications like TurboTax for tax year 2013 (due April 15, 2014) and beyond. This is no longer the case for tax year 2013 because the City will now miss the vendor change deadlines. See "Arts Education and Access Income Tax," June 2012, for details about cash flow timing computation.

Figure G. Revised Combined Deposits and Costs over the First Five Fiscal Years (Ended June 30) of the Arts Income Tax – High Impact Estimate

Year	FYE 6/30/13	FYE 6/30/14	FYE 6/30/15	FYE 6/30/16	FYE 6/30/17
Projected cost (adjusted by CPI and General Fund overhead)	$862,500	$551,400	$574,972	$589,957	$600,134
Projected gross revenues (**before** proposed change)	$8,994,387	$12,930,066	$12,813,223	$12,898,062	$13,059,680
Decrease (increase) in tax revenues	$525,368	$1,904,473	-$468,468	$700,490	$700,490
Projected gross revenues (**after** proposed change)	$8,469,019	$11,025,593	$13,281,692	$12,197,572	$12,359,190
Projected net revenues (reduced by projected costs)	$7,606,519	$10,474,193	$12,706,720	$11,607,615	$11,759,056
5% of projected gross revenues	$423,451	$551,280	$664,085	$609,879	$617,959
Gap between projected gross revenues and 5% of gross revenues	-$439,049	-$120	$89,113	$19,921	$17,826
Costs as a percentage of projected gross revenues (**after** proposed change)	**10.2%**	**5.0%**	**4.3%**	**4.8%**	**4.9%**
Costs as a percentage of projected gross revenues (**before** proposed change)	8.5%	4.3%	4.5%	4.6%	4.6%