Downtown Business Incentive Program

August 28, 2023

Revenue Division
Bureau of Revenue and Financial Services
Office of Management and Finance
City of Portland, Oregon

Summary

In an effort to revitalize downtown Portland, one option is to enact a targeted tax credit. A proposed Downtown Business Incentive (DBI) program credit can encourage businesses to lease downtown office and retail space and increase the number of workers coming into the downtown area. Businesses that meet the DBI program criteria will potentially pay a reduced amount of City of Portland Business License Tax (BLT). This document provides details on structure, implementation, risks, and other considerations of the proposed DBI program.

Program Parameters

1) To be eligible:

    a. A BLT taxpayer must enter into a new lease or extend a current lease for a period of four years or more. An extended lease must be extended from the end of an existing lease.

    OR

    b. The taxpayer must occupy taxpayer-owned building space.

    AND

    c. The taxpayer must maintain at least 15 employees, each working at least half their time, in the downtown Portland building space. The taxpayer must file/provide an attestation for each tax year that they claim a credit that they have met this requirement.

2) The maximum credit is $250K, capped at the lesser of:

    a. 100% of the BLT for the year of origination.

    b. 1% Business License Tax (BLT) income limit in year of origination.

    c. $30/square footage of building space occupied in the taxpayer's business. To prevent a taxpayer from claiming a credit that is materially out of proportion to their presence in downtown Portland, it is appropriate to cap the deduction at an amount related to the size of the lease.

3) The DBI credit originates in 2023 or 2024, is a nonrefundable credit divided by four, and taken equally over four consecutive years beginning with the year of origination. A credit cannot be claimed for both years. The one fourth of the credit that is allowed in a year cannot exceed the amount of tax owed in that year and cannot be carried to or used in another year.

4) Total program is capped at $25M.

5) The entire credit must be repaid with statutory interest under 7.02.710 in the following circumstances. No penalty will be applied to the repaid credit amount.

    a. Where the lease/extension is broken prior to expiration of the lease period.

    b. Where the taxpayer-owned building space is sold before the four-year credit period is complete.

c. Where the 15-employee requirement is no longer met during the four-year credit period.

Projected Effectiveness

As drafted, the program will allow a maximum credit per taxpayer of $250K taken over four years for businesses meeting the 15-employee requirement. This balances the policy goal to meaningfully incentivize Portland businesses to renew leases and stay in Portland, with the City's need to manage the impact on the general fund and allow the Revenue Division to implement and administer the program beginning with tax year 2023.

The 15-employee requirement allows a manageable number of businesses to participate, including smaller businesses. Lowering the threshold below 10 employees will allow more businesses to participate. However, it cannot be implemented for tax year 2023 due to the expanded interfaces needed to manage a program with a larger number of accounts. Lowering the threshold also makes it more likely the program hits the maximum credit caps, requiring adjustments that reduce the amount of credit each business receives.

The shorter the recovery period, the more incentive businesses have to participate and the easier the program is to administer.

Implementation and Complexity Timeline

As proposed, this can be executed for Tax Year 2023 if City Council passes in September 2023.

The implementation timeline is four months.

The DBI credit will require an application and approval in advance.

1) Taxpayers will apply for the credit by 1/31/2024 for a credit on their tax year 2023 BLT return or by 1/31/2025 for a credit on their tax year 2024 BLT return.
2) A lease must be entered into or extended in the 2023 or 2024 calendar year. A 2023 calendar year lease/extension may be used with a tax year 2024 BLT return (with tax year 2024 being the year of origination) if the 2023 BLT return was not used for calculating the credit.
3) The credit is then claimed over four consecutive tax years beginning with the year of origination.

Administration Complexity

Spreading the credit over a single consistent period of 4 years versus two periods (4 or 8 years, 5 or 10 years, etc.) makes the program much easier to administer. A robust tracking system will be needed.

There are two options for administering the $25M cap:

1) Either the Revenue Division makes the applications first come first serve and cap approvals at $12.5M per year based on prior year tax amounts or,
2) The Revenue Division approves all qualifying credits and then reduces everyone's credit pro rata if the cap is exceeded.

Note: If approvals are capped, there are potential equity concerns. For instance, businesses with more resources have a greater chance of applying for the credit rather than emerging small businesses, women-owned, minority-owned or other typically less resourced businesses. These concerns are better addressed if the program is not handled on a first come first serve basis. The proposed $25M total program cap also lessens the equity concerns.

Budget, One-Time, Ongoing

Spreading the credit over four years is less of an initial impact on the budget. The general fund revenue impact will be limited to $25M over a period of four to six years.

Administration costs will include one-time implementation costs and ongoing costs.

Revenue Division implementation costs are estimated at $108K with a 4-month implementation timeline.

In addition to implementation costs, the Revenue Division's costs to administer this program are estimated at $600K per year (which would include 2 FTE ongoing) for the first two years of the program. For the third, fourth, fifth and sixth year of the program, the Revenue Division's costs are estimated at $350K per year (which would include 1 FTE ongoing). The detailed breakdown is available in a separate document.

Any DBI credit claimed will reduce General Fund revenues for the tax year the credit is claimed on the BLT return.

Accurately modeling the revenue/budget impact is not possible given the limited data available to the Division for leases and taxpayer office/retail locations. The revenue target/cap should not be exceeded. In the credit pre-approval process discussed above, the Revenue Division will compare the taxpayer's credit to their most recently filed return to determine how total potential credits are tracking with the revenue target for each tax year. In the unlikely event that the number of taxpayers requesting the credit exceeds the credit cap, all credits will be proportionately prorated to remain under the aggregate credit cap.

Actual loss of revenue (in tax credits) for the program cannot be accurately determined in advance. It is not possible to accurately estimate how many taxpayers will take advantage of the credit. Tax data on returns that have not been filed is unknowable. (The credit is based on and limited by the amount of tax calculated on their 2023 or 2024 tax return, which is generally not filed before April of 2024 and 2025.)

The use of the credit will begin impacting the General Fund in FY 2023-24, but the impact likely will not be material in this fiscal year. It will significantly impact the General Fund starting in FY 2024-25, with likely the peak impact in FY 2024-25 and 2025-26. After 2025-26, the impact will still be significant and near the peak until approximately FY 2029-30, when it will taper off significantly. After FY 2029-30, the program will likely not have a material impact on the General Fund.

Geography

A logical DBI incentive program boundary is the same boundary used for the downtown Clean and Safe Enhanced Service District (CAS). The revenue impacts in this document assume that this boundary will be used. Expanding the boundary beyond CAS will allow more businesses to participate; however, total credits will reach the credit cap sooner, necessitating a future reduction in their credit. Furthermore, with the increased number of businesses that qualify, tax year 2024 would be the earliest possible implementation for a larger boundary. Opening the boundary will increase the workload and potentially the number of FTE required.

Alternatively, the Revenue Division was asked to consider including Downtown, Old Town, Lower Albina, and Lloyd into the geographies covered by the BLT incentive in the proposal. These districts were rated as the most impacted and most distressed post-pandemic. To keep the number of eligible businesses manageable and maintain a tax year 2023 implementation, the employee threshold will need to be moved from 10 to 15-20. Revenue has reviewed this proposed expansion and believes this can be implemented for tax year 2023.

By increasing the number of employees to 15 there is a risk that the large number of applications causes a significant delay in approval, return processing and issuing refunds. It also increases the likelihood that the program credit cap will be reached, which will require reducing each business's credit. This will likely create a significant negative response.

Program Implementation, Administration and Enforcement Considerations

- The Revenue Division will administer this program through the Business License Tax program as a non-refundable credit. The program will originate a tax credit for either tax year 2023 or 2024, not both.
- A business must be registered with the Revenue Division. Once a business is registered, they will be able to apply for the tax credit electronically through our website.
- The Revenue Division will review applications under the pre-approval option and verify claims after returns are filed. If the number of claims far exceed estimates, the Revenue Division may not be able to thoroughly review every claim timely.
- An application, with instructions, will need to be created and made available for businesses to review.
- A new line will need to be added to the Combined Tax Returns. Instructions will need to be drafted for the forms. This change will require vendor coordination for our electronic filing formats, as well as updates to our Integrated Tax System (ITS) and Portland Revenue Online (our filing portal) for the credit and internal systems testing.
- The audit rate will be low, likely only in conjunction with an existing audit. The half-time employee attestation will be difficult to verify.
- Taxpayers will get a full-year's benefit from a partial-year lease (no proration based on lease date).
- The Revenue Division will need to monitor for fraud (and other bad faith activities) such as setting up multiple tax entities to claim the credit. A separate policy and/or administrative rule can be enacted to address issues in advance and as they arise.
- Penalties for falsely claiming the credit should be high.
- The credit will be considered confidential tax return information under the Business License Law. The Revenue Division will not be able to report out to other City staff (or the public) regarding which businesses have applied for and claimed the credit.

Program Communication

- There should be a September 2023 target date to send business accounts an informative one-page letter notifying them of the incentive.
- A press release should also be considered in order to reach a greater population of businesses.
- Revenue and the Mayor's office will work on communication rollout.

Other Considerations

- Many small/struggling businesses will likely only get a small benefit or no benefit. There can be equity concerns that this incentive is only beneficial to larger businesses. It should be noted, however, that small businesses, especially retail, will likely benefit from other businesses taking advantage of the credit. This incentive will increase downtown foot traffic.

Enactment

The DBI credit program will be enacted by Portland City Council through a code change. The enacted code should authorize/direct the Revenue Division to adopt rules and policies related to the new program. There will be the need for thorough, specific guidance, including web pages, forms, instructions, FAQs, etc.