

Portland's Clean Energy Tax Out of Whack With Voter Intent

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In this installment of SALT Policy Pickles, the authors examine Portland's clean energy surcharge tax and the complexities that surround it.

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In 2018 Portland, Oregon, voters approved the Portland clean energy surcharge (CES), which is a 1 percent gross receipts tax on certain retail sales by certain "large" retailers. The CES came about

through Measure 26-201, which was a ballot initiative designed to fund clean energy projects and promote climate justice through a new tax on large retailers. Marketed as a straightforward solution to raise \$30 million annually, the CES promised to transform the city's approach to environmental sustainability.

But as the CES took effect, this policy pickle came uncanned. Ultimately, the CES's impact became more complex and far-reaching than voters could have ever imagined. Initially portrayed as a modest, targeted tax, the CES has evolved because of changes made by the city council and the city's revenue division. These modifications expanded the tax's scope well beyond voter's intentions, resulting in unexpected and repeated surges in tax collections — nearly \$200 million annually, more than six times the original estimate.

It is not uncommon, and perhaps even expected, for an initiative's revenue collections to differ from the figures touted by political advocates during a campaign. After all, even seasoned economists with years of experience and access to elaborate datasets and models often struggle to accurately forecast tax revenues. Yet the sheer magnitude of the disparity between promised revenues and actual amounts collected is truly remarkable and made some of us Portland tax geeks perk our heads up. Such a large gap raises questions about the nature and scope of the tax as it has been implemented. In the case of the Portland CES, the gap is not merely a routine forecasting error; it reflects a tax that has morphed into something far more expansive than what was sold to voters.

Coming up on the CES's sixth voter birthday, we examine the legislative and administrative modifications to the tax, effectively implementing

a tax scheme neither presented to nor approved by Portland voters. These changes not only conflict with political messaging and campaign promises but also with the city's charter and the Oregon Constitution, potentially opening the door to substantial litigation.

An Overview of Portland's CES

As currently applied, Portland's CES is a 1 percent tax levied on the gross receipts of certain large retailers with retail sales within the city, with only a handful of exemptions.¹ Large retailers are defined in the city's code as any business subject to the city's business license (income) tax with gross revenues from "retail sales" exceeding \$1 billion and local "retail sales" of \$500,000 or more. And "retail sale" is defined in the city's code to mean the sale other than a sale for resale, including services.

While technically the CES is a surcharge on a taxpayer's business license (income) tax return, the funding mechanism operates as a standalone gross receipts tax, combining features of sales, gross receipts, and net income taxes. Like other gross receipts taxes, there are no deductions for cost of goods sold, labor expenses, or operational overhead.

As administered, the city applies the CES, which is a transactional tax, through the lens of its business license (income) tax. The city uses a business's apportionment factors — examining the income sourced to Portland (numerator) and total income (denominator) — to determine whether the CES applies to the taxpayer. Under this approach, any business with more than \$500,000 in Portland-source income and more than \$1 billion in total income is automatically deemed subject to the tax. This approach ignores whether the taxpayer is a "retailer" or whether its sales are "retail sales" — but we will leave those little details for a later discussion.

¹The ballot measure excluded groceries, medicines, healthcare services, utilities, cooperatives, and credit unions. The city council later adopted ordinances creating new exemptions for residential garbage and recycling services, construction contractors, and administrators of certain retirement plans.

We will catch our breath; let's remember that most states rely on general sales taxes as a significant funding source because they are supported by well-established frameworks and decades of administrative experience. Oregon and its localities, however, are among the few governments that don't impose a sales tax, leaving them without the institutional knowledge or infrastructure typically accompanying these taxes.² Some may think this is a good thing, but the creation of "interesting" and "new" taxes is really not something we see as all that productive.

That said, let's be very clear: Portland's CES is a transactional tax, similar to a sales tax levied on the sale of retail goods. But unlike a sales tax, which is passed directly to consumers at the point of sale based on the value of individual transactions, the CES is imposed on the total retail sales receipts of the business. The tax's structure is simply unlike any other known tax in the country, perhaps even the world.

Also, unlike a traditional sales tax, which uses common definitions and practices to ensure uniformity across states, the CES employs its own definitions for "retail sales" and "larger retailers," leading to confusion in the tax's real-world application. Instead of using generally accepted terms, the tax requires taxpayers to determine their liability by reconciling their income tax apportionment factors across all jurisdictions, adjusting those figures to account for the city's unique definition of retail sales.³

Portland's Unique and Limited Taxing Authority

Before diving into a discussion on potential legal problems facing the CES, it is important to understand that Oregon's home rule authority is very particular. Oregon provides broad constitutional and statutory home rule powers to chartered localities.⁴ And the courts have

²For additional discussion about Portland's quirky tax system, see Nikki E. Dobay and Jeff Newgard, "Unweirding Portland's Targeted Tax Regime," *Tax Notes State*, Sept. 28, 2020, p. 1359.

³The city of Portland and the state of Oregon rely on a single-sales-factor apportionment regime, counting only their sales in the jurisdiction relative to sales everywhere else. Thus, to a degree, there is a similarity between sales and the apportionment factors. However, income tax apportionment does not account solely for retail sales, let alone Portland's unique definition of retail sales.

⁴See Or. Const. Art. VI, section 10.

consistently held that municipalities must adhere strictly to the powers granted by their charters unless otherwise provided by state or federal law.⁵ As such, if residents of a jurisdiction confer broad taxing authority to a jurisdiction within its charter, the governing board can impose a tax without taking the matter to voters. But if the charter does not grant such authority, the governing board of that jurisdiction must request authorization from voters to create a new tax or materially change an existing tax.⁶ In Portland's case, the charter does not provide an inherent grant of authority, and thus the city must request authorization to enact a new tax or modify an existing tax through a public vote.

During the 2000s, Portland's charter authority became a central issue in a series of legal cases involving the city's attempts to include short-term vacation rental platforms in its lodging tax. The legal challenge centered on whether the city had the authority to broaden its existing tax to include those platforms as booking agents. In *City of Portland v. HomeAway.com Inc.*, the U.S. District Court of Oregon rejected the city's arguments that its charter provides the inherent authority to tax, including imposing tax on these online platforms without a direct mandate from voters.⁷ The court emphasized that while Portland could levy taxes approved by voters, any significant changes or expansions to existing taxes required explicit voter authorization.

In his ruling, Judge Michael Mosman left no ambiguity regarding the charter authority, finding:

a city's voters can give the city government the ability to levy taxes without legislative authorization. But this does not mean a home rule city can tax with impunity. A city has authority to impose a tax only if (1) the Charter confers such authority, explicitly or implicitly, and (2) the authority has not been preempted by state or federal law.⁸

The court also noted that "none of the Charter provisions discussed . . . give the City the authority it desires."⁹

The *HomeAway.com* decision underscores the limitations of Portland's charter authority and the risks associated with legislative or administrative attempts to create or expand taxes. The decision serves as a clear precedent demonstrating that any efforts by the city to impose new tax obligations or significantly modify existing taxes without voter authorization can be successfully challenged in court.

Voter Perception and the Promise of a Targeted Retail Tax

Since the bedrock of localities' (including Portland's) taxing authority is voter authorization, it is crucial to consider the voters' perceptions (or intent) when they enacted the measure creating the CES. Relying on ballot materials, including the ballot title and voter pamphlet, it becomes clear the electors were led to believe they were endorsing a relatively straightforward initiative aimed at addressing climate change and promoting social justice. The measure was framed as a tax on the sales of large retailers — specifically, so-called big-box retail corporations. The rhetoric surrounding the measure suggested the tax would be limited to the sale of consumer goods and services, implying a narrow and specific application. Moreover, the proponents of the measure repeatedly referenced "national retail stores" as the tax's intended target.¹⁰

The emphasis on retail sales of consumer goods was not just a talking point; it was a central pillar of the campaign that resonated with the electorate and was pivotal to securing the measure's passage. Many voters likely felt reassured by the specificity of the campaign's focus, believing they were making a decision with clear, positive outcomes without unintended consequences.

⁵ See *Jarvill v. City of Eugene*, 613 P.2d 1, at 7-8 (Or. 1980).

⁶ See *City of Portland v. Portland Gas & Coke*, 156 P. 1070 (Or. 1916).

⁷ See *City of Portland v. HomeAway.com Inc.*, 240 F. Supp. 3d 1099, 1107 (D. Or. 2017).

⁸ *Id.*

⁹ *Id.* We would note that the city raised every provision within its charter possible in this litigation.

¹⁰ See Portland Clean Energy Fund, "Frequently Asked Questions."

Portland City Council Amendments to the CES

Several months after voters approved the measure creating the CES, the Portland City Council codified the measure into the city's code. In the supporting documents for the ordinances, the city characterized the amendments as "narrowly tailored" to clarify the measure, such as formatting and general administration of tax returns.¹¹ In reality, however, the ordinances made several substantial changes to the funding mechanism, radically changing the tax as passed by the voters.

While the amendments were characterized as narrowly tailored, the regulatory effects were anything but. Following the adoption of the ordinances, Portland's Revenue Division promulgated a rule providing that the CES applies to *any* sale of a good or service unless it is a sale for resale:

All business activity is either goods-producing or service-producing, both of which are considered Retail Sales unless the good or service is being sold for resale by another entity. Unless CES or this rule expressly excludes a specific type of sale, all goods-producing or service-producing business activity is subject to CES.¹²

The city's amendment radically broadened the scope of the CES, casting a wide net over virtually all business activity within the city. Service providers, professional firms, and numerous other businesses — that were neither retailers nor in the business of making retail sales — were all now subject to the tax. These businesses were never intended or approved by voters as targets of the CES. The targeted levy on "large retailers" morphed overnight into a sweeping tax redefining all business activity as retail.

The evolution of the tax is perhaps most apparent in the city revenue division's rules defining "retail sales." Despite the tax originating as an imposition on "large retailers," as the term is used colloquially, the city's own regulations say providers of business-to-business services are

retailers subject to the tax. For instance, the rules require a business providing assembly line services to a manufacturer to treat those invoices as retail sales, despite no retail transaction ever occurring.¹³ The revenue division's rule also includes the sale of real property as a "retail sale," assuming it is in the regular course of a taxpayer's trade or business.¹⁴

And finally, the city's ordinances altered the use of certain funds; for example, the city amended the treatment of revenues derived from motor fuel and vehicle sales to a separate fund.¹⁵ The Oregon Constitution prohibits certain taxes on these sales unless the revenues from these sources are used exclusively for public highways, roads, streets, and roadside rest areas and no other purposes.¹⁶ While the city charter empowers the city to provide a system for the "custody . . . of all public moneys," changing the definition of funds here directly contradicts the voters' understanding of the tax.¹⁷ Voters approved the CES as a funding mechanism for renewable energy projects — not highway projects.

These broad redefinitions not only deviate from the clear voter intent of targeting consumer-facing retailers but also ensnare countless businesses that were never envisioned as part of the taxable base. As a result, companies that traditionally operate far outside the scope of retail are now entangled in a complex and expansive tax system neither anticipated by voters nor transparently communicated during the campaign.

CES Revenue Validates Concerns

During the campaign, the supporting documents in the voter pamphlet assured electors the tax would raise \$30 million annually, reaffirming the notion of a targeted tax on large retailers.¹⁸ However, revenue from the CES has

¹³ See *id.*, Example 4 ("Sales to retailers and wholesalers of tangible personal property that will be resold in the regular course of business as 'new' merchandise to the end user or consumer.").

¹⁴ See *id.*, Example 2 ("Incidental sales of real property outside the normal course of business.").

¹⁵ See Portland City Council Ordinance No. 189390 and Portland City Charter section 5.04.560.

¹⁶ See Or. Const. Article IX, section 3a.

¹⁷ See Portland City Charter section 7-101.

¹⁸ See Multnomah County Voters' Pamphlet, General Election M-49 (Nov. 6, 2018).

¹¹ See Portland City Council Ordinance No. 189389.

¹² See Portland Business Tax Administrative Rules LIC-5.06 — Clean Energy Surcharge (CES) — Retail Sale.

grown exponentially each year, far surpassing these initial projections. In its first year alone, collections more than doubled the original estimate, generating \$62.7 million, and nearly doubled again in its second year to \$116.7 million. The city's most recent revenue projection estimates the tax will raise \$198 million by the end of this year. Over its next five years, the tax is estimated to rake in more than \$1.3 billion.¹⁹

This dramatic increase in revenue underscores the alarming reality that the CES has strayed far from its original intent. The surge in collections is not a reflection of a booming retail sector in Portland — something the city's boosters and businesses would surely welcome — but rather evidence of a profound and unwarranted expansion of retail activity in the eyes of the tax.

Legal Implications of Mismatched Voter Intent and Tax Enforcement

The disparity between Portland electors' understanding of the tax and the reality of the CES's implementation raises serious legal questions. The supporting materials for the measure leave no doubt the initiative intended to raise taxes on retailers as the term is commonly understood. If the backers of the measure intended an all-encompassing tax, they made no effort to express as much in the official explanation.

But looking at the CES in its current form, it is difficult, perhaps impossible, to reconcile the differences between the tax authorized by the voters and the one imposed on businesses today. At its core, these are two fundamentally different taxes. The measure voters approved was envisioned as a targeted tax on the retail sales of large retailers — a seemingly straightforward initiative. However, the tax has evolved into something much more expansive, capturing a wide array of business activities never presumed to fall within its scope. Did the voters authorize a sweeping tax on nearly all business activity, or merely a specific tax on large retailers? As discussed above, Portland lacks the charter authority to simply wave a wand and impose any

tax it would like. And while city council members would like businesses to believe they have that authority, that is simply not the case.

U.S. and State Constitutional Infirmities

In addition to the city lacking the charter authority to modify and expand the CES to its liking, the tax also raises serious federal and state constitutional questions. Specifically, is the CES's usage of a receipts thresholds compatible with the U.S. commerce and equal protection clauses as well as Oregon's uniformity clause?

While some political operatives may prefer to structure tax initiatives to target a boogeyman — in this case, “nationwide retail businesses” — the mechanisms used to reach that targeted base will inevitably draw immense scrutiny.²⁰ The U.S. commerce clause empowers Congress, not state and local governments, to regulate interstate business activity.²¹ The quintessential feature of the CES is its application of a gross receipts tax on large taxpayers engaging in retail activity across state lines, relying on a threshold that excludes only smaller and in-state businesses.

Similarly, the CES raises questions over its consistency with the U.S. equal protection and Oregon uniformity clauses, constraining the government's ability to create arbitrary groups of taxpayers.²² It is a feature, not a bug, of the CES to create two arbitrary classes of taxpayers — “larger retailers” and, inherently, “not larger retailers” — and to create a different tax system for each class.

Since the receipts threshold creates arbitrary taxpayer classifications, violating long-standing safeguards against targeted taxes, these challenges may fundamentally undermine the CES. Unlike the charter authority issue referenced previously, which could be avoided simply by returning to voter intent, the remedy for these infirmities could result in a detrimental outcome for the city. Because the legal system tends to favor remedial action over rescinding a law in its entirety, the courts may level the playing field by eliminating the receipts threshold, applying the

¹⁹ See Gosia Wozniacka and Shane Dixon Kavanaugh, “Portland Clean Energy Fund's Staggering Windfall Spurs Money Grab, Threatens Climate Justice Ambitions,” *The Oregonian*, Feb. 24, 2024.

²⁰ See E.D. Mondaine, “Portland's Chance for Corporate Accountability,” *The Oregonian*, Sept. 1, 2018.

²¹ U.S. Const. Art. I, section 8, cl. 3.

²² U.S. Const. Amend. XIV and Or. Const. Art. I, section 32.

tax across the board. While this outcome is certainly undesirable, it may prove to be the consequence of targeting the tax base in this manner.

Conclusion

Although the CES is about to celebrate its sixth voter birthday, it is still a new and evolving tax. And while there are many reasons taxpayers have yet to take this tax head on, the opportunity for taxpayers to raise legal challenges is extremely ripe. Moreover, many businesses, particularly those outside the traditional retail sector, are only now beginning to receive notices from the city demanding payment. As these businesses confront unanticipated tax liabilities, they must grapple with a tax far exceeding its original scope.

If voter intent can be so easily overridden or ignored, what limits, if any, exist on the city's taxing authority? The notion that voter approval could be stretched to justify any subsequent changes or expansions to a tax is legally precarious and erodes public trust in the electoral process. The CES, as it currently stands, is a cautionary tale of the problems that arise as the boundaries of voter authorization are taken for granted. ■

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