August 2020
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Oregon Income Tax Connection to Federal Law

Oregon tax law is connected in many ways to federal tax law. In particular, the structure of Oregon's income tax (both personal and corporate components) is based on federal definitions and administration. This relationship is often referred to as "federal connect" or "reconnect". There are two components to this connection: (1) the definition of "taxable income"; and (2) other areas of tax law unrelated to the definition of taxable income. This report provides a brief overview of how Oregon has chosen to connect to federal tax law over the past several decades. Generally, the policy approach has been to maintain connection to federal law. Occasionally, the Legislature has chosen to disconnect from specific federal policies after changes have been made by Congress. These are times when Oregon chooses to not conform to federal law changes.

TAXABLE INCOME BASE

Since 1969, Oregon taxable income has been based on federal taxable income as defined in the Internal Revenue Code (IRC). As a result, increases in federal deductions and exemptions (which are used to calculate taxable income) often directly reduce Oregon taxable income and Oregon tax liability (and vice versa). Conversely, changes in federal tax rates and credits generally do not have a direct effect on Oregon because tax rates and credits are not part of the definition of taxable income and Oregon is not connected to them.[1]

The two components of Oregon's federal connection are subject to different constitutional restrictions. In general, the Legislature may not cede its law-making authority to any other entity, including the federal government. This means that when the Legislature chooses to connect to federal law, that connection date must be a date prior to the effective date of the state legislation. By convention, the Legislature has usually chosen to connect to federal law as amended and in effect on December 31 of the year prior to the legislative session. The one exception to this "look back" requirement is Oregon's income tax base as defined by federal taxable income.[2] In this one case, the state is permitted to maintain a continuous connection to federal law—for the definition of taxable income—without legislative action.

Prior to 1997, Oregon did not automatically adopt federal changes in taxable income. Legislation was required each session to update Oregon's connection to the IRC. Although the Legislature generally chose to connect to federal changes made during the preceding two years, some exceptions exist.

Since 1997 Oregon has frequently maintained an automatic connection to changes in taxable income as defined by the IRC. This policy of a continuous connection is known as "rolling reconnect". Under a rolling reconnect policy, the revenue impacts resulting from changes in federal taxable income are estimated as

[1] In simplest terms, tax liability = (taxable income × tax rates) - credits
[2] This amendment to the Oregon Constitution accompanied the statutory tax changes enacted in 1969 and was adopted by the voters in 1970.

needed and then incorporated into the Oregon current law revenue forecast. While the Legislature continues to review and monitor federal tax changes each year, specific legislation disconnecting Oregon from federal law is required to avoid inherently adopting federal changes to the Oregon tax base.

DISCONNECT EXAMPLES

Under a rolling reconnect policy, the Legislature still needs to annually consider updating the federal connection date for all aspects of connection other than the definition of taxable income. Consequently, there is a reconnect bill each legislative session that changes the year of the connection date to the most recent calendar year. At the same time and depending on the existing economic conditions, the Oregon Legislature has chosen to occasionally disconnect from certain federal tax policies that affect taxable income. For example, shortly after adopting the federal taxable income as the tax base, the 1971 Legislature chose to disconnect from increases made to the federal standard deduction and personal exemption. Disconnecting from these increases prevented reductions in Oregon tax revenue. In 1975, the Legislature established Oregon standard deduction and personal exemption polices separate from the federal policies, effectively establishing a permanent disconnect. Below are examples of other times when the Legislature has disconnected from selected federal policies.

2018: Disconnected from a federal 20 percent deduction for certain pass-through and proprietorship entities.

2009: Disconnected from federal provisions for bonus depreciation, the discharge of indebtedness and Section 179 expensing. Suspended the “rolling reconnect” for tax years 2009 and 2010.

2003: Disconnected from federal policies such as depreciation, Section 179 expensing, and various other provisions. Suspended the “rolling reconnect” for tax years 2003 through 2005.

1997: Established a “rolling reconnect” to the definition of taxable income.

1981: Disconnected from federal accelerated depreciation provisions. Conformity to federal depreciation treatment was not reestablished until 1995.

REVENUE FEEDBACK EFFECT

Oregon personal income taxpayers who claim itemized deductions on their federal return are allowed to deduct Oregon income taxes as one of the itemized deductions. At the same time, Oregon filers are allowed a subtraction (i.e. deduction) against their Oregon taxes for the amount of federal income taxes paid.[3] This cross-deductibility of Oregon and federal income taxes has complicated implications. Reductions in federal income tax result in a reduced subtraction for some taxpayers, and thereby greater Oregon tax liability (and vice versa). Similarly, a reduction in Oregon income tax may result in a smaller federal itemized deduction, thereby leading to greater federal tax liability (and vice versa) for certain filers. This interaction has been muted to some extent by the federal Tax Cuts and Jobs Act (2017), which limited the federal itemized deduction of state and local taxes to $10,000. Revenue feedback effects result from Oregonians’ ability to subtract some of their federal tax liability from their Oregon taxable income. This feedback occurs whether or not Oregon connects to the federal changes, but the size of the subtraction may be affected by the degree of connection.

[3] The subtraction is up to $6,800 in 2019 and indexed to inflation. Also, it is limited to single filers with income under $145,000 and joint filers under $290,000.