Research Brief

The American Recovery and Reinvestment Act of 2009

(The Impact on Oregon)

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Summary

On Tuesday, February 17, 2009, the President signed into law the American Recovery and Reinvestment Act of 2009. The Act contains several provisions that could affect Oregon personal and corporate income taxes, either directly or indirectly. This paper briefly describes these types of impacts and those provisions with the largest impacts. Because Oregon is currently tied to federal law in effect on December 31, 2008, most of the changes that would have a direct impact do not automatically flow through to Oregon taxpayers. Specific action is needed by the 2009 Assembly for them to take effect.

As shown in the table below, the sum of the direct impacts on 2009-11 would be a loss $135 million; the sum of the indirect impacts is an increase of $59.5 million. The provisions that currently affect Oregon revenue – the indirect impacts and net operating losses impact – have been incorporated into the March 2009 revenue forecast.

Federal Provision	**Biennium** ($ Million)		
	2009-11	**2011-13**	**2013-15**
Direct Impacts			
Bonus Depreciation	-68.5	27.8	18.0
Unemployment insurance	-29.0	0.0	0.0
Discharge of indebtedness	-26.7	-1.7	7.5
Net operating losses	-5.9	2.1	1.1
Section 179 expensing	-2.9	1.6	0.7
Earned income credit	-2.0	0.0	0.0
Subtotal	-135.0	29.8	27.3
Indirect Impacts			
Making-work-pay credit	52.1	0.0	0.0
American opportunity credit	4.1	0.6	0.0
Homebuyer credit	2.3	0.0	0.0
AMT patch	1.0	0.0	0.0
Subtotal	59.5	0.6	0.0

Direct Impacts

Direct impacts affect Oregon taxpayers by directly reducing their tax liability. For the most part, the direct impacts depend on action taken by the 2009 Assembly because they affect taxable income. The Legislature would need to affirmatively connect to these specific provisions for the revenue impacts to take effect. The one exception is the provision pertaining to net operating losses. More detail is provided below but this impact is due to the filing of amended personal income tax returns, so no legislative action is necessary for the impact to take effect.

Bonus Depreciation

Businesses are allowed to recover investment costs of tangible property through depreciation deductions that are taken over the lifespan of the equipment. The mechanism for determining the depreciation schedule is the Modified Accelerated Cost Recovery System (MACRS). The specific recovery period and depreciation method depend on the type of property. The Act allows businesses to deduct 50 percent of the adjusted basis in the first year; the remaining 50 percent is depreciated according to the current schedules. So the first year depreciation is the sum of the 50 percent “bonus” depreciation and the first year depreciation of the remaining 50 percent of the adjusted basis. Generally, the 50 percent bonus depreciation is only for property placed in service in 2009.

The policy is intended to encourage businesses to continue making capital investments at a time when consumer demand appears to be softening. Without the incentive, businesses may delay making such investments, possibly amplifying the effects of the economic downturn. The policy results in an estimated revenue loss in the 2009-11 biennium as business deductions are larger than they would be otherwise. Then those same deductions are lower in subsequent years leading to a revenue gain in the subsequent biennia.

Exclusion of unemployment insurance benefits

Generally, unemployment insurance benefits are taxable income. For tax year 2009, up to $2,400 in benefits are excluded from federal taxation. This policy represents a 60 percent exclusion of these benefits on average. In 2008, recipients received an average benefit of just under $4,000; in total, roughly $955 million in benefits were paid. The provision benefits those individuals whose income for the year remains high enough that they are required to file an income tax return.

Discharge of Indebtedness

Generally, when a taxpayer cancels or repurchases debt for an amount less than its issue price, the difference between the issue price and the repurchase price is considered income. This provision allows businesses who repurchase their debt in 2009 or 2010 to include the income ratably over five years beginning in 2014 rather than in the year of repurchase. The provision applies to specific types of business debt repurchased with cash between January 1, 2009 and December 31, 2010. Current information suggests that nationally most of this benefit is expected to accrue to private equity firms.

Net Operating Losses

At the federal level businesses that have losses in the current tax year may file amended returns and apply those losses to the prior two tax years (called “carrybacks”). The Act extends this two year period to up to five years for tax years ending in 2008. It is limited to businesses with annual gross receipts of no more than $15 million in 2008. For corporations, Oregon has its own provisions for net operating losses (NOL) and does not allow NOL carrybacks, so the change has no impact on Oregon. However, businesses subject to the personal income tax are affected by this change. Presumably, when these taxpayers file amended federal returns reflecting lower taxable income they would also file amended Oregon tax returns and claim refunds for tax from prior years. One effect of this policy is to make the other provisions, such as the bonus depreciation and Section 179 expensing, more effective by enabling companies with little or no income in the current year to receive a tax benefit.

Section 179 Expensing

Up to certain limits, businesses may elect to recover investment costs under Internal Revenue Code (IRC) Section 179 by deducting (or "expensing") the cost of qualifying property in a single year rather than through depreciation deductions over time. Prior to enactment, businesses were allowed to expense up to $128,000 of qualified property costs in 2009. The $128,000 was to be phased-out to the extent the qualifying costs exceed $510,000. The Act increases the expensing amount to $250,000 and the phase-out threshold to $800,000. The provision applies to tax years beginning in 2009.

The effect of this policy is similar to that of the bonus depreciation described above. It encourages businesses to maintain 2009 investment levels or shift them from later years into 2009; hence revenue loss in the 2009-11 biennium and the increases in the subsequent biennia. Generally, most of the tax benefit from this provision accrues to relatively smaller firms.

Expansion of the earned income tax credit

Individuals are eligible for a credit against earned income up to certain levels. The amount of the credit depends on the number of dependents and is phased-out as income increases. This provision expands the credit for tax years 2009 and 2010. For families with 3 or more children, the credit increases from 40% to 45% of qualifying earnings. Also, the income range over which the credit phases out for joint filers is increased from $3,120 to $5,000. Because the Oregon credit is 6 percent of the federal credit, tying to this provision would reduce Oregon revenue. Roughly 60,000 Oregon filers are expected to benefit from this provision.

Indirect Impacts

Indirect impacts are the result of lower federal taxes reducing the federal tax subtraction, thereby increasing personal income taxes for Oregonians. Technically, any change that affects federal taxes could affect the federal tax subtraction. (Affected taxpayers will be those whose subtraction is below the limit – $5,850 in 2009 – after accounting for the changes in federal law.) These impacts, however, tend to be relatively small, unless they are of a magnitude comparable to the Making Work Pay credit contained in the Act.

Making Work Pay Credit

For tax years 2009 and 2010, taxpayers are eligible for a refundable credit equal to 6.2 percent of earned income, up to $400 for individuals and $800 for couples. The credit is phased-out for individuals with income between $75,000 and $95,000 and joint filers with income between $150,000 and $190,000. The IRS has implemented new withholding tables reflecting the credit so taxpayers will see lower federal withholding and begin benefitting from the credit this spring.

The credit constitutes a reduction in federal income taxes for tax years 2009 and 2010, so when Oregon taxpayers file those respective tax returns, their federal tax subtraction claimed on the Oregon return will be reduced by the amount of their federal credit. The reduction in the subtraction results in a revenue increase for Oregon. Taxpayers not affected are those whose federal tax is greater than the limit on the federal tax subtraction after incorporating their credit and those taxpayers for whom their current federal tax subtraction does not affect their Oregon taxes.

The table below shows the impact on Oregon taxpayers for tax year 2009. In total, nearly 1.3 million Oregon taxpayers are expected to receive an estimated total of nearly $675 million in federal credits this year through lower withholding. The resulting increase in Oregon taxes is roughly $26 million. Affected single filers will receive an average federal credit of $360, with an average Oregon tax increase of $17. Affected joint filers will receive an average federal credit of $744 which results in an average Oregon tax increase of $24.

Taxpayers Affected by the Making Work Pay Credit
Tax Year 2009

Income Group ($000)	Single Filers*					Joint Filers				
		Federal Credit		Tax Change			Federal Credit		Tax Change	
	Returns	Total ($M)	Average ($)	Total ($M)	Average ($)	Returns	Total ($M)	Average ($)	Total ($M)	Average ($)
< 20	360,555	$120.5	$334	$3.4	$9	71,753	$47.0	$654	$0.1	$1
20 - 40	213,879	$84.6	$396	$6.0	$28	91,101	$69.2	$759	$1.8	$20
40 - 60	95,501	$37.6	$394	$2.5	$27	97,659	$76.0	$778	$4.5	$46
60 - 80	41,552	$15.7	$378	$0.3	$7	97,244	$75.6	$778	$4.7	$48
80 - 100	13,397	$2.2	$166	$0.0	$1	81,752	$63.4	$775	$2.0	$24
100 - 120	0	$0.0	$0	$0.0	$0	51,022	$39.7	$777	$0.4	$8
120 - 140	0	$0.0	$0	$0.0	$0	30,516	$23.7	$777	$0.1	$2
140 - 160	0	$0.0	$0	$0.0	$0	18,619	$13.8	$741	$0.0	$1
160 - 180	0	$0.0	$0	$0.0	$0	11,633	$4.8	$411	$0.0	$0
180 - 200	0	$0.0	$0	$0.0	$0	4,146	$0.4	$108	$0.0	$0
> 200	0	$0.0	$0	$0.0	$0	0	$0.0	$0	$0.0	$0
Total	724,883	$260.7	$360	$12.3	$17	555,445	$413.5	$744	$13.5	$24

* Includes Head-of-Household, Married-filing-Separate, and Qualified Widow(er) returns

American Opportunity Credit

The Act increases the two-year Hope credit of up to $1,800 ($3,600 in total) to a four-year, $2,500 credit ($10,000 in total). The credit is for tax years 2009 and 2010 and is equal to 100 percent of the first $2,000 spent on qualifying expenses plus 25 percent of the next $2,000. The credit is also potentially refundable up to $1,000. It phases out for individuals between $80,000 and $90,000 and for joint filers between $160,000 and $180,000. The credit can not be claimed for expenses paid using funds from tax-preferred accounts such as 529 plans and Coverdell Savings Accounts.

Homebuyer Credit

The first-time home buyer credit had been a refundable credit equal to 10 percent of the purchase price of a principal residence, up to $7,500 for most taxpayers ($3,750 if married-filing-separate). The credit was to be recaptured ratably over 15 years beginning in the second year after purchase. The Act increases the credit to $8,000 and eliminated the recapture provision. It is effective for residences purchased in 2009.

Alternative Minimum Tax Exemption

When calculating the federal alternative minimum tax (AMT), taxpayers are allowed an exemption – similar to a standard deduction – that, historically, has not been indexed to inflation. In recent years, however, Congress has enacted a series of one or two year changes to the exemption amount to prevent a large number of taxpayers from paying the AMT. This provision constitutes another one year fix, for tax year 2009. In 2008 the exemption amounts were $46,200 for individuals and $69,950 for joint returns. In 2009, they were to return to their 2000 levels of $33,750 for singles and $45,000 for joint filers. The Act sets the 2009 exemptions at inflation-adjusted amounts of 2008 – $46,700 for individuals and $70,950 for joint filers. Generally, taxpayers subject to the AMT have federal taxes that exceed the federal tax subtraction, so this has a limited indirect impact.

Outstanding Issues

Because Oregon is currently tied to federal law in effect on December 31, 2008, there are two issues that remain unclear as to their impact on Oregon taxpayers. The first is a provision that effectively overturns the IRS ruling on built-in losses for banks and other financial institutions. The second is for a new federal program that provides subsidies to help individuals who have lost their jobs purchase health insurance.

Built-In Losses

Generally, a business that acquires another business is not allowed to apply any existing operating losses of the acquired company ("built-in losses") against the gains of the acquiring company. The intent is to limit the tax-motivated acquisitions of loss corporations. In the fall of 2008 the IRS issued a ruling (2008-83) that exempted banks from this treatment – enabling them to offset gains with such losses after an ownership change. The Act states that IRS exceeded its authority in issuing this ruling and effectively repealed it as of January 1, 2009. The issue in question is whether or not the repeal flows through to Oregon given our current connection date of December 31, 2008. Assuming the frozen connection to statute also applies to IRS rulings, then the affected companies could continue to claim these losses when filing Oregon tax returns unless action is taken by the Legislature.

Health Insurance Assistance Program

Generally, individuals may choose to participate in either Cobra or the state continuation program to purchase health insurance after losing a job, but they must pay the full amount of the insurance cost. The Act would allow eligible individuals to purchase health insurance at the rate of 35 percent of the total cost. The remaining 65 percent is paid for by either the former employer or health insurance provider, which is then reimbursed through a credit against the payroll tax. Generally, such fringe benefits are exempt from taxation; and the Act states that the subsidy is exempt from federal taxation. The issue in question is whether or not these subsidies would be considered tax exempt as a fringe benefit – even though they are no longer employees – or if the language in the Act pertaining to their tax status was necessary to make them exempt. If it is the later case, then the subsidies would likely be considered taxable for Oregon purposes.

For additional information, contact the Legislative Revenue Office, 503-986-1266