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REVENUE IMPACT OF H.R. 1836: THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

H.R. 1836 "The Economic Growth And Tax Relief Reconciliation Act Of 2001" was approved by conference committee on May 25, 2001. The Joint Committee on Taxation estimated the tax changes in H.R. 1836 will reduce federal tax revenues by a cumulative total of $1.35 trillion through FY 2011. Tax reductions in H.R. 1836 are achieved by phasing-in changes in several different aspects of the federal income and estate tax systems, including reduction in the tax base (through increased deductions and exclusions), reduction in tax rates (including widening of tax brackets) and increased tax credits.[1] These changes begin in different years and phase-in at different rates over the budgetary period. The total impact of federal tax changes on Oregon revenues is a combination of three different components: the reconnect effect, the feedback effect and behavioral response. The impact of changes in economic behavior have already been incorporated into the current economic and revenue forecast and so are not addressed here.[2] The reconnect and feedback components are discussed below.

RECONNECT

Oregon taxable income is based on Federal Adjusted Gross Income as defined by the Internal Revenue Code (IRC). Oregon tax law automatically connects to changes in the definition of taxable income as they are incorporated in the IRC ("rolling reconnect"). Under rolling reconnect, the revenue impact resulting from these changes in federal taxable income is continuously incorporated into the Oregon current law revenue forecast. Federal changes that increase deductions or otherwise reduce the taxable income base generally also directly reduce Oregon taxable income and Oregon tax liability.

Provisions of H.R. 1836 that reduce Oregon revenues through reduction in the taxable income base include: increased deductibility for contributions to IRAs and deferred compensation accounts (401K etc.), extending the income exclusion for employer-provided education assistance, allowing a deduction for qualified higher education expenses, increased deductibility for student loan interest payments, and removing the income limits on certain itemized deductions.

FEEDBACKS

The cross-deductibility of Oregon and federal income taxes creates some more complicated feedback effects. A subtraction for federal income taxes paid up to $3,000 is allowed against Oregon taxable income. Reductions in federal income tax result in a smaller subtraction for some taxpayers and thereby greater Oregon tax liability.[3] This effect will be magnified beginning in 2002 when the federal tax subtraction increases to $5,000 under Measure 88.

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[1] Because of budgetary restrictions all changes sunset 12/31/2010. For tax year 2011 the federal income tax and estate tax system reverts back to its form prior to passage of H.R. 1836.

[2] The Office of Economic Analysis produces quarterly economic and revenue forecasts for current and subsequent biennia. These forecasts incorporate up-to-date expectations of external factors likely to affect the national and state economies, including anticipated federal government monetary and fiscal policies.

[3] State income taxes are also deductible from federal taxable income, so increases in Oregon income tax tend to reduce federal tax liability, and vice versa.

Federal tax reductions in H.R. 1836 that have a significant positive impact on Oregon revenues through the feedback effect include: increased federal child credit, reduced tax rates, inserting a 10% tax bracket in the lower portion of the current 15% bracket, widening the 15% bracket for married taxpayers, increased standard deduction for married taxpayers, and removing the income limits on the personal exemption.

ESTATE TAX

H.R. 1836 also phases-in the repeal of the federal estate tax. This is done by a combination of reduced tax rates and increased effective exemption amounts via the "unified credit." The estate tax is completely repealed in 2010 (however in 2011 the estate tax reverts back to its current form!). In order to mitigate some of the revenue impact during the early years of the phase-out, H.R. 1836 reduces the tax credit allowed for state death taxes paid, repealing the credit entirely in 2005.[4] Many states, including Oregon, use the state death tax credit as a "pick-up" tax, collecting the maximum amount allowed as a credit against the federal estate tax under federal law, and no more. Thus Oregon estate tax collections are tied to the federal estate tax, especially the state death tax credit.

However since the estate tax is not an income tax, Oregon does not automatically connect to changes in federal estate tax law as it connects to changes in taxable income.[5] Oregon law is currently tied to the federal state death tax credit as in effect in 1997. This means that Oregon estate tax collections will not automatically decline due to the changes in H.R. 1836. But phase-out of the federal tax will exert pressure on the Legislature to either update the Oregon pick-up tax or enact a more formal estate tax law.[6]

REVENUE IMPACT

The tables below show the estimated Oregon General Fund Revenue impact resulting from the combined tax changes in H.R. 1836. The first table shows the total impact without connection to the estate tax changes in the bill. **This is the most likely scenario under current law.**

General Fund Revenue Impact of 2001 H.R. 1836 ($ million)*			
Biennium	Reconnect	Feedback	Total Excluding Estate Tax
2001-03	-21.2	60.8	**+ 39.6**
2003-05	-41.0	74.8	**+ 33.8**
2005-07	-39.3	104.6	**+ 65.3**
* Based on May 2001 Oregon quarterly revenue forecast.			

The second table (below) shows the impact if the Legislature decided to connect to the estate tax changes in H.R. 1836. Note that the net impact in 2001-03 would be reduced by $22 million, and the net impact would be negative in subsequent biennia. **This change would require legislation.**

Impact Including Connection to Estate Tax Changes ($ million)*			
Biennium	Total Excluding Estate Tax	Estate Tax	Total Including Estate Tax
2001-03	39.6	-22	**+ 17.6**
2003-05	33.8	-66	**- 32.2**
2005-07	65.3	-88	**- 22.7**
* Based on May 2001 Oregon quarterly revenue forecast.			

[4] The state death tax credit is reduced by 25% in 2002, 50% in 2003, 75% in 2004 and eliminated beginning in 2005.

[5] See June 6, 2001 opinion from Legislative Counsel.

[6] Oregon previously had its own statutory estate tax until 1987.