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Research Brief
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Oregon Income Tax Reconnect and "The Job Creation and Worker Assistance Act of 2002"

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 generally directly reduce Oregon taxable income (and vice versa). Changes in federal tax rates and credits, on the other hand, generally do not have a direct effect on Oregon income tax.

Prior to 1997 Oregon did not automatically adopt federal changes in taxable income. Legislation was required to update Oregon's connection to the IRC. Although the Legislature has generally chosen to connect to federal changes, on at least two prior occasions it did not:

1. In 1971 the Legislature disconnected from increases in the federal standard deduction and personal exemption. Oregon eventually reconnected to the federal code in 1975 after establishing a separate personal exemption and standard deduction in Oregon statute.
2. In 1981 the Legislature disconnected from federal accelerated depreciation provisions. While only property placed in service from 1981 through 1984 was affected by the disconnect, full conformity to federal depreciation treatment was not reestablished until 1995.[1]

Since 1997 Oregon has automatically connected to changes in taxable income as they are incorporated in the IRC. This is called "rolling reconnect". Under rolling reconnect, the revenue impact resulting from changes in federal taxable income, including feedback effects, is periodically estimated and continuously incorporated into the Oregon current law revenue forecast. The Legislature continues to review and monitor federal tax changes each biennium, however specific legislation is now required to avoid adopting federally-imposed changes in the Oregon tax base.

Revenue Feedback Effect

Cross-deductibility of Oregon and federal income taxes has some more complicated implications. For personal income tax payers, a limited subtraction up to $5,000 for federal income taxes paid is allowed against Oregon taxable income.[2] Reductions in federal income tax result in a smaller subtraction for some taxpayers, and thereby greater Oregon tax liability (and vice versa). Revenue feedback results from Oregon personal income tax payers' ability to subtract some of their federal income taxes from Oregon taxable income. Note that revenue feedback occurs whether or not Oregon connects to the federal changes.[3]

[1] Specific cases were also addressed in the 1997 and 1999 Legislative sessions.
[2] The tax subtraction limit increased from $3,000 to $5,000 on January 1, 2002 as a result of 2000 Ballot Measure 88.
[3] Another type of effect called "Economic Feedback" may occur due to the influence of tax changes on economic behavior. The impact of economic feedback is estimated separately and incorporated into the quarterly revenue forecasts by the state economist .

Recent Reconnect History

2001: H.R. 1836 "The Economic Growth And Tax Relief Reconciliation Act Of 2001" was passed in May 2001. This was the most significant federal tax legislation since 1986. H.R. 1836 makes several changes to federal personal income and estate taxes, including reducing tax rates and increasing deductions, exclusions and credits.[4]

Connection to H.R. 1836 reduced Oregon income taxes by an estimated $21 million in 2001-03 due to reductions in the taxable income base. However revenue feedback (via the federal tax subtraction) increased revenues by an estimated $61 million. The net result was an increase of about $40 million in 2001-03 revenues due to H.R. 1836.

2000: The tax provisions in H.R. 5662 "The Community Renewal Tax Relief Act of 2000" and H.R. 4986 "The Foreign Sales Corporation Repeal And Extraterritorial Income Exclusion Act Of 2000" had a slightly negative net impact on Oregon revenues. Automatic connection to the tax base reductions in these two bills reduced estimated Oregon tax collections by $3 million in 2001-03.

1999: Connection to the tax provisions in H.R. 1180 "The Tax Relief Extension Act of 1999" reduced estimated Oregon tax collections by $1 million in 2001-03.

1998: Connection to the tax provisions in H.R. 2676 "The IRS Restructuring and Reform Act of 1998" increased Oregon tax collections by an estimated $1 million in 2001-03.

(Note: These impacts have been incorporated into the current revenue forecast.)

The Job Creation and Worker Assistance Act of 2002

Congress recently passed "The Job Creation and Worker Assistance Act of 2002." This bill extends some expiring tax credits, contains targeted tax relief for New York City, expands a net operating loss carryback for businesses, and allows unemployed workers an additional 13 weeks of benefits in certain cases. However the most significant revenue impact component of the legislation is a provision allowing businesses a first-year bonus depreciation deduction equal to 30% of the adjusted basis for qualified property placed in service between September 10, 2001 and September 11, 2004. In most cases this deduction will pass through to Oregon taxable income.

The table shows the estimated impact on Oregon income taxes due to changes in taxable income compared with prior law. Over 90% of the impact is the result of the bonus depreciation provision.[5]

Estimated Oregon Reconnect Impact of "The Job Creation and Worker Assistance Act of 2002"	
Biennium	**General Fund Revenue Impact**
2001-03	- $148 million
2003-05	- $93 million
2005-07	+ $84 million

Since the most significant changes in the Act affect corporate taxes, the revenue feedback will be quite small.[6] Economic feedback generated by any increased investment and employment will be estimated separately and incorporated by the state economist into the June 2002 Oregon Economic and Revenue Forecast.

[4] Budgetary restrictions force all changes in HR 1836 to sunset December 31, 2010. Thus beginning tax year 2011, federal income and estate taxes revert back to their form prior to passage of H.R. 1836.
[5] The revenue impact becomes positive in 2005-07 because the bonus depreciation sunsets in 2004. Thereafter the aggregate depreciation deduction become less than it was projected to be under prior law.
[6] Corporations are not able to subtract federal income taxes from Oregon taxable income.