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Research Brief
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Oregon Income Tax Reconnect

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 Oregon tax liability (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 did generally choose to connect to recent changes, on at least two prior occasions it did not: 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. In 1981 the Legislature disconnected from federal accelerated depreciation provisions. Conformity to federal depreciation treatment was not reestablished until 1995.

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. While the Legislature continues to review and monitor federal tax changes each biennium, specific legislation is now required to avoid adopting federal changes to the Oregon tax base.

Revenue Feedback Effect

The cross-deductibility of Oregon and federal income taxes has some more complicated implications. A limited subtraction up to $3,000 for federal income taxes paid is allowed against Oregon taxable income. Reductions in federal income tax result in a reduced subtraction for some taxpayers, and thereby greater Oregon tax liability (and vice versa). This effect will be amplified beginning in 2002 when the federal tax subtraction limit increases to $5,000 under Measure 88.

Revenue feedback results 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.[1]

[1] Economic feedback may also occur due to the impact of federal tax changes on national and local economic behavior. The impact of economic feedback is estimated by the state economist and incorporated into the quarterly revenue forecasts.

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 the federal personal income tax, including reducing tax rates and increasing certain deductions, exclusions and credits.[2]

H.R. 1836 was estimated to reduce Oregon income taxes by $21 million in 2001-03 due to reductions in the taxable income base. This occurred because Oregon connected to the federal changes in taxable income. However feedback effects (via the federal tax subtraction) increased revenues by an estimated $61 million. The net result was an increase of about $40 million in estimated 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 slightly negative net effects on Oregon revenues. Automatic connection to the tax base reductions in these two bills will reduce Oregon tax collections by an estimated $3 million in 2001-03.

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

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

Future Reconnect

Congress is currently debating a new bill, H.R. 3090 "The Economic Security and Recovery Act of 2001." The version of the bill passed by the House includes significant business tax relief and accelerates some of the phased tax rate reductions in H.R. 1836. The Senate (Baucus) version contains more specifically targeted tax provisions and increased spending. The most significant components of the House bill are a three-year bonus depreciation allowance for new capital purchases and retroactive repeal of the corporate Alternative Minimum Tax (AMT). The Senate (Baucus) version includes a smaller bonus depreciation adjustment and retains the corporate AMT.[3]

The estimated impacts on Oregon income taxes of the House and Senate (Baucus) bills are shown in the table below. These impacts are due to the reductions in the taxable income base. Since most of the tax changes in H.R. 3090 affect corporate taxes, the revenue feedback effect of both bills will be very small.[4]

Estimated Reconnect Impact of HR 3090 ($ mil)		
Biennium	**House**	**Senate (Baucus)**
2001-03	-169	-41
2003-05	-91	+13

[2] 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.

[3] Other Senate proposals were reported to include bonus depreciation provisions similar to the House bill.

[4] Corporations are not able to subtract federal income taxes from Oregon taxable income. The economic feedback effect of the on the Oregon economy will be estimated separately by the state economist and incorporated directly into future economic and revenue forecasts.