STATE OF OREGON

Research Brief

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American Taxpayer Relief Act of 2012

On January 2, the President signed into law the American Taxpayer Relief Act of 2012 (ATRA). The bill extends various provisions of federal tax law, thus avoiding the taxation side of the fiscal cliff.[1] More specifically, the bill permanently extends tax cuts originally enacted in 2001 and 2003, extends for five years tax cuts originally enacted in 2009, and extends for one or two years provisions collectively known as "extenders". The provisions adopted by Congress differ from those assumed in the December revenue forecast. This research report briefly describes these provisions and provides estimates of their impact on Oregon's revenue stream, which will be incorporated into the February forecast.

These impacts are relative to the December 2012 economic and revenue forecast. Of particular note are the assumptions contained in that forecast because they provide the baseline to which the new legislation is compared. At the time that forecast was prepared, there was significant uncertainty about what Congress would do in response to the fiscal cliff – the many tax provisions that were scheduled to change on January 1, 2013. Briefly, that forecast included the assumption that, in general, 2012 tax law would be extended through 2013 and that the new Congress would address any policy changes. There were two specific exceptions to these assumptions. First, higher federal tax rates were assumed to be made permanent for single taxpayers with income above $200,000 and joint taxpayers with income above $250,000. Second, the 50 percent bonus depreciation was assumed to sunset in 2012.

To better explain the impact on Oregon's revenue stream, the provisions are separated into three distinct groups: those with an immediate impact, those known as "extenders", and those needing Oregon legislation. The table on page 2 contains the estimates for these three groups. The total of direct and indirect impacts for the first group – those provisions which have an immediate impact – are -$2.6 million for 2011-13, -$12.9 million for 2013-15, and +$26.9 million for 2015-17.

The direct effects are the result of changes to the tax base (i.e. taxable income). An increase (decrease) in the tax base leads to an increase (decrease) in Oregon taxes. The bonus depreciation and Section 179 expensing apply to property placed in service in 2013. They effectively move depreciation from later years into 2013. Consequently, there is a revenue loss in 2013 and corresponding revenue increases in subsequent tax years. ATRA also includes a one year

[1] The deadline for potential federal spending reductions has been moved to March 1, 2013.

extension of unemployment benefits; these benefits are taxable so the extension results in a revenue gain. Prior to the 2001 law changes, itemized deductions were limited for higher income taxpayers. The 2001 changes gradually repealed the limitation; in 2012 there was no limitation. As described above, the December forecast incorporated the assumption that there would be no limit in 2013, but there would be in 2014 and later. ATRA included a limitation that was less restrictive than the prior law. So for tax year 2013, there is a revenue gain (limited deductions compared to unlimited deductions) but for subsequent tax years there is a revenue loss (less limited deductions compared to more limited deductions).

Immediate Impact

Federal Provision	Biennium ($ Million)*		
	2011-13	2013-15	2015-17
Direct effects			
Bonus depreciation	-$11.6	-$32.4	$22.3
Unemployment insurance	$12.5	$12.5	$0.0
Section 179 expensing	-$3.6	-$9.6	$5.2
Itemized deductions	$0.0	$5.0	-$24.0
Other	$0.0	-$7.0	-$10.5
Subtotal	-$2.6	-$31.5	-$6.9
Indirect effects			
Federal child credit	$0.0	$10.9	$22.2
Other	$0.0	$7.8	$11.6
Subtotal	$0.0	$18.6	$33.8
Total	**-$2.6**	**-$12.9**	**$26.9**

Tax Extenders

Federal Provision	Biennium ($ Million)		
	2011-13	2013-15	2015-17
Individual	-$10.0	-$10.5	-$0.3
Business	-$12.1	-$13.1	-$1.5

Needing Legislation

Federal Provision	Biennium ($ Million)		
	2011-13	2013-15	2015-17
Earned income credit	$0.0	-$12.8	-$13.6
Dependent care credit	$0.0	-$0.7	-$0.4

Assumes tax credits are extended

The indirect effects, on the other hand, have an inverse relationship because Oregon taxpayers are allowed to deduct federal taxes on their Oregon return. Up to the limit of the federal tax subtraction ($6,250 in 2013), provisions that decrease (increase) federal taxes will increase (decrease) Oregon taxes. The provision with the most significant indirect impact is the federal child credit, which was scheduled to be reduced from $1,000 in 2012 to $500 in 2013. Similar to other provisions, the December forecast included the assumption that the credit would remain at the $1,000 level for 2013 and then fall to $500 beginning in 2014. Consequently, the changes in ATRA result in no revenue impact in tax year 2013 but a revenue gain in subsequent tax years.

The second group is collectively referred to as tax "extenders". These are provisions that historically have been scheduled to sunset, but that Congress has repeatedly shown a willingness to extend one or two years at a time. While Oregon's revenue forecast is required to be based strictly on Oregon tax law, there is more room for judgment about the possible course of federal tax law. For federal provisions that fall into this category, the general assumption is that future congressional action will follow its recent history. So, while the table shows a revenue loss, these impacts are already implicitly incorporated into the current forecast.

The third group contains provisions that do not immediately affect Oregon revenues, but could pending legislative action on Oregon's tie to federal law. The Oregon constitution limits how changes in federal law can affect Oregon taxes. For all provisions other than those related to the definition of taxable income, Oregon statute is tied to federal law as of a specific date. Currently, that connection date is December 31, 2011. These impacts, which are primarily due to the earned income credit, would be part of the policy discussion of updating our connection date to federal tax law.

Immediate Impact – Direct Effects

Direct impacts affect Oregon taxpayers by directly reducing their tax liability. For the most part, the direct impacts immediately affect Oregon tax revenue collections because we have a continuing tie to the definition of taxable income, the "rolling reconnect". The Legislature would need to affirmatively disconnect from these specific provisions to negate the revenue impacts.

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 2013.

Unemployment insurance benefits

Generally, unemployment insurance benefits are taxable income. The legislation extends unemployment compensation and extended benefits for 2013. Depending on how taxpayers have chosen to handle their withholding and estimated tax payments, these taxes could be collected throughout the tax year or at the time they file their 2013 tax return.

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. In 2012, taxpayers were allowed to expense up to $139,000 of qualified property costs; the deduction was phased-out to the extent the costs exceeded $560,000. The baseline assumption in the December forecast was that this policy would be extended for 2013. In fact, ATRA allowed deductions up to $500,000 with a phase-out threshold of $2 million. The provision applies to property placed in service in 2013.

Itemized Deductions

At the federal level, individual taxpayers are allowed to take a deduction for items such as medical expenses, home mortgage interest, state and local taxes, and charitable contributions. Taxpayers are allowed to deduct the greater of either these expenses (i.e. itemized deductions) or the standard deduction. With the exception of state and local taxes, Oregon allows the same itemized deductions. For most of the 1990s, there was a limit on the amount of these deductions for higher income taxpayers. The 2001 tax changes gradually eliminated this limitation so that for tax years 2010 through 2012 there was no limit. As stated above, the assumption in the December revenue forecast was that there would 2012 law would continue into 2013 (that there would be no limit) but the prior limit would be re-instated in 2014 and beyond. ATRA, however, included a limit that is less restrictive than prior law. So for tax year 2013, there is a revenue gain (limited deductions compared to unlimited deductions) but for subsequent tax years there is a revenue loss (less limited deductions compared to more limited deductions).

Other

Most of these impacts are related to education. The estimated impact is primarily driven by deductions allowed for employer provided educational assistance and an expanded deduction for student loan interest. There is a revenue gaining provision that allows employers to offer, and conversions made to, a to Roth retirement account. To the extent that taxpayers convert retirement funds from a regular account to a Roth account, untaxed income would be subject to income taxes without penalty.

Immediate Impact – Indirect Effects

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 federal taxes are below the limit – $6,250 in 2013 and phased-out for higher income filers.) These impacts, however, tend to be relatively small, with the occasional exception such as the federal child credit.

Child Credit

In 2012 taxpayers were allowed a $1,000 credit per eligible child. That credit had been scheduled to revert to $500 in tax year 2013. The Act actually made the $1,000 level permanent. Because of the magnitude of the credit, its impact on federal taxes is significant enough to materially change the federal tax subtraction, thus resulting in a significant impact on Oregon taxes. Similar to other provisions, the December forecast assumed that the $1,000 level would be continued for 2013 and then fall to $500 in 2014. Consequently, there is no impact in tax year 2013 but there is an Oregon revenue gain in subsequent tax years.

Other

The estimated impact here is primarily due to changes to the federal standard deduction and the federal alternative minimum tax. The standard deduction was permanently adjusted so the joint amount is twice the single amount, eliminating this aspect of the so-called “marriage penalty”. For the alternative minimum tax, the Act made a permanent change to the exemption amount and indexed the exemption, phase-out threshold, and tax bracket for inflation.

Tax Extenders

The impact from individual extenders is primarily for the deduction for qualified tuition expenses, but includes the discharge of indebtedness on a principal residence, and the deduction for mortgage insurance premiums. There are also several business extenders, but the impact is dominated by the treatment of active financing income. This provision is an exception to the general rule that passive income earned by a foreign subsidiary is considered taxable.

Needing Legislation

These two credits represent sections of Oregon law that are tied to federal law but are unrelated to taxable income. As such, our tie to federal law must be as of a specific date (currently December 31, 2011). The revenue impact would only be realized upon a change in the federal connection date. A key change to the dependent care credit is the definition of eligible expenses, to which Oregon is tied. The Oregon earned income credit is six percent of the federal credit. Key changes to the federal credit were an increase in the phase-out range for joint filers, a greater credit for larger families, and simplified definitions for income and qualifying children. Both of the Oregon credits are scheduled to sunset, so the estimated impacts shown through the 2015-17 biennium assume that the sunset dates are extended.