Oregon's Revenue Forecast and the Tax Cuts and Jobs Act

Oregon's income tax laws are largely based on federal income tax laws. Oregon's revenue forecast is a "current law" forecast, which means the chief economist makes no assumptions about any tax law change the Legislature may or may not enact. The same strict assumption is not true with respect to federal tax law. Historically, the chief economist has regularly made assumptions about federal tax law, especially when expiring federal laws are regularly renewed or extended. This remains true with the March 2025 revenue forecast, which includes the assumption that the tax policies in the Tax Cuts and Jobs Act of 2017 (TCJA) continue beyond the Act's sunset date of December 31, 2025 (i.e., the TCJA is simply extended).[1]

When considering the projected General Fund revenue for 2025-27, it's important to understand the implications of these federal law assumptions. While potential federal changes are nearly unbounded, this document focuses on the TCJA. The table below shows the estimated impacts on General Fund (GF) revenue from not extending the TCJA provisions. The estimated revenue loss is $200 million in tax year 2026, growing to $276 million in 2030. The direct impacts are generally because the TCJA reduced overall itemized deductions by restricting or eliminating specific deduction provisions. Oregon is tied to these deduction changes so if allowed to increase, Oregon tax collections would decrease. The indirect impacts are due to the Oregon federal tax subtraction. This document provides a high-level description of these potential impacts.

Estimated Revenue Impacts of a TCJA Sunset

	Oregon Tax ($M)				
Federal Tax Policy	**2026**	**2027**	**2028**	**2029**	**2030**
Direct Impacts	-$144	-$154	-$166	-$211	-$209
Indirect Impacts	-$57	-$59	-$63	-$65	-$67
Total	-$200	-$214	-$229	-$277	-$276

Background

Federal income tax laws are the basis for Oregon's income tax laws. Oregon is specifically tied to the federal definition of taxable income. This connection can be as of a specific date (a "fixed" or "static" connection) or it can be continuous (a "rolling" connection). Oregon currently has a

[1] Most of the laws that are scheduled to sunset apply to the personal income tax.

"rolling connection", meaning most federal tax law changes that affect taxable income would automatically affect Oregon tax collections. For example, if Congress were to create or eliminate a deduction, then Oregon would also create or eliminate that deduction, causing a corresponding Oregon revenue decrease or increase. These types of impacts are referred to as 'direct impacts'. Oregon has the ability to affect the magnitude of these impacts through the state's connection policies.

Oregon law also allows a subtraction for the amount of federal taxes paid each year, via the 'federal tax subtraction'. Generally, the larger the federal tax liability, the larger this subtraction and the lower Oregon tax liability.[2] This impact is known as an 'indirect impact'. Oregon's ability to affect this impact is through the structure of the federal tax subtraction.

In December of 2017, the TCJA made several changes to federal personal and corporate income taxes. The corporate income tax changes are (generally) permanent. The personal income tax changes are only in effect for tax years 2018 through 2025. Barring congressional action, the federal personal income tax will largely return to its pre-2018 structure. Federal discussions continue about extending or modifying federal tax law, but details are unknown at this time.

Direct Impacts

The largest of these impacts are two from federal law itemized deductions: State and Local Taxes (SALT) and Miscellaneous Expenses.

State and Local Taxes Deduction

For federal tax purposes, Oregon personal taxpayers may claim an itemized deduction for state and local income taxes and local property taxes (SALT).[3] This policy effectively shifts, or exports, a portion of these taxes to the federal government. For Oregon taxes, only property taxes and local income taxes are (generally) deductible. Prior to 2018, the SALT deduction did not have a dollar limitation. The TCJA imposed a limit on the deduction of $10,000, which is effectively an Oregon limit on deduction of property tax and local income taxes. If the TCJA were to sunset, it would return to an uncapped deduction. Because Oregon ties directly to the federal deductions, the larger deduction would reduce Oregon tax collections.

Two additional factors are relevant. First, the passage of local income taxes in the Portland area in recent years is projected to lead to an increase of this deduction for Oregon taxpayers, compared to deduction levels prior to 2018. Just as the federal deduction is an export of state & local taxes to the federal government, the deduction of these local taxes on Oregon tax forms is a partial shift of local tax burden to the state.

Second, the current deduction limit led to the Legislature enacting the Business Alternative Income Tax (BAIT).[4] By shifting taxes paid from individuals to qualifying pass-through business entities (where state income tax deductibility is not limited), the BAIT effectively reduces the impact of the federal SALT deduction limit on federal tax liability. The BAIT was originally enacted

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[2] The subtraction is phased-out for higher income tax filers. Details are in the next section of this document.

[3] Federal policy allows for the deduction of income or sales taxes, but not both. Oregon does not have a general sales tax.

[4] Alternatively known at the PTE-E (pass-through entity elective) tax.

in 2021 for two years and then extended in 2023 for another two years. Currently, SB 111 in the Senate Finance & Revenue committee proposes another 2-year extension. The policy would continue the income tax on certain business income with a corresponding personal income tax credit.

Miscellaneous Expenses Deduction

This is another itemized deduction in federal tax policy that existed prior to the TCJA. If the TCJA were to sunset, it would return as a federal deduction in 2026. Prior to the TCJA, "certain miscellaneous deductions" were allowed to the extent they exceeded two percent of the taxpayer's Adjusted Gross Income (AGI). Examples of these items include unreimbursed employee expenses, tax preparation fees, and certain education expenses incurred during temporary employment. A full list is available in IRS Publication 529. Just as with the SALT deduction, Oregon General Fund tax collections would be reduced by this deduction.

Other Tax Provisions

There are a handful of other provisions that are collectively projected to have a relatively smaller impact on Oregon revenue, should the TCJA sunset. These policies include: the limitation on noncorporate business losses and the deduction of qualified moving expenses. Another specific example is that the deduction for casualty loss (e.g., from fire) has been limited to losses that result from federally declared disasters.

Indirect Impacts

When calculating Oregon taxable income, taxpayers may subtract up to $8,250 of federal income tax paid during for tax year 2024. This limit is adjusted to inflation and is fully available to single filers with income under $125,000 and joint filers with income under $250,000. The subtraction amount is phased out for single filers with income between $125,000 and $145,000 and for joint filers with income between $250,000 and $290,000. The subtraction is not available to filers with income above those income limits. This subtraction means, generally, that when federal taxes increase, this subtraction amount increases, causing Oregon taxes to decrease. The magnitude of the federal tax change due to the TCJA is sufficiently large that there is a measurable impact on the total amount of the federal tax subtraction for all taxpayers collectively.

History of Oregon's Connection to Federal Law

Oregon tax law is connected in many ways to federal tax law. In particular, the structure of Oregon's income tax (both personal and corporate components) is based on federal definitions and administration. This relationship is often referred to as "federal connect" or "reconnect". There are two components to this connection: (1) the definition of "taxable income"; and (2) other areas of tax law unrelated to the definition of taxable income. While state policy has been to generally maintain a rolling connection to federal law, there have been exceptions. Occasionally, the Legislature has chosen to disconnect from specific federal provisions. At other times the Legislature has chosen not to conform to any federal law changes.

Taxable Income Base

In general, the Legislature may not cede its law-making authority to any other entity, including the federal government. The one exception to this requirement is that Oregon's income tax base may be defined by federal taxable income.[5] Consequently, there are two components of Oregon's connection to federal law, based on the constitutional restrictions.

First is taxable income, which can be either connected to changes as they are made at the federal level or alternatively can be frozen and connected to federal definitions at a single point in time. Only with this definition is the state permitted to maintain a continuous connection to federal law without legislative action.

Second, all other provisions not related to the definition of income must be connected to the law as it existed at a past point in time. When the Legislature chooses to connect to federal law other than in defining income, that connection date must be a date prior to the effective date of the state legislation. By convention, the Legislature has usually chosen to connect to federal law as amended and in effect on December 31 of the year prior to the legislative session.

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 (which are used to calculate taxable income) often directly reduce Oregon taxable income and Oregon tax liability (and vice versa). Conversely, changes in federal tax rates and credits generally do not have a direct effect on Oregon because tax rates and credits are not part of the definition of taxable income and Oregon is not connected to them.[6]

Prior to 1997, Oregon did not automatically adopt federal changes in taxable income. Legislation was required each session if the policy choice was to update Oregon's connection to the IRC. Although the Legislature generally chose to connect to federal changes made during the preceding two years, some exceptions existed.

Since 1997 Oregon has frequently, but not always, maintained an automatic connection to changes in taxable income as defined by the IRC. This policy of a continuous connection is known as "rolling reconnect". Under a rolling reconnect policy, the revenue impacts resulting from changes in federal taxable income are estimated as needed and then incorporated into the Oregon current law revenue forecast. While the Legislature continues to review and monitor federal tax changes each year, specific legislation disconnecting Oregon from federal law may be required to avoid inherently adopting federal changes to the Oregon tax base.

Disconnect Examples

Under a rolling reconnect policy, the Legislature still needs to annually consider maintaining that policy as well as updating the federal connection date for all aspects of connection other than the definition of taxable income. Consequently, there is a reconnect bill each legislative session that changes the year of the connection date to the most recent calendar year. At the same time and depending on the existing economic conditions, the Oregon Legislature has chosen to

[5] This amendment to the Oregon Constitution accompanied the statutory tax changes enacted in 1969 and was adopted by the voters in 1970.

[6] In simplest terms, tax liability = (taxable income × tax rates) - credits

occasionally disconnect from certain federal tax policies that affect taxable income. For example, shortly after adopting the federal taxable income as the tax base, the 1971 Legislature chose to disconnect from increases made to the federal standard deduction and personal exemption. Disconnecting from these increases prevented reductions in Oregon tax revenue. In 1975, the Legislature established Oregon standard deduction and personal exemption polices separate from the federal policies, effectively establishing a permanent disconnect. Below are examples of other times when the Legislature has disconnected from selected federal policies.

2018: Disconnected from a federal 20 percent deduction for certain pass-through and proprietorship entities.

2009: Disconnected from federal provisions for bonus depreciation, the discharge of indebtedness and Section 179 expensing. Suspended the rolling reconnect for tax years 2009 and 2010.

2005: Disconnected from the Qualified Production Activities Income deduction/rate and the exclusion of federal subsidies for prescription drug plans; reinstated the rolling reconnect as of 2005.

2003: Disconnected from federal policies such as depreciation, Section 179 expensing, and various other provisions. Suspended the rolling reconnect for tax years 2003 through 2005.

1997: Established a rolling reconnect to the definition of taxable income.

1981: Disconnected from federal accelerated depreciation provisions. Conformity to federal depreciation treatment was not reestablished until 1995.

Policy Options

The Legislature's options for interacting with federal policy usually result in some form of the following actions.

1. Maintain the current "rolling reconnect" policy.
2. Return to a "static" connection by connecting to IRC as of a specific date in the past.
3. Maintain the "rolling reconnect" while disconnecting from specific provisions.