CHAPTER 1. INCOME TAX (PERSONAL AND CORPORATION)

Personal Income Tax

The personal income tax, sometimes called the "individual" income tax, is the State of Oregon's largest source of revenue. For the 1995–97 biennium $6.3 billion, or 82 percent, of General Fund revenues came from the individual income tax.

In estimating tax expenditures related to the personal income tax, the first step is to define the 'normal' tax system. Any departures from the normal system that reduce taxes are considered tax expenditures. For this report, we adopt the definition of the normal tax system used by the U.S. Congressional Research Service and the Congressional Joint Committee on Taxation. Under that definition, the normal tax base is income from all sources, including both monetary and non-monetary income, less any expenses incurred in earning the income. Monetary income includes wages, salaries, interest, dividends, public assistance payments, and all other monetary income. Examples of non-monetary income include the value of health benefits provided by employers, the value of gifts received by the taxpayer, and discounts that employees may receive when they buy products from their employer.

The starting point for calculating Oregon's personal income tax is federal taxable income, and this connection to the federal tax code has a number of important implications for Oregon's tax. The connection substantially reduces compliance costs for taxpayers. Using the same definition of income allows taxpayers to transfer substantial amounts of their federal tax return information directly onto their Oregon tax returns, greatly reducing the number of calculations taxpayers need to make and reducing the possibility for errors. The connection to the federal definition of taxable income also makes the tax easier for the State of Oregon to administer.

The other important effect of connecting to the federal definition of taxable income is that doing so implicitly adopts many of the tax expenditures that exist in the federal tax code. Any special provisions allowed at the federal level that reduce taxable income will flow through to Oregon's tax and result in lower Oregon tax collections. There currently are 75 of these special federal provisions—exclusions and deductions—that flow through to Oregon's personal income tax. Because federal tax credits are applied after the calculation of federal taxable income, federal credits do not flow through to Oregon's tax.

For the 1997–99 biennium, the connection to the federal definition of taxable income reduces Oregon personal income tax revenue by nearly $3.0 billion. While Oregon could "disconnect" from the federal tax code (or parts of it) to collect some of that potential revenue, doing so would increase compliance costs for taxpayers and administrative costs for the State of Oregon.

In addition to the tax expenditures resulting from exclusions and deductions in the federal tax code, there are 19 subtractions in Oregon law that further reduce taxable income. In 1997–99 these subtractions reduce tax revenue by about $1.0 billion. For federal exclusions and deductions, as well as Oregon subtractions, the provisions reduce taxable income more for taxpayers in higher tax rate brackets, generally helping high-income taxpayers the most. In addition, only taxpayers who itemize their deductions receive the benefits of most federal deductions, again helping mostly high-income taxpayers.

Once taxable income is calculated, tax liabilities (prior to credits) are calculated by applying the tax rates. Oregon's personal income tax has three rate brackets: 5, 7, and 9 percent. In 1993 the brackets were indexed to reflect changes in the U.S. Consumer Price Index.
For 1998 the brackets are:

Single and Separate Returns		*Joint and Head of Household Returns*	
Taxable Income	Tax before Credits	Taxable Income	Tax before Credits
Not over $2,300	5% of taxable income	Not over $4,600	5% of taxable income
$2,300 to $5,800	$115 + 7% of income over $2,300	$4,600 to $11,600	$230 + 7% of income over $4,600
Over $5,800	$360 + 9% of income over $5,800	Over $11,600	$720 + 9% of income over $11,600

Oregon's personal income tax contains 34 credits. The personal exemption credit is available to all taxpayers and increases each year based on growth in the Portland Consumer Price Index. For 1998 the credit is $132. The other 33 credits are designed to provide tax relief for specific groups of taxpayers. None of the credits is "refundable," meaning that taxpayers can use the credit only up to the amount of their tax liabilities. If the credit is larger than the tax liability, the share of the credit that exceeds the tax liability goes unused or, for some credits, can be used in later years. In 1997–99, credits reduce Oregon personal income tax revenue by roughly $800 million.

Corporation Income Tax

Oregon's corporation income tax is a tax on corporate profits where net income is the measure of profitability. The tax is actually two taxes: the corporation excise tax and the corporation income tax. The excise tax is paid by corporations that are "doing business" in Oregon, and the income tax is paid by corporations that have income originating in Oregon but that are not considered to be "doing business" here. Ninety-nine percent of all corporations pay the excise tax, and just one percent pay the income tax. Because the taxes are nearly identical and the tax base is net income, we refer to both taxes simply as the corporation income tax. The corporation income tax is the second largest source of revenue for the state General Fund. For the 1995–97 biennium, corporation income taxes were $684 million, or 8.9 percent of General Fund revenues.

As with the personal income tax, the 'normal' tax base for the corporate income tax includes income from all sources, both monetary and non-monetary, less expenses incurred in earning the income. Tax provisions that are departures from the normal base represent tax expenditures.

Oregon uses federal taxable income with some modifications as its tax base. As with the personal income tax, connecting to the federal tax code reduces compliance costs for taxpayers, makes administration of the tax easier for the State of Oregon, and implicitly adopts many of the tax expenditures that exist in the federal tax code. For the 1997–99 biennium, the connection to the federal definition of taxable income reduces Oregon corporation income tax revenue by roughly $244 million. There are only three Oregon-specific subtractions that can further reduce the taxable income of corporations, and they have a negligible effect in reducing corporate taxes. After Oregon taxable income is calculated, the tax rate of 6.6 percent is applied to arrive at the tax liability (prior to credits).

There are 29 credits available on the corporation income tax. None is refundable, but most allow unused credit amounts to be carried forward and used in later years. In 1997–99 these credits reduce corporation tax revenue by roughly $79 million.

Beginning in 1997, foreign insurance companies become subject to the corporation income tax, rather than the insurance gross premium tax, and are exempt from all local government taxes other than property taxes. For more details, see the introduction to Chapter 5 Insurance Taxes.