Oregon Considers Decoupling from the Federal Tax Code

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Many states are implementing sweeping tax reforms this legislative season, and it's easy to overlook seemingly smaller changes that could have a long-lasting impact on a state's tax system. The proposed changes to federal tax code conformity in Oregon are a good example of a change that could significantly reshape the state's tax code in the future, despite being framed as temporary technical adjustments.

H.B. 2092, which passed the House and is now in the Senate, proposes to "temporarily disconnect from the automatic, rolling connection to the federal law definition of taxable income." This would suspend Oregon's rolling conformity to federal taxable income, a provision that has been in place since 1997, and which is called the "rolling reconnect" in Oregon. Although the change is written to be temporary and applies only to the 2025 tax year, the bill may serve as a vehicle for continuing this decoupling in future years—especially if major changes are made to the federal tax code.

Rolling vs. Static Conformity

Currently, Oregon is one of the 24 states with rolling conformity, meaning that the state automatically conforms to the Internal Revenue Code (IRC) on a rolling basis and requires legislation to decouple from any new federal amendments. Other states either have a static (fixed) conformity that goes back to a specific date or conform selectively without universal reference to a specific version of the IRC. Compared to 2018, when 18 states had rolling conformity, 6 more states have joined the group of automatic conformers.

Generally, rolling conformity is a more beneficial approach, as it simplifies compliance for individuals and businesses while reducing administrative complexity and uncertainty. Importantly, rolling conformity still allows state legislators to decouple from specific provisions by enacting targeted state legislation. In fact, every state makes certain modifications or adjustments, but in many cases with rolling conformity, these changes are relatively minor. Oregon, for instance, decoupled from the pass-through deduction in 2018 to prevent a potential loss of revenue from this provision of the 2017 federal tax reform.

By contrast, static conformity or selective conformity creates additional complexity for taxpayers. Under these approaches, states often use an outdated version of the IRC and can selectively decouple from certain provisions (e.g., elements of major federal tax reforms) or—more problematically—conform only to revenue-raising provisions in the updated federal tax code.

Negative Consequences of Decoupling from the IRC

When states use an outdated version of the IRC as the basis for their tax code, similar terms often have different definitions, rules vary, and regulations and judicial rulings applicable to the current version of the IRC may not be operative, or may have a different application, under the previous one to which a state conforms. This creates substantial complexity and ambiguity for taxpayers and administrators alike. The challenge is particularly acute for businesses operating in multiple states. While every state decouples from certain federal provisions, it is dramatically easier to account for select differences than to comply with a fully outdated code.

Even most static conformity states typically try to keep up to date with the IRC, often reconnecting via legislation every year. The counterexample would be California, where the state still uses the IRC as it existed in 2015—before the Tax Cuts and Jobs Act, the Inflation Reduction Act, and other significant changes. Instead of broadly conforming to those federal tax changes, California has done so only selectively, conforming to certain new revenue-raising

provisions without updating the code more holistically. This can prove particularly bad when certain changes are intended to offset, or are best paired together, and a state only adopts one of them—the pay-for, say, without including the offsetting change it was meant to pay for.

Path Forward

Oregon has one of the most complex tax codes in the nation. Its corporate income taxation includes two layers—the corporate income tax and a gross receipts tax—which disincentivize businesses from expanding their operations in the state. (In fact, the state recently avoided adding a third layer to this system through Measure 118.) The individual income tax features one of the highest top marginal rates in the country and, when combined with certain local taxes in the Portland area, reaches 14.77 percent for individuals and 21.62 percent for pass-through entities.

State legislators should focus on improving Oregon's tax competitiveness by using the tools of sound policymaking, rather than decoupling from the IRC and making an already complex tax code even more convoluted and difficult to comply with.

If Congress adopts future federal tax changes from which Oregon wishes to decouple, lawmakers are always able to have that debate. Preemptively freezing conformity, however, throws the baby out with the bathwater and risks a permanent decoupling, *a la* California.

As complex as California's outdated conformity regime is, most companies can't avoid dealing with it: we're talking about California, after all, which boasts about 14 percent of US GDP. If Oregon, at a little more than 1 percent of US GDP, imposes similar complexity, those compliance costs will loom much larger.