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Senate Bill 1507 Was Passed by the Oregon Legislature and Will Likely Become Law - Breaking Down What It Means to Oregon Businesses

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Senate Bill 1507 ("SB 1507"), which aims to disconnect Oregon's state tax laws from a few provisions of the Internal Revenue Code (the "IRC" or the "Code"), was recently passed by the Oregon Senate and the Oregon House of Representatives. There is no sign that Governor Tina Kotek intends to veto the legislation. Consequently, in accordance with Section 49 of SB 1507, it will take effect on the 91st day after the date on which the 2026 regular session of the 83rd legislative assembly adjourns sine die. If my math is accurate, SB 1507 will be effective around June 8, 2026.

The revenue impact of SB 1507, as reported by the Oregon Legislative Revenue Office, is a savings for the state of approximately $300 million during the 2025-2027 biennium. The question that follows is how SB 1507 creates the huge revenue savings.

SB 1507 partially decouples Oregon from the IRC, meaning that Oregon will not recognize certain provisions of the Code. The legislation was passed with fanfare that it would only impact the use of provisions of the Code that "mainly benefit the wealthy." I am not sure that statement is accurate. My take is that the provisions in question are aimed at helping closely held businesses - not simply the wealthy.

SB 1507 decouples Oregon law from two key provisions of the Code: IRC Section 1202 and IRC Section 168(k). Both are important provisions that often benefit small, closely held businesses.

IRC Section 1202

As previously reported, Code Section 1202 has a rich history. It was originally enacted by federal lawmakers more than three decades ago as part of the Revenue Reconciliation Act of 1993. Code Section 1202 was one of many provisions of that legislation aimed at stimulating investment in closely held businesses.

In a nutshell, Code Section 1202 allows shareholders of certain closely held businesses to potentially exclude some of the gain from the sale of the shares. To qualify for the exclusion, however, several rigid requirements must be met. For one, the corporation that issues stock must be a "qualified small business"

and must meet an active business test for substantially all the taxpayer's holding period of the corporation's stock. For that purpose, a "qualified small business" is defined as: a business with aggregate gross assets (cash and the adjusted basis of its assets) of $50 million or less at all times between August 10, 1993, and immediately after the stock issuance. Further, at least 80% of the corporation's assets (by value) must be used in the active conduct of a trade or business during substantially all of the taxpayer's holding period of the stock. Lastly, the corporation cannot be engaged in providing health, law, consulting, accounting, finance, farming, mining or hospitality services.

The United States Congress tinkered with Code Section 1202 over the years, enhancing the benefits it offered small business owners. In 2009, as part of the American Recovery and Reinvestment Act of 2009, Congress temporarily increased the amount of gain exclusion offered under this provision. The next year, as part of the Small Business Jobs Act of 2010, Congress temporarily increased the gain exclusion in limited circumstances to 100%. Impetus for that amendment to Code Section 1202 (increasing the benefit to 100%) was recognition by lawmakers that many taxpayers who otherwise qualified for gain exclusion under Code Section 1202 could not take advantage of it due to other provisions of the Code, including the individual alternative minimum tax ("AMT"). The 100% exclusion, however, enhanced the benefit so that taxpayers subject to the AMT would see some benefit from the application of Code Section 1202. Accordingly, as part of the Protecting Americans from Tax Hikes Act of 2015, Congress made the 100% exclusion permanent.

The One Big Beautiful Bill Act (the "OBBBA"), signed into law by President Trump on July 4, 2025, made several significant changes to the existing framework for the exclusion of capital gains from the sale of qualified small business stock ("QSBS") under Code Section 1202.

Prior to the OBBBA, Code Section 1202 allowed noncorporate taxpayers holding QSBS for more than five years to exclude from gross income certain eligible gain realized upon the taxable sale or other disposition of the stock. The percentage of the gain allowed to be excluded was 50%, 75% or 100%, depending on when the stock was acquired. The OBBBA enhanced Code Section 1202 in many respects, including eliminating the provision of the Code that subjected excluded gain to the AMT. Of course, the excluded gain may still be subject to the 3.8% net investment income tax under IRC Section 1411.

As stated above, to qualify for the Code Section 1202 exclusion, rigid requirements must be met. Again, the issuing corporation must be a "qualified small business" and meet an active business test for substantially all of the taxpayer's holding period of the stock. Further, at least 80% of the corporation's

assets (by value) must be used in the active conduct of a trade or business during substantially all of the taxpayer's holding period of the stock. Lastly, the corporation cannot be engaged in providing health, law, consulting, accounting, finance, farming, mining or hospitality services.

SB 1507 decouples Oregon tax law from Section 1202 of the Code. Accordingly, for Oregon residents who meet these rigid hurdles, a hefty Oregon income tax liability could result from the sale of their stock in a qualified small business.

The decoupling of IRC Section 1202 from Oregon tax laws may provide more impetus for residents who would otherwise qualify for the IRC Section 1202 exclusion, to consider changing their residence to a more tax-friendly state before the sale of the QSBS occurs. Those states still include Arizona, Florida, Nevada, Tennessee and Texas. Whether SB 1507 in regard to Code Section 1202 will add to the existing impetus for Oregon business owners to leave the state is yet to be seen. At any rate, it is undeniably another factor motivating taxpayers to leave Oregon.

IRC Section 168(k)

As previously reported, in accordance with the Tax Cuts and Jobs Act of 2017 ("TCJA"), businesses were permitted to immediately deduct (or expense) 100% of the cost of certain qualifying property placed into service during the taxable year instead of depreciating the property over several years. The deduction, commonly referred to as bonus depreciation, was scheduled to phase down by 20% each year starting in 2023 and be fully eliminated by the end of 2026.

The concept of bonus depreciation is not new to our tax laws. Various iterations of the concept have been in the Code for decades. In general, the impetus for bonus depreciation is twofold, namely: (i) to stimulate business investment in qualified property such as machinery and equipment; and (ii) to enhance the cash flow of businesses, allowing greater investment in operations, including expanding the workforce.

Under Code Section 168(k), to qualify for the TCJA's bonus depreciation, property acquired by the taxpayer must constitute "qualified property." Subject to specified exceptions, qualified property under the TCJA includes property that the Code assigns a depreciation recovery period of 20 years or less.

Section 70301 of the OBBBA made this provision of the TCJA a so-called permanent provision of the Code and recalibrated it at a fixed level of 100%. Consequently, because of the OBBBA, 100% bonus depreciation is a continuing feature of the Code that will not be allowed to sunset at the end of 2026, unless lawmakers decide to revisit the issue.

SB 1507 decouples Oregon tax law from Section 168(k). Accordingly, Oregon businesses that are otherwise eligible for bonus depreciation under Code Section 168(k) will have to add back the depreciation for Oregon income tax purposes and use the other allowable depreciation methods contained in the IRC. The result is that most businesses will likely end up spreading the cost of machinery, equipment and other qualified property over five to seven years. The businesses that will be most adversely impacted by SB 1507 will be those Oregon businesses that routinely make a substantial investment in machinery and equipment, including agriculture, construction, manufacturing and transportation businesses.

Whether the decoupling of IRC Section 168(k) from Oregon tax laws will disincentivize investment in equipment, machinery and other qualified property by Oregon businesses, and/or put Oregon at a competitive disadvantage in attracting new businesses to the state (or motivate existing Oregon businesses to leave), is yet to be seen.

Some Good News

SB 1507 is not all bad news for Oregon businesses. It creates a new $1,000 non-refundable income tax credit for employers for each new job created during the tax year that pays at least 150% of the minimum wage (i.e., $22.58 or more per hour). The credit, however, maxes out at ten jobs per taxpayer (i.e., $10,000).

Concluding Thoughts

Oregon lawmakers could have used a more precise tool to scale back both Code Section 1202 and Code Section 168(k) by placing more stringent eligibility requirements on taxpayers in order to use these provisions for Oregon income tax purposes. For example, in the case of IRC Section 1202, the legislature could have reduced the gross asset limitation (e.g., from $50 million to $25 million) or reduced the deduction (e.g., from 100% to 75%). Likewise, in the case of bonus depreciation under Code Section 168(k), Oregon lawmakers could have added a limit on the amount of bonus depreciation that may be taken in a taxable year (e.g., $10 million) or limited its use to businesses with taxable income (before bonus deprecation) of a specified dollar amount (e.g., under $25 million). Instead, Oregon lawmakers used a blunt instrument, eliminating Oregon taxpayers' access to two Code provisions otherwise available to businesses in most states.

Some lawmakers who were opposed to SB 1507 have announced plans for a referendum to overturn the bill. If successful, it would allow Oregon voters in November 2026 to have the last say on whether SB 1507 will become law. A successful referendum, however, is likely a long shot. Time will tell!

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