Bill Analysis

Peter A. Cooper _Legislative Service Commission_

H.B. 754

123rd General Assembly
(As Introduced)

Reps. Netzley, Buchy, Trakas

BILL SUMMARY

- Replaces the voter-approved taxes charged by each city, local, and exempted village school district on real property for current expenses (including "emergency" levies) with a school district income tax; tangible personal property remains subject to those property levies.

- Imposes the replacement income tax at a rate calculated to yield approximately the same total amount of revenue as is raised by voter-approved current expense taxes on real property for 2001.

- Permits school boards, with voter approval during 2002, to reduce the rate of the new income tax in exchange for an equivalent increase in the taxes charged against tangible personal property; but limits the increase to the amount of the property tax reduction for commercial and industrial real property (Class II) that results from the elimination of voter-approved current expense taxes on that property class.

- Reduces the rate of the income tax in any year the tax yields 110% or more of the revenue that would be raised from real property taxes upon the current property valuation at 2001 tax rates.

- Creates a state subsidy to be paid to a school district if the tax yields less than 95% of the amount of the real property taxes that would have been charged if they hadn't been replaced (based on 2001 property tax rates).

- Continues to permit school districts to impose (with voter approval) local option income taxes, taxes against all property for permanent improvements and other capital expenditures, and to levy current expense taxes against tangible personal property.

- Modifies school funding provisions to reflect that the local share of funding consists of income taxes in addition to property taxes.

- Imposes the new income tax in 2003, and provides that school district current expense taxes not be charged against real property beginning with the 2003 tax year (i.e., taxes payable in 2004).

- Repeals the authority of school boards to levy two kinds of school district current expense levies.

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CONTENT AND OPERATION

<u>Income tax to replace taxes on real property</u>

(secs. 5748.01, 5748.02, 5748.03, 5748.04, and 5748.09)

The bill imposes an income tax in each city, local, and exempted village school district beginning January 1, 2003. Revenue from the income tax will replace voter-approved taxes charged against real property for current expenses. (The effect on property taxes is discussed below.) The income tax is in addition to any income tax that is levied in the school district under existing law (in this analysis, these are referred to as "local option" school district income taxes in order to distinguish them from the tax imposed by the bill). The income tax imposed by the bill is imposed on the same income, is collected in the same manner, is administered under the same procedures, and is subject to the same penalty and interest provisions as the existing local option school district income taxes. The tax applies only to individual residents of each school district and estates that are domiciled in the school district, and applies only to the portion of a resident's Ohio adjusted gross income (as computed for state income tax purposes) received while that person is a resident of the school district. Individuals subject to the tax must file a school district income tax return with their Ohio income tax return. Households consisting of at least one person aged 65 or older are entitled to a $50 credit against the tax.

Currently, school boards may propose property tax reductions that apply to all property (both real and tangible personal) when proposing a school district income tax. These proposed reductions will no longer be permitted under the bill.

Effect on school district property tax levies

Voter-approved current expense levies

(secs. 5705.21, 5705.214, 5705.215, 5705.25, and 5748.09(E) and (G))

For tax year 2003 and thereafter, school district current expense levies will not be charged against real property. School district current expense levies that have been approved by voters before the end of 2001 will not be levied against real property for tax year 2003 and thereafter; school district current expense levies that are approved in 2002 or thereafter will not apply to real property for tax year 2003 and thereafter.[1] Any school district current expense levy in effect for tax year 2003 or thereafter will apply only to taxable tangible personal property (i.e., tangible personal property used in business or in providing public utility services).

The bill repeals the authority of school boards to levy two kinds of current expense levies: a levy that is phased in at gradually increased rates each year for five years (sec. 5705.212), and a levy that increases each year by a specified dollar amount or percentage (sec. 5705.213).

The bill provides for the payment of any outstanding property tax anticipation notes that may be payable from the real property taxes that will not be collected for tax year 2003 and thereafter. The proceeds of the school district income tax imposed by the bill are pledged toward the payment of any such notes that are outstanding on January 1, 2003.

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[1] *Likewise, so-called "emergency" levies will not apply to real property. The effect on emergency levies is discussed further below.*

"Emergency" levies

(secs. 5705.194 to 5705.197; Section 3)

Under current law, so-called "emergency" levies may be imposed (subject to voter approval) if the school board declares that the tax is necessary "to avoid an operating deficit" or to provide for "emergency requirements" (the circumstances that would constitute an emergency are not defined by the statute). Emergency levies raise a fixed dollar amount that remains the same each year. To raise the specified dollar amount, the rate of an emergency levy is adjusted each year to discount any changes in taxable property values: if the aggregate property valuation increases, the tax rate decreases proportionately; if aggregate property valuation decreases, the tax rate increases proportionately. Emergency levies may be levied for no more than five years at a time.

Under the bill, emergency levies apply only to tangible personal property in tax year 2003 and thereafter. The rate of any emergency levy in effect in tax year 2002 *and* in 2003 or thereafter will not be adjusted upward in 2003 and subsequent years to account for the fact that the tax no longer applies to real property; instead, the rate is to be adjusted so that the tax yields the same amount that was raised by the tax from tangible personal property for tax year 2002.

Inside millage; capital and dual purpose levies

(secs. 5705.215, 5705.217, 5705.218, 5705.25, and 5748.09(E) and (G))

School district property taxes levied within the 10-mill limitation ("inside millage") are not affected by the bill even if they are levied for current expenses; they will continue to apply to taxable real property and taxable tangible personal property as under current law. School district property taxes levied for permanent improvements or for paying debt charges also are not affected by the bill; these levies would continue to apply to both real and tangible personal property. With respect to levies that are divided among permanent improvements and current expenses (sec. 5705.217) or between debt repayment and current expenses (sec. 5705.218), the part of the levy apportioned to current expenses will apply only to taxable tangible personal property; the part apportioned to permanent improvements or debt repayment will continue to apply to both real property and tangible personal property. A tax levy by a county school financing district that is levied only for current expenses will apply only to tangible personal property; financing district levies for permanent improvements only or for both permanent improvements and current expenses will continue to apply to both real property and tangible personal property. (A county school financing district is a taxing district consisting of several school districts that is created for the purpose of broadening the property tax base of the districts and jointly funding specific programs or improvements--see sec. 5705.215.)

Budget and tax rate certification procedures

(secs. 5705.29 and 5748.09(E))

The bill requires school district tax budgets to reflect the reduction in the tax rates to be charged against real property, and directs county fiscal authorities to ensure that the real property tax reductions prescribed by the bill occur as prescribed. Specifically, when school boards submit their tax budgets for fiscal years 2004 and thereafter, the revenue estimates contained in the budgets must incorporate the real property tax reduction. Beginning with fiscal year 2003 budgets, county budget commissions are prohibited from approving any school district levy upon real property if the levy is a voter-approved levy for current expenses. And county auditors are directed not to extend any such levy against real property for tax years 2003 or thereafter.

Determination of income tax rates

(sec. 5748.09(B) and (C))

The rate of the income tax to be imposed in a school district (in addition to any existing local option income tax levied there) is to be computed so that the income tax generates approximately the same amount of revenue in 2003 that was charged against real property by current expense and emergency levies for tax year 2001 (i.e., revenue that was collectible in calendar year 2002). The income tax rate necessary to generate that amount of revenue is to be rounded upward to the next higher increment of one-tenth of one per cent. The Tax Commissioner is required to estimate this rate, and, for this purpose, each county auditor is required to certify the tax year 2001 tax rates to the Tax Commissioner for each school district in the county by October 31, 2001. Rates must be certified for each levy imposed under sections 5705.194 to 5705.197 (emergency levies), 5705.21 (general school district levies), 5705.212 (phased in rate levies), and 5705.213 (levies growing by a specified amount or percentage each year).

Example: In tax year 2001, the Wabash City School District levies 25 voter-approved mills (composite effective rate) for current expenses and 7 "emergency" mills, which raise $7.5 million in current expense revenue from real property and $2.1 million in emergency revenue from real property. Thus, a total of $9.6 million in real property taxes is subject to replacement by the bill's school district income tax. The taxable school district income in the district in 2003 is estimated to be $400 million. In order to replace the $9.6 million in real property taxes, a school district income tax rate of 2.4% is required.

Option to decrease income tax rate

(sec. 5748.09(C) and (D))

The bill permits school boards to propose an income tax rate that is lower than the rate necessary to replace the taxes that the school district no longer will receive from real property. The lower income tax rate must be proposed in combination with an increase in the rate of tax to be levied on taxable tangible personal property. The higher taxes implied by the higher property tax rate on tangible personal property cannot be greater than the tax reduction on Class II real property (commercial and industrial) that results from reducing taxes on real property. In other words, the tax rate on tangible personal property cannot be increased beyond the extent necessary to offset the Class II real property tax reduction with the additional tangible personal property taxes generated by the increased rate. This is referred to in the bill as the "maximum additional rate of tax upon tangible personal property." In order for the proposal to take effect, voters must approve it at an election held in 2002.

In order to exchange a higher tax rate on tangible personal property for a lower income tax rate, a school board must adopt two resolutions. The first resolution requests that the Tax Commissioner estimate (1) the amount of income tax that would be generated from each 1/10th of 1% increment of the income tax rate in 2003, (2) the millage rate on tangible personal property that raises the same amount as each 1/10th of 1% in income tax rate, and (3) the "maximum additional rate of tax upon tangible personal property." The school board must certify the first resolution to the Tax Commissioner, and the Tax Commissioner must certify the estimates to the school board within 30 days after receiving the board's resolution.

The school board's second resolution must propose a reduction in the income tax rate (as initially estimated by the Tax Commissioner to offset the reduction in real property taxes) and an increase in the tangible personal property tax rate.[2] The proposed income tax rate reduction must be expressed in 1/10th of 1% increments. The increased tangible personal property tax rate is the total of the property tax rate increases corresponding with each such increment (as estimated according to (2), above), but the additional rate must not exceed the "maximum additional rate of tax upon tangible personal property." The second resolution must be certified to the board of elections in substantially the same manner as a traditional property tax levy resolution. It may be submitted only at an election in May, August, or November 2002. If the school board fails to properly certify the resolution for any of those elections, or if the proposal is disapproved by voters at each election at which it is submitted, then the income tax goes into effect in 2003 at the full rate estimated by the Tax Commissioner as necessary to offset the reduction in real property taxes. No subsequent opportunity is authorized to exchange a lower income tax rate for a higher tax rate on tangible personal property. If the proposal is approved by voters,

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[2] *A school board does not have to adopt a second resolution if it decides not to proceed with the income tax rate reduction/tangible personal property tax rate increase proposal.*

then the lower income tax rate takes effect in 2003, and the school board is authorized to levy the increased rate on tangible personal property in 2003 (payable in 2003) and thereafter; the authority to levy the increased rate is in continuous effect and does not terminate. The school board also is authorized to issue notes in anticipation of the collections from the tangible personal property tax (but not more than 50% of the first year's collections may be anticipated).

Example: The income tax rate necessary to replace the real property tax revenue of the Wabash City School District is 2.4%. The Tax Commissioner estimates that each 1/10th of 1% of income tax levied in the district will yield $400,000 in 2003; that the taxable value of tangible personal property for tax year 2003 will be $75 million; and that Class II real property taxes will be reduced in tax year 2003 by $3 million because of the reduction in the rate of taxation on real property required under the bill. Thus, the maximum amount by which tangible personal property taxes may be increased is $3 million. This implies a maximum additional rate of tax upon tangible personal property of 40 mills ($3 million divided by $75 million). If the school board seeks to reduce the income tax rate by the maximum amount permitted under the bill, it can propose to reduce the rate by seven increments of 1/10th of 1% ($3 million divided by $400,000, rounded downward to the next lower whole number), yielding an income tax rate of 1.7%, in exchange for increasing the tax rate on tangible personal property by 40 mills.[3] (Because the income tax is to be levied in increments of 1/10th of 1%, rounding to that increment yields income tax revenues of $6.8 million which, when added to the $3 million in additional tangible personal property taxes, exceeds the replaced real property taxes by $200,000.)

Subsidy for income tax revenue shortfalls

(sec. 3317.0217)

The bill provides a subsidy to compensate school districts if their annual income tax revenue falls below 95% of the real property tax revenue the district would have collected if the tax rate on real property remained at the tax year 2001 level. If a school district's annual income tax revenue falls below the 95% threshold, the subsidy is computed to cover the deficiency between the actual income tax revenue and 95% of the hypothetical real property tax revenue. Thus, the greatest revenue shortfall that a school district could experience (comparing the bill's

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[3] *This example assumes that tangible personal property constitutes 20% of the district's total taxable property valuation and that Class II real property constitutes about one-third of total taxable real property valuation. A higher concentration of tangible personal property, a lower concentration of Class II real property, or a combination of these factors would result in a lower maximum additional rate of tax upon tangible personal property.*

income tax against the district's hypothetical real property tax revenue) is 5%. The hypothetical real property tax revenue is computed on the basis of the district's tax year 2001 property tax rate upon the preceding tax year's real property values (i.e., in 2005, the computation is based on what would have been raised by tax year 2001 tax rates against tax year 2004 real property values). The Department of Education is responsible for computing the subsidy computation each year on the basis of information supplied by the Tax Commissioner.

Example: In 2006, the Wabash City School District's income tax collections are $10 million. The taxable value of real property in the district is $350 million. The Tax Commissioner determines that if the tax year 2001 combined tax rate for current expense/emergency purposes had been levied against real property for tax year 2005, that rate would have generated $11.2 million. Thus, the income tax raised $1.2 million less than the amount that would have been raised from real property taxes at 2001 tax rates, or 89% of the amount that would have been raised in real property taxes. Therefore, the district is entitled to a subsidy equal to the difference between its 2006 income tax collections ($10 million) and 95% of the $11.2 million it would have raised in real property taxes (i.e., $10,640,000)--a $640,000 subsidy.

Income tax rate reduction if revenue exceeds limitation

(sec. 5748.09(D))

The bill places a limit on the increase in a school district's income tax revenue. The limit applies only to revenue from the income tax imposed by the bill; it does not apply to the "local option" income taxes imposed by school boards with voter approval. The limit prevents income tax revenue in any year from exceeding 110% of the tax year 2001 property taxes. (Only real property taxes charged for tax year 2001 are considered; delinquent charges from prior years are not considered.) The limit is imposed through a reduction in the income tax rate (in increments of 1/10th of 1%) sufficient to bring income tax revenue within 110% of the tax year 2001 real property taxes. The income tax rate reduction will apply in the following year (i.e., if 2004 income tax collections exceed the limit, the rate is reduced for 2005 and thereafter).

Effects on school funding law

"20-mill qualifier"

(secs. 3317.01(A) and 3317.021(C))

Currently, school districts are required to levy the equivalent of at least 20 mills in property taxes for current expenses in order to qualify for foundation funding aid from the state. (A tax rate of 20 mills per dollar of taxable value is equivalent to a 2% tax rate.) Revenue from local school district income taxes count toward the qualification requirement.

The bill maintains the 20-mill equivalent requirement, expressing it in terms of a percentage of the taxable value of real and tangible personal property in a school district rather than in terms of a property tax rate. Thus, in order for a school district to qualify for foundation funding, it must raise tangible personal property taxes and income taxes for current expenses in an amount that equals at least 2% of the value of the taxable value of real and tangible personal property in the district.

Basic aid formula charge-off

(secs. 3317.02(O) and (P) and 3317.022)

The basic aid funding formula is designed to ensure that each school district has a specified amount available to spend for each pupil from state and local funding sources. This is accomplished by multiplying each district's enrollment by the specified per-pupil amount, adjusting the resulting product by a relative local cost index, and deducting an amount representing local funding responsibility. This deduction--the so-called "charge-off"--is 23/1000ths of the district's taxable property valuation (equivalent to the proceeds from a 23-mill effective tax rate) adjusted for the incomes of district residents. The charge-off is the equalizing component of the basic aid formula, since a greater amount is deducted for school districts with relatively high property valuation (or relatively higher resident incomes, or both) than for districts with relatively low valuation (or low resident income).[4]

The bill modifies the charge-off component to reflect the replacement of real property taxes with income taxes to pay current expenses. The charge-off will equal the lesser of the following: (1) 23/1000ths of the district's taxable property valuation (real and personal), adjusted for residents' incomes as under current law, or (2) the sum of total school district income tax revenue for current expenses (including both the tax imposed by the bill and "local option" income taxes) and voter-approved property taxes for current expenses (which will consist only of current expense levies on tangible personal property).

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[4] *For many property-wealthy school districts, the charge-off is sufficiently high that the computed net aid amount is significantly less than the aid the district received in a specified prior year. In such cases, the basic aid formula computation is effectively ignored, and the district receives a "guarantee" amount that is computed on the basis of the aid it received in a specified prior year. See sec. 3317.0212.*

"Recognized valuation"

(secs. 3317.01, 3317.015, 3317.02(T) and (W), and 3317.16)

Currently, an adjustment is made in a school district's basic aid formula charge-off each year to phase in the effects of increasing real property values. The property values used in computing the charge-off have tended to increase substantially every three years when the most recent tax reappraisals and updates have been completed. If the recognized valuation adjustment were not made, an increase in real property values would cause a school district's charge-off amount (and, therefore, its implied local funding capacity or responsibility) to increase abruptly by a factor of 2.3% of the increase in taxable value. But the adjustment permits the charge-off amount to reflect only one-third of the most recent property value increases each year, which prevents a district's implied local funding responsibility from increasing so abruptly and significantly in a single year. The charge-off reflects the entire increase in property values only in the third year following the year when the updated property values are incorporated into the funding formula.

Under the bill, the recognized valuation adjustment will not be made in the charge-off computation. The adjustment is rendered unnecessary because taxes will no longer be levied against real property for current expenses. Recognized valuation will continue to be computed for each school district in order to be incorporated into the computation of each joint vocational school district's formula charge-off (see sec. 3317.16).

Other effects

(secs. 3317.02(L), (O), (P), 3317.021, and 3317.022)

Since the bill replaces voter-approved taxes on real property with an income tax, certain information no longer must be computed or used to determine formula aid amounts. The amount of property taxes payable to a school district will be determined only on the basis of taxes on tangible personal property. The basic aid formula will not be adjusted to reflect tax-exempt real property, as is currently done for school districts where a significant portion of the real property is exempted from taxation. The Tax Commissioner no longer must certify the taxable value of real property to the Department of Education. And the Tax Commissioner must separately certify the total property tax rate charged against tangible personal property and real property, since the rate charged against real property and tangible personal property will no longer be the same rate.

Income tax applies to public pension benefits

(secs. 145.56, 3307.41, 3309.66, and 5505.22)

Currently, benefits paid under various public employee retirement systems are taxable under the state income tax or "local option" school district income taxes (Public Employees Retirement System, State Teachers Retirement System, School Employees Retirement System, and State Highway Patrol Retirement System). Likewise, the benefits paid under these public employee retirement systems are to be subject to the school district income tax imposed by the bill.

Effective date

(Section 4)

Since the bill imposes a tax, it takes effect immediately upon being filed with the Secretary of State's office after being signed by the Governor. However, the bill will not begin to operate until the 91st day after that filing because it contains a delayed effective date.

COMMENT

Article XII, Section 2 of the Ohio Constitution requires that all land and improvements (real property) be taxed uniformly--i.e., taxed on the same proportion of its fair market value (which must be determined under a uniform method) and at the same tax rate within a taxing jurisdiction. But the uniform rule does not require that real property be taxed uniformly as compared to tangible personal property. See, e.g., *State, ex rel. Struble, v. Davis*, 132 Ohio St. 555 (1937).

HISTORY

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Introduced	08-14-00	p. 2205

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