Bill Analysis

Andre Imbrogno *Legislative Service Commission*

H.B. 258

125th General Assembly
(As Introduced)

Reps. Trakas, Willamowski, Williams, Schaffer, Reidelbach, Cates, Brinkman, Fessler, Gilb, Buehrer, Husted, Hughes, Young, Aslanides, Seitz, Calvert, Seaver

BILL SUMMARY

- Provides for the taxation of capital gains at rates equal to or lesser than the tax rates applied to other types of income, and provides for the phasing out of the tax on capital gains.

- Replaces the existing "bright line" test for residency--based upon the number of "contact periods" in the state--with a test based on more circumstantial evidence of domicile.

CONTENT AND OPERATION

Capital gains

Current law

Capital gains and losses are gains and losses resulting from the sale or exchange of capital assets. In general, "capital assets" are all assets held by a taxpayer except property held for resale in the normal course of business, trade accounts and notes receivable, depreciable property, and real estate used in a trade or business or for rental or royalty activity (Internal Revenue Code Section 1221). Under federal law, capital gains on assets held for 12 months or less are taxed in the same manner as other types of income; however, capital gains on assets held for longer than 12 months are taxed at special capital gain rates, which are generally lower than the rates that apply to income that is not capital gain. (The capital gain rate will not apply if it is higher than the tax rate applied to a taxpayer's non-capital gain income. If the capital gain rate is higher than the rate applied to a taxpayer's non-capital gain income, the capital gains are taxed at the rate applied to the non-capital gain income.) Under the Internal Revenue Code, the capital gains tax is calculated, in part, on the basis of a taxpayer's "net capital gain," which is the amount, if any, by which the taxpayer's net long-term capital gain for the taxable year (i.e., net capital gain on assets held for more than a year) exceeds net short-term capital loss (i.e., net capital loss on assets held for one year or less). Taxpayers report capital gains and losses to the federal government using Internal Revenue Service Schedule D ("Schedule D").

In contrast to federal law, Ohio's income tax law does not distinguish between capital gains and other types of income. In Ohio, capital gains and other types of income are combined in a single tax base--Ohio adjusted gross income--and taxed at the same rates.

Separate tax rates applied to net capital gain--phase out of the capital gains tax

(R.C. 5747.01, 5747.011, 5747.012, 5747.02, 5747.05, 5747.054, 5747.13, 5747.22, and 5748.01)

Under the bill, for taxable years beginning in 2005 and thereafter, capital gains are taxed separately from other types of income.[1] Under current law, capital gains and other income comprise a taxpayer's "Ohio adjusted gross income," which is the tax base used to calculate Ohio income tax. The bill requires that taxpayers deduct from their Ohio adjusted gross incomes any net capital gain for the taxable year as calculated and reported on Schedule D. The remaining "non-capital gain" income then is taxed under the existing (graduated) tax rate schedule; the net capital gain is taxed at either the highest marginal tax rate that applies to the non-capital gain income, or a specified "phaseout rate," whichever is less. The phaseout rate is 7% for taxable years beginning in 2005 and decreases by 1% each year until taxable year 2012 at which time the tax on net capital gain is completely phased out.

Example

As an illustration of how the bill operates, suppose, for example, a taxpayer has an Ohio adjusted gross income (less exemptions) of $50,000, $15,000 of which constitutes net capital gain. Under current law, the taxpayer owes a tax of $1,857.30 ($1,337.20 plus 5.201% of everything over $40,000). In contrast, under the bill, the $15,000 of net capital gain is taxed separately from Ohio adjusted gross income. So, the taxpayer would have an Ohio adjusted gross income (excluding the net capital gain) of only $35,000 and a net capital gain of $15,000.

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[1] *The bill's separate treatment of capital gains applies to individuals and estates, but not to trusts, because trusts are not subject to Ohio's income tax with respect to taxable years beginning after 2004.*

In this example, the removal of net capital gain from Ohio adjusted gross income means that the taxpayer is now in a lower non-capital gain income tax bracket, so the taxpayer pays a tax on the $35,000 of non-capital gain income of $1,114.35 ($445.80 plus 4.457% of everything over $20,000). In addition, for taxable year 2005, the taxpayer would pay tax on the $15,000 of net capital gain at the same rate that applies to the non-capital gain income--4.457%--resulting in a tax of $668.55. (The 4.457% rate applies because it is less than the 7% phaseout rate that applies for taxable years beginning in 2005.) Thus, under the bill, the taxpayer's total tax is $1,782.90, as compared to $1,857.30 under current law.

Using the same figures but applying them to taxable year 2010, for instance, the taxpayer would pay the same tax on non-capital gain income but would pay tax on the net capital gain at a phaseout rate of only 2%, which results in a total tax of $1,414.35. For taxable years beginning in 2012 and thereafter, the taxpayer would pay no tax on the net capital gain.

Residency tests changed

(R.C. 5747.01, 5747.24 (repealed), and 5747.25 (repealed))

Any individual earning or receiving income in Ohio is subject to the state's income tax, whether or not the individual is an Ohio resident. Residency affects how Ohio credits a taxpayer for any tax liability to another state on the same income. An Ohio resident may claim a credit for taxes paid to another state (up to the amount of the Ohio tax on the same income). A nonresident may claim a credit for the amount of Ohio income tax on the portion of the nonresident's Ohio adjusted gross income that is not allocable to Ohio.

Current "bright line" residency test

For income tax purposes, a "resident" is a person who is domiciled in this state. Under current law, a person is presumed to be domiciled depending upon the number of "contact periods" the person has in Ohio during the taxable year. A person has one contact period in Ohio if the person spends at least some portion, however minimal, of two consecutive days in Ohio while away overnight from an abode located outside Ohio.

A person is presumed to be *not* domiciled in Ohio during a taxable year if the person has no more than 120 contact periods in Ohio during the taxable year and has at least one abode outside Ohio during the entire taxable year. Generally speaking, this presumption is conclusive.[2]

[2] *The Tax Commissioner may request a statement from an individual verifying that the individual was not domiciled in Ohio by virtue of having 120 or fewer contact periods*

A person is presumed to be domiciled in Ohio during the entire taxable year if the person has no more than 182 contact periods in Ohio during the taxable year but does not satisfy the presumption (above) of not being domiciled in Ohio. A person can rebut this presumption for any portion of the taxable year with a preponderance of the evidence to the contrary. A person who rebuts the presumption for any portion of the taxable year, but not the entire year, is presumed to be domiciled in Ohio for the remainder of the year.

A person also is presumed to be domiciled in Ohio during an entire taxable year if he or she has at least 183 contact periods in Ohio during the taxable year. An individual can rebut this presumption for any portion of the taxable year only with clear and convincing evidence to the contrary. Here again, an individual who rebuts the presumption for any portion of the taxable year is presumed to be domiciled in Ohio for the remainder of the taxable year.[3]

Under current law, an individual who is presumed to be a resident of Ohio under the existing residency tests may elect to be treated as a nonresident in return for a reduction in the amount of the nonresident credit. An individual who makes the election for any taxable year is considered to be a nonresident for the entire taxable year. When an individual makes this election, the number of contact periods the individual has in excess of 120 is used to calculate the amount of Ohio adjusted gross income allocable to Ohio for purposes of calculating the nonresident credit. The more contact periods an individual has in excess of 120, the larger the portion of income allocable to Ohio and, accordingly, the smaller the amount of the nonresident credit that may be claimed by the individual.

Under the bill, domicile continues to be a basis for being treated as a resident for purposes of the Ohio income tax; however, the bill eliminates the bright-line test for domicile based upon contact periods. The bill also eliminates taxpayers' option of being treated as nonresidents in exchange for a reduced nonresident credit calculated on the basis of contact periods.

The bill defines a "resident" as an individual who lives in and maintains a permanent place of abode in the state and who does not maintain a permanent place of abode anywhere else, unless the person lives outside of Ohio for more

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and an abode outside of Ohio. If the individual does not furnish the statement, the individual is presumed to have been domiciled in the state for the entire taxable year. The individual may rebut this presumption with a preponderance of evidence to the contrary. (R.C. 5747.24(B) and (C).)

[3] *An administrative rule sets forth criteria for determining whether an individual has rebutted the presumption of domicile in Ohio with a preponderance of the evidence or with clear and convincing evidence. (O.A.C. 5703-7-16.)*

than 335 days during the taxable year. Presumably, under the bill, domicile would be determined by examining all of the facts and circumstances surrounding an individual's residency. (In effect, the bill restores the statutory test for residency that existed until 1993, when the General Assembly enacted the contact period test in S.B. 123 of the 120th General Assembly.)

HISTORY

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