Bill Analysis

Peter A. Cooper *Legislative Service Commission*

H.B. 379

125th General Assembly
(As Introduced)

Reps. Schaffer, Gilb, Fessler, Young

BILL SUMMARY

- Reduces total income taxes by an amount equivalent to the sales taxes generated from a state sales tax rate above 5%.
- Increases the income tax deduction for unreimbursed medical expenses.
- Expressly adopts the federal income tax treatment of health savings accounts.

CONTENT AND OPERATION

Income tax decrease to offset additional sales tax revenue

(R.C. 131.44 and 5747.02)

The bill creates a mechanism for reducing income taxes to offset the increased sales tax revenue arising from the recent state sales tax increase. Income tax rates would be reduced each year the state sales tax rate exceeds 5%. (The state sales and use tax rate was increased from 5% to 6% for two years, beginning July 1, 2003, and ending June 30, 2005.) The income tax rate reduction would be calculated so that total income taxes would be decreased by approximately the same amount as the additional sales tax revenue arising from the sales tax increase.[1]

The income tax reduction would be computed by the Tax Commissioner each August 15, beginning in 2004. To compute the income tax reduction, the Tax Commissioner must compute the additional sales tax revenue collected in the preceding fiscal year (the "excess sales tax revenue"). The excess sales tax

[1] *References in this analysis to the sales tax include the corresponding use tax on out-of-state purchases.*

revenue is the portion of total sales tax revenue raised by a state sales tax rate above 5%. With a sales tax rate of 6%, the excess sales tax revenue would be one-sixth of the total sales tax revenue collected in the preceding fiscal year. The Tax Commissioner then must compute the percentage that the excess sales tax revenue is of the total income tax revenue collected in the preceding fiscal year. (For example, if the excess sales tax revenue for FY 2004 is $1 billion, and the income tax revenue is $8 billion, the percentage is 12.5%.) Once the income tax reduction percentage is computed, that percentage is added to any income tax reduction percentage provided through the Income Tax Reduction Fund.[2] Income tax rates then must be reduced by the sum of the two percentages. The income tax rate reductions would apply to taxable years that begin in the calendar year in which the computation is made.

The bill's income tax reduction mechanism would operate whenever the state sales tax rate exceeds 5%. For example, if the rate were 5.5%, the excess sales tax revenue would be one-tenth of the total sales tax revenue. If the sales tax rate changes during a fiscal year, the excess sales tax revenue would be computed on the basis of the average of the rates imposed each month of the fiscal year.

Income tax deduction for medical expenses

(R.C. 5747.01(A)(11)(b))

Currently, in computing Ohio income taxes, a taxpayer may deduct unreimbursed medical expenses to the extent those expenses exceed 7.5% of the taxpayer's federal adjusted gross income (FAGI). The kinds of medical expenses that are deductible for Ohio income tax purposes are the same as the kinds that are deductible for federal income tax purposes.

The bill increases the deductible amount by permitting taxpayers to deduct unreimbursed medical expenses to the extent they exceed 5% of FAGI. The enhanced deduction is available for taxable years beginning in or after 2004.

Income tax treatment of Health Savings Accounts

(R.C. 5747.01(A)(15))

The bill permits taxpayers to claim the same income tax preferences that federal law allows for "health savings accounts." Under recent federal legislation,

[2] *The Income Tax Reduction Fund requires income tax rates to be reduced whenever there is a fiscal year-end surplus, the balance in the Budget Stabilization Fund is 5% of General Revenue Fund revenue, and certain year-end budget reserve requirements are met.*

individuals who open and hold health savings accounts are allowed to deduct cash contributions to the account, up to specified annual limits. Also, investment earnings on account balances are exempt from taxation unless account withdrawals are spent for something other than medical expenses. Health savings accounts may be held by any person, whether or not employed, as long as the person is covered by a "high-deductible" health plan and is not covered by Medicare or another general health plan.[3]

Specifically, the bill permits taxpayers to deduct cash contributions to a health savings account to the same extent contributions are deductible for federal income tax purposes. The federal tax-deductible amount is equal to the deductible under the high-deductible health plan, but is limited to a maximum annual dollar amount. The maximum annual dollar limit depends on whether the health plan covers only one person or covers two or more persons. The annual limits for 2004 are as follows:

Annual tax-deductible contribution limits for health savings accounts		
Health plan coverage	***Age under 55***	***Age 55 or over***
Individual	$2,250	$2,750
Multiple	$4,500	$5,000

Note: Limits are to be adjusted annually for inflation, and the limits for ages 55 and over increase by $100 per year for five years.

The tax-deductible amount is reduced by one-twelfth for every month the taxpayer is not covered by a high-deductible health plan.

In the case of most Ohio taxpayers, the federal tax deduction will automatically reduce the Ohio taxable income reported by the taxpayer. But the bill ensures that the federal deduction is recognized by law for Ohio tax purposes, because changes in federal law are not necessarily incorporated automatically into an Ohio law that refers to the federal law.[4] The bill also requires a taxpayer who

[3] *To qualify as a high deductible health plan, a plan must have an annual deductible of at least $1,000 (individual coverage) or $2,000 (multiple coverage), and the sum of the deductible and other out-of-pocket expenses must be no more than $5,000 (individual) or $10,000 (multiple). Special rules apply to some plans.*

[4] *The "nondelegation" provision of the Ohio Constitution, Article II, Section 26, has been construed in some cases to mean that changes in a federal statute that is incorporated by reference in an Ohio statute do not change the meaning or scope of the Ohio statute unless the General Assembly enacts the changes.*

spends money from a health savings account for anything other than medical expenses to add that amount to Ohio taxable income (if it has not already been added back for federal tax purposes). This ensures consistency with the federal law.

Similarly, investment earnings on health savings accounts are not included in federal adjusted gross income, so the earnings will not appear in a taxpayer's reported Ohio taxable income. The bill ensures that Ohio law recognizes and adopts the federal tax exclusion for investment earnings. The bill also requires taxpayers to add back investment earnings on any account funds spent on nonmedical expenses, consistent with federal tax treatment.

HISTORY

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