Ohio Legislative Service Commission

Bill Analysis

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H.B. 134

129th General Assembly
(As Introduced)

Reps. Schuring, Young, Hall, J. Adams, Combs, Okey, Stebelton, Wachtmann, Mecklenborg, Balderson, Hollington, Slaby

BILL SUMMARY

- Reduces the maximum income tax rate on individuals' net capital gains reinvested in Ohio-based businesses or property to 2.5%.

CONTENT AND OPERATION

Taxation of capital gains

Current law

Under current law, all taxable income is subject to one uniform tax rate schedule. The schedule is graduated so that a higher rate applies to income exceeding specified dollar thresholds, but it does not cause any one form of income, such as a capital gain, to bear a higher rate than any other form.

The only special treatment of capital gain income under current law is a deduction for capital gains realized from selling or otherwise disposing of tax-exempt "public obligations" − i.e., bonds and other securities issued by Ohio, an Ohio instrumentality, or an Ohio local government, and fractionalized interests in such securities. Losses on such securities are added to federal adjusted gross income to the extent the losses were deducted in computing FAGI in order to preclude federally deducted losses from offsetting other items of Ohio taxable income.

Proposed reduction in tax rate

The bill distinguishes "Ohio-based reinvestment" from all other forms of taxable income for the purpose of applying a lower tax rate to capital gains from non-Ohio investments that are reinvested in Ohio-based businesses or property (the bill defines such reinvested capital gains as "Ohio-based reinvestments"). The proposed rate is 2.5%.

"Ohio-based reinvestments" are defined to be investments in any of the following: shares of a business incorporated under Ohio law, a pass-through entity where the majority of equity ownership interests are owned directly by persons subject to the Ohio income tax, bonds issued by Ohio or its subdivisions, tangible personal property used in business and located in Ohio, and real property located in Ohio. An Ohio-based reinvestment qualifies for the lower tax rate only if the taxpayer realizes net capital gains from selling or disposing of a non-Ohio-based investment in the same year. (A non-Ohio-based investment is any investment that is not an Ohio-based reinvestment.) The amount of the Ohio-based reinvestment that qualifies for the lower tax rate cannot be greater than the net capital gain from the non-Ohio-based investment.

Hold harmless

For some lower-income filers, their highest marginal tax rate is lower than the proposed 2.5% tax rate on Ohio-based reinvestments. For any of those filers who also report Ohio-based reinvestments, the bill does not cause an increase in their tax liabilities. Each taxpayer's income tax would be computed in two ways, applying the bill's reduced 2.5% rate and applying the current rate schedules, and the taxpayer would owe tax on the basis of the computation producing the lower of the two tax amounts. (For taxable years beginning in 2011 or later, the 2.5% rate will be higher than the normal marginal rate only for taxpayers whose taxable income is under $15,000.)

Holding period

To qualify for the bill's reduced tax rate, an Ohio-based reinvestment must be held for at least three years. If a taxpayer disposes of an Ohio-based reinvestment within three years, the taxpayer must pay the regular Ohio tax rate on the proceeds from the disposal, plus a 10% penalty, and interest at the statutory rate (4% for 2011). A taxpayer may avoid this additional charge by purchasing another Ohio-based reinvestment in the same year. The new Ohio-based reinvestment may qualify for the 2.5% rate but only to the extent it exceeds the proceeds from disposal of the "old" Ohio-based reinvestment.

Personal exemptions

Current law allows every taxpayer to claim personal exemptions for the taxpayer, the taxpayer's spouse, and each dependent. The personal exemptions are subtracted from the taxpayer's adjusted gross income, which reduces tax liability. Each exemption equaled $1,600 in 2010, and is adjusted each year on the basis of an index of general price inflation.

Because the bill divides taxable income into two parts – capital gains reinvested in Ohio-based investments and all other taxable income – the bill also prescribes how the personal exemptions are to be applied for taxpayers whose Ohio-based reinvestment will be taxed at the 2.5% tax rate. The exemptions are to be subtracted first from the taxpayer's other, non-capital gain income, and any remaining balance is subtracted from the reinvested capital gain income. This ensures that the exemptions reduce tax liability to the greatest degree because they reduce the income that is subject to the higher marginal tax rate – i.e., non-capital gain income – before applying to reinvested capital gain income.

HISTORY

ACTION	DATE
Introduced	03-01-11

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