LSC Greenbook

Analysis of the Enacted Budget

Tax Provisions

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Tax Provisions

- H.B.1 newly creates motion picture and new markets tax credits
- H.B.1 expands the sales and use tax base by including sales of medical services by Medicaid health insuring corporations

Overview

Am. Sub. H.B. 1 (H.B. 1) makes few changes to the existing tax structure, but creates two new tax credits, the motion picture tax credit and the new markets tax credit. The operating budget act expands the existing job creation and job retention tax credits and increases amounts available for the technology investment tax credit. H.B. 1 also subjects sales of medical services by a Medicaid health insuring corporation to the sales tax and to the insurance premiums taxes, and temporarily reduces statutory distributions of GRF tax revenues to the Public Library Fund (PLF) from 2.22% to 1.97% in FY 2010 and FY 2011.

Sales and Use Tax – Medicaid Insurance Premiums

H.B. 1, starting October 1, 2009, imposes the sales tax on health care services provided by a Medicaid health insuring corporation for Medicaid enrollees residing in Ohio, unless the tax is determined to be an "impermissible health care-related tax" for federal Medicaid purposes. The operating budget act also eliminates the tax if federal authorities determine that this expansion of the Ohio sales and use tax base is impermissible and its imposition would result in a reduction in federal financial assistance for Medicaid services. The act designates the corporations as the consumers of the services, rather than the individual receiving the services.

The Office of Budget and Management expects this provision to increase revenue to the GRF by $138.4 million in FY 2010 and by $214.6 million in FY 2011. The Local Government Fund (LGF) and the PLF would gain $8.3 million in FY 2010 and $12.8 million in FY 2011. Revenues to local governments under permissive local and transit authorities' sales taxes may be up to $31.5 million in FY 2010 and $48.9 million in FY 2011.

Insurance Taxes – Medicaid Insurance Premiums

H.B. 1 includes Medicaid premiums received by domestic insurance companies (i.e., companies headquartered in Ohio) within the tax base of the domestic insurance tax. If the company is headquartered in another state, the operating budget act includes such premiums in the foreign insurance tax base. This provision is effective October 1, 2009. The taxation of Medicaid premiums will increase revenue to the GRF by $25.1 million in FY 2010 and by $39.1 million in FY 2011, according to the Office of

Budget and Management. This provision would also increase revenue to the LGF and PLF by $1.6 million (combined) in FY 2010 and by $2.5 million in FY 2011.

REAL PROPERTY TAX

School District Conversion Levy

H.B. 1 authorizes school districts levying taxes for current expenses with an aggregate effective tax rate exceeding 20 mills (2%) on residential and agricultural real property to convert, with voter approval, the millage in excess of 20 mills to a single levy for a specified amount of money. The levy conversion would have the effect of suspending future application of H.B. 920 tax reduction factors on the remaining 20 mills, so long as the district does not impose additional current expense millage for other than a fixed amount of money, such as an emergency levy. Consequently, school district tax revenues for current expenses, at the 20-mill floor, would grow with increases in appraised property values. This differs from school districts with current expense levies in excess of 20 mills, for which tax revenues, on increases in appraised values of properties previously taxed in the same class of properties, grow only on inside or unvoted millage, typically 4 mills to 5 mills. (These districts' tax revenues may, however, grow as a result of other changes, such as new construction.)

H.B. 1 requires the state to reimburse a school district levying a conversion tax for the amount of any resulting loss of tax revenue on real property other than residential and agricultural and on public utility personal property due to the conversion. Generally, effective tax rates for residential and agricultural real property are lower than for other real property and are lower than the full tax rates on public utility personal property, not subject to tax reduction factors. So replacement of current expense millage with a conversion levy, at a uniform rate across the three classes of property, and raising the same amount of tax revenue from residential and agricultural property, would generally entail taxation of the other real property and public utility personal property at lower rates than before. If a conversion levy imposed for a continuing period of time is decreased, state reimbursement based on passage of the levy is reduced proportionately, and if the levy is repealed, state reimbursement is terminated. The reimbursement is phased out each year in increments equal to 50% of the annual inflationary revenue growth from residential and agricultural property resulting from the suspension of the H.B. 920 reduction on 20 mills of taxation. The reimbursement ends when the computation results in a reimbursement of zero or after 13 years, whichever occurs first.

School boards are authorized to propose conversion levies in 2010 through 2014, and for a term of up to ten years or continuously. A school district conversion levy applies to the tax year in which voters approve it. A conversion levy and a renewal of a conversion levy may be proposed only at a primary or general election. A school board

eligible to impose a conversion levy may propose that the levy raise a smaller amount from residential and agricultural real property than the levies that the conversion levy would replace. Voters are authorized to decrease or repeal a conversion levy that originally was imposed for a continuing period of time. H.B. 1 prevents a school board eligible to impose a conversion levy under the bill from adopting a resolution proposing the imposition of the conversion levy and repealing fewer mills than is necessary to reduce the effective tax rate for current expense levies on residential and agricultural real property to 20 mills. The board may, however, propose a conversion levy for a smaller amount.

The reimbursement cost to the state for conversion levies cannot be determined because it is subject to voter behavior. Imposition of conversion levies in place of other current levies is permissive for school boards and voters, with the state fully reimbursing initial revenue losses from appropriation item 200901 in the budget of the Department of Education. The Tax Commissioner is to certify these amounts to the Department of Education, with reimbursement payments to be made by the last day of April and October. If any additional amounts are determined to be necessary for these payments, they are appropriated by H.B. 1.

Manufactured and Mobile Home Tax Reduction Reimbursements

H.B. 1 consolidates into one annual payment the semiannual state reimbursement of local governments for the 10% and 2.5% property tax reductions for manufactured and mobile homes. Previous law provided for certification on or before April 15 and September 15 of any adjustments to amounts certified previously, with half to be reimbursed upon receipt of each certification. H.B. 1 specifies that the certification to the Tax Commissioner of the amount of these tax reductions is to be made by each county treasurer on or before the second Monday in September, and the annual reimbursement is to be made within 90 days thereafter.

This provision delays but does not change the amounts reimbursed to local governments. In calendar year 2007, the amount of the 10% reduction for manufactured and mobile homes was $2.6 million and the amount of the 2.5% reduction was $0.4 million. This delay will reduce state payments by an estimated $1.5 million in FY 2010 only.

Property Tax Exemption, Remission for Lessee Port Authority

H.B. 1 authorizes for FY 2010 and FY 2011 the exemption and remittance of taxes paid on airport property leased by a port authority that was precluded from exemption because the port authority did not own the property, as required under prior law, at the time it submitted the application for exemption. To be eligible for the exemption, the current owner must apply for it by January 1, 2010. This provision is likely to require the remittance of tax revenues for previous years by units of local government. LSC

does not anticipate that the departments of Taxation or Education will adjust payments for changes to tax revenues for prior years, and accordingly, the provision may not affect state payments to these units of local government.

COMMERCIAL ACTIVITY TAX

H.B. 1 makes various changes to the commercial activity tax (CAT) law. Most of those changes have little or no fiscal effect. The operating budget act creates a new exclusion to the CAT for receipts of an employer from payroll deductions relating to the reimbursement of the employer for advancing moneys to unrelated parties on an employee's behalf. Also, the existing exclusion from gross receipts of life insurance proceeds is expanded to all kinds of insurance, unless the insurance reimburses the taxpayer for business revenue losses. These provisions reduce revenues from the CAT by an indeterminate amount.

H.B. 1 provides a limited refund for taxpayers that registered and paid the CAT in 2005 and 2006 and later determined that they did not have nexus[1] with Ohio or that their taxable receipts were below $150,000. The refunds will reduce revenues from the CAT. LSC has no data on the taxpayers due refunds and cannot estimate the state revenue loss.

Prior to H.B. 1, the CAT law prohibited any taxpayer from billing or invoicing another person for the tax. However, the operating budget act authorizes a lessor to bill or invoice a lessee for the CAT under a written lease agreement. H.B. 1 requires the Tax Commissioner to notify a taxpayer (nonlessor) by certified mail the first time the taxpayer bills or invoices another person for the taxpayer's CAT tax liability. The Tax Commissioner may, but is not required to, impose a fine of up to $500 for the taxpayer's first violation; the Commissioner is required to impose a $500 fine for subsequent violations. LSC expects this provision to have a minimal fiscal effect.

H.B. 1 amends the due date of tax returns from the 40th day following each calendar year to the tenth day of the second month following the end of each quarter. The operating budget act requires taxpayers constituted of two or more persons (i.e., consolidated elected and combined group taxpayers) designate a reporting person that can legally bind the group for CAT filings and tax liabilities. These provisions have no fiscal effect.

[1] R.C. 5751.01 provides criteria based on a firm's Ohio payroll, property, and gross receipts which create nexus for purposes of the CAT and which require the company to pay the tax.

TAX CREDITS

Motion Picture Tax Credit

H.B. 1 authorizes a refundable credit[2] against the corporate franchise tax or the personal income tax for a motion picture or a television show produced at least partly in Ohio. The credit equals 25% of the lesser of the budgeted eligible production expenditures or the actual eligible expenditures, as determined by the Director of Development. To be eligible for the credit, a production must have at least $300,000 in eligible expenditures. Qualifying productions include feature-length films; documentaries, television series, or miniseries; interactive web sites. The operating budget act excludes sexually explicit productions, and television news, sports, weather, market reports, awards shows and galas, fundraisers, infomercials, and in-house advertising. To be eligible for the tax credit, a production must be certified by the Director of Development who may charge a fee for the application. The fees collected are to be deposited into the newly created Motion Picture Tax Credit Program Operating Fund. H.B. 1 states that the Director shall use money in the fund to pay expenses related to the administration of the Ohio film office and the motion picture tax credit. Expenditures on a production are subject to verification by an independent certified public accountant. After receiving verification, the Director of Development is to determine eligible production expenditures and issue a certificate in that amount.

The tax credit is 35% with respect to payroll expenditures on behalf of resident cast and crew wages. H.B. 1 limits the amount of credit to $5 million per production. The aggregate limit is $30 million for FYs 2010-2011, of which not more than $10 million of tax credit may be allowed in the first year of the biennium. However, the aggregate limit is $20 million for each succeeding biennium. The revenue loss from the motion picture tax credit is likely to vary from year to year. The biennial revenue loss to the GRF from the motion picture credit will be up to $28.3 million. Revenue foregone by the LGF and the PLF would be up to $1.1 million and $0.6 million, respectively, in FYs 2010-2011. In future biennia, the revenue loss to the GRF from the motion picture tax credit may be up to $18.8 million. The revenue loss to the LGF and the PLF may be up to $0.7 million and $0.4 million, respectively.

New Markets Tax Credit

The operating budget act authorizes up to $10 million of tax credits annually for insurance companies and financial institutions for purchasing and holding securities issued by low-income community organizations, in accordance with the federal New

[2] For a refundable credit, if the amount of credit exceeds the tax liability, the excess is returned to the taxpayer. In the case of a nonrefundable credit, the amount of credit usable in a tax year cannot exceed the tax liability.

Markets Tax Credit law. The nonrefundable Ohio new markets tax credit applies against the corporate franchise and the insurance taxes, and is limited to $1 million per qualifying business. If the amount of credit exceeds the tax otherwise due, the taxpayer may carry forward the excess for up to four of the ensuing years.

Existing federal law provides for an income tax credit of up to 39% of the cost of investment at original issue in investment vehicles associated with providing investment capital for low-income communities. The Ohio new markets tax credit is 39% of the portion of the investment that relates to projects in Ohio (that received the federal tax credit). Beginning in 2010, the credit may be claimed over seven years. However, H.B. 1 specifies that no credit can be claimed during the first two years. Seven percent of the cost of investment may be claimed in 2012, and 8% of the cost of investment may be claimed in each of the following four years. H.B. 1 requires the Treasurer of State to invoice, if needed, insurance companies in the procedure to recapture credits and specifies that the existing three-year statute of limitations on assessing unpaid taxes does not apply to the recapture.

The new markets tax credit will decrease revenue from the corporate franchise tax and the domestic and foreign insurance taxes, potentially starting in FY 2012. The GRF revenue loss per annual tax credit award will be up to $9.4 million. The revenue loss to the LGF will be up to $0.4 million, and revenue foregone to the PLF will be up to $0.2 million. Due to the phase-in of the credit, the revenue loss from the initial tax credits will be spread over several years.

Job Creation Tax Credit

The operating budget act eases the requirements to qualify for the refundable job creation tax credit. This credit is available against the CAT and the foreign and domestic insurance taxes. Under prior law, the credit was based on income tax withholdings from new full-time employment. H.B. 1 authorizes job creation tax credits based on annual aggregate payroll withholdings (which include both full-time and part-time employees) and payroll growth. The credit will be calculated based on the increase in tax withholdings from all employees employed at a project. The credit will equal a percentage of the growth in income tax withholding from the base year (the 12 months preceding the date the credit is granted) to the year of the credit. H.B. 1 eliminates the explicit job creation condition for tax credit agreements and substitutes a requirement that the Ohio Tax Credit Authority determines whether a project will increase payroll and income tax revenue. The business must maintain operations at the project site for the greater of seven years or the term of the credit plus three years. Other changes are made to the tax credit, including the addition of the possibility of a "claw back" of up to 100% of the credit if the taxpayer fails to maintain operations at the project location for the required term of the credit, and the ability of a taxpayer to

relocate or transfer an "unsubstantial" number of positions without seeking the approval of the Director of Development. The operating budget act also specifies that the credit may be based only on employee withholdings occurring on or after the day the taxpayer becomes eligible for the credit.

These provisions may reduce tax revenues from the CAT and the insurance taxes due to less stringent criteria for obtaining the credit compared to current law. However, both the amount and the timing of the potential revenue loss are indeterminate, as they depend on the total amounts of credits authorized by the Ohio Tax Credit Authority and credit claims by taxpayers.

Job Retention Tax Credit

Similarly to the job creation tax credit, H.B. 1 also authorizes job retention tax credits based on annual aggregate payroll withholdings (which include both full-time and part-time employees) and payroll growth. The provision regarding the relocation of employees is identical to that of the job creation tax credit.

H.B. 1 expands the tax credits to domestic and foreign insurance companies, eliminates the additional credit available to call centers, and relaxes the threshold levels to qualify for the job retention tax credit. The job retention tax credit had been applied only against the CAT starting in FY 2009. To be eligible for the job retention tax credit under previous law, an employer had to employ an average of at least one thousand employees in full-time employment positions at a project site during each of the twelve months preceding the application for a tax credit. Also, the employer had to invest at least $200 million in the aggregate at the project site during a period of three consecutive calendar years, or at least $100 million if the average wage of all full-time employment positions at the project site was greater than 400% of the federal minimum wage.

H.B. 1 reduces the investment threshold to qualify for the job retention tax credit from $200 million to $50 million for manufacturing facilities, and to $20 million for investments in facilities with significant corporate administrative functions (as defined by the Director of Development by rule). Further, the employment threshold for the project is reduced from 1,000 full-time employees to 500 full-time equivalent employees. This change allows part-time employees to be considered and included in the count of employees for the tax credit. H.B. 1 also limits the amount of tax credits that may be issued to $13 million in tax year 2010. For tax years after 2010, the limit increases by $13 million each year. For tax years 2024 and after, the limit is $195 million. The limit applies only to credits for projects approved on or after July 1, 2009.

H.B. 1 requires the Superintendent of Insurance to consider applications filed by insurance companies and the Director of Development to consult with the

Superintendent of Insurance in adopting rules to implement the credit for insurance companies.

These changes potentially reduce tax revenues from the CAT and insurance taxes because of less stringent criteria for obtaining the credits compared to previous law. Both the amount and the timing of the revenue loss are indeterminate, as they depend on the total amounts of credits authorized by the Ohio Tax Credit Authority and credit claims by taxpayers.

Allocation of Historic Preservation Tax Credits among Partners

H.B. 1 authorizes taxpayers that are organized as a partnership or other form of pass-through entity to allocate the existing historic preservation tax credit among partners or other equity owners in proportions other than according to ownership interest proportions. This provision does not limit or disallow pass-through treatment of the credit if the certificate owner is a pass-through entity. This provision has no direct fiscal effect on the state or political subdivisions.

Technology Investment Tax Credit

H.B. 1 increases from $30 million to $45 million the total amount of technology investment tax credits that may be issued to businesses engaged in research and development or technology development. This provision will decrease, over a number of years, revenues from the personal income tax, the public utility tax, and the dealers in intangibles tax. The revenue loss per fiscal year during the biennium is indeterminate.

Venture Capital Tax Credit

H.B. 1 increases the time a venture capital tax credit may be claimed from June 30, 2026, to June 30, 2036. A credit may not be claimed before July 1, 2007 or after June 30, 2026, except that, with respect to loans made from the proceeds of obligations issued by port authorities under section 4582.71 of the Revised Code, a credit may not be claimed before July 1, 2012, or after June 30, 2036. Also, H.B. 1 places a limit of $380 million on the revenue losses across all fiscal years that the program operates. Venture capital tax credits generally may be claimed against the dealers in intangibles tax, the domestic and foreign insurance taxes, the public utility excise tax, the corporate franchise tax, and the personal income tax. This expansion of the Ohio Venture Capital Program potentially decreases state tax revenue collections after the current biennium.

OTHER TAX CHANGES

Incorporation of Changes to the Internal Revenue Code

Am. Sub. H.B. 1 expressly incorporates into Ohio's personal income tax law changes made to federal income tax law since December 30, 2008, and permits a taxpayer whose taxable year ends after that date, but before the effective date of the

incorporated changes, to elect to apply federal law as it existed before that date. The American Recovery and Reinvestment Act of 2009 (ARRA) – the federal "stimulus" bill – is the principal federal act whose tax law changes were incorporated in the Ohio personal income tax.

From the numerous provisions in the ARRA, only three will materially reduce Ohio income tax revenues: (1) the exclusion of up to $2,400 of unemployment insurance benefits from gross income for taxable year 2009, (2) the deferral of income from discharge of certain indebtedness, and (3) the extension of the net operating loss carry-back period from three to five years for taxpayers with 2008 gross receipts of $15 million or less (only those losses realized for the taxable year beginning or ending in 2008 are eligible for this extended carryback treatment).

This provision reduces revenues from the personal income tax by $59.8 million in FY 2010 and $10.4 million in FY 2011, according to the Department of Taxation. Revenue loss to the GRF would be $56.4 million in FY 2010 and $9.8 million in FY 2011. The combined revenue loss to the LGF and the PLF would be $3.4 million in FY 2010 and $0.6 million in FY 2011.

Tax Deduction for Employer-Paid Health Insurance Premiums for Dependents

The operating budget act makes changes to insurance law related to providing health insurance to dependents up to age 29; those changes are described in more detail in the Department of Insurance Greenbook. Federal income tax law excludes health insurance premiums paid by an employer from an employee's gross income, so that such premiums are not taxable income under the federal or Ohio income tax. Federal income tax law limits the age of dependents for whom such health insurance premiums are not taxable (to age 25 in the case of dependents who are full-time students). The insurance provision described above allows employers to pay premiums for an employee's dependents up to age 29, and thus may increase taxable income for taxpayers in relevant circumstances.

H.B. 1 provides a tax deduction under the individual income tax for taxpayers in such circumstances, but also makes it voluntary on the part of employers to pay the premium for such dependents, which limits the potential revenue loss from this provision. LSC expects the revenue loss from the deduction to be under $1 million per year, starting in FY 2011.

Natural Gas Distribution Tax

H.B. 1 extends to natural gas distributors with 70,000 or fewer customers the authority previously held by natural gas distributors with 50,000 or fewer customers to aggregate all of the natural gas distributed by the company in Ohio when determining the tax rate. Under previous law, for natural gas distributors with more than 50,000 customers, the tax rate varied according to the volume distributed to each customer (a

lower marginal rate on higher volumes), so aggregating all customer volumes for distributors with 70,000 or fewer customers reduces the total tax due. Data from the Ohio Department of Taxation suggest that one or two natural gas distributors would initially appear to be affected by this change. Assuming that most of the customers are typical Ohio residential natural gas users implies a potential revenue loss of up to $0.5 million, though the tax revenue loss could range considerably higher for larger natural gas users. Revenues from the natural gas distribution tax are distributed to the School District Property Tax Replacement Fund (Fund 7053), which receives 68.7% of the revenues, and to the Local Government Property Tax Replacement Fund (Fund 7054), which receives 31.3% of the revenues. If amounts in these funds are insufficient to make payments required under R.C. 5727.85 and R.C. 5727.86, the difference is to be transferred from the GRF.

Kilowatt Hour Tax

H.B. 1 modifies the computation for determining the tax liability of a commercial or industrial purchaser electing to self-assess the kilowatt hour tax, beginning January 1, 2011, from one based on both a per-kilowatt hour rate and a percentage of the price paid, to one based solely on a per-kilowatt hour rate. Electricity customers that use more than 45 million kilowatt hours (kWhs) of electricity per year are permitted to self-assess this tax under current law. Self-assessors currently pay a tax of $0.00075 per-kWh for the first 504 million kWhs used during a year, plus 3.5% of the "total price" of electricity used. The definition of total price for this purpose is, generally speaking, the total amount spent by a user for electricity. Beginning with the meter reading period that includes January 1, 2011, this provision would change the self-assessors' tax to $0.00257 per kWh for the first 500 million kWhs per year, plus $0.001832 per kWh for each kWh in excess of 500 million. The impact of the provision will approximately be revenue neutral, based on FY 2009 kilowatt hour tax data. However, the actual impact of this provision in future years would depend on electric prices and consumption at that time.

Provisions Affecting Local Governments

Public Library Fund

From August 1, 2009, through the end of FY 2010, and for all of FY 2011, the allocation of money to the Public Library Fund (Fund 7065) is reduced to 1.97% of total tax revenue credited to the GRF. In the absence of this temporary reduction, 2.22% of total GRF tax revenue would be credited to Fund 7065, under section 131.51 of the Revised Code. This change is estimated to reduce the amount of money that will be distributed to public libraries statewide during the biennium by $84.3 million. This

reduction of distributions to the PLF is a corresponding gain to the GRF over the biennium.

Full Reimbursements to Local Governments through FY 2011

Am. Sub. H.B. 1 reimburses 100% of revenue losses of local taxing units other than school districts due to the phase-out of general business tangible personal property taxes through the state's FY 2011. (This provision does not affect school districts which under current law are held harmless through FY 2011.) Under current law, revenues from the CAT are earmarked for reimbursing school districts and other local governments for the reductions and phase-out of local taxes on most tangible personal property. The reimbursements to units of local government were scheduled to begin phasing out in May 2011. To extend full reimbursements through the end of FY 2011, a transfer of $11.2 million is required to be made in FY 2011 from the GRF to the Local Government Tangible Property Tax Replacement Fund (Fund 7081) to offset the estimated loss of reimbursement to units of local government in FY 2011. Extension of this hold harmless provision to years after FY 2011, in H.B. 1 as passed by the General Assembly, was vetoed by the Governor.

Municipal Income Taxation of Justices and Certain Judges

H.B. 1 authorizes, starting January 1, 2010, only the City of Columbus and the municipal corporation of residence to levy an income tax on the income of the justices of the Ohio Supreme Court. The operating budget act also authorizes only the municipal corporation of residence to levy a tax on the income of a judge sitting in assignment of the Chief Justice, or a judge of a district court of appeals sitting in multiple locations within the district, received as a result of services rendered as a justice or a judge. This provision has no effect on the state, but may minimally increase municipal income tax revenue to Columbus and certain other municipalities.

New Convention Facilities Authority Lodging Tax

H.B. 1 authorizes a convention facilities authority (CFA) in a county having a population between 135,000 and 150,000, and containing a municipality with a population of 50,000 or more, to levy a lodging tax (with the approval of the board of county commissioners) of up to 3% to finance the construction and operation of a convention, entertainment, or sports facility (including through the issuance and retirement of CFA bonds), and to pay the CFA's operating costs. Only Clark County matches the population qualification. The authority is temporary; the CFA must adopt a resolution to impose the levy by November 1, 2009. This provision also subjects the CFA's authority to levy the tax to a referendum under specified conditions.

Definition of Hotel – Lodging Tax

H.B. 1 permits local authorities to modify the definition of a hotel for purposes of local lodging taxes. This provision may increase revenues to counties, townships, or municipal corporations from the lodging tax.

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