Fiscal Note & Local Impact Statement

123 rd General Assembly of Ohio

BILL: **H.B. 65** DATE: **April 12, 1999**

STATUS: **As Introduced** SPONSOR: **Rep. Coughlin**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Creates an Ohio income tax deduction for interest expense paid on a margin account**

State Fiscal Highlights

STATE FUND	FY 2000	FY 2001	FUTURE YEARS
General Revenue Fund			
Revenues	Loss of $31.5 million	Loss of $34.6 million	Losses increasing annually
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2000 is July 1, 1999 – June 30, 2000.

- The proposed deduction would result in a revenue loss of $35.2 million in FY 2000 and $38.7 million in FY 2001. The state GRF would bear $31.5 million and $34.6 million of the loss, respectively, with the remainder borne by local governments.

- LBO estimates that approximately 74,500 Ohio filers would claim the deduction in tax year 1999. That number is estimated to rise to about 78,200 in tax year 2000. About 48% of the filers claiming the deduction would have incomes above $100,000. Filers with incomes above $100,000 would get 88.4% of the tax benefit from the deduction.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2000	FY 2001	FUTURE YEARS
LLGSF (Allocated to libraries and a few local governments)			
Revenues	Loss of $2.0 million	Loss of $2.2 million	Losses increasing annually
Expenditures	- 0 -	- 0 -	- 0 -
LGF and LGRAF (Allocated to counties, municipalities, townships, and special districts)			
Revenues	Loss of $1.7 million	Loss of $1.9 million	Losses increasing annually
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- Through the three local government funds, libraries and local governments would lose $3.7 million in FY 2000 and $4.1 million in FY 2001.

Detailed Fiscal Analysis

Current federal law allows taxpayers to deduct interest on margin accounts and other investment expenses from taxable income. This is not an adjustment to income, but an itemized deduction. This means that the investment expenses are not excluded from federal adjusted gross income (FAGI). Since FAGI is the starting point for determining Ohio income tax liability, this means that the investment expenses are included in Ohio Taxable Income (OTI).

The bill would provide an Ohio deduction for one form of these investment expenses, namely interest expenses on margin accounts. In estimating the revenue loss from this deduction, LBO has relied on federal tax data (from the IRS, Statistics of Income Division) on investment expenses. The federal data does not break down investment interest expense into margin interest and other types of interest expense. We assume that most of the investment expense interest is from margin interest.

LBO has estimated Ohio filers and amounts using federal tax data from tax year 1996, as provided by the IRS, Statistics of Income (SOI) division. That year, an estimated 64,360 taxable Ohio returns claimed $375.27 million in investment interest expense. LBO estimates that the total revenue loss from a deduction in that year would have been $26.4 million. The estimate is summarized in the table below. Note that 78% of the tax benefit goes to taxpayers with incomes above $200,000.

Estimated Ohio Revenue Loss, Tax Year 1996 Data

OTI Class	# taxable returns	amount deducted	tax rate	revenue loss
$0-$5,000	156	$535,692	0.743%	$3,980
$5,000-$10,000	608	$1,008,051	1.486%	$14,980
$10,000-$15,000	927	$1,295,062	2.972%	$38,489
$15,000-$20,000	1,289	$3,144,256	3.715%	$116,809
$20,000-$40,000	5,925	$10,946,163	4.457%	$487,870
$40,000-$80,000	16,692	$26,426,056	5.201%	$1,374,419
$80,000-$100,000	7,950	$17,570,333	5.943%	$1,044,205
$100,000-$200,000	15,311	$39,748,687	6.900%	$2,742,659
$200,000 and above	15,500	$274,598,628	7.500%	$20,594,897
Total	64,360	$375,272,928		$26,418,309

Based on recent SOI data, and considering the boom in stock purchasing that has taken place over the last couple of years, LBO assumes that these amounts have grown by 10% annually since tax year 1996. In that case, the estimated revenue losses for tax year 1999 (FY 2000) and tax year 2000 (FY 2001) would be $35.2 million and $38.7 million, respectively. Since capital gains have been growing much more quickly than 10% per year, this assumed growth rate may be too low.

The state GRF will absorb 89.5% of the annual revenue loss, with the three local government funds absorbing the other 10.5%. The table below shows the estimated losses by fund, by fiscal year.

Revenue Losses by FY, by Fund

	FY 2000	FY 2001
GRF	$31.47	$34.62
LLGSF	$2.00	$2.20
LGF	$1.48	$1.62
LGRAF	$0.21	$0.23
Total	$35.16	$38.68

LBO assumes that the number of filers taking the deduction has grown by only 5% annually (i.e. the average deduction per filer is increasing), so that in tax year 1999 approximately 74,500 Ohio filers would claim the deduction, and in tax year 2000 the figure would be approximately 78,200.

The Department of Taxation's ***Tax Expenditure Report*** for FY 2000-2001 shows only 4 deductions or exemptions that cause an annual revenue loss in excess of $1 million. To put the revenue loss from the proposed margin interest deduction in perspective, we have compared it to the other 4 exemptions or deductions. The margin interest deduction would result in a loss much smaller than the losses from the personal exemption or the social security and railroad retirement deduction, but much larger than the exemption of disability income ($12.3 million in FY 2000 and $13.0 million in FY 2001), or the health insurance deduction for the self-employed ($6.9 million in FY 2000, $7.7 million in FY 2001).

❑ *LBO staff Frederick Church, Senior Economist*

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