Fiscal Note & Local Impact Statement

127 th General Assembly of Ohio

Ohio Legislative Service Commission
77 South High Street, 9th Floor, Columbus, OH 43215-6136 ✧ Phone: (614) 466-3615
✧ *Internet Web Site:* http://www.lsc.state.oh.us/

BILL: **H.B. 304** DATE: **November 6, 2007**

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

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Excludes from income taxation discharges of indebtedness attributable to canceled residential mortgage obligations**

State Fiscal Highlights

STATE FUND	FY 2008	FY 2009	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	Potential loss of $80.2 million or more	Potential increase in loss
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2007 is July 1, 2006 – June 30, 2007.

- The bill authorizes a taxpayer to exclude income recognized for taxable years 2008 through 2012 under the Internal Revenue Code arising from the discharge, in whole or in part, of indebtedness secured by a first mortgage on the taxpayer's principal residence. No deduction is allowed for the discharge of second or inferior mortgages or "home equity" loans.
- The income tax deduction for canceled mortgages as proposed is estimated to reduce income tax revenue by approximately $85.2 million at the current level of foreclosures in Ohio. Based on the formula enacted in H.B. 119 of the 127th General Assembly, the General Revenue Fund would bear 94.1% of the revenue loss.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2008	FY 2009	FUTURE YEARS
Counties, municipalities, townships, and libraries (LGF, LLGSF)			
Revenues	- 0 -	Potential loss of $5.0 million or more	Potential increase in loss
Expenditures	- 0 -	- 0 -	- 0 -
School Districts			
Revenues	- 0 -	Potential loss of $4.7 million or more	Potential increase in loss
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.

- The bill authorizes a taxpayer to exclude income recognized for taxable years 2008 through 2012 under the Internal Revenue Code arising from the discharge, in whole or in part, of indebtedness secured by a first mortgage on the taxpayer's principal residence. No deduction is allowed for the discharge of second or inferior mortgages or "home equity" loans.

- The income tax deduction for canceled mortgages as proposed is estimated to reduce income tax revenue by approximately $85.2 million at the current level of foreclosures in Ohio. Based on the formula enacted in H.B. 119 of the 127th General Assembly, the Local Government Fund (LGF) would bear 3.68% of the revenue loss and the Library and Local Government Support Fund (LLGSF) would bear 2.22% of the revenue loss.

- School district income tax revenue would be reduced due to a reduction in the tax base. An approximate calculation has been made based on the estimated share in the tax base for the school districts levying an income tax and the average school district income tax rate.

Detailed Fiscal Analysis

H.B. 304 excludes from the Ohio income tax the amounts of canceled residential mortgage loans that have been included as income under federal adjusted gross income. Indebtedness on the taxpayer's principal residence is eligible only to the extent it is from a first mortgage, i.e., it does not include discharge of a second or inferior mortgage or home equity loans. The qualifying amount for the deduction shall not exceed the difference between the outstanding principal amount of indebtedness on the taxpayer's principal residence immediately before the discharge and the sum of net sales proceeds of the real property and outstanding principal amount of any other indebtedness secured by the principal residence. The tax deduction is authorized for taxable years 2008 through 2012.

Estimation of income tax revenue loss

Using some broad parameters and some assumptions, an attempt was made to estimate the fiscal impact of the bill. Main sources of the data used in these estimations are the Mortgage Bankers Association, Federal Reserve Bank publications, and some other commercial and industry sources.

At the end of the second quarter of 2007, residential loans for one to four family unit housing at commercial banks in Ohio were $318 billion[1] and single family first mortgage loans at savings and loan associations were $27 billion,[2] yielding a total of $345 billion in mortgage loans in Ohio. At a 3.6% foreclosure rate,[3] the value of foreclosed loans is estimated as $12.4 billion. Assuming an average price of $150,000 yields an estimated 82,870 borrowers facing foreclosure. If 75% of the value of the house is recovered in resale and the remaining 25% is considered forgiven debt, then the estimated amount of deduction from the Ohio income tax base is $3.1 billion. Applying an average effective income tax rate of 2.741% yields an estimated revenue loss of $85.2 million.

[1] Federal Deposit Insurance Corporation (FDIC), *Statistics on Depository Institutions*, June 30, 2007.
[2] Office of Thrift Supervision, *Interest Rate Risk Exposure Report*, June 18, 2007.
[3] Mortgage Bankers Association.

This estimated revenue loss is likely to be affected by the following factors, thus rendering it difficult to be more accurate. The amount of discharge of indebtedness could be higher or lower due to the uncertainty of the resale price for these foreclosed homes, if they are resold at all. According to industry sources, existing nondelinquent mortgage loans that are on an adjustable rate basis may soon become due for resetting at higher interest rates. Many of these borrowers may find their loans slip into past-due stage and some percentage of such loans could be added to foreclosed categories in the future.[4] Further, with house prices declining, current borrowers may not have much equity left in their homes to support enhanced mortgage payments, and such home price declines will increase the share of forgiven loans in foreclosed homes.

However, some of the borrowers might be able to negotiate some interim relief from their lenders and thus may not lose their homes in foreclosure. Lower income groups among these borrowers will owe less income tax due to lower income tax rates (than the average rate of 2.741% considered here). Hence, the revenue loss would be lower than estimated to that extent.

LSC fiscal staff: Isabel Louis, Economist

HB0304IN.doc/lb

[4] The delinquency rate in Ohio (past due loans, a precursor for foreclosures) shows increase as per MBA reports. The rate increased from 5.9% of all outstanding residential mortgage loans in last quarter of 2006 to 6.7% in first quarter of 2007.