Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: H.B. 277 of the 128th G.A. **Date**: August 12, 2010

Status: As Introduced **Sponsor**: Reps. Snitchler and Jordan

Local Impact Statement Procedure Required: Yes

Contents: Authorizes a $2,400 state and school district income tax withholding credit for an employer that hires and employs a previously unemployed individual

State Fiscal Highlights

STATE FUND	FY 2010	FY 2011	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	- 0 -	Potential loss of several hundred millions of dollars, spread over more than one fiscal year
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2010 is July 1, 2009 – June 30, 2010.

- The bill creates a $2,400 subsidy per qualifying employee to Ohio employers, which decreases revenues from the personal income tax. The General Revenue Fund would bear 94.1% of the revenue loss under permanent law.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2010	FY 2011	FUTURE YEARS
Counties, municipalities, libraries, school districts, LGF, and PLF			
Revenues	- 0 -	- 0 -	Potential loss of several tens of millions of dollars, spread over more than one fiscal year
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.

- State GRF tax receipts are distributed under permanent law in part to the Local Government Fund (LGF, 3.68%), and the Public Library Fund (PLF, 2.22%). Thus, the reduction in revenues from the personal income tax from the bill reduces distributions to these funds.
- The reduction in school district income tax receipts may reduce revenue to schools, if those shortfalls are not reimbursed by the state.

Detailed Fiscal Analysis

The bill provides a state and school district income tax withholding credit of $2,400 per worker to employers who hire qualifying unemployed workers between January 1, 2010, and January 1, 2011. The credit would be deducted from withholding taxes required to be remitted by the employer. For an employer to be eligible for the credit, the worker must have been unemployed for the four consecutive weeks immediately preceding the date of hire, must remain with the employer for 24 months, and be paid compensation equal to or more than the average unemployment compensation paid to persons receiving unemployment compensation. The bill does not require the new employee to have been receiving unemployment benefits.

Under current law, an employer is generally required to deduct and withhold state income taxes from an employee's compensation, and remit to the state amounts withheld from the employee's pay. The amount withheld depends on the employee filing status, income level, and the number of exemptions declared by the employee to the employer. When the employee files an individual income tax return, those amounts are counted toward the payment of the employee's individual income tax liability. The withholdings may be more or less than the taxpayer's income tax liability, which results in a tax refund or additional tax due with the tax return. The bill does not specify whether employees are considered to have paid the share of the income tax withholding not remitted for purposes of their annual state or school district income tax return.

Fiscal analysis

Unlike other tax credits that are applied against a specific tax liability incurred by an employer, the bill creates a $2,400 employer subsidy per employee based on the employee's individual state and school district income tax withholdings that an employer is required to remit to the state.[1] LSC is unable to determine the fiscal cost of H.B. 277 precisely, but the potential one-time revenue loss may be up to $1.52 billion and may be realized over several fiscal years. The bill may reduce state revenue starting in FY 2012, due to the 24-month employment requirement. Revenues from GRF taxes, such as the state personal income tax, are distributed to the General Revenue Fund (GRF, at 94.1%), the Local Government Fund (LGF, 3.68%), and the Public Library Fund (PLF, 2.22%). Therefore, the reduction in personal income tax withholdings would reduce distributions to all three funds. The GRF revenue loss would be up to $1.43 billion, the LGF revenue loss would be up to $55.8 million, and the PLF revenue loss would be up to $33.7 million.

As of January 2010, 178 school districts levy an income tax. Based on the revenue loss estimate for the state personal income tax above, the revenue loss from the school districts may be up to $53.2 million.

[1] For a number of employees, the subsidy will be larger than their income tax withholdings.

Estimation

The revenue effects of the bill are uncertain, depending on the pace of economic recovery during calendar year (CY) 2010. New hires are from a pool that may include new entrants in the workforce, workers re-entering the workforce, and unemployed workers. The number of new hires could be as high as 1.75 million in CY 2010, based on a private employment forecast of about 4.3 million by the national forecasting firm Global Insight[2] and an annual hire rate of 0.407 derived from data from the Job Opening and Labor Turnover Survey (JOLTS) of the U.S. Bureau of Labor Statistics (BLS). JOLTS provides regional and national hire rates as a percentage of employment and this fiscal note uses the 2008 annual hire rate for the Midwest. This estimate is dependent on changes in total employment and the number of new hires. Of the estimated number of hires, credit-eligible hires would be about 1.14 million, based on 65% of total unemployed persons being without work for at least five weeks from BLS data on the duration of unemployment.[3] Multiplying the number of credit-eligible hires by the credit amount yields initial credits of $2.73 billion. The total amount of potential credits would increase if the hire rate is higher than assumed above. Please note that the number of new hires specifically induced by the new tax credit would be difficult to ascertain (because they probably cannot be distinguished from hires that would have been made in any case).

The number of annual hires may appear unreasonably large relative to the total number of unemployed Ohioans at any particular point in time (for example, 625,000 in June 2010). Even during recessions, businesses continue to hire and fire employees, and the number of unemployed results, in part, from that churn. For example, a person could be employed one month, unemployed the next, quit looking for work for a while, and be hired again several months later. As noted before, some workers may be hired upon entering or re-entering the workforce, without having been counted as unemployed. The upper bound of the amount of initial credits could actually be as high as $2.73 billion therefore, but it is possible that the bill may yield actual tax credits well below that level.

H.B. 277 requires the newly hired workers to remain with the employer for 24 months before the worker can qualify the employer for the tax credit. A share of newly hired workers will not qualify for the withholding income tax credit, because they may not remain two years with the same employer. This provision of the bill adds another layer of uncertainty to the estimate. In 2008, the total quit rate (voluntary and involuntary separations) was 25.5%, according to BLS. Assuming 25.5% of hires will leave credit-eligible employers each year decreases the potential revenue loss from the

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[2] January 2010 Forecast.

[3] This is the average of duration of unemployment between 2000 and 2009. The share of total unemployed persons with at least five weeks of unemployment varied from 55.1% (2000) to 77.8% (2009).

bill to up to $1.52 billion. Any excess income tax withholding credits may be deducted from undeposited withholding taxes for subsequent withholding periods until fully utilized. This fiscal note assumes that all available credits will be realized. Realized tax credits are likely to differ from one employer to another based on the number of qualifying employees and their compensations. Among qualifying employees may potentially be former employees that were laid off and rehired by the same employers. The proposed bill requires the employer to use a federal system, "E-verify" to verify the lawful employment eligibility of an employee on the basis of whom the credit is claimed. This provision may limit the supply of workers available to employers, but is not likely to affect the fiscal cost of the credit.

Indirect effects

Assuming that the bill induces hiring that would not have taken place otherwise, the bill potentially reduces the number of unemployed persons, the duration of unemployment for certain employees, and the amount of unemployment compensation claims. Thus, the bill potentially reduces state expenditures for unemployment benefits and, possibly, increases other state taxes. However, LSC cannot estimate this decrease in expenditures or possible additional revenues. Also, estimating the magnitudes of such indirect effects is, in general, outside the scope of LSC fiscal notes. The number of new hires specifically induced by the new tax credit would be difficult to ascertain because they probably cannot be distinguished from hires that would have been made regardless of the tax credit. Also, some firms may respond to the tax credit by laying off and then rehiring the same workers. These behavioral responses to the subsidy cannot be estimated.

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