Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: Sub. H.B. 365 of the 129th G.A. **Date**: February 27, 2012

Status: As Passed by the House **Sponsor**: Rep. Beck and Dovilla

Local Impact Statement Procedure Required: No (Corrected after initial review)

Contents: To reduce the enhanced federal depreciation add-backs under the personal income tax, based upon withholding growth

State Fiscal Highlights

STATE FUND	FY 2012	FY 2013	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	Loss between $1.1 million and $4.3 million	Annual revenue loss for two more years followed by an annual revenue gain for three years up to an amount that offsets the FY 2013-FY 2015 revenue losses
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.

- Reducing enhanced federal income tax depreciation add-backs to Ohio adjusted gross income (OAGI) would reduce annual GRF revenues between $1.1 million and $4.3 million for FY 2013-FY 2015. Beginning in FY 2016, the bill increases GRF revenues for three years up to an amount equal to the FY 2013-FY 2015 revenue loss. The LSC estimate assumes no change in federal law regarding enhanced depreciation allowances as it exists on the date of this fiscal note.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2012	FY 2013	FUTURE YEARS
Counties, municipalities, townships, and public libraries (LGF and PLF)			
Revenues	- 0 -	- 0 -	Annual revenue losses up to $127,000 through FY 2015 followed by annual revenue gains up to $127,000 for three years through FY 2018
Expenditures	- 0 -	- 0 -	- 0 -
School districts that levy a school district income tax (SDIT)			
Revenues	- 0 -	Loss between $25,000 and $99,000	Annual revenue losses up to $99,000 through FY 2015 followed by annual revenue gains up to $99,000 for three years through FY 2018
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.

- Reducing enhanced federal income tax depreciation add-backs to OAGI for FY 2013 would reduce Local Government Fund (LGF) and Public Library Fund (PLF) revenues up to $127,000 per year for two years once the FY 2012-FY 2013 biennium ends. From FY 2015-FY 2018, the LGF and PLF would gain up to $127,000 per year. The maximum LGF and PLF net revenue gain over the five-year period would not exceed $0.1 million.
- The reduced add-backs to OAGI will reduce the tax base for the majority of the Ohio school districts that levy a school district income tax (SDIT) for tax years (TY) 2012-2014, but increase the tax base in each of the following three tax years. The annual revenue loss in those first three years will be approximately offset by annual revenue gains in TY 2015-TY 2017. Presently, 152 school districts levy an SDIT where OAGI serves as the tax base, and approximately 11.4% of Ohio's taxable income is attributable to one of these 152 school districts.

Detailed Fiscal Analysis

H.B. 365 allows business owners that pay the personal income tax and increase Ohio withholding by at least 10% to reduce the amount of the enhanced depreciation expenses that businesses must add back to their Ohio adjusted gross income (OAGI) beginning in tax year (TY) 2012.[1] There are two forms of the enhanced allowances: "bonus depreciation" and "enhanced expensing."

Current law requires that five-sixths of enhanced depreciation expenses be added back to OAGI in the tax year claimed on the federal return, and allows one-fifth of that amount to be subtracted from OAGI over the subsequent five years. The effect is to spread out over six years the revenue effects of federal bonus depreciation on state revenues. H.B. 365 would spread the revenue effects over three years for taxpayers that increase withholding by at least 10%, and the entire state revenue effect would be concentrated in a single year if the taxpayer increases withholding by an amount greater than or equal to its enhanced depreciation expenses. By increasing withholding at least 10%, the business is expediting its state tax benefits over a shorter time period, but the business does not receive a net benefit over the six-year horizon. Essentially, the business reduces the required add-back amount in the initial year(s), decreasing taxes paid for one to three years (depending on increase in withholding) and effectively increasing taxes paid in the latter years of the six-year horizon. This condensed three-year (or one-year) horizon begins in the earliest occurring year that a federal and Ohio net operating profit exists.

The bill's newly created adjustment applies to individuals, estates, and trusts that own all or a share of a sole proprietorship, partnership, S corporation, limited liability company, or other form of pass-through entity that withholds employees' Ohio income taxes.

The federal government enacted the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," which contained a temporary extension of multiple tax incentives. The enhanced depreciation deduction in this federal legislation serves as an incentive for businesses to invest in depreciable assets.

Separately, H.B. 365 adds clarity to state law for certain taxpayers claiming one-fifth depreciation deductions under current law. Specifically, a taxpayer that incurs a net operating loss (NOL) may claim the deduction in the first year in which the owner's depreciation allowances do not result in or increase the business's net operating loss.

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[1] Ohio personal income taxpayers are required to disclose the amount of their five-sixths adjustments for IRC section 168(k) and 179 depreciation expense on Schedule A of their individual income tax return. Neither the commercial activity tax nor the corporate franchise tax requires taxpayers to add back these enhanced depreciation allowance amounts.

The bill applies this same guiding philosophy prospectively to taxpayers that claim deductions corresponding with the reduced add-back authorized by H.B. 365.

This clarifying provision codifies guidance from the Tax Department, which disseminated its position to taxpayers through its web site. The guidance precluded taxpayers from filing amended returns to claim this adjustment for tax years prior to 2011. However, it stated that one-fifth foregone deductions whose corresponding five-sixths add-back occurred in TY 2006 and thereafter may be taken on the 2011 and subsequent tax returns. Accordingly, the NOL provision does not have a fiscal effect because it codifies current departmental practice. H.B. 365 would affect only taxable years beginning in TY 2012 and subsequent years when the federal enhanced depreciation provisions are in effect.

Fiscal effect

Given data limitations, it is impossible to estimate the annual revenue effect from the bill precisely. However, the bill is approximately revenue neutral over the six-year period beginning in FY 2013. Data limitations prevent LSC staff from providing an estimate of the most likely outcome within the ranges of FY 2013 revenue losses shown. The LSC estimate assumes no change in federal law[2] regarding enhanced depreciation allowances as it exists on the date of this fiscal note.

Public data sources enable LSC to estimate the aggregate impact of enhanced depreciation adjustments to OAGI. The Joint Committee on Taxation (JCT) is a nonpartisan committee of the United States Congress that prepares official revenue estimates of all tax legislation considered by Congress. In using their federal revenue estimates for the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," LSC estimated (see Table 1) the Ohio taxpayers' share of the most recent federal tax provision for enhanced federal depreciation allowances.

Some of the federal incentives expire at the conclusion of TY 2011 whereas others expire at the conclusion of TY 2012. JCT presented their estimates by federal fiscal year, and LSC converted the JCT estimate into state fiscal years. Table 1 separately displays the impact of federal tax provisions expiring at the close of TY 2011 in state FY 2012 and the impact of provisions expiring at the end of TY 2012 in state FY 2013. Because H.B. 365 specifies that its provisions begin in TY 2012, the bill will not affect state revenues for FY 2012. H.B. 365 would affect only taxable years that include its effective

[2] Because H.B. 365 amends the Revised Code, any change to federal law that enacts enhanced depreciation allowances for a future year would have a wholly separate state fiscal effect than what is contained in this fiscal note. The outcome of a future change would likely be a revenue loss to state and local governments in the first one to three years that is offset by revenue gains in subsequent years.

date and subsequent years when the federal enhanced depreciation provisions are in effect.

Table 1. Estimated Impact of Federal Enhanced Depreciation on Ohio Taxpayers ($ in millions)			
Federal Fiscal Year	**2011**	**2012**	**2013**
JCT Revenue Estimate (*source: JCX-54-10*)	(55,430.0)	(58,224.0)	315.0
Estimated Impact on Federal Taxable Income	(165,462.7)	(173,803.0)	940.3
Estimated Impact on Ohio Taxpayers' Incomes	(992.8)	(1,042.8)	5.6
State Fiscal Year	**2011**	**2012**	**2013**
Estimated Impact on Ohio Taxpayers' Incomes	N/A	(1,514.2)	(518.6)

Federal provisions expiring at the end of TY 2012 will impact Ohio tax returns for six years because Ohio requires taxpayers to spread the immediate federal tax reductions in equal parts across six years. If H.B. 365 were enacted, the maximum GRF share of the total revenue loss for the expiring federal provisions would be up to $4.3 million in FY 2013-FY 2015. From FY 2016 through FY 2018, the annual GRF revenue gain would be up to the FY 2013-FY 2015 revenue loss. This maximum revenue loss estimate for FY 2013-FY 2015 implies that the marginal income being added back to taxpayers OAGI would be taxed at a 5% rate, which reflects the assumption that these employers' marginal incomes are sourced in the upper tax brackets.

The maximum revenue loss assumes 10% withholding growth in TY 2012 enables the majority of taxpayers who claim the enhanced federal depreciation allowances to condense their state tax treatment into three years rather than six. Although unlikely, LSC only has access to public data and can only utilize aggregated figures for Ohio taxpayers. LSC does not know of any data sources or research materials that state how much withholding growth occurs once an employer takes advantage of these federal tax incentives. It is not out of the question to establish a range whereby the actual cost is assumed to be between 25% and 100% of this maximum revenue loss.

Local Government Fund and Public Library Fund

Receipts from the personal income tax are deposited into the GRF. Under permanent law, a portion of GRF tax receipts are subsequently transferred to the Local Government Fund (LGF) and the Public Library Fund (PLF). Am. Sub. H.B. 153 (the operating budget act for FYs 2012 and 2013) fixed the LGF and PLF transfer amounts at predetermined levels so that any increase (or decrease) in tax receipts during the biennium will affect the GRF only. For FY 2014 and subsequent years, transfers to the LGF and PLF will resume based on a fixed percentage, but the applicable percentage is not yet known. The Tax Commissioner will determine, by July 5, 2013, the ratio of FY 2013 transfers to the respective funds to total FY 2013 GRF tax revenues. Subsequent transfers to the LGF and PLF will be based on those respective ratios. The net revenue

gain to the local government funds on account of H.B. 365, which is predicated upon the maximum net revenue gain for the Ohio income tax over the five-year period from FY 2014 through FY 2018, would be indeterminable for future biennia, but likely no more than $127,000. The annual revenue losses in FY 2014-FY 2015 would be offset, if not exceeded, by revenue gains from FY 2016-FY 2018.

School district income tax

School district income taxes (SDIT) are based on either Ohio taxable income (OTI) of taxpayers residing in the school district or on the portion of that income that is earned income, generally limited to wages and self-employment income. School boards and voters of individual school districts choose whether to enact income taxes in their districts and which of these two tax bases to use. For school districts in which OTI serves as the starting point for calculation of school district income taxes, the reduction in OAGI will reduce OTI and the school district income tax revenues derived from Ohio taxable income. Presently, 152 school districts levy an SDIT where OTI serves as the tax base, and approximately 11.4% of Ohio's taxable income is attributable to taxpayers in one of these 152 school districts. During FY 2010, school districts raised $250.6 million through school district income taxes where OTI serves as the tax base. The amount of the local revenue reduction for each respective school district depends on the number (if any) of employers in that district that utilize the tax incentives in H.B. 365. The maximum revenue loss to school districts for FY 2013-FY 2015, which is predicated upon the maximum revenue loss for the Ohio income tax, would be no more than $99,000 per year. The SDIT would receive an annual revenue gain from FY 2016-FY 2018 up to the FY 2013-FY 2015 loss.

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