Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: H.B. 365 of the 129th G.A. **Date**: December 6, 2011

Status: As Introduced **Sponsor**: Reps. Beck and Dovilla

Local Impact Statement Procedure Required: Yes

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	Loss between $3.2 million and $12.6 million	Loss between $4.2 million and $16.9 million	Annual revenue loss between $1.0 million and $16.4 million where total seven-year revenue loss would not exceed $99.5 million
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 GRF revenues between $3.2 million and $16.9 million per year for the FY 2012-FY 2013 biennium. Beginning in FY 2014, the bill reduces GRF revenues between $1.0 million and $16.4 million per year through FY 2018. The maximum GRF revenue loss over seven years would not exceed $99.5 million.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2012	FY 2013	FUTURE YEARS
Counties, municipalities, townships, and public libraries (LGF and PLF)			
Revenues	- 0 -	Loss, potentially up to $500,000	Loss, potentially up to $500,000 annually
Expenditures	- 0 -	- 0 -	- 0 -
School districts that levy a school district income tax (SDIT)			
Revenues	Loss between $72,000 and $288,000	Loss, potentially up to $386,000	Loss, potentially up to $386,000 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.

- Reducing enhanced federal income tax depreciation add-backs to OAGI would reduce Local Government Fund (LGF) and Public Library Fund (PLF) revenues up to several hundred thousands of dollars per year once the FY 2012-FY 2013 biennium ends. The maximum LGF and PLF revenue loss over seven years would not exceed $2.1 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). 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. The maximum SDIT revenue loss over seven years would not exceed $2.3 million.

Detailed Fiscal Analysis

H.B. 365 allows business owners that pay the personal income tax and increase Ohio withholding to reduce the amount of the enhanced depreciation expenses that businesses must add back to their Ohio adjusted gross income (OAGI).[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 reduce the required add-back amount in the initial year, decreasing taxes paid that year and effectively increasing taxes paid in the following five years, but leaving an overall reduction in state revenues. The "adjusted" add-back amount cannot be a negative amount.

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.

Fiscal effect

Given data limitations, it is impossible to estimate the revenue loss from the bill precisely. The fiscal note provides an estimate for the maximum revenue loss, but it is highly unlikely that the maximum revenue loss will occur. Data limitations prevent LSC staff from providing an estimate of the most likely outcome within the ranges of revenue losses shown.

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

[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.

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 tax year (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.

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)

Each set of expiring provisions 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. The maximum GRF share of the total revenue loss for all expiring provisions would be $99.5 million between FY 2012 and FY 2018. The federal provisions expiring in TY 2011 would not exceed $75.7 million in total personal income tax revenue losses, and the provisions expiring in TY 2012 would not exceed $25.9 million in foregone state revenue. These maximum revenue loss estimates imply 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 that growth in withholding reduces the depreciation add-back amount to $0 for all taxpayers who claim the enhanced federal depreciation allowances. 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 the 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 revenue loss to the local government funds on account of H.B. 365, which is predicated upon the maximum revenue loss for the Ohio income tax, would be indeterminable for future biennia, but likely no more than $500,000 per year.

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, which is predicated upon the maximum revenue loss for the Ohio income tax, would be no more than $386,000 per year.

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