Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: Sub. H.B. 510 of the 129th G.A. **Date**: May 16, 2012

Status: As Passed by the House **Sponsor**: Rep. Amstutz

Local Impact Statement Procedure Required: Yes

Contents: Eliminates the corporation franchise tax and the dealers in intangibles tax and creates the financial institutions tax

State Fiscal Highlights

STATE FUND	FY 2013	FY 2014	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	Potential loss from the elimination of the corporate franchise tax and the dealers in intangibles tax Potential gain from the new financial institutions tax	Loss from the elimination of the corporate franchise tax and the dealers in intangibles tax Gain from the new financial institutions tax
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 eliminates the corporation franchise tax (CFT) and the dealers in intangibles tax (DIT) at the end of 2013, and replaces both taxes with a new tax, the financial institutions tax (FIT), in tax year (TY) 2014. The bill specifies tax revenue targets of $200 million for the FIT in FY 2014, and another revenue target of $191 million or $212 million in FY 2016, depending on potential rate adjustments based on actual revenues in FY 2014. Receipts from the proposed FIT, similarly to those of the CFT and the DIT, will be deposited in the GRF.
- If tax revenue targets are not achieved in FY 2014, or in FY 2016, the bill includes rate adjustment mechanisms to increase or decrease receipts in future fiscal years to certain levels specified in the bill.
- Taxpayers currently paying the DIT would generally be taxed under the commercial activity tax (CAT). This provision will increase revenue from the CAT. In FY 2013 and subsequent years, 50% of receipts from the CAT are deposited in the GRF, 35% in the School District Tangible Property Tax Replacement Fund (Fund 7047) and 15% in the Local Government Tangible Property Tax Replacement Fund (Fund 7081).

- Overall, the bill may decrease GRF revenue by an uncertain amount, though the revenue loss may be up to $30 million per year, when compared to the introduced version of the bill.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2012	FY 2013	FUTURE YEARS
Counties, municipalities, townships, public libraries, and other local governments			
Revenues	- 0 -	- 0 -	Loss from the elimination of the corporate franchise tax and the dealers in intangibles tax Gain from the new financial institutions tax
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 would have no effect on local governments if the FIT produces revenues equal to amounts the CFT and the DIT would have provided. Alternatively, if revenues from the FIT are lower than combined CFT and DIT receipts, local governments may experience a decrease in distributions of tax receipts from the GRF.
- The taxation of dealers in intangibles under the CAT will increase GRF revenues from this tax source. However, the elimination of the DIT will decrease GRF revenues by a much larger amount, so net GRF revenue will decrease. This would reduce distributions of GRF revenues to local governments.
- Under permanent law, a share of GRF tax receipts is transferred to the Local Government Fund (LGF) and the Public Library Fund (PLF). For FY 2014 and subsequent years, the Tax Commissioner will determine, by July 5, 2013, transfers to the LGF and the PLF.

Detailed Fiscal Analysis

The bill enacts a new financial institutions tax (FIT) for firms that are currently subject to the corporation franchise tax (CFT), eliminates the dealers in intangibles tax (DIT), and imposes the commercial activity tax (CAT) on dealers in intangibles. Receipts from both the CFT and the DIT are credited to the GRF. The CFT is imposed on financial institutions, bank holding companies, financial holding companies, savings and loan holding companies, and certain affiliates of those firms. It is levied at a rate of 1.3% (13 mills) on a firm's net worth (capital, surplus, undivided profits, and apportioned on the basis of various business presence factors, and excluding certain items such as goodwill, appreciation, and abandoned property). The DIT is levied on a dealer's shares of stock and capital at a rate of 0.8% (8 mills). The bill terminates the CFT at the end of 2013, and essentially replaces the CFT with the FIT, which would first apply to tax year (TY) 2014. Similarly, the bill terminates the DIT and levies on most of those taxpayers the CAT, starting in TY 2014, though certain DIT affiliates of financial institutions may be taxed under the new FIT. LSC's bill analysis provides more details on the various provisions of the bill.

FIT taxpayers

The bill defines financial institutions for the purposes of the FIT as either bank organizations or holding companies of bank organizations. Bank organizations are the same classes of institutions (described above) that are currently subject to the CFT. Credit unions, insurance companies, and institutions organized under the Federal Farm Loan Act (or a successor), which are not subject to the existing CFT, will not be subject to the new tax. The bill exempts diversified savings and loan holding companies, and grandfathered unitary savings and loan companies from the FIT.[1] The FIT extends the taxation of financial institutions to noncorporate forms of business organizations.

FIT tax base, tax rates, and estimated revenue

The bill levies the FIT on the "total Ohio equity capital" of financial institutions. The bill, however, excludes from the FIT tax base a financial institution's equity capital in noncontrolling (or minority) interests in subsidiaries that are not financial institutions. "Total Ohio equity capital" includes a financial institution's common stock, perpetual preferred stock, surplus, retained earnings, treasury stock, unearned

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[1] A diversified savings and loan holding company is a savings and loan holding company whose subsidiary savings association and related financial activities represented less than 50% of its consolidated net worth and of its consolidated net earnings for a fiscal year, as determined under federal law. A grandfathered unitary savings and loan company is a holding company that may hold only one savings and loan subsidiary and engages in a broad range of nonfinancial activities unlimited by restrictions on nonfinancial activities that, without the grandfathering, would apply under the federal Bank Holding Company Act of 1956.

employee stock ownership plan shares, that are apportioned to Ohio. Taxpayers operating in multiple states are required to apportion total equity capital in proportion to gross receipts sitused to Ohio. The apportionment of gross receipts (generally, total income without deduction for expenses) would be based on the share of the benefit from services that the taxpayer's customers receive in Ohio compared to those benefits received everywhere. For multi-state taxpayers, the physical location where the customer uses or receives the benefit of what was received is to be paramount in determining the proportion of the benefit in Ohio to the benefit everywhere. The bill lists examples of gross receipts to be used for the apportionment. (Under the CFT, the apportionment is based on a formula that includes sales (70%), payroll (15%), and property (15%); no apportionment formula applies to the DIT). The bill specifies taxpayers may request an alternative method of apportionment, if apportionment provisions in the bill do not fairly represent their business.

The FIT specifies three tax rates: a rate of 0.8% (8 mills) which applies to the first $200 million of a taxpayer's total Ohio equity capital; a rate of 0.4% (4 mills) of a taxpayer's total Ohio equity capital between $200 million and $1.3 billion; and a rate of 0.25% (2.5 mills) which applies to the amount of total Ohio equity capital in excess of $1.3 billion. (The introduction of a middle bracket potentially would reduce GRF revenue by up to $7 million, when compared to the introduced bill). The minimum FIT tax is to be $1,000. The bill specifies a first revenue target of $200 million in FY 2014, which is less than the CFT and the DIT are projected to yield. Though not exactly comparable to the previous amount, comparatively, the CFT and the DIT are projected to yield $258 million in FY 2012[2] and $257 million in FY 2013, which would each be below FY 2011 combined receipts of $277 million. (Appendix A provides reported financial institutions and DIT tax liabilities in recent years.)

Though no FY 2014 official revenue forecasts have been published, it is probable the FIT may generate GRF revenues lower in magnitude than receipts from the CFT and the DIT. It is also possible, however, that the FIT may yield revenue higher than the CFT in FY 2014, based on reported tax liabilities in most recent years.[3] The bill prescribes a tax rate adjustment mechanism if revenue from the new tax in TY 2014 (the first year the tax is levied) is more than 110% or less than 90% of $200 million. If revenue exceeds 110% of the first target tax amount or $220 million, the Tax Commissioner must decrease the tax rates for 2015 and subsequent years to the rates

[2] This includes receipts of $220 million and $38 million from the CFT and the DIT, respectively. Through April 2012, refunds have caused CFT receipts to fall $68 million below estimate, and the tax is likely to finish the year below estimate. More generally, the end of the CFT for nonfinancial corporations created large swings in fiscal years' receipts due to additional one-time receipts being collected such as in FY 2011 and refunds for taxes overpaid, such as appeared to be the case in FY 2012.

[3] Actual collections in a fiscal year vary from tax liabilities reported by taxpayers due to tax credits, tax payments that may fall into another fiscal year such as additional payments after audits, refunds from taxes overpaid, and other tax reconciliations from prior tax years.

that would have provided $220 million in receipts. If the 2014 tax rates generate less than 90% of the target tax amount or less than $180 million, the rate for 2015 for the third-tier bracket would be adjusted upward to the rate that would have raised a total of $180 million for the tax. The bill provides another test period in TY 2016, and a second target tax amount of $212 million (106% of the first target amount) for that year, or if applicable, $191 million (106% of $180 million if rates were adjusted after the first test period in TY 2014). The bill also prescribes an additional rate adjustment mechanism based on tax collections in TY 2016, to be applied starting in TY 2017. If, for the tax year beginning on January 1, 2016, the total amount of taxes collected from all taxpayers is greater than 110% of the second target tax amount, the Tax Commissioner is to decrease each tax rate in effect on January 1, 2016, by a percentage equal to the percentage by which the amount of taxes collected exceeded the second target tax amount. Alternatively, if the total amount of taxes collected from all taxpayers is less than 90% of the second target tax amount, the Tax Commissioner is to increase the tax rate for each dollar of total Ohio equity capital in excess of $1.3 billion by a percentage equal to the difference of the percentage by which the second target tax amount exceeded the actual amount of taxes collected minus 10% of the second target tax amount.

Revenue from the proposed new tax, which will commence in FY 2014, is to be credited to 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 the 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 the PLF will be based on those respective ratios. If the FIT produces receipts below revenues that the CFT and the DIT would have provided to the GRF, local governments may experience a decrease in distributions of tax revenues.

Dealers in intangibles

The bill eliminates the DIT and imposes the CAT on most dealers in intangibles. The bill authorizes a nonrefundable tax credit against the FIT for a financial institution with a dealer in intangibles in its qualifying controlled group (group of entities grouped together for purposes of the FIT). These dealers in intangibles would pay the DIT in 2014 for the preceding tax year, while paying the FIT in 2014 for TY 2014 and subsequent years.

The taxation of dealers in intangibles under the CAT will increase GRF receipts from that tax source, though all revenues from the DIT would be lost. Taxpayers with less than $150,000 in taxable gross receipts are exempt from the CAT, and those with taxable gross receipts between $150,000 and $1 million pay the minimum tax of $150. Taxpayers with taxable gross receipts above $1 million pay the CAT at a rate of 0.26%. Some dealers in intangibles are likely to be exempt from the CAT, and others will pay the minimum tax of $150. Though this provision raises CAT receipts, the loss of DIT revenues would be much larger in magnitude than any increased CAT revenue. The transfer of dealers in intangibles to the CAT may decrease GRF revenues, by an uncertain amount, but likely by several millions of dollars per year (compared to the introduced version of the bill), and potentially up to $20 million per year. In FY 2013 and future years, CAT receipts are distributed to the GRF (50%), the School District Tangible Property Tax Replacement Fund (Fund 7047, 35%) and the Local Government Tangible Property Tax Replacement Fund (Fund 7081, 15%). If distributions of CAT receipts to Funds 7047 and 7081 are insufficient for the required reimbursements to schools and other local governments, the GRF subsidizes the two funds.

FIT tax reporting

Each taxpayer must file an annual report by March 31 of the tax year. If two or more financial institutions are related by ownership or control in such a way that they are required to be included in the same report to federal regulatory authorities (e.g., the Federal Reserve Board or the Federal Financial Institutions Examination Council), they may file a FIT annual report and pay the tax as a consolidated group composed of all such institutions. Under the current CFT, individual banks or individual members of a consolidated or controlled group may file separate CFT returns.

FIT tax payments and credits

The annual tax payment is due by May 31 of the tax year. Estimated payments are due on the preceding January 31, March 31, and May 31. The January payment must equal either the minimum $1,000 tax or one-third of the estimated annual tax, whichever is greater. The March payment must equal one-half of the remaining balance of the estimated annual tax after subtracting the amount of the January payment. The remaining May payment must equal the other remaining one-half. The Tax Commissioner may extend the period of time for filing an annual report to October 15. Payments must be made by electronic funds transfer, though the bill authorizes a taxpayer to apply to the Commissioner to be excused from the requirement for good cause. The bill authorizes the following FIT credits to be claimed by taxpayers subject to the new tax: research and development, job creation, job retention, venture capital loan loss, historic building rehabilitation, New Markets, motion picture production, and the credit for regulatory assessments paid to the Department of Commerce's Division of Financial Institutions. LSC assumes existing tax credit agreements are applicable and firms currently entitled to nonrefundable credits may carry their existing credit over to the new FIT. The bill also clarifies that, for certain taxpayers, job retention tax credits must be exhausted against the CAT before they could be applied to the FIT.

Temporary CAT amnesty for certain affiliates of insurance companies

The bill provides that the Tax Commissioner shall not assess or hold liable for the failure to report or pay the CAT for any tax periods ending before January 1, 2014, a corporation or any other person directly or indirectly owned by one or more insurance companies that are subject to the domestic or the foreign insurance premiums taxes, provided the corporation, but not the other person or persons, so owned by the insurance company or companies reported and paid the CFT and not the CAT for taxable periods before January 1, 2014. This provision will reduce GRF revenue by an uncertain amount.

Municipal taxing authority

The bill specifies that municipal corporations may not levy a tax that is "the same as or similar to" the new FIT. Current law prohibits municipal corporations from levying most of the kinds of taxes the state currently levies (the income tax being the major exception). If there were no such prohibition, municipal corporations would be authorized to levy taxes under their home rule authority, without authorization from the General Assembly.

Appendix A

Financial Institutions and Dealers in Intangibles Liability, and CFT Receipts, FY 2005 through FY 2011, in millions						
Tax Year	**CFT Liability of Financial Institutions**	**Dealers in Intangibles Liability**	**Combined FI & DIT Liability**	**Fiscal year**	**Total CFT Receipts**	**Combined CFT & DIT Receipts**
2011	$172.8	$38.1	$210.9	2011	$237.2	$276.9
2010	$166.1	$40.4	$206.5	2010	$142.3	$182.7
2009	$148.1	$36.8	$185.0	2009	$521.4	$558.2
2008	$135.5	$33.7	$169.2	2008	$754.6	$788.3
2007	$149.3	$31.9	$181.1	2007	$1,125.7	$1,157.5
2006	$153.9	$30.5	$184.4	2006	$1,105.9	$1,136.3
2005	$125.0	$36.0	$161.0	2005	$1,111.6	$1,147.6

Please note financial institutions' liability for TY 2011 is very preliminary and is subject to change. Also note that fiscal years' receipts for the CFT include receipts from nonfinancial corporations from FY 2005 through FY 2009. The tax was phased out for those nonfinancial corporations in FY 2010.

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