Ohio Legislative Service Commission

Russ Keller

Fiscal Note & Local Impact Statement

Bill: H.B. 601 of the 130th G.A.

Date: August 26, 2014

Status: As Introduced

Sponsor: Reps. Beck and J. Adams

Local Impact Statement Procedure Required: Yes

Contents: Permits taxpayers to permanently continue applying certain expired federal tax provisions in calculating Ohio income tax, and declares an emergency

State Fiscal Highlights

STATE FUND	FY 2015	FY 2016	FUTURE YEARS
General Revenue Fund			
Revenues	Loss of $63.3 million or more	Loss of $34.0 million or more	Annual loss up to tens of millions of dollars
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2013 is July 1, 2012 – June 30, 2013.

- Incorporating permanent changes to Ohio Adjusted Gross Income (OAGI) that reflect recently expired Internal Revenue Code (IRC) provisions will reduce Ohio Taxable Income (OTI) for Ohio taxpayers, and reduce Ohio personal income tax (PIT) revenues. GRF revenue losses would be $63.3 million or more in FY 2015 and $34.0 million or more in FY 2016. Annual losses in future years may be up to tens of millions of dollars.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2014	FY 2015	FUTURE YEARS
Counties, municipalities, townships, and public libraries (LGF and PLF)			
Revenues	- 0 -	Loss of $2.2 million or more	Loss up to $1.2 million
Expenditures	- 0 -	- 0 -	- 0 -
School districts that levy a school district income tax (SDIT)			
Revenues	- 0 -	Potential loss up to $1.3 million	Potential loss up to $0.7 million
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 reductions to OAGI would reduce Local Government Fund (LGF) and Public Library Fund (PLF) revenues by $2.2 million or more in FY 2015, and future year losses may be up to $1.2 million.
- The reductions to OAGI will reduce the tax base for the majority of the Ohio school districts that levy a school district income tax (SDIT). Taxpayers living in these school districts have approximately 8.5% of Ohio taxable income. If tax returns from these areas claimed 8.5% of the marginal decrease in income, potential SDIT revenue losses would be up to $1.3 million beginning in FY 2015, and up to $0.7 million in future years.

Detailed Fiscal Analysis

The bill permanently incorporates expired provisions of the Internal Revenue Code (IRC) into Ohio income tax law. The expired provisions would materially change Ohio Adjusted Gross Income (OAGI). Ohio's income tax returns use OAGI to determine Ohio Taxable Income (OTI). A reduction in OAGI lowers personal income tax (PIT) receipts.

The following Ohio income tax provisions are extensions of pre-2014 IRC provisions. Federal legislation to extend these expiring provisions has not yet been authorized. H.B. 601 codifies the following income tax provisions that expired when the most recent federal temporary authority lapsed (i.e., December 31, 2013):

- Elementary and secondary school teacher deduction for previously eligible expenses;
- Qualified tuition expenses deduction;
- Exclusion of Individual Retirement Arrangement (IRA) distributions for charitable purposes;
- Increased depreciation for certain qualified leasehold improvements, restaurant property, and retail improvement property;
- Bonus depreciation deductions and enhanced expensing (separately, Ohio generally requires taxpayers to spread the immediate tax reductions from bonus depreciation and enhanced expensing in equal parts across three to six years);
- Exclusion of 100% of gain on certain small business stock;
- Basis adjustment for stock of S corporations making charitable contributions of property;
- Exclusion of discharge of principal residence indebtedness for individuals;
- Parity for exclusion for employer-provided mass transit and parking benefits;
- Adjust the cost recovery period for race horses and motorsports entertainment complexes;
- Depreciation allowance for second generation biofuel plant property;
- Deduction for energy efficient commercial buildings;
- Special expensing rules for mine safety equipment as well as qualified film or television productions; and
- Exclusion of income attributable to domestic production activities in Puerto Rico and income from an empowerment zone designation.

Fiscal effect

The permanent extensions contained in H.B. 601 were previously authorized by federal income tax law, but the federal authorization expired for tax years (TYs) beginning after December 31, 2013. The fiscal effect of H.B. 601 will begin with state taxes filed for TY 2014, which corresponds to filing periods beginning in FY 2015. Table 1 summarizes the state revenue effects of H.B. 601 for each of the next two fiscal years.

Table 1. State Fiscal Effect of Permanent Income Tax Extensions Contained in H.B. 601 (amounts in millions)		
Type of Personal Income Tax Extension	**FY 2015**	**FY 2016**
Income Tax Provisions Paid by Individuals	($18.5)	($11.9)
Income Tax Provisions Paid by Energy Businesses	($0.1)	$0
Nonbonus Depreciation Tax Provisions Paid by Businesses	($0.9)	($0.7)
Bonus Depreciation & Section 179 Tax Provisions Paid by Businesses	($45.9)	($22.6)
Total	**($65.5)**	**($35.2)**

Although H.B. 601 makes permanent those federal tax provisions that expired, the U.S. Congress has pending legislation, S. 2260, that would authorize the H.B. 601 income tax provisions for two more years through December 31, 2015. The state fiscal effect of H.B. 601 and the pending federal legislation should have similar fiscal effects for FY 2015-FY 2016, but the state fiscal effect in future years would be different because H.B. 601 makes permanent income tax changes whereas the federal legislation proposes a two-year temporary extension of expired provisions.

The Joint Committee on Taxation (JCT) estimated the federal revenue effects of the IRC extensions contained in S. 2260, the Expiring Provisions Improvement Reform And Efficiency Act Of 2014. The JCT estimates served as the basis for the Ohio fiscal effect in Table 1. All of the federal tax provisions were converted into a taxable income base using the appropriate federal tax rates. Ohio was assumed to have 4% of that tax base because Ohio's share of the nation's income is approximately 4%. Not all of the Ohio-sourced income affected by S. 2260 will be subject to the personal income tax (PIT) – some will be income to entities taxed under the Commercial Activity Tax, the Financial Institutions Tax, and other state taxes. All income tax extension provisions are assumed to have an impact on PIT, but only a fraction – 15% or less depending on the provision – of the business tax extenders are likely to impact PIT revenues (*reflecting the fact that many businesses file PIT returns as pass-through entities*).[1] Appropriate PIT rates were applied to all of the relevant Ohio-sourced income to determine the state fiscal effect in Table 1.

[1] Pass-through entities include partnerships, S corporations, joint ventures, limited liability companies, and any other business entity that is not a trust or corporation and has not elected to be classified as a C corporation.

The business tax extenders concerning bonus depreciation required a separate methodology because the Revised Code spreads the state revenue impact over a period that can be as long as six years. The fiscal effect for the bonus depreciation provisions for a given year will continue over a multi-year period because of the add-back and expensing formula specified in the Revised Code. The bonus depreciation amounts apply to property placed into service after December 31, 2013, so much of the fiscal effect will begin in FY 2015.

Finally, the extent of revenue losses identified in Table 1 is dependent on taxpayer behavior. The largest fiscal effect is attributed to bonus depreciation, and it is very difficult to predict behavioral responses to that type of incentive. If taxpayer behavior differs from that predicted by JCT, revenue losses could substantially differ from estimates.

Local Government Fund and Public Library Fund

Receipts from the personal income tax are deposited into the GRF. Under permanent law, 3.32% of GRF tax receipts are subsequently transferred to the Local Government Fund (LGF) and the Public Library Fund (PLF) in equal amounts. The combined revenue loss to the local government funds due to H.B. 601 is likely to be $2.2 million or more in FY 2015, and future year losses would be up to $1.2 million.

School district income tax

School district income taxes (SDIT) are based on either the Ohio Taxable Income (OTI) of taxpayers residing in the school district or 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 the calculation of school district income taxes, the reduction in OAGI authorized by H.B. 601 will reduce OTI and the school district income tax revenues derived from Ohio taxable income. As of January 2014, 146 school districts levied an income tax from the "traditional" tax base rather than the earned income tax base. During FY 2013, these school districts raised $277.2 million through school district income taxes. Taxpayers living in school districts with the "traditional" tax base have approximately 8.5% of Ohio taxable income. The amount of the local revenue reduction for each respective school district depends on the number (if any) of taxpayers in that district that are impacted by the OAGI changes authorized by H.B. 601. If tax returns from these areas claimed 8.5% of the OTI reduction, aggregate SDIT revenues would be reduced up to $1.3 million in FY 2015, and up to $0.7 million in future years.

Emergency clause

The bill includes an emergency provision which makes its provisions effective as soon as signed into law.

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