Ohio Legislative Service Commission

Russ Keller

Fiscal Note & Local Impact Statement

Bill: Am. S.B. 28 of the 130th G.A.

Date: March 5, 2013

Status: As Reported by Senate Ways & Means

Sponsor: Sen. Obhof

Local Impact Statement Procedure Required: Yes

Contents: Incorporates changes to the Internal Revenue Code into Ohio law, and declares an emergency

State Fiscal Highlights

STATE FUND	FY 2013	FY 2014	FUTURE YEARS
General Revenue Fund			
Revenues	Loss of $23.6 million or more	Loss of $55.3 million or more	Annual loss up to $34.6 million
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 changes to the Internal Revenue Code (IRC) into Ohio law will reduce Federal Adjusted Gross Income (FAGI) for Ohio taxpayers, and reduce Ohio revenues because FAGI serves as the starting point for determining Ohio Taxable Income. GRF revenue losses would be $23.6 million or more in FY 2013, $55.3 million or more in FY 2014. Annual losses in future years may be up to $34.6 million.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2013	FY 2014	FUTURE YEARS
Counties, municipalities, townships, and public libraries (LGF and PLF)			
Revenues	- 0 -	Loss of $1.9 million or more	Loss up to $1.2 million
Expenditures	- 0 -	- 0 -	- 0 -
School districts that levy a school district income tax (SDIT)			
Revenues	Potential loss up to $0.5 million	Potential loss up to $1.1 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 FAGI would reduce Local Government Fund (LGF) and Public Library Fund (PLF) revenues by $1.9 million or more in FY 2014, and future year losses may be up to $1.2 million.

- The reductions to FAGI will reduce the tax base for the majority of the Ohio school districts that levy a school district income tax (SDIT). As of January 2013, 147 school districts levy an SDIT where Ohio taxable income serves as the base, and approximately 8.5% of Ohio's taxable income is attributable to one of these 147 school districts. Potential SDIT revenue losses would be up to $0.5 million in FY 2013, up to $1.1 million in FY 2014, and up to $0.7 million in future years. Revenue estimates assume taxpayers affected by the changes to IRC are uniformly distributed across Ohio's taxing jurisdictions.

Detailed Fiscal Analysis

The bill incorporates changes to the Internal Revenue Code (IRC) since December 20, 2012 into Ohio income tax law. Ohio tax law incorporates by reference parts of the IRC and other federal laws. Periodic amendments to federal law do not become part of Ohio law unless they are incorporated by an act of the General Assembly. Several changes have been made to the IRC since the last time Ohio conformed to federal income tax law (Am. Sub. H.B. 472 of the 129th General Assembly), and some of the changes are estimated to have materially changed Federal Adjusted Gross Income (FAGI). Ohio's income tax returns start with FAGI, and the reduction in FAGI affects Ohio Taxable Income (OTI).

The latest assorted federal changes being incorporated are those enacted by H.R. 8, the "American Taxpayer Relief Act of 2012," which took effect January 2, 2013. Most of the foregoing provisions are extensions of pre-2013 federal provisions. Many of them are extended only for a limited period of time (i.e., through December 31, 2013). The principal amendments to federal law the bill incorporates are the following income tax provisions:

- Elementary and Secondary School Teacher Deduction;
- Qualified Tuition Expenses Deduction;
- Exclusion of IRA Distributions for Charitable Purposes;
- Increased Depreciation for Certain Qualified Leasehold Improvements, Restaurant Property, and Retail Improvement Property;
- Bonus Depreciation Deductions and Enhanced Expensing (Ohio departs from federal income tax law and 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;
- Exclusion of Discharge of Principal Residence Indebtedness for Individuals;
- Parity for Exclusion for Employer-Provided Mass Transit and Parking Benefits;

- Permanent Exclusion for Employer-Provided Educational Assistance;
- Permanent Exclusion of National Health Service Corps and Armed Forces Scholarships; and
- Permanent Exclusion for Paid Interest on Qualified Education Loans.

Fiscal effect

Many of the extensions authorized by H.R. 8 that have a state fiscal effect are scheduled to sunset December 31, 2013. Their primary fiscal effect will be on taxes filed for TY 2012 and TY 2013, which corresponds to filing periods in FY 2013 and FY 2014. Ohio's dependent care credit is identified separately because it is the only provision that is not an income exclusion; all other provisions affect FAGI. The amount of Ohio's credit is dependent on the federal dependent care credit. H.R. 8 made permanent the previous expansion of the federal dependent care credit. Table 1 summarizes the tax extensions contained in the American Taxpayer Relief Act of 2012, and their state revenue effects by fiscal year.

Table 1. State Fiscal Effect of IRC Extensions Contained in H.R. 8 and Expiring Deductions (amounts in millions)

Type of IRC Extension	FY 2013	FY 2014	Future Years
Permanent Extension of Income Exclusions	($1.8)	($9.1)	($9.6)
Permanent Extension of Dependent Care Credit Expansion	0	($8.8)	($9.0)
Temporary Individual Tax Provisions	($9.3)	($10.1)	0
Temporary Business, Non-Bonus Depreciation Tax Provisions	($2.0)	($1.0)	($0.4)
Temporary Business, Bonus Depreciation & Section 179 Tax Provisions	($10.5)	($28.3)	($16.8)
Total	**($23.6)**	**($57.3)**	**($35.8)**

The Joint Committee on Taxation (JCT) estimated the federal revenue effects of the IRC extensions contained in H.R. 8, and these 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 H.R. 8 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 individual 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 will continue beyond its two year extension 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, 2012, so much of the fiscal effect is centered in FY 2014, but the increased Section 179 expensing applies to the tax year beginning after December 31, 2011, so some fiscal effect will be reflected in FY 2013.

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, 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. At this time, LGF and PLF shares of total GRF tax receipts are estimated at 1.69% and 1.67%, respectively, during the FY 2014-FY 2015 biennium. The revenue loss to the local government funds due to S.B. 28 is likely to be $1.9 million or more in FY 2014, 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 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 FAGI will reduce OTI and the school district income tax revenues derived from Ohio taxable income. As of January 2013, 147 school districts levy an SDIT where OTI serves as the tax base, and approximately 8.5% of Ohio's taxable income is attributable to taxpayers in one of these 147 school districts. 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 IRC changes recognized for conformity by S.B. 28. Potential statewide revenue losses would be up to $0.5 million in FY 2013, up to $1.1 million in FY 2014, and up to $0.7 million in future years. These revenue estimates assume taxpayers affected by the changes to IRC are uniformly distributed across Ohio's taxing jurisdictions.

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