Fiscal Note & Local Impact Statement

124 th General Assembly of Ohio

Ohio Legislative Service Commission
77 South High Street, 9th Floor, Columbus, OH 43215-6136 ✧ Phone: (614) 466-3615
✧ *Internet Web Site:* http://www.lsc.state.oh.us/

BILL: **Am. Sub. S.B. 180**

DATE: **December 10, 2002**

STATUS: **As Enacted - Effective April 9, 2003 (Certain provisions effective November 1, 2003**

SPONSOR: **Sen. Armbruster**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Creates the Ohio Venture Capital Program to provide for the direction of moneys from loans into investments in venture capital funds secured through Program revenues and refundable and nonrefundable tax credits that may be claimed against the corporation franchise tax, the personal income tax, the domestic insurance tax or the foreign insurance tax; requires state and county taxing officials to notify local taxing authorities of pending pollution control tax exemption applications; allows certain real property taxpayers to file a complaint with the Board of Tax Appeals; prohibits municipal corporations from taxing S corporations shareholders' distributive shares of net profits; and makes changes to the job retention tax credit**

State Fiscal Highlights

STATE FUND	FY 2003	FY 2004	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	$2.5 million loss from changes to the job retention tax credit	Up to $19.0 million loss per year depending upon the amount of venture capital program tax credits granted and claimed; Annual loss from changes to the job retention tax credit increasing by $2.5 million per year to $10.0 million in FY 2007 and thereafter
Expenditures	- 0 -	Potential minimal increase	Potential minimal increase
Ohio Venture Capital Fund			
Revenues	- 0 -	Potential gain	Potential gain
Expenditures	- 0 -	- 0 -	-0-
Ohio Department of Development			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	- 0 -	Potential increase of up to $90,000	Potential increase of up to $90,000

Note: The state fiscal year is July 1 through June 30. For example, FY 2003 is July 1, 2002 – June 30, 2003.

- The bill creates the Ohio Venture Capital Authority, the Ohio Venture Capital Program, and the Ohio Venture Capital Fund in the state treasury.

- The Ohio Venture Capital Authority will establish lending and investment policies and provide for the direction of private moneys in the Ohio venture capital program investment fund. The program fund will consist of proceeds from loans acquired by the program administrator and interest earned on moneys in the fund. Loans and investments made through the Ohio Venture Capital Program will be guaranteed by moneys in the Ohio Venture Capital Fund and, if necessary, by tax credits granted to investors by the Authority.

- The Authority may grant refundable and nonrefundable corporate franchise, personal income, domestic insurance or foreign insurance tax credits to certain investors incurring specified losses in the Ohio Venture Capital Program. The General Revenue Fund receives 95.2 percent of corporate franchise tax revenues, 89.5 percent of personal income tax revenues, and 100 percent of revenues from the insurance taxes.

- The Department of Development will provide the Ohio Venture Capital Authority with space and technical assistance. This may increase yearly expenditures by about $90,000 for the Department of Development.

- The bill requires state and county officials to notify local taxing authorities of pending pollution control tax exemption applications. The Department of Taxation estimates a 5 percent increase in expenditures related to pollution control tax exemption applications, or $3,750. Currently, the Department spends approximately $75,000 a year on the Pollution Control Tax Exemption Program. ($75,000 x 5% = $3,750)

- The bill proposes to allow certain real property taxpayers to file a complaint with the Board of Tax Appeals. Due to the small number of taxpayers that would be eligible to re-file, the BTA will incur only a minimal increase in expenditures.

- The bill modifies the new job retention tax credit (Am. Sub. H.B. 405) and makes companies that invest in research and development eligible for the job retention tax credit. The bill also decreases to $100 million the minimum amount of investment required to qualify for the credit. These changes to the job retention credit will decrease revenues to the General Revenue Fund. GRF receives 95.2 percent of corporate franchise tax revenues.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2003	FY 2004	FUTURE YEARS
Counties and Local Governments			
Revenues	- 0 -	$0.1 million loss from changes to the job retention tax credit	Up to $1.0 million loss depending upon the amount of venture capital tax credits granted and claimed; Annual loss from changes to the job retention tax credit increasing by $0.1 million per year to $0.5 million in FY 2007 and thereafter.

Expenditures	- 0 -	- 0 -	- 0 –
Municipal Corporations			
Revenues	Potential loss from not taxing distributions from S Corporations	Potential loss from not taxing distributions from S Corporations	Potential loss from not taxing distributions from S Corporations
Expenditures	- 0 -	- 0 -	- 0 -
County Boards of Revisions			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	Potential Minimal Increase	Potential Minimal Increase	Potential Minimal Increase
School Districts and Other Local Governments			
Revenues	Potential Loss of Delinquent Tax Revenue	Potential Loss of Delinquent Tax Revenue	Potential Loss of Delinquent Tax Revenue
Expenditures	- 0 -	Potential decrease from tax exemption notifications	Potential decrease from tax exemption notifications

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- In the years after the current biennium, the venture capital tax credits will reduce revenues to local government funds. The Local Government Fund (LGF) receives 4.2 percent of corporate franchise and personal income taxes. The Local Government Revenue Assistance Fund (LGRAF) receives 0.6 percent of both state taxes. The Library and Local Government Support Fund (LLGSF) receives 5.7 percent of the state personal income tax.

- ***The modifications to the job retention tax credit will*** decrease corporate franchise tax revenues to the Local Government Fund (LGF) and Local Government Revenue Assistance Fund (LGRAF). LGF receives 4.2 percent and LGRAF 0.6 percent of corporate franchise tax revenues.

- The bill requires County Auditors to send notices to the various taxing authorities that would be affected by potential tax exemptions. This would have a minimal cost for county auditors' offices.

- The notices required by the bill will allow school districts and local governments to better budget their tax revenue and plan for potential repayment. The notification may also allow local taxing authorities to file an objection to the exemption before the exemption is final.

- Under the bill, tax bills will be reduced to reflect the findings of the BTA, however no refunds or credits will be issued as a result of the valuation complaints. Thus, the only potential loss of revenue is the "disputed taxes" that have not been paid, which would currently be noted as delinquent.

- The bill proposes to allow certain real property taxpayers to file a complaint with Board of Tax Appeals. When a taxpayer files such a complaint they must notify the county board of revision (BOR) in which the original complaint was filed. The BOR is responsible for notifying any person that was party to the original complaint. This could cause a minimal increase for certain county BORs.

- The bill prohibits municipalities from taxing distributions from S corporations to their shareholders. Some municipal corporations will lose an undetermined amount of revenues from this provision.

Detailed Fiscal Analysis

The Ohio Venture Capital Program

S.B. 180 creates the Ohio Venture Capital Authority (OVCA) and the Ohio Venture Capital Fund (OVCF) in the state treasury. The nine-member OVCA will implement lending and investment policies designed to advance entrepreneurship in Ohio through the Ohio Venture Capital Program (OVCP) and a designated private for-profit investment fund, which will become the Ohio Venture Capital Program's administrator. OVCA may choose up to two program administrators for its program fund. OVCA members serve without compensation, but will receive necessary expenses associated with their appointment. Seven of the members will be appointed by the Governor with the advice and consent of the Senate. The Director of Development and the Tax Commissioner will be the other members of the OVCA.

The Ohio venture capital program investment fund will borrow from investors to make loans and investments in venture capital funds for seed funding and other private ventures, primarily in Ohio. The bill requires the program administrator to provide at least 1 percent of the amount of outstanding loans to the program fund and receive a pro-rata share of net income or loss. However, the program administrator (or the fund manager employed by the program administrator) is not entitled to the security against losses. The bill specifies that 75 percent of the program fund must be invested in private for-profit venture capital funds with head offices in Ohio. Also, at least 50 percent of the program funds in any venture capital fund must be invested in Ohio-based enterprises. The bill allows the program administrator to invest in venture capital funds of funds. The bill also limits the amount of program fund money that may be invested in a single venture capital fund (or in a multitude of venture capital funds operating under the same management leadership) to $10 million. Investor (lender) losses are incurred when the program administrator is unable to timely repay a lender.

If revenues in the OVCF are insufficient, the Ohio Venture Capital Authority may grant refundable and nonrefundable personal income, corporate franchise or insurance premium tax credits to those investors that incur losses. The bill allows investors (lenders) to elect to receive either a refundable tax credit or a nonrefundable tax credit. If a lender elects a refundable tax credit, the amount refunded would be 75 percent of the amount by which the tax credit exceeds the taxpayer's tax liability. If a lender elects a nonrefundable credit, the amount of the credit would not exceed the taxpayer's tax liability. This election, once made, is irrevocable. OVCA will enter into written contracts with investors specifying conditions and loss amounts that would require the issuance of tax credits. Furthermore, OVCA will establish terms and conditions under which the Authority will extend those guarantees against losses and other measures to ensure the safety and soundness of investments under the Ohio Venture Capital Program. Tax credits granted by OVCA cannot exceed the amount of established losses incurred by investors.

The bill authorizes the issuance of refundable and nonrefundable personal income, corporate franchise, domestic insurance and foreign insurance tax credits that may be granted by OVCA to investors in the Ohio Venture Capital Program. OVCA cannot grant more than $20.0 million in tax credits in any one fiscal year. The tax credits may not be carried forward and are not transferable. ***Actual state revenue loss will depend on the amount of tax credits granted by the Authority and claims against the various taxes by investors. The Authority will not grant any credit that may be claimed in the first four years of the Ohio Venture Capital Program.***

Assuming that initial investments in seed and venture capital enterprises under the OVCP commence in FY 2004, state revenue loss from the tax credits may potentially begin in fiscal year 2009, if program revenues in the OVCF were insufficient to cover investors' losses. Ultimately, state revenue loss will depend on the success or failure of investments made under the OVCP. Seed and venture capital enterprises (particularly in "high technology") may yield high dividends but also may have a high risk of failure. If the investments are successful, the OVCF will receive at least 90 percent of "excess" revenues generated by the program administrator. "Excess" revenues are amounts by which the program fund revenues from various investments exceed the amounts required to pay principal or interest to lenders, the profit share of the program administrator, and administrative expenses incurred by the program administrator. If seed and venture capital enterprises funded under the Ohio Venture Capital Program are highly successful, there might be no need for the issuance of tax credits by the Ohio Venture Capital Authority. **However, the bill is silent on the total amount of authorized tax credits that may be issued under the Ohio Venture Capital Program. Thus, the potential total program cost cannot be determined.** Tax credits under the Ohio Venture Capital Program may not be claimed after June 30, 2026.

Potential state revenue loss may be up to $20 million per year depending on the success or failure of investments made under the OVCP and the amount of tax credits granted and claimed. The General Revenue Fund (GRF) revenue loss may be up to $19.0 million each year. The GRF receives 95.2 percent of the corporate franchise tax, 89.5 percent of the personal income tax, and 100 percent of the insurance taxes. The Local Government Fund (LGF) receives 4.2 percent of the corporate franchise and personal income taxes. The Local Government Revenue Assistance Fund (LGRAF) receives 0.6 percent of corporate franchise and personal income taxes. Revenue losses to LGF and LGRAF may be up to $0.8 million and $0.2 million, respectively.

The bill directs the Department of Development to provide the Ohio Venture Capital Authority with space and such technical assistance as required by the Authority. According to the Department of Development, this assistance will increase yearly expenditures by about $90,000 starting in FY2004.

Notification of pending pollution control property tax exemptions

Under existing law tangible property that reduces or eliminates air, noise, or water pollution is exempt from taxation. For such property to be exempted, the property owner must apply for and obtain a pollution control exemption certificate. In the case of property used for air or noise pollution control, the application must be filed with the Tax Commissioner; in the case of property used for water pollution control, the application must be filed with the Director of Environmental Protection. These officials then investigate and determine whether the property qualifies for a tax exemption. This process can sometimes be lengthy. However, regardless of when the determination is made, the tax exemption relates back to the date when the application was filed (in the case of air and noise pollution control property) or the date when the owner acquired the property or began building it (in the case of a water pollution control property). If, in the meantime, property taxes were paid for the property, the taxes must be refunded, with interest, by the various taxing authorities where the property is located.

The bill prescribes a procedure for notifying affected taxing authorities that an application for a tax exemption for a pollution control facility has been filed[1]. Generally, the notices serve to provide advance notification of the possible effects of the exemption if it is granted--particularly the potential for refunds. The procedure is initiated when an application for an exemption is filed. In the case of air and noise pollution control property, the Tax Commissioner, as soon as it is practicable to do so, must provide a copy of the application and any accompanying documents to the county auditor of the county where the facility is (or will be) located. The Commissioner must include a statement showing the estimated taxable value of the facility and the estimated taxes that would be charged on the facility if the facility were to be taxed in the year in which the application is received. In the case of water pollution control property, the Director of Environmental Protection initiates the procedure by forwarding a copy of the application to the Tax Commissioner. As soon as it is practicable to do so, the Tax Commissioner must forward the application and any accompanying documents to the county auditor of the county where the facility is (or will be) located. The Commissioner must include a statement showing the estimated taxable value of the facility, and the estimated taxes that would be charged on the facility if the facility were to be taxed in the year in which the application is received.

Within 60 days after receiving the statement from the Tax Commissioner, the county auditor must send notices to the various taxing authorities that would be affected by the tax exemption. The notices must state the following:

- That a pollution control exemption application has been filed;
- The estimated assessed value of the property;
- The annual taxes on the property (computed on the basis of current tax rates);
- That approval of the application will exempt the property from taxation and may require the taxing authority to refund taxes already paid for the property after the certificate becomes effective.

These statements and notices must be issued with respect to exemption certificate applications filed on or after the bill's effective date, and with respect to any applications received before the bill's effective date if the exemption certificate has not been issued before January 1, 2004.

If, after the original statement is issued, the estimate of the assessed value changes by 10 percent or greater, the Tax Commissioner must issue an amended notice reflecting the changes.

The bill places additional responsibilities on the Ohio Environmental Protection Agency, the Department of Taxation, and county auditors' offices. The Ohio EPA estimates this will have a minimal or no fiscal impact on the agency. The Department of Taxation estimates a 5 percent increase in expenditures related to pollution control tax exemption applications. Currently, the Department spends

[1] As used in this section, "facility" means an air pollution control facility, noise pollution control facility, energy conversion facility, thermal efficiency improvements facility, or solid waste energy conversion facility as defined in section 5709.20 or 5709.45 of the Revised Code.

approximately $75,000 a year on the Pollution Control Tax Exemption Program, thus under the bill, expenditures on the program will increase by approximately $3,750 ($75,000 x 5% = $3,750). County auditors' office would also incur additional minimal costs associated with issuing notices to the various taxing authorities affected by potential tax exemptions.

The bill has the potential to save school districts and other local governments money. The application process for tax exemptions on pollution control facilities can often span a number of years. In some cases property taxes are paid on the property to be exempted during the years the application is being considered.[2] If this is the case and the exemption is granted, school districts and local governments that received the tax revenue for the years during the application process are then required to refund the taxes with interest. While the amount of tax revenue created by the pollution controls vary greatly by industry and project, there is potential for the refunds to be in excess of $1 million. By making these local governments aware of the potential exemptions and refunds through the notification process, local taxing authorities can better budget their tax revenue and plan for potential repayment. The notification may also allow local taxing authorities to file an objection to the exemption before the exemption is final.

Filing of complaints with the Board of Tax Appeals

The bill proposes to allow certain real property taxpayers to re-file a complaint with the Board of Tax Appeals (BTA). To qualify taxpayers must meet the following three criteria: (1) the taxpayer disputes the valuation or assessment of commercial real property, (2) The complaint must previously have been made, but dismissed for lack of jurisdiction, (3) The taxpayer must not yet have paid the full taxes due on the property that relate to the complaint. Under the bill, the complaint could be filed for any tax year mentioned in the original complaint that occurred within one sexennial reappraisal period within the last 10 years. The taxpayer will have six months to file the complaint. Under the bill, when a qualifying taxpayer files a complaint he or she must also file a notice of the complaint with the county board of revision with which the original complaint was filed. When the county board of revision receives the notice, it must notify any person that was a party to any proceeding on the original complaint conducted by the board of revision, and file proof of such notices with the BTA. The taxpayer will have six months to file the complaint.

If the BTA finds the amount of taxes charged for the years to be in excess of the amount due, the county auditor will not be allowed to refund the overpayment of taxes, nor will the auditor be allowed to issue credit for the overpayment. The county must only adjust the amount of taxes shown to be due on the tax list. Thus, if a taxpayer has only paid the "undisputed" portion of their property taxes, the disputed taxes, which would currently be designated as "delinquent taxes", would no longer be due. The BTA estimates few taxpayers would be eligible to re-file complaints under the bill, and believes they will incur only a minimal increase in costs due to the bill. However, because the exact cases are not known, LSC is unable to estimate the amount of delinquent property taxes that could potentially be forgone if the boards of revision would adjust property assessments.

[2] All tangible personal property that is not yet functional is exempt from taxation. Thus, while the pollution controls are being built or installed, they are exempt from taxation. The property only becomes taxable when it is able to function.

Municipal Taxation of Distributions From S Corporations

Generally, municipal corporations that have a business profits tax impose the tax both on regular corporations and on S corporations. Some municipal corporations currently tax distributive shares of net income from S corporations under their personal income tax ordinances. Other municipal corporations do not. LSC is unable to determine which municipal corporations out of the approximately 560 municipalities statewide are currently imposing a tax on S corporation shareholder distributions. The bill prohibits municipal corporations that impose a municipal income tax from taxing distributions of net profits to shareholders of S corporations. Thus, those municipalities that tax shareholder distributions from S corporations will lose an undetermined amount of personal income tax revenues as a result of S.B. 180. To the extent that S.B. 180 prompts some S corporations located in municipalities to distribute all of their operating profits, those cities might also lose revenues under their business profits tax.

Modifications to the Job Retention Tax Credit

The bill substantially modifies the job retention tax credit (Am. Sub H.B. 405). In addition to manufacturing companies that invest in new plants and equipment, the bill extends eligibility to companies that invest in research and development, or provide "significant corporate administrative functions." The bill decreases the minimum amount of investment to $100 million over a three-year period (currently the minimum investment is $200 million) for firms where the average wage of employment positions is greater than 400 percent of the federal minimum wage. H.B. 405 limited the tax credit to manufacturing operations and required that investments be made to facilities within a five-mile radius. The bill increases this requirement to 15 miles. Also, the bill specifies the repayment of tax credits for companies that fail to satisfy their commitments and allows companies to renegotiate the amount or term of the tax credit.

Credits are granted for investments made from January 1, 2002 through December 31, 2006. Although it is not possible to predict the number or size of projects qualifying for this credit in the future, LSC assumes that a small number of companies will become eligible annually due to the modifications made to the job retention credit (possibly two or three businesses annually) and that the majority of claims will be against the corporate franchise tax (although a small amount may be claimed against the personal income tax). The annual total number of eligible employees would be highly variable due to the wide range in employment. The maximum job retention tax credit is equal to 75 percent of the Ohio income tax withheld from the employees of the eligible business occupying full-time employment positions at the project site. Assuming the maximum credit of 75 percent of payroll, if an additional 3,000 workers were eligible for this credit, the cost of this credit would be approximately $3.5 million. However, this tax credit is nonrefundable. Assuming that only 75 percent of the tax credits will be claimed, state revenue loss would be up to $2.6 million in FY 2004 (FY 2004 would be the first year the job retention tax credit affects revenues). Each year an additional $2.6 million in credits may be claimed. Thus, estimated revenue loss from the modifications to the job retention tax credit would be $5.2 million in FY 2005, $7.8 million in FY 2006, $10.4 million in FY 2007 and following years. GRF revenue loss (at 95.2 percent of state revenue) would be $2.5 million and $5.0 million in FY 2004 and FY 2005, respectively. Again, assuming that most recipients of the tax credits are corporations, local government fund revenue loss (at 4.2 percent of state franchise tax revenue to the LGF and 0.6 percent to the LGRAF) would be $0.1 million in FY 2004 and $0.2 million in FY 2005.

This amount of revenue loss would be in addition to the $4.4 million in state revenue loss LSC had estimated for Am. Sub. H.B. 405. Thus, revenue loss from the job retention tax credit would be $6.9 million in FY 2004. Similarly, total revenue loss for the ensuing years would be $13.8 million in FY 2005, $20.7 million in FY 2006, and $27.6 million in FY 2007 and remain at that level for the next several years.

LSC fiscal staff: Jean J. Botomogno, Economist
Nickie Evans, Economist

FN124\SB0180EN.doc