Ohio Legislative Service Commission

Bill Analysis

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Sub. H.B. 365

129th General Assembly
(As Reported by S. Ways & Means & Economic Development)

Reps. Beck and Dovilla, Stebelton, Blessing, Terhar, Hollington, J. Adams, R. Adams, Amstutz, Anielski, Antonio, Baker, Barnes, Blair, Boose, Boyd, Brenner, Bubp, Buchy, Butler, Combs, Conditt, Damschroder, Derickson, DeVitis, Duffey, Gardner, Garland, Grossman, Hackett, C. Hagan, Hall, Hayes, Henne, Hill, Hottinger, Johnson, Kozlowski, Landis, Letson, Maag, Martin, McGregor, Milkovich, Newbold, O'Brien, Peterson, Roegner, Rose, Rosenberger, Ruhl, Schuring, Sears, Slaby, Slesnick, Sprague, Stinziano, Szollosi, Thompson, Uecker, Winburn, Young, Batchelder

Sens. Schaffer, Beagle

BILL SUMMARY

- Allows business owners who claim an enhanced federal income tax depreciation deduction and who increase payroll to claim more of the deduction that the business owner otherwise must add-back for Ohio income tax purposes, as follows:

  --If the business increases employee income tax withholdings by more than 10% over a year, the owner may claim the enhanced depreciation deduction over three, rather than six, years.

  --If the business's increased withholdings exceed the owner's enhanced depreciation expenses for the year, the owner may claim the entire enhanced depreciation deduction for that year.

- Clarifies Ohio income tax treatment of enhanced depreciation allowances in a taxable year in which a business's allowances result in or increase the business's federal net operating loss carryback or carryforward.

CONTENT AND OPERATION

The bill allows owners of businesses that increase Ohio payroll 10% or more over a preceding year to claim, beginning in taxable year 2012, more of the enhanced depreciation allowances that businesses are allowed under federal tax law. Whether a business increases Ohio payroll is measured by whether the business' total Ohio income tax withholdings for employees remitted to the Tax Commissioner increases. The bill also clarifies the procedures for claiming enhanced depreciation allowances following a taxable year in which a state deduction is disallowed because a business's allowances resulted in or increased the business's federal net operating loss carryback or carryforward.[1]

Federal enhanced depreciation allowances

Currently, federal tax law gives enhanced depreciation allowances for businesses that invest in certain depreciable business assets. There are two forms of the enhanced allowances: "bonus depreciation" and "enhanced expensing." Both are intended to induce increased business investment by permitting businesses to accelerate the tax benefit of asset depreciation deductions, moving it into earlier years than customarily allowed. They were originally enacted by Congress in 2002 and have been extended and increased several times since, but are scheduled to expire at the end of 2012.[2] Bonus depreciation allows a business to immediately deduct 50% of the cost of an asset (plus the customary first-year depreciation deduction) instead of using the usual depreciation schedules.[3] Enhanced expensing increases the value of an asset that can be immediately deducted when it is acquired or placed in service. Whereas the customary immediate expensing limit was $25,000, the enhanced expensing allowance is up to $125,000 for 2012, depending on when the asset is placed into service and subject to certain limitations.[4]

Ohio's treatment of enhanced depreciation allowances

The enhanced federal deductions reduce federal taxable income in the early years after the assets are acquired (as compared to the customary deductions), and therefore reduce Ohio taxable income and income tax revenue. When these federal enhancements were enacted, Ohio and several other states whose income tax bases were tied to the federal tax base blunted the state revenue reductions that would have resulted from the enhancements by not allowing taxpayers to claim the enhanced depreciation deductions all in a single year. Ohio instead required taxpayers to spread

[1] R.C. 5747.01(A)(20) and (A)(21).

[2] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111–312, 124 Stat. 3296, 3298–99. The enhanced deductions for some kinds of property do not expire until the end of 2013.

[3] 26 U.S.C. § 168(k) (2012).

[4] 26 U.S.C. § 179 (2012).

the immediate tax reductions in equal parts across six years.[5] For example, a taxpayer claiming a federal bonus depreciation deduction of $120,000 in one year was required to claim an Ohio deduction of only $20,000 per year over six years. This smooths the income tax revenue impact over six years instead of allowing it to be concentrated in one year.

Enhanced depreciation allowances for businesses that increase payroll

The bill permits Ohio business owners who owe Ohio income tax to claim a greater share of their bonus depreciation or enhanced expensing allowance if the business's annual Ohio payroll withholdings are at least 110% of the business's Ohio payroll withholdings in the preceding year. A business owner qualifying for federal bonus depreciation, enhanced expensing, or both, and thus otherwise required under current law to spread that extra allowance over six years for Ohio tax purposes, could instead claim the extra allowance in equal amounts over three years. If the increase of the business's annual income tax withholdings exceeds the sum of allowable bonus depreciation and enhanced expense amounts, then the owner may claim the owner's entire enhanced depreciation deduction in a single year.[6]

The bill's extra allowance 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.

Net operating loss carrybacks and carryforwards

Under federal law, if a business takes income tax deductions in excess of its income, it incurs a net operating loss. Any excess deductions generally may be carried back two years, via amended returns, or carried forward for 20 years against a business's past or future income, respectively.[7]

Under current law, a business owner must add back for Ohio income tax purposes five-sixths of the federal enhanced depreciation allowances in the taxable year in which the owner takes the corresponding federal deduction. Then, the owner may deduct the unclaimed five-sixths amount in equal one-fifth increments over the following five years. But to the extent that the enhanced allowances resulted in or increased a business's net operating loss carryback or carryforward for any taxable year, the business owner is disallowed the one-fifth deduction for that year.

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[5] R.C. 5747.01(A)(20) and (21).

[6] R.C. 5747.01(A)(20).

[7] 26 U.S.C. § 172(b) (2012).

The bill clarifies the procedure for later claiming one-fifth depreciation deductions foregone under current law as a result of a business owner's enhanced depreciation allowances resulting in or increasing the business's federal net operating loss carryback or carryforward for that year. A business owner is authorized to deduct the amount of the foregone deduction in the first year in which the owner's allowances do not result in or increase the business's net operating loss carryback or carryforward.[8]

The bill disallows deduction of any enhanced federal depreciation or expensing allowance for a taxable year if the business's allowances result in or increase the owner's net operating loss carryback or carryforward for that year; instead, the business owner must add back the entire amount of the federal deduction.[9] The owner may then claim the federal deduction in six equal increments beginning in the following year, unless, in that year, the owner's claimed allowances result in or increase the owner's net operating loss carryback or carryforward.[10] In such a situation, the owner is authorized to carry forward any foregone one-sixth deduction to the first year in which the allowances do not result in or increase the federal net operating loss carryback or carryforward.[11]

Refunds

The bill expressly disallows income tax refunds for bonus depreciation deductions that had been forfeited before the bill's clarifications became effective, so a business is not able to file amended returns to claim adjustments for taxable years before 2012.[12]

HISTORY

ACTION	DATE
Introduced	11-01-11
Reported, H. Ways & Means	01-26-12
Passed House (89-8)	02-08-12
Reported, S. Ways & Means & Economic Development	05-10-12

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[8] R.C. 5747.01(A)(21)(c).

[9] R.C. 5747.01(A)(20)(a)(v).

[10] R.C. 5747.01(A)(21)(a)(iii).

[11] R.C. 5747.01(A)(21)(c).

[12] R.C. 5747.01(A)(21)(d).