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Ohio Legislative Service Commission

Office of Research and Drafting

Legislative Budget Office

S.B. 18

134th General Assembly

Fiscal Note & Local Impact Statement

Revised

Click here for S.B. 18's Bill Analysis

Version: As Reported by Senate Ways & Means

Primary Sponsors: Sens. Roegner and Schaffer

Local Impact Statement Procedure Required: Yes

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Highlights

- The bill incorporates into Ohio income tax law changes made to the federal Internal Revenue Code (IRC) since March 27, 2020. The most significant of those changes occurred in December 2020, with provisions predominantly affecting tax returns to be filed for tax year (TY) 2020 and years thereafter.
- Incorporation of IRC changes potentially reduces personal income tax (PIT) revenue by millions of dollars during the FY 2022-FY 2023 biennium. The revenue loss would be shared by the GRF (96.68%), the Local Government Fund (LGF, 1.66%), and the Public Library Fund (PLF, 1.66%). Funds deposited into the LGF and PLF are distributed to counties, municipalities, townships, and public libraries according to statutory formulas and decisions by county budget commissions.
- The bill excludes from the commercial activity tax (CAT) those dividends received by a taxpayer from the State Insurance Fund of the Ohio Bureau of Workers' Compensation. The revenue loss from this provision will be several millions of dollars in FY 2022, and possibly in FY 2023. CAT revenue is distributed to the GRF (85%), the School District Tangible Property Tax Replacement Fund (13%), and the Local Government Tangible Property Tax Replacement Fund (2%).
- The bill declares itself an emergency measure that will go into immediate effect.

Detailed Analysis

The bill incorporates changes to the IRC made by House Resolution (HR) 133 of the 116th U.S. Congress, the "Consolidated Appropriations Act, 2021," into Ohio income tax law.[1]

In general, 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 provisions in HR 133 modified the definition of federal adjusted gross income (FAGI) and these actions materially affect the tax base for some Ohio taxpayers. FAGI is the starting point for determining Ohio adjusted gross income (FAGI with certain additions and deductions), Ohio taxable income, and other elements of the Ohio tax base. In the sections that follow, select provisions within the recent federal legislation are addressed, and their state revenue impact is discussed.

New tax provisions unique to HR 133

The following income tax provisions are new tax topics that were not previously enacted by previous iterations of federal legislation. The implication for conformity through S.B. 18 is that these provisions would alter state tax collections from their historical patterns observed in prior years.

Temporary special rule for determination of earned income

If tax year (TY) 2020 earned income of a taxpayer is less than the taxpayer's earned income for the preceding taxable year, the individual may elect to use TY 2019 earned income when determining their TY 2020 federal earned income tax credit (EITC). Incorporating this federal provision affects the Ohio earned income credit available under the personal income tax (PIT). The state credit's value equals 30% of the federal EITC. In a typical year, the Ohio earned income credit reduces PIT receipts by about $70 million. About 900,000 Ohio taxpayers claimed the federal EITC in TY 2018.

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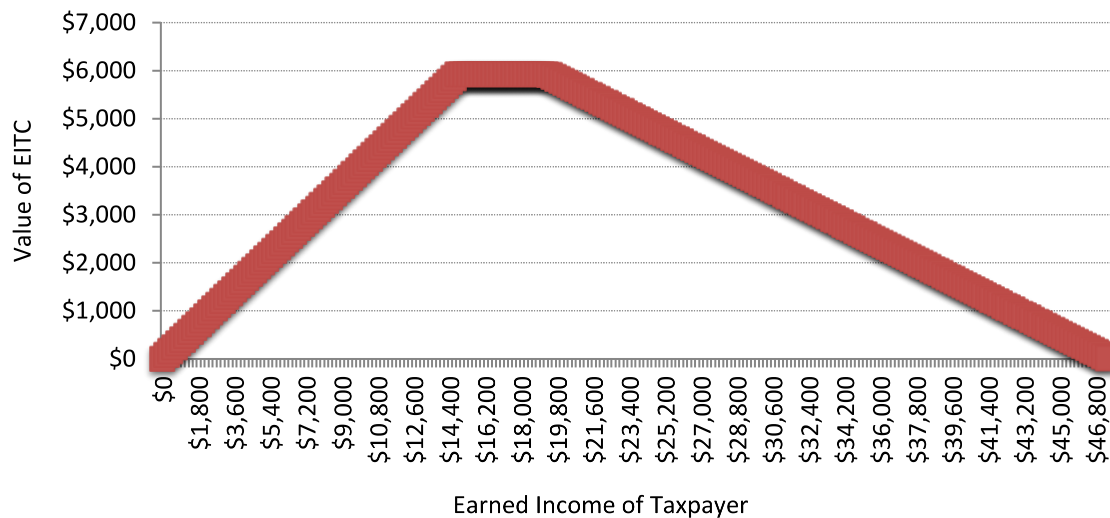
[1] Because S.B. 18 incorporates "the Internal Revenue Code (IRC) or other laws of the United States as they exist on the effective date," the bill could incorporate other forthcoming laws enacted by Congress. For example, H.B. 197 of the 133rd General Assembly incorporated changes made by HR 748 of the 116th U.S. Congress, the "Coronavirus Aid, Relief, and Economic Security (CARES) Act" because that legislation's effective date coincided with the same date for H.B. 197.



Incorporating this federal change will prove advantageous for a portion of taxpayers claiming the EITC. The chart above for a single individual with two children[2] illustrates how the federal EITC escalates in value as a person earns more money, then plateaus at a maximum amount, before subsequently phasing out the benefit for higher income levels. A policy permitting taxpayers to substitute their higher TY 2019 income largely benefits EITC recipients that are "left of the plateau," or up to $15,000 in income, in this chart. Because this federal provision does not uniformly benefit every taxpayer claiming the EITC, its fiscal effect is difficult to estimate with certainty. Nevertheless, it is not unreasonable to anticipate that incorporating this federal provision could reduce PIT receipts by several million dollars in FY 2021 when TY 2020 tax returns are filed. The actual revenue loss depends on the individual circumstances of applicable taxpayers.

Temporary allowance of full deduction for business meals

Generally, taxpayers can deduct only 50% of their business meal expenses, including meals incurred while away from home on business. The deduction lowers FAGI, which has implications for the Ohio tax base. HR 133 increased the deduction to 100% for a two-year period commencing January 1, 2021. The change is expected to incentivize more business meals at restaurants and other similar establishments, but it is difficult to forecast demand given the ongoing COVID-19 pandemic.

The business meal deduction can be utilized against sole proprietorship income, or claimed against partnership and S-corporation income. Nationwide Internal Revenue Service (IRS) statistics for TY 2018 show that fewer than 3% of meal deductions were claimed by individuals. Continuing Ohio law enables taxpayers to deduct the first $250,000 (or $125,000 for married couples filing separate tax returns) of business income included in their FAGI. So, more

[2] Please note that this "plateau" would be different for various taxpayers, based on individual circumstances of the household.

than 90% of Ohio taxpayers with business income do not pay income tax on those amounts. Therefore, those Ohioans are unaffected by the provision related to business meal expenses. The bill essentially applies to relevant individuals with unreimbursed meal expenditures and those with taxable business income. If 30,000 Ohio taxpayers claimed an additional $1,600 in meal deductions per year, the resulting income, $48 million, would be exempt from taxation due to S.B. 18. If that income is otherwise taxed at 3%, the conformity bill would reduce PIT receipts by $1.4 million. The assumed increase in meal deductions could be considerably less than $1,600 per return if taxpayers' behavior in 2021-2022 is different than meal expensing trends reported on their TY 2018 filings.

CARES Act provisions extended or clarified by HR 133

Although H.B. 197 incorporated the CARES Act, the state revenue effect of those provisions were not addressed in the enacted fiscal note because the CARES Act coincidentally became public law on the same date H.B. 197 was effective. Some of the provisions enacted in the CARES Act for TY 2020 were extended or otherwise modified by the latest federal legislation. The original fiscal effect of CARES Act provisions have yet to be observed because tax returns for TY 2020 will be filed during the latter months of FY 2021. Absent data on taxpayer behavior, it is difficult to forecast the fiscal effect of extending these new provisions for additional years. Incorporating these changes will likely reduce state tax receipts. The following items are those believed by LBO to be the most consequential.

Certain charitable contributions deductible by non-itemizers

If a taxpayer does not itemize deductions on Schedule A (Form 1040), the taxpayer may take a charitable deduction for cash contributions made in 2021. This deduction first applied to TY 2020, but recent federal legislation incorporated by S.B. 18 extends this deduction to TY 2021. The parameters are somewhat expanded for TY 2021, as the $300 limit on cash contributions to charities is increased in TY 2021 to $600 for those filing a joint return. The maximum deductible amount for all other filing circumstances remains at $300.

IRS statistics show that approximately 92% of Ohio taxpayers claimed the standard deduction for TY 2018. About one-third of taxpayers also filed joint returns in that year. If 10% of those claiming the standard deduction (520,000 tax returns) deduct the maximum amount ($400 per return, weighted average) for charitable contributions on their TY 2021 returns, they would exclude $208 million from FAGI. By incorporating this federal provision, S.B. 18 could reduce FY 2022 receipts by $6 million, assuming a 3% state income tax rate would otherwise apply to this income.

Extension of exclusion for certain employer payments of student loans

If a taxpayer receives educational assistance benefits from his or her employer under an educational assistance program, the taxpayer can exclude up to $5,250 of those benefits each year. Tax-free educational assistance benefits include payments made after March 27, 2020, and before January 1, 2026, whether paid to the employee or to a lender, of principal or interest on any qualified education loan incurred by the employee for education of the employee. The employer does not classify those benefits alongside wages, tips, and other compensation shown on the employee's Form W-2, box 1. Consequently, the employee does not have to include the benefits on his or her income tax return.

Clarification of the tax treatment of Paycheck Protection Program loan forgiveness

The Paycheck Protection Program (PPP) provides "covered loans" to help businesses keep their workforce employed during the COVID-19 pandemic. Borrowers may be eligible for PPP loan forgiveness if they maintain certain levels of employee compensation in the weeks following loan disbursement. The CARES Act declared that PPP recipients can exclude covered loan forgiveness from their gross income, which effectively renders the loan a tax-free grant. The IRS subsequently determined that existing IRC "disallows any otherwise allowable deduction" against the tax-exempt income resulting from PPP loan forgiveness.[3] The IRS regards a deduction against tax-exempt income as "a double tax benefit." Deductions should not be taken against PPP loans because the taxpayer has a reasonable expectation for reimbursement via loan forgiveness. The Consolidated Appropriations Act, 2021 specified that, "no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income provided by" PPP loan forgiveness.[4]

According to U.S. Small Business Administration (SBA) reporting, the PPP enabled 149,144 loans to Ohio-based applicants for a total of $18.53 billion in calendar year (CY) 2020.[5] However, PPP loan data is not indicative of loan forgiveness or program compliance. LBO is unaware of a resource that documents which loans were forgiven. The conformity provision in S.B. 18 only applies to the deductibility of expenses against forgiven loans. LBO staff assumes most loans will be forgiven.

Because the PIT excludes the first $250,000 of business income from tax, this S.B. 18 provision is especially applicable to large PPP loans. Table 1 summarizes SBA loan information for Ohio recipients that borrowed at least $150,000. The bill's conformity to FAGI is most relevant to individuals' business income (Schedule C and Schedule E). Multiple business types specified in the table are unlikely to yield that sort of income to individuals.

Table 1. CY 2020 Paycheck Protection Program Loans of $150,000 and Above for Ohio

Business Type	$150,000-$350,000	$350,000-$1 million	$1 million-$2 million	$2 million-$5 million	$5 million-$10 million	Grand Total
Corporation	4,966	2,868	809	343	72	9,058
Limited Liability Company (LLC)	3,657	1,728	387	200	49	6,021
Subchapter S Corporation	2,882	1,708	537	268	64	5,459

[3] https://www.irs.gov/pub/irs-drop/n-20-32.pdf.

[4] Refer to Sections 276 and 278 of "Subtitle B—COVID-related Tax Relief Act of 2020."

[5] https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program/ppp-data.

Table 1. CY 2020 Paycheck Protection Program Loans of $150,000 and Above for Ohio						
Business Type	**$150,000-$350,000**	**$350,000-$1 million**	**$1 million-$2 million**	**$2 million-$5 million**	**$5 million-$10 million**	**Grand Total**
Nonprofit Organization	670	518	200	121	10	1,519
Partnership	156	83	24	6	4	273
Unspecified	79	73	26	7	2	187
Sole Proprietorship	115	37	9	4	2	167
Limited Liability Partnership	95	47	13	5	4	164
All Other Business Types	58	65	23	13	3	162
Total	**12,678**	**7,127**	**2,028**	**967**	**210**	**23,010**

Source: LBO tabulation of SBA data released in August 2020

Provisions extended by HR 133 that precede the CARES Act

Some income tax provisions affected by HR 133 existed in previous tax years. The implication of their earlier presence means Ohio taxpayers already utilized the FAGI definition in previous state tax filings. Prior year PIT receipts already reflect these taxpayer behaviors. Incorporating an extension of expired provisions should not materially alter the regular pattern of state tax collections. However, two items can be regarded as consequential because Congress recently modified them.

Modification and extension of exclusion from gross income of discharge of qualified principal residence indebtedness

If a borrower's debt is forgiven or discharged for less than the full amount owed, the difference may be canceled. The amount of the canceled debt may be taxable and reportable on a borrower's tax return for the year the cancellation occurs, depending on statements provided by the lender. However, federal law generally allows taxpayers to exclude income from the discharge of debt on their principal residence. The exception applied to debt forgiven in calendar years 2007 through 2020.

HR 133 extended this exclusion for five years, which applies to TY 2021 through TY 2025. By conforming to this change, S.B. 18 will reduce PIT receipts in FY 2022-FY 2026. However, the latest federal legislation reduced the amount of income eligible for exclusion. In prior years, up to $2 million of forgiven debt was eligible ($1 million if married filing separately). Beginning with TY 2021, the limit was lowered to $750,000 ($350,000 if married filing separately). Therefore, Ohio taxpayers could ultimately report more taxable income on behalf of their cancelled mortgage debt in TY 2021 than they did in prior years.

Depreciation of certain residential rental property over 30-year period

Continuing federal law provides business owners with a general depreciation system (GDS) method, but enables them to elect an alternative depreciation system (ADS) option for most property. If a taxpayer chooses to use ADS for their residential rental property, the election must be made in the first year the property is placed in service. Once this election is made, the taxpayer can never revoke it.

Under the GDS option, residential rental property, inclusive of buildings, structures, and structural components (e.g., furnaces, water pipes, venting), depreciates over a 27.5-year recovery period. The Tax Cuts and Jobs Act of 2017 (TCJA) changed the ADS recovery period for residential rental property from 40 years to 30 years. These TCJA changes affect property placed in service after December 31, 2017.

The Consolidated Appropriations Act, 2021, amended the ADS method for certain residential rental property. According to IRS instructions,[6] "the ADS recovery period for residential rental property placed in service before January 1, 2018, is 30 years if the property is held by an electing real property trade or business (as defined in section 163(j)(7)(B)) and sections 168(g)(1)(A), (B), (C), (D), or (E) did not apply to the property before January 1, 2018."

Since this federal law change is retroactive to TY 2018, it could yield a larger fiscal effect on FY 2021 receipts as taxpayers utilize this ADS option for TY 2018-TY 2020. IRS statistics from TY 2018 show that only 6,657 taxpayers nationwide claimed a 40-year recovery period for property placed into service during 2018. Presumably, these taxpayers could benefit from the retroactive nature of the recent federal change, but the provision is likely to have limited effect on Ohio tax receipts. As previously mentioned, the PIT provides a $250,000 business income deduction, which substantially diminishes the fiscal impact of conforming to FAGI changes that reduce business income.

Commercial activity tax exclusions

Gross receipts exclusion for PPP loan forgiveness

The commercial activity tax (CAT) applies to most businesses regardless of the organization type under which that business operates.[7] In general, persons with annual taxable gross receipts of $150,000 or less are not subject to the CAT, and filers with more than $150,000 but less than or equal to $1 million taxable gross receipts in the previous calendar year pay the $150 annual minimum tax and file an annual return. Taxpayers with taxable gross receipts between $1 million and $2 million pay $800 plus 0.26% of the taxable gross receipts in excess of $1 million, those with taxable gross receipts between $2 million and $4 million pay $2,100 plus 0.26% of the taxable gross receipts in excess of $1 million, and those with taxable gross receipts in excess of $4 million pay $2,600 plus 0.26% of the taxable gross receipts in excess of $1 million.

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[6] https://www.irs.gov/publications/p527.

[7] For example, sole proprietorships, partnerships, LLCs, S corporations, corporations, trusts, and all other type of associations are subject to the CAT, if their taxable receipts exceed the minimum threshold. Certain businesses that have their own tax regimes, such as financial institutions or insurance companies, are not subject to the CAT because they pay another type of business tax.

The CARES Act excluded PPP loan forgiveness from a taxpayer's gross income, and H.B. 481 of the 133rd General Assembly excluded those same receipts from the CAT. The Consolidated Appropriations Act, 2021 authorized an additional $284.45 billion in PPP loans. Borrowers can apply for a PPP Loan until March 31, 2021, and the law allows certain eligible borrowers that previously received a PPP loan to apply for a "Second Draw" PPP loan with the same general loan terms as their "First Draw" PPP loan.

Since this latest round of PPP loans is less than $525.01 billion lent to businesses nationwide during CY 2020, the CAT exclusion authorized by S.B. 18 is likely smaller in scope than the H.B. 481 provision. LBO staff does not have data on the Ohio businesses availing themselves of this most recent PPP authorization. Tens of thousands of Ohio businesses could benefit from the CAT exclusion, but their actual tax savings will vary depending on their taxable receipts in CY 2021 and the balances of their forgiven loans.

Gross receipts exclusion for BWC dividends

The bill authorizes an exclusion from the CAT for the amount of excess surplus (i.e., dividends) of the State Insurance Fund received by a taxpayer from the Ohio Bureau of Workers' Compensation (BWC) pursuant to rules adopted under section 4123.321 of the Revised Code on or after January 1, 2020. In general, BWC specifies a procedure for returning excess workers' compensation premiums to employers, if the BWC Board of Directors determines that the surplus of earned premiums over losses is larger than needed to maintain solvency of the State Insurance Fund. The exclusion is for dividends paid to employers in calendar years 2020 and thereafter.

Table 2 provides dividends paid to private and public employers in the last three calendar years. In 2020, BWC paid a total of $7.88 billion in dividends from the fund to both private and public employers that maintained workers' compensation coverage under the fund. Public employers are not liable for the CAT, so the exclusion from taxable gross receipts in the bill would affect the $6.82 billion in excess surplus returned to private taxpayers.

Table 2. Dividends Paid to Employers from BWC State Insurance Fund

Calendar Year	Public Employers ($ in millions)	Private Employers ($ in millions)
2018	$157	$1,105
2019	$172	$1,252
2020	$1,055	$6,823

Source: BWC communication with LBO staff

If all dividends paid to private employers were taxable at the 0.26% rate, the exclusion would have amounted to a revenue loss of about $17.7 million in FY 2022. However, due to the structure of the CAT, the revenue loss from this provision in the bill will likely be less, though LBO cannot determine the reduction in CAT receipts due to lack of data. A number of taxpayers receiving the excess surplus may remain exempt from the tax because their taxable gross receipts would still be below the $150,000 threshold. Another set of taxpayers would also have their CAT liability unchanged as their taxable gross receipts, including the dividend, would remain below

$1 million. As a result, an unknown share of the $6.82 billion in excess surplus returned to private taxpayers would not give rise to any additional CAT liability. To the extent a CAT taxpayer paid additional tax on the excess surplus received, such a taxpayer would be entitled to a refund. The bill is likely to reduce CAT revenue by several millions of dollars in FY 2022. Though the amount of the revenue loss is undetermined, LBO cannot rule out a revenue reduction exceeding $10 million, based on CY 2020 dividends, possibly starting in the last quarter of the current fiscal year (see emergency provision) and with the majority of the loss realized in FY 2022. However, the total fiscal loss in FY 2022 will be dependent on the level of excess surplus returned to taxpayers in CY 2021. Assuming dividends paid by BWC return to their pre-pandemic levels after CY 2021, revenue losses from the bill in future years would also decrease to potentially less than $1 million annually.

Current law earmarks revenues from the CAT for the GRF (85%) and for reimbursing school districts and other local governments for the reductions and phase-out of local taxes on most tangible personal property. Other revenues from the CAT are split between the School District Tangible Property Tax Replacement Fund (13%) and the Local Government Tangible Property Tax Replacement Fund (2%) for reimbursement purposes. Revenue reductions to the GRF and local funds would be proportional to allocations to those funds in existing law.

Any decrease in total GRF tax receipts would also decrease the amount distributed to the LGF and the PLF. Under existing law, 1.66% of total GRF tax receipts is allocated to each fund beginning in FY 2022. Any reduction to the LGF and PLF would decrease distributions from the funds to counties, municipalities, townships, public libraries, and other political subdivisions in the state.

Emergency provision

The bill declares itself an emergency measure that will go into immediate effect.

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