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OHIO LEGISLATIVE SERVICE COMMISSION

Office of Research and Drafting

Legislative Budget Office

H.B. 116
(l_135_0686-3)
135th General Assembly

Fiscal Note & Local Impact Statement

[Click here for H.B. 116's Bill Analysis]

Version: In House Ways and Means

Primary Sponsors: Reps. Peterson and Claggett

Local Impact Statement Procedure Required: No

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Highlights

Fund	FY 2024	FY 2025	Future Years
State General Revenue Fund			
Revenues	Loss up to $364 million	Loss up to $130 million	Gain up to $494 million
Expenditures	$0	$0	$0
Local Government and Public Library funds (counties, municipalities, townships, and public libraries)			
Revenues	Loss up to $13 million	Loss up to $4 million	Gain up to $17 million
Expenditures	$0	$0	$0

Note: The fiscal year for the state, school districts, and certain other local governments runs from July 1 through June 30 and is designated by the calendar year in which it ends. For other local governments, the fiscal year is identical to the calendar year.

- The bill repeals a 2003 change to state income tax law that spreads single-year federal deductions for bonus depreciation and enhanced expensing allowances across six years of Ohio taxable income. Under the bill, taxpayers may advance all future years' deductions for which they are entitled into tax year (TY) 2023. Also, taxpayers would not be required to add-back to their Ohio adjusted gross income (OAGI) any bonus depreciation amounts deducted from the federal tax return in TY 2023 and years thereafter.

- The bill is revenue neutral over a nine-year period. It would pull forward revenue losses from the subsequent years, but doing so creates revenue gains in future years by avoiding revenue losses that would occur in those years under current law.
- Revenue losses are likely offset in part due to add-backs and deductions being taken by taxpayers who are eligible for nonresident credits, but LBO does not have data with which to estimate those interaction effects. Because of this, losses in the table are described as "up to."
- Revenue losses under the income tax primarily reduce GRF revenue, but also reduce revenue to the Local Government Fund (LGF) and the Public Library Fund (PLF). These funds are used to distribute revenue to municipalities, counties, townships, public libraries, and certain special districts.

Detailed Analysis

The bill "re-couples" Ohio's personal income tax (PIT) with federal tax law that allows businesses to claim enhanced depreciation deductions with respect to certain assets. Current law dampens the immediate revenue effects of the federal deductions by requiring businesses to add back $^{5}/_{6}$ of their federal deduction in the year it is claimed and deduct the amount added-back over five subsequent years. Effectively, current Ohio law spreads the benefits of the deduction for taxpayers over six years instead of allowing them the full benefit in the initial year.

The bill eliminates the requirement that businesses add-back any enhanced depreciation allowances. Instead, a taxpayer can deduct the full amount of allowances that the taxpayer deducts for federal income tax purposes in the same year the taxpayer deducts those expenses on its federal return.

For taxpayers that were required to add-back an allowance before 2023, the bill provides for an election. The taxpayer may either (a) continue to deduct any add-backs that the taxpayer would have otherwise been able to deduct, according to the same schedule the taxpayer would have followed, were the bill not enacted or (b) deduct the entire unused portion of the taxpayer's deductions in 2023.

Background

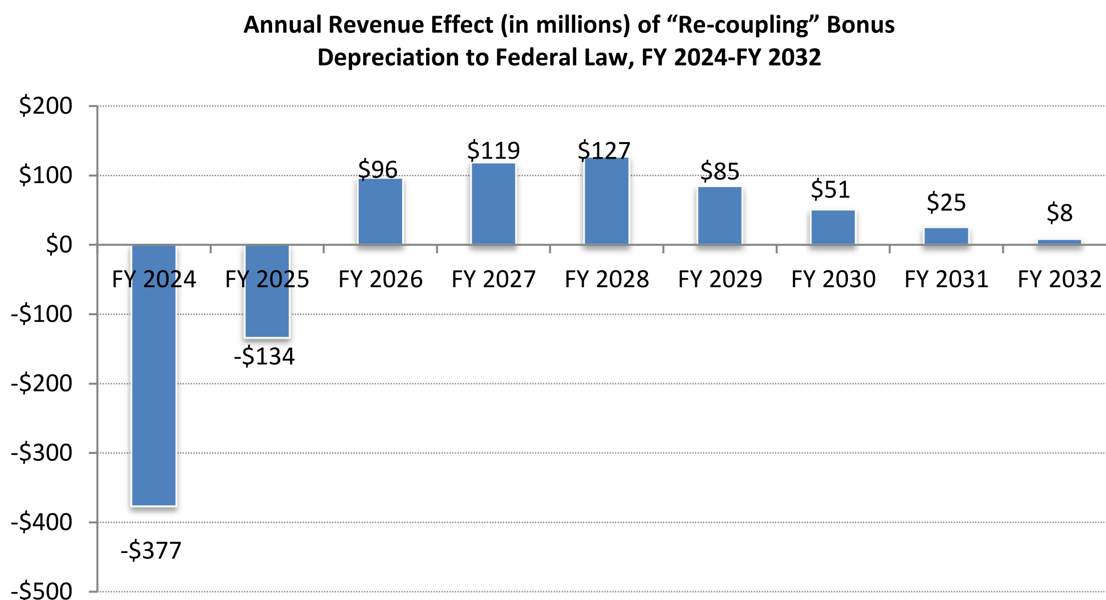
In 2003, H.B. 95 of the 125th General Assembly enacted the PIT provision in current law, requiring Ohio taxpayers to add-back to their OAGI $^{5}/_{6}$ of amounts they deducted on their federal tax return that year for enhanced depreciation, and allowing subsequent deductions totaling that amount. The General Assembly routinely enacts legislation that conforms the Ohio definition of income to the federal definition, so this add-back provision created an outcome by which Ohio could still conform with federal law, but spread the resulting state revenue losses from bonus depreciation and enhanced expensing allowances over a six-year period. Typically, the federal government enacts temporary bonus depreciation provisions to spur the economy.[1] Such actions

[1] Federal legislation has enacted bonus depreciation in some form or another every year since September 11, 2001, with the exception of a three-year hiatus for property placed into service from 2005 through 2007.

originally coincided with an economic recession, so the law in H.B. 95 essentially delayed an immediate PIT loss during that potentially difficult budgetary environment and instead spread the PIT losses over a six-year horizon.[2]

Fiscal effect

The PIT losses related to federal enhanced depreciation tax policy will occur regardless of whether the bill is enacted. The bill pulls forward those future revenue losses, which would begin as early as TY 2023. As illustrated in the chart below, the bonus depreciation amounts added back prior to January 1, 2023, would create a revenue loss when TY 2023 PIT returns are filed in FY 2024. Given the magnitude of the PIT deductions available to taxpayers in TY 2023, it is likely that some taxpayers will carryforward the deductions to TY 2024. In doing so, the revenue loss on behalf of the bill will spread across two years, FY 2024 and FY 2025. The Ohio Department of Taxation estimates that roughly two-thirds of the deductions would be claimed in the first year, and the remaining one-third would be claimed in TY 2024. Once the bulk of the deductions are exhausted, the PIT revenue losses would reverse to gains in FY 2026 through FY 2032.



Ohio law[3] regards bonus depreciation adjustments as nonbusiness income, so the amounts added back and deducted would be subject to the progressive PIT rates, up to 3.99%. However, the chart above assumes an effective tax rate of 2.0% on the applicable income, as

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[2] The provision applied also to Ohio's corporate franchise tax (CFT) at that time, but the CFT has since been repealed.

[3] Refer to the Ohio Department of Taxation's website for detailed explanation of the topic, or search for "bonus depreciation" on tax.ohio.gov.

taxpayers reporting bonus depreciation adjustments often use tax credits to reduce the liability incurred by their (higher) marginal tax rate.[4]

The amount added back in a given year is highly dependent on the federal tax code and the economic environment. On the other hand, the PIT deductions for a given year are comparatively easy to forecast because they align with amounts previously added back. For example, the expected deduction for TY 2023/FY 2024 under current law will be $1/5$ of the prior five years of add-back amounts.[5]

The amount of bonus deprecation added back substantially increased in response to the Tax Cut and Jobs Act of 2017 (TCJA). The federal legislation extended and modified the additional first-year depreciation deduction through TY 2026. The 50% allowance was increased to 100% for property acquired and placed in service after September 27, 2017, and before January 1, 2023. As noted above, Ohio income tax law does not permit these entire amounts to be deducted on a taxpayer's PIT; instead, $5/6$ of the federal deduction must be added back to their OAGI. More than $8.24 billion was added back by Ohio taxpayers in TY 2018. In contrast, taxpayers only added back about $4.00 billion in TY 2016, which was the year immediately preceding the TCJA.[6]

The Ohio General Assembly incorporated the TCJA changes to the Ohio tax code when it enacted a conformity bill, S.B. 22 of the 132nd General Assembly. The state revenue losses arising from the TCJA bonus depreciation materialized with that legislation, so H.B. 116 does not change that outcome; instead, it only affects the timing of when it occurs.

Synopsis of Fiscal Effect Changes

The bill's fiscal effects remain unchanged under the substitute bill. The revisions in this fiscal note reflect updated assumptions about the taxpayers' applicable tax rate (i.e., 2% vs. 3%) and their capacity to claim the PIT deductions in a single year. The assumptions were updated in light of information recently received from the Department of Taxation.

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[4] In TY 2021 data, taxpayers whose federal adjusted gross income (FAGI) was $500,000 or more accounted for nearly $3/4$ of the amount added back. And for this group, nonresident credits also amounted to nearly $3/4$ of tax liability before credits. LBO does not have data detailed enough to precisely account for the effects of the nonresident credit in reducing the scale of associated revenue gains and losses.

[5] TY 2023 deduction = $1/5$ of TY 2022 addback + $1/5$ of TY 2021 addback + $1/5$ of TY 2020 addback + $1/5$ of TY 2019 addback + $1/5$ of TY 2018 addback.

[6] The reason the addback amount was not $0 was because the Protecting Americans from Tax Hikes (PATH) Act of 2015 enacted bonus depreciation tax policy for that year.