S.B. 246
134th General Assembly

Fiscal Note & Local Impact Statement
Revised

Click here for S.B. 246’s Bill Analysis

Version: As Introduced
Primary Sponsors: Sens. Rulli and Lang
Local Impact Statement Procedure Required: Yes

Philip A. Cummins, Senior Economist

Highlights

<table>
<thead>
<tr>
<th>Fund</th>
<th>FY 2022</th>
<th>FY 2023</th>
<th>Future Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>State General Revenue Fund</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td>Potential loss of $0.9 million</td>
<td>Potential loss of $74.8 million</td>
<td>Potential loss of $77.5 million in FY 2024 and additional amounts thereafter</td>
</tr>
<tr>
<td>Expenditures</td>
<td>Possible increase</td>
<td>Possible increase</td>
<td>Possible increase</td>
</tr>
</tbody>
</table>

Local Government and Public Library funds (counties, municipalities, townships, and public libraries)

| Revenues                         | Potential loss of about $34,000 | Potential loss of $2.6 million | Potential loss of $2.7 million in FY 2024 and additional amounts thereafter |

Note: The state or school district fiscal year 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.

- With the bill, state revenue from a voluntary tax by an electing pass-through entity (PTE) on income would be offset by refundable credits to PTE owners based on their proportionate share of the tax, to the extent that these credits are claimed.
Estimated revenue losses to the state stem from reductions in tax rates, from 3.99% for income reported on Form IT-4708 to 3% with the bill, for taxpayers that do not claim the refundable credits. In addition, a one-time loss results from expected changes in the timing of payments. Estimates shown in the table above are from the Department of Taxation (TAX).

To the extent that GRF tax revenue is reduced, revenue sharing through the Local Government Fund (LGF, Fund 7069) and the Public Library Fund (PLF, Fund 7065) would also be lowered.

TAX may incur added expenses to administer the new tax and associated credits.

### Detailed Analysis

Pass-through entities (PTEs) include S corporations, partnerships, and limited liability companies. PTEs generally share the characteristic of “passing through” tax liability to their owners, thereby taxing income only at the owner level and avoiding taxation at both the entity and owner levels. The bill levies a tax on income of a PTE apportioned to Ohio at a rate of 5% for taxable years beginning in 2022 and 3% for taxable years thereafter, but only if that entity elects to become subject to the tax. All tax revenue from the new tax would be credited to the GRF. An owner of an interest in the PTE would be authorized to claim a refundable credit against the owner’s Ohio income tax liability equal to the owner’s proportionate share of the tax paid by the PTE.

The bill is a response to a provision of the 2017 federal Tax Cuts and Jobs Act, which limited the amount of state or local income or general sales tax (SALT) that a federal income taxpayer could deduct to $10,000 (for married taxpayers filing separately, $5,000). Under an Internal Revenue Service determination, taxes paid by a PTE are not taken into account for federal income tax purposes in applying the SALT deduction limitation to an individual who is a partner or owner of the PTE.¹

### Taxpayer behavior

PTEs subject to Ohio law are required to withhold tax on the proportionate share of income to nonresident owners. The nonresident investors are entitled to refundable credits based on the amounts of this withholding tax paid by the PTEs, which they can apply against Ohio income taxes due from them on this income. Alternatively, if withholding taxes paid on their behalf by the PTE equal or exceed the Ohio income taxes that they owe, the nonresident owners need not file Ohio returns.²

Every year, withholding tax paid by PTEs exceeds refundable credits claimed. The amount of unclaimed credits is sizable. Various reasons may account for out-of-state taxpayers not claiming all credits to which they are entitled. The specific reasons that account for the large amounts not claimed are uncertain. One explanation is that in states with income taxes that allow an offset against taxes owed for taxes paid to other states, savings on Ohio income taxes may result in smaller offsets against those states’ taxes. Calculations of these offsets are complex, as

---

¹ Notice 2020-75.
² More precisely, if total allowed credits equal or exceed taxes otherwise due, no return is required.
a general statement, but for affected taxpayers, filing to reduce their net taxes paid to Ohio may result in little or no net overall benefits taking account of taxes paid to all jurisdictions. Another explanation is that some out-of-state taxpayers who do not claim credits for which they are eligible may leave these credits unclaimed because the tax savings from filing Ohio returns to claim the credits would be offset by additional charges for accounting services to file the returns. This explanation may be applicable to taxpayers with relatively small amounts of Ohio taxes due, but does not appear to explain the sizable amounts of credits left unclaimed. Other considerations not here identified may play a role in this behavior. Whatever the reasons, historically part of these refundable credits that nonresident taxpayers are eligible to claim have nevertheless remained unclaimed.

The analysis reported here is based on an assumption that out-of-state taxpayers will continue not to claim all refundable credits that they are eligible to claim, and that the share of credits not claimed will remain in line with recent experience.

**Effects on state income tax**

The analysis in this section relies on information provided by the Department of Taxation (TAX). The Department anticipates a shift in the timing of payments with the bill, with some payments that would occur in June under current law instead being made in July with the bill. This change is assumed to begin in 2022, in the estimates shown in the table above, but would depend on the timing of the bill’s enactment.

A larger revenue loss is estimated to result from a reduction in the tax rate paid on a portion of PTE income, from 3.99% for PTEs that would file the current IT-4708 composite return to 3% with the bill, starting in tax year 2023. For taxpayers who claim the credits for PTE withholding tax paid on their behalf, this revenue loss to the state would be offset by payment of smaller refunds to taxpayers. But for taxpayers who would not claim these credits, under current law or the bill, there would be no offset for the revenue loss to the state from the lower withholding tax rate. Resulting estimated all funds income tax revenue losses are $1.0 million in FY 2022, $77.4 million in FY 2023, $80.1 million in FY 2024, and continuing revenue losses thereafter.

TAX may incur costs to implement and administer the bill’s provisions. These costs may be paid from GRF line item 110321, Operating Expenses.

**Revenue sharing**

To the extent that GRF tax revenue is decreased by the bill, revenue to the Local Government Fund (LGF, Fund 7069) and the Public Library Fund (PLF, Fund 7065) would be reduced. Each fund receives 1.66% of GRF tax revenue under codified law. During the current biennium, the PLF receives 1.70% of GRF tax revenue as provided by an uncodified provision of H.B. 110, the main operating budget act.