Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: S.B. 2 of the 131st G.A.

Date: February 1, 2016

Status: As Passed by the House

Sponsor: Sen. Peterson

Local Impact Statement Procedure Required: Yes

Contents: To expressly incorporate recent changes in the Internal Revenue Code into Ohio law, and to declare an emergency

State Fiscal Highlights

STATE FUND	FY 2016	FY 2017	FUTURE YEARS
General Revenue Fund			
Revenues	Loss of millions of dollars	Loss of millions of dollars	Loss of millions of dollars
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2016 is July 1, 2015 – June 30, 2016.

- Incorporating changes to the Internal Revenue Code (IRC) into Ohio law will reduce Ohio Adjusted Gross Income (OAGI) for Ohio taxpayers, and reduce Ohio revenues because OAGI serves as the starting point for determining Ohio taxable income. GRF revenue losses would be millions of dollars per year beginning in FY 2016. Annual losses in future years are dependent on the amount of bonus depreciation deductions and enhanced expensing occurring in calendar year 2015 and thereafter.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2016	FY 2017	FUTURE YEARS
Counties, municipalities, townships, and public libraries (LGF and PLF)			
Revenues	Loss of $1 million or more	Loss of $1 million or more	Loss of $100,000 or more
Expenditures	- 0 -	- 0 -	- 0 -
School districts that levy a school district income tax (SDIT)			
Revenues	Loss up to hundreds of thousands	Loss up to hundreds of thousands	Loss up to tens of thousands
Expenditures	- 0 -	- 0 -	- 0 -

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

- All income tax revenues are deposited into the GRF, the Local Government Fund (LGF) and Public Library Fund (PLF). Permanent law requires that each receive 1.66% of GRF receipts, but a temporary provision of Am. Sub. H.B. 64 of the 131st General Assembly increased the PLF share to 1.70% for FY 2016 and FY 2017. Conforming to the federal definition of income will reduce combined revenue to the LGF and PLF by up to $1 million or more in FY 2016 and FY 2017.
- The reduction in Ohio taxable income under the bill would reduce school district income tax revenues to those districts that use Ohio taxable income as the basis for calculation of taxes owed. Taxpayers living in these school districts have approximately 8.6% of Ohio taxable income. If tax returns from these areas claimed 8.6% of the marginal increase in this deduction, aggregate school district income tax (SDIT) revenues would be reduced by hundreds of thousands of dollars in FY 2016 and FY 2017.

Detailed Fiscal Analysis

The bill incorporates changes to the Internal Revenue Code (IRC) since April 1, 2015 into Ohio income tax law. 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 changes have been made to the IRC since the last time Ohio conformed to federal income tax law (Am. H.B. 19 of the 131st General Assembly), and some of the changes are estimated to have materially changed Federal Adjusted Gross Income (FAGI). Ohio's income tax returns start with FAGI, and the reduction in FAGI affects Ohio taxable income (OTI).

The latest assorted federal changes being incorporated are those enacted by H.R. 2029, the "Protecting Americans from Tax Hikes Act of 2015," which took effect December 18, 2015. The foregoing provisions are extensions of previous federal provisions. Many are extended permanently whereas others are extended through December 31, 2019, and some provisions are extended through December 31, 2016. The principal amendments to federal law that Sub. S.B. 2 incorporates are the income tax provisions identified in Table 1.

Table 1. Principal FAGI determinants extended by H.R. 2029 of the 114th U.S. Congress
Permanent extensions
Elementary and secondary school teacher deduction for classroom expenses
Exclusion of Individual Retirement Arrangement (IRA) distributions for charitable purposes
Depreciation cost recovery period adjustments for certain leasehold improvement property, restaurant property, and retail improvement property
Exclusion of 100% of gain on certain small business stock
Parity for exclusion for employer-provided mass transit and parking benefits
Basis adjustment to stock of S corporations making charitable contributions of property

Table 1. Principal FAGI determinants extended by H.R. 2029 of the 114th U.S. Congress
Extended through December 31, 2019
Bonus depreciation deductions and enhanced expensing[1]
Extended through December 31, 2016
Qualified tuition expenses deduction
Depreciation cost recovery period adjustments for race horses and motor sports entertainment complexes
Exclusion of discharge of principal residence indebtedness for individuals
Depreciation allowance for second generation biofuel plant property
Deduction for energy efficient commercial buildings
Election to expense advanced mine safety equipment
Special expensing rules for certain film and television productions
Income adjustments for businesses in a designated empowerment zone

Some of the larger individual income tax effects are explained in further detail below:

H.R. 2029 permits taxpayers who have mortgage debt cancelled or forgiven after 2014 to avoid paying taxes on that amount as taxable income. Under this provision, up to $2 million of forgiven debt is eligible to be excluded from income ($1 million if married filing separately) through tax year (TY) 2016. This provision was originally created in the Mortgage Debt Relief Act of 2007 to shield taxpayers from having to pay taxes on cancelled mortgage debt stemming from mortgage loan modifications. Enacting conformity for this provision would reduce state revenues by $9 million to $15 million per year in FY 2016 and FY 2017.

H.R. 2029 extends the ability to deduct the cost of mortgage insurance on a qualified personal residence. The deduction is phased out ratably by 10% for each $1,000 by which the taxpayer's AGI exceeds $100,000. Thus, the deduction is unavailable for a taxpayer with an AGI in excess of $110,000. The bill extends this provision for two additional years, through TY 2016. Enacting conformity for this provision would reduce state revenues by $4 million to $7 million per year in FY 2016 and FY 2017.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) created an above-the-line tax deduction for qualified higher education expenses. The maximum deduction was $4,000 for taxpayers with AGI of $65,000 or less ($130,000 for joint returns) or $2,000 for taxpayers with AGI of $80,000 or less ($160,000 for joint returns). H.R. 2029 extends the deduction to the end of TY 2016. Enacting conformity for this provision would reduce state revenues by $3 million to $5 million per year in FY 2016 and FY 2017.

[1] Ohio departs from federal income tax law and generally requires taxpayers to spread the immediate tax reductions from bonus depreciation and enhanced expensing in equal parts across six years.

H.R. 2029 permanently extends the provision that permits an IRA owner who is age 70½ or older generally to exclude from gross income up to $100,000 per year in distributions made directly from the IRA to certain public charities. Enacting conformity for this provision would reduce state revenues by several million dollars per year.

H.R. 2029 permanently extends the $250 above-the-line tax deduction for teachers and other school professionals for expenses paid or incurred for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and service), other equipment, and supplementary materials used by the educator in the classroom. Enacting conformity for this provision would reduce state revenues by approximately $1 million per year.

The business tax provisions are not addressed in such detail because IRS statistics are less discrete about the business income and deductions incurred by sole proprietors, partnerships, and S corporations. The business tax extenders concerning bonus depreciation will differ from the individual income tax provisions because the Revised Code spreads the state revenue impact over a period that can be as long as six years. The fiscal effect for the bonus depreciation provisions will continue beyond its five-year federal extension because of the add-back and expensing formula specified in the Revised Code.

Temporary earned Income credit provisions made permanent

The American Taxpayer Relief Act of 2012 temporarily extended through December 31, 2017 certain earned income tax credit (EITC) provisions originally authorized by the American Recovery and Reinvestment Act of 2009. The Protecting Americans from Tax Hikes Act of 2015 made these changes permanent, which will affect GRF receipts beginning in FY 2019. The now permanent provisions are those authorizing an EITC rate of 45% for taxpayers with three or more qualifying children as well as an increased EITC value for married couples filing joint returns.

Although not a factor in determining FAGI, the federal EITC can affect the state income tax liability of an Ohio taxpayer. Since TY 2013, a nonrefundable earned income credit is available for Ohio taxpayers who are eligible for the federal EITC on their federal tax returns. The Ohio earned income credit is equal to 10% of the taxpayer's federal EITC. Because these federal changes were made permanent, the personal income tax will forego between $1 million and $10 million of additional revenue in future years.

Local taxing jurisdictions

All personal income tax (PIT) revenues are deposited into the GRF, the Local Government Fund (LGF) and Public Library Fund (PLF). Permanent law requires that each receive 1.66% of GRF receipts, but a temporary provision of Am. Sub. H.B. 64 of the 131st General Assembly increased the PLF share to 1.70% for FY 2016 and FY 2017. Enacting Sub. S.B. 2 would reduce the LGF and PLF each by hundreds of thousands of dollars.

School district income taxes (SDIT) are based on either Ohio taxable income of taxpayers residing in the school district or on the portion of that income that is earned income, generally limited to wages and self-employment income. School boards and voters of individual school districts choose whether to enact income taxes in their districts and which of these two tax bases to use. For school districts in which Ohio taxable income serves as the starting point for calculation of school district income taxes, conforming to the federal definition of income will reduce school district income tax revenues. LSC does not have an estimate of the amount of this reduction. As of January 2016, 144 school districts levied an income tax from the "traditional" tax base rather than the earned income tax base. During FY 2015, these school districts raised $300.1 million through school district income taxes. The local revenue reduction amount caused by Sub. S.B. 2 for each respective school district depends on the number (if any) of taxpayers living in that district who utilize the benefits conferred by Sub. S.B. 2. Taxpayers living in school districts with the "traditional" tax base have approximately 8.6% of Ohio taxable income. If tax returns from these areas claimed 8.6% of the income reductions granted by Sub. S.B. 2, aggregate SDIT revenues would be reduced by several million dollars per year, beginning in FY 2016.

Emergency clause

The bill includes an emergency provision which makes its provisions effective as soon as signed into law.

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