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134th General Assembly

Final Analysis

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Primary Sponsors: Sens. Roegner and Schaffer

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SUMMARY

- Incorporates into Ohio income tax law changes to federal tax law taking effect since March 27, 2020.
- Exempts "second draw" Paycheck Protection Program (PPP) loan amounts forgiven under the Consolidated Appropriations Act, 2021 from the commercial activity tax (CAT).
- Exempts from the CAT Bureau of Workers' Compensation (BWC) dividends paid to employers in 2020 and 2021.
- Authorizes the Tax Commissioner to temporarily abate any interest or penalties for the underpayment of state and school district income taxes due on unemployment benefits received in 2020.
- Allows individuals to elect to have state income tax withheld from their unemployment benefits.
- Sets the rate of a withholding tax paid by certain pass-through entities on a percentage of its nonresident investors' distributive income equal to the income tax rate on taxable business income, effectively reducing those withholding rates.

DETAILED ANALYSIS

Incorporation of Internal Revenue Code changes

The act incorporates into Ohio tax law recent changes to the Internal Revenue Code (IRC) or other federal law taking effect after March 27, 2020.[1]

[1] R.C. 5701.11(A).

Several changes to federal law are incorporated, including several changes made by the "Consolidated Appropriations Act, 2021," H.R. 133 of the 116th Congress, in December of 2020 (referred to in this analysis as "CAA 2021"), and the "American Rescue Plan Act of 2021," H.R. 1319 of the 117th Congress, in March of 2021 (referred to as "ARPA 2021"). Several of these changes directly affect the tax base of many Ohio income tax taxpayers by increasing or decreasing federal adjusted gross income (FAGI), the starting number for determining a taxpayer's Ohio taxable income.[2] The incorporated changes also affect the tax base of school districts levying an income tax on the basis of FAGI.[3]

The following is a list of some of the most significant of the federal law changes affecting Ohio law, including, in bold, the federal law or laws that enacted each change:

Changes affecting individuals

- A temporary look-back rule for determination of earned income for purposes for the earned income tax credit (EITC) **(CAA 2021)**. (Ohio allows a piggy-back credit based on a taxpayer's federal EITC.)
- A temporary expansion in the amount of and eligibility for the EITC **(ARPA 2021)**.
- A temporary increase in the amount of the child and dependent care credit **(ARPA 2021)**. (Ohio allows a piggy-back credit for certain taxpayers that receive the federal child and dependent care credit.)
- The extension of an exclusion from gross income for the discharge of indebtedness of a qualified principal residence **(CAA 2021)**.
- A temporary exclusion from gross income for the discharge of student loan indebtedness **(ARPA 2021)**.
- A temporary exclusion from gross income for the first $10,200 received in unemployment benefits for taxpayers with $150,000 or less in FAGI (or $300,000 or less for joint filers) **(ARPA 2021)**.
- An extension of the temporary allowance of a deduction for charitable contributions by nonitemizers **(CAA 2021)**.
- A clarification that the educator expense tax deduction includes expenses for personal protective equipment and other supplies related to the prevention of the spread of COVID-19 **(CAA 2021)**.
- An exclusion from gross income for emergency financial aid grants **(CAA 2021)**.
- The transition from a deduction for qualified tuition and related expenses to an increased phase-out threshold of the Lifetime Learning Credit **(CAA 2021)**.

[2] R.C. 5747.01(A), not in the act.

[3] R.C. 5748.01(E), not in the act.

- Temporary special rules for health and dependent care flexible spending arrangements **(CAA 2021 and ARPA 2021)**.

Changes affecting businesses

- The allowance of a 30-year depreciation period for certain residential rental property **(CAA 2021)**.
- The temporary allowance of a full deduction for business meals (generally, business meals are only 50% deductible) **(CAA 2021)**.
- A clarification of the tax treatment of Paycheck Protection Program loan forgiveness, including a clarification that expenses paid with covered loans can be deductible **(CAA 2021)**.
- An extension of the payment deadline for certain deferred payroll taxes (including certain self-employment taxes) **(CAA 2021)**.
- The extension of the work opportunity tax credit **(CAA 2021)**. (Ohio allows a deduction for employee wages that could not be deducted from the business owners' FAGI due to the work opportunity credit.)
- The extension of an exclusion for certain employer payments of student loans **(CAA 2021)**.
- An extension of the limitation on excess business losses for noncorporate taxpayers **(ARPA 2021)**.
- An exclusion from gross income for Restaurant Revitalization Fund (RRF) grants and Targeted Economic Injury Disaster Loan (EIDL) advances **(ARPA 2021)**.

Reason for incorporation

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.[4] The incorporation applies to only general, undated references to the IRC or other federal laws, and does not apply to references that specify a date.

If federal tax law amendments are not incorporated, an affected taxpayer would have to adjust the taxpayer's federal adjusted gross income or taxable income, either by adding or subtracting the relevant amounts, in order to compute the taxpayer's Ohio tax liability.

Alternative tax law election

The act also revises Ohio tax law with respect to an election available to taxpayers whenever federal amendments become incorporated. A taxpayer whose taxable year ended after March 30, 2018, and before March 27, 2020, could irrevocably elect to apply to the taxpayer's state tax calculation the federal tax laws that applied to that taxable year. (The two March dates are the dates of the two most recent incorporations.) The election was available to

[4] See *State of Ohio v. Gill*, 63 Ohio St.3d 53 (1992).

taxpayers who were subject to the personal income tax and to electric and telephone companies that are subject to municipal income taxes.

The act allows this election to be made for a taxpayer's taxable year ending after March 27, 2020, but before the incorporation provision's effective date. The act retains a provision specifying that similar elections made under prior versions of the law remain effective for the taxable years to which the previous elections applied.[5]

Commercial activity tax (CAT) exclusions

Exemption for forgiven PPP loan amounts

The act exempts "second draw" Paycheck Protection Program (PPP) loan amounts forgiven under the CAA 2021 from the commercial activity tax (CAT). A similar exemption exists under continuing law for "first draw" PPP loan amounts forgiven under the Coronavirus Aid, Relief, and Economic Security (CARES) Act.[6] Under continuing law, similar to federal income tax law, forgiven debt is generally considered to be taxable gross receipts for purposes of the CAT.

The CARES Act allowed businesses affected by the coronavirus pandemic to apply for PPP loans. In December 2020, the CAA 2021 expanded the program to allow some businesses that received a PPP loan under the CARES Act to apply for a "second draw" loan. For both types of loans, the debt will be forgiven if the loan is used for payroll costs or mortgage, rent, or utility payments during an 8- or 24-week period beginning with the loan's origination. Such canceled debt is not taxable for federal income tax purposes, whereas most forgiven debt is considered taxable income.[7]

Temporary exemption for BWC dividends

The act also exempts from the CAT Bureau of Workers' Compensation (BWC) dividends paid to employers in 2020 and 2021.[8]

Under continuing law, the BWC is required to develop a procedure for the return of excess workers' compensation premiums to employers if the board of directors determines that the surplus of earned premiums over losses is larger than needed to maintain solvency. Generally, such payments, referred to as "dividends," are considered to be taxable gross receipts for purposes of the CAT.[9]

Income taxes on unemployment benefits

The act makes two changes – one temporary and one permanent – relating to the income taxation of unemployment benefits. First, it authorizes the Tax Commissioner to abate any interest or penalties for the underpayment of state and school district income taxes due on

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[5] R.C. 5701.11(B).

[6] Section 36 of H.B. 481 of the 133rd General Assembly.

[7] 15 United States Code (U.S.C.) 636m.

[8] Section 6.

[9] R.C. 4123.321, not in the act.

unemployment benefits received in 2020. Second, it allows individuals to elect to have state income tax withheld from their unemployment benefits.

Temporary interest and penalty waiver

The act authorizes the Commissioner to abate any interest or penalties resulting from a taxpayer not making a full, timely payment of state and school district income taxes due on unemployment benefits received in 2020, but only if the taxpayer timely files the taxpayer's annual 2020 return. Under continuing law, unemployment benefits received in that year are generally subject to federal, state, and school district income taxes, subject to the temporary 2020 unemployment compensation exemption authorized under ARPA 2021 (see "**Changes affecting individuals**," above). In general, unpaid income tax accrues interest from the date it was due and the taxpayer is subject to penalties for the failure to timely pay the tax. Continuing law broadly authorizes the Commissioner to abate income tax penalties, but not accrued interest.[10]

If a taxpayer with interest or penalties abated under the act does not pay the tax due by June 30, 2023, all abated amounts are automatically reimposed on that unpaid amount from the date it was due in the absence of the act's extension, unless the Commissioner decides to permanently abate the penalties pursuant to the Commissioner's existing authority. A taxpayer who pays any interest or penalties that otherwise would have qualified for this abatement may request a refund of the amounts paid, except for any amounts reimposed on the taxpayer for failure to pay taxes due.[11]

State income tax withholding

The act also allows individuals to elect to have state income tax withheld from their unemployment benefits. Under continuing law, individuals may request, at the time they apply for benefits, that the Department of Job and Family Services (JFS) withhold federal income tax on their benefits. Federal law authorizes states to allow state income tax withholding on unemployment benefits, provided the withholding mechanism is approved by the U.S. Secretary of Labor.[12] Under the act, the JFS Director, in consultation with the Tax Commissioner, prescribes the rate or rates at which state income tax will be withheld from unemployment benefits.[13] Federal income taxes are withheld at a flat 10% rate.[14]

State income tax may be withheld from unemployment benefits paid on and after January 1, 2022. If an individual is already receiving benefits and has elected to have federal

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[10] R.C. 5747.08(G) and 5747.15, not in the act.

[11] Section 5.

[12] 26 U.S.C. 3304(a)(4)(C).

[13] R.C. 4141.321 and 5747.065.

[14] See Internal Revenue Service Form W-4V (rev'd February 2018), https://www.irs.gov/pub/irs-pdf/fw4v.pdf.

income tax withheld from those benefits, JFS must notify the individual of the option to also have state income tax withheld from their benefits beginning in 2022.[15]

Pass-through entity withholding tax

Under continuing law, the Ohio income tax applies to income received by an owner or investor in a pass-through entity (PTE) from the PTE's business activities in the state. (PTEs include S corporations, partnerships, and limited liability companies treated for federal income tax purposes like partnerships.) In order to ensure collection of the tax from nonresident individuals and entities – which, aside from their ownership of the PTE, would not be required to file an individual tax return – a PTE is required to withhold the income tax due from its nonresident investors. This "withholding tax" is imposed directly on the PTE, even though the underlying tax liability belongs to the investors.

The act sets the rates at which PTEs remit taxes on nonresident investor income equal to the 3% income tax rate that applies to taxable business income, effectively reducing the PTE withholding rates from 5% to 3% for individual investors[16] and from 8.5% to 3% for nonindividual investors.[17] The act does not change an existing alternative means for a PTE to report and pay income taxes owed by its noncorporate investors: a PTE may file a composite return (Form 4708) covering its investors and pay tax for them at the highest of the graduated tax rates for nonbusiness income (4.797% currently).[18]

The rate changes apply to a PTE's taxable years beginning on or after January 1, 2023.[19]

HISTORY

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Reported, S. Ways & Means	02-09-21
Passed Senate (32-0)	02-10-21
Reported, H. Ways & Means	03-24-21
Passed House (98-0)	03-24-21
Senate concurred in House amendments (33-0)	03-24-21

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[15] Section 8.

[16] R.C. 5747.41.

[17] R.C. 5733.41.

[18] R.C. 5747.08(D), not in the act.

[19] Section 7.