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OHIO LEGISLATIVE SERVICE COMMISSION

Office of Research and Drafting

Legislative Budget Office

H.B. 467
133rd General Assembly

Fiscal Note & Local Impact Statement

Click here for H.B. 467's Bill Analysis

Version: As Reported by House Ways and Means

Primary Sponsor: Reps. Scherer and Rogers

Local Impact Statement Procedure Required: Yes

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Highlights

Fund	FY 2022	FY 2023	Future Years
State General Revenue Fund			
Revenues	$0	Possible one-time $30.6 million loss	$0
Expenditures	$0	$0	$0
Local Government and Public Library funds (counties, municipalities, townships, and public libraries)			
Revenues	$0	Possible one-time $1.0 million loss	$0
Expenditures	$0	Commensurate reduction	$0

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.

- The bill reduces the withholding tax rate for certain pass-through entities to 3%, starting with tax years that begin after January 1, 2023.
- Taxpayer liabilities would be unchanged. However, the rate reductions are estimated to give rise to a one-time revenue loss of $31.6 million in FY 2023, due to the timing of payments during the fiscal year.

- Lower GRF tax revenues in the fiscal year would reduce distributions through the Local Government Fund (LGF, Fund 7069) and the Public Library Fund (PLF, Fund 7065), by an estimated $1.0 million. The balance would be retained by the GRF.

Detailed Analysis

The bill reduces withholding tax rates to 3% on certain pass-through entities (PTEs). PTEs include partnerships, S corporations, and limited liability companies. PTEs "pass through" the liability to pay tax on their income to their investors, thereby avoiding a second layer of taxes at the business entity level. Although income taxes are not owed by the PTEs themselves but are due instead from the investors in the PTEs, payments referred to as withholding taxes are made by some PTEs for which the investors in those entities can claim refunds or credits against taxes owed. This withholding tax helps reduce tax avoidance.

For certain out-of-state investors in PTEs that are not individuals or are various financial institutions and some others, the withholding tax rate falls from 8.5% to 3%.[1] For out-of-state investors in PTEs who are individuals and for trusts with beneficiaries who are out-of-state individuals, the withholding tax rate falls from 5% to 3%. The 3% rate equals the rate on taxable business income.

No state personal income taxpayer's tax liability is changed by the bill. Taxpayers are eligible for refunds of withholding tax paid in excess of tax due. However, timing differences between when the tax is withheld and when the refunds are paid will result in a one-time tax revenue loss from the reduction in withholding tax rates that LBO estimates at $31.6 million in FY 2023. This estimate is based on data provided by the Department of Taxation. The loss occurs because refunds (or final settlements) are paid in arrears, for the prior tax year, so adjust more slowly than cash flows from changes in the withholding tax. This remains the case even if the taxpayer owes no tax on the income for which withholding tax was paid. For example, a taxpayer eligible to deduct business income from the PTE that totals less than the maximum allowed deduction of $125,000 for a married taxpayer filing separately and $250,000 for all other taxpayers would owe no tax on that income.

How such a loss would occur can be illustrated in the following way. Estimated withholding tax payments are due quarterly from PTEs affected by the bill, in the month following the end of the quarter. The bill specifies that the changes apply to qualifying taxable years beginning on or after January 1, 2023. This implies that reductions in the withholding tax will start in April 2023, for the January-March quarter. If, for example, for a specific investor the April 2023 withholding tax payment and each subsequent quarterly payment is reduced by $100, that investor's refund for tax year 2022, assumed to be paid in the first half of 2023, would be unaffected by the change. The change in the April withholding tax payment, for the

[1] This part of the bill, amending R.C. 5733.41, applies with certain exceptions to non-Ohio domiciled entities including other PTEs; financial institutions; financial holding companies; bank holding companies; savings and loan holding companies; persons directly or indirectly owned by one or more financial institutions, financial holding companies, bank holding companies, or savings and loan holding companies; persons that solely facilitate or service securitizations by these entities; certain affiliates of insurance companies; and estates and trusts subject to the personal income tax.

2023 first quarter, would not affect the investor's refund until 2024. In FY 2023 the state would receive $100 less for this investor, from the April withholding tax payment, and with the refund unchanged in that year, would incur a net revenue loss of $100. In FY 2024 and thereafter, assuming the change per quarter continues to be a reduction of $100, the state would receive $400 less for this investor, from the July, October, January, and April withholding tax payments, and would refund $400 less, for no net revenue loss.

These changes are shown in the table below, for calendar year (CY) 2022 to CY 2024. Withholding Tax in the first line of the table is paid to the state by the PTE on behalf of the investor. Refund is paid to the investor by the state, assumed in this example to be paid in the April-June quarter. Net to State is the difference between withholding tax and refund. The line labeled Fiscal Year aggregates payments in the Net to State line for the appropriate four quarters.

Illustrative Changes in Withholding Tax for and Refund Paid to Qualifying Investor

	CY 2022		CY 2023				CY 2024	
	July-Sep.	Oct.-Dec.	Jan.-March	April-June	July-Sep.	Oct.-Dec.	Jan.-March	April-June
Withholding Tax	$0	$0	$0	-$100	-$100	-$100	-$100	-$100
Refund	$0	$0	$0	$0	$0	$0	$0	-$400
Net to State	$0	$0	$0	-$100	-$100	-$100	-$100	+$300
Fiscal Year	-$100				$0			

In this simple illustration, income and net taxes due are held unchanged from year to year. Actual withholding tax and refund amounts obviously would vary.

State tax revenue from the withholding tax on PTEs is treated as individual income tax revenue and so is part of GRF tax revenues. Consequently, the Local Government Fund (LGF) and Public Library Fund (PLF) would also lose revenue. The LGF and PLF each receive monthly distributions of a portion of GRF tax revenues in the previous month. In codified law, both funds receive 1.66% of GRF tax revenue. The two funds would incur a total of $1.0 million in estimated one-time revenue losses in FY 2023. All revenues to each fund are distributed in the month received to local governments, primarily municipalities, counties, and townships, and public libraries. The balance, estimated at $30.6 million, would be retained by the GRF.

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