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Bill Analysis

Version: As Introduced

Primary Sponsor: Rep. Roemer

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SUMMARY

- Temporarily modifies Ohio's treatment of federal income tax enhanced depreciation allowances by permitting the following for a business owner with a net operating loss in a taxable year ending in 2020 or 2021:
  - Allows the owner to claim a portion of the owner's allowance in that taxable year that the owner would otherwise have to add back for Ohio income tax purposes.
  - Allows the owner to claim a portion of the owner's allowance in a prior year that includes a net operating loss carryback from those years, even if claiming that allowance results in or increases a net operating loss in that prior year.

DETAILED ANALYSIS

The bill temporarily modifies how federal income tax enhanced depreciation allowances may be deducted for state income tax purposes. First, the bill allows a business owner with a net operating loss (NOL) in a taxable year ending in 2020 or 2021 to claim a portion of the owner's enhanced depreciation allowance in that year. Under current law, a business owner would not be able to deduct, in calculating the owner's Ohio income tax liability, any portion of the allowance for a year in which the deduction would cause the business to have or increase an NOL. Second, the bill allows a business owner to claim enhanced depreciation allowances in a prior year, if that prior year includes an NOL carryback from a taxable year ending in 2020 or 2021, even if the allowance would result in or increase the owner's NOL in that prior year.

Federal enhanced depreciation allowances

Federal income tax law gives enhanced depreciation allowances for businesses that invest in certain depreciable business assets, i.e., tangible personal property and certain real property. There are two forms of the enhanced allowances: "bonus depreciation" and "enhanced expensing." Both are intended to induce increased business investment by permitting businesses to accelerate the tax benefit of asset depreciation deductions, moving it into earlier years than customarily allowed under traditional depreciation schedules. They were originally enacted by Congress in 2002 as temporary measures to combat the recessionary economic trends.[1] Congress made enhanced expensing permanent in 2015, and extended the bonus depreciation allowance several times, which is currently scheduled to be phased out by 2026.[2]

Bonus depreciation allows a business to immediately deduct a percentage of the cost of an asset (plus the customary first-year depreciation deduction) instead of using the usual depreciation schedules. Currently, bonus depreciation allows a business owner to deduct 100% of the cost of the asset if the asset is placed into operation before 2023. That percentage decreases in equal increments beginning in 2023 until bonus depreciation is phased out in 2026.[3]

Instead of or in addition to taking a depreciation deduction, business owners may also deduct as a current business expense the cost of certain otherwise-depreciable property, up to a maximum amount. Enhanced expensing increases the value of an asset that can be immediately deducted when it is acquired or placed in service. The enhanced expensing allowance is currently up to $1 million, depending on when the asset is placed into service and subject to certain limitations.[4]

Ohio's treatment of enhanced depreciation allowances

The enhanced federal depreciation deductions reduce federal taxable income in the early years after the assets are acquired (as compared to the customary depreciation deductions), and therefore reduce Ohio taxable income and income tax revenue. When these federal enhancements were enacted, Ohio and several other states whose income tax bases were tied to the federal tax base blunted the state revenue reductions that would have resulted from the enhancements by not allowing business owners to claim the enhanced depreciation deductions all in a single year. Ohio instead requires an owner to spread the immediate tax reductions in equal parts across six years by requiring the owner to add back five-sixths of the cost of the asset and deducting the remaining cost in equal increments over the following five years. For example, an owner claiming a federal bonus depreciation deduction of $120,000 in one year is required to add back $100,000, and permitted to claim an

[1] "Job Creation and Worker Assistance Act of 2002," 107 P.L.147 (March 9, 2002) (enacting bonus depreciation); "Jobs and Growth Tax Relief Reconciliation Act of 2003," 108 P.L.27 (May 28, 2003) (enacting enhanced expensing).

[2] "Consolidated Appropriations Act of 2016," 114 P.L.113 (December. 18, 2015); "Coronavirus Aid, Relief, and Economic Security Act of 2020," 116 P.L.136 (March 27, 2020).

[3] 26 United States Code (U.S.C.) § 168(k).

[4] 26 U.S.C. § 179.

Ohio deduction of $20,000 per year over the following five years. This smoothed the income tax revenue impact over six years instead of concentrating it in one year.[5]

Business owners may, in certain cases, claim a greater share of their enhanced allowances if the business's annual Ohio payroll withholdings either exceed 110% of those withholdings in the preceding year or exceed the sum of enhanced depreciation allowances for a year. In the former situation, the owner could instead claim the extra allowance in equal amounts over three, rather than six years.[6] If the latter situation applies, the owner may claim the owner's entire enhanced depreciation deduction in a single year.[7]

2020 and 2021 losses and depreciation allowances

Whether a business has an NOL may impact the manner in which the business's owner may employ the six-year or three-year smoothing mechanism described above. Under federal law, if a business owner takes income tax deductions in excess of the owner's income, the owner incurs an NOL. Any excess deductions generally may be carried back up to two years (or up to five years if the loss occurred in 2018, 2019, or 2020), via amended returns, or carried forward until the entire amount is claimed against a business's past or future income, respectively.[8]

Current law requires a business owner to add back the entire amount of the owner's enhanced depreciation allowance if the business incurred an NOL for that year. The owner is then permitted to deduct that unclaimed amount in equal increments over the following six or three years, as applicable.

The bill temporarily suspends the requirement to add back the entire cost of the asset if the owner incurs an NOL for any taxable year ending in 2020 or 2021.[9] As a result, the owner is only required to add back five-sixths or two-thirds of the cost of the asset, as applicable, and is permitted to deduct, under continuing law, the remaining unclaimed amount in equal increments over the following five or two years. In other words, the enhanced depreciation allowance is allowed to increase the business owner's NOL for that year, resulting in a higher NOL carryforward or carryback.

Carry back of 2020 and 2021 losses

Under the bill, a business owner may claim enhanced depreciation allowances for taxable years ending in 2020 or 2021 in such a manner as to increase its NOL carryforward or carryback. In such a situation, under current law, if the NOL is carried back to a prior taxable year, and that carryback increases the owner's NOL in that year, the owner would be required

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[5] R.C. 5747.01(A)(17)(a)(i) to (ii) and (A)(18)(a)(i).

[6] R.C. 5747.01(A)(17)(a)(iii) and (A)(18)(a)(ii).

[7] R.C. 5747.01(A)(17)(a)(iv).

[8] 26 U.S.C. § 172(b).

[9] R.C. 5747.01(A)(17)(a)(v).

to add back, in an amended return, any enhanced depreciation deduction the owner claimed for that prior year.

The owner would be required, under continuing law, to wait to claim any added back enhanced depreciation allowance until the first year in which the allowances do not result in or increase the business's NOL, i.e., a year in which the business's profits exceed its enhanced depreciation allowances.

The bill suspends the prohibition barring a business owner from claiming an enhanced depreciation allowance for a prior tax year if doing so would increase the business's NOL in that year. But the suspension only applies if the increased NOL that would otherwise result in the added back enhanced depreciation allowance arises from an NOL carried back from a loss incurred in taxable year 2020 or 2021. In other words, a business owner may carryback a 2020 or 2021 NOL without having to add back any of its claimed enhanced depreciation allowances it already claimed for that prior year.[10]

HISTORY

Action	Date
Introduced	02-09-21

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[10] R.C. 5747.01(A)(18)(c).