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OHIO LEGISLATIVE SERVICE COMMISSION

Office of Research
and Drafting

Legislative Budget
Office

S.B. 246
134th General Assembly

Final Fiscal Note & Local Impact Statement

[Click here for S.B. 246's Bill Analysis](#)

Primary Sponsors: Sens. Rulli and Lang

Local Impact Statement Procedure Required: Yes

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Highlights

Fund	FY 2023	FY 2024	Future Years
State General Revenue Fund			
Revenues	Potential loss up to \$75.7 million, depending on participation rates	Potential loss up to \$77.5 million, depending on participation rates	Potential annual losses, depending on participation rates
Expenditures	Possible increase	Possible increase	Possible increase
Local Government and Public Library funds (counties, municipalities, townships, and public libraries)			
Revenues	Potential loss up to \$2.6 million, depending on participation rates	Potential loss up to \$2.7 million, depending on participation rates	Potential annual losses, depending on participation rates

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 provides a new option for a pass-through entity (PTE) to comply with Ohio income tax law by directly imposing an income tax on the PTE, if the PTE elects to be subject to this tax. The PTE's owners or investors would then be able to claim a refundable credit on their individual income tax returns equal to their proportionate share of the tax paid by the PTE.
- The bill does not affect PTE owners' or investors' tax liabilities. However, the bill would lower the withholding rate from the current 3.99% for income reported on Form IT-4708 to 3%. Therefore, it would result in a decrease in state income tax revenue, despite also decreasing the amount of unclaimed refunds. The magnitude of the decrease in state

income tax revenue depends on the number of taxpayers opting for the bill's option. Historically, withholding tax paid by PTEs exceeds refundable credits claimed annually.

- Estimates shown in the table above are based on analysis from the Department of Taxation (TAX) and assume that the share of refundable credits not claimed will remain in line with recent experience. 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

Effects on state income tax revenue²

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.³

Historically, 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

¹ Notice 2020-75.

² The estimates in this section rely on analysis provided by the Department of Taxation (TAX). The Department anticipated a shift in the timing of payments with the bill, with some payments from taxpayers that would occur in June 2022 under current law instead being received in July, in FY 2023, with the bill. With the passage of time, LBO instead assumes the revenue loss estimated by TAX for June of FY 2022 now occurs in FY 2023. The timing of losses would depend on when the bill is enacted and its effective date.

³ More precisely, if total allowed credits equal or exceed taxes otherwise due, no return is required.

claiming all credits to which they are entitled. The specific reasons that account for the large amounts not claimed are uncertain. Whatever the reasons, historically part of these refundable credits that nonresident taxpayers are eligible to claim have nevertheless remained unclaimed.

The analysis of the bill's effects on state income tax revenue 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.

While the bill does not affect PTE owners' or investors' tax liabilities, the revenue loss from the bill is expected 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 in tax year 2023 and thereafter. For taxpayers who claim the credits for PTE withholding tax paid on their behalf, this revenue loss to the state would be fully offset by payment of smaller refunds to those taxpayers, or of no refunds if none are owed with the lower withholding tax rate. But for taxpayers who would not claim these credits under current law, 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 up to \$78.3 million in FY 2023, up to \$80.1 million in FY 2024, and continuing revenue losses thereafter. The figures reported here assume that all eligible PTEs opt to pay the new tax. While that is a strong assumption, a reliable alternative assumption is not available, so the figures shown are the likely upper limit of any revenue losses from the bill, and actual annual losses could be significantly smaller depending on participation rates.

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.

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