OHIO LEGISLATIVE SERVICE COMMISSION

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Office of Research and Drafting

Legislative Budget Office

H.B. 1
135th General Assembly

Fiscal Note & Local Impact Statement

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Version: As Introduced

Primary Sponsor: Rep. Mathews

Local Impact Statement Procedure Required: Yes

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Highlights

- The bill eliminates most state income tax brackets for nonbusiness income and imposes a marginal tax rate of 2.75% on income in excess of $26,050. The permanent tax cut would reduce all funds revenue by approximately $1,734 million in FY 2024, $1,854 million in FY 2025, and increasing amounts in future years.
- In addition, a one-time revenue loss is expected in FY 2024 resulting from revised employer withholding tables issued by the Tax Commissioner. LBO's preliminary estimate of this loss is $867 million, which would bring the all-funds revenue loss estimate to $2,601 million in FY 2024.
- The revenue losses will be shared by the state GRF (96.68%), the Local Government Fund (LGF, Fund 7069), and Public Library Fund (PLF, Fund 7065). The LGF and PLF each receive 1.66% of GRF tax revenue under codified law. Therefore, the revenue loss to the GRF is estimated to be $2,515 million in FY 2024 and $1,792 million in FY 2025 and the loss to both the LGF and PLF is estimated to be $43 million in FY 2024 and $31 million in FY 2025.
- The bill reduces the property tax assessment rate on real property from 35% to 31.5% in tax year (TY) 2024 and then indexes the assessment rate to inflation beginning the following year. This would result in revenue losses to school districts and local governments estimated at $538 million in FY 2025 and increasing amounts in future years.
- The bill's decreasing real property assessment rates generally are expected to increase state aid to school districts through the state foundation aid formula, offsetting local tax revenue losses to some degree beginning in FY 2026.

- The bill eliminates the GRF reimbursement of the 10% rollback starting in TY 2024, which reduces GRF expenditures by an estimated $1,309 million per year. The GRF will realize about half a year of the savings in FY 2025 and the full annual amount continuing in subsequent years.
- The bill changes the rollback for owner-occupied residences from 2.5% of most taxes levied to $125 beginning in TY 2024. This may increase expenditures from the GRF to reimburse school districts and local governments for the rollback by $150 million to $180 million per year. About half of that cost ($75 million to $90 million) would be incurred in FY 2025.
- The bill provides an enhanced homestead exemption for long-time, low-income residents, which may increase expenditures from the GRF to reimburse school districts and local governments by an estimated $121 million per year. About half of that cost ($60 million) would be incurred in FY 2025.
- The bill indexes the amount exempted by the homestead exemption to inflation. This change, in conjunction with the changes in the assessment rate and the rollbacks, is estimated to increase the amount of the exemption and GRF reimbursements by about $28 million for TY 2024 and by similar amounts in years thereafter.
- The bill states that the legislature intends to appropriate funds to local governments affected by the bill, but does not specify details or include these appropriations.

Detailed Analysis

The bill reduces income tax rates and eliminates income tax brackets above the bottom taxable bracket. It reduces the real property tax assessment rate from 35% to 31.5%, ties future changes in the assessment rate to changes in the gross domestic product deflator, and makes other changes to property taxation. The bill states the legislature's intent to appropriate funds to reimburse resulting revenue losses of local governments in FY 2024 and FY 2025.

Income tax changes

The bill replaces, starting in tax year 2023, the current tax brackets for nonbusiness income (Ohio adjusted gross income less taxable business income and less exemptions, for individuals) with a single bracket in which tax before credits is charged. Nonbusiness income of $26,050 or less remains untaxed. The tax rate for nonbusiness income over $26,050 up to $46,100 is reduced by 0.5%, from 2.765% to 2.75%. For nonbusiness income over $46,100, marginal tax rates are reduced by 14.8% to 31.1%, depending on the bracket.

This change would reduce personal income tax (PIT) liability by an estimated $1,734 million in TY 2023 and $1,854 million in TY 2024. In addition, the Tax Commissioner would revise the employer withholding tax table to align withholding receipts with the corresponding PIT liability. Such an action would result in a one-time revenue loss during FY 2024 in addition to the TY 2023 PIT liability cut. LBO's preliminary estimate of this loss is $867 million, but the actual amount of the loss would depend on the Tax Commissioner, who maintains discretion over the design of the withholding tax table under R.C. 5747.06. The existing table has eight brackets, with marginal withholding rates up to 5.009%, which contrasts with the tax policy in the bill that essentially consolidates the progressive nonbusiness income tax into two brackets with a top marginal rate of 2.75%.[1]

Lower GRF tax revenue would reduce transfers to each of the LGF and PLF by an estimated $43 million and $31 million, respectively, in those years at the 1.66% rate for each in codified law. LGF revenues are transferred to counties, municipalities, townships, and some other local governments. PLF revenues are transferred to public libraries, with a small amount going to local governments. Amounts retained by the GRF are estimated to be reduced by $2,515 million and $1,792 million, respectively, in FY 2024 and FY 2025. All amounts would tend to rise in most future years.

As noted above, the bill states that the General Assembly intends to appropriate funds in FY 2024 and FY 2025 to local governments affected by the bill's changes. Whether this intent would extend to school districts, or to public libraries, is unclear, and the bill does not appropriate funds.

Potential indirect fiscal effects

Income tax rate reductions ranging up to 31.1% would likely have the indirect effect of increasing the income tax base. To the extent there is such an increase in the tax base, it would result in an increase in PIT revenue. LBO does not know of a reliable source for determining the magnitude of such indirect effects, though published academic research on the effect of cuts to federal (and state) income tax rates concludes that indirect effects are likely to be small relative to the direct effects.

Property tax changes

The bill makes various changes to law governing property taxation. It reduces the assessment rate for real property by 10% in tax year (TY) 2024, and ties future assessment rate changes to national price inflation. It eliminates the 10% reduction (rollback) in taxes due on some Class I real property, and changes the 2.5% rollback for owner-occupants to a fixed dollar amount. It gives the Tax Commissioner limited authority to change the years in which counties undergo valuation reappraisals or updates. It allows eligible long-term homeowners to claim the homestead exemption on up to $50,000 market value of their residences.

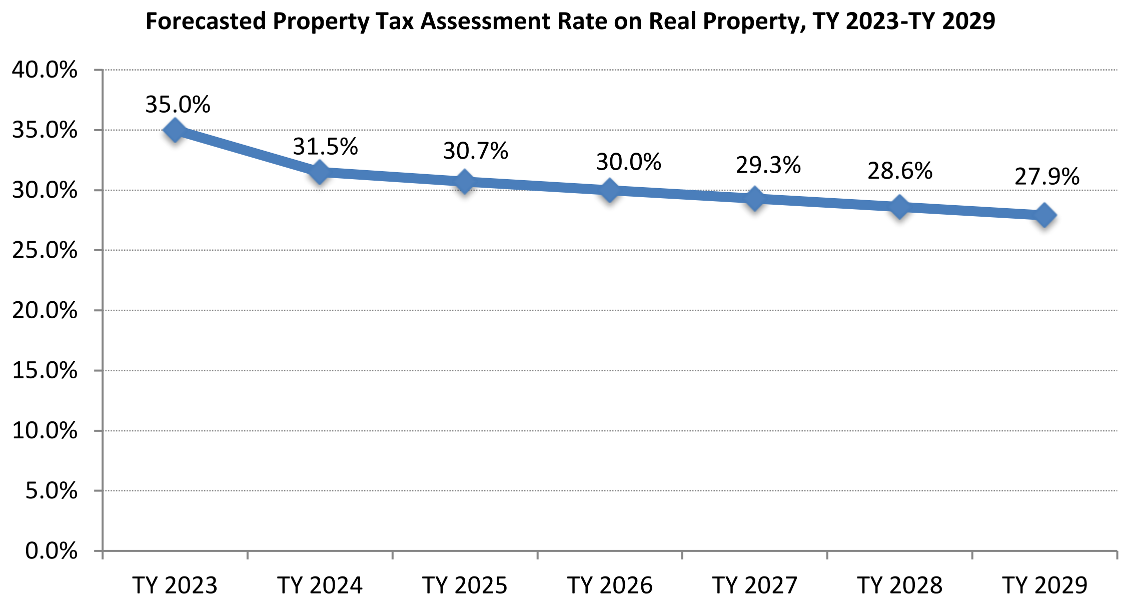
Reduction of assessment rate and elimination of 10% rollback

The bill reduces the real property assessment rate from 35% to 31.5% in TY 2024, a reduction of 10%, and ties future declines in the assessment rate to increases in the gross domestic product (GDP) deflator, a very broad index of nationwide prices.[2] The accompanying chart illustrates assessment rates that might result from the bill. The forecast for years after TY 2024 is based on the February 2023 prediction for annual changes in the GDP deflator from

[1] LBO staff cannot reliably predict how the Tax Commissioner would alter employer withholding tables in response to a PIT change imposed by the bill. Our office inquired shortly after the bill was introduced, and we are awaiting a response. Please regard withholding estimates in this analysis as preliminary, until the Ohio Department of Taxation offers firm guidance.

[2] This measure of inflation is also used to adjust PIT personal and dependent exemption amounts and the homestead exemption.

forecasting firm IHS Markit. Real property taxes are paid a year in arrears, so the change in the assessment rate for TY 2024 would affect payments generally made in the first half of calendar year 2025. GRF reimbursements lag the tax payment dates, and about half of the effects on the GRF of the bill's changes would occur in FY 2025 with the balance in FY 2026.



The bill eliminates the 10% rollback for qualifying levies on residential and agricultural real property, and eliminates the corresponding GRF reimbursement for losses of school districts and local governments from that rollback. Qualifying levies are levies approved before September 29, 2013, and subsequent renewals of these levies. Levies that are not qualifying levies are not subject to rollbacks. Whether a levy is a qualifying levy or not does not alter revenues to taxing authorities, but only whether they are due in full from taxpayers or in part from the GRF to reimburse for reductions in the amounts due from taxpayers.

The lower assessment rate will reduce tax revenues of school districts and local governments from some levies and not from others.

- For inside millage, the 10 mills (1%) of taxes that taxing authorities may levy without seeking voter approval, the tax rate would remain unchanged and the lower assessment rate would reduce tax revenues by 10% for TY 2024.
- For levies to raise fixed sums of money, the tax rates at which the levies are assessed would rise by the amount needed to generate the required sums. The necessary upward rate adjustment would generally be by less than 10% since the taxes are imposed on public utility tangible personal property (PUTPP) as well as real property, and PUTPP valuations are not affected by the bill.
- For outside fixed-rate levies subject to tax reduction factors, the lower property valuations from the bill's reduction in the assessment rate would be offset or partly offset by higher effective tax rates, up to the voted millage. The calculations are done for

carryover property, taxed in the same valuation class in both the current and prior tax years. So for levies with effective rates that are 90% or less of the voted rate, the effective tax rate would adjust upward to fully offset the reduction in assessed value, resulting in no revenue loss. Tax rates on levies with effective rates equal to the voted rates could not adjust upward, and tax revenue from these levies would decline 10% for TY 2024. Tax rates on levies with effective rates between 90% and 100% of their voted rates would adjust upward to the voted rates, resulting in loss of tax revenue by less than 10%.

The 10% rollback in current law applies to residential and agricultural (Class I) real property only. Taxes on all other (Class II) real property are not subject to rollbacks or GRF reimbursements.

Taxes in TY 2024, when the bill's change to the real property assessment rate would go into effect, will depend on future valuations and on future levy enactments and expirations. What follows is an estimate based on extrapolating net taxes charged on Class I and Class II real property into the future at historical rates of change. Shares of net taxes charged in each of the categories identified above are estimated based on sums of millage rates in taxing districts statewide for TY 2022, the latest available. This estimation approach greatly simplifies the calculation, but at the cost of the precision that would result from multiplying the rates on the many property levies statewide times the respective taxable values and computing sums of the resulting products. The estimation technique employed here gives an order of magnitude approximation to the bill's effects.[3]

Net real property taxes charged in TY 2024 under current law are estimated at $20.0 billion, consisting of $15.4 billion on Class I property and $4.6 billion on Class II property.

- Inside millage accounted for 18.8% of the sum across taxing districts of levy millage applicable to Class I property in TY 2022 and 16.3% of the sum for Class II property. Using these percentages, net taxes charged for inside millage would be an estimated $3.7 billion (Class I $2.9 billion, Class II $0.8 billion) for TY 2024. A 10% tax revenue loss due to the assessment rate change totals an estimated $365 million.
- Fixed-sum levies estimated in the same way are 11.7% of Class I property millage and 10.1% for Class II. On an estimated net taxes charged for TY 2024 totaling $2.3 billion (Class I $1.8 billion, Class II $0.5 billion), no revenue loss would be incurred as a result of the assessment rate change.
- Fixed-rate levies subject to tax reduction factors accounted for the majority of net taxes charged. Many – an estimated $11.6 billion (Class I $9.5 billion, Class II $2.1 billion) – are

[3] An alternative calculation performed just for school districts and joint vocational school districts, using both tax rates and property values, indicates that schools would have lost $191 million in property tax revenue for TY 2022 if H.B. 1 had been in effect for that year. Adjusted for estimated growth in property values from 2022 to 2024, this would be equivalent to about $204 million in the year that the bill's property tax provisions would go into effect. Based on this estimate, the $298 million loss estimated using the simpler approach described above could be considered an upper bound on the revenue loss for TY 2024. Time constraints did not permit replicating this alternative approach for other types of local governments.

levied at 90% of voted millage or less, so could fully adjust to offset a 10% reduction in assessed value in TY 2024. An estimated $2.0 billion (Class I $0.9 billion, Class II $1.1 billion) are levied at rates between 90% and 100% of gross millage, and for $0.6 billion (Class I $0.4 billion, Class II $0.2 billion) the effective tax rate equals the voted rate. The revenue loss on fixed-rate levies from the bill's 10% reduction in the assessment rate in TY 2024 is estimated at $172 million.

Total net real property tax revenue losses for TY 2024, generally payable in FY 2025, are estimated at $538 million.[4] Tax revenue losses are estimated at $298 million for schools and $239 million for other local governments. In TY 2025 and thereafter, assessment rates would adjust downward further with changes in the GDP deflator, resulting in additional losses in FY 2026 and subsequent years.

Most levies (85.0% of Class I millage in TY 2022) are qualifying levies. The share in TY 2024 under current law may be smaller, with passage of new levies and expiration of older ones. At the 85.0% share, Class I rollbacks for the nonbusiness credit and associated GRF reimbursements would total about $1,309 million for TY 2024. The bill would eliminate these rollbacks and GRF reimbursements. School district and local government revenue losses would generally occur in the first half of calendar year 2025. About half of the first-year GRF reimbursement would have taken place in FY 2025 with the balance in FY 2026, along with half of the next year's GRF reimbursement.

Property owners would gain from the tax reductions resulting from the lower assessment rate but lose from the loss of the rollback for the nonbusiness credit. The latter would affect Class I real property only. Net taxes charged to owners of residential and agricultural real property would increase an estimated $929 million. Net taxes charged to owners of Class II real property would decrease an estimated $157 million.

Effects of lower property tax assessment rates on school funding

The bill's decreasing real property assessment rates generally would be expected to increase state aid through the state foundation aid formula, the largest source of state support for the operating costs of school districts and joint vocational school districts. This increase will partially offset the loss in local tax revenue resulting from the bill beginning in FY 2026. The magnitude of the increase will depend on future valuations and the parameters of the school funding formula that will be in use in the future.[5]

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[4] Components do not sum to totals shown due to rounding.

[5] Under H.B. 110 of the 134th General Assembly, the current state foundation aid formula is effective through FY 2023. Current law requires the General Assembly to determine the calculations for FY 2024 and succeeding years. The current, as well as previous, formulas have used taxable property values as a factor in the determination of the state and local shares of total foundation funding, so that lower taxable property value results in lower local shares and higher state shares.

Change in rollback for owner-occupied residences

The bill replaces the 2.5% rollback for owner-occupied property with a $125 rollback. The state would continue to reimburse from the GRF the revenue loss of the local taxing unit due to the rollback.

Not all homeowners eligible for this rollback appear to claim it. State reimbursements in 2021 for the owner occupancy credit totaled about $226 million.[6] Statewide taxes paid on owner-occupied housing in 2021 totaled $10.3 billion, based on an American Community Survey (ACS) query. If we assume that the self-reported $10.3 billion in taxes was total actual payments by homeowners, net of rollbacks, the pre-rollback total of amounts on which the 2.5% rollbacks would have been figured is $11.5 billion, implying $244 million in 2.5% rollbacks on qualifying levies.

The number of owner-occupied housing units in 2021 statewide was 3.2 million, as shown by the ACS query. Of this total number, if the number of those actually claiming the credit was proportional to the ratio of credits claimed, $226 million, to credits estimated to be potentially available, $244 million, about 3.0 million households would have claimed the credit. This implies that on average the 2.5% rollbacks amounted to $75 per unit.

The bill's provision for a $125 rollback per homestead amounts to a $50 increase on average per homestead. If we assume that this rollback will be claimed for 3.0 million homesteads, the reimbursement cost to the GRF would rise by about $150 million. Alternatively, for the full 3.2 million households, a $125 owner-occupied rollback would lower taxes by $406 million, $180 million more than in 2021. This range, $150 million to $180 million, represents savings for homeowners and increased cost to the GRF. About half of the GRF reimbursement would occur in FY 2025 and the rest in FY 2026. The full yearly amount of additional GRF reimbursement would continue in FY 2026 and thereafter.

As with other property tax changes in the bill, this change would go into effect for TY 2024 for real property and TY 2025 for manufactured homes, both payable in FY 2025.

Changes in assessment year

The bill allows the Tax Commissioner to delay reappraisal or update in any county by a year during the period 2024-2029 only. This flexibility may help in evening out the reappraisal and update workload on firms that specialize in this type of work, thus assisting counties in completing required assessments of valuations. In 2023, 41 counties are scheduled for reappraisal or update, including two of the state's largest counties. In 2024 and 2025, 24 and 23 counties are scheduled, respectively.

Market valuations of property tend to rise in most years, so delaying reappraisal or update in a county will tend to lower tax revenues. A delayed schedule would be a permanent change, effectively locking in lower revenues in the year from which the reappraisal or update was shifted and every three years thereafter, continuing indefinitely. Part of this shortfall would tend to be offset in the next two years. So this change is not without cost, though the magnitude of the cost of changes will depend on decisions made by the Tax Commissioner in implementing the change.

[6] Department of Taxation Table PD-1 for calendar year 2021, issued March 9, 2022.

Enhancements to homestead exemption

Inflation indexation

The bill indexes for inflation the true (or market) value of property excluded from taxation by the homestead exemption. In current law, the value of property excluded from taxation is stated as $25,000 of the true (or market) value of the property, which is multiplied by the assessment rate and the effective tax rate to determine the amount of the tax exemption.[7] For disabled veterans and survivors of first responders in current law, and for long-time residents under the bill, the value of property excluded from taxation is $50,000 of true value. The bill adjusts both of these amounts for inflation.

The inflation measure used, the GDP deflator, is the same index used for adjusting the assessment rate. Thus the rise in the true value of property subject to the homestead exemption will be approximately offset by the decline in the assessment rate in years after TY 2024, holding the taxable value exempted little changed from year to year, in years after TY 2024.[8] True value exempted from taxation by the homestead exemption in TY 2024 will be $25,800 if the GDP deflator rises 3.2% in 2023.[9] The decline in the assessment percentage would reduce the maximum taxable value exempted in TY 2024 by the homestead exemption for most homeowners to $8,127, a 7.1% decline.

Changes made by the bill would also alter tax rates multiplied by exempted taxable values to determine the amount of each homestead exemption. As discussed above, inside millage rates would be unchanged in TY 2024 by the bill's change in the assessment rate. Fixed-sum levy rates would adjust upward enough to raise the same amount of money, when multiplied by the sum of real property values, reduced 10% by the assessment rate change, and of PUTPP values, unchanged by the bill. Effective rates on fixed-rate levies would adjust upward by varying amounts to or toward voted millage rates. A precise assessment of the appropriate change in the rate would be a complex calculation. The upward adjustment in the rate is here estimated at 8.2%.

A decline in taxable value of 7.1% and a rise in the effective millage rate of 8.2%, coupled with the net effect of the increase in the owner-occupied credit from $75 on average to $125 and the elimination of the 10% rollback, imply an increase in the total amount of the homestead exemption. The total amount of the exemption has been declining for years, as persons who qualified a decade ago when eligibility was not subject to an income test cease to be homeowners. State reimbursements in 2021 for the homestead exemption totaled about

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[7] A further adjustment is also made to take account of the rollbacks.

[8] The changes are not exactly offsetting because calculation of the taxable value exempted as specified in R.C. 323.152(A)(1)(d)(iii) is equivalent to the product of one plus the GDP deflator percent change, times the previous year's exempted amount, while the assessment percentage as specified in R.C. 5715.01(B) is equivalent to the product of one minus the GDP deflator percent change, times the previous year's assessment percentage. For positive changes in the GDP deflator, this formulation gives rise to very gradual declines in taxable value exempted, measured in nominal dollars. Inflation of 3% per year, for example, implies declines in taxable value exempted of about 0.1% per year.

[9] This is the February 2023 prediction of forecasting firm IHS Markit, services of which are used by LBO.

$364 million.[10] By 2024, the amount is projected to decline to $325 million, based on recent rates of decline. The inflation indexation provisions of the bill along with the increase in the average effective millage rate and the change in the 10% and owner-occupied rollbacks are predicted to increase the homestead exemption by about $28 million in TY 2024. Due to the considerable uncertainties in the components of this forecast, it should be viewed as only a rough approximation. Half of the GRF reimbursement would take place in FY 2025, and half would take place in FY 2026.

Long-time residents

The bill provides an enhanced homestead exemption to homeowners who (1) are age 65 or older, disabled, or the surviving spouse age 59 to 64 of a person who applied and qualified for the exemption; (2) have income not more than a threshold amount adjusted each year for inflation, which was $34,600 for 2022; and (3) have continuously owned and occupied the homestead for 20 or more years. The enhanced exemption is on up to $50,000 market value of the homestead, which would be adjusted upward for inflation. So an owner-occupant satisfying the requirements, other than the new 20-year residency requirement, for a homestead exemption on up to $25,000 market value, adjusted for inflation, of a homestead could qualify for up to twice as large an exemption upon reaching 20 years residency in the home. A surviving spouse of a person who applied and qualified for the reduction would also qualify.

Most owner-occupied residences of persons age 65 or older are the homes of persons who have lived in the same residence for 20 years or more, as indicated by an ACS query. In 2021, 65% of owner-occupied residences of persons age 65 or older had been the homes of those persons for 20 years or more. On average, these long-time residents paid somewhat lower taxes. They accounted in 2021 for 62% of property taxes paid by all persons in that age group.

Limiting the exemption to homeowners with low incomes as well as 20 years of residency in the same home reduces the share of owner-occupied residences further, to 23% of owner-occupied households of homeowners age 65 and older, about 260,000 households. These homeowners would save an estimated $121 million in taxes, which would be reimbursed from the GRF.

Property Tax Administration Fund changes

The bill eliminates a credit to the Property Tax Administration Fund (Fund 5V80) of up to 0.25% of the amount by which taxes charged against real property were reduced under R.C. 319.302, repealed by the bill. This section provides for the 10% rollback. The 0.25% credit to the fund was suspended in FY 2022 by a provision of H.B. 110 of the 134th General Assembly. The provision would raise up to about $3 million per year. Department of Taxation costs to administer the 10% rollback, paid in part from this fund, will be reduced by the rollback's elimination by the bill.

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[10] Department of Taxation Table PD-1 for calendar year 2021, issued March 9, 2022.