Ohio Legislative Service Commission

Final Analysis

Sam Benham

Sub. S.B. 208

131st General Assembly
(As Passed by the General Assembly)

Sens. Beagle, Peterson, Eklund, Bacon, Coley, Faber, Gardner, Hite, Hottinger, Jones, LaRose, Lehner, Manning, Obhof, Oelslager, Patton, Seitz, Uecker, Widener

Reps. Amstutz, Anielski, Antani, Antonio, Brown, Conditt, Cupp, Derickson, Dever, Dovilla, Duffey, Grossman, Hackett, Hambley, Hayes, Henne, Hill, Huffman, T. Johnson, Kunze, LaTourette, Manning, Ryan, Scherer, Schuring, Sears, R. Smith, Sprague, Terhar, Rosenberger

Effective date: February 15, 2016; certain provisions effective November 15, 2015

ACT SUMMARY

- Provides that, for taxable years beginning in 2015, any taxable business income under $250,000 (or $125,000 for spouses filing separate returns) is subject to graduated tax rates similar to those applicable to nonbusiness income and not higher than 3%, while any business income in excess of those amounts remains subject to the recently enacted 3% flat tax rate.

- Specifies that a taxpayer may apply personal exemptions and tax credits to reduce the taxpayer's tax on business income, tax on nonbusiness income, or both.

- Changes the method for phasing out payments that school districts receive to reimburse them for their loss of tangible personal property taxes and requires a one-year supplemental payment to some school districts adversely affected by the prior reimbursement method.

- Modifies the commercial activity tax exclusion for receipts from the sale of certain consumer products within an integrated supply chain.

- Repeals obsolete sections of the Income Tax Law relating to expired tax credits.

CONTENT AND OPERATION

Business income tax rates for 2015

The act modifies the tax rates applicable to certain business income for taxable years beginning in 2015. This modification relates to recent changes made in H.B. 64 of the 131st General Assembly, which increased the business income deduction and substituted a 3% flat tax rate on business income for the tiered tax rate brackets that previously applied to such income, while maintaining those tiered rate brackets for nonbusiness income.

Under prior law, as modified by H.B. 64, all business income in excess of the business income deduction was subject to a 3% flat rate. For taxable years beginning in 2015, the business income deduction equals 75% of the taxpayer's first $250,000 of business income ($125,000 for spouses filing separate returns). For taxable years beginning in 2016 or thereafter, the deduction increases to 100% of the taxpayer's first $250,000 (or $125,000) of business income.

H.B. 64's imposition of a 3% flat tax for the 2015 taxable year could have resulted in a subsection of taxpayers paying more tax for that taxable year than they otherwise would have absent H.B. 64. Without the H.B. 64 changes, taxpayers would have received a business income deduction equal to 50% of the taxpayer's first $250,000 of business income ($125,000 for spouses filing separately), and the amount remaining would have been subject to the tiered tax rate brackets. A taxpayer's combined taxable income (both nonbusiness income and business income remaining after the 50% deduction) of around $20,900 or less would have fallen into a tax bracket with a rate lower than 3%. After H.B. 64, however, any of that taxpayer's business income remaining after the 75% business deduction would have been subject to a flat 3% rate, resulting in a higher net tax.

In order to avoid this result, the act provides that, for taxable years beginning in 2015, the portion of a taxpayer's business income that is under $250,000 ($125,000 for spouses filing separately) and that remains taxable after the business income deduction will be subject to tiered brackets. The brackets are identical to the tiered brackets applicable to nonbusiness income, except with respect to income above $41,700. As illustrated below, the marginal tax rate applicable to nonbusiness income over $41,700 is 3.465% or higher. By contrast, the act caps the marginal rate applicable to business income over $41,700 at 3%.

2015 Nonbusiness Income Tax Rates	
$5,200 or less	0.495%
More than $5,200 but not more than $10,400	0.990% of the amount in excess of $5,200
More than $10,400 but not more than $15,650	1.980% of the amount in excess of $10,400
More than $15,650 but not more than $20,900	2.476% of the amount in excess of $15,650
More than $20,900 but not more than $41,700	2.969% of the amount in excess of $20,900
More than $41,700 but not more than $83,350	3.465% of the amount in excess of $41,700
More than $83,350 but not more than $104,250	3.960% of the amount in excess of $83,350
More than $104,250 but not more than $208,500	4.597% of the amount in excess of $104,250
More than $208,500	4.997% of the amount in excess of $208,500

2015 Business Income Tax Rates	
$5,200 or less	0.495%
More than $5,200 but not more than $10,400	0.990% of the amount in excess of $5,200
More than $10,400 but not more than $15,650	1.980% of the amount in excess of $10,400
More than $15,650 but not more than $20,900	2.476% of the amount in excess of $15,650
More than $20,900 but not more than $41,700	2.969% of the amount in excess of $20,900
More than $41,700	3% of the amount in excess of $41,700

As a whole, the act's modification ensures that no taxpayer will pay a higher marginal tax rate on business income for the 2015 taxable year than the taxpayer otherwise would have if H.B. 64 had not been enacted.[1]

Use of income tax personal exemptions and tax credits

Personal exemptions

The act clarifies that a taxpayer may use the taxpayer's personal exemptions to reduce either taxable nonbusiness income or taxable business income (or both). Prior

[1] R.C. 5747.01(A)(31) and (HH) and 5747.02.

law, as amended by H.B. 64, explicitly allowed personal exemptions to be applied only against nonbusiness income.[2]

Under continuing law, taxpayers are allowed a personal exemption for the taxpayer, the taxpayer's spouse, and any dependents. The exemption amounts for 2014 equal $2,200 for taxpayers with an Ohio adjusted gross income (OAGI) of less than $40,000, $1,950 for taxpayers with an OAGI between $40,000 and $80,000, and $1,700 for taxpayers with an OAGI of more than $80,000.

Credits

The act also allows taxpayers to claim income tax credits against tax liability arising from either business income or nonbusiness income. Prior law, as amended by H.B. 64, limited the application of certain credits to either a taxpayer's business income tax liability or nonbusiness income tax liability, as applicable. (For example, the joint filing credit could be applied only against a nonbusiness income tax liability.)[3]

TPP replacement payments to school districts

The act changes the schedule for phasing out payments that school districts receive to reimburse them for the previous termination or reduction of taxes on tangible personal property.[4] The reimbursement partly compensates for property tax revenue reductions brought about by legislated reductions in the taxable value of property used by electric, natural gas, and telephone utilities and by the termination of taxes on tangible personal property used in business. The act affects payments that are based on tax losses from local operating levies that are imposed at a fixed millage rate (i.e., not emergency levies or bond levies); such levies constitute the largest class of reimbursable levies (about 75% of all school district and JVSD reimbursement payments).

Prior law

Under prior law as recently enacted by H.B. 64, reimbursement for such fixed-rate levies would have been phased down at a pace governed by how much those payments were for FY 2015 as a percentage of a school district's total operating

---

[2] R.C. 5747.02(A)(4)(b).

[3] R.C. 5709.65, 5709.66, 5747.05, 5747.054, 5747.055, 5747.056, 5747.059, 5747.22, 5747.27, 5747.28, 5747.29, 5747.331, 5747.37, 5747.65, 5747.66, 5747.71, 5747.75, 5747.76, 5747.80, 5747.81, and 5747.98.

[4] R.C. 5709.92.

revenue.[5] Payments were phased out more quickly for districts whose FY 2015 replacement payments were a relatively small percentage of their total resources. The phase-out also incorporated a tax-raising capacity factor designed to continue relatively greater payments for more years for districts that have relatively lower personal income and per-pupil property wealth. For districts in the middle 20% (third quintile) of tax capacity, the replacement payment would have been made in FY 2016 only if and to the extent that the FY 2015 payment represented more than 1.5% of the district's total resources; in FY 2017, the percentage would have increased from 1.5% to 3%, and it would have increased by an increment of 1.5% each year thereafter. The initial percentage was 2% for districts in the highest tax capacity quintile, 1.75% for those in the next-highest quintile, 1.25% for the second-lowest quintile, and 1% for the lowest quintile. The initial percentage was 2% for all joint vocational school districts.

Example. As an example of prior law's phase-down schedule, consider a district in the middle tax capacity quintile whose FY 2015 reimbursement payment for fixed-rate operating levies was about $2.7 million, which was about 6.3% of its total operating revenue of about $42.4 million. As a district in the middle tax capacity quintile, its FY 2016 phase-out percentage would have been 1.5%. Its FY 2016 payment for fixed-rate operating levies would have equaled its FY 2015 payment for such levies minus 1.5% of its total operating revenue. Thus:

FY 2016 payment = [$2.7 million – (1.5% x $42.4 million)]

= [$2.7 million - $636,000]

= $2,064,000

The district's FY 2017 payment would have equaled its FY 2015 payment minus 3% of its total operating revenue:

FY 2017 payment = [$2.7 million – (3% x $42.4 million)]

= $1,428,000

The FY 2018 payment, using a 4.5% phase-out percentage, would have equaled $792,000. In FY 2019, when the percentage is 6%, the payment would have equaled $156,000. No payment would have been made to the district after FY 2019 for fixed-rate operating levies because that year's phase-out percentage (7.5%), when multiplied by

[5] Total operating revenue (named "total resources" in the law) is based on tax year 2014 operating levy taxes and FY 2015 state education aid, reimbursements for operating and nondebt levies, income taxes, and casino tax revenue.

the district's total operating revenue, would have yielded an amount that exceeded the district's FY 2015 reimbursement for those levies.

FY 2017 supplement

For FY 2017, the act maintains the existing reimbursement framework, but provides for a separate "supplemental" payment for city, local, and exempted village school districts. The payment guarantees that the combined amount of state foundation funding and TPP reimbursement for fixed-rate operating levies that a district receives in fiscal year 2017 will equal at least 96% of the combined amount of state foundation funding and TPP reimbursement for fixed-rate operating levies that the district received in FY 2015.[6]

Proposed phase-down beginning FY 2018

The act replaces, beginning in FY 2018, the prior phase-down schedule with one that phases the payments down each year solely on the basis of a fixed portion of each school district's taxable property valuation. Specifically, reimbursement payments would begin to decline in FY 2018 by 1⁄16 of 1% of a district's taxable property valuation averaged over the three-year period from 2014 to 2016. (1⁄16 of 1% is the equivalent of 5⁄8 mills per dollar of valuation, or 0.0625%). In FY 2019, the payment would equal the FY 2018 payment minus 0.0625% of the three-year average valuation, and each succeeding year's payment would equal the immediately preceding year's payment minus 0.0625% of the three-year average valuation until the payment amount reaches zero.

Example. Consider the school district in the preceding example of prior law's operation, and assume it has a three-year average total taxable value for 2014 – 2016 of $475 million. 1⁄16 of 1% of this amount is $296,400. Under the act, the FY 2018 payment equals its FY 2017 payment reduced by this amount:

FY 2018 payment = $1,428,000 - $296,400 = $1,131,600

Its FY 2019 payment will equal its FY 2018 payment minus the same $296,400:

FY 2019 payment = $1,131,600 - $296,400 = $835,200

---

6 H.B. 64 of the 131st General Assembly included a similar provision authorizing supplemental payments guaranteeing that, in both FY 2016 and 2017, a district receive combined state foundation funding and TPP reimbursement for fixed-rate operating levies equal to at least 100% of the combined amount of state foundation funding and TPP reimbursement for fixed-rate operating levies the district received in FY 2015. However, the Governor vetoed the supplemental payment authorized for FY 2017.

Its payments will be reduced by $296,400 each year through FY 2021, when it receives its final payment of $242,400. In FY 2022, it will no longer receive a reimbursement for its fixed-rate operating levies.[7]

Exclusion for health and beauty product supply chain receipts

Continuing law excludes, for purposes of calculating the base of the commercial activity tax (CAT), receipts from sales of beauty, health, personal care, or aromatic products (including candles), or packaging or components of those products (collectively referred to as "qualified property"), when the sales are between businesses within an integrated supply chain ("integrated supply chain vendors"). (The CAT is levied on the basis of a business' taxable gross receipts.) To qualify for the exclusion, a vendor must provide certain services within an area of land located in New Albany, Ohio. The exclusion applies retroactively to CAT periods beginning in 2011 and later.

The act makes several changes to this exclusion. First, the act changes the categories of receipts and sales that qualify for the exclusion. Under prior law, an "integrated supply chain" was two or more integrated supply chain vendors that systematically collaborate and coordinate business operations with a retailer on the flow of goods from the point of their material sourcing through their delivery to a retailer; retailers themselves were specifically excluded from the integrated supply chain. The act authorizes the retailer to be included as part of an integrated supply chain, thus enabling receipts from sales to the retailer to qualify for the exclusion.[8] The act also expands the existing definition of "retailer" to include not only a person engaged primarily in making retail sales, but also any person consolidated or combined with such a person for purposes of paying the CAT. Those consolidated or combined persons are considered retailers even if they themselves are not primarily engaged in making retail sales.[9] Additionally, the act expands the definition of qualified property by (1) including finished retail products, and (2) no longer requiring packaging to be incorporated into the finished retail product in order to be considered qualified property, but limits the definition by excluding machinery, furniture, and fixtures.[10]

Second, the act adjusts the services that may qualify a vendor for the exclusion. Under continuing law, receipts may be excluded only if the vendor provides "integrated

---

[7] The examples in this analysis are not intended to reflect the typical or average difference between prior law's payment outcomes and payment outcomes under the act.

[8] R.C. 5751.01(F)(2)(jj)(i), (iii), and (v).

[9] R.C. 5751.01(F)(2)(jj)(vii).

[10] R.C. 5751.01(F)(2)(jj)(ii).

supply chain services" within its integrated supply chain. Under prior law, such services encompassed manufacturing, processing, and packaging goods that will become finished retail products. The act expands these services to also include procuring raw materials that will become finished retail products but also specifies that the finished goods must be capable of being sold by a retailer in the same integrated supply chain.[11]

Third, in addition to authorizing integrated supply chain vendors to exclude receipts from the sale of qualified property as under continuing law, the act authorizes vendors to exclude receipts from the sale of integrated supply chain services to another vendor or retailer in the supply chain. The act also clarifies that excludable receipts do not include receipts of a person outside the supply chain from selling raw materials to a member of the supply chain, or receipts of a supply chain member from sales to persons outside the supply chain.[12]

Fourth, the act requires each retailer with integrated supply chain vendors that would qualify for the exclusion to annually submit a list to the Tax Commissioner identifying those vendors for the upcoming year.[13] Upon receipt of the list, the Commissioner must issue a certificate to each vendor and the retailer entitling the vendors to exclude their supply chain receipts for that year. The act requires the retailer to notify the Tax Commissioner of any changes to the list and requires the Commissioner to issue revised certificates, including the effective date of any change. Vendors are not eligible for the exclusion unless they appear on the list for that year.[14]

The act requires the retailer to furnish a list of persons that were or are integrated supply chain vendors of the retailer between 2011 and 2016. The list authorizes listed vendors to obtain retroactive refunds for those years and to prospectively take the exclusion for 2016 tax periods. The retailer must submit the list by December 1, 2015.[15]

Fifth, the act adjusts the potential geographical area in which integrated supply chain services must be provided to qualify a vendor for the exclusion. Under prior law, to qualify for the exclusion, vendors in the same supply chain had to provide supply

[11] R.C. 5751.01(F)(2)(jj)(vi).

[12] R.C. 5751.01(F)(2)(jj)(i).

[13] If the retailer is a member of a group of related companies that file CAT reports together as a combined or consolidated group, the list must be submitted by the company that is responsible for filing CAT reports for the group (the "reporting person.")

[14] R.C. 5751.01(F)(2)(jj)(v).

[15] Section 6.

chain services within the same parcel or contiguous parcels of land of between 400 and 700 acres located in a county with a 2010 population between 165,001 and 170,000 (i.e., Licking County) and a city with a 2010 population between 7,501 and 8,000 (i.e., New Albany). The act (1) removes the requirement that such parcels be contiguous, (2) requires that the acreage be located within the corporate limits of New Albany as they existed on September 29, 2015, (3) requires that the supply chain existed on September 29, 2015, and (4) removes the maximum acreage limitation—instead requiring the total area to exceed 100 acres.[16]

Sixth, the act prohibits a business from excluding receipts in an integrated supply chain from the sale of qualified property related to prescription drugs, durable medical equipment, mobility enhancing equipment, or a prosthetic device.[17]

Finally, the act removes the requirement that an integrated supply chain vendor have receipts from sales within an integrated supply chain as a "direct" member of that supply chain to qualify for the exclusion.[18]

Removal of expired tax credits

The act also removes several obsolete sections of the Income Tax Law that relate to income tax credits that have expired. The expired tax credits are:

(1) The credit for retailers of alternative fuel;

(2) The credit for payment of tangible personal property taxes for property used in manufacturing or refining;

(3) The credit for businesses that increase their export sales;

(4) The credits for purchasers of new manufacturing machinery or equipment in 1995 or 1996;

(5) The credit for economic development of a distressed area;

(6) The credits for employers that provide day-care for children of employees, establish a day-care center for employees' children, or reimburse employees for day-care expenses;

---

[16] R.C. 5751.01(F)(2)(jj)(viii).

[17] R.C. 5751.01(F)(2)(jj)(iv).

[18] R.C. 5751.01(F)(2)(jj)(iii).

(7) The credit for purchases of lights and reflectors for installation on agricultural tractors to comply with statutory lighting and reflector requirements;

(8) The credit for the payment of certain employee training costs.[19]

HISTORY

ACTION	DATE
Introduced	09-03-15
Reported, S. Ways & Means	10-21-15
Passed Senate (33-0)	10-21-15
Reported, H. Ways & Means	10-27-15
Passed House (87-6)	10-27-15
Senate concurred in House amendments (30-0)	10-27-15

15-SB208-131.docx/emr

[19] R.C. 5733.48, 5747.051, 5747.057, 5747.26, 5747.261, 5747.31, 5747.32, 5747.34, 5747.35, 5747.36, 5747.38, 5747.39, and 5747.77 (repealed); R.C. 9.66, 122.16, 122.172, 122.173, 5733.33, 5733.42, 5733.98, 5747.21, 5747.212, and 5747.22 (amended to remove cross-references).