Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: S.B. 208 of the 131st G.A. as amended by AM1060

Date: October 6, 2015

Status: In Senate Ways & Means

Sponsor: Sen. Beagle

Local Impact Statement Procedure Required: Yes

Contents: To modify the 2015 tax rates applicable to taxable business income and permit taxpayers to claim personal exemptions and credits regardless of their income type

State Fiscal Highlights

- Modifying the personal income tax code for tax year 2015 will create a revenue loss. The FY 2016 GRF revenue loss is estimated between $75 million and $81 million.
- Beginning in FY 2017 and years thereafter, changes made to the availability and use of tax credits represent a GRF revenue loss because they reduce the income tax liability of certain taxpayers. The annual GRF revenue loss could range from slightly less than $2 million to nearly $8 million, depending on taxpayers' characteristics.

Local Fiscal Highlights

- Modifying the personal income tax code for tax year 2015 will create a revenue loss for the Local Government Fund (LGF) and Public Library Fund (PLF). The LGF and PLF receive 1.66% and 1.7% of GRF tax revenues, respectively. During FY 2016, each fund could lose between $1.3 million and $1.4 million.
- Beginning in FY 2017 and years thereafter, the changes in S.B. 208, as amended by AM1060, will reduce the combined revenues to these two funds by less than $300,000 per year.
- The bill permanently changes the applicability of personal exemptions to those returns that only have business income. This provision reduces the Ohio Taxable Income for some taxpayers, and to the extent that those affected taxpayers are subject to the School District Income Tax, school districts will lose revenue.

Detailed Fiscal Analysis

S.B. 208, as amended by AM1060, changes the personal income tax (PIT) laws with two major provisions: (1) changing the tax rates applicable to the nonexempt portion of the first $250,000 of business income in tax year (TY) 2015 and (2) specifying that PIT personal exemptions and credits apply to PIT filers regardless of their income type.

An itemized summary of the fiscal effects is in Table 1. Each major provision is discussed in further detail below.

Table 1. Revenue effects of S.B. 208 as amended by AM1060 provisions (amounts in millions)		
Tax Provision	**FY 2016 (TY 2015)**	**FY 2017 (TY 2016)**
Tax nonexempt business income below $250k separately on a graduated tax table where marginal rates do not exceed 3%, rather than a flat 3% rate	($76)	$0
Specify that PIT personal exemptions and certain credits can also apply to those PIT filers with only business income	($2 to $8)	($2 to $8)
Total Revenue Gain/(Loss), All Funds	($78 to $84)	($2 to $8)

All revenue effect estimates in this Fiscal Note are, as with any Fiscal Note, compared to current law. In particular, the bill's fiscal effects are measured against income tax provisions enacted by Am. Sub. H.B. 64 of the 131st General Assembly. One implication from Table 1 is that no identically situated taxpayer with business income would pay more in TY 2015 under S.B. 208, as amended by AM1060, than they would have under current law.

Tax year 2015 small business deduction

The bill changes the tax rates applicable to the nonexempt portion of business income. Under current law, enacted in H.B. 64, the first 75% of business income up to $250,000 is exempt from tax in TY 2015, and the nonexempt business income is taxed at a 3% rate. S.B. 208 distinguishes between the nonexempt "wedge" income and the business income in excess of $250,000. Colloquially, the wedge can be described as the nonexempt 25% of the first $250,000 in business income; the size of the wedge cannot exceed $62,500. Under current law, the wedge is treated the same as all other nonexempt business income – it is subject to a 3% tax rate. The bill changes the tax treatment of this wedge by separating it from all other income and applying the graduated tax rates to this nonexempt business income. The graduated rates differ from those enacted in H.B. 64 because they are modified to ensure the marginal rate does not exceed 3%; all nonexempt business income in excess of $41,700 is taxed at 3%.

Relative to current law, separately taxing the wedge at the modified income tax rates represents a tax cut for most taxpayers and no change for others with low incomes. The $62,500 wedge would incur a tax liability (before credits) of $1,553, which is less than the liability incurred by a 3% flat tax – $1,875.

The fiscal effect depends on the incidence and distribution of business income. This sort of analysis can best be gleaned from access to Ohio tax returns. In the absence of this privileged information, LSC can examine summary tables publicly available on the Department of Taxation's website. According to the summary tables for TY 2013, the most recent year available, nearly 400,000 taxpayers claimed the small business deduction that year, deducting a total of $8.24 billion in income; tax law applicable to TY 2013 allowed taxpayers to deduct 50% of their business income below $250,000. The summary tables provide an average small business deduction value for given level of Ohio Taxable Income. In a very rough fashion, these two variables allow an estimation of the average taxpayer's total business income. Based on this methodology, the provision will yield a $76 million revenue decrease, of which the GRF would bear nearly $74 million and the remaining $2.5 million would be apportioned to the Local Government Fund and the Public Library Fund.

Expand applicability of the personal exemption and certain tax credits

According to the recent operating budget, H.B. 64, the personal exemption only reduces the Ohio Taxable Income of those returns with nonbusiness income. S.B. 208 removes that distinction and permits taxpayers to claim the personal exemption even if business income is the sole source of income. Separately, the enacted budget also created a new law making income tax credits applicable against: (a) nonbusiness income only, (b) business income only, or (c) both types of income. Refer to Table 2 for a comprehensive list of income tax credits and their current applicability. S.B. 208, as amended by AM1060, removes these distinctions and permits taxpayers to claim any income tax credit for which they are eligible.

At this time, it is unclear how many Ohio tax returns will be affected by this expanded applicability of the personal exemption and certain tax credits. A critical determinant of this fiscal effect is unknown; namely, how many Ohio returns claiming the small business deduction have business income as their sole source of income. Nevertheless, federal tax return data can offer some clues. According to TY 2011 data analyzed by the Tax Policy Center,[1] 5.6% of tax units with business income had business income greater than 50% of the tax unit's Federal Adjusted Gross Income (FAGI). Presumably, a smaller percentage of returns had business income equal to 100% of FAGI, but LSC cannot speculate on this percentage. As a conservative approach, roughly 20,000 Ohio tax returns (where 5% is multiplied by 400,000 returns claiming the small business deduction) are assumed to be affected by this S.B. 208 provision.

As mentioned above, the budget bill limited some income tax credits based on the type of income (refer to Table 2). Some notable credits not available to those taxpayers with business income as their sole source include: the $20 personal exemption credit (claimed on 2.7 million TY 2013 returns, or 50% of all state returns), the joint filer credit (1.2 million returns, or 23% of total), the low income credit (1.2 million returns, or

[1] Table T11-0150 from the Tax Policy Center, which is a joint venture of the Urban Institute and Brookings Institution, http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3031&DocTypeID=7.

22% of total), the retirement income credit (0.9 million returns, or 17% of total), the senior citizen credit (0.9 million returns, or 16% of total), and the earned income credit (0.5 million returns, or 9% of total). S.B. 208 expands the applicability of the personal exemption and these tax credits. If S.B. 208 allows 20,000 returns to reduce their average income tax liability by $100,[2] the state revenue loss would be $2 million. If the average taxpayer savings is closer to $400,[3] the state revenue loss would be $8 million. The GRF share would equal 96.64% of these revenue losses.

Table 2. Summary of Personal Income Tax Credits and the Type of Income Against which the Credit is Applicable per Am. Sub. H.B. 64		
Nonbusiness Income Only	**Business Income Only**	**Both Types of Income**
retirement income credit	credit for employers that reimburse employee child care expenses	credit for adoption of a minor child
senior citizen credit	credit for purchases of lights and reflectors	nonresident credit
lump sum distribution credit	nonrefundable job retention credit	credit for a resident's out-of-state income
dependent care credit	credit for selling alternative fuel	refundable credit for rehabilitating a historic building
lump sum retirement income credit	second credit for purchases of new manufacturing machinery and equipment and the credit for using Ohio coal	refundable job creation credit or job retention credit
low-income credit	job training credit	refundable credit for taxes paid by a qualifying entity granted under R.C. 5747.059
credit for displaced workers	enterprise zone credit under R.C. 5709.66	refundable credits for taxes paid by a qualifying pass-through entity
campaign contribution credit	credit for the eligible costs associated with a voluntary action under R.C. 5747.32	refundable credit for losses on loans made to the Ohio venture capital program
$20 personal exemption credit	credit for employers that establish on-site child day-care centers	refundable motion picture production credit
joint filer credit	ethanol plant investment credit	refundable credit for financial institution taxes paid by a pass-through entity
earned income credit	credit for purchases of qualifying grape production property small business investment credit enterprise zone credits under R.C. 5709.65 research and development credit credit for rehabilitating a historic building	

[2] Generally, $100 reflects the tax savings for a return with 1.5 personal exemptions that avoids paying a marginal rate of 2.969% on income benefitting from the newly applicable personal exemption. In this example, no newly applicable credits are utilized.

[3] Generally, $400 reflects the tax savings for a return with multiple personal exemptions and the presence of other credits that now apply because of the bill.

The bill also removes several sections of the Revised Code that related to tax credits that have expired. The specific tax credits involved are detailed in the LSC Bill Analysis, and there is no fiscal effect from these changes.

Local government funds and school district income tax

Modifying the personal income tax code for tax year 2015 will create a revenue loss for the Local Government Fund (LGF) and Public Library Fund (PLF). The LGF and PLF receive 1.66% and 1.7% of GRF tax revenues, respectively. During FY 2016, each fund could lose between $1.3 million and $1.4 million. Beginning in FY 2017 and years thereafter, the changes in the bill will reduce the combined revenues to these two funds by less than $0.3 million per year.

The bill permanently changes the applicability of personal exemptions to those returns that only have business income. This provision reduces the Ohio Taxable Income for some taxpayers, and to the extent that those affected taxpayers are subject to the School District Income Tax (SDIT), schools districts will lose an amount of revenue that cannot be estimated. Taxpayers with only business income could be subject to the "traditional" SDIT or the newer version of the SDIT that only applies to earned income. The earned income SDIT would not affect as many taxpayers as the traditional SDIT because the only business income applicable to this newer SDIT is self-employment income (including income from partnerships).

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