



Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: S.B. 2 of the 131st G.A. **Date:** February 11, 2015
Status: As Reported by Senate Finance **Sponsor:** Sen. Peterson

Local Impact Statement Procedure Required: Yes

Contents: To expressly incorporate recent changes in the Internal Revenue Code into Ohio law, and to declare an emergency

State Fiscal Highlights

| STATE FUND | FY 2015 | FY 2016 | FUTURE YEARS |
|-----------------------------|-------------------------------------|------------------------------|------------------------------|
| General Revenue Fund | | | |
| Revenues | Loss of tens of millions of dollars | Loss of indeterminate amount | Loss of indeterminate amount |
| Expenditures | - 0 - | - 0 - | - 0 - |

Note: The state fiscal year is July 1 through June 30. For example, FY 2016 is July 1, 2015 – June 30, 2016.

- Incorporating changes to the Internal Revenue Code (IRC) into Ohio law will reduce Ohio Adjusted Gross Income (OAGI) for Ohio taxpayers, and reduce Ohio revenues because OAGI serves as the starting point for determining Ohio taxable income. GRF revenue losses would be tens of millions of dollars in FY 2015. Annual losses in future years are dependent on the amount of bonus depreciation deductions and enhanced expensing occurring in calendar year 2014.

Local Fiscal Highlights

| LOCAL GOVERNMENT | FY 2015 | FY 2016 | FUTURE YEARS |
|--|------------------------------------|------------------------------|------------------------------|
| Counties, municipalities, townships, and public libraries (LGF and PLF) | | | |
| Revenues | Loss of \$1 million or more | Loss of indeterminate amount | Loss of indeterminate amount |
| Expenditures | - 0 - | - 0 - | - 0 - |
| School districts that levy a school district income tax (SDIT) | | | |
| Revenues | Loss up to several million dollars | Loss of indeterminate amount | Loss of indeterminate amount |
| Expenditures | - 0 - | - 0 - | - 0 - |

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- All income tax revenues are deposited into the GRF, and the Local Government Fund (LGF) and Public Library Fund (PLF) each receive 1.66% of GRF receipts. Conforming to the federal definition of income will reduce combined revenue to the LGF and PLF by up to \$1 million or more in FY 2015.
 - The reduction in Ohio taxable income under the bill would reduce school district income tax revenues to those districts that use Ohio taxable income as the basis for calculation of taxes owed. Taxpayers living in these school districts have approximately 8.5% of Ohio taxable income. If tax returns from these areas claimed 8.5% of the marginal increase in this deduction, aggregate school district income tax (SDIT) revenues would be reduced by several million dollars in FY 2015.
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Detailed Fiscal Analysis

The bill incorporates changes to the Internal Revenue Code (IRC) since March 22, 2013 into Ohio income tax law. Ohio tax law incorporates by reference parts of the IRC and other federal laws. Periodic amendments to federal law do not become part of Ohio law unless they are incorporated by an act of the General Assembly. Several changes have been made to the IRC since the last time Ohio conformed to federal income tax law (Am. S.B. 28 of the 130th General Assembly), and some of the changes are estimated to have materially changed Federal Adjusted Gross Income (FAGI). Ohio's income tax returns start with FAGI, and the reduction in FAGI affects Ohio taxable income (OTI).

The latest assorted federal changes being incorporated are those enacted by H.R. 5771, the "Tax Increase Prevention Act of 2014," which took effect December 19, 2014. The foregoing provisions are extensions of previous federal provisions. All of them are extended through December 31, 2014. The principal amendments to federal law the bill incorporates are the following income tax provisions:

- Elementary and secondary school teacher deduction for classroom expenses;
- Qualified tuition expenses deduction;
- Exclusion of Individual Retirement Arrangement (IRA) distributions for charitable purposes;
- Depreciation cost recovery period adjustments for race horses and motor sports entertainment complexes and certain leasehold improvement property, restaurant property, and retail improvement property;
- Bonus depreciation deductions and enhanced expensing (Ohio departs from federal income tax law and generally requires taxpayers to spread the immediate tax reductions from bonus depreciation and enhanced expensing in equal parts across six years);
- Exclusion of 100% of gain on certain small business stock;

- Exclusion of discharge of principal residence indebtedness for individuals;
- Parity for exclusion for employer-provided mass transit and parking benefits;
- Depreciation allowance for second generation biofuel plant property;
- Deduction for energy efficient commercial buildings;
- Election to expense advanced mine safety equipment;
- Special expensing rules for certain film and television productions;
- Basis adjustment to stock of S corporations making charitable contributions of property; and
- Income adjustments for businesses in a designated empowerment zone.

Fiscal effect

Some of the larger individual income tax effects are explained in further detail below:

H.R. 5771 permits taxpayers who have mortgage debt cancelled or forgiven after 2013 to avoid paying taxes on that amount as taxable income. Under this provision, up to \$2 million of forgiven debt is eligible to be excluded from income (\$1 million if married filing separately) through tax year (TY) 2014. This provision was originally created in the Mortgage Debt Relief Act of 2007 to shield taxpayers from having to pay taxes on cancelled mortgage debt stemming from mortgage loan modifications. Enacting conformity for this provision would reduce state revenues by \$9 million to \$15 million in FY 2015.

H.R. 5771 extends the ability to deduct the cost of mortgage insurance on a qualified personal residence. The deduction is phased out ratably by 10% for each \$1,000 by which the taxpayer's AGI exceeds \$100,000. Thus, the deduction is unavailable for a taxpayer with an AGI in excess of \$110,000. The bill extends this provision for one additional year, through TY 2014. Enacting conformity for this provision would reduce state revenues \$4 million to \$7 million in FY 2015.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) created an above-the-line tax deduction for qualified higher education expenses. The maximum deduction was \$4,000 for taxpayers with AGI of \$65,000 or less (\$130,000 for joint returns) or \$2,000 for taxpayers with AGI of \$80,000 or less (\$160,000 for joint returns). H.R. 5771 extends the deduction to the end of TY 2014. Enacting conformity for this provision would reduce state revenues \$3 million to \$5 million in FY 2015.

H.R. 5771 extends for one year the provision that permits an IRA owner who is age 70½ or older generally to exclude from gross income up to \$100,000 per year in distributions made directly from the IRA to certain public charities. Enacting conformity for this provision would reduce state revenues by several million dollars in FY 2015.

H.R. 5771 extends for one year the \$250 above-the-line tax deduction for teachers and other school professionals for expenses paid or incurred for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and service), other equipment, and supplementary materials used by the educator in the classroom. Enacting conformity for this provision would reduce state revenues approximately \$1 million in FY 2015.

The business tax provisions are not addressed in such detail because IRS statistics are less discrete about the business income and deductions incurred by sole proprietors, partnerships, and S corporations. The business tax extenders concerning bonus depreciation will differ from the individual income tax provisions because the Revised Code spreads the state revenue impact over a period that can be as long as six years. The fiscal effect for the bonus depreciation provisions will continue beyond its one-year extension because of the add-back and expensing formula specified in the Revised Code. The bonus depreciation amounts and increased Section 179 expensing applies to property placed into service after December 31, 2013. These provisions sunset on December 31, 2014, so much of the fiscal effect is centered in FY 2015.

Local taxing jurisdictions

All personal income tax (PIT) revenues are deposited into the GRF, and the Local Government Fund (LGF) and Public Library Fund (PLF) each receive 1.66% of GRF receipts. Enacting S.B. 2 will reduce the LGF and PLF each by hundreds of thousands of dollars.

School district income taxes (SDIT) are based on either Ohio taxable income of taxpayers residing in the school district or on the portion of that income that is earned income, generally limited to wages and self-employment income. School boards and voters of individual school districts choose whether to enact income taxes in their districts and which of these two tax bases to use. For school districts in which Ohio taxable income serves as the starting point for calculation of school district income taxes, conforming to the federal definition of income will reduce school district income tax revenues. LSC does not have an estimate of the amount of this reduction. As of January 2014, 146 school districts levied an income tax from the "traditional" tax base rather than the earned income tax base. During FY 2013, these school districts raised \$277.2 million through school district income taxes. The local revenue reduction amount caused by S.B. 2 for each respective school district depends on the number (if any) of taxpayers living in that district who utilize the benefits conferred by S.B. 2. Taxpayers living in school districts with the "traditional" tax base have approximately 8.5% of Ohio taxable income. If tax returns from these areas claimed 8.5% of the income reductions granted by S.B. 2, aggregate SDIT revenues would be reduced by several million dollars during FY 2015.

Emergency clause

The bill includes an emergency provision which makes its provisions effective as soon as signed into law.

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