Ohio Legislative Service Commission

Russ Keller

Fiscal Note & Local Impact Statement

Bill: H.B. 326 of the 131st G.A.

Date: September 23, 2015

Status: As Introduced

Sponsor: Reps. Amstutz and McClain

Local Impact Statement Procedure Required: Yes

Contents: To modify the 2015 tax rates applicable to taxable business income; expand the eligibility for the joint filer credit; 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 could create a revenue gain or loss, depending on the characteristics of tax returns filed in that year. The FY 2016 GRF revenue loss could be as much as $37 million; alternatively, the GRF could gain nearly $12 million.
- Beginning in FY 2017 and years thereafter, the changes in H.B. 326 represent a GRF revenue loss because they reduce the income tax liability of certain taxpayers. The annual GRF revenue loss could range from $23 million to $72 million, depending on taxpayers' characteristics.

Local Fiscal Highlights

- Modifying the personal income tax code for tax year 2015 could create a revenue gain or 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 $0.6 million; alternatively, each fund could gain up to $200,000 (approximately).
- Beginning in FY 2017 and years thereafter, the changes in H.B. 326 will reduce the combined revenues to these two funds by $0.8 million to $2.5 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, school districts will lose revenue.

Detailed Fiscal Analysis

H.B. 326 changes the personal income tax (PIT) laws with three 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, (2) expanding the eligibility for the joint filer credit, and (3) 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 H.B. 326 provisions (amounts in millions)		
H.B. 326 Tax Provision	**FY 2016 (TY 2015)**	**FY 2017 (TY 2016)**
Tax nonexempt business income below $250k at graduated rates rather than a flat 3% rate	+$36	$0
Expand eligibility for the joint filer credit	($22 to $66)	($22 to $66)
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	(-$38) to +$12	($24 to $74)

All revenue effect estimates in this Fiscal Note are, as with any Fiscal Note, in comparison with current law. A notable implication in this case is that Am. Sub. H.B. 64 of the 131st General Assembly, and its income tax provisions, are current law. One implication from Table 1 is that some taxpayers with business income would pay more under H.B. 326 than they would have under current law. It may be worth noting here that no identically situated taxpayer claiming the small business deduction in both TY 2014 and TY 2015 will have a higher tax liability in TY 2015 than in TY 2014 under H.B. 326, due to the various tax changes enacted in H.B. 64 (notably the tax rate reductions).

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 of the 131st General Assembly, 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. H.B. 326 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 grouping it with nonbusiness income and applying the graduated tax rates (enacted in H.B. 64) to this combined amount.

Relative to current law, taxing the wedge at the marginal income tax rates represents a tax cut for some taxpayers and a tax increase for others. The outcome depends on the presence of nonbusiness income. If the taxpayer does not have nonbusiness income, the $62,500 wedge would incur a tax liability (before credits) of $1,649, which is less than the liability incurred by a 3% flat tax – $1,875. However, if the taxpayer had $125,000 in nonbusiness income, the $62,500 wedge would be taxed at the marginal rate of 4.597%, which yields a "wedge" liability of $2,873.

The fiscal effect depends on the incidence and distribution of nonbusiness income. This sort of analysis can only 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 while assigning the residual amount as nonbusiness income. Based on these rough calculations using average income/deduction amounts per return, the bill would increase taxes on 60% of tax returns utilizing the small business deduction while decreasing taxes on the remaining 40%. Collectively, those paying higher taxes would see a $46 million increase in their liability while those benefitting from a tax cut would save $10 million. The net effect is a $36 million revenue increase, of which the GRF would gain nearly $34 million and the remaining $1.2 million would be apportioned to the Local Government Fund and the Public Library Fund.

Joint filer credit expansion

The joint filer credit is available to those married couples that file joint returns and meet criteria regarding both spouses' income. To qualify for this credit under current law, the spouses must each have qualifying[1] Ohio adjusted gross income of at least $500. The bill removes the requirement that spouses must each have at least $500 of earned income, and instead requires that each spouse have at least $500 in adjusted gross income from any source.

[1] Qualifying income is often referred to as "earned" income because income sources that do not qualify are interest, dividends and distributions, royalties, rent, and capital gains.

Table 2. Change in Potential Eligibility for Joint Filer Credit under H.B. 326			
Data Source	**Total Couples**	**Current Law: Joint Filer Credit (JFC)**	**Proposed Law: Gain in JFC couples**
Resident Married Couples Implied by Ohio Tax Returns from TY 2013	2,007,785	1,236,286 tax returns claimed credit	n/a
Ohio Married Couples per query from American Community Survey; income standardized for 2013	2,120,057	1,144,655 assumed to be eligible	624,710 potentially newly eligible

Based on Tax Department data for TY 2013, approximately 2 million married couples filed resident tax returns (see Table 2). The number reflects the 1.8 million PIT returns filed jointly, and the nearly 200,000 couples that filed separately.[2] Among those filing jointly, 1.2 million married couples claimed the joint filer credit. This outcome implies roughly 60% of the married couples filing Ohio resident returns benefitted from the credit. The total value of the credits claimed for TY 2013 was $236 million, but since this is a nonrefundable credit, the state revenue loss was a lower amount, $219 million, according to FY 2014 data from the Tax Expenditure Report.[3] The tax returns do not provide any insights as to why married couples filing jointly did not claim the joint filer credit. Other data sources are better suited to capture the economic characteristics of married couples. By examining the earned and unearned incomes of married householders and their spouses, it is possible to estimate the potential fiscal effect of this provision.

The U.S. Census Bureau, which is part of the U.S. Department of Commerce, conducts the American Community Survey (ACS). This is a mandatory, ongoing statistical survey that samples a small percentage of the population every year. Among other things, the ACS asks married couples about the amount and type of income received by each spouse. ACS data for Ohio largely aligns with TY 2013 data from the Tax Department. Table 2 shows that about 1.1 million Ohio married couples would be expected to qualify for the joint filer credit, and 1.2 million couples did indeed claim the credit on their tax returns. The small discrepancy could be attributed to ACS sampling error or slight differences in the ACS's definition of earned income as compared to the tax code. Regardless, the two figures are close enough to validate the usefulness of the ACS data set.

By removing the restriction on what type of income counts as qualifying income, H.B. 326 is expanding the joint filer credit to include any married couple in which both spouses have at least $500 of qualifying income. The ACS data suggest this would make up to 624,710 additional couples (refer to Table 2) eligible for the joint filer credit.

[2] For TY 2013, Ohio residents filed 344,737 returns with status of married filing separately. By assuming that both spouses filed separately, half of this total serves as the number of couples with this filing status.

[3] The Tax Expenditure Report is prepared by the Department of Taxation and the report is included in the Governor's operating budget. The FY 2014 revenue loss (reflecting TY 2013) returns was $211.8 million. Because the report reflects only GRF losses, this figure is adjusted upward to show the full state revenue loss. The GRF share of tax receipts was 96.68% that year, so the implied total PIT loss was $219.1 million.

If every one of these couples was indeed eligible and filed a tax return,[4] it would increase the eligible population by 55%. Nevertheless, some of the unearned income captured by the ACS data is not taxable under Ohio law. The two largest nontaxable sources of income likely captured by ACS are Social Security benefits as well as interest and dividends received on behalf of federal debt issuances. Upwards of 500,000 married couples could have these nonqualifying items on their returns. However, LSC does not have access to the necessary taxpayer information to determine how many tax returns without the joint filer credit utilize deductions for nontaxable unearned income.

In the unlikely event that H.B. 326 enables all 624,710 married couples to claim the joint filer credit, it would increase the state revenue loss by $88.2 million.[5] If we suppose that one-fourth of the potentially newly eligible couples claim the credit, it yields roughly a $22 million revenue loss. If we assume three-fourths of the potentially newly eligible married couples claim the credit as a result of H.B. 326, it could yield a $66 million revenue loss.

Under current law, the value of foregone state revenues attributed to the joint filer credit grows slightly from year to year. Because unearned income is a more volatile source than earned income, the annual revenue loss in future years may not grow in such a linear fashion.

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. H.B. 326 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 3 for a comprehensive list of income tax credits and their current applicability. H.B. 326 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

[4] The ACS data show that Ohio had about 2.1 million married couples in 2013 but roughly 2.0 million filed resident returns. This discrepancy could have multiple explanations, including a potential sampling error or perhaps reflecting the incidence of married individuals that do not file a resident tax return.

[5] Based on a tax return-style simulation on ACS data using a sample size of 7,473 records representing the 624,710 married couples. The ACS data do not include income from capital gains, so the pool of 624,710 married couples likely underpredicts the married couples that might be affected by H.B. 326.

analyzed by the Tax Policy Center,[6] 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 H.B. 326 provision.

As mentioned above, the budget bill limited some income tax credits based on the type of income (refer to Table 3). 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 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). H.B. 326 expands the applicability of the personal exemption and these tax credits. If H.B. 326 allows 20,000 returns to reduce their average income tax liability by $100,[7] the state revenue loss would be $2 million. If the average taxpayer savings is closer to $400,[8] the state revenue loss would be $8 million.

Table 3. 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

[6] 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.

[7] 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.

[8] 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.

Table 3. 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**
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	

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 could create a revenue gain or loss for the Local Government Fund (LGF) and Public Library Fund (PLF). The LGF and PLF receive 1.66% and 1.7% of GRF revenues, respectively. During FY 2016, each fund could lose more than $0.6 million; alternatively, each fund could gain up to $200,000 (approximately). Beginning in FY 2017 and years thereafter, the changes in the bill will reduce the combined revenues to these two funds by $0.8 million to $2.5 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).

HB0326IN.docx/jc