Russ Keller

Fiscal Note & Local Impact Statement

Bill: S.B. 22 of the 132nd G.A.

Status: As Enacted

Sponsor: Sen. Peterson

Local Impact Statement Procedure Required: No

Subject: To incorporate recent changes to federal adjusted gross income into Ohio law and to declare an emergency

State & Local Fiscal Highlights

- Personal income tax revenue would be reduced by $11 million during FY 2018, according to the Department of Taxation, from federal changes in the Bipartisan Budget Act of 2018 affecting tax returns filed for tax year (TY) 2017.
- The net fiscal effect of federal law changes made in the Tax Cuts and Jobs Act (TCJA), with provisions generally effective starting in TY 2018 (FY 2019), is undetermined.
- The state income tax revenue change would be shared by the state General Revenue Fund (GRF, 96.66% in FY 2019 and 96.68% thereafter), the Local Government Fund (LGF, 1.66%), and the Public Library Fund (PLF, 1.68% in FY 2019 and 1.66% thereafter). Funds deposited into the LGF and PLF are distributed to counties, municipalities, townships, and public libraries according to statutory formulas and decisions by county budget commissions.
- Ohio Taxable Income (OTI) serves as the tax base for one of the two types of School District Income Tax. The modification of federal adjusted gross income incorporated by this bill may affect OTI by indeterminate amounts for affected school districts.

Detailed Fiscal Analysis

The definition of federal adjusted gross income (FAGI) in the Internal Revenue Code was modified on multiple occasions by federal lawmakers since March 30, 2017, and these actions affect the tax base for some Ohio taxpayers. S.B. 22 incorporates two major changes to federal law into Ohio law. Changes to federal law would modify FAGI, which is the starting point for determining Ohio's personal income tax base.

The bill incorporates into Ohio law changes made by the Bipartisan Budget Act of 2018, which extended to December 31, 2017 several federal income tax provisions that had expired on December 31, 2016. Those changes would reduce Ohio income tax revenue by a total of $11 million in FY 2018, according to the Department of Taxation. The most significant provision in the Act, the extension of exclusion from gross income of discharge of indebtedness on qualified principal residence loans, was expected to reduce Ohio income tax by $10 million.

The bill also incorporates changes made in the Tax Cuts and Jobs Act (TCJA), H.R. 1 of the 115th Congress. Most of the changes made by TCJA are effective for tax years starting after December 31, 2017, thus the bulk of state revenue effects would start with tax year 2018 (FY 2019).

Some of these changes are temporary, scheduled to sunset after 2025; because the changes last for the next several biennia, the temporary nature is ignored for current purposes.

The following provisions would tend to increase FAGI for some Ohio taxpayers, thereby likely having the effect of increasing Ohio income tax revenue:

- **Limit on pass-through entity losses:** The bill limits the amount of the distributive loss of a pass-through entity (PTE) that a PTE investor may claim in a taxable year, to $250,000 ($500,000 for joint filers). Any remaining loss may be carried forward as a net operating loss (NOL).
- **Limit net interest deduction:** The bill limits the existing deduction for net business interest expense to no more than 30% of the business's adjusted taxable income.
- **Modification of NOL deduction:** The bill limits the NOL deduction for a given year to 80% of taxable income, and modifies associated carryback provisions.
- **Moving expenses:** The bill repeals a deduction that was allowed for moving expenses incurred by a taxpayer that relocates for work.[1] In addition, employer reimbursements to employees for moving expenses that would otherwise qualify for the moving expense deduction will no longer be excluded from employees' incomes.
- **Treatment of alimony:** Previously, alimony was treated as income by the recipient and deductible for the payer. Under the bill, alimony is not considered income for the recipient, and is not deductible by the payer. Because the amounts involved would in future be taxable to the alimony payer, who is typically subject to higher marginal income tax rates than the payee, this would tend to increase revenue.
- **Re-characterization of Roth IRA conversions:** Previously, if a person converted a traditional IRA to a Roth IRA, they could reverse (re-characterize) that decision (return those contributions to a traditional IRA). Generally, when money is converted from a (pre-tax) traditional IRA to an (after-tax) Roth IRA, the transaction is taxable – unless the

[1] The repeal does not apply to members of the armed forces.

money is converted back to a traditional IRA within a given period of time. The bill prohibits these types of re-characterizations.

- **Exclusion for bicycle commuting reimbursements:** Previously, up to $20 of the amount an employer reimburses its employee for bicycle commuting expenses could be excluded from the employee's income. The bill suspends this exclusion.

The following provisions would tend to decrease Ohio income tax revenue, following adjustments to reduce FAGI:

- **Newly eligible expenditures for 529 College Savings Plans:** The TCJA permits 529 account owners to use distributions from 529 plans to pay K-12 tuition and other education expenses up to $10,000 per student, per year, for enrollment at public, private, or religious elementary or secondary schools.
- **Other changes affecting business income:** The TCJA extends and expands bonus depreciation, increases section 179 expensing to $1 million, expands "qualified property" for purposes of section 179 expensing, and makes changes to certain accounting rules for small business.

Please note that the list above is not exhaustive as TCJA includes numerous other provisions that may affect Ohio income taxes to a lesser degree.

Several of the changes affect the tax treatment of business income, but Ohio no longer has a corporate income tax, and only a fraction of taxpayers under Ohio's personal income tax still pay state tax on their business income. Continuing Ohio law allows a personal income tax deduction for the first $250,000 (joint filers) or $125,000 (single) of business income, and taxes business income at levels above these thresholds at a flat 3% rate. The TCJA changes to business income would not change Ohio income tax liabilities for a substantial majority of taxpayers who take the Ohio business income deduction. Determining the revenue effects of the changes to tax treatment of business income is the primary difficulty in accurately estimating the revenue effects of the bill.

Suspension of requirements regarding dependents

The bill also includes language regarding dependents claimed on Ohio tax returns. Under the TCJA, personal exemptions are suspended for TY 2018 through TY 2025, so no dependents will be claimed on the federal tax return. State law currently requires a dependent be claimed on the federal return in order to be claimed on the Ohio return. This provision suspends this state requirement in order to prevent an increase in Ohio personal income tax liability.

State tax deduction for contributions to 529 college savings plans for K-12

The bill amends Chapter 3334. of the Revised Code to match the expanded definition of eligible higher education expenses enacted by the TCJA. Under the bill, taxpayers may claim a deduction on their state return for contributions made for previously ineligible education expenses, such as tuition for those in kindergarten through 12th grade. The expansion of 529 plan fund usage for K-12 education expenses is likely to give rise to increased contributions to the plan; therefore, this provision will reduce income tax receipts as personal income tax filers exclude up to $4,000 of contributions per child to the plan, under continuing law. The tax department estimates that this expansion would reduce revenue by $20 million in FY 2019. LSC has not independently estimated the behavior of taxpayers with regard to the expansion of 529 plan fund usage, but agrees with the tax department that this provision is likely to result in a significant income tax revenue loss.

Fiscal impact

Given the extent and complex nature of these changes, and the confidential nature of individuals' tax returns, LSC cannot provide a precise estimate of the net state revenue effect of incorporating into state law the FAGI and other changes from the TCJA. The expansion of 529 plan distributions for K-12 education expenditures will decrease income tax revenues. However, the rest of the changes made in the TCJA and incorporated into Ohio law are likely to increase income tax revenues.

The Local Government Fund (LGF) receives 1.66% of all GRF tax receipts, and the Public Library Fund (PLF) receives 1.68% of those receipts in FY 2019 and 1.66% thereafter. Ohio Taxable Income (OTI) serves as the tax base for one of the two types of school district income tax. The modification of FAGI incorporated by this bill may affect the tax base by minimal, albeit indeterminate, amounts for affected school districts that use OTI as their tax base.

Emergency clause

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

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