The Current State of the States
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Breaking News

2014 – 2015 Ohio Budget Bill Finalized

Income Tax Reductions and Key Veto Items Highlight Final Version of Budget

On June 28th, 2013, GBQ published a "Breaking News" SALT Watch describing changes to Am. Sub House Bill 59 ("H.B. 59") approved by the House and Senate and sent to Governor Kasich. On Sunday, June 30th, the final day of the State's fiscal year, Governor Kasich utilized his line item veto power to eliminate several of the proposed changes and signed the bill into law. There are a significant number of changes in the tax and incentives areas. Below is a detailed listing of these changes along with some commentary and key considerations:

Income Tax

- Rate Reduction: Personal income tax rates will be reduced by a total of 10% over the next three years as follows:
  - Tax years beginning in 2013 (retroactive to January 1st) - 8.5% reduction compared to existing rates;
  - Tax years beginning in 2014 - 9% reduction compared to existing rates; and
  - Tax years beginning in 2015 or thereafter – full 10% reduction compared to existing rates.
- Small Business Tax Cut: Owners of pass-through entities will receive a small business tax deduction of 50% of the first $250,000 of business income.
- State Earned Income Tax Credit: Effective January 1, 2013, establishes a nonrefundable earned income tax credit in the amount of 5% of the taxpayer's federal earned income tax credit.
- Repeal of Income Tax Deduction for Wagering Losses: Disallows any deduction for gambling losses despite the fact that they may be deductible for federal tax purposes.
- Elimination of Personal Exemption "Double-Dipping": Effective January 1, 2014, individual taxpayers are prohibited from claiming a personal exemption or a personal exemption credit on his or her income tax return for any taxable year in which another taxpayer may claim the individual as a dependent.
- $20 Personal Exemption Credit Income Limit: The $20 per person tax credit is eliminated for persons earning more than $30,000 annually.

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Commentary:

While not as significant as initially proposed, the rate reduction and small business tax cut are keystones of the Governor's original plan. They represent a noteworthy shift from income taxes toward a more "consumption based" tax system with the increase of the state sales tax rate. This is one of the fundamental ideological differences between the Democrats and Republicans in the General Assembly. It does, however, more closely match taxing regimes in many countries outside the United States, specifically in Europe, whose budgets are more largely funded by "consumption" or value-added taxes.

Commercial Activity Tax / Motor Fuels Receipts Tax

- *Changes to Minimum CAT payment*: Institutes a graduated minimum tax based on the taxpayer's total annual taxable gross receipts. Payment is due May 10th of each calendar year. This structure replaces the $150 minimum tax on the first $1M in taxable gross receipts that all CAT taxpayers pay under existing law.
  - $1M or less of annual taxable gross receipts - $150
  - $1 – $2M of annual taxable gross receipts - $800
  - $2 – $4M of annual taxable gross receipts - $2,100
  - Greater than $4M of annual taxable gross receipts - $2,600

- *Creation of the Motor Fuel Receipt Tax*: Effective July 1, 2014, the motor fuel receipts tax (MFRT) will replace the commercial activity tax on receipts from the sale or exchange of motor fuel. The new tax is levied at a rate of 0.65% and applies only to a "supplier's" first sale of motor fuel delivered to a location in Ohio. A supplier is limited to a person who sells motor fuel from a terminal or refinery rack outside the "distribution system" (refineries and pipelines). Dubbed "CAT at the Rack", this provision effectively limits the applicability of a gross receipts tax to only the initial sale of motor fuel in Ohio, rather than each sale throughout the supply chain as imposed under prior law.

- *Tax Commissioner's General Authority to Issue CAT Assessments*: Authorizes the Tax Commissioner to issue an assessment for unpaid taxes, penalties, and interest against any person liable for the unpaid amount, including any person jointly and severally liable for a commercial activity tax liability incurred by the person's consolidated taxpayer group.

- *Exclusion for Grain Handlers*: Excludes receipts of licensed agricultural commodity handlers from the sale of agricultural commodities.

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- *Penalties for Improperly Excluded QDC Receipts*: Removes the previously established $500,000 penalty for improperly excluded qualified distribution center (QDC) receipts. Establishes a new penalty on the operator of the QDC that equals the amount which would have been paid by suppliers to the distribution center had the improperly issued a QDC certificate not been used. Additionally, in calculating the penalty, there is no deduction for any amounts actually paid by suppliers.

Commentary:

The changes to the minimum payment for CAT will have a direct impact on many taxpayers' liabilities and the calculations used to arrive at the tax due. This is especially true for taxpayers whose annual tax liability may be unknown as of May 10th of any given year.

Despite arguments against additional exclusions to the CAT, the "carve-outs" for motor fuel and grain handlers were approved in the final version of the bill. Those arguing against such carve-outs insist that any exclusion eroding the CAT tax base are contrary to the original legislative intent of a "broad base – low rate" tax.

Incentives

- *Impact Facility Agreements Under County Sales and Use Tax*: Extends through 2015 the ability for counties and businesses to enter into agreements under which the business agrees to construct an "impact facility" and the county agrees to remit to the business up to 75% of the county sales taxes collected on retail sales made from the facility.

- *Qualified Energy Project Tax Exemption*: Extends the filing deadline by five years for the owner or lessee of a qualified energy project to submit the appropriate documentation and place into service an energy facility using renewable energy and to qualify for an ongoing property tax exemption.

- *Changes to Refundable Jobs Retention Tax Credit*: Extends the credit to eligible businesses whose principle place of business is not located in the same political subdivision as the capital investment when the business maintains a unit/division with at least 4,200 employees at the project site.

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- *Historic Rehabilitation Tax Credit*: States that expenses incurred by the owner of an historic property related to rehabilitation may be attributed to a qualified lessee of the property for purposes of the credit.

Commentary:

The changes to incentive programs listed above are not widely applicable and in several cases seem to be targeted at specific taxpayers. With the passage of the aforementioned personal income tax rate reductions in H.B. 59, taxpayers should consider the financial impact on remaining benefits available under existing Job Retention or Job Creation Tax Credits agreements.

Sales / Use Tax

- *Rate Increase*: Legislation increases the state sales tax rate from **5.5% to 5.75%** effective Sept. 1, 2013.

- *Taxability of Certain Digital Products and Magazine Subscriptions*: Effective January 1, 2014, the new law subjects "specified digital products", defined as electronically transferred digital audiovisual works, digital audio work, or digital books to sales tax. It also eliminates the current exemption for magazine subscriptions.

- *Exemption for Certain Data Center Equipment*: Allows the Tax Credit Authority ("TCA") to enter into a single agreement authorizing an exemption for purchases of computer equipment by multiple businesses operating at a single data center. The legislation reduces to $1.5M (from $5M) the annual payroll that must be maintained at the data center and does not require the applicant to provide electronic information services in order to qualify for the exemption. Finally, it allows a business to join an existing exemption agreement between the TCA and another business.

- *Marketplace Fairness Act*: Expresses the intent of the General Assembly, through the addition of definitions for "Remote Sale", Remote Seller", and "Remote Small Seller" to adopt any amendments necessary to effectuate changes required to conform with the Marketplace Fairness Act of 2013 should it be passed by the United States Congress.

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Commentary:

The sales tax rate increase is one of the key "gap fillers" to pay for the income tax reductions for individuals and small businesses shifting a portion of the state tax burden from income/earnings to consumption of goods.

Notable vetoes by the Governor in the sales tax area include the hotly debated proposal to lower nexus standards in order to force on-line retailers to collect sales tax from Ohio residents. In his veto message, the Governor cited numerous legal challenges to similar statutes in other states as his reasoning. This means that for the time being the Governor is choosing not to put Ohio on the forefront but remain on the "waiting list" for federal legislation and/or case law. This is consistent with the inclusion of language regarding Ohio's conformity with the Marketplace Fairness Act should it be passed.

The change in taxability of digital products and magazine subscriptions will pose a new compliance burden on two industries not necessarily accustomed to collection and remittance of sales tax.

Real Property Tax

- *Changes to Property Tax Rollbacks*:
  - Currently, a 2.5% homestead exemption is applied to owner-occupied residential real property for owners who are permanently disabled or at least 65 years of age. With the passage of the bill, the 2.5% homestead exemption will not apply to those individuals with annual incomes above $30,000. However, current qualified individuals will continue to qualify for the 2.5% exemption.
  - The 10% property tax rollback for residential and agricultural real property is eliminated for any new or replacement levies. Similarly, the 2.5% exemption for owner-occupied residential property is eliminated. The bill does not impact existing and renewal levies.

Commentary:

With the elimination of the property tax rollbacks, the State of Ohio will no longer subsidize new or replacement local levies. The tax burden of real property owners will increase and local jurisdictions / school districts may face additional opposition to get new or replacement levies on the ballot.

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Other Items of Note

Following are additional bills GBQ is tracking with their status:

- ***HB 138*** – As part of the budget bill process, changes related to the Board of Tax Appeals ("BTA") were removed from HB 59 and placed into a separate "compromise" bill. These changes include instituting a small claims division, adopting rules to manage appeals, establishing a mediation program as well as certain other procedural items. This bill, which should streamline the BTA's processes and reduce the backlog of outstanding appeals, does not appear to be controversial, has passed through the General Assembly and is on its way to Governor Kasich's desk for final approval.

- ***HB 5*** – This important and hotly debated bill, containing provisions for municipal income tax uniformity, is currently in the House Ways and Means Committee. Timing is unclear on additional actions to move this bill through the House.

Next Steps

Now that H.B. 59 has officially become law, it is important for taxpayers to begin analyzing the impact of its provisions on their state tax compliance, tax liabilities, incentives agreements, etc. GBQ is available to assist with any questions or issues that may arise.

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