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OHIO LEGISLATIVE SERVICE COMMISSION

Office of Research
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Office

S.B. 18
134th General Assembly

Fiscal Note & Local Impact Statement

[Click here for S.B. 18's Bill Analysis](#)

Version: As Passed by the House

Primary Sponsors: Sens. Roegner and Schaffer

Local Impact Statement Procedure Required: Yes

Russ Keller, Senior Economist, and other LBO staff

Highlights

- The bill incorporates into Ohio income tax law changes made to the federal Internal Revenue Code (IRC) since March 27, 2020. The two most significant changes occurred in December 2020 and March 2021, with provisions predominantly affecting tax returns to be filed for tax year (TY) 2020 and years thereafter.
- Incorporation of IRC changes potentially reduces personal income tax (PIT) revenue up to \$200 million during the FY 2022-FY 2023 biennium. The revenue loss would be shared by the GRF (96.68%), the Local Government Fund (LGF, 1.66%), and the Public Library Fund (PLF, 1.66%). Nevertheless, some PIT losses could instead occur earlier in FY 2021, if taxpayers do not rely on amended tax returns to claim the benefits of tax conformity.
- The bill excludes from the commercial activity tax (CAT) those dividends received by a taxpayer in 2020 and 2021 from the State Insurance Fund of the Ohio Bureau of Workers' Compensation. The revenue loss from this provision will be several millions of dollars in FY 2022, and possibly in FY 2023. CAT revenue is distributed to the GRF (85%), the School District Tangible Property Tax Replacement Fund (13%), and the Local Government Tangible Property Tax Replacement Fund (2%).
- The bill reduces the withholding tax rate for certain pass-through entities to 3%, starting with tax years that begin after January 1, 2023. Taxpayer liabilities would be unchanged. However, the rate reductions are estimated to give rise to a one-time revenue loss of \$31.6 million in FY 2023, due to the timing of payments during the fiscal year.
- The bill declares itself an emergency measure that will go into immediate effect.

Detailed Analysis

The bill incorporates changes to the federal Internal Revenue Code (IRC) made by two acts of U.S. Congress, the “Consolidated Appropriations Act, 2021” (CAA 2021), and the “American Rescue Plan Act of 2021” (ARPA 2021) into Ohio income tax law.¹

In general, 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 provisions in CAA 2021 and ARPA 2021 modified the definition of federal adjusted gross income (FAGI) and these actions materially affect the tax base for some Ohio taxpayers. FAGI is the starting point for determining Ohio adjusted gross income (FAGI with certain additions and deductions), Ohio taxable income, and other elements of the Ohio tax base. In the sections that follow, select provisions within the recent federal legislation are addressed, and their state revenue impact is discussed.

In addition to incorporating such changes, the bill provides two exclusions from the commercial activity tax (CAT), and reduces the withholding rate for certain pass-through entities (PTEs). Sections of the fiscal note outlining the revenue effects of these provisions follow those immediately below, which address conforming Ohio’s income tax base to federal law.

New tax provisions unique to CAA 2021 and ARPA 2021

The following income tax provisions are new tax topics that were not previously enacted by previous iterations of federal legislation. The implication for conformity through S.B. 18 is that these provisions would alter state tax collections from their historical patterns observed in prior years.

Exclusion of the first \$10,200 of 2020 unemployment compensation

ARPA 2021 permits taxpayers to exclude up to \$10,200 per person when filing their tax year (TY) 2020 federal return. The provision applies to those taxpayers whose FAGI is less than \$150,000, so it is a broad-based tax benefit likely encompassing about 94% of those receiving unemployment compensation.

The Internal Revenue Service (IRS) instructs taxpayers to use “the amount reported in box 1 of your Form 1099-G.” The Ohio Department of Job and Family Services (ODJFS) issues this form to those receiving the assorted types of unemployment compensation, inclusive of (1) unemployment insurance, (2) extended unemployment benefits, (3) pandemic emergency unemployment compensation, (4) pandemic unemployment assistance, (5) federal pandemic unemployment compensation, and (6) lost wages supplemental payment assistance. ODJFS reported to LBO that payments under these various programs totaled \$16.34 billion during 2020.

Few data sources provide the details necessary to evaluate this federal provision. The Joint Committee on Taxation (JCT) is a nonpartisan committee which prepares revenue estimates of all revenue legislation considered by the U.S. Congress. Although JCT scores the nationwide impact, the federal impact may serve as the basis for a rough state-level impact, if suitably

¹ H.B. 197 of the 133rd General Assembly already incorporated changes made by HR 748 of the 116th U.S. Congress, the “Coronavirus Aid, Relief, and Economic Security (CARES) Act” because that legislation’s effective date coincided with the same date for H.B. 197.

adjusted. Under this methodology, ARPA 2021 would exempt between \$3.52 billion and \$6.12 billion from Ohioans' FAGI, which reduces personal income tax (PIT) receipts between \$81 million and \$141 million. Given the late hour at which this federal policy was enacted, the resulting PIT revenue loss would likely occur through amended tax returns filed during FY 2022. The GRF share of this loss would be 96.68% during that year.

LBO requested additional data from ODJFS on March 11 about the number of recipients and the magnitude of unemployment compensation specified on Form 1099-G(s) issued by the agency. As of this date, we are still awaiting a response. The LBO estimate in this fiscal note should be regarded as preliminary until ODJFS provides LBO with additional information about the \$16.34 billion it may have documented on the Form 1099-G(s) issued to Ohio recipients.

Temporary special rule for determination of earned income

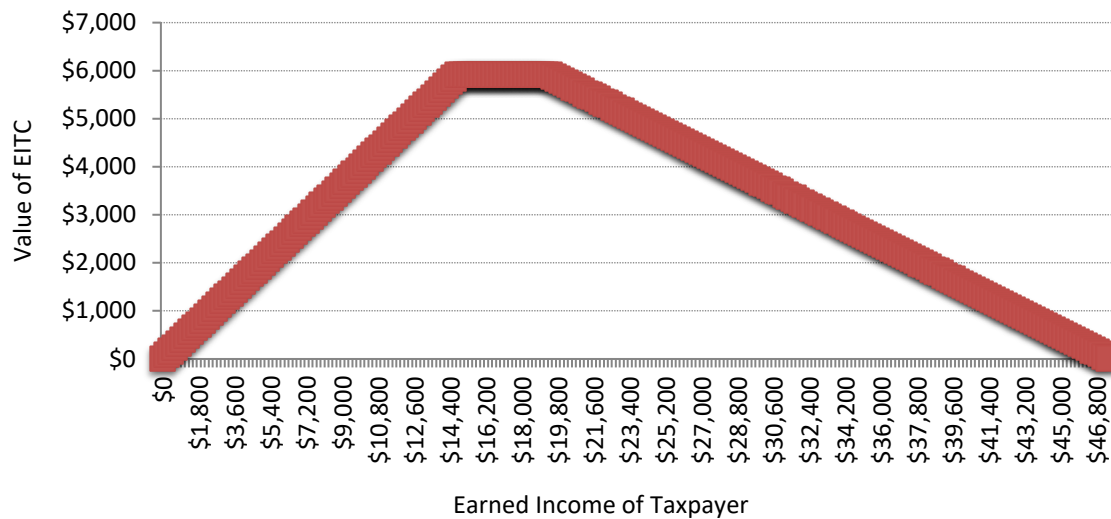
If TY 2020 earned income of a taxpayer is less than the taxpayer's earned income for the preceding taxable year, CAA 2021 permits the individual to elect to use TY 2019 earned income when determining their TY 2020 federal earned income tax credit (EITC). Similarly, a provision within ARPA 2021 enables taxpayers to use their TY 2019 earned income to determine their TY 2021 EITC, if their TY 2021 earned income is below the TY 2019 level.

Incorporating these federal provisions affects the Ohio earned income credit available under the personal income tax (PIT). The state credit's value equals 30% of the federal EITC. In a typical year, the Ohio earned income credit reduces PIT receipts by about \$70 million. About 900,000 Ohio taxpayers claimed the federal EITC in TY 2018.

Incorporating this federal change will prove advantageous for a portion of taxpayers claiming the EITC. The chart below for a single individual with two children² illustrates how the federal EITC escalates in value as a person earns more money, then plateaus at a maximum amount, before subsequently phasing out the benefit for higher income levels. A policy permitting taxpayers to substitute their higher TY 2019 income largely benefits EITC recipients that are "left of the plateau," or up to \$14,800 in income, as seen in this chart. Because this federal provision does not uniformly benefit every taxpayer claiming the EITC, its fiscal effect is difficult to estimate with certainty. Nevertheless, it may be reasonable to anticipate that incorporating this federal provision could reduce PIT receipts by several million dollars in FY 2021-FY 2022 when TY 2020-TY 2021 tax returns are filed. The actual revenue loss depends on the individual circumstances of applicable taxpayers.

² Please note that this "plateau" occurs at different income levels for other categories of EITC recipients, which vary according to household circumstances (i.e., marital status, number of qualifying children).

**Value of TY 2020 Federal EITC at Various Levels of Earned Income
for a Single Individual with Two Children**



Temporary allowance of full deduction for business meals

Generally, taxpayers can deduct only 50% of their business meal expenses, including meals incurred while away from home on business. The deduction lowers FAGI, which has implications for the Ohio tax base. CAA 2021 increased the deduction to 100% for a two-year period commencing January 1, 2021. The change is expected to incentivize more business meals at restaurants and other similar establishments, but it is difficult to forecast demand given the ongoing COVID-19 pandemic.

The business meal deduction can be utilized against sole proprietorship income, or claimed against partnership and S-corporation income. Nationwide IRS statistics for TY 2018 show that fewer than 3% of meal deductions were claimed by individuals. Continuing Ohio law enables taxpayers to deduct the first \$250,000 (or \$125,000 for married couples filing separate tax returns) of business income included in their FAGI. So, more than 90% of Ohio taxpayers with business income do not pay income tax on those amounts. Therefore, those Ohioans are unaffected by the provision related to business meal expenses. Conforming to this provision affects only individuals with unreimbursed meal expenditures and those with taxable business income. If 30,000 Ohio taxpayers claimed an additional \$1,600 in meal deductions per year, the resulting income, \$48 million, would be exempt from taxation due to S.B. 18. If that income is otherwise taxed at 3%, the conformity bill would reduce PIT receipts by \$1.4 million. The assumed increase in meal deductions could be considerably less than \$1,600 per return if taxpayers' behavior in 2021-2022 is different than meal expensing trends reported on their TY 2018 filings.

Student loan forgiveness

ARPA 2021 enacted special rules for student loans discharged over a five-year period from TY 2021-TY 2025. The legislation excludes from a taxpayer's FAGI "any amount" of discharged student loans, regardless of whether they were made by public or private lenders. In general, a taxpayer must report as income the amount of student loan debt that is canceled, forgiven, or discharged. JCT regarded this provision as having a small revenue impact, but that analysis

reflects current circumstances. If a future federal action were to eliminate more student debt obligations, this income exclusion would have a larger, and perhaps much larger, impact.

Assorted changes to federal credits affecting the state income tax

ARPA 2021 made multiple changes to the EITC, which affects the eponymous state credit (as explained above). The recent legislation made temporary changes affecting the EITC for TY 2020 and TY 2021, but most of the revisions apply to taxpayers with no qualifying children. The EITC pays progressively higher amounts to low-income individuals, depending on the number of children in their households. Statistics show that about one-fourth of EITC recipients have no qualifying children, but their revenue impact is proportionally smaller because their credits are substantially less than recipients with children.

Similarly, ARPA 2021 augmented the federal child and dependent care credit, which affects the associated state income tax credit available to those with incomes below \$40,000. The value of the PIT credit is based upon amounts reported on a taxpayer's federal return. The efficacy of this state tax benefit has waned in recent years because the PIT no longer applies to those with incomes below \$22,150. The Tax Expenditure Report, as published by the Ohio Department of Taxation, estimates that this credit reduces PIT receipts by less than \$2 million per year. Their conclusion suggests that the nonrefundable credit exceeds the state tax liability for many of the 45,000 taxpayers claiming this credit.

CARES Act provisions extended or clarified by CAA and ARPA

Although H.B. 197 incorporated the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the state revenue effect of those provisions were not addressed in the enacted fiscal note because the CARES Act coincidentally became public law on the same date H.B. 197 was effective. Some of the provisions enacted in the CARES Act for TY 2020 were extended or otherwise modified by the latest federal legislation. The original fiscal effect of CARES Act provisions has yet to be observed because tax returns for TY 2020 will be filed during the latter months of FY 2021. Absent data on taxpayer behavior, it is difficult to forecast the fiscal effect of extending these new provisions for additional years. Incorporating these changes will likely reduce state tax receipts. The following items are those believed by LBO to be the most consequential.

Certain charitable contributions deductible by non-itemizers

If a taxpayer does not itemize deductions on Schedule A (Form 1040), the taxpayer may take a charitable deduction for cash contributions made in 2021. This deduction first applied to TY 2020, but CAA 2021 extended this deduction to TY 2021. The parameters are somewhat expanded for TY 2021, as the \$300 limit on cash contributions to charities is increased in TY 2021 to \$600 for those filing a joint return. The maximum deductible amount for all other filing circumstances remains at \$300.

IRS statistics show that approximately 92% of Ohio taxpayers claimed the standard deduction for TY 2018. About one-third of taxpayers also filed joint returns in that year. If 10% of those claiming the standard deduction (520,000 tax returns) deduct the maximum amount (\$400 per return, weighted average) for charitable contributions on their TY 2021 returns, they would exclude \$208 million from FAGI. By incorporating this federal provision, S.B. 18 could reduce FY 2022 receipts by \$6 million, assuming a 3% state income tax rate would otherwise apply to this income.

Extension of exclusion for certain employer payments of student loans

If a taxpayer receives educational assistance benefits from his or her employer under an educational assistance program, the taxpayer can exclude up to \$5,250 of those benefits each year. Tax-free educational assistance benefits include payments made after March 27, 2020, and before January 1, 2026, whether paid to the employee or to a lender, of principal or interest on any qualified education loan incurred by the employee for education of the employee. The employer does not classify those benefits alongside wages, tips, and other compensation shown on the employee's Form W-2, box 1. Consequently, the employee does not have to include the benefits on his or her income tax return.

Clarification of the tax treatment of Paycheck Protection Program loan forgiveness

The Paycheck Protection Program (PPP) provides "covered loans" to help businesses keep their workforce employed during the COVID-19 pandemic. Borrowers may be eligible for PPP loan forgiveness if they maintain certain levels of employee compensation in the weeks following loan disbursement. The CARES Act declared that PPP recipients can exclude covered loan forgiveness from their gross income, which effectively renders the loan a tax-free grant. The IRS subsequently determined that existing IRC "disallows any otherwise allowable deduction" against the tax-exempt income resulting from PPP loan forgiveness.³ The IRS regards a deduction against tax-exempt income as "a double tax benefit." Deductions should not be taken against PPP loans because the taxpayer has a reasonable expectation for reimbursement via loan forgiveness. CAA 2021 specified that, "no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income provided by" PPP loan forgiveness.⁴

According to U.S. Small Business Administration (SBA) reporting, the PPP enabled 149,144 loans to Ohio-based applicants for a total of \$18.53 billion in calendar year (CY) 2020.⁵ However, PPP loan data is not indicative of loan forgiveness or program compliance. As of March 18, nationwide statistics show that 99.7% of 2020 PPP loan amounts reviewed by the SBA were forgiven. However, the status of nearly two-thirds of the 2020 PPP loan amounts is still uncertain because the SBA has yet to receive or complete its review of borrowers' loan forgiveness applications. The conformity provision in S.B. 18 only applies to the deductibility of expenses against forgiven loans. LBO staff assumes most loans will be forgiven.

Because the PIT excludes the first \$250,000 of business income from tax, this S.B. 18 provision is especially applicable to large PPP loans. Table 1 summarizes SBA loan information for Ohio recipients that borrowed at least \$150,000. The bill's conformity to FAGI is most relevant to individuals' business income (Schedule C and Schedule E). Multiple business types specified in the table are unlikely to yield that sort of income to individuals. Nevertheless, under plausible

³ <https://www.irs.gov/pub/irs-drop/n-20-32.pdf>.

⁴ Refer to Sections 276 and 278 of "Subtitle B—COVID-related Tax Relief Act of 2020."

⁵ <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program/ppp-data>.

assumptions,⁶ conforming to this CAA 2021 provision regarding deductibility could reduce PIT receipts by tens of millions of dollars for the applicable tax years.

Table 1. CY 2020 Paycheck Protection Program Loans of \$150,000 and Above for Ohio

Business Type	\$150,000- \$350,000	\$350,000- \$1 million	\$1 million- \$2 million	\$2 million- \$5 million	\$5 million- \$10 million	Grand Total
Corporation	4,966	2,868	809	343	72	9,058
Limited Liability Company (LLC)	3,657	1,728	387	200	49	6,021
Subchapter S Corporation	2,882	1,708	537	268	64	5,459
Nonprofit Organization	670	518	200	121	10	1,519
Partnership	156	83	24	6	4	273
Unspecified	79	73	26	7	2	187
Sole Proprietorship	115	37	9	4	2	167
Limited Liability Partnership	95	47	13	5	4	164
All Other Business Types	58	65	23	13	3	162
Total	12,678	7,127	2,028	967	210	23,010

Source: LBO tabulation of SBA data released in August 2020

Tax treatment of federal grants

The bill incorporates the federal income exclusion of (1) restaurant revitalization grants, and (2) amounts received from the Small Business Administration in the form of a targeted Economic Injury Disaster Loan (EIDL) advance. In practice, both of those federal funding sources would be treated in the same fashion as forgiven PPP loans, so the recipients can also claim deductions for this tax-free income. However, these grant programs are more limited in scope than the PPP loans, so the funds will be disbursed to distinct recipients.

Congress appropriated \$5 billion in restaurant revitalization grants for small businesses with fewer than \$500,000 in gross receipts during 2019. The remaining \$23.6 billion available to restaurants under the ARPA 2021 does not have a similar means test on gross receipts. However, grants are limited to a business's losses during the pandemic, and further subject to a cap of

⁶ Assumptions regarding the average numbers of owners of different types of business, as well as the percentage of loans that were forgiven.

\$10 million (or \$5 million per physical location of the eligible entity). Separately, another \$15 billion in EIDL advances was appropriated by ARPA 2021 for distressed small businesses, nonprofits, and venues. Because the latest appropriations for these federal funds were enacted on March 11, LBO does not have an estimate of the fiscal effect on the PIT of these provisions that would be related to Ohio-based businesses receiving these prospective awards.

Provisions extended by CAA 2021 that precede the CARES Act

Some income tax provisions affected by CAA 2021 existed in previous tax years. The implication of their earlier presence means Ohio taxpayers already utilized the FAGI definition in previous state tax filings. Prior year PIT receipts already reflect these taxpayer behaviors. Incorporating an extension of expired provisions should not materially alter the regular pattern of state tax collections. However, two items can be regarded as consequential because Congress recently modified them.

Modification and extension of exclusion from gross income of discharge of qualified principal residence indebtedness

If a borrower's debt is forgiven or discharged for less than the full amount owed, the difference may be canceled. The amount of the canceled debt may be taxable and reportable on a borrower's tax return for the year the cancellation occurs, depending on statements provided by the lender. However, federal law generally allows taxpayers to exclude income from the discharge of debt on their principal residence. The exception applied to debt forgiven in calendar years 2007 through 2020.

CAA 2021 extended this exclusion for five years, which applies to TY 2021 through TY 2025. By conforming to this change, S.B. 18 will reduce PIT receipts in FY 2022-FY 2026. However, that same federal legislation reduced the amount of income eligible for exclusion. In prior years, up to \$2 million of forgiven debt was eligible (\$1 million if married filing separately). Beginning with TY 2021, the limit was lowered to \$750,000 (\$350,000 if married filing separately). Therefore, Ohio taxpayers could ultimately report more taxable income on behalf of their canceled mortgage debt in TY 2021 than they did in prior years.

Depreciation of certain residential rental property over 30-year period

Continuing federal law provides business owners with a general depreciation system (GDS) method, but enables them to elect an alternative depreciation system (ADS) option for most property. If a taxpayer chooses to use ADS for their residential rental property, the election must be made in the first year the property is placed in service. Once this election is made, the taxpayer can never revoke it.

Under the GDS option, residential rental property, inclusive of buildings, structures, and structural components (e.g., furnaces, water pipes, venting), depreciates over a 27.5-year recovery period. The Tax Cuts and Jobs Act of 2017 (TCJA) changed the ADS recovery period for residential rental property from 40 years to 30 years. These TCJA changes affect property placed in service after December 31, 2017.

CAA 2021 amended the ADS method for certain residential rental property. According to IRS instructions,⁷ “the ADS recovery period for residential rental property placed in service before January 1, 2018, is 30 years if the property is held by an electing real property trade or business (as defined in section 163(j)(7)(B)) and sections 168(g)(1)(A), (B), (C), (D), or (E) did not apply to the property before January 1, 2018.”

Since this federal law change is retroactive to TY 2018, it could yield a larger fiscal effect on FY 2021 receipts as taxpayers utilize this ADS option for TY 2018-TY 2020. IRS statistics from TY 2018 show that only 6,657 taxpayers nationwide claimed a 40-year recovery period for property placed into service during 2018. Presumably, these taxpayers could benefit from the retroactive nature of the recent federal change, but the provision is likely to have limited effect on Ohio tax receipts. As previously mentioned, the PIT provides a \$250,000 business income deduction, which substantially diminishes the fiscal impact of conforming to FAGI changes that reduce business income.

Commercial activity tax exclusions

The CAT applies to most businesses regardless of the organization type under which that business operates.⁸ In general, persons with annual taxable gross receipts of \$150,000 or less are not subject to the CAT, and filers with more than \$150,000 but less than or equal to \$1 million taxable gross receipts in the previous calendar year pay the \$150 annual minimum tax and file an annual return. Taxpayers with taxable gross receipts between \$1 million and \$2 million pay \$800 plus 0.26% of the taxable gross receipts in excess of \$1 million, those with taxable gross receipts between \$2 million and \$4 million pay \$2,100 plus 0.26% of the taxable gross receipts in excess of \$1 million, and those with taxable gross receipts in excess of \$4 million pay \$2,600 plus 0.26% of the taxable gross receipts in excess of \$1 million.

Gross receipts exclusion for PPP loan forgiveness

The CARES Act excluded PPP loan forgiveness from a taxpayer’s gross income, and H.B. 481 of the 133rd General Assembly excluded those same receipts from the CAT. CAA 2021 authorized an additional \$284.45 billion in PPP loans. Borrowers can apply for a PPP Loan until March 31, 2021, and the law allows certain eligible borrowers that previously received a PPP loan to apply for a “Second Draw” PPP loan with the same general loan terms as their “First Draw” PPP loan.

Since this latest round of PPP loans is less than \$525.01 billion lent to businesses nationwide during CY 2020, the CAT exclusion authorized by S.B. 18 is likely smaller in scope than the H.B. 481 provision. LBO staff does not have data on the Ohio businesses availing themselves of this most recent PPP authorization. Tens of thousands of Ohio businesses could benefit from the CAT exclusion, but their actual tax savings will vary depending on their taxable receipts in CY 2021 and the balances of their forgiven loans.

⁷ <https://www.irs.gov/publications/p527>.

⁸ For example, sole proprietorships, partnerships, LLCs, S corporations, corporations, trusts, and all other type of associations are subject to the CAT, if their taxable receipts exceed the minimum threshold. Certain businesses that have their own tax regimes, such as financial institutions or insurance companies, are not subject to the CAT because they pay another type of business tax.

Gross receipts exclusion for BWC dividends

The bill authorizes an exclusion from the CAT for the amount of excess surplus (i.e., dividends) of the State Insurance Fund received by a taxpayer from the Ohio Bureau of Workers' Compensation (BWC) pursuant to rules adopted under section 4123.321 of the Revised Code on or after January 1, 2020, and before January 1, 2022. In general, BWC specifies a procedure for returning excess workers' compensation premiums to employers, if the BWC Board of Directors determines that the surplus of earned premiums over losses is larger than needed to maintain solvency of the State Insurance Fund. The exclusion is for dividends paid to employers in calendar years 2020 and 2021.

Table 2 provides dividends paid to private and public employers in the last three calendar years. In 2020, BWC paid a total of \$7.88 billion in dividends from the fund to both private and public employers that maintained workers' compensation coverage under the fund. Public employers are not liable for the CAT, so the exclusion from taxable gross receipts in the bill would affect the \$6.82 billion in excess surplus returned to private taxpayers.

Calendar Year	Public Employers (\$ in millions)	Private Employers (\$ in millions)
2018	\$157	\$1,105
2019	\$172	\$1,252
2020	\$1,055	\$6,823

Source: BWC communication with LBO staff

If all dividends paid to private employers were taxable at the 0.26% rate, the exclusion would have amounted to a revenue loss of about \$17.7 million in FY 2022. However, due to the structure of the CAT, the revenue loss from this provision in the bill will likely be less, though LBO cannot determine the reduction in CAT receipts due to lack of data. A number of taxpayers receiving the excess surplus may remain exempt from the tax because their taxable gross receipts would still be below the \$150,000 threshold. Another set of taxpayers would also have their CAT liability unchanged as their taxable gross receipts, including the dividend, would remain below \$1 million. As a result, an unknown share of the \$6.82 billion in excess surplus returned to private taxpayers would not give rise to any additional CAT liability. To the extent a CAT taxpayer paid additional tax on the excess surplus received, such a taxpayer would be entitled to a refund.

The bill is likely to reduce CAT revenue by several millions of dollars in FY 2022. Though the amount of the revenue loss is undetermined, LBO cannot rule out a revenue reduction exceeding \$10 million, based on CY 2020 dividends, possibly starting in the last quarter of the current fiscal year (see emergency provision) and with the majority of the loss realized in FY 2022. However, the total fiscal loss in FY 2022 will be dependent on the level of excess surplus returned to taxpayers in CY 2021.

Current law earmarks revenues from the CAT for the GRF (85%) and for reimbursing school districts and other local governments for the reductions and phase-out of local taxes on

most tangible personal property. Other revenues from the CAT are split between the School District Tangible Property Tax Replacement Fund (13%) and the Local Government Tangible Property Tax Replacement Fund (2%) for reimbursement purposes. Revenue reductions to the GRF and local funds would be proportional to allocations to those funds in existing law.

Any decrease in total GRF tax receipts would also decrease the amount distributed to the LGF and the PLF. Under existing law, 1.66% of total GRF tax receipts is allocated to each fund beginning in FY 2022. Any reduction to the LGF and PLF would decrease distributions from the funds to counties, municipalities, townships, public libraries, and other political subdivisions in the state.

Personal income tax

Pass-through entity withholding

The bill reduces withholding tax rates to 3% on certain PTEs. PTEs include partnerships, S corporations, and limited liability companies. PTEs “pass through” the liability to pay tax on their income to their investors, thereby avoiding a second layer of taxes at the business entity level. Although income taxes are not owed by the PTEs themselves but are due instead from the investors in the PTEs, payments referred to as withholding taxes are made by some PTEs for which the investors in those entities can claim refunds or credits against taxes owed. This withholding tax helps reduce tax avoidance.

For certain out-of-state investors in PTEs that are not individuals or are various financial institutions and some others, the withholding tax rate falls from 8.5% to 3%.⁹ For out-of-state investors in PTEs who are individuals and for trusts with beneficiaries who are out-of-state individuals, the withholding tax rate falls from 5% to 3%. The 3% rate equals the rate on taxable business income.

No state personal income taxpayer’s tax liability is changed by the bill. Taxpayers are eligible for refunds of withholding tax paid in excess of tax due. However, timing differences between when the tax is withheld and when the refunds are paid will result in a one-time tax revenue loss from the reduction in withholding tax rates that LBO estimates at \$31.6 million in FY 2023. This estimate is based on data provided by the Department of Taxation. The loss occurs because refunds (or final settlements) are paid in arrears, for the prior tax year, so adjust more slowly than cash flows from changes in the withholding tax. This remains the case even if the taxpayer owes no tax on the income for which withholding tax was paid. For example, a taxpayer eligible to deduct business income from the PTE that totals less than the maximum allowed deduction of \$125,000 for a married taxpayer filing separately and \$250,000 for all other taxpayers would owe no tax on that income.

⁹ This part of the bill, amending R.C. 5733.41, applies with certain exceptions to non-Ohio domiciled entities including other PTEs; financial institutions; financial holding companies; bank holding companies; savings and loan holding companies; persons directly or indirectly owned by one or more financial institutions, financial holding companies, bank holding companies, or savings and loan holding companies; persons that solely facilitate or service securitizations by these entities; certain affiliates of insurance companies; and estates and trusts subject to the personal income tax.

Unemployment compensation withholding

The bill allows individuals, at the time they apply for unemployment benefits, to elect to have state income tax withheld from their benefits. Current law allows individuals to request that ODJFS withhold federal income tax on their benefits, but does not specifically allow such a request for state income tax. The bill also allows individuals already receiving unemployment benefits who elected to have federal income tax withheld to elect to have state income tax withheld. The provision does not have a net fiscal effect, but income tax receipts may be received sooner than otherwise collected under current law.

Waiver of income tax penalties related to unemployment benefits

The bill authorizes the Tax Commissioner to temporarily waive any interest or penalties for a taxpayer that does not make a full, timely payment of state and school district income taxes due on unemployment benefits received in 2020, if the taxpayer timely files an annual return for that year. However, the provision reimposes on that underpayment any interest or penalties waived by the Commissioner if the taxpayer does not pay the tax due by June 30, 2023, unless the Commissioner exercises the Commissioner's existing authority to permanently abate such penalties. The bill allows a taxpayer that has already paid any such interest or penalties to request a refund of those amounts, except for any amounts reimposed on that underpayment.

The provision will not directly result in revenue loss, as it authorizes rather than requires abatement of penalties on underpayments. If the Commissioner does abate most or all such interest and penalties, the amount of the revenue loss could range up to the low millions of dollars.

Emergency provision

The bill declares itself an emergency measure that will go into immediate effect.