Ohio House Bill 64: Budget for Fiscal Years 2016-2017 Featuring Significant Tax Changes

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Just before Valentine's Day, House Bill 64 containing the provisions of Ohio Governor John Kasich's budget bill for the 2016-2017 fiscal years was introduced. Continuing a trend from prior budgets, the plan calls for further reductions in the personal income tax rate, expansion of the small business deduction, revisions to the minimum commercial activity tax for business with less than $2 million in annual receipts, and increased personal exemptions for lower and middle income taxpayers. The reductions would be paid for in part by increases in the rates of the sales, cigarette and commercial activity taxes, expanding the sales tax to a number of new services, as well as a revamping of Ohio's severance tax on oil and natural gas. Over-all, the proposal claims a tax reduction of over $500 million over the two years of the budget.

Personal Income Tax

Current law contains a deduction for one-half of the first $250,000 for an individual's net business income; this deduction applies to sole proprietors as well as to the owners of pass-through entities such as partnerships, S corporations, and limited liability companies. The budget retains this provision for businesses with income in excess of $2 million. In addition, the bill proposes to exclude small business income from any business with gross receipts up to $2 million.

Personal income tax rates will be reduced 15 percent during the first year of the budget, with an additional 8 percent reduction for the second year. The top personal income tax rate would be reduced from the current 5.33 percent to 4.1 percent over the two years.

The personal exemption for taxpayers earning less than $40,000 annually would be increased from $2,200 to $4,000 for taxable years beginning in 2015 or later. For those earning between $40,000 and $80,000 annually, the exemption would increase from $1,950 to $2,850.

The plan also proposes to means-test some deductions and credits. This provision applies to the deduction for social security and railroad retirement benefits; the $50 senior credit; and the lump sum retirement credit. Taxpayers with annual income in excess of $100,000 would no longer be able to claim these deductions and credits.

Commercial Activity Tax

Under current law, the tax on the first $1 million in annual taxable gross receipts is not determined by multiplying the taxable gross receipts by the statutory rate; instead, taxpayers pay a graduated minimum tax based on their total taxable gross receipts from the prior year. Under the bill, the minimum tax for taxpayers with less than $2 million in annual taxable gross receipts would be reduced from $800 to $150. For taxpayers with annual taxable gross receipts between $2 million and $4 million, the minimum tax would be $2,100. The minimum tax for taxpayers with annual taxable gross receipts in excess of $4 million remains at $2,600.

The rate of the tax will increase from 0.26 percent of annual taxable gross receipts in excess of $1 million to 0.32 percent of such receipts, an increase of roughly 23 percent.

There is a new exclusion for receipts from the sale of vapor products by a dealer equal to the amount of the new state excise tax on such products (see Tobacco Tax discussion). This exclusion mirrors a number of other exclusions for various taxes collected by taxpayers to be remitted to the state.

The bill also changes the distribution of receipts from the CAT. Small amounts would be allocated for administrative purposes, be earmarked for highway infrastructure purposes, or be used for purposes of the school district and local government tangible property tax replacement funds. The majority of the tax, up to 75 percent for tax years beginning in 2016, would be distributed to the general revenue fund.

Sales Tax

The state sales tax rate will be increased by one-half cent, from 5.75 percent to 6.25 percent.

The tax will also be expanded to a number of services, including cable TV subscription services and parking. In addition, the tax is expanded to the following services, regardless of the profession of the provider unless the provider is an employee of the recipient of the service:

- Transactions by which bad debt is or is to be transferred;
- Travel service, which means acting as an agent in selling travel, tour, or accommodation services to the general public and commercial clients;
- Research and public opinion polling service, which means systematically gathering, recording, tabulating and presenting marketing and public opinion data;
- Public relations service, which means designing and implementing public relations campaigns designed to promote the interests and image of one or more clients;
- Lobbying service, which means any activity that serves to influence the behavior or opinion of an individual, an industry, or an organization;
- Management consulting service, which means any activity that provides advice and assistance to businesses and other organization on business issues; and
- Debt collection service, which means collecting payments for claims and remitting payments collected to their clients; and
- Repossession service, which means repossessing tangible assets for the creditor as a result of delinquent debts.

The current exclusion for sales of services transacted by the state or its political subdivisions is repealed.

Ohio currently reduces the price paid for a new car or boat by the value of any car or boat traded in, the value of which is applied against the purchase price. This reduction will be cut in half.

Finally, the vendor discount, intended to reimburse vendors for the cost of collecting, reporting, and remitting the sales tax, will be capped at $1,000 monthly.

<u>Severance Tax</u>

The severance tax is a volume-based tax imposed on oil and natural gas at a rate, including a regulatory fee, of $.20 per barrel and $.03 per MCF, respectively. These rates apply to oil and natural gas produced by both conventional vertical wells and horizontal wells using hydraulic fracking technology. Condensate and natural gas liquids are not separately taxed.

In the case of oil or natural gas produced by vertical wells, the tax would be imposed at rates of 20¢ per barrel of oil, and 3¢ per MCF of natural gas; the existing assessment fees would be repealed. In the case of oil, natural gas, condensate, or natural gas liquids produced by horizontal wells, the tax would be based on the volume of product produced during a calendar quarter multiplied by the average quarterly spot price of the commodity in question. For each product, the "average quarterly spot price" means, for the quarter that begins six months prior to the existing quarter, the average daily spot price of a specified quantity of product, as publicly available from a source determined by the tax commissioner. Before the first day of each quarter, the tax commissioner is required to certify and post on the Department's web site, the average quarterly spot price for each product for the ensuing quarter.

The tax is imposed at the following rates:

- For oil, the tax is imposed at a rate of 6.5 percent
- For natural gas that enters the natural gas distribution system without processing, 6.5 percent;
- For all other natural gas, 4.5 percent;
- For condensate collected at a point other than the wellhead, 6.5 percent; and
- For natural gas liquids collected other than at the wellhead, 4.5 percent.

Funds generated by the tax are deposited into the severance tax receipts fund. After any transfer of funds into the tax refund fund, the remaining funds are credited as follows:

- Monthly, an amount to the oil and gas well fund and geological mapping fund, based on amounts appropriated for regulation, geological mapping, and plugging idle and orphaned wells.
- Quarterly, of the remaining amount,
    - 10 percent to the county severance tax fund;
    - 5 percent to the severance tax infrastructure fund
    - 5 percent to the severance tax endowment fund
    - 80 percent to the general revenue fund.

<u>Tobacco Tax</u>

The tax rate on cigarettes is increased from 62.5 mills per cigarette to 112.5 mills, or $1.00 per package of 20 cigarettes. The bill also eliminates the discount for wholesalers or retailers for adding tax stamps to the cigarettes that are sold.

a. Minimum Cigarette Pricing

The bill imposes a scheme to regulate the price at which cigarettes may be sold. The “retail cigarette price” is the wholesale cigarette price multiplied by 1.08. If a county cigarette tax has been imposed, that tax is deducted from the wholesale price before the calculation is made, and then is added to the calculated price. The “wholesale cigarette price” means 1.03 multiplied by the sum of the manufacturer’s list price, the state tax paid, and any county tax.

The Department of Taxation is required to post on its website a list of each manufacturer licensed to sell cigarettes in Ohio; the brands the manufacturer is licensed to sell in Ohio; and the manufacturer’s list price for each brand family of cigarettes. A manufacturer may not sell cigarettes in Ohio that are not on the list, and must notify the tax commissioner of any price change before implementing the change.

Wholesale and retail sellers may not sell cigarettes below the wholesale price or retail price, respectively, and generally may not offer promotions that would result in prices below the posted prices. The license of a seller who violates these requirements may be revoked. However, this provision does not apply to brand close-outs; the sale of damaged or imperfect products; sales during the liquidation of a business; or sales made pursuant to court order.

b. Rate Increase on Other Tobacco Products

With respect to other tobacco products, the tax is increased to 60 percent of the wholesale or retail price, as appropriate. Any sellers’ discount is repealed.

c. New Tax on Vapor Products, i.e., e-cigarettes

A new tax scheme for “vapor products” is included in the bill in new Chapter 5744. A “vapor product” means a noncombustible product made of, or derived from, nicotine and that is intended for human consumption., and that includes any mechanical heating element to deliver the product. A tax is imposed on the “cigarette equivalent” of the vapor product. The cigarette equivalent of a liquid product is one-tenth of one milliliter, while the cigarette equivalent of a solid product is 1 gram, including the weight of any delivery device. The tax is imposed at the same rate as the tax on cigarettes; that is, the tax rate is 122.5 mills per cigarette equivalent.

The bill establishes licensing, filing, and assessment procedures that closely mirror those relating to regular tobacco products. Wholesale and retail sellers will have to obtain a license from the department of taxation in order to sell vapor products in the state. Sellers will also have to file monthly tax returns and remit payment of the tax by the 15th day of the month following the month covered by the return. The tax commissioner may require that all filings and payments are to be made through the Ohio Business Gateway or by other electronic means, and may also excuse persons from electronic filing and payment requirements.

Provision is made for responsible party liability where tax has not been paid, and for successor liability in the case of businesses that are sold or transferred to another.

There would be a four-year statute of limitations for both assessments and refunds. This period can be extended by agreement of the taxpayer and the tax commissioner.

Receipts from the tax are to be credited to the general revenue fund. The tax and licensing requirements would be effective January 1, 2016.

Overall Reduction in Taxes

The proposal is expected to result in a net reduction in taxes of $246 million in fiscal year 2016, and an additional $277 million in fiscal year 2017.

Summary

In the broadest sense, the tax proposals contained in H.B. 64 are similar to those included in the last budget proposal: lower income taxes on individuals and small-business owners, paid for in part by increased sales, commercial activity, tobacco and severance taxes, especially on large business entities. Opposition to the prior proposal resulted in a somewhat scaled back reduction in income taxes and more modest increases in the sales tax rate, as well as increases in the taxes applicable to tobacco and alcohol. A budget bill must be in place by June 30, 2015. It will contain provisions to reduce the personal income tax. It remains to be seen what other tax provisions will be included in the final bill.