Fiscal Note & Local Impact Statement

127 th General Assembly of Ohio

Ohio Legislative Service Commission
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BILL: **H.B. 117** DATE: **April 17, 2007**

STATUS: **As Introduced** SPONSOR: **Rep. Raussen**

LOCAL IMPACT STATEMENT REQUIRED: **No — No local cost**

CONTENTS: **Permits a school district that levies an income tax to have the tax administered by an entity other than the Department of Taxation**

State Fiscal Highlights

STATE FUND	FY 2007	FY 2008	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	- 0 -	- 0 -	- 0 -
School District Income Tax Fund			
Revenues	- 0 -	Possible loss	Possible loss ranging to more than $250 million
Expenditures	- 0 -	Possible decrease	Possible decrease ranging to more than $250 million

Note: The state fiscal year is July 1 through June 30. For example, FY 2007 is July 1, 2006 – June 30, 2007.

- The Department of Taxation administers the school district income tax under current law. Amounts collected for each district that imposes an income tax are distributed to those districts quarterly. These distributions totaled about $202 million in FY 2006 and may top $245 million in FY 2007 based on year-to-date distributions. Potentially, if all school districts with income taxes switched to other administrators, as permitted under the bill, both receipts and distributions could decline by this amount. The actual decline might be much smaller, but probably would grow in future years.

- School district revenues from the income tax are net of a 1.5% charge to cover Department of Taxation administrative costs. Any excess of this charge over actual expense to administer the tax is returned to school districts. If part of the administrative responsibility is shifted to other entities, as the bill allows, these Department of Taxation costs might be reduced along with the Department's revenues from the 1.5% charge. Net distributions to school districts of $245 million would imply about $4 million in charges at a 1.5% rate.

- If Department of Taxation expenditures for administration of the school district income tax include both fixed and variable costs, the Department's total outlays for this purpose might not decline as much as revenue from the 1.5% charge. Shifting from a system in which all school district income taxes are administered in a single way, as at present, to one in which school districts would employ various administrators has the potential to create confusion among taxpayers and require added Department of Taxation expenditures for taxpayer assistance.

- Interest on balances in the fund that holds receipts from the school district income tax is retained in that fund and distributed quarterly to the school districts that impose income taxes. These interest earnings this fiscal year (first nine months) have totaled $1.7 million. Smaller fund balances, as a result of school district decisions to employ administrators for this tax other than the Department of Taxation, as permitted by the bill, would tend to reduce interest earnings.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2007	FY 2008	FUTURE YEARS
School Districts			
Revenues	- 0 -	Possible Increase	Possible Increase
Expenditures	- 0 -	- 0 -	- 0 -
Other Local Governments			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- Under the bill, school districts may enter into agreements with entities other than the Department of Taxation to administer their income taxes, but may pay no more for this service than the Department charges, currently 1.5%. A school district might choose another administrator to save on this fee or in anticipation of some other benefit. This possible fee reduction is shown in the table above as an enhancement of net revenue, i.e., as unchanged collections from taxpayers less smaller administrative fees.

- If a new administrator was more effective than the Department at collecting from late payers, underpayers, or nonpayers, a larger increase in revenues could result. The probability of any such revenue enhancement is unclear.

- No direct fiscal effect on other political subdivisions.

Detailed Fiscal Analysis

This bill would allow school districts with income taxes to enter into agreements with entities other than the Department of Taxation to administer those taxes. Under current law, the Department of Taxation administers all school district income taxes. Other entities that could provide this service under the bill include a municipality with an income tax and with at least 51% of its boundaries overlapping with school district boundaries,[1] the Central Collection Agency, the Regional Income Tax Agency, or other organizations similar to the latter two agencies. Current law provides for a 1.5% charge against amounts paid by taxpayers to defray Department of Taxation costs to administer the tax, and school districts might choose another administrator that offered to provide this service at a lower charge. Alternatively, school districts might choose another administrator for other anticipated benefits.

As of January 2007, 164 school districts had income taxes. In all of FY 2006, distributions from the Department of Taxation to school districts of money raised by these taxes totaled $202.3 million. FY 2007 distributions through the first three quarterly payments were 21% higher than a year earlier, which if continued would imply distributions for the full year of over $245 million. This amount will tend to grow over time with increases in incomes, though it may shrink in recessions. If additional school districts vote to have income taxes, or if school districts raise their income tax rates, the total amount raised will also tend to grow. Revenues to the School District Income Tax Fund, from which these distributions are made, include money from income tax withholding, estimated tax payments, and annual payments accompanying school district income tax returns generally due April 15. Interest on money in the fund is credited to the fund. Distributions to school districts are paid quarterly, within 30 days of the end of each calendar quarter.

School districts that levy income taxes are required by the bill to adopt a resolution on or before July 1, 2008, that enters into a written agreement with one of the above-noted entities for administration of that tax beginning in tax year 2008. The bill also provides that the Department of Taxation will continue to administer the tax if a board of education fails to adopt such a resolution, until such time as the board does adopt a resolution entering into an agreement with another entity for administration of its school district income tax beginning in tax year 2008 or a subsequent year. Potentially, administration of all of these tax revenues could be switched to entities other than the Department of Taxation, though the actual amount switched might be much smaller. Because the bill does not declare an emergency, it could not go into effect until FY 2008. Distributions by the Department to school districts would not start to decline until the second half of that fiscal year.

If the Department of Taxation charge for administration of the school district income tax, 1.5% of collections, exceeds expenses, the excess is returned to the fund from which distributions to school districts are made. The charge was 3% through FY 1993 but was reduced in subsequent years because the Department was not spending all the money that the charge was raising. Under the bill, the Department of Taxation would no longer receive the 1.5% charge or any other compensation for those school district income taxes that it no longer administered because another entity was providing that service.

[1] That the municipality and school district have overlapping territory as well as boundaries is not explicit in the bill.

An entity other than the Department of Taxation may charge a school district up to, but no more than, the amount that would be charged by the Department of Taxation to administer its school district income tax. The bill further provides that funds must be deposited in the school district's account by the entity administering the tax within 24 hours of receipt, in contrast with quarterly distribution of receipts administered by the Department of Taxation. There consequently would be no counterpart, with administrative entities other than the Department of Taxation, to the quarterly distribution of interest earnings on funds held by the Department. Prompt access to funds could increase the attractiveness of the income tax to school districts.

If another entity is able to administer the school district income tax at lower cost than the amount charged by the Department of Taxation—the lesser of 1.5% of collections or actual expenses to administer the tax—and agrees to pass these savings on to a school district, the school district would benefit from enhanced net revenues. Efficiencies resulting from overlapping territory and taxpayers in common with those of a municipality might give rise to such savings, for example. Alternatively, a school district might choose a different entity to administer its income tax for perceived improvements in service or other benefits. An expectation that another entity might be more effective in collecting taxes owed by late payers, underpayers, or nonpayers is one such potential benefit. Whether any such gains are probable is not clear.

For a few school districts with income taxes, increased revenues from the income tax, as a result of lower administrative costs or other gains, may not add to funds available for school district use. In school districts receiving charge-off supplemental aid, also called gap aid, the state pays the difference between local tax revenues actually generated, including both property and school district income taxes, and the local revenue assumed in the foundation aid program's calculations. The amount of gap aid would be reduced dollar for dollar with any increase in school district income tax receipts, until the gap aid was eliminated. So these districts might have no financial incentive to switch to a lower cost administrator for their income taxes, unless the savings were large enough to more than eliminate gap aid and actually add to the funds available to them to use. Among school districts with income taxes in FY 2005, nine were also gap aid districts and received a total of $2.3 million in gap aid.

To the extent that Department of Taxation expenditures to administer the school district income tax include fixed as well as variable costs, these expenditures might not decline in line with the reduction in funds available, from the 1.5% charge, to pay these costs. Also, by adding to the complexity of the tax system, allowing individual school districts to contract with alternative administrators instead of having all school district income taxes administered by a single entity as at present, the changes that the bill would bring about might create confusion among taxpayers and increase the time and effort required for them to file their annual tax returns. Providing additional taxpayer assistance to these taxpayers could add to Department of Taxation expenditures, at a time when funds available to pay these costs would be reduced.

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