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Fiscal Note & Local Impact Statement

Bill: H.B. 144 of the 128th G.A. **Date**: March 25, 2010

Status: As Introduced **Sponsor**: Rep. Grossman

Local Impact Statement Procedure Required: Yes

Contents: To grant an income tax credit eliminating tax liability for six years for individuals who obtain a baccalaureate degree and who reside in Ohio

State Fiscal Highlights

STATE FUND	FY 2010	FY 2011	FUTURE YEARS
General Revenue Fund (GRF)			
Revenues	Minimal loss, if any	Potential revenue loss of $23.5 million or more	Annual revenue loss will vary, but magnitude will increase from tens of millions of dollars to potentially more than $125.3 million
Expenditures	Minimal increase, if any	Potential additional expense of more than $100,000 for BOR	Potential additional annual expense of more than $100,000 for BOR

Note: The state fiscal year is July 1 through June 30. For example, FY 2010 is July 1, 2009 – June 30, 2010.

- The GRF revenue loss will increase over the first six full years of the tax credit's existence before the annual revenue loss plateaus to a sum of $125.3 million or more depending on the tax incentive's impact on future behavior. Subsequent growth will be roughly equivalent to the growth in Ohio wage and salary income.
- The Board of Regents (BOR) may need to hire additional personnel or contract with a separate entity to perform administrative duties required by the bill. H.B. 144 does not increase any BOR appropriations.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2010	FY 2011	FUTURE YEARS
Local Government Fund (LGF) and Public Library Fund (PLF)			
Revenues	Minimal loss, if any	Potential revenue loss of $1.4 million or more	Annual revenue loss will vary, but magnitude will increase from several million dollars to potentially more than $10 million
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.

- The revenue loss will increase over the first six full years of the tax credit's existence before the annual revenue loss plateaus to a sum of $7.9 million or more depending on the tax incentive's impact on future behavior. Subsequent growth will be roughly equivalent to the growth in Ohio wage and salary income.
- During the FY 2010-FY 2011 biennium, the GRF will bear 94.35% of the total revenue loss and the Local Government Fund (LGF) and Public Library Fund (PLF) would bear 3.68% and 1.97%, respectively. Beginning in FY 2012, the GRF will bear 94.1% of the total revenue loss, and the PLF will resume its statutory share of personal income tax revenue, which is 2.22%.

Detailed Fiscal Analysis

The bill authorizes an income tax credit for an individual who graduates with a baccalaureate degree on or after the bill's effective date from an institution of higher education and who resides in Ohio. The credit eliminates the individual's net tax liability for six years. The individual must claim the credit for the individual's taxable year that includes the date the credit application was approved and for each of the succeeding five taxable years, unless the individual defers the credit.

If during the first five years of the credit period, the individual leaves Ohio to reside in another state other than to attend an institution of higher education as a full-time student, the individual is liable to the state for credit taken and forfeits all unused credit. The liability may be collected by assessment.

The individual must apply to the Board of Regents for the credit within one year after obtaining the baccalaureate degree. If the individual is entitled to the credit, the Board is required to issue a tax credit certificate to the individual, which must state the individual's name and Social Security number, the date the credit application was approved, and the taxable years for which the credit must be claimed.

The Board of Regents is required to identify institutions of higher education and to specify the information required to be disclosed in applications for tax credit certificates and credit deferral and any documents that must be submitted. The Board may designate an entity, including a nonprofit private organization, to perform the Board's administrative duties under the credit program.

Fiscal effect

The personal income tax credit authorized by the bill would reduce state revenues by $24.9 million or more in FY 2011 depending on the tax incentive's impact on future behavior; of the total revenue loss, General Revenue Fund (GRF) revenue would decrease by an amount of $23.5 million or more. The remainder of the revenue loss would be at the expense of the Local Government Fund (LGF) and the Public Library Fund (PLF). In the second year of the credit, the revenue loss would increase as graduates who received tax credits in FY 2011 would receive a second year's worth of credit in FY 2012, and another year's worth of graduates would be able to claim the credit for their first year. Total state revenue would decrease by another $22.6 million as compared to the previous year; of the total revenue loss, GRF revenue would decline by another $21.3 million. The GRF revenue loss will further increase over the first six full years of the tax credit's existence before the annual revenue loss plateaus to a sum potentially more than $125.3 million. Subsequent growth will be roughly equivalent to the growth in Ohio wage and salary income.

During the FY 2010-FY 2011 biennium, the GRF will bear 94.35% of the total revenue loss and the LGF and PLF would bear 3.68% and 1.97%, respectively. Upon expiration of temporary law authorized by Am. Sub. H.B. 1 of the 128th General

Assembly, the PLF will resume its statutory share of personal income tax revenue, which is 2.22%. Thus, beginning in FY 2012, the GRF will bear 94.1% of the total revenue loss. As a result, the local government funds will potentially lose $1.4 million or more in FY 2011, and the annual revenue loss will increase over the successive five years until it reaches a sum of $7.9 million or more in the sixth full year after authorization.

IRS statistics indicate that nonwage income for Ohio taxpayers is primarily derived from retirement savings and pensions as well as capital gains on investments. This analysis assumes recent college graduates earn no income beyond their wages and salaries. This surely understates the total income and the resulting foregone tax revenue, but this understatement is assumed to be more or less neutralized by an assumption regarding average salary. The Regents' data identify average salaries for employed graduates, which is not a true average of all persons earning a degree. Obviously, unemployed individuals are absent from the analysis and their inclusion would lower both the average starting salary and the resulting estimate of foregone revenue.

For each income level, I applied an effective tax rate to determine the estimated per capita income tax liability. The effective tax rates were sourced in tax year (TY) 2005 Ohio returns, and adjusted to reflect the statutory rate reductions in H.B. 66 of the 126th General Assembly. H.B. 318 of the 128th General Assembly will have a very minor impact on this bill because only personal income tax rates for TY 2009-TY 2010 rates were affected by that legislation. H.B. 144 only grants the income tax exemption to an individual that graduates on or after the enactment of the legislation, so it is likely that if H.B. 144 were enacted during TY 2010, it would not affect a full year's worth of college graduates. An exemption-eligible Bachelor's degree graduate earning $32,608 in FY 2011 would save approximately $577 on his or her Ohio income taxes. Beginning in TY 2010, the state income tax brackets will be indexed to the rate of inflation. Within this analysis, I use wage and salary forecasts adjusted for inflation to account for the indexing. Starting salaries for graduates have grown modestly in recent years, and I assumed they will grow at the same rate as aggregate real wage disbursements in future years[1] (such that annual growth rates range between 0.08% and 3.10%). Income for "carryover graduates," namely, those that are more than a year removed from their graduation yet still eligible for the exemption, grows at a faster rate. For this analysis, I assumed income for carryover graduates grows at the rate of Ohio's real personal income, which dictates annual growth rates between 1.75% and 5.04%.[2]

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[1] All forecasts for future real personal income and real wages are provided by Global Insight.

[2] While growth rates for starting salaries are rooted in BOR data, salaries for carryover graduates are rooted in tax return data. Generally, income tax revenue growth is highly correlated with the growth in personal income. Therefore, it is preferable to use real personal income growth in this analysis because it serves as the best available proxy for Ohio's future tax base.

The estimated revenue loss is based on multiplying the per graduate figure, $577 in the first year, by approximately 57,442 graduates in the first year. The 57,442 figure is derived from historical data on college graduates in Ohio, grade level enrollment data from the Ohio Department of Education (ODE), and birth rate information from the Ohio Department of Health (ODH). Generally, this analysis assumes the number of conferred degrees peaks at a level above 58,000 in 2013 and 2014 before subsiding somewhat in the future years to an annual number between 52,000 and 55,000.

The underlying assumption in this analysis maintains that 75% of college graduates will remain in Ohio, with a tax credit or without one. This assumption is rooted in BOR surveys of Ohio college graduates. To the extent that the bill's tax incentive succeeds in increasing this historically typical percentage, the revenue losses in future years would be reduced. Certainly, numerous factors affect whether individuals will move out of state, but the extent to which state income tax policy bears on a person's decision making remains unclear. Given the data on existing behavior does not easily lend itself to a definitive conclusion, LSC economists do not evaluate the tax exemption's resulting effects on Ohio residency.

H.B. 144 will not only affect Ohio personal income tax collections, the legislation will increase costs for the Ohio Board of Regents, which must administer the application and issuance of the tax credit certificates authorized by this legislation. A representative from BOR expects that the agency will need to devote additional full-time equivalent (FTE) staff persons to this task or contract with a separate entity to perform the work. Further details and plans are unavailable at this time, but more analysis will occur by BOR leadership to determine the best way to integrate this potential impact within the agency's budget and table of organization.

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