



# Ohio Legislative Service Commission

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## Fiscal Note & Local Impact Statement

**Bill:** H.B. 10 of the 129th G.A.

**Date:** February 2, 2011

**Status:** As Introduced

**Sponsor:** Rep. Sears

**Local Impact Statement Procedure Required:** Yes

**Contents:** To authorize refundable credits against the personal income tax or commercial activity tax for the completion of a voluntary action to remediate a contaminated site; to authorize an additional refundable credit if the person returns the property to productive use; to exempt from fees and penalties authorized under environmental protection laws for one year after the covenant not to sue is issued

### State Fiscal Highlights

STATE FUND	FY 2011	FY 2012	FUTURE YEARS
<b>General Revenue Fund</b>			
Revenues	Minimal loss	Potential loss between \$2.9 million and \$17.0 million	Potential loss between \$5.8 million and \$17.0 million annually through FY 2019
Expenditures	- 0 -	- 0 -	- 0 -
<b>Voluntary Action Program Fund (Fund 4R90)</b>			
Revenues	Minimal gain	Potential gain of several hundred thousand dollars or more	Potential gain of several hundred thousand dollars or more.
Expenditures	Minimal increase	Potential increase of several hundred thousand dollars or more	Potential increase of several hundred thousand dollars or more
<b>Hazardous Waste Management Fund (Fund 5050)</b>			
Revenues	Minimal gain	Potential gain	Potential gain
Expenditures	Minimal increase	Potential increase of several hundred thousand dollars or more	Potential increase of several hundred thousand dollars or more
<b>Environmental Protection Fund (Fund 5BC0)</b>			
Revenues	Minimal gain	Potential gain	\$0, the scheduled fees for this state special revenue fund end on 7/1/2012
Expenditures	Minimal increase	Potential increase of several hundred thousand dollars or more	- 0 -

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

- The refundable tax credit for voluntary action programs and for returning properties to productive use may reduce personal income tax and commercial activity tax revenues. The two tax credits may reduce annual GRF revenues between \$2.9 million and \$17.0 million through FY 2019. The credit is authorized only for expenditures on voluntary actions initiated before tax year (TY) 2018.
- If the incentive increases the volume of covenant not to sue (CNS) requests submitted to the Ohio Environmental Protection Agency (EPA), it may cause a sustained increase of several hundred thousand dollars or more to be incurred by the three funds that support the Voluntary Action Program activity.

## Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2011	FY 2012	FUTURE YEARS
<b>Counties, municipalities, townships, and public libraries (LGF and PLF)</b>			
Revenues	Minimal loss	Potential loss between \$0.2 million and \$1.1 million	Potential loss between \$0.4 million and \$1.1 million annually through FY 2019
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 refundable tax credit for voluntary action programs and for returning properties to productive use may reduce personal income tax revenue, which is one of the taxes for which receipts are credited to the GRF. The Local Government Fund (LGF) and the Public Library Fund (PLF) would bear 3.68% and 1.97%, respectively, of any revenue loss to tax receipts credited to the GRF. Beginning in FY 2012, the GRF tax revenue distribution formula in the Revised Code necessitates that the PLF would bear 2.22% of the revenue loss.

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## Detailed Fiscal Analysis

The bill authorizes two tax credits against the commercial activity tax or personal income tax. Both credits are refundable, meaning that, if the amount of the credit exceeds the taxpayer's tax liability for a tax period after applying all other credits to which the taxpayer may be entitled, the taxpayer is entitled to a refund of the excess. If a pass-through entity claims a credit against the commercial activity tax, its owners may not claim the same credit against the personal income tax. Both tax credits are available for certain actions undertaken by the taxpayer only if they are undertaken on or before December 31, 2017. H.B. 10 also exempts the person from fees and penalties authorized under environmental protection laws for one year after the covenant is issued.

### **Voluntary action credit**

The first credit is allowed for a taxpayer who receives, on or after the bill's effective date, a covenant not to sue (CNS) from the Director of Environmental Protection under Ohio's Voluntary Action Program (VAP). The Voluntary Action Program encourages businesses to remediate and reuse real property contaminated by hazardous materials or petroleum by providing various benefits after remediation occurs, including the issuance of a covenant not to sue, which immunizes the property owner from civil liability to the state to perform additional investigational and remedial activities. The credit may be claimed for each covenant the taxpayer receives.

The credit equals 25% of the taxpayer's expenditures made directly to conduct the remedial activities resulting in the covenant. For pass-through entity owners, the credit equals the owners' distributive or proportionate share of that amount. The credit is authorized only for expenditures on voluntary actions initiated before 2018.

According to data from the Ohio Environmental Protection Agency (EPA), state certified professionals have issued 422 No Further Action (NFA) letters since the VAP was fully implemented in 1997. Among the 422 NFAs, 386 CNS requests were submitted to the Ohio EPA, and the agency issued 314. Generally, 20-35 NFA letters are submitted in a given year, so if this trend continues in future years, it is reasonable to anticipate 15-26 CNS issuances from the Ohio EPA, annually. Table 1 below provides an illustrative example of the resulting tax revenue loss on account of the VAP refundable credit for a single year. The scenario in table 1 is based upon trends in prior years, so future economic activity may not be similar.

<b>Table 1: Illustrative Example of VAP Refundable Credit Value for a Single Year</b>		
CNS issuance by Ohio EPA (annual)	15	26
Remediation expenditures <sup>1</sup> Per CNS issuance (in millions, \$)	2.5 – 4.2	2.5 – 4.2
Percentage of remediation expenditures paid with private funding <sup>2</sup>	33%	33%
Total value of refundable credits for all CNS issuances (in millions, \$)	3.09 – 5.20	5.36 – 9.01

If the typical number of NFA letters were submitted in a given year, and the trend of CNS issuances resulting from these NFA letters remains constant, the proposed VAP refundable tax credit would reduce total tax revenues by \$3.1 million to \$9.0 million, annually.

Please note that the number of properties in the VAP is just a fraction of all contaminated properties in Ohio. The complete list of brownfields is unknown because the Ohio EPA no longer maintains a list of contaminated properties.<sup>3</sup> Nationally, the U.S. EPA estimates there are upwards of 450,000 brownfield sites, but the exact number is not known. Thus, the number of contaminated Ohio properties that could enter the VAP may increase dramatically as a result of the tax incentives. Such behavioral responses would increase the total value of the refundable credits beyond the estimates above. The presence of a 25% refundable credit may affect future behavior because of its value as equity in a project. One national expert<sup>4</sup> in brownfield financing suggests that lenders "usually require developers to have at least 25 percent equity in a project to make sure the borrower has significant capital at risk," and "most banks also adhere to an informal rule of thumb in evaluating the viability of a project – cleanup costs should not exceed 25 percent of the fair market value of the property once it is clean."

Presently, the Internal Revenue Code allows the costs of brownfield cleanups to be expensed by taxpayers. Under this federal tax incentive, certain environmental cleanup costs at targeted sites may be fully deducted by eligible taxpayers in the year in which they occurred, rather than having to be capitalized and spread over a period of years. The federal Office of Management and Budget (OMB) estimates that this tax

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<sup>1</sup> A Government Accountability Office (GAO, 2005) report on uses for Economic Development Administration (EDA) funds represented \$2.5 million – \$4.2 million as the lower and upper bound for projects utilizing Brownfield Grant funding awarded by EDA. However, the current upper bound might be higher.

<sup>2</sup> The National Conference of State Legislatures (NCSL) State Legislative Report, "Financing Brownfields Cleanup and Redevelopment," cited an International Economic Development Council Report where public sector (state, federal, and local governments) contributed approximately 67% of funds used in redeveloping brownfields. The value of credits will be larger, if private financing is higher than assumed in the table.

<sup>3</sup> In the late 1990s, the Ohio EPA had a master list of contaminated properties. The list was apparently discontinued due to lawsuits by owners of properties that were on the list.

<sup>4</sup> Bartsch, Charles. "Financing Brownfield Cleanup and Redevelopment." *Government Finance Review* (February 2002).

provision reduced federal revenues by \$290 million in 2009, of which \$240 million was attributable to corporations and \$50 million was attributable to individual taxpayers. If this distribution is reflected in future credit claims, the CAT is likely to bear more of a revenue loss than the Ohio personal income tax. Revenues from the CAT are earmarked mostly for reimbursing school districts and other local governments for the reductions and phase-out of local taxes on most tangible personal property (TPP). Under current law, the GRF is required to subsidize the required reimbursements to the School District Tangible Property Tax Replacement Fund and the Local Government Tangible Property Tax Replacement Fund, if CAT receipts are insufficient. The share of CAT receipts to school districts is 70%. The share of CAT receipts to local governments other than school districts, which is variable, is currently 30% for FY 2011. That share will decrease to 24.7% in FY 2012, and to 19.4% in FY 2013. The GRF share will rise from 0% in FY 2011 to 5.3% in FY 2012 and 10.6% in FY 2013. The tax credit is likely to reduce receipts from the CAT and distributions to the three funds. If CAT receipts are insufficient for the reimbursements, current law requires a GRF subsidy to the two replacement funds.

Permanent law prescribes the distribution of receipts from the personal income tax to the GRF (94.1%), the Local Government Fund (LGF, 3.68%), and the Public Library Fund (PLF, 2.22%). Under temporary law, for FY 2011, 94.35% of such receipts are to be distributed to the GRF and 1.97% to the PLF. Thus, the reduction in receipts from the personal income tax will decrease distributions to the three funds.

### **Productive use credit**

The second refundable credit authorized by H.B. 10 is allowed for a taxpayer who qualifies for the previously described VAP credit and who returns the property to productive use. A property is returned to productive use if it is used to conduct a trade or business, or if the property is certified for occupancy by a local authority and it is suitable for use in a trade or business. Leasing the property for a commercial, industrial, or residential purpose qualifies as productive use. The credit is determined in the same manner as the voluntary action credit.

LSC anticipates that a majority of the properties involved in the VAP credit issuance would be returned to public use, but a year or more may elapse between the time when a property receives the voluntary action credit and when it receives the productive use credit. A property owner may need to complete additional work after the CNS issuance before a site is ready for productive use. Accordingly, the proposed productive use refundable tax credit would reduce total tax revenues by an amount similar to that of the voluntary action credit, which is \$3.1 million to \$9.0 million, annually.

## **Environmental fee and penalty exemption**

The bill exempts a person who receives a CNS relating to a voluntary action initiated before 2018 from any fees or civil or administrative penalties that otherwise could be imposed pursuant to various environmental protection laws. The exemption lasts for one year after the date the covenant is issued. The Ohio EPA collects fees from those submitting NFA letters for a CNS, but these fees are collected before the CNS is issued, so these types of fees would not be eliminated.

The fees and penalties that may otherwise have been imposed are those authorized in the following Revised Code chapters: 3704. (air pollution), 3734. (solid and hazardous waste), 3745. (Environmental Protection Agency), 3750. (emergency planning and response), 3751. (hazardous substances), 3752. (cessation of chemical handling operations), 6109. (safe drinking water), and 6111. (water pollution).

At this time, LSC does not have an estimate of the amount of future fee and penalty revenue that will be foregone by the provision in H.B. 10.

## **Ohio Environmental Protection Agency operating expenses**

The Ohio EPA has spent more than \$2 million, annually, for its existing VAP. If the tax credits proposed in H.B. 10 result in an elevated number of applications over the next seven years, additional efforts will be required by agency personnel to operate the VAP, which includes certifying professionals to issue NFAs; evaluating CNS requests submitted to the agency; and conducting audits of at least 25 % of all NFA letters submitted to the VAP in each calendar year. The agency has multiple revenue sources to offset some of the costs incurred. The sources include certified professionals' fees, fees accompanying NFA letters submitted to the agency, certified laboratory fees, and cost recovery policies for technical assistance provided by the agency. If the tax credits proposed in the bill increase applications, additional fee revenue would be gained by the respective state special revenue funds.