Ohio Legislative Service Commission

Phil Cummins

Fiscal Note & Local Impact Statement

Bill: H.B. 98 of the 129th G.A. **Date**: February 28, 2011

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

Local Impact Statement Procedure Required: Yes

Contents: Reduces income tax rate on unearned income of seniors

State Fiscal Highlights

STATE FUND	FY 2011	FY 2012	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	- 0 -	Loss, potentially of hundreds of millions of dollars
Expenditures	- 0 -	- 0 -	- 0 -
Local Government Fund (Fund 7069), Public Library Fund (Fund 7065)			
Revenues	- 0 -	- 0 -	Loss, potentially of tens of millions of dollars
Expenditures	- 0 -	- 0 -	Decrease, potentially of tens of millions of dollars

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

- The bill would allow individuals age 70 and 1/2 years or older to have their unearned income taxed at a rate of 1%, beginning in tax year (TY) 2013. Unearned income is defined for this purpose as all income taxable in Ohio other than employee compensation and self-employment earnings.
- Individuals electing the 1% tax rate could not also subtract the retirement income credit in calculating their tax liabilities.
- Direct personal income tax revenue losses might total in the hundreds of millions of dollars, but this range is quite uncertain. No account is taken of indirect effects such as changes in migration decisions that might be induced by lower tax rates.
- GRF revenue losses would be 94.1% of total revenue losses.
- Revenue losses to the state's local government funds would be 5.9% of total revenue losses. These funds distribute their revenues to units of local government and public libraries.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2011	FY 2012	FUTURE YEARS
Counties, Municipal Corporations, Other Local Governments, Public Libraries			
Revenues	- 0 -	- 0 -	Loss, potentially of tens of millions of dollars
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.

- Direct revenue losses to the state's Local Government Fund and Public Library Fund, resulting from a lower state personal income tax rate on unearned income of seniors, would reduce distributions to counties, municipal corporations, other units of local government, and public libraries, potentially totaling tens of millions of dollars.

Detailed Fiscal Analysis

The bill allows Ohio personal income taxpayers age 70 and 1/2 years or older to elect to have their unearned income taxed at a 1% rate. Unearned income is defined to include all income except employee compensation and net self-employment earnings. In calculating taxes owed, exemptions are to be subtracted first from earned income. If the exemption amount exceeds earned income, the excess is subtracted from unearned income. Persons who choose to have their unearned income taxed at the 1% rate may not also claim the retirement income credit.

Not all persons eligible for the new 1% rate would benefit from choosing to be taxed at that rate. Persons in the lower tax brackets would pay less tax by claiming the retirement income credit instead of opting for the 1% rate. Whether an individual taxpayer would pay less tax by choosing the retirement income credit or the 1% rate would depend on the details of the taxpayer's situation. While numerous Ohioans, if this bill becomes law, might choose not to have their unearned income taxed at the 1% rate, only a small portion of total unearned income is received by persons with low incomes.

The analysis that follows focuses only on the direct effects of the bill. Indirect effects of the legislation, such as changes to migration decisions induced by the lower tax rate, are outside the scope of this analysis.

Data on which to base an analysis of the fiscal effects of this bill are limited. An analysis of the changes proposed in this bill, using IRS data for TY 2007, showed earned income as defined in the bill of $211 billion in Ohio and unearned income of $71.6 billion in the state. TAX data for that year show Ohio personal income tax liability of $9.4 billion. The IRS data show five income brackets. Average tax rates can be derived for these. However, if $1 of unearned income is shifted from being taxed under current law to being taxed at 1%, the relevant tax rate would be that at the margin. Marginal tax rates can be calculated (more precisely, averages of the marginal tax rates) for each of the five brackets. For a taxpayer whose income is all unearned, the average tax rate would give a better indication of revenues foregone if the unearned income is instead taxed at the 1% rate. For a taxpayer with some earned income and some unearned income, the marginal rate may give a better indication.

If unearned income of all Ohioans in 2007 in each of the five income brackets was taxed at the average tax rate calculated for that bracket, the sum across all brackets of tax revenue on this unearned income would total $2.9 billion. At the calculated marginal tax rates for the five brackets, tax revenue on the unearned income would be $3.9 billion. If, instead, this unearned income of all Ohioans was taxed at a 1% rate, tax revenue would be $0.7 billion. The implied tax revenue foregone would be $2.2 billion to $3.2 billion.

Limiting those who could take advantage of the 1% rate to persons age 70 and 1/2 years and older would sharply reduce the estimated direct revenue loss. Nationwide in 2007, IRS data indicate that 44% of unearned income (as defined in this bill) was received by persons age 65 and older. Based on a 1998 IRS study, an estimated 62% of all tax returns filed by persons age 65 and older, with adjusted gross income of $20,000 or more, were filed by persons age 70 and 1/2 years and older. This percentage is here used to estimate the share of unearned income received by persons age 70 and 1/2 years and older, whose income might be high enough that they would choose to be taxed at the 1% rate, at approximately 27%, calculated as 62% of 44%. A further small adjustment is made for the older age mix of Ohioans.

Applying the estimated 27% of total unearned income received by persons age 70 and 1/2 years and older to the $2.2 billion to $3.2 billion of tax revenue that would be foregone if all Ohioans could choose the 1% rate implies a tax revenue loss of $600 million to $870 million in 2007. Lower tax rates in TY 2013 reduce the estimated loss to $510 million to $760 million. These estimates are based implicitly on 2007 income, with no adjustment for inflation indexing.

The range calculated in the preceding paragraph may overstate the loss to the extent that Ohio's lower share of the nation's unearned income than of earned income might be concentrated disproportionately among older persons. Calculations using IRS data indicate that 3.4% of nationwide earned income is attributed to Ohio but only 2.8% of unearned income (as defined above). If Ohio's lower share of nationwide unearned income, as defined in the bill, than of earned income in TY 2007 is concentrated among persons age 65 and older, then unearned income in the state of persons in that age group would be reduced by an estimated 30%. The lower end of the range for the estimated loss of tax revenue in TY 2010 would be reduced to about $360 million.

Local government funds

Reductions in personal income tax revenues would reduce revenues to the GRF and the local government funds. Under permanent law, 94.1% of any reduction in tax revenue would reduce revenue to the GRF, and the remaining 5.9% of the reduction would reduce revenue to the Local Government Fund (3.68%) and the Public Library Fund (2.22%).

School district income tax

The bill has no effect on school district income tax revenues. It provides that the amount of unearned income deducted in calculating Ohio personal income taxes owed is to be added back to adjusted gross income, for the purposes of any other section of the Revised Code, unless the reference or context indicates otherwise. Ohio adjusted gross income less exemptions is one of the bases for the school district income tax.