Ohio Legislative Service Commission

Jean J. Botomogno

Fiscal Note & Local Impact Statement

Bill: H.B. 600 of the 130th G.A.

Date: September 2, 2014

Status: As Introduced

Sponsor: Reps. Beck and J. Adams

Local Impact Statement Procedure Required: Yes

Contents: Earmarks new Ohio use tax collections for paying back amounts borrowed to issue unemployment benefits and for reducing tax rates for the sales and use and the commercial activity taxes

State Fiscal Highlights

STATE FUND	FY 2015	FY 2016	FUTURE YEARS
Sales and Use Tax Relief Fund (established by the bill)			
Revenues	- 0 -	- 0 -	Potential gain
Expenditures	- 0 -	- 0 -	Potential increase
Commercial Activity Tax Relief Fund (established by the bill)			
Revenues	- 0 -	- 0 -	Potential gain
Expenditures	- 0 -	- 0 -	Potential increase
Federal Unemployment Insurance Debt Retirement Fund (established by the bill)			
Revenues	- 0 -	Potential gain	Potential gain
Expenditures	- 0 -	Potential increase	Potential increase
Income Tax Reduction Fund (Fund 4R80)			
Revenues	- 0 -	Potential loss	Potential loss
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2015 is July 1, 2014 – June 30, 2015.

- The bill earmarks "new" Ohio use tax collections by remote sellers for purposes of paying back amounts borrowed from the federal government to issue unemployment benefits and for reducing tax rates for the sales and use tax (SUT) and the commercial activity tax (CAT). Thus, the bill potentially reduces receipts from those two GRF sources.
- The bill eliminates an existing earmark of new Ohio use tax collections to the Income Tax Reduction Fund (ITRF, Fund 4R80).
- New use tax collections will be deposited in several funds created by the bill: the federal unemployment insurance debt retirement fund, the SUT relief fund, and the CAT relief fund; and it prescribes conditions under which deposits are made and balances in those funds used.

- Revenue from the sales and use tax is deposited in the GRF, and a share of GRF tax revenue is distributed to the GRF, LGF, and PLF. Thus, any reduction to sales tax rates would also reduce the amount distributed to the two local government funds. However, any reduction in GRF tax revenues would require a transfer of funds from the SUT relief fund to the GRF, LGF and PLF to make them whole.
- Half of the receipts from the CAT are deposited in the state GRF, while the School District Tangible Property Tax Replacement Fund (Fund 7047) and the Local Government Tangible Property Tax Replacement Fund (Fund 7081) receive 35% and 15%, respectively. Therefore, the two replacement funds would also experience revenue decreases, except that the bill provides for transfers from the CAT relief fund to make whole the GRF, the LGF, the PLF, and Fund 7047 and Fund 7081, for any revenue losses due to the reductions in CAT rates.

Local Fiscal Highlights

- Under permanent law, a share of GRF tax revenue is distributed to the LGF and PLF. Thus, any reduction to GRF tax receipts would also reduce the amount distributed to the LGF and PLF. However, the bill holds the funds harmless by requiring transfers from the SUT relief fund to the LGF and PLF.
- A reduction in revenue from the CAT would also decrease distributions to Fund 7047 and Fund 7081. However, the bill holds the funds harmless by requiring transfers from the CAT relief fund to the two funds.

Detailed Fiscal Analysis

H.B. 600

The bill earmarks "new" Ohio use tax collections (i.e., revenue above that in a prior estimating period) by remote sellers for purposes of paying back amounts borrowed from the federal government to issue unemployment benefits and for reducing tax rates for the sales and use tax (SUT) and the commercial activity tax (CAT). H.B. 600 creates the federal unemployment insurance debt retirement fund, the SUT relief fund, and the CAT relief fund; and it prescribes conditions under which deposits are made, and how cash in the funds and fund balances would be used.

Current law requires new Ohio use tax collections by remote sellers to be deposited twice annually in the Income Tax Reduction Fund (ITRF; Am. Sub. H.B. 59 of the 130th General Assembly). The new remote seller use tax collections are defined as collections remitted by remote sellers in excess of (1) remittances by sellers that collect use taxes under the Streamlined Sales and Use Tax Agreement (Revised Code section 5740.03) and (2) refunds issued to remote sellers. This added revenue would be added to the surplus GRF revenue from which an income tax rate reduction may be determined. H.B. 600 eliminates this ITRF earmark and redirects new Ohio use tax collections by remote sellers for purposes described in the bill. The bill specifies that new remote seller use tax revenue does not include the amount of use taxes by remote sellers who do not have substantial nexus and voluntarily registered under section 5741.17 of the Revised Code, or any refunds issued during the fiscal year to remote sellers from the tax refund fund.

New remote seller use tax revenue would be credited to the federal unemployment insurance debt retirement fund to the extent those collections do not exceed the debt the state owes to the federal government for amounts borrowed to issue unemployment benefits from the state unemployment compensation trust fund. If the debt is paid or is no longer owed, the remainder of new remote seller use tax collections and any money remaining in the debt retirement fund, under conditions specified in the bill, would be credited to the SUT relief fund. After that, any remaining cash would be credited to the CAT relief fund. The bill prescribes a mechanism by which the Tax Commissioner and OBM Director would credit new use taxes remitted by remote sellers to reduce the rates for the two taxes. These newly calculated tax rates would depend on the growth of use tax collections from remote sellers and balances in the two relief funds.

Ohio use tax collections

Estimates of uncollected sales and use taxes from remote retailers vary widely. The Department of Taxation pegged Ohio sales and use tax revenue losses from electronic commerce at $250 million in FY 2012. The University of Cincinnati's estimate of lost use taxes was $209 million for CY 2011, while researchers at the University of Tennessee[1] suggested the loss was $274 million. Please note that these estimates are for e-commerce only and not total remote sales (which would include mail order catalogs, and telephone purchases), so revenue losses for all remote sales are necessarily larger than the estimate above. For example, they were estimated at $350 million per year by the Department of Taxation.

Use tax collections through individual income tax returns totaled $2.8 million and $3.0 million, respectively in 2011 and 2012. Of the uncollected sales and use taxes, the total amount that may be remitted annually by remote sellers, the year-over-year growth in use tax collections, and new use tax revenue to be used for the calculation of the tax reductions under the bill are difficult to estimate. For sales and use taxes collected currently, the Department of Taxation reports payments by remote sellers associated with the existing Streamlined Sales Tax Project (SSTP). For example, annual new remittances through the SSTP were $7.4 million and $8.1 million in FY 2012 and FY 2013, respectively. (Those amounts would be excluded from new use taxes collected under the bill.)

Ohio's debt to the federal government

Ohio's debt to the federal unemployment loan fund is currently $1.4 billion.[2] If the level of new use tax revenue is comparable to amounts received through the SSTP (i.e., $7 million to $8 million annually), retiring Ohio's debt may take several decades, unless federal legislation forces nationwide use tax collections by remote vendors. If Ohio was able to collect $350 million in lost use taxes, erasing the existing debt to the unemployment loan fund would take at least four years. However, such outcome is unlikely at this time because Ohio cannot compel remote retailers to collect the use tax.

In addition to the uncertainty about the annual growth of use tax collections, how much debt Ohio would owe each year to issue unemployment benefits cannot be readily estimated. Loan balances have changed over the years, as new loans are incurred or payments are made. For example, in federal fiscal year (FFY) 2013, Ohio borrowed $294.2 million, whereas in FFY 2009, during the recession, Ohio borrowed $1.4 billion; and loan balances would decrease if Ohio makes principal payments from the state's Unemployment Compensation Trust Fund or by additional revenue from

[1] Professors Fox and Bruce at the University of Tennessee have been producing estimates of sales and use tax revenue losses from remote sales since 2001. Please note that their estimates have consistently been higher than those of other tax analysts.

[2] http://workforcesecurity.doleta.gov/unemploy/budget.asp#tfloans.

higher federal unemployment taxes paid by Ohio employers. For instance, in FY 2012, Ohio repaid a little over $1.0 billion to the federal government. Payments have been issued, generally, from the Unemployment Compensation Interest Contingency Fund (Fund 5HC0), which in the current biennium is funded by a transfer from the GRF.

Fiscal analysis

Paying back the federal debt, assuming it stays at the current level, could take from four years to several decades, with the difference in time frames due primarily to contingencies regarding loan balances in the next few years, economic downturns which may require more borrowing, and what the U.S. Congress might do. Also, assuming Congress ultimately allows states to compel use tax collections by remote retailers, realization of significant annual revenues under the potential new legal landscape would be slow; no tax rates would be reduced until the federal debt is repaid. After that, depending on the annual increase in total sales and use tax revenue and the growth in new use tax revenues, the bill may result in no rate change, or rates of 5.50% or 5.25%, down from the existing sales and use tax of 5.75%. Similarly, the CAT rate of 0.26% on taxable gross receipts may be unchanged, or reduced to 0.23% or 0.20% of taxable gross receipts. Due to all the uncertainties described above, LSC is unable to calculate potential reductions in rates and revenues from the bill, and when those fiscal effects may occur.

H.B. 600 eliminates the earmark in current law and redirects new Ohio use tax collections by remote sellers from the ITRF for the purposes described in the bill. Thus, the ITRF will experience a revenue decrease.

Any reduction in tax rates for the SUT would potentially reduce revenues to the GRF. Under permanent law, a portion of GRF tax receipts is subsequently transferred to the Local Government Fund (LGF, 1.66%) and the Public Library Fund (PLF, 1.66%). Similarly, a reduction in tax rates for the CAT would decrease CAT revenues. CAT receipts are deposited in part in the GRF (50%), 35% in the School District Tangible Property Tax Replacement Fund (Fund 7047), and 15% in the Local Government Tangible Property Tax Replacement Fund (Fund 7081). Any reduction in CAT revenues would also reduce revenue to Fund 7047 and Fund 7081, though current law requires a GRF subsidy if revenues to the local funds are insufficient for required reimbursements to local governments (for the elimination of the tangible personal property tax on general business). However, the bill specifies that a transfer of money from the SUT relief fund to the GRF and to the LGF and PLF would hold those funds harmless for reductions in revenue to the GRF from decreased tax rates. Similarly, the bill holds the Funds 7047 and 7081 harmless by requiring transfers from the CAT relief fund for any reduction of CAT revenue from any rate decrease.

The Marketplace Fairness Act of 2013

Several bills have been introduced over the years in the U.S. Congress to help states require remote vendors to collect use taxes, but none of those previous bills became law. The Marketplace Fairness Act of 2013, the latest federal legislative response to the Supreme Court's rulings on use tax collections, could grant states clear use tax taxing authority: it would authorize qualifying states to compel online and catalog retailers to collect sales tax at the time of a transaction regardless of whether the retailer has a substantial nexus to the state. This authority would extend only to states that impose sales and use taxes and meet certain statutorily prescribed standards of simplicity. The bill passed the U.S. Senate in May 2013, but its fate in the House of Representatives remains uncertain. The General Assembly expressed the intent in H.B. 59 to enact conforming state legislation upon the enactment of the Marketplace Fairness Act of 2013 (or other similar legislation) by Congress. It also specified that the intent of the conforming state legislation is not to create a nexus between Ohio and remote sellers for any tax other than those imposed by Ohio sales and use tax laws. Please note that if the Marketplace Fairness Act or similar legislation becomes federal law, revenue from remote sellers may increase by between $200 million and $300 million on an annual basis, though it may likely take several years to get to those levels.

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