HOUSE BILL 5

IMPACT ANALYSIS

Understanding the cumulative financial impact of House Bill 5 in the context of the last four years of funding cuts to local communities

November 20, 2014

INNOVATION OHIO

INNOVATIONOHIO.ORG

Understanding the cumulative financial impact of House Bill 5 in the context of the last four years of funding cuts to local communities

3 KEY POINTS

$82 MILLION
total estimated annual cost of HB 5 alone on Ohio's communities

$495 MILLION
total annual cost to communities from HB 5, estate tax elimination, LGF cuts, and TPP/KWH reimbursement cuts

Nearly
$1 BILLION
in lost revenue for local services over a two-year budgetary period

EXECUTIVE SUMMARY

Changes proposed in House Bill 5, legislation pending in the Ohio General Assembly, could result in a substantial reduction in resources for hundreds of Ohio communities that levy an income tax, and could lead to further budget consequences such as service cuts and tax increases. When combined with the significant loss of revenue that municipalities are already facing as a result of policy changes enacted by Governor Kasich and the legislature over the past four years, the potential impact to Ohio communities is staggering.

We estimate the statewide impact to communities from House Bill 5 if it passes at over **$82 million** per year. When considered along with the cuts to municipalities already enacted over the past four years, we found that Ohio cities and villages will be coping with nearly **half a billion dollars less** in their annual budgets to provide services. For some Ohio communities, **the reduction in resources exceeds 20% of their annual budgets**, and will be difficult to absorb without tax increases or major cuts in services.

As legislators prepare to consider proposals to reduce the state income tax in Governor Kasich's next two-year budget, the impact of past cuts to cities and the resulting reality of income tax increases at the local level must be considered.

HB 5: AN OVERVIEW

In early 2013, Ohio Representatives Grossman and Henne introduced House Bill 5, legislation aimed at creating uniformity in the collection and administration of municipal income taxes in Ohio. The legislation requires municipalities to repeal existing income tax ordinances and replace them with new statutes consistent with the language of the bill.

Among the ways the bill creates uniformity between cities is by mandating the format and deadlines for tax filing in order to make it easier for taxpayers to comply. The bill extends the concept of uniformity further, however, into areas that will impact the tax revenue communities collect. Below are 6 provisions in HB 5 that cost local communities.

HB 5: 5 THINGS THAT COST COMMUNITIES

1. HB 5 defines which types of income are taxable and what must be excluded from taxation in all Ohio cities and villages that collect income tax. Notably, it forbids taxation of certain types of benefits awarded to highly-compensated executives.

2. Perhaps most significantly, the bill requires communities to allow the deduction of business "net operating losses" (NOLs) and, when losses exceed income, carry forward any unused loss for up to five years. Because it creates a deduction from taxable income, the provision will reduce revenue for the 234 Ohio cities and villages that currently do not allow the deduction of NOLs or do so over a shorter time period.

3. HB 5 contains a change to Ohio's "occasional entrant" language, increasing the number of days a worker can work in a city before their income is taxable from 12 to 20, and prohibits municipalities from collecting taxes during those first 20 days, reducing taxable revenue to the community.

4. The legislation further eliminates the so-called "throwback" provision for remote sales, in which profits from the sale of goods are taxable at the location from which they are shipped if no remote salesperson is used. Elimination of this provision means a significant loss of revenue in communities that are home to businesses that sell online or through catalogs. In one example, Columbus estimates that the impact of this one provision on just 15 businesses it surveyed would result in a loss of over $560,000 for the City each year.

5. Finally, House Bill 5 contains a number of changes in tax administration for municipalities that will have a financial impact, including the requirement to use certified mail and limits on the procedures for conducting audits, and changes the legal remedies available to municipalities for the recovery of payments and fines.

HB 5 COMES IN WAKE OF OTHER CUTS TO LOCAL COMMUNITIES

The past four years have seen a strain in the relationship between the state and local communities as longstanding partnerships in which revenue was shared between the state and local communities were unilaterally eroded or ended.

In the 2012-2013 operating budget:

1 The state **cut by half the amount of state tax revenue that is returned to communities** through the Local Government Fund.

2 In that same budget, **the legislature eliminated the state's estate tax** – 80% of the proceeds of which went to local communities.

3 The state also **phased out reimbursement by the state for lost revenue** caused when the state reformed its tax code to eliminate sources of revenue depended upon by local taxing authorities.

The net result of those changes imposed by state lawmakers beginning in 2011 is significant erosion in funding for local communities. We estimate that those changes (reduction in Local Government Funding, reimbursement for TPP and KWH tax losses and the elimination of the estate tax) have resulted in an annual loss of revenue to Ohio's cities and villages valued at $413 million each year. This does not even account for losses to townships, counties, libraries and other taxing authorities whose funds were cut by the state in the past four years. We looked at municipalities because of the prospect of HB 5 and its additional impact on the over 600 cities and villages in Ohio that levy an income tax.

POTENTIAL IMPACTS OF HB 5

The financial impacts of HB 5 on communities are challenging to quantify, requiring communities to make estimates about how much of currently taxable income would no longer be taxable as a result of changes in the legislation. We were able to gather estimates from **187 cities and villages** from testimony offered to the Ohio House Ways & Means committee, resolutions drafted by city officials, media reports, and estimates provided by the cities and regional tax authorities. **In total, these communities reported a potential annual impact from HB 5 that could exceed $39 million.** This estimate is conservative, as the impact of several of the provisions are unknowable, as they involve income based outside the municipality or deductions not currently reported or allowed and are therefore not available for purposes of estimation.

For the cities that did not report estimated impacts from HB 5, we calculated the revenue impact per capita for the cities for which estimates are available to the population of the state's remaining 429 communities that levy an income tax. Combined, we estimate the potential statewide impact of HB 5 on cities and villages that levy an income tax at over $85 million each year.

When taken with the annual impacts of other cuts to local government contained in the past two state budgets, the impact to municipalities will approach half a billion dollars per year.

The complete list of 187 communities that reported estimated impacts from House Bill 5 is available on the Innovation Ohio website, but a representative sampling of cities and villages with the estimated impact of the bill, combined with additional state-level cuts experienced since 2011, is on the following page. For some communities, the total amount of revenue lost represents nearly a third of the resources with which the community had to operate just five years ago.

> "IN TOTAL, THESE COMMUNITIES REPORTED A POTENTIAL ANNUAL IMPACT FROM HB 5 THAT COULD EXCEED
> **$39 MILLION.**"

POTENTIAL STATEWIDE IMPACT OF HB 5

	Municipalities	*Total Population*	*HB 5 Impact*
Cities with estimates	187	3,372,862	$39,663,567
Cities without estimates	429	3,870,480	$45,515,365
TOTAL STATEWIDE	**616**	**7,243,342**	**$85,178,932**

CUMULATIVE IMPACT OF HB 5 TO MUNICIPALITIES

	2010	*2014*	*Annual Cut*
*Estate Tax**	$151,929,334	$ -	$151,929,334
TPP/KWH	$87,863,271	$4,553,098	$83,310,173
LGF	$376,202,010	$198,020,401	$178,181,609
HB 5	**	**	$82,438,024
		TOTAL	**$495,859,140**

* Estate tax varies widely by year; the average of 2008-2011 collections was used.

** The impact of HB 5 will not be felt until tax year 2015 or later.

ESTIMATED IMPACT FROM HB 5 *(representative sampling of cities and villages)*

MUNICIPALITY	HB 5 IMPACT	ESTATE TAX CUT*	LGF CUT**	TPP/KWH CUT	TOTAL CUTS	2010 RESOURCES ***	% OF RESOURCES LOST
Athens	$100,000	$281,482	$354,161	$56,228	$791,871	$11,100,879	7%
Bedford	$1,717,062	$149,922	$328,991	$508,256	$2,704,232	$16,784,970	16%
Brook Park	$312,000	$143,026	$460,880	$548,744	$1,464,650	$21,725,298	7%
Brookville	$200,000	$203,193	$67,581	$15,246	$486,020	$2,753,553	18%
Bucyrus	$500,000	$197,131	$166,067	$116,789	$979,988	$5,471,368	18%
Carlisle	$60,000	$13,951	$38,013	$16,621	$128,585	$1,172,786	11%
Centerville	$728,000	$1,430,213	$292,351	$76,464	$2,527,028	$14,233,349	18%
Cincinnati	$5,200,000	$16,044,505	$12,674,797	$3,174,399	$37,093,701	$409,789,449	9%
Clayton	$725,451	$251,479	$130,307	$55,407	$1,162,644	$4,277,288	27%
Columbus	$3,000,000	$7,960,351	$20,031,223	$4,635,500	$35,627,073	$625,262,081	6%
Dayton	$2,451,000	$714,633	$6,403,598	$1,790,642	$11,359,873	$138,153,576	8%
Englewood	$550,000	$243,550	$157,348	$198,026	$1,148,924	$8,403,886	14%
Fairfield	$400,000	$504,083	$726,751	$538,763	$2,169,598	$31,869,173	7%
Franklin	$482,591	$48,970	$183,234	$310,099	$1,024,894	$7,503,368	14%
Gahanna	$197,989	$329,330	$686,986	$81,318	$1,295,624	$18,282,341	7%
Gallipolis	$60,000	$173,436	$40,691	$55,307	$329,434	$2,172,752	15%
Grandview Heights	$75,000	$92,503	$256,729	$171,874	$596,106	$8,006,370	7%
Granville	$150,000	$527,295	$96,017	$6,703	$780,015	$3,475,519	22%
Grove City	$237,055	$302,730	$543,610	$200,427	$1,283,822	$19,579,740	7%
Hamilton	$676,000	$2,457,665	$1,041,011	$465,866	$4,640,542	$33,141,526	14%
Heath	$700,000	$184,564	$79,934	$216,599	$1,181,097	$7,043,406	17%
Hillsboro	$92,500	$145,709	$91,235	$61,572	$391,016	$3,967,304	10%
Huber Heights	$975,000	$160,898	$447,843	$487,112	$2,070,853	$20,323,752	10%
Kettering	$706,000	$2,513,525	$717,379	$526,648	$4,463,553	$51,338,192	9%
Lakewood	$220,000	$782,036	$1,772,729	$331,675	$3,106,441	$30,342,698	10%
Mansfield	$1,000,000	$936,716	$1,311,818	$471,621	$3,720,154	$30,568,624	12%
Marietta	$245,000	$463,757	$248,498	$39,500	$996,755	$9,447,621	11%
Marysville	$500,000	$174,660	$181,191	$244,964	$1,100,815	$10,528,206	10%
Maumee	$65,876	$101,237	$385,204	$300,429	$852,746	$16,029,591	5%
Miamisburg	$600,000	$341,761	$266,008	$397,695	$1,605,465	$14,532,759	11%
Middletown	$600,000	$677,615	$883,333	$1,423,645	$3,584,592	$28,071,384	13%
Monroe	$360,000	$351,998	$123,987	$396,149	$1,232,135	$8,629,829	14%
Moraine	$86,000	$15,463	$183,904	$219,017	$504,384	$16,340,130	3%
Mount Vernon	$300,000	$342,080	$217,206	$188,713	$1,048,000	$11,894,598	9%
Napoleon	$258,347	$178,147	$161,460	$72,868	$670,822	$3,752,994	18%
Newark	$2,000,000	$789,358	$1,028,639	$260,969	$4,078,966	$26,333,711	15%
North Canton	$949,500	$935,291	$293,786	$179,390	$2,357,967	$8,196,610	29%
Oakwood	$436,000	$1,073,884	$117,466	$60,441	$1,687,791	$8,989,913	19%
Parma Heights	$609,565	$296,080	$495,142	$101,949	$1,502,735	$12,078,557	12%
Piqua	$500,000	$644,295	$450,595	$243,879	$1,838,769	$12,724,135	14%
Reynoldsburg	$131,659	$259,092	$665,880	$21,008	$1,077,638	$12,380,564	9%
Sidney	$95,000	$192,129	$410,750	$361,447	$1,059,326	$15,247,384	7%
Silverton	$300,000	$49,116	$139,050	$42,748	$530,914	$2,435,914	22%
Springboro	$838,000	$116,857	$145,374	$61,504	$1,161,735	$10,788,644	11%
Springfield	$618,000	$898,189	$1,580,771	$414,003	$3,510,964	$36,915,379	10%
Tiffin	$170,000	$444,198	$295,076	$146,119	$1,055,393	$9,263,270	11%
Trotwood	$704,000	$299,658	$301,505	$352,671	$1,657,834	$11,331,807	15%
Troy	$750,000	$290,816	$579,230	$369,687	$1,989,734	$17,063,676	12%
Union	$25,000	$17,537	$62,984	$103,644	$209,165	$2,261,563	9%
Upper Arlington	$1,500,000	$3,455,024	$1,029,856	$135,254	$6,120,133	$25,855,694	24%
Van Wert	$40,000	$275,933	$111,701	$92,124	$519,758	$7,299,346	7%
West Carrollton	$425,000	$111,454	$175,055	$142,466	$853,975	$8,893,127	10%
Westerville	$400,000	$673,082	$749,598	$919,827	$2,742,507	$37,810,678	7%
Worthington	$443,087	$528,419	$423,861	$127,207	$1,522,573	$20,721,662	7%
Xenia	$477,000	$282,158	$616,008	$203,044	$1,578,210	$12,046,025	13%

* Estate tax cut based on average collections, 2008-2012

** Actual distributions to municipalities from individual counties' undivided local government funds are not available for years later than 2012. Instead, cuts were estimated by taking 50% of each community's 2010 distribution.

*** Total resources available to each community from Tax Department Estimates

HOW THE ESTIMATES WERE MADE

Estate Tax

The estate tax was eliminated in House Bill 153 beginning in tax year 2012. Cities and villages no longer receive any revenue from this source. To calculate the impact of this revenue loss, an average of the four most recent years for which data were available (* 2012 was excluded because of one village distribution that caused the statewide total to vary greatly from the norm) was used because estate tax collections tend to vary from year to year, depending on who dies.

House Bill 5

We estimated the statewide impact of the legislation by compiling estimates of its predicted impact from tax officials in a wide range of municipalities across Ohio and extend the average impact to the remainder of jurisdictions that levy a tax but did publish provide estimates. These estimates come from testimony to the Ohio House Ways & Means committee, local resolutions, media reports, and estimates obtained directly from cities and regional tax authorities. Based on 2012 US Census population estimates, we then calculated the average per capita impact to the cities reporting an impact from HB 5 and applied this to the population of the cities for which estimates have not been made public.

Local Government Fund

The amount communities receive from the Local Government Fund began to decline in Calendar Year 2011 (State Fiscal Year 2012) as a result of the passage of House Bill 153. Therefore, we established a baseline for local government fund distributions by looking at the amount cities and villages received in Calendar Year 2010 and comparing to the amount they are estimated to receive in Calendar Year 2014. To estimate 2014 distributions, we used actual distributions for the first eleven months and the average monthly distribution was used for the December amount.

The portion of county undivided local government funds that is received by municipalities was based on data from the Ohio Department of Taxation from reports by county auditors. To estimate the amount of County Undivided Local Government Funds that went to cities and villages in 2014, we multiplied the amount distributed to counties by the share of County Undivided Local Government Funds that went to municipalities received in 2012 – the last year for which actual distribution data is available ($227.1 million out of $430.5 million, or 52.75%).

Tangible Personal Property Tax and Public Utility Tax Reimbursements

Over the last decade, Ohio set aside revenue from the Commercial Activity Tax, the Kilowatt Hour Tax and the Natural Gas Distribution Tax to make up for revenue lost to local taxing authorities as a result of tax reform and gas and electricity deregulation at the state level. Changes incorporated into House Bill 153 and that took effect in 2011 dramatically reduced these payments to local communities. To calculate the annual impact of these changes, we looked at the amount municipal taxing authorities received in state reimbursements in Calendar Year 2010 compared to the amounts they will receive in 2014. For many communities, the reimbursements have been eliminated, but in cases where the revenue represented a substantial share of local funds, a portion is still distributed.

[1] Testimony of Melinda Frank, Tax Administrator for the City of Columbus, before the House Ways and Means Committee, April 30, 2012.

[2] Ohio Department of Taxation, Estate Tax Data Series, http://www.tax.ohio.gov/tax_analysis/tax_data_series/estate/publications_tds_estate.aspx

[3] Ohio Department of Taxation, Local Government Fund Distributions, http://www.tax.ohio.gov/government/ohiodepartmentoftaxation.aspx

[4] Ohio Department of Taxation, Local Government Fund Tax Data Series, http://www.tax.ohio.gov/tax_analysis/tax_data_series/local_government_funds/publications_tds_local.aspx

[5] Ohio Department of Taxation, Tangible Property Tax Reimbursement and Electric and Gas Deregulation Reimbursement Municipal Phase Out Data, http://www.tax.ohio.gov/personal_property/phaseout.aspx

INNOVATION OHIO

IS A NEW TYPE OF

POLICY THINK TANK.

INNOVATION OHIO

/INNOVATIONOHIO

@INNOVATIONOHIO

35 E. GAY STREET, SUITE 260 COLUMBUS, OHIO 43215 • 614-220-0150

INNOVATIONOHIO.ORG