- Sales tax rate increased and base expanded
- Gas tax increased
- Local Government Funds frozen at FY 2003 levels

# Tax Provisions

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## INTRODUCTION

Work on Am. Sub. H.B. 95 (the main operating budget) and Am. Sub. H.B. 87 (the transportation budget) was carried out during an economic "soft spot." FY 2003 tax revenue performance was sub par and the prospects for improvement in the FY 2004-2005 biennium were limited. The tax provisions in the executive proposed budget had the dual goals of tax reform and revenue enhancement. As economic and revenue forecasts worsened, tax reform became secondary to revenue enhancement. The most noteworthy changes were the temporary increase in the sales tax rate from 5% to 6% and the phased-in increase in the motor fuel tax. However, the motor fuel tax changes were not related to GRF financing needs; instead they were related to highway financing and constructing needs (as required by the Ohio Constitution). Once again, deposits into and distributions from the three local government funds were frozen at the levels of the most recent fiscal year.

## *SALES AND USE TAX*

Am. Sub. H.B. 95 makes numerous changes to sales and use tax laws. Most notably, the budget act temporarily increases the sales tax rate from 5% to 6%, expands the sales and use tax base to include additional services, and makes required revisions to the sales tax law to comply with the Streamlined Sales and Use Tax Agreement. The changes to sales and use tax laws are to take effect July 1, 2003, except where otherwise specified.

### Temporary Increase in Sales and Use Tax Rate

Am. Sub. H.B. 95 temporarily increases the sales and use tax rate from 5% to 6%. The rate increase applies to taxable sales occurring between July 1, 2003 and June 30, 2005. The budget act provides that on and after July 1, 2005, the sales and use tax rate returns to 5%. Am. Sub. H.B. 95 includes tax rate schedules specifying the brackets to be applied during the period the sales and use tax is 6%. The higher sales and use tax rate is estimated to increase GRF revenue by about $1,161.0 million in FY 2004 and $1,215.0 million in FY 2005.

### Expansion of the Sales and Use Tax Base

The budget act expands the sales and use tax base by imposing the tax on new services effective August 1, 2003, and by eliminating certain exemptions. Sales of the following services will be taxable: storage facilities (not including parking), selected personal care services (skin care, tanning, manicures, pedicures, application of cosmetics, etc), satellite broadcasting, dry cleaning and laundry (not including

coin operated), delivery charges,[15] snow removal, intrastate transportation of persons (not water transportation), vehicle towing, and telecommunication services (which will be taxable after January 1, 2004). The sales tax base expansion will increase GRF revenue by $119.5 million in FY 2004 and $224.1 million in FY 2005. Am. Sub. H.B. 95 increases the sales tax base by about 2.8% in FY 2005. The sales tax on local telephone services will generate about 65% of additional revenues from the sales tax base expansion in FY 2005. Excluding additional revenues from the sales tax on local phone services, the sales tax base would increase by about 1%.

### *Personal Storage Facilities*

Am. Sub. H.B. 95 subjects sales of personal storage facilities services (such as self-storage units, lockers, safe deposit boxes, etc.) to the sales tax. The bill imposes the sales tax on all transactions related to the storage of tangible personal property, except for property that the user of the storage facility service holds for business purposes. Thus, the sales tax will not apply to business storage charges (such as those for warehousing of raw material, in-process goods, or finished goods storages). Parking services for a motor vehicle are not taxable under Am. Sub. H.B. 95. The sales tax on personal storage services is expected to increase GRF revenues by $4.1 million in FY 2004 and $5.4 million in FY 2005.

### *Laundry and Dry Cleaning Services*

Under previous law, industrial laundry cleaning services for items used in a trade or business were subject to sales or use taxes. Am. Sub. H.B. 95 expands the sales tax to cleaning services for all laundry and dry cleaning items, regardless of whether such items are personal items or items used in a trade or business. However, the budget act exempts from the sales tax self-service (coin-operated) facilities for use by consumers. The extension of the sales tax to most laundry and dry cleaning services is expected to increase GRF revenue by $16.3 million in FY 2004 and $20.2 million in FY 2005.

### *Local Telecommunications Services*

The budget act subjects to sales and use tax local telecommunication services[16] billed to persons on or after January 1, 2004. These are services provided primarily by local exchange telephone companies that were subject to the public utility excise tax. Am. Sub. H.B. 95 expands the existing definition of "telecommunications service" to include related fees and ancillary services, including universal service fees, detailed billing services, directory assistance, service initiation, voice mail service, and other services, such as caller ID and three-way calling. Am. Sub. H.B. 95 maintains the sales tax exemption for local telephone communication service using coin-operated telephones and paid for by coins. The sales tax on local telecommunication services will increase GRF revenue by an estimated $58.0 million in FY 2004 (the tax applies for half the year). In FY 2005, GRF revenue is estimated to increase by $146.1 million.

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[15] See the definition of "price" below in the section discussing revisions to sales and use tax laws due to requirements of the Streamlined Sales and Use Tax Agreement.

[16] Am. Sub. S.B. 143 of the 124th General Assembly clarified the sourcing and the taxation of mobile telecommunication services sold or situsted to Ohio after July 31, 2002, pursuant to the U.S. "Mobile Telecommunications Sourcing Act" Pub. Law No. 106-252. Sales of mobile telecommunications services were already taxable under previous sales and use tax law and remain taxable in current law.

### *Satellite Broadcasting Services*

Am. Sub. H.B. 95 imposes the sales and use tax on satellite broadcasting services. As defined in the budget act, "satellite broadcasting services" means the distribution or broadcasting of programming or services directly to the subscriber's equipment. The sales tax base will also include all service and rental charges, premium channels or other special services, installation and repair service charges, and any other charges having any connection with the provision of the service. The sales and use tax will not apply when broadcasting services are obtained with the use of ground receiving and distribution equipment and for redistribution to other consumers or subscribers. Am. Sub. H.B. 95 specifies that purchases of satellite broadcasting services for resale to customers or subscribers remain exempt from the sales and use tax. The taxation of satellite broadcasting services is estimated to increase GRF revenues by $19.6 million in FY 2004 and $26.7 million in FY 2005.

### *Personal Care Services*

Am. Sub. H.B. 95 imposes the sales tax on various personal care services such as skin care, the application of cosmetics, manicures, hair removal, tattooing, body piercing, tanning, massage, spas, and other similar services. However, services provided by a licensed physician or chiropractor, and the cutting, coloring, or styling of an individual's hair are exempted from the sales tax. This provision is estimated to increase GRF revenues by $1.9 million in FY 2004 and $2.3 million in FY 2005.

### *The Transportation of Persons*

Am. Sub. H.B. 95 extends the sales and use tax to the intrastate transportation of persons by motor vehicle or aircraft, except for transportation provided by ambulance, by a public transit bus, and transportation of property by persons holding a certificate of public convenience and necessity issued under federal law. Thus, the transportation of property by the trucking industry and movers of goods remains tax-exempt. Am. Sub. H.B. 95 also maintains the sales tax exemption for the transportation of persons by a water transportation company. The taxation of the transportation of persons provided by intrastate taxis, limos, and aircraft is expected to increase GRF revenues by $6.4 million in FY 2004 and $8.1 million in FY 2005.

### *Snow Removal Service*

Am. Sub. H.B. 95 imposes the sales tax on snow removal service by mechanized means, but only if the person providing the service has more than $5,000 in sales of snow removal services during the year. The minimum threshold implies that occasional snow removal services by most persons will not be taxed. The taxation of snow removal services is expected to increase GRF revenue each year by about $0.2 million. However, state revenue from snow removal service will fluctuate yearly according to the amount of snowfall.

### *Towing Service*

Am. Sub. H.B. 95 extends the sales tax to the towing or conveyance of a wrecked, disabled, or illegally parked vehicle. This provision is expected to increase GRF revenue by $5.7 million in FY 2004 and $7.4 million in FY 2005.

### *Elimination of the Exemption for Purchases of Personal Property Used in the Process of Surface Mining Reclamation*

Under previous law, equipment and material used in the grading, reseeding, or other reclamation of surface land mined for coal or other minerals were exempt from the sales and use tax. Am. Sub. H.B. 95 eliminates the sales tax exemption for purchases of personal property used in the process of surface mining reclamation. This provision is estimated to increase GRF revenue by about $0.2 million each year of the biennium.

### *Elimination of the Exemption for Sales of Vanpool Ridesharing Vehicles*

Under prior law, the sale or leasing of a motor vehicle was exempt from the sales and use tax if it was exclusively used for a vanpool ridesharing agreement where the vendor is selling or leasing vehicles pursuant to a contract between the Department of Transportation and the vendor. Am. Sub. H.B. 95 eliminates this exemption and is estimated to increase GRF revenue by about $0.1 million each year of the biennium.

### *Sales of Wide-Area Transmission Services and 1-800 Services*

Under previous law, Wide-Area Transmission Services (WATS), 1-800 and 1-800 type services and other selected telecommunication services were exempt from the sales and use tax. Sales of private communications services that entitle the purchaser to exclusive use of a communications channel were also exempt from the sales and use tax. Am. Sub. H.B. 95 broadens the sales tax base by eliminating the sales tax exemption for wide-area transmission services (WATS), 1-800 services, and private communications services. However, the budget act also creates an exemption for sale of telecommunication services by call-centers. A "call-center" is any physical location where telephone calls are placed or received in high volume and that employs sufficient individuals to fill at least 50 full-time equivalent positions. The "call-centers" would be at locations where businesses concentrate activities such as telemarketing, customer service, computer technical services, etc. The Department of Taxation estimates that these changes will increase GRF revenues by $60.5 million in FY 2004 and $64.0 million in FY 2005.

## Changes to Sales and Use Tax Laws to Conform to the Streamlined Sales and Use Tax Agreement

Am. Sub. H.B. 95 makes numerous modifications to sales and use tax laws to conform to the Streamlined Sales and Use Tax Agreement.[17] Generally, this interstate agreement focuses on improving sales tax collection systems nationwide through uniformity in the state and local tax bases, uniformity of major tax base definitions, a central electronic registration system for all member states, simplification of state and local tax rates, uniform sourcing rules for all taxable transactions, simplified administration of exemptions, and simplification of tax returns and remittances. To reflect the requirements in the interstate

[17] On November 12, 2002, 34 states and the District of Columbia involved in the Streamlined Sales Tax Implementing States process approved the Streamlined Sales and Use Tax Agreement based upon recommendations made by the Streamlined Sales and Use Tax Project. The Agreement goes into effect when ten states with at least 20% of the population of states imposing a sales tax have come into compliance. However, collection of sales and use tax by remote vendors remains voluntary until either Congress or the U.S. Supreme Court makes the collection mandatory. As of July 2003, about 20 states have passed streamlined sales and use tax agreement legislation.

agreement, Am. Sub. H.B. 95 revises sales and use tax definitions, sourcing provisions, the tax rate schedules, and the laws regarding how local tax rates are levied or changed. This section provides a brief description of changes to the Ohio sales and use tax law that generally bring Ohio into compliance with the requirements of the Streamlined Sales and Use Tax Agreement.

Am. Sub. H.B. 95 limits the frequency of changes in local tax rates, requires a uniform method of calculating and rounding the amount of taxes owed, provides uniform standards for attributing the sourcing of transactions to taxing jurisdictions, and makes several other changes.[18] Most of the changes have no or minimal fiscal impact. Revisions to certain definitions in sales and use tax law modify the tax base and hence have a fiscal impact. Among the changes, the following have a significant fiscal impact: changes to the definition of "price," "food," "drugs," "prescriptions," and "durable medical equipment," and the adoption of a new mathematical rounding of sales tax liability.

### *Delivery Charges and Other Changes to the Definition of "Price"*

Generally, the differences (that have a potential fiscal impact) between the definition of "price" under prior law and the new definition is that Am. Sub. H.B. 95 includes delivery charges and excludes "discounts" in the definition of "price." Under prior law, separately stated delivery charges were not included in the definition of "price," and "price" did not allow for any deduction for discounts. Separately stated delivery charges on an aggregate bill charged a customer were not taxable. The sales tax applied only to the value of tangible personal property purchased and delivered. For vendor discounts, the sales tax liability was calculated by applying the sales tax rate directly to the price of the item of tangible personal property. The resulting amount (item's price plus tax liability) was then reduced by any available discount to arrive at the customer's "final" outlay for the transaction.

For taxable sales made after July 1, 2003, the sales tax liability is calculated after the vendor discount has been applied and subtracted from the value of the item or service.[19] For sales after August 1, 2003, when a vendor makes a taxable sale and charges the consumer a delivery charge, the charge is part of the taxable price of the sale. "Price" also includes items such as a refundable security deposit for the use of tangible personal property. Additionally, under the use tax, the produced cost of an item of tangible personal property is its "price" if a consumer produces the property for sale, but then removes it from inventory for the consumer's own use. The Tax Department estimates that the taxation of delivery charges will increase GRF revenues by about $7.0 million in FY 2004 and $7.4 million in FY 2005.

Am. Sub. H.B. 95 clarifies the taxation of transactions that include both taxable and nontaxable items. In the case of a transaction in which telecommunications service, mobile telecommunication service, or cable television service is sold in a bundled transaction that is not itemized, the entire "price" is subject to the sales and use tax unless the vendor can identify the nontaxable portion of the transaction. If requested

[18] A complete description of these revisions and other changes to the sales and use tax laws is available in the bill analysis for Am. Sub. H.B. 95 at www.lsc.state.oh.us. Information about the Streamlined Sales Tax Project can be found at www.streamlinedsalestax.org.

[19] "Price" does not include: "discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a vendor and taken by a consumer on a sale." Where the discount is reimbursed by a third party (for example manufacturers' discount) to the vendor, the "price" still includes the value of the discount. Am. Sub. H.B. 95 did not change the special definition of "price" for "motor vehicles" (R.C. 5739.01 (H) (2) remains unchanged). So the new provision regarding "discounts" would not apply to vehicle sales. For example, auto manufacturers discounts would not affect the sales tax liability in the sale of an automobile.

by the customer, the vendor shall disclose the selling price for the taxable services included in the aggregate bill. Am. Sub. H.B. 95 provides that the burden of proving any nontaxable charges in the sale is on the vendor.

### *Changes to the Definition of "Food"*

Under prior law, the definition of "food" specifically named the items that are or are not food.[20] The definition of "food" in Am. Sub. H.B. 95 is much broader and describes the term as "substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value."

The definition of "food" in Am. Sub. H.B. 95 includes gum, blended fruit juices with less than 100% fruit juice, bottled, mineral or carbonated water, and ice, all of which were taxed under previous law. Therefore, under the new definition, these listed items are not subject to the sales and use tax and thus removed from the sales tax base. This reduction in the sales and use tax base creates a revenue loss.

Am. Sub. H.B. 95 defines certain other items that are excluded from the definition of "food" such as tobacco, alcoholic beverages, soft drinks, and dietary supplements. "Soft drinks" are nonalcoholic beverages that contain natural or artificial sweeteners. "Soft drinks" do not include beverages that contain milk or milk products, soy, rice, or other milk substitutes, or beverages that contain greater than 50% vegetable or fruit juice by volume. The budget act defines "dietary supplements" as any product, other than tobacco, "that is intended to supplement the diet and that is intended for ingestion in tablet, capsule, powder, softgel, gelcap, or liquid form, or, if not intended for ingestion in such a form, is not represented as conventional food for use as a sole item of a meal or of the diet; that is required to be labeled as a dietary supplement, identifiable by the 'supplement facts' box found on the label, as required by federal law, and that contains a vitamin; mineral; an herb or other botanical; an amino acid; a dietary substance for use by humans to supplement the diet by increasing the total dietary intake; or a concentrate, metabolite, constituent, extract, or combination of any of these ingredients." Am. Sub. H.B. 95 maintains the exception for food purchased for off-premise consumption.

The changes to the definition of "food" will be effective July 1, 2004. Therefore, the provision generates no revenue loss in FY 2004. In FY 2005, GRF revenue loss from the expansion of the definition of food is estimated at about $19.0 million.

### *Changes to the Definition of "Tangible Personal Property"*

Am. Sub. H.B. 95 modifies the definition of "tangible personal property" for the purpose of sales and use tax laws to conform to the Streamlined Sales and Use Tax Agreement. However, the sales taxation of items of tangible personal property is essentially unchanged. Tangible personal property includes motor vehicles, electricity, water, gas, steam, and prewritten computer software. Under the interstate agreement, electricity is considered to be tangible personal property subject to the sales or use tax. However,

[20] Under previous law, "food" is defined as cereals and cereal products, milk and milk products, meat and meat products, fish and fish products, eggs and egg products, vegetable and vegetable products, fruit and fruit products, pure fruit juices, condiments, sugar and sugar products, coffee and coffee substitute, tea, cocoa and cocoa products. Food does not include spirituous and malt liquors, soft drinks, sodas, and beverages that are ordinarily sold at bars and soda fountains; root beer and root beer extracts; malt and malt extracts; mineral oils, cod liver oils, and halibut liver oils; medicines, including tonics, vitamin preparations, and other products sold primarily for their medicinal properties; and water, including mineral, bottled, and carbonated waters and ice.

Am. Sub. H.B. 95 continues the exclusion of electricity from the sales tax by specifically stating that the sales and use tax does not apply to sales of electricity through wires. The bill defines "prewritten computer software" as computer software (including prewritten upgrades) that is not designed and developed to the specifications of a specific purchaser.[21] However, under previous rule in the Ohio Administrative Code, a sale of canned software was considered to be a sale of tangible personal property. Therefore, this change has no fiscal impact.

### *New Definitions for "Drug" and "Prescription"*

Under prior law, sales of drugs dispensed by a licensed pharmacist upon the order of a licensed health professional were exempt from sales and use taxes, along with certain listed items, such as insulin. However, the term "drugs" was not defined. Am. Sub. H.B. 95 excludes from taxation sales of drugs for a human being, if such drugs are dispensed on the order of a person authorized by law to prescribe the drugs. The budget act defines both "drug" and "prescription"[22] and those changes broaden the number of drugs that are exempt from taxation by expanding the sales tax exemption to items such as vaccines and chemotherapy drugs consumed at the doctors' office or clinics. The changes might also create sales tax exemptions for certain drugs (available with or without prescriptions) which were previously taxable. The provisions regarding "drugs" and "prescriptions" are effective January 1, 2004. The expansion of the sales tax exemption for drugs is estimated to reduce GRF revenue by $3.4 million in FY 2004 and $7.7 million in FY 2005.

### *Changes to the Definition of "Durable Medical Equipment," "Mobility Enhancing Equipment," and "Prosthetic Device"*

Under previous law, sales of artificial limbs, braces, crutches, prosthetic devices, wheelchairs, and other listed tangible personal property were exempt from the sales and use tax. However, the items were not defined. Rather, they were listed with some description of the exemption. Am. Sub. H.B. 95, adopting the language in the Streamlined Sales and Use Tax Agreement, defines "durable medical equipment," "mobility enhancing equipment," and "prosthetic device."[23] The budget act revises the exemption for

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[21] "Prewritten computer software" includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the purchaser. If a person modifies or enhances computer software of which the person is not the original author or creator, the person is deemed to be the author or creator only of such person's modifications or enhancements.

[22] "Drug" is a compound, substance, or preparation, and any component of a compound, substance, or preparation, other than food, dietary supplements, or alcoholic beverages that is recognized in the official United States Pharmacopoeia, official Homeopathic Pharmacopoeia of the United States, or official national formulary, and supplements to them; is intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease; or is intended to affect the structure or any function of the body (R.C. 5739.01(FFF)). A "prescription" is an order, formula, or recipe issued in any form of oral, written, electronic, or other means of transmission by a duly licensed practitioner authorized by the laws of this state to issue a prescription (R.C. 5739.01(GGG)).

[23] "Durable medical equipment" is defined as equipment, including repair and replacement parts for such equipment, that can withstand repeated use, is primarily and customarily used to serve a medical purpose, generally is not useful to a person in the absence of illness or injury, and is not worn in or on the body (R.C. 5739.01(HHH)). "Mobility enhancing equipment" is equipment, including repair and replacement parts for such equipment, that is primarily and customarily used to provide or increase the ability to move from one place to another and is appropriate for use either in a home or a motor vehicle, that is not generally used by persons with normal mobility, and that does not include any motor vehicle or equipment on a motor vehicle normally provided by a motor vehicle manufacturer (R.C. 5739.01(III)). The bill defines "prosthetic device" as a replacement, corrective, or supportive device,

sales of prosthetic devices, durable medical equipment for home use, or mobility enhancing equipment, when made pursuant to a prescription and when such devices or equipment are for use by a human being. Under current practices, prosthetic devices and other items sold to aid mobility-impaired patients are generally tax exempt. Therefore, these changes to the definitions of durable medical equipment, prosthetic devices and mobility enhancing equipment would have minimal fiscal effect on state revenues. General Revenue Fund revenue loss each year of the biennium may be about $0.1 million.

### *Elimination of Tax Brackets and New Mathematical Rounding of Sales and Use Tax Liability*

The Streamlined Sales and Use Tax Agreement requires that a uniform method of calculating and rounding the amount of taxes owed be used to simplify state and local tax rates. Under prior law, a vendor or seller calculates and collects sales and use taxes based on schedules (or tax brackets) set forth in the sales and use tax law. Tax brackets are calculated such that tax liability amounts are "rounded up." On sales of 15¢ or less, no tax applies. On sales in excess of 15¢, the price is multiplied by the aggregate rate of state and local sales or use taxes in effect. The computation is carried out to six decimal places, and then the resulting amount is increased to the next highest cent. This method of calculating sales and use taxes owed to the state will remain in effect until December 31, 2005, after which a method proposed by the Streamlined Sales Tax Agreement will be imposed.

Am. Sub. H.B. 95 eliminates, effective January 1, 2006, the sales and use tax brackets and the exemption on sales of 15¢ or less, and requires that the vendor must compute the tax on each sale by multiplying the price by the aggregate rate of taxes in effect. The computation must be carried out to three decimal places, and if the tax owed is a fractional amount of a cent, the tax must be rounded to a whole cent using a method that rounds up to the next cent whenever the third decimal place is greater than four. A vendor may elect to compute the tax due on a transaction on an item or an invoice basis. The elimination of the 15-cents threshold has a minimal (positive) fiscal impact on state revenue. The elimination of the sales and use tax brackets and of the previous "rounding up" creates a revenue loss. Due to the effective date of these provisions, no revenue loss will occur in the current biennium. The Tax Department estimates that the adoption of these changes may reduce GRF revenues in FY 2006 by up to $15.0 million.[24]

Am. Sub. H.B. 95 makes several other changes required by the Streamlined Sales and Use Tax Agreement to simplify the administration of sales and use tax law. Some of those changes are listed below and have little or no impact on state revenues.

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including repair and replacement parts for the device, worn on or in the body to artificially replace a missing portion of the body, prevent or correct physical deformity or malfunction, or support a weak or deformed portion of the body, but does not include corrective eyeglasses, contact lenses, or dental prostheses (R.C. 5739.01(JJJ)).

[24] Generally the revenue loss is one cent per transaction for some percentage of the hundreds of millions of transactions each year.

### *Change to the Definitions of "Lease" and "Rental"*

Am. Sub. H.B. 95 revises the definition of "lease" by also calling it a "rental," and expands the existing definition to include future options to purchase or extend the lease or rental.[25] Under the new definitions, "lease" and "rental" are essentially identical for sales and use tax purposes. The new definitions do not apply to leases or rentals that existed before July 1, 2003. The definition of "lease" or "rental" will not apply if the leased tangible personal property is transferred to the lessee at the end of the lease term after completion of required lease payments, and payment of an option price of less than $100 or 1% of total required payments. Such transactions will be treated as conditional sales. Also, if a "leased" tangible personal property is provided with an operator for a fixed or indefinite period of time for the property to perform as designed, such transaction will not be treated as a "lease" or "rental" (the operator must do more than maintain, inspect, or set up the tangible personal property). Am. Sub. H.B. 95 moves the provisions regarding accelerated tax payments on leases to another section of the sales tax law (R.C. 5739.02(A)(2) and 5741.02(A)(2)) such that the taxation of all transactions subject to the accelerated lease payments (motor vehicles, watercraft, outboard motors, aircraft, and certain business equipment)[26] would continue as in previous law.

### *Simplification of the Administration of Exemptions*

Ohio's sales and use tax laws contain various exemptions and exceptions to taxation. Am. Sub. H.B. 95 consolidates many of those exceptions and exemptions into R.C. 5739.02, to simplify administering of exemptions, as required by the Streamlined Sales and Use Tax Agreement. Administration of exemptions is facilitated to allow for the acceptance of uniform exemption certificates. Under the streamlined sales tax agreement, sellers will be relieved from the "good faith" requirements that existed in prior law, and purchasers will be responsible for paying tax interest and penalties for claiming incorrect exemptions.

### *Restrictions on Frequency of Changes in Local Tax Rates*

The Streamlined Sales and Use Tax Agreement requires that Ohio restrict the frequency of local sales and use tax rate changes to lessen the difficulties faced by sellers when there is a change in a tax rate or base. Am. Sub. H.B. 95 provides that a resolution that levies or changes local sales and use taxes becomes effective on the first day of a calendar quarter following the expiration of 65 days, rather than 60 days,[27] from the date of its adoption. The Tax Commissioner, upon receipt from a board of county commissioners or board of elections of a certified copy of a resolution or notice of the results of an

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[25] The definition applies regardless of whether a transaction is characterized as a lease or rental under generally accepted accounting principles, the Internal Revenue Code, Title XIII of the Revised Code (which addresses commercial transactions), or other federal, state, or local laws.

[26] Am. Sub. H.B. 405 of the124th General Assembly.

[27] Am. Sub. S.B. 143 of the 124th General Assembly revised the local sales and use tax laws to require that a resolution that levies or changes local sales and use taxes becomes effective on the first day of a calendar quarter following the expiration of 60 days from the date of its adoption. S.B. 143 made other changes to sales and use tax laws that are not modified by Am. Sub. H.B. 95. For example, if a vendor that is registered with the central electronic registration system makes a sale in Ohio by a printed catalog, and the consumer computes the tax on the sale based on local rates published in the catalog, S.B. 143 required that the tax levied or rate changed could not apply until the first day of a calendar quarter following the expiration of 120 days from the date of notice by the Tax Commissioner to the vendor, or to the vendor's certified service provider, if the vendor has selected one.

election, must give notice of a tax rate change in a manner that is reasonably accessible to all affected vendors, at least 60 days prior to the effective date of the rate change. The budget act also applies the catalog notice provision of 120 days notice to sellers (included in Am. Sub. S.B. 143 of the 124th General Assembly) to the law regarding the repeal or increase of local permissive sales taxes adopted as an emergency measure. No fiscal impact is expected from the restriction on the frequency of changes to local sales tax rates.

### *Uniform Standards for Attributing the Source of Transactions to Various Taxing Jurisdictions*

The Streamlined Sales and Use Tax Agreement requires uniform standards for attributing the taxation of all taxable transactions to various taxing jurisdictions. A complete description of standards for attributing the source of taxable transactions to various taxing jurisdictions is available in the bill analysis for Am. Sub. H.B. 95 at the LSC website. ***The Legislative Service Commission has not completed an estimate of the fiscal impact of the adoption of new sourcing standards for sales and use tax purposes. However, LSC believes that the net fiscal effect of all the changes in the sourcing standards would be minimal.***

#### *Sourcing Standards for Most Transactions*

Under the interstate agreement, member states must have uniform standards for attributing the source of transactions to taxing jurisdictions. These standards are used to determine where a sale occurred (sometimes termed the "situs" or the "source" of the transaction). Am. Sub. S.B. 143 of the 124th General Assembly revised the general sourcing law that applies to most transactions to conform to the Streamlined Sales and Use Tax Agreement's uniform sourcing proposal, and was to take effect July 1, 2003. Am. Sub. H.B. 95 delays the effective date of the revision of the general sourcing law until January 1, 2004, and makes other changes. The general sourcing law will apply only to a vendor's or seller's obligation to collect and remit state and local sales or use taxes. It does not affect the obligation of a consumer to remit use taxes on the storage or use of tangible personal property to the jurisdiction of that storage or use. Other revisions include certain requirements for consumers to file with vendors multiple points of use exemption forms when consumers purchase tangible personal property or a service for use in business or when the property or service is available for use in several taxing jurisdictions.

#### *Sourcing Standards for "Direct Mail" Purchases*

Am. Sub. H.B. 95 establishes in the general sourcing law a new sourcing requirement for a purchaser of "direct mail"[28] that is not a holder of a direct payment permit.[29] Am. Sub. H.B. 95 requires that type of purchaser to provide to the vendor in conjunction with the purchase either a direct mail form prescribed by the Tax Commissioner, or information to show the jurisdictions to which the direct mail is delivered to recipients. Upon receipt of a direct mail form, the vendor is relieved of all obligations to collect, pay, or

[28] "Direct mail" is "printed material delivered or distributed by United States mail or other delivery service to a mass audience or to addressees on a mailing list provided by the consumer or at the direction of the consumer when the cost of the items are not billed directly to the recipients." It includes tangible personal property supplied directly or indirectly by the consumer to the direct mail vendor for inclusion in the package containing the printed material, but excludes multiple items of printed material delivered to a single address.

[29] Generally, a direct pay permit holder is a manufacturer or consumer who purchases tangible personal property for which the taxable status cannot be determined at the time of purchase. These consumers are authorized to make sales and use tax payments directly to the state.

remit the applicable tax and the purchaser is obligated to pay that tax on a direct pay basis. A direct mail form remains in effect for all future sales of direct mail by the vendor to the purchaser until it is revoked in writing.

Upon receipt of information from the purchaser showing the jurisdictions to which the direct mail is delivered, the vendor is required to collect the tax according to the delivery information provided by the purchaser. The vendor is relieved of any further obligation to collect tax on any transaction where the vendor has collected tax based on the delivery information provided by the purchaser.

If the purchaser of direct mail does not have a direct payment permit and does not provide the vendor with either a direct mail form or delivery information, the vendor must collect the tax under an existing sourcing provision that requires that the sale be sourced to the address from which tangible personal property was shipped, or from which the service was provided, disregarding any location that only provided an electronic transfer of the property sold or service provided. Am. Sub. H.B. 95 provides that this provision does not limit a purchaser's obligation for sales or use tax to any state to which the direct mail is delivered.

If a purchaser of direct mail provides the vendor with documentation of direct payment authority, the purchaser cannot be required to provide direct mail form or delivery information to the vendor.

### *Sourcing Standards for Sales, Leases, and Rentals of Transportation Equipment*

Under Am. Sub. H.B. 95, a sale, lease, or rental of "transportation equipment"[30] must be sourced under the existing general sourcing law. For leases of tangible personal property without recurring payments, Am. Sub. H.B. 95 requires that the attribution of a taxable transaction to a taxing jurisdiction must be done under the existing general sourcing law. For leases of tangible personal property with periodic payments, Am. Sub. H.B. 95 prescribes how they would be attributed to taxing jurisdictions. Rules would vary according to the type of equipment (motor vehicles, watercraft, aircraft, etc.). A complete description of the various sourcing standards for sales and leases of transportation equipment is available in the bill analysis for Am. Sub. H.B. 95 at www.lsc.state.oh.us.

### *Sourcing Telecommunications Sales*

Am. Sub. H.B. 95 repeals the existing mobile telecommunications sourcing law and adopts the interstate agreement's sourcing standard, effective July 1, 2003. Under the bill, the amount of state and local sales taxes due on sales of telecommunications service, information service, or mobile telecommunications service, is the sum of those taxes imposed at the sourcing location of the consummation of the sale. Rules for the sourcing of telecommunication sales vary according to the type of telecommunication, whether a service address is available, the place of primary use of the service, and whether the calling service is

[30] For purposes of sourcing (attributing a taxable transaction to a taxing jurisdiction), "transportation equipment" is defined as locomotives and railcars that are utilized for the carriage of persons or property in interstate commerce; trucks and truck-tractors with a gross vehicle weight rating of greater than 10,000 pounds, trailers, semi-trailers, or passenger buses that are registered through the International Registration Plan and are operated under authority of a carrier authorized and certificated by the United States Department of Transportation or another federal authority to engage in the carriage of persons or property in interstate commerce; or aircraft that are operated by air carriers authorized and certificated by the United States Department of Transportation or another federal authority to engage in the carriage of persons or property in interstate or foreign commerce. Containers designed for use on and component parts attached to or secured on these items are also "transportation equipment."

prepaid or postpaid. A complete description of sourcing of telecommunication services is available in the bill analysis for Am. Sub. H.B. 95 at www.lsc.state.oh.us.

### *Bad Debt*

Am. Sub. H.B. 95 modifies the bad debt provisions in the sales and use tax law. Generally, a vendor may deduct from its taxable receipts the amount of "bad debt" it has incurred. Bad debt is any debt that has become worthless or uncollectible for at least six months and that may be claimed as a federal tax deduction.[31] Under prior law, "bad debt" did not include any accounts receivable that have been sold to a third party for collection. Am. Sub. H.B. 95 removes this restriction. The bill also provides that in any reporting period in which the amount of bad debt exceeds the amount of taxable sales for the period, the vendor may file a refund claim. The refund claim will be for any tax collected on the bad debt in excess of the tax reported on the sales tax return. However, such refund claim must be filed within four years of the due date of the return on which the bad debt first could have been claimed.

When a vendor's filing responsibilities have been assumed by a certified service provider,[32] the certified service provider must claim the bad debt allowance on behalf of the vendor. The certified service provider must credit or refund to the vendor the full amount of any bad debt allowance or refund. Am. Sub. H. B. 95 provides that no person, other than the vendor in the transaction that generated the bad debt or a certified service provider, may claim the bad debt allowance.

## Other Sales and Use Tax Law Changes in Am. Sub. H.B. 95

### *New Sales Tax Exemptions for Aircraft with Fractional Share Ownership*

Am. Sub. H.B. 95 creates new exemptions for parts and services used in repairing and maintaining aircraft with fractional ownership (R.C. 5739.01(KKK)). The budget act also imposes a sales and use tax liability cap of $800 per plane (or for sale of interests in a plane) purchased in a fractional share ownership program in Ohio. To qualify for the tax exemptions and the sales tax liability cap, a fractional share ownership program is required to have at least 100 "air worthy" aircraft. A fractional aircraft ownership program provides significant management services to an aircraft owned by several persons where each owner has at least one-sixteenth interest. The management services include safety guidelines, maintenance, crew training, and record keeping. The application of the sales and use tax statutes to sales of fractional ownership of aircraft in Ohio is unclear and appears to be in dispute, thus affecting the estimation of potential state revenue loss from these provisions. Depending upon how the taxation of fractional ownership of planes and their servicing is ultimately resolved, the number of aircraft, parts, and services purchased by Ohio fractional aircraft ownership programs, GRF revenue loss from this new tax exemption may be up to $7.6 million per year.

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[31] "Internal Revenue Code of 1954," 68A. Stat. 50, 26 U.S.C. 166 and related regulations.

[32] The Streamlined Sales and Use Tax Agreement provides three technology models for sellers and vendors: the certified service provider model (CSP) model, the certified automated system (CAS) model, and any proprietary system certified by the states as CAS. A seller can choose one of the three technology models or continue to use the traditional tax collection system. Under the certified service provider model, the seller selects a CSP as an agent to perform all of the seller's sales and use tax functions. The certified service provider determines the amount of tax due, pays the state, and files returns with the state. The certified service provider is also liable for the tax due unless there are errors by the state or fraud by the seller. A complete description of the responsibility of the CSP, CAS, or vendors with proprietary systems is available at www.streamlinedsalestax.org.

### *Increase in the Filing Threshold for Accelerated Sales Tax Payments and Increase in the Vendor Discount*

Am. Sub. H.B. 95 increases the liability threshold for accelerated sales tax payment[33] remittances from $60,000 to $75,000 per year, and temporarily increases the vendor discount from 0.75% to 0.90%. Increasing the threshold for accelerated sales tax payment for electronic filers decreases the number of such filers required to accelerate sales tax payments. This provision is estimated to decrease GRF revenues by $3.8 million in FY 2004, with no fiscal effect in FY 2005. Increasing the discount percentage also reduces GRF revenues. The revenue loss to GRF from raising the vendor discount to 0.90% is estimated at $22.5 million in FY 2004 and $24.5 million in FY 2005. This revenue loss includes the interaction of the vendor discount with the sales tax rate increase and the tax base expansion.

## *CORPORATE FRANCHISE TAX*

Am. Sub. H.B. 95 includes several changes to corporate franchise tax law. The budget act modifies the treatment of certain business expenses, extends the carryforward for unused venture capital tax credits, imposes a new corporate franchise tax on local telephone companies (with a special treatment of the amortization of book-tax differences), and adopts new methods for determining business income and nonincome. Am. Sub. H.B. 95 also updates corporate franchise tax law for rights to lottery proceeds acquired by a corporation, and increases the minimum tax for companies with at least 300 employees and $5 million in sales.

### Modification to the Treatment of Internal Revenue Code Section 179 Deduction and Extension of the "Bonus" Depreciation

In May 2003, Congress passed the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003 that included two provisions that affect the Ohio corporate franchise tax. One provision increased the first-year depreciation "bonus"[34] from 30% to 50% for qualified assets purchased after May 2003, and extended it beyond the original September 10, 2004 date to December 31, 2004. Another provision of the

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[33] Am. Sub. H.B. 40 (125th General Assembly) accelerated the sales tax payment schedules for vendors and direct pay permit holders that remit sales tax electronically. Under prior law, sales and use tax payments were made on the 23rd of each month for prior-month sales. Under current law, direct pay permit holders pay each month one fourth of the tax liability for the same month in the preceding calendar year on the eleventh, eighteenth, and twenty-fifth day of each month; and on the twenty-third day of each month, the permit holder shall report the taxes due for the previous month less any amounts already paid during the month under H.B. 40. Vendors and sellers have the same required monthly payment dates as the direct pay permit holders. However, their accelerated tax payments are based on the amount of taxes collected during the month. The first payment (eleventh day) is based on tax collected in the first seven days of the month. The second payment (eighteenth) is for tax collected between the eighth day through the fourteenth day, and the third payment (twenty-fifth day) is for taxes collected between the fifteenth day and the twenty-first day of the month.

[34] The first-year depreciation "bonus" was created by the federal Job Creation and Worker Assistance Act of 2002. Corporate taxpayers could claim a first-year depreciation deduction equal to 30% of the adjusted basis of a qualified property. After the first year, the remaining depreciable amount from the purchased asset would be deducted under the pre-existing depreciation rules. To qualify, the property must: (1) be acquired after September 10, 2001 and before September 11, 2004, and (2) satisfy the general rules under the Modified Accelerated Cost Recovery System (MACRS). Eligible property includes: property with a recovery period of 20 years or less, water utility property, some computer software, and qualified leasehold improvements. Current first-year depreciation for a 5-year property, 7-year property, 10-year property, and 15-year property is 20%, 14.29%, 10%, and 5%, respectively.

JGTRRA expanded the maximum threshold for IRC Section 179 election[35] for certain businesses to $100,000, up from $25,000. Under these provisions, some businesses could entirely deduct, under certain conditions, purchases of capital equipment and certain computer software in the year of purchase, thus reducing their federal and Ohio taxable net incomes.

After Congress passed the Job Creation and Worker Assistance Act (JCWA) of 2002 that would have decreased state revenues, the 124th General Assembly enacted Am. Sub. S.B. 261 to mitigate JCWA's impact on revenue from the corporate franchise and personal income taxes. S.B. 261 required Ohio taxpayers who claimed the "bonus" depreciation in their federal tax returns to add-back five-sixths of the amount of "bonus" depreciation (deducted in the federal tax returns) to their Ohio corporate tax returns. In addition, S.B. 261 allowed such taxpayers to deduct one-fifth of that tax year's depreciation add-back for each of the next five consecutive years. Thus, for Ohio taxpayers, the benefits of the JCWA were extended over six years.

Using a mechanism similar to S.B. 261 and to respond to the JGTRRA of 2003, Am. Sub. H.B. 95 requires Ohio taxpayers who claim the new depreciation "bonus" and the special section IRC 179 expenses in their federal tax returns to add-back to Ohio income, five-sixths of the amount of additional deduction or "qualifying IRC section 179 depreciation expense"[36] (in the federal tax returns) in their Ohio corporate tax returns. Am. Sub. H.B. 95 also allows such taxpayers to deduct one-fifth of that tax year's add-back in each of the next five consecutive years. According to the Tax Department, these modifications to the corporate franchise tax law prevent a decrease of up to $12.0 million in FY 2004 and $20.0 million in FY 2005 in corporate franchise tax revenues, primarily from the IRC Section 179 expensing provision.

### Carryforward of Unused Venture Capital Credit for Ten Years

Am. Sub. H.B. 95 allows taxpayers that have been issued a nonrefundable tax credit by the Ohio Venture Capital Authority (created by S.B. 180, 124th General Assembly) to carry forward any unused portion of the tax credit for a period of up to ten years. The Ohio Venture Capital Authority provides both nonrefundable and refundable tax credits that may be claimed against the corporation franchise tax, the personal income tax, the domestic insurance tax, or the foreign insurance tax. The carryforward of unused nonrefundable venture capital tax credits may minimally decrease revenues.

### New Corporate Franchise Tax on Telephone Companies

Am. Sub. H.B. 95 removes telephone companies from the public utility excise tax (PUET) and imposes a corporation franchise tax on those companies.[37] A "telephone company" is any person engaged in the business of providing local exchange telephone service in Ohio. Telephone companies will no longer pay the PUET on their gross receipts billed after June 30, 2004 and will be subject to the corporate franchise tax starting in tax year (TY) 2005 (with revenue gained in FY 2005).

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[35] IRC Section 179 provides taxpayers the election to fully deduct as cost (i.e., expense) certain depreciable business assets in the year they are placed in service, rather than following regular depreciation schedules such as MACRS.

[36] For purposes of this calculation, the qualifying section 179 depreciation expense is the difference between the depreciation expense allowed under IRC section 179 and the depreciation expense allowed in that section as it existed on December 31, 2002.

[37] Also, Am. Sub. H.B. 95 imposes a new sales tax on sales of local telephone services.

Am. Sub. H.B. 95 transfers from the PUET to the corporate franchise tax nonrefundable credits for eligible nonrecurring 911 service and credits for services for the communicatively impaired.[38] The tax credit for nonrecurring 911 services may be carried forward until it is fully claimed. However, the maximum amount of all credits for 911 services that can be claimed will be $15 million. If the combined prior years and current credits in a tax year exceed this amount, the tax commissioner will reduce eligible credits allowed for that tax year such that the sum of all credits for 911 services does not exceed the maximum cap of $15 million. The tax credit allowed for the cost of providing services for the communicatively impaired may be carried forward until fully claimed.

Am. Sub. H.B. 95 creates a new nonrefundable corporate franchise tax credit for "incumbent local exchange carriers" existing on January 1, 2003, and with fewer than 25,000 access lines as shown on the company annual report filed with the Public Utilities Commission of Ohio. This tax credit is calculated by subtracting from these "small" telephone companies corporate franchise tax liability what the PUET liability for the company would have been in a year, prior to applying available PUET tax credits. Then, the resulting amount is multiplied by varying percentages between TYs 2005 and 2009. The applicable percentages are 100% for TY 2005, 80% for TY 2006, 60% for TY 2007, 40% for TY 2008, and 20% for TY 2009. This tax credit for "small" telephone local exchange carrier will not be available after TY 2009. Revenue gain from the corporate franchise tax on local telephone companies is estimated at $6.0 million in FY 2005 by the Department of Taxation.

### Amortization of Book-Tax Differences for Telephone Companies

Am. Sub. H.B. 95 prescribes how differences between the accounting value and the tax value of a telephone company's assets will be treated under the corporate franchise law. Generally, corporations depreciate or expense certain items in their balance sheet in ways that may create a difference between the value of certain assets for accounting purposes and their value for tax purposes. Under current law, any difference between the two sets of values resulting from a tax law change would be recognized in a tax gain or a loss immediately in the year the tax change takes effect. However, Am. Sub. H.B. 95 defers the tax recognition of any book-tax difference for telephone companies, and requires amortization of the tax effect of the differences in the two sets of values over a ten-year period, beginning in 2010. Only assets on a company's books and other records on December 31, 2003, for a company that was subject to the public utility excise tax qualify for this treatment. This provision has no fiscal effect in the current biennium.

### New Method for Determining Multi-State Corporation Business and Nonbusiness Income for Allocation and Apportionment Purposes

The corporation franchise tax liability for interstate corporations is based on the portion of their net income or net worth that is allocated or apportioned to Ohio. Under previous law and the Ohio method of treating income, a company allocated certain types of statutory-listed income whether or not the income was part of the company's active trade or business. Income from net rents and royalties from real or personal property, capital gains and losses on the disposition of property, dividends, and patent and copyright royalties (some of these sources of income may or may not be "business" income) were allocated entirely to Ohio or entirely outside Ohio. All other income not statutorily listed to be allocated was apportioned on the basis of three factors meant to measure the extent of a corporation's business

[38] This tax credit is calculated based on expenses incurred by telephone companies to provide services to visually or hearing impaired customers.

activity in Ohio: property (average cost of property owned in Ohio divided by cost of property owned everywhere), sales (sales in Ohio divided by sales everywhere), and payroll (total compensation in Ohio divided by total compensation everywhere).

Am. Sub. H.B. 95 adopts the distinction between "business" and "nonbusiness" income used by many other states in the Uniform Division of Income for Tax Purposes Act (UDITPA).[39] Generally, business income will be apportioned to Ohio according to the same three-factor formula, and nonbusiness income will be entirely allocated either to Ohio or to another state. As a general rule under this new method, all income is presumed to be business income. The budget act also changes how the property and sales factors are computed, and how certain sources of nonbusiness income are allocated. For example, any property a corporation rents or leases will be included in the calculation of the property factor if the net income from these operations is "business" income. If the income were "nonbusiness" income, the property would be excluded from the property factor and thus would be allocated to Ohio or elsewhere. The sales factor is changed to remove receipts that are excluded from a corporation's gross income, and to include in the factor certain receipts from insurance companies or nonelectric public utilities owned by a corporation, and receipts from financial institutions owned by a corporation.

Am. Sub. H.B. 95 makes other clarifications to the computation of apportionment for certain transactions such as sales or rents of property, and allocation of dividends, gains, and losses from stock sales by certain qualifying controlled groups. Generally, net rents and royalties from property not located or utilized in Ohio are allocable outside the state. Capital gains and losses from the sale or disposition of property not located or utilized in Ohio are allocable outside the state. If information on the physical location of assets were not available to the taxpayer, then certain gains and losses would be apportionable.

The Tax Department estimates that the new treatment of business and nonbusiness income for apportionment will increase state revenues by $23.8 million in FY 2004 and $34.0 million in FY 2005. The corresponding GRF revenue gain will be $22.7 million in FY 2004 and $32.4 million in FY 2005.

### Update of Corporate Franchise Tax Law for the Allocation of Lottery Proceeds Purchased by a Corporation

Under existing law, individual income or corporate franchise taxes must be paid in connection with the transfer of Ohio lottery prize awards to a corporation at the time of the transfer. Am. Sub. H.B. 95 updates the corporation franchise law with respect to a corporation doing business in Ohio and elsewhere that receives current or future payment of lottery prize awards. Such a multi-state corporation may likely apportion or allocate certain items in their Ohio tax returns. Am. Sub. H.B. 95 specifies that prize awards awarded by the Ohio Lottery and acquired by a multi-state corporation are allocable to Ohio for calculation of the Ohio corporation franchise tax. The bill clarifies that non-Ohio lottery prize awards and related gains from non-Ohio lotteries (and purchased by a corporation doing business in Ohio) are allocable outside of Ohio for franchise tax purposes, i.e., that such corporate income will not be taxed in Ohio. This provision is expected to have only a minimal fiscal effect.

[39] UDITPA defines "business income" as income, including gains or loss, arising from transactions and activities in the regular course of the taxpayer's trade or business, and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts for the taxpayer's regular trade or business operations. "Nonbusiness income" means all income other than business income and may include, but is not limited to, compensation, rents and royalties from real or tangible property, capital gains, interest, dividends and distributions, patent and copyright royalties, and lottery winnings, prizes and awards.

### Increase in the Minimum Franchise Tax to $1,000 for Companies with at Least 300 Employees or at Least $5 Million in Sales

Am. Sub. H.B. 95 increases the minimum tax from $50 to $1,000 per year for corporations with at least 300 employees or at least $5 million in worldwide sales. The increase in the minimum tax also applies to financial institutions. According to the U.S. Census Bureau, approximately 2,300 companies in Ohio had at least 300 employees in calendar year 2000.[40] In FY 2001, 46,389 corporations paid the minimum $50 in tax liability. During the same fiscal year, 24,112 corporations paid between $50 and $1,000 in tax liability, and 29,412 had more than $1,000 in tax liability.[41] An undetermined number of corporations with at least 300 employees or at least $5 million in worldwide sales are among corporations that paid $50 through $1,000 in corporate tax liability. State revenue gain from the increase in the minimum tax is estimated at $1.2 million in FY 2004 and $2.3 million in FY 2005. This provision is estimated to increase GRF revenue by $1.1 million in FY 2004 and $2.2 million in FY 2005.

### Extension of the Maximum Period for Claiming the Job Creation and the Job Retention Tax Credits

Under R.C. section 122.171, the Ohio tax credit authority may grant to an eligible business a nonrefundable credit against the corporate franchise or personal income tax for a period up to ten taxable years. The job creation or the job retention tax credits[42] shall be in an amount not exceeding 75% of the Ohio income tax withheld from the employees of the eligible business occupying full-time employment positions at the project site during the calendar year that includes the last day of the taxable year for which the credit is granted. Am. Sub. H.B. 95 extends the maximum period for claiming the job creation credit or the job retention credit from 10 years to 15 years.

This change would probably not affect the revenue loss under the recent job retention tax credit. However, there is a possibility that the provision might affect revenue loss under the job creation tax credit. The Department of Taxation estimates no revenue impact from the job creation tax credit in FY 2004 and $5.0 million revenue loss in FY 2005.[43] However, some of the tax credit agreements might be modified as a result of Am. Sub. H.B. 95. Assuming that current tax credit agreements are unchanged, this extension of the maximum period for claiming the job creation tax credit will have no fiscal impact in FY 2004 or FY 2005.

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[40] U.S. Census Bureau, *County Business Patterns 2001, Ohio*, Washington, D.C., 2003.

[41] Ohio Department of Taxation, 2002 Annual Report.

[42] S.B. 363 of 119th General Assembly created the refundable job creation tax credit. As of December 2002, 722 of the 1,266 projects that have received this tax credit are active. Am. Sub. H.B. 405 (124th General Assembly) created the nonrefundable job retention tax credit for manufacturing companies making capital investments exceeding $200 million over a three-year period at a specific project site as specified by the Ohio Tax Credit Authority. The job retention credit was substantially modified by H.B. 675 (124th General Assembly) that decreased the investment threshold to $100 million and also expanded the eligibility for this credit to companies that invest in research and development.

[43] Tax Expenditures Report for FYs 2004 and 2005.

## *MOTOR FUEL TAX*

### Tax Increase

Am. Sub. H.B. 87 increases the motor fuel tax, which had been 22 cents per gallon, by two cents per gallon effective July 1, 2003, and by an additional two cents per gallon effective July 1, 2004. The total tax will therefore become 24 cents per gallon from July 1, 2003 through June 30, 2004, and 26 cents per gallon from July 1, 2004 through June 30, 2005. The bill increases the tax by an additional two cents per gallon on July 1, 2005, which will make the total tax 28 cents per gallon, but that increase will not take effect if the Director of the Ohio Department of Transportation (ODOT) finds both (1) that the amount of federal motor fuel excise tax appropriated to Ohio is at least equal to 95% of federal taxes paid in Ohio, and (2) that Ohio no longer receives a net loss of federal motor fuel tax due to federal tax reductions, rebates, or assistance on behalf of ethanol-based or alcohol-based motor fuels.

The old 22-cent tax was the sum of five distinct tax levies, each created under a different section of the Revised Code. The tax increase is added to one of the existing five levies, a two-cent levy provided for by section 5739.29 of the Revised Code. Am. Sub. H.B. 87 alters the distribution of the previously existing two-cent levy and, in the process of doing so, creates a new formula for distribution of the revenues from the tax increase. The old formula first distributed a share of the tax proceeds to the Tax Refund Fund, the Waterways Safety Fund, and the Wildlife Boater Angler Fund, after which tax proceeds were used to pay debt service on Highway Obligation Bonds and Highway Improvement Bonds. If any funds remained after satisfying the debt service, they were deposited into the Highway Operating Fund.

The new formula retains the distribution to the Tax Refund Fund, the Waterways Safety Fund, and the Wildlife Boater Angler Fund, but requires that the remainder be deposited into the Gasoline Excise Tax Fund. A portion of this money is then distributed to local governments, with the proportion going to them increasing in stages from zero prior to August 15, 2003, to one-eighth beginning August 15, 2003, to one-sixth beginning August 15, 2004, to three-sixteenths beginning August 15, 2005. This total amount is distributed to local governments in the following proportions: 42.86% is distributed to municipal governments; 37.14% is distributed to counties; and 20% is distributed to townships. Remaining revenues from this tax levy then follow the original distribution formula: they are used first to pay debt service on Highway Obligation Bonds and Highway Improvement Bonds, and then are deposited into the Highway Operating Fund.

These changes are estimated to increase revenues from the tax by approximately $135 million in FY 2004 and by $273 million in FY 2005. In subsequent fiscal years, the increase in revenues is estimated to be either $276 million or $414 million, depending on the finding of the Director of ODOT. The increased revenue in FY 2004 would be distributed to the Waterways Safety Fund (approximately $1.2 million), the Wildlife Boater Angler Fund (approximately $0.2 million), and to local governments (approximately $14.8 million). Since the debt service on highway bonds would presumably be met under either the old formula or the new one, the remainder of the increased revenue, approximately $119.1 million, would go to the Highway Operating Fund. In FY 2005, the increased revenue would be distributed to the Waterways Safety Fund (approximately $2.4 million), the Wildlife Boater Angler Fund (approximately $0.3 million), to local governments (approximately $44.1 million), and to the Highway Operating Fund (approximately $226.4 million). In subsequent fiscal years, the Waterways Safety Fund would receive $2.4 million (or $3.6 million), depending on the finding of the Director of ODOT, the Wildlife Boater Angler Fund would receive $0.3 million (or $0.5 million), and local governments would receive $51.0 million (or $76.6 million).

## Exempt Educational Groups

Am. Sub. H.B. 87 permits school districts to receive refunds of the increase in the tax for any fuel they use to transport students. Am. Sub. H.B. 95 extends this permission to joint vocational school districts and to educational service centers, and permits all school districts (and educational service centers) to receive refunds of the increase in tax for fuel they purchase for operational purposes other than transporting students. These provisions are estimated to reduce transportation costs to school districts and to educational service centers by approximately $700,000 in FY 2004 and by approximately $1.4 million in FY 2005. In subsequent fiscal years the estimated cost reductions total either $1.4 million or $2.1 million, depending on whether there is a third increase in the motor fuel tax on July 1, 2005. There would be corresponding reductions in revenue available to the Highway Operating Fund and to counties, municipalities, and townships for road and bridge projects. The reductions in revenue to the Highway Operating Fund are estimated to be approximately $525,000 in FY 2004, $1.1 million in FY 2005, and either $1.1 million or $1.6 million in subsequent fiscal years. The remaining savings to school districts, approximately $175,000 in FY 2004, $350,000 in FY 2005, and either $350,000 or $525,000 in subsequent fiscal years, would constitute a reduction in revenue to counties, municipalities, and townships.

## Township Formula

Beginning August 15, 2003 the distribution of tax revenues from the levy provided under section 5735.29 of the Revised Code to individual townships follows a new formula. A township will receive the greater of (1) the amount derived from the formula described above, or (2) 70% of a formula amount based half on the number of motor vehicles registered in the township, and half on the number of township lane miles. The sum total of all distributions to townships under this formula is projected to exceed the amount provided by the distribution formula described above. The difference is made up by reducing the distributions described above to municipal governments, to counties, and to the Highway Operating Fund. The distributions to each of these three recipients are reduced by an equal amount. In addition to this enhancement of townships' share of the tax levy, townships are to receive a share of money retained by the Highway Operating Fund due to Am. Sub. H.B. 87 phasing out a transfer from that fund to the Department of Public Safety. That transfer has historically been used primarily to fund the operations of the Ohio State Highway Patrol. Details of the changes in financing Department of Public Safety programs may be found in that agency's section of the Final Analysis. Under these provisions the amount going to townships will eventually increase by approximately $7.2 million, assuming that the full six-cent increase in the tax levy is made, with the distributions to counties, municipal governments, and the Highway Operating Fund each reduced by approximately $2.4 million.

## Credits to Highway Operating Fund

Am. Sub. H.B. 87 changes the distribution of the two-cent motor fuel tax levy provided by section 5735.05 of the Revised Code. Current law provides that municipal corporations, counties, and townships receive shares of this tax levy, which are distributed by way of the State and Local Government Highway Distribution Fund according to a formula specified in section 5735.23 of the Revised Code. Beginning August 15, 2004, the bill reduces the distributions to counties and municipal corporations by $248,625 apiece each month, and reduces the distribution to townships by $87,750 monthly. The Highway Operating Fund receives corresponding increases in its share of this tax levy.

### Refunds for Water Intentionally Added to Fuel

Am. Sub. H.B. 95 permits people who use motor fuel to which water was intentionally added so that the resulting fuel contains at least 9% water by volume to receive a refund for motor fuel taxes and motor fuel use taxes paid on 95% of the water contained in the fuel.[44] This provision creates a minimal loss of revenue to the Highway Operating Fund, the Local Transportation Improvement Program Fund, the Waterway Safety Fund, the Wildlife Boater Angler Fund, and to local governments.

## *MOTOR FUEL USE TAX*

The motor fuel use tax is imposed on the use of fuel to operate commercial vehicles on public highways in Ohio. Prior to the enactment of Am. Sub. H.B. 87, the tax rate was equal to the motor fuel tax rate, 22 cents per gallon, plus a supplemental tax of three cents per gallon. Am. Sub. H.B. 87 reduces the supplemental tax to two cents per gallon effective July 1, 2004 and Am. Sub. H.B. 95 makes changes to the wording of this provision in order to clarify the intent. If the motor fuel tax is increased to 28 cents per gallon on July 1, 2005, the two-cent supplement will be reduced to zero effective on that date. If the supplemental tax is fully phased out, the Department of Taxation estimates that revenue will decrease by approximately $35 million. The three-cent supplemental tax was traditionally used first to retire highway bonds, with the remaining revenue deposited in the Highway Operating Fund.

## *PUBLIC UTILITY EXCISE TAX*

Am. Sub. H.B. 95 exempts local telephone companies from this tax beginning with gross receipts received by those companies after June 30, 2004. Telephone companies must make a final filing under the tax on or before August 1, 2004. Telephone companies will be newly subject to both the corporate franchise tax and the sales and use tax under the bill. This change would have no fiscal effect in FY 2004, but would reduce GRF revenues from the tax by approximately $105 million in FY 2005, and would reduce revenues to the local government funds by an additional $5 million that year.

## *KILOWATT-HOUR TAX*

Am. Sub. H.B. 95 overrides the statutory distribution of the kilowatt-hour tax for the biennium. Under the statutory distribution, the Local Government Fund receives two and six hundred forty six one-thousandths percent of the revenue from the tax, and the Local Government Revenue Assistance Fund receives three hundred seventy eight one-thousandths percent of the revenue. Am. Sub. H.B. 95 continues a provision of Am. Sub. H.B. 94 of the 124th General Assembly that distributes this revenue share to the GRF instead. This provision is estimated to increase revenues to the GRF by approximately $19.2 million in FY 2004 and $19.6 million in FY 2005, and would reduce total revenues to the local government funds by the same amounts.

[44] One commercially-available product of which Department of Taxation officials are aware that would qualify for the refunds is a clean-burning fuel that reduces vehicular emissions.

## *PROPERTY TAXES*

### Inventory Tax

Am. Sub. H.B. 95 accelerates the rate at which the inventory tax is phased out. Inventories currently are assessed at 23% of their true value. The bill provides that in TYs 2005 and 2006, the assessment rate will be reduced by two percentage points each year, if statewide collection of tangible personal property taxes for the second preceding year exceeds that in the third preceding year. If this condition is not met, the assessment rate will remain unchanged in that tax year at the rate in the preceding tax year. In tax years 2007 and thereafter, the assessment rate will be reduced by two percentage points each year, with no trigger mechanism to slow the decline. Once the assessment rate reaches zero, inventories will no longer be listed for taxation.

This change will reduce revenues to school districts and other local governments by an estimated $35 million in CY 2005. Revenue losses will increase over time. This will increase the cost of the state basic aid formula due to the reduction in property valuation. The CY 2005 reduction will increase costs to the state by approximately $10 million in FY 2007, because of a lag in the formula. These costs also will increase over time.

### Elimination of Reimbursement of Tangible Property Tax Exemption

The budget act eliminates, over a ten-year period, the state's reimbursement of the loss of tax revenue to local governments that results from tax exemption for tangible personal property on the first $10,000 of taxable value at each business. In FY 2004, the reimbursement will be reduced to 90% of the amount reimbursed in FY 2003. Subsequently, the reimbursement will be reduced an additional ten percentage points each year. No reimbursement will be paid after FY 2012. Businesses with $10,000 or less in taxable value of tangible personal property will no longer be required to report that value, so reimbursements will continue to be based on FY 2003 data.

General Revenue Fund payments to school districts and other local government for reimbursement of the tax loss associated with this exemption will decline by an estimated $9.7 million in FY 2004, by $19.7 million in FY 2005, and by larger amounts in subsequent years. However, increased school foundation payments would offset some of the school district loss.

### Property Tax Administration Fund

Am. Sub. H.B. 95 creates the Property Tax Administration Fund to defray costs incurred by the Department of Taxation in administering property taxes and equalization of real property valuations. Amounts to be transferred to this new fund from the GRF are calculated as 0.3% of the 10% real property tax rollback plus 0.15% of the public utility personal property tax plus 0.75% of the tangible personal property tax. All of these tax amounts are for the preceding tax year. The costs are then shifted to local governments. This is accomplished by reducing reimbursement from the GRF of tax losses to local governments resulting from the 10% rollback by an amount equal to the transfers to the Property Tax Administration Fund.

This part of the tax bill will reduce payments to school districts and other local governments by an estimated $11.6 million in FY 2004 and $11.9 million in FY 2005. These amounts would have been paid out of line items 110-901, Property Tax Allocation – TAX, and 200-901, Property Tax Allocation – EDU.

### Public Utility Property Tax – Telephone Companies

Am. Sub. H.B. 95 reduces the assessment rate for telephone company property installed prior to 1995, from 88% of true value currently. The assessment rate is reduced to 67% in TY 2005, 46% in TY 2006, and 25% in tax years 2007 and thereafter. The assessment rate for telephone company property installed more recently remains unchanged at 25% of true value.

These changes will reduce tax revenues to school districts and other local governments by an estimated $11.0 million in FY 2006, $20.1 million in FY 2007, and $27.7 million in FY 2008.

### Remission of Penalties for Late Payment of Property Taxes

Am. Sub. H.B. 95 permits county boards of revision to remit penalties for late payment of real and personal property taxes if the failure to make timely payment was due to reasonable cause and not willful neglect. It changes existing law to permit county auditors, rather than the Tax Commissioner, to remit late payment penalties under certain circumstances. It permits a taxpayer to request review by the Tax Commissioner of a denial of remission of a penalty by a board of revision or a county auditor.

The addition of reasonable cause to the list of reasons for remission of penalties for late payment of taxes may reduce revenue from penalties.

### Abatement of Taxes on Qualifying Property

The tax bill temporarily permits the Tax Commissioner to abate collection of past-due taxes, penalties, and interest on properties qualified for tax exemption, but for which a tax exemption application was not filed. Included in the list of types of property qualified for this abatement are school property, churches, colleges, government and public property, charities, and graveyards. The opportunity to apply for this abatement is limited to 12 months from the effective date of this temporary law. The Tax Commissioner is given discretion to extend the abatement to taxpayers that apply for tax-exempt status but do not separately apply for abatement of past-due amounts.

This law may reduce revenues from taxes, penalties, and interest, on qualifying property for which no application was made for tax exemption.

## *TEMPORARY ADJUSTMENTS TO LOCAL GOVERNMENT DISTRIBUTIONS*

Am. Sub. H.B. 95 freezes, for FY 2004 and FY 2005, amounts of state tax receipts that are deposited into and distributed from the Local Government Fund, the Local Government Revenue Assistance Fund, and the Library and Local Government Support Fund at the lower of the formula amounts or the levels of FY 2003 (after all adjustments and reductions). The freezes affect deposits of receipts from the personal income tax, the sales tax, the use tax, the corporate franchise tax, the public utilities excise tax, and the kilowatt-hour tax. Tax receipts that would otherwise have been credited to the local funds will instead be credited to the GRF. The freezes are estimated to add $121.2 million to the GRF in FY 2004 and $187.9 million in FY 2005.

## *MUNICIPAL INCOME TAX*

Am. Sub. H.B. 95 makes several changes to the municipal income tax. The definition of "qualifying wages" subject to municipal income tax withholding requirements is revised and made uniform. The budget act also redefines the business net profit tax base. Municipal corporations are authorized to

exempt from taxation certain compensation attributable to nonqualified deferred compensation plans and extend a tax credit to taxpayers for certain losses associated with nonqualified deferred compensation plans. Additionally, employers are not required to notify municipal tax administrators of the identity of employees for whom compensation has been deferred. Businesses are required to adjust their municipal income tax bases to account for certain intercorporate transactions involving intangible property and interest expense. In addition, rental income from rental activity not constituting a business or profession is subject to net profit tax only by the municipal corporation in which the property that generated the profit is located. The budget act establishes new rules and procedures for appeals of tax administrators' decisions. These new rules apply to taxable years beginning on or after January 1, 2003. The tax credit for S corporation shareholders whose distributive shares of net profits are subject to municipal income taxation at both entity and individual levels is restored. This credit was deleted in S.B. 180 of the 124th General Assembly. Beginning in January 2004, telephone companies are subject to municipal income tax and businesses are required to use "Business Gateway" (a centralized and computer network system) to file their municipal income tax returns.

## *OTHER TAX PROVISIONS*

### Lodging Tax for Port Authority Military-use Facilities

Am. Sub. H.B. 95 authorizes a county to use revenue from existing lodging tax authority, or to increase its lodging tax rate by up to 2%, or both to help fund operations of port authority facilities on which or adjacent to which is located an installation of the armed forces of the United States, reserves, or national guard. This change may result in increased lodging tax revenues to local authorities.