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H.B. 86
134th General Assembly

Fiscal Note & Local Impact Statement

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Version: As Introduced

Primary Sponsor: Rep. Roemer

Local Impact Statement Procedure Required: No

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Highlights

Fund	FY 2021	FY 2022	Future Years
State General Revenue Fund			
Revenues	Possible loss up to tens of millions of dollars	Possible loss up to tens of millions of dollars	Gains about equal cumulatively to losses in first two years
Local Government and Public Library Funds (Counties, municipalities, townships, and public libraries)			
Revenues	Possible loss up to hundreds of thousands of dollars	Possible loss up to hundreds of thousands of dollars	Gains about equal cumulatively to losses in first two years

Note: The state or school district fiscal year runs from July 1 through June 30 and is designated by the calendar year in which it ends. For other local governments, the fiscal year is identical to the calendar year.

- The bill changes Ohio law pertaining to income tax treatment of depreciation expense and net operating losses, which may result in state revenue losses in FY 2021 and FY 2022, of uncertain magnitude, possibly ranging up to tens of millions of dollars. Actual near term losses would depend on taxpayer behavior.
- Depending on the timing of its enactment, the bill may not affect FY 2021 revenues, in which case revenue losses would occur in FY 2022.
- These revenue losses would be about offset by revenue gains in subsequent years.

Detailed Analysis

The bill makes two changes to law affecting taxpayers with federal net operating losses (NOLs) in TY 2020 and TY 2021. For certain taxpayers the bill waives a requirement, for those two years only, that those taxpayers add back an additional $\frac{1}{6}$ of accelerated federal depreciation expense to federal adjusted gross income (FAGI) in calculating their Ohio adjusted gross income (OAGI). Waiving the required additional addback would reduce OAGI and state tax revenues in those years, and increase OAGI and state tax revenues in future years by approximately equal amounts. Second, the bill lets certain taxpayers carry back NOLs from TY 2020 and TY 2021 who could not do so under current law. NOLs may be carried back up to five years, allowing a taxpayer to file an amended return and claim a refund. NOLs not used to reduce taxes may be carried forward indefinitely. Consequently, this change made by the bill would increase taxpayer refunds currently and decrease state tax revenues, but would imply approximately offsetting higher taxes due and higher state tax revenues in future years. Taxpayers would benefit on a net basis from these changes because of the time value of money. These provisions are explained more fully below.

LBO does not have a basis for precise estimates of the revenue losses in FY 2021 and FY 2022 that would result from enactment of the bill. Available data do support an estimate that the potential losses to the state could be sizable, perhaps ranging to tens of millions of dollars in those years. Because the losses pertain to the timing of recognition for income tax purposes of taxpayer losses, the near-term state tax revenue losses would be approximately offset by revenue gains in future years.

Ohio tax treatment of accelerated depreciation and NOLs

Calculation of Ohio income taxes owed starts with FAGI, then makes various adjustments. For taxpayers with income from a proprietorship or pass-through entity, one of these adjustments is to add back to FAGI an allowance for any reduction in the taxpayer's income that resulted from accelerated depreciation, in the year the accelerated depreciation is allowed for federal income tax purposes. The amount of the addback is then subtracted (deducted) from FAGI in future years. Specifically, the addback is calculated from depreciation expense allowed by subsection (k) of section 168 of the Internal Revenue Code (IRC), sometimes referred to as bonus depreciation, and that allowed by IRC section 179, which provides for expensing of certain capital outlays, except that up to $25,000 of section 179 expensing is not included in the addback calculation. In this fiscal note, the sum of these amounts is referred to as accelerated depreciation.

Generally, the addback equals $\frac{5}{6}$ of the amount of accelerated depreciation. If the taxpayer incurred an NOL for federal income tax purposes and the loss resulted from the accelerated depreciation, in current law all ($\frac{6}{6}$) of the accelerated depreciation is added back. For an employer that increased Ohio income taxes withheld by 10% or more from the previous year, the addback is reduced to two-thirds of the amount of accelerated depreciation.

If $\frac{5}{6}$ is added back, subsequent deductions are taken over the next five years (generally $\frac{1}{6}$ per year). If $\frac{1}{6}$ is added back, the deductions are taken over six years (also generally $\frac{1}{6}$ per year). If $\frac{2}{3}$ is added back, deductions are over two years. Deductions are taken in equal amounts each year, but a taxpayer is not permitted to claim a depreciation deduction in a tax year that includes a federal NOL or an NOL carryback or carryforward. The deduction must be used in the next subsequent tax year without an NOL. The addback and subsequent deduction do not affect the Ohio business income deduction or taxable business income, but instead flow through to taxable nonbusiness income.

Exceptions to the requirement for an addback include a taxpayer whose ownership interest in a pass-through entity is less than 5%. No addback is required for such an entity's accelerated depreciation. Neither is an addback required for depreciation from a business that increases its Ohio employer withholding by as much as or more than the amount of the depreciation.

Federal NOLs result when a taxpayer's deductions exceed income for a tax year, but U.S. Internal Revenue Service (IRS) rules limit what can be deducted in figuring an NOL. Various sources give rise to NOLs, including deductions from a trade or business, rental property, and casualty and theft losses from a federally declared disaster. Eligible expenses of work as an employee and moving expenses also were part of NOLs in past years, but are not deductible for most taxpayers in 2018 through 2025. Losses from operating businesses are the most common sources of NOLs.

Ohio treatment for NOL carrybacks parallels federal treatment. The federal Coronavirus Aid, Relief, and Economic Security (CARES) Act enacted in March 2020 liberalized treatment of NOLs, allowing NOLs to be carried back up to five years for losses in 2018, 2019, and 2020, and increasing the amounts of NOLs that may be used.

Bill provision pertaining to addbacks

The bill creates an exception, for TY 2020 and TY 2021 only, to the requirement that a taxpayer who incurs a federal net operating loss for the year must add back the entire amount of the accelerated depreciation instead of ⅚ of it. The net effect of this change is a gain in TY 2020 and TY 2021 for taxpayers with accelerated depreciation and NOLs, equal to the taxes otherwise due on ⅙ of accelerated depreciation. In the next five years after each of 2020 and 2021, depreciation of this addback is the same with the bill and in current law, implying no net change.

In TY 2026 and TY 2027, under the bill taxpayers would have deducted all of the addbacks, so would forego a deduction equal to ⅙ of accelerated depreciation in TY 2020 and TY 2021, respectively, for those with NOLs in those two earlier years. Foregoing the deduction in TY 2026 and TY 2027 would increase tax liabilities by an amount approximately equal to the tax benefit in TY 2020 and TY 2021, respectively. The equivalence of gains and losses would depend on the marginal tax brackets and other circumstances of the taxpayers at the beginning and end of these periods.

For example, a taxpayer with $600 of accelerated depreciation in TY 2020, who incurred an NOL for federal income tax purposes that resulted from the accelerated depreciation, is required under current law to add back all of the accelerated depreciation, $100 per year in each of TY 2021 through TY 2026. Under the bill, the taxpayer would add back only $500 of the $600 of accelerated depreciation, and depreciate that amount evenly by $100 per year in each of TY 2021 through TY 2025. The net effect of this change would be a reduction of OAGI by $100 in TY 2020 and an increase of OAGI by $100 in TY 2026.

Bill provision pertaining to NOL carrybacks

The bill also creates an exception, for carrybacks of federal NOLs from TY 2020 and TY 2021, to the limitation that no deduction of addbacks from prior years may be taken in a year to which an NOL is carried back to the extent that such depreciation results in or increases a federal net operating loss carryback or carryforward.

This exception may allow some taxpayers to carryback NOLs that would only be carried forward under current law. By filing amended returns for these earlier years, taxpayers could receive refunds instead of waiting to benefit from use of the NOLs in future years.

Cost of the bill

Dollar amounts potentially involved are substantial. The IRS reports NOLs of more than $209 billion nationwide in 2018, the latest year published. NOLs will likely climb sharply with this year's recession. The dollar amount of net operating losses nationwide rose in recession years 2008 and 2009, by 12% and 28%, respectively. NOLs continued rising in 2010 through 2012 as economic recovery got underway, by a total of 52% over the three years, leveling out thereafter. By 2018, NOLs had risen a further 11%.

LBO is not aware of IRS NOL data for Ohio, but plausibly a similar pattern occurred here. Comparable figures for Ohio could range to more than $7 billion in 2018, based on the state's share of the nation's population as a very rough indicator of the state's share of nationwide NOLs. At an average marginal state income tax rate estimated at 2.2%, the potential tax savings from using these NOLs to offset other income range to more than $160 million. The 2020 recession is likely to increase NOLs of Ohio taxpayers in the year of the recession and beyond. The magnitude of such an increase is uncertain, but plausibly could be as large as in 2008-2009 and thereafter or larger. Taxpayers can be expected to use part of these NOLs under current law to reduce tax obligations in 2021 and 2022. The bill would create opportunities for additional near-term tax savings.

The Department of Taxation publishes data on annual Ohio addbacks for IRS 168(k) and 179 depreciation expenses. The data as published include no indication whether the addback is $^{5}/_{6}$ of the accelerated depreciation amount, $^{6}/_{6}$, or $^{2}/_{3}$. If no taxpayers added back $^{6}/_{6}$, the provision of the bill reducing the required addback to $^{5}/_{6}$, if it had been in effect in 2018, would not have saved taxpayers any money. We can put an upper limit on the hypothetical savings in 2018 by modeling the effect, at the other extreme, of assuming that all taxpayers added back $^{6}/_{6}$ in that year. This exercise indicates that the maximum possible savings in 2018 would have been approximately $30 million. The state revenue loss from this provision of the bill, if it had been in effect for tax year 2018, would have been intermediate between zero and $30 million.

The savings from the bill's increase in allowable NOL carrybacks is less readily estimated but plausibly could be similarly large for the five years to which NOLs may be carried back. It would also let persons with NOLs, by filing amended returns for those earlier years, reduce the net amount of their Ohio income taxes in the next two years rather than in subsequent years, as noted above. The amount of near-term tax savings for these taxpayers potentially ranges into the tens of millions of dollars.

The state would lose tax revenue in FY 2021 and FY 2022 with the bill, estimated at up to tens of millions of dollars. Given the extent of uncertainty, LBO cannot rule out that the combined fiscal effect of the two provisions may range higher in at least one of those years, depending on taxpayer behavior and the timing of filing of amended returns. The bill does not include an emergency clause so would go into effect 90 days after enactment and Governor's action. Revenue losses anticipated in FY 2021 might be deferred until FY 2022. The state would gain revenue in subsequent years, with the total of such gains approximately offsetting the amount of losses in the first two years.

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