Client Alert: Significant Ohio Tax Changes Included in the 2014/2015 Budget Bill

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On Sunday June 30, 2013, Governor Kasich signed Ohio's biennial budget bill, which includes numerous provisions impacting Ohio taxpayers. Though the tax reforms in the final bill are not as sweeping as originally proposed, they will still impact virtually every state tax in some fashion. The following is a brief summary of some of the more significant provisions in Am.Sub.H.B. 59 (the Bill).

Income Tax Rate Reduction. Individual income tax rates will decrease by 10% over the next three years – by 8.5% in 2013, 0.5% in 2014, and 1.0% in 2015. The current top marginal rate of 5.925% applicable to income over $200,000 will decrease to 5.333% by 2015.

Small Business Investor Income Deduction. The Bill creates a new income tax deduction equal to one-half of an individual's business income attributable to Ohio activities. The deduction is capped at $62,500 for individuals filing using married filing separate status and $125,000 for all other individuals. This equates to a maximum savings of $6,666 per year under the new rate structure for 2015. Owners of a business organized as a pass-through entity (e.g., an S corporation or partnership) should benefit from this new deduction.

Sales and Use Tax. The Bill contains several sales and use tax provisions of note, including:

1. The state sales tax rate will increase from 5.5% to 5.75%.
2. "*Digital products*" will be subject to tax when sold for permanent use or less than permanent use. Digital products include electronically transferred audiovisual works, digital audio works, and digital books. Digital products does not include sales to or by a cable service provider, video service provider, or broadcaster of cable service or programming or video service or programming.
3. The Bill expresses the General Assembly's intent to conform Ohio sales tax law in the event that Congress passes legislation authorizing states to require remote sellers without "substantial nexus" to collect state use tax. The Federal Marketplace Fairness Act

(Act) is currently pending in the U.S. House after being approved in the Senate earlier this year. The Act would allow states to require remote sellers to collect use tax if the state is a full member of the Streamlined Sales and Use Tax Agreement or if the state meets an alternative standard found in the Act. Ohio is currently an associate member, but indications are that Ohio will apply to the SST Governing Board for full member status and should be well-positioned for approval.

4. In the event Congress passes the Act, the Bill requires the state to deposit the new use tax revenue collected from remote sellers into the Income Tax Reduction Fund, as opposed the General Revenue Fund. These additional contributions to the Income Tax Reduction Fund could trigger individual income tax rate decreases.
5. Governor Kasich vetoed language passed by the House and Senate that would have expanded the list of activities that create a presumption that a seller of goods has "substantial nexus" with Ohio and is therefore required to collect and remit use tax. Notably, the language Governor Kasich vetoed included so-called "click-through nexus," whereby a person would have been required to collect and remit use tax if the person generated at least $10,000 in Ohio sales during the preceding twelve-month period through referrals from Ohio residents.

Commercial Activity Tax. Under current law the CAT imposed on the first $1 million of taxable gross receipts is $150. The Bill changes that amount for persons with taxable gross receipts exceeding $1 million. For persons with taxable gross receipts greater than $1 million and less than or equal to $2 million, the first $1 million will now be subject to tax of $800. For taxable gross receipts greater than $2 million and less than or equal to $4 million, the first $1 million will be subject to tax of $2,100. For taxable gross receipts greater than $4 million, the first $1 million will be subject to tax of $2,600.

Motor Fuel Receipts Tax. In response to the Ohio Supreme Court's *Beaver Excavating* decision last year that found the state had spent CAT revenues attributable to gross receipts from the sale of motor fuel for non-highway purposes in violation of the Ohio Constitution, the Bill reforms the way such receipts are taxed and spent by the state. This new tax is very similar to the CAT, but is imposed only on receipts from the sale of motor fuel. The MFRT is imposed at a higher rate (0.65%) than the CAT (0.26%). The MFRT is imposed on motor fuel suppliers and only applies to initial sales made for delivery to a location in Ohio. To the extent tax revenues from the MFRT are attributable to sales of motor fuel used to propel vehicles on public highways and waterways, such revenues will be allocated for purposes relating to maintaining highways (including debt service of bonds issued by the state to fund highway infrastructure projects), funding traffic law enforcement, and covering hospitalization costs of indigent persons injured in accidents on the public highways.

Real Property Tax. The Bill will curtail the local property tax rollback, whereby the state effectively pays either 10% or 12.5% of each eligible taxpayer's residential or agricultural property tax bill by reimbursing such amounts to the local taxing authorities. This reimbursement will stop with respect to new levies, including replacement levies. Existing levies (including those passed in August 2013) and renewals of existing levies will not be affected. The bill also imposes a means test on the homestead exemption. Going forward, a person age 65 or older will not qualify for the $25,000 reduction of market value if such person earns more than $30,000 per year.

Conclusion. This summary paints in broad strokes, and the Bill certainly changes other tax provisions that we do not mention herein. For a more in-depth understanding of any tax changes made in Am.Sub.H.B. 59, please contact one of the Vorys attorneys listed above.