

Ohio bill proposes personal income tax reduction, pass-through income deduction, sales tax rate reduction and base expansion, and severance tax modifications

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In brief

House Bill 59 was introduced on February 12, 2013, incorporating Ohio Governor John Kasich's proposed state budget for 2014-2015. H.B. 59 proposes to: (1) cut personal income tax rates by 20%; (2) cut personal income tax on pass-through income; (3) reduce the sales tax rate from 5.5% to 5.0%; (4) expand the sales tax base to include most services; and (5) modify the severance tax.

If enacted as they currently read, the proposals are expected to result in a net tax cut of \$1.4 billion across three fiscal years while shifting some of the tax burden from income to consumption. Taxpayers performing and receiving services in Ohio should anticipate the increased transaction taxes and collection responsibilities that would result should H.B. 59 be enacted. [[Ohio House Bill 59](#), [Ohio Operating Budget](#), Fiscal year 2014-2015]

In detail

Cutting personal income tax rates by 20%

H.B. 59 proposes a phased-in 20% reduction in all nine of Ohio's personal income tax brackets over a three-year period from 2013 to 2015. This would reduce the top marginal tax rate from 5.925% to 4.74%.

The governor's budget proposal provides that withholding rates will be cut in September 2013, July 2014, and January 2015 to reflect the reduced tax rates. As

the method of determining withholding amounts is prescribed by rule of the tax commissioner, we anticipate that the Department will modify its withholding tables consistent with the governor's proposal should H.B. 59 be enacted in its current form.

Cutting personal income tax on pass-through income

Individual owners of pass-through entities (PTEs) pay Ohio's personal income tax

(recall that Ohio no longer has a general corporate income tax). Applicable to taxable years beginning on or after January 1, 2013, H.B. 59 would provide these taxpayers a deduction of 50% of their annual 'small business investor income,' up to a \$375,000 deduction. The maximum deduction for separate filing married couples is \$187,500 each.

'Small business investor income' means the portion of a taxpayer's adjusted gross income that is business income,

reduced by deductions, apportioned or allocated to Ohio pursuant to Ohio's PTE apportionment and allocation provisions.

By capping the deduction at \$375,000, the governor intends the deduction to primarily benefit small businesses. While H.B. 59 refers to income subject to this deduction as 'small business investor income,' there appears to be no requirement conditioned upon the size of the business or the investor.

Cutting state sales tax rate from 5.5% to 5.0%

H.B. 59 proposes a reduction in the state sales and use tax rate from 5.5% to 5.0% effective for sales occurring on or after September 1, 2013.

Local sales and use taxes will also be modified (a reduction is expected) according to the revenue growth resulting from the expanded sales tax base. Under current law, counties and transit authorities (localities) may impose their own sales and use tax. H.B. 59 proposes to repeal these local taxes effective August 31, 2013 and replace these taxes with specified rates, per locality, from September 1, 2013 to March 31, 2015. Effective April 1, 2015, the county and transit authorities' rates will be adjusted pursuant to a formula that accounts for the increased tax received by the localities.

Broadening the sales tax base to include all services, with some exceptions

H.B. 59 couples the rate reduction described above with an expansion of the sales tax base to include a wide range of services. As provided in the governor's budget, the purpose of broadening the sales tax base to include services is to ensure that the sales tax applies to "all economic activity on an equal basis." The budget proposes that services should be

treated like goods by taxing services generally, unless they are exempt, rather than the current treatment of exempting services unless explicitly made taxable.

Effective for sales occurring on or after September 1, 2013, H.B. 59 repeals provisions specifying certain services subject to tax and replaces them with the broad provision subjecting to sales and use tax "all transactions by which a service is or is to be provided." A 'service' is further defined as "an act performed for another person for a fee, retainer, commission, or other consideration."

H.B. 59 enumerates certain services excluded from the sales and use tax, including: medical and health care services, real property construction services, rental of residential property serving as a person's primary residence, educational services, social assistance services, day care services, transactions by which a consumer obtains insurance, residential trash removal, certain employee services, funeral services, and oil and gas drilling services.

Because H.B. 59 broadly subjects all services to Ohio's sales and use tax, specific taxable services are not enumerated in the bill. However, the governor's budget details the following previously exempt services that are intended to be subject to the proposed sales tax on services. This list is for illustrative purposes only, since it does not exhaust all possible services that would be subject to tax under H.B. 59.

- **certain finance, insurance (except insurance policy purchases), and real estate services**, including investment counseling, loan broker fees, property sales agents, real estate management fees (rental agents),

and banking institution service charges

- **personal services**, including accounting, legal, and tax return preparation services
- **business and professional services**, including accounting, bookkeeping, advertising (other than ad placement), architectural, engineering, call center, debt collection, credit rating and information, data mining, legal, lobbying and consulting, management consultation, marketing, and secretarial services
- **software**, including programming custom software and modifying pre-written software
- **online services**, including downloaded books, movies, movies, and other electronic goods
- **admission and amusement fees**
- **intrastate courier transportation services**
- **industrial refuse collection**
- **intangible property and/or a license to use intangible property**

Severance tax restructuring

Subject to varying effective dates, H.B. 59 would create a new severance tax structure for the output of horizontal wells and modify the taxation of vertical wells.

The governor's proposal recognizes that different methods of drilling should be taxed using different measures. For example, the extraction of oil, gas, and other hydrocarbons from new wells drilling in certain shale formations (horizontal drilling) is fundamentally different than traditional vertical wells.

For Ohio's new horizontal wells, H.B. 59's proposed tax would be based on the *value* of the extracted resources, rather than their *volume* (which is how vertical wells are currently being taxed).

Tax on non-horizontal well output will continue to be measured by volume; however, certain rates will change. No tax would be imposed on non-horizontal well output under ten thousand cubic feet of gas per day in a quarterly period.

The takeaway

While some taxpayers will benefit from the reduction in individual income and sales tax rates, the expansion of sales tax to include most services represents a broad shift in policy and may result in an overall increase in tax to businesses purchasing previously exempt services in Ohio. Furthermore, it is unclear how certain services received at multiple locations will be sourced under the bill. H.B. 59 also provides that a person making sales of services is the consumer of any service used in performing that service - effectively precluding a resale exception for

services. Companies should analyze how H.B. 59 will affect their business, including the impact on their current sales and use tax compliance processes.

Organizations with multiple operating entities should be concerned over H.B. 59's apparent absence of a general exception for services provided among affiliates. Does Ohio intend for intercompany services to be subject to the proposed transaction tax?

We will closely monitor this bill and report on significant developments as it moves through the legislative process.

Let's talk

If you have any questions regarding H.B. 59, please contact:

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