Fiscal Note & Local Impact Statement

122 nd General Assembly of Ohio

BILL:	**Am. Sub. H.B. 697**	DATE:	**February 10, 1998**
STATUS:	**As Reported by House Finance and Appropriations**	SPONSOR:	**Rep. Johnson**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Increases the state sales tax by 1.0 cents, with half going to primary and secondary education, half going to property tax relief. Contains maintenance of effort language that requires per-pupil GRF education spending to grow at least by inflation, in addition to the new tax money.**

State Fiscal Highlights

STATE FUND	FY 1999	FY 2000	FUTURE YEARS
School Trust Fund			
Revenues	Gain of $520 million	Gain of $586 million	Gains increase from $613 million in FY 2001 to $699 million in FY 2004
Expenditures	- 0 -	- 0 -	- 0 -
Property Tax Relief Fund			
Revenues	Gain of $520 million	Gain of $586 million	Gains increase from $613 million in FY 2001 to $699 million in FY 2004
Expenditures	- 0 -	- 0 -	- 0 -
General Revenue Fund			
Revenues	Loss of $53 million	Loss of $59 million	Losses increase from $62 million in FY 2001 to $71 million in FY 2004
Expenditures	- 0 -	- 0 -	- 0 -

- The 1.0 cent increase in the state sales tax is expected to generate $1.04 billion in FY 1999. This is less than a full-year impact due to the way the tax is collected. The tax is then expected to generate $1.17 billion in FY 2000, with growth of about 4.5% annually thereafter.

- The newly created School Trust Fund (STF) gets half of the new sales tax revenue, or $520 million in FY 1999 and $586 million in FY 2000. The money is to be used for school operations, education technology, school facilities, and debt service for school facilities.

- The Property Tax Relief Fund gets half of the new sales tax revenue, or $520 million in FY 1999 and $586 million in FY 2000. The tax revenue can be used only for providing tax relief to homesteads. This limits the tax relief to owner-occupied real property - specifically a home and surrounding land up to one acre.

- The loss to the GRF is an indirect impact. LBO has tried to be cautious in its revenue estimate, assuming that a 1 cent increase in the state sales tax reduces consumption of taxable goods by 1 percent. If this is true, then the GRF will lose $53 million in FY 1999 as a result of that reduced consumption.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 1999	FY 2000	FUTURE YEARS
Counties, Municipalities, and Townships (loss from LGF and LGRAF)			
Revenues	Loss of $2.5 million	Loss of $2.8 million	Losses increase from $3.0 million in FY 2001 to $3.4 million in FY 2004
Expenditures	- 0 -	- 0 -	- 0 -
Counties and Transit Authorities			
Revenues	Loss of $11.1 million	Loss of $12.7 million	Losses increase from $13.3 million in FY 2001 to $15.1 million in FY 2004
Expenditures	- 0 -	- 0 -	- 0 -

- Counties, municipalities, townships, and other local governments lose revenue through an indirect effect, in the same way as the GRF. The projected 1 percent decrease in the sales of taxable goods reduces the amount going to the LGF and the LGRAF by about $2.5 million in FY 1999, $2.8 million in FY 2000, and by increasing amounts thereafter.

- Counties and transit authorities are projected to lose about $11.1 million in FY 1999 and $12.7 million in FY 2000 through the loss in taxable sales due to the increased state sales tax. The losses increase by 4.5% annually thereafter.

Summary of State and Local Fiscal Highlights

The fiscal effects shown above in the "State Fiscal Highlights" section and the "Local Fiscal Highlights" section are combined and summarized by the following table.

Net Effect of Revenues/Expenditures

	FY 1999	FY 2000	Future Years
State GRF	$53 million loss	$59 million loss	Loss increases from $62 million in FY 2001 to $71 million in FY 2004
School Trust Fund and school districts	$520 million gain	$586 million gain	Gains increase from $613 million in FY 2001 to $699 million in FY 2004
Counties, municipalities, townships, transit authorities and other political subdivisions (other than school districts)*	$13.6 million loss	$15.5 million loss	Loss increases from $16.3 million in FY 2001 to $18.5 million in FY 2004

Detailed Fiscal Analysis

1) Increases the state sales tax by 1.0 percent, to 6.0 percent, effective July 1, 1998 (this limits collections in FY 1999 to 11 months worth of revenue, because of the way the non-auto tax is collected with a one-month lag). The tax proceeds will be split between the School Trust Fund and the Property Tax Relief Fund.
2) Requires that the 50% of the sales tax revenue going to the Property Tax Relief Fund be used for tax relief for homestead property. The mechanism by which relief is provided is not specified.
3) Requires that GRF per-pupil education spending after FY 1999 grow at least by inflation, as measured by the CPI-U, as a safeguard against using the new sales tax money to supplant GRF education funding.

Increase in the State Sales Tax

Increasing the state sales and use tax rate from 5% to 6% will act to increase tax revenues. However, the increase in the tax rate will act to decrease the amount spent on taxable purchases. The tax base will be reduced for two reasons. First, a higher tax rate increases the after-tax prices of items purchased which will act to decrease the quantity of items purchased. Second, the higher sales tax rate will create, in some cases, a sales tax differential with neighboring states. The sales tax differential may induce individuals to make purchases in other states rather than in Ohio. Revenue from the auto sales tax will not be affected because Ohio residents who purchases automobiles out of state pay the Ohio use tax, not the sales tax of the other state. Because the tax base will be reduced in response to the increase in the tax rate, the additional revenue due to the one-percent increase will be less than the current revenue divided by five.

There is research support for the idea that raising the state sales tax rate will reduce taxable purchases. In summarizing prior research on the impact of sales taxes on economic activity, the final report of the Commission to Study the Ohio Economy and Tax Structure (CSOETS) notes that a one percent sales tax differential along a state border has been found to reduce spending in the higher tax area by between one percent and 10 percent (p. 248). When combined with the estimate that about 30 percent of Ohio's economic activity is in border counties (p. 249), this suggests that increasing the state sales tax rate by one percent could reduce pre-tax spending somewhat in the border counties.[1]

LBO has made the rather conservative assumption that a 1% increase in the state sales tax reduces purchases of taxable items in Ohio by 1%. So, the School Trust Fund and the Property Tax Relief Fund gain revenue, but the GRF, the Local Government Fund (LGF), the Local Government Revenue Assistance Fund (LGRAF), counties, and transit authorities all lose by having the tax base reduced.

Under the bill, the tax increase will take effect on July 1, 1998. This means that in the first year, the non-auto portion of the tax will result in only 11 months worth of revenue (August through June). The vast majority of the non-auto portion of the sales and use tax is paid by vendors on the 23rd of the month, based on prior month activity.

1 ***Taxation and Economic Development: A Blueprint for Tax Reform in Ohio***, Roy Bahl, editor (Columbus: Battelle Press).

LBO’s forecasts of the revenue impacts on all the affected parties for FY 1999-2004 are given in the table below. Sales tax collections are assumed to grow at 4.5% annually.

Impacts by Fund or Type of Government of 1% State Sales Tax Rate Increase

	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
School Trust Fund Gain	$520.3	$586.3	$612.6	$640.2	$669.0	$699.1
Property Tax Relief Fund Gain	$520.3	$586.3	$612.6	$640.2	$669.0	$699.1
GRF Loss	($50.0)	($56.4)	($58.9)	($61.6)	($64.3)	($67.2)
LGFs Loss	($2.5)	($2.8)	($3.0)	($3.1)	($3.2)	($3.4)
County and Transit Authority Loss	($11.1)	($12.7)	($13.3)	($13.9)	($14.5)	($15.1)

Property Tax Relief

Because the bill does not specify what form the property tax relief is to take, there is little that can be said at this point. The bill does restrict the tax relief to homesteads, so that only owner-occupied residential housing would qualify. Based on LBO's projections of the new sales tax revenue, and of the future level of residential property taxes, the sales tax money that is earmarked for tax relief is about 11.5% to 12% of residential taxes. That means that all residential taxes could be reduced by 11.5% to 12% under the bill. If this were done by increasing the current 2.5% residential rollback, the new residential rollback would be 14% to 14.5%. When this amount is added to the 10% rollback received by all real property, the total rollback on residential property could be 24% to 24.5%. This would mean that the state would be picking up almost 1/4 of the tax bill for homeowners.

Of course, the new tax relief could take the form of a refundable income tax credit, as in HJR 22, a circuit-breaker program, an increase in the homestead exemption for the elderly and disabled, a fixed dollar credit per homestead, or some combination of any of those options.

Maintenance of Effort

In an effort to prevent the use of the new sales tax money for replacing rather than augmenting existing GRF education funding, the bill contains a maintenance of effort (MOE) requirement. The MOE provision requires that in any year, GRF appropriations per pupil equal base year (FY 1999) funding, plus inflation as measured by the CPI-U. LBO's forecasts of CPI inflation for the near future, based on forecasts by professional econometric forecasting firms, is in the range of 2.5% to 3.0% annually. This does not materially affect our forecasts of GRF spending on education in the near future, since we had assumed that "baseline" growth in education funding even without the changes made in H.B. 650 would be about 4.5% annually. This provision could significantly affect the GRF budget in FY 2000 or FY 2001 if there was a recession in those years.

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