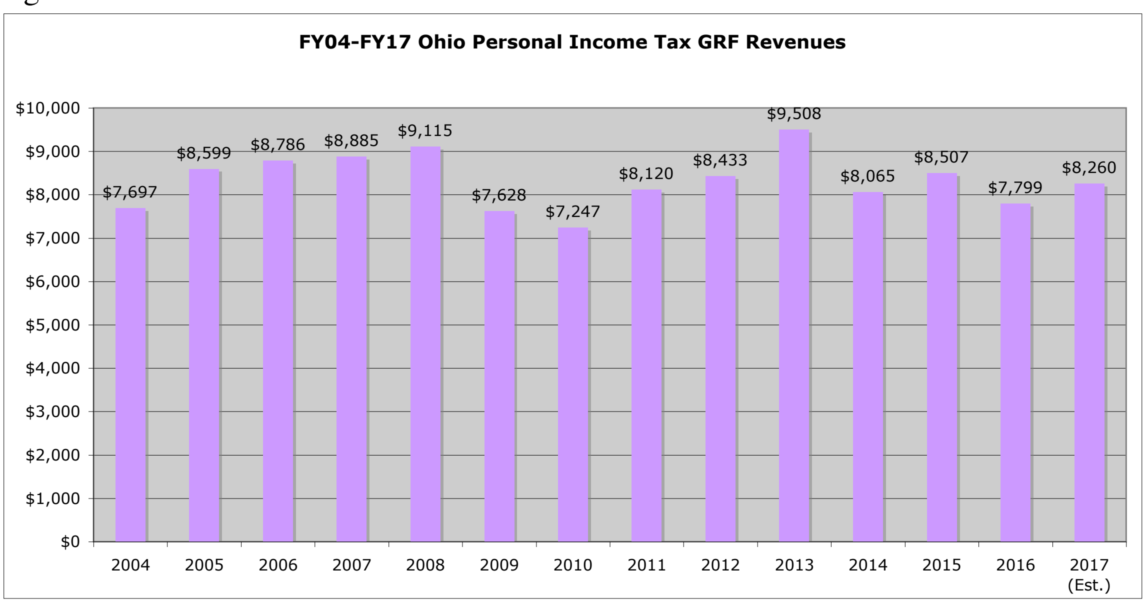
Brief analysis of FY 16 and FY 17 GRF tax revenues

The Fiscal Year (FY) 16-17 state budget adopted in House Bill (HB) 64 in June 2015 included a number of significant changes to the state tax code. The main changes were a 6.3% reduction in personal income tax rates, an increase in the small business income tax deduction to 75% in 2016 and 100% in 2017, and a 35 cent per package increase in the cigarette tax from $1.25 to $1.60 per pack. These tax changes, along with a continuation of the phase-down of Tangible Personal Property (TPP) tax replacement payments, which resulted in a larger share of Commercial Activity Tax (CAT) revenue being deposited to the state General Revenue Fund (GRF), had a significant impact on GRF tax revenues in FY 16 and FY 17.

Figure 1 below shows Ohio personal income tax GRF revenues from FY 04 through FY 17. This graph clearly shows the significant fluctuation in income tax revenues from FY 08 through FY 17. This fluctuation results from a more than 1/3 reduction in income tax rates since 2006 combined with the effects of the economic recession in 2009 and 2010. FY 13 is the only year where income tax revenues have exceeded pre-recession (2008) levels. FY 16 income tax revenues were $707 million below FY 15 levels, while FY 17 income tax revenues are currently projected to increase by $461 million to $8.260 billion. However, FY 16 income tax revenues were $218 million below projections for the year and OBM's August 2016 revised FY 17 GRF income tax revenue estimate reflects a $223 million downward revision from the original June 2015 projection of $8.483 billion.

Figure 1: FY 04-FY 17 Ohio Personal Income Tax GRF Revenues



At the same that income tax revenues have been diminishing since 2013, sales tax revenues have been following a quite different trajectory. Figure 2 below shows Ohio sales tax GRF revenues from FY 04 through FY 17. Figure 2 clearly shows that state sales tax revenues have increased steadily every year since the recession ended in 2010. This growth is primarily due to economic expansion. And also due to an increase in the state sales tax rate from 5.5% to 5.75% in September 2013 and to expansion of the sales tax base to include additional services. Sales tax revenues have increased from $7.077 billion in FY 10 to a projected $10.808 billion in FY 17. This is an increase of $3.73 billion (52.7%).

Figure 2: FY 04-FY 17 Ohio Sales Tax GRF Revenues

The extent of the relative changes in Ohio state income and sales tax revenues can best be seen, however, when they are placed side by side on the same graph.

Figure 3: FY 04-FY 17 Comparison of Ohio Income & Sales Tax GRF Revenues

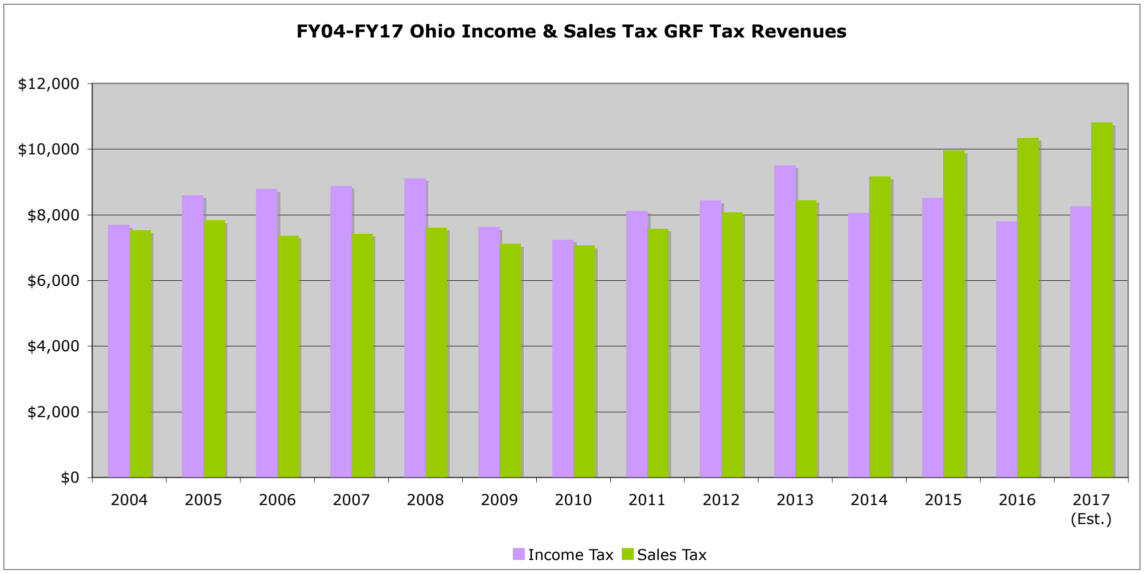
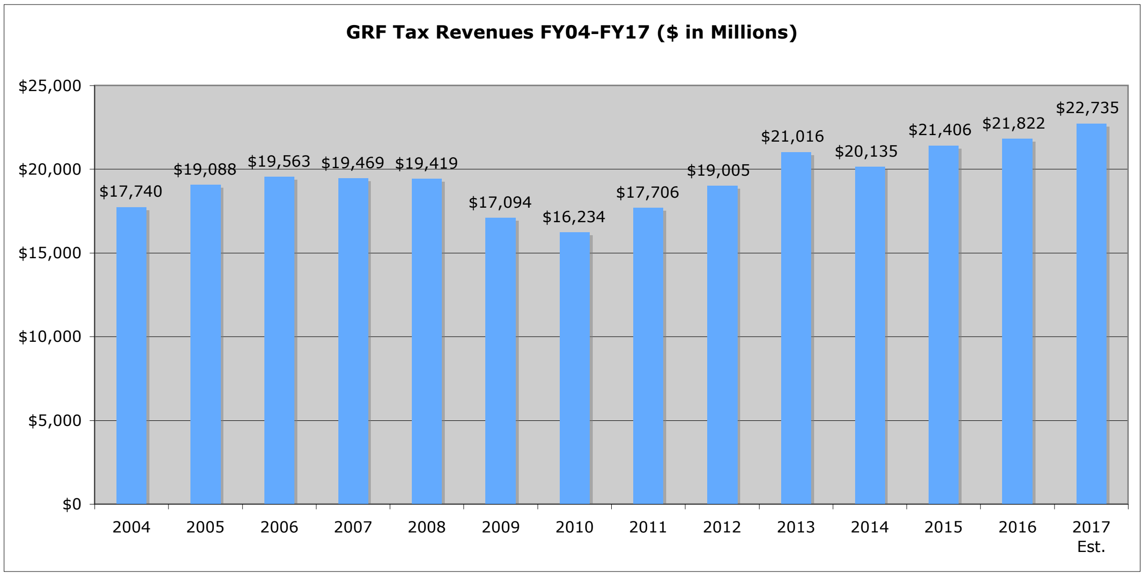


Figure 3 provides a comparison of Ohio GRF income and sales tax revenues from FY 04 to FY 17. Note that from FY 14 onward state sales tax revenues have exceeded state income tax revenues. Prior to 2014, the last time that Ohio state sales tax revenues exceeded state income tax revenues was 1986.

Figures 4 and 5 below provide a comprehensive comparison of total GRF tax revenues from FY 04 through FY 17. Figure 4 shows total GRF tax revenues over the past 14 years. This graph clearly shows that GRF tax revenues in FY 13, FY 14, FY 15, FY 16 and FY 17 are higher than any time in state history (total GRF tax revenues in FY 03 and earlier were below FY 04 levels), and that FY 17's $22.7 billion in GRF tax revenues is a new high water mark for Ohio. However, the figures in Figure 4 fail to take account of several policy changes that were made in the FY 12-13 and FY 16-17 state budgets, which increased GRF taxes by decreasing payments made to schools and other local governments in Ohio. These policy changes are accounted for in Figure 5.

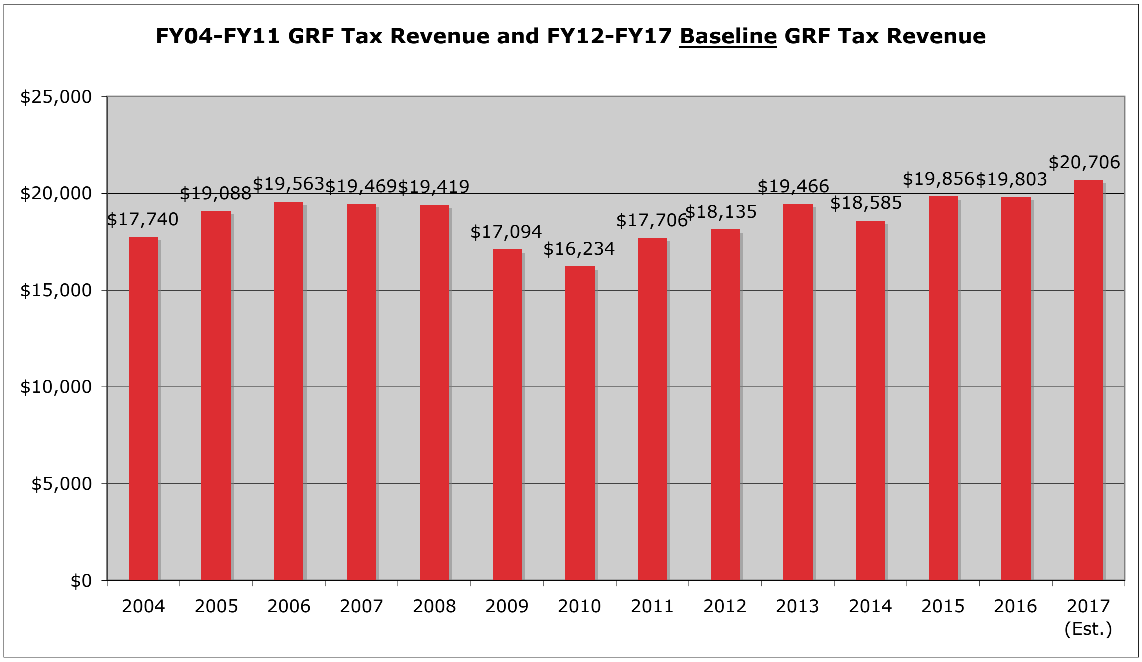
Figure 4: FY 04-FY 17 Ohio GRF Tax Revenues



Policy changes in FY 12 and FY 13 cut the Local Government Fund (LGF) in half, began a phase-out of TPP Tax replacement payments to schools and other local governments, and modestly reduced the Public Library Fund (PLF). The reduction in these payments to local governments allowed $870 million of additional revenue that had previously been diverted to flow into the GRF in FY 12 and $1,550 million to flow into the GRF in FY 13, FY 14, and FY 15. Further reductions in TPP payments to schools and other local governments contained in the FY 16-17 budget (HB 64) were estimated in February 2015 by OBM to direct an additional $485 million into the GRF from the CAT and Kilowatt hour tax in FY 16 and an additional $495 million into the GRF in FY 17. Once adjustments to LGF and PLF payments are made the net effect of the policy change to the TPP payments is $469 million in FY 16 and $479 million in FY 17.

Figure 5 adjusts for these effect of these policy changes by providing estimates of the “baseline” GRF tax revenues that would have been available to the GRF from the state’s taxes had the changes to the local government payments not occurred. Figure 5 shows that FY 14 GRF tax revenues were below FY 05 revenue levels (prior to the beginning of the state’s income tax reductions) and that FY 15, FY 16, and FY 17 all show baseline GRF tax revenues in excess of the revenue levels reached prior to both the recession and to the more than 1/3rd reduction of the state personal income tax that has occurred since 2006.

Figure 5: FY 04-FY 17 Ohio Baseline GRF Tax Revenues



Revised OBM FY 17 GRF tax revenue estimates

Table 1 provides a comparison between OBM's adjusted FY 17 GRF tax revenue estimates from January 2016 (primarily reflecting SB 208 corrections to the small business tax exemption changes included in HB 64) and revised FY 17 estimates prepared by OBM last month. Table 1 shows that the January 2016 adjusted revenue estimates forecast $23.017 billion in GRF tax revenue. The updated July 2016 estimates now forecast $22.735 billion in GRF tax revenue — a $282 million decrease.

The newly revised July revenue estimates are based on two considerations. First, OBM estimates "Baseline" reductions in tax revenue totaling $238.7 million compared to the January 2016 revenue estimate for several taxes. Baseline revenue reductions were most notable in the Personal Income Tax (-$223.0 million), Non-Auto Sales Tax (-$36.5 million), and the Commercial Activity Tax (-$34.9 million). In addition, revenue estimates for the Auto Sales tax (+$13.0 million) and Cigarette Tax (+$45.6 million) were adjusted upward. These revenue changes primarily reflect the performance of these tax revenue sources in FY 16. In FY 16, income tax revenues were $217.7 million below estimate, sales taxes were $40.8 million below estimate, and CAT revenues were $25.6 million below estimate. These adjustments are termed "Baseline Revenue Revisions" in Table 1.

Table 1: July 2016 OBM FY 17 GRF Tax Revenue Estimates (In Millions of Dollars)

GRF Tax Revenue Source	FY 2017 January 2016 Adjusted Estimate	Revisions Due to Various Tax Law Changes	"Baseline" Revenue Revisions	FY 2017 Revised July 2016 Estimate	$ Change
Non-Auto Sales & Use	$9,476.9	($32.8)	($36.5)	$9,407.6	($69.3)

Auto Sales & Use	$1,387.0		$13.0	$1,400.0	$13.0
Subtotal Sales & Use	$10,863.9	($32.8)	($23.5)	$10,807.6	($56.3)
Personal Income	$8,483.0		($223.0)	$8,260.0	($223.0)
Corporate Franchise	$0.0			$0.0	$0.0
Financial Institutions Tax	$195.9		$27.1	$223.0	$27.1
Commercial Activity Tax	$1,332.4	($10.5)	($34.9)	$1,287.0	($45.4)
Petroleum Activity Tax	$5.2		$0.8	$6.0	$0.8
Public Utility	$105.4		($1.9)	$103.5	($1.9)
Kilowatt Hour	$340.6		($8.4)	$332.2	($8.4)
MCF	$68.0		($2.0)	$66.0	($2.0)
Foreign Insurance	$310.0		($8.5)	$301.5	($8.5)
Domestic Insurance	$288.0		($10.0)	$278.0	($10.0)
Other Business & Property	$0.0			$0.0	$0.0
Cigarette	$924.4		$45.6	$970.0	$45.6
Alcoholic Beverage	$55.0			$55.0	$0.0
Liquor Gallonage	$45.0			$45.0	$0.0
Estate	$0.0			$0.0	$0.0
Total Tax Receipts	$23,017	($43.3)	($238.7)	$22,735	($282.0)

A second (and less significant reason from a dollar standpoint) reason for revising the FY 17 GRF tax revenue estimates is the impact of various tax policy changes included in legislation passed in 2016. These changes include:

—A doubling of the Motion Picture Tax Credit in HB 390 which primarily impacts Commercial Activity Tax revenues.
—SB 264's passage of the August 5-7th sales tax "holiday" exempting clothing (up to $75), school supplies (up to $20), and school instructional materials (up to $20) from the sales tax for the duration of the first weekend in August.
—Creation of a sales tax exemption for metal bullion and coins included in SB 172.
—Creation of a sales tax exemption for digital advertising services and certain related electronic services in HB 466.

OBM estimates that these tax policy changes will have net effect of reducing FY 17 GRF tax revenues by -$43.3 million.

Outlook for FY 18 — Medicaid managed care sales tax
Since 2005, Ohio has imposed a tax on the services provided by Medicaid managed care organizations. This tax was initially a franchise fee but was switched to the state sales tax (now 5.75%) after federal officials ruled the franchise tax impermissible. However, the Federal government has now ruled that the sales tax on Medicaid managed care companies is also impermissible and will no longer be allowed after June 30, 2017.

State sales tax revenues from Medicaid managed care services are roughly $550 million per year. In addition, local county and transit district “piggyback” sales tax revenues amount to roughly $200 million per year.

Because the managed care sales tax can be administered throughout FY 17, there will be no revenue impact during the current biennial budget period. This also means that replacement tax revenue options can be included in the FY 18-19 budget deliberations that will begin in late January of next year. In the FY 16-17 budget process, an increase of 4% in the state hospital fee was proposed which would have raised about $500 million per year. This is an example of a possible replacement revenue source for the managed care tax.