APPENDIX

H.B. 1 Preliminary Analysis
March 2023
By Justin D. Cook and Patrick L. Murphy
Bricker & Eckler LLP

H.B. 1, introduced and sponsored by Rep. Adam Matthews (R-Lebanon), proposes sweeping changes to Ohio's personal income tax and real property tax regimes. Overall, the bill proposes to flatten Ohio's personal income tax rate and make a number of interrelated changes to the way real property taxes are calculated. Below, we address the possible impact H.B. 1 will have on manufacturers and a number of questions about this bill's mechanics.

Income Tax Changes

While the proposed changes to Ohio's personal income tax code are significant from a budgetary standpoint, they are relatively straightforward. H.B. 1 would eliminate Ohio's current progressive income tax system for individual taxpayers and replace it with a flat 2.75% state income tax rate applicable to non-business personal income. Individuals making less than $26,050 per year though would remain exempt from income tax. In essence, H.B. 1 proposes a tax structure on personal income similar to the one already applicable to business income. In fact, under H.B. 1, business income would continue to be taxed at a flat 3% after application of the business income deduction.

The proposed changes to Ohio's income tax would only impact manufacturers indirectly. Ohio's statewide entity-level business tax, the commercial activity tax ("CAT"), applies to nearly all entities that generate gross receipts by conducting business activities whose benefits are received in the state. The CAT rate would remain unchanged under H.B. 1.

A reduction in the non-business income tax rate under H.B. 1, however, would result in a lower income tax rate for a manufacturer's employee base. It would also reduce the rate applicable to certain dividends, guaranteed payments, interest, capital gains, and royalties.

Real Property Tax Changes

The proposed changes to Ohio's real property tax regime are more challenging to unpack, both because so many variables in the property tax calculation are modified and due to ambiguity in how H.B. 1 would interact with existing law. On its face, H.B. 1 appears to provide a reduction in real property taxes for businesses. However, lawmakers have questioned whether H.B. 920, adopted into law in 1976, will override some of the changes proposed by H.B. 1.

From a technical standpoint, H.B. 1 proposes to do the following:

- Reduce the maximum tax assessment percentage from 35% to 31.5% of real property's true value[1];

- Index the 31.5% assessment percentage to inflation, requiring the Tax Commissioner to adjust the assessment percentage down on an annual basis to account for inflation increases affecting real property values;

- Eliminate the 10% "rollback" currently applicable to non-business property;

- Change the 2.5% homestead exemption to a flat $125 credit; and

- Provide an increased homestead exemption for individuals owning and occupying property for 20 years or more.

Manufacturers are not directly impacted by the 10% rollback or the homestead exemptions being either reduced or eliminated. At the same time, manufacturers would enjoy a lower taxable value after application of H.B. 1's reduced assessment percentage

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[1] Specifically, HB 1 would alter current language in R.C. 5715.01(B) as follows (additions underlined):

> The taxable value shall be ~~that per cent of~~ the true value in money, or current agricultural use value in the case of land valued in accordance with section 5713.31 of the Revised Code, multiplied by the assessment percentage for the tax year determined by the commissioner ~~by rule establishes, but it shall not exceed~~ under this division. The assessment percentage for the first tax year ending after the effective date of this amendment shall be thirty-one and one-half per cent. In August of each year, beginning with the first full year following the effective date of this amendment, the commissioner shall adjust the assessment percentage applicable to the current tax year by multiplying the percentage increase in the gross domestic product deflator computed that year under section 5747.025 of the Revised Code by the assessment percentage for the preceding tax year, then subtracting the resulting product from that assessment percentage, and rounding the difference to the nearest one-thousandth of one per cent. If the adjusted assessment percentage computed under this division exceeds ~~thirty-five~~ thirty-one and one-half per cent, the assessment percentage for that tax year shall instead be thirty-one and one-half per cent. The commissioner shall publish the adjusted assessment percentage on the web site of the department of taxation not later than the last day of August, beginning the first full year following the effective date of this amendment.

that floats inversely to the prevailing rate of inflation.[2] Thus, H.B. 1 appears to provide a reduction in real property taxes for business owners over both the near and long-term.

H.B. 920, however, provides a complicating factor.[3] Codified as R.C. 319.301, this statute already operates to curb inflationary increases in taxes imposed by certain levies (primarily voted levies). In simplified terms, it does this by locking in the dollars levies may collect on an annual basis from real properties that were on tax rolls for the prior year. It is unclear how H.B. 920 will interact with H.B. 1's proposal to index the assessment percentage for inflation. There is potential that H.B. 920 could lessen many of the tax reductions reflected in the current version of H.B. 1. Questions about this came up in the bill's first hearing before the Ways and Means Committee. Representative Matthews acknowledged some aspects of the bill will likely change as a result of the legislative process, noting that an enacted version of the bill "may not look like what is in front of you today."

Interpretational challenges with H.B. 1's property tax modifications make estimating their cost difficult as well. Even after the state publishes its initial model (which should

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[2] This appears to be a likely outcome given the legal reasoning contained in the 1960s-era "Park Investments cases." Those cases established that the assessment percentage on real property had to be the same across the state.

Prior to the Ohio Supreme Court's holdings in the Park Investments cases, it was common for county auditors to establish the taxable value of business and commercial property at a higher rate (typically 40-50%) than for residential and agricultural property (which was typically at 30%). To end this practice, in the mid-1970s the Ohio General Assembly set a uniform assessment rate of 35% for all real property across the state. This 35% rate remains in place today.

Source: Ohio Education Policy Institute, which provided its analysis at the following link: http://www.oepiohio.org/index.php/research-reports/house-bill-1-summary-and-analysis/ (last visited February 28, 2023).

[3] In 1976, after the setting of the 35% assessment percentage and following very rapid inflation in home prices, Ohio enacted HB 920, one of the most stringent property tax limitations in the country.

HB 920's goal was to insulate homeowners from the effects of inflationary increases in their property, by introducing "tax reduction factors." These reductions were designed to adjust the tax rate downward when property increased in value after property reappraisal. The HB 920 tax reduction factors are applied separately in each of Ohio's 4,000+ taxing districts, and they are applied separately to residential and agricultural property from business and commercial property.

Source: Ohio Education Policy Institute, which provided its analysis at the following link: http://www.oepiohio.org/index.php/research-reports/house-bill-1-summary-and-analysis/ (last visited February 28, 2023).

come soon), these numbers are likely to evolve as the legislation text itself changes. Manufacturers should follow this bill closely through the budget season.