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EXTERNAL ALERT

Ohio Governor's Proposed 2014-15 Budget Would Result in Significant Tax Law Changes

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Overview

Ohio Governor John Kasich recently released his proposed 2014-2015 budget.[1] The Governor's goal is to reform Ohio's tax structure by: reducing the overall personal income tax levy, adding a new deduction for individual owners of pass-through entities, adopting changes to the severance tax structure, and reducing the sales and use tax rate while broadening the sales and use tax base to include taxation of services.

In this Tax Alert we highlight the more significant proposed tax law changes, including the various effective dates and the related revenue estimates.

Individual Income Tax Proposals

Beginning January 1, 2013, the proposed 2014-2015 budget would reduce the personal income tax rate for all Ohioans by 20%, phased in over a three-year period.[2]

- If enacted, the income tax rate for the highest marginal income bracket would drop to 4.74% in 2015 from the current rate of 5.925%.[3]

The proposal would also reduce the state income tax burden upon individual owners of pass-through entities ("PTEs").[4]

- The proposal calls for the creation of a deduction equal to 50% of the business income earned by owners of PTEs in calculating their Ohio income tax.[5]
- The proposal would cap the owner's business income eligible for the deduction at $750,000 annually.[6] Thus, the maximum deduction allowable would be $375,000 annually per PTE owner.

Severance Tax Proposals

Horizontal drilling to obtain oil, gas and other hydrocarbons has become increasingly prevalent in the eastern portion of Ohio, notably in the Marcellus and Utica/Point Pleasant Shale regions. In response to this increased activity, the Governor has proposed a new severance tax structure for horizontal wells as compared to that applicable to conventional vertical wells. These changes are projected to generate approximately $156 million of tax revenue during FY 2015, the first full year after implementation.[7]

Regarding horizontal wells, the proposal would impose a two-tiered tax rate regime based on the value of the extracted resources.[8]

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[1] *Ohio's Jobs Budget 2.0.* Governor John Kasich's FY 2014-15 Budget Recommendations are available at: **http://jobsbudget.ohio.gov/Reforms.pdf**. Governor Kasich's proposed tax law changes are reflected in pending Ohio House Bill No. 59.
[2] Governor Kasich's FY 2014-15 Budget Recommendations at 40. The loss in revenue from the proposed individual income tax reduction is expected to be offset by the restructuring of the severance tax and an expansion in the base of the sales and use tax. *Id*. at 53.
[3] *Id*. at 40.
[4] Under the proposed budget, PTEs would include partnerships, limited liability companies, Subchapter S corporations and sole proprietorships. *Id*. at 41.
[5] *Id*. at 41.
[6] *Id*.
[7] *Id*. at 53.
[8] *Id*. at 51.

- Natural gas would be taxed at 1% of market value.[9]
- Natural gas liquids ("NGLs"), oil, and condensate would be taxed at 4% of market value.[10] However, in the first year of production, while owners are recovering the cost of their investment, a lower tax rate of 1.5% would be imposed.[11]

The Governor has also proposed a change in the severance tax applicable to production from traditional vertical wells. This change would be effective upon the date of enactment.[12]

- The tax on natural gas, which is currently $0.03 per MCF (1,000 cubic feet), would be amended to impose tax in an amount equal to the lesser of 1 percent of market value or $0.03 per MCF.[13]
- Additionally, gas wells where the average production is less than 10 MCF per day, based on a daily average per quarter, would be exempted from the Ohio severance tax. Based on projections, this change would exempt the output of nearly 45,000 conventional vertical gas wells in Ohio.

Sales and Use Tax Proposals

Effective September 1, 2013, the proposed 2014-2015 budget would make the following changes to the sales and use tax (these changes are projected to generate approximately $1.77 billion of tax revenue during FY 2015, the first full year after implementation):[14]

- Broaden the sales tax base for purchases made after September 1, 2013 to include all services other than the following service categories (which have yet to be defined):[15]
    - Health Care Services
    - Oil and Gas Drilling Services
    - Construction Services
    - Rental of Residential Property
    - Education Services
    - Social Assistance Services
    - Day Care Services
    - Insurance Premiums
    - Residential Trash Removal
- Reduce the state sales and use tax rate from 5.5% to 5.0%.[16]
- Reduce local sales and use tax rates (county and transit authority) incrementally to account for the increase in revenue from the broader sales and use tax base that would include services.[17]

Contacts

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[9] *Id*.
[10] *Id*.
[11] *Id*.
[12] *Id*.
[13] *Id*.
[14] *Id*. at 45.
[15] *Id*. at 43-44.
[16] *Id*. at 45.
[17] *Id*. at 48.

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