Cincinnati Law Library News

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Ohio's Taxing Fight Against the Florida Flight: What's Ahead

By Patrick J. Saccogna

Introduction

The Ohio General Assembly has recently passed several pieces of tax legislation intended to make Ohio a more "tax friendly" state, showing that Ohio lawmakers indeed are fighting back against what has become a dramatic and substantial exodus of Ohio residents to other, typically warmer weather states. Ohio legislators have also introduced some other tax bills that, if passed, would further this purpose.

Perhaps most significantly, the Ohio General Assembly passed Sub. H.B. 73, which, effective for taxable years beginning on or after January 1, 2007, alters the "bright line" test for determining whether an individual is an Ohio resident for Ohio income tax purposes[1].

The purpose of this article is to compare Ohio's current individual income tax and transfer tax regimes to those of what many believe is the "gold standard" of tax havens and what is certainly a prime destination of Ohio refugees—Florida—and to discuss the impact on such comparison that some of Ohio's recently introduced tax bills would have if enacted[2].

Yes, Ohio is battling back, but is it enough to stem or even slow the tide of the massive population shift away from Ohio?[3] What additional steps might Ohio take to make the state more tax favorable to its residents and prospective residents?

State of the States: Florida and Ohio Comparison Runs Hot and Cold

Despite some recent efforts by Ohio to

ease the income and transfer tax burdens it imposes on its residents and their estates, the authors' side-by-side comparison of Florida's and Ohio's respective tax schemes reveals that there is simply no contest: Florida still wins by a landslide. Ohio is not giving up, however, and a number of recent lawmaking proposals may, if enacted, narrow the gap. What is clear is this: without further action by the legislature, Ohio's demographic state of affairs will not improve.

This article includes a rather detailed "Tale of the Tapes" in Table 1, which compares Florida to Ohio in several important demographic areas, including population, anticipated population growth, age and education of residents, housing, income and employment, and crime. The Table serves as background and context to this article's comparison of Florida to Ohio in the income, intangibles, gift, estate and inheritance, and generation-skipping transfer tax areas, and discussion of how such comparison may be altered by possible future Ohio tax legislation.

Income Tax

When it comes to taxes, perhaps the most vivid line of demarcation between Florida and Ohio is in the income tax arena.

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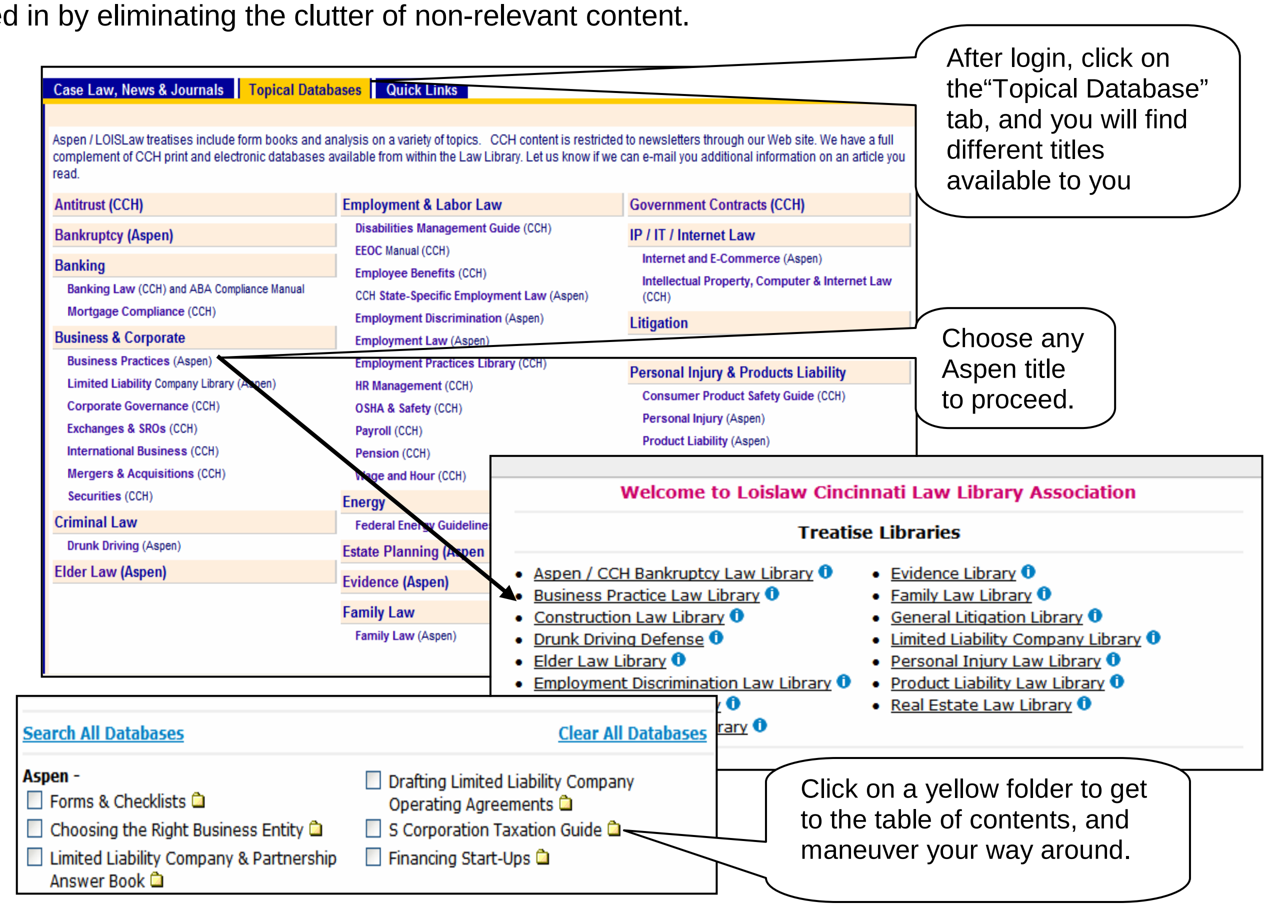

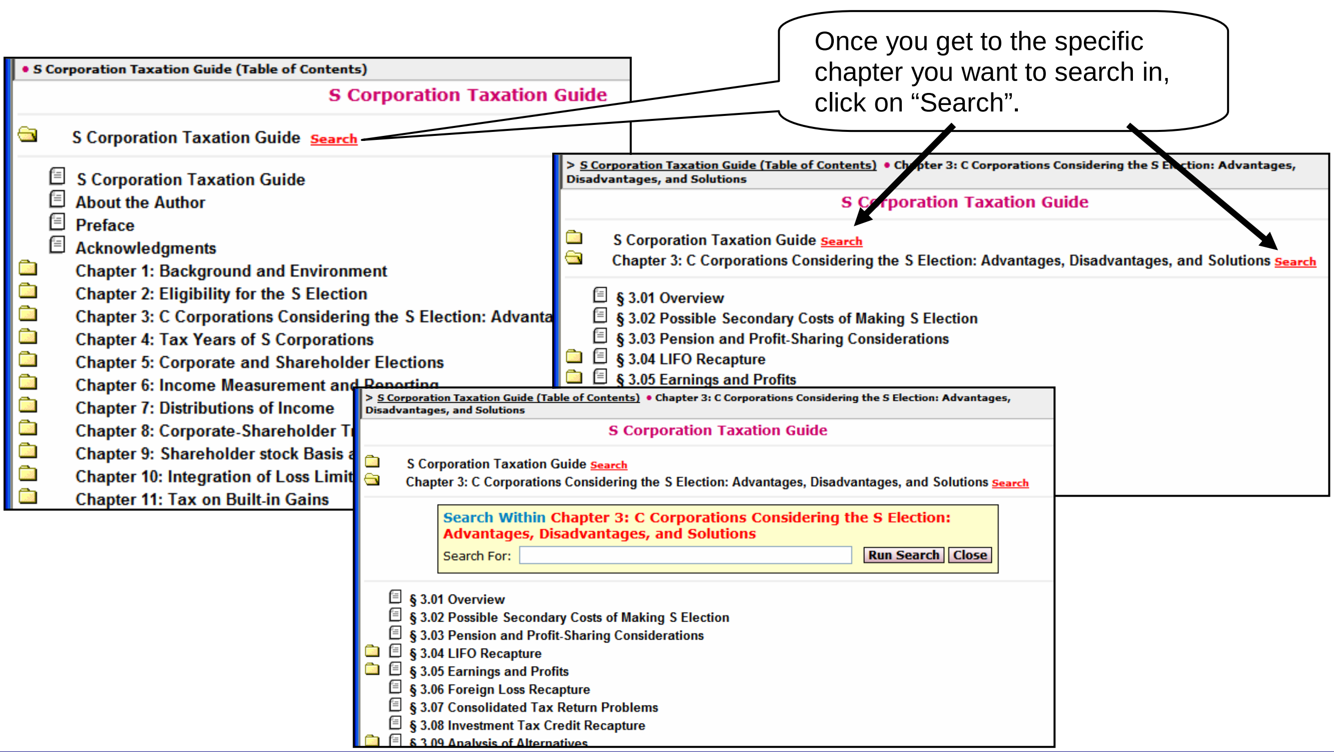

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Florida does not impose an income tax on individuals, resident or otherwise, because its constitution forbids it from doing so[4]. Likewise, Florida's constitution prohibits its municipalities from levying an income tax on individuals[5]. There does not now exist any serious discussion in Florida of a constitutional amendment that would lift such prohibition, although one may surmise of the possibility in the future given the magnitude of Florida's predicted population growth over the next twenty-plus years.[6]

Ohio, on the other hand, has consistently and, relative to other states, rather heavily taxed the income of its residents for some 35 years.[7] Nonresidents are also subject to Ohio's income tax on their Ohio-sourced income.[8] Unlike their Florida brethren, Ohio's municipalities may, and do, levy additional income taxes on their residents.

Under current Ohio law, an individual determines his or her Ohio income tax liability by beginning with federal adjusted gross income (which includes capital gains) and reducing that figure by any applicable deductions (which do not include most federal deductions, such as those for charitable contributions and home mortgage interest). Ohio employs a graduated tax rate schedule for individuals that, for taxable years beginning in 2007, features a maximum tax bracket of 6.555% on Ohio adjusted gross income (less exemptions) in excess of $200,000.[9]

Over the last several years, Ohio legislators have begun to take measures aimed at reducing the burdens and limiting the reach of Ohio's income tax on individuals. In 2005, the Ohio General Assembly passed H.B. 66, which reduced the highest tax bracket from 7.5% for taxable years beginning in 2004 to 5.925% for taxable years beginning in 2009 or thereafter.[10] This legislation included similar rate reductions for lower bracket taxpayers.[11] In addition, Sub. H.B. 73 extended the aggregate period of time an individual may spend in Ohio during a given taxable year without being treated as an Ohio resident for Ohio income tax purposes from approximately four months to approximately six months, effective for tax years beginning in 2007 and thereafter.[12] This change should encourage "snowbirds" to remain in or return to Ohio and spend their money here for longer periods of time without instilling in them the fear of being ensnared by the Ohio income tax. Finally, H.B. 699, passed in late 2006, updated the Ohio Revised Code's reference to federal law for Ohio tax purposes so that the provisions of the Pension Protection Act of 2006 are now incorporated into the Ohio Revised Code.[13] As a result, Ohio residents are able to take advantage of the new "Charitable IRA Rollover" for federal and Ohio tax purposes. This means that an eligible IRA owner may directly contribute up to a maximum of $100,000 from his or her IRA to one or more qualified charities for each of the tax years 2006 and 2007 and exclude that amount from his or her gross income for both federal and Ohio income tax purposes.

Even after considering these recent tax reduction measures, however, Florida and Ohio remain miles apart when it comes to individual income taxes, and this divide is key to the overall tax comparison of the two states. Recognizing this, Ohio lawmakers have indicated they may not be finished on the income tax front. A tax bill that was introduced last year, H.B. 578, would have, if enacted, permitted a new income tax deduction of up to $25,000 per person per year (or $35,000 per year for joint filers) for certain retirement income. The deduction described in H.B. 578 would have encompassed income, benefits, annuities, and distributions that are made from or pursuant to a pension, retirement or profit-sharing plan. This type of legislation is not novel in this country, as some of Ohio's neighboring states have enacted similar initiatives to provide tax breaks to their residents in hopes to retain them as such. Pennsylvania, for example, excludes both the gain on an individual's sale of his or her residence, and distributions from a qualified plan received after retirement and attainment of age 59 ½, from the reach of its income tax. Similarly, Michigan permits a deduction from an individual's adjusted gross income for his or her retirement and pension distributions.[16]

Intangibles Tax

For many years, Florida imposed an intangible personal property tax on the January 1 market value of intangible personally owned, managed, or controlled by Florida residents or persons conducting business in Florida. Some observers once thought that, other things being equal, when considering

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Florida's intangibles tax and Ohio's income tax together, Florida was only marginally more tax favorable. In recent years, though, Florida residents rather easily sidestepped the intangibles tax by using limited partnerships or "FLITE" (or "FLINT") trusts designed to take advantage of certain loopholes within the Florida law. Initially, Florida seemed to turn the other cheek to these rather blunt, artificial tactics. Finally, however, Florida legislators, resigned to the fact that the intangibles tax had essentially become a "voluntary" one, repealed the tax effective January 1, 2007.[17]

Given Ohio's hale-hearty income tax, Ohio lawmakers have not seen fit to levy an intangibles tax.

Gift Tax

At first blush, one area Ohio appears to find itself on even ground with Florida is gift taxation. Neither Florida nor Ohio imposes a gift tax, *per se*.

The absence of a gift tax in Florida seems obvious given that the state does not impose an estate or inheritance tax. Ohio, however, does impose an estate tax and has attempted to "backstop" such tax in a manner more indirect than a gift tax. So, while not calling it a "gift tax," Ohio does impose its estate tax on certain lifetime gifts made by Ohio decedents by generally requiring that the value of a decedent's gross estate include the value of all property or interest in such property of which the decedent has at any time during his or her life made a transfer "in contemplation of death."[18] For these purposes, any transfer made by the Ohio decedent within three years of his or her death is deemed to have been made in contemplation of death, unless the contrary is shown.[19] Certain exceptions apply to this so-called "gift in contemplation of death" rule, including gifts made more than three years before the decedent's death, and bona fide sales for an adequate and full consideration in money or money's worth.[20] Nevertheless, while Ohio does not impose a "gift tax" on any gifts made by its residents, it certainly does impose its estate tax on such of those gifts that are made in contemplation of the decedent's death. Given this phenomenon, Florida is the clear winner in the "gift tax" arena.

Even if Ohio decides to retain its estate tax in one form or another, dropping the "gift in contemplation of death" rule would not bring any of its residents to tears. Not only would Ohio achieve a less onerous transfer tax system, but it would also simplify it.

Estate and Inheritance Taxes

Besides incomes taxes, the estate tax area is where Florida shines brightest when compared to Ohio.

Generally, Florida's constitution proscribes Florida from levying a tax upon the estate or inheritance of an individual.[21] Florida, however, does impose a "soak up", or sponge, tax upon the transfer of the estate of every Florida resident equal to the amount of the federal state death tax credit allocable to Florida.[22] The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), however, completely phased-out the federal estate tax credit for state death taxes paid for decedents dying after December 31, 2004, effectively

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"repealing" Florida's "soak up" tax. Florida's response to date? None. Florida's lack of action (which action in this case would require amendment to its constitution) could be taken as the state's tacit approval of such repeal. On the other hand, though, if the state death tax credit "returns from the ashes" in 2011 as EGTRRA requires, or returns by some other federal action, Florida's "soak up" tax will be back in business.

The laws of Ohio, like those of Florida, do not include an inheritance tax. Ohio, however, has long levied an estate tax on the transfer of the taxable estate of every person who at the time of death was a resident of Ohio.[23] Ohio's estate tax on its residents' estates is levied on the value of the taxable estate, which generally includes the value of all property in which the decedent held an interest at death, less certain deductions for, among other things, transfers to the decedent's surviving spouse, debts and administration expenses, and charitable gifts.[24] The tax is imposed based on a six-bracket graduated rate schedule, ranging from 2% for taxable estates of $40,000 or less, to $23,600 plus 7% of the value of the taxable estate that exceeds $500,000.[25] Ohio's estate tax rules allow a credit against the estate tax equal to the lesser of $13,900 or the amount of the tax for persons dying on or after January 1, 2002.[26] This effectively permits the estate of an Ohio decedent to shelter a rather paltry $338,333 from the clutches of the tax. Of the **few states** in the **entire country** that still impose an estate tax, Ohio stands at the peak in terms of the magnitude of such tax, for its estate tax is the highest in the nation on taxable estates below $3 million.[27]

Additionally, Ohio levies an estate tax on the portion of a nonresident's estate that is located or situated in Ohio.[28] The income tax "bright line" residency test, as recently altered by Sub. H.B. 73, however, does not apply in determining whether or not a decedent at the time of death was an Ohio resident for Ohio estate tax purposes.[29] Generally, the estate tax residency determination is made by examining all of the relevant facts and circumstances at the time of the decedent's death.[30]

Importantly, Ohio's estate tax is in addition to that imposed by federal law. This is to be contrasted with Florida's now-repealed "soak up" tax, which effectively represented only Florida's share of the entirety of the federal estate tax on a Florida decedent's estate.

As if its "regular" estate tax were not sufficient, Ohio formerly imposed an additional "soak up" tax on more substantial estates. In the aftermath of EGTRRA and an ensuing bitter, well-documented battle between the Ohio Department of Taxation and a multitude of estates of Ohio decedents, Ohio repealed its "soak up" estate tax effective for decedents dying after June 30, 2005 with the enactment of H.B. 66.[31] This action could be viewed as a first step in Ohio's ultimate relaxation or elimination of its estate tax.

Given the alarming differences between Florida's (and indeed most states') laws and Ohio's laws in the estate tax area, and Ohio's coming to grips with its dwindling population growth and the resulting economic implications, it is extremely important that Ohio legislators introduce proposals to move Ohio into the estate tax mainstream. In May 2006, lawmakers introduced H.B. 589, which, if enacted, would have increased the Ohio estate tax exemption amount to match its federal counterpart. That means that Ohio's skinny $338,333 exemption would have immediately risen to $2 million upon enactment of the measure, and then to $3.5 million in 2009. It is believed that H.B. 589 will be reintroduced this year as an Ohio State Bar Association bill.[32] Query how Ohio should react to EGTRRA's year 2010 "holiday" from the federal estate tax or year 2011's return to pre-EGTRRA exemption levels.

Earlier this year, several Ohio legislators went even further with the introduction of H.B. 3. This legislation, if enacted, would, among other things, repeal Ohio's estate tax on December 31, 2007, increase the minimum taxable estate in Ohio for 2007 from $338,333 to $500,000, and authorize Ohio municipalities to levy, with voter approval, a *local* estate tax commencing January 1, 2008.

Finally, yet another measure introduced this year would not go as far as either H.B. 3 or H.B. 589. If it passes, H.B. 4 would increase Ohio's estate tax exemption amount from $338,333 to $366,250 beginning on July 1, 2007 and increase the exemption beginning in 2008 and thereafter in proportion to consumer price inflation. This bill, if passed, would also authorize municipalities to exempt (and repeal such exemption) from the estate tax

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any assets located in such municipality.

Generation-Skipping Transfer Tax

Generation-skipping transfer taxation is another area where Florida and Ohio are on equal footing. Neither Florida nor Ohio currently imposes a generation-skipping transfer tax, but, as explained below, like the estate tax area, that could change with future modifications that the federal government makes to the Internal Revenue Code.

The Florida Constitution does not prohibit Florida from taxing generation-skipping transfers. Florida's tax treatment of generation-skipping transfers, however, is similar to its "soak up" estate tax, in that Florida imposes a "soak up" tax on generation-skipping transfers where the original transferor is a Florida resident at the time the transfer was made.[33] Florida's "soak up" tax on generation-skipping transfers is tied, like the Florida sponge estate tax, to the amount allowable as a state death tax credit under the Internal Revenue Code.[34] EGTRA phased out the state death tax credit in its entirety with respect to generation-skipping transfers occuring after December 31, 2004, effectively repealing Florida's "soak up" tax on generation-skipping transfers.[35] Such repeal, however, is not permanent, because the federal government could at some point revive the state death tax credit.

Ohio uses a similar "soak up" tax regime with respect to generation-skipping transfers, and effectively repealed its tax by updating the definition of the Internal Revenue Code in Ohio Rev. Code § 5731.01(F) to reference the 1986 Internal Revenue Code.[36] The primary difference is that Florida tied its definition of the Internal Revenue Code to the 1986 version in 1989[37] , rather than waiting, like Ohio, until June 30, 2005, when Ohio H.B. 66 became effective.[38]

Conclusion

The State of Ohio may be facing a point of no return. It is already among the bottom five states in population growth. It faces mammoth anticipated future population losses to other states, including Florida, and the economic difficulties of that spectre. Ohio's national reputation is infamous: the state is one of, if not the worst, tax states in the United States. Ohio must act. The typical voter holds a pocketbook tightly when confronted with the subject of taxes. While Ohio certainly can do little to increase its average daily temperature or reduce its annual snowfall, it can legislate significant, meaningful changes to its tax regime and send a bold message to its residents: We want you to stay; let's rebuild our state together. That message easily extends to nonresidents: We want you to come; we have changed our laws. Ohio can capitalize on the momentum of its recently passed laws by doing what all but a precious few other states have already done and jettisoning its archaic estate tax. It's high time for Ohio to put up or shut up.

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