

Revenue & Budget

LOOPHOLES IN A LOOPHOLE: AFFLUENT OHIOANS GET TAX CREDITS INTENDED FOR THOSE WHO AREN'T

Zach Schiller and Wendy Patton

Tens of thousands of upper-income Ohioans qualify for tax credits that seemingly are limited to those who have much lower incomes. It's legal and probably costs the state millions.

Many taxpayers who claim a deduction for at least \$100,000 in business income also claim a host of means-tested tax credits, including the child care and dependent credit, the retirement income credit, the \$50 senior citizen credit and the \$20 personal and dependent exemption credit. Ohioans are eligible for these income-tax credits, as well as the homestead exemption to local property taxes, only if their income is below a certain level. Other credits and exemptions vary based on income, with more going to those below certain income cut-offs. However, upper-income Ohioans who claim the business income deduction – also known as the LLC loophole – can sidestep these limits and claim larger credits and exemptions even though they make far more than the eligibility thresholds seem to suggest. This deduction, first enacted in 2013 and since expanded, is for owners of businesses like limited liability companies, S Corporations and partnerships known as passthrough entities.

You only qualify for these credits and exemptions, or benefit to the maximum degree, if your income is below \$100,000, or in some cases much less. The \$20 personal and dependent exemption credit goes only to those with an Ohio income tax base below \$30,000. Because taxpayers can deduct up to \$250,000 in business income in determining eligibility, many Ohioans with more than \$100,000 in overall income are getting these breaks. In Tax Year 2016, this included 28,433 taxpayers who claimed the \$20 personal and dependent exemption and 30,546 who claimed the joint filing credit.

Though the total value of these tax breaks can't be precisely estimated, Policy Matters figured the cost could be more than \$4.9 million a year (excluding the homestead exemption, for which there are no data). Not all these taxpayers may owe enough to the state to take full advantage of these income tax credits, which are nonrefundable.

Use of these credits and exemptions by those making at least \$100,000 badly undercuts the General Assembly's moves to limit them to those with more modest incomes. This mean-testing applies to wage earners but if you own a limited liability company or an S Corporation, no such limits apply. The General Assembly can fix this by eliminating the business income deduction, which costs the state nearly \$1.1 billion a year in revenue with few benefits. Short of that, the legislature could add a sentence to the definition of each such credit or exemption that says: "For the purposes of this section, the definition of income shall include Ohio Adjusted Gross Income plus Business Income Deduction."