Ohio | Department of Taxation

Richard A. Levin, Tax Commissioner

An Explanation of the Distribution of Kilowatt-Hour Tax and Natural Gas Distribution Tax Revenues to Local Governments

December 2010

Introduction

The purpose of this document is to describe in some detail the distribution of revenue to local governments from the kilowatt-hour and natural gas distribution taxes. The formula for distributing revenue from these taxes is gradually evolving, as described in more detail below.

Senate Bill 3 and Senate Bill 287 (both enacted during the 123rd General Assembly) respectively created taxes on the distribution of electricity (the kilowatt-hour or "kWh tax") and natural gas (the natural gas distribution or "Mcf tax")[1].

These new taxes were created to replace revenues lost due to other tax changes made by the two bills. S.B. 3 also created the Local Government Property Tax Replacement Fund (hereafter referred to as the "Local Replacement Fund") and the School District Property Tax Replacement Fund, both of which receive a portion of the revenue generated by these two taxes. This document discusses only the funding of, and distributions made from, the Local Replacement Fund; it does not discuss the distribution of revenues to school districts from the School District Property Tax Replacement Fund.

Since 2002 local government units have received "replacement" revenues in the form of payments from these two taxes. The kWh and the Mcf taxes were each originally designed to generate the amount of money that was "lost" due to other tax changes made by S.B. 3 and S.B. 287. The amount of money needed to replace the revenue that local governments lost (using computations prescribed by these two pieces of legislation) was deposited into the Local Replacement Fund. Initially, the amount distributed to each local government unit from this fund was based solely on the amount of money that each unit lost due to the property tax changes made by the two bills. Since 2007, these "direct replacement" payments have begun to be phased-out. This phase-out will continue until 2016, after which time these replacement payments will be eliminated. (See Table 1, below, for the phase-out schedule.)

[1] The term "Mcf tax" refers to the standard abbreviation for one thousand cubic feet, which is used to measure natural gas quantities.

Tax Analysis Division
P.O. Box 530
Columbus, Ohio 43215 U.S.A.

At the same time, while the direct replacement payments are starting to phase out, a new distribution method is being phased in. Starting in August 2007 the local governments began to receive distributions of so-called "surplus" revenues. The "surplus" revenue is the amount of money left over in the Local Replacement Fund after the replacement payments have been made. Thus, the surplus revenues come from the same revenue sources as the "replacement" payments, but the distribution of the surplus revenues is based on a different formula. The new formula, which takes into consideration the changing circumstances of the local governments, is discussed in more detail below.

In 2017, once the replacement payments have been totally phased-out, local governments will receive revenue from the Local Replacement Fund based solely on the formula that is currently being used to calculate the distribution of the surpluses.

The remainder of this document discusses the background and the distribution of this revenue in greater detail.

Distributions in more detail

Background

Senate Bill 3 (enacted in June 1999) made both regulatory and tax changes for electric utilities. Senate Bill 287 (enacted in December 2000) made changes to the property taxation of natural gas utilities.

Before the enactment of these two bills, the tangible personal property of most public utilities was assessed at 88 percent of depreciated cost. Exceptions to this were production equipment of investor-owned electric utilities, which was assessed at 100 percent of original cost, and all tangible personal property of co-operative electric utilities, which was assessed at 50 percent of original cost. All tangible property of non-utility businesses was at this time assessed at 25 percent of depreciated value.

Because of S.B. 3 and S.B. 287, effective Jan. 1, 2001, the assessment rates on all natural gas utility tangible personal property and electric production tangible personal property were reduced to 25 percent of true value, with "true value" essentially representing depreciated cost.[2] The S.B. 3/S.B. 287 reductions in assessment rates reduced the property tax revenues for all jurisdictions with tax levies. However, the state fully reimbursed the local governments for the losses, followed by a gradual transition to a new distribution formula (as explained below).

[2] Assessment rates on electric company property were further reduced in 2006, but those rate reductions have no impact on the collection or distribution of kWh or Mcf tax revenues discussed here.

The reimbursements to schools and local governments were funded by revenues generated by two new taxes created specifically to replace the reduced taxes on tangible personal property. S.B. 3 created a kilowatt-hour (kWh) tax on the distribution of electricity in Ohio Revised Code section 5727.81. S.B. 287 created a natural gas distribution ("Mcf") tax in R.C. 5727.811.

Other than a fairly narrow exception for certain business consumers of electricity (who may opt to pay the kWh tax directly to the state of Ohio), these taxes are imposed on electric and natural gas utilities, and are not levied directly on consumers. All of the Mcf tax and 37 percent of the kWh tax[3] revenue is split between two permanent dedicated funds: the School District Property Tax Replacement Fund and the Local Government Property Tax Replacement Fund ("Local Replacement Fund"). The Local Replacement Fund currently receives 31.3 percent of the revenue generated by the Mcf tax and 11.6 percent of the revenue generated by the kWh tax.

Distribution of Revenue from the Local Replacement Fund (R.C. 5727.86)

The first distributions to schools and local governments of replacement fund revenues were made in February, 2002. The distributions, or payments, were based on a determination by the Department of Taxation of the "fixed rate levy losses" incurred by each taxing district – that is, the amount of revenue that was lost by each taxing district due to the S.B. 3 and the S.B. 287 assessment rate reductions, using the property values and levies that existed in the last year before the legislation took effect. (Payments based on the fixed rate levy losses are referred to as "direct replacement payments" for purposes of this document.) These fixed rate levy loss amounts essentially portray a "snapshot" of the initial impact of the two bills on the property tax revenues of local governments. The amount of each district's fixed rate levy loss remains unchanged over time, even if some of the levies that the original calculation was based on no longer exist. (If the local taxing district ceases to exist or merges with another, it is handled differently.) However, the amount of the replacement payment declines over time in accordance with the phase-out schedule.

Phase-out of the direct replacement payments and the calculation of the surplus (R.C. 5727.86(A)(1) and 5727.86(E))

For local governments, the direct replacement payments are to continue for 15 years. During the first five years (2002–2006), the replacement payments equal 100 percent of the losses. For the next five years (through 2011), the payments

[3] The remaining 63 percent of the kWh tax is intended to replace revenue from the public utility excise tax as it formerly applied to electricity distributors. Therefore, this revenue is directed to the state General Revenue Fund.

are for 80 percent of the losses. For the final five years, the percentage declines steadily until it reaches zero in year 2017, as shown in Table 1.

Table 1 – Replacement Payment Phase-out Schedule	
Tax year	**Percentage of utility property tax loss that is directly replaced***
2002-2006	100%
2007-2011	80%
2012	66.7%
2013	53.4%
2014	40.1%
2015	26.8%
2016	13.5%
2017 and thereafter	0%

*Based on the fixed rate levy loss as calculated by the Department of Taxation

As the direct replacement amounts decline, the remaining revenue deposited to the credit of the Local Replacement Fund (referred to below as the "surplus") continues to be distributed to local governments – but it is distributed according to a formula intended to reflect current conditions instead of the conditions existing at the time the legislation was passed.

To reiterate, local governments will perpetually receive monies from the Local Replacement Fund, since the fund will continue to receive an earmarked portion of kWh tax and Mcf tax revenues; see Table 2 for the specific earmarked funding percentages.

Table 2 – Permanent Funding Percentages for the Local Replacement Fund from the kWh tax and Mcf tax*	
Percentage of kWh tax revenue to the Local Replacement Fund	**Percentage of Mcf tax revenue to the Local Replacement Fund**
11.6%	31.3%

*In certain years when the replacement payments were at 100% of utility property tax losses and tax revenues did not produce sufficient revenue, additional amounts were deposited into the Local Replacement Fund.

What changes over time, however, is the manner by which the revenue is allocated to local governments from the fund, as the replacement payments phase-out and the "surplus" payments phase-in.

Twice a year (on Jan. 31 and July 31) the Ohio Department of Taxation calculates the "surplus" in the Local Replacement Fund.[4] The surplus is then distributed to all taxing jurisdictions based on a formula provided in Ohio Revised Code division 5727.86(E). The Department not only calculates the surplus, it also calculates the amount to be distributed to each taxing jurisdiction or unit.

Distribution of surplus revenues to counties

In accordance with the new formula, one-half of the surplus revenue is distributed to each county in proportion to each county's population. The other half is distributed to each county based on the proportion that the "fixed rate levy losses" for all taxing units in the county bears to the total amount of such losses for all local taxing units in the state.

Allocation of surplus revenues to local taxing units within counties

After each county receives its share of the surplus, the county auditor then distributes that revenue to each local taxing unit in the county in the proportion that the local taxing unit's current taxes charged and payable are of the total current taxes charged and payable of all the local taxing units in the county.

Division 5727.86(C) of the Revised Code also then provides for the disposition of this revenue by each of the local taxing units. With the exception of the revenue that is designated for distribution to the county (based on countywide levies), the Revised Code provides that the surplus distributions to all other local entities (i.e., townships, municipalities, and special districts) are to be deposited into each entity's general fund.

In the case of countywide levies, the surplus amounts are to be credited to each levy in the proportion that the current taxes charged and payable from each levy of or by the county bears to the total current taxes charged and payable from all levies of or by the county. In other words, the specific levies are used as a basis for calculating the amount of revenues that each local taxing district receives from the

[4] Surplus calculations were not made before 2007 because any surplus that may have existed in the fund was negligible and not required to be distributed at that time. A few times, in fact, the state needed to transfer funds from the GRF to the Local Replacement Fund in order to make the required replacement payments.

fund, but only in the case of counties is the use of the revenue that the entity receives from the fund restricted to the uses that the specific levies entail.

Distribution of revenue to local governments after the direct replacement payments are phased out

After the "direct payments" are fully phased-out the local governments will continue to receive the money generated by the kWh tax and the Mcf tax and deposited into the Local Replacement Fund; however, they will receive that money exclusively through the "new" formula – that is, the formula currently used for distributing the "surplus" revenue, as explained above. The Department of Taxation will continue to make the calculations of the amounts of money to be distributed to each local government in February and August of each year. The calculations will be based on the revenue generated by the prior year tax levies as well as the most recent population data and will depend upon the revenues generated by the kWh and Mcf taxes and credited to the Local Replacement Fund.

More information

Local officials or others with questions about distribution of kWh tax and Mcf tax revenue may contact: Tracey Burner, Revenue Accounting Division, 614-466-7150; or Doris Mahaffey, Tax Analysis Division, 614-466-0096 (e-mail at tpp@tax.state.oh.us).