



State Revenue Update: Decreased state premiums for Medicare Part D bring more relief, but weaknesses in the CAT and Personal Income Tax revenue spell trouble ahead

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Recovery Act decreases state premiums for Medicare Part D

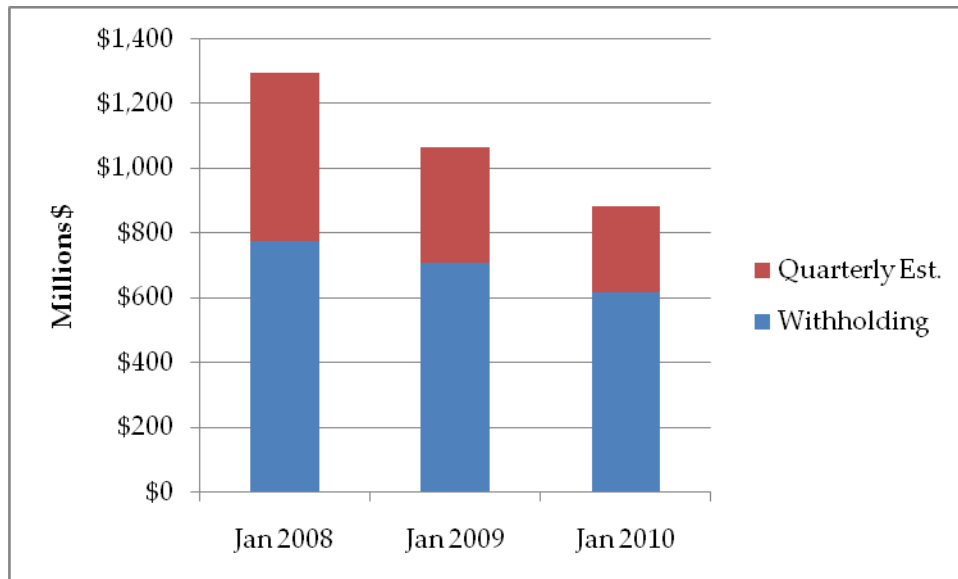
In a welcome piece of good news for Ohio's budget, the U.S. Department of Health and Human Services announced that the federal government will lower the amount of premium payments that states have to provide to offset the cost of Medicare coverage for state residents who are eligible for both Medicare and Medicaid. Increased funds are being made available under the American Recovery and Reinvestment Act (ARRA). Under the plan, the federal government will extend its matching payments for the state Medicaid program to Medicare Part D premiums that are paid by the state. The move is expected to save the state \$151 million between now and the end of the calendar year.¹

Income Tax receipts were 15.6 percent below expectations in January

Total GRF tax receipts from all sources are about 1 percent (\$99.5 million) below expectations for the first seven months of the state fiscal year.² January General Revenue Fund (GRF) income tax receipts were a different story, however, coming in 15.6 percent, or \$139.5 million, below the state budget office's expectations. If shortfalls of this magnitude continue for the second half of the fiscal year, budget cuts or adjustments may be necessary. Through the first seven months of the fiscal year, income tax receipts are 2.3 percent below expectations and 13.5 percent below last year's level.

The major sources of income tax revenue throughout the year are amounts withheld by employers from wages and salaries, estimated quarterly payments from self-employed individuals and other business owners, and annual returns. Withholding generally accounts for about 70 percent of total income tax receipts, and estimated quarterly payments about 14 percent. Not surprisingly, given Ohio's 10.9 percent unemployment rate, the combined withholding and quarterly estimated payment amounts for January, 2010, were \$413 million, or 32 percent below January, 2008, levels when the recession first started (see Fig 1.) About 5 percent of the reduction can be attributed to the change in income tax rates that took place from 2008 to 2009.

Figure 1: Personal Income Tax Withholding and Quarterly Estimated Payments, January, 2008 – January, 2010.



Source: Office of Budget and Management

Slumping CAT revenues will be inadequate to reimburse schools and local governments through FY 2013

The Commercial Activity Tax, or CAT, is a new business tax that was phased-in as the former state corporate income tax and local business tangible property tax were phased out. Even under the original state revenue assumptions before the recession, the CAT did not come close to replacing all of the revenue lost from this exchange. Previous expectations were that CAT revenue would be sufficient to reimburse schools and local governments for lost tangible personal property tax revenue but would have little left over for the state GRF. Until FY 2009, the CAT performed above expectations.

In the current biennium, CAT revenue is inadequate to reimburse schools and local governments for lost tangible personal property revenue. As a consequence, revenue from other GRF sources has to be found in order for the state to make reimbursement payments. The Tax Department expects that \$493 million in GRF funds will be required over the biennium to supplement CAT revenues. These GRF funds could have been used for other programs in this difficult budget environment.

The amount of GRF resources needed to supplement CAT revenues in the current budget may grow even more if the CAT continues to underperform. For the first seven months of the fiscal year, the Office of Budget and Management reports that CAT revenues are \$63.7 million (or 8.5 percent) below expectations.

Even more worrisome is that the Tax Department expects the need for additional GRF resources to continue in the next biennium and beyond. The table below shows that even under an optimistic scenario of 5 percent annual growth in CAT revenues, \$322 million will be needed in FY 2012-2013.

Table 1: CAT Revenue scenarios and GRF subsidies for Tangible Property Tax Replacement Payments, FY 2012-2013

Assumed Annual CAT Revenue Growth (percent)	GRF Total Subsidy (millions)
2	\$438.3
3.5	\$380.5
5	\$322.1

Source: Ohio Department of Taxation.³

The shortfall in CAT revenues adds to the potential \$8 billion financial crunch that the state faces in its next budget. The fact that CAT revenues are inadequate to reimburse schools and local governments shows the urgent need for reform. The CAT's 0.26 percent tax rate on gross sales (26 cents for every \$100) needs to be adjusted upward so that the CAT can again meet scheduled reimbursement payments and still return significant amounts to the GRF.

¹ For more information, see the U.S. Department of Health and Human Services, "Obama Administration GrantsRelief to States on Payments to Medicare for Part D Costs," Feb. 18, 2010, available at <http://www.hhs.gov/news>.

² Ohio Office of Budget and Management. Monthly Financial Report. Feb. 10, 2010.

³ Ohio Department of Taxation. Tangible Property Tax Phase Out: Background Material. Powerpoint presentation to Local Government Officials, January 25, 2010. Slide 21, "CAT Shortfalls and GRF Subsidies."