



# Members Brief

An informational brief prepared by the LSC staff for members and staff of the Ohio General Assembly

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## Property Tax Reduction Factor

Ohio applies a “property tax reduction factor” to partially mitigate property tax increases resulting from increasing property values. The reduction factor is used to calculate a property tax credit and is determined every year as the percentage by which taxes must be reduced for a levy to yield the same amount of taxes, within a specified class of property, as in the prior year.

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### Introduction and basic operation

In 1976, the General Assembly enacted H.B. 920, which made significant property tax reforms.<sup>1</sup> One of those reforms replaced a millage rollback system that applied permanent millage reductions on tax rates for both real property, i.e., land and buildings, and personal property, i.e., moveable things, in response to inflation. That act replaced the millage rollback system with a tax credit designed to achieve a similar result for real property (simultaneous changes were made for personal property taxes but those are not discussed here). The credit is often called the H.B. 920 tax reduction factor.

The tax reduction factor is calculated every year and separately for every levy it applies to. It is a percentage by which a tax levy’s collections must be reduced to ensure most of the property covered by the levy generates the same amount of tax revenue as it did in the prior year. The percentage reduction is then applied as a credit on tax bills, reducing the required payment for each of those levies. Without the tax reduction factor, an increase in property values

<sup>1</sup> H.B. 920 of the 111<sup>th</sup> General Assembly.

of 10% would result in a 10% increase in property taxes before any other reduction a property owner might qualify for. The tax reduction factor, however, largely stabilizes the amount of taxes that may be charged against the existing stock of real property.

While simple in concept, the tax reduction factor's operation is complex. This brief discusses the following complexities:

- The reduction is calculated for and applies separately to two distinct classes of real property, the first being agricultural/residential and the second being everything else.
- The tax reduction factor distinguishes between inflationary increases in aggregate property values and increased property values from new construction by application to "carryover property" only – property that is taxed in the same class in the current and preceding tax years.
- Some tax levies are exempt from the tax reduction factor.
- The reduction is suspended in a school district if it would deprive the district of a minimum level of operating revenue.

## Complexities

### Property classification

When initially enacted in 1976, the tax reduction factor applied uniformly to all real property. But there was an issue: residential property tended to appreciate faster than commercial and industrial property. So, under the previous system, if commercial and industrial property increased in value by 5% per year and residential property increased by 8% per year, the tax reduction percentage would be somewhere between 5% and 8%. Commercial and industrial property would receive a reduction greater than its 5% growth rate, and residential property would receive a reduction less than its 8% growth rate. Over time, this was bound to cause residential property to bear an increasingly larger share of the overall tax burden.

The solution to this new tax burden shifting problem came in 1980, but it was not simply a matter of rewriting H.B. 920. The Ohio Constitution's "uniform rule" requires all property to be taxed by uniform rule according to value, not according to how it is currently used. In 1976, there was no exception to the uniform rule.

Consequently, the voters approved a constitutional amendment to prevent the emerging tax burden shift. It authorized the General Assembly to divide real property into two separate classes based on use exclusively for the purpose of computing separate tax reduction factors for each class.<sup>2</sup> The classes involved are broad: "Class I" property is residential and agricultural property and "Class II" is all other property, including commercial and industrial property.<sup>3</sup>

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<sup>2</sup> Article XII, Sections 2 and 2a(C). The tax reduction factor is not mandated by the Ohio Constitution. What the Constitution does require is that if the General Assembly enacts a law classifying real property in order to compute separate tax reductions, the tax reductions must be made precisely in the manner prescribed by the Constitution.

<sup>3</sup> R.C. 5713.041.

## Carryover property

As mentioned above, the tax reduction factor is calculated using the change in value of carryover property only, i.e., property that is on both the current and preceding year's tax list and that is in the same class during each year.<sup>4</sup> In other words, the tax reduction factor does not apply to property or improvements that were not taxed in the preceding year or to property that changed classes from one year to the next. For example, if a new building is constructed on a property, the increased taxable value from the building will not be included when the tax reduction factor is calculated. Similarly, if residential property is converted to commercial use, the tax reduction factor will not account for that property's land or building value in the year following the change.

Likewise, reduction factors do not adjust to stabilize revenue when property is removed from carryover property through exemption, demolition, or reclassification. For example, when property is removed from carryover property through a tax exemption, the removal reduces total revenue generated by the applicable levy. But because the property is no longer carryover property, it is excluded from the tax reduction factor calculation so other property does not make up the revenue loss.

## Exempt levies

The tax reduction factor applies to adjust the collections of most individual tax levies. But the following types of levies are exempt from reduction, under both the Ohio Constitution and current statute:

- Levies within the 10-mill limitation on unvoted taxes. The Ohio Constitution and current statute allow combined state and local taxes on property up to 10 mills without voter approval; this is often called "inside millage."<sup>5</sup>
- Levies authorized by municipal charter, often called "charter millage." Like inside millage, the Ohio Constitution and current statutory law specifically allow unvoted levies that are authorized in a municipal corporation's charter.<sup>6</sup>
- Levies imposed specifically to pay debts. These so-called "bond levies" are levied for the term of indebtedness and are designed to collect a fixed amount of money each year.
- Any other levy imposed at whatever rate is necessary to raise a specified sum of money, which are often called "fixed-sum levies," and which most notably include school district emergency levies.<sup>7</sup>

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<sup>4</sup> R.C. 319.301(B)(2).

<sup>5</sup> Article XII, Section 2, Ohio Constitution; R.C. 5705.02 and 5705.31. For more information on inside millage, see the Legislative Service Commission's *Members Brief*, [Inside Millage \(PDF\)](#), which is available on LSC's website at: [lsc.ohio.gov](http://lsc.ohio.gov).

<sup>6</sup> Article XII, Section 2, Ohio Constitution; R.C. 5705.18.

<sup>7</sup> Article XII, Section 2a, Ohio Constitution; R.C. 319.301(A).

These exceptions leave only levies above the 10-mill limitation that are imposed at a fixed rate, often called “fixed-rate levies,” as subject to the tax reduction factor. However, these levies, in the aggregate, currently make up the majority of tax millage levied by local governments.

### **Millage floors**

Another limitation of the tax reduction factor is a law that guarantees school districts at least 20 mills of property taxes to pay operating expenses. This “20-mill floor” suspends the tax reduction factor as applied to either class of property once the reduction has reduced the total taxes charged against that class for current operating expenses, including both inside millage and voted fixed-rate millage, to 2% of taxable value in that class. That is equivalent to 20 mills of property tax. In most cases, the 20-mill floor does not mean that the tax reduction does not apply to a class of property at all; it does apply in most cases, but the reduction is not as great as it would be if the floor did not apply. A separate two-mill floor applies to joint vocational school districts.<sup>8</sup>

### **Decreasing property values**

The tax reduction factor must be determined every year, including years when property values decrease, whether due to market conditions or action by the General Assembly to reduce true or taxable property values. When the aggregate taxable value of property decreases from one year to the next, the revenue from a levy to which the reduction factor applies is maintained at the same level because the factor is calculated at zero. Revenue levels are maintained at a steady level until the aggregate taxable value of property declines enough to completely offset prior increases in value from the time the levy was originally imposed. If the aggregate property value declines to the point that it is less than the value that existed when the levy was first applied, the aggregate revenue collected will then decrease accordingly.<sup>9</sup>

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<sup>8</sup> R.C. 319.301(E). For a more thorough discussion of the 20-mill and two-mill limitations, see the Legislative Service Commission’s *Members Brief*, [Property Tax Millage Floors for School Districts \(PDF\)](#), which is available on LSC’s website at: [lsc.ohio.gov](http://lsc.ohio.gov).

<sup>9</sup> R.C. 319.301(D).