Policy Matters Ohio

Executive Summary
June 2012

The Bank Tax Shuffle

House weakens HB 510, adds exemptions

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Key findings

- The House version of a new tax on banks adds new exemptions and credits, leaving it tilted in favor of big institutions
- The House-approved bill reduces the amount the tax will produce, so financial institutions likely won't pay as much tax as they do now
- A revised trigger mechanism to ensure the new tax brings in targeted revenue won't work as well to raise rates if revenue falls short as it does to lower them

A new tax on Ohio's banks, a chief aim of which originally was to cut loopholes in the old taxes, would add new exemptions, credits and exclusions in its latest version. One result: Mortgage lenders, securities brokers, payday lenders, finance companies, and other so-called "dealers in intangibles" would get a huge tax cut. According to the Ohio Department of Taxation, such dealers that are not affiliated with other financial institutions would see their overall taxes fall from $20 million a year to no more than $4 million. Another portion of the bill provides an open invitation to insurance-company affiliates to avoid additional taxes between now and 2014 by taking advantage of an exemption from the Commercial Activity Tax.

These are just some of the ways that the House of Representatives weakened the tax proposal, House Bill 510, before passing it in May. It is now under consideration in the Senate. Besides reducing the revenue the tax will generate, a host of new provisions would chip away at the base of the new tax and continue to leave big banks with a large share of the proposed rate cuts.

The Kasich administration first proposed the new tax as a part of its Mid-Biennium Review. The Financial Institutions Tax (FIT) would replace the corporate franchise tax and the tax on dealers in intangibles, respectively, on what was said to be a revenue-neutral basis. Tax Commissioner Joseph W. Testa outlined in legislative testimony how companies currently are able to legally avoid Ohio's existing taxes for financial institutions because of the way they are set up. By forcing financial institutions to report all of their equity capital on a consolidated basis and eliminating a big exemption, the new tax would cover a far larger base than the existing corporate franchise tax and undercut such tax avoidance.

Unfortunately, and contradictory as it might seem, the original proposal as well as the House-approved version would funnel what should be added revenue for the state right back to the banks. The General Assembly should stick with the original attempt by the Kasich administration to cut loopholes – but without cutting rates on big banks, in particular.

It is difficult to parse all the details of the proposal to determine how much financial institutions will pay under the new tax regime compared to what they do now. However, it appears likely that they will pay less, as suggested by both the state tax commissioner and the Legislative Service Commission. The revenue target for the tax was reduced from $225 million a year to $200 million a year.

The House-approved version includes three brackets, one more than was in the original bill proposed by the Kasich administration. However, it still leaves Ohio’s nine or ten largest financial institutions paying a special low rate on much of their capital. Big banks aren’t better banks, as their role in the recent financial crisis made clear. Thus, it is questionable policy for the state to favor them with lower rates.

The House-approved version of the bill chips away at the tax base with a slew of changes. It’s hard to know who will really benefit from some of these changes. However, there’s little question that the positive aspect of the original proposal – to bring financial institutions under a single tax and eliminate a costly exemption, thus reducing the opportunities for tax avoidance – has been undercut.

The bill includes a trigger mechanism to ensure that revenue comes in close to the $200 million annual target. However, in the House version, this trigger is stronger in correcting greater-than-expected performance than it is if the tax brings in less than expected.

According to the taxation department, banks are avoiding tens of millions of dollars a year in taxes through the legal use of today’s tax code. The loopholes should be closed, but the proceeds should not be redistributed to the banks. The big banks, in particular, should pay more than they do now, reflecting the end of loopholes they previously enjoyed. The new tax should not create new means of tax avoidance and the trigger should be strengthened so it corrects as much on the down side as it does on the up side. The FIT should increase revenue, to provide aid to fight the foreclosure crisis and to restore public services that have been undercut in the current state budget.

Policy Matters Ohio is a non-profit, non-partisan research institute with offices in Cleveland and Columbus.