Policy Matters Ohio

Tax Policy
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Testimony to the House Ways & Means Committee on House Bill 5

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Good afternoon, Chairman Beck, Ranking Member Letson and members of the committee. My name is Zach Schiller and I am the research director at Policy Matters Ohio, a nonprofit, nonpartisan organization with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify today regarding House Bill 5.

A major effort to overhaul Ohio's municipal income tax should reduce tax avoidance, guarantee a broad tax base, and ensure that those most able to pay are in fact doing so. Unfortunately, House Bill 5 does not accomplish those things. It ignores existing tax loopholes, such as one that allows firms to use passive investment companies to reduce their reported income, costing municipalities tens of millions of dollars a year. A company can set up a passive investment company, and then pay that company for the right to use a trademark, for instance. Fred Church, then an official with the Department of Taxation, wrote a memo in 2003 describing how this works:

> "To avoid Ohio's municipal income tax, a corporation or a flow-through entity could simply pay some of its operating income as intangible property expense to another entity that could be in Ohio, or that could even be in the same city. The key here is that Ohio municipalities cannot tax intangible property income, so that the act of taking operating income and "turning it into" intangible property income makes it disappear from the Ohio municipal income tax base. The company paying the expense gets a deduction, while the company receiving the payment earns income that the municipalities cannot tax."

Church estimated then that municipalities could see a revenue gain of $27.9 million in Fiscal Year 2004 if such tax avoidance were restricted. Even now, this is costing Ohio municipalities tens of millions of dollars annually, for no good reason. Inexplicably, House Bill 5 is silent on this. Given the conclusion of many cities and the Legislative Service Commission that the bill would reduce municipal revenue, it is especially perplexing that this loophole is not addressed in the bill.

House Bill 5 is framed mostly as an effort to make municipal income taxes more uniform. However, it forgoes an opportunity to do so by preserving the carve-outs affluent residents of Cincinnati and Findlay enjoy on income from stock options. Though it takes a step in the right direction by ending the ability of additional cities to allow this starting in 2015, there is no good reason to allow such continued special treatment.

While it may seem sensible to use the state's definition of who is a resident, this is outlined too narrowly in Ohio law, allowing affluent residents who spend significant time out of state to avoid municipal tax. This is helpful to "snowbirds" who spend part of the year in Florida but still spend much of the year in Ohio. This should not be simply applied at the local level. Snowplows should come before snowbirds as a priority for the General Assembly.

Policy Matters Ohio published a report in January on House Bill 601, HB 5's predecessor, that identified a number other ways that the bill allows tax avoidance to continue, or even creates new avenues to avoid the tax (see attached). Unfortunately, not much was changed in House Bill 5 regarding the issues we wrote about then. The proposal should restrain tax avoidance, instead of ignoring or even inviting it. Thank you for the opportunity to testify, and I am happy to answer any questions.

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