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Breaking Bad

Ohio tax breaks escape scrutiny

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The Ohio General Assembly soon will approve a new two-year state budget. But so far, instead of closely reviewing the 129 tax exemptions, deductions and credits that reduce the amount of revenue the state would otherwise receive, it is adding to them. The Senate budget bill, which was approved last week, includes seven new exemptions and expands or extends six others. Only two are set for repeal. These include a modest deduction covering dependents that two different taxpayers can deduct on their state income tax, and the Technology Investment Tax Credit, which has reached its authorized limit.

Key findings

- Ohio's 129 tax exemptions, deductions and credits, worth $7.7 billion a year, are similar in number and size to two years ago.
- Despite repeal of taxes that should have cut 44 tax expenditures, the number of such breaks is not much lower today than 10 years ago.
- Most tax expenditures go to businesses.
- There is no regular review of tax breaks.
- The Senate budget bill includes a dozen new or expanded tax breaks, but would repeal only two.

The biggest new tax expenditure, as such exemptions are known, would be a break worth about $700 million a year for owners of certain Ohio businesses. It would exempt half of up to $750,000 from the income tax. This huge exemption, which overnight would become the second-biggest in the tax code, is very poorly targeted and is unlikely to result in significant new job creation.[1] A recent national study by researchers at the U.S. treasury department found that only 11 percent of taxpayers reporting business income own a bona fide small business with employees other than the owner.[2] The new tax break would benefit passive investors who have no role in business decisions, while opening up new avenues for tax avoidance.

To fund this big new tax expenditure, some have proposed curbing others. For instance, the Ohio Chamber of Commerce has suggested reducing or minimizing the $20 credit and the personal,

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[1] See Mazerov, Michael, Testimony to the Ohio House Finance & Appropriations Committee on HB 59 Income Tax Plan, Center on Budget & Policy Priorities, March 19, 2013, available at http://www.policymattersohio.org/mazerov-mar2013, and Zach Schiller, "Tax Break for Business Owners Won't Help Ohio Economy," Policy Matters Ohio, Apr. 2, 2013, at http://www.policymattersohio.org/tax-break-apr2013.

[2] Matthew Knittel, Susan Nelson, Jason DeBacker, John Kitchen, James Pearce, and Richard Prisinzano, "Methodology to Identify Small Businesses and Their Owners," Office of Tax Analysis, U.S. Department of Treasury, August 2011, Table 15, available at http://1.usa.gov/qOZ4FX.

spousal and dependent exemption available under the income tax.[3] Reducing or eliminating such exemptions and using the funds for a business-income tax exemption would shift taxes from the more affluent to poor and middle income Ohioans. That's because it is the former who benefit the most from such a cut. Cutting existing tax expenditures to finance unproductive new ones is not a useful exercise.

However, a regular review of Ohio's tax expenditures is very much in order. A biennial report produced by the Ohio Department of Taxation (ODT) examines state tax expenditures, and should serve as a starting point for a reevaluation of all 129 of them.

This year's tax expenditure report, as always, is Book Two of the governor's executive budget proposal. In it, the taxation department estimated that in Fiscal Years 2014 and 2015, 129 such exemptions and credits will amount to more than $7.7 billion in annual foregone revenue to the state's General Revenue Fund (see Table 1 below). "Tax expenditures result in a loss of tax revenue to state government, thereby reducing the funds available for other government programs," ODT noted in the report. "In essence, a tax expenditure has the same fiscal impact as a direct government expenditure."[4] The report estimates foregone revenue, which is not necessarily what the state would take in if a tax expenditure were to be repealed.[5] Still, the loss of revenue is sizeable, given the current expectation that the state will generate $21.1 billion in GRF tax revenue in fiscal 2014.[6]

"Unlike direct budgetary expenditures, unless there is a pre-existing termination date, tax expenditures may remain in effect indefinitely with little or no scrutiny by policy makers," the tax expenditure report notes.[7] Over the past couple of years, new attention has focused on tax expenditures. However, the General Assembly has no regular process to hold hearings on tax expenditures or to systematically examine them.[8]

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[3] Navin, Dan, Ohio Chamber of Commerce, Testimony on Tax Reform and House Bill 59 Before the Senate Ways & Means Committee, May 22, 2013, p. 2, at http://bit.ly/150JNdn. The chamber also has proposed other tax changes to pay for income-tax cuts. Its proposal to means test the property-tax homestead exemption, so that it once again is available only to low- and moderate-income homeowners, has some merit. However, revenue from such a change should not go to an income-tax cut that will favor the most affluent Ohioans while doing little for the economy.
[4] Governor John R. Kasich, Ohio Department of Taxation, The State of Ohio Executive Budget, Fiscal Years 2014-2015, Tax Expenditure Report, p. 1, available at http://1.usa.gov/13EVGI3.
[5] The revenue estimates in the report reflect "General Revenue Fund revenue foregone," or the benefits to recipients of the credits and exemptions. This is not necessarily the same as what the state would receive if the exemptions were eliminated, and as it has before, the department notes in bold-faced type that "**the figures in this report do not represent potential revenue gain from the repeal of the tax expenditure.**" (p.4) There may be a time lag before the full effect of repealing the tax expenditure shows up in revenues, not all taxpayers may immediately comply with the change in law, or taxpayers could behave differently because of the change. See Ibid, pp. 3-4. In testimony to the Senate Ways & Means Committee, then Deputy Tax Commissioner Frederick Church said that the report's estimates are "close to, but not exactly equal to, expected revenue gains from repeal of expenditures." Frederick Church, Presentation to Senate Ways and Means and Economic Development Committee, Nov. 17, 2011.
[6] Testimony of Director Timothy S. Keen, Office of Budget and Management, Senate Finance Committee, April 16, 2013, Attachment 3. This is a baseline estimate, before any tax changes that could be made in the budget.
[7] Tax Expenditure Report, p. 1.
[8] There was some examination of the issue of tax expenditures in 2011 by a special committee of the House in 2011 and by the Senate Ways & Means Committee, respectively, but these did not result in specific legislation. See below for more on the former effort.

The General Assembly should closely review the report, and reduce or eliminate unneeded loopholes. Both the House and Senate should review each of the 129 tax expenditures, starting with the 90 where the foregone revenue is $1 million or more a year in FY15. All tax expenditures should be given sunset dates, so that they only continue after an affirmative decision that they should. And a permanent review mechanism should be established.

The taxation department projects that the total value of tax expenditures will grow 13 percent between FY12 and FY15, as shown in Table 1.

Table 1
Summary of revenue foregone due to tax expenditures

FY12	FY13	FY14	FY15
$7,054,000,000	$7,294,100,000	$7,707,600,000	$7,983,700,000

Source: Ohio Department of Taxation.

This report covers some of the highlights of this year's tax expenditure report, which include:

- The number of tax expenditures has remained about the same. It increased to 129, from 128 in the previous biennium.
- Most of the exemptions, credits and deductions go to businesses. Seventy-six of the tax expenditures, accounting for just over half of the total value in FY14 or $4.0 billion, go for business assistance and economic development.
- Sales-tax expenditures account for the largest share of the total: 57, adding up to $5.08 billion in FY14, or nearly two-thirds of the total. While figures in the report do not estimate the revenue gains from repeal, it is still worth noting that the current estimate from the Office of Budget and Management for GRF sales and use tax revenue in FY14 is $8.92 billion, so the sales-tax base is significantly smaller due to these tax expenditures. Thirty-six income-tax expenditures are valued at $2 billion in FY14.[9]
- Seven new tax expenditures valued at a total of $72.2 million in FY14 have been added since the last tax expenditure report two years ago. Five, valued at a total of $225.4 million in FY13, were eliminated because of the repeal of the corporate franchise tax (1) and the estate tax (4). The individual income tax credit for alternative fuel sold at retail expired.
- The vast bulk of Ohio's tax expenditures continue as usual, with no regular review. Despite agreement across the political spectrum that a regular review of Ohio's tax expenditures is in order, the General Assembly has not taken action on the issue.
- 44 tax expenditures have ended over the past decade because of the repeal of the corporate franchise and estate taxes. Yet at 129, the total number today is just 9 below what it was in 2003 because so many have been transferred to be used against other taxes, or altogether new ones have been created. Leaving aside cases where tax expenditures were repealed and replaced with something similar, or originally approved for just a limited time, the General Assembly has only eliminated two individual tax expenditures over the past decade.

In his budget proposal, Gov. Kasich made a modest effort to repeal some tax expenditures. He sought to eliminate the sales-tax exemption for magazine subscriptions, worth $7.4 million in FY14; the

[9] In his 2001 testimony to the Senate Ways & Means Committee, then Deputy Tax Commissioner Frederick Church noted that the accuracy of many income-tax expenditures is quite high, because of information reported on income-tax returns. In contrast, he said, "most sales tax expenditures are difficult to quantify because detail on the exemptions is not reported on tax returns. Alternative data sources must be used."

newly created income-tax deduction for gambling losses (see below) and allowing an individual to be claimed as a dependent by more than a single taxpayer, respectively ($33.8 million together).[10] He also proposed eliminating the Technology Investment Tax Credit, a program that provides credits to investors in qualified, technology-based Ohio companies, though existing credits would be honored (this credit was estimated to cost $3.8 million in FY13 and $1.4 million in FY14 before dialing down to 0 in FY15, as the program has reached its cap).[11]

However, in its version of the budget, the House struck the governor's elimination of the gambling-loss deduction (estimated at GRF $29 million a year) and the magazine subscription sales-tax exemption. The Senate in its budget bill agreed on these two measures with the House.

A description of many of the tax expenditures that are created or expanded in the House and Senate budget bills can be found in Appendix 1. Among them are:

- A new Commercial Activity Tax exclusion for grain handlers. The LSC has estimated this would reduce CAT revenue by $11 million a year, half of which would go to the General Revenue Fund and half to school districts and local governments. This new exemption is based on the idea that for-profit grain handlers need it to compete with nonprofit grain handlers, which aren't subject to the tax. It has been opposed, however, by the Ohio Manufacturers' Association, whose representative noted in testimony to the Senate Ways & Means Committee that, "All for-profit enterprises should be paying the CAT; in fact, equality in the burden of taxation demands that they all remain subject to the tax."[12] Added by the House, this new tax break was retained by the Senate.
- A new property-tax exemption in the House version of the budget would cover fraternal organizations like the Masons that provide financial support for charitable purposes and have been operating in Ohio for at least 100 years. As *The Plain Dealer* reported, the Legislative Service Commission has estimated the cost to local governments and school districts at $4.8 million or more a year.[13] This would not show up in the tax expenditure report, because it is not a state exemption, but a local one. It is no less a matter of state policy, however.

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[10] Executive Budget for Fiscal Years 2014 and 2015, Section B, Revenue Estimates and Methodology, p. B-7, available at http://media.obm.ohio.gov/OBM/Budget/Documents/operating/fy-14-15/bluebook/budget/Section-B_14-15.pdf. The governor also sought to explicitly subject digital goods and services to the sales tax, and to impose the sales tax on many new services while lowering the state rate to 5 percent. Since the sales tax is not now defined to cover services unless they are specifically enumerated, the state does not consider it to be a tax expenditure that they are not covered. Both of these proposals were deleted in the House version of the bill.

[11] Tax expenditure report, p. 7.

[12] Mark Engel, Bricker & Eckler, Ohio Manufacturers' Association Tax Counsel, House Bill 59 Testimony before the Ways & Means Committee of the Ohio Senate, May 22, 2013, p.7. He continued: "If for-profit grain handlers are competing with non-profit cooperatives, the answer is not to exempt the for-profit entities from the CAT. Rather, perhaps to the extent that a non-profit entity is performing a commercial activity in competition with for-profit enterprises, receipts from that activity should be subject to the tax just like those of a for-profit entity." Available, as is the following letter, at http://www.ohiosenate.gov/committee/ways-and-means# The OMA was joined by five other groups in a statement to the committee that read in part: "Continuing our united support over the past eight years against diluting the CAT base, the Ohio Manufacturers' Association, The Ohio Society of CPAs, Ohio State Bar Association, Ohio Chemistry Technology Council, Ohio State Medical Association and Ohio Dental Association have joined together again to reiterate our continued opposition to exemptions, earmarks, and/or credits to the CAT." Letter to the Hon. Tim Schaffer, Chair, Senate Ways & Means Committee, May 21, 2013.

[13] Higgs, Robert, "House Budget Provision Would Give Fraternal Organizations a Tax Break," *The Plain Dealer*, Apr. 16, 2013. See also Legislative Service Commission, H.B. 59 of the 130th General Assembly, Comparison Document, p. 566.

- A retailer could keep 75 percent of the piggyback sales tax it would otherwise pay to a county if it employs at least 150 people and meets certain other requirements. This break, originally approved in 2006 to support Bass Pro Shops in Wood County, had expired, but was revived in the Senate, with a lower investment requirement ($30 million instead of $50 million). It includes tighter restrictions than before in that at least 50 percent of the customers must live in within 50 miles of the facility and relocations of employees and property from other facilities elsewhere in Ohio are not permitted. Promoted as a spur to other development in the area, the Bass Pro has not attracted much nearby investment.[14]

Overall, the Senate budget will would create six new state tax expenditures while repealing two. That does not include the additional local tax breaks that it authorizes.

Inexplicably, neither the governor, the House nor the Senate sought to eliminate some of the obvious special-interest breaks in the tax code.[15] Some examples are:

- A write-off against the Commercial Activity Tax for losses companies experienced before it was enacted, even though they no longer pay taxes on their income. This break is available only for companies with at least $50 million in losses; small businesses that had losses less than that were excluded. Value in FY14: $5.5 million;
- A $19.5 million sales-tax exemption in both FY14 and FY15 for pollution-control equipment purchased by utilities even though most of it is mandated;[16]
- The vendor discount, worth $54.3 million in FY14, under which retailers that collect the sales tax get a 0.75 percent discount on what they collect if they send the tax in by the due date of the tax return. While this uncapped discount may have made sense before the days of computers, today this is a windfall for big retailers, which get most of the benefit. According to data in the previous tax expenditure report, more than half of the $50.7 million received in such discounts in 2008 went to the 687 retailers that collected at least $1 million in tax, while the 197,487 other retailers got the rest;[17]
- One worth $600,000 for buyers of shares in jet aircraft, who pay only a fraction of the sales tax they would otherwise.[18] The state has an $800 cap on total state sales tax paid for each aircraft, so a buyer who spends $150,000 could save thousands of dollars in sales tax.

The LSC noted that, "The cost estimate is based on a 2001 survey so may substantially understate the current cost," and that revenue losses "could rise in the future as increasing numbers of groups satisfy this restriction." See http://www.lsc.state.oh.us/fiscal/comparedoc130/housepassed/tax.pdf.

[14] See Chavez, Jon, "Bass Pro's Allure Falls Short," *The Toledo Blade*, July 8, 2009, at http://bit.ly/14zgemk. A recent visit to the area found little new development.

[15] Both the House and Senate bills seek to collect use taxes from Internet retailers that use Ohio affiliates to sell their products by clicking through to such retailers' web sites. It is an appropriate and necessary measure, though it will probably take Congressional action to collect such taxes in full. A bill to do so is pending in Congress and both the Ohio House and Senate budget bills also express the intent to enact conforming state legislation if that is approved. As helpful as the budget bills are on this issue, the provisions do not rein in a tax expenditure, they are simply an attempt to collect taxes that are already due.

[16] See Schiller, Zach, Report to the Ohio Budget Planning and Management Commission, Policy Matters Ohio, August, 2010, p. 9, available at http://www.policymattersohio.org/pdf/BPMC2010.pdf.

[17] State of Ohio, Executive Budget, Fiscal Years 2011 and 2012, Book Two, Tax Expenditure Report, Prepared by the Department of Taxation and Submitted to the 128th General Assembly, February 2009, p. 51.

[18] Ohio Department of Taxation, Sales Tax Expenditure Estimate 1.32, $800 tax cap on qualified fractionally owned aircraft. Produced on January 23, 2013. Based simply on sales of such aircraft in Ohio, the amount of foregone revenue would be greater. However, the biggest seller of such aircraft said it would locate sales outside Ohio to minimize its tax

Largest tax expenditures

The list of the largest tax expenditures has remained similar to that from two years ago. Nineteen of the top 20 in value in FY14 were listed in the top 20 for FY12 in the last report. Notably, the one that fell off the list – the exemption from the corporate franchise tax for goodwill and abandoned property, estimated to be worth $123 million in FY13 – no longer exists. It had long been a major avenue for tax avoidance.[19] This exemption does not exist in the new tax on banks created by the General Assembly last year, the financial institutions tax (The FIT replaced what was left of the corporate franchise tax. This was Ohio's corporate income tax until 2005, when it was phased out for most non-financial companies). The Kasich administration targeted the exemption in its appeal for the new FIT,[20] and its elimination represents an important step forward in cracking down on tax avoidance. Regrettably, the additional revenue generated was given back to the banks in the form of rate cuts and the bill also contained new loopholes.[21]

Moving into the top 20 is the exclusion from the CAT of qualifying distribution center receipts against the commercial activity tax. Suppliers to big Ohio distribution centers with more than $500 million in sales don't have to pay the tax on such sales under this exclusion, as long as more than half of what each center ships goes outside Ohio.[22] One of the faster-growing tax expenditures, it is estimated to increase 15.7 percent between FY12 and FY15, to $89.7 million.[23]

The Columbus Dispatch described recently how Jackson, Ohio, businessman Alan Stockmeister convinced the General Assembly to amend the existing tax break for suppliers of certain big distribution centers so that it would also include his precious-metals refining business. According to the Dispatch, he wanted to open a new copper-recycling business in Waverly, but said he needed tax relief to do so – and that without it, he might also be forced to move his existing metals-refining business to Texas, where the parent company is located. "Within a few weeks, legislators amended an existing Ohio exemption for distribution warehouses to include metal refineries in the state's

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exposure if there was no cap, so the state would not receive the additional revenue.

[19] See Schiller, Zach, "Limiting Loopholes: A Dozen Tax Breaks Ohio Can Do Without," Policy Matters Ohio, September 2008, available at http://www.policymattersohio.org/limiting-loopholes-a-dozen-tax-breaks-ohio-can-do-without.

[20] See Joseph Testa, Tax Commissioner, Testimony on Tax Provisions of House Bill 487, House Ways & Means Committee, March 21, 2012.

[21] See Zach Schiller, Policy Matters Ohio, "Memo Concerning HB 510 to members of the Senate Ways & Means & Economic Development Committee," Nov. 28, 2012, including previous reports cited, available at http://www.policymattersohio.org/waysmeans-nov2012. For an example, see below.

[22] Budget bills approved by both the House and the Senate would remove a recently enacted $500,000 penalty for improperly excluded receipts from a qualified distribution center, and replace it with a new one on the operator of such a facility. This would equal the amount that would have been owed by the suppliers of the distribution center had it not been improperly certified by the state. The House version would deduct from that penalty the amount actually paid by such suppliers.

[23] The value of this exemption could be larger than that. In its estimate of this exemption two years ago, the taxation department figured that the sheer scale of the inventory shipped into one such distribution center was so large that suppliers to it would instead ship to other, non-Ohio locations if the exemption were repealed. This cut the total estimate for the exemption by more than 70 percent, though such a course of action is uncertain. This year, the taxation department has redacted its calculation of that effect so it is hard to say how big it is. See Ohio Department of Taxation, Commercial Activity Tax Expenditure Estimate: Qualifying Distribution Center Receipts Exclusion, Jan. 10, 2011 and Dec. 27, 2012.

Appalachia region. The Department of Taxation calculated the cost of the exemption for Ohio Precious Metals to be $1.3 million in 2014," the *Dispatch* reported. [24]

In addition to Ohio Precious Metals, six other facilities are certified under this exclusion this year: Cardinal Health National Logistics Center in Groveport; Humana Pharmacy Inc., doing business as RightSource, in West Chester; McKesson Corp. in Washington Court House; Medco Health Solutions of Columbus West; PC Connection Services in Wilmington; and Primary Healthcare Distribution Inc. doing business Curascript in Grove City.[25] Part of the growth in the value of this exemption reflects the increasing number of users. With this exemption, the state is favoring large companies over small ones. This tilts the advantage to big companies and violates a tenet of sound taxation: That "businesses and persons with similar assets and income should be taxed alike."[26]

Some on the top 20 list have risen while others have fallen. Most significantly, the estimated value of the sales and use tax exemption for sales to the state, its subdivisions and certain other states fell substantially, dropping that exemption from 11th biggest two years ago to 16th in the current report. The lower estimates were based on new U.S. Census data that showed a decrease in reported non-construction capital outlays for local government, along with a change in assumptions about how big a share of local-government spending goes towards items covered by the exemption.[27]

By far the largest tax expenditure, triple the size of any other at an estimated $1.8 billion in FY14 and $1.88 billion in FY15, is the sales-tax exemption for machinery, equipment, fuel and supplies used in manufacturing. Most states with a sales tax have a similar exemption. However, Ohio's has not been examined closely since it was last overhauled in 1990. The size of this exemption suggests it should be reviewed more often.

Table 2 lists the 20 largest tax expenditures, according to the taxation department. Seven of the top ten in value are sales-tax exemptions. With two exceptions, each of the top 20 accounts for at least $100 million in foregone revenue.[28]

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[24] Vardon, Joe, "Ohio losing $7.7 billion due to tax loopholes," The Columbus Dispatch, Apr. 21, 2013. The Department of Taxation used the statutory minimum to estimate the value of the new exemption.

[25] See http://www.tax.ohio.gov/commercial_activities/qualified_distribution_centers.aspx for company certificates

[26] Sheridan, Richard G., David A. Ellis and Richard Marountas, "Implications of Tax Expenditures on Ohio's Revenue System," *Taxing Issues*, The Federation for Community Planning, October 2002, p. 10

[27] Ohio Department of Taxation, Tax Analysis Division, Sales and Use Tax Expenditure: Sales to the State of Ohio, its political subdivisions and certain other states are exempt from the sales and use tax, Nov. 2, 2012. Additional information also provided by the Tax Analysis Division.

[28] The taxation department does not include the sales tax exemption on food for off-premises consumption in the tax expenditure report because it is part of the Ohio Constitution and cannot be changed simply through legislative action. The department has four basic criteria for determining whether a tax provision constitutes an Ohio tax expenditure: 1) the item reduces, or has the potential to reduce, one of the state's General Revenue Fund taxes, 2) the items would have been part of the defined tax base, 3) the item is not subject to an alternative tax and 4) the item is subject to change by legislative action. Tax Expenditure report, pp. 2-3.

Table 2			
Top 20 tax expenditures by foregone General Revenue Fund revenue FY2014 in millions of dollars			
Type of tax against which exemption is taken	**Tax expenditure description**	**Foregone FY2014 revenue**	**Originally enacted**
Sales and Use	Property used primarily in manufacturing	$1,796.9	1935
Individual Income	Personal exemption	$591.2	1972
Sales and Use	Prescription drugs and selected medical supplies	$482.9	1961
Sales and Use	Sales of TPP and services to electricity providers	$441.9	2000
Sales and Use	Sales to churches and certain other types of nonprofits	$432.7	1935
Sales and Use	Social Security & railroad retirement benefits exemption	$318.0	1972
Sales and Use	TPP used in agriculture or mining	$316.7	1935
Sales and Use	Packaging and packaging equipment	$261.6	1961
Individual Income	Joint filer credit	$238.0	1973
Commercial Activity	Exclusion of first $1 million of gross receipts	$218.2	2005
Sales and Use	Building & construction materials used in certain structures	$193.2	1959
Individual Income	$20 personal exemption credit	$166.7	1983
Individual Income	Resident credit for income taxed by another state	$153.8	1972
Individual Income	Value of motor vehicle trade-ins	$153.3	1981
Individual Income	Retirement income credit	$145.3	1983
Sales and Use	Sales to the state, its subdivisions & certain other states	$139.1	1935
Sales and Use	Transportation of persons and property	$130.4	1935
Sales and Use	TPP used directly in providing public utility services	$116.7	1935
Sales and Use	Property and services sold to telecomm providers	$98.7	1987
Commercial Activity	Qualifying distribution center receipts	$85.4	2006

Source: Ohio Department of Taxation.

Since the last tax expenditure report was issued two years ago, seven new expenditures have been added, estimated at $72.2 million in FY14 and $60.9 million in FY15. As noted above, five were eliminated, including the goodwill exemption cited earlier and four deductions or credits against the estate tax. That tax was repealed effective January 1, 2013. Three other tax credits against the corporate franchise tax worth a total of $14.2 million in FY14 were transferred to the new Financial Institutions Tax.[29] The individual income tax credit for alternative fuel sold at retail, first approved in 2007 and continued through 2011, expired.

The largest new tax expenditure added since the last report is a new small-business investment tax credit, estimated at $32.1 million in FY14. This investment tax credit, dubbed InvestOhio and worth up to $100 million each biennium starting in FY2014-15, was dropped into the last biennial budget in conference committee without public review. The break will go to investors in companies with at

[29] One of these three, which allowed the state-chartered savings and loans to claim a credit for an annual assessment under the corporate franchise tax, was repealed and replaced by a new tax cred against the FIT. See Tax Expenditure Report, p. 32.

least 50 Ohio employees or more than half of whose employees are in Ohio. Companies will have to have assets of less than $50 million or annual sales of no more than $10 million. Investors can get a 10 percent income-tax credit if they invest in such companies and hold onto the investment long enough. The total amount of such credits estimated by the taxation department declines in FY15, based on applications for the credit to the Ohio Development Services Agency.[30]

For the investor to receive the tax break, the company has to make at least one of five different types of investments equal to or greater than the investor's outlay, ranging from motor vehicles to compensation of new employees to property used in the business.[31] However, no new job creation is required (although the program was modified last year to require reports on job creation).

Also going into effect for the year that began Jan. 1 is a new income-tax deduction for gambling losses. Approved in 2010, this new deduction, worth $29 million a year, allows gamblers to subtract their losses from their winnings in calculating their income tax. As columnist Tom Suddes of *The Plain Dealer* pointed out at the time, unlike the Internal Revenue Service, Ohio hadn't allowed a deduction for gambling losses. Though it was approved as part of casino legislation, Suddes noted, it doesn't just cover casino losses in Ohio, but "losses racked up anywhere (Indiana or Las Vegas, say) and not just losses from casino gambling, but also losses on horse-race bets; lottery tickets; "you name it," a Taxation Department official confirmed." [32] As mentioned above, Gov. Kasich sought to eliminate this tax break in his budget proposal. A bill sponsored by Sen. Shannon Jones would repeal the break and use the revenue to increase the income-tax credit for adoption of a child, as well as raise the maximum deduction for college savings contributions.[33]

Motor fuel dealers also won a new exclusion from the CAT tax for product exchanges that don't involve monetary compensation other than payment for differences in location and grade. Fred Church, then deputy director of tax policy and budget for the Department of Taxation, testified when the exemption was being considered two years ago that it threatened the viability of the CAT, which was designed as a broad-based, low rate tax. "If state government continues to allow exemptions from the CAT, or credits, or special tax rates, then every industry that is subject to the CAT can be expected to look through the law, find an industry that is somewhat similar that has an exemption or a credit, and ask for a similar exemption or credit," he said then.[34] Table 3 lists these new tax expenditures and estimates of foregone revenue from them.

[30] Ohio Department of Taxation, Tax Analysis Division, New Tax Expenditure: InvestOhio Tax Credit, Feb. 25, 2013
[31] Ohio Revised Code, Section 122.86
[32] Suddes, Tom, "Tax Deduction for Gambling Losses Doesn't Make Sense," *The Plain Dealer*, June 6, 2010
[33] Senate Bill 108, at http://www.legislature.state.oh.us/bills.cfm?ID=130_SB_108
[34] Gongwer News Service Ohio Report, March 10, 2011. The Senate budget bill includes the creation of a new motor fuel receipts tax, modeled on the CAT, so it is not yet clear if that new tax will be established and whether this tax break would be usable against it.

Table 3			
New tax expenditures in the FY14-15 report In millions of dollars			
Type of tax against which exemption is taken	**Tax expenditure description**	**FY2014**	**FY 2015**
Individual Income	Small business investment credit	$32.1	$20.2
Individual Income	Gambling loss deduction	$29.0	$29.0
Commercial Activity	Exclusion for exchanges of petroleum not involving monetary compensation	$8.1	$8.5
Individual Income	Deduction for Pell grant or Ohio College Opportunity Grant proceeds	$3.0	$3.2
Sales and Use	Sale of equipment used in an eligible computer data center	Minimal	Minimal
Individual Income	Credit for pass-through entity investor's share of financial institutions tax	Minimal	Minimal
Commercial Activity	Exemption for receipts of certain uranium enrichment facilities	Minimal	Minimal
	Total	**$72.2**	**$60.9**
Source: Ohio Department of Taxation.			

Invisible growth in tax expenditures

The list above does not cover all the measures that the General Assembly has taken that extend or expand tax expenditures since the last report. Newly authorized local property tax breaks are not included, so action the legislature took last year exempting operators of convention centers in Columbus and Youngstown from property taxes go unrecognized in the report, as does continued extension of the state's Enterprise Zone program.[35] The national research group Good Jobs First published a study in 2011 of enterprise zones in the Cleveland and Cincinnati areas between 1996 and 2010. The study concluded that, "One hundred and sixty-four small and medium-sized business establishments with an estimated 14,500 employees received lucrative tax breaks as they merely moved around within the Cincinnati and Cleveland metropolitan areas. These subsidized relocations were overwhelmingly outward bound and by many measures, especially in the Cleveland region, fueled suburban sprawl."[36] Reform in this local abatement program called for in a study mandated by the General Assembly in 2007 has never occurred, yet the program has continued to be extended.[37] Amended Senate Bill 112, approved in the Senate and pending in the House**,** would extend the program for another two years.

Other changes in tax expenditures involve the expansion of existing tax breaks. The new law allowing call centers to obtain tax credits for workers who are employed out of their homes isn't a

[35] Schiller, Zach, "Multiplying Tax Breaks: Exemptions Grow Even as Talk Increases of Reining Them In," Policy Matters Ohio, August, 2012, pp. 2-4, available at http://www.policymattersohio.org/tax-breaks-aug2012

[36] Greg LeRoy and Leigh McIlvaine, "Paid to Sprawl: Subsidized Job Flight from Cleveland and Cincinnati," Good Jobs First, July 2011, available at http://www.goodjobsfirst.org/paidtosprawl

[37] Patton, Wendy, Policy Matters Ohio, Testimony on Senate Bill 112 before the Senate Committee on Workforce and Economic Development, May 15, 2013, available at http://www.policymattersohio.org/enterprise-zones-may2013

new tax expenditure, nor were the expansions of the Job Retention Tax Credit in 2011. Similarly, in the budget two years ago, the General Assembly added to the existing sales-tax exemption for building materials and related services used in livestock structures so it also included those for captive deer, known in some circles as "the Bambi exemption." Last year, the General Assembly enlarged a sales-tax exemption for the direct-marketing industry, and expanded the motion-picture credit, from $20 million per biennium to $40 million per biennium.[38] It is clear that the motion-picture credit doesn't come close to paying for itself, in that state and local tax revenue from the film production is far smaller than the credits given out.[39] A major question with these credits is whether they generate a local motion-picture industry or if they simply require indefinite continuation of state subsidies to bring in an out-of-town industry.[40]

In other instances, special breaks aren't considered tax expenditures because the tax law providing for them doesn't provide for that to be a part of the tax base to begin with. Thus, the 2012 bill creating the new financial institutions tax calls for certain so-called dealers in intangibles, such as captive finance companies, to be taxed under the CAT instead of the financial institutions tax. In its fiscal note on the bill, the Legislative Service Commission said that the impact was uncertain, but likely would cost the General Revenue Fund several million dollars a year and potentially up to $20 million.[41]

Tax expenditures now vs. 10 years ago

Over the past decade, the number of tax expenditures has fallen from 138 to 129.[42] However, that decline masks major changes in the state's exemptions, credits and deductions. The creation and elimination of entire taxes has been the hallmark of Ohio policy over that timeframe, rather than any attempt to broaden the tax base by reviewing tax expenditures. Since 2003, Ohio has phased out its corporate franchise tax, which had 39 tax expenditures a decade ago, and the estate tax, with 5.[43] The General Assembly also changed telephone company taxation in 2003, making local phone companies

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38 Schiller, "Multiplying Tax Breaks," op. cit., pp. 4-5

39 According to the input-out model used in a 2012 study, production of 27 films in Ohio generated $5.9 million in state and local taxes, compared to an estimated $28.6 million given out in credits, adjusted for inflation. See Clouse, Candi, Center for Economic Development, Maxine Goodman Levin College of Urban Affairs, Cleveland State University, "Analysis and Economic Impact of the Film Industry in Northeast Ohio and Ohio," March 2012, available at http://bit.ly/NhvPxk. Clouse also found that each dollar Ohio spends on the motion picture tax credit results in $1.20 to the economy, "making this a positive program for the state to pursue." However, the study does not appear to have taken into account the reduction in government spending (and consequent negative effects on the economy) that results from the tax credit, since Ohio must run a balanced budget. It also assumes that all 27 projects that received the tax credit during the study period it reviewed would not have been shot in Ohio but for the credit. For these reasons, the report may overstate the economic benefits for Ohio.

40 See, for instance, Tannenwald, Robert, "State Film Subsidies: Not Much Bang For Too Many Bucks," Center on Budget & Policy Priorities, Updated Dec.9, 2010, available at http://www.cbpp.org/cms/index.cfm?fa=view&id=3326.

41 Botomogno, Jean J., Ohio Legislative Service Commission, Fiscal Note & and Local Impact Statement, Am. Sub. H.B. 510 of the 129th G.A., As Enacted, Dec. 11, 2012, p. 6, available at http://www.lsc.state.oh.us/fiscal/fiscalnotes/129ga/hb0510en.pdf

42 See State of Ohio, Executive Budget, Fiscal Years 2004 and 2005, Book Two, Tax Expenditure Report, Prepared by the Department of Taxation and Submitted to the 125 General Assembly by Governor Bob Taft, February 2003. The taxation department made changes in how it estimates the value of tax expenditures between the two reports, so a direct comparison of the dollar totals is not meaningful.

43 Other taxes, notably the tangible personal property tax and the dealers in intangibles tax, also have been phased out, but these did not noticeably affect the tax expenditure report.

subject to the sales tax and corporate franchise tax but exempting them from the public utility excise tax (this eliminated 5 tax expenditures).[44]

Had no new tax breaks been created, it would have meant a meaningful decline in the total number with the disappearance of all of these tax expenditures. However, that's not what happened. Ten of the tax expenditures from the corporate franchise tax were transferred to be used against other state taxes. The Commercial Activity Tax, created in 2005 as a broad tax to replace the loophole-ridden franchise tax, has a total of 19 tax expenditures worth an estimated $427.3 million in FY14, compared to total estimated CAT receipts of $1.75 billion.[45] Legislators added 7 new sales-tax expenditures and 12 new income-tax expenditures over the past decade. (See list in Appendix 2.) Leaving aside cases where tax expenditures were repealed and replaced with something similar, or originally approved for just a limited time, the General Assembly eliminated only two individual tax expenditures over the past decade:

- The sales-tax exemption for motor vehicles used exclusively for a vanpool ridesharing agreement when the vendor is selling or leasing the vehicle under a contract with the Ohio Department of Transportation. This exemption, whose value was deemed "minimal" or less than $1 million in the 2003 tax expenditure report, was one of a dozen sales-tax "special interest carve-outs" that Gov. Bob Taft sought to repeal in his biennial budget proposal that year. Only this one was stricken from the Ohio Revised Code.[46]
- The sales-tax exemption for investment coins and metal bullion. This is sometimes known as the Noe amendment because coin dealer Tom Noe, convicted in the Coingate scandal for engaging in a pattern of corruption in his management of Ohio's $50 million rare-coin fund investment with the Bureau of Workers' Compensation, helped win its approval in the General Assembly in 1989. The exemption was repealed in the 2005 biennial budget bill after the scandal.[47]

Clearly, the General Assembly has not made a serious effort to review individual tax expenditures over the past decade and determine if they are still needed.

Fast-growing tax expenditures

Among substantial tax expenditures that are expected to grow the most between FY12 and FY15 according to the Taxation Department are the historic preservation tax credit, used against the individual income tax and various financial institution taxes, and the job retention tax credit, used against the commercial activity tax. Five of the next nine fastest-growing tax expenditures are

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[44] Legislative Service Commission, Final Comparison Document, Amended Substitute House Bill 95, Main Operating Appropriations Bill, 125th General Assembly, Aug. 15, 2003, p.795, available at http://www.lsc.state.oh.us/fiscal/comparedoc125/comparedoc125_en.pdf

[45] Executive Budget for Fiscal Years 2014 and 2015, Section B, Revenue Estimates and Methodology, p. B-17, available at http://media.obm.ohio.gov/OBM/Budget/Documents/operating/fy-14-15/bluebook/budget/Section-B_14-15.pdf

[46] State of Ohio, Executive Budget, Fiscal Years 2004 and 2005, The Executive Budget Briefing Document for Governor Bob Taft's Budget. Taft also proposed eliminating the sales-tax exemptions for newpapers and magazine subscriptions, and sought to cut in half the exemption on the value of trade-ins on new cars, watercraft and outboard motors. He failed with those proposals. For proposal details, see Legislative Service Commission, Bill Analysis, HB 95 (As Introduced), at http://www.lsc.state.oh.us/analyses125/h0095-i-125.pdf pp.305-6

[47] House Bill 26 in the current session would reauthorize an exemption for investment metal bullion and investment coins. House Bill 26, available at http://www.legislature.state.oh.us/bills.cfm?ID=130_HB_26

health-care related. Table 4 lists the 16 tax expenditures that are expected to grow by the greatest relative amount between FY12 and FY15, and are estimated to be worth at least $10 million in FY15.

Table 4

Fastest-growing tax expenditures between FY12 and FY15, worth at least $10 million in FY15 (in millions of dollars)

Type of tax against which exemption is taken	Tax expenditure description	FY12	FY13	FY14	FY15	Growth FY12-15*
Individual Income	Historic preservation tax credit	$27.0	$30.1	$60.6	$77.8	188.1%
Commercial Activity	Job retention tax credit	$8.3	$12.6	$12.9	$13.2	59.0%
Insurance Premium	Deduction for premiums from qualified small business alliances	$21.7	$26.0	$29.0	$34.0	56.7%
Individual Income	Exemption for active-duty military income	$22.9	$25.2	$28.4	$31.3	36.7%
Individual Income	Deduction for taxpayers not eligible for employer medical plans	$19.5	$20.6	$22.2	$24.6	26.2%
Sales and Use	Prescription drugs and selected medical supplies	$414.6	$436.2	$482.9	$516.7	24.6%
Individual Income	Resident credit for income taxed by another state	$135.3	$144.2	$153.8	$163.9	21.1%
Individual Income	Pre-1972 trust exemption	$9.6	$10.3	$11.1	$11.6	20.8%
Individual Income	Deduction for long-term care insurance premiums	$14.5	$15.2	$16.4	$17.2	18.6%
Commercial Activity	Credit for increased research and development	$9.4	$9.9	$10.5	$11.1	18.1%
Sales and Use	Artificial limbs, prostheses and other medical equipment	$25.8	$27.2	$28.7	$30.4	17.8%
Sales and Use	Tangible personal property used in agriculture or mining	$272.1	$289.3	$316.7	$320.5	17.8%
Sales and Use	Sales by churches and certain types of non-profit organizations	$31.9	$33.6	$35.5	$37.5	17.6%
Sales and Use	Property used in highway transportation for hire	$37.0	$40.0	$42.3	$43.2	16.8%
Sales and Use	Sales of tangible personal property & services to electricity providers	$399.8	$420.3	$441.9	$464.6	16.2%

Source: Ohio Department of Taxation. *Estimated

The last biennial budget extended in perpetuity, from June 30, 2011, the 25 percent credit for expenses to rehabilitate historic buildings, and allowed $60 million in such credits per year against the personal income tax, the corporate franchise tax, or the dealers in intangibles tax (these last two taxes are being phased out, so it will then be available against the new Financial Institutions Tax). The budget required a cost-benefit analysis of the project as part of the approval process. According to the 2012 annual report, a total of $327 million in tax credits has been approved for 156 projects to rehabilitate 229 buildings for a total investment of $2 billion, including federal tax credits.[48]

The job retention tax credit has not grown as much as was expected in the previous tax expenditure report. This may be in part because some large projects awarded such credits either have not gone forward (American Greetings, Diebold) or have only just been completed (Goodyear Tire & Rubber, Eaton) and only now will be eligible for such credits, which are based on the earnings of employees. While not as large as earlier expected, its projected growth between FY12 and FY15 still ranks second among all those tax expenditures estimated at $10 million or more in FY15.

In its 2009 report, the Taxation Department broke out tax expenditures by broad type. It discontinued doing so, but Policy Matters Ohio has used the same categories earlier employed by the department to provide such a breakdown. Business is the biggest beneficiary of Ohio's tax expenditures. Overall, 76 of the tax expenditures, accounting for just over half of the total value in FY14 or $4.0 billion, go for business assistance and economic development. Another 13, valued at $878 million in FY14, are assistance to public and nonprofit organizations. Fourteen expenditures amounting to $696 million are health or education-related assistance to individuals. And 26 tax expenditures totaling $2.1 billion are other financial assistance to individuals. Thus, overall, individuals are to receive 40 tax expenditures estimated at $2.8 billion in FY14.

Tax expenditures get more public attention than they used to. The Ohio Chamber of Commerce repeatedly has urged a review; together with the Metro Chambers of Commerce of Ohio, it again called for a review in the December 2012 update of its priorities for the state, Redesigning Ohio.[49] Two years ago, urged on by three organizations of disparate views on other issues, the state Senate included the creation of a permanent review committee in the budget, but it was excised by the conference committee and did not make it into the final budget document.[50] Since then, committees in both houses have held hearings on tax expenditures. Rep. John Adams, R-Sidney, who chaired the special House committee that heard testimony in five cities across the state in 2011 on tax expenditures and other tax issues, put out his own report afterward, in which he stated:

> "Tax Expenditures are both poor policy and poor concept, and there was near unanimity that such expenditures should be reviewed both for permanent validity and also on an ongoing basis, e.g., being subjected to performance audits and periodic renewal. The Chair agrees that expenditures should be subject to review each two years, on a rotating basis, during off budget years, so that the results are available in budget negotiations. The House Ways & Means Committee should establish a standing subcommittee to review tax expenditures and issue a report to the House."[51]

Bills have been introduced by legislators on both sides of the aisle that would require a regular review of all of them: House Bill 24 by Rep. Terry Boose, R-Norwalk, and House Bill 81, by Reps. Mike

[48] Ohio Development Services Agency, Ohio Historic Preservation Tax Credit Program, 2012 Annual Report, p. 15, available at http://development.ohio.gov/files/reports/2012OHPTCAnnualReport.pdf
[49] Ohio Chamber of Commerce and Metro Chambers of Commerce, Redesigning Ohio, Update: 2012, available at http://www.columbus.org/www/dcms/files/pdf/reports/redesigning-ohio-120712-final.pdf.
[50] Backers included the Buckeye Institute, the Center for Community Solutions and Greater Ohio Policy Center.
[51] Ohio House of Representatives, Legislative Study Committee on Ohio's Tax Structure, Chairman's Report, State Representative John Adams, April 13, 2012, p. 6

Foley, D-Cleveland, and Denise Driehaus, D-Cincinnati (The bills differ on certain points, such as how often: HB 24 calls for a review every eight years, while HB 81 would require one every two years). Rep. Boose delivered sponsor testimony on HB 24 before the House Ways & Means Committee on June 12. "Allowing poorly performing tax expenditures to exist in perpetuity is not sound tax policy," he noted.[52] Members of the Senate also have shown interest in possible review of tax expenditures.[53] However, no bill has moved close to approval yet.

To be more than a review that sits on a shelf, these legislative efforts need to add automatic sunsets, so that new and existing tax expenditures expire unless they are explicitly renewed. This would make the review process meaningful.

Ohio's tax expenditure report provides a beginning point for analysis. It is time for the General Assembly to scrutinize spending through the tax code as it does other state expenditures.

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[52] Rep. Terry Boose, Sponsor Testimony – House Bill 24, House Ways & Means Committee, June 12, 2013
[53] An attempt by Sen. Charleta Tavares to amend the current Senate budget bill to require a biennial report by the tax commissioner on tax incentives given to businesses was tabled, however. See Senate Journal, Thursday, June 6, 2013, pp. 584-6.

Appendix 1

In addition to those cited in the text of the report, the House and Senate budget bills would create or expand a number of other tax expenditures at both the state and local level. Only those that affect state revenue will be captured in future tax expenditure reports. The following describes many of these changes not already cited in the report.

The House budget bill would create an income tax deduction for retirement pay related to service in the Commissioned Corps of the National Oceanic and Atmospheric Administration (NOAA) and the Commissioned Corps of the Public Health Service (PHS). The LSC estimates the annual revenue loss to the state's General Revenue Fund at $235,000 each year. It also would extend by five years the deadline for owners of a qualified energy project to submit a property tax application to qualify for an exemption. This tax break against tax that utilities pay was implemented to encourage renewable energy generation projects. Already extended by two years in the last biennial budget, this further extends the deadline.[54]

For its part, the Senate retained the above changes in the House version, while creating some new exemptions and expanding others currently in the tax code. The Senate bill has provisions for:
A new sales tax break for goods and services used in aerospace vehicle research and development. The Legislative Service Commission says the revenue loss from this tax break, which is identical to one Gov. Kasich vetoed last year, is "potentially sizable."
Expansion of an existing tax break for purchases of computer data center equipment. Among other things, a taxpayer would only need to maintain an annual payroll at the data center of $1.5 million to qualify, instead of the existing $5 million.
Looser requirements for the New Markets Tax Credit program, which is supposed to support investments in low-income communities. An amendment would eliminate the requirement that a taxpayer receive a federal credit in order to qualify for a state credit.
Allowing the nonprofit corporation that owns the Toledo Mud Hens baseball team to avoid paying sales and use tax on its purchases. This provision is retroactive, and would wipe out a $553,389 assessment that the corporation owes to the state under a determination by the tax commissioner that the corporation is appealing. While this measure may deserve consideration, given the corporation's close relationship to Lucas County, this long-standing issue should not be resolved through an amendment added into the Senate budget bill two days before its approval.
Permitting a large company to qualify for a special Job Retention Tax Credit that does not meet current requirements of the program, as its principal place of business does not have to be in the same political subdivision as the investment.
Expanding a veterans' organization property tax exemption by increasing the income limit to $36,000 a year. As the LSC notes, current law exempts veterans' organization property unless the property is held for the production of rental or other income in excess of $10,000.

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[54] The Legislative Service Commission noted that local taxing jurisdictions "would receive less revenue from a given project, but in some cases, the revenue loss would be permissive." Such projects must also make service payments in lieu of taxes. See Legislative Service Commission, Comparison Document, H.B. 59 of the 130th General Assembly, Main Operating Appropriations Bill, As Passed by the Senate, June 7, 2013, pp. 648-9
http://www.lsc.state.oh.us/fiscal/comparedoc130/housepassed/tax.pdf. Other citations of the LSC in this appendix come from the same document.

Excluding workers' compensation insurance premium deposits from the domestic and foreign insurance company premiums tax base, under certain conditions. The LSC notes that a similar exclusion applies under continuing law to premiums deposits received for fire and inland marine insurance provided by such companies.

While some of these new or expanded breaks expenditures may be reasonable, others are not. Many were inserted in the budget very late in the process with little opportunity for close public review. This highlights the need for a tax expenditure review process encompassing new and existing exemptions, deductions and credits.

Appendix 2

New sales-tax and income-tax expenditures created between 2003 and 2013

Expenditure title	Revenue foregone, FY14/15 in millions of dollars	Year enacted
Sales and Use Tax		
Tangible personal property used in electronic publishing	$5.8/$6.0	2007
Property and services used in constructing a qualifying convention center	$1.5/Minimal	2010
$800 tax cap on qualified fractionally-owned aircraft	$1.0/$1.0	2003
Sales of materials and services for maintenance and repair of aircraft	$3.9/$4.0	2008
Flight simulators	$1.5/$1.5	2008
Equipment used in an eligible computer data center	Minimal/Minimal	2011
Sales of tangible personal property and services for maintenance and repair of qualified fractionally-owned aircraft	Minimal/Minimal	2003
Individual Income Tax		
Exemption for active-duty military income	$28.4/$31.3	2006
Exemption for pre-1972 trusts	$11.1/$11.6	2006
Exemption for military retirement income	$31.8/$33.0	2008
Deduction for health insurance coverage of qualifying adult children and other dependents	$3.7/$3.8	2009
Gambling loss deduction	$29.0/$29.0	2010
Deduction for Pell and Ohio College Opportunity grants	$3.0/$3.2	2011
Credit for taxpayers with income below $10,000	$9.5/$9.1	2005
Historic structure rehabilitation credit	$60.6/$77.8	2007
Motion picture tax credit	$19.3/$19.3	2009
Small business investment credit	$32.1/$20.2	2011
Deduction for organ donation expenses	Minimal/Minimal	2007
Credit for financial institution tax	Minimal/Minimal	2006

Source: Ohio Department of Taxation.