Tax breaks expand in state budget

By Zach Schiller

The new state budget adds significant new tax breaks to a tax code that already included 128 of them, worth more than $8 billion a year. At the same time, the General Assembly turned down a number of proposals to limit or repeal some existing tax exemptions and credits. This leaves the state with more tax breaks, totaling hundreds of millions of dollars a year, than the number when the year began. All but a small portion of this drain on revenue comes from an expansion of a tax break to business owners that is unlikely to generate significant new jobs, just as an earlier form of this deduction did not do so.

This report reviews new tax exemptions, credits and deductions approved as part of the budget. These breaks are known as "tax expenditures" because they are in effect another form of state spending, just spending done through the tax code. "Tax expenditures result in a loss of tax revenue to state government, thereby reducing the funds available for other government programs," the Ohio Department of Taxation noted in its 2013 tax expenditure report. "In essence, a tax expenditure has the same fiscal impact as a direct government expenditure."

Key findings

- The new state budget adds significant new tax breaks.
- The General Assembly enlarged a huge tax break for business owners that hasn't resulted in job gains.
- Other new exemptions include one specially tailored for companies in the same supply chain located in a New Albany business park, and a sales-tax break for meat processors that simply follow federal safety regulations.
- Legislators rejected proposals to require regular reviews of all tax breaks, but approved a one-time look at tax credits.

By far the largest new tax break in the budget is an expanded deduction for income from owners of passthrough entities – businesses such as partnerships and S Corporations whose income is taxed when it passes through to its owners. The Kasich administration has estimated the cost of that expansion in Fiscal Year 2017 at $558 million. The initial tax break, approved in 2013, did not produce overall job gains for the state, or a significant increase in employment at small businesses that were hiring employees for the first time. Business owners in general invest because there is a growing market for their products or services, not because they have more cash in their wallets. The average tax savings in 2014 from the deduction was about $1,050, with most claiming far less than that. As a result, it's not surprising that many business owners didn't bother claiming it at all—the taxation department spent $38,000 informing 130,000 such owners they were eligible for it but hadn't claimed it.

A number of others were approved. These included:

- A break on the state's main business tax for companies located in a suburban Columbus business park that are in the same supply chain making "a personal care, health, or beauty product or an aromatic product, including a candle." This carve-out, which is retroactive, favors such companies over similar ones elsewhere, including those in Ohio. The Office of Budget and Management (OBM) estimated the cost at $5 million this year and $3 million in Fiscal Year 2017.

- A sales-tax exemption covering sanitation services provided to meat slaughtering or processing operations simply because they are necessary to comply with federal meat safety regulations. Estimated FY 2017 cost: $2.6 million.
- A sales-tax exemption on rental vehicles that car dealers provide while repairing customer vehicles, if the cost of the rental vehicle is being reimbursed. Estimated cost: $2.7 million.
- Expansion of a local property tax break that covers fraternal organizations like the Masons and the Moose if the property is used to provide educational or health services on a nonprofit basis.

Other tax breaks for which OBM estimated costs included changes in how the tax paid on petroleum products is calculated for some fuels ($2.8 million in FY 2017) and in how certain credit associations that make loans to farmers are taxed ($400,000). The General Assembly also created other new tax breaks, such as a special reimbursement for a company that uses at least 7 million kilowatt hours a year of wind energy, and continued others that been set for expiration.

Not all of the changes in tax breaks were revenue losers. The General Assembly means-tested four income-tax credits, including the retirement income credit and the $50 senior credit, so that only those taxpayers with income below $100,000 are eligible for them. The narrowed eligibility for those two is expected to generate $28.4 million in FY 2017. The legislature also overhauled the state's rules for when sales or use tax must be collected, including a requirement that online retailers must collect tax if they use Ohio web sites to refer potential customers.

A missed opportunity: No review for tax breaks

Ohio still has no thorough, regular review of its tax expenditures, even though they would amount to a sizeable share of state tax revenues if they didn't exist. Legislators rejected language in the Senate budget bill that would have required such a review, the second time that has happened in four years, as well as Gov. Kasich's proposal for a one-time examination of tax expenditures. That represents a missed an opportunity to review the spending the General Assembly has authorized through the tax system.

However, in a positive step, it did provide for a review of the state's tax credits. And even as the budget was being approved, the House unanimously passed House Bill 9, which calls for a permanent committee to review all tax expenditures every eight years. While this bill could be strengthened, most notably by including automatic expiration for all existing tax expenditures, it deserves approval by the Senate. Just as legislators make decisions on state expenditures, all spending through the tax code also should be regularly reviewed. Instead, the General Assembly is approving additional tax expenditures.