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FOR RELEASE TUESDAY A.M., MAY 31, 2005
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Senate committee bill would cap Commercial Activity Tax, positioning it for inevitable decline

Ohio's proposed Commercial Activity Tax (CAT) on businesses, which in its House version already did not raise as much revenue as the taxes it is to replace, has been further weakened in the bill now pending before the Senate Finance Committee. This version of the bill permanently caps total revenue collected at a predetermined level after fiscal year 2010, so that it inevitably would decline in relation to the economy and as a share of state revenue. The Senate committee also added more credits and exemptions. These two sources of erosion will undercut CAT revenues significantly and belie the claim that it is a broad tax relatively free of special-interest provisions.

Previous versions of the budget bill had set different trigger mechanisms to adjust the rate of the CAT if it produced more or less revenue than had been estimated during various times between now and the 2010 fiscal year. By contrast, the Senate committee bill would automatically adjust the rate downward starting in fiscal year 2007 if revenues are above the targeted level. There is no automatic upward adjustment if revenues are below the target. While collections might bump up slightly in a given year before the rate was adjusted down again, after fiscal 2011 the amount would never rise appreciably from a fixed $1.594 billion.[1]

Setting up a tax at a fixed dollar amount means that over time, it will dwindle, as inflation reduces the value of the dollars collected. Policy Matters Ohio previously has described how when fully implemented the House version of the CAT would generate $600 million a year less than the two taxes it is designed to replace, the corporate franchise tax and the tangible personal property tax.[2] The Senate committee version does not change that, setting the stage for future state financial problems. And even while the Senate committee version would position the CAT for inevitable decline, it also reduces the revenue the tax would generate through the addition of new credits and exemptions.

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[1] The provision also cites specific amounts the CAT is intended to produce prior to fiscal year 2011, and calls for the tax commissioner to report to the General Assembly on the rate that would have been required to generate those amounts. The rate is to be revised downward if the tax generates more than the specified amounts.

[2] See *Strengthen, Don't Scrap, Ohio's Corporate Franchise Tax,* May 2005. http://www.policymattersohio.org/Ohio_CFT_Study_2005_05.htm This estimate is conservative, because it does not include $100 million in annual credits estimated by the Taft Administration or exemptions and credits added in the House version of the budget.

Previous versions of the budget bill permitted four types of credits to be taken against the CAT. Under the Senate Finance Committee bill, companies that have received any of these four existing credits against the corporate franchise tax would be able to use remaining amounts of those credits against the CAT beginning in 2008. These include the job creation tax credit, the research and development loan program credit, the credit for increased research and development expenses and the job retention tax credit. The Department of Taxation has previously estimated that these credits will cost a total of $36.6 million in FY06 and $52 million in FY07.[3] However, in the case of the job creation tax credit, this estimate only looked at what the state would gain if it stopped granting new credits July 1, 2005; it did not include the ongoing cost of existing credits that have already been granted. In tax year 2003, $34.3 million in such credits were claimed against the corporate franchise tax by nonfinancial companies.[4] It is not possible to predict the exact value of the amount of new credits that will be issued or claimed between now and 2008 compared to the amount that will expire. However, based on current information, the cost of permitting these credits to be taken against the CAT could be $70 million a year, or possibly as much as $86 million a year, while these credits last.[5]

The Senate Finance Committee version of the budget also would allow companies with accumulated operating losses of $50 million as of 2004 to write them off against the CAT tax beginning in 2010.[6] Such losses currently can be used to reduce payments of corporate franchise tax, but that will become impossible when the tax disappears. This new credit would only apply to a small number of very large companies, since few Ohio companies ever generate as much as $50 million in losses.

A major element in the rationale for replacing the corporate franchise tax with the Commercial Activity Tax is that the state should shift away from taxing income, which many companies have found ways to disguise or shift to other states, and instead tax gross receipts. By permitting companies to carry over credits for net operating losses to the CAT, the General Assembly would allow the very largest money losers to reduce their taxes, while profits of money-making companies would go untaxed.

The creation of this new tax break is one of a number of new credits and exemptions that would weaken the CAT even before it has been implemented. We should strengthen the corporate franchise tax, not eliminate it. If the CAT is enacted, it should produce at least as much revenue or more than that generated by the two taxes it is to replace.[7] New loopholes should not be created that undercut the new tax.

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[3] Ohio Department of Taxation, State of Ohio, Executive Budget, Fiscal Years 2007 and 2007. Book Two, Tax Expenditure Report. Submitted to the 126th General Assembly by Governor Bob Taft, February 2005. e

[4] Ohio Department of Taxation, Tax Data Series, Table CF – Credits, No. 54 (2004), August 04, 2004.

[5] Job creation tax credits generally last between five and ten years, according to the Ohio Department of Development, but may be granted for up to 15 years. See Ohio Job Creation Tax Credit Program, Program Guidelines and Application Process, http://www.odod.state.oh.us/EDD/jctc/GUIDELIN.pdf and Ohio Revised Code Section 122.17, http://www.odod.state.oh.us/EDD/jctc/JCTCHB95Section.pdf, accessed May 28, 2005. Job retention tax credits may be granted for up to 10 years. See Ohio Job Retention Tax Credit Program, http://www.odod.state.oh.us/EDD/JRTC.pdf, accessed May 28, 2005.

[6] The credit would be phased in over 10 years and would be limited to half of the taxpayer's CAT liability in any year, after deducting any other credits.

[7] Just replacing the revenue these taxes generate now would not make up for the decline that the corporate franchise tax, in particular, has sustained since the late 1990s. See *Strengthen, Don't Scrap, Ohio's Corporate Franchise Tax.*