

Tax & Budget

LOOPHOLES UPON LOOPHOLES: OHIO BUSINESS OWNERS CAN DOUBLE BENEFITS FROM SOME DEDUCTIONS

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Ohio business owners are able to get double tax benefits out of certain deductions to their state income tax. Hundreds of thousands of Ohioans may be able to take advantage of the tax law in this way. Though the exact value is difficult to calculate, it may be costing the state millions of dollars a year in revenue. This underlines that Ohio's income-tax break for business owners, often known as the LLC loophole, is itself riddled with special-interest loopholes unavailable to most Ohio taxpayers.

Policy Matters Ohio previously described how tens of thousands of affluent business owners who use the passthrough tax break are also claiming other deductions intended for those with lower incomes. Another loophole allows tax filers who own 20 percent of a business to deduct the compensation they are paid, distorting and extending a tax break that is supposed to cover business profits, not salaries.

The LLC loophole, first enacted in 2013 and expanded subsequently, exempts owners of partnerships, sole proprietorships, S Corporations and limited liability companies from state income tax on the first \$250,000 in earnings from such entities. (They are known as "passthrough entities" because their owners are taxed on profits from them under the individual income tax as they pass through to them.) Income over that amount is taxed at just 3 percent, lower than the nearly 5 percent rate they would otherwise pay.

Here's how some are able to get double tax benefits: Business owners can take tax deductions for health insurance, retirement contributions and half of self-employment tax, much as wage earners do. But in many instances, they may not need to subtract them when separately figuring out their business income. That means their business income is larger than it would otherwise be - and since business owners can deduct \$250,000 of such income when they figure how much will be taxable, it means they are effectively getting the benefit of these deductions twice.

When the LLC loophole was first enacted, such double tax benefits were not allowed. However, the practice has been available since legislators changed the law in 2015.

While it is now the second-largest Ohio tax break, costing more than \$1 billion a year, the LLC loophole has not produced economic results. It should be repealed. Short of that, it should be tightened up so business owners are unable to use it in ways that would dumbfound most Ohioans without such artifices available to them. That includes the double tax benefits highlighted in this report. The General Assembly should restore the limitation on this practice that existed until 2015. Then, the additional revenue will be available to make investments that Ohioans badly need.