Policy Matters Ohio

TESTIMONY
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Taxes

Testimony on House Bill 234 before the House Ways & Means Committee

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Chair Merrin, Ranking Member Sobecki and members of the House Ways & Means Committee, my name is Zach Schiller and I am research director of Policy Matters Ohio, a nonpartisan, nonprofit organization with the mission of creating a more vibrant, equitable, sustainable and inclusive Ohio. We urge you to oppose House Bill 234, which would repeal the Commercial Activity Tax (CAT). Instead of giving big corporations a major tax cut by simply repealing the CAT, most Ohioans would be better served if you retain the CAT and add a fair and effective tax on corporate profits. Even with the $2 billion in annual revenue that the CAT generates, the General Assembly has not paid for the Fair School Funding Plan or numerous other needs of Ohio, so repealing the tax is not sensible.

Who will benefit if this bill passes? The largest beneficiaries will be big corporations in Ohio. Eighty-two corporations with gross receipts of $1 billion or more were liable for a total of $503 million in CAT tax in Fiscal Year 2021, according to the taxation department, or about a quarter of the total. Some 1,107 firms with gross receipts between $100 million and $ 1 billion were liable for another $676 million, or 33% of the total.

Ohio's smallest businesses will gain little or nothing from the repeal of the CAT. Altogether, the taxation department reports, 105,565 companies or 64.9% of those liable for the tax had Ohio gross receipts ozf less than $1 million – meaning that they only have to pay $150 a year. In fact, these companies as a group actually got money back because of refundable credits. And businesses with less than $1 million in annual gross receipts don't have to pay the CAT. These businesses certainly number in the tens of thousands. So contrary to what one proponent witness said, eliminating the CAT will *not* be better for businesses of all sizes. The vast majority of small businesses in Ohio – and indeed, the vast majority of businesses, period – pay little or no CAT tax.

Moreover, according to 2019 data from the taxation department, 65% of active CAT taxpayers are passthrough businesses, owners of which don't have to pay any income tax on the first $250,000 of their income and a lower rate on rest.[1] So if HB 234 were to be approved, a large number of these owners would pay no income or general business tax. Business owners should pay taxes as ordinary Ohioans do to support the public services we and they depend on.

Overall, Ohio corporations have profited from significant tax cuts, and business taxes in Ohio are lower than in other states. Over the generation between the late 1970s and the first decade of the new century, the share of Ohio state and local taxes paid by business declined while that of individuals increased.[2] Then, in 2005, the General Assembly approved the phase-out of two major business taxes – the corporate franchise tax on nonfinancial companies and the tangible personal property tax – and their replacement with the new Commercial Activity Tax. The franchise tax was Ohio's corporate income tax, levied on profits or net worth. The tangible personal property tax was a local tax on machinery, equipment, furniture, fixtures and inventory – property not in land or buildings. Both had been relatively weak for years, which had contributed to the dwindling business share of state and local taxes.

The two-for-one swap reduced the revenue Ohio collects in business taxes. Based on CAT revenue in Fiscal Year 2021 of more than $2 billion and other much smaller taxes that replaced the franchise tax, the net loss in annual revenue is more than $1 billion. Authors of a 2007 review of the changes matter-of-factly noted that "…the net result was a large business tax cut."[3] As the Ohio Business Roundtable told the Ohio Supreme Court in a 2008 filing: "The new business tax system substantially lowered the overall tax burden on business."[4] These cuts are still reverberating through school districts and local governments, and reducing the amounts that levies across the state bring in for everything from children's services to community colleges.

According to a report by Ernst & Young, which compiles a study each year for the Council on State Taxation, a corporate lobbying group, Ohio's business taxes are well below the average in other states.[5] E&Y found that in Fiscal Year 2020, Ohio's combined state and local taxes on business were considerably lower than the national average as a share of private-sector gross state product (3.8% vs. 4.5%). Business taxes per employee were also much lower than the U.S. average ($4,700 vs. $6,500). In each case, only six states showed lower numbers than Ohio (two others were the same as Ohio in share of

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[1] Policy Matters Ohio calculation based on email from Gary Gudmundson, Ohio Department of Taxation, Jan.8, 2021. Data is as of Oct. 28, 2020.

[2] See Hill, Edward W., Ohio's Competitive Advantage: Manufacturing Productivity," Maxine Goodman Levin College of Urban Affairs, Cleveland State University, 2001, and Zach Schiller, "Ohio's State and Local Taxes: The Dwindling Business Share," Policy Matters Ohio, May 2004, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/ohios-state-and-local-taxes-the-dwindling-business-share

[3] Church, Frederick and Christopher Hall, "Ohio Tax Reform: Cuts and Repeals and that Darn CAT," State Tax Notes, Jan. 8, 2007, p. 34.

[4] Memorandum in Support of Jurisdiction of Amicus Curiae Ohio Business Roundtable, Ohio Grocers Association et. al. v. William W. Wilkins (Richard A. Levin), in his official capacity as Ohio Tax Commissioner, Ohio Supreme Court Case. No. 08-2018, Oct. 17, 2008, p2.

[5] Ernst & Young, "Total state and local business taxes, State-by-state estimates for FY20," October 2021, at https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/news/2021/ey-total-state-and-local-business-taxes.pdf

GSP). Clearly, if business taxes were a large factor in state economic performance, Ohio would be excelling. There is no need for Ohio to repeal the CAT "to be competitive."

In the mid-1970s, franchise tax accounted for 16% of taxes supporting the state's general operations.[6] In Fiscal Year 2021, the CAT and other taxes that replaced the franchise tax added up to less than half that share of the General Revenue Fund.[7] Slashing business taxes hasn't worked. Ohioans continue to have lower median incomes than people in other states.[8] Job growth was weak before the pandemic, and since February 2020, Ohio has not recovered as much of its job losses as the nation as a whole.[9] Four out of the ten most common jobs in the state pay so little that a worker with a family of three would be eligible for food aid.[10] Reducing taxes for business and the affluent, whose share of wealth nationally remained near a three-decade high before the pandemic hit, is not a prescription for economic growth and shared prosperity.[11]

The largest exemption to the CAT, worth $226.6 million this fiscal year, is the exclusion of the first $1 million in gross receipts from the tax. It's true that there are too many exemptions to the CAT tax – and the General Assembly can and should do something about that. You could start by limiting the exclusion for distribution center receipts, which is valued at $225.1 million this fiscal year. Governor Kasich attempted to do that. His budget chief, Tim Keen, outlined in testimony how this allows suppliers to huge drug distribution centers to legally avoid paying taxes.[12] This tax break, which has grown enormously and is expected to be the largest CAT exclusion next fiscal year, should be cut back. A much smaller one allows certain receipts from companies that are part of a supply chain in a New Albany business park to avoid the CAT—a special interest giveaway if there ever was one. Reining in these exemptions can and should be done without repealing the tax.

As you have heard from other witnesses, a major concern expressed about the CAT has been the pyramiding that can take place. However, as you've also heard, the CAT's low rate has moderated that issue.

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[6] Schiller, Zach, "Ohio's Vanishing Corporate Franchise Tax," Policy Matters Ohio, Oct. 15, 2002, p. 3, at https://www.policymattersohio.org/files/research/franchisetax.pdf

[7] Legislative Service Commission, Historical Revenues and Expenditures, GRF Revenue History, at http://www.lsc.ohio.gov/pages/reference/current/historicalrevandexpenditure.aspx

[8] U.S. Census Bureau, Historical Income Tables: Households, Table H-8, Median Household Income by State, at https://www.census.gov/data/tables/time-series/demo/income-poverty/historical-income-households.html

[9] U.S. Bureau of Labor Statistics, State and Metro Area Employment, Hours & Earnings, at https://www.bls.gov/sae/data/

[10] See Shields, Michael, "Still Working for Too Little in Ohio," Policy Matters Ohio, April 28, 2022, at https://www.policymattersohio.org/research-policy/fair-economy/work-wages/still-working-for-too-little-in-ohio

[11] Smialek, Jeanna, "Even as Americans grew richer, inequality persisted," The New York Times, Sept. 28, 2020, at https://www.nytimes.com/2020/09/28/business/economy/coronavirus-pandemic-income-inequality.html See also Mazerov, Michael, "Kansas Provides Compelling Evidence of Failure of "Supply Side" Tax Cuts, Center on Budget and Policy Priorities, Jan. 22, 2018, at https://www.cbpp.org/research/state-budget-and-tax/kansas-provides-compelling-evidence-of-failure-of-supply-side-tax-cuts regarding personal income tax cuts and "Cutting State Corporate Income Taxes Is Unlikely to Create Many Jobs," Center on Budget and Policy Priorities, Sept. 14, 2010, at https://www.cbpp.org/research/cutting-state-corporate-income-taxes-is-unlikely-to-create-many-jobs regarding corporate income tax cuts.

[12] See Schiller, Zach, "Tax Breaks Should Be Reined In," Policy Matters Ohio, May 4, 2017, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/tax-breaks-should-be-reined-in

The General Assembly has not fully funded the Fair School Funding Plan, which has the promise of providing fair funding to schools and creating an excellent public school in every ZIP code. You could help far more families access safe and quality child care so parents work. You could reduce the stiff cost of college tuition, and give county human service departments enough money to fully protect the many seniors in danger of abuse. You could add funding to the Housing Trust Fund to reduce homelessness. And you could fully fund the oversight of the Minority Health Strike Force Blueprint, making Ohioans healthier, especially Black and brown Ohioans, who face the worst health outcomes. These are just some of the needs that the General Assembly has not met even with the $2 billion a year that comes in from the CAT tax. And that does not take into account the hundreds of millions of dollars of CAT revenue used to reimburse school districts and local governments that would need to be replaced were the tax to be eliminated. All this indicates the imprudence of repealing it.

Ohio corporations pay a variety of taxes regardless of their profits. That includes more than $4 billion a year in real property tax. In fact, Ohio's old corporate income tax, the franchise tax, started out as a tax on net worth, and for decades required corporations to pay on their net worth if they had no income. Instead of repealing the CAT, you should add a corporate profits tax so that companies that make significant profits pay something on those gains.[13]

Ohio is one of just six states without a corporate income tax. Such a tax not only would provide revenue to pay for needs outlined earlier and others, it would make Ohio's tax system more fair. The most affluent Ohioans, the 1% making more than $456,000 a year, on average pay only a little over half as much of their income in state and local taxes as the fifth of Ohioans who make under $19,000.[14] Stock ownership is concentrated among white, upper-income households, so a corporate profits tax would go part of the way toward turning Ohio's upside-down tax system right side up and reversing its discriminatory racial effects. The General Assembly could institute a corporate profits tax keeping the same bottom thresholds the CAT has now, so that only companies with gross receipts of $1 million or more would be covered.

We urge that you retain the Commercial Activity Tax, cut special-interest breaks in the tax, and require that profitable companies pay a tax on their earnings. Thank you for the opportunity to testify.

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[13] See Schiller, Zach, "Ohio Needs a Corporate Profits Tax," Policy Matters Ohio, Jan. 12,2021, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/ohio-needs-a-corporate-profits-tax

[14] Patton, Wendy, "Ohio State and Local Taxes Hit Poor and Middle-Income Families the Hardest," Policy Matters Ohio, Oct. 17, 2018, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/ohio-state-and-local-taxes-hit-poor-and-middle-income-families-the-hardest. Based on 2015 income levels and includes nonelderly Ohio residents.