Policy Matters Ohio

POLICY BRIEF
JUNE 2019

Revenue & Budget

TAX BREAKS IN THE STATE BUDGET FOR 2020-21

What's in, what's axed, and what ought to be done

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EXECUTIVE SUMMARY

The governor's budget presented to the 133d General Assembly included little tax policy. The Ohio House of Representatives added numerous tax provisions in the budget bill, House Bill 166. Some tax breaks were scuttled, others added. As the Senate sets final priorities, we encourage it to concur with much of what the House chopped and eliminate even more. Policy Matters Ohio previously examined other provisions in the House bill that would limit the deduction for business income known as the LLC loophole while cutting income-tax rates and brackets. In this report, we look at a selection of tax provisions relating to special interest tax breaks; cleaning up and clarifying tax treatment of certain industries and taxpayers; addressing social needs with tax breaks; and both expansion of and addition to local tax breaks for corporations and developers.

Policy Matters Ohio agrees with a number of the provisions in the House bill that would clean up the tax code, while opposing others that would create or expand special interest breaks. Altogether, this would generate well over $100 million a year that could be used to invest in Ohio and Ohioans.

The governor's budget proposes and the House approved a new Opportunity Zone Investment income-tax credit that would give additional public resources to wealthy owners of capital gains who invest in census tracts designated for deep U.S. subsidy through the federal Opportunity Zone program. The $50 million the state will forgo each two-year period could be better used to help with home ownership and rehabilitation for low-income residents, better public transit and other direct investments that will create opportunity for those who live in these low-income census tracts.

In its budget bill, the House appropriately repealed a number of special interest tax breaks. These include the $40 million-a-year movie tax credit, which does not generate tax revenue to pay for itself; a sales-tax break for wealthy Ohioans who buy time shares in jet aircraft; and a sales-tax exemption for investment in coins and metal bullion, which was reinstated after an earlier repeal and vetoed by then-Governor Kasich, who said: "There is no reason to provide preferential treatment to one class of items and not others that could possibly increase in value, such as art, sports cards, or antiques."

The House bill also would ensure taxes are collected on a variety of goods and services, leveling the playing field for all sellers. These include:

- Collecting sales tax on the full price of hotel rooms sold by travel intermediaries like Priceline and Expedia;
- Ensuring that sales tax already due on online purchases is collected, in line with a U.S. Supreme Court decision last year. This would also extend to sales by Amazon and others of merchandise from others, just as other states are requiring;

- Changing the law to make it crystal clear that Uber and Lyft, which already are supposed to charge sales tax, will do so. Legislators should make sure, though, that terms in the bill don't wind up reducing the price on which tax is paid.

As state dollars for health and human services have been backfilled with federal funds and restricted by stingy budget policies, lawmakers have turned to spending through the tax code to address pressing social needs. The House budget bill would create three new tax credits or exemptions for abating lead hazards at old homes, for companies to hire formerly incarcerated people, and for child care centers that serve children from households that receive public assistance. While each of these is well-intentioned, they are too small, not well-targeted, and their goals would be better achieved through grant programs or other investments.

The House also would expand the manufacturing sales-tax exemption in two different ways, at an annual cost of $30 million. The Tax Expenditure Review Committee (TERC) was established to review Ohio's 134 tax breaks. Instead of such expansions, the General Assembly should appropriate funds to properly staff the TERC and refer proposals like these to that committee to ensure existing tax credits and exemptions are well understood and changes enhance efficiency and effectiveness.

The House bill also includes other provisions that should be scrapped. These include one that would exempt a portion of the value of land subdivided for residential development, but not developed, from the local property tax. This would shift taxes to other homeowners and businesses and could lower property tax revenues available to schools and other jurisdictions. Another provision would allow out-of-state business owners to avoid having state income tax withheld by Ohio companies they own if they agree to pay it themselves directly. This would impose new administrative burdens on the taxation department and could lead to a loss of revenue.

The Senate should avoid creating new special interest tax breaks while concurring with the House in closing loopholes. The additional funds should be invested in Ohio's pressing needs. For example:

- The $40 million the state would gain from closing the movie tax credit could be used in grants for lead abatement in targeted urban and rural neighborhoods throughout the state.
- The $5 million forgone to the tax break for investors in coins and bullion could be used to boost operating revenues for the Ohio Civil Rights Commission to restore education and outreach services, expand investigative staff and offer a hotline for reporting wage theft.
- The $50 million gained from collection of online sales tax could replenish the housing trust fund, increase food aid for low-income families and expand adult protective services to safeguard the estimated 105,000 Ohioans struggling with elder abuse across the state.
- The $20 million the state would save through improving taxation of hotel intermediaries could be used to replenish the municipal distribution of the local government fund, eliminated completely in the current budget, easing the strain on hard-pressed local budgets.

This is just a fraction of the needs for investment, but illustrates how elimination of special interest tax breaks can provide public services that can rebuild lives and communities, protect children and elderly, and restore services that thousands need and depend on.

INTRODUCTION

The governor's budget presented to the 133d General Assembly included little tax policy, but the Ohio House of Representatives added many provisions in their version of the state budget bill, House Bill 166. Among other changes, some tax breaks were scuttled, others added. As the Senate sets final priorities, we encourage it to concur with many of the tax breaks the House chopped and eliminate even more.[1] Policy Matters Ohio previously has examined other tax provisions in the House budget bill that would limit the deduction for business income known as the LLC loophole while cutting income-tax rates and brackets.[2] While reining in the LLC loophole is appropriate, there are better uses for the revenue than rate and bracket cuts. In this report, we look at a selection of tax provisions relating to special interest tax breaks; cleaning up and clarifying tax treatment of certain industries and taxpayers; addressing social needs with tax breaks; and both expansion of and addition to local tax breaks for corporations and developers.

Policy Matters Ohio agrees with a number of the provisions in the House bill that would clean up the tax code, while opposing others that would create or expand special interest breaks. Altogether, though the exact amount is unclear, this would generate well over $100 million a year that could be used to invest in Ohio and Ohioans.[3]

SPECIAL INTEREST TAX BREAKS PROPOSED AND REPEALED

Opportunity Zone tax break (Annual loss: $25 million[4] to the state): The governor's budget proposes a new Opportunity Zone Investment tax credit (against the personal income tax) equal to 10% of an investment in an Opportunity Zone investment fund. Capped at $50 million per biennium and $1 million per investor, this would be a nonrefundable tax credit; changes by the House of Representatives make it transferrable.

This tax break would give additional public resources to wealthy owners of capital gains who invest in census tracts designated for deep U.S. subsidy through the federal Opportunity Zone program. Development in the designated Opportunity Zones, which are low-income census tracts, could boost property values and harm low-income residents by driving up rents and driving out existing businesses. They also may well go toward development in areas where such subsidies aren't needed. The $50 million the state will forgo each two-year period could be better used to help with home ownership and rehabilitation for low-income residents of the tract; better public transit to give residents more access to services, jobs and broader opportunity; career connections with anchor institutions expanding in an Opportunity Zone; as a grant program for companies who hire ex-offenders who are residents of an Opportunity Zone or for child care centers serving low-income residents of an Opportunity Zone.[5]

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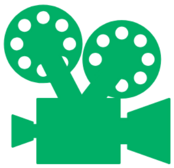
[1] Patton, Wendy and Schiller, Zach, "Tax Breaks to Tighten, Trim or Trash," Policy Matters Ohio, March 2019 at https://bit.ly/2Mvejhl
[2] Schiller, Zach and Wendy Patton, "The Good and Bad in the House Tax Plan," Policy Matters Ohio, May 15, 2019, at https://bit.ly/2wFDwLA and "Closing the LLC Loophole," May 29, 2019, at https://bit.ly/31mWxRd
[3] In some instances, repealing an existing tax break won't necessarily generate as much in additional revenue as it may be valued at for those now receiving it. However, the overall amount generated by changes proposed here would exceed $100 million.
[4] This estimate and others in this report are yearly figures, usually for Fiscal Year 2021. Unless otherwise noted, numbers are from the Legislative Service Commission Comparative Document at https://bit.ly/2IvdpMC and the Department of Taxation's 2020-2021 Tax Expenditure Report at https://bit.ly/2Kybz0g
[5] Patton, Wendy, "Testimony before the Senate Ways and Means Committee," Policy Matters Ohio, March 5, 2019 at https://bit.ly/2ZhwwAN



Motion picture tax credit (Annual gain: $40 million for the state): The House repealed the refundable, transferrable tax credit for motion picture production expenditures, which pays for 30% of eligible expenditures of film production activity. Across the nation movie tax credits, used by states to compete for film production activity, do not yield enough state tax dollars to pay for themselves. Ohio's is no different: A Cleveland State University study found that between 2011 and 2015 the state spent $32 million on the tax credit, but got back just $6.7 million in state and local tax revenue. California and New York dominate the market for film production with gigantic tax break programs. Other states, including Ohio, get a tiny piece of the action.[6] The Senate should concur with the House and repeal this tax break.

Fractional ownership in private jets (Gain: $13.6 million for the state): The House repealed a number of tax credits for the aircraft industry, including a sales tax break that places an $800 cap on sales of shares of qualified fractionally owned aircraft. A wealthy buyer who spends $275,000 for 1/16th of the flight time of a private jet saves thousands of dollars in sales tax. The sales tax break goes only to some of the wealthiest residents, and it adds up to millions the state will forgo.

Precious metal and coins (Gain: $5.6 million for the state): The House repealed the sales tax exemption for sales of investment bullion and coins. If the Senate concurs, this will be the second time this loophole has been closed. It was first closed in 2005 following a scandal ("Coingate") and reinstated in 2016 after several tries. Governor Kasich vetoed a 2013 attempt, stating: "There is no reason to provide preferential treatment to one class of items and not others that could possibly increase in value, such as art, sports cards, or antiques. Therefore, this veto is in the public interest."[7] He was right; the Senate should concur with the House and repeal this exemption.

CLEANING UP AND CLARIFYING THE TAX CODE

Hotel intermediaries (Gain: $20 million for the state, $13 million for locals): This loophole, closed by the House, was not enacted by lawmakers but emerged as online intermediaries changed the booking business in the travel industry. Companies like Priceline and Expedia pay less in taxes to state and local governments for your room booking than the hotel itself would if you had booked directly. Instead of paying state sales and local lodging taxes based on the final price of the room, they typically only pay taxes on the discounted rate they pay the hotel for the room. Savings do not flow through to consumers.[8] The House bill would eliminate the preferential treatment these companies receive. The Legislative Service Commission (LSC) has estimated this would generate several million dollars in FY 2020 and up to $21 million in FY 2021 from the state sales tax, along with up to $4.9 million in local piggyback sales taxes and up to $8 million in lodging taxes in FY 2021.

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[6] Pennsylvania Film Production Tax Credit: An Evaluation of Program Performance, Independent Fiscal Office, January 2019 (https://bit.ly/31fXAIT), cited in Patton, Wendy, "Budget Bite: Motion Picture Tax Credit," May 31, 2019 at https://bit.ly/2WoGJtj
[7] Schiller, Zach: "Testimony: No justification for tax break on coin sales," Policy Matters Ohio, April 26, 2016 at https://bit.ly/2Wwcplq
[8] "Lawmakers should close loopholes for travel sites," July 13, 2015 at https://bit.ly/2KyJO7I

Collecting sales tax for online purchases (Gain: $50 million to state, $12.2 million to locals): Last June, the U.S. Supreme Court ruled[9] that states could require online and catalogue retailers without a physical presence in a state to collect the sales tax. (The tax had always been due, but such retailers weren't required to collect it.) Though Ohio had taken some earlier steps to compel major online retailers to collect the tax, it hasn't yet moved to implement the Supreme Court decision. The House budget bill does just that, including the standards approved by the court, more than $100,000 in annual sales or 200 or more separate transactions. The bill also includes a requirement that online sellers that hawk others' merchandise, like Amazon and eBay, are "marketplace facilitators" that must collect on behalf of these other sellers. Such language has been included by the District of Columbia and 29 states.[10] This is sensible since it levels the playing field between retailers. The LSC has estimated that by FY 2021, these provisions would generate $50 million a year in state sales tax and another $12.2 million for counties and transit authorities. "Revenue gains may by higher depending on the behavioral response of remotes sellers and marketplace facilitators," LSC said. The taxation department has noted that many out-of-state sellers have moved to begin collecting tax, and state Budget Director Kimberly Murnieks testified April 24 that "tax collections from out-of-state sellers have grown by double digits in the July through February period." Still, the LSC figures may be low.[11]

Sales tax on transportation network companies such as Uber and Lyft (Gain: Between $17.7 million and $26.6 million to the state, $4.3 million to $6.5 million to locals): Existing state law requires that sales tax be collected on "transportation of persons by motor vehicle or aircraft" within the state. Thus, Uber and Lyft ought to be collecting Ohio sales tax now. In fact, the state has tried to get Uber to pay up.[12] In a case pending before the Board of Tax Appeals, the state has sought for Uber to pay $1.35 million for the third quarter of 2015 alone, plus interest and penalties. Uber has appealed the case, claiming it provides access to an app and does not provide transportation services. Hearings first set last year have been delayed till at least the end of this year. The budget bill makes crystal clear that that Uber and Lyft, "and not the transportation network company driver," is the vendor. While this additional language shouldn't be necessary given existing state law, if it leads to the tax being collected, it's a positive. There is no reason Uber and Lyft should get special treatment compared to taxis. Tax Commissioner Jeff McClain testified that changes in the definition of "price" in the House bill would result in a tax cut for the industry and would violate the Streamlined Sales and Use Tax Agreement, a compact that harmonizes state sales taxes.[13] Legislators should ensure neither of those things happen, and make changes accordingly.

[9] Schiller, Zach, "U.S. Supreme Court overturns outdated sales-tax rule," Policy Matters Ohio, July 18, 2018 at https://bit.ly/2wK92li
[10] National Conference of State Legislatures, "Remote Sales Tax Collection," June 3, 2019, at http://bit.ly/2Xy93Le
[11] Testimony of Kimberly Murnieks to the House Finance Committee, April 24, 2019 at https://bit.ly/2MydNzp
[12] Schiller, Zach, "State to Uber: Pay Up," Policy Matters Ohio, February 14, 2018 at https://bit.ly/2XyJNVb
[13] McClain, Jeff, Tax Commissioner, Testimony to the Senate Finance Committee, May 23, 2019, at http://bit.ly/2WrD8dW

Passthrough entity tax: The state requires partnerships and other passthrough entities to withhold state income tax on out-of-state owners through what's called the passthrough entity tax. The House bill would change the rate of that tax to 3%, the current rate paid by business owners on income over $250,000, and would also allow individuals to agree that they are covered by the state income tax and will pay the tax themselves instead of having it withheld through the company they own. These changes are not likely to be helpful. Changing the rate to 3% at the same time as the bill would eliminate the 3% rate for business income over $250,000 appears to be a mistake and does not make sense. It should be stricken from the bill so the rate paid by the passthrough entity is the same as the taxpayer ultimately must pay. Allowing these out-of-state residents to opt to pay individually also undercuts the basic point of the passthrough entity tax; it's easier for the state to keep track of the Ohio companies than what could be tens of thousands of out of state individuals. The General Assembly should keep that part of the tax as it is, while syncing up the rate under this tax mechanism with whatever income-tax rates the bill winds up with.

The LSC says these provisions in the House bill may result in a decline in tax revenue, possibly ranging to millions of dollars. Other estimates have varied widely.

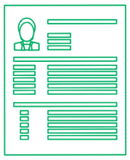
SOCIAL NEEDS

As state dollars for health and human services have been backfilled with federal funds and restricted by stingy budget policies, lawmakers have turned to spending through the tax code to address pressing social needs. The Earned Income Tax Credit for working families is an example of a broadly successful use of the tax code to help low-income families. However, the tax code is meant to raise revenues to support investments; it is not a means of investment itself when conventional budget expenditures are cut off. While the social purpose tax credits in House Bill 166 are well intentioned, they are too small and not well targeted.

Lead abatement tax credit (Loss: $5 million to the state): The budget includes a new nonrefundable tax credit for abating lead hazards in housing built before 1978. Governor DeWine proposed the new credit in his budget, and the House increased it from $5 million over the biennium to $5 million a year. Unused credits can be carried forward for seven years. The need for lead abatement is great,[14] but a problem of this size needs a dedicated fund through direct state support. Senator Matt Dolan will ask for $2.5 million a year for an initiative in Cleveland, where the level of lead poisoning among children is four times the national average.[15] The tax credit proposed in the budget is helpful, but far from sufficient. Lead abatement is needed in thousands of Ohio homes to prevent children from being poisoned, but also in toxic homes where children already have been tested with high lead levels. The bill does not target these homes or communities where the need for lead abatement is concentrated. Like most tax credits, it is a scattershot use of limited state resources.

[14] Dissell, Rachel and Zeltner, Brie, "Toxic Neglect: Cleveland's lead poisoning legacy - Curing Cleveland's legacy of lead poisoning, Cleveland.com at https://bit.ly/2Wo3760

[15] Dissell, Rachel and Zeltner, Brie, "Cleveland City Council legislation aims for 'systemic change' in approach to lead poisoning, Cleveland.com, updated June 3, 219 at https://bit.ly/2wK2HMU



Income tax credit for hiring formerly incarcerated people (Loss: $3 million to the state): This tax break piggybacks the federal work opportunity tax credit (WOTC) for employing people who have been convicted of a crime. (The maximum credit under the federal WOTC is $2,400.) The state credit equals 30% of the taxpayer's federal WOTC, and any unclaimed balance may be carried forward for seven years.

Ensuring ex-felons move into productive jobs should be an important part of the corrections process, but this tax credit is piggy-backed on a federal credit that has been found to benefit large firms in high turnover, low-wage industries that received the tax credit for hiring workers whom they would have hired in the absence of the credit. Studies found unintended consequences included stigma, displacement of existing workers and churning of workforce.[16] The money for this credit would be better used for employment training, job placement and even directly subsidized job programs for returning citizens.

Property tax break for child care centers (Unknown impact on schools and local government): This provision authorizes a partial real property tax exemption for child care centers that serve children from households that receive public assistance. The size of the tax break depends on the share of children served from households receiving public assistance and only goes to centers that are licensed by the Ohio Department of Job and Family Services and meet other qualifications.

It is unclear how many centers would be able to take advantage of this partial tax break. There is no evaluation of the number of child care centers that might benefit from this tax break, and no estimate of cost. In fact, few may benefit at all: Many child care centers are not-for-profits that may pay no property tax.

There is a pressing need for more investment in Ohio's child care programs. It is harder to qualify for public child care assistance in Ohio than in 48 other states. Most of the funding for Ohio's child care program comes from the federal government, with far too little state investment. Lawmakers urgently need to find a sufficient, sustainable funding source—and at the same time expand eligibility so that more low-income families are eligible.[17] Tax breaks like this don't provide a solution for the real problem.

EXPANDING EXISTING TAX BREAKS

The Tax Expenditure Review Committee (TERC) was established to review Ohio's 134 tax breaks. Instead of expanding tax breaks as described below,[18] the General Assembly should appropriate funds to properly staff the TERC and refer proposals like these to that committee

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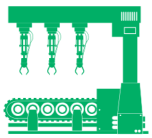
16 Lower-Basch, Elizabeth, "Big ideas for Job Creation," CLASP, November, 2011 at https://bit.ly/2KbCWOz
17 Petrik, Will, "Budget bite: Public child care and early education, Policy Matters Ohio, April 29, 2019 at https://bit.ly/2IsrRFf
18 The Tax Expenditure Review Committee included the manufacturing tax break in the review conduced in the spring of 2018. There was no staff funded to review the tax breaks considered, although testimony and background information on each tax break by the Ohio Legislative Service Commission were considered. See Patton, Wendy and Schiller, Zach, "Weak review: Tax Expenditure Review Committee should balance tax breaks against Ohio's needs," Policy Matters Ohio, June 4, 2018 at https://bit.ly/2rcxklf.

to ensure existing tax credits and exemptions are well understood and changes enhance efficiency and effectiveness. Policy Matters Ohio has recommended an appropriation of $530,000 a year, the same as recommended in House Bill 166 for the Joint Medicaid Oversight Committee in 2021.[19]



Food processing manufacturing equipment tax break (Loss: $2.2 million to the state, $0.5 million to locals): This provision would expand one component of the manufacturing sales tax exemption, which exists to prevent the “pyramiding” of sales tax cost in manufactured goods, which may contain many different purchased components. It would extend the tax break that currently exists for equipment and supplies used to clean equipment used in the production or processing of dairy products ORC 5739.011(B)(13) to all industries that produce or process any sort of food for human consumption.

Cleaning supplies used in manufacturing (Loss: $27.7 million to the state, $6.8 million to locals): The House proposal also includes a much bigger expansion of the manufacturing sales tax exemption to cleaning in all manufacturing (equipment, supplies and building and janitorial services used to clean or maintain any tangible personal property, machinery, or equipment that is used primarily in a continuous manufacturing operation).

ALLOWING LOCALS TO GIVE MORE

Tax increment financing (Loss to locals: Unknown): Authorizes municipalities, townships, and counties, under certain conditions, to extend the term of a tax increment financing (TIF) property tax exemption by up to 30 additional years. TIFs exempt tax revenue on a specified percentage, up to 100%, of the increase in real property value, and redirect service payments equal in amount to taxes that would otherwise be due into a special fund usually used to pay for new infrastructure. To be eligible for the proposed extension, the TIF (1) must generate $1.5 million in service payments in the immediately preceding year, (2) must not generate more than $1.5 million in any other preceding year (this requirement only applies after 2020), and (3) the property owner must compensate the school district fully for its property tax losses. This is a special interest provision. The LSC is unable to quantify the impact of this proposed tax break on local government finances. Current law limits the term of TIF tax exemptions to 30 years; extending it beyond then should be viewed with skepticism. The sponsor should make clear what projects and owners will benefit to allow a complete understanding of it and whether it should be considered. Until then, it should be denied.

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[19] Patton, Wendy, Testimony to the Senate Finance Committee on House Bill 166, May 23, 2019 at http://bit.ly/2WrD8dW

Tax break for undeveloped but subdivided residential land (Loss to locals: unknown but could run into the low millions of dollars): The House budget bill would exempt a portion of the value of land subdivided for residential development, but not developed, from the local property tax. It would exempt value in excess of the fair market value of the property from which that land was subdivided, apportioned according to the relative value of each subdivided parcel, for at least three but no more than five years.

The proposal would make property taxes less fair, shifting the share of school and local government levies from the frozen properties to other homeowners and businesses. It could also lower property tax revenues available to schools as well as emergency service, parks and recreation, library and health and human service levies in urban and suburban places where residential development is concentrated. According to the LSC Comparative Document, the revenue loss could amount to "the low millions of dollars" statewide. The majority of this loss will be sustained by school districts.

This tax subsidy is inappropriate, given the state's struggle to fund Ohio's current school funding formula, let alone mitigate the decades-old problem of inequality in school funding between rich and poor districts that make Ohio's approach to school funding unconstitutional.

CONCLUSION

The Senate should avoid creating new special interest tax breaks while concurring with the House in closing tax loopholes. The additional funds should be used to invest in the pressing needs of Ohio and Ohioans. For example:

- The $40 million the state would gain from closing the movie tax credit could be used in grants for lead abatement in targeted urban and rural neighborhoods throughout the state.
- The $5 million forgone to the tax break for investors in coins and bullion could be used to boost operating revenues for the Ohio Civil Rights Commission to restore education and outreach services, expand investigative staff and offer a hotline for reporting wage theft (as proposed in House Bill 221).
- The $50 million gained from collection of online sales tax could replenish the housing trust fund, increase food aid for low-income families and expand adult protective services to safeguard the estimated 105,000 Ohioans struggling with elder abuse across the state.
- The $20 million the state would save through improving taxation of hotel intermediaries could be used to replenish the municipal distribution of the local government fund, eliminated completely in the current budget, easing the strain on hard-pressed local budgets.

This is just a fraction of the needs for investment, but illustrates how elimination of special interest tax breaks can provide public services that can rebuild lives and communities, protect children and elderly, and restore services that thousands need and depend on.