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Budget Bite

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The budget proposed by the Ohio Senate majority contains cuts in everything from aid to local governments to hospitals and transit agencies. Yet it also includes a number of new tax breaks that together will cost the state, school districts and local governments tens of millions of dollars. While the effect of some is postponed beyond the two-year budget, these breaks will further reduce investments Ohio needs to make in education and critical services now and in the future.

Among the proposed tax breaks is a doubling, to $4,000 a year, of the income-tax deduction that taxpayers can claim from college or disabilities savings accounts. The Legislative Service Commission estimates the cost at $6.9 million a year. If the General Assembly is interested in making college more affordable, it should put the money into the Ohio College Opportunity Grant, the state's need-based aid program, and basic support to colleges to underwrite classroom instruction. Tax advantages from college savings accounts accrue mostly to more affluent taxpayers, and are unlikely to significantly increase college attendance for low-income Ohioans.

Another provision of the bill would extend for another year the three-day sales-tax holiday that covers clothing, school supplies and certain instructional materials, within certain price limits. The LSC estimates the cost to the state, local governments and libraries at $15.2 million in the 2019 fiscal year, while counties and transit authorities would lose $3.7 million. Though proponents dispute these numbers, this tax break is poorly targeted. Low-income families who could most use the benefit of a tax holiday are the least able to take advantage of it, since many are just getting by and don't have extra disposable income to buy new clothing and school supplies.

The Senate bill also would tax what are called "premium cigars" at 50 cents each, compared to the current rate of 17 percent on the wholesale price of the cigar. "The provision reduces revenues by an undetermined magnitude," the LSC said. By comparison, the Kasich administration proposed taxing such cigars at $2 apiece, in line with increases on other tobacco tax products it put forward.

Perhaps the largest new tax break included in the Senate bill would be a new, nonrefundable tax credit for insurance companies and financial institutions that invest in "rural and high-growth industry funds" that contribute capital to certain types of businesses with substantial operations in Ohio. The new credit wouldn't affect the upcoming budget, because it would be spread over a four-year period beginning three years after the investment. Altogether, up to $60 million in such credits could be awarded. Half of each fund's investments must be made in rural businesses, and half in high-growth industry businesses. Some safeguards are attached: Certain kinds of businesses such as massage parlors and country clubs are excluded from receiving the investments, and there are investment requirements, mandated progress reports and provisions for recapturing the credits if the fund fails to meet certain benchmarks.

But the provision defines “high-growth industry concern” so broadly that the term is hardly accurate – it covers everything from mining and construction to warehousing and health care—and many other industries as well. But even that doesn’t cover it. The bill also says, “Upon the request of a fund or an operating company, the (development services) agency may certify an operating company as a high-growth industry business concern, irrespective of the industry in which the operating company is engaged, if the agency determines that a growth investment in the operating company would be beneficial to the economic growth of the state.” The definition of a rural business concern also is loose: It simply can’t be located in a city with a population of greater than 50,000 or in “an urbanized area adjacent to such a city.” Alternatively, it can be in any area determined to be “rural in character” by the U.S. undersecretary of agriculture for rural development.

If the aim of this credit’s proponents is to spark new investment in rural or high-tech companies, they have targeted it poorly. Ohio already has a multitude of tax incentives, including one for investors who provide new equity to small companies. Indeed, the bill estimates (see p. 4630) that during the upcoming two-year budget period, $686 million will be claimed in seven such business credits, and the state will have a total of $1.5 billion outstanding from them at the end of Fiscal 2019. That doesn’t include the business income deduction created in 2013, which eliminates state income tax on the first $250,000 in profits for many business owners and reduces the rate they pay on income over that amount. That tax break is now costing about $1 billion a year in state tax revenue without visible economic results. The General Assembly should be cutting back on such tax breaks, not creating more of them.

The Senate bill also boosts significantly the benefit of the Current Agricultural Use Value (CAUV) program, under which farmers pay property taxes on their land based on its use for farming as opposed to its market value. According to the LSC, this would cause a loss of up to $13 million in Fiscal Year (FY) 2018 to both school districts and local governments, respectively, and up to $21 million for each by FY 2020. As previous testimony (see March 8, 2017) on a similar freestanding bill in the Senate described, 2015 updates made by the taxation department in the CAUV formula have begun to reduce farm property valuations, which had spiked and remain high compared to historical levels.

Slashing taxes for farmers will result in tax increases for residential taxpayers because under some of Ohio’s local taxes, reductions for some are made up with increases for other taxpayers. But a portion of local levies doesn’t work that way, so a reduction in agricultural property values because of a different CAUV formula can also mean revenue losses for schools and other taxing authorities. It also can impact the state’s school funding formula, tax expert Howard Fleeter has noted, increasing state aid to school districts with lower property values because of the CAUV decreases, and reducing aid to districts with little or no agricultural property.

While tax rates for farmers deserve further discussion, these other factors, related to the structure of Ohio’s systems of local taxation and school funding, deserve more consideration.

Habitat for Humanity's ReStore outlets, and possibly some others like them, would benefit from a new property tax exemption in the Senate bill. It exempts a retail store operated by a charitable nonprofit housing organization that sells primarily donated household items. The LSC estimates the fiscal effect at $164,000 a year.

The bill also retains a number of new or extended tax breaks that were in the House bill and are expected to reduce state revenue. These include:

- A kilowatt hour tax break on electricity used in chlor-alkali production (loss of about half a million dollars a year);
- Allowing owners of a historic rehabilitation tax credit to claim it against the Commercial Activity Tax (CAT) for another two years (revenue loss "potentially in the millions");
- Coverage for a new category of work-from-home employees under the state's job creation tax credit (loss of less than $1 million a year), and
- A new sales-tax exemption for prescription optical aids, such as eyeglasses and contact lenses. The LSC estimated this would cost the General Revenue Fund $22.4 million, with additional losses to local governments and libraries. This would only begin in Fiscal Year 2020, after the two-year budget.

The Senate bill includes a few steps to reduce or eliminate tax breaks included in the House bill. These included narrowing a new sales-tax exemption so it only covers songs downloaded from a commercial digital jukebox, and scrapping a provision that would allow a data center more time to make the investment needed to qualify for a sales-tax exemption.

Still, the bill did not incorporate modest proposals made by the Kasich administration to limit or repeal unneeded tax breaks. Most significantly, the governor would have required that suppliers to certain big distribution centers pay a minimum of Commercial Activity Tax. According to taxation department estimates, such companies are receiving tax benefits worth half a billion dollars a year from this tax break. Under the Kasich proposal, suppliers would pay the CAT on at least 10 percent of the receipts from goods they ship to these distribution centers. The administration estimated this would boost revenues by $26.3 million over the biennium.

Instead of closing loopholes, the Senate would generate more revenue by offering an amnesty to taxpayers who didn't pay or underreported taxes that were due and aren't already being audited or penalized. If they pay up, such taxpayers can avoid penalties and half of the interest that otherwise would be due. The tax department last conducted a broad amnesty in 2012. Such amnesties should only be allowed infrequently, since otherwise they signal that the tax laws aren't really that stringent, discouraging compliance.

So far, both houses of the General Assembly have added more new tax breaks rather than cracking down on existing ones. They still have an opportunity to reverse course. They should start with the business income deduction, as The Plain Dealer said in a recent editorial. Moving to kill unproductive tax breaks and avoiding new ones would make the tax system fairer while generating the revenues we need.