Policy Matters Ohio

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Taxes & Budget

Ohio needs a corporate profits tax

Beneficiaries of the pandemic should pay up

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Introduction

Corporations can't operate without using our collective public resources. They need a well-trained, educated and healthy workforce. Public roads and airports are necessary to move their products to market. Their offices depend on public water and sewer facilities, while their contracts are enforced through the court system. Yet Ohio is one of just six states with no state-level corporate income tax.[1] All surrounding states have such taxes, with rates ranging from 5.0% to 9.99%. This means that companies that are profiting immensely from the pandemic are not contributing commensurately to public services funded by the state. That needs to change. This report outlines how Ohio came to be without a tax that exists in most states, what that means, and how we can remedy that.

Millions of Ohioans are hurting. In the week ended Jan. 2, 475,875 claimed some form of unemployment benefits.[2] With tens of thousands losing their health insurance along with their jobs, more than 304,000 were added to Medicaid in the year ended last November.[3] The number of Ohioans receiving food aid under the Supplemental Nutrition Assistance Program (SNAP) surged with the pandemic and remained 140,000 higher in October than it was a year earlier.[4] Meanwhile, schools are struggling to provide online education while spending more in many cases to more safely provide in-person classes. Even if there is not a major fall-off in revenue this fiscal year as the state budget office previously has predicted, Ohio's revenue outlook is uncertain at best.

While basic needs like enough food and quality housing are out of reach for many Ohioans, leveraging our public resources for our long-term success is also urgent. Unaffordable colleges, huge health disparities between white and Black Ohioans,[5] underdeveloped broadband infrastructure and availability, lack of child care and early education for all families, flagging public transit systems and more mean that a status quo budget that just preserves existing initiatives is not enough.

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[1] The others are Nevada, South Dakota, Texas, Washington and Wyoming. Municipalities in Ohio tax corporate profits under their municipal income taxes. Though complete information is hard to come by, such taxes amounted to about $600 million out of the $4.7 billion collected several years ago. See Schiller, Zach, "Kasich plan to take over business-profits tax collection raises concerns," Policy Matters Ohio, March 6, 2017, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/kasich-plan-to-take-over-business-profits-tax-collection-raises-concerns

[2] Ohio Department of Job & Family Services, Unemployment Insurance Claims, Claims Trends – Weekly & Monthly at https://ohiolmi.com/home/UIclaims

[3] Ohio Office of Budget & Management, Monthly Financial Report, Dec. 10, 2020, p. 19, at https://archives.obm.ohio.gov/Files/Budget_and_Planning/Monthly_Financial_Report/2020-12_mfr.pdf

[4] Ohio Department of Job and Family Services, Public Assistance Monthly Statistics March through August 2020 statistics, https://bit.ly/3mHV7KI

[5] See "More than a mask," COVID-19 Ohio Minority Health Strike Force Blueprint, Aug.19, 2020, at https://coronavirus.ohio.gov/static/MHSF/MHSF-Blueprint.pdf

Policy Matters Ohio issued two reports last year outlining ways that Ohio policymakers can raise the revenue we need — from those who can afford it — to balance the state budget without damaging austerity moves. One put forward 20 measures, including modernizing our extraordinarily weak severance tax on oil and gas, and closing various tax breaks.[6] Another would rebalance our personal income tax, so that many of the lowest-income Ohioans pay less and the highest-income residents pay more.[7] In this report, we add a third leg to the revenue stool: Reinstating Ohio's corporate profits tax. Such a measure not only would provide needed revenue, but as one of the few taxes based on the ability to pay, would make Ohio's tax system more fair.

Profiting during the pandemic

While many small businesses struggle to stay open, more than a few big companies are reaping benefits of the pandemic. From toymakers to delivery services, online retailers to makers of cleaning products, some are cleaning up. Here's what *The Wall Street Journal* reported when Amazon and Google reported their third-quarter earnings:

> *"Tech giants including Amazon.com Inc. and Google reported strong quarterly sales and profits that showed how pandemic-era demand for their digital services and gadgets is driving them to new heights even in the midst of a debate about their market power.*
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> *"The financial results announced Thursday, which included record revenue at Facebook Inc., illustrated again how increased remote working and living has elevated use of everything from online retail and social media to cloud-computing services and digital advertising—accelerating shifts in consumer and business behavior that are expected to continue beyond the COVID-19 pandemic.*
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> *"Amazon, which had delivered record sales in the second quarter of the year, topped that level in the three months through September, with revenue soaring 37% to a record $96.2 billion. Profit nearly tripled to $6.3*

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[6] Patton, Wendy and Zach Schiller, "Protect Essential Services with Public Resources," Policy Matters Ohio, July 7, 2020, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/protect-essential-services-with-public-resources and

[7] Patton, Wendy, "Rebalance the Income Tax to Build a Better Ohio for Everyone," Policy Matters Ohio, Oct. 15, 2020, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/rebalance-the-income-tax-to-build-a-better-ohio-for-everyone

billion, propelled by strong online sales as well as digital advertising and growth in its lucrative cloud-computing arm."[8]

Though performance varied between companies, *the Journal* reported that, "Together, the five biggest tech companies by value—Apple, Amazon, Alphabet, Facebook and Microsoft Corp., which reported Tuesday—took in 18% more revenue in the latest quarter than a year earlier."

It's not just the huge tech companies. Zoom Video Communications made as much money in May, June and July as it did in all of 2019. A 367% increase in revenue in the following quarter propelled it to further huge income gains.[9] Demand for Clorox wipes and disinfecting sprays has grown more than fivefold during amid the pandemic; overall company sales were up 21% and profits grew 29% in the most recently reported quarter.[10] Sales of Barbie dolls and other like-branded items also rose 29% in the third quarter, as Mattel surprised analysts with profits nearly 2½ times their predictions.[11] The do-it-yourself business powered paint-maker Sherwin-Williams Co. to a 25% gain in earnings per share in the quarter.[12] FedEx beat earnings expectations in the quarter ended Nov. 30 as profits nearly doubled from the same quarter a year earlier.[13]

Not every company that has boomed in in the pandemic is reporting robust earnings. For instance, despite its strength in food delivery and a blockbuster initial public offering of stock in December, Doordash has struggled to make a profit.[14] But many companies are prospering even as millions file for unemployment benefits. In an analysis of 13 of the biggest retailers including Amazon, researchers at the Brookings Institution found that revenues were up 14% and profits 39% so far over last year. "In

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[8] Mattioli, Dana, "Big Tech Companies Reap Gains as Covid-19 Fuels Shifts in Demand," The Wall Street Journal, Oct. 29, 2020, at https://www.wsj.com/articles/amazon-sales-surge-amid-pandemic-driven-online-shopping-11604003107

[9] https://www.marketwatch.com/story/zoom-makes-as-much-money-in-three-months-as-it-did-in-all-of-2019-stock-heads-toward-more-records-2020-08-31#:~:text=For%20the%20third%20quarter%2C%20Zoom,for%20full%2Dyear%20adjusted%20profit. And https://www.globenewswire.com/news-release/2020/11/30/2136882/0/en/Zoom-Reports-Results-for-Third-Quarter-Fiscal-Year-2021.html#:~:text=Revenue%3A%20Total%20revenue%20for%20the,quarter%20of%20fiscal%20year%202020.

[10] Terlep, Sharon, "Clorox, with its sales surging from the coronavirus, to get new CEO," The Wall Street Journal, Aug. 3, 2020, at https://www.wsj.com/articles/clorox-posts-higher-sales-as-consumers-stock-up-on-disinfectants-11596454128

[11] Kumar, Uday Sampath, ""This is Barbie's holiday season, says Mattel as toy demand surges," Reuters, Oct. 22, 2020, at https://www.reuters.com/article/us-mattel-results/this-is-barbies-holiday-season-says-mattel-as-toy-demand-surges-idUSKBN2772Y2

[12] Miller, Ben, "With rise in do-it-yourself sales, Sherwin-Williams posts good Q3 results," Cleveland Business Journal, Oct. 27, 2020, at https://www.bizjournals.com/cleveland/news/2020/10/27/sherwin-williams-q3-sales-profits-rise.html?ana=e_ae_set1&j=90534979&t=Afternoon&mkt_tok=eyJpIjoiTVRBME9ERmpZakUxTldZNCIsInQiOiJ1ZmN5Q00xM0kwYWlsbmVrK1hubXF1MFB5QUhLcHRVcm4ydEg2TW10VWw1eENnanZMeVVsT0RuT2FvN2E4cWZDR2xMOVJGdjFLXC9ZTHhzWDRlNjFKbkRjN1loXC9YZ3pSdVwvZWh3d2hPb1pQZWhKYTZpd1NUcmttRDlaY3N2ZjZKeURRSXQ4YzIzNzRSWHBjRGFvY3BJcnc9PSJ9

[13] Garland, Max, "FedEx sees high demand in second quarter, increased expenses prepping for holiday peak," Memphis Commercial Appeal, Dec. 17, 2020, at https://www.commercialappeal.com/story/money/industries/logistics/2020/12/17/fedex-earnings-2020-covid-19-vaccine-holiday-shipping/3924934001/

[14] Kelso, Alicia, "Now that Doordash is public, here's how it plans to be profitable," Forbes, Dec. 10, 2020, at https://www.forbes.com/sites/aliciakelso/2020/12/10/now-that-doordash-is-public-heres-how-it-plans-to-be-profitable/?sh=1a1e4a016472

total, the 13 companies reported 2020 profits to date of $67 billion, which is an additional $16.9 billion compared to last year."[15] In short, many major companies across a variety of industries have prospered during the pandemic.

Business taxes in Ohio

Overall, Ohio business 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.[16] 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 (CAT). 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. Even in the bad recession year of 2009, the old corporate franchise tax would have generated nearly $1.4 billion from nonfinancial companies, and nationally, state corporate income taxes have increased since then.[17] The tangible personal property (TPP) tax regularly generated at least $1.6 billion a year. Even assuming no increase since then in the TPP and the 21% increase in state corporate income taxes nationwide between 2009 and 2018, together they would have generated nearly $3.3 billion that year.[18] Based on CAT revenue in fiscal year 2020 of $1.98 billion, and other taxes of $83 million that replaced the franchise tax, the net loss in annual revenue is $1 billion or more.[19] Authors of a 2007 review of the changes matter-of-factly noted

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[15] Kinder, Molly, Laura Stateler and Julia Du, "Windfall profits and deadly risks: How the biggest retail companies are compensating essential workers during the COVID-19 pandemic," The Brookings Institution, November 2020, at https://www.brookings.edu/essay/windfall-profits-and-deadly-risks/?utm_campaign=Metropolitan%20Policy%20Program&utm_medium=email&utm_content=101777786&utm_source=hs_email

[16] 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

[17] Ohio Department of Taxation, Corporate Franchise Tax: Number of Corporations and Reported Tax Liability, by Tax Base and Industry, Tax Year 2009, at https://tax.ohio.gov/static/tax_analysis/tax_data_series/corporation_franchise/cf12/cf1-5ty09.pdf

[18] U.S. Census Bureau, Annual Survey of State and Local Government Finances, at https://www.census.gov/programs-surveys/gov-finances.html

[19] "Taxes and Fees Collected by the Ohio Department of Taxation," received from Gary Gudmundson, Ohio Department of Taxation, Dec. 18, 2020. Besides the CAT, the Petroleum Activity Tax covers businesses that paid the Corporate Franchise Tax. All of these numbers exclude financial institutions.

that "…the net result was a large business tax cut."[20] 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."[21] 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 business lobbying group, Ohio's business taxes are below the average in other states.[22] E&Y found that in Fiscal Year 2019, 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 (3.7% vs. 4.5%). The business share of such taxes also was below average (39.8% vs. 44.0%), as were business taxes per employee ($4,700 vs. $6,500).

Moreover, the 2017 federal tax law has put more money in the pockets of many Ohio business owners. The Tax Cuts and Jobs Act, slashed corporate taxes and provided a big new tax break for owners of partnerships, S Corporations and other businesses known as "passthrough entities" because their profits are taxed under the individual income tax as they pass through to the owners. The Institute on Taxation and Economic Policy (ITEP), a national nonprofit with a sophisticated model of state and federal tax systems, analyzed the law and found that in 2018, Ohio shareholders got the bulk of $2.5 billion in corporate tax cuts from the law. In addition, passthrough owners saw U.S personal income tax reductions worth more than $1.2 billion.[23]

In the mid-1970s, franchise tax accounted for 16% of taxes supporting the state's general operations.[24] In Fiscal Year 2020, the CAT and other taxes that replaced the franchise tax added up to not much more than half that share of the General Revenue Fund.[25] Slashing business taxes hasn't worked. Ohioans continue to have lower average incomes people in other states.[26] Even before the pandemic, job growth was weak, and six out of the 10 most common jobs in the state paid so little

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

[21] 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.

[22] Ernst & Young, "Total state and local business taxes, State-by-state estimates for FY19," October 2020, at https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/2020-business-tax-burden-study---final.pdf While the economic model on which this study relies is a black box, the study is widely used by the business community to compare state taxes

[23] Wamhoff, Steve, "Extensions of the new tax law's temporary provisions would mainly benefit the wealthy," Institute on Taxation and Economic Policy, April 10, 2018, at https://itep.org/tcja20182026/

[24] 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

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

[26] Shields, Michael, "Newly released Census data show Ohioans fared better by end of expansion," Policy Matters Ohio, Sept. 17, 2020, at https://www.policymattersohio.org/press-room/2020/09/17/newly-released-census-data-show-ohioans-fared-better-by-end-of-expansion

that a worker with a family of three would be eligible for food aid.[27] 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, but does funnel more money to the richest in the state.[28]

Recommendations

Reinstating the corporate income tax

One way to reinstate a corporate income tax in Ohio is to follow the basic idea behind the old corporate franchise tax. Nonfinancial companies figured out how much they would pay under two different methods, one based on their net income, the other on their net worth. They paid whichever was higher, though at one point the amount under the net worth formula was capped.[29]

Similarly, companies now could continue paying the Commercial Activity Tax or, if their computed Corporate Income Tax was higher, they'd pay that instead. Only profitable companies would wind up paying more under this structure. And indeed, under the old franchise tax, only a small share paid based on their income. However, a small number of big corporations paid most of the tax: In 2009, the last year the tax was due on nonfinancial companies, just 195 of them had liability of more than $1 million, but together they were on the hook for $665 million, or nearly half of the total corporate franchise tax computed that year.[30] A dual tax of this kind bases at least some of the payment on income, so that corporations like Amazon that are benefiting from the pandemic make additional contributions to combat it. By using

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[27] See Shields, Michael, April Hopcraft and Siyang Liu, "State of Working Ohio 2020: Reset and Unrig," at https://www.policymattersohio.org/research-policy/fair-economy/work-wages/state-of-working-ohio/state-of-working-ohio-2020-reset-and-unrig, and Shields, Michael, JobWatch, Policy Matters Ohio, March 6, 2020 at https://www.policymattersohio.org/research-policy/fair-economy/work-wages/job-watch/its-official-2019-worst-year-for-ohio-jobs-since-recession and March 27,2020 at https://www.policymattersohio.org/research-policy/fair-economy/work-wages/job-watch/calm-before-the-storm. See also Shields, Michael, "Working for Less," Policy Matters Ohio, May 1, 2020, at https://www.policymattersohio.org/research-policy/fair-economy/work-wages/working-for-less-2020

[28] 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.

[29] Schiller, op. cit., p. 4. Under the old franchise tax, companies figured their liability based on an apportionment formula, taking into account the proportion of their payroll, property and sales they had in the state. The formula triple-weighted sales versus the other two factors for nonfinancial companies. This and other elements of the new tax would need to be configured appropriately, using best practices.

[30] Ohio Department of Taxation, Tax Analysis Division, Tables CF-2A and 2B, March 3, 2010, at https://tax.ohio.gov/wps/portal/gov/tax/researcher/tax-data-series/other-tax-statistics-archive/tds-archives-cf. These numbers are prior to the 80% tax reduction applicable to most taxpayers that year.

the CAT as a backstop, it also ensures that large corporations pay tax because they continue to receive public services even when their profits dip.

As it is now, most companies with big increases in Ohio sales will pay something more because the Commercial Activity Tax will be applied to the new sales. However, at just a 0.26% rate, that means a company with a $10 million increase in Ohio sales will pay only an additional $26,000 in CAT tax.

Passthrough entities

One of the weaknesses of the old corporate franchise tax was that it excluded partnerships, S Corporations, sole proprietorships and other passthrough entities. Most companies, including limited liability companies (LLCs), are now organized this way. But whatever the merits of such treatment for small companies, there is little justification for extending it to large passthroughs that operate similarly to other big corporations.

Some states, such as Kentucky, already tax limited liability entities. By contrast, not only does Ohio not tax corporate profits at the state level, it provides a huge tax break to owners of LLCs and other passthrough entities. It exempts the first $250,000 in income from the personal income tax, and provides a special, low rate on such income over that amount. This costs more than $1.17 billion a year,[31] without showing real results in additional small business hiring. Policy Matters Ohio earlier proposed limiting this tax break to $100,000 and eliminating the special 3% rate.[32]

While this deduction was initially called the Small Business Investor Income Deduction, it is by no means limited to owners of small businesses. The 30,780 Ohio residents who claimed at least $240,000 in business income deductions in Tax Year 2018 accounted for just 4.7% of all those residents claiming the deduction, but they filed for nearly $7.7 billion or almost 31% of the deductions claimed.[33] Researchers of federal tax breaks for passthrough owners previously have found passthrough entities may be very large indeed. The Congressional Research Service found in 2012 that "…30% of S corporation receipts are generated by the largest 0.3% of S corporations, and 41% of partnership receipts are generated by the largest 0.2% of partnerships. Similarly, the largest 0.2% of S corporations hold 43% of S corporation assets, while the largest 1.1% of partnerships hold 78% of partnership assets."[34]

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[31] Email from Gary Gudmundson, Ohio Department of Taxation, Oct. 6, 2020. Figure is for Tax Year 2017.
[32] Patton and Schiller, op. cit.
[33] Ohio Department of Taxation, Individual Income Tax: 2018 IT-1040 Schedule IT-BUS, Business Income Deduction Amount Claimed and Number of Returns, by Amount of Business Income Deduction Claimed and Residency Status, March 26, 2020, at https://tax.ohio.gov/wps/portal/gov/tax/researcher/tax-analysis/tax-data-series/individual-income/publications-tds-individual/bidty18
[34] Congressional Research Service, "Taxing Large Pass-throughs as Corporations: How Many Firms Would Be Affected?" March 30, 2012, at https://www.everycrsreport.com/reports/R42451.html

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Concluded researchers at the Center for American Progress: “The lower tax rates on income from pass-throughs are often defended based on the assumptions that all small businesses are pass-throughs and that all passthroughs are small businesses. Both assumptions are wrong. In fact, the growing number of pass-through entities has very little to do with small business. Indeed, several of the largest U.S. hedge funds are taxed as partnerships.”[35]

All of this suggests that a reinstated Ohio corporate income should cover large passthrough entities, which should not receive special treatment originally intended as an aid to small businesses.

Limiting tax avoidance

An even more critical aspect of a new corporate profits tax is taking steps to limit tax avoidance. Ohio’s old corporate franchise tax was often described as a “swiss cheese” tax because it was easy for corporations to avoid paying it.

According to data released by the Ohio Department of Taxation, 18 of the top 50 companies in Ohio ranked by sales paid $1,000 or less in corporate franchise tax for tax year 2004, prior to the repeal of the tax.[36] Each had Ohio sales of at least $500 million. A researcher at the state taxation department found in a 2003 study that fully one-half of the largest C corporations in this state paid no more than a relatively small flat corporate franchise tax to the state of Ohio.[37] Obviously, a new corporate income tax needs to be structured so that can’t happen.

Some corporations avoid tax liability by shifting income generated in one state to another on paper. The majority of states with corporate income taxes – 27 out of 44 – treat corporations composed of a parent and its subsidiaries as a single entity for tax purposes. Combined reporting, as it is known, prevents many of the most common ways that corporations perform such income shifts and avoid taxes. The biggest problem, of course, is corporations finding ways to shift income to low-tax countries, which has to be fixed at the federal level.[38] Nevertheless, in reinstating a corporate profits tax, Ohio should take the lead of others in adopting combined reporting – and doing so in a fashion that is most likely to cut off avenues for what is

[35] Thornton, Alexandra and Brendan V. Duke, “Ending the Pass-Through Tax Loophole for Big Business,” Center for American Progress, August 2016, at https://www.americanprogress.org/issues/economy/reports/2016/08/10/139261/ending-the-pass-through-tax-loophole-for-big-business/

[36] Mark Niquette, “Many big companies pay lowest state tax,” The Columbus Dispatch, March 16, 2005. See also Zach Schiller, “Strengthen, don’t scrap, Ohio’s corporate franchise tax,” Policy Matters Ohio, May 2005, at https://www.policymattersohio.org/files/research/ohiocftstudy200505.pdf

[37] Amount of corporate franchise tax liability by large and medium corporations, memorandum to Frederick Church, administrator, Tax Analysis Division, from Christopher Hall, asst. administrator, Tax Analysis Division, Ohio Department of Taxation, January 8, 2003. C Corporations are regular corporations under federal tax law.

[38] Even here, however, Ohio could mitigate the international income shifting problem by including subsidiaries doing business in well-known foreign tax haven countries in combined reporting and/or conforming with the federal Global Intangible Low-Taxed Income (GILTI) provision of the 2017 federal income tax overhaul law – both of which several states have done.

euphemistically known as "tax planning."[39] Other steps will also need to be taken to combat tax avoidance.

Reinstating a corporate profits tax is not likely to hurt the Ohio economy. As Reed College Economics Professor Kimberly Clausing observed in a Los Angeles Times column on federal taxes, "raising the tax rate on corporate profits is perfectly reasonable during a recession. Corporate taxes are paid only by profitable corporations, and for those without profits, any percent of zero is zero."[40] Most young, expanding companies don't have significant profits, if they have any at all.[41] They are unlikely to be affected by a corporate income tax. A Maryland researcher recently found that adults in their prime working years are equally likely to be employed in states with higher corporate taxes as in states with lower corporate taxes. Typical workers, he found, are paid more for each hour on the job in states with higher corporate taxes than their counterparts in states with lower corporate taxes.[42]

Other states have business taxes that feature both income and other elements. Oregon, for instance, has a both a corporate excise or income tax and a gross receipts tax.[43] New Hampshire has both a Business Profits Tax (BPT) and a Business Enterprise Tax (BET), which is based compensation, interest and dividends paid, regardless of profit; taxes paid under the BET can be credited against a company's BPT liability.[44]

How much would a new tax raise and what would that mean for Ohio?

Bringing back a corporate income tax would benefit Ohio because we need additional revenue to support the investments that provide opportunity for all and allow businesses to thrive. That includes educating Ohioans. The state Senate last month refused to act on a bill approved by the House that would have created a new school funding formula, in large measure because the Republican majority was unwilling to take on the $1.9 billion a year in additional funds required to make the new formula work. In addition to maintaining our unconstitutional school funding

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[39] Specifically, with a new corporate profits tax, Ohio should adopt the direct approach, also known as the Finnigan variant, after a California case that addressed how combined reporting and apportionment are applied when some members of a unitary corporate group are subject to a corporate income tax ("have nexus") in a state and others aren't.
[40] Clausing, Kimberly, "Op-Ed: The Tax Cuts and Jobs Act was wrongheaded from Day 1. It should be rethought," The Los Angeles Times, at https://www.latimes.com/opinion/story/2020-10-22/op-ed-clausing-economics-headline
[41] Mazerov, Michael, "Testimony to House Finance and Appropriations Committee on HB 59 Income Tax Plan," Center on Budget and Policy Priorities, March 19, 2013, at http://www.policymattersohio.org/wp-content/uploads/2013/03/MazerovHB59_Mar2013.pdf
[42] Meyer, Christopher, "Closing corporate tax loopholes is still the right choice for a thriving Maryland," Maryland Center on Economic Policy, September 2020, p. 6, at https://www.mdeconomy.org/corporatetax/
[43] See Oregon Department of Revenue, Oregon corporate excise and income tax reports, at https://www.oregon.gov/dor/programs/gov-research/Pages/research-corp-excise.aspx and Oregon Legislative Revenue Office, 2020 Oregon Public Finance: Basic Facts, Research Report #1-20, at https://www.oregonlegislature.gov/lro/Documents/Basic%20Facts%202020b.pdf
[44] New Hampshire Fiscal Policy Institute, "Business Tax Revenue and the State Budget," Sept. 10, 2019, at https://nhfpi.org/resource/business-tax-revenue-and-the-state-budget/

formula, lawmakers continue to underfund higher education. Thus, it looks increasingly unlikely that we will meet the state goal that by 2025, 65% of those between 25 and 64 should have a degree, certificate or other postsecondary workforce credential of value in the workplace.[45] How will Ohio and its economy thrive with an undereducated population? Or with a public health system that Governor Mike DeWine has noted is underfunded?[46] Business needs healthy, educated workers to thrive.[47] A successful economy also requires a sound, modern infrastructure, including accessible broadband. Today, hundreds of thousands of Ohioans lack such access, including both much of Appalachian Ohio and underserved urban areas.[48] Major investments are needed to remedy that.

Reinstating a corporate income tax also would be a step toward reforming our upside-down tax system. Now, the poorest Ohioans on average pay nearly double as much of their income in state and local taxes as the top 1%, who make more than $490,000 a year.[49] This is especially damaging to many Black and Hispanic Ohioans, who are more likely to be among the poorest fifth that on average pays the highest share of their income in such taxes. Most of the ultimate cost of a corporate income tax falls on those who own stock.[50] So since stock ownership is concentrated among white, upper-income households,[51] a corporate profits tax would go part of the way toward turning Ohio's tax system right side up and reversing its discriminatory racial effects.

It's hard to say how much a new Ohio corporate profits tax would raise, and much would depend on the details of how it is structured. However, at the request of Rep. Michael Skindell, the Legislative Service Commission examined the issue, which provides an order of magnitude of what such a tax would generate. It reviewed a form of the proposal made in this report: A new tax, added on to the CAT, under which companies would compare their liability against their CAT liability and pay the higher of the two. It would mirror the CAT in covering the same companies, excluding those with gross receipts under $150,000; those with receipts below $1 million would continue paying a flat $150. Corporations in industries currently exempt

[45] Attainment Goal 2025, Ohio Department of Higher Education, at https://www.ohiohighered.org/attainment. See van Lier, Piet, "Higher Education in Ohio: Ambitious goals need better funding," Policy Matters Ohio, Dec. 17, 2020, at https://www.policymattersohio.org/research-policy/quality-ohio/education-training/higher-education/higher-education-in-ohio-ambitious-goals-need-better-funding

[46] Filby, Max, "Ohio spends less per capita on public health than nearly every other state," Columbus Dispatch, April 2, 2020 at https://bit.ly/2LujgXV

[47] Berger, Noah and Peter Fisher, "A Well-Education Workforce Is Key to State Prosperity," Economic Policy Institute, Aug. 22, 2013, at https://www.epi.org/publication/states-education-productivity-growth-foundations/

[48] See "Ohio Broadband Effort," Buckeye Hills Regional Council, Executive Summary at https://bit.ly/346ixTn and Bill Callahan, "COVID-19 makes tearing down nation's digital barriers more urgent," Policy Matters Ohio, 4/3/20 at https://bit.ly/3a3JUB7

[49] Patton, op.cit.

[50] Wiehe, Meg, Aidan Davis, Carl Davis, Matt Gardner, Lisa Christensen Gee and Dylan Grundman, Institute on Taxation and Economic Policy, "Who Pays? A distributional analysis of the tax system in all 50 states," Sixth Edition, October 2017, p. 140, at https://itep.sfo2.digitaloceanspaces.com/whopays-ITEP-2018.pdf

[51] Bhutta, Neil, Andrew C. Chang, Lia J. Dettling, and Joanne W. Huse, with assistance from Julia Hewitt, "Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances," FEDS Notes, Sept. 28,2020, at https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm

from the CAT, like banks and insurance companies that pay other state taxes, would be excluded.[52] The analysis found that such a new corporate franchise tax covering C Corporations (but not passthrough entities) levied at an 8.5% rate might increase state revenue by up to $669 million before credits, and possibly up to $495 million after tax credits.[53] The analysis is only a rough one, based on the ratio of net taxable income to business receipts from Internal Revenue Service data. It listed a number of caveats and noted that the estimated gain should be used with caution in the absence of bill language.[54]

At the request of Policy Matters Ohio, ITEP produced estimates of what a new Ohio corporate profits tax might generate.[55] ITEP looked at a freestanding profits tax, prior to any amount of Commercial Activity Tax a company might already pay. Using methodology similar to that used in a 2019 report and applying the tax to the federal income tax base apportioned to Ohio, ITEP found that a new tax levied at an 8.5% rate would generate nearly $3.4 billion.[56]

ITEP's approach, unlike the LSC's, is to map federal taxable income to each state based on Gross State Product, based on the industrial make-up of each state. Based on a flat 5% rate, such a tax on its own would generate nearly $2 billion, it found. Of course, these estimates come before the CAT companies are paying, which would significantly reduce the net collections of the new corporate income tax. They also include some industries that aren't covered by the CAT, such as the banking and insurance industries, and other receipts that the CAT doesn't cover. While the methodology is different and not directly comparable, ITEP's analysis underlines that significant revenue would be available from a new, broad-based corporate profits tax.

[52] The new tax would need to be drafted so that it did not disturb the current arrangement under which portions of CAT receipts are deposited into other funds besides the General Revenue Fund, and subsidies to those funds are made up if the CAT revenue is not sufficient to make reimbursements to school districts and other taxing units.

[53] Botomogno, Jean J., Ohio Legislative Service Commission, Memo on new corporate franchise tax, Dec. 3, 2020

[54] The memorandum cited a number of factors, including that the amount generated would be less during recessions, when corporate profits decrease, including in 2020. It doesn't include the effect of the federal tax act passed in 2017 or other U.S. tax changes earlier this year, and revenue would also depend on how much companies could use income-shifting accounting to reduce their liabilities, as they did under the old corporate franchise tax. It also doesn't take into account potential changes in taxpayer behavior, including changes in business organization, or the proposal made in this paper to cover large passthrough entities. In addition, such analysis also doesn't attempt to figure out how many individual firms would have higher liability under a new profits tax than under the CAT, which ultimately would determine how much the new tax raised.

[55] Email from Aidan Davis, Institute on Taxation and Economic Policy, Nov. 20, 2020

[56] See the earlier report by Richard Phillips and Nathan Proctor, U.S. PIRG, "A simple fix for a $17 billion loophole: How states can reclaim revenue lost to tax havens," Jan. 17, 2019, at https://itep.org/a-simple-fix-for-a-17-billion-loophole/

Conclusion

This report has laid out the reasons why reinstating a corporate profits tax in Ohio is both realistic and needed, as well as how it could be accomplished. That is just one part of reforms that are necessary to provide the revenue for the public services that would allow all Ohioans maximum opportunity, regardless of where they live and whether they are Black, white or brown. They also would make progress in turning our upside-down tax code right side up, so that affluent Ohioans pay more of their income in state and local taxes than those with low incomes. Ohio needs to reinstate a tax on corporate profits.

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