Revenue and Budget

Testimony on House Bill 110 before the Senate Local Government and Elections Committee

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Good morning Chair Gavarone, Ranking Member Maharath and members of the committee. I am Zach Schiller, research director at Policy Matters Ohio, a non-profit, non-partisan research organization that is building a more prosperous, equitable, inclusive and sustainable Ohio. Thank you for this opportunity to speak today on tax cuts and tax breaks in House Bill 110. This is not the time for lawmakers to further drain resources from Ohio's eroded, insufficient and unfair tax system. Senators should eliminate the 2% income-tax rate cut in the House bill. In addition, senators should scrap new special-interest tax carve-outs the House included in the budget bill — for venture capital, precious metals, and capital gains.

Policy Matters Ohio asked the Institute on Taxation & Economic Policy (ITEP), a Washington, D.C., nonprofit with a sophisticated model of state and local tax systems, to examine the 2% income-tax cut in the House budget. ITEP found that the cut would go largely to the most affluent Ohioans, without doing anything to help Ohioans making less than $22,000 a year.

In 2020, taxpayers with income of less than $22,150 did not have to pay Ohio income tax, a figure that would rise to $22,400 under the House bill. Though these taxpayers on average pay a larger share of their income in overall state and local taxes than the most affluent do, none of them would pay less under the 2% cut. Altogether, the three-fifths of tax filers who are paid less than $61,000 a year would get just 7% of the total tax cut. Those in the middle fifth of the income spectrum, making between $40,000 and $61,000 a year, on average would pay $7 less a year. Nearly half of the tax reduction would go to the wealthiest 5%, who are paid more than $205,000, with the richest 1%, who make at least $490,000, averaging a $612 cut and getting nearly a quarter of the tax savings. Though most taxpayers would get small if any benefit from the rate cut, the hundreds of millions of dollars in forgone revenue could meaningfully boost public services.

Ohio policymakers have cut the state income tax by more than a third since 2005, while sending $1 billion a year to businesses owners in the form of a tax deduction. Together with other major tax changes, this has reduced tax revenue by $7 billion a year. Tax filers in the wealthiest 1% received more than $40,000 a year in tax cuts on average from these previous changes, while middle-income taxpayers averaged a $14 tax increase and those in the bottom fifth of tax filers paid an average of $126 more. Ohio's economy has underperformed the nation over that time period, adding relatively fewer jobs. Ohio's upside-down tax code also falls more heavily on Black and brown families, which flat-rate income-tax cuts will exacerbate. Tax cuts, in short, are a failed policy in Ohio.

In addition to the rate cut, the House also would create new tax breaks in the budget bill. This is singularly misplaced in that the General Assembly has not followed Ohio law and reviewed existing tax breaks to see if they should be modified or repealed. Ohio law calls for all tax expenditures to be reviewed over an eight-year cycle. After an initial weak review of 15 sales-tax breaks in the 132nd General Assembly, the Tax Expenditure Review Committee (TERC) never met in the last session. Embarrassingly, the executive budget, which is required to include the TERC report, includes the old 2018 TERC report, since no review was conducted in 2019-2020. Before the General Assembly creates new tax breaks it ought to get a handle on how well the $9 billion in annual tax breaks we have now are performing.

As you consider the tax measures approved in the House, the Senate also should carefully consider the possible impact of the American Rescue Plan Act (ARPA). That act, approved by Congress in March, stipulates that states adopting net tax cuts can't use ARPA funds to pay for them, and requires states to repay ARPA funds used to do so. Guidance from the U.S. Department of Treasury will establish what is covered by this language, but it's quite plausible the 2% rate reduction and tax breaks included in the House budget could be covered. That would make them expensive indeed.

Capital Gains tax deduction

One of the new tax breaks in the House bill would allow business owners to deduct capital gains from selling interests in their businesses, which would amount to either the capital gain from such a sale or a percentage of the business payroll over a specified period. Why is it in the interests of the state of Ohio to incentivize Ohio business owners to sell their businesses? If the measure is intended to spur creation of new businesses, why is it drafted so that any owner of an existing business who has operated it for five years can sell it and benefit from the deduction? This would not help Ohio's economy; it would simply drain revenue from the budget. The Legislative Budget Office said that while it did not have an estimate of the magnitude of the revenue losses from this new break, beginning in Fiscal Year 2027: "The parameters governing the deduction appear consistent with a revenue loss in the millions in some years, and LBO cannot rule out losses in the tens of millions in some years." Ohio's passthrough business owners already are favored with a deduction that eliminates the income tax they would otherwise pay on income up to $250,000. There is no justification for providing another deduction that will deplete state revenue needed for public services.

Another venture capital tax deduction?

The House budget bill also proposes to certify certain "venture capital operating companies" and back them with a state tax deduction. The Legislative Budget Office cannot quantify the cost but cautions: "…it is feasible to anticipate an income tax revenue loss of tens of millions per year beginning in FY 2027, albeit with substantial variability in revenue effects from year-to-year."

Ohio already has a state venture capital program. Managed by an affiliate of the Cincinnati-based Fort Washington Investment Advisors, the program invested dollars the state raised through a bond offering into private entities with a promise that earnings from the investments could pay off the debt. The bonds were backed with a guarantee of tax credits equal to the debt service if the investments did not yield the necessary return. They didn't. In 2017, the Columbus Dispatch reported that the state venture capital fund needed about $15 million in taxpayer money to make bond payments. The state has continued to pay the debt service through the tax credit guarantee — $14 million a year. Having learned the hard way that the risky venture capital environment can be hard on state resources, the lawmakers should steer clear of such new tax breaks. If you believe the state should undertake risky investments like this, do it through an economic development grant program which can be more carefully monitored and scrutinized. Instead of creating yet another business tax break, Ohio should put more resources into educating our young people.

Sales tax exemption — investment metal bullion and coins

The House budget bill proposes a sales tax break for investment metals and coins, a textbook example of the kind of special interest tax giveaway that should not be considered. It was dubbed the "Noe exemption," after coin dealer Tom Noe, who worked to gain its approval in 1989 and was later convicted in the "Coingate scandal" for corruption in management of a $50 million rare-coin fund investment within the Ohio Bureau of Workers' Compensation. It was repealed in 2005 in the wake of the scandal, but resurrected in House Bill 59, the 2013 biennial budget bill. Governor Kasich vetoed it, stating: "The sales tax is intended to be a broad-based tax, regardless of whether or not the purchasers believe or hope that the items they buy will increase in value. 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." Nevertheless, he signed it into law in separate legislation in 2016; it was then repealed — again — in the current budget bill (HB 166 of the 133d General Assembly). And here it is again, in HB 110; it should be removed.

The $5.8 million could be used to fund many different services, such as boosting state support for programs that serve elderly people who have been neglected or abused, or making up for federal cuts to services for domestic violence survivors. Some of this money could be used to fund staff for the Tax Expenditure Review Committee.

In summary, we ask you to eliminate the $378 million income-tax rate cut, because it does little or nothing to help Ohioans of middle and low income and further benefits the very wealthiest Ohioans. The three tax breaks cited above also should be excised from the budget. You can use the resources you save on public services that benefit all Ohioans.