

Testimony to the Grace Commission

Zach Schiller

Good afternoon, Chairmen Coley and Schuring and members of the committee. My name is Zach Schiller and I am research director at Policy Matters Ohio, a nonprofit, nonpartisan organization with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify today.

Ohio's 128 tax exemptions, credits and deductions – appropriately known as “tax expenditures,” since they are state spending by another name – add up to nearly \$9 billion a year in foregone revenue, roughly the same amount as what we spend on K-12 education. Some are appropriate and useful. However, Ohio could invest in a brighter future by scrutinizing and eliminating unneeded tax breaks that litter the revised code, and using that money to invest in our communities. Such investments are badly needed.

One of the biggest tax expenditures is also one of the newest: The income-tax break for business income, approved in 2013 and expanded since then so that it now is probably the second-biggest tax expenditure, costing an estimated \$800 million a year. The supposed purpose of this break is job creation and economic development. Yet this tax break has not produced overall job gains for the state, or a significant increase in employment at small businesses that were hiring employees for the first time.

Say you work as an employee of a landscaping business, and pay state income tax on your earnings. If you instead did the identical job, but as a contractor working for your own one-person company, you could use this deduction to avoid all Ohio income tax on the first \$250,000 in income. This violates a tenet of sound taxation: That businesses and persons with similar assets and income should be taxed alike. We recommend that you ask the Ohio Department of Taxation to look into the number of individuals who have gone from wage earners to business owners, and estimate what proportion of those they believe have changed their status to take advantage of this new tax provision.

We also urge you to send a signal to your colleagues that, in keeping with the Grace Commission's mandate to “Identify opportunities for increased efficiency and reduce costs achievable by executive action or legislation,” the General Assembly should reject these proposed new tax expenditures:

- House Bill 343, which would cost \$131 million a year to the state and more than \$35 million to libraries, counties, other local governments, and transit agencies through a new tax break on temporary services;

- House Bill 475, expanding the movie tax credit from \$20 million to \$75 million a year. By allowing the credit to be transferable for the first time, this would introduce new inefficiencies. A portion of the credit goes to entities that have nothing to do with movie production, so the full value would not be used to support film-making. And it would make the credit harder to administer. If Ohio desires to spend \$150 million in each two-year budget to stimulate a new motion picture industry, it would be far better to debate the merits of creating a new grant program side by side with funding for schools and other services. .
- Senate Bill 172, which would reinstate the sales-tax break on investment coins and metal bullion. In vetoing a similar measure three years ago, Governor Kasich noted, “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.”

Last year, Governor Kasich recommended limiting or eliminating a number of tax breaks in his executive budget. For instance, he proposed:

- Eliminating the tax credit and discount that sellers of beer, wine and mixed beverages get for paying their alcoholic beverage tax a few weeks in advance;
- Limiting the amounts retailers can receive for collecting the sales tax, known as the vendor discount. Most states either have no discount at all or cap the amount, ensuring that big retailers do not reap a windfall. Indeed, Tax Commissioner Joe Testa said in testimony that Ohio’s 0.75 percent discount “essentially functions as a profit center” for big-volume retailers. According to data in the 2009 tax expenditure report, more than half of the \$50.7 million received in such discounts in 2008 went to the 687 retailers that collected at least \$1 million in tax, while the 197,487 other retailers got the rest;
- Cutting the sales-tax exemption for trade-ins of used cars and boats in half, and
- Repealing the 2.5 percent discount that distributors of cigars, chewing tobacco and other tobacco products get for timely payment of their taxes. “It shouldn’t be necessary to reward businesses for paying their tax on time,” as Testa noted.

We agree with Commissioner Testa and Governor Kasich. Together, those changes would have generated more than \$130 million in extra state revenue by 2017.

Beyond these tax breaks, others, too, deserve limitation or repeal. For example, the state offers a write-off against the commercial activity tax for losses that big companies experienced before the tax was enacted, even though they no longer pay taxes on their income. This credit was only available to companies with such deductions that amounted to more than \$50 million, making it clearly discriminatory against smaller businesses. The tax code features a sales-tax exemption worth more than \$27 million a year for pollution-control equipment purchased by utilities even though most of it is mandated, and a cap on sales tax for wealthy buyers of shares in jet aircraft, who pay only a fraction of the tax they would otherwise.

The above is not a comprehensive list. Most importantly, it indicates that tax expenditures deserve the same scrutiny as legislative appropriations. As we have previously suggested to the 2020 Tax Policy Commission, the Grace Commission should request that the Department of Taxation and

the Legislative Service Commission detail their understanding of why each of these expenditures was originally approved, and whether that purpose is being met now.

A permanent mechanism for regularly analyzing every tax expenditure should be approved. House Bill 9 would take a useful step in that direction by requiring a review of tax expenditures every eight years. HB 9 would have a more significant impact if it included automatic sunsets for tax expenditures, so they expired unless the General Assembly reauthorized them. There is no guarantee that the state will continue spending each biennium on specific line items, and there should be no such guarantee for spending through the tax code. The worth of each expenditure should be proven, just as legislative appropriations are tested in the budget process.

A previous witness was asked about research regarding a flat-rate income tax. Commissioner Testa had something to say about that before the 2020 Tax Policy Commission that bears repeating here: “It’s going to be hard to come up with a rate that doesn’t create a lot of losers.” That’s because the graduated income tax in Ohio and 32 other states is based on ability to pay. It makes up for some of the unfairness of sales, property and excise taxes, which fall more heavily on low- and middle-income taxpayers. Even so, Ohio’s state and local tax system is tilted against those taxpayers. A recent analysis by the Institute on Taxation and Economic Policy (ITEP), a national research group with a sophisticated model of state and local tax systems, found that the bottom-earning fifth of Ohioans on average pay nearly twice as much in state and local taxes as the top 1 percent do. Of the ten states with the most regressive tax systems, five have no general income tax, and three more – Illinois, Pennsylvania and Indiana – have flat-rate income taxes. In an analysis before the approval of last year’s budget, ITEP found that as a group, the bottom 95 percent of Ohioans would pay more under a 3.5 percent flat income tax than they were paying.

A flat tax is hardly a prescription for job and economic growth, as the experience of Michigan and other nearby states indicates. Jobs grew less than the national average over the past decade in states neighboring Ohio with flat income taxes. Overall, economic performance of the eight states with flat income taxes is all over the map.

As income inequality has grown, so has the need for a strong, graduated income tax, in which the tax rate goes up as income does. A flat tax that reduces taxes on top earners, the only ones who have been experiencing significant income growth, reduces the state’s long-term ability to generate sustainable revenue needed to provide for public services.

And our state needs more significant investments in a host of areas. Despite growing recognition of the need for strong public transportation systems, Ohio’s state support remains far below that of most other states – and transit agencies struggle just to maintain existing services. Quality preschool and child care is unavailable to many families, though early childhood education helps children thrive in school and helps parents work. While we have capped or frozen tuition, Ohioans still have a harder time affording to go to college than most Americans. Tens of thousands of vacant properties scar our neighborhoods. Across Ohio’s non-Medicaid human services, state funding next fiscal year will be \$263 million below funding in 2008, adjusted for inflation - although need, represented by the poverty level among the population, has grown. This has left case workers struggling to provide basic human services, like child protective services, in counties across the state.

This is inefficiency, writ large. Ohio can ill afford to underinvest in key public services even while doling out hundreds of millions of dollars a year for unneeded tax breaks.

Thank you for allowing me to testify. I am happy to answer any questions that you may have.

###

*Policy Matters Ohio is a non-partisan policy research institute
creating a more vibrant, equitable Ohio.*