TESTIMONY
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Tax & Budget

Testimony

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Good morning, Chairman Oelslager and members of the committee. I am Wendy Patton, senior project director at Policy Matters Ohio, a nonprofit, nonpartisan research institute with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for this opportunity to testify today. We are pleased to see the implementation of House Bill 9 of the 131st General Assembly, which established a formal review of Ohio's $9 billion in annual tax expenditures, commonly known as tax breaks.

Today's review includes some of the largest items among Ohio's 129 tax expenditures. The manufacturing exemption alone represents a use of state resources that is greater than annual funding for the Ohio Departments of Rehabilitation and Correction and Youth Services combined.[1] The 15 items we were told are on the agenda for evaluation over the next five weeks represent more Ohio tax dollars foregone than are spent in the primary Medicaid budget line (651525).[2] The growth rate of Ohio's tax expenditures is estimated to be 8.3 percent in the 2018-19 budget period compared to the prior, two-year budget; by comparison, the General Revenue Fund will grow by 2.1 percent. Three of the five tax breaks you are evaluating today are among the top 10 in terms of the largest dollar growth over that time period (the sales tax exemptions for manufacturing machinery and equipment, sales to churches and non-profits and packaging materials and equipment).

House Bill 9 provided for the Tax Expenditure Review Committee to direct the Legislative Service Commission (LSC) in assisting it. Given the enormous size, long history and complexity of the tax expenditures under review today, a thorough analysis should have been requested from LSC and provided in advance to the public, so Ohioans could comment more knowledgeably on this huge use of state resources. House Bill 9 outlined specific criteria for the committee to consider in deciding whether each expenditure should be continued, repealed, modified or scheduled for further review. The notice for this meeting asked the public to address the criteria. The lack of prior and published evaluation makes it difficult for both the public and lawmakers to make the most effective use of this hearing.

Other states provide detailed evaluations for this work. Washington State, a leader in tax break oversight, releases an annual overview of all state and local tax expenditures and their impact on beneficiaries and state revenues by tax and by sector. The Indiana Legislative Services Agency's Incentive Review Team of eight, with the assistance of eight additional analysts named as authors, takes a deep dive into business incentives and recommends modifications. So does the Maryland Department of Budget and Management, which last November found a biotech incentive ineffective and recommended improvement through coordination with related programs, better targeting and a reduction of administrative burden. Virginia's evaluation of the state's sales-tax exemption for non-profits included a survey of the

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[1] Total state expenditure (excluding federal funds) for the Ohio Department of Rehabilitation and Correction in 2018 is $1.8 billion and funding for the Ohio Department of Youth Services (excluding federal) is $216.5 million. The manufacturing exemption is $2.2 billion in 2018.
[2] Total state expenditure (net of federal dollars) in the 651525 agency line item, the primary Medicaid line item in the General Revenue Fund, is $3.7 billion in 2018. The estimate of revenue foregone in 2018 of because of the five items to be considered today totals $3.2 billion in 2018; for the first 15 items of the tax expenditure report, it is $4.5 billion.

tax break in other states and found in some places it is far narrower than in others. Texas requires an incidence study of each tax break, which allows lawmakers and the public to understand the income levels of beneficiaries for major tax breaks, and how tax breaks impact various sectors.

Understanding each tax expenditure should begin with data on how many entities are benefiting from it. A number of other states provide such information. For instance, California's tax expenditure report disclosed that 8,099 returns in 2015-16 claimed its sales and use tax exemption for manufacturing and research and development equipment and leases. In response to a query from Policy Matters Ohio, the Ohio Department of Taxation told us that it does not have data to identify how many taxpayers have utilized the manufacturing exemption or others on today's agenda. While purchasers of many items excluded from the sales tax are required to fill out certificates to claim an exemption, these are designed to protect the vendors collecting the tax, and the taxation department only sees them if it is conducting an audit. The committee should ask the department and the LSC how data on the number of entities receiving exemptions can be collected, or estimated in limited cases, and recommend legislation to ensure that.

In conducting your review, the committee should look into more detailed questions (Policy Matters recommended some in a September report). For instance, in examining whether a tax break "promotes or would promote growth or retention of high-wage jobs in the state," one of the factors permitted under the law, the committee should request data on wage levels for employees at recipient companies, and whether they are paid enough that they and the family members do not need public benefits such as Medicaid and food aid. In considering possible modifications, the committee should consider whether guard rails should be added to ensure that recipients are paying taxes, complying with state laws and providing information that allows for appropriate review of the tax break. In Virginia, for instance, the law that established the sales-tax exemption for nonprofit organizations required, among other things, that they be in compliance with state solicitation laws, have administrative costs that do not exceed 40 percent of annual gross receipts, and provide an estimate for their total taxable purchases.

Over time, individual tax breaks are changed, broadened, and extended through the courts and the General Assembly. Tax expenditures are not a normative and structural part of every state's tax code, but benefits created through the political process – passed into law – and changed the same way, over time. For example, in some places, the manufacturing exemption is partial and does not cover the full tax, while in others, it is only provided to new or expanding businesses. While the vast majority of states with a sales tax offer some kind of a manufacturing exemption, its form and effect stems from a political process that varies from state to state and over time. Lawmakers need to ensure that it and the others now under review remain appropriate, true to their purpose and effective for Ohio's current economy.

The state has cut funding for libraries and local governments and underfunded early childhood education, public transit and other services relative to need. Yet tax expenditures – which have every bit as much impact on the state budget – have continued to grow and proliferate. Beyond a review of specific tax expenditures, the Tax Expenditure Review Committee should look to cut back on tax breaks. As the tax counsel to the Ohio Manufacturers' Association told the 2020 Tax Policy Commission two years ago, "To preserve the integrity of the broad tax base and ensure fairness, credits and exemptions should be reduced and discouraged."

Some may come before you today seeking to expand exemptions. While like you, we will listen with an open mind, we suggest that before making such recommendations, you weigh carefully if this is the best purpose that Ohio's tax dollars can be put toward given the challenges that the state faces. The existing manufacturing exemption does not exempt all business inputs from the sales and use tax; if so, there would be no need for the Ohio Administrative Code to outline 64 different examples of what is and isn't taxable under the exemption. This is a $2.2 billion dollar program. Committee members should understand all of the elements of this tax exemption, who they serve, and changes over time, to ensure they make sense in today's economy. This is how you look at expenditures in the budget. There is no reason to treat tax expenditures differently.

Tax expenditures represent an invisible entitlement that persists over time. It is the job of the Tax Expenditure Review Committee to bring transparency and accountability to this huge use of state resources. Transparency requires an analysis to inform the public that goes beyond testimony of witnesses, some of whom may be beneficiaries. We urge you to provide better information for the next meetings and continue to improve the tools you need to make long-overdue decisions about continuing, repealing or modifying Ohio's $9 billion in tax expenditures.