POLICY MATTERS OHIO

Tax loopholes are expenditures

But they become permanent, unlike other appropriations.

This fiscal year, the state will forego $7.73 billion taxpayer dollars due tax exemptions, credits and deductions, or "tax expenditures," as they are known. That is just about the size of the biennial budget shortfall faced by the State of Ohio.

According to the Ohio Department of Taxation, tax expenditures result in a loss of tax revenue to state government, thereby reducing the funds available for other government programs.

Tax expenditures are passed in legislation, but not revisited. The reason for the initial incentive may have passed, but the tax expenditure lives on. For example, brewers and beer importers receive a credit on beer and malt beverage taxes paid a few weeks in advance. This may have been enacted to encourage timely compliance with a new tax law. But its purpose – to incentivize compliance – has passed.

Exemptions and credits against the sales tax account for an estimated $5 billion this fiscal year, or close to two-thirds of the total for tax expenditures in the state. The Ohio Manufacturers' Association recently noted that the state sales tax "has become riddled with exemptions, carve-outs and credits."

Among the tax expenditures included in Ohio law are:

- A tax break for banks that is much greater than the entire corporate franchise tax they pay.
- A $1.7 billion annual sales-tax exemption for manufacturers on purchases of machinery, equipment, supplies and fuel, which has not been examined since it was last overhauled in 1990.
- Special breaks for special industries, such as a sales-tax cap for affluent buyers of time shares in jet aircraft.
- A credit for previous operating losses against the Commercial Activity Tax – available only to companies that had $50 million in losses. Small companies with small losses were not eligible.
- Ohio also gives special treatment to mortgage brokers and payday lenders: They pay a lower state tax rate because of an outmoded tax unique to Ohio.
- Lobbyists and debt collectors don't have to bill their clients for sales tax.

Other states are limiting tax expenditures:

Oklahoma approved a two-year moratorium on a number of tax credits, while deferring the payment of others.

Colorado has made a number of changes to its tax expenditures:

- ended its sales-tax exemptions for direct mail advertising materials, energy used in manufacturing, candy and soda, downloaded software, food wrappers and condiments, and agricultural input such as pesticides.
- repealed the income-tax credit for certain alternative-fuel cars and
- limited the income-tax deduction for business operating loss to $250,000 a year.

Iowa suspended its scandal-plagued film credit for two years and took other steps to reduce credits.

Kansas gave a two-year, 10 percent “haircut” to a slew of tax credits, from R&D incentives to expenses associated with plugging abandoned gas or oil wells.

Table 1: Top 20 tax expenditures in Ohio, FY 2011, by Forgone GRF Revenues

Top 20 Tax Expenditures, FY2011, by Foregone General Revenue Fund Revenue				
Rank	**Type of tax against which exemption is taken**	**Tax expenditure description**	**Foregone FY2011 Revenue (millions of dollars)**	**Originally Enacted**
1	Sales and use	Property used primarily in manufacturing tangible personal property	1,724.30	1935
2	Sales and use	Sales of prescription drugs and selected medical items	696.9	1961
3	Individual income	Personal, spousal, and dependent deduction	519.8	1972
4	Sales and use	Building and construction materials and services used in certain structures	435.5	1959
5	Individual income	Social Security and railroad retirement benefits	362	1972
6	Sales and use	Sales to churches and certain other non-profit organizations	347.5	1935
7	Sales and use	Sales of tangible personal property and services to electricity providers	331.8	2000
8	Sales and use	Packaging and packaging equipment	230.4	1961
9	Individual income	Joint filer credit	225.2	1973
10	Commercial activity	Exclusion of first $1 million of taxable gross reciepts	222.8	2005
11	Corporate franchise	Goodwill, appreciation, and abandoned property of financial institutions	186.8	1933
12	Sales and use	Transportation of persons and property	177.4	1935
13	Sales and use	Tangible personal property used or consumed in agriculture and mining	153	1935
14	Individual income	$20 personal exemption credit	152.5	1983
15	Individual income	Resident credit for income taxed by another state	141.1	1972
16	Individual income	Retirement income credit	135.1	1983
17	Sales and use	Sales to the state, its political subdivisons and certain other states	129.3	1935
18	Sales and use	Value of motor vehicle trade-ins	120.2	1981
19	Sales and use	Tangible personal property used directly in providing public utility services	117.6	1935
20	Commercial activity*	Job creation credit	101.5	1993

Source: Policy Matters Ohio based on data from the Ohio Department of Taxation