Institute finds leak in tax collection

Study points out corporate hole

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COLUMBUS | Ohio needs to put a clamp on the ability of businesses to avoid the corporate franchise tax, the tax levied on a company s net income or its net worth, particularly in light of a looming state budget crisis.

That's the major conclusion of a study released Wednesday by Policy Matters Ohio, a Cleveland based nonprofit research institute.

Daniel Navin, managing director of legislative affairs for the Ohio Chamber of Commerce cautioned, however, that keeping taxes low is one advantage Ohio can offer in the competition for jobs with states that offer such amenities as mountains and ocean coastlines.

According to the study, the corporate franchise tax accounted for 16 percent of the state's general fund revenue in 1975, but just 4.6 percent in fiscal 2002, which ended June 30. The decrease is part of an overall decline in the share of state and local taxes paid by business, the study said. It cited a report by Cleveland State University economist Ned Hill that found overall business taxes fell from nearly 40 percent of state and local taxes in 1976, to 29 percent in 1999.

Part of the reason for the percentage decline of the corporate franchise tax in the general fund is growth in other taxes, such as the personal income tax, the study said. Tax avoidance, however, also is a major reason, the study found

The amount of corporate franchise taxes collected decreased in each of the past four fiscal years, the study said.

"Compared to gross state product, the measure of everything produced in Ohio, corporate

franchise tax revenues are at their lowest level in decades," the study found.

One way businesses avoid taxes is by shifting income to affiliated companies in other states, where it will not be taxed as heavily, the study said.

A second reason for the decline is a $150,000 cap on corporate franchise taxes collected under the net-worth formula. The cap has been in effect since 1999.

The state collects the tax on either a company s profits or its net worth the assets of a company minus its liabilities whichever is higher.

The net-worth provision is included to make sure the state continues to collect some taxes when the economy weakens and profits sag, the study said. Capping the tax "helped lead to an especially large falloff in collections when the economy weakened," it said.

The study also said tax credits and reductions in tax rates have cut down on collections.

The study recommends that Ohio do what California and 15 others states have done require combined reporting. This would require that affiliate companies operating as a single business be treated as a single taxpayer. The Ohio Department of Taxation has estimated that combined reporting would mean an additional $200 million a year for the state, the study said.

Also, the study called for eliminating the $150,000 cap on taxes collected under the networth formula. The cap discriminates in favor of large companies, the study said.

It also called for a moratorium on the creation of new tax credits and stricter standards for using existing ones.

Navin, the Ohio Chamber of Commerce executive, said there are valid business reason other than tax avoidance for companies to operate a number of affiliated entities that are

taxed separately. Requiring combined reporting would put Ohio at a competitive disadvantage with states that don t have it, he said.

Also, putting a cap on taxes collected under the net-worth formula was just one part of comprehensive franchise tax reform enacted in 1997. Businesses gave up some tax benefits in exchange for the cap, he said.

Navin said the chamber doesn t oppose getting rid of unproductive tax credits, but that some of them such as those aimed at spurring investment, creating jobs and providing job training are needed.