Limiting Loopholes:
A dozen tax breaks Ohio can do without

Executive Summary

Ohio gives special tax treatment to payday lenders and mortgage brokers – they pay a lower state tax rate than banks under an outmoded tax unique to Ohio. Lobbyists and debt collectors don't have to bill their clients for sales tax. The state recently made it much easier for high-income retirees who spend part of the year out of state to avoid paying Ohio income tax. These tax breaks, which together cost the state more than $65 million a year, are among those that are squeezing the state budget even as it is feeling more stress from the weakening economy.

The state should conduct a broad review of the tax code to pinpoint tax loopholes that should be closed. In this report, Policy Matters Ohio begins that task by identifying a dozen tax breaks whose elimination or limitation would both make the state tax system fairer and generate up to $270 million annually in revenue for needed investments. Besides those above, these also include:

- Three property-tax reduction programs that should be limited to those who need them. These include the homestead exemption for seniors (which would save at least $118 million a year) and the 10 percent and 2.5 percent rollbacks for residential homeowners and owner occupants (which, together, would save at least $5.2 million a year). Both Gov. George Voinovich and Gov. Bob Taft unsuccessfully attempted to limit the latter rollbacks based on the value of the property. Taft would have limited it to property values under $1 million.

- Special-interest breaks on the Commercial Activity Tax. These favor giant distribution centers at a cost of $6 million a year. They also give special advantages to companies that lost tens of millions of dollars prior to the phase-out of the state's corporate income tax. These companies will be allowed to write off these losses over 20 years starting in 2010, costing the state up to $45 million a year. Lose a little, and the state can't help you. Lose a bundle, and you qualify.

- A recent loophole that allows certain trusts to choose which tax to pay, the income tax or the Commercial Activity Tax, cutting their taxes by up to $18 million this fiscal year.

- A newly created tax break for Avon Products, which won a sales-tax exemption on machinery and equipment at a new warehouse in Zanesville nine months after it broke ground (costing at least $3.7 million). The General Assembly extended this special break to Avon because the company had been mistakenly told by state officials that it would be eligible for another existing tax break. Rather than create a new loophole for Avon, the state should repeal the original one (costing $6.4 million this fiscal year).

- An exclusion from the main tax on banks that allows them to shift income into subsidiaries and avoid taxation.

These tax breaks are unwise in good times and unaffordable now, as the state budget faces a new period of stress. Gov. Ted Strickland has already ordered cuts and adjustments to the current biennial spending plan twice, by a total of more than $1.2 billion, amidst lower than expected tax revenues. In the next two-year budget, beginning July 1, additional pressures will face the General Assembly, including the continuing phase-in of tax cuts approved in 2005. Reductions in the income tax alone are expected to slash more than $2 billion from state revenues each year starting in FY2010, compared to before the tax

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cuts. Yet Ohio has additional needs, such as handling the all-time record number of prisoners in state facilities, supporting additional spending called for in the higher education plan and providing insurance for rising numbers of Medicaid enrollees. And that excludes outlays for primary and secondary education, and other needed investments in Ohio's people and infrastructure.

Under Ohio's state and local tax system, like those in most states, low- and middle-income taxpayers pay a larger share of their income in taxes than upper-income taxpayers do. The tax breaks identified here further skew Ohio's taxes against individuals in general and low- and middle-income individuals in particular, in favor of businesses and higher-income individuals. This report is not comprehensive. Beyond eliminating or limiting the tax breaks described here, the state should review which services should be covered by the sales tax, as much of this sector falls outside the tax. It should conduct a regular review of all the tax breaks embedded in the revised code, as some states already do.

This report was prepared with financial support from The Center for Community Solutions. The conclusions and opinions do not necessarily represent those of The Center for Community Solutions. Community Solutions is preparing an update of its series on Ohio's tax system, Taxing Issues, which it plans to complete before the end of the year (For more information about the update, contact John Habat, Director, Public Policy and Advocacy, at 216-781-2944 or jhabat@CommunitySolutions.com).

Policy Matters Ohio has previously released a report making recommendations regarding the state income tax (see http://www.policymattersohio.org/StepTowardFiscalBalance.htm), and will be releasing additional tax research this year.