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BUDGET BRIEF

New Tax Breaks in the Ohio State Budget

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The budget bill approved by the Ohio General Assembly in June imposes devastating cuts on schools, local governments and health and human services. These cuts will hurt our economy and result in fewer jobs in the public and private sectors. Yet elected leaders who tout the virtue of spending cuts are spending on the other side of the ledger: In the tax code. The final phase-in of a 21 percent income tax cut enacted in 2005 is costing $800 million over the two-year budget. This did not require specific action to go into effect. By contrast, legislators affirmatively approved more than $400 million a year in new tax breaks when fully implemented, the bulk of them for wealthy Ohioans and special interests. And that underlines a key aspect of largest tax changes in the budget: They are timed so they don't substantially affect revenues until after the FY2012-13 biennium, leaving it to the next General Assembly to figure out how to make up the hundreds of millions of dollars of lost revenue to the state and localities.

The budget authorizes, expands, extends or otherwise modifies more than a dozen tax breaks for businesses, agriculture, energy, racetracks and more. It eliminates the estate tax, which applies to just the wealthiest 8 percent of Ohio estates, and provides hundreds of millions of dollars for local services. In the first few months of the 129th General Assembly, Ohio legislators have considered more than three dozen tax cuts, credits, modifications or eliminations and Governor John Kasich has discussed possible new tax cuts for banks and investors.

Tax expenditures are earmarks in the tax code, but get a lot less attention. These exemptions, credits and deductions often benefit particular entities or special interests. While frequently justified on the basis of "job creation," many are targeted to boost profits; in these cases, jobs are generally a secondary objective that may or may not "trickle down." They are the gift that keeps on giving: Ohio's tax expenditure budget will amount to more than $7 billion a year for 128 tax breaks during FY12-13, some of which have been on the books since the 1930s.

The budget bill, House Bill 153, in one form included a proposal inserted by the Senate that would have established a tax expenditure review commission, charged with scrutinizing the objectives and effectiveness of each tax expenditure. The commission was to review each proposed tax expenditure as a step in the legislative process and existing tax expenditures were to be individually reviewed once every eight years. However, this measure was not included in the final budget bill.

Tax expenditures and other changes included in the budget bill are listed and briefly described below. Dozens of other new tax expenditures are under consideration in the General Assembly. One would provide a commercial activity tax (CAT) credit on investment losses by foreign entrepreneur investors who invest in certain Ohio projects. Another would reduce the income tax rate on capital gains reinvested in Ohio-based investments. These are just two among many. The state should be reviewing and restricting tax expenditures, rather than simply adding more of them.

Tax breaks proposed in HB 153, the SFY 2012-13 budget

1) A new personal income-tax tax credit on investments in "small business enterprises." This investment tax credit, dubbed InvestOhio and worth up to $100 million each biennium starting in FY2014-15, was dropped into the budget in conference committee without public review. The break would go to investors in companies with at least 50 Ohio employees or more than half of whose employees are in Ohio. Companies would have to have assets of less than $50 million or annual sales of no more than $10 million. Investors could get a 10 percent income-tax credit if they invested in such companies and held onto the investment long enough. The tax break is written so that an investor can qualify even if a company does nothing more than continue paying its existing employees. No new job creation is required. The proposal would reward many who would invest in Ohio anyway, costing the state badly needed revenue. It will complicate the tax system and add to the need for tax enforcement, while its benefit is unproven.

2) Commercial activity tax exemption for uranium enrichment facility transactions: This authorizes a commercial activity tax exemption for receipts from transactions involving uranium within a specific zone containing a uranium enrichment facility that meets certain qualifications. This tax break is targeted to operations of a particular entity, USEC Inc., at the Piketon nuclear reservation, where suppliers would not have to pay the CAT. It's uncertain if this project is going forward, but the Legislative Service Commission said the potential revenue may be several million dollars per year.

3) Expansion of the New Refundable Job Retention Tax Credit (JRTC): This provision gives a tax benefit which may be greater than the state commercial activity tax the recipient company pays; if so, the State writes a refund check for the overage. The General Assembly expanded a credit created earlier this year for an incentive deal for American Greetings. Originally the credit had a ceiling of $8 million a year, but a provision in the budget bill expands boosts the limit to $25 million in such credits between FY2011 and FY2013. The exact impact on the FY12-13 budget is not clear, but up to $25 million of such credits may be taken annually for 15 years.

4) Computer Data Center Sales and Use Tax Exemption: The budget authorizes the Tax Credit Authority to grant a full or partial exemption from all sales and use taxes for equipment used in the operation of a computer data center business that invests $100 million and maintains a $5 million annual payroll. Various sales tax exemptions for machinery and equipment purchased for use in manufacturing and other industries already exist; this expands the benefit to computer data centers. This is the type of tax loophole that benefits a particular company or a narrow set of companies, such as one for electronic publishers, dubbed the Lexis-Nexis tax break. The LSC pegs the estimated fiscal impact vaguely, at several millions of dollars. However, if a company should qualify, the benefit could run into the tens of millions of dollars, depending on the size of the investment and the deal negotiated by the state.

5) Sales Tax Exemption for Certain Tangible Property and Services Used in Agriculture: The budget exempts from the sales and use tax building materials and related services used in livestock structures for captive deer, horses and fish.* It also exempts tangible personal property or agricultural land tiles used "primarily" (in place of "directly" in current law) for farming, agriculture, horticulture, or floriculture. The estimated fiscal effect is not quantified. The state taxation department estimated in its biennial tax expenditure report that the previous exemption covering property used or consumed directly in farming (as well as mining and production of crude oil and natural gas) would be worth $276.5 million in FY2012. This could grow with the new language, but the amount is not known.

6) Sales and Use Tax Exclusion for Redeemed Customer Loyalty Coupons: The budget excludes from sales tax purchases made with gift cards or certificates that are part of a vendor's awards, loyalty, or promotional program. The fiscal effect is not quantified.

7) Historic Building Rehabilitation Tax Credit: The budget extends the credit for rehabilitating a historic building, which was to end June 30th of 2011, in perpetuity and allows $60 million in such credits per year against the personal income tax, the corporate franchise tax, or the dealers in intangibles tax. This yearly revenue loss won't begin to accrue significantly until after the FY2012-2013 biennium. The budget requires a cost-benefit analysis of the project as part of the approval process.

8) Estate Tax Repeal: The budget repealed the estate tax, effective in 2013. This tax amounted to $286 million in calendar 2010. Local governments receive 80 percent of the tax – $231 million in 2010 – so they will feel most of the effect. The estate tax does not impact 92 percent of Ohio's estates. The proceeds from eliminating this tax will go to heirs of wealthy estates. Local governments will have to make up for the cuts by raising less progressive taxes or eliminating services that help communities and families thrive. As with a number of the tax cuts and tax breaks approved in the budget, the repeal does not significantly affect revenue in the FY12-13 biennium, so the General Assembly has created a revenue hole that the next General Assembly will be responsible for.

9) Tax Exemptions for Privatized State Services: Sales, income and commercial activity tax breaks are provided for private firms that might operate the Ohio Turnpike and JobsOhio, the private entity taking over the state development department that is to buy the state wholesale liquor function. Such tax breaks will boost the return on investment for investors who purchase state assets. It will deprive Ohioans of revenues needed to support the state budget and its services. The fiscal effect is not quantified.

10) Tax on wagers at race tracks: Racing Facility Capital Improvement Tax Reduction Extension: Extends by three years, to December 31, 2017, from December 31, 2014, the final date on which a horse racing permit holder is eligible to take tax reductions to recover costs incurred in a renovation, reconstruction, or remodeling project costing at least $6 million at a race track (The taxes reduced are those paid on amounts wagered on racing). This credit amounted to $1.27 million in Fiscal Year 2009.

11) Tax Amnesty. The state will conduct two tax amnesty programs that between them will cover most major taxes, allowing delinquent taxpayers who haven't yet been assessed penalties to come forward and pay taxes they owe. One is a general amnesty on a variety of different

* The exemption was incorrectly described in an earlier version of this brief, which said that the tax exemption for building materials for structures used for horses and fish had been eliminated.

taxes, while another covers just the use tax, which is a complement to the sales tax that covers products used in Ohio on which sales tax is not paid (this levels the playing field between in-state and out-of-state vendors). The taxation department estimated that the two programs together would generate $12 million over the FY12-13 biennium. This includes an estimated $36 million gain attributable to taxes the state never would have collected if it were not for the existence of the general amnesty. It also includes a loss of revenue from the use tax amnesty estimated at $12 million in both FY12 and FY13. Participants in the use-tax amnesty will be immune from such tax liabilities incurred prior to January 1, 2009, thus reducing the amount of tax that would otherwise be paid as a result of audits. While the taxation department estimated the overall revenue effect of the amnesties to be positive, if such amnesties become frequent, they can promote taxpayers gaming the system. Ohio’s last general tax amnesty was in 2006. The General Assembly appropriated $2.5 million to administer the program.

The above list is not comprehensive; the General Assembly also made some other changes in tax provisions, such as mandating a seven-year time limit on assessment of unpaid use tax. More importantly, it also seized hundreds of millions of dollars a year that previously had flowed to schools and local governments in compensation for the phase-out of various local taxes (Policy Matters Ohio will summarize that in a separate release).

The legislature also made a number of changes regarding local property taxes:

1) School property tax exemption: Under current law, school buildings or land are subject to taxation if they are “leased or otherwise used with a view to profit.” The budget exempts such property from taxation if they are schools specializing in science, technology, engineering and math (STEM), charter schools, Educational Service Centers, or chartered, nonpublic schools serving primary or secondary educational purposes. The Legislative Service Commission says this may reduce taxes for some public schools and local governments, but does not estimate the amount.

2) Qualified energy project exemption to public utility property taxes: This tax break against the tax utilities pay on tangible personal property was implemented to encourage renewable energy generation projects (for example, wind farms or solar fields) that break ground in Ohio by the end of 2011. The budget extends the deadline by two years. Local fiscal impact is anticipated where such projects locate, but is not quantified by the LSC.

3) Convention center in Cincinnati: The budget exempts the Cincinnati convention center from property tax, “regardless of whether the property is leased to or otherwise operated or managed by a person other than the city.” It authorizes abatement of unpaid taxes for the convention center for any tax year at issue on the bill's effective date. The LSC notes that this reduces real property tax revenue in Hamilton County.

4) Reauthorization of Enterprise Zones. The budget authorizes the use of Enterprise Zone tax abatements for another year, until Oct. 15, 2012. While the use of these local property tax abatements has waned with the phase-out of the Tangible Personal Property tax, a recent report by the nonprofit Good Jobs First documented how EZ abatements in the Cleveland and Cincinnati areas have fueled suburban sprawl and regional inequality.