

# \$7 BILLION IN OHIO TAX BREAKS, AND NOBODY'S WATCHING

A REPORT FROM  
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ZACH SCHILLER

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## Executive Summary

The General Assembly should pay close attention to the new tax expenditure report. Prepared by the Ohio Department of Taxation (ODT) and sent to the legislature with the rest of Gov. John Kasich's budget, this report examines credits, deductions and exemptions in the tax code that reduce the amount of revenue the state would otherwise receive.

The taxation department estimated that in both Fiscal Years 2012 and 2013, 128 such exemptions and credits amounted to more than \$7 billion in foregone revenue to the state's General Revenue Fund. "Tax expenditures result in a loss of tax revenue to state government, thereby reducing the funds available for other government programs," ODT noted in the report. "In essence, a tax expenditure has the same fiscal impact as a direct government expenditure." The report estimates foregone revenue, which is not necessarily what the state would get if a tax expenditure was repealed.

Most tax expenditures remain in effect indefinitely with little or no scrutiny by policy makers. No committee of the General Assembly holds hearings on tax expenditures or systematically examines them as part of the budget process. Remarkably, Gov. Kasich has not proposed to limit or eliminate a single tax expenditure in his budget proposal. This is despite huge reductions in aid to local governments and proposed cutbacks to public education and higher education spending, programs for children, and most other items in the budget

A number of other states have a regular review process for tax expenditures. Since Ohio does not, we have no idea if the breaks are accomplishing their purpose or in some instances even what that purpose might be. This contradicts Gov. Kasich's stated intention to crack down on corporate welfare.

Among the highlights in the new report are:

- The number of tax expenditures has grown. It increased to 128, from 122 in the previous biennium.
- Most of the exemptions, credits and deductions go to businesses. Seventy-three of the tax expenditures, accounting for just over half of the total value in FY12 or \$3.7 billion, go for business assistance and economic development.
- Sales-tax expenditures account for the largest share of the total: 56, adding up to \$4.8 billion in FY12 and more than \$5 billion in FY13.
- Credits against the commercial activity tax (CAT) will amount to \$456.7 million in FY12, compared to estimated tax collections of \$1.47 billion.
- Five business tax credits against the commercial activity tax – four economic development incentives and a credit against past losses – are estimated to add up to more than \$100 million in annual tax credits. This tax was created in 2005 in part to cut down on loopholes that had existed in the corporate income tax it replaced.

- The state continues to provide special-interest tax exemptions and credits such as one for wealthy buyers of time shares in jet aircraft. That sales tax cap is worth more than the \$500,000 a year by which the governor's budget proposal would reduce aid to foodbanks. Eliminating the sales-tax exemption for pollution-control equipment purchased by utilities – most of it mandated – could reduce the cut to libraries by 21 percent.

Even while existing tax expenditures are going unexamined, the General Assembly is adding new ones. The recently approved transportation budget includes an exemption under the CAT for certain exchanges of motor fuel. ODT estimated its cost at \$5 million to \$10 million a year, not including a clause making it retroactive. It was approved despite opposition from business groups, which saw it compromising the broad base of the tax.

The General Assembly should closely review the tax expenditure report, and reduce or eliminate unneeded loopholes. It should set a target – 10 percent of the \$7.4 billion estimated for FY12 would make a good starting point – for temporary or permanent annual reductions as part of the FY12-FY13 budget. This could include reductions in tax credits, as other states have undertaken.

The General Assembly should set up a schedule to review all tax expenditures on a permanent basis. The purpose of each of the 128 tax expenditures identified in the report should be spelled out, so that the review can determine whether that purpose is being met. New tax expenditures should have automatic sunsets, so they only continue after their worth has been proven.

Not all tax breaks and loopholes are covered in the tax expenditure report. For instance, lobbyists don't collect sales taxes; the sales tax only covers services if they are specifically named in the law. A new income-tax deduction for gambling losses is not included because it won't affect collections in the FY12-13 biennium. These tax breaks don't make sense.

While it does not provide a comprehensive list of loopholes, Ohio's tax expenditure report provides a beginning point for analysis and action on this important element of the state budget. Now, it is up to the General Assembly to get started.

Little-noticed in Gov. John Kasich's budget proposal is Book Two, the tax expenditure report. This biennial report, produced by the Ohio Department of Taxation (ODT), examines credits, deductions and exemptions in the tax code that reduce the amount of revenue the state would otherwise receive.

The taxation department estimated that in both Fiscal Years 2012 and 2013, 128 such exemptions and credits will amount to more than \$7 billion in foregone revenue to the state's General Revenue Fund (see Table 1 below). "Tax expenditures result in a loss of tax revenue to state government, thereby reducing the funds available for other government programs," ODT noted in the report. "In essence, a tax expenditure has the same fiscal impact as a direct government expenditure." The report estimates foregone revenue, which is not necessarily what the state would get if a tax expenditure was repealed.<sup>1</sup>

The General Assembly should closely review the report, and reduce or eliminate unneeded loopholes. Both the House and Senate should review each of the 128 tax expenditures, starting with the 95 where the foregone revenue is \$1 million or more a year. The legislature also should consider reductions in exemptions – at a time when the state is likely to cut crucial support for public education, all tax breaks should be considered for temporary cutbacks. A number of other states have taken action to reduce tax expenditures, and especially tax credits, in light of fiscal distress. Additional recommendations are set out at the end of this report.

**Table 1. Summary of Revenue Foregone**

FY10	FY11	FY12	FY13
\$6,851,000,000	\$7,170,500,000	\$7,432,200,00	\$7,757,500,000

Source: Ohio Department of Taxation

This brief covers some of the highlights of this year's tax expenditure report, which include:

- The number of tax expenditures has grown. It increased to 128, from 122 in the previous biennium.<sup>2</sup>

<sup>1</sup> The revenue estimates in the report reflect "General Revenue Fund revenue foregone," or the benefits to recipients of the credits and exemptions. This is not necessarily the same as what the state would receive if the exemptions were eliminated, and as it has before, the department notes in bold-faced type that "the figures in this report do not represent potential revenue gain from the repeal of the tax expenditure." (p.4) There may be a time lag before the full effect of repealing the tax expenditure shows up in revenues, not all taxpayers may immediately comply with the change in law, or taxpayers could behave differently because of the change. State of Ohio, The Executive Budget, Fiscal Years 2012 and 2013, Book Two: the Tax Expenditure Report, Prepared by the Ohio Department of Taxation, Joe Testa, Tax Commissioner, p. 1, available at <http://obm.ohio.gov/>.

<sup>2</sup> One of the six credits shown in the new report that wasn't in the previous one – the 25% credit for certain purchases by electronic information service providers – was included though it basically is superseded by another full exemption for property used in electronic publishing. However, the taxation department included it because it still exists in Ohio law, though it has a minimal impact on revenue. E-mail from Christopher Hall, Ohio Department of Taxation, March 21, 2011.

- Most of the exemptions, credits and deductions go to businesses. Seventy-three of the tax expenditures, accounting for just over half of the total value in FY12 or \$3.7 billion, go for business assistance and economic development.
- Sales-tax expenditures account for the largest share of the total: 56, adding up to \$4.8 billion in FY12 and more than \$5 billion in FY13.
- Credits against the commercial activity tax will amount to \$456.7 million in FY12, compared to estimated tax collections of \$1.47 billion.
- Four credits – economic development incentives – that were previously taken against the franchise tax but now are taken against the commercial activity tax are projected at \$93.3 million in FY13. In FY10, they were estimated to cost \$71.9 million. This is largely because of expected growth in the job retention tax credit. A fifth credit estimated at \$8 million a year allows companies to write off against the CAT previous losses above \$50 million they experienced. Thus, altogether, more than \$100 million in transferred business tax credits are expected against this tax, which was created in 2005 in part to cut down on loopholes that had existed in the corporate income tax.
- The state continues to provide special-interest tax exemptions and credits such as one for wealthy buyers of time shares in jet aircraft, and neither the General Assembly nor the governor have moved to scrutinize them or develop a regular review process, as some other states have.

“Unlike direct budgetary expenditures, unless there is a pre-existing termination date, tax expenditures may remain in effect indefinitely with little or no scrutiny by policy makers,” the report notes.<sup>3</sup> Ohio is unusual among states in producing a tax expenditure report as a part of its budget process. However, no committee of the General Assembly holds hearings on tax expenditures or systematically examines them. Remarkably, Gov. Kasich has not proposed to limit or eliminate a single tax expenditure in his budget proposal. This is despite huge reductions in aid to local governments and proposed cutbacks to public education and higher education spending, programs for children, and many other items in the budget.

Among the tax exemptions and credits estimated in ODT report are:

- One worth \$600,000 for buyers of shares in jet aircraft, who pay only a fraction of the sales tax they would otherwise.<sup>4</sup> The state has an \$800 cap on total state sales tax paid for each aircraft, so a buyer who spends \$150,000 may save thousands of dollars in sales tax. By contrast, the governor’s budget proposal would reduce aid to foodbanks by \$500,000 each year.<sup>5</sup>

<sup>3</sup> Tax Expenditure Report, p. 1

<sup>4</sup> Ohio Department of Taxation, Sales Tax Expenditure Estimate 1.32, \$800 tax cap on qualified fractionally-owned aircraft. Produced on January 19, 2011. Based simply on sales of such aircraft in Ohio, the amount of foregone revenue would be greater. However, the biggest seller of such aircraft said it would locate sales outside Ohio to minimize its tax exposure if there was no cap, so the state would not receive the additional revenue.

<sup>5</sup> State of Ohio, The Executive Budget, Fiscal Years 2012 and 2013, Book Four: The Savings Book, p. 46

- A tax break for banks covering goodwill, appreciation and abandoned property. This exemption is worth more than 61 percent of the entire amount of corporate franchise tax expected to be collected in FY12. The tax expenditure report estimates the foregone revenue at \$119.6 million in FY2012, while the franchise tax is expected to generate \$195 million that year.<sup>6</sup> Under this exclusion, banks may be able to reduce their tax by shifting income-producing assets into out-of-state subsidiaries in exchange for stock in those subsidiaries.<sup>7</sup> While the exact amount of savings from reining in this exclusion is not clear, it would certainly pay for the \$4.7 million over two years that the proposed budget would eliminate in General Revenue Funding for Federally Qualified Health Centers, along with other important programs being cut at the Department of Health.
- A \$17.3 million sales-tax exemption in both FY12 and FY13 for pollution-control equipment purchased by utilities even though most of it is mandated.<sup>8</sup> This could instead reduce the cut to libraries by 21 percent.
- A write-off against the Commercial Activity Tax for losses companies experienced before it was enacted, even though they no longer pay taxes on their income. This break is available only for companies with at least \$50 million in losses; small businesses that had losses less than that were excluded. Value in FY12: \$8 million.<sup>9</sup> If Ohio had this revenue, it could avoid the governor's proposed elimination of the kinship permanency program, which keeps families together by allowing grandparents and other relatives to care for children who otherwise would go to more expensive foster care. That program is to be cut by \$5 million a year.
- The vendor discount, worth \$49.4 million in FY12, under which retailers that collect the sales tax get a 0.75 percent discount on what they collect if they send the tax in by the due date of the tax return. While this uncapped discount may have made sense before the days of computers, today this is a windfall for big retailers, which get most of the benefit. According to data in the previous tax expenditure report, more than half of the \$50.7 million received in such discounts in 2008 went to the 687 retailers that collected at least \$1 million in tax, while the 197,487 other retailers got the rest.<sup>10</sup>

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<sup>6</sup> State of Ohio, The Executive Budget, Fiscal Years 2012 and 2013, Book One Economic Forecast and Income Estimates, p. B-12

<sup>7</sup> See Schiller, Zach, *Limiting Loopholes: A Dozen Tax Breaks Ohio Can Do Without*, Policy Matters Ohio, September 2008, p. 6, available at <http://www.policymattersohio.org/pdf/LimitingLoopholes2008.pdf>

<sup>8</sup> See Schiller, Zach, Report to the Ohio Budget Planning and Management Commission, Policy Matters Ohio, August, 2010, p. 9, available at <http://www.policymattersohio.org/pdf/BPMC2010.pdf>

<sup>9</sup> This credit was estimated to cause a larger revenue loss in the previous tax expenditure report, but was scaled down because most of the applications for the credit were rejected or adjusted downward by the Taxation Department after audit.

<sup>10</sup> State of Ohio, Executive Budget, Fiscal Years 2011 and 2012, Book Two, Tax Expenditure Report, Prepared by the Department of Taxation and Submitted to the 128<sup>th</sup> General Assembly, February 2009, p. 51.

Most states with sales taxes either limit the discount or don't have it at all.<sup>11</sup> Capping this discount would easily pay for the cut in the proposed budget for the Ohio College Opportunity Grant, the state's need-based financial aid program for college students.

As noted, it can't be assumed that the state would receive all of the potential revenue were tax expenditures repealed. However, to put the size of these in perspective, the foregone revenue estimated by the Taxation Department for all tax expenditures would add up more than a quarter of the GRF revenue if added to taxes that are expected to be collected. This is based on estimated tax receipts in FY2012 and FY 2013, which are estimated in the governor's budget proposal at \$18.58 billion and \$19.96 billion, respectively.<sup>12</sup>

A number of other states have established a regular review process for tax expenditures.<sup>13</sup> Ohio has not. Thus, we have no idea if they are accomplishing their purpose or in some instances even what that purpose might be. This is a dramatic failing in light of the state's budget crisis and the major cuts that have been proposed for local governments, K-12 education and across the wide arc of state activities. It also contradicts Gov. Kasich's stated intention to crack down on corporate welfare.<sup>14</sup>

The list of the largest tax expenditures has remained similar to that from two years ago; 19 of the top 20 in value in FY12 were listed in the top 20 for FY11 in the last report. Some have risen while others have fallen, however.

By far the largest, estimated at \$1.57 billion in FY12 and \$1.62 billion in FY13, is the sales-tax exemption for machinery, equipment, fuel and supplies used in manufacturing. Most states with a sales tax have a similar exemption. However, Ohio's has not been examined closely since it was last overhauled in 1990. The size of this exemption suggests it should be reviewed more often. Table 2 lists the 20 largest tax expenditures, according to the taxation department. With one exception, each accounts for at least \$100 million in foregone revenue:<sup>15</sup>

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<sup>11</sup> Good Jobs First, "Skimming the Sales Tax: How Wal-Mart and Other Big Retailers (Legally) Keep a Cut of the Taxes We Pay on Everyday Purchases," November 2008, available at <http://www.goodjobsfirst.org/sites/default/files/docs/pdf/skimming.pdf>

<sup>12</sup> State of Ohio, The Executive Budget, Fiscal Years 2012 and 2013, Book One, p. B-37. The governor's proposal would transfer significant revenue into the GRF that has previously gone to local governments and libraries. If this part of his proposal is not approved, or scaled back, the share that tax expenditures represent of GRF taxes would rise.

<sup>13</sup> Washington, Oregon and Arizona, for instance, have such regular examinations. See Schiller, Zach, Report to the Ohio Budget Planning and Management Commission, Policy Matters Ohio, August, 2010, pp. 10-11, available at <http://www.policymattersohio.org/pdf/BPMC2010.pdf>

<sup>14</sup> John R. Kasich, Governor, State of Ohio, 2011 State of the State Address, March 8, 2011, pp. 11-12, available at <http://governor.ohio.gov/LinkClick.aspx?fileticket=F0dznJHdKRE%3d&tabid=40> .

<sup>15</sup> The taxation department does not include the sales tax exemption on food for off-premises consumption in the tax expenditure report because it is part of the Ohio Constitution and cannot be changed simply through legislative action. The department has four basic criteria for determining whether a tax provision constitutes an Ohio tax expenditure: 1) the item reduces, or has the potential to reduce, one of the state's General Revenue Fund taxes, 2)

Table 2

<b>Top 20 Tax Expenditures, FY2012, by Foregone General Revenue Fund Revenue</b>				
<b>Rank</b>	<b>Type of tax against which exemption is taken</b>	<b>Tax expenditure description</b>	<b>Foregone FY 2010 Revenue (millions of dollars)</b>	<b>Originally Enacted</b>
1	Sales and use	Property used primarily in manufacturing	\$1,568.9	1935
2	Sales and use	Sales of prescription drugs and selected medical supplies	\$571.4	1961
3	Individual Income	Personal exemption	\$560.2	1972
4	Sales and use	Sales of tangible personal property and services to electricity providers	\$463.0	2000
5	Sales and use	Sales to churches and certain other types of non-profits	\$395.3	1935
6	Sales and use	Tangible personal property used in agriculture or mining	\$276.5	1935
7	Sales and use	Social security and railroad retirement benefits exemption	\$266.8	1972
8	Sales and use	Packaging and packaging equipment	\$258.6	1961
9	Individual Income	Joint filer credit	\$228.8	1973
10	Commercial Activity	Exclusion of first \$1 million of gross receipts	\$211.0	2005
11	Sales and use	Sales to the state, its subdivisions and certain other states	\$199.1	1935
12	Sales and use	Building and construction materials and services used in certain structures	\$180.9	1959
13	Individual Income	\$20 personal exemption credit	\$165.3	1983
14	Individual Income	Resident credit for income taxed by another state	\$141.3	1972
15	Individual Income	Retirement income credit	\$135.7	1983
16	Individual Income	Value of motor vehicle trade-ins	\$130.2	1981
17	Sales and use	Transportation of persons and property	\$127.1	1935
18	Corporate Franchise	Goodwill, appreciation, and abandoned property of financial institutions	\$119.6	1933
19	Sales and use	Tangible personal property used directly in providing public utility services	\$110.0	1935
20	Sales and use	Sales of tangible personal property and services sold to providers of telecommunications services	\$94.0	1987

Source: Ohio Department of Taxation

Since the last tax expenditure report was issued two years ago, five new ones have been added, estimated at \$26.3 million in FY12 and \$16.8 million in FY13. Table 3 lists these new tax expenditures and estimates of foregone revenue from them:

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the items would have been part of the defined tax base, 3) the item is not subject to an alternative tax and 4) the item is subject to change by legislative action. Tax Expenditure report, pp. 2-3.

Table 3

<b>New Tax Expenditures in the FY12-13 Report</b>			
<b>Type of tax against which exemption is taken</b>	<b>Tax expenditure description</b>	<b>FY2012 (millions)</b>	<b>FY2013 (millions)</b>
Sales and Use	Property & services used in constructing a qualifying convention center	\$2.0	\$2.0
Individual Income	Deduction for employer-paid health coverage of qualifying adult children and other dependents	\$3.5	\$3.7
Individual Income	Motion picture tax credit	\$19.8	\$9.4
Individual Income	Credit for alternative fuel sold by retailers	\$1.0	\$0.0
Corporate Franchise	New markets tax credit	\$0.0	\$1.7
	<b>Total</b>	<b>\$26.3</b>	<b>\$16.8</b>

Source: Ohio Department of Taxation

The sales tax exemption for property and services used in constructing a qualifying convention center is for the Cleveland convention center under construction. The individual income tax credit for alternative fuel sold at retail is currently available only through the end of calendar 2011, which is why no foregone revenue is shown for FY13.<sup>16</sup> The amount estimated for the motion picture credit falls in FY13 because the legislation establishing that credit called for a larger amount of credits to be given out in the first year than subsequently. A number of other states have been trimming or repealing their motion-picture tax credits. “Now, as states face a total of \$72 billion in budget deficits in their coming fiscal years, according to the National Conference of State Legislatures, some are concluding Hollywood gets a lot more than it gives,” an article in *Bloomberg BusinessWeek* reported last November.<sup>17</sup>

Three other tax expenditures were approved in the past two years that are not listed as new items in the report. Last year, the General Assembly approved an income-tax deduction for gambling losses, but it doesn’t take effect till 2013 and will have its first impact on the state budget in Fiscal Year 2014; the tax expenditure report only reviews the FY12-13 biennium, so it wasn’t included. This deduction is notable, however: It is likely to cause tens of millions of dollars in revenue losses to the state, while allowing gamblers to deduct from their income gambling losses wherever they occurred.<sup>18</sup>

The legislature also approved an income-tax exemption for military veteran bonus payments approved by Ohio voters, but because the Internal Revenue Service has indicated that it will consider such income to be excludable for federal tax purposes, the Ohio exemption has no fiscal effect and wasn’t included in the report. In addition, a bill was enacted to exempt pension

<sup>16</sup> This credit existed previously, but was set to end before the end of the last biennium, and was not included in the last tax expenditure report. Conversation with Christopher Hall, Tax Analysis Division, Ohio Department of Taxation, March 21, 2011

<sup>17</sup> Moroney, Tom, “Strapped States to Hollywood: Stay Home,” *Bloomberg BusinessWeek*, Nov. 24, 2010, see [http://www.businessweek.com/magazine/content/10\\_49/b4206031973534.htm](http://www.businessweek.com/magazine/content/10_49/b4206031973534.htm)

<sup>18</sup> Ohio Legislative Service Commission, Fiscal Note and Local Impact Statement, Sub. H.B. 519 of the 128<sup>th</sup> General Assembly, available at <http://www.lsc.state.oh.us/fiscal/fiscalnotes/128ga/hb0519cc.htm> See also Suddes, Tom, “Tax Deduction for Gambling Losses Doesn’t Make Sense,” *The Plain Dealer*, June 6, 2010

income paid to members of the commissioned corps of the U.S. Public Health Service and NOAA. This provision was simply folded into the existing income tax exemption for military veteran pension income.<sup>19</sup>

Even while the 128 existing tax expenditures are going unexamined, the General Assembly is adding new ones. The transportation budget approved March 23 includes an exemption under the Commercial Activity Tax for certain exchanges of motor fuel. In testimony on this proposal, the Taxation Department estimated it could cause a revenue loss of between \$5 million and \$10 million a year, not including a retroactivity clause that could make it considerably larger.

According to Gongwer News Service, Fred Church, deputy director of tax policy and budget for the Department of Taxation, testified that the exemption threatens the viability of the CAT, which was designed as a broad-based, low rate tax. "If state government continues to allow exemptions from the CAT, or credits, or special tax rates, then every industry that is subject to the CAT can be expected to look through the law, find an industry that is somewhat similar that has an exemption or a credit, and ask for a similar exemption or credit," he said.

"The tax base will erode and either the tax will lose all its usefulness as a tool to raise revenue for the state government or it will become unfair," Church added.<sup>20</sup>

The proposal was approved despite a statement opposing it signed by a number of major business and professional organizations. "As original proponents of the tax reform package in 2005, we have worked tirelessly to reiterate to lawmakers the importance of maintaining a broad-based tax code, with the lowest possible tax rate," said the letter signed by Eric Burkland of the Ohio Manufacturers' Association, Barbara Benton of the Ohio Society of CPAs, Tim Maglione of the Ohio State Medical Association, David Owsiany of the Ohio Dental Association, and Jack Pounds of the Ohio Chemistry & Technology Council. The proposed exemption for the petroleum industry would "compromise the integrity of a broad-based tax," the groups said.<sup>21</sup>

Among substantial tax expenditures that are expected to grow the most between FY10 and FY13 according to the Taxation Department are the job retention tax credit, used against the commercial activity tax and expanded twice in the last two years, and the historical preservation tax credit, used against the individual income tax. The next two both reflect the increase in health-care costs: The sales-tax exemption on pharmaceuticals, and the deduction from the insurance-premium tax that insurers may deduct from amounts received from underwriting a health care plan under the qualified small employer health care alliance program. Table 4 lists the 10 tax expenditures that are expected to grow by the greatest relative amount between FY10 and FY13, and are estimated to be worth at least \$10 million in FY13:

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<sup>19</sup> E-mail from Christopher Hall, Ohio Department of Taxation, Dec. 20, 2010

<sup>20</sup> Gongwer News Service Ohio Report, March 10, 2011

<sup>21</sup> Gongwer News Service Ohio Report, March 10, 2011

Table 4

<b>Fastest-growing tax expenditures between FY10 and FY13, worth least \$10 million in FY13</b>						
<b>Type of tax against which exemption is taken</b>	<b>Tax expenditure description</b>	<b>FY2010 (millions)</b>	<b>FY2011</b>	<b>FY2012 (millions)</b>	<b>FY2013</b>	<b>Estimated Growth, FY2010-FY2013</b>
Commercial Activity	Job retention tax credit	\$4.5	\$11.5	\$16.5	\$21.5	378%
Individual Income	Historic preservation tax credit	\$24.7	\$40.6	\$41.9	\$59.9	143%
Insurance Premium	Deduction for premiums from qualified small business alliances	\$15.5	\$18.3	\$21.7	\$26.0	68%
Sales and Use	Prescription drugs and selected medical supplies	\$460.2	\$513.5	\$571.4	\$637.6	39%
Sales and Use	Value of motor vehicle trade-ins	\$107.1	\$118.2	\$130.2	\$143.9	34%
Sales and Use	Sales of tangible personal property and services to electricity providers	\$387.7	\$436.2	\$463.0	\$491.5	27%
Sales and Use	Motor vehicles sold in Ohio for use outside the state	\$33.5	\$36.9	\$39.2	\$41.6	24%
Individual Income	Resident credit for income taxed by another state	\$127.4	\$131.9	\$141.3	\$151.9	19%
Individual Income	Social security and railroad retirement benefits exemption	\$237.8	\$239.5	\$266.8	\$280.1	18%
Individual Income	Exemption for active-duty military income	\$18.0	\$19.0	\$20.0	\$21.2	18%

Source: Ohio Department of Taxation

Unlike in the past report, the Taxation Department did not provide a break-out of tax expenditures by broad type, so Policy Matters Ohio has done so using the categories employed by the department two years ago. Business is the biggest beneficiary of Ohio’s tax expenditures. Overall, 73 of the tax expenditures, accounting for just over half of the total value in FY12 or \$3.7 billion, go for business assistance and economic development. Another 13, valued at \$878 million in FY12, are assistance to public and nonprofit organizations. Thirteen expenditures amounting to \$760.2 million are health or education-related assistance to individuals. And 26 tax expenditures totaling \$2.0 billion are other financial assistance to individuals. Thus, overall, individuals are to receive 26 tax expenditures estimated at close to \$2.8 billion in FY12.

The Taxation Department’s estimates for foregone revenue for Fiscal Years 2010 and 2011 have fallen somewhat from what was estimated two years ago. This is because of the addition of new data and some changes in the methodology of how they are calculated. Most importantly, the estimated foregone revenue fell substantially from earlier estimates for the sales tax exemption for building and construction materials used in contracts with the government, churches and certain other entities. The department changed its assumptions in making this estimate, plus the data now reflect the major decline in that industry. As this shows, many of the estimates are

approximations, based on Taxation Department analysis of available statistics and reasonable assumptions.

As noted, four tax credits now available against the commercial activity tax that originally were used to offset corporate franchise tax liability are expected to grow to a total of \$93.3 million in FY13. This does not include the new addition to the Job Retention Tax Credit for American Greetings Corp. in a bill just passed by the General Assembly, which will increase the total. Last year's budget bill loosened the criteria for the Job Retention Tax Credit. According to the Taxation Department's analysis, some companies receiving it only have enough liability under the CAT to claim a small portion of the credit.<sup>22</sup> Still, it is expected to grow by \$5 million a year, to \$21.5 million in FY13. The Job Creation Tax Credit, a broader incentive program, is expected to result in \$56.8 million in foregone revenue that year. The amount of JCTC credits certified fell between FY09 and FY10, as the Department of Development cleared out a paperwork backlog. This suggests some of these credits were not necessary. However, the amount of revenue foregone going forward is not as great as anticipated two years ago.

Not all tax breaks and loopholes are covered in the tax expenditure report. For instance, the last two commissions that studied Ohio's state and local tax system concluded that we should eliminate the dealers in intangibles tax, which allows payday lenders, mortgage brokers and other financial companies dealing in "intangibles" to pay a lower rate than banks do. That tax generated \$41.1 million in FY10, \$13.9 million of which went to localities. Instead of increasing the rate, the Kasich administration proposes to divert the share that has gone to localities for the state, reducing local governments' revenue.

The report also doesn't include services that aren't covered by the sales tax. Lobbyists, for instance, don't charge sales tax on their services. That's because under state law, tangible things are automatically covered by the tax unless they are excluded, but services are only covered if they are specifically listed. As services become a bigger and bigger part of the economy, this has narrowed the base of the sales tax.

Nor does the report reflect the very substantial sums the state spends to cover local property-tax breaks for homeowners. In Fiscal 2010, the state reimbursed school districts and local governments for \$1.69 billion in three local property-tax rollback programs, one for 10 percent, another for 2.5 percent for owner occupants, and a third for the homestead exemption that goes to elderly and disabled homeowners. Gov. George Voinovich and Gov. Bob Taft each tried to means-test the two property tax rollbacks, so that they would not go to the wealthiest homeowners. Each failed. The homestead exemption, too, was broadened more than necessary when it was expanded in 2007; as then House Speaker Jon Husted argued, it should have been limited.<sup>23</sup>

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<sup>22</sup> Ohio Department of Taxation, Commercial Activity Tax Expenditure: Job Retention Tax Credit, Oct. 27, 2010

<sup>23</sup> See William Hershey, "Husted Pursues Budget Changes," *The Dayton Daily News*, June 12, 2007, and "Penny Wise," Editorial, *The Plain Dealer*, June 12, 2007.

Last year, the Ohio Manufacturers' Association concluded that the state sales tax was "riddled with exemptions, carve-outs and credits," and called for a comprehensive examination of the state sales tax.<sup>24</sup> New governors in a number of states have proposed cutbacks in tax expenditures. Some legislators, such as Minnesota state Sen. Julianne Ortman, the Republican chair of the Taxes Committee, note that tax expenditures are another form of state spending, which should be reviewed as other aspects of state spending are.<sup>25</sup>

Policy Matters Ohio has detailed in three previous reports how tax expenditures permanently ensconced in the tax code do not receive the regular scrutiny that expenditures do, even though they come out of the state's pocketbook and affect its ability to finance its activities.<sup>26</sup> More information on tax expenditures, including a table of a dozen loopholes that should be limited or eliminated, is available in our report last summer to the Ohio General Assembly's Budget Planning and Management Commission.<sup>27</sup>

The General Assembly should closely review the tax expenditure report, and reduce or eliminate unneeded loopholes. It should set a target – 10 percent of the \$7.4 billion estimated for FY12 would make a good starting point – for temporary or permanent annual reductions as part of the FY12-FY13 budget. This could include reductions in tax credits, as states such as Kansas and Oklahoma have undertaken.

The General Assembly should set up a schedule to review all tax expenditures on a permanent basis. The purpose of each of the 128 tax expenditures identified in the report should be spelled out, so that the review can determine whether that purpose is being met. New tax expenditures should have automatic sunsets, so they only continue after their worth has been proven.

Ohio's tax expenditure report provides a beginning point for analysis and action on this important element of the state budget. Now, it is up to the General Assembly to get started.

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<sup>24</sup> Ohio Manufacturers' Association, "The Policy Point: A Competitive Ohio Tax System," *Retooling Ohio*, Vol. 8, 2010, available at [http://www.informz.net/ohiomfg/data/images/oma-04756\\_retooling\\_tax\\_2010.08\\_v3.pdf](http://www.informz.net/ohiomfg/data/images/oma-04756_retooling_tax_2010.08_v3.pdf)

<sup>25</sup> Goodman, Josh, "Eliminating Tax Breaks: A Path to Budget Compromise?", *Stateline.org*, March 24, 2011, available at [http://www.stateline.org/live/details/story?contentId=561481&utm\\_source=ConstantContact&utm\\_medium=email&utm\\_campaign=My%2BEmail%2BSubject](http://www.stateline.org/live/details/story?contentId=561481&utm_source=ConstantContact&utm_medium=email&utm_campaign=My%2BEmail%2BSubject)

<sup>26</sup> See *Exempt from Scrutiny: Tax Breaks in Ohio*, February 2007, available at <http://www.policymattersohio.org/ExemptFromScrutiny2007.htm>; *Limiting Loopholes: A Dozen Tax Breaks Ohio Can Do Without*, September 2008, available at <http://www.policymattersohio.org/pdf/LimitingLoopholes2008.pdf>; and *Spending by Another Name: The 2009 Ohio Tax Expenditure Report, June 2009*, available at <http://www.policymattersohio.org/OhioTaxExpenditures2009.htm>

<sup>27</sup> Schiller, Zach, Report to the Ohio Budget Planning and Management Commission, Policy Matters Ohio, August, 2010, pp.8-13, available at <http://www.policymattersohio.org/pdf/BPMC2010.pdf>

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MAIN OFFICE: 3631 PERKINS AVENUE, SUITE 4C-E • CLEVELAND, OHIO 44114

COLUMBUS: 300 E. BROAD STREET, SUITE 490 • COLUMBUS, OHIO 43215

[HTTP://WWW.POLICYMATTERSOHIO.ORG/](http://www.policymattersohio.org/)



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