Losing the Company Dime:
Ohio's Vanishing Corporate Franchise Tax

Ohio businesses are paying a far smaller share of the cost of state and local government than they did 25 years ago. Individuals are picking up the slack. Declining proceeds from Ohio's corporate franchise tax (the state's corporate profits tax) account for part of the diminished share paid by Ohio businesses.

In the mid-1970s, Ohio's corporate franchise tax was a major source of revenue for the state budget, accounting for 16 percent of the taxes supporting the General Revenue Fund. By fiscal year 2002, that figure had declined to 4.6 percent. Collections from the corporate franchise tax have dropped in each of the last four fiscal years, contributing to Ohio's current budget problems. Adjusted for inflation, revenues from the tax have fallen below what they were during the deep recession in the early 1980s.

Why the Decline?

Declining business profits have contributed to the recent fall-off in franchise tax revenues, and the share of taxes the state receives from this tax has fallen as other taxes increased. Yet quite apart from these factors, the corporate franchise tax in Ohio has been undermined by corporate tax avoidance and state tax policy.

Tallying the Bill

Ohio's corporate franchise tax is not simply a corporate income tax. Companies figure out what they would owe under two different methods, and pay whichever is higher. One is based on a company's net income, the other on its net worth. (Net worth is a measure of a company's value. It is the amount of assets a company has minus its liabilities). If a company is making very little money or losing money, it will still pay a corporate franchise tax based on its net worth. That makes sense, since money-losing companies still use state services. However, the state capped the net worth tax in 1999, a move that helped only large companies and cut into collections.

Dodging the Bill

Corporations have found legal ways to avoid paying the corporate franchise tax. One common tactic is shifting income to affiliates in other states where profits will not be taxed as heavily. In addition, many new businesses are organized so that they escape paying the tax.

Changes in Ohio law have reduced the tax and added new credits for companies, some of which are not well targeted. Wal-Mart Stores, for instance, won a $2.6 million credit in 2001 for a warehouse it had already started building. Changes in federal law and aggressive tax sheltering at the federal level have also reduced Ohio franchise tax revenues, since when federal tax liability drops, state tax liability usually drops with it.

Footing the Bill

Most Ohio companies do not pay large amounts in corporate franchise taxes. In 2001, four out of five companies paid $2,000 or less, and more than half of those were liable for the minimum of $50 (this is before adding in tax credits.) Based on how much is paid per person in state corporate income taxes, Ohio ranks below its neighbors and the U.S. average. Companies also pay income taxes to municipalities in the state. When those are figured in, Ohio's state and local corporate income taxes are closer to the national average.

Paying the Bills

Ohio should take steps to curb corporate tax avoidance and strengthen the franchise tax. It should repeal the net-worth cap and force companies to report the income of all their affiliates that operate together, as California and 15 other states do. That requirement, called "combined reporting," would cut down on income-shifting and produce roughly $200 million a year in additional revenue, according to the Ohio Department of Taxation. The Ohio General Assembly should stop creating new tax credits. Big companies with publicly traded stock also should disclose their corporate franchise tax returns. These measures would help restore the franchise tax.

Because corporate franchise taxes do not cover most new businesses and do not account for a large share of the business tax burden, these measures are not likely to hurt the economy. The impact of business taxes on new investment is uncertain at best, and notably, states with combined reporting have not seen a slowdown in economic growth.

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