Policy Matters Ohio

Executive Summary
April 2012

Bank tax cuts loopholes, reduces rates

Proposal also provides unneeded help to big banks

Zach Schiller

Ohio Gov. John Kasich has proposed a new tax, called the Financial Institutions Tax (FIT), to replace existing taxes that cover banks, savings institutions, mortgage and securities brokers, payday lenders, and other financial institutions. The proposal should be lauded for cutting major loopholes that have allowed big, multistate banks to legally avoid what they would otherwise pay under the corporate franchise tax.

However, it would then transfer the gains from closing loopholes back to banks in the form of lower rates. This will deprive the state of much-needed revenue. Just a dozen of the biggest institutions are likely to benefit from a special, bigger rate cut for the largest banks – and they would get a substantial share of the rate cut. The plan also will favor the biggest multi-state institutions with a major presence in Ohio, which will benefit from a new formula for determining what share of a bank's operations is in Ohio.

Key findings

- The new tax would cut tax loopholes, a good thing, but unwisely give the extra revenue to banks
- Just a dozen of the biggest institutions are likely to benefit from a special, bigger rate cut for the largest banks
- Redistributing state taxes among banks isn't likely to do much for the Ohio economy
- Additional revenue should go to remedying the foreclosure crisis and restoring other service cuts

Ohio currently levies a corporate franchise tax on banks and savings institutions, which they pay at a 1.3 percent rate on their net worth. About 1,000 other companies, largely affiliates of financial institutions or insurance companies, also pay the franchise tax. Mortgage and securities brokers, payday lenders, finance companies and other "dealers in intangibles" pay a separate tax, at a rate of 0.8 percent. In place of these taxes, the Kasich proposal would create a FIT. Its main features are:

- It would apply to all financial institutions regardless of how they are organized.
- Company reports to federal regulators would determine their equity capital, on which they would be taxed. These reports are to be filed on a consolidated basis, aimed at eliminating shifts in net worth between affiliates that have undercut the franchise tax.
- The amount would be determined first on what share of overall gross receipts are in Ohio, based on where customers receive service, not where the company performs it.
- After this "Ohio equity capital" is determined, taxpayers would pay a rate of 0.8 percent; for equity over $500 million, the rate would dip to 0.25 percent. Each institution would pay a minimum $1,000.
- Companies would be allowed to use seven existing tax credits against the new tax.

- It would be expected to produce $225 million a year in revenue, or the same amount projected for current taxes. A one-time trigger would adjust rates a year after the FIT starts, to ensure that the tax is raising within 10 percent of $225 million.

The Kasich administration has estimated that a few banks that have been using loopholes and some out-of-state institutions will see their taxes go up about $30 million annually, but that almost all other Ohio banks will see their combined total taxes cut by that amount. The proposal is plugged as a boon to small banks. It isn't clear who will be the biggest beneficiaries, but it's likely that some of the biggest Ohio banks will get a large piece of it.

The idea that cutting bank tax rates will fuel more lending and a stronger economy is misplaced. Since many Ohio banks already are "flush with cash," as a representative of the industry puts it, cutting their taxes is unlikely to lead to new lending. Ohio banks are doing well, as a Feb. 28 press release from the Ohio Bankers League entitled "Bumper Quarter for Ohio Banks" attests, and are in no need of a tax cut.

The new gross-receipts formula for determining how much of a bank's capital to tax represents a change from the main formula used today, which also includes a bank's payroll and property. This means big, multistate banks with major operations here will be taxed on a small share of their capital. The change makes no difference to small banks with all of their business here. This change is touted as a way to bring more jobs here, but it hasn't necessarily worked out that way when states have changed their overall corporate taxes and based them only on in-state sales.

The long-term stagnation in tax revenues from Ohio financial institutions suggests that the revenue target set for the tax is too low. Ohio's overall existing taxes on financial institutions have not grown with those institutions or kept up with inflation. In Tax Year 2011, financial institutions paid only 7 percent more in franchise tax than they did in 2002, despite greater growth in deposits. The taxes that the FIT would replace are considerably lower in inflation-adjusted terms than they were in 1998.

Communities across Ohio have been badly damaged by foreclosures. While a host of efforts are needed to confront this crisis, foreclosure counseling is effective and needs more support instead of cutbacks. Ohio has 100,000 or more vacant and abandoned properties that should be demolished. More aid is needed. Beyond the foreclosure problem, Ohio communities and schools are struggling to maintain services in the face of major cuts in the current state budget.

The tax rate for banks should not be reduced. All financial institutions, including payday lenders, mortgage brokers and other "dealers in intangibles" should pay the same 1.3 percent rate that banks pay now. The new FIT should also include geographical reporting requirements so we can tell how much is paid by Ohio and out-of-state banks. Having a trigger mechanism is smart, since it's never certain what a new tax will raise, but it will need to be watched closely. A similar trigger was created in 2005 for the Commercial Activity Tax – but two years later, the upward trigger was eliminated.

Legislators should cut the loopholes. They should ensure that Ohio's biggest banks are paying an equitable amount. And additional revenue from a more robust tax should be used to provide aid to combat the foreclosure crisis, and then to restore public services that were undercut in the current state budget.