

Testimony to the Senate Ways & Means Committee on House Bill 5

Zach Schiller

Good afternoon, Chairman Peterson, Ranking Member Tavares and members of the committee. My name is Zach Schiller and I am the research director at Policy Matters Ohio, a nonprofit, nonpartisan organization with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify today regarding House Bill 5.

A major effort to overhaul Ohio's municipal income tax should reduce tax avoidance, guarantee a broad tax base, and ensure that those most able to pay are in fact doing so. Unfortunately, House Bill 5 does not accomplish those things. It ignores existing tax loopholes, such as one that allows firms to use passive investment companies to reduce their reported income, costing municipalities tens of millions of dollars a year. A company can set up a passive investment company, and then pay that company for the right to use a trademark, for instance. Fred Church, then an official with the Department of Taxation, wrote a memo in 2003 describing how this works:

“To avoid Ohio's municipal income tax, a corporation or a flow-through entity could simply pay some of its operating income as intangible property expense to another entity that could be in Ohio, or that could even be in the same city. The key here is that Ohio municipalities cannot tax intangible property income, so that the act of taking operating income and “turning it into” intangible property income makes it disappear from the Ohio municipal income tax base. The company paying the expense gets a deduction, while the company receiving the payment earns income that the municipalities cannot tax.”

Church estimated then that municipalities could see a revenue gain of \$27.9 million in Fiscal Year 2004 if such tax avoidance were restricted. Even now, this is costing Ohio municipalities tens of millions of dollars annually, for no good reason. Inexplicably, House Bill 5 is silent on this. Given the conclusion of many cities and the Legislative Service Commission that the bill would reduce municipal revenue, it is especially perplexing that this loophole is not addressed in the bill.

House Bill 5 is framed mostly as an effort to make municipal income taxes more uniform. However, it forgoes an opportunity to do so by preserving the carve-outs affluent residents of Cincinnati and Findlay enjoy on income from stock options. Though it ends the ability of additional cities to allow this starting in 2016, it effectively allows additional cities to further reduce uniformity by adding that carve-out over the next year. There is no good reason to allow such special treatment.

The bill would create a new loophole by prohibiting cities from taxing the profit a company makes when it ships a product or service outside the city where it is located to another place where it does not regularly solicit sales. As a number of other witnesses have testified, this elimination of the “throwback” provision is another step backwards, reducing municipal revenue and allowing such sales to go untaxed in any municipality.

These are just a few examples of how House Bill 5 moves in the wrong direction. The bill should restrain tax avoidance, instead of ignoring or even inviting it. Thank you for the opportunity to testify.

*Policy Matters Ohio is a nonprofit, non-partisan research institute
with offices in Cleveland and Columbus.*