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Spending through the tax code:
Tax expenditure report illustrates need for review

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State government funds public services like schools, health and human services and universities through the operating budget or General Revenue Fund. The state also spends plenty on tax breaks for certain goods, services, industries, activities, individuals and even companies. One difference between spending through the budget and spending through the tax code is that budget items are reviewed and adjusted every two years. Spending through the tax code can last forever, without reconsideration or adjustment.

Lack of oversight is a problem. The 2016-17 tax expenditure report listed 128 items that will cost the state almost $9 billion in the 2017 fiscal year. Many date back decades to when the economy and technology were far different. One dates back to 1896.

There is important momentum in the General Assembly to provide better oversight to tax expenditures. House Bill 9, which passed the House in June 2015, would create a legislative committee to review tax expenditures at least once every eight years. The committee would make a recommendation for continuation, modification or repeal of each tax break. House Bill 9 passed unanimously and has had two hearings in the Senate. Separately, House Bill 64, the budget bill for 2016 and 2017, created a committee to study and make recommendations on Ohio's tax system. Under the bill, the new "2020 Tax Policy Study Commission" is to review and evaluate all state tax credits, among other things. There is a lot to review. This issue brief presents highlights of the 2016-17 tax expenditure report and new additions or deletions since it was published in February 2015. Tax credits are separated out for analysis.

Key findings

- Ohio's spending through the tax code will be almost $9 billion annually by 2017, about the same spent on schools in the state's operating budget.
- More than half goes to business and economic development, about the same as state dollars spent on Medicaid.
- Tax expenditures are not regularly reviewed, like budget expenditures, nor do they expire.
- House Bill 9, passed unanimously by the House, is a positive step toward oversight, but it could go much further in reviewing tax expenditures.

Key findings

The tax expenditure report, published along with the governor's executive budget proposal, lists 128 tax expenditures in 2016-17. The Ohio Department of Taxation forecasts that the value of revenues foregone will be $8.5 billion in 2016 and $8.9 billion in 2017.
Other important findings include:

- Ohio spends as much on tax expenditures as it spends in the General Revenue Fund (the state operating budget) on K-12 education.
- Tax expenditure reports are submitted with the executive budget proposal. Revenues foregone as a result of tax expenditures in the 2016-17 report grew by $1.3 billion (8.3 percent) compared to the 2014-15 tax expenditure report.
- More than half of the value of all tax expenditures – $4.9 billion in 2017 – goes to business and economic development. About a quarter provides fiscal assistance to individuals, mostly through the income tax.
- Sales tax expenditures account for the largest share. There are 56 tax breaks in the sales and use tax, adding up to $5.6 billion in 2016, two-thirds of total revenues foregone.
- The sales tax exemption for property used in manufacturing is by far the largest overall tax expenditure, as it has been for many years. With expected foregone revenue of $1.89 billion in 2016, it is almost triple the size of the second-largest tax expenditure, the sales tax exemption for sales to churches and other nonprofits.
- The so-called "small business" investor income tax deduction, created in the 2014-15 budget, was initially forecast to cost $327.2 million in 2017 – before it was expanded in the budget bill and subsequently in Senate Bill 208. In just its fifth year, it likely would become the second-largest tax expenditure, based on data in the report and estimates of expansion costs.
- The historic structure rehabilitation tax credit grows the fastest of all tax breaks over $10 million in value. The 2020 Tax Policy Study Commission was specifically charged with reviewing this particular tax credit.

Tax expenditures make up a significant share of overall state spending, but they are not regularly reviewed. Without review, we do not know if they are still economically useful. Granted, they may be useful for other reasons. For example, many states agree taxing food and prescription drugs is not desirable for equity reasons. Other tax breaks, such as the sales tax expenditure covering purchases of goods used in the manufacturing process, are aimed at preventing multiple payments of tax on the same item. However, allowing any public expenditure to continue and grow without review and reassessment is not prudent fiscal oversight.

Governors – including Gov. Kasich – have proposed eliminating or limiting many tax expenditures. The legislature has ignored many of his proposals. At the same time, at any given time, many new tax breaks are under consideration in the general assembly, which takes more readily to spending through the tax code than on the budget side of the ledger.

House Bill 9 and the review of tax credits by the 2020 Tax Policy Study Commission create the potential to improve, update and make our tax system more efficient and equitable.