BEFORE THE WAYS AND MEANS COMMITTEE
OF THE OHIO HOUSE OF REPRESENTATIVES
REPRESENTATIVE TIM SCHAFFER, CHAIRMAN

TESTIMONY
OF
MARK ENGEL
BRICKER & ECKLER LLP
OMA TAX COUNSEL

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Mr. Chairman and members of the Committee, my name is Mark Engel. I'm a Partner in charge of Bricker & Eckler's Cincinnati-Dayton office; my practice is taxation, with concentrated experience in all aspects of state and local taxation, including tax planning, compliance, and litigation in sales and use, income, commercial activity, public utility, and property taxation as well as economic development. I also serve as tax counsel for The Ohio Manufacturers' Association (OMA). I'm testifying today on behalf of OMA regarding the governor's business tax proposals incorporated in House Bill 49. The OMA was created in 1910 to advocate for Ohio's manufacturers; today, it has 1400 members. Its mission is to protect and grow Ohio manufacturing.

For Ohio to be successful in a global economy, the state's tax structure must encourage investment and growth and be competitive nationally and internationally. A globally competitive tax system is characterized by (a) certainty, (b) equity, (c) simplicity and (d) transparency. Economy of collections and convenience of payment are also important considerations. And, generally, manufacturers support efforts to broaden the business tax base, which enables lower rates.

It is poor tax policy to single out any one segment of the economy or group of taxpayers to bear the cost of tax relief for the general population. Similarly, except to resolve existing inequality, or in cases of other policy imperatives, Ohio tax policy should not create a windfall for any group of taxpayers at the expense of other groups of taxpayers. Compliance and administration of any tax should be as simple and inexpensive as possible for taxpayers and tax administrators alike.

Good tax policy also generates necessary revenues to support the essential functions of government. To ensure transparency regarding the true cost of government and the rate of its growth, however, funding government programs with fee revenue instead of general fund revenue should be discouraged. Good budgeting and spending restraint at all levels of government are vital to ensure a competitive tax environment.

Major tax reforms approved by the Ohio General Assembly in 2005 and additional reforms from 2011-2016 have led to significant improvements to a tax system that was for many years widely regarded as outdated. Reforms included reducing overall tax rates, eliminating tax on investment, broadening the tax base, providing more stable and predictable revenues, and simplifying compliance.

The elimination of the tangible personal property tax, the corporate franchise tax, and the estate tax has strengthened the competitiveness of Ohio's tax system. So has the reduction of the personal income tax rate as well as the creation of a broad-based, low-rate commercial activity tax.

Commercial Activity Tax

Major tax reforms approved by the Ohio General Assembly in 2005 led to significant improvements to a tax system that was obsolete. These reforms reduced overall tax rates, eliminated tax on investment, and broadened the tax base, all of which have provided more stable and predictable revenues, and simplified compliance.

The most competitive aspects of the commercial activity tax, or CAT, are its broad base, its low rate, and its broad application to business entities. Those attributes can only be maintained when the state stands firm against pleas for individual carve-outs and exemptions. House Bill 49 does propose several changes to the CAT. However we appreciate that the budget does not propose to increase the rate nor does it carve out any new exemptions from the current base. We would encourage the House to follow the governor's lead and keep the rate where it has been since the CAT was enacted, and not allow any new exemptions to the tax. Every new exemption puts increased pressure on the rate leaving the remaining taxpayers vulnerable to an increase in the tax.

As a gross receipts tax, the CAT applies to every transaction in the chain of commerce. Thus, the tax is paid multiple times and is included in the price that the final consumer pays for a good or service. The distortive effect of taxing intermediate transactions is minimized when the tax rate is kept low. By raising the rate, this distortive effect is magnified. It renders Ohio's tax structure less transparent and its businesses less competitive. It is important for the House to remember these key particulars about the CAT as the budget debate plays out. The rate must remain low for the CAT to work effectively.

CAT Facts

Much has been debated regarding the CAT. For manufacturers, while the tax is not perfect, it has done much to spur growth and investment in Ohio's largest industry. According to Ohio Department of Taxation Fiscal Year 2016 Commercial Activity Tax Returns data, manufacturers made up the second-largest group of CAT taxpayers, representing 11 percent of all taxpayers (retail trade is the largest).

Moreover, manufacturers pay 23.8 percent of the state's total – more than any other group (in terms of CAT revenues based only on the 0.26 percent CAT rate for gross receipts in excess of $1 million).

When it was first enacted, there were few exclusions from the CAT and only four credits. The tax expenditure associated with those exclusions in 2009, the first year the tax was fully phased in, was approximately $300 million. Those exclusions were built into the tax as enacted and the 0.26 percent rate was established with those exclusions in mind.

In its fiscal year 2018-2019 tax expenditure report, the Department of Taxation lists a larger number of exclusions and credits to the CAT. The total cost of those expenditures is more than $600 million! Thus, in just over 10 years, additional credits and exclusions were added to the tax that doubled the amount of the tax expenditure.

The CAT is a stable tax. Although it is a gross receipts tax that pyramids along the economic chain, it is tolerated because of its broad base and low, low rate. However, in less than 10 years, tax expenditures associated with the tax have doubled. Ohio cannot chip away at the base and expect to avoid increases to the rate. Ohio traveled down this path before with the franchise and personal property taxes. The trip was a disaster. Ohio should not venture down that path again with the CAT.

The CAT was enacted as a tax on commercial activity. All enterprises engaged in such activity should be paying the CAT; in fact, equality in the burden of taxation demands that all remain subject to the tax.

Sales Tax / Income Tax

House Bill 49 proposes to increase the state sales from 5.75% to 6.25%. The rationale offered for increasing the sales tax rate is the belief that in order to spur economic growth, consumption, rather than income, should be taxed. That is one of the reasons the CAT, which taxes commercial consumption, was enacted. Similarly, a sales tax acts to tax personal consumption. It is not intended to tax business inputs such as raw materials, machinery and equipment that are used to produce other outputs that are ultimately taxed.

Manufacturers were pleased to see that the budget proposal did not include a large expansion of sales tax to certain business services and the proposed expansion would not be applied to transactions between members of an affiliated group of entities. Both would be detrimental and stifle manufacturing and economic growth in Ohio. However manufacturers already pay a large amount of sales tax in Ohio. According to the 2015 Annual Report of the Ohio Department of Taxation, manufacturers as an economic segment paid more than $426,000,000 in sales and use taxes directly to the state of Ohio. This is in addition to the untold millions of tax dollars that were paid to, and reported by, vendors and retailers located in Ohio. In terms of tax directly owed to state, as opposed to the tax that is collected from others, manufacturing is one of the largest payers of sales and use taxes in the state. Any increase in the sales tax places an increased tax burden on all manufacturers and remains a concern.

House Bill 49 proposes to collapse the nine existing income tax brackets to five brackets. Current rates starting at 0.495 percent and topping out at 4.997 percent for incomes above $200,000 are reduced to 0.456 percent to 4.33 percent. The personal exemption for taxpayers with taxable income less than $40,000 would increase from $2,250 to $3,000. For taxpayers with a taxable income between $40,000 and $80,000, the exemption would increase from $2,000 to $2,500. Finally, income limitation for taxpayers eligible for the low income credit is increased from $10,000 to $15,000 in adjusted gross income less personal exemptions.

As noted earlier, sound tax policy dictates that any tax should have a broad base, a low rate, and few exclusions in order to minimize economic distortion. OMA applauds recent efforts, including House Bill 49 to reduce Ohio’s personal income tax rates and collapse the number of income tax brackets. However, OMA is concerned when those efforts have typically been tied to a proposal to increase the sales tax. This tax-shifting is not beneficial and may be counter-productive as businesses and consumers adjust to higher and higher sales tax rates. Rather, if income tax rates are to be reduced further, exclusions and exemptions from the personal income tax ought to be re-examined. If rates are reduced, the need for those exclusions and exemptions disappears. This would provide a broader base and a lower rate for all taxpayers, reduce overall taxes, and avoid the problems of tax-shifting.

Ohio currently relies upon a number of taxes of general application to fund its operations. Tax-shifting and other efforts that reduce or increase reliance on any of those taxes should be considered with great caution. One only needs to consider the crisis in Nevada in 2008, or the current crisis in Alaska, to recognize the problems of over-reliance on any one tax. Just as a broad base is important for any single tax, a broad base of general taxes is equally important for the fiscal welfare of Ohio.

Ohio manufacturers understand that lowering the state’s income tax rates and reducing the number of brackets is intended to increase the state’s overall competitiveness with other states when attempting to attract new businesses and/or retain expanding businesses. We are worried however, by offsetting these reductions, a much higher burden is placed on the sales tax and increases in other taxes such as the tax on beer.

Centralized Municipal Business Tax Collections

Historically Ohio has had one of the country's most administratively burdensome taxing structures, mostly attributable to Ohio's local income tax system. Ohio is one of a handful of states that taxes both individuals and businesses at the local level and the only state in which each municipal corporation makes its own rules and regulations. The administrative cost in time and money puts Ohio at a disadvantage compared to its peer states and diverts Ohio businesses' resources from productive activity.

In the past, the OMA has advocated that Ohio adopt a consolidated and streamlined municipal income tax code that would create a uniform statewide standard. Despite the good progress made in House Bill 5 (130th General Assembly), Ohio's municipal tax system remains costly and cumbersome to businesses as they are still required to comply with a myriad of different local tax systems.

House Bill 49 would make Ohio's municipal income tax system simpler and more predictable, both important characteristics of a competitive tax system. The bill does two things in particular that manufacturers support when it comes to municipal taxes. First, the bill seeks to minimize compliance costs associated with filing in multiple jurisdictions. The governor's proposal to centralize collection and administration for business filers would significantly reduce the time and cost associated with multiple net profits return filings. Second, the bill proposes to eliminate the "throwback" rule. This outdated rule discourages economic development; this punitive tax puts Ohio cities at a competitive disadvantage for attracting business investment.

These important reforms of Ohio's municipal income tax system will help increase Ohio's overall competiveness.

Conclusion

The OMA supports tax policy that supplies sufficient revenue for the execution of necessary state services in a manner that stimulates economic growth, investment and job creation. Tax policy should encourage growth of capital, and growth in jobs in Ohio.

Manufacturing is the largest contributor to the state's GDP, contributing more than 17 percent. The success of Ohio manufacturing – through its vast network of in-state customers and suppliers - large global firms and their local supply chains - enhances the economic vitality of all other Ohio industries and Ohioans' quality of life. Reducing tax rates in a manner that treats all taxpayers fairly should be encouraged.

House Bill 49 provides some tax benefits to manufacturers including reducing income taxes and centralizing municipal business tax collections without increasing the CAT or expanding sales tax services to affiliated entities or business to business transactions. However, as one of the largest payers of the state’s sales tax, Ohio manufacturers are concerned about the shift from income to sales tax.

Thank you very much for the opportunity to comment and provide input to House Bill 49, the proposed state operating budget. Ohio’s manufacturers are prepared to help improve the business climate in the state. We look forward to continuing our partnership with the administration and the General Assembly.

I’ll be pleased to answer any questions you may have.

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