TESTIMONY
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Tax & Budget

Testimony on HB 166 before the Transportation Subcommittee of the House Finance Committee

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Restoring 10 essential investments

1. **PUBLIC TRANSIT:** In 2015, ODOT found unmet market demand of 37 million rides, and state funding has dropped since then. While the $70 million-a-year agreement is a start, the state needs to chip in $150 million in 2020, rising to $185 million a year by 2025.
2. **PUBLIC CHILD CARE ELIGIBILITY:** A family of three can't make more than $27,024 a year to get child care aid in Ohio. Initial income eligibility is lower than most states. $140 million could raise eligibility with a goal of setting the ceiling at 200percent of poverty.
3. **REVENUE SHARING:** State lawmakers need to rebuild the funding partnership with local governments, including restoring the Local Government Fund, cut by $370 million a year since 2011 (adjusted for inflation).
4. **SUPPORTING JUSTICE:** State cuts have strained local budgets, including the courts: There is danger justice may be been compromised in some places. The executive budget boosts state share of county indigent legal defense by $60 million.
5. **NEED-BASED FINANCIAL AID:** Ohio is the 45th least affordable state for college for families of low and modest income. Ohio should assure affordable college, but today community college students cannot get OCOG aid during the school year; $106 million additional dollars would restore financial aid for 114,500 community college students.
6. **FEED THE HUNGRY:** One in seven Ohioans struggles with hunger. One in five Ohio children may go to bed hungry. An additional $10 million would bring state funding for food banks and summer feeding programs for kids to $30 million a year.
7. **AFFORDABLE HOUSING:** $20 million a year in state funding for the Housing Trust Fund could almost double the number of affordable housing projects.
8. **FUND SCHOOLS BASED ON COST OF EDUCATION:** The number of economically disadvantaged students is up by 67 percent but state funding for schools that serve is woefully inadequate. The Governor's $550 million plan for wrap-around services, or something like it in the Cupp-Patterson education initiative, may start to rebuild support for these students.
9. **OHIO'S EARNED INCOME TAX CREDIT:** Legislators improved the state EITC in the transportation budget, but it must also be made refundable to help the poorest families.
10. **THE TAX EXPENDITURE REVIEW COMMITTEE:** The tax break oversight committee should be fully staffed: $1 million a year would provide staff and expert studies.

Good morning, Chairman Greenspan, Ranking Member Skindell and members of the committee. My name is Wendy Patton and I am a Senior Project Director of 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. For more than a decade, Ohio lawmakers have focused on income-tax cuts that overwhelmingly benefit the wealthiest at the

expense of investment in communities and people. The box above shows a list of 10 essential investments needed in Ohio's growing but low-wage economy. This list includes just a sample of unmet needs, but provides an overview of what could and should be addressed in a state budget.
The important rebuilding we see initiated in this budget should be supported by predictable and sustainable state-based revenues, but state revenues have been deeply cut since 2005. Tax cuts have not been the prescription for prosperity in Ohio. Our state lags consistently the nation in job creation. Almost 15 years of tax cuts have eliminated an estimated $6 billion in state revenues and further shifted the weight of state and local taxes from wealthy to middle- and lower-income families. Forecasts that underlie the proposals in HB 166 show that Ohio will continue to trail behind the United States in employment growth (see page B-4 of the governor's proposal) and nearly every other indicator (see Ohio Legislative Service Commission forecast, pages 7-9).
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We were pleased to see that this budget proposal largely does not include further income-tax reductions. Today we want to address the tax policy it does include: The Opportunity Zone tax incentive, the growing liability of economic development credits as outlined in the budget bill, why the business income deduction needs to be eliminated and how the revenue system could raise sufficient resources to meet the needs the state while making the tax code more fair, balanced and sustainable.

Spending thorough the tax code: Ohio has 134 tax breaks in the tax expenditure report, which is part of the governor's executive budget. They total more than $9 billion and have grown significantly as investment in critical services like education and human services lagged. This budget would expand them and does not fix outrageous problems in the second-largest, the LLC Loophole.

Opportunity Zone tax break: The 2017 overhaul of federal tax code included the Opportunity Zone program, which offers deep tax breaks to investors who place capital gains in developments in low income census tracts. HB 166 proposes to sweeten this deep federal subsidy with another tax break that will cost the state $50 million a year. If the intention of this tax break is to help low-income Ohioans it, it's a poor investment: it will drain state revenue away from programs that would help struggling families get by and it may drive up rents in some places, leading to the loss of affordable housing, the exodus of existing businesses and loss of jobs. The Center on Budget and Policy Priorities has been one of the strongest national voices for programs that protect families of low and modest incomes for over 30 years. It describes the problems of the Opportunity Zone program as follows:

- The central feature of the Opportunity Zone program is a package of capital gains tax breaks, which overwhelmingly benefit a small group of individuals who are already doing well. More than two-thirds of capital gains income nationwide goes to the wealthiest 1percent of households.
- Investors will get the biggest tax break by targeting investments to places where they can expect to gain the greatest profits. This means that the program largely incentivizes investment in areas that already had strong growth prospects rather than guiding investments toward the communities with the greatest needs.
- The program does not include any protections to ensure companies that receive tax benefits hire residents of the communities where they are located; offer decent wages or benefits; build affordable units in residential properties; or offer other connections that might benefit residents.

The way the federal incentive is structured, investors will get a modest return through deferral of initial capital gains taxes, but a potentially significant return with the forgiveness of any additional capital gains that result upon exit from the Opportunity Fund investment. The kind of projects likely to offer the highest return and attract the most private capital include luxury residential, retail, entertainment and hospitality developments – the kind of projects already being built in some targeted census tracts in Ohio, like Cleveland's west side, the Grandview area in Columbus, or Over-the-Rhine in Cincinnati. This type of investment can cause gentrification, driving out existing residents while creating low-wage jobs or no jobs at all in the targeted community. Philanthropies, some individual investors and perhaps university endowments will take advantage of these tax breaks to boost the fortunes of struggling communities, but the vast majority of investors will be merely seek the highest returns.

If state legislators want to help low-wage workers and their families, they should first and foremost provide sufficient funding for health and human services in the 2020-2021 budget. That way, we can make sure people living in high poverty areas can get to work using public transit. We can support them when they're at work by helping them afford a safe, quality child care center to care for their children. And we can prepare those children to thrive in today's economy by helping them pursue higher education by expanding need-based aid to community college students. Ohio has the resources we need to do this, but the General Assembly has prioritized tax cuts for the state's wealthiest residents and tax breaks for special interests.

Ohio's tax breaks need real scrutiny: Ohio has 134 tax breaks, also known as tax expenditures, that will cost an estimated $9.5 billion in foregone revenue in 2020 and $9.8 billion in 2021. Tax expenditures will have grown by 17.7 percent between 2012 and 2021, adjusted for inflation. A Tax Expenditure Review Commission (TERC) was formed and met for the first time in 2018, but the review of 15 sales tax breaks, totaling $5.5 billion a year in state and local revenues foregone, was so weak that all were continued with no changes. Eight of the 15 items reviewed had no proponents come in and tell the committee why the tax breaks were useful and why they should be continued. Two commissioners voted to reject the final recommendations of the report and two more of the seven member panel commented on the need to improve oversight.

To fulfill its mission of providing careful oversight of Ohio's billions in annual tax breaks, TERC should operate like budget oversight committees and obtain the resources to do so. The Joint Medicaid Oversight Commission, with oversight of almost $8 billion in annual state taxpayer and provider funds, meets monthly, has a budget of $840,000, a staff of two and contracts with accountants and actuaries. The TERC budget should be similar and should be funded in this budget.

Some tax breaks need trimmed or repealed: The vendor discount is a tax break that needs to be trimmed. Retailers receive a tax break for collecting the sales tax. Sixty percent of this $58 million break goes to less than 1 percent of all retailers, those with over $1 million a year in sales. Means-testing this so the Walmarts and Macy's do not get an outsized portion of Ohio's generous discount would be an improvement. Ohio gives a generous tax break to suppliers of certain big distribution centers. This reduces costs for pharmaceutical manufacturers or distributors – the break is worth $169 million next fiscal year – while the state of Ohio and numerous cities and counties sue some of these same companies for their alleged role in the opioid crisis. Numerous other tax breaks should be reined in. These include sales-tax exemptions for coin dealers and egg producers, wealthy buyers of timeshares in jet aircraft and data centers that provide just a few dozen jobs but get tens of millions in exemptions. Some of our largest tax breaks have grown enormously over time and no longer address the original purpose. Spending through the tax code should be scrutinized with no less care than spending through the budget, and it takes highly trained staff and experts to fully analyze complicated tax break programs.

LLC Loophole: The deduction for business income, first enacted in 2013 and expanded subsequently, exempts owners of partnerships, sole proprietorships, S Corporations and limited liability companies from state income tax on the first $250,000 in earnings from such businesses, known as "passthrough entities." Income over that amount is taxed at just 3 percent, lower than the nearly 5 percent rate they would otherwise pay. The Department of Taxation estimated the cost of the tax break, often known as the LLC loophole, at $1.086 billion in 2016.

This tax break should be repealed. It has not produced economic results. The number of passthrough businesses in the state has grown more slowly than it has nationally. And first-time hiring by new Ohio businesses also has lagged behind the country. We badly need this revenue to make investments in Ohio and Ohioans.
Moreover, this unproductive LLC loophole is itself riddled with special-interest loopholes unavailable to most Ohio taxpayers. Tens of thousands of affluent business owners who use the passthrough tax break also claim other deductions intended for those with lower incomes. Another loophole allows tax filers who own 20 percent of a business to deduct the compensation they are paid, distorting and extending a tax break that is supposed to cover business profits, not salaries. Hundreds of thousands of Ohio business owners may be able to get double tax benefits out of certain deductions to their state income tax.

Tax breaks for individual companies: The budget bill lists the cost of tax credits for individual companies given through the economic development system. The revenues forgone as companies claim their tax credits during the upcoming biennium will total more than a half-billion dollars. Outstanding liability from these eight business tax credit programs – the value of credits that have been authorized but not yet claimed - will be an estimated $1.2 billion at the end of FY2021. The proposed Opportunity Zone tax break would make the state forego an additional $50 million in revenues in 2021. In addition, separately from the budget bill, the General Assembly is considering additional tax credits, including an expansion of the motion picture tax credit, a new tax credit for insurance companies that invest in large real estate developments and a "megaproject" tax credit.

A fully staffed TERC should investigate existing economic development tax credits before we engage in this further expansion of them.

A plan for rebuilding the state revenue system, fairly: As we have recounted, dramatic tax cuts since 2005 have not significantly bolstered the Ohio economy, while costing us dearly in investments that were never made in our schools, infrastructure and public services. We won't go over all the details here, but Policy Matters Ohio has laid out a plan to restore Ohio's income tax. That includes a refundable earned income tax credit. In addition, steps should be taken to modernize our tax system so that it covers today's and tomorrow's economy (see pp. 5-7 of this earlier testimony).

Important rebuilding we see initiated in this budget, and new investments necessary to improve systems, should be supported by predictable and sustainable state-based funding now and in the future. But lawmakers prioritized tax cuts that overwhelmingly benefitted the wealthiest at the expense of maintaining investment in essential services needed in the changing economy. By 2018, the wealthiest 1 percent of Ohioans paid almost $41,000 less in state taxes, on average, than they would have under Ohio's tax laws of 2004, before all the tax cutting started. Those in the middle pay about the same. The lowest income taxpayers pay about $140 a year more, on average, because taxes like the sales tax that fall more heavily on the less affluent have gone up. Today, the poorest pay almost twice the share of income in Ohio's state and local taxes as the wealthiest. And Ohio's economy, as we mentioned before, has been slower than the national economy and is predicted to continue a sub-par performance over the next two years. Meanwhile, with the proliferation of low wage jobs, more and more Ohio families struggle to make ends meet and worry about their children's future. Workers in Ohio's vast, low-wage economy increasingly need public services like Medicaid, child care assistance and food aid. In 2000, four out Ohio's 10 largest job groups left a full-time worker with two children eligible for, and needing, SNAP food assistance to make ends meet. In 2017, it was six out of ten of the largest job groups. Ohio needs to rebuild its revenue system – fairly – to provide the funding we need in this budget and beyond.