

TESTIMONY REGARDING THE 2016-2017 BIENNIAL BUDGET

Before the Senate Ways and Means Committee

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Good morning Chairman Peterson, Vice Chairman Beagle, Ranking Member Tavares, and members of the Committee. My name is Dave Froling. I am a state and local tax partner with the law firm Vorys, Sater, Seymour and Pease LLP. I am testifying today on behalf of the more than 6,500 members of the Ohio Council of Retail Merchants. Chairman Peterson invited the Council to testify today and we are pleased to do so.

Tax policy plays an important role relative to Ohio's economy and the welfare of Ohio's businesses and citizens. It requires careful thought and a delicate touch. The Council appreciates that the Ohio House of Representatives acknowledged this truism in the version of the biennial budget bill they passed last month, Am. Sub. H.B. 64. As this Committee and the Senate begin the task of considering Ohio's tax policy for the 2016-2017 biennium, the Council firmly believes that the proposed 2020 Tax Policy Study Commission should be part of the final version of the budget bill. In addition, we offer the following comments for your consideration.

At the outset, it is important to highlight the significance of the retail industry to Ohio and the State's economy. The retail industry in Ohio accounts for \$46.5 billion of Ohio's annual Gross Domestic Product and supports 1.5 million jobs, which is one in four of all Ohio jobs - - more than any other industry. As to the State's fiscal well-being, simply put, the more taxable sales retailers make, the more Ohio sales tax they collect and remit to the State. As the General Assembly debates the merits of consumption based taxes over income taxes, legislative tax policy relative to maximizing retail sales becomes increasingly important to both retailers and the State.

This morning I will focus on eight areas of legislative tax policy that are important to retailers.

1. Personal Income Tax Rate Reductions

The Council can appreciate the Governor's goal of lowering Ohio's personal income tax rates. That being said, the Council believes such rate reductions should not be financed by businesses through increased business taxes. Many Council members operate as pass-through entities. An increase in the sales tax rate, an expansion of the sales tax base, and an increase in the commercial activity tax rate would all serve to negatively impact owners of pass-through entities. Indeed, such increases and/or expansions may offset any personal income tax savings the owner realizes from a reduction in personal income tax rates. Undoubtedly for those individuals, such tax increases would outweigh the personal income tax savings they realize.

The Council would also like to take this opportunity to remind the Committee of the legislation that the 130<sup>th</sup> General Assembly skillfully passed in 2013. In Am. Sub. H.B. 59, the General Assembly positioned Ohio so that once Congress passes the Federal Marketplace Fairness Act (or a similar bill), all the ensuing Ohio sales tax collected from remote sellers will be allocated to the existing Ohio Income Tax Reduction Fund. The anticipated Ohio sales tax collections should Congress take action range anywhere from \$250 million to \$650 million per year. This amount of sales tax collections can have a material and positive impact on Ohio's income tax rates without increasing taxes on businesses and without any cuts to State spending. The Council encourages the Senate to reach out to your counterparts in Washington to explain how Ohio citizens stand to benefit if Congress passes the Federal Marketplace Fairness Act.

It is critically important to note that as online sales continue to increase—2014 marked the first holiday season where online sales surpassed brick-and-mortar sales—Ohio's sales tax base continues to erode. Ohio's inability to capture the tax due on many of these

remote sales is not fair to the taxpayers who have lawfully paid the sales or the use tax on their taxable purchases, and it is not fair to Ohio's brick-and-mortar businesses that are lawfully acting as the State's agent in collecting and remitting the sales tax. Should the General Assembly decide to increase Ohio's reliance upon consumption based taxes, it is imperative that the State take every action necessary to collect what is already owed by statute but is not being collected.

There are 26 states that have enacted laws that require remote sellers to collect sales tax at the point of sale. The Ohio General Assembly attempted to pass such a statute in Am. Sub. H.B. 59 of the 130<sup>th</sup> General Assembly, however, the enabling language was vetoed by the Governor, citing concerns of prolonged litigation. Michigan is the most recent state to enact this requirement (2014), however, there has been no legal challenge to their statute, which becomes effective October 1, 2015. The most likely reason there has been no such litigation in Michigan is that in late 2013, the United States Supreme Court declined to take up a challenge to a similar statute enacted by the State of New York. Given these recent developments, it is reasonable for the Ohio General Assembly to once again consider legislation to require remote sellers to collect and remit Ohio sales tax.

## 2. Ohio's Sales Tax Holiday

The Council was pleased that last year the 130<sup>th</sup> General Assembly adopted a temporary sales tax holiday. In accordance with Am. Sub. S.B. 243, the holiday is set to commence this August 7, 8, and 9. The holiday applies to: sales of clothing where the per item price is \$75 or less; sales of school supplies where the per item price is \$20 or less; and the sales of school instructional material where the per item price is \$20 or less. The Council is confident that the holiday, which coincides with back to school shopping, will be a "win-win-win" for the State, retailers, and parents. Accordingly, the Council encourages this Committee to consider making the sales tax holiday permanent and more robust.

### 3. Sales Tax Rate Changes and Tax Base Expansion

Considering an increase in the sales tax rate requires careful evaluation and study. The same can be said for expanding the sales tax base. These two endeavors are not to be undertaken lightly. There is a delicate balance between retail sales and the corresponding sales tax rate. If Ohio is to shift tax policy from income taxes to a greater reliance upon consumption taxes, there must be some assurance that the consumption taxes will generate the necessary (and forecasted) revenue. Higher sales tax rates can adversely impact certain areas of consumer spending along with consumer purchasing habits, and Ohio can ill afford to become a sales tax island. Until Congress enacts the Federal Marketplace Fairness Act, the General Assembly needs to proceed carefully relative to evaluating the appropriate sales tax rate. Likewise, absent a thorough study by a body such as the wisely proposed 2020 Tax Policy Study Commission, any expansion of the sales tax base should be put on hold.

### 4. Sales Tax Vendor Allowance

As you know, Ohio retailers are required by law to collect sales tax on all taxable retail sales made in Ohio, and to timely remit that tax to the State. This collection and remittance obligation extends not only to the general revenue fund component of the tax, but also with respect to the local county piggyback taxes that range anywhere from 0.25% to 2.25% throughout the State. To help defray the costs associated with these collection and remittance obligations, Ohio law allows retailers that remit on a timely basis to retain a small portion of the collected tax. This retention is commonly referred to as the “vendor discount.”

The term “vendor discount” is a misnomer. The more accurate term should be “vendor compensation” as this amount represents the fee that Ohio pays retailers for serving as a trustee of the State for collecting and timely remitting the State’s sales tax. Indeed, the vendor

discount should not be listed as a tax expenditure as it is not “lost” revenue. It is more accurately described as an investment in an “agency relationship” between public and private sectors that supports the efficient collection and remission of billions of dollars in sales tax.

Under current law, the allowance is three-fourths of one percent (i.e., 0.75% or .0075) of the sales tax collected by retailers, with no cap. The purpose of this allowance is to reimburse vendors for their compliance costs associated with collecting and remitting the sales tax. A 2006 study prepared by PricewaterhouseCoopers LLP, styled “*Retail Sales Tax Compliance Costs: A National Estimate*,” indicates that, during 2003, average state and local sales tax compliance costs for all retailers in the U.S. were 3.09% of sales taxes collected. When broken down by size, small retailers were at 13.47%, medium retailers were at 5.20% and large retailers were at 2.17% of sales taxes collected. The Council has every reason to believe these percentages have not changed materially since 2003. That said, Ohio’s current allowance of 0.75% does not come close to covering the actual costs associated with collection and remittance of the sales tax. If anything, the Legislature should consider increasing the rate to at least 1.0%.

#### 5. Commercial Activity Tax (CAT)

In 2005, the Council strongly opposed the enactment of the CAT. The CAT is not fair to high volume, low margin retailers – or any company that is high volume, low margin, regardless of its business. The Council’s position has not changed over the past ten years, nor has the CAT’s negative impact on many of our members. The General Assembly should take a long, hard look at the CAT. We welcome the opportunity to work with you to identify how the CAT can be improved relative to retailers via the proposed 2020 Tax Policy Study Commission.

#### 6. Cigarette and Tobacco Taxes

Taxes on cigarettes and tobacco products are often an easy target when the General Assembly either wants or needs to raise revenue to finance other budget expenditures.

The impact of increasing these taxes on retailers in general, and in particular those retailers operating along Ohio's borders, is well documented. It is estimated that 7,500 Ohio retailer and wholesaler jobs are supported by in-state tobacco sales. Moreover, the average convenience store sells about \$700,000 worth of cigarettes and other tobacco products each year, which accounts for just over 40% of in-store sales. Increasing cigarette and tobacco taxes would have an adverse impact on such sales, resulting in an adverse impact on Ohio tax collections. Simply put, the General Assembly needs to proceed carefully when evaluating Ohio tax policy relative to cigarette and tobacco products and the potential impact any changes could have on previously sold bonds.

#### 7. Tax Expenditures/Tax Policies

On March 25, 2015, I testified before this Committee on behalf of the Council. I will not restate my testimony today. In lieu of doing so, I have included my previous testimony along with the written remarks I am providing today. In brief, there are several tax statutes that primarily benefit retailers, and there are a number of statutes that primarily benefit other industries, but secondarily benefit some retailers as well. The Council is confident that all of the policies that I testified about on March 25, some of which have withstood the test of time for decades, will continue to be part of Ohio law should the General Assembly choose to re-examine them.

#### 8. Sales Tax Bad Debt Deduction

When a consumer makes a purchase using a private label credit card—one where the retailer's name appears on the card--the retailer must advance the sales tax to Ohio at the time of purchase even though the consumer does not pay their corresponding credit card bill until some later point in time.

Under current law, if the consumer fails to pay their private label credit card bill, the retailer can seek a refund of, or credit for, the Ohio sales tax the retailer advanced to the State on the consumer's behalf, provided the retailer incurred the corresponding bad debt for federal income tax purposes. This law has been in statute for decades and acknowledges that the ultimate liability for the Ohio sales tax is the consumer's. If the retailer is not able to recoup the Ohio sale tax previously advanced to the State, then the ultimate liability for the sales tax is improperly shifted from the consumer to the retailer.

When the current law was enacted, retailers financed their own private label credit cards, and the law worked well for the manner in which business was conducted at the time. That said, methods of conducting business have long since changed. Very few of Ohio's major retailers finance their own credit cards anymore; they have found it more efficient to engage a private label credit card company to own and manage their credit card programs. Although the manner of doing business has changed, the tax law in Ohio has not kept up with these changes. While retailers that own their own credit accounts are still entitled to claim a sales tax bad debt deduction, retailers that have outsourced this function to a private label credit card company cannot claim such a deduction. Likewise, the private label credit card company cannot claim such a deduction either. Thus, in these situations, while the customer has not paid their sales tax liability (or the price of the underlying merchandise), the State is nonetheless retaining the sales tax advanced by the retailer. This amounts to an unjust windfall for the State at the expense of the retailer and the private label credit card company.

Last year, the Legislature recognized this flaw in Ohio sales tax law and, with the blessing of bill sponsors Senators Peterson and Beagle, the House Finance and Appropriations Committee passed an amendment to Am. Sub. S.B. 263 to correct the problem. Unfortunately, the amendment was removed on the House floor at the request of the Governor's office. Since

that time, the Council believes that the Administration's vocalized concerns have more than adequately been addressed. As such, we ask this Committee to consider this important amendment and include it as part of the biennial budget bill.

Chairman Peterson, Vice Chairman Beagle, Ranking Member Tavares and Committee members, I appreciate your thoughtful attention and I thank you for your time. I would be happy to answer any questions you may have.