

STATEMENT OF THE OHIO STATE BAR ASSOCIATION
IN OPPOSITION TO ADDING SALES TAX AND
COMMERCIAL INCREASES TO HOUSE BILL 64

Presented by Kelvin M. Lawrence
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Before the Senate Ways and Means Committee
Robert Peterson, Chair
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Chairman Peterson, Vice-Chair Beagle, Ranking Member Tavares, and members of the Committee, my name is Kelvin Lawrence, and I am the Chair of the Ohio State Bar Association Taxation Law Committee. Thank you for allowing me the time to offer the OSBA's position with respect to a few of the tax proposals potentially under consideration for House Bill 64 ("H.B. 64") that would have a negative impact on the businesses that we serve.

The interest of the Ohio State Bar Association is to preserve the broadest access to legal services and to maintain the ability of Ohio legal professionals to provide their services competitively. H.B. 64, as it was introduced, proposed to impose Ohio sales and use tax on a number of new business services for the first time. These services included, but were not limited to: lobbying services, management consulting services, and debt collection services. These terms were so broadly and imprecisely defined in the initial version of the bill that they could have had the effect of expanding Ohio sales tax to include legal services. It is for that reason that we spoke out against H.B. 64 when it was before the House. Preventing any effort to impose the Ohio sales tax on legal services is the primary reason we are here today.

It is without question that the expansion of the sales tax to include legal services would increase the cost of doing business in Ohio compared to other states, especially states on our borders, as businesses located in Ohio would be placed at a competitive disadvantage. Requiring Ohio-based providers of legal services to collect sales tax on their services could encourage Ohio businesses to consider addressing their legal needs from a state without similar tax burdens. To cite a common refrain, "It's nothing personal, it's only business."

We are also concerned because auditing for sales tax on legal services could result in the breach of the attorney-client privilege, and because the taxation of services generally is problematic.

The OSBA is also concerned that proposals to increase the Commercial Activity Tax ("CAT") rate or to have different tax rates for classes of taxpayers would be discriminatory and would detract from the reasons the OSBA supported the CAT in 2005. The CAT is a broad-based, low-rate tax that is relatively easy to administer. Proposals to increase the rate of tax will cause distortions, while basing tax rates on business category will lead to disputes over classification.



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During my oral testimony today, I intend to highlight a few of our concerns with respect to both the sales tax and the CAT.

1. Imposing sales tax on legal services is bad for Ohio, and would place another cost on businesses that call Ohio home.

Imposing the sales tax on legal services is a tax on justice itself. Our system of justice is an adversary system that relies on parties in legal proceedings to have qualified advocates. To impose a tax on that advocacy is a tax on the justice that litigants deserve. Even when a legal matter does not involve litigation, people are best served by informing themselves of the scope of legal consequences before making decisions. Imposing an additional cost on a service creates an incentive to purchase less of that service. On the margin, a tax on legal services creates a disincentive for purchasers to seek counsel before taking actions that could have significant legal consequences. This can have negative effects throughout our legal system and society. An ounce of prevention, it is said, is worth a pound of cure.

2. The definitions for the services subjected to Ohio sales and use tax in H.B. 64 as introduced were so imprecise as to make it difficult or impossible to determine which services were taxable under the proposal.

The definitions used for the taxable services in H.B. 64 as it was introduced were the most serious problem with H.B. 64 because they were so imprecise as to make it impossible for either a lawyer or her client to know whether a particular activity was taxable. Although legal services were not explicitly made taxable in the bill as introduced, the services that would have been made taxable under the proposal were to be taxed “regardless of the profession of the provider of the service,” which meant that some – but not all – of the things lawyers do might have become taxable. This would have created great potential for a tax assessment to unexpectedly surprise taxpayers acting in good faith.

3. Any sales tax on services is difficult to administer, in part because services are difficult to source.

If a service is taxable, it generally will be taxable to the state where the purchaser receives the benefit of the service. If tax is imposed on legal services, and a lawyer advises on an issue with multi-state implications, it may be impossible for the lawyer to know where the client will benefit from that advice. Growing businesses do not have the time or resources to engage in the philosophical inquiry required to fully answer that question. This is among the reasons that a sales tax on services generally should be avoided.

4. The experience of the sales tax on Employment Services has taught us that any sales tax on services has the potential to expand in unexpected ways.



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The imposition of the sales tax on services in general is problematic, and the historical perspective of practitioners dealing with the tax on Employment Services is instructive. The tax on Employment Services was intended to encompass a very limited definition of temporary personnel staffing. However over time aggressive interpretation has broadened that definition to tax numerous other services, some of which did not exist at the time the statute was adopted. Many businesses providing management consulting, information technology, and computer programming services have found activities which they and their customers understood to be nontaxable professional services subjected to tax under audit.

5. A tax on legal services would result in a breach of the attorney-client privilege.

If the Ohio Department of Taxation performs a sales and use tax audit of a law firm, an auditor must review all invoices from the law firm to its clients, and determine which services are subject to tax. This will require a detailed examination of the services described in each invoice, which would violate client confidences, and would result in a breach of the attorney-client privilege.

6. The sales tax fundamentally is designed as a tax on end consumption, not on business inputs, and the sales tax proposals in H.B. 64 as introduced were targeted specifically at business inputs.

If a business is subjected to a tax, the business must incorporate that tax into the price of its goods or services. The result is to compound the effect of the tax, and to increase prices across an economy. Imposing the sales tax on these business inputs will decrease the resources that businesses paying the tax can use to grow, and will require them to pass the tax on to their customers, thus increasing the cost of their services. This pyramiding effect has the potential to completely offset the benefits gained by a reduction in income tax. Additionally, taxing business inputs increases the cost of business development, thereby creating an anti-business atmosphere in Ohio.

7. An increase in the rate of the Ohio Commercial Activity Tax is bad for business in Ohio.

The Commercial Activity Tax ("CAT") was enacted as part of Ohio's tax reform program in 2005, largely on the basis that it was a broad-based, low-rate tax. It is well understood that the CAT, as a gross receipts tax, suffers from a structural problem in that its lack of a credit for inputs means it pyramids the tax burden at each level of the supply chain, creating distortions throughout our economy. The effect of such a pyramiding is minimized by keeping the rate of tax as low as possible. Increasing the rate of tax – even if only on a subset of taxpayers – would detrimentally affect the entire economy of the state. OSBA supported and continues to support the CAT so long as it remains a broad-based, low-rate, tax that is easy to administer.



8. Bifurcation of CAT tax rates by category of business is unwise and will spawn disputes.

There has been discussion in some quarters of different CAT rates for businesses in different categories. This is unwise because it detracts from the CAT's character as a broad-based, low-rate tax that is easy to administer. Invariably, where there are distinctions in tax rates based on category, there will be disputes around which businesses properly are included in each category, and how tax should apply to enterprises with multiple lines of business. Because the CAT is imposed without regard to profitability, businesses would have a legitimate interest in reducing their CAT exposure.

H.B. 64 as it passed the House included a proposal for an "Ohio 2020 Tax Policy Study Commission" to review the state's tax structure and policies and to make recommendations to the General Assembly on how to maximize Ohio's competitiveness by the year 2020. The Ohio State Bar Association counts among its membership attorneys who are well-versed in the complex legal issues that are part and parcel of modern state tax systems. If the Senate should adopt a proposal for a similar Commission, we request that the OSBA be included as a constituent member. Because of the diversity and experience of its members, the OSBA is well-positioned to add value to the efforts of the proposed Commission.

We thank you, Mr. Chairman, and members of the Committee, for your time and respectfully request that you determine that Ohio is best served by reducing the state income tax without expanding the sales tax to include legal services, and without raising the CAT on any businesses in Ohio. I am available to answer any questions you or members of the Committee may have.