



THE BUCKEYE INSTITUTE

**Interested Party Testimony Submitted to the Ohio
House Finance State Government and Agency Review
Subcommittee on Municipal Income Tax**

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Thank you, Chairman Faber, Ranking Member Patterson, and members of the Committee for the opportunity to testify today regarding tax provisions in the biennial budget proposal. My name is Greg Lawson, and I am the Senior Policy Analyst at The Buckeye Institute for Public Policy Solutions here in Columbus.

Governor Kasich's proposal regarding the centralized collection of net profits under the municipal income tax is a small but significant step on Ohio's path to a more rational, fair, and growth-oriented tax policy. To finally shake free from the shackles of Ohio's "rust belt" reputation, the state must become more attractive to new and expanding businesses—and that must include a more business-friendly tax code that is simple, fair, and transparent. Unfortunately, Ohio's municipal income tax is none of those things.

The Buckeye Institute applauds the Governor's suggestion to simplify municipal income tax filings through the Ohio Business Gateway as a welcome component of broader tax reform. As Ohio works to lower her cumulative tax burden, it is important to recognize that the state's tax *structure* imposes its own costs above and beyond the tax rates themselves.

Several weeks ago as I discussed Ohio's tax structure with friends from the non-partisan Tax Foundation, several business groups, and other interested parties, I was struck by how often the conversations included criticisms of our state's hopelessly byzantine municipal taxes. None of the other tax issues we discussed elicited the same kind of recurring complaint, and it is no wonder that Ohio's business community—from the National Federation of Independent Business¹ to the Ohio Chamber of Commerce² to the Ohio Society of CPAs—supports fixing our broken system.

¹ NFIB, "Ohio Municipal Tax Reform Passage a Must for Small-Business Owners," November 14, 2014, <http://www.nfib.com/content/nfib-in-my-state/ohio/ohio-municipal-tax-reform-passage-a-must-for-small-business-owners-67188/>.

² Ohio Chamber of Commerce, "Legislative Issues-Tax and Spending," <http://ohiochamber.com/issue-advocacy/legislative-issues/tax-spending/>.

As the Committee knows, only a handful of other states impose municipal income taxes, and with over 600 municipalities levying their own income taxes, the burdens and headaches created by this arcane system are legion. For example:

Employers and employees must file tax returns in each jurisdiction where tax is owed. This creates an administrative nightmare for small businesses, like contractors, with employees working across multiple jurisdictions.³ An electrical contractor in northeast Ohio with only 19 employees reportedly filed an astounding 221 W-2 forms and 39 business returns, many resulting in less than \$5 of tax liability.⁴ Such absurdities can mean hundreds of extra hours and thousands of additional dollars devoted to tax compliance, accountants, and staff dedicated to tracking tax withholdings and remittance.⁵ For smaller businesses with limited resources, these added costs can mean the difference between a “good year” and a bad one, and may even drive some businesses from certain municipalities as they look to avoid tax sinkholes.

Adding insult to injury, many Ohioans do not even get a vote on the municipal income taxes they pay. Because municipal taxes are assessed by the employer’s location and not the employee’s residence, many commuters are forced to pay taxes for which they never voted. Most—but not all—municipalities offer credits to their residents to help offset taxes paid to other municipalities. Each municipality may choose whether and how much credit to offer for neighboring taxes,⁶ thus subjecting some of us to an ad-hoc assessment of double taxation. Such a confounding system is simply not sound tax policy that minimizes taxation’s effect on employers or employees.

Significant tax reform is needed, therefore, as Ohio continues to climb out of the economic hole that saw nearly 620,000 private sector jobs leave the state between 2000 and 2010. Only Michigan suffered worse over that span. Despite private sector job

³ Municipal Tax Reform Coalition, “How Ohio’s Municipal Tax System Hurts Business,” Fact Sheet, accessed March 2, 2017

⁴ *Ibid.*

⁵ *Ibid.*

⁶ Regional Income Tax Authority. “Tax Rate Tables,” 2017, <https://www.ritaohio.com/resources/tax-rates-tables>.

growth since then, much more needs to be done to spur our recovery, including making the state's *overall* tax climate more attractive to new private sector employers to ignite economic growth.

It is no great secret that entrepreneurial start-ups drive job creation. Several years ago, the Kaufmann Foundation concluded that between 1977 and 2005 existing U.S. firms sustained a net *loss* of jobs per year while first year start-up businesses added an average of 3 million jobs annually.⁷ Most new businesses, of course, start small, which means that attracting new *small* businesses is vital to Ohio's economic future. Significant barriers to entry—such as Ohio's ad hoc Net-Operating Loss (NOL) Carry forward rules—continue to threaten our job-growth prospects. By leaving NOLs to the discretion of each municipality, for example, Ohio's system packs a pernicious punch on fledgling ventures unable to deduct their initial losses once they become profitable.⁸ Instead of making it easier for new companies to thrive, Ohio has left many promising start-ups struggling to survive.

Ohio could send a strong signal that she is serious about competing with her neighbors for new business by eliminating the miasma of confusion surrounding the municipal income tax system. A few years ago, The Buckeye Institute identified several ways to address the state's municipal tax problem.⁹ Our suggestions are no less poignant today and they include:

- Standardizing reciprocal municipal income tax credits across jurisdictions
- Allowing for an eventual 20-year NOL consistent with federal tax policy to facilitate start-up businesses regardless of jurisdiction
- Setting a higher threshold for filing a return (currently \$10) to avoid taxpayers spending more in filing than they have in tax liability

⁷ Tim Kane, "The Importance of Startups in Job Creation and Job Destruction," Ewing Marion Kauffman Foundation, July 2010, http://www.kauffman.org/~media/kauffman_org/research%20reports%20and%20covers/2010/07/firm_formation_importance_of_startups.pdf.

⁸ Ohio Rev. Code § 718.01

⁹ Greg R. Lawson, "More Must Be Done for Real Municipal Income Tax Reform," The Buckeye Institute, November 7, 2014, <https://www.buckeyeinstitute.org/blog/detail/more-must-be-done-for-real-municipal-income-tax-reform>.

- Allowing businesses to use a simple form to declare that they conducted no business in a specific municipality, exempting them from filing a complete return
- Adopting a “Taxpayer Bill of Rights”

House Bill 5 in the 130th General Assembly addressed several of these suggestions in part, but much still remains to be done.¹⁰ Ohio’s municipal income tax ranks among the worst local tax systems in the country, and our businesses, communities, and citizens will continue to suffer its burdens and ill-effects until meaningful reforms—like those proposed by Mr. Kasich—are enacted.

Thank you for your time. I would be happy to answer any questions that the Committee might have.

¹⁰ Ohio General Assembly, “House Bill 5 As Enrolled,” accessed March 2, 2017 at http://archives.legislature.state.oh.us/bills.cfm?ID=130_HB_5.