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BEFORE THE SENATE FINANCE COMMITTEE
House Bill 166 Interested Party Testimony
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Chair Dolan, Vice Chair Burke, Ranking Member Sykes, and members of the Senate Finance Committee, thank you for the opportunity to provide testimony on House Bill 166, the State's Budget Bill. My name is Doug Simson and I am the Chairman of First City Bank here in Columbus, Ohio.

I thank you all for everything you have done to help the banking industry and for your time and consideration of the issues impacting our industry. I am particularly concerned about one of the items in the Budget bill passed by the House and currently retained in the Senate's version of the budget. House Bill 166 eliminates the pass-through credit for Financial Institution Tax (FIT) to shareholders of S-Corporation banks. This change results in a 20% tax increase to First City Bank shareholders which is a departure from the state's long-standing tax policy for S-Corporation banks. This significant tax increase will have negative consequences for the community banking industry and effect its ability to serve the people of Ohio.

<u>S-Corporation State Taxation History & Financial Institution Tax</u>

Upon converting to a S-Corporation, from 2004 through 2013 our taxation was regulated by the Ohio Franchise Tax. The Ohio Franchise Tax regulation exempted S-Corporation banks from the tax. Consequently, from 2004 through 2013 S-Corporation banks were not subject to any corporate tax from the state. However, S-Corporation shareholders have been and continue to be taxed on 100% of the bank's net income whether distributed to shareholders or not.

Beginning in 2014, House Bill 510 eliminated the Ohio Franchise Tax and replaced it with the current Financial Institution Tax. The Financial Institution Tax is a tax based on the net equity of the bank at a rate of .8% on the first $200 million of equity. The new Financial Institution Tax was structured to have no effect on S-Corporation shareholders nor increase revenue from these S-Corporation banks to the state. The exact amount of the tax was offset by an equal tax credit. House Bill 510, passed in 2014, provided that the Financial Institutions Tax paid by the bank would pass through to the shareholder as a refundable credit against the personal income tax liability of the shareholder, therefore making the net state tax impact on shareholders zero and net revenue to the state zero. The current proposal eliminates the pass-through credit to shareholders. The elimination of the pass-through credit is tantamount to a new tax for S-Corporation bank shareholders and subjects all S-Corporation bank shareholders to double state taxation.

Furthermore, House Bill 510 was revenue neutral as it related to banks. Therefore, the elimination of the pass-through credit will increase revenue to the state from S-Corporation banks in direct conflict to the intent of House Bill 510.

Impact on First City Bank

On the surface it would seem as though these tax policy changes would not influence the bank, only the shareholders. For an S-Corporation bank, which is a pass-through entity, this is a distinction without a difference. Anything that effects one will have a similar effect on the other.

Founded in 1907, First City Bank is a small family owned community bank located in Columbus Ohio that is an S corporation for tax purposes. We specialize in commercial and investment real estate lending in central Ohio. During the past 5 years, we have loaned $67,000,000 in our community, much of which was directly to small businesses. The elimination of the tax credit reduces our ability to continue providing credit to support small businesses going forward.

Our $60,000 tax credit removal would result in an effective tax increase of 20% of our earnings in state taxes since the bank's net income was $300,000 in 2018. The extremely competitive environment from non-taxed credit unions and the rising cost of regulation create enough challenges to provide a fair return to our shareholders. Adding an additional 20% tax burden, thus raising our Ohio taxes for shareholders to nearly 24% of net income, will cause us to reevaluate our business strategies. This will likely result in the need to reduce overhead expense and reassess our staffing needs. If these changes are not enough, we may no longer be able to remain an independent community bank. I believe no company in today's competitive world can afford to pay a 24% Ohio tax burden and continue to exist, especially when competing against credit unions which pay no taxes.

Summary

Eliminating the pass-through credit for FIT to shareholders and increasing taxes by 20% would be devastating to any business owner. No business can survive paying 24% of net income in state taxes. The increase in tax burden will compromise our ability to support the lending needs of our community. The loans we make would need to be more conservative to offset the reduced after-tax profitability of the business. We would not be able to support the community's borrowing needs to the extent we do today. A strong community banking industry is vital to the economy of all communities and states, as community banks provide approximately 65% of all small business loans. Small businesses are among the leading sources for job creation in our country.

In conclusion, eliminating the pass-through credit would threaten First City Bank's ability to exist and continue to provide its valuable services as a Community Bank. Thank you for your time and I would be happy to answer any questions.