



Department of
Taxation

INTRODUCTION

Chairman Schuring, Vice-Chair Rulli, Ranking Member O'Brien, and members of the Senate General Government and Agency Review Committee: my name is Jeff McClain, Tax Commissioner for the Ohio Department of Taxation.

Thank you for the opportunity to testify today on the budget request for the Ohio Department of Taxation (ODT), the tax proposals that are included in Governor Mike DeWine's Fiscal Year (FY) 2020-2021 budget, and various amendments included in the As Passed by House version of House Bill 166.

OVERVIEW OF ODT BUDGET AND OPERATIONS

The ODT budget request for FY 2020-2021 is structured to support innovative ways to make the best use of taxpayer dollars. ODT administers and enforces 30 different state and local taxes and fees, including state and school district individual income taxes, state and local sales taxes, and various business and excise taxes. ODT also oversees the ad valorem (property tax) appraisals in Ohio's 88 counties. Collections of taxes and fees administered by ODT generate approximately \$30 billion each year to support many functions of state and local government, including education, health care, transportation, and law enforcement.

ODT's all funds budget request for FY 2020 is approximately \$135.5 million, which is comprised of \$61.4 million for GRF General Operating Expenses and \$74.1 million for Dedicated Purpose Funds (DPF). The total request for FY 2021 is approximately \$138.2 million, which is comprised of \$62.5 million for GRF Operating and \$75.6 million for DPF.

Our mission is to provide quality service to Ohio taxpayers by helping them comply with their responsibilities and by fairly applying the law. This mission statement guides ODT in establishing priorities, allocating resources, and maximizing work efforts.

Our primary objectives as a Department are as follows:

1. Process tax returns, payments, and refund requests filed by individuals and businesses. More than 97% of the revenue collected by ODT comes from voluntary compliance.
2. Conduct audit and compliance programs to educate and ensure the correct amounts have been paid by taxpayers. In FY 2018, these programs generated an additional \$712.6 million in cash payments, supplementing the taxes that are paid voluntarily.
3. Provide customer service to help taxpayers fulfill their tax filing responsibilities. ODT handled 769,917 taxpayer telephone calls, responded to 68,936 email inquiries and assisted 11,234 walk-in customers during FY 2018.
4. Improve operations and modernize the legacy computer systems by moving forward with various initiatives.
5. Identify efficiency gains that will enable ODT to operate in the most economical way possible.
6. Improve customer service by leveraging technology.

Operational Objectives: Cutting Costs and Increasing Efficiency

ODT recently developed and implemented the following operational changes:

- **Providing superior customer service** – ODT strives to provide the best customer service to all taxpayers.
- **Fighting Tax Fraud** - ODT continues to improve methods of blocking attempted income tax fraud, while reducing the cost of fighting fraud and minimizing the inconvenience to taxpayers.
- **Audit Selection** – ODT is utilizing data analytics to objectively and efficiently identify taxpayers who may be noncompliant with their tax obligations.
- **Ohio Virtual Tax Academy** - Attendance at OVTA webinars continues to grow as we provide education outreach, which includes continuing education credits to attorneys and CPAs. Since 2014, more than 11,800 people have attended OVTA webinars for free.

Setting Priorities for FY 2020-21

Personal Income Tax Replacement - ODT's existing personal income tax system, which administers both personal and school district income taxes, is written in COBOL and runs on an IBM mainframe. All other business taxes have been migrated to STARS (Oracle-based integrated tax system). This administration is currently evaluating the best approach for a new platform.

Data Capture Upgrade - ODT processed 1.2 million paper returns and 1.68 million check payments in FY 2018. The software used to process this volume is 11 years old. While the number of taxpayers who file paper returns continues to decrease, we must maintain an effective and efficient system to deposit revenue and process returns. This project involves upgrading the software to a new version to take advantage of better processing, additional security, and better data handling/reporting. ODT expects to complete this project in 2020.

Portal to Connect ODT with Local Governments – ODT exchanges data with many local governments including counties, municipalities, and school districts. Historically, the exchange of data has been largely a manual process both to and from ODT. The first phase of the project allowed ODT to develop and implement a secure portal that facilitates the electronic transfer of data to and from municipalities for purposes of the municipal net profit tax. ODT continues to enhance the functions of the portal and will soon roll out a means to collect historical data from municipalities for that tax. ODT plans to include other local government data exchanges in the portal in the future to increase efficiency for both the State and local government.

Municipal Income Tax for Electric Light Companies and Local Exchange Telephone Companies

(MELT) System Upgrade – The system used to administer MELT will be almost 20 years old by the end of this biennium. The technology underlying that system has become obsolete, making the system very costly to update and maintain. During this biennium, the goal is to put this system on a more modern and configurable platform.

ODT AND ADMINISTRATION TAX PROPOSALS

Lead Abatement Tax Credit – Governor DeWine has been vocal about family safety and protecting Ohio's youngest and most vulnerable citizens. Continuing his efforts in Congress, Governor DeWine's proposal

creates an application and certificate program for the Ohio Department of Health to grant an income tax credit for individuals who incur expenses for lead abatement activities. This program also creates a nonrefundable credit against the Ohio personal income tax for said taxpayers. If the amount of the credit is greater than a taxpayer's liability, the credit may be carried forward for up to seven taxable years. The credit is equal to the lesser of the lead abatement costs incurred on the eligible dwelling or \$10,000. Over the biennium, \$5 million per year has been appropriated for this program.

Opportunity Zones -- The 2017 federal Tax Cuts and Jobs Act included the Opportunity Zone program. Working with communities across the state and the U.S. Treasury, Ohio established 320 Opportunity Zones in low-income, high-poverty census tracts. The zones have a high potential for job creation, a vision for new investment, and possibilities for development.

Governor DeWine has included a 10% nonrefundable state income tax incentive in this budget to further draw on those investments to Ohio communities. This new credit is carved out of the budget of an existing but under-utilized tax credit (InvestOhio).

Municipal Net Profit Negative Distribution Repayment – I am happy to report that the centralized collection of the Municipal Net Profit Tax is off to a successful start in its first year, and we are entering our second season. We now have approximately 3,600 companies using the centralized filing system and we expect that number to grow. Taxpayers can file the annual tax return and declaration of estimated taxes electronically through the Ohio Business Gateway or through Modernized e-File (MeF) with an approved software vendor. Please be assured that the Department of Taxation is committed to ensuring that all municipalities receive every dollar they're entitled to, while also making sure that business taxpayers don't make municipal net profit tax payments in excess of what's required.

ODT recently asked the Controlling Board to request funds to cover an over-distribution issue that was overlooked as the original legislation was changed in the last budget from a mandatory filing system to an opt-in program. The Controlling Board transfer of cash into the municipal income tax fund simply allows monies to be allocated to the appropriate municipalities in a timely manner.

Taxpayers using the centralized system make payments based on their combined annual estimated tax liability, meaning the total estimated annual tax liability for all municipal corporations in which the

taxpayer has business. Taxpayers make one payment each quarter toward that combined estimated annual liability. The state system distributes the money as directed by the taxpayer to the appropriate municipalities. In some instances, a taxpayer may estimate high in one city and low in another and need to adjust that in subsequent quarters. As the year goes by, the actual amount of tax owed becomes clearer, but ultimately, with filing extensions, it can take up to 18 months for the true tax liability to be determined. Once the true liability for a previous year is known, taxpayers often make adjustments to current year declarations, typically in the fourth quarter.

Right now, the only way to compensate for overpayments to a city is for the state to hold off on any additional payments to that city until the amount of money that city has received equals the amount of money it is actually owed. When you hear about a “negative tax distribution”, it really means the city has received too much money from one or more taxpayers in prior distributions.

The state system has to balance on two fronts: 1) it has to match up estimated payments to a city with the actual estimated tax liability; and then 2) it has to balance the totality of all payments into the system with all of the necessary distributions. In that grand mix, when some cities receive too much money, there’s not enough left to make complete distributions to other cities. That’s why we went to the State of Ohio Controlling Board to borrow two million dollars: to cover required distributions until final returns are filed and the system can reconcile itself.

That’s also why we are seeking a law change that will require municipalities to return excess payments to the state within 30 days. We are rightfully focused on getting revenue to municipalities in a quick and efficient manner; likewise, taxpayer overpayments should be returned in a similar fashion. That will make the entire system run more smoothly. In the event the municipality fails to repay the state in the prescribed time, the language allows the tax commissioner to deduct the amount owed from the next distribution.

Municipal Net Profit and Municipal Electric Light and Telephone Companies – Language included in the operating budget creates a separate Municipal Net Profit Tax Fund to receive revenue from the centralized collection system. Under current law, the revenue is deposited into the Municipal Income Tax Fund, which also receives revenue from the state administered municipal income tax on electric and telephone companies.

AS-PASSED-BY-HOUSE ITEMS

ODT Budget -- ODT's all funds budget passed by the House for FY 2020 is approximately \$133.4 million, which is comprised of \$61.4 million for GRF General Operating Expenses and \$72.0 million for Dedicated Purpose Funds (DPF). The total request for FY 2021 is approximately \$136.0 million, which is comprised of \$62.5 million for GRF Operating and \$73.5 million for DPF. This reflects a reduction of the percentage of the CAT revenue to be credited to the Revenue Enhancement Fund from the current .75% to .65% or \$2.1 million per fiscal year. ODT relies on the revenues in this fund to defray costs of administering CAT.

Personal Income Tax – The House included language to reduce the Business Income Deduction (BID) from \$250,000 to \$100,000 (or from \$125,000 to \$50,000 for married filing separately) and repealed the 3% flat tax on taxable business income over \$250,000. Under the House-passed version, business income over the \$100,000 threshold will now be taxed through the bracketed rate structure.

The bill contains modifications to the bracketed rate structure. The bottom two brackets have been reduced to zero, and for all other brackets, the marginal rates have been reduced by 6.6%.

Also, the House included language to reduce the rate of tax paid by certain pass-through entities on a percentage of the non-resident investors' distributive income from 5% to 3% for individual investors and from 8.5% to 3% for non-individual investors. This provision also authorizes a pass-through entity to avoid withholding the tax if a non-resident investor submits a statement to the entity, subject to the penalties of perjury, affirming that the investor intends to comply with and remit state income tax as required by law.

Sales and Use Tax – Various sales and use tax changes were made by the House.

The House modified the definition of substantial nexus for use tax for remote sellers. This included two main provisions: inclusion of the South Dakota standard that was upheld by the United States Supreme Court in *Wayfair v. South Dakota*, and marketplace facilitator language.

The House also modified the sales taxation of "transportation network companies" (TNC) services. The proposed language excludes from the definition of "price" any service fee charged except for the base

fare for distance driven or time. The House also changed the definition of “price” to require hotel intermediaries to collect and remit sales tax on the amount the intermediary advertises to the customer as the hotel room’s price.

Exemptions were repealed for the following items: aviation repair and maintenance services and parts, sales of flight simulators, sales of investment bullion and coins, the \$800 cap on sales of qualified fractionally-owned aircrafts, sales of property and services for maintenance and repair of qualified fractionally-owned aircrafts, and the sales of qualified property to qualified motor racing teams.

Exemptions were expanded for manufacturers: to include equipment and supplies to clean processing equipment that is part of a continuous manufacturing operation to produce food (currently limited to dairy products); and to include equipment, supplies, building and janitorial services used to clean or maintain any tangible personal property, machinery, or equipment that is part of a continuous manufacturing operation.

Financial Institutions Tax – Language limits the tax base such that total equity capital in excess of 14% of total assts would not be included in the tax base.

Chairman Schuring and members of the Senate General Government and Agency Review Committee, I am greatly appreciative of your time and would be happy to answer any questions you may have.