



## Tax Policy

### **Testimony on Senate Bill 18 before the Senate Ways & Means Committee**

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Chair Blessing, Ranking Member Williams and members of the Senate Ways & Means Committee: Thank you for the opportunity to testify on Senate Bill 18. This legislation needs to be changed so that it helps Ohioans who are struggling amidst the pandemic—and so it does not provide unneeded new tax breaks to the most affluent Ohioans. As already noted in testimony from the CPAs' society, it is not new for Ohio to decouple from federal tax law. That is what you should do in a few key instances.

Ohio should not follow along with some of the tax cuts Congress approved last December as part of the latest COVID relief act. That bill authorized another round of Paycheck Protection Program loans to businesses. These loans will be forgiven so long as employee and other compensation levels are maintained, and they are used for payroll and other eligible expenses. However, in the relief bill passed late in the Trump administration, Congress not only decided to make the forgiven loans tax-free, it also allowed recipients to deduct from their taxes payroll and other expenses they paid with the loans. Congress also made this retroactive to the beginning of the program.

This is a classic double dip for wealthy Ohioans. The Internal Revenue Service specifically prohibited the deductibility of such expenses with the first round of PPP loans, citing existing law and precedent. Now, while hundreds of thousands of Ohioans are paying taxes on the unemployment compensation they received last year, business owners will avoid paying taxes on their forgiven loans they used to pay workers' wages, and they'll get tax deductions. Adam Looney of the Brookings Institution described it this way: "In short, it's a benefit targeted to a trifecta of inequity: (1) you need to own a business sophisticated enough to get a PPP loan; (2) the more income you have, the more you benefit; (3) your benefit is largest if you're in the highest tax bracket." With \$800 billion in PPP loans authorized, the deductions could drain the federal government of an enormous amount of revenue.

In Ohio, the tax break will go to owners of what are called "passthrough businesses," entities like limited liability companies, S corporations and others whose owners are taxed as the income passes through to them. While a fiscal note was not

available at the time this testimony was written, \$9 billion in PPP loans already have been made to these companies. Ohio already has a lavish tax break for such business owners — known as the LLC Loophole — so they don't have to pay income tax on the first \$250,000 in such business income (\$125,000 if married filing separately). The new federal tax break in Ohio will only benefit owners with more than that amount of business income. In other words, it's a giveaway to the most affluent business owners.

You can and should choose to “decouple” from that new federal tax break in Senate Bill 18, and ensure that such expenses paid for with PPP loans aren't deductible. Alternatively, you should allow the deductions but make the loans taxable. But both tax breaks should not be allowed.

At the same time, Ohio should decouple from another unneeded tax break in the federal COVID relief bill: the deduction for business meals and entertainment, colloquially known as the three-martini lunch deduction. Scaled back under the Tax Cuts & Jobs Act of 2017, Congress reinstated it in the December bill. Howard Gleckman of the Tax Policy Center, who called it “a long-standing boondoggle,” described it this way: “Corporate executives and small business owners routinely used it to write off their personal expense as costs of doing business. Want to take your spouse to a fancy anniversary dinner? Charge it to the business and take a deduction. Want to shoot a round at the country club? Take a client—and claim a deduction. The tax scam has been around so long that martinis had time to be fashionable, become passe, and turn trendy all over again.”

Nor is the deduction likely to turn around dining habits in the middle of a pandemic or be much help to small neighborhood restaurants.

The state could use money saved from decoupling to help the hundreds of thousands of Ohioans who were laid off in 2020 and who will be on the hook for state income tax on unemployment benefits. This, too, is a matter of conformity to the federal tax code; Ohio taxes unemployment benefits because they are taxed at the federal level and the state uses federal adjusted gross income as the starting point for its income tax. So this fits exactly with the subject of SB 18. Unlike with federal income tax on unemployment compensation (UC), Ohio gave claimants no option to have Ohio income tax withheld by the state. With the pandemic and recession far from over, the General Assembly should reduce or eliminate these UC taxes.

Last year, Ohioans received more than \$15 billion in UC benefits, much of that from critical federal programs that boosted the amounts workers received and assisted the self-employed, so-called “gig” workers, and others who don't ordinarily qualify for benefits. In addition, thousands of Ohioans who never received benefits could be subjected to federal income taxes because fraudsters including international crime syndicates used stolen identities to collect UC benefits. Attorney General Dave Yost sent

a letter to Ohio's Congressional delegation asking them to sponsor legislation assuring that victims don't have to pay income taxes on claims falsely filed in their name.

Taxes on unemployment benefits cut against both of its two purposes: Protecting wage earners from hardship while they are out of work and boosting the economy by adding to consumer spending power. UC taxes amount to a benefit cut, while also reducing their effect as an economic stabilizer. Economists Alan Blinder and Mark Zandi estimated that a dollar paid in unemployment benefits generates \$1.61 in economic activity. Ideally, Congress should eliminate federal income taxes on unemployment compensation altogether. Sen. Richard Durbin of Illinois and Congresswoman Axne have proposed legislation exempting the first \$10,200 of unemployment payments from taxation for 2020.

You can remedy the problem for Ohio's income tax. As long as state income tax is assessed on unemployment benefits, the General Assembly should give unemployed Ohioans the option of having state income tax withheld, as many other states already do. This would eliminate the problem of Ohioans having surprising tax bills. The legislature should also eliminate the 2020 tax, at least for those of moderate income, and phase the tax out altogether going forward. At a minimum, you should waive all penalties and interest for nonpayment and provide generous repayment terms for two to three years.

Do you want to allow Ohioans to be blindsided by a tax on UC benefits they can ill afford, while you legislate a windfall to some of our most affluent residents? Instead of providing new tax cuts for well-to-do Ohioans by passing SB 18 as is, you should decouple Ohio from federal tax law. At the same time, you should part ways with federal tax policy and end — or at least reduce — taxation of unemployment benefits.

Thank you very much for the opportunity to testify.