BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
OPPONENT TESTIMONY ON THE PACKAGE OF TAX PROVISIONS IN HB 64
TUESDAY – MARCH 11, 2015

Chairman McClain and Members of the Committee,

My name is Dan Navin and I am the Assistant Vice President of Tax & Economic Policy for the Ohio Chamber of Commerce. I also serve as the staff liaison for our affiliate organization, the Ohio Small Business Council, which advocates on behalf of the interests of small businesses across the state.

In my 23+ years with the Chamber, we have significantly contributed to many revisions and reforms of different components of Ohio's tax structure – updating the "primarily used in manufacturing" sales tax exemption, revising the net worth base of the corporation franchise tax (CFT), reducing the assessment percentage of inventory and machinery & equipment under the tangible personal property tax (TPP), twice enacting major reforms of the municipal income tax, eliminating the estate tax, making numerous changes to the major taxes during budget crises (1992, 2001, 2009) and, of course, the 2005 tax reform package that resulted in the elimination of the CFT and TPP tax, a 21 percent income tax cut and imposition of the commercial activity tax (CAT).

You can tell from this list that we are a business advocacy organization, working to advance public policies that will lead to business investment, job creation and the growth of our state's economy. You should know as well that we come to our positions on pending tax legislation through our Ohio Chamber Tax Committee, comprised of about 150 state & local tax analysts, managers, directors and consultants from Fortune 1000 companies and medium-size businesses, law/accounting/tax consulting firms, local chambers of commerce and small business owners with a heightened interest in tax issues.

Since the Ohio Chamber represents businesses of all types, sizes and industries, our Tax Committee assesses a serious tax reform plan such as the one in House Bill 64 as a comprehensive package, so the Chamber's position is on the plan as a whole and not as a set of separate positions on the various component parts. But there is no doubt our members may feel especially strongly about one or more of the proposals in the tax reform plan, and that is certainly the case on the administration's executive budget tax plan.

One of our over-riding principles in all of these tax debates is that we are looking for win-win scenarios – plans that will stimulate business investment and growth and create jobs without intentionally establishing a zero-sum game pitting potential winners against and at the expense of potential losers. Unfortunately, the administration's executive budget reflects precisely that philosophy and intended outcome, moving in the direction of providing economic benefits to small business and individual taxpayers that must be paid for by higher taxes on larger businesses. Small businesses are impacted when larger companies' tax bills go up, as small businesses are customers or suppliers of larger businesses and, when larger businesses have less to spend, small businesses lose sales opportunities.

Despite these common sense principles, the administration's executive budget is a plan that involves major tax shifting with questionable overall benefit to the state's economy. Consequently, the Ohio Chamber cannot agree with the fundamental premise of the plan and, therefore, cannot support it.

Our opposition to the tax package is not about the impact on individual taxpayers or pass-through entity business owners but rather, after the offsetting $5.2 billion in tax increases much of which is to be borne by businesses, we believe the net $523 million tax reduction will not result in a substantial improvement to the state's economic competitiveness.

In fact, the members and board of the Ohio Chamber's Small Business Council (OSBC) were similarly skeptical about any potential overall positive impact of the plan, in that while they concede it sends out a positive message about Ohio, the $2 million gross receipts threshold/cliff also creates a disincentive to growing beyond that figure. There is also a belief among OSBC members that the proposed plan in particular, and the state's tax code in general, is too complex and, since most small businesses have no tax department of their own, they are looking for simplicity. Further, the fact is that small businesses are not clamoring for the proposed exemption from income tax, as it is estimated that over 135,000 existing small business owners are not even taking advantage of the current 50% of pass-through income up to $250,000 small business deduction.

Now let me discuss our perspective on the two major reasons for our concerns about the plan – the proposed CAT rate increase and the expansion of the sales tax to various business-to-business services, most notably on "management consulting". First, the CAT.

For those that don't know the history, the Ohio Chamber back in 2005 was opposed to the enactment of the CAT as the primary state tax on businesses on the basis that it was an unfair gross receipts tax that created several inequities or distortions in the tax code, some of which were pointed out in the EY study that was described yesterday. One of the other reasons for our opposition was the concern that the CAT would be one, if not the first, option immediately considered in looking for revenue for whatever purpose state policymakers might wish to pursue.

That may or may not be the case now but I can categorically say the following – the main reason the CAT has survived since its enactment is that **it is a low rate tax** on a broad base comprised of sales of both goods and services. Yes, there is pyramiding of the CAT at each stage of the production or distribution chain as it's imposed on the taxable gross receipts of Ohio suppliers at sometimes three or four levels. But the CAT's low rate is the singular characteristic that makes it palatable to many Ohio businesses and significantly raising that rate up, as this plan would, could potentially jeopardize the competitive advantage Ohio manufacturers in particular enjoy. In fact, we think that reducing the CAT rate should be a tax relief option and we would welcome participation in such discussions.

The Ohio Chamber believes the administration is focusing on a significant problem with the state's tax code – that is, Ohio's marginal personal income tax rates are a competitive issue relative to other states, especially when you add on the local municipal income taxes that apply where companies sell their goods and services and in which they have employees working. I am referring to some states with which Ohio is in competition for new investment and jobs that have either a flat rate state income tax (IN 3.40%, MI 4.25%, PA 3.07%) or no state income tax (FL and TX).

However, in his State of the State address, Gov. Kasich said, "If you don't do that (increase the CAT rate)…you won't get these lower taxes. It won't happen." As the EY tax study concluded in the section on the effect of the proposed CAT rate increase, "The implications of the CAT as a pyramiding tax are that the tax becomes embedded in the price of inputs as they move between businesses and consumers in the supply chain….The distortionary and discriminatory characteristics of the CAT are muted at very low rates. As rates are increased, distortions and differential effects increase dramatically." What the Ohio Chamber and our members are saying is if that is the tradeoff [higher CAT (and other tax increases on businesses) for lower personal income taxes], then we'd rather not seek such significant personal income tax cuts in a single two-year period.

Now, the sales tax base expansion. For some time now, one of the justifications put forward for expanding the base of the sales tax to various services purchased by businesses from businesses (B2B), especially professional services such as legal and accounting, has been that Ohio should shift away from income taxes to so-called "consumption" taxes. In this context, the term "taxing consumption" is intended to mean subjecting to sales tax many or all of the services sold/purchased within the state's economy which, it has been asserted, comprises up to two-thirds of Ohio's gross state product.

What is not said is contained in the 1st paragraph of the EY tax study in the Sales Tax section, where it says, "Expansion of the sales tax to include new categories of business and professional services (as well as consumer services) has implications that are quite similar to those of a gross receipts tax, though with a much narrower base. Such expansion runs contrary to the basic economic premise of the general retail sales tax as a tax on final consumption. Many of the same undesirable outcomes that occur from increased CAT rates are possible from taxing business services depending upon the extent to which taxed services are used across different sectors and the number of stages that such services appear in the supply chain of a particular product or service."

In other words, subjecting business and professional services should not be thought of as a tax on final consumption, but rather a pyramiding tax on production or distribution. Take the example of "management consulting services", which would become subject to sales tax under the executive budget, and is defined as follows:

"Management consulting service" means: any activity that provides advice and assistance to businesses and other organizations on business issues. The business issues may include, *but are not limited to*:

- **Financial planning and budgeting**
- **Equity and asset management**
- **Records management**
- **Office planning**
- **Strategic and organizational planning**
- **Site selection**
- **New business startup**
- **Business process improvement**
- **Human resource management**
- **Marketing issues and planning**
- **New product development**
- **Pricing strategies**
- **Licensing and franchise planning**
- **Manufacturing operations improvement**
- **Productivity improvement**
- **Production planning and control**
- **Quality assurance and control**
- **Inventory management**
- **Distribution and warehouse operations**
- **Materials management and handling**
- **Telecommunications management**
- **Utilities management.**

That's 22 separate expenses that are commonplace across Ohio companies' operations. Under this definition, virtually every facet of a business that the company's management either provides in-house or contracts for with an outside provider will become subject to sales tax. And that doesn't even begin to encompass "lobbying services" which are defined in the bill as "any activity that serves to influence the behavior or opinion of an individual, an industry or an organization." How's that for broad.

As noted in the EY study, "For Ohio firms that produce for sale in markets outside of Ohio, this additional embedded tax will place them at a competitive disadvantage with competing, non-Ohio firms. Firms producing in this environment will be required to absorb most of the economic burden of the tax. Ohio firms producing for national or local markets will also have incentives to purchase from out-of-state suppliers to reduce the level of embedded tax. This will force local, Ohio, suppliers to reduce prices and absorb the tax." These B2B services proposed to be subject to sales tax will make more Ohio businesses less competitive and, thus, should be rejected.

Tax Expenditure Review

I want to end on somewhat of a note of optimism and agreement with regard to the executive budget's tax proposals. In 2010, the Ohio Chamber and the eight metro chambers of commerce issued a report entitled, *Redesigning Ohio:Transforming Government into a 21st Century Institution*. It was intended as a road map for long-term, transformational change and included an analysis of Ohio's economic situation at that time and made a host of recommendations touching ten different areas of state and local government operations. One of the recommendations was that Ohio needs to periodically review the effectiveness of state tax credits, exemptions and deductions – in other words, tax expenditures.

These nine organizations called for Ohio to implement a comprehensive tax expenditure review that would be shared with the public and policymakers as follows:

1. Utilize the tax policy principles of neutrality, economic competitiveness, stability, equity and simplicity to conduct a thorough review and cost-benefit analysis of the 128 existing tax expenditures in the budget;
2. Use both a static and dynamic analysis of the costs and benefits of tax expenditures; and,
3. Improve the quality and scope of Ohio's biennial Tax Expenditure Report.

The language in HB 64 in ORC section 5703.94, House Bill 6 sponsored by Rep. Boose and House Bill 65 sponsored by Rep. Driehaus all address, in slightly different ways, the creation and operation of a Tax Expenditure Review Committee. We can debate the requisite period of time each tax expenditure should be reviewed and how many members should be on the committee. As a starting point, we agree that a tax expenditure review committee of some kind should be established. The Ohio Chamber suggests that there should be at least a few (three) private sector appointees with tax expertise and experience, in addition to any legislative and/or executive branch appointees.

In conclusion, the Ohio Chamber appreciates that the concerns of businesses across the state are being duly and seriously considered. We are committed to working with the administration and members of the General Assembly to achieve the growth of our economy and the enhancement of the competitiveness of businesses in our state. Thank you, Chairman McClain, for the opportunity to share our thoughts and welcome the opportunity to answer any questions you or the committee members may have.