



Testimony on Tax Expenditures
Before the Ohio Senate Ways and Means Committee
By Thomas M. Zaino, CPA, JD on behalf of
The Ohio Society of CPAs

March 4, 2015

Chairman Peterson, Vice Chairman Beagle, Ranking Member Tavares and members of the Senate Ways and Means Committee, thank you for providing this opportunity to speak on behalf of 21,000 members of The Ohio Society of CPAs regarding tax expenditures. I am Tom Zaino, Chair-Elect of The Ohio Society. I also am the managing member of Zaino, Hall & Farrin, LLC, and formerly served as tax commissioner for the State of Ohio under former Governor Bob Taft.

What are Tax Expenditures?

As you know from the Tax Expenditure Report issued in relation to the FY 2016-2017 budget, there are reportedly 128 tax expenditures in current state law, each of which is associated with a cost to Ohio's General Revenue Fund. All of these tax expenditures result in a loss to the state's bottom line. However, many tax expenditures are designed to encourage particular behavior or to ensure Ohio's tax system is competitive with other taxing jurisdictions. For example, a particular tax exemption, credit or deduction might encourage the creation or retention of jobs that otherwise might not exist, or the purchase of equipment for use in Ohio facilities instead of in a facility located out of state – both events that could drive increased sales, increased jobs, increased tax revenues or other positive economic development outcomes that outweigh the cost of the tax expenditure. Also, many tax expenditures are simply an ordinary or normal part of a typical state's tax base. An example of an ordinary or "normal" exemption is a sales tax exemption for business inputs to prevent pyramiding of the tax. Still other tax expenditures generate benefits to society. Tax exemptions for many charitable programs benefiting the less fortunate are an example.

I would like to draw your attention to the National Conference of State Legislatures document entitled *Tax Expenditure Budgets and Reports: Best Practices* (attached). The document suggests that a tax expenditure is best thought of as a "deviation from the 'normal' tax structure."¹ Of course, that begs the question: what is a "normal" tax structure? In many states, deductions for ordinary and necessary business expenses and sales tax exemptions for purchases of business inputs are generally considered part of the "normal" tax structure. The document also suggests some best practices to consider when evaluating tax expenditures.

¹ *Tax Expenditure Budget and Reports: Best Practices*, National Conference of State Legislatures Task Force on State and Local Taxation, Adopted August 18, 2014, at page 1.

How to Evaluate Tax Expenditures

Many states struggle with what is the best way to evaluate tax expenditures. No matter what the reason for a tax expenditure, the same thing holds true for all of them: you cannot know whether they are still relevant and are achieving their stated goals unless you take a hard look at each one. In recent years, Ohio officials have taken a closer look at many of these expenditures and have done a better job of auditing beneficiaries of some of the tax credits available to ensure compliance with agreements, but an even closer examination would be beneficial.

A common approach to evaluating expenditures in the Private Sector is zero-based budgeting. Under this approach, every program's continued existence is assumed to be on the chopping block, and its continuation must be justified by proving that it is achieving intended results. Sometimes this evaluation results in updating the program to reflect changes in business or the economy that only become evident after the program has been launched. This is often the case with start-up programs, which can take several years to fully evolve. Other times, even with start-ups, a program might be viewed as an experiment. As we all know, some experiments succeed, while others fail. Cutting one's losses so that one can use the resources for a different, more beneficial effort is often necessary. But the only way to know for sure if a program's financial investment is achieving its goals is to take a close, hard look.

OSCPA believes that all existing deductions, credits and exemptions should be evaluated in a similar manner to ensure they are achieving their goals and purposes. As the Department of Taxation's Tax Expenditure Report correctly states, "unless there is a pre-existing termination date, tax expenditures may remain in Ohio law indefinitely." OSCP supports sun setting tax expenditures after an appropriate period of time to ensure there is a full vetting of the exemption, credit, or deduction to see if continuation is the best approach. Because certainty for taxpayers is also important, an appropriate period of time for the evaluations could be every ten years, depending on the nature of the expenditure.

In 2010, OSCP's Ohio Budget Advisory Task Force Report recommended carefully studying the various economic development tax credit programs to ensure the dedicated funds are being used for their intended purpose, and to analyze from a cost/benefit lens the number of jobs created vs. the tax revenue received in correlation to tax payment investment.² While we recommended independent performance audits of the various credits, sunset programs could also support this effort. Performance audits could be an alternative approach if the sunset approach is not an option. Performance audits could also be used for the income tax credits and deductions.

The Impact of Proliferating Tax Expenditures

The proliferation of tax expenditures may be most evident today in Ohio's Personal Income Tax. We know that many Ohioans and members of the General Assembly are concerned about the income tax

² *Ohio Budget Advisory Task Force Report*, The Ohio Society of CPAs, June 2010, at page 7.

rates in our state. Please notice that in the first year of Ohio's Personal Income Tax, the 1972 tax return was literally a postcard. On the front of the postcard was the demographic information and short form. On the back of the postcard was the long form (see Attachment). Why was the tax return so short? Because the tax was very simple, with few deductions, credits or exemptions. Taxpayers could figure out their tax obligations on their own, without needing to pay CPAs or other tax preparers.

Since 1972, numerous deductions, credits and exemptions have been enacted. When I left the role of Tax Commissioner in 2003, Ohio's long form was two pages and its EZ form was one page. Today, Ohio's long form is four pages and its EZ form is two pages. Both forms are now longer than their federal counterparts. Over the last 10 years, the number of personal income tax expenditures has increased from 21 in 2005 to 36 today--15 new tax expenditures in just ten years!

Evolution of Personal Income Tax Return			
(number of full-sized pages ³)			
	1972	2003	2015
Ohio Short Form	¼	1	2
Federal Short Form	1	1	1
Ohio Long Form	¾	2	4
Federal Long Form	2	2	2

Philosophically, I encourage you to consider the following question: is it better to have a large number of tax expenditures, which reduces the revenue raised by the income tax, increases rates for all, and impacts a limited-time event or limited number of people, or is it better to have a much smaller number of expenditures, which lowers the tax rate and cost of compliance for all Ohioans. To make that question a bit tougher, what if I asked: is it better to provide a one-time tax benefit for a family adopting a child, or does it make better sense to provide a much lower income tax rate over the next 18+ years during which the family must feed, care for, and educate the child? Make no mistake; adoption of children is an important and worthy cause to incentivize. But, perhaps the General Assembly should look to create grants outside of the tax system to directly encourage adoption as needed and then lower tax rates to enable the family to support those children over the years.

The Impact of Eliminating or Limiting Tax Expenditures

When done in a thoughtful and well-planned manner, Ohioans can benefit from the elimination of true tax expenditures. For example, the elimination of the Corporation Franchise Tax also eliminated 40 tax expenditures in exchange for the broad based, low rate Commercial Activity Tax (CAT), which has just 18 tax expenditures. Since Ohio fully converted to the CAT in 2009, Ohio's economic growth has been outstanding. The OSCPA believes the new business tax system and personal income tax cuts resulting from the 2005 tax reform strongly supported this growth.

³ Page calculations do not include separate supporting schedules. The 1972 federal Short Form 1040A was a two-sided half page return. The Federal Form EZ did not exist in 1972. For comparison purposes, in 2003 and 2014, the federal Form 1040EZ is used. See www.irs.gov.

While many existing business-related tax expenditures are part of the "normal" tax base, adding new deductions, credits, and exemptions to the CAT can result in picking winners and losers, picking some businesses or industries over other businesses or industries.

Considerations

As the Committee approaches the difficult task of reviewing tax expenditures, OSCPA encourages you to consider a number of approaches that will help keep tax rates low or make them even lower.

- Recognize the definition of tax expenditure: a deviation from the normal tax base.
- Consider establishing measurable goals and purposes for each tax expenditure, which can be used in the future to evaluate their effectiveness.
- Avoid picking winners and losers. For example, don't create a tax benefit for one part of industry that puts it at a financial advantage over another.
- Explore what surrounding states and other key economic competitors are doing tax-wise with a given industry; learn from their mistakes and successes.
- Remember that Ohio businesses, both big and small, are no longer competing with just businesses in neighboring states, but with businesses around the globe.
- Ohio shouldn't "give away the store." If the desired activity will take place in our state without a tax expenditure, don't create one.

OSCPA and I applaud Governor Kasich and all members of the House of Representatives and the Senate for your past efforts to improve Ohio's economy and to make our great state not only as competitive as possible, but also a place where people want to grow their business and raise a family. We have supported many of the initiatives you have adopted that have improved Ohio, and we look forward to continuing to work with you to explore opportunities to improve our state even more.

Again, I appreciate this opportunity to share our thoughts, and would be happy to answer any questions you might have.