

**FINAL REPORT
AND
RECOMMENDATIONS**
of the
**Joint Committee to Study
State Taxes**

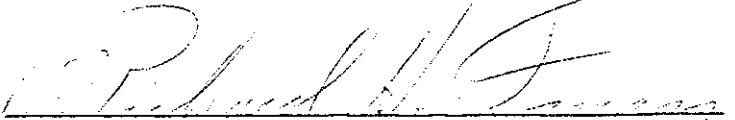
114th General Assembly
December 1982

To the Members of the Ohio General Assembly:

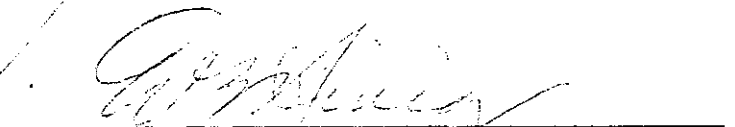
The Joint Legislative Committee to Study State Taxes is pleased to present to you the Committee's recommendations concerning state and local taxes in Ohio. The Committee was created by Am. Sub. H.B. 694 for the purpose of studying the state's tax structure and recommending alternatives to the present system.

The Committee conducted ten hearings at which voluminous and informative testimony was presented and research material was reviewed. Six additional meetings were held to deliberate over tax policy issues. In the course of our deliberations we adopted a long-range perspective on the state's tax structure, emphasizing the importance of the fundamental qualities of a good tax system, such as equity, simplicity, economic neutrality, and ease of compliance and administration, rather than concentrating on the state's more immediate fiscal dilemmas. While the members of the Committee are acutely aware of the current shortfall in state revenues, the Committee believes that these current problems, although serious, are temporary. For this reason the Committee concentrated on broader policy questions for the purpose of redesigning the Ohio tax structure to make it more equitable, productive, and economically progressive in the future. Thus the report and recommendations of the Committee are presented as a long-term guide for the development of a sound state and local tax system in Ohio.

Sincerely,



Senator Richard H. Finan, Co-Chairman



Representative William E. Hinig, Co-Chairman

The members of the Joint Committee to Study State Taxes:

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ACKNOWLEDGMENTS

The Committee wishes to express its appreciation for the assistance that it received in the course of its work. Technical assistance in the form of background information and statistical data was provided by Shelagh Baker, William Driscoll, and Priscilla Walker of the Legislative Service Commission, Patricia Rupich of the Legislative Budget Office, and Richard Levin and Julie Carpenter of the Department of Taxation's Division of Research and Statistics. The Committee is particularly appreciative of the spirit of cooperation with which the Department of Taxation, the Department of Tax Equalization, and the Department of Insurance responded to its requests for information. The Committee also wishes to recognize Kathy Darling and Diane Yutzy who provided administrative support. Thanks are also due to Brenda Buchanan, Cathy Kamer, and Janice Wellborn of the Legislative Service Commission for typing, reproducing, and binding the report.

Finally, the Committee wishes to thank the many individuals and organizations who testified before the Committee or furnished it with information or other assistance.

Meeting dates of the Joint Committee to Study State Taxes and the speakers or authors of written testimony submitted on each date are listed below.

January 13, 1982 - Organizational Meeting

March 24, 1982 - Organizational Meeting

April 14, 1982

- Steven D. Gold - Project Director, Intergovernmental Finance, National Conference of State Legislatures

- Donald Phares - University of Missouri

April 30, 1982

- Fredrick Stocker - Professor of Economics, Ohio State University

- David Cleeton - Oberlin College

- John Beck - Case Western

- Leo Navin - Assistant Professor of Economics, Bowling Green State University

June 22, 1982

- Former Tax Commissioners: Stanley J. Bowers
Gerald A. Donahue
Robert J. Kosydar

July 7, 1982

- Representatives of Chamber of Commerce: Gerald H. Royer
Thomas J. Reilly
John D. Naughton
I. John Reimers

- Ray Goodin - Ohio Electric
- Raymond R. Thomas - Ohio Gas
- John McFerran - Ohio Bell
- Mary Laird Duchi - Battelle Memorial Institute

July 8, 1982

- Edgar L. Lindley - Tax Commissioner

- Thomas R. Johnson - President, Ohio Manufacturer's Association

July 21, 1982

- Tim Doran - Ohio Automobile Dealers Association
- Bill Davidson - Farm Equipment Dealers Association
- Jim Henry - Ohio Retail Merchants Association
- William Schmidt - Vice President of the Ohio Arts and Crafts Guild
- Jack Heyman - Sunshine Artists, U.S.A.
- Tom Workman - Domestic Insurance Companies
- Daniel J. Kelso - Vice President of the Insurance Federation

July 22, 1982

- Braxton E. Tewart - American Lung Association of Ohio
- Bruce Stout - Ohio Bankers Association and Ohio State Bar Association
- Doug Trail - Ohio Manufacturer's Association
- Craig Calhoun - Ohio Motorcycle Dealers Association
- Bob Roach - Ohio Equipment Distributors Association
- Charles Myers - Ohio Land Improvement Contractors
- Charles Calhoun - Ohio Public Expenditure Council
- John Coleman - Ohio Municipal League

August 3, 1982

- Dan Nash - Kroger Company
- Sam Dyer - Federated Department Stores
- Jack Advent - Ohio Association of Tobacco and Candy Distributors
- John Schmuhl - Ohio Cable Television
- Paul Bachman - Vice President of the Baldwin United Leasing Company
- Larry Kandel - Ohio Farm Bureau

August 4, 1982

- Victor Feldmiller - Ohio Society of Certified Public Accountants
- Thomas DeLuca - Ohio Society of Certified Public Accountants
- Ron Beach - Association of Ohio Philanthropic Homes for the Aging

August 17, 1982

- Robert R. Kinney - Department of Tax Equalization
- Jack Brown - Secretary of Ohio Association of School Business Officials
- Bill Phillis - Department of Education
- Glen Darr - Ohio Education Association
- Paul E. Spayde - Associate Executive Vice President of Ohio School Boards Association (Retired)
- Robert Crabbs - Selected School Leagues
- Lou Kitchen - Ohio Association of Public School Employees
- Gary Keller - Lakota Local School District
- Leonard Stevens - Len's Implement Sales

Committee Deliberations:

- September 15, 1982
- September 28, 1982
- October 14, 1982
- November 17, 1982
- November 22, 1982
- November 23, 1982

TANGIBLE PERSONAL PROPERTY TAX

1. THE TANGIBLE PERSONAL PROPERTY TAX SHOULD BE REPEALED IF THE GENERAL ASSEMBLY CAN FIND AN ACCEPTABLE SOURCE OF REVENUE THAT IS ADEQUATE TO REPLACE THE REVENUE LOST THROUGH REPEAL. IF SUCH A REPLACEMENT REVENUE SOURCE CANNOT BE AGREED UPON AND THE TAX REPEALED, THE ASSESSMENT PERCENTAGES SHOULD BE GRADUALLY REDUCED AND THE REVENUE LOSS OFFSET THROUGH GROWTH IN THE PERSONAL PROPERTY TAX BASE, OR IN OTHER BUSINESS TAXES, OR THROUGH THE ELIMINATION OF EXEMPTIONS AND CREDITS THAT BENEFIT BUSINESS TAXPAYERS. THE STATE SHOULD ASSIST LOCAL GOVERNMENTS IN MEETING DEBT OBLIGATIONS SERVICED BY AFFECTED DEBT LEVIES AS THESE REDUCTIONS IN THE TANGIBLE PERSONAL PROPERTY TAX BASE REDUCE THE YIELD OF THE TAXES IMPOSED TO SERVICE THAT DEBT.

The Committee received more testimony about the tangible personal property tax than about any other issue. As a result of this testimony, the Committee is convinced that the tangible personal property tax imposes an unreasonable burden on the business taxpayer because it is levied without regard to the taxpayer's ability to pay it. Therefore, the Committee believes this tax ought to be repealed.

However, as a practical matter, the tax on tangible personal property produces substantial revenue. The Department of Taxation estimates that in 1983 the tax will provide \$966 million for local governments. The replacement of this amount all at once would impose an unreasonable burden on the remaining components of the state's tax structure.

As a more realistic alternative to immediate repeal of the personal property tax, the Committee recommends the assessment percentages be gradually reduced. Such reductions should occur when net losses from the lower assessment rates can be minimized or eliminated through growth in the property tax base itself, increases in revenue from other business taxes, or the elimination of business tax exemptions or credits. The current assessment percentages for personal property are 100% for utility property generally, 50% for selected utility property, 35% for inventory, and 38% for all other personal property, the latter percentage will be reduced to 36% in 1983 and 35% for each subsequent year.

When the personal property tax is repealed or reduced through lower assessment percentages, the state should assist local government in repaying outstanding debt to the extent that the repayment of such debt is dependent on the personal property tax base. This should prevent any major shift in the burden of debt levies from tangible personal property to real property.

2. THE PERSONAL INCOME AND CORPORATE FRANCHISE TAX CREDITS FOR NEW MACHINERY AND EQUIPMENT SHOULD BE REPEALED WHEN THE ASSESSMENT PERCENTAGE APPLICABLE TO SUCH PROPERTY UNDER THE TANGIBLE PERSONAL PROPERTY TAX IS REDUCED TO 30% OF TRUE VALUE. HOWEVER, PROPERTY THAT QUALIFIED FOR THE CREDIT PRIOR TO ITS REPEAL SHOULD CONTINUE TO BE ELIGIBLE FOR THE CREDIT.

Current law permits taxpayers to claim a credit against the personal income tax and the corporation franchise tax for machinery and equipment used in manufacturing and purchased on or after January 1, 1978. The credit equals the difference between the tangible personal property taxes charged against the property and paid in the taxable year and the property taxes that would have been paid if the property were assessed at 20% of its true value.

The Committee believes that at the time of their enactment these credits for manufacturing equipment relieved some of the unfair impact of the personal property tax and may have induced some additional capital investment. However, the Committee is concerned about the potential impact of these credits on the state's General Revenue Fund. The Department of Taxation estimates that these credits will cost the state \$54.1 million in 1983 and \$61.7 million in 1984.

The Committee believes that any unfairness in the burden of the personal property tax or any investment disincentive caused by the burden of that tax should be addressed directly through changes in the property tax (see Recommendation 1). Therefore, the Committee recommends that when the assessment percentage

applicable to machinery and equipment has been reduced to 30% of true value the personal income and corporation franchise tax credits for such property should be repealed.

Since some taxpayers relied upon the existence of the credit for new machinery and equipment in making their capital investments, the credit should continue to be allowed for machinery and equipment purchased prior to the credits' repeal.

3. THE DEPARTMENT OF TAXATION SHOULD CONSIDER STREAMLINING THE PROCESSING OF INTERCOUNTY CORPORATION PERSONAL PROPERTY TAX RETURNS THROUGH STANDARDIZATION IN THE EXCHANGE OF DATA OR BETTER USE OF COMPUTERIZED DATA PROCESSING.

The Committee received testimony suggesting improvements are possible in the processing of intercounty corporations' tangible personal property tax returns. Specifically, it appears that some standardization of the form in which information passes among corporations, the Department of Taxation, and the counties would simplify the administrative task of processing intercounty corporate returns. Better utilization of computerized data processing techniques may assist this simplification process. The Department of Taxation, in consultation with the county auditors, should develop a plan for accomplishing the goal of this Recommendation.

PUBLIC UTILITY TAXES

4. A UNIFORM STATE TAX SHOULD BE IMPOSED ON THE REAL AND PERSONAL PROPERTY OF PUBLIC UTILITIES TO REPLACE TAXES FOR CURRENT EXPENSES CURRENTLY LEVIED ON SUCH PROPERTY BY SCHOOL DISTRICTS. THE TAX SHOULD BE ENACTED THROUGH A CONSTITUTIONAL AMENDMENT AND LEVIED FOR THE PURPOSE OF PROVIDING OPERATING FUNDS FOR PRIMARY AND SECONDARY EDUCATION. WITH RESPECT TO PUBLIC UTILITY PROPERTY TAXES LEVIED FOR OTHER KINDS OF POLITICAL SUBDIVISIONS, THE NEED FOR A SOLUTION TO PROBLEMS INVOLVING THE APPORTIONMENT OF PUBLIC UTILITY PROPERTY, COMPENSATION FOR ADDITIONAL SERVICE REQUIREMENTS IMPOSED BY PUBLIC UTILITY PLANTS, AND THE SATISFACTION OF OUTSTANDING DEBT OF POLITICAL SUBDIVISIONS DEPENDENT ON THE PUBLIC UTILITY COMPONENT OF THE PROPERTY TAX BASE MUST BE ADDRESSED.

The Committee received testimony indicating that the problem of school funding equity is exacerbated by the concentration of public utility property valuation in relatively few school districts. The result is that public utility property taxes benefit a few school districts to a disproportionate extent while other districts must finance education through higher taxes on a smaller tax base. On the basis of this testimony, the Committee believes that the public utility property should become a tax resource for the whole state to be shared fairly among the state's school districts. This can be accomplished through the levying of a uniform state tax on public utility property for the purpose of funding primary and secondary education.

Constitutional limitations on the taxation of property in excess of one per cent of true value and on the taxation of real property preclude a special state public utility tax except through the adoption of a constitutional amendment. Such an amendment should allow counties, cities, townships, and all other taxing subdivisions other than school districts to continue to levy taxes on public utility property. It should also permit school districts to continue debt levies until outstanding debt is retired to prevent a shifting of the debt burden to nonutility property with respect to debt that has already been approved by the voters of each school district.

About 70% of all public utility property taxes are now levied by school districts. To produce the same amount of revenue (\$350 million) for school districts through a uniform state tax would require a tax rate of 30 to 35 mills.

The treatment of taxes levied by cities, counties, townships, and other taxing subdivisions on public utility property presents a special problem. The Committee believes that the location of a public utility plant in a political subdivision imposes costly public service requirements on the subdivision, and the addition of the public utility property to the local tax base provides some compensation for the additional costs associated with that plant. For this reason the Committee perceives some benefit in permitting all taxing subdivisions other than school districts to continue to tax public utility property as under current law. If this alternative were adopted in conjunction with a state public utility property tax for schools, school districts should be permitted to continue to levy taxes for outstanding school debt.

However, the Department of Taxation has presented evidence to the Committee indicating that changes in technology used by public utilities are making the apportionment of public utility property value among taxing districts more and more difficult. For some subdivisions, changes in the equipment used by a public utility have caused abrupt reductions in the tax base. These subdivisions have found public utility property to be an unstable component of the tax base.

The problem of apportioning public utility property among the taxing districts of the state would be resolved if all public utility taxes were levied on a statewide basis. The disadvantage of such a system is that political subdivisions with utility plants would not be compensated automatically for the additional service requirements imposed by such plants. In addition, if all public utility property taxes were levied on a statewide basis, some state assistance would be necessary for political subdivisions to the extent that they rely on public utility property for the repayment of outstanding debt.

The Committee believes that some method should be devised to reconcile the solution of public utility property apportionment problems with the need for political subdivisions affected by the presence of public utility plants to pay for public services.

5. THE ESTIMATED PAYMENT OF THE PUBLIC UTILITY EXCISE TAX DUE IN OCTOBER UNDER TEMPORARY LAW PROVISIONS SHOULD BECOME A PERMANENT FEATURE OF THE EXCISE TAX PAYMENT SCHEDULE.

Under current law public utilities make advance payments of their excise tax liability on January 15, March 1, and June 1. Each payment is equal to one-third of the preceding year's tax liability. A settlement occurs on the fourth Monday in December to reconcile the amount of each utility's estimated payments with its actual liability. Amended Substitute House Bill 694 advanced the payment that would have been due on January 15, 1983 to October 15, 1982. The effect of this change is to reduce the concentration of receipts from public utility excise taxes in the second half of the state fiscal year by moving one third of those receipts into the first half of fiscal year 1983. In 1984, the first estimated excise tax payment again will be due on January 15 as provided under permanent law.

Under the permanent payment schedule, receipts from the utility excise tax are concentrated in the second half of the state fiscal year. The Committee believes that the use of the October 15 payment date provides a better cash flow by moving payment of the first third of the estimated taxes into the first half of the state fiscal year. The Committee recommends that the earlier payment date (October 15) be made a permanent part of the excise tax payment schedule for these reasons.

Since the accelerated payment was required in 1982, the Committee believes that the continued use of this payment schedule will not impose an unreasonable burden on the cash flow of public utilities.

PERSONAL INCOME AND CORPORATION FRANCHISE TAXES

6. ESTIMATED PAYMENT REQUIREMENTS UNDER THE PERSONAL INCOME AND CORPORATE FRANCHISE TAXES SHOULD BE MORE STRICTLY ENFORCED.

The Committee received testimony indicating that the estimated payment requirement of the personal income tax and the corporation franchise tax should be more vigorously enforced. Estimated payments are required under the personal income tax law if the amount of anticipated tax liability will exceed the amount of taxes withheld for the current year. In the case of the corporation franchise tax, estimated payments are due if a taxpayer files an estimated tax report before January 31 in lieu of filing an annual report. In the case of both taxes an interest charge is required to be applied to the amount of any underpayment.

Testimony indicated that some taxpayers are not paying estimated taxes when they are due or in amounts appropriate to their estimated liability or appropriate to their actual liability.

By enforcing the statutory requirements governing estimated payments more vigorously, the state can improve its cash flow, earn interest on tax money paid at the earlier dates specified by statute, and ensure the collection of taxes due in the same way that withholding ensures the collection of taxes on wage income.

The Committee believes that the fairness and credibility of the tax system depends upon the evenhanded enforcement of its statutory provisions. These qualities are undermined when some taxpayers can avoid reasonable requirements of the tax law. Either through statutory changes or through more vigorous administrative efforts the provisions governing estimated tax payments should be enforced.

In order to avoid unfair consequences from the enforcement of estimated payment penalties, some exception should be permitted where estimated taxes are reasonably based on the preceding year's tax liability.

7. THE EXISTING PAYMENT SCHEDULE FOR THE CORPORATE FRANCHISE TAX CONCENTRATES REVENUE RECEIPTS IN THE SECOND HALF OF THE FISCAL YEAR, WHICH CREATES A CASH FLOW PROBLEM FOR THE STATE. THE GENERAL ASSEMBLY SHOULD DEVISE A PAYMENT SCHEDULE THAT RESOLVES THIS CASH FLOW PROBLEM, PREFERABLY THROUGH A SYSTEM OF ESTIMATED PAYMENTS. THE TRANSITION TO A NEW PAYMENT SCHEDULE SHOULD BE ACCOMPLISHED WITHOUT CAUSING AN UNACCEPTABLE LOSS OF REVENUE TO THE STATE AND WITHOUT REQUIRING TAXPAYERS TO MAKE DOUBLE TAX PAYMENTS DURING THE TRANSITION PERIOD. THE FILING OF THE TANGIBLE PERSONAL PROPERTY TAX RETURN SHOULD BE COMBINED WITH THE FILING OF THE CORPORATE FRANCHISE TAX RETURN IF AN EFFICIENT METHOD OF COMBINED FILING CAN BE DEVISED.

Corporation franchise tax receipts are concentrated in the second half of the state's fiscal year. In fiscal year 1982, 95.8% of all corporation franchise tax receipts were received in the period January 1 to June 30. This unbalanced payment schedule is a major contributor to the state's cash flow problem.

A payment schedule of quarterly estimated franchise tax payments would distribute receipts from this tax more uniformly throughout the state's fiscal year. The most difficult problem in implementing such a schedule is how to make the transition from the current payment method. During the transition either the state must sacrifice some revenue by delaying the implementation of the new schedule, or taxpayers must bear the burden of paying all of the taxes for one taxable year plus at least some of the taxes for another taxable year within the same 12-month period. Thus the transition to a new payment schedule must be carefully designed to minimize the revenue loss imposed on the state and to avoid collecting the taxes for two taxable years from taxpayers within one annual period. Under current circumstances the Committee did not believe that the state could bear the full cost of the transition period.

The Committee also received testimony indicating that the filing of tangible personal property tax returns should be combined with the filing of corporate franchise tax returns. The Committee believes that such combined filings would ease taxpayer compliance. However the Committee recognizes that serious administrative problems are associated with moving to an estimated payment system for the personal property tax. If an efficient method of combining the filing of corporation franchise and personal property tax returns (as opposed to payment schedules) can be devised, it should be adopted.

8. THE SCHOOL DISTRICT INCOME TAX POSES POTENTIAL PROBLEMS OF ADMINISTRATION, TAXPAYER COMPLIANCE, SCHOOL FUNDING EQUITY, AND COMPETITION WITH MUNICIPALITIES FOR THE SAME TAX BASE. THE GENERAL ASSEMBLY SHOULD EXAMINE THE IMPLEMENTATION OF SCHOOL DISTRICT INCOME TAXES AS THEY ARE ENACTED TO DETERMINE WHETHER THESE POTENTIAL PROBLEMS ACTUALLY ARISE. IF THEY DO OCCUR, THE GENERAL ASSEMBLY SHOULD MODIFY THE SCHOOL DISTRICT INCOME TAX TO MAKE IT WORKABLE OR REPEAL THE AUTHORITY OF SCHOOL DISTRICTS TO LEVY IT.

Current law permits the voters of school districts to approve the imposition of an income tax for school operating expenses. The tax is collected in conjunction with the state personal income tax.

The Committee believes that the school district income tax is characterized by several potential problems. First, it will be difficult to administer because the Tax Department will be required to track taxpayers according to their school district of residence. Second, taxpayer compliance will be difficult, especially for employers who are required to withhold taxes for employees in many different school districts. Third, the income taxes may tend to be approved in high income districts where schools already have adequate property tax resources, thus exacerbating differences in school funding rather than reducing educational resource inequities. Fourth, municipalities have relied on the income tax base for revenue for many years. The availability of a local income tax to schools may impair the ability of municipalities to raise needed revenues.

Because the voters of two school districts did approve school district income taxes in November 1982, the Committee believes that the tax should be given a chance to work. However, the implementation of this tax should be scrutinized carefully to determine whether anticipated problems actually arise. If problems do occur, the General Assembly should move quickly to make the school district income tax workable, or it should repeal the authority to levy such taxes.

The bill containing the original legislation authorizing school districts to levy school district income taxes did not come before the Ways and Means Committee of the House or Senate. In the future, major changes in tax policy of this kind should not be enacted until the committees that deal with taxation have the opportunity to study the proposed legislation.

9. THE COMMITTEE RECOMMENDS AGAINST INDEXING THE INCOME TAX TO PROVIDE AUTOMATIC ADJUSTMENTS FOR INFLATION.

An indexed income tax is an income tax that includes provision for automatic changes in the tax brackets, or in personal exemptions or credits, or both. The changes are based on some "index" of inflation and are designed to prevent the imposition of higher effective tax rates that occurs when a taxpayer's nominal income increases faster than its value due to inflation.

The Committee believes that some adjustment in the Ohio personal income tax is necessary to account for the inflation that has occurred in recent years. (See Recommendation 11.) However, the Committee does not find automatic adjustments in brackets or exemptions an appropriate solution to this problem. For one thing, the unanticipated effects of indexing have caused serious fiscal problems for some states. Moreover, no existing measure of inflation offers the kind of accuracy that should be required of an index that causes automatic changes in income tax burdens.

Therefore, the Committee rejects indexing of the income tax. Instead, it recommends that the General Assembly periodically review the state's income tax structure to ensure that the effects of inflation do not unfairly distort its burden on taxpayers.

10. THE GENERAL ASSEMBLY SHOULD REPEAL THE PERSONAL INCOME TAX CREDIT FOR HOME IMPROVEMENT EXPENDITURES AND THE PERSONAL INCOME TAX CREDITS AND CORPORATE FRANCHISE TAX CREDITS FOR EXPENDITURES ON SOLAR, WIND, AND HYDROTHERMAL ENERGY DEVICES. IN THE INTEREST OF PRESERVING THE SIMPLICITY OF THE TAX SYSTEM, THE GENERAL ASSEMBLY SHOULD ACT JUDICIOUSLY WHEN CONSIDERING PROPOSED TAX CREDITS THAT WOULD FURTHER COMPLICATE THE ADMINISTRATION OF THE INCOME TAX.

Current law permits a tax credit for home improvement expenditures to be claimed against the personal income tax. Credits may also be claimed against the income and corporation franchise taxes for expenditures on solar, wind, and hydrothermal energy devices.

The Committee believes that expenditures for home improvements and alternative energy devices are socially beneficial. However, the Committee received convincing testimony from the current Tax Commissioner as well as from several of his predecessors discouraging the use of the state tax system as a tool for achieving social goals. The Committee believes that the aforementioned tax credits have little incentive effect since they tend only to reward individuals for doing that which they would have done anyway. In addition, the Committee finds that whatever minimal social benefit results from such credits is offset by the resulting complication of the tax system and its administration. Therefore, the Committee recommends the repeal of these credits.

In the future, the General Assembly should be guided by a similar concern for retaining the simplicity of the tax system and should not enact new tax credits of this type without a compelling justification.

11. THE PERSONAL EXEMPTION UNDER THE INCOME TAX SHOULD BE THE SAME DOLLAR AMOUNT AS THE FEDERAL INCOME TAX PERSONAL EXEMPTION.

The amount allowed as a personal exemption under the personal income tax has not been adjusted recently to account for inflation. The Committee believes that the personal exemption should be raised to \$1,000 to adjust the state's income tax structure for the effects of inflation. This would make the state personal exemption the same as the personal exemption allowed under the federal income tax.

12. BY USING TWO SEPARATE RATES FOR SINGLE RETURNS AND JOINT RETURNS THE INCOME TAX LAW SHOULD APPROXIMATE THE SAME RELATIONSHIP IN TAX BURDEN BETWEEN SINGLE AND JOINT RETURNS AS OCCURS UNDER FEDERAL INCOME TAX LAW.

The Committee was presented with a problem concerning the treatment of married taxpayers under the existing personal income tax structure. Married taxpayers are treated unfairly to the extent that they must file the same type of return (joint or single) for the state income tax as they file for the federal income tax.

The Committee recommends that the state use a dual rate system: one set of rates for single returns and another for joint returns. The purpose of the separate schedules would be to establish a relationship between rates applied to single returns and joint returns that is approximately the same as the difference in rates applied to each such return under the federal income tax. The dual rate structure would replace the joint filer credit used under current law, which is inadequate because it only benefits married couples where both spouses have earned income.

13. THE CURRENT, TEMPORARY RATES ON UPPER INCOME BRACKETS SHOULD BE MADE PERMANENT.

Under current law the highest income tax bracket is 3½% on income in excess of \$40,000. A temporary law provision for tax years 1982 and 1983 calculates the taxes for those years using a schedule that imposes a tax of 4% on income from \$80,001 to \$100,000 and 5% on income in excess of \$100,000.

The Committee believes that these temporary rates should be made permanent. This Recommendation arises from the state's need for adequate revenue to provide essential state services and assistance to schools and other local governments. The relatively low level of the income tax rates, the graduated structure of the tax, and the fact that these additional rates are imposed on those best able to pay, are reasons for believing that this is the fairest method for obtaining some of the revenue needed.

SALES TAX

14. THE GENERAL ASSEMBLY SHOULD PROPOSE A CONSTITUTIONAL AMENDMENT THAT WOULD PERMIT THE APPLICATION OF THE SALES TAX TO PREPARED FOOD PURCHASED FROM RESTAURANTS FOR OFF PREMISES CONSUMPTION.

Current constitutional law prohibits the imposition of the sales tax on sales of food for consumption off the premises where sold.

The Committee believes that the original intent of this constitutional provision was to exempt from taxation sales of nonrestaurant food. Since the enactment of that constitutional provision in the 1930's, many changes have occurred in the restaurant business and in personal eating habits; in the last 20 years the sale of carry-out food has become a major aspect of the restaurant

business. Serious administrative problems for the Department of Taxation and compliance problems for taxpayers have resulted from the necessity for distinguishing taxable restaurant sales from nontaxable sales of carry-out food.

The Committee emphatically agrees with the original intent of the Constitution--to exempt food as a necessity from the sales tax. However the Committee believes that restaurant food ought to be taxed whether it is eaten in the restaurant or carried out. For this reason the Committee recommends that the General Assembly submit a constitutional amendment to the voters that would permit the imposition of the sales tax on sales of carry-out or prepared food.

15. IN THE FUTURE THE GENERAL ASSEMBLY SHOULD REJECT PROPOSALS FOR SALES TAX EXEMPTIONS THAT ARE NOT JUSTIFIED BY COMPELLING REASONS.

The Committee was concerned by testimony and by information showing the narrowing of the sales tax base over time through the enactment of exclusions and exemptions. The result is a reduction in the productivity of the sales tax, and a need for relatively higher rates to obtain the same amount of revenue. The Committee endorses the notion that the best sales tax is one with relatively low rates applied to the broadest possible base.

The Committee realizes that each request for special sales tax treatment may seem justified when viewed in isolation. However, the cumulative impact of special exemptions and exclusions is the reduction in the productivity of the sales tax as a revenue source and the ultimate imposition of higher tax burdens on the transactions that remain taxable.

In the interest of preserving a broad tax base, the General Assembly should view requests for special sales tax treatment skeptically, unless such proposals can be justified by sound reasons related to the tax system as a whole.

16. THE GENERAL ASSEMBLY SHOULD BROADEN THE SALES TAX BASE TO INCLUDE RECREATIONAL AND ENTERTAINMENT SERVICES WITH THE EXCEPTION OF SERVICES PROVIDED BY GOVERNMENT AND NON-PROFIT ORGANIZATIONS.

As noted in Recommendation 15, the Committee favors a sales tax policy that emphasizes a broad tax base, and the tax base could be significantly broadened through the addition of certain services.

Specifically, the Committee recommends that transactions involving the provision of recreational and entertainment services be made taxable under the sales tax. Examples of such newly taxable services would include professional sports, movies, cable television, theatrical events, and golf course fees. Where such services are provided on a non-profit basis, they should not be taxable. Examples would include fees for publicly owned recreational facilities, college and high school athletic events, and performances by community theaters.

17. THE GENERAL ASSEMBLY SHOULD CONSIDER EXPANDING THE SALES TAX BASE TO INCLUDE ADDITIONAL SERVICES ON AN ITEM-BY-ITEM BASIS.

The Committee reviewed several classes of services including personal services, professional services, and business services. Many members of the Committee are concerned that the taxation of certain business and professional services would affect adversely the competitive position of Ohio businesses in national markets such as architectural consultants, law firms, and engineering consultants. Furthermore, administrative problems are foreseen in defining the location where such services are performed for sales tax purposes. The Committee had some reservations about the appropriateness of taxing other types of services such as personal services like those provided by beauty salons, barbershops, and funeral homes.

Therefore, the Committee believes that a general recommendation to include classes of services such as business, personal, or professional services would be inappropriate. The Committee suggests that the General Assembly review specific services in these classes to determine if they can be added to the tax base without adverse effects on the equity or efficient administration of the sales tax.

18. A VENDOR'S LICENSE SHOULD BE MADE AVAILABLE FOR TRANSIENT VENDORS AT A MINIMAL COST.

Under current law a transient vendor may obtain a transient vendor's license from the Tax Commissioner for an initial fee of \$100 with a \$40 annual renewal fee required each subsequent year. For a \$5 fee, a limited vendor may obtain a limited vendor's license entitling the vendor to make sales in a county at a specific temporary event for the shorter of 17 days or the duration of the event.

The Committee received testimony from representatives of persons who make and sell arts and handicrafts at temporary craft shows throughout the state. The Committee was convinced by this testimony that the existing vendor's license requirements impose an unreasonable burden on the participants in these craft shows.

The Committee realizes that the Department of Taxation has an interest for enforcement purposes in preventing the illegitimate use of vendor's licenses to avoid payment of sales taxes. However, the Committee believes that the Department's enforcement interests can be protected without imposing such an unfair burden on transient vendors. Therefore, the Committee recommends that a more reasonable fee structure be made available for transient vendors.

REAL PROPERTY TAXES

19. REAL PROPERTY VALUES SHOULD BE UPDATED ANNUALLY IF AN ANNUAL UPDATE SYSTEM IS COST EFFECTIVE AND WHEN THE RESOURCES AVAILABLE TO THE DEPARTMENT OF TAX EQUALIZATION AND THE COUNTY AUDITORS MAKE SUCH A SYSTEM POSSIBLE.

Current law provides for reappraisal of real property values every six years and updates three years after each reappraisal. The Committee believes that annual updates would provide more accurate information on current values than triennial updates. Since the property tax is levied according to the value of property, a tax based on the most accurate assessment of property value represents the most equitable form of the property tax.

However, the Committee received testimony that indicated that annual updates may not be cost effective. The cost of conducting annual updates could be either greater than any potential increase in tax revenue resulting from the changes (increases or decreases) in valuations or greater than the marginal improvement in the accuracy of property values. Not all of Ohio's counties are presently computerized and annual updates could also create significant difficulties in such counties. As a result of this testimony the Committee recommends a system of annual updates of real property values only when the resources, including computers and trained, experienced personnel, are available to the offices of the Department of Tax Equalization and county auditors that would make the change to such a system cost effective.

20. THROUGH A STATUTORY CHANGE, OR, IF NECESSARY, THROUGH A CONSTITUTIONAL AMENDMENT THE TAX REDUCTION FACTOR MECHANISM SHOULD BE MODIFIED TO PERMIT A MODEST AMOUNT OF GROWTH IN REAL PROPERTY TAXES.

The Committee recognizes the difficulty local governments are experiencing in meeting their expenses with current revenues and believes that allowing a modest amount of growth in real property taxes could ameliorate some of these fiscal problems. It appears, however that section 2a of Article XII of The Ohio Constitution prohibits the use of a classified tax reduction if it permits revenue growth.

The Committee recommends that if real property remains classified the Constitution be amended to allow a modest amount of growth in real property taxes. Alternatively, statutory changes should be enacted that permit growth in local revenue in the context of a uniform tax reduction factor for all real property.

21. TAX LEVY LAW SHOULD BE CLARIFIED AS IT RELATES TO THE TAX REDUCTION FACTOR AND ITS IMPACT ON THE EFFECTIVE RATE OF PROPERTY TAX LEVIES.

Current tax levy law provides for the submission of three different types of tax levies: additional levies, renewal levies, and replacement levies (for vocational school districts only). The selection of a particular type of levy affects the manner in which the tax reduction factor is applied with respect to that levy. The Committee believes that confusion exists concerning the appropriate form of levy and the appropriate millage rate that should be submitted by local taxing authorities. The General Assembly should address this problem through appropriate legislation that clarifies the tax levy procedures to be followed and the millage rates to be used in the case of each type of tax levy submitted by local taxing authorities.

22. THE 2½% ROLLBACK OF TAXES ON RESIDENTIAL REAL PROPERTY SHOULD BE REPEALED.

THE GENERAL ASSEMBLY SHOULD PROPOSE A CONSTITUTIONAL AMENDMENT TO PERMIT ENACTMENT OF A HOMESTEAD EXEMPTION FOR RESIDENTIAL AND AGRICULTURAL REAL PROPERTY IN PLACE OF THE 10% ROLLBACK OF REAL PROPERTY TAXES, WHICH SHOULD BE REPEALED UPON THE IMPLEMENTATION OF THE HOMESTEAD EXEMPTION.

Current law provides real property tax relief in the form of a 10% reduction of all real property taxes and an additional 2½% reduction of real property taxes on any owner occupied homestead. Local governments are reimbursed from the state's General Revenue Fund for the amount of these reductions. Testimony presented to the Committee indicated that the cost of these reductions has increased significantly since their enactment. The 10% cost of the reduction has increased by 122.8% in the nine years it has been in effect (an average of 9.3% per year), and the 2½% reduction has increased by 20.7% in the past year. Each year that the amounts charged against real property increase, the cost of these reductions will also rise.

The Committee feels strongly that some type of property tax relief should remain in effect for residential and agricultural real property owners but also believes that the cost of such relief should be more stable. For these reasons the Committee recommends the elimination of the 2½% reduction for homeowners and the replacement of the 10% rollback with a constitutionally authorized homestead exemption for all residential and agricultural real property owners. The Committee does not intend that the new homestead exemption replace the current homestead exemption for low income elderly and permanently disabled homeowners, but that it be an additional form of relief to replace the current 10% rollback.

23. THE DEADLINE FOR REQUESTING A SPECIAL ELECTION SHOULD BE SHORTENED SO THAT AFTER THE JUNE PRIMARY DATE, A SCHOOL DISTRICT MAY REQUEST A SPECIAL ELECTION IN AUGUST.

Current law requires that if a school district wishes to submit a proposed tax levy to the voters at a special election in August, the resolution requesting the levy must be adopted prior to the June primary. Consequently a school district that submits a tax levy on the June ballot must decide whether to request a special election in August before the results of the June election are known. The Committee believes that requirements for submitting proposed school tax levies to the voters should permit a school district to obtain the results of the June election before it is required to request an August election.

24. THE COMMON LEVEL OF ASSESSMENT FOR REAL PROPERTY SHOULD NOT BE BASED ON A SIMPLE THREE-YEAR AVERAGE OF REAL PROPERTY SALES DATA BUT UPON THE MOST RECENT THREE YEARS OF SALES DATA WEIGHTED ACCORDING TO ACCEPTABLE STATISTICAL TECHNIQUES TO OBTAIN THE MOST ACCURATE AND CURRENT ESTIMATE OF THE COMMON LEVEL OF ASSESSMENT.

Current law requires that the common level of assessment for real property in each county must be determined on the basis of a three-year average of real property sales data. The effect of using a simple average of three years of sales is to weight the data from each year equally. As a result, sales assessment data tend to reflect a level of assessment that lags 18 months behind the true common level of assessment. The Department of Tax Equalization testified that such untimely data fail to meet the constitutional standard that requires property to be assessed at its true value.

The Committee and the Department agree that the common level of assessment should be computed on the basis of the most recent three years of sales data. However, section 5715.012 of the Revised Code should be amended to permit the Department to weight such data according to acceptable statistical techniques to reflect as nearly as possible the current common level of assessment.

25. A COOPERATIVE EFFORT BETWEEN LOCAL GOVERNMENT AND THE DEPARTMENT OF TAX EQUALIZATION SHOULD BE MADE TO REVIEW THE TAXABLE STATUS OF EXEMPT PARCELS OF REAL PROPERTY. THE COST OF THE PROGRAM SHOULD BE FUNDED PARTLY THROUGH AN INCREASE IN THE MONEY APPORTIONED TO THE COUNTY REAL ESTATE ASSESSMENT FUND UNDER DIVISION (B) OF SECTION 319.54 OF THE REVISED CODE.

The Committee received information from the Department of Tax Equalization showing that its programs to check the status of tax exempt real property were successful in returning significant amounts of property to the tax list. These programs were able to identify parcels that should never have qualified for exemption in the first place or that no longer qualified because of a change in use.

Programs to check exempt real property should be a standard feature of the property tax system. The Department of Tax Equalization and the counties should begin a cooperative effort to review the taxable status of tax exempt parcels of real property. The cost of this program should be funded partly through an augmented budget for the Department (see Recommendation 34) and through an increase in the money apportioned from property taxes to the real estate assessment fund in each county.

25. THE GENERAL ASSEMBLY SHOULD REVIEW REAL PROPERTY TAX EXEMPTIONS PROVIDED UNDER CURRENT LAW FOR THE PURPOSE OF LIMITING OR REPEALING THE AVAILABILITY OF TAX EXEMPTIONS FOR USES THAT ARE ONLY INCIDENTAL TO CHARITABLE, EDUCATIONAL, OR PUBLIC PURPOSES AND THAT THROUGH JUDICIAL DETERMINATION HAVE BEEN EXPANDED BEYOND THE LEGISLATIVE INTENT.

The Committee received testimony indicating that the grounds for obtaining exemptions from real property taxes have been expanded to the point where even a tenuous relationship between the actual use of property and a legitimately exempt purpose often results in freedom from taxation. Two reasons explain the expansion in the availability of property tax exemptions. First, division (B) of section 5709.121 of the Revised Code contains an ambiguous definition of exempt purposes that is conducive to a broad interpretation of what may be exempt from taxes. Second, judicial interpretations of this provision and other statutory provisions concerning tax exempt uses of real property have enlarged upon the original intent of the General Assembly in enacting the exemption statutes.

The Committee believes that the exemption from taxes for property truly used for public worship or for charitable, educational, or public purposes is a vital part of a fair tax structure. However, where the use of property is related tenuously, incidentally, or indirectly to such worthy purposes, the exemption of that property from taxes thrusts an inequitable burden on the property that remains taxable.

The General Assembly should limit or repeal the availability of tax exemptions for uses that are only indirectly or incidentally related to exempt uses of property. This task should be accomplished through a careful review of the exemption statutes, as recently interpreted by the courts, followed by appropriate legislation.

INTANGIBLE PERSONAL PROPERTY TAXES

27. THE TAX ON INTANGIBLE PERSONAL PROPERTY SHOULD BE REPEALED. REPLACEMENT FUNDING FOR LIBRARIES SHOULD BE OBTAINED FROM A LIBRARY GUARANTEE FUND. IT IS THE EXPLICIT INTENTION OF THE COMMITTEE THAT THE FUNDS CURRENTLY AVAILABLE TO THE COUNTIES FOR LIBRARY FUNDING NOT BE REDUCED AS A RESULT OF THIS CHANGE.

The Committee found that the tax on intangible personal property is characterized by two fatal defects. First, the tax itself is inequitable because its effect is to impose a flat rate tax on income derived from productive investments at a rate of 5%, while income from all other sources is taxed according to a graduated rate schedule. The practical result is that income is taxed differently according to its source. Second, the inequity of the intangibles tax is compounded by the fact that identifying owners of taxable intangibles is difficult, and the way in which it is administered enables many taxpayers to evade the tax.

Given these defects, the Committee believes that the total repeal of the intangibles tax is justified. However, the Committee recognizes that the intangibles tax has been a stable funding source for public libraries throughout the state. The Committee strongly recommends that the repeal of the intangibles tax be accompanied by the enactment of a mechanism for replacing lost revenue for libraries. The Committee was unanimous in its agreement that funds currently available to the counties for library funding should not be reduced when the intangibles tax is repealed. Interest and dividend income would be subject to the personal income tax if the intangibles tax is repealed, and the Committee believes that the additional income tax revenue can provide a substantial portion of the library replacement funds that will be needed to implement this recommendation.

28. THE THRESHOLD FOR REQUIRING THE COUNTY AUDITOR TO FILE A DUPLICATE COPY OF THE INTANGIBLE PERSONAL PROPERTY TAX SHOULD BE RAISED.

This recommendation and Recommendation 29 refer to the administration of the tax on intangible personal property of individuals, single county corporations, and unincorporated businesses. As noted in Recommendation 27, the Committee believes that the intangible personal property tax should be repealed. However, if the tax is not repealed some improvements in its administration are necessary.

Current law requires each person to return a list of all taxable property that he owns. Returns listing intangible personal property are to be filed between February 15 and April 30. Returns are filed with the county auditor, who sends a duplicate copy to the Tax Commissioner in the case of state size returns, (returns showing income yield of \$500 or more or taxable property of \$5,000 or more and returns listing the property of a corporation). With respect to all other returns, the auditor as deputy of the Tax Commissioner acts as assessor of the property.

The Committee believes that the threshold amounts of income yield (\$500) and property value (\$5000) should be adjusted upward to reflect the effects of inflation. The Department of Taxation recommends doubling these amounts so that the county auditor would file duplicate returns with the Tax Commissioner if the returns show \$1000 of income yield or \$10,000 of property value. The Committee chose not to endorse these specific amounts but recommends a substantial upward adjustment to be determined when specific legislation is under consideration. The benefit of this change will be a reduction in the administrative burden imposed on the county auditor in the course of assessing and collecting the intangibles tax by reducing the number of qualified returns that must be identified, duplicated, and sent to the Tax Commissioner.

29. IF THE INTANGIBLES TAX IS NOT REPEALED, IT SHOULD BE ENFORCED VIGOROUSLY, ESPECIALLY FOR THE PURPOSE OF OBTAINING MORE UNIFORM ENFORCEMENT.

As previously described, the Committee favors the repeal of the tax on intangible personal property. If that tax is retained, the Committee believes that improvements in its administration are necessary.

Based on testimony presented to it, the Committee determined that administration of the intangible personal property tax is nonuniform in two important respects:

1. Many taxpayers successfully evade the intangibles tax, and the differing efforts of county auditors to obtain compliance have resulted in nonuniform administration of the tax.

2. County auditors are not uniformly enforcing penalty provisions for failing to file a return or for failing to pay intangibles taxes in a timely matter.

Because intangible personal property is easy to conceal, the identification of owners of taxable property requires a positive program by the county auditor designed to obtain compliance with the tax. Given the difference in resources available to each auditor, the Committee found that the effectiveness of enforcing compliance with the intangibles tax naturally differs from county to county.

Greater uniformity of enforcement could be obtained through more centralized administration of the intangibles tax by the Department of Taxation or by increasing the resources available to the county auditors.

ESTATE TAX

30. THE ESTATE TAX SHOULD NOT APPLY TO ESTATES PASSING BETWEEN SPOUSES. THIS POLICY SHOULD BE PHASED IN BETWEEN 1984 AND 1986.

Under a recent change in federal law, the federal estate tax generally does not apply at the time that an estate passes from a deceased to the deceased's surviving spouse. Instead, the tax is imposed at the death of the second spouse. The Committee endorses the general policy embodied in the federal law that the estate tax should not be imposed when an estate passes from one spouse to another.

The Committee recognizes that many municipalities and townships are dependent on the estate tax for a significant part of their annual revenue. The immediate and full implementation of an exemption for interspouse transfers of estates would impose a hardship on those local governments. Therefore, the Committee recommends that the General Assembly enact legislation that follows the federal policy of not taxing estates when they pass from one spouse to another. However, this policy should be phased in during the period 1984 to 1986 to minimize the impact of this change on municipalities and townships.

INSURANCE TAXES

31. THE STATE SHOULD PROVIDE AN INSURANCE TAX STRUCTURE THAT ENCOURAGES THE AVAILABILITY OF ADDITIONAL VENTURE CAPITAL THROUGH LONG TERM INVESTMENT IN OHIO BY FOREIGN AND DOMESTIC INSURANCE COMPANIES. THE DESIGN OF THIS STRUCTURE SHOULD ADHERE TO THE PRINCIPLES ESTABLISHED IN RECOMMENDATION 37.

The Committee received testimony indicating the state's insurance tax structure could be designed in such a way as to encourage investment in Ohio by insurance companies. The Committee believes that the state's taxes on foreign and domestic insurance companies should include a provision that enhances the flow of insurance company investments into Ohio. The insurance tax system is a sufficiently discrete part of the state's tax structure that such investment incentives could be implemented without violating the general principle against special tax concessions recommended in Recommendation 37.

32. THE STATE SHOULD DETERMINE THE LEAST COSTLY ADMINISTRATIVE METHOD FOR TAXING TANGIBLE PERSONAL PROPERTY LEASED TO NONINSURANCE BUSINESSES BY INSURANCE COMPANIES.

Current law imposes special insurance taxes on foreign and domestic insurance companies in lieu of all other taxes except the real property tax. As a result the tangible personal property of insurance companies is exempt from local property taxes.

The Committee received evidence showing that some insurance companies lease to noninsurance businesses tangible personal property included in the general exemption of insurance companies' personal property. The Committee believes that only personal property of insurance companies used directly in the insurance business should benefit from the exemption. Property leased for noninsurance purposes should be taxable.

This recommendation is based on the Committee's concern that the tax system apply to all taxpayers as equitably as possible. The principle of equity is violated where insurance companies can lease tax-exempt property but their competitors in the leasing business must pay taxes on property they lease to others. When the cost of property taxes is passed on as part of the rental price, the noninsurance company lessor may have to charge a higher price for the same leased equipment than its insurance company counterpart. Equity demands that property involved in such transactions be taxed similarly, regardless of whether it is owned by an insurance company.

MISCELLANEOUS

33. THE BUDGET OF THE DEPARTMENT OF TAXATION SHOULD BE INCREASED BY 30% IN FY 1984.

Testimony presented to the Committee by the Tax Commissioner and three former tax commissioners included recommendations for increased expenditures for the Department of Taxation. The Department presented information to the Committee showing that every dollar spent on the salaries and support expenses of its auditors generated \$24 of additional audit revenue. While this ratio would tend to fall as Department expenditures increase, the Committee is convinced that expenditures in the Tax Department budget will be recovered easily through increased tax receipts for the state.

Additional information presented by the Department of Taxation shows that Ohio ranks last among eleven midwestern states in terms of expenditures per capita budgeted for tax collection and administration. In general, while other states have been expanding tax department enforcement efforts through higher appropriations to their tax departments, the Department of Taxation is spending less in constant dollars now than it did ten years ago.

The Committee believes that the Department can effectively utilize a 30% increase in its budget for fiscal year 1984 and recommends that the Department's appropriation reflect such an increase.

34. THE BUDGET OF THE DEPARTMENT OF TAX EQUALIZATION SHOULD BE INCREASED SO THAT THE DEPARTMENT CAN PERFORM ITS DUTIES MORE EFFECTIVELY.

The Department of Tax Equalization provides essential support to the county auditor in the assessment and collection of real property taxes. Especially in the smaller counties, the county auditor must rely heavily upon the Department for legal and technical advice needed to administer the property tax. In addition, the Commissioner of Tax Equalization is responsible for maintaining the uniformity and equality of assessment procedures and results. At current levels of funding the Department does not have adequate resources to fulfil its duties in the most effective way. Its budget should be increased so the administration of the state's property tax system can be improved.

35. THE GENERAL ASSEMBLY SHOULD REQUIRE THE DEPARTMENT OF TAXATION TO ESTABLISH PERMANENT AUDITING OPERATIONS IN OTHER STATES TO AUDIT CORPORATIONS DOING BUSINESS IN OHIO. THE TAX COMMISSIONER SHOULD BE PERMITTED SOME DISCRETION IN SELECTING THE MOST COST EFFECTIVE LOCATIONS AND METHODS FOR ESTABLISHING SUCH OPERATIONS.

The Committee received testimony indicating that corporations headquartered in Ohio are audited more heavily than corporations based in other states. The Committee believes the Department of Taxation should establish permanent auditing operations in other states to audit corporations that do business in Ohio. The result of more intensive auditing of out-of-state corporations will be that Ohio corporations will receive relatively more even-handed treatment.

The Tax Commissioner is in the best position to determine whether the auditing of out-of-state corporations in any given location can be accomplished best by sending Ohio resident auditors there, hiring residents of other states on a permanent basis, sharing audits with other states, or some other method.

36. THE COMMITTEE RECOMMENDS AGAINST THE NEW EARMARKING OF GENERAL REVENUE TAXES FOR EDUCATION OR OTHER PURPOSES.

After considering cash flow estimates and information concerning the effects of earmarking on state budgeting, the Committee has concluded that new earmarking of general revenue taxes would not improve the funding of education in Ohio and could interfere with the future ability of the General Assembly to effectively allocate tax revenues among the various state services that must be funded.

In some earmarking situations, such as the dedication of user charges to the maintenance of a particular facility, there is a relationship between revenues and the purpose for which expenditures are to be made that can be expected to keep revenues and expenditures in balance over a period of time. In contrast, because there is no general revenue tax that is related to education funding needs, tax revenues and educational expenditures are unlikely to change at the same rate and would be out of balance within a few years. Research indicates that earmarking states have been unable to fund state aid to education entirely from earmarked revenues and have repeatedly found it necessary to make additional appropriations from their general funds. If revenues from earmarked taxes grew more quickly than was anticipated, an alternative possibility is that earmarked revenues could exceed the amount the legislature would otherwise have appropriated for education. Education would then be relatively "overfunded" at the expense of other state services that do not have access to earmarked funds.

The Committee has also taken note of studies by the Tax Foundation and the Montana Legislative Fiscal Office that show a significant decline in the practice of earmarking state taxes. The Tax Foundation found that earmarked taxes represented 51% of state tax collections in fiscal year 1954. According to the Montana study, by fiscal year 1979 the average proportion of earmarked revenue to total state revenue nationwide was 23%. The Montana researchers found that the decline in earmarked taxes as a percentage of collections was due to growth in nonearmarked taxes, particularly income taxes, and to state actions to remove earmarking provisions from statutes and constitutions. The reason most frequently given for removal of such provisions was that earmarking interferes with legislative control over state spending.

37. THE MOST DESIRABLE TAX POLICY FOR ENCOURAGING ECONOMIC DEVELOPMENT IS A FAIR AND NEUTRAL TAX STRUCTURE. SPECIAL TAX CONCESSIONS ARE JUSTIFIED ONLY IF THE COMPETITION FROM TAX CONCESSIONS OFFERED BY OTHER STATES REQUIRES OHIO TO PROVIDE SIMILAR CONCESSIONS. THE STATE SHOULD ATTEMPT TO REDUCE TAX CONCESSION COMPETITION, BOTH AMONG STATES AND AMONG POLITICAL SUBDIVISIONS OF THE STATE, SUCH AS COMPETITION FOR ECONOMIC DEVELOPMENT BETWEEN CENTRAL CITIES AND THEIR SURROUNDING POLITICAL SUBDIVISIONS.

Based on the information and testimony presented to it, the Committee generally concluded that the overall impact of state and local taxes on economic development is relatively small. The reasons that support this conclusion include:

1. The deductibility of state and local taxes in computing taxable income for federal income tax purposes lessens the impact of any state tax on business.
2. When businesses consider investing in more than one state, costs other than taxes, such as transportation, land, energy, and wages are more important.

3. Much economic growth occurs through the indigenous development of small business in a state rather than through changes in location by large businesses. In the case of such small business development interstate tax differentials are not usually a factor in the decision making process.

For these and other reasons the effect of state tax policy on economic development is limited. However the Committee believes that there are important reasons economic issues cannot be ignored when evaluating state/local tax structures:

1. Once a business decides to locate within a metropolitan area tax differentials among local taxing districts do have some impact on the final location. This fact assumes some importance for state economic development in cases such as Cincinnati where one metropolitan area is located in two or more states.
2. When states offer special tax concessions other states may be forced to consider whether they will be placed at a competitive disadvantage if they do not respond with concessions of their own.
3. Where one component of the tax system falls too heavily on one type of economic activity, the result may be a disincentive to invest in that activity in that state.

The state can take two general directions in relating its tax policies to economic development. One approach would assume that the best posture for economic development is a tax structure that is balanced, neutral, and fair. This approach emphasizes the overall business climate. The other approach emphasizes special tax concessions to bring about economic development.

The Committee believes that the best tax structure for encouraging economic development is one that emphasizes general goals such as balance, neutrality, and equity. A tax system that meets these criteria will produce a general business climate that is conducive to growth.

The special tax concessions provided for business expansion in Ohio involve so many potential problems that the Committee does not recommend such concessions generally. However, under certain circumstances, it may be necessary for the

state to offer special tax concessions where the necessity of maintaining a competitive position with other states requires their use. The Committee believes that special tax concession programs foster a destructive competition among states and even among political subdivisions of the same state. The state should make an effort to reduce such competition.

Expert testimony before the Committee indicated that the overall tax burden in Ohio is relatively low compared to other states. The Committee believes this relatively low tax burden and other generally positive features of the state's tax climate such as stability and equity in the tax system provide the best tax incentive for encouraging economic development. The General Assembly should periodically assess the state's tax structure to ensure that none of its components have become a disincentive to economic development. In fact, the Committee's recommendations concerning the tangible personal property tax may be viewed in this context as the identification of one such possible disincentive.

38. ACCESS TO THE STATE'S ECONOMETRIC MODEL SHOULD BE AVAILABLE TO THE OFFICE OF BUDGET AND MANAGEMENT, THE LEGISLATIVE BUDGET OFFICE, THE DEPARTMENT OF TAXATION, AND THE STATE AUDITOR. IN PRESENTING REVENUE PROJECTIONS TO THE GENERAL ASSEMBLY, THE DIRECTOR OF THE OFFICE OF BUDGET AND MANAGEMENT SHOULD DEMONSTRATE THE RELATIONSHIP BETWEEN THE PROJECTIONS AND THE ECONOMIC VARIABLES USED IN THE MODEL. REVENUE ESTIMATES ADOPTED BY THE GENERAL ASSEMBLY BECOME THE RESPONSIBILITY OF THE GENERAL ASSEMBLY.

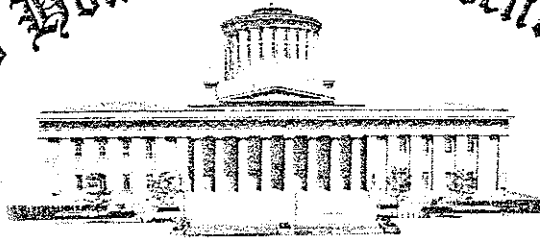
THE GENERAL ASSEMBLY SHOULD ESTABLISH A MECHANISM TO REVIEW LONG RANGE REVENUE PROJECTIONS IN EACH EVEN-NUMBERED YEAR FOR THE PURPOSE OF RELATING ECONOMETRIC AND OTHER INFORMATION COVERING AT LEAST A FIVE-YEAR PERIOD TO THE STATE'S LONG RANGE REVENUE NEEDS AND OTHER ECONOMIC PLANNING ISSUES.

The Committee reviewed information about the state's new econometric model, which will become fully operational in 1983. The Committee believes that if a number of state agencies have access to the information generated by the model, they will each use the information somewhat differently and consequently will give the General Assembly some alternative interpretations to consider.

The Committee believes it is important for the General Assembly to be able to see the relationship between the information generated by the model and the fiscal options available to the state. Therefore, the Committee recommends that the Office of Budget and Management relate its revenue projections to the model. Once revenue estimates have been adopted by the General Assembly, it must take responsibility for the estimates regardless of which agency may have provided the projections on which the estimates are based.

The pace of changes in the state's revenue resources and expenditure requirements makes imperative the use of fiscal planning on other than an ad hoc basis. The availability of a state econometric model should make possible more long range fiscal and economic planning at the state level. The General Assembly should devise a mechanism for reviewing revenue and expenditure needs and other economic issues. This review should occur in even-numbered years of each biennium and should analyze the state's fiscal and economic prospects for a five-year period.

Ohio House of Representatives



Columbus
43215

December 31, 1982

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COMMITTEES:

Rules
House Legislative Ethics
Committee
House Republican Policy Committee
Committee
Legislative Service Commission

Dear Member of the Ohio General Assembly:

While signing the committee report, I must register my dissent to the committee's recommendation 37.

Tax policy must always be fair. It is not, cannot, and should not, however, always be neutral. Tax policy by necessity must be based upon rational classifications.

I agree with the implication of the committee recommendation that special tax concessions or incentives are not justified if competition from other states does not require Ohio to provide similar concessions in order to encourage desired economic activity. I do not agree, however, with the committee conclusion that "SPECIAL TAX CONCESSIONS ARE JUSTIFIED ONLY (emphasis added) IF THE COMPETITION FROM TAX CONCESSIONS OFFERED BY OTHER STATES REQUIRES OHIO TO PROVIDE SIMILAR CONCESSIONS." While I agree that we should attempt to reduce tax concession or incentive competition between the states, I do not agree that Ohio's tax policy should be neutral in its effect upon political subdivisions, particularly in relation to the economic development of central cities and surrounding political subdivisions.

Ohio's Constitution in many cases prohibits the state from providing either money or credit to private businesses for the purpose of encouraging economic development and job creation and retention. One of the few tools available to encourage private business actions which foster economic development and job creation and retention is the rational use of tax concessions or incentives. Reasonable persons may well disagree about the relative weight with which such concessions or incentives affect business decision making. We should not, however, as a matter of policy eliminate this weapon from our economic development arsenal.

The test for the administration of any tax incentive program is whether the desired economic action would not take place without the use of the tax incentive or concession. If it would not, then the

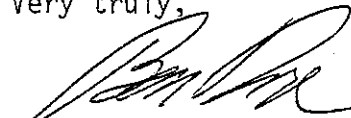
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incentive or concession has been well used and there will be a revenue increase rather than a loss from its use. If it would, then the incentive should not be used; and if it is used, the result will be an unjustified revenue loss. I have full confidence that local government officials are well qualified to make what is essentially a rational business judgment in granting tax incentives and concessions.

I strongly believe that we should use tax incentives and concessions to encourage economic development in Ohio's center cities where unemployment is the greatest and economic development is most needed. To do otherwise is to ignore the reality that Ohio is an urban state and that the health of Ohio's cities is vital to the health of the entire state's economy, government and education structure, and quality of life.

Very truly,



Waldo Bennett Rose

WBR:k1g