Ohio | Department of Taxation

Chairman Oelslager and members of the Tax Expenditure Review Committee, my name is Joe Testa, Tax Commissioner for Ohio.

Thank you for the opportunity to provide testimony today on Ohio's tax expenditures. Reviewing Ohio's existing tax expenditures, now totaling over $9 billion in forgone annual revenue, is a component of sound tax policy. As you are aware, some of Ohio's 100-plus tax expenditures have been on the books for decades and are seldom subject to formal review. Establishing a committee structure to regularly review tax expenditures will help ensure that the policy objectives of these tax expenditures are being fulfilled.

Today I plan to provide an overview of Ohio's Tax Expenditure Report (TER) and discuss the mechanics of tax expenditures, the criteria used to determine whether a tax provision constitutes a tax expenditure, and the sources of data used in the estimate of tax expenditures.

Overview

The concept of tax expenditures was first articulated in 1967 by the U.S. Department of the Treasury. In the broadest sense, the tax expenditure concept is uniform and constant: a tax expenditure represents a legislated variation from—more commonly a reduction to—a standardized tax base. The executive and legislative branches of the U.S. government, most state governments, and many foreign governments utilize their own versions and definitions of tax expenditures.

Ohio law defines a tax expenditure to mean a tax provision in the Ohio Revised Code (ORC) that exempts, either in whole or in part, certain persons, income, goods, services, or property from the effect of taxes established in the ORC, including, but not limited to, tax deductions, exemptions, deferrals, exclusions, allowances, credits, reimbursements, and preferential tax rates.

Tax expenditures take the form of tax benefits for certain taxpayers or activities and result in forgone revenue to the state. Unlike direct budgetary expenditures, tax expenditures may remain in law indefinitely without a pre-determined termination date. Section 5703.48 of the Ohio Revised Code requires the Tax Commissioner to produce a tax expenditure report as an appendix to the biennial budget. The report gives a description of each tax expenditure as well

as an estimate of revenue foregone or unavailable to the General Revenue Fund. It is available online at the Office of Budget and Management and Ohio Department of Taxation websites.

Criteria

The determining factor in identifying a tax provision as a tax expenditure is whether it exists as an exemption, credit, deduction, etc. in the Ohio Revised Code. The item must meet the following criteria to be considered a tax expenditure:

- The item would have been otherwise taxable had there not been a legislatively enacted exemption or exclusion.
- The item must reduce or have the potential to reduce one of the state's General Revenue Fund taxes. For example, the foregone motor fuel tax for gasoline used in off-road vehicles is not a tax expenditure because it does not impact the General Revenue Fund.
- The item is not subject to an alternative tax. Persons or activities subject to an alternative tax are not considered a tax expenditure. For example, insurance companies are excluded from the commercial activity tax under Ohio statute, but this exclusion is not considered a tax expenditure because insurance companies are subject to the insurance premium taxes.
- The item is exempt or excluded as a result of state legislative action. Anything that can only be changed by a state constitutional amendment, a federal law change, or a federal constitutional amendment is not considered a tax expenditure in this report. For example, the foregone sales tax related to take-out food is not a tax expenditure because it can only be changed by an amendment to the state constitution.

The Tax Expenditure Report

The Ohio Tax Commissioner has been required to produce a TER every biennium since 1987. The TER provides a description of each tax expenditure and an estimate of the dollars unavailable to the GRF because of the tax expenditure for that two-year period. It compares those foregone revenues to the amount of revenues that were unavailable to the GRF in the immediately preceding biennium.

For the Fiscal Year 2018-2019 biennium, estimates were produced for 129 tax expenditures, spread across nine different taxes. The chart on the following page is a breakdown on the number of expenditures and estimated revenue forgone by tax type.

(Dollar Amounts in Millions)

Tax Type	Number of Tax Expenditures	FY 2018 Impact	FY 2019 Impact
Sales & Use Tax	56	$5,988.1	$6,197.4
Individual Income Tax	37	$2,311.3	$2,397.7
Commercial Activity Tax	20	$670.8	$694.5
Public Utility Excise Tax	3	$98.0	$101.4
Insurance Premium Taxes	3	$22.1	$22.1
Cigarette and OTP Taxes	2	$17.5	$17.3
Financial Institutions Tax	3	$5.0	$6.9
Alcoholic Beverage Tax	4	$2.6	$2.6
Kilowatt Hour Tax	1	Minimal	Minimal
Grand Total All Taxes:	**129**	**$9,115.4**	**$9,439.9**

-Note: "Minimal" indicates that the amount of forgone revenue is under $1 million.

-Note: Certain persons or activities excluded from taxes are taxed under alternative taxes which have separate tax expenditures.

I will add that since the publication of the FY18-19 TER, two additional tax expenditures were enacted as part of House Bill 49: a kilowatt hour tax exemption for electricity consumed in the production of chlorine and a sales tax exemption for music purchases and delivery from digital jukeboxes. Both exemptions are estimated to produce minimal revenue losses.

It is important to note that because there may be unaccounted for overlap between expenditures, the TER figures are not intended to be relied upon as an estimate of the revenue gain if all tax expenditures were repealed simultaneously. Each tax expenditure is estimated assuming all other expenditures remain in law.

Data Sources

The Department estimates each expenditure statically using the most reliable data available. Any estimate's accuracy depends upon the reliability of the data. Generally speaking, the Department considers internal data to be more reliable than external data; however, internal data is not always available for the estimation of certain tax expenditures. Accordingly, the Department devised data reference codes for individual expenditures:

- Data Source Code A is internal departmental data,
- Data Source Code B is data produced by governmental agencies other than the Department, and
- Data Source Code C is all other data including data from business information service providers, academic research, and non-profit organizations.
- Some estimates may be based on a mixture of data sources.

For the most recent TER, 36 tax expenditure estimates relied on Data Source Code A, 24 relied on Data Source Code B, 10 were Data Source Code C, and 59 were combinations of two or more

data sources. One point worth considering with tax expenditure legislation is data reporting. When taxpayers are required to quantify and report the tax benefit to the Department, the higher the confidence will be in the reliability of the related estimates. For example, the estimate for the medical savings account deduction is developed solely from the amounts reported on Line 33 of Ohio Schedule A, which is filed along with the Ohio IT 1040.

Conclusion

Chairman Oelslager and members of the Tax Expenditure Review Committee, I hope this brief review of the Tax Expenditure Report is of value to you. I again would like to thank you for the invitation to discuss this key area of tax policy. I, along with staff from ODT's Tax Analysis Division, would be happy to take your questions.