



**TESTIMONY
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ON BEHALF OF
THE OHIO SOCIETY OF CPAS**

TO

**Senate Tax Reform
Subcommittee**

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The Ohio Society of CPAs, established in 1908, represents more than 21,000 CPAs in business, education, government and public accounting. The Ohio Society's members not only meet statutory and regulatory requirements as CPAs, but also embrace the highest standards of professional and ethical performance. This is achieved through ongoing professional education, comprehensive quality review and compliance with a strict Code of Professional Conduct.

THE OHIO SOCIETY OF CPAs

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Chair Peterson and members of the Senate Tax Reform Subcommittee, on behalf of the over 21,000 CPAs and accounting professionals making up The Ohio Society of CPAs (OSCPA), thank you for this opportunity to provide some of the CPA profession's thoughts on Ohio's tax structure. We share the committee's goal of seeking to ensure the best possible tax environment for Ohio's citizens and businesses, and applaud your efforts earlier this year to make our great state more competitive through lower income tax rates on individuals and pass-through entity business owners.

I'm Michael Petrecca, a CPA and attorney, past member of OSCPAs Executive Board, and the managing partner of PricewaterhouseCoopers Columbus office. PWC employs over 1,000 individuals in our state and represents a wide variety of businesses and individual clients. I specialize in representing privately-held entities, their investors and shareholders, in various tax and business matters.

OSCPA members touch every aspect of business in every county in Ohio. Whether in a small accounting firm or serving as a CEO or CFO in a Fortune 500 company, CPAs are trusted business advisors responsible for ensuring compliance with federal, state, and local tax and regulatory requirements. As such we have a unique perspective on the impact tax policy has on operating a business as well as on individual taxpayers. Outlined below are some areas businesses and business owners across the state face on a daily basis.

I appreciate the opportunity to not only go over some general observations regarding Ohio tax policy, but value your interest in sharing our views on what Ohio tax laws should look like if our state were starting "from scratch."

General Observations

First, I'd like to go over some tax basics: OSCPAs Tax Legislation Policy Committee developed a series of guiding principles to good tax policy (attached) focused on important areas such as simplicity, predictability, stability, uniformity, competitiveness and fairness. We encourage you to follow these guidelines as you address ongoing tax reform efforts.

Further, during any tax reform discussion, consideration should be given to avoid having tax policy be the driving force behind a small business entity's choice for form of doing business (i.e. becoming a C Corporation rather than a pass-through entity).

In addition, any discussion of state tax reform must include not only state tax policies but also Ohio municipal tax policies. Both have a major impact on business and individual taxpayers.

OHIO AREAS OF TAXATION

Commercial Activity Tax:

OSCPA supports the commercial activity tax (CAT) in its current form. The CPA profession was a leading advocate for the 2005 tax reform package (Am. Sub. HB 66) that replaced the corporate franchise and tangible personal property taxes with the CAT and lowered the personal income tax rates. The pre-2005 business tax structure was complex, punitive, and a hard sell to CEOs who considered retaining or relocating their business to Ohio. In the case of the tangible personal property tax, it punished investment in inventory and equipment. The corporate franchise tax had a very high rate with very low revenue collection due to the multitude of credits

and exemptions that had been introduced over the years. The CAT's very broad base and low rate of .26% provides predictability for businesses and encourages business investment in our state. The tax is predictable, relatively stable even in economic fluctuations and has few exemptions or credits. Further, excluding the CAT on goods an Ohio business ships out of state is an additional incentive for businesses, particularly those in border-states, to seriously consider Ohio as a location for their business. Conversely, if an out-of-state company has bright-line presence and at least \$150,000 in taxable gross receipts situated to Ohio during the calendar year, they will be subject to the CAT. This structure rewards Ohio-based companies, which is a plus to our state's economic development efforts. Further, we've heard from a number of entities around the country that Ohio's CAT is very attractive due to its simplicity, predictability and low rate – especially in view of what it replaced.

As you likely know, it has been OSCPAs longstanding position to oppose any credits, carveouts or exemptions to the CAT except in the case of constitutionality conflicts or solid public policy concerns (such as 25,000 jobs leaving Ohio without the exemption). As mentioned before, the CAT's current rate is very low. If we want it to remain this way, we simply cannot return to the days of the corporate franchise tax when incentivizing niche industries through business tax breaks resulted in Ohio's business tax structure turning into Swiss cheese. If you strongly believe a niche industry must have special treatment, pursue a grant. Not only will it protect the CAT base, but at the end of the day a business is much more attracted to a cash incentive over a tax credit.

In 2005, OSCPAs analyzed the impact of the total tax reform package against the structure that existed at that time across a variety of industries. Overwhelmingly the result found the CAT to be a net positive for most types of business. (It's important to remember the onerous taxes the CAT replaced that are no longer being paid by Ohio businesses.) It has also been the experience of numerous Ohio CPAs that the CAT has continued to be a net positive since its inception and should be continued. We encourage you to avoid any changes – especially adopting varying rates for different industries or exempting industries such as high volume/low margin businesses – that would force the CAT rate to increase, thereby nullifying the very positive impact of this tax on Ohio businesses and on economic development.

Sales and Use Tax:

Ohio's state sales and use tax rate is now 5.75%. In addition, our state's 88 counties and four (4) regional transit authorities may levy additional sales and use taxes, which when added to the state rate creates a range from 6.5% to 8.0%

Keeping the sales and use tax rate as low and competitive as possible is optimal so there is minimal impact on the purchase and consumption of goods and services – especially for vendors in border areas. This is particularly true during economic uncertainty as business growth depends in part upon demand for goods and services. A broad base is also important in keeping the rate low; however, it is important to understand that tax policy *does* impact behavior, particularly given the joint state/local sales tax rates across Ohio and the reality that very few states tax professional services.

Given technological capabilities, many professional services can be provided remotely, putting Ohio businesses at a competitive disadvantage should a sales tax be assessed on their services. Further, general sourcing rules and definitions do not work for numerous services because such services frequently involve (but are not limited to): multiple points of delivery/use; multiple points of creation; multiple sub-service providers; multiple delivery dates of partial

products; and multiple taxing jurisdictions. In addition, a sales and use tax on services would create administrative complexities, be counter to good tax policy and have a negative impact on Ohio's economic development by driving business outside the state's borders. Only a handful of states broadly tax professional services and none of them are near Ohio.

In the case of subjecting sales tax on accounting and consulting services – a position we have opposed for many years – there would be a tax assessed on the mandate to file tax returns or undergo a government-mandated audit. Ohioans are given no choice by the IRS and state and local taxing jurisdictions to file tax forms or be audited, just as most individuals needing legal advice have no choice but to retain an attorney. Ohio should not add misery to an otherwise already miserable experience by adding 6.5% to 8.0% to the bill, especially since they can forego the increase by retaining such services in almost any other state. Further, it is unrealistic to think that most consumers will consistently pay Ohio's use tax.

Tax Expenditures:

According to the Ohio Department of Taxation's *Book Two: The Tax Expenditure Report*¹, as of March 2011 there were 128 tax expenditures permitted in Ohio law ranging from the historic structure rehabilitation tax credit to the personal, spousal, and dependent exemption on the individual income tax form.

We applaud the attention that has been given to date to this area, but measuring the benefits of tax expenditures or return on investment (ROI) should be a routine practice to ensure the benefits are exceeding the costs. For those expenditures already in place, we advocated in our 2009 *Budget Advisory Task Force Report* that performance audits of tax expenditure programs should be utilized to independently ensure that the funds are being used for their intended purpose. This result should be a public document that analyzes through a cost/benefit lens the number of jobs created vs. tax revenue received in correlation to taxpayer investment. Going forward, a ROI analysis should be mandated with each new tax expenditure program and/or the credits should be subject to sunset or mandatory review. Given the limited funds available for tax expenditure purposes, results must be measurable.

Similarly a review of taxation policy and structure among industries not subject to the CAT would also be prudent. Businesses that compete for the same customers and provide similar services should be subject to the same level of taxation and not be picked as a winner or loser based upon their business structure.

Income Tax

We fully supported your efforts in HB 59 to reduce Ohio's personal income tax rate by 10%, and support continuing efforts to reduce the rate even more to make Ohio more competitive with other key states.

If Ohio were starting from scratch, the most simple and predictable income tax approach would be to have a flat tax rate for all, with as few exemptions and credits as possible. Doing so would make Ohio much more competitive with surrounding states – most of which already have a flat rate.

¹ <http://tax.ohio.gov/divisions/communications/publications/FY%202012-2013%20TER%20-%20final.pdf>

Looking realistically, however, it likely would be very difficult for Ohio to adopt a flat tax rate at this point in time due to political realities. But it isn't too late to eliminate as many credits and exemptions as possible to be able to significantly drive down the rate. It makes more sense to pay less in taxes over multiple years than to receive a credit or deduction for a single year or for an isolated event.

As you pursue additional reforms to Ohio's tax system, we encourage caution when undergoing this effort to ensure changes don't have unintended consequences. For example, taxes should not be raised on one business sector in order to lower taxes on another, and reductions in the individual income tax rate should be paid for through changes impacting individuals (i.e. reducing or eliminating exemptions and credits impacting individual taxpayers).

Municipal Income Taxes

One of the most meaningful ways to improve Ohio's business and individual tax environment is to address our state's municipal income tax system. Per international site selection experts, the lack of uniformity in this area is the #2 negative Ohio has going against it where economic development is concerned (our labor environment is #1) largely because we have close to 600 cities and villages that assess an income tax and they can all have differing definitions, rules and regulations. Toledo was the first Ohio city to assess a municipal income tax in the 1940's.

For over 20 years, this has been one of the top problem areas for Ohio CPAs and Ohio businesses. The concern of our members isn't the rate, though when added to the state income tax rate it has a big impact. Rather, it's the compliance burden, as many Ohio businesses pay more in compliance costs than they owe in taxes. It's unthinkable that Ohio's existing municipal income tax system forces a number of businesses to pay more in postage than the value of the check in the envelope because it's spread out over many cities, or that many businesses must file one federal tax return, one state tax return, and dozens of municipal tax returns if they provide goods or services in multiple jurisdictions. It's a significant burden that taxpayers in almost every other state in the nation do not have to deal with: only 10 states have laws where cities tax both where you work and where you live – most with just one or two cities assessing income tax – and Ohio stands alone as the only one without common definitions and regulations. Michigan and Pennsylvania are the closest to Ohio's system, yet both adopted uniformity in the mid-1960's.

We fully recognize and support Ohio's cities and villages having the resources they need to provide essential services. However, if Ohio were to start from scratch, we would strongly advocate for a much more common sense approach: any city or village assessing an income tax would have to follow the same procedures; would have the same definitions and treatment of income; income could only be taxed where the business is located; or, for individuals, where they live rather than both where they work AND live. Further, it's no secret that Ohio CPAs and many businesses would like to see some sort of centralized filing approach. Having said that, and no matter how much sense it makes from an economic development viewpoint, the system has been around for over 60 years and we recognize that politically it would be very difficult to adopt some of those approaches. For example, OSCPA is NOT before you today advocating for centralized collection or to limit taxation to either where you work or live for individuals or just to a principle place of business for a business taxpayer. But we very much do support the Legislature requiring all cities to follow uniform definitions, rules and regulations to bring some common sense to the existing system and to cut down on the paperwork. It would be so much better to have our business owners dedicate that time and money instead to growing their businesses – and by extension, creating more jobs.

House Bill 5 is currently before the Ohio House and is supported by the Ohio Municipal Tax Reform Coalition, an entity made up of 30 Ohio associations representing over 350,000 employers and professionals. This legislation, as proposed by OSCPA and others in the business community, will go a long way toward fixing the existing morass of local tax laws. OSCPA urges your support and your quick action when the legislation reaches your Chamber. I can't stress enough how critically important enactment of this key tax reform proposal is to your constituents, and how much of a negative impact it is having every day on our state's economic development efforts.

As I'm sure you will hear from cities and villages in your districts, municipalities are concerned about potential revenue cuts. We support the creation of a study committee made up of legislators, business representatives and city representatives to evaluate a year's worth of actual revenues (as opposed to "guesstimates"), as well as any documented revenue changes up or down, after HB 5 takes effect. The committee would be charged with making spending recommendations to the Legislature in time for the next biennial budget cycle. As a long-time tax professional in Ohio serving a multitude of clients, I can't stress enough the importance of reforms to the municipal income tax system - and the sooner the better. I personally have clients who refuse to locate to Ohio because of our state's existing tax system, and I know I am not alone as a CPA.

Summary

OSCPA represents thousands of experts in a wide variety of industries. We urge you to take advantage of your CPA constituents' expertise. CPAs are viewed by our clients and employers as a valuable resource, and we hope you will do the same.

Thank you for your willingness to listen to the perspective of Ohio's Certified Public Accountants. We look forward to working with you as you continue your efforts to make Ohio a state where job providers want to locate and residents want to live, work and raise their families. I'd be happy to respond to any questions you might have.



Guiding Principles of Ohio Tax Policy

As part of its responsibility as a technical committee, The Ohio Society of CPAs' Tax Legislation Policy Committee has developed guiding principles in tax policy that the Society uses as a framework when developing positions on tax-related legislative and regulatory matters. These guidelines, as developed, dictate that Ohio tax laws and regulations should meet the following guiding principles by being:

Simple:

The tax structure should facilitate taxpayer compliance by being easy to understand and administer. It should contain certainty and predictability, transparency, and promote economic growth.

Stable:

In order to fund essential government services, the tax structure should provide adequate revenue to fund those services without disproportionately burdening any taxpayer group. Any tax structure should emphasize fiscal discipline and restraint.

Equitable and Fair:

The tax structure should be fair and equitable, and not disproportionately burden any taxpayer group.

Competitive:

Ohio's tax structure should position the state to be more competitive, in both the short and long-term. Serious consideration should be given to taxes assessed - or not assessed - in other states, particularly neighboring states.

Uniform:

To the extent possible, Ohio's tax laws should be uniform with federal tax laws, and local taxes should be consistent across the state. Consideration should be given to any lag time for Ohio to adopt federal tax changes, and the complexity and uncertainty such a delay creates for Ohio taxpayers.