WRITTEN TESTIMONY

House Tax Reform Legislative Study Committee

The Ohio Society of Certified Public Accountants

September 12, 2013

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.

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

OSCPA members touch every aspect of business in every county in Ohio. Whether in a small accounting firm or serving as a 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 they have a unique perspective on the impact tax policy has on operating a business. Outlined below are some examples of what businesses and business owners across the state face on a daily basis.

General Observations

OSCPA's Tax Legislation Policy Committee developed a series of guiding principles to good tax policy (attached), that we encourage the Ohio General Assembly to follow as you address ongoing tax reform efforts. These focus on important areas such as simplicity, predictability, stability, uniformity, competitiveness and fairness.

During any tax reform discussion, consideration should be given to avoiding 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 or vice versa).

Any discussion of state tax reform must include one of the most meaningful ways to improve Ohio's business tax environment: addressing our state's municipal income tax system. Per international site selectors, the lack of uniformity in this area is the #2 negative Ohio has going against it where economic development is concerned. For over 20 years, this has been one of the top problem areas for Ohio CPAs. The concern of our members isn't the rate – it's the compliance burden, as many Ohio businesses pay more in compliance costs than they owe in taxes. Since potential revenue cuts to municipalities are the primary barrier to reform in this area, we suggest considering using state funds to cover some or all of the losses.

Commercial Activity Tax:

OSCPA 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 commercial activity tax (CAT) and lowered the personal income tax rates. The pre-2005 business tax structure was complex, punitive, and a hard sell to CEOs who were considering 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 sitused 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.

It is the position of OSCPA 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). 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.

As is the case with any tax structure, there are some businesses that pay more under the CAT than they would have before 2005, and some that pay less. For example, pass-through entities such as accounting firms not previously subject to the corporate franchise tax are subject to the CAT. However, many pass-through entities are small businesses that either are not subject to the CAT (taxable gross receipts of $150,000 or less in the calendar year) or have $1 million or less in gross receipts and are subject only to a $150 flat tax, PLUS all pass-through owners have the benefit of the 21% income tax decrease that was implemented in 2005, the 10% individual taxpayer reduction and 50% pass-through owner reduction implemented this year.

In 2005, OSCPA 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 almost every type of business. 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 economic development.

<u>Sales and Use Tax:</u>
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%

Currently businesses are provided a .75 of 1% (0.0075) discount rate for the timely filing of sales tax returns. In OSCPA's 2009 *Budget Advisory Task Force Report* we questioned the need for the practice to continue. That question continues to be asked today, especially given that the burden of the filing requirement has been significantly minimized for many businesses due to technological advances -- not to mention the money it would save the state. Of note is the fact no one receives a discount or incentive to remit employer withholding taxes on time.

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 an audit. Ohioans are given no choice by the IRS and state and local taxing jurisdictions to file tax forms or be audited, just as 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. 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 support the 2013 efforts of Governor Kasich and leaders of the Ohio House and Ohio Senate to reduce Ohio's personal income tax rate by 10%, and support continuing efforts reduce the rate even more to make Ohio competitive with other key states.

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

However, 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 (reducing or eliminating exemptions and credits impacting individual taxpayers). It makes more sense to pay less in taxes over multiple years than to receive a credit or deduction for a single year for an isolated event.

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 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.