TAX EXPENDITURE REPORT

The State of Ohio Executive Budget

for Fiscal Years 2022-2023

Governor Mike DeWine

Ohio Department of Taxation

Tax Commissioner Jeffrey McClain

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Governor Mike DeWine
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Dear Governor DeWine,

It is my pleasure to present Ohio's Tax Expenditure Report for the Governor's Executive Budget for the ensuing fiscal biennium, a responsibility required of the Tax Commissioner by Sections 107.03 and 5703.48 of the Ohio Revised Code.

This report describes 138 state tax expenditures allowed under current law including a description of each tax expenditure, a detailed estimate of the amount of revenues not available to the general revenue fund under existing laws during each fiscal year of the biennium covered by the budget due to the operation of each tax expenditure, and, in comparative form, the amount of revenue not available to the general revenue fund during each fiscal year of the immediately preceding biennium due to the operation of each tax expenditure.

The report is not intended to and does not evaluate the merits of these tax expenditures. Nonetheless, it is intended to serve as an important resource for those entrusted to make decisions about Ohio's state budget for the ensuing fiscal biennium.

Sincerely,

Jeffrey A. McClain,
Tax Commissioner

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INTRODUCTION

State of Ohio Tax Expenditure Report

Section 5703.48 of the Ohio Revised Code (R.C.), enacted in 1987, requires the department of taxation to prepare and submit a tax expenditure report to the governor in each even-numbered year. R.C. 107.03(D)(6) requires the governor to submit the report to the Ohio General Assembly as an appendix to the governor's biennial budget. The report provides a description of each tax expenditure under existing law and a detailed estimate of the approximate amount of revenue not available (or "revenue foregone") to the General Revenue Fund (GRF) in each fiscal year of the current and ensuing fiscal biennia because of the operation of each tax expenditure.

R.C. 5703.48 defines a "tax expenditure" to mean "a tax provision in the Revised Code that exempts, either in whole or in part, certain persons, income, goods, services, or property from the effect of taxes levied by the state, including, but not limited to, tax deductions, exemptions, deferrals, exclusions, allowances, credits, reimbursements, and preferential tax rates, provided" certain statutory criteria apply to the provision. Academic literature has described tax expenditures as "special preferences" that are "departures from the normal tax structure and are designed to favor a particular industry, activity, or class of persons" and that "essentially represent government spending for the favored activities or groups made through the tax system rather than through direct grants, loans, or other forms of government assistance."[1] Unlike direct budgetary expenditures, unless there is a pre-existing termination date, tax expenditures may remain in law indefinitely.

An important purpose of this report is to inform the executive and legislative branches during the state budgetary process of revenue foregone to the GRF because of tax expenditures. This report provides an estimate of the dollar value of each tax expenditure, but it makes no statement on the expenditure's appropriateness or merit.

In this edition, estimated revenue foregone to the GRF is provided for the following two fiscal year (FY) biennial budget periods: FY 2020-2021 and FY 2022-2023. This edition includes 138 different state tax expenditures and provides the legal citation(s), year of enactment, and year(s) of major alterations (if any), and a brief description of each tax expenditure.[2]

Am. Sub. H.B. 9 (131st General Assembly) created the Tax Expenditure Review Committee to review all current tax expenditures at least once every eight years and make recommendations on whether each tax expenditure should be continued, modified, repealed, or scheduled for further review. The Committee is made up of six voting members: three Representatives and three Senators appointed by the Speaker of the House and Senate President, respectively (in consultation

[1] Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept, and the Budget Reform Act of 1974*, 17 Boston College Industrial and Commercial Law Review 679, 680 (1976).
[2] Tax expenditures having an estimated annual revenue impact of below $1 million are noted as minimal.

with their minority leader counterparts), and the state Tax Commissioner or the Tax Commissioner's designee as a non-voting member.[3]

The Tax Expenditure Concept

Since the tax expenditure concept was first articulated in 1967 by Stanley S. Surrey (Assistant Secretary for Tax Policy, U.S. Department of the Treasury), the executive and legislative branches of the U.S. government, most state governments, and many foreign governments have issued their own versions of a tax expenditure report. In its broadest outline, 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. Beyond this broad conceptualization, however, varying ideas about what constitutes a tax expenditure have led to differing approaches for identifying them.

At the federal level, the Joint Committee on Taxation (JCT) of the U.S. Congress is vested with the privilege of publishing a report on federal tax expenditures for the House Committee on Ways & Means and the Senate Committee on Finance.[4] According to the JCT:

> *Tax expenditure analysis can help both policymakers and the public to understand the actual size of government, the uses to which government resources are put, and the tax and economic policy consequences that follow from the implicit or explicit choices made in fashioning legislation.*[5]

The JCT consults with the Office of Tax Analysis in the U.S. Department of the Treasury to produce the report.[6] The JCT's first report was prepared in 1972 covering FY 1967-1971, and subsequent reports cover every five-year period since FY 1977-1981.[7]

The vast majority of states and the District of Columbia produce a tax expenditure report in some form.[8] There is variation among the states on what is considered a tax expenditure (and by extension, implied "baseline" tax structures).[9] Ultimately, the variation stems from a fundamental ambiguity in the tax expenditure analysis: The lack of universally applicable and accepted definition of "tax expenditure" sufficiently robust in meaning for it to be used by all jurisdictions

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[3] R.C. 5703.95

[4] The complete collection of JCT tax expenditure reports is available at https://www.jct.gov/publications/?it=content&category_name=Tax%20Expenditures. For an international perspective, the Organisation for Economic Co-operation and Development (OECD) has studied the use of tax expenditures internationally, including the United States. Organisation for Economic Co-operation and Development, *Tax Expenditures in OECD Countries* (2010).

[5] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2019-2023* (JCX-55-19), December 18, 2019 at 1.

[6] *Id*.

[7] *Id* at 1.

[8] Institute on Taxation and Economic Policy, *available at* https://itep.org/state-by-state-tax-expenditure-reports/.

[9] *E.g.*, Jason Levitis, Nicholas Johnson & Jeremy Koulsih, *State Budget Accountability Through Tax Expenditure Reports*, State Tax Notes, May 27, 2009, at 655.

and for all taxes. As a result, each reporting agency applies an operating definition of "tax expenditure" with analytical utility for that agency and its administration, as well as legislative policymakers and the wider policy audience within that jurisdiction.[10]

Tax Expenditures in This Report

R.C. 5703.48 defines "tax expenditure" for purposes of this report. A "tax expenditure" means "a tax provision in the Revised Code that exempts, either in whole or in part, certain persons, income, goods, services, or property from the effect of taxes levied by the state, including but not limited to, tax deductions, exemptions, deferrals, exclusions, allowances, credits, reimbursements, and preferential tax rates" provided certain statutory criteria are met.

Listed below are the statutory criteria used to determine whether a tax provision constitutes a tax expenditure for this report. All four criteria must be true for the item to be considered as such:

1. **The provision reduces, or has the potential to reduce, revenue to the GRF.**

   By law, the tax expenditure report includes only taxes the revenue from which are allocated in whole or in part to the GRF. Therefore, locally levied taxes are excluded from this report. Also excluded are certain state taxes the revenues from which are not allocated to the GRF (such as the motor fuel tax, horse racing tax, and the severance tax).

2. **The persons, income, goods, services, or property exempted by the provision would have been part of a defined tax base.**

   For a provision to be a tax expenditure, it specifically must exempt from taxation a person or activity that otherwise would have been part of the tax base. There are some items specifically exempt by the Ohio Revised Code that are not considered to be part of the tax base. These items are not included as a tax expenditure in this report. For example, services, unless specifically enumerated, are not part of Ohio's sales and use tax base. Therefore, this report does not list the numerous services that are not part of the sales and use tax base. Other examples include the sales tax "resale" exemption (discussion in the Sales & Use Tax section of this report) and the commercial activity tax exclusion for non-profit entities.

[10] Some agencies work under a statutorily prescribed definition of "tax expenditure." Even though these agencies comply with the statutory definition in good faith and to the maximum extent possible, there is no statutory definition with sufficient nuance and logic to guide all determinations. The agencies must develop an operating definition of tax expenditure and use reasonable judgement to determine the items that fit the definition.

3. **The persons, income, goods, services, or property exempted by the provision are not subject to an alternate tax levied by the state.**

   Persons or activities subject to alternative taxes are not considered tax expenditures in this report. For example, insurance companies are excluded from the commercial activity tax under the Ohio Revised Code, but this exclusion is not considered a tax expenditure since insurance companies are taxed under the insurance premium taxes.

4. **The provision is subject to modification or repeal by an act of the General Assembly.**

   The provision must take the form of an exemption, deduction, credit, etc., existing in the Ohio Revised Code. Anything that can be changed only by a state constitutional amendment, federal law change, or federal constitutional amendment is not considered a tax expenditure in this report. For example, Article XII, Section 3 of the Ohio Constitution prohibits the levy of collection of any excise tax upon the sale or purchase of food for human consumption off the premises where sold. Therefore, the R.C. 5739.02(B)(2) sales and use tax exemption for the sale or purchase of food for human consumption off the premises where sold is not considered a tax expenditure in this report.

Tax expenditures are organized in this report by tax types. Although revenue from the natural gas excise tax is distributed to the GRF, there are no tax expenditures related to it. Some tax expenditures apply to more than one tax. In most of these instances, the effects are combined and reported under a single tax so as not to be repetitive.[11]

Interpretation of Tax Expenditures

Tax policy experts have identified nuanced ways to evaluate tax expenditures.[12] Tax expenditures provide an explicit accounting of deviations from a baseline tax structure. Users of a tax expenditure report can identify deviations from a baseline, who benefits, and the relative fiscal magnitudes. The report may serve as a foundation for further analysis on whether, and to what degree, a tax expenditure violates principles of good tax policy (e.g., efficiency, fairness, simplicity, and uniformity). To one degree or

[11] Example: The Job Creation Tax Credit is shown in the commercial activity tax (CAT) section, though the credit may be claimed against not only the CAT, but also the petroleum activity tax, insurance premium taxes, financial institutions tax, and the individual income tax. The estimate displayed in the report reflects the total of all applicable taxes.

[12] *E.g.*, Eric J. Toder, Address at the National Tax Association Annual Conference (November 19, 2005), *available at* https://www.urban.org/sites/default/files/publication/50941/411371-Tax-Expenditures-and-Tax-Reform.PDF.

another, tax expenditures might reduce economic efficiency, heighten tax complexity, or treat people with the same ability to pay in a disparate or inequitable manner.

Tax expenditures are often viewed as an appropriate mechanism for spending government resources. Under this viewpoint, the tax system can serve as an instrument for reallocating resources or otherwise addressing economic inefficiencies. Thus, the tax expenditure report identifies the specific circumstances under which policymakers have chosen to allocate state resources through the tax code to address a perceived societal need or want fully or partially. According to this conceptualization, then the question is whether the "spending" is appropriate and not necessarily whether it violates a tax policy principle.

Quantifying Tax Expenditures

In accordance with R.C. 5703.48, the FY 2020-2021 Biennial Tax Expenditure Report identifies the estimated revenue that is foregone, or "spent", by the GRF because of the existence of a tax expenditure under current law. The estimates reflect the amount of financial benefit provided to recipients, adjusted to reflect the GRF's share of the tax expenditure. No further adjustments are made to the estimates, except where another tax expenditure is also available to the taxpayer for the same item or activity ("overlap").

There are other methods to quantify tax expenditures including estimating revenues that would be gained if the tax expenditure were repealed. The tax expenditures in this report are not quantified using methods other than "revenue foregone." Estimates produced under a "revenue gain from repeal" concept encompass an extensive array of (primarily downward) adjustments. An example would be an adjustment regarding the effective date of a repeal as there may be important cash-flow consequences associated with the effective date of a repeal. Another potentially significant adjustment involves taxpayer behavioral responses to the repealed tax expenditure. Economic activity would likely be affected to varying degrees as tax is newly applied to the previously tax-exempt item or activity. Furthermore, one may expect short-term compliance difficulties with the newly taxed item or activity.

To summarize, the figures in this report do not represent the estimated revenue gain from repeal of each tax expenditure. Instead, the figures reflect reasonable estimates (rounded to the nearest $100,000 for estimates of $1 million or more) of the tax benefits realized by recipients of the tax expenditure's benefits – what has been referred to as the "revenue foregone." Additionally, while this report provides totals summing the tax expenditures by tax type and in total, the totals do not represent the revenues that would be gained by the GRF from repealing all the tax expenditures simultaneously.

Data Sources for Tax Expenditure Estimates

The accuracy of the estimates varies with the source of data and applicability of the data to the tax expenditure provision. In some instances, the Ohio Department of Taxation (ODT) must rely on external sources that may not be as reliable or accurate as internal data that is relied upon to estimate the revenue foregone from other tax expenditures. A data reference code has been provided to identify the source for individual tax expenditures as follows:

Data Source Code (A):	Data emanating from tax returns filed with ODT as well as other information generated by the Department.
Data Source Code (B):	Data produced by government agencies other than ODT such as other State of Ohio agencies, the federal government (e.g., Internal Revenue Service, U.S. Census Bureau, and others), other state governments, and Ohio local governments.
Data Source Code (C):	All other data sources, including (but not limited to) information from business information service providers, academic research, and non-profit research organizations.