



**House Ways and Means Subcommittee
H.B. 59 – Sales Tax Provisions
Testimony of Thomas M. Zaino on behalf of
The Ohio Society of CPAs**

Chairman McClain, Ranking Member Letson, and members of the House Ways and Means Subcommittee, thank you for this opportunity to appear before you today on behalf of The Ohio Society of CPAs (“The Ohio Society”). My name is Tom Zaino. I am a CPA and an attorney. I served as tax commissioner under Governor Bob Taft from 1999 through 2003. I am an active member of The Ohio Society and I serve on its Tax Legislation Policy Committee and am a former executive board member.

To begin, I want to applaud Governor Kasich and all members of the House and Senate for your past efforts to improve Ohio’s economy and to make our great state not only as competitive as possible, but also a place where people want to grow their business and raise a family. The Ohio Society has supported many of the initiatives that have made Ohio better and are now part of Ohio law, and we look forward to working with you now and in the future to explore new ways to improve our state even more.

With regard to H.B. 59 and its proposed tax reform, there are certainly some positive concepts contained in the package. However, The Ohio Society has significant concerns about a certain provision it believes would put Ohio at a competitive disadvantage and make Ohio stand out in a much less positive way: the proposal to dramatically expand Ohio’s sales tax base to countless professional services, as well as to the transfer of intangible property.

Among The Ohio Society’s concerns is the negative impact on all types of Ohio businesses. Because so few states have a broad sales tax on services, if the overall goal of HB 59 is to drive economic development and job creation in our state, the sales tax expansion proposal is going in the wrong direction.

There are only three states that can be said to broadly tax nearly all services and none of these are in the Midwest. In fact, South Dakota is the only one of these that imposes a true sales tax upon a broad array of services. The other two, Hawaii and New Mexico, impose a gross receipts tax upon services at a rate and in a manner that in many ways looks like a sales tax, but is not a true sales tax. Michigan, along with Florida and Massachusetts previously adopted a broad professional services sales tax but quickly repealed their laws when they discovered how difficult implementation was—assessing a sales tax on services is quite different from assessing a sales tax on tangible goods, as these states discovered the hard way. I am not aware of any state that imposes a sales tax on intangibles, including trademarks, patents, copyrights, franchises and licenses.

As you know, the proposed legislation flips the current practice of assessing sales and use tax only on specifically enumerated services to one where ALL services are taxed unless specifically exempted. The list of fewer than 200 services outlined to you by administration officials clearly is just the tip of the iceberg: the Mackinac Institute reported that the federal Office of Management and Budget says there are thousands of services in existence. The Ohio Department of Taxation has estimated our state will have around 200,000 new sales tax vendors

should this mandate become law. I believe that number could be much higher as unanticipated service providers are identified. The way the law is currently drafted, those new vendors not only include the businesses we all generally think about, but will also include the neighborhood kids we pay to babysit or remove the snow from our driveways. Dealing with the burdens of complying with these proposed changes will not only require additional resources for businesses, but also will require additional resources and government workers for the state to effectively administer and enforce the proposed law.

The tens of thousands of CPAs in Ohio represent virtually every business sector that exists. CPAs understand business and CPAs understand taxes. To ensure it was fully representing the views of its members, particularly since the sales tax expansion was being proposed in part to offset income tax reductions, The Ohio Society surveyed its members. Around 20% took the time to complete the survey despite it being audit and tax season, and over 80% noted their opposition to broadly expanding the sales tax base. Two of every three CPAs noted they opposed the tax reform package as a whole, indicating that the sales tax base expansion was so unworkable that it overshadowed any positive impact the income tax reductions would provide.

Concerns that were expressed by these CPAs centered around increased financial pressure on businesses, increased costs for business-to-business and related party transactions, enforcement and situsing problems, and the competitive disadvantage Ohio-based businesses would face under this type of tax system. Specific concerns from members include the following:

- Adoption of this broad sales tax on business inputs, with no business to business exemption, will put Ohio businesses at a competitive disadvantage compared to those in nearly every other state. For instance, a company that purchases any professional services to help run its business, or leases real property to house their warehousing or manufacturing operation, or licenses technology to be incorporated into their product, will have those costs increase, on average, by over 6%. Businesses located outside Ohio will not bear that same cost on their business inputs. As a result, the price of products or services of Ohio-based businesses will be higher than those produced by a competitor located in nearly any other state.
- Many Ohio businesses will seek to use the services of professionals located outside Ohio in an effort to avoid Ohio sales tax. Some may argue that the playing field will still be level because of the use tax. However, it is unreasonable to believe that every business will remember to track and ultimately pay its use tax obligations, or that the Ohio Department of Taxation will be able to fully audit and enforce each business' or individual's use tax obligations.
- Under Ohio law, sales tax must be remitted by the vendor to the state when the bill is sent, not when the bill is paid. This means that service providers who typically send a bill rather than receive payment at the time service is provided will be forced to "float the loan" to the state should the client not pay in a timely manner. As you can imagine, there are many customers in our state who can take months to pay a bill – and that is assuming the total due is actually paid. Some customers pay only a portion of their bill,

and others don't pay at all. Again, this will increase the cost of doing business in Ohio that won't be incurred in any other Midwestern state.

- Sourcing services is, from a practical perspective, much more difficult than situsing services. H.B. 59 provides no clarity as to how services will be sitused. Situsing services to where the benefit is received is easy to say, but extremely complicated, costly and uncertain for both taxpayers and the government to implement. For example, situsing can be particularly challenging when working with a client “virtually,” or on the phone with multiple people located in multiple states or countries.
- Small businesses that are located in Ohio and that continue to use Ohio professionals will see a 6% increase in their costs in numerous areas, such as: advertising, bookkeeping, design costs to lay out their office space, accounting work to set up or grow their business, legal bills to defend against a “slip and fall” case, rent, background and credit checks, auditing costs to obtain a bank loan, bank service charges, accounting fees to comply with local, state and federal tax filing mandates, computer software programming, using independent contractors of any sort including anyone who gets a 1099, etc. This increased cost of doing business will put them at a competitive disadvantage with similar businesses in other states, and likely will largely mitigate—or even over take—the savings they would see under the 20% personal income tax reduction and 50% pass-through income tax deduction.
- Many professionals, whether attorneys, consultants, or accountants, work in regional or national practices and can serve their clients from any geographic base. If clients are charged higher fees when doing business with Ohio professionals, they will shift to professionals in another state. For example, our state's largest Ohio-based accounting firm is in Cleveland, with offices in three other states. They estimate \$30 million in services are provided to a group of out-of-state clients. If the clients have 20% of their business located in Ohio, the firm would have to assess a 6% sales tax on that 20%, which is \$360,000. They will simply move the CPAs working with those clients to the Chicago office rather than lose the client or “eat” that \$360,000 in sales tax. The result? Not only does Ohio lose the sales tax revenue, they will also lose several high-income professionals and their related charitable contributions, local consumer purchases, etc. Now multiply that times the dozens and dozens of Ohio law firms, ad agencies, architecture firms, business consulting firms, engineering companies, accounting firms, etc., etc. that are now in our state and service out-of-state clients. Can we really afford to force these high-income earners out of our state?
- Almost all businesses lease office, warehouse or plant space. While the proposal provides an exemption for residential leasing, it appears that the bill is intended to tax commercial leasing. Rent is often the second highest cost to a small business, behind labor. Adding 6% to the rent bill of a business—large or small—will have a negative impact either in the form of less return to the investors, less wages for the workers, or higher prices on its products or services.
- To keep customers from going to an out-of-state service provider, an Ohio small business owner who specializes in public relations, advertising, consulting, etc. may be

forced to absorb the sales tax cost—meaning they just cut their income by 6%. If the client does pay the sales tax, it will likely prevent the professional from raising their fees anytime soon, meaning they won't have the income to give employee raises either.

- Looking to the impact on consumers, let's look at the American dream: the Ohio Association of Realtors estimates the taxes associated with realtor commissions, appraisals and title searches and insurance will add over \$600 to the closing costs for a someone buying a \$125,000 home – meaning many potential homebuyers may have to, at best, delay their home purchase.
- The typical family will, if HB 59 passes as is, see a 20% income tax reduction over three years. From Year One they will see the cost for dozens of services and activities they currently use out of necessity or choose to enjoy go up 6%. Undoubtedly, for many families the increased amount they pay in sales tax will be more than the reduction in income tax owed.
- Turning to larger businesses, many of which are C Corporations that will not benefit from the pass-through entity tax deduction, they will incur the same 6% hike in their cost of doing business. If they have subsidiaries, or sister companies, there is no exception for sales from one to another, leading to pyramiding of sales tax with no true economic benefit. Again, these are costs such businesses would not experience in nearly every other state.
- Many businesses buy other businesses or sell portions of their own business. Any business that purchases the stock of an Ohio business that is not publicly traded will pay, on average, a 6% premium for such stock. If instead, the purchaser bought the assets of such Ohio business, it will pay, on average, a 6% premium on any intangibles owned by the selling company, such as goodwill, patents, leases, etc.

And, I would be remiss if I didn't point out the irony of requiring Ohioans to pay a tax for the privilege of paying their taxes. There is nothing optional about complying with tax filing mandates, and the IRS estimates that 60% of the taxpaying population uses outside assistance because they view the tax compliance process to be intimidating and complicated. The same goes with being audited by the Ohio Department of Taxation or multiple local municipalities – most taxpayers view professional assistance as a necessity.

I could go on with even more examples of how the proposed broad sales tax expansion and related lack of clarity will negatively impact the competitiveness of companies doing business in our state. The 2003 Report of the Committee to Study State and Local Taxes, a joint legislative/executive and bipartisan report, described five principles of a quality tax system: simplicity, fairness, stability, neutrality and competitiveness. H.B. 59's proposed expansion of the sales tax violates every one of these principles. On behalf of the 22,000 members of The Ohio Society, I urge you to reject this provision of HB 59.

Thank you for your consideration. Mr. Chairman, I would be happy to answer any questions of you or of others on the committee.