# Ohio Legislators Set to Benefit from Business Tax Cut

*The two-year state budget, currently the subject of final House-Senate conference committee negotiations, contains a tax break aimed at business owners that could directly benefit nearly half of Ohio's sitting legislators.*

In the state's two year operating budget, Governor Kasich has proposed granting relief from taxation from the personal income tax for so-called "pass-through" business entities, touted as a way to spur job creation. Under the Senate-passed version of the bill (Sub H.B. 59), currently pending before a House-Senate conference committee, owners of these business entities would be allowed to exclude 50% of their business income from taxation up to $750,000.[1]

Pass-through entities (PTEs) are a so-named because the tax liabilities of the company "pass-through" to the individual owners of the company.[2] That tax liability is then reported as personal income, removing the need to file separate returns for business and personal income, and avoiding the burdens of double taxation. Generally, PTEs include certain corporations (S Corp.), partnerships (LLP, LPA) and limited liability companies (LLC) that are not taxed as corporations through voluntary election by the owners of that business association.[3]

Republican lawmakers have argued that cutting the personal income taxes of the owners of these entities will encourage investment in new capital and create new jobs. However, there is little evidence that this policy will result in new hiring. Policy Matters Ohio concluded that the overwhelming majority of pass-through entities have no employees outside the ownership structure of the company.[4] In addition, according to the Ohio Department of Taxation, over 80% of the qualifying business entities in Ohio have less than $25,000 in income and would receive an average savings of $372 under the terms of the bill as proposed.[5] Because of its size and targeting at business owners and investors, this policy is unlikely to – or not provided sufficient incentive to – create jobs as a result.

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[1] *Analysis of H.B. 59 As Introduced*, Legislative Services Commission, http://www.lsc.state.oh.us/budget/agencyanalyses130/introduced/tax.pdf. The bill creates a new state income tax deduction for individuals receiving business income as a sole proprietor or as an owner of a pass-through entity. The deduction equals 50% of business income included in a taxpayer's federal adjusted gross income and not otherwise deducted in computing Ohio taxable income, and to the extent apportioned to Ohio. A new proposed amendment, which has received hearings in the House and Senate Ways and Means committees, but has not yet been incorporated in HB59, would lower the exclusion to the first $250,000 in income.

[2] *IRS Internal Revenue Manual. 8.19.1.2. Pass-through Entity Defined.* http://www.irs.gov/irm/part8/irm_08-019-001.html#d0e67

[3] Ohio Revised Code. 5733.04 (0).

[4] *Tax Break for Business Owners Won't Help Ohio Economy*, Policy Matters Ohio, 4/2/2013. http://www.policymattersohio.org/tax-break-apr2013#_ftn7. The majority of the business owners who would benefit from the proposal employ no one. More than half are sole proprietors, and, nationally, 85 percent of sole proprietors have no employees. The other beneficiaries are owners of partnerships and S corporations. National data show that 76 percent of partnerships have no employees, and 49 percent of S corporations have no employees.

[5] *Ohio Senate resurrects Kasich's small-business tax cut, debate over its impact persists*, Cleveland Plain Dealer, 6/1/2013. http://www.cleveland.com/open/index.ssf/2013/06/ohio_senate_resurrects_kasichs.html

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There are no proposals before the conference committee to lower the Commercial Activity Tax, paid by over 150,000 businesses for the privilege of doing business in Ohio.[6]

Interestingly, many Ohio legislators, set to vote on the bill later this week, are themselves owners of pass-through entities and could personally benefit from preferential tax treatment as a result of its passage. Our research has found that ***at least 57 and up to 69 members of the General Assembly own or are somehow affiliated with a pass-through entity***.

Innovation Ohio reviewed mandatory 2012 Financial Disclosure Statements filings from current members of the Ohio General Assembly with the Joint Legislative Ethics Commission.[7] Forty-seven legislators were found to have a direct personal ownership of a PTE. Of this group, 31 members – 21 Representatives and 10 Senators – reported income in 2012 that would be subject to the favorable tax treatment in the bill, while another 16 – 13 Representatives and 3 Senators – had no income to report in 2012, but would enjoy the tax benefit once their business brings in revenue.

**Legislative Members Who Own Or Are Affiliated With PTEs**

| | Derive Income From PTE | Own PTE But No Income | Indirect PTE Affiliation | Corporation Affiliation | Totals |
|---|---|---|---|---|---|
| **Number of Legislators** | 31 | 16 | 10 | 12 | **69** |

An additional 10 members – 8 Representatives and 2 Senators – list a non-ownership stake in a PTE, either as an employee or spouse of a PTE owner. Twelve more members – 9 Representatives and 3 Senators – are affiliated with incorporated business entities, but because these (usually small) corporations can elect to be taxed as a PTE or subject to corporate taxation, it is impossible to determine from incorporation records alone whether these members will directly benefit from the beneficial tax treatment under the bill.[8]

In all, some 181 pass-through entities are affiliated with Ohio legislators and may benefit, thanks to this affiliation, from the new tax treatment under the bill.[9]

With votes on the final legislation expected later this week, if they aim to spur job creation, we would encourage legislators to dump this self-serving provision and instead focus on policy measures better targeted at creating incentives for companies to hire new employees.

[6] In fact, the tax reform proposal rolled out last week and expected to be incorporated into Sub HB 59 today actually taxes additional small businesses with incomes under $1 million to pay for the income tax cut for pass-through entities.
[7] Ohio Joint Legislative Ethics Commission, Financial Disclosure Statements. Navigate to the “FDS filed 1994-present” link to access the database. Last accessed 6/3/2013.
[8] Ohio Secretary of State Business Name Search. Last accessed 6/3/2013.
[9] All included business entities were counted to arrive at the ceiling number of 181. Confirmed PTE’s: 77 in House, 35 in Senate. Incorporated Entities: 51 in House, 6 in Senate. Unknown Entities: 5 in House, 7 in Senate.