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Before the House Finance & Appropriations Committee
Written Testimony on HB 59

March 21, 2013

Chairman Amstutz, Ranking Minority Member Sykes and members of the House Finance & Appropriations Committee, my name is Marin Gibson and I am the Managing Director and Associate General Counsel of State Government Affairs for the Securities Industry and Financial Markets Association (SIFMA)[1].

On behalf of SIFMA members, I am submitting written testimony in opposition to the proposed imposition of Ohio sales tax on services and financial products contained in HB 59 as introduced. These new taxes would create a competitive disadvantage for Ohio businesses and would likely lead to decreased business activity and decreased employment in Ohio. Taxes on services and intangible financial products will increase the cost of doing business in Ohio, a cost that is not imposed in most other states. The new taxes would negatively impact our customers, which is likely to cause the loss of both customers and revenue.

In the modern economy, customers can easily move their business and conduct transactions outside of Ohio to avoid the tax. If customers purchase services from providers without a physical presence in Ohio, no Ohio sales tax will be billed – this creates a competitive disadvantage for Ohio companies. While the customer is responsible to self-assess and remit "use tax," there is substantial risk of noncompliance with self-assessing tax in these situations. For a large company, this self-assessment process is a very time-consuming and complex issue. For an individual, compliance is very unlikely. More than likely, this will make administration of the tax difficult for the Department of Taxation with the result being a need to dedicate additional resources to conduct purchase audits of Ohio businesses.

In most states, sales tax has been imposed on the sale of tangible personal property and limited types of services. Ohio has historically followed the majority of states - taxing only a limited number of specific services. This has helped preserve the state's competitive business environment.

Earlier this year, Minnesota introduced legislation that would have imposed a sales tax on services. However, the Governor recently eliminated the sales tax on services proposal from the budget plan. Nebraska also tabled a similar plan earlier this year.

New Mexico and Hawaii are two other states that are frequently referred to for imposing sales tax on a broad range of services. However, in both of these states, a gross receipts tax is imposed,

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA has offices in New York and Washington, D.C. For more information, visit http://www.sifma.org.

rather than a sales tax. In addition, both of these states have a smaller population and a much different economic environment than does Ohio.

Notably, there are a number of states which have enacted or attempted to enact sales tax on services including:

- In July of 1987, Florida passed a sales tax on services; 6 months later Florida repealed the legislation because it put in-state businesses at a competitive disadvantage to out-of-state counterparts.

- In October 2007, Michigan enacted a broad tax on services; a taxpayer coalition was quickly formed to repeal it, worried that it would negatively affect jobs. The tax was repealed 17 hours after it became effective.

- In 1990, Massachusetts passed a tax on services that applied only to services provided to businesses; the state repealed the tax 2 days after it took effect because of the fear of economic harm and potential job loss.

One primary concern with HB 59 is the imposition of sales tax on services such as investment management fees, investment advice fees and investment counseling fees. This additional cost to our customers in Ohio will have a direct correlation to the amount Ohioans invest for their future. Specifically, if our Ohio clients are required to pay sales tax, they will have less money to invest and save for their future. The new tax discourages savings and increases costs to consumers in Ohio.

The current proposal also appears to impose a sales tax on the sale of mortgages, as a mortgage is intangible property, but a mortgage is not a financial instrument which is excluded from intangible property. This provision would make Ohio an outlier. It is common practice for mortgages to be sold as part of investment strategies and to obtain additional capital to continue lending. Indeed, for the last few years, over 90% of mortgage loans originated in the United States have been sold to subsequent purchasers, typically into a securitization trust issued or guaranteed by a government or quasi-government mortgage finance agency such as Fannie Mae, Freddie Mac, or Ginnie Mae. Lenders will not ultimately bear the cost of the sales tax - they will pass on this cost to Ohio borrowers. Mortgage borrowers in Ohio will face higher closing costs, higher rates, or some combination of both; in other words, it will become more difficult for Ohioans to secure affordable financing for mortgages. Given the fragile state of many housing markets, this would be a particularly harmful effect of this tax proposal.

Additionally, the current proposal does not directly address the sourcing of sales of services. In other words, when is Ohio tax due or not due on a particular transaction? It is often difficult to determine where the "sale" of a service occurs, especially if there is no property or deliverable to the customer. The determination of sales location becomes more complex because not only must one determine if the sale is Ohio-based, but also in which Ohio municipality the sale occurs. Additionally, the determination for the sourcing of intangibles, such as mortgages, may be even more complex than the sale of services. More specific statutory guidance would be required to assist our members in making a determination as to whether Ohio sales tax might be due.

Furthermore, many of the services that would be taxable under this proposal are business-to-business (B2B) transactions. There are a number of "good tax policy" reasons why B2B sales should not be subject to sales tax:

- The sales tax is designed to be a tax on consumption; when business-to-business services are taxed, it becomes a tax on production. This is especially true with respect to the Ohio proposal because there is not even an affiliate sales tax exemption. It is possible that throughout the sales cycle, sales tax may be due on intercompany sales despite the fact there has been no economic gain.

- Such taxes are particularly harmful to and are a disadvantage to small businesses. The new taxes would increase direct costs, some of which may not necessarily be understood by small business. This would also greatly increase tax compliance requirements and cost.

- These taxes impede overall economic development and put Ohio at a competitive disadvantage, in particular with competitive firms that operate in a state without such taxes – which is the case in most states.

- The taxes imposed on business services would have a "pyramiding" effect – the tax is imposed on each transaction in the economic flow. This will result in increased costs at each level and higher-costs to the final consumer. This tax will be more similar to the European VAT model – where tax is imposed on each transaction, at each level of the economy. However, with a VAT there is a credit mechanism to offset tax collected and remitted, to minimize pyramiding.

Practically speaking, there are concerns with the imposition date (9/1/2013) and the ability for businesses to develop and implement systems in time to begin to collect and report sales tax withholding. Generally, such systems implementation projects take many months, even years, and without a final resolution of the budget proposals expected until the summer, there will not be enough time for businesses to comply with the new requirements.

In conclusion, the members of SIFMA applaud Governor John Kasich and the Ohio General Assembly's commitment to enacting policies that support business growth and job creation. But, SIFMA does not believe the expansion of sales tax to services and certain intangibles included in HB 59 will compliment such goals. We believe that enactment of this legislation would create a competitive disadvantage for Ohio businesses and will likely lead to decreased business activity and decreased employment in Ohio. The tax on services and certain intangible financial products will increase the cost of doing business in Ohio, a cost that is not imposed in most other states, which will end up being passed on to the citizens of Ohio.

If you have any questions or need additional information, please contact SIFMA's Ohio counsel, Tony Fiore of Kegler, Brown, Hill & Ritter at 614-462-5400, or contact me at SIFMA directly at 212-313-1317 or at mgibson@sifma.org.