LETTING THE CAT OUT OF THE BAG

How to Improve Ohio's Economy and National Rankings

Rea S. Hederman Jr.; Andrew J. Kidd Ph.D.; and James B. Woodward, Ph.D.

ECONOMIC RESEARCH CENTER
at THE BUCKEYE INSTITUTE

Letting the CAT Out of the Bag

How to Improve Ohio's Economy and National Rankings

Rea S. Hederman Jr.; Andrew J. Kidd Ph.D.; and James B. Woodward, Ph.D.

July 29, 2020

ECONOMIC RESEARCH CENTER
at THE BUCKEYE INSTITUTE

Table of Contents

EXECUTIVE SUMMARY

Economic freedom and opportunity help families provide for themselves and their futures, and make it easier for companies to grow and invest in their workforces. Government regulations and tax policies can foster or hinder that freedom and opportunity. Even as Ohio policymakers have heeded The Buckeye Institute's advice and reduced regulatory burdens in recent years,[1] Ohio still maintains an antiquated, Depression-era tax that hampers growth and prosperity for employers and employees across the state. The commercial activity tax (CAT) is an expensive, compounding tax that dramatically distorts economic decision-making while providing relatively little revenue to the state. Rather than tax corporate profits, the CAT taxes gross receipts, meaning that businesses face sizable tax liabilities even during unprofitable years and periods of economic distress. Eliminating the CAT is overdue.

Only a handful of states still impose a commercial activity tax on their business communities, and with good reason. The CAT is a "pyramiding tax" that raises the price of goods at every stage of their production, forcing Ohio consumers to pay artificially high prices at checkout. The current 0.26 percent CAT rate is deceptively low. Its real economic effect is closer to a seven to 10 percent corporate income tax rate, which makes it one of the highest effective corporate taxes in the country.[2] The CAT inflicts the most economic damage on businesses with low profit margins while contributing less than seven percent of the state's tax revenue and three percent of the budget.[3]

The true costs and limited benefits of this distortionary tax make it a prime target not only for reduction, but for elimination altogether. Repealing the CAT would

---

[1] **Ohio Governor Signs Buckeye Institute-Championed Policy to Help Military Spouses Work in Ohio**, The Buckeye Institute press release, January 27, 2020; and **Ohio Governor Signs The Buckeye Institute-Championed Best-in-the-Nation Occupational Licensing Reform Policy**, The Buckeye Institute press release, January 4, 2019; and **Common Sense Initiative**, Goveronr.Ohio.Gov (Last visited March 30, 2020).
[2] Daniel R. Mullins, Andrew D. Phillips, and Daniel J. Sufranski, ***Analysis of Proposed Changes to Select Ohio Taxes Included in the Ohio Executive Budget and Ohio House Bill Number 64***, State Tax Research Institute, March 2015; and Jared Walczak and Janelle Cammenga, ***Fiscal Fact No. 639: State Corporate Income Tax Rates and Brackets for 2019***, The Tax Foundation, February 27, 2019.
[3] Daniel R. Mullins, Andrew D. Phillips, and Daniel J. Sufranski, ***Analysis of Proposed Changes to Select Ohio Taxes Included in the Ohio Executive Budget and Ohio House Bill Number 64***, State Tax Research Institute, March 2015; ***Annual Report: Fiscal Year 2018***, Ohio Department of Taxation, 2018; and **2019 Am.Sub.H.B. 166**.

raise Ohio's standings in two prominent national economic indices: the Fraser Institute's *Economic Freedom of North America* (EFNA) index and the Tax Foundation's *State Business Tax Climate Index*. Both indices provide extensive methodologies and comprehensive approaches that quantify the effects of different tax and economic policies across states. The EFNA measures economic freedom using publicly available government data and Tax Foundation compares how well states achieve optimal tax policy for economic growth. Eliminating the CAT hypothetically will improve Ohio's rankings in both indices: rising from 40^{th} to 34^{th} in the EFNA's sales and gross receipt taxes index; and from 42^{nd} to a shared 1^{st} place in the Tax Foundation's corporate tax rankings.

Ohio's rise in independent rankings after hypothetically eliminating the CAT confirms the severity of the outdated tax's drag on the state's economy. Repealing this heavy corporate tax burden now, especially as employers and employees struggle to survive and recover from the disruptive effects of the coronavirus, will enhance the economic freedom and opportunity that Ohio needs.

INTRODUCTION

Although many factors may determine where a business ultimately sets-up shop, businesses consistently tend to locate in states with favorable corporate tax regimes that encourage economic freedom, profitability, and growth.[4] This is not surprising. The more money that businesses spend paying taxes, the less money they have for hiring workers and expanding their operations. In sum, taxes threaten corporate growth and profitability, and that threat affects corporate decision-making.

To help policymakers promote economic freedom, stimulate job-growth, and attract businesses, the Fraser Institute and the Tax Foundation regularly distill the various differences in state tax policies. Itemizing and ranking these policy differences gives policymakers a better understanding of the potential economic effects of their policy choices. The Tax Foundation's annual *State Business Tax Climate Index* scores the types and rates of state-imposed taxes, clearly identifying which taxes distort and harm economic growth. The Fraser Institute uses publicly available state data on tax collections, government spending, and labor regulations to evaluate and compare states in its annual EFNA index.[5]

States that rank higher on the Fraser Institute's EFNA index tend to see more business start-ups.[6] Conversely, states that impose high tax rates on businesses

---

[4] Claudio A. Agostini, "**The Impact of State Corporate Taxes on FDI Location**," *Public Finance Review*, Volume 35, Issue 3 (May 2007) p. 335-360; Timothy J. Bartik, "**Small Business Start-Ups in the United States: Estimates of the Effects of Characteristics of States**," *Southern Economic Journal* Volume 55, Number 4 (April 1989) p. 1004-018; Leslie E. Papke "**Taxes and Other Determinants of Gross State Product in Manufacturing: A First Look**," *Proceedings of the Annual Conference on Taxation Held under the Auspices of the National Tax Association-Tax Institute of America*, Volume 82 (1989) p. 274-82; W. Robert Reed, "**The Robust Relationship between Taxes and U.S. State Income Growth**," *National Tax Journal*, Volume 61, Number 1 (March 2008) p. 57-80; and Michael J. Wasylenko, "**Taxation and Economic Development: The State of the Economic Literature**," *New England Economic Review*, Issue March/April (March 1997) p. 37-52.

[5] Jared Walczak, ***2020 State Business Tax Climate Index***, Tax Foundation, October 22, 2019; Dean Stansel, Jose Torra, and Fred McMahon, ***Economic Freedom of North America 2019***, Fraser Institute, November 7, 2019.

[6] Travis Wiseman and Andrew T. Young, "**Economic Freedom, Entrepreneurship, & Income Levels: Some US State-Level Empirics**," *American Journal of Entrepreneurship*, Volume 6, Issue 1 (May 2013) p. 104-124; Boris Nikolaev, Joshua C. Hall, John M. Pulito, and Benjamin J. VanMetre, "**The Effect of Personal And Economic Freedom On Entrepreneurial Activity: Evidence From A New State Level Freedom Index**," *American Journal of Entrepreneurship*, Volume 6, Issue 1 (May 2013) p. 88-103; and Noel D. Campbell and Tammy M. Rogers, "**Economic**

receive low scores and poor rankings, in line with economists' findings that high business taxes discourage new and existing firms from locating in a state because companies prefer lower corporate tax rates or no corporate tax at all.[7] A higher ranking in the Tax Foundation study indicates that a state has a better environment for business investment, which leads to economic growth.

Ohio's tax regime does not promote a favorable business climate or economic freedom, ranking 37th in the EFNA index and 38th on Tax Foundation's index.[8] Ohio fares even worse in the business-tax policy sub-rankings—40th in EFNA's sales tax revenue as a percentage of income ranking and 42nd in the Tax Foundation's corporate tax rank.[9] The state's poor showing, especially in the sub-rankings, stems in large part from Ohio's commercial activity tax or CAT. This tax penalizes production and gross revenues, instead of profits, and creates disincentives for innovation, productivity, and commercial investments in labor and industry. Thus, the CAT directly impedes economic growth and prosperity for all Ohioans, not just business owners.

In an economic downturn, taxes on businesses can prolong economic hardship by making it more difficult for businesses to operate. The CAT can be particularly damaging since it taxes total sales rather than profits, which means that even unprofitable firms may face large tax bills even during periods of economic distress. Thus, The Buckeye Institute has already called for delaying the CAT in 2020 in order to help Ohio businesses weather the economic conditions created by the coronavirus.[10] But a better, permanent solution, would eliminate Ohio's CAT, which will raise Ohio's ranking in the EFNA index and the Tax Foundation's index, increase productivity, attract new businesses, and spur hiring across the state.

Freedom and Net Business Formation," *Cato Journal*, Volume 27, Number 1 (Winter 2007) p. 23-36.

[7] Leslie E. Papke, "**Subnational Taxation and Capital Mobility: Estimates Of Tax-Price Elasticities**," *National Tax Journal*, Volume 40, Issue 2 (1987) p. 191-203; and Leslie E. Papke "**Interstate Business Tax Differentials and New Firm Location: Evidence from Panel Data**," *Journal of Public Economics*, Volume 45, Issue 1 (June 1991) p. 47-68.

[8] Jared Walczak, ***2020 State Business Tax Climate Index***, Tax Foundation, October 22, 2019; Dean Stansel, Jose Torra, and Fred McMahon, ***Economic Freedom of North America 2019***, Fraser Institute, November 7, 2019.

[9] *Ibid.*

[10] Rea S. Hederman Jr., ***Policy Solutions for the Pandemic: Suspending the CAT Will Help Ohio's Economy***, The Buckeye Institute, May 28, 2020.

Commercial Activity Taxes Harm Businesses and Consumers

Among business taxes, gross receipts taxes—like Ohio's CAT—are the most economically distortionary and harmful. Unlike the more commonly used corporate income tax, gross receipts taxes require companies to pay taxes on their overall revenue, not their profits. Therefore, whereas a corporate income tax burdens profitable businesses, a gross receipts tax burdens all businesses, regardless of profitability.[11] Some states with gross receipts taxes allow for expense deductions, but Ohio does not, making a bad tax even worse.[12]

On March 9, 2020, Ohio Governor Mike DeWine declared a state of emergency due to the coronavirus pandemic. In the following days, government mandates shuttered many businesses from bowling alleys to restaurants, with other companies dramatically reducing production and customer services. The result has been widespread job losses and declining profits. Even in such an environment, however, Ohio levies the CAT, further endangering businesses still struggling to survive and making the state's economic recovery more difficult.[13]

Ohio's 0.26 percent CAT rate may appear small, but it creates an expensive "tax pyramid," whereby the state taxes a product or service multiple times as it moves through production, artificially inflating the final price paid by consumers.[14] Because the CAT taxes revenues, rather than profits, each step in the business-to-business production process adds more cost to cover the tax. The more steps in the process the more hidden tax the retail consumer must finally pay. (See Figure 1.)[15] And such pyramiding price distortions ultimately affect the marketplace.[16] As one economist found, replacing a one-time point-of-sale sales tax with a revenue-

---

[11] John L. Mikesell, ***Gross Receipts Taxes in State Government Finances: A Review of Their History and Performance***, Tax Foundation and Council on State Taxation, January 31, 2007.

[12] Jared Walczak, ***Special Report No. 238: Ohio's Commercial Activity Tax: A Reappraisal***, Tax Foundation, September 26, 2017.

[13] Rea S. Hederman Jr., ***Policy Solutions for the Pandemic: Suspending the CAT Will Help Ohio's Economy***, The Buckeye Institute, May 28, 2020.

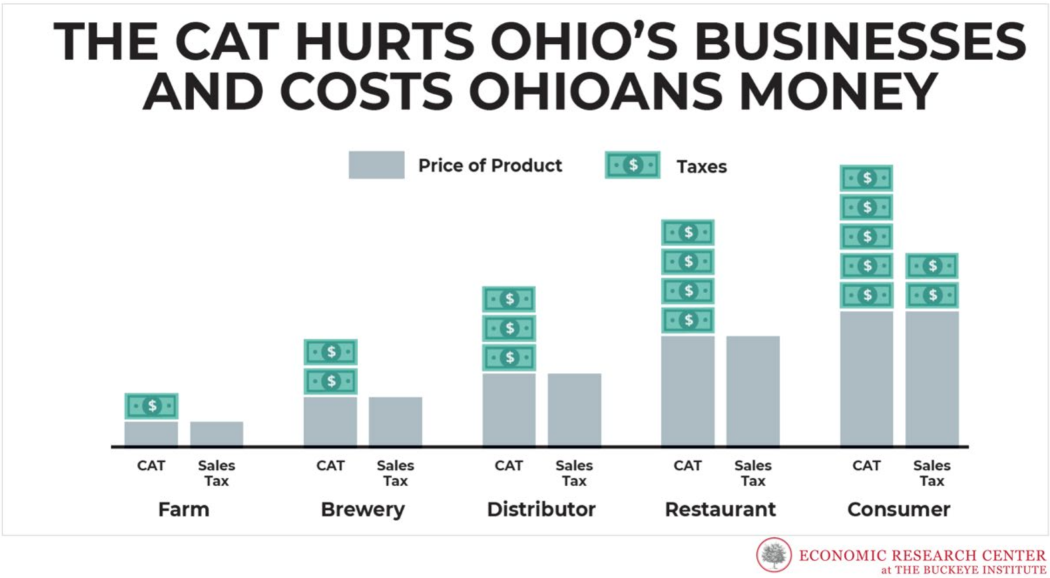
[14] Andrew Chamberlain and Patrick Fleenor, ***Special Report No. 147: Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes***, Tax Foundation, December 4, 2006.

[15] ***Ohio Illustrated: A Visual Guide to Taxes and the Economy***, Tax Foundation and The Buckeye Institute, June 7, 2017.

[16] Sales tax policy can still suffer from pyramiding if it levies sales and use taxes on business-to-business transactions.

neutral gross receipts tax raised consumer prices by an average of 0.5 percent and reduced demand by an average of 1.6 percent.[17]

Figure 1.



In addition to raising wholesale and retail consumer prices, the CAT's tax pyramid tightens profit margins for Ohio businesses. Profit margins for the Cincinnati-based Kroger grocery chain, for example, are typically two to three percent. Thus, even a seemingly small cost increase in the supply lines due to the CAT can significantly hurt the company's bottom-line.[18] The CAT's estimated effective tax rate on profits (*i.e.*, the effective corporate income tax rate) in Ohio is 7.9 percent in the retail sector, and ranges as high as 10.4 percent in the construction industry. These high effective tax rates show that the CAT's low statutory rate can be misleading and helps to explain Ohio's poor economic rankings.[19]

The CAT is a deceptively high, distortionary tax that discourages businesses from locating and investing in Ohio. A study on Tennessee's similar gross receipts tax

---

[17] Andre J. Barbe, "**Pyramiding, Productive Efficiency, and Revenue under a Gross Receipts Tax**," *Multistate Tax Commission Review*, Volume 23, Number 1 (Winter 2013) p. 14-21.
[18] Courtney Reagan, **What's Behind the Rush Into the Low-Margin Grocery Business**, cnbc.com (Last visited March 30, 2020); Chris Mosby, **Fortune 500: These Ohio Companies Make 2019 List**, patch.com (Last visited March 30, 2020); and ***Ohio Major Employers-Section 1***, Ohio Development Services Agency, May 2019.
[19] Daniel R. Mullins, Andrew D. Phillips, and Daniel J. Sufranski, ***Analysis of Proposed Changes to Select Ohio Taxes Included in the Ohio Executive Budget and Ohio House Bill Number 64***, State Tax Research Institute, March 10, 2015.

found that fewer new businesses open in counties with the highest gross receipts rates compared to counties with no gross receipts tax.[20] Other research on business taxes indicates that a ten percent increase in the corporate income tax reduces small business start-ups by 1.2 percent, branch plant openings by 2.2 percent, and employment by 1.4 percent.[21] Another study found that a one percent increase in a state's corporate tax rate leads to a one percent reduction in its share of foreign investment, with those funds going to more tax-friendly states.[22]

Mobility trends in the United States make such economic disincentives and adverse tax policies all the more important. Today, more than one-third of Americans consider themselves "mobile" or "open to, and able to move locations if an opportunity comes along."[23] Thus, a business tax that discourages growth and hiring pushes these mobile workers toward states with lower or no business taxes and that can therefore offer better job opportunities. Recent data bear this out. In 2019, for example, Ohio's rate of outbound-migration was sixth highest among the 48 contiguous states, just behind other high-tax states like New Jersey, New York, and Connecticut.[24]

Most states imposed gross receipts taxes after the Great Depression to shore-up falling tax revenues, but soon replaced them with broader sales taxes that were easier to administer and provided a more stable revenue stream.[25] And although most states rejected these taxes for decades, Ohio imposed its CAT on businesses in 2005[26] to become one of only seven states with some type of gross receipts tax

[20] William F. Fox and Matthew N. Murray, "**Local Public Policies and Interregional Business Development**," *Southern Economic Journal*, Volume 57, Number 2 (October 1990) p. 413-427.
[21] Timothy J. Bartik, "**Small Business Start-Ups in the United States: Estimates of the Effects of the Characteristics of States**," *Southern Economic Journal*, Volume 55, Number 4 (April 1989) p. 1004-1018.
[22] Claudio A. Agostini, "**The Impact of State Corporate Taxes on FDI Location**," *Public Finance Review*, Volume 35, Issue 3 (May 2007) p. 335-360.
[23] Gizem Koşar, Tyler Ransom and Wilber van der Klaauw, ***Understanding Migration Aversion Using Elicited Counterfactual Choice Probabilities***, Federal Reserve Bank of New York, April 10, 2019.
[24] ***Annual 2019 United Van Lines National Movers Study***, United Van Lines, January 2, 2020.
[25] Eric J. Coffill and Jessica N. Allen, "**Some Observations on Gross Receipts Taxes**," *Journal of Multistate Taxation and Incentives*, Volume 27, Number 4 (July 2017); and Nicole Kaeding, **The Return of Gross Receipts Taxes**, TaxFoundation.org, March 28 2017.
[26] John L. Mikesell, ***Gross Receipts Taxes in State Government Finances: A Review of Their History and Performance***, Tax Foundation and Council on State Taxation, January 31, 2007.

still on the books.[27] The state's 15-year experiment with the commercial activity tax has failed and it is time for it to end.

[27] Katherine Loughead, ***Fiscal Fact No. 683: State Tax Changes as of January 1, 2020***, Tax Foundation, December 20, 2019.

Bad Nexus Policies Hurt Businesses and Economic Activity

In addition to the CAT's economic disincentives and negative effects, the tax also suffers from flawed criteria for determining which companies must pay it. Generally, companies are subject to state taxation if they have a legal "nexus" to the state.[28] Companies may establish that nexus with a physical location or by selling to customers within a particular state. A company's physical presence (*e.g.*, a store or offices) will subject the company to the state's business tax regime. Companies without such a physical presence may still have to meet a state's sales tax requirements if they sell goods to customers in the state. Thus, for example, companies may avoid paying a state's high corporate taxes by selling to customers and doing business in that state without a physical store or presence there.

With the advent and growth of online retail sales, states began to experiment with nexus policies to generate tax revenue from internet sales and online economic activity.[29] In response to the rapid increase in online shopping, Ohio wrote new nexus rules for establishing a company's "physical presence" in the state. Ohio's early rules ultimately were not enforced, but the recent legal history of nexus rules shows how significantly those rules affect economic decision-making.

In 2017, Ohio enacted—but did not enforce—a "cookie nexus" and a "click-through nexus" for the state's CAT and sales tax.[30] Under the cookie nexus, a company would establish a "physical presence" in Ohio if it installed a cookie, a tiny bit of computer code, on an Ohio consumer's computer or cell phone.[31] Click-through nexus would be established "when an in-state business receives a commission for referring a certain amount of sales to the out-of-state seller, as through a website link."[32] That "certain amount" would have been $10,000.[33]

Cookies are ubiquitous in online retail and small businesses often use referrals to drive traffic to their online storefront, likely hosted by an out-of-state company. So

---

[28] **What is Nexus?,** Salestaxinstitute.com (Last visited April 14, 2020).
[29] Jared Walczak and Janelle Cammenga, ***Fiscal Fact No. 680: State Sales Taxes in the Post-Wayfair Era***, Tax Foundation, December 12, 2019.
[30] *Ibid.*
[31] Monika Miles, **Ohio's New Online Sales Tax: Now Cookies Can Create Nexus?**, MilesConsultingGroup.com, August 1, 2017.
[32] Scott Peterson, **A guide to click-through nexus**, Avalara.com, June 30, 2016.
[33] *Ibid.*

if Ohio had enforced the cookie- and click-through-nexus standards, many out-of-state businesses selling to just a select number of Ohio-based customers would have been subject to new taxes, despite having minimal economic interaction with Ohioans.[34] Retailers challenged this administrative and technical burden, resulting in low enforcement of the new nexus laws.

Several other states adopted an "economic nexus" policy that forced retailers, regardless of their physical presence in the state, to collect and remit sales and use taxes once they reached a certain level of economic activity in the state. These states measured "economic activity" by the dollar value of sales, the number of sales, or both. Retailers challenged these economic nexus rules all the way to the United States Supreme Court. In *South Dakota v. Wayfair*, the Supreme Court held that states may rely on a company's economic activity, rather than mere physical presence, in the state to establish the necessary nexus for taxation.[35] After the *Wayfair* decision in 2018, corporate revenue or transactions with customers in a state may now satisfy the requisite nexus. Ohio subsequently repealed its cookie- and click-through-nexus standards, and adopted an economic activity nexus regime.[36]

Wayfair, however, does not indicate the appropriate revenue or transactions thresholds for states to use when imposing taxes. Thus, Ohio, for example, simply copied South Dakota's relatively low sales tax threshold even though Ohio's population and economy are 13 times larger than South Dakota's.[37] By following South Dakota's lead after *Wayfair*, Ohio has exacerbated some of the worst aspects and complexities of its commercial activity tax.

First, because the CAT applies to business-to-business transactions, both out-of-state and Ohio-based companies will pass the CAT costs onto firms that buy raw materials and intermediate goods from any businesses that have a relationship with an Ohio-based business, layering on more costs and passing them onto consumers.

---

[34] Gail Cole, **Ohio may adopt economic nexus, eliminate click-through nexus and cookie nexus**, avalara.com, July 11, 2019; and Alex Ebert, **Retail Group Drops Ohio 'Cookie' Sales Tax Suit, For Now**, news.bloombergtax.com, December 19, 2018.
[35] ***South Dakota v. Wayfair, Inc.*** 585 U.S. __ (2018).
[36] Jared Walczak and Janelle Cammenga, ***Fiscal Fact No. 680: State Sales Taxes in the Post-Wayfair Era***, Tax Foundation, December 12, 2019.
[37] **GDP by State**, BEA.gov (Last visited March 30, 2020); and **2018 National and State Population Estimates**, Census.gov (Last visited March 30, 2020); ***Sales and Use Tax Guide***, South Dakota Department of Revenue, July, 2019; and ***Substantial Nexus and Marketplace Facilitator Changes***, Ohio Department of Taxation, July 23, 2019.

Second, the Ohio Department of Taxation's guidance on the CAT set gross receipts thresholds for establishing an Ohio nexus lower than those for remote sellers who must remit the sales tax in some cases.[38] That is, even though the CAT is similar to the sales tax in many ways, it can kick in at a lower revenue threshold than is typically used in sales tax calculations from an out-of-state retail business to a customer in Ohio. This can result in tax pyramiding if, for example, a small, out-of-state distributor selling to a business in Ohio is subject to the CAT and the Ohio-based business must then remit the state's sales tax, too. Consumers ultimately bear the cost of such pyramiding in the form of higher prices relative to a well-designed sales tax, as discussed above. And some out-of-state businesses with especially thin profit margins may conclude that expanding into Ohio is not worth the tax risk.

Third, other CAT law provisions indicate that smaller businesses or businesses that want to market products heavily in Ohio may face a large tax bill for making "too many" sales to Ohioans. And accurately predicting how many sales a firm expects to make in Ohio in a given year may prove too difficult for smaller firms to bear. Consider a small business in Indiana (which does not collect a gross receipts tax) that makes 75 percent of its sales to residents of Washington State (which collects a gross receipts tax) and 25 percent of its sales in Ohio. The Indiana business would be subject to Ohio's CAT and Washington's gross receipts tax. But the difficulty, relative complexity, and inherent uncertainty of predicting what percentage of sales will go to which state will likely deter some firms from selling their goods in Ohio in the first place.

Ohio's nexus threshold rules risk making it more profitable for a business in Kentucky to sell to customers across the country than to neighboring customers just across the Ohio River. Those same rules may discourage small Pennsylvania businesses from hiring an Ohio-based worker because such a hire would subject the business to Ohio's CAT—even if it never makes a sale in Ohio.

[38] Ohio established five conditions for establishing whether a business has a sufficient economic nexus in the state, called a "bright-line presence", and is thus subject to the CAT. If a business or individual is "domiciled" (*i.e.*, resides in) in Ohio, it must comply with the CAT. The gross receipts threshold is $500,000 but a business will also be subject to the CAT if does any of the following: 1) Owns $50,000 worth of property in Ohio, 2) Has payroll in the state of $50,000 or more, or, most troubling of all, 3) "Has at any time during the calendar year within this state at least 25 percent of the person's total property, total payroll, or total gross receipts."[38] The department of taxation goes on to explain that "if a person had $25,000 worth of property in Ohio and the value of its total property everywhere was $100,000 or less, bright-line presence would still exist, despite R.C. 5751.01(I)(1)." See ***CAT 2005-02 – Commercial Activity Tax: Nexus Standards – September, 2005; May, 2011; November, 2019***, Ohio Department of Taxation, November, 2019.

After *Wayfair*, Ohio should at least simplify the CAT nexus policies to include only "economic activity" and abandon other, more complicated nexus rules that discourage companies from doing business with Ohio. A better solution would eliminate the state's CAT altogether and encourage economic growth and investment.

Suspending the CAT Will Help Ohio's Economy

Not only do high corporate taxes harm the economy—leaving more workers without jobs or opportunities to earn a living—but in an economic downturn, taxes on businesses can prolong economic hardship and make it difficult for businesses to operate. As noted, the CAT can be particularly damaging since it taxes total sales and not profits, sending even unprofitable companies a potentially large tax bill in times of economic distress.[39]

A burdensome and complex nexus policy only compounds corporate taxation's economic damage. After reviewing economic studies of the adverse effects of gross receipts taxes, we consulted with contributors to the Tax Foundation's *State Business Tax Climate Index* and the Fraser Institute's EFNA index to estimate Ohio's potential new economic rankings under a CAT-free regime.[40] Currently, Ohio ranks 37th in the EFNA rankings and 38th in the Tax Foundation's index. Ohio also rates a dismal 42nd in the Tax Foundation's corporate tax ranking,[41] and 40th in the EFNA tax revenue sub-index. In the EFNA Report, Ohio is 31st in the nation when looking at state and local tax policy.

Eliminating the CAT would dramatically affect the state's corporate tax policy ranking by the Tax Foundation, raising Ohio from 42nd into 1st place in the *State Business Climate Index* because Ohio would no longer have a corporate tax of any kind.[42] Such a dramatic improvement suggests that the CAT's complexities and burdens weigh heavily on Ohio's economy. Relieving these burdens will allow

---

[39] Rea S. Hederman Jr., ***Policy Solutions for the Pandemic: Suspending the CAT Will Help Ohio's Economy***, The Buckeye Institute, May 28, 2020.

[40] We appreciate Dean Stansel, Ph.D., of Southern Methodist University for his analysis on the impact of eliminating the CAT on Ohio's ranking in the EFNA index and Ulrik Boesen and Jared Walczak of the Tax Foundation for their input on the impact of eliminating the CAT on Ohio's ranking in the *State Business Climate Index*.

[41] Jared Walczak, ***2020 State Business Tax Climate Index***, Tax Foundation, October 22, 2019; Dean Stansel, Jose Torra, and Fred McMahon, ***Economic Freedom of North America 2019***, Fraser Institute, November 7, 2019.

[42] Although we propose paying for eliminating the CAT with a government spending cut, a broader tax reform effort that paid for getting rid of the CAT with tax base broadening or rate changes in other taxes would shift Ohio's overall ranking in the index in different ways, depending on the other policy prescription. Therefore, although the corporate tax ranking change is significant, other tax changes to pay for the corporate tax ranking improvement could raise or lower Ohio's ranking in the overall index.

companies to invest in their workers' compensation, improve productivity, and create better products and services for customers and clients. And ranking first on the Tax Foundation's state corporate tax policy list would bolster Ohio's long-term economic growth by making the state more attractive to capital investment.

Ending Ohio's CAT would also positively affect Ohio's ranking in the EFNA index's government spending and tax metrics. According to the Ohio Department of Taxation's figures for Fiscal Year 2018, eliminating the CAT would remove $1.76 billion from Ohio's tax revenues, [43] which would improve Ohio's EFNA tax revenue sub-index ranking by six places, from 40th to 34th in the country, and raise Ohio's tax ranking three spots to 28th ("Area 2" in the subnational category under EFNA's methodology).

The CAT's $1.76 billion in revenue represents less than seven percent of Ohio's total tax revenue and less than three percent of the state's total budget. [44] These relatively small percentages explain the modest ranking improvements gained by eliminating the CAT in EFNA's rankings. But alleviating the tax and administrative burdens of compliance will free-up resources for companies that do business in Ohio, allowing them to reinvest in workers and capital purchases, two important drivers of economic growth.[45] Such a solution would increase business and job growth while having only a *de minimis* effect on government operations and revenues.[46]

[43] ***Annual Report: Fiscal Year 2018***, Ohio Department of Taxation, 2018.
[44] ***Annual Report: Fiscal Year 2018***, Ohio Department of Taxation, 2018; and **2019 Am.Sub.H.B. 166**.
[45] Garrett Watson, ***Fiscal Fact No. 634: Resisting the Allure of Gross Receipts Taxes: An Assessment of Their Costs and Consequences***, Tax Foundation, February 6, 2019.
[46] Nicole Kaeding, ***Oregon's Gross Receipts Tax Proposal Would Hurt Job Creation***, Tax Foundation, July 19, 2016.

Conclusion

Ohio's CAT and the state's poorly constructed nexus law harms economic growth by syphoning much-needed capital from businesses (even unprofitable businesses), artificially raising the costs of production and consumption, and discouraging new firms from hiring Ohioans or doing any business in the state. Nationally-recognized tax-policy rankings bear this out, showing that Ohio's corporate tax regime compares unfavorably to other states' pro-growth policies. Eliminating the CAT—a failed tax that almost all other states have abandoned—would have a modest effect on Ohio's revenues and government operations, but will dramatically improve economic growth by freeing up corporate resources spent on administrative compliance for more productive capital investments and workforce growth.

Two prominent tax-policy indices that measure economic freedom currently rate Ohio among the bottom tier of states due in large part to the CAT. Repealing the state's commercial activity tax will improve Ohio's ranking in the EFNA report and the Tax Foundation's *State Business Tax Climate Index*. The CAT's complexity and economic distortions restrict Ohio's measurable economic freedom, and relieving those burdens will raise Ohio from 40th to 34th in the EFNA's sales and gross receipts taxes index and from 42nd to 1st place in the Tax Foundation's corporate tax rankings. Such improvements demonstrate that reducing corporate tax burdens can create a stronger economy with rising job growth and burgeoning business activity. As Ohio companies and their employees struggle to survive and recover from the economic effects of the novel coronavirus, state policymakers should help them by eliminating an outmoded, anti-growth tax policy that only exacerbates the current economic downturn.

About the Authors

Rea S. Hederman Jr. is the executive director of the Economic Research Center and vice president of policy at The Buckeye Institute. In this role, Hederman oversees Buckeye's research and policy output. A nationally recognized expert in healthcare policy and tax policy, Hederman has published numerous reports and papers looking at returning health care power to the states, the impact of policy changes on a state's economy, labor markets, and how to reform tax systems to spur economic growth.

Prior to joining Buckeye, Hederman was director, and a founding member of the Center for Data Analysis (CDA) at the Heritage Foundation, where he served as the organization's top "number cruncher." Under Hederman's leadership, the CDA provided state-of-the-art economic modeling, database products, and original studies.

While at Heritage, Hederman oversaw technical research on taxes, health care, income and poverty, entitlements, energy, education, and employment, among other policy and economic issues, and he was responsible for managing the foundation's legislative statistical analysis and econometric modeling.

In 2014, Hederman was admitted into the prestigious Cosmos Club as a recognition of his scholarship. He graduated from Georgetown Public Policy Institute with a Master of Public Policy degree and holds a Bachelor of Arts degree in history and foreign affairs from the University of Virginia.

Andrew J. Kidd, Ph.D. was an economist with the Economic Research Center at The Buckeye Institute. In this position, Kidd conducted and produced original economic research that looked at and analyzed the impact of state and federal policies on peoples' lives and on the economy.

James B. Woodward, Ph.D. is an economic research analyst with the Economic Research Center at The Buckeye Institute. In this position he collects economic data, performs research, and writes about economic policy issues.

Woodward has a wide range of research interests, including state budgets, tax policy, health care policy, and occupational licensing. He is the co-author of a number of reports and policy briefs outlining commonsense, free-market policies that can save taxpayers money, strengthen the economy, and limit the size of government.

Woodward's research has been instrumental in some of Buckeye's most impactful research. He was a co-author of Healthy and Working: Benefits of Work Requirements for Medicaid Recipients, which revealed that Medicaid work and community engagement requirements could increase the lifetime earnings for people who transition off of Medicaid by nearly $1 million. He was also a co-author of Sustaining Economic Growth: Tax and Budget Principles for Ohio, which outlined principles that Ohio policymakers should use to guide their decisions on the state's budget. Additionally, Woodward was a co-author of a number of papers that analyzed the economic impact of tax proposals being considered by government bodies in Iowa, Alaska, and Arizona.

Prior to joining The Buckeye Institute, Woodward earned his Master of Public Policy and his Ph.D. in public policy from the University of Kentucky. During his time there, Woodward worked for the commonwealth's Hazard Mitigation Grant program, helping to verify the quality of regional emergency preparedness plans. He also performed policy research for the Commonwealth Council on Developmental Disabilities, contributing to a paper on possible, new treatment options for those with disabilities.

A native of Athens, Ohio, Woodward earned his bachelor's degree in economics from Ohio University before going on to complete his graduate studies.

Letting the CAT Out of the Bag: How to Improve the Ohio's Economy and National Rankings

ECONOMIC RESEARCH CENTER
at THE BUCKEYE INSTITUTE
88 East Broad Street, Suite 1300
Columbus, Ohio 43215
(614) 224-4422
BuckeyeInstitute.org