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State and Local Tax Alert: House Bill 64: Sales Tax Increases Will Affect You

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The language of Governor Kasich's 2016-2017 biennial budget bill was recently released. House Bill 64 has 84,757 lines and 2,783 pages of text. Many of the details track very closely to [summaries of the bill announced during the preceding weeks](#). The proposal includes significantly reduced personal income tax rates, continued and expanded small business income tax exclusions and higher personal exemptions.

However, many business taxes would increase, including sizeable rate increases of the commercial activity tax, sales and use taxes and the severance tax. The administration has been very clear about its vision of shifting Ohio from a personal income tax state to a consumption tax state. It views the overall package as fair and balanced and one that promotes job growth and results in a net \$500 million cut in taxes.

But, the devil is in the detail, and so it is with House Bill 64 as applied to Ohio businesses. Within the bill is a yet unmeasured threat to businesses. That threat relates to the proposal to broaden the sales tax base. House Bill 64 would expand sales taxes to several categories of service transactions such as: (i) parking charges, (ii) debt collection services, (iii) repossession services, (iv) lobbying services, (v) public relations, (vi) market research services and (vii) management consulting services. These appear to be segments of services, transactions within silos.

Now that we have those definitions, the service segments and silos take on new and greatly expanded form.

Those hoping the definitions would be a light read punctuated by familiar tax terms and phrases will be disappointed. The bill introduces a new tax lexicon. It contains sales tax definitions that seem benign, but upon closer scrutiny do not favor businesses.

First, the language preceding the list of proposed taxable services provides that these services are taxable "**regardless of the profession of the provider of the service....**" Thus, we see accountants, lawyers,

engineers and any professional squarely in the tax sights of the bill. Whereas past attempts to tax services did so by enumerating them, House Bill 64 directs the tax at everyone irrespective of professional degree or designation. A specific example may be helpful to illustrate this point.

Taxable repossession services are defined as “repossessing tangible assets for a creditor as a result of delinquent debts.” Taxable debt collection services means “collecting payments for claims and remitting payments collected to clients including ... account or delinquent account collection services and tax collection services.” It seems undeniable that law firms and accounting firms providing these services to clients fall within the taxable target base. Although no one has subjected legal and accounting services to sales tax, the bill seems to be doing so piecemeal.

But, there’s more. Lobbying services are defined to mean “any activity that serves to influence the behavior or opinion of an individual, an industry, or an organization.” This is an extremely broad definition. What purpose does a lawyer have in presenting arguments to a jury or judge if it is not to influence opinion? Yet, this reasoning goes well beyond lawyers. How does this definition apply to advertising services which is a classic opinion and behavior shaping activity? Are advertising services within this broad definition? Does preparing tax returns or financial statements seek to influence behavior and opinion? Arguably, they do.

Let’s try analyzing an easier service definition. “Parking of a motor vehicle” is proposed as a taxable service. But, the bill also eliminates the sales tax exemption for services provided by political subdivisions. Will fees charged by municipalities at parking meters be subject to sales tax? What seems easily deciphered is not.

The proposed sales tax base expansion that carries the most significant perils for business is management consulting services. The term is defined as “any activity that provides advice and assistance to businesses on business issues.” WOW! Read that again.

On its face, every business that purchases any services from accounting to legal, from real estate management to warehouse logistics, from engineering to software development, from advertising to quality control will be subject to sales tax. Will dues paid to trade associations for services qualify? Perhaps those also would be lobbying services. Service providers will be required to add sales tax to invoices, collect it and remit it to the state. Even services expressly excluded from definitions in other subsections of the code become taxable as management consulting services. **All services purchased by a business are in sales tax jeopardy.** As an added zinger, there is no affiliated group exemption making services rendered between related business entities taxable.

Based on these definitions, Ohio businesses should identify their annual spend on services, multiply the total by 8% and be prepared to pay that additional amount in annual sales tax. This is a huge amount of tax. It represents a significant shift in the consumption tax burden to businesses. Moreover, the attending costs and risks of sourcing the benefit of services will add complexity to compliance.

For example, will marketing advice prepared and communicated to an Ohio based business at the service provider’s offices in Manhattan be subject to Ohio use tax because they constitute management consulting services the benefit of which is used in Ohio? Will Ohio businesses constantly be the target of Ohio sales and use tax audits for services rendered outside Ohio because it always seems arguable that service benefits are received at the customer location regardless of where they are performed?

The Department of Taxation will be tasked with enforcing these new taxes and business will seek to avoid them. This exercise of cat and mouse will make its way into audit roulette giving tax professionals full employment but adding tax risk to businesses.

How will these new taxes affect the competitiveness of Ohio companies? The addition of an 8% sales tax could drive significant portions of the service industry to other states. Those service providers could avoid sales tax on services rendered to non-Ohio customers at new locations outside Ohio because the services neither would be rendered in nor would the benefit be received in Ohio. But, if the same services are performed at an Ohio office for a non-Ohio customer, those services might be subject to Ohio sales tax.

Imposing sales tax on services has never been easy. There are many unknown risks which businesses naturally resist because the financial costs can be heavy. In House Bill 64, the administration may be attempting too much in taxing virtually all business services. But, this attempt is not unprecedented. It was proposed in the last state budget and defeated by the legislature.

If this broadbased tax increase on Ohio businesses was not intended, then significant refinement and clarification of the definitions is essential. At the very least, the breadth of the proposed tax language should serve to initiate dialogue and force the best arguments to surface. This may be administration's goal.

Irrespective of the intent, the language and the tax details are now known. Which side of the discussion will your business take? House Bill 64 increases the CAT rate by nearly 25%, it increases the state sales and use tax rates by nearly 10% and it arguably broadens the sales tax base to include nearly every service that businesses buy and sell.

A more accurate question may be which side of the discussion can your business afford to take?

The state and local tax professionals at Vorys stand in support of open dialogue and discussion. If your business needs to understand the proposed tax changes better, call us. We know tax. We can help.