



## **Ohio Supreme Court upholds Commercial Activity Tax, but revenues still fall short of meeting state's needs**

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In a major tax law case decided today (*Ohio Grocers Association v. Levin*), the Ohio Supreme Court upheld the constitutionality of the state Commercial Activity Tax (CAT), a new tax that began in 2005. The ruling will preserve approximately \$188 million dollars in revenue this year and means the state will not have to repay more than \$355 million of previous years' tax collections. It removes one of many threats to the revenue stream in the new state biennial budget and may help to postpone the need for budget reductions this calendar year. The CAT is expected to bring in approximately \$1.4 billion per year over the next two years.

Even with this favorable decision, CAT collections still do not match revenue levels of the two taxes it replaced: the state corporate franchise tax, and the local tangible personal property tax. Replacing the local tangible personal property tax alone would require nearly \$1.7 billion per year. Other programs have been cut for the state to maintain its commitments to reimburse schools and local governments for their losses. The current budget cuts approximately \$2 billion from state general fund spending levels of 2008, with social services taking the hardest hits just at a time when they are most needed. Now that a major challenge to the tax has been removed, policymakers should take this opportunity to increase revenues from the CAT to a level that fully reimburses schools and local governments for their losses and still generates enough for vital state programs such as education, Medicaid, emergency assistance to financially struggling families, and mental health services.

The challenge by Ohio Grocers' Association alleged that the CAT violated the Ohio constitution's prohibition against applying an excise tax, such as the sales tax, to food consumed off the premises. The Grocers argued that the CAT, which is applied to a business' gross receipts, is an illegal excise tax on the sale of food at their stores. The state argued that the CAT is a tax on the privilege of doing business in Ohio, and not an

excise tax. The court agreed with the state and found that the state has options in how to measure the value of a business franchise tax:

As we have explained, our decisions have made clear that a tax “measured by” some factor is not the same as a tax “upon” that factor. Those decisions further undermine the Grocers’ expansive reading. In short, Sections 3(C) and 13 do not prohibit a privilege-of-doing-business tax on food sellers, even if that privilege is measured by gross receipts that include proceeds from the sale of food.” (*Ohio Grocers v. Levin*, Slip Opinion No. 2009-Ohio-4872, para. 23, p. 9).

This ruling would seem to increase the chance of the state prevailing in a lawsuit by petroleum distributors that alleged that CAT proceeds derived from the sale of motor fuel must be devoted to the transportation budget. Even so, the administration and legislature are not in the clear in terms of pending legal actions. A separate case, recently appealed to the Supreme Court, challenges the legality of using \$258 million in tobacco settlement funds for Medicaid and other state programs. Another case, which the state lost, requires the government to pay interest to recipients of unclaimed funds held in trust by the Ohio Department of Commerce. The schedule of payments is yet to be worked out, but the budget relies on \$385 million in unclaimed funds during the biennium in order to balance.

The foundations of the budget remain shaky, and Ohio faces an even steeper revenue cliff in two years when the federal stimulus funds run out. Policymakers’ gamble on getting \$933 million from slot machines looks more like a long shot every day, as seven of the nine racetracks missed the deadline for the initial payment of license fees. The state has better options than relying on gambling. Increasing the CAT should be part of a larger tax reform package. After five straight years of income tax cuts, it’s high time to consider income tax increases on the wealthy and closing the numerous loopholes and credits in the tax code.