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Study: Nationwide, average sales tax hit all-time highs

BOB PASCHEN
Daily Reporter Staff Writer
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The average sales tax charged by states, counties, cities and districts in 2003 reached an all time high, resulting in the largest overall sales tax increase in more than 10 years, according to a report released by Berwyn, Pa.-based tax tech company Vertex Inc.

The combined average tax rate, calculated by adding state, county and city/district sales taxes rose to 8.53 percent, the biggest single year increase since 1992.

Over the past two years, the combined average tax rate rose 26 percent. During the previous 10 years, from 1992 to 2001, the combined average increased a cumulative 29 percent.

The state average rate calculated by Vertex clocked in at 5.32 percent, with the county average rate at 1.63 percent, and the city and district average rate at 1.76 percent.

Ohio was among four states, including Vermont, New York and Idaho, that raised state-level sales taxes in 2003. Approximately, 8,019 state, county and city jurisdictions in the U.S. charge a sales tax.

In 2003, there were 954 rate changes nationwide, 412 were increases, 66 were reductions, 206 were new rates. But 270 of these changes occurred in Kansas.

In an effort to "streamline" its tax collections, Kansas amended the taxable point of sale from where goods are sold (origin), to where they are delivered (destination). These changes were made primarily to collect taxes on Internet and catalog purchases.

Gary Gudmundson, spokesman for the Ohio Department of Taxation said similar measures take effect in Ohio beginning in January 2005.

Each year since Vertex began collecting data in 1981, sales taxes gradually have increased, with the exception of 1999 when the combined average rate dropped a small two-hundredths of a percent.

In 1981, state average tax rates were 4.10 percent (5.32 percent in 2003). County rates in 1981 were 1.15 percent (1.632 percent), city/district rates were 1.26 percent (1.576 percent), with the combined average rate in 1981 at 6.52 percent (8.53 percent).

Sales tax increases were enacted in 2003 primarily to plug holes in state budgets around the country.

"State and local jurisdictions that are grappling with budget deficits and a struggling economy are adding sales taxes or increasing their rates to recoup lost revenue," said Diana DiBello, Vertex director of tax who oversaw the study.

Because of Ohio's one cent sales tax increase, and through expanding the sales tax base to include such formerly untaxed items as dry cleaning, massages, tattooing, mini-storage, satellite broadcasting and snow removal, the Ohio Department of Taxation estimates it will collect an additional \$1.24 billion a year in revenue for fiscal year 2004, with \$61.9 million coming from the expansion. By fiscal year 2005, that figure rises to \$1.32 billion, with \$71.8 million coming from tax base expansion.

In fiscal 2003, the state collected \$6.4 billion in sales and use taxes.

In addition to the one cent, statewide sales tax increase, seven counties in Ohio raised their sales tax rate in the 12 months between January 2003 and January 2004, according to ODT.

Gudmundson said that since the introduction of the personal Ohio income tax in 1972, though, state sales tax has remained relatively flat as a percentage of overall revenue.

In 1972, sales tax generated 47.3 percent of state revenue. In 1977, after income tax kicked in, that number dropped to 39.6 percent. In 1992, sales tax accounted for 38 percent; in 1997, it was 38.5 percent, and by 2002, it was 39 percent.

But one of the factors that has allowed state sales tax to remain constant for more than 15 years is a steady increase, or reliance on, the state personal income tax.

At its inception in the early 1970s, Ohio personal income tax generated about 7 percent of overall state revenue, according to a report issued by the Committee to Study State and Local Taxes. By 2002, personal income tax accounted for 47.2 percent of state revenue.

"Personal income tax has gone way up," Gudmundson said. "That's a point the previous Tax Commission made all along."

While individuals shoulder a growing percentage of the Ohio tax burden, corporate franchise tax revenues have dwindled.

The CSSLT reported that in 1972, the year the state income tax went into effect, corporate taxes made up 16.3 percent of Ohio's general revenue fund. By 2002, that number dropped to 4.2 percent.

In 1993, corporation franchise taxes brought in \$854 million, while individual income tax netted \$4.7 billion. A decade later, in 2003, corporation franchise taxes accounted for \$808 million in state revenue, while personal income tax brought in \$8.26 billion.

One reason for this continuing tidal shift, Gudmundson said, was that some business owners reported company revenue as personal income tax. The corporate tax level tops out at 8.5 percent, while the maximum personal income tax is 7.5 percent.

"Corporations can plan around the tax," Gudmundson said. "They can shift revenue to out-of-state subsidiaries. 'Tax planning' is a neutral term used (for skirting corporate taxes). Others would say it was tax avoidance." But, by any name, the practice is "perfectly legal."

With pro-business groups such as the National Federation of Independent Businesses and the Small Business Survival Committee claiming that Ohio's tax system remains unfriendly to businesses, the pressure on legislators to keep corporate taxes low will likely remain. In an effort to add to its tax revenues, Ohio has opted to join states such as Kansas and change the "sourcing" for sales tax.

According to federal law, businesses that do not have a physical presence - be it storefront, warehouse or service center - in a state are not required to charge any sales tax.

What has turned this tax provision into a huge tax loophole has been the Internet.

E-commerce has made storefronts unnecessary, and state governments that are facing diminished tax revenues, soaring health care costs and an aging population salivate at the revenue potential taxes on Web and catalog purchases would dump in leaky state coffers.

State governments are so unified and aligned on this issue that, as Vertex reported in its sales tax study, nearly 42 states are on board to enact "sourcing" or "streamlined" changes to their tax collections.

Gudmundson said the idea was to have such large support nationally that states would petition the federal government en masse to change the law and require out-of-state merchants to collect taxes.

Ohio's General Assembly approved the measure, which was set to go into effect in January 2004. But Gudmundson said enough vendors got wind of the changes, they convinced legislators to enact a one-year delay. In its 2003, annual report, ODT estimated that closing this loophole would generate (in 2003 dollars) about \$500 million a year.

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