

## Testimony to Subcommittee of the House Ways & Means Committee on HB 59 sales-tax plan

Zach Schiller

Good morning, Chairman McClain and members of the committee. My name is Zach Schiller and I am the research director at Policy Matters Ohio, a nonprofit, nonpartisan organization with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify today regarding House Bill 59.

The governor's proposal to broaden the sales tax while lowering the rate is good tax policy—if it is accompanied by measures to reduce the effect this increase in taxes will have on low- and moderate-income Ohioans, and unnecessary restrictions on counties and transit agencies are removed. However, the proceeds of these changes should not be used to lower the income tax or exclude business income from that tax.

Despite the addition of dozens of services to the Ohio sales-tax base over the years, the tax does not cover the same share of the economy as it did back in the 1970s. One rough measure of this is the size of the sales-tax base, adjusted for changes in the rate, compared to personal income in the state. By that measure, the sales tax covered about 34 percent of personal income last fiscal year, compared to well over 40 percent in 1977. Some of this erosion is a result of Internet sales and legislation that excluded certain purchases from the sales tax. However, it is clear that the Ohio sales tax covers a narrow and declining share of the state's economy.

Ohio needs more revenue, not less. This is evident from both from the cuts in services we have seen with the reductions in aid to schools and local governments, and in the investments that Ohio needs to make in its future. The additional revenue from the sales-tax changes in HB 59 should not be given away in income-tax cuts. Such cuts would go mostly to affluent Ohioans, adding to inequality, and our experience shows that they do not produce significant economic growth.

Broadening the sales tax to cover more services will even out the current bias goods receive over services. This is also good tax policy; there is no reason one type of purchase should be favored over another.

However, as demonstrated in a report Policy Matters Ohio released last month, the application of the sales tax to services, even with the rate cut, will fall more heavily on low- and moderate-income Ohioans than on upper-income taxpayers. The Institute on Taxation and Economic Policy, which has a sophisticated model of state and local tax systems, found that on average, the fifth of taxpayers who made less than \$18,000 in 2012 will pay an additional \$71 a year in sales tax under the governor's proposal. While that's much less than the \$781 a year that will be paid

on average by the top 1 percent of Ohio taxpayers who made more than \$335,000 last year, it accounts for a greater share of low-income Ohioans' income. Though many of the services to be taxed for the first time are consumed especially by upper-income Ohioans, overall, lower- and middle-income taxpayers will feel a greater impact. ITEP's model takes into account the services consumed by members of different income groups, and those services that are not to be taxed under the governor's proposal.

Lower- and middle-income Ohioans already pay more of their income in state and local taxes than upper-income Ohioans do. While broadening the sales tax is a smart idea, it needs to be accompanied by measures to reduce or eliminate the impact on low- and moderate-income Ohioans.

Two different and complementary measures should be adopted. Twenty two states now have their own refundable Earned Income Tax Credits, which piggyback off the federal credit. More than 900,000 Ohioans receive the federal EITC, which encourages work, helps children succeed, historically has received bipartisan support and is spent in the local economy. A state EITC is worthwhile in its own right, but would be especially important in offsetting the impact of a broadening in the sales tax.

In addition, Ohio should adopt a sales-tax credit, which would provide a flat amount for each member of a family below an income threshold. For instance, New Mexico's credit provides between \$10 and \$450 a year to residents with income under \$22,000. Ohio can fashion its own such credit. Between this and an EITC, most low- and moderate-income Ohioans could be protected from the tax increases they will otherwise see from the sales-tax base broadening. Strong outreach efforts should be planned to make sure eligible people apply for each of these credits.

The governor's sales-tax proposal falls short in another area as well: Its treatment of county and transit-agency sales taxes. As currently structured, it complicates the tax system. Local tax rates, set at odd levels based on state calculations, will fluctuate year to year. Worst of all, counties and transit agencies will have their hands tied should they find themselves in a financial bind by the three-year prohibition on rate increases. This would keep voters from making their own decisions at the local level about how to govern their communities. Counties and transit agencies should not be limited from participating fully in broadening of the sales-tax base.

If the sales tax is broadened, many vendors will be collecting the tax for the first time. The taxation department will need to educate them, process the additional returns, and expand its auditing effort. This will require more staff and resources.

Broadening the sales tax, if accompanied by the steps I have outlined, would produce a more viable long-term source of funding for the public services that we need. Ensuring that the tax applies also to digital goods and services, such as books and movies, is a positive step. However, the bill leaves all but one of the 57 existing sales-tax exemptions intact. House Bill 59 should include a mechanism to review these and other tax expenditures, including a sunset provision so that their value will need to be shown in order for them to continue.

Ohio, like other states, also needs to be able to collect more effectively the taxes that are due on purchases made from Internet and catalog retailers. Currently, we are restricted by Supreme Court decision from requiring such retailers to collect those taxes. Our congressional representatives should be urged to support the Marketplace Fairness Act of 2013, HR 684/S 336, which would correct that and compel such retailers to collect tax at the time of the transaction, as other retailers do.

Thank you for allowing me to testify on the sales-tax component of HB 59. I am happy to answer any questions that members of the committee may have.

*Policy Matters Ohio is a nonprofit, non-partisan research institute  
with offices in Cleveland and Columbus.*