Policy Matters Ohio

Executive Summary
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Income-Tax Repeal: A Bad Deal for Ohio

Swap for sales tax would sting most taxpayers

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Eliminating the Ohio income tax would blow an enormous hole in the state budget, one that would have to be paid for with gigantic budget cuts or major increases in other taxes. Paying for even just half of it with a sales-tax increase – which is how the General Assembly paid for a significant share of last year's income-tax cuts – would mean higher overall taxes for low- and moderate-income Ohioans, according to a new analysis by the Institute on Taxation and Economic Policy.

Key findings

- Repealing Ohio's income tax and making up half the cut with a sales-tax hike would slice $33,576 off the average tax bill of the top 1 percent of taxpayers.
- Under this scenario, the bottom fifth would end up paying $145 more a year than last year.
- Fully replacing the income tax with a higher state sales tax would mean boosting the sales tax to 10.7 percent.

ITEP, a nonprofit research group based in Washington, D.C., with a sophisticated model of the state and local tax system, found that fully replacing the income tax with a higher sales tax would mean that the lowest-earning 80 percent of Ohioans would, as a group, see a tax hike. It would also mean boosting the state sales tax by nearly 5 percentage points, to 10.7 percent.

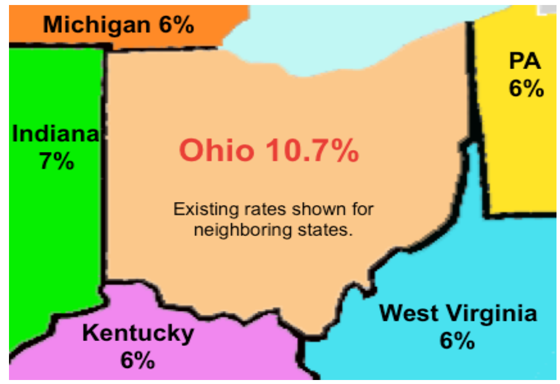
Gov. John Kasich has made clear his interest in repealing Ohio's income tax. Last year, a 10 percent cut in income-tax rates over three years approved by the General Assembly was accompanied by a quarter-penny increase in the sales tax. At the request of Policy Matters Ohio, ITEP analyzed the effects of repealing the income tax, which generates almost 40 percent of state tax revenue – more than $8 billion a year – and swapping the sales tax for all or part of the lost revenue.

ITEP found that if just half of an income-tax repeal was swapped for a higher sales tax, the poorest fifth of Ohio taxpayers, who made less than $19,000 last year, would pay an additional $145 a year. By contrast, the top 1 percent, who made at least $360,000, would receive an annual tax cut of $33,576, or enough to purchase a top-end 2014 Mazda MX-5 Miata Grand Touring Convertible every year. As a group, the bottom 40 percent of Ohioans would pay more in taxes than they did last year.

If half of the revenue loss from income-tax repeal were made up with sales tax hikes, ITEP calculated, the state sales tax would have to be increased by nearly 2.5 percentage points, pushing the state-only sales tax to 8.2 percent. Since local sales tax averages about 1.28 percent across the state, Ohioans would pay a combined sales tax rate averaging close to 9.5 percent.

If all of the income tax cut were paid for by increases in the state sales tax, ITEP found, the lowest-earning 80 percent of Ohioans would, as a group, see a tax hike. The middle fifth of taxpayers, who made between $34,000 and $54,000 last year, would see an average increase of $354 a year, yet the top 1 percent would see average a cut worth more than $31,000. The state sales tax would need to rise by nearly 5 percentage points, to 10.7 percent, to finance repeal of the income tax. That would be the highest state rate in the country, far higher than the 6 percent state sales-tax rates in most neighboring states. It would push the average combined state-and-local rate to about 12 percent.

Estimated statewide sales tax if boosted to replace Ohio's income tax



Source: Ohio estimate by ITEP; other rates from Federation of Tax Administrators.

As part of its analysis, ITEP reviewed what repeal of the income tax alone would mean for Ohio taxpayers in different income groups, prior to the inevitable steps that would have to be taken to pay for resulting revenue reduction. The top 1 percent of Ohio taxpayers on average would see an annual tax cut of $36,135. The middle fifth of Ohio taxpayers would see a reduction of $668, while those in the bottom fifth would see just a $27 average annual tax cut.

The top 1 percent on average would receive 54 times as much as middle-income taxpayers would get. A quarter of the tax cut would go to the top 1 percent, and 70 percent to the top 20 percent. The lowest-earning 60 percent of Ohio taxpayers would get just 12 percent of the total tax reduction. ITEP's calculations are based on 2013 income levels and tax rates, so they reflect what Ohio taxpayers would have paid in the tax season that just ended had the tax been repealed.

Nearly one dollar in every six of an income-tax repeal would not stay in the state but would go to pay higher federal taxes on Ohio residents, because Ohio taxpayers would not be able to deduct as much state tax on their U.S. returns. This is considerably more than the entire tax cut that would be received by the lowest-earning 60 percent of Ohio taxpayers.

Ohio's tax system already is weighted in favor of upper-income taxpayers, who pay a much smaller share of their income in state and local taxes than lower-income taxpayers do. Repealing the income tax would have little impact on the overall taxes paid by the poorest Ohioans. Moreover, most of the tax cuts that middle-income Ohioans would see from income-tax repeal would be wiped out if the sales tax were used to replace just half of the lost revenue from such a repeal. And that would still require billions of dollars in annual cuts to public services.

The income tax is the only state tax that is based on ability to pay. Slashing it without making up most of the revenue is a prescription for financial disaster, or huge cuts in public services. Yet making up the revenue with other taxes would shift who pays taxes from the affluent to everybody else. It's no coincidence that five of the six states with the most regressive tax system lack a general personal income tax. Wiping out the income tax would be a bad deal for Ohio.