Policy Matters Ohio

Executive Summary
May 2014

Flawed Tax Cuts in Senate Budget Bill

FY2015 reductions divert funds, flow mostly to the affluent

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Key findings

- A Senate budget bill will cost more than $400 million in fiscal year 2015, diverting funds needed for public services.
- Half of the one-year tax cut will go to the top 5 percent of Ohio earners.
- A business-income deduction would be expanded though there is no evidence it has increased Ohio jobs.
- An increase in the Earned Income Tax Credit, while beneficial, does little for the poorest Ohioans because it remains nonrefundable.

A state budget bill approved by the Ohio Senate last week includes substantial new tax cuts, adding up to more than $400 million in fiscal year 2015. While the biggest part of that reduction is limited to one year only, it diverts significant funds from needed public services. At the same time, a new analysis shows that half of the one-year tax cut will go to the top 5 percent of Ohioans. The top 1 percent will get a tax cut for the year averaging $1,846, while the poorest fifth of Ohioans will see just a $4 reduction.

The tax changes in the Senate version of House Bill 483 include two permanent provisions aimed at lower- and middle-income Ohioans, an expansion of the state Earned Income Tax Credit (EITC) and increases in personal exemptions to the state income tax for those earning up to $80,000 a year. However, as an analysis by the nonprofit research group Institute on Taxation and Economic Policy (ITEP) reveals, these provide only very modest savings for middle-income Ohioans and almost nothing for the poorest Ohioans. For it to deliver meaningful benefits to those at the bottom of the income scale, who need it most, the state EITC needs to be refundable, so filers get a refund if the credit exceeds income-tax liability. The Senate bill keeps the credit nonrefundable.

The Senate bill would:

- Accelerate the last piece of an across-the-board, 10 percent income-tax cut approved last year, so that the final 1 percent reduction scheduled to take place in calendar 2015 instead would take place this year;
- Expand a deduction for business income from the state income tax, which covers the owner's share of profits from sole proprietorships, limited liability companies, and other entities. The bill would increase the share of such business income that could be deducted from 50 percent to 75 percent, while also raising the cap on the amount of income that could be shielded from tax from $125,000 to $187,500;
- Increase personal exemptions under the income tax. Taxpayers with Ohio adjusted gross income of $40,000 or less would see their exemptions increase from $1,700 to $2,200 starting in tax year 2014; those with income over $40,000 but less than or equal to $80,000 would see an increase to $1,950; and

- Boost Ohio's state Earned Income Tax Credit (EITC), first approved last year, to 10 percent of the federal credit from the current 5 percent.

Both the Legislative Service Commission and the Kasich administration have estimated the one-year total cost of these changes at more than $400 million. By far the largest of them, accounting for more than half the total, is the expansion in the business-income tax break, which was first approved last year. It isn't certain yet whether this existing tax break will cost the half-billion dollars that was originally estimated, but another thing about it is clear: There has been no surge in Ohio jobs since the tax break was created last June. Ohio employment since then has grown more slowly than in the nation as a whole, and more slowly than in the period prior to approval of the measure. It is no surprise that the new tax break hasn't led to a job surge, since the vast majority of those who are able to take advantage of this deduction do not employ anyone, and the average credit claimed so far has been $731.

The ITEP analysis of the tax provisions found that altogether, 31 percent of the total tax cut covering 2014 income will go to the top 1 percent of Ohio taxpayers, and half will go to the top 5 percent, those who made at least $151,000 last year. Speeding up the across-the-board rate cut and expanding the business-income deduction will accrue mostly to the advantage of Ohio's affluent; half of the bigger business-income tax break will go to the top 1 percent, while the bottom four-fifths of taxpayers will get only 8 percent of it. By contrast, the combined effect of boosting the nonrefundable EITC and increasing personal exemptions for those with income up to $80,000 is extremely modest. Middle-income taxpayers on average will see a $24 cut in taxes, while those in the bottom fifth will average a cut of just $4.

Increasing the EITC, which encourages work and brings greater fairness to the tax code, is a small step toward making the credit count for working Ohioans. But more is needed to truly fix Ohio's credit. Under the Senate bill, the EITC would still be nonrefundable and capped, so that those who make more than $20,000 in Ohio Taxable Income can only receive a credit that is half of their tax bill. Under the bill, taxpayers in the middle fifth of earners would see a modest average tax savings of $7 a year ($58 among those in that group who qualify for a credit). The poorest Ohioans would see almost no benefit; the increase in the tax credit would be so small that it would round to no change in the average tax. Only 1 percent of the total increase in the credit would go to the fifth of Ohioans who made less than $19,000 last year, and even among the small number who benefit, the average increase in their credit would be just $6 a year.

In comparison, a refundable EITC provides much larger benefits, and targets them toward low-income workers. A 10 percent refundable EITC, with no cap, would provide an average of $61 a year on average to Ohioans who earned less than $19,000 last year. Fully 44 percent of the credit would go to this group, and among those in the group who qualified, they would see an average of $186 a year. While increasing the EITC is a positive step, it needs to be made refundable to provide real benefits to the poorest Ohioans.

The Senate tax changes, adopted without public input, will siphon more than $400 million next fiscal year into tax cuts. Most of this will go to affluent Ohioans. Instead of more tax cuts like the expanded business-income tax break, we should restore and boost funding to local governments, education and health and human services. This approach would improve communities, build opportunities for children and create the needed infrastructure for businesses.