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The Great Ohio Tax Shift

Changes since 2005 widen inequality

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Major changes in Ohio's tax system over the past nine years have slashed average annual tax bills for the state's most affluent 1 percent of taxpayers by more than $20,000, while the bottom three-fifths of state taxpayers as a group are seeing an overall increase.

Key findings

- Ohio's top 1 percent are getting an average tax cut of $20,000 a year because of major tax changes since 2005
- The bottom 60 percent of Ohioans are paying more as a group
- All of the biggest tax changes since 2005 have further slanted Ohio's state and local tax system in favor of the affluent
- The $3 billion annual revenue cut has reduced resources for needed public services

That is the most significant finding of a new analysis conducted for Policy Matters Ohio by the Institute on Taxation and Economic Policy, a nonprofit research group in Washington, D.C., with a sophisticated model of the state and local tax system. ITEP examined major tax changes in Ohio since 2005, and how they affected Ohioans last year compared to what individuals and families would have paid had the pre-2005 tax system remained in place. Among the changes included in the analysis were:

- Raising the sales tax from 5.0 percent to 5.75 percent;
- The creation of the Commercial Activity Tax (CAT) in 2005;
- The repeal of the tangible personal property tax, a local tax on machinery, equipment, inventory, furniture and fixtures;
- The repeal of the corporate franchise tax, which was Ohio's corporate income tax;
- The increase in the cigarette tax from 55 cents to $1.25 a pack, and
- Reductions in the personal income tax, including the 21 percent rate reduction enacted in 2005, the 10 percent reduction approved in 2013, and the creation of a new deduction for business income approved last year.

Other, smaller changes in state taxes are also included. A data note at the end of the report describes in full what is covered in the analysis.

Table 1 shows how Ohioans in different income groups fared with the tax changes. Taken as a group, the bottom three-fifths of Ohio taxpayers, with incomes of $54,000 a year or less, are paying more in state and local taxes due to the changes. Among the higher-income groups, which are seeing lower taxes overall because of the shifts in the tax code, the benefits also are skewed. While the results for individual taxpayers vary, on average, the benefits grow as income increases.

Table 1

Impact of Ohio tax changes on different income groups, 2005 to date

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income range	**Less than $19,000**	**$19,000 - $34,000**	**$34,000 - $54,000**	**$54,000 - $82,000**	**$82,000 - $151,000**	**$151,000 - $360,000**	**$360,000 or more**
Average income	$11,000	$26,000	$44,000	$66,000	$106,000	$217,000	$1,006,000
Average tax change	+$138	+$142	+$65	-$95	-$609	-$2,919	-$20,477
Tax change as share of income	+1.2%	+0.5%	+0.1%	-0.1%	-0.6%	-1.3%	-2.0%

Source: Institute on Taxation and Economic Policy, July 2014. Covers total 2013 income and includes Ohio residents only. See Data Note at end of report on what is covered in the analysis.

It is notable that while the very wealthiest got an annual tax cut exceeding $20,000 on average, the lowest fifth of Ohioans actually had income of less than $19,000 in 2013 – and saw their taxes rise slightly, on average. Individuals and families earning in the middle of the income range - $34,000 to $54,000 – also saw a small average increase in taxes, while the wealthiest enjoyed the $20,000 windfall.

ITEP's analysis, which examined the effect on Ohio residents only, includes the impact of the 2013 creation of the state nonrefundable, capped Earned Income Tax Credit (EITC), at 5 percent of the federal credit, and the General Assembly's increase of that credit to 10 percent of the federal credit earlier this year. While the state EITC reduces the income tax for some moderate-income taxpayers,[1] it and other steps like it are overwhelmed by other measures that increased taxes especially for low- and middle-income Ohioans. Most notably, these include increases in the sales tax and the enactment of the Commercial Activity Tax, a share of which is passed on to consumers.

The personal income tax cuts, including substantial cuts in all personal income tax rates and the creation of a new tax break for business income, resulted in lower taxes for all income groups. However, the most affluent Ohioans saw far larger income-tax cuts than lower- and middle-income residents, both in absolute dollars and as a share of their incomes. The top 1 percent on average saw a 1.9 percent cut as a share of income, compared to just 0.7 percent for the average middle-income taxpayer, and 0.3 percent for low-income Ohioans. Ohio's progressive income tax increases with income, so when it is cut across the board, the biggest benefits go to the richest tax filers. For low-

[1] See Halbert, Hannah, "A Credit that Counts," Policy Matters Ohio, Oct. 17, 2013, at http://www.policymattersohio.org/eitc-oct2013 and Schiller, Zach and Hannah Halbert, "Flawed Tax Cuts in Senate Budget Bill," Policy Matters Ohio, at May 27, 2014, at http://www.policymattersohio.org/senate-budget-may2014, which reviewed the impact of increasing the state EITC as the General Assembly did in June. See also an update on Ohio's EITC forthcoming from Policy Matters Ohio.

income Ohioans, income taxes are a very small share of the state and local taxes they pay, so even substantial cuts in income tax don't change their overall taxes very much (see Figure 1, p. 4).
Only the top 1 percent benefited from the total of all the other tax changes taken together, excluding the income-tax cuts. Put another way, the bottom 99 percent of Ohioans as a group saw a net tax increase. Table 2 breaks out the income-tax changes from the others, and their average effects on different income groups.[2]

Table 2

Impact of Ohio tax changes as a share of income, 2005 to date

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income range	**Less than $19,000**	**$19,000 - $34,000**	**$34,000 - $54,000**	**$54,000 - $82,000**	**$82,000 - $151,000**	**$151,000 - $360,000**	**$360,000 or more**
Average income	$11,000	$26,000	$44,000	$66,000	$106,000	$217,000	$1,006,000
Personal income tax changes as share of income	-0.3%	-0.6%	-0.7%	-0.8%	-1.0%	-1.5%	-1.9%
Other tax changes as share of income	+1.5%	+1.1%	+0.9%	+0.6%	+0.5%	+0.1%	-0.2%
Grand total, tax changes as share of income	+1.2%	+0.5%	+0.1%	-0.1%	-0.6%	-1.3%	-2.0%

Source: Institute on Taxation and Economic Policy, July 2014. Covers total 2013 income and includes Ohio residents only. Numbers may not add due to rounding. See Data Note at end of report on what is covered in the analysis.

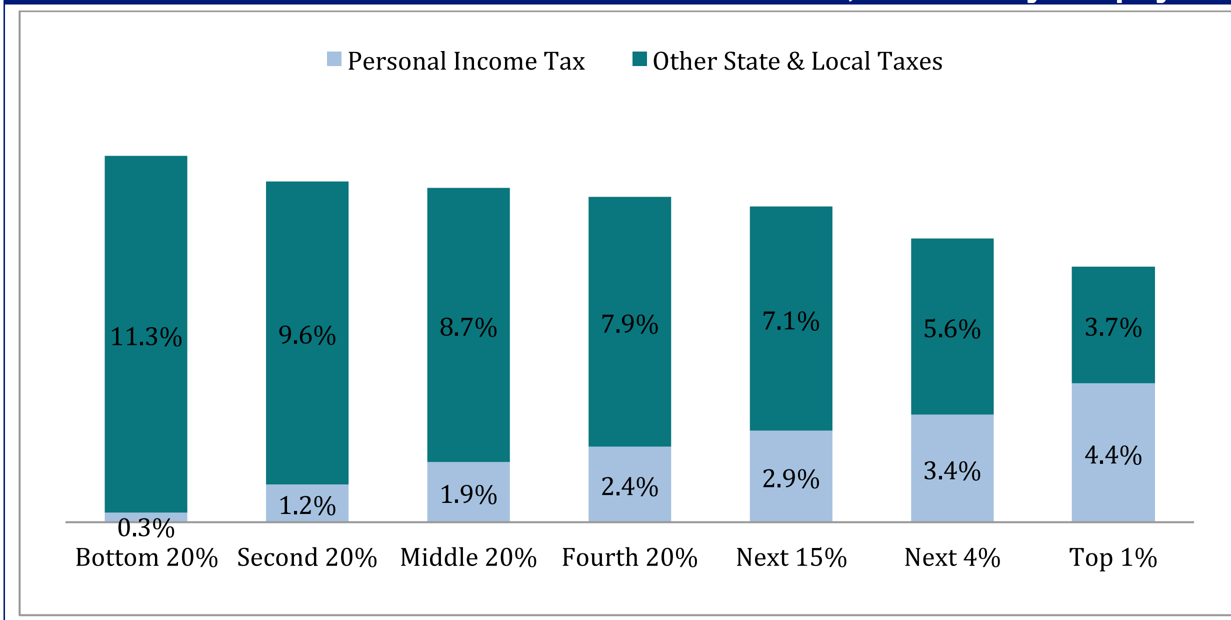
Some of the tax changes besides the income-tax cuts benefited others besides those in the top 1 percent. However, each of the biggest tax changes – the sales and cigarette taxes increases, the creation of the CAT, and repeal of the tangible personal property and corporate franchise taxes – was a regressive change. Lower- and middle-income Ohioans saw tax increases or little change in their taxes with each of these measures, while upper-income Ohioans saw tax cuts or smaller increases than those who earn less. While other useful policy goals may sometimes have been achieved with these tax changes – such as a better balance in the tax load between manufacturers and other industries through the elimination of the tangible property tax, or public health benefits from higher cigarette taxes – one of their effects was to further slant Ohio's tax system against those least able to pay.

[2] Among the tax changes approved in 2005 was the cigarette tax increase. This increase was felt especially by lower-income Ohioans. However, even excluding the higher cigarette taxes to break out the effects for nonsmokers, the bottom two-fifths of Ohioans – those with income of less than $34,000 last year – averaged overall tax increases from changes in the tax code over the past nine years. The middle fifth of earners, who on average saw a small tax increase from the changes, basically broke even, on average, if the cigarette tax increase is excluded or if they don't smoke.

And Ohio's tax system, like those in most states, is indeed set up so that lower- and middle-income earners pay a larger share of their incomes in state and local taxes than the most affluent do. Figure 1, based on an earlier ITEP analysis, shows the share of income paid by different income groups in personal income taxes and other state and local taxes, respectively. This analysis, the most current now available, covers nonelderly tax filers only, at 2010 income levels, based on Ohio tax law in January 2013.[3] That was after the big tax changes in 2005 had been phased in, but before more recent changes such as the 10 percent income-tax cut approved later in 2013. Thus, it reflects some, but not all, of the tax changes reviewed in this release. It also indicates the important role played by the personal income tax, as the only major tax based on ability to pay. While this earlier analysis is not directly comparable to the one above, it shows how Ohio's tax system favors upper-income taxpayers. As shown in subsequent ITEP analyses released by Policy Matters Ohio, tax policy changes enacted since January 2013 have further shifted the tax load from the most well-off to lower- and middle-income Ohioans.[4]

Figure 1

State and Local Taxes as a Share of 2010 Income, Nonelderly Taxpayers



Source Institute on Taxation and Economic Policy, January 2013. Changes cover nonelderly Ohio residents only, at 2010 income levels, based on Ohio tax law as of January 2013.

The changes in Ohio taxes since the passage of House Bill 66 in June 2005 also have slashed the amount of revenue available for investment in needed services, costing $3 billion a year. Ohio needs to boost support to education at all levels. That includes early education (pre-kindergarten), where

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[3] See Policy Matters Ohio, "Ohio's state and local taxes hit poor and middle class much harder than wealthy," Jan. 30, 2013, at http://www.policymattersohio.org/income-tax-jan2013#sthash.UORzU3BD.dpuf

[4] See Patton, Wendy, Zach Schiller and Piet van Lier, "Overview: Ohio's 2014-2015 Budget," Policy Matters Ohio, Oct. 3, 2013, Table 1, p. 5, at www.policymattersohio.org/budget-oct2013, and Zach Schiller, "Cuts and Breaks: Tax Changes in the Mid-Biennium Review," Policy Matters Ohio, July 4, 2-014, at http://www.policymattersohio.org/wp-content/uploads/2014/07/070114-FINAL-Tax-Changes-in-MBR-3.pdf.

only a third of the $100 million sought by state Sen. Peggy Lehner to restore funding[5] and put 22,000 Ohio children in preschool was approved as part of the current two-year budget; K-12, where support remains below earlier levels;[6] and after high school. Community college students are ineligible for the Ohio College Opportunity Grant, the state's source of need-based aid, which despite an increase in the current budget remains well below pre-recession levels.[7] State support to local governments (including Local Government Fund, tax reimbursements, estate tax and casino tax) has been reduced by $1.5 billion over the current biennium compared to the FY2010-2011 budget.[8] Despite a continued high level of foreclosures, in April the state stopped accepting new applications to its Save the Dream program, its largest effort to help homeowners avoid foreclosure; demolishing or rehabilitating the thousands of vacant and abandoned homes across the state would cost hundreds of millions of dollars.[9] Ohio's infant mortality rate remains shockingly high, while a $26 million bipartisan proposal to address it has not yet been enacted. These are just some of the state's needs that are going unmet.

As previous Policy Matters Ohio reports have shown, Ohio's economy has not improved relative to the nation's since the major tax cuts in 2005.[10] Between June 2005 and July 2014, Ohio lost 126,000 jobs, or 2.3 percent of its total, while the nation gained more than 5 million, or 3.8 percent.

Conclusion

The major changes in Ohio tax policy over the past nine years have favored the richest Ohioans and are costing the state $3 billion a year. The wealthy have seen significant tax cuts, while the bottom three-fifths of Ohio earners as a group are paying more. In effect, lower-income Ohioans are helping to pay for tax cuts for others in the state who earn much more. Our job growth, meanwhile, has trailed the country's, and we do not have available significant resources that could be used to improve public services. Ohio needs to dramatically alter its tax policy.

Data note

ITEP's analysis is based on taxes Ohioans were responsible for paying at 2013 income levels. It includes two permanent tax changes enacted by the General Assembly in June of 2014 – the expansion of the nonrefundable state Earned Income Tax Credit to 10 percent from 5 percent, and the increase in income-tax exemptions for those making $80,000 or less a year. It does not include the temporary expansion of the business-income tax deduction for 2014 only. The ITEP analysis of revenue effects takes into account that significant shares of some Ohio taxes are not paid by Ohioans; this is especially true of certain business taxes, such as the now-repealed tangible personal property

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[5] Ohio saw the largest drop among all the states in number of pre-schoolers enrolled in public early education in 2012, and in 2013, the state ranked 39th for serving just 2 percent of 4-year-olds. "Ohio's Pre-K Meets New Benchmarks for Site Visits," May 2014 at http://nieer.org/sites/nieer/files/YB13_OH_Release.pdf

[6] Op. cit., Patton et al.. pp. 9-12.

[7] Halbert, Hannah, "Blocking the College Door: Cuts to Financial Aid Lock Ohio Students Out," Policy Matters Ohio, March 6, 2014, at http://www.policymattersohio.org/ocog-mar2014

[8] Op. cit. Patton et al., see Table 4, p. 15.

[9] Schiller, Zach, "Home Insecurity 2014: Foreclosures and Housing in Ohio," May 9, 2014, at http://www.policymattersohio.org/foreclosure-may2014

[10] See Halbert, Hannah, "Empty Promises: Ohio Job Growth Trails Nation Since 2005 Tax Overhaul," Policy Matters Ohio, Apr. 25, 2013, at http://www.policymattersohio.org/jobwatch05-apr2013 and Policy Matters Ohio, "Five Years Since the 2007 Recession and Ohio Still in the Red," July 18, 2014, at http://www.policymattersohio.org/jobwatch_jul_2014

tax and the CAT. ITEP's tax fairness analysis shows the impact of the tax changes falling on Ohio residents. The analysis compares taxes paid for 2013 with estimates of what the tax system prior to the 2005 overhaul would have generated in revenue in 2013.
The analysis includes:

- The 21 percent cut in income-tax rates enacted in 2005, and the full 10 percent reduction in rates approved in 2013
- The credit approved in 2005 that wipes out income-tax liability for those whose Ohio adjusted gross income (minus exemptions) does not exceed $10,000.
- The 10 percent capped nonrefundable state Earned Income Tax Credit
- The creation of a new income-tax deduction covering 50 percent of the first $250,000 in business income
- The limitation of the $20 personal exemption credit to those with Ohio Taxable Income of less than $30,000 a year and the repeal of the income-tax deduction for gambling losses, both approved last year.
- The repeal of the corporate franchise tax (It assumes the repeal of the dealers in intangibles tax and the corporate franchise tax that had been paid by financial institutions will replaced by the new Financial Institutions Tax).
- The repeal of the Tangible Personal Property Tax
- The increase in the state sales tax from 5.0 percent to 5.75 percent, approved in 2005 and 2013
- The increase in the cigarette tax from 55 cents to $1.25 a pack included in the 2005 tax package
- The elimination of the 10 percent rollback on real property tax for businesses
- The creation of the Commercial Activity Tax. It also includes the portion of the CAT that has been converted to a tax on motor fuel because of an Ohio Supreme Court decision, and the increase in CAT minimum tax for many businesses approved last year.

The analysis does not include the repeal of the estate tax, which was effective in 2013, and the advent of casinos and racinos that generate tax revenue and payments to the Ohio Lottery (the latter is in part because we don't know what share of the tax revenue comes from Ohioans). Inclusion of these changes would have further increased the regressivity of Ohio's state and local tax system, under which lower- and middle-income Ohioans pay more of their income in taxes than the most affluent do. The estate tax was paid on fewer than 8 percent of all Ohio estates, because estates worth less than $338,333 were effectively exempt.

The report does not attempt to measure the extent to which local tax levies have risen to make up for lost Tangible Personal Property Tax revenue. It does not include five other changes to the income or sales tax in the 2013 tax package, or the changes made last year in the homestead exemption and property-tax rollbacks. Other changes in exemptions, credits and deductions besides those listed above are not specifically included.