

## Flat tax mandate: Unwise, unwarranted Study of Ohio tax system should not prejudge outcome

By Zach Schiller

The Senate budget bill approved Thursday, like the House-approved version, would create a tax policy study commission to review the state's tax structure. But the Senate would require the study commission to make recommendations "on how to transition Ohio's personal income tax to a flat tax of three and one-half percent or three and three-quarters percent beginning tax year 2018."<sup>1</sup>

The flat tax in the Senate bill would raise taxes on middle-income Ohioans and further weight the state and local tax system in favor of the most affluent. But even if the flat tax was a great idea, this language ties the committee's hands with a specific policy goal, unlike the original House language. If the committee is looking to make Ohio more competitive, as the bill states, how does it know prior

to any study that these specific proposals are the ways to get there? It's not as if the eight states that currently have flat income taxes have shown uniformly above average economic performance. And if the committee should decide on a flat tax, how does it know what rate to set? In short, the Senate's language inappropriately converts what could be a valuable opportunity to examine the state's tax structure into a flat tax transition committee. The conference committee of House and Senate members hammering out a final budget bill should jettison the flat-tax language.

An Ohioan with two children who earned \$120,000 in wage and salary income last year would have paid more in income tax under the flat tax plan than he or she did for 2014.<sup>2</sup> Those making

### Key findings

- Senate budget bill asks a committee to recommend how to transition to a flat personal income tax of 3.5 percent or 3.75 percent.
- That provision prejudices what the committee will find.
- A 3.5 percent or 3.75 percent flat tax would increase taxes on middle-class Ohioans.
- Bottom 95 percent of taxpayers as a group would pay more, with top 5 percent paying less.

<sup>1</sup> See House Bill 64, As Passed by the Senate, at <https://www.legislature.ohio.gov/legislation/legislation-documents?id=GA131-HB-64>. The Senate also would have the committee come up with a proposal by Oct. 1 to reform Ohio's severance tax. A strengthening of that tax has been discussed for years and is long overdue. See

<sup>2</sup> This calculation takes into account the available personal exemptions; tax deductions and credits can change how much any individual taxpayer must pay.

less than that would do even worse.<sup>3</sup> Data provided to Policy Matters Ohio by the Institute on Taxation and Economic Policy, a national research institute with a sophisticated model of the tax system, show that the bottom 95 percent of Ohio taxpayers taken as a group would pay more under either of the proposed flat-tax rates than under today's tax system. They would pay more, so that the top 5 percent – those with incomes last year of at least \$163,000 – could pay less. This would mean a tax increase for far more Ohioans than those getting a tax cut. It's unclear if those who inserted the flat tax language understood that or thought about how it would affect state revenues.

Ohio, like most states, has a progressive income tax. This is the only major tax based on the ability to pay. It makes up for some of the unfairness of sales, property and excise taxes, which fall more heavily on low- and middle-income taxpayers. But even so, Ohio's state and local tax system is tilted against those taxpayers.<sup>4</sup> Of the ten states with the most regressive tax systems, five have no general income tax, and three more – Illinois, Pennsylvania and Indiana – have flat-rate income taxes.<sup>5</sup>

As income inequality has grown, so has the need for a strong, graduated income tax, in which the tax rate goes up as income does. A flat tax that reduces taxes on top earners, the only ones who have been experiencing significant income growth,<sup>6</sup> reduces the state's long-term ability to generate sustainable revenue needed to provide for public services.

Both the House and Senate legislation would have the committee make tax-policy recommendations “on how to maximize Ohio's competitiveness by the year 2020...” A large majority of academic studies have found that differences in interstate tax levels have little if any effect on relative rates of economic growth.<sup>7</sup> That could disappoint the committee. But it should at least be allowed to do its work and conduct a full review of the tax system instead of settling on a policy beforehand.

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<sup>3</sup> That excludes those who don't pay income tax now and would not under a flat tax.

<sup>4</sup> Patton, Wendy, “Ohio State and Local Taxes Hit Poor and Middle Class the Hardest,” Policy Matters Ohio, Jan. 14, 2015, at <http://www.policymattersohio.org/tax-report-jan2015>

<sup>5</sup> Institute on Taxation & Economic Policy, “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,” Fifth Edition, January 2015, p. 4, at <http://www.itep.org/whopays/>

<sup>6</sup> Policy Matters Ohio, “Income Inequality is High and Growing in Ohio,” Jan. 26, 2015, at <http://www.policymattersohio.org/inequality-jan2015>

<sup>7</sup> Leachman, Michael and Michael Mazerov, “State Personal Income Tax Cuts: Still a Poor Strategy for Economic Growth,” Updated May 14, 2015, at <http://www.cbpp.org/research/state-budget-and-tax/state-personal-income-tax-cuts-still-a-poor-strategy-for-economic>