

Flat tax would mean more taxes for most Ohio's affluent would get windfall, study finds

By Zach Schiller

Nearly three-quarters of Ohioans would pay more in state income taxes under flat-rate tax plans for which a joint legislative commission is developing an implementation plan. At the same time, the most affluent 1 percent of Ohioans would see tax cuts averaging \$4,000 or more a year.

Those are two key conclusions from an analysis prepared for Policy Matters Ohio by the Institute on Taxation and Economic Policy (ITEP), a national research institute with a sophisticated model of the tax system.

The 2020 Tax Policy Commission was established under the last budget bill and is required 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 in tax year 2018...”¹

Ohio, like most states, has a progressive income tax, meaning rates increase on new income as income goes up. This is the only major tax based on 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. Even so, Ohio’s state and local tax system is tilted against those taxpayers.² Of the 10 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.³

ITEP found that under a 3.5 percent flat tax, 72 percent of Ohioans would pay more in income tax for 2016, while just 4 percent would pay less. The remaining 24 percent would pay the same

Key findings

- A joint committee of the Ohio General Assembly is supposed to recommend how to transition to a flat personal income tax of 3.5 or 3.75 percent
- Almost three-quarters of Ohioans would pay more under such a flat-rate tax
- The top 1 percent would average a tax cut of \$4,000 or more a year, while middle-class Ohioans would pay more.
- A taxpayer with two kids and \$50,000 in wages would pay an additional \$536, or 50 percent more than now, under a 3.5 percent flat tax.

¹ See Amended Substitute House Bill 64, As Enrolled, at <https://www.legislature.ohio.gov/legislation/legislation-documents?id=GA131-HB-64>. The committee is also looking at other aspects of Ohio’s tax system. For Policy Matters Ohio testimony before the commission, see “Tax Breaks Need Review,” March 22, 2016, at <http://www.policymattersohio.org/taxbreak-testimony-march2016> and “Tax Cuts, Flat Tax Aren’t the Answer,” Sept. 26, 2016, at <http://www.policymattersohio.org/2020testimony-sept2016>.

² Patton, Wendy, Policy Matters Ohio, “Wealthy Not Paying Fair Share of State and Local Taxes,” Apr. 11, 2016, at <http://www.policymattersohio.org/blogpost-taxes-april2016>

³ 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/>

amount they do now (many of these residents do not have income-tax liability, though they pay other taxes such as sales and property taxes). The bottom four-fifth of taxpayers – those making less than \$92,000 a year – would pay for 81 percent of the cuts. On average, it would mean an increase of \$423 in the annual tax bill for those in the middle fifth of the income spectrum, making between \$39,000 and \$60,000 this year. Meanwhile, the top 1 percent, who make at least \$397,000 a year, would see an average annual cut of more than \$5,000 and receive nearly three-quarters of the gains.

Table 1 shows how a flat 3.5 percent income tax affects Ohioans in different income groups:

Table 1							
Impact of a 3.5% flat income tax							
	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income range	Less than \$21,000	\$21,000 - \$39,000	\$39,000 - \$60,000	\$60,000 - \$92,000	\$92,000 - \$169,000	\$169,000 - \$397,000	\$397,000 or more
Average income	\$13,000	\$29,000	\$49,000	\$74,000	\$119,000	\$242,000	\$1,110,000
Tax change as % of income	0.8%	1.0%	0.9%	0.6%	0.3%	-0.2%	-0.5%
Average change	\$102	\$284	\$423	\$456	\$374	-\$428	-\$5,271
Share of taxpayers facing an increase	40%	71%	88%	92%	94%	24%	4%

Source: Institute on Taxation and Economic Policy, August 2016. Covers total 2016 income and includes Ohio residents only. Figures are rounded.

An Ohioan with two children who earns \$150,000 in wage and salary income this year would have paid more in income tax under the 3.5 percent flat-tax plan than under current rates.⁴ Those making less than that would do even worse⁵ -- a taxpayer with two kids and \$50,000 in earnings would see a \$536 tax hike, more than 50 percent. A 3.5 percent flat tax would mean a tax increase for 18 times as many Ohioans as those getting a tax cut. As Tax Commissioner Testa told the joint legislative committee last year, “It’s going to be hard to come up with a rate that doesn’t create a lot of losers.”⁶

Table 2 shows how a flat 3.75 percent tax – the other alternative the committee is supposed to examine under the budget bill – would affect Ohioans of different income levels. Effects are similarly harmful to a 3.5 percent tax. Seventy-four percent of taxpayers would see a tax increase, while only 2 percent would get a tax cut; the remainder would see no change. On average, the middle fifth would see an increase of \$508 in their annual tax bill, while the top 1

⁴ This calculation takes into account the available personal exemptions; tax deductions and credits can change how much any individual must pay. This release examines flat-tax proposals without other changes to the tax system.

⁵ That excludes those who don’t pay income tax now and would not under a flat tax.

⁶ Answer as part of testimony to the 2020 Tax Policy Commission, Oct. 22, 2015. See Jim Siegel, *The Columbus Dispatch*, “Lawmakers find Ohio’s frack tax to be low but reluctant to increase it,” Oct. 23, 2015, at <http://www.dispatch.com/content/stories/local/2015/10/22/severance-tax-meeting.html>

percent would average a cut of more than \$4,000. The bottom four-fifths of taxpayers would pay for 76 percent of the cuts, and the top 1 percent would receive more than four-fifths of the gains.

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income range	Less than \$21,000	\$21,000 - \$39,000	\$39,000 - \$60,000	\$60,000 - \$92,000	\$92,000 - \$169,000	\$169,000 - \$397,000	\$397,000 or more
Average income	\$13,000	\$29,000	\$49,000	\$74,000	\$119,000	\$242,000	\$1,110,000
Tax change as % of income	0.9%	1.1%	1.0%	0.8%	0.5%	-0.0%	-0.4%
Average change	+\$114	+\$326	+\$508	+\$585	+\$599	-\$40	-\$4,018
Share of taxpayers facing an increase	41%	72%	88%	92%	96%	56%	5%

Source: Institute on Taxation and Economic Policy, August 2016. Covers total 2016 income and includes Ohio residents only. Figures are rounded.

Flat-rate income taxes – or reducing the number of brackets, as some advocate – would do little to simplify the tax system. To do that, legislators would need to slash the credits, deductions and exemptions that account for most of the lines on your tax form. Under a flat-rate tax, applying your tax rate at the end of the form wouldn't be much different from looking up your rate in the tax tables now.

Nor does a flat tax have any direct connection to state economic performance. Among the seven states that have had a flat-rate tax for the past decade, three have shown better job growth than the nation as a whole. But four have lagged behind – and those four happen to be the ones most similar to Ohio: Illinois, Indiana, Michigan and Pennsylvania.

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, those who have been experiencing significant income growth,⁷ could reduce the state's long-term ability to generate sustainable revenue needed to provide for public services.

In short, the 2020 Tax Policy Commission should report that the flat-rate taxes it is studying are a bad deal for Ohio.

⁷ Policy Matters Ohio, "U.S. and Ohio Incomes Highly Unequal," June 16, 2016, at <http://www.policymattersohio.org/wp-content/uploads/2016/06/EPI-Incomes-Unequal-OH-Release-June2016.pdf>