November 7, 2019
Wendy Patton, et al.

Tax Policy

Legislators made important changes to tax policy in the transportation budget as well as in the main operating budget. The overall effect was to further slant the state and local tax system against low- and middle-income Ohioans in favor of the very affluent, continuing a long-term trend. However, for most tax filers, the changes were relatively small, amounting to less than 0.2% of annual income.

THE GAS TAX

The transportation budget, approved earlier in the year, included the first change to the gas tax since 2003. Ohio joined 32 other states which have overhauled or increased gas taxes since 2013, boosting the gas tax by 10.5 cents per gallon to 38.5 cents and the tax on diesel fuel by 19 cents per gallon to 47 cents. At this level the gas tax remains lower than in Pennsylvania (58.7 cents), Michigan (44.1) and Indiana (42.9).) Funds go largely to much-needed upkeep of roads and bridges. The state maintained its policy to not fund public transit or other alternative transportation options from the state's gas tax revenues.

THE EARNED INCOME TAX CREDIT

In addition, lawmakers increased the state Earned Income Tax Credit (EITC) to 30% from 10%, while wiping out a unique cap that had limited the credit for those earning more than $20,000. The EITC changes benefited some low-income Ohioans, but did little for the poorest fifth of Ohio residents earning less than $24,000 a year. That's because, though they pay on average nearly twice as much in overall state and local taxes as the top 1% do, most poor Ohioans don't pay much in state income tax. Ohio's EITC is nonrefundable, meaning it only wipes out taxes that are due; unlike the federal EITC and those of most states with their own versions, it does not provide a refund if its value exceeds a taxpayer's tax liability.[1]

INCOME TAX CUTS

The operating budget included an across-the-board 4% cut in income-tax rates, and eliminated the bottom two income-tax brackets, increasing to $21,750 the amount one has to make before paying tax. It also stopped adjusting brackets and the size of the personal exemption for inflation for one year, an effective tax increase. These income-tax changes in the operating budget added up to just an average $23 tax cut for the fifth of Ohioans in the middle of the income spectrum.[2] Overall, these cuts in the income tax amounted to more than $330 million a year.[3]

SALES TAX FOR ONLINE RETAILERS

The budget also provided that out-of-state on-line retailers would have to start collecting the sales tax. That tax has always been due on online purchases, but out-of-state retailers hadn't been required to collect it. The U.S. Supreme Court ruled last year that they could be, and most states have moved to implement such requirements.[4] This levels the playing field among retailers, allowing brick-and-mortar stores to compete with online operators. Importantly, the provision covers sales by third parties over platforms like Amazon. It covers sellers once they have Ohio gross receipts of $100,000 or 200 or more sales transactions in the state.

Both the higher gas tax and the more complete collection of the sales tax are needed steps. However, they fall more heavily on low-income taxpayers. That underlines the need for a refundable EITC and other measures that would reverse this regressive trend in Ohio tax policy. Altogether, the major tax changes this year mean that the poorest fifth of taxpayers, with income below $24,000 a year, will see an average increase of $2, or 0.02% of income, according to an analysis for Policy Matters Ohio by the Institute on Taxation and Economic Policy (ITEP). Middle-income tax filers who make between $42,000 and $63,000 a year will average a $93-a-year increase, or 0.18% of income. Those in the top 1%, making $496,000 or more, will see an average cut of $746, or 0.06% of income.[5] Table 1 shows the average tax changes for different income groups:

Table 1

Major 2019 tax changes enacted

2019 Incomes	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $24,000	$24,000 – $42,000	$42,000 – $63,000	$63,000 – $101,000	$101,000 – $208,000	$208,000 – $496,000	$496,000 or more
Average Income	$14,000	$32,000	$52,000	$79,000	$137,000	$298,000	$1,264,000
Tax Change as % Total of Income	0.02%	0.16%	0.18%	0.14%	0.06%	–0.02%	–0.06%
Average Tax Change	$2	$54	$93	$112	$90	–$39	–$746

Source: Institute on Taxation and Economic Policy. Ohio residents only.

THE LLC LOOPHOLE

A key question during the budget debate was whether the General Assembly would act to rein in unneeded tax breaks, especially the $1.1 billion business income deduction. This provision, also known as the LLC loophole, allows owners of limited liability companies, S Corporations and certain other businesses to avoid income tax on the first $250,000 in business income, and to pay a lower rate on income over that amount. It has not led to increases in the growth of new businesses or first-time hiring by new businesses, compared to the nation. Ohio's share of small businesses has continued to dwindle and our overall economic performance remains subpar.[6] But while lawmakers in both chambers voted to limit this tax break, the governor didn't agree, and in the end only modest adjustments were made.

In one positive move, beneficiaries of the tax break no longer will be able to use it to qualify for means-tested exemptions and credits.[7] That will save the state a total of $14.4 million a year,[8] while keeping affluent business owners from getting tax breaks intended for those who make far less. The legislature also excluded lawyers and lobbyists from receiving the deduction. Lawmakers subsequently has voted to end this exclusion.[9] It was a minor change: just $25 million a year out of the more than $1 billion the deduction is worth, according to the taxation department. Instead of excluding just one small group from getting this unproductive tax break, the General Assembly should wipe it out altogether.

OTHER TAX BREAKS

The LLC loophole was just the largest of the tax breaks that the General Assembly considered cutting back. The House also voted to eliminate the motion picture tax credit and the sales-tax cap for wealthy buyers of timeshares in jet aircraft, both of which deserved to go on the scrap heap.[10] However, neither measure made it into the final bill. A few such measures did, such as the repeal of the sales-tax exemption on investment coins and metal bullion, and another on sales of certain property to qualified motor racing teams.[11]

ECONOMIC DEVELOPMENT TAX BREAKS

But the General Assembly also created or expanded new economic development tax breaks when it has yet to seriously examine those already on the books.[12] It created a new tax credit for investments in federal Opportunity Zones that will benefit wealthy investors and loosened requirements for the Job Retention Tax Credit so that, contrary to its name, it no longer requires any specific amount of job retention in some instances. A recommendation from the Tax Expenditure Review Committee that the legislature "consider hiring additional assistance to aid in the review process" went ignored.[13] Meanwhile, the budget bill estimates that the state will authorize $440.5 million in eight different economic development tax credits during the biennium, that nearly $560 million such credits will be claimed, and that more than $1.2 billion in credits will be outstanding as of June 30, 2021. The General Assembly needs to engage in more thorough examination of these and other tax breaks.

OVERALL IMPACT

Changes to the tax code in the 2020-2021 budget further distort Ohio's upside-down tax code to benefit the wealthy and special interests at the expense of middle and low-income Ohioans.

The legislature approved the imposition of a 10-cent-per-millileter taxon vapor products, while raising the age to purchase vapor and tobacco products to 21. Taken together, these provisions will reduce state revenue by $13.8 million in FY2021, according to the taxation department (because it will reduce vaping). Altogether, the operating budget will trim GRF revenues by $177.1 million that year, it estimated.[14]

Governor DeWine vetoed half a dozen of the tax provisions included in the operating budget bill.[15] One of those would have authorized a property-tax reduction for certain homeowners in tony Hunting Valley. It would have capped their school property taxes based on the number of pupils going to the Orange School District, costing the district millions of dollars.[16]

Endnotes

1. Stein, Ben, “Refundability Now,” Policy Matters Ohio, June 4, 2019 at https://bit.ly/2IHda1p
2. Schiller, Zach, “Ohio tax shift away from the wealthy: The pattern repeats,” Policy Matters Ohio, August 8, 2019 at https://bit.ly/2kR7aeC
3. Ohio Department of Taxation and Office of Budget and Management, “Tax Revenue Impact of House Bill 166, As Of 7/31/19, General Revenue Fund Impacts.”
4. “U.S. Supreme Court overturns outdated sales-tax rule,” Policy Matters Ohio, July 18, 2018 at https://bit.ly/2wK92Ii
5. Schiller, op. cit. ITEP, a Washington, D.C., nonprofit, has a sophisticated model of the state and local tax system. It analyzed the increases in fuel taxes and changes in the EITC in the transportation budget, along with the operating budget’s cuts in income-tax rates and brackets, the suspension for one year of indexing income-tax brackets and personal exemptions to inflation, and new requirements for online retailers to collect the sales tax.
6. Schiller, Zach, “Closing the LLC loophole,” Policy Matters Ohio, May 29, 2019 at https://bit.ly/31mWxRd
7. For an explanation of this issue, see Zach Schiller, “Loopholes in a loophole,” Policy Matters Ohio, Oct. 31, 2018 at https://bit.ly/2HkZgCX
8. That includes $8.3 million for a variety of state income tax credits and exemptions, and $6.1 million that the state will not pay as reimbursements to local governments for homestead exemptions. Ohio Department of Taxation and Office of Budget and Management, Tax Revenue Impact of House Bill 166, As Of 7/31/19, General Revenue Fund Impacts. That excludes approximately $11 million a year that school districts with income taxes will save from a similar provision (see Legislative Service Commission, Comparison Document, House Bill 166—133rd General Assembly, Main Operating Budget Bill, July 23, 2019, p. 865, at https://bit.ly/2myyChC).
9. The House voted on Oct. 10 to amend Senate Bill 26 and end the exclusion of lawyers and lobbyists. As of the publication of this report, the Senate had not yet acted on whether to accept the House version of the bill. See ”House Votes to Restore Business Tax Break,” Policy Matters Ohio, Oct.10, 2019, at https://www.policymattersohio.org/press-room/2019/10/10/house-votes-to-restore-business-tax-break
10. Patton, Wendy and Zach Schiller, “Tax breaks to tighten, trim or trash,” Policy Matters Ohio, March 27, 2019 at https://bit.ly/2kx9KWL
11. The budget also included a new credit for abating lead hazards and an expansion of an existing sales-tax exemption for equipment and supplies used to clean equipment that produces food, while it eliminated the income-tax credit for campaign contributions and a credit for a passthrough entity investor’s share of the financial institutions tax. For a more complete description of the budget bill’s changes in Ohio’s tax breaks, see Patton, Wendy and Schiller, Zach, “Ohio’s Ballooning Tax Breaks,” Policy Matters Ohio, Sept. 5, 2019 at https://bit.ly/2ma5nla
12. Patton, Wendy and Zach Schiller, “Weak Review: Tax Expenditure Review Committee should balance tax breaks against Ohio’s needs,” Policy Matters Ohio, June 4, 2018, at https://bit.ly/2rcxkIf Separate from such state tax breaks, the General Assembly also made numerous changes in local taxes that don’t affect state revenues, such as new property-tax breaks for certain child-care centers, special measures affecting taxes in specific counties, and changes in the municipal income tax. It also cut tax rates on certain highly capitalized banks and applied the sales tax to newly authorized “peer-to-peer” car-sharing programs.
13. Tax Expenditure Review Committee, November 2018 Report, p. 34
14. Op. cit., Ohio Department of Taxation and Office of Budget and Management. That covers the effect on the state General Revenue Fund, but not those on local governments. The fuel tax increases in the transportation budget were estimated to produce $865 million in annual revenue, split between state and local governments. The expansion of the state EITC will cost $38 million a year, prior to the rate cuts in the operating budget. A new exemption costing about $3 million a year covers motor fuel purchased to power a refrigeration unit on any vehicle other than one used for the comfort of vehicle occupants. Legislative Service Commission, Comparative Document, House Bill 62—133rd General Assembly, Transportation Budget (FY2020-2021), Apr. 4, 2019 at https://bit.ly/2I1hZL2 and Cummins, Philip A., Greenbook, LSC Analysis of Enacted Budget, Ohio Department of Taxation, Sept. 2019 at https://bit.ly/2kCZ0X6
15. State of Ohio, Executive Department, Office of the Governor, Veto Messages, “Statement of the Reasons for the Veto of Items in Amended Substitute House Bill 166,” July 18, 2019, Item #24 at http://bit.ly/2IT96Du
16. Op. cit., Cummins, p. 28, and Tobias, Andrew J., “Gov. Mike DeWine blocks stealthy budget change that would have helped Hunting Valley, cost Orange schools,” Cleveland.com, July 19, 2019 at https://bit.ly/2Ngollr