Policy Matters Ohio

TESTIMONY
May 15, 2019

Tax & Budget

Testimony on HB 166 before the Senate Committee on General Government and Agency Review

Zach Schiller and Wendy Patton

Good afternoon, Chairman Schuring, Ranking Member O'Brien and members of the committee. My name is Zach Schiller and I am research director of Policy Matters Ohio, a nonprofit, nonpartisan organization with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify on the tax provisions of House Bill 166. We are glad to see the business income tax break limited in the bill. This is a big, positive step for Ohio. On the other hand, the reductions in income-tax brackets and rates will help some families, but will not significantly benefit most of the poorest Ohioans. This group pays nearly twice the share of their income in state and local taxes as the wealthiest 1 percent because of sales, excise and property taxes, which weigh more heavily on the less affluent. Rather than using the proceeds of the changes in tax breaks to cut brackets and rates, they should be used to make the state earned income tax credit refundable and to support investments in education, child care and other necessities.

The state of Ohio has $6 billion less in annual tax revenues as a result of tax cuts since 2005, and has need of many investments. The box below shows just a few of the investments a state budget could and should make in the people and communities of Ohio.

Essential investments for Ohio

- Maintain the Medicaid expansion without freezes or barriers to coverage and care.
- Make the state Earned Income Tax Credit refundable to reach the poorest Ohioans.
- Raise eligibility for public child care aid to 200 percent of poverty, starting in this budget, and ensure stable funding for a higher quality public childcare system.
- Keep seniors safe at home by boosting adult protective services by $10 million a year.
- Rebuild revenue sharing with Ohio's local governments. Start with restoration of the Local Government Fund's municipal distribution.
- Base school foundation funding on a formula that ensures rich and poor communities have equally good schools, regardless of local property wealth.
- Reduce the high cost of college tuition with more funding to the State Share of Instruction. Index it to inflation so Ohio's system of public higher education is not eroded by inflation again.
- Boost need based aid - the Ohio College Opportunity Grant - by an additional $106 million annually. Use it to support community college and regional campus students.
- Fully fund Ohio foodbanks' request for an additional $10 million a year in food aid.
- Fund voluntary SNAP E&T at $4 million a year to secure matching federal funds for training so Ohioans can meet work requirements, get training, and get the food they need.

TAX POLICY CHANGES IN THE HOUSE BUDGET

We applaud the proposed limitation on the costly and ineffective business income deduction, often known as the LLC Loophole, along with steps to keep it from being abused by high-income taxpayers. This $1 billion tax break deserves to go on the scrap heap. It has not brought an increase in first-time hiring by new businesses, while the growth of passthrough entities has continued to trail the national average. Reducing the size of the deduction to $100,000 is an excellent first step. Eliminating the special 3 percent rate on income above the deductible amount is a second. This tax break has further slanted our tax system in favor of those who need such treatment least, and the limits to the LLC Loophole in HB 166 will affect affluent Ohioans who can afford it.

The House budget bill would have Ohio join the growing ranks of states that require online and catalogue retailers to collect the sales tax, as the U.S. Supreme Court allowed in its Wayfair decision last year. Including marketplace facilitators is a crucial element. These steps will create a more level playing field between out-of-state retailers and Ohio merchants, enable an existing tax to be collected, and generate revenue for needed services. The bill also takes appropriate steps in phasing out tax breaks such as the sales-tax exemptions for fractional jet aircraft and investment bullion and coins, as well as the motion-picture tax credit.

However, using the proceeds of these welcome changes to cut income-tax brackets and rates will do little for most of the poorest Ohioans. Low-income Ohioans pay a much larger share of their income in state and local taxes than the richest Ohioans do. But many pay little or no income tax. First, this is because it is a graduated tax. It is also because the existing $10,500 threshold for paying the tax, plus personal exemptions and the state Earned Income Tax Credit (EITC), wipe out all or most income tax liability for many of the poorest working taxpayers. For instance, a working single parent with two children and income of $20,000 pays no income tax now.

Policy Matters Ohio asked the Institute on Taxation & Economic Policy, a Washington, D.C.,-based nonprofit with a sophisticated model of the state and local tax system, to analyze the major changes in the business income deduction, along with the cuts in brackets and rate reduction. It found that only 1 percent of Ohio tax filers would pay more under these components of the House bill. Virtually the entire increase in taxes from limiting the deduction and eliminating the special 3 percent rate would be paid by the top 5 percent of Ohio taxpayers, those making $208,000 or more a year. And four-fifths of it would be paid by the top 1 percent, who make at least $496,000.

However, the tax cuts would go mostly to those with higher than average incomes, with only a relatively small amount going to the lowest-income Ohioans. Those benefitting the most in dollars under the House plan have already gained on average from the state's tax changes over the past 15 years. The poorest fifth of Ohioans, who pay the largest share of their income in taxes of any income group, would see only modest gains; more than three-quarters of them would not see any reduction in taxes. So while the richest Ohioans would pay a good deal more, the plan would not reverse most of the tax shift to the poorest Ohioans that has taken place since 2005.

Proceeds from trimming the LLC Loophole and cutting other unproductive tax breaks should be used instead to make the state earned income tax credit refundable and to support needed investments, some of which are described in the table above.

The federal EITC is the nation's most powerful anti-poverty program. It is only available to working families. As helpful as the state EITC is, improved by the General Assembly in the transportation budget, it does not do enough to help the poorest Ohioans because it is not refundable. That's because when the credit is in excess of state income tax paid, you get no refund. ITEP examined adding a 10 percent refundable EITC, so eligible tax filers would receive either that or the 30 percent nonrefundable EITC, whichever is more. According to ITEP's analysis, that would cost about $170 million a year, or about a third of the amount generated from limiting the LLC Loophole. It found that 56 percent of the tax cut that resulted would go to the poorest fifth of Ohioans, compared to just 8 percent under the House plan. A greater share of the poorest Ohioans would benefit, and those in that group who did would average a gain of $248 compared to $160 under the House bill, a significant difference for this group. Clearly, a refundable EITC is much better targeted at the poorest Ohio families—and that would still leave most of the additional revenue from tightening the LLC Loophole available for needed investments.

Not every tax change in the bill is a positive. The Opportunity Zone tax break is not good policy. The Opportunity Zone program is made up of deep federal subsidy for wealthy owners of capital gains. If the state wants to invest in Opportunity Zones, it should be through direct funding to help the low-income residents of these census tracts with better services, links to good jobs, improved public transportation to broaden employment opportunities, better access to high quality child care, and other services that build opportunity for people, not add to the wealth of investors. This expensive tax break, amounting to $50 million in GRF revenue in 2021, should be eliminated from the budget.

The state will issue a half billion dollars in new business incentive tax credits over the biennium. It will pay out for a half billion, and will carry $1.2 billion in tax credit liability at the end of the biennium. By 2020, Ohio will forego almost $10 billion dollars in tax breaks. These breaks are growing fast – by 18 percent since 2011 – but they are not scrutinized like budget expenditures are. While it is appropriate to repeal most of the tax breaks the House includes in this bill, you also need to give the Tax Expenditure Review Committee the staff and resources it needs to do a thorough examination of all the state's 134 tax breaks. It would make sense to appropriate $530,000 a year, as the budget bill does in 2021 for the Joint Medicaid Oversight Committee.

ONGOING NEED FOR INVESTMENT

Ohio's ranking among states in overall health indicators is near the bottom and today we remain near the top for deaths due to the drug epidemic, despite important progress. Investment in children remains inadequate for childcare and early education. Our infant mortality rate is higher than 42 other states. College in Ohio remains prohibitively expensive: Ohio is ranked 45th highest in college costs with community colleges and public universities costing 11.5 percent and 14.5 percent more than the national average, respectively. Local governments throughout Ohio work with $1.5 billion less a year than they had in 2010, due to the state's elimination of tax authority, phase-out of tax reimbursements and cuts to revenue sharing. The $528 million from downsizing the LLC loophole could support a handful of the urgent needs shown in the box on the first page and elsewhere in the testimony:

The LLC Loophole cut:

Revenue from shrinking the LLC Loophole could be used to invest in:

Investment	Estimated cost
10% refundable Earned Income Tax Credit	$170 million
Increased eligibility for public child care to at 175% FPL	$200 million
Municipal distribution of Local Government Fund (LGF)	$40 million
Additional assistance for foodbanks	$10 million
Increased funding for OCOG	$106 million
Tax Expenditure Review Commission staff & outside expertise	$500,000
TOTAL	$526.5 million

Source: Policy Matters Ohio. Estimates based on information from the Ohio Department of Taxation, the Institute on Taxation and Economic Policy (ITEP), the Education Policy Institute and the appropriations spreadsheet for HB 166 as introduced

We welcome Governor DeWine's call for investment in Ohio and note the executive budget's impressive investments in Ohio's underfunded child protective services, in indigent legal services and in the mental health continuum of care – investments strengthened in the House budget. The Medicaid expansion and the children's health insurance program are fully funded. The House budget boosts funding to protect seniors from elder abuse by $1.5 million in each year – more is needed – and it earmarks $1.2 million for wage and hour enforcement each year, eliminating the 2021 cut in the executive budget. The Commission on Minority Health gets increased funding to address the infant mortality crisis. We appreciate these changes.

However, House Bill 166 still lacks adequate funding for education and key services Ohioans need. The bill's limitations on the business income deduction are welcome indeed. But they should not be spent on across-the board tax cuts. A refundable EITC and spending for education and key services would better serve Ohio.

Thank you for this opportunity to testify. I will be glad to take any questions.