Policy Matters Ohio

August 2017

Budget

Tax changes in the Ohio budget

A missed opportunity

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Introduction

The biggest news about taxes in the new Ohio budget is what isn't in it. There is no new round of income tax cuts, paid for in part with various tax increases. That was what Governor Kasich proposed,[1] and what the General Assembly approved in each of the previous two biennial budget bills. But Governor Kasich's plan went nowhere. Ohio has been on a tax-cutting spree that has lasted most of the last dozen years. These cuts have sapped the state of billions of dollars a year of vitally needed revenue and weighted the tax system in favor of the wealthiest at the expense of low- and middle-income Ohioans. So, this is welcome news indeed.

But while the General Assembly did not approve a big, regressive tax cut, it still altered Ohio's tax system. It approved a range of new or expanded special-interest tax breaks. Some of the most expensive ones thankfully were vetoed by Governor Kasich. The budget also:

- Cut the amount of municipal income tax some businesses pay on their profits, while setting up a parallel state collection system that companies will have the option of using instead of filing with municipal tax authorities. Together, these moves will reduce municipal revenues and undercut cities' authority over an important funding source;
- Cut property taxes for farmers, resulting in increases for some residential taxpayers and reduced funding for some school districts;
- Cut two brackets out of the state income tax, eliminating the tax for a small number of low-income taxpayers;
- Changed the way appeals of some tax decisions are made;
- Forced some out-of-state online retailers selling in Ohio to collect the sales tax for the first time; and
- Provided an amnesty for those who haven't paid taxes they owe.

Though there were a few bright spots – the sales-tax provision for online retailers and the modest benefit for some low-income Ohioans, in particular – the budget amounts to another missed opportunity to eliminate unneeded tax breaks and revamp Ohio's tax system, both to provide the revenue we need and rebalance it to rely more heavily on those who can afford to pay.

[1] Schiller, Zach, "Kasich plan continues tax shift," Policy Matters Ohio, Feb. 16, 2007, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/kasich-plan-continues-tax-shift

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Municipal income tax

Businesses will be able to opt to file their municipal income taxes through the Ohio Business Gateway, the electronic portal that businesses use to file a number of other taxes. The state tax commissioner will oversee the administration of these filings, and charge a 0.5 percent fee to municipalities based on tax collections. After years of reductions in state aid and moves by the General Assembly to preempt local authority, now the state will collect a portion of the tax that is the biggest revenue source for Ohio's municipal governments. The tax on business profits accounts for over $600 million of the more than $4.7 billion collected annually.

Proponents claim that the current system is burdensome to business, saying that those that operate in multiple locations have to file many times and deal with different collection practices and appeals processes. However, previous efforts to make the tax more uniform have already standardized many of the rules covering business profits. Existing Ohio law prior to the budget's passage allowed businesses to file a generic income-tax form.[2] Companies already could file a single return with the Regional Income Tax Agency (RITA) which collects income tax for about 270 communities. They could do the same with the Central Collection Agency, which covers more than 70 jurisdictions. These two forms would cover the majority of the 613 communities in the state that levy local income tax.

Recently, the General Assembly enacted legislation preempting local governments from effectively passing many local ordinances. This restricts localities' ability to set minimum wages, require family leave or similar benefits, regulate ridesharing companies like Uber and Lyft, or require public projects to hire local residents (although court decisions have kept some of these measures from going forward, including a recent Ohio Supreme Court decision regarding the operation of red light cameras). The legislature has stripped revenue from local governments by repealing the estate tax, reducing reimbursements for a now-defunct local property tax, and cutting aid through the Local Government Fund (LGF). The budget bill also took $35 million in LGF aid and used it instead for an opioid initiative. Given these actions, cities are understandably mistrustful.

Allowing for state collection of local income tax on business profits raises the prospect that the state will move to eliminate the local profits tax altogether. Ohio approved the repeal of its own state tax on corporate income in 2005, becoming one of only six states without such a tax. Why would the state collect a tax on business profits at the local level when it doesn't do so for itself? Though the budget bill did not end the municipal tax on business profits, there is reason for concern.

Originally, Governor Kasich sought to mandate state collection of municipal income tax on business profits, but that proposal failed in the House. The move to allow businesses to choose to file their municipal income tax forms with the state instead will create two separate sets of tax rules. Melinda J. Frank, income tax administrator for the city of Columbus, noted in testimony that the intent of the municipal income tax bill approved in 2015, House Bill 5, was to bring uniformity and simplicity to the tax—and that the different requirements, forms, penalties, interest and methods of enforcement between those that file with the state versus municipalities, "undermines the uniformity previously achieved."[3]

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[2] Ohio Revised Code Section 718.05

[3] Frank, Melinda J., Income Tax Division Administrator, City of Columbus, Testimony before the Ohio Senate Finance Committee, June 6, 2017, p. 3, at

The provision also removes auditing authority from municipalities. Under the bill, they can ask the taxation department for an audit, but they're not guaranteed one. While Auditor of State Dave Yost supported the opt-in provision, he said in a June 23 letter to Rep. Ryan Smith, co-chair of the conference committee on the budget, that municipalities needed to have recourse to an audit mechanism. "Cities are in the best position to observe a business's activities," he wrote. "A restaurant reporting minimal profits but with a line out the door every day, is visible locally, but not from the distance of the capital. A local city is an indispensable partner in ensuring the integrity and accuracy of the tax system."[4]

Kent Scarrett, executive director of the Ohio Municipal League, has called the move to allow state collection of the tax on business profits a "significant violation of home rule." Cities and villages are weighing whether to file a lawsuit against centralized collection.[5]

The budget bill also eliminates what is known as the "throwback rule" in the municipal income tax. Currently, when a company sells goods and delivers them to another city where it doesn't regularly solicit sales, those sales are "thrown back" to the home city and taxed there. The budget bill ends this provision, creating a new loophole so that tax will not be paid on those sales to any municipality. A majority of the 44 states with corporate income taxes have such throwback provisions to ensure that profit is taxed.

Kathy Hecht, city auditor for Athens, noted that the end of throwback would cost the city $68,000 a year, enough to pay a full-time police officer or firefighter.[6] "Our citizens and businesses still want the services they have come to expect from us, and delivering those services requires human beings," said Richard Donnelly, tax administrator of Grove City, in June testimony before the Senate Finance Committee. "Someone has to drive the snowplow. Someone has to pick up the phone when a caller dials 911," Donnelly said. "The elimination of the throwback will make it a challenge for Grove City and many other municipalities to maintain our safety and service personnel."[7] RITA found 50 of the communities it serves would lose at least $50,000 a year, and conservatively estimated the loss across all those it services at $11 million annually.[8] Eliminating throwback will especially hurt communities with warehouses that deliver directly to consumers. An earlier move to eliminate throwback was removed from House Bill 5, the 2014 bill that overhauled the municipal income tax.

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[4] Yost, Dave, Auditor of State, Letter to Hon. Ryan Smith, Chairman, Conference Committee on House Bill 49, June 23, 2017. Yost recommended a system under which the party in error would pay for an audit when it was completed.
[5] Gongwer News Service, "Centralized Tax Collection Plan Could Spur Lawsuit," Volume 86, Report 125, June 29, 2017, and interview with Kent Scarrett, July 26, 2017.
[6] Hecht, Kathy, City Auditor of the City of Athens, Testimony to the Senate Finance Committee, pp. 1-2, at http://ohiosenate.gov/committee/finance#
[7] Donnelly, Richard, City of Grove City, Testimony before the Senate Finance Committee, Sub. House Bill 49 (Biennial Budget), June 6, 2017, pp. 1-2, at http://ohiosenate.gov/committee/finance#
[8] Regional Income Tax Agency memo, June 12, 2017, and email from Amy Arrighi, chief legal counsel, July 27, 2017.

Property taxes for farmers

The budget bill also boosted the benefit of the Current Agricultural Use Value (CAUV) program, under which farmers pay property taxes on their land based on its use for farming as opposed to its market value. According to the Legislative Service Commission (LSC), this would cause a loss of $4 million in Tax Year 2017 to both school districts and local governments, respectively, and such losses would grow each year until 2022, when each would lose $14 million.[9] As previous testimony on a similar freestanding bill in the Senate described,[10] declines in crop prices and 2015 updates made by the taxation department in the CAUV formula have begun to reduce farm property valuations, which had spiked and remain high compared to historical levels.

Cutting taxes for farmers will result in tax increases for residential taxpayers because under some of Ohio's local taxes, reductions for some are made up with increases for other taxpayers. But a portion of local levies doesn't work that way, so a reduction in agricultural property values because of a different CAUV formula can mean revenue losses for schools and other taxing authorities. It also can impact the state's school funding formula, tax expert Howard Fleeter has noted,[11] increasing state aid to school districts with lower property values because of the CAUV decreases, and reducing aid to districts with little or no agricultural property. The General Assembly satisfied agricultural interests with its CAUV reductions, but at the expense of schools and residential taxpayers.

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[9] Legislative Service Commission, HB 49 of the 132nd General Assembly, Comparative Document, Department of Taxation, p. 5, at http://www.lsc.ohio.gov/fiscal/comparedoc132/en/tax.pdf. Other LSC estimates cited in this report come from this same Comparative Document.
[10] Dixon, Stan, Ohio Department of Taxation, Interested Party Testimony on Senate Bill 36, Senate Ways & Means Committee, March 8, 2017, p. 4, at http://ohiosenate.gov/committee/ways-and-means#
[11] Fleeter, Howard, Ohio Education Policy Institute, Analysis of Proposed Changes to the CAUV Formula, June 14, 2017, included in testimony to the Senate Finance Committee by the Ohio School Boards Association, The Buckeye Association of School Administrators and the Ohio Association of School Business Officials on Substitute House Bill 39, June 15, 2017, at http://ohiosenate.gov/committee/finance#

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Tax breaks

Among the tax breaks in the bill was a doubling, to $4,000 a year, of the income-tax deduction that taxpayers can claim from college or disabilities savings accounts. The LSC estimates the cost at $6.9 million a year. The Office of Budget & Management (OBM) puts the cost at $7.4 million in 2019.[12] To make college more affordable, the General Assembly should instead have provided basic support to colleges or put the money into the Ohio College Opportunity Grant, the state's need-based aid program. Tax advantages from college savings accounts accrue mostly to more affluent taxpayers, and are unlikely to significantly increase college attendance for low-income Ohioans.[13]

Another provision of the bill extends for another year the three-day sales-tax holiday that covers clothing, school supplies and certain instructional materials, within certain price limits. The LSC estimates the cost to the state, local governments and libraries at $15.2 million in the 2019 fiscal year,[14] while counties and transit authorities would lose $3.7 million. Though proponents dispute these numbers, this tax break is poorly targeted.[15] Low-income families who could most use the benefit of a tax holiday are the least able to take advantage of it, since many are just getting by and don't have extra disposable income to buy new clothing and school supplies.

The budget bill also taxes what are called "premium cigars" at 50 cents each, compared to the current rate of 17 percent on the wholesale price of the cigar. The LSC and OBM both estimated this would reduce revenues by $1.4 million in FY2018 and $1.5 million in FY2019. By comparison, the Kasich administration proposed taxing such cigars at $2 apiece, in line with increases on other tobacco tax products it put forward. Under the bill, the 50-cent tax will be adjusted annually based on the Consumer Price Index.

Habitat for Humanity's ReStore outlets, and possibly some others like them, would benefit from a new property tax exemption in the bill. It exempts a retail store operated by a charitable nonprofit housing organization that sells primarily donated household items. The LSC estimates the fiscal effect at $164,000 a year.
The bill also retains a number of new or extended tax breaks that originated in the House bill and are expected to reduce state revenue.[16] These include:

- A kilowatt hour tax break on electricity used in chlor-alkali production (loss of about half a million dollars a year, according to the LSC; unless otherwise stated, revenue estimates in this paragraph are from the LSC. In this case, OBM puts the loss at $400,000)

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[12] Office of Budget & Management, "HB 49 scoring as passed by the General Assembly," received from OBM Aug. 3, 2017. LSC estimates are generally used in this section of the report, usually supplemented with OBM figures when available. In most instances, their estimates were similar.
[13] Jackson, Victoria, "Tax Deductions Aren't the Key to Affordable College," Policy Matters Ohio, Apr. 24, 2017, at https://www.policymattersohio.org/research-policy/quality-ohio/education-training/tax-deductions-arent-the-key-to-affordable-college
[14] Local governments and libraries, which receive a share of tax collections through the Local Government Fund and Public Library Fund, would together lose $500,000 of that amount, the LSC estimated
[15] Slivka, Andrew, "Why Ohio's Sales Tax Holiday Isn't Such a Deal," Policy Matters Ohio, Aug. 5, 2015, at https://www.policymattersohio.org/blog/2015/08/05/why-ohios-sales-tax-holiday-isnt-such-a-deal
[16] Schiller, Zach, "Tax Breaks in the House Bill," Policy Matters Ohio, June 9, 2017, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/budget-bite-tax-breaks-in-the-house-bill For additional details on the tax breaks included in another version of the budget,, see "Budget Bite: Tax Breaks in the Senate Bill," June 16, 2017, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/budget-bite-tax-breaks-in-the-senate-bill

- Allowing owners of a historic rehabilitation tax credit to claim it against the Commercial Activity Tax (CAT) for another two years (revenue loss "potentially in the millions"). This break already had been extended previously;
- Coverage for a new category of work-from-home employees under the state's job creation tax credit (loss of less than $1 million a year; OBM said $300,000 in 2019). Some home-based employees already may be counted under the tax credit, but the LSC noted that they must be paid at least 131 percent of the federal minimum wage, among other restrictions;
- A new sales-tax exemption covering songs downloaded from a commercial digital jukebox (an uncertain decrease in revenue; OBM pegged it at $1 million a year);
- Allowing the operator of a data center more time to make the investment needed to qualify for an existing sales-tax exemption (loss of probably less than $1 million a year), and
- Allowing any amount under the $40 million annual cap on motion-picture tax credits to be awarded the following year if the full $40 million is not awarded in a fiscal year, along with changes in fees and other elements of the program (may reduce tax receipts beginning in FY18 depending on the amount of underutilized credits; some additional fee revenue).

The budget bill also indefinitely extended the authority of counties and municipal corporations to enter into enterprise zone agreements with businesses. Under these agreements, qualified businesses that expand or locate in Ohio may pay lower property taxes for a period. Previously, this authority had been extended for limited periods.

While the bill included a variety of new or expanded tax breaks, it did not incorporate modest proposals made by the Kasich administration to limit or repeal unneeded tax exemptions and credits. Most significantly, the governor would have required that suppliers to certain big distribution centers pay a minimum of Commercial Activity Tax. According to taxation department estimates, such companies are receiving tax benefits worth half a billion dollars a year from this tax break.[17] Under the Kasich proposal, suppliers would have paid the CAT on at least 10 percent of the receipts from goods they shipped to these distribution centers. The administration estimated this would have boosted revenues by $26.3 million over the biennium.

[17] Schiller, Zach, "Tax Breaks Should be Reined In," Policy Matters Ohio, May 4, 2017, at https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-breaks-should-be-reined-in

The governor's vetoes

Thankfully, Governor Kasich vetoed a number of the most costly tax breaks the General Assembly approved. Altogether, according to OBM estimates, this saved the state a total of $581 million in revenue over the two-year budget period. Most of that total would have come from a new exemption to the state sales tax for automatic data processing, computer services and electronic publishing that are provided primarily for the delivery, receipt or use of another non-taxable service. As obscure as that may sound, the administration estimated the cost of this new exemption at $115 million in Fiscal Year 2018, $121 million in 2019 and, because the bill called for it to be retroactive back to 2007, another $246.5 million in refunds, excluding interest.[18]

Kasich also vetoed a poorly targeted "rural and high-tech jobs" credit. Under the vetoed bill, "high-growth industry concern" covered everything from mining and construction to warehousing and health care—and many other industries as well. And the definition of a rural business concern also was loose: It simply couldn't be located in a city with a population of greater than 50,000 or in "an urbanized area adjacent to such a city." Alternatively, it could be in any area determined to be "rural in character" by the U.S. undersecretary of agriculture for rural development. In his veto message, Kasich noted that only half of the investment had to be made in rural areas, and that "the definition of rural is overly broad, permitting even more funds to be spent in non-rural areas." However, he also said he supported the intent of the provision and would work with Ohio Senate leadership on the issue in separate legislation.[19] Up to $60 million in such credits could have been awarded over four years under the program, though it would have had little impact during the two-year budget period.

A third veto covered what would have been a new sales-tax exemption for up to $650 spent on prescription optical aids, such as eyeglasses and contact lenses. The LSC estimated this would cost the General Revenue Fund $22.4 million, with additional losses to local governments and libraries, while OBM put the loss at well over $30 million a year. Kasich said in his veto message that this "is not compliant with the Streamlined Sales and Use Tax Agreement and therefore jeopardizes the sales-tax revenue (which came to $43.8 million in 2013) the state receives for its membership in that agreement."[20] Under the agreement, which is aimed at encouraging online retailers to collect the sales tax, states have harmonized their definitions of what is taxable.

Kasich also vetoed another provision that he said would cost the state $18.8 million. It would have allowed certain motor-vehicle dealers to remit sales tax directly to the state, instead of to the local clerk of courts. However, according to the governor, the state would have continued paying the clerks of court the fees they receive now, even though they would no longer be responsible for collecting the tax. "It is inappropriate for Ohio taxpayers to pay clerks of court for work they did not do," the governor said in his veto message.[21]

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[18] Governor John R. Kasich, Veto Message, Statement of the Reasons for the Veto of Items in Amended substitute House Bill 49, Item 42, June 30, 2017, and OBM HB 49 Scoring, Op. Cit.

[19] Governor John R. Kasich, Veto Message, Statement of the Reasons for the Veto of Items in Amended substitute House Bill 49, Item 44, June 30, 2017, at

[20] Ibid, Item 43. According to the taxation department, the $43.8 million "is the sum of collections in FY 2013 from taxpayers filing the Simplified Electronic Return (SER) from Streamlined Sales Tax, plus collections from taxpayers filing on the Ohio return who are registered with Streamlined Sales Tax." That may understate the total the state receives, since some taxpayers may remit such tax due to the state's membership in the Streamlined Sales Tax without notifying the taxation department (Email from Gary Gudmundson, Ohio Department of Taxation, July 7, 2017)

[21] Ibid, Item 41.

Instead of closing loopholes, the General Assembly offered an amnesty to taxpayers who didn't pay or underreported taxes that were due and aren't already being audited or penalized. If they pay up, such taxpayers can avoid penalties and half of the interest that otherwise would be due. The Kasich administration estimates that the amnesty will generate $20 million in tax receipts this fiscal year.[22] The bill appropriates $1.5 million to fund the program, and says that the first $20 million in receipts from it will go into the General Revenue Fund, with any remainder going into the rainy day fund. The tax department last conducted a broad amnesty in 2012.[23] Such amnesties should only be allowed infrequently, since otherwise they signal that the tax laws aren't really that stringent, discouraging compliance. Previous general amnesties in 2006 and 2012 brought in nearly $60 million and more than $30 million, respectively, so they are seeing diminishing returns.[24]

[22] Office of Budget & Management, "HB 49 scoring as passed by the General Assembly," received from OBM Aug. 3, 2017
[23] Email from Howard Wheat, Ohio Department of Taxation, June 15, 2017. See also http://www.tax.ohio.gov/communications/information_releases/amnesty_info.aspx
[24] See http://www.tax.ohio.gov/communications/information_releases/amnesty_info.aspx and https://www.bizjournals.com/columbus/news/2012/07/16/general-tax-amnesty-program-nets-305.html

Bright spots

The General Assembly rejected the biggest elements in Governor Kasich's tax proposal, including a major across-the-board reduction in the income tax that would have further slanted the tax system against low- and middle-income Ohioans. In a modest move that will help some low-income Ohioans, it eliminated two tax brackets that covered those with income up to $10,500 and provided that Ohioans would begin paying tax when income exceeds $10,500. This reduces the number of brackets in Ohio's income tax from nine to seven, catering to those who would like to see a flatter Ohio income tax. At the same time, the legislature repealed the low-income credit that previously had meant those with annual income of $10,000 or below did not owe income tax.

The real impact of these moves taken together is tiny, as they only affect the narrow band of taxpayers with income between $10,000 and $10,500. The LSC estimated the cost of the provision at $3 million a year, meaning that about 38,000 taxpayers in this group would save $78 in 2017 and $77 in 2018. However, this likely overstates the savings, since it does not take into account the Earned Income Tax Credit and other credits that reduce the amount such taxpayers pay now. The Office of Budget & Management (OBM) estimated the cost of the change at $2 million in 2019.[25] The number of those benefiting from the change would grow slightly each year, since the $10,500 amount (like other brackets) will grow with inflation.

The General Assembly also took a positive step to modernize the tax system in approving a provision aimed at causing more online retailers to collect the state sales tax.[26] That tax is due on purchases made for use in Ohio, but under a 25-year-old U.S. Supreme Court decision, a retailer must have a physical presence in a state for it to be required to collect the tax (or have "nexus," as lawyers say). A number of states have openly challenged that decision recently, approving legislation or rules aimed at developing a test case of its ongoing validity. In the budget bill, Ohio's General Assembly requires tax collection by sellers who use "in-state software to sell or lease tangible personal property or services to consumers," and have more than $500,000 in annual Ohio sales.[27] Some have interpreted this to mean that retailers who use "cookies," files stored on customers' computers to facilitate sales, would be covered under the bill, and it drew an immediate attack from an Internet commerce trade group.[28] However, Rep. Gary Scherer, who helped draft the language, has said it does not cover the use of cookies.[29]

Regardless of whether the new language covers the use of cookies or not, there is good reason to believe that many large online retailers will come under the new nexus provision and have to start collecting the tax. That's because they use smart phone apps, which clearly involve an in-state presence of software through which purchases can be made. Some companies may also be covered under another section of the bill, which provided that sales tax be collected when sellers with more than $500,000 in annual Ohio sales arrange to use "a content distribution network in this state to accelerate or enhance the delivery of the seller's web site to consumers…" Internet vendors may use these networks of local computer servers

[25] Office of Budget & Management, "HB 49 scoring as passed by the General Assembly," received from OBM Aug. 3, 2017
[26] The use tax, levied at the same rate as the sales tax, covers purchases made for use in Ohio when the vendor did not charge sales tax. It has been levied since 1936. See http://www.tax.ohio.gov/portals/0/sales_and_use/ohio_use_tax_8_23_11.pdf
[27] Am. Sub. HB 49, pp. 2305-6
[28] Ebert, Alex, "Ohio 'Cookie Nexus' for Online Sales Tax Likely to Crumble," Bloomberg BNA, July 12, 2007.
[29] Hamilton, Amy, "Last-Minute Provision in Ohio Budget Not 'Cookie Nexus,' Drafter Says," State Tax Today, July 18, 2017. Massachusetts has moved to cover the use of cookies under its sales tax.

to accelerate the delivery of web pages to their customers, making it more likely they will stay on a web site and return to it.

The Department of Taxation does not believe these provisions will generate any revenue during the current biennium because of the existing Supreme Court precedent.[30] While the nexus provisions are likely to be litigated, they are a positive step toward leveling the playing field between Main Street and online retailers and collecting revenue that is already due to the state (as well as counties and local transit agencies, which would collect more tax on their local piggyback sales-tax levies).

The General Assembly also approved additional transparency regarding seven business incentive tax credits, a total of $1.5 billion of which are estimated to be outstanding by the end of Fiscal Year 2019, according to the budget bill.[31] Governor Kasich proposed and the legislature approved that the main operating state budget bill submitted by the governor include detailed estimates on the amount of such credits authorized in each year of the biennium, the amount of credits claimed each year, and the amount outstanding at the end of the budget period. These include tax credits for job creation, job retention, historic preservation, motion pictures, New Markets, research and development, and small business investment (called the InvestOhio credit).

[30] Email from Gary Gudmundson, Ohio Department of Taxation, July 10, 2017
[31] Am. Sub. HB No. 49, Page 3365

Conclusion

For the first time in years, legislators approved a budget that doesn't significantly cut ongoing revenues for public services or shift the responsibility for paying taxes onto those who can least afford it. There are even a handful of positive tax changes in the budget bill. But municipalities see erosion of their control over an important tax, while farmers gain at the expense of school districts and residential taxpayers. Instead of slashing unneeded tax breaks, the General Assembly has added a few more. Only vetoes from Governor Kasich kept these from being more costly. Ohio's need for a balanced tax system that delivers the revenue we need and taxes those who can afford to pay remains as real as ever.

Acknowledgements

The Center on Budget and Policy Priorities

The George Gund Foundation

The Ford Foundation

We would also like to thank Michael Mazerov of CBPP and Howard Fleeter of the Ohio Education Policy Institute for their input and recommendations.