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Revenue & Budget

Setting the foundations for a thriving Ohio with a proactive tax agenda

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Introduction

Ohioans—no matter where we live or what we look like—want to live in resilient and thriving communities. To build these communities we must pool our resources and embark on projects that ensure prosperity and well-being as widely as possible. Taxes are the tool to do exactly that. But over the past two decades many state politicians have colluded with corporate lobbyists to give tax breaks to the rich, to open loopholes for special interests, and to provide handouts for wealthy corporations. The result is an upside-down tax code. The Ohioans with the lowest incomes pay far more of their income in state and local taxes than the most affluent do and, as a result, the state cannot equitably meet Ohio's basic needs, nor can it begin to lay the foundations for the types of communities we would all love to live in.

This need not be so. We already have all the resources we need to build a more prosperous Ohio. Policymakers have the power to build a fair, proactive tax system that can be the basis for economic vitality and social prosperity. In this report, we describe some of the most important building blocks of a fairer state tax system and propose an ambitious but realizable tax agenda. **Our proactive tax agenda could provide more than $3.6 billion a year in revenue**. We have calculated that bringing back the corporate income tax could raise about $1 billion of that figure. The rest would derive from a set of proactive tax proposals that would **reduce average taxes for the bottom 80% of Ohioans** and draw 95% of revenue increases from wealthiest 5% of Ohioans. Our tax plan benefits all low-income households and, in doing so, helps address longstanding racial inequities. A new state thriving families tax credit and an expanded Earned Income Tax Credit are particularly beneficial to low-income Black, Hispanic, and multiracial households.

Figure 1

Proactive Revenue Plan Breakdown

Revenue impact of proposed tax policies

Plan element	Amount
Fair taxation on very high incomes	$2,700,000,000
Corporate income tax	$1,000,000,000
Elimination of LLC loophole	$1,000,000,000
Tax support for families	-$1,100,000,000
Total	$3,600,000,000

Source: PMO calculations based on Institute on Taxation and Economic Policy estimates for all elements except the corporate income tax, which was our estimate based on methodology from the Ohio Legislative Service Commission.

Our tax agenda would begin to fix Ohio's upside-down tax system. The policy proposals would raise the average tax contributions of Ohio's richest quintile and reduce taxes for the 80% of households with the lowest incomes by an average of $212. More than one in five Ohioans (21%) would pay less in taxes. The tax reduction for Black families in the bottom 80% of income earners would average $294. The average would be $354 for Hispanic — a close proxy for Latinx — families in the same

portion of the income distribution and $245 for multiracial families.[1] On the other hand, only 10% of Ohioans would see a tax increase and 95% of the increases would be paid by the richest 5% of Ohioans.

Below we describe the current state of taxation in Ohio and some of the critical needs that state legislators have not addressed. Then we discuss how progressive income taxation, corporate income taxes, the closing of tax loopholes, and tax support for families with low incomes can serve as building blocks for a more equitable and prosperous Ohio. The recommendations presented in these pages are based on previous Policy Matters research and on estimates provided by the Institute on Taxation and Economic Policy (ITEP), a Washington, D.C., nonprofit with a sophisticated model of the state and local tax system.

The state of state taxation

In the past decades Ohio policymakers have produced an upside-down tax system that undercuts our collective prosperity. Succinctly, the people with the lowest incomes are paying more, the wealthy are receiving handouts, and the state is being drained of the resources it needs to ensure the well-being of its residents. The windfall tax revenues of the past year — total General Revenue Fund (GRF) tax revenues exceeded estimates by $2.7 billion (10.8%) in fiscal year (FY) 2022 — may generate a false sense of security.[2] But the surpluses will not last: Forecasts for 2023 indicate a slowing of state tax revenues across the country and Ohio's Office of Budget and Management estimates a 0.8% decline in GRF tax revenues compared to FY 2022 actual receipts.[3] Despite recent financial performance and improved credit ratings, there is a daunting laundry list of overdue needs that have not been addressed due to policy choices to divert public funds to pad corporate bottom lines and the bank accounts of the wealthy few. The time to shore up Ohio's fiscal foundations is now.

In Ohio, the wealthiest households pay less taxes (as a share of their income) than working-class families do.[4] Over the past 17 years — since the state budget bill approved in 2005 — major tax legislation has led the 60% of Ohio households with the lowest incomes to pay more annual taxes, on average. Meanwhile, the richest 1% of Ohio households, with an average annual income of almost $1.5 million, now contribute an average of nearly $51,000 per year less than they once did (see Figure 2) — enough to buy themselves a new luxury car every year. Three fourths of the value of income tax cuts have gone to the richest 20% of households and changes to sales taxes, excise taxes and business taxes shifted tax responsibilities from the wealthy onto low-income families.[5]

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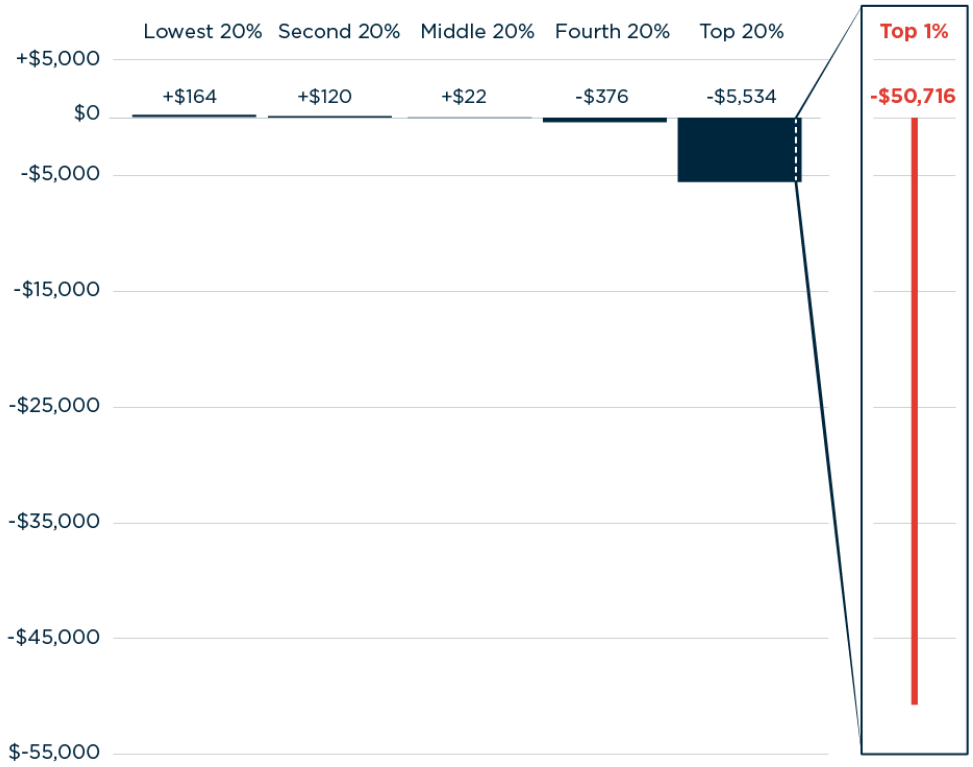
[1] "Hispanic" is the term used in Census surveys; it describes individuals who speak Spanish as their primary language, and largely overlaps with "Latinx" people, who are people from or descended from Latin American communities.
[2] Ohio Office of Budget and Management (August 2022) State of Ohio Monthly Financial Report https://bit.ly/3GFWarq.
[3] Dadayan, L. (2022). States Forecast Weaker Revenue Growth Ahead of Growing Uncertainties. *Tax Policy Center* Ohio OBM (August, 2022) State of Ohio Monthly Financial Report https://tpc.io/3jOxAvu
[4] Patton, W. (2018) Ohio state and local taxes hit poor and middle-income families the hardest, *Policy Matters Ohio* http://bit.ly/2XdUufL
[5] Bervejillo, G. (2022). The Great Ohio Tax Shift, 2022. *Policy Matters Ohio* *https://bit.ly/17YearTaxShift*

State politicians have also eroded Ohio's tax system by enacting an ever-growing list of tax exemptions, abatements and deductions, many of which only benefit corporations and wealthy individuals.[6] These reductions to the state's tax base are known as tax expenditures and, in the current budget cycle, they cost the state about $9 billion per year.[7] That is nearly as much as the state spends on primary and secondary education.[8] Since the effective dissolution of the tax expenditure review committee, which last met in 2018, there has been no specific mechanism for reviewing these expenditures.[9] And, unlike most state outlays, tax expenditures do not sunset. As the Republican chair of the Senate Ways and Means committee, Louis Blessing, put it: "[current tax expenditures] represent the ultimate Revised Code roach motel. Once they go in, they never come out."[10]

Figure 2

Ohio's upside-down tax code benefits few at the expense of many

Impact of Ohio's major taxation legislation since 2005 by income level



Source: Institute on Taxation and Economic Policy, December 2021, based on estimated 2022 incomes. Includes Ohio residents only. See The Great Ohio Tax Shift for further details of the analysis. Note: Estimates for "Top 1%" are also included in calculation of "Top 20%."

[6] Patton, W. and Driscoll, J. (2021) More public money to private interests. *Policy Matters Ohio* https://bit.ly/38ee8zm
Nowicki, N. (2022) Legislators pass tax breaks since July 2021 worth millions. *Policy Matters Ohio* https://bit.ly/3WDBHcl
[7] Tax Expenditure Report, The State of Ohio Executive Budget for Fiscal Years 2022-2023 https://bit.ly/3PmerMn
[8] Patton, W. et al. (2021). Review of Ohio's 2022-23 budget. *Policy Matters Ohio* https://bit.ly/2022BudgetReview
[9] The tax expenditure review committee will be officially abolished in March 2023. The General Assembly eliminated it in the 2021 budget bill and, correcting a technical error under which that wasn't effective till 2024, acted in December 2022 to make it effective in March 2023.
[10] Gongwer (December 7, 2022) Oil, Gas Drilling Measure Among Nine Clearing Senate https://bit.ly/3ifVyzo

The cumulative impact of this tax shift is a state revenue shortfall of about $8 billion a year. This means that people with the lowest incomes are paying for these changes both with higher taxes and by sacrificing basic services like health care, education and infrastructure. According to the Department of Transportation, for example, the state's infrastructure "has billions of dollars in transportation needs going into the future."[11] In fact, the American Society of Civil Engineers gives Ohio's infrastructure a mediocre grade of C- and estimates that each year Ohioans each incur more than $500 in automobile repair costs due to driving on roads in need of repair.[12] There is also a desperate need to expand services to the more than 1.2 million Ohioans who struggle to pay for basic expenses and the estimated 463,800 children who live in poverty.[13] Ohio consistently ranks near the bottom of key health indicators and has an infant mortality rate for Black babies that is more than twice that of the general population's national average.[14] The Fair School Funding Plan approved by the General Assembly in 2021 is underfunded, our colleges are unaffordable, and there is lead in too many of our homes.[15]

Economic growth is a function of healthy communities, educated workers, effective infrastructure, and of equitably shared resources.[16] Yet, the short-term opportunist mentality of tax-cutting state politicians has undermined Ohio's capacity to provide the material and social infrastructure of broad-based sustainable economic prosperity.[17] Ohio's economy has continued to decline in terms of jobs and businesses created relative to the rest of the nation.[18] In a typical year, the growth of Ohio's Gross State Product (GSP) lags that of the rest of the country.[19] And during economic downturns, Ohio consistently suffers deeper proportional losses and more protracted recovery times than the national average.[20] State policymakers continue to legislate tax incentives on the offhand chance that hypothetical external investors will come to Ohio and make up for decades of sacrifices across the state by offering (highly subsidized) jobs in one city. The truth is that corporate investment — such as the much-anticipated Intel semiconductor fabs outside Columbus — are contingent on the social and material infrastructural conditions that are made possible by state

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[11] The Hannah Report (November 4, 2022). Ohio Receives $250 Million in Infrastructure Money So Far. https://www.hannah.com/DesktopDefaultPublic.aspx?type=hns&id=k%2fVUM7o9nr4%3d&u=TbpgQbwDi5c%3d
[12] ASCE (2021) Ohio 2021 Report Card. https://infrastructurereportcard.org/state-item/ohio/
[13] Household Spending Table 1. Census Bureau, Household Pulse Survey: July 27 – August 8, accessed on Sept 19, 2022, https://bit.ly/3eXOpSc. Petrik, W. (2022). New census data show Ohio lags most states in median income and childhood poverty. *Policy Matters Ohio*. https://bit.ly/3T4lN8P
[14] The Commonwealth Fund (2022). 2022 Scorecard on State Health System Performance https://bit.ly/3QhjkY8
[15] Pruitt, T. (2021). The Fair School Funding Plan: an end to Ohio's K-12 Hunger Games? Policy Matters Ohio. https://www.policymattersohio.org/blog/2021/09/16/the-fair-school-funding-plan-an-end-to-ohios-k-12-hunger-games. Zuckerman, J. (2021) Report: 650,000 lead pipes still carry water in Ohio; 2nd most in U.S. *Ohio Capital Journal.* https://ohiocapitaljournal.com/2021/07/19/report-650000-lead-pipes-still-carry-water-in-ohio-2nd-most-in-u-s/. Digest of Education Statistics: Table 330.20 *National Center for Education Statistics* https://bit.ly/3Cn25z0
[16] Stone, C. (2017) Economic Growth: Causes, Benefits, and Current Limits. *Center on Budget and Policy Priorities*. https://www.cbpp.org/research/economy/economic-growth-causes-benefits-and-current-limits, Berger, N. and Fisher, P. (2013) A Well-Educated Workforce is Key to State Prosperity. *Center on Budget and Policy Priorities*. https://www.epi.org/publication/states-education-productivity-growth-foundations/, Bivens, J. and Banerjee, A. (2022) Inequality's drag on aggregate demand. *Center on Budget and Policy Priorities* https://bit.ly/3ienT9k
[17] Contrary to the claims of many corporate-backed politicians, there is little convincing scientific evidence of a positive relationship between tax cuts and economic growth, see: https://tpc.io/3Ge8kGt, https://bit.ly/3Z8DZSv, https://bit.ly/3CpOJC9, and https://brook.gs/3WMsxKl.
[18] Bervejillo, G. (2022) Ohio's LLC loophole: Public dollars, private benefits. *Policy Matters Ohio* https://bit.ly/3CjrklF
[19] Ohio Legislative Service Commission. Ohio Economic Facts, found at: https://bit.ly/3ienCTH
[20] Shields, M. and Volker, A. (2022) A Better Bargain: State of Working Ohio 2022. *Policy Matters Ohio.* https://bit.ly/3WLJRzs

revenue; economic development incentives are not a major factor in corporate location decisions.[21] Ultimately, decades of tax cuts and tax incentives have not produced the economic vitality Ohioans need, while they have kept the state from providing needed public services.

Progressive income taxes

The beginning of a solution to Ohio's problems is no mystery: a robust and equitable tax system. State legislators must ensure that our collective resources are used to guarantee a thriving, sustainable Ohio for years to come, rather than allow them to be siphoned off by wealthy individuals and corporations. The way to do this is to make sure that we all contribute personal income taxes commensurate with our ability to pay.

The personal income tax is Ohio's second largest source of revenue (after the state sales and use tax). In fiscal year 2022 this revenue source accounted for $11.2 billion, 38.6% of all state-level taxes.[22] It is the cornerstone of almost all government services: parks, libraries, public education, subsidies for child care, senior services, emergency services, and more. It even helps offset the cost of property taxes.[23]

One of the strengths of the personal income tax is that it is based on the ability to pay. In general, those who have the most resources pay the highest share. But even then, it is a relatively modest contribution. A slight increase in the rate of taxation of the wealthiest households can fund significant social programs that benefit all. Where states have increased taxes on the wealthiest households, only an economically insignificant amount have chosen to leave.[24] Most wealthy households are embedded in the state where they live: They have businesses relations and familial ties that make them unlikely to emigrate in the short term and in the long term they benefit just as much as anyone else from better social services and broad-based prosperity.[25]

However, over the past decades state politicians have whittled away at the foundations of our personal income tax by eliminating brackets and reducing tax rates for the wealthy. Under Republican Gov. George Voinovich in the 1990s the wealthiest Ohioans paid a tax rate of 7.5% on income over $200,000. Today they pay a top rate of 3.99%, covering income over $115,300. Not only do wealthy Ohioans benefit enormously from working and living in Ohio but they spend a smaller

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[21] Intel has repeatedly explained that their decision to situate their investment in Ohio is directly related to local education levels, existing infrastructure, and geographic considerations, see: https://intel.ly/3Z5CqVv. On the impact of tax incentives see: Bartik, T. (2018). "But For" Percentages for Economic Development Incentives: What Percentage Estimates are Plausible Based on the Research Literature? Upjohn Institute working paper; 18-289. https://bit.ly/3QmLmSf.
[22] Ohio Legislative Service Commission. Historical revenue tables. found at: https://bit.ly/3jGmvMU
[23] Schiller, Z. (2017) Ohio needs a strong income tax. *Policy Matters Ohio*. https://bit.ly/2SarjJB
[24] Young, C. and Lurie, I. (2022) Taxing the Rich: How Incentives and Embeddedness Shape Millionaire Tax Flight. *Washington Center for Equitable Growth*. https://bit.ly/3WNl8dZ. There is evidence of a small amount of tax-motivated migration, see: https://www.nber.org/papers/w26349 and https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4037764.
[25] The few millionaires that do emigrate are those that are least embedded in local economies. Thus, progressive taxation on the wealthy still produces considerable net revenues. See: https://bit.ly/3GqjfQ6

proportion of their income into the local economy.[26] This contributes to the state's increasingly unequal wealth distribution: The top 1% captured nearly 86% of Ohio's overall annual income growth between 1973 and 2015.[27] It is time that wealthy Ohioans give back to the community that made their prosperity possible.

We propose a new tax on the richest Ohioans at a rate of 7.5% on incomes above $250,000 and a rate of 8.99% on incomes above $1 million. These new tax brackets would have no impact on 98% of Ohioans. Moreover, according to estimates provided by ITEP, those impacted would pay an average increase equal to less than 2% of their yearly income. Meaning that most wealthy Ohioans would barely notice the difference and would still have a net tax reduction relative to their pre-2005 tax contributions. This modest contribution by the wealthiest Ohioans by itself could raise about $1.7 billion per year, enough to double General Revenue Funds used to support small towns and localities. If these tax rates were applied to the business income that currently goes untaxed because of the LLC loophole (more on this below) then it could generate an additional $1 billion in revenue which could fully fund the Fair School Funding Plan and have an enormous impact on families and children across the state.

Corporate income tax

Ohio needs a corporate income tax. Ohio corporations that report substantial and growing profits are not contributing commensurately to public services that make their profits possible. Corporations need educated workers, a transportation system to move their products, the courts to enforce their contracts, and any number of other services. A corporate income tax could firm up Ohio's economic foundation and help guarantee shared prosperity for years to come.

The weakening of Ohio's business taxes goes back decades.[28] In 2005, the General Assembly phased out two major business taxes, including the franchise tax that covered corporate profits, and replaced them with the new Commercial Activity Tax (CAT) on gross receipts. As the Ohio Business Roundtable told the Ohio Supreme Court in a 2008 filing, "The new business tax system substantially lowered the overall tax burden on business."[29]

In fact, Ohio became an exception: It is one of just six states with no state-level corporate income tax.[30] All surrounding states have such taxes, with rates ranging

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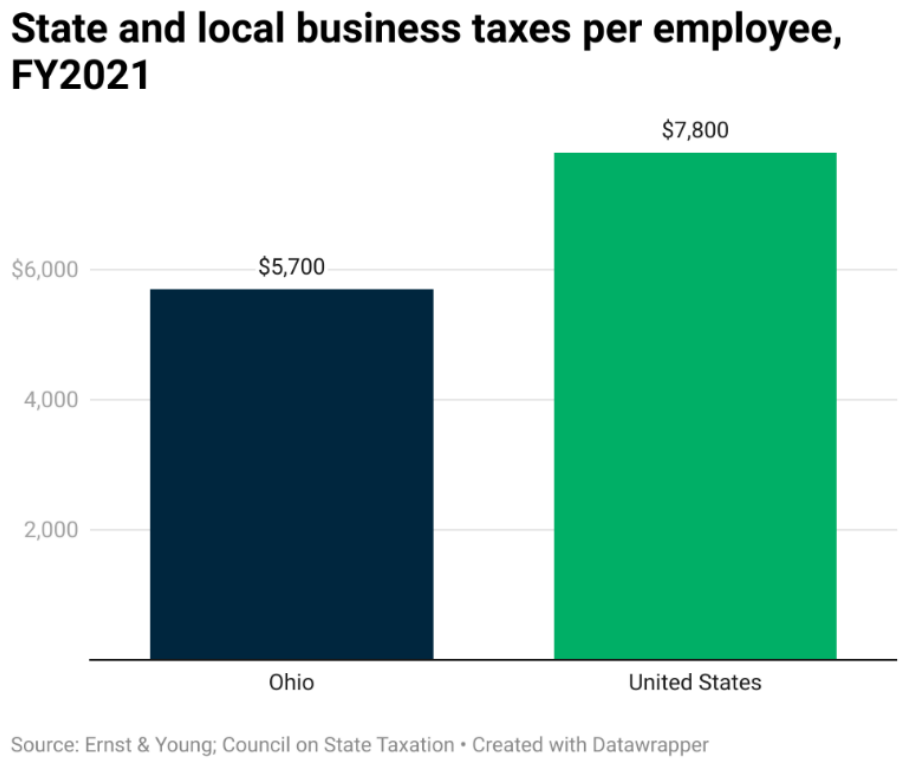
[26] Johnson, N. (2010). Budget cuts or Tax Increases at the State Level: Which is preferable in a weak economy? *Center on Budget and Policy Priorities*. https://www.cbpp.org/research/budget-cuts-or-tax-increases-at-the-state-level.
[27] Stein, B. (2018) Unfair Share. *Policy Matters Ohio* http://bit.ly/UnfairShare
[28] See: Hill, E. (2004). Ohio's Competitive Advantage: Manufacturing Productivity. Maxine Goodman Levin College of Urban Affairs, Cleveland State University, 2001, and Schiller, Z. (2004). Ohio's State and Local Taxes: The Dwindling Business Share. *Policy Matters Ohio*. https://www.policymattersohio.org/files/research/ohiobiztaxesmay2004.pdf
[29] Memorandum in Support of Jurisdiction of Amicus Curiae Ohio Business Roundtable, Ohio Grocers Association et. Al. v. Williams W. Wilkins (Richard A. Levin), in his official capacity as Ohio Tax Commissioner, Ohio Supreme Court Case No. 08-2018, Oct. 17, 2008, p2.
[30] Federation of Tax Administrators, "Range of State Corporate Income Tax Rates (for Tax Year 2022 – as of January 1, 2022), at https://www.taxadmin.org/assets/docs/Research/Rates/corp_inc.pdf

from 5.0% to 9.9%.[31] Ohio's total effective business tax rate (TEBTR) — combined state and local business taxes as a share of private-sector gross state product — is among the lowest in the nation, considerably lower than the national average (4.1% vs. 4.9%).[32] The business share of total state and local taxes is also below average (39.8% vs. 43.6%), as are business taxes per employee, as shown in Figure 3.

Figure 3



Meanwhile, across the country state corporate profits tax receipts grew yearly by an average of 10.3%, adjusted for inflation, between the first quarter of 2010 and the same quarter in 2022.[33] Just in the past few years, corporate profits have skyrocketed. According to Tax Notes, in FY 2022, 13 states that account for three-quarters of state corporate tax revenue saw receipts grow by 48% compared to pre-pandemic averages.[34] While corporate profits taxes can be volatile, they were unusually strong the past couple of years, and Ohio will see none of this bounty.

[31] Pennsylvania, which has a rate of 9.9% this year, is reducing that to 8.99% in 2023 and in steps to 4.9% in 2031. Ernst & Young, "Pennsylvania Enacts Corporate Income Tax Rate Reduction and Other Tax Changes," Tax News Update, U.S. Edition, July 18, 2022, at https://go.ey.com/3GdhByJ

[32] Ernst & Young, "Total state and local business taxes, State-by-state estimates for FY21," December 2022, at https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/2209-4097478_50-state-tax-2022-final-e-file.pdf E&Y produces the study annually for the Council on State Taxation, a business lobbying group.

[33] Dadayan, Lucy, "State Revenues Still Strong, But for How Long? State Tax and Economic Review, 2022 Quarter 1," Tax Policy Center, August 2022, at https://www.urban.org/sites/default/files/2022-08/STER_2022Q1.pdf

[34] Sullivan, Martin A., "Have Sky-High Corporate Tax Revenues Peaked?" Tax Notes, Sept. 19, 2022. California accounted for an outsized share of the gain, but even leaving out that state, receipts grew 31%. Sullivan estimated that pretax profits in the federal fiscal year ending Sept. 30, 2022, would be 48% above the pre-pandemic five-year average.

Ohio should reinstate an 8.5% state-level corporate income tax that works in concert with the existing CAT tax. Business could contribute according to the higher of the two tax liabilities, as they did under the old franchise tax. (Under that tax, companies figured how much they'd pay under two formulas, one based on net worth, one on corporate profits, and paid whichever was higher.)[35] The new tax would mirror the CAT in covering the same corporations, excluding those with gross receipts under $150,000; those with receipts below $1 million would continue paying a flat $150. Corporations in industries currently exempt from the CAT, like banks and insurance companies that pay other state taxes, would be excluded.[36] A dual tax of this kind bases at least some of the payment on income, so that state revenues grow with the economy and companies pay more when they are more able to do so. By using the CAT as a backstop, it also ensures that large corporations pay tax because they continue to receive public services even when their profits drop. And, to limit tax avoidance, Ohio should join 27 other states and adopt combined reporting, under which corporations composed of a parent and subsidiaries are combined as a single entity for tax purposes.[37]

Most companies would be unaffected by this change, since the large majority have receipts below $1 million a year.[38] In fact, most young, expanding companies don't have significant profits; instead, they reinvest profits into expansion, hiring, and R&D.[39] Only more profitable corporations would wind up paying more under this structure. And, since stock ownership is concentrated among white, upper-income households, a corporate profits tax would go part of the way toward turning Ohio's tax system right side up and reversing its discriminatory racial effects.[40]

The revenue raised by this new corporate income tax would depend on how it was structured. The Legislative Service Commission (LSC) examined a similar proposal at the request of Rep. Michael Skindell two years ago. Updating the LSC's analysis using its methodology, a new corporate franchise tax covering C corporations levied at an

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[35] At one point, the amount paid under the net worth formula was capped. Under the old franchise tax, companies figured their liability based on an apportionment formula, taking into account the proportion of their payroll, property and sales they had in the state. The formula triple-weighted sales versus the other two factors for nonfinancial companies. This and other elements of the new tax would need to be configured appropriately, using best practices. Schiller, Z. (2002). Ohio's Vanishing Corporate Franchise Tax. *Policy Matters Ohio* https://bit.ly/3WZUghY.

[36] The new tax would need to be drafted so that it did not disturb the current arrangement under which portions of CAT receipts are deposited into other funds besides the General Revenue Fund.

[37] For more detail on limiting tax avoidance, see Schiller, Z. (2021) Ohio needs a corporate profits tax. *Policy Matters Ohio* https://bit.ly/TaxCorporateProfits. The paper also explains why such a tax should cover large passthrough entities.

[38] Ohio Department of Taxation, "Commercial Activity Tax: Number of Taxpayers and Tax Return Data, Fiscal Year 2022," Table 2, at https://bit.ly/3Cp5JsI. Some 101,958 CAT filers out of 163,730 tax filers in Fiscal Year 2022 had receipts under $1 million, or 62%, and that doesn't include those with receipts below $150,000.

[39] Mazerov, M. (2013). Testimony to House Finance and Appropriations Committee on HB 59 Income Tax Plan. *Center on Budget and Policy Priorities*. https://www.policymattersohio.org/wp-content/uploads/2013/03/MazerovHB59_Mar2013.pdf see also Mazerov, M (2010). Cutting State Corporate Income Taxes is Unlikely to Create Many Jobs. *Center of Budget and Policy Priorities*. https://www.cbpp.org/research/cutting-state-corporate-income-taxes-is-unlikely-to-create-many-jobs

[40] Bhutta, N. et al. (2020). Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances. FEDS Notes, https://bit.ly/3vBCBub.

8.5% rate might increase state revenue by up to $1 billion before credits in addition to existing CAT revenue.[41]

The LLC loophole

One of the biggest drains on Ohio's collective resources is the Business Income Deduction, more commonly known as the LLC loophole. The LLC loophole is a state tax provision that allows individuals who make money from a specific form of business ownership — such as through the ownership of a limited liability company — to avoid paying taxes on their first $250,000 of income and to pay a low flat tax rate on income above that. This subsidy is not dependent on job creation nor is it specific to strategic economic sectors or positive social outcomes. It is simply a handout to those who can maneuver their income into a specific legal form. It is among Ohio's most expensive tax breaks; it disproportionately rewards a small number of high-income individuals; its benefits to small business owners are marginal at best; and it has negligible overall economic impact.

Ohio legislators created the LLC loophole for tax year 2013 and fully expanded and phased it in by tax year 2016. The loophole is composed of an income deduction — which by itself is the third-largest tax break in the state — and a flat reduced tax rate of 3% on income above that deduction.[42] Ohio taxpayers who derive income from their passthrough entities such as sole proprietorships, S corporations, partnerships, and LLCs can claim this deduction and significantly reduce their tax liability.[43] As of tax year 2022, the loophole costs Ohio about $1 billion per year in lost tax revenue.[44]

There is no requirement that individuals who receive this deduction create jobs or even conduct anything akin to businesslike activity. If national statistics are any indication, a large share of them are doing none of these things. According to researchers from the U.S. Department of Treasury, only 54% of the nation's passthrough entities conduct "businesslike" activity and 86% of them do not create jobs for anyone but their owners. Another Treasury study found that as much as a third of passthrough income is secured by accounting schemes and other opaque

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[41] See Schiller, "Ohio Needs a Corporate Profits Tax," pp. 10-11, and Jean J. Botomogno, Ohio Legislative Service Commission, Memo on new corporate franchise tax, Dec. 3, 2020. The LSC analysis was based on Internal Revenue Service numbers on income subject to federal tax and business receipts. The LSC noted the analysis was a rough one and should be used with caution in the absence of bill language.

[42] For a list of tax breaks see: https://bit.ly/3PmerMn. An analysis of these can be found at Patton, W. and Driscoll, J. (2021). More public money to private interests. *Policy Matters Ohio*. https://bit.ly/38ee8zm

[43] These legal entities are known as "passthrough entities" because their yearly profits are passed on to their owners and taxed as individual income, rather than at the level of the business itself, as in the case with corporate income.

[44] The Department of Taxation did not provide a current calculation of the total cost of the loophole. According to the Department's communications officer, the last time the value of the BID and the 3% rate was calculated was for taxable year 2017. The figure was $1,171.2 million (Correspondence with Gary Gudmundson 1/5/22). The most recent tax expenditure report gave a figure of $656.2 million for fiscal year 2022 but did not include the value of the flat tax rate, see: https://bit.ly/3PmerMn. Using the Department of Taxation's data on claimed business income, and assuming relatively proportional business income growth across income levels, we calculated an estimate of the growth of business income since 2017. We then deflated our estimate to account for recent reductions in income tax rates. For information on the Business Income Deduction see: https://bit.ly/3RYLsjw

financial initiatives that cannot be traced to a distinct individual.[45] The growth of passthrough entities has been a part of widening national economic inequality since they are disproportionately owned by wealthy older, white, males and white-collar workers that are not in any particular need of tax relief.[46]

According to Ohio Department of Taxation data, the top 10% of those who claimed business income in tax year 2020 — claiming at least $160,000 of business income — received more than half the total value of the deduction. These 68,500 tax filings received an average tax cut of at least $8,000 each (a lot, but not nearly enough to hire a new employee), adding up to more than $551 million in forgone taxes in tax year 2020. This is without counting the additional benefits received by those paying the low flat tax rate on their income above $250,000.

Meanwhile, most business income claimants receive only modest benefits from the loophole. More than half (58.7%) of those who claimed business income in tax year 2020 —representing roughly 381,000 tax returns — claimed less than $20,000 and received less than 7.6% of the total value of the deduction. That means that the majority of those benefited by the loophole receive a tax break worth less than $1,000 — a negligible amount when it comes to significant business decisions.

Lawmakers should close the LLC loophole. The LLC loophole is an expensive handout to wealthy Ohioans. It contributes to economic inequality and drains resources from needed social and economic services. Eliminating the LLC loophole would raise at least $1 billion and would affect less than 10% of tax filers. According to ITEP estimates, 82% of the revenue raised by eliminating this wasteful loophole would be paid by the richest 5% of Ohioans.

Support for families in need

The final pillar of our proactive tax plan is to make the tax system fairer by scaling down the contributions of those who have a lower ability to pay. Families and low-income households already pay a higher share of their income in taxes and should be supported with a state-level thriving families tax credit — designed to resemble the federal child tax credit (CTC)—and a refundable earned Income tax credit (EITC). These tax credits have been shown to reduce child poverty and provide security to those whose wages cannot guarantee their basic needs.[47]

The EITC is a refundable tax credit for low- to moderate- income working households that is adjusted according to the size of the household and its income level. It helps

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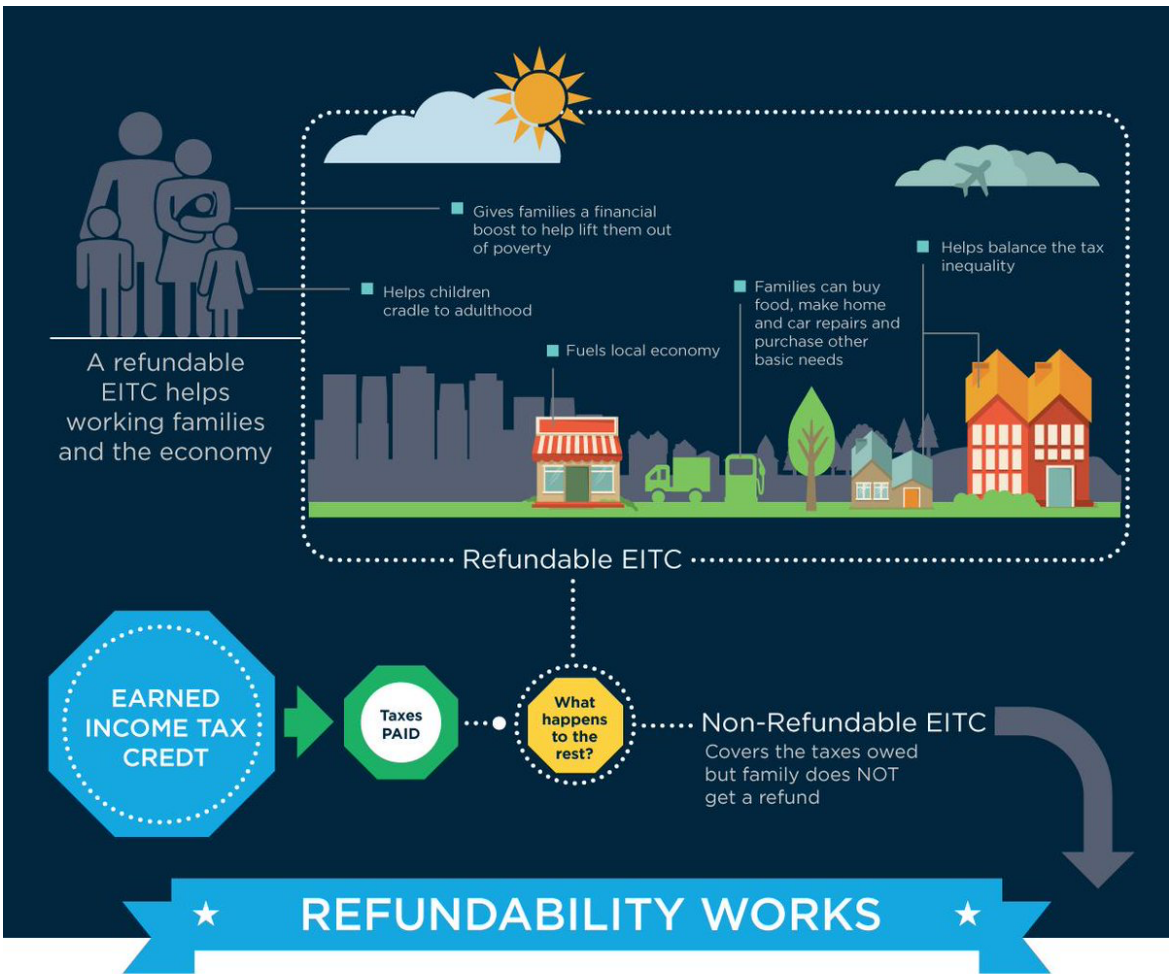
[45] Cooper, M. et al, (2016). Business in the United States: Who Owns it, and How Much Tax Do They Pay? *Tax Policy and the Economy.* 30:1. When business income does pass through to its owners, we are able to get a clearer picture of who benefits from passthrough entities using personal income tax data.

[46] Figures are from 2014, tables can be found at: https://home.treasury.gov/system/files/131/TP4-Tables-UPDATED-12192018.xlsx. Goldschlag, N. et al (2017). Just Passing Through: Characterizing U.S. Pass-Through Business Owners. Working *Papers 17-69, Center for Economic Studies, U.S. Census Bureau. Cooper, M. et al (2016).*

[47] Petrik, W. and Laplace, G. (2022). Increase family security and expand opportunity in Ohio. *Policy Matters Ohio* *https://bit.ly/3CnlVKy.* Williams, K. (2021) Strengthen Ohio's EITC to help working families. *Policy Matters Ohio* *https://bit.ly/3IlsaCv*

offset the higher share of income lower-income families pay in sales tax, payroll tax, property tax and other state and local taxes. In doing so, it expands economic security, and improves educational and health outcomes.[48]

The federal EITC has existed since the mid 1970s, and since 2014 Ohio has matched a portion of the federal credit. In 2019, Gov. Mike DeWine and the General Assembly increased Ohio's EITC from 10% to 30% of the federal credit but did not make it refundable.[49] That makes Ohio one of just six states with an EITC that lacks refundability.[50] The result is that Ohioans with the lowest income — those most likely to have tax liabilities that are smaller than the amount of the credit — do not receive the full benefit of the tax policy. Therefore, a refundable EITC would be particularly beneficial for Black and Latinx families and women who continue to earn disproportionately smaller incomes than white men.[51] **Our proactive tax plan creates a refundable EITC at a rate of 10% of the federal credit, while keeping the existing 30% nonrefundable credit.**



[48] Caines, R. (2017). 5 Ways the EITC Benefits Families, Communities, and the Country. *Center on Budget and Policy Priorities*, https://bit.ly/2SevEeS.
[49] See: https://www.legislature.ohio.gov/legislation/legislation-documents?id=GA133-HB-62.
[50] State Earned Income Tax Credits (accessed December 2022). *Urban Institute* https://urbn.is/3ike8Gt.
[51] Shields, M. and Volker, A. (2022). Williams, K. (2020) Strengthen the Ohio EITC: The Working Family Tax Credit. *Policy Matters Ohio* https://bit.ly/3Zfd7jB

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Direct payments to families with children — such as the expanded federal CTC included in the American Rescue Plan — have been shown to reduce child poverty and make families more secure in difficult times. The expanded federal CTC provided all families making $150,000 or less with a fully refundable annual tax credit of $3,600 per child under 6 and $3,000 per child between 6 and 17. The policy change had an immediate impact on children and families across the nation. Nationally, the monthly CTC payments cut child poverty by roughly 30%.[52] In Ohio, more families could pay for groceries, rent, gas, childcare and other necessities.[53] Parents were able to continue working. Fewer families reported that they didn't have enough to eat.[54]

For this proactive tax agenda, we propose a state-level thriving families tax credit (TFTC) intended to replicate the success of the expanded federal CTC. In a recent report, Policy Matters has explored several possible ways to design a state-level TFTC.[55] Here we propose a refundable **$700 credit per child under the age of 18 for households with yearly incomes below $65,000.** The tax credit would phase out for families who make between $65,000 and $85,000 annually.

The combination of a refundable EITC and a state TFTC would have a powerful impact on Ohio households with the lowest incomes and the state as a whole. According to ITEP calculations, 40% of Ohio's lowest income quintile — tax filers with annual income of less than $23,000 a year — would see an average tax reduction of $626. Three-quarters of the benefits would go to the 60% of households with lowest incomes: Their average tax cut would be $232. The credits would be particularly beneficial to Black, Latinx, and multiracial households which are disproportionately represented in Ohio's lowest income quintiles. (See Figure 4.)

Figure 4

Average tax change as a result of proposed tax credits

Demographic Group (income below)	Total	Lowest 80% ($107,000)	Lowest 60% ($65,000)	Lowest 40% ($42,000)
White	−$168	−$202	−$209	−$210
Black	−$277	−$300	−$326	−$358
Asian	−$141	−$183	−$189	−$159
Hispanic	−$316	−$360	−$359	−$376
Multiple	−$227	−$251	−$272	−$282
Overall	−$185	−$221	−$232	−$242

Darker color indicates a larger tax reduction. Estimates provided by ITEP

[52] Parolin, Z. et al. (2021). Monthly Poverty Rates among Children after the Expansion of the Child Tax Credit. *POVERTY & SOCIAL POLICY BRIEF* https://bit.ly/3Qdwzco. Turner, C. (2022). The expanded child tax credit briefly slashed child poverty. Here's what else it did. *NPR*. https://n.pr/3xGAJI9

[53] Perez-Lopez, D. and Mayol-García, Y. (2021). Parents With Young Children Used Child Tax Credit Payments for Child Care. *US Census Bureau*. https://bit.ly/3DIOPX9.

[54] Petrik, w. (2021). Expanded child tax credit immediately improved life for Ohio children and families. *Policy Matters Ohio*. https://bit.ly/3BB559I

[55] Petrik, W. and Laplace, G. (2022).

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Recommendations and conclusion

We have the resources we need to build a more prosperous Ohio — it's a matter of how our elected officials choose to allocate them. The proposal outlined in these pages could provide enough revenue to fund the material and social infrastructure of a renewed, sustainable and equitable Ohio. Our proactive tax agenda is composed of the following elements:

- **An expansion of the personal income tax to 7.5% on incomes above $250,000 and 8.99% on incomes above $1 million.**
- **A state-level corporate income tax at a rate of 8.5%, which corporations would pay if it were higher than their existing commercial activity tax.**
- **Closing the LLC loophole.**
- **A refundable EITC at a rate of 10% of the federal credit.**
- **A thriving families tax credit of $700 per child under the age of 18 for households with yearly incomes below $65,000.**

Using a combination of figures provided by ITEP and our own calculations — ITEP does not include corporate income taxes as part of its microsimulation tax model — we estimate that, if enacted in its entirety, the agenda could produce more than $3.6 billion in additional revenue. This figure is net of new tax credits that would substantially benefit Ohioans with lower incomes. A significant portion of this revenue, almost $1 billion, would arise from the synergies between the elimination of the LLC loophole and the new income tax brackets. Wealthy individuals who today pay little to no taxes because their income is considered business income would go on to contribute something more akin to a fair share.

Policymakers have the power to build a fair proactive tax system that can be the basis for economic vitality and broad-based social prosperity. To do this, they must counteract decades of regressive tax policies that have allowed the wealthy and powerful to sidestep their contributions to society. We need a tax system that ensures all Ohioans, regardless of age, gender, race or ability, have the tools and opportunity to live a good life. Moreover, our tax system can help repair legacies of racialized discrimination that still plague our state. Our proactive tax agenda can contribute to these efforts.

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Appendix

The analysis presented in this report was derived in part from ITEP's proprietary microsimulation tax model, which estimates the amount of federal, state and local taxes paid by residents of every state at different income levels under current law and under alternative tax structures. The table below illustrates ITEP's estimates of the combined impact of our proactive tax agenda excluding the proposed corporate income tax.

Proactive Tax Agenda							
ITEP estimates of the proposal's combined impact							
	Bottom 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Richest 1%
Income Range	< $23,000	$23,000 - $42,000	$42,000 - $65,000	$65,000 - $107,000	$107,000 - $228,000	$228,000 - $551,000	> $551,000
Average Income in Group	$ 14,000	$ 32,000	$ 53,000	$ 83,000	$ 146,000	$ 327,000	$ 1,447,000
Tax Change as a % of Income	–1.8%	–0.7%	–0.4%	–0.2%	0.1%	0.9%	3.3%
Average Tax Change	–248	–234	–208	–157	+154	+2,904	+48,354