Policy Matters Ohio

EXECUTIVE SUMMARY
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Tax & Budget

OVERHAUL: A PLAN TO REBALANCE OHIO'S INCOME TAX

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Ohio needs a new tax policy, one that raises the revenue needed to provide excellent schools, strong public transit and treatment for Ohioans caught in the state's drug epidemic. Dramatic tax cuts since 2005 have weakened Ohio and created an upside-down system that causes those near the bottom of the income scale to pay nearly twice the share of their income in state and local taxes as the top 1 percent, who earn more than $1 million a year on average. Policy Matters Ohio outlines here a set of changes to the state income tax—the only major tax based on the ability to pay—that will bolster our ability to make key investments in education, human services and local governments. It will begin to reverse the slant of our tax system against low- and middle-income Ohioans—yet because state and the recent federal tax cuts have been so enormous, few of even the richest residents will be paying more overall when our proposed increases are added to recent cuts.

Policy Matters proposes the following changes to the state income tax:

- Restore the 7.5 percent income-tax rate on income over $218,250 approved in 1992 under Gov. George Voinovich;
- Add a new 8.5 percent rate on income over $500,000;
- Repeal the business income deduction enacted in 2013, which drains more than $1 billion a year from state revenues with little discernible impact on jobs or small-business growth, and
- Make our state earned income tax credit (EITC) refundable, removing a cap that reduces the amount many Ohioans may receive, and raising it to 20 percent of the federal amount.

This would generate almost $2.6 billion a year, including the cost of expanding the EITC, according to analysis by the Institute on Taxation and Economic Policy (ITEP), which has a model of the tax system. It would still leave Ohio's richest taxpayers with overall annual state tax cuts averaging more than $2,000 a year—and they'll receive additional giant tax cuts because of the federal tax bill approved last December. Many low- and moderate-income Ohioans, some 17 percent of tax filers in all, would see a tax cut if these state tax changes were enacted. Another 71 percent would see no change in what they pay.

Ohio needs to invest more in its people. We are falling behind many states in the share of low-income children who go to pre-school; our schools lost 3,200 social workers, guidance counselors and music, art and gym teachers between 2005 and 2014; our public higher education system is now one of the most expensive in the nation and need-based financial aid has not kept up even though higher-wage states have more educated workers. Communities need more funding to fight the drug epidemic. Ohio ranks last in state funding of children's services even after the boost in the current state budget. State funding for public transit remains a third of what the state Department of Transportation recommended in 2015. Local governments have lost a billion dollars a year in state aid, making it harder to ensure basic services.

Current Ohio tax policies aren't working. Cutting income-tax rates by a third since 2005, and creating the new LLC loophole, an exemption for owners of businesses like limited liability companies who pay personal income tax on their profits, have not brought strong job growth. First-time hires at new businesses have been flat since this huge tax break was approved in 2013. Moreover, changes in Ohio's taxes since 2005 have disproportionately benefited the highest income earners. ITEP analyzed the major changes in Ohio's tax system since then. It found that these have provided the top 1 percent of earners, who make at least $480,000 a year, with an average cut of $40,790 a year. That compares to an average increase of $10 for the 20 percent of filers in the middle of the income ladder, who make between $39,000 and $59,000, and an average increase of $140 for those with the lowest 20 percent of incomes, who make less than $22,000 a year.

The Policy Matters proposal would reverse some of the worst effects of the tax changes, generating revenue for needed investments while rebalancing the tax system based on how much people can pay. The proposed strengthening of the state EITC, a credit that goes to workers who meet income guidelines, means that many low- and moderate-income Ohioans would see a tax cut under the proposal. Middle-income filers as a group would receive a very small tax cut. The top 1 percent would pay 73 percent of the increase. The next 4 percent, earning more than $194,000, pay 19 percent of the tax increase. The bottom 60 percent, making less than $59,000, would pay less than 1 percent of the total. State tax cuts since 2005 more than offset the average increase for any Ohio income group from this tax plan.

The Policy Matters plan also needs to be seen in light of the federal tax law approved in late 2017. ITEP's analysis shows that this year, that will mean an average tax cut for Ohio's top 1 percent of $40,190. Combining the major state tax changes since 2005, the federal tax changes, and the effects of the Policy Matters plan, these top earners will see a huge tax cut this year. The new federal tax law also will increase the U.S. debt by an estimated $1.5 trillion over 10 years, building political pressure to cut federal programs that Ohio families of modest and low income rely on in the low-wage economy.

Ohio's economy needs long-term investments in the education and welfare of residents and restored state support to local governments, public transit and libraries. The state can pay for this by restoring state income taxes on the richest households. The tax proposal would make our state and local tax system more fair than it is today, while allowing state and local governments to prepare for federal cuts in critical services, should they occur. Rebalancing the tax code is a key to a more prosperous, equitable Ohio.