Budget & Revenue

Testimony on HB 33 before the Senate Agriculture and Natural Resources Committee

Guillermo Bervejillo (Bear-veh-he-yo), PhD

Chair Schaffer, Vice Chair Landis, Ranking Member Hicks-Hudson, and members of the Senate Agriculture and Natural Resources Committee, thank you for the opportunity to testify on House Bill 33. I am Dr. Guillermo Bervejillo, State Policy Fellow at Policy Matters Ohio, a nonpartisan, nonprofit research organization with a mission to create a more prosperous, equitable, and sustainable Ohio.

This committee has the responsibility of ensuring that the foundations for Ohio’s future are strong and lasting. In this critical time of post-pandemic recovery, the tax policies decided in this budget bill will reverberate years to come. We should use what surpluses there are to strengthen Ohio’s social and economic infrastructure to guarantee education, health, and opportunities in every community.

Let’s not repeat the mistakes of the past. Tax breaks for the wealthy and cuts to critical public institutions dragged out the recovery from the Great Recession, misallocated our collective resources, and hamstrung the state’s economic vitality. I urge you to ignore the siren song of corporate-backed tax cutting propagandists. We have cut income taxes 12 times over the past 23 years and the fanciful stories of growth and prosperity have yet to materialize. We have not received an influx of interstate migration, and what luck we have had attracting external investment — which has not outweighed the opportunity cost of defunding our communities — has been a direct result of social and economic infrastructure made possible by the collective investment of our tax dollars.

The income tax changes proposed in House Bill 33 would create more tax cuts for the wealthy, and temporary tax increases for some middle-income households (R.C. 5747.02, Sections 757.50 and 803.210). Only the top third of Ohioans would receive the full benefit of the proposed income tax rate reduction. More than half the value of the tax cut (50.7%) will go to the wealthiest 20% of Ohio households (who make more than $124,000 per year). And, because the bill suspends inflation adjustments, households making between $23,000 and $75,000 per year will, on average, see a temporary tax increase in the coming biennium. The bottom 20% of Ohio will see nothing but continued underinvestment in their communities: The likely results of spending cuts to offset the permanent $400-million-per-fiscal-year price tag.

---

2 Figures provided by the Institute on Taxation and Economic Policy.
3 Figure provided by LSC, disregarding the effect of suspending bracket indexing.
The tax reduction proposed in HB 33, if passed, will continue to drag down Ohio’s economy, limiting the state’s capacity to dedicate resources to critical social institutions and physical infrastructure. Worse yet would be if this committee folded to the pressure of corporate lobbyists preaching the myth of the so-called “flat tax.”

**The dangers of the so-called “flat tax”**

The flat tax is fiscally irresponsible, unfairly skewed, and an inefficient use of our collective resources. It is, in essence, a handout to the wealthy that comes at the cost of defunding critical needs such as schools, libraries, and other public institutions. If we adopt it, wealthy Ohioans will no longer be asked to contribute in accordance with the benefits they have reaped from society. They will be allowed to harvest the bounty that we have all sowed, without chipping in their fair share.

Study after study has shown that flat taxes primarily benefit the rich. For example, the 2.75% “flat” personal income tax proposed in House Bill 1 would provide nothing for the bottom 20% of Ohio households, a few dollars for middle-income Ohioans, and an average tax cut of $11,000 for the wealthy 1%. According to an analysis by the Institute on Taxation and Economic Policy (ITEP)—a nonprofit with a sophisticated model of the state and local tax system—89% of the value of the tax cut would go to the richest 20% of households (those making more than $124,000 per year) and 35% would benefit the richest 1% of households (those that make more than $617,000).
In truth, the flat tax does not achieve a flat state taxation schedule. That is because in Ohio, the wealthier you are, the less state and local taxes you pay as a share of your income. Sales taxes, property taxes, and excise taxes are all taxes that fall disproportionately on low-income Ohioans. The personal income tax is the only state tax that is based on your ability to pay. Flattening the income tax makes the whole tax system even more skewed in favor of the rich. If the committee truly desires to flatten the tax system, you should increase taxes on wealthy Ohioans until they pay the same share of their income in taxes as working-class Ohioans do.

There is no logical reason why this “flat tax” experiment will deliver where other tax cuts have failed. In other states, flat taxes have not been able to guarantee economic prosperity. In fact, Midwestern states with flat taxes have tended to grow slower than both Ohio and the national average. The chart below provides a comparison of annual GDP growth of flat tax states from 2014 to 2021. (I use these dates because 2014 is when North Carolina instituted its flat tax.) The flat tax states with the highest growth rates had some of the highest tax rates. It is also worth noting that the proposed 2.75% rate is substantially below that of the states depicted in the chart.

None of this is very surprising. Economic growth is a function of healthy communities, educated workers, effective infrastructure, and other social factors that are made possible by state revenue. Flat income taxes guarantee a regressive tax structure, are not particularly beneficial to small businesses, are not meaningfully simpler than graduated income taxes, and can cause budget challenges.

Flat taxes are also not a particularly good tool to attract businesses or investors. According to a recent ITEP study, local taxes account for just 2.3 percent of the cost of doing business, with the other 98 percent tied up in other areas like payroll, equipment, and

<table>
<thead>
<tr>
<th>State</th>
<th>Tax rate</th>
<th>GDP growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illinois</td>
<td>4.95%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>3.07%</td>
<td>2.8%</td>
</tr>
<tr>
<td>Indiana</td>
<td>3.15%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Michigan</td>
<td>4.25%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Ohio</td>
<td>--</td>
<td>3.5%</td>
</tr>
<tr>
<td>United States</td>
<td>--</td>
<td>4.1%</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>5.00%</td>
<td>4.5%</td>
</tr>
<tr>
<td>North Carolina</td>
<td>4.75%</td>
<td>4.6%</td>
</tr>
<tr>
<td>Colorado</td>
<td>4.40%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Utah</td>
<td>4.85%</td>
<td>6.8%</td>
</tr>
</tbody>
</table>

Recently, Massachusetts has added another tax bracket and Arizona, Idaho, Kentucky, Iowa, Mississippi, and Georgia have either become flat tax states or are in the process of doing so. Table: Policy Matters Ohio • Source: U.S. Bureau of Economic Analysis. • Created with Datawrapper

---


real estate costs. Moreover, Ohio’s existing business taxes are already below the national average. According to a study by Ernst & Young for the Council on State Taxation, a business lobbying group, Ohio’s state and local business taxes per employee were $5,700 in Fiscal Year 2021, compared to a national average of $7,800. As a share of Gross State Product, Ohio was 4.1% vs. national average of 4.9.

Flat taxes are also unlikely to attract significant interstate migration. The data on interstate migration show that the principal reasons people move are for better housing options, for career reasons, and for family. We also know that interstate migration has declined in recent decades, down to a rate of 1.5% of households since 2010, half of what it had been decades prior. Over that same period there has been an increasing divergence in state tax rates that has not slowed declining residential mobility.

People move to where they can live happily and comfortably. They move to places that have great parks, good schools for their kids, strong healthcare systems, and a sense of community that comes from broad-based prosperity. People start businesses where there is trustworthy infrastructure, where there is a strong workforce, and where customers can afford their products. It is disingenuous to claim that state income taxes are a driving factor in residential or commercial mobility.

Most wealthy households are embedded in the state where they live: They have business 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 public services. The few millionaires that might emigrate in the face of tax increases are those that are least embedded in local economies and experience has shown that they are never numerous enough to outweigh the direct benefits that come from adequately funding schools and other public institutions.

**Other tax changes in HB 33**

Many of the tax provisions included in the budget are poorly targeted and worryingly inefficient. While the impulse to support young families with a sales tax exception on infant products (R.C. 5739.01, 5739.02; Section 803.50) is commendable, this is not well targeted. The sales tax exemption will most benefit those who can afford top-of-the-market infant products. Meanwhile Ohio parents who can only buy the cheapest diapers or acquire infant clothes second-hand will see less benefit from this exemption. A sales-tax credit would better accomplish the goal of this provision.

---


The homeowners’ savings account deduction suffers from a similar flaw (R.C. 5747.01, 5747.84, Sections 701.10, 803.160, 803.220). Ohioans who are in most need of housing assistance do not have $5,000 in annual disposable income to take advantage of this policy. The house buying process is complex enough as it is; this obstruse accounting mechanism will not make it any easier. Take-up will likely be more prevalent among higher-income Ohioans who don’t need such assistance.

The bonus depreciation deduction is an expensive and unnecessary addition to the tax code (R.C. 5747.01, 5733.40, Section 803.160). This proposal will cost the state more than $500 million in the short run. If the tax structure does not change then most would be recouped in the long run, but what is lost forever is the opportunity to dedicate those resources to the urgent issues facing Ohioans today. Notably, bonus depreciation that Ohio would allow through this bill gives taxpayers credit for investments their businesses make elsewhere, outside Ohio. What interest does Ohio have in providing a tax break when companies invest in Denver or Dallas instead of Dayton? It is especially unproductive to allow taxpayers to accelerate depreciation from prior to 2023 that was to be spread over subsequent years. Those investment decisions were already made, so it’s just a costly giveaway that will not incentivize any new investment. Most states, like Ohio, remain decoupled from federal law on bonus depreciation.

The proposed budget also includes a permanent increase in the motion picture tax credit: from $40 million to $75 million (R.C. 122.85). This is an expansion of an already wasteful tax expenditure. As a study from the National Conference of State Legislatures explains: “The states that have performed evaluations of their film tax incentive programs have commonly found that, despite the positive anecdotal evidence that accompanies big film projects, such programs do not provide a substantial return on investment and, if economic development is the goal, other policy avenues might be more productive.” Ohio’s motion picture tax credit does not pay for itself and should be abolished.

The motion picture tax credit expansion will add to the long list of existing state tax expenditures. Tax expenditures are policies that forgo tax revenue to benefit a target population. They can be beneficial, providing support for those who need it most. The low-income housing tax credit seems likely to spur the construction of more low-income housing, which would help alleviate Ohio’s severe shortage of affordable housing stock. We also applaud the support provided to the residents of East Palestine (R.C. 5747.01, 5751.01; Section 803.160). However, the lack of oversight and the fact that tax expenditures do not sunset mean that many tax expenditures are likely wasteful handouts to special interest groups. The list in the tax expenditure report has ballooned to 154 tax expenditures accounting for $11 billion of forgone revenue every year or 37% of state revenues. Fifteen new tax expenditures listed in the Governor’s Tax Expenditure Report by themselves account for an additional $200 million of forgone revenues.

Concluding recommendations

Il R.C. 175.16, 175.12, 5725.36, 5725.98, 5726.58, 5726.98, 5729.19, 5729.98, 5747.83, and 5747.98
Long-term prosperity is built from the ground up, by investing in people, places, and institutions that will create the next great innovations. Legislators are in a very fortunate position to be able to restore and reinvest in Ohio. Researchers in partnership with community-based organizations have identified many high priority areas that need real investment. A portion of this list is included here, but the recommendations are also reflected in Ohio’s People’s Budget (available at https://www.allinforohio.com/peoples-budget).

**Boost the economic security of children and families.** A Thriving Families Tax Credit would help nearly 986,000 families and 1.8 million children with an average tax refund of roughly $1,000 a year. This tax credit would help more families pay for groceries and reduce hunger and insecurity. State lawmakers can amend H.B. 33 to include the Thriving Families Tax Credit.

**Boost the financial security of Ohio workers.** Adding a 10% refundable option to Ohio’s Earned Income Tax Credit (EITC) would put more money back in the pockets of workers who are paid low wages. State lawmakers can re-write the tax code to help stabilize families, give children more opportunities for a better life, and build a more equitable Ohio.

**Restore the Voinovich-era 7.5% tax rate on incomes above $250,000 and add a new rate of 8.99% on incomes above $1 million.** This reform would have no impact on 98% of Ohioans. The personal income tax is the only state-level tax that is based on the ability to pay: Those who have more resources contribute more. An increase in the rate of taxation of the wealthiest households can fund education and significant social programs that benefit everyone — and it is broadly popular in polls of likely voters. This modest contribution by the wealthiest Ohioans by itself could raise about $1.7 billion per year, enough to fully fund the Fair School Funding Plan and have an enormous impact on families and children across the state.

**Close the LLC loophole.** The LLC loophole, formally known as the Business Income Deduction, 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 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. Eliminating the LLC loophole would affect less than 10% of tax filers. According to estimates by ITEP, 82% of the revenue raised by eliminating this wasteful loophole would be paid by the richest 5% of Ohioans. If the loophole were closed in conjunction with the strengthened personal income tax proposed above, it could generate an additional $1 billion in revenue.

**Reinstate an 8.5% state-level corporate income tax that works in concert with the existing CAT tax.** Ohio corporations that report substantial and growing profits are not contributing commensurately to public services that make their profits possible. 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. This legislature should reinstate the 8.5% corporate income tax, requiring corporations to pay the higher of the two.\footnote{For our plan to set the foundations of a thriving Ohio see: https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/setting-the-foundations-for-a-thriving-ohio-with-a-proactive-tax-agenda}

Thank you for the opportunity to give testimony of HB 33, I would be happy to answer any questions you may have.