



Zach Schiller: That 2005 overhaul of Ohio's tax code? It isn't working

By Zach Schiller

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On Friday, Akron residents and others from Northeast Ohio will have a chance to tell a special committee of the Ohio House of Representatives what they think about the state tax system.

If there is one message the committee should hear, it's this: The big overhaul of the tax system in 2005 — billed as just the thing Ohio needed to generate jobs and improve its standing — hasn't worked. It's time to revisit it, both to generate more revenue to meet the state's needs and to make the tax system more fair for Ohioans.

More than six years ago, the Ohio General Assembly approved the biggest changes in the state and local tax system in a generation. It slashed personal income tax rates by 21 percent, saving \$10,000 a year for the most affluent Ohioans and a fraction of that for the vast majority of the rest of us. It also eliminated the state's tax on corporate profits, making Ohio one of only six states in the country without such a tax, and phased out a major local property tax on business that covered machinery, equipment, inventory and other items. It replaced these two taxes with a new one called the commercial activity tax (CAT), which covers business receipts.

The Ohio Department of Taxation already has told the committee that the tax changes are costing the state at least \$2.5 billion a year. Had those cuts not been in effect, we would have had the money to avoid the big cuts to public education and local governments that were the major feature in the two-year state budget approved in June.

Ohioans can see that the tax cuts didn't work. Ohio has a smaller share of the country's jobs today than we did when the tax overhaul was approved. Growth in our economic output and personal income have trailed behind the nation as a whole.

It's not surprising that the tax cuts didn't bring strong economic gains. As researchers at the Federal Reserve Bank of Cleveland have found, there isn't a significant relationship between state income growth and average tax rates. In July, North Dakota and South Dakota had the lowest and third-lowest unemployment rates in the country. Yet North Dakota has the fifth-highest overall state and local tax level in the country, while South Dakota has the lowest.

Ohio taxes, and taxes on business in particular, are not exceptionally high. In fact, a number of recent studies have found that business investment in Ohio is taxed at competitive or even low rates.

The tax study committee that will be visiting Akron is reviewing three tax issues in particular: the sales tax, the commercial activity tax, and tax expenditures, the overall term for tax exemptions, credits and deductions.

The CAT is a very broad, low-rate tax, covering a wide array of businesses. With the CAT, businesses are paying about \$1.8 billion a year less than under the two taxes it replaced. This contributes to the imbalance between what individuals and businesses pay in state and local taxes: Businesses pay far less as a share of the total now than they did in the 1970s.

The sales and use tax, after the income tax, is the biggest source of state tax revenue. However, since it only covers goods and those services that are specifically included, it increasingly covers a smaller and

smaller part of the Ohio economy. If you hire a lobbyist or a debt collector, for instance, you don't pay the sales tax. The General Assembly needs to broaden the base of the sales tax to cover more services.

Ohio tax expenditures add up to more than \$7 billion a year. They receive no regular review. Some of these are special-interest giveaways. Why do we give utilities a break on the sales tax for pollution control equipment they are mandated to use? Why do buyers of time-shares in jet aircraft get a break on the sales tax? The committee should call for a detailed study of all 128 tax breaks. Tax expenditures should be given automatic sunset dates, so they expire unless their worth is proved as part of a review.

Ohio's state and local tax system is weighted against low- and middle-income Ohioans, who pay a larger share of their income in such taxes than rich Ohioans do. The 2005 tax overhaul reinforced that and deprived the state of essential resources for public services. The tax overhaul needs to be revisited to provide needed revenue from those who can afford to pay.

Schiller is research director at Policy Matters Ohio, a Cleveland-based think tank.

The Ohio House Tax Structure Study Committee will hold its Akron hearing on Friday at 10:30 a.m. at the Martin University Center on the University of Akron campus.

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