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To: The Honorable Larry Householder, Speaker of the House

From: Frederick Church, Deputy Tax Commissioner

Date: March 31, 2004

**RE: DISTRIBUTIONAL IMPACT OF THE PROPOSED THREE BRACKET
INCOME TAX WHERE THE TAX RATES ARE NOT MARGINAL
RATES**

The Ohio Department of Taxation (ODT) has reviewed Representative Kilbane's income tax proposal, which has three tax brackets. The tax brackets are not conventional tax brackets, with marginal tax rates. Representative Kilbane's plan is extremely unusual in that at certain income levels filers pay higher tax rates on all of their income, not just on their income above the breakpoint.

The impact that this has on filers who move from being below the income breakpoints to exceeding the income breakpoints can be illustrated by simple examples.

Example 1: married joint filers with income of \$20,000 pay no tax, but married joint filers with income of \$20,001 would pay tax of \$500.03. This means that the additional tax on that additional \$1 of income slightly exceeds 50,000 percent.

Example 2: married joint filers with income of \$45,000 pay tax of \$1,125.00, but married joint filers with income of \$45,001 would pay tax of \$1,755.04. This means that the additional tax on that additional \$1 of income slightly exceeds 63,000 percent.

As one might expect, the huge additional burdens placed on taxpayers at low to moderate income levels leads to an overall change in the distribution of tax burdens that favors high income taxpayers at the expense of middle-income taxpayers (very low income taxpayers, whose federal adjusted gross income is less than \$10,000, also benefit from this proposal).

The table in Appendix A has detail on how many taxpayers have tax increases and how many taxpayers have tax decreases in 7 different income brackets. The table also shows what the average increase or decrease in taxes is in each group, and overall. The results in the table are based on a simulation of Representative Kilbane's proposal compared to current law for tax year 2001, so that the current law distributions are based not on future year projections but on actual historical results.

To summarize the table results, 3.34 million Ohio taxpayers would experience tax increases under Representative Kilbane's proposal, while 1.42 million Ohio taxpayers

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would get tax cuts. The ratio of taxpayers with tax increases to those with decreases is 2.4 to 1. Put another way, of all the taxpayers whose taxes change as a result of Representative Kilbane's proposal, about 70 percent bear tax increases while 30 percent receive tax cuts.¹

The impacts of Representative Kilbane's proposal are starkest on middle income Ohioans. Of the taxpayers whose federal adjusted gross income (FAGI) is between \$10,000 and \$80,000, 85 percent would have tax increases under Representative Kilbane's proposal (3.16 million taxpayers get income tax increases, while 0.57 million get tax cuts). Even for taxpayers with incomes between \$80,000 and \$100,000, losers outnumber winners by almost 2 to 1, and the amount of additional taxes exceeds the amount of tax decreases by about 4 to 1.

Since Representative Kilbane's proposal is very close to revenue neutral in the aggregate (it cannot be exactly revenue neutral due to technical considerations such as limiting the amount of digits in the proposal's tax rates) the tax increases borne by the middle class must be made up by tax cuts elsewhere. The table in Appendix A shows that 91.5 percent of taxpayers whose incomes exceed \$100,000 get tax cuts, and the tax reductions for those 314,000 taxpayers exceed \$1 billion.

In addition to the summary distribution results in Appendix A, ODT has prepared two examples of the impact of Representative Kilbane's proposal on actual Ohio taxpayers. These are shown in Appendix B.

The two taxpayers chosen were a senior citizen couple filing jointly and a married couple with two wage earners filing jointly. The reason that ODT chose these two particular examples was that they illustrate the features of Representative Kilbane's proposal that create tax increases for middle-income taxpayers. For senior citizens, the removal of the current-law exclusion for social security income, the removal of the senior credit (\$50 per return), and the removal of the retirement income credit all contribute to large tax increases, both in dollar terms and in percentage terms.

The senior citizen taxpayer shown in Appendix B would have a tax increase of \$1,216, or 321 percent, under Representative Kilbane's proposal.

For joint filers where both spouses earn income, one of the features of Representative Kilbane's proposals that exacerbates the tax increases is the elimination of the joint filer credit. As the example in Appendix B shows, even without the loss of the credits, the two-earner couple would pay more tax under Representative Kilbane's proposal, but the loss of the \$20 personal exemption credits and the joint filer credit more than doubles the tax increase, from \$231 to \$515 (a total increase of 37.3 percent).

¹ There are roughly 600,000 Ohio returns that show zero liability under both current law and Representative Kilbane's proposal. These "no change" taxpayers are not shown in the table in Appendix A.

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**Cc: The Honorable Sally Conway Kilbane
Jonathan McGee, Chief of Staff, House Majority Caucus
Christine Morrison, Caucus Executive Assistant, House Majority Caucus
Kim Wisecup, Administrator of Legislation
Doris Mahaffey, Senior Tax Analyst
Mike Sobul, Assistant Administrator of Tax Analysis
Mark Aiken, Legislative Liaison**

APPENDIX A

DISTRIBUTIONAL IMPACT IN 2001 OF INCOME TAX WITH TWO TAX BRACKETS: 2.5% AND 3.9%

\$10,000 Exemption for Single and Married filing separate returns - applies only to taxpayers with FAGI of \$10,000 or less

\$15,000 exemption for Head of Household applies only to taxpayers with FAGI of \$15,000 or less

\$20,000 Exemption for Married filing joint returns - applies only to taxpayers with FAGI of \$20,000 or less

No other Deductions, Additions, Exemptions, or Credits, Except the Resident and Non Resident Credits

Brackets depend on filing status:

Lower bracket: for single & married filing separate: \$0 to \$35,000; for head of household - \$0 to \$40,000; for married filing separate - \$0 to \$45,000

Higher bracket: for single & married filing separate: \$35,000 and above; for head of household - \$40,000 and above; for married filing separate - \$45,000 and above

Comparison of Representative Kilbane's Plan as if it Had Existed in 2001 with Actual 2001 Tax Burdens

		Under \$10K	\$10K-\$20K	\$20K-\$40K	\$40K-\$60K	\$60K-\$80K	\$80K-\$100K	Over \$100K	Total
Taxpayers with Lower Taxes	Count	445,978	173,903	325,822	35,239	37,224	85,493	313,538	1,416,997
	Dollar Amount	\$11,424,820	\$14,386,818	\$20,691,331	\$3,246,956	\$2,252,093	\$13,726,211	\$1,020,123,168	\$1,085,851,195
	Average Decrease	\$26	\$83	\$64	\$92	\$61	\$161	\$3,254	\$766
Taxpayers with Higher Taxes	Count	0	664,628	1,189,036	845,894	459,742	154,059	29,081	3,342,420
	Dollar Amount	\$0	\$142,899,374	\$261,309,030	\$380,998,649	\$208,864,809	\$51,777,164	\$26,787,291	\$1,072,636,317
	Average Increase	\$0	\$215	\$220	\$450	\$454	\$336	\$922	\$321
All Taxpayers	Count	445,978	838,531	1,514,658	881,133	496,966	239,552	342,599	4,759,417
	Dollar Amount	-\$11,424,820	\$128,512,756	\$240,617,689	\$377,751,693	\$206,612,716	\$38,050,953	-\$993,335,877	-\$13,214,878
	Average Change	-\$26	\$153	\$159	\$429	\$416	\$159	-\$2,899	-\$3
Percentage with higher taxes:		0.0%	79.3%	78.50%	96.0%	92.5%	64.3%	8.5%	70.2%

NOTES

1) Tax rates are Flat rates: Each taxpayer pays rate applicable to his FAGI level on all taxable income

2) Exemptions only available to taxpayers with incomes equal to or less than relevant exemption;

Taxpayers with income higher than exemption are taxed on entire amount of income

APPENDIX B

EXAMPLES OF TAX INCREASES UNDER REPRESENTATIVE KILBANE'S PLAN

	Senior/ Current Law	Senior/ Kilbane Plan	2 Wage Earner/ Current Law	2 Wage Earner/ Kilbane Plan
FAGI	45,317	45,317	48,605	48,605
OAGI	31,182	45,317	48,605	48,605
Taxable Income	28,882	45,317	46,305	48,605
Tax Before Credits	841	1,767	1,665	1,896
Credits	290	0	284	0
Liability	551	1,767	1,381	1,896
Percent Increase		321 %		37.3 %