Policy Matters Ohio

Tax Policy
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Testimony to Subcommittee of the House Ways & Means Committee on HB 59 income-tax plan

Zach Schiller

Good morning, Chairman McClain, Ranking Member Letson and members of the committee. My name is Zach Schiller and I am the research director at Policy Matters Ohio, a nonprofit, nonpartisan organization with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify today regarding House Bill 59.

The governor's proposal to reduce the income tax through a 20 percent rate cut and the exclusion of half of business income from the tax will make the state's tax system less fair, providing a far larger benefit to upper-income Ohioans than to middle-income or low-income Ohioans. At the same time, these changes are unlikely to produce significant economic gains. We strongly urge that the subcommittee reject the income-tax proposals, which also will weaken the state's finances.

The income tax is the only major tax that is based on the ability to pay. Even with that, lower- and middle-income Ohioans pay a larger share of their income in state and local taxes than upper-income Ohioans do. According to an analysis by the Institute on Taxation and Economic Policy (ITEP), the proposed 20 percent rate cut on average would mean a tax cut of just $144 a year for Ohioans in the middle fifth of the income spectrum, who made between $33,000 and $51,000 in 2012. The bottom fifth will average just $7. Those in the top 1 percent, who earned more than $335,000, will see a reduction of $7,777. Higher-income Ohioans also will see a much greater reduction as a proportion of their income than low-income Ohioans do (the report is available at www.policymattersohio.org/tax-policy-feb2013).

We have recent experience with income-tax cuts. The 21 percent income-tax reduction approved by the Ohio General Assembly in 2005 has now had years to work the economic magic that its proponents said it would create. Between June 2005 and January 2013, Ohio lost 236,000 jobs, or 4.4 percent of the total. During that time, the United States gained more than 1.1 million jobs, or 0.9 percent. Ohio also has lagged by other economic measures, such as manufacturing jobs and personal income. This began well before the recession; we didn't just fall behind when the economy was doing poorly. Thankfully, we have seen some improvement since the end of the recession in June 2009.

However, the budget proposal submitted by Gov. Kasich assumes that Ohio will grow less than the national economy during both fiscal years 2014 and 2015. According to the forecast by IHS Global Insight that is the basis for tax revenue estimates used in the budget, Ohio's personal income, real gross domestic product, nonfarm employment and retail sales will grow less than those of the United States as whole (see House Finance Committee testimony of Budget Director

Timothy S. Keen, February 5, 2013). Why would we double down on a bet that did not work last time?

States without income taxes were hit by the recession just as Ohio was. Nevada, with no income tax, had the highest unemployment rate in the country as of December. States without income taxes don't perform any better on a number of key measures of economic performance, such as median household income growth, than those with the highest top income-tax rates; in fact, they often do worse. One recent study reviewed state economic growth between 2007 and 2011, and found that there was no statistically significant relationship between the top individual income-tax rate on the one hand and state GDP, nonfarm employment or per capita income on the other.

The business-income exclusion is very poorly targeted and is unlikely to result in significant new job creation. The taxpayers who benefit on average will get so little that they couldn't add employees in any meaningful way. Based on 2009 data from the taxation department, the median taxpayer benefiting from the exclusion has annual business income of $3,103. Even if all of this income were taxed at the full rate, the exclusion would result in an annual tax cut of less than $200. A recent national study by researchers at the U.S. treasury department found that only 11 percent of taxpayers reporting business income own a bona fide small business with employees other than the owner. Yet at the same time, the proposed business-income exclusion represents a windfall for affluent passive investors, and partners in law firms and other partnerships.

Business owners who will benefit from the exclusion also received the 2005 income-tax cuts, since they pay tax on such income under that tax. Yet there is scant evidence that those cuts resulted in growth in Ohio's small businesses. Between 2004 and 2010, Ohio's share of U.S. employment fell both at companies with fewer than 20 employees and those with fewer than 500 employees. Yet this new tax exclusion will drain more than $600 million a year from the state.

This revenue is needed. The income-tax reductions will keep Ohio from reversing cuts to local governments, schools and human services that have damaged our communities. Our college and university tuition is high, yet our support of need-based aid remains well below earlier levels even as more Ohioans need to get a college education. The state provides just $366,003 a year for all 88 counties to divide in order to provide protective services for the neglected and abused elderly. Scores of public library systems across Ohio have had to seek local property tax levies for the first time because of the decline in state support over several budget cycles. Ohio ranks 47th in state support of public transportation. Subsidies for child care, which allow parents to work, were chopped in the last budget and have not been reinstated.

The overall tax proposal in the governor's budget calls for a net tax cut of half a billion dollars in Fiscal Year 2016. This shifts to the next legislature the responsibility for finding budget cuts or other revenues to make up this amount. This is fiscally irresponsible, creating a deficit in the next budget. It repeats the mistake of the 2005 tax cuts, which spilled out beyond the FY2006-07 biennium and were not paid for. They combined with the weak economy to help cause the budget crises of 2009 and 2011. We should not repeat the mistake and approve unfunded tax cuts.

The administration also intends to fill up the rainy day fund and give more than $400 million in tax cuts for this year. This is ill-advised. ITEP has analyzed how a cut of that size for Ohio residents would affect people in different income groups. The fifth of Ohio taxpayers in the middle of the income spectrum on average would see a tax cut of $36 a year. Those in the bottom fifth would see just a $2 cut. Those in the top 1 percent, meanwhile, on average would see a reduction of more than $1,900 a year. These funds would be better used restoring services and investing in Ohio’s future than for a tax cut that most Ohioans will barely notice. Businesses need key services, just as individual Ohioans do. That means good schools and colleges that produce skilled workers, health care that ensures workers keep working and stay productive, modern infrastructure that allows businesses to get their goods to market, and public safety and court systems.

The income-tax cuts proposed in House Bill 59 will further tilt the tax system in favor of Ohio’s most affluent, while doing little for our economy. We need to move in the opposite direction. One concrete step would be to enact a refundable state Earned Income Tax Credit, as a percentage of the existing federal EITC. Created by President Gerald Ford in 1975 and expanded under every presidential administration since, the EITC is lauded for its direct impact in lifting families with children above the poverty line, making work pay, and sending federal dollars to local communities.

Thank you for allowing me to testify on the income-tax component of HB 59. I am happy to answer any questions that members of the committee may have.

Policy Matters Ohio is a nonprofit, non-partisan research institute with offices in Cleveland and Columbus.