Sales-tax credit would help low-income Ohioans

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Gov. John Kasich has proposed major changes in Ohio's tax system, including broadening the sales tax to cover most services and cutting the state rate from 5.5 percent to 5 percent. This would produce needed revenue and make the sales tax more viable long-term, since more and more of the Ohio economy is based on services. The problem: Low- and moderate-income Ohioans would be most affected, as they would pay the most as a share of their income.

One way to blunt the impact of sales tax broadening on low- and moderate-income Ohioans is to adopt a sales-tax credit. These credits, which five states currently offer, provide a set amount for each member of a family to offset some of the cost of a sales or similar tax. If the governor's sales-tax proposal does not go forward, such a credit is still worth consideration because it would provide a targeted way to offset the regressivity of the existing sales tax.

Key findings

- A state sales-tax credit, styled on one in New Mexico, would benefit hundreds of thousands of Ohioans.
- A sales-tax credit would provide a targeted way to offset the regressivity of the existing sales tax.
- Together with a state Earned Income Tax Credit, it could protect nearly two-thirds of the lowest-income Ohioans from the effects of Gov. Kasich's plan to broaden the sales tax.

Ohio could model such a credit on New Mexico's Low Income Comprehensive Tax Rebate (LICTR). The credit is available to filers with income below $22,000 a year, is biggest for large, low-income families and gradually phases out as income grows. A family of three at the federal poverty level this year, meaning they have income of $19,530 or below, would receive $40; a family of two at the poverty level of $15,510 or less would receive $55. The tax is refundable, meaning the value of the credit does not depend on the amount of income tax owed.

The Institute on Taxation and Economic Policy, a Washington, D.C., research group with a sophisticated model of the state and local tax system, examined how the implementation of a New Mexico-style credit would affect taxpayers of different income groups in Ohio. Assuming that half of those eligible for the credit would receive it, ITEP found that nearly half of Ohioans in the bottom fifth of the income spectrum, with earnings of less than $18,000 in 2012, would benefit from such a credit. On average, those qualifying in this income group would receive $106 a year. It would cost the state about $70 million a year.

The New Mexico LICTR can definitely be improved upon. Despite inflation, it hasn't been increased since 1998, and the income cut-off of $22,000 leaves many out. The Ohio version should expand on the existing New Mexico credit to increase the amounts and the phase-out threshold. This would offset more sales-tax payments and allow more Ohioans to benefit.

Ohio also should adopt a state Earned Income Tax Credit, as 24 states and the District of Columbia have. The credit is based on a percentage of the federal program, ranging from 3.5 percent to 50 percent. A state EITC provides additional support to low-income families by helping them purchase essentials and save for future emergencies. It helps children succeed, historically has received bipartisan support, and is spent in the local economy. A state EITC funded at 10 percent of the federal credit would provide the average qualifying Ohio family $224 a year.

As beneficial as an EITC would be, it would only cover a third of the poorest Ohio taxpayers, those in the bottom fifth of the income spectrum. The enactment of a New Mexico-style sales-tax credit along with it would double that number, compared to an EITC alone. This would allow more than 700,000 low-income Ohioans – those who made less than $18,000 in 2012 – to receive protection.

Qualified tax filers would receive either one credit or the other, whichever worked out to more for them. In all, more than 1.2 million Ohioans would receive the sales tax credit or the EITC. That would cost about $230 million a year, less than one tenth of the additional revenue the Kasich administration estimates from the sales-tax broadening.

A combination of these two credits would help offset much of the impact of a sales-tax base-broadening on low-income Ohioans. Those qualifying taxpayers in the lowest fifth of the income spectrum on average would get $155, or more than the additional sales tax they would pay under the Kasich proposal.

Strong promotion needed

The enactment of both of these credits as outlined in this report would not fully protect low- and moderate-income Ohioans from the proposed expansion of the sales tax. A robust promotional campaign would be needed to ensure participation in both credits, especially the sales-tax credit. Otherwise, eligible taxpayers may not learn about the credit, and those who do not have to file income tax forms might not claim it. The sales-tax credit also would require more of an outreach effort than a state EITC because of the existing federal EITC program, which benefited more than 950,000 Ohioans in tax year 2011.

Kasich's proposal to broaden the sales tax may not survive, or it could be drastically scaled back. Legislators should keep a sales-tax credit in mind in any event. Though Ohio's constitution prohibits taxing groceries and other food consumed off the premises, our state and local tax system is still weighted against low- and moderate-income taxpayers. Those nonelderly Ohioans in the bottom fifth of the income scale (making less than $17,000 in 2010) on average pay 11.6 percent of their income in state and local taxes, compared to just 8.1 percent for those in the top 1 percent, who each made more than $324,000 that year. Much of this difference is because the existing sales tax falls most heavily on low- and moderate-income Ohioans. A sales-tax credit is a targeted way to address this ongoing problem, which would be intensified by the Kasich administration proposal to apply the sales tax broadly to services.