Policy Matters Ohio

Tax Policy
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Testimony to House Ways & Means Committee on tax reform

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Good afternoon, Chairman Beck, 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 tax reform.

As you consider tax reform proposals, we believe it is especially important to ensure that the state has adequate revenue to make needed investments in Ohio's future, and that those who are able to pay are bearing the biggest responsibility for doing so. Neither of these things is true now. Nor can it be said that Ohio's state tax system meets the tax policy principles of simplicity and a broad base when 129 tax expenditures valued at more than $7 billion a year clutter the tax code.

Ohio is not investing as much as it needs to achieve long-term economic success, or to provide the services that distinguish a caring society. Our spending on K-12 education is not adequate. A large majority of Ohio school districts responding to a recent survey report that they have cut or frozen salaries and benefits, laid off staff, or cut back on classroom materials and supplies to deal with the loss of state funding since 2011. Students in many districts are facing larger class sizes, reduced course offerings, and an increase in "pay-to-play" requirements for extra-curricular activities. Despite what Governor Kasich recently called "these unbelievably high costs of higher education," actions to make college affordable remain insufficient.

At the same time, we require poor and middle-income Ohioans to pay more of their income in state and local taxes than the most affluent do. This is clear from a recent analysis by the Institute on Taxation and Economic Policy. Ohio residents in the middle fifth of the income spectrum, who made between $31,000 and $49,000s in 2010, pay 10.6 percent of their income in such taxes, compared to just 8.1 percent for those in the top 1 percent, who made at least $324,000 in 2010. Those in the bottom fifth, who made less than $17,000, paid relatively more: 11.6 percent.

With that backdrop, it would be misplaced to cut the income tax, or to seek additional sources of revenue in order to add to the 7 percent reduction the House approved in HB 59. That's what the General Assembly did in 2005 and since then Ohio:

- Has trailed every state but three in job growth
- Has seen slower employment growth than the nation in every major industrial sector
- Underperformed the nation on jobs before, during and after the recession
- Has finally been reporting a lower unemployment rate than the nation—but more because workers are leaving the labor force than because of job growth.

This shows that income-tax cuts are not the tonic for Ohio's economy. On the contrary, we should bolster the income tax so that top earners pay more than they do now. The 7.5 percent top rate adopted under Gov. George Voinovich in 1992 did not prevent Ohio from generating more than 100,000 jobs each year from 1993 to 1995.

Ohio has phased out its corporate income tax, becoming just one of six states in the country without one. While the Commercial Activity Tax has a broad base, it delivers far less revenue than the two business taxes it replaced. This was been made painfully clear to school districts and local governments that have seen huge chops in the state payments that reimbursed them for lost tangible personal property tax—including vital levies for mental health, children's and senior services. Over the last generation, Ohio's taxes have shifted so that individuals are paying a greater share of Ohio's state and local taxes, while the share paid by business has declined. This needs to be rebalanced.

Tax expenditures deserve to be examined and debated on a regular schedule just as state spending is. Many tax expenditures have continued for decades, draining state revenue, providing a special advantage to certain taxpayers, without an accounting for whether they serve their original purpose or even what that purpose is. Others are as new as the current biennial budget.

Seventy-six existing tax expenditures, accounting for more than half the total value, go for business assistance and economic development. These should be included in a unified economic development budget, which would require disclosure of who is benefiting from all of the state's economic development programs and what beneficiaries provide in return over time. This should include a specific listing of the recipients of these tax expenditures and the public benefits they provide – jobs, wages, investments, etc. – as is already required for some existing economic development programs.

All tax expenditures should be sunsetted so they will only continue if a review determines that they are necessary. Some should be repealed or limited. For example, the $800 sales-tax cap for purchases of shares in jet aircraft – in effect, timeshares for those wealthy enough – should be scrapped. So should the provision that allows big companies – and big companies only – to write off losses from years ago against the Commercial Activity Tax.

In reviewing the state's 129 tax expenditures and other elements of the tax code, it's important to keep in mind that the state and local tax system is weighted against low- and middle-income Ohioans. Reducing or eliminating income-tax exemptions and credits such as the $20 credit and using the funds for an across-the-board income-tax cut would amount to a tax shift from poor and middle income Ohioans to the more affluent. That's because it is the latter who benefit the most from across-the-board cuts.

The tax expenditure report does not cover local property-tax credits and reimbursements, though these are a creation of state law. Both Gov. Voinovich and Gov. Taft attempted set a ceiling for the two property-tax rollbacks, so that they would not go to owners of the most expensive homes. When he was House Speaker in 2007, Jon Husted similarly attempted to means-test the homestead exemption, which was significantly expanded. These were worthy efforts that deserve reexamination.

We need to modernize our tax system so it covers today's industries. This means a severance tax that will capture more than the current tiny share of revenue from hydraulic fracturing as our state's resources are depleted. Studies of the oil and gas industry over the past 40 years make clear that state tax rates have miniscule impact on oil and gas production.

It also means collecting the use tax due on catalog and Internet purchases. The House budget bill that includes a click-through nexus provision is a welcome step in that direction, as is action pending in Congress. Separate from the collection of taxes already due, the shrinking share of Ohio's economy that is covered by the sales tax mandates a long-term evaluation of adding services to the sales-tax base.

More immediately, creation of a refundable state Earned Income Tax Credit would benefit 800,000 working families in Ohio. Created by President Gerald Ford in 1975 and supported by 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 (for an interactive map of the benefits a state EITC would bring to each Ohio county, see www.policymattersohio.org/eitc-map-apr2013). A state EITC would help make Ohio's tax system fairer. As a percentage of the federal credit, it would be easy to implement.

Ohio's tax system should be overhauled to produce the revenue we need for public services and investments that support our economic success and maintain and improve our quality of life. At the same time, it needs to depend less on low- and middle-income Ohioans, and more on those who can afford it.

Thank you for the opportunity to testify. I would be happy to answer any questions.