Testimony to the House Tax Reform Legislative Study Committee

Zach Schiller

Good afternoon, Chairman Scherer, Ranking Member Letson and members of the committee. My name is Zach Schiller and I am research director of Policy Matters Ohio, a nonpartisan, nonprofit research institute with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify today regarding tax policy.

Policy Matters Ohio has testified twice previously before the committee, and I am here again today to supplement our previous testimony (available at www.policymattersohio.org/tax-testimony-sep2013 and www.policymattersohio.org/local-govt-sept2013).

As we described in North Ridgeville, state support for local governments has declined, and it is having a real impact. According to numbers distributed by the Kasich administration and described to you at this committee's hearing in Batavia on August 21, state support for local governments – separate from school funding – is down by nearly $1 billion or 10 percent between the two-year period covered by the FY10-11 biennial budget and the two years of the current FY14-15 budget. This is without adjustment for inflation. This reduction is meaningful, resulting in cutbacks to services and in local government employment.

We noted earlier that the Office of Budget and Management had significantly overestimated the amount of revenue that is available for general-purpose local government services. Payments for operation of water and sewer systems, airport landing fees, money paid by students for school lunches, and other items are included by the Census Bureau in its totals and thus are also a part of OBM's compilation of revenues available to local governments. None of these revenue sources can make up for the loss of tax reimbursements or Local Government Fund disbursements.

It is worth noting that when baseball fans go to watch the Toledo Mud Hens, the money they spend buying tickets is considered local government revenue by the Census Bureau and OBM. Lucas County includes the nonprofit corporation that owns the team in its financial statements, treating it as a "component unit" much like the county land bank and its convention and visitors bureau. This underlines that figures supplied by OBM detailing local-government revenues – aimed at showing that cuts in aid are insubstantial – do not show the reality that local governments face.

Historically, Ohio's provision and financing of services has been much more heavily focused at the local level than is typical among states. For example, as we pointed out at the North Ridgeville hearing, Ohio ranks lowest among states in the share the state finances of children's services and services for the developmentally disabled, but first in local financing of those services, through the property tax.

As Ohio's tax system developed over the past century, intertwined state and local finances developed together. When the inheritance tax was established at the end of the nineteenth century, it was split between state and local government, with a quarter going to local government. When the sales tax was established during the Depression, it funded the Local Government Fund. When the income tax was established in the 1970s, the property tax rollback was established along with it. When the tangible personal property tax, a local business tax, was eliminated by the state tax overhaul of 2005, tax reimbursements were promised for more than a decade to allow local finance to adjust.

The Kasich administration is moving in the opposite direction of history now, slashing the local government fund, eliminating the estate tax, accelerating phase-out of the tax reimbursements – sweeping reductions, without the state taking more responsibility for vital services performed by local government. The elimination of the property tax rollback - part of the deal in establishing the income tax – will result in higher property taxes across income levels, and less aid from the state to local governments. The administration's own projections indicate state funding of the property tax rollback will result in $34 million less state aid to locals in fiscal year 2015, and $96 million less in fiscal year 2016.

We previously testified that the tax changes in the budget will further tilt Ohio's tax system against lower- and middle-income taxpayers. When you reduce the state income tax and replace it with the sales tax, you shift who pays for Ohio's public services to lower- and middle-income Ohioans so that affluent Ohioans – those who can afford to pay more – are paying less. This is what the Institute on Taxation & Economic Policy found when it reviewed the tax changes in this year's budget bill (see www.policymattersohio.org/itep2-jun2013 for a full explanation). Taxpayers in the bottom fifth of the income spectrum, who made less than $18,000 last year, on average will pay $12 more under the tax package, while those in the top 1 percent, who made at least $335,000, on average will get an annual tax cut worth more than $6,000. The income-tax reduction also will siphon off vital revenue needed for public services, from schools to public health.

There has been talk again of repealing Ohio's income tax. Replacing income-tax revenue with other sources means that middle-income Ohioans pay more, so that rich Ohioans can pay less. And if the revenue were not replaced – as is true of a significant portion of the recently enacted tax cuts – the General Assembly would be risking Ohio's financial condition.

As you know, the Ohio constitution limits debt service to 5 percent of those obligations paid by the General Revenue Fund and net lottery proceeds. Without revenue from the income tax, the state would exceed that debt limit this fiscal year. Under the Ohio constitution, the state would be unable to issue new debt supported by the General Revenue Fund unless the General Assembly authorized it with a three-fifths vote in each house. Such a vote would be required for each state debt issue, leaving aside certain obligations issued to retire bond anticipation notes.

Alternatively, the General Assembly could increase other taxes, stretch out debt repayment or slash new capital spending to delay or avoid hitting the limit. However, eliminating the income tax would significantly reduce Ohio's ability to repay its debts and to invest in future capital projects. There are other reasons not to repeal the income tax, but this is certainly an important one.

We also testified previously that we need a tax system that bestows special preferences only with careful consideration, regular reviews, and sunsets that ensure they are not entitlements. The committee should review House Bill 24 and House Bill 81, and propose speedy approval of a regular review mechanism – with the addition of sunsets, like the state of Washington recently did.

In that context, we were glad to hear that Governor Kasich is reversing an announced policy to withhold from the public state estimates of the value of tax credits that are awarded. In fiscal year 2013, according to the taxation department, companies claimed 170 Job Creation Tax Credits amounting to $68 million, up from $28.4 million a year earlier and $52.7 million in FY11 (These numbers are for credits claimed, not those awarded, so they show the effect of previous awards). Taxpayers should be able to evaluate how their money is being spent.

Thank you for the opportunity to testify. I am happy to answer any questions you may have.

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