Policy Matters Ohio

Tax Policy
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Kasich tax proposal would skew tax system even more in favor of Ohio's affluent

Tax cuts would average more than $11,000 a year for top 1 percent

The Kasich administration proposal to cut income taxes and expand sales and other taxes would produce big tax cuts for Ohio's most affluent residents, while increasing taxes on lower- and moderate-income families.

The proposal would provide an $11,906 annual tax cut on average to taxpayers in the top 1 percent of the income spectrum, who made more than $388,000 in 2014. The bottom three-fifths of taxpayers as a group, making less than $58,000 a year, would see increases in state and local taxes. Those in the bottom fifth, making less than $20,000 last year, would see an increase of $116 on average. Even excluding changes in tobacco taxes in Gov. Kasich's proposal, taxpayers making less than $37,000 a year – those in the bottom two-fifths of the income spectrum – on average would see no benefit from the plan.

Proposed tax changes would benefit wealthiest Ohioans

Average **cut** for top 1 percent

$11,906

Average **cut** for next 4 percent

$890

Average **increase** for lowest 20 percent

$116

Those are the results of an analysis by the Institute on Taxation and Economic Policy, a Washington, D.C.-based research group that has a sophisticated model of the tax system, for Policy Matters Ohio. Table 1 provides the breakdown of the overall impact of the changes proposed by the Kasich administration, excluding the governor's severance tax plan.[1]

Income-tax cuts will flow heavily to the most affluent, further increasing inequality in Ohio while doing little for our economy. By contrast, the increase in the sales-tax rate and most of the other proposed tax increases will fall more heavily on lower- and middle-income Ohioans.

[1] ITEP modeled the administration's full tax proposal except for the severance tax, the one-time cigarette floor stock tax, the elimination of the deduction for early filing and payment of beer and wine tax, the reduction of the watercraft trade-in exemption to 50 percent and the new vapor product tax. See data notes at the end of this report for more description.

Table 1							
Impact of proposed tax changes							
	Lowest 20%	**Second 20%**	**Middle 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Income range	Less than $20,00	$20,000 - $37,000	$37,000 - $58,000	$58,000 - $89,000	$89,000 - $163,000	$163,000 - $388,000	$388,000 or more
Average income	$12,000	$28,000	$47,000	$72,000	$115,000	$234,000	$1,071,000
Tax change as % of income	0.9%	0.4%	0.1%	–0.0%	–0.2%	–0.4%	–1.1%
Average change	$116	$122	$64	-$27	-$219	-$890	-$11,906
Source: Institute on Taxation and Economic Policy, Feb. 2015. Excludes Gov. Kasich's severance tax proposal, and some other elements of his plan. See data notes below for full details.							

Income-tax cuts

The Kasich administration tax plan has a number of elements. The proposal would cut income-tax rates by 23 percent over two years, which comes on top of previous cuts that have slashed the top rate from 7.5 percent in 2004 to 5.33 percent today. Those cuts and other tax changes since then have already provided $20,000 each year on average to filers in the top 1 percent.[2] The rate cut, adjusted to include other changes in the package, is expected to cost $4.6 billion over the two-year budget. Under the proposal, owners of businesses with $2 million or less in annual receipts who pay individual income tax on income from them would see such taxes eliminated (this would add to an existing tax break for business owners). The Kasich administration estimates this would cost nearly $700 million over two years. The proposal also would boost income-tax personal exemptions for those with less than $80,000 in annual income.

Among a host of measures to help pay for the income-tax cuts, the governor proposed means-testing three significant income-tax provisions for seniors: A deduction for Social Security income, a $50 senior credit and a credit for retirement income.[3] Only those with income below $100,000 would continue to be eligible for these deductions or credits. Both these proposals and the increases in personal exemptions would make the income tax more fair, but the proposed rate cuts and business-income tax cuts overwhelm their positive impact.

Altogether, ITEP found that the income-tax changes alone would produce a $13,000 gain on average for those in the top 1 percent, who would receive 31 percent of the total tax cut. Those in the middle fifth of the income spectrum would see a reduction of $219 on average, while those in the bottom fifth would receive just $16. Altogether, the bottom 60 percent of Ohioans by income would receive just 15 percent of the income-tax reductions. All this is looking only at the income-tax cuts, not the rest of the tax proposal.

Table 2 shows the total of the proposed income-tax changes:

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[2] Schiller, Zach, "The Great Ohio Tax Shift," Policy Matters Ohio, Aug. 18, 2014, at http://www.policymattersohio.org/tax-shift-aug2014

[3] This sentence has been corrected from the original version, which said: "Among a host of measures to help pay for the income-tax cuts, the governor proposed means-testing three different income-tax provisions for seniors: A deduction for Social Security income, a $50 senior credit and a credit for lump-sum retirement income." A similar correction, reflecting that the analysis covers the retirement income credit and not two small lump-sum credits, has also been made below in the Data Notes.

Table 2							
Impact of proposed income-tax changes alone							
	Lowest 20%	**Second 20%**	**Middle 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Impact of proposed 23 percent rate cut, business-income exemption, increased personal exemptions and means-testing of senior deduction/credits							
Tax change as % of income	–0.1%	-0.3%	-0.5%	-0.5%	-0.5%	-0.6%	-1.2%
Average tax change	-$16	-$94	-$219	-$365	-$627	-$1,395	-$13,096
Share of tax change	1%	4%	10%	17%	22%	13%	31%
Source: Institute on Taxation and Economic Policy, February 2015. See data notes below for full details.							

These income-tax cuts would further tilt Ohio's state and local tax system in favor of the state's wealthiest residents. A separate report issued in January 2015 by ITEP showed that overall, nonelderly Ohioans in the top 1 percent pay considerably less of their income in state and local taxes than middle-class and poor Ohioans do (see http://www.policymattersohio.org/tax-report-jan2015).

Sales and other tax changes

ITEP also examined the effects of the administration's proposals to raise other taxes. These include increasing the state sales-tax rate from 5.75 percent to 6.25 percent, extending the sales tax to a number of additional services and increasing cigarette and other tobacco taxes. The proposal also would raise the rate of the Commercial Activity Tax, while lowering the minimum CAT tax paid by some companies; increase the severance tax on oil and gas produced using high-volume horizontal wells; and reduce or scrap some other tax breaks.

The biggest single increase – more than $1.5 billion over the two-year budget – would come from the rise in the sales-tax rate (the figure doesn't count Kasich's proposed expansion of services subject to sales tax). Sales-tax rate increases fall more heavily on low- and middle-income residents, in part, because they spend more of their income than upper-income taxpayers do. The Commercial Activity Tax, which businesses pay on Ohio receipts, ultimately falls on individual taxpayers much like a sales tax.

As shown in Table 3, Ohio residents in every income group pay more under the proposed increases in other taxes. The top 1 percent on average would pay $1,190 more a year, while middle-income Ohioans would pay $284 and low-income residents, $132. While the amounts are smaller, for low- and middle-income residents, these increases constitute a larger share of their income.

To offset that, one obvious step is to implement a refundable state Earned Income Tax Credit (EITC), as more than 20 states already have. Ohio has a state EITC, but it is not refundable, meaning it only wipes out state income tax liability and doesn't help those who earn too little to pay income tax. It also is capped for those earning over $20,000. This tax credit for working families should be refundable like the federal EITC, extending help to far more working Ohioans.[4] The General Assembly also should consider adding sales tax credits, which provide a flat amount for each member of a family below an income threshold.

Table 3							
Impact of other tax changes (includes sales-tax and other changes not including income-tax changes)							
	Lowest 20%	**Second 20%**	**Middle 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Tax change as % of income	1.1%	0.8%	0.6%	0.5%	0.4%	0.2%	0.1%
Average tax change	$132	$216	$284	$338	$408	$505	$1,190
Source: Institute on Taxation and Economic Policy, February 2015. Excludes Gov. Kasich's severance tax proposal, and some other elements of his plan. See data notes below for full details.							

Gov. Kasich's proposal includes a $1-a-pack increase in the cigarette tax and a boost in the tax on other tobacco taxes. As Table 4 shows, these tobacco-tax changes fall most heavily on the lowest-income Ohioans. Cigarette taxes are charged per unit, not based on price, and lower-income individuals are more likely to smoke.[5]

Table 4							
Impact of tobacco tax changes and of Kasich tax plan without them							
	Lowest 20%	**Second 20%**	**Middle 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Impact of cigarette and other tobacco tax changes							
Tax change as % of income	+0.5%	+0.2%	+0.2%	+0.1%	+0.1%	+0.0%	+0.0%
Average change	+$60	+$70	+$81	+$82	+$91	+$97	+$104
Impact of the full tax proposal without tobacco tax changes							
Tax change as % of income	+0.5%	+0.2%	-0.0%	-0.2%	-0.3%	-0.4%	-1.1%
Average change	+$55	+$51	-$16	-$109	-$311	-$987	-$12,010
Source: Institute on Taxation and Economic Policy, February 2015. Excludes Gov. Kasich's severance tax proposal, one-time cigarette floor stock tax, and some other elements of his plan. See data notes below for full details.							

Of course, only tobacco users will pay the added tobacco taxes. However, as also shown in Table 4, excluding the tobacco tax changes, the proposal remains highly rewarding to Ohio's most affluent, while costing more on average for the bottom two-fifths of Ohio residents. Middle-income Ohioans see an average annual tax cut of just $16, so little that as a share of income it rounds to zero.

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[4] Halbert, Hannah, "Out-of-Step: More Needed to Make Ohio EITC A Credit that Counts," Policy Matters Ohio, Aug. 26, 2014, at http://www.policymattersohio.org/out-of-step-aug-2014

[5] Centers for Disease Control and Prevention, "Current Cigarette Smoking Among Adults in the United States," at http://www.cdc.gov/tobacco/data_statistics/fact_sheets/adult_data/cig_smoking/index.htm#national

Some of the Kasich administration's tax proposals, such as the boost in the cigarette tax and the severance tax, serve other worthwhile public policy goals. A higher cigarette tax can reduce smoking and improve public health, while a stronger severance tax can help communities affected by fracking, ensure that Ohio is receiving adequate compensation for the depletion of one-time resources and make our taxes more comparable to those in other states. Broadening the sales tax base can be helpful because our economy has shifted to services, many of which have been untaxed, while the Commercial Activity Tax could well be increased, since it has never come close to replacing the revenue that was lost when it was created in place of two other major business taxes. Policy Matters Ohio previously has endorsed certain other measures in Gov. Kasich's proposal, such as applying the sales tax to lobbying and debt collection, and reducing the vendor discount for big retailers.[6]

However, these measures and others to modernize Ohio's tax system should be considered on their own, not to pay for unneeded income-tax rate cuts and business-income tax exemption. We should maintain and bolster the state's progressive income tax, instead of weakening it as the Kasich administration would do. That would both allow us to invest in needed public services and rebalance the tax system in favor of most Ohioans.

In June 2005, the Ohio General Assembly approved a 21 percent phased-in reduction of income-tax rates; the cuts were increased further in 2013. Since June 2005, Ohio has lost 1.6 percent of its jobs, while the nation as a whole has grown by 4.8 percent. Gov. Kasich's budget proposal is based on economic forecasts that Ohio will continue to underperform the nation during the upcoming two-year budget period in output, personal income and job growth.[7] There is no reason to believe that another round of tax cuts will bring a different outcome.

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[6] See Zach Schiller, "Limiting Loopholes: A Dozen Tax Breaks Ohio Could Do Without," Policy Matters Ohio, November 2008, at http://www.policymattersohio.org/limiting-loopholes-a-dozen-tax-breaks-ohio-can-do-without and Testimony to the House Legislative Study Committee on Ohio's Tax Structure, Sept. 11, 2011, at http://www.policymattersohio.org/testimony-to-the-house-legislative-study-committee-on-ohio%E2%80%99s-tax-structure

[7] Blueprint for a New Ohio, Governor John R. Kasich's Fiscal Years 2016-2017 Budget, Section B, Economic Forecast and Income Estimates, p. B-4, at http://blueprint.ohio.gov/doc/budget/State_of_Ohio_Budget_Recommendations_FY-16-17.pdf The forecast, prepared by IHS Global Insight, predicted Ohio's unemployment rate would be similar to the national rate, though the Office of Budget and Management noted that Ohio's rate has dropped and may end up below the projection.

Data Notes

The ITEP analysis covers Ohio residents and is based on 2014 income levels. The income-tax analysis includes the administration proposals to eliminate that tax on income from businesses with $2 million or less in annual receipts, reduce rates by 23 percent over two years, increase personal exemptions for those with income of less than $80,000, and means-test the deduction for Social Security, the $50 senior credit and the retirement income credit. The analysis of other tax changes includes the proposed increase in the state sales-tax rate by half a penny, the extension of the sales tax to additional services (including the local sales tax on that larger base), the reduction of the motor-vehicle trade-in tax exemption to 50 percent and capping the vendor discount for collecting the sales tax. It also includes increasing the Commercial Activity Tax rate from 0.26 percent to 0.32 percent while lowering the alternative minimum CAT tax for companies with gross receipts between $1 million and $2 million, increasing the cigarette tax by $1.25 a pack and the other tobacco products (OTP) tax rate from 17 percent to 60 percent and eliminating the discount for early payment of both the cigarette tax and the OTP tax.

Gov. Kasich's proposal to increase the severance tax on oil and gas is not included in the overall analysis, but that would mostly be paid by out-of-state taxpayers. Also excluded from the analysis is the cigarette floor stock tax, a one-time measure; the elimination of the deduction for early filing and payment of beer and wine tax, the reduction of the watercraft trade-in exemption to 50 percent, the means-testing of two small, lump-sum senior or retirement credits and the new vapor product tax).

Policy Matters Ohio is a nonprofit, nonpartisan state policy research institute with offices in Cleveland and Columbus. The Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research organization based in Washington, D.C. that works on federal, state, and local tax policy issues. ITEP's Microsimulation Tax Model allows it to measure the distributional consequences of federal and state tax laws and proposed changes in them, both nationally and on a state-by-state basis.