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Income-tax cuts: Bad medicine for Ohio

By Zach Schiller and Sam Whipple

Gov. John Kasich has proposed cutting the state income tax by 23 percent and creating a new tax break for business owners. Along with increases in the personal exemption, these tax cuts would cost $5.7 billion over the next two years. Much of that would be paid for through a variety of tax increases, including a ½-penny boost in the state sales tax, to 6.25 percent.

Income-tax cuts are a bad idea. The overall tax proposal would shift who pays taxes in favor of the most affluent (http://bit.ly/1DfWy8l). It would provide an $11,906 annual 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 – would see no benefit from the plan, on average.

Key findings

- Plan would cut taxes on the top 1 percent and raise them, on average, for the bottom 60 percent.
- $523 million in tax cuts would be better spent on education and needed public services.
- After a decade of tax cuts, hiring by the smallest businesses and overall Ohio job growth have underperformed the nation.
- 96 percent of taxpayers don't pay the top income-tax rate.

As in most states, Ohio's graduated income tax means higher earnings are taxed at a higher rate. It is the only major tax based on ability to pay. By contrast, the sales tax falls more heavily on lower- and middle-income Ohioans, who spend more of their income. They already pay more of their income in state and local taxes than affluent Ohioans do (http://bit.ly/14Y97s3). One million Ohioans, one in five tax filers, do not pay income taxes and would clearly pay more under the Kasich proposal. Many others also would lose out.

Expected to generate more than $16 billion in the current, two-year state budget, the income tax is a crucial source of support for schools, libraries, human services and public safety. It's also critical for paying state debt that allows us to build or renovate roads, college buildings and community projects (http://bitly.com/wbTs9q). The $523 million in tax cuts that the governor's proposal would deliver over two years could instead be invested in education and a host of other needed public services.

For the first time in a quarter century, Ohio collected more sales tax than income tax last fiscal year. Under Gov. Kasich's tax proposal, sales-tax revenues would be almost double those from the income tax in Fiscal Year 2017. The income tax grows with the economy and balances other revenue sources like the sales tax, so sharply cutting it reduces the state's fiscal flexibility.

“High income taxes punish risk taking, investment in job creation and they drive some of our best and brightest to other states,” Gov. Kasich declared in his State of the State speech. But if high income taxes punish risk taking, how does Gov. Kasich explain Silicon Valley in California, a state which has some of the highest top income-tax rates in the country and also the home bases of such companies as Apple, Google, Facebook and Twitter?

Taxes simply aren’t the huge factor in generating prosperity that they are often made out to be. Investments in education are more important: (http://bit.ly/1nZqgDU). Most of the academic literature finds that state income tax levels are not an important factor in economic growth. Nor have income-tax cuts by states worked well at generating economic growth (http://bit.ly/1FM5UaQ).

They haven’t worked in Ohio. A 21 percent income-tax cut approved in 2005, followed by another 10 percent cut in 2013, left Ohio with 84,000 (1.6 percent) fewer jobs while the nation gained more than 6 million (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 (http://1.usa.gov/1FfPHLq, *page B-4*).

Nor have the income-tax cuts or a $350 million-a-year tax break for business owners approved in mid-2013 brought about any surge of small businesses that have added employees for the first time. Ohio’s business births, as the U.S. Bureau of Labor Statistics calls them, did not increase between the first half of 2012 and the same period in 2014. In fact, though there was some growth after the recession, they were 11 percent below the number in the first half of 2005, when our last big tax cuts were approved. New employment at these small companies is down even more since then.

Gov. Kasich’s claim that $12 billion in income left Ohio between 1995 and 2010 for states with lower income taxes also is deeply flawed (http://bit.ly/1siD0GR).When people leave a state, they usually leave their job, which most often is filled by someone else in Ohio. North Carolina, which had a higher top income-tax rate than Ohio during that period, was the second-top destination of Ohioans leaving the state. People are far more likely to move between states because of job prospects, housing costs, family considerations and weather than tax levels (http://bit.ly/1M1aq7N).

Tax cuts that aren’t fully paid for with other new revenues can be financially irresponsible. Ohio’s own experience should convince us: The state found itself in a giant budget hole in early 2011 not just because of recession but because of the $2.5 billion a year in tax cuts approved earlier.

Gov. Kasich said in his speech, “We've already cut Ohio's income tax rate from 5.9 to 5.33 percent, and our budget will take it all the way down to 4.1 percent over the next two years.” But 96 percent of Ohio income-tax filers don’t pay that tax rate. He referred to the top rate, which only covers income over $208,500 a year. The average effective income-tax rate for Ohio residents for 2010 – after credits and before recent tax cuts – was 3.4 percent, according to the taxation department. The vast bulk of Ohioans benefit from paying income tax instead of higher levels of other taxes.

Ohio needs a stronger income tax, not a weaker one. The General Assembly should increase income-tax rates on the most affluent, starting with restoring the 7.5 percent rate on annual income over $250,000 and creating a new 8.5 percent bracket on income over $500,000.