Policy Matters Ohio

Tax Policy

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Testimony to the Senate Ways & Means Committee on Senate Bill 208

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Good morning, Chairman Peterson, Ranking Member Tavares and members of the committee. My name is Zach Schiller and I am research director for 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 Senate Bill 208.

The initial tax break that is the subject of this bill, approved in 2013 and expanded temporarily last year, did not produce overall job gains for the state. The number of jobs in Ohio has grown less in the 26 months since this break was approved than it did in the same period prior to that. Ohio job growth also has underperformed U.S. job growth since June 2013. Nor have we seen a significant increase in employment at small Ohio businesses that are hiring employees for the first time (known as "business births"). According to the U.S. Bureau of Labor Statistics, the number of employees added by such small Ohio businesses amounted to 85,856 last year – below what it was in 2012, the year before this tax break was approved, and down 28 percent from the number a decade earlier. This tax break has not succeeded, even while it is costing the state hundreds of millions of dollars a year in revenue needed for important investments.

As it is, under House Bill 64, business owners will pay a 3 percent flat income-tax rate for this year on income that isn't excluded under the expanded passthrough income deduction. Deputy Tax Commissioner Kruse noted here earlier this month that the bill "makes clear that progressive income tax rates will apply to the 25 percent of business income that's not deductible for tax year 2015…"

In other words, in approving this bill, the General Assembly would replace a flat 3 percent rate for certain income with a graduated income tax. The taxation department has said that, were it not for this bill, business owners would incur additional income tax of $52 million this year.

This illustrates the important positive role of the graduated income tax. Just as many business owners would see an increase in their taxes because of the switch from a graduated tax to a flat, 3 percent rate, most Ohio taxpayers would find themselves paying more under such a tax. As we have previously noted, under a flat 3.5 percent rate, the bottom 95 percent of Ohio taxpayers would pay more than they do today.

Reducing Ohio's state income tax and replacing some of the lost revenue with additional sales tax or cigarette tax, as the General Assembly has done in recent years, has the same effect. Just as you are trying to protect business owners in this legislation, low- and middle-income Ohioans deserve the same approach. We hope you will keep that in mind as you consider tax legislation in future. Ohio needs a stronger graduated income tax, in which the tax rate goes up as income does.

Ohioans will be interested to know how the General Assembly will fund the tax reduction in Senate Bill 208. If the cost is more than $50 million, that would represent half of the FY 2017 tax reimbursements to schools in the budget approved by the General Assembly in June and vetoed by the governor. In that sense, this represents a diversion of revenue you as legislators had approved for schools to owners of limited liability companies, S corporations and other passthrough entities. Moreover, based on our experience with this tax break, much of the benefit will go to the owners of the largest such companies. According to data from the taxation department, the 6 percent of the total using it who claimed at least a $100,000 deduction for 2014 accounted for almost 42 percent of the total amount claimed. We would be better off investing these funds in our schools.

Mr. Chairman, thank you for allowing me to testify on this legislation. I am happy to answer any questions that you or any of the other members of the committee may have.

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