Policy Matters Ohio

TESTIMONY
March 14, 2023

Budget & Revenue

Testimony on HB 1 before the House Ways and Means Committee

Guillermo Bervejillo *(Bear-veh-he-yo)*, **PhD**

Chair Roemer, Vice Chair Merrin, Ranking Member Troy and members of the House Ways and Means Committee, thank you for the opportunity to testify in opposition to House Bill 1. I am Dr. Guillermo Bervejillo, State Policy Fellow at Policy Matters Ohio, a non-partisan, not-for-profit research organization with a mission to create a more prosperous, equitable, and sustainable Ohio.

This bill proposes a substantial rewriting of Ohio's property and personal income taxes. It is an overly complicated, poorly designed bill that does not achieve what the sponsor claimed it would. It represents a massive wealth transfer from Ohio's communities to a wealthy few. It is based on unsound economic reasoning and, if passed, it will hollow out Ohio's critical social and economic infrastructure.

The bill will increase residential and agricultural property taxes by an estimated $929 million.[1] The bill will reduce property tax revenues to schools and local government services by $538 million. And, critically, it will slash all-funds revenues by $2.6 billion in FY 24 and nearly $2 billion every year after that. All the FY 24 revenue losses and some $780 million of annual losses in subsequent years are not paid for in the bill.

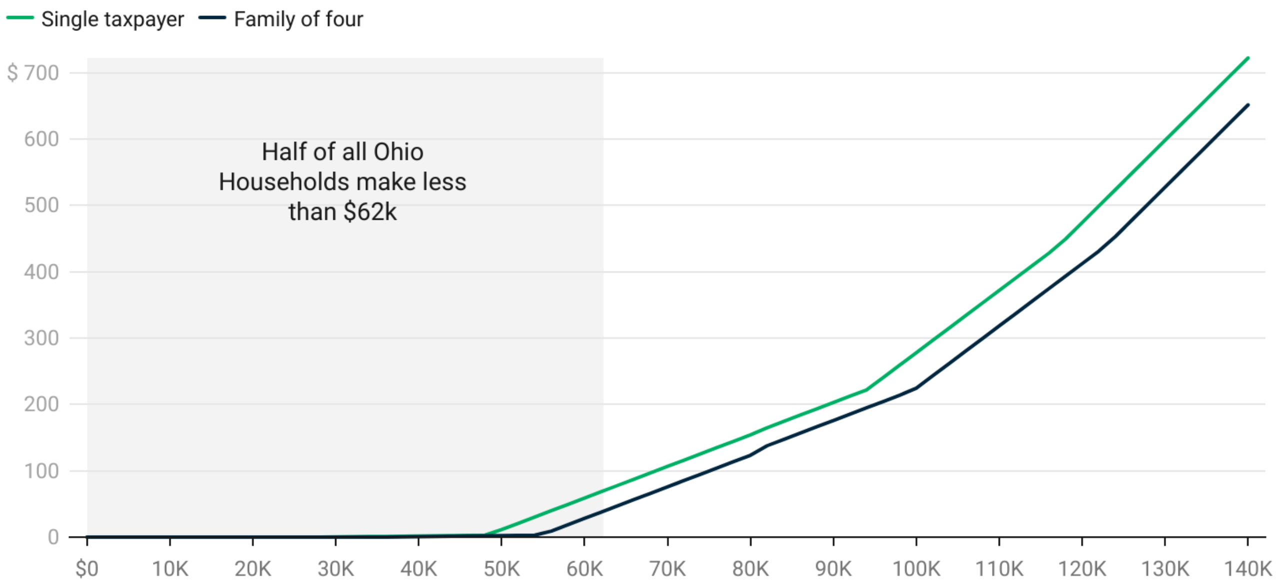
I would like to focus on a particularly pernicious threat to the well-being of our state: the proposed changes to the state's personal income tax. The so-called "flat tax" contained in this bill is a fiscally irresponsible, unfairly skewed, and inefficient use of our collective resources. It is, in essence, a handout to the wealthy that comes at the cost of defunding critical needs such as schools, libraries, and other public institutions. Wealthy Ohioans will no longer be asked to contribute in accordance with the benefits they have reaped from society. They will be allowed to harvest the bounty that we have all sowed, without chipping in their fair share.

Families making less than $30,000 per year will get nothing from these changes. Families making $50,000 will see a tax cut of $3 or less. Meanwhile, an individual making a half million dollars per year could see an annual tax cut of more than $5,000. The graph below depicts just how skewed the benefits of the proposed 2.75% personal income tax would be.

---

[1] Some of which will be offset by the changes made to the rollback to owner-occupied residences and the expanded homestead exemption. For detailed analysis, see LSC Fiscal Note: https://www.legislature.ohio.gov/download?key=20516&format=pdf

Tax Savings by Household Income



Reduction in Ohio tax liability by taxable nonbusiness income and family size

Chart: Policy Matters Ohio • Created with Datawrapper

An examination of the flat-tax proposal by the Institute on Taxation and Economic Policy (ITEP)—a nonprofit with a sophisticated model of the state and local tax system—found that 89% of the value of the tax cut will go to the richest 20% of households (those making more than $124,000 per year) and 35% will benefit the richest 1% of households (those that make more than $617,000), which will receive an average tax cut of more than $11,000. Meanwhile, the bottom half of Ohio households will receive nothing or very near nothing. The table below is for Ohio residents and uses 2023 incomes.

Impact of HB 1

ITEP estimates of the bill's impact

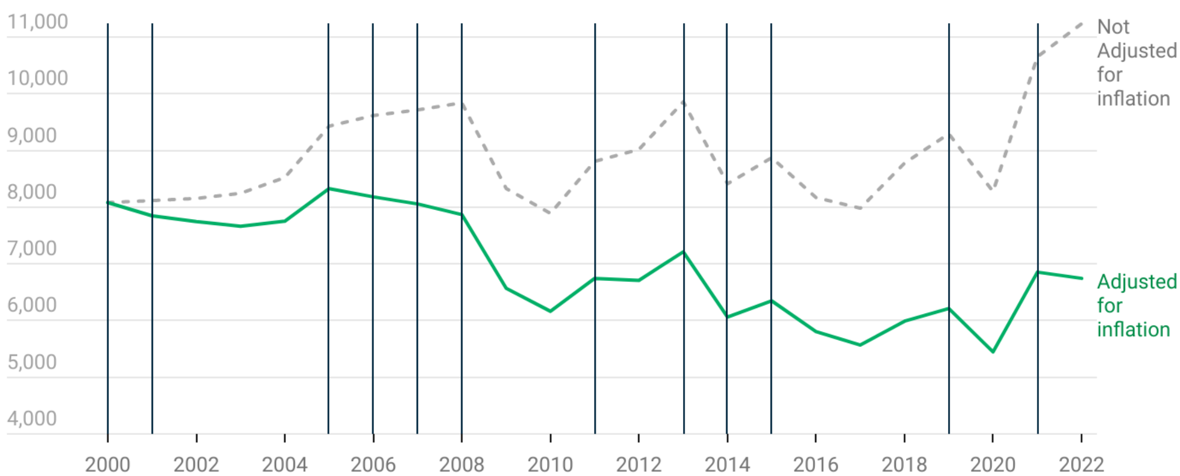
	Bottom 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Richest 1%
Income Range	< $23,000	$23,000 - $47,000	$47,000 - $75,000	$75,000 - $124,000	$124,000 - $244,000	$244,000 - $617,000	> $617,000
Average Income in Group	$ 12,000	$ 34,000	$ 61,000	$ 97,000	$ 159,000	$ 347,000	$ 1,534,000
Tax Change as a % of Income	0%	0%	-.04%	-.16%	-0.4%	-0.57%	-0.73%
Average Tax Change	$0	-$1	-$24	-$155	-$628	-$1,974	-$11,166

In truth, the bill does not achieve a flat state taxation schedule. That is because in Ohio, the wealthier you are, the less state and local taxes you pay as a share of your income.[2] Sales taxes, property taxes, and excise taxes are all taxes that fall disproportionately on low-income Ohioans. The personal income tax is the only state tax that is based on your ability to pay. Flattening the income tax makes the whole tax system even more skewed in favor of the rich. If Rep. Mathews truly desires to flatten the tax system, he should increase taxes on wealthy Ohioans until they pay the same share of their income in taxes as working-class Ohioans do.

Instead, the bill contributes to the decades-long drive to defund Ohio's communities. As we heard during sponsor testimony "we've seen this movie before." We've heard the well-oiled talking points and the empty promises. Ohio has been steadily cutting taxes for decades and the fanciful stories of growth and prosperity have yet to materialize. In fact, because of the business income deduction—also known as the LLC loophole—Ohio already has a flat tax, or no tax at all, on business income. Yet over the past two decades, Ohio's share of employment and number of business establishments have steadily declined relative to the rest of the country. In a typical year, Ohio grows slower than the national average.[3] And when recessions hit, they hit harder and last longer than the national average.[4] Moreover, the very simple exercise of adjusting historical state revenues for inflation (see graph below) dispels any notion that there may be a relation between tax cuts and increased tax revenue.

Tax cuts do not drive Income tax revenue growth

Cuts in top tax rates depicted by vertical bars. Personal income tax revenues (in millions)



Inflation adjustment using 2000 dollars.

Chart: Policy Matters Ohio • Source: Legislative Service Commission Historical Revenues, Ohio Department of Taxation • Created with Datawrapper

---

[2] Patton, W. (2018) Ohio state and local taxes hit poor and middle-income families the hardest, Policy Matters Ohio. https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/ohio-state-and-local-taxes-hit-poor-and-middle-income-families-the-hardest

[3] Data from Business Dynamics Statistics – Census Bureau, see: Bervejillo, G, (2022) Ohio's LLC loophole: Public dollars, private benefits. Policy Matters Ohio. https://www.policymattersohio.org/research-policy/quality-ohio/revenue-budget/tax-policy/ohios-llc-loophole-public-dollars-private-benefits

[4] Shields, M. (2022). State of Working Oho, 2022. Policy Matters Ohio. https://www.policymattersohio.org/research-policy/fair-economy/work-wages/state-of-working-ohio/state-of-working-ohio-2022#_ftn13

There is no logical reason why this “flat tax” experiment will deliver where other tax cuts have failed. In other states, flat taxes have not been able to guarantee economic prosperity. In fact, Midwestern states with flat taxes have tended to grow slower than both Ohio and the national average. The chart below provides a rudimentary comparison of annual GDP growth of flat tax states from 2014 to 2021 (I use these dates because 2014 is when North Carolina instituted its flat tax). The flat tax states with the highest growth rates had some of the highest tax rates. It is also worth noting that the proposed 2.75% rate is substantially below that of the states depicted in the chart.

Comparing Flat Tax States

Compound annual GDP growth rate between 2014 and 2021

State	Tax rate	GDP growth
Illinois	4.95%	3.0%
Pennsylvania	3.07%	2.8%
Indiana	3.15%	3.3%
Michigan	4.25%	3.4%
Ohio	--	3.5%
United States	--	4.1%
Masschusets	5.00%	4.5%
North Carolina	4.75%	4.6%
Colorado	4.40%	5.0%
Utah	4.85%	6.8%

Recently, Massachusetts has added a another tax bracket and Arizona, Idaho, Kentucky, Iowa, Mississippi, and Georgia have either become flat tax states or are in the process of doing so.

Table: Policy Matters Ohio • Source: U.S.Bureau of Economic Analysis. • Created with Datawrapper

None of this is very surprising. Economic growth is a function of healthy communities, educated workers, effective infrastructure, and other social factors that are made possible by state revenue. Flat income taxes guarantee a regressive tax structure, are not particularly beneficial to small businesses, are not meaningfully simpler than graduated income taxes, and can cause budget challenges.[5]

Flat taxes are also not a particularly good tool to attract businesses or investors. According to a recent ITEP study, local taxes account for just 2.3 percent of the cost of doing business, with the other 98 percent tied up in other areas like payroll, equipment, and real estate costs.[6] Moreover, Ohio’s existing business taxes are already below the national average. According to a study by Ernst & Young for the Council on State Taxation, a business lobbying group, Ohio's state and local business taxes per employee were $5,700 in Fiscal Year 2021, compared to a national average of $7,800. As a share of Gross State Product, Ohio was 4.1% vs. national average of 4.9%.[7]

[5] Byerly-Duke, E. and Davis, C. (2023) The Pitfalls of Flat Income Taxes. Institute for Taxation and Economic Policy. https://itep.org/the-pitfalls-of-flat-income-taxes/#:~:text=In%20short%3A%20A%20flat%20tax,but%20come%20with%20significant%20disadvantages

[6] Davis, C. and Gardner, M. (2022) Tax Foundation’s ‘State Business Tax Climate Index’ Bears Little Connection to Business Reality, Institute on Taxation and Economic Policy, https://itep.org/tax-foundation-state-business-tax-climate-index-bears-little-connection-to-business-reality/.

[7] Phillips, A. et al (2022). Total state and local business taxes. Ernst & Young LLP. https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/2209-4097478_50-state-tax-2022-final-e-file.pdf

Flat taxes are also unlikely to attract significant interstate migration. During sponsor testimony Rep. Wiggam mentioned that his son lived in Texas and, perhaps due to a lack of knowledge of state level taxation, felt that he could not move back to Ohio. Texas, of course, has no income tax. However, that does not mean that total taxes in Texas are much lower than Ohio's. Ohio's total state taxation is below the national average. In FY 2020, Ohio's overall state and local taxes added up to $4,897 per capita, ranking 28th highest in the country (vs. a national average of $5,650). Texas sat at $4,721, ranked 31st. It wasn't too much different as a share of income: Ohio at 9.1% ranked 27th; Texas, at 8.5%, ranked 35th. National average was 9.4%.[8] Rep. Wiggam's son, assuming he has an income not too far from average, saves about $176 by living in Texas, not nearly enough to cover a flight back to Ohio for Thanksgiving or other holidays.

There is plenty of good research to clarify any confusion surrounding the relationship between state taxes and interstate migration. For example, the data show that the principal reasons why people move are: for better housing options, for career reasons, and for family.[9] We also know that interstate migration has declined in recent decades, down to a rate of 1.5% since 2010, half of what it had been decades prior. Over that same period there has been an increasing divergence in state tax rates that has not slowed declining residential mobility.[10]

Other empirical studies show that households with lower incomes move across state lines more frequently than those with higher incomes, even though interstate migration can be quite costly.[11] California, a high-tax state, is one of the states that loses the fewest number of wealthy residents to interstate migration. States with relatively high-income taxes continue to receive millions of interstate migrants. And Florida, which has no income tax, has lost tens of thousands of households to Georgia and North Carolina, both with significant income taxes.[12]

People move to where they can live happily and comfortably. They move to places that have great parks, good schools for their kids, strong healthcare systems, and a sense of community that comes from broad-based prosperity. People start businesses where there is trustworthy infrastructure, where there is a strong workforce, and where customers can afford their products. It is disingenuous to claim that state income taxes are a driving factor in residential or commercial mobility.

Most wealthy households are embedded in the state where they live: they have business relations and familial ties that make them unlikely to emigrate in the short term and in the long term they benefit just as much as anyone else from better social services. The few millionaires that might emigrate in the face of tax increases are those that are least

---

[8] Department of Taxation website: https://tax.ohio.gov; tax data from U.S. Census; income data from U.S. Department of Commerce, Bureau of Economic Analysis.

[9] Hall, A. et al. (2009) "The County-to-County Migration of Taxpayers and their Incomes, 1995-2006." KU School of Business. Technical Report 09-0306; Ning, J. et al. (2022). "The Economics of Internal Migration: Advances and Policy Questions." Finance and Economics Discussion Series 2022-003. Washington: Board of Governors of the Federal Reserve System, https://doi.org/10.17016/FEDS.2022.003; Federal survey data also confirms: https://www2.census.gov/programs-surveys/demo/tables/geographic-mobility/time-series/historic/hst_mig_a_5.xlsx

[10] Mazerov, M. (2023) "Tax-Related Migration Is Grossly Exaggerated: a Research Preview" CBPP. https://www.cbpp.org/blog/tax-related-migration-is-grossly-exaggerated-a-research-preview

[11] Carl Davis, "New Research Shows Millionaires Less Mobile than the Rest of Us," Institute on Taxation and Economic Policy, May 2016. https://itep.org/new-research-shows-millionaires-less-mobile-than-the-rest-of-us/

[12] Mazerov, M. (2023).

embedded in local economies and past experience has shown that they are never numerous enough to outweigh the direct benefits that come from adequately funding schools and other public institutions.[13]

Ohio can ill afford the long-term revenue loss from a flat income tax. We need affordable childcare and colleges, broad access to preschool, and the full funding of the Fair School Funding Plan. We need all our children to be well-fed, and to improve our public health to reduce our scandalously high infant mortality. These are just some of the forgone improvements that have had to take a backseat to tax cuts and backwards tax policy. We urge the committee to reject House Bill 1.

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

[13] Young, C. and Lurie, I. (2022) Taxing the Rich: How Incentives and Embeddedness Shape Millionaire Tax Flight. Washington Center for Equitable Growth. https://bit.ly/3WNl8dZ