House Ways and Means Committee

HB 400 Testimony

February 24, 2010

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Chairman Letson, Ranking Minority Member Huffman, and Members of the Committee, my name is Howard Fleeter and I am here representing the Education Tax Policy Institute (ETPI). Thank you for the opportunity to share with you some information relating to the income tax in Ohio. This presentation has 8 parts to it. They are:

1. Principles of a Quality Tax System
2. House Bill 66 Tax Changes (2005)
3. Summary of GRF Tax Revenues, FY00-FY11
4. Assessment of HB 66 Tax Changes According to Tax Principles
5. Ohio's Tax Ranking Compared with Other States
6. Ohio Compared to States Without Income Taxes
7. Equity Impact of Repealing Ohio's State Income Tax
8. Conclusion: Income Tax Repeal and Tax Principles

In the interests of time I will summarize the main points from each section rather than read each in its entirety. I will then answer any questions that you might have.

1. Principles of a Quality Tax System

Ohio has conducted numerous studies of its state and local tax systems over the past 40 years. The most recent of these was the result of SB 261 in 2001, which required the state of Ohio to convene the Committee to Study State and Local Taxes (CSSLT). Thomas Zaino, the Tax Commissioner at the time, chaired this Committee. The Committee was first convened in July 2002 and met for 7 months before releasing a draft report in January 2003. The final report of the Committee was released on March 1, 2003.

As was the case with all other prior studies of Ohio's tax structure, 5 commonly accepted principles of a quality tax system were articulated in the CSSLT report. These principles are:

- **Simplicity** - the tax system should be easy to understand, administer, and comply with

- **Equity** – the tax system should treat similarly situated tax payers similarly (horizontal equity) and also recognize that taxpayers with different abilities to pay should pay differently (vertical equity).
- **Stability** - The tax system exists for the purpose of funding essential government services and therefore must provide stable funding for this purpose in both good and bad economic times. In this regard, diversifying revenue sources is advantageous.
- **Neutrality** – The tax system should not unduly influence economic behavior. Economists agree that broad-based (few exemptions), low rate tax taxes best succeed in this regard.
- **Competitiveness** – Ohio's tax system should not impose excess burdens on taxpayers, particularly as compared to other states.

2. House Bill 66 Tax Changes (2005)

Many of the CSSLT recommendations formed the basis for the tax reforms enacted in HB 66 in 2005. Indeed, 3 of the main findings of the Committee were that Ohio's corporate franchise tax *rate* was relatively high while the tax *yield* was relatively low, the tangible personal property tax was onerous, especially the portion taxing business inventory, and combined state and local income taxes were higher than in surrounding states, primarily due to municipal income taxes rather than to the state income tax (see page 63 of CSSLT report).

The HB 66 tax reforms were to be phased-in over a 5 year period from FY06 to FY10. The tax changes are now fully phased-in with the exception of the final 4.2% reduction in the state income tax rates, which has been delayed until 2011. The major tax changes in the HB 66 tax reforms are as follows:

1. Elimination of the entire Tangible Personal Property Tax on general business property (not just the inventory component)
2. Elimination of the Corporate Franchise Tax
3. Creation of the Commercial Activity Tax (CAT)
4. 21% Decrease in State Income Tax rates (top bracket rate reduced from 7.5% to 5.9% and all other rates reduced proportionally)
5. Increase in the Cigarette Tax from 55 cents per pack to $1.25 per pack
6. Permanent State Sales Tax rate set at 5.5% (until FY03 permanent rate was 5.0%, in FY04 and FY05 the rate was temporarily increased to 6.0% to balance budget)

At the time HB 66 was enacted the Ohio Department of Taxation estimated the revenue impact of the tax changes as follows:

HB 66 Tax Increases

- Commercial Activity Tax = $1.6 billion (this estimate has now been reduced to $1.4 billion)
- Cigarette Tax Increase = $400 million
- Class 2 Rollback Repeal = $400 million

Total Tax Increases = $2.4 billion

HB 66 Tax Decreases

- Local TPP Tax repeal = $1.6 billion
- Corporate Franchise Tax repeal = $1.6 billion (this represents the maximum amount of revenue that would have been collected from this tax – actual revenue never reached this level)
- 21% Reduction in Personal Income Tax = $2.2 billion (currently $1.7 billion because the delay in the implementation of the last year of the income tax rate reduction increases state revenue by roughly $425 million per year.

Total Tax Decreases = $5.4 billion

Net HB 66 Revenue Loss Relative to FY05= $3.0 billion

HB 66 Tax Change

- Change in Sales Tax (Temporary 6% to Permanent 5.5%) = $800 million

The change in the sales tax rate to 5.5% can be characterized as either a reduction from the FY05 temporary rate of 6.0% or an increase from the prior FY03 permanent rate of 5.0%. From the standpoint of revenue impact it is probably most appropriate to characterize it as a tax decrease (revenue loss), and from the standpoint of tax structure it is probably most appropriate to characterize it as a tax increase. For this reason, it has not been included in the net revenue change calculation above.

3. Summary of GRF Tax Revenues, FY00-FY11

Table 1 below shows GRF tax revenues by category from FY 2000 through FY 2011.

Table 1: GRF Tax Revenues FY2000 – FY2011 (Dollars in Millions)

Fiscal Year	Income Tax	Sales Tax	Corporate Franchise	PU & KWH	Cigarette Tax	Other Taxes	Total GRF Taxes
2000	7,232.0	5,913.7	969.4	642.1	287.7	572.9	15,617.8
2001	7,263.4	5,935.6	915.3	663.3	282.5	589.4	15,649.5
2002	7,304.1	6,038.0	712.3	583.5	281.3	555.1	15,474.3
2003	7,420.7	6,397.9	747.2	558.5	599.9	593.6	16,317.9
2004	7,698.9	7,530.6	809.2	565.4	557.5	577.9	17,739.5
2005	8,598.9	7,827.1	1,051.6	443.9	577.7	588.8	19,088.0
2006	8,786.4	7,368.2	1,054.9	501.5	1,084.1	768.3	19,563.4
2007	8,885.3	7,424.5	1,076.5	487.2	986.3	609.2	19,468.9
2008	9,114.7	7,614.1	753.5	388.9	950.9	597.3	19,419.5
2009	7,628.0	7,112.8	520.8	320.5	924.8	586.9	17,093.7
2010 Est	7,052.6	6,979.0	100.0	330.0	823.0	611.5	15,896.1
2011 Est	7,130.3	7,218.1	125.0	330.0	794.0	624.5	16,221.9

Source: LSC "Table 1A - Historical GRF Revenue, FY1975-FY 2009". FY10 and FY11 estimates from OBM conference committee budget report. Revenue figures do not include funds to be deposited in the Local Government Fund or Pubic Library Fund.

The data in Table 1 show the following:

- Income tax revenues are forecast to be less in FY11 than they were in FY00. This is due to the combination of the HB 66 tax cuts and the national economic recession that began in 2008.
- Sales tax revenues are forecast to be less in FY11 than in FY04
- HB 66 has almost completely eliminated the corporate franchise tax. All that remains now is the net worth tax on financial institutions and a modest amount of revenue from taxing affiliates of financial institutions and insurance companies.
- The cigarette tax has increased from the 5th largest state GRF tax revenue source (when the Public Utility Excise Tax and Kilowatt Hour tax are considered together) in FY00 to the 3rd largest source currently. This is due to both the phase-out of the corporate franchise tax and as a result of two cigarette tax rate increases (from 24 cents to 55 cents in 2002 and later to $1.25 in 2005). The Commercial Activity Tax (CAT) is also larger than the cigarette tax (see Table 2 below); however revenue from the CAT is currently earmarked for replacement payments to local governments and schools for lost revenues as a result of the elimination of the tangible personal property tax on general business and is not part of the GRF.
- GRF tax revenues in FY11 are forecast to be less than those received in FY03. This is due both to the effects of the HB 66 tax reforms and to the effects of the national economic recession started in 2008.
- Initial estimates of the impact of HB 66 forecast that GRF tax revenues would fall

in 3 of the 5 years of the phase-in period. These estimates were on target through 2008 as the data show that revenues fell in both FY07 and FY08 after modestly increasing in FY06.

Table 2 below shows CAT revenues for FY06-FY10. The $185.1 million in revenue in FY06 was part of the GRF. All CAT revenue from FY07 forward has been earmarked to local governments and schools for Tangible Personal property tax replacement payments.

Table 2: Commercial Activity Tax (CAT) Revenues from FY06-FY10 ($ in Millions)

FY06	FY07	FY08	FY09	FY10 (Est.)
$185.1	$563.7	$929.7	$1,160.4	$1,400.0

Source: Ohio Department of Taxation

4. Assessment of HB 66 Tax Changes According to Tax Principles

The House Bill 66 tax reforms have received bipartisan support. They were initially enacted under a Republican Administration and Republican General Assembly. Their implementation was continued under a Democratic Administration, Republican Senate and Democratic House of Representatives. The tax reforms also received broad support from the business community, particularly the Ohio Business Roundtable. Using the 5 principles for a quality tax system from the CSSLT, the HB 66 tax reforms can be evaluated as follows:

Simplicity – Simplicity of the tax code has been improved by the elimination of the tangible personal property tax on general business (for which multiple tax rates existed for many larger companies with locations in multiple taxing districts), and by the replacement of the corporate franchise tax with the Commercial Activity Tax for most Ohio businesses.

Equity – The income tax reductions were proportional with all income levels receiving the same percentage decrease in the rates, however the actual rate decrease was greater for higher income brackets than for lower brackets. In addition, now 2 of the 3 largest GRF taxes - the sales tax and the cigarette tax - are regressive in nature (regressive taxes have lower income taxpayers paying a higher percentage of their income in taxes than do higher income taxpayers).

Stability – The ability to fund state government services has been compromised by the over $3 billion revenue reduction associated with the HB 66 tax reforms. Before the impact of the 2008 national economic recession took place, GRF revenues in FY10 were estimated to be less than GRF tax revenues in FY06. Five years of essentially flat GRF revenues made it more difficult for the state to respond to the economic downturn.

Neutrality – The Commercial Activity Tax is a broad based, low rate tax with very few exemptions. Economists are in widespread agreement that a tax of this type will have minimal influence on business decisions. Consequently, the CAT is expected to have a far less distortionary effect on business decisions than did the corporate franchise tax.

Competitiveness – The repeal of the tangible personal property tax on general business removes the component of Ohio's tax system that was most different from other states, thus increasing Ohio's competitive standing. The high rates of the corporate franchise tax also adversely effected Ohio's competitive position.

5. Ohio's Tax Ranking Compared with Other States

The U.S. Census Bureau publishes data on state and local taxes that can be used to make comparisons of tax burdens across states. Virtually every comparison or ranking of state tax systems relies on this data. The Federation of Tax Administrators, the organization of state tax and revenue agencies, annually publishes rankings of state, local, and state and local combined tax burdens. Rankings are computed on the basis of taxes paid per capita and on the basis of taxes as a percentage of personal income. These are the two most commonly accepted measures for comparing tax burdens across states. Other methods (such as those used by the Tax Foundation) attempt to make complicated adjustments to these numbers using methodologies that rely on non-standard and unproven assumptions that have not been peer reviewed. These rankings are widely viewed by economists to be invalid.

Tables 3, 4 and 5 below summarize where Ohio stands on the Federation of Tax Administrators rankings from 2004 through the most recent year for which this data is available (FY08 for state tax data and FY07 for local tax data). In these tables a rank of "1" indicates the highest taxes and a rank of "50" indicates the lowest taxes.

Table 3: Ohio State + Local Tax Levels Compared with U.S. Averages, FY 2004-2007

	FY 2004	**FY 2005**	**FY 2006**	**FY 2007**
Ohio Per Capita S+L Taxes	$3,419	$3,637	$3,773	$4,012
Ohio Rank	**20**	**22**	**23**	**25**
U.S. Average	$3,440	$3,698	$4,001	$4,234
Ohio Taxes as % of Income	11.4%	11.8%	11.8%	12.2%
Ohio Rank	**12**	**12**	**17**	**11**
U.S. Average	11.0%	11.3%	11.6%	11.6%

Source: Federation of Tax Administrators and U.S. Census Bureau. Rankings for years prior to FY07 can be found on the Ohio Department of Taxation website. Rankings do not include District of Columbia.

Table 3 shows that Ohio's ranking on state and local taxes per capita has fallen from 20th in 2004 to 25th in 2007 (the second year of the 5 year phase-in of the HB 66 tax reforms). Ohio's ranking of state and local taxes as a percent of personal income has remained roughly the same over this time period.

Table 4: Ohio State Tax Levels Compared with U.S. Averages, FY 2004-2008

	FY2004	FY 2005	FY 2006	FY 2007	FY 2008
Ohio Per Capita State Taxes	$1,963	$2,093	$2,140	$2,264	$2,296
Ohio Rank	**26**	**28**	**35**	**35**	**35**
U.S. Average	$2,011	$2,186	$2,379	$2,512	$2,575
Ohio State Taxes as % of Income	6.6%	6.8%	6.7%	6.9%	6.7%
Ohio Rank	**30**	**28**	**34**	**32**	**31**
U.S. Average	6.4%	6.7%	6.9%	6.9%	6.7%

Source: Same as Table 3.

Table 4 shows that Ohio's ranking on state taxes per capita has fallen from 26th in 2004 to 35th in 2006-2008 (the first three years of the 5 year phase-in of the HB 66 tax reforms). Ohio's ranking of state taxes as a percent of personal income has remained roughly the same over this time period. Note that Commercial Activity Tax revenues are included in the data used for these rankings.

Table 5: Ohio Local Tax Levels Compared with U.S. Averages, FY 2004-2007

	FY2004	FY 2005	FY 2006	FY 2007
Ohio Per Capita Local Taxes	$1,456	$1,544	$1,632	$1,748
Ohio Rank	**16**	**17**	**18**	**16**
U.S. Average	$1,430	$1,512	$1,621	$1,722
Ohio Local Taxes as % of Income	4.9%	5.0%	5.1%	5.3%
Ohio Rank	**10**	**9**	**9**	**5**
U.S. Average	4.6%	4.6%	4.7%	4.7%

Source: Same as Tables 3 and 4.

Table 5 shows that Ohio's ranking on local taxes per capita has remained roughly the same from 2004 to 2007. Ohio's ranking of local taxes as a percent of personal income has increased from 10th in 2004 to 5th in 2007. The data contained in Tables 3-5 clearly shows that Ohio ranks much higher compared to other states on local tax burden than it does on state tax burden.

6. Ohio Compared to States Without Income Taxes

Seven states (Alaska , Florida, Nevada, South Dakota, Texas, Washington and Wyoming) do not have a state income tax. Two other states (New Hampshire and Tennessee) tax only dividend and interest income. These states have simply never adopted an income tax. According to LSC, no state with a broad-based income tax in effect for the long-term has ever eliminated it. Table 6 provides population and unemployment rate data for these nine states and Ohio.

Table 6: Population and Unemployment in Selected States

	State	Estimated Population (July 1, 2009)	Unemployment Rate (December 2009)
1	Texas	24,782,302	8.30%
2	Florida	18,537,969	11.80%
3	**Ohio**	**11,542,645**	**10.90%**
4	Washington	6,664,195	9.50%
5	Tennessee	6,296,254	10.90%
6	Nevada	2,643,085	13.00%
7	New Hampshire	1,324,575	7.00%
8	South Dakota	812,383	4.70%
9	Alaska	698,473	8.80%
10	Wyoming	544,270	7.50%

Source: *2009 Population Estimates,* U.S. Bureau of Census and Bureau of Labor Statistics, *Unemployment Rates Seasonally Adjusted*

Of these nine states, 3 (Alaska, Texas and Wyoming) have significant supplies of natural resources (such as oil and natural gas) that can generate tax revenue. 2 states (Florida and Nevada) rely heavily on tourism to generate revenue. Nevada can also tax its extensive casino and gaming industry. Ohio is 14 times larger than South Dakota and nearly 9 times larger than Wyoming, each of whom have populations smaller than that of Cuyahoga County.

Thus Washington and Tennessee (which are each roughly half the population of Ohio) probably serve as the closes states to Ohio among those that do not have broad-based personal income taxes. Note that the unemployment rate in Tennessee is equivalent to that in Ohio, and the unemployment rate in Washington is only 1 percentage point less than that in Ohio.

More detailed examination of the Federation of Tax Administrator's data showing the rankings of all 50 states is also illuminating. This data is contained in tables 7 and 8.

Table 7 shows all 50 states ranked according to 2008 State Revenue per capita. The states without an income tax are shaded in gray. This table shows that in terms of state revenue per capita in 2008, Ohio ranks 35th, below 4 of the 9 states without a broad tax on personal income (Alaska, Wyoming, Washington and Nevada) and above the other five.

Table 7 also illustrates where Ohio would rank if it had no state income tax in 2008. If Ohio had eliminated the state income tax in 2008, the state would have had $9.115 billion less in revenue. This would have reduced Ohio's state tax burden per capita from $2,296 (35th) to $1,502 (50th). This would have placed Ohio $141 per capita below South Dakota.

Table 7: 2008 State Tax Revenue Per Capita

Rank	State	Per Capita Taxes	Rank	State	Per Capita Taxes
1	**Alaska**	**$12,276**	26	Illinois	$2,472
2	Vermont	$4,095	27	North Carolina	$2,470
3	**Wyoming**	**$4,070**	28	Idaho	$2,397
4	Hawaii	$3,996	29	Virginia	$2,369
5	Connecticut	$3,818	30	Kentucky	$2,356
6	North Dakota	$3,604	**31**	**Nevada**	**$2,352**
7	New Jersey	$3,526	32	Nebraska	$2,341
8	Minnesota	$3,509	33	Indiana	$2,339
9	Massachusetts	$3,360	34	Oklahoma	$2,329
10	Delaware	$3,357	**35**	**Ohio**	**$2,296**
11	New York	$3,356	36	Iowa	$2,295
12	California	$3,193	37	Mississippi	$2,252
13	Maryland	$2,948	38	Utah	$2,172
14	New Mexico	$2,860	39	Arizona	$2,109
15	Maine	$2,797	**40**	**Florida**	**$1,956**
16	**Washington**	**$2,740**	41	Colorado	$1,949
17	West Virginia	$2,689	42	Alabama	$1,946
18	Wisconsin	$2,681	43	Oregon	$1,913
19	Arkansas	$2,637	44	South Carolina	$1,887
20	Rhode Island	$2,628	45	Georgia	$1,877
21	Pennsylvania	$2,581	**46**	**Tennessee**	**$1,857**
	U.S. Total	**$2,575**	47	Missouri	$1,855
22	Kansas	$2,555	**48**	**Texas**	**$1,836**
23	Montana	$2,541	**49**	**New Hampshire**	**$1,711**
24	Louisiana	$2,495	**50**	**South Dakota**	**$1,643**
25	Michigan	$2,477		**Ohio No Inc. Tax**	**$1,502**

Source: Federation of Tax Administrators and U.S. Census Bureau.

Table 8 shows all states ranked according to 2007 State and Local revenue per capita. The states without an income tax are again shaded in gray. This table shows that in terms of state and local revenue per capita in 2007, Ohio ranks 25th, again below Alaska, Wyoming, Washington and Nevada, and ahead of the other 5 states without a broad tax on personal income.

Table 8 also illustrates where Ohio would rank on state and local taxes per capita if Ohio did not have a state income tax in 2007. If Ohio had eliminated the state income tax in 2007, the state would have had $8.885 billion less in revenue. This would have reduced Ohio's state and local tax burden per capita from $4,012 (25th) to $3,238 (43rd). This would have placed Ohio ahead of only Kentucky (by $3), Idaho, South Carolina, South Dakota, Tennessee, Mississippi and Alabama.

Table 8: 2007 State & Local Tax Revenue Per Capita

Rank	State	Per Capita Taxes	Rank	State	Per Capita Taxes
1	**Alaska**	**$7,268**	**26**	**Florida**	**$4,009**
2	New York	$6,898	27	Colorado	$3,848
3	**Wyoming**	**$6,205**	28	New Mexico	$3,797
4	Connecticut	$6,044	29	Michigan	$3,691
5	New Jersey	$5,944	30	Arizona	$3,673
6	Hawaii	$5,139	31	Iowa	$3,665
7	Massachusetts	$4,966	**32**	**New Hampshire**	**$3,614**
8	Maryland	$4,817	33	North Carolina	$3,586
9	California	$4,754	34	Georgia	$3,481
10	Vermont	$4,714	**35**	**Texas**	**$3,441**
11	Minnesota	$4,566	36	Montana	$3,419
12	Rhode Island	$4,545	37	Oregon	$3,413
13	Illinois	$4,290	38	West Virginia	$3,371
14	Maine	$4,280	39	Utah	$3,337
15	**Washington**	**$4,269**	40	Indiana	$3,332
16	Delaware	$4,245	41	Oklahoma	$3,312
	U.S. Average	**$4,234**	42	Missouri	$3,265
17	Pennsylvania	$4,208	43	Arkansas	$3,242
18	Virginia	$4,205		**Ohio No Inc. Tax**	**$3,238**
19	Wisconsin	$4,169	44	Kentucky	$3,235
20	**Nevada**	**$4,089**	45	Idaho	$3,185
21	Kansas	$4,088	46	South Carolina	$3,134
22	North Dakota	$4,085	**47**	**South Dakota**	**$3,009**
23	Nebraska	$4,034	**48**	**Tennessee**	**$3,005**
24	Louisiana	$4,020	49	Mississippi	$2,989
25	**Ohio**	**$4,012**	50	Alabama	$2,909

Source: Federation of Tax Administrators and U.S. Census Bureau.

7. Equity Impact of Repealing Ohio's State Income Tax

One final question to examine is the equity impact of repealing the state income tax. It is possible to answer this question using detailed data about income tax liability according to the income class of taxpayers who pay the tax published in the Ohio Department of Taxation Annual Report. The most recent data available come from the 2008 Annual Report and are for tax year 2006.

Table 9 shows the data about income tax distribution for tax year 2006 with two changes. First, the table collapses the 39 income classes shown in the Annual Report to four classes. Second, because the data is for 2006, it includes only the first two years of 4.2% annual reductions in the income tax rates enacted in HB 66. Therefore it is necessary to adjust the data for the final three years (a total of 13.6% additional reductions in tax rates). This was done by multiplying the tax liability amounts shown by the Department of Taxation by 87.4%. This adjustment reduced the total tax income tax payments in 2006 from $9.1 billion to roughly $8.0 billion, which more accurately shows the effect from total repeal of the income tax than does the actual 2006 liability.

Table 9: Detailed Ohio Income Tax Data by Income Class, Tax Year 2006, Adjusted for Scheduled Income Tax Reductions in Current Law

Income Class	Number of Returns	Federal Adj. Gross Income	Ohio Tax Liability	Tax Liability Per Return	Percentage of Tax Liability
0 to $50,000	3,591,439	$78.8 Billion	$1.2 Billion	$334	15.01%
$50,000 to $100,000	1,242,305	$87.3 Billion	$2.3 Billion	$1,834	28.52%
$100,001 to $250,000	425,165	$59.2 Billion	$2.0 Billion	$4,777	25.42%
$250,001 and more	89,820	$114.1 Billion	$2.5 Billion	$27,621	31.05%
Total	**5,348,729**	**$339.4 Billion**	**$8.0 Billion**	**$1,494**	**100.00%**

Source: Data from Ohio Department of Taxation, Calculations by Driscoll & Fleeter

Table 9 shows that taxpayers with income between zero and $50,000 would save an average of $334 per return if the income tax were repealed. These low and lower middle income tax payers would receive 15% of the total tax reduction. Taxpayers earning more than $250,000 per year would save an average of $27,621 per return. They would collect 31% of the savings or more than twice the percentage obtained by the zero to $50,000 group.

Table 10 shows the distribution of income tax returns by income class in both absolute numbers and in percentage terms.

Table 10: Number and Percentage of Income Tax Returns by Income Class, Tax Year 2006

Income Class	Number of Returns	Percentage of Returns
0 to $50,000	3,591,439	67.15%
$50,000 to $100,000	1,242,305	23.23%
$100,001 to $250,000	425,165	7.95%
$250,001 and more	89,820	1.68%
Total	5,348,729	100.00%

Source: Data from Ohio Department of Taxation, Calculations by Driscoll & Fleeter

The table shows that returns from taxpayers earning $50,000 or less account for two-thirds of all income tax returns. While taxpayers earning over $250,000 filed 1.68% of all returns - less than 2%.

The combination of Tables 1 and 2 shows that the two-thirds of Ohio taxpayers with the lowest income receive 15% of the benefits of income tax repeal. In contrast, fewer than 2% of Ohio taxpayers receive 31% of the benefit of income tax repeal.

Looked at another way, less than 10% of Ohio taxpayers earn $100,000 or more. These taxpayers would obtain more than half of the benefit of H.B. 400's income tax repeal. Their tax savings would account for over 56% of the entire reduction.

The data in Tables 9 and 10 clearly show the progressive nature of Ohio's income tax. Further, it is imperative to note that the progressive nature of Ohio's income tax is by design not by accident. As mentioned earlier, Ohio's two other largest taxes on individuals (the sales tax and the cigarette tax) are regressive. 41 states have a comprehensive income tax. As noted in the CSSLT final report (page 51), only 6 of these states had a flat rate income tax in 2003.

Conclusion: Income Tax Repeal and Tax Principles

Based upon the preceding analysis, the CSSLT tax system principles can be used to evaluate the impact of a repeal of Ohio's personal income tax.

- **Simplicity** - the tax system would be simpler without a state income tax
- **Equity** – the vertical equity of Ohio's tax system would be severely compromised by the repeal of the state income tax. As the data in Tables 9 and 10 show, the bottom two thirds of Ohio's taxpayers would enjoy only 15% of the benefits of the repeal, while the top 2% of Ohio's taxpayers would enjoy 31% of the benefits.

- **Stability** - Ohio's income tax currently brings in more than $7 billion in General Revenue Fund revenue. This is more than 44% of GRF tax revenues. Full implementation of the income tax repeal would occur in 2019 under the current version of H.B. 400. LSC has estimated that the income tax in that year would yield about $12 billion in revenue. Therefore the cost of repealing the income tax as of the year of its full implementation would equal $12 billion. The elimination of such a large amount of revenue from the state budget would have devastating consequences for state services. Local services that receive state funding (such as K-12 education) would also be severely affected.
- **Neutrality** – Some argue that Ohio's multiple bracket income tax system is a disincentive to business investment. It can also be argued that this concern was satisfactorily addressed by the 21% income tax reduction that was part of HB 66. Rather than focusing on the number of rate brackets, however, it is more valid to consider Ohio's overall level of state taxes. In this regard, Ohio ranks 35th among the 50 states in state taxes per capita according to data which reflects only 3 of the 5 years that are needed to fully phase-in the HB 66 tax reforms.
- **Competitiveness** – The 2003 Committee to Study State and local taxes conducted the most recent comprehensive evaluation of Ohio's tax system. They did NOT conclude that the existence of the state income tax was a serious impediment to Ohio's competitiveness with other states. In fact, comparison of Ohio with other states without an income tax is not promising. Five of the other states have other industries that they can tax in order to make up foregone income tax revenue. Two of the other states are a fraction of the size of Ohio and do not provide useful comparisons. The other two states exhibit unemployment rates that are the same or similar to that in Ohio.

Business location is a complex decision based on many factors, only one of which is taxes. While lower tax bills can act as one kind of incentive for economic development, infrastructure improvements, a strong education program, and a first class university system to provide an attractive employment base offer other kinds of incentives. One approach would lower taxes, while the other would emphasize more investment in public services.

It is unclear what advantage Ohio would attain by eliminating its income tax. At some point, the additional benefit from lower taxes reaches a point of diminishing returns. Moreover, it is not clear how much a strategy of cutting personal taxes can even affect business activity. Rather than cutting taxes merely for the sake of cutting them, a more prudent strategy would allow Ohio's previously enacted *business* tax reforms time to work in a normal economic environment before imperiling public services through drastic tax cuts with no focus on business activity.