



# THE BUCKEYE INSTITUTE

## **Ohio Needs Responsible, Comprehensive Tax Reform**

Interested Party Testimony  
Ohio House Ways and Means Committee  
Ohio House Bill 1

Greg R. Lawson, Research Fellow  
The Buckeye Institute

March 28, 2023

As Prepared for Delivery

Thank you, Chair Roemer, Vice Chair Merrin, Ranking Member Troy and members of the Committee, for the opportunity to testify on the education policies in Ohio House Bill 1.

My name is Greg R. Lawson, I am a research fellow at **The Buckeye Institute**, an independent research and educational institution—a think tank—whose mission is to advance free-market public policy in the states.

The tax reforms in House Bill 1 make a strong effort to improve Ohio’s *overall* tax climate by reducing and flattening the state income tax to 2.75 percent on income greater than \$26,050. According to the **Tax Foundation**, this reduced rate would be the lowest flat tax in the Midwest and the second lowest in the country. That alone marks a significant improvement and laudable accomplishment.

But House Bill 1 also takes some initial steps to disentangle local property taxes from state income taxes—a decades-old entanglement that needs to be fixed. General Assemblies in the 1970s and 80s sought political cover to implement and later hike the state income tax, so they dramatically raised state subsidies paid to local governments as an incentive to reduce property taxes and thus—theoretically—ease the overall tax burden being imposed on all state taxpayers. In reality, however, this opaque policy merely papered over an unwise income tax increase. That short-sighted decision has made effective, comprehensive tax reform extraordinarily difficult ever since. And now is the time for that comprehensive reform.

Flush with major general revenue surpluses, Ohio can afford responsible tax reforms that put Ohio taxpayers first.

### **A Flatter, Lower State Income Tax**

House Bill 1 follows The Buckeye Institute’s **four principles** of good tax policy.

It is **pro-growth** because it reduces tax rates on two key components for prosperity and job creation: investment and labor. A stronger economy with lower taxes and more job growth will make Ohio more competitive and attractive to businesses and their employees—an important edge in a transitioning global economy and tight labor market.

It **improves transparency** by allowing taxpayers to easily identify what tax they owe. It **promotes equity** because it treats similarly-situated taxpayers similarly; it does not tax income multiple times; and it does not favor some industries over others. And it comports with tax **simplicity** by incentivizing the elimination of many unnecessary tax loopholes that undermine the first three principles of sound tax policy.

These reforms will help the **2.2 million** Ohio workers employed by small businesses with 500 employees or less that make up nearly 45 percent of all Ohio jobs. They will also help those same small businesses that typically do not have battalions of tax lawyers and accountants at-the-ready, by reducing their overall tax and tax-compliance burdens. And that help is sorely needed. Ohio

hammers small businesses with the nation's **worst** local tax regime—the municipal income tax—which has helped make Ohio's local tax burden the 13<sup>th</sup> worst in the country.

To fulfill the promise of House Bill 1, this Committee should propose closing more tax loopholes, reducing the flat tax rate even further, and including language that announces the General Assembly's goal to eventually eliminate the state income tax entirely. House Bill 1 should include **revenue triggers** such that any further rate reductions may only happen when specified revenue goals are met. This fiscally responsible provision would act as a circuit breaker for tax cuts during fiscal stress and recessions. Critically, these revenue triggers would prevent the nightmare budget scenarios that **Kansas** encountered when it refused to right-size its budget while cutting taxes.

### **Making Local Governments More Accountable**

House Bill 1's property tax reforms serve two important functions: they help pay for the flatter, reduced income tax; and they make local governments more accountable by making tax policy more transparent.

A legalized shell game played with taxpayer money has allowed local governments to overspend for more than 40 years by obscuring the full cost of local public services. Taxpayers in one part of the state have been **subsidizing** local levies in other parts of the state through a 2.5 percent homestead exemption and a 10 percent nonbusiness property tax payment. In 2013, these subsidies were eliminated for all **new and replacement levies**, but maintained for renewal levies. These subsidies have created perverse incentives that encourage local officials to overspend because nonresident taxpayer dollars help foot the bill—that is, taxpayers who cannot vote on local spending decisions. Removing these subsidies will better align local officials' decision-making with the services and expenses their resident voters actually demand.

House Bill 1 rightly eliminates most of the remaining shell-game subsidies while reducing the percentage of property values subject to property tax from 35 percent to 31.5 percent. And despite local government hand-wringing at the prospect of unsubsidized spending, the General Assembly should move forward, eliminate the subsidies, and compel local officials to better control and prioritize their local spending. Such reform is decades overdue.

### **Easing the Tax Transition**

The General Assembly has several options for making the transition to a low, flat tax and subsidy-free regime easier on local governments.

- **One-time payment to ease the transition.** The state could use its large budget surplus to make a one-time payment to local governments in the amount of their lost subsidy revenue to sustain them until their renewal levies are on the ballot. Such a one-time payment would avoid the need for immediate local tax increases and give officials time to educate taxpayers on the full cost of local services.

- **Temporary phase-out subsidy.** The state could give local governments a *temporary* subsidy phased out over time, similar to the phase-out reimbursement local governments received when Ohio eliminated the **tangible personal property tax** in 2005.
- **Phase outs consistent with income tax reduction.** The state could phase out the property tax subsidies at a rate consistent with the income tax reduction.
- **Increase the local government fund for public safety and infrastructure.** The state could increase the Local Government Fund payouts for local public safety and infrastructure.

As it takes these steps, the General Assembly should convene a taskforce of local government stakeholders and policy experts to help local governments deliver services more efficiently and effectively. The Buckeye Institute has outlined a **series** of local government funding reforms that would benefit local taxpayers.

- **Eliminate unfunded mandates on local governments.** Local governments incur many costs because of demands made by the state. Unfunded mandates must be eliminated to help local governments balance their budgets and meet their constituents' demands, not the General Assembly's.
- **Spend state resources on specific, critical needs.** State tax dollars should be appropriately designated to address specific local needs, especially public safety.
- **Share state revenues with local communities in need.** State policymakers should engage in revenue sharing with local governments and communities that genuinely need state assistance to provide critical goods and services. This particularly applies to townships that rely exclusively on property taxes and fees for revenue.
- **Tailor local funding and projects to core community needs.** Focusing local spending on managing and serving core needs and responsibilities will keep local spending more in line with local resources.
- **Pursue sharing local resources.** Cooperative purchasing and shared government services will help local governments use taxpayer funds more effectively, making local communities less dependent on revenue-sharing from Columbus.
- **Spend more transparently.** By increasing transparency and accountability, local governments will ultimately prove more efficient and less reliant on state-collected tax dollars to meet their fiscal needs.

House Bill 1 moves Ohio toward the comprehensive tax and spending reform that it has needed for decades. It will make the state more economically competitive and pave the way for reforming Ohio's byzantine system of local government taxation.

Thank you for your time and attention. I would be happy to answer any questions that the Committee might have.

### ***About The Buckeye Institute***

*Founded in 1989, The Buckeye Institute is an independent research and educational institution – a think tank – whose mission is to advance free-market public policy in the states.*

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