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Tax Reform Principles for Ohio

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Executive Summary

Today, Ohio Governor John Kasich released his new fiscal budget. The Governor and General Assembly continue to reform Ohio's complicated and harmful tax code. Noteworthy reforms have already been made over the past decade, including lowering the top personal income tax rate, eliminating the death tax, phasing out the tangible personal property tax, and providing significant small business tax relief; but other proposed tax plans would have moved Ohio's tax code in the wrong direction.

Ohio is not alone in making changes to its tax code. Many states and even other countries have altered their tax systems to encourage entrepreneurship and economic prosperity. If Ohio fails to move in the right direction on tax policy, it will cede ground to the states that have enacted pro-growth reforms and will become less attractive for both business investment and workers. It is crucial that policymakers seek to draft the best tax bill possible. To that end, there are key principles that should guide the efforts of the 131st General Assembly in considering tax reform.

Any good tax bill will be based on the following four principles:

- **Pro-growth** – A tax system should minimize tax distortions, avoid high rates and discourage tax avoidance. A good tax plan will reduce tax rates on investment and labor, which are key components for economic prosperity and job creation.
- **Simplicity** – The tax code should be simplified by reducing loopholes, credits, and deductions. Complying with the tax code should not be burdensome. A simpler tax code makes it easier for both government administration and taxpayer compliance. A more complicated tax code increases the risk of special interest carve-outs and favors.
- **Transparency** – The tax code should be clear, enabling taxpayers to easily identify which specific taxes they pay. Ohioans should be able to understand debates over changes in tax policy and know how their elected officials are representing their interests.
- **Fairness and Equitability** – A good tax code promotes equity by ensuring that taxpayers in similar situations are treated similarly, income is not taxed multiple times, and industries are not singled out for preferential tax treatment. Alternatively, industries and individuals should not be punished and subject to punitive tax rates with gov-

ernment picking winners and punishing losers. People and businesses with equivalent earnings should pay similar taxes. Rates should not force individuals and businesses to change filing status for better tax treatment.

Policymakers should determine the efficacy of proposed tax changes. Dynamic modeling analysis offers the best prediction of how the economy in Ohio will respond to tax changes. The federal government is now utilizing dynamic analysis, as do most research economists. Dynamic analysis is an important tool that should be a part of Ohio's tax reform project.

Ohio's leaders and citizens must settle on a plan of action to improve our state. Ohio's position at 49th of the 50 states on the ALEC Economic Performance Index underscores that there is certainly no shortage of opportunities for improvement.[1] The upcoming budget discussion gives Ohio policymakers the chance to enact good tax reform based on the four key principles that will lead to better economic performance.

State policymakers implemented significant tax reform in the mid-2000s and again in a series of bills over the previous two General Assemblies. Those reforms included eliminating the cumbersome tangible personal property tax, phasing in a 21% income tax reduction, reducing the income tax while eliminating the death tax, and embracing an up-to-75% deduction on small business income. Despite these positive efforts, tax policy remains a critical area for additional pro-growth reform in the coming biennium. Ohio retains a burdensome tax code when examined at the state and local level. The structure of Ohio's tax system is unique in its complex and constrictive nature, and it is from this structure that problems emerge. The tax structure has caused more than half a century of job growth that is below the national average. The good news is that it can be changed.

The need for tax reform is real. The new legislative session and re-election of Governor John Kasich provide a tremendous opportunity to build upon previous successes in tax reform and to craft a better tax policy for Ohio.

Background

Every year Ohioans spend a substantial amount of time working to pay their tax burden. In 2011, nearly 10% of Ohio's economic activity was used to pay state and local taxes.[2] According to the Tax Foundation, in fiscal year 2011, only 17 states had a larger tax burden than Ohio.[3] Conversely, six states dedicated less than 8% of their income to meeting the tax burden. Though this ranking is not an enviable position for Ohio, it is also not an unusual one – 14 states have a tax burden within three tenths of a percentage point of Ohio's.[4] In other words, Ohio's tax burden is sizeable, but not so large as to make the state a grossly offending outlier. Ohio's tax burden suffers more from its composition than its magnitude.

1 Laffer, Arthur B., Stephen Moore and Jonathan Williams. "Rich States, Poor States 7th Edition." American Legislative Exchange Council. April 15, 2014 at http://alec.org/docs/RSPS_7th_Edition.pdf (January 6, 2015).

2 The Tax Foundation, "State Tax Climate: Ohio" at http://taxfoundation.org/state-tax-climate/ohio (January 26, 2015).

3 Malm, Liz and Gerald Prante. "Annual State-Local Tax Burden Ranking FY 2011." Tax Foundation. April 2, 2014 at http://taxfoundation.org/article/annual-state-local-tax-burden-ranking-fy-2011 (January 26, 2015)

4 *Ibid.*

Reductions have been made in the income tax rates for all income brackets, which top out at 5.33% .[5] Even with these lower rates, the structure of Ohio's income tax remains broken down into an above-average number of tax brackets causing further complexity in Ohio's tax code. Ohio does not levy a state corporate income tax and recently abolished its estate tax, yet this void has been filled by two other taxes that few other states levy: local corporate income taxes and the gross receipts tax.

Few states even allow municipalities to levy their own corporate income taxes due to the onerous cost of complying with so many different tax codes. Similarly, complex webs of taxes motivated recent, albeit very limited, efforts to reform Ohio's uniquely bad system of local taxes on personal income, but such taxes on corporate income remain largely unchecked.

The gross receipts tax, or "Commercial Activity Tax" (CAT), is levied on every exchange of products between businesses. This situation means that by the time an Ohio hamburger bun reaches the store shelf, it has already subjected its farmer, miller, baker, shipper, wholesaler, and grocer to a tax. What's more, each of these businesses is taxed based on the price they paid for the product rather than on the profit they derive from it. Every one of these businesses must therefore take on a tax liability before they make their first dollar, simply as a result of doing business in Ohio. The obvious disincentives this system creates explain why only four other states choose to levy taxes in this manner.[6]

Finally, as with many states, Ohio's tax code is replete with tax expenditures, or loopholes. Tax expenditures have proliferated at the state and federal levels for decades. Once ensconced in statute, they are often forgotten and become entrenched and therefore immune to substantial scrutiny. While they are reviewed briefly during the drafting of the initial budget blue print every biennium, there are few, if any, performance measures that allow the expenditure to be reviewed for efficacy and fairness. Further, every tax expenditure makes an exception to the tax code, thus narrowing the base of what is taxed. Not only does this system create certain winners, it also establishes losers by forcing the remaining tax to be borne by fewer taxpayers. Eliminating some tax expenditures would meet several of the four key principles for tax reform and would advance good tax policy.

There have been a series of beneficial reforms to Ohio's tax code over the past decade. Personal income tax rates have been lowered, the Death tax has been eliminated, and significant tax relief has been granted to the engines of job creation – small businesses. Going back to the mid-2000s, the burdensome tangible personal property tax was also phased out, giving a boost to manufacturers, which are still a major component of Ohio's economy. Unfortunately, CAT rates have been increased and remain a potential target for further increases. Additionally, unsound tax increases targeting specific industries have also been pursued. The entire local tax structure remains mired in complexity despite the previous General Assembly's House Bill 5 that introduced modest, first step measures to simplify the municipal income tax system. These measures did include some exemptions for developing businesses, but the system remains complex and retains fundamental flaws unlike those found in any other state.[7] Further, successful future reform should be designed to create simple, fair, and economically-efficient taxes.

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5 State of Ohio Department of Taxation, "Individual Income Tax" at http://www.tax.ohio.gov/ohio_individual/individual/annual_tax_rates.aspx (January 26, 2015).

6 Laffer, Arthur B., Stephen Moore and Jonathan Williams. "Rich States, Poor States 7th Edition." American Legislative Exchange Council. April 15, 2014 at http://alec.org/docs/RSPS_7th_Edition.pdf (January 6, 2015).

7 Lawson, Greg R. "More Must be Done for Real Municipal Income Tax Reform." The Buckeye Institute for Public Policy Solutions at http://buckeyeinstitute.org/uploads/files/More%20Must%20be%20Done%20for%20Real%20Municipal%20Income%20Tax%20Reform%20(11-2014)(1).pdf (January 26, 2015).

Four Principles of Sound Tax Policy

Pro-Growth

Tax revenue is necessary for a government to carry out its functions. Taxes enable government to provide essential services such as defense and public safety. However, taxes are also an impediment to economic growth. How a government collects tax revenue is vital to ensuring prosperity and opportunity for citizens.

Economists at the Organization for Economic Community Development (OECD), write, "They (taxes) need to be set up to minimize taxpayers' compliance costs and government's administrative cost, while also discouraging tax avoidance and evasion. But taxes also affect the decisions of households to save, supply labor and invest in human capital, the decisions of firms to produce, create jobs, invest and innovate, as well as the choice of savings channels and assets by investors. What matters for these decisions is not only the level of taxes but also the way in which different tax instruments are designed and combined to generate revenues."

According to OECD economists, a tax system should create the least amount of economic harm. Research shows that higher tax rates, particularly on investment, reduce economic growth. The former head of President Obama's Council of Economic Advisors, Christina Romer, found that *"tax increases are highly contractionary."*[8] For this reason, tax rates should be set as low as possible so as not to reduce the amount of investment or work that individuals and companies undertake.

The fact that taxes change economic behavior is not new or controversial. Governments often enact taxes for the specific purpose of changing individual or business behavior. For example, policymakers often advocate raising the excise tax on cigarettes in order to discourage smoking by making cigarettes more expensive. A tax credit can be a subsidy like a tax credit for solar panels or electric cars that encourages more consumption of those goods. One does not need to endorse these taxes or credits to understand that they are intended to alter behavior.

The higher a tax rate is, the larger the "tax wedge" on goods and services will be. A "tax wedge" is the difference between the price paid for a product or service and the price received by the producer of the product or service. A payroll tax is a tax wedge on the labor of a worker. An excise tax on a product is a wedge on that product. State taxes make up only a portion of the total wage tax an Ohio citizen faces. Taxes at the federal and local level also contribute to the overall tax burden.

Tax rates are only one part of a designing a good tax system. Governments facilitate more economic growth and therefore receive more tax revenue if they have a tax system that minimizes distortions and maximizes growth. A study by economists at the OECD found that the worst tax for economic growth is corporate tax.[9]

The second worst tax for economic growth is personal income tax. Higher marginal tax rates on income discourage work and investment. The best form of taxation is on consumption, which encourages savings. Any tax reform that would shift taxes from individuals to businesses is worse for workers and families.

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8 Romer, Christina D. and David H. Romer, "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks," American Economic Association, 100 (June 2010), ppg. 763-801.

9 Organization for Cooperation and Economic Development, "Tax and Economic Growth," Economics Department Working Paper No. 620. July 11, 2008.

A good tax system does not tax the most mobile factors of production such as workers or capital, which can and do leave Ohio easily. Ohio faces competition not just from other countries, but from other states as well. Unfortunately, Ohio ranks in the bottom five of all states in losing income and high-skilled workers to other states.[10] No other state lost as many taxpayers during the Great Recession of 2009 to 2010 as Ohio.[11] Taxes that single out businesses encourage additional harmful migration out of Ohio.

Simplicity

The principle of tax simplicity holds that taxpayers must find it easy to understand, calculate, and pay their tax burden. The Treasury Department's 1984 report on tax reform to President Reagan defined tax simplicity in terms of what it is *not*:

> "Simplicity is not wondering which receipts and checks to save because the tax law is too complex and is constantly changing. Simplicity is not computing dozens of deductions and credits, and wondering all the while whether other means of saving tax might have been missed through ignorance of the laws. Nor is simplicity being forced to wade through long and complicated instruction booklets or resort to professional assistance, in order to meet the civic responsibility to pay taxes."[12]

Ohio's convoluted municipal income tax system is a perfect example of tax policies distracting private enterprise from undertaking efforts to grow and create jobs. The testimony of small business owner Lisa Crosley to the Senate Ways and Means Committee in November of 2014 provides a first-person point of view:

> "At the end of First Quarter, 2013, my payroll tax pay service paid quarterly tax to 28 municipalities. 17 required tax payments of less than $10. Six required payments between $11 and $25; 3 between $26 and $99 and ONLY TWO required payments of $100 or more. One city received $1.80, another 82 cents, another 46 cents, and, last but not least, one city received a whopping 22 cents! In one instance, it was necessary to file a return to inform the city I hadn't worked there! The cost of processing these tiny payments to local governments far exceeds the benefit."[13]

Ms. Crosley, and all Ohioans, deserve better, and more tax reform is needed.

Simplifying Ohio's tax policies is a critical step toward a better-functioning tax system. The complex status quo of the present tax structure burdens taxpayers with high administrative costs in several ways. Citizens and businesses are forced to spend excessive amounts of time and money

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10 Borean, Richard. "Migration of Personal Income Between the States." Tax Foundation, August 19, 2013 at http://taxfoundation.org/blog/monday-map-migration-personal-income (January 29, 2015)

11 Laffer, Arthur B., Stephen Moore and Jonathan Williams. "Rich States, Poor States 7th Edition." American Legislative Exchange Council. April 15, 2014 at http://alec.org/docs/RSPS_7th_Edition.pdf (January 6, 2015).

12 United States Department of the Treasury. "Tax Reform for Fairness, Simplicity, and Economic Growth," p. 16, November 1984 at http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1All.pdf (January 9, 2014).

13 Ohio Senate Ways and Means Committee. "Testimony of Lisa Crosley, President, EnviroControl Systems, Inc." November 13, 2014 at http://static1.squarespace.com/static/5123c769e4b03a5603ce7853/t/54666060e4b0728d56f9b8f1/1415995488398/Lisa+Crosley_EnviroControl+Systems.pdf (Jan. 12, 2015).

understanding and complying with their tax obligations. Many taxpayers must hire a consultant to file taxes for them. Cases of inadvertently wrong returns are driven even higher by confusion and frustration with the rules. Complex laws also create more work for tax collectors and auditors, and theexcess labor costs for these government employees are forced back to taxpayers. This waste of resources creates a drag on economic growth and fosters ill will towards the tax system.

When Ohio gained statehood in 1803, it imposed only one land tax on residents.[14] That one tax has ballooned to more than 20 types of state and local taxes.[15] The 2014-2015 Tax Expenditure Report lists 129 tax expenditures—exemptions, deductions, and credits for state taxes—that are buried in Ohio law.[16] The current state tax laws at Ohio Revised Code Title 57 run over 697,000 words or about 1,528 pages.[17]

Such complexity creates heavy administrative burdens for citizens and businesses. In tax year 2011, approximately 56% of federal individual income tax filers hired a third party to prepare their tax returns.[18] A Mercatus Center report estimates that Americans spend $67 to $378 billion per year in accounting costs just to prepare their tax returns, and this compliance burden takes $148 to $609 billion out of the national economy annually.[19] The latest IRS data estimates that $450 billion (or about 17%) of annual tax liability is not paid on time, with $385 billion remaining unpaid even after enforcement measures.[20]

Simplifying the tax code will benefit all Ohioans by providing a boost to economic growth and rooting out wasteful practices.

Reducing the strain on businesses will free up resources to expand and create jobs. Individual citizens will experience fewer headaches at tax time and pay less for tax advice, allowing them the freedom to spend their hard-earned money in other ways. The cost of government will decrease, as fewer hours are required of collectors and auditors to enforce a byzantine tax code.

Further, many tax laws are born from a policymaker's desire to manage the economy, control economic behavior, or dole out special favors through taxation. Even well-intentioned tax provisions can create unintended consequences and prove to be too complicated for some taxpayers to take advantage.

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14 State of Ohio Department of Taxation. "Taxation in Ohio: History of Major Changes" at http://www.tax.ohio.gov/portals/0/taxeducation/history/taxation%20in%20ohio_history.pdf (January 8, 2015).

15 State of Ohio Department of Taxation. "2013 Annual Report," pp. 27-199, at http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2013_annual_report/2013_AR_internet.pdf(January 9, 2015).

16 State of Ohio Department of Taxation. "Tax Expenditure Report, The State of Ohio Executive Budget, Fiscal Years 2014-2015," pp. 1, at http://obm.ohio.gov/Budget/operating/doc/fy-14-15/bluebook/budget/Tax_14-15.pdf (January 12, 2015).

17 Ohio Rev. Code Ann. §57.

18 Koskinen, John. "MSP #5: Regulation of Return Preparers," Taxpayer Advocate Service at http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/REGULATION-OF-RETURN-PREPARERS-Taxpayers-and-Tax-Administration-Remain-Vulnerable-to-Incompetent-and-Unscrupulous-Return-Preparers.pdf (January 12, 2015).

19 Fichtner, Jason J. and Jacob Feldman. "The Hidden Costs of Tax Compliance," The Mercatus Center at George Mason University. May 20, 2013, at http://mercatus.org/publication/hidden-costs-tax-compliance (January 9, 2015).

20 United States Internal Revenue Service. "Tax Gap Estimates for Tax Year 2006, FS-2012-6." January 6, 2012 at http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study (January 9, 2015).

A commitment to a simple tax system would free up resources, eliminate many distorting laws, and contribute to a freer and more efficient economy.

Transparency

A good tax system needs to be transparent. Transparency in taxation means that taxpayers should be able to easily gather information about *which* taxes they pay (directly and indirectly), *why* those taxes are in place, *who* put them into law, *how much* revenue those taxes collect and *from whom*, and *how* those tax dollars are used. Transparency strengthens the ability of taxpayers to hold policymakers accountable for their decisions and affect change when those decisions are harmful. In the long run, transparency and accountability also make the tax structure more efficient.

For almost all ordinary Ohioans, the tax code is impossibly complex, preventing most taxpayers from knowing and understanding the taxes they pay.

In many cases, citizens do not vote on the collection and use of taxes they pay. For example, all Ohioans vote on local and state taxes separately at the polls. However, local governments receive more money than they collect directly from their taxpayers through the opaque "Local Government Fund" (LGF). The LGF redistributes state tax revenues back to local governments without allowing citizens to have a say in how many LGF dollars are collected from them or how they are redistributed.

Economist Armen Alchian theorized that when government officials are handed money in such an opaque manner, they are prone to spend it in their own best interest rather than in the best interests of the taxpayers.[21] Giving tax dollars to bureaucrats to misspend is a waste of resources.

Thus, a transparent tax code is favorable because it prevents misuse and promotes economic efficiency and accountability.

Fairness and Equitability

As Adam Smith observed, "The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."[22]

A tax system should be fair and equitable for all taxpayers. The tax code should not treat individuals and businesses that are situated similarly in disproportionate ways. The tax code should also not be used to punish or reward different classes of taxpayers or to establish "winners" and "losers."

21 Alchian, Armen A. "Market Prices, Property and Behavior", in Benjamin, Daniel K., ed, The Collected Works of Armen A. Alchian, Volume 2 (2006): p. 464. Liberty Fund, Inc.: Indianapolis, IN.

22 Smith, Adam. "An Inquiry into the Nature and Causes of the Wealth of Nations", Edwin Cannan, ed. 1904, Library of Economics and Liberty at http://www.econlib.org/library/Smith/smWN21.html (December 19, 2014).

Economists frequently use two basic approaches when evaluating the fairness and equitability of a tax system: the *Benefit Principle* and the *Ability to Pay Principle.*[23]

Under the Benefit Principle, taxes are the price paid for government goods and services. As the benefits a taxpayer receives from the government increase, the taxes paid by that individual should increase commensurately. By contrast, under the Ability to Pay Principle, the capacity of taxpayers, both horizontally and vertically, is used as the determining factor in the amount of taxes paid. Horizontal equity is used to assure that similarly situated taxpayers pay equivalent taxes while vertical equity places greater stress on the distributional aspects of a given tax and represents the impetus behind progressive income taxation.[24]

Horizontal equity can be difficult to determine. For example, families with the same income can be taxed at dramatically different levels depending on their size and marital status. Vertical equity is also an amorphous concept. There is no generally agreed upon standard for how much taxpayers should pay in tax as a percentage of their income. Already, based upon Tax Year 2012 data from the Ohio Department of Taxation, the top 7% of income tax filers in Ohio paid more than 50% of all income taxes while the bottom 50% of taxpayers paid only around 5% of the total.[25] Whether this disparity is appropriate is subject to a great deal of disagreement, and subjective perceptions rather than hard data often drive that debate.

The two hypothetical examples below illustrate the importance of the principles of fairness and equitability.

1) Joan, Tina, and Barbara are all single women without children who work as paralegals in the City of Columbus. Each earns $45,000 annually. Joan lives in Bexley. Tina lives in Columbus. Barbara lives in Westerville. In Ohio, residents are taxed at their location of employment *and* at their residence. Columbus and Bexley each have a 2.5% municipal income tax rate, while Westerville has a 2% rate. Currently, Bexley offers only a partial (65%) credit for the income tax Joan already pays to Columbus. Consequently, despite both Bexley and Columbus having the same rate of income taxation, Joan will be double-taxed and pay more than both Tina and Barbara. By contrast, Tina pays municipal income tax only to Columbus since she both works and lives there. Meanwhile, Barbara gets a full credit from Westerville for the taxes she pays to Columbus and thus incurs no additional tax liability to the Westerville since its rate of taxation is lower than the one in Columbus.

2) Two manufacturing companies are considering relocating to Cincinnati. They both anticipate the creation of between 30 and 50 jobs. One gets a job creation tax credit from the state and the other does not.

In the first example, similarly situated taxpayers are treated differently based upon where they live and the credits, or lack thereof, that are offered by different cities. In that example, it is not the rate itself that is the cause of a lack of fairness. Those rates are a matter of local control and people

23 Damsk, James A. and Robert A. Lawson, PhD. "Tax Reform for Ohio's New Millennium." The Buckeye Institute for Public Policy Solutions, at http://www.buckeyeinstitute.org/docs/Tax_Reform.pdf (January 6, 2015).

24 *Ibid.*

25 Using tax data series from the Ohio Department of Taxation available at http://www.tax.ohio.gov/tax_analysis/tax_data_series/individual_income/publications_tds_individual.aspx (January 5, 2015).

can choose where to live. Rather, the unfairness is caused by the embedded problems in the system, especially the lack of full reciprocity among tax credits offered by a taxpayer's city of residency. Taxpayers can be double-taxed if they happen to live in a city that does not offer a full credit for the taxes they *already* paid to the jurisdiction where they work. This discrepancy is a violation of the principles of fairness and equitability, and provides another reason that a fundamental overhaul of the municipal tax system in Ohio is needed beyond the one that cleared at the end of the previous General

Assembly session.[26] In the second example, two manufacturing companies that anticipate creating a comparable number of jobs are treated differently. With the state offering a tax credit to one and not the other, it is tilting the playing field to the advantage of one over the other for reasons that are not fully transparent.

It is imperative to examine an entire state tax system when determining its overall fairness and equitability. Tax expenditures, popularly known as loopholes, as well as certain credits, typically litter state tax codes. Each of these expenditures unfairly creates "winners" and "losers." Additionally, the impact of different forms of taxes must be taken into account. Changes to one tax may superficially appear to improve fairness and equitability when assessed in isolation from the full system. Yet, when reviewed within the context of the entire code, those same change could easily cause wide-ranging inequity.

The Need to Use Dynamic Analysis When Reforming the Tax Code

Dynamic scoring is a method of analysis that accounts for and predicts behavioral changes by people and businesses in real world economic activity as a result of changes to policy. This type of analysis effectively assesses the actual impact various policies will have by figuring out how people and businesses will likely respond to incentives and disincentives written into the tax code.

The federal government has used dynamic scoring for major tax bills as well as for other proposed legislation on major issues such as immigration. Other states use dynamic scoring as a policy tool, and most economists use dynamic simulation models in their publications and research for leading economic journals.[27] Dynamic models are an established, accepted tool for economic analysis and research.

Dynamic models also allow for alterations in the way that components of the model interact over time. In contrast, static models maintain a fixed relationship between variables. In a static model, tax revenue can rise and fall in a nearly perfect linear relationship because changes in other parts of the model such as shifts in amount of earnings, number of jobs, or size of the tax base are not reflected.

Using dynamic analysis enables legislators to understand how tax changes impact the future balance sheet of Ohio. Policies that are anti-growth will be shown to cost more in a dynamic analysis

26 Lawson, Greg R. "More Must be Done for Real Municipal Income Tax Reform." The Buckeye Institute for Public Policy Solutions. November 6, 2014 at http://buckeyeinstitute.org/uploads/files/More%20Must%20be%20Done%20for%20Real%20Municipal%20Income%20Tax%20Reform%20(11-2014)(1).pdf (January 26, 2015).

27 Furth, Salim. "Accurate Budget Scores Require Dynamic Analysis" The Heritage Foundation Backgrounder #2984, December 30, 2014 at http://www.heritage.org/research/reports/2014/12/accurate-budget-scores-require-dynamic-analysis (January 29, 2015).

model than a static model's score would indicate because slower economic growth produces a smaller tax base in the future. On the other hand, more pro-growth policies produce a larger tax base and would be reflected to do so in a dynamic model.

One example is the 2014 federal proposal by then-Congressman Dave Camp, which grew the economy and would have created up to 2 million jobs over the next decade, according to the Joint Committee on Taxation, the official scorekeepers of tax policy for Congress.[28] The Joint Committee was able to use its dynamic macro-economic models to analyze the Camp plan. Dynamic analysis is an important step in illustrating how pro-growth plans create economic growth and revenue feedbacks that can be used for additional tax savings or government spending.

Static tax analysis rewards anti-growth plans by making assumptions that they will not harm the economy or change economic behavior by people and businesses. For example, every economic model and analysis shows that raising taxes on capital decreases investment. The Congressional Budget Office writes, "When tax rates are high, investors require higher before-tax rates of return and thus forgo investments with lower returns that they otherwise would have made."[29] Yet a static analysis of higher taxes on capital will not account for a corresponding change in the level of capital investment as a result of higher taxes.

Ohio policymakers should consider using dynamic analysis of future tax plans to understand how they affect Ohio's economy. Dynamic scoring will enable the state to anticipate changes to its future tax base and labor force as a result of a new tax law.

A good tax reform plan then does not have to be bound by a static analysis showing revenue neutrality in the future when a dynamic analysis would show that those same tax plans increasing or reducing growth will impact the amount of tax revenue available to the state in the coming years.

Conclusion

Ohio's long-standing struggle with sub-optimal job and income growth speaks to an overall business climate that is not sufficiently conducive to the growth needed for the state to remain a national leader. Already, Ohio has seen its population growth stagnate as citizens are lured to the south and west by more vibrant competing states that are outperforming Ohio. Consequently, tax reform in Ohio must remain a priority for policymakers.

Moving toward the elimination of the state personal income tax is a sound strategy. Taxes on income are a leading dampener on long-term capital and wealth accumulation. However, the way in which this reform is implemented is just as important, if not more so, than the reduction itself. If the wrong taxes are raised or the tax code is made less transparent and more complex in order to accomplish this task, Ohio will continue to move in the wrong direction economically. Additionally, a focus on state-level tax changes to the exclusion of further reform to Ohio's overly complex local income tax system will also prevent the state from moving forward.

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28 Congress of the United States Joint Committee on Taxation. "Macroeconomic Analysis of the Tax Reform Act of 2014." February 26, 2014 at https://www.jct.gov/publications.html?func=startdown&id=4564 (January 29, 2015)

29 Congressional Budget Office, "Tax Capital Income: Effect Marginal Tax Rates Under 2014 Law and Selected Policy Options." December 18, 2014 at http://www.cbo.gov/sites/default/files/cbofiles/attachments/49817-Taxing_Capital_Income_0.pdf (January 29, 2015).

Though Ohio's tax code cannot be created completely anew, adherence to sound principles of taxation can facilitate long-needed improvements to a system that continues to be prejudiced against growth.

A pro-growth tax system creates fewer distortions that unduly and negatively influence personal and business decisions. A tax system that is simple will improve compliance and reduce wasted resources. A tax system that is transparent helps to assure that taxpayers see and understand how the system operates. Finally, a tax system that is fair and equitable will even the playing field rather than favoring special interests over ordinary citizens and businesses.

Violations of these principles will result in a tax code that retains its fundamental problems. Growth will remain underwhelming with all Ohioans and Ohio businesses suffering the ongoing financial consequences. Adherence to these principles, alternately, will be a significant step on the path to enhancing Ohio's economic position and reversing decades of relative economic decline.

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