Ben Franklin famously stated that, “in this world nothing can be said to be certain, except death and taxes.” While there is very little we can do about the former, fixing our broken tax code is fully within our control. Although there are many reasons why businesses and individuals decide where to operate and live, tax rates and tax code complexity are often cited as some of the most important considerations.

At the federal level, this dynamic has been on display in recent years as numerous companies have chosen to move overseas, citing America’s high corporate tax rate as one of the main contributing factors. The same calculation plays out at the state level as well: because states are free to devise their own tax regimes, there is great disparity from one state to the next, which can result in companies and individuals opting to move to greener tax pastures. It is within this context that we should view Ohio’s tax code and efforts to improve it: compared to neighboring states, what are Ohio’s tax rates and how complex is the code, for both individuals and businesses?

Finally, we must keep in mind that Ohio’s budget must balance each year and that approximately one third of the budget is comprised of state taxpayer dollars – any efforts to reduce state taxes will necessarily create a budget hole that must be filled either through increased growth or by accompanying cuts or tax increases elsewhere in the budget. While recognizing the need to balance the budget, raising taxes on hardworking families is not a fiscally sound, pro-growth, conservative solution. Ohio’s leaders should look to fix budget problems with policies that encourage economic growth and investment in the state, rather than simply raising taxes.

Although it is only a fraction of the overall tax picture, the primary focus for most Ohioans during tax reform discussions centers on the individual rate – almost every individual in Ohio pays individual income taxes, and the individual rate is also critically important to the thousands of sole proprietorships, LLC’s, LLP’s, and S-corporations whose taxes are calculated based on the owner’s individual return. According to the Ohio Department of Taxation’s 2015 Personal Income Tax report, Ohioans paid $8.88 billion in taxes, which is more than a $400 million increase on the year before. Although both of these years are a sharp downturn in tax dollars paid compared to the years prior, thanks to the enactment of several tax cut measures signed by Governor Kasich. These tax cuts were enacted This personal income tax revenue accounts for nearly one quarter of the state’s entire General Revenue Fund (GRF), while sales and use

taxes make up nearly 30 percent, and the CAT and other taxes comprising another fifteen percent. Combined, taxes are responsible for nearly 70 cents of every dollar in the GRF.

Looking at state income tax rates, Ohio is in the middle of the pack compared to its neighbors: Ohio's top marginal individual income tax rate for 2017 is 4.997%, which places it fourth, ahead of the top rates of 6.5% in West Virginia and 6.0% in Kentucky, but trailing Michigan at 4.25%, Indiana at 3.23%, and Pennsylvania at 3.07%. Compared to the nation as a whole, Ohio is firmly in the middle of the pack: the national average top marginal rate is 4.65%. This by no means a perfect measuring stick however, as state tax codes vary wildly. For example, while Ohio has a higher top rate than Indiana, Michigan, and Pennsylvania, those three states have a flat rate, meaning all taxpayers in the state pay the same rate, regardless of income level. Additionally, how states treat exemptions and deductions, how they define taxable income, and many other issues can complicate these comparisons. Another major consideration is whether the state allows individual municipalities to level their own income taxes. While only a handful of states do so, Ohio is one of them, meaning that while Ohio's state income tax rates may be relatively competitive, they do not paint the full picture of income taxation. Notably, several cities in Kentucky, Michigan, and Pennsylvania also permit municipal income taxing, as do all 92 counties in Indiana. West Virginia does not have municipal income taxation.

The final rate consideration in regards to individual taxes is the state's sales tax rate. Sales taxes are one of the largest sources of revenue for states across the country and can best be measured by comparing the sales tax revenue collected by each state as a percentage of its total state and local tax collection. In this measure, the Tax Foundation ranks Ohio 22nd, at 25%, which puts its sales tax revenue percentage higher than all of its neighbors except Indiana at 28.3%. Since first enacted over 80 years ago, Ohio's sales tax has nearly doubled, from 3% initially in 1935 to 5.75% in 2017. However this rate does not tell the full story, as each of Ohio's 88 counties also impose their own sales and use tax, which increase the rate to anywhere from 6.5% to 8% when the two taxes are combined. This puts Ohio at a great disadvantage compared to its neighbors. When the state sales tax is combined with the average local sales tax added on, Ohio has the highest rate of all its neighbors at 7.14%. In fact, with the exception of Indiana at 7.0%, the remaining four neighboring states all have a combined rate of more than a half percentage point less, with Michigan and Kentucky each having the lowest rate at 6.0%. This puts Ohio businesses and the state at risk of losing revenue as discerning consumers will simply choose to cross state lines to make large purchases thanks to a lower overall price across the border.

While rates are often the first and only item considered when comparing tax codes, the complexity of a state's tax code also plays a vital role in both ensuring residents pay their taxes properly, but also in reducing unnecessary compliance costs that come with more complicated codes. Ohio first implemented its state income tax in 1972 with a total of six tax brackets, each with progressively higher rates as an individual's income increased. Over the years, Ohio has added an additional three brackets, for a total of nine under current law. Ohio's nine brackets put the state behind only California and Missouri, each of which have ten brackets, in tax code

complexity. In comparison, three of Ohio's neighboring states (Indiana, Pennsylvania, and Michigan) have just one flat tax rate regardless of taxable income level.

In addition to these nine brackets, Ohio has over thirty possible credits and deductions taxpayers can utilize, which have helped grow the length of Ohio's personal income tax form from not even a full page when it was implemented in 1972, to six full pages today. Finally, as mentioned above, Ohio is one of a handful of states with local income taxes imposed by over 700 various cities, towns, and villages. Ohio is second only to Pennsylvania in the number of local tax jurisdictions by state. While the personal income tax code obviously affect all Ohio taxpayers, they are also critically important to the thousands of sole proprietorships, LLC's, LLP's, and S-corporations whose taxes are calculated based on the owner's individual return.

Compared to its neighbors, Ohio's individual tax rates and the complexity of its code at best, place the state in the middle of the pack. In order to improve these rankings, Ohio should look to lower rates while simplifying its code to ease tax collection and lower compliance costs. Ohio's nine tax brackets should be compressed, potentially to the point of implementing a flat tax like several of its neighbors. While reducing the number of brackets will likely result in less revenue flowing to the GRF, this can be offset by eliminating unnecessary credits and deductions within the code. This will be a painful process as many of these credits and deductions have garnered wide popularity, but if combined with a broadening of the tax base by reducing the number of brackets, Ohio will create a far simpler tax code that will help Ohio compete with its neighbors.

While the personal side of the tax code rightfully occupies a large portion of the tax reform discussion, there are two other key business tax provisions unique to Ohio that bear mentioning. The first is the Commercial Activity Tax (CAT), which is a tax on "the privilege of doing business in Ohio" per the Ohio Department of Taxation. The CAT was first implemented in 2005 as a way to replace Ohio's personal property and corporate franchise taxes and is simply a gross receipts tax: any individual (which includes all businesses taxed on the owner's individual return) with gross receipts greater than $150,000, or any business with gross receipts greater than $500,000, own $50,000 in property, spend $50,000 on payroll, or are domiciled in Ohio must pay the tax.  Last year, the CAT generated nearly $1.7 million in total revenue.

The CAT has been derided by economists, particularly the Tax Foundation for three main reasons: the tax has a pyramiding effect, it lacks transparency, and it particularly harms low margin businesses. Because the tax is imposed at every level of production, the end result is higher prices for consumers as the CAT tax paid at every point in the production chain is simply rolled into the price of the finished goods consumers purchase. Additionally, a gross receipts tax such as the CAT is particularly tough on so-called "high volume, low margin" businesses. These are companies that are only able to survive because of how many units they sell, not how much they can make per unit. Any tax like the CAT will necessarily tighten these margins, making it harder for Ohio businesses to compete. Finally, the CAT is particularly harmful because of its unique status: only five states nationwide employ gross receipts taxes and realistically only three others (Texas, Nevada, and Washington) have a system that compares to Ohio's CAT.

The key difference however is that none of these states also have a personal income tax. Not only is Ohio the only state amongst its neighbors to impose the CAT and a personal income tax, it is the only state in the country to do so.

The final tax consideration to mention is the severance tax, which is imposed exclusively on the extraction of oil and gas from the ground in Ohio. Under current law, Ohio's severance tax is 10 cents per barrel of oil and 2.5 cents per MCF (thousand cubic feet) of natural gas. In recent years, Governor Kasich has proposed changing the severance tax to a percentage rate that would increase the overall tax paid, however these proposals have been routinely defeated in the state legislature. Thanks to Ohio's oil and gas boom, the severance tax has generated massive revenue for the state in recent years: in 2015 the tax produced $40.1 million in revenue, more than 5 times the amount collected just a decade earlier. The severance tax poses an interesting set of obstacles for lawmakers. On one hand, the added revenue that raises the tax would create is attractive: it can offset tax cuts elsewhere and there is logic behind forcing companies that are extracting natural resources from the state to have to pay a tax to the state to do so. On the other hand however, the oil and gas industry is responsible for tens of thousands of jobs if not more, and as oil and gas prices drop, any increase in taxes will further strain the industry, perhaps to the point where companies choose to relocate out of the state. This is a fine line that Ohio's elected officials must walk, and while it is important to look for sources of revenue that can then in theory offset tax cuts for all Ohioans, doing so to the detriment of one of Ohio's fastest growing industries at such a critical moment could prove disastrous.

Ohio must work to improve its tax code to better compete with its neighboring states. While its personal tax rates are competitive, the number of brackets and the additional imposition of taxes at the local level complicate the code and discourage investment. In addition, the state should consider reforming the CAT and severance taxes to further attract investment in the state. Ultimately these two taxes merely operate as a tax collection shell game: in exchange for cutting rates elsewhere, the state has chosen to implement these taxes to make up the difference. Rather than employ a straightforward tax framework, Ohio's complex tax code threatens to drive business away from Ohio. As the state looks at ways to grow jobs and attract new investment, lawmakers should consider the tax code as one key area in which they can foster a more business friendly environment than their neighbors by creating a more streamlined tax code that encourages investment in the state.