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Wishful Thinking About Tax Burdens in Ohio

by Mark Robyn and Rob Shrum

Richard Levin, Ohio's top revenue official, continues to cheerlead for the state's broken tax system, as covered by the *Urbana Daily Citizen*,[1] the *Lancaster Eagle Gazette*,[2] and the *Akron Beacon Journal*.[3] Levin's pronouncement late last month that Ohio is not a high-tax state would normally be dismissed as an April Fool's Day joke, but he tries to add weight to his claim by citing a report by the Federation of Tax Administrators (FTA).

Levin says the numbers show that Ohio has a middle-of-the-road tax burden, but he is misconstruing Census data and consequently comes to an incorrect conclusion.

Levin's Numbers from the FTA Are Just State Tax Collections Divided by Population, Which Is Not a Burden Measure and Should Not Be Used to Compare States

The Federation of Tax Administrators' (FTA) analysis utilizes state tax collections data and population data from the US Census Bureau, and personal income data from the Bureau of Economic Analysis. Dividing total state tax collections by population and personal income yields the two measures in the FTA's study: taxes per person and taxes as a percent of income. These calculations show that Ohio's state tax collections are 35th highest on a per capita basis, and 33rd highest when measured as a percentage of Ohioans' personal income.

On the surface this type of analysis seems cut and dry, but the numbers are easy to misinterpret. The FTA analysis of Census data used by Levin compares only *state* tax collections and not *state and local* tax collections, resulting in an apples-and-oranges comparison due to states having varying levels of local tax powers. (Ohio has high local tax collections.) Census itself warns that

[1] http://www.urbanacitizen.com/main.asp?SectionID=3&SubSectionID=5&ArticleID=153548
[2] http://www.lancastereaglegazette.com/article/20100401/NEWS01/4010304
[3] http://www.ohio.com/business/89894102.html

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its data does not account for tax incidence and should not be used in this way. Yet the FTA and Levin use it in this improper way anyway.

Cherry-Picking State Tax Collections and Not Including Local Tax Collections Provides an Inaccurate Base of Comparison Against Other States

Data on state-level tax collections is useful for some purposes. We at the Tax Foundation have sometimes included the table in our *Facts & Figures* booklet[4] each year, though we prefer to use *state revenues*, which include non-tax revenues. But it should not be interpreted as the total tax burden faced by Ohioans because it does not take into account local taxation. Local-level taxation makes up nearly 45% of all taxes collected in Ohio, relatively high among the states. Cherry-picking state data, as Levin did, thus results in an inaccurately positive measure for Ohio.

The delegation of powers and responsibility for services between localities and states vary greatly from one state to another. If two states provide the same level of services at the same costs, but one prefers to have most spending and taxing decisions made from the State Capitol while the other prefers localities to provide the services and collect the taxes, Levin's use of FTA data would suggest that the first state has a higher tax burden. In fact, they are equal.

A Complete Measure of Tax Burden Must Go Beyond Tax Collection Data and Look at Economic Incidence

Imagine a piano teacher giving lessons to students from his house. Would anyone say that the piano teacher is paying for the lessons, just because the payments were collected in his house? Richard Levin and the FTA apparently would, since they do not understand the difference between tax *collections* and tax *burdens*. Collections are a measure of the total amount of money brought in within a given geographic area. Burdens are a measure of the taxes owed by people.

To get a true account of the tax burden borne by residents of Ohio, we must go beyond simply dividing tax collections by population. This is because the person who writes the tax payment check is not necessarily the same person who bears the economic burden of the tax. The Census Bureau understands this and includes the following warning in their *State Government Tax Collections in 2009*[5] report, from which the FTA obtained its tax data:

Analysis using total tax or per capita tax as a measure of tax burden on the citizens of a particular state can be misleading and misinterpreted. Different states use different approaches to taxation, and comparing only the total taxes collected by each state is not enough to understand the economic impact of those states' taxes. The U.S. Census Bureau's statistics on state tax revenues reflect the taxes a state collects from activity within the state, not necessarily from the individuals within a state.

For example, the state of Florida's general sales and gross receipts revenue is highly reliant on tourism from out-of-state residents, and therefore using a per capita amount for this sales and gross receipts tax would be misleading to describe the tax burden for the state's citizens. A similar case occurs in Alaska, where severance tax is paid solely by oil and gas companies that operate within the state and not the citizens of the state, thus a per capita figure is not reflecting the true burden upon the citizens. In each of these cases, per capita should be seen not as a

[4] http://www.taxfoundation.org/publications/show/2181.html
[5] http://www.census.gov/govs/statetax/

burden on the citizen but rather a reflection of the portion of tax imposed on behalf of each citizen.

In short, the Census itself recognizes a significant flaw in relying on per capita tax collections to measure tax burdens. Its example of Alaska is instructive: the state has no income or state sales tax and derives most of its revenue from severance taxes on the extraction of oil and gas. While these severance taxes are *collected* in Alaska, they are *borne* mostly by consumers around the country in the form of higher prices. Collections data (and the FTA report) would show Alaska to be a high-tax state; after accounting for tax exporting, Alaskans actually have one of the lowest tax burdens.

The same is true of Florida. When tourists visit Florida they spend money and pay the state's sales tax on those purchases. While the tax is collected in Florida, the burden of the tax is not on Florida residents but tourists from around the country. Heeding the Census Bureau's warning, our *State and Local Tax Burdens* study[6] acknowledges and addresses these concerns of tax exporting.

Ohio's State-Local Tax Burden Per Capita Is 18th Highest Nationally; 7th Highest Nationally as a Percentage of Income

When one includes state and local revenue sources and accounts for tax exporting, as we do in our *State-Local Tax Burdens*[7] report, Ohio's true tax burden per capita in 2008 stands at 18th nationally, with a tax burden per capita of $4,049, 17 places higher than the FTA ranking used by Levin. Ohioans spend 10.4% of their income on state-local taxes, the 7th highest in the United States, higher than the national average of 9.7%, and drastically higher than the FTA's ranking of 33rd. This is very different from the picture painted by those who wish to portray Ohio as a low-tax state.

Not Only Is Ohio's Tax Burden High; Its Taxes Are Also Badly Structured

When evaluating a state's tax climate, one must consider both the overall level of taxation and the structure of a state's tax system. In addition to having an above-average tax burden, Ohio has a badly structured tax system, including a gross receipts tax. Near-unanimous economic evidence warns against gross receipts taxes as warping investment incentives in a way that takes a heavy toll on the state's economy.

It is true that Ohio no longer has a corporate income tax; it has something worse: a gross receipts tax called the Commercial Activities Tax (CAT). These taxes have deceptively low statutory rates, but high effective tax rates. This is because the tax is charged on the full price of the product *every time* it passes between firms in the production chain. For instance, a loaf of bread that passes through its production chain of farmer, miller, and baker would be taxed in full at each level of production. This is in contrast to other taxes, which aim to tax each final retail product once and only once.

Since the price at each step includes the costs incurred during previous phases of production, including taxes, the result is that the gross receipts tax is charged on previous taxes paid, an effect known as tax pyramiding. This leads to very different effective tax rates between similar

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[6] http://www.taxfoundation.org/taxdata/show/335.html
[7] http://www.taxfoundation.org/taxdata/show/335.html

industries and products, distorting company structure and economic decisions. Virtually all economists agree that while gross receipts taxes look attractive because of simple administration and low statutory tax rates, they actually introduce severe economic distortions and damage a state's economy. The existence of Ohio's gross receipts tax is one reason that the state is ranked 47th in our *State Business Tax Climate Index*.

Ohio's nine-bracket personal income tax system is one of the nation's most complex, with a top rate of 5.925% that kicks in at an income level of $200,000. Approximately 180 school districts and 579 cities impose income taxes ranging from 0.50% to 2.75%.

Levin has specifically ridiculed the Tax Foundation for criticizing Ohio's intangibles tax, saying that it has not existed since 1985. We responded to him, pointing out that the tax is still alive and well and that Levin was a named defendant in a case involving the tax before the Ohio Supreme Court in 2008. Levin now says the tax doesn't "meaningfully" exist. Perhaps for him, but not for those who have to pay it and comply with its rules.

Conclusion

State officials in Ohio have steadily engaged in a propaganda effort to claim that the state's tax system is non--distortionary and the burden on its taxpayers is low. But this conclusion is based upon misuse of data provided by organizations like the FTA whose own data sources warn against their flawed methodology.

The reality is that all reliable evidence tells Ohioans that they're more heavily taxed at the state-local level than the residents of most states. In 2008 their state and local tax burden was 18th highest on a per capita basis and 7th as a percentage of income. The state ranks very poorly on our *State Business Tax Climate Index*.[8] Levin and his supporters may want to believe that Ohio is America's best kept secret for low taxes, but it ain't so.

To earn such bragging rights, state officials need to acknowledge the position they are in and work for lower tax burdens and a sounder tax system that does not distort economic decisions.

[8] http://www.taxfoundation.org/taxdata/show/22661.html