CHAPTER 2:

Taxes and Revenue Structure

Every budget has a revenue side and an expenditure side. The economic climate within which Ohio's tax system operates shapes the revenue side of the equation. Several major sources of revenue fuel the state budget, and many others fund the operations of local government. However, two state taxes, the sales and use tax and the individual income tax, are preeminent in terms of their contribution to the General Revenue Fund (GRF), generating five out of every six GRF tax dollars. The commercial activity tax and cigarette and other tobacco taxes also provide significant support to the GRF.[1]

Ohio added both the individual income tax and the corporate franchise tax to the tax code in 1971. Dozens of other law changes were made at this same time in order to keep local schools from closing, to reopen state parks, and to expand other state programs. In 1983, Ohio raised individual income tax rates dramatically and altered numerous other taxes to pay for income support and health care for the poor instead of having to reduce or eliminate other state programs. In 1992, the state increased so-called "sin" taxes on cigarettes and alcoholic beverages and added a new bracket to the personal income tax, along with other tax law changes, again to finance public assistance and health care programs. With the exception of these major decennial tax increases, most of the state's tax policy has been created with an eye toward improving the state's economic development climate. Such was the case with the tax reform package enacted in 2005, which had the added effect of changing the structure of Ohio's business taxes. The intent of these tax law changes was to boost Ohio's economic competitiveness by reducing disincentives for business investment in Ohio. Increasing the state's competitiveness was also cited as a major driver of the large rate reduction in the individual income tax enacted in the 2005 reform package as well as in more recent efforts in this same direction in 2013 and 2015.

Principles of Taxation

Since 1960, more than a dozen major studies of Ohio's state and local revenue structure have been undertaken, including a million-dollar comprehensive study completed in 1995 by the Commission to Study the Ohio Economy and Tax Structure. Until 2005, the studies themselves had never provided the impetus to change the structure. At their best, what the studies did was provide guidance on the best way to raise additional revenues once a separate determination of need was made based on a review of spending.

Those who study tax systems largely agree on the principles of a high-quality revenue system. It contains complementary elements and is reliable, diverse, equitable, understandable, efficient, accountable, and uniform in its administration. It should also promote equalization, minimize interstate competition, and not be used as an instrument of social policy.[2] Table 2-1 briefly describes each of these principles and provides an assessment of how well the State of Ohio measures up to each.[3]

While no state, including Ohio, has a perfect tax system, the state does meet many of the principles that tax experts advocate. However, a number of problem areas remain.

Table 2-1: How Ohio Measures Up

PRINCIPLE	ASSESSMENT FOR OHIO
Complementary: components of state and local tax systems should fit together as a logical whole.	State tax policy does not take into account the relationship between the regressive nature of the municipal income tax on payroll and the state's progressive individual income tax.
Stability, Certainty, and Adequacy: components should produce revenues not overly sensitive to economic change, infrequently altered with sufficient revenues to meet needs.	The sales tax is sensitive to economic conditions, because of its relatively narrow base, and the commercial activity tax is unstable; more than adequate revenues are produced in good economic times but not enough in bad times.
Diversity: by levying a variety of taxes, individual biases tend to be canceled out.	There is a diverse revenue system, but a large number of tax expenditures require higher tax rates.
Equity: the incidence of taxes among income groups should be progressive; families with similar income should be taxed uniformly, while persons with subsistence income are shielded from taxation.	Overall, the system is regressive, with substantial tax burdens placed on low-income households, especially through the application of the sales, property, municipal income, and excise taxes.
Efficient and Simple: tax compliance should be easy.	Industry-specific taxes and a large number of tax expenditures make the business tax structure complex, but individual taxes and their collection are efficient and simple.
Accountability: components of accountability are open to discussion with regard to tax changes, property tax assessments on full value, local government mandate review, and publication of a tax expenditure budget.	There is strict adherence to accountability with mandatory fiscal notes on legislation with local government impacts and biennial tax expenditure reports, but accountability is diminished when complex tax changes are decided in the context of the state budget.
Uniform Administration: administration should be professional and uniform with regular reports showing how the tax system is working.	Except for local property taxation, where recommendations for uniformity have repeatedly been made, state administration is uniform and professional, and reporting suggests few enforcement problems.

PRINCIPLE	ASSESSMENT FOR OHIO
Equalization: state should have programs to assure that poor jurisdictions have sufficient resources to provide an adequate level of services.	Equalization of resources among school districts is a well-recognized problem; many other units of local government operating directly under state mandates have the same disparities in tax-raising capacity as school districts; general revenue-sharing assists counties, municipalities, and some special districts, but this funding has diminished markedly in recent years.4
Competitiveness: tax concessions should only be provided to generate new jobs and investments; there should be a system to regularly evaluate how the total packages of business and personal taxes compare to competitive neighbors.	While economic and workforce development loans, grants, and tax credits are scrutinized by the Attorney General for economic impact and compliance, regular competitiveness comparisons are not made independently by the state.
Social Policy: the use of the revenue system to encourage particular social policy outcomes should be avoided.	To the extent that tax expenditures have been enacted to serve as incentives for particular behavior, they violate this principle.

Ohio's Economic and Tax Climate

Taxes, the major component of the state's revenue structure, are comprised of a tax rate applied to a base. The tax base is the object of the taxation. Thus, the base for the sales tax is retail sales, and the base for the individual income tax is income. Changes in the tax base are dependent on economic and demographic considerations, while the tax rate is more politically sensitive.

Tax Base Factors

Change from Manufacturing to Services. Because of its central location in the nation, its highly developed transportation system, its willing and skilled labor force, its work ethic, and its proximity to markets, Ohio long occupied a position as one of the leading industrial states in the nation. However, major shifts have occurred in Ohio employment over the last half century. Between 1970 and 2010, manufacturing employment decreased from 48 percent of total employment to just 13 percent. Ohio manufacturing employment dropped an astounding 400,000 between 2000 and 2010, from 1,023,444 to 620,308. By 2010, durable manufacturing accounted for less than 10 percent of the gross state product and all manufacturing accounted for only 17 percent.[5] During this same timeframe, service jobs increased from 9.4 percent to 44.5 percent of total employment. However, while the trough in manufacturing hiring has been a major factor in state revenue woes in more than one recession, it was the productivity of the manufacturing sector, and not the service industries, that led Ohio out of the Great Recession. Ohio contributed 5.0 percent of total U.S. manufacturing output in 2015, far above its overall 3.4 percent share of total U.S. gross domestic product.

Average Earnings. The structural change in the economy, shifting from highly paid manufacturing jobs to lower paid jobs in the service industry, impacted both state and local budgets, the tax structures of which were weighted toward taxes based on personal income. Average weekly earnings in the service sector in Ohio are about 60 percent of those in manufacturing. Thus, although Ohio's per capita income increased from $18,669 in 1990 to $43,478 in 2015 in nominal dollars, it ranked only 30th in the nation in per capita income, significantly below the 21st ranking it enjoyed in 1990.[6]

Transfer Payments Compared to Wages. Another important factor contributing to Ohio's economic condition is that wages and salaries make up a declining portion of total personal income in Ohio. Whereas transfer payments, such as income maintenance, retirement, disability, unemployment insurance, veterans' benefits, and medical insurance, were 13.5 percent of Ohio personal income in 1975, they rose to 20.1 percent in 2015. This was significantly higher than the national average of 17.3 percent.[7]

The lower personal income is, the less taxable income there will be. The less disposable income there is, the less that will be spent on retail sales, meaning fewer sales tax receipts. The more personal reliance there is on transfer payments, the less that will be paid in individual income taxes. Since the 1990s, the individual income tax has been a "workhorse" for state revenue systems. It has shown itself to be elastic and has accounted for a much larger percentage of tax revenues in those states that impose it. This has been especially true in Ohio. However, the Great Recession, coupled with the impact of 2005 tax reform and subsequent individual income tax reductions in 2013 and 2015, has altered this dynamic.

Population Growth. Ohio's population stagnation has affected its economic and tax climate, and likely, the converse is also true. While the population grew from 7,947,000 in 1950 to 10,652,000 in 1970, Ohio's growth from that point has been quite limited. In 1985, Ohio dropped from the sixth to the seventh largest state in the nation. According to the 2015 census estimate, Ohio's total population is 11,658,609. Since 2000, Ohio's median age has increased by 3.2 years to 39.4 years, 1.4 years above the nation's median age.[8] Fully, 16 percent of Ohio's population is age 65 or greater. Given the aging of the "Baby Boomers," the expectation is that Ohio's population will continue to grow older over the next decade. It is estimated that the state's population over age 65 will increase to 18.2 percent by 2020 and to 22.8 percent by 2030.[9] The implications of this demographic change are likely to be significant, with state revenues declining and state spending increasing. An aging population spends less on durable goods and more on social services, which are taxed less but cost government more.

Poverty Level. Poverty has remained stubbornly high despite state and federal reform efforts, of which the goal is self-sufficiency for the large number of single-parent, female-headed households. Cleveland and Cincinnati rank first and third in the nation among cities of more than 250,000 in population in their poverty rate among children. Nearly one in every two children in these cities live in poverty.[10] The percentage of Ohioans living at or under the poverty level at any age, 14.6 percent in 2016, was just above the national average. By 2000, the poverty rate in Ohio had declined to 10 percent. However, it increased through the decade, especially during the Great Recession, to 16 percent in 2010. It declined to 14.6 percent by 2016, representing 1,645,000 individuals.[11] Among female householders with related children without a husband, the poverty rate at the height of the Great Recession was a startling 45 percent. A poor, dependent population makes for a low tax base in addition to creating a higher demand for public services.

Table 2-2 lists the federal poverty guidelines for the 48 contiguous states and the District of Columbia for 2018:

Table 2-2: Federal Poverty Guidelines for the 48 Contiguous States and the District of Columbia for 2018

PERSONS IN FAMILY/HOUSEHOLD	POVERTY GUIDELINE
1	$12,140
2	16,460
3	20,780
4	25,100
5	29,420
6	33,740
7	38,060
8	42,380
9+	add $4,320 for each additional person

Source: Federal Register, January 18, 2018.

Tax Rate Factors

Business Climate and Taxes. Ohio policymakers are especially concerned with the state's business climate and the connection that the level of taxation plays in determining it. Several sources rate the state's business taxes annually. Most of these rating organizations, such as the Tax Foundation, include the state's corporate and individual tax structure among their most important criteria. It ranked Ohio's business climate as only 45th among the states in 2017.

Notably, rankings that place less emphasis on state taxation levels do not reach the same conclusion about Ohio. CNBC's 2018 Top States for Business ranked the state 15th among its peers, largely on the basis of its infrastructure capacity and affordable cost of living. However, it ranked Ohio only 37th regarding its legal and regulatory environment. *Site Selection Magazine*, which annually ranks state business climate on the scope of recent corporate project investments as well as the perceived friendliness of state leadership to business, placed Ohio 3rd among all states in 2016.

Matthew Murray of the University of Tennessee dismisses the connection between taxes and economic growth, concluding, "Most studies have found that the general tax and expenditure structure either exerts no impact or a small impact on the location and growth of economic activity."[12] Nonetheless, much of the state's tax policy has been developed with an eye toward the state's economic development and recognition that, rightly or wrongly, rating firms continue to rank a state's tax structure by its business climate. Whenever the issue of raising taxes surfaces, a major concern is what the impact of doing so would be on the state's relative competitiveness.

Voter Reaction. Another political consideration in setting the tax rate is voter reaction. Politicians blame Governor John Gilligan's 1974 re-election loss primarily on his having taken the lead in proposing the state's individual income tax several years earlier. The Democrats' loss of the Ohio Senate in the 1984 election is often tied to their support of Governor Richard Celeste's income tax increase the prior year. The common wisdom in Ohio politics is that supporting a major tax increase is tantamount to political suicide. Voter defeat of the proposed increase in the state sales tax rate in 1997, even though tied to supposedly popular causes of state support for education and property tax relief, reinforced this notion. No major, across the board, individual income tax rate increases have been approved in Ohio since 1983. In 2005, a temporary 1 percent state sales tax increase was made permanent at one-half cent. However, the increase was coupled with a reduction in individual income tax rates that would reach 21 percent by 2011. As a result, there was little, if any, negative voter reaction. A similar result occurred in 2013 when a 10 percent individual income tax cut was paired with a one-quarter cent increase in the sales tax. There have been numerous business and individual income tax rate reductions since 1982, usually approved in the interest of encouraging economic growth. However, lowering tax rates during periods of economic growth can have the unpopular consequence of requiring either larger increases or, more likely, necessitating significant program funding reductions later when the economy slows down.

Sources of Revenue

Ohio's sources of revenue include (1) federal grants and entitlements; (2) other intergovernmental receipts; (3) agency receipts; and (4) state receipts. Most revenue sources are dedicated funds. That is, funds from the revenue source are designated for a particular use. Its origins are with the Ohio Constitution, which specifies that the receipts from highway use taxes and motor vehicle licenses must be used only for highway-related purposes. The state legislature has subsequently applied this same principle to many other taxes. It has dedicated all or a portion of the proceeds of certain taxes to a single purpose. For example, hunting and fishing license collections can only be used for wildlife purposes. The proceeds from court costs and driver's license reinstatement fees are deposited into a Crime Victims Compensation Fund. The legislature has assigned portions of the General Revenue Fund (GRF) as well as some existing taxes to specific uses. For example, a portion of the GRF goes exclusively to public libraries.

The dedication of funds effectively removes these resources from budget balancing. It takes "off the top" a portion of receipts and allocates them without consideration of budgetary need and with minimum budget review. Programs dependent on GRF appropriations must justify their proposed spending, illustrate how well they are meeting their goals, and demonstrate their achievements. Items funded by dedicated revenues are not subject to the same level of public accountability.

Federal Grants and Entitlements

In addition to state-level dedicated revenues, Ohio receives a substantial amount of federal funds, all of which are for specified purposes.

Forward Funding. Congressional budgeting is a three-step process. First, an authorizing standing committee establishes a program and its goals, along with a formula for the distribution of funds. This step is referred to as an "authorization." Usually programs are limited to no more than five years, after which they must be reauthorized. Next, the congressional budget committee establishes maximum spending ceilings for categories of federal funds. Finally, congressional appropriations committees will make annual appropriations to the program on the basis of a fiscal year that begins on October 1 and ends on September 30. As most states operate on a July 1–June 30 basis, including Ohio, some federal programs are "forward funded." That is, funds appropriated on October 1 are not available until the following July 1. With forward funding, states receive information on the level of funding before the fiscal year starts.

While this describes how the federal budget process is supposed to work, in reality, the process is fundamentally broken. Rather, the federal government has been forced to operate virtually every year through a series of continuing resolutions. Congress has not finalized its appropriations process for all governmental agencies prior to the start of the federal fiscal year since 1994.

Types of Federal Funding. Federal funds appropriated to the states are either in the form of grants, which usually specify a maximum percentage or fixed amount that can be expended on administering the grant, or in the form of entitlements. In Ohio, federal funds account for nearly one third of the money the state spends each year. The state legislature appropriates federal moneys, except for in certain circumstances under which the Controlling Board can authorize spending unappropriated federal funds, as described in Chapter 7. Chapter 3 describes how the state accounts for and appropriates federal funds.

Grants. There are four different kinds of federal grants. The first are those appropriated for a specific project. This is now less common with diminished earmarking by members of Congress. The second type, categorical grants, are authorized for a specific purpose and usually require appropriations of state and/or local matching moneys in order to be received. A third type, block grants, are increasingly common as the federal government continues a process called "devolution," whereby more authority over the use of federal funds is delegated or devolved to states. Like categorical grants, the total amount of funds available from a block grant is capped. Fourth, and finally, the federal government makes entitlement grants, which are treated differently from other grant types.

Block grants and categorical grants are quite similar. The main distinguishing characteristic is that block grants give the recipient more freedom from complex accounting and reporting requirements. Block grants have historically arisen when the federal government consolidates a number of categorical grants into a larger block with considerably fewer restrictions than the individual categorical grants. However, in 1996, Congress created the Temporary Assistance to Needy Families Block Grant (TANF), substituting a capped appropriation for the previously open-ended entitlement program Aid to Families with Dependent Children.

Entitlements. The level of federal funding available from an entitlement grant depends on the number of clients who meet program eligibility requirements as defined by the states within federal guidelines. Matching rates are established by a federal formula. Thus, participation in a federal entitlement program commits a state to its own open-ended appropriation for the matching moneys. The only way a state can reduce its spending commitment in an entitlement program is to tighten its program eligibility requirements within federal limits. Over the years, the federal government has eliminated many entitlement programs. The largest remaining federally funded program that requires substantial state participation is Medicaid, which provides health care services for persons meeting prescribed eligibility requirements. However, Congressional efforts to "repeal and replace" the Affordable Care Act have targeted even this program as a candidate for block grant status in order to control and reduce expenditures.

Other Intergovernmental Receipts

In addition to federal grants and entitlements, Ohio receives money from local units of government through matching moneys required for various state grants. However, these are not counted as revenues; instead they are deducted from the grants the local government receives from the state.

Agency Receipts

State agencies often retain revenues for their own program use. Agency receipts come from a variety of sources, including fees for mailing and distributing documents or charges for publications, and various fees and fines. They also include intradepartmental charges, where one state agency charges another for the use of its services. For example, a variety of centralized services, such as personnel administration and purchasing services provided by the Ohio Department of Administrative Services, are paid for by a percentage charge levied on the salaries and wages of all other state agencies. The amount cannot exceed the cost of the activity, as the state cannot make a profit on these activities.

It is difficult to distinguish agency receipts from other non-tax revenues such as licenses, permits, and fees generated by agencies that are deposited into the General Revenue Fund (GRF). Only by examining the legislation authorizing the levying of the receipt or, in some cases, an authorization by the Controlling Board, can a determination be made about whether a given license, fee, or other non-tax receipt is an agency receipt or a non-tax state revenue. For example, third-party payments made by insurance companies to support patients in regional psychiatric hospitals of the Ohio Department of Mental Health and Addiction Services and developmental centers of the Ohio Department of Developmental Disabilities used to be deposited into the state's GRF. However, a 1997 law change allowed the affected departments to retain the funds. The existence of agency receipts complicates the budgeting process.

State Receipts

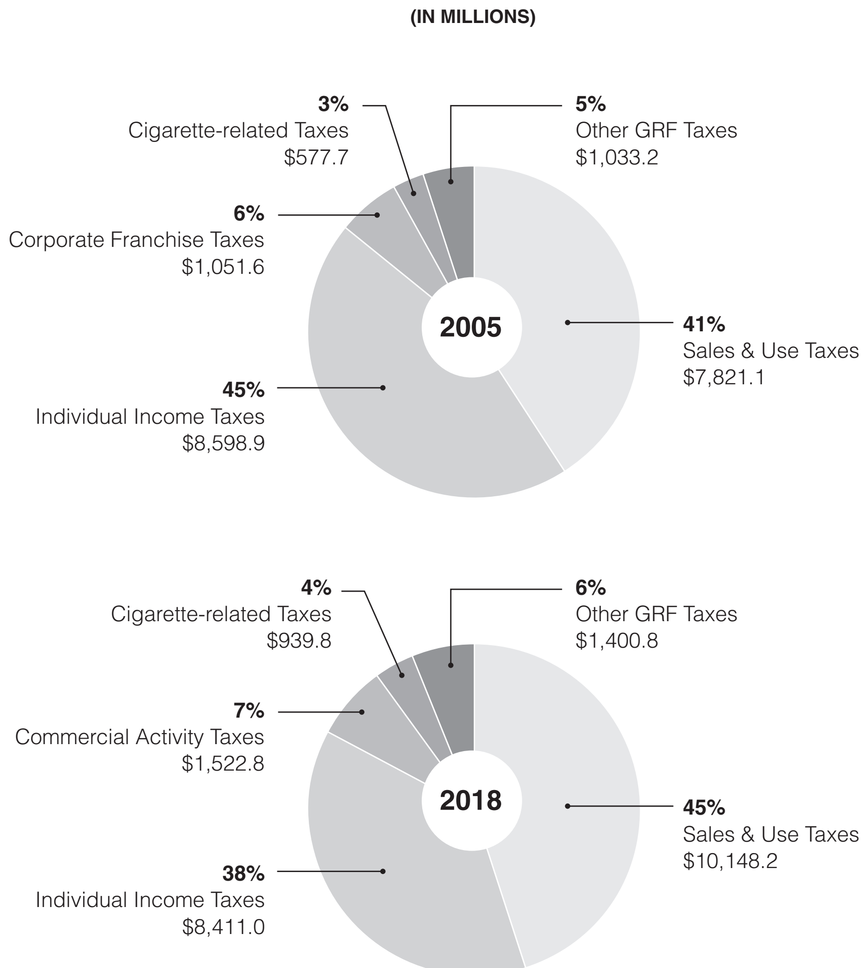
State receipts can be categorized as those derived from taxes on businesses and individuals, license fees, and non-tax revenues, including the State Lottery. The state also authorizes the imposition of taxes by local units of government. The local government tax structure is important insofar as the state's ability to raise revenues from its own taxes is influenced by the level of taxation in local jurisdictions.

State Taxes

Sales and Use Taxes. The state general sales tax rate was established in 1934 with a rate of 3 percent. The use tax was added one year later. The current state sales and use tax rate is 5.75 percent. The rate was temporarily set at 6 percent for FY 2004 and FY 2005, and then "permanently" set at 5.5 percent by the budget bill for the FY 2006–2007 biennium. It was increased in the budget bill for the FY 2014–2015 biennium to 5.75 percent to help offset revenue lost from a reduction in individual income tax rates that was contained in the same legislation. The increased sales tax rate instituted in 2005, coupled with the several phased individual income tax rate cuts passed since that time, substantially narrowed the gap in revenue produced by these two vital sources. With the additional sales tax rate increase in 2013, it returned to its former position as the largest generator of General Revenue Fund (GRF) resources for the first time in 30 years, displacing the individual income tax, which had held this distinction during the interim.

Figure 2-1 depicts the changing relative shares of the sales and use tax, the individual income tax, and other major GRF taxes from FY 2005 to FY 2018. The increased importance of the sales and use tax over the period and the concomitant decrease of the individual income tax can be readily observed.

Figure 2-1: GRF Tax Revenues – FY 2005 and FY 2018



Source: Ohio Legislative Service Commission.

Beginning in 1983, the sales tax base was broadened to include more services. The list of transactions and services covered under the sales and use tax has grown steadily over time. In addition to applying the tax to the sale or rental of tangible personal property at retail, the sales and use tax is levied on hotel lodging; repair of tangible personal property; installation of tangible personal property; washing, cleaning, or painting a motor vehicle; laundry and dry cleaning services; automatic data processing, computer services, and electronic information services used in business; telecommunication services; landscaping and lawn care services; private investigation and security services; building maintenance and janitorial services; employment services and employment placement services; exterminating services; physical fitness facility services; recreation and sports club services; mobile telecommunication services; satellite broadcasting services; personal care services; transportation of persons by motor vehicle or aircraft within the state; motor vehicle towing services; snow removal services; electronic publishing services; warranty, maintenance, or service contracts; transactions by which tangible personal property is stored; and when a specified digital product is provided for permanent or less than permanent use. Nevertheless, many services remain exempt from the sales and use tax.

Broadening the base does not make the sales tax immune to the effects of the economy. Enforcement is difficult, and many services with potential growth are not yet included. The advent of Internet sales has had a dampening impact on sales tax receipts regardless of the economic conditions. Enforcement has been especially problematic when collecting use taxes, which taxpayers most commonly owe when buying from an Internet retailer. However, a 2018 U.S. Supreme Court decision ruling that states can require online retailers to collect sales tax could do much to alleviate this problem. In anticipation of a favorable court ruling, language was included in the FY 2018–2019 budget stating that an online seller has a substantial nexus in Ohio if it has more than $500,000 in sales in the state and meets other criteria. However, guidelines at the federal level are needed to ensure consistency among the states and to minimize confusion in implementation of the court decision.

The sales tax is traditionally analyzed in two distinct components, auto sales and non-auto sales, based on how differentially they behave during variable economic conditions. While the economy impacts both auto sales and non-auto sales in a positive and negative sense, sales tax collections from the purchase or lease of an automobile are particularly sensitive to economic realities. Individuals often live where they work, and shop where they live and work; consequently, difficult economic times result in fewer purchases, especially of discretionary items. Large purchases — and few are larger for a family than the purchase or lease of an automobile — are often deferred during difficult economic times. Smaller purchases, however, more often include those day-to-day necessities that must be acquired regardless of personal circumstances. While this is true for the purchase of other durable goods as well, such as appliances, tax collections from non-auto sales only decrease during steep economic declines, such as during the Great Recession, and even then, fall less precipitously than auto sales. During periods of economic recovery, we see a mirror image with sales tax revenue derived from the sale or lease of automobiles increasing more steeply than other items subjected to the sales tax, although growth is universal. However, since non-auto sales account for seven of every eight sales tax dollars, the overall trend for the tax has been as a steady and reliable provider of state revenue, at least when compared to other sources.

Tax Expenditures. State law provides that all retail sales of tangible personal property are taxed unless there is a specific exemption provided in law. The numerous exemptions, deductions, and credits that pervade the state tax code are commonly known as tax expenditures. State law requires the Ohio Department of Taxation to prepare a comprehensive inventory of tax expenditures from identified General Revenue Fund taxes, and these are assembled each biennium as a second major document comprising the Executive Budget Request in addition to the "Blue Book."[13] Tax expenditures result in a state tax revenue loss and reduce the funds available to pay for government programs. Thus, their effect is the same as direct government expenditures. However, tax expenditures do not appear in appropriations bills and are not analyzed and reviewed during the budget process. Similar information will need to be provided on the FY 2020–2021 budget regarding the foregone revenue resulting from "business incentive" tax credits.

According to the Ohio Department of Taxation, there are currently 56 exemptions in the sales and use tax alone. The tax consulting firm, Levin & Driscoll (now Howard Fleeter & Associates), classified these exemptions as follows:

- Exemptions whose intent is to prevent "pyramiding" of the sales tax. These are exemptions based on the way in which the property is being used; the item itself is not exempt, but rather, how it is used creates the exemption. An example is property used in agriculture and mining.
- Exemptions that are intended to make the tax more equitable or to favor certain entities or types of economic activity. These exemptions deal with the nature of the consumer, or in some cases, the seller. An example would be the exemption of newspapers from payment of the sales tax.
- Most services are exempt not because of a specific exemption granted in law but because, unlike personal property where everything is taxable unless exempt, only certain specific services such as automobile washing are subject to the tax. All others, including those with the most potential for growth, are exempt.

Sales tax expenditures resulted in a loss of about $6.2 billion in revenue for FY 2019, according to the Department of Taxation. If all of these expenditures were repealed, the General Assembly could have reduced the sales tax rate from the current 5.75 percent state rate by nearly half to just slightly more than 3 percent without a loss in revenues. This fact illustrates that the base upon which a tax is levied is as important as the rate in determining what the yield from the tax will be.

In total, there are 129 tax expenditures in the Ohio tax code, resulting in a loss of about $9.4 billion in FY 2019. In addition to the sales and use tax, the other notable state tax with a significant number of tax expenditures is the individual income tax. It has 37 credits, deductions, and exemptions, resulting in a revenue loss of approximately $2.4 billion in FY 2019.

H.B. 9 of the 131st General Assembly, effective March 2017, created a Tax Expenditure Review Committee to ensure a regular review of each tax expenditure. The seven-person committee consists of three members of each house and the Tax Commissioner or designee. The committee is tasked with providing a report on its work by July 1st of each even-numbered year. The committee held its initial meetings during the spring of 2018.

Individual Income Taxes. Although a 1912 constitutional amendment authorized its imposition, Ohio's individual income tax was not enacted until 1971. It is applied only on federal adjusted gross income as reported on the federal income tax return. Various adjustments are made before applying a set of graduated tax rates with seven rate classes. Certain adjustments are added and subtracted from federal adjusted gross income and then personal exemptions are subtracted. Tax liability is determined by applying the appropriate rate to the result. There is an income tax liability even if the resulting income tax is as low as one dollar.

Progressivity and Indexation. Graduating the individual income tax makes it a progressive tax; the higher the income, the greater the rate of taxation levied on it. Indexation insures the continuation of the original progressivity. Indexing means that the rate would be designed so that as inflation increases, wage protection is provided to the individual to prevent a person from moving into a higher tax bracket with a higher tax liability unless income rises faster than inflation.

The effect of inflation is that it places a relatively higher burden on low- and moderate-income taxpayers, the elderly, and those with large families because of the relative tax value of personal exemptions and deductions that remain flat in spite of increases in income. To help overcome that effect, beginning in 2000, Ohio adopted an indexing system for the standard personal exemption, which was $1,050 for each dependent in tax year 1999, rising to $1,800 by 2017. In 2014, the exemption amount for low- and middle-income individuals was increased to $1,950 for persons with incomes between $40,000 and $80,000 and to $2,200 for persons reporting income less than $40,000. By 2017, the exemptions for taxpayers in these categories had risen to $2,050 and $2,300, respectively. In 2010, tax brackets were adjusted for inflation for the first time. The top tax bracket has increased from $200,000 to $213,350 since this time.

Individual Income Tax Credits and Exemptions. Over the years, adjustments have been made to the individual income tax for a variety of purposes. These exclusions include income tax exemptions, which are deductions against an individual's adjusted gross income, and income tax credits, which are deductions from the individual's tax liability.

The largest exclusion is the personal exemption deduction. Other major exemptions include the deduction of all Social Security, Railroad Retirement, and other qualified retirement benefits as well as disability income and health insurance premiums paid in excess of the federal amount allowed as an adjustment to income. Income tax credits include a $20 credit for each personal exemption claimed; a $50 credit for senior citizens with reported income of less than $100,000; a child and dependent care credit; a joint filer credit; and a resident credit for income taxed by another state. There are also credits for displaced worker training, retirement income, adoption expenses, and pass-through entities. Beginning in 2005, a low-income taxpayer credit for taxpayers with $10,000 or less of taxable income reduced their tax liability to zero. This credit was eliminated in the FY 2018–2019 budget, as it was unnecessary because of the elimination of the lowest tax brackets. In 2013, a nonrefundable earned income credit was enacted to benefit other low-income individuals.

In 1996, the legislature established the Income Tax Reduction Fund, which uses a budget surplus to provide for a temporary income reduction. The reduction is applicable for only one year at a time, after which the rates return to their permanent statutory levels. The amount of the budgetary surplus minus any moneys the legislature has set aside for reserves or special appropriations is used to determine the amount of the rate reduction. At the end of FY 1996, the surplus permitted a 6.61 percent reduction in rates; in 1997, it was 3.99 percent; in 1998, it was 9.34 percent. Rate reductions continued through 2000, but none were made for subsequent tax years.

Rate Reductions Since 2005. A series of rate reductions were to be phased in over five years to result in a total rate reduction of 21 percent beginning with the 2005 tax year. In addition, an income tax on trusts that was enacted on a temporary basis in 2002 was made permanent in 2005 as part of the tax reform. The final year of the five-year tax cut was subsequently postponed by recommendation of Governor Ted Strickland to balance the FY 2010–2011 biennial budget, but it was subsequently restored just prior to the governor leaving office in January 2011. The FY 2014–2015 budget included a three-year additional 10 percent rate reduction that was later accelerated to full implementation in just two years. The FY 2016–2017 budget included yet one more rate reduction of 6.3 percent, a level sufficient to bring the top rate below five percent. Effective with tax year 2016, rate classes ranged from 0.495 percent to 4.997 percent. The top rate, which in 2017 applied to those with incomes of $213,350 or more, had been 7.185 percent before the series of rate reductions commenced in 2005. This represents a reduction of more than 30 percent. At this same time, a separate tax base was created for business income with a 3 percent flat rate for income over $250,000. Business income below this level was fully deductible.

Governor Kasich proposed an additional reduction in the FY 2018–2019 budget that would have reduced the top rate to 4.33 percent and collapsed the brackets from the current nine to only five. The proposal was largely rejected since it was to be paid for through a 0.5 cent sales tax increase as well as an expansion of the sales tax base. However, the number of tax brackets was reduced to seven through the elimination of the lowest two brackets. Taxpayers with incomes of $10,500 or less will owe no tax.

Pass-Through Entity and Trust Withholding Taxes. Beginning in 1998, the state began to collect taxes on moneys earned by partnerships, also known as S Corporations, which previously escaped the payment of individual or corporate income taxes on revenues they earn doing business in Ohio. The tax levied was a 5 percent withholding tax on the income of qualifying investors and 8.5 percent on investors who are not individuals. Revenue collected from this source is treated as individual income tax revenue. Beginning in FY 2005, the entity tax was phased out for certain investors consistent with the phase-out of the corporate franchise tax.

Commercial Activity Taxes. The phase-in of a new commercial activity tax (CAT) began in 2005 as a companion to the phase-out of the corporate franchise tax and the tangible property tax. Unlike the corporate franchise tax, it applies to any legal person or entity unless specifically exempted. Those excluded are public utilities, with the exception of local and long-distance telephone companies, financial institutions, insurance companies, and nonprofit institutions, all but the last of which are subject to separate taxes applying to them. Motor vehicle fuel receipts were excluded from the CAT in 2013 as a result of an Ohio Supreme Court ruling. This led to the enactment of a separate petroleum activity tax. A number of other types of finance-related businesses are exempted.

Local and long- distance telephone companies are now taxed as general businesses under the CAT rather than as utilities. Also, job creation and retention tax credits and qualified research expenses credits, available for the former corporate franchise tax and the individual income tax, are also available to CAT taxpayers.

Businesses pay the tax based on their gross receipts with those with less than $150,000 exempted from payment. Those with gross receipts between $150,000 and $1 million pay a flat $150. The annual minimum tax for those with gross receipts between $1 million and $2 million is $800; for those with gross receipts between $2 million and $4 million, it is $2,100; and for those with gross receipts in excess of $4 million, it is $2,600. Businesses whose receipts exceed $1 million pay the annual minimum tax plus the CAT at a rate of 0.26 percent for receipts in excess of $1 million. The tax specifically applies to both in-state and out-of-state businesses with taxable Ohio receipts. The tax was phased in, with taxpayers paying 23 percent of their CAT liability in FY 2006, 40 percent in FY 2007, 60 percent in FY 2008, 80 percent in FY 2009, and 100 percent in FY 2010 and thereafter. The definition of gross tax receipts includes a number of exemptions and exclusions. Since it is based on gross receipts, the CAT does not differentiate between profitable and unprofitable businesses, a frequent criticism of the tangible property tax, which was being phased out at this time.

Receipts from the CAT are earmarked for the General Revenue Fund (GRF) and also for reimbursing school districts and other local governments for the reductions and phase-out of local taxes on most tangible personal property, which was another component of the tax reform package enacted by the General Assembly in 2005. Between FY 2007 and FY 2011, none of the receipts were deposited into the GRF. All of the revenue went to school districts and other local governments. However, the FY 2012–2013 budget required 25 percent of CAT revenues to be deposited in the GRF in FY 2012 and 50 percent in FY 2013. The FY 2016–2017 budget subsequently increased the GRF share to 75 percent, as the phase-out of tangible personal property reimbursements continued. It was further increased to 85 percent in the FY 2018–2019 budget. The CAT stands only behind the sales tax and the individual income tax as a contributor to GRF income.

Petroleum Activity Taxes. When motor vehicle fuel receipts were excluded from the commercial activity tax (CAT) in a 2013 Ohio Supreme Court case, the General Assembly enacted a separate petroleum activity tax (PAT) on the sale or exchange of motor vehicle fuel with revenues dedicated to highway purposes. A year later, the basis for the tax was changed from actual gross receipts to calculated gross receipts: the taxable gallons sold within the state multiplied by a statewide wholesale price per gallon. The PAT is levied at a rate of 0.65 percent, 2.5 times the CAT rate. Revenue from this source is credited to the General Revenue Fund.

Cigarette and Other Tobacco Taxes. The current excise tax is levied at $1.60 per pack of 20 cigarettes. The rate was increased by 35 cents per pack in the FY 2016–2017 budget. Governor John Kasich proposed an additional increase in the FY 2018–2019 budget, but the recommendation was rejected. Other tobacco products are taxed at 17 percent of their wholesale price, except for “premium cigars,” which carry a maximum tax of 50 cents per cigar, and “little cigars,” which are taxed at 37 percent. “Premium cigars” are defined as a roll of tobacco with a binder and wrapper of leaf tobacco with no tip or mouthpiece and a weight of at least six pounds per 1,000 rolls. “Little cigars” include any rolled, filtered tobacco product other than cigarettes. Governor Kasich proposed taxing e-cigarettes in both the FY 2016–2017 and FY 2018–2019 budgets, but the efforts were unsuccessful on both occasions. Nevertheless, cigarette and other tobacco taxes remain the fourth largest contributor to the General Revenue Fund.

Proof of payment by cigarette wholesalers is shown by stamps or meter impressions attached to each pack of cigarettes. There is a discount of 1.8 percent of the face value of the tax stamps or meter impressions as compensation for affixing the stamps on the cigarette pack and a 2.5 percent discount for other tobacco product dealers.

Cuyahoga County levies two separate cigarette taxes. However, the legislature has since prohibited the local levy of cigarette taxes by other jurisdictions.

Public Utilities Excise Taxes. Public utilities, except for electric and telephone companies, are exempt from payment of business taxes in Ohio, which partially explains the narrowness of Ohio’s commercial activity tax base. Instead, public utilities, including natural gas, heating, telegraph, water transportation, and water works companies, pay a flat percentage excise tax of 4.75 percent, and pipelines are charged 6.75 percent, based on gross receipts earned in Ohio. Approximately 95 percent of revenue from Public Utilities Excise Taxes comes from natural gas companies. Since 2008, all revenue has been transferred to the General Revenue Fund.

Kilowatt-Hour Taxes. In 2001, the kilowatt-hour tax was created to replace the public utility excise tax on electric companies and the tax losses from a reduction in the electric utility personal property tax assessment rates. Payment of the tax by electric distribution companies is determined by the number of kilowatt hours distributed to end users in Ohio. Revenue from this source is credited to the General Revenue Fund.

Natural Gas Distribution Taxes. In 2001, the legislature reduced the assessment rate for natural gas distribution companies' personal property from 88 percent to 25 percent. This revenue had gone to school districts and other local governments. In order to compensate for the revenue loss, a natural gas consumption tax was imposed based upon the amount of natural gas distributed through a meter to an end user in Ohio. Rates are based on the volume of gas used (Mcf or 1,000 cubic feet). Effective with the FY 2012–2013 budget, revenues from this tax source have been credited to the General Revenue Fund.

Financial Institutions Taxes. The Financial Institutions Tax is imposed on financial institutions conducting business in the state or otherwise having nexus in the state. The tax has a three-tiered rate structure: eight mills on the first $200 million of total Ohio equity capital, four mills on each such dollar greater than $200 million and less than $1.3 billion, and 2.5 mills on each dollar greater than $1.3 billion. Rates can be adjusted annually when either exceeding or falling below the targeted tax amount. Revenue from this source is credited to the General Revenue Fund.

Insurance Premium Taxes. Special taxes based on the amount of premiums sold are applied to both domestic and foreign insurance companies doing business in Ohio. Until a major restructuring of the tax, which was fully phased in by tax year 2003, different tax rates were applied to companies organized under Ohio law and those organized under the laws of other states. Since 2003, the base for both kinds of companies has been identical. Revenue from this tax, which is separately administered by the Ohio Department of Insurance rather than the Ohio Department of Taxation, is credited to the General Revenue Fund.

Alcohol Beverages and Liquor Gallonage Taxes. Different excise tax rates are applied to beer and malt beverages, wine, cider, mixed alcoholic beverages, and spirituous liquor. Alcohol beverage taxes are administered by the Ohio Department of Taxation. Liquor gallonage taxes are derived through sales by the nonprofit entity JobsOhio Beverage System. Tax rates on each alcoholic beverage vary by type and alcohol content. In addition to these taxes, various kinds of permit fees are levied for the sale, distribution, and manufacture of alcoholic beverages. All alcohol beverage taxes and fees are credited to the General Revenue Fund, except a portion of the gallonage tax on wine, sparkling wine, and vermouth, which is deposited in the Ohio Grape Industries Fund. The state permits a 3 percent advance payment credit or discount on the tax to recognize the administrative costs paid by the wholesaler applying state tax stamps to the beverages.

Until 2008, counties were authorized to levy taxes on all alcoholic beverages for the purpose of operating or servicing the debt of a sports facility operated by the county or a development corporation. Only Cuyahoga County opted to levy such taxes. The General Assembly has prohibited the levying of any additional local alcohol taxes.

Severance Taxes. An excise tax based on weight or volume of a natural resource removed is levied on businesses that remove those substances from the soil or water of the state. The taxes are applied to coal, salt, limestone or dolomite, sand and gravel, oil, natural gas, clay, sandstone and shale, and conglomerate, gypsum, and quartzite, with varying rates applied to each. Severance tax revenue is dedicated to a variety of natural resource purposes.

Ohio's severance taxes are insufficient for the state to take advantage of the recent boom in hydraulic fracturing, or "fracking," for natural gas shale deposits. Governor John Kasich initially proposed increasing the severance tax for the purpose of providing a reduction in the individual income tax rate in his 2012 Mid-Biennium Review, but the legislature rejected the recommendation. He has made numerous similar proposals since this time, all of which have met similar fates.

Motor Vehicle Fuel and Motor Fuel Use Taxes. Economists call taxes on motor vehicle fuels "benefit base" excise taxes because when consumers pay them it helps to approximate the cost of the use of a governmental service. When a consumer drives more, gas consumption will increase, and more taxes will be paid. Ohio's fuel tax consists of five separate levies totaling 28 cents per gallon, each of which is distributed differently.

Although the Ohio Constitution restricts the use of the fuel tax to highway-related purposes, the state uses the revenues for a variety of purposes. After setting aside specific amounts for highway bond retirement, 0.875 percent is transferred to the Waterways Safety Fund, 0.125 percent to the Wildlife Boater Angler Fund, and an amount equal to one cent of the fuel tax is provided for the Local Transportation Improvement Program. Each month, $100,000 is transferred to the Grade Crossing Fund and 0.275 percent is allocated to the Motor Fuel Tax Administrative Fund. The remainder is distributed with approximately 70.2 percent retained by the state, 12.7 percent to municipalities, 11.1 percent to counties, and 6 percent to townships. A portion of the tax on motor fuel sold by the Ohio Turnpike Commission's gas stations is returned to the Commission for turnpike projects.

There is also a motor fuel use tax imposed on operators of motor vehicles with three or more axles and weighing more than 26,000 pounds. The motor vehicle fuel-use tax is also 28 cents per gallon.

None of these tax sources has changed since 2005. Federal fuel taxes have not changed since 1993. Given that consumption has been stable in recent years, revenues available for road projects have stagnated.

Replacement Tire Fee. A $1 per tire fee is assessed to defray the cost of regulating tire scrap facilities and for the efforts to limit the accumulation of scrap tires. Two percent of revenues are used to administer the program with the remainder divided evenly between the Scrap Tire Management Fund and the Soil and Water Conservation District Assistance Fund.

Horse Racing Wager Taxes. In addition to paying permit fees, groups conducting horse races must pay a tax on the amount wagered on horse races. The tax is called the pari-mutuel wagering tax, and the rate charged varies from 1 to 4 percent based on the amount wagered daily. A special tax of 3.5 percent applies to results other than for win, place, or show, known as "exotic" daily wagering. There is an additional pari-mutuel wagering tax levied on the total wagering per meet. It is assessed at 0.10 percent for wagering totaling less than $5 million and at 0.15 percent for wagering over $5 million.

Since 2014, seven horse racetracks have operated Video Lottery Terminals (VLTs) programs, commonly known as "racinos." In FY 2016, these "racinos" generated revenue of $868.9 million, 66.5 percent of which is distributed to racetrack owners, including a small amount for addressing problem gambling. The balance was distributed to the Ohio Lottery Commission for the benefit of primary and secondary education.

Wireless 9-1-1 Fee. Since 2014, wireless telephone subscribers with a billing address in Ohio have been assessed a monthly charge of 25 cents to support local wireless 9-1-1 services. Purchasers of prepaid wireless calling devices are charged a 9-1-1 fee of 0.005 percent of sale price. Wireless 9-1-1 fees provide state funding for local wireless 9-1-1 services. Three percent of the fees may be retained by the state for program administrative expenses.

License Fees

This source of state revenue includes license and fee receipts from businesses, occupations, and motor vehicles. It also includes insurance agent fees, factory building fees, motor carrier fees, and fees from occupations and businesses not elsewhere classified, such as the managed care franchise fee enacted in the FY 2018–2019 budget to replace the Medicaid managed care sales tax.

Non-Tax Revenues

The state collects non-tax revenues from refunds and recoveries, fines and forfeitures, sales of goods and services, and receipts from local government. Earnings on investments made by the Treasurer of State provide a large source of state income, with proceeds being credited to the fund of origin except as otherwise provided in law. Non-tax revenues to the General Revenue Fund (GRF) also include reimbursements from other funds for services rendered by state agencies that receive GRF appropriations. Lottery profits are also transferred to the GRF to partially support primary and secondary education.

State Lottery. The state lottery was established to generate revenue for programs benefiting primary and secondary education. A variety of online and instant ticket games are operated with traditional sales totaling $3.06 billion in FY 2016, of which profits totaling $784.1 million were transferred to the Ohio Department of Education. The balance was expended for Lottery operations, awards to players as prizes, and payments to agents as bonuses and commissions. Lottery sales grew spectacularly during the 1980s, rising from $36.7 million in 1980 to $2.3 billion in FY 1996. Then, they dropped to $1.9 billion in FY 2001 before rising to more than $3 billion in FY 2016.

VLT sales at “racinos” distributed an additional $291 million in revenue to the Ohio Lottery Commission in FY 2016. The vast majority of these funds, $282 million, was transferred to the Ohio Department of Education; the balance was for administrative expenses of the commission. In total, $1,066.1 billion was transferred for primary and secondary education purposes in FY 2016.

Local Government Receipts

In addition to shared state revenues and federal receipts, the major sources of revenue for local governments are real and personal property taxes, municipal income taxes, and county sales taxes. In 2012, local governments in Ohio collected $21.8 billion in local taxes, with property taxes accounting for $14.0 billion of the total. Municipal income taxes generated $4.6 billion; and sales and gross receipts taxes provided $2.2 billion. Several smaller tax sources accounted for the balance.[14] Regardless of the revenue source, it is important to note that local governments include not only counties, municipalities, and townships but also school districts and a myriad of other local taxing districts. Only four states have more local governmental units than Ohio. The state’s 3,842 local governmental units includes 841 special district governments in addition to its 88 counties, 937 municipalities, 1,308 townships, and 668 public school systems. In 2012, Ohio had 43.7 local governments per county compared to the national average of 28.7.[15]

In considering tax policy changes, particularly with respect to the sales and use and individual income taxes, the state legislature is always concerned with the total state and local tax burden that will result for each taxpayer. The Federation of Tax Administrators, a Washington-based research group representing tax administrators, ranked Ohio's state and local tax burden near the national average in 2014. It placed Ohio 26th in state and local tax burden when measured on a per capita basis and 24th when viewed as a percentage of personal income. If only state tax burden is examined, however, Ohio's ranking is much lower. In 2014, the state ranked 36th in per capita tax burden and 34th when measured as a percentage of personal income. Using a different methodology, the Tax Foundation, a conservative-leaning Washington, D.C,. nonprofit organization specializing in tax policy, arrived at similar results. It determined that Ohio's state and local tax burden was 25th among the states in 2014 in terms of per capita taxation, while ranking 34th in 2015 when only state tax burden was considered.[16] Thus, it can be concluded that although Ohio has an average tax burden overall, its state-only tax burden is comparatively low while its local tax burden is significantly greater. These rankings mask vast differences in the level of local taxation imposed by Ohio governments.

State tax burden is not only lower in Ohio than for its national counterparts, it has been declining over the last decade. Total General Revenue Fund (GRF) tax revenue as a percentage of Ohio gross domestic product declined nearly 15 percent from a high of 4.1 percent in 2005 to just 3.5 percent in 2015.

Moreover, Ohio is unique among the states in that since 1935 it has shared its revenue sources with local taxing districts and also allows them to levy the same kinds of taxes for their own uses. However, funding distributions to local taxing districts have recently been greatly restricted when compared to historic funding support. Prior to the FY 2012–2013 budget, the Local Government Fund (LGF) received 3.68 percent of GRF distributions. In FY 2012, the LGF was reduced to 75 percent of FY 2011 distributions. In FY 2013, the LGF received just 50 percent of GRF distributions. By FY 2014, the distribution had been reduced to a fixed 1.66 percent of the GRF. The FY 2018–2019 budget redirected an additional $17.65 million annually in LGF funds that had been earmarked for municipalities to the Targeting Addiction Assistance Fund to help address the opioid epidemic confronting the state and its communities. LGF funding in total was reduced by 82 percent from FY 2011 to FY 2018. In addition to these reductions, local governments no longer receive funding from the former dealers in intangibles and estate taxes, which have been repealed. Some reductions occurred to the Public Library Fund as well at this time. This fund, which was created in 1985, currently receives 1.68 percent of GRF resources.

Real Property Taxes. The real property tax applies to the taxable value of land and buildings. It is Ohio's oldest tax, having been levied since 1825.[17] The rate at which real property is assessed is 35 percent of its market value. The Ohio Constitution requires that all real property must be taxed by uniform rule according to value, with some exceptions.[18] Since 1974, the market value of commercial agricultural property has been assessed on the basis of its current use instead of its "highest and best" potential use as is the case with other real property. Elected county auditors administer the property tax law and must physically reappraise all parcels every six years to determine the new market value. Every three years, the appraisal is updated without the use of a physical inspection.

Property rates vary with the taxing jurisdiction, with taxes limited by state law to 1 percent of taxable value, or 35 percent of true value, unless otherwise approved by the electorate. The Ohio Constitution, however, permits property to be levied at up to 1 percent of full value without a vote. Property taxes are expressed in mills with 10 mills equaling one cent.

Real Property Tax Credits. There are three major credits or direct reductions of the real property tax rather than reductions of value: the 10 and 2.5 percentage rollbacks, the homestead exemption for senior and disabled homeowners, and the tax reduction factor.

In the case of the 10 percent property tax rollback, which reduces each taxpayer's bill by that percentage and an extra 2.5 percent for owner-occupied dwellings, the state makes a General Revenue Fund appropriation to repay local taxing districts for the loss of revenue they experience from this rollback. Real property used in business activity was exempted from the 2.5 percent rollback in 2005 and effective with the FY 2014–2015 budget. Neither rollback applies to new and replacement levies.

The homestead exemption functions in a similar manner to the property tax rollbacks. It allows qualified elderly and disabled homeowners and their surviving spouses to shield $25,000 of the market value of their home from all local property taxes. In 2007, the homestead exemption was expanded to all senior citizens and qualifying disabled homeowners and their surviving spouses, regardless of income, dramatically increasing the number eligible for the tax break. However, the FY 2014–2015 budget restored means testing for new participants in the program, while grandfathering all existing beneficiaries. The income threshold, which was $31,800 for tax year 2017, is adjusted annually for inflation.

Real Property Tax Reduction Factor. The loss of revenue from the tax reduction factor is borne by the applicable local taxing districts. Separate percentage reductions are applied to the combined value of residential and agricultural property and the combined value of commercial, industrial, mineral, and public utility property. Since the enactment of House Bill 920 of the 111th General Assembly in 1976, the reductions remain in effect until there is a new increase or decrease in value, with the exception of new construction. The effect of the complicated computation is to eliminate increases in voted taxes that occur when existing real property in a taxing unit is reappraised or updated.

Proceeds of Real Property Taxes. Approximately two-thirds of all real property taxes are used to support public schools, with the remainder going to counties, municipalities, and special taxing districts. The local share of health and human services programs, such as programs for mental health and developmental disabilities, and for children and senior citizens, are financed by real property taxes. The state Supreme Court has ruled unconstitutional Ohio's system of financing public education, because it requires school districts to seek voter approval of real property taxes to support half of their spending.[19] One of the court's concerns was the fact that the ability of a jurisdiction to raise revenues from real property taxes varies according to the tax value of the land and buildings in the jurisdiction and the capacity of the owners of that property to pay taxes on it. Tax capacity and effort vary widely across the state; consequently, governmental services that depend upon the tax to pay for them also fluctuate.

Property Taxes on Public Utilities. Ohio taxes the real and tangible personal property of electric utilities differently than other businesses. Public utility tangible personal property is the only personal property remaining subject to taxation, since changes were enacted by the General Assembly in 2005. The taxes on tangible personal property apply to telegraph, electric, natural gas, pipeline, waterworks, water transportation, heating, rural electric, and railroads holding property in Ohio. The assessment rates vary from 24 to 85 percent, depending on the kind of utility.

More than 70 percent of all utility valuation comes from electric companies, which became subject to legislation enacted in 1999, changing the way in which that industry is taxed. The 1999 Deregulation Act made revisions to the method used to determine the true value of an electric or rural electric company's production equipment and in how electric company production equipment was apportioned.[20] The assessment on electrical transmission and distribution personal property is 85 percent, and the assessment on electric production personal property is 24 percent. The act also reduced the tax assessment rates for all electric company tangible personal property, except transmission and distribution property, to 25 percent of true value. It also levied a kilowatt-hour tax on electric distribution companies to replace the revenues lost from that assessment rate reduction.

Manufactured Home Real Property Taxes. The owner of a manufactured modular home pays a specific tax based on the assessed value of the home. If the home is leased or rented and used as a residence, it is subject to this tax. Homes situated after January 1, 2000, are assessed at 35 percent of true value. For homes situated before this date, the taxable value is either 40 percent of its cost or 40 percent of its market value at the time of purchase, whichever is greater. The tax rate is determined by the voters and varies according to the location of the home, with a minimum tax of $36 per year. The 2007 homestead exemption expansion for eligible seniors and disabled homeowners was also made available to manufactured home owners regardless of how taxes were assessed on the manufactured home. Revenues for manufactured home taxes are distributed to taxing subdivisions in the same manner as other real estate and public utility taxes.

Real Property Conveyance Fee. There is a mandatory statewide conveyance fee on the transfer of real property of one mill, or $1 on every $1,000 of property value sold or transferred. In addition, an optional county permissive fee of up to three mills may be assessed. Ross County is the only county that does not assess a permissive fee.

Municipal Income Taxes. Municipalities can levy a municipal income tax on wages, salaries, and other compensation earned by residents of the municipality and by non-residents working in the municipality. The municipal income tax is also applied on the net profits of incorporated and unincorporated businesses attributable to the activities in the municipality. The City of Toledo enacted the first municipal income tax in 1946, some 25 years before the enactment of Ohio's individual income tax. In 1957, the legislature enacted the Uniform Municipal Income Tax Law establishing broad regulations for the administration of this important local revenue source. In 2015, 616 Ohio municipalities levied the tax.

Up to 1 percent of the municipal income tax can be levied without voter approval. Taxes are imposed at a rate determined locally, which currently ranges from 0.5 percent to 3.0 percent. Many Ohioans actually pay more in municipal payroll taxes than in state income taxes, largely because the tax is applied at a flat rate and without deductions. For this reason, unlike the individual income tax, it is not considered a progressive tax.

Ohio's three largest cities reported revenues in 2015 that accounted for more than 30 percent of total municipal income tax receipts. The City of Columbus alone generated $781.7 million, or 15.7 percent, of total municipal income tax revenue for that year. Cincinnati and Cleveland reported revenues from this source of $364.8 million and $357.6 million, respectively.

Legislation was enacted in 2014 to standardize several aspects of how the municipal income tax is calculated, including the establishment of a uniform tax base. Other areas standardized included the treatment of net operating loss carryforward, pass-through entities, occasional entrant treatment, and various administrative procedures. The FY 2018–2019 Executive Budget included a provision for centralized municipal net profit tax administration, but this was rejected in favor of a voluntary opt-in approach to administration. The budget also eliminated the "throw-back" provision regarding the apportionment of the sale of goods.

Another recurring state legislative issue about the municipal income tax is "reciprocity." Since a taxpayer can be required to pay a city income tax on the basis of both residence and workplace, some consider this to be double taxation. Proposals to mandate "reciprocity" between jurisdictions, thus eliminating the system of double taxation that now exists, have frequently been advanced but never enacted. However, some Ohio municipalities have revenue-sharing agreements providing the tax liability in the municipality of employment and then applying a percentage, up to 100 percent, of the liability in the municipality of residence as a deduction from that payment.

Municipal Income Taxes for Utilities. In 2000, the state provided that electric light companies and telephone companies within any municipality imposing a municipal income tax were subject to payment of that tax. This tax is administered by the state rather than the individual municipalities that administer their own municipal income taxes.

School District Income Taxes. Since 1981, the state has authorized school districts to levy a resident income tax on the amount reported as Ohio adjusted gross income for state income tax purposes less the personal exemptions. The tax may be levied in multiples of a quarter of 1 percent, with current rates ranging from 0.25 percent to 2.0 percent. A taxpayer 65 years old or greater receives a $50 credit against the amount of school district income tax due. In 2005, the legislature authorized school districts to approve an income tax that applies only to earned income of individuals with no deductions. As of 2017, almost one third of the state's public school districts levied a school district income tax. Of the 190 school districts with an income tax, 144 districts levied it on the basis of adjusted gross income, known as the "traditional" tax base, and the remaining 46 districts did so on an earned income basis.

County and Regional Transit Authority "Piggyback" Sales Taxes. Counties and regional transit authorities can levy what is called a "piggyback" sales tax that is in addition to the 5.75 percent state rate. These can be levied at rates of 0.25 percent to 1.5 percent in 0.1 percent increments. The county sales tax is levied on county general revenue up to 1.0 percent, with an additional 0.5 percent tax allowable for specified purposes. The applicable rate for most taxable sales depends on the location of the vendor. For computer services, telecommunications service, private investigation and security services, and lawn care and landscaping services, the rate is based on the location of the purchaser. The applicable use tax rate for all taxable sales is the location of the purchaser. The state collects all sales taxes and then returns the piggyback share to the levying counties. All 88 counties levy a county sales-and-use tax. In addition, eight regional transit authorities levy them in addition to state and county permissive sales taxes. These can be levied at the same rates as county permissive sales taxes.

Cuyahoga and Franklin counties levy the highest combined state and local sales tax at rates of 8.0 percent and 7.5 percent, respectively. Table 2-3 shows the number of counties at each of the total combined state and local sales tax rates for 2018.

Table 2-3: Combined State and Local Sales and Use Tax Rates

RATE	NUMBER OF COUNTIES
6.50%	2
6.75%	11
7.00%	10
7.25%	60
7.50%	4
7.75%	0
8.00%	1

Note: 2018 rates.

The elimination of the Medicaid managed care sales tax effective with the FY 2018–2019 budget resulted in a potential substantial loss of revenue to counties and regional transit authorities. Transition aid was provided to ameliorate the loss in the immediate future, but a provision to provide a more permanent solution that would require federal approval was vetoed by Governor John Kasich. The House of Representatives voted to override the veto, but the Senate did not follow suit.

Lodging Taxes. Municipalities, townships, and counties can levy an excise tax on charges for rooms in hotels and motels, for a total combined rate of no more than 6 percent. However, lodging taxes in several Ohio counties range considerably higher than this because of a number of special provisions concerning the construction and operation of convention, entertainment, and sports facilities.

Admissions Taxes. Unlike most states, admissions are not subject to the state sales tax in Ohio. However, since 1998, operators of movie theaters, theme parks, professional sporting events, and other places of amusement for which there is an admissions charge, as well as country club dues, may be subject to a municipal tax. The FY 2016–2017 budget bill created “tourism development districts” (TDD) and made these entities eligible to tax admissions. However, only an area within Stark County meets the statutory definition of a TDD.

Resort Area Gross Receipts Taxes. This business privilege tax is imposed on persons making general sales or providing intrastate transportation within a designated resort area or tourism development district. The tax is currently levied only by the resort areas of Put-in-Bay Township and the villages of Kelley’s Island and Put-in-Bay. All revenue is locally retained.

Gross Casino Revenue Taxes. Authorized by a 2009 amendment to the Ohio Constitution, the casino gross revenue tax is paid by casinos in Cincinnati, Cleveland, Columbus, and Toledo at a rate of 33 percent of their operator’s gross revenues. More than half (51 percent) of the proceeds of the tax are distributed to counties according to population. Counties with populations greater than 80,000 share the proceeds evenly with the largest city in the county. More than one-third (34 percent) of the receipts are distributed to public school districts based on student population. Five percent of revenues are distributed to the four casino host cities. The remaining funds are distributed for the operations of the Ohio Casino Control Commission and the Ohio State Racing Commission, and for gambling and addiction programs and law enforcement training. Although 90 percent of gross casino tax revenues are distributed to local government entities, the tax is administered by the Ohio Department of Taxation.

Summary

The state's tax structure sets the parameters for budget development, as it determines how much money will be available for spending. While state tax policy obviously impacts state government, recent changes have had a particularly limiting effect on the resources that local taxing districts have at their disposal. Determining the level of taxation is a critically important tax policy decision involving consideration of what is occurring in neighboring states, changes in federal tax policy, economic conditions, and political consequences. While determining the level of taxation involves many variables, once the decision is made to raise or lower taxes, nationally accepted principles of taxation provide guidance on what a high-quality revenue system should look like. However, changes intended simply to make state and local taxes fairer have almost never been undertaken in Ohio despite numerous studies that have established a road map for creating a better tax structure.

Endnotes

1 The Ohio Department of Taxation prepares a number of documents which provide detailed information about Ohio's taxes including its *Annual Report: Fiscal Year 2017*. Current information is also found in the biennial *State of Ohio Executive Budget*, Book One, prepared by the Ohio Office of Budget and Management, and Book Two, prepared by the Ohio Department of Taxation. These documents were used in the preparation of this chapter.

2 This compilation results from a special study by state legislators and staff convened by the Lincoln Institute of Land Policy and the National Conference of State Legislatures in 1987 and its ensuing publication in 1988, *The Unfinished Agenda for State Tax Reform*.

3 The analysis of how well Ohio measures up to these principles is derived in part from a study by Richard G. Sheridan, *Paying for Public Services, A Citizen's Guide to Ohio Taxes*, Federation for Community Planning, Cleveland, Ohio, 1993.

4 Special districts in this category, which rely upon voter-approved property taxes for most of their receipts, include among others: special developmental disabilities districts; mental health districts; independent drug and alcohol addiction services districts; and county health departments.

5 Ohio Department of Job and Family Services Labor Market Information and "Job Watch – October 2011," Policy Matters Ohio, Cleveland, Ohio.

6 Ohio Department of Job and Family Services, Labor Market Information and *Dayton Business Journal*, March 30, 2016.

7 Bureau of Business & Economic Research, University of New Mexico, 2012 and Thomas Suddes, "Ohio Hopes Next Governor Has More than Slogan," *Columbus Dispatch*, May 21, 2017.

8 Ohio Development Services Agency, 2017 and Doug Caruso and Danae King, "Growing Diversity: Ohio Sees Increase in Hispanic, Asian Residents," *The Columbus Dispatch*, June 21, 2018.

9 www.ohio-population.org.

10 U.S. Census Bureau, *American Community Survey 2017*.

11 Ohio Development Services Agency, "*The Ohio Poverty Report,*" February 2018.

12 Summary of current research provided at the 82nd Annual Conference of the National Tax Association as reported in *State Policy Reports*, Vol. 8, Issue 19, 1993.

13 Ohio Revised Code Sections 107.03 and 5703.48.

14 U.S. Census of Governments, 2012.

[15] U.S. Census of Governments, 2012.

[16] William Hershey and Lucas Sullivan, "How Tough Is Ohio's Tax Burden on Business?" *Toledo Blade*, March 20, 2011.

[17] Prior to this time, the state continued the territorial practice of taxing land, but not improvements based on the fertility of the land.

[18] The exceptions are that agricultural land may be valued according to current, rather than "highest and best" use; certified air, water, and noise pollution control facilities are exempt; property of governmental and private institutional owners is exempt; and qualified real property located in an enterprise zone is exempt.

[19] *DeRolph v. Ohio*, 86 Ohio St. 3rd 1, 1997. A more complete discussion of this case and its financial implications is found in Chapters 10 and 14.

[20] SB 3 of the 123rd General Assembly.