A Mortal Threat to Ohio's Economic Competitiveness: SB352, HB754, and the Buckeye Institute Lawsuit

September 2020

Background

On March 27, 2020 Ohio Governor Mike DeWine signed into law HB197, providing emergency relief to Ohioans in light of the coronavirus pandemic. Section 29 of this bill states that during the pandemic state of emergency, income tax shall be collected by the jurisdiction where the employer is located, not an employee's work-from-home location. In July 2020, the Buckeye Institute filed a lawsuit in the Franklin County Court of Common Pleas challenging Section 29 of HB197. In August 2020, SB352 and HB754 were introduced. These bills intend to repeal Section 29 of HB197 and allow the jurisdiction of residence to collect income tax from employees working from home instead of the jurisdiction where the employer is located.[i]

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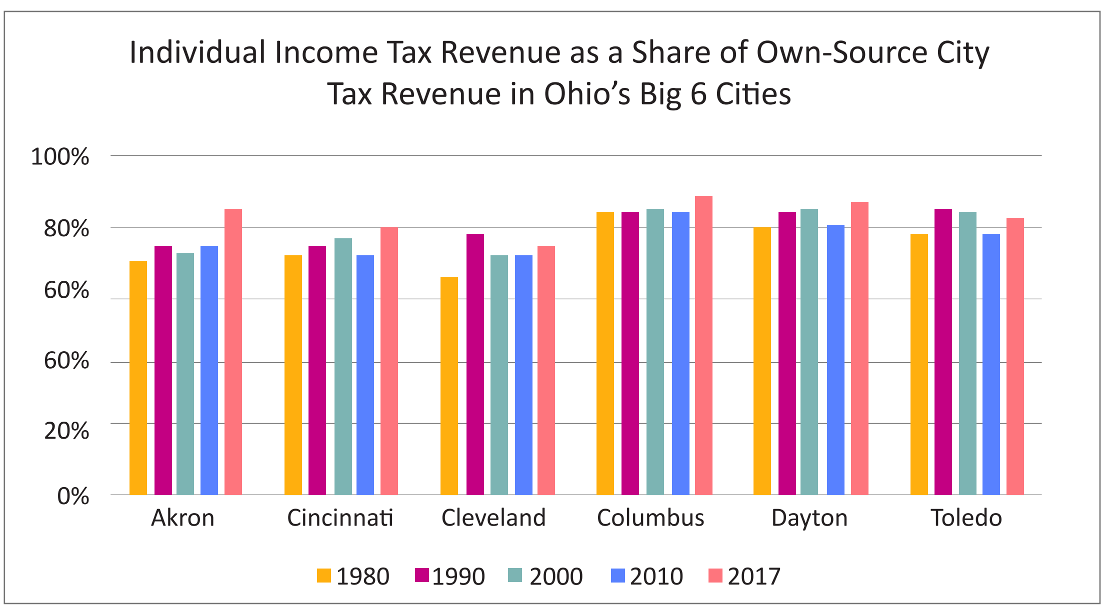
The Buckeye Institute lawsuit, SB352, and HB754 are short-sighted and mortally jeopardize Ohio's economic competitiveness. These efforts threaten the ability of Ohio's largest economic centers to pay debt service on past strategic investments, envision future ones, and maintain critical services, thereby hampering their ability to drive economic growth, retain existing employers, and attract new ones.

Repealing Section 29 will cause dramatic drops in revenue for Ohio's largest cities; we estimate it would cause a net decrease of $306 million total revenue to Ohio's 6 largest cities alone. It would also set off a cascade of unintended consequences through Ohio's tax system and undo at least sixty years of precedent in Ohio's tax policy. Without a comprehensive restructuring to address its consequences, repealing Section 29 will be devastating to the financial health of Ohio's cities and thus the state.

Individual income tax revenue has comprised an extremely large share of city tax revenue in Ohio for decades. For nearly a half century, individual income taxes have generated the vast majority of own-source city tax revenue in Ohio.[ii] Newly released data compiled by the Lincoln Institute of Land Policy demonstrates this trend has held in Ohio's six largest cities by population (hereafter referred to as the "Big 6") for the last forty years, the entirety of the data set. In fact, the preeminence of municipal income tax collections predates the Lincoln Institute's data. Toledo passed the first municipal income tax ordinance in 1946; by 1957 the Ohio General Assembly had enacted a uniform municipal income tax law in response to the growing number of cities that were establishing income tax ordinances.[iii]

For nearly a half century, individual income taxes have generated the vast majority of city-controlled tax revenue in Ohio.

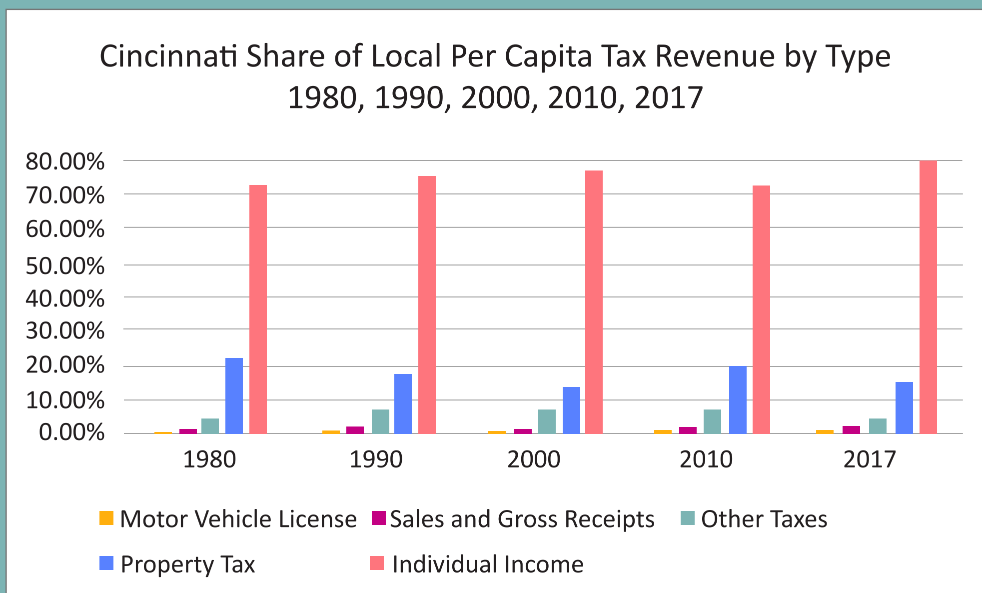
The chart below demonstrates the steady reliance on individual income tax revenue as a share of city-generated taxes for 1980, 1990, 2000, 2010 and 2017, the most recent year data are available.



Source: GOPC, Lincoln Institute of Land Policy. Fiscally Standardized Cities database.

By 2017, individual income tax comprised over 82% of own-source city tax revenue for all six of Ohio's largest cities compared with 74% in 1980. In 1980, Cleveland was the least reliant city on individual income tax with 65% of own-source city tax revenue generated via individual income tax. In 2017, Cleveland was still the least reliant with 75% of all own-source city tax revenue generated by individual income, and Columbus was the most reliant with 88% of own-source city tax revenue generated through this source.

A Closer Look at Own-Source City Tax Revenue: Cincinnati Example

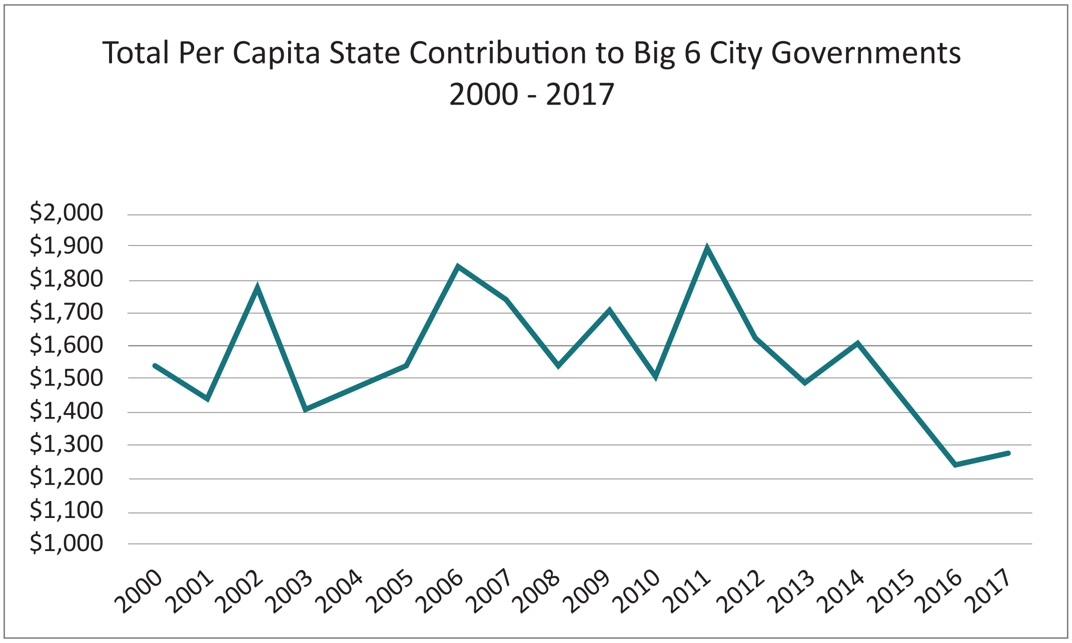


Source: GOPC, Lincoln Institute of Land Policy. Fiscally Standardized Cities database.

Cincinnati's own-source city tax revenue demonstrates the importance of individual income tax relative to other forms of tax revenue with the city budget. In 2017, individual income tax comprised nearly 80% of all city taxes, generating almost 6 times as much revenue as property taxes and more than 50 times sales and gross receipts to the city of Cincinnati.

The importance of income tax revenue to cities has only increased in recent years as funds from the State to local government entities have waned since the 2000s. Between 2000 and 2017, state contributions to local governments with geographic territories in the Big 6 Cities[iv] decreased by 8% and the state funds directed specifically to city government decreased by 17% (from $1,531 per capita in 2000 to $1,277 per capita in 2017 in adjusted 2017 dollars).

During this period, the Local Government Fund was reduced, the estate tax was repealed and the tangible personal property tax was repealed. The reduction in these former sources of revenue to all types of local governments (e.g. cities, counties, school districts, special districts) increases the importance of the remaining sources of locally-sourced funds.

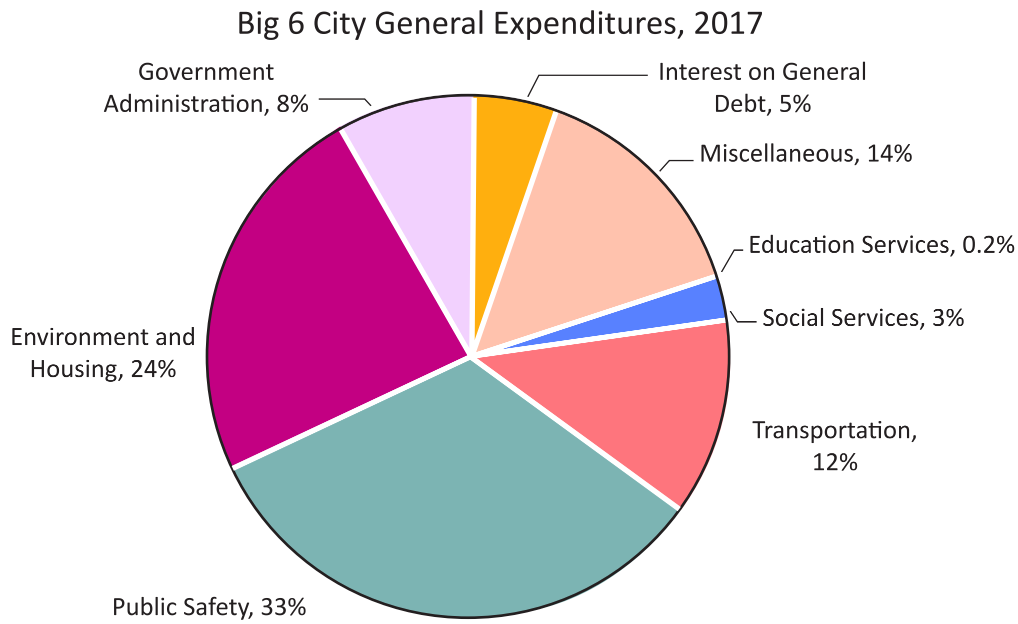


Source: GOPC, Lincoln Institute of Land Policy. Fiscally Standardized Cities database.

Income tax revenue funds city services essential for maintaining the health, safety, and well-being of residents and visitors, as well as maintaining the infrastructure that supports economic development and jobs. Cities in Ohio use their income tax revenue to fund a large array of community and economic development services, including, but not limited to:

- animal control
- construction and maintenance of sanitary and storm sewers
- construction and maintenance of many aspects of the highway/road network
- fire protection
- garbage collection
- government-wide insurance
- health inspections
- home ownership programs
- home repair programs
- policing and law enforcement activity
- public health
- regulation of air and water quality premiums
- sewage treatment
- snow and ice removal on roads
- In Columbus, school districts receive a small amount of Individual Income tax revenue

In 2017, Public Safety (which includes Police, Fire, Corrections, and Inspections) accounted for 33% of Big 6 City general expenditures[vi] followed by Environment and Housing, which includes Parks and Recreation, Community Development, Sewerage, and Waste Management.[v]



Source: GOPC, Lincoln Institute of Land Policy. Fiscally Standardized Cities database.

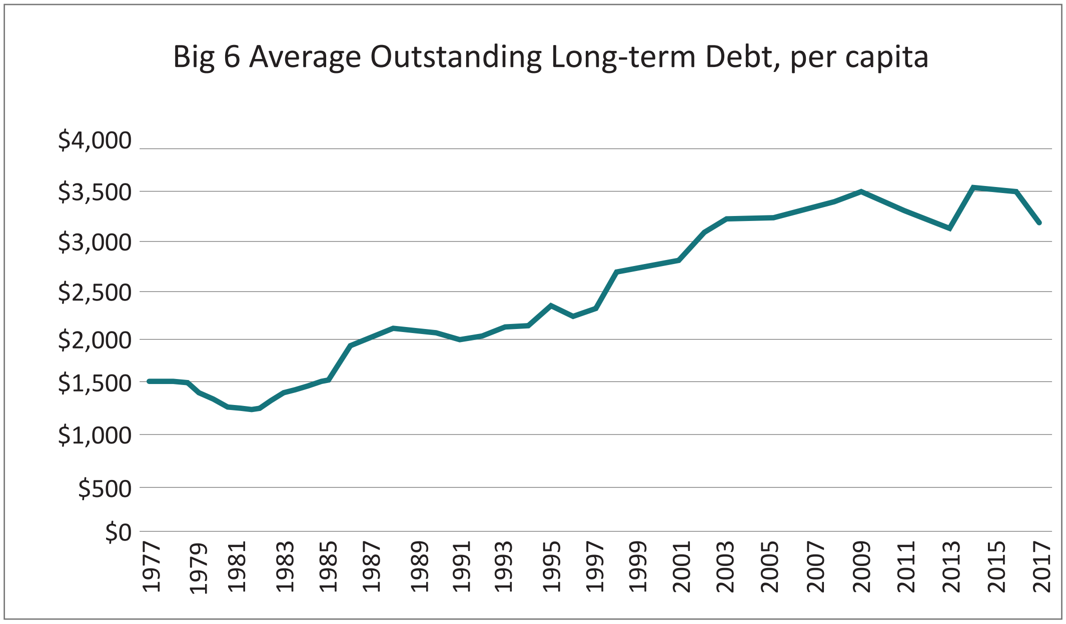
City services are not all cash-in, cash-out propositions amenable to rapid reallocation as proponents of the repeal of Section 29 suggest. This is particularly true of the strategic infrastructure investments cities make that drive regional economic health. The infrastructure employers relied on to get employees to their workplaces still has pre-pandemic bond debt that needs to be retired, even if work-from-home commuters haven't used roads or bridges within our Big 6 Cities in the last five months,

Reliance on long-term debt has increased in the last 40 years for Ohio's Big 6. From 1977 to 2017, the average per capita amount of outstanding debt doubled from $1,596 to $3,222.

City street resurfacing and improvements are required investments for a city to maintain its street network, and, by extension, maintain the regional and state transportation networks that are key components of Ohio's economy. Like roads, many other capital investments are financed over many years by revenue collected annually. It is logical that many of the services mentioned above rely on periodic investments and not simply small, proportionate expenditures. Often these investments are made via municipal bonds.

City services are not all cash-in, cash-out propositions amenable to rapid reallocation

Most cities in Ohio dedicate a portion of their income tax collections to capital and infrastructure debt. As one example, one-fourth of Columbus's income tax collections are used to pay its bond obligations, which finance infrastructure projects that are too large to be financed in one payment. This bond debt is typically redeemed within 10 years, meaning the City is still paying off its 2013, 2016, and 2019 bonds. Other cities have similar timelines for capital and infrastructure debt, and most cities rely on their income taxes to help service that debt.[vii]



Source: GOPC, Lincoln Institute of Land Policy. Fiscally Standardized Cities database.

A Closer Look at the Advantages of Municipal Bonds: Columbus Example

In 2019, citizens of the City of Columbus voted and approved a billion dollar bond program to pay for major investments in street and utility improvements, among other capital projects. The 2019 bond packages invest nearly $70 million over the next two years on street resurfacing projects. A study done 10 years earlier concluded that the city would have to spend $60 million per year on resurfacing to maintain roadways, nearly double what it spends now. Bond programs provide a means to finance expensive, but necessary, projects across a municipality.

Ohio Cities have large shares of city workers who reside outside the city, which means cities stand to lose significant revenue if income tax is restructured in light of the unforeseen pandemic. In 2017, Columbus had the largest share of workers who also reside in the city with 41.3%, while Dayton had the largest number of city workers who reside outside the city at 81.6% of all workers working in the city.

City	Share of City Workers who reside Outside the City	Share of City Workers who reside Within the City
Akron	72.8%	27.2%
Cincinnati	76.0%	24.0%
Cleveland	77.4%	22.6%
Columbus	58.7%	41.3%
Dayton	81.6%	18.4%
Toledo	57.6%	42.4%

Source: GOPC, On the Map, United States Census, Data from 2017

Repealing Section 29 could cost Ohio's six largest cities alone an estimated net loss of $306 million

Repealing Section 29 could cost Ohio's six largest cities alone an estimated net $306 million in revenue and will have similarly negative impacts on other cities in Ohio that rely heavily on income tax revenue. The following table illustrates the potential financial impact of this policy on Ohio's Big 6 cities. For the purposes of a gross estimate, we estimated that revenue will decrease proportionally to the percentage of workers who reside outside the city, and that 30% of those workers will work from home.[viii]

How much do cities stand to lose by repealing Section 29?		
Big 6 Income Tax Revenue, 2017	$	2,112,876,523
Share of Big 6 Workers that Reside *Outside* the City		69%
Share of Workers now Working From Home		30%
Potential decrease in revenue (rounded)	*$*	*(437,000,000)*

Source: GOPC, Lincoln Institute of Land Policy; On the Map, United States Census, Data from 2017

Cities also stand to gain revenue by collecting income tax revenue from city residents employed outside the city who are now working from home. To approximate this impact, we estimated the total income that city residents who work elsewhere would earn based on city median household incomes. We then applied the average effective income tax rate of the Big 6 and estimated the potential increase in income tax revenue, assuming 30% of these workers are working from home.

How much do cities stand to gain by repealing Section 29?		
Average Median Household Income of Big 6 Residents	$	35,987
Number of Big 6 Residents that Work Outside the City		510,614
Total Est. Income of Big 6 Residents Working Outside the City	$	18,375,295,813
Share of Workers now Working From Home		30%
Total Est. Income of Big 6 Residents now Working From Home	$	5,512,588,744
Average Effective Income Tax Rate of the Big 6 Cities		2.39%
Potential increase in revenue (rounded)	*$*	*131,000,000*

Source: GOPC, Lincoln Institute of Land Policy; On the Map, United States Census, Data from 2017; Ohio Department of Taxation, Municipal Income Tax Rate Database

The potential net impact of repealing Section 29 is $306 million. This was calculated by adding the potential revenue lost from former commuters into the city now working from home, to the revenue gained by city residents working from home who previously worked elsewhere. The resulting estimated figure demonstrates an order of magnitude and is not precise because: 1) the percentage of people actually working from home is in flux; 2) income tax revenue collections are based on incomes that aren't factored into this estimate; and 3) recent changes in unemployment rates are also not reflected. However, higher income workers are more likely to hold jobs that allow for remote work, and are more likely to commute.[ix]

What is the estimated potential impact of repealing Section 29?		
Potential decrease in revenue	$	(437,000,000)
Potential increase in revenue	$	131,000,000
Net Impact on Big 6 income tax revenue	*$*	*(306,000,000)*

Source: GOPC, Lincoln Institute of Land Policy; On the Map, United States Census, Data from 2017

A loss of $306 million from Ohio's Big 6 Cities would have extraordinary consequences for Ohio's major metro regions, which would not be limited just to the 6 Big Cities. For example, the roadway systems in Ohio's Big 6 Cities are part of larger regional and state networks. Poor road conditions within the city's jurisdiction, due to insufficient funds, would slow commerce and shipping and increase accidents and fatalities for the entire region.[x] This will severely hamper the state's economic competitiveness as it works to retain and attract employers.

Potential Impacts from Losing $306 million	
77	fewer miles of expanded interstate highway
245	fewer miles of milled and resurfaced road
77	fewer miles of new 2-lane road
38	fewer miles of 4-lane road

Source: GOPC, American Road & Transportation Builders Association

Ohio's income tax structure should not be changed. Using a temporary pandemic to justify changes to a long-term tax structure would unfairly penalize cities who have long supported Ohio's economic competitiveness and made investment decisions based on the expectation of this structure's existence. No one had predicted a pandemic; it would be patently unfair to Ohio's cities to change the income tax structure at this juncture.

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About the Greater Ohio Policy Center

The Greater Ohio Policy Center (GOPC) is a statewide non-profit organization with a mission to improve Ohio's communities through smart growth strategies and research. Our vision is a revitalized Ohio. GOPC is highly respected for its data-driven, nonpartisan policy analysis, research expertise, and policy development, and regularly provides expert analyses to public, private and nonprofit leaders at the local, state and national level.

This brief was researched and written by Erica Spaid Patras with assistance from Maria Walliser-Wejebe and Alison Goebel.

Endnotes

i House Bill 197 (133 GA) https://www.legislature.ohio.gov/legislation/legislation-documents?id=GA133-HB-197 Senate Bill 352 (133 GA) https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA133-SB-352

ii We use "own-source city tax revenue" to indicate the funds the city has jurisdiction over to set rates for and collect. Cities receive additional dollars from state and federal formulas, as well as from user fees, fines and charges, like utility fees or transit revenue that is automatically funneled back into service operation; the majority of this brief focuses only on the revenue Ohio cities can actually control. Additionally, this nomenclature differentiates between revenue within the city's purview and revenue available to other local jurisdictions operating within the geographic boundaries of the city. For example, income tax revenue generally funds city government, while property tax revenue generally flows to school districts; while property tax revenue may be spent within city boundaries, decisions about how it is used are not made by city leaders.

iii Ohio Department of Taxation, Fiscal Year 2019 Annual Report; Municipal Income Section, p 118 https://tax.ohio.gov/static/communications/publications/annual_reports/2019AnnualReport/AR2019.pdf#page=118

iv County government, city government, school districts, and special districts, like libraries.

v The uses of funds are included within the Lincoln Institute for Land Policy Fiscally Standardized Cities database and were constructed using data for individual local governments from the U.S. Census Bureau's quinquennial Census of Government Finance and the Annual Surveys of State and Local Government Finance. Detailed definitions for all fiscal variables are available in the Census Bureau's Government Finance and Employment Classification Manual, which is available at: http://www.census.gov/govs/classification/

vi General Expenditures refers to all city spending categories, except for intergovernmental expenditures, utility expenditures, liquor store expenditures, and employee retirement trust expenditures.

vii https://www.ohioauditor.gov/auditsearch/Search.aspx ; select "financial audit" for the city you wish to research; select a recent audit. Information provided in "Notes to the Basic Financial Statements" section.

viii At the time of this writing, a Gallup poll found 62% of workers reported working from home (https://news.gallup.com/poll/306695/workers-discovering-affinity-remote-work.aspx), Forbes reported on two studies which found 36% and 37% of jobs, respectively, could be done from home (https://www.forbes.com/sites/traversmark/2020/04/24/what-percentage-of-workers-can-realistically-work-from-home-new-data-from-norway-offer-clues/#4a7d8f2f78fe), and Stanford's Institute for Economic and Policy Research reported 42% of workers working from home. We considered all of these, the timeframes they were generated, and opted for an even lower 30% to account for some additional unemployment that may not be adequately reflected in the earlier figures.

ix "Workers who could work at home, did work at home, and were paid for work at home, by selected characteristics, averages for the period 2017-2018" (Table 1 continued) page 10. https://www.bls.gov/news.release/pdf/flex2.pdf

x Ohio cities maintain local and state routes within their jurisdiction. ODOT maintains federal interstate freeways.