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Ohio May Become Latest State To Improve Its Tax Code And Biden Administration Should Take Note

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During the pandemic, 43 states reduced taxes in some way, including Ohio. The Buckeye state consolidated tax brackets and cut its top marginal rate. Now, Ohio policymakers are considering another round of tax reforms that would create one flat income tax rate and reduce state subsidies to local governments. These reforms would improve Ohio's tax climate, making it more attractive to workers and businesses. The Biden administration should take note.

Since 2010, state individual income tax rates have been steadily declining nationwide. As the figure below shows, both the median and average top income tax rate fell from 2010 to 2023, and both are projected to fall further given the tax reform bills being discussed across the country.

Ohio's proposed reforms would contribute to this trend. House Bill 1 would create one tax rate of 2.75% that would apply to income greater than $26,050. Currently, Ohio has four tax brackets and a top individual income tax rate of 3.99% that applies to income over $115,300.

Research shows that simpler tax codes with lower rates and broader bases promote innovation, boost economic growth, and increase employment. Ohio's proposed tax reform would encourage work by allowing people to keep more of what they earn. It would also encourage investment by small businesses. Since many small business owners pay taxes under the individual income tax code (pass-through entities), this plan would reduce taxes for them, too, giving them more money to invest in equipment, facilities, and their workers.

In addition to simplifying Ohio's tax code and reducing the tax burden for workers, the proposal would also disentangle state income taxes from local property taxes. Current Ohio tax law provides a 2.5% homestead exemption from local property taxes and a 10% non-business property tax payment from the state. These provisions essentially force some areas of the state to subsidize the local spending of other areas. The proposed reforms would end these state-level subsidies and require local governments to fund more of their own spending.

Ending the state subsidies to local governments is good tax policy since it would make Ohio's tax code simpler and more transparent. It would also make local governments more accountable to their constituents by making it harder for local officials to hide the true cost of government-provided goods and services.

As Buckeye Institute research fellow Greg Lawson notes, "These subsidies have created perverse incentives that encourage local officials to overspend because nonresident taxpayer dollars help foot the bill—that is, taxpayers who cannot vote on local spending decisions. Removing these subsidies will better align local officials' decision-making with the services and expenses their resident voters actually demand."

While state-level reforms like the one being considered in Ohio are improving state and local tax climates, the federal tax code could get worse. The Biden administration has been working with other Organization for Economic Co-operation and Development (OECD) countries on a new global tax system. The proposal includes two pillars: The first would create a new system for allocating tax rights across countries and the second would create rules to enforce a 15% global minimum tax on businesses.

Both pillars are underdeveloped due to disagreements among countries about the particulars, so the complete implications of the proposals are unclear. But what is clear is that the Biden administration is trying to outsource U.S. tax policy to the OECD or some other yet-to-be-formed global entity that is not accountable to U.S. taxpayers.

The OECD was initially established to promote global economic growth, primarily by increasing free trade and preventing businesses with interests in multiple countries from being taxed multiple times. For 50-plus years it was largely successful, as international trade expanded and international tax competition encouraged countries to implement pro-growth tax codes with lower rates. From 1981 to 2021, the average OECD corporate tax rate fell from roughly 48% to 24%.

More recently, the OECD, with encouragement from Biden officials such as Treasury Secretary Janet Yellen, has spearheaded a movement to raise taxes across the world with little input from voters or their elected representatives. As Adam Michel of the Cato Institute points out, instead of encouraging growth through sensible tax policies that incentivize work and investment, today's OECD "…is better thought of as an aspiring international cartel of revenue-maximizing tax collectors intent on one thing: higher taxes."

Congress should push back on the Biden administration's attempt to bypass American voters when it comes to tax policy. By asking tough questions, Congress can ensure voters understand exactly what a U.S. commitment to a new global tax regime would entail. While the details are murky, it is easy to see that taxes for U.S. businesses, and thus U.S. workers and consumers, would increase.

Rather than collaborating with high-tax European countries via the OECD, federal officials should follow Ohio's and other states' lead by simplifying the U.S. tax code. There are hundreds of federal deductions and exemptions that could be eliminated to help offset lower rates. America's economy is the most innovative and successful in the world because we do not levy the high work-crushing and innovation-smashing taxes that European countries do. Instead of raising taxes to match Europe, we should continue to look for ways to simplify the federal tax code and lower taxes.

Ohio's proposed tax reforms would improve its tax climate and make it a better place to work or start a business. The Biden administration should pay more attention to the pro-growth tax changes happening in states such as Ohio and less to the harmful tax policies coming from the OECD.