



Research
Foundation

Economic Impact of the Business Income Deduction in Ohio

April 2021



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Over the last four years there has been much public debate about the benefits and costs associated with certain tax provisions in effect in Ohio. Our organization’s mission is to provide non-partisan, educational resources on public policy issues that may impact Ohio’s economy, job creation, and long-term competitiveness. Therefore, the Ohio Chamber of Commerce Research Foundation set out to investigate the economic impact of the Business Income Deduction and 3% flat rate on business income (known as the BID) as there has been no comprehensive, data-driven analysis of the BID to date. We contracted with Ernst & Young (EY) to conduct a study on the econometric effects of the BID, and the results of the analysis show there is a positive correlation between the enactment of the BID and a growth in economic activity and production in Ohio.

The BID, initially enacted in 2013 and updated to its current implementation for tax years 2016 and beyond, allows taxpayers filing an individual tax return with business income to deduct up to \$125,000 of that business income (if single or married filing separately) or \$250,000 of that business income (if married and filing jointly), with any remaining business income taxed at a 3% rate as opposed to the top individual marginal rate of nearly 4.8%. The stated goal of the BID was to allow business owners to retain more of their capital, allowing them to reinvest those dollars into their operations and spur economic activity. Thus, a method of assessing the impact of the BID is to investigate whether increased economic activity has occurred when compared to levels of economic activity prior to the enactment of the BID.

When controlling for other variables such as the economic and demographic characteristics of the state and taking into account other factors such as trends in the national economy, the analysis conducted by EY demonstrates that there was roughly \$5.9 billion in increased economic activity in Ohio in 2018, when compared to an economic model in which the BID was not in effect. Further, these models suggest that the effect of the BID on Ohio’s economy supported nearly 60,000 jobs, including 14,000 jobs at businesses with less than 50 employees, and helped to keep 1,200 businesses from potentially closing.

Estimated economic effects of Ohio’s BID in 2018

Economic performance measures	Implied effect for Ohio
Gross state product growth	+\$5.9 Billion value of GSP
Total employment growth	+59,700 more employees
Small business employment growth	+14,300 more employees
Establishment exit rate	1,200 fewer business closures

Source: “Analysis of Ohio’s Business Income Tax Incentives,” Ernst & Young, April 2021

As the report confirms, because the BID is a deduction on the total business income claimed by taxpayers on their individual tax return, the deduction is not multiplied by ownership in several businesses.¹ The report also makes clear that the BID provides the most benefit to those taxpayers with the lowest adjusted gross income (AGI). In 2018, 66% of the business income covered by the deduction flowed to taxpayers with an AGI of less than \$400,000, per data from the Ohio Department of Taxation.

¹ https://tax.ohio.gov/static/forms/ohio_individual/individual/2019/schedule_itbus_fi.pdf. In other words, the so-called “LLC Loophole” whereby some have asserted that an owner can divide a business into multiple LLCs to obtain multiple deductions of up to \$250,000 for each LLC is non-existent.

When comparing Ohio’s individual income tax rates on business income to that of neighboring or peer states across the country, it becomes clear that Ohio is a much more attractive place for a small business to grow with the BID in effect. Among nine states compared in the table below, Ohio ranked sixth with a top marginal individual rate on business income of 4.8%. With the BID in effect, we trail only Texas and Tennessee among this group, states with a 0% tax on most business income. The BID also offsets the anti-competitive impact of Ohio’s significant municipal tax on net profits of businesses, which can add an additional 0.5-3% to the Ohio tax rate on business income.²

Regional and selected state comparison of top marginal individual rates on business income, 2014 & 2018

State	2014 top marginal rate on business income	2014 Rank	2018 top marginal rate on business income	2018 Rank
Texas	0.00%	1	0.00%	1
Tennessee	0.00%	1	0.00%	1
Ohio	4.80%	6	3.00%	3
Pennsylvania	3.07%	3	3.07%	4
Indiana	3.40%	4	3.23%	5
Michigan	4.25%	5	4.25%	6
North Carolina	5.80%	7	5.50%	7
Georgia	6.00%	8	6.00%	8
Wisconsin	7.65%	9	7.65%	9

Source: Wolters Kluwer

In conclusion, we set out to determine whether the introduction of the Business Income Deduction had a noticeable effect on the state economy in Ohio. The econometric analysis performed by EY provides data that suggests the BID supported almost \$6 billion in economic activity in 2018. The models also suggest the economic activity supported nearly 60,000 jobs and suggest that the provisions helped keep 1,200 businesses open. Based on those results, it is our opinion that the BID has had the intended effect of spurring increased economic activity and incentivizing small business owners to reinvest those tax savings back into their operations.

Following is the Executive Summary of the EY report, “Analysis of Ohio’s Business Income Tax Incentives.” Should you have interest in reading the full report, please visit our website at <http://ohiochamberfoundation.com>.

² Ohio Department of Taxation Annual Report, Fiscal Year 2020, Municipal Income Tax, p. 122.

Executive summary

EY was commissioned by the Ohio Chamber of Commerce Research Foundation to empirically examine the economic effects of the Business Income Deduction and reduced rate on business income (referred to in this report as the “BID”). The deduction is an Ohio tax provision which allows taxpayers with business income to deduct the first \$250,000 (or \$125,000 depending on filing status) of Ohio business income. Additionally, business income is taxed at an incentivized rate of 3% compared to the nearly 4.8% top marginal individual income tax rate. The deduction is limited based on the total business income reported by an individual taxpayer, meaning owners of multiple businesses would not be able to take the \$250,000 deduction separately for each business entity.¹

This analysis examines the economic effects of the BID in terms of total statewide employment, small business employment, establishment exit rates and Gross State Product (GSP).² The econometric analysis finds that the \$250,000 deduction and other business income tax incentives increase the overall level of economic activity in Ohio and other states where such incentives exist. Specifically, the analysis examines four types of economic effects and finds the following impacts from Ohio’s BID:

- ▶ **Gross State Product:** A gain of \$5.9 billion in 2018 compared to the Ohio economy absent of the BID.
- ▶ **Total employment:** A gain of 59,700 employees in 2018 compared to the Ohio economy absent of the BID.³
- ▶ **Small business employment:** Small business employment growth (defined as businesses with less than 50 employees) of 14,300 employees in 2018 compared to the Ohio economy absent of the BID.
- ▶ **Establishment exit rate:** 1,200 fewer business failures in 2018 (the establishment exit rate) absent of the BID.⁴

Table 1. Estimated economic effects of the Ohio BID, 2018⁵

Economic performance measures	Implied effect for Ohio
Gross state product growth	+\$5.9 billion value of GSP
Total employment growth	+59,700 more employees
Small business employment growth	+14,300 more employees
Establishment exit rate	1,200 fewer business closures

Source: EY analysis

While many industrial states, such as Ohio, have seen only moderate growth on various economic measures over the past decade, the BID has contributed to increased overall economic activity in the state. The econometric analysis presented in this study shows the growth of GSP, total employment, small business employment and improvement in the establishment exit rate resulting from the BID.

¹ Please see Ohio IT BUS schedule: https://tax.ohio.gov/static/forms/ohio_individual/individual/2019/schedule_itbus_fi.pdf

² Data from 2003 to 2018 from all 50-states were used to develop an econometric model, which estimated these economic outcomes.

³ These effects do not compound over time. For example, the effect of repealing the BID in 2018 would be a reduction of 59,700 jobs. This does not imply another reduction of 59,700 jobs the following year. The same holds for the other three economic outcome variables of interest: GSP, small business employment and the establishment exit rate.

⁴ Business failures are measured by establishments that had employees in the previous year that no longer have employees and does not necessarily imply business bankruptcy or closure.

⁵ These values are not the coefficients associated with the econometric models. These values are point estimates for Ohio derived from the econometric coefficients given the Ohio BID and preferential rate on business income.