Policy Memo

Index Income Tax Brackets to Inflation
February 24, 2025

The Buckeye Institute's Recommendation

Until recently, Ohio ranked among the 24 states that index their income tax brackets to inflation. Under an indexed system, the thresholds for marginal tax brackets automatically increase at the same rate as inflation. This indexing policy prevents diminished purchasing power by ensuring that wage and salary increases caused by inflation are not then hit with higher income taxes. Regrettably, Ohio suspended this sound policy for tax years 2023 and 2024—a move that increased state revenues, but cost Ohio workers dearly during the worst inflationary period in 40 years. The General Assembly should immediately reinstate the indexed system and resist the temptation to abandon it again.

Why It Matters

Progressive income tax systems tax earnings at increasing marginal rates. Their proponents argue that those with higher incomes can and should pay higher average income tax rates than those with lower incomes. A progressive tax system that does not index its marginal tax brackets to rise at the same rate as inflation, however, inflicts "bracket creep" on wage and salary earners. Bracket creep occurs when earners demand higher pay to help offset inflationary price increases, but the higher pay increases total income for those earners to such a degree that they are pushed into higher marginal tax brackets, resulting in higher overall taxation and diminished purchasing power. For example, in an inflation-indexed system in which income less than $50,000 is taxed at one percent and income at or greater than $50,000 is taxed at two percent, if inflation is three percent, then the minimum threshold for the two percent tax rate will automatically rise to $51,500, so that income between $50,000 and $51,500 will still be taxed at one percent. This empowers earners making a bit less than $50,000 to seek pay increases to offset inflation without worrying that their raise will push them into a higher marginal tax bracket that negates the raise's added purchasing power.

Inflation-indexed systems also lower the overall tax burden of those who do not receive inflation-induced pay increases. Consider the previous example, but with an individual earning $55,000 who does not receive a raise in response to the three percent inflation. Regardless of whether inflation-indexing is in place, that individual will pay a top marginal rate of two percent. But under an inflation-indexed system, that earner's two percent tax rate only applies to the income above $51,500—not $50,000. Thus, even without a "bracket creep" raise, the earner pays less tax.

Despite these benefits to taxpayers, Ohio suspended its inflation-indexed system for two years starting in 2023, just in time for the worst inflationary period since the early 1980s. That mistake exacerbated the Ohio consumer's fiscal crunch. Data from the U.S. Census Bureau's **Annual Survey of State Government Tax Collections** indicate that Ohio raised $11.3 billion in personal income revenue in 2023. Assuming two percent growth in tax receipts between 2023 and

2024 would yield roughly $11.5 billion in tax revenue for 2024. The federal GDP deflator (the metric Ohio uses to index its tax brackets) was 3.6 percent in 2023 and 2.4 percent in 2024, for a total of six percent over that two-year span. Assuming that total tax collections were therefore six percent higher than they would have been with inflation-indexing, then the failure to index tax brackets during 2023-2024 cost Ohio taxpayers $663 million.

Conclusion

Ohio must immediately return to indexing personal income tax rates to the rate of inflation and resist the temptation to suspend indexing going forward. Suspending the inflation-adjusted index may yield additional tax revenues, but now is not the time, nor is an unindexed tax system the way, to go about filling public coffers. Inflation has hit Ohio households hard enough during the last four years. Forcing them also to choose between a modest raise or remaining in their current tax bracket presents an unseemly choice at precisely the wrong time. And reinstating the index policy will help reduce the double-whammy burden of inflation and higher marginal tax rates for all taxpayers. Ohio should make inflation-indexing a permanent part of its income tax policy and end the current suspension.