

IN THE SUPREME COURT OF OHIO

08-2018

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| OHIO GROCERS ASSOCIATION, et al. | : | Case No. _____ |
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| Plaintiffs-Appellees, | : | On Appeal from the Franklin |
| | : | County Court Appeals, |
| v. | : | Tenth Appellate District |
| | : | Case No. 07AP-813 |
| WILLIAM W. WILKINS [RICHARD A. LEVIN], | : | |
| in his official capacity as Ohio Tax Commissioner, | : | |
| | : | |
| Defendant-Appellant. | : | |

**MEMORANDUM IN SUPPORT OF JURISDICTION OF AMICI CURIAE,
 THE OHIO MANUFACTURERS' ASSOCIATION,
 OHIO STATE MEDICAL ASSOCIATION,
 THE OHIO SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS,
 OHIO DENTAL ASSOCIATION,
 OHIO CHEMISTRY TECHNOLOGY COUNCIL,
 AND OHIO STATE BAR ASSOCIATION**

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| <p>FILED</p> <p>OCT 17 2008</p> <p>CLERK OF COURT SUPREME COURT OF OHIO</p> |
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TABLE OF CONTENTS

| | <u>Page</u> |
|--|-------------|
| TABLE OF CONTENTS..... | i |
| STATEMENT OF INTEREST OF AMICI CURIAE..... | 1 |
| STATEMENT OF THE CASE AND FACTS..... | 3 |
| EXPLANATION OF WHY THIS CASE IS OF PUBLIC AND GREAT GENERAL INTEREST | 3 |
| A. The Court of Appeals’ Decision Derailing Ohio’s New Business Tax Structure by Creating a Favored Class of Business Taxpayers is of Public and Great General Interest. | 3 |
| B. Ohio’s Commercial Activity Tax Is of Public and Great General Interest Because It Directly Affects Innumerable Persons Doing Business in Ohio. | 7 |
| ARGUMENT..... | 8 |
| Proposition of Law: The CAT is a franchise tax imposed on the privilege of doing business in the State of Ohio, not a transactional excise tax and, therefore, does not violate Article XII, Sections 3(C) and 13 of the Ohio Constitution as applied to retailers and wholesalers of food..... | 8 |
| CERTIFICATE OF SERVICE | 12 |

STATEMENT OF INTEREST OF AMICI CURIAE

In June 2005, the General Assembly adopted a tax reform package – House Bill 66 (“H.B. 66”) designed to address the economic malaise that has afflicted Ohio for many years. In adopting H.B. 66, the General Assembly sought to replace Ohio’s antiquated tax system that “kills jobs and hinders economic growth” with one that promotes investment in the equipment and technology Ohio workers need to be efficient, productive, and competitive in the global economy.¹

A critical component of this tax reform bill was a multi-year phase out of Ohio’s tangible personal property tax and the corporation franchise tax. Every major study of Ohio’s tax system over the past 40 years has acknowledged the anti-competitive nature of the tangible personal property tax and has called for adjustments to or wholesale elimination of this tax.² With its many loopholes, the corporation franchise tax was largely ineffective in generating revenue. Its net worth component also placed undue burden on capital-intensive and start-up businesses.³ H.B. 66 replaces both the tangible personal property tax and the corporation franchise tax with a new commercial activity tax (the “CAT”). The CAT is a broad-based, low rate tax that applies to virtually all business activity in Ohio with annual gross receipts of \$150,000 or more.

Another important component of this tax reform package is the significant reduction in Ohio’s personal income tax. The top marginal rates, especially when

¹ *Hearing on H.B. 66 Before the Fin. and Appropriations Commt. of the Ohio House of Representatives, 126th Gen. Assembly (March 8, 2005)* (testimony of David W. Johnson, President and CEO, Summitville Tiles, Inc. and Chairman of the Ohio Manufacturers’ Association).

² *Id.* See generally, Bahl, *Taxation & Economic Development: A Blueprint for Reform in Ohio* (1996), 55 (hereinafter *Bahl*).

³ *Bahl*, at p. 54.

combined with local income taxes, likewise provide an impediment to capital formation. Under H.B. 66, Ohio's high personal income tax is reduced 4.2 percent annually for five years. The 21 percent personal income tax reduction is especially important to the thousands of Amici Curiae members who are small business owners, as they essentially pay their business tax through their personal income tax. This reduction was also funded by the CAT.

Amici curiae, The Ohio Manufacturers' Association, Ohio State Medical Association, The Ohio Society of Certified Public Accountants, Ohio Dental Association, Ohio Chemistry Technology Council, and Ohio State Bar Association (collectively "Amici Curiae"), are statewide associations that represent diverse segments of Ohio's economy. Collectively, Amici Curiae represent approximately 75,000 members, virtually all of whom conduct business in Ohio. Despite their diversity, Amici Curiae's nearly 75,000 members have at least two things in common – they are Ohio taxpayers subject to Ohio's CAT, and they are all vitally concerned with reversing Ohio's economic malaise. As CAT taxpayers, they have a critical and substantial interest in ensuring that this tax is applied fairly and equitably. As business persons in Ohio, their economic vitality is inextricably tied to the economic climate of the state.

Additionally, as advisors to taxpayers, members of the Ohio State Bar Association and the Ohio Society of Certified Public Accountants support the tax reform measures because they are clear and simplify compliance, providing lawyers and accountants with a solid foundation to competently represent or render advice to clients.

The decision of the Tenth District Court of Appeals holding that Ohio's CAT is an unconstitutional excise tax when applied to gross receipts on the wholesale or retail

sale of food is important to all businesses in Ohio. Regardless of whether a business supports or opposes the CAT, it is crucial for this Court to address the CAT's application (and any exceptions thereto) sooner rather than later. This Court's resolution of the issue will have far-reaching implications for economic development in Ohio, fairness among business taxpayers, certainty for Ohioans regarding their tax obligations, and stability for recipients of tax dollars so that they can budget and spend appropriately.

STATEMENT OF THE CASE AND FACTS

Amici curiae adopt the Statement of the Case and Facts set forth in the Ohio Tax Commissioner's Memorandum in Support of Jurisdiction.

EXPLANATION OF WHY THIS CASE IS OF PUBLIC AND GREAT GENERAL INTEREST

A. The Court of Appeals' Decision Derailing Ohio's New Business Tax Structure by Creating a Favored Class of Business Taxpayers is of Public and Great General Interest.

Before the General Assembly passed H.B. 66, Ohio's business tax code was widely acknowledged to be outdated, burdensome and anticompetitive. Ohio's former business tax code, with its roots planted in Ohio's economy of the 1930s, was premised on outmoded and outdated assumptions. The

[former] code assumes that Ohio competes with only a few states for the business locations of capital-intensive heavy industry. This is no longer true. The [former] code assumes that Ohio's businesses have little effective competition and can pass along cost increases imposed by our taxes to out-of-state customers. This is no longer true. The [former] tax code assumes that large capital investments will lock a business into its location for a long period of time. This is no longer true.⁴

⁴ *Hearing on H.B. 66 Before the Finance and Financial Inst. Commt. of the Ohio Senate, 126th Gen. Assembly (May 20, 2005)* (testimony of Edward W. Hill, Professor and Distinguished Scholar of Economic Development, Maxine Goodman Levin College of Urban Affairs, Cleveland State University).

As such, Ohio's former business tax code was a relic from Ohio's past – not a gateway to its future.⁵ For decades, Ohio's business tax burden fell disproportionately upon capital-intensive industry segments, such as manufacturing -- which happen to be the same segments that produced some of Ohio's best paying jobs.⁶ For years, Ohio had been losing jobs, particularly in the manufacturing sector. In fact, between 2000 and 2005, Ohio lost more than 207,000 manufacturing jobs.⁷ With this reality as a backdrop, the Taft administration proposed a comprehensive tax reform package that represented a major overhaul of state tax policy.

For more than one hundred years prior to the adoption of H.B. 66, Ohio's tax scheme included a franchise tax based in whole or in part on the net worth of the taxpayer and a tangible personal property tax on businesses in Ohio. The net income base of the corporate franchise tax is a high rate, narrow-base tax. It is riddled with so many loopholes that it is ineffective in generating the stable, predictable revenues required to provide essential government services. The net worth base reduced the return on capital, punishing capital-intensive and start-up businesses. The tangible personal property tax is a tax on most business inventory, machinery, equipment, and

⁵ Hill, *Ohio's Competitive Advantage: Manufacturing Productivity*, (2001) (The Urban Center, Maxine Goodman Levin College of Urban Affairs, Cleveland State University and Supported by The Ohio Manufacturers' Association), at 81.

⁶ In 2005, the year the tax reform bill was adopted, the average annual wages for a manufacturing employee in Ohio was \$48,208. By comparison, the average for a retail worker was \$22, 846. See *Payroll and Contributions by Commercial Sector as Covered Under the Ohio and Federal Unemployment Compensation Laws* (Ohio Dept. of Job and Family Services, Office of Workplace Development), January 25, 2007.

⁷ Wail & Friedhoff, *Bearing the Brunt: Manufacturing Job Loss in the Great Lakes Region, 1995-2005* (The Brookings Inst., Washington, D.C.), July 2006, at Table 2.

furniture and fixtures. The tangible personal property tax not only negatively and disproportionately impacts capital-intensive businesses, such as manufacturing, it actually punishes companies for making the capital investments that are vital to Ohio's ability to stay competitive in the global market. Similarly, the high marginal rates of the personal income tax impede capital formation and investment in small businesses in Ohio.

In addition, each of these taxes is complicated, is expensive to comply with, and is hard to administer.⁸ The many exclusions and exceptions to these taxes also caused the economic impact of these taxes to vary widely across business sectors.

Recognizing that over the past several decades Ohio's business tax code has deterred capital investment and economic growth, the General Assembly sought to change Ohio's tax structure to encourage capital investment and stimulate economic growth in Ohio. The end result was H.B. 66, which was the first re-write of Ohio's tax code in more than 70 years.

H.B. 66's reforms were designed to achieve several important policy objectives, such as:

- **Reducing overall tax rates** – for both businesses and individuals, in an effort to attract and retain talent;
- **Eliminating tax on investment** – thereby spurring innovation, growth and job creation;
- **Broadening the tax base** – to spread the tax burden more equitably among all sectors of the Ohio economy; and
- **Simplifying compliance** – thereby reducing costs to business and to the State.

⁸ *Bahl* at p. 49.

The CAT is a critical component of this comprehensive tax reform package. It is a broad-based, low-rate privilege of doing business in Ohio tax measured by the gross receipts from business activity conducted in Ohio. The rationale underlying the CAT is straightforward: eliminate investment deterrent taxes -- such as the personal property tax on inventory, machinery, equipment, and furniture, the corporate franchise tax, and high personal income tax rates -- and replace them with a broad-based, low-rate, simple tax on the privilege of doing business in Ohio. The CAT applies to every business in Ohio with taxable gross receipts in excess of \$150,000. Businesses with gross receipts of at least \$150,000, but less than \$1 million, pay a fixed minimum tax of \$150 for the year. Those with gross receipts in excess of \$1 million pay the \$150 minimum tax, plus 0.26 percent of gross receipts over \$1 million (once the tax is fully phased in). In short, the CAT was enacted to spread taxes equally and more fairly over all business segments in Ohio.

The CAT replaces the franchise and tangible personal property taxes as the primary tax on businesses in Ohio. It also funds the reduction in personal income tax rates that is so critical to the owners of many businesses. By enacting the CAT, the General Assembly sought to meet Ohio's revenue needs by utilizing a low-rate tax applicable to all persons doing business in Ohio. That is, the General Assembly expanded the base of taxpayers, but imposed the tax at a very low rate.

The Tenth District Court of Appeals' decision derails Ohio's comprehensive tax reform package by reducing the number of taxpayers subject to the broad-based CAT. This decision, which effectively precludes the General Assembly from taxing certain types of businesses, strikes at the heart of the General Assembly's authority to determine

tax policy. It reduces equity among business taxpayers in Ohio by creating a favored class of business taxpayers who will no longer pay any general business tax to support the benefits of government that they receive. Creating exclusions from taxes increases the burden on the rest of the taxpayers who remain subject to the tax; thus, such exclusions are not favored. *Akron Home Medical Services, Inc. v. Lindley* (1986), 25 Ohio St. 3d 107, 495 N.E.2d 417 For these many reasons, this case is one of public and great general interest.

B. Ohio's Commercial Activity Tax Is of Public and Great General Interest Because It Directly Affects Innumerable Persons Doing Business in Ohio.

Because nearly all persons and entities doing business in Ohio are subject to the CAT, it directly affects hundreds of thousands of businesses. The extremely broad application of the CAT to all segments of Ohio's economy – from manufacturing to service providers (such as lawyers, accountants, doctors, and dentists) – makes this a case of great general interest.

The decision of the Tenth District Court of Appeals, holding the CAT unconstitutional as it applies to certain types of businesses, disturbs the delicate balance and intended purpose of H.B. 66. Specifically, if certain businesses or segments of Ohio's economy are no longer required to pay the CAT, the other businesses subject to the CAT will inevitably need to fill the void. To the extent projected revenue from the CAT is not generated because those excluded businesses or segments of Ohio's economy are not required to pay this tax, there will be a shortage of revenue for state and local governments to provide necessary services. One means to generate sufficient revenue to meet the needs of Ohioans will no doubt be to increase the rate of the CAT

(or other taxes) and apply it to all other businesses that are required to pay it. Since the issue before the Court impacts, directly or indirectly, the tax obligations of innumerable persons and entities doing business in Ohio, it is of great general interest.

Not only do persons and entities doing business in Ohio deserve fairness and certainty regarding the tax laws that apply to them, state and local governments need stability in their sources of revenue in order to plan and budget for the provision of essential services. The unanticipated exclusion resulting from the decision of the Tenth District Court of Appeals will negatively impact the ability of local jurisdictions (that previously relied on tangible personal property tax revenues to support their operations) to continue to provide critical government services as the replacement revenue for the lost taxes is diminished. Because the Tenth District Court of Appeals' decision directly impacts Ohio's public fisc and indirectly affects all Ohioans, it is a case of great public interest.

ARGUMENT

Proposition of Law: The CAT is a franchise tax imposed on the privilege of doing business in the State of Ohio, not a transactional excise tax and, therefore, does not violate Article XII, Sections 3(C) and 13 of the Ohio Constitution as applied to retailers and wholesalers of food."12

In addressing the legal arguments in the context of whether to accept this case, Amici Curiae urge the Court to consider the purpose and intent of the CAT. Under the plain language of R.C. 5751.02, the CAT is a tax on the privilege of doing business in Ohio and not a transactional tax:

(A) For the purpose of funding the needs of this state and its local governments beginning with the tax period that commences July 1, 2005, and continuing for every tax period thereafter, there is hereby levied a commercial activity tax on each person with taxable gross income receipts

for the privilege of doing business in this state. * * * The tax imposed under this section is **not a transactional tax.** . . (Emphasis added).

Historically, taxes levied by states for the privilege of doing business are considered franchise taxes. Ohio's corporation franchise tax, which is being phased out and replaced by the CAT, is a classic example of a tax on the privilege of doing business in Ohio, and not on the underlying assets that provide the measure of the tax. *Bank One Dayton, N.A. v. Limbach* (1990), 50 Ohio St. 3d 163, 553 N.E.2d 624, rehearing denied 51 Ohio St. 3d 710, 555 N.E. 2d 647; *Gulf Oil Corp. v. Lindley* (1980), 61 Ohio St. 3d 23, 398 N.E.2d 790; *Aluminum Co. of America v. Evatt* (1942), 140 Ohio St. 385, 45 N.E. 2d 118; *Southern Gum Co. v. Laylin* (1902), 66 Ohio St. 578, 64 N.E. 564. During the many years that the corporation franchise tax has been in existence, it has historically applied to food retailers and wholesalers. Like other businesses, food retailers and wholesalers paid an annual tax imposed upon the privilege of doing business in Ohio. Like other businesses, food retailers and wholesalers computed the tax based upon income generated by their sales of food and food products.

By adopting R.C. 5751.02, the General Assembly not only expressly stated that the CAT is an annual tax on the privilege of doing business, the General Assembly replaced Ohio's primary business taxes, the corporate franchise and tangible personal property taxes, with the CAT. Once the CAT is fully implemented and the corporation franchise tax completely phased out, tax revenue previously generated by the corporate franchise tax and the tangible personal property tax will be generated through the CAT.⁹

The CAT is without question a critical component in Ohio's comprehensive tax reform package. By adopting H.B. 66, the General Assembly was concerned about the

⁹ As a curb on state government spending, the CAT was designed to produce less revenue than that produced by the franchise and personal property taxes.

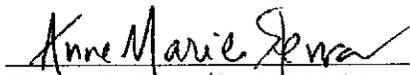
historically inequitable tax burden levied on capital-intensive businesses in Ohio and desired to create a more equitable tax structure that encouraged investment and innovation. The General Assembly was also cognizant of the Ohio Constitution's prohibition on excise taxes as applied to retailers and wholesalers of food. After much deliberation, the General Assembly carefully crafted a general tax structure designed to make Ohio more competitive by encouraging investment and innovation, but without levying a tax on transactions involving any particular goods or services.

When the corporate franchise tax and the tangible personal property tax are completely eliminated (in 2010 and 2009, respectively), and with the personal income tax rates reduced, the CAT will be the primary source of business tax revenue (excluding real estate taxes) for Ohio. If the decision of the Tenth District Court of Appeals stands as the law of Ohio, food retailers and wholesalers will effectively become a favored class of business taxpayers, exempt from paying for the privilege of doing business in Ohio, separate and apart from the rest of the Ohio business taxpayers.

CONCLUSION

The impact of the Tenth District's decision extends well beyond the parties to this appeal. Countless Ohio business taxpayers and the recipients of their tax dollars will also be affected by the Tenth District Court of Appeal's decision. This Court should accept this appeal and provide certainty regarding Ohio's new tax law to all Ohioans.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing MEMORANDUM IN SUPPORT OF JURISDICTION OF AMICI CURIAE was sent via regular U.S. mail, postage prepaid this 17~~th~~ day of October 2008, to the following:

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