

IN THE SUPREME COURT OF OHIO

OHIO GROCERS ASSOCIATION, et al., : Case No. 08-2018
: :
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. :

**MERIT BRIEF OF AMICI CURIAE,
THE OHIO MANUFACTURERS' ASSOCIATION,
OHIO STATE MEDICAL ASSOCIATION,
THE OHIO SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS,
OHIO DENTAL ASSOCIATION, AND
OHIO CHEMISTRY TECHNOLOGY COUNCIL
IN SUPPORT OF APPELLANT**

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TABLE OF CONTENTS

	<u>Page</u>	
TABLE OF CONTENTS.....	i	
TABLE OF AUTHORITIES	ii	
STATEMENT OF INTEREST OF AMICI CURIAE.....	1	
STATEMENT OF THE CASE AND FACTS	3	
ARGUMENT.....	3	
 Proposition of Law:		
The Commercial Activity Tax is a franchise tax imposed on the privilege of doing business in the State of Ohio. It is not a transactional excise tax on sales and, therefore, does not violate Article XII, Sections 3(C) and 13 of the Ohio Constitution as applied to retailers and wholesalers of food.		3
A. The Background and Purpose of Ohio’s Commercial Activity Tax.....	3	
B. The Court of Appeals Wrongly Concluded that the CAT is a Tax Imposed upon Individual Sales Transactions, Rather than a Franchise Tax Imposed upon the Privilege of Doing Business in Ohio.....	7	
1. The plain language of the CAT provides that it is a tax on the privilege of doing business in Ohio, and is not a transactional tax.....	8	
2. This Court has consistently recognized that the franchise tax is an excise tax imposed upon the privilege of doing business in Ohio, and not on the property or individual transactions that serve as the measure of the tax.	10	
3. The strong presumption of constitutionality has not been overcome.....	13	
4. There is no justification for creating a favored class of taxpayers who will no longer pay any general business tax in Ohio.	16	
CONCLUSION.....	18	
CERTIFICATE OF SERVICE	19	

TABLE OF AUTHORITIES

Page

CASES

<i>Akron Home Med. Servs., Inc. v. Lindley</i> (1986), 25 Ohio St.3d 107, 495 N.E.2d 417	16
<i>Arbino v. Johnson & Johnson</i> , 116 Ohio St.3d 468, 2007-Ohio-6948, 80 N.E.2d 420.....	13
<i>Banc One Dayton, N.A. v. Limbach</i> (1990), 50 Ohio St.3d 163, 553 N.E.2d 624.....	11
<i>East Ohio Gas Co. v. Limbach</i> (1986), 26 Ohio St.3d 63, 498 N.E.2d 453	11, 15, 16
<i>In re Nowak</i> , 104 Ohio St.3d 466, 2004-Ohio-6777, 820 N.E.2d 335	13
<i>Mutual Holding Company v. Limbach</i> (1994), 71 Ohio St.3d 59, 641 N.E.2d 1080	11
<i>Ohio Grocers Assn. v. Wilkins</i> , 178 Ohio App.3d 145, 2008-Ohio-4420, 897 N.E.2d 188	7
<i>Rio Indal, Inc. v. Lindley</i> (1980), 62 Ohio St.2d 283, 405 N.E.2d 291	9, 10
<i>So. Gum Co. v. Laylin</i> (1902), 66 Ohio St. 578, 64 N.E. 564.....	10
<i>State ex rel. Dickman v. Defenbacher</i> (1955), 164 Ohio St. 142, 57 O.O. 134, 128 N.E.2d 59	13
<i>State ex rel. Swetland v. Kinney</i> (1982), 69 Ohio St.2d 567, 433 N.E.2d 217	13
<i>State ex rel. Forchheimer v. LeBlond</i> (1923), 108 Ohio St. 41, 140 N.E. 491, 1 Ohio L. Abs. 435.....	14
<i>Wheeling Steel Corp. v. Porterfield</i> (1970), 21 Ohio St.2d 57, 255 N.E.2d 257.....	10

STATUTES

R.C. 5725.18	11
R.C. 5725.25	11
R.C. 5727.30	11
R.C. 5727.38	11
R.C. 5733.01(A).....	9
R.C. 5739.02	8
R.C. 5751.02	9

R.C. 5751.02(A)..... 10, 13

R.C. Chapter 5733..... 9, 11

R.C. Chapter 5751..... 14, 16

R.C. Chapter 5753..... 8

OHIO CONSTITUTION

Article XII, Section 13 8, 9, 13, 14

Article XII, Sections 3(C)..... passim

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 combined with local income taxes, likewise provide an impediment to capital formation. Under H.B. 66, Ohio’s high

¹ *H.B. 66 Biennial Budget: Hearing 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) (attached as Exhibit A).

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

³ *Bahl*, at 54.

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, and Ohio Chemistry Technology Council (collectively "Amici Curiae"), are statewide associations that represent diverse segments of Ohio's economy. Collectively, Amici Curiae represent approximately 51,000 members, virtually all of whom conduct business in Ohio. Despite their diversity, Amici Curiae's 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.

The decision of the Tenth District Court of Appeals holding that Ohio's CAT is an unconstitutional excise tax when applied to gross receipts that include receipts from the wholesale or retail sale of food is important to all businesses in Ohio. The decision is wrong because it mischaracterizes the CAT as a tax on individual transactions, contrary to 100 years of consistent case law from this Court. 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 Merit Brief.

ARGUMENT

Proposition of Law:

The Commercial Activity Tax is a franchise tax imposed on the privilege of doing business in the State of Ohio. It is not a transactional excise tax on sales and, therefore, does not violate Article XII, Sections 3(C) and 13 of the Ohio Constitution as applied to retailers and wholesalers of food.

A. The Background and Purpose of Ohio's Commercial Activity Tax

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

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

⁴ *H.B. 66 Biennial Budget: Hearing 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) (attached as Exhibit B).

⁵ Edward W. Hill, *Ohio's Competitive Advantage: Manufacturing Productivity 81* (The Urban Center, Levin College of Urban Affairs, Cleveland State University and Supported by The Ohio Manufacturers' Association 2001); http://www.urban.csuohio.edu/faculty/ned-hill/site/pubs/tpc_economic_development.htm.

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 corporation 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 corporation 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, 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.

⁶ In 2005, the year the tax reform bill was adopted, the average annual pay for a manufacturing employee in Ohio was \$48,208. By comparison, the average annual pay for a retail worker was \$22,846. See Ohio Dept. of Job and Family Servs. Office of Workforce Dev., Payroll and Contributions by Commercial Sector as Covered Under the Ohio and Federal Unemployment Compensation Laws (Jan. 25, 2007) (attached as Exhibit C).

⁷ Howard Wial & Alec Friedhoff, Bearing the Brunt: Manufacturing Job Loss in the Great Lakes Region, 1995-2005, Table 2 (The Brookings Inst., July 2006); http://www.brookings.edu/reports/2006/07useconomics_wial.aspx.

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. Indeed, as advisors to taxpayers, members of The Ohio Society of Certified Public Accountants support the tax reform measures at issue in this case because, unlike the previous taxing measures, the CAT is clear and simplifies compliance, providing accountants with a solid foundation to render advice competently to clients.

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.

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, furniture, and fixtures, the corporation franchise tax, and high personal income tax

⁸ *Bahl*, at 49.

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 corporation 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.

Early reports about the success of the tax reform are encouraging. Numerous businesses, including Whirlpool Corporation, Dover Chemical, Amylin Pharmaceuticals, and Polymer Packaging, Inc., all based decisions to locate or expand in Ohio in part on Ohio's tax reform efforts. Ohio Business Roundtable, *Ohio Tax Reform: Year 2 in Review*, at 6, 8, 10 (2008)⁹; Tax Reform at Work: Just a Few Examples, *Retooling Ohio* (Ohio Mfrs' Assn), Vol. 5 (2008), at 2¹⁰.

And, for the third year in a row since the enactment of the sweeping tax reform, *Site Selection Magazine* has awarded Ohio the Governor's Cup for the most new and expanded large-

⁹ http://www.ohiomeansbusiness.com/year2tax_report/obr_taxreport_year2.pdf

¹⁰ <http://www.ohiomfg.com/AM/Template.cfm?Section=Search1§ion=200850&template=/CM/ContentDisplay.cfm&ContentFileID=8237>

scale capital projects. Mark Arend, Eyes on the Prize, Site Selection Magazine, March-April 2009, at 160-173.¹¹ One major criterion for the award is the tax environment of the state.

A recently-released report concluded that Ohio's tax burden on businesses, determined as a percentage of profit, or ability to pay, was fourth lowest in the country in 2008. Caroline M. Sallee & Patrick L. Anderson, 2008 State Business Tax Burden Rankings (Anderson Economic Group 2009).¹² That same report concluded that the tax burden on Ohio business as both a share of personal income and as a share of private gross state product, was fourth and 18th, respectively.¹³

Clearly, the stated purpose of tax reform—to equalize and reduce Ohio's business tax burden in order to make Ohio more attractive to business investment—is working.

B. The Court of Appeals Wrongly Concluded that the CAT is a Tax Imposed upon Individual Sales Transactions, Rather than a Franchise Tax Imposed upon the Privilege of Doing Business in Ohio.

In its decision, the Court of Appeals acknowledged that the CAT is imposed upon the privilege of doing business in Ohio, as set forth in the plain language of the statute creating the CAT. *Ohio Grocers Assn. v. Wilkins*, 178 Ohio App.3d 145, 2008-Ohio-4420, 897 N.E.2d 188, ¶16. But, it then inexplicably turned a blind eye to over 100 years of consistent case law from this Court that recognizes that a franchise tax is imposed upon the privilege of doing business and is not a tax imposed upon the underlying property or transactions that make up the measure of the tax, and concluded that the CAT was in fact a tax imposed upon individual sales

¹¹ <http://www.siteselection.com/issues/2009/mar/Cover/>

¹² <http://www.andersoneconomicgroup.com/Publications/Detail/tabid/125/articleType/ArticleView/articleID/7832/2008-State-Business-Tax-Burden-Rankings-3rd-Annual-Report.aspx>

¹³ In 2005, before tax reform was implemented, Ohio's overall tax burden was the 27th highest or 23rd lowest. By 2007, its position had improved to the 12th lowest. See Ohio Business Roundtable, Ohio Tax Reform: Year 2 in Review, at 14-15 (2008).

transactions. As a result of this mistake, the Court of Appeals erroneously held that the CAT violated Sections 3(C) and 13 of Article XII of the Ohio Constitution. Although the Court of Appeals recognized the strong presumption of constitutionality afforded to all statutes, it did not articulate how this strong presumption was overcome in this case. The Court of Appeals' decision and holding are erroneous and must be reversed.

1. The plain language of the CAT provides that it is a tax on the privilege of doing business in Ohio, and is not a transactional tax.

Section 3, Article XII of the Ohio Constitution provides in part:

Laws may be passed providing for:

* * *

(C) Excise and franchise taxes and for the imposition of taxes upon the production of coal, oil, gas, and other minerals; except that no excise tax shall be levied or collected upon the sale or purchase of food for human consumption off the premises where sold.

Section 13, Article XII of the Ohio Constitution provides:

No sales or other excise taxes shall be levied or collected (1) upon any wholesale sale or wholesale purchase of food for human consumption, its ingredients or its packaging; (2) upon any sale or purchase of such items sold to or purchased by a manufacturer, processor, packager, distributor or reseller of food for human consumption, or its ingredients, for use in its trade or business; or (3) in any retail transaction, on any packaging that contains food for human consumption on or off the premises where sold. For purposes of this section, food for human consumption shall include non-alcoholic beverages. This section shall not affect the extent to which the levy or collection of sales or other excise taxes on the retail sale or retail purchase of food for human consumption is permitted or prohibited by Section 3(C) of this Article.

An excise tax is a tax on a privilege. By the plain language of these provisions, excise taxes may not be imposed upon the sale or purchase, whether at wholesale or retail, of (i) food itself; (ii) processing equipment for food; or (iii) packaging for food for human consumption.

An excise tax that is imposed upon the privilege of making sales or purchases is a sales tax. For example, R.C. 5739.02 provides that "an excise tax is hereby levied on each retail sale

made in this state.” The former soft drink tax imposed under R.C. Chapter 5753, likewise, was an excise tax that applied to wholesale sales of soft drink syrup and beverages. These are precisely the type of excise tax that is proscribed by Section 3(C) and Section 13 of Article XII. The key question to be answered, then, is this: What is the privilege that is being taxed?

With respect to the CAT, the plain language of R.C. 5751.02 provides the CAT is a tax on the privilege of doing business in Ohio over a specified period of time, and is not a transactional tax on the privilege of making sales or purchases:

(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** * * * The tax imposed by this section **is an annual privilege tax** for the calendar year that, in the case of calendar year taxpayers, is the annual tax period and, in the case of calendar quarter taxpayers, contains all quarterly tax periods in the calendar year. (Emphasis added).

This language is similar to that used for the corporation franchise tax. Specifically, the corporation franchise tax set forth in R.C. 5733.01(A) provides that the tax imposed by Chapter 5733 is imposed on each corporation “for the privilege of exercising its franchise.” R.C. 5733.01(A). The nature of the corporation franchise tax was clearly and succinctly explained by this Court in the second paragraph to the syllabus in *Rio Indal, Inc. v. Lindley* (1980), 62 Ohio St.2d 283, 285, 405 N.E.2d 291:

The Ohio corporate franchise tax is a privilege tax. It is not a tax on corporate income, sales, or receipts, but rather is a tax on the privilege of doing business in Ohio. Its purpose is to tax the fair value of business done in Ohio. Accordingly, it is based on the proportion of a corporation’s business done in Ohio to the total of its business done everywhere. [citation omitted] To the extent that a corporation exercises its corporate privilege in Ohio, it must pay the franchise tax.

Under the description articulated in *Rio Indal*, the CAT is a franchise tax. R.C. 5751.02(A) provides that the CAT is imposed upon the privilege of doing business for a stated

period of time. To the extent a taxpayer engages in commercial activity in Ohio, it is subject to this tax.

As set forth above, the new CAT franchise tax is designed, in part, to replace Ohio's corporation franchise tax. The plain language creating the CAT should be read with this in mind. As discussed below, the CAT is a franchise tax in operation as well. It is not a sales tax.

2. **This Court has consistently recognized that the franchise tax is an excise tax imposed upon the privilege of doing business in Ohio, and not on the property or individual transactions that serve as the measure of the tax.**

For over one hundred years, this Court has recognized that the corporation franchise tax is an excise tax imposed upon the privilege of doing business in Ohio, and not on the property or transactions that serve as the measure of the tax. As far back as 1902, this Court rejected the notion that the franchise tax was a tax on the underlying property of the corporation when the Court stated the tax "is not a property tax on property owned by the corporation, but is an excise tax the amount of which is fixed and measured by the amount of subscribed or issued and outstanding capital stock." *So. Gum Co. v. Laylin* (1902), 66 Ohio St. 578, 596, 64 N.E. 564.

Seventy years later this Court reiterated its position regarding the franchise tax in *Wheeling Steel Corp. v. Porterfield* (1970), 21 Ohio St.2d 57, 60-61, 255 N.E.2d 257: "The statutory Ohio franchise tax * * * is purely a privilege tax and not a tax on income, sales or receipts. It is laid upon the privilege of doing business in Ohio for the current annual period, measured by the value of Ohio business done in proportion to the total business done within and without Ohio."

In *Banc One Dayton, N.A. v. Limbach* (1990), 50 Ohio St.3d 163, 553 N.E.2d 624, this Court again rejected the notion that the franchise tax was a tax imposed upon the underlying property that served as the measure of the tax. In that case, the taxpayers argued that the

franchise tax imposed upon financial institutions was actually a tax on their property. The court concluded that in operation and effect, the tax was indeed a franchise tax imposed upon the privilege of doing business in Ohio.

The matter of the nature of a franchise tax has been described in a similar manner in the context of two other Ohio franchise taxes. In *Mutual Holding Company v. Limbach* (1994), 71 Ohio St.3d 59, 641 N.E.2d 1080 (Moyer, C.J.), the taxpayer was an insurance company subject to the annual franchise tax imposed on the privilege of being a domestic insurance company pursuant to R.C. 5725.18. Its wholly-owned noninsurance subsidiary was subjected to the corporation franchise tax imposed by R.C. Chapter 5733. R.C. 5725.25 provided that the tax imposed upon insurance companies under R.C. 5725.18 was “in lieu of” all taxes on the property of the insurance company. The taxpayer argued that this provision prohibited the imposition of the corporation franchise tax on its noninsurance subsidiary. The Court rejected this position. It recognized that a franchise tax, such as that imposed by R.C. 5725.18, was a tax on the privilege of doing business as an insurance company, and not a tax on the property of the entity paying the tax. “Measuring tax liability in terms of net worth does not convert a franchise tax into a property tax. [Citation omitted.] R.C. 5725.18 is a franchise tax measured by net worth, not a tax on net worth.” 71 Ohio St.3d at 60 (emphasis added).

In *East Ohio Gas Co. v. Limbach* (1986), 26 Ohio St.3d 63, 498 N.E.2d 453, the taxpayer was a natural gas company subject to the public utility excise tax imposed under R.C. 5727.30 and R.C. 5727.38 on the privilege of owning property or doing business in Ohio. During the taxable year the General Assembly passed legislation that increased the tax rate and applied the increase to the current open tax year. *Id.* at 65. The taxpayer claimed that the rate could not be changed during the current taxable year on the basis that it was an impermissible retroactive tax

increase on individual transactions. *Id.* at 66. In rejecting this argument, this Court characterized the flaw in the taxpayer's argument as follows:

The linchpin of appellant's argument is its claim that the excise tax on its gross receipts is a transactional tax comparable in nature to a sales tax, calculable with certainty as each dollar is received. Thus, appellant contends, the General Assembly is estopped from increasing its tax liability for the period prior to the effective date of Am. Sub. H.B. No. 100.

Appellant mischaracterizes the nature of the tax imposed upon it pursuant to R.C. 5727.38. It is not a tax on daily transactions. Rather, R.C. 5727.38 stated in relevant part that this is an annual excise tax, calculated at the conclusion of the utility's tax year, based upon gross receipts from an annual period:

* * * *

This court has previously stated that the excise tax on public utilities is a tax on a privilege—the privilege of doing business in this state. [citation omitted] The critical legal distinction which appellant ignores is that the tax is not imposed on gross receipts as they are received. Annual gross receipts are merely the measure of the tax on the privilege. [citation omitted].

East Ohio Gas, 26 Ohio St.3d at 66-67.

Thus, while a franchise tax is in fact an excise tax, it is an excise tax imposed upon the privilege of doing business in Ohio. It is not a tax on underlying receipts, or sales, income, or property. Those items merely serve variously as the measure of the tax. And, a franchise tax is a tax calculated at the conclusion of the taxable period, based upon the entire measure for that period. It is very different from a sales tax, which is an excise tax that is imposed upon individual sales transactions.

In form and in substance, the CAT is a franchise tax. Like the corporation franchise tax and the public utility gross receipts tax, it is imposed for the privilege of doing business in Ohio. Like the corporation franchise tax and the public utility gross receipts tax, it is imposed for exercising that privilege over a prescribed period of time. Like the corporation franchise tax and the public utilities gross receipts tax, it is calculated upon some aggregate measure of activity.

Like the corporation franchise tax and the public utilities gross receipts tax, it is not a tax on individual sales. *See generally*, R.C. 5751.02(A).¹⁴

3. The strong presumption of constitutionality has not been overcome.

In determining whether the CAT runs afoul of Sections 3(C) and 13 of Article XII, there is a strong presumption favoring the statutes' constitutionality. *State ex rel. Swetland v. Kinney* (1982), 69 Ohio St.2d 567, 575, 433 N.E.2d 217. Before the statutes can be declared unconstitutional, "it must appear beyond a reasonable doubt that the legislation and constitutional provisions are clearly incompatible." *Arbino v. Johnson & Johnson*, 116 Ohio St.3d 468, 2007-Ohio-6948, 80 N.E.2d 420, ¶25 (quoting *State ex rel. Dickman v. Defenbacher* (1955), 164 Ohio St. 142, 57 O.O. 134, 128 N.E.2d 59, paragraph one of the syllabus).

The CAT was enacted as part of a comprehensive reform of Ohio's major business taxes. It is well-established that the Ohio judiciary must afford the Ohio General Assembly "great latitude" when the General Assembly is "enacting comprehensive legislation" or when exercising its own powers. *In re Nowak*, 104 Ohio St.3d 466, 2004-Ohio-6777, 820 N.E.2d 335, ¶43. "The basis of that principle lies in the separation of the powers of government into three branches, and the duty of each of the branches not to encroach upon the essential prerogatives of the others." *State ex rel. Forchheimer v. LeBlond* (1923), 108 Ohio St. 41, 49, 140 N.E. 491, 1 Ohio L. Abs. 435. Thus, the judiciary must afford deference to other branches of government, specifically the General Assembly and any legislative enactments it may compose.

¹⁴ Interestingly, no reported case has been found in which the sellers of (1) food consumed off the premises where sold, (2) equipment used in the processing of food, or (3) packaging for food, contested their obligation to include income from such sales in the calculation of their corporation franchise tax liability. Thus, prior to the enactment of H.B. 66, Appellees understood the difference between an excise tax on individual transactions and a corporation franchise tax that included proceeds from such transactions in the tax base, and paid the corporation franchise tax.

In this case, the Court of Appeals failed in to make any effort to reconcile the provisions of R.C. Chapter 5751 with Sections 3(C) and 13 of Article XII. It failed to give due deference to the actions of the General Assembly in addressing the tax and economic policies of this State. And, quite simply, it failed to articulate how the presumption of validity was overcome.

Sections 3(C) and 13 of Article XII prohibit the imposition of excise taxes upon sales and purchases of food consumed off the premises where sold, wholesale transactions of food, food processing equipment, and packaging for food. Quite clearly, they prevent the imposition of sales and use taxes directly on those individual transactions. The sections do not, however, operate to preclude the imposition of a franchise tax on the privilege of doing business where the tax is measured in part from gross receipts derived from commercial activity involving food, processing equipment and packaging.

The first sentence of Section 3(C) mentions both excise and franchise taxes. The proscription against taxes on the sale and purchase of food for consumption off the premises where sold applies only to excise taxes imposed directly on those sales. Similarly, the prohibitions contained in Section 13 apply to excise taxes on the sale and purchase of the enumerated items. A franchise tax is indeed a form of excise tax, but it is not an excise tax imposed upon sales. Moreover, Section 3(C) and Section 13 clearly distinguish franchise taxes from other excise taxes directly imposed upon the sales of food and related items. The fact that franchise taxes are separately specified and are not among the prohibited taxes must be given effect; otherwise, their inclusion in the first sentence of Section 3(C) is meaningless.

Moreover, including gross receipts in the base upon which the CAT is measured can be easily harmonized with the terms of Section 3(C) and Section 13 by holding fast to what this Court has consistently recognized for over 100 years: A franchise tax is a tax imposed upon the

privilege of doing business. It is not a tax imposed upon property, income, sales, or gross receipts.

The Court of Appeals' decision is flawed because it failed to recognize these two fundamental principles. Citing absolutely no contrary authority, the Court of Appeals ignored 100 years of settled Ohio tax law. Based solely on the fact that gross receipts served as the measure of the tax, it erroneously concluded the CAT was a transaction tax, like a sales tax. There simply is no basis in fact, or in law, for this conclusion.

Notably, the Court of Appeals made absolutely no effort to address the case most directly on point—*East Ohio Gas Co. v. Limbach* (1986), 26 Ohio St.3d 63, 498 N.E.2d 453—nor to reconcile that case's holding with the Court of Appeals' decision. Like the present case, *East Ohio Gas* involved a franchise tax imposed upon the privilege of doing business. *Id.* at 66. Like the present case, *East Ohio Gas* involved a franchise tax measured by the gross receipts from business done during the measurement period. *Id.* at 67. Like the present case, the *East Ohio Gas* taxpayer argued that a franchise tax measured by gross receipts was really a transaction tax on individual sales. *Id.* at 66. Like the present case, the *East Ohio Gas* taxpayer's argument was premised upon a fundamental misunderstanding of the nature of a franchise tax. In *East Ohio Gas*, this Court had no difficulty rejecting the taxpayer's argument. *Id.* at 66-68. Given the similarities, this Court should have no difficulty reaching a similar result in this case.

The decision below is directly contrary to the decision of this Court in *East Ohio Gas Co. v. Limbach*. The settled law regarding the nature of a franchise tax easily squares the provisions of Section 3(C) and Section 13 of Article XII and R.C. Chapter 5751.

4. There is no justification for creating a favored class of taxpayers who will no longer pay any general business tax in Ohio.

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 Med. Servs., Inc. v. Lindley* (1986), 25 Ohio St.3d 107, 108, 495 N.E.2d 417.

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 favored businesses or segments of Ohio's economy are no longer required to pay the CAT, the many 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. This result, which creates a favored class of business taxpayers, is completely contrary to the intent and purpose of the CAT.

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.

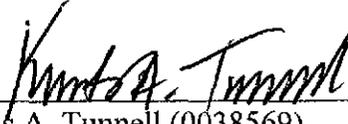
The CAT is without question a critical component in Ohio's comprehensive tax reform package. By adopting H.B. 66, the General Assembly was concerned about the historically inequitable tax burden levied on capital-intensive businesses in Ohio and desired to create a more equitable tax structure that encouraged 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 corporation 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. For years they paid the corporation franchise tax for the privilege of doing business in Ohio based in part on income derived from sales of food. There is no reason for them not to pay the CAT for that same privilege. Appellees' arguments to the contrary should be rejected, and the decision of the Tenth District Court of Appeals must be reversed.

CONCLUSION

The CAT is a franchise tax imposed upon the privilege of doing business in Ohio. While *measured* by gross receipts, it is not a tax *on* those receipts, nor is it a tax on the transactions giving rise to those receipts. Sections 3(C) and Section 13 of Article XII prohibit the imposition of excise taxes on the sale or purchase of listed items. By their very terms, they do not apply to franchise taxes. Therefore, the fact the CAT includes within its measure, gross receipts from sales of food and related items does not violate these two sections. The decision of the Court of Appeals to the contrary is unlawful and must be reversed.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing MERIT BRIEF OF AMICI CURIAE IN SUPPORT OF APPELLANT was sent via regular U.S. mail, postage prepaid this 3rd day of April 2009, to the following:

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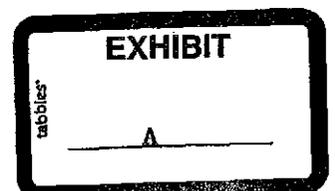
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**BEFORE THE FINANCE & APPROPRIATIONS COMMITTEE
OF THE
OHIO HOUSE OF REPRESENTATIVES**

CHARLES CALVERT, CHAIR

**TESTIMONY
OF
DAVID W. JOHNSON
PRESIDENT AND CEO, SUMMITVILLE TILES, INC.
&
CHAIRMAN, THE OHIO MANUFACTURERS' ASSOCIATION**

MARCH 8, 2005



Chairman Calvert . . . members of the House Finance & Appropriations Committee . . . Good afternoon. And thank you for the opportunity to testify today.

My name is David Johnson. I am President and CEO of Summitville Tiles, Inc. in Columbiana County. Summitville Tiles is a 93-year-old, family-owned ceramic tile and brick manufacturer located in northeast Ohio . . . and is one of the last remaining such manufacturers in the United States thanks to low-cost foreign imports and the high costs of manufacturing in America.

Our products can be found everywhere from the roof deck of the White House to the floors of McDonald's restaurants worldwide.

Despite the debilitating effects of imports on the U.S. ceramic tile business, the quality of our product are such that today we are exporting millions of square feet of tiles to China of all places.

I also serve as Chairman of The Ohio Manufacturers' Association. As you may know, the OMA is Ohio's leading public policy advocacy organization strictly for manufacturing. The OMA, which is the voice of the manufacturing industry at the state house, represents approximately 2,000 Ohio manufacturers ranging in size from small- to medium-sized companies all the way up to the state's largest manufacturers.

Representing these perspectives, I am here today to testify in support of House Bill 1 and Governor Taft's tax reform proposal.

Let me say at the start: I believe the tax reforms outlined in House Bill 1 will do more to create and protect jobs . . . and to spur investment and economic growth in Ohio . . . than any single public policy action in the last several decades.

Legislative testimony often contains "doom and gloom" warnings of this potential loss, or that potential risk. I certainly am concerned about the future of manufacturing . . . and the future of our state. But the scenario I want to paint for you today begins with a look backward in time, not forward.

The cold, hard reality is that Ohio has lost more than 200,000 manufacturing jobs in the last five years. That's about 20 percent of the total manufacturing jobs in the state. This job loss has hit companies large and small all across Ohio, in every corner of the state.

During this time frame, my own company . . . that for years upon years had prided itself on never having a layoff . . . had to close two of its four manufacturing facilities, close eleven distribution centers, and lay off some 450 employees. Talk about *feeling* pain!

Job loss of the magnitude that has hit Ohio's manufacturing sector, in particular, has affected the state, its citizens, its communities, and its tax base in a very palpable way.

Yet, manufacturing still generates about 25 percent of Ohio's Gross State Product – far more than any other sector of the economy. According to a Cleveland State University economist, Ohio's manufacturing workers contribute 68 percent more, per worker, to the Gross State Product than non-manufacturing workers.

So, a 20 percent job loss in manufacturing represents a major blow to the state's economic output, income growth, and consumer buying power . . . with negative effects that cascade down through all layers of our interconnected economy.

Let me be clear: State tax policy is not the only reason for the loss of 200,000 manufacturing jobs . . . but it is a big reason, with its huge negative impact on investment and productivity.

More importantly, it's one factor we have the ability to do something about . . . if we choose.

Simply tinkering at the edges of Ohio's antiquated business tax system will not fix the problem. Instead, we need a bold overhaul of the philosophy, the structure and the imposition of business taxation.

The tax reforms outlined in House Bill 1 will give us exactly that.

Now, does every single manufacturer in the state think the proposed tax changes are a good idea? No. But I can tell you this: The vast majority of our member companies will benefit from long-awaited relief on the oppressive tax deterrents to capital investment.

For that reason, and because we believe the proposed tax reforms clearly are good for Ohio . . . and in the best interests of the state's broad and diverse economy . . . the OMA Board of Directors unanimously endorses the tax reform proposal in House Bill 1.

We are grateful to Governor Taft for his courage and leadership in tackling head-on a challenge that has defied reform efforts for years. And we appreciate the commitment of Speaker Husted to make tax reform a legislative priority this session.

We understand that the debilitating impact of Ohio's current tax structure on investment and job creation did not happen intentionally or maliciously. We are being hindered by a decades-old system that is the by-product of a dramatically different world and time.

But the fact remains, the system is outdated – and a liability.

Every major study of Ohio's tax system in the last 40 years has noted the anti-competitive nature of the tangible personal property tax . . . and has called for adjustments or elimination of the tax.

The current tax system kills jobs and hinders economic growth in two major ways:

First, it discourages companies from making the capital investments in machinery and equipment that are needed to improve productivity and enhance competitiveness . . . which in turn are key factors in attracting, creating and retaining good jobs.

Second, it is structured in a way that results in manufacturers shouldering a disproportionately large share of the business tax burden in our state.

Let me comment in more detail on each of these two problems.

In the world of manufacturing, the keys to staying competitive in tough domestic and foreign markets are innovation and productivity. To become more efficient and more productive, we must continually invest in state-of-the-art machinery, equipment and technology.

Unfortunately, at a time when other states . . . and countries like China . . . are doing everything they can to protect and attract manufacturing jobs, Ohio's archaic tax system punishes companies for making the capital investments we need to stay competitive. This is particularly true for Ohio's tangible personal property tax on machines and equipment. Instead of promoting investment in the tools our workers need to be efficient and productive, our state tax policy discourages those investments by increasing our tax burden whenever we buy a new machine or piece of equipment.

As illogical as it sounds, Ohio actually taxes the tools our workers need to compete.

Ohio's tax code hinders manufacturing investment in other ways. Corporate franchise tax rates in Ohio are higher than those of neighboring states, which means less money available for capital investments . . . and also discourages companies that might otherwise consider Ohio as a place to locate new operations and new jobs.

And, for smaller manufacturers especially, Ohio's high personal income tax rates make it more difficult to invest in new machinery and equipment.

Bear in mind, most of Ohio's small- to mid-sized private companies . . . which employ most of the people in the state . . . are sub-chapter S corporations. This means that the shareholders of these corporations pay taxes on the earnings of the corporation as they would their personal income . . . even though such earnings are not necessarily distributed out to the shareholders.

In essence, sub-chapter S shareholders are paying taxes on the working capital of their respective companies.

That's why the reduction in personal income taxes, as proposed in House Bill 1, is so critical.

There are some people who say Ohio workers can't compete in the global economy. But I'm here to tell you that is patently untrue.

Ohio's manufacturing workers can compete with workers from anywhere in their world if they're given the tools to do the job. Right now, however, we are running in a hotly contested global race for jobs and economic security . . . handicapped by a state tax policy that is as helpful as a pair of lead shoes.

In the case of Summitville Tiles, we are more than just running a foot race to compete; we are waging a titanic battle for *survival*.

As one of the last producers of ceramic tile left in America, we recognize that the only way for us to survive is to invest in new technology to improve our productivity and to lower our costs of operation. Just this past year, we have invested over a million dollars in doing just this. We ought not be penalized for making such a vital investment . . . but that is exactly what Ohio's tangible personal property tax does. These are the kinds of investments, after all, that save companies, save jobs, and ultimately save Ohio's tax base.

Manufacturing is a highly capital-intensive business. So manufacturers feel the brunt of the negative impact of the Ohio's tangible personal property tax. In fact, for decades, manufacturers have shouldered a disproportionately large share of the Ohio's business tax burden.

I refer you to the table entitled "State and Local Taxes," which is attached to your printed copy of my testimony. This table graphically and dramatically illustrates the inequity of the state and local tax burden as allocated among different business sectors in Ohio. If you consider the combined amount the tangible personal property tax and corporate franchise tax . . . as a percentage of contribution to Gross State Product . . . you'll find that manufacturers pay a disproportionately higher share of Ohio's business tax burden than other sectors of the state's economy. In some cases, we pay as much as 500 percent higher.

So, even though manufacturing has been, and continues to be, the well-documented strength of the state's economy . . . the state "rewards" manufacturers with a disproportionately large share of the business tax burden . . . on top of penalizing them for making the investments they need to remain competitive.

Clearly, we have a huge disconnect between tax policy and economic reality. Just as clearly, the tax reforms in House Bill 1 represent a rational, logical and fair way to fix the problem.

Before I conclude my remarks, I want to address two additional issues that have arisen during the tax reform debate.

The first has to do with what some people refer to as "pyramiding." The question is, "Won't the new Commercial Activity Tax, which is based on Ohio sales, result in every supplier in a company's supply chain passing on the cost of its own CAT . . . and driving up the cost of the final product?"

The fact is, suppliers already pass on the cost of the taxes they currently pay. So, because the CAT replaces two taxes that currently create pyramiding . . . with a single, lower-rate tax . . . it's possible in some cases that the proposed reforms will actually reduce the effect of pyramiding.

Finally, I want to speak candidly on an issue that has drawn some media attention.

To the extent that manufacturers have been disadvantaged by the current tax system, some other sectors of the state's economy have benefited by paying a disproportionately small share of the business tax burden . . . so it should come as no surprise that a few segments within the business community are opposed to the tax reform proposal as outlined in House Bill 1.

I respectfully suggest that preserving a status quo where not all companies pay their fair share is not in the state's best interest.

In the final analysis, I submit that there are two bottom-line questions to ask:

First, "Will the proposed reforms fix the major identified problems with the current system?" The answer is a resounding "Yes."

The Governor's plan will promote, instead of penalize, investment in the machinery and equipment manufacturers need to stay competitive, and to protect manufacturing job security.

Second, "Will the proposed reforms be fair to the broad spectrum of businesses in the state?" Again the answer clearly is "Yes."

The reforms will even out business taxes so all sectors of the economy will share more equitably in the business tax burden. Just as important, it will be more difficult for companies to avoid their fair share through sophisticated tax planning and accounting, as currently happens with the Corporate Franchise Tax.

We will be replacing an outdated system that discourages investment . . . and counterproductively penalizes the bedrock sector of the state's economy . . . with a low-rate, broad-based, difficult-to-avoid tax that encourages investment, strengthens competitiveness, and spurs job growth.

In closing, let me remind everyone that a strong manufacturing sector is vital to Ohio's overall economic health. The purchasing power of Ohio's 823,000 manufacturing workers supports all other sectors of our economy, in particular the service and retail sectors.

In 2003, the average annual wage for a manufacturing worker in Ohio was \$45,908. To put that in context, consider that the average annual wage of a retail worker was less than half that -- \$22,503.

When manufacturing suffers, the entire state economy suffers. When manufacturing facilities close up shop and people lose their jobs, the ripple effects are terrible and far-reaching: hardship for families . . . gutted local communities . . . reduced tax revenues for the state . . . and a wave of economic fallout that stretches across a wide network of economically-linked communities and industries.

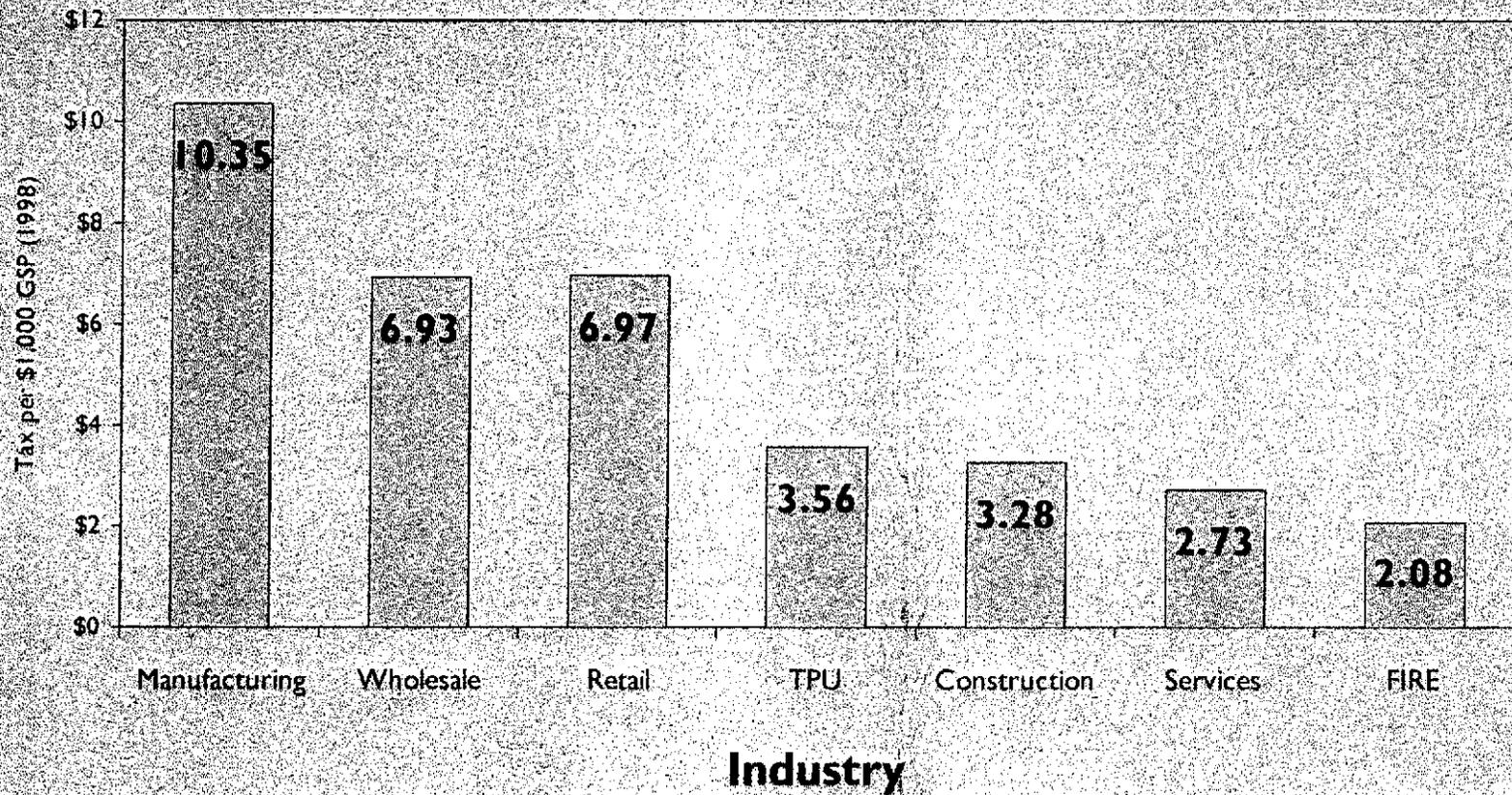
The tax reform package contained in House Bill 1 will be good for Ohio's manufacturing sector. Just as importantly, it also will be good for every other sector of the state's economy -- which makes it very desirable public policy.

Speaking on behalf of the OMA's nearly 2,000 member companies . . . I will tell you that these reforms – and the many benefits they will yield – cannot come soon enough.

Chairman Calvert . . . members of the committee . . . thank you for your kind attention.

On behalf of the OMA, I want to say that we look forward to assisting you in your deliberations in any way we can. And, of course, I will be happy to answer any questions you may have about my testimony.

State and Local Taxes in Ohio



FIRE - Finance, Insurance, Real Estate TPU - Transportation, Public Utility



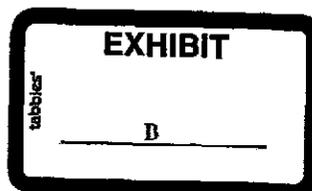
Toward a Pro-Growth Business Tax Policy

Testimony of
Edward W. (Ned) Hill
Professor and Distinguished Scholar of Economic Development
Maxine Goodman Levin College of Urban Affairs
Cleveland State University
Before the
Finance and Financial Institutions Committee of the Ohio Senate
May 20, 2005

Chairman Carey and members of the Committee, thank you for the opportunity to testify in favor of Ohio House Bill 66. Before I begin my testimony I need to reveal a potential conflict of interest concerning this bill. I am one of two principle investigators on a research project conducted by Deloitte Consulting and Cleveland State University for the Ohio Department of Development (ODOD) and the Ohio Business Development Council (OBDC) through TechSolve on the competitive position of Ohio's economy. The draft report is currently under review by senior staff at OBDC and ODOD. This work began in late August 2004 and the draft report was presented last week. I will be referring to some of the outcomes from that research in my comments. My contractual relationship with ODOD has concluded and ODOD has not influenced my thoughts regarding the bill before you. However, the research that the CSU team completed with our colleagues at Deloitte confirmed the necessity for major structural reform of business taxes in the state. I have a history of speaking on the subject of business taxation in the state of Ohio and what I say today will be consistent with what I said before my work with the state began.

Whenever major changes to a tax code are considered all I can think of is the saying attributed to Louisiana's Depression-era Senator Huey Long: "Don't tax you. Don't tax me. Tax the feller behind the tree." The bill you have before you represents a major, and long-needed, change in the structure of taxation in the state of Ohio. The proposed structural reforms are so fundamental that no one wants to be behind Huey Long's tree.

Please ignore the editorial prodding of the *Wall Street Journal*; fiscal responsibility dictates that business taxes cannot be simply cut, they need to be restructured. The tax burden needs to be shifted to encourage capital formation and productivity increases, and a replacement business tax is required. Saying that we should keep the current



structure of taxes, but with lower rates, is fiscally irresponsible and does not address economic development disadvantages we have in our economic base.

The business tax code has acted as a deterrent to capital investment in the state and represents a perfect gateway to the economy of 1934. The 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 code assumes that Ohio's businesses have little effective competition and can pass along costs increases imposed by our taxes to out-of-state customers. This is no longer true. The 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.

My book, *Ohio's Competitive Advantage: Manufacturing Productivity*, demonstrated that the Tangible Personal Property Tax and Corporate Franchise Tax results in manufacturing and wholesale firms carrying a disproportionately heavy tax load as a percent of Gross State Product (GSP). Table 1 is taken from that book. Manufacturing paid \$10.35 per \$1,000 of GSP, Retail paid \$6.97, and Wholesale paid \$6.93. Compare manufacturing's \$10.35 to the service sector's \$2.73. Since I completed those estimates the Tangible Personal Property Tax is on a multi-year phase out. But the phase-out is so gradual that the snow cap of Mount Kilimanjaro will disappear before the Tangible Personal Property Tax goes away. Meanwhile the complexity and cost of complying with these taxes continue. In economic terms these two major business taxes are horizontally inequitable. Two firms with identical profits and identical gross revenues will pay vastly different state taxes based on how they produce their product.

From the state's perspective horizontal inequity is an irrelevant economic nicety if it does not impair the performance of the state's economy and its development and if the tax is an efficient and politically acceptable revenue source. These two taxes fail all of these tests.

The Tangible Personal Property Tax is expensive to comply with, hard to administer if you take tax auditing seriously, and results in a distribution of tax wealth among school systems that is arguably unconstitutional. The Tangible Personal Property Tax is uncompetitive when compared to other states, resulting in state's reliance on the

Enterprise Zone Tax Abatement program to offset this competitive flaw in the Code. Additionally, Ohio's inter-municipal tax abatement wars are a by-product of the resulting interstate tax competition. All you need to do to pit one local jurisdiction in Ohio against another is to have an out-of-state strawman location and then engage two municipalities within Ohio in a bidding contest. The result is that the Tangible Personal Property Tax is shifted to companies that do not move and to small to mid-sized corporations that are not sophisticated enough to engage in this economic development mating ritual.

The Corporate Franchise Tax is simply a failed tax. Large firms can, and do, avoid it. The tax can be gamed by companies with multi-state or multi-national operations that shift value to low tax states and countries to avoid payment. The issue of where profits are generated or value is created in today's globally integrated supply chain is difficult and expensive for a state to ascertain. The Corporate Franchise Tax does not generate sufficient revenue, it is difficult to administer, and it is a tax on retained earnings and profits. These are two items that state economic development policy should encourage; not discourage.

Finally, we have to recognize that many of Ohio's small to mid-sized businesses have converted to Subchapter S corporations due to incentives that exist under the Federal Tax Code. This means that they pay their corporate taxes through their personal income taxes. When the state's income tax is added to municipal income taxes we have the 5th highest income tax rate in the nation. This is an incentive to move out of state. How often that occurs I do not know.

The structural components of the proposed changes in Ohio's tax code that are invigorating are the elimination of the Tangible Personal Property Tax and the Corporate Franchise Tax, coupled with the 21 percent across the board decrease in personal income taxes. The replacement business tax is the Corporate Activities Tax (CAT), which is a 0.26 percent tax on gross receipts, or sales to Ohio businesses, with the first \$1 million being exempt. My understanding is that the proposed CAT does not affect sales by banks or utilities—they are covered under a separate portion of the code. The resulting tax has integrity, is elegant, is simple, and is fair. Fair, flat, and easy is a goal in taxation and the CAT achieves this. Small businesses and startups are protected because retained earnings are not taxed and low sales volumes are not taxed. Work-in-

progress inventory is exempt. This structure can only be retained as long as carve-outs do not take place. Please maintain the integrity of the CAT.

Some have asserted that the new tax code is regressive. This is not true. State taxes in Ohio will remain progressive, but they will not be as progressive as the current code. However, the Governor's income tax proposal exempts the first \$10,000 in income from the income tax, which partially offsets the impact of retaining half of last year's penny increase in the sales tax. There is a shift in tax incidence from income to consumption under this plan. Consumption taxes are also being raised on tobacco and alcohol. If the legislature feels that the resulting price increases in alcohol will be too high it can always eliminate state mandated minimum mark-ups and eliminate the protection it provides to the liquor wholesale industry. This will most likely result in net prices to consumers falling after the gallonage taxes are increased. Personally, I have never met a tobacco tax I did not like. Research shows that the best deterrent to teenage tobacco use of all kinds is high prices. Increasing the price of tobacco prevents addiction and has public health benefits. The only constraint is the threat of smuggling.

In Table 2 I outline a number of criteria for assessing a tax. It is longer than most lists that are generated from the public finance literature because I include economic development considerations. At this point in time, in Ohio, we need to consider economic development and the future economic health of our state. The current tax code is broken in economic development terms. We need a code that encourages investment in equipment, that stops taxing inventory and retained earnings, and install a code that encourages production and new product development. Ohio needs a tax code that favors investment in equipment. In our economic base people are hired as a complement to new equipment. To increase hiring at good wages we need to encourage investment in new products and in capital equipment. The structure of the proposed tax code does this.

There are eight figures included in this testimony. These are bubble charts of the economic drivers of Ohio's economy and of the state's six regional economies. The driver industries were identified using a multivariate statistical technique that emphasizes productivity and market share as measured by Gross Product (GP), the economist's equivalent to value added in the production process. The size of each bubble indicates

the GP of each industry in 2003. The horizontal axis, or x-axis, is a measure of Ohio's specialization in each industry. If the industry's share of Ohio's GP is proportionate to the industry's share of GP nationally the ratio, or Location Quotient, would be 1.0. This is where the horizontal axis begins. We placed a vertical dotted line in red at 2.0 to indicate when Ohio's share of GP is twice the national average. The vertical axis, or y-axis, is the Compound Average Growth Rate in GP from 1998 to 2003—roughly from Ohio's business cycle peak to the end of the recession. If the bubble is below the horizontal axis GP declined over this time period and if it is above the axis GP increased.

The figures form 4 quadrants. The industries that are on each graph are those where Ohio and its regions are currently in their strongest competitive position. Those that are in the upper right quadrant are healthy driver industries. Those in the lower right have challenged business strategies, cyclically sensitive products, or need an injection of new products. Those in the upper left are targets of opportunity where Ohio can grow by increasing national market share. The few that are in the lower left quadrant are in trouble and are losing their competitive advantage. (Health care is included in these bubble charts due to the clinical excellence of Ohio's hospitals.)

The point I want to make in regards to business tax reform is that retailing is not on any of these charts. These industries are capital intensive; many are in manufacturing or in back-office service provision. Motor vehicle assembly and parts is the only driver industry that is both a state driver industry and a driver industry in each region. Corporate and divisional headquarters is another industry that ties this state together. Logistics, distribution, and warehousing, is part of the economic base along the entire western edge of the state. Yet, if you look in the Northwest, the distribution facilities are across the border in Michigan; if you look in the Southwest Kentucky houses the facilities even though the flat land is in Ohio; and if you look at the West Central region Indiana has the cost advantage.

In our forthcoming report to the state we also identify growth opportunities and emerging technologies where the state is competitively positioned. These opportunities are connected to this existing base and they are capital intensive. The tax code is Ohio's industrial policy and it must work to support this type of activity if we are to have a positive economic future.

Our research team included Deloitte's Fantus practice. They examined Ohio from an economic development site selector's perspective. They insist that the "sticker" price of a state's business tax code matters a good deal in eliminating regions from consideration in site location analysis. The site location consultants will never find out what the discounted tax price could have been because the initial screening is done electronically and uses posted data. The electronic trolling for data never results in catching unpublished discounted tax costs.

On a related point, the academic literature on site location is frequently misrepresented. The older literature did show that state and local taxes either did not matter or mattered little when it came to site location decisions. The newer literature, published over the past decade, comes to a different conclusion. The combination of taxes and services provided do matter. The reason is that with improved telecommunications, cheaper transportation, mobile labor in the United States, and global competition more and more locations are tied in terms of their locational characteristics. State and local taxes are still fourth and fifth on the list of decision factors, but the more important factors of the location of customers, location of suppliers, and workforce skills and availability are tied across locations. Taxes have become a tie breaker. Note, however, that the skills of the local labor force remain more important than taxes.

Finally, the research we performed showed that taxes are of concern to Ohio's business community. As part of the research we had nearly 100 corporate representatives meet in 12 expert panels across the state. We asked them to fill out a public policy questionnaire. The results are reported in Table 3. The largest business concerns were healthcare costs and energy costs. After that the Tangible Personal Property Tax and Corporate Franchise Tax were identified. The analysis of the comments of the expert panels reached seven conclusions:

1. At the top of the list of tax concerns among business leaders was the tangible tax on equipment and inventory.
2. Businesses perceive that the tax penalizes success, discourages investment and expansion within the state, and forces business owners to consider relocating out of the state.

3. One panelist said: "How can you keep people in Ohio when they can go two states away and they don't have to pay personal property tax?"
4. Manufacturers noted that the tax affects how they think about inventory and cited the tradeoffs they have to make between carrying inventory to provide immediate customer service and the tax costs of carrying the inventory.
5. Even though the state may provide abatements and tax credits that make Ohio a competitive location option, the system's complexity and lack of transparency is an impediment when businesses need to make fast-paced investment decisions.
6. Out-of-state investors and site selectors may see Ohio's "list price" for taxes and move on to consider another location without spending the time to understand the state's "discounted price" after abatements and incentives.
7. Ohio's list price of taxes results in a "sticker shock" that eliminates the state from consideration, panelists said. Other business leaders noted the cost of complying with state tax codes and regulations, citing the need to hire more accountants.

Thank you for the opportunity to testify.

Table 1

Manufacturing and Trade Pay High State Tax Burdens

**Tangible Personal Property and Corporate Franchise Taxes:
1999**

Industrial Division	Combined Tax Burden	
	Tax Per \$1,000 of GSP	Rank
Agriculture	1.84	9
Mining	21.39	1
Construction	3.28	6
Manufacturing	10.35	2
Transportation & Public Utilities	3.56	5
Wholesale Trade	6.93	4
Retail Trade	6.97	3
FIRE*	2.08	8
Services	2.73	7

* FIRE represents finance, insurance, and real estate

Source: Edward W. Hill (2001) *Ohio's Competitive Advantage*

Table 2

Fifteen Tax Criteria:

Tax Administration, Tax Compliance, Economic Development, Economic Efficiency

Tax Administration-- Paying government's bills

1. Revenue *sufficiency*
2. Revenue growth (*elasticity*)
3. Factor *immobility*
4. Cyclical *volatility*
5. Portfolio *diversity*
6. Ease of administration (*efficiency*)

Tax Compliance-- Paying taxes

7. Ease of compliance (*simplicity*)
8. *Transparency*
9. *Predictability*
10. *Equity* (horizontal and vertical)

Economic development--Growing the economy

11. Encourages *productivity* growth
12. Supports *competitive advantage*
13. *Competitive* with other states

Economic efficiency--Not hurting comparative advantage

14. Factor *neutrality*
15. *Benefits principle*

Table 3

Which of the following public policy areas is a problem for your business?

Public Policy Area	Not a Problem		Neutral		Major Problem	N/A	Response Average Rating
Health care insurance costs	4%	1%	3%	24%	64%	3%	4.5
Energy Prices: Electricity	8%	8%	24%	30%	26%	3%	3.6
Energy Prices: Natural Gas	9%	10%	23%	32%	24%	3%	3.5
State of Ohio Business Taxes: Tangible personal property tax	8%	10%	21%	29%	20%	11%	3.5
Torts & associated insurance & legal costs	13%	8%	20%	28%	26%	5%	3.5
State of Ohio Business Taxes: Corporate Franchise Tax	8%	8%	33%	24%	15%	13%	3.4
State of Ohio Business Taxes: Municipal profits tax (wage tax)	8%	8%	30%	25%	16%	12%	3.4
Workers compensation	10%	14%	21%	34%	15%	6%	3.3
Corporate Sales Taxes	10%	13%	36%	19%	13%	10%	3.1
Environmental Regulations	11%	17%	42%	17%	8%	4%	3.0
Tax abatement	14%	10%	47%	11%	8%	9%	2.9
Availability of bank loans/ capital	31%	9%	26%	13%	14%	7%	2.7
Electricity Service & Availability	23%	19%	31%	18%	5%	4%	2.6
Wireless network availability	31%	15%	31%	14%	4%	4%	2.4
Road infrastructure	30%	18%	33%	9%	5%	5%	2.4
Railroad infrastructure	41%	11%	30%	5%	3%	10%	2.1



Source: Industry Based Competitive Strategies for Ohio: Managing Three Portfolios (draft).

Figure 1

State-level Driver Industry Portfolio

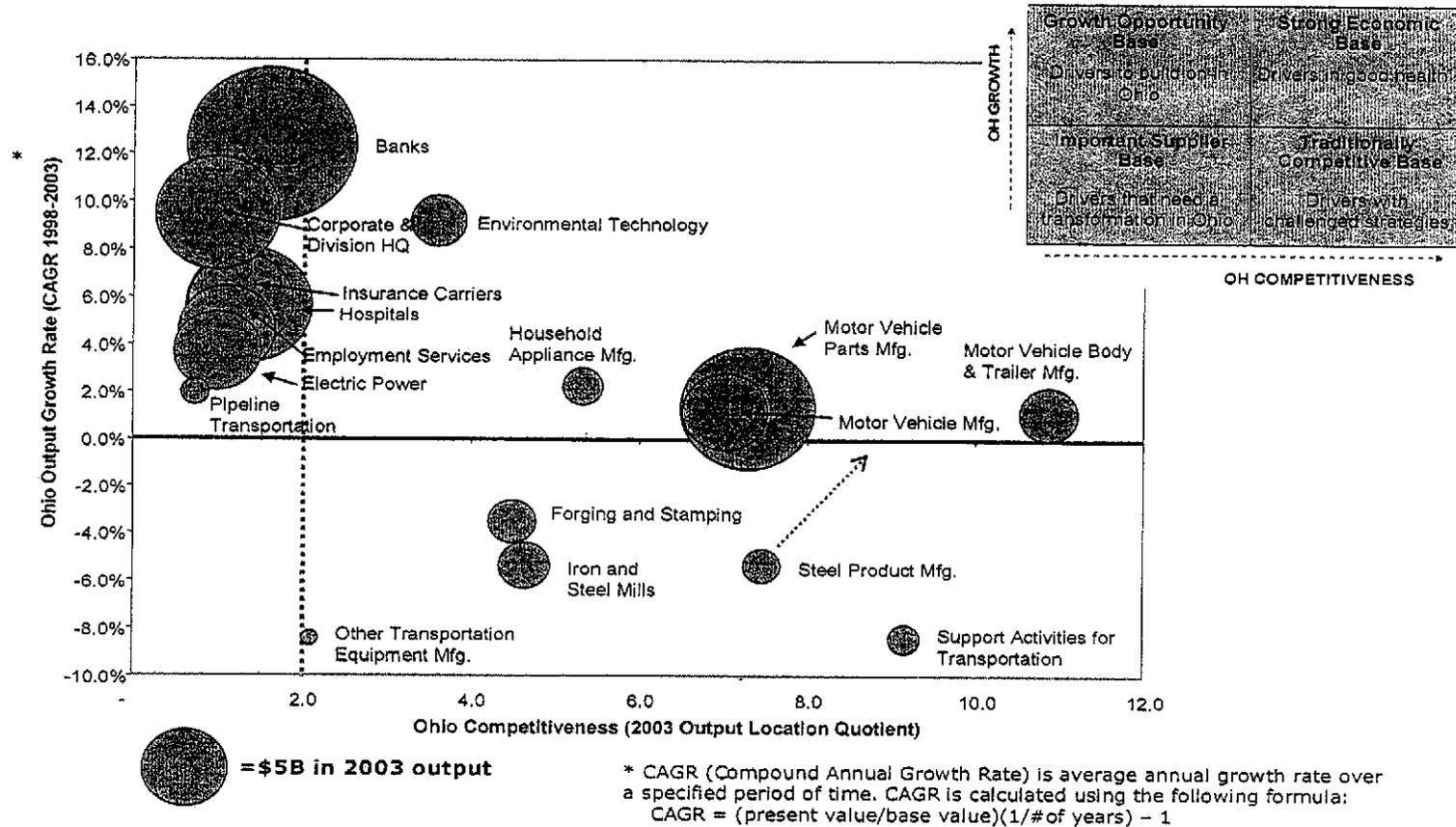


Figure 2



Ohio: A portfolio of regions Regional geography

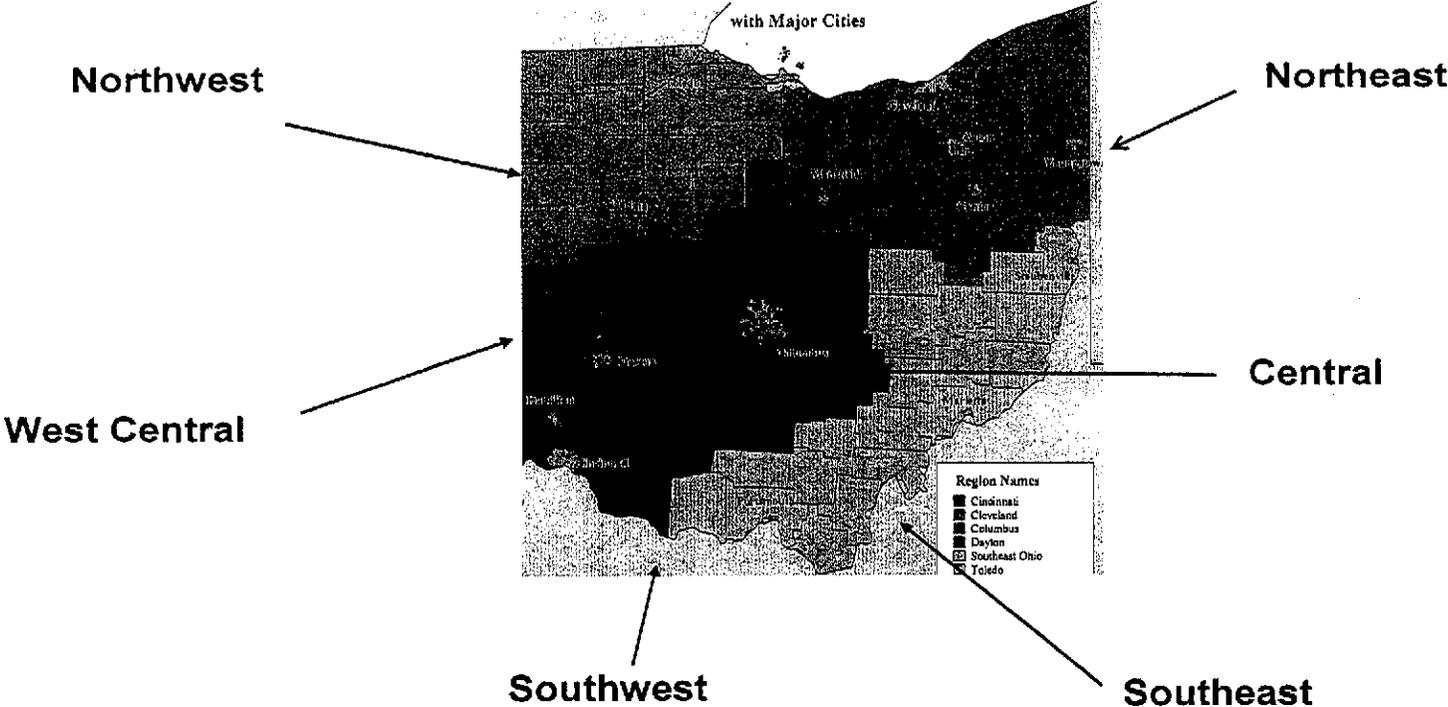


Figure 3

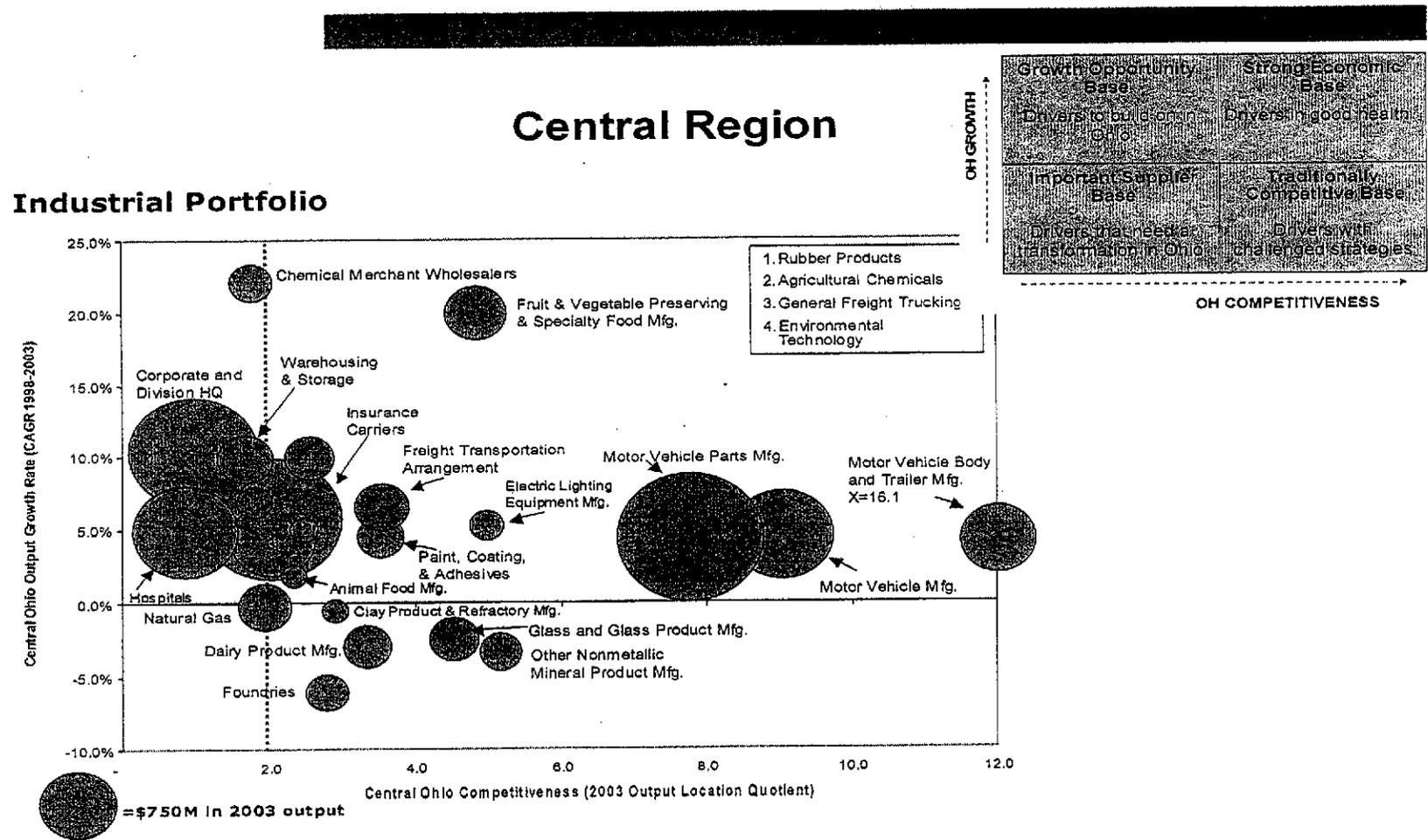


Figure 4

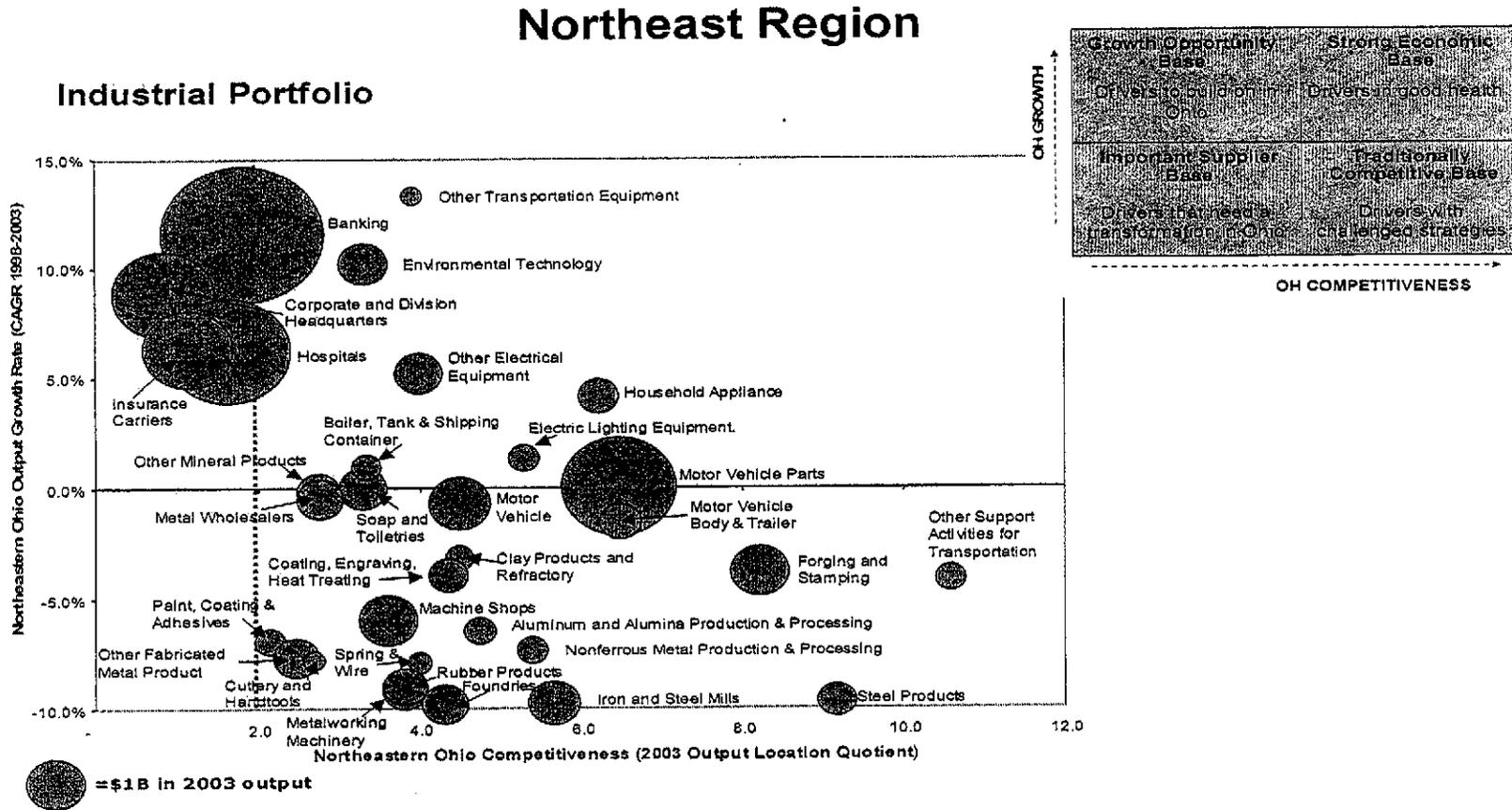


Figure 5

Northwest Region

Industrial Portfolio

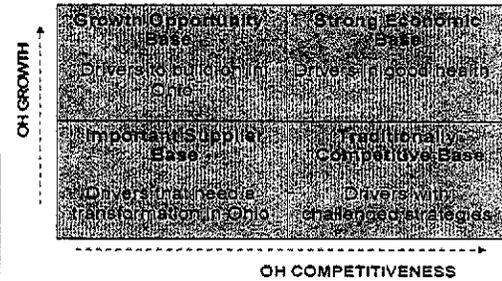
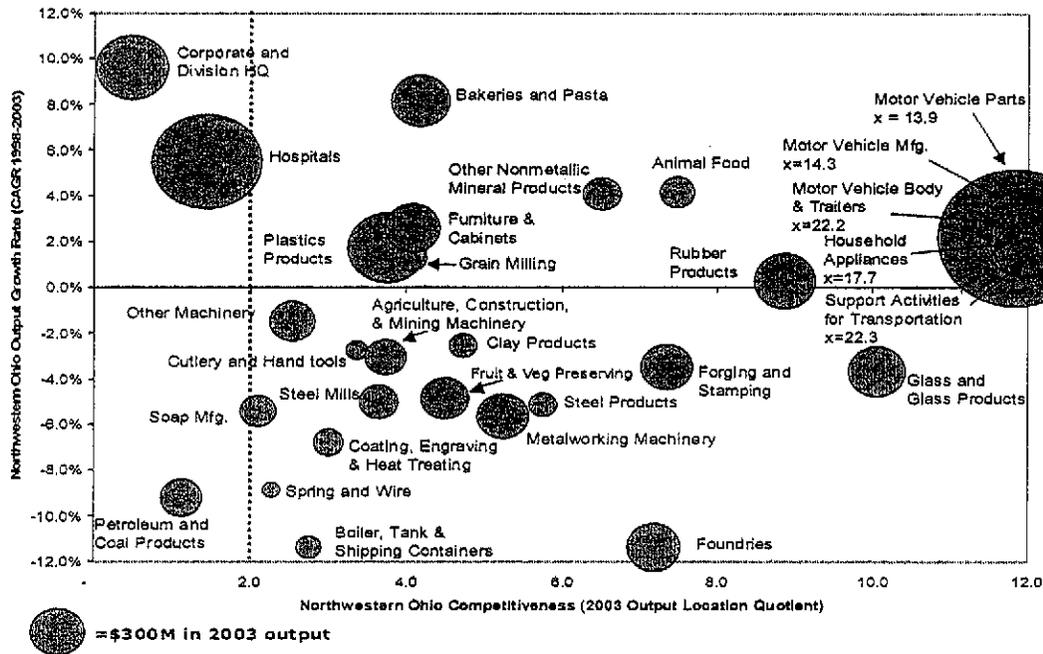


Figure 6

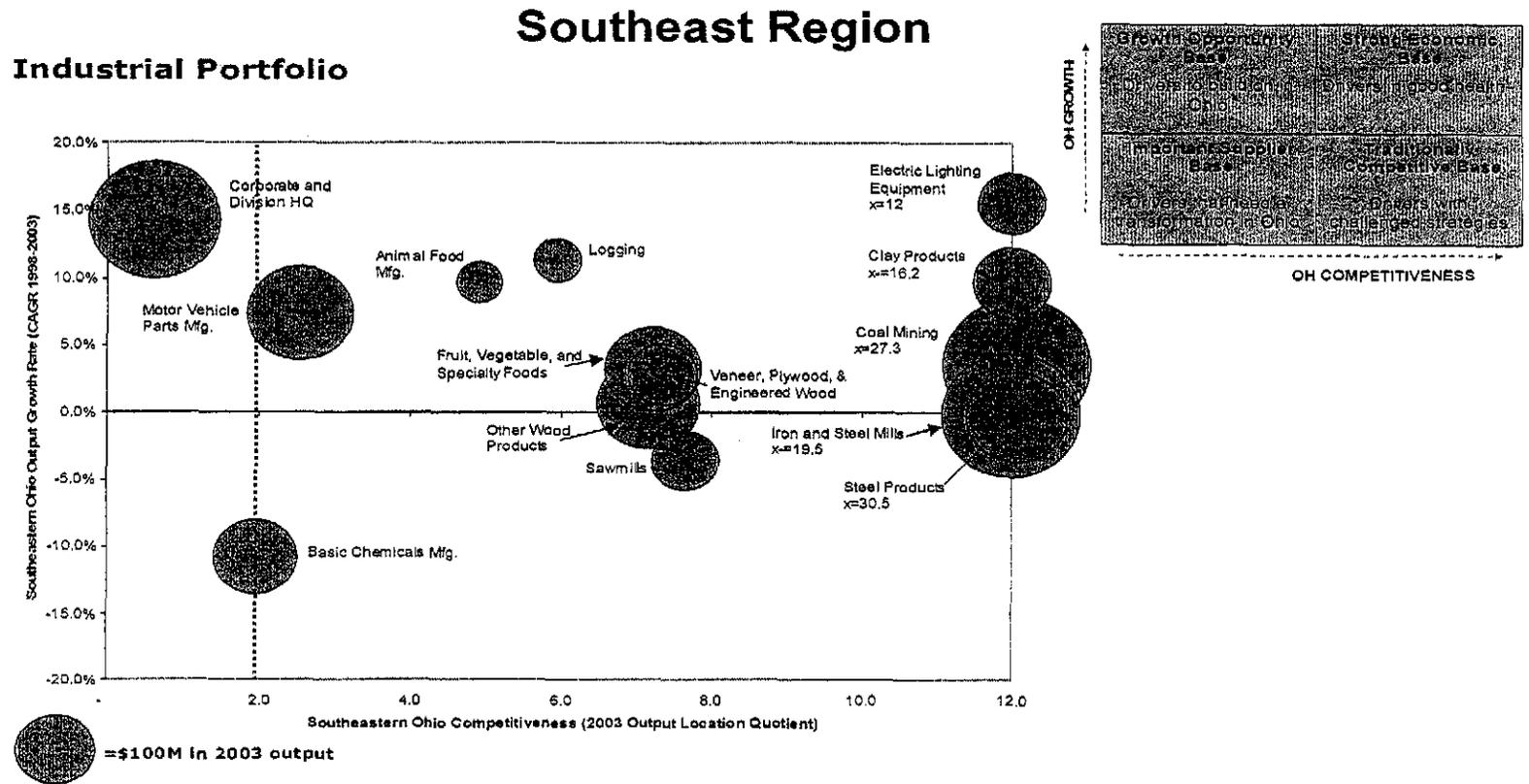


Figure 7

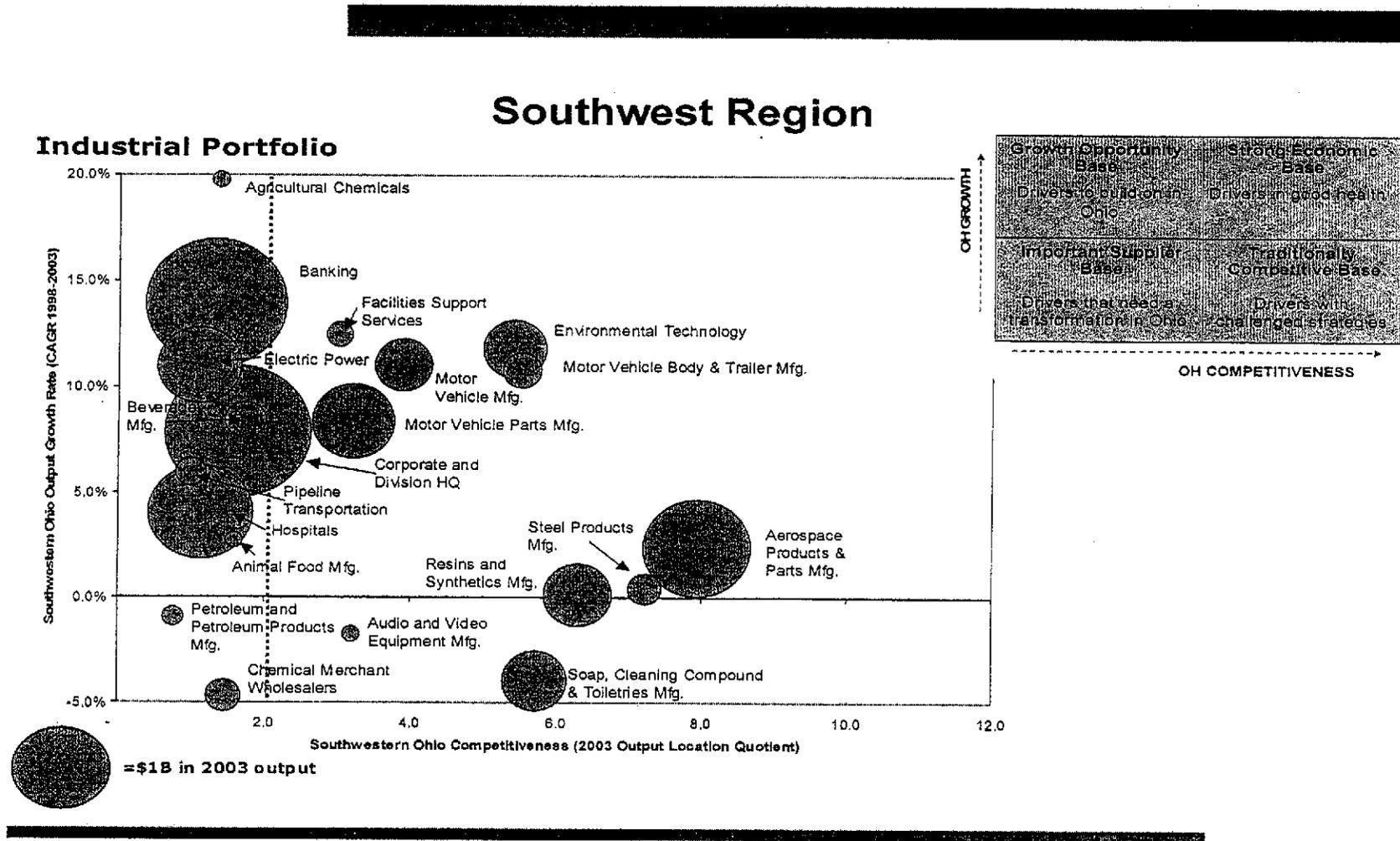
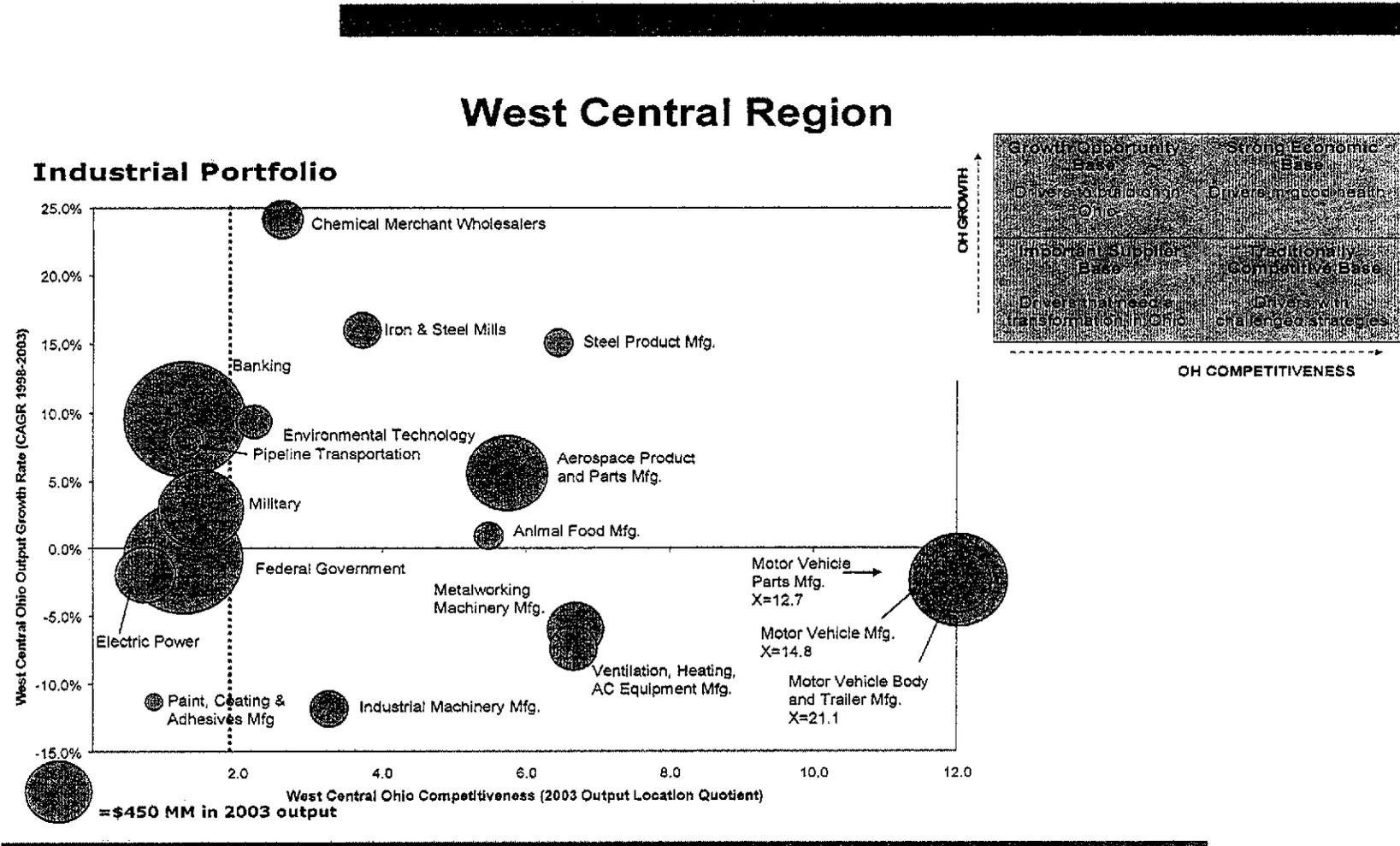


Figure 8



**Payroll and Contributions by Industrial Sector
as Covered under the Ohio and Federal Unemployment Compensation Laws (a)**

Industrial Sector	Total Annual Wages (in thousands)	Average Annual Wage	Total Wages Paid (in thousands)				Total Taxable Wages (b) (in thousands)	Total Contributions (c) (in thousands)	Average Contribution Rate
			First Quarter	Second Quarter	Third Quarter	Fourth Quarter			
Total covered under Ohio UC Law (d)	\$193,627,858	\$37,009	\$46,470,803	\$46,973,818	\$49,057,117	\$51,126,119	\$40,918,775	\$945,826	2.31%
Private Sector	167,769,662	36,830	40,329,692	40,430,444	42,539,229	44,470,298	40,887,335	945,365	2.31
Agriculture, forestry, fishing and hunting	328,617	23,247	66,037	84,847	92,403	85,330	140,509	4,058	2.89
Mining	598,856	55,504	141,370	151,666	151,896	163,925	113,967	3,835	3.37
Utilities	1,441,071	70,679	400,266	341,634	361,085	338,085	199,412	2,955	1.48
Construction	9,408,638	40,472	1,953,077	2,288,675	2,549,686	2,617,299	2,776,485	138,731	5.00
Manufacturing	39,140,027	48,208	9,679,300	9,408,994	9,692,191	10,359,542	8,296,299	235,844	2.84
Wholesale trade	12,091,618	51,345	2,974,721	2,865,774	3,012,619	3,238,504	2,442,216	54,337	2.22
Retail trade	14,023,098	22,846	3,307,429	3,482,224	3,602,004	3,631,441	5,397,272	78,186	1.45
Transportation and warehousing	6,418,035	38,629	1,476,695	154,593	1,665,473	1,729,933	1,791,573	37,349	2.08
Information	4,504,361	50,118	1,152,662	1,086,909	1,136,930	1,127,860	848,255	17,949	2.12
Finance and insurance	12,424,333	54,079	3,472,706	2,848,622	2,991,337	3,111,668	2,357,614	37,042	1.57
Real estate and rental and leasing	2,238,979	32,179	532,486	525,433	576,629	604,431	668,707	15,209	2.27
Professional and technical services	12,449,731	53,755	2,900,781	2,960,680	3,069,450	3,518,820	2,417,572	60,518	2.50
Management of companies and enterprises	8,317,934	84,342	2,252,414	1,960,273	2,092,093	2,013,155	1,272,549	23,094	1.81
Administrative and waste services	7,693,308	24,576	1,751,019	1,882,000	2,021,559	2,038,730	3,348,127	89,158	2.66
Educational services	2,461,268	28,706	586,893	623,186	609,816	641,372	202,255	5,000	2.47
Health care and social assistance	23,650,824	35,592	5,284,973	5,739,358	6,105,637	6,520,856	3,554,713	58,125	1.64
Arts, entertainment, and recreation	1,580,605	23,251	313,314	384,194	455,006	428,090	479,021	11,588	2.42
Accommodation and food services	5,103,692	11,827	1,174,081	1,281,038	1,349,692	1,298,882	3,238,127	47,107	1.45
Other services, except public administration	3,894,667	23,184	909,467	969,001	1,003,824	1,012,375	1,342,662	25,280	1.88
State & Local Government	25,858,196	38,217	6,141,112	6,543,375	6,517,888	6,655,821	31,440	462	1.47
State Government	5,871,220	44,431	1,367,282	1,499,933	1,421,710	1,582,295
Local Government	19,986,976	36,708	4,773,829	5,043,442	5,096,179	5,073,526	31,440	462	1.47
Federal Government (e)	4,564,121	59,357	1,109,674	1,143,056	1,143,924	1,167,468

(a) Based upon employers' reports for 2005 received in the Bureau of Labor Market Information through July 1, 2006. (b) For contributory employers, only the first \$9,000 of each worker's earnings were subject to contributions under the Ohio Unemployment Compensation Law. Nonprofit organizations may elect reimbursing status. Reimbursing employers, federal, state, and local government entities (except local government employers that elect contributory status) do not pay contributions or report taxable payrolls. (c) Contributions received or receivable. Excludes voluntary contributions. (d) Includes the Private Sector and State and Local Government entities; excludes Federal Government agencies. Subtotals may not add to totals due to rounding. (e) Includes only Federal Government agencies.

Ohio Department of Job and Family Services
Office of Workforce Development
Bureau of Labor Market Information
Columbus 43266 01/25/07 RS 203.2N

