

ORIGINAL

IN THE SUPREME COURT OF OHIO

BEAVER EXCAVATING COMPANY, et al.,	:	Case No. 11-1536
	:	
Plaintiffs-Appellants,	:	On Appeal from the Franklin
	:	County Court Appeals,
v.	:	Tenth Appellate District
	:	Case No. 10AP-581
JOSEPH W. TESTA,	:	
in his official capacity as Ohio Tax Commissioner,	:	
	:	
Defendant-Appellee.	:	

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**MERIT BRIEF OF AMICI CURIAE,  
THE OHIO MANUFACTURERS' ASSOCIATION  
AND  
THE OHIO SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS,  
IN SUPPORT OF APPELLEE**

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## 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.<sup>1</sup>

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 acknowledged the anti-competitive nature of the tangible personal property tax and called for adjustments to or wholesale elimination of this tax.<sup>2</sup> 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.<sup>3</sup> H.B. 66 replaced 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 was the significant reduction in Ohio’s personal income tax. The top marginal rates, especially when combined with local income taxes, likewise provided an impediment to capital formation. Under H.B. 66, Ohio’s

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<sup>1</sup> *H.B. 66 Biennial Budget: Hearing Before the Fin. and Appropriations Commt. of the Ohio House of Representatives*, 126<sup>th</sup> 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).

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

<sup>3</sup> *Bahl*, at 54.

high personal income tax was reduced 4.2 percent annually for five years. The 21 percent personal income tax rate reduction was 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 and The Ohio Society of Certified Public Accountants, (collectively "Amici Curiae"), are statewide associations that represent diverse segments of Ohio's economy. Collectively, Amici Curiae represent thousands of 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 continuing Ohio's economic rebirth. 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 not a tax "relating to" fuel used for propelling vehicles on the public highways, and therefore not subject to Article XII, Section 5a, is important to all businesses in Ohio. *Beaver Excavating Co. v. Levin*, 10<sup>th</sup> District, No. 10AP-581, 2011-Ohio-3649. The decision correctly characterizes the CAT as a tax on the privilege of doing business that broadly applies to virtually all businesses, regardless of the source of their receipts. The decision is consistent with over 100 years of consistent case law from this Court, including its most recent decision in *Ohio Grocers Association v. Levin*, 123 Ohio St. 3d 303, 2009-Ohio-4872, 916 N.E. 2d 446. This Court's resolution of the issue by upholding the decision of the Court of Appeals 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 generally on the privilege of doing business in the State of Ohio. It is not a tax relating to motor fuel and, therefore, does not violate Ohio Constitution Article XII, Sections 5a as applied to motor fuel dealers.

#### **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.<sup>4</sup>

As such, Ohio's former business tax code was a relic from Ohio's past—not a gateway to its future.<sup>5</sup> For decades, Ohio's business tax burden fell disproportionately upon capital-

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<sup>4</sup> *H.B. 66 Biennial Budget: Hearing Before the Finance and Financial Inst. Commt. of the Ohio Senate*, 126<sup>th</sup> 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).

<sup>5</sup> Hill, *Ohio's Competitive Advantage: Manufacturing Productivity* 81 (The Urban Center, Levin College of Urban Affairs, Cleveland State University and Supported by The Ohio

intensive industry segments, such as manufacturing—which happen to be the same segments that produced some of Ohio’s best paying jobs.<sup>6</sup> 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.<sup>7</sup> 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 was a high rate, narrow-base tax. It was riddled with so many loopholes that it was 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 impacted capital-intensive businesses, such as manufacturing, it actually punished companies for making the capital investments that are vital to Ohio’s ability to stay competitive in the global market. Similarly, the high marginal

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Manufacturers’ Association 2001), accessed at <http://urban.csuohio.edu/research/ohiomanufacturing/ohiomanufacturing.htm>

<sup>6</sup> 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).

<sup>7</sup> Wial & Friedhoff, *Bearing the Brunt: Manufacturing Job Loss in the Great Lakes Region, 1995-2005*, Table 2 (The Brookings Inst., July 2006); accessed at [http://www.brookings.edu/reports/2006/07useconomics\\_wial.aspx](http://www.brookings.edu/reports/2006/07useconomics_wial.aspx).

rates of the personal income tax impeded capital formation and investment in small businesses in Ohio.

In addition, each of these taxes was complicated, was expensive to comply with, and was difficult to administer.<sup>8</sup> 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 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:

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<sup>8</sup> *Bahl*, at 49.

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 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 replaced the corporation franchise and tangible personal property taxes as the primary tax on businesses in Ohio. It also funded the reduction in personal income tax rates that was so critical to the owners of many businesses that operate as pass-through entities, such as partnerships, subchapter S corporations, and limited liability companies. 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 reportedly 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* (2008), at 6, 8, 10<sup>9</sup>.

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<sup>9</sup> Accessed at [http://web.archive.org/web/20081231152905/http://www.ohiomeansbusiness.com/year2tax\\_report/obr\\_taxreport\\_year2.pdf](http://web.archive.org/web/20081231152905/http://www.ohiomeansbusiness.com/year2tax_report/obr_taxreport_year2.pdf)

For the fourth time in five years following the enactment of the sweeping tax reform, *Site Selection Magazine* in 2011 awarded Ohio the Governor's Cup for the most new and expanded large-scale capital projects. Arend, *Ohio Victorious in 2011 Facilities Race*, *Site Selection Magazine* (March 2012).<sup>10</sup> One major criterion for the award is the tax environment of the state.

In January 2012, the Tax Foundation and KPMG issued a joint report in which the authors concluded that Ohio's tax burden on businesses was the third lowest in the country for new business during 2011, and the fifth lowest for established business during the same period. *Location Matters: A Comparative Analysis of State Tax Costs on Business* (Tax Foundation & KPMG 2012)<sup>11</sup> At page 19, the report placed Ohio's lofty status squarely at the feet of the 2005 tax reform. This report is especially telling given the historically poor reviews of Ohio's tax system given by the Tax Foundation in earlier years. *See, for example*, Padgitt, *2011 State Business Tax Climate Index* (Tax Foundation, October 2010), where Ohio ranked as the 46<sup>th</sup> worst tax system.<sup>12</sup>

Similarly, in 2011 the Small Business & Entrepreneurship Council reported that Ohio had the ninth best tax climate for small business and entrepreneurs. Keating, *Business Tax Index 2011: Best to Worst State Tax Systems for Entrepreneurship and Small Business* (Small Business & Entrepreneurship Council, 2011).<sup>13</sup>

Finally, also in 2011, the Council on State Taxation, together with Ernst & Young, issued a report in which it was concluded that as a result of Ohio's tax reform effort in 2005, Ohio had

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<sup>10</sup> Accessed at <http://www.siteselection.com/ss/issues/2012/Mar/Cover.cfm>

<sup>11</sup> Accessed at <http://taxfoundation.org/files/location%20matters.pdf>

<sup>12</sup> Accessed at <http://web.archive.org/web/20101125122422/http://www.taxfoundation.org/files/bp60.pdf>

<sup>13</sup> Accessed at <http://www.sbecouncil.org/businessindex2011/report.pdf>

the third lowest effective tax rate on business. Cline, Philips & Neubig, *Competitiveness of State and Local Business Taxes on New Investment* (Tax Foundation & Council on State Taxation, April 2011).<sup>14</sup>

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 Correctly Concluded that the CAT is a General Franchise Tax Imposed upon the Privilege of Doing Business in Ohio and is Not Related to Motor Fuel for Purposes of Article XII, Section 5a.**

In its decision, the Court of Appeals recognized that the CAT is imposed generally upon the privilege of doing business in Ohio, as set forth in the plain language of the enabling statute. *Beaver Excavating Co. v. Levin*, 10<sup>th</sup> District, No. 10AP-581, 2011-Ohio-3649. Relying extensively upon this Court’s decision in *Ohio Grocers Association v. Levin*, 123 Ohio St. 3d 303, 2009-Ohio-4872, 916 N.E. 2d 446, it also recognized the distinction between a tax imposed upon a specific factor or object, and including the factor or object in the measurement of a broadly-applied franchise tax. Looking at the background and history behind the adoption of Section 5a it concluded that any relationship between the CAT and motor fuel was too attenuated to find a violation of Section 5a. This holding is correct and must be affirmed by this Court.<sup>15</sup>

**1. In *Ohio Grocers Association v. Levin*, this Court held that the CAT is a tax on the privilege of doing business in Ohio and is not constrained by the activities included in its measure.**

Ohio Constitution Article XII, Section 3 provides in part:

Laws may be passed providing for:

\* \* \*

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<sup>14</sup> <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=78442>

<sup>15</sup> Although amici’s brief focuses on only some of the legal issues presented in this case, it agrees with the position of the Tax Commissioner on the remaining issues as well.

(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.

Ohio Constitution Article XII, Section 5a provides:

No moneys derived from fees, excises, or license taxes relating to registration, operation, or use of vehicles on public highways, or to fuels used for propelling such vehicles, shall be expended for other than costs of administering such laws, statutory refunds and adjustments provided therein, payment of highway obligations, costs for construction, reconstruction, maintenance and repair of public highways and bridges and other statutory highway purposes, expense of state enforcement of traffic laws, and expenditures authorized for hospitalization of indigent persons injured in motor vehicle accidents on the public highways.

By the plain language of these provisions, the General Assembly has plenary authority to enact franchise and other excise taxes. However, revenues from any fee, excise or licenses taxes relating to fuel used for propelling vehicles on the public highways may only be expended for the specified purposes. If the CAT is a fee, excise or license tax relating to motor fuel, then the resulting tax proceeds must be used for the specified purposes only. If it is not such a fee, excise or license tax, then the use of its revenues are not so limited.

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 an excise tax on any particular transaction, activity other than the general activity of conducting business in Ohio, or object:

(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).

In *Ohio Grocers Association v. Levin*, 123 Ohio St. 3d 303, 2009-Ohio-4872, 916 N.E. 2d 446, this Court engaged in an exhaustive analysis of the long history of cases addressing the question of the nature of a franchise tax generally, as well as the nature of the CAT specifically. In that case, the Court concluded that the CAT was exactly what it purported to be: a franchise tax imposed upon the privilege of doing business in Ohio. *Ohio Grocers Association v. Levin*, at ¶14. Just as important, the Court recognized that including various activities, receipts, or property in the measure of such a tax did not render the tax one that was imposed upon those activities, receipts, or property. *Ohio Grocers Association* at ¶17.

The Court of Appeals recognized that an analogous question was presented to it below: Does the fact that receipts from the sale of motor fuel are included in the measure of the CAT render the CAT an excise tax “related to” motor fuel within the meaning of Article XII, Section 5a? Based upon the history behind the adoption of Section 5a and this Court’s long line of cases underpinning its decision in *Ohio Grocers Association*, the Court of Appeals correctly ruled that any relationship between the CAT and the sale of motor fuel was too attenuated to find a violation of Section 5a. *Beaver Excavating Co. v. Levin*, 10<sup>th</sup> District, No. 10AP-581, 2011-Ohio-3649, ¶34. That decision is correct and must be affirmed.

The history behind the adoption of Section 5a clearly established the mischief to be addressed was the diversion of taxes on the motoring public away from highway purposes and to general fund purposes. The arguments in favor of the adoption of the provision clearly focused on fees and excises imposed directly upon automobiles and motor fuel. *Beaver Excavating Co.*, at ¶28. This was emphasized in 1972, when the Ohio Constitutional Revision Committee Finance and Taxation Committee report made specific reference to automobile registration fees,

the highway use tax, and the motor fuel tax, as the taxes to which the limitation applied. *Id.* at ¶30.

This is consistent with the generally understood meaning of the words “related to.” The Merriam-Webster Online Dictionary defines “related” as “connected by reason of an established or discoverable relation.”<sup>16</sup> There is a clearly an established or discoverable relation between motor fuel and a tax that is imposed specifically upon the sale or use of such fuel. However, no such link exists when the tax revenues derive from a broad-based tax on the privilege of doing business generally, and some of the receipts by which the tax is measured derive from some taxpayers who happen to sell motor fuel. As noted by the Court of Appeals, such a link is simply “too attenuated” to invalidate the statute as applied to Appellants.

**2. The strong presumption of constitutionality has not been overcome.**

In determining whether the CAT runs afoul of Article XII, Section 5a, there is a strong presumption favoring the statutes’ constitutionality. *State ex rel. Swetland v. Kinney*, 69 Ohio St.2d 567, 575, 433 N.E.2d 217 (1982). 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*, 164 Ohio St. 142, 128 N.E.2d 59 (1955), 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

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<sup>16</sup> Accessed at [www.merriam-webster.com/dictionary/related](http://www.merriam-webster.com/dictionary/related)

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*, 108 Ohio St. 41, 49, 140 N.E. 491 (1923). Thus, the judiciary must afford deference to other branches of government, specifically the General Assembly and any legislative enactments it may compose.

In this case, Section 5a limits the appropriation of revenues from excise taxes related to motor fuel. Quite clearly, the restriction applies to taxes imposed specifically upon automobiles and motor fuel. *See Beaver Excavating Co. v. Levin*, at ¶¶28, 30. The section does 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 motor fuel. Such a construction is supported by neither the history of the provision, nor the wording used.

However, even if one considers that Appellants have raised an argument that the CAT relates to motor fuel in some respect, their argument must fail. As this Court observed in *Ohio Grocers* at ¶24:

The Grocers, at best, urge a competing plausible reading. But plausibility is insufficient to prevail, because the Grocers must prove the CAT’s unconstitutionality beyond a reasonable doubt. Thus, it is not enough to show that one plausible reading requires the statute to be stricken as unconstitutional, when another plausible reading permits it to survive.

Appellants face the same challenge here. As noted by the Court of Appeals, the words “related to” are ambiguous and could be read broadly to apply to virtually every activity. At the same time, as noted by the Court of Appeals, the history and background behind the adoption of Section 5a demonstrate a very narrow and focused purpose: To insure the appropriation of taxes and fees on automobiles and motor fuel to specified purposes. As was the case with the Grocers, Appellants suggest merely one plausible reading of the provision in question. A plausible reading simply isn’t enough.

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

The Appellants' argument derails Ohio's comprehensive tax reform package by reducing the number of taxpayers subject to the broad-based CAT. This position, which effectively precludes the General Assembly from taxing certain types of businesses based solely on the fortuities of the specific product or service sold by the business, 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*, 25 Ohio St.3d 107, 108, 495 N.E.2d 417 (1986).

The position of the Appellants, that the CAT is 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 Appellants' position will negatively impact the ability

of local jurisdictions (that previously relied on tangible personal property tax revenues to support their operations and now rely on the CAT) 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 and competitive tax structure that encouraged investment and innovation. The General Assembly was also cognizant of the Ohio Constitution's strictures on the expenditure of funds from excise taxes relating to motor fuel. 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.

With the corporation franchise tax and the tangible personal property tax completely eliminated, and with the personal income tax rates reduced, the CAT is the primary source of business tax revenue (excluding real estate taxes) for Ohio. If the Appellants are successful with their tax dodge efforts, wholesale and retail motor fuel dealers, among others, 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 motor fuel. For years owners of pass-through entities paid personal income tax based in part on income derived from sales of motor fuel. There is no reason for them not to pay the CAT for that same privilege. Appellants' arguments to the contrary should be rejected, and the decision of the Tenth District Court of Appeals must be affirmed.

## CONCLUSION

Ohio Constitution Article XII, Section 5a limits the expenditure of revenues from fees and excise taxes relating to motor fuel. 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. The connection between this general business tax and sales of motor fuel by a business is too slender for purposes of Section 5a; the CAT is not a tax related to motor fuel. Therefore, the fact the CAT includes within its measure, gross receipts from sales of motor fuel does not violate this section. The decision of the Court of Appeals finding that the CAT is not a tax relating to motor fuel is lawful and must be affirmed.

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 APPELLEE was sent via regular U.S. mail, postage prepaid this 12<sup>th</sup> day of May 2012, to the following:

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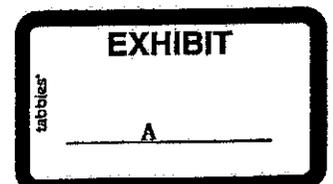
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**BEFORE THE FINANCE & APPROPRIATIONS COMMITTEE  
OF THE  
OHIO HOUSE OF REPRESENTATIVES  
CHARLES CALVERT, CHAIR**

**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.

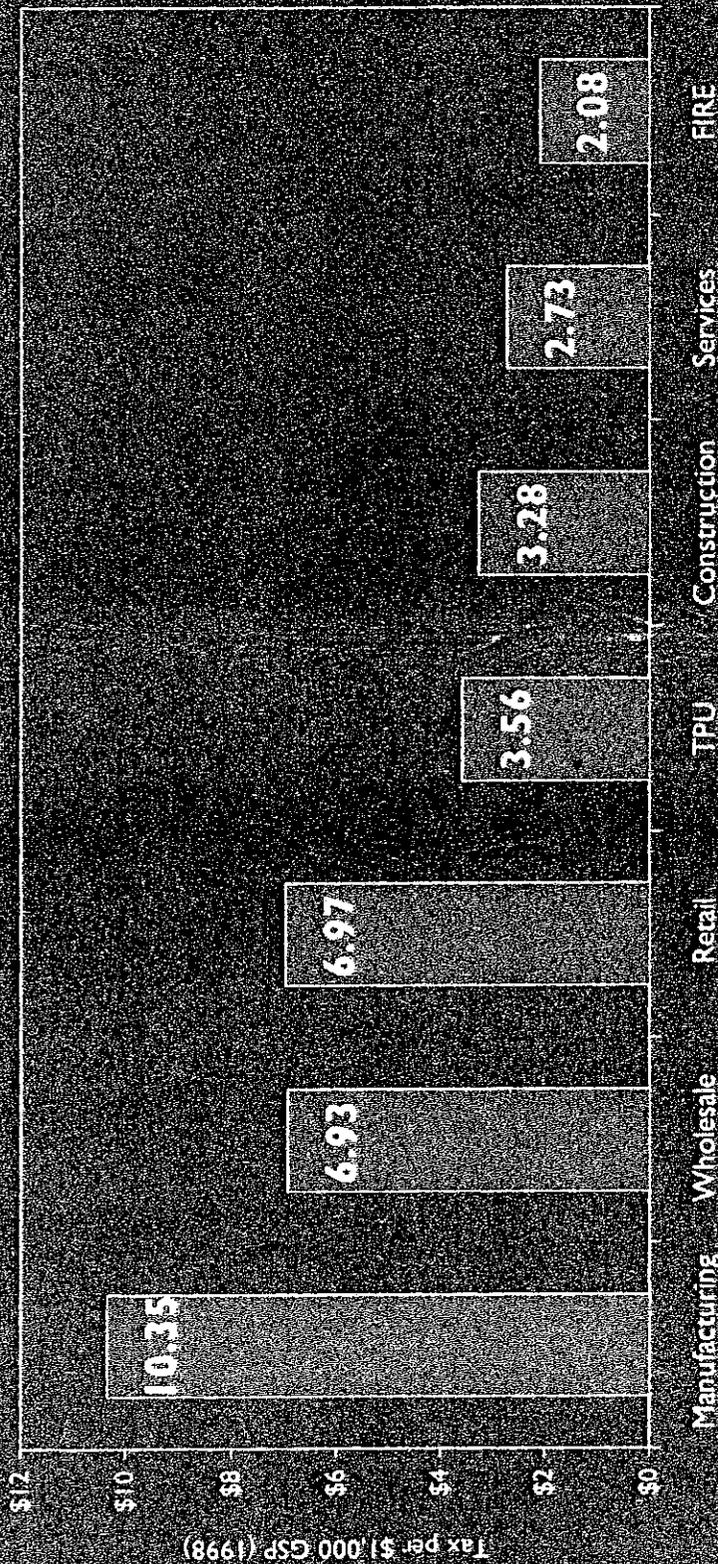
The tax reform package contained in House Bill 1 will be good for Ohio's manufacturing sector. Just as importantly, it also will be good for every other sector of the state's economy -- which makes it very desirable public policy.

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



## Industry

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 5<sup>th</sup> 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**

- |   |  |
|---|--|
| <p><b>Tax Administration-- Paying government's bills</b></p> <ol style="list-style-type: none"> <li>1. Revenue <i>sufficiency</i></li> <li>2. Revenue growth (<i>elasticity</i>)</li> <li>3. Factor <i>immobility</i></li> <li>4. Cyclical <i>volatility</i></li> <li>5. Portfolio <i>diversity</i></li> <li>6. Ease of administration (<i>efficiency</i>)</li> </ol> | <p><b>Economic development--Growing the economy</b></p> <ol style="list-style-type: none"> <li>11. Encourages <i>productivity</i> growth</li> <li>12. Supports <i>competitive advantage</i></li> <li>13. <i>Competitive</i> with other states</li> </ol> |
| <p><b>Tax Compliance-- Paying taxes</b></p> <ol style="list-style-type: none"> <li>7. Ease of compliance (<i>simplicity</i>)</li> <li>8. <i>Transparency</i></li> <li>9. <i>Predictability</i></li> <li>10. <i>Equity</i> (horizontal and vertical)</li> </ol>  | <p><b>Economic efficiency--Not hurting comparative advantage</b></p> <ol style="list-style-type: none"> <li>14. Factor <i>neutrality</i></li> <li>15. <i>Benefits principle</i></li> </ol>   |

Table 3

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

Public Policy Area	Not a Problem	Minor Problem	Neutral	Major Problem	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	14%	10%	47%	11%	8%	9%	2.7
Electricity Service & Availability	31%	9%	26%	13%	14%	7%	2.6
Wireless network availability	23%	19%	31%	18%	5%	4%	2.6
Road infrastructure	31%	15%	31%	14%	4%	4%	2.4
Railroad infrastructure	31%	15%	31%	14%	4%	4%	2.4
Railroad 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

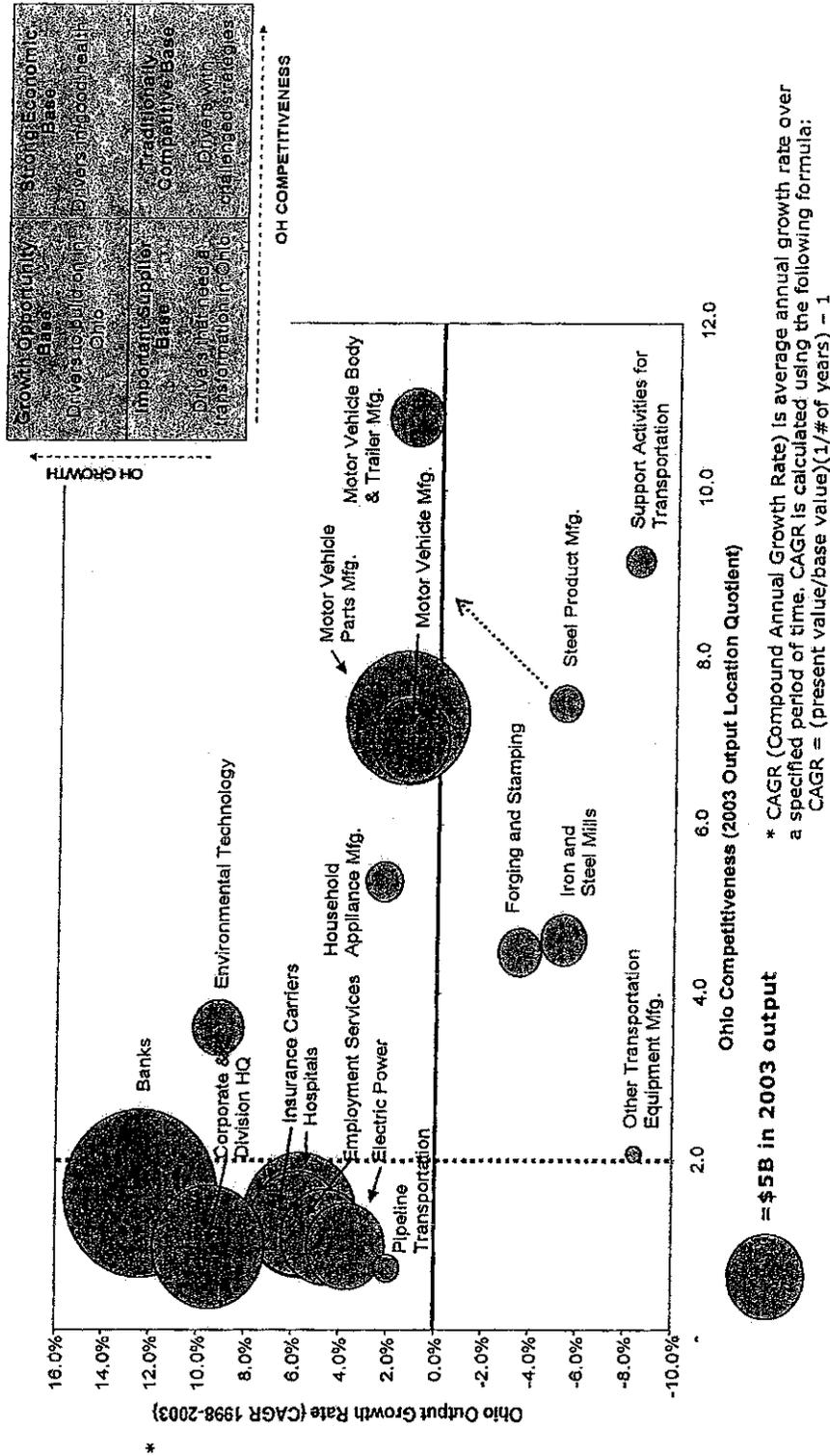


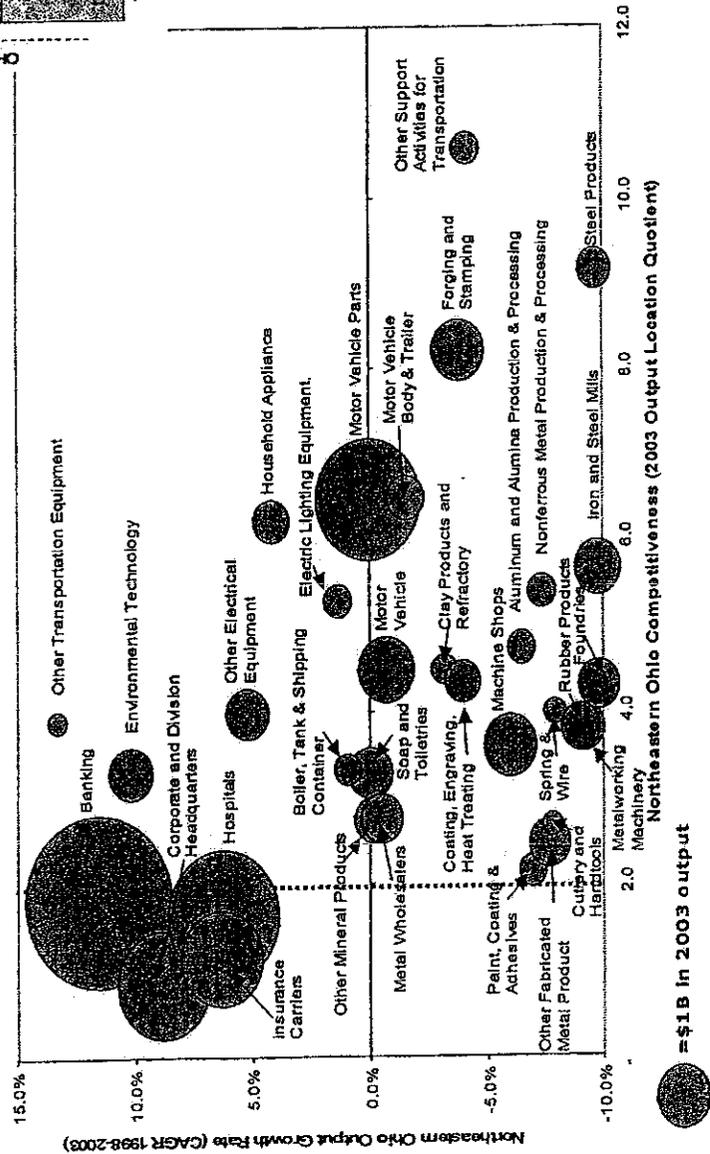




Figure 4

# Northeast Region

## Industrial Portfolio



<b>Growth Opportunity Base</b> Drives growth in Ohio	<b>Strong Economic Base</b> Drives long-term success
<b>Important Supplier Base</b> Drives areas of transformation	<b>Traditionally Competitive Base</b> Drives with challenged strategies

OH COMPETITIVENESS →

Figure 5

# Northwest Region

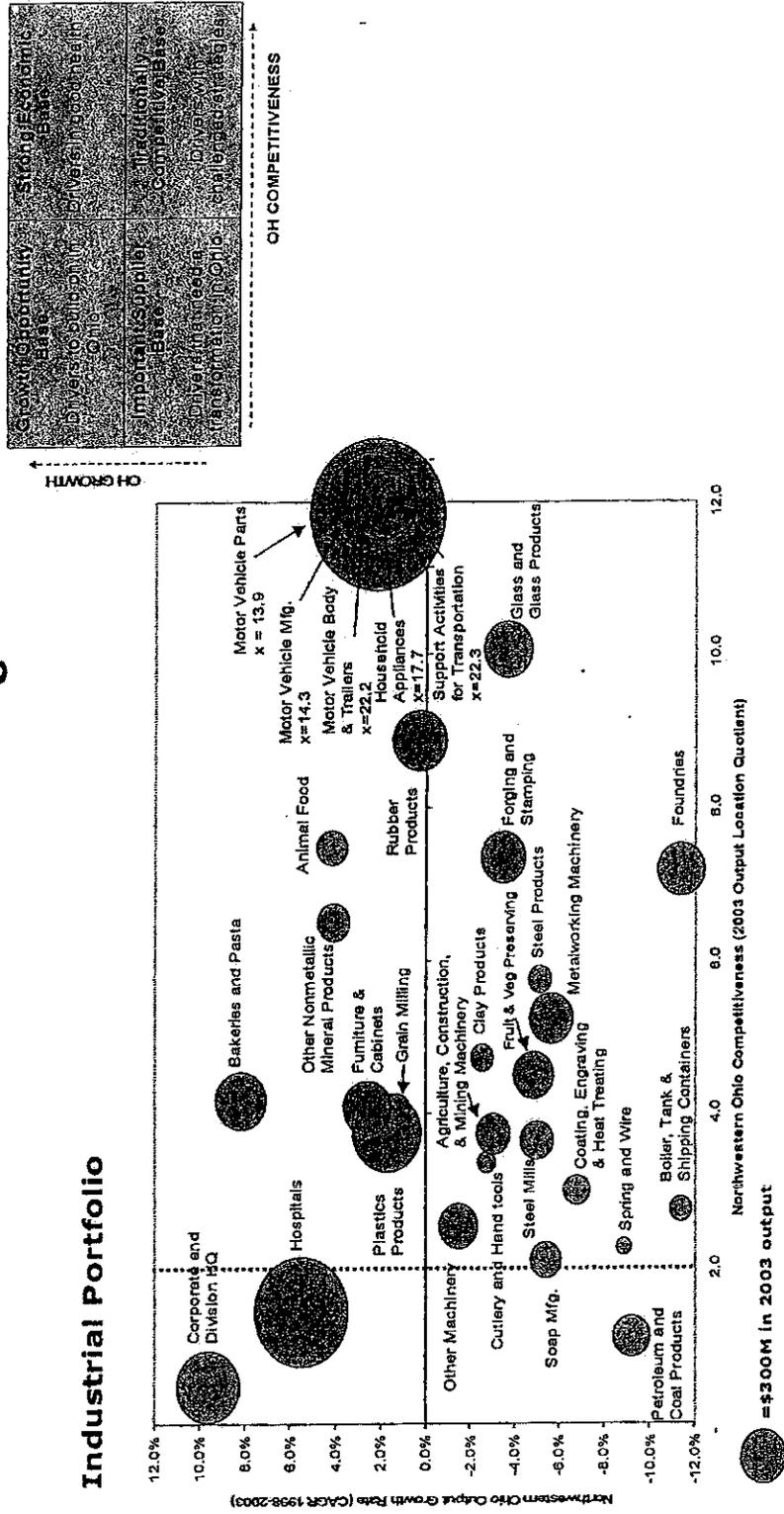


Figure 6

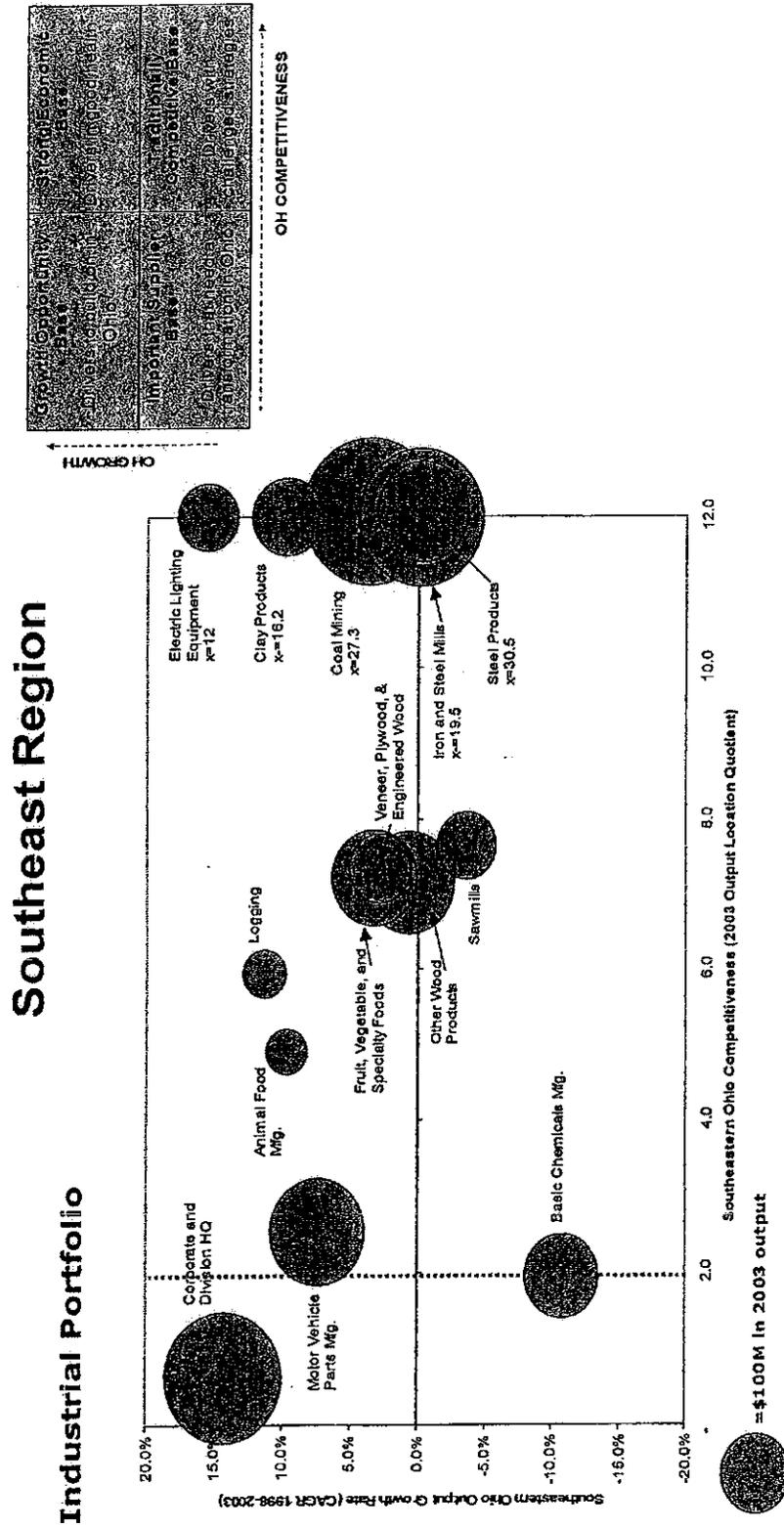
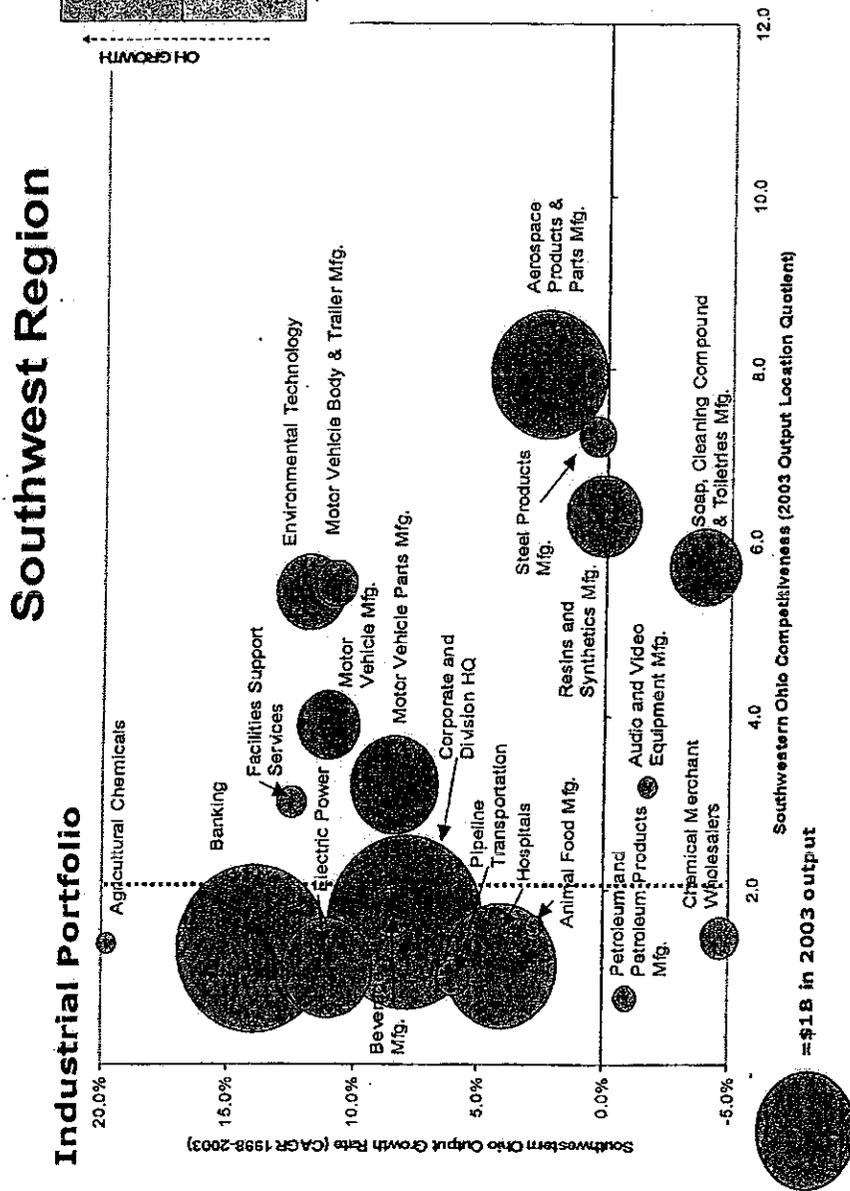


Figure 7

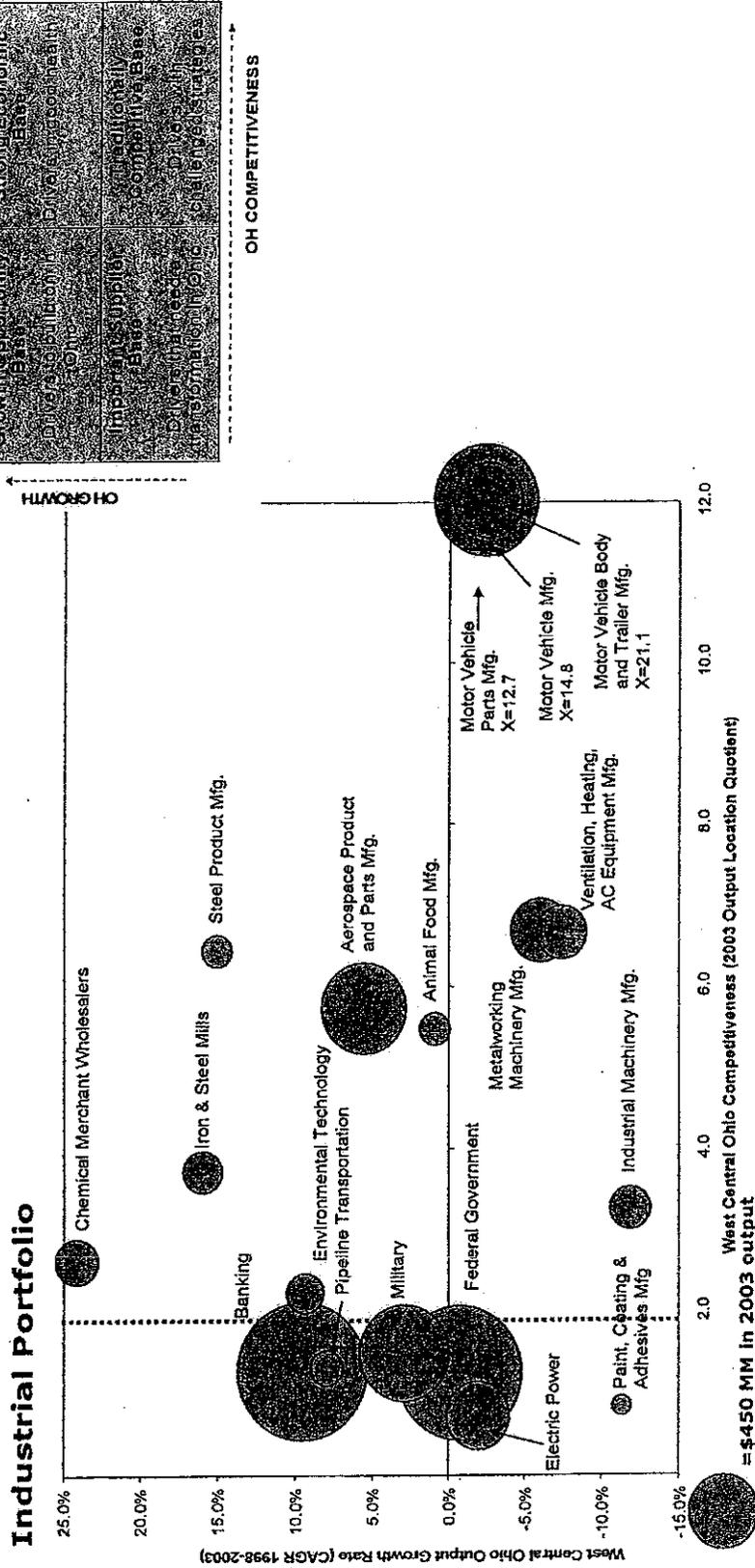


Growth Opportunity Based	Strategic Growth Based
Importantly Supplier Based	Traditionally Competitive Base

OH COMPETITIVENESS

Figure 8

# West Central Region



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			
<b>Total covered under Ohio UC Law (d)</b>	<b>\$193,627,858</b>	<b>\$37,009</b>	<b>\$46,470,803</b>	<b>\$46,973,818</b>	<b>\$49,057,117</b>	<b>\$51,126,119</b>	<b>\$945,826</b>	<b>2.31%</b>	
<b>Private Sector</b>	<b>167,769,662</b>	<b>36,830</b>	<b>40,329,692</b>	<b>40,439,444</b>	<b>42,539,229</b>	<b>44,470,298</b>	<b>945,365</b>	<b>2.31</b>	
Agriculture, forestry, fishing and hunting	328,617	23,247	66,037	84,847	92,403	85,330	4,058	2.89	
Mining	598,856	55,504	141,370	151,666	151,896	153,925	3,835	3.37	
Utilities	1,441,071	70,679	400,266	341,634	361,085	338,085	2,955	1.48	
Construction	9,408,638	40,472	1,953,077	2,289,675	2,549,586	2,617,299	138,731	5.00	
Manufacturing	39,140,027	48,208	9,679,300	9,408,994	9,692,191	10,359,542	235,844	2.84	
Wholesale trade	12,091,618	51,345	2,974,721	2,865,774	3,012,619	3,238,504	54,337	2.22	
Retail trade	14,023,098	22,846	3,307,429	3,482,224	3,602,004	3,631,441	78,186	1.45	
Transportation and warehousing	6,418,035	38,629	1,476,695	1,54,593	1,665,473	1,729,933	37,349	2.08	
Information	4,504,361	50,118	1,152,662	1,086,909	1,136,930	1,127,860	17,949	2.12	
Finance and insurance	12,424,333	54,079	3,472,706	2,848,622	2,991,337	3,111,668	37,042	1.57	
Real estate and rental and leasing	2,238,979	32,179	532,486	525,433	576,629	604,431	15,209	2.27	
Professional and technical services	12,449,731	53,755	2,900,781	2,960,660	3,069,450	3,518,820	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	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	89,158	2.66	
Educational services	2,461,268	28,706	586,893	623,186	609,816	641,372	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	58,125	1.64	
Arts, entertainment, and recreation	1,580,605	23,251	313,314	384,194	455,006	428,090	479,021	2.42	
Accommodation and food services	5,103,692	11,827	1,174,081	1,281,038	1,349,692	1,298,882	47,107	1.45	
Other services, except public administration	3,894,667	23,184	909,467	969,001	1,003,824	1,012,375	25,280	1.88	
<b>State &amp; Local Government</b>	<b>25,858,196</b>	<b>38,217</b>	<b>6,141,112</b>	<b>6,543,375</b>	<b>6,517,888</b>	<b>6,655,821</b>	<b>462</b>	<b>1.47</b>	
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	462	1.47	
<b>Federal Government (e)</b>	<b>4,564,121</b>	<b>59,357</b>	<b>1,109,674</b>	<b>1,143,056</b>	<b>1,143,924</b>	<b>1,167,468</b>	<b>...</b>	<b>...</b>	

(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 01/26/07 RS 203.2N

