ORIGINAL

IN THE SUPREME COURT OF OHIO

NAVISTAR, INC. Appellant, v. RICHARD A. LEVIN [JOSEPH W. TESTA], Tax Commissioner of Ohio, Appellee.	: : : : : : : : : :	Case No. 14-0140 Appeal from the Ohio Board of Tax Appeals Case No. 2010-575

MERIT BRIEF OF AMICI CURIAE,
OHIO MANUFACTURERS' ASSOCIATION AND
OHIO CHAMBER OF COMMERCE,
IN SUPPORT OF APPELLANT
NAVISTAR, INC.

Mark A. Engel (0019486)
Counsel of Record
Anne Marie Sferra (0030855)
Bricker & Eckler LLP
9277 Centre Pointe Drive, Suite 100
West Chester, OH 45069
Tel: (513) 870-6700
Fax: (513) 870-6699
mengel@bricker.com

Counsel for Amici Curiae,
Ohio Manufacturers' Association
and Ohio Chamber of Commerce

Maryann B. Gall (0011812)
Counsel of Record
230 West Street, Suite 700
Columbus, OH 43215
Tel: (614) 947-5199
mbgall@mbgalltax.com

Counsel for Appellant,
Navistar, Inc.
fka International Truck & Engine Co.

Michael DeWine (0009181)
Attorney General of Ohio
Barton A. Hubbard (0023141)
Assistant Attorney General
Counsel of Record
30 East Broad Street, 25th Floor
Columbus, Ohio 43215
614-466-5967
614-466-5087 fax
bhubbard@ag.state.oh.us

Counsel for Appellee
Richard A. Levin, Ohio Tax Commissioner

Laura A. Kulwicki (0039547)
Anthony L. Ehler (0039304)
Steven L. Smisek (0061615)
Vorys, Sater, Seymour and Pease LLP
52 East Gay Street
Columbus, OH 43216-1008
Tel: (614) 464.5438
Fax: (614) 719-4622

Co-Counsel for Appellant,
Navistar, Inc.
fka International Truck & Engine Co.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER AUTHORITIES

STATEMENT OF INTEREST OF AMICI CURIAE

In June 2005, the Ohio General Assembly adopted a tax reform package—House Bill 66 ("H.B. 66")—designed to address the economic malaise that had 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 acknowledged the anti-competitive nature of the tangible personal property tax and called for adjustments to or wholesale elimination of this tax. See, generally, Bahl, *Taxation & Economic Development: A Blueprint for Reform in Ohio* (1996) (hereinafter *Bahl*). 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. *Bahl*, at 54. 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. Business in general, and manufacturers specifically, have consistently supported the tax reform changes made by H.B. 66. Included in the CAT scheme was a credit based on unused Ohio net operating loss carryforwards incurred under the franchise tax.

---

[1] *H.B. 66 Biennial Budget: Hearing Before the Fin. and Appropriations Comm. 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).

The Ohio Manufacturers' Association ("OMA") is a statewide nonprofit trade association whose membership consists of over 1,400 manufacturing companies. As the sole trade association advocating exclusively for manufacturing issues, the OMA effectively represents the interests of manufacturing businesses employing approximately 660,000 Ohioans. Although they make up only slightly more than 10% of all CAT payers, manufacturers pay over 27% of all CAT in the state.[2] Thus, manufacturers are keenly interested in the proper, consistent, and lawful administration of that tax.

Founded in 1893, the Ohio Chamber of Commerce ("Chamber") is Ohio's largest and most diverse statewide business advocacy organization. The Chamber works to promote and protect the interests of its more than 8,000 business members and the thousands of Ohioans they employ while building a more favorable Ohio business climate. As an independent and informed point of contact for government and business leaders, the Chamber is a respected participant in the public policy arena. Through its member-driven standing committees and the Ohio Small Business Council, the Chamber formulates policy positions on issues as diverse as education funding, taxation, public finance, health care, environmental regulation, workers' compensation and campaign finance. The advocacy efforts of the Chamber are dedicated to the creation of a strong pro-jobs environment – an Ohio business climate responsive to expansion and growth.

The decision of the Board of Tax Appeals ("BTA") that the Tax Commissioner may ignore the plain language of R.C. 5751.53(A)(6)(b) and substitute his judgment for that of the General Assembly in order to reduce the credit to which a taxpayer is entitled is

---

[2] *See* Ohio Department of Taxation, *2013 Annual Report*, Table 1, page 35, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2013_annual_report/2013_AR_internet.pdf accessed July 22, 2014.

important to all taxpayers in Ohio, but is especially so to manufacturers. The holding permits the Tax Commissioner to ignore the plain language of a statute that he is charged to implement and to substitute his preferences for that of the General Assembly. The decision also reduces certainty and clarity in the tax laws, leaving taxpayers to the whim of a bureaucrat responsive only to the need of the state's fisc as to the application and interpretation of an otherwise clear provision. Neither implication is acceptable. The decision of the BTA is both unreasonable and unlawful. For the sake of all taxpayers, it must be reversed.

STATEMENT OF CASE AND FACTS

Amici agree with the Statement of Case and Facts as set forth in the Brief of Appellant Navistar, Inc.

LAW AND ARGUMENT

PROPOSITION OF LAW:

Courts have no legislative authority and may not supply provisions omitted from an act by the General Assembly. There is no authority to add to, enlarge, supply, expand, extend or improve the terms of a statute to meet a situation for which there is no provision.

R.C. 5751.53 provides for a credit against a taxpayer's CAT liability based upon net operating loss ("NOL") carryforwards[3] previously generated, but not used, for Ohio franchise tax purposes. The single issue presented in this case is whether the Tax Commissioner may ignore the date specified by the General Assembly as the date on which the amount that serves as the basis for the credit under R.C. 5751.53(A)(6)(b) is calculated. That statute provides that the amount that serves as the basis for the credit, the taxpayer's

[3] The purpose of recognizing NOL carryforwards is to "ameliorate the unduly drastic consequences [to taxpayers] of taxing income strictly on an annual basis." *Libson Shops, Inc. v. Koehler*, 353 U.S. 382, 386 (1957).

"applicable Ohio net operating loss carryforward" must be based upon the taxpayer's deferred tax asset, net of any related valuation allowance amount, both as reflected on the taxpayer's books and records on the last day of its taxable year ending in 2004.

The taxpayer, Navistar, Inc., took the statute at its word and computed its applicable Ohio NOL carryforward based on those books and records as they existed by the filing deadline of June 30, 2006. Upon audit, however, and in contravention of the express terms of the statute, the Tax Commissioner determined that he had the authority to reduce Navistar's applicable Ohio NOL carryforward to reflect subsequent changes to Navistar's accounting books and records that occurred after the specified filing date. Inexplicably, the Board of Tax Appeals affirmed the Tax Commissioner's unlawful action.

A. Temporary Tax Differences: Deferred Tax Assets and Valuation Allowances

Because there are differences between tax accounting rules and standard accounting practices, there often arise temporary differences between a taxpayer's tax bill and what its financial statements suggest. Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 109*, "Accounting for Income Taxes" (February 1992) (hereafter, *FAS 109*); testimony of Mr. Pinney, a CPA and accounting expert on FAS 109, at II Tr. 392-400. These temporary differences may result in either a future tax liability (that is, current taxes were lower that the financial accounting records might have suggested), or a future tax benefit (that is, current taxes were higher than financial accounting records might have suggested). An example of a future tax liability is presented when a depreciation method used for tax purposes depletes the value of an asset more quickly than might be permitted by financial accounting standards. The current tax benefit will have to be repaid in the future. An example of a future tax benefit is presented by a NOL; because net income for tax purposes may not be reduced below zero, the excess NOL may be used against future tax liability. These differences are known as "temporary differences." *FAS 109,* ¶13.

A deferred tax asset is recognized for a temporary difference that will result in amounts deductible in future years and for carryforwards. The deferred tax asset represents a tax deduction in future years. In addition, a valuation allowance (a contra-account or liability) is established if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. *FAS 109,* ¶ 17.e. For example, if a taxpayer has a deferred tax benefit of $100, but it is more likely than not that only $60 will be used, the taxpayer enters a deferred tax asset of $100 on its balance sheet, and a corresponding valuation allowance of $40.

In establishing a valuation allowance, both positive and negative evidence must be considered and a judgment is made based upon that information. *FAS 109*, ¶ 20. Although past performance weighs heavily in the judgment, a subjective forecast of the future performance of the taxpayer is also required. And, as noted by Mr. Pinney at II Tr. 428, 449-450, and Ms. Garnant, a CPA and Navistar's vice president of tax, at II Tr. 289-290, as time goes by, additional information becomes available that may cause a change in the judgment regarding the amount, if any, of a valuation allowance. *FAS 109*, ¶ 26.

B. R.C. 5751.53 - The Credit for Disallowed Ohio Net Operating Loss Carryforward

In the waning days before the enactment of H.B. 66, a small group of manufacturers approached the Department of Taxation regarding an issue presenting a serious financial statement issue for them. Manufacturing is inherently cyclical in nature and the years prior to 2005 were difficult years for manufacturers in general, and for Ohio manufacturers specifically. During many of those years, many manufacturers (and other businesses as well) suffered significant NOLs for franchise tax purposes. These losses created NOL carryforwards which, pursuant to *FAS 109*, resulted in deferred tax assets being created on their balance sheets.

However, H.B. 66 proposed to eliminate the corporation franchise tax, which is the tax under which these NOL carryforwards were incurred. If there were no longer a tax against which to apply a deferred tax asset, then it became more likely than not that none of the deferred tax asset would be used; as a result, *FAS 109* would require those taxpayers to create a valuation allowance that would totally eliminate those assets. The result would be a significant impact to the financial statements of those taxpayers.

Consequently, the manufacturers, the Department of Taxation, and the General Assembly devised a credit that would soften the blow and permit the affected taxpayers to retain some of the benefit of their deferred tax assets against the CAT. *See generally* the testimony of Messrs. Hall and Church, both deputy tax commissioners, at III Tr. 473-511. The result was the credit for NOL carryforwards that was enacted as R.C. 5751.53.

R.C. 5751.53 provides for a credit against the CAT equal to a taxpayer's "amortizable amount." The "amortizable amount" equals the sum of a taxpayer's "disallowed Ohio net operating loss carryforward" and other net deferred tax items apportioned to Ohio, multiplied by 0.08. R.C. 5751.53(A)(6) defines the "disallowed Ohio net operating loss carryforward:"

> (6) "Disallowed Ohio net operating loss carryforward" means the lesser of the amounts described in division (A)(6)(a) or (b) of this section, but the amounts described in divisions (A)(6)(a) and (b) of this section shall each be reduced by the qualifying amount.

(a) * * * *

(b) The Ohio net operating loss carryforward amount that the qualifying taxpayer used to compute the related deferred tax asset reflected on its books and records on the last day of its taxable year ending in 2004, adjusted for return to accrual, but this amount shall be reduced by the qualifying related valuation allowance amount. For the purposes of this section, the "qualifying related valuation allowance amount" is the amount of Ohio net operating loss reflected in the qualifying taxpayer's computation of the valuation allowance account, as shown on its books and records on the last day of its taxable year ending in 2004, with respect to the deferred tax asset relating to its Ohio net operating loss carryforward amount.

The qualifying amount is $50,000,000. R.C. 5751.53(A)(11)(a).

This credit was included in the law when the CAT was first enacted. Thus, its impact was included in the revenue projections associated with the CAT. Evidence presented at the hearing indicated that Amortizable Amount Reports were timely filed on behalf of approximately 54 different taxpayers by the deadline of June 30, 2006. Of those 54, at the time of the BTA's hearing:

- 45 had been denied in part or totally for various reasons;
- one was granted that made up approximately 2/3 of the total amount claimed by all taxpayers; and
- 8 remain unresolved.

C. Navistar Complied With R.C. 5751.53 and Is Entitled to the Credit Claimed

R.C. 5751.53(A)(6)(b) provides that the disallowed Ohio NOL carryforward is based on the "books and records on the last day of [the] taxable year ending in 2004," reduced by the related qualifying related valuation allowance amount measured from the same documents on the same date. Thus, the statute bases the amount of the credit, if any, upon a snapshot of the taxpayer's financial books and records as of a specific date. As Mr. Church testified at III Tr. 507, it was important to pick a specific date because the Department of Taxation needed a date certain for audit purposes.

In this case, that is exactly what Navistar did. It reported the figures that were calculated according to the numbers reflected on its financial books of accounting. It reported the figures on the last day of its taxable year ending in 2004: October 31, 2004. It filed the Amortizable Amount Report before June 30, 2006. There is absolutely no evidence in the record that Navistar reported incorrect figures, or used an incorrect date or taxable year. There is no evidence that Navistar did not file the necessary information sheet by the deadline. Indeed, Mr. Pottorf, the executive administrator of the Department of Taxation's audit division, testified at II Tr. 219 that Navistar in fact complied with all the various requirements with respect to timing and notice necessary in order to claim the credit.

In applying statutory provisions, the statute is to be applied as enacted. "Courts have no legislative authority and should not make their office of expounding statutes a cloak for supplying something omitted from an act by the Ohio General Assembly." *Storer Communications, Inc. v. Limbach*, 37 Ohio St. 3d 193, 194, 525 N.E. 2d 466 (1988), quoting *State ex rel. Foster v. Evatt*, 144 Ohio St 65, 56 N.E.2d 265 (1944), paragraph seven of the syllabus . Words that are used are not to be ignored, nor are words to be added that are not included in the statute. *Columbus Suburban Coach Lines, Inc. v. PUCO*, 20 Ohio St. 2d 125, 254 N.E. 2d 8 (1969). As a result, when a statute is clear on its face, there is no need to resort to any rule of statutory construction. The statute is to be applied as enacted. *Lancaster Colony Corp. v. Limbach*, 37 Ohio St. 3d 198, 199, 524 N.E.2d 1389 (1988).

This principle was recently affirmed and applied by this Court in resolving another tax case. *Cincinnati Community Kollel v. Testa*, 135 Ohio St. 3d 219, 2013-Ohio-396, 985 N.E.2d 1236. In *Cincinnati Community Kollel*, a taxpayer claimed a real property tax exemption pursuant to R.C. 5709.12 and 5709.121(A)(2) for property that was owned by an educational institution and used as a residence by students, who in turn also used the property to pursue their studies. Despite the absence of any language relating to the primary use of the property, the Tax Commissioner denied the exemption on the basis that the property was primarily used as a private residence, rather than for educational purposes. On appeal, the BTA affirmed that determination. This Court reversed the decision of the BTA on the basis that the particular statute in question, R.C. 5709.121(A)(2), did not contain a requirement relating to the primary use of the property, and neither the Tax Commissioner, nor the BTA could impose such a requirement. *Cincinnati Community Kollel*, at ¶¶ 26, 27.

A similar situation is presented here. The language of the statute is straight-forward in providing that the amount of the credit available to a taxpayer is based upon the contents of its books and records as of the last day of its taxable year ending in 2004 as reflected in the Amortizable Amount Report that was due June 30, 2006. Navistar followed that language. In its timely-filed Amortizable Amount Report filed prior to June 30, 2006, it based its amortizable amount upon the Ohio NOL carryforward and related valuation allowance as reflected on its financial books of accounting on October 31, 2004. Subject to review for accuracy, it was entitled to the credit as set forth in the notice that it filed with the Department of Taxation.

D. The Decision of the BTA is Unlawful

The BTA, however, failed to apply the statute as enacted. Instead, it was seduced by the Tax Commissioner's argument that the authority to audit the credit to "correct any errors" provided by R.C. 5751.53(D) extended to disregarding the deadline specified as to the calculation of the amortizable amount. BTA Decision and Order at 7-8.

The legal flaw in this decision is that there is no authority for the Tax Commissioner to consider subsequent revisions to a taxpayer's financial statements. R.C. 5751.53(A)(6)(b) is clear: the amount of the credit is based upon the amounts reflected in the taxpayer's books and records as of the last day of its taxable year ending in 2004, and as set forth on the notice filed with the Tax Commissioner pursuant to R.C. 5751.53(D). At the time the Amortizable Amount Report was submitted, there were no errors in that report to be corrected on audit. There is nothing in the statute to indicate that the Tax Commissioner may consider events of any sort subsequent to the deadline contained in R.C. 5751.53(D). No rule was promulgated to address this issue. Even the information release issued by the Tax Commissioner explaining the credit contains no reference to the authority of the Tax Commissioner to consider events subsequent to the filing deadline. *Information Release CAT 2006-06 – Commercial Activity Tax Credit for Unused Franchise Tax Net Operating Losses* – Issued April, 2006. To paraphrase Dr. Seuss, the General Assembly meant what it said, and it said what it meant. The proposition is that simple: There is no authority for the Tax Commissioner to consider information as of any other date.

To the extent there is any tension between the provisions of R.C. 5751.53(A)(6)(b) and 5751.53(D), and within the latter provision itself, the resolution of that tension is straight-forward. The authority to audit granted by R.C. 5751.53(D) refers to the accuracy and timeliness of the various amounts and reports as of the date the Amortizable Amount Report was due, but does not serve to extend to the Tax Commissioner the authority to disregard the deadlines imposed by the statute to consider subsequent events.

The authority for the Tax Commissioner to audit the matter as provided in R.C. 5751.53(D) is not limitless, nor is it toothless. As noted by Mr. Pottorf at II Tr. 245-250, there are a number of things that would need to be reviewed before the credit would be approved. For example, the Tax Commissioner might want to check the accuracy of the NOL carryforward and its allocation to Ohio, even going back to 1990 to do so. He could check to make sure that the figures set forth on the notice accurately reflect the figures contained in the taxpayer's books and records as of the specified date. These are not meaningless exercises.

It is ironic that the very party that insisted upon a firm date with respect to the credit when it was enacted, the Tax Commissioner, now is the party that wishes to ignore that same deadline.

The Tax Commissioner simply went beyond the terms of the statute. In adjusting the amount of the credit for events that occurred after the due date for the Amortizable Amount Report on June 30, 2006, he took action for which provision is not made in the statute, just as he did in *Cincinnati Community Kollel*. That action is unlawful.

The concept of a restatement of financial statements is not new; *FAS 109* was issued in 1992. If there were a concern with subsequent changes to a taxpayer's books and records or financial statements that required adjustment of the credit, the authority to accommodate those changes could have been included in the statute. The General Assembly did not see fit to include such authority within the statute. The Tax Commissioner has no authority to do that which the General Assembly did not authorize that official to do. If there is a perceived gap in the statute, the proper action is to go back to the General Assembly and propose a fix. The Tax Commissioner cannot be allowed to close that perceived gap at his whim as to what suits the state's financial interests.

The action of the Tax Commissioner that was sustained by the decision of the BTA not only is unlawful as a general rule, but it is poor policy as well. There is no notice to taxpayers in the statute, an administrative rule, or an information release, that subsequent events could be considered. There are no guidelines as to the instances when this can occur or any time limits that may apply to it. There are no instructions as to what happens when, as happened here, multiple changes occur. Consider the selective manner in which the Tax Commissioner took action in this case. There is a superficial attraction to the idea that if a taxpayer subsequently changes figures that reduce the amount of a credit, the credit should be reduced. But, those changes could have had the opposite effect. They could have resulted in an increase in the amortizable amount. In fact, in 2011 Navistar was able to eliminate the valuation allowance, which would have increased the credit available to it. However, have no doubt about this: Had the subsequent changes reduced the valuation allowance, thereby increasing the amount of the amortizable amount and the credit, the Tax Commissioner would not have made the change. Instead, that official would be taking the exact position that Navistar is taking in this case.

This latter point also illustrates the vagaries inherent in permitting the Tax Commissioner the unfettered discretion to ignore the deadline and plain language of R.C. 5751.53(D) and 5751.53(A)(6)(b). If he is able to ignore the statutory deadline, then there is no guidance as to which subsequent events are to be considered, and which are not. This increases the opportunities for abuse of, and unequal treatment among, taxpayers. For example, if the Tax Commissioner can go back to 1990 to recalculate a net operating loss to determine the amount of the NOL that is available during 2007 or another open year, then future events should likewise be considered when an open year is audited. That would require the Tax Commissioner to recognize that the valuation allowance was eliminated in 2011 and the entire deferred tax asset should have been available to Navistar for the credit. Amici do not suggest this should be permitted. However, if the deadline imposed by R.C. 5751.53(D) is to be ignored in any context, it must be ignored in the context of all subsequent events. That renders the deadline meaningless.

Neither taxpayers, nor the tax authority, may ignore the express language of a statute when it suits their purposes to do so. This statute is clear. The figures reflected on the books and records as of the specified date determine the amount of the credit and subsequent changes are not considered. Considerations of notice, clarity, and fairness all compel this result.

This does not result in a windfall to taxpayers. The fact a valuation allowance is established does not mean that a taxpayer is not entitled to claim the full benefit of a deferred tax asset. The full amount remains available to the taxpayer should future events occur so that it can be claimed. Indeed, in 2011 subsequent events caused Navistar to eliminate the valuation allowance and recognize the full value of the deferred tax asset for balance sheet purposes.

This case illustrates the wisdom in imposing a deadline by which the amount of the credit would be determined. It is a deadline that the Department, itself, wanted placed into the statute. It is a deadline that the General Assembly placed in the statute. It is a deadline that is imposed without deference to taxpayers, or the Tax Commissioner. Most important, it is a deadline without exceptions. The Tax Commissioner cannot now argue that the deadline should be ignored because to do so favors his position. The decision of the BTA holding that the deadline does not apply goes beyond the clear terms of R.C. 5751.53. That decision introduces uncertainty, reduces clarity, and is manifestly unfair. It is, therefore, unlawful and must be reversed.

CONCLUSION

R.C. 5751.53(D) clearly provides for the date by which the amortizable amount is to be calculated and claimed. This deadline is clear and provides notice to all parties, taxpayers and tax collectors alike, of the requirements of the statute. The language is plain and admits of no confusion. It should be applied as enacted.

The action of the Tax Commissioner that was upheld by the BTA disregards the clear language of the statute. The position goes beyond the clear language of the statute and provides discretion to the Tax Commissioner where no such authority is indicated. It permits the Tax Commissioner arbitrarily to consider events that favor that official's position, and to disregard those events that do not. This renders the statute unclear and arbitrary. Taxpayers have a right to expect more. Not only is this action unwise and unfair, but it is also unlawful. For those reasons, the decision of the BTA must be reversed.

Respectfully submitted,

Mark A. Engel

Mark A. Engel (0019486)
Counsel of Record
Anne Marie Sferra (0030855)
Bricker & Eckler LLP
9277 Centre Pointe Drive, Suite 100
West Chester, OH 45069
Tele: 513.870.6565
Fax: 513.870.6969
Email: mengel@bricker.com

Attorneys for Amici Curiae,
Ohio Manufacturers' Association
and Ohio Chamber of Commerce

CERTIFICATE OF SERVICE

Copies of the foregoing Brief of Amici Curiae Ohio Manufacturers' Association and Ohio Chamber of Commerce were mailed by first-class U.S. Mail this 4th day of September 2014, to Maryann B. Gall, 230 West Street, Suite 700, Columbus, OH 43215, attorney for Navistar, Inc., Appellant, and to Michael DeWine, Attorney General, and Barton A. Hubbard, Assistant Attorney General, Taxation Section, 30 East Broad Street, 25th Floor, Columbus, OH 43215, attorneys for Richard A. Levin [Joseph W. Testa], Tax Commissioner of Ohio, Appellee.

Mark A. Engel

Mark A. Engel (0019486)
Attorney for Amici Curiae
Ohio Manufacturers' Association
and Ohio Chamber of Commerce

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 <u>backward</u> 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 <u>two</u> of its four manufacturing facilities, close <u>eleven</u> 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 respectively 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.