



**HOUSE FINANCE COMMITTEE  
INTERESTED PARTY TESTIMONY ON HB 64**

**Submitted on March 26, 2015 by:  
Andrea Ashley, Vice President of Government Relations  
Associated General Contractors of Ohio**

Chairman Smith, Vice Chair Schuring, and Ranking Member Driehaus:

Thank you for the opportunity to testify on HB 64, and share our concerns on specific matters impacting the construction industry.

My name is Andrea Ashley, and I am the Vice President of Government Relations for the Associated General Contractors (AGC) of Ohio. AGC of Ohio is a commercial construction association that represents large and small commercial general contractors and specialty contractors. Most AGC of Ohio members are commercial or industrial builders. Our members construct and renovate a wide variety of vertical structures like schools, office buildings, apartments and dormitories, industrial facilities, parking structures, and utility and waste water treatment plants... to name a few.

**COMMUNITY SCHOOL CLASSROOM FACILITIES GRANTS**

HB 64 creates a new Community School Classroom Facilities Grant program (C230W4). The program would be jointly administered by the Ohio Department of Education and Ohio School Facilities Commission (OSFC). There is \$25 million earmarked for the grants, which could be used for the purchase, construction, reconstruction, renovation, remodeling or addition to classroom facilities.

As currently drafted, construction projects under the program would not be subject to the laws under Chapter 153 of the Ohio Revised Code. Chapter 153 contains the vast majority of construction laws related to public building projects, like publicly-funded school construction – laws that ensure some form of transparency, competition, and public notice of projects.

If the State of Ohio is providing public funds for the community schools to operate, as well as funding their facilities' construction programs, schools receiving the grants should have to comply with the same public construction laws applicable to other K-12 schools funded and administered by the OSFC and/or Ohio Facilities Construction Commission.

AGC has been working with the Mechanical Contractors Association of Ohio, the Ohio Chapter of the National Electrical Contractors Association, and the Construction Employers Association in Cleveland in the hopes of having the grant language amended to incorporate Chapter 153 and ensure competition, transparency and public notice on construction projects funded under with a Community School Classroom Facility Grant.

### **SALES TAX INCREASE & EXPANSION; COMMERCIAL ACTIVITIES TAX**

To provide a bit of background about the commercial construction industry, most Ohio contractors would be considered small-to-medium sized businesses, and the majority are structured as pass-through entities. Most are closely-held or family-owned.

The construction industry is grateful for the legislature's and Governor's efforts to improve the tax climate in Ohio. We greatly appreciate some of the recent changes made to simplify Ohio's municipal tax structure and lessen the tax burden on pass-through entities. However, contractors have expressed concern about the proposed CAT and sales tax changes contained in HB 64.

#### **Sales tax expansion; definition of management consulting service**

The expansion of the sales tax to include previously untaxed services and the broadened definition of "management consulting service" could potentially cover a wide range of construction services. Some examples include construction management, value engineering (cost control consultation), building information modeling, and other pre-construction and project consulting services.

Additionally, as other business groups have articulated, few states have such a broad sales tax on services, which could put Ohio businesses, including construction companies, at a competitive

disadvantage. Many Ohio contractors, especially those in border areas, provide construction services for out-of-state owners. Given the competitive nature of the industry and focus on best price and best value, Ohio contractors would be placed at a disadvantage since many contracts are awarded by slim margins.

Lastly, the sales tax increase and expansion will increase the cost of many services and products contractors need to operate their business.

### **Sales tax on management services to other members of a consolidated group**

Many construction firms have affiliated companies that specialize in certain types of construction or construction services, real estate and development, or supply construction materials or equipment. The sales tax on management services to other members of a consolidated group is a new tax that would add a significant cost to their operations.

For one AGC member, whose three entities combined employ on average 100 people, the tax on the management services between the affiliated companies would amount to \$108,000 based on services provided last year.

### **Increase of CAT and the pancake effect in building construction**

The commercial building industry is a high volume, low margin industry with multiple tiers of contractors. Those contractors who are directly hired by the construction owner pay CAT on their entire contract amount. Then, a significant portion of the contracted amount is subcontracted out to subcontractors with specialized operations, who in turn pay the CAT on their contract amounts. Then, those subcontractors contract with other sub-subcontractors for certain portions of their contracted amount, and those sub-subcontractors pay CAT on their contract amounts. It is not uncommon for a commercial building project to have three to five tiers of contractors on a project.

Essentially, the CAT is pancaked in the building industry – with the same dollar being taxed multiple times. And, unlike heavy highway operations, the building industry is not equipment intensive, and building contractors did not see significant tax savings when the state moved to the CAT.

An increase in the CAT from 2.6 mills to 3.2 mills will increase construction costs. And contrary to popular belief, the CAT cannot always be included in construction bids, and contractors do sometimes have to take the CAT out of their project's profits.

One of our contractor members—who primarily works as a construction manager on public and private projects provided the following information based on the company's contracts last year:

- The firm contracted and paid CAT on \$56 million
- Five percent of the contracted amount went toward the company's project management services, contract coordination, overhead, profit, etc. The remaining 95 percent of the contracted amount was subcontracted
- The company believes that approximately 40 percent of the subcontracted amount was contracted out to sub-subcontractors

Based on those assumptions for the projects in which the contractor was involved, the difference in the CAT would be over \$78,000, or 0.13 percent, more than double the 0.06 percent additional CAT increase proposed. (And keep in mind, this is only based on three tiers of contractors; many of the firm's projects had one or two additional tiers.)

Lastly, given the application of the CAT in the building industry, very few small, pass-through building contractors will meet the \$2 million in gross receipts to pay no income tax on business income or the flat \$150 in CAT – even if the amount of work they self-perform is under the \$2 million threshold.

### **Timing of CAT increase**

If passed as currently drafted, the CAT increase would go into effect July 1 of this year. We have received calls from contractors asking if, when, and how much will the CAT be increased so they can incorporate the change into their bids, with the hope that the construction owners would cover the additional tax burden. Obviously, those questions cannot be answered yet. But employers should have time to budget and prepare for tax increases.

**General view of proposed tax changes:**

One contractor in the northern part of the state submitted a spreadsheet that spelled out the potential impact of the tax changes. The company, who employees about 225 people (over 350 during the summer, which is prime construction season), is looking at a \$286,714 tax increase. The spreadsheet is attached to my testimony, for your information.

In conclusion, we thought you might be interested in some of the comments we've received from construction employers about the overall tax proposal:

*"The construction industry in the Midwest has been hit particularly hard over the last several years due to the economic slowdown, and now just as we are starting to see some light at the end of the tunnel we are going to be hit with higher taxes!"*

*"There are too many double-edged swords in the proposed tax changes and most if not all of them will be bad for Ohio. Unfortunately, I don't see a lot in this plan to cut significant governmental costs – that would be the best approach in my opinion."*

*"Taxing only those businesses above a certain threshold is certainly not fair. Every business should be required to pay its fair share and this 'threshold' would certainly lead to some setting up many smaller companies to avoid having to pay the tax instead of just growing one company."*

*"The CAT increase amounts to about \$33,500 of additional tax for us. The CAT is an easy target and seems small when talking 2.6 mills to 3.2 mills. To put it in terms the Governor and Legislature might appreciate, this is cost of one of our accounting clerks."*

None of the contractors from whom we've heard – large or small – think the proposed tax package would benefit their company or believe it is worth the reduction on personal income taxes. In fact, they view it in totality as a tax increase, and believe the proposal would ultimately offset past tax reductions on pass-through entities.

# Ohio Governor Kasich's Tax Reform Proposal

*Impact on one Ohio construction firm*

CAT		<u>Estimated 2015</u>
Gross Receipts		120,000,000
Current Rate	0.0026	312,000
Proposed Rate	0.0032	384,000
Increase		72,000
 Intercompany Services		 1,180,000
Proposed sales tax+county (6.25% state + 1.5% county)	7.75%	91,450
 Constr Mgmt Sales		 525,000
Proposed sales tax+county (6.25% state + 1.5% county)	7.75%	40,688
 Legal & Professional Fees		 285,000
Proposed sales tax+county (6.25% state + 1.5% county)	7.75%	22,088
 Sales Tax Rate Increase		
Tax paid on estimated purchases (old rate)		834,742
Tax at New Rate		895,230
Increase		60,489
 <b>Total Estimated Additional Tax</b>		 <b><u>286,714</u></b>