BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
REPRESENTATIVE DEREK MERRIN, CHAIRMAN

TESTIMONY
OF
RACHAEL CARL
THE OHIO MANUFACTURERS' ASSOCIATION

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Mr. Chairman and members of the House Ways and Means Committee, my name is Rachael Carl, and I am the director of public policy services for The Ohio Manufacturers' Association (OMA). I appreciate the opportunity to provide testimony on House Bill 234.

The OMA was created in 1910 to advocate for Ohio's manufacturers; today, it has 1,300 members. Its mission is to protect and grow Ohio manufacturing.

Ohio's Former Tax Structure

Prior to 2005, Ohio's tax structure was essentially unchanged since the 1930s when Ohio's economy was driven by agriculture and manufacturing. Its tax structure reflected that economy. The major taxes were the real property tax, the sales and use taxes, the tax on tangible personal property used in business, and the corporate franchise tax measured on net worth. However, both the franchise tax and the tangible personal property tax, especially, hit capital-intensive industries harder than other industries and had to be paid whether the entity made or lost money. Thus, the manufacturing sector paid an inordinately high level of state tax when compared with other segments of the economy.

As service industries made up a larger share of Ohio's economy, the inequality in the state tax burden between manufacturing and other segments of the economy was exacerbated. Many service sector entities operate without a significant investment in capital; hence, their tangible personal property and net worth franchise tax liabilities were minimal. Many of these service organizations operate on thinner margins or can adjust their finances to minimize income; as a result, little state income tax was generated. In addition, many of these new service entities were organized as pass-through entities that were not subject to the franchise tax. As the demand for state services grew, the only recourse was to raise rates on existing taxes and taxpayers. In many cases, that meant an increased tax burden for Ohio manufacturers.

Paradoxically, Ohio continued to add exemptions from, and exceptions to, the various taxes during this time. As a result, Ohio businesses were saddled with a number of taxes that had high nominal rates, but state government struggled to raise sufficient levels of revenue for governmental operations. The discrepancies between taxpayers and economic segments also increased and compliance with the tax laws became more complicated.

The large and increasing number of exemptions and exclusions – added over the years in order to render the franchise, personal property, and sales and use taxes less onerous – narrowed the bases of those taxes. Accompanied by the steady rise in tax rates, the tax structure was not only inefficient, but also discriminatory to businesses with heavy investment in capital.

Tax Reform Enacted

Over the years, calls increased to reform Ohio's tax system to render it more fair and competitive. Finally, in early 2005, true tax reform was proposed. The goals of this reform were:

- Eliminate the taxation on investment and shift to the taxation of consumption;
- Broaden the overall business tax base;
- Reduce overall business tax rates;
- Improve fairness;
- Provide a more stable and predictable flow of state revenue; and
- Simplify compliance for taxpayers.

The result was a comprehensive overhaul of Ohio's tax system by H.B. 66. As enacted, the bill:

- Eliminated the tangible personal property tax on new investment in manufacturing and phased out the tax on all general business property over four years;

- Phased out the corporate franchise tax for most corporations over five years;
- Phased in a 21% reduction in personal income tax rates ratably over five years (the last reduction was delayed two years in 2009 to balance the state budget during the Great Recession, but was implemented in 2011); and
- Enacted the commercial activity tax (CAT), a broad-based, low-rate tax measured by gross receipts from virtually all business activities and entities.

H.B. 66 became law in June 2005. Although generally opposed to gross receipts taxes because of their compounding nature, taxpayers warmed to the CAT as the net savings over the former franchise and personal property taxes became clear due to the broad base, limited exclusions, and the low rate. There were favorable provisions added for smaller businesses – only taxpayers having more than $150,000 in taxable gross receipts must pay the CAT and CAT taxpayers with taxable gross receipts between $150,000 and $1 million pay only $150 for the calendar year. Additionally, compliance costs were slashed as taxpayers no longer had to undertake the arduous process of preparing personal property tax returns or corporate franchise tax reports.

Results of Tax Reform

Through time, questions have been raised regarding the effectiveness of the 2005 tax reform efforts. The OMA has been at the forefront in demonstrating that, indeed, the effort was worthwhile.

- Since 2005, Ohio has been awarded *Site Selection* magazine's "Governor's Cup" numerous times. The Governor's Cup is awarded annually to the state having the most major new business projects – and projects per capita – in the nation. Recently winning the award for 2020, the magazine noted that Ohio "deliver[s] the kind of business climate and fiscal predictability that capital investors from around the world rely on for long-term success, even during a year unlike any other in modern memory."

- The Small Business & Entrepreneurship Council's Business Tax Index in 2019 (the most recent year published) rated Ohio's state tax system as 13th best nationally.

- In the 2021 edition of its "Top States for Business" comparison, CNBC ranked Ohio second best in the nation for cost of doing business. According to the network, this category includes "each state's business tax climate, as well as tax burdens for various types of businesses and facilities."

Summary

I share this history of the CAT to provide the background of how we got to where we are today. Certainly, manufacturers would appreciate a lesser tax burden. Lower taxes mean more opportunities to allocate additional dollars to investments in their facilities, equipment, employees, and communities. The legislature has continued to provide for those opportunities most recently through the enactment of the state's biennial budget bill, in which the tax on employment services was repealed and the personal income tax was reduced, among other important improvements in Ohio's tax structure.

However, we offer a word of caution. If Ohio can truly forgo the approximately $2 billion in revenue generated by the CAT, we are in. But should the state find itself in a situation where the foregone revenue becomes an issue for balancing its budget, a repeal-now-replace-later approach would create uncertainty for businesses everywhere.

As mentioned previously, manufacturers have a history of bearing the brunt of the state's tax burden on businesses. We know you do not take lightly the impacts of tax reforms on job creators, and we simply ask that you continue to evaluate the competitiveness of Ohio's tax structure with cautious optimism and deliberation. We also urge that any repeal of the CAT is not accompanied by a repeal-and-replace model that could harm the competitiveness of Ohio manufacturers in today's global market.

Thank you very much for the opportunity to appear here today. I'd be pleased to answer any questions.