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Testimony of Albert F. Macre, CPA on Municipal Tax Issues

Thank you, Mr. Chairman and members of the Ohio Senate Ways & Means Committee. My name is Albert F. Macre and I'm here to provide the committee with some thoughts and perspectives on Ohio's municipal income tax system that I have developed over twenty five years as a practicing Certified Public Accountant, Assistant Professor of Accounting at the Franciscan University of Steubenville, and as an owner of several small businesses. I am providing this testimony on behalf of the Ohio Chapter of the National Federation of Independent Business, on whose Leadership Council I serve. The NFIB/OH represents 25,000 Ohio small businesses.

In 1850, English author Francis Edward Smedley penned a quote with which we are all familiar… "All is fair in love and war." Had Mr. Smedley been alive today, he surely would have surely appended his quote to include Ohio's current convoluted system of municipal taxation.

Several years ago, I had the honor of providing similar testimony to the House Committee addressing what I felt to be some serious flaws and inequities embedded sporadically within the various Ohio municipality tax laws. One, which to my understanding remained unaddressed in the House Bill, is the issue of offsetting tax credits for residents of one municipality for wage taxes paid to another. This was no doubt quite a relief for those municipalities which can now continue to double tax the earnings of their residents.

One issue that <u>was</u> addressed in the House Bill and one to which I wish to speak today is the Net Operating Loss carry forward.

Currently many Ohio municipalities do not allow for Net Operating Loss Carry Forwards (NOLS) – the process by which losses from a prior year or years can be offset against current year profits. This position is both arbitrary and inherently unfair. The 365 day year provides us with an excellent tool for measuring the amount of time it takes the earth to revolve once around the sun, but fails miserably as a means of providing a time period during which to measure the profits and losses of many business entities.

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First, the year fails to accurately reflect, in many cases, the true operating results of a business entity, which in many cases do not occur in a single year. An example would be a small construction contractor, who for simplicity's sake keeps his tax records on the cash basis. This contractor might incur substantial material, labor and overhead cost in one year, generating a loss. In the subsequent year, as payments are received on completed jobs, this contractor would likely earn a net profit. Without the ability to use prior years' NOLs to offset current year income, the contractor has in essence been disallowed legitimate expense deductions in arriving at his taxable income. The same might be said for a law firm that incurs expenses to prepare for a case that will be heard in a year or two. Those expenses which were incurred to ultimately generate the revenue from the case will, like the contractor's, be non-deductible if the firm incurs a NOL.

Second, the failure to allow NOL carry forwards is to completely ignore the cyclical nature of business operations. Not all businesses can count on steady streams of income from operations. An accounting practice, with its stable client base and expense structure, can expect relatively consistent profits from year to year. But what of a ski resort or commercial snow plowing service that has the unfortunate experience of having to survive an abnormally mild winter? Or a lawn care service that has to endure a hot, dry summer? All of the expenses incurred to keep these businesses in a state of readiness should the weather become friendly will likely throw these businesses into the red. Without the ability to carry forward these losses, these expenses would, in effect, become permanently non-deductible should the mild winter turn into an early spring or if the heat wave lingered into the fall.

Finally, many businesses – especially those that sell durable goods – suffer losses during periods of prolonged economic downturn. Those losses have no value from a tax savings perspective when the economy picks up and sales volume increases. The owner's willingness to continue operations at a loss ultimately creates a tax inflow for the municipality during the good times. In essence, the failure to allow businesses to carry forward losses for a reasonable period of time places the municipality in the enviable position of an opportunistic business partner who only shows up for his cut of the profits in those years when the business is booming, while leaving his erstwhile associate hanging out to dry during the lean years.

Since the United States Revenue Act of 1918, both federal and state governments have recognized the need to remedy the unbalanced burden on businesses forced to calculate their taxable incomes as if 365 days is magically the Alpha and Omega of the business cycle. Ohio and its municipalities would improve their competitive positions by reforming their business tax policies to correspond more accurately with business cycles through the adoption of a 5-year carry forward rule.

In 1957, U.S. Supreme Court Justice Harold Burton wrote, “NOL carryovers ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. They were designed to permit a taxpayer to set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year.”

Ohio has become a much friendlier place for profitable business entities as a result of the Small Business Investor Deduction included in the first biennial budget passed under Governor Kasich. Perhaps now would be a good time to address the needs of those businesses that haven’t been so fortunate.

In closing, allow me to say that it has been my honor to stand before this committee to share my thoughts and perspectives on this important issue. If nothing else, I hope that I have provided a little “food for thought” as you deliberate.

I would be happy to answer any questions you may have.

All the best,

Albert F. Macre

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