



**BEFORE THE ECONOMIC AND WORKFORCE DEVELOPMENT COMMITTEE  
THE OHIO HOUSE OF REPRESENTATIVES  
REPRESENTATIVE NAN BAKER, CHAIR**

**HOUSE BILL 343  
TESTIMONY  
OF  
LUKE HARMS  
SENIOR MANAGER, GOVERNMENT RELATIONS  
WHIRLPOOL CORPORATION**

**NOVEMBER 18, 2015**

Chair Baker and members of the Committee, my name is Luke Harms. I'm Senior Manager of Government Relations at Whirlpool Corporation. Whirlpool is the number one appliance manufacturer in the world, with approximately 100,000 employees and 70 manufacturing and technology centers. Here in Ohio, Whirlpool has five manufacturing facilities with approximately 10,000 employees.

I'm testifying here today on behalf of The Ohio Manufacturers' Association (OMA) with respect to House Bill 343, which proposes to repeal the sales tax on employment services. The OMA was created in 1910 to advocate for Ohio's manufacturers; today, it has 1400 members. Its mission is to protect and grow Ohio manufacturing.

Today I will provide you with background information about the existing sales tax exemption provided to manufacturers with respect to the purchase and use of machinery and equipment used in a manufacturing operation to produce tangible personal property for sale. I will cover the sound policy reasons to extend such tax treatment to employment services.

### **Ohio's Sales and Use Taxes**

Ohio's sales tax was first enacted as a temporary measure in the depths of the Great Depression in the 1930s. At that time, it was conceived as a tax on final personal consumption of tangible goods. One year after initial enactment, the use tax was enacted; the two taxes were made permanent and the first exemption for machinery and equipment used to produce tangible personal property for sale by manufacturing was added. Similar exclusions were made for other activities that, similarly, resulted in the production of goods that would be subject to the tax upon final sale.

The rationale for these exclusions is simple: The taxes are intended to be imposed upon the final consumption of goods and, now, those selected services that are subject to tax. Intermediate transactions prior to the final sale of the product, including the acquisition of machinery and equipment and the raw materials that are incorporated into the final product, are not intended to be taxed. The basis for this is four-fold:

First, imposing the tax on intermediate transactions (sometimes called business inputs) causes the tax to be imposed at each step in the production of a good. This causes the tax to pyramid at each step of the economic ladder, resulting in an effective tax rate that may be much higher than the statutory rate. For example, in conjunction with the 1994 tax study commissioned by the General Assembly, the staff provided an example in which a sales tax rate of 6.5 percent applied to two stages of production resulted in an effective tax rate of 9.5 percent at the time of the final retail sale.<sup>1</sup>

Second, imposing the tax on business inputs increases the cost of doing business through the higher prices that result from the tax. Business generally will respond to higher costs in combination of three ways: It may decide to charge higher prices; it may pay lower wages to workers (or expatriate those positions elsewhere); or it may provide a lower return on investment to owners.<sup>2</sup>

Third, direct inputs lead to the production of more valuable goods that are ultimately subject to the tax.

Fourth, the provision has economic development implications. Every single state that surrounds Ohio has a sales tax. Every one of those states has some sort of exemption from the tax for machinery and equipment used in the production of tangible goods to be sold by manufacturers. Moreover, the *1994 Study* also found that lower rates of taxation on business equipment increase the rate of business formation of smaller firms. Thus, imposing the sales tax on manufacturing machinery and equipment puts Ohio at a disadvantage from an economic development perspective.<sup>3</sup>

The application of sales and use taxes to business inputs has been the subject of comment on at least two prior occasions in Ohio. In 1982, the Final Report and Recommendations of the Joint Committee to Study State Taxes (114<sup>th</sup> General

---

<sup>1</sup> Roy Bahl, Ed., *Taxation and Economic Development: A Blueprint for Tax Reform in Ohio* (Battelle Press 1994), p. 277-278 (the "1994 Staff Report").

<sup>2</sup> *Taxation and Economic Development in Ohio: A Blueprint for the Future*, Final Report of the Commission to Study the Ohio Economy and Tax Structure (December 23, 1994), p. iii ("1994 Study").

<sup>3</sup> *Id.*, at p. 5-4.

Assembly, December 1982), pp. 15-16 concluded that the taxes should be imposed broadly on consumer spending, but very selectively on business spending. Similarly, the *1994 Study* at p. 5-4 and the *1994 Staff Report* at p. 27 both recognized that the sales tax should only be imposed upon the final consumer and that business inputs should not be taxed at all. The taxation of business inputs should be avoided because doing so leads to multiple levels of taxation and economic disadvantages. Moreover, the *1994 Report* concluded that if the sales tax is extended to services, there should be liberal exemptions for transactions between businesses.

### **Manufacturing Exemptions for Tangible Personal Property Is Not Absolute**

Manufacturers enjoy exemption for three categories of purchases:

- Machinery and equipment used primarily during and in the manufacturing process
- Ingredients and materials that are incorporated into the final product that is produced for sale
- Packages and packaging equipment

However, this does not mean that manufacturers do not pay sales and use taxes in Ohio. Manufacturers purchase and use many goods and services that are not included in the manufacturing exemptions. Those items include machinery and equipment that is used before manufacturing begins, or after it ends; cleaning equipment and supplies; maintenance and repair equipment and supplies; storage facilities; most safety items; and office supplies and equipment and motor vehicles. As a result, manufacturers pay millions of dollars in sales and use taxes annually to the state of Ohio.

According to the 2014 Annual Report of the Ohio Department of Taxation, manufacturers as an economic segment paid more than \$410,000,000 in sales and use taxes directly to the state of Ohio. This is in addition to the untold millions of tax dollars that were paid to, and reported by, vendors and retailers located in Ohio. It appears that in terms of tax directly owed to the state, as opposed to tax that is collected from others, manufacturing is one of the largest payers of sales and use taxes in the state.

## **The Tax on Employment Services**

Effective January 1993, in order to fill a hole in the state budget, employment services were added as a taxable service by a conference committee facing a midnight deadline to reach agreement on a new budget. A taxable “employment service” included any transaction in which a person provides personnel to perform work under the supervision or control of another, whether on a short- or long-term basis, where the personnel are paid by the person who provided them. The entire amount paid for the service served as the base on which the tax was calculated.

Originally, four categories of transactions were excluded from the definition. Those four categories include:

- Transactions between members of an affiliated group;
- Persons providing medical and health care services;
- Persons providing contracting and subcontracting services; and
- Persons assigned to another pursuant to a contract of at least a year in duration that specifies that each employee covered by the agreement is “permanently” assigned to the purchaser.

A fifth category, involving services that were resold, was later added to the statute.

The tax generated a great deal of revenue, more than was expected, and the Department became more and more aggressive when it came to auditing the issue. The result was increased uncertainty on the part of business and increased time and expense in litigation responding to the aggressive enforcement activities of the Department.

For example, many manufacturers had begun employing temporary labor as a means of providing extra flexibility in meeting their workforce needs. Whether on a “temp-to-hire” basis, or as a means of meeting temporary up-ticks in production activities, manufacturers increasingly turned to vendors of temporary employees to fill those needs. Not surprisingly, many of those manufacturers assumed that the existing manufacturing exemption, which exempted purchases of machinery and equipment

used to produce tangible personal property for sale in a continuous manufacturing operation, would also cover workers on the manufacturing floor that operated the exempt equipment. Manufacturers and other purchasers of employment services also believed that in appropriate circumstances the services would be resold. After protracted litigation, they were soon disabused of both notions.

Another area that served fertile for litigation was the exclusion for employees that were “permanently assigned” to the purchaser. As noted previously, there were two conditions to this exclusion. First, the employees had to be provided pursuant to an agreement of a least a year in duration. Second, the agreement had to “specify” that the employees were provided to the purchaser on a “permanent” basis.

This provision likewise resulted in a flood of litigation involving issues such as

- Whether the agreement had to be written, or whether an oral agreement would suffice.
- The length of the term of the agreement, especially those that renewed or were cancelable at will.
- The meaning of the requirement that employees be “permanently assigned” to the purchaser.
- Whether the mere recitation of language in a service agreement that employees were permanently assigned was sufficient; or whether the course of conduct between the parties also had to establish that the positions were indeed indefinite.

The Department of Taxation continues to pursue employment services aggressively. It argues that employee turnover is a sign that the employees are not permanently assigned. It also takes the position that an agreement must set forth the name of every employee covered by the agreement, and that if any of the employees provided under an agreement are not provided on an indefinite basis, then the entire agreement is tainted and none of the employees qualify for the exclusion.

In recent audits, the Department takes the position that virtually any transaction involving personnel was a taxable employment service. Thus, transactions in which outside consultants are retained to provide services, such as computer and software design, an engineer, or a skilled tradesperson, are routinely picked up on audit as employment services.

### **The Tax on Employment Services Should Be Repealed**

House Bill 343 proposes to do away with the tax on employment services completely. The bill deletes “employment services” from the list of taxable transactions in R.C. 5739.01(B)(3)(k); it deletes the definition of “employment services” found in R.C. 5739.01(JJ); and deletes reference to the provision in other statutes.

Repeal of this provision reflects sound policy.

First, repeal is consistent with the recent efforts of Ohio tax policy to move away from the taxation of economic investment and towards personal consumption. Manufacturers invest in manufacturing machinery and equipment in order to expand or maintain their capacity to provide jobs and to produce a product for sale, a product that in most cases will be subject to the sales and use taxes when it is sold and used.

Since 2005, Ohio has attempted to move away from the taxation of business investment. It eliminated the tax on business tangible personal property. It eliminated the net worth base of the corporation franchise tax. And, it excludes from the commercial activity tax, receipts in the nature of a return on investment, including labor costs. Repealing the sales tax on employment services is consistent with this policy.

Second, imposing the sales tax on business inputs, including manufacturing machinery and equipment and labor is contrary to sound tax policy. As previous tax study commissions<sup>4</sup> have concluded, good tax policy is based on simplicity, equity, stability, neutrality and competitiveness. Subjecting employment services to tax renders the tax more opaque, more complex, and less fair as final consumers who are less

---

<sup>4</sup> 1994 Study, p. 5-1; *Report of the Committee to Study State and Local Taxes*, March 1, 2003, p. 6.

economically advantaged pay an even higher proportion of their family income in sales taxes. The tax on employment services violates the principles of neutrality and competitiveness as it results in higher costs, which may influence economic decisions and competitiveness. Taken together, all these factors may in fact render the tax less stable.

Just as wages are not subject to sales and use taxes; and business inputs, such as ingredients, machinery and equipment, are exempted from the sales and use taxes, so too should amounts paid for temporary employees engaged in manufacturing activities be excluded from the tax. Employees are a business input; the sales tax should not apply to transactions by which such labor is obtained.

Third, the provision has generated more and more litigation as the Department has taken increasingly aggressive positions with respect to it. The provision is neither clear, nor is it easy to administer.

Temporary employment services play a critical role for manufacturers. At Whirlpool, temporary employees help the company manage seasonal demand changes for appliances. For example, our KitchenAid small appliance factory in Greenville has much higher shipment levels in the months leading up to the holiday season and our major appliance factories in Clyde, Marion, Findlay and Ottawa also see a significant uptick in shipments in the summer, driven by increased home construction and renovations. Temporary employment services not only help us avoid layoffs, but they help recruit skilled workers, many of whom eventually become Whirlpool employees. We compete in a competitive global environment. The products we produce here in Ohio must compete every day with imported appliances from Mexico, China and many other countries.

In conclusion, the impact of H.B. 343, to repeal the imposition of sales and use taxes on temporary employment services is not only founded on sound tax and economic policy, but will help Ohio manufacturers like Whirlpool to remain globally competitive. The sales and use taxes are intended to be taxes on ultimate household consumption; they are not intended to apply to business inputs or to intermediate transactions. Applying

the taxes to transactions involving the investment in labor, especially in labor to operate manufacturing machinery and equipment increases the cost of the goods that are produced, negatively impacts economic decisions, and may place Ohio at a disadvantage when it comes to economic development. That isn't good policy. It ought not to be the policy of Ohio.

Thank you. I'll be pleased to answer any questions you may have.