NAFEM®
North American Association of Food Equipment Manufacturers

Statement of David Rolston, President and CEO of Hatco Corporation, on behalf of the North American Association of Food Manufacturers, at a hearing of the House Committee on Small Business, U.S. House of Representatives, February 14, 2008

The Business Activities Tax and its Impact on Small Businesses

Madam Chairman, committee members, I am David Rolston, President and CEO of Hatco Corporation., a manufacturer of commercial food warming equipment, toasters, and water heaters headquartered in Milwaukee, WI. We have 375 employees, and the company is 100 percent employee-owned.

I also am chair of the Government Relations Committee of the North American Association of Food Equipment Manufacturers, for which I speak today. NAFEM represents more than 600 US companies that manufacture commercial food preparation, cooking, storage and table service equipment and supplies used in restaurants, cafeterias, institutional kitchens, and other commercial food service establishments. Typical products are freezers, refrigerators, stoves, ovens and broilers, food warmers, display tables, serving trays, cutlery, and virtually everything you would see in a commercial restaurant kitchen or food service area.

This is a surprisingly large industry. Total domestic sales are over $8 billion -- and it is an industry composed predominantly of small businesses. Sixty-six percent of the members have sales less than $10 million a year with fewer than 100 employees. We have members from 46 states of the union. Most, like Hatco, are single-state companies, with no physical presence outside their home states.

Efficiency and predictability are essential to a small business. The growing practice of states to assess “business activity” taxes on firms that have no physical presence in the taxing jurisdiction has come as an unpleasant and shocking surprise. If left unchecked, these taxes will become a nightmare for small businesses, increasing our administrative costs, adding an unnecessary layer of inefficiency, and limiting our ability to grow.

Let me give you our example. Hatco, like most NAFEM members, sells through independent manufacturers’ representatives who represent 10-15 companies. Hatco also uses independent service agents to complete warranty repairs on our equipment. Again, these independent companies service the equipment of many different manufacturers. Neither of these types of independent companies cause Hatco to have a physical presence outside of Wisconsin. Nonetheless, we are now being forced to pay business activity taxes in four states where we have customers but no physical presence. Justification given by the states for these taxes is the existence of the representatives or service agents.

Of course, our manufacturers’ representatives and service agents in these states do pay income taxes on their own business profits. That is as it should be. We should be paying taxes in states where we have presence and receive government services. For us, that is Wisconsin. We should not be paying business activity taxes – which are a form of income tax – where we have no physical presence.

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We don’t know what other states will come at us next. These tax bills catch us by surprise. When states first contact us, they sometimes come on hard. One state originally demanded that we pay eight years of back taxes. This would have been significant. Others have threatened penalties.   Litigation, of course, is impractical for a small firm. We try to negotiate, and then we pay up. We can’t pass the costs on, so both the tax payments and, even worse, the administrative costs, are off our bottom line.

What are the consequences? Think about where this is going. Facing business activity taxes assessed by four states where we have no presence is bad enough, but 20 states? 30 states? We would have to add staff just to attempt to keep track of these unforeseeable obligations, file the returns, and try to stay clear of penalties and demands for back taxes. These would, of course, be unproductive employees – a hit to our efficiency. And bear in mind that we are a 100 percent employee-owned company. Any added costs hurt every employee.

And what about the overall impact on the economy? The taxes we pay to states where we have no physical presence come off our net profits. So do the administrative costs. As our net income after expenses is reduced, the taxes we owe to Wisconsin and to the federal government also are reduced. After you factor in both the added taxes and the added administrative costs, both to us and to the states, I doubt that anyone is coming out ahead on what the economists would call a macroeconomic level.

Certainly if other states jump on this bandwagon, we will just be spreading the taxes around, with little, if any, net benefit to anyone.

As a small manufacturer in the US, we face many threats from competitors outside our borders. We continue to be successful by staying lean and smart. Adding unnecessary headcount to administer programs like activity taxes makes us less competitive with overseas companies.

For many years, it has been the presumption that businesses pay taxes only in states where they have physical presence and receive government services. We believe the Congress should act to preserve this standard.

Thank you.