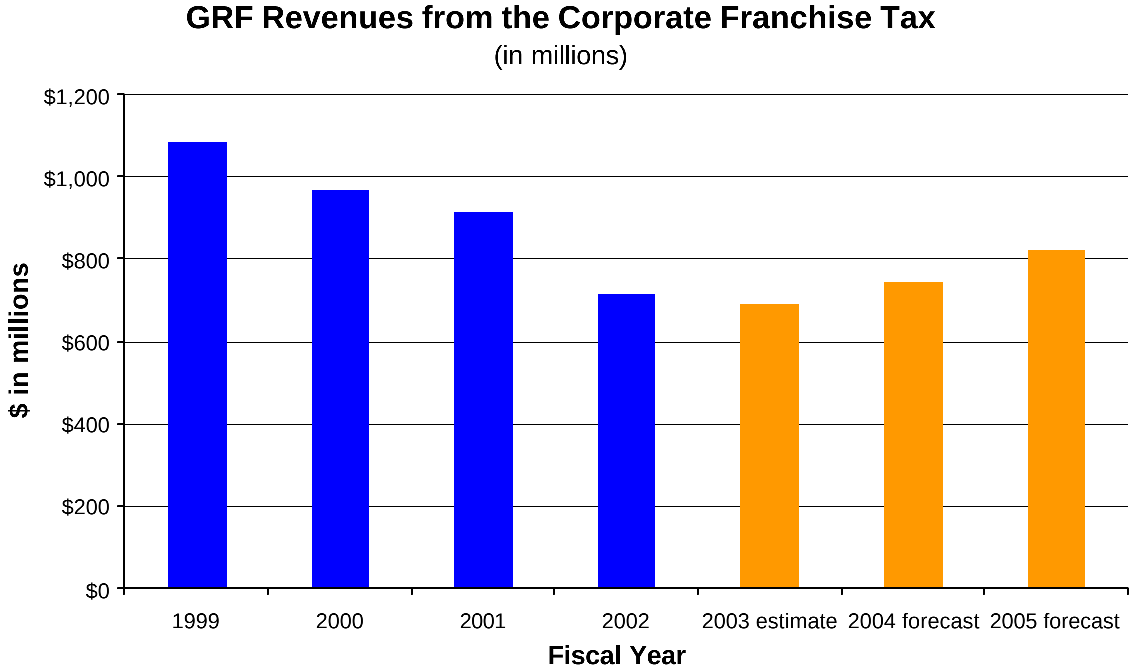
Corporate Franchise Tax

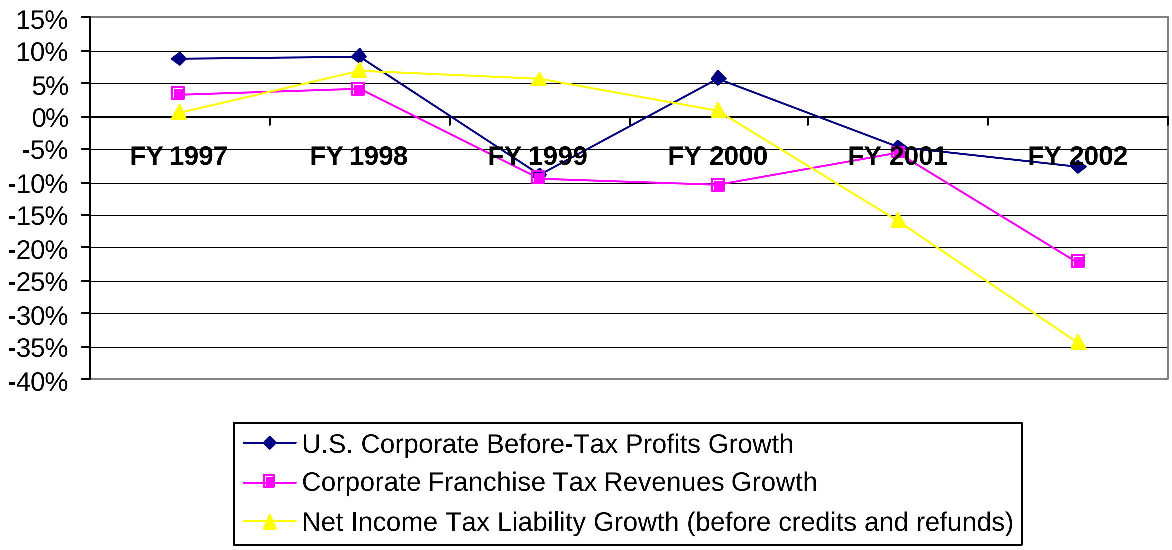


	FY 1999 Actual	FY 2000 Actual	FY 2001 Actual	FY 2002 Actual	FY 2003 Estimate	FY 2004 Forecast	FY 2005 Forecast
Corporate Franchise	$1,084.1	$969.4	$915.3	$712.3	$690.0	$742.1	$821.5
growth	-9.4%	-10.6%	-5.6%	-22.2%	-3.1%	7.6%	10.7%

The franchise tax has two bases: the net worth base (generally determined as net book value of assets minus the net carrying value of liability) and the net income base (generally, the Ohio portion of the federal taxable income with exclusions and additions as required by statute). Differing tax rates apply to each tax base. The corporate taxpayer calculates its Ohio tax liability under the two bases and pays the higher of the two tax liabilities. H.B. 215 (FY 1998-1999 Operating Budget) decreased the net worth tax rate from 5.82 mills to 4 mills and capped the net worth tax liability at $150,000 for each corporation, effective in FY 1999. The full impact of those net worth tax changes have decreased the cushioning effect of the net worth tax base on franchise tax revenues in an environment of lower corporate net income and profits. In addition, more and more new firms are taking advantage of alternative forms of business organization (such as limited liability company), which are not generally subject to the corporate franchise tax. Instead, this net business income is taxed under the personal income tax as a pass-through entity, which has helped contribute to increased volatility in that tax.

LSC derives its forecasts of baseline corporate franchise tax (CFT) revenues from projections of U.S. corporate profits. Translating a corporate profits forecast into a franchise tax forecast is not straightforward because of the dual base of the franchise tax (net worth or net income), the fact that corporations often have taxable years that do not coincide with calendar years, and corporations' decisions on the timing and use of statutory tax credits. In the past, the net worth tax base kept revenues from falling as sharply as profits in recessions or downturns. During the current downturn, it has had less of a cushioning effect. The cap on net worth tax liability of $150,000 shifted many of the corporations to the net income basis (which is not capped). This caused franchise tax revenues to decline greatly as corporate profits fell and the net income tax liability fell. Regardless of a firm's net worth, its net worth liability would at most be the cap amount.

Growth in corporate franchise tax revenues and corporate profits



An analysis of tax revenues in the last few years shows that the elasticity of the corporate franchise tax revenues with respect to U.S. corporate profits has increased. The graph also suggests that this elasticity is asymmetrical. During a period of economic growth, the growth in corporation franchise tax revenues is slower than the growth in U.S. corporate profits. During a downturn, the decline in Ohio franchise tax revenues would be larger than the decline in U.S. before-tax profits. Forecasted corporate franchise tax revenues are based on the profit forecast and elasticity estimates for the next two years. LSC expects a negative growth in franchise tax revenues in FY 2003. U.S. before-tax profits are forecasted to grow 12.6 percent in 2003 and 17.8 percent in 2004. Ohio franchise tax revenues are expected to grow at the rates of 7.6 percent in FY 2004 and 10.7 percent in FY 2005.

Public Utility Excise Tax