

Tony Simmons

President and Chief Executive Officer – McIlhenny Company

February 26, 2014

Business Activity Tax Simplification Act of 2013

Subcommittee on Regulatory Reform, Commercial and Antitrust Law

Good Afternoon, my name is Tony Simmons and I am President and CEO of McIlhenny Company located at Avery Island, Louisiana. McIlhenny Company is a 146-year old family owned and operated business whose most famous product is TABASCO® Brand Pepper Sauce. McIlhenny Company has 240 employees most of whom work at Avery Island. I am the 5th generation of my family to run the company started by my great great grandfather Edmund McIlhenny. In addition to running my family business I also serve as chairman of the S Corporation Association and as a director of America's Wetland Foundation.

TABASCO® is sold in over 166 countries and bottled in 22 languages and dialects. We make every bottle of TABASCO® at Avery Island and you will find our product in almost, if not every, grocery store in America. In addition to our sales through retailers we also sell a large percentage of our product to the food service industry where it is used by chefs in the kitchen, as well as served as a condiment on table tops in the front of the restaurant.

Although we only have one manufacturing plant, we currently pay state income and/or franchise tax in 13 states in addition to Louisiana. We are subject to these taxes because we have employees and/or tangible personal property in those states which meets the physical presence standard in establishing nexus, meaning

it is easy for us to understand and comply. Additionally, we pay income or other forms of business activity tax in 7 additional states, thus a total of 21 states including our home state of Louisiana. Although we are not a large business we spend a significant amount of time and money to attempt to ensure we comply with all state regulations concerning the payment of state taxes. I want to make clear that we are not objecting to paying taxes to states where McIlhenny has employees or operations. Fully aware that location of McIlhenny people and property creates physical presence in certain states, the Company has dutifully fulfilled its obligation to pay state and local taxes in the appropriate jurisdictions. We understand our obligation to pay tax in areas where we locate in order to operate our business. Rather, I am here today to speak in support of HR 2992, the “Business Activity Tax Simplification Act” because we are seeing an increase in the number of cases where states are expanding their definition of substantial nexus to increase the number of nonresident companies subject to state income tax. They are doing this by applying a concept called “economic nexus,” which argues that a state should be permitted to tax a non-resident company with not physical presence in the jurisdiction simply because that company has customers in the state. I will give you three examples McIlhenny Company has faced over the last several years and which I think will demonstrate to you why a bright line

definition of what activity constitutes nexus is so important to companies that do business in multiple states. I will show you first, an example of how a municipality in Washington State imposed a Business and Occupation tax on our company, resulting in a demand for back taxes, penalties & interest 6 to 10 years after the fact; second, an over reach by Michigan which caused the state to demand we pay income tax in Michigan; and finally, a proposal by the state of Maine asserting that a company like McIlhenny would have nexus in the state if we attempt to promote the product directly to the consumer by doing in store product demonstrations or even price reductions.

I will start with the case of a city in Washington State.

Last year, we responded to an inquiry from a city in Washington. As a matter of everyday business, in addition to monitoring tax database services and consulting with our tax advisors on these matters, McIlhenny Company also receives and responds to questionnaires from various tax authorities across the country. Our internal accounting group, with assistance of our CPA firm, completed a questionnaire submitted by this municipality, as always, accurately disclosing the information requested. Not having employees or inventory physically located in the city, we were confident that we had no filing obligation. Upon review,

however, the city claimed that our utilization of an independent sales broker with a branch office in the city established nexus in the jurisdiction and established a filing obligation. Here it is important to note that under current year rules, we were notified that nexus was established due to the broker's address, however, our business activity with the jurisdiction fell below the de minimis standards for a tax obligation. Along with this notification, however, came a request from the auditor for pertinent information going back to 2003. Following their review of the historical data, the city levied a Business & Occupation (B&O) tax assessment of just over \$32,000 in tax, penalties, and interest reaching back to the tax years 2003 thru 2008. This levy was based on a rule that provided for a tax basis of TABASCO® products sales in what amounted to essentially the entire state of Washington.

In our work on this case, we learned that the expanded basis rule within the B&O tax calculation had been vigorously challenged by businesses, and subsequently revised in 2009 to limit the basis to the borders of the taxing authority jurisdiction, in this case, the city. We struggled with the concept of a tax authority reverting back to a prior law, which at some point in time supported a tax assessment, although current law had been improved to eliminate the expanded reach. As this case remains open today, I am not able to expand on it further.

However, suffice it to say that the costs of time, energy, and dollars dedicated to this process outweigh the tax obligation; an underlying issue surrounding this topic.

Going back a few years to 2002, among our initial exposures to the difficulty in reconciling an individual state definition of nexus to PL 86-272 standards, we encountered the Single Business Tax Nexus standards of Michigan. Noting that there were no McIlhenny employees, inventories, or real property in the State, and that sales solicitations were performed by an independent sales broker in Michigan, we contested Michigan's long reach across state lines. Despite our extensive correspondence with the State and our numerous appeals on the merits of our case, an audit by the State resulted in a back tax liability in excess of \$85,000. Several years later in 2007 the tax was repealed and replaced by the Michigan Business Tax (MBT) and eventually the corporate income tax for C corporations and individual liability for S corporation shareholders. The nexus determination, however, also generated an ongoing annual obligation of \$50,000 on average over the remaining years under MBT and more currently an annual obligation of \$25,000 for the company's shareholders. Again, the process of defending our position, and subsequent monitoring and compliance added unfairly to the overall burden while it was in effect.

Finally, our tax advisors have recently brought to our attention a developing situation where the State of Maine is declaring that promotion of a product within a grocery store by a third-party representative located in their state creates nexus and a filing obligation for the manufacturer based on the state analysis and interpretation of an old sales tax case. Keeping in mind that our sales broker arrangement in Maine is consistent with our business practice of using independent entities to solicit sales, the delivery of the goods originated from a location outside Maine, and the TABASCO® goods are in reality the property of the retailer, we are uncertain on how Maine could convey presence to an out-of-state entity in this instance for income tax purposes. No doubt we will continue to monitor this interpretation as it could possibly have a direct impact on our business.

As I noted in my opening remarks, with its unique flavor and ability to enhance the flavor of food and beverages, TABASCO® Brand Pepper Sauce has gathered a tremendous following of users, providing for sales opportunities in all fifty states. With the Company's relatively small footprint at Avery Island, Louisiana, we have been able to fulfill this demand through the use of various independent business entities that provide expertise in sales, marketing, physical logistics and other

supply chain activities, many of which operate on a local or regional basis in various states around the country.

From these examples, I believe you can appreciate the level of complexity our Company is now required to embrace as we attempt to understand the differences in nexus definitions among the states. As you might imagine, the environment in the consumer goods industry, in general, and the hot and spicy food market category, in particular, is quite competitive. Monitoring, interpreting, and complying with, unclear and constantly changing individual state and local nexus regulations places an undue burden on our limited resources, and brings uncertainty to our business planning and execution.

It is our contention that adopting the principles set forth in BATSA will provide, our TABASCO® business and other businesses similar to ours with clarity and certainty relating to our state income tax obligations. We clearly understand that modernization of the law brought about through BATSA may not provide a lower overall tax obligation for our Company, but we do believe it will provide for more efficient application of our compliance efforts, and eliminate the uncertainty from the moving targets associated with nexus establishment. This enables us to focus our energies and resources on growing our business on a level playing field ...