OHIO STATE BAR ASSOCIATION TAXATION COMMITTEE
Sales/Use Tax Subcommittee Report
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I. EXEMPTIONS

A. Manufacturing

Accel, Inc. v. Testa, Slip Opinion No. 2017-Ohio-8798. The Taxpayer's production of gift sets using its customers' products qualified as manufacturing. The manufacturing exemption is defined broadly to include items used in manufacturing, assembling, processing, or refining a product. Assembly is defined as "*attaching or fitting together parts to form a product, but [does] not include packaging a product.*" R.C. 5739.01(R). The Court addressed the characterization of an activity involving assembly and packaging, the latter of which being specifically excluded from the definition. The Court found that Accel's activities of compiling its customers' toiletry products into gift sets reasonably fit into "manufacturing" even though involving both "assembly" and "packaging."

Accel did more than just package products, as the gift set creation involved three stages— design, planning, and assembly. Accel highlighted the significance of, and value created by, the design and planning phases, which typically took two to six months before the gift sets were ready to be assembled. Although Accel's operations included packaging (boxing, wrapping and bounding), this did not disqualify its activities from constituting "assembling" and, thus, being a manufacturer. The packaging was merely incidental to assembly of the gift set components which, when placed together, created a "*new and differently marketable product.*"

Accordingly, when packaging is an incidental part of the overall purpose to create a new and more valuable product, the activity is properly characterized as product assembly and, accordingly, is entitled to the manufacturing exemption. This decision is consistent with the Ohio Board of Tax Appeals' decision, *Express Packaging, Inc. v. Limbach*, Ohio BTA Case No. 89-K-22 (September 18, 1992).

B. Transportation for Hire

The R.L. Best Company v. Testa, Ohio BTA Case No. 2015-2237 (December 4, 2017), appeal pending in the Seventh District Court of Appeals. The BTA found that the Taxpayer was not entitled to exemption for its transportation property (i.e., trucks / trailers) for two independent reasons. First, the Taxpayer did not separately charge for the transportation of customer property to or from its facility where it had been repaired, although the BTA acknowledged that costs associated with the transportation were included in the Taxpayer's cost recovery for the overall charge to repair the customer's

property. Accordingly, although the BTA acknowledged that the Company built the transportation charge into its repair costs, exemption was not available since it did not separately charge for such transportation, being found to be provided as a courtesy (even though the customer only received transportation if it made the repair purchase).

As the second basis for exemption denial, the BTA determined that "dead mileage" occurring when the truck was empty either en route to pick up property to be repaired or to deliver property that had been repaired must be ignored in the numerator for purposes of determining whether the 50% test was met (i.e., use of trucks/trailers more than 50% of the time to transport other person's property), even though the only purpose for the trucks/trailers' movement while empty was to accomplish the customer property transportation. Only "loaded" trips are to be considered in determining primary use of the trucks/trailers.

C. Resale

Karvo Paving Co. v. Testa, Ohio BTA Case No. 2016-782 (January 4, 2018), appeal pending in the Ninth District Court of Appeals. The contractor challenged the assessment on purchases of traffic maintenance property required for ODOT and other public road projects, contending such property was effectively sold via the transfer of possession to ODOT for a fee. The traffic maintenance property included barrier walls, barricades, temporary traffic lights, message boards and signs. The Tax Commissioner asserted this property was not sold but was used by the contractor during performance of the road project.

The BTA held that possession of the traffic maintenance property was transferred because ODOT project engineers controlled the placement and use of the property, which fulfills the state's public obligation to control traffic. Further, the contract documents specified the size, type, amount, and price of traffic maintenance property required for the projects. Therefore, the BTA found that the contractor did not owe use tax on the traffic maintenance property since it was resold to ODOT as rented equipment as part of the public road contract.

D. Casual Sale Exemption

Karvo Paving Co. v. Testa, Ohio BTA Case No. 2016-782 (January 4, 2018); appeal pending in the Ninth District Court of Appeals. The casual sale exemption not available for leased property even though the related lessor had previously used the property in its business. The leased property had been converted to the lessor's inventory via the lease. The BTA found that leasing was the only business of the lessor and the separate entity status of the lessor must be respected.

II. TAXABLE SERVICES

A. Employment Services.

Accel, Inc. v. Testa, Slip Opinion No. 2017-Ohio-8798. The Court found the leased employees provided by Resource Staffing were nontaxable, qualifying for the one-year permanent assignment exception of R.C. 5739.01(JJ)(3) even though the number of provided personnel fluctuated significantly throughout the year and was greatest during the fall, as the holidays approached.

Consistent with its prior precedent, the Court stated that both the contract and facts and circumstances must be reviewed to determine if exception is warranted.

Contract: Although the contract in the record did not have explicit wording specifying permanent assignment, contract wording is not critical. To support assignment for an indefinite period, the contract simply cannot specify an ending date. So, the focus is on an open ended contract (i.e., no language limiting the assignment).

Purpose: The employee must not be provided as a substitute for a current employee who is on leave or to meet seasonal or short-term work load needs. In meeting this standard, the Court focused on the continuity of the workforce as supported by: (a) utilization of the same workers with only their hours being adjusted; and (b) the employees not being used for brief spikes associated with a busy season. The Court stated: "*Ultimately, the distinction between seasonal or short-term-work load employment and more regular employment is one of degree not of kind. In every enterprise, the workload may experience periods of ebb and flow.*"

Accordingly, the following facts should be present to support qualification for the one-year permanent assignment exception: 1) along with reciting a one-year term, the contract cannot include language supporting an ending date for any assignment; 2) the same employees should be supplied to the extent possible (i.e., while working for the provider and satisfactory to the client); and 3) the employees cannot be provided for work load spikes/busy season needs or as a substitute for a current employee on leave.

Karvo Paving Co. v. Testa, Ohio BTA Case No. 2016-782 (January 4, 2018); appeal pending in the Ninth District Court of Appeals. The BTA held that the contractor's purchases of employment services from an affiliated entity were exempt under R.C. 5739.01(JJ)(4) (affiliate group exception). The contractor and affiliated entity were both owned entirely by husband and wife, but had different majority owners – the husband was the majority owner of the contractor, while the wife was the majority owner of the provider. The Tax Commissioner asserted that exemption was not warranted because the same individual did not control both entities. However, the BTA found that the husband had complete control over the business operations of both companies, as his wife (the majority shareholder) granted this control to him in writing. Accordingly, the contractor's purchases of employment services were exempt under the affiliated group exception. The BTA's ruling highlights the scope of this exception, as affiliated status may be established by showing the business operations of two companies are controlled by the same individual, even if majority ownership is not the same.

III. LEGISLATION

A. Local Sales / Use Tax Rates

Sub. H.B. 69 – Counties and transit authorities may levy local sales / use tax rates in increments of 0.1% or 0.25%. R.C. 5739.021 and R.C. 5739.023. Previous law (H.B. 49) had changed law to authorize 0.1%, but eliminated increments of 0.25%.

B. Exemption

S.B. 8 – Corrective eyeglasses and contact lenses will be exempt from sales / use tax effective July 1, 2019. Added to definition of "prosthetic devices" in R.C. 5739.01(JJJ).

IV. OHIO ADMINISTRATIVE CODE

Proposed Rule Changes

Ohio Admin. Code § 5703-9-21 (manufacturing) – Will be reposted by Department of Taxation to incorporate comments.

Ohio Admin. Code § 5703-9-49 (responsible party) – Comments submitted to Department of Taxation, Laura Stanley. Original proposal will not be adopted.

V. DEPARTMENT OF TAXATION GUIDANCE

Information Release ST 2017-02 – Sales and Use Tax: Software Nexus and Network Nexus – Oct. 2017

Interprets nexus provisions effective January 1, 2018 providing that use of in-state software or content distribution networks in Ohio creates a rebuttable presumption that nexus exists if the seller has greater than $500,000 of Ohio sales in the previous or current calendar year. This Information Release supplements Information Release ST 2001-01.

Example of In-State Software Nexus relies upon "a catalog application which is downloaded onto the customer's computer or cell phone. The catalog application is software, in the form of html and java script coding used in displaying the seller's website on the customer's computer or cell phone." This presence is considered to satisfy the *Quill* standard.

Example of Network Nexus involves a seller of security services that uses a content distribution network with three Ohio servers that "enhance delivery of Seller's website and/or web-based services to consumers in Ohio and surrounding states."

Trailing nexus exists until the "seller no longer has nexus creating contacts for one calendar year."

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