

ORIGINAL

**IN THE
SUPREME COURT OF OHIO**

**FREUDENBERG NOK
GENERAL PARTNERSHIP,**

Appellee,

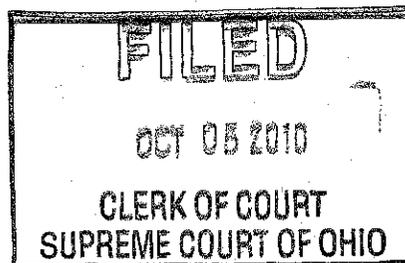
v.

**WILLIAM W. WILKINS
TAX COMMISSIONER OF OHIO
[RICHARD A. LEVIN],**

Appellant.

CASE NO. 2010-0866

**On Appeal from the
Ohio Board of Tax Appeals
Case No. 2006-K-1556 and
Case No. 2006-K-1558**



**BRIEF OF APPELLEE
FREUDENBERG NOK GENERAL PARTNERSHIP**

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STATEMENT OF THE CASE AND FACTS

This case is before the Court pursuant to the Tax Commissioner's appeal as of right from a decision of the Board of Tax Appeals ("BTA" or "Board"). Notice of Appeal, Appellant's Appx. 1 - 11. For purposes of hearing and decision, the BTA combined two appeals by the taxpayer, Freudenberg NOK General Partnership ("FNOK") from final determinations by the Tax Commissioner: one involving an application for refund of \$65,965.22 sales tax erroneously collected and paid for the period January 1, 2001 to December 8, 2004 (BTA No. 2006-K-1556) and another involving a petition for reassessment challenging use tax assessments of \$106,966.78 for use tax and pre-assessment interest for the period January 1, 2000 to December 31, 2002 (BTA No. 2006-K-1558). *BTA Decision and Order* 1 - 2; Appellant's Appx. 11 - 12. In both cases, the taxpayer claimed that the purchases at issue for items used at its Milan, Ohio facility ("Milan facility") were exempt from sales and tax under the "warehouse exemption" currently codified as R.C. 5739.02(B)(42)(j). *Id.* 5; Appellant's Appx. 15.

The Commissioner denied both the refund application and the petition for reassessment on the grounds that FNOK was not engaged in "direct marketing" as defined in R.C. 5739.02(B)(42)(j) and 5739.02(B)(35), and thus that purchases used at the facility in question are not eligible for the "warehouse exemption." *Id.* On appeal, the Board reversed the Tax Commissioner, holding that FNOK was engaged in "direct marketing" as defined in the foregoing statutes, and thus that purchases by the facility in question were eligible for the "warehouse exemption." *Id.* 8 - 9; Appellant's Appx. 18 - 19. Having concluded that the FNOK facility is eligible for the "warehouse exemption," the Board then considered the taxpayer's evidence that particular purchases by that facility were exempt from sales and use tax as items "use[d] or consume[d] . . . primarily in storing, transporting, mailing, or otherwise

handling purchased sales inventory” at a warehouse that is eligible for the exemption. *Id.* 9, *Appellant’s Appx.* 19 (citing R.C. 5739.02(B)(42(j))). The BTA found that several purchases at issue were subject to sales or use tax because FNOK’s evidence was not sufficient to show a particular item’s use “primarily in storing, transporting, mailing, or otherwise handling purchased sales inventory”. *Id.* 13, *Appellant’s Appx.* 23. With respect to many other items, however, the Board found that FNOK had presented sufficient evidence of the purchased item’s exempt use, and thus held that the taxpayer was entitled to sales and use tax exemption for those items. *Id.* 12 -13, *Appellant’s Appx.* 22 – 23. FNOK did not appeal the BTA’s decision and thus does not contest the Board’s conclusions regarding the items that it found were not used for exempt purposes. The Tax Commissioner’s appeal from the Board’s decision challenges both the facility’s eligibility for the “warehouse exemption” and the BTA’s factual determinations that certain individual items were used in an exempt manner. *Notice of Appeal* 2 - 7, *Appellant’s Appx.* 2 – 7.

The record before the BTA consisted of the Statutory Transcripts provided by the Tax Commissioner with respect to both cases on appeal (*Supp.* 1 – 383); 43 Exhibits presented by FNOK and accepted into evidence before the Board (*Supp.* 384 – 465; *Second Supp.* 3 – 5); and the transcript of testimony of one witness, the Milan facility’s Chief Financial Officer, Jason Meier (*Tr.* 11 – 144, *Second Supp.* 11 – 144). The first part of Mr. Meier’s testimony (*Tr.* 11 - 17; *Second Supp.* 11 - 17), and Exhibits 1 – 9 (*Supp.* 384 - 430) show that the Milan facility is a warehouse (*Tr.* 14 lines 9 – 13; *Second Supp.* 14); that orders are placed for product at the Milan facility “primarily through electronic means, direct mail, faxes, email, [and] telephone communications”; (*Tr.* 14 lines 16 - 22; *Second Supp.* 14); and that product is shipped from the Milan facility to its customers by means of mail or common carrier (*Tr.* 14 – 15 lines 23 – 12;

Second Supp. 14 – 15). Counsel also read to the witness the definition of “direct marketing” in R.C.5739.02(B)(35), and asked the witness whether “based on the facts you just recited, . . . Milan’s method of receiving and fulfilling orders meets this definition.” (Tr. 15, lines 13 – 25; Second Supp. 15). After the Hearing Examiner overruled opposing counsel’s objection to the question (Tr. 16, lines 1 – 23; Second Supp. 16), the witness answered the question in the affirmative (Tr. 16 – 17, lines 24 – 5; Second Supp. 16 – 17).

Later in his testimony, the witness established the evidentiary foundation for Exhibits relating to sales and financial information relating to the Milan facility (Tr. 48 – 61 lines 6 – 11; Second Supp. 48 – 61). The witness testified that, based on the Exhibits presented, 48 percent of the product sold by the Milan facility is resold to the customer in the same form, and that the other 52% of the product sold goes to customers who do not resell the product in the same form. (Tr. 54 – 55 lines 22 – 4; Second Supp. 54 – 55). The other 52 percent of the product sold, according to the testimony, goes to customers who change the form of the product before reselling the changed product, either by incorporating the parts into a finished manufactured product or by assembling the Milan facility “subkit” into a “master kit” which the Milan facility’s customer then sells to others. (Tr. 55 lines 1 – 20; Second Supp. 55; Exhibit 1 p. 2, Supp. 385).

The witness’ testimony and Exhibits also established that 84 percent of the product sold by the Milan facility is sold outside of the State of Ohio (Tr. 56 lines 1 – 10, Second Supp. 56; Exhibit 1 p. 3, Supp. 386) and that over 80 percent of the product purchased by the Milan facility is from suppliers that are not part of FNOK (Tr. 56 – 57 lines 13 – 1, Second Supp. 56 – 57; Exhibit 1 p. 4, Supp. 387).

Most of the remaining witness testimony concerned the ways in which the purchases whose taxability is at issue in this appeal are used to store or handle inventory at the Milan facility (Tr. 17 – 48 lines 14 – 5, Second Supp. 17 – 48). The Tax Commissioner presented no evidence in the hearing or otherwise regarding whether particular items were used to store or process inventory at the Milan facility, and made no findings in this regard in either Final Determination at issue. See Final Determination (Petition for Reassessment) Supp. 1 – 3; Final Determination (Refund Claim) Supp. 344 – 346. The facts relating to particular purchases whose use is at issue in this appeal will be referenced directly to the record in the Law and Argument Section, under the Proposition of Law No. 2.

FNOK respectfully asks that the BTA's decision in this matter be affirmed because it is neither unreasonable nor unlawful. The decision was lawful, because as shown below it correctly applied the relevant statutes to determine that purchases used at FNOK's facility are eligible for the "warehouse exemption." The decision was reasonable, because the Board's factual conclusions were supported by sufficient probative evidence in the record.

LAW AND ARGUMENT

As shown in greater detail below, the "warehouse exemption" under R.C. 5739.02(B)(42)(j) exempts from sales tax items that are used in a qualifying warehouse or similar facility (the subject of Proposition of Law No. 1 below), provided that the items are used in a certain way (the subject of Proposition of Law No. 2 below). Per R.C. 5741.02(C)(2), purchases that are or would be exempt from sales tax are also exempt from use tax. As shown below, FNOK's Milan facility is a qualifying warehouse eligible for this exemption, and the particular items that the BTA found were used in an exempt manner at the Milan facility are in fact eligible for the exemption. The Tax Commissioner's attempt to add conditions to the

availability of this exemption that are not in the statute should be rejected as an attempt by the executive branch to do what only the General Assembly may do: add words to a statute.

Proposition of Law No. 1

Under the “direct marketing” eligibility condition for the R.C. 5739.02(B)(42)(j) sales and use tax exemption, the taxpayer is not required to show that it predominantly makes “retail sales to end-user purchasers” from the warehouse’s inventory.

The “warehouse exemption” at issue in this case exempts from sales and use tax “things transferred” used or consumed “primarily in storing, transporting, mailing, or otherwise handling purchased sales inventory in a warehouse, distribution center, or similar facility when the inventory is primarily distributed outside this state to retail stores of the person who owns or controls the warehouse, distribution center, or similar facility, to retail stores of an affiliated group of which that person is a member, or by means of direct marketing.” R.C.

5739.02(B)(42)(j). The statutory language just quoted requires the taxpayer to show both 1) that the facility where the items is used or consumed qualifies for the exemption (“a warehouse . . . or similar facility . . .) and that the items are used at that qualifying facility for certain purposes (“primarily in storing, transporting, mailing, or otherwise handling . . . inventory”). In the cases on appeal, the Tax Commissioner made no findings regarding whether particular purchases were primarily used “in storing, transporting, mailing, or otherwise handling . . . inventory”. Final Determination, (Petition for Reassessment) Supp. 1 – 3; Final Determination (Refund Claim) Supp. 344 – 345. Rather, the Commissioner rejected all of the claimed exemptions because he concluded that the facility itself did not qualify for the exemption under R.C. 5739.02(B)(42)(j). Final Determination, (Petition for Reassessment), Supp. 1 – 2; Final Determination (Refund Claim) Supp.344 – 345. As shown below, the Commissioner erroneously concluded that

FNOK's facility was not of the type that is eligible for the warehouse exemption. The BTA thus correctly concluded as a matter of law and fact that FNOK's facility qualifies for the warehouse exemption and should be affirmed.

The FNOK facility at issue in this appeal meets all of the R.C. 5739.02(B)(42)(j) requirements for the type of facility whose purchases may be eligible for the warehouse exemption. R.C. 5739.02(B)(42)(j) establishes four requirements for the facility itself to be one at which the warehouse exemption may be claimed, and this taxpayer has shown that it meets each of them. First, the facility at which the exemption is claimed must be a "warehouse, distribution center, or similar facility." R.C. 5739.02(B)(42)(j). Second, the inventory at the facility must primarily be "purchased sales inventory." *Id.* Third, the inventory must be "primarily distributed outside this state". *Id.* In his final determinations appealed in this case, the Tax Commissioner concedes that these three requirements are met. Final Determination, (Petition for Reassessment), Supp. 2; Final Determination (Refund Claim), Supp.344 – 45. But the primary issue in this appeal is whether the fourth and final statutory requirement is met, concerning how the inventory from the Milan facility is sold or distributed.

In addition to the three requirements that the Tax Commissioner concedes are met by the Milan facility, R.C. 5739.02(B)(42)(j) requires that the inventory from an eligible warehouse be "primarily distributed . . . to retail stores of the person who owns or controls the warehouse, distribution center, or similar facility, to retail stores of an affiliated group of which that person is a member, or by means of direct marketing." FNOK admits that the inventory at the facility at issue is not distributed primarily to retail stores owned or controlled by FNOK and its affiliates, and thus that FNOK does not utilize either of the first two of the three alternative distribution methods that allow a warehouse to qualify for the exemption. But, as shown below, the FNOK

facility at issue meets the third alternative distribution method requirement because its inventory is distributed “by means of direct marketing” as that term is used in R.C. 5739.02(B)(42)(j).

A. Terms defined in a statute should be construed in accordance with the statutory definition.

The General Assembly directs that words defined in a statute be construed according to the definition in the statute. R.C. 1.42. While R.C. 5739.02(B)(42)(j) does not define “direct marketing,” it states that as used therein, “ ‘direct marketing’ has the same meaning as in division (B)(35) of this section [5739.02].” R.C. 5739.02(B)(35), in turn, states that “ ‘direct marketing’ means the method of selling where consumers order tangible personal property by United States mail, delivery service, or telecommunication and the vendor delivers or ships the tangible personal property sold to the consumer from a warehouse, catalogue distribution center, or similar fulfillment facility by means of the United States mail, delivery service, or common carrier.” The Tax Commissioner found that FNOK “receives orders from its customers by means of the mail, delivery service, or telecommunications” and that FNOK “ships the tangible personal property from its warehouse by means of common carrier.” Final Determination (Refund Claim), Supp. 345. *See also* Final Determination (Petition for Reassessment), Supp. 2. On this basis, the BTA concluded that the inventory at FNOK’s inventory is “primarily distributed . . . by means of direct marketing” (R.C. 5739.02(B)(42)(j)) and thus that the facility at issue meets all of the statutory requirements for the warehouse exemption. *BTA Decision and Order*, 7 – 9; Appellant’s Appx. 17 – 19.

Nonetheless, the Commissioner denied FNOK’s claimed exemption on the grounds that the Milan facility failed to meet an additional condition that does not appear in the above-quoted statutes: that “direct marketing” requires the direct marketer to make “retail sales.” Final

Determination (Petition for Reassessment) Supp. 2; Final Determination (Refund Claim), Supp. 345. In his Brief in this case, the Tax Commissioner asserts that even making “retail sales” is not enough; but rather, an eligible warehouse must make “retail sale[s] to end-user purchasers.” Appellant’s Brief 5¹. By taking this position, the Tax Commissioner made two errors. First, as a matter of law, neither the R.C. 5739.02(B)(42)(j) exemption nor the R.C. 5739.02(B)(35) definition of “direct marketing” limits “direct marketing” to distribution methods involving “retail sales” (much less “retail sale[s] to end-user purchasers”, a term that is not defined or used in the relevant statutes). And second, as a matter of fact, FNOK has presented credible and uncontroverted evidence that a majority of its sales from the facility at issue meet the current statutory definition of “retail sales”.

B. The relevant statutory definition of “direct marketing” requires that the direct marketer make “sales,” rather than “retail sales” or “retail sales to end-user purchasers.”

The relevant statutory definition of “direct marketing” provides that “direct marketing” is “a method of selling.” R.C. 5739.02(B)(35). That statutory definition does not state that “selling,” to qualify as “direct marketing,” be “retail selling” or “retail selling to end-user purchasers.” But the sales tax statutes define “selling” as something different than, and broader than, “retail selling.” “Selling” includes “[a]ll transactions by which title or possession, or both, of tangible personal property, is or is to be transferred, or a license to use or consume tangible personal property is or is to be granted.” R.C. 5739.01(B)(1). Clearly, the Milan facility’s inventory has its title and possession transferred to others, so that the Milan facility is engaged in “selling.” See Final Determination (Petition for Reassessment), Supp. 1 – 3; Final Determination

¹ Since Appellant filed an Amended Brief in the case at bar, “Appellant’s Brief” as used herein refers to his Amended Brief, and Appellant’s Appx. as used herein refers to Appellate’s Appendix to his Amended Brief.

(Refund Claim), Supp. 344 – 45 (Tax Commissioner’s final determinations admit that the Milan facility’s inventory is held for sale).

The statutory definition of “direct marketing” does not require “retail selling” because the text of the definition does not restrict “selling” to “retail selling.” The statute currently defines “retail sales” as those “sales” except those which qualify for the resale exemption. R.C. 5739.01(E)². Since the statute defines both “sales” and “retail sales,” and the latter is a narrower term, the General Assembly would preface “sale” or “selling” with the word “retail” if it intended to refer to a “retail sale.” This Court has consistently held that a statute must be construed without adding to the text words that were not included by the General Assembly. *See, e.g., State ex rel. Purdy v. Clermont Cty. Bd. Of Elections*, 77 Ohio St.3d 338 (1997). In fact, the General Assembly has used “retail” as part of the definition of several other exemptions, showing that it knows how to distinguish between “selling” and “retail selling.” For example, two of the exemptions provided in R.C. 5739.02(B)(35) require that a sale qualifying for the exemption in that section be used in making “retail sales.” R.C. 5739.02(B)(35)(a) & (b). One of these exemptions requires that the purchased item be used in connection with “direct marketing retail sales.” R.C. 5739.02(B)(35)(a). Since the General Assembly is not presumed to do a vain or useless thing, it is presumed to insert language into a statute to accomplish some definite purpose. *State v. Wilson*, 77 Ohio St.3d 334 (1997). If the definition of “direct marketing” required that it apply only to “retail sales,” the use of the phrase “direct marketing

² An earlier version of the statute, in effect until June 25, 2003, defined “retail sales” to exclude not only sales covered by the resale exemption, but also sales covered by several other exemptions that are now part of R.C. 5739.02(B). *See* 150 Ohio Laws, Pt. II, 1999-2001, 2030-2032 (Appellant’s Appx. 189-191, 194-196). There is no evidence that this change was intended to make a substantive change in the operation of the sales tax laws. The purpose of this change was to combine most exemptions into a single section, thus simplifying the administration of exemptions as required by the Streamlined Sales and Use Tax Agreement. *See* Excerpt from the Ohio Legislative Service Commission’s Analysis of Am. Sub. H.B. 95 (Appellee’s Appx. 1 – 3).

retail sales” in the foregoing statute would be redundant, and thus vain and useless. By inserting “retail sales” after “direct marketing in R.C. 5739.02(B)(35)(a), the General Assembly thus must have intended that the phrase “direct marketing” by itself would not be restricted to marketing leading to “retail sales.”

The text of other exemptions also shows that the General Assembly uses different words from those employed in R.C. 5739.02(B)(42)(j) when it wishes to restrict an exemption to situations involving retail sales or sales to an “end-user purchaser.” For example, another type of warehouse exemption (one not claimed by the taxpayer in this case) applies where the warehouse’s inventory is “held for sale to . . . direct sellers”, where a “direct seller” is defined in part as “a person selling consumer products to individuals for personal or household use and not from a fixed retail location.” R.C. 5739.02(B)(48)(a) & (b) (emphasis added). While the text R.C. 5739.02 (B)(48) clearly requires that only those selling directly to a type of end-user purchaser qualify for that exemption, there is no comparable text in R.C. 5739.02 (B)(43)(j) that would restrict the exemption under the latter section to a type of end-user purchaser.

C. A “Consumer” and a “Vendor,” as defined in the relevant statutes, are parties to a “sale” but need not be parties to a “retail sale.”

Perhaps realizing that this Court’s precedents do not allow the Tax Commissioner to add words to a statute that the General Assembly did not include, the Commissioner’s brief advances other creative arguments to support his conclusion that “direct marketing” occurs only in the context of “retail sales.” For reasons set forth below, this Court should also reject these arguments. First, the Commissioner asserts that the R.C. 5739.02(B)(35) definition of “direct marketing” applies only to “retail sales” because the definition requires a shipment from a “vendor” (which we concede), and because only a person making retail sales can be a “vendor”

(which we do not concede). Appellant's Brief 7 – 9. The sales and use tax statute defines a “vendor” as “the person . . . by whom the transfer effected or license given by a sale is or is to be made or given”. R.C. 5739.02(C). A “vendor,” in short, is one who makes a “sale,” not just one who makes a “retail sale,” unless we are to violate the rule that words are not to be added to a statute in the guise of construing it. Next, the Tax Commissioner argues that FNOK's Milan facility cannot be a “vendor,” and thus a direct marketer, because FNOK does not have an Ohio vendor's license. Appellant's Brief 9. But the statutes do not require every “vendor,” or even every “vendor” making retail sales, to obtain a vendor's license: only a person “making retail sales subject to a tax” is required to obtain a vendor's license. R.C. 5739.17(A) (emphasis added). *See also* Ohio Admin. Code 5703-9-01(A) (vendor's license required only for a “vendor making retail sales subject to the Sales Tax”). R.C. 5939.02(B) currently lists at least 50 situations (i.e., exemptions) where sales tax does not apply to a retail sale. A person making only those types of sales, even if none of the sales were for resale (and thus all “retail sales”) does not make “retail sales subject to the Sales Tax” and thus is not required to obtain a vendor's license. For example, a vendor selling only to the State or to political subdivisions (which are not subject to tax under R.C. 5939.02(B)(1)) or selling only to the Federal government (exempt under R.C. 5739.02(B)(10)) would not be required to obtain a vendor's license. FNOK is not required to have a vendor's license not because it is not a “vendor,” and not even because it makes no “retail sales,” but because it makes only sales that are exempt from the sales tax (i.e., sales that are not “retail sales subject to the Sales Tax”). In short, FNOK is a “vendor” under the sales tax laws, even though it is not the type of vendor that is required to obtain a vendor's license.

This Court should also reject the Commissioner's related argument (in Appellant's Brief 7 – 9) that FNOK's Milan facility does not do "direct marketing" because the R.C. 5939.02(B)(35) definition of direct marketing requires a sale to a "consumer" (which we admit) and because a "consumer" must be someone who owes sales tax on the transaction (which we deny). The sales tax statute defines "consumer" as "the person . . . to whom the transfer effected or license given by a sale is or is to be made or given". R.C. 5939.01(D)(1). As used in the sales tax statutes, being a "consumer" is a necessary but not sufficient condition to being liable for sales tax on a sale. Even a reseller is called a "consumer" in the statutes, though by definition a reseller's purchase is not a retail sale. *See* R.C. 5939.01(E). And, many of the exemptions in R.C. 5939.02(B) apply to transactions where the tax-exempt purchaser is called a "consumer." *See, e.g.,* R.C. 5939.02(B)(7), (25), & (27)(a). Thus, while only a "consumer" is subject to sales tax, (per R.C. 5739.03(A)), a person can be a "consumer" even in a transaction that is exempt from sales tax. The statute does not require all "consumers" to pay sales tax – only a "consumer" in a "taxable sale". *See* R.C. 5739.03(A).

The Tax Commissioner admits that FNOK's Milan facility receives orders from customers for tangible personal property, and that it ships the ordered property to its customers. Final Determination (Petition for Reassessment), Supp. 1 – 2; Final Determination (Refund Claim), Supp. 344 – 45. Evidence presented before the BTA clearly shows that FNOK received revenue for these transfers of tangible personal property, and thus that the transfers were for consideration. *See, e.g.,* FNOK Exhibit 2, Supp. 288. This activity undeniably is a series of "transactions for consideration . . . by which title or possession, or both, of tangible personal property, is . . . transferred", which is the statutory definition of "sale or selling." R.C. 5739.01(B)& (B)(1). In the foregoing transactions, FNOK's Milan facility is also clearly "the

person . . . by whom the transfer effected or license given by a sale is . . . given”, which is the statutory definition of “vendor”. R.C. 5739.01(C). And, the Milan facility’s customers are thus “person[s] . . . to whom the transfer effected or license given by a sale is . . . made”, which is the statutory definition of “consumer[s].” 5739.01(D)(1). Based on the foregoing, the BTA concluded that the Milan facility makes sales to “consumers,” and by implication that FNOK’s Milan facility is a “vendor,” and thus met those and all other elements of the definition of one engaged in “direct marketing.” Appellant’s Appx. 7 – 8. This Court should reject the Commissioner’s argument that the Milan facility is not engaged in “direct marketing” because of a specious argument that it is not a “vendor” or that its customers are not “consumers”, as those terms are used in the warehouse exemption statute.

D. Neither the Tax Commissioner’s interpretation nor legislative history should be considered in this case because the statutory definition of “direct marketing” is not ambiguous.

The Revised Code authorizes the use of “legislative history” and the “administrative construction of a statute” to determine legislative intent only where “a statute is ambiguous”. R.C. 1.49. Applying the preceding statute, this Court has held that an unambiguous statute is to be applied according to its plain meaning, rather than interpreted based on factors such as legislative history or administrative construction. *See L.J. Minor Corp. v. Breitenbach*, 77 Ohio St.3d 168 (1996). Similarly, this Court has held that the in pari materia rule of construction may be utilized only where there is some doubt or ambiguity regarding the meaning of a statute. *State ex rel. Burrows v. Indus. Comm.*, 78 Ohio St.3d 78 (1997). Based on the discussion in parts A. through C. above of this Argument, the statutory definition of “direct marketing” is not ambiguous, at least with regard to the issue of whether retail selling is a necessary condition for “direct marketing.” Thus, this Court should reject the Tax Commissioner’s attempt to modify

the statutory definition of “direct marketing” through arguments based on the Commissioner’s administrative position, evidence of legislative history, or the reading of other statutes believed to be in pari materia. In addition, as discussed in the remaining sections under this Proposition of Law, the application of these rules of construction, even if appropriate, do not support adding a “retail sales” requirement to the statutory definition of “direct marketing.”

E. The Tax Commissioner has failed to prove the existence of an administrative interpretation of “direct marketing” that is entitled to deference.

The Commissioner’s Brief asserts that his position that “direct marketing” occurs only where there are “retail sales” is a “sixteen-year administrative position” that is entitled to “great deference” by this Court. Appellant’s Brief 1, 11. As shown in Section D. just above, deference to administrative positions is due only where the statute is ambiguous. *See UBS Fin Servs. v. Levin*, 119 Ohio St.3d 286, 292 (2008) (citing R.C. 1.49 for position that the Tax Commissioner’s interpretation is given deference only if the statute is ambiguous and if the Commissioner’s interpretation is reasonable). But, more significantly, the Commissioner has provided no evidence, and has cited no authority, that his position in the present litigation is a “sixteen-year administrative position.” The Commissioner does not cite, and we have not identified, any published authority (regulations, Information Releases, tax return instructions, Tax Commissioner Opinions etc.) establishing that the Commissioner has taken this position prior to the instant case. And, unlike other situations where the Court has found the existence of an administrative interpretation entitled to such deference, the Commissioner has produced no evidence regarding the existence of a long-standing administrative position. *See UBS Fin Servs. v. Levin*, 119 Ohio St.3d 286, 291 - 292 (2008) (long-time Taxation Department employee testified at the BTA that a particular interpretation had been followed by the Department “for

several decades”). The Commissioner, in fact, presented no testimony or other evidence to the BTA at all in the present case, other than the Statutory Transcript. Tr. 3., Second Supp. 3. The Commissioner has not cited, and we have not found, anything in the statutory transcript supporting the existence of a “sixteen-year administrative position.” And, even if the Statutory Transcript contained a document making such a claim, it should be given no weight by the BTA or by this Court because it would be hearsay evidence, not given under oath or subject to cross-examination by the adverse party. *See* Evid. R. 801(C), 802.

The Statutory Transcript provided by the Commissioner, in fact, contains a document that may contradict the existence of any long-standing administrative interpretation under which FNOK’s Milan facility is not of the type that is eligible for the “warehouse exemption.” A letter from then Lieutenant Governor and Development Director Bruce Johnson to FNOK’s project manager lists, among the “Tax Incentives” potentially available at what was then the proposed Milan facility, the “Warehouse Machinery and Equipment Sales Tax Exemption.” Bruce Johnson Letter, Supp. 237 – 240. The Lieutenant Governor described this exemption in the following words:

Warehouse Machinery and Equipment Sales Tax Exemption: Provides an exemption from . . . sales tax for companies that purchase eligible warehousing equipment. Purchases include machinery and equipment used primarily (51%) in storing, transporting, mailing or handling inventory in a warehouse . . . if the inventory handled by the facility is . . . distributed by means of direct marketing.

Id., Supp. 237. The Lieutenant Governor did not mention any requirement that “direct marketing” could occur only if the Milan facility made “retail sales.” It seems odd that a fellow cabinet member who uses the warehouse exemption to attract new investment to Ohio would not be aware of a long-standing administrative position that would deny this taxpayer that

exemption. The above letter is not inadmissible hearsay because it is an admission by our adverse party, the Tax Commissioner. See Evid. R. 801(D)(2).

We also ask this Court to adopt the rule that the Tax Commissioner's interpretation, to be entitled to deference in construing a tax statute, should be taken by the Tax Commissioner prior to the litigation in which that interpretation is asserted (rather than for the first time by his counsel during the course of litigation) and that the Commissioner's interpretation ideally be in a form – such as a published regulation or Information Release – that gives notice to the public and to taxpayers prior to any tax controversy in which that interpretation is asserted. In Federal jurisprudence, an agency's interpretation of a statute is given considerable deference only if it is the result of "formal adjudication or notice and comment rulemaking", and is given less deference if it takes the form of "opinion letter" or of "policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law." *Christensen v. Harris County*, 529 U.S. 576, 587 (2000). In fact, under Federal law, an administrative interpretation that does not result from formal rule-making is " 'entitled to respect' . . . only to the extent that it has the power to persuade." *Id.* Further, the U.S. Supreme Court does not give an assertion made by an agency's counsel in the course of litigation the same weight that it would give to a published position of the agency taken prior to the litigation, since "Congress has delegated to the administrative official and not to appellate counsel the responsibility for elaborating and enforcing statutory commands." *Investment Co. Institute v. Camp*, 401 U.S. 617, 628 (1971).

The policy rationale for these Federal decisions should apply with equal force to administrative interpretations of the Ohio Tax Commissioner and of his counsel in a tax appeal. This Court should require that, for an interpretation by or on behalf of the Tax Commissioner to be given any deference in the construction of a statute, it should 1) be made by the Tax

Commissioner prior to litigation, rather than by his counsel during the course of litigation, and 2) be done in a way that is designed to provide notice to the public and to taxpayers prior to litigation. In fact, there is a statutory basis for holding that such a position by the Tax Commissioner, to be valid, would have to take the form of a formal rule subject to notice and comment under Ohio's Administrative Procedures Act. Ohio's Administrative Procedures Act states that a "rule" is "any rule, regulation, or standard, having a general and uniform operation, adopted, promulgated, and enforced by any agency under the authority of the laws governing such agency", but "does not include any internal management rule of an agency unless the internal management rule affects private rights." R.C. 119.01(C) (emphasis added). Surely, an "administrative position" taken by the Tax Commissioner on a consistent basis for a period of time, and that affects a taxpayer's eligibility for an exemption provided by the General Assembly, fits within this definition of a "rule," even though it has not been published in the Ohio Administrative Code. And, if such consistent administrative interpretations are "rules," they are not valid unless they are adopted in accordance with R.C. Chapter 119. See R.C. 119.02. On this basis, this Court could conclude that a consistent administrative interpretation of a statute by the Tax Commissioner is a "rule" and is only valid if it is adopted with the formality of a rule – a conclusion that would lead to a similar result to that in the Federal cases discussed above which give a high degree of deference to an agency's interpretation of a statute only where that interpretation is in the form of a formal agency rule.

This Court should at a minimum require that an agency interpretation, to be considered as evidence of the meaning of an ambiguous statute, be published to the public prior to the litigation at hand for other important reasons. First, the statute permitting the use of "administrative construction of the statute" as an aid to construction of an ambiguous statute states that "the

court, in determining the intention of the legislature, may consider among other matters . . . [t]he administrative construction of the statute.” R.C. 1.49. Thus, the administrative construction is one of many factors to be considered in determining the General Assembly’s intent, not the intent of the Tax Commissioner. And, how can an administrative interpretation be indicative of the will of the General Assembly, when that interpretation is neither reflected in legislative history (a separate factor to be considered under R.C. 1.49) nor published in a form that creates a presumption that the General Assembly is at least aware of that position? Even in the *UBS* case relied on by the Commissioner, the BTA found that the Tax Commissioner’s position was not only long-standing, but also had been communicated to taxpayer’s before that litigation in the form of the Department’s tax return instructions. *UBS Financial Services, Inc. v. Zaino*, BTA Case No. 2003-T-1139 (May 25, 2007), 10, unreported; Appx. 45.

Finally, publication of a position to the public at large prior to litigation is required by fundamental fairness to taxpayers. An administrative interpretation that clarifies the meaning of an ambiguous statute is the functional equivalent of an act by the General Assembly that provides the same clarification, particularly if given a high degree of deference by the Courts. And yet, our Constitutional structure would not permit a secret or unpublished act of the General Assembly to have the force of law. See Ohio Const. Art. II, § 15 (approved acts must be filed with the Secretary of State). Even a statute will be declared unconstitutional and unenforceable under the familiar “void for vagueness” doctrine if the statute fails to give notice to those affected by it: “The critical question in all cases is whether the law affords a reasonable individual of ordinary intelligence fair notice and sufficient definition and guidance to enable him to conform his conduct to the law; those laws that do not are void for vagueness.” *Norwood v. Horney*, 110 Ohio St.3d 353, 380 (2006) (emphasis added). If even a legislative act must give

reasonable notice to those affected by it to be valid, an administrative position that is considered in ascertaining the meaning of a legislative act should also give reasonable notice to those affected – which requires, at a minimum, that the administrative interpretation should be published prior to the litigation that seeks to enforce it.

The Tax Commissioner has not shown that the statutory definition of “direct marketing” is ambiguous, and has not demonstrated the existence of a long-standing administrative construction that could be considered (following an initial determination that the statute is ambiguous) in construing the statute. And, for reasons set forth just above, any administrative construction of this statute is unpublished prior to the filing of the Brief in this case and thus, for important policy reasons, should not be considered as evidence of legislative intent under R.C. 1.49. Thus, this Court should reject the Tax Commissioner’s alleged administrative practice as evidence of any legislative intent to require that the definition of “direct marketing” applies only those making retail sales.

F. The legislative history does not prove that the statutory definition of “direct marketing” applies only in the context of retail sales.

The Tax Commissioner argues that the legislative history of the relevant statutes (present R.C. 5739.02(B)(35) and (42)(j)) shows that the General Assembly intended that “direct marketing” occurs only during a “retail sale,” and that therefore a taxpayer engages in “direct marketing” for purposes of the R.C. 5739.02(B)(42)(j)) exemption only if the taxpayer makes “retail sales” from the warehouse’s inventory. Appellant’s Brief 12 - 13. The Court should reject this argument, not only because legislative history should be considered in construing a statute only if the statute has been shown to be ambiguous (as shown in Section D. above) but also because the legislative history shows no intent by the General Assembly that the warehouse

exemption under R.C. 5739.02(B)(42)(j)) be available only for warehouses from which “retail sales” are made.

The Commissioner’s counsel argues, and we agree, that current R.C. 5739.02(B)(35) was enacted at the time that the former exemption for items “directly used in making retail sales” was repealed. Appellant’s Brief 12 – 13; Appellant’s Appx. 138, 156. We also agree with the Commissioner that two of the three particular exemptions provided in R.C. 5739.02(B)(35) apply only to taxpayers making retail sales. Appellant’s Brief 13; Appellant’s Appx. 127 – 128. But this is the case because the text granting those particular exemptions expressly refers to “retail sales.” *See* R.C. 5739.02(B)(35)(a) & (b). A third exemption in R.C. 5739.02(B)(35) applies to refrigerated automatic food vending machines and does not expressly limit the exemption to such machines used to make retail sales. R.C. 5739.02(B)(35)(c). While refrigerated vending machines would typically be used to make retail sales, the text of the exemption does not require that it be used in making retail sales for the machine to qualify for exemption. In theory, a purchaser could buy a refrigerated food vending machine to keep at home for the buyer’s private amusement, and yet that purchase would fit within the exemption defined in R.C. 5739.02(B)(35)(c).

Assuming, *arguendo*, that all of the exemptions in R.C. 5739.02(B)(35) apply only to taxpayers “making retail sales,” this does not lead to a conclusion that all of the exemptions in another part of 5739.02(B) apply only to persons making retail sales. First, the legislative history of R.C. 5739.02(B)(42)(j)) (the basis for the exemption claimed by FNOK) does not indicate either a link to the former “directly used in retail sales” statute or an intent that exemptions under R.C. 5739.02(B)(42)(j) be available only at warehouse facilities that make retail sales. The warehouse exemption at issue in this case was originally enacted in 2005, two years after the

former “directly used in making retail sales” exemption was rescinded and replaced by current R.C. 5739.02(B)(35). See Appellant’s Appx iii (Table of Contents showing legislative history); Excerpt from the Ohio Legislative Service Commission’s Analysis of Am. Sub. H.B. 904 (Appellant’s Appx. 127 – 128); 116 Ohio Laws, Pt. II, 69-70 (Appellant’s Appx. 129 – 133); 145 Ohio Laws, v H66 (Appellant’s Appx. 178 – 187). The Commissioner has presented no evidence that the warehouse exemption was intended to replace all or part of the former “directly used in making retail sales” exemption, and thus no evidence from legislative history that the General Assembly intended the warehouse exemption to be available only at warehouses that make retail sales. The only relationship between the two sections (aside from their both being one of the 50 current subdivisions of R.C. 5739.02(B), listing all sales tax exemptions except that for resale) is that R.C. 5739.02(B)(42)(j) incorporates the definition of “direct marketing” that is also used in R.C. 5739.02(B)(35) – just as it also, apparently for drafting convenience in both cases, incorporates by reference the definition of “affiliated group” in another R.C. section. As shown below, incorporating this definition in no way limits the exemption for direct marketers under R.C. 5739.02(B)(42)(j) to those “making retail sales”.

Since only the definition of “direct marketing” in R.C. 5739.02(B)(35) is incorporated by reference into R.C. 5739.02(B)(42)(j), the General Assembly’s chosen words express no intent to incorporate any of the other requirements for the 5739.02(B)(35) exemptions into the requirements for the 5739.02(B)(42)(j) exemption. In addition, it is not the text of the “direct marketing” definition in R.C. 5739.02(B)(35), but other parts of the text not incorporated into R.C. 5739.02(B)(42)(j), that causes the (B)(35) exemptions to apply only to those in retail sales. The first two R.C. 5739.02(B)(35) exemptions expressly apply only to consumers involved in retail sales, while the third exemption (for vending machines) applies to a consumer that is not

expressly required to be involved in making retail sales. Of the (B)(35) exemptions, it is only the exemption in R.C. 5739.02(B)(35)(b) that applies to “direct marketing vendors.” R.C. 5739.02(B)(35)(b). And, this latter exemption applies to those making retail sales, not because of the text of the definition of “direct marketing” (which appears at the end of R.C. 5739.02(B)(35), and subdivision (c)), but because subdivision (b) of 5739.02(B)(35) expressly applies only to “[s]ales to direct marketing vendors” of certain items used “for direct marketing retail sales.” R.C. 5739.02(B)(35)(b). The definition of “direct marketing” at the end of R.C. 5739.02(B)(35) makes no mention of “retail sales,” and if it did, the phrase “direct marketing retail sales” in subdivision (b) of that section would be redundant. If “direct marketing” is limited to those making “retail sales,” there would be no need to add the words “retail sales” after “direct marketing” in R.C. 5739.02(B)(35)(b). Again following the rule that the General Assembly is presumed not to add words to a statute without a purpose, it should be presumed to have a reason to add the words “retail sales” after “direct marketing” in R.C. 5739.02(B)(35)(b). *See State v. Wilson*, 77 Ohio St.3d 334 (1997). The only conceivable reason for adding those words is that the use of the phrase “direct marketing” in R.C. 5739.02(B)(35)(b), as that term is defined later in (B)(35), would not by itself limit the exemption to those making retail sales, so that only by including the reference to “retail sales” in (B)(35)(b) could that particular exemption be limited to those making retail sales.

Applying these same concepts to the other grounds for exemption in R.C. 5739.02(B)(42)(j), the fact that taxpayers other than direct marketers qualify for the exemption in that section only if they make retail sales does not support a conclusion that direct marketers must also make retail sales to qualify for the exemption in that section. The warehouse exemption is available to those who meet the other requirements in that section and who also use

one of three primary distribution methods for the warehouse inventory: 1) "to retail stores of the person who owns or controls the warehouse," 2) "to retail stores of an affiliated group," or 3) "by means of direct marketing." R.C. 5739.02(B)(42)(j). In the first of these three situations, the taxpayer presumably is a retail seller, because it is the same "person" that owns "retail stores" (a term not defined in the statute, but presumably meaning a fixed location from which retail sales are made). The taxpayer in the second situation could be a wholesaler, rather than a retailer, albeit a wholesaler that is part of an affiliated group with a retailer. R.C. 5739.02(B)(42)(j) incorporates the definition of "affiliated group" from R.C. 5739.01(B)(3), under which an affiliated group can be two or more corporations where one corporation "owns or controls more than fifty percent of the other corporation's common stock with voting rights." R.C. 5739.01(B)(3). For sales tax purposes, however, a transfer for consideration between two related corporations is generally (absent a specific exemption, such as that in R.C. 5739.01(B)(3)) regarded as a transaction between separate persons, and thus subject to sales tax just as if the legal entities were not related. See R.C. 5739.01(A) ("person" includes a corporation); *IBEC Industries Inc. v. Lindley*, 62 Ohio St.2d 279 (1980) (transfers of tangible personal between corporations for consideration are "sales" for sales tax purposes). Thus, a person using the second distribution method permitted under R.C. 5739.02(B)(42)(j) is a wholesaler (one making sales to a related party retailer), but not a retailer. Stated differently, under the second alternative distribution method that permits an exemption under R.C. 5739.02(B)(42)(j), the person claiming the exemption does not make retail sales from the warehouse inventory, but rather sells its inventory to another person who does make retail sales.

Based on the foregoing, this Court should reject the Tax Commissioner's argument that a direct marketer must make retail sales to qualify for the exemption under R.C. 5739.02(B)(42)(j)

simply because some of the other taxpayers that are exempt under that section make retail sales. Some of the other (B)(42)(j) exempt taxpayers make retail sales (or at least own “retail stores”), while others make only sales for resale (albeit to one or more related entities). This is not a sufficient basis for concluding that direct marketers must make retail sales to qualify for the 5739.02(B)(42)(j) exemption – especially since the drafters used the phrase “direct marketing” in division (B)(42)(j) rather than the phrase “direct marketing retail sales” as in division (B)(35). The General Assembly did not add the words “retail sales” adjacent to “direct marketing” in 5739.02(B)(42)(j), and this Court should not allow the Tax Commissioner to insert those words under the guise of statutory construction. *See Vought Industries v. Tracy*, 72 Ohio St.3d 261 (1995).

An additional reason for rejecting the Tax Commissioner’s contention that “direct marketing” requires the making of “retail sales” is that this would lead to the anomalous result that most of the purchases made from the Milan facility prior to June 26, 2003 would not be “retail sales” and that the majority of the sales made after that date would not be “retail sales,” despite the apparent legislative intent that the legislative change effective on that date should not result in substantive changes to the sales tax law. The record shows that 48 percent of the Milan plant’s inventory is resold in the same form (thus qualifying for the resale exemption under current R.C. 5739.01(E)), while 52 percent of it is changed in some form before being resold by the Milan plant’s customer (thus being exempt from sales tax under, in most cases, the manufacturing or processing exemption under current R.C. 5739.02(B)(42)(a)). Tr. 54 – 55 lines 22 – 20; Second Supp. 54 – 55; Exhibit 1 p. 2, Supp. 385. Thus, under the version of R.C. 5739.01(E) in effect since June 26, 2003, more than half of the Milan facility’s sales would be sales that are not eligible for the resale exemption, and thus that are “retail sales” as currently

defined. However, under the version of R.C. 5739.01(E) effective prior to June 26, 2003, sales covered by the manufacturing and processing exemption were also excepted from the definition of "retail sale." *See* 150 Ohio Laws, Pt. II, 396, 1999 - 2000, Appellant's Appx. 188, 189 - 190 (showing that the manufacturing exemption was located at R.C. 5739.01(E)(2) prior to the effective date of House Bill 95 of the 125th General Assembly on June 26, 2003). This would mean that, prior to June 26, 2003, most of the sales made from the Milan facility were NOT "retail sales," since virtually of the sales were either sales for resale (under prior R.C. 5739.01(E)(1) or sales excluded from the definition of "retail sales" under prior R.C. 5739.01(E)(2).

If, as the Commissioner contends, only retail sales qualify as "direct marketing" under the warehouse exemption, this would mean that purchases by the Milan facility prior to June 26, 2003 did not qualify for the warehouse exemption (since most of the sales from that warehouse were not yet "retail sales"), while purchases by the Milan facility on or after June 26, 2003 would be eligible for the warehouse exemption (since most of the Milan facility's sales would thereafter be "retail sales" due to the change in definition). And yet, the legislative history does not show that this or any other substantive change in the sales tax law was intended by moving the manufacturing exemption from R.C. 5739.01(E) (where it was excluded from the definition of retail sales) to R.C. 5739.02(B) (where it is one of the items that, though "retail sales," are nonetheless exempt from sales tax). *See* Ohio Legislative Service Commission's Analysis of Am. Sub. H.B. 95, 464 & 469; Appx. 2, 3 (intent in making this change was to comply with Streamlined Sales and Use Tax Agreement by consolidating most exception and exemptions into 5739.02(B)). If the General Assembly did not intend to enact a substantive change in the sales tax law by removing the manufacturing exemption from the list of exclusions from the definition

of “retail sale” and moving it to the list of exemptions, it must have thought that changing the definition of “retail sale” in this way would not substantively alter the operation of the sales tax law. If the availability of the warehouse exemption does not turn on the making of “retail sales” (as opposed to “sales”), then and only then does the House Bill 95 change not make a substantive change in the sales tax law. This is further evidence that the General Assembly did not intend that the making of retail sales not be a requirement for the availability of the warehouse exemption for direct marketers.

The final “legislative intent” argument raised in the Commissioner’s Brief is that allowing a sales tax exemption for warehouses engaged in “direct marketing”, but who do not make retail sales, would cause the other alternative eligibility conditions in R.C. 5739.02(B)(42)(j) to be “rendered virtually or completely meaningless – in direct violation of one of the most basic tenets of statutory construction.” Appellant’s Brief 15. But the restrictions on the other alternative distribution methods that permit exemption under R.C. 5739.02(B)(42)(j) are not made meaningless by making an exemption for “direct marketing” available for warehouses that do not make retail sales. A wholesaler qualifies for exemption, under the interpretation we advocate, only if that wholesaler is part of an affiliated group with a retailer or if that wholesaler uses a particular sales method – specifically, “the method of selling where consumers order tangible personal property by United States mail, delivery service, or telecommunication and the vendor delivers or ships the tangible personal property sold to the consumer from a warehouse, catalogue distribution center, or similar fulfillment facility by means of the United States mail, delivery service, or common carrier.” R.C. 5739.02(B)(35). Wholesalers that are not part of an affiliated group with a retailer, and that use a selling method that does not include all of the elements of “direct marketing,” would not be eligible for the

warehouse exemption. For example, wholesalers that deliver product using their own vehicles, or that allow the customer to order or pick up their own product at the warehouse, or that receive orders from their own sales force (rather than from their customers via the permitted ordering methods) would not be direct marketers and thus not eligible for the warehouse exemption as direct marketers. These restrictions are far from meaningless, and thus create no presumption that direct marketers must make retail sales in order for the rest of the statute to have meaning.

In Sections A. through C. above, we demonstrated that there is no basis in the text of R.C. 5739.02(B)(42)(j) or 5739.02(B)(35), and in the statutory definitions used within those sections, for the position that a direct marketer qualifies for the warehouse exemption only if that taxpayer makes retail sales. This Court has said that it looks for legislative intent not to determine what statute the General Assembly intended to enact, but rather to clarify any ambiguities in the meaning of the state that the General Assembly *did* enact. “ ‘The question is not what did the general assembly intend to enact, but what is the meaning of that which it did enact.’ ” *Seeley v. Expert, Inc.*, 26 Ohio St.2d 61, 72 (1971), quoting *Slingsluff v. Weaver*, 66 Ohio St. 621 (1902), syllabus paragraph two. For reasons elaborated above, the legislative history does not support a conclusion that the statute enacted by the General Assembly limited the “warehouse exemption” under R.C. 5739.02(B)(42)(j) to only those direct marketers making retail sales.

Based on the foregoing, the BTA’s holding that the Milan facility is engaged in “direct marketing” and thus eligible for the warehouse exemption correctly applies the relevant statutes and should accordingly be affirmed.

Proposition of Law No. 2

The Board of Tax Appeal’s factual conclusion that certain purchased items are “used . . . primarily in storing, transporting, mailing, or otherwise handling purchased sales inventory”

should be affirmed because the decision applies the correct legal standard and is supported by a sufficient quantity of reliable, probative evidence.

A. Standard of review.

This Court's precedent's hold that a BTA decision is to be upheld on appeal if is "reasonable and lawful", meaning that the decision is based on a correct legal conclusion and that the BTA's factual findings are supported by reliable and probative evidence in the record. *Columbus City School Dist. Bd. of Edn. v. Zaino*, 90 Ohio St.3d 496, 497 (2001); *Gahanna-Jefferson Local School Dist. Bd. of Edn. v. Zaino* (2001), 93 Ohio St.3d 231, 232 (2001); *Am. Natl. Can Co. v. Tracy*, 72 Ohio St.3d 150, 152 (1995). This Court reiterated these standards of review for BTA cases in a just released case, *Global Knowledge Training, L.L.C. v. Levin*, ___ Ohio St.3d. ___, 2010 -Ohio- 4411, 2010 WL 3719079 (September 23, 2010).

The preceding Proposition of Law No. 1 relates to the BTA's principal legal conclusion in this case, regarding whether a direct marketer must be engaged in making retail sales to qualify for the warehouse exemptions. Under this Proposition of Law No. 2, we will show that the BTA also correctly resolved a mixed question of law and fact regarding whether certain purchases by this taxpayer are used "primarily in storing, transporting, mailing, or otherwise handling . . . inventory" and thus eligible for sales and use tax exemption under R.C. 5739.02(B)(42)(j). As shown below, the BTA applied the correct legal standard in making its determination, and its factual findings are supported by sufficient evidence in the record before the Board.

B. The manufacturing exemption has different eligibility requirements than the warehouse exemption, so that cases applying manufacturing exemption definitions are of limited value in determining the scope of the warehouse exemption.

Part of the Commissioner's objection to the BTA's findings that certain items are used in a tax-exempt manner results from a misapplication of (as well as a misinterpretation of) the standards used to determine whether these purchases would qualify for the manufacturing exemption if they were used in a manufacturing versus a warehousing environment. R.C. 5739.02(B)(42)(j) provides a sales tax exemption for certain purchases used or consumed in "storing, transporting, mailing, or otherwise handling . . . inventory", with no statutory definitions or guidance of these terms beyond the text of (B)(42)(j) just quoted. The manufacturing exemption under subdivision (B)(42)(g), by contrast, applies to purchases used "primarily in a manufacturing operation to produce tangible personal property for sale." R.C. 5739.02(B)(42)(g). The term "manufacturing operation," in turn, is defined at length both in R.C. 5739.011 (a lengthy section devoted entirely to a definition items eligible for the manufacturing exemption) and in Ohio Admin. Code 5703-9-21 (the longest section of the Tax Department's part of the Administrative Code, which is also devoted exclusively to defining the manufacturing exemption). There is nothing in the Revised Code or the Administrative Code, and also nothing in case law, showing an intent that these provisions relating to the manufacturing exemption should apply in any way to the warehouse exemption. In fact, under the manufacturing exemption, inventory handling equipment is generally not exempt from sales tax unless it is used to handle "work in process" inventory, whereas the warehouse exemption specifically applies to equipment that handles inventory that is not "work in process" because it is "purchased sales inventory". Compare Ohio Admin. Code 5703-9-21(C)(2) & (D)(2) (equipment exempt if it handles work in process inventory, but taxable if it handles pre-production inventory or finished product inventory) with R.C. 5739.02(B)(42)(j) (exemption applies to equipment that handles "purchased sales inventory," i.e., to inventory that will be

resold in the same form). Similarly, equipment used for inventory storage (other than work in process inventory) is not exempt under the manufacturing exemption (Ohio Admin. Code 5703-9-21(C)(2)), but is exempt under the warehouse exemption (R.C. 5739.02(B)(42)(j)).

The above examples illustrate why this Court should not apply the text of the manufacturing exemption statutes or regulations to a case involving the warehouse exemption, and should use caution in applying case law based on the manufacturing exemption provisions in construing the scope of the warehouse exemption. Nonetheless, in the next section of this Argument, we will show that many of these purchases which the BTA found to be exempt in this case would be exempt even if certain potentially relevant restrictions on items eligible for the manufacturing exemption also applied to the warehouse exemption.

C. There is sufficient evidence in the record to support the BTA's finding that the items whose exempt use are challenged by the Tax Commissioner' were "used . . . primarily in storing, transporting, mailing, or otherwise handling purchased sales inventory" and thus eligible for the warehouse exemption.

The Tax Commissioner's Notice of Appeal (Appellant's Appx. 6 – 8) and his Brief object to the BTA's conclusions that the following purchases by this taxpayer were used in a manner qualifying them for the warehouse exemption: 1) "Sample kits"; 2) "Structural Column Protection," 3) a "compressed air line," 4) a "Sprinkler system", 5) a "Forklift Battery/Charger", 6) a "Crown Battery Charger Stand and Sackett Battery Han," and 7) "Tempus Systems, Inc. Maintenance, Terminals, Manual". Appellant's Brief 17 – 18. As a preliminary matter, the Commissioner's appeal of the BTA's decisions with regard to the "Tempus Systems, Inc." items appears to be in error, since these purchases relate to a timeclock and the BTA found that the timeclock related purchases were not exempt from sales tax. *BTA Decision and Order* 10, 13;

Appellant's Appx. 20, 23. Since FNOK, the taxpayer, did not appeal this or any other aspect of the Board's decision in this matter, the Tax Commissioner's appeal of a decision finding that a purchase was subject to sales and use tax is probably inadvertent. In any event, FNOK does not ask this Court to hold that the Tempus Systems, Inc. purchases are exempt from sales or use tax.

1. "Sample kits"

The Commissioner argues that the "Sample Kits" are used as "instructional items," and that "these instructional items are not used in any form of 'handling' of the purchased sales inventory." Appellant's Brief 17. To the contrary, the Board found that the "sample kits" (which the BTA more appropriately calls "visual demonstration boards") were "used to provide illustration to [FNOK's] assembly line employees as well as its quality control personnel to ensure the correct individual components are included within specific product kits." *BTA Decision and Order* 10; Appellant's Appx. 20. In other words, rather than finding that these kits were used primarily for training personnel prior to their handling inventory, the Board found that they were actually used by Milan facility personnel during the time that they were actively "storing, transporting, mailing, or otherwise handling . . . inventory". *Id.* 13, Appellant's Appx. 23. The BTA's conclusion that these "visual demonstration boards" or "shadow boards" were actively used in the processing of inventory is confirmed by the sole witness' testimony (that of the Milan Facility's Chief Financial Officer, Jason Meier) regarding the use of these items:

A. So to illustrate, you buy a kit that has five to ten parts within it and that particular kit would then turn into a visual aid to show that you create the right kit, the right time, when it is needed . . . to ultimately support the customer's requirements.

Tr. 33 – 34 lines 22 – 2; Second Supp. 33 – 34. Mr. Meier testified that these assembled kits of parts are also referred to as "shadow boards," and that they are used in "a quality control function within the process." Tr. 33 lines 15 – 20; Second Supp. 15 – 20. Later in his testimony, Mr.

Meier provided the following further elaboration regarding the use of these “samples” or “shadow boards”:

. . . Those products are purchased primarily for the use of the shadow board and the quality control point on a particular line when packaging the product.

For sake of illustration, you’ve got kits that could be one part and hundreds of parts. The product looks very similar to the naked eye but very different in terms of function. . . . We have a lot of material handling movements. So this is a quality control point to ensure that the right product is put into the right kit and that the customer gets what he or she has ordered. . . .

The shadow boards are a quality control point. It’s literally a four-by-six board that has each part laid out, the part description, and the requirements. It’s laminated and taped so that you have a visual inspection to ensure that the right products are on the board. It is literally a kit or finished kit. It is laid out as a quality control point at the assembly line for the respective operators.

Tr. 38 – 40 lines 19 – 13; Second Supp. 38 – 40 (emphasis added).

From the testimony just presented, the BTA could conclude, and did conclude that the “sample kits” or “shadow boards” were used not for training preparatory to the handling of inventory, but during the actual process of assembling the inventory into the kits desired by a particular customer for shipment to that customer – in other words, that they were used to handle, process, or mail inventory. Thus unlike the fork lifts in the case cited by the Commissioner (*Q3 Stamped Metal, Inc. v. Zaino*, 92 Ohio St.3d 493 (2001)), these items are used while the relevant process (handling inventory) is ongoing, rather than when the relevant process (the manufacturing process in *Q3 Stamped Metal*) is in suspense. To the extent that the scope of the manufacturing exemption is relevant to the scope of the warehouse exemption, we should note that, under the manufacturing exemption, items used for quality control during the manufacturing process are tax-exempt. See Ohio Admin. Code 5703-9-21(C)(4) & (6) and Example 4. Accordingly, the BTA’s conclusion that the “sample kits” qualify for the warehouse exemption is both lawful and supported by the evidence, and thus should be affirmed.

2. “Structural Column Protection”.

The BTA found that the “Structural Column Protection,” which it described as “a round fiberglass protection device . . . to protect both the wall/inventory racks and inventory itself from damage from the forklifts” qualifies for the warehouse exemption. *BTA Decision and Order* at 10, 13; Appellant’s Appx. 20 - 23. Although his Brief does not challenge the factual basis for the BTA’s conclusion regarding how this item is used (which is amply supported in the record³), the Tax Commissioner argues that this item is not exempt because it “serve[s] only a protective function similar to the protective, non-exempt function of the welding glasses in *Q3 Stamped Metals* [92 Ohio St.3d 493].” Appellant’s Brief 17. The Tax Commissioner’s argument should be rejected for several reasons. First, under the manufacturing exemption, equipment whose primary purpose is *employee* safety (as opposed to the safety of the product being manufactured) is not exempt from sales tax. R.C. 5739.011(C)(6) (no manufacturing exemption for “property used for the protection and safety of workers”). But the manufacturing exemption does apply to tangible personal property that is necessary to prevent damage to the manufactured product or to equipment that acts on the manufactured product. *See. E.g., L-S II Electro Galvanizing Co. v. Zaino*, BTA Case Nos. 98-G-412 and 244 (June 29, 2001), unreported; Appx. 49 (grindstones that remove excess electrolyte, this protecting production machinery and the manufactured product from damage during the manufacturing process, are exempt). By analogy, property that is necessary to prevent forklifts (which handle inventory) from damaging inventory or the inventory storage facility is necessary for storing or handling inventory at the Milan facility and thus should be eligible for the warehouse exemption under R.C. 5739.02(B)(42)(j).

³ See Tr. 25 lines 2 – 16; Second Supp. 25.

3. “Compressed air line”.

The BTA found that the “Compressed air line” was used in storing or handling inventory and thus qualifies for the warehouse exemption. *BTA Decision and Order* 10, 13; Appellant’s Appx. 20, 23. The BTA concluded that this air line was “used to operate pneumatic equipment, e.g., socket gun, within the Milan facility which serves to keep inventory handling equipment, e.g., forklifts, operational.” *Id.* 10, Appellant’s Appx. 20. Again, the Tax Commissioner does not challenge the BTA’s factual conclusion regarding how this item is used, and their factual conclusion is supported by evidence in the record (Tr. 25 – 26 lines 20 – 10; Second Supp. 25 – 26). While agreeing with the BTA’s description of the equipment’s use, the Commissioner objects that property used to repair equipment that handles inventory is not covered by the warehouse exemption, again citing the *Q3 Stamped Metal* manufacturing exemption case as authority. Appellant’s Brief 19. We agree that, under the manufacturing exemption, property that is used to clean, maintain or repair manufacturing equipment usually is not exempt (although repair parts and repair services for manufacturing equipment are exempt). *See* R.C. 5739.011(B)(18) & (C)(8). This situation is easily distinguishable because the specific restrictions and definitions of the manufacturing exemption do not apply to the warehouse exemption, as argued in Section B. above under this Proposition of Law No. 2. Even if an analogy to the manufacturing exemption is appropriate here, however, the manufacturing exemption would apply to property that cleans, maintains, or repairs manufacturing equipment if that takes place during the manufacturing process and is necessary for the continuation of the manufacturing process. *See L-S II Electro Galvanizing Co. v. Zaino*, BTA Case Nos. 98-G-412 and 244 (June 29, 2001), unreported; Appx. 49 (“cleaning” equipment is exempt if it is necessary for the continuation of the manufacturing process). Forklifts cannot be handle inventory if not

kept in good repair. Therefore, equipment that is used to repair forklifts is used in “storing, transporting, mailing, or otherwise handling . . . inventory” and thus is exempt from sales tax under R.C. 5739.02(B)(42)(j). This Court should thus affirm the BTA’s conclusion that the compressed air line is exempt.

4. “Sprinkler system”.

The BTA held that the sprinkler system qualifies for the warehouse exemption because it is “required by [the] fire code and serves to protect [the] product,” i.e., the inventory kept at the Milan plant. *BTA Decision and Order* 10, 13; Appellant’s Appx. 20, 23. As in the case of the column support discussed above, the Tax Commissioner does not question the BTA’s findings regarding how this property is used, but rather argues that it should not be exempt because it “serve[s] only a protective function similar to the protective, non-exempt function of the welding glasses at issue in *Q3 Stamped Metals*.” Appellant’s Brief 19 – 20. The Commissioner’s objection is no more valid here than is with regard to the structural column support discussed above. Although the sprinkler contributes to employee safety as well, the evidence shows that its primary purpose is to protect the inventory from fire damage. Tr. 26 lines 14 – 21; Second Supp. 26. Even to the extent that manufacturing exemption rules apply to the warehouse exemption, the *Q3 Stamped Metals* decision held that equipment that contributes to worker safety but that is also necessary for the manufacturing process is exempt, even though it would not be exempt if its sole or primary purpose was worker safety. *Q3 Stamped Metals*, 92 Ohio St.3d at 496. Even though the sprinklers also contribute to employee safety, the BTA had sufficient evidence to conclude that the sprinklers are used primarily to store inventory at the Milan facility, and thus are exempt from sales tax under R.C. 5739.02(B)(42)(j).

5. "Forklift Battery/Charger".

The BTA found that "the battery charger element used to maintain a charge in battery operated forklifts and guidance wires imbedded into concrete which receives/transmits signals allowing particular forklifts to move to designated inventory locations" were eligible for the warehouse exemption because they handle inventory at the Milan plant. *BTA Decision and Order* 10, 13; Appellant's Appx. 20, 23. As with regard to the items discussed above, the Commissioner does not challenge the factual findings regarding how these items are used, and the described use is supported by the record. Tr. 22 lines 1 – 20; Second Supp. 22. The Commissioner's Brief appears to challenge the battery charger, but not of the guidance wires – perhaps acknowledging that the description of the guidance wires plainly shows that they are used in processing inventory and thus are eligible for the warehouse exemption. Appellant's Brief 18 – 19. While the Commissioner again attempts an analogy to the manufacturing exemption to argue that battery chargers should not be tax-exempt, that analogy (if valid) would not support his argument with regard to the battery charger. Under the manufacturing exemption, property that supplies electricity to manufacturing machinery is clearly exempt from sales tax. R.C. 5739.011(B)(9). By analogy, equipment that supplies electricity to inventory handling equipment (forklifts) is also necessary for handling inventory, and thus should be eligible for the warehouse exemption. The BTA thus had a sufficient legal and factual basis for concluding that the battery charger is eligible for the warehouse exemption.

6. "Crown Battery Charger Stand and Sackett Battery Han."

The Commissioner's Brief at page 19 objects to the tax exemption of items which his Brief describes as "Crown Battery Charger Stand and Sackett Battery Han". His objection appears to be directed to the following text in the BTA's decision:

- Total Fleet Solutions: Wire Guidance System and Installation; Crown Batteries Charger Stands, Sackett Battery Han – associated with the above-referenced guidance wires and batteries.

BTA Decision and Order 10 Appellant's Appx. 20.

But the BTA did not use the just-quoted description when it stated its findings regarding which items were and which were not exempt from sales or use tax. The BTA rather held that the following items, among others, were not taxable under the warehouse exemption: "Forklift Battery/Charger and Guidance Wire" (*Id.* 12, Appellant's Appx. 22) as well as "guidance wires and batteries, maintenance costs associated with its Toyota truck, pickers, etc." (*Id.* 13, Appellant's Appx. 23). We presented just above the reasons why the guidance wires and batteries or battery chargers qualify for the warehouse exemption from sales and use tax, and the portions of the record that support the exempt use of these items. The reference to Total Fleet Solutions in the BTA's decision apparently means the purchases listed on page 23 of the Commissioner's Statutory Transcript in the Petition for Reassessment (Appellant's Supp. 23), which the tax agent listed therein as follows:

"ICX Corporation – Total Fleet Solutions, Holland Toyota Picker Invoice"

"Total Fleet Solutions, Inc. – Milan Monthly Maintenance Bill for Phases I&II (Lifts, Pickers etc.)".

FNOK's Chief Financial Officer testified that the purchases thus described were "relating to our material handling of the Toyota pickers" and "basically a maintenance bill for two phases on all the pickers. So it's all relating to the material handling equipment." Tr. 47 – 48 lines 19 – 5; Second Supp. 47 – 48. Earlier in his testimony, the same witness described a "picker" as a specialized piece of inventory handling equipment and detailed its use in the warehouse. Tr. 19 – 20, lines 12 – 1; Second Supp. 19 – 20. Thus, the reference to "Total Fleet Solutions" in the BTA decision is to invoices for maintenance of "pickers," which are inventory handling

equipment. As shown in the discussion of the compressed air line above, maintenance of inventory handling equipment is as essential to inventory handling as maintenance of manufacturing equipment is to manufacturing. And, just as maintenance parts and service for manufacturing equipment qualify for the manufacturing exemption as items used in manufacturing, maintenance parts and service for inventory handling equipment should qualify for the warehouse exemption as purchases used for inventory handling equipment.

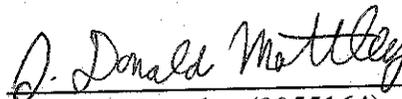
The BTA's holding that some but not all of the FNOK purchases at issue are exempt from tax shows that it conscientiously considered the evidence presented to it and appropriately analyzed each contested purchase's use under the correct legal standard – asking whether that items was employed in “ ‘ storing, transporting, mailing, or otherwise handling’ inventory” as required to qualify for the R.C. 5739.02(B)(42)(j) exemption. Accordingly, this part of the BTA Decision and Order, like the rest of it, should be affirmed by this Court.

CONCLUSION

FNOK has shown, under Proposition of Law No. 1 above, that its Milan facility meets all of the requirements for its inventory storage and handling purchases to be exempt from sales and use tax under the warehouse exemption (R.C. 5739.02(B)(42)(j)). The Tax Commissioner's attempt to add an additional requirement to those provided for in the exemption statute should be rejected. Under Proposition of Law No. 2 above, FNOK has shown that all of the particular items that the BTA found were used for storing and handling inventory at the Milan facility were, in fact and in law, used for that purpose. Thus, both legally and factually, all of the purchases that the BTA found were exempt from sales and use tax were properly held to be

exempt. Accordingly, we ask this Court to affirm the BTA's decision that certain purchases at the Milan plant qualify for the warehouse exemption from sales and use tax.

Respectfully submitted,



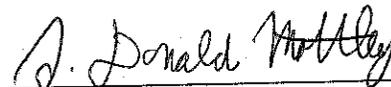
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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing *Brief of Appellee Freudenberg NOK General Partnership* was served, via email attachment and via U.S. postage prepaid mail, this 5th day of October, 2010, upon:

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Final Analysis

*Jennifer Parker,
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and other LSC staff*

Legislative Service Commission

Am. Sub. H.B. 95*
125th General Assembly
(As Passed by the General Assembly)

Rep. Calvert

**Sens. Harris, DiDonato, Carnes, Jacobson, Blessing, Goodman, Fingerhut,
Miller, Mallory, Prentiss, White**

**Effective date: June 26, 2003; certain provisions effective September 26, 2003;
certain provisions effective on other dates; certain items vetoed**

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Within each category, a summary of the items appears first (in the form of dot points), followed by a discussion of their content and operation. Items generally are presented in the order in which they appear in the Revised Code.

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The act also creates a new personal liability provision in the use tax law. The provision is similar to the one in the sales tax law.

Revisions made to comply with the Streamlined Sales and Use Tax Agreement

Background

In 2002, Am. Sub. S.B. 143 of the 124th General Assembly enacted the Simplified Sales and Use Tax Administration Act (R.C. Chapter 5740.), a model act recommended by the National Conference of State Legislatures for the development of a voluntary, streamlined system for collection of sales and use taxes from remote sellers. S.B. 143 required Ohio to participate in multi-state discussions to develop the system through a Streamlined Sales and Use Tax Agreement (interstate agreement) recommended by NCSL, which provides states with a structure for simplifying their sales and use collection systems by changing state statutes to establish the system envisioned by the model act. In S.B. 143, Ohio revised some of its state and local sales and use tax laws to reflect simplification and administration requirements contained in the model act that were required for Ohio to become one of the Streamlined Sales and Use Tax Implementing States with power to develop and amend the interstate agreement.

Since that time, Ohio has been participating in the multi-state discussions and, on November 12, 2002, the Implementing States approved the interstate agreement. To come into effect, at least ten states comprising at least 20% of the total population of all states imposing a state sales tax must be found to be in compliance with the interstate agreement's requirements. This means that some states will have to revise their laws to reflect the requirements contained in the current interstate agreement in order to become member states under the agreement, which entitles a state to collect taxes from sellers that have registered with the central electronic registration system established by the member states.

Generally, the interstate agreement focuses on improving collection systems through state-level administration of sales and use tax collections, uniformity in state and local tax bases, uniformity of major tax base definitions, a central, electronic registration system for all member states, simplification of state and local tax rates, uniform sourcing rules for all taxable transactions, simplified administration of exemptions, simplified tax returns, protection of consumer privacy, and simplification of tax remittances.

To reflect the requirements in the interstate agreement, the act revises sales and use tax definitions, sourcing provisions, the tax rate schedules, and the laws regarding how local tax rates are levied or changed. Except as indicated otherwise in each topic heading, the effective date of most of the act's streamlined sales and use tax revisions is July 1, 2003.



use taxes, and provides that, in the case of the lease or rental of those types of property, with a fixed or indefinite term of more than 30 days, the sales or use tax must be collected by the vendor or seller at the time the lease or rental is consummated and calculated by the vendor or seller on the basis of the total amount to be paid by the lessee or renter under the lease or rental agreement. If the total amount of the consideration for the lease or rental includes amounts that are not calculated at the time the lease or rental is executed, the tax must be calculated and collected by the vendor or seller at the time such amounts are billed to the lessee or renter.

For an open-end lease or rental, the sales or use tax must be calculated by the vendor or seller on the basis of the total amount to be paid during the initial fixed term of the lease or rental, and for each subsequent renewal period as it comes due.

If the price consists in whole or part of the lease or rental of tangible personal property, other than the property just discussed, continuing law requires that sale or use taxes be measured by the installments of that lease or rental.

Simplification of administering exemptions

(R.C. 5739.01(E) and 5739.02(B)(43))

By virtue of being amended many times throughout the years, Ohio's sales and use tax laws had exceptions and exemptions to taxation spread out in various provisions. The act consolidates many of those exceptions and exemptions into the tax levy and exemption statute, R.C. 5739.02, to simplify administering exemptions, as required by the interstate agreement. In particular, the act moves the retail sales exceptions to the list of sales and use tax exemptions. The only exception the act eliminates is the exception for "things transferred" for reclamation (see "Exemptions eliminated," above).

Restrictions on frequency of changes in local tax rates

(R.C. 5739.021, 5739.022, 5739.023, and 5739.026; Sections 134.14 to 136, 158(B), and 183(C))

The interstate agreement requires member states to restrict the frequency of local sales and use tax rate changes to lessen the difficulties faced by sellers when there is a change in a tax rate or base. S.B. 143 revised the local sales and use tax laws to require that a resolution that levies or changes local sales and use taxes becomes effective on the first day of a calendar quarter following the expiration of 60 days from the date of its adoption. If a vendor that is registered with the central electronic registration system makes a sale in Ohio by printed catalog, and the



5703-9-01 Vendor's license requirements.

(A) A vendor engaged in making retail sales subject to the Sales Tax at a fixed place of business must obtain a license therefor and, in case such vendor makes retail sales from vehicles operated by his agents, such sales in the county in which the fixed place of business is located may be made under the license issued for the fixed place of business.

A license for a fixed place of business will not permit the vendor, or employees of the vendor, to operate vehicles in any other county in the State without securing additional licenses. A vendor who makes retail sales from vehicles in more than one county must obtain a license for each county in which he makes such sales.

A license obtained by a vendor for a fixed place of business does not cover retail sales of property purchased from the vendor having the license and resold from vehicles where the operators of such vehicles are not the agents of the vendor having the license but are making the sales for their own profit and in connection with their own business.

A person who does not have a stock of merchandise from which orders are filled, selling on a commission basis for a vendor who has a fixed place of business is not required to procure a vendor's license as he is in fact the agent for the vendor with the license.

Persons selling on a straight commission basis, who sell from a stock of goods which they carry with them, are vendors and will be required to procure a vendor's license and collect the tax in the regular manner.

(B) Vendors having no fixed place of business and selling from vehicles must procure a vendor's license for each vehicle, which vehicle shall constitute his place of business. Such license shall cover all sales made from the one vehicle only in one county. If sales are made from the vehicle in more than one county, licenses shall be procured in each county in which sales are made. The application for each license must set forth a residence or permanent mailing address in the state to which all communications from the Department of Taxation may be sent. A change in this address must be reported promptly to the Department.

Vendors having no fixed place of business and not selling from a vehicle shall procure one license in each county in the state in which sales are made. The application for each license must set forth a residence or permanent mailing address in this state to which all communications from the Department of Taxation may be sent. A change in this address must be reported promptly to the Department.

(C) In those cases where an individual incorporates his business a new license will be required. Likewise, where a corporation is dissolved and is operated by a sole owner, a new license is required. In the case of a dissolution of a partnership by death, the surviving partner or partners may operate under the existing license for sixty days only, at the expiration of which time a new license must be procured for the operation of the business. Trustees in bankruptcy, legal representatives of deceased persons and receivers, when appointed by competent authority, may operate indefinitely under the existing license but must immediately notify the Department of Taxation of their appointment.

A vendor's license shall terminate and be null and void if the business is moved to a new location or if

the business is sold, or if an individual or partnership incorporates his or their business, or if a partnership is dissolved, or if a corporation dissolves.

Corporations upon making application for a vendor's license must display their corporation charter number, as registered with the Secretary of State, immediately following their name on the application for license.

If the applicant for a vendor's license is a holder of Liquor Permit issued by the Ohio Department of Liquor Control such vendor's license must conform with Liquor Permit in name and address so as to establish the identity of the actual owner.

In the case of two or more persons constituting a single vendor who operates a single retail establishment under one license, the Department of Taxation must be promptly notified of the retirement of any such person from business in such establishment or the entrance of any person under an existing arrangement.

(D) Hotels, which includes all establishments having five or more rooms which are used or offered for use as sleeping accommodations for transient guests, must hold a vendor's license for the location in which the business is conducted.

(E) No license need be procured by public and parochial schools where the only sales consist of serving meals in cafeterias and selling school supplies to students, not as a business and at no profit.

(former TX-11-01); Eff 10-12-69; 9-28-76

Rule promulgated under: RC 5703.14

5703-9-21 Sales and use tax; manufacturing.

(A) For purposes of this rule, all purchases of tangible personal property are taxable, except those in which the purpose of the consumer is to incorporate the thing transferred as a material or a part into tangible personal property to be produced for sale by manufacturing, assembling, processing, or refining or to use the thing transferred, as described in section 5739.011 of the Revised Code and this rule, primarily in a manufacturing operation to produce tangible personal property for sale.

This means that a person who buys tangible personal property and will make it a part or constituent of something that he is manufacturing for sale, or buys something that is used in a manufacturing operation, does not have to pay sales or use tax on the thing purchased.

Tangible personal property purchased by a manufacturer as a component or constituent of a product to be manufactured for sale is excepted from sales and use tax. The purchase of all such tangible personal property is not taxable, even though a portion will be lost or removed as waste or for testing. The manufacturer must pay use tax on the price, as defined in division (G) of section 5741.01 of the Revised Code, of any completed product not sold and stored or used by the manufacturer in a taxable manner, except such product that is consumed in testing or is disposed of because it is defective or otherwise unsalable.

(B)(1) "Manufacturing operation" means a process in which materials are changed, converted, or transformed into a different state or form from which they previously existed and includes refining materials, assembling parts, and preparing raw materials and parts by mixing, measuring, blending or otherwise committing such materials or parts to the manufacturing process. "Manufacturing operation" does not include packaging.

Tangible personal property purchased by a manufacturer for use in packaging is taxable unless exempted pursuant to division (B)(15) of section 5739.02 of the Revised Code.

Any business whose sole activity is a process that does not include conversion or alteration of tangible personal property into a different state or form is not a manufacturer and is not covered by this rule.

The manufacturing operation begins when the raw materials or parts are committed to the manufacturing process. If the raw materials or parts are stored after being received at the manufacturing facility, the raw materials or parts are not committed until after they are removed from such initial storage. The point of commitment is where the materials handling from such initial storage has ceased or the point where the materials or parts have been mixed, measured, blended, heated, cleaned, or otherwise treated or prepared for the manufacturing process, whichever first occurs. If the raw materials or parts are not stored, they are committed at the point where materials handling from the place of receipt ceases or where they are mixed, measured, blended, heated, cleaned, or otherwise treated or prepared for the manufacturing process, whichever first occurs. The commitment of the materials or parts need not be irrevocable, but they must have reached the point, after materials handling from initial storage has ceased, where they normally will be utilized within a short period of time. The point of commitment frequently will be different for particular materials and parts, since they are introduced at different times in the manufacturing operation.

Things used in any activity, including movement or storage of the materials or parts before they are

committed are taxable.

See examples 1, 2, 3, 4, 6, 9, 40, 61, 63, and 64.

(2) "Refining" means removing or separating a desirable product from raw or contaminated materials by distillation or physical, mechanical, or chemical processes.

This definition of "refining" describes a type of manufacturing process and is not limited to the petroleum industry. A business whose sole activity is sorting material by size or other physical characteristic, or washing dirt or other contaminants from the surface of parts or other materials is not engaged in refining.

See examples 4, 5, and 63.

(3) "Assembly" and "assembling" mean attaching or fitting together parts to form a product, but do not include packaging a product.

Assembly generally refers to the process whereby previously manufactured parts or components are brought together and attached to create a complete, or more complete, item.

See example 15.

(4) "Manufacturer" means a person who is engaged in manufacturing, processing, assembling, or refining a product for sale.

(5) "Manufacturing facility" means a single location where a manufacturing operation is conducted, including locations consisting of one or more buildings or structures in a contiguous area owned or controlled by the manufacturer.

The manufacturer does not have to own or lease the property, but must have the legal right to use it. If the property under the control of the manufacturer is not contiguous, it is not a single manufacturing facility.

See examples 21, 23, and 57.

(6) "Materials handling" means the movement of the product being or to be manufactured, during which movement the product is not undergoing any substantial change or alteration in its state or form.

(7) "Testing" means a process or procedure to identify the properties or assure the quality of a material or part.

(8) "Completed product" means a manufactured item that is in the form and condition as it will be sold by the manufacturer. An item is completed when all processes that change or alter its state or form or enhance its value are finished, even though the item subsequently will be tested to ensure its quality or be packaged for storage or shipment.

A product may be completed, as far as a particular manufacturer is concerned, even though it is not in

the form in which it will be sold to the ultimate consumer because it will be further manufactured by another manufacturer. If the product will be further manufactured by the same manufacturer at a different manufacturing facility, the product is still in-process and is not completed.

See examples 8, 13, and 64.

(9) "Continuous manufacturing operation" means the process in which raw materials or components are moved through the steps whereby manufacturing occurs. Materials handling of raw materials or parts from the point of receipt or pre-production storage or of a completed product, to or from storage, to or from packaging, or to the place from which the completed product will be shipped, is not a part of a continuous manufacturing operation.

The continuous manufacturing operation begins at the point where the raw materials or parts are committed and ends at the point where the product is completed.

There may be several continuous manufacturing operations at the same manufacturing facility, each producing a different product.

The things used in the continuous manufacturing operation include all production machinery, the materials handling equipment that moves the product between the production machines, and any equipment, such as tanks, shelves, or racks, that temporarily store or hold the product in between production machines. Even though testing equipment used to test in-process product is not taxable under this rule, no testing procedure is part of the continuous manufacturing operation unless it is physically and functionally integrated between steps on the production line.

See examples 1, 6, 8, 11, 19, and 63.

(C) Things transferred for use in a manufacturing operation include, but are not limited to, any of the following:

(1) Production machinery and equipment that act upon the product or machinery and equipment that treat the materials or parts in preparation for the manufacturing operation.

Production machinery is the equipment that actually changes the state or form of the product, that is, the tangible personal property being manufactured for sale. Also included is the equipment that treats the product by blending, mixing, measuring, washing, agitating, filtering, heating, cooling, or similar processes after the material or parts have been committed to the manufacturing operation and before the product is completed.

See examples 1, 4, 7, 8, 18, 24, 27, 32, 35, 56, 60, 61 and 63.

(2) Materials handling equipment that moves the product through a continuous manufacturing operation; equipment that temporarily stores the product during the manufacturing operation; or, excluding motor vehicles licensed to operate on public highways, equipment used in intraplant or interplant transfers of work in process where the plant or plants between which transfers occur are manufacturing facilities operated by the same person.

Any equipment, except motor vehicles registered for highway operation, used to move or transport the

In-process product between manufacturing facilities of the same manufacturer, is considered to be used in the manufacturing operation.

See examples 1, 8, 9, 10, 11, 57, 59, 60, 63, and 64.

(3) Catalysts, solvents, water, acids, oil, and similar consumables that interact with the product and that are an integral part of the manufacturing operation.

This describes those substances that do not appreciably become a component part of the product, but which usually come in contact with the product during the manufacturing process.

See examples 1, 13, 14, 28, 35, and 62.

(4) Machinery, equipment, and other tangible personal property used during the manufacturing operation that control, physically support, produce power for, lubricate, or are otherwise necessary for the functioning of production machinery and equipment and the continuation of the manufacturing operation.

Materials which are used to make foundations, supports, and other things which are incorporated into a building or structure and become accessions to the real estate may not be purchased without payment of tax under this rule. Foundations, structural steel, and similar items which provide physical support and which retain their status as personal property must be treated for purposes of taxation separately from the equipment which they support.

Foundations and supports for production machinery, materials handling equipment, and other equipment used in a continuous manufacturing operation are not taxable. Similarly, foundations and supports for tangible personal property used to manufacture tangible personal property used in the manufacturing operation, as described in paragraph (C)(5) of this rule; for testing equipment, as described in paragraph (C)(6) of this rule; and for equipment used to handle or store scrap for recycling at the same facility, as described in paragraph (C)(7) of this rule, are deemed necessary for the continuation of the manufacturing operation and are not taxable.

Tangible personal property that monitors in-process product or that lubricates, cools, monitors, or controls production machinery, materials handling equipment, and other equipment used in a continuous manufacturing operation is not taxable. Similarly, tangible personal property that lubricates, cools, monitors, or controls equipment used to manufacture tangible personal property used in the manufacturing operation, as described in paragraph (C)(5) of this rule; testing equipment, as described in paragraph (C)(6) of this rule; and equipment used to handle or store scrap for recycling at the same facility, as described in paragraph (C)(7) of this rule, is deemed necessary for the continuation of the manufacturing operation and is not taxable. However, all equipment that makes or stores records of monitoring is taxable.

See examples 1, 15, 16, 17, 18, 25, 29, 52, 55, 57, and 59.

(5) Machinery, equipment, fuel, power, material, parts, and other tangible personal property used to manufacture machinery, equipment, or other tangible personal property used in manufacturing a product for sale.

If a manufacturer makes an item that is used in the manufacturing operation as described in this rule, such as tools, tooling, replacement parts for machinery, or consumable substances, such as acid or solvents, the raw materials and components that go into that item are not taxable.

Certain things used by the manufacturer to make the item that will be used in the manufacturing operation are also not taxable. These things include the machinery which manufactures the item by changing the state or form of the raw materials or components, the materials handling equipment which moves the item between such machinery, and any fuel or power used to operate the machinery or materials handling equipment.

After the item is in the form in which it will be used in the manufacturing operation, any equipment that stores it or moves it to or from the manufacturing operation is taxable.

See example 18.

(6) Machinery, equipment, and other tangible personal property used by a manufacturer to test raw materials, the product being manufactured, or the completed product.

The equipment and supplies that the manufacturer uses to perform testing, and tangible personal property used to physically support, control, lubricate, cool, or monitor such equipment are not taxable. Those things that are merely used in the lab or other area where testing occurs, but play no part in the actual testing procedures, such as furniture, storage equipment, and computers that record or store the test results, are taxable. The testing activity is not part of the continuous manufacturing operation unless it is physically and functionally integrated between steps on the production line. Materials handling equipment used to transport test samples is taxable. Equipment and supplies used to test fuel, consumables, equipment, or anything else that is not a raw material, the product being manufactured, or a completed product are taxable.

See examples 3, 4, 19, and 60.

(7) Machinery and equipment used to handle or temporarily store scrap that is intended to be reused in the manufacturing operation at the same manufacturing facility.

In this context, scrap is any portion or component of the product being manufactured that is removed, intentionally or unintentionally, from the manufacturing process or that is residual after the process is completed. If the manufacturer recycles the scrap back into the manufacturing operation at the same facility, the equipment which moves or stores the scrap is not taxable.

Scrap which is to be sold or to be reused as a raw material by the manufacturer at another facility, is considered to be processed in a manufacturing operation if the state or form of the scrap is changed or altered. In such a case, the scrap, as it is removed from the manufacturing operation, is a raw material and the equipment which transports or stores it before it is committed to the operation where it undergoes manufacturing is taxable. After such manufacturing is over, the processed scrap is a completed product.

See examples 22 to 24, 47, and 61.

(8) Electricity, coke, gas, water, steam, and similar substances used in the manufacturing operation;

machinery and equipment used for, and fuel consumed in, producing or extracting those substances; and machinery, equipment, and other tangible personal property used to treat, filter, pump, alter voltage, or otherwise make the substance suitable for use in the manufacturing operation.

Anything that is a fuel or a source of power for machinery used in the manufacturing operation, or that provides energy for the manufacturing process itself, is not taxable. Similarly, substances which transmit energy, such as steam or cooling water which transmits heat to or from the process or machinery, are not taxable. Any equipment that the manufacturer uses to generate, produce, or extract these substances, as well as fuel used to power such generation or extraction, is not taxable.

Tangible personal property which treats the fuel or power is not taxable. Such things may include coal crushers, electrical transformers, fuel or water filters, and water treatment chemicals.

See examples 22 to 32, 59, and 64.

(9) Machinery, equipment, and other tangible personal property used to transport or transmit electricity, coke, gas, water, steam, or similar substances used in the manufacturing operation from the point of generation, if produced by the manufacturer, or from the point where the substance enters the manufacturing facility, if purchased by the manufacturer, to the manufacturing operation.

Such equipment includes wires, conduit, pipes, larry cars, and conveyors.

See examples 12, 22 to 32.

(10) Machinery, equipment, and other tangible personal property that treats, filters, cools, refines, or otherwise renders water, steam, acid, oil, solvents, or similar substances used in the manufacturing operation reusable, provided that the substances are intended for reuse and not for disposal, sale, or transportation from the manufacturing facility.

See examples 1, 20, 33, 34, 35, 36, 37, and 64.

(11) Parts, components, and repair and installation services for items used in the manufacturing operation as described in paragraph (C) of this rule.

Replacement parts for nontaxable equipment are not taxable. Any repair service or installation service purchased from an independent contractor for repairing or installing nontaxable equipment is not taxable.

See examples 38, 44, 55, and 56.

(D) Things transferred for use in a manufacturing operation do not include:

(1) Tangible personal property used in administrative, personnel, security, inventory control, record keeping, ordering, billing, or similar functions.

Those things that are used in the "non-manufacturing" aspects of the manufacturer's business are generally taxable. This includes what is broadly known as office equipment, furniture, and supplies. Anything, including computers and software, used for communication, ordering, billing, inventory

control, or record keeping, including testing or production records, is taxable.

Things used in providing security include devices to monitor or observe personnel or detect intruders.

See examples 7, 15, 16, 19, 39, and 55.

(2) Tangible personal property used in storing raw materials or parts prior to the commencement of the manufacturing operation or used to handle or store a completed product, including storage that actively maintains a completed product in a marketable state or form.

(3) Tangible personal property used to handle or store scrap or waste intended for disposal, sale, or other disposition, other than reuse in the manufacturing operation at the same manufacturing facility.

(4) Tangible personal property used to store fuel, water, solvents, acid, oil, or similar items consumed in the manufacturing operation.

All types of storage, be it of raw materials or parts, product (except in-process product), completed product, consumables, fuel, waste, scrap, equipment, tools, supplies, repair parts, etc., is taxable.

Similarly, anything used to handle, move, or transport people or personal property in the manufacturing facility is taxable, except for materials handling during a continuous manufacturing operation or during the manufacture of an item which will be used in the manufacturing operation, as described in paragraph (C)(5) of this rule, or the transmission of fuel, power, and similar substances as described in paragraph (C)(9) of this rule.

See examples 1, 2, 3, 4, 6, 9, 11, 20, 37, 40, 41, 42, 43, 44, 47, 59, 60, 61, and 64.

(5) Tangible personal property that is or is to be incorporated into realty.

Any tangible personal property that will become part of the real estate is taxable under this rule.

See examples 32, 45, and 46.

(6) Machinery, equipment, and other tangible personal property used for ventilation, dust, or gas collection, humidity or temperature regulation, or similar environmental control, except machinery, equipment, and other tangible personal property that totally regulates the environment in a special and limited area of the manufacturing facility where the regulation is essential for production to occur.

All equipment and supplies that monitor, regulate, or improve the environmental conditions in the manufacturing facility are taxable. This includes all lighting, heaters, air conditioning equipment, fans, heat exhaust equipment, air make up equipment, dust control or collection equipment, and gas detection, collection, and exhaust equipment. This should not be read to change the traditional classification of real and personal property.

The only exception to the taxing of these items is equipment which totally regulates the environment in a special and limited area of the facility, such as a clean room or paint booth, where such total regulation is essential for production to occur. Even in such a special area, things that do not provide essential environmental regulation, such as safety or communication equipment, are taxable.

See examples 7, 47, 48, and 49.

(7) Tangible personal property used for the protection and safety of workers, unless the property is attached to or incorporated into machinery and equipment used in a continuous manufacturing operation.

Protective clothing and devices, such as safety shoes, gloves, earplugs, hard hats, respirators, first aid supplies, etc. are taxable. Similarly, equipment installed to protect workers or shield them from harm is taxable, unless it is made a part of machinery or equipment used in a continuous manufacturing operation.

Equipment and supplies used to detect, extinguish, prevent, cure, or mitigate fire, explosion, flood, or other calamity in the manufacturing facility are taxable.

See examples 9, 43, 50, 51, 52, and 53.

(8) Machinery, equipment, and other tangible personal property used for research and development.

See examples 18 and 54.

(9) Machinery, equipment, and other tangible personal property used to clean, repair, or maintain real or personal property in the manufacturing facility.

Tools, equipment, and supplies made or purchased by the manufacturer for use in maintaining, installing, repairing, or cleaning its property, real or personal, are taxable. This includes any such items used on nontaxable equipment. This does not apply to repair or replacement parts or supplies which are taxable or not, depending on the taxability of the equipment into which they are installed.

See examples 32, 55, 56, and 58.

(10) Motor vehicles registered for operation on the public highways.

See examples 21, 57, and 63.

(E) For purposes of this rule, any tangible personal property used by a manufacturer in both a taxable and a nontaxable manner shall be totally taxable or totally exempt from taxation based upon its quantified primary use. If the tangible personal property consists of fungibles, they shall be taxed upon the proportion of the fungibles used in a taxable manner.

See examples 19, 25, 59 and 64.

(F) Persons whose only activity is printing and whose product produced for sale consists wholly of printed matter are not manufacturers under this rule. The taxability of things used by printers must be determined pursuant to division (E)(8) of section 5739.01 of the Revised Code.

If a portion of a manufacturer's manufacturing process involves printing, the taxability of the tangible personal property primarily devoted to the printing operation shall be determined pursuant to division (E)(8) of section 5739.01 of the Revised Code.

(G) Nothing in this rule restricts or denies any exception or exemption that may be available to a manufacturer under other provisions of the sales tax statutes or rules of the tax commissioner.

EXAMPLES

Example 1

A steel manufacturer galvanizes its flatroll steel to provide its customers with a corrosion resistant product. Through electrolysis and a recirculating zinc solution, zinc is chemically bonded to the steel. Recirculation of the zinc solution involves an intricately-woven system of fibrecast pipes, pumps, dissolution tanks, and electrolytic recirculating tanks, all of which are controlled by computers. As with many other types of manufacturing-related equipment, the size, weight, and configuration of these items require special foundations and supports. The entire system provides the necessary recipe and volume of solution for precise applications of zinc in a high velocity rolling mill.

- The zinc solution is a raw material which becomes a component of the completed product.
- The solution in which the zinc is dissolved is a consumable that interacts with the product and is not taxable.
- The piping system, dissolution tank, pumps, and electrolytic holding tanks are all used in a continuous manufacturing operation and are not taxable.
- The computers are used to control production machinery and in-process materials handling. The foundations and structural supports similarly are used in connection with production machinery. Therefore, these items are all not taxable.

Example 2

A manufacturer of concrete owns a ready-mix batch plant. Cement and aggregate are purchased from and delivered by outside suppliers. Cement is removed from delivery trailers by a vacuum system, which deposits the cement in a storage silo. Aggregate of particular sizes is delivered by dump trucks. The aggregate is stored in piles, segregated by size. As needed, cement is removed from the silo by screw conveyor and batched into a mixing drum. Aggregate is moved from the proper pile(s) by a front loader, which deposits the aggregate on a belt conveyor which lifts the stone up and into the mixing drum. Water is added into the drum and mixing commences. After a short time, concrete is discharged into mixer trucks. The mixing drums on the trucks operate via power take off from the truck engines. The concrete continues to be mixed as the trucks deliver it to the customer. One hundred per cent of this batch plant's output is sold to others by the manufacturer.

- The cement and water are committed to the manufacturing operation at the mixing drum. The cement vacuum system, storage silo, and screw conveyor are taxable.
- The aggregate is committed to the manufacturing operation when materials handling (via the front loader) from initial storage ceases and the aggregate is deposited on the conveyor which deposits it into the mixing drum.
- The aggregate conveyor and mixing drum are not taxable.

- The manufacturing operation continues in the mixer truck and is not completed until the concrete is discharged from the truck's mixer. Because the truck's mixer operates by power take off from the truck engine, the entire vehicle is production machinery and is not taxable.

Example 3

A secondary smelter of aluminum uses a scale as part of an automated process which measures out quantities of purchased aluminum scrap for use in the casting process in the foundry. The aluminum is delivered to the scale by a crane which removes the material from storage and puts it into a hopper which feeds the scale.

- The aluminum scrap is a purchased material, not scrap which is generated at this manufacturing facility; therefore, the equipment for its storage and handling are taxable. This includes whatever storage facility is set up for it and the crane.
- Because the raw material is committed to the manufacturing process at the hopper, neither the hopper nor the scale is taxable.

Example 4

An oil refinery obtains supplies of raw crude from numerous sources. It stores this crude in various tanks, withdrawing samples from each so that, in a laboratory in another part of the plant, it can conduct tests to determine the composition of each lot. Subsequently, various crude is metered and piped to another tank for blending to meet process specifications. Thereafter, the blended crude is desalted to remove impurities such as bottom sediments and water, and then is pumped to a preheat furnace to commence the distillation process.

- The storage tanks in which the raw crude is placed upon receipt are taxable. The fact that the tanks store the crude while laboratory tests are being conducted upon the samples makes no difference to the status of these tanks.
- The meters and piping used to transport the raw crude to the blending tank are not taxable from the point of metering. The crude is committed to the manufacturing process when it is metered after initial storage.
- The equipment used to blend the crude is not taxable as the crude has been committed to the manufacturing process.
- The storage and handling equipment used after the blending tank is not taxable.
- The desalting equipment and preheat furnace treat the crude in preparation for the manufacturing operation after it has been committed to the process and are thus not taxable.
- The equipment used to test the raw crude is not taxable.

Example 5

A cement manufacturer purchases limestone which is stored in piles at its facility. Prior to committing

the limestone to the process, the manufacturer periodically hoses down the limestone to keep down the dust.

- This activity does not constitute refining. Consequently, the hose and other equipment used to hose down the pile would be taxable.

Example 6

A manufacturer makes roofing shingles. It first makes a paper felt. This is passed through a saturator tank which contains asphalt that has been heated with steam to a very high temperature. This saturates the felt with the asphalt. The saturated felt is coated with granite dust; colored granules are then applied to one side and talc to the other. The material is then cooled and either cut to size or rolled up for shipment.

The colored granules are placed in storage when they are purchased. When they are to be used, they are transported to the blending box, where different colors are mixed together and applied to the roofing material. The purchased talc is also placed in a storage tank and then is transported to the manufacturing line by a series of pneumatic handling devices, which deposit it into a hopper over the production line. It then falls onto the shingle material passing underneath the hopper.

- The storage facilities for the granules and talc are taxable as they are storing raw materials which will be incorporated into the product.
- The handling devices for both the granules and talc are also taxable as they are handling raw materials from their initial storage and before they are committed to the manufacturing process.
- The blending box is the point at which the processing involving the colored granules begins, as the granules are mixed and applied to the roofing material at that point. It is therefore not taxable.
- The talc hopper is also not taxable as it is the point where handling from initial storage has ceased and the material is committed to the manufacturing process.

Example 7

A paper manufacturer makes special paper for use in full color photocopying. The process to apply the paper coating must be done in a dust and pollution free environment. Rolls of paper are passed through a machine where the coating is applied and dried. This process occurs in a clean room, which is separated from the rest of the plant by airtight partitions and ceiling coated with an easily cleaned plastic. Three of the walls and the ceiling are free standing and not part of the walls and ceiling of the building itself; the fourth wall, however, is a section of a wall of the larger structure. Employees can only enter the clean room through two airlocks, which prevent dirty air from entering. All air is filtered and regulated as to temperature and humidity by heat pumps, electric heaters, dehumidifiers, and exhaust fans that serve only the clean room and maintain a positive air pressure in the room. This equipment is automatically controlled by a small computer using data from air monitoring sensors in the room. Employees must wear disposable paper coveralls, overshoes, and caps. The room has an intercom to minimize personnel traffic in and out of the room. Lighting in the room is by normal fluorescent fixtures attached to the ceiling.

- The paper coater is production machinery and is not taxable.
- The clean room, including the heaters, heat pumps, light fixtures, etc., remains tangible personal property, since its special use primarily serves the business rather than the real estate.
- Since the clean room provides environmental regulation in a special and limited area, and such regulation is essential for the manufacturing to occur, it is not taxable. This includes the partitions and ceiling, airlocks, heat pumps, heaters, dehumidifiers, exhaust fans, ductwork, air monitors, lights, regulating computer, and the special clothing used by the workers to prevent product contamination within the room.
- The intercom is taxable.

Example 8

In manufacturing glassware, molten glass is dropped into molds in a forming machine, where it is spun into the desired form. The formed glassware is released from the molds onto a conveyor where it gradually cools. The conveyor enters and annealinglehr which tempers the glass. From annealing, the glassware moves on a long conveyor which again allows it to cool. The glassware is then sprayed with silicone which makes it scratch resistant.

- The manufacturing operation ends with the silicon sprayer.

Example 9

A manufacturer purchases castings which will be a component part of the manufacturer's product. The castings are received on trucks in metal boxes on pallets. The pallets are unloaded by forklift and placed in racks in the receiving area of the warehouse. As they are needed, a pallet is removed from storage by a different forklift and moved to a cleaning process. A worker removes the castings from the box by hand, placing them in a wire basket that is attached to a counterweighted arm which allows the worker to lower the basket into a tank containing chemicals which remove dirt, grease, and similar contaminants. After dipping, the worker, who wears rubber gloves to protect her hands from the strong chemicals, places the castings on a conveyor which moves them to a grinding operation.

- The holding of the castings after receipt is initial storage. Both forklifts and the storage racks are taxable.
- The castings have been committed to the manufacturing operation when deposited by the second forklift at the washing operation. The chemicals, dip tank, basket, and arm are not taxable, since they treat a component part after materials handling from initial storage has ended.
- The conveyor that moves the castings to the first production machine (the grinder) is not taxable because the continuous manufacturing operation began at the dip tank.
- The rubber gloves used to protect the worker are taxable.

Example 10

A manufacturer of clay pipe uses forklift tractors to transport the pipe from the machine in which it is formed to the kiln.

- The forklift tractors are used to handle an in-process product and are are not taxable.

Example 11

A petroleum refinery produces an intermediate feed, such as naphtha, which is temporarily stored. It eventually will be further processed into a completed product which will be sold.

- The equipment used to transport the feed to and from the storage tank, as well as the storage tank, are used to handle an in-process material and are not taxable.

Example 12

Water purchased from a public utility is used by a refiner to quench (cool) a gaseous product stream flowing from a distillation tower so as to lower its temperature or convert it to a liquid for further processing. Since the water does not touch the product directly, it does not need any treatment to make it suitable for use in the manufacturing operation.

- The water is used in the manufacturing operation. Any equipment used to handle it from the point where it enters the manufacturing facility is not taxable. Any piping from the utility supply line is therefore not taxable.

Example 13

A steel fabricator purchases coil steel. After the steel is committed to the manufacturing operation, it is dipped in solvent to remove dirt, oil, and grease. It is then further cleaned by dipping in an acid bath. After fabrication is completed, the steel is sprayed with oil to prevent formation of rust on the surface of the product. After the oil spray, the steel is transported to the truck dock for loading and shipping.

- The solvent and acid are consumables used to prepare the product during the manufacturing operation and are not taxable.
- The spraying of the protective oil on the completed product constitutes the end of the manufacturing operation.
- The oil is a consumable which interacts with the product and is therefore not taxable.

Example 14

A catalyst is used by a chemical manufacturer to facilitate or cause a reaction between other chemicals during the processing operation.

- The catalyst interacts with the product, is an integral part of the manufacturing operation, and is therefore not taxable.

Example 15

At a motor vehicle assembly plant, the manufacturer uses a bar code system to track the flow of components. As components are received from other manufacturing facilities or outside suppliers, a bar code label is attached and then scanned with a wand to record it in the plant mainframe computer, along with pertinent data keyed in by the employee to identify the part. This computer is also used for various administrative functions. It does not control the assembly line. Particular components are assigned to particular vehicles, in order to assemble vehicles conforming to those ordered by dealers, etc. After the vehicle is fully assembled, an employee scans all labels. A printout is made that permits a comparison between what components were supposed to be included in each vehicle and which components actually were assembled. The label on the emissions equipment is also scanned prior to emissions testing, in order to record the component in the emissions test data base. Purchases include labels, label printers, scanners, printers, computer terminals, and equipment to interface with the plant mainframe.

- This bar code system is primarily used to monitor the progress of the product in the continuous manufacturing operation. The labels and scanning wands are not taxable, except for first scanner and the scanner used prior to emissions testing. The first scanner is used to record a part in inventory and is therefore taxable. The scanner prior to emissions testing is taxable because the vehicle is completed before it is used. The scanner is not testing equipment.
- Since the bar code labels are used in the manufacturing operation, the label printers are not taxable.
- The computer terminals allow employees to monitor the progress of the scanned parts and are not taxable.
- The equipment that interfaces with the mainframe computer is taxable. The computer printers, similarly, produce records of the information and are taxable.

Example 16

The functioning of the melt furnace in a glass manufacturing facility is monitored and controlled from an operator's booth, which is on a raised platform about fifty feet from the furnace. Heat sensors in the furnace are wired to the control booth, where the temperature data is drawn on a continuous graph. The operator watches the graph and can adjust the furnace by altering the flow of fuel (natural gas) or oxygen, batch material proportions, or by adjusting the flue in the furnace stack.

- The sensors in the furnace monitor production and are not taxable.
- The control booth and the equipment and controls in it are not taxable.
- The temperature graphing device which records the temperature data is taxable since it functions as a recordkeeping device.
- The platform that supports the control booth is not taxable, since it supports the operator of production machinery.
- The furnace stack and flue assembly within the stack are not taxable, since they provide regulation of the furnace temperature.

Example 17

A manufacturer of high technology electronic equipment provides its workers with microscopes which enable them to manipulate the components as they are assembled into the product.

- The microscopes are not taxable because they are necessary for the continuation of the manufacturing operation.

Example 18

A castings manufacturer upgrades its foundry by installing a new computer controlled mold maker and an automatic caster. Because of their size and weight, both machines require special concrete foundations. Casting sand is blended to proper consistency with water and certain chemicals in a muller. An auger moves the sand to a feed bin attached to the mold maker. Molds are made automatically in accordance with computer instructions. The instructions for each job are developed in the engineering shop using a microcomputer and software which was purchased from the manufacturer of the mold making equipment. The instructions are placed on a computer disk which an employee carries to the computer that controls the mold maker. The completed molds leave the molder on a conveyor which moves them to the caster.

- The mold maker and its foundation are not taxable, since the molds are used in manufacturing the product for sale. The nontaxable equipment includes everything from the sand muller to the exit of the molds from the mold maker.
- The computer that controls the molder is not taxable.
- The purchased software and the computer in the engineering shop are taxable, since they do not actually control the machinery.
- The conveyor that moves the molds from the mold making process is taxable, since the molds do not enter the manufacturing operation until they reach the caster.
- The caster is production machinery. The caster and its foundation are not taxable.

Example 19

A paint manufacturer makes paint pursuant to customer specifications. After a batch is finished, a sample is ladled into a quart jar and taken to the lab for testing to assure adherence to the customer's specs. In the lab, twenty cubic centimeters are placed in a beaker which is then placed in a centrifuge. After centrifuging, the separated components of the paint are examined under a microscope for content. The test results are manually entered into a computer. The computer generates a printed report and a label, both listing the test results and other information about the particular paint batch, e.g., name of customer and date of manufacture. The label is attached to the quart jar which contains the remainder of the paint sample. The jar is placed in a storage cabinet where it is retained for five years.

- The testing procedure assures the quality of the completed product and the equipment which is used in conducting the testing is not taxable. This includes the centrifuge, beaker, and

microscope.

- The ladle, quart jar, and the storage cabinet are not used in testing nor in any other aspect of the manufacturing operation and are taxable. In addition, the quart jar and storage cabinet are used primarily in a function related to storage, record-keeping, and therefore are taxable.
- The computer, computer printer, and jar label are used only to record the test results and are taxable.

Example 20

A manufacturer operates a job shop foundry where it melts ingots of raw pot metal in an electric furnace. The molten metal is poured into jacketed molds, through which water is circulated to speed up the cooling and solidification of the metal. The water is pumped from a tank, chemically treated, and conveyed by pipes to the molds. The heated water is filtered and pumped from the molds to an outside cooling tower and then returned to the same tank. Make-up water is pumped from a well on premises into the tank. The treatment chemicals are stored in liquid form in a tank, from which they are pumped and metered.

- The furnace and molds are part of the continuous manufacturing operation and are not taxable.
- The water is an energy transmitting substance since it removes heat from the manufacturing operation. The water treatment chemicals, water pumps, pipes, well and cooling tower are not taxable. Since the water tank is part of the recirculation system, it also is not taxable.
- The chemical storage tank, meter, and pump are taxable, since they are merely storing or handling consumables prior to their initial use in the manufacturing operation.
- Since the trucks are registered for highway use, they are taxable.

Example 21

A large manufacturing facility is located on three hundred fifty acres of land on the outskirts of a large metropolitan area. The production machinery and equipment is spread over several miles. The plant property is divided at various points by a river, a railroad, and a public highway. Work in process is moved from one production phase to another by large licensed trailer trucks. A private bridge was constructed to cross the river, a tunnel was constructed under the railroad, and the trucks cross the public highway.

- This property is contiguous since the separations are only public or private rights of way and not land used for other public or private interests.
- Since the trucks are registered for highway operation, they are taxable.

Example 22

A plastics manufacturer uses injection molds to form the product. Excess plastic trim is knocked off the molds and collected on a conveyor. The conveyor moves the trim to a grinder where it is reduced in

size. Another conveyor moves the plastic to a regrind bin where it is stored until needed. The reground trim is manually removed from the storage bin in hoppers and added, in certain proportions, to the purchased plastic pellets in the feed bins for the mold injection presses.

- Since the trim is recycled back into the manufacturing operation, the entire process of collecting, transporting, regrinding, and reintroducing the trim is part of the manufacturing operation and not taxable. The regrind storage bin is holding in-process product between stages of production and is not taxable.

Example 23

A steel manufacturer operates two plants. Plant A produces basic steel in a BOF furnace and has bar and hot rolled strip steel producing lines. Plant B, located several miles away, produces cold rolled strip coils. All production lines produce steel scrap in the form of trimmings or defective product. At plant A, scrap from both lines is chopped to size and taken to a storage area. When needed it is added back to the furnace to be again used in steel production. The scrap from plant B is chopped to size and taken to plant A where it also is used to make new steel.

- Since plants A and B are not contiguous, they are separate manufacturing facilities.
- Since the scrap at plant A is returned to the furnace, all items of property used to handle and store the scrap are not taxable.
- The equipment used to handle and transport scrap produced at plant B is taxable since the scrap is transported to plant A for reuse.
- Since the choppers at both plants change the form of the scrap, they are not taxable.

Example 24

During paper manufacturing, the fibers that will comprise the finished paper product are put into a water solution. The water is drawn by an intake pipe and pump from a river that flows next to the manufacturing facility. The water is filtered and chemically treated and pumped into the hydropulper where it is combined with wood chips and other fiber source material. The resulting slurry is pumped to a fourdrinier which removes most of the water by means of vacuum pumps. The water so removed, as well as slurry that otherwise escapes the process is collected, since it contains usable fibers. This slurry is returned to the hydropulper by pumps and pipes.

- The water is a consumable that is used in the manufacturing operation. The river intake, pumps, filter, and chemicals are not taxable since they either treat the water or transport the water from the point of extraction at the river.
- The hydropulper and fourdrinier are production machinery and not taxable.
- The slurry recovery and recirculating is part of the manufacturing operation, since it recycles the product back into the manufacturing operation at the same manufacturing facility. The pumps and piping are not taxable.

Example 25

A plastics manufacturer generates steam in coal-fired boilers. Eighty-five per cent of the steam is used to heat reactor tanks, in which the first step in the manufacturing operation takes place. An insulated steam line carries the steam from the boiler to the reactor vessels. Fifteen per cent of the steam is diverted from the main steam line to heat the buildings in the manufacturing facility.

The coal purchased to fire the boilers is received at a river dock. The coal is unloaded from barges by a crane and is moved from the dock by a conveyor belt to a conical storage tower. As needed, the coal is pushed by a small bulldozer into a feed bin, which dumps the coal onto another conveyor belt which moves it to a coal pulverizer. A screw conveyor moves the pulverized coal from the pulverizer to a storage bin. Another screw conveyor removes the pulverized coal from the bin and a forced air system injects it into the boiler combustion chamber. The rate of injection is computer controlled.

Water for the boiler is pumped from the river, filtered, chemically treated, and stored in a water tank outside the boiler building. As the water is pumped from the storage tank, additional chemicals are added. Both the water and the air used to inject the pulverized coal are preheated by means of a heat exchanger in the boiler exhaust stack.

- Eighty-five per cent of the coal and boiler water chemicals are not taxable, since eighty-five per cent of the resulting steam is used in the manufacturing operation.
- The boiler and main steam line, including the latter's insulation, are not taxable, since a majority of the steam is consumed in the manufacturing operation. The line which carries steam for building heat is taxable.
- The coal unloading and handling equipment and the pulverizer are not taxable. The conical storage tower and the pulverized coal bin are taxable, since they merely store the coal.
- The forced air pulverized coal injection system is not taxable.
- The river water inlet, pumps, lines, filters, and treatment chemicals are not taxable. The water storage tank is taxable.
- The boiler exhaust heat exchanger is not taxable.
- The computer that controls the pulverized coal injection is taxable.

Example 26

A manufacturer of ready-mix concrete uses a steam generator to heat water which is used in mixing and warming component materials in the manufacture of ready-mix concrete. The concrete is sold to construction contractors and other consumers.

- The water is not taxable, as it transmits heat used in the manufacturing operation and becomes part of the product produced for sale.
- The generator is not taxable as it makes the water suitable for use in the manufacturing

operation.

Example 27

A manufacturer of extruded rubber products uses injection molding machines to force rubber through dies in order to form the desired shapes. The molding machines are operated by compressed air. The air compressor is fed air from an air dryer. The dryer is necessary to keep moisture out of the air compressor lines and production machinery.

- The injection molding machines are not taxable as they are production machinery which act upon the product.
- The air dryer and compressor are not taxable because they make the air used to power the molding machines suitable for use in that function.

Example 28

A steel manufacturer uses coke in the production of iron. Coke is a fuel which provides some of the heat required for smelting and it is also the source of carbon, a necessary ingredient in the manufacture of steel, which dissolves into the hot metal.

Coke is manufactured from metallurgical grade coal in a coke plant. The coal is crushed, blended (high and low volatile coals are mixed) and transferred to the ovens by means of conveyor systems. The crushed, blended coal is placed in a larry car which runs across the top of the coke ovens and charges the coal into the ovens. The coke battery consists of a series of ovens lined with refractory brick which bake the coal to produce coke. The coke battery is built from the ground up and does not have a separate foundation.

- The coke battery and the coal crushing, blending, and charging systems, and larry cars are not taxable.

Example 29

A manufacturer buys a new coal pulverizer. The coal is fed to a boiler to produce steam to generate electricity to power equipment used to manufacture products.

- The pulverizer is used to make the coal suitable for use in the manufacturing operation and is not taxable.

Example 30

A boiler is used to produce steam which primarily operates machinery and equipment used in the manufacturing operation. Other equipment feeds water into the boiler. This includes items such as pumps and a piping system. There is also a system which filters and treats raw water drawn from a creek running through the manufacturing facility.

- The boiler is used to produce power for the manufacturing operation and is therefore not taxable.

- The water is used to transmit energy to the manufacturing operation and is not taxable.
- The piping, pumps, filters, and water treatment equipment are not taxable.

Example 31

A manufacturer installs an electrical distribution system, including generators, transformers, electrical switchgear, cable and related equipment. The electricity is used solely to produce and supply electricity to the manufacturing operation.

- The entire electrical generation and distribution system is not taxable.

Example 32

A manufacturer of specialty coil steel products uses natural gas to heat annealing furnaces. The furnaces heat treat the manufacturer's product and are part of the continuous manufacturing operation. In a field owned by the manufacturer and adjacent to the plant, the manufacturer drills two natural gas wells, using a drilling rig, trencher, and various other tools, and installs drips, pumps, and transmission lines to provide gas for these furnaces. The manufacturer also installs a gas line connected to the local utility company line through which purchased gas is piped for heating the buildings in the manufacturing facility. A branch line connects this purchased gas line to the line going from the wells to the annealing furnaces, in order to supplement, if necessary, the gas produced from the wells. One hundred per cent of the well-produced gas is burned in the annealing furnaces. No more than twenty per cent of the purchased gas is burned in the furnaces.

- The line connected to the utility's line is incorporated into the real estate, since it primarily carries gas to heat the buildings. The wells, pumps, transmission lines and associated equipment, and the branch line remain personalty, since they carry gas for use in the manufacturing operation only.
- The wells, pumps, transmission lines and associated equipment, and the branch line are part of the manufacturing operation and are not taxable since they are extracting and transporting fuel used in the manufacturing operation.
- The material for the line connected to the utility's line is taxable.
- The drilling rig, trencher, and other tools used to install the well and gas lines are taxable.

Example 33

A manufacturer purchases pumping and filtering equipment and related tanks and tubing to supply lubricating and coolant fluids to drilling and cutting machinery. This equipment is used to recirculate the fluids so that they may be reused in the manufacturing operation.

- As the fluids are being treated for reuse in the manufacturing operation, the equipment which moves and treats the fluid is not taxable.

Example 34

A manufacturing operation uses water as a coolant in its production operation. The water is continuously recirculated in a closed system. The recirculation system includes a cooling tower and related pumps and piping.

- As the water is a substance used in the manufacturing operation, the recirculation system equipment is not taxable.

Example 35

The production of flatroll metal products requires that an oil mixture, which serves as both a rolling lubricant and a coolant, be continuously sprayed on sheets in the rolling mill. Spent oil is simultaneously removed and passed through a filtering process which is interconnected with the rolling mill, after which the oil is resprayed onto the sheets.

- The rolling mill is a production machine and is not taxable.
- The oil filtration machinery treats the oil for reuse; therefore, this equipment is not taxable.

Example 36

A manufacturer of truck and tractor engines uses what are known as wet machines in its engine head and block assembly lines. These machines require the presence of a liquid coolant to operate. In the absence of such a coolant the machines would heat up rapidly, ultimately destroying the tool and the part being machined. Therefore, the interface between the tool and the block or head is flooded by spraying it with liquid coolant, a water soluble oil.

In order to save on the expense of the oil, the manufacturer devised a system to recapture the used liquid. After the coolant is sprayed on the component, it drops through a funnel-like chamber into an underground trough. The coolant collects in a u-shaped channel along with the scrap metal chips and dust produced by the machining operations. The coolant is conveyed through the underground trough by means of air pressure to a collecting tank outside the plant where a conveyor lifts the bigger chips from the coolant. These chips then enter a chipwringer which wrings out excess coolant. From the tank, the coolant is pumped back into the plant through a series of pipes. Along the way, it passes through a series of filters which removes any remaining metal particles. Thereafter the coolant is returned to the machining lines where the process begins anew.

- The entire recirculating system is not taxable. The oil is used in the manufacture of the engine heads and blocks. The recirculating system is used to filter this oil to make it reusable for the manufacturing operation. The substances are in fact intended for reuse and not for disposal or sale.

Example 37

A producer of alloy steel uses an acid solution to pickle its products. The pickling process removes scale. After pickling, the used acid is filtered to remove impurities. The filtered solution is then pumped into a tank where pure acid is added to the solution in order to raise the acid content. From this tank, the solution is pumped and piped into the pickling tanks. After the acid is reused a certain number of times it can no longer be purified and strengthened sufficiently to be economically useful. It is

therefore transported through a series of pipes to an acid disposal plant, where the acid is neutralized by mixing it with lime in a tank designated the neutralizing tank. The mixture is then pumped into a sludge pond.

- The acid solution would not be taxable as it interacts with the product. The pickling tanks are production machinery and thus also not taxable.
- The pipes from the pickling tanks through the filtration system are not taxable, as this is a treatment system which makes a substance used in the manufacturing operation reusable, and the substance is in fact intended for reuse.
- The piping system used to transport the spent acid to the acid disposal plant, the pump into the neutralizing tank, the tank itself, the lime, and the pumps and pipes used to dispose of the neutralized solution are taxable under this rule as at this point the substance is not intended for reuse.

Example 38

An automobile manufacturer has a plant which stamps out steel to make automobile body parts. The manufacturer employs an engineering firm to procure and generally oversee the installation of a cold press machine which presses sheet metal into doors. The engineering firm contracts out the labor for installation of the piece of production machinery in the manufacturer's plant. The contractor which installs the machine bills the manufacturer directly.

- The charges from the contractor for the services to install the machine are not taxable as they involve the installation of an item used primarily in a manufacturing operation to produce tangible personal property for sale.

Example 39

A manufacturer builds and furnishes a new administration building. The building contains offices for executives and the personnel and accounting department. The manufacturer leases a computer to process personnel, payroll, accounting, and billing information.

- All office equipment and furnishings located in the administration building are taxable.
- The computer is taxable.

Example 40

A food processor has an automated batch system for dry ingredients. The ingredients are received from outside suppliers on pallets in bags, cartons, paper drums, etc. They are moved from the receiving warehouse area by forklift, which deposits the pallets near the dry batch mixer. Some ingredients are dumped by employees directly into the mixer. Some are dumped into feed bins which discharge directly onto a scale. The proper amount of ingredient per batch is programmed into the scale by an employee. The scale controls the feed bins, opening them in turn and shutting them when the proper weight is reached. The dry ingredients are mixed and discharged by a covered conveyor to the next stage, where water is added.

- The dry ingredients do not undergo a change in state or form until mixed with water; however, the manufacturing operation begins as to the dry ingredients when they are dumped into the feed bins or directly into the dry batch mixer, since they have been committed to the manufacturing operation when the materials handling (via the forklift) from the warehouse ceases. Thus, the bins, mixer, and scale are not taxable.
- The forklift is taxable.

Example 41

A manufacturer uses a forklift primarily to move finished goods from a storage warehouse and load them on trucks for shipment to customers.

- The tangible personal property in the warehouse and the forklift are taxable, since they are storing or handling a completed product.

Example 42

A manufacturer purchases storage equipment for the purpose of storing raw materials prior to commitment to the manufacturing operation includes tanks, racks, holding bins, and similar equipment.

- Such storage equipment is subject to tax.

Example 43

A fiberglass manufacturer generates fiberglass waste as part of its manufacturing process. The waste is collected in various ways, including a vacuum system with collection hoses that permit workers to clean up small particles. The vacuum system deposits the fiberglass into a holding bin. Larger pieces, including rejected material that fails quality assurance testing, is transported in skid boxes by lift truck. All waste fiberglass is baled and transported by the manufacturer's trucks to a landfill for disposal. All employees in the plant are required to wear masks to prevent them from inhaling glass fibers.

- Since the waste fiberglass is not sold or recycled by the manufacturer, the baler and all of the handling equipment, including the vacuum system, is taxable.
- The protective masks worn by the employees are taxable.

Example 44

Replacement parts for production machinery are kept in storage bins in the plant storeroom.

- While the parts are not taxable, the storage bins are taxable.

Example 45

A manufacturer has its employee parking lot repaved. It separately purchases the required materials and contracts the labor.

- The materials incorporated into the parking lot are taxable as the lot is real property. The labor is not taxable as it pertains to an improvement to realty. Had the manufacturer entered into an agreement whereby the contractor provided both material and labor, there would be no direct tax consequences to the manufacturer.

Example 46

A manufacturer purchases a heating system and other related parts to be incorporated into a manufacturing facility. The heating system will provide heat and serve solely for the building.

- The heating system and all related parts purchased will be taxable since it is used to produce heat for the building and not used in any manufacturing operation.

Example 47

A manufacturer of unassembled furniture has an extensive dust collection system throughout the manufacturing facility. Collecting units are located over the boring mills, saws, edgebanders, planes, and other places in the plant. Fans and ductwork exhaust the dusty air through a series of filters. The saw dust falls from the filters into movable hoppers. These hoppers are periodically dumped into a mixer, where the saw dust is blended with a small amount of liquid adhesive. The mixture is removed from the mixer by a screw conveyor to a press which forms it into briquettes which the manufacturer sells. The briquettes fall onto a conveyor belt which moves through a heat tunnel which causes rapid drying.

- The entire dust collection system is taxable, since it provides environmental control throughout the entire manufacturing facility.
- The portable dust hoppers are taxable, since they are handling a waste product.
- The adhesive, mixer, screw conveyor, press, belt conveyor, and heat tunnel are not taxable, since they are used to manufacture a product for sale.

Example 48

A manufacturer makes various kinds of candy canes. The process requires that temperature and humidity in the plant be maintained within certain narrow parameters.

- Since the temperature and humidity are regulated in the plant as a whole, rather than a special, limited area within the plant, all the equipment used to provide such regulation is taxable.

Example 49

A manufacturer of automotive parts paints the parts as part of its manufacturing process. The painting is done in paint booths, which are enclosures containing ventilation and other equipment that provide the booth with a controlled atmosphere so that paint is applied to each piece under nearly identical conditions, resulting in a uniform product. The paint is applied by a spraying system which results in a considerable amount of overspray. To flush this excess paint from the booth, a water spray flows through continuously. The water is drained from the booth into a treatment system which filters out

the paint. Neither the paint nor the water is reusable in the process, so they are disposed of in accordance with pollution control regulations.

- The paint booth and its ventilation equipment are not taxable since they regulate the environment in a special and limited area of the manufacturing facility.
- The water spray equipment is also not taxable as it is necessary for the continuation of the manufacturing operation.

Example 50

An automotive parts manufacturer is ordered by a federal inspector to install guardrails along the sides of aisles traveled by forklifts and a floor sweeper in order to provide a barrier for the protection of employees operating nearby machinery. The inspector also requires the installation of flashing lights on the moving equipment. The forklifts are primarily used to move in-process product.

- The guardrails are taxable.
- The forklifts themselves are not taxable since they are used for materials handling during the continuous manufacturing operation, so the flashing lights attached to them are not taxable. The flashing lights attached to the floor sweeper are taxable.

Example 51

All of the manufacturer's employees must wear ear plugs, safety glasses, hard hats, and steel toed shoes when in production areas. Some employees must wear leather or rubber gloves and aprons, depending on their jobs. The manufacturer provides all of these protective articles to the employees without charge, except eyeglasses and shoes. Employees must provide their own eyeglasses. However, the manufacturer usually buys, by special order, safety shoes for the employees and sells them, with a minimum markup to cover administrative expenses.

- All of these protective articles and clothing are used in taxable functions. The manufacturer consumes everything except the eyeglasses and shoes and must therefore pay tax on its purchases of those items.
- Since the manufacturer is making retail sales of safety shoes, it must have a vendor's license and collect sales tax on such sales made to the employees.
- The employees must pay tax to the suppliers of their safety glasses.

Example 52

A manufacturer produces electronic equipment. Its process requires that static electricity be eliminated from the environment. If it is not, the static will destroy the electrical components. In order to ensure that the static electricity is properly discharged, the manufacturer has its production employees wear a wrist bracelet which attaches to a grounded object. The manufacturer also requires that the production employees wear contaminant-free overalls so that the production area remains free of dirt.

- The wrist bracelets are not taxable since they are equipment necessary to the production process.
- The overalls are taxable since they are clothing worn throughout the plant instead of in a special and limited portion of the manufacturing facility where the environment is totally regulated.

Example 53

A manufacturer has several safety concerns in the manufacturing plant for which it has taken various measures. It has attached guards to certain of the production machinery to protect the workers from injury and placed safety signs at various points throughout the plant. It also furnishes clothing and other equipment to workers primarily for the workers' safety and protection. Finally, the manufacturer hangs fire extinguishers on walls throughout the plant.

- Machinery guards are attached to the production machinery and are therefore not taxable.
- General safety items, unless actually attached to production machinery, are taxable. Therefore, the safety signs, clothing, and other equipment are taxable.
- The fire extinguishers are taxable.

Example 54

A manufacturer of household products purchases a computer and software for use in designing packaging for its products (a "CAD" system). The CAD equipment allows the manufacturer's design engineers to create and evaluate various package sizes and shapes and the effects of using different package materials. Similarly, the system can be used to design and layout different labeling. A plotter prints out the designs for review by management. When a new design is selected, the system generates detailed drawings which are sent to package manufacturers and printers who will produce the new items.

- The entire CAD system, including the software, is used in research and development and is taxable.

Example 55

A manufacturer installs probes on a grinding machine, in part by using a special tool that was purchased for that purpose. The grinder is production machinery. The probes measure vibrations in the bearings of the machine while it is operating. A chart recorder records the data from the probes. When vibrations exceed a certain tolerance, new bearings are ordered and installed, thus allowing the manufacturer to make the repair in a controlled fashion and avoid extended downtime and/or more extensive damage to the grinder.

- The probes are not taxable, since they monitor the functioning of equipment used in the continuous manufacturing operation.
- The chart recorder merely makes a record of the monitoring and is taxable.

- The tool purchased to install the probes is taxable.
- The replacement bearings are not taxable, since they are incorporated into equipment used in the manufacturing operation.

Example 56

A manufacturer shuts down a reactor, which is used in the manufacturing operation, for routine maintenance. During shutdown, a section of the reactor wall is cut out, removed by crane, and a new section is welded in. Thereafter, the reactor is cleaned and the lines are flushed in preparation for start-up. All work is done by employees of the manufacturer.

- The labor performed to remove the old section, install the new section, clean the reactor and flush the lines is not taxable.
- The new section of the reactor wall is not taxable as it is part of a production machine.
- The welding torch, crane, equipment used to clean and flush the reactor, and related consumables, such as acetylene and cleaning compounds, are items used to clean, repair, install, or maintain personal property in the manufacturing facility and are therefore taxable.

Example 57

A manufacturer purchases two trucks to move work in process between buildings within the manufacturing facility. One truck is not registered for highway use since it is used solely on the manufacturer's private property. The second truck is registered, since it must travel a short distance on a public highway which passes through the manufacturing facility.

- The unregistered truck is not taxable, since it is used in materials handling of in-process product.
- The truck registered for highway operation is taxable.

Example 58

A manufacturer of paper products uses an extremely large and complex paper-making machine. The machine consists of many parts and requires constant servicing. Some parts themselves are massive and heavy. These parts must periodically be removed and replaced.

The manufacturer uses what it calls the wet end crane to lift, remove, and replace these heavy parts. The crane is sixty feet above the plant floor and it traverses the entire length of the paper-making machine by means of overhead rails.

- The wet end crane is taxable as it is machinery used to repair, install, or maintain real or personal property in the manufacturing facility.

Example 59

Concrete pipe is made in a forming kiln. The formed pipe is moved by lift truck to a steam room where

it cures for one day. The steam curing speeds up the necessary chemical reaction to harden the pipe. Steam is produced by a propane fueled boiler. The propane is stored in six tanks, with lines going to a single vaporizer which converts the liquid into gas. The concrete pipe is removed from the steam room to an area where employees patch and smooth pits and flaws in the pipe. The pipe is then moved to an outside storage area where it remains for at least twenty days to allow final curing. When sold, the pipe is loaded onto flatbed trailers by a yard boom truck. Movement of the pipe in the facility is done by three interchangeable lift trucks. The lift trucks are used seventy-five per cent of the time moving the pipe to and from the steam room, twenty per cent of the time moving from the finishing area to the yard, and five per cent of the time in miscellaneous activities. The lift trucks are battery powered and share the use of a single battery charger.

- The propane, propane lines and vaporizer, boiler, and hand tools used in finishing are not taxable. The propane storage tanks are taxable.
- The lift trucks are primarily used for materials handling as part of the continuous manufacturing operation. The lift trucks and battery charger are not taxable.
- The boom truck is taxable.

Example 60

A manufacturer produces bottle caps and furnace air filters at its single facility. The bottle caps are die punched from coils of sheet steel strip. The bottle caps are then passed through an inspection device and any caps which are found unacceptable are carried by a conveyor to a bin where they are held for sale. Acceptable caps continue through additional steps which include printing and the insertion of a gasket. After the bottle caps are punched from the sheet steel strip, the remaining perforated strip is recoiled and moved by a lift truck to temporary storage racks, from which point it is further trimmed to length during its assembly into furnace air filters.

- This constitutes a single manufacturing operation that produces two different products at the same manufacturing facility.
- The punching, printing, and gasket insertion equipment are all used in the production of the bottle caps and are therefore not taxable.
- The recoiling equipment and trimming equipment are production machines and not taxable.
- The device for inspecting the bottle caps is not taxable since it is used for testing the product.
- The lift truck and storage racks are not taxable because they handle or temporarily store in-process product.

Example 61

A manufacturer purchases sheet metal for fabrication into various products. After initial storage, the sheet metal is transported to slitters by a propane powered lift truck. The slitters cut the sheet metal to length, after which it is transported to the stamping presses. As the steel goes through the stamping process, excess metal in the form of chips is produced. The metal chips are removed from the

stamping area through a chute and conveyor system which transports the metal chips to a baler. The baler compresses the chips into bales which are then sold to industrial customers as scrap metal.

- The sheet metal is committed to the manufacturing operation when deposited at the slitters by the lift truck. The lift truck and the propane used to power it are taxable.
- The slitters and stamping presses are production machinery and are not taxable.
- The metal chips are scrap. Since the scrap is sold, rather than being reused in the manufacturing operation at the same facility, the chutes and conveyors which handle the scrap metal chips are taxable.
- Since the baler changes the form of the chips which are intended to be sold, the baler is production machinery and not taxable.

Example 62

A meat processor makes sausage, wieners, salami, bologna, and similar products. After grinding and mixing, the meat is extruded into casings of various types and sizes. The meat is then smoked and/or cooked. After cooking the casings are removed and discarded.

- The casings are consumables that physically interact with the product during the continuous manufacturing operation and are not taxable.

Example 63

A dairy purchases raw milk from farmers. The milk is picked up by trucks owned by the dairy. Upon arrival at the dairy facility, a pump removes the milk from the truck through a pipe and pumps it into a clarifier, which is a centrifuge that removes particle contaminants. From the clarifier, the raw milk is pumped into a storage silo where it is held for period of time. After the raw milk is removed from the silo, it proceeds through various processes, including separation (where cream is removed), blending (where cream is added back to reach proper butterfat content), standardization (where vitamin supplements are added), pasteurization, and homogenization. After homogenization, the milk is pumped to filling equipment which packages the milk in cartons or jugs.

- The trucks which deliver the milk from the farmers and the pump which removes the milk from the trucks are taxable.
- The clarifier actively refines the raw milk by centrifuging and is not taxable. The clarifier is the beginning of the manufacturing operation and the raw material (milk) is committed at that point.
- All equipment, pipes, pumps, and tanks (including the silo holding the raw milk), which process, move, or temporarily store the milk up to and including the homogenization process, are part of the continuous manufacturing operation and not taxable.

Example 64

An ice cream manufacturer purchases cream, sklm milk, sugar, and various flavorings and additives.

The cream and milk are placed into refrigerated tanks when received. Any particular flavoring is placed into one of several storage tanks. All of these tanks are connected by piping to a mixing tank. In-line meters control the amount of cream, milk, and flavoring withdrawn from the tanks and batched in the mixing tank. After mixing, the ice cream is packaged into cartons and moved by conveyor through a freeze tunnel, where most of the ice cream becomes solid. After the freeze tunnel, the packaged product moves slowly through a hardening room on roller conveyors. The hardening room is a large freezer where the temperature is maintained at minus thirty degrees. The solidification of the ice cream is completed in the hardening room. On exit from the hardening room, the product is shrink-wrapped in appropriate quantities (e.g., four half gallons), palletized, and moved by lift truck into a large freezer to await shipment.

The tanks, freezers, and some in-process piping is cooled by a refrigeration system, which consists of compressors, condensers, piping, and an in-line tank for the coolant. Based upon an analysis of the refrigeration system piping used in the various areas of the facility, it has been determined that twenty per cent of the system is used to cool the cream and milk tanks, ten per cent for the mixing tank, in-process piping, and packaging operation, thirty per cent for the freeze tunnel and hardening room, and forty per cent for the freezer warehouse.

- The initial storage tanks for the cream, milk, and flavorings are taxable.
- The milk, cream, and flavoring are committed to the manufacturing operation at the point they are metered prior to entering the mixing tank. The meters and subsequent piping and the mixing tank are not taxable.
- The ice cream is not completed until it leaves the hardening room. The freeze tunnel, hardening room, and roller conveyors are not taxable.
- The forklift that moves the palletized product into the freezer warehouse is taxable.
- The freezer warehouse is taxable, since it is storing a completed product.
- Sixty per cent of the coolant is taxable, since that is the proportion of this fungible used in a taxable manner.
- The condensers, compressors, and tank for the refrigeration system are taxable, since their quantified primary use (sixty per cent) is taxable.
- Since the refrigeration system piping is essentially identical, it is properly treated as fungible for sales tax purposes and is sixty per cent taxable.

Replaces rule 5703-9-21; Eff 10-29-77; 11-18-78; 12-1-90

Rule promulgated under: RC 5703.14

Rule authorized by: RC 5703.05

Rule amplifies: RC 5739.01, 5739.011, 5741.02

OHIO BOARD OF TAX APPEALS

UBS Financial Services, Inc.,
f/k/a/ PaineWebber, Inc.,

Appellant,

vs.

Thomas M. Zaino, Tax
Commissioner of Ohio,

Appellees.

CASE NO. 2003-T-1139

(DEALER IN INTANGIBLES TAX)

DECISION AND ORDER

APPEARANCES:

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Entered May 25, 2007

Ms. Margulies, Mr. Eberhart, and Mr. Dunlap concur.

UBS Financial Services, Inc., appeals from a final determination of the Tax Commissioner, in which the commissioner affirmed three dealer in intangibles tax ("DIT") assessments issued for tax years 1999, 2000, and 2001. UBS claims that the

commissioner erred by a) not allowing a deduction for "landlord contributions" when computing taxable value and b) failing to include in the DIT's receipts factor all receipts from the sale of UBS' securities inventory, including the original cost of the securities to UBS. For the following reasons, we affirm the commissioner's determination in its entirety.

UBS is a Delaware corporation that is engaged in brokering various investment and capital products to its clients. It has its principal place of business located in New Jersey. In addition, UBS operates a "branch office" system throughout the United States, including Ohio. H.R., Vol. I, at 53. The branch offices service what UBS refers to as its "individual clients group." Through its branch offices, UBS provides its individual clients with equity stocks, securities, commodities, insurance, trusts, wrap products,¹ mutual funds, other securities and related products and services. H.R., Vol. I, at 48 and 53. UBS' "institutional clients" purchase similar products and services primarily through UBS' New Jersey office. H.R., Vol. I, at 53. For its services, UBS charges or earns commissions, management fees, interest income, and gains on inventory sales. H.R., Vol. I, at 78.

In 2001, the Department of Taxation conducted an audit on UBS' 1999-2001 DIT returns. As a result of the audit, the department disallowed certain landlord contributions in determining the value of UBS' leasehold improvements and increased the numerator of the gross receipts factor. UBS was assessed an additional tax of

¹ Wrap products are those in which a client invests with a money manager who charges the client an annual fee based upon a percentage of the assets, rather than on each transaction conducted throughout the year. H.R., Vol. I, at 55.

\$195,287.68 for tax year 1999, \$228,437.04 for tax year 2000 and \$360,357.52 for tax year 2001. See S.T., Vol. II, at 517, 539, and 526.

UBS subsequently filed a petition for reassessment, challenging the deficiency assessments. In addition to challenging the assessments, UBS claimed in its petition that it had incorrectly reported "gross receipts" for the apportionment calculation during each of the assessed years. UBS claimed that it had erroneously included one percent of its net trading profits from inventory sales in both the numerator and denominator, rather than one percent of all of its gross receipts from the inventory sales. UBS claimed that a recalculation of the factor would result in a refund for each of the assessed years. UBS has not filed any amended DIT returns or filed an application for refund.²

Upon review of the petition for reassessment, the commissioner affirmed the three assessments in their entirety and further declined to make UBS' requested changes to the apportionment factor. UBS, on appeal, concedes the increases made to the numerator of the receipts factor, but argues that the commissioner erred in not permitting the landlord contributions and in not recalculating the factor using gross receipts from inventory sales.

We begin our review by observing that the findings of the Tax Commissioner are presumptively valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121. Consequently, it is incumbent upon a taxpayer challenging a

² The record indicates that UBS did request the auditing agent to issue a refund based upon UBS' suggested changes to the apportionment factor. The agent, however, relied upon UBS' returns, as filed, in recommending the assessments. The assessments did not alter the apportionment factor, as reported by UBS.

determination of the commissioner to rebut the presumption and to establish a clear right to the requested relief. *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138. In this regard, the taxpayer is assigned the burden of showing in what manner and to what extent the commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213.

UBS is a "dealer in intangibles," as that term is defined in R.C. 5725.01(B).³ Pursuant to R.C. 5725.13, the property of a dealer in intangibles must be listed and assessed at its fair value and is to be taxed in the manner prescribed in R.C. 5725.01 to 5725.26, inclusive.⁴ Under R.C. 5725.14, a dealer is required to file an annual return with the Tax Commissioner that shows, in detail, the dealer's resources and liabilities. If the dealer maintains separate business offices, whether within Ohio only or within and without the state, the report must also show the gross receipts from business done at each office during the year ending on the thirty-first day of the preceding December.

³ R.C. 5725.01(B), as enacted during the assessment period, provided: "Dealer in intangibles' includes every person who keeps an office or other place of business in this state and engages at such office or other place in a business that consists primarily of *** buying or selling bonds, stocks, or other investment securities, whether on the person's own account with a view to profit, or as agent or broker for others, with a view to profit or personal earnings."

⁴ The DIT is a tax "distinguished from a franchise tax or other form of excise tax." *Bond & Mortgage Investment Co. v. Evatt* (Oct. 28, 1943), BTA No. 8061, unreported. The tax is not one on the entity as a corporation and a dealer in intangibles. *Id.* at 609; *Household Finance Corp. v. Porterfield* (1970), 24 Ohio St.2d 39. A dealer in intangibles does not pay Ohio franchise tax. R.C. 5733.09(A). The DIT "is imposed upon the dealer's capital *** to the extent that the capital is employed in Ohio." *Household Finance*, *supra*, at 43.

Upon receipt of the return, "the commissioner is to ascertain and assess all the shares of such dealers in intangibles, the capital stock of which is divided into shares, representing capital employed in this state, and the value of the property representing the capital, not divided into shares, employed in this state by such dealer in intangibles, according to the aggregate fair value of the capital, surplus, and undivided profits as shown in such report, including in the case of an unincorporated dealer, the value of property converted into nontaxable bonds or securities within the preceding year, without deduction for indebtedness created in the purchase of such nontaxable bonds or securities." R.C. 5725.15.

R.C. 5725.15 further provides that, where the dealer has separate offices within and without Ohio, the amount of capital employed in Ohio shall bear the same ratio to the entire capital of the corporation, wherever employed, as the "gross receipts" of the Ohio offices bear to the entire gross receipts of the dealer, wherever arising. During the assessment years, R.C. 5725.14 defined "gross receipts," for the purpose of allocation in the case of a dealer principally engaged in the business of selling or buying stocks, bonds, and other similar securities, as "the aggregate amount of all commissions charged plus one percent of the aggregate amount of all other receipts."⁵

UBS' primary specification of error relates to the proper interpretation of the phrase "aggregate amount of all other receipts" for purposes of defining "gross

⁵ Beginning with the 2003 tax year, R.C. 5725.14 now provides, at R.C. 5725.14(3)(b), that "gross receipts" means, "In the case of a dealer in intangibles principally engaged in the business of selling or buying stocks, bonds, or other similar securities either on the dealer's own account or as agent for another, the aggregate amount of all commissions charged." See Am.Sub.H.B. No. 405, effective March 14, 2002, 149 Ohio Laws, Part IV, at 6624.

receipts" under former R.C. 5725.14. Nevertheless, before we can proceed to consider the merits of UBS' contentions, we must address a jurisdictional issue raised by the commissioner. The commissioner maintains that UBS can seek a review of only the increased liability imposed pursuant to the audit of UBS' returns. The commissioner argues that UBS is precluded from seeking, through its petition for reassessment, a refund on amounts UBS originally paid as a result of the information UBS voluntarily reported on its DIT returns. According to the commissioner, UBS must seek a refund on any alleged overpayments through an application for refund.

In reviewing the commissioner's contention, we note that, in its 1999-2001 DIT returns, UBS voluntarily reported its receipts using its "net trading profits" from inventory sales in the numerator and denominator of the apportionment formula, as specified by the commissioner's instructions on the returns, and voluntarily returned and paid the tax based upon its reporting. UBS did not contest the accuracy of the returns at the time they were filed, nor did UBS make any claim for any deduction from book value at the time of making its returns, as specifically required by R.C. 5725.15.⁶ During the department's audit, UBS stated that it had erred in calculating the apportionment factor and claimed that it should have based its receipts on "cash received," rather than on the "net trading profits." The agent disagreed and finished the audit using the information reported by UBS in each of its returns. Although UBS informally advanced the issue during the department's audit, UBS neither filed amended returns nor submitted an application for refund.

⁶ R.C. 5725.15 provides: "Claim for any deduction from book value of capital, surplus, and undivided profits must be made in writing by the dealer in intangibles at the time of making his return."

R.C. 5725.15 provides, "Whenever the commissioner assesses the fair value of the capital, surplus, and undivided profits of a dealer in intangibles at an amount *in excess of the book value thereof as shown by its report*, or disallows any claim for deduction from book value of such capital, surplus, and undivided profits, he shall give notice and proceed as provided in section 5711.31 of the Revised Code." (Emphasis added.) R.C. 5711.31 specifies both the manner in which the commissioner must give notice of the assessment and the requirements for the filing of a petition for reassessment. Under R.C. 5711.31, the commissioner, upon review of the petition for reassessment, "may make such correction *to the assessment*, as he finds proper." (Emphasis added.)

The commissioner relies upon *Wright Aeronautical Corp. v. Glander* (1949), 151 Ohio St. 29, to support his claim that we lack subject-matter jurisdiction over UBS' specification of error. We find *Wright* to be instructive, in that the court considered a situation where a taxpayer had voluntarily made a tax return and had paid the tax thereon without making any protest that the return was inaccurate, or without filing at the time the return was filed a written claim for a deduction in book value. Nevertheless, the utility of *Wright* is limited because the taxpayer raised its claim of error for the first time before this board, rather than in the proceedings before the commissioner.

We do find *Internatl. Business Machines Corp. v. Zaino* (2002), 94 Ohio St.3d 152, however, to be supportive of the commissioner's position. In *IBM*, the court considered a situation in which a taxpayer sought a refund of an overpayment of

franchise tax through a petition for reassessment rather than through an application for refund. The commissioner had issued a deficiency assessment against the taxpayer. The taxpayer filed a petition for reassessment, seeking a review of the assessment. In addition, the taxpayer argued that changes should be made in the reporting of certain deferred tax asset accounts. The taxpayer argued that, if the entire debit balance was included in its net worth calculation, not only would its franchise tax liability be reduced to zero, but also it would be entitled to a refund. Upon review, the commissioner cancelled the assessment but did not grant the additional refund requested by IBM. The commissioner maintained that, in the absence of a refund application, his authority was limited to the amount of the deficiency assessment.

Upon appeal, the court agreed. In reviewing the assessment statute for franchise tax, the court stated, "There is no language in R.C. 5733.11 that grants the commissioner authority to refund any amount greater than that paid toward the deficiency assessment with the petition for reassessment. Therefore, when the commissioner has made an assessment under R.C. 5733.11, the amount that may be contested and refunded under that statute is limited to the amount paid on the deficiency assessment. No refund of the money paid with the filing of the franchise tax returns is available under R.C. 5733.11" *IBM*, supra, at 154-155.

We find the circumstances before us to be similar. R.C. 5711.31 limits the commissioner's authority to making "such correction *to the assessment*, as he finds proper." (Emphasis added.) Hence, as his authority is limited to the assessment itself, the commissioner is limited to the amount either paid or due on the deficiency

assessment.⁷ The commissioner could not go beyond the assessment to consider any other claim for refund not made at the time of filing or not made pursuant to an application for refund. *IBM*, supra. See, also, *Wright*, supra, at paragraph one of the syllabus.

We stress that this is not to say that UBS did not have an avenue to seek a refund of money paid with the filing of its DIT returns. UBS could have filed amended returns and then challenged any refusal by the commissioner to value UBS' property according to the amendments. *Lincoln Elec. Co. v. Limbach* (1993), 66 Ohio St.3d 176. Alternatively, UBS could have filed an application for refund under R.C. 5703.05(B), with any certificate of abatement issued on an overpayment being tendered as provided by R.C. 5725.16. See *IBM*, supra, at 155. Cf. *Lancaster Colony Corp. v. Lindley* (1980), 61 Ohio St.3d 268. UBS has filed neither an amended return for each of the years at issue nor an application for refund. As such, UBS has failed to comply with a specific requirement necessary for our review. *IBM*, supra, at 156.

Although we find jurisdiction wanting in this instance, if we had considered the contested issue, we would have found that the record before us supports the Tax Commissioner's interpretation of R.C. 5725.14. As previously stated, the issue raised by UBS concerns the proper interpretation of the phrase "aggregate amount of all other receipts" for purposes of defining "gross receipts" under former R.C. 5725.14. UBS maintains that the phrase "all other receipts" should include not only the gains and losses from the sale of securities on its own account (as opposed to

⁷ UBS had paid the assessment prior to the commissioner's issuance of his final determination. See R.C. 5725.22.

acting as an agent for its customers), but should also include the broker's cost of purchasing the securities. The commissioner counters that "receipts" means the aggregate gains or losses from the sale of securities. Although perhaps an oversimplification, the issue may be hypothetically illustrated by looking at a broker's purchase of stock for \$10.00 per share. The broker then sells the stock at a price of \$15.00 per share. Under UBS' theory, the "receipts" generated by the sale are \$15.00 per share, i.e., the cash received. According to the commissioner, the "receipts" are \$5.00 per share, i.e., the broker's gain.

For each of the tax years in question, UBS filed its DIT return (Tax Form 980) pursuant to the commissioner's instructions, which specified that income was to be used when calculating "receipts." This calculation was made in Exhibit C to the return. The instructions for Exhibit C provided:

"In the case of a dealer engaged primarily in the business of dealing in securities as principal, broker, or both, gross receipts shall consist of the aggregate amount of commissions charged for business done at each office, plus 1% of the aggregate amount of all other receipts from business done at each office.

"Exhibit 'C' is used by brokers who have offices both in Ohio and out. To calculate the Ohio percentage of business for brokers, 100% of commissions charged plus 1% of all other income earned in Ohio, divided by 100% of commissions charged elsewhere plus 1% of all other income everywhere. Line 3, Exhibit A, is then multiplied by the percentage obtained from this calculation."
Appellees Ex. F, at page 2 of Form 980-A.

While UBS acknowledges that it filed according to the instructions, it argues that the return is in error and that it should have reported using cash received rather than income. In support, UBS relies upon decisions from other jurisdictions and

the testimony of both Thomas Stampfli, who was UBS' Chief Financial Officer, Eastern Division, during the assessment period, and Louis DeVico, who is UBS' Manager of State and Local Taxes.

We find the cases relied upon by UBS to be unpersuasive. They concern other taxes, and one of the cited cases involves the definition of "total sales," which was defined as "gross receipts." As to the testimony, we do find the witnesses to be credible; however, the testimony, while knowledgeable, goes little beyond personal theory. Given the self-interested nature of the testimony, we do not find it sufficient to overcome the burden in favor of the commissioner. In this regard, we remind the parties that we will determine the weight and credibility to be accorded the testimony and other evidence presented. *Cardinal Fed. S. & L. Assn. v. Cuyahoga Cty. Bd. of Revision* (1975), 44 Ohio St.2d 13.

In addition, the commissioner presented the testimony of Dr. Ray Stephens, a former Senior Academic Fellow of the Office of Chief Accountant, Securities and Exchange Commission, and currently the director of the School of Accountancy at Ohio University. Dr. Stephens testified as to the accounting principles that apply to brokers like UBS. Dr. Stephens testified that "receipts" would be defined as "revenue received in cash." H.R., Vol II, at 141. According to Dr. Stephens, the term "revenue" may have several meanings, depending upon the industry and the type of transaction. H.R., Vol. II, at 142 and 148. Dr. Stephens testified that accounting practice defines "revenue" for purposes of the sale of securities in the brokerage

industry as "the amount of gain or loss from the principal transactions." H.R., Vol. II, at 174. See, also, H.R., Vol. II, at 143.

We agree with the commissioner that the term "receipts," as used in R.C. 5725.14, contemplates factors intrinsic to both the DIT, a tax unique to Ohio, and the sale of securities in the brokerage industry. We find Dr. Stephens' testimony to be credible and probative of the issue. We therefore accept the commissioner's interpretation that, under R.C. 5725.14, "receipts" means the amount of gain or loss on the relevant transactions.

This definition also comports with the commissioner's historical application of R.C. 5725.14 when calculating the gross factor for use in R.C. 5725.15. A review of DIT returns from several years, see Appellee's Exs. B-J, along with the testimony of Michael Sachs, a former employee of the Department of Taxation who supervised the DIT audits, establishes that the commissioner has for several decades interpreted the term "receipts" to mean the gain or losses on the transactions. "Due deference should be given to statutory interpretations by an agency that has accumulated substantial expertise and to which the General Assembly has delegated enforcement responsibility." *Weiss v. Pub. Util. Comm.* (2000), 90 Ohio St.3d 15, at 17-18, citing *Collinsworth v. W. Elec. Co.* (1992), 63 Ohio St.3d 268, at 272. See, also, *State ex rel. Clark v. Great Lakes Contr. Co.*, 99 Ohio St.3d 320, 2003-Ohio-3802, at ¶ 10 ("It is a fundamental tenet of administrative law that an agency's interpretation of a statute that it has the duty to enforce will not be overturned unless the interpretation is unreasonable."); *In re Estate of Packard* (1963), 174 Ohio St. 349,

at 356 (holding that "**** long standing administration practices are not only persuasive, but should not be set aside unless judicial construction makes it imperative to do so."). There is nothing unreasonable in the commissioner's interpretation of R.C. 5725.14.

In its final specification of error, UBS asserts that the commissioner erred in adding the landlord contributions portion of its leasehold improvements in UBS' net worth. At the time it enters into a lease, UBS makes substantial renovations to the office. Improvements include new wiring to support UBS' computer system. H.R., Vol. I, at 238. In such situations, UBS will enter into an arrangement in which the landlord agrees to pay for a portion of the improvements. For purposes of the DIT, UBS reported the cost of the improvements, less the amount of funds it received from the landlord. H.R., Vol. I, at 238. The commissioner counters that the total cost of the improvements should be included because the improvements themselves exist regardless of who pays for them. See S.T., Vol. I, at 1.⁸

Upon review, we agree with the commissioner. The improvements are part of UBS' net worth, regardless of whether UBS received a discount in its lease as part of making the necessary improvements to its offices. Moreover, it is clear that UBS treated the landlord contributions as an asset in its financial statements. See S.T. at 126, 184, 185. In addition, UBS provided only general testimony as to the type of

⁸ The commissioner also argues that there is no jurisdiction to consider UBS' specification because UBS failed to make a written claim for a deduction in book value at the time it filed each return. In support, the commissioner relies on *Willys-Overland Motors, Inc. v. Evatt* (1943), 141 Ohio St.402. However, the instant matter differs factually. The court specified in *Willys-Overland* that the commissioner was without jurisdiction to consider a request for a deduction from book value where the request was not made in writing at the time of filing *and* where the commissioner failed to assess any item in excess of the value reported. *Id.* at paragraph four of the syllabus. Here, the commissioner did assess UBS for property that the commissioner believed was omitted.

improvements involved. We reiterate that UBS has the burden of coming forward with probative evidence to support its claims. *Alcan*, supra. In considering the evidence before us, we are unable to conclude that UBS has met its burden of proving, with competent and probative evidence, that the commissioner's inclusion of the landlord contributions was in error.

In conclusion, we find that we are without jurisdiction to consider UBS' contention that the broker's cost of purchasing securities should be included in its "receipts" under R.C. 5725.14. We further find that UBS has failed to prove, by competent and probative evidence, that the commissioner's inclusion of landlord contributions is in error. Finally, upon review of the record before us, we conclude that the commissioner's final determination is supported by a preponderance of the evidence and is in accordance with law. Accordingly, we affirm the Tax Commissioner's final determination.

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OHIO BOARD OF TAX APPEALS

L-S II Electro Galvanizing Company,)

Appellant,)

vs.)

Roger W. Tracy, Tax)
Commissioner of Ohio,)

Appellee.)

and)

L-S II Electro Galvanizing Company,)

Appellant,)

vs.)

James J. Lawrence,)
Tax Commissioner of Ohio,)

Appellee.)

CASE NOS. 98-G-412
99-G-244

(USE TAX)

DECISION AND ORDER

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ENTERED: June 29, 2001

Mr. Johnson, Ms. Jackson and Ms. Margulies concur.

This matter came to be considered by the Board of Tax Appeals upon notices of appeal filed herein under dates of April 23, 1998 and February 5, 1999, by counsel for the above-named appellant from final orders of the Tax Commissioner dated March 24, 1998 and January 8, 1999. The Commissioner affirmed use tax assessments previously levied against the appellant for the tax period January 1, 1993 through December 31, 1994 and tax period January 1, 1995 through December 31, 1996 respectively. The separate appeals were consolidated for hearing purposes only by this Board on November 4, 1999. However, this decision and order will treat the appeals as consolidated for dispositive purposes as well.

The Tax Commissioner's final determination in B.T.A. No. 98-G-412 reads, in pertinent part, as follows:

"This matter comes on for final determination pursuant to R.C. 5741.14. A hearing was held in Cleveland on September 4, 1997. Present were Robert S. Black and William J. Beres.

"This assessment came about subsequent to a use tax audit of the petitioner's purchases for the period January 1, 1993 through December 31, 1994. The petitioner, a producer of corrosion-resistant zinc-coated steel, has raised an objection to the assessment.

"At its Columbus plant, the taxpayer receives rolls of uncoated sheet steel which are galvanized when they pass through a system of rollers and liquid galvanizing material ('the bath'). At one point, the steel passes across a roller ('conductor roll') which carries a negative electric charge, then into the bath and between positively-charged electric anodes, then out of the bath and over another conductor roll. The effect is that electricity passes from the roller to

the sheet steel, then from the sheet steel through the galvanizing liquid to the anodes. This causes the zinc galvanizing material to bond to the steel.

"While in operation, the conductor rolls are in continuous contact with grindstones. The grindstones scrape off excess electrolyte, which drops back into the bath. If the surface of a conductor roll becomes rough, the flow of electricity will arc and create a dent in the strip. According to the taxpayer, the grindstone system's sole function is to prevent imperfection from appearing on the conductor rolls that would be transferred, as dents, to the steel strip.

"The taxpayer contends that the grindstones are excepted under R.C. 5739.011(B)(4) as equipment which is otherwise necessary for the continuation of the manufacturing operation. However, the language excluding the items in R.C. 5739.011(C) from the manufacturing exception is encompassing:

'For purposes of division (E)(9) of section 5739.01 of the Revised Code, the thing transferred does not include any of the following:

'(9) Machinery, equipment, and other tangible personal property used to clean, repair, or maintain real or personal property in the manufacturing facility; . . . (Emphasis added.)

"Division (C) of R.C. 5739.011 does not make allowance for items which are "otherwise necessary" in division (B) of the same statute. Rather, it admits that some of the items listed under it might in fact be necessary for manufacturing to occur, but they are nevertheless excluded. The objection is denied. . . ."

The Tax Commissioner's final determination in B.T.A. No. 99-G-244 is similar to B.T.A. No. 98-G-412. A slight difference in rationale does exist and the determination reads in part, as follows:

***The taxpayer contends that the grindstones are 'otherwise necessary' for the functioning of production machinery and are therefore excepted. The section of the statute quoted above is re-iterated in Ohio Administrative Code 5703-9-21-(C)(4). Explanations are given there for portions of the statute, but not for the phrase 'otherwise necessary.'

"R.C. 5739.011(C)(9) provides that 'machinery, equipment, and other tangible personal property used to clean, repair, or maintain real or personal property in the manufacturing facility' is taxable.

"Specific provisions of a statute control over general provisions. R.C. 1.51 states:

"If a general provision conflicts with a special or local provision, they shall be construed, if possible, so that effect is given to both. If the conflict between the provisions is irreconcilable, the special or local provision prevails as an exception to the general provision, unless the general provision is the later adoption and the manifest intent is that the general provision prevail.

"It is clear that the grinders are used to clean and maintain the conductor rolls; the taxpayer's own description of the process indicates this. Because R.C. 5739.011(C)(9) specifically provides that cleaning and maintenance items are not exempt, this controls over the general exception of 5739.011(B)(4) for things 'otherwise necessary' for the functioning of production equipment. Accordingly, the taxpayer's contention cannot be allowed. . . ."

The appellant's notices of appeal specified the same error on the part of the Tax Commissioner. They read in pertinent part, as follows:

The Tax Commissioner erred in affirming the assessment of use tax on the purchase of grindstones used by Appellant in its manufacturing operations. The grindstones are used primarily in a manufacturing operation to produce tangible personal property for sale and their purchase is exempt from tax under R.C. 5739.01(E)(9), R.C. 5739.011 and R.C. 5741.02(C)."

This matter is submitted to the Board of Tax Appeals upon the notices of appeal, the statutory transcripts furnished by the Tax Commissioner, the record of the evidentiary hearing, and the brief submitted by appellant.

L-S II Electro-Galvanizing Company is a joint venture owned by LTV Steel and Bethlehem Steel, the latter having bought the original interest from Sumitomo Metals. The appellant is in the business of producing electro galvanized steel for automobile manufacturers. The component at issue in the instant appeal is the grindstone system used on the electro galvanizing line. The line plates steel strips with zinc and nickel for use in the automobile industry as exterior surfaces in doors, hoods, and tops. The process was developed to meet customer needs for flawless product for automobiles.

As we begin our review of the instant appeal, the Board notes that the findings of the Tax Commissioner are presumptively valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121. It is therefore incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut that presumption and establish a right to the relief requested. *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138. Moreover, the taxpayer must show in what manner and to what extent the Tax Commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213.

Appellant's contention of error relates to the Commissioner's assessments of use tax for purchases of items for the grindstone system used in the manufacturing

process. R.C. 5739.02 levies a sales tax upon all retail sales made in Ohio. A correlative use tax is imposed by R.C. 5741.02. If a transaction is not subject to sales tax, it follows that the transaction, if made within Ohio, is also not subject to use tax. R.C. 5741.02(C). Since our analysis of the relevant sales and use tax provisions is essentially identical, in the context of this appeal we shall refer only to the applicable sales tax provisions.

For purposes of the exception, the term "manufacturing operation" is defined in R.C. 5739.01(S):

"(S) 'Manufacturing operation' means a process in which materials are changed, converted, or transformed into a different state or form from which they previously existed and includes refining materials, assembling parts, and preparing raw materials and parts by mixing, measuring, blending, or otherwise committing such materials or parts to the manufacturing process. 'Manufacturing operation' does not include packaging."

R.C. 5739.01(E) provides an exception for sales of property used in a "manufacturing operation":

"(E) 'Retail sale' and 'sales at retail' include all sales except those in which the purpose of the consumer is: ***

"(9) To use the thing transferred, as described in section 5739.011 of the Revised Code, primarily in a manufacturing operation to produce tangible personal property for sale[.]"

R.C. 5739.011(B) provides a description of those items used in a "manufacturing operation":

"(B) For purposes of division (E)(9) of section 5739.01 of the Revised Code, the 'thing transferred' includes, but is not limited to, any of the following: ***

"(1) Production machinery and equipment that act upon the product or machinery and equipment that treat the

materials or parts in preparation for the manufacturing operation; ***

"(4) Machinery, equipment, and other tangible personal property used during the manufacturing operation that control, physically support, produce power for, lubricate, or are otherwise necessary for the functioning of production machinery and equipment and the continuation of the manufacturing operation; ***

The Tax Commissioner relies on provisions of R.C. 5739.011(C) which read in part:

"(C) For purposes of division (E)(9) of section 5739.01 of the Revised Code, the 'thing transferred' does not include any of the following: ***

"(9) Machinery, equipment, and other tangible personal property used to clean, repair, or maintain real or personal property in the manufacturing facility; ***"

Consequently, we must examine these statutory provisions in the context of the use of the grindstone system. The appellant claims that the grindstone system falls under R.C. 5739.011(B)(4) as "machinery or equipment used in the manufacturing process that is otherwise necessary for the functioning of the production machinery and the continuation of the manufacturing operation." The Tax Commissioner counters by claiming that the grindstone system in fact is a "cleaning" system and falls into the taxable provisions of R.C. 5739.011(C)(9). After careful review of the record, we agree with the appellant and find that the grindstone system is excepted from use tax.

To be exempt under 5739.011(B)(4) the machinery must be shown to be necessary to the manufacturing process. The appellant's witness was Wayne L. Bontempo, an engineer employed by the appellant, who had extensive knowledge about the production activity in dispute. His uncontroverted testimony about the process described how the grindstone system is necessary to manufacture the steel

product. He testified that the reason why appellant used the grindstone system was because it served a primary function in the steel production line. Mr. Bontempo described with great care and detail how the grindstone system operates continuously while the steel strip is plated, to polish the steel rollers over which the steel strip passes, removing the build up of zinc and nickel electro galvanizing material from the steel rollers. The undesirable and random build up of zinc and nickel material on the surface of the steel rollers causes dimples, dents, and the uneven distribution of the electro galvanizing material on the steel strip as it passes through the zinc and nickel solution and over the steel rollers. The grindstone system prevents the adherence of electro galvanizing material to the steel roller, allowing a uniform chemical bonding of the customer-specified zinc and nickel electro galvanizing material to the steel strip. Based on the foregoing, we conclude that the grindstone system is integral to the manufacturing process and has nothing to do with cleaning and repairing personal property.

Secondly, the record reflects that the grindstone system actually costs appellant more in terms of production life of the conductor rolls but that appellant uses the grindstones anyway to produce the steel. (R. 23) Clearly, the grindstone system is not something that the appellant undertakes at frivolous expense; it is a necessity. When machinery is used because it is the only method to accomplish the manufacturing task, then exception from use tax should flow.

The process here is in many ways analogous to the process considered in *The Dannon Company Inc. v. Tracy* (Sept. 11, 1998), BTA No. 97-M-233, unreported. There we ruled that the clean-in-place system attached to the processing equipment was necessary to control the growth of organisms during the processing of yogurt distinct from a maintenance function. In that matter, we determined that Dannon could not produce the desired product without the system in place. This is the same issue currently before us. The grindstone system is unequivocally necessary to continue the manufacture of galvanized steel as required by its customers.

We also consider the grindstone system to be analogous to the water spray system included in paint booths which in Example 49, Ohio Adm. Code 5703-9-21 is deemed exempt equipment necessary for continuation of the manufacturing process or operation.

Lastly, the argument of the Tax Commissioner that the grindstone system is used to "clean and maintain" the conductor rolls used during the galvanized steel production is not supported by the evidence. The grindstones perform a continual necessary function that could be interpreted as a "cleaning" process; appellant testified that the grindstones do remove properties from the steel during production in a manner that resembles scrubbing and polishing. (R. 18) But in fact, the grindstones provide a function of allowing the steel to be properly produced. The grindstones allow for the steel to move through the whole production system smoothly and effectively. This function is distinct from what "cleaning" is under the statute. "Cleaning" under R.C. 5739.011 is for something that cleans property in the manufacturing facility. This is something separate from the manufacturing process, and consequently is taxable. However, the grindstone system is an integral and necessary part of the manufacturing process. Without the grindstones, the steel manufacturing simply could not function in the manner it is designed to operate. This function far outweighs any "cleaning" function that the grindstones might have.

Even if the grindstones were found to have a "cleaning" function, liability for use tax is still not established. When a dual purpose is found for property it must lead to a consideration of the primary purpose of the property in question. *The Mead Corp v. Glander* (1950), 153 Ohio St. 539. Primacy is determined upon the need for the item purchased, its usefulness and value to the product being manufactured. *Ace Steel Bailing v. Porterfield* (1969), 19 Ohio St.2d 137. In addition, any ambiguity between the two statutes at issue must be construed in favor of the taxpayer. *Gulf Oil Corp. v. Kosydar* (1975), 44 Ohio St.2d 108. In the present matter, we conclude that, without the grindstones, making galvanized steel that is saleable to the customer is virtually

impossible. The grindstone system provides a necessary and integral function for the galvanized steel production. Consequently, any "cleaning" function the grindstones have is secondary and not relevant when examining if the grindstones should be subject to use tax.

For all the foregoing reasons, we find appellant has met its burden to prove error on the part of the Tax Commissioner and his assessment of use tax upon items included in the grindstone system.

Accordingly, this Board orders that the Tax Commissioner's use tax assessments against appellant must be reversed, and the matter remanded to the Tax Commissioner for reassessment in accordance with this decision.

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1.42 Common, technical or particular terms.

Words and phrases shall be read in context and construed according to the rules of grammar and common usage. Words and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly.

Effective Date: 01-03-1972

1.49 Determining legislative intent.

If a statute is ambiguous, the court, in determining the intention of the legislature, may consider among other matters:

- (A) The object sought to be attained;
- (B) The circumstances under which the statute was enacted;
- (C) The legislative history;
- (D) The common law or former statutory provisions, including laws upon the same or similar subjects;
- (E) The consequences of a particular construction;
- (F) The administrative construction of the statute.

Effective Date: 01-03-1972

119.01 [Effective Until 9/13/2010] Administrative procedure definitions.

As used in sections 119.01 to 119.13 of the Revised Code:

(A)(1) "Agency" means, except as limited by this division, any official, board, or commission having authority to promulgate rules or make adjudications in the civil service commission, the division of liquor control, the department of taxation, the industrial commission, the bureau of workers' compensation, the functions of any administrative or executive officer, department, division, bureau, board, or commission of the government of the state specifically made subject to sections 119.01 to 119.13 of the Revised Code, and the licensing functions of any administrative or executive officer, department, division, bureau, board, or commission of the government of the state having the authority or responsibility of issuing, suspending, revoking, or canceling licenses.

Except as otherwise provided in division (I) of this section, sections 119.01 to 119.13 of the Revised Code do not apply to the public utilities commission. Sections 119.01 to 119.13 of the Revised Code do not apply to the utility radiological safety board; to the controlling board; to actions of the superintendent of financial institutions and the superintendent of insurance in the taking possession of, and rehabilitation or liquidation of, the business and property of banks, savings and loan associations, savings banks, credit unions, insurance companies, associations, reciprocal fraternal benefit societies, and bond investment companies; to any action taken by the division of securities under section 1707.201 of the Revised Code; or to any action that may be taken by the superintendent of financial institutions under section 1113.03, 1121.06, 1121.10, 1125.09, 1125.12, 1125.18, 1157.01, 1157.02, 1157.10, 1165.01, 1165.02, 1165.10, 1349.33, 1733.35, 1733.361, 1733.37, or 1761.03 of the Revised Code.

Sections 119.01 to 119.13 of the Revised Code do not apply to actions of the industrial commission or the bureau of workers' compensation under sections 4123.01 to 4123.94 of the Revised Code with respect to all matters of adjudication, or to the actions of the industrial commission, bureau of workers' compensation board of directors, and bureau of workers' compensation under division (D) of section 4121.32, sections 4123.29, 4123.34, 4123.341, 4123.342, 4123.40, 4123.411, 4123.44, 4123.442, 4127.07; divisions (B), (C), and (E) of section 4131.04, and divisions (B), (C), and (E) of section 4131.14 of the Revised Code with respect to all matters concerning the establishment of premium, contribution, and assessment rates.

(2) "Agency" also means any official or work unit having authority to promulgate rules or make adjudications in the department of job and family services, but only with respect to both of the following:

(a) The adoption, amendment, or rescission of rules that section 5101.09 of the Revised Code requires be adopted in accordance with this chapter;

(b) The issuance, suspension, revocation, or cancellation of licenses.

(B) "License" means any license, permit, certificate, commission, or charter issued by any agency. "License" does not include any arrangement whereby a person, institution, or entity furnishes medicaid

services under a provider agreement with the department of job and family services pursuant to Title XIX of the "Social Security Act," 49 Stat. 620 (1935), 42 U.S.C. 301, as amended.

(C) "Rule" means any rule, regulation, or standard, having a general and uniform operation, adopted, promulgated, and enforced by any agency under the authority of the laws governing such agency, and includes any appendix to a rule. "Rule" does not include any internal management rule of an agency unless the internal management rule affects private rights and does not include any guideline adopted pursuant to section 3301.0714 of the Revised Code.

(D) "Adjudication" means the determination by the highest or ultimate authority of an agency of the rights, duties, privileges, benefits, or legal relationships of a specified person, but does not include the issuance of a license in response to an application with respect to which no question is raised, nor other acts of a ministerial nature.

(E) "Hearing" means a public hearing by any agency in compliance with procedural safeguards afforded by sections 119.01 to 119.13 of the Revised Code.

(F) "Person" means a person, firm, corporation, association, or partnership.

(G) "Party" means the person whose interests are the subject of an adjudication by an agency.

(H) "Appeal" means the procedure by which a person, aggrieved by a finding, decision, order, or adjudication of any agency, invokes the jurisdiction of a court.

(I) "Rule-making agency" means any board, commission, department, division, or bureau of the government of the state that is required to file proposed rules, amendments, or rescissions under division (D) of section 111.15 of the Revised Code and any agency that is required to file proposed rules, amendments, or rescissions under divisions (B) and (H) of section 119.03 of the Revised Code. "Rule-making agency" includes the public utilities commission. "Rule-making agency" does not include any state-supported college or university.

(J) "Substantive revision" means any addition to, elimination from, or other change in a rule, an amendment of a rule, or a rescission of a rule, whether of a substantive or procedural nature, that changes any of the following:

(1) That which the rule, amendment, or rescission permits, authorizes, regulates, requires, prohibits, penalizes, rewards, or otherwise affects;

(2) The scope or application of the rule, amendment, or rescission.

(K) "Internal management rule" means any rule, regulation, or standard governing the day-to-day staff procedures and operations within an agency.

Effective Date: 06-18-2002; 04-14-2006; 2007 HB100 09-10-2007

This section is set out twice. See also § 119.01, as amended by 128th General Assembly File No. 45, HB 292, § 1, eff. 9/13/2010.

119.01 [Effective 9/13/2010] Administrative procedure definitions

As used in sections 119.01 to 119.13 of the Revised Code:

(A)(1) "Agency" means, except as limited by this division, any official, board, or commission having authority to promulgate rules or make adjudications in the civil service commission, the division of liquor control, the department of taxation, the industrial commission, the bureau of workers' compensation, the functions of any administrative or executive officer, department, division, bureau, board, or commission of the government of the state specifically made subject to sections 119.01 to 119.13 of the Revised Code, and the licensing functions of any administrative or executive officer, department, division, bureau, board, or commission of the government of the state having the authority or responsibility of issuing, suspending, revoking, or canceling licenses.

Except as otherwise provided in division (I) of this section, sections 119.01 to 119.13 of the Revised Code do not apply to the public utilities commission. Sections 119.01 to 119.13 of the Revised Code do not apply to the utility radiological safety board; to the controlling board; to actions of the superintendent of financial institutions and the superintendent of insurance in the taking possession of, and rehabilitation or liquidation of, the business and property of banks, savings and loan associations, savings banks, credit unions, insurance companies, associations, reciprocal fraternal benefit societies, and bond investment companies; to any action taken by the division of securities under section 1707.201 of the Revised Code; or to any action that may be taken by the superintendent of financial institutions under section 1113.03, 1121.06, 1121.10, 1125.09, 1125.12, 1125.18, 1157.09, 1157.12, 1157.18, 1165.09, 1165.12, 1165.18, 1349.33, 1733.35, 1733.361, 1733.37, or 1761.03 of the Revised Code.

Sections 119.01 to 119.13 of the Revised Code do not apply to actions of the industrial commission or the bureau of workers' compensation under sections 4123.01 to 4123.94 of the Revised Code with respect to all matters of adjudication, or to the actions of the industrial commission, bureau of workers' compensation board of directors, and bureau of workers' compensation under division (D) of section 4121.32, sections 4123.29, 4123.34, 4123.341, 4123.342, 4123.40, 4123.411, 4123.44, 4123.442, 4127.07, divisions (B), (C), and (E) of section 4131.04, and divisions (B), (C), and (E) of section 4131.14 of the Revised Code with respect to all matters concerning the establishment of premium, contribution, and assessment rates.

(2) "Agency" also means any official or work unit having authority to promulgate rules or make adjudications in the department of job and family services, but only with respect to both of the following:

(a) The adoption, amendment, or rescission of rules that section 5101.09 of the Revised Code requires be adopted in accordance with this chapter;

(b) The issuance, suspension, revocation, or cancellation of licenses.

(B) "License" means any license, permit, certificate, commission, or charter issued by any agency. "License" does not include any arrangement whereby a person, institution, or entity furnishes medicaid services under a provider agreement with the department of job and family services pursuant to Title XIX of the "Social Security Act," 49 Stat. 620 (1935), 42 U.S.C. 301, as amended.

(C) "Rule" means any rule, regulation, or standard, having a general and uniform operation, adopted, promulgated, and enforced by any agency under the authority of the laws governing such agency, and includes any appendix to a rule. "Rule" does not include any internal management rule of an agency unless the internal management rule affects private rights and does not include any guideline adopted pursuant to section 3301.0714 of the Revised Code.

(D) "Adjudication" means the determination by the highest or ultimate authority of an agency of the rights, duties, privileges, benefits, or legal relationships of a specified person, but does not include the issuance of a license in response to an application with respect to which no question is raised, nor other acts of a ministerial nature.

(E) "Hearing" means a public hearing by any agency in compliance with procedural safeguards afforded by sections 119.01 to 119.13 of the Revised Code.

(F) "Person" means a person, firm, corporation, association, or partnership.

(G) "Party" means the person whose interests are the subject of an adjudication by an agency.

(H) "Appeal" means the procedure by which a person, aggrieved by a finding, decision, order, or adjudication of any agency, invokes the jurisdiction of a court.

(I) "Rule-making agency" means any board, commission, department, division, or bureau of the government of the state that is required to file proposed rules, amendments, or rescissions under division (D) of section 111.15 of the Revised Code and any agency that is required to file proposed rules, amendments, or rescissions under divisions (B) and (H) of section 119.03 of the Revised Code. "Rule-making agency" includes the public utilities commission. "Rule-making agency" does not include any state-supported college or university.

(J) "Substantive revision" means any addition to, elimination from, or other change in a rule, an amendment of a rule, or a rescission of a rule, whether of a substantive or procedural nature, that changes any of the following:

(1) That which the rule, amendment, or rescission permits, authorizes, regulates, requires, prohibits, penalizes, rewards, or otherwise affects;

(2) The scope or application of the rule, amendment, or rescission.

(K) "Internal management rule" means any rule, regulation, or standard governing the day-to-day staff procedures and operations within an agency.

Amended by 128th General Assembly File No. 45, HB 292, § 1, eff. 9/13/2010.

Effective Date: 06-18-2002; 04-14-2006; 2007 HB100 09-10-2007

This section is set out twice. See also § 119.01, effective until 9/13/2010.

119.02 Compliance - validity of rules.

Every agency authorized by law to adopt, amend, or rescind rules shall comply with the procedure prescribed in sections 119.01 to 119.13, inclusive, of the Revised Code, for the adoption, amendment, or rescission of rules. Unless otherwise specifically provided by law, the failure of any agency to comply with such procedure shall invalidate any rule or amendment adopted, or the rescission of any rule.

Effective Date: 10-01-1953

5739.011 Exemptions for manufacturing.

(A) As used in this section:

(1) "Manufacturer" means a person who is engaged in manufacturing, processing, assembling, or refining a product for sale and, solely for the purposes of division (B)(12) of this section, a person who meets all the qualifications of that division.

(2) "Manufacturing facility" means a single location where a manufacturing operation is conducted, including locations consisting of one or more buildings or structures in a contiguous area owned or controlled by the manufacturer.

(3) "Materials handling" means the movement of the product being or to be manufactured, during which movement the product is not undergoing any substantial change or alteration in its state or form.

(4) "Testing" means a process or procedure to identify the properties or assure the quality of a material or product.

(5) "Completed product" means a manufactured item that is in the form and condition as it will be sold by the manufacturer. An item is completed when all processes that change or alter its state or form or enhance its value are finished, even though the item subsequently will be tested to ensure its quality or be packaged for storage or shipment.

(6) "Continuous manufacturing operation" means the process in which raw materials or components are moved through the steps whereby manufacturing occurs. Materials handling of raw materials or parts from the point of receipt or preproduction storage or of a completed product, to or from storage, to or from packaging, or to the place from which the completed product will be shipped, is not a part of a continuous manufacturing operation.

(B) For purposes of division (B)(42)(g) of section 5739.02 of the Revised Code, the "thing transferred" includes, but is not limited to, any of the following:

(1) Production machinery and equipment that act upon the product or machinery and equipment that treat the materials or parts in preparation for the manufacturing operation;

(2) Materials handling equipment that moves the product through a continuous manufacturing operation; equipment that temporarily stores the product during the manufacturing operation; or, excluding motor vehicles licensed to operate on public highways, equipment used in intraplant or interplant transfers of work in process where the plant or plants between which such transfers occur are manufacturing facilities operated by the same person;

(3) Catalysts, solvents, water, acids, oil, and similar consumables that interact with the product and that are an integral part of the manufacturing operation;

(4) Machinery, equipment, and other tangible personal property used during the manufacturing operation that control, physically support, produce power for, lubricate, or are otherwise necessary for

the functioning of production machinery and equipment and the continuation of the manufacturing operation;

(5) Machinery, equipment, fuel, power, material, parts, and other tangible personal property used to manufacture machinery, equipment, or other tangible personal property used in manufacturing a product for sale;

(6) Machinery, equipment, and other tangible personal property used by a manufacturer to test raw materials, the product being manufactured, or the completed product;

(7) Machinery and equipment used to handle or temporarily store scrap that is intended to be reused in the manufacturing operation at the same manufacturing facility;

(8) Coke, gas, water, steam, and similar substances used in the manufacturing operation; machinery and equipment used for, and fuel consumed in, producing or extracting those substances; machinery, equipment, and other tangible personal property used to treat, filter, pump, or otherwise make the substance suitable for use in the manufacturing operation; and machinery and equipment used for, and fuel consumed in, producing electricity for use in the manufacturing operation;

(9) Machinery, equipment, and other tangible personal property used to transport or transmit electricity, coke, gas, water, steam, or similar substances used in the manufacturing operation from the point of generation, if produced by the manufacturer, or from the point where the substance enters the manufacturing facility, if purchased by the manufacturer, to the manufacturing operation;

(10) Machinery, equipment, and other tangible personal property that treats, filters, cools, refines, or otherwise renders water, steam, acid, oil, solvents, or similar substances used in the manufacturing operation reusable, provided that the substances are intended for reuse and not for disposal, sale, or transportation from the manufacturing facility;

(11) Parts, components, and repair and installation services for items described in division (B) of this section;

(12) Machinery and equipment, detergents, supplies, solvents, and any other tangible personal property located at a manufacturing facility that are used in the process of removing soil, dirt, or other contaminants from, or otherwise preparing in a suitable condition for use, towels, linens, articles of clothing, floor mats, mop heads, or other similar items, to be supplied to a consumer as part of laundry and dry cleaning services as defined in division (BB) of section 5739.01 of the Revised Code, only when the towels, linens, articles of clothing, floor mats, mop heads, or other similar items belong to the provider of the services;

(13) Equipment and supplies used to clean processing equipment that is part of a continuous manufacturing operation to produce milk, ice cream, yogurt, cheese, and similar dairy products for human consumption.

(C) For purposes of division (B)(42)(g) of section 5739.02 of the Revised Code, the "thing transferred" does not include any of the following:

(1) Tangible personal property used in administrative, personnel, security, inventory control, record-

keeping, ordering, billing, or similar functions;

(2) Tangible personal property used in storing raw materials or parts prior to the commencement of the manufacturing operation or used to handle or store a completed product, including storage that actively maintains a completed product in a marketable state or form;

(3) Tangible personal property used to handle or store scrap or waste intended for disposal, sale, or other disposition, other than reuse in the manufacturing operation at the same manufacturing facility;

(4) Tangible personal property that is or is to be incorporated into realty;

(5) Machinery, equipment, and other tangible personal property used for ventilation, dust or gas collection, humidity or temperature regulation, or similar environmental control, except machinery, equipment, and other tangible personal property that totally regulates the environment in a special and limited area of the manufacturing facility where the regulation is essential for production to occur;

(6) Tangible personal property used for the protection and safety of workers, unless the property is attached to or incorporated into machinery and equipment used in a continuous manufacturing operation;

(7) Tangible personal property used to store fuel, water, solvents, acid, oil, or similar items consumed in the manufacturing operation;

(8) Except as provided in division (B)(13) of this section, machinery, equipment, and other tangible personal property used to clean, repair, or maintain real or personal property in the manufacturing facility;

(9) Motor vehicles registered for operation on public highways.

(D) For purposes of division (B)(42)(g) of section 5739.02 of the Revised Code, if the "thing transferred" is a machine used by a manufacturer in both a taxable and an exempt manner, it shall be totally taxable or totally exempt from taxation based upon its quantified primary use. If the "things transferred" are fungibles, they shall be taxed based upon the proportion of the fungibles used in a taxable manner.

Effective Date: 09-26-2003; 06-30-2006; 04-04-2007

5741.02 Levy of tax - rate - exemptions.

(A)(1) For the use of the general revenue fund of the state, an excise tax is hereby levied on the storage, use, or other consumption in this state of tangible personal property or the benefit realized in this state of any service provided. The tax shall be collected as provided in section 5739.025 of the Revised Code, provided that on and after July 1, 2003, and on or before June 30, 2005, the rate of the tax shall be six per cent. On and after July 1, 2005, the rate of the tax shall be five and one-half per cent.

(2) In the case of the lease or rental, with a fixed term of more than thirty days or an indefinite term with a minimum period of more than thirty days, of any motor vehicles designed by the manufacturer to carry a load of not more than one ton, watercraft, outboard motor, or aircraft, or of any tangible personal property, other than motor vehicles designed by the manufacturer to carry a load of more than one ton, to be used by the lessee or renter primarily for business purposes, the tax shall be collected by the seller at the time the lease or rental is consummated and shall be calculated by the seller on the basis of the total amount to be paid by the lessee or renter under the lease or rental agreement. If the total amount of the consideration for the lease or rental includes amounts that are not calculated at the time the lease or rental is executed, the tax shall be calculated and collected by the seller at the time such amounts are billed to the lessee or renter. In the case of an open-end lease or rental, the tax shall be calculated by the seller on the basis of the total amount to be paid during the initial fixed term of the lease or rental, and for each subsequent renewal period as it comes due. As used in this division, "motor vehicle" has the same meaning as in section 4501.01 of the Revised Code, and "watercraft" includes an outdrive unit attached to the watercraft.

(3) Except as provided in division (A)(2) of this section, in the case of a transaction, the price of which consists in whole or part of the lease or rental of tangible personal property, the tax shall be measured by the installments of those leases or rentals.

(B) Each consumer, storing, using, or otherwise consuming in this state tangible personal property or realizing in this state the benefit of any service provided, shall be liable for the tax, and such liability shall not be extinguished until the tax has been paid to this state; provided, that the consumer shall be relieved from further liability for the tax if the tax has been paid to a seller in accordance with section 5741.04 of the Revised Code or prepaid by the seller in accordance with section 5741.06 of the Revised Code.

(C) The tax does not apply to the storage, use, or consumption in this state of the following described tangible personal property or services, nor to the storage, use, or consumption or benefit in this state of tangible personal property or services purchased under the following described circumstances:

(1) When the sale of property or service in this state is subject to the excise tax imposed by sections 5739.01 to 5739.31 of the Revised Code, provided said tax has been paid;

(2) Except as provided in division (D) of this section, tangible personal property or services, the acquisition of which, if made in Ohio, would be a sale not subject to the tax imposed by sections 5739.01 to 5739.31 of the Revised Code;

(3) Property or services, the storage, use, or other consumption of or benefit from which this state is

prohibited from taxing by the Constitution of the United States, laws of the United States, or the Constitution of this state. This exemption shall not exempt from the application of the tax imposed by this section the storage, use, or consumption of tangible personal property that was purchased in interstate commerce, but that has come to rest in this state, provided that fuel to be used or transported in carrying on interstate commerce that is stopped within this state pending transfer from one conveyance to another is exempt from the excise tax imposed by this section and section 5739.02 of the Revised Code;

(4) Transient use of tangible personal property in this state by a nonresident tourist or vacationer, or a nonbusiness use within this state by a nonresident of this state, if the property so used was purchased outside this state for use outside this state and is not required to be registered or licensed under the laws of this state;

(5) Tangible personal property or services rendered, upon which taxes have been paid to another jurisdiction to the extent of the amount of the tax paid to such other jurisdiction. Where the amount of the tax imposed by this section and imposed pursuant to section 5741.021, 5741.022, or 5741.023 of the Revised Code exceeds the amount paid to another jurisdiction, the difference shall be allocated between the tax imposed by this section and any tax imposed by a county or a transit authority pursuant to section 5741.021, 5741.022, or 5741.023 of the Revised Code, in proportion to the respective rates of such taxes.

As used in this subdivision, "taxes paid to another jurisdiction" means the total amount of retail sales or use tax or similar tax based upon the sale, purchase, or use of tangible personal property or services rendered legally, levied by and paid to another state or political subdivision thereof, or to the District of Columbia, where the payment of such tax does not entitle the taxpayer to any refund or credit for such payment.

(6) The transfer of a used manufactured home or used mobile home, as defined by section 5739.0210 of the Revised Code, made on or after January 1, 2000;

(7) Drugs that are or are intended to be distributed free of charge to a practitioner licensed to prescribe, dispense, and administer drugs to a human being in the course of a professional practice and that by law may be dispensed only by or upon the order of such a practitioner.

(8) Computer equipment and related software leased from a lessor located outside this state and initially received in this state on behalf of the consumer by a third party that will retain possession of such property for not more than ninety days and that will, within that ninety-day period, deliver such property to the consumer at a location outside this state. Division (C)(8) of this section does not provide exemption from taxation for any otherwise taxable charges associated with such property while it is in this state or for any subsequent storage, use, or consumption of such property in this state by or on behalf of the consumer.

(9) Tangible personal property held for sale by a person but not for that person's own use and donated by that person, without charge or other compensation, to either of the following:

(a) A nonprofit organization operated exclusively for charitable purposes in this state, no part of the net income of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which consists of carrying on propaganda or otherwise attempting to influence

legislation; or

(b) This state or any political subdivision of this state, but only if donated for exclusively public purposes.

For the purposes of division (C)(10) of this section, "charitable purposes" has the same meaning as in division (B)(12) of section 5739.02 of the Revised Code.

(D) The tax applies to the storage, use, or other consumption in this state of tangible personal property or services, the acquisition of which at the time of sale was excepted under division (E) of section 5739.01 of the Revised Code from the tax imposed by section 5739.02 of the Revised Code, but which has subsequently been temporarily or permanently stored, used, or otherwise consumed in a taxable manner.

(E)(1)(a) If any transaction is claimed to be exempt under division (E) of section 5739.01 of the Revised Code or under section 5739.02 of the Revised Code, with the exception of divisions (B)(1) to (11) or (28) of section 5739.02 of the Revised Code, the consumer shall provide to the seller, and the seller shall obtain from the consumer, a certificate specifying the reason that the transaction is not subject to the tax. The certificate shall be in such form, and shall be provided either in a hard copy form or electronic form, as the tax commissioner prescribes.

(b) A seller that obtains a fully completed exemption certificate from a consumer is relieved of liability for collecting and remitting tax on any sale covered by that certificate. If it is determined the exemption was improperly claimed, the consumer shall be liable for any tax due on that sale under this chapter. Relief under this division from liability does not apply to any of the following:

(i) A seller that fraudulently fails to collect tax;

(ii) A seller that solicits consumers to participate in the unlawful claim of an exemption;

(iii) A seller that accepts an exemption certificate from a consumer that claims an exemption based on who purchases or who sells property or a service, when the subject of the transaction sought to be covered by the exemption certificate is actually received by the consumer at a location operated by the seller in this state, and this state has posted to its web site an exemption certificate form that clearly and affirmatively indicates that the claimed exemption is not available in this state;

(iv) A seller that accepts an exemption certificate from a consumer who claims a multiple points of use exemption under division (D) of section 5739.033 of the Revised Code, if the item purchased is tangible personal property, other than prewritten computer software.

(2) The seller shall maintain records, including exemption certificates, of all sales on which a consumer has claimed an exemption, and provide them to the tax commissioner on request.

(3) If no certificate is provided or obtained within ninety days after the date on which the transaction is consummated, it shall be presumed that the tax applies. Failure to have so provided or obtained a certificate shall not preclude a seller, within one hundred twenty days after the tax commissioner gives written notice of intent to levy an assessment, from either establishing that the transaction is not subject to the tax, or obtaining, in good faith, a fully completed exemption certificate.

(4) If a transaction is claimed to be exempt under division (B)(13) of section 5739.02 of the Revised Code, the contractor shall obtain certification of the claimed exemption from the contractee. This certification shall be in addition to an exemption certificate provided by the contractor to the seller. A contractee that provides a certification under this division shall be deemed to be the consumer of all items purchased by the contractor under the claim of exemption, if it is subsequently determined that the exemption is not properly claimed. The certification shall be in such form as the tax commissioner prescribes.

(F) A seller who files a petition for reassessment contesting the assessment of tax on transactions for which the seller obtained no valid exemption certificates, and for which the seller failed to establish that the transactions were not subject to the tax during the one-hundred-twenty-day period allowed under division (E) of this section, may present to the tax commissioner additional evidence to prove that the transactions were exempt. The seller shall file such evidence within ninety days of the receipt by the seller of the notice of assessment, except that, upon application and for reasonable cause, the tax commissioner may extend the period for submitting such evidence thirty days.

(G) For the purpose of the proper administration of sections 5741.01 to 5741.22 of the Revised Code, and to prevent the evasion of the tax hereby levied, it shall be presumed that any use, storage, or other consumption of tangible personal property in this state is subject to the tax until the contrary is established.

(H) The tax collected by the seller from the consumer under this chapter is not part of the price, but is a tax collection for the benefit of the state, and of counties levying an additional use tax pursuant to section 5741.021 or 5741.023 of the Revised Code and of transit authorities levying an additional use tax pursuant to section 5741.022 of the Revised Code. Except for the discount authorized under section 5741.12 of the Revised Code and the effects of any rounding pursuant to section 5703.055 of the Revised Code, no person other than the state or such a county or transit authority shall derive any benefit from the collection of such tax.

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