

**10:00 a.m. (EST)**  
**1-866-362-9768**  
**552-970-8972#**



# **Tax Committee**

**June 20, 2018**

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**2018 Tax Committee  
Calendar**  
Meetings will begin at 10:00 a.m.  
  
**Wednesday, October 10**

**OMA Tax Committee Meeting Sponsor:**





## OMA Tax Policy Committee

June 20, 2018

### AGENDA

**Welcome & Self-Introductions:**

Shay Music, Chairman  
The J.M. Smucker Company

**Guest Speakers**

Brian Schneider, RSM US LLP

Cody Tolle, RSM US LLP

**OMA Public Policy Report**

Rob Brundrett, OMA Staff

**Guest Speakers**

Matt Chafin, Chief Counsel & Chief  
Ethics Officer, Ohio Department of  
Taxation

Laura Stanley, Division Counsel, Sales  
and Use Taxes, Ohio Department of  
Taxation

**OMA Counsel's Report**

Justin Cook, Bricker & Eckler LLP

Please RSVP to attend this meeting (indicate if you are attending in-person or by teleconference) by contacting Denise: [dlocke@ohiomfg.com](mailto:dlocke@ohiomfg.com) or (614) 224-5111 or toll free at (800) 662-4463.

Additional committee meetings or teleconferences, if needed, will be scheduled at the call of the Chair.

**Thanks to Today's Meeting Sponsor:**





## **Brian T. Schneider**

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### **Summary of experience**

Brian has more than 20 years of public accounting experience and has been involved in all aspects of state taxation planning including income/franchise tax, tax credits and incentives, property tax and sales and use tax. Brian's experience includes working with SEC clients and privately held companies with significant experience in the manufacturing and distribution industry. Brian focuses on state and local tax planning, entity structuring and tax risk management.

Brian leads the Ohio state and local tax practice and focuses on the manufacturing and distribution, automotive and food and beverage industries.

### **Professional affiliations and credentials**

- Certified public accountant
- American Institute of Certified Public Accountants
- Ohio Society of Certified Public Accountants

### **Education**

- Bachelor of Science, accounting and business pre-law, Ohio University
- Master of Science, taxation, University of Cincinnati



## **Cody S. Tolle**

Senior Associate, Tax Services  
RSM US LLP  
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### **Summary of experience**

Cody joined the firm in January of 2016 and has been involved in all aspects of state taxation compliance including income/franchise tax, tax credits and incentives, property tax and sales and use tax. Cody focuses on state and local tax consulting and tax risk management for clients with significant state tax compliance obligations.

### **Professional affiliations and credentials**

- Certified public accountant
- American Institute of Certified Public Accountants

### **Education**

- Bachelor of Science, accounting and finance, Wright State University



June 11, 2018

MEMORANDUM TO: The Honorable John R. Kasich, Governor  
The Honorable Mary Taylor, Lt. Governor

FROM: Timothy S. Keen, Director **TK**

SUBJECT: Monthly Financial Report

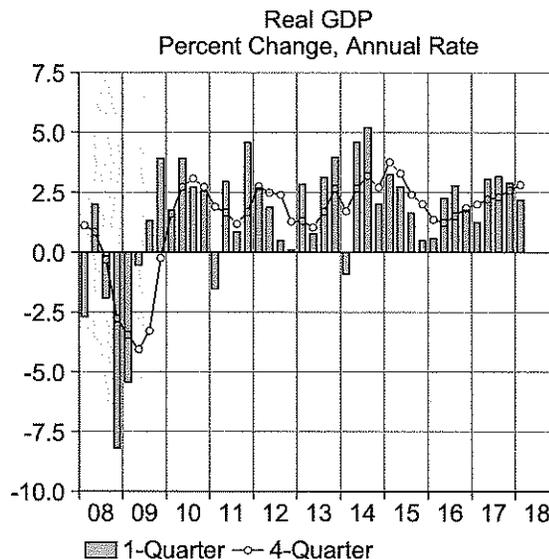
## ECONOMIC SUMMARY

### Economic Performance Overview

- Economic growth slowed to 2.2% in the first quarter after averaging 3% during the previous three quarters.
- U.S. employment increased by 223,000 jobs in May for a 3-month average of 179,000 jobs per month. The unemployment rate decreased to an expansion-low of 3.8%.
- Ohio nonfarm payroll employment decreased by 1,000 jobs in April, and the March increase was revised down by 1,500 jobs to 9,300. Nevertheless, Ohio employment has increased by over 42,000 jobs through the first four months of the year. The unemployment rate decreased to 4.3% in April – the lowest level since July 2001.
- Leading economic indicators remain consistent with uninterrupted economic growth through 2018.

### Economic Growth

**Real GDP** expanded at a revised annual rate of 2.2% during the first quarter, down from a 3.0% pace during the three previous quarters. Growth was 2.8% on a year-over-year basis, which is the fastest since the second quarter of 2015 and the culmination of a string of steady increases during the last couple of years from a low of 1.2% in the second quarter of 2016. The first-quarter results do not reflect the potentially positive effects of the recent federal tax changes and spending increases, but also do not reflect potential negative effects from recently imposed international trade restrictions.



The first-quarter slowdown probably does not mark a genuine downshift from the 3% rate during the previous three quarters. First-quarter growth has been lower than growth in other quarters in recent years, suggesting that weakness in the most recent quarter is at least partly a result of mismeasurement (known in the economic literature as “residual seasonality”). Other key indicators of current and future growth remain consistent with a faster pace of growth.

Sentiment among small businesses was stable in May and very near the elevated average level since the November 2016 election, according to the Index of Small Business Optimism from the **National Federation of Independent Business (NFIB)**. In fact, the Index has been higher only 20 times out of the last 433 surveys. Four of the ten sub-indexes increased, while three decreased and three were unchanged.

National leading economic indicators continued to strengthen in April, and remain consistent with uninterrupted expansion through the end of 2018. The Conference Board’s composite **Leading Economic Index** increased 0.4% after strong readings in each of the previous six months. Eight of the ten components of the index increased, led by the interest rate spread and followed by the average workweek of production workers and the ISM Index for New Orders. The index was held back by a decline in business permits and stock prices.

In addition, the diffusion of 1-month and 3-month changes in the coincident economic indexes for the fifty states remained very positive in April, as did the diffusion of the state leading economic indexes. Both measures, which have provided some warning of recessions in the past, had deteriorated heading into last fall.

As shown in the table below, the **consensus among forecasters** is that real GDP growth is picking up in the second quarter. The Federal Reserve Bank of Atlanta projects growth of 4.5%, based on the recent trajectory of key indicators so far during the second quarter. The Federal Reserve Bank of New York “Nowcast” projects growth of 3.3%. The latest projection from the Survey of Professional Forecasters from the Philadelphia Federal Reserve Bank is for 3.0% growth. The Blue Chip consensus, which is an average from a different group of forecasters, is 3.2%, with a range of 2.6% to 3.8% from the average of the lowest ten to the highest ten forecasts. Finally, the IHS GDP Tracker projection for second-quarter growth is 4.1%.

Source	Date	2018-Q2 GDP Forecast
Atlanta FRB (GDPNow)	6/6/18	4.5%
New York FRB (Nowcast)	6/1/18	3.3%
Philadelphia FRB (SPF*)	5/11/18	3.0%
Blue Chip	6/1/18	3.2% (2.6%-3.8%)
IHS	6/7/18	4.1%
*Survey of Professional Forecasters (2nd month of each quarter)		

## **Employment**

Labor markets remain very healthy, with reports of strong demand and constrained supply. The labor index from the Conference Board's survey of consumers increased notably in May to its highest level since March 2001. The index is calculated as the percentage of respondents who think jobs are plentiful, minus the percentage who think jobs are hard to get. Retaining and hiring qualified workers was cited as the number one challenge faced by small businesses responding to the latest survey by the NFIB.

**Nonfarm payrolls** across the country increased by 223,000 jobs in May. Private nonfarm payrolls increased by 218,000 jobs. The 5,000 public sector job increase occurred at the state and local level, especially local government outside of education.

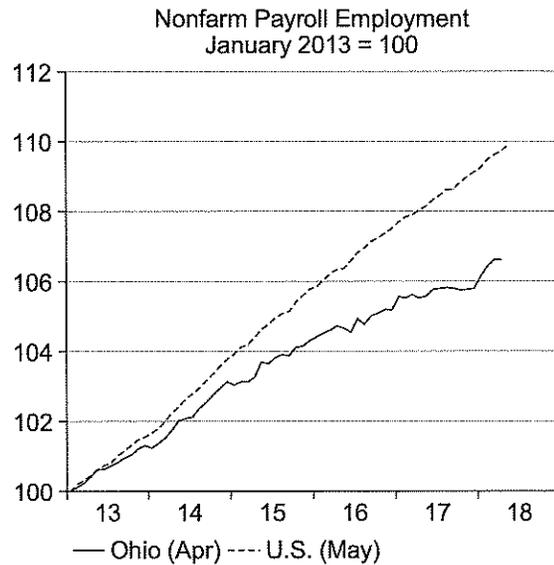
Job gains were widespread across sectors, led by retail (+31,100), health care (+28,900), construction (+25,000), professional and technical services (+22,600), and manufacturing (+18,000).

The total change during the previous two months was revised up by 15,000 jobs, and the average gain during the most recent three months was 179,000, which was slightly below the average during the previous twelve months of 197,000. During the first five months of the year, employment increased by 1.037 million jobs, compared with a gain of 862,000 jobs during the year-earlier period.

The **unemployment rate** decreased by 0.1 percentage point to 3.8% – the lowest level since December 1969. The decrease occurred due to a 281,000 decline in the number of unemployed and an increase in total employment of 293,000. The broadest measure of unemployment, the U-6 unemployment rate, decreased 0.2 percentage points to 7.6%, also an expansion-low and the lowest since May 2001. The U-6 unemployment rate includes those who say that they want to work but have stopped looking because they believe they cannot find a job as well as those working part-time who would prefer full-time work.

**Average hourly earnings** of all employees on private nonfarm payrolls increased 0.3% in May to 2.7% above the year earlier level. The year-over-year rate of change has moved very little since rising to 2.8% last September, which along with 1-month spikes to that level in July 2016 and January 2018 is the high for this cycle. Policymakers and investors are watching the rate of change in wages for signs that price inflation will pick up.

**Ohio nonfarm payroll employment** decreased by 1,000 jobs in April, and the March increase was revised down by 1,500 jobs to 9,300. Ohio employment is up by 42,400 jobs year-to-date to a level of 5.58 million jobs. Gains during the month in trade, transportation and utilities (+2,500), professional and business services (+2,300), and other services (+1,300) were offset by losses in leisure and hospitality (-2,900), manufacturing (-1,800), and financial activities (-1,700).



During the twelve months ending in April, Ohio employment increased by 56,900 jobs. The largest gains were in trade, transportation and utilities (+13,500), manufacturing (+10,500), and educational and health services (+7,900). Employment decreased only in the information category (-900).

According to the most recent survey of economic conditions from the Federal Reserve Bank of Cleveland, companies in and around Ohio had continued difficulty in finding qualified workers across a broad range of occupations, yet companies also reported no meaningful changes to wage pressures. Employers in the area appear to be raising wages enough to stay competitive, but keeping those increases in line with recent trends.

Among the **contiguous states**, year-over-year employment growth was strongest in Pennsylvania (+1.4%), Indiana, Michigan, and Ohio (+1.0%), West Virginia (+0.9%), and Kentucky (+0.4%). Manufacturing employment increased year-over-year in Ohio (1.5%), Indiana (1.0%), Pennsylvania and West Virginia (0.6%), and in Michigan (0.1%). Manufacturing employment decreased 1.4% in Kentucky.

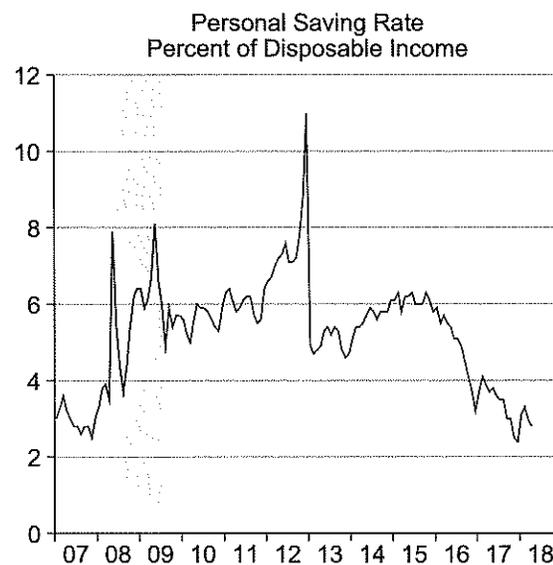
The **Ohio unemployment rate** decreased by 0.1 percentage points to 4.3% in April – the lowest level since July 2001. The decline on the month resulted from a decrease in the number of unemployed of 3,600 and an increase in the total number employed of 10,900 workers. The labor force was higher by 7,300. Since last July, the unemployment rate has declined by 0.8 percentage points, with much of that decline (0.6 points) in just the first four months of 2018.

Across the country in April, the unemployment rate decreased notably from the month before in four states – Illinois, New Mexico, South Carolina, and Delaware. Changes in the unemployment rate in the remaining states and the District of Columbia were not statistically meaningful.

### **Consumer Income and Consumption**

Personal income and spending both remained solid in April. **Personal income** increased 0.3%, reflecting a 0.4% increase in wage and salary disbursements and flat personal dividend income. The March gain was revised down to 0.2%. Wage and salary disbursement also picked up from a 0.2% increase in the previous month. Compared with a year earlier, personal income was up 3.8% and wage and salary disbursements were higher by 4.6%.

The **personal saving rate** decreased to 2.8% in May, down from 6.3% in October 2015. Other than readings near 2.5% last November and December, the 2.8% saving rate is the lowest since the eve of the last recession in November 2007. The 3.5 percentage point decrease during the last 30 months resulted from personal consumption spending growing about half again as fast as personal income. The strength in spending growth occurred across durable goods, nondurable goods, and services.



A low saving rate can indicate optimism about the economy on the part of consumers, but it also entails risk. If economic conditions deteriorate, a low savings rate can mean that households have to curtail consumption sharply to bring spending back into line with stagnant or reduced incomes.

**Personal consumption expenditures** increased by 0.6% in April after an upward revision to 0.5% in March. Spending was flat in February. Spending for durable goods increased 0.3% in April despite a modest decline in unit sales of light motor vehicles. Spending for nondurable goods rebounded 0.9% after two straight months of small declines. Spending for services grew 0.5% after a 0.6% rise the month before. The decrease in motor vehicle sales from 17.1 million in April to 16.8 million in May likely subtracted from spending for durable goods in May.

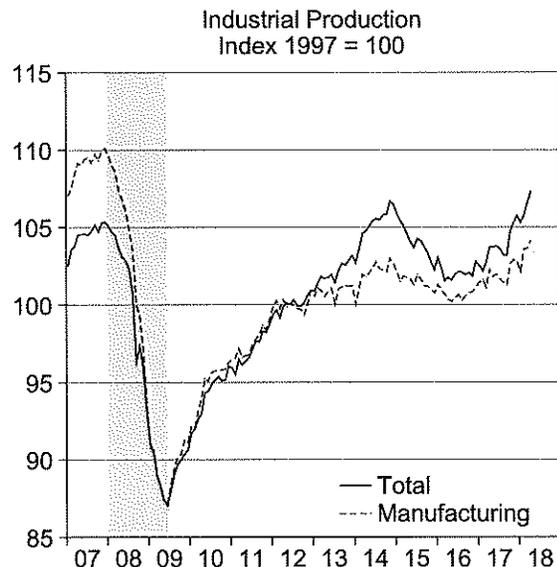
In and around Ohio, participants in the Cleveland Fed survey reported that retail sales activity was in line with, or weaker than, activity across the country. A grocery chain operator identified population loss and online shopping as causes of weak sales. Most respondents expected better sales in the months ahead, although some expressed concern about the effects of tariffs on goods imported from China.

**Consumer confidence** points to continued gains in income and spending in the current quarter. The Conference Board measure strengthened in May while the University of Michigan/Reuters measure weakened again, but both remained at cyclically high levels. The Conference Board's consumer confidence index increased 2.4 points in May. Assessments of both current and future conditions improved, with views of the present rising to the highest level relative to views of the future since 2001.

The percentage of respondents who expect higher income in six months minus those who expect lower income retreated from the April mark, which had been the highest level since June 2001. Purchasing plans for the next six months fell across the board. The apparent strength in consumer moods evident in the Conference Board index is tempered somewhat by the pullback in assessments of both current and future conditions in the University of Michigan/Reuters survey in May.

### **Industrial Activity**

**Industrial production** increased by 0.7% in April to 3.5% above its year earlier level. The March change was revised up from 0.5% to 0.7%, but the annualized first-quarter change was adjusted down from 4.5% to 2.3%. Industrial production appears on track for an annualized gain of approximately 5% in the second quarter.



**Manufacturing** production increased by 0.5% in April, although the March change was revised from an increase of 0.1% to no change. Motor vehicle assemblies were above schedule, pointing to higher output and inventory-building during this quarter. **Mining** output increased 1.1%, reflecting energy-related drilling. **Utilities** production increased 1.9% in April, as cool weather created unseasonably strong heating demand.

Production across the country in some industries that are key employers in Ohio was weak. Aside from a 2.3% increase in machinery production, output fell 0.5% in the primary metal and fabricated metal products industries and 1.3% in motor vehicles and parts. Compared with a year ago, production increased 4.7% in fabricated metal products, 3.1% in motor vehicles and parts, 2.9% in machinery, and 2.5% in primary metal.

Demand for products manufactured in and around Ohio strengthened into early May, according to the Cleveland Fed survey. Respondents cited strong consumer confidence, seasonal factors, and fear of future price increases as causes. Most contacts expect demand to weaken due to trade-related price increases. Higher demand for heavy machinery and other capital goods was reported by many producers in the durable goods sector.

Reports of improving conditions from **purchasing managers** in manufacturing remained widespread in May. The PMI<sup>®</sup> increased from 57.3 in April to 58.7 in May – strongly consistent with continuing expansion in the manufacturing sector. The important New Orders and Production sub-indexes increased impressively. The composite index has been above 55 in each of the last seventeen months, and the year-to-date average of 59.0 is consistent with the apparent momentum in industrial production.

Of the eighteen industries tracked by the Manufacturing ISM<sup>®</sup> *Report on Business*, sixteen reported growth in the latest month. Among the industries with a disproportionate effect on Ohio manufacturing employment, primary metals, machinery, fabricated metal products, and transportation equipment all reported expansion.

One purchasing manager in the transportation industry said, “We are overselling our forecast and don’t see an end to the upswing in business.” The contact also noted, however, that concern about the tariffs proposed in Section 301 was prompting a search for alternatives to sourcing goods from China (Section 301 of the Trade Act of 1974 provides the executive branch with the authority to respond to unfair, unreasonable, or discriminatory trade practices and gives the Office of the U.S. Trade Representative (USTR) the ability to take action to compel another country to eliminate the offending act, policy, or practice, with the president’s approval). Similarly, a purchasing manager in the fabricated metals products industry said, “We are concerned about the strong dollar ... as well as the steel tariffs, which are causing domestic steel prices to rise.” Finally, a contact in the machinery industry said, “Sales remain strong. Lead times and direct material costs are soaring.”

### **Construction**

**Construction put-in-place** increased 1.8% in April, essentially offsetting the 1.8% decline in March. Private construction advanced by 2.8%, also recouping the March decline. Public construction fell 1.3% after an upwardly revised 1.2% gain in March. Momentum among the categories that are used

in calculating GDP – so called core construction – softened heading into the second quarter, but the recent trend remains consistent with strong second-quarter growth in real GDP.

Private residential improvements was the center of weakness in March and the center of strength in April. After falling 10.1% in March, the highly volatile and often significantly revised category recovered by 11.6% in April. The rebound accounted for more than three-quarters of the increase in both private and total construction put-in-place in during the month. The recent volatility is likely related to rebuilding following last year’s damaging hurricane season.

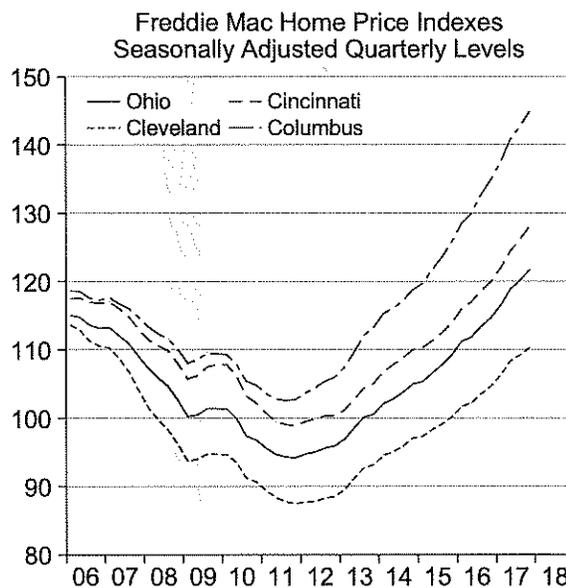
Total **housing starts** decreased 1.2% in April on a 3-month moving average basis after a 3.3% increase in March. The decrease occurred entirely in the multi-family segment, which was down 4.3%. Single-family starts edged slightly higher. Midwest starts rose 3.8% due to a 31.0% increase in multi-family that outweighed a 4.2% decrease in single-family. Compared with a year earlier, total starts were higher by 7.7%, while Midwest starts were lower by 2.5%.

The more-forward-looking permits were unchanged nationally and increased 3.3% in the Midwest on a 3-month moving average basis. Compared with a year earlier, permits rose 7.5% nationally but fell 6.6% in the Midwest due to exceptionally strong activity during February-April 2017.

**Home sales** were positive in April. Sales of existing homes edged higher by 0.5% nationally and 1.1% in the Midwest on a 3-month moving average basis. Both were down modestly from a year earlier. Sales of newly built homes increased 1.5% across the country and 1.9% in the Midwest on a 3-month moving average basis. Compared with a year earlier, new home sales were higher by 7.5% nationally and 10.8% in the Midwest.

Homebuilders in and around Ohio reported that customer demand was either steady or improving, according to the Cleveland Fed survey. Purchasers have been motivated by the strong job market, higher mortgage rates, and rising home prices. Real estate agents reported stable demand by first-time buyers and those with Section 8 vouchers. Homebuilders expect current trends to continue into the summer.

Limited supply is constraining sales and pushing up prices. **Home prices** across the country posted their 73rd consecutive monthly increase in March to 6.5% above the year earlier level, 47.1% above the cyclical low reached in February 2012, and 8.8% higher than the previous peak reached in February 2007, according to the Case-Shiller index.



As reported by Freddie Mac, home prices increased 2.1% in the first quarter to 7.5% year-over-year. In comparison, prices across Ohio increased 2.5% in the quarter and 7.2% from a year ago. In major metro areas in Ohio: prices increased 2.5% in the quarter and 7.7% from a year ago in Cincinnati; 2.0% in the quarter and 5.9% from a year ago in Cleveland; and 3.1% in the quarter and 8.6% from a year ago in Columbus after seasonal adjustment.

## *REVENUES*

**May GRF receipts totaled \$2,714.4 million** and were \$8.7 million (0.3%) above estimate. Tax revenues were \$57.9 million (2.9%) above estimate, led again by the personal income tax, which posted a \$92.6 million (15.7%) overage, as employer withholding, estimated payments, annual returns, payments from trusts, and refunds all contributed to better than expected revenues.

The GRF tax revenue overages in May extended beyond the income tax. The auto sales tax was above estimate by \$15.5 million (12.7%), and the commercial activity tax (CAT) was above estimate by \$17.6 million (5.7%), both posting the second very strong month in a row. The financial institutions tax (FIT) was also \$11.1 million (40.7%) above estimate. There were two negative tax sources to report: first, the non-auto sales tax, which was \$8.4 million (1.1%) below estimate, although this modest shortfall follows strong performances in March and April. The second negative was in the insurance taxes. The foreign insurance tax was \$11.0 million (78.5%) below estimate, as refunds exceeded the estimated amount, and the domestic insurance tax was \$66.9 million (74.5%) below estimate. The domestic insurance tax variance is expected to be a timing matter, where payments in June eventually make up for the May shortfall.

For the fiscal year, GRF tax revenues are now \$418.7 million (2.1%) above estimate. The income tax has by far the biggest overage, at \$401.9 million (5.6%). Income tax revenues have benefitted from both stronger than expected withholding and strong tax filing season results, in which estimated payments and annual returns have exceeded estimate and refunds have been below estimate.

Sales tax revenues are also above estimate for the year, by \$40.2 million (0.4%). Results there have been mixed, with auto revenues \$76.1 million (6.2%) above estimate, while non-auto revenues were still below estimate at -\$35.9 million (0.5%).

Revenues from both the CAT and the FIT are also above estimate for the year, by \$27.2 million (1.8%) and \$20.8 million (12.8%), respectively.

The income tax, sales tax, CAT and FIT are collectively \$490.2 million above estimate for the year. All the other tax sources combined are \$71.6 million below estimate for the year, but the insurance taxes alone are \$76.1 million below estimate (again, with most of this variance due to timing), meaning that all other taxes are a small \$4.5 million above estimate.

Non-tax revenues followed their \$52.6 million April overage with a \$48.0 million shortfall (7.1%) in May, meaning that the results for the two months combined were close to offsetting. This was true of individual categories within non-tax revenues as well.

Federal grants followed a \$38.8 million overage in April with a \$33.1 million shortfall in May, as Medicaid GRF spending swung from being \$71.0 million over estimate in April to being \$44.8 million below estimate in May. Intrastate Transfer Voucher (ISTV) revenue went from being \$15.2 million above estimate in April to being \$9.5 million below estimate in May, as statewide indirect cost allocation payments were received in April instead of May as originally estimated and were also larger than originally estimated.

For the year, non-tax revenues are below estimate by \$263.5 million (2.8%), with the main factor being that federal grants are \$243.5 million (2.7%) below estimate for the year. The federal grants shortfall is within \$19 million of the variance in the federal share of Medicaid spending, which is well within the expected deviation of federal revenues from the federal share of spending. The other significant variance in year-to-date non-tax revenues is in the "Other income" category, where revenues are \$31.0 million (11.1%) below estimate for the year, due to the fact that JobsOhio liquor enterprise payments have come in lower than estimated as a result of costs associated with modernization of the liquor information technology infrastructure.

Variances for the fiscal year-to-date by category are provided in the following table (\$ in millions). From a pure revenue perspective, non-federal revenue may be the most important category to examine because it filters out the impact of federal grants. Such grants are inextricably tied to Medicaid spending, and therefore a shortfall in such grants that results from underspending is not bad news from a budgetary perspective. At this juncture, non-federal revenues are \$402 million or 2.0% above estimate, very close to the variance for tax revenues.

Category	Includes:	YTD Variance	% Variance
Tax receipts	Sales & use, personal income, corporate franchise, financial institutions, commercial activity, MCF, public utility, kilowatt hour, foreign & domestic insurance, other business & property taxes, cigarette, alcoholic beverage, liquor gallonage, & estate	\$418.7	2.1%
Non-tax receipts	Federal grants, earnings on investments, licenses & fees, other income, intrastate transfers	(\$263.5)	-2.8%
Transfers	Budget stabilization, liquor transfers, capital reserve, other	\$3.2	2.5%
<b>TOTAL REVENUE VARIANCE:</b>		<b>\$158.3</b>	<b>0.5%</b>
<b>Non-federal revenue variance</b>		<b>\$401.8</b>	<b>2.0%</b>
<b>Federal grants variance</b>		<b>(\$243.5)</b>	<b>-2.7%</b>

On a year-over-year basis, May GRF revenues and transfers were down by \$208.3 million (7.1%) from the last May. However, this decrease is due completely to a decline of \$318.3 million (33.6%) in federal grants received. Non-federal revenues increased by \$109.9 million (5.6%) from last May, led by a \$135.7 million (7.0%) increase in tax revenues. The income tax alone increased by \$126.2 million (22.7%) from last May.

Year-to-date GRF revenues and transfers have decreased by \$1,298.9 million (4.2%) from last year, but that decline is driven by the policy change discussed in prior issues of this report. Both non-auto sales tax revenues, which were down \$497.0 million (5.9%) and federal grants, which were down \$2,063.9 million (19.2%) reflect the fact that a policy decision by the Centers for Medicare and Medicaid Services (CMS) led to the elimination of the sales tax on Medicaid managed care premiums and an accounting change that altered where associated federal grant revenue was deposited.

To be more specific, in fiscal year 2010-2017, Medicaid managed care company premiums were subject to the sales tax, and this revenue was deposited into the GRF. This revenue helped support Medicaid spending from the GRF and the subsequent drawdown of federal revenue was therefore also deposited into the GRF. Beginning in fiscal year 2018, the sales tax no longer applies to Medicaid managed care premiums. Instead, a new federally approved Medicaid related provider tax on all Medicaid managed care organizations and non-Medicaid major medical managed care organizations is levied. Receipts from this tax, as is the case with all other Medicaid related health care provider taxes, go into a dedicated purpose fund and help support Medicaid spending. The federal dollars drawn down by the disbursement of these non-GRF funds are deposited into a federal fund, not the GRF. This change will reduce non-auto sales tax receipts, GRF Medicaid spending, and related federal grant revenue in fiscal year 2018, as it has done throughout the first eleven months.

Once adjusting for these policy and accounting changes, a much more optimistic picture emerges. Non-federal revenues have increased so far in fiscal year 2018 by \$765.1 million (3.8%). If not for the loss of the sales tax on Medicaid premiums, GRF non-federal revenues would have increased by \$1,439.1 million (7.5%). GRF tax revenues by themselves, absent the Medicaid premium sales tax change, would have increased by \$1,208.7 million (6.4%).

**GRF Revenue Sources Relative to Monthly Estimates – May 2018**  
**(\$ in millions)**

<b>Individual Revenue Sources Above Estimate</b>		<b>Individual Revenue Sources Below Estimate</b>	
Personal Income Tax	\$92.6	Domestic Insurance Tax	(\$66.9)
Commercial Activity Tax	\$17.6	Federal Grants	(\$33.1)
Auto Sales Tax	\$15.5	Foreign Insurance Tax	(\$11.0)
Financial Institutions Tax	\$11.1	ISTVs	(\$9.5)
Public Utilities Excise Tax	\$4.7	Non-auto Sale Tax	(\$8.4)
Natural Gas Distribution Tax	\$2.5	License and Fees	(\$3.0)
Kilowatt Hour Tax	\$1.7	Other Income	(\$2.4)
Other Sources Above Estimate	\$0.1	Other Sources Below Estimate	(\$2.6)
<b>Total above</b>	<b>\$145.6</b>	<b>Total below</b>	<b>(\$136.9)</b>

Note: Due to rounding of individual sources, the combined sum of sources above and below estimate may differ slightly from the total variance

**Non-Auto Sales and Use Tax**

May non-auto sales and use tax collections totaled \$724.8 million and were \$8.4 million (1.1%) below estimate. As noted earlier, the negative variance followed strong performances – the best of the fiscal year – in March and April. May’s collections left growth for the fiscal year, after adjusting for the elimination of the tax on Medicaid Health Insuring Corporation (MHIC) premiums, unchanged from April at 2.3% (please see the table below).

**Non-Auto Sales Tax Revenue Growth Without MHIC– FY18 through May  
(\$ in millions)**

	May-17	May-18	FY 17 YTD	FY 18 YTD
Non-Auto sales tax GRF	\$787.3	\$724.9	\$8,413.3	\$7,916.3
Non-Auto sales tax PLF (Library Fund)	\$16.4	\$17.7	\$174.6	\$176.7
Non-Auto sales tax, all funds	\$803.7	\$742.5	\$8,587.9	\$8,093.0
MHIC revenues (state)	\$73.8	\$0.0	\$745.8	\$71.7
GRF and PLF revenues without MHIC	\$729.9	\$742.5	\$7,842.2	\$8,021.3
<b>Change from prior year in non-MHIC collections</b>				
<b>Pct. change from prior year in non-MHIC collections</b>		\$12.7		\$179.2

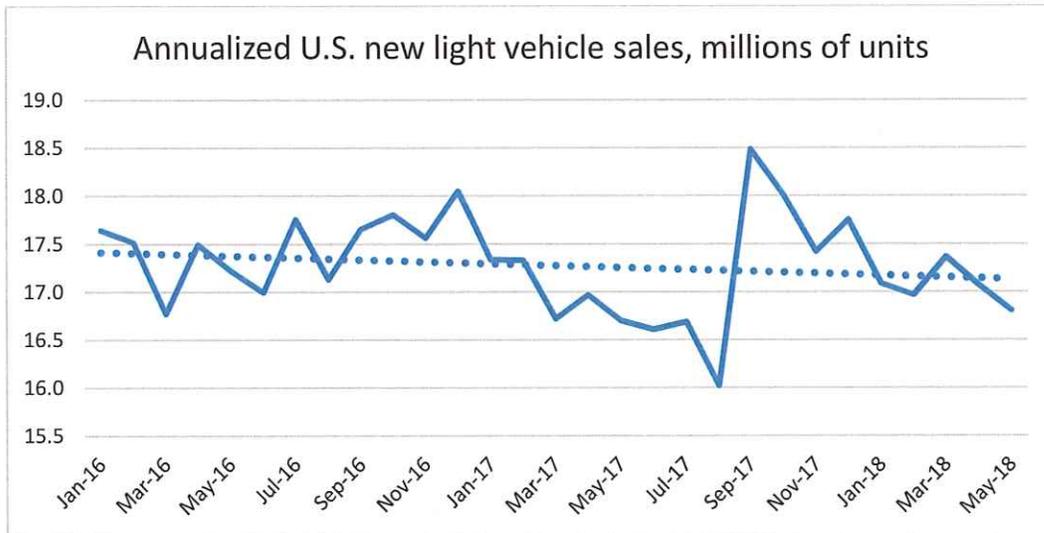
July was the last month of Medicaid Health Insuring Corporations (MHIC) sales tax collections, as mentioned above. Beginning in August, the sales tax on MHIC capitation payments was replaced by a Medicaid related provider tax on member months of both Medicaid and non-Medicaid major medical managed care organizations, which is being deposited into a non-GRF dedicated purpose fund. As a result, non-auto sales tax collections are expected to be negative relative to fiscal year 2017 in all of the remaining months of fiscal year 2018. After one adjusts for sales tax collections from MHICs, estimated growth for all of fiscal year 2018 is 2.5%.

As noted in last month’s issue of this report, OBM’s measure of retail prices, which is specially constructed to reflect the non-auto sales tax base (e.g. omitting motor vehicles and parts, omitting grocery stores, etc.) still shows slightly negative year-to-year price changes through the first quarter of 2018. These negative price changes can also be observed in the CPI for commodities, minus food and energy, which has tracked closely with the OBM-constructed price index over the past few years. It is unlikely that non-auto sales tax growth will accelerate much without some retail price inflation. Through May, non-auto sales tax growth remains about 2% below income tax withholding growth, on a 6-month moving average basis.

**Auto Sales Tax**

Auto sales tax revenues in May were \$15.5 million (12.7%) above the estimate, and are now \$76.1 million (6.2%) above estimate for the year. Revenues are 3.6% above their year-ago level.

As noted in last month’s issue of this report, the auto sales tax continues to exceed expectations despite a plateau in unit sales of new light vehicles at the national level. Unit sales dropped to an annualized level of 16.8 million units in May. The trend over the past 2.5 years is clearly slightly downward, as illustrated by the graph below.



Several factors may be supporting sales tax revenue growth even as new unit sales fall. First, as noted in last month’s issue of this report, sales have been shifting from lower-priced autos to higher-priced light trucks. Light trucks now account for almost three-quarters of estimated light vehicle expenditure. Bureau of Economic Analysis (BEA) data through April shows that average light truck prices are now about \$11,600 (45%) above average car prices. Second, average prices of both light trucks and cars have increased over the past year. Third, there appears to have been some movement since the end of fiscal year 2017 away from leasing and toward purchasing of autos. For accounting purposes auto leasing tax revenue is counted as non-auto revenue, and auto purchasing revenue is counted as auto revenue; this shift will tend to boost measured auto sales tax revenue.

**Personal Income Tax**

GRF personal income tax receipts for May totaled \$682.8 million and were \$92.6 million (15.7%) above estimate. This strong performance is broad-based, with all tax payment categories (except “other payments,” which is comprised of collections by the attorney general) exceeding estimate and refunds were also modestly smaller than expected.

Withholding was above estimate by \$20.5 million for the month, and for the year withholding is \$142.2 million above estimate. It has increased by 5.0% from last year, compared to an estimate of 3.1%. The greater-than-anticipated withholding performance in May is consistent with outcomes demonstrated throughout this fiscal year. As previously noted, this source continues to outpace the estimates of Ohio wage and salary income from the Bureau of Economic Analysis (BEA).

May is not a significant payment month for estimated payments. Nonetheless, revenue from this source exceeded the May estimate by \$3.6 million (37.5%).

Annual return tax payments considerably exceeded estimate by \$46.0 million (186.4%) in May. This represents the largest source of revenue overage for the month. This is another indication of what appears to be strong growth in total tax liability for tax year 2017. For the fiscal year, annual return payments are \$59.5 million (8.6%) above estimate, more than making up for the lower than anticipated results demonstrated during the first-half of this fiscal year (which primarily reflected tax year 2016 extension returns).

Furthermore, trust tax return payments show strong growth. These payments were above estimate by \$15.1 million (377.6%) in May. The apparent strength is largely due to tax return deposit timing; trust tax return payments in April were low relative to estimate, so May performance makes up for this drop. For the year-to-date, trust tax payments were above estimate by \$59.5 million (8.6%).

May refunds were \$13.6 million (11.2%) below estimate, and for the January-May period, refunds are \$49.7 million (3.2%) below estimate. Although the count of refunds being paid out has increased relative to last year, refund amounts per return have dropped.

On a year-over-year basis, May GRF income tax collections were \$126.2 million (22.7%) above May 2017 collections. For the year, collections are up by \$764.7 million (11.2%). Except for the “other” return category, all payment categories have improved from last year. Growth in withholding and estimated payments accounts for \$605.2 million, explaining most of the GRF income tax growth.

<b>FY2018 PERSONAL INCOME TAX RECEIPTS BY COMPONENT (\$ in millions)</b>						
	Estimate May	Actual May	\$ Var	Actual May-2018	Actual May-2017	\$ Var Y Over- Y
Withholding	\$694.6	\$715.1	\$20.5	\$715.1	\$669.1	\$46.0
Quarterly Est.	\$9.7	\$13.3	\$3.6	\$13.3	\$9.4	\$4.0
Trust Payments	\$4.0	\$19.1	(\$15.1)	\$19.1	\$1.6	\$17.5
Annual Returns & 40 P	\$24.7	\$70.7	\$46.0	\$70.7	\$23.5	\$47.2
Other	\$11.3	\$7.4	(\$3.9)	\$7.4	\$11.0	(\$3.6)
Less: Refunds	(\$121.6)	(\$108.0)	\$13.6	(\$108.0)	(\$126.0)	\$18.0
Local Distr.	(\$32.5)	(\$35.0)	(\$2.5)	(\$35.0)	(\$32.1)	(\$2.9)
Net to GRF	\$590.2	\$682.8	\$92.6	\$682.8	\$556.5	\$126.3

### **Commercial Activity Tax**

May commercial activity tax (CAT) receipts deposited in the GRF totaled \$326.7 million and were \$17.6 million (5.7%) above estimate. Of the four due-date months during fiscal year 2018, May is the only one to produce a positive variance.

Monthly CAT revenues have not displayed a consistent trend this year, with six of the 11 months above estimate and five months below. Notably, all funds revenues in each of the four months that precede a quarterly due date for the tax – July, October, January, and April – have been well above the estimate. Those four months have had a collective overage of \$60.9 million, while the total for the seven other months have collectively fallen short of the estimate by \$28.2 million, yielding a net all funds overage for the year \$32.7 million. Perhaps some factor has led taxpayers to shift their payment timing so that a larger share of total payments due is being sent in early.

On a quarterly basis, revenues collected via CAT have shown less variation, as illustrated in the table below. The final quarterly payment for the year occurred in May. Because the June estimate is quite small, barring any unusual and unforeseen developments it is anticipated that total fiscal year 2018 CAT revenues will exceed the estimate.

<b>FY 2018 CAT Payments, Actual vs. Estimate and vs. Prior Fiscal Year</b>						
	Estimate	Actual	Variance	% Var	2017 Actual	% Change from 2017
Q1	\$410.3	\$421.5	\$11.2	2.7%	\$401.6	4.9%
Q2	\$443.3	\$443.0	(\$0.3)	-0.1%	\$430.8	2.8%
Q3	\$484.5	\$466.1	(\$18.3)	-3.8%	\$459.0	1.5%
Q4	\$433.2	\$473.4	\$40.2	9.3%	\$459.3	3.1%

\*Assumes June 2018 revenues will match the \$11.4 million estimate. Because the current-year actual contains the June 2018 estimate, the fourth quarter dollar variance and percentage figures are also estimates

GRF CAT revenues are \$226.6 million (17.6%) higher than collections at the same point last fiscal year. For the month, revenues of \$326.7 million are \$46.9 million (16.8%) higher than May of the previous fiscal year. This increase is partly due to a change in the allocation formula found in the latest biennial budget bill (H.B. 49) that increased the GRF share of CAT receipts from 75 percent to 85 percent.

All funds revenues have increased by \$63.6 million (3.7%) from fiscal year 2017. At the old GRF percentage of CAT revenue (and the old administrative fee percentage of 0.85%), GRF CAT revenues would have increased by \$47.7 million from a year ago. The remaining \$178.9 million of increase is due to the H.B. 49 law change.

A look at quarterly estimated and actual all funds revenues shows that CAT revenues have continued to grow every quarter, but the rate of growth slowed as the year has progressed, from 4.9% initially to 1.5% in the third quarter, and then is expected to increase in the fourth quarter. Based on April and May 2018 performance, we now anticipate a fourth quarter year-over-year growth rate well above the -5.7% that had been expected for this quarter.

### **Financial Institutions Tax**

May financial institutions tax collections were \$38.3 million, \$11.1 million (40.7%) above estimate. For the year, collections are \$20.8 million (12.8%) above estimate.

The overall story of the FIT has been unexpectedly good this fiscal year. May’s results build on the considerable overages posted in January, February, and March.

The positive May performance is tempered by uncertainties related to payment timing. The last quarterly payment of the year is due Thursday, May 31. As always, the split between revenues booked in May and revenues booked in June is somewhat uncertain, so it will not be until early June that the final standing of FIT revenues relative to the estimate is known. It is reasonable to assume that at least some of the overage in May is due to early than originally expected revenue collection, and therefore June revenues could very well fall below the forecast.

## **GRF Non-Tax Receipts**

GRF non-tax revenues in May totaled \$627.1 million and were \$48.0 million (7.1%) below estimate. Year-to-date non-tax revenues were \$263.5 (2.8%) below estimate.

For the month, federal grants were below estimate by \$33.1 million (5.0%) due to underspending in the GRF Medicaid category. Through May, federal Medicaid revenues have tracked relatively closely with Medicaid underspending, as year-to-date federal Medicaid revenues were approximately \$18.8 million (0.2%) less than year-to-date spending for Medicaid federal share, which is within the expected variance range. For the year, federal grants were \$243.5 million (2.7%) below estimate.

Revenues from ISTVs were \$9.5 million (100.3%) below estimate as Statewide Indirect Cost Allocation payments were received in April instead of May as anticipated. Year-to-date ISTV revenues were \$6.2 million (65.1%) above estimate.

License and fee revenues were \$3.0 million (482.7%) below estimate, primarily due to the correction of a \$3.0 million payment that was incorrectly deposited into the GRF in April.

132nd General Assembly  
Regular Session  
2017-2018

**A BILL**

To enact sections 5739.41, 5741.26, and 5747.073 of the Revised Code to allow manufacturers that purchase new manufacturing machinery and equipment to claim a credit against income tax withholding and sales tax remittances and against the use tax.

**BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF OHIO:**

**Section 1.** That sections 5739.41, 5741.26, and 5747.073 of the Revised Code be enacted to read as follows:

**Sec. 5739.41.** (A) Terms used in this section have the same meanings as in section 5747.073 of the Revised Code.

(B) A credit is allowed against the tax due under section 5739.02 of the Revised Code for a manufacturer that is a vendor or a holder of a direct payment permit and that makes an eligible purchase of new manufacturing machinery or equipment. The credit may reduce either of the following amounts:

(1) The taxes required to be remitted by a vendor under section 5739.12 of the Revised Code; or

(2) The tax due from a direct payment permit holder under section 5739.031 of the Revised Code.

The credit shall be applied against such amounts that are due during the two calendar years after the end of the credit period. If the amount of the credit claimed on a return exceeds

the amount of tax due or required to be remitted with that return, the excess credit may be carried forward and applied against the amounts due or required to be remitted with subsequent returns filed during that two-year period.

(C) Subject to division (D) of this section, the amount of the credit shall equal the total cost of eligible purchases of new manufacturing machinery or equipment made by the manufacturer during the credit period, multiplied by one of the following percentages:

(1) Twenty per cent, if the average rate of unemployment in the county in which such new manufacturing machinery or equipment is located and used during the credit period is equal to or greater than one hundred twenty-five per cent of the average rate of employment in the state for the same period;

(2) Fifteen per cent in all other cases.

(D)(1) The amount of credit allowed under this section shall be reduced by the amount of credit claimed on the basis of the same credit period under section 5741.26 or 5747.073 of the Revised Code.

(2) If a manufacturer is both a vendor and a direct payment permit holder, any credit claimed under division (B)(1) shall reduce the credit available to be claimed under division (B)(2) of this section, and vice versa.

(3) The aggregate credit claimed under this section or section 5741.26 or 5747.073 of the Revised Code by a manufacturer or, if the manufacturer is a member of an affiliated group, by the manufacturer's affiliated group, shall not exceed five million dollars for each credit period. As provided in section 5747.073 of the Revised Code, the term "credit period," and thus the limitation on the maximum credit allowable under this section or section 5741.26 or 5741.073 of the Revised Code, shall apply separately with respect to each facility; credits arising

from eligible purchases of new manufacturing machinery or equipment for use at separate facilities shall not be aggregated for purposes of the credit limitation provided in this division (D)(3) of this section.

(E) Taxes collected by a manufacturer and not remitted pursuant to this section shall be considered to have been paid by the manufacturer for the purposes of this chapter.

For the purpose of determining the amount of taxes collected under this chapter to be returned to counties and transit authorities under division (B)(1) of section 5739.21 of the Revised Code, the "aggregate amount of money collected" during a month with respect to each area in which a county or transit authority levies a tax shall include the total amount of reduction in taxes for that month that results from credits allowed by this section.

**Sec. 5741.26.** (A) Terms used in this section have the same meanings as in section 5747.073 of the Revised Code.

(B) A credit is allowed against the tax imposed by section 5741.02 of the Revised Code for a manufacturer that is a consumer and that makes an eligible purchase of new manufacturing machinery or equipment. The credit shall be claimed during the two calendar years after the end of the credit period. If the amount of the credit claimed on a return exceeds the amount of tax required to be remitted with that return, the excess credit may be carried forward and applied against the amounts required to be remitted with subsequent returns filed during that two-year period.

(C) Subject to division (D) of this section, the amount of the credit shall equal the total cost of eligible purchases of new manufacturing machinery or equipment made by the manufacturer during the credit period, multiplied by one of the following percentages:

(1) Twenty per cent, if the average rate of unemployment in the county in which such new manufacturing machinery or equipment is located and used during the credit period is equal to or greater than one hundred twenty-five per cent of the average rate of employment in the state for the same period;

(2) Fifteen per cent in all other cases.

(D)(1) The amount of credit allowed under this section shall be reduced by the amount of credit claimed on the basis of the same credit period under section 5739.41 or 5747.073 of the Revised Code.

(2) The aggregate credit claimed under this section or section 5739.41 or 5747.073 of the Revised Code by a manufacturer or, if the manufacturer is a member of an affiliated group, by the manufacturer's affiliated group, shall not exceed five million dollars per credit period. As provided in section 5747.073 of the Revised Code, the term "credit period," and thus the limitation on the maximum credit allowable under this section or section 5739.41 or 5747.073 of the Revised Code, shall apply separately with respect to each facility; credits arising from eligible purchases of new manufacturing machinery or equipment for use at separate facilities shall not be aggregated for purposes of the credit limitation provided in this division (D)(2) of this section.

(E) Taxes collected by a manufacturer and not remitted pursuant to this section shall be considered to have been paid by the manufacturer for the purposes of this chapter.

For the purpose of determining the amount of taxes collected under this chapter to be returned to counties and transit authorities under division (B) of section 5741.03 and division (B)(1) of section 5739.21 of the Revised Code, the "aggregate amount of money collected" during a month with respect to each area in which a county or transit authority levies a tax shall

include the total amount of reduction in taxes for that month that results from credits allowed by this section.

**Sec. 5747.073. (A) As used in this section:**

(1) "Affiliated group" means two or more persons related in such a way that one person owns or controls the business operations of another member of the group.

(2) "Cost" means cost as capitalized on the books of the person acquiring property. If property is leased, "cost" means the actual amount of any lease payments made during the credit period. "Cost" does not include any portion of the basis of property that is determined by reference to the basis of other property held at any time by the person acquiring the property.

(3) "Credit period" means the first calendar year that begins on or after the effective date of this act or after the end of the preceding credit period, whichever is later, in which a manufacturer purchases new manufacturing machinery or equipment, and the ~~ensuring-ensuing~~ calendar year. A ~~separate "credit period" - applies shall apply to each facility-on an individual facility basis. to purchases made for use at only a single facility- Therefore, if~~ a taxpayer or ~~member of the taxpayer's affiliated group~~ purchases new manufacturing machinery or equipment for use at more than one facility during a two-year period, a separate "credit period" applies to purchases made at each of the separate facilities. A "credit period" shall not include any calendar year included in another credit period for the same facility.

(4) "Eligible purchase" means the purchase by a manufacturer of new manufacturing machinery or equipment that meets both of the following requirements:

(a) The manufacturer uses the new manufacturing machinery or equipment in this state as a manufacturer.

(b) The cumulative cost of the new manufacturing machinery or equipment purchased during a credit period, when added to the cumulative cost of any other new manufacturing machinery or equipment purchased by other members of the manufacturer's affiliated group during the credit period, equals or exceeds five per cent of the aggregate net book value of all tangible personal property located at the facility where the purchases are to be installed as of the last day of the credit period.

(5) "Manufacturer" means a person who purchases, receives, or holds personal property for the purpose of adding to its value by manufacturing, refining, rectifying, or combining different materials with a view of making a gain or profit by so doing.

(6) "Manufacturing machinery or equipment" means machinery or equipment, and tools and implements, including any associated patterns, jigs, dies, drawings, and business fixtures, used by a manufacturer at a manufacturing facility or for research and development purposes. "Manufacturing machinery or equipment" includes any such property leased to the manufacturer.

(7) "New manufacturing machinery or equipment" means ~~manufacturing machinery or equipment the original use of which~~ ~~by the taxpayer or a member of the taxpayer's affiliated group~~ ~~commences in this state~~ ~~with a manufacturer~~. ~~"New manufacturing machinery or equipment" may include manufacturing machinery or equipment used by a person unrelated to the taxpayer prior to the taxpayer's purchase of the manufacturing machinery or equipment, provided its original use by the taxpayer or a member of the taxpayer's affiliated group commences in this state.~~

(8) "Purchase" means any acquisition, whether by lease or otherwise, of manufacturing machinery or equipment for a consideration, provided that both of the following requirements are met:

(a) The manufacturing machinery or equipment is not acquired by one member of an affiliated group from another member of the same affiliated group.

(b) The basis of the manufacturing machinery or equipment for the person who acquires the machinery or equipment is not determined in whole or in part by reference to the seller's or lessor's adjusted basis of such property.

(B) A credit is allowed against taxes withheld and required to be remitted under sections 5747.06 and 5747.07 of the Revised Code by an employer that is a manufacturer and that makes an eligible purchase of new manufacturing machinery or equipment. The credit shall be applied against withheld taxes required to be remitted during the two calendar years after the end of the credit period. If the amount of the credit claimed on a return exceeds the amount of tax required to be remitted with that return, the excess credit may be carried forward and applied against the amount of tax required to be remitted with subsequent returns that are due during that two-year period.

(C) Subject to division (D) of this section, the amount of the credit shall equal the total cost of eligible purchases of new manufacturing machinery or equipment made by the manufacturer during the credit period, multiplied by one of the following percentages:

(1) Twenty per cent, if the average rate of unemployment in the county in which such new manufacturing machinery or equipment is located and used during the credit period is equal to or greater than one hundred twenty-five per cent of the average rate of employment in the state for the same period;

(2) Fifteen per cent in all other cases.

(D)(1) The amount of credit allowed under this section shall be reduced by the amount of credit claimed on the basis of the same credit period under section 5739.41 or 5741.26 of the Revised Code.

(2) The aggregate credit claimed under this section or sections 5739.41 or 5741.26 of the Revised Code by a manufacturer or, if the manufacturer is a member of an affiliated group, by the manufacturer's affiliated group, shall not exceed five million dollars for each credit period. As provided in division (A)(3) of this section, the term "credit period," and thus the limitation on the maximum credit allowable under this section or section 5739.41 or 5741.26 of the Revised Code, shall apply separately with respect to each facility; credits arising from eligible purchases of new manufacturing machinery or equipment for use at separate facilities shall not be aggregated for purposes of the credit limitation provided in this division (D)(2) of this section.

(E) Amounts withheld by a manufacturer from the compensation of an employee under section 5747.06 of the Revised Code and not remitted pursuant to this section shall be considered to be paid by the employee for the purposes of the employee's tax liability under this chapter.

# IMPACTS OF TAX REFORM

Discussion on Ohio Conformity to the TCJA &  
Sales Tax Implications of *South Dakota v. Wayfair*.

June 20, 2018

# Today's Presenters

Brian Schneider – RSM US LLP – Dayton, Ohio

Cody Tolle – RSM US LLP – Cincinnati, Ohio

# Agenda

Topic	Minutes
Objectives of the presentation	2
Overall, what is the impact of TCJA on the state and local tax landscape?	5
What does this mean for Ohio?	15
Discussion on <i>South Dakota v. Wayfair</i>	20
Q&A	5

# Fiscal health of the states

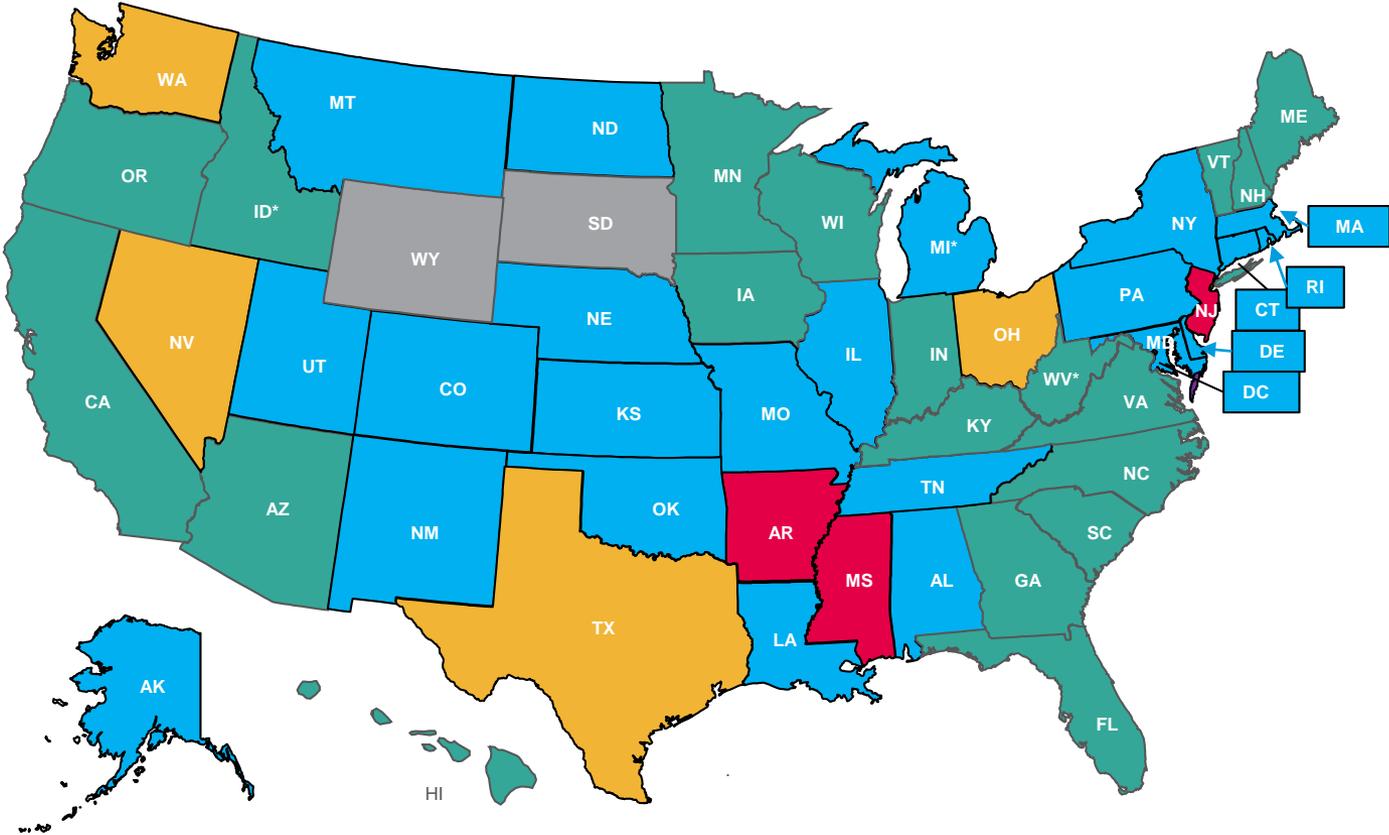
- Regardless of federal tax reform, many states are experiencing their own fiscal crisis.
- Weak overall state and local tax collections in 2016 and 2017 are impacting FY18 budgets and beyond.
  - Weak growth among sales and use and individual income taxes – the two largest tax revenue sources.
  - Slow tax revenue collections are expected to continue into 2018.
- We're not looking at a repeat of the great recession, but the potential for significant state-level tax reform with an eye toward generating revenue is high.

# Federal reform impact on the states

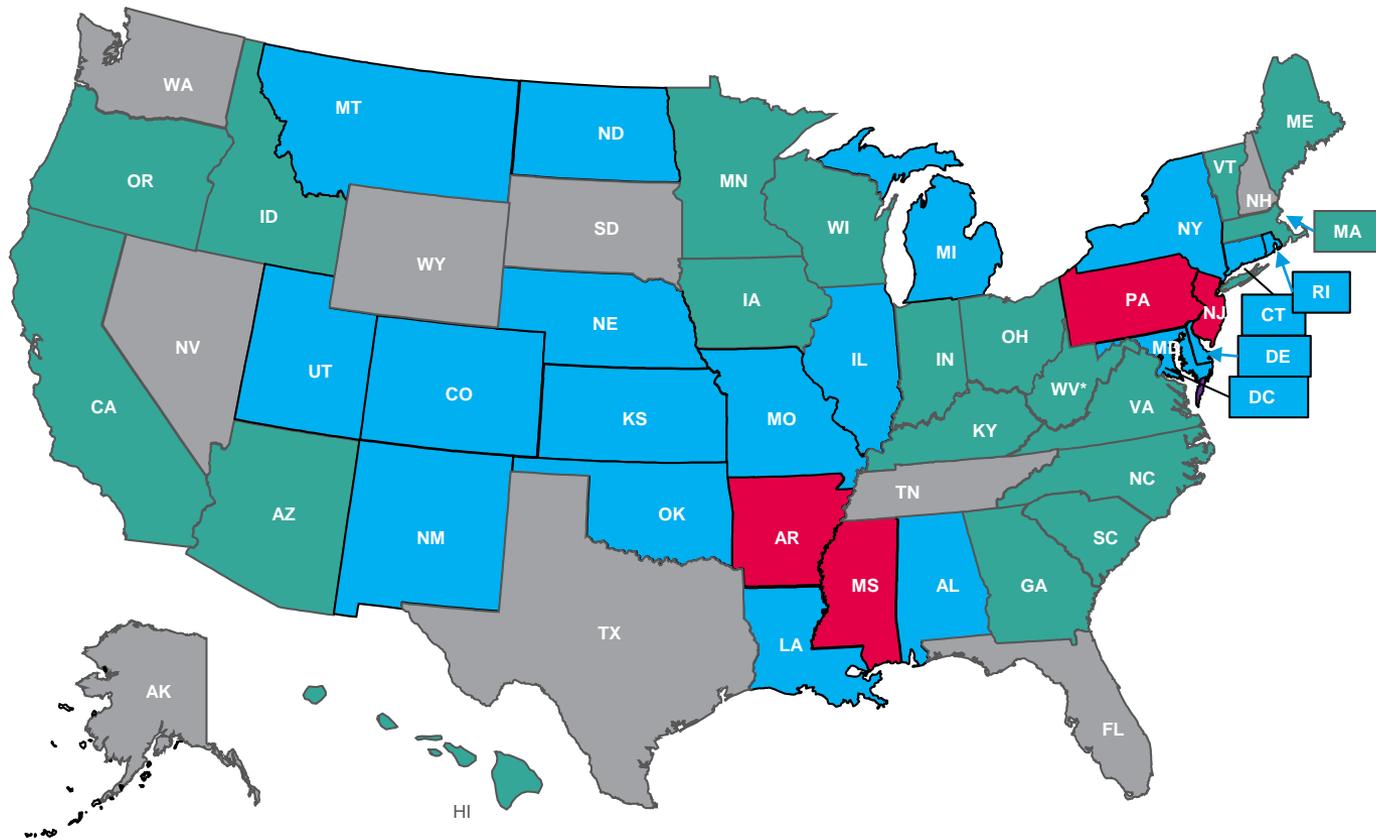
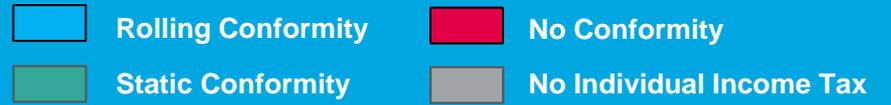
- Could have wide-ranging impacts on state budgets.
- Conformity rules and timing are key.
- How will states respond?
  - Possible windfall for some states coupled to federal deductions that become eliminated, but there may be political issues if the states conform to close the budget gap.
  - Look for conformity legislation in the near term, and broader state-level reform in the long term.
  - Don't expect revenue neutrality (e.g., states may adopt interest expense limitations but decouple from depreciation rules, etc.).

# Corporate tax conformity

- Rolling Conformity
- No Conformity
- Static Conformity
- Gross Receipt Tax State



# Individual tax conformity



# Ohio conformity to the IRC

- Ohio elects to conform to the Internal Revenue Code using the static approach.
- Therefore, any changes to the IRC are not considered a part of Ohio law until new legislation is enacted updating the date of Ohio's conformity to the IRC.
- On March 30<sup>th</sup>, 2018, Governor Kasich signed SB 22 which updated the conformity date to the IRC to the date of signature, bringing the provisions set forth in the TCJA to fruition.

# What does this mean for personal income tax?

- While Ohio does not have a corporate income tax, the change in conformity date still brings about changes to the personal income and municipal income tax regimes.
- For personal income taxes, most of the provisions set forth in TCJA are after the calculation of the Federal Adjusted Gross Income (“FAGI”).
  - With Ohio’s starting point being FAGI, this means most of the provisions in TCJA do not apply.
    - The new federal business income deduction (199A) will not be allowed for Ohio because it is claimed after FAGI.
  - The two most significant changes that do affect personal income tax are:
    1. 5/6 Addback on 100% Bonus Depreciation.
    2. Limit on business interest expense under §163(j)

# What does this mean for municipal income tax?

- Currently, some municipalities are challenging the state's authority to enact laws on the local tax level. However, these litigations are still ongoing and; therefore, we must assume Chapter 718 of the Ohio Revised Code is the applicable statutes for municipal income tax.
- Ohio municipalities have historically not decoupled from federal tax provisions separately from the ORC.
- It is possible that some Ohio municipalities might break the mold and decouple from certain provisions in TCJA.

# Ohio municipal tax changes with TCJA

- Shown below are the significant changes to the net profit tax returns for Ohio municipalities:

TCJA Provision	Ohio Municipal Treatment*
IRC Section 965(a) – One-time repatriation of foreign earnings. Included as subpart F income, taxable on the federal tax return.	Likely will be included in the starting point of taxable income without any representation in the apportionment factors (i.e. not in the sales factor denominator).
IRC Section 163(j) – Interest expense deduction limitation.	Likely will be included in the starting point of taxable income with no subsequent subtraction from income to offset it.
IRC Sections 168(k), 179 – 100% Bonus depreciation and immediate expensing	Likely will be included in the starting point of taxable income without no subsequent modifications.
Other Provisions: <ul style="list-style-type: none"> <li>• Elimination of DPAD</li> <li>• Changes to meals and entertainment rules</li> <li>• Stricter capitalization rules of R&amp;D Expenses</li> </ul>	<ul style="list-style-type: none"> <li>• Also eliminated at local level.</li> <li>• Same changes apply at local level.</li> <li>• Same rules apply at local level.</li> </ul>

# Impacts to the Ohio CAT

- As the Ohio CAT is a tax on “taxable gross receipts” no significant changes are expected as a result of the TCJA.
- One change to keep in mind:
  - The TCJA limits like-kind exchange treatment to real property transactions.
  - This may result in additional taxable CAT gross receipts as those receipts would no longer fall into §1031, which the ORC explicitly excludes from “taxable gross receipts”.
  - This is currently being litigated to decide treatment.

# South Dakota v. Wayfair

# South Dakota v. Wayfair

- In 2016, South Dakota enacted SB 106 that required remote sellers to register, collect and remit sales tax if, in the previous calendar year, the seller met one of the 3 conditions:
  1. Physical Presence (either by employee or property)
  2. Had over \$100,000 of gross revenue from delivery of goods into South Dakota.
  3. Sold these goods for delivery into South Dakota in 200 or more separate transactions.
- After the South Dakota Supreme Court upheld a lower court decision in favor of Wayfair, the US Supreme Court granted certiorari on January 2, 2018 and heard oral arguments from both parties on April 17<sup>th</sup>.

# South Dakota v. Wayfair

- The importance of the Supreme Court hearing this case is that this is the first time in 26 years that the physical nexus standard set forth by *Quill Corp. v. North Dakota* has been revisited by the Court.
  - The *Quill* case established the physical nexus (presence) standard that has been the precedent of sales tax nexus for the last two and half decades.
- There are 3 possible outcomes of the case:
  1. The Court reaffirms *Quill*.
  2. The Court overturns *Quill*.
  3. The Court does not rule on the merits of *Quill*.

# South Dakota v. Wayfair – The Court Reaffirms *Quill*

- If the Court reaffirms *Quill*, the physical presence nexus standard set forth in *Quill* will again be the precedent on which sales tax nexus determination.
- This will result in economic nexus standards established in other states (ex. Ohio) being challenged and (most likely) struck down by the state courts.
  - The state courts will have essentially no other options other than following the decision in *Quill* and the reaffirmation through *Wayfair*.
- Use tax reporting and notification compliance obligations on remote sellers will likely expand

## South Dakota v. Wayfair – The Court Overturns *Quill*

- If the Court overturns *Quill*, the physical presence nexus requirement will end and will no longer be applicable in determining sales tax nexus.
- This will result in economic nexus standards established in other states (ex. Ohio) being upheld.
- Additional states would establish economic nexus standards resulting in significant sales tax compliance for companies that sell to multiple states.
- It is important to keep in mind that Congress can establish new laws and overrule the US Supreme Court under any outcome.

# South Dakota v. Wayfair – No Ruling

- If the Court does not rule on the merits of *Quill*, the physical presence nexus requirement remain status quo for the time being.
- In this scenario, it is highly likely that the Court would assert that this type of issue should be decided in Congress and would strongly urge Congress to act in the near future.
- Little to no conversation has been had by Congress in the past on this issue and no leanings are readily apparent in how they would respond to such a recommendation.

# Considerations for Manufacturers

- Maintain state legislative and regulatory tracking of nexus expansion laws.
- Consider ASC 450 (contingencies) issues with state that have economic nexus
- Consider the new use tax reporting and notification compliance obligations on remote sellers
- Understand current nexus footprint
- Re-evaluate current approach to sales tax collection
- Automate your sales and use tax compliance

# Economic sales tax nexus laws change daily

State	Effective Date	Current Status	Brief Summary
Alabama	Jan. 1, 2016	Effective/challenged	excess of \$250,000 in sales
Georgia	Jan. 1, 2019	Effective later	excess of \$250,000 or 200 or more transactions
Hawaii	July 1, 2018	Effective later	excess of \$100,000 in sales or in 200 or more transactions
Illinois	Oct. 1, 2018	Effective later	excess of \$100,000 in sales or in 200 or more transactions
Indiana	July 1, 2017	Stayed/challenged	excess of \$100,000 in sales or in 200 or more transactions
Iowa	Jan. 1, 2019	Effective later	excess of \$100,000 in sales or in 200 or more transactions
Kentucky	July 1, 2018	Effective later	excess of \$100,000 in sales or in 200 or more transactions
Maine	Oct. 1, 2017	Effective	excess of \$100,000 in sales or in 200 or more transactions
Mississippi	Dec. 1, 2017	Effective	excess of \$250,000 in sales
North Dakota	<i>Quill</i> overturned	Effective later	excess of \$100,000 in sales or in 200 or more transactions
Ohio	Jan. 1, 2018	Effective	excess of \$500,000 in sales
Pennsylvania	March 1, 2018	Effective	Election: use tax reporting, or collection when excess of \$10,000 in sales
Rhode Island	Aug. 17, 2017	Effective	excess of \$100,000 in sales or in 200 or more transactions
South Dakota	May 1, 2016	Overtured/challenged	excess of \$100,000 in sales or in 200 or more transactions
Tennessee	Jan. 1, 2017	Stayed/challenged	excess of \$500,000 in sales
Vermont	<i>Quill</i> overturned	Effective later	excess of \$100,000 in sales or in 200 or more transactions
Washington	Jan. 1, 2018	Effective	Election: use tax reporting, or collection when excess of \$10,000 in sales
Wyoming	July 1, 2017	Stayed/challenged	excess of \$100,000 in sales or in 200 or more transactions

# QUESTIONS AND ANSWERS?

THANK YOU FOR  
YOUR TIME AND  
ATTENTION

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**TO: OMA Tax and Finance Committee**  
**FROM: Rob Brundrett**  
**SUBJECT: Tax Public Policy Report**  
**DATE: June 20, 2018**

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### **Overview**

The biggest tax and finance news continues to come from the federal government with the passage of tax reform and the steel and aluminum tariffs hitting. In Ohio the business community secured a big court victory over local government and members remain engaged on the manufacturing sales and use tax exemption rule that is being reviewed by the Department along with looking for ways to make Ohio manufacturing even more competitive in regards to tax and economic development policy.

### **Tax Legislation**

#### **Senate Bill 114 / House Bill 155 – Vehicle Training Tax Credit**

Senate Bill 114 and House Bill 155 are companion bills that authorize tax credits for expense incurred by employers to train a commercial vehicle operator. These bills would allow businesses to take credits against the CAT. The bills had one hearing in the House and Senate. OMA met with both proponents of the bills and sponsors of the bills. Proponent and sponsors followed the advice of the OMA and removed the CAT from the list of taxes that could be credited.

#### **Senate Bill 132 – Foreign Trade Zone CAT Credit**

The bill would establish a five-year pilot program whereby taxpayers with facilities in Ohio with activated foreign trade zone status may claim a nonrefundable commercial activity tax credit equal to the amount redeployed by the taxpayer to job creation and renewable energy resources. OMA participated in an interested party meeting earlier this fall and expressed serious concern over the proposal.

#### **House Bill 185 – Political Contributions Tax Credit**

The bill expands the scope of political contributions that qualify for the income tax credit for contributions to political campaigns to candidates for any state, county, municipal, or district office. It had its first hearing last June.

#### **Senate Bill 203 – Throw-Back Rule Reinstatement**

The bill would reinstate the municipal income tax "throw-back rule" used in apportioning business income among municipalities. The throw-back rule was eliminated with OMA backing during the budget bill process.

#### **House Bill 216 – Used Vehicle Trade-In Credit**

The bill authorizes a sales and use tax trade-in credit for purchases of used motor vehicles from a licensed dealer. The bill had two hearings prior to the summer break last year.

#### **House Bill 262 – Independent Budget Process**

The bill would provide for the preparation of a state biennial budget independent of that submitted by the Governor and to authorize the Legislative Service Commission, upon

the request of the Speaker of the House of Representatives or the President of the Senate, to arrange for an independent actuarial review of a proposed bill, specified analyses of economic policy initiatives and state benchmarking data, and a study of the state's long-range financial outlook. The bill was introduced and referred to committee last June.

#### Senate Bill 266 and House Bill 529 – Capital Bill

Earlier this year the House and Senate unveiled the capital appropriations budget bill. The bill is designed to fund capital improvement projects throughout the state. This year the bill focused on funding opioid treatment with \$222 million for health and human services projects.

Other major funding allocations included \$600 million for school construction, \$483 million for universities and community colleges, \$514 million for local infrastructure projects, \$234 million for parks, and \$147 million for local community projects.

The budget was quickly moved and approved in the spring.

#### Senate Bill 309 – Megaproject Business Tax Credits

The bill lengthens the maximum term of the job creation tax credit for businesses making substantial fixed asset and employment investments and for their suppliers. The bill also authorizes commercial activity tax exclusions for receipts of those suppliers from sales to such businesses, and to authorize local governments to grant longer term property tax exemptions for such businesses or suppliers. The bill is in response to large projects going out to bid like Foxconn and Amazon H2Q

#### House Bill 320 – Long-Range Financial Outlook Council

The bill creates the Long-Range Financial Outlook Council for the purpose of informing the public and the General Assembly about the financial status of the state by studying financial and other conditions and issuing an annual long-range financial outlook report. The bill had its second hearing in November.

#### House Bill 525 – Film Tax Credit-Live Theater

House Bill 525 would expand the current motion picture tax credit to live stage theater productions and increase the maximum amount of credits from \$40 million to \$100 million per fiscal year. The bill again is sponsored by Speaker Pro Tem Schuring which makes House passage a real possibility. The OMA testified questioning why Ohio would more than double the credit against the CAT. The House Finance Committee passed the bill last month. However instead of expanding the current amount from \$40 million to \$100 million, they instead only expanded the current amount to also cover live stage theater productions.

#### Capital Expenditure Investment Tax Credit

OMA tax committee members have been working on a capital expenditure tax credit bill that manufacturers could take advantage of in Ohio. OMA staff has been working with legislators for potential introduction this summer or fall. The most recent version of the credit is at LSC for redraft.

## **Tax News**

### **OMA Testifies on “Tax Expenditures”**

Testifying before a special Tax Expenditure Review Committee, OMA’s Rob Brundrett, Director, Public Policy Services, urged the committee to protect the sales and use tax manufacturing exemption.

“The rationale for these exclusions is simple: The taxes are intended to be imposed upon the final consumption of goods and now, those selected services that are subject to tax. Intermediate transactions prior to the final sale of the product, including the acquisition of machinery and equipment and the raw materials that are incorporated into the final product, are not intended to be taxed,” Brundrett said.

He recommended expansion of the exemption to: 1) temporary workers; 2) industrial janitorial and maintenance services; and 3) certain equipment and supplies used to clean food processing equipment.

The Tax Expenditure Review Committee met three times this spring reviewing a variety to tax exemptions.

### **U.S. Supreme Court Revisits Quill and Physical Presence**

OMA Connections Partner, Clark, Schaefer, Hackett (CSH), posts: “On April 17th, the U.S. Supreme Court revisited Quill Corp. v. North Dakota, which held that in order for a state to impose sales tax on an out-of-state seller, the seller must have physical presence in the state. The case is being reviewed again because the recent South Dakota v. Wayfair, Inc. suit is asking that the Quill decision be repealed.

“... The Quill standard has enabled online sellers to forego collecting and remitting sales tax in states where the seller has no physical presence. The potential revenue loss for the states in uncollected sales tax is enormous – in the billions of dollars. ...

“It is difficult to predict which way the Court will decide this case. But no matter their decision, it will be binding precedent across the country. Either the physical presence standard will continue to be the law and Quill will be upheld, or the Court will overturn Quill and set forth new nexus standards. A decision is expected sometime in June ...”

### **Muni Tax Collection System Found to be Constitutional**

A Franklin County Common Pleas Court judge dismissed a muni tax collection lawsuit brought by about 160 Ohio municipalities that challenged a new law that allows the State of Ohio to collect local business taxes.

House Bill 49, which was Gov. John Kasich’s two-year budget bill, allowed business owners the option to file municipal net profit tax returns directly with the Ohio Department of Taxation, instead of with the municipality in which the business operates.

OMA backed this law change because it streamlines the filing process for businesses, which often operate in multiple municipalities.

### **Tax Dept. Accepts OMA Request to Improve Mfg. Sales/Use Exemption**

The Ohio Department of Taxation (ODT) released its latest draft of the Manufacturing Sales and Use Exemption rule review.

Reacting to the previous draft, the OMA working group had advocated for removing this language (4th paragraph, division (B)(1)): “However, the maintain (sic) materials in the same state or form as they are received or measuring raw materials to verify quantities received, does not constitute commitment,” thus arguing for a complete definition of tax exempt materials committed to the manufacturing process.

Responding to the OMA’s comments, ODT agreed to remove the objectionable provision from the draft rule. Keeping that language out of the rule would be a major win for manufacturers.

#### OMA Requests Senator Brown’s Support on Money Market Reg Bill

The OMA asked Senator Sherrod Brown to support The Consumer Financial Choice and Capital Markets Preservation Act (Senate Bill 1117). The bill would reverse an October 2016 regulatory action by the Securities and Exchange Commission (SEC) that requires money market funds (MMFs) to account for their underlying net asset value (NAV) on a floating basis.

OMA wrote: “... This new SEC rule requires MMFs to account for their underlying net asset value (NAV) on a floating basis, rather from a fixed sum. This rule change has negatively impacted our larger members who issue commercial paper for short term borrowings.

“Prior to the rule change, the Prime MMFs were generally significant purchasers of commercial paper. These purchases provided a competitive market place for short term financing. ... Our members have relied on these fixed NAV MMFs as safe, efficient and reliable sources of short-term financing and cash management. ... Senate Bill 1117 would revert back to allowing MMFs underlying NAV to be fixed, as it was for 40 years prior to this recent SEC rule.”



**BEFORE THE GOVERNMENT ACCOUNTABILITY AND OVERSIGHT COMMITTEE  
OF THE OHIO HOUSE OF REPRESENTATIVES  
REPRESENTATIVE LOUIS BLESSING III, CHAIRMAN**

**TESTIMONY  
OF  
ROB BRUNDRETT  
DIRECTOR, PUBLIC POLICY SERVICES  
THE OHIO MANUFACTURERS' ASSOCIATION**

**MARCH 20, 2018**

Mr. Chairman and members of the Committee, my name is Rob Brundrett. I am the Director of Public Policy Services for The Ohio Manufacturers' Association (OMA). I am providing interested party testimony today on behalf of OMA regarding House Bill 525. The OMA was created in 1910 to advocate for Ohio's manufacturers; today, it has nearly 1,400 members. Its mission is to protect and grow Ohio manufacturing.

Manufacturing is the powerhouse in Ohio's economy. In addition to copies of my testimony I have provided committee members with a copy of "2017 Ohio Manufacturing Counts." This book is prepared annually by the OMA to provide facts about the importance of manufacturing to Ohio's economy.

Manufacturing is the largest of the state's 20 industry sectors. Manufacturing contributed more than \$108 billion in GDP in 2016, the most recent year represented in this publication. This amounts to nearly 18% of the state's economy. The second largest industry sector is government at 11%. Ohio is the third largest manufacturing state in the U.S. following only California and Texas.

Almost 700,000 Ohioans work in manufacturing and these workers earn an average \$58,000 per year.

For Ohio to be successful in a global economy, the state's tax structure must encourage investment and growth and be competitive nationally and internationally. A globally competitive tax system is characterized by (a) certainty, (b) equity, (c) simplicity and (d) transparency. Economy of collections and convenience of payment also are important considerations.

Major tax reforms approved by the Ohio General Assembly in 2005 and additional reforms from 2011-2016 have led to significant improvements to Ohio's tax system. Reforms included reducing overall tax rates, eliminating tax on investment, broadening the tax base, providing more stable and predictable revenues, and simplifying compliance.

The elimination of the tangible personal property tax, the corporate franchise tax, and the estate tax has strengthened the competitiveness of Ohio's tax system. So has the reduction of the personal income tax rate as well as the creation of a broad-based, low-rate commercial activity tax.

The strength of the CAT is its broad base, its low rate, and its broad application to virtually all business entities. Those attributes can only be maintained when the state stands firm against individual carve-outs and exemptions for narrow interests.

When it was first enacted, there were few exclusions and credits from the CAT. The tax expenditure associated with those exclusions in 2010, the first year the tax was fully phased in, totaled approximately \$300 million. Those exclusions were built into the tax as enacted and the 0.26 percent rate was established with those exclusions in mind.

In its fiscal year 2018 tax expenditure report, the Department of Taxation lists a larger number of exclusions and credits to the CAT. The total cost of those expenditures, without consideration of the credits, is more than \$700 million! Thus, in just a little more than 10 years, additional credits and exclusions were added to the tax that doubled the amount of the tax expenditure.

The CAT is a stable tax. Although it is a gross receipts tax that pyramids along the economic chain, it is tolerated because of its broad base and low, low rate. However tax expenditures associated with the tax have doubled. Chipping away at the base can only continue so long before an increase in the rate becomes the only way to continue to collect comparable revenues. Ohio traveled down this path before with the franchise and personal property taxes. Ohio should not venture down that path with the CAT.

The CAT was enacted as a tax on commercial activity. *All* enterprises engaged in such activity should pay the CAT; in fact, equality in the burden of taxation demands that they all remain subject to the tax. Exemptions, exclusions and credits violate the rule of equality and render the tax less clear, less fair and more complicated.

House Bill 525 more than doubles the amount of CAT credits available under the motion picture tax credit. The more credits that are added to the tax the more pressure is on the remaining businesses subject to the CAT. With more exemptions and credits, pressure builds to raise the low rate to make up for the loss in revenue. If you review the attachment I have included with my testimony you will see that enacting this credit would have the fourth largest impact to the CAT.

It is important to understand where CAT exemption savings are invested. Does that money stay in Ohio or does it go to outside interests in New York, California, or some other state? If Ohio is looking to drive business in Ohio it should be creating tax credits for capital projects in Ohio for the benefit of Ohioans. These types of projects require investment from local businesses already on the ground, and the business is much less likely to walk away from Ohio at the completion of the credit because it has invested capital in the state.

Since the enactment of tax reform in 2005, OMA has maintained a principled, consistent approach to tax policy in Ohio. That approach insists on certainty, equity, simplicity, and transparency. The erosion of the tax reform legislation, in the form of carve-outs and exclusions to the CAT, creates disparity by selecting winners and losers, renders the tax more complicated, and reduces transparency as it becomes more difficult to determine who is entitled to which exclusions.

Thank you very much for the opportunity to appear here today. I'd be pleased to try to answer any questions that you might have.

###



## Commercial Activity Tax Impact

The Commercial Activity Tax (CAT), which took effect on July 1, 2005, is an annual tax imposed on the privilege of doing business in Ohio and is measured by gross receipts from business activities in the state. The CAT applies to business entities with taxable gross receipts of more than \$150,000 per calendar year, and is levied on a tiered basis:

<u>Taxable Gross Receipts</u>	<u>CAT</u>
\$150,000 - \$1 million	\$150 minimum tax
\$1 million - \$2 million	\$800 plus 0.26% of gross receipts greater than \$1 million
\$2 million - \$4 million	\$2,100 plus 0.26% of gross receipts greater than \$1 million
\$4 million or more	\$2,600 plus 0.26% of gross receipts greater than \$1 million

### Impact on Manufacturers

According to Ohio Department of Taxation *Fiscal Year 2017 Commercial Activity Tax Returns* data, manufacturers are the second-largest group of CAT taxpayers, **representing 10.5% of all taxpayers** (retail trade is the largest). And yet . . .

- In terms of **CAT revenues** based only on the 0.26% CAT rate for gross receipts in excess of \$1 million, **manufacturers pay 28.2% of the state's total** – far more than any other group.
- In terms of **total CAT revenues** paid, including the minimum tax, manufacturers still pay the most as a group – **27.6% of all CAT before** credits and **24% of all CAT after** credits – generally twenty-two percent more than the next largest taxpayer group (retail trade).

*See next page for the financial impact of CAT exclusions, deductions and credits.*



**Foregone Revenue from CAT Exclusions, Deductions and Credits**

Below are estimates of revenue foregone in FY 2018 by the state General Revenue Fund from various CAT exclusions, deductions and credits.<sup>1</sup> Dollar amounts are millions.

Exclusion of first \$1 million of taxable gross receipts	\$252.2
Qualified distribution center receipts exclusion	\$169.0
Job creation credit	\$113.0
Job retention tax credit	\$63.6
Motion picture credit	\$40.0
Credit for increased qualified research and development expenses	\$36.9
Casino receipts in excess of "gross casino revenue"	>\$10.0 <sup>2</sup>
Agricultural receipts	\$8.0
Professional employer organization exclusion	\$7.2
Credit for net operating loss carry forwards and other deferred tax assets	\$4.5
State and federal cigarette tax exclusion	\$4.1
Motor vehicle transfer exclusion	\$2.3
Exclusion of real estate brokerage gross receipts not retained	\$1.7
Consumer product integrated supply chain exclusion	\$1.6
Exclusion of certain services to financial institutions	\$1.5
State and federal alcoholic beverage excise tax exclusion	\$1.3
Exclusion for tax differential of CAT/PAT for railroads	\$1.0
Anti-neoplastic drug exclusion	\$1.0
Exemption for pre-1972 trusts	<\$1.0 <sup>3</sup>
Horse racing taxes and purse exclusion	<\$1.0
Receipts from sale of uranium from qualifying uranium enrichment zone	<\$1.0
Providing public services exclusion	No Estimate Available
Petroleum receipts <sup>4</sup>	No Estimate Available
Ohio Historic Preservation Tax Credit Program	No Estimate Available

**Estimated Total Foregone Revenues**

**More than \$718.9 million**

NOTE: Actual total foregone revenues will be higher than estimated total foregone revenues, which reflect indefinite revenues for casino receipts and undetermined revenues for the public services exclusion, petroleum receipts and motion picture credit.

<sup>1</sup> Unless otherwise noted, the source for the data listed above is the Ohio Department of Taxation Tax Expenditure Report (Fiscal Years 2018-2019).

<sup>2</sup> Ohio Legislative Service Commission estimates foregone revenue from casino receipts in excess of "gross casino revenue" will be "tens of millions of dollars."

<sup>3</sup> The Ohio Department of Taxation Tax Expenditure Report provides only general "less than \$1 million" estimates for three items in this list (rather than precise estimates as provided for the other items). For this reason, we have chosen not to include any foregone revenue for the three items with estimated foregone revenues of less than \$1 million each.

<sup>4</sup> Motor vehicle fuel dealers pay a one-time tax of 0.65% on their sales of petroleum products.



**BEFORE THE TAX EXPENDITURE REVIEW COMMITTEE  
SENATOR SCOTT OELSLAGER, CHAIRMAN**

**TESTIMONY  
OF  
ROB BRUNDRETT  
DIRECTOR, PUBLIC POLICY SERVICES  
THE OHIO MANUFACTURERS' ASSOCIATION**

**APRIL 11, 2018**

Mr. Chairman and members of the Committee, my name is Rob Brundrett. I am the Director of Public Policy Services for The Ohio Manufacturers' Association (OMA). The OMA was created in 1910 to advocate for Ohio's manufacturers; today, it has nearly 1,400 members. Its mission is to protect and grow Ohio manufacturing.

Manufacturing is the powerhouse in Ohio's economy. In addition to copies of my testimony, I have provided committee members with a copy of "2017 Ohio Manufacturing Counts." This book is prepared annually by the OMA to provide facts about the importance of manufacturing to Ohio's economy.

Manufacturing is the largest of the state's 20 industry sectors. Manufacturing contributed more than \$108 billion in GDP in 2016, the most recent year represented in this publication. This amounts to nearly 18% of the state's economy. The second largest industry sector is government at 11%. Ohio is the third largest manufacturing state in the U.S. following only California and Texas.

Almost 700,000 Ohioans work in manufacturing and these workers earn an average \$58,000 per year.

### **Ohio's Sales and Use Taxes**

Ohio's sales tax was first enacted as a temporary measure in the depths of the Great Depression in the 1930s. At that time, it was conceived as a tax on final personal consumption of tangible goods. One year after initial enactment, the use tax was enacted; the two taxes were made permanent and the first exemption for machinery and equipment used to produce tangible personal property for sale by manufacturing was added. Similar exclusions were made for other activities that, similarly, resulted in the production of goods that would be subject to the tax upon final sale.

The rationale for these exclusions is simple: The taxes are intended to be imposed upon the final consumption of goods and, now, those selected services that are subject to tax. Intermediate transactions prior to the final sale of the product, including the acquisition of machinery and equipment and the raw materials that are incorporated into the final product, are not intended to be taxed. The basis for this is four-fold:

First, imposing the tax on intermediate transactions (sometimes called business inputs) causes the tax to be imposed at each step in the production of a good. This causes the tax to pyramid at each step of the economic ladder, resulting in an effective tax rate that may be much higher than the statutory rate. For example, in conjunction with the 1994 tax study commissioned by the General Assembly, the staff provided an example in which a sales tax rate of 6.5 percent applied to two stages of production resulted in an effective tax rate of 9.5 percent at the time of the final retail sale.<sup>1</sup>

Second, imposing the tax on business inputs increases the cost of doing business through the higher prices that result from the tax. Business generally will respond to higher costs in a combination of three ways: It may decide to charge higher prices; it may pay lower wages to workers (or expatriate those positions elsewhere); or it may provide a lower return on investment to owners.<sup>2</sup>

Third, direct inputs lead to the production of more valuable goods that are ultimately subject to the tax.

Fourth, the provision has economic development implications. Every single state that surrounds Ohio has a sales tax. Every one of those states has some sort of exemption from the tax for machinery and equipment used in the production of tangible goods to be sold by manufacturers. Moreover, the *1994 Study* also found that lower rates of taxation on business equipment increase the rate of business formation of smaller firms. Thus, imposing the sales tax on manufacturing machinery and equipment puts Ohio at a disadvantage from an economic development perspective.<sup>3</sup>

The application of sales and use taxes to business inputs has been the subject of comment on at least two prior occasions in Ohio. In 1982, the Final Report and Recommendations of the Joint Committee to Study State Taxes (114<sup>th</sup> General

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<sup>1</sup> Roy Bahl, Ed., *Taxation and Economic Development: A Blueprint for Tax Reform in Ohio* (Battelle Press 1994), p. 277-278 (the "1994 Staff Report").

<sup>2</sup> *Taxation and Economic Development in Ohio: A Blueprint for the Future*, Final Report of the Commission to Study the Ohio Economy and Tax Structure (December 23, 1994), p. iii ("1994 Study").

<sup>3</sup> *Id.*, at p. 5-4.

Assembly, December 1982), pp. 15-16 concluded that the taxes should be imposed broadly on consumer spending, but very selectively on business spending. Similarly, the *1994 Study* at p. 5-4 and the *1994 Staff Report* at p. 27 both recognized that the sales tax should only be imposed upon the final consumer and that business inputs should not be taxed at all. The taxation of business inputs should be avoided because doing so leads to multiple levels of taxation and economic disadvantages. Moreover, the *1994 Report* concluded that if the sales tax is extended to services, there should be liberal exemptions for transactions between businesses.

### **Manufacturing Exemptions for Tangible Personal Property are Not Absolute**

Manufacturers enjoy exemption for three categories of purchases:

- Machinery and equipment used primarily during and in the manufacturing process
- Ingredients and materials that are incorporated into the final product that is produced for sale
- Packages and packaging equipment

However, this does not mean that manufacturers do not pay sales and use taxes in Ohio. Manufacturers purchase and use many goods and services that are not included in the manufacturing exemptions. Those items include machinery and equipment that are used before manufacturing begins, or after it ends; cleaning equipment and supplies; maintenance and repair equipment and supplies; storage facilities; most safety items; and office supplies and equipment and motor vehicles. As a result, manufacturers pay millions of dollars in sales and use taxes annually to the state of Ohio.

According to the 2017 Annual Report of the Ohio Department of Taxation, manufacturers as an economic segment paid more than \$483 million in sales and use taxes directly to the state of Ohio. This is in addition to the untold millions of tax dollars that were paid to, and reported by, vendors and retailers located in Ohio. It appears that

in terms of tax directly owed to the state, as opposed to tax that is collected from others, manufacturing is one of the largest payers of sales and use taxes in the state.

### **The Exemption Should Not Be Repealed**

Repeal of the manufacturing exemption should not be considered.

First, repeal is contrary to the recent efforts of Ohio tax policy to move away from the taxation of economic investment and towards personal consumption. Manufacturers invest in manufacturing machinery and equipment in order to expand or maintain their capacity to provide jobs and to produce a product for sale, a product that in most cases will be subject to the sales and use taxes when it is sold and used.

Since 2005, Ohio has attempted to move away from the taxation of business investment. It eliminated the tax on business tangible personal property. It eliminated the net worth base of the corporation franchise tax. And, it excludes from the commercial activity tax receipts in the nature of a return on investment. As noted earlier in my remarks, the purchase of machinery and equipment by manufacturers is not final consumption. Rather, it reflects an investment in the business. The sales tax exemption for manufacturing machinery and equipment is consistent with this policy.

Imposing the sales tax on business inputs, including manufacturing machinery and equipment (and labor) is contrary to sound tax policy. As previous tax study commissions<sup>4</sup> have concluded, good tax policy is based on simplicity, equity, stability, neutrality and competitiveness. Removing the exemption and subjecting those purchases to tax will render the tax more opaque, more complex, and less fair as final consumers will pay an even higher proportion of their family income in sales taxes. Removing the exemption violates the principles of neutrality and competitiveness as it results in higher costs, which may influence economic decisions and competitiveness. Taken together, all these factors may in fact render the tax less stable.

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<sup>4</sup> 1994 Study, p. 5-1; *Report of the Committee to Study State and Local Taxes*, March 1, 2003, p. 6.

## **Exclusion of Services as Manufacturing Inputs**

There many additional cases in which the sales or use tax should be amended to exclude specific manufacturing service inputs. I'll briefly describe three specific recommendations involving: 1) temporary workers; 2) industrial janitorial and maintenance services; and 3) certain equipment and supplies used to clean food processing equipment.

**One**, Ohio does not impose sales or use taxes (or the CAT) on the wages paid to employees. Just as wages are not subject to such taxes, and business inputs, such as ingredients, machinery and equipment, are exempted from the sales and use taxes, so too should amounts paid for temporary employees engaged in manufacturing activities that are otherwise exempt from the tax. Such temporary employees are a business input; the sales tax should not apply to transactions by which such labor is obtained (See attached OMA House Bill 343 Testimony, 131<sup>st</sup> General Assembly).

**Two**, Ohio also taxes industrial janitorial and maintenance services. Manufacturers' production facilities and the equipment components of their production processes require continuous repair and maintenance. Without the required cleaning, repairs and maintenance the machinery breaks down and fails to produce acceptable products for sale to customers. Cleaning industrial assets is absolutely critical to the manufacturing process. It is a necessary business input and sales tax should not apply.

**Three**, Ohio law currently exempts the 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. This exemption was born out of a court case many years ago. This exemption is limited to one type of manufacturer who was party to that court case. However the reasons why the exemption makes sense to dairy manufacturers also apply to a variety of other food manufacturers who use clean-in-place technology to ensure that the food all of us eat is safe.

## **Conclusion**

In conclusion, the manufacturing exemption is founded on sound tax and economic policy. The sales and use taxes are intended to be taxes on ultimate household consumption; they are not intended to apply to business inputs or to intermediate transactions. Applying the taxes to transactions involving the investment in manufacturing machinery and equipment increases the cost of the goods that are produced, negatively impacts economic decisions, and may place Ohio at a disadvantage when it comes to economic development. That isn't good policy. It ought not to be the policy of Ohio.

Thank you. I'll be pleased to try to answer any questions you may have.



**BEFORE THE ECONOMIC AND WORKFORCE DEVELOPMENT COMMITTEE  
THE OHIO HOUSE OF REPRESENTATIVES  
REPRESENTATIVE NAN BAKER, CHAIR**

**HOUSE BILL 343  
TESTIMONY  
OF  
LUKE HARMS  
SENIOR MANAGER, GOVERNMENT RELATIONS  
WHIRLPOOL CORPORATION**

**NOVEMBER 18, 2015**

Chair Baker and members of the Committee, my name is Luke Harms. I'm Senior Manager of Government Relations at Whirlpool Corporation. Whirlpool is the number one appliance manufacturer in the world, with approximately 100,000 employees and 70 manufacturing and technology centers. Here in Ohio, Whirlpool has five manufacturing facilities with approximately 10,000 employees.

I'm testifying here today on behalf of The Ohio Manufacturers' Association (OMA) with respect to House Bill 343, which proposes to repeal the sales tax on employment services. The OMA was created in 1910 to advocate for Ohio's manufacturers; today, it has 1400 members. Its mission is to protect and grow Ohio manufacturing.

Today I will provide you with background information about the existing sales tax exemption provided to manufacturers with respect to the purchase and use of machinery and equipment used in a manufacturing operation to produce tangible personal property for sale. I will cover the sound policy reasons to extend such tax treatment to employment services.

### **Ohio's Sales and Use Taxes**

Ohio's sales tax was first enacted as a temporary measure in the depths of the Great Depression in the 1930s. At that time, it was conceived as a tax on final personal consumption of tangible goods. One year after initial enactment, the use tax was enacted; the two taxes were made permanent and the first exemption for machinery and equipment used to produce tangible personal property for sale by manufacturing was added. Similar exclusions were made for other activities that, similarly, resulted in the production of goods that would be subject to the tax upon final sale.

The rationale for these exclusions is simple: The taxes are intended to be imposed upon the final consumption of goods and, now, those selected services that are subject to tax. Intermediate transactions prior to the final sale of the product, including the acquisition of machinery and equipment and the raw materials that are incorporated into the final product, are not intended to be taxed. The basis for this is four-fold:

First, imposing the tax on intermediate transactions (sometimes called business inputs) causes the tax to be imposed at each step in the production of a good. This causes the tax to pyramid at each step of the economic ladder, resulting in an effective tax rate that may be much higher than the statutory rate. For example, in conjunction with the 1994 tax study commissioned by the General Assembly, the staff provided an example in which a sales tax rate of 6.5 percent applied to two stages of production resulted in an effective tax rate of 9.5 percent at the time of the final retail sale.<sup>1</sup>

Second, imposing the tax on business inputs increases the cost of doing business through the higher prices that result from the tax. Business generally will respond to higher costs in combination of three ways: It may decide to charge higher prices; it may pay lower wages to workers (or expatriate those positions elsewhere); or it may provide a lower return on investment to owners.<sup>2</sup>

Third, direct inputs lead to the production of more valuable goods that are ultimately subject to the tax.

Fourth, the provision has economic development implications. Every single state that surrounds Ohio has a sales tax. Every one of those states has some sort of exemption from the tax for machinery and equipment used in the production of tangible goods to be sold by manufacturers. Moreover, the *1994 Study* also found that lower rates of taxation on business equipment increase the rate of business formation of smaller firms. Thus, imposing the sales tax on manufacturing machinery and equipment puts Ohio at a disadvantage from an economic development perspective.<sup>3</sup>

The application of sales and use taxes to business inputs has been the subject of comment on at least two prior occasions in Ohio. In 1982, the Final Report and Recommendations of the Joint Committee to Study State Taxes (114<sup>th</sup> General

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<sup>1</sup> Roy Bahl, Ed., *Taxation and Economic Development: A Blueprint for Tax Reform in Ohio* (Battelle Press 1994), p. 277-278 (the "1994 Staff Report").

<sup>2</sup> *Taxation and Economic Development in Ohio: A Blueprint for the Future*, Final Report of the Commission to Study the Ohio Economy and Tax Structure (December 23, 1994), p. iii ("1994 Study").

<sup>3</sup> *Id.*, at p. 5-4.

Assembly, December 1982), pp. 15-16 concluded that the taxes should be imposed broadly on consumer spending, but very selectively on business spending. Similarly, the *1994 Study* at p. 5-4 and the *1994 Staff Report* at p. 27 both recognized that the sales tax should only be imposed upon the final consumer and that business inputs should not be taxed at all. The taxation of business inputs should be avoided because doing so leads to multiple levels of taxation and economic disadvantages. Moreover, the *1994 Report* concluded that if the sales tax is extended to services, there should be liberal exemptions for transactions between businesses.

### **Manufacturing Exemptions for Tangible Personal Property Is Not Absolute**

Manufacturers enjoy exemption for three categories of purchases:

- Machinery and equipment used primarily during and in the manufacturing process
- Ingredients and materials that are incorporated into the final product that is produced for sale
- Packages and packaging equipment

However, this does not mean that manufacturers do not pay sales and use taxes in Ohio. Manufacturers purchase and use many goods and services that are not included in the manufacturing exemptions. Those items include machinery and equipment that is used before manufacturing begins, or after it ends; cleaning equipment and supplies; maintenance and repair equipment and supplies; storage facilities; most safety items; and office supplies and equipment and motor vehicles. As a result, manufacturers pay millions of dollars in sales and use taxes annually to the state of Ohio.

According to the 2014 Annual Report of the Ohio Department of Taxation, manufacturers as an economic segment paid more than \$410,000,000 in sales and use taxes directly to the state of Ohio. This is in addition to the untold millions of tax dollars that were paid to, and reported by, vendors and retailers located in Ohio. It appears that in terms of tax directly owed to the state, as opposed to tax that is collected from others, manufacturing is one of the largest payers of sales and use taxes in the state.

## The Tax on Employment Services

Effective January 1993, in order to fill a hole in the state budget, employment services were added as a taxable service by a conference committee facing a midnight deadline to reach agreement on a new budget. A taxable “employment service” included any transaction in which a person provides personnel to perform work under the supervision or control of another, whether on a short- or long-term basis, where the personnel are paid by the person who provided them. The entire amount paid for the service served as the base on which the tax was calculated.

Originally, four categories of transactions were excluded from the definition. Those four categories include:

- Transactions between members of an affiliated group;
- Persons providing medical and health care services;
- Persons providing contracting and subcontracting services; and
- Persons assigned to another pursuant to a contract of at least a year in duration that specifies that each employee covered by the agreement is “permanently” assigned to the purchaser.

A fifth category, involving services that were resold, was later added to the statute.

The tax generated a great deal of revenue, more than was expected, and the Department became more and more aggressive when it came to auditing the issue. The result was increased uncertainty on the part of business and increased time and expense in litigation responding to the aggressive enforcement activities of the Department.

For example, many manufacturers had begun employing temporary labor as a means of providing extra flexibility in meeting their workforce needs. Whether on a “temp-to-hire” basis, or as a means of meeting temporary up-ticks in production activities, manufacturers increasingly turned to vendors of temporary employees to fill those needs. Not surprisingly, many of those manufacturers assumed that the existing manufacturing exemption, which exempted purchases of machinery and equipment

used to produce tangible personal property for sale in a continuous manufacturing operation, would also cover workers on the manufacturing floor that operated the exempt equipment. Manufacturers and other purchasers of employment services also believed that in appropriate circumstances the services would be resold. After protracted litigation, they were soon disabused of both notions.

Another area that served fertile for litigation was the exclusion for employees that were “permanently assigned” to the purchaser. As noted previously, there were two conditions to this exclusion. First, the employees had to be provided pursuant to an agreement of a least a year in duration. Second, the agreement had to “specify” that the employees were provided to the purchaser on a “permanent” basis.

This provision likewise resulted in a flood of litigation involving issues such as

- Whether the agreement had to be written, or whether an oral agreement would suffice.
- The length of the term of the agreement, especially those that renewed or were cancelable at will.
- The meaning of the requirement that employees be “permanently assigned” to the purchaser.
- Whether the mere recitation of language in a service agreement that employees were permanently assigned was sufficient; or whether the course of conduct between the parties also had to establish that the positions were indeed indefinite.

The Department of Taxation continues to pursue employment services aggressively. It argues that employee turnover is a sign that the employees are not permanently assigned. It also takes the position that an agreement must set forth the name of every employee covered by the agreement, and that if any of the employees provided under an agreement are not provided on an indefinite basis, then the entire agreement is tainted and none of the employees qualify for the exclusion.

In recent audits, the Department takes the position that virtually any transaction involving personnel was a taxable employment service. Thus, transactions in which outside consultants are retained to provide services, such as computer and software design, an engineer, or a skilled tradesperson, are routinely picked up on audit as employment services.

### **The Tax on Employment Services Should Be Repealed**

House Bill 343 proposes to do away with the tax on employment services completely. The bill deletes “employment services” from the list of taxable transactions in R.C. 5739.01(B)(3)(k); it deletes the definition of “employment services” found in R.C. 5739.01(JJ); and deletes reference to the provision in other statutes.

Repeal of this provision reflects sound policy.

First, repeal is consistent with the recent efforts of Ohio tax policy to move away from the taxation of economic investment and towards personal consumption. Manufacturers invest in manufacturing machinery and equipment in order to expand or maintain their capacity to provide jobs and to produce a product for sale, a product that in most cases will be subject to the sales and use taxes when it is sold and used.

Since 2005, Ohio has attempted to move away from the taxation of business investment. It eliminated the tax on business tangible personal property. It eliminated the net worth base of the corporation franchise tax. And, it excludes from the commercial activity tax, receipts in the nature of a return on investment, including labor costs. Repealing the sales tax on employment services is consistent with this policy.

Second, imposing the sales tax on business inputs, including manufacturing machinery and equipment and labor is contrary to sound tax policy. As previous tax study commissions<sup>4</sup> have concluded, good tax policy is based on simplicity, equity, stability, neutrality and competitiveness. Subjecting employment services to tax renders the tax more opaque, more complex, and less fair as final consumers who are less

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<sup>4</sup> 1994 Study, p. 5-1; *Report of the Committee to Study State and Local Taxes*, March 1, 2003, p. 6.

economically advantaged pay an even higher proportion of their family income in sales taxes. The tax on employment services violates the principles of neutrality and competitiveness as it results in higher costs, which may influence economic decisions and competitiveness. Taken together, all these factors may in fact render the tax less stable.

Just as wages are not subject to sales and use taxes; and business inputs, such as ingredients, machinery and equipment, are exempted from the sales and use taxes, so too should amounts paid for temporary employees engaged in manufacturing activities be excluded from the tax. Employees are a business input; the sales tax should not apply to transactions by which such labor is obtained.

Third, the provision has generated more and more litigation as the Department has taken increasingly aggressive positions with respect to it. The provision is neither clear, nor is it easy to administer.

Temporary employment services play a critical role for manufacturers. At Whirlpool, temporary employees help the company manage seasonal demand changes for appliances. For example, our KitchenAid small appliance factory in Greenville has much higher shipment levels in the months leading up to the holiday season and our major appliance factories in Clyde, Marion, Findlay and Ottawa also see a significant uptick in shipments in the summer, driven by increased home construction and renovations. Temporary employment services not only help us avoid layoffs, but they help recruit skilled workers, many of whom eventually become Whirlpool employees. We compete in a competitive global environment. The products we produce here in Ohio must compete every day with imported appliances from Mexico, China and many other countries.

In conclusion, the impact of H.B. 343, to repeal the imposition of sales and use taxes on temporary employment services is not only founded on sound tax and economic policy, but will help Ohio manufacturers like Whirlpool to remain globally competitive. The sales and use taxes are intended to be taxes on ultimate household consumption; they are not intended to apply to business inputs or to intermediate transactions. Applying

the taxes to transactions involving the investment in labor, especially in labor to operate manufacturing machinery and equipment increases the cost of the goods that are produced, negatively impacts economic decisions, and may place Ohio at a disadvantage when it comes to economic development. That isn't good policy. It ought not to be the policy of Ohio.

Thank you. I'll be pleased to answer any questions you may have.

## 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 ~~being manufacturing~~ manufactured 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. ~~However, the agitating or heating of raw materials to maintain these materials in the same state or form as received or measuring raw materials to verify quantities received, does not constitute commitment.~~ 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, ~~and 65.~~

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(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 and, solely for the purposes of division (B)(12) of section 5739.011, a person who meets all the qualifications of that division.

(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.

(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.

See examples 63 and 64.

(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,~~ and 54.

(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,~~ and 54.

~~(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)~~(9) 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 fibre-cast 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 annealing Lehr 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~~ for hand protection 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 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.~~

As part of the manufacturing process, welding robots are used throughout an assembly plant to weld the various components of the final product. Fumes created from the welding process contain harmful complex metal oxide compounds from consumables, base metals and the base metal coatings, creating safety concerns for employees throughout the manufacturing facility. Special ventilation and exhaust systems are installed in the direct vicinity of the welding operation to supply fresh air and exhaust the fumes containing the harmful components. The ventilation and exhaust equipment is not essential for purposes of continuing production, but merely is in place to help cleanse the environment of the manufacturing facility.

\* The special ventilation and exhaust systems are neither incorporated into machinery or equipment used in a continuous manufacturing operation and do not qualify as excepted safety equipment, nor totally regulate the environment in a limited area of the facility where such total regulation is essential for production to occur. As such, the systems are 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.

\* Any equipment or supplies used to clean the processing equipment, pipes, pumps, and tanks discussed above are not taxable because they are part of a continuous manufacturing operation to produce milk.

#### **Example 64**

An ice cream manufacturer purchases cream, skim 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.

\* Any equipment or supplies used to clean the freeze tunnel, processing equipment in the hardening room, and roller conveyors are not taxable because they are part of a continuous manufacturing operation to produce ice cream.

\* 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.

#### Example 65

A paving asphalt manufacturer purchases sand, stone, and asphalt cement from an outside source. The sand and stone are weighed as they are received to ensure the proper amount of product was received by the manufacturer and is subsequently stored in an outside storage area at the manufacturer's facility. The asphalt cement is stored in a tank that churns and heats the asphalt cement to ensure its viscosity. When the paving asphalt manufacturer is ready to produce asphalt, the sand and stone are moved by conveyor to a screening grate to be classified by size and the product may be subsequently crushed to the necessary levels. Once the sand and stone are at suitable sizes, the products (along with the resulting stone dust) are moved by conveyor to feeder bins, which measure the appropriate amount of each product based on the purpose of the resulting asphalt. Conveyors move the proper amounts of sand, stone, and stone dust to the dryer to remove humidity. Everything then goes into a mixer, including asphalt cement. The mixer empties directly into trucks that will deliver the asphalt to the paving site.

\* The scale that weighs the incoming sand and stone is taxable. This is an administrative process prior to the beginning of manufacturing to ensure the proper amounts of raw materials were received.

\* The initial storage tank for the asphalt cement and the equipment that churns and heats the asphalt in the storage tank are taxable because they do not change the asphalt cement into a different state or form from which it was received. It merely maintains the product in its original form.

\* The conveyors that take the sand and stone to be classified by size are taxable because the raw materials are not committed to the manufacturing process. The point of commitment is the screening grate.



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## Ohio Manufacturers' Association

Tax Counsel Report  
June 20, 2018  
By Justin D. Cook  
Bricker & Eckler LLP

### Administrative Actions:

The Ohio Department of Taxation (the "Department") proposed revisions to two commercial activity tax ("CAT") regulations:

- O.A.C. 5703-29-16 – the proposed change provides that when calculating the "Ohio delivery percentage" for purposes of the Qualified Distribution Center rules, the computation will be carried out to six decimal places (instead of four).
- O.A.C. 5703-29-14 – the proposed change adjusts the definition of "cash discounts" and adds various examples to the regulation.

The Department recently released statistics on the amount of funds collected through the Tax Amnesty Program, which ran from January 1<sup>st</sup> through February 15<sup>th</sup>. In all, the State collected about \$14.3 million in tax receipts, with sales and use tax comprising the largest share, followed by the CAT and individual income tax.

Ohio's Tax Expenditure Review Committee met on April 11<sup>th</sup> to consider the sales and use tax-exemption for manufacturers. Mr. Brundrett of the OMA gave testimony in support of this continued exemption.

### Judicial Actions:

#### Ohio Supreme Court

*Lafarge North America, Inc. v. Testa*, 2018-Ohio-2047, 2018 Ohio LEXIS 1437, issued by the Supreme Court on May 31, 2018, is the most recent decision involving the manufacturing exemption from Ohio sales and use tax. In *Lafarge*, the taxpayer processed slag from large mounds built-up over several decades (*i.e.*, "slag mountains") into pellets used for purposes that include road construction. Contrary to the BTA's prior decision, the Court held that the slag was committed to the manufacturing process, thus marking beginning of the taxpayer's continuous manufacturing operation, when large chunks of slag were broken off of the slag mountains and crushed by bulldozers. This overturned the BTA's decision, which previously held that the taxpayer's manufacturing process did not begin until after the broken

pieces of slag were delivered by truck to the taxpayer's mill for further processing.

*Navistar, Inc. v. Testa*, 2018-Ohio-1895, 2018 Ohio LEXIS 1274 involved the credit against the CAT for amortizable net losses under R.C. 5751.53. A taxpayer's potential credit (*i.e.*, the "amortizable amount") under the statute is adjusted by a "valuation allowance." In the present case, the taxpayer filed a timely amortizable amount report reflecting a valuation allowance calculated by the taxpayer. However, the taxpayer subsequently restated the financial statements upon which the valuation allowance was based. In calculating the taxpayer's credit, the Court held the tax commissioner may consider the taxpayer's restated financials. Consequently, based on the taxpayer's restated financials, the Court concluded the taxpayer's initial valuation allowance was not GAAP compliant.

*Dana Corp v. Testa*, 2018-Ohio-1561, 2018 Ohio LEXIS 878 also addressed the amortizable net loss credit. Specifically, the Court in *Dana Corp* interpreted R.C. 5751.53(F) relating to adjustments of the amortizable amount when a company undergoes a corporate reorganization. Dana Corp underwent a bankruptcy which resulted in the recognition of cancellation of debt income ("CODI"). Through bankruptcy proceedings, old Dana Corp transferred all of its net operating losses ("NOLs") to new Dana Corp for federal income tax purposes, subject to a reduction to account for recognition of CODI. Subsequently, the tax commissioner sought to reduce Dana Corp's potential amortizable amount by the same percentage that CODI reduced Dana Corp's NOLs for federal income tax purposes. Ultimately, the Court sided with Dana Corp, holding that "R.C. 5751.53 does not authorize an adjustment of the amortizable amount on account of the occurrence of a tax-free reorganization. Instead, division (F) first permits the credit to transfer in that limited context and then prescribes apportionment of the credit among successors to the extent that those successors obtain only a part, rather than all, of the NOLs of the predecessor." The Court further explained that the statute "calls for apportioning the amortizable amount if there is more than one successor; it does not call for reducing the amortizable amount itself."

*Arbors East RE, LLC v. Franklin Cty. Bd. of Revision*, 2018-Ohio-1611, 2018 Ohio LEXIS 885, provided that the BTA's refusal to allocate any portion of a recent bulk sale price to assets other than real estate was improper and based upon legal errors. While the BTA held as a matter of law that any allocation of a sale price to goodwill is improper, the Court clarified that when the record permits, the business value of a nursing home or congregate-care facility should be separated from its real estate value. The Court also confirmed that the allocation of a sale price is not prohibited merely because there is no documentation of an allocation contemporaneous with the sale—instead, after-the-fact appraisal evidence and testimony may be offered to show that the original allocation of a sale price on a conveyance-fee statement did not reflect the value of the real estate. Ultimately, this should prove to be a very favorable case for property owners.

*Lone Star Steakhouse & Saloon of Ohio, Inc. v. Franklin Cty. Bd. of Revision*, 2018-Ohio-1612, 2018 Ohio LEXIS 887, held that a facially qualifying sale enjoys a presumption of recency even when it occurs more than 24 months *after* the relevant tax-lien date. This is an important ruling, as it clarifies and distinguishes the well-established rule that a sale that occurs more than 24 months *before* the tax lien date should *not* be presumed to be recent.

### Ohio Court of Appeals

Nothing to report.

### Ohio Board of Tax Appeals

*Shapoval v. Testa*, BTA No. 2017-484, 2018 Ohio Tax LEXIS 625 (Feb. 26, 2018) involves R.C. 5739.02(B)(32), which exempts from sales tax the sale of vehicles used primarily to transport tangible personal property for hire. The BTA held that “evidence to indicate the actual miles logged by the subject vehicle and the percentage of miles attributable to the transportation of personal property for hire is *required*” to show the vehicle is used primarily in manner that qualifies for exemption. Thus, the case is instructive of the type of records taxpayers must maintain if planning to claim exemption.

*SMK Industries, LTD v. Testa*, BTA 2017-703, 2018 Ohio Tax LEXIS 997 (Apr. 30, 2018) addressed how gross receipts of a remote-seller of tangible personal property are situs for CAT purposes. The BTA held that situs depends on the “ultimate destination” of the goods, not upon which party designates the common carrier or where title technically passes under the terms of the sales contract.

*Palace Hotels, LLC v. Testa*, BTA No. 2016-1300, 2018 Ohio Tax LEXIS 474 (Mar. 5, 2018) involved use tax and the construction contract exemption. The taxpayer constructed a waterpark on the grounds of its hotel. The BTA agreed with the taxpayer’s challenge of the tax commissioner’s assessment, holding the items such as the plumbing, decking, electric, and foundation were real property under R.C. 5701.02, thus exempt from sales and use tax under R.C. 5739.01(B)(5). The BTA further stated that “because the services were part of the overall price for construction of the waterpark, we likewise find the professional engineering services...to be exempt.”

*USC Consulting Group LLC v. Testa*, BTA No. 2017-2246, 2018 Ohio Tax LEXIS 1361 (June 8, 2018) involved a CAT assessment for consulting services provided by taxpayer. The BTA upheld the Tax Commissioner’s assessment related to consulting services largely performed in Canada, but for which the benefit was received in Ohio.

### Tax Commissioner Opinions

Nothing to report.

### United States Supreme Court

We can expect a decision from the Supreme Court in *State of South Dakota v. Wayfair, Inc.*, 2017 S.D. 56 (Sept. 13, 2017) this June. As previously reported, on January 12, 2018, the United States Supreme Court granted a writ of certiorari in *Wayfair, Inc.* At issue is whether the Supreme Court will uphold its prior decisions that prohibit states from requiring sellers to collect and remit sales and use tax on the sale of goods in states where sellers have no physical presence.

## Tax

### Senate Votes to Make JobsOhio More Transparent

June 8, 2018

As session days run out, the Senate amended an unrelated bill to require greater transparency and accountability of JobsOhio, Governor Kasich's privatized economic development agency. The amendment supported by Auditor of State Dave Yost requires performance audits of JobsOhio every four years.

"JobsOhio is a quasi-public agency that exists to serve a public purpose for Ohioans," Auditor Yost said in a **press statement**. "The people of Ohio deserve a seat at the table. This amendment ensures that any performance audit of JobsOhio is completely independent." The amendment later won unanimous bipartisan support by the full Senate even though JobsOhio officials oppose the legislative mandate. Both Republican and Democrat gubernatorial candidates have called for improved transparency. *6/7/2018*

### Update on Uncertainties in New Tax Law

June 8, 2018

From OMA Connections Partner RSM: "Many taxpayers and their advisors are frustrated by the uncertainties created by a number of new provisions of the Tax Cuts and Jobs Act of 2017. Some uncertainties are unavoidable – such as whether the new 20 percent pass-through deduction and other individual provisions will be made permanent, or whether the 21 percent corporate tax rate, theoretically 'permanent,' will be increased by a later Congress.

"Other issues arise from the novelty of many of the new provisions, the existence of apparent gaps or possible errors in the expedited drafting process, and questions as to whether those gaps can or will be filled by technical corrections legislation, regulations or other IRS guidance. Alternatively, taxpayers and their advisors will simply have to deal with the statutory language as is, and make their best determination as to what Congress intended in any particular case."

**Read more.** *6/4/2018*

### Tax Implications of Foreign-Derived Intangible Income

June 8, 2018

Multinational automakers and suppliers may be able to reduce their tax rate by capitalizing on their foreign-derived income. Read a **post** from OMA Connections Partner, RSM. *6/4/2018*

### Complying with the EU General Data Protection Regulation

May 25, 2018

Here's an **infographic** from OMA Connections Partner, RSM, representing seven misconceptions about the General Data Protection Regulation (GDPR), a regulation in European Union (EU) law on data protection and privacy for all individuals within the EU. Companies that don't think they have EU data sometimes do. **Read more here.** *5/24/2018*

### The Facts about ESOPs

May 18, 2018

From OMA Connections Partner, GBQ Partners: "A large number of privately-held U.S. companies are owned by members of the "baby boomer" generation, and with these owners approaching retirement age, many are considering an Employee Stock Ownership Plan ("ESOP") as a way to easily liquidate their ownership while receiving "fair market value." An ESOP is a qualified retirement plan, similar to a 401(k), which allows the employees of a company to become owners of the stock of their employer."

See **some facts** gathered by GBQ about U.S. ESOP companies. *5/15/2018*

### IRS Sheds Some Light on Business Interest Expense Deductions

May 4, 2018

Here's a recent post from OMA Connections Partner, Clark, Schaefer, Hackett: "The Tax Cuts and Jobs Act (TCJA) imposes a limit on deductions for business interest for taxable years beginning in 2018. The limit, like other aspects of the law, has raised some questions for taxpayers. In response, the IRS has issued temporary guidance in Notice 2018-28 that

taxpayers can rely on until it releases regulations. While the guidance provides some valuable information, it also leaves some questions unanswered.”

Read **more from CSH here**. 4/30/2018

### **U.S. Supreme Court Revisits Quill and Physical Presence**

April 27, 2018

OMA Connections Partner, Clark, Schaefer, Hackett (CSH), posts: “On April 17th, the U.S. Supreme Court revisited *Quill Corp. v. North Dakota*, which held that in order for a state to impose sales tax on an out-of-state seller, the seller must have physical presence in the state. The case is being reviewed again because the recent *South Dakota v. Wayfair, Inc.* suit is asking that the Quill decision be repealed. “... The *Quill* standard has enabled online sellers to forego collecting and remitting sales tax in states where the seller has no physical presence. The potential revenue loss for the states in uncollected sales tax is enormous – in the billions of dollars. ...

“It is difficult to predict which way the Court will decide this case. But no matter their decision, it will be binding precedent across the country. Either the physical presence standard will continue to be the law and *Quill* will be upheld, or the Court will overturn *Quill* and set forth new nexus standards. A decision is expected sometime in June ...”

Read **more from CSH about the case here**. 4/24/2018

### **Reporting Unclaimed Funds: What Is Your Responsibility?**

April 27, 2018

All businesses that are located and/or operate in the state of Ohio are required to file an Annual Report of Unclaimed Funds with the division per Ohio Administrative Code Section 169.01.

A few points about businesses’ reporting requirements:

- There are no minimum reportable dollar amounts, except for unclaimed wages less than \$50.00.

- Businesses must file a report annually. Businesses not holding any unclaimed funds must still file a Negative (NONE) Report.

Learn **more here**. 4/25/2018

### **IRS Blended Tax Rate Guidance for Fiscal Year-end Corporations**

April 23, 2018

OMA Connections Partner, RSM, posted this Tax Alert: “The 21 percent federal corporate tax rate now in effect applies to tax years beginning after Dec. 31, 2017. Previously, the maximum federal corporate tax rate was 35 percent. For a corporation’s fiscal year or companies with tax years that begin before Dec. 31, 2017, but end after that date (an Affected Fiscal Year) – for example, a year beginning Oct. 1, 2017 and ending Sept. 30, 2018, – a blended rate applies.

“The IRS has released **Notice 2018-38**, explaining how to apply the blended rate under section 15 of the Tax Code, as well as news release **IR-2018-99**, conveying the basic message that for Affected Fiscal Years, the blended rate applies in lieu of either the new 21 percent rate or the tax rate applicable under old law.”

Read **more from RSM here**. 4/19/2018

### **OMA Testifies on “Tax Expenditures”**

April 13, 2018

Testifying before a special Tax Expenditure Review Committee, OMA’s Rob Brundrett, Director, Public Policy Services, **urged the committee** to protect the sales and use tax manufacturing exemption.

“The rationale for these exclusions is simple: The taxes are intended to be imposed upon the final consumption of goods and now, those selected services that are subject to tax. Intermediate transactions prior to the final sale of the product, including the acquisition of machinery and equipment and the raw materials that are incorporated into the final product, are not intended to be taxed,” Brundrett said.

He recommended expansion of the exemption to: 1) temporary workers; 2) industrial janitorial and maintenance services; and 3) certain

equipment and supplies used to clean food processing equipment. *4/11/2018*

### **Ohio Ranks 11th in Tax Burden**

**April 13, 2018**

Every year around tax filing day, the website WalletHub ranks the 50 states across the three

tax types of state tax burdens — property taxes, individual income taxes and sales and excise taxes — as a share of total personal income in the state.

This year **Ohio ranks 11th** (highest tax burden) among the states. The total tax burden is 9.48% in Ohio. That is higher than any of our surrounding states. In the Midwest, only Illinois and Minnesota are higher. *4/9/2018*

## Taxation Legislation

Prepared by: The Ohio Manufacturers' Association  
Report created on June 14, 2018

- HB11**      **INCORPORATING FEDERAL REVENUE CHANGES** (SCHERER G) To expressly incorporate changes in the Internal Revenue Code since February 14, 2016, into Ohio law.  
*Current Status:* 3/30/2017 - **SIGNED BY GOVERNOR**; eff. 3/30/2017  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-11>
- HB49**      **OPERATING BUDGET** (SMITH R) Creates FY 2018-2019 main operating budget.  
*Current Status:* 8/22/2017 - Consideration of Governor's Veto  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-49>
- HB61**      **TAX EXEMPTION-FEMININE PRODUCTS** (JOHNSON G, KELLY B) To exempt from sales tax the sale of tampons and other feminine hygiene products associated with menstruation.  
*Current Status:* 10/10/2017 - House Ways and Means, (Second Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-61>
- HB70**      **FUEL TAX TRANSPARENCY** (MERRIN D) To enact the "Fuel Tax Transparency Act" requiring stickers to be placed on retail service station pumps displaying the rates of federal and state taxes applicable to gasoline and diesel fuel.  
*Current Status:* 3/15/2017 - House Government Accountability and Oversight, (First Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-70>
- HB86**      **MINIMUM WAGE INCREASE** (SMITH K, CRAIG H) To increase the state minimum wage to ten dollars and ten cents per hour beginning January 1, 2019.  
*Current Status:* 2/28/2017 - Referred to Committee House Economic Development, Commerce and Labor  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-86>
- HB89**      **AUGUST SALES TAX HOLIDAY** (PATTERSON J, KELLY B) To provide for a three-day sales tax "holiday" in August 2017 during which sales of clothing and school supplies are exempt from sales and use taxes.  
*Current Status:* 2/28/2017 - Referred to Committee House Ways and Means  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-89>
- HB104**      **TAX REFUND ON BAD DEBTS** (SCHAFFER T) To allow vendors to receive a refund of sales tax remitted for bad debts on private label credit accounts when the debt is charged off as uncollectible by the credit account lender.  
*Current Status:* 4/17/2018 - Senate Finance, (First Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-104>
- HB133**      **DISASTER RELIEF ACT** (RYAN S) To create the Disaster Relief Act to exempt out-of-state disaster businesses and qualifying out-of-state employees from certain taxes and laws with respect to disaster work on critical infrastructure performed in this state during a declared

disaster.

**Current Status:** 6/7/2018 - Consideration of Senate Amendments; House Does Concur, Vote 87-0

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-133>

**HB155**      **VEHICLE TRAINING TAX CREDIT** (SPRAGUE R, HOWSE S) To authorize a tax credit for expenses incurred by an employer to train a commercial vehicle operator.

**Current Status:** 5/15/2018 - **BILL AMENDED**, House Ways and Means, (First Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-155>

**HB162**      **TAX CREDIT-SOUND RECORDING** (SMITH K, LATOURETTE S) To authorize a refundable income tax credit for individual investors in a sound recording production company equal to a portion of the company's costs for a recording production or recording infrastructure project in Ohio.

**Current Status:** 5/9/2017 - House Ways and Means, (First Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-162>

**HB173**      **IN-HOME EMPLOYEES TAX CREDIT** (LATOURETTE S, PATTON T) To provide that compensation paid to certain home-based employees may be counted for purposes of an employer qualifying for and complying with the terms of a Job Creation Tax Credit.

**Current Status:** 5/9/2017 - House Ways and Means, (First Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-173>

**HB177**      **TAX EXEMPTION-COMMUNITY GYMS** (WEST T) To exempt memberships to gyms or other recreational facilities operated by charitable organizations from sales and use taxation.

**Current Status:** 11/14/2017 - House Ways and Means, (Third Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-177>

**HB185**      **POLITICAL CONTRIBUTIONS TAX CREDIT** (HAMBLEY S) To expand the scope of political contributions that qualify for the income tax credit for contributions to political campaigns to candidates for any state, county, municipal, or district office.

**Current Status:** 6/6/2017 - House Ways and Means, (First Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-185>

**HB216**      **USED VEHICLE TRADE-IN CREDIT** (HAMBLEY S, BRINKMAN T) To authorize a sales and use tax trade-in credit for purchases of used motor vehicles from a licensed dealer.

**Current Status:** 6/6/2017 - House Ways and Means, (Second Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-216>

**HB243**      **FIREWOOD SALES TAX** (PATTERSON J, CERA J) To exempt from sales and use taxation the bulk sale of firewood and certain other heating fuels, and to reimburse the Local Government Fund and Public Library Fund and county and transit sales tax collections for the resulting revenue losses.

**Current Status:** 6/20/2017 - House Ways and Means, (First Hearing)  
**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-243>

**HB262**      **INDEPENDENT BUDGET PROCESS** (BUTLER, JR. J, ROMANCHUK M) To provide for the preparation of a state biennial budget independent of that submitted by the Governor and to authorize the Legislative Service Commission, upon the request of the Speaker of the House of Representatives or the President of the Senate, to arrange for an independent actuarial review of a proposed bill, specified analyses of economic policy initiatives and state benchmarking data, and a study of the state's long-range financial outlook.

**Current Status:** 6/20/2017 - Referred to Committee House Government Accountability and Oversight

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-262>

**HB314**      **LAW ENFORCEMENT TAX CREDIT** (SCHAFFER T) To allow an income tax credit for law enforcement officials who purchase safety or protective items to be used in the course of official law enforcement activities.

**Current Status:** 2/14/2018 - **REPORTED OUT AS AMENDED**, House State and Local Government, (Third Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-314>

**HB320**      **LONG-RANGE FINANCIAL OUTLOOK COUNCIL** (HAGAN C, ROEGNER K) To create the Long-range Financial Outlook Council for the purpose of informing the public and the General Assembly about the financial status of the state by studying financial and other conditions and issuing an annual long-range financial outlook report.

**Current Status:** 11/28/2017 - House Financial Institutions, Housing and Urban Development, (Second Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-320>

**HB337**      **TEXTBOOK SALES TAX EXEMPTION** (DUFFEY M) To exempt from sales and use tax textbooks purchased by post-secondary students.

**Current Status:** 2/20/2018 - **REPORTED OUT AS AMENDED**, House Ways and Means, (Fourth Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-337>

**HB342**      **LOCAL TAX ISSUES-ELECTION DATES** (MERRIN D) To permit local tax-related proposals to appear only on general and primary election ballots and not on an August special election ballot and to modify the information conveyed in election notices and ballot language for property tax levies.

**Current Status:** 4/18/2018 - **REPORTED OUT AS AMENDED**, House Government Accountability and Oversight, (Sixth Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-342>

**HB351**      **NOAA AND PHS TAX EXEMPTION** (PERALES R, BUTLER, JR. J) To require municipal corporations to exempt from taxation the military pay of members of the commissioned corps of the National Oceanic and Atmospheric Administration and Public Health Service.

**Current Status:** 6/6/2018 - **REPORTED OUT**, Senate Ways and Means, (Third Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-351>

- HB361**      **PROPERTY TAX COMPLAINTS TIMEFRAME** (GREENSPAN D) To increase the time within which boards of revision must decide property tax complaints.  
**Current Status:** 12/5/2017 - **REPORTED OUT**, House Government Accountability and Oversight, (Fourth Hearing)  
**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-361>
- HB371**      **TAXES ON UNSOLD PROPERTY** (MERRIN D) To exempt from property taxation the increased value of land subdivided for residential development until construction commences or the land is sold.  
**Current Status:** 3/1/2018 - Re-Referred to Committee  
**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-371>
- HB441**      **TAX RETURN-PREPAID CARD** (LANESE L, DEVER J) To allow the Department of Taxation to provide taxpayers who file electronic returns the option of receiving their income tax refund in the form of a prepaid card.  
**Current Status:** 4/10/2018 - House Government Accountability and Oversight, (First Hearing)  
**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-441>
- HB460**      **RIPARIAN BUFFERS-TAX EXEMPTION** (PATTERSON J, SHEEHY M) To exempt qualifying riparian buffers in the Western Basin of Lake Erie from property taxation, to reimburse local taxing units for resulting revenue losses, and to require soil and water conservation districts to assist landowners with the creation and maintenance of riparian buffers.  
**Current Status:** 2/13/2018 - House Energy and Natural Resources, (Second Hearing)  
**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-460>
- HB525**      **FILM TAX CREDIT-LIVE THEATER** (SCHURING K) To extend eligibility for the motion picture tax credit to certain live stage theater productions, to increase the maximum amount of credits that may be awarded from \$40 million to \$100 million per fiscal year, and to make other revisions to the law governing administration of the credit.  
**Current Status:** 5/22/2018 - **REPORTED OUT AS AMENDED**, House Government Accountability and Oversight, (Sixth Hearing)  
**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-525>
- HB529**      **CAPITAL APPROPRIATIONS** (RYAN S) To make capital appropriations and changes to the law governing capital projects and to make reappropriations for the biennium ending June 30, 2020.  
**Current Status:** 3/30/2018 - **SIGNED BY GOVERNOR**; eff. 90 days  
**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-529>
- HB545**      **SALES TAX AFTER PURCHASE** (ARNDT S) To authorize small retailers to remit sales

taxes when the retailer receives payment from the purchaser if the payment is received after the purchased item is delivered or the service is provided.

**Current Status:** 5/22/2018 - House Ways and Means, (Second Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-545>

**HB569 SALES TAX-BUSINESS ELECTRONIC SERVICES** (LIPPS S, REINEKE W) To modify the standard for determining when the sales and use tax applies to business-related electronic services that are provided together with other services.

**Current Status:** 4/10/2018 - Referred to Committee House Ways and Means

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-569>

**HB575 TAX CREDIT-VOLUNTEER FIREFIGHTER/EMS** (KELLER C, REZABEK J) To grant income tax credits to persons who serve as volunteer firefighters or emergency medical service technicians.

**Current Status:** 6/5/2018 - **BILL AMENDED**, House Ways and Means, (Third Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-575>

**HB606 TAX EXEMPTION-MAPLE SAP** (PATTERSON J, LATOURETTE S) To authorize a property tax exemption for land used for commercial maple sap extraction and to reimburse, up to \$3 million per year, local governments for revenue lost from the exemption.

**Current Status:** 5/15/2018 - Referred to Committee House Ways and Means

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-606>

**HB641 FORKLIFT TAX EXEMPTION** (ANTANI N) To exempt from sales and use tax things purchased by an interstate logistics business and used primarily to move completed manufactured products to the point from which they are shipped from a manufacturing facility and related power sources.

**Current Status:** 5/22/2018 - House Ways and Means, (First Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-641>

**HB670 MUNICIPAL TAX WITHHOLDING** (BARNES, JR. J) To enact the "Simplified Alternative Withholding Tax Compliance Act" authorizing an employer to enter into an agreement with a municipal tax administrator to prescribe, subject to certain parameters, the portion of nonresident employee wages that will be subject to the municipal corporation's income tax.

**Current Status:** 6/13/2018 - House State and Local Government, (First Hearing)

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-HB-670>

**SB9 AUGUST TAX HOLIDAY** (BACON K) To provide for a three-day sales tax "holiday" in August 2017 during which sales of clothing and school supplies are exempt from sales and use taxes.

**Current Status:** 6/13/2017 - **SIGNED BY GOVERNOR**; eff. 6/13/17

**State Bill Page:** <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-9>

- SB36**      **AGRICULTURAL COMPUTATION** (HITE C) To require that the computation of the capitalization rate for the purposes of determining CAUV of agricultural land be computed using a method that excludes appreciation and equity buildup and to stipulate that CAUV land used for a conservation practice or enrolled in a federal land retirement or conservation program for at least three years must be valued at the lowest of the values assigned on the basis of soil type.  
*Current Status:* 5/16/2017 - Referred to Committee House Ways and Means  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-36>
- SB65**      **ENERGY STAR TAX HOLIDAY** (BROWN E) To provide a three-day sales tax "holiday" each April during which sales of qualifying Energy Star products are exempt from sales and use taxes.  
*Current Status:* 3/22/2017 - Senate Ways and Means, (Second Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-65>
- SB114**      **CDL TRAINING TAX CREDIT** (HITE C) To authorize a tax credit for expenses incurred by an employer to train a commercial vehicle operator.  
*Current Status:* 5/3/2017 - Senate Ways and Means, (First Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-114>
- SB123**      **PROPERTY TAX COMPLAINT PROCESS** (COLEY W) To limit the right to initiate most types of property tax complaints to the property owner and the county recorder of the county in which the property is located.  
*Current Status:* 6/14/2017 - Senate Ways and Means, (Second Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-123>
- SB131**      **EMPLOYEE COMPENSATION-TAX CREDITS** (DOLAN M) To provide that compensation paid to certain home-based employees may be counted for purposes of an employer qualifying for and complying with the terms of a Job Creation Tax Credit.  
*Current Status:* 6/6/2017 - Referred to Committee House Ways and Means  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-131>
- SB132**      **TAX CREDIT-FOREIGN TRADE** (DOLAN M, EKLUND J) To establish a five-year pilot program whereby taxpayers with facilities in this state with activated foreign trade zone status may claim a nonrefundable commercial activity tax credit equal to the amount redeployed by the taxpayer to job creation and renewable energy resources.  
*Current Status:* 4/26/2017 - Referred to Committee Senate Ways and Means  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-132>
- SB147**      **OHIO RURAL JOBS ACT** (HITE C) To enact the "Ohio Rural Jobs Act" which authorizes a nonrefundable tax credit for insurance companies that invest in rural business growth funds, which are certified to provide capital to rural and agricultural businesses.  
*Current Status:* 9/27/2017 - Senate Ways and Means, (Second Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-147>

- SB176**      **MUNICIPAL INCOME TAX RESTRICTIONS** (JORDAN K) To prohibit municipal corporations from levying an income tax on nonresidents' compensation for personal services or on net profits from a sole proprietorship owned by a nonresident.  
*Current Status:* 9/7/2017 - Referred to Committee Senate Ways and Means  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-176>
- SB187**      **DELINQUENT MUNICIPAL INCOME TAXES** (EKLUND J, WILSON S) To allow municipal corporations to charge delinquent taxpayers the costs of collecting municipal income taxes regardless of whether the costs are incurred before or after a judgment is entered against the taxpayer.  
*Current Status:* 11/7/2017 - Senate Finance, (First Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-187>
- SB203**      **MUNICIPAL TAX RULE REINSTATEMENT** (DOLAN M) To reinstate the municipal income tax "throw-back rule" used in apportioning business income among municipalities.  
*Current Status:* 11/15/2017 - Referred to Committee Senate Finance  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-203>
- SB209**      **PROPERTY TAX EXEMPTIONS-TIF** (COLEY W, EKLUND J) To modify the conditions that determine the relative priority of property tax exemptions when a parcel subject to a tax increment financing arrangement concurrently qualifies for another exemption.  
*Current Status:* 10/25/2017 - Referred to Committee Senate Ways and Means  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-209>
- SB224**      **GOODS TAXATION-FOREIGN DELIVERY** (EKLUND J) To exempt from sales and use tax goods purchased by a foreign citizen or entity if the goods are in Ohio only temporarily for package consolidation before being delivered to a foreign address, and to declare an emergency.  
*Current Status:* 4/17/2018 - **SUBSTITUTE BILL ACCEPTED**, Senate Finance, (Third Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-224>
- SB266**      **CAPITAL BUDGET** (OELSLAGER S) To make capital appropriations and changes to the law governing capital projects and to make reappropriations for the biennium ending June 30, 2020.  
*Current Status:* 3/6/2018 - Senate Finance, (Third Hearing)  
*State Bill Page:* <https://www.legislature.ohio.gov/legislation/legislation-summary?id=GA132-SB-266>