

MEMORANDUM

TO: Robert A. Brundrett, OMA
FROM: Mark A. Engel, Bricker & Eckler LLP
DATE: April 20, 2017
RE: Proposed Changes to Manufacturing Rule

The Ohio Department of Taxation has proposed some changes to O.A.C. 5703-9-21, the sales tax manufacturing rule. Taxation has asked for comments about its proposed changes. At your request, we've reviewed the proposed changes, and offer a few comments for your consideration in respond

Ohio, like many states, provides an exemption from the sales tax for purchases of tangible personal property used in the process by which tangible personal property is produced for sale by manufacturing. For many years, this exemption was the subject of a good deal of litigation as to its application and scope. In an effort to provide more certainty and to reduce the amount of litigation, in 1989 the legislature enacted a sweeping revision to the manufacturing exemption.¹ At the same time, Taxation promulgated a rule providing guidance, including examples, relating to the application of this new rule.² Both of these provisions were the result of a lengthy process in which representatives of industry and Taxation met to hammer out provisions that would be acceptable to both parties. Although the result did not eliminate areas of contention entirely, the amount of litigation was significantly reduced.

As part of the required review of its rules, Taxation has proposed some revisions to the rule, and has asked for comments by April 28, 2017. This represents the first time since the rule was first promulgated in 1989 that changes have been proposed.

Some of the proposed changes are not material. For example, there is a minor wording change made in the second paragraph of division (A). The wording in the definition of a "manufacturer" found in division (B)(4) of the rule incorporates language relating to the exemption for qualified research and development equipment. Similarly, division (D)(8) of the rule is revised to exclude qualified research and development equipment from the provision that research and development equipment generally does not qualify for exemption and wording in Example 9 is revised slightly.

Other changes, although few in number, may be significant. The following suggested changes are substantive in nature:

¹ R.C. 5739.011.

² O.A.C. 5703-9-21.

1. Proposed changes in the fourth paragraph of division (B)(1), relating to the beginning of the manufacturing process and the commitment of materials to that process;
2. Proposed new division (C)(12) relating to equipment used to clean towels, linens, and other similar items provided as part of a laundry cleaning service;
3. Proposed new division (C)(13) relating to equipment used to clean processing equipment in manufacturing related to dairy products produced for human consumption;
4. Revision to Example 2 that add the words “measured and” to the example;
5. Example 54 is revised to address the exemption of qualified research and development equipment;
6. The addition of a statements of exemption in Examples 63 and 64 relating to cleaning dairy processing equipment; and
7. New examples 65 and 66 relating to the beginning point of manufacturing and safety equipment.

To the extent these changes are substantive in nature, they may have a profound impact on the industry and its needs to consider the changes and weigh in on them. That will be extremely difficult to do under the short time frame provided by Taxation for input.

More importantly, this represents the first time in almost 30 years that revisions to the rule have been proposed. The rule was crafted in a very deliberative and collaborative manner, and it has enjoyed relative success in achieving its goals of relative certainty and reduced litigation. In light of this history, it seems that taking a similar approach to any amendment to the rule would be advisable. The approach taken by Taxation is contrary to this history. It can only damage the good will and common understanding that were generated in the original process. The damage that may result from this unilateral and speedy action is foolish.

We’d suggest that representatives of Taxation and the manufacturing sector meet to discuss the issues that have led to these proposed changes and attempt to work out language to address those concerns. Sufficient time needs to be provided for such a process to work. Collaboration should be encouraged. This rule provided a good example of the success that collaboration can generate. That process should be continued, and not undone.