

Understanding the Manufacturing Sales Tax Exemption

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Department of
Taxation

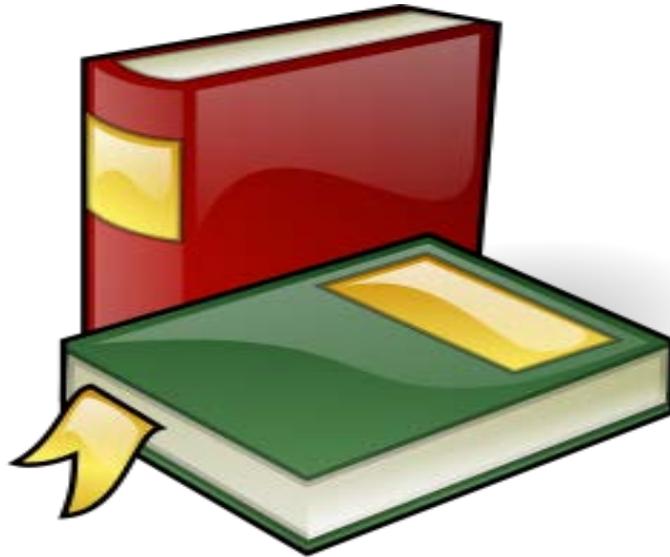
Agenda

- I. Manufacturing Exemption Overview
- II. Manufacturing Operation
- III. Items that Qualify for the Exemption
- IV. Items that Do Not Qualify for the Exemption
- V. Percentages of Taxability
- VI. Services and Software Related to Manufacturing
- VII. Research and Development
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Manufacturing Exemption Overview

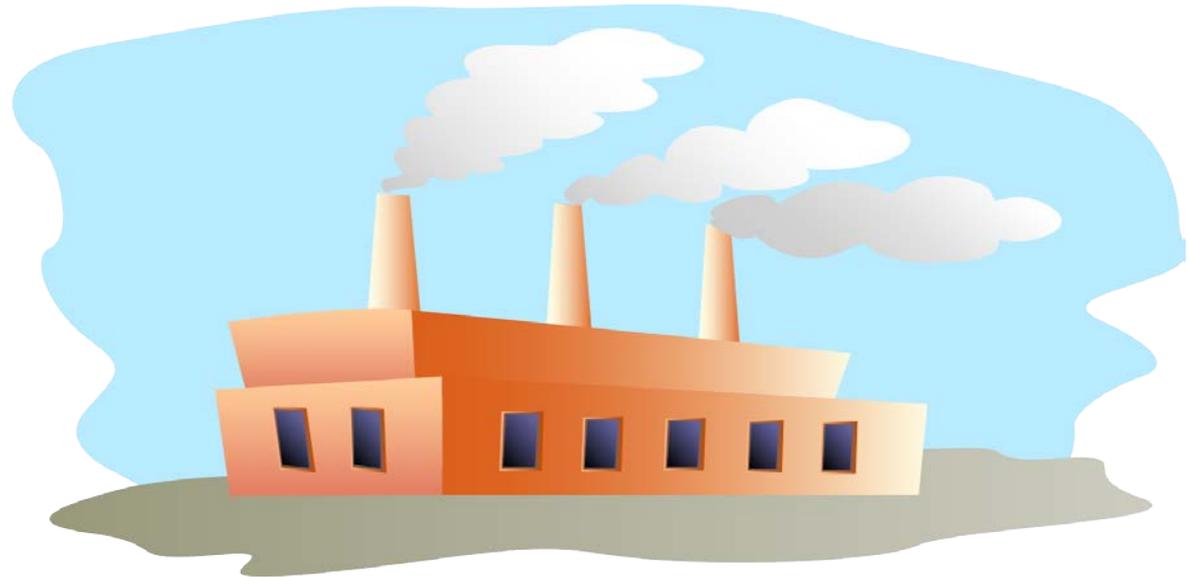
What is the Manufacturing Exemption?

- It is a statutory exemption from sales tax laid out in 5739.02 (B)(42)(g) for specific items used in a manufacturing process, as described in O.R.C. 5739.011



Who Qualifies?

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



Who Qualifies?

- Refining is defined in the Revised Code as removing or separating a desirable product from raw or contaminated materials by distillation or physical, mechanical, or chemical processes.
- Assembly and assembling is defined in the Revised Code as attaching or fitting together parts to form a product, but do not include a packaging product.

Who Qualifies?

- A manufacturer must be changing the state or form of a material in order to sell it
- Completing repairs of TPP owned by another party does not qualify

Who Qualifies?

- Per Ohio Administrative Code 5703-9-14 (F)(1), a taxpayer that operates as both a manufacturer and a contractor must elect to be treated as one or the other on the purchase of raw materials
- Example: Window manufacturer that also completes installation



Purchasing Qualifying Items Exempt

- Provide vendor an exemption certificate for items qualifying for the exemption

- The reason for exemption would be “Use in manufacturing”

Sales and Use Tax Unit Exemption Certificate

The purchaser hereby claims exception or exemption on all purchases of tangible personal property and selected services made under this certificate from:

_____ (Vendor's name)

and certifies that the claim is based upon the purchaser's proposed use of the items or services, the activity of the purchase, or both, as shown hereon:

Empty rectangular box for describing the proposed use of items or services.

Purchaser must state a valid reason for claiming exception or exemption.

Purchaser's name

Purchaser's type of business

Street address

City, state, ZIP code

Signature

Title

Date signed

Vendor's license number, if any

Vendors of motor vehicles, titled watercraft and titled outboard motors may use this certificate to purchase these items under the "resale" exception. Otherwise, purchaser must comply with either Administrative Code Rule 5703-9-10 or 5703-9-25.

This certificate cannot be used by construction contractors to purchase material for incorporation into real property under an exempt construction contract. Construction contractors must comply with Administrative Code Rule 5703-9-14.

Purchasing Qualifying Items Exempt

- This is not a blanket exemption for materials used in all aspects of a manufacturer's business
- Only items directly involved in the manufacturing process will qualify for exemption
- Some vendors will sell items used both in and outside the manufacturing process.

Manufacturing Operation

Manufacturing Operation

- This is defined in O.A.C. 5703-9-21 as “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.”

Beginning of the Manufacturing Operation

- Raw materials are committed to the manufacturing process when any of the following occur.
 - 1) Where materials handling from initial storage has ceased
 - 2) Where materials handling from the place of receipt ceases (w/o initial storage)
 - 3) Where materials have been mixed, measured, blended, heated, cleaned, or otherwise treated or prepared for the manufacturing process
 - 4) Different materials can have different points of commitment

Beginning of the Manufacturing Process

- Materials handling is defined in the Revised Code as 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.



End of the Manufacturing Operation

- The manufacturing operation has ended when the item being manufactured will have no further alterations to it and is considered to be a completed product (or finished good).

End of the Manufacturing Operation

- Completed product is defined in the Revised Code as a manufactured item that is in the form and condition as it will be sold by the manufacturer.

End of the Manufacturing Operation

- Packaging does not qualify for the manufacturing exemption, however, a specific packaging exemption exists under O.R.C. 5739.02 (B)(15)



Manufacturing Operation - Summary

- Exemption for manufacturing exists for items that have specific and direct interactions with the good in process between the beginning and the end of the manufacturing operation

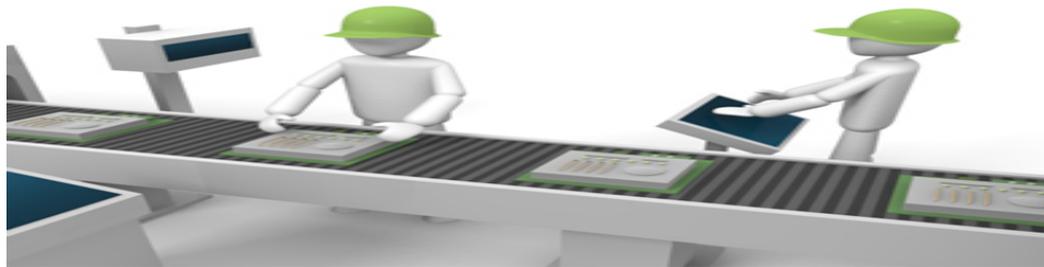
Items that Qualify for Exemption

Items that Qualify for Exemption

- Items that qualify for the manufacturing exemption include but are not limited to the following
- Production machinery and equipment that act upon the product
 - ✓ Also included are parts, components, and repair and installation services for such equipment

Items that Qualify for Exemption

- Materials Handling Equipment
 - ✓ Examples include forklifts, conveyors, pressurized piping, etc.
 - ✓ Fuel for such piping is also exempt



Items that Qualify for Exemption

- Catalysts, solvents, water, acids, oil, and similar consumables

Items that Qualify for Exemption – Consumables Example

- **Example:** 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.

Items that Qualify for Exemption – Consumables Example

- **Test Your Knowledge:**

1. In the preceding example, what would be the taxability of the solvent and acid used to clean the steel?
2. At what point would the manufacturing process be considered complete?
3. What would be the tax status of the oil that is added to the steel?

Items that Qualify for Exemption – Consumables Example

- **Answers:**

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

Items that Qualify for Exemption

- 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

Items that Qualify for Exemption – Control and Support Example

- **Example:** 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.

Items that Qualify for Exemption – Control and Support Example

- **Test Your Knowledge:**

1. What would be the taxability of the sensors in the furnace?
2. Do the control booth and equipment within qualify for exemption?
3. What is the tax status of the temperature graphing device?
4. Does the platform supporting the control booth qualify for exemption?

Items that Qualify for Exemption – Control and Support Example

- **Answers:**

1. The sensors in the furnace monitor production and are not taxable.
2. The control booth and the equipment and controls in it are not taxable.
3. The temperature graphing device which records the temperature data is taxable since it functions as a recordkeeping device.
4. The platform that supports the control booth is not taxable, since it supports the operator of production machinery.

Items that Qualify for Exemption

- 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

Items that Qualify for Exemption

- Equipment directly used in testing any of the following:
 1. Raw Materials
 2. The product being manufactured
 3. The completed product

Items that Qualify for Exemption

- Testing is defined in the Revised Code as a process or procedure to identify the properties or assure the quality of a material or product.
 - ✓ In order to qualify, the item in question must have direct involvement in completing the test.

Items that Qualify for Exemption

- 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
- Any source of fuel or power for machinery used in the manufacturing operation
 - ✓ Any equipment used by the manufacturer to generate such fuel or power is also exempt

**Items that Do NOT
Qualify for
Exemption**

Items that Do NOT Qualify for Exemption

Items that Do NOT qualify for the manufacturing exemption include but are not limited to the following

- Tangible goods used in administrative, inventory control, or similar functions
- Storage of raw materials prior to commitment to the manufacturing operation

Items that Do NOT Qualify for Exemption

- Equipment used for materials handling of raw materials prior to commitment to the manufacturing operation
- Equipment used for materials handling of finished goods
- Storage of finished goods
- Storage of process consumables

Items that Do NOT Qualify for Exemption

- Machinery, equipment and other tangible property used for ventilation, dust or gas collection, humidity or temperature regulation, or similar environmental control
 - ✓ Exception would be if it totally regulates the environment in a special and limited area necessary for production to occur
 - a) Clean room
 - b) Paint booth

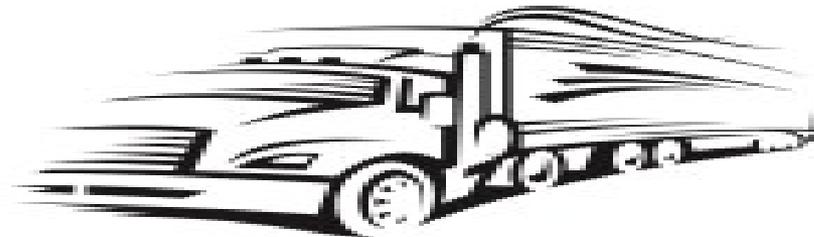
Items that Do NOT Qualify for Exemption

- Tangible Personal Property used for protection or safety of workers
 - ✓ Exception would be if the property were attached or incorporated into machinery and equipment used in the manufacturing operation



Items that Do NOT Qualify for Exemption

- Motor vehicles registered for operation on public highways
 - ✓ Vehicles moving goods between manufacturing facilities prior to Work in Process becoming finished goods would not qualify.



Percentages of Taxability

- Items used within the manufacturing process can be used in both a taxable and exempt manner
- Primary use for machinery
- Treatment of fungibles
- Items for which use is difficult to determine



Percentages of Taxability

- R.C. 5739.011(D)

A machine that is used by a manufacturer in both a taxable and exempt manner is treated as either totally taxable or totally exempt based upon its **quantified primary use**

- Examples from O.A.C. 5703-9-21

- Boilers
- Lift Trucks
- Refrigeration system



Percentages of Taxability

- *AeroQuip Corp. v. Tracy*, B.T.A. No. 97-T-1612 (2000)
- *AeroQuip Corp. v. Tracy*, B.T.A. No. 2000-S-161 (2002)

“Quantified” can be any measurement of use

Time of use

Amounts processed

Will vary according to item



Percentages of Taxability

- R.C. 5739.011(D)

Fungibles that are used in both a taxable and exempt manner shall be taxed upon the proportion of the fungibles used in a taxable manner

Percentage of taxability
determined by study completed
by ODT and taxpayer



Percentages of Taxability

- *B.F. Goodrich Co. v. Lindley*, 58 Ohio St.2d 364 (1979)

Coal and fuel used to power manufacturing equipment and heat buildings

Primary use test cannot be used to escape payment of tax by failing to separate fungibles

Percentages of Taxability

- Natural Gas
- Propane for forklifts
- Small parts and tools



Services & Software

Employment Services



Building Maintenance & Janitorial Services

Computer Services &
Software



Employment Services

- R.C. 5739.01(B)(3)(k) & (JJ)
 - supplying personnel, (temporary or long-term)
 - to perform work under another's supervision or control
 - personnel receive their compensation from the provider of the employment service

Employment Services

- R.C. 5739.01(JJ)(3)
 - Contract of at least one year
 - Contract specifies that each employee is assigned “permanently”



Employment Services

H.R. Options v. Zaino, 100 Ohio St.3d 373 (2004)

Permanent = Indefinite Period

No ending date

Not a substitute for employee

Not short term work

“The contract, along with the facts and circumstances of the assignment, should permit the Tax Commissioner’s agent to determine permanency.”

Employment Services

- *Bellemar Parts Industries, Inc. v. Tracy*, 88 Ohio St.3d 351 (2000)

Rejected resale exemption

Employment services are not a “thing transferred”

Specific services are listed per R.C. 5739.02(B)(42)



Building Maintenance & Janitorial

R.C. 5739.01(B)(3)(j)

Providing building maintenance and janitorial services is defined as a taxable sale

R.C. 5739.01(II)

Cleaning the interior or exterior of a building and any tangible personal property therein

- less than \$5,000
- establishment described in 21 U.S.C. 608



Building Maintenance & Janitorial

R.C. 5739.011(C)(8)

The “thing transferred” does not include machinery used to clean, repair or maintain real or personal property in the facility

Except as provided in R.C. 5739.011(B)(13)



Building Maintenance & Janitorial

- Clean-in-Place Systems

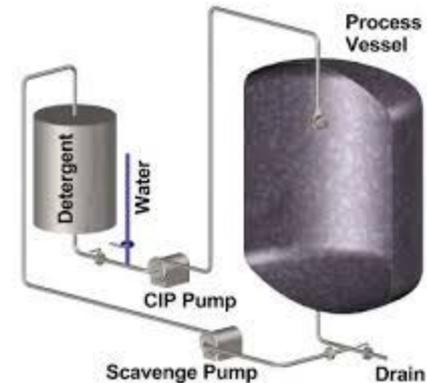
Do not qualify for the manufacturing exemption unless you are producing:

milk

ice cream

yogurt

cheese



Building Maintenance & Janitorial

- *The Dannon Company, Inc. v. Tracy*, B.T.A. No. 97-M-233 (1998)



Distinction between cleaning and necessary for the manufacturing process

Limited to certain yogurt production, but R.C. 5739.011(B)(13) exempts all dairy cleaning equipment

Computer Services & Software

Minco Tool & Mold, Inc. v. Limbach, B.T.A. No. 88-E-157
(1990)

Software that was used to control production machinery based upon CAD-CAM drawings qualified for the manufacturing exemption



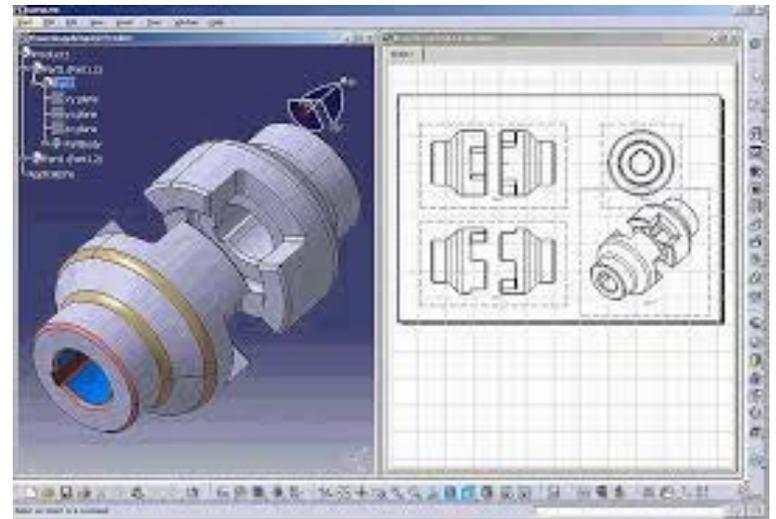
Computer Services & Software

Software that would not qualify for the exemption:

Monitoring Software

Product Design Software

Inventory Software



Research & Development

- R.C. 5739.02(B)(42)(i)
 - Exempts purchases where the purpose is to use the “thing transferred” as **qualified research and development equipment**
 - Not limited to manufacturers



Research & Development

- R.C. 5739.01(GG)
 - Research and development
 - Designing, creating new products, equipment or manufacturing processes
 - Conducting scientific experiments to increase scientific knowledge that might reveal new products, equipment or manufacturing processes



Research & Development

- R.C. 5739.01(HH)
 - Qualified Research and Development Equipment
 - Capitalized tangible personal property
 - Used to conduct research and development

Research & Development

Testing

Limited to manufacturers

Tangible personal property

Raw materials, in-process product, or completed product

R&D

Not limited

Capitalized items only

New products or processes and experiments

Miscellaneous

- *Q3 Stamped Metal, Inc. v. Zaino*, 92 Ohio St.3d 493 (2001)

“Otherwise necessary for the functioning of production machinery and equipment and the continuation of the manufacturing operation.”



Miscellaneous

R.C. 5739.031

Direct Payment Authority

Procedural Agreements Review



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