

Publications

Ohio Tax Reform: Focus on Sales and Use Tax, Oil and Gas Businesses

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Introduction

Ohio Governor John Kasich's FY 2014-2015 biennial budget bill (House Bill No. 59) was recently introduced. Within the bill are significant Ohio sales and use tax reform proposals.

Overview

Ohio currently imposes tax on sales and uses of all tangible personal property not otherwise exempt and on sales of approximately 20 specifically enumerated and defined services. Sales (including rental and lease) of real property, intangible property and non-enumerated services are not presently part of the definition of sale and therefore are not taxable. As such, no exemption currently needs to be applied to avoid sales or use tax on the purchase or use of these types of "things."

Services Generally

The bill abandons the approach of defining and listing specific services that may be taxed. Instead, it expands the definition of sale to include all services. The term "services" is defined broadly as "any act performed for another for a fee, retainer, commission or other consideration." There are several notable exclusions from this expansive definition including: medical and health care services; educational services; adult and child day care services; construction contractor services; funeral services; mining services; and services of an employee to his/her employer.

As a result, virtually all acts performed by any person, business, enterprise, joint venture, partnership, etc., for another in exchange for something of value would be a service subject to Ohio sales or use tax. Yes, this means *all* non-excluded services. If you can think of or describe an act rendered for a fee that is not expressly excluded, it's a taxable service under the bill. Many services never before taxed would be taxable under the proposed tax reform such as accounting, engineering, legal, banking, insurance, business consulting, advertising

(space and time), transportation, public utility, software engineering and management services.

Processing, Fractionating, Gathering, Refining and Transportation Services

Under the bill, sales of processing services, fractionating services, gathering services, refining services and transportation services, although never previously taxed in Ohio, would now be at risk of being subject to sales and use tax. This is tremendously important for oil and gas businesses. Will their activity be subject to sales tax when currently it is not?

Moreover, because the person rendering these services may not be considered to be selling tangible personal property to others, **equipment used in rendering these acts would be taxable when purchased.** Again, this is a crucial point to consider when budgeting for investment.

Drilling Services

Drilling services may be treated somewhat differently under the bill. One of the exclusions from the definition of “service” under the bill is for “services used directly in producing tangible personal property by mining.” “Mining” is not defined, but given the way in which “mining” is used with respect to other current sales and use tax exemptions, it is possible to infer that “mining” includes the production of crude oil and natural gas. Thus, an argument could be raised that drilling services are “mining,” and thus not taxable as services under the bill. This conclusion is less than clear, however, and the General Assembly should provide clarification.

Commercial Land Rents

In addition to the service exclusions listed above, the bill also excludes from the definition of services the rental of apartments, condominiums and houses to those using them as a primary domicile. The implication of this exclusion is that rental of commercial real estate is intended to be a taxable service. At the very least, it is logical to read the bill as treating the rental of commercial real estate as a sale of services subject to sales tax. This could increase the amounts paid by producers to land owners. Again, some clarification is needed.

Intangible Property – Royalties

The definition of sale would be expanded under the bill to include sales of intangible property. Sales or uses of trademarks, copyrights, patents, franchises and licenses will be taxable. The language in the bill also would seem to impose tax on sales in which royalty payments are made as well as sales of stock, bonds, commercial paper, money market funds, mutual funds and business investments of all kinds. This carries an obvious sales tax risk associated with royalty payments made to landowners for mineral rights.

Related Party Transactions

The bill provides no exemption for sales transactions between members of an affiliated group. Such affiliated members will be treated as strangers for purposes of Ohio sales and use tax. When we apply this concept to information already covered on the expansion of the tax base to services and intangible

property, the rendition of administrative, tax, legal, marketing, advertising, billing and purchasing services among affiliates (perhaps under the umbrella of a “management services fee”) will be taxable. Charges among affiliates for the use of trademarks, patents, franchises, licenses and copyrights also will be taxed. Charges for rental of commercial real estate among affiliates also will be taxed. These results will hit businesses with Ohio headquarters particularly hard.

Conclusion

The good news is the bill is just that, a bill. It is not clear whether all our conclusions are intended tax reforms or were drafting oversights. It is highly doubtful that the bill will become law in its current form. In fact, it likely will change. Clarifications are necessary, and persuading the General Assembly to clarify in a favorable way is possible. Each business should monitor the bill and start internal reviews for effects on both compliance and budgets.

We will be following the bill closely. If you have questions or concerns about Ohio sales or use tax matters, please contact one of our state and local tax attorneys.