

# Ohio AgriBusiness Association

## Preliminary Overview of the Sales Tax Provisions and Implications

In Ohio House Bill 59

Prepared on February 19, 2013

One of the more wide-ranging aspects of the tax measures included in the Governor's budget, H.B. 59, is the extension of the sales tax to virtually all services in Ohio. This represents a seismic shift in the taxation of services in Ohio, as under current law, services are generally exempt from sales tax unless they are specifically made subject to the tax. Under the proposal, all services will be subject to tax unless they are specifically exempted from the tax. This change may have some profound implications for all businesses that use professional services in Ohio.

### What is a "Service"?

The definition of a "sale" is expanded to include all transactions by which a service is, or is to be provided.<sup>1</sup> The term "service" means any act performed for another person for any type of consideration.<sup>2</sup> The bill specifically excludes from the tax the following services:<sup>3</sup>

Services Excluded from Sales and Use Tax	
Medical and health care services	Educational and tutoring services
Real property construction services	Lease of residential property that is a primary residence
Obtaining insurance	Adult and child care services
Services to produce tangible personal property by mining	Residential trash pick-up and disposal
Services rendered by employees to employers	Funeral services
Social assistance services	

<sup>1</sup> H.B. 59, as introduced, lines 103735-103736

<sup>2</sup> Id., lines 104151, 104212-104215

<sup>3</sup> Id., lines 104216-104244

It will be presumed that all other services are subject to tax. The person who provides the service will have to register as a vendor, collect the tax from its customers, and remit the tax to the state.

### **What is a “Consumer”?**

A “consumer” is the person who receives the benefit of a service and is the person who is liable for the tax on the services that it receives.

The proposed structure for tax on services contrasts with Ohio’s current approach to sales tax on tangible property. Generally, in the case of a person making sales of tangible items, purchases of items that are resold, or that are incorporated into property to be resold, are not subject to the tax. H.B. 59, however, provides that a person who makes sales of services is the consumer of any service used in performing the service and that the purchase of services by such a person is not subject to the resale exception.<sup>4</sup>

In addition, the current law regarding the farming and manufacturing exemptions, for example, is limited to transfers of tangible property and does not include services that are used in the course of those activities. These exemptions have not been updated to account for the taxation of services. These provisions mean that a person obtaining services to help it provide services to others would have to pay sales tax on the services that it acquired, as well as charge sales tax on the services that it performs. Similarly, farmers and manufacturers will have to pay tax on services and intangibles used in their farming and manufacturing operations. Thus, the treatment of intermediate purchases of services does not appear to track the treatment of intermediate purchases of tangible property. It is unclear whether this disparity is intentional.

### **Services Among Related Parties**

Another change proposed in H.B. 59 that will be significant for many business organizations affects “related parties.” Under current law, there is an exclusion from the tax for certain services, such as electronic information services<sup>5</sup> and employment services<sup>6</sup> that are provided to other members of a related group. H.B. 59 appears to delete this exclusion, so that service transactions between members of a related group are now subject to the tax. As a result, business organizations that have shared services agreements among legal entities within the organization, or that have created separate legal entities to provide services to other entities within the organization, may be required to pay tax on those services.

### **Intangible and Digital Products**

The bill also subjects to the tax sales of intangible property<sup>7</sup> and digital products.<sup>8</sup> Payments for licenses to use trademarks, copyrights, patents, and other intangibles, for example, will be subject to the tax.<sup>9</sup> The term “digital products” includes digital audio works, such as video clips;

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<sup>4</sup> Id., lines 103920-103924

<sup>5</sup> Id., lines 103697-103705

<sup>6</sup> Id., lines 104445-104446

<sup>7</sup> Id., lines 103737-103739

<sup>8</sup> Id., lines 103766-103768

<sup>9</sup> Id., lines 104839-104845

digital audio works, such as sound recordings; and digital books, including any work that is generally recognized as a book.<sup>10</sup> Again, the person paying for the right to use intangibles, or to obtain a digital product, will be required to pay sales tax on the transaction.

### **Location of the Sale**

In addition to state-wide sales tax, counties and transit authorities may also impose local sales tax at various rates. Therefore, it becomes important to determine where a sale takes place for both state and local tax purposes so that the correct tax can be collected and paid to the state.

Under existing law, there are some general guidelines as to where a sale takes place, using a cascading model to determine where the service is deemed to occur:<sup>11</sup>

- The general rule is that if a consumer receives a service at the vendor's place of business, the vendor's place of business is the location of the transaction.
- If the service is not received at the vendor's place of business, the place at which the customer receives the benefit of the service is the location of the service.
- If neither of these two rules applies, the transaction is located at the address of the consumer, if known, or at the place from which the service was provided, if the address is not known.

With respect to many services and customers, it may be especially difficult for a vendor to determine the location at which a sale takes place where the customer has multiple locations. There is no guidance in H.B. 59 regarding the location of the "service". If the bill is enacted, we would expect this type of guidance to come through rules or other communications from the Department of Taxation.

### **Responsibilities for Payment and Collection of the Tax**

If the bill becomes law, persons who provide services will have to register as vendors and will be required to charge and collect tax from their customers, and pay the tax over to the state. Consumers who are not charged the tax by their vendors will be required to register and to self-pay the tax directly to the state. A vendor may not absorb the tax and pay it on behalf of a consumer. Finally, if tax is not collected on a transaction, both the consumer and the vendor may be pursued for the tax.

### **Income Tax Reduction**

The bill also makes two major changes in the personal income tax. First, the bill reduces all rates by 20% over three tax years, beginning with 2013. When the reductions are fully phased in, in 2015, the top marginal rate will have been reduced from 5.925% to 4.74%.

In addition, owners of pass-through entities may deduct one half of their share of the net business income of the pass-through entity, up to \$375,000, from their Ohio taxable income. If the bill is enacted as introduced, this change will be effective for the 2013 tax year.

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<sup>10</sup> Id., lines 104778-104793

<sup>11</sup> Id., lines 107043-107079

## **Concluding Comments**

As a reminder, this overview reflects our current understanding of certain provisions of H.B. 59. In the coming days, we will learn more about these issues, and will try to update interested parties. It is very possible that further information may lead us to revise our analysis, and that the legislation will be amended as it moves through the General Assembly.

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