

COURT OF APPEALS PAVES THE WAY FOR RESALE  
OF TRAFFIC CONTROL EQUIPMENT, EXPANDS  
AFFILIATE DEFINITION AND REMANDS CASUAL  
LEASE ISSUE

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The Ninth District Court of Appeals rendered its decision in *Karvo Paving Co. v. Testa*, 2019-Ohio-3974 on September 30, 2019, addressing three sales tax issues and one jurisdictional issue.

Karvo Paving Co. (Karvo) is a road construction company owned by George Karvounides that provides and installs traffic control equipment (barrier walls, temporary traffic lights, signs and message boards) to the Ohio Department of Transportation (ODOT) as required by ODOT's contract. Karvo rented the equipment that it provided and installed from a related entity, K&H Excavating, LCC (K&H). K&H was an entity formed by Mr. Karvounides and his wife. K&H also provided employees to Karvo that were treated as employment services by the Ohio Department of Taxation.

### Sales Tax Issues

First, *Karvo* paves the way for claiming the resale exception for traffic control equipment purchased by highway contractors. The Commissioner argued that Karvo used the traffic control equipment itself in providing its road construction services. The Court affirmed the decision of the Ohio Board of Tax Appeals (BTA), which held that the traffic control equipment was rented by Karvo to ODOT. The Court based its decision on the fact that ODOT took possession of the traffic control equipment to protect drivers from going into the work-zone.

Second, *Karvo* provides guidance on what type of ownership/control creates an “affiliate” relationship for purposes of the affiliate exclusion for employment services found in Ohio Revised Code (R.C.) 5739.01(JJ)(4). The affiliate exclusion excludes employment service transactions between members of an affiliated group. R.C. 5739.01(B)(3)(e) provides that an affiliate group means:

two or more persons related in such a way that one person **owns or controls** the business operation of another member of the group. In the case of corporations with stock, one corporation owns or controls another if it owns more than fifty per cent of the other corporation’s common stock with voting rights. (emphasis added)

Mr. Karvounides owned 100% of *Karvo* and owned 45% of *K&H*. Mr. Karvounides’ wife owned the other 55% of *K&H*. Mr. Karvounides testified that he controlled *K&H* even though he was not the majority owner. The Court relied on such testimony and agreed with the BTA’s finding that such control created the following affiliated group – Mr. Karvounides, *Karvo* and *K&H*. Since *K&H* was an LLC, the greater than 50% ownership test found in R.C. 5739.01(B)(3)(e) did not apply since that test only applies to corporations. As a result, sales of employment services between *K&H* and *Karvo* qualified for the affiliate exclusion found in R.C. 5739.01(JJ)(4).

Third, *Karvo* overturned the BTA’s finding that certain excavation equipment purchased by *K&H* and leased to *Karvo* was not subject to the casual sale exemption found in R.C. 5739.02(B)(8) and remanded this issue to the BTA. *K&H* purchased excavation equipment from a previous owner around 2000. *K&H* utilized such equipment to provide site excavation services. After a few years, *K&H* stopped performing site excavation services and leased the excavation equipment to *Karvo*. *Karvo* argued that the casual sale exemption applied to the lease of such equipment from *K&H*.

R.C. 5739.02(B)(8) provides an exemption from sales and use tax relating to casual sales. “Casual sale” is defined in R.C. 5739.01(L) to mean:

a sale of an item of tangible personal property that was obtained by the person making the sale, through purchase or otherwise, for the person’s own use and was previously subject to any state’s taxing jurisdiction on its sale or use, and includes such items acquired for the seller’s use that are sold by an auctioneer employed directly by the person for such purpose, provided the location of such sales is not the auctioneer’s permanent place of business. \*\*\*

The Commissioner argued that (i) *K&H* only leased equipment, (ii) there is no concept of “casual leases” in R.C. 5739.01 and (iii) *Karvo* failed to demonstrate that sales tax was previously paid on the equipment. The BTA found that the casual sale exemption did not apply because *K&H*’s business was limited to leasing equipment during the audit period. The Court found that there is no time limit to determine if a purchase qualifies for the casual sale exemption and that *K&H* initially purchased such equipment to provide excavation services. The Court

further found that the BTA did not address the Commissioner's second and third arguments so the Court declined to address those arguments. As a result, the Court remanded this matter to the BTA to re-examine whether the excavation equipment is exempt under R.C. 5739.02(B)(8).

### **Jurisdictional Issue**

The Commissioner argued that the Ninth District Court of Appeals did not have jurisdiction over the appeal and instead the Tenth District Court of Appeals had jurisdiction over the appeal. Karvo argued that because it is a corporation and its principal place of business is in Summit County, the Ninth District Court of Appeals had jurisdiction over the appeal.

R.C. 5717.04 provides that the jurisdiction for an appeal of the BTA is as follows:

The proceeding to obtain a reversal, vacation, or modification of a decision of the board of tax appeals determining appeals from final determinations by the tax commissioner of any preliminary, amended, or final tax assessments, reassessments, valuations, determinations, findings, computations, or orders made by the commissioner, and final determinations of a local board of tax review created under section 718.11 of the Revised Code, shall be by appeal to the supreme court or to the court of appeals for the county in which the property taxed is situated or in which the taxpayer resides. **If the taxpayer is a corporation, then the proceeding to obtain such reversal, vacation, or modification shall be by appeal to the supreme court or to the court of appeals for the county in which the property taxed is situated, or the county of residence of the agent for service of process, tax notices, or demands, or the county in which the corporation has its principal place of business.** In all other instances, the proceeding to obtain such reversal, vacation, or modification shall be by appeal to the court of appeals for Franklin county. (emphasis added)

The Commissioner relied on *Stines v. Limbach*, 61 Ohio App.3d 461 (10<sup>th</sup> Dist. 1988), which held that the "other instances" language in R.C. 5717.04 (last sentence of R.C. 5717.04 above) controlled when the tax at issue is a sales tax. As a result, The Court in *Stines* determined that the Tenth District Court had jurisdiction to hear the appeal.

In *Karvo*, the Ninth District Court disagreed with the Tenth District Court's interpretation and concluded that since Karvo was a corporation and its principal place of business was Summit County (see bolded language above), the Ninth District Court has jurisdiction to hear the appeal.

Please note that the State has until October 30, 2019 to file an appeal to the Ohio Supreme Court. Since the appeal is from a court of appeals decision, the Ohio Supreme Court does not have to accept the appeal.

**If you have any questions regarding the Karvo case or any other state and local tax matter, please contact [John Trippier](#), [Rich Farrin](#) or any other [ZHF professional](#).**

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