

# OHIO SUPREME COURT PROVIDES GUIDANCE ON EMPLOYMENT SERVICES AND MANUFACTURING

DECEMBER 11, 2017



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MEMBER

On December 6, 2017, the Ohio Supreme Court issued its opinion in *Accel, Inc. v. Testa*, Slip Opinion No. 2017-Ohio-8798, affirming the decision of the Ohio Board of Tax Appeals (BTA), which held that Accel, Inc.’s (Accel) operations constituted assembling and therefore qualified for the manufacturing exemption from sales and use tax. The Court also affirmed the BTA’s decision relating to purchases of staffing services, finding that the purchases from Resource Staffing were not taxable because they qualified for the exclusion found in R.C. 5739.01(JJ)(3) – the personnel were assigned on a permanent basis under a contract for at least one year.

## **BTA Standard of Review**

Initially, the Court addressed the proper standard of review in appeals from the tax commissioner to the BTA. The tax commissioner argued that the BTA erred by substituting its factual findings for that of the tax commissioner, rather than giving deference to the tax commissioner’s factual findings under a “clearly unreasonable or unlawful” standard. The Court rejected that argument, holding that the BTA’s standard for reviewing the tax commissioner’s factual findings is *de novo*, and that the BTA owes no deference to the tax commissioner’s findings. Under this standard, a taxpayer need only present evidence proving that the tax commissioner’s findings were incorrect.

## Assembly

Accel produces gift sets for customers (retailers and other manufacturers) through a three-stage process—a design phase, a planning phase, and an assembly phase. The Court determined that Accel’s process met the definition of assembling—putting together components into a new functional (or in this case aesthetic) whole. While the Court agreed that Accel’s operations involved packaging (as defined by the statute) the gift sets, the Court held that the packaging was an incidental function to Accel’s assembly of a new and differently marketable product. As a result, Accel was entitled to the manufacturing exemption for its purchases of materials used and incorporated into the gift sets.

## Staffing Services

Accel purchased staffing services from both Resource Staffing and Manpower, which the tax commissioner determined under audit were taxable purchases of employment services<sup>1</sup>. In its decision, the BTA found that the purchases from Resource Staffing were excluded from sales tax because the purchases qualified for the exclusion found in R.C. 5739.01(JJ)(3) – the personnel were assigned on a permanent basis under a contract for at least one year. The BTA found that Accel failed to present evidence sufficient to establish that the purchases of staffing services from Manpower qualified for the R.C. 5739.01(JJ)(3) exclusion.

The Court affirmed the BTA’s decision finding that the purchases from Resource Staffing qualified for the R.C. 5739.01(JJ)(3) exclusion. The tax commissioner argued that the contract must state that the personnel are “permanently assigned” for the exclusion to apply. The Court rejected this argument, stating that the Court has previously provided a facts-and-circumstances test to determine if the R.C. 5739.01(JJ)(3) exclusion applies (see *H.R. Options, Inc. v. Zaino*, 100 Ohio St.3d 373, 2004-Ohio-1, 800 N.E.2d 740 and *Bay Mechanical & Elec. Corp. V. Testa*, 133 Ohio St.3d 423, 2012-Ohio-4312, 978 N.E.2d 882).

The tax commissioner next argued that the employee assignments were seasonal or designed to meet “short-term workload conditions,” which the Court indicated in *H.R. Options* would not qualify as a permanent assignment. The tax commissioner argued that the “labor force fluctuates with the seasons,” as demonstrated by the heaviest spending on employee labor from August through December.

Through testimony, Accel explained that:

- It sought to have employees return for job after job once they had been

<sup>1</sup>See R.C. 5739.01(B)(3)(k) and 5739.01(JJ) - (JJ) “Employment service” means providing or supplying personnel, on a temporary or long-term basis, to perform work or labor under the supervision or control of another, when the personnel so provided or supplied receive their wages, salary, or other compensation from the provider or supplier of the employment service or from a third party that provided or supplied the personnel to the provider or supplier. “Employment service” does not include: \*\*\*\*(3) Supplying personnel to a purchaser pursuant to a contract of at least one year between the service provider and the purchaser that specifies that each employee covered under the contract is assigned to the purchaser on a permanent basis.

- trained;
- During periods when less work was available, hours would be reduced instead of discharging the staff person;
- Of the 647 persons supplied from 2006 to 2011, 358 of those persons worked more than a year at Accel; and
- Resource Staffing would not reassign personnel placed with Accel to other clients when the workload at Accel decreased.

Based on the fact that Accel retained the same personnel through high-activity and low-activity periods (even though there was fluctuation throughout the year), the BTA rejected the argument that the personnel were seasonal employees. The Court agreed, finding that:

“Ultimately, the distinction between seasonal or short-term-workload employment and more regular employment is one of degree, not of kind. In every enterprise, the workload may experience periods of ebb and flow. It seems entirely reasonable, therefore, that what matters in an ebb-and-flow business for purposes of R.C. 5739.01(JJ)(3) and our precedents is the continuity of the workforce, i.e., are the same workers having their hours adjusted or are new workers being brought in to handle the extra work during the busy season only? Based on Lluberes’s testimony, the BTA found the former to be true. Under H.R. Options, bringing back the same workers each time with differing hours is consistent with permanent assignment; using new workers just for a brief workload spike is not.”

Based on *Accel, Inc. v. Testa*, we can take away the following as it relates to employment services:

1. The Court has reasserted that the test to determine whether the exclusion found in R.C. 5739.01(JJ)(3) applies is based on the facts and circumstances of the contract and the actual performance of such contract. The test is not whether the “magic words” are present in the contract; and
2. The mere fact that there is fluctuation in staffing purchases does not by itself negate the R.C. 5739.01(JJ)(3) exclusion. Understanding a company’s business operations and how the staffing personnel are used will be important factors in determining whether the personnel are permanently assigned, thus qualifying for the exclusion.

If you would like to discuss the *Accel* opinion, any sales and use tax manufacturing issues or any sales and use tax employment services issues, please contact John Trippier, Rich Farrin or any of the other professionals at Zaino Hall & Farrin LLC.

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