SALT BUZZ$_{HF}$

Ohio BTA Rejects Tax Commissioner's Overly Narrow View of Where Manufacturing Begins

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The Ohio Board of Tax Appeals (BTA) reversed the Department's interpretation of where manufacturing begins for sales tax purposes in *Marion Ethanol, LLC (et. al.) v. McClain*, BTA Case Nos. 2017-337 and 2017-338 (May 16, 2019). Marion Ethanol, LLC (Marion) operates biorefineries that manufacture ethanol and other corn-based products, including animal feed, corn oil, and wet and dry distillers grains. The process to produce the ethanol and other corn-based products begins with corn, the primary raw material, being delivered to Marion's facilities where it is tested for quality, moisture, and temperature. Accepted corn is emptied into sub-grade hoppers that funnel the corn to a conveyer. The corn is transported on the conveyer past a strong magnet designed to remove any metal contaminants. The corn continues on the conveyer to bins designed to hold the corn. The corn is deposited into the bins based on certain qualities, such as moisture content. The corn is then emptied from the bins and proceeds to a scalper, a rotating bin that removes debris (corn cobs, sticks, leaves and stalks) from the corn.

The case involved the sales tax exemption for items used primarily in a manufacturing operation, provided by R.C. 5739.02(B)(42)(g). The Department

argued that manufacturing begins at the scalper. Marion argued that manufacturing begins at the magnet. The BTA agreed with Marion, relying on the Ohio Supreme Court's recent decision in *Lafarge N. Am., Inc. v. Testa*, 153 Ohio St.3d 245, 2018-Ohio-2047. The BTA determined that the magnet refines (defined as "removing or separating a desirable product from raw or contaminated materials by distillation or physical, mechanical, or chemical processes") the corn and, therefore, manufacturing begins at the magnet. The BTA further noted that the corn was committed to the manufacturing process at the magnet due to the integrated nature of the manufacturing operation.

Marion also argued that because sodium hydroxide, which is used throughout the manufacturing process to remove excess starch and proteins, is added to animal feed produced at Marion's facilities the sodium hydroxide should be exempt. However, during the use tax audit, Marion executed a Letter of Agreement that 95% of the sodium hydroxide was used directly in cleaning. Marion argued that it was not bound by the Letter of Agreement based on language contained in the agreement – "the agreement does not constitute an admission of any tax liability nor waive the right for taxpayer to appeal this or any provision of the review." The Tax Commissioner argued that Marion was bound by the agreement.

The BTA agreed with the Tax Commissioner relying on the Ohio Supreme Court's decision in *Shugarman Surgical Supply v. Zaino*, 97 Ohio St.3d 183, 2002-Ohio-5809, which provided that while a taxpayer may not like the results obtained by its agreement with the commissioner, such fact does not invalidate the agreement. As a result, 95% of the sodium hydroxide was held taxable.

ZHF Observation: This decision (and many others that precede it) highlights the importance of analyzing any audit-related agreements presented during an audit prior to signing them. Some clients have a policy to not sign any agreements as part of an audit. Care should be taken before adopting such a blanket policy, as businesses may be forced to automatically give up certain benefits resulting from such agreements.

Please keep in mind that *Marion* can still be appealed by either party within 30 days from the date of the decision.

If you have any questions regarding this case or any other state and local tax issue, please contact Richard Farrin, John Trippier or any other ZHF professional.

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