

OHIO BOARD OF TAX APPEALS

REDFLEX TRAFFIC SYSTEMS, INC., (et. al.),

CASE NO(S). 2012-2997

Appellant(s),

(USE TAX)

vs.

DECISION AND ORDER

JOSEPH W. TESTA, TAX COMMISSIONER OF
OHIO, (et. al.),

Appellee(s).

APPEARANCES:

For the Appellant(s)

- REDFLEX TRAFFIC SYSTEMS, INC.
Represented by:
MARK ENGEL
BRICKER & ECKLER LLP
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For the Appellee(s)

- JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO
Represented by:
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COLUMBUS, OH 43215

Entered Friday, October 24, 2014

Mr. Williamson, Mr. Johrendt, and Mr. Harbarger concur.

Appellant appeals from a final determination of the Tax Commissioner wherein he affirmed a use tax assessment issued against appellant resulting from an audit of its purchases for the period of January 1, 2001 through December 31, 2007. The matter is considered upon the notice of appeal, the statutory transcript ("S.T.") certified by the commissioner, the record of the hearing before this board ("H.R."), and the parties' briefs.

Appellant was assessed on its purchases of "electronic camera parts and equipment, mounting equipment and cabinet housing" used in the vehicle monitoring and enforcement services it provided to seven municipalities in Ohio. S.T. at 1. Pursuant to contracts with each of the municipalities, appellant designs, installs, maintains, and uses the equipment to monitor speed and/or red-light traffic violations and allow the municipalities to issue citations for such violations. H.R., Exs. 5-11. Although appellant made several arguments against the assessment in its petition for reassessment, the commissioner focused on its argument that the property in question was resold to the municipalities and therefore not subject to sales and use taxes, and that the property was incorporated into other property and therefore subject to the sales tax exemption applicable to manufacturing. The commissioner found neither argument availing, affirmed the assessment, and denied appellant's request for remission of the associated penalty based on appellant's percentage of compliance and audit responsiveness. We specifically note that this board does not have

jurisdiction to consider any argument raised by appellant before this board regarding the application of R.C. 5739.02(B)(42)(g), as it was not previously raised before the commissioner. *CNG Dev. Co. v. Limbach* (1992), 63 Ohio St.2d 28.

Appellant thereafter appealed to this board. At this board's hearing, appellant presented the testimony of two of its employees regarding the functioning of its systems and its relationships with its customers, and the testimony of a representative of one of its customers, the City of Columbus, Ohio.

In our review of this matter, we are mindful that the findings of the Tax Commissioner are presumptively valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121. Consequently, it is incumbent upon a taxpayer challenging a determination of the commissioner to rebut the presumption and to establish a clear right to the requested relief. *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138. In this regard, the taxpayer is assigned the burden of showing in what manner and to what extent the commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213. We further note that "[s]tatutes relating to exemption or exception from taxation are to be strictly construed, and one claiming such exemption or exception must affirmatively establish his right thereto." *Natl. Tube Co. v. Glander* (1952), 157 Ohio St. 407, paragraph two of the syllabus. See, also, *Ball Corp. v. Limbach* (1992), 62 Ohio St.3d 474; *Highlights for Children, Inc. v. Collins* (1977), 50 Ohio St.2d 186.

Pursuant to R.C. 5739.02, an excise ("sales") tax is levied upon "each retail sale made in this state." By virtue of R.C. 5741.02, a corresponding tax is imposed upon the storage, use, or consumption in this state of any tangible personal property when tax was not paid to a seller, unless the property would be exempt from the imposition of the sales tax. "Sale" is defined as "[a]ll transactions by which title or possession, or both, of tangible personal property, is or is to be transferred, or a license to use or consume tangible personal property is or is to be granted" for a consideration. R.C. 5739.01(B)(1). However, R.C. 5739.01(E) further defines "retail sale" as "all sales, *except those in which the purpose of the consumer is to resell the thing transferred or benefit of the service provided*, by a person engaging in business, in the form in which the same, or is to be, received by the person." Appellant argues that its arrangements with its seven municipal customers in Ohio are such that it re-sells the subject property to the municipalities, and therefore, it is not subject to use tax. In the final determination, the commissioner initially noted that some of the purchased materials "were combined and imbedded within asphalt and attached to poles and wires in the customer's jurisdiction," and, therefore, were not transferred in the same form as received. S.T. at 2.

Further, the commissioner found that no sale occurred, despite appellant's argument that it transferred a limited license to use the property to its customer jurisdictions. Specifically, the commissioner found that the contracts with appellant's customers granted them a right to access and use appellant's *system*, rather than the tangible personal property itself. He further found that appellant failed to demonstrate any separate consideration for the property, apart from the service appellant provides. Citing *Emery Industries, Inc. v. Limbach* (1989), 43 Ohio St.3d 134, the commissioner found that the true object of the transactions between appellant and its customers was service, and therefore there was no resale of the property itself.

On appeal, appellant argues that contracts with five of its seven customer municipalities specifically grant a limited license to use appellant's system, including its tangible and intangible property. In the remaining two contracts, appellant argues that, despite specific language, the contracts clearly indicate a limited license to use. In all instances, appellant argues that the contracts are supported by consideration in the form of appellant's receipt of a portion of the fine revenue from each jurisdiction pursuant to each contract. The commissioner responds by arguing that it is the appellant, not the municipalities, that actually uses the property at issue. He argues that the evidence indicates that appellant designs the systems, installs the equipment, maintains and repairs the equipment, insures and indemnifies the equipment, and ultimately uses the equipment to issue notifications to the customer pursuant to its specific requests. Appellee's Brief

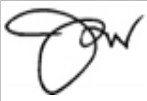


at 22. Indeed, testimony elicited at this board's hearing indicated that appellant's customers primarily use the system as a whole to (1) review potential violations, (2) authorize the issuance of citations, and (3) print copies of content created by the system. H.R. at 313, Ex. 10 at 8-9.

Upon review of the evidence before us, we agree that, despite any contract language regarding a limited license to use appellant's system, the property at issue in this matter is not resold to appellant's customers. Its customers have virtually no interaction with the subject property after the initial consultation about its placement and design. Appellant retains exclusive title and possession of the property. Ex. 10; H.R. at 175-176, 222-223. Appellant continues to maintain and upgrade the property after installation. Its customers merely respond to notifications by appellant that potential violations have occurred, or seek to access the information appellant's system has acquired. Therefore, any use of the system is by appellant. Its customers merely contract for the services appellant provides with the assistance of the subject property. We therefore find that the property was not re-sold and does not qualify for the exception from "sale" found in R.C. 5739.01(E). See *Laurel Transportation, Inc. v. Zaino*, 92 Ohio St.3d 220, 2001-Ohio-167; *Fliteways v. Lindley* (1981), 65 Ohio St.2d 21.

We next turn to appellant's argument that, if the subject property is not resold, it undergoes a change in state or form such that it qualifies for the exemption from the sales tax in R.C. 5739.02(B)(42)(a) applicable to manufacturing. R.C. 5739.02(B)(42) exempts from the sales tax "sales where the purpose of the purchase is *** (a) To incorporate the thing transferred as a material or a part into tangible personal property to be produced for sale by manufacturing, assembling, processing, or refining ***." R.C. 5739.01(S) defines "manufacturing" as "a process in which materials are changed, converted, or transformed into a different state or form from which they previously existed." R.C. 5739.01(R) defines "assembling" as "attaching or fitting together parts to form a product," excluding packaging. Upon review of the processes for design and installation of appellant's systems for its customer jurisdictions, we find no evidence that the requisite change, conversion, or transformation takes place such as to render the process "manufacturing" under Chapter 5739. Further, we are not persuaded that the property is assembled to form a product. As explained above, it is clear that the product appellant is providing is a service through use of its camera and vehicle monitoring equipment. It is not the assembling of the various materials installed at its customers intersections that forms that product.

In consideration of whether the instant penalty should have been abated, we look to the court in *Jennings & Churella Constr. Co. v. Lindley* (1984), 10 Ohio St.3d 67, which held "[r]emission of the penalty is discretionary. *** Appellate review of this discretionary power is limited to a determination of whether an abuse has occurred. ***" Id. at 70. In determining whether an abuse of discretion has occurred, we are guided by the court's pronouncement in *J.M. Smucker, L.L.C. v. Levin*, 113 Ohio St.3d 337, 2007-Ohio-2073, ¶16 ("Under that standard of review [i.e., an abuse of discretion], it is [an appellant's] burden to show 'more than an error of law or judgment'; the appellant must show that in denying the abatement, the Tax Commissioner's 'attitude is unreasonable, arbitrary or unconscionable.'"). See, also, *Huffman v. Hair Surgeon, Inc.* (1985), 19 Ohio St.3d 83. In this instance, upon review of the record, we find no evidence that the commissioner abused his discretion in failing to abate the subject penalty.

Other arguments raised by appellant in the notice of appeal that were not pursued, either at this board's hearing or by way of written argument, are considered a failure by appellant to meet its burden of proof regarding such issues. Based upon the foregoing, we find that appellant has failed to meet its burden of proof in establishing that the tax commissioner's determination was in error. Accordingly, we find that the final determination of the tax commissioner must be, and hereby is, affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Williamson		
Mr. Johrendt		
Mr. Harbarger		

I hereby certify the foregoing to be a true and complete copy of the action taken by the Board of Tax Appeals of the State of Ohio and entered upon its journal this day, with respect to the captioned matter.



A.J. Groeber, Board Secretary