OHIO BOARD OF TAX APPEALS

EAST MANUFACTURING CORPORATION, (et. al.),	CASE NO(S). 2015-2111
Appellant(s),	(USE TAX)
vs.	DECISION AND ORDER
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO, (et. al.),	
Appellee(s).	

APPEARANCES:

For the Appellant(s) - EAST MANUFACTURING CORPORATION
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Entered Monday, April 17, 2017

Mr. Harbarger, Ms. Clements, and Mr. Caswell concur.

This matter is considered by the Board of Tax Appeals upon a notice of appeal from a final determination of the Tax Commissioner, filed herein by East Manufacturing Corporation ("East"). The commissioner adjusted a use tax assessment against East, relating to the period of January 1, 2003 through December 31, 2006. We consider this appeal upon the notice of appeal, the statutory transcript certified to this board by the Tax Commissioner ("S.T."), the evidence and testimony presented at a hearing before this board ("H.R."), and the written argument submitted by the parties.

The findings of the Tax Commissioner are presumed valid. *Alcan Aluminum Corp. v. Limbach*, 42 Ohio St.3d 121 (1989). It is therefore incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption and establish a right to the relief requested. *Belgrade Gardens v. Kosydar*, 38 Ohio St.2d 135 (1974); *Midwest Transfer Co. v. Porterfield*, 13 Ohio St.2d 138 (1968). Moreover, the taxpayer is assigned the burden of showing in what manner and to what extent the Tax Commissioner's determination is in error. *Kern v. Tracy*, 72 Ohio St.3d 347 (1995); *Federated Dept. Stores, Inc. v. Lindley*, 5 Ohio St.3d 213 (1983). Where no competent and probative evidence is presented to this board by the appellant to show that the Tax Commissioner's findings are incorrect, then the Board of Tax Appeals must affirm the Tax Commissioner's findings. *Kroger Co. v. Limbach*, 53 Ohio St.3d 245 (1990); *Kern*, supra; *Alcan*, supra.

East manufactures primarily aluminum truck trailers. The Department of Taxation conducted an audit of East's purchases, which ultimately resulted in an assessment. H.R. at 13. Although other issues were pursued through its petition for reassessment before the Tax Commissioner, on appeal to this board, East only contests the Department's assessment of use tax on its purchases of natural gas. Specifically, East contends that its purchases of natural gas are exempt from sales tax, pursuant to R.C. 5739.011(C)(5), which provides:

> "(C) For purposes of division (B)(42)(g) of section 5739.02 of the Revised Code [sales tax does not apply to '[s]ales where the purpose of the purchaser is to *** use the thing transferred, as described in section 5739.011 of the Revised Code, primarily in a manufacturing operation to produce tangible personal property for sale'], the 'thing transferred' does not include any of the following:
>
> "(5) Machinery, equipment, and other tangible personal property used for *** humidity or temperature regulation, or similar environmental control, except machinery, equipment, and other tangible personal property that totally regulates the environment in a special and limited area of the manufacturing facility where the regulation is essential for production to occur (.)"

East maintains all/portions of its facility's six buildings at a specific temperature "to create the necessary temperature conditions for the extensive welding that takes place in its manufacturing process." Brief at 2. With regard to welding, East claims that all aluminum materials to be welded, and the tools used to weld them, must be kept at 50 degrees or warmer, to avoid the accumulation of condensation on the aluminum and ensure a good welding bond. Additionally, in order to avoid affecting a paint's color or drying time, the 50 degree temperature is also beneficial.

East custom builds its trailers, which can be large and unwieldy, e.g., 53 feet long, which requires "the manufacturing space to be flexible and not confined by interior walls that would impede the movement of *** work-in-process." Brief at 4; H.R. at 39. Therefore, "[t]he manufacturing portion of Building A and the entire space in Buildings B through F are open, without interior walls, so as to allow movement of the large in-process trailers to the different designated manufacturing stations in each of the buildings." Brief at 4. As a result, because there are no walls in most of the facility, the heat East claims is necessary for welding and painting purposes, is not "contained" in any manner and permeates basically all of the facility; East claims that such approach to temperature control is more cost effective. "Allowing each building to be heated entirely, even though unnecessary, is less expensive than such additional costs associated with adding walls to contain the heat." Brief at 7. Not only would the actual construction of the walls add costs, but additions to the manufacturing process necessary to "work around" the walls, e.g., equipment to move lengthy trailers-in-process around the walls would be necessary, also creating extra expenses. H.R. at 39-40, 48. Regardless, East argues that its "regulation of temperature within the special and limited areas of its Facility that includes the special/limited sub-areas of its buildings *** qualifies as 'totally regulating the environment'" under the foregoing statutory provision. Brief at 11.

The commissioner reiterates that in order for East to qualify for exception from taxation, "'(1) the machinery, equipment, or other tangible personal property must be used to totally regulate the environment, (2) the regulation must be in a special and limited area of the manufacturing facility, and (3) the regulation must be essential for production to occur.' *Ellwood* [*Engineered Castings, Co. v. Zaino*, 98 Ohio St.3d 424, 2003-Ohio-1812, ¶36]." Brief at 13. He concluded that East's manufacturing process did not comport with any of the foregoing requirements.

Ohio Adm. Code 5703-9-21(D)(6) further explains R.C. 5739.011(C)(5), specifically, as follows:

> "(D) Things transferred for use in a manufacturing operation do not include:
>
> "***

"(6) Machinery, equipment, and other tangible personal property used for ventilation, dust, or gas collection, humidity or temperature regulation, or similar environmental control, except machinery, equipment, and other tangible personal property that totally regulates the environment in a special and limited area of the manufacturing facility where regulation is essential for production to occur.

"All equipment and supplies that monitor, regulate, or improve the environmental conditions in the manufacturing facility are taxable. This includes all lighting, heaters, air conditioning equipment, fans, heat exhaust equipment, air makeup equipment, dust control or collection equipment, and gas detection, collection, and exhaust equipment. ***

"The only exception to the taxing of these items is equipment which totally regulates the environment in a special and limited area of the facility, such as a clean room or paint booth, where such total regulation is essential for production to occur. ***"

In *Aeroquip Corp. v. Tracy* (Dec. 15, 2000), BTA No. 1997-T-1612, unreported, this board set forth considerations in interpreting R.C. 5739.011(C)(5), stating:

"This burden is two-fold. First, a taxpayer must demonstrate that the regulation of a special and limited area is *total*. This suggests more than a general or conjunctive usage of an environmental control in or around an area. 'Total' implies comprehensiveness; it pertains to the regulation of a limited area in its entirety. Thus, where the regulation is of a general nature, such as where the equipment being regulated is open to the whole facility, the exception will not apply. *Hamilton Fixture* [*Co. v. Tracy* (June 9, 1995), BTA No. 1993-K-870, unreported]. Once a taxpayer has established that the regulation is total, it then has the additional burden of demonstrating that the regulation is essential for production to occur. If a taxpayer fails to meet either prong of this test, the item is taxable." (Emphasis sic.) Id. at 23.

See also *Aeroquip Corp. v. Zaino* (Nov. 15, 2002), BTA No. 2000-S-161, unreported (wherein this board held that "a taxpayer must demonstrate that the regulation of a special and limited area is total. *** [I]f the equipment being regulated is open to the entire manufacturing facility, the exception will not apply. *** In order to qualify for exception under R.C. 5739.011(C)(5), the equipment must regulate an environment that is enclosed, self contained, sealed, or in some other way separated from that of the entire manufacturing facility."

Thus, under the requirements of R.C. 5739.011(C)(5), we first conclude that East has failed to establish how the affected manufacturing area, which consists of all or portions of all of the buildings within the facility, could qualify as a "special and limited" area. While we acknowledge East's contention that because it manufactures large trailers that move through all of the buildings, it would be cost prohibitive to create special or limited areas within each building in which specific temperatures could be maintained, we find no exception within the statutory provision that permits regulation of a general nature, due to cost constraints. Therefore, as we have determined that appellant has not met the requirement of environmental control "in a special or limited area," we need not address the remainder of the considerations set forth in R.C. 5739.011(C)(5), as East must meet all of them.

East, however, also claims that its purchases of natural gas are excepted from taxation pursuant to R.C. 5739.011(B)(4) and (8). Those sections provide:

"(B) For purposes of division (B)(42)(g) of section 5739.02 of the Revised Code, the 'thing transferred' includes, but is not limited to, any of the following:

"(4) Machinery, equipment, and other tangible personal property used during the manufacturing operation that control, physically support, produce power for, lubricate, or are

otherwise necessary for the functioning of production machinery and equipment and the continuation of the manufacturing operation;

"***

"(8) Coke, gas, water, steam, and similar substances used in the manufacturing operation; ***"

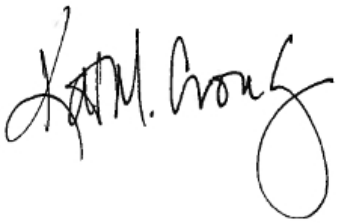
With regard to whether the natural gas purchased by East is "*necessary* for the *** continuation of the manufacturing operation," we liken our conclusion herein to the board's in *Reiter Dairy, Inc. v. Limbach* (Jan. 15, 1993), BTA No. 1990-Z-503, unreported, in which we determined that the system in question served a quality control function, which was not central to the manufacture of milk and ice cream, i.e., necessary for manufacturing. East regulates the temperature in its facility, in order to ensure a certain level of quality in its trailers that it argues is obtained through the welding process; however, as East's witness testified, East could bolt the trailers it builds, rather than weld them, as its competitors do. H.R. at 24. Further, testimony also indicated that some of the issues raised by failure to regulate temperature in the manufacturing areas were cosmetic in nature, e.g., trailers were not as "shiny" and therefore not as "attractive." H.R. at 26. The temperature regulation was deemed necessary by East for purposes of creating trailers "within *** [a] margin of acceptable quality." H.R. at 108. We conclude that such regulation of temperature in the manufacturing process constitutes a quality control function, rather than a necessity for manufacturing.

Finally, with regard to East's claim that its purchase of natural gas should be exempt from taxation because the natural gas is "used in the manufacturing operation," our previous conclusion that the temperature regulation was not "necessary" for the manufacturing operation is dispositive. The heat produced by the natural gas is generally dispersed throughout East's facility and, as such, is not part of the manufacturing operation; only the natural gas used in the welding systems and paint booths is used in the "manufacturing operation," and, accordingly, was properly excluded from East's assessment. S.T. at 88.

Therefore, based upon the foregoing, we conclude that the Tax Commissioner's findings were reasonable and lawful. It is the decision and order of the Board of Tax Appeals that the final determination of the commissioner be affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Harbarger		
Ms. Clements		
Mr. Caswell		

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.



Kathleen M. Crowley, Board Secretary