

Newfield Publications, Inc.,)	CASE NO. 96-K-91
)	
Appellant,)	(USE TAX)
)	
vs.)	DECISION AND ORDER
)	Rev'd on Appeal Nov. 10, 1999
Roger W. Tracyx Ta)	
Commissioner of Ohio,)	87 Ohio St.3d 150, 1999-Ohio-312
)	
Appellee.)	

APPEARANCES:

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Entered: September 18, 1998

Ms. Jackson and Mr. Manoranjan concur. Mr. Johnson not participating.

This cause and matter is before the Board of Tax Appeals as a result of a notice of appeal filed on February 5, 1996, by appellant, Newfield Publications, Inc. Appellant appeals a final determination of the Tax Commissioner, dated December 18, 1995, wherein said official denied objections to a use tax assessment which had been issued for the period of April 1, 1991 through June 30, 1993. The Tax Commissioner did, however, conditionally remit a portion of the penalty which had been assessed.

We now proceed to consider this appeal based upon appellant's notice of appeal, the statutory transcript certified by

the Tax Commissioner, the record of the hearing convened before this Board on October 31, 1996 and the written briefs which have been submitted by counsel. In addition to the documentary exhibits which were introduced on its behalf, at this Board's hearing appellant presented the testimony of two witnesses: Andrew M. Marx, a former employee of appellant familiar with the systems in issue; and Vilis Donis, an employee of appellant who was involved in appellant's original acquisition of the items in issue and their subsequent transfer to Neodata, the company which has since acquired the items in issue.

Appellant is engaged in the business of selling books, both juvenile and adult, decks of cards and children's toys. These items are packaged at appellant's distribution facility located in Fairfield, Ohio¹ and transported to United States Postal Service bulk mail centers for ultimate delivery to appellant's customers. Marx described appellant's packaging of its products as follows. Although some books, depending upon their size, may be placed into individual cartons manually, most of appellant's products are placed into flat cartons by its "Series 1,000" machine. These individual packages, which are the packages ultimately delivered to appellant's customers, are then closed, sealed and labeled with a bar code.

¹Initially, appellant's distribution facility was located in Columbus, Ohio. However, in August 1992, appellant's distribution operations were transferred to Fairfield, Ohio. The items whose purchases are at issue in this appeal were purchased for use at the Fairfield, Ohio facility.

Throughout the packaging process, the individual packages are transported on Automotion conveyor equipment which allows them to travel without interruption from machine to machine. Marx indicated the length of the conveyor equipment utilized at appellant's facility is a specific design feature intended to allow the sorting process to catch-up with the actual packaging of appellant's products. Photobeams are in place at various points throughout the process which monitor the movements of packages and, in the event there is a back-up, cause each piece of equipment to shut down.

Once they are sealed and labeled, the packages then enter the "Kosan sortation system" ("Kosan"), referred to in the industry as a "tilt tray machine." As the packages enter the Kosan, the package is weighed in order to ensure appropriate postage is placed on it. At the same time, the bar code on the package is scanned to ascertain its ultimate destination. Depending upon where the individual package is to be delivered, it will travel on the Kosan to one of seventy-four sortation destinations where, by virtue of the tilt trays, it will be placed into a large corrugated cardboard container. These larger containers, which are approximately seven feet tall and four foot square, are used only to transport the individual items to the bulk mail centers.

The items whose purchases appellant claims are exempt from taxation are comprised primarily of the Kosan and the Automotion conveyor equipment. That portion of appellant's packaging operations which places products into individual packages is not in issue in this appeal.

In his final determination, the Tax Commissioner concluded that the items at issue were "used for various functions before and after packaging, but are not used in packaging as that term is defined in the statute." As a result, he denied appellant's claim that the purchases of the Kosan and the Automotion conveyor equipment were exempt from tax. On appeal, appellant has specified the following as error:

"THE AMOUNT OF USE TAX INCLUDED IN THE FINAL DETERMINATION IS INCORRECT DUE TO, BUT NOT LIMITED TO, THE FOLLOWING REASONS:

"1. The Final determination and Assessment unlawfully imposes a sales/use tax upon purchases of machinery, equipment, and materials for use in packaging tangible personal property sold at retail. R.C. 5739.01(B)(15).

"2. The Final Determination and Assessment unlawfully imposes a sales/use tax twice upon a single purchase of tangible personal property. Pursuant to R.C. 5739.02, it is intended that a sales/use tax be levied upon the same transaction once².

"3. The aforementioned Final Determination and Assessment includes and does not abate penalties and penalty interest notwithstanding the following facts:

"- Newfield did not intentionally disregard the sales and use tax laws of the State of Ohio;

"- Newfield attempted, to the best of its ability, to comply with Ohio's use tax reporting requirements;

²No evidence was presented at hearing with respect to this claim nor was any legal argument advanced by appellant in its post-hearing brief. We will therefore presume that appellant has now waived this specification of error.

"- Newfield is registered and currently files its Consumers' Use Tax Accounts on a timely basis;

"- Newfield extended its full cooperation and assistance to the Agent throughout the course of the audit and the audit review meeting; and

"- Newfield believes that many of the assessed purchases involve complicated issues with regard to the applicability of sales and use tax.

"Wherefore, Newfield had requested, in its timely filed Petition for Reassessment, full abatement of any and all penalties included in the Assessment." (Emphasissic.)

In an appeal from a final determination of the Tax Commissioner, an appellant shoulders an affirmative burden to demonstrate error in the factual findings made by that official. In Federated Dept. Stores, Inc. v. Lindley (1983), 5 Ohio St.3d 213, the Supreme Court stated:

"[W]hen an assessment is contested, the taxpayer has the burden '*** to show in what manner and to what extent ***' the commissioner's investigation and audit and the findings and assessments based thereon, were faulty and incorrect." Id. at 215.

The preceding was reaffirmed in Alcan Aluminum Corp. v. Limbach (1989), 42 Ohio St.3d 121:

"Absent a demonstration that the commissioner's findings are clearly unreasonable or unlawful, they are presumptively valid. Furthermore, it is error for the BTA to reverse the commissioner's determination when no competent and probative evidence is presented to show that the commissioner's determination is factually incorrect. ***" Id. at 124. (Citation omitted.)

It is therefore incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the preceding presumption and establish a clear right to the relief requested. Belgrade Gardens v. Kosydar (1974), 38 Ohio St.2d 135; Midwest Transfer Co. v. Porterfield (1968), 13 Ohio St.2d 138.

Pursuant to R.C. 5739.02, an excise ("sales") tax is levied upon all retail sales made in Ohio. By virtue of R.C. 5741.02, a similar tax is imposed upon the storage, use or consumption in this state of any tangible personal property or the benefit realized in this state of any services provided. R.C. 5741.02(A). If the transaction is not subject to sales tax, it follows that it is also excepted from the imposition of use tax. R.C. 5741.02(C). Given the complementary nature of these taxing provisions, we will refer only to the applicable sales tax statutes within the remainder of our decision.

As previously indicated, appellant challenges the Tax Commissioner's denial of the packaging exemption with respect to its purchases of the Kosan and Automotion conveyor equipment. Relative in this regard, R.C. 5739.02(B)(15) exempts from taxation:

"Sales to persons engaged in any of the activities in division (E)(2) or (9) of section 5739.01 of the Revised Code, to persons engaged in making retail sales, or to persons who purchase for sale from a manufacturer tangible personal property that was produced by the manufacturer in accordance with specific designs provided by the purchaser, of packages, including materials and parts for packages, and of machinery, equipment, and material for use primarily in packaging tangible personal property produced for sale by or on the order of the person doing the packaging, or sold at retail. Packages include bags, baskets, cartons, boxes, cans, bottles, bindings, wrappings, and

other similar devices and containers and 'packaging' means placing therein.³"

Two requirements must be met in order for a purchase to be exempt from tax pursuant to R.C. 5739.02(B)(15): (1) the item in issue must be purchased by an entity either engaged in manufacturing or making retail sales; and (2) the item so purchased must be used primarily in packaging tangible personal property produced for sale. The parties apparently agree that appellant is engaged in an enterprise of the type described in R.C. 5739.01(E)(2) in that it makes retail sales to its customers. With respect to the second requirement, the parties also agree a package, in this case a large cardboard container, must restrain movement in more than one plane of direction. Custom Beverage Packers v. Kosydar (1973), 33 Ohio St.2d 68. The point upon which they disagree involves whether the packaging exemption extends to the present situation in which an item, already packaged for delivery to the end-consumer, is placed in a container for transportation from appellant's packaging facility to a bulk mailing center. For the reasons which follow, we conclude that the exemption does not so apply and that the items at issue are not entitled to the exemption set forth in R.C. 5739.02(B)(15).

In Hawthorne Mellody v. Lindley (1981), 65 Ohio St.2d 47, the Supreme Court considered the application of the packaging

³R.C. 5739.02(B)(15) was amended on several occasions throughout the audit period. The version quoted above, to which both parties have referred, became effective January 1, 1993. As it appears that the issue in this case is unaffected by the various statutory changes, this Board likewise refers to the January 1, 1993 version of R.C. 5739.02(B)(15).

exemption to a portion of an overall conveyor system which unstacked and cleaned returned plastic and wire milk cases and then transported the cases to another part of the taxpayer's operations where they would be repacked with filled milk cartons. Rejecting the Tax Commissioner's argument that the conveyor system was not entitled to the packaging exemption because it was not used to place the product into the package, the court held:

"The issue presented is whether this portion of the conveyor system should be considered as a separate piece of machinery or equipment used to unstack, clean and convey milk cases (packages); or, alternatively, as an integral part of machinery or equipment used in placing milk cartons (tangible personal property produced for sale) in milk cases (packages). Only in the latter case would this portion of the conveyor system be excepted from taxation under R.C. 5739.02(B)(15). ***

"The record indicates that the portion of the conveyor system at issue is an integral part of machinery or equipment used in placing milk cartons in milk cases. This portion unstacks and cleans plastic and wire milk cases returned from customers and then conveys them to a machine which places filled milk cartons in these milk cases. Simultaneously, in another portion of the system, milk cartons are filled, conveyed and loaded into the above machine. After the milk cartons are placed in the milk cases, the milk cases are automatically stacked, and then conveyed to delivery trucks.

"Based upon the above evidence, we find that the portion of the conveyor system at issue is an integral part of the machinery or equipment used in placing tangible personal property produced for sale (milk cartons) in packages (milk cases). Thus, this portion of the conveyor system is excepted from taxation under R.C. 5739.02(B)(15)." Id. at 52-53. (Footnote omitted.)

Thereafter, in Kroger Co. v. Limbach (1990), 53 Ohio St.3d 245, the court reaffirmed the preceding decision and this Board's application of it, when we found exempt those "items comprising the product-packaging lines, based on its finding that they were used in 'an integrated activity and an essential part of the packaging activity[.]'" The Supreme Court again rejected the Tax Commissioner's argument that entitlement to R.C. 5739.02(B)(15) is restricted to only those "purchases of packages or equipment for use in packing tangible personal property produced for sale and used directly in inserting such product into the package." Id. at 246.

On February 12, 1992, the Supreme Court decided two cases in which claim was made to the packaging exemption. In Ball Corp. v. Limbach (1992), 62 Ohio St.3d 474, the court reversed this Board's finding that the taxpayer's purchases of an automated carton-forming system⁴ and an automated conveyor system were entitled to the R.C. 5739.02(B)(15) exemption. The carton-forming system was briefly described by the court as one producing cartons which the taxpayer sold to its customers, while the conveyor system was described as being "used to move constructed cartons to a work station where partitions were inserted by an employee and from

⁴With respect to the carton-forming system, the matter was remanded in order for us to determine whether it was excepted from tax "as machinery or equipment used directly in the production of tangible personal property for sale by manufacturing or processing as contemplated by former R.C. 5739.01(E)." Id. at 480. Subsequently, this Board found that the carton-forming equipment so qualified. See Ball Corp. v. Limbach (July 17, 1992), B.T.A. No. 88-H-1091, unreported.

there to a packaging point where 'the packer would install the bottles into the cartons.'" Id. at 476.

In Union Carbide Corp. v. Limbach (1992), 62 Ohio St.3d 548, although affirming this Board's determination that the taxpayer's packaging of batteries was exempt pursuant to R.C. 5739.02(B)(15), the court disabused the notion that, as argued in the present case by appellant, a continuous packaging operation warrants exemption to all equipment used therein:

"In Kroger Co. v. Limbach (1990), 53 Ohio St.3d 245, at 247 *** we stated:

"'The BTA was correct to follow the analysis of Hawthorne Mellody and its action was reasonable and lawful.'

"In Kroger, supra, the BTA found that 'the items comprising the product-packaging lines *** were used in "an integrated activity and an essential part of the packaging activity" ***.' Id. at 246 ***. The Kroger decision ratified our holding in Hawthorne Mellody v. Lindley (1981), 65 Ohio St.2d 47 ***. In Hawthorne Mellody, supra, we acknowledged the correctness of the Tax Commissioner's strict construction requirement for exceptions from taxation, but granted exception because the particular portion of the taxpayer's conveyor system was not 'considered as a separate piece of *** equipment used to unstack, clean and convey milk cases (packages)' but rather 'as an integral part of *** equipment used in placing milk cartons (tangible personal property produced for sale) in milk cases (packages).' Id. at 52 ***. By affirming the finding of the BTA and by embracing the language of Hawthorne Mellody, supra, we do not reject our earlier determinations relative to the appropriate construction of tax statutes or to the propriety of separating items of tangible personal property from a system of manufacturing, processing, or packaging. Rather, we reiterate our conclusion that we will examine particular items of machinery, equipment or material alleged to be excepted from taxation by reason

of the function they perform."⁵ Id. at 549-550. (Parallel citations omitted.)

See, also, Anheuser-Busch, Inc. v. Tracy (Oct. 24, 1997), B.T.A. Nos. 95-T-922, et seq., unreported, appeal pending Sup. Ct. No. 97-2443.

As previously indicated, appellant asks that we find exempt its purchases of equipment which repackage the items it sells because larger cartons constitute a "package" and because its packaging operations are part of integrated plant system. While appellant repeatedly refers to the items in issue as being part of its continuous, uninterrupted and integrated packaging operations, as pointed out by the court in Union Carbide, the use of the items themselves must be reviewed in order to determine their taxable status. In conducting such a review in this case, although we agree with appellant that the larger cartons in which individual packages are placed are indeed packages themselves, we cannot agree that the items at issue fall within the purview of the exemption.

R.C. 5739.02(B)(15) applies to machinery, equipment and materials used "in packaging tangible personal property produced for sale *** or sold at retail[.]" The Kosan and Automotion conveyor equipment are not used in packaging the items which appellant sells at retail, i.e., books, cards and toys, because such

⁵In reaching this conclusion, the court, earlier in its decision, made the following reference to R.C. 5739.02(B)(15):

"In analyzing the applicability of this exception we '*** focus upon the distinct function of each item of tangible personal property subject to assessment and its relationship to' the packaging process. Bird & Son, Inc. v. Limbach (1989), 45 Ohio St.3d 76, at 79 ***." Id. at 549.

items have already been packaged by the time they reach this equipment. Instead, the Kosan and Automotion conveyor equipment are used by appellant, after the packaging process contemplated by R.C. 5739.02(B)(15) has been completed, to weigh, sort and bundle these individual packages in bulk for transporting them to the mail center from which they are sent.

As additional support for its claim, appellant has cited several decisions of this Board in which items involved in the "repackaging" of goods sold at retail have been granted exemption. See, e.g., Avon Products, Inc. v. Lindley (Sept. 11, 1984), B.T.A. No. 82-F-104, unreported; The Limited Stores, Inc. v. Tracy (Mar. 18, 1994), B.T.A. No. 91-K-1287, unreported. However, we find those cases distinguishable from the present one in that the larger containers in which smaller ones were placed in those instances were actually used to ship the goods to sales representatives or individual retail stores. In this case, the large cardboard containers, which are either reused or discarded by the mail centers after the packaged items are removed, serve merely as a device for transporting appellant's packaged products to a mail center.

Appellant also asserted in its notice of appeal that the Tax Commissioner's decision to conditionally reduce penalties is erroneous. While appellant's assistance in the underlying audit is to be commended, we are unable to conclude that the Tax Commissioner abused his discretion in declining to remit penalties in their entirety. See Huffman v. Hair Surgeon, Inc. (1985), 19 Ohio St.3d 83. Indeed, by conditionally remitting a portion of the penalty it appears that the Tax Commissioner took into

consideration appellant's actions. See Gen. Motors Corp. v. Tracy (Feb. 25, 1994), B.T.A. No. 91-K-1558, unreported, at 14-16, affirmed (1995) 73 Ohio St.3d 29, 32, affirmed on other grounds (1997) __ U.S. __.

Based upon the foregoing, it is the decision of the Board of Tax Appeals that appellant's specifications of error are not well-taken and they are therefore overruled. Accordingly, it is the order of this Board that the Tax Commissioner's final determination must be, and hereby is, affirmed. ohiosearchkeybta