



Interested Party Testimony on House Bill 466
Prepared by The Ohio Society of CPAs for
The Ohio House of Representatives
Ways & Means Committee

Chairman Schaffer, Ranking Member Cera and Members of the House Ways & Means Committee, thank you for this opportunity to offer interested party testimony on House Bill 466. I'm Greg Saul, Director of Tax Policy for The Ohio Society of CPAs (OSCPA). First of all, I want to point out that the Society is very grateful that during last year's operating budget (HB 64) proceedings the Legislature declined to expand the state sales tax base to a series of services offered and used by our members and others in the business community, including lobbying and management consulting services.

Recently, however, we believe an administrative interpretation by the Ohio Department of Taxation (ODT) expands Ohio's state sales tax base to services previously not taxed. Specifically, ODT issued updated Information Release ST 1999-04 in December 2015, which followed an earlier presentation held during the Ohio Virtual Tax Academy on March 11, 2015. We believe both of these developments (see attached) point to the application of state sales tax to new services, under the electronic information services (EIS), automatic data processing (ADP), and computer services (CS) umbrella. Although these terms are defined in ORC 5739.01(Y)(1)(a), (b), and (c), below are the examples that ODT has provided as being taxable in their opinion:

EIS: subscription services, inventory advertising, on-line chat features, mass e-mails, credit reports, internet access, service to remotely access your office computer, webinars, and email service.

ADP: software as a service (SAAS) "in the cloud," payroll processing, and billing services.

CS: taxable only if performed in conjunction with the sale of computer equipment or system software.

As mentioned above, ODT's updated Information Release includes examples of EIS services that are taxable – services that were not included in the original Information Release issued in 1999. The ODT cites to a 2008 Ohio Supreme Court case – that actually ruled in favor of the taxpayer – *Marc Glassman, Inc. v. Levin*, as authority for these new examples. However, *Glassman* specifically construed HB 152, which amended R.C. 5739.01 in 1993, saying "the amendments appear to have split the

former broad category of 'automatic data processing and computer services' into three separate categories **without thereby expanding the overall scope of the sales tax**" (emphasis added).

In the absence of a specific legislative enactment including these new examples, ODT could have run these services through the JCARR process – giving taxpayers fair notice and an opportunity to comment. Further, since ODT is taking these positions on audits, taxpayers are being subjected to 4 years of potential liability risks rather than the policy being limited and applied prospectively only.

Under ORC 5739.01(B)(3)(e), the three categories are only taxable if the service is "provided for use in business." The transaction is not taxable if the "true object" is the receipt of "personal or professional services" to which the three categories are "incidental or supplemental." Also see ORC 5739.01(Y)(1)(d). Personal and professional services are defined as **including but not limited to** the ten services listed in ORC 5739.01(Y)(2)(a) to (j). Finally, ORC 5739.01(Y)(1)(c)(ii) provides an additional exclusion specifically for EIS under "electronic publishing" – see ORC 5739.01(LLL).

Further, the "true object" analysis is actually contained in OAC 5703-9-46(B), which ODT discusses on page 4 of the Information Release. To determine whether one of the three categories is taxable as a service, ODT has set up a balancing test to evaluate whether the true object of the transaction renders a "significant benefit" to the consumer or whether it is "merely incidental or supplemental." See OAC 5703-9-46(B)(3)(a) and (b). The phrase "significant benefit" does not appear anywhere in the ORC, nor is it defined in the OAC. At the top of page 5, ODT arrives at the conclusion that **ALL** of their EIS examples on pages 2-4 are a significant benefit to the business customer and are not merely incidental to the personal or professional services – therefore the transactions are taxable services.

House Bill 466 is narrowly focused on addressing the "inventory advertising" issue under EIS by excluding "digital advertising services." Make no mistake: OSCPA strongly supports efforts to exempt digital advertising from state sales tax. However, we also strongly believe that this approach is too narrow. We have drafted an amendment, along with the Ohio State Bar Association (OSBA), to address the broader EIS and ADP issue, as clearly ODT is pursuing a number of new services for taxation beyond digital advertising. The amendment is similar to current law already contained in ORC 5739.012(B)(2) addressing bundled service transactions, which was itself based on language in the Streamlined Sales Tax Act.

We want to make it clearer that taking a nontaxable service, such as advertising or educational coursework, and performing it via the web/internet or cloud infrastructure does not render the otherwise nontaxable service taxable. By using the broader approach, the legislature does not have to go through the future exercise of amending the statute (ORC 5739.01) for every new service that comes up. Also, you can avoid the issue that arises when some services are excluded as non-taxable (i.e. specifically calling out digital advertising services), leaving others that have already been listed by ODT to be presumed taxable because of a failure to also be excluded in the statute.

Thank you again for this opportunity to offer interested party testimony on House Bill 466, and for your consideration of a broader fix to this problem. I'm available to answer any of your questions.