

# The Ohio Retail Sales Tax Act

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The Ohio Retail Sales Tax Act, born of the depression years, is designed to eliminate the pyramiding of tax, and in conformity with that object the tax is levied, insofar as is possible, on the sale to the ultimate consumer. This has been done by so defining retail sales as to exclude from taxation all intermediate sales and by also exempting specific classes of property such as feed and seeds, ice and items such as motor vehicle fuel, cigarettes and beer, upon which other taxes already were levied. The Sales Tax Act, like many other emergency taxes, was originally enacted as a temporary measure to relieve the financial crisis facing the State of Ohio and its many political subdivisions. The expiration date of the original act was first postponed and then eliminated, thus permanently incorporating into the tax structure of the state this lucrative source of revenue.

The industry-wide exclusions from taxation contained in the original act, under which tangible personal property used or consumed in retailing, mining, manufacturing and other business activities was excluded from taxation, were somewhat narrowed when the legislature inserted the word "directly" in the definition of retail sale. This came as a result of the realization that tangible personal property even remotely used in mining, manufacturing and other business activities was escaping taxation. At the present time, tangible personal property when used or consumed "directly" in making retail sales or "directly" in the production of goods for sale by manufacturing, mining and processing, among other things, is excluded from taxation. This change, modifying the former broad language of the definitive exclusions, should have produced increased revenues for state and local government units. The legislature, however, yielding to pressure from varied sources, has from time to time amended the definitive section of the statute to embrace new exclusions which have more than offset any advantage which might have resulted from inserting the word "directly." Furthermore, the supreme court, after more than a decade, has attempted to define the word "directly" without complete success. Cases are pending at the present time which involve the interpretation of this concept.

In considering the history of the Ohio Retail Sales Tax Act, Judge Hart in the case of *Kroger Grocery and Baking Company v.*

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*Glander*,<sup>1</sup> describes the evolution of some of these exclusions in the following language:

It was also the evident intention of the General Assembly that the statutes here involved be liberally construed in favor of the intermediate purchaser of items of tangible personal property which are used to make the ultimate property sold more valuable. This is indicated by certain recent amendments which the General Assembly has made in the taxing statutes in question, to the end that such intermediate purchasers be relieved of the tax. The original definition of 'retail sale' and the exceptions from such definition were adopted by the General Assembly on December 6, 1934 (115 Ohio Laws, pt. 2, 306). On March 25, 1935 (116 Ohio Laws, 41), the General Assembly repealed the exception originally limited to sales of 'feed, seeds, lime or fertilizer,' and broadened the exception by providing that 'farmers and horticulturists shall be considered manufacturers or processors in the interpretation of this act.' On May 15, 1935 (116 Ohio Laws, 248), the General Assembly added to the exceptions the sale of tangible personal property used in mining. Questions immediately arose as to what was comprehended in the term 'mining,' whereupon the General Assembly on May 8, 1941 (119 Ohio Laws, 389), clarified and liberalized this exception by including in the statute the words, 'mining including without limitation the extraction from the earth of all substances which are classed geologically as minerals.' Following that amendment, this court in the case of *Bailey v. Evatt, Tax comm'r.*, . . . held that 'the production for commercial sale of sand and gravel from natural sand and gravel deposits by stripping the surface soil therefrom with a drag line and removing such sand and gravel from pits with a steam shovel constitutes 'mining' \* \* \*.'

In 1942, 1943 and 1944, assessments were made against certain laundry and linen supply companies on the purchase of material used by them in producing 'linen service' to customers. Those assessments were affirmed by the Board of Tax Appeals between May 2 and June 4, 1945, on the ground that such materials were not used in 'industrial cleaning' excepted by the statute. Appeals were taken to this court, but while the appeals were pending and before this court, on February 13, 1946, decided the case of *Pioneer Linen Supply Co. v. Evatt, Tax Comm'r.*, . . . to the effect that laundry service or supply service was not within the term 'industrial cleaning,' the General Assembly under date of June 13, 1945 (121 Ohio Laws, 247), broadened the exception by adding the words 'or to use or consume the thing directly in the rendition of towel and linen service or supply \* \* \*.'

In 1944, an assessment was made against the Huron Fish Company on the purchase of certain fish nets used

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<sup>1</sup> 149 Ohio St. 120, 130, 77 N.E. 2d 921, 926 (1948).

for commercial fishing as being a retail sale and not a sale of tangible personal property used and consumed in the production of other tangible personal property for sale. While an appeal from that assessment was pending before the Board of Tax Appeals and before an appeal was taken to this court in the case of *Huron Fish Co. v. Glander*, Tax Comm'r., . . . the General Assembly on June 13, 1945 (121 Ohio Laws, 247), added to the statute a new exception in the words '(f) to use or consume the thing directly in commercial fishing.' Finally, on June 9, 1947, the 'mining' exception was extended or clarified by adding (122 Ohio Laws, 439) the following: 'and services in the exploration for and production of crude oil and natural gas.'

The foregoing comments by the supreme court illustrate the turbulent history of the Sales Tax Act and also indicate the intention of the legislature to adhere to the original plan of the act in avoiding the taxation of intermediate sales in order to avoid imposing tax upon tax. The extent to which this theory has been carried is illustrated by comparing the Ohio law with the sales or gross receipts tax laws of Michigan, Illinois, and California. The following chart is limited to a comparison of exclusions from taxation contained in the definitive sections of the Ohio law with the laws of the other states.

**Application of Sales Tax in Michigan, Illinois, and California  
To Items Excluded by Definition of "Retail Sale"  
In Ohio Sales Tax Act, 1947**

Ohio	Michigan	Illinois	California
A. Resale	A. Not taxed	A. Not taxed	A. Not taxed
<b>B. Incorporation into Personal Property as an ingredient or component part by</b>	<b>B.</b>	<b>B.</b>	<b>B.</b>
1. Manufacturing	1. Not taxed	1. Not taxed	1. Not taxed
2. Processing	2. Not taxed	2. Not taxed	2. Not taxed
3. Refining	3. Not taxed	3. Not taxed	3. Not taxed
<b>C. Used or consumed Directly in the Production of Tangible Personal Property by:</b>	<b>C.</b>	<b>C.</b>	<b>C.</b>
1. Manufacturing — Tangible personal property (such as machinery, tools, equipment and supplies) which while essential to the operation do not enter into or become a component part of the product	1. Not taxed	1. Taxed	1. Taxed
2. Processing	2. Not taxed	2. Taxed	2. Taxed
3. Refining	3. Not taxed	3. Taxed	3. Taxed
4. Mining	4. Taxed (except explosives, timbers, drills and electricity)	4. Taxed	4. Taxed
5. Farming	5. Not taxed	5. Taxed (except feeds, seeds, and fertilizer used in producing products for sale)	5. Taxed (except feeds, seeds and fertilizer used in producing products for human consumption or sale)

6. Horticulture	6. Not taxed	6. Taxed (except seeds and fertilizer used in producing products for sale)	6. Taxed (except seeds and fertilizer used in producing products for human consumption or sale)
7. Floriculture	7. Not taxed	7. Taxed (except as above)	7. Taxed (except seeds and fertilizer used to produce products for sale)
8. In making retail sales	8. Taxed (except commercial advertising)	8. Taxed	8. Taxed
9. Used directly in Public Utility Service	9. Taxed	9. Taxed	9. Taxed
D. Security for the performance of an obligation by the vendor	D. Not taxed	D. Not taxed	D. Not taxed
E. Used or consumed directly in industrial cleaning	E. Taxed	E. Taxed	E. Taxed
F. Commercial fishing	F.	F. Taxed	F. Taxed

The Supreme Court of Ohio, in interpreting the definition of retail sale contained in Section 5546-1, General Code, has reached the conclusion that the definition provides tests for the imposition of the tax and are not tests for the exemption of property from tax; and has enunciated the rule that in the construction of this segment of Section 5546-1, General Code, any doubts which exist will be resolved in favor of the taxpayer and against the taxing authority.<sup>2</sup> Under these circumstances, the burden is upon the taxing authority to establish that a transaction comes within the purview of the definition before the tax may be lawfully imposed. This situation adds to the difficulties encountered in the administration of the act.

In addition to the definitive exclusions, Section 5546-2, General Code, provides for numerous specific exemptions. These exemptions do not follow any fixed pattern. The number of specific exemptions has been increased from time to time by the legislature since the passage of the original act. During each legislative session many proposals are made to exempt additional classes of personal property. Although the majority of these proposals have been defeated, a substantial number have been adopted during the life of the act. The total potential tax yield of the act is further diminished by this large number of specific exemptions. In addition, these specific exemptions also add to the complexity of problems in the administration of the act.

The supreme court, in construing the act relative to the powers of the administrator to make assessments, has declared that estimations of tax due based on averages compiled by the Department of Taxation are improper.<sup>3</sup> To comply with this decision, the Department of Taxation would be required to examine each sale made

<sup>2</sup> See Note 1, *Supra*.

<sup>3</sup> *Foster v. Evatt*, 144 Ohio St. 65, 56 N.E. 2d 265 (1944).

by the vendor in order to ascertain the amount of tax which such vendor should have collected. Obviously, this is an impossible task. It has been estimated that it would require the full-time services of substantially all the employees of the Division of Sales and Use Taxes to keep abreast of the current sales of a single large Ohio retail merchant. As an alternate procedure, the Tax Commissioner is empowered to make audits and assess delinquent taxes against vendors under the provisions of Section 5546-12A. Ostensibly a three percent tax is levied upon gross receipts derived from retail sales, subject to the same exclusions contained in Section 5546-1, and exemptions provided by Section 5546-2, with relation to the retail sales tax levied against the ultimate consumer. The amount due under this levy, however, may be offset by the vendor by the amount of tax he has collected from his customers. This section does not provide for an independent levy of tax despite the language used by the legislature, but is merely a device to insure the collection of approximately the amount of tax levied by Section 5546-2.<sup>4</sup>

The vendor's report of tax collected from consumers, and taxes, if any, payable under Section 5546-12A, are combined in each regular semi-annual return and serve as an excellent means of detecting vendors who are not cancelling sufficient prepaid tax receipts. While audits and assessments may not be made based upon rates of tax collection established by the experience of the Department of Taxation, those same rates may be used in the office audit of the vendor's semi-annual return and will indicate whether or not a particular vendor is collecting tax from his customers at a normal percentage for the business in which he is engaged. When these discrepancies are noted, the Department of Taxation is in a much better position to determine whether or not the more expensive unit audit should be made.

In addition to the exclusions from taxation above referred to, the Ohio act contains numerous specific exemptions. The Ohio act has been compared with the laws of Michigan, Illinois and California and indicates that Ohio exempts more items from taxation than any of the states with which it is compared. The numerous specific exemptions contained in the act obviously make substantial inroads upon the potential yield of the act.

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<sup>4</sup> Winslow-Spacarb Inc., v. Evatt, 144 Ohio St. 471, 59 N.E. 2d 924 (1945).

**Application of Sales Tax in Michigan, Illinois, and California  
To Items Specifically Exempt in Ohio, 1947**

Ohio	Michigan	Illinois	California
1. Sales to the state and its political subdivisions	1. Not taxed	1. Taxed (Sales to federal government incur tax liability)	1. Taxed
2. Food	2.	2.	2.
a. For consumption off premises	a. Taxed	a. Taxed	a. Not taxed
b. Sold by schools to students	b. Not taxed	b. Not taxed	b. Not taxed
3. Food and seeds Feeds	3. Not taxed	3. Not taxed if used in producing products for sale	3. Not taxed if used in producing products for sale or human consumption
4. Newspapers and magazines	4.	4.	4.
a. Newspapers	a. Not taxed	a. Not taxed	a. Not taxed
b. Magazines (subscriptions)	b. Not taxed	b. Not taxed	b. Not taxed
5. Ice	5. Taxed	5. Taxed	5. Taxed (except when used in packing and transporting food products out of the state)
6. Gasoline and Liquid Fuels which are taxed by the state	6. Taxed (state but not federal tax is deductible)	6. Taxed (state but not federal tax is deductible)	6. Not taxable
7. Cigarettes	7. Taxed	7. Taxed	7. Taxed
Brewer's wort	Taxed	Taxed	Taxed
Brewer's malt	Taxed	Taxed	Taxed
8. Beer	8. Taxed (state beer tax deductible)	8. Taxed	8. Taxed
Wine	Taxed	Taxed	Taxed
Spirituos Liquors (sold by department of Liquor Control)	Not taxed	Taxed	Taxed
9. Public Utilities	9.	9.	9.
a. Artificial gas	a. Taxed	a. Not taxed	a. Not taxed
b. Natural gas	b. Taxed	b. Not taxed	b. Not taxed
c. Electricity	c. Taxed	c. Not taxed	c. Not taxed
d. Water	d. Not taxed	d. Not taxed	d. Not taxed
10. Casual and Isolated Sales	10. Not taxed	10. Not taxed	10. Not taxed
11. Not within taxing power	11. Not taxed	11. Not taxed	11. Not taxed
12. Transportation of persons or property	12. Not taxed	12. Not taxed	12. Not taxed
13. Professional and Personal Service	13. Not taxed	13. Not taxed	13. Not taxed
14. Sales to charitable and religious organizations	14. Taxed (except religious organizations)	14. Taxed	14. Taxed
15. Nitroglycerine or explosives used in mining, etc.	15. Not taxed	15. Taxed	15. Taxed
16. Hearses and ambulances for use outside state	16. Taxed	16. Taxed	16. Taxed
17. Ships or vessels to be used principally in Interstate Commerce	17. Not taxed	17. Not taxed	17. Not taxed

In the administration of any tax law, the problem of evasion presents serious questions. This is especially true in the administration of sales tax acts such as Ohio's which contains a substantial number of exclusions and exemptions. Although the statute provides for the collection of the tax and the cancellation of the prepaid tax receipts in the proper amount at the time such sale is made,<sup>5</sup> an excellent opportunity to pocket the tax money is afforded the unscrupulous vendor and the vendor who is merely lax in this respect. Unless each sales tax receipt is cancelled at the time the sale is made, there is danger that the tax money collected by the vendor will not find its way into the public treasury.

In order to arouse the tax-paying public and to instill in them the desire to secure the tax receipts to which they are entitled at the time purchases are made, the legislature enacted Sections 5546-26a, 5546-26b, 5546-26c, 5546-26d and 5546-26e, which became effective February 28, 1939. These sections provide for the redemption of cancelled prepaid receipts by various organizations enumerated in Section 5546-26a and to individuals, as well, who furnish evidence that they have assisted the state in the collection of the tax. These provisions *potentially* increase the cost of administration of the present act by the rate of three percent at which sales tax receipts will be redeemed; however, that potentiality has not developed since the enactment of these provisions. The highest percentage of sales tax receipts redeemed in comparison with gross amount of sales tax collected occurred in 1944 when the redemptions amounted to 1.92 percent of the value of stamps sold. These sections provide for a voluntary method of policing by the buying public, thus minimizing the cost of sustained enforcement procedure by personnel of the Department of Taxation. The act provides for penalties to be enforced against vendors who fail, refuse, or neglect to cancel prepaid tax receipts in accordance with the provisions of the act. These penalties must be enforced through local courts after investigators have collected sufficient facts to justify prosecution. This procedure is slow and cumbersome and is not always productive of the desired results. In addition, local law enforcement officers have not always been sympathetic with the enforcement of the act and unsuccessful prosecution of violators is damaging to the enforcement of the act.

In evaluating sales or gross receipts tax acts, an important factor is the cost of administration. No accurate figures have been collected relating to the costs of administration of the Michigan, Illinois or California acts, so that it is impossible to make a comparison with Ohio's costs. For the sake of brevity, consideration will be given only to the costs of administration in Ohio for the calendar

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<sup>5</sup> OHIO GEN. CODE § 5546-3 (Supp. 1949).

year 1948, which is the most recent year for which complete data is available.

Many factors enter into the cost of administration of the Ohio act. In addition to the payroll and travel expense of employees of the division charged with the administration of the act, other substantial expenditures are made. These include the cost of printing prepaid tax receipts, compensation paid by the Treasurer of State to agents who sell prepaid tax receipts, compensation paid to county treasurers who sell sales tax receipts, redemption of cancelled prepaid tax receipts and vendors' discounts. With respect to this last item, the Ohio act provides for a three percent discount to licensed vendors purchasing prepaid tax receipts, so that for each one dollar face value of prepaid tax receipts the vendor pays only ninety-seven cents.

In the year 1948 with a gross revenue of \$143,909,301.00, the total expenditures in the above classifications amounted to \$10,053,631.00. Of this amount \$1,708,846.00 was allocated to salaries and travel expense, and includes \$504,424.00, representing the cost of printing prepaid tax receipts. The vendors' discounts allowed amounted to \$4,151,986.00, and redemptions of cancelled prepaid tax receipts amounted to \$2,774,195.00. Treasurer's agents, other than county treasurers, received \$823,419.00, and the county treasurers received \$595,185.00, for handling the sale of prepaid tax receipts during 1948.

County treasurers' compensation amounts to one percent of the face value of prepaid tax receipts. The agents of the Treasurer of State, on the other hand, are paid on a sliding scale of one percent of the first \$20,000.00 worth of stamps handled, three-fourths of one percent of the excess of \$20,000.00 to \$100,000.00, and one-half of one percent of all stamps in excess of \$100,000.00. The compensation to these agents is computed each four weeks and not over the period of the entire year. During 1948 there were 235 such agents, 40 of whom were individuals and 195 of whom were banks. One agent of the treasurer during 1948 sold \$10,083,056.33 worth of stamps and received \$54,749.77 as compensation for handling these stamps.

In addition to the direct cost of redemption represented by the amount paid out to applicants during the year, a portion of the salaries included in the administrative expense allocated to the operation of the Sales Tax Division is chargeable to redemptions. During the calendar year of 1948 the Sales Tax Division processed 71,693 applications, of which 15,156 applications for redemption were filed in behalf of private individuals to whom a total amount of \$257,918.21 was paid, and 56,537 applications for redemption were made by qualified organizations, total payment to them being



\$2,516,276.43. Each application is verified by the Department of Taxation by weighing the stamps presented for redemption, from which the value of the stamps can be calculated.

From 1940 to 1948 the revenues under the Retail Sales Tax Act have approximately tripled. During the same period, total income payments to Ohio residents, both individuals and corporations, also have approximately tripled. In the following chart, tax revenues and income received by residents, including business entities, of Ohio, Michigan, Illinois and California are set out for the years 1940 to 1948, both inclusive.

## Tax Revenue and Income Payments

	OHIO		MICHIGAN	
	Tax Revenue	Income	Tax Revenue	Income
1940	\$52,771,563	\$4,448,000,000	\$66,638,061	\$3,425,000,000
1941	65,246,532	5,646,000,000	82,907,746	4,271,000,000
1942	60,115,229	7,022,000,000	84,075,668	5,526,000,000
1943	63,342,743	8,417,000,000	90,531,206	6,924,000,000
1944	67,361,262	8,967,000,000	96,584,164	7,259,000,000
1945	75,780,571	9,122,000,000	105,732,434	6,902,000,000
1946	108,018,680	9,742,000,000	147,138,308	7,481,000,000
1947	129,007,346	10,945,000,000	178,979,872	8,646,000,000
1948	143,909,301	12,136,000,000	199,006,400	9,223,000,000

  

	ILLINOIS		CALIFORNIA	
	Tax Revenue	Income	Tax Revenue	Income
1940	\$97,809,705	\$5,746,000,000	\$104,812,363	\$5,606,000,000
1941	97,756,602	6,889,000,000	130,120,071	7,044,000,000
1942	82,298,156	8,267,000,000	132,617,507	9,348,000,000
1943	83,942,654	9,476,000,000	131,466,383	12,444,000,000
1944	91,089,474	10,297,000,000	143,746,430	13,739,000,000
1945	96,236,726	10,849,000,000	167,381,164	13,882,000,000
1946	129,231,187	12,153,000,000	224,958,495	15,184,000,000
1947	154,705,474	13,449,000,000	269,521,478	16,256,000,000
1948	172,109,572	15,167,000,000	292,139,168	17,099,000,000

It is difficult, if not impossible, to estimate the revenues realized in Michigan, Illinois, and California attributable to the fewer number of exemptions and exclusions contained in their respective acts, for the reason that other factors such as population and per capita expendable income also affect the amount of tax revenue produced by these statutes. It is safe to say, however, that the difference in the numbers of exemptions and exclusions has a very material effect upon the amount of revenue realized. It is to be noted that the revenues shown in the above chart are progressively larger as the number of exemptions and exclusions diminishes as between the states compared.

Sales taxes, because they provide substantial revenues, will in all probability remain a permanent part of the tax structure in many of the states. This is most certainly true of Ohio. Without the revenues produced by the Sales Tax Act, it is probable that the legislature would turn to the taxation of income as a substitute, since this lucrative source of income has not yet been tapped in Ohio.

The revenue produced by the act undoubtedly could be sub-

stantially increased by modifying or eliminating some of the exemptions or by narrowing the definitive exclusions. Such procedure, however, would entail the re-examination of the philosophy of the act, and the legislature, over the years, has consistently demonstrated its adherence to the theory that the ultimate retail sale should bear the tax burden.

As an alternate, the redemption of cancelled prepaid tax receipts could be eliminated in an effort to increase the tax yield. Substantial items of cost would thereby be avoided. It is questionable, however, whether such a step would increase the net yield of the act. The redemption feature was originally enacted to encourage the cancellation of prepaid tax receipts and thus increase tax revenue, and since this scheme has been in effect through several sessions of the legislature, it may be assumed that the legislature approves of it. Furthermore, it is likely that enforcement drives, just as costly, would be required to attain the same amount of net revenue.

Opponents of the Ohio Sales Tax Act assert that the use of prepaid tax receipts is costly and unnecessary. This viewpoint disregards the fact that this method of collection is a constant reminder to the citizens of Ohio of their role as taxpayers. Too many taxes are hidden today, creating the impression that someone else is bearing the burden of taxation. The ultimate consumer, however, bears many of these taxes without being aware of it. The problem is highly impersonal to him, and he does not realize how much of his income is taken for governmental uses and purposes.

In a period where government demands for revenue are expanding, the public generally should know the extent of the burden imposed upon them, and tax measures such as the Ohio Sales Tax Act accomplish that purpose.