State and Local Tax Alert: Ohio Supreme Court Clarifies Sales Tax Law on Business Purchase of Promotional Items

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This holiday season, Ohio based professional sports teams[1] have at least one tax reason for which they can give thanks. On the day before Thanksgiving, the Ohio Supreme Court announced its decision in *Cincinnati Reds, LLC v. Testa* (November 21, 2018), Slip Op. 2018-Ohio-4669. The Court held that the purchase of promotional items by the Reds and advertised to ticket buyers as "giveaway" memorabilia were purchased by the Reds with the purpose of reselling those items. As a result, the Reds were not obligated to pay sales or use tax on its purchase or ownership of the promotional items. The Court reversed the decision of the Board of Tax Appeals which had held that the Reds had no contractual obligation to ticket buyers to resell the promotional items and that the ticket buying fans had no contractual expectation that the price paid for admission included the purchase of a promotional item. Rather, the Board of Tax Appeals concluded the items were given away free of any charge outside the price paid for a ticket.

But, it is the Ohio Supreme Court that has the final say in such matters. There was a well-written majority opinion and reasoned dissent. In our opinion, the case could have gone either way.

The final decision is best understood in the context of history and case law. Ohio has a sales tax that imposes a fairly high rate of tax on the last sale, *i.e.*, the ultimate consumption. [2] In the *Reds* case, the Court articulated this point by stating:

> One main feature of the sales and use taxes is the legislative intent to limit imposition of the tax to retail transactions, while excluding or exempting from the tax earlier transactions that are not retail transactions but rather are at the production or wholesale levels.

Over the years, the Court has reasoned through other fact patterns with findings that a nontaxable "sale-for-resale" resulted. For example, when an automobile manufacturer purchased tooling, which it provided to its part supplier for no set monetary price, the Court found that a resale

occurred based on the fact that automobile manufacturer and supplier had entered into a bilateral requirements contract and those promises exchanged constituted valuable consideration to support a resale of the tooling. The tooling was not taxable upon "resale" because the supplier itself used the tooling in manufacturing, a claim the automobile manufacturer could not make about its use of the tooling.

A similar result occurred when the Court considered whether soda-dispensing equipment purchased by the soda distributor and provided to a retailer for no monetary charge. The Court found resale based on the retailer's promise to bear the risk of loss for the equipment while in its possession. Thus, the purchase by the distributor was a tax-excepted sale-for-resale. Here again, the retailer was not taxable under the exemption formerly provided for items used in making retail sales. The distributor could not have made such a claim.

Still another example of broad application of the resale exception for businesses was the purchase of laundry services by a hotel. There, the Court held that the benefit of the otherwise taxable laundry services was resold in the form of lodging services. The resale exemption was applied to the hotel's purchase of laundry services. In that case, the ultimate consumption of the laundry services was taxable because the retail lodging services were taxable.

In each of these cases, the Ohio Supreme Court found that a sale-for-resale occurred. In each case, the Court pushed the question of taxability to the ultimate user or consumer of the item in question. The intermediary was given a pass on the tax under the resale exception. In this way, the recent decision in *Reds* is a continuation of prior resale/ultimate consumption decisions.

However, the significant break in this case from those in the past is that it involved items purchased to promote sales of other items. The promotional items were characterized by the Reds as free giveaways transferred to the ultimate purchasers of event tickets. Ticket prices did not vary between a game where free memorabilia was offered and others that did not. The implications of this decision may take years to fully understand and clarify. As an example, we are confident that our friends at quick-service restaurants will find the *Reds* decision helpful to combat sales tax historically paid on their purchases of toys included in kids' meals. Indeed, refund claims may be appropriate. Companies that provide toys in boxes of kids' cereal should benefit as well. This list of potential beneficiaries is quite long. The Court's decision may be a gift that keeps on giving, one for which we all might be thankful.

If you would like to discuss this decision in more detail and consider it in the context of your use of promotional items, please contact us.

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[1] The Ohio tax principles examined apply to other types of businesses as discussed later in this Tax Alert.

[2] The phrase "high rate of tax" admittedly is relative. As a comparison, we invite the readers' consideration of the Ohio Commercial Activity Tax with its much lower rate of 0.26% but with no available resale exemption.