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State and Local Tax Alert: Ohio Supreme Court Decision on Employment Services Requires Closer Analysis; Broad Tax Exclusion Not Likely Intended

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For nearly 30 years, Ohio taxpayers have been searching for an “easy answer” to avoid sales tax on employment services. There is no short supply of people who claim to know where that “holy grail” of Ohio tax solutions can be found. The recent decision by the Ohio Supreme Court in *Seaton Corp. v. Testa*, Slip Op. 2018-Ohio-4911 (12-12-18), is certain to advance that narrative. We caution taxpayers to read and apply *Seaton* very carefully.

That case focused on the statutory definition of employment services in R.C. 5739.01(JJ) which requires that personnel supplied must perform work or labor under the supervision or control of someone other than the provider (usually the customer). In *Seaton*, the service provider contracted with its customer to “furnish, manage and supervise” the staff it provided. The Court characterized the service relationship as one where:

Seaton was required to screen, hire, and train lower-level workers to assist in production operations at Kal Kan’s pet food manufacturing plant in Columbus, Ohio. This included maintaining an on-site office at Kal Kan’s plant, conducting interviews and testing applicants, and providing job orientation, uniforms, and safety equipment to those individuals selected for employment with Seaton at Kal Kan’s plant. Seaton was also required to schedule its workers, maintain an attendance policy, and process payroll. And by agreement, Seaton had “the exclusive right to control” Seaton workers; neither Kal Kan nor Seaton could “assign, direct, or oversee” the activities of the other party’s workforce.

The Tax Commissioner disagreed with the taxpayer. The commissioner determined the customer exercised control over its manufacturing process and facility in sufficient mode and manner that the customer necessarily supervised and controlled the personnel Seaton supplied. On the facts presented and as found by the Ohio Board of Tax Appeals, the Court sided with the taxpayer.

We believe there are several key points to take into account when trying to understand and apply *Seaton* as legal precedent.

1. The Court mentioned on numerous occasions that it was relying on the reasonable findings of fact by the Board of Tax Appeals as to control and supervision. To us, the record seemed light on facts drawn out by cross-examination of *Seaton's* witness regarding day-to-day, task-by-task control and supervision of assigned personnel. Instead, the Tax Commissioner seemed to misplace importance on his argument that because the customer controlled the overall facility, it must be in control of and supervise the assigned personnel. This was a tactical error not likely to be repeated. In follow-up disputes, the Tax Commissioner probably will explore and examine in great detail the nature and extent of supervision over people and tasks, not just of the plant, the facility or any processing line.
2. Supervision and control needs to be task specific to meet the standards set by the Ohio Supreme Court. In *Seaton*, the Court relied heavily on its earlier decision in *Crew 4 You, Inc. v. Wilkins* (2005), 105 Ohio St.3d 356. In denying the taxpayer argument there, the Court emphasized that it focused on the customer's control over schedules, workplace assignments, meetings, rehearsals and work tasks performed at the job site. Service providers often retain control over employment related factors (*i.e.*, W-2 payroll processing, designations of seniority and benefits within the service provider organization, drug screening, etc. ...). This type of control is not sufficient. Understanding the Court's recognition of two types of supervision and control to reach different tax results in *Seaton* and *Crew 4 You* is extremely important.
3. The type of assignment likely to qualify for the tax carve-out in *Seaton* is one where a third-party provider is required to take over an entire operation or sub-operation at a larger facility and to supervise the personnel on day-to-day tasks in performing the work. In *Seaton*, this operation was internal logistics. Businesses will need to consider carefully whether to cede nearly complete authority over portions of its operations and personnel at its own facilities in order to save sales tax. This should be a question looked at from many angles, including tax, human resources and employment law.

We recommend exercising great care and a balanced review of the pros and cons of the tax planning requirements from *Seaton* in the broader legal environment of the workplace. Some will rush to rely on *Seaton* as the easy answer to sales tax savings. This may backfire for tax or other reasons.

Like most things, if it seems too good or easy to be true, it probably is. It is highly unlikely that the Tax Commissioner will concede the loss of statewide tax revenue just because of one case and the notion of shifting control on paper alone.