

Wyandot, Inc.,)
)
 Appellant,) Case No. 95-J-1338
)
 vs.) (USE TAX)
)
 Roger W. Tracy,) DECISION AND ORDER
 Tax Commissioner of Ohio,)
)
 Appellee.)

APPEARANCES:

For the Appellant - Emens, Kegler, Brown,
 Hill & Ritter
 By: Melvin D. Weinstein
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 Columbus, Ohio 43215

For the Appellee - Betty Montgomery
 Attorney General of Ohio
 By: Janyce C. Katz, Assistant
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Entered October 3, 1997

Mr. Johnson, Ms. Jackson and Mr. Manoranjan concur.

The Board of Tax Appeals is considering this matter pursuant to a notice of appeal filed herein by Wyandot, Inc. ("Appellant") Appellant has appealed from a final determination of the Tax Commissioner which assessed use tax against the appellant. The body of the final determination provides in pertinent part:

"This assessment is the result of an audit of the petitioner's purchases from July 1, 1990, through June 30, 1991. The petitioner, a manufacturer of snack foods, filed a petition for reassessment objecting to a portion of the assessment. A hearing was held on the matter on February 22, 1994, in Columbus, Ohio at which time the petitioner was represented by Robert

Schmidt, Senior Vice-President of Finance and Administration, Robert Wentz, Vice-President of Accounting Services, and Steven Russi, an attorney from Emens, Kegler, Brown, Hill, & Ritter. Objections raised by the petitioner are discussed in the paragraphs below.

"The petitioner contends that certain assessed purchases qualify for exemption under either R.C. 5739.02(B)(15), the packaging exemption, or R.C. 5739.01(E)(10), the manufacturing exemption. It described the procedure for packaging its products as follows: After the food products are seasoned (the last step of processing under the manufacturing exception), they are moved to the packaging area where they are placed in an enclosed storage conveyor for approximately 10 minutes. At approximately the same time, other equipment adds labels and date codes to the plastic bags which form the package. From the storage conveyor, the products are moved through a check weighing system to an Ishida weigher where they are weighed in individual buckets and then dropped through a metal detector and hood into the labeled plastic bags. After the product is dropped into a bag, the bag is heat sealed and moved by a pack-off conveyor to a table where a human packer places bagged products into shipping cartons. The storage and check weigher are used after production has ceased and before packing has begun, and the date coder, labeler, metal detector, pack-off conveyor and table are not used in packaging. The date coder and labeler merely add information to the package material, a function the Supreme Court found not to be exempt in Loctite Corp. v. Tracy (1994), 71 Ohio St. 3d 401. Metal detectors do not act in any way to package the product. The use of the pack-off conveyor and table is similar to that of the conveyor used to move bagged flour from the bagging equipment to where workers manually placed the bags onto pallets, where they are secured in Mennel Milling Co. v. Limbach (January 31, 1991), Hancock App.

No. 5-89-4, unreported. The court there found the conveyor taxable. The objection is allowed as to the remaining items. The tax amount of \$21,642.83 will be removed from the assessment.

"The petitioner claims that certain assessed purchases are used in a continuous manufacturing operation as defined by R.C. 5739.011 and are therefore exempt. Raw material handling or equipment used to move finished products to a packaging or shipping area does not qualify for exemption under R.C. 5739.01(E)(10). Furthermore, manufacturing means that the equipment is used in transforming or converting raw materials into a different form than originally existing (sic). The contested items include air cylinders for corn cookers, repairs made to cheese slurry pumps, aluminum pans, repairs to chutes, gasketed doors, hoppers, repair parts for mill box assembly, an elevator bucket, mezzanine and stairs, bins, and chains. Other than the air cylinders, the commissioner is not convinced that the remaining items are part of a continuous manufacturing process. Pumping cheese slurry to a processing line is raw material handling and a taxable activity. Furthermore, the petitioner has failed to show how doors and a mezzanine and stairs qualify for the manufacturing exemption. Although the petitioner claims that hoppers, bins, and an elevator bucket are used in its manufacturing plant, these items are also used to handle raw materials prior to their introduction into the manufacturing operation. It has not established that the aluminum pans, chutes, mill box assembly, and chains are entitled to the manufacturing exemption. The tax amount of \$13.04 will be removed from the assessment."

The notice of appeal challenging the final determination provides:

"1. The Commissioner erred in assessing use tax on Appellant's purchase of tangible personal property used by Appellant directly or primarily in manufacturing within the meaning of Ohio Revised Code 5739.01(E).

"2. The Commissioner erred in assessing use tax on Appellant's purchase of tangible personal property used by Appellant in packaging activities within the meaning of Ohio Revised Code 5739.02(B)(15).

"3. The Commissioner erred in assessing use tax on Appellant's purchase of tangible personal property used by Appellant in packaging or manufacturing activities which were used in a continuous manufacturing operation within the meaning of Ohio Revised Code 5739.011.

"4. The Commissioner erred in finding that the repairs made to Appellants' (sic) cheese slurry pumps, and Appellant's purchases of aluminum pans, repairs to chutes, purchase of gasketed doors, hoppers, repair parts for mill box assembly, purchases of an elevator bucket, mezzanine and stairs, bins and chains were not part of a continuous manufacturing process within the meaning of Ohio Revised Code 5739.011.

"5. The Commissioner erred in finding that the purchases or repairs set out in paragraph 4, above, were not directly used in packaging activities within the meaning of Ohio Revised Code 5739.01(B)(15), or in the alternative, were not directly used in the manufacturing process within the meaning of Ohio Revised Code 5739.01(E).

"6. The Commissioner erred in finding that Appellant's storage conveyor and check weigher are used after production

has ceased and before packaging has begun and are thus not exempt from taxation under Ohio Revised Code 5739.01(E) or, in the alternative, 5739.02(B)(15).

"7. The Commissioner erred in finding that Appellant's date coder, labeler, metal detector, pack-off conveyor and table are not used in packaging and are thus not exempt from taxation under Ohio Revised Code 5739.01(E) or, in the alternative, 5739.02(B)(15).

"8. The Commissioner erred in assessing penalties and preassessment interest on the items appealed in paragraphs 1 through and including 7, above.

"9. The Commissioner's final determination is erroneous and contrary to law."

The matter has been submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript certified herein by the Tax Commissioner, the evidence adduced at the hearing conducted herein, which is contained in the hearing record ("R."), and the briefs filed by counsel for the parties.

In conducting our review, we acknowledge the presumption that the Tax Commissioner's findings are valid. As the Supreme Court held in Alcan Aluminum Corp. v. Limbach (1989), 42 Ohio St. 3d 121, 124:

"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."

It is therefore incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption of validity which attaches to the Commissioner's findings, 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. The taxpayer is assigned the burden of showing the manner and extent that the Tax Commissioner's determination is in error. Federated Dept. Stores, Inc. v. Lindley (1983), 5 Ohio St. 3d 213.

The appellant is an Ohio corporation based in Marion, Ohio. It manufactures a variety of fast food snacks such as white and yellow tortilla chips, corn chips, cheese puffs, popcorn, and caramel corn. (R. 11) Approximately eighty percent of appellant's products goes to the private label industry such as Eagle Snacks, Frito-Lay, Meijers, Aldi's food stores, and other independent grocers and salted snack manufacturers. The appellant sells to the private label companies under its own product names such as "Pow Wow", "Tender Delight", and "Munch Mate". These products are sold in case quantities of fifty to three hundred, to department stores, grocery chains and convenient stores, either directly, or through independent distributors. (R. 13, 14)

This case is being issued on the same day as Wyandot, Inc. v. Tracy, B.T.A. No. 95-J-1339, unreported, ("Wyandot I") which deals with use tax on the taxpayer's purchases during the period, July 1, 1988 through June 30, 1990. Except as otherwise indicated herein, the issues are largely the same in both cases. For sake of brevity, we will refer to the companion case wherever possible. For example, the taxpayer's production process is set out fully in the earlier decision.

Applicable Law

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¹ which read, in pertinent part:

"(E) 'Retail sale' and 'sales at retail' include all sales except those in which the purpose of the consumer is:

"(2) To incorporate the thing transferred as a material or a part, into tangible personal property to be produced for sale by manufacturing, assembling, processing,"

* * *

"(10) To use the thing transferred, as described in section 5739.011 of the Revised Code, primarily in a manufacturing operation to produce tangible personal property for sale."

Subsection (S) provides a definition of a "manufacturing operation":

"(S) 'Manufacturing operation' means a process in which materials are changed, converted, or transformed into a different state or form from which they previously existed and includes refining materials, assembling parts, and preparing raw materials and parts by mixing, measuring, blending, or otherwise committing such materials or parts to the manufacturing process.

'Manufacturing operation' does not include packaging."

R.C. 5739.011 provides a further definition:

"(6) 'Continuous manufacturing operation' means the process in which raw materials or components are moved through the steps whereby manufacturing occurs. Materials handling of raw materials or parts from the point of receipt or pre-production storage or of a completed product, to or from storage, to or from packaging, or to the place from storage, to or from packaging, or to the place from which the completed product will be shipped, is not a part of a continuous manufacturing operation."

Division (B) of R.C. 5739.011 contains a listing of machinery and equipment which may be included in the term "thing transferred" in division (E)(10). As further guidance in interpreting the statute, the Tax Commissioner promulgated Ohio Adm. Code 5703-9-21 which provides:

"(A) For purposes of this rule, all purchases of tangible personal property are taxable, except those in which the purpose of the consumer is to incorporate the thing transferred as a material or a part into tangible personal property to be produced for sale by manufacturing, assembling, processing, or refining or to use the thing transferred, as described in section 5739.011 of the Revised Code and this rule, primarily in a manufacturing operation to produce tangible personal property for sale. ...

"(B)(1) 'Manufacturing operation' means a process in which materials are changed, converted, or transformed into a different state or form from which they previously existed and includes refining materials, assembling parts, and preparing raw materials and parts by mixing, measuring, blending or otherwise committing such materials or parts to the manufacturing process. 'Manufacturing operation' does not include packaging.

"Tangible personal property purchased by a manufacturer for use in packaging is taxable unless exempted pursuant to division (B)(15) of section 5739.02 of the Revised Code. ...

"The manufacturing operation begins when the raw materials or parts are committed to the manufacturing process. If the raw materials or parts are stored after being received at the manufacturing facility, the raw materials or parts are not committed until after they are removed from such initial storage. The point of commitment is where the materials from such initial storage has ceased or the point where the materials or parts have been mixed, measured, blended, heated, cleaned, or otherwise treated or prepared for the manufacturing process, whichever first occurs. The commitment of the materials or parts need not be irrevocable, but they must have reached the point, after materials handling from initial storage has ceased, where they normally will be utilized within a short period of time. The point of commitment frequently will be different for particular materials and parts, since they are introduced at different times in the manufacturing operation."

This statutory definition of a manufacturing operation is a codification of many of the concepts that have been formulated by the Supreme Court in considering prior law. It is not essentially inconsistent with the former decisions. The Court has held that in order to determine whether an item is to be excepted from the definition of "retail sale", one must "identify the beginning and the end of the manufacturing process and determine whether the items in dispute were used or consumed primarily in the production of tangible personal property for sale by manufacturing or processing or in 'packaging'." Youngstown Bldg. Material & Fuel Co. v. Bowers (1958), 167 Ohio St. 363. In Southwestern Portland Cement Co. v. Limbach (1988), 35 Ohio St. 3d 196, the Court stated:

"To find a manufacturing exception under R.C. 5739.01(E)(2), it must first be determined that the manufacturing has occurred (i.e., a transformation or conversion of material or things into a different state or form has taken place). Then, the beginning and end of

the manufacturing must be delineated. Finally, it must be decided whether the item under examination was used or consumed directly in manufacturing (i.e., during and in the manufacturing period)."

The Court provided further clarification of this test in Ball Corp. v. Limbach (1992), 62 Ohio St. 3d 474:

"The challenge is to identify the beginning and the end of the manufacturing process and to determine whether items in dispute were used or consumed directly in the production of tangible personal property for sale by manufacturing or processing or in 'packaging.' ... It is not to determine whether such items are essential to the operation of an integrated plant; the question is rather, 'when does the manufacturing or processing activity begin and end, and is the property used or consumed during and in the manufacturing or processing period'."

The parties agree that the manufacture of appellant's snack foods begins when the raw corn is pumped from the silos to the precookers. For reasons set forth in Wyandot I, supra, we agree with the appellant that the manufacturing process ends when the products exit the seasoning drum.

Cheese Slurry Pump

The first item in question is appellant's cheese slurry pump. The cheese slurry is mixed in a kettle for approximately five minutes, and is then moved from the bottom of the kettle over to the seasoning applicator. The cheese is then sprayed onto the product through the seasoning drum. The pump is clearly used during the processing of appellant's snack foods. Apparently, the Commissioner agreed with this conclusion, finding that the repairs to the pumps in the cheese slurry area were entitled to the manufacturing exemption in Wyandot, Inc. v. Tracy, BTA Case No. 95-J-1339, unreported, released on the same date as the within appeal. The Board therefore finds that this item was improperly assessed herein.

Aluminum Pans

The appellant next challenges the assessment of its aluminum pans. These pans are located in the packaging area under the storage conveyors. As product is stored on the conveyor, some of the seasoning will fall off. They

serve as catch pans to catch the excess seasoning that falls off the product.

The Board finds that this item was properly assessed. In American Natl. Can Co. v. Tracy (1995), 75 Ohio St. 3d 150, the Court denied the packaging exemption to case erectors that produced cardboard containers. After the containers were formed, the bottles were manually placed in the containers. The Court held that the exception provided by R.C. 5739.01(B)(15) only applies to equipment used in placing tangible personal property produced for sale in packages.

The test to be applied in determining the packaging exception was further refined in Ball Corp. v. Limbach supra. In that case, the appellant sold bottles which were packaged in cartons. The Court held that a carton forming and conveying system was not packaging machinery or equipment, or an integral part thereof, and thus was not entitled to exception on that basis. However, exemption was allowed for the same carton forming and conveying system that made cartons which the taxpayer sold to its customers.

These cases focus upon the tangible personal property that is being sold, and then identifies the equipment that makes the packages, and places the property in the packages. Machinery or equipment that places the tangible personal property that is for sale in packages is entitled to the exception. Also, the exception has been allowed for systems that are integral parts of machinery or equipment that place tangible personal property in packages. Union Carbide Corp. v. Limbach (1992), 62 Ohio St. 3d 548. Custom Beverage Packers v. Kosydar (1973), 33 Ohio St. 2d 68.

Appellant's aluminum pans catch excess seasoning that falls off the product as it is being transported on conveyors to the Ishida weigher. This item does not make the bag nor does it place the tangible personal property in the bag. It also is not an integral part of the system that bags the product. The Board therefore finds that this item was properly assessed.

Chute Repairs and Hoppers

The appellant next challenges the assessment of repairs made to its chutes, and the assessment of its hoppers. In the packaging area, the product is vibrated out of the dispersion feeder onto the radial feeders, and into the pool hoppers. The pool hoppers act as a reservoir for the weigh hoppers. Once the proper weight is achieved, the weigh hoppers dump their load through the discharge chutes into the bags. These chutes and hoppers are an integral part of the system that places the chips into the bags. The Board therefore finds that these items were improperly assessed.

The appellant also uses hoppers in the production of popcorn, caramel corn, cheese puffs, and baked cheese crunch curls. The hoppers are used to feed the products to the oven in order to get even, uniform cooking. This step is clearly during the processing of appellant's snack foods. The Board therefore finds that the hoppers that feed the products to the oven were improperly assessed.

Gasketed Doors

Appellant has also objected to the assessment of an item described as gasketed doors. However, the record is silent regarding the use of this item, as is appellant's post hearing brief. The Tax Commissioner determined that this item was not part of the continuous manufacturing operation. The appellant has failed to submit any evidence showing how its gasketed doors were used. The Board therefore finds that this item was properly assessed.

Mill Box Assembly Repair Parts

The next contested items are repair parts for the mill box assembly. The evidence clearly showed that the corn is ground in the mill box assembly. The grinding action, and the amount of pressure produced in the mill box causes frequent replacement and repair. It is clear that the grinding of the corn is a necessary step which occurs during the production of appellant's snack foods. The mill box assembly and its repair parts were therefore improperly assessed.

Elevator Buckets

Appellant next challenges the assessment of its elevator buckets. The buckets transport the popcorn as it comes through the tumbler. Cheese and oil are sprayed on the popcorn at this stage. The popcorn is then taken into the bin by the buckets. As it goes up the elevator and into the bin, the cheese and oil begin to soak so that the popcorn is no longer moist when it comes out on the packaging side. This item is clearly used during the processing of appellant's products. Contrary to the Commissioner's finding, these buckets are part of appellant's continuous manufacturing process and were improperly assessed.

Mezzanine and Stairs

The next category includes appellant's mezzanine and stairs which provide access to the kettles during the cooking process. An operator stands on the mezzanine to perform various functions such as making sure the corn has been delivered to the kettles, making certain that the kettles are operating properly, and observing the pressure valves that control the amount of steam pressure in the individual kettles. The operator takes samples from his perch, and adds lime and water to the kettles as needed.

These items are not used directly in the production of appellant's snack foods. At best, they provide access to production area equipment. The mezzanine and stairs are not used or consumed in the production of appellant's product. The appellant has contended, by way of post-hearing brief, that the mezzanine and stairs are part of a continuous manufacturing process, since the precookers sit on the mezzanine, off the plant floor, while the soak vats fit down through openings in the mezzanine. However, the appellant is espousing the integrated plant theory which has been rejected by the Ohio Supreme Court. The Court stated in Ball Corp. v. Limbach, supra,

"Despite the complexities and improvements in sophisticated manufacturing processes, the issue for resolution in this case is as it was over thirty years ago when we decided Youngstown Bldg. Material & Fuel Co. v. Bowers (citation omitted). Here, as there, the challenge is to identify the beginning and the end of the manufacturing process and to determine whether items in dispute were used or consumed directly in the production of tangible personal property for sale by manufacturing or processing or in 'packaging.' . . . It is not to determine whether such items are essential to the operation of an integrated plant; the question is rather, 'when does the manufacturing or processing activity begin and end, and is the property used or consumed during and in the manufacturing or processing period'."

The mezzanine and stairs at best provide a perch for a worker to monitor the manufacturing process. They do not play a direct role in the process. Inasmuch as the mezzanine and stairs are not used in the production of appellant's snack foods, the Board finds that these items were properly assessed.

Bins and Chains

We next address appellant's bins and chains. Chains hold the bins and drive the elevator buckets that transport the popcorn through the tumbler. The bins and chains are used during the same stage as the elevator buckets. The chains drive the bins that hold the popcorn as the cheese and oil are allowed to soak in prior to packaging. As are the buckets, the bins and chains are part of appellant's continuous manufacturing process, and were therefore improperly assessed.

Remaining Issues

The following items were also at issue in Wyandot I, supra, and accordingly, we reiterate the holdings in that case:

1. Conveyor system. These items were properly assessed.
2. Check weigher. These items were improperly assessed.
3. Date coder and labeler. These items were improperly assessed.
4. Packoff conveyor and table. These items were improperly assessed.
5. Metal (mass) detector. This item was improperly assessed.
6. Penalties. The penalties were properly assessed.

Therefore, based upon the preponderance of the evidence, the Board finds and determines that the final determination of the Tax Commissioner should be, and hereby is, affirmed in part, and reversed in part, in accordance with the foregoing decision. The penalties and interest assessed on items determined herein to be entitled to exemption are hereby abated. The penalties and interest on items determined herein to have been properly assessed shall remain intact.

During the audit period, R.C. 5741.02 imposed an excise tax on the storage, use, or other consumption in Ohio of tangible personal property, or the benefit realized in Ohio of any service provided. The tax would not apply to the storage, use or consumption of tangible personal property or services purchased, if the sale of said property or services, or benefit, would not have been a taxable event had the sale occurred in Ohio. Therefore, only the sales tax provisions are discussed herein. ohiosearchkeybta