

# OHIO

## Description and Scope:

This document describes and critiques Ohio's imposition of sales tax on "automatic data processing," "computer services," and "electronic information services."

## Definitions and Impositions:

The Ohio sales tax base is largely determined by items that are included and excluded from the statutory definition of "sale."<sup>1</sup>

In addition to the inclusion of "specified digital products" under the Streamlined Sales Tax Agreement, the tax base also includes transactions in which "[a]utomatic data processing, computer services, or electronic information services are or are to be provided for use *in business* when the true object of the transaction is the receipt by the consumer of automatic data processing, computer services, or electronic information services rather than the receipt of personal or professional services to which automatic data processing, computer services, or electronic information services are incidental or supplemental."<sup>2</sup>

Prior to the adoption of these impositions came a series of cases considering data processing and computer services. One case involved taking a customer's records and returning those records in computerized, *printed*, form.<sup>3</sup> The court held the transactions were taxable as the printed product was tangible personal property.

Another case considered "time-sharing" of computer equipment.<sup>4</sup> The court held these providers of "centralized" computing were licensing the use of the computers, which were tangible personal property. In another case, the court held the results of data processing were taxable regardless of whether the result was a printout or not.<sup>5</sup> However, in this case, a hardcopy was eventually provided to the customer. The court relied on the licensing of the use of the computers as in the later *Babcock* case.

Subsequent to these cases, the Ohio General Assembly defined and imposed tax on automatic data processing, computer services, and electronic information services.<sup>6</sup> The three items were categorized as services and are defined below.

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<sup>1</sup> Ohio Rev. Code Ann. § 5739.01(B).

<sup>2</sup> Ohio Rev. Code Ann. § 5739.01(B)(3)(e).

<sup>3</sup> *Miami Citizens National Bank & Trust Company v. Lindley*, 50 Ohio St. 2d 249 (1977).

<sup>4</sup> *Babcock & Wilcox Co. v. Kosydar*, 48 Ohio St. 2d 251 (1976).

<sup>5</sup> *Citizens Financial Corp. v. Kosydar*, 43 Ohio St. 2d 148 (1975).

<sup>6</sup> Ohio Rev. Code Ann. § 5739.01(B)(3)(e).

“Automatic data processing’ means processing of others’ data, including keypunching or similar data entry services together with verification thereof, or providing access to computer equipment for the purpose of processing data.”<sup>7</sup>

“Computer services’ means providing services consisting of specifying computer hardware configurations and evaluating technical processing characteristics, computer programming, and training of computer programmers and operators, provided in conjunction with and to support the sale, lease, or operation of taxable computer equipment or systems.”<sup>8</sup>

“Electronic information services’ means providing access to computer equipment by means of telecommunications equipment for either examining or acquiring data stored in or accessible to the computer equipment or placing data into the computer to be retrieved by a designated recipient with access to the computer equipment.”<sup>9</sup>

These definitions appear to be inspired by the preceding cases, but the resulting definitions were not limited to the items that were the subject of the litigation. For example, the *Babcock* case considered “time-sharing” of computer equipment, by name. This can be defined as a design that “enables multiple users to operate a computer system concurrently without interfering with each other.”<sup>10</sup> However, the adopted definitions are not this precise. The Ohio General Assembly developed their own definitions, rather than limiting the impositions to the fact patterns of the cases.

Automatic data processing, computer services, and electronic information services do not include personal or professional services. Personal or professional services are defined as all services other than automatic data processing, computer services, and electronic information services, and a dozen services are specifically excluded.<sup>11</sup> The Ohio Supreme Court has stated that “the term ‘personal and professional services’ connotes services that are performed by people, which are distinct from services performed primarily by computer systems.”<sup>12</sup>

“Retail sale” or “sales at retail” includes all sales, except those in which the purpose of the consumer is to resell the thing transferred or benefit of the service provided, by a person engaging in business, in the form in which the same is, or is to be, received by the person.<sup>13</sup>

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<sup>7</sup> Ohio Rev. Code Ann. § 5739.01(Y)(1)(a).

<sup>8</sup> Ohio Rev. Code Ann. § 5739.01(Y)(1)(b).

<sup>9</sup> Ohio Rev. Code Ann. § 5739.01(Y)(1)(c).

<sup>10</sup> IBM, Time-Sharing, <https://www.ibm.com/history/time-sharing>.

<sup>11</sup> Ohio Rev. Code Ann. § 5739.01(Y)(1)(d) and (Y)(2).

<sup>12</sup> *Cincinnati Federal Savings & Loan Company v. McClain*, 168 Ohio St. 3d 123, 130 (2022).

<sup>13</sup> Ohio Rev. Code Ann. § 5739.01(E).

## **Critique:**

### *Clarity and ease of application:*

Ohio's definitions include multiple limiters. For example, electronic information services are limited to those provided by means of telecommunications equipment. This is further limited to examining or acquiring data stored in or accessible to the computer equipment, or placing data into the computer. But not just placing the data into the computer, placing the data into the computer specifically to be retrieved by the designated recipient. And not just to any designated recipient, but a recipient with access to the computer equipment. Each of these limiters is both a clarification and a potential point of contention as to whether the limiter applies.

Additionally, the imposition portion seems to create inconsistent tests: the true object test and the incidental or supplemental test. "Incidental" and "supplemental" could also have different meanings, further fragmenting the analysis.

Multiple tests create potential ambiguity. Using automatic data processing as an example, the true object of the transaction must be the receipt of automatic data processing. However, the imposition definition goes on to state "rather than the receipt of personal or professional services to which automatic data processing...[is] incidental or supplemental." Conceivably, automatic data processing may not be the true object of the transaction but may be more than "incidental or supplemental." The results of the first test suggest no tax, but the results of the second test suggest taxability. The double test diminishes clarity.

In *Cincinnati Federal*,<sup>14</sup> the Ohio Supreme Court ignored the potential inconsistency resulting from the combination of the true object test and the incidental or supplemental test. The Court ultimately held that the evidence should be evaluated to determine whether the charges "relate primarily" to automatic data processing and electronic information services or primarily to personal or professional services, without reference to the "incidental or supplemental" language in the statute.<sup>15</sup>

### *Revenue generation or stability:*

This is closely related to the clarity and ease of application criterion above. Ohio's imposition of tax on the three defined products contributes to revenue generation, especially at the outset. However, reliance on definitions with specificity and multiple limiters may not support tax base stability. In the long term, the specificity may cause even slight changes to products to entirely remove them from the tax base.

One example: electronic information services require the customer to access computer equipment to either examine or acquire data. This raises the question of whether the

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<sup>14</sup> *Cincinnati Federal Savings & Loan Company v. McClain*, 168 Ohio St. 3d 123 (2022).

<sup>15</sup> *Cincinnati Federal* at 130.

customer is examining or acquiring data or receiving a conclusion drawn from the data. The answer depends on the facts and the Ohio Supreme Court answered for one set of facts in a 2008 case.<sup>16</sup> The facts and result are not important, what is important is that the more limiters, the more the tax base depends on each taxpayer's facts, which can evolve.

*Compatibility with other elements of the tax structure:*

Ohio's three terms are categorized as services to ensure compatibility with the rest of the sales tax structure. The defined terms are discrete items that could be plugged into nearly any sales tax regime with minimal amendment. In Ohio, the items were inserted into an existing list of taxable services, ensuring that the accessory provisions in the sales tax were applicable. Additionally, Ohio is a member of the Streamlined Sales Tax system, so it is assumed Ohio's approach would not violate the Streamlined Sales Tax Agreement.

Most states' sales tax systems include a list of taxable services, providing an obvious place for the state to insert definitions similar to Ohio's.

*Pyramiding of taxes:*

Ohio's approach applies tax to the enumerated items only for "use *in business*." Ohio's imposition applies exclusively to business purchases and therefore leads to pyramiding.

*Other considerations:*

The statute applies for "use *in business*," and businesses will use products like automatic data processing and computer services across their entire network of business locations. This raises the specter of multiple points of use.

The Ohio Board of Tax Appeals has ruled that the true object test must be separately applied to each charge, "regardless of whether such services would be offered independently."<sup>17</sup>

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<sup>16</sup> *Marc Glassman, Inc. v. Levin*, 119 Ohio St. 3d 254 (2008).

<sup>17</sup> *Check Free Services Corp. v. Harris*, Case Nos. 2019-43 (2024), following *Cincinnati Federal Savings & Loan Company v. McClain*, 168 Ohio St. 3d 123, 130 (2022).