

Manufacturing Pelletized Slag: Ohio Supreme Court Addresses Application of Use Tax



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The Ohio Supreme Court (“Court”) in a May 31st opinion addressed the application of Ohio’s use tax to an Ohio facility processing slag. See *Lafarge North America, Inc., v. Testa, Tax Commr.*, 2018 WL 2440300.

Lafarge North America, Inc. (“Lafarge”) operates a facility (“Facility”) in Lordstown, Ohio, which manufactures pelletized slag.

Slag is a by-product that separates from molten ore during steelmaking. The Court notes that once separated from the ore:

. . . molten slag cools and solidifies into a stony substance. From there, it may be crushed into different sizes and used in construction applications, often as a base for roads.

The Lafarge Facility breaks up and transports solidified slag. The slag is obtained from a large slag mass (“Slag Mountain”) that was generated by numerous steel mills over several decades. The pelletized slag manufactured by the Facility is sold for use in road construction.

The Ohio Department of Taxation (“Department”) assessed use tax, interest, and a penalty against Lafarge for purchases for fuel and repair parts for equipment used at the Facility to break up and transport the slag.

Lafarge challenged the assessment.

The Board of Tax Appeals (“BTA”) affirmed. BTA concluded:

Lafarge is simply moving raw material from a pre-production point of storage, not ‘continuing’ a manufacturing operation.

If further noted that manufacturing begins when the slag pieces arrive at the mill.

In initially framing the issue on appeal the Court states that the applicability of the tax is dependent upon whether the activity is part of the Facility’s “manufacturing operations” under R.C. 5739.02(B)(42)(g). The use tax does not apply to the purchase of an item intended for use “primarily” in a manufacturing operation to produce tangible personal property for sale.

The Tax Commission had determined that the breaking up and transport of slag from the Slag Mountain precedes Lafarge’s manufacturing operation, concluding:

. . . Lafarge’s manufacturing operation does not begin until the slag reaches equipment that screens and sorts it by size.

The Department had concluded during an audit that various equipment used to remove and transport slag from the Slag Mountain were not part of the manufacturing operations. Therefore, purchases of fuel and repair parts for such equipment were deemed taxable.

In analyzing the issue the Court references a Lafarge manager's testimony before the BTA. The manager described a three-step process to produce marketable slag which included:

1. a bulldozer,
2. front-end loaders and dump trucks, and
3. a screening plant.

The Department conceded that Lafarge's production of pelletized slag was a manufacturing operation within the meaning of R.C. 5739.02(B)(42)(g). However, he had rejected the argument as to when the manufacturing operations were initiated. The activities at the Slag Mountain were characterized as merely excavating and transporting of raw material from storage. As a result, the argument was that the manufacturing operation did not begin until the slag reached the screening plant.

LaFarge responded that it breaks up the slag into marketable sizes almost entirely at the Slag Mountain (i.e., before the slag reaches the screening plant).

The Court, in assessing these arguments, considered the statutory definition of "manufacturing operation." It notes language in the definition which includes:

. . . a process in which materials are changed, converted, or transformed into a different state of form from which they previously existed.

It further notes a second part of the definition which lists activities included within the primary definition as merely illustrating types of actions that constitute a manufacturing operation.

Additional cited language clarifies that the manufacturing operation begins when the raw materials or parts are committed to the manufacturing process.

The Court, therefore, states that a determination as to whether the slag manufacturing operation begins at the Slag Mountain requires addressing two questions:

- When is the slag "changed, converted, or transformed into a different state or form from which it previously existed?"
- When is the slag committed to the manufacturing process?

The Court states that to answer such questions it must be noted that the object of Lafarge's manufacturing operation is to reduce the Slag Mountain to smaller marketable pieces of slag. It further states:

To get there, Lafarge simply breaks up the material and crushes it. Its process never involves mixing and blending in other materials, adding chemicals, heating, cooling, or otherwise treating the slag.

The Court further states that:

"the evidence shows that the equipment is not merely facilitating the transportation of slag from 'initial storage' to the screening plant. It is undisputed that after separating slag from the mountain, the bulldozer drives over it, crushing it in the process. To be sure, this action allows the front-end loaders to pick up the slag for transport, but the evidence does not support the conclusion that that is the bulldozer's only purpose.

The Court also notes that undisputed evidence indicates the slag does not undergo any significant transformation in form once it reaches the screening plant and that once it arrives at the screening plant the slag does not undergo any additional material change, conversion, or transformation into a different state or form from which it previously existed.

As a result, the final question is stated to be whether the fuel and repair parts purchased for the equipment at issue are used “primarily” in the manufacturing operation.

The main issue is therefore characterized as to the extent to which the fuel and repair parts are used in manufacturing as opposed to the landfill operation that Lafarge also operates at the same site. The Court states that on remand that the BTA should determine on the existing record the extent to which the use tax applies to the fuel and repair-part purchases that the company made for the six pieces of equipment it used for slag manufacturing at its Facility.

A copy of the [opinion](#) can be downloaded here.