A Clear Lens for Tax Statutes

by Edward J. Bernert


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In this article, Bernert provides background for the Ohio Supreme Court's decision in *Stingray* to no longer construe tax statutes providing exemptions in a manner favoring tax collection, and he explores some background for and potential implications of the opinion.

The Supreme Court of Ohio recently announced an important change in the way the court will interpret tax statutes. The majority of the court, through Justice R. Patrick DeWine, announced the new policy as follows:

> Our task is not to make tax policy but to provide a fair reading of what the legislature has enacted: one that is based on the plain language of the enactment and not slanted toward one side or the other. . . . Tax statutes must be read through a clear lens, not one favoring tax collection. Thus, we make clear today that henceforth we will apply the same rules of construction to tax statutes that we apply to all other statutes.[1]

At issue was the interpretation of a new Ohio statute that provided a sales and use tax exemption for items used directly in oil and gas production. This article will focus on the court's announcement generally and not examine the specific sales tax issues in the case.

The new approach to statutory construction is not confined to the decisions of the supreme court or appellate courts but must be adopted by the Ohio Department of Taxation and the Ohio Board of Tax Appeals (BTA). Before the decision, the Ohio tax commissioner expressed a narrow construction principle in final determinations of tax appeals, such as: "Laws relating to exemption are to be strictly construed against exemption."[2] In *Stingray*, the BTA applied a rule of strict construction for exemption, writing: "Because Stingray claims an exemption from the general operation of the sales tax, it must show that the amended statute 'clearly expresses the exemption in relation to the facts of its claim.'"[3] After *Stingray*, the BTA has revised its standard to provide that "tax statutes should be interpreted neutrally and not interpreted as 'favoring tax collection.'"[4]

Justice DeWine made clear that the court was intentionally departing from the long-established standard of narrowly construing tax exemption statutes.[5] The *Stingray* summary prepared by the court's public information office had the headline "Tax Case Decision Has Broad Implications for Future Tax Cases."[6] Therefore, some background

[1] *Stingray Pressure Pumping LLC v. Harris*, 2023-Ohio-2598, para. 22 (Ohio 2023); Chief Justice Sharon L. Kennedy and justices Patrick F. Fischer and Joseph T. Deters joined the majority opinion; Justice Jennifer Brunner concurred in judgement only; and justices Michael P. Donnelly and Melody J. Stewart concurred in part and dissented in part. The author was co-counsel for the taxpayer.

[2] Citing *National Tube Co. v. Glander*, 157 Ohio St. 407, 105 N.E.2d 648 (Ohio 1952); *Clear Wireless LLC*, Assessment No. 100000410037, Final Determination of the Tax Commissioner, at 3 (Feb. 16, 2023).

[3] Quoted in *Stingray*, 2023-Ohio-2598, para. 19.

[4] *Rino's Auto Sales Inc. v. McClain*, Ohio BTA No. 2019-2778, slip op. at 8 (Aug. 23, 2023) — a commercial activities tax case.

[5] *Stingray*, 2023-Ohio-2598, paras. 20-22.

[6] Dan Trevas, "Tax Case Decision Has Broad Implications for Future Tax Cases," Court News Ohio, Aug. 2, 2023.

is helpful to understand the court's decision in context and identify its implications.

The Origin of the Narrow Construction Doctrine

Justice DeWine said that the special rule for applying tax exemptions narrowly "appears to be a carryover from 19th century caselaw dealing with the Contracts Clause of the United States Constitution and limitations on intrusion into state sovereignty."[7] In Ohio, in what appears to be the earliest expression of the rule, the supreme court stated that "laws relating to exemption of property from taxation being in derogation of equal rights are strictly construed."[8] No authority was cited for this position in the syllabus or body of the case, but the court declared the principle to be "well settled."[9]

Steve R. Johnson, who has written extensively on the canons for interpreting state tax statutes, observed that many courts cited the principle without explaining the basis for the rule.[10] Johnson speculated that the doctrine likely reflected the principle of horizontal equity — "the idea that similarly situated taxpayers should be taxed similarly."[11]

Justice DeWine acknowledged the horizontal equity arguments as the basis for the rule of narrow construction. He cited an Ohio property tax case to the effect that an exemption places a heavier burden on the nonexempt.[12] To the extent that horizontal equity is a policy justification for the rule for taxes generally, the principle reflects tax policy and not a means of divining legislative intent. In Ohio, the General Assembly has announced legislative principles that are to be used as aids in the construction of statutes.[13] The rule of narrow construction is not listed by statute. Moreover, the rule does not by its nature reflect a means of interpreting legislative language but reflects a substantive rule of law that can frustrate rather than fulfill legislative intent by imposing an overly restrictive reading of the statutory language that is inconsistent with the actual words used therein.

The majority opinion in *Stingray* rejected the application of the tax policy favoring the narrow construction of tax exemptions. The opinion instead chose to apply the "plain and ordinary meaning of the statutory text."[14] The key to construction becomes what the language of the statute provides unencumbered with a narrow reading intended to project a limiting tax policy against applying the words of the statute as enacted. The rules of construction for tax laws must mirror the mode of analysis applied to nontax statutes.[15]

An equal and fair application of the tax scheme unquestionably is a desirable policy goal. Sometimes the addition of an exemption by the legislature, however, is intended to place the exemption's beneficiaries on the same footing as another class of already exempt taxpayers. In other cases, the legislature determines that an exemption is needed to make the state competitive and attractive to business. The core of Justice DeWine's analysis is that tax policy decisions are within the prerogative of the legislature and not the judicial branch.[16]

Stingray Was Foreshadowed by Earlier Cases

Stingray, despite being a clear break from the prior method used to construe tax exemption statutes, is a logical step in the progression of the law. In 1999, the Ohio Supreme Court applied an important proviso to the narrow construction principle when it stated, "We read exemption statutes strictly, but we will not require more qualifications for an exemption than the General Assembly does."[17]

Stingray reflects an understanding that the evaluation of the meaning of statutes is the role of

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[7] Justice DeWine cited Justice Antonin Scalia and Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 395-363 (2012); *Stingray*, 2023-Ohio-2598, para. 21.

[8] *Cleveland-Cliffs Iron Co. v. Glander*, 145 Ohio St. 423, syllabus 3 (1945).

[9] *Id.* at 430.

[10] Steve R. Johnson, "Interpreting State Tax Exemptions, Deductions, and Credits," *State Tax Notes*, Feb. 23, 2009, p. 607.

[11] *Id.* at 608, citing David Brunori, *State Tax Policy: A Political Perspective* 17-18 (2005).

[12] *Stingray*, 2023-Ohio-2598, para. 21, citing *Parma Heights v. Wilkins*, 105 Ohio St. 3d 463, 2005-Ohio-2818, para. 10 (Ohio 2005).

[13] See the general provisions of the Ohio Revised Code.

[14] *Stingray*, 2023-Ohio-2598, para. 20.

[15] *Id.* at para. 22.

[16] *Id.* at para. 21.

[17] *Newfield Publications Inc. v. Tracy*, 87 Ohio St. 3d 150, 153 (1999) (internal citations omitted). The author was counsel in that case.

the courts that are responsible for determining the applicable law. A distinct but parallel concept addresses whether the courts should defer to the interpretation of statutes by taxing agencies. In 2012, the Ohio Supreme Court expressed the court's role in determining legal issues on appeal from the BTA as it found that "the proper construction and application of [tax statutes] presents a question of law, and our review in that regard is not deferential but *de novo*."[18] This principle also was reflected in a widely followed nontax case as the court reaffirmed that its proper role was to determine what the law means regarding all laws administered by state administrative agencies.[19] "We reaffirm today that it is the role of the judiciary, not administrative agencies, to make the ultimate determination about what the law means."[20]

Then last year the court addressed whether some services were taxable automatic data processing/electronic information services or nontaxable personal services. The court found that personal services were distinct from the taxable services and should not be classified as exemptions from those taxable categories and thus avoided the issue of how narrowly to construe tax exemptions. Justice DeWine, however, in a concurring opinion joined by now-Chief Justice Sharon L. Kennedy, raised the issue of the proper construction of exemptions, writing: "Unless the legislature has explicitly provided otherwise, the traditional rules of statutory construction apply."[21] The rationale in the concurring opinion in *Cincinnati Federal* in 2022 was adopted as the majority opinion in *Stingray*.

Application of the Principle Outside Tax Exemption Cases?

The *Stingray* decision addressed the application of tax exemptions and did not address the use of the liberal construction in favor of the taxpayer when construing tax imposition statutes. Earlier, the Ohio Supreme Court found that the principle of the liberal construction in favor of taxpayers in tax imposition matters to be "a central tenet of tax jurisprudence" in that "a statute that imposes a tax requires strict construction against the state, with any doubt resolved in favor of the taxpayer."[22]

The principle that a tax statute should "not be extended by implication beyond the clear import of the language" is well recognized in the law.[23] This concept can be traced back to an 1869 statement made before the House of Lords by Lord Cairns:

> I am not at all sure that in a case of this kind — a fiscal case — form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.[24]

In the majority opinion in *Stingray*, Justice DeWine stated explicitly that the court would not read the statute to favor tax collection. He then stated that the rules of construction for tax cases should mirror the rules of construction that the court applies to all other statutes.[25] Does this signal that the court will abandon the rule of liberal construction when a tax imposition statute is being considered? Because important

[18] *Progressive Plastics Inc. v. Testa*, 2012-Ohio-4759, para. 15 (2012).

[19] *TWISM Enterprises LLC v. State Board of Registration for Professional Engineers & Surveyors*, No. 2022-Ohio-4677, para. 3 (Ohio 2022), cited in *Stingray*, 2023-Ohio-2598, para. 18.

[20] *Id.* at para. 3.

[21] *Cincinnati Federal Savings & Loan Co. v. McClain*, 2022-Ohio-725, para. 50 (2022).

[22] *Columbia Gas Transmission Corp. v. Levin*, 2008-Ohio-511, para. 34 (2008), citing *Gulf Oil Corp. v. Kosydar*, 44 Ohio St. 2d 208, 339 N.E.2d 820 para. 1 of the syllabus (Ohio 1975). *See also Bosher v. Euclid Income Tax Board of Review*, 2003-Ohio-3886, para. 14 (2003) (applying the same principle to Ohio municipal income tax).

[23] *United States v. Merriam*, 263 U.S. 179 (1923).

[24] *Partington v. Attorney General*, L.R. 4 H.L. 100, 122 (1869).

[25] *Stingray*, 2023-Ohio-2598, para. 22.

distinctions exist between the narrow construction rule for exemption and the liberal construction of tax imposition statutes in favor of taxpayers, the liberal construction standard for tax statutes should survive the rejection of the narrow construction standard.

First, the majority rejected the use of the narrow construction standard as reflecting tax policy, which is the province of the legislative branch and should not drive courts' decisions.[26] In contrast, the liberal construction of tax imposition statutes has been classified by the court as "a central tenet of tax jurisprudence."[27] Tax jurisprudence is different than tax policy. "Jurisprudence" refers to the theory of law and encompasses the process by which courts make decisions. While tax policy is the province of the legislature, the courts have a central role in developing tax jurisprudence. As a rule of tax jurisprudence, the rule of liberal construction of tax imposition statutes should continue to be applied.

The second reason to distinguish the two rules of construction is Justice DeWine's observation that the narrow construction principle is at odds with the application of the plain and ordinary meaning of the words of the statute.[28] The rule places the court in a position of second-guessing the "right" result in a case, not because of the language of the statute, but despite the statute. In contrast, the liberal construction principle honors and advances a focus on the reading of the words of the statute by insisting that the words are to be applied to determine whether the statute imposes the tax.

I propose the following three elements for reading tax statues:

- The plain and ordinary meanings of the words in the tax statute are to be applied.
- The tax statute is to be read with a clear lens and should not reflect an interpretation favoring taxation.
- The legislature must impose the tax or create the exemption by the language of the statute, and neither condition should be created by implication.

Commissioner's Presumption of Correctness Remains the Law

The rule of narrow construction and the presumption of correctness sometimes have been conflated to suggest that a taxpayer bears a burden to show that the exemption statute clearly applies. The presumption of correctness, however, is not a rule of statutory construction but a statement of the burden of proof imposed on taxpayers. Ohio law sets forth the presumption of correctness in the following terms: "For the purpose of the proper administration of this chapter [the Ohio sales tax], and to prevent the evasion of the tax, it is presumed that all sales made in this state are subject to the tax until the contrary is established."[29] The tax commissioner does not have the burden to prove that the tax is due; instead, the taxpayer has the burden to show that the tax commissioner's assertion of liability is incorrect. This is an evidentiary standard. In Ohio there is not a high standard for rebutting the presumption — the taxpayer's "burden for rebutting the tax commissioner's finding is simply to prove that the findings were incorrect."[30] Thus, the taxpayer must present evidence to support the claim for exemption, and *Stingray* does not eliminate that requirement. But the presumption of correctness does not dictate how the statute is to be interpreted.

Where Do We Go From Here?

In a recent decision, the Supreme Court of Michigan did not go as far as the Ohio Supreme Court in rejecting the narrow construction rule but instead limited its role:

> We take this opportunity to clarify that because the canon requiring strict construction of tax exemptions does not help reveal the semantic content of a statute, it is a canon of last resort. That is, courts should employ it only when an act's language, after analysis and subjection to

[26] *Id.*

[27] See *Columbia Gas* and *Bosher*, *supra* note 22.

[28] *Stingray*, 2023-Ohio-2598, para. 20.

[29] Ohio Rev. Code section 5739.02(C).

[30] *Accel Inc. v. Testa*, 2017-Ohio-8798, para. 14 (2017).

the ordinary rules of interpretation, presents ambiguity.[31]

Perhaps more state courts will revisit the use of narrow construction principles in tax cases in the future.

The *Stingray* decision eliminates the bias against taxpayers when construing a statute creating a tax exemption but does not create a bias in favor of tax exemptions, which are not to be created by implication. The court's reasoning reveals a robust and rigorous review of the facts and the statute before determining that the exemption applies. It would be a mistake for taxpayers to assert an overly broad approach when claiming exemptions by combining dubious claims with the more defensible claims of exemption and then count on the tax department, the BTA, or the state supreme court to sort the wheat from the chaff. In *Stingray*, the taxpayer avoided asserting an exemption for items, such as the frack tanks and monitoring equipment, that were essential to the production of oil and gas but could not be deemed to be used directly for tax purposes. Taxpayers and practitioners need to be careful when presenting cases so that the court does not come to regret rejecting the traditional bias in favor of taxation.

The department and the BTA have emphasized the rule of narrow construction in audits, reviews at tax appeals within the tax department, and appeals to the BTA and the courts. It is reasonable to expect that the tax department will be compelled to apply a more even-handed reading of tax exemptions going forward. ■

[31] *TOMRA of North America Inc. v. Department of Treasury*, 952 N.W.2d 384, 389 (Mich. 2020) (quotation and footnote omitted).