Members Brief

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Excise Taxes on Food and Drinks

The Ohio Constitution and state law limit the applicability of the retail sales and use tax to certain food and beverage purchases. Generally, food that is purchased for consumption away from the place where it is sold cannot be subject to the sales tax. So, in general, while one's grocery bill or takeout order is tax free, a dine-in meal at a restaurant is taxed. However, there are numerous exceptions and nuances that affect whether a particular food purchase is subject to the sales tax.

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Introduction

In 1934, the General Assembly enacted the state's first retail sales tax. Though the tax exempted the sale of liquid milk consumed off of the premises where sold and loaves of bread, no other foods were exempted. In the midst of the Great Depression, levying the tax on food, in particular for home consumption, was decidedly unpopular. In response, in 1936, voters initiated and approved a constitutional amendment which prohibited levying an excise tax on the sale of

food that is consumed off of the premises where it is purchased.[1] The amendment effectively limited the sales tax to food sold and served in areas under the control of the seller, such as restaurants, which were seen as more of a luxury.[2]

After voters passed the constitutional amendment, the General Assembly codified the exemption.[3] However, in doing so, the legislature sought to limit the scope of the exemption by defining food to exclude certain products, such as alcoholic beverages, soft drinks, candy and confectionery, and various medicines and dietary supplements.

> *"[N]o excise tax shall be levied or collected upon the sale or purchase of food for human consumption off the premises where sold."*
>
> Article XII, Section 3(C), Ohio Constitution

This brief explores these limitations or exclusions, along with other definitional questions and nuances, several of which became the subject of court challenges.

What is "food"?

Currently, for sales tax purposes, "food" includes any liquid, concentrated, solid, frozen, dried, or dehydrated substances that are sold for consumption by humans for taste or nutritional value. Soft drinks, tobacco, alcoholic beverages, and dietary supplements are specifically excluded from this definition and so are subject to the sales tax.[4] This definition of food is influenced by the multi-state Streamlined Sales and Use Tax Agreement ("SSUTA"). Ohio became a full member to the SSUTA on January 1, 2014, and is obligated to conform its sales tax law to the Agreement.[5] Part of that requirement is using the SSUTA's uniform definitions. Accordingly, Ohio's definition of "food" closely follows that of the SSUTA, with no substantive difference.[6]

Candy

The SSUTA authorizes a member state to exclude candy from its definition of food, but Ohio has not done so because courts have interpreted the constitutional food exemption to include candy. In fact, after the General Assembly codified the sales tax exemption for most food, the first controversy arose from its attempt to exclude candy and confectionary from the

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[1] Article XII, Section 3(C), Ohio Constitution (originally Article XII, Section 12, Ohio Constitution).

[2] See *Castleberry v. Evatt*, 147 Ohio St. 30, 34 (1946); see also Mark Wert, *Here's Why a Cup of Coffee Is Tax Free in Ohio*, Cincinnati Enquirer (September 9, 2014), which may be accessed by conducting a keyword "coffee sales tax 2014" search on the Cincinnati Enquirer's website: cincinnati.com.

[3] Ohio Gen. Code Ann. § 5546-2 (Banks-Baldwin 1940) (now R.C. 5739.02(B)(2)).

[4] R.C. 5739.01(CCC)(1).

[5] See the Ohio details page, which may be found by following the link under the "Full Member States" heading on the Streamlined Sales Tax Governing Board's homepage: streamlinedsalestax.org.

[6] Appendix C, Part II, Pages 113-117, Streamlined Sales and Use Tax Agreement (PDF), which is available under the library section of the Streamlined Sales Tax Governing Board's website: streamlinedsalestax.org.

definition of food, and thereby subject them to the sales tax. In 1939, the Ohio Supreme Court took up this question and ruled the taxation of these products to be unconstitutional. Using a dictionary definition of candy, and referencing the practice of travelers using candy when traveling, the Court found candy to be classified as food protected from taxation by the Ohio Constitution. That a food may be considered unhealthy or a luxury was not enough to exclude it from that protection.[7]

Soft drinks and other beverages

One of the original exclusions from the definition of food that still remains is that for soft drinks, and its definition can produce curious results. Under current law, a soft drink is any nonalcoholic beverage that contains natural or artificial sweeteners. However, the term does not include any beverage that contains milk products or substitutes, such as soy or rice, or that is more than 50% vegetable or fruit juice.[8] This definition, particularly with the exclusions, encompasses products that one may not typically think of as soft drinks.

Juice

For example, certain fruit or vegetable juices are considered soft drinks while others are not. This difference hinges on the concentration of pure fruit or vegetable juice in the beverage as well as whether or not the juice has added sweeteners.[9] This was, in essence, the conclusion an Ohio court came to in 1972, before the General Assembly had statutorily defined soft drinks. At that time, the statutory definition of tax-exempt food explicitly included "fruits, fruit products and pure fruit juices." The court ruled that while pure fruit juices were food, the beverages at issue had been adulterated with substances not found in the pure juice, e.g., sugar, coloring agents, and acids, so the beverage did not qualify as tax-exempt food.[10] Now, the exemption applies to juice drinks that have over 50% juice, so this standard has been relaxed somewhat, but it still draws a line between exempt and nonexempt juice drinks.

Coffee

When the General Assembly first defined food after the 1936 amendment, coffee, along with tea and cocoa, were explicitly included in that definition.[11] Today, whether coffee is subject to the sales tax can be more complicated. When a coffee contains sugar or another sweetener, it is a nonalcoholic beverage that contains a sweetener, making it fit the definition of a taxable

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[7] *Andrews v. Tax Com. of Ohio*, 135 Ohio St. 374, 376 (1939).

[8] R.C. 5739.01(CCC)(2)(c). This is the same as the definition in the SSUTA, see Appendix C, Part II, Page 116, Streamlined Sales and Use Tax Agreement (PDF), which is available under the library section of the Streamlined Sales Tax Governing Board's website: streamlinedsalestax.org.

[9] See Plaindealing, Cleveland Plain Dealer, November 29, 2000, at 1E, available at 2000 WL 5177530 ("On [the Tax Commissioner's] desk are two bottles of Snapple, one of which is taxable in Ohio and the other of which is not. The reason? The percentage of fruit juice is greater in one than the other, thus making one a food item and the other a taxable beverage.").

[10] *Beatrice Foods Co. v. Porterfield*, 33 Ohio App.2d 83, 84-86 (1st Dist. 1972).

[11] Ohio Gen. Code Ann. § 5546-2 (Banks-Baldwin 1940).

soft drink. However, if that sweetened coffee also contains milk, milk products, or milk substitutes, it no longer qualifies as a soft drink and is exempt when purchased to-go.[12]

Wholesale soft drinks

In 1992, the General Assembly enacted an excise tax on the wholesale sale of soft drinks and soft drink syrup.[13] Just like in 1936, this prompted an initiated constitutional amendment, which was approved by voters in 1994.[14] The new amendment prevented excise taxes at the wholesale level on food, but the amendment defined food to include all nonalcoholic beverages, including soft drinks.

> *"No sales or other excise taxes shall be levied or collected . . . upon any wholesale sale or wholesale purchase of food for human consumption, its ingredients or its packaging . . . . For purposes of this section, food for human consumption shall include non-alcoholic beverages. This section shall not affect the extent to which the levy [of excise taxes on the sale of food] is permitted or prohibited by Section 3(C) of this Article."*
>
> Article XII, Section 13, Ohio Constitution

Interestingly, this amendment seems to have solidified the constitutionality of the General Assembly's levy of the regular sales tax on soft drinks. Prior to the 1994 amendment, an argument could have been made that soft drinks should have been treated the same as candy, and that the General Assembly should not have been permitted to exclude them from the definition of "food" simply because they are unhealthy or a luxury. One trial judge even ruled that way in the lead up to the constitutional amendment.[15] However, the 1994 amendment specified that it had no effect on the levy of a regular sales tax under the 1936 amendment. Presumably, the amendment's sponsors could have taken the opportunity to define food to include nonalcoholic beverages for the purposes of that section as well, but did not.

Supplemental nutrition assistance program

Ohio law also specifically exempts from sales and use tax food purchased with federal Supplemental Nutrition Assistance Program (SNAP) benefits, but, for this exemption, the definition of food cites to federal law.[16] The only significant differences this makes is with regard to soft drinks and foods that are sold hot. Under federal law, food means "any food or food product for home consumption," except for alcoholic beverages, tobacco, and "hot foods or hot food products ready for immediate consumption."[17] The federal definition does not exclude soft

[12] See Wert *supra* note 2.

[13] H.B. 904 of the 119th General Assembly, 144 Ohio Laws 6726-33.

[14] Article XII, Section 13, Ohio Constitution.

[15] *Lobbyist, Lawmakers Uncork Pop Tax Again*, Dayton Daily News (August 23, 1993) (discussing *Ohio Soft Drink Assoc. v. Tax Commissioner*, 93-CV-000729, Franklin County Court of Common Pleas (1993)).

[16] R.C. 5739.02(B)(16) (citing 7 U.S.C. § 2012 and related federal regulations); O.A.C. 5703-9-48 (same).

[17] 7 U.S.C. § 2012(k).

drinks. Accordingly, while purchasing a soft drink from a grocery store with cash would be subject to Ohio's sales tax, if it is purchased with SNAP benefits, the soft drink would not be taxed.

What is the "premises where sold"?

The constitutional amendment prohibited sales tax on food consumed off the premises where sold. When the exemption was first codified, premises was not defined and so the Ohio Supreme Court was left to determine what qualified and what did not. Under current law, the definition of premises includes any property or portion of property where a person makes retail sales or otherwise uses the property in conjunction with their business.[18]

"'Premises' includes any real property or portion thereof upon which any person engages in selling tangible personal property at retail or making retail sales and also includes any real property or portion thereof designated for, or devoted to, use in conjunction with the business engaged in by such person."

R.C. 5739.01(K).

One of the first questions about what premises meant dealt with vending machines. The Court was presented with two theories. The first, referred to as the metes and bounds theory, posited that the entire building where sales of food were consummated constituted the premises. The control theory, meanwhile, argued it was only the limited portion of a building or structure which the vendor had actual possession of or control over which counted. In adopting the control theory, the Court relied on the intention of the voters in adopting the constitutional amendment, reasoning that taxing food served in restaurants and similar establishments, under the control of the vendor, was the object. Accordingly, because the vendor only operated the vending machines and had no other control over the premises, its food sales were exempted from sales tax. In reaching this decision, the Court also implied that deliveries would be similarly exempted.[19]

Next, the Court considered the sales of a contracted concessions vendor at Old Cleveland Stadium. Customers would buy food from booths or vendors in the stands and consume it in the stadium. Again using the control theory, the Court reasoned that because the vendor did not have exclusive control of the premises, similar to the vending machine case, the sales were not subject to taxation.[20] In contrast, the Court later interpreted premises to include the parking lot of a drive-in ice cream shop. Although not a part of the building in which the sales were made, customers frequently consumed the food in the parking lot, which was both in the actual possession and control of the vendor.[21]

However, exclusive control over the area of consumption is not necessarily the only determining factor. For example, a third party that operated a company cafeteria was found liable for sales tax, even though it was the company that furnished and equipped the eating

[18] R.C. 5739.01(K).

[19] *Castleberry v. Evatt*, 147 Ohio St. 30, 33-34 (1946).

[20] *Cleveland Concession Co. v. Peck*, 159 Ohio St. 480, 484 (1953).

[21] *Ilersich v. Schneider*, 176 Ohio St. 255, 256-57 (1964).

space. In this case, the Court focused on the primary purpose of the operation, which was to provide restaurant and cafeteria facilities to company employees. The fact that the vendor did not have exclusive control of the dining area was not enough to exempt its sales.[22] Similarly, common food courts are also considered to be the premises of restaurants connected to them for sales tax purposes.[23]

Other food exemptions

Exemption for school food sales

Transactions between certain vendors and customers are explicitly exempted separately from the general exemption. For example, food sold to students by a school from a cafeteria, dormitory, fraternity, or sorority is also exempted from the sales tax. This exemption applies to private, public, and parochial schools as well as colleges and universities. It is not conditioned on the food being consumed off-site.[24]

Exemption for employer-served food

Additionally, meals served to employees by their employer without charge are also not considered sales subject to taxation, so long as the employer records the meals as part of the employees' compensation for services performed or work done.[25]

Exemption applicability to other taxes

The Ohio Supreme Court declined to extend the food and drink exemption beyond the sales tax. Shortly after the commercial activity tax (CAT) was enacted in 2005, a group of grocers challenged the tax arguing that as applied to their business, it was no more than an excise tax on the sale of food.[26] The Court held that the CAT was not an excise tax "upon the sale or purchase of food" and so did not violate the Ohio Constitution. Instead, the CAT is a privilege-of-doing-business tax, and the constitutional provisions do not prohibit using the gross receipts from food sales to compute the value of that privilege. The distinction is "between a tax *upon* a certain factor and a tax upon a privilege *measured by* that factor."[27] The Court drew on precedent from the corporation franchise tax that the CAT replaced and on the wording of both constitutional amendments which limit the exemption to excise taxes, not franchise taxes, i.e., a privilege-of-doing-business tax.[28]

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[22] *Buddies Lunch System, Inc. v. Bowers*, 170 Ohio St. 410, 414-15 (1960). The Court also noted here that the codification of the definition of "premises" in 1959, though not applicable to the time period at issue in the case, would also produce the same result.

[23] *D&A Rofael Enters., Inc. v. Tracy*, 85 Ohio St.3d 118 (1999).

[24] R.C. 5739.02(B)(3).

[25] R.C. 5739.02(B)(5).

[26] H.B. 66 of the 126th General Assembly.

[27] *Ohio Grocers Ass'n v. Levin*, 123 Ohio St.3d 303, 2009-Ohio-4872, ¶¶ 16-17 (emphasis in original).

[28] *Id.* at ¶¶ 28-29.