

IN THE SUPREME COURT OF OHIO

OHIO GROCERS ASSOCIATION, et al., :
 :
 : Plaintiffs-Appellees, : Case No. 08-2018
 :
 : v. : On Appeal from the Franklin
 : County Court of Appeals,
 WILLIAM W. WILKINS, [RICHARD A. : Tenth Appellate District
 LEVIN], in his official capacity as Ohio Tax :
 Commissioner, : Court of Appeals Case
 : No. 07AP-813
 :
 Defendant-Appellant. :

MERIT BRIEF OF PLAINTIFFS-APPELLEES
OHIO GROCERS ASSOCIATION, CARFAGNA'S, INCORPORATED,
CFZ SUPERMARKETS, INC., READING FOOD SERVICES, INC.,
AND THE SANSON COMPANY

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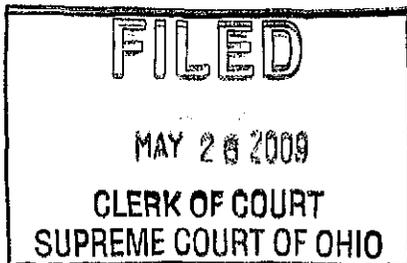


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INTRODUCTION

“[T]here is no economic consequence that follows necessarily from the use of the particular words, ‘privilege of doing business,’ and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect.”
Complete Auto Transit, Inc. v. Brady (1977), 430 U.S. 274, 288.

In 1934, at a time of high unemployment, significant economic distress, and compelling state budgetary need, the General Assembly imposed for the first time a general sales tax, including sales of almost all food. The reaction of Ohio’s citizens was to immediately pass an amendment to Ohio’s Constitution prohibiting not only the sales tax on food but all “excise taxes” “levied or collected upon the sale or purchase of food.” Ohio Constitution, Article XII, Section 3(C). Approximately sixty years later, when the General Assembly attempted to impose a tax on food at the wholesale level, Ohio’s citizens again passed another amendment to the Constitution making it clear that all hidden taxes on food, including those at the wholesale level, were prohibited. Ohio Constitution, Article XII, Section 13.

Thus, Article XII, Section 3(C) and Section 13 combine to prohibit the imposition of all excise taxes levied or collected on the sale or purchase of food at the wholesale level and at the retail level when such food is to be consumed off the premises where sold. Because the taxation of the food increases the costs of food for consumers, these provisions are intended to prohibit all excise taxes on the sales of food, except for dine-in sales, from being a source of revenue for the State of Ohio.

This case involves the applicability of these Constitutional provisions to Ohio’s recently adopted commercial activity tax (the “CAT”), which for the first time in Ohio’s history imposes a general business tax based solely upon gross receipts. When receipts are generated from the sale of food, the CAT operates and has the effect of imposing a tax liability on every dollar of food sold in Ohio. For every \$100 of food sold, a corresponding tax of \$0.26 is incurred.

Simply put, the CAT is an excise tax, and by operation and effect, it is levied or collected upon the sale or purchase of food.

According to the State of Ohio, however, the broad prohibitions against taxing food sales contained in the Ohio Constitution do not apply to the CAT because 1) Section 3(C) and Section 13 should be interpreted to apply to sales taxes only; and 2) the CAT is not a sales tax but rather a tax “on the privilege of doing business in Ohio *measured by* gross receipts.” Thus, the issue in this case is simple to state: Can the State of Ohio avoid the will of Ohio’s citizens as expressed in the Ohio Constitution’s prohibition against taxing food simply by labeling a tax levied upon the gross receipts from the sale of food a privilege tax measured by gross receipts? The answer to this question must be an unqualified no.

Ohio’s constitutional prohibitions against the taxing of food are not limited to sales taxes alone, but rather, apply to a broad category of taxes, excise taxes, including those like the CAT. Second, the validity of any particular tax is not governed by the label given that tax by the General Assembly. Rather, a state tax must be examined by its operation and substantive effect. Labeling the CAT a privilege tax measured by gross receipts does not change the inherent nature of what is being taxed. Common sense and logic tells us that a tax that is “measured by” gross receipts is a tax on such gross receipts. Common sense and logic tells us that a tax “measured by” food sales is a tax upon the sale and purchase of food. Economically, the CAT, when imposed on the receipts for the sale of food, has the same financial effect on Ohio’s consumer as a traditional sales tax. Simply put, the substantive operation and practical effect of the CAT, when applied to the receipts from the sale of food, cannot be ignored. To do so, as the Commissioner requests, exalts form over substance and would create a loophole in the Constitution that the Legislature could exploit at will.

Thus, when applied to the CAT, the Constitution requires a specific and narrow result – that receipts from the sale of food not be included in the calculation of taxable gross receipts for purposes of the CAT. Such sales must be exempted in the same way that receipts from sales of food are exempted from the state’s sales tax. In so doing, the will of the people will be honored without exempting any Ohio business from its obligations to pay its fair share of tax. Ohio food sellers would continue to pay the CAT on all their non-food sales and on their food sales for consumption on-premises.

Food is a unique commodity. As the proponents of the 1936 constitutional amendment stated, it “is the greatest necessity of life,” and taxes on it “are the most unjust and obnoxious that could be levied.” The CAT, when applied to food sales, is no less unjust and obnoxious simply because of how the state labels the tax. The Decision of the Court of Appeals should be affirmed.

STATEMENT OF FACTS AND THE CASE

Ohio's Constitutional Provisions Limiting Taxation of Food.

There are two provisions of the Ohio Constitution that expressly limit the taxation of food. First, Article XII, Section 3(C) of the Ohio Constitution provides that “no excise tax shall be levied or collected upon the sale or purchase of food for human consumption off the premises where sold.” This language, originally contained in its own stand-alone provision of the Ohio Constitution (Article XII, Section 12), first became part of the Ohio Constitution when it was passed by Ohio’s voters through the initiative process on November 3, 1936. See 116 (Part II) Ohio Laws 337-78.

The second provision is Article XII, Section 13 of the Ohio Constitution. This provision provides that “[n]o sales or other excise taxes shall be levied or collected (1) upon any wholesale sale or wholesale purchase of food for human consumption, its ingredients or its packaging... .” Effective December 8, 1994, this provision, also adopted by initiative petition (passed by the voters in the 1994 general election), prohibits the taxation of any wholesale sales or purchases of food.

There are no exceptions to the prohibitions against excise taxes on the sale of food, and the obvious import of these provisions is inescapable. The citizens of Ohio have repeatedly determined that the sale of food should not be a source of revenue for the State of Ohio and have seen fit to make such prohibition part of the state’s Constitution.

The Commercial Activity Tax.

In 2005, as part of the state budget bill (Amended Substitute House Bill 66, effective July 1, 2005), the Ohio Legislature enacted a series of tax revisions generally designed to lessen the burden of taxation on Ohio’s businesses. One of the key components of that package was a new

“commercial activity tax” (commonly referred to as the “CAT”), which for the first time in Ohio’s history imposed a general business tax based solely on gross receipts.

Specifically, the CAT imposes a tax on any person with annual “taxable gross receipts” in excess of \$150,000. R.C. 5751.02, R.C. 5751.03, and R.C. 5751.01(E)(1). It applies to individuals, corporations, or partnerships. See R.C. 5751.01(A) (defining “person”).

The CAT is imposed at a flat rate of \$150 for the first \$1 million of annual “taxable gross receipts” plus, when fully phased-in, at the rate of two and sixth tenth mills (0.26 percent) per dollar of taxable gross receipts above one million dollars. R.C. 5751.03.¹ In short, the CAT imposes a gross receipts tax on annual receipts greater than \$1 million on a percent basis. “Gross receipts” means the total amount realized by a person, without deduction for the costs of goods sold or other expenses incurred, that contribute to the production of gross income of the person. R.C. 5751.01(F).

Based upon these statutory provisions, Ohio retail grocers and Ohio food wholesalers must pay a 0.26 percent CAT on all receipts over \$1 million annually, including those received from their sale of food for human consumption. In other words, for every dollar *in sales* of food made by Ohio grocers above the \$1 million threshold, Ohio grocers incur a corresponding percentage of that dollar in commercial activity tax.

Likewise, while businesses are precluded from *separately* billing, invoicing, or charging the amount of the CAT in transactions with their consumers, businesses are specifically permitted to include an amount sufficient to recover the CAT in the price charged for a good or service. R.C. 5751.02(B). Thus, while Ohio food sellers may not include a *separate* charge to their customers to recover the amount of the CAT associated with each purchase, Ohio grocers

¹ R.C. 5751.032 provides that the Tax Commissioner is to periodically adjust the percentage rate to be imposed on gross receipts based upon the actual amounts collected in prior periods.

are specifically permitted to include an amount sufficient to recover the CAT in the price of the food sold.

The Litigation Below.

On February 17, 2006, the Appellees (the Ohio Grocers Association and individual food retailers and wholesalers) filed their Complaint below, seeking declaratory relief that the CAT provisions that impose a percentage tax on gross receipts from the sale of food violated Sections 3(C) and 13 of Article XII of the Ohio Constitution and seeking injunctive relief prohibiting the Defendant-Appellant, the Ohio Tax Commissioner (at the time, William Wilkins; currently Richard Levin) from enforcing the application of such provisions to gross receipts from the retail sale of food for human consumption off-premises and/or from the wholesale sale of food.

The parties filed cross-motions for summary judgment, and each party relied upon expert testimony in support of their respective motions. Appellees relied upon the testimony of Robert A. Lawson, Ph.D, then the George H. Moor Professor of Economics at the School of Management of Capital University, Columbus, Ohio. (Copies of Dr. Lawson's two affidavits and two reports are included in the Second Supplement (consecutively numbered as pages "SS-1-31" filed herewith.) Dr. Lawson is an expert in the field of economics, public finance, and has written and lectured extensively in the area of taxation and the effects thereof. Affidavit of Robert Lawson at ¶2 (SS-1); see also Dr. Lawson's *curriculum vitae*, attached to his Affidavit as Exhibit 1 (SS-3).

The Commissioner relied upon the testimony of Mr. Patrick Anderson. Mr. Anderson has a B.A. degree in political science and a Masters degree in public policy. See "Analysis of Ohio Commercial Activities Tax" by Patrick L. Anderson, Principal, Anderson Economic Group (hereinafter "Anderson Report") (a copy of which is found at S-1 of the Supplement to the

Commissioner's Merit Brief). Mr. Anderson considers himself a "business economist." Anderson Deposition Transcript, 12/18/2006, (hereinafter "Anderson Dep. Vol. I") at p. 30 (SS-38).

On August 24, 2007, the Trial Court filed its Decision (copy at Appellant's Appendix Ex. 4) denying Appellants' Motion for Summary Judgment and Granting Appellee's Cross-Motion for Summary Judgment. Appellees appealed, and on September 2, 2008, the Tenth District Court of Appeals reversed, holding that "the CAT when applied to gross receipts from the wholesale sale of food and from the retail sale of food for human consumption off premises where sold, operates as, and is, an excise tax levied or collected upon the sale or purchase of food, which is prohibited by Sections 3 and 13 of Article XII of the Ohio Constitution."

On February 4, 2009, this Court granted the Appellant's request for discretionary review.

ARGUMENT

The Appellees' Proposition of Law:

The CAT is an excise tax and is prohibited by Article XII, Section 3(C) and Section 13 of the Ohio Constitution when applied to gross receipts from the sales of food other than for on-premises consumption. Article XII, Section 3(C) and Section 13 of the Ohio Constitution exempt gross receipts from the sale of food other than for on-premises consumption from being included in the calculation of taxable gross receipts used to determine the CAT.

- A. Article XII, Section 3(C) and Section 13 are not limited to sales taxes but apply to all excise taxes, including privilege taxes, levied or collected upon gross receipts from the sales of food.**

Under the Commissioner's interpretation, Article XII, Section 13 and Section 3(C) of the Ohio Constitution prohibit only a traditional sales tax on food and nothing more. The Commissioner's interpretation cannot be squared with the text of such provisions, the historical record of their adoption, the broad purposes sought to be achieved by the voters in adopting them, or common sense. In sum, Sections 3(C) and 13 apply to all excise taxes when such taxes are levied or collected upon the sale or purchase of food, including gross receipts from such sales.

- 1. The language of Section 3(C) and Section 13 establishes that they are intended to apply to excise taxes generally and not only to sales taxes.**

Had the drafters of Article XII, Sections 3(C) and 13 intended to prohibit only sales taxes on food, they certainly did not say so. In fact, the drafters went out of their way to not say so.

"It is well settled that in the interpretation of an amendment to the Constitution the object of the people in adopting it should be ascertained and given effect and that the polestar in the construction of constitutional, as well as legislative, provisions is the intention of the makers and adopters thereof." *Castleberry v. Evatt* (1946), 147 Ohio St. 30, 33. By their terms, Sections 3(C) and 13 do not limit themselves to "sales taxes" or "transactional" taxes. Rather, these

constitutional provisions prohibit a broad category of taxes, i.e., “excise taxes,” when such taxes are “levied *or* collected upon the sale *or* purchase of food.”

This Court need only look to the text of Section 13 as conclusive proof that Ohio’s constitutional prohibitions are not intended to be limited to “sales taxes” on food. Section 13 specifically prohibits “sales or other excise taxes.” It is axiomatic in construing enactments that words are not inserted into an act without some purposes. *Cheap Escape Company, Inc. v. Haddox, L.L.C.*, 120 Ohio St.3d 493, 2008-Ohio-6323, ¶16; see also *State ex rel. Petit v. Wagner* (1960), 170 Ohio St. 297, 301 (court should not interpret one constitutional provision so as to render adoption of other provision a vain and superfluous act). The Commissioner’s interpretation simply reads the phrase “or other excise taxes” in Section 13 out of existence.

Significantly, Ohio is not alone in protecting food sales from being a source of revenue for the state. Where states have intended their constitutional provisions to be limited to sales taxes, they expressly state as much. See e.g., California Constitution, Article XIII, Section 34 (“Neither the State of California nor any of its political subdivisions shall levy or collect a sales or use tax on the sale of ... food”); Louisiana Art. 7, § 2.2 (“Effective July 1, 2003, the sales and use tax imposed by the state of Louisiana or by a political subdivision ... shall not apply to sales or purchases of ... food”); Michigan Constitution Article 9, Section 8 (“No sales tax or use tax shall be charged or collected ... on the sale or use of food...”).

Ohio could have expressly limited its constitutional provisions to sales taxes as these other states have done. Ohio did not do so, and this decision must be given meaning. See *Bellemar Parts Industries, Inc. v. Tracy* (2000), 88 Ohio St.3d 351, 355 (rejecting proposed statutory interpretation when General Assembly could have simply said so but did not); accord *Key Serv. Corp. v. Zaino* (2002), 95 Ohio St.3d 11, 15.

2. **Section 3(C) does not exclude franchise taxes from its prohibiting language simply because the term “franchise taxes” is separately listed in Section 3(C)’s introductory clause.**

The Commissioner argues that because Section 3(C) authorizes both “excise and franchise taxes” in its authorizing clause but only identifies “excise taxes” in its prohibiting clause, the prohibition against excise taxes on food sales must be read to exclude franchise taxes. In other words, the Commissioner argues that even though franchise taxes are a type of excise tax, the term “excise tax” should be read to not include franchise taxes for purpose of Section 3(C). The Commissioner’s argument is not persuasive, as it ignores the history of the adoption of the authorizing and prohibiting clauses as stand-alone provisions and ignores the long-standing and universal case law from this Court holding that franchise taxes are a type of excise tax. Moreover, to the extent there is some technical distinction between a franchise tax and an excise tax generally, the CAT is not a franchise tax and would not therefore be excluded from the prohibiting clause even under the Commissioner’s theory.

- a. The constitutional prohibition against excise taxes on retail food sales was originally adopted in 1936 as a stand-alone provision without any reference to franchise taxes at all.

When originally adopted, and for 40 years thereafter, the constitutional prohibition against excise taxes levied or imposed upon retail food sales or purchases did not include the authorization clause relied upon by the Commissioner here. Rather, the Commissioner’s argument is based solely on the fact that in 1976 the prohibiting provision was merged with the authorizing provision, a consolidation that the Commissioner concedes was intended to have no substantive legal effect.

Specifically, the authorizing clause was adopted by the 1912 Ohio Constitutional Convention (effective January 1, 1913) as then-Section 10 of Article XII. Original Section 10

stated in its entirety: “Laws may be passed providing for excise and franchise taxes and for the imposition of taxes upon production of coal, oil, gas and other minerals.” On the other hand, Section 3(C)’s prohibiting clause was adopted by Ohio’s voters through the initiative process on November 3, 1936, as then-Section 12 of Article XII. Section 12 stated in its entirety: “On and after November 11, 1936, no excise tax shall be levied or collected upon the sale or purchase of food for human consumption off the premises where sold.” See 116 (Part II) Ohio Laws 337-78. (Appellee’s Appendix, Ex. 11, at A-111.) It was not until 1976 that the two provisions were merged into the current version of Section 3(C) by House Joint Resolution 15, the adoption of which the Commissioner admits was intended to have no substantive change. See Appellee’s Merit Brief at p. 25.

Moreover, the Commissioner ascribes substantive meaning to language in Section 3(C)’s authorization clause that this Court long-ago recognized to be of no import. The purpose of original Section 10 was not to provide authorization for franchise taxes or excise taxes generally, or to make a constitutional distinction between franchise taxes and excise taxes. The power of the state to impose such taxes was well-established, even prior to the adoption of Section 10 in 1912. See *Western Union Telegraph Co. v. Mayer* (1876), 28 Ohio St. 521; *Adams Exp. Co. v. State* (1896), 55 Ohio St. 69; *Southern Gum Co. v. Laylin* (1902), 66 Ohio St. 578.

Rather, the substantive import of the adoption of original Section 10 was to make the authority of the General Assembly to levy taxes on the production of coal, oil, gas and other minerals clear. *State ex rel. Zielonka v. Carrel* (1919), 99 Ohio St. 220, 224 (“It is to be concluded that the incorporation of this new section in the Constitution [Section 10] was to make certain the authority of the General Assembly to levy tax on the specified minerals named, for certainly, in view of the legislation and construction thereof by the Supreme Courts of both Ohio

and the United States, no express grant of power was required in order to sustain either excise or franchise taxation.”). Given this history, there is simply no basis to conclude that the use of the term “excise taxes” in the prohibiting clause of Section 3(C) was intended to exclude “franchise taxes” from its scope.

- b. When the constitutional prohibition contained in Section 3(C) was adopted in 1936, it was already well-established that the term “excise tax” included any privilege tax, occupational tax, or franchise tax imposed by the state, including those imposed on gross receipts, like the CAT.

By 1936, the law was already well-established that the terms “excise tax” included privilege taxes, occupational taxes, and most importantly, franchise taxes. See, e.g., *Southern Gum*, 66 Ohio St. at 596 (holding that the 1902 corporate franchise tax imposing a 0.10% tax on the subscribed or issued and outstanding capital stock of a corporation was not a tax on property but “an excise tax.”); *Cincinnati, Milford & Loveland Traction Co. v. State* (1916), 94 Ohio St. 24, 27 (“An excise tax is a tax assessed for some special privilege or immunity granted to some artificial or natural person [and]... [i]n the case of a corporation it is sometimes spoken of as a franchise tax.”); *Saviers v. Smith* (1920), 101 Ohio St. 132, paragraph four of the syllabus (“An excise is a tax imposed on the performance of an act, the engaging in an occupation, or the enjoyment of a privilege.”); *Zielonka*, 99 Ohio St. 220 (upholding a city’s occupational tax as a valid excise tax).

Ohio law remained unchanged through the adoption of Section 13 in 1994 and continues uninterrupted to today. See, e.g., *Litton Indus. Products, Inc. v. Limbach* (1991), 58 Ohio St.3d 169, 170 (“The franchise tax, an excise tax, taxes corporations for the privilege of doing business in Ohio in corporate form.”); *Hoover Universal Inc. v. Limbach* (1991), 61 Ohio St.3d 563, 568, 575 (“The franchise tax, an excise tax. . . .”); *KeyCorp v. Tracy* (1999), 87 Ohio St.3d 238, 240

(“Franchise tax is an excise tax. . . .”); *Wesnovtek Corp. v. Wilkins*, 105 Ohio St.3d 312, 2005-Ohio-1826 (“The Ohio franchise tax is an excise tax. . . .”).

Accordingly, when the citizens of Ohio adopted the prohibitions against excise taxes levied or collected upon the sale or purchase of food at both the retail and wholesale level, they understood that the term “excise tax” broadly included taxes imposed for the privilege of doing business in Ohio including franchise taxes.

This long-standing and uninterrupted understanding that the term “excise tax” includes franchise taxes fundamentally distinguishes Sections 3(C) and 13 from the constitutional provisions at issue in *State ex rel. Maurer v. Sheward* (1994), 71 Ohio St.3d 513, on which the Commissioner extensively relies. In *Maurer*, this Court was asked to determine whether Article III Section 11 of the Ohio Constitution authorized the General Assembly to prescribe procedural regulations as to the application process for executive commutations or just as to pardons. The relevant constitutional provision provided: “[The Governor] shall have power ... to grant reprieves, commutations, and pardons ...; subject, however, to such regulations, as to the manner of applying for pardons, as may be prescribed by law.” *Id.* at 520. Relators argued that the authority to regulate the application process for “pardons” also included the authority to regulate commutations because the word “pardons” could be interpreted broadly to include all types of executive clemency. *Id.*

This Court rejected Relator’s arguments holding that the “subject to” clause applied only to pardons and not commutations. *Id.* at 522. In so doing, this Court specifically recognized that prior decisions from this Court had expressly held that commutations and pardons were two entirely different types of clemency. *Id.* at 521. Given that these cases “conclusively established” that pardons did not include commutations, this Court was left with the

unmistakable conclusion that the “subject to” clause did not provide the authority to regulate commutations. *Id.*

Here, in direct contrast to *Maurer*, there is an unbroken line of authority holding that the term “excise taxes” includes “franchise taxes.” And unlike *Maurer*, there is no line of authority, let alone a single case, for the proposition that “excise taxes” do not include “franchise taxes” for purposes of constitutional interpretation or otherwise. *Maurer* therefore is not analogous to this case, and it provides no support for the conclusion that franchise taxes are exempted from the prohibiting clause of Section 3(C). In fact, the logic of *Maurer* actually supports a finding that the term “excise taxes” for purposes of Section 3(C) includes franchise and other privilege taxes.

Likewise, nothing in *Ilersich v. Schneider* (1964), 176 Ohio St. 255, or the Franklin County Court of Common Pleas’ decision in *Cameron Coca-Cola Bottling v. Tracy* (July 28, 1993), Franklin C.P. No. 93CVH02-729, is to the contrary. Neither case involved the question of whether Section 3(C) applied to other types of excise taxes in addition to a sales tax. Rather, both cases involved application of a sales tax and more importantly involved application of provisions not at issue here. In *Ilersich, supra*, the issue was the meaning of consumed “off the premises where sold”, and in particular, whether that term included an adjacent parking lot owned by the retail seller. *Cameron Cocoa-Cola Bottling* involved the imposition of a sales tax on the sales of soft-drinks at the wholesale level. *Id.* at 3. The issue in that case was whether the tax on *wholesale* sales of soft-drinks was prohibited by Section 3(C). That decision led to the enactment of Section 13, making it clear that excise taxes levied or collected upon the sale or purchase of food at the wholesale level were also prohibited. In short, nothing in either case stands for the proposition that the language in Section 3(C) or Section 13 applies only to the traditional sales tax.

- c. The CAT is not a franchise tax and therefore would not be excluded from Section 3(C)'s prohibiting clause even under the Commissioner's theory.

To the extent there is any meaningful constitutional distinction between a "franchise tax" on the one hand and an "excise tax" on the other, that distinction has no relevance to this case. Technically speaking, the CAT is not a franchise tax.

Not every tax imposed on the privilege of doing business in Ohio is a "franchise tax." Rather, a franchise tax is a tax a *corporation* owes for the privilege of exercising its *corporate franchise* to do business in the state: "A domestic corporation is given life and continued existence by the state, and this life and existence, with their accompanying powers, constitute the franchise; and this franchise being valuable and given by the state, the state may impose a franchise tax thereon to the amount of the value thus conferred and continued..." *Southern Gum*, 66 Ohio St. at 595. "An excise tax is a tax assessed for some special privilege or immunity granted to some artificial or natural person, based upon the grant of such privilege or immunity. In the case of a corporation it is sometimes spoken of as a franchise tax." *Cincinnati, Milford & Loveland*, 94 Ohio St. at 27.

In other words, a franchise tax is levied on a corporation for the privilege of doing business in the corporate form. *Diamond Financial Holdings, Inc. v. Limbach* (1993), 67 Ohio St.3d 228, 231 (a corporation "owes a franchise tax for the privilege of exercising its corporate franchise to do business in the ensuing tax year..."); *Litton Indus. Products*, 58 Ohio St.3d at 170, ("The franchise tax, an excise tax, taxes corporations for the privilege of doing business in Ohio in corporate form."); see also *United Air Lines, Inc. v. Porterfield* (1971), 28 Ohio St.2d 97, 105, (recognizing that excise tax imposed on the privilege of engaging in the business of transporting persons or property by air was not a franchise tax since it was not imposed on the right to do business *in the corporate form*).

The CAT, however, is not limited to corporations. It is applicable to non-corporate taxpayers alike. The CAT applies (with certain enumerated exceptions) to *any person* with annual taxable gross receipts in excess of \$150,000. It applies to individuals, corporations, or partnerships. See R.C. 5751.01(A) (defining “person”). Thus, while the CAT, when fully phased-in, replaces Ohio’s corporate franchise tax, the CAT itself is not a franchise tax.

3. History indicates that Section 3(C) and Section 13 were intended to apply to all forms of taxation of food sales except sales for on-premises consumption.

It is readily conceded that the 1936 adoption of Section 3(C)’s prohibition against excise taxes on food was in direct response to a retail sales tax imposed on food in 1934. Likewise, it is readily conceded that the 1994 adoption of Section 13 was in direct response to the then-recently enacted wholesale pop tax. Nonetheless, while both constitutional provisions were adopted in response to specific sales taxes on food, the historical context of their adoption supports a broader application of the provisions beyond the sales tax context.

As already noted, the drafters of both provisions did not limit the language of either provision to sales taxes, even though sales taxes were the immediate harm sought to be relieved by their adoption. The use of broader language is compelling evidence that the drafters and the Ohio voters intended both provisions to apply to more than sales taxes.

In fact, within a decade after the adoption of the 1936 amendment, this Court rejected a narrow understanding of the provisions contained in Section 3(C) and specifically recognized that the intent of that amendment was to broadly preclude the taxation of food:

What was the purpose of the constitutional amendment? It has been urged by the appellant that the argument advanced by the committee appointed to sponsor the amendment, shows that it was to ‘repeal the sales tax on food for Home Consumption.’ However, we find the further statement in the argument, that ‘food is the greatest necessity of life. A special tax on food is the most unjust and obnoxious that could be levied.’ [*Castleberry*, 147 Ohio St. at 33.]

This Court further explained that the proponents of Section 3(C), and the citizens of Ohio when they adopted the amendment, “sought to *broaden and extend the freedom of sales of food from taxation.*” *Castleberry*, 147 Ohio St. Id. at 33-34. Thus, the “particular purpose of the amendment” was to allow taxes “only [on] sales for food which is sold and served in restaurant or other similar places under the control of the vendor.” Id. at 34.

Similarly, in 1994, the proponents of Section 13 made it clear that Section 13 was not only intended to close the “loophole” created by the decision in *Cameron Cocoa-Cola Bottling*. See Ohio Sec’y of State, State Issue 4 Certified Ballot Language (Nov. 8, 1994) (Appellee’s Appendix, Ex. 12, at A-116.) Rather, the Section 13 proponents argued generally that “[a]llowing state government to enact hidden taxes on food [would] set a dangerous precedent” and that adoption of Section 13 was necessary to “restore Ohio’s tradition of protecting consumers from paying taxes on food.” Id.

Thus, history shows that Ohioans have always understood that food is different from other items of commerce and that taxes imposed on food sales are to be prohibited. Twice, when confronted by taxes on food, the citizens of Ohio have passed constitutional amendments to overturn such taxes, and have done so with language more broad in scope than the specific taxes at issue. In short, history firmly establishes that Ohio’s Constitution is intended to prohibit food sales from being a source of revenue for the state, regardless of the state’s effort to find new and unique ways to circumvent such prohibitions.

- 4. That Sections 3(C) and 13 were never applied to Ohio’s general business taxes before today simply reflects the historical fact that the CAT is the first time Ohio has imposed a general business tax on food sellers based upon their gross receipts, including those from the sale of food.**

The Commissioner and certain of the *amici* make much of the fact that when Section 3(C) and Section 13 were adopted, no one ever suggested that such provisions applied to the

then-existing corporate franchise taxes typically paid by Ohio's food sellers. According to the Commissioner, Ohio's failure to modify or challenge the then-existing corporate franchise tax indicates that the constitutional provisions were always understood to apply only to sales taxes paid by consumers. The Commissioner overstates the significance of the history and simply ignores that fact that prior to the CAT, Ohio's general corporate franchise tax did not impose a tax on gross receipts, let alone gross receipts from food sales.

In 1936, when Section 3(C) was adopted, the corporate franchise tax was imposed on the "fair value on an asset basis of the capital stock" of the corporation. G.C. 5498, 11 Ohio Laws 473 (see Appellee's App., Ex. 15, at A-129.) Thereafter, including 1994, when Section 13 was adopted, the Ohio corporate franchise tax imposed a tax on net income or net worth. See generally R.C. Chapter 5733.

Obviously, net income and net worth are not the equivalent of sales. In fact, the amount of sales does not correlate in any way to net income or net worth. A large amount of sales (i.e., gross receipts) can produce little or no income or net worth. Accordingly, under the corporate franchise tax there was no direct relationship between sales on the one hand and net worth or net income on the other.

Under the CAT, however, there is a direct, one-to-one correlation between sales and gross receipts, and thus under the CAT, there is a direct, one-to-one correlation between sales and the tax base. This fundamental feature of the CAT distinguishes it from the corporate franchise tax, and it is this fundamental feature that implicates Article XII, Section 3(C) and Section 13.

While the Commissioner correctly notes (see Appellant's Merit Brief at pp. 46-47) that a "sales factor" was one of three components used to determine the amount of the tax base (i.e.,

either net income or net worth) to be apportioned to Ohio for purposes of Ohio's corporate franchise tax, the sales themselves were not in any way the object of the tax. See generally, R.C. 5733.05; see also *Lancaster Colony Corp. v. Limbach* (1988), 37 Ohio St.3d 198. In other words, the percentage of Ohio sales compared to the corporation's total sales everywhere merely determined what portion of certain income and net worth were subject to the tax in Ohio. Neither the actual amount of sales, nor the amount of gross receipts derived from such sales, were themselves subject to the tax.

In short, when Section 3(C) was adopted in 1936 and when Section 13 was adopted in 1994, Ohio's corporate franchise tax did not impose a tax on food sales. Accordingly, there is no reason to attribute any meaning to the fact that prior to the adoption of the CAT, Ohio's food sellers never challenged the corporate franchise tax as being a violation of Article XII, Section 3(C) or Section 13.

B. The CAT is an excise tax levied or collected upon the sale or purchase of food even if it is labeled a privilege tax "measured by" gross receipts.

According to the Commissioner, the CAT is exempt from Article XII, Section 3(C) and Section 13 because it is a privilege tax measured by gross receipts, not a tax on food sales. In so arguing, the Commissioner goes to great lengths to identify certain characteristics of the CAT that differentiate it from a sales or transactional tax, and which, according to the Commissioner, mandate a finding that the CAT is a franchise tax. The Commissioner's arguments however do not save the CAT from its constitutional infirmities.

The fact that the CAT is not the same as a sales tax misses the point. Since Section 3(C) and Section 13 are not limited to "sales taxes" alone, the constitutional validity of the CAT when imposed on gross receipts from the sales of food is not dependent upon whether the CAT is considered a privilege tax or a sales tax. There is no dispute that the CAT purports to be a

privilege tax, and Appellees readily concede that there are numerous administrative distinctions between the CAT and the traditional sales tax. The issue here is not whether the CAT is equivalent to a sales tax in all respects, or for that matter whether it is more akin to the corporate franchise tax. Rather, the issue in this case is whether the CAT is prohibited by the Ohio Constitution because it is an excise tax levied or collected upon the sale or purchase of food.

The CAT, when imposed on gross receipts from the sale of food, is substantively a tax on the sale or purchase of food, and suffers from the very same evils as the sales taxes that prompted the citizens of Ohio to adopt Section 3(C) and Section 13. None of the distinguishing characteristics cited by the Commissioner undercuts the reality that practically speaking and from a substantive economic perspective, the CAT's gross receipts tax amounts to a tax on the sale and purchase of food.

Finally, while the Commissioner cites numerous cases for the general proposition that privilege taxes may be "measured by" some underlying factor without converting the tax into a tax on that factor, none of the cases involved application of Article XII, Sections 3(C) or 13. Moreover, none of the cases involved the analogous issue presented here, i.e., whether a "measuring stick" based upon gross receipts may include receipts from the sale of specific items that are specifically exempted from taxation by Ohio's Constitution. In fact, none of the cases relied upon by the Commissioner stand for the broad proposition espoused by the Commissioner – i.e., that this Court may ignore what is being taxed so long as it is labeled a "measuring stick."

- 1. In determining the constitutionality of the CAT, this Court is required to analyze the substantive operation and effect of its provisions, not how it is labeled.**

This Court has repeatedly held that "[t]he nature of a tax must be determined by its operation, rather than by its particular descriptive language." *Bank One Dayton, N.A. v. Limbach* (1990), 50 Ohio St.3d 163, 166, citing *Educational Films Corp. of America v. Ward* (1931), 282

U.S. 379 “A state tax is examined by its operation and current effect.” *Id.* at 168. Thus, “[w]hen passing on the constitutionality of a state taxing scheme it is firmly established that this Court concerns itself with the practical operation of the tax, that is substance rather than form.” *United Air Lines*, 28 Ohio St.2d at 100, quoting *American Oil Company v. Neill* (1965), 380 U.S. 451, 455; see also *Pittsburgh C & St. L. Ry. Co. v. State* (1892), 49 Ohio St. 189, 201 (tax statute’s “constitutionality must be determined by its operation” not “by the name that may be assigned to it;” tax imposed on every mile of railroad was equivalent to a property tax and therefore unconstitutional).

For example, in *United Airlines*, 28 Ohio St.2d at 97, this Court upheld the constitutionality of an Ohio airline excise tax, which by its terms was “imposed upon the *privilege of engaging in the business* of transporting persons or property by air within this state.” *Id.* at 99, quoting former R.C. 5745.02. Like the CAT, the airline excise tax was “measured by” receipts associated with flights beginning and ending in the state and receipts based on the proportion of the mileage within the state to the entire mileage of flights starting or ending outside of the state. *Id.* at 100-101. And like the CAT, the excise tax imposed a flat percentage tax on such receipts. *Id.*

The airline challenged the tax on the ground that it improperly taxed the bare privilege of engaging in interstate commerce in violation of the United States Constitution. *Id.* at 100. This Court disagreed, specifically ruling that while the tax was labeled a tax imposed on the privilege of doing business, it was still in substance a tax levied upon the fairly apportioned gross receipts on business done within the state. *Id.* at 101. “Although a statute uses the terminology that it is taxing a privilege to do business, such a tax is not *ipso facto* unconstitutional in its application to an instrumentality of interstate commerce when the substance of the law lays a tax on the fairly

apportioned gross receipts of that activity based on business done with the state.” Id. at 101 (emphasis added). As this Court stated, “[w]e cannot condemn [the tax] solely on the basis of the labeling terminology employed by the General Assembly. Id. at 101. In so doing, this Court quoted United States Supreme Court Justice Brennan’s view that the tax must be analyzed by its substance – i.e., a tax levied on gross receipts: “To me, the more realistic way of viewing the tax and evaluating its constitutional validity is to make it as what it is in substance, a *levy on gross receipts* fairly apportioned to the taxing state ...” Id. at 107, quoting *Railway Express Agency v. Virginia* (1959), 358 U.S. 434, 447 (J. Brennan dissenting) (emphasis added).

The same analysis applies in this case. Just as the tax evaluated in *United Airlines* was not deemed invalid simply because it was labeled a tax on the privilege of doing business, the CAT cannot avoid invalidity simply because it is so labeled. Rather, this Court has an obligation to look beyond the CAT’s label and determine whether the CAT, by *operation and effect*, falls within the prohibitions contained in the Ohio Constitution, i.e., whether it is an excise tax levied or collected upon the sale or purchase of food.

2. In substance, the CAT is a excise tax on gross receipts, which is another way of saying sales.

While the stated purpose of the CAT is to levy a tax for the privilege of doing business in Ohio, see R.C. 5751.02(A), substantively it is a tax on gross receipts. When taxable gross receipts are generated from the sale of food, the CAT operates and has the effect of being a tax on food sales.

The provisions of the CAT that are being challenged in this litigation impose a percentage tax on annual gross receipts above \$1 million. Above the \$1 million mark, what determines the amount of tax incurred by each taxpayer is the amount of gross receipts received by that taxpayer. By operation and effect, the CAT is nothing more than an excise tax on gross

receipts. Even the Commissioner's own expert witness, Mr. Patrick Anderson, agreed. Mr. Anderson testified that the CAT is an excise tax that is imposed upon gross receipts. See Anderson Report at ¶38 (S-10-11) (A tax that is applied at every stage of production, like the CAT, constitutes a "gross receipts tax."); Anderson Report at ¶14 (SS-4) ("The CAT imposes a gross receipts tax on Ohio businesses.").

For retailers and wholesalers of food products, "taxable gross receipts" is simply another way of saying "food sales." While not every receipt received by an Ohio grocer is derived from food sales, all sales of food are included in a grocer's taxable gross receipts. For every one dollar of food sold there is a corresponding and identifiable commercial activity tax incurred. Thus, the Court of Appeals correctly held that by operation and effect, the CAT's gross receipts tax is levied or collected upon the sale or purchase of food because the receipts from such sales are included in the CAT on a one-to-one ratio.

The Court of Appeals is not alone in this conclusion. The United States Supreme Court itself has recognized that a gross receipts tax, functionally equivalent to the CAT, "in effect ... operates as a tax on the sale of goods and services." See, e.g., *United States v. New Mexico* (1982), 455 U.S. 720, 727 (discussing New Mexico's gross receipts tax); see also *DirecTV, Inc. v. Tolson* (E.D.N.C., 2007) 498 F.Supp.2d 784, 787 (noting that the practice in North Carolina is to refer to taxes levied on gross receipts as "sales" taxes).

Significantly, the only other court of appeals to discuss the substantive nature of the CAT has agreed that it operates as a tax on sales. *Mosser Constr., Inc. v. Toledo* (6th App.), 2007-Ohio-4910, 2007 WL 2745222. In *Mosser*, a construction contractor sought payment of its CAT liability from the City of Toledo under a provision in a contract that required the city "to pay all sales, consumer, use and other similar taxes required to be paid by the Contractor . . . during the

performance of the Work.” Id. at ¶12. Like the Commissioner here, the city argued that the CAT was an annual business tax for the privilege of doing business in Ohio and by its terms, i.e., R.C. 5751.02(A), was not a transaction tax. Id. at ¶34. Thus, according to the city, the CAT was not a “sales, consumer, or use tax” contemplated by the contract to be shifted to the city, but instead should be characterized as an “overhead” cost to be borne by the contractor alone. Id. The Court of Appeals disagreed, specifically rejecting the notion that the characterization of the CAT in R.C. 5751.02(A) governed the analysis. Rather, “since the amount of tax owed is tied to the amount of a business's gross receipts, the [CAT] is similar to a sale or consumer tax and not an overhead tax.” Id. at ¶36. The city therefore was required to pay the contractor that amount of its CAT liability associated with the gross receipts received by the contractor from the city for the work on the project. Id.

Thus, contrary to the suggestion of the Commissioner, the Court of Appeals decision here did not plow new ground when it held that the CAT, when applied to receipts on food sales, operates as a tax on such sales. The Court of Appeals simply recognized reality.

3. The CAT is no less a tax on the sale of food even though the CAT is collected from the seller rather than from the consumer.

The Commissioner makes much of the fact that the *legal* incidence (the identity of who is legally responsible for paying the tax) of the CAT is different from the sales tax – i.e., the CAT is imposed on Ohio sellers while the sales tax is imposed on Ohio consumers. Of course, Section 3(C) and Section 13 are not concerned with who pays the tax. Rather, they apply to taxes levied or collected upon sales or purchase. It is the nature of what is taxed that matters, not who pays it.

Significantly, the economic incidence of a tax (who actually bears the burden of a tax, regardless of who is legally responsible for paying the tax) is invariant to the legal incidence of the tax. Thus, for example, a five percent tax on a product, whether imposed on the seller or on

the buyer, results in the same distribution of the tax burden. See Lawson Affidavit, Exhibit 2 (hereinafter “Lawson Report”) at p. 2-3 (Second Supplement at SS-13-14). Consequently, there is no economic difference between the CAT and a traditional sales tax simply because the former is collected from the seller and the latter is collected from the consumer.

In fact, a formal economic analysis shows that the effect of the CAT and the effect of the traditional sales tax is the same. A sales tax results in an increase in the price paid by the buyer, a decrease in the price received by the seller, and an overall decrease in the quantity purchased. Lawson Report at p. 3-4 (SS-14-15); Lawson Affidavit at ¶5(c) (SS-2) (“The CAT will increase food prices to consumers, decrease net prices to sellers, and reduce quantities sold, in exactly the same way as a conventional sales tax on the sale of food would have.”). Like the sales tax, the financial burden of the CAT is borne by Ohio’s consumers even though the seller pays the tax.

4. The CAT is no less a tax on the sale or purchase of food even though it is based upon aggregate sales and remitted later.

The fact that the length of time between the actual sales transaction and the payment of the tax may be different between the retail sales tax and the CAT is meaningless in the determination of what kind of tax the CAT is from a practical and substantive perspective. See Robert Lawson’s “Reply to ‘Analysis of Ohio Commercial Activities Tax’ by Patrick L. Anderson” (hereinafter “Lawson Reply”) attached to Supplemental Affidavit of Robert Lawson (SS-18).

In practice, both the sales tax and the CAT are in fact paid to the government at some point *after* the transaction takes place. In both cases, it is the aggregate sales amount that makes up the tax base. When a vendor remits sales tax to the state, it does not submit a record of each separate transaction with each separate sales tax collected. Rather, the vendor identifies its gross sales (i.e., gross receipts) minus exempted sales for the period (usually monthly) and applies the

applicable tax rate. See Universal Ohio State, County and Transit Sales Tax Return.² This basic calculation is substantively identical to that undertaken to calculate a vendor's CAT obligations on a quarterly basis. And like the CAT, it is ultimately the seller who is responsible for ensuring that the sales tax is paid. See e.g., *Time Warner Operations, Inc. v. Wilkins*, 111 Ohio St.3d 559, 2006-Ohio-6210 (cable company required to collect and remit sales tax on rental of converter boxes).

Thus, the alleged distinction between the CAT and a traditional retail sales tax is similar to that between the FICA payroll tax and the Self-Employment Tax, both of which exact the same tax on earnings, but are remitted and administered in two very different ways. While these differences may be important to the taxpayers and tax authorities, they do not change the fundamental nature of what is being taxed.

Likewise, while the tax base of the CAT is broader than the tax base of the retail sales tax, "this means only that the [CAT] is a sales tax with a broader base." Lawson Reply at p. 9 (SS-27). Some states use broader tax bases than others in administering their retail sales tax, but they are all sales taxes despite the wide variation in the definitions of the tax base. *Id.*

In short, the CAT is no less a tax on the sale or purchase of food than a traditional retail sales tax simply because it is based upon aggregate sales and remitted later. Appellant's expert did not fundamentally disagree. At his deposition, Mr. Anderson testified that the CAT "in concept and largely in execution" is "a gross receipts tax, meaning it taxes *transactions* business to business and business to consumer." Anderson Deposition Vol. II (12/19/06) at p. 20 (SS-48); see also *Id.* at 16-17 (SS-47-48) (opining that a gross receipts tax was "a tax on all transactions, including business-to-business transactions").

² http://tax.ohio.gov/documents/forms/sales_and_use/Universal2006/-ST_UST1Long.pdf.

Indeed, it would be a perverse reading of the Constitution to suggest that it strictly prohibits the taxation of each individual sale, but freely permits the taxation of two or more combined sales. As the Court of Appeals explained, “though not based on individual sales at the time they are made, the CAT is merely based on the aggregate of all sales within a specified time frame. If the legislature is prohibited from collecting a tax on the individual sale, it logically follows that legislature would be prohibited from collecting a tax on the aggregate of those same sales.” Court of Appeals Decision at ¶21.

5. The CAT is no less a tax on the sale or purchase of food because it exempts certain transactions from the calculation of the tax and provides limited credits against the tax.

The Commissioner highlights the fact that the CAT shares many of the same exemptions and tax credits that were previously applicable under the corporate franchise tax as evidence that the CAT is in the nature of a franchise tax. Exemptions and credits are not unique to any tax scheme, let alone a franchise tax or the CAT. More to the point, the existence of such exemptions and credits says nothing about the underlying nature of what is being taxed. While exemptions may reduce the size of the tax base and while credits may reduce the tax owed, the fundamental nature of what is being taxed does not change.

An income tax is no less an income tax simply because the state allows deductions to reduce taxable income or allows credits to offset tax liabilities. A tax on property is no less a property tax because some taxpayers are granted a homestead exemption. A tax on sales is no less a sales tax because certain transactions are exempted from the tax. See R.C. §2739.02(B) (exempting numerous transactions from the sales tax). Likewise, the CAT is no less a tax on gross receipts, including receipts from food sales, simply because some transactions between

consolidated taxpayers are exempt from the calculation and because special credits are granted to certain taxpayers.

6. This Court’s “measuring stick” jurisprudence does not save the CAT from the prohibitions contain in Section 3(C) and Section 13.

The Commissioner cites numerous cases for the general proposition that a tax imposed on the privilege of doing business may be measured by some underlying factor without converting the tax into a tax on that factor. While the language referenced by the Commissioner from these cases is broad, the actual holdings of these cases are inapposite. None of the cases involved application of Article XII, Sections 3(C) or Section 13. None of the cases involved application of a constitutional provision that specifically prohibits a broad category of taxes (excise taxes) on a specific element of commerce (food sales). And while some of the cases involved the use of gross receipts as a “measuring stick,” none of those cases involved the issue of whether such taxable gross receipts may include receipts from the sale of specific items that are expressly exempt from taxation by Ohio’s Constitution. In fact, when viewed in context, the actual holdings of the opinions principally relied upon by the Commissioner have no meaningful relevance to this case.

For example, in *East Ohio Gas Company v. Limbach* (1986), 26 Ohio St.3d 63, the issue was not the underlying validity of including certain transactions or sales in the calculation of gross receipts used to measure the excise tax applicable to public utilities. Rather, the issue was whether the state could lawfully change the tax rate during the applicable tax year. The key analysis therefore involved when the tax liability became fixed for purpose of Article II, Section 28’s prohibition against retroactive laws. The analysis did not involve the underlying validity of including any particular element of commerce within the gross receipts measuring stick. Thus, while *East Ohio Gas* would be relevant if the Appellees were challenging a change in the CAT’s

tax rate during the annual period, it is not relevant to the issue of whether food sales can be constitutionally included in gross receipts for determining the tax base.

In *Bank One Dayton, N.A. v. Limbach* (1990), 50 Ohio St.3d 163, the issue was one of federal statutory interpretation. In particular, the issue was whether it was a violation of federal statutory law to include the value of federal obligations owned by a financial institution in calculating a bank's net worth for Ohio's corporate franchise tax. *Id.* at 163-64. This Court held that the applicable franchise tax for financial institutions satisfied the test under the federal statute as a nondiscriminatory "true" franchise tax, and therefore was statutorily exempted from the general statutory provision exempting federal obligations from taxation by a state or political subdivision. *Id.* at 166-170. Significantly, in so holding, this Court specifically reaffirmed the governing principle that "[t]he label by which a tax is known should not control the constitutional principles by which it is judged." *Id.* at 168 (internal citations omitted).

In *Cincinnati, Milford & Loveland*, 94 Ohio St. at 24, the Court ruled that a taxpayer could not deduct rental payments made to another taxpayer from its gross earnings used to calculate a tax on gross earnings. In so doing, the Court rejected the notion that the fact that such rental payments also made up the gross earnings of another taxpayer amounted to an unconstitutional double taxation. Thus, while this case would be relevant if Appellees were challenging the CAT on the basis that taxing gross receipts is a form of double taxation because the cost of goods sold are included in the gross receipts of wholesalers and producers of that same food, it has no relevance to whether gross receipts from the sale of food can be constitutionally taxed in the first place.

Likewise, several of the other cases relied upon by the Commissioner involved challenges to state taxation on federal commerce clause grounds having nothing to do with the

underlying validity of the alleged measuring stick, but rather whether the state tax scheme was consistent with the then-applicable federal law related to state taxation of interstate commerce. See e.g., *Aluminum Co. of America v. Evatt* (1942), 140 Ohio St. 385; *The Western Union Telegraph Company* (1876), 28 Ohio St. 521. Again, none of these cases have any relevance to whether the CAT's gross receipts tax imposed on retail and wholesale food sales in Ohio is constitutional.

None of the cases stand for the broad proposition espoused by the Commissioner, i.e., that simply because the CAT is labeled a privilege tax, it matters not how it operates substantively. And none of the cases stand for the proposition that this Court should simply ignore what is being taxed so long as it is labeled a measuring stick. In fact, none of the cases could stand for such a proposition since this Court has rejected such a superficial and formalistic approach. See *United Airlines*, 28 Ohio St.2d 97; *Bank One Dayton*, 50 Ohio St.3d 163. As the United State Supreme Court has stated, “[T]here is no economic consequence that follows necessarily from the use of the particular words, ‘privilege of doing business,’ and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect.” *Complete Auto Transit, Inc. v. Brady* (1977), 430 U.S. 274, 288. While the CAT may be characterized as a privilege tax for purposes of state tax administration, when applied to receipts from the sales of food, it results in the very effect forbidden by Sections 3(C) and 13.

C. The Commissioner’s interpretation renders the protections of Article XII of the Ohio Constitution effectively meaningless.

The most striking aspect of the Commissioner’s interpretation is that it renders the prohibitions contained in Article XII, Sections 13 and 3(C) avoidable at will by the Legislature. Under the Commissioner’s interpretation, nothing stops the Legislature from imposing a sales

tax on food under the guise of any other tax so long as it is not labeled a “sales tax” or so long as the state can assert that tax is merely “measured by” such food sales but not “on” food sales.

As an example, it is questionable under the Commissioner’s interpretation whether the constitution even protects against the imposition of the use tax on food. Pursuant to R.C. 5741.02(A), the use tax is not a tax on a sale or purchase of any good, but rather is a tax imposed on the “storage, use, or other consumption in this state of tangible personal property...” The use tax is a tax upon the privilege of use of property. *United Transp. Union Ins. Ass. v. Tracy* (1998), 82 Ohio St.3d 333, 336.

While food is exempt from the use tax by statute, see R.C. 5741.02(C)(2), the imposition of the use tax on food would not fall under the constitutional prohibitions at issue in this case under the Commissioner’s interpretation of those provisions, i.e., that they only prohibit sales taxes on food. Thus, if the Commissioner is correct, nothing prohibits the state from levying a sales tax on food by simply changing its label to a “use tax.”

In sum, the Commissioner’s interpretation allows the Legislature to impose a tax that is identical to a sales tax on food simply by taxing its “use or consumption” and not its sale. Certainly when the citizens of Ohio adopted Article XII, Sections 3(C) and 13, they did not do so with the expectation or understanding that the Legislature could so easily by-pass their provisions. Yet, this absurd result is the logical and practical effect of the Commissioner’s interpretation, and is a compelling example of why it must be rejected. *State ex rel. Corrigan v. Perk* (1969), 19 Ohio St.2d 1, 10 (in interpreting and construing Constitution, one of the most basic and fundamental precepts which a court is required to follow is to give a fair and reasonable construction to the language therein, and to avoid a narrow or unreasonable construction which would lead to absurd or unreasonable consequences).

D. The declaratory relief sought by Appellees is narrow in scope and commanded by the Ohio Constitution despite the purported popularity of the CAT or the possible effects such ruling may have on state tax revenues.

The Commissioner contends that a ruling in Appellees' favor would "wreak havoc" on Ohio's tax laws by casting doubt on Ohio's tax jurisprudence and by exposing the CAT to potential challenges on multiple fronts. Similarly, the amici, while numerous, raise no separate legal argument as to the constitutionality of the CAT, but instead represent a collective plea to this Court to uphold a politically popular piece of legislation and to protect the stream of state tax revenue generated by the CAT when imposed on food sales. The Commissioner's and the amici's concerns are overblown and irrelevant.

First, a ruling in Appellees' favor would be easy to administer and would not exempt Ohio's grocers from paying a business tax. It would merely require an exemption to the calculation of taxable gross receipts under the CAT for receipts derived from the sale of food except for on-premises consumption. Such an exemption would mirror those already applicable to Ohio's sales tax. Significantly, Ohio's food sellers would continue to pay the CAT on all their non-food sales and on dine-in food sales.

Second, a ruling in Appellees' favor would require no "rewrite" of Ohio's tax law. This case involves a specific issue of law never presented before, relating to two specific constitutional provisions and their applicability to a new Ohio tax. As already demonstrated, a finding in Appellees' favor is not only consistent with this Court's prior jurisprudence, including *East Ohio Gas* and *Bank One Dayton*, but mandated by the language of the Ohio Constitution and this Court's longstanding precedent that this Court must look to the substantive, practical effects of a tax to determine its validity.

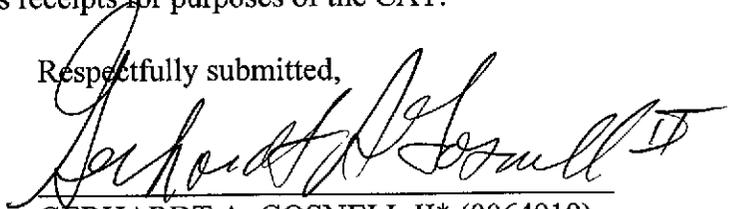
Third, the respective merits of other possible challenges to the CAT will each need to be addressed on their own. Suffice it to say, for example, a ruling that the CAT imposes an excise tax on food sales in violation of Article XII, Sections 3(C) and 13 is a very different matter than whether the “substantial nexus” test of *Quill v. North Dakota* (1992), 504 U.S. 298, for federal commerce clause analysis is implicated by the CAT.

Finally, it goes without saying that the CAT is no more constitutional when applied to food sales because the state is in need of tax revenue or because numerous interest groups supported its passage. The Ohio Constitution prohibits the taxation of food sales, and the CAT, by operation and effect, falls squarely within its terms.

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals should be affirmed, and this Court should hold that Article XII, Section 3(C) and Section 13 of the Ohio Constitution exempt gross receipts from the sale of food other than for on-premises consumption from being included in the calculation of taxable gross receipts for purposes of the CAT.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing *Merit Brief of Plaintiffs-Appellees Ohio Grocers Association, Carfagna's, Incorporated, CFZ Supermarkets, Inc., Reading Food Services, Inc., and the Sanson Company* was sent via regular U. S. Mail, postage prepaid, this 26th day of May 2009, to the following:

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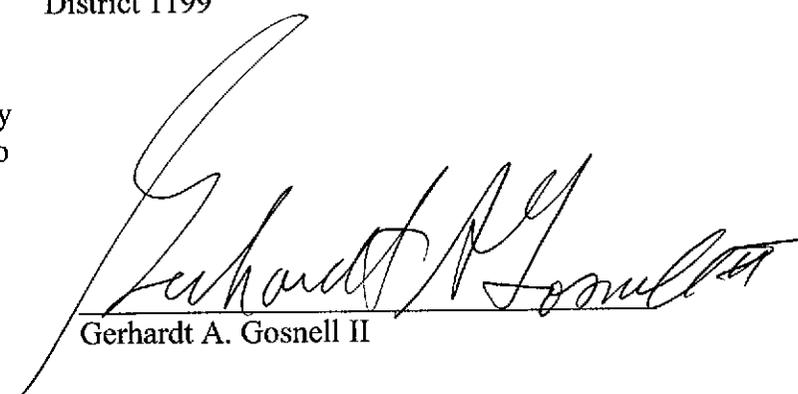
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