

**In The  
Supreme Court of Ohio**

NEWEGG, INC.,

:

Appellant,

:

Case No. 2015-0483

v.

:

Appeal from the Ohio Board of  
Tax Appeals, BTA Case No. 2012-234

JOSEPH W. TESTA,  
TAX COMMISSIONER OF OHIO,

:

:

Appellee.

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**MOTION TO DISMISS APPELLANT'S ASSIGNMENTS OF ERROR  
NUMBERS 1 AND 3 (sic)**

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## MOTION

Pursuant to S.Ct. Prac. R. 14.4(A), appellee Joseph W. Testa, Tax Commissioner of Ohio, respectfully requests that this Court dismiss certain Assignments of Error from Newegg's Notice of Appeal. These Assignments of Error are jurisdictionally barred because they were not raised before the BTA as errors with the Tax Commissioner's Final Determinations, as required by R.C. 5717.02. Because Newegg failed to raise those errors in its Notice of Appeal to the BTA, this Court lacks jurisdiction to consider them. R.C. 5717.02; R.C. 5717.04; *Bd. of Educ. of South-Western City Sch. v. Kinney*, 24 Ohio St. 3d 184, 185-187 (1986).

In particular, Newegg now attempts to raise new, "as-applied" constitutional challenges to this Court that were not raised to the Tax Commissioner or the Board of Tax Appeals. These "as-applied" challenges concern novel questions of the application of the dormant Commerce Clause of the U.S. Constitution to portions of Ohio's Commercial Activity Tax. Specifically, Newegg's putative as-applied challenges appear in assignments of error numbered 1 and 3<sup>1</sup> (sic – Newegg has two assignments of error numbered "3;" the "second" number "3" is the as-applied challenge that is at issue).

But as-applied constitutional challenges relating to Tax Commissioner Final Determinations must be raised in the first instance in the Notice of Appeal to the BTA. *South-Western City Sch.*, 24 Ohio St.3d at 185-187. Newegg failed to specify an as-applied challenge to the constitutionality of any CAT statute in its Notice of Appeal to the BTA. Accordingly, this Court lacks jurisdiction over those challenges now, and must dismiss them. R.C. 5717.02; R.C. 5717.04; *Cleveland Gear Co. v. Limbach*, 35 Ohio St.3d 229, 229, (1988); *South-Western City*

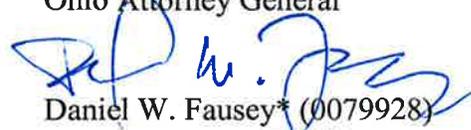
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<sup>1</sup> To the extent that Newegg argues that it raised as-applied challenges in other Assignments of Error, the same analysis applies – such challenges were not raised below and are not jurisdictionally proper before this Court.

*Sch.*, 24 Ohio St.3d at 185-187. The reasons for the motion are set forth more fully in the following memorandum in support.

Respectfully submitted,

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## MEMORANDUM IN SUPPORT

### Introduction

Newegg's Notice of Appeal to this Court is an attempt to tailor wolf's clothing for the sheep in its BTA Notice of Appeal. Newegg did not raise an as-applied constitutional challenge to the nexus provisions of the CAT, or to the statute imposing the CAT, in its BTA Notice of Appeal, but instead dressed up a basic statutory interpretation assignment of error to look like a constitutional issue. Now that Newegg has seen that its statutory interpretation argument can't withstand scrutiny, as the BTA held, Newegg attempts to raise in its Notice of Appeal to this Court the very as-applied constitutional challenge to the nexus provisions that it so carefully avoided in its Notice of Appeal to the BTA.

This Court should follow its own well-settled precedent and dismiss these newly raised as-applied constitutional challenges, because this Court does not have jurisdiction to consider issues that Newegg did not raise in its Notice of Appeal to the BTA. Former R.C. 5717.02<sup>2</sup>; R.C. 5717.04; *South-Western City Sch.*, 24 Ohio St.3d at 185-187.

Newegg cannot point to a single CAT statute in its Notice of Appeal to the BTA that it alleged was unconstitutionally applied. Similarly, there is no statement anywhere in Newegg's Notice of Appeal that *any* Ohio statute was applied against Newegg in an unconstitutional manner. This claim would be fairly easy to make—all it would have taken would have been a simple sentence like "application of R.C. 5751.01(H)(3) to Newegg violates the Commerce Clause of the US Constitution." Indeed, Newegg's Notice of Appeal to this Court is a model for how easy it is to raise an as-applied challenge, in two short sentences:

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<sup>2</sup> The version of R.C. 5717.02 that was in effect when Newegg filed its Notice of Appeal provided that the Notice of Appeal to the BTA "shall" "specify the errors [in the Final Determination] complained of." The statute was amended in 2013 to provide that the Notice of Appeal "shall contain a short and plain statement of the claimed errors in the determination or redetermination of the tax commissioner."

3 [sic]. The Board's Decision affirming the final determination should be reversed, and the assessments cancelled, because the CAT statute is unconstitutional as applied to Newegg. In particular, if interpreted to require the imposition of the CAT against Newegg, R.C. 5751.01(H)(3), (1)(3), (1)(4) & (F)(2)(jj), and R.C. 5751.02, or any of them, are unconstitutional as applied.

Notice of Appeal at 9.

Yet Newegg's BTA Notice of Appeal is devoid of any such claims. In the nine pages of the BTA Notice of Appeal, no single sentence sets forth an as-applied challenge.

This was intentional. Newegg—as did many out-of-state retailers before it and after, who were represented by the same law firm—pursued a litigation strategy that expressly avoided making any constitutional challenge. L.L. Bean was the first of these sellers represented by the same counsel, whose BTA Notice of Appeal is identical in its legal claims to Newegg's, to have its appeal decided by the BTA. See Ex. A and compare to Ex. C. And indeed, L.L. Bean explained in reference to its own, identical BTA Notice of Appeal that “[t]his case does not involve a challenge to the constitutionality of an Ohio statute.” See Ex. E, L.L. Bean's Pre-hearing Statement at 1. This statement was made *after* all of the BTA Notice of Appeal for Newegg had been filed. Compare Ex. C with Ex. E.

Instead, Newegg—and the other taxpayers following Bean's mold—argued for a limiting construction on a statute that governs exclusions from gross receipts—the measuring stick for the CAT. See Ex. A and compare to Exs. B 1-3, Ex. C, and Exs. D 1-2 (substantially identical BTA Notices of Appeal filed by the same law firm on behalf of L.L. Bean, Inc, Crutchfield, Inc., Newegg, Inc., and Mason Companies, Inc., respectively). Instead of arguing that any CAT statute was unconstitutionally applied, Newegg argued that those statutes should be construed so as to avoid potential constitutional infirmities. See Ex. C, Newegg's Notice of Appeal, at Assignment of Errors 4-6, pages 6-7, respectively.

The statute cited by Newegg is R.C. 5751.01(F)(2)(jj) (formerly numbered R.C. 5751.01(F)(2)(ff)), which provides that gross receipts cannot include “any receipts for which the tax imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio.”

Newegg asserted that this exclusion from gross receipts actually incorporates dormant Commerce Clause jurisprudence, in that it places a duty on the Tax Commissioner to determine whether the person who earned receipts may be taxed under prevailing constitutional nexus standards, *before* he can apply the clear-cut statutory bright-line presence standards that explicitly provide what constitutes substantial nexus under the CAT. In this way, Newegg sought to obtain a “limiting” construction of R.C. 5751.01(F)(2)(jj), based upon incorporation of federal commerce clause jurisprudence through the definition of excluded gross receipts. Because its receipts were not “gross receipts” under R.C. 5751.01(F)(2)(jj), Newegg argued, it did not have “taxable gross receipts of at least five hundred thousand dollars” under R.C. 5751.01(I)(3) and therefore lacked “bright-line presence” in the state. And, because it lacked “bright-line presence,” Newegg asserted, it lacked “substantial nexus” for CAT under R.C. 5751.01(H)(3). Newegg argued that the statutes must be read that way *in order to avoid constitutional infirmities*. See, Ex. C, Newegg’s BTA Notice of Appeal at Assignments of Error 4-6, pages 6-7. Thus, Newegg’s argument was entirely statute-bound by design, and relied on a limiting interpretation of R.C. 5751.02(F)(2)(jj).

But, nowhere in Newegg’s Notice of Appeal did Newegg claim that any CAT statutes *had been applied in violation of its constitutional rights*. By framing its arguments this way, Newegg may have hoped to avoid the consequences of raising a true constitutional challenge, such as the presumption of constitutionality and the heavy burden on challengers. Newegg may

have also hoped for a “statutory interpretation” that the BTA *could* provide, inasmuch as the agency lacks the authority to declare statutes unconstitutional. But whatever the impetus for the strategy was, Newegg must bear the consequences of choosing such a litigation approach, which includes forgoing the right to raise an as-applied challenge on appeal to this Court. R.C. 5717.02; R.C. 5717.04; *South-Western City Sch.*, 24 Ohio St.3d at 185-187.

Moreover, Newegg’s argument in this regard is foreclosed by the plain language of the statute. R.C. 5751.01(F)(2)(jj) has no bearing on whether Newegg, as a business entity engaged in commercial activities, has constitutional nexus with Ohio. The statute governs the taxability of *receipts*, not *persons*.

Instead, the determination of nexus for taxing persons is governed by other statutes, such as R.C. 5751.01(H) and (I) which provide “bright line” factors for determining whether a person has substantial nexus with Ohio. Newegg’s construction would also put R.C. 5751.01(F)(2)(jj) at odds with the express statutory language that the CAT applies to persons *whether or not* they have substantial nexus with the state. R.C. 5751.02(A) (“Persons on which the commercial activity tax is levied include, *but are not limited to*, persons with substantial nexus with this state.”) It was only after Newegg realized the futility of its statutory construction argument that it began advancing the notion that it *had* raised an as-applied challenge all along.

But by choosing to frame its appeal as a matter of statutory interpretation, Newegg also intentionally abandoned taking a head-on constitutional challenge to any Ohio statute. This was the litigation strategy that it chose, and this Court should not permit Newegg to pretend otherwise, now that it has seen the failings of its approach.

## Law and Argument

Newegg is an out-of-state retailer doing business in Ohio that refused to register for and pay Ohio's Commercial Activity Tax (CAT). The CAT was enacted as part of a major reform of Ohio's tax code which was phased in starting in 2005, as the Corporate Franchise Tax was phased out. The CAT is the primary privilege of doing business tax in Ohio.

The CAT applies to businesses that meet specified criteria for establishing a substantial nexus with Ohio, one of which is meeting one of the "bright-line presence factors," set forth in R.C. 5751.01(I). R.C. 5751.01(H)(3). Under one such bright-line presence factor, businesses (like Newegg) that have taxable gross receipts exceeding \$500,000 in a year from sales sourced to Ohio, have substantial nexus with Ohio, and those businesses must register with Ohio and pay the CAT.

In this case, the Commissioner applied the plain language of this bright-line statutory standard and assessed the CAT on Newegg based on its volume of Ohio sales.

- A. Newegg's "cookie cutter" Notice of Appeal follows the same self-professed litigation strategy of other out-of-state retailers, represented by the same law firm, of raising a question of statutory interpretation rather than an as-applied constitutional challenge to any CAT statute.**

In its Notice of Appeal to the BTA from the Tax Commissioner's Final Determinations, Newegg did not challenge the constitutionality of the bright-line nexus provision upon which the Tax Commissioner relied. Rather than challenging the constitutionality of the Tax Commissioner's actions or the relevant statutes, Newegg adopted a litigation strategy intended to avoid a direct constitutional challenge, by instead advancing a statutory interpretation argument that would require incorporating federal dormant Commerce Clause jurisprudence into a definitional CAT statute. Newegg argued for a limiting construction of the statutory exclusion from gross receipts set forth in former R.C. 5751.01(F)(2)(jj) of "any receipts for which the tax

imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio.”

Newegg’s litigation strategy avoided a constitutional challenge to the CAT nexus provisions, choosing instead to argue that the statute at issue incorporated dormant Commerce Clause jurisprudence by reference. See Newegg’s BTA Assignments of error 4-6 in Ex. C at p. 6-7, respectively. True, Newegg’s BTA Notice of Appeal discuss dormant Commerce Clause jurisprudence, but only to support its argument that its Ohio gross receipts qualify for the statutory exclusion. *Id.*

The error raised in Newegg’s BTA Notice of Appeal was simply a matter of statutory interpretation. For support, Newegg cited the definitional statute R.C. 5751.01(F)(2)(jj), which provides a definition of certain receipts that are to be excluded from the calculation of “gross receipts,” which is the measuring stick for CAT liability. Newegg asserted that under R.C. 5751.01(F)(2)(jj), Newegg’s Ohio receipts were, by definition, excluded from “gross receipts” that could form the basis of CAT liability. *Id.* This is so, Newegg asserted, because R.C. 5751.01(F)(2)(jj) provides an exclusion from gross receipts for “any receipts for which the tax imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio.”

Newegg asserted that this language in R.C. 5751.01(F)(2)(jj) statutorily requires the taxing authorities and tribunals to determine whether the person who earned receipts may be taxed under prevailing constitutional nexus jurisprudence. According to Newegg, because its receipts are not “gross receipts” under this construction of the statute, other CAT statutes prohibit the assessment by their plain language, as follows. R.C. 5751.01(H) levies the CAT on persons with “substantial nexus” with Ohio which includes, among other criteria, persons with

“bright-line” presence. “Bright-line presence” is defined by R.C. 5751.01(I)(3) as relevant here to persons with “taxable gross receipts of at least five hundred thousand dollars.” So, Newegg argued, because it’s gross receipts were “excluded” under R.C. 5751.02(F)(2)(jj), it did not have “bright-line presence” under R.C. 5751.01(I)(3) and therefore lacked “substantial nexus” with the state for tax purposes under R.C. 5751.01(H)<sup>3</sup>. See, Newegg’s BTA Assignments of Error 2-6, at pages 5-7 of Ex. C, respectively. Newegg’s arguments were purely a matter of statutory construction.

Newegg admitted that its appeal was based merely on statutory construction in its BTA Notice of Appeal, wherein Newegg explains its issues on appeal thusly:

4. Newegg’s receipts are not subject to taxation because, under R.C. 5751.01(F)(2)(jj), such tax is “prohibited by the Constitution or laws of the United States ...”

5. Ohio statutes *should be interpreted to avoid* the imposition of CAT on Newegg, *inasmuch as imposing the tax on Newegg would violate the Company’s rights* under the Commerce Clause of the United States Constitution *as discussed below*. It is the duty of those charged with interpreting and applying the law to *construe it* so as to “prevent a declaration of unconstitutionality.” *Conold v. Stern*, 138 Ohio St, 352, 25 N.E.2d 133, 143 (1941) (citation omitted). Only by excluding Newegg from the reach of the CAT can the constitutionality of the statute be preserved.

6. Application of the CAT to Newegg *would* violate the Company’s rights under the Commerce Clause \* \* \*

Ex. C, Newegg’s BTA Notice of Appeal, Assignments of Error 4-6, at pages 5-6, respectively (emphasis added).

Thus, Newegg actually raised *no* as-applied constitutional challenge to any CAT statute in its BTA Notice of Appeal and, as explained below, is therefore prohibited from raising such challenges now, before this Court.

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<sup>3</sup> To the extent that Newegg claims that it challenged R.C. 5751.01(H) or (I) or 5751.02, it was only in this context; that is, as a matter of the application of those statutes to Newegg’s interpretation of R.C. 5751.02(F)(2)(jj).

True, Newegg attempts to dress the “sheep” of its statutory interpretation argument in the “wolf’s clothing” of a constitutional challenge. But when the wolf’s clothing is removed, there is no wolf, but only a lamb underneath. This appeal was never a matter of constitutional challenge, but merely statutory interpretation.

Moreover, Newegg’s statutory interpretation argument fails on its own terms. R.C. 5751.01(F)(2)(jj) does *not* incorporate dormant Commerce Clause jurisprudence and accordingly it does *not* impose a duty on the Tax Commissioner to determine the taxability of persons under such federal Commerce Clause jurisprudence. This division of the statute has nothing to do with the issue of whether Newegg, as a business entity engaged in commercial activities, has constitutional nexus with Ohio.

The exclusion set forth in R.C. 5751.01(F)(2)(jj) addresses the taxability of certain *receipts*, as opposed to *persons*, under the CAT. The import of R.C. 5751.01(F)(2)(jj) is to exclude certain receipts that, by their very nature, may not be taxed. For example, Ohio could not impose a tax on receipts which the federal government preempted from state taxability under the inter-governmental tax immunity doctrine. Newegg does not claim that its receipts are of a particular nature that would make them immune from state taxation. Instead, Newegg purposefully confuses state power to tax receipts with state authority to tax a person.

Newegg’s peculiar reading of the exception statute would supersede and therefore supplant the “bright-line factors” of R.C. 5751.01(H)(3) and (I) by requiring that the determination of substantial nexus be made pursuant to federal commerce clause jurisprudence, rather than by the General Assembly’s express statutory criteria. Worse, Newegg’s reading of R.C. 5751.01(F)(2)(jj) and would render useless the express requirement of R.C. 5751.01(I)(3), that a person has substantial nexus with Ohio simply by virtue of having “gross receipts of at

least five hundred thousand dollars.” R.C. 5751.01(H) and (I) explicitly define what constitutes substantial nexus under the CAT. Newegg’s illogical reading of the exception to the definition would force the Tax Commissioner to *first* determine if Newegg has substantial nexus with Ohio under the standards set forth in dormant Commerce Clause jurisprudence, in order to determine whether Newegg’s receipts are excluded by R.C. 5751.01(F)(2)(jj). If that hurdle is cleared, *only then* would the Commissioner include Newegg’s receipts in determining that it has nexus under the bright-line sales threshold amount set forth in R.C. 5751.01(I)(3).

The inside-out logic of Newegg’s argument is self-apparent: if the Commissioner must first determine whether Newegg’s receipts are not excluded by determining whether Newegg is subject to CAT pursuant to federal commerce clause jurisprudence, then he would have no need to apply the bright-line presence standards, because he would have determined that Newegg had nexus with Ohio under the United States Constitution, which is sufficient under R.C. 5751.01(H)(4).

And Newegg’s interpretation of the exception to the definition of gross receipts is in direct contradiction with the plain language of R.C. 5751.02, which instructs that the CAT applies to persons *whether or not* they have substantial nexus with the state. R.C. 5751.02 (“Persons on which the commercial activity tax is levied include, *but are not limited to*, persons with substantial nexus with this state.”) Thus, Newegg’s proposed interpretation of a statute that provides an exclusion from gross receipts puts that statute squarely at odds with the *very statute that levies the CAT* and would render meaningless the “bright-line” nexus test of the statute. As such, Newegg’s statutory arguments were easily dispelled by the BTA.

In this way, Newegg’s argument for a limiting statutory construction is easily resolved, and there is no basis for Newegg’s allegation that R.C. 5751.01(F)(2)(jj) incorporates the

dormant Commerce Clause jurisprudence. And beyond this statutory construction argument, no constitutional as-applied challenge was raised by Newegg at all.

This is not mere hyperbole—Newegg’s Notice of Appeal and litigation strategy were cookie-cutter copies from an earlier appeal by the same law firm for a different client, where the taxpayer *expressly admitted* that no constitutional challenge had been raised.

Newegg’s Assignments of Error to the BTA in this appeal mirrored the exact same claims made by other out-of-state businesses, represented by the same counsel as Newegg, in BTA appeals from their own respective CAT assessments. See Ex. A and compare to Exs. B 1-3, Ex. C, and Exs. D 1-2 (substantially identical BTA Notices of Appeal filed by the same law firm on behalf of L.L. Bean, Inc, Crutchfield, Inc., Newegg, Inc., and Mason Companies, Inc., respectively).

The first appeal by one of these out-of-state retailers to reach this Court was the appeal of *L.L. Bean, Inc. v. Levin*, Case No.2014-0456, which was settled in mediation. See, Ex. A, E, and F. The Notice of Appeal to the BTA in Bean’s case read virtually identically to those filed by Newegg, differing only to conform to the particular facts of Bean’s assessment—the legal arguments were identical. See Ex. A and compare to Exs. B 1-3, Ex. C, and Exs. D 1-2 (substantially identical BTA Notices of Appeal filed by the same law firm on behalf of L.L. Bean, Inc, Crutchfield, Inc., Newegg, Inc., and Mason Companies, Inc., respectively)<sup>4</sup>.

Contemporaneous Notices of Appeal filed by other out-of-state retailers represented by the same counsel followed the cookie-cutter mold set forth in Bean’s original filing. *Id.* None of these Notices of Appeal contain an as-applied challenge to any CAT statute or the Tax Commissioner’s application thereof.

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<sup>4</sup> Interestingly, these parties continued their “one size fits all” approach in their appeals to this Court—the Notices of Appeal of L.L. Bean, Crutchfield, Newegg, and Mason are all identical.

Tellingly, in its Pre-hearing Statement filed with the BTA, Bean expressly disavowed having raised any constitutional challenge to any CAT provision in its BTA Notice of Appeal. See Ex. E, L.L. Bean's Pre-hearing Statement at 1. In no uncertain terms, Bean gratuitously announced that "[t]his case does not involve a challenge to the constitutionality of an Ohio statute." *Id.* Instead, Bean alleged that the Commissioner erred in his interpretation of the statutory exclusion from the definition of taxable gross receipts. Bean did not seek to have the bright-line presence statute invalidated; instead, it argued that it did not meet the bright-line taxable gross receipts amount because all of its Ohio receipts fell within the statutory exclusion. *Id.* Thus, Bean's Notice of Appeal, which is essentially identical to those filed by Newegg, did not contain an as-applied dormant Commerce Clause challenge to the constitutionality of the CAT "bright-line nexus" provisions, or to the constitutionality of any other CAT provision *by its own admission.*

The Tax Commissioner and his counsel rely on BTA Notices of Appeal to prepare for defense of the Tax Commissioner's Final Determinations. When an appellant does not present a challenge in its BTA Notice of Appeal, the Tax Commissioner's preparation for defense of the assessment is prejudiced. This was anticipated by the General Assembly when it required a taxpayer to "specify the errors" complained of in the Tax Commissioner's Final Determination.

Newegg struggles mightily now to fix the lack of an as-applied challenge, claiming that it *did* raise such a challenge. But in its BTA Notice of Appeal, Newegg can identify no single, simple, constitutional challenge to any CAT statute. Most revealing in this regard are the lengths that Newegg must go to in order to summon the specter of an as-applied challenge from its Notice of Appeal. In reality, any valid challenge raised by a taxpayer based on a claimed lack of substantial nexus with Ohio would necessarily depend on challenging the constitutionality of

R.C. 5751.02, or the nexus provisions of R.C. 5751.01(H) and (I), which Newegg has not done in this case.

**B. The BTA recognized that Newegg’s litigation strategy was to encapsulate its constitutional arguments as matter of statutory interpretation, rather than an as-applied constitutional challenge to any CAT statute.**

The Tax Commissioner explained to the BTA that Newegg chose not to challenge the constitutionality of the CAT nexus provisions head-on, but adopted this statutory construction argument as a litigation strategy to skirt the rocks and shoals that accompany a true constitutional challenge.

The BTA agreed that Newegg did not raise an as-applied constitutional challenge, but merely tried to incorporate the federal Commerce Clause jurisprudence as an issue of statutory construction. *BTA Decision and Order* at unnumbered page 3. Accordingly, the BTA considered Newegg’s arguments only in the context of statutory interpretation as receipts “excluded” from the definition of “gross receipts” under R.C. 5751.01(F)(2)(jj): “Specifically, Newegg claims its gross receipts are *excluded* from the CAT, pursuant to the U.S. Constitution, Commerce Clause, and the ‘substantial nexus’ and corresponding ‘in-state presence analysis encountered thereunder.” *BTA Decision and Order* at unnumbered page 3 (citing See R.C. 5751.01(F)(2)(jj)).

The BTA had no difficulty concluding that Newegg’s attempt to incorporate the federal Commerce Clause jurisprudence as a matter of statutory construction to override the General Assembly’s interpretation was foreclosed by the plain operation of the CAT statutes that apply *regardless* of whether the taxpayer has “substantial nexus” under the U.S. Supreme Court’s Commerce Clause jurisprudence. As the BTA held, “[e]ven without considering any constitutional claims, however, we conclude, *under the plain language set forth therein*, the

pertinent CAT statutes do not impose such an in-state presence requirement (emphasis added).” *BTA Decision and Order* at unnumbered page 4. And “[W]e are constrained to follow the mandate of the General Assembly in concluding that appellant, an out-of-state seller, has substantial nexus within this state by virtue of its gross receipts for the reporting periods in question.” *Id.* (quoting from *L.L. Bean, Inc. v. Levin*, BTA No. 2010-2859 (Mar. 6, 2014)).

The BTA did recognize a limit to its own jurisdiction, stating that “[a]ny constitutional implications of the relevant statutory authority must be considered by a tribunal that has jurisdiction over such questions of constitutional interpretation.” *Id.* at unnumbered page 3. However, in light of the BTA’s holding that Newegg did not advance a constitutional claim, and that the statutory interpretation advanced by Newegg was fatally defective, this statement was mere dicta.

Moreover, the BTA did not, in any part of its decision, hold that Newegg had properly raised an as-applied constitutional challenge in its Notice of Appeal. On the contrary, the BTA held that:

***The parties hereto agree that Newegg has not challenged the constitutionality of the relevant statutes***, but has instead, challenged the commissioner’s conclusion that Newegg is liable for the commercial activity tax, which Newegg argues is prohibited by the U.S. Constitution. Specifically, Newegg claims its gross receipts are excluded from the CAT, pursuant to the U.S. Constitution, commerce Clause, and theb “substantial nexus” and corresponding “in-state analysis thereunder. See *R.C. 5751.01(F)(2)(jj)*).

*Id.* at unnumbered page 3. Newegg recognizes that the BTA held that it raised no constitutional challenge, but argues to this Court that it had. In support of its assertion that it raised an as-applied challenge, Newegg cites to it BTA Notice of Appeal, Assignment of Error 6. Newegg Notice of Appeal at 10. But this assignment of error does not contain an as-applied challenge to the constitutionality of Ohio’s CAT statutes. As we explain above (see page 10, *infra*), this BTA

Assignment of Error actually confirms that it was Newegg's litigation strategy to *not* raise a constitutional challenge, but to instead merely seek a limiting construction of R.C. 5751.02(F)(2)(jj).

**C. Because Newegg failed to raise an as-applied constitutional challenge to any CAT statute in its BTA Notice of Appeal, this Court lacks jurisdiction to consider any such claims and must dismiss them.**

This lack of an as-applied challenge in Newegg's Notice of Appeal to the BTA means that this Court has no jurisdiction over such challenges. This Court has steadfastly held in a long line of decisions that one who challenges the constitutionality of the Tax Commissioner's application of a tax statute to particular facts is required to raise that challenge at the first available opportunity during proceedings before the Tax Commissioner. See, *Cleveland Gear*, 35 Ohio St.3d at 229, syllabus at 2 ("The question of whether a tax statute is unconstitutional when applied to a particular state of facts must be raised in the notice of appeal to the Board of Tax Appeals, and the Board of Tax Appeals must receive evidence concerning this question if presented, even though the Board of Tax Appeals may not declare the statute unconstitutional."); see also, *South-Western City Sch.*, 24 Ohio St.3d at 185-187, citing *Sun Finance & Loan Co. v. Kosydar* (1976), 45 Ohio St.2d 283, 284, fn. 1. Otherwise, it would be "impossible to develop the factual record necessary for the resolution of the case." *South-Western City Sch.*, 24 Ohio St.3d at 186, citing *Petrocon v. Kosydar*, 38 Ohio St.2d 264 (1974).

Therefore, a failure to properly raise such a constitutional challenge constitutes a waiver of that issue. *South-Western City Sch.*, 24 Ohio St.3d at 186. Moreover, when the Tax Commissioner's Final Determination does not resolve a particular error (because it was not raised by the taxpayer), then there is no basis for appeal regarding that error. *CNG Dev. Co. v. Limbach*, 63 Ohio St.3d 28, 32 (1992).

By its express terms, Newegg's Notice of Appeal to the BTA contained no as-applied challenges to the constitutionality of any CAT statutes. R.C. 5717.02; *Cleveland Gear*, 35 Ohio St.3d at 229; *South-Western City Sch.*, 24 Ohio St.3d at 185-187. Therefore no as-applied challenge to the CAT is properly before this Court. By failing to raise it before the Commissioner and at the BTA, Newegg cannot raise it now.

Even if Newegg had attempted to raise an as-applied constitutional challenge in its Notice of Appeal, such attempt lacked the specificity required to state a challenge to the constitutionality of any CAT statute. R.C. 5717.02; R.C. 5717.04; *Norandex, Inc. v. Limbach*, 69 Ohio St.3d 26, 31,(1994) fn.1; *Richter Transfer Co. v. Bowers*, 174 Ohio St. 113, 114 (1962); *see, also, Queen City Valves v. Peck*, 161 Ohio St. 579, 583 (1954).

True, Newegg's BTA Notice of Appeal contain a prefatory discussion on dormant Commerce Clause jurisprudence, wherein it asserted that such jurisprudence requires a physical presence in Ohio. And Newegg may point to this discussion as the premise for an assignment of error challenging the constitutional validity of the CAT's bright-line presence nexus provisions, or to R.C. 5751.02, which imposes the CAT whether the business has substantial nexus with Ohio or not. But the sections of Newegg's BTA Notice of Appeal in which these arguments appear do not raise any allegation of error with the Tax Commissioner's Final Determination. They are in the Section of the Notice of Appeal entitled "Background," not the section entitled "Assignments of Error." See, Ex. C at pages 2-4 and compare pages 5-8. And more accurately, the discussion of the dormant Commerce Clause jurisprudence appears in the Notice of Appeal merely to inform Newegg's limiting statutory construction argument that appears in paragraphs 4-6 of its BTA Notice of Appeal. Newegg argued that this jurisprudence informs the meaning of

the phrase “prohibited by the Constitution or laws of the United States” under R.C. 5751.02(F)(2)(jj).

But Newegg raised no such alternative as-applied challenge to these or any other CAT provision. Instead, Newegg limited its appeal to the scope of the exclusion from the definition of gross receipts, set forth in R.C. 5751.01(F)(2)(jj). Newegg did not challenge the constitutionality of that statute, either, but merely argued that it should be construed to require the Tax Commissioner to first determine whether Newegg had substantial nexus with Ohio under the prevailing Commerce Clause jurisprudence, prior to applying the specific statutory provisions defining what constitutes substantial nexus under the CAT. The failure to specify which, if any, statutory provision is unconstitutional fails to meet the jurisdictional requirements of R.C. 5717.02. *Castle Aviation, Inc. v. Wilkins*, 109 Ohio St.3d 290, 297 (2006).

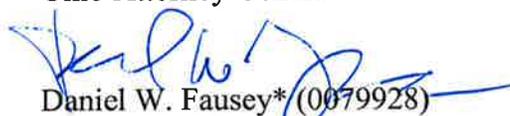
Newegg chose to structure its appeal to the BTA in this manner, but, having seen that its statutory construction theory will not carry the day, now asserts that it had raised an as-applied challenge all along. This Court should find that it does not have jurisdiction to consider the as-applied challenge to the CAT as set forth in Assignments of Error 1 and 4 of Newegg’s Notice of Appeal to this Court, because no such assignment of error was contained in its Notice of Appeal to the BTA. Because Newegg failed to specify an as-applied challenge to the constitutionality of any CAT statutes in its Notice of Appeal to the BTA, this Court lacks jurisdiction over those challenges now, and must dismiss them. R.C. 5717.02; R.C. 5717.04; *Cleveland Gear*, 35 Ohio St.3d at 229; *South-Western City Sch.*, 24 Ohio St.3d at 185-187.

## CONCLUSION

For the above reasons, this Court should dismiss and refuse to consider Newegg's Assignments of Error 1 and 3 (sic) on subject matter jurisdictional grounds because Newegg failed to raise those errors to the BTA.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that the foregoing Motion to Dismiss was served by ordinary US Mail and email this 10 day of June, 2015, upon the following:

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*Counsel for Appellant Newegg, Inc.*

  
\_\_\_\_\_  
Daniel Fausey

**In The  
Supreme Court of Ohio**

NEWEGG, INC.,	:	
Appellant,	:	Case No. 15-0483
v.	:	Appeal from the Ohio Board of Tax Appeals, BTA Case No. 2012-234,
JOSEPH W. TESTA,	:	
TAX COMMISSIONER OF OHIO,	:	
Appellee.	:	

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**APPELLEE’S APPENDIX TO MOTION TO DISMISS**

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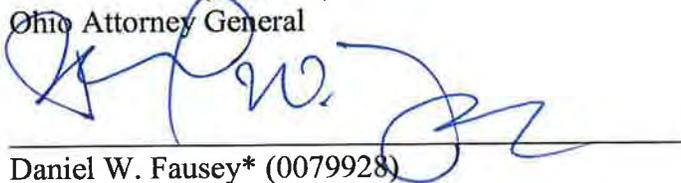
*Counsel for Appellee/Cross-Appellant  
Joseph W. Testa, Tax Commissioner of Ohio*

**APPENDIX**

Exhibit	Document	Date
A	Notice of Appeal (L. L. Bean v. Tax Commissioner)	October 8, 2010
B-1	Notice of Appeal (Crutchfield v. Tax Commissioner)	March 23, 2012
B-2	Notice of Appeal (Crutchfield v. Tax Commissioner)	September 10, 2012
B-3	Notice of Appeal (Crutchfield v. Tax Commissioner)	June 25, 2013
C	Notice of Appeal (Newegg v. Tax Commissioner)	January 19, 2012
D-1	Notice of Appeal (Mason Companies v. Tax Commissioner)	April 24, 2012
D-2	Notice of Appeal (Mason Companies v. Tax Commissioner)	August 27, 2012
E	Appellant's Pre-hearing Statement (L. L. Bean v. Tax Commissioner)	August 12, 2013
F	Decision and Order (L. L. Bean v. Tax Commissioner)	March 6, 2014

Respectfully submitted,

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Joseph W. Testa, Tax Commissioner of Ohio*

BEFORE THE OHIO BOARD OF TAX APPEALS

RECEIVED  
OCT 08 2010  
DEPT. OF TAXATION OF OHIO  
OFFICE OF TAX COMMISSIONER

L.L. BEAN, INC., )  
15 Casco Street )  
Freeport, Maine 04243-8325, )  
 )  
Appellant, )  
 )  
vs. )  
 )  
RICHARD A. LEVIN, )  
Tax Commissioner of Ohio, )  
30 East Broad Street, 22<sup>nd</sup> Floor )  
Columbus, Ohio 43215, )  
 )  
Appellee. )

BTA Case No. \_\_\_\_\_

(COMMERCIAL ACTIVITY TAX)

Amount in Controversy:  
Approximately \$210,770

NOTICE OF APPEAL

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LEGAL COUNSEL FOR APPELLANT,  
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tabbles®  
EXHIBIT  
A

Pursuant to Section 5717.02 of the Ohio Revised Code ("R.C."), L.L. Bean, Inc. ("L.L. Bean" or the "Company") hereby gives notice of appeal to the Ohio Board of Tax Appeals (the "Board") from a Final Determination (the "Determination") issued by Richard A. Levin, Tax Commissioner of the State of Ohio (the "Commissioner") that affirmed assessments of Ohio Commercial Activity Tax (the "CAT"), with respect to the period of July 1, 2005 through and including March 31, 2008 (the "Tax Period"), and dated August 10, 2010. A copy of the Determination is attached as required by statute.<sup>1</sup> See Exhibit A.

### **BACKGROUND**

1. L.L. Bean is a direct marketer. It sells its goods by mail and telephone order and through the Internet from locations entirely outside of the State of Ohio.
2. While some of L.L. Bean's customers reside in Ohio, L.L. Bean itself has no personnel, agents, representatives, or property of any kind in Ohio, makes no sales within the State of Ohio, and fulfills all orders from locations outside of Ohio by means of interstate common carriers.
3. As a result, L.L. Bean has been, and remains, protected from the imposition of Ohio's state and local taxes under the Commerce Clause of the United States Constitution. See, e.g., *National Bellas Hess v. Ill. Rev. Dep't*, 386 U.S. 753 (1967) (establishing a "bright-line" physical presence requirement before taxes can be imposed on remote sellers); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (upholding the "bright-line" rule, and protecting the "discrete realm of commerce" occupied by direct marketers). See, also, *Commonwealth Edison Co. v. Montana*,

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<sup>1</sup>As discussed below, the Determination contains confidential taxpayer information, and was disseminated publicly by the Commissioner to a variety of media outlets, including, on information and belief, media outlets that had not requested a copy. The Commissioner asserts that he had the right to do so based upon his obligation to maintain a "journal" of all final determinations, a conclusion with which L.L. Bean disagrees for reasons outlined below. Because the Determination has been widely made public as a result of the Commissioner's actions, L.L. Bean sees no practical value in asking the Board to keep it private in connection with this appeal. However, L.L. Bean reserves the right to seek the entry of a protective order to govern any other confidential information that may be disclosed to the Commissioner or the Board.

453 U.S. 609 (1981) (applying the bright-line rule to a general revenue tax on the value of coal extracted from the state, and finding that “the interstate business must have a substantial nexus with the State before any tax may be levied on it”); *Standard Pressed Steel Co. v. Washington Rev. Dept.*, 490 U.S. 560(1975) (requiring a physical presence in connection with a tax on the gross receipts of a foreign corporation resulting from sales to a State of Washington customer, and not involving use taxes or use tax collection duties).

4. The United States Supreme Court has long, and consistently, held that a company does not fall under the tax powers of a foreign state absent “local incident” on the part of the company that brings it within the tax authority of that state. See, e.g., *Norton Co. v. Ill. Rev. Dep’t*, 340 U.S. 534, 537 (1951) (explaining that states can “more easily” meet the “local incident” requirement in sales and use tax cases, “because the impact of those taxes is on the local buyer or user”); accord *National Geographic Society v. Cal. Bd. of Equalization*, 430 U.S. 551, 558 (1977) (noting that the requirement of a “local incident” is higher in gross receipts tax cases since, unlike sales and use taxes, because they involve a direct tax, rather than simply “the administrative [burden] of collecting it”); see, also, *Standard Pressed Steel Co. v. Wash. Dep’t of Rev.*, *supra* (a gross receipts tax case citing, with approval, the “local incident” requirement of *Norton*); accord *Tyler Pipe Industries, Inc. v. Wash. Dept. of Rev.*, 483 U.S. 232, 251 (1987) (requiring an in-state physical presence before a business and occupations tax could be imposed, citing *National Geographic*, and quoting, with approval, the lower court’s observation that “the crucial factor governing nexus is whether the activities *performed in this state on behalf of the taxpayer* are significantly associated with the taxpayer’s ability to establish and maintain a market *in this state* for the sales”). [Emphasis added].

5. In addition to its constitutional protections, L.L. Bean also submits that it does not satisfy the statutory requirements for imposition of the CAT inasmuch as it does not satisfy the in-state activity requirements that underpin the imposition of such tax.

6. Read as a whole, the CAT seeks to tax in-state business activities, not those between Ohio residents and those companies, like L.L. Bean, having no in-state presence whatsoever. See, e.g., R.C. 5751.033. Moreover, even if it were to be held that the CAT statutes were ambiguous as to their application to out-of-state companies like L.L. Bean, “there is one fundamental precept which still obtains in the interpretation of taxation statutes, to wit, that in case of doubt, such doubt is to be resolved in favor of the taxpayer.” *Stephens v. Glander*, 151 Ohio St. 62, 84 N.E.2d 279, 281 (1949).

7. L.L. Bean submits that, when all doubts are resolved in its favor as required by law, the assessment against it should be rescinded in its entirety.

8. Alternatively, L.L. Bean submits that any penalty sought to be imposed on the Company should be rescinded based upon the fact that the Commissioner’s refusal to rescind the penalties was arbitrary and capricious because it (1) was reasonable for L.L. Bean to conclude that Ohio’s attempt to export a domestic tax to a foreign corporation with no in-state presence violated state and federal law; and (2) L.L. Bean’s reliance on well established legal principles, including the United States Supreme Court bright-line “substantial nexus” rule, was justified and appropriate in Ohio’s unprecedented attempt to impose the CAT on nonresident mail order and Internet sellers.

#### **THE FINAL DETERMINATION**

9. In response to a finding that L.L. Bean owed the CAT for the Tax Period, the Determination rested on two grounds.

10. First, the Determination concluded that L.L. Bean had a "bright-line presence" in Ohio, as that term is defined by statute, under R.C. 5751.01(I)(3) because it received taxable gross receipts from Ohio "during the calendar year" of "at least five hundred thousand dollars." [Determination at 3 (L.L. Bean "was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year")].

11. There was no other "bright line" statutory basis for the Determination's conclusion that L.L. Bean owed CAT for the Tax Period.

12. Second, the Determination concluded that, while no physical presence of L.L. Bean in Ohio had been shown, L.L. Bean's "continuous, systematic, and significant solicitation and exploitation of the economic market place in Ohio is sufficient" to satisfy the "substantial nexus" requirement of the Commerce Clause. [Determination at 4]. In this regard, the Commissioner relied upon the provisions of R.C. 5751.01(H)(4) that "[require] the commercial activity tax to be imposed to the fullest extent permissible under the Constitution." [Determination at 3].

13. The United States Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), rejected an "economic nexus" theory in the context of a use tax assessment imposed upon a direct marketer.

14. In admitting that no physical presence of L.L. Bean had been shown or relied upon by the Commissioner, the Determination sought to reserve its investigation of any "physical presence" of L.L. Bean for another day in the event that the Determination was not sustained "on either of these grounds," i.e., \$500,000 per year in gross receipts or the "economic nexus" argument rejected in *Quill*. [Determination at 4, fn.1].

15. The Determination revealed no authority for the proposition that the Commissioner, if he were to lose this case, could either re-audit or reassess L.L. Bean for the Tax Period by asserting arguments that were known to the Commissioner and which could have been raised in connection with the Determination, but as to which the Commissioner made the voluntary and intentional decision not to assert.

### **THE DISCLOSURE OF TAXPAYER INFORMATION**

16. Beginning on or about August 10, 2010, and continuing thereafter, the Commissioner set about to disclose publicly the Determination in a manner contrary to statute, and in violation of the confidentiality protections of Ohio law.

17. Specifically, on information and belief, the Commissioner and/or his agents and representatives began faxing copies of the decision to media outlets and other parties without the request of those parties and without notice being given to L.L. Bean of those actions.

18. L.L. Bean believes that the faxing of the Determination violates L.L. Bean's confidentiality rights under R.C. 5751.12 in violation, therefore, of the Ohio Taxpayer Bill of Rights, R.C. 5703.54.

19. Upon learning of this conduct, L.L. Bean corresponded by e-mail with the Office of the Chief Counsel for the Commissioner on September 3, 2010, explaining that "the Final Determination includes specific quarterly tax amounts based upon confidential sales information provided by L.L. Bean," and advising the Commissioner "of the potentially harmful consequences of such disclosure in the highly competitive retail industry."

20. In that same September 3, 2010 correspondence, L.L. Bean requested, among other things, "the legal authority upon which Department personnel relied in making such public disclosure of taxpayer information."

21. On September 8, 2010, the Office of the Chief Counsel responded to L.L. Bean, taking the position that the Commissioner's disclosure was authorized by R.C. 5703.05(L), which provides that the Commissioner's duties include "[m]aintaining a journal, which is open to public inspection, in which the tax commissioner shall keep a record of all final determinations of the commissioner."

22. On September 10, 2010, L.L. Bean responded that the Final Decision "was not simply maintained in the Commissioner's journal, but sent by the Department, including by fax, to persons outside the Department," and asked again for "the specific statutory authority" supporting the dissemination of confidential taxpayer information in that fashion. L.L. Bean also requested access to the Commissioner's "journal" so that it could review its contents.

23. In a written response on September 13, 2010, the Office of Chief Counsel first noted that the "journal of the tax commissioner is available for viewing at our offices (address shown below) between the hours of 8:00 a.m. and 5:00 p.m., Monday through Friday, holidays excluded." L.L. Bean was told that while an appointment was not required, it would ensure the availability of the room, among other things. On information and belief, there is no "journal" within the meaning of R.C. 5703.05(L). Moreover, the Commissioner's actions in this case go well beyond maintaining a "journal, which is open to public inspection."

24. In the September 13, 2010 response, the Chief Counsel provided no legal authority for the dissemination of the Final Determination unrelated to maintenance of the "journal," and asserted that it had retained no records or information regarding those to whom copies of L.L. Bean's Determination had been sent or the employees who sent the Determination to outside parties.

## ASSIGNMENTS OF ERROR

1. Because L.L. Bean engages in no commercial activity within the State of Ohio and, likewise, neither owns nor leases property in the state, either directly or indirectly, the Company is not "doing business in the state" under R.C. 5751.02. The CAT, therefore, does not apply.
2. L.L. Bean lacked a "substantial nexus with this state" under R.C. 5751.01(H) inasmuch as it (a) neither owned nor used "part or all of its capital in this state" [R.C. 5751.01(H)(1)]; (b) lacks a "certificate of compliance with the laws of this state authorizing [it] to do business in this state" [R.C. 5751.01(H)(2)]; and (c) does not "otherwise [have] nexus in this state \*\*\* under the Constitution of the United States." [R.C. 5751.01(H)(4)].
3. L.L. Bean lacked a "'bright-line presence' in this state" under R.C. 5751.01(H)(3) & (I) inasmuch as it did not have (a) "at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars" [R.C. 5751.01(I)(1)]; (b) "during the calendar year payroll in this state of at least fifty thousand dollars" [R.C. 5751.01(I)(2)]; (c) during the calendar year "taxable gross receipts of at least five hundred thousand dollars," inasmuch as (i) none of its gross receipts are subject to taxation in Ohio; and (ii) it had no taxable sales within the State of Ohio [R.C. 5751.01(I)(3)]; or (d) "during the calendar year within this state at least twenty-five per cent of the person's total property, total payroll, or total receipts" [R.C. 5751.01(I)(4)], and was not "domiciled in this state as an individual or for corporate, commercial, or other business purposes." [R.C. 5751.01(I)(5)].
4. L.L. Bean's receipts are not subject to taxation because, under former R.C. 5751.01(F)(2)(z) [later R.C. 5751.01(F)(2)(aa) and now R.C. 5751.01(F)(2)(ff)], such tax is "prohibited by the Constitution or laws of the United States \*\*\*."

5. L.L. Bean's receipts are not subject to taxation under R.C. 5751.02(A) because it lacks a "substantial nexus with this state" under the United States Constitution. See R.C. 5751.01(F)(2)(ff), 5751.01(H)(1)-(4), and 5751.01(I)(1)-(5).

6. Ohio statutes should be interpreted to avoid the imposition of the CAT on L.L. Bean, inasmuch as imposing the tax on L.L. Bean would violate the Company's rights under the Commerce Clause of the United States Constitution. It is the duty of those charged with interpreting and applying a law to construe it so as to "prevent a declaration of unconstitutionality." *Conold v. Stern*, 138 Ohio St. 352, 25 N.E.2d 133, 143 (1941)(citation omitted). Only by excluding L.L. Bean from the reach of the CAT can the constitutionality of the tax be preserved.

7. L.L. Bean contends that, notwithstanding footnote 1 of the Determination, the Commissioner has relinquished any right to assert that the Determination should be upheld on the basis of a "physical presence" of L.L. Bean in the State of Ohio, and that his attempt to reserve this claim for another Determination to be issued later in connection with the Tax Period is ineffective.

8. Should the Board permit the Commissioner to assert a basis for the assessment not set forth or relied upon in the Determination (e.g., the "physical presence" of L.L. Bean in Ohio), L.L. Bean contends that the application of the CAT to L.L. Bean would violate the Company's rights under the Commerce Clause of the United States Constitution because L.L. Bean does not possess the requisite "bright-line" physical presence in Ohio. See, e.g., *National Bellas Hess v. Ill. Rev. Dep't*, 386 U.S. 753 (1967) (establishing a "bright-line" physical presence requirement before taxes can be imposed on remote sellers); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (upholding the bright-line rule). See, also, *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (applying the bright-line rule to a general revenue tax on the value of coal

extracted from the state, and finding that “the interstate business must have a substantial nexus with the State before any tax may be levied on it”); *Tyler Pipe Industries, Inc. v. Wash. Dept. of Rev.*, 483 U.S. 232, 251 (1987). Since the bright-line physical presence test applies to taxes like the CAT, the assessment is void in its entirety.

9. Even if an “economic presence test” were to be applied to this case, the imposition of the CAT against L.L. Bean would be unlawful inasmuch as L.L. Bean lacked an economic presence in Ohio, and, instead, merely communicated with customers in Ohio via interstate commerce from locations entirely outside of the state.

10. The tax imposed upon L.L. Bean was excessive because it was based upon an inaccurate, excessive calculation of taxable gross sales made to Ohio residents.

11. The Commissioner and/or his agents or representatives violated L.L. Bean’s confidentiality rights under R.C. 5751.12 by sending out the Determination in a manner unauthorized by law and in violation, therefore, of the Ohio Taxpayer Bill of Rights, R.C. 5703.54, which authorizes the recovery of damages and attorneys’ fees where the Commissioner’s actions “are clearly unsupportable under the law.”

12. The Commissioner erred in arbitrarily and capriciously assessing penalties for each of the aforesaid reasons, as well as based upon L.L. Bean’s good faith reliance upon existing federal constitutional law as regards to the application of the “substantial nexus” rule to cases involving gross receipts taxes, as well as sales and use taxes and other state taxes, and the Commissioner’s unclean hands in connection with its violation of L.L. Bean’s confidentiality rights. R.C. 5751.12 and 5703.54.

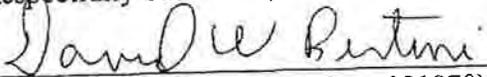
### **REQUEST FOR HEARING**

Appellant requests that the Board of Tax Appeals or its attorney examiners conduct a *de novo* evidentiary hearing in Columbus, Ohio in connection with these assignments of error.

REQUEST FOR RELIEF

L.L. Bean respectfully asks that the Determination be cancelled in its entirety, that the Commissioner be barred from issuing a new Determination on the basis of any "physical presence" of L.L. Bean in the State of Ohio, and that L.L. Bean be awarded such damages as it can prove at the hearing in this matter, together with a recovery of its attorneys fees, costs, and such other relief as is just under the circumstances.

Respectfully Submitted,

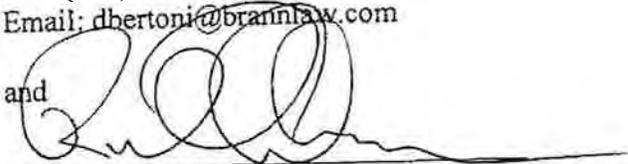


George S. Isaacson (Maine Reg. 001878)  
David W. Bertoni (Maine Reg. 006993)  
Martin I. Eisenstein (Maine Reg. 003027)

*per the  
authorization  
10-8-10  
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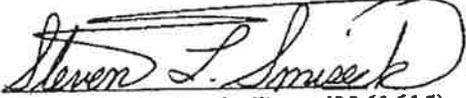
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LEGAL COUNSEL FOR APPELLANT,  
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**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of this Notice of Appeal has been filed, via hand delivery, with Richard A. Levin, Tax Commissioner of Ohio, 30 East Broad Street, 22<sup>nd</sup> Floor, Columbus, Ohio, on this 8th day of October, 2010.

  
Steven L. Smiseck, Esq. (0061615)



# FINAL DETERMINATION

Date: AUG 10 2010

L.L. Bean, Inc.  
15 Casco St.  
Freeport, ME 04033

Re: Eight Assessments  
Commercial Activity Tax

This is the final determination of the Tax Commissioner on petitions for reassessment filed pursuant to R.C. 5751.09 regarding the following assessments:

Assessment No. 17200629735266				<u>Late Payment</u>	
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Penalty</u>	<u>Total</u>
7/1/2005 – 12/31/2005	\$33,375.00	\$1,409.98	\$16,018.75	\$5,006.25	\$55,809.98
1/1/2006 – 3/31/2006	\$16,744.50	\$ 462.42	\$ 7,535.03	\$2,511.68	\$27,253.63
4/1/2006 – 6/30/2006	\$28,860.00	\$ 365.30	\$12,987.00	\$4,329.00	\$46,541.30
Assessment No. 17200710960520				<u>Late Payment</u>	
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Penalty</u>	<u>Total</u>
7/1/2006 – 9/30/2006	\$36,140.00	\$ 314.86	\$16,263.00	\$5,421.00	\$58,138.86
Assessment No. 17200710960519				<u>Late Payment</u>	
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Penalty</u>	<u>Total</u>
10/1/2006 – 12/31/2006	\$36,290.00	\$ 556.78	\$16,263.00	\$5,421.00	\$58,530.78
Assessment No. 17200715527680				<u>Late Payment</u>	
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Penalty</u>	<u>Total</u>
1/1/2007 – 3/31/2007	\$36,140.00	\$1,542.63	\$16,263.00	\$5,421.00	\$59,366.63
Assessment No. 17200728943029				<u>Late Payment</u>	
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Penalty</u>	<u>Total</u>
4/1/2007 – 6/30/2007	\$54,210.00	\$ 819.83	\$24,394.50	\$8,131.50	\$87,555.83
Assessment No. 17200736147689				<u>Late Payment</u>	
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Penalty</u>	<u>Total</u>
7/1/2007 – 9/30/2007	\$54,210.00	\$ 582.20	\$24,394.50	\$8,131.50	\$87,317.70
Assessment No. 17200805890498				<u>Late Payment</u>	
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Penalty</u>	<u>Total</u>
10/1/2007 – 12/31/2007	\$54,360.00	\$4,573.00	\$24,462.00	\$8,154.00	\$91,549.00
Assessment No. 17200815829369				<u>Late Payment</u>	
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Penalty</u>	<u>Total</u>
1/1/2008 – 3/31/2008	\$10,000.00	\$ 43.84	\$ 3,500.00	\$2,000.00	\$15,543.84



AUG 10 2010

The petitioner contends that it is not subject to the commercial activity tax, and requests cancellation of the assessments. This contention is not well taken. In summary, the petitioner is subject to the tax because it has "substantial nexus with this state," as that phrase is defined in R.C. 5751.01(H). The petitioner satisfies the third and/or fourth conditions in that division, and therefore is a person on whom the tax is levied. The petitioner sells various apparel and consumer goods through orders received via telephone, mail, and the Internet. While the petitioner admits that it has customers in Ohio to which it sells and ships these goods, it asserts that it has no activities or contacts in Ohio which rise to the level necessary for Ohio to constitutionally impose the tax.

Effective June 30, 2005, R.C. 5751.02(A) levies the commercial activity tax

\* \* \* on each person with taxable gross receipts for the privilege of doing business in this state. For the purposes of this chapter, "doing business" means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state.

Pursuant to R.C. 5751.01(H), a person has "substantial nexus with this state" if the person meets any of the following conditions:

- (1) Owns or uses a part or all of its capital in this state;
- (2) Holds a certificate of compliance with the laws of this state authorizing the person to do business in this state;
- (3) Has bright-line presence in this state;
- (4) Otherwise has nexus with this state to an extent that the person can be required to remit the tax imposed under this chapter under the Constitution of the United States.

Pursuant to R.C. 5751.01(I), a person "has bright-line presence" in this state for a reporting period if the person meets any of the following conditions:

- (1) Has at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars. \* \* \*
- (2) Has during the calendar year payroll in this state of at least fifty thousand dollars. \* \* \*
- (3) Has during the calendar year taxable gross receipts of at least five hundred thousand dollars.
- (4) Has at any time during the calendar year within this state at least twenty-five percent of the person's total property, total payroll, or total gross receipts.
- (5) Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.

Division (F) of R.C. 5751.01 defines gross receipts as "the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person \* \* \* [including] [a]mounts realized from the sale,

exchange, or other disposition of the taxpayer's property to or with another." Specifically excluded from gross receipts are "any receipts for which the tax imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio." R.C. 5751.01(F)(2)(aa) (formerly R.C. 5751.01(F)(2)(z)).

"Taxable gross receipts" is defined as gross receipts situated to this state under R.C. 5751.033. For purposes of the petitioner, division (E) applies:

Gross receipts from the sale of tangible personal property shall be situated to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has completed shall be considered the place where the purchaser receives the property. \*

\* \*

The petitioner's overriding assertion is that the Commerce Clause of the United States Constitution precludes the State of Ohio from subjecting it to the commercial activity tax under the authority of R.C. 5751.01(H)(3) or (4). The petitioner contends that imposition of the tax pursuant to either (H)(3) or (H)(4) is improper because the petitioner allegedly does not have the nexus with Ohio that is required under the Commerce Clause. The petitioner asserts that the nexus required is a "physical presence" in the taxing state, which it alleges it did not have during the assessed periods.

To the extent that the petitioner is challenging the constitutionality of R.C. 5751.01(H)(3), (4) and/or R.C. 5751.01(I)(3), the Commissioner is without jurisdiction to adjudicate the constitutionality of those statutes. However, the laws of Ohio are presumed to be constitutional. See *State ex rel. Swetland v. Kinney* (1982), 69 Ohio St.2d 567. Moreover, a discussion of the constitutional issues is particularly warranted for two reasons. First, R.C. 5751.01(H)(4) requires the commercial activity tax to be imposed to the fullest extent permissible under the Constitution. Second, regardless of R.C. 5751.01(H)(4), compliance with constitutional limitations on state taxation is the sine qua non of any tax assessment.

The Tax Commissioner's assessments have been computed based on the petitioner's representations of the amounts realized from its selling of goods to Ohio consumers. By the petitioner's own admission, the goods sold were delivered by common carrier to their ultimate destination in Ohio. Thus, they were "received in this state" and were "taxable gross receipts" within the meaning of R.C. 5751.033(E) and R.C. 5751.01(I)(3). The petitioner has disclosed and does not contest the amount of the actual gross receipts it received attributable to Ohio customers for the periods assessed, except for Assessment No. 17200815829369. For each calendar year at issue, taxable gross receipts greatly exceeded \$500,000.00, so the petitioner had "bright-line presence" pursuant to R.C. 5751.01 (H)(3) and R.C. 5751.01(I)(3). Therefore, the petitioner had "substantial nexus with this state" and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.

The petitioner contends that application of the commercial activity tax to it would violate the Commerce Clause since the petitioner allegedly does not possess the "bright-line" physical presence in Ohio required by *National Bellas Hess v. Ill. Rev. Dep't* (1967), 386 U.S. 753 and *Quill Corp. v. North Dakota* (1992), 504 U.S. 298. In *Quill*, the Court held that North Dakota's

attempt to require an out-of-state mail order company with no physical presence in the state to collect and remit use tax violated the "substantial nexus" requirement of the Commerce Clause. However, in the years since *Quill*, the Court has not extended its holding to other taxes, including income taxes or gross receipts taxes. The highest court in most, but not all, states that have considered the issue, including Ohio, has found that *Quill* applies only to sales and use taxes. See *Couchot v. State Lottery Commission* (1996), 74 Ohio St.3d 417 (finding that the physical-presence requirement of *Quill* was not applicable to taxation of Ohio Lottery winnings of a nonresident, because *Quill* applied only to sales and use taxes, although the requirement would have been satisfied anyway by virtue of the winner's purchase and redemption of the winning ticket in Ohio in a prior year). See also, for example, *Geoffrey v. South Carolina* (1993), 437 S.E.2d 13, *A & F Trademark, Inc. v. Tolson* (2004), 167 N.C. App. 150, *LANCO, Inc. v. Dir., Div. of Taxation* (2006), 908 A.2d 176, *Tax Comm'r v. MBNA America Bank* (2006), 220 W.Va. 163, and *Capital One Bank v. Commissioner* (2009), 453 Mass. 1.

The petitioner contends that even if the holding of *Quill* is limited to the sales and use tax context, that holding should apply to the commercial activity tax. However, the Supreme Court of Ohio recently found that the commercial activity tax is not, as the petitioner asserts, the functional equivalent of a sales tax. See *Ohio Grocers Ass'n v. Levin* (2009), 123 Ohio St.3d 303 (holding that the tax is not an excise tax "upon the sale or purchase of food"). Therefore, the *Quill* requirement of physical presence does not apply to the commercial activity tax.

In order to be constitutionally valid, the assessments herein must still satisfy the "substantial nexus" requirement of the Commerce Clause. The petitioner's continuous, systematic, and significant solicitation and exploitation of the economic marketplace in Ohio is sufficient for this purpose. The petitioner continually sends thousands of catalogs to Ohio residents by mail, and engages in numerous other forms of advertising in Ohio in various media, including print and television. The depth of the petitioner's success in penetrating the economic marketplace in Ohio is demonstrated by their level of gross receipts from Ohio sales of tangible personal property, which for the periods assessed exceeded \$100,000,000.00 in the aggregate. This level of activity is clearly "substantial," much more than the minimal connection needed to satisfy the Due Process Clause of the Constitution. Therefore, under established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or Constitution of either the United States or Ohio<sup>1</sup>

Lastly, the petitioner contends that even if it was subject to the tax and required to file returns and pay the amounts due, the assessed penalties should be abated in full due to its reasonable reliance on its interpretation of constitutional principles limiting state taxation. The petitioner was assessed penalty pursuant to R.C. 5751.06(A), (B)(1), and (D). The Tax Commissioner may abate these penalties pursuant to R.C. 5751.06(F). The petitioner's contention is not well taken, although as shown below the penalties are reduced herein because each of the assessed penalties is calculated as a percentage of tax due.

<sup>1</sup> Given the bright-line nexus standard set forth in R.C. 5751.01(H)(3) and R.C. 5739.01(I)(3), and the "economic presence" nexus encompassed within the scope of R.C. 5751.01(H)(4), the Tax Commissioner has not investigated nor issued findings concerning the petitioner's assertion that it lacked a "physical presence" in this state during any of the assessed periods. In the event, however, that the Commissioner's final determination is appealed and, on appeal the reviewing tribunal or court does not ultimately sustain the Commissioner's final determination on either of these grounds, the Commissioner hereby reserves ruling on the petitioner's assertion that it lacked a "physical presence" within the state during any of the assessment periods. In such event, the Tax Commissioner would render findings on the "physical presence" issue upon remand of any such adverse ruling.

Therefore, in accordance with the actual gross receipts figures supplied, the assessments are modified as follows<sup>2</sup>:

<b>Assessment No. 17200629735266</b>					
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
7/1/2005 – 12/31/2005	\$16,211.00	\$ 684.86	\$7,294.95	\$2,431.65	\$26,622.46
1/1/2006 – 3/31/2006	\$ 5,019.00	\$ 138.61	\$2,258.55	\$ 752.85	\$ 8,169.01
4/1/2006 – 6/30/2006	\$ 5,465.00	\$ 69.17	\$2,459.25	\$ 819.75	\$ 8,813.17
<b>Assessment No. 17200710960520</b>					
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
7/1/2006 – 9/30/2006	\$ 7,610.00	\$ 66.30	\$3,424.50	\$1,141.50	\$12,242.30
<b>Assessment No. 17200710960519</b>					
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
10/1/2006 – 12/31/2006	\$19,661.00	\$ 301.65	\$8,847.45	\$2,949.15	\$31,759.25
<b>Assessment No. 17200715527680</b>					
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
1/1/2007 – 3/31/2007	\$9,953.00	\$ 424.84	\$ 4,478.85	\$1,492.95	\$16,349.64
<b>Assessment No. 17200728943029</b>					
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
4/1/2007 – 6/30/2007	\$9,207.00	\$ 139.24	\$4,143.15	\$1,381.05	\$14,870.44
<b>Assessment No. 17200736147689</b>					
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
7/1/2007 – 9/30/2007	\$11,595.00	\$ 124.53	\$ 5,217.75	\$1,739.25	\$18,676.53
<b>Assessment No. 17200805890498</b>					
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
10/1/2007 – 12/31/2007	\$34,275.00	\$2,883.36	\$15,423.75	\$5,141.25	\$57,723.36
<b>Assessment No. 17200815829369</b>					
<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
1/1/2008 – 3/31/2008	\$10,000.00	\$ 43.84	\$ 3,500.00	\$2,000.00	\$15,543.84

Current records indicate that no payments have been made on these assessments. However, due to payment processing and posting time lags, payments may have been made that are not reflected in this final determination. **Any unpaid balance bears post-assessment interest as provided by law, which is in addition to the above total.** Payment shall be made payable to Ohio Treasurer Kevin Boyce. Any payment made within sixty days of the date of this final determination should be forwarded to: Ohio Department of Taxation, Compliance Division, P.O. Box 1090, Columbus, Ohio, 43216-1090.

<sup>2</sup> The assessments are modified to reflect the tax due on the taxable gross receipts supplied by the petitioner. Since the petitioner has not filed returns reflecting these amounts, the figures are subject to audit and assessment of additional tax. See R.C. 5751.09(F).

00000203

AUG 10 2010

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE FINAL DETERMINATION RECORDED IN THE TAX COMMISSIONER'S JOURNAL.

*Richard A. Levin*  
RICHARD A. LEVIN  
TAX COMMISSIONER

/s/ Richard A. Levin

Richard A. Levin  
Tax Commissioner

BEFORE THE OHIO BOARD OF TAX APPEALS

RECEIVED  
MAR 23 2012  
DEPT. OF TAXATION OF OHIO  
OFFICE OF TAX COMMISSIONER

CRUTCHFIELD, INC., )  
1 Crutchfield Park )  
Charlottesville, VA 22911 )  
Appellant, )  
vs. )  
JOSEPH W. TESTA, )  
Tax Commissioner of Ohio )  
30 East Broad Street, 22nd Floor )  
Columbus, OH 43215, )  
Appellee. )

BTA Case No. \_\_\_\_\_

(COMMERCIAL ACTIVITY TAX)

Amount in Controversy:  
Total Tax, Penalties,  
and Pre-Assessment  
Interest of \$106,239.43, Plus  
Post-Assessment Interest.

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NOTICE OF APPEAL

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Martin I. Eisenstein (Maine Reg. 003027)  
Matthew P. Schaefer (Maine Reg. 007992)

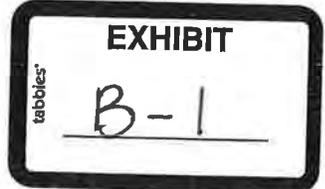
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LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.

LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.



Pursuant to Section 5717.02 of the Ohio Revised Code ("R.C."), Crutchfield, Inc. ("Crutchfield" or the "Company") hereby gives notice of appeal to the Ohio Board of Tax Appeals ("the Board") from a final determination dated January 26, 2012 ("Determination") issued by Joseph W. Testa, Tax Commissioner of the State of Ohio ("Commissioner") that affirmed assessments of Ohio Commercial Activity Tax ("CAT") against Crutchfield with respect to the following tax periods: (1) July 1, 2005 through December 31, 2005; (2) January 1, 2006 through March 31, 2006; (3) April 1, 2006 through June 30, 2006; (4) July 1, 2006 through September 30, 2006; (5) October 1, 2006 through December 31, 2006; (6) January 1, 2007 through March 31, 2007; (7) April 1, 2007 through June 30, 2007; (8) July 1, 2007 through September 30, 2007; (9) October 1, 2007 through December 31, 2007; (10) January 1, 2008 through March 31, 2008; (11) April 1, 2008 through June 30, 2008; (12) July 1, 2008 through September 30, 2008; (13) October 1, 2008 through December 31, 2008; (14) January 1, 2009 through March 31, 2009; (15) April 1, 2009 through June 30, 2009; (16) July 1, 2009 through September 30, 2009; (17) October 1, 2009 through December 31, 2009; (18) January 1, 2010 through March 31, 2010; and (19) April 1, 2010 through June 30, 2010 (together, the "Tax Periods"). A copy of the Determination is attached hereto as required by statute. See Exhibit A.

### **BACKGROUND**

1. Crutchfield is an online retailer with no connection to the State of Ohio. It sells its goods through the Internet from locations entirely outside of the state.
2. While some of Crutchfield's customers reside in Ohio, Crutchfield itself has no personnel, agents, representatives, or property of any kind in Ohio, and makes no sales from within the State of Ohio.
3. As a result, Crutchfield is protected from imposition of the Commercial Activity Tax ("CAT") under the Commerce Clause of the United States Constitution. The United States

Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe Industries, Inc. v. Wash. Dep't of Revenue*, 483 U.S. 232, 250 (1987). This “bright line,” physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess v. Ill. Dep't of Revenue*, 386 U.S. 753 (1967), and subsequently reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

4. As it applies to gross receipts taxes like the CAT, the Court has made clear that the physical presence standard is only satisfied through in-state activities by, or on behalf of, the taxpayer that are significantly associated with its ability to establish and maintain a market in the state. *Tyler Pipe*, 483 U.S. at 250; *Standard Pressed Steel, Inc. v. Wash. Dep't of Revenue*, 419 U.S. 560, 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617, 626 (1981) (citing *Bellas Hess* for threshold of state taxing power for gross receipts tax purposes, and finding sufficient presence); *see also Norton Co. v. Ill. Dep't of Revenue*, 340 U.S. 534, 537 (state lacks authority to impose gross receipts tax on a company with no “local incident” in the state). The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than the “bright line,” physical presence test of *Tyler Pipe* and *Quill*. Because Crutchfield lacks the necessary physical presence in Ohio required under the Commerce Clause, it is not subject to the CAT, and the assessments against it should be cancelled.

5. In addition to its constitutional protections, Crutchfield also submits that it does not satisfy the statutory requirements for imposition of Ohio’s Commercial Activity Tax (the

“CAT”) inasmuch as it does not satisfy the in-state activity requirements that underpin the imposition of such tax.

6. Read as a whole, the CAT seeks to tax in-state business activities, not those between Ohio residents and those companies, like Crutchfield, having no in-state presence whatsoever. Moreover, even if it were to be held that the CAT statutes were ambiguous as to their application to out-of-state companies like Crutchfield, “there is one fundamental precept which still obtains in the interpretation of taxation statutes, to wit, that in case of doubt, such doubt is to be resolved in favor of the taxpayer.” *Stephens v. Glander*, 151 Ohio St. 62, 84 N.E.2d 279, 281 (1949).

7. Crutchfield submits that, when all doubts are resolved in its favor as required by law, the Determination against it should be vacated in its entirety and the assessments cancelled.

8. Further, Crutchfield submits that any penalty sought to be imposed on the Company should be rescinded because: (1) it was reasonable for Crutchfield to conclude that Ohio’s attempt to export a domestic tax to a foreign corporation with no in-state presence violated state and federal law; and (2) Crutchfield’s reliance on well established legal principles, including the United States Supreme Court bright-line “substantial nexus” rule was justified and appropriate in light of Ohio’s unprecedented attempt to impose the CAT on non-resident mail order and Internet sellers.

### **THE FINAL DETERMINATION**

9. In support of his finding that Crutchfield was subject to the CAT, despite its lack of physical presence in Ohio, for each of the Tax Periods, the Commissioner rested the Determination on the following grounds:

10. First, the Determination concluded that Crutchfield had “substantial nexus” with Ohio as that term is defined in the statute [*see* R.C. 5751.01(H)], based on the “bright-line presence” test set forth in R.C. 5751.03(I)(3). [Determination at 2.] The Commissioner concluded that “the petitioner had “substantial nexus with this state” and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.” *Id.* at 4.

11. There was no other “bright-line” statutory basis for the Determination’s conclusion that Crutchfield owed CAT for the Tax Period.

12. The Commissioner concluded that “[u]nder established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or the Constitution of either the United States or Ohio.” [*Id.*]

13. Each of the grounds given by the Commissioner for the Determination is in error.

#### **ASSIGNMENTS OF ERROR**

1. Because Crutchfield engages in no commercial activity within the State of Ohio and, likewise, neither owns nor leases property in the state, either directly or indirectly, the Company is not “doing business in this state” under R.C. § 5751.02. The Commercial Activity Tax, therefore, does not apply.

2. Crutchfield lacked a “substantial nexus with this state” under R.C. § 5751.01(H) inasmuch as it: (a) neither owned nor used “part or all of its capital in this state” [R.C. 5751.01(H)(1)]; (b) lacks a “certificate of compliance with the laws of this state authorizing [it] to do business in this state” [R.C. 5751.01(H)(2)]; and (c) does not “otherwise [have] nexus in this state ... under the constitution [sic] of the United States.” [R.C. 5751.01(H)(4)].

3. Crutchfield lacked a “‘bright-line presence’ in this state” under R.C. § 5751.01(H)(3) & (I) inasmuch as it did not have: (a) “at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars” [R.C.

5751.01(I)(1)]; (b) “during the calendar year payroll in this state of at least fifty thousand dollars” [R.C. 5751.01(I)(2)]; (c) during the calendar year “taxable gross receipts of at least five hundred thousand dollars,” inasmuch as (i) none of its gross receipts are subject to taxation in Ohio; and (ii) it had no taxable sales within the State of Ohio [R.C. 5751.01(I)(3)]; or (d) “during the calendar year within this state at least twenty-five per cent [sic] of the person’s total property, total payroll, or total receipts.” [R.C. 5751.01(I)(4)]. In addition, Crutchfield was not “domiciled in this state as an individual or for corporate, commercial, or other business purposes.” [R.C. 5751.01(I)(5)].

4. Crutchfield’s receipts are not subject to taxation because, under R.C. § 5751.01(F)(2)(ff), such tax is “prohibited by the Constitution or laws of the United States ...”

5. Ohio statutes should be interpreted to avoid the imposition of the CAT on Crutchfield, inasmuch as imposing the tax on Crutchfield would violate the Company’s rights under the Commerce Clause of the United States Constitution, as discussed below. It is the duty of those charged with interpreting and applying a law to construe it so as to “prevent a declaration of unconstitutionality.” *Conold v. Stern*, 138 Ohio St. 352, 25 N.E.2d 133, 143 (1941) (citation omitted). Only by excluding Crutchfield from the reach of the CAT can the constitutionality of the tax be preserved.

6. Application of the CAT to Crutchfield would violate the Company’s rights under the Commerce Clause of the United States Constitution since Crutchfield does not possess the requisite “bright-line” physical presence in Ohio. The Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe*, 483 U.S. at 250 (1987) (“the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this

State”) (internal citation omitted and emphasis added); *Standard Pressed Steel*, 419 U.S. at 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (applying the bright-line rule to a general revenue tax on the value of coal extracted from the state, and finding that “the interstate business must have a substantial nexus with the State before any tax may be levied on it”). This physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess* and subsequently reaffirmed in *Quill*. The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than physical presence test of *Tyler Pipe* and *Quill*. Since the bright-line physical presence test applies to taxes like the CAT, the assessments are void in their entirety, and the Determination should be vacated.

7. Even if an “economic presence test” were to be applied to this case, the imposition of the CAT against Crutchfield would be unlawful inasmuch as Crutchfield lacked an economic presence in Ohio, and, instead, merely communicated with customers in Ohio via interstate commerce from locations entirely outside of the state.

8. The Commissioner’s assessment of the “failing to register penalty” is erroneous and unlawful in that Crutchfield was not required to register for the CAT because Crutchfield was not a “person subject to” chapter 5751 of the Revised Code. R.C. 5751.04(B).

9. The penalty should be abated. The Commissioner erred in arbitrarily and capriciously asserting penalties for each of the aforesaid reasons, and in light of Crutchfield’s good faith reliance upon existing federal constitutional law in regard to the application of the “substantial

nexus” test to cases involving gross receipts taxes, as well as sales and use taxes and other state taxes.

**REQUEST FOR HEARING**

Appellant Crutchfield requests that the Board of Tax Appeals or its attorney examiners conduct a *de novo* hearing in Columbus, Ohio in connection with these assignments of error.

**REQUEST FOR RELIEF**

Crutchfield respectfully asks that the Determination be vacated in its entirety, that the assessments against Crutchfield for the Tax Periods cancelled, that the Commissioner be barred from asserting CAT liability against Crutchfield for the Tax Periods, and that Crutchfield be awarded such other relief as is just and equitable.

Respectfully submitted,

  
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LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.

**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of this Notice of Appeal has been filed, via hand delivery, with Joseph W. Testa, Tax Commissioner of Ohio, 30 East Broad Street, 22nd Floor, Columbus, Ohio, on this 23rd day of March, 2012.

A handwritten signature in black ink, appearing to read "Steven L. Smiseck", written over a horizontal line.

Steven L. Smiseck

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# FINAL DETERMINATION

Date: JAN 26 2012

Crutchfield Corporation  
1 Crutchfield Park  
Charlottesville, VA 22911

Re: Nineteen Assessments  
Commercial Activity Tax  
Taxpayer ID No. 96059827  
Tax Period: 2005-2010

This is the final determination of the Tax Commissioner on a petition for reassessment filed pursuant to R.C. 5751.09 concerning the following commercial activity tax assessments:

<u>Assessment No.</u>	<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Payments</u>	<u>Total</u>
17201017321478	07/01/05-12/31/05	\$1,958.00	\$550.65	\$2,076.90	\$0.00	\$4,585.55
17201017321479	01/01/06-03/31/06	\$1,106.00	\$294.86	\$608.30	\$0.00	\$2,009.16
17201017321480	04/01/06-06/30/06	\$1,663.00	\$418.48	\$914.65	\$0.00	\$2,996.13
17201017321481	07/01/06-09/30/06	\$1,663.00	\$393.33	\$914.65	\$0.00	\$2,970.98
17201017321482	10/01/06-12/31/06	\$1,813.00	\$396.82	\$997.15	\$0.00	\$3,206.97
17201017321483	01/01/07-03/31/07	\$1,707.00	\$339.95	\$938.85	\$0.00	\$2,985.80
17201017321484	04/01/07-06/30/07	\$2,561.00	\$458.95	\$1,408.55	\$0.00	\$4,428.50
17201017321485	07/01/07-09/30/07	\$2,561.00	\$407.30	\$1,408.55	\$0.00	\$4,376.85
17201017321486	10/01/07-12/31/07	\$2,711.00	\$376.49	\$1,491.05	\$0.00	\$4,578.54
17201017321487	01/01/08-03/31/08	\$2,628.00	\$312.55	\$1,445.40	\$0.00	\$4,385.95
17201017321488	04/01/08-06/30/08	\$3,505.00	\$346.95	\$1,927.75	\$0.00	\$5,779.70
17201017321489	07/01/08-09/30/08	\$3,505.00	\$276.27	\$1,927.75	\$0.00	\$5,709.02
17201017321490	10/01/08-12/31/08	\$3,655.00	\$228.21	\$2,010.25	\$0.00	\$5,893.46
17201017321491	01/01/09-03/31/09	\$3,085.00	\$154.59	\$1,696.75	\$0.00	\$4,936.34
17201017321492	04/01/09-06/30/09	\$3,856.00	\$145.15	\$2,120.80	\$0.00	\$6,121.95
17201017321493	07/01/09-09/30/09	\$3,856.00	\$96.03	\$2,120.80	\$0.00	\$6,072.83
17201017321494	10/01/09-12/31/09	\$3,856.00	\$52.40	\$2,120.08	\$0.00	\$6,029.20
17201100738715	01/01/10-03/31/10	\$10,000.00	\$254.25	\$5,500.00	\$0.00	\$15,754.25
17201100738714	04/01/10-06/30/10	\$10,000.00	\$156.71	\$5,500.00	\$0.00	\$15,656.71
	<b>Total</b>	<b>\$65,689.00</b>	<b>\$5,659.94</b>	<b>\$37,128.23</b>	<b>\$0.00</b>	<b>\$106,239.43</b>

The petitioner is a corporation based in Virginia. The petitioner is a direct marketer that sells consumer electronics through the Internet from locations entirely outside of Ohio. The petitioner ships its merchandise via the U.S. Mail or using common carriers. The petitioner is not incorporated in Ohio and does not have physical facilities, offices, or showrooms in Ohio. The petitioner has no employees in Ohio and does not own or lease property in Ohio. A review of the petitioner's website indicates that the petitioner sends free catalogs to U.S. resident customers.

Information in the possession of the Tax Commissioner shows that the petitioner had more than \$500,000 in sales to customers in Ohio and that it failed to file and pay the commercial activity tax required by R.C. 5751.02(A).

The petitioner initially requested a personal appearance hearing. The petitioner subsequently requested a telephone hearing that was conducted on August 9, 2011. During the hearing, the petitioner's representative stated that the facts in the case were identical to the facts presented by another Internet retailer in its petition for reassessment, for which an appeal was pending at the Ohio Board of Tax Appeals.

The petitioner contends that it is not subject to the commercial activity tax, and requests cancellation of the assessments. This contention is not well taken. In summary, the petitioner is subject to the tax because it has "substantial nexus with this state," as that phrase is defined in R.C. 5751.01(H). The petitioner satisfies the third and/or fourth conditions in that division, and therefore is a person on whom the tax is levied. The petitioner sells consumer goods through orders received via the Internet and telephone orders. While the petitioner admits that it has customers in Ohio to which it sells and ships these goods, it asserts that it has no activities or contacts in Ohio which rise to the level necessary for Ohio to constitutionally impose the tax.

Effective June 30, 2005, R.C. 5751.02(A) levies the commercial activity tax

\* \* \* on each person with taxable gross receipts for the privilege of doing business in this state. For the purposes of this chapter, "doing business" means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state.

Pursuant to R.C. 5751.01(H), a person has "substantial nexus with this state" if the person meets any of the following conditions:

- (1) Owns or uses a part or all of its capital in this state;
- (2) Holds a certificate of compliance with the laws of this state authorizing the person to do business in this state;
- (3) Has bright-line presence in this state;
- (4) Otherwise has nexus with this state to an extent that the person can be required to remit the tax imposed under this chapter under the Constitution of the United States.

Pursuant to R.C. 5751.01(I), a person "has bright-line presence" in this state for a reporting period if the person meets any of the following conditions:

- (1) Has at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars. \* \* \*
- (2) Has during the calendar year payroll in this state of at least fifty thousand dollars. \* \* \*
- (3) Has during the calendar year taxable gross receipts of at least five hundred thousand dollars.

JAN 26 2012

- (4) Has at any time during the calendar year within this state at least twenty-five percent of the person's total property, total payroll, or total gross receipts.
- (5) Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.

Division (F) of R.C. 5751.01 defines gross receipts as "the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person \* \* \* [including] [a]mounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another." Specifically excluded from gross receipts are "any receipts for which the tax imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio." R.C. 5751.01(F)(2)(aa) (formerly R.C. 5751.01(F)(2)(z)).

"Taxable gross receipts" is defined as gross receipts situated to this state under R.C. 5751.033. For purposes of the petitioner, division (E) applies:

Gross receipts from the sale of tangible personal property shall be situated to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has completed shall be considered the place where the purchaser receives the property. \*

\* \*

The petitioner's overriding assertion is that the Commerce Clause of the United States Constitution precludes the State of Ohio from subjecting it to the commercial activity tax under the authority of R.C. 5751.01(H)(3) or (4). The petitioner contends that imposition of the tax pursuant to either (H)(3) or (H)(4) is improper because the petitioner allegedly does not have the nexus with Ohio that is required under the Commerce Clause. The petitioner asserts that the nexus required is a "physical presence" in the taxing state, which it alleges it did not have during the assessed periods.

To the extent that the petitioner is challenging the constitutionality of R.C. 5751.01(H)(3), (4) and/or R.C. 5751.01(I)(3), the Commissioner is without jurisdiction to adjudicate the constitutionality of those statutes. However, the laws of Ohio are presumed to be constitutional. See *State ex rel. Swetland v. Kinney* (1982), 69 Ohio St.2d 567. Moreover, a discussion of the constitutional issues is particularly warranted for two reasons. First, R.C. 5751.01(H)(4) requires the commercial activity tax to be imposed to the fullest extent permissible under the Constitution. Second, regardless of R.C. 5751.01(H)(4), compliance with constitutional limitations on state taxation is the sine qua non of any tax assessment.

The Tax Commissioner's assessments have been computed based on information in the Tax Commissioner's possession. By the petitioner's own admission and by information available at the petitioner's website, the goods sold were delivered by common carrier to their ultimate destination in Ohio. Thus, they were "received in this state" and were "taxable gross receipts" within the meaning of R.C. 5751.033(E) and R.C. 5751.01(I)(3). For each calendar year at issue, based on information in the possession of the Tax Commissioner, taxable gross receipts exceeded \$500,000.00, so the petitioner had "bright-line presence" pursuant to R.C. 5751.01

(H)(3) and R.C. 5751.01(I)(3). Therefore, the petitioner had “substantial nexus with this state” and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.

The petitioner contends that application of the commercial activity tax to it would violate the Commerce Clause since the petitioner allegedly does not possess the “bright-line” physical presence in Ohio required by *National Bellas Hess v. Ill. Rev. Dep’t* (1967), 386 U.S. 753 and *Quill Corp. v. North Dakota* (1992), 504 U.S. 298. In *Quill*, the Court held that North Dakota’s attempt to require an out-of-state mail order company with no physical presence in the state to collect and remit use tax violated the “substantial nexus” requirement of the Commerce Clause. However, in the years since *Quill*, the Court has not extended its holding to other taxes, including income taxes or gross receipts taxes. The highest court in most, but not all, states that have considered the issue, including Ohio, has found that *Quill* applies only to sales and use taxes. See *Couchot v. State Lottery Commission* (1996), 74 Ohio St.3d 417 (finding that the physical-presence requirement of *Quill* was not applicable to taxation of Ohio Lottery winnings of a nonresident, because *Quill* applied only to sales and use taxes, although the requirement would have been satisfied anyway by virtue of the winner’s purchase and redemption of the winning ticket in Ohio in a prior year). See also, for example, *Geoffrey v. South Carolina* (1993), 437 S.E.2d 13, *A & F Trademark, Inc. v. Tolson* (2004), 167 N.C. App. 150, *LANCO, Inc. v. Dir., Div. of Taxation* (2006), 908 A.2d 176, *Tax Comm’r v. MBNA America Bank* (2006), 220 W.Va. 163, and *Capital One Bank v. Commissioner* (2009), 453 Mass. 1.

The petitioner contends that even if the holding of *Quill* is limited to the sales and use tax context, that holding should apply to the commercial activity tax. However, the Supreme Court of Ohio recently found that the commercial activity tax is not, as the petitioner asserts, the functional equivalent of a sales tax. See *Ohio Grocers Ass’n v. Levin* (2009), 123 Ohio St.3d 303 (holding that the tax is not an excise tax “upon the sale or purchase of food”). Therefore, the *Quill* requirement of physical presence does not apply to the commercial activity tax.

In order to be constitutionally valid, the assessments herein must still satisfy the “substantial nexus” requirement of the Commerce Clause. The petitioner’s continuous, systematic, and significant solicitation and this exploitation of the economic marketplace in Ohio is sufficient for this purpose. Therefore, under established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or Constitution of either the United States or Ohio.

Lastly, the petitioner contends that even if it was subject to the tax and required to file returns and pay the amounts due, the assessed penalties should be abated in full due to its reasonable reliance on its interpretation of constitutional principles limiting state taxation. The petitioner was assessed penalty pursuant to R.C. 5751.06(A), (B)(1), and (D). The Tax Commissioner may abate these penalties pursuant to R.C. 5751.06(F). The petitioner’s contention is not well taken.

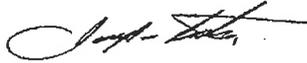
Accordingly, the assessments are affirmed.

Current records indicate that no additional payments have been made on these assessments. However, due to payment processing and posting time lags, payments may have been made that are not reflected in this final determination. **Any unpaid balance bears post-assessment interest as provided by law, which is in addition to the above total.** Payments shall be made

payable to "Ohio Treasurer Josh Mandel." Any payment made within sixty days of the date of this final determination should be forwarded to: Department of Taxation, Commercial Activity Tax Division, P.O. Box 16678, Columbus, OH 43216-6678.

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE FINAL DETERMINATION RECORDED IN THE TAX COMMISSIONER'S JOURNAL



JOSEPH W. TESTA  
TAX COMMISSIONER

/s/ Joseph W. Testa

Joseph W. Testa  
Tax Commissioner

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OHIO DEPARTMENT OF TAXATION  
OFFICE OF THE TAX COMMISSIONER

BEFORE THE OHIO BOARD OF TAX APPEALS

**CRUTCHFIELD, INC.,**  
1 Crutchfield Park  
Charlottesville, VA 22911

Appellant,

vs.

**JOSEPH W. TESTA,**  
Tax Commissioner of Ohio  
30 East Broad Street, 22nd Floor  
Columbus, OH 43215,

Appellee.

BTA Case No. \_\_\_\_\_

(COMMERCIAL ACTIVITY TAX)

Amount in Controversy:  
Total Tax, Penalties,  
and Pre-Assessment  
Interest of \$60,988.50, Plus  
Post-Assessment Interest.

**NOTICE OF APPEAL**

Martin I. Eisenstein (Maine Reg. 003027)  
(application for Pro Hac Vice Admission to be filed)  
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LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.



Pursuant to Section 5717.02 of the Ohio Revised Code (“R.C.”), Crutchfield, Inc. (“Crutchfield” or the “Company”) hereby gives notice of appeal to the Ohio Board of Tax Appeals (“the Board”) from a final determination dated July 26, 2012 (“Determination”) issued by Joseph W. Testa, Tax Commissioner of the State of Ohio (“Commissioner”) that affirmed assessments of Ohio Commercial Activity Tax (“CAT”) against Crutchfield with respect to the following tax periods: (1) July 1, 2010 through September 30, 2010; (2) October 1, 2010 through December 31, 2010; (3) January 1, 2011 through March 31, 2011; (4) April 1, 2011 through June 30, 2011; and (5) July 1, 2011 through September 30, 2011 (together, the “Tax Periods”). A copy of the Determination is attached hereto as required by statute. See Exhibit A.

### **BACKGROUND**

1. Crutchfield is an online retailer with no connection to the State of Ohio. It sells its goods through the Internet from locations entirely outside of the state.
2. While some of Crutchfield’s customers reside in Ohio, Crutchfield itself has no personnel, agents, representatives, or property of any kind in Ohio, and makes no sales from within the State of Ohio.
3. As a result, Crutchfield is protected from imposition of the Commercial Activity Tax (“CAT”) under the Commerce Clause of the United States Constitution. The United States Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe Industries, Inc. v. Wash. Dep’t of Revenue*, 483 U.S. 232, 250 (1987). This “bright line,” physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess v. Ill. Dep’t of Revenue*, 386 U.S. 753 (1967), and subsequently reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

4. As it applies to gross receipts taxes like the CAT, the Court has made clear that the physical presence standard is only satisfied through in-state activities by, or on behalf of, the taxpayer that are significantly associated with its ability to establish and maintain a market in the state. *Tyler Pipe*, 483 U.S. at 250; *Standard Pressed Steel, Inc. v. Wash. Dep't of Revenue*, 419 U.S. 560, 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617, 626 (1981) (citing *Bellas Hess* for threshold of state taxing power for gross receipts tax purposes, and finding sufficient presence); *see also Norton Co. v. Ill. Dep't of Revenue*, 340 U.S. 534, 537 (state lacks authority to impose gross receipts tax on a company with no "local incident" in the state). The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than the "bright line," physical presence test of *Tyler Pipe* and *Quill*. Because Crutchfield lacks the necessary physical presence in Ohio required under the Commerce Clause, it is not subject to the CAT, and the assessments against it should be cancelled.

5. In addition to its constitutional protections, Crutchfield also submits that it does not satisfy the statutory requirements for imposition of Ohio's Commercial Activity Tax (the "CAT") inasmuch as it does not satisfy the in-state activity requirements that underpin the imposition of such tax.

6. Read as a whole, the CAT seeks to tax in-state business activities, not those between Ohio residents and those companies, like Crutchfield, having no in-state presence whatsoever. Moreover, even if it were to be held that the CAT statutes were ambiguous as to

their application to out-of-state companies like Crutchfield, “there is one fundamental precept which still obtains in the interpretation of taxation statutes, to wit, that in case of doubt, such doubt is to be resolved in favor of the taxpayer.” *Stephens v. Glander*, 151 Ohio St. 62, 84 N.E.2d 279, 281 (1949).

7. Crutchfield submits that, when all doubts are resolved in its favor as required by law, the Determination against it should be vacated in its entirety and the assessments cancelled.

8. Further, Crutchfield submits that any penalty sought to be imposed on the Company should be rescinded because: (1) it was reasonable for Crutchfield to conclude that Ohio’s attempt to export a domestic tax to a foreign corporation with no in-state presence violated state and federal law; and (2) Crutchfield’s reliance on well established legal principles, including the United States Supreme Court bright-line “substantial nexus” rule was justified and appropriate in light of Ohio’s unprecedented attempt to impose the CAT on non-resident mail order and Internet sellers.

### **THE FINAL DETERMINATION**

9. In support of his finding that Crutchfield was subject to the CAT, despite its lack of physical presence in Ohio, for each of the Tax Periods, the Commissioner rested the Determination on the following grounds:

10. First, the Determination concluded that Crutchfield had “substantial nexus” with Ohio as that term is defined in the statute [*see* R.C. 5751.01(H)], based on the “bright-line presence” test set forth in R.C. 5751.03(I)(3). [Determination at 3.] The Commissioner concluded that “the petitioner had ‘substantial nexus with this state’ and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.” *Id.* at 3.

11. There was no other “bright-line” statutory basis for the Determination’s conclusion that Crutchfield owed CAT for the Tax Period.

12. The Commissioner concluded that “[u]nder established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or the Constitution of either the United States or Ohio.” [*Id* at 4.]

13. Each of the grounds given by the Commissioner for the Determination is in error.

### **ASSIGNMENTS OF ERROR**

1. Because Crutchfield engages in no commercial activity within the State of Ohio and, likewise, neither owns nor leases property in the state, either directly or indirectly, the Company is not “doing business in this state” under R.C. § 5751.02. The Commercial Activity Tax, therefore, does not apply.

2. Crutchfield lacked a “substantial nexus with this state” under R.C. § 5751.01(H) inasmuch as it: (a) neither owned nor used “part or all of its capital in this state” [R.C. 5751.01(H)(1)]; (b) lacks a “certificate of compliance with the laws of this state authorizing [it] to do business in this state” [R.C. 5751.01(H)(2)]; and (c) does not “otherwise [have] nexus in this state ... under the constitution [sic] of the United States.” [R.C. 5751.01(H)(4)].

3. Crutchfield lacked a “‘bright-line presence’ in this state” under R.C. § 5751.01(H)(3) & (I) inasmuch as it did not have: (a) “at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars” [R.C. 5751.01(I)(1)]; (b) “during the calendar year payroll in this state of at least fifty thousand dollars” [R.C. 5751.01(I)(2)]; (c) during the calendar year “taxable gross receipts of at least five hundred thousand dollars,” inasmuch as (i) none of its gross receipts are subject to taxation in Ohio; and (ii) it had no taxable sales within the State of Ohio [R.C. 5751.01(I)(3)]; or (d)

“during the calendar year within this state at least twenty-five per cent [sic] of the person’s total property, total payroll, or total receipts.” [R.C. 5751.01(I)(4)]. In addition, Crutchfield was not “domiciled in this state as an individual or for corporate, commercial, or other business purposes.” [R.C. 5751.01(I)(5)].

4. Crutchfield’s receipts are not subject to taxation because, under R.C. § 5751.01(F)(2)(ff), such tax is “prohibited by the Constitution or laws of the United States ...”

5. Ohio statutes should be interpreted to avoid the imposition of the CAT on Crutchfield, inasmuch as imposing the tax on Crutchfield would violate the Company’s rights under the Commerce Clause of the United States Constitution, as discussed below. It is the duty of those charged with interpreting and applying a law to construe it so as to “prevent a declaration of unconstitutionality.” *Conold v. Stern*, 138 Ohio St. 352, 25 N.E.2d 133, 143 (1941) (citation omitted). Only by excluding Crutchfield from the reach of the CAT can the constitutionality of the tax be preserved.

6. Application of the CAT to Crutchfield would violate the Company’s rights under the Commerce Clause of the United States Constitution since Crutchfield does not possess the requisite “bright-line” physical presence in Ohio. The Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe*, 483 U.S. at 250 (1987) (“the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this State”) (internal citation omitted and emphasis added); *Standard Pressed Steel*, 419 U.S. at 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S.

609 (1981) (applying the bright-line rule to a general revenue tax on the value of coal extracted from the state, and finding that “the interstate business must have a substantial nexus with the State before any tax may be levied on it”). This physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess* and subsequently reaffirmed in *Quill*. The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than physical presence test of *Tyler Pipe* and *Quill*. Since the bright-line physical presence test applies to taxes like the CAT, the assessments are void in their entirety, and the Determination should be vacated.

7. The Commissioner’s assessment of the “failing to register penalty” is erroneous and unlawful in that Crutchfield was not required to register for the CAT because Crutchfield was not a “person subject to” chapter 5751 of the Revised Code. R.C. 5751.04(B).

8. The penalty should be abated. The Commissioner erred in arbitrarily and capriciously asserting penalties for each of the aforesaid reasons, and in light of Crutchfield’s good faith reliance upon existing federal constitutional law in regard to the application of the “substantial nexus” test to cases involving gross receipts taxes, as well as sales and use taxes and other state taxes.

### **REQUEST FOR HEARING**

Appellant Crutchfield requests that the Board of Tax Appeals or its attorney examiners conduct a *de novo* hearing in Columbus, Ohio in connection with these assignments of error.

**REQUEST FOR RELIEF**

Crutchfield respectfully asks that the Determination be vacated in its entirety, that the assessments against Crutchfield for the Tax Periods cancelled, that the Commissioner be barred from asserting CAT liability against Crutchfield for the Tax Periods, and that Crutchfield be awarded such other relief as is just and equitable.

Respectfully submitted,

*Martin I. Eisenstein* <sup>*L.S.L. per email authentication*</sup>  
Martin I. Eisenstein (Maine Reg. 0017878)  
(application for Pro Hac Vice Admission to be filed)

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LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.

**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of this Notice of Appeal has been filed, via hand delivery, with Joseph W. Testa, Tax Commissioner of Ohio, 30 East Broad Street, 22nd Floor, Columbus, Ohio, on this 10<sup>th</sup> day of September, 2012.



Steven L. Smiseck (0061615)



# FINAL DETERMINATION

Date: JUL 26 2012

Crutchfield Corporation  
1 Crutchfield Park  
Charlottesville, VA 22911

Re: Five Assessments  
Commercial Activity Tax  
Taxpayer ID No. 96059827  
Tax Periods: 2010 - 2011

This is the final determination of the Tax Commissioner on five petitions for reassessment filed pursuant to R.C. 5751.09 concerning the following commercial activity tax assessments:

<u>Assessment No.</u>	<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Payments</u>	<u>Total</u>
17201131820313	07/01/10-09/30/10	\$10,000.00	\$393.42	\$2,000.00	\$0.00	\$12,393.42
17201131820314	10/01/10-12/31/10	\$10,000.00	\$291.51	\$2,000.00	\$0.00	\$12,291.51
17201131820315	01/01/11-03/31/11	\$10,000.00	\$195.07	\$2,000.00	\$0.00	\$12,195.07
17201131820316	04/01/11-06/30/11	\$10,000.00	\$94.25	\$2,000.00	\$0.00	\$12,094.25
17201133443980	07/01/11-09/30/11	\$10,000.00	\$14.25	\$2,000.00	\$0.00	\$12,014.25
	<b>Total</b>	<b>\$50,000.00</b>	<b>\$988.50</b>	<b>\$10,000.00</b>	<b>\$0.00</b>	<b>\$60,988.50</b>

The petitioner is a corporation based in Virginia. The petitioner is a direct marketer that sells consumer electronics through the Internet from locations entirely outside of Ohio. The petitioner ships its merchandise via the U.S. Mail or using common carriers. The petitioner is not incorporated in Ohio and does not have physical facilities, offices, or showrooms in Ohio. The petitioner has no employees in Ohio and does not own or lease property in Ohio. A review of the petitioner's website indicates that the petitioner sends free catalogs to U.S. resident customers. Information in the possession of the Tax Commissioner shows that the petitioner had more than \$500,000 in sales to customers in Ohio and that it failed to file and pay the commercial activity tax required by R.C. 5751.02(A).

The petitioner waived its right to a hearing, therefore the matter is decided based upon the evidence available to the Tax Commissioner and the evidence supplied along with the petition.

The petitioner contends that it is not subject to the commercial activity tax, and requests cancellation of the assessments. This contention is not well taken. In summary, the petitioner is subject to the tax because it has "substantial nexus with this state," as that phrase is defined in R.C. 5751.01(H). The petitioner satisfies the third and/or fourth conditions in that division, and therefore is a person on whom the tax is levied. The petitioner sells consumer goods through orders received via the Internet and telephone orders. While the petitioner admits that it has customers in Ohio to which it sells and ships these goods, it asserts that it has no activities or contacts in Ohio which rise to the level necessary for Ohio to constitutionally impose the tax.

Effective June 30, 2005, R.C. 5751.02(A) levies the commercial activity tax

\* \* \* on each person with taxable gross receipts for the privilege of doing business in this state. For the purposes of this chapter, "doing business" means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state.

Pursuant to R.C. 5751.01(H), a person has "substantial nexus with this state" if the person meets any of the following conditions:

- (1) Owns or uses a part or all of its capital in this state;
- (2) Holds a certificate of compliance with the laws of this state authorizing the person to do business in this state;
- (3) Has bright-line presence in this state;
- (4) Otherwise has nexus with this state to an extent that the person can be required to remit the tax imposed under this chapter under the Constitution of the United States.

Pursuant to R.C. 5751.01(I), a person "has bright-line presence" in this state for a reporting period if the person meets any of the following conditions:

- (1) Has at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars. \* \* \*
- (2) Has during the calendar year payroll in this state of at least fifty thousand dollars. \* \* \*
- (3) Has during the calendar year taxable gross receipts of at least five hundred thousand dollars.
- (4) Has at any time during the calendar year within this state at least twenty-five percent of the person's total property, total payroll, or total gross receipts.
- (5) Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.

Division (F) of R.C. 5751.01 defines gross receipts as "the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person \* \* \* [including] [a]mounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another." Specifically excluded from gross receipts are "any receipts for which the tax imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio." R.C. 5751.01(F)(2)(aa) (formerly R.C. 5751.01(F)(2)(z)).

"Taxable gross receipts" is defined as gross receipts situated to this state under R.C. 5751.033. For purposes of the petitioner, division (E) applies:

Gross receipts from the sale of tangible personal property shall be situated to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation,

the place at which such property is ultimately received after all transportation has completed shall be considered the place where the purchaser receives the property. \*

\* \*

The petitioner's overriding assertion is that the Commerce Clause of the United States Constitution precludes the State of Ohio from subjecting it to the commercial activity tax under the authority of R.C. 5751.01(H)(3) or (4). The petitioner contends that imposition of the tax pursuant to either (H)(3) or (H)(4) is improper because the petitioner allegedly does not have the nexus with Ohio that is required under the Commerce Clause. The petitioner asserts that the nexus required is a "physical presence" in the taxing state, which it alleges it did not have during the assessed periods.

To the extent that the petitioner is challenging the constitutionality of R.C. 5751.01(H)(3), (4) and/or R.C.5751.01(I)(3), the Commissioner is without jurisdiction to adjudicate the constitutionality of those statutes. However, the laws of Ohio are presumed to be constitutional. See *State ex rel. Swetland v. Kinney* (1982), 69 Ohio St.2d 567. Moreover, a discussion of the constitutional issues is particularly warranted for two reasons. First, R.C. 5751.01(H)(4) requires the commercial activity tax to be imposed to the fullest extent permissible under the Constitution. Second, regardless of R.C. 5751.01(H)(4), compliance with constitutional limitations on state taxation is the sine qua non of any tax assessment.

The Tax Commissioner's assessments have been computed based on information in the Tax Commissioner's possession. By the petitioner's own admission and by information available at the petitioner's website, the goods sold were delivered by common carrier to their ultimate destination in Ohio. Thus, they were "received in this state" and were "taxable gross receipts" within the meaning of R.C. 5751.033(E) and R.C. 5751.01(I)(3). For each calendar year at issue, based on information in the possession of the Tax Commissioner, taxable gross receipts exceeded \$500,000.00, so the petitioner had "bright-line presence" pursuant to R.C. 5751.01(H)(3) and R.C. 5751.01(I)(3). Therefore, the petitioner had "substantial nexus with this state" and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.

The petitioner contends that application of the commercial activity tax to it would violate the Commerce Clause since the petitioner allegedly does not possess the "bright-line" physical presence in Ohio required by *National Bellas Hess v. Ill. Rev. Dep't* (1967), 386 U.S. 753 and *Quill Corp. v. North Dakota* (1992), 504 U.S. 298. In *Quill*, the Court held that North Dakota's attempt to require an out-of-state mail order company with no physical presence in the state to collect and remit use tax violated the "substantial nexus" requirement of the Commerce Clause. However, in the years since *Quill*, the Court has not extended its holding to other taxes, including income taxes or gross receipts taxes. The highest court in most, but not all, states that have considered the issue, including Ohio, has found that *Quill* applies only to sales and use taxes. See *Couchot v. State Lottery Commission* (1996), 74 Ohio St.3d 417 (finding that the physical-presence requirement of *Quill* was not applicable to taxation of Ohio Lottery winnings of a nonresident, because *Quill* applied only to sales and use taxes, although the requirement would have been satisfied anyway by virtue of the winner's purchase and redemption of the winning ticket in Ohio in a prior year). See also, for example, *Geoffrey v. South Carolina* (1993), 437 S.E.2d 13, *A & F Trademark, Inc. v. Tolson* (2004), 167 N.C. App. 150, *LANCO, Inc. v. Dir., Div. of Taxation* (2006), 908 A.2d 176, *Tax Comm'r v. MBNA America Bank* (2006), 220 W.Va. 163, and *Capital One Bank v. Commissioner* (2009), 453 Mass. 1.

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The petitioner contends that even if the holding of *Quill* is limited to the sales and use tax context, that holding should apply to the commercial activity tax. However, the Supreme Court of Ohio recently found that the commercial activity tax is not, as the petitioner asserts, the functional equivalent of a sales tax. See *Ohio Grocers Ass'n v. Levin* (2009), 123 Ohio St.3d 303 (holding that the tax is not an excise tax "upon the sale or purchase of food"). Therefore, the *Quill* requirement of physical presence does not apply to the commercial activity tax.

In order to be constitutionally valid, the assessments herein must still satisfy the "substantial nexus" requirement of the Commerce Clause. The petitioner's continuous, systematic, and significant solicitation and this exploitation of the economic marketplace in Ohio is sufficient for this purpose. Therefore, under established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or Constitution of either the United States or Ohio.

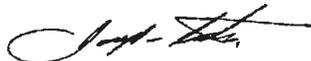
Lastly, the petitioner contends that even if it was subject to the tax and required to file returns and pay the amounts due, the assessed penalties should be abated in full due to its reasonable reliance on its interpretation of constitutional principles limiting state taxation. The petitioner was assessed penalties pursuant to R.C. 5751.06(A), (B)(1), and (D). The Tax Commissioner may abate these penalties pursuant to R.C. 5751.06(F). The petitioner's contention is not well taken.

Accordingly, the assessments are affirmed.

Current records indicate that no payments have been made on these assessments. However, due to payment processing and posting time lags, payments may have been made that are not reflected in this final determination. **Any unpaid balance bears post-assessment interest as provided by law, which is in addition to the above total.** Payments shall be made payable to "Ohio Treasurer Josh Mandel." Any payment made within sixty days of the date of this final determination should be forwarded to: Department of Taxation, Commercial Activity Tax Division, P.O. Box 16678, Columbus, OH 43216-6678.

**THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.**

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE FINAL DETERMINATION RECORDED IN THE TAX COMMISSIONER'S JOURNAL

  
JOSEPH W. TESTA  
TAX COMMISSIONER

/s/ Joseph W. Testa

Joseph W. Testa  
Tax Commissioner



Department of  
Taxation

Dear Taxpayer:

Enclosed is the Tax Commissioner's final determination regarding your case. The title is captioned either "Journal Entry" or "Final Determination."

You have the right to appeal this decision to the Board of Tax Appeals. Unlike appeals to the Tax Commissioner, proceedings before the Board of Tax Appeals are very formal, and the Board's procedures must be carefully followed. An appeal to the Board may be done in the following way:

- You have only **60 days** from the date you received this final determination to appeal.
- If you choose to appeal, you must send the Board of Tax Appeals your original notice of appeal and two copies. A copy of the enclosed final determination should also be attached to each notice of appeal. Your notice of appeal must **clearly** state why you are appealing. The law requires you to describe carefully each error which you believe the Tax Commissioner made.
- You must also send the Tax Commissioner a copy of your notice of appeal **and** a copy of the enclosed final determination.
- The Board of Tax Appeals and the Tax Commissioner **must each receive** the notice of appeal and the copy of the final determination within 60 days of your receipt of this final determination. In order to file your appeal on time, you must mail the notices by certified mail, express mail, or authorized delivery service and make sure that the recorded date is within 60 days of your receipt of the enclosed final determination. Ordinary mail delivery is not considered received until each agency actually receives your notice of appeal. Alternatively, you may personally deliver the notices before the 60 days are up to be sure both agencies receive it within the 60-day time limit. Appeals which are received late do not meet the requirements of the law and cannot be considered.

For your information, Ohio Revised Code Section 5717.02 appears on the back of this letter. This is the section of the Code stating the requirements for a proper appeal to the Board of Tax Appeals. You **must** follow all of these **mandatory** requirements in order to appeal. If you don't, you may lose your right to appeal.

The mailing address of the Board of Tax Appeals is:

30 East Broad Street  
24<sup>th</sup> Floor State Office Tower  
Columbus, OH 43215

The Tax Commissioner's mailing address is:

30 East Broad Street, 22<sup>nd</sup> Floor  
P.O. Box 530  
Columbus, OH 43216-0530

RECEIVED

HD JUN 26 2013 *lw*

BEFORE THE OHIO BOARD OF TAX APPEALS

OHIO DEPARTMENT OF TAXATION  
OFFICE OF THE TAX COMMISSIONER

CRUTCHFIELD, INC., )  
 1 Crutchfield Park )  
 Charlottesville, VA 22911 )  
 )  
 Appellant, )  
 )  
 vs. )  
 )  
 JOSEPH W. TESTA, )  
 Tax Commissioner of Ohio )  
 30 East Broad Street, 22nd Floor )  
 Columbus, OH 43215, )  
 )  
 Appellee. )

BTA Case No. \_\_\_\_\_

(COMMERCIAL ACTIVITY TAX)

Amount in Controversy:  
 Total Tax, Penalties,  
 and Pre-Assessment  
 Interest of \$39,703.01, Plus  
 Post-Assessment Interest.

*lw*

---

NOTICE OF APPEAL

---

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 Matthew P. Schaefer (Maine Reg. 007992)  
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LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.

LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.

tabbles®  
**EXHIBIT**  
B-3

Pursuant to Section 5717.02 of the Ohio Revised Code (“R.C.”), Crutchfield, Inc. (“Crutchfield” or the “Company”) hereby gives notice of appeal to the Ohio Board of Tax Appeals (“the Board”) from a final determination dated May 1, 2013 (“Determination”) issued by Joseph W. Testa, Tax Commissioner of the State of Ohio (“Commissioner”) that affirmed assessments of Ohio Commercial Activity Tax (“CAT”) against Crutchfield with respect to the following tax periods: (1) October 1, 2011 through December 31, 2011; (2) January 1, 2012 through March 31, 2012; and (3) April 1, 2012 through June 30, 2012 (together, the “Tax Periods”). A copy of the Determination is attached hereto as required by statute. *See* Exhibit A.

### BACKGROUND

1. Crutchfield is an online retailer with no connection to the State of Ohio. It sells its goods through the Internet from locations entirely outside of the state.

2. While some of Crutchfield’s customers reside in Ohio, Crutchfield itself has no personnel, agents, representatives, or property of any kind in Ohio, and makes no sales from within the State of Ohio.

3. As a result, Crutchfield is protected from imposition of the Commercial Activity Tax (“CAT”) under the Commerce Clause of the United States Constitution. The United States Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe Industries, Inc. v. Wash. Dep’t of Revenue*, 483 U.S. 232, 250 (1987). This “bright line,” physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess v. Ill. Dep’t of Revenue*, 386 U.S. 753 (1967), and subsequently reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

4. As it applies to gross receipts taxes like the CAT, the Court has made clear that the physical presence standard is only satisfied through in-state activities by, or on behalf of, the taxpayer that are significantly associated with its ability to establish and maintain a market in the state. *Tyler Pipe*, 483 U.S. at 250; *Standard Pressed Steel, Inc. v. Wash. Dep't of Revenue*, 419 U.S. 560, 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617, 626 (1981) (citing *Bellas Hess* for threshold of state taxing power for gross receipts tax purposes, and finding sufficient presence); *see also Norton Co. v. Ill. Dep't of Revenue*, 340 U.S. 534, 537 (state lacks authority to impose gross receipts tax on a company with no "local incident" in the state). The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than the "bright line," physical presence test of *Tyler Pipe* and *Quill*. Because Crutchfield lacks the necessary physical presence in Ohio required under the Commerce Clause, it is not subject to the CAT, and the assessments against it should be cancelled.

5. In addition to its constitutional protections, Crutchfield also submits that it does not satisfy the statutory requirements for imposition of Ohio's Commercial Activity Tax (the "CAT") inasmuch as it does not satisfy the in-state activity requirements that underpin the imposition of such tax.

6. Read as a whole, the CAT seeks to tax in-state business activities, not those between Ohio residents and those companies, like Crutchfield, having no in-state presence whatsoever. Moreover, even if it were to be held that the CAT statutes were ambiguous as to

their application to out-of-state companies like Crutchfield, “there is one fundamental precept which still obtains in the interpretation of taxation statutes, to wit, that in case of doubt, such doubt is to be resolved in favor of the taxpayer.” *Stephens v. Glander*, 151 Ohio St. 62, 84 N.E.2d 279, 281 (1949).

7. Crutchfield submits that, when all doubts are resolved in its favor as required by law, the Determination against it should be vacated in its entirety and the assessments cancelled.

8. Further, Crutchfield submits that any penalty sought to be imposed on the Company should be rescinded because: (1) it was reasonable for Crutchfield to conclude that Ohio’s attempt to export a domestic tax to a foreign corporation with no in-state presence violated state and federal law; and (2) Crutchfield’s reliance on well established legal principles, including the United States Supreme Court bright-line “substantial nexus” rule was justified and appropriate in light of Ohio’s unprecedented attempt to impose the CAT on non-resident mail order and Internet sellers.

### **THE FINAL DETERMINATION**

9. In support of his finding that Crutchfield was subject to the CAT, despite its lack of physical presence in Ohio, for each of the Tax Periods, the Commissioner rested the Determination on the following grounds:

10. First, the Determination concluded that Crutchfield had “substantial nexus” with Ohio as that term is defined in the statute [*see* R.C. 5751.01(H)], based on the “bright-line presence” test set forth in R.C. 5751.03(D)(3). [Determination at 3.] The Commissioner concluded that “the petitioner had ‘substantial nexus with this state’ and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.” *Id.* at 3.

11. There was no other “bright-line” statutory basis for the Determination’s conclusion that Crutchfield owed CAT for the Tax Period.

12. The Commissioner concluded that “[u]nder established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or the Constitution of either the United States or Ohio.” [*Id.* at 4.]

13. Each of the grounds given by the Commissioner for the Determination is in error.

### ASSIGNMENTS OF ERROR

1. Because Crutchfield engages in no commercial activity within the State of Ohio and, likewise, neither owns nor leases property in the state, either directly or indirectly, the Company is not “doing business in this state” under R.C. § 5751.02. The Commercial Activity Tax, therefore, does not apply.

2. Crutchfield lacked a “substantial nexus with this state” under R.C. § 5751.01(H) inasmuch as it: (a) neither owned nor used “part or all of its capital in this state” [R.C. 5751.01(H)(1)]; (b) lacks a “certificate of compliance with the laws of this state authorizing [it] to do business in this state” [R.C. 5751.01(H)(2)]; and (c) does not “otherwise [have] nexus in this state ... under the constitution [sic] of the United States.” [R.C. 5751.01(H)(4)].

3. Crutchfield lacked a “‘bright-line presence’ in this state” under R.C. § 5751.01(H)(3) & (I) inasmuch as it did not have: (a) “at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars” [R.C. 5751.01(I)(1)]; (b) “during the calendar year payroll in this state of at least fifty thousand dollars” [R.C. 5751.01(I)(2)]; (c) during the calendar year “taxable gross receipts of at least five hundred thousand dollars,” inasmuch as (i) none of its gross receipts are subject to taxation in Ohio; and (ii) it had no taxable sales within the State of Ohio [R.C. 5751.01(I)(3)]; or (d)

“during the calendar year within this state at least twenty-five per cent [sic] of the person’s total property, total payroll, or total receipts.” [R.C. 5751.01(I)(4)]. In addition, Crutchfield was not “domiciled in this state as an individual or for corporate, commercial, or other business purposes.” [R.C. 5751.01(I)(5)].

4. Crutchfield’s receipts are not subject to taxation because, under R.C. § 5751.01(F)(2)(ff), such tax is “prohibited by the Constitution or laws of the United States ...”

5. Ohio statutes should be interpreted to avoid the imposition of the CAT on Crutchfield, inasmuch as imposing the tax on Crutchfield would violate the Company’s rights under the Commerce Clause of the United States Constitution, as discussed below. It is the duty of those charged with interpreting and applying a law to construe it so as to “prevent a declaration of unconstitutionality.” *Conold v. Stern*, 138 Ohio St. 352, 25 N.E.2d 133, 143 (1941) (citation omitted). Only by excluding Crutchfield from the reach of the CAT can the constitutionality of the tax be preserved.

6. Application of the CAT to Crutchfield would violate the Company’s rights under the Commerce Clause of the United States Constitution since Crutchfield does not possess the requisite “bright-line” physical presence in Ohio. The Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe*, 483 U.S. at 250 (1987) (“the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this State”) (internal citation omitted and emphasis added); *Standard Pressed Steel*, 419 U.S. at 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S.

609 (1981) (applying the bright-line rule to a general revenue tax on the value of coal extracted from the state, and finding that “the interstate business must have a substantial nexus with the State before any tax may be levied on it”). This physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess* and subsequently reaffirmed in *Quill*. The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than physical presence test of *Tyler Pipe* and *Quill*. Since the bright-line physical presence test applies to taxes like the CAT, the assessments are void in their entirety, and the Determination should be vacated.

7. The Commissioner’s assessment of the “failing to register penalty” is erroneous and unlawful in that Crutchfield was not required to register for the CAT because Crutchfield was not a “person subject to” chapter 5751 of the Revised Code. R.C. 5751.04(B).

8. The penalty should be abated. The Commissioner erred in arbitrarily and capriciously asserting penalties for each of the aforesaid reasons, and in light of Crutchfield’s good faith reliance upon existing federal constitutional law in regard to the application of the “substantial nexus” test to cases involving gross receipts taxes, as well as sales and use taxes and other state taxes.

### **REQUEST FOR HEARING**

Appellant Crutchfield requests that the Board of Tax Appeals or its attorney examiners conduct a *de novo* hearing in Columbus, Ohio in connection with these assignments of error.

**REQUEST FOR RELIEF**

Crutchfield respectfully asks that the Determination be vacated in its entirety, that the assessments against Crutchfield for the Tax Periods cancelled, that the Commissioner be barred from asserting CAT liability against Crutchfield for the Tax Periods, and that Crutchfield be awarded such other relief as is just and equitable.

Respectfully submitted,

*Matthew P. Schaefer* *By A.L.S. Per email AUTH*  
\_\_\_\_\_  
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Matthew P. Schaefer (Maine Reg. 007992)

*Steven L. Smiseck*  
\_\_\_\_\_  
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LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.

LEGAL COUNSEL FOR APPELLANT,  
CRUTCHFIELD, INC.

**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of this Notice of Appeal has been filed, via hand delivery, with Joseph W. Testa, Tax Commissioner of Ohio, 30 East Broad Street, 22nd Floor, Columbus, Ohio, on this 25th day of June, 2013.

  
Steven L. Smiseck (0061615)



Department of  
Taxation

Office of the Tax Commissioner  
30 E. Broad St., 22<sup>nd</sup> Floor • Columbus, OH 43215

FINAL  
DETERMINATION

Date: MAY - 1 2013

Crutchfield Corporation  
1 Crutchfield Park  
Charlottesville, VA 22911

Re: Three Assessments  
Commercial Activity Tax  
Taxpayer ID No. 96059827  
Tax Periods: 10/01/2011 - 06/30/2012

This is the final determination of the Tax Commissioner on a petition for reassessment filed pursuant to R.C. 5751.09 concerning the following commercial activity tax assessments:

<u>Assessment No.</u>	<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Payments</u>	<u>Total</u>
17201219256375	10/01/11-12/31/11	\$10,000.00	\$117.53	\$2,000.00	\$0.00	\$12,117.53
17201219256376	01/01/12-03/31/12	\$10,000.00	\$44.38	\$2,000.00	\$0.00	\$12,044.38
17201228344172	04/01/12-06/30/12	\$10,000.00	\$41.10	\$5,500.00	\$0.00	\$15,541.10
	Total	\$30,000.00	\$203.01	\$9,500.00	\$0.00	\$39,703.01

The petitioner is a corporation based in Virginia. The petitioner is a direct marketer that sells consumer electronics through the Internet from locations entirely outside of Ohio. The petitioner ships its merchandise via the U.S. Mail or using common carriers. The petitioner is not incorporated in Ohio and does not have physical facilities, offices, or showrooms in Ohio. The petitioner has no employees in Ohio and does not own or lease property in Ohio. A review of the petitioner's website indicates that the petitioner sends free catalogs to U.S. resident customers. Information in the possession of the Tax Commissioner shows that the petitioner had more than \$500,000 in sales to customers in Ohio and that it failed to file and pay the commercial activity tax required by R.C. 5751.02(A).

The petitioner waived its right to a hearing, therefore the matter is decided based upon the evidence available to the Tax Commissioner and the evidence supplied along with the petition.

The petitioner contends that it is not subject to the commercial activity tax, and requests cancellation of the assessments. This contention is not well taken. In summary, the petitioner is subject to the tax because it has "substantial nexus with this state," as that phrase is defined in R.C. 5751.01(H). The petitioner satisfies the third and/or fourth conditions in that division, and therefore is a person on whom the tax is levied. The petitioner sells consumer goods through orders received via the Internet and telephone orders. While the petitioner admits that it has customers in Ohio to which it sells and ships these goods, it asserts that it has no activities or contacts in Ohio which rise to the level necessary for Ohio to constitutionally impose the tax.

Effective June 30, 2005, R.C. 5751.02(A) levies the commercial activity tax

MAY - 1 2013

\* \* \* on each person with taxable gross receipts for the privilege of doing business in this state. For the purposes of this chapter, "doing business" means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state.

Pursuant to R.C. 5751.01(H), a person has "substantial nexus with this state" if the person meets any of the following conditions:

- (1) Owns or uses a part or all of its capital in this state;
- (2) Holds a certificate of compliance with the laws of this state authorizing the person to do business in this state;
- (3) Has bright-line presence in this state;
- (4) Otherwise has nexus with this state to an extent that the person can be required to remit the tax imposed under this chapter under the Constitution of the United States.

Pursuant to R.C. 5751.01(I), a person "has bright-line presence" in this state for a reporting period if the person meets any of the following conditions:

- (1) Has at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars. \* \* \*
- (2) Has during the calendar year payroll in this state of at least fifty thousand dollars. \* \* \*
- (3) Has during the calendar year taxable gross receipts of at least five hundred thousand dollars.
- (4) Has at any time during the calendar year within this state at least twenty-five percent of the person's total property, total payroll, or total gross receipts.
- (5) Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.

Division (F) of R.C. 5751.01 defines gross receipts as "the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person \* \* \* [including] [a]mounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another." Specifically excluded from gross receipts are "any receipts for which the tax imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio." R.C. 5751.01(F)(2)(jj) (formerly R.C. 5751.01(F)(2)(z)).

"Taxable gross receipts" is defined as gross receipts situated to this state under R.C. 5751.033. For purposes of the petitioner, division (E) applies:

Gross receipts from the sale of tangible personal property shall be situated to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of

transportation, the place at which such property is ultimately received after all transportation has completed shall be considered the place where the purchaser receives the property. \* \* \*

The petitioner's overriding assertion is that the Commerce Clause of the United States Constitution precludes the State of Ohio from subjecting it to the commercial activity tax under the authority of R.C. 5751.01(H)(3) or (4). The petitioner contends that imposition of the tax pursuant to either (H)(3) or (H)(4) is improper because the petitioner allegedly does not have the nexus with Ohio that is required under the Commerce Clause. The petitioner asserts that the nexus required is a "physical presence" in the taxing state, which it alleges it did not have during the assessed periods.

To the extent that the petitioner is challenging the constitutionality of R.C. 5751.01(H)(3), (4) and/or R.C.5751.01(I)(3), the Commissioner is without jurisdiction to adjudicate the constitutionality of those statutes. However, the laws of Ohio are presumed to be constitutional. See *State ex rel. Swetland v. Kinney* (1982), 69 Ohio St.2d 567. Moreover, a discussion of the constitutional issues is particularly warranted for two reasons. First, R.C. 5751.01(H)(4) requires the commercial activity tax to be imposed to the fullest extent permissible under the Constitution. Second, regardless of R.C. 5751.01(H)(4), compliance with constitutional limitations on state taxation is the sine qua non of any tax assessment.

The Tax Commissioner's assessments have been computed based on information in the Tax Commissioner's possession. By the petitioner's own admission and by information available at the petitioner's website, the goods sold were delivered by common carrier to their ultimate destination in Ohio. Thus, they were "received in this state" and were "taxable gross receipts" within the meaning of R.C. 5751.033(E) and R.C. 5751.01(I)(3). For each calendar year at issue, based on information in the possession of the Tax Commissioner, taxable gross receipts exceeded \$500,000.00, so the petitioner had "bright-line presence" pursuant to R.C. 5751.01(H)(3) and R.C. 5751.01(I)(3). Therefore, the petitioner had "substantial nexus with this state" and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.

The petitioner contends that application of the commercial activity tax to it would violate the Commerce Clause since the petitioner allegedly does not possess the "bright-line" physical presence in Ohio required by *National Bellas Hess v. Ill. Rev. Dep't* (1967), 386 U.S. 753 and *Quill Corp. v. North Dakota* (1992), 504 U.S. 298. In *Quill*, the Court held that North Dakota's attempt to require an out-of-state mail order company with no physical presence in the state to collect and remit use tax violated the "substantial nexus" requirement of the Commerce Clause. However, in the years since *Quill*, the Court has not extended its holding to other taxes, including income taxes or gross receipts taxes. The highest court in most, but not all, states that have considered the issue, including Ohio, has found that *Quill* applies only to sales and use taxes. See *Couchot v. State Lottery Commission* (1996), 74 Ohio St.3d 417 (finding that the physical-presence requirement of *Quill* was not applicable to taxation of Ohio Lottery winnings of a nonresident, because *Quill* applied only to sales and use taxes, although the requirement would have been satisfied anyway by virtue of the winner's purchase and redemption of the winning ticket in Ohio in a prior year). See also, for example, *Geoffrey v. South Carolina* (1993), 437 S.E.2d 13, *A & F Trademark, Inc. v. Tolson* (2004), 167 N.C. App. 150, *LANCO, Inc. v. Dir., Div. of Taxation* (2006), 908 A.2d 176, *Tax Comm'r v. MBNA America Bank* (2006), 220

W.Va. 163, and *Capital One Bank v. Commissioner* (2009), 453 Mass. 1.

MAY - 1 2013

The petitioner contends that even if the holding of *Quill* is limited to the sales and use tax context, that holding should apply to the commercial activity tax. However, the Supreme Court of Ohio recently found that the commercial activity tax is not, as the petitioner asserts, the functional equivalent of a sales tax. See *Ohio Grocers Ass'n v. Levin* (2009), 123 Ohio St.3d 303 (holding that the tax is not an excise tax "upon the sale or purchase of food"). Therefore, the *Quill* requirement of physical presence does not apply to the commercial activity tax.

In order to be constitutionally valid, the assessments herein must still satisfy the "substantial nexus" requirement of the Commerce Clause. The petitioner's continuous, systematic, and significant solicitation and this exploitation of the economic marketplace in Ohio is sufficient for this purpose. Therefore, under established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or Constitution of either the United States or Ohio.

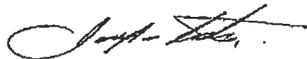
Lastly, the petitioner contends that even if it was subject to the tax and required to file returns and pay the amounts due, the assessed penalties should be abated in full due to its reasonable reliance on its interpretation of constitutional principles limiting state taxation. The petitioner was assessed penalty pursuant to R.C. 5751.06(A), (B)(1), and (D). The Tax Commissioner may abate these penalties pursuant to R.C. 5751.06(F). The petitioner's contention is not well taken.

Accordingly, the assessments are affirmed.

Current records indicate that no payments have been made on these assessments. However, due to payment processing and posting time lags, payments may have been made that are not reflected in this final determination. **Any unpaid balance bears post-assessment interest as provided by law, which is in addition to the above total.** Payments shall be made payable to "Ohio Treasurer Josh Mandel." Any payment made within sixty days of the date of this final determination should be forwarded to: Department of Taxation, Commercial Activity Tax Division, P.O. Box 16678, Columbus, OH 43216-6678.

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE FINAL DETERMINATION RECORDED IN THE TAX COMMISSIONER'S JOURNAL



JOSEPH W. TESTA  
TAX COMMISSIONER

/s/ Joseph W. Testa

Joseph W. Testa  
Tax Commissioner



Department of  
Taxation

Dear Taxpayer:

Enclosed is the Tax Commissioner's final determination regarding your case. The title is captioned either "Journal Entry" or "Final Determination."

You have the right to appeal this decision to the Board of Tax Appeals. Unlike appeals to the Tax Commissioner, proceedings before the Board of Tax Appeals are very formal, and the Board's procedures must be carefully followed. An appeal to the Board may be done in the following way:

- You have only **60 days** from the date you received this final determination to appeal.
- If you choose to appeal, you must send the Board of Tax Appeals your original notice of appeal and two copies. A copy of the enclosed final determination should also be attached to each notice of appeal. Your notice of appeal must **clearly** state why you are appealing. The law requires you to describe carefully each error which you believe the Tax Commissioner made.
- You must also send the Tax Commissioner a copy of your notice of appeal **and** a copy of the enclosed final determination.
- The Board of Tax Appeals and the Tax Commissioner **must each receive** the notice of appeal and the copy of the final determination within 60 days of your receipt of this final determination. In order to file your appeal on time, you must mail the notices by certified mail, express mail, or authorized delivery service and make sure that the recorded date is within 60 days of your receipt of the enclosed final determination. Ordinary mail delivery is not considered received until each agency actually receives your notice of appeal. Alternatively, you may personally deliver the notices before the 60 days are up to be sure both agencies receive it within the 60-day time limit. Appeals which are received late do not meet the requirements of the law and cannot be considered.

For your information, Ohio Revised Code Section 5717.02 appears on the back of this letter. This is the section of the Code stating the requirements for a proper appeal to the Board of Tax Appeals. You **must follow** all of these **mandatory** requirements in order to appeal. If you don't, you may lose your right to appeal.

The mailing address of the Board of Tax Appeals is:

30 East Broad Street  
24<sup>th</sup> Floor State Office Tower  
Columbus, OH 43215

The Tax Commissioner's mailing address is:

30 East Broad Street, 22<sup>nd</sup> Floor  
P.O. Box 530  
Columbus, OH 43216-0530

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JAN 19 2012 BSK

DEPT. OF TAXATION OF OHIO  
OFFICE OF TAX COMMISSIONER

BEFORE THE OHIO BOARD OF TAX APPEALS

NEWEGG, INC.,  
16839 E. Gale Avenue  
City of Industry, CA 91745

Appellant,

vs.

JOSEPH W. TESTA,  
Tax Commissioner of Ohio  
30 East Broad Street, 22nd Floor  
Columbus, OH 43215,

Appellee.

BTA Case No. \_\_\_\_\_

(COMMERCIAL ACTIVITY TAX)

Amount in Controversy:  
Approximately \$1,160,000 in Tax,  
Penalties, and Pre-Assessment  
Interest, Plus Post-Assessment  
Interest.

NOTICE OF APPEAL

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LEGAL COUNSEL FOR APPELLANT,  
NEWEGG, INC.

EXHIBIT

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C

Pursuant to Section 5717.02 of the Ohio Revised Code ("R.C."), Newegg, Inc. ("Newegg" or the "Company") hereby gives notice of appeal to the Ohio Board of Tax Appeals ("the Board") from a final determination dated November 22, 2011 ("Determination") issued by Joseph W. Testa, Tax Commissioner of the State of Ohio ("Commissioner") that affirmed assessments of Ohio Commercial Activity Tax ("CAT") against Newegg with respect to the following tax periods: (1) July 1, 2005 through December 31, 2009; (2) January 1, 2010 through March 31, 2010 (including 2010 estimated tax); (3) April 1, 2010 through June 30, 2010; (4) July 1, 2010 through September 30, 2010; (5) October 1, 2010 through December 31, 2010; and (6) January 1, 2011 through March 31, 2011 (including 2011 estimated tax) (together, the "Tax Periods"). A copy of the Determination is attached hereto as required by statute. See Exhibit A.

### **BACKGROUND**

1. Newegg is an online retailer with no physical presence in the State of Ohio. It sells its goods through the Internet from locations entirely outside of the state.
2. While some of Newegg's customers reside in Ohio, Newegg itself has no personnel, agents, representatives, or property of any kind in Ohio, and makes no sales from within the State of Ohio.
3. As a result, Newegg is protected from imposition of the Commercial Activity Tax ("CAT") under the Commerce Clause of the United States Constitution. The United States Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe Industries, Inc. v. Wash. Dep't of Revenue*, 483 U.S. 232, 250 (1987). This "bright line," physical presence standard derives from constitutional principles and authorities set forth by the

Court in *National Bellas Hess v. Ill. Dep't of Revenue*, 386 U.S. 753 (1967), and subsequently reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

4. As it applies to gross receipts taxes like the CAT, the Supreme Court has held that the physical presence standard is only satisfied through in-state activities by, or on behalf of, the taxpayer that are significantly associated with its ability to establish and maintain a market in the state. *Tyler Pipe*, 483 U.S. at 250; *Standard Pressed Steel, Inc. v. Wash. Dep't of Revenue*, 419 U.S. 560, 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617, 626 (1981) (citing *Bellas Hess* for threshold of state taxing power for gross receipts tax purposes, and finding sufficient presence); *see also Norton Co. v. Ill. Dep't of Revenue*, 340 U.S. 534, 537 (state lacks authority to impose gross receipts tax on a company with no "local incident" in the state). The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than the "bright line," physical presence test of *Tyler Pipe* and *Quill*. Because Newegg lacks the necessary physical presence in Ohio required under the Commerce Clause, it is not subject to the CAT, and the assessments against it should be cancelled.

5. In addition to its constitutional protections, Newegg also submits that it does not satisfy the statutory requirements for imposition of Ohio's Commercial Activity Tax (the "CAT") inasmuch as it does not satisfy the in-state activity requirements that underpin the imposition of such tax.

6. Read as a whole, the CAT seeks to tax in-state business activities, not those between Ohio residents and those companies, like Newegg, having no in-state presence

whatsoever. Moreover, even if it were to be held that the CAT statutes were ambiguous as to their application to out-of-state companies like Newegg, “there is one fundamental precept which still obtains in the interpretation of taxation statutes, to wit, that in case of doubt, such doubt is to be resolved in favor of the taxpayer.” *Stephens v. Glander*, 151 Ohio St. 62, 84 N.E.2d 279, 281 (1949).

7. Newegg submits that, when all doubts are resolved in its favor as required by law, the Determination against it should be vacated in its entirety and the assessment cancelled.

8. Further, Newegg submits that any penalty sought to be imposed on the Company should be rescinded because: (1) it was reasonable for Newegg to conclude that Ohio’s attempt to export a domestic tax to a foreign corporation with no in-state presence violated state and federal law; and (2) Newegg’s reliance on well established legal principles, including the United States Supreme Court bright-line “substantial nexus” rule was justified and appropriate in light of Ohio’s unprecedented attempt to impose the CAT on non-resident mail order and Internet sellers.

### **THE FINAL DETERMINATION**

9. In support of his finding that Newegg was subject to the CAT, despite its lack of physical presence in Ohio, for each of the Tax Periods, the Commissioner rested the Determination on the following grounds:

10. First, the Determination concluded that Newegg had “substantial nexus” with Ohio as that term is defined in the statute [see R.C. 5751.01(H)], based on the “bright-line presence” test set forth in R.C. 5751.03(I)(3). [Determination at 3.] The Commissioner stated that Newegg “had annual sales situated to Ohio in excess of \$500,000.00 and, therefore, met the bright-line presence requirement subjecting it to the commercial activity tax.” [*Id.*]

11. There was no other “bright-line” statutory basis for the Determination’s conclusion that Newegg owed CAT for the Tax Period.

12. At the same time, the Commissioner found that there is no ambiguity in the application of the CAT to an out-of-state retailer with no physical presence in the State of Ohio, such as Newegg. According to the Commissioner, despite the physical presence requirement of the Commerce Clause, the terms of the CAT dictate that it applies to Newegg, based solely on Newegg’s annual gross receipts from sales to Ohio purchasers. [*Id.*]

13. Finally, the Commissioner stated that “[u]nder established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or the Constitution of either the United States or Ohio.” [*Id.*]

14. Each of the grounds given by the Commissioner for the Determination is in error.

#### **ASSIGNMENTS OF ERROR**

1. Because Newegg engages in no commercial activity within the State of Ohio and, likewise, neither owns nor leases property in the state, either directly or indirectly, the Company is not “doing business in this state” under R.C. § 5751.02. The Commercial Activity Tax, therefore, does not apply.

2. Newegg lacked a “substantial nexus with this state” under R.C. § 5751.01(H) inasmuch as it: (a) neither owned nor used “part or all of its capital in this state” [R.C. 5751.01(H)(1)]; (b) lacks a “certificate of compliance with the laws of this state authorizing [it] to do business in this state” [R.C. 5751.01(H)(2)]; and (c) does not “otherwise [have] nexus in this state ... under the constitution [sic] of the United States.” [R.C. 5751.01(H)(4)].

3. Newegg lacked a “‘bright-line presence’ in this state” under R.C. § 5751.01(H)(3) & (I) inasmuch as it did not have: (a) “at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars” [R.C. 5751.01(I)(1)]; (b) “during the

calendar year payroll in this state of at least fifty thousand dollars” [R.C. 5751.01(I)(2)]; (c) during the calendar year “taxable gross receipts of at least five hundred thousand dollars,” inasmuch as (i) none of its gross receipts are subject to taxation in Ohio; and (ii) it had no taxable sales within the State of Ohio [R.C. 5751.01(I)(3)]; or (d) “during the calendar year within this state at least twenty-five per cent [sic] of the person’s total property, total payroll, or total receipts.” [R.C. 5751.01(I)(4)]. In addition, Newegg was not “domiciled in this state as an individual or for corporate, commercial, or other business purposes.” [R.C. 5751.01(I)(5)].

4. Newegg’s receipts are not subject to taxation because, under R.C. § 5751.01(F)(2)(ff), such tax is “prohibited by the Constitution or laws of the United States ...”

5. Ohio statutes should be interpreted to avoid the imposition of the CAT on Newegg, inasmuch as imposing the tax on Newegg would violate the Company’s rights under the Commerce Clause of the United States Constitution, as discussed below. It is the duty of those charged with interpreting and applying a law to construe it so as to “prevent a declaration of unconstitutionality.” *Conold v. Stern*, 138 Ohio St. 352, 25 N.E.2d 133, 143 (1941) (citation omitted). Only by excluding Newegg from the reach of the CAT can the constitutionality of the tax be preserved.

6. Application of the CAT to Newegg would violate the Company’s rights under the Commerce Clause of the United States Constitution since Newegg does not possess the requisite “bright-line” physical presence in Ohio. The Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe*, 483 U.S. at 250 (1987) (“the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this State”) (internal citation omitted and emphasis added); *Standard Pressed Steel*, 419 U.S. at 562-64 (1975)

(sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (applying the bright-line rule to a general revenue tax on the value of coal extracted from the state, and finding that “the interstate business must have a substantial nexus with the State before any tax may be levied on it”). This physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess* and subsequently reaffirmed in *Quill*. The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than physical presence test of *Tyler Pipe* and *Quill*. Since the bright-line physical presence test applies to taxes like the CAT, the assessments are void in their entirety, and the Determination should be vacated.

7. The penalty should be abated. The Commissioner erred in arbitrarily and capriciously asserting penalties for each of the aforesaid reasons, and in light of Newegg’s good faith reliance upon existing federal constitutional law in regard to the application of the “substantial nexus” test to cases involving gross receipts taxes, as well as sales and use taxes and other state taxes.

**REQUEST FOR HEARING**

Appellant Newegg requests that the Board of Tax Appeals or its attorney examiners conduct a *de novo* hearing in Columbus, Ohio in connection with these assignments of error.

**REQUEST FOR RELIEF**

Newegg respectfully asks that the Determination be vacated in its entirety, that the assessments against Newegg for the Tax Periods cancelled, that the Commissioner be barred from asserting CAT liability against Newegg for the Tax Periods, and that Newegg be awarded such other relief as is just and equitable.

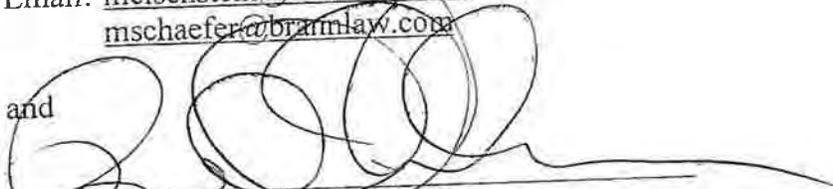
Respectfully submitted,

*Martin I. Eisenstein by ROA per e-mail  
authoyate on 1/19/12*

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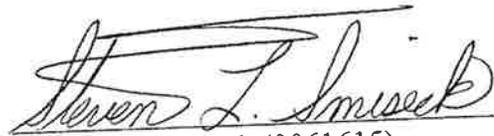
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LEGAL COUNSEL FOR APPELLANT,  
NEWEGG, INC.

**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of this Notice of Appeal has been filed, via hand delivery, with Joseph W. Testa, Tax Commissioner of Ohio, 30 East Broad Street, 22nd Floor, Columbus, Ohio, on this 19th day of January, 2012.

  
Steven L. Smiseck (0061615)



NOV 28 2011

1000000034

# FINAL DETERMINATION

Date: NOV 22 2011

Newegg Inc.  
16839 E. Gale Avenue  
City of Industry, CA 91745

Re: Six Assessments  
Commercial Activity Tax

This is the final determination of the Tax Commissioner with regard to the petitions for reassessment under R.C. 5751.09 concerning the following commercial activity tax assessments:

<u>Assessment No.</u>	<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Late Filing Penalty</u>	<u>Late Payment Penalty</u>	<u>Total</u>
17201034126112	7/1/2005 - 12/31/2009	\$447,580.00	\$54,081.00	\$156,655.00	\$111,895.00	\$770,211.00
17201034427316	2010 1st quarter/2010 estimate	\$50,000.00	\$1,117.81	\$17,500.00	\$10,000.00	\$78,617.81
17201034427317	2010 2nd quarter	\$50,000.00	\$630.14	\$17,500.00	\$10,000.00	\$78,130.14
17201034427318	2010 3rd quarter	\$50,000.00	\$126.03	\$17,500.00	\$10,000.00	\$77,626.03
17201106110042	2010 4th quarter	\$50,000.00	\$71.23	\$17,500.00	\$10,000.00	\$77,571.23
17201114476189	2011 1st quarter/2011 estimate	\$50,000.00	\$38.36	\$17,500.00	\$10,000.00	\$77,538.36

The petitioner was assessed as the result of an audit which was commenced because it failed to register for the Ohio commercial activity tax. The petitioner is the second largest on-line only retailer in the United States selling information technology and consumer electronic products. Most orders are fulfilled through on-line processing centers in California and New Jersey. The petitioner conducts the majority of its marketing efforts on-line through targeted marketing via affiliates, search engines, shopping comparison sites and e-mail programs. Its off-line marketing activities include advertisements in various technology publications, print and electronic catalogs, box inserts, event participation, public relations and targeted broadcast and major media print and broadcast activities designed to increase its brand awareness. The petitioner fulfills its orders from warehouses located in New Jersey and Tennessee.

The audit results clearly determined that the petitioner had more than \$500,000 in sales to customers in Ohio. Consequently, it was required to file and pay the commercial activity tax required by R.C. 5751.02(A) which it failed to do. The petitioner was assessed and it submitted petitions for reassessment, requesting a hearing which was duly held.

The petitioner makes the following contention:

\* \* \* Newegg is protected from imposition of the Commercial Activity Tax ("CAT") under the Commerce Clause of the United States Constitution. The Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe Industries,*



*Inc. v. Wash. Dep't of Revenue*, 483 U.S. 232, 250 (1987). \* \* \* In addition to its constitutional protections, Newegg also submits that it does not satisfy the statutory requirements for imposition of Ohio's Commercial Activity Tax (the "CAT") inasmuch as it does not satisfy the in-state activity requirements that underpin the imposition of such tax. Read as a whole, the CAT seeks to tax in-state business activities, not those between Ohio residents and those companies like Newegg, having no in-state presence whatsoever. Moreover, even if it were to be held that the CAT statutes were ambiguous as to their application to out-of-state companies like Newegg, "there is one fundamental precept which still obtains in the interpretation of taxation statutes, to wit, that in case of doubt, such doubt is to be resolved in favor of the taxpayer." *Stephens v. Glander*, 151 Ohio St. 62, 84 N.E.2<sup>nd</sup> 279, 281 (1949).

While the petitioner has customers in Ohio to which it sells and ships goods, it asserts that it has no activities or contacts in Ohio which rise to the level necessary for Ohio to constitutionally impose the tax.

The petitioner's contention is not well taken. The petitioner is subject to the tax because it has "substantial nexus with this state," as that phrase is defined in R.C. 5751.01(H). The petitioner satisfies the third condition in that division, and therefore is a person on whom the tax is levied.

Effective June 30, 2005, R.C. 5751.02(A) levies the commercial activity tax

\* \* \* on each person with taxable gross receipts for the privilege of doing business in this state. For the purposes of this chapter, "doing business" means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state.

Pursuant to R.C. 5751.01(H), a person has "substantial nexus with this state" if the person meets any of the following conditions:

- (1) Owns or uses a part or all of its capital in this state;
- (2) Holds a certificate of compliance with the laws of this state authorizing the person to do business in this state;
- (3) Has bright-line presence in this state;
- (4) Otherwise has nexus with this state to an extent that the person can be required to remit the tax imposed under this chapter under the Constitution of the United States.

Pursuant to R.C. 5751.01(I), a person "has bright-line presence" in this state for a reporting period if the person meets any of the following conditions:

- (1) Has at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars. \* \* \*
  - (2) Has during the calendar year payroll in this state of at least fifty thousand dollars. \*
- \* \*

- (3) Has during the calendar year taxable gross receipts of at least five hundred thousand dollars.
- (4) Has at any time during the calendar year within this state at least twenty-five percent of the person's total property, total payroll, or total gross receipts.
- (5) Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.

Division (F) of R.C. 5751.01 defines gross receipts as "the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person \* \* \* [including] [a]mounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another." Specifically excluded from gross receipts are "any receipts for which the tax imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio." R.C. 5751.01(F)(2)(aa) (formerly R.C. 5751.01(F)(2)(z)).

"Taxable gross receipts" is defined as gross receipts situated to this state under R.C. 5751.033. For purposes of the petitioner, division (E) applies:

Gross receipts from the sale of tangible personal property shall be situated to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has completed shall be considered the place where the purchaser receives the property. \*

\* \*

There is no ambiguity. The petitioner had annual sales situated to Ohio in excess of \$500,000.00 and, therefore, met the bright-line presence requirement subjecting it to the commercial activity tax.

Further, gross receipts from the sale of tangible personal property are situated to Ohio if "such property is ultimately received in Ohio after all transportation has been completed \* \* \* regardless of where title passes or other conditions of sale." R.C. 5751.033(E). Consequently, the Ohio commercial activity tax requires the property to be situated to Ohio because Ohio was the ultimate destination of the property. Therefore, the gross receipts were properly situated to Ohio.

The petitioner has more than \$500,000.00 in taxable gross receipts situated to Ohio for periods assessed and, thus has "bright-line presence." As such, the petitioner has "substantial nexus" with Ohio. Under established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or Constitution of either the United States or Ohio.

The petitioner is a person doing business in Ohio and, therefore, subject to the Ohio Commercial Activity tax. R.C. 5751.02. The petitioner failed to provide any support to show otherwise nor did it provide actual Ohio gross receipts for the periods assessed.

Accordingly, the assessments are affirmed and will stand as issued.

Current records indicate that no payments have been made on these assessments. However, due to payment processing and posting time lags, payments may have been made that are not reflected in this final determination. Any tax balances unpaid after the assessment dates bear post-assessment interest for the period between the assessment dates and payments as provided by law, which is in addition to the above totals. Payments shall be made payable to "Ohio Treasurer Josh Mandel." Any payment made within sixty days of the date of this final determination should be forwarded to: Department of Taxation, Commercial Activity Tax Division, P.O. Box 16678, Columbus, Ohio 43216-6678.

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE FINAL DETERMINATION RECORDED IN THE TAX COMMISSIONER'S JOURNAL



JOSEPH W. TESTA  
TAX COMMISSIONER

/s/ Joseph W. Testa

Joseph W. Testa  
Tax Commissioner

BEFORE THE OHIO BOARD OF TAX APPEALS

MASON COMPANIES, INC., )  
425 Well Street, Suite 100 )  
Chippewa Falls, WI 54774 )  
Appellant, )  
vs. )  
JOSEPH W. TESTA, )  
Tax Commissioner of Ohio )  
30 East Broad Street, 22nd Floor )  
Columbus, OH 43215, )  
Appellee. )

BTA Case No. \_\_\_\_\_  
(COMMERCIAL ACTIVITY TAX)  
Amount in Controversy:  
Approximately \$82,065.79 in Tax,  
Penalties, and Pre-Assessment  
Interest, Plus Post-Assessment  
Interest.



NOTICE OF APPEAL

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David W. Bertoni (Maine Reg. 006993)

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LEGAL COUNSEL FOR APPELLANT,  
MASON COMPANIES, INC.



Pursuant to Section 5717.02 of the Ohio Revised Code (“R.C.”), Mason Companies, Inc. (“Mason” or the “Company”) hereby gives notice of appeal to the Ohio Board of Tax Appeals (“the Board”) from a final determination dated February 16, 2012 (“Determination”) issued by Joseph W. Testa, Tax Commissioner of the State of Ohio (“Commissioner”) that affirmed assessments of Ohio Commercial Activity Tax (“CAT”) against Mason with respect to the following tax periods:

07/01/05 – 12/31/05  
01/01/06 – 03/31/06  
04/01/06 – 06/30/06  
07/01/06 – 09/30/06  
10/01/06 – 12/31/06  
01/01/07 – 03/31/07  
04/01/07 – 06/30/07  
07/01/07 – 09/30/07  
10/01/07 – 12/31/07  
01/01/08 – 03/31/08  
04/01/08 – 06/30/08  
07/01/08 – 09/30/08  
10/01/08 – 12/31/08  
01/01/09 – 03/31/09  
04/01/09 – 06/30/09  
07/01/09 – 09/30/09  
10/01/09 – 12/31/09  
01/01/10 – 03/31/10

(together, the “Tax Periods”). A copy of the Determination is attached hereto as required by statute. See Exhibit A.

### **BACKGROUND**

1. Mason is an online retailer with no physical presence in the State of Ohio. It sells its goods through the Internet from locations entirely outside of the state.
2. While some of Mason’s customers reside in Ohio, Mason itself has no personnel, agents, representatives, or property of any kind in Ohio, and makes no sales from within the State of Ohio.

3. As a result, Mason is protected from imposition of the Commercial Activity Tax (“CAT”) under the Commerce Clause of the United States Constitution. The United States Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe Industries, Inc. v. Wash. Dep’t of Revenue*, 483 U.S. 232, 250 (1987). This “bright line,” physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess v. Ill. Dep’t of Revenue*, 386 U.S. 753 (1967), and subsequently reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

4. As it applies to gross receipts taxes like the CAT, the Supreme Court has held that the physical presence standard is only satisfied through in-state activities by, or on behalf of, the taxpayer that are significantly associated with its ability to establish and maintain a market in the state. *Tyler Pipe*, 483 U.S. at 250; *Standard Pressed Steel, Inc. v. Wash. Dep’t of Revenue*, 419 U.S. 560, 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617, 626 (1981) (citing *Bellas Hess* for threshold of state taxing power for gross receipts tax purposes, and finding sufficient presence); *see also Norton Co. v. Ill. Dep’t of Revenue*, 340 U.S. 534, 537 (state lacks authority to impose gross receipts tax on a company with no “local incident” in the state). The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than the “bright line,” physical presence test of *Tyler Pipe* and *Quill*. Because Mason lacks the necessary

physical presence in Ohio required under the Commerce Clause, it is not subject to the CAT, and the assessments against it should be cancelled.

5. In addition to its constitutional protections, Mason also submits that it does not satisfy the statutory requirements for imposition of Ohio's Commercial Activity Tax (the "CAT") inasmuch as it does not satisfy the in-state activity requirements that underpin the imposition of such tax.

6. Read as a whole, the CAT seeks to tax in-state business activities, not those between Ohio residents and those companies, like Mason, having no in-state presence whatsoever. Moreover, even if it were to be held that the CAT statutes were ambiguous as to their application to out-of-state companies like Mason, "there is one fundamental precept which still obtains in the interpretation of taxation statutes, to wit, that in case of doubt, such doubt is to be resolved in favor of the taxpayer." *Stephens v. Glander*, 151 Ohio St. 62, 84 N.E.2d 279, 281 (1949).

7. Mason submits that, when all doubts are resolved in its favor as required by law, the Determination against it should be vacated in its entirety and the assessment cancelled.

8. Further, Mason submits that any penalty sought to be imposed on the Company should be rescinded because: (1) it was reasonable for Mason to conclude that Ohio's attempt to export a domestic tax to a foreign corporation with no in-state presence violated state and federal law; and (2) Mason's reliance on well established legal principles, including the United States Supreme Court bright-line "substantial nexus" rule was justified and appropriate in light of Ohio's unprecedented attempt to impose the CAT on non-resident mail order and Internet sellers.

## THE FINAL DETERMINATION

9. In support of his finding that Mason was subject to the CAT, despite its lack of physical presence in Ohio, for each of the Tax Periods, the Commissioner rested the Determination on the following grounds:

10. First, the Determination concluded that Mason had “substantial nexus” with Ohio as that term is defined in the statute [*see* R.C. 5751.01(H)], based on the “bright-line presence” test set forth in R.C. 5751.03(I)(3). [Determination at 3.] The Commissioner stated that Mason’s “taxable gross receipts greatly exceeded \$500,000.00, so the petitioner had a ‘bright-line presence’ . . . and was subject to [commercial activity] tax.” [*Id.*]

11. There was no other “bright-line” statutory basis for the Determination’s conclusion that Mason owed CAT for the Tax Period.

12. According to the Commissioner, despite the physical presence requirement of the Commerce Clause, the terms of the CAT dictate that it applies to Mason, based solely on Mason’s annual gross receipts from sales to Ohio purchasers. [*Id.*]

13. Finally, the Commissioner stated that “[u]nder established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or the Constitution of either the United States or Ohio.” [*Id. at 4.*]

14. Each of the grounds given by the Commissioner for the Determination is in error.

## ASSIGNMENTS OF ERROR

1. Because Mason engages in no commercial activity within the State of Ohio and, likewise, neither owns nor leases property in the state, either directly or indirectly, the Company is not “doing business in this state” under R.C. § 5751.02. The Commercial Activity Tax, therefore, does not apply.

2. Mason lacked a “substantial nexus with this state” under R.C. § 5751.01(H) inasmuch as it: (a) neither owned nor used “part or all of its capital in this state” [R.C. 5751.01(H)(1)]; (b) lacks a “certificate of compliance with the laws of this state authorizing [it] to do business in this state” [R.C. 5751.01(H)(2)]; and (c) does not “otherwise [have] nexus in this state ... under the constitution [sic] of the United States.” [R.C. 5751.01(H)(4)].

3. Mason lacked a “‘bright-line presence’ in this state” under R.C. § 5751.01(H)(3) & (I) inasmuch as it did not have: (a) “at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars” [R.C. 5751.01(I)(1)]; (b) “during the calendar year payroll in this state of at least fifty thousand dollars” [R.C. 5751.01(I)(2)]; (c) during the calendar year “taxable gross receipts of at least five hundred thousand dollars,” inasmuch as (i) none of its gross receipts are subject to taxation in Ohio; and (ii) it had no taxable sales within the State of Ohio [R.C. 5751.01(I)(3)]; or (d) “during the calendar year within this state at least twenty-five per cent [sic] of the person’s total property, total payroll, or total receipts.” [R.C. 5751.01(I)(4)]. In addition, Mason was not “domiciled in this state as an individual or for corporate, commercial, or other business purposes.” [R.C. 5751.01(I)(5)].

4. Mason’s receipts are not subject to taxation because, under R.C. § 5751.01(F)(2)(ff), such tax is “prohibited by the Constitution or laws of the United States ...”

5. Ohio statutes should be interpreted to avoid the imposition of the CAT on Mason, inasmuch as imposing the tax on Mason would violate the Company’s rights under the Commerce Clause of the United States Constitution, as discussed below. It is the duty of those charged with interpreting and applying a law to construe it so as to “prevent a declaration of unconstitutionality.” *Conold v. Stern*, 138 Ohio St. 352, 25 N.E.2d 133, 143 (1941) (citation

omitted). Only by excluding Mason from the reach of the CAT can the constitutionality of the tax be preserved.

6. Application of the CAT to Mason would violate the Company's rights under the Commerce Clause of the United States Constitution since Mason does not possess the requisite "bright-line" physical presence in Ohio. The Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe*, 483 U.S. at 250 (1987) ("the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this State") (internal citation omitted and emphasis added); *Standard Pressed Steel*, 419 U.S. at 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (applying the bright-line rule to a general revenue tax on the value of coal extracted from the state, and finding that "the interstate business must have a substantial nexus with the State before any tax may be levied on it"). This physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess* and subsequently reaffirmed in *Quill*. The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than physical presence test of *Tyler Pipe* and *Quill*. Since the bright-line physical presence test applies to taxes like the CAT, the assessments are void in their entirety, and the Determination should be vacated.

7. The Commissioner's assessment of the "failing to register penalty" is erroneous and unlawful in that Mason was not required to register for the CAT because Mason was not a "person subject to" chapter 5751 of the Revised Code. R.C. 5751.04(B).

8. The penalty should be abated. The Commissioner erred in arbitrarily and capriciously asserting penalties for each of the aforesaid reasons, and in light of Mason's good faith reliance upon existing federal constitutional law in regard to the application of the "substantial nexus" test to cases involving gross receipts taxes, as well as sales and use taxes and other state taxes.

### REQUEST FOR HEARING

Appellant Mason requests that the Board of Tax Appeals or its attorney examiners conduct a *de novo* hearing in Columbus, Ohio in connection with these assignments of error.

### REQUEST FOR RELIEF

Mason respectfully asks that the Determination be vacated in its entirety, that the assessments against Mason for the Tax Periods cancelled, that the Commissioner be barred from asserting CAT liability against Mason for the Tax Periods, and that Mason be awarded such other relief as is just and equitable.

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*L. Ehler  
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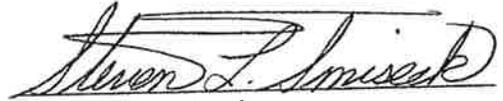
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LEGAL COUNSEL FOR APPELLANT,  
MASON COMPANIES, INC.

**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of this Notice of Appeal has been filed, via hand delivery, with Joseph W. Testa, Tax Commissioner of Ohio, 30 East Broad Street, 22nd Floor, Columbus, Ohio, on this 24th day of April, 2012.

  
Steven L. Smiseck



# FINAL DETERMINATION

Date: FEB 16 2012

Mason Companies, Inc.  
425 Well Street, Suite 100  
Chippewa Falls, WI 54774



Re: 18 Assessments  
Commercial Activity Tax  
Taxpayer ID No. 96060720  
Tax Period: 2005-2010

The final determination of the Tax Commissioner issued on January 26, 2012 pertaining to this taxpayer is hereby vacated and is replaced by the following:

This is the final determination of the Tax Commissioner on a petition for reassessment filed pursuant to R.C. 5751.09 concerning the following commercial activity tax assessments:

<u>Assessment No.</u>	<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Payments</u>	<u>Total</u>
17201019728458	07/01/05-12/31/05	\$20,000.00	\$5,677.26	\$12,000.00	\$0.00	\$37,677.26
17201019728459	01/01/06-03/31/06	\$10,000.00	\$2,692.33	\$5,500.00	\$0.00	\$18,192.33
17201019728460	04/01/06-06/30/06	\$10,000.00	\$2,542.74	\$5,500.00	\$0.00	\$18,042.74
17201019728461	07/01/06-09/30/06	\$10,000.00	\$2,391.51	\$5,500.00	\$0.00	\$17,891.51
17201019728462	10/01/06-12/31/06	\$10,000.00	\$2,251.07	\$5,500.00	\$0.00	\$17,715.07
17201019728463	01/01/07-03/31/07	\$10,000.00	\$2,017.81	\$5,500.00	\$0.00	\$17,517.81
17201019728391	04/01/07-06/30/07	\$10,000.00	\$1,818.36	\$5,500.00	\$0.00	\$17,318.36
17201019728392	07/01/07-09/30/07	\$10,000.00	\$1,616.71	\$5,500.00	\$0.00	\$17,116.71
17201019728393	10/01/07-12/31/07	\$10,000.00	\$1,415.07	\$5,500.00	\$0.00	\$16,915.07
17201019728394	01/01/08-03/31/08	\$10,000.00	\$1,215.62	\$5,500.00	\$0.00	\$16,715.62
17201019728395	04/01/08-06/30/08	\$10,000.00	\$1,016.16	\$5,500.00	\$0.00	\$16,516.16
17201019728396	07/01/08-09/30/08	\$10,000.00	\$814.52	\$5,500.00	\$0.00	\$16,314.52
17201019728397	10/01/08-12/31/08	\$10,000.00	\$650.68	\$5,500.00	\$0.00	\$16,150.68
17201019728398	01/01/09-03/31/09	\$10,000.00	\$527.40	\$5,500.00	\$0.00	\$16,027.40
17201019728399	04/01/09-06/30/09	\$10,000.00	\$402.74	\$5,500.00	\$0.00	\$15,902.74
17201019728400	07/01/09-09/30/09	\$10,000.00	\$275.34	\$5,500.00	\$0.00	\$15,775.34
17201019728401	10/01/09-12/31/09	\$10,000.00	\$162.19	\$5,500.00	\$0.00	\$15,662.19
17201019728402	01/01/10-03/31/10	\$10,000.00	\$62.47	\$5,500.00	\$0.00	\$15,562.47
<b>Total</b>		<b>\$190,000.00</b>	<b>\$27,549.98</b>	<b>\$105,500.00</b>	<b>\$0.00</b>	<b>\$323,013.98</b>

The petitioner contends that it is not subject to the commercial activity tax, and requests cancellation of the assessments. This contention is not well taken. In summary, the petitioner is subject to the tax because it has "substantial nexus with this state," as that phrase is defined in R.C. 5751.01(H). The petitioner satisfies the third and/or fourth conditions in that division, and therefore is a person on whom the tax is levied. The petitioner sells goods through orders received via telephone, mail, and the Internet. While the petitioner admits that it has customers in Ohio to which it sells and ships these goods, it asserts that it has no activities or contacts in Ohio which rise to the level necessary for Ohio to constitutionally impose the tax.

Effective June 30, 2005, R.C. 5751.02(A) levies the commercial activity tax

\* \* \* on each person with taxable gross receipts for the privilege of doing business in this state. For the purposes of this chapter, "doing business" means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state.

Pursuant to R.C. 5751.01(H), a person has "substantial nexus with this state" if the person meets any of the following conditions:

- (1) Owns or uses a part or all of its capital in this state;
- (2) Holds a certificate of compliance with the laws of this state authorizing the person to do business in this state;
- (3) Has bright-line presence in this state;
- (4) Otherwise has nexus with this state to an extent that the person can be required to remit the tax imposed under this chapter under the Constitution of the United States.

Pursuant to R.C. 5751.01(I), a person "has bright-line presence" in this state for a reporting period if the person meets any of the following conditions:

- (1) Has at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars. \* \* \*
- (2) Has during the calendar year payroll in this state of at least fifty thousand dollars. \* \* \*
- (3) Has during the calendar year taxable gross receipts of at least five hundred thousand dollars.
- (4) Has at any time during the calendar year within this state at least twenty-five percent of the person's total property, total payroll, or total gross receipts.
- (5) Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.

Division (F) of R.C. 5751.01 defines gross receipts as "the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person \* \* \* [including] [a]mounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another." Specifically excluded from gross receipts are "any receipts for which the tax imposed by this chapter is

prohibited by the Constitution or laws of the United States or the Constitution of Ohio." R.C. 5751.01(F)(2)(aa) (formerly R.C. 5751.01(F)(2)(z)).

"Taxable gross receipts" is defined as gross receipts situated to this state under R.C. 5751.033. For purposes of the petitioner, division (E) applies:

Gross receipts from the sale of tangible personal property shall be situated to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has completed shall be considered the place where the purchaser receives the property. \*

\* \*

The petitioner's overriding assertion is that the Commerce Clause of the United States Constitution precludes the State of Ohio from subjecting it to the commercial activity tax under the authority of R.C. 5751.01(H)(3) or (4). The petitioner contends that imposition of the tax pursuant to either (H)(3) or (H)(4) is improper because the petitioner allegedly does not have the nexus with Ohio that is required under the Commerce Clause. The petitioner asserts that the nexus required is a "physical presence" in the taxing state, which it alleges it did not have during the assessed periods.

To the extent that the petitioner is challenging the constitutionality of R.C. 5751.01(H)(3), (4) and/or R.C. 5751.01(I)(3), the Commissioner is without jurisdiction to adjudicate the constitutionality of those statutes. However, the laws of Ohio are presumed to be constitutional. See *State ex rel. Sweland v. Kinney* (1982), 69 Ohio St.2d 567. Moreover, a discussion of the constitutional issues is particularly warranted for two reasons. First, R.C. 5751.01(H)(4) requires the commercial activity tax to be imposed to the fullest extent permissible under the Constitution. Second, regardless of R.C. 5751.01(H)(4), compliance with constitutional limitations on state taxation is the sine qua non of any tax assessment.

The Tax Commissioner's assessments have been computed based on the petitioner's representations of the amounts realized from its selling of goods to Ohio consumers. By the petitioner's own admission, the goods sold were delivered by common carrier to their ultimate destination in Ohio. Thus, they were "received in this state" and were "taxable gross receipts" within the meaning of R.C. 5751.033(E) and R.C. 5751.01(I)(3). For each calendar year at issue, taxable gross receipts greatly exceeded \$500,000.00, so the petitioner had "bright-line presence" pursuant to R.C. 5751.01 (H)(3) and R.C. 5751.01(I)(3). Therefore, the petitioner had "substantial nexus with this state" and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.

The petitioner contends that application of the commercial activity tax to it would violate the Commerce Clause since the petitioner allegedly does not possess the "bright-line" physical presence in Ohio required by *National Bellas Hess v. Ill. Rev. Dep't* (1967), 386 U.S. 753 and *Quill Corp. v. North Dakota* (1992), 504 U.S. 298. In *Quill*, the Court held that North Dakota's attempt to require an out-of-state mail order company with no physical presence in the state to collect and remit use tax violated the "substantial nexus" requirement of the Commerce Clause. However, in the years since *Quill*, the Court has not extended its holding to other taxes,

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including income taxes or gross receipts taxes. The highest court in most, but not all, states that have considered the issue, including Ohio, has found that *Quill* applies only to sales and use taxes. See *Couchot v. State Lottery Commission* (1996), 74 Ohio St.3d 417 (finding that the physical-presence requirement of *Quill* was not applicable to taxation of Ohio Lottery winnings of a nonresident, because *Quill* applied only to sales and use taxes, although the requirement would have been satisfied anyway by virtue of the winner's purchase and redemption of the winning ticket in Ohio in a prior year). See also, for example, *Geoffrey v. South Carolina* (1993), 437 S.E.2d 13, *A & F Trademark, Inc. v. Tolson* (2004), 167 N.C. App. 150, *LANCO, Inc. v. Dir., Div. of Taxation* (2006), 908 A.2d 176, *Tax Comm'r v. MBNA America Bank* (2006), 220 W.Va. 163, and *Capital One Bank v. Commissioner* (2009), 453 Mass. 1.

The petitioner contends that even if the holding of *Quill* is limited to the sales and use tax context, that holding should apply to the commercial activity tax. However, the Supreme Court of Ohio recently found that the commercial activity tax is not, as the petitioner asserts, the functional equivalent of a sales tax. See *Ohio Grocers Ass'n v. Levin* (2009), 123 Ohio St.3d 303 (holding that the tax is not an excise tax "upon the sale or purchase of food"). Therefore, the *Quill* requirement of physical presence does not apply to the commercial activity tax.

In order to be constitutionally valid, the assessments herein must still satisfy the "substantial nexus" requirement of the Commerce Clause. The petitioner's continuous and significant exploitation of the economic marketplace in Ohio is sufficient for this purpose. Therefore, under established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or Constitution of either the United States or Ohio.

Lastly, the petitioner contends that even if it was subject to the tax and required to file returns and pay the amounts due, the assessed penalties should be abated in full due to its reasonable reliance on its interpretation of constitutional principles limiting state taxation. The petitioner was assessed penalty pursuant to R.C. 5751.06(A), (B)(1), and (D). The Tax Commissioner may abate these penalties pursuant to R.C. 5751.06(F). The petitioner's contention is not well taken, although as shown below the penalties are reduced herein because each of the assessed penalties is calculated as a percentage of tax due.

Therefore, in accordance with the actual gross receipts figures supplied, the assessments are modified as follows<sup>1</sup>:

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<sup>1</sup> The assessments are modified to reflect the tax due on the taxable gross receipts supplied by the petitioner. Since the petitioner has not filed returns reflecting these amounts, the figures are subject to audit and assessment of additional tax. See R.C. 5751.09(F).

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<u>Assessment No.</u>	<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Payments</u>	<u>Total</u>
17201019728458	07/01/05-12/31/05	\$1,579.00	\$448.22	\$1,868.45	\$0.00	\$3,895.67
17201019728459	01/01/06-03/31/06	\$901.00	\$242.58	\$495.55	\$0.00	\$1,639.13
17201019728460	04/01/06-06/30/06	\$1,674.00	\$425.65	\$920.70	\$0.00	\$3,020.35
17201019728461	07/01/06-09/30/06	\$1,428.00	\$341.51	\$785.40	\$0.00	\$2,554.91
17201019728462	10/01/06-12/31/06	\$1,572.00	\$348.21	\$864.60	\$0.00	\$2,784.81
17201019728463	01/01/07-03/31/07	\$1,657.00	\$334.35	\$911.35	\$0.00	\$2,902.70
17201019728391	04/01/07-06/30/07	\$2,828.00	\$514.23	\$1,555.40	\$0.00	\$4,897.63
17201019728392	07/01/07-09/30/07	\$2,293.00	\$370.71	\$1,261.15	\$0.00	\$3,924.86
17201019728393	10/01/07-12/31/07	\$2,695.00	\$381.36	\$1,482.25	\$0.00	\$4,558.61
17201019728394	01/01/08-03/31/08	\$2,266.00	\$275.46	\$1,246.30	\$0.00	\$3,787.76
17201019728395	04/01/08-06/30/08	\$3,874.00	\$393.66	\$2,130.70	\$0.00	\$6,398.36
17201019728396	07/01/08-09/30/08	\$3,316.00	\$270.10	\$1,823.80	\$0.00	\$5,409.90
17201019728397	10/01/08-12/31/08	\$3,476.00	\$226.18	\$1,911.80	\$0.00	\$5,613.98
17201019728398	01/01/09-03/31/09	\$2,812.00	\$148.30	\$1,546.60	\$0.00	\$4,506.90
17201019728399	04/01/09-06/30/09	\$3,992.00	\$160.77	\$2,195.60	\$0.00	\$6,348.37
17201019728400	07/01/09-09/30/09	\$4,073.00	\$112.15	\$2,240.15	\$0.00	\$6,425.30
17201019728401	10/01/09-12/31/09	\$4,252.00	\$68.96	\$2,338.60	\$0.00	\$6,659.56
17201019728402	01/01/10-03/31/10	\$4,329.00	\$27.04	\$2,380.95	\$0.00	\$6,736.99
<b>Total</b>		<b>\$49,017.00</b>	<b>\$5,089.44</b>	<b>\$27,959.35</b>	<b>\$0.00</b>	<b>\$82,065.79</b>

Current records indicate that no additional payments have been made on these assessments. However, due to payment processing and posting time lags, payments may have been made that are not reflected in this final determination. **Any unpaid balance bears post-assessment interest as provided by law, which is in addition to the above total.** Payments shall be made payable to "Ohio Treasurer Josh Mandel." Any payment made within sixty days of the date of this final determination should be forwarded to: Department of Taxation, Commercial Activity Tax Division, P.O. Box 16678, Columbus, OH 43216-6678.

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE FINAL DETERMINATION RECORDED IN THE TAX COMMISSIONER'S JOURNAL

  
 JOSEPH W. TESTA  
 TAX COMMISSIONER

/s/ Joseph W. Testa

Joseph W. Testa  
 Tax Commissioner

*RW*

**BEFORE THE OHIO BOARD OF TAX APPEALS**

**MASON COMPANIES, INC.,** )  
425 Well Street, Suite 100 )  
Chippewa Falls, WI 54774 )

Appellant, )

vs. )

**JOSEPH W. TESTA,** )  
Tax Commissioner of Ohio )  
30 East Broad Street, 22nd Floor )  
Columbus, OH 43215, )

Appellee. )

BTA Case No. \_\_\_\_\_

(COMMERCIAL ACTIVITY TAX)

Amount in Controversy:  
Approximately \$50,311.42 in Tax,  
Penalties, and Pre-Assessment  
Interest, Plus Post-Assessment  
Interest.

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**NOTICE OF APPEAL**

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David W. Bertoni (Maine Reg. 006993)

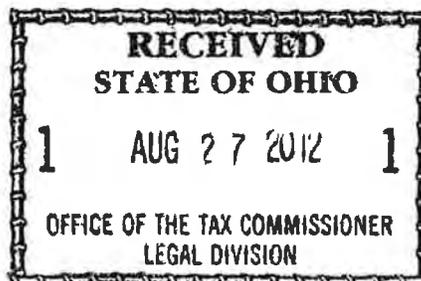
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MASON COMPANIES, INC.

LEGAL COUNSEL FOR APPELLANT,  
MASON COMPANIES, INC.



Pursuant to Section 5717.02 of the Ohio Revised Code (“R.C.”), Mason Companies, Inc. (“Mason” or the “Company”) hereby gives notice of appeal to the Ohio Board of Tax Appeals (“the Board”) from a final determination dated June 28, 2012 (“Determination”) issued by Joseph W. Testa, Tax Commissioner of the State of Ohio (“Commissioner”) that affirmed assessments of Ohio Commercial Activity Tax (“CAT”) against Mason with respect to the following tax periods:

04/01/10 – 06/30/10  
07/01/10 – 09/30/10  
10/01/10 – 12/31/10  
01/01/11 – 03/31/11  
04/01/11 – 06/30/11  
07/01/11 – 09/30/11

(together, the “Tax Periods”). A copy of the Determination is attached hereto as required by statute. See Exhibit A.

### **BACKGROUND**

1. Mason is an online retailer with no physical presence in the State of Ohio. It sells its goods through the Internet from locations entirely outside of the state.
2. While some of Mason’s customers reside in Ohio, Mason itself has no personnel, agents, representatives, or property of any kind in Ohio, and makes no sales from within the State of Ohio.
3. As a result, Mason is protected from imposition of the Commercial Activity Tax (“CAT”) under the Commerce Clause of the United States Constitution. The United States Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe Industries, Inc. v. Wash. Dep’t of Revenue*, 483 U.S. 232, 250 (1987). This “bright line,” physical presence standard derives from constitutional principles and authorities set forth by the

Court in *National Bellas Hess v. Ill. Dep't of Revenue*, 386 U.S. 753 (1967), and subsequently reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

4. As it applies to gross receipts taxes like the CAT, the Supreme Court has held that the physical presence standard is only satisfied through in-state activities by, or on behalf of, the taxpayer that are significantly associated with its ability to establish and maintain a market in the state. *Tyler Pipe*, 483 U.S. at 250; *Standard Pressed Steel, Inc. v. Wash. Dep't of Revenue*, 419 U.S. 560, 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617, 626 (1981) (citing *Bellas Hess* for threshold of state taxing power for gross receipts tax purposes, and finding sufficient presence); *see also Norton Co. v. Ill. Dep't of Revenue*, 340 U.S. 534, 537 (state lacks authority to impose gross receipts tax on a company with no "local incident" in the state). The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than the "bright line," physical presence test of *Tyler Pipe* and *Quill*. Because Mason lacks the necessary physical presence in Ohio required under the Commerce Clause, it is not subject to the CAT, and the assessments against it should be cancelled.

5. In addition to its constitutional protections, Mason also submits that it does not satisfy the statutory requirements for imposition of Ohio's Commercial Activity Tax (the "CAT") inasmuch as it does not satisfy the in-state activity requirements that underpin the imposition of such tax.

6. Read as a whole, the CAT seeks to tax in-state business activities, not those between Ohio residents and those companies, like Mason, having no in-state presence whatsoever. Moreover, even if it were to be held that the CAT statutes were ambiguous as to their application to out-of-state companies like Mason, “there is one fundamental precept which still obtains in the interpretation of taxation statutes, to wit, that in case of doubt, such doubt is to be resolved in favor of the taxpayer.” *Stephens v. Glander*, 151 Ohio St. 62, 84 N.E.2d 279, 281 (1949).

7. Mason submits that, when all doubts are resolved in its favor as required by law, the Determination against it should be vacated in its entirety and the assessment cancelled.

8. Further, Mason submits that any penalty sought to be imposed on the Company should be rescinded because: (1) it was reasonable for Mason to conclude that Ohio’s attempt to export a domestic tax to a foreign corporation with no in-state presence violated state and federal law; and (2) Mason’s reliance on well established legal principles, including the United States Supreme Court bright-line “substantial nexus” rule was justified and appropriate in light of Ohio’s unprecedented attempt to impose the CAT on non-resident mail order and Internet sellers.

#### **THE FINAL DETERMINATION**

9. In support of his finding that Mason was subject to the CAT, despite its lack of physical presence in Ohio, for each of the Tax Periods, the Commissioner rested the Determination on the following grounds:

10. First, the Determination concluded that Mason had “substantial nexus” with Ohio as that term is defined in the statute [*see* R.C. 5751.01(H)], based on the “bright-line presence” test set forth in R.C. 5751.01(I)(3). [Determination at 3.] The Commissioner stated that Mason’s

“taxable gross receipts greatly exceeded \$500,000.00, so the petitioner had a ‘bright-line presence’ . . . and was subject to [commercial activity] tax.” [*Id.*]

11. There was no other “bright-line” statutory basis for the Determination’s conclusion that Mason owed CAT for the Tax Period.

12. According to the Commissioner, despite the physical presence requirement of the Commerce Clause, the terms of the CAT dictate that it applies to Mason, based solely on Mason’s annual gross receipts from sales to Ohio purchasers. [*Id.*]

13. Finally, the Commissioner stated that “[u]nder established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or the Constitution of either the United States or Ohio.” [*Id. at 4.*]

14. Each of the grounds given by the Commissioner for the Determination is in error.

#### **ASSIGNMENTS OF ERROR**

1. Because Mason engages in no commercial activity within the State of Ohio and, likewise, neither owns nor leases property in the state, either directly or indirectly, the Company is not “doing business in this state” under R.C. § 5751.02. The Commercial Activity Tax, therefore, does not apply.

2. Mason lacked a “substantial nexus with this state” under R.C. § 5751.01(H) inasmuch as it: (a) neither owned nor used “part or all of its capital in this state” [R.C. 5751.01(H)(1)]; (b) lacks a “certificate of compliance with the laws of this state authorizing [it] to do business in this state” [R.C. 5751.01(H)(2)]; and (c) does not “otherwise [have] nexus in this state . . . under the constitution [sic] of the United States.” [R.C. 5751.01(H)(4)].

3. Mason lacked a “‘bright-line presence’ in this state” under R.C. § 5751.01(H)(3) & (I) inasmuch as it did not have: (a) “at any time during the calendar year property in this state

with an aggregate value of at least fifty thousand dollars” [R.C. 5751.01(I)(1)]; (b) “during the calendar year payroll in this state of at least fifty thousand dollars” [R.C. 5751.01(I)(2)]; (c) during the calendar year “taxable gross receipts of at least five hundred thousand dollars,” inasmuch as (i) none of its gross receipts are subject to taxation in Ohio; and (ii) it had no taxable sales within the State of Ohio [R.C. 5751.01(I)(3)]; or (d) “during the calendar year within this state at least twenty-five per cent [sic] of the person’s total property, total payroll, or total receipts.” [R.C. 5751.01(I)(4)]. In addition, Mason was not “domiciled in this state as an individual or for corporate, commercial, or other business purposes.” [R.C. 5751.01(I)(5)].

4. Mason’s receipts are not subject to taxation because, under R.C. § 5751.01(F)(2)(ff), such tax is “prohibited by the Constitution or laws of the United States ...”

5. Ohio statutes should be interpreted to avoid the imposition of the CAT on Mason, inasmuch as imposing the tax on Mason would violate the Company’s rights under the Commerce Clause of the United States Constitution, as discussed below. It is the duty of those charged with interpreting and applying a law to construe it so as to “prevent a declaration of unconstitutionality.” *Conold v. Stern*, 138 Ohio St. 352, 25 N.E.2d 133, 143 (1941) (citation omitted). Only by excluding Mason from the reach of the CAT can the constitutionality of the tax be preserved.

6. Application of the CAT to Mason would violate the Company’s rights under the Commerce Clause of the United States Constitution since Mason does not possess the requisite “bright-line” physical presence in Ohio. The Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Tyler Pipe*, 483 U.S. at 250 (1987) (“the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly

associated with the taxpayer's ability to establish and maintain a market in this State") (internal citation omitted and emphasis added); *Standard Pressed Steel*, 419 U.S. at 562-64 (1975) (sufficient nexus for gross receipts tax established through presence of full-time employee in the state calling on customers); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (applying the bright-line rule to a general revenue tax on the value of coal extracted from the state, and finding that "the interstate business must have a substantial nexus with the State before any tax may be levied on it"). This physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess* and subsequently reaffirmed in *Quill*. The Supreme Court relied upon *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison* in upholding the physical presence test for sales and use taxes in *Quill*, and the Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than physical presence test of *Tyler Pipe* and *Quill*. Since the bright-line physical presence test applies to taxes like the CAT, the assessments are void in their entirety, and the Determination should be vacated.

7. The Commissioner's assessment of the "failing to register penalty" is erroneous and unlawful in that Mason was not required to register for the CAT because Mason was not a "person subject to" chapter 5751 of the Revised Code. R.C. 5751.04(B).

8. The penalty should be abated. The Commissioner erred in arbitrarily and capriciously asserting penalties for each of the aforesaid reasons, and in light of Mason's good faith reliance upon existing federal constitutional law in regard to the application of the "substantial nexus" test to cases involving gross receipts taxes, as well as sales and use taxes and other state taxes.

**REQUEST FOR HEARING**

Appellant Mason requests that the Board of Tax Appeals or its attorney examiners conduct a *de novo* hearing in Columbus, Ohio in connection with these assignments of error.

**REQUEST FOR RELIEF**

Mason respectfully asks that the Determination be vacated in its entirety, that the assessments against Mason for the Tax Periods cancelled, that the Commissioner be barred from asserting CAT liability against Mason for the Tax Periods, and that Mason be awarded such other relief as is just and equitable.

Respectfully submitted,



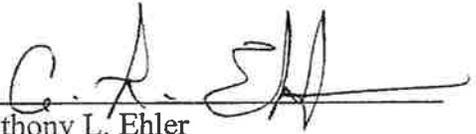
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LEGAL COUNSEL FOR APPELLANT,  
MASON COMPANIES, INC.

**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of this Notice of Appeal has been filed, via hand delivery, with Joseph W. Testa, Tax Commissioner of Ohio, 30 East Broad Street, 22nd Floor, Columbus, Ohio, on this 27th day of August, 2012.

  
\_\_\_\_\_  
Anthony L. Ehler



0000000222

# FINAL DETERMINATION

Date: JUN 28 2012

Mason Companies, Inc.  
425 Well Street, Suite 100  
Chippewa Falls, WI 54774

JUL 6 2012

Re: 6 Assessments  
Commercial Activity Tax  
Taxpayer ID No. 96060720  
Tax Period: 2010-2011

This is the final determination of the Tax Commissioner on six petitions for reassessment filed pursuant to R.C. 5751.09 concerning the following commercial activity tax assessments:

<u>Assessment No.</u>	<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Payments</u>	<u>Total</u>
17201131920709	04/01/10-06/30/10	\$10,000.00	\$498.63	\$5,500.00	\$0.00	\$15,998.63
17201131920707	07/01/10-09/30/10	\$10,000.00	\$397.81	\$5,500.00	\$0.00	\$15,897.81
17201131920706	10/01/10-12/31/10	\$10,000.00	\$295.89	\$5,500.00	\$0.00	\$15,795.89
17201131920704	01/01/11-03/31/11	\$10,000.00	\$199.45	\$5,500.00	\$0.00	\$15,699.45
17201131920710	04/01/11-06/30/11	\$10,000.00	\$98.63	\$5,500.00	\$0.00	\$15,598.63
17201133443985	07/01/11-09/30/11	\$10,000.00	\$14.25	\$5,500.00	\$0.00	\$15,514.25
	Total	\$60,000.00	\$1,504.66	\$33,000.00	\$0.00	\$94,504.66

The petitioner contends that it is not subject to the commercial activity tax, and requests cancellation of the assessments. This contention is not well taken. In summary, the petitioner is subject to the tax because it has "substantial nexus with this state," as that phrase is defined in R.C. 5751.01(H). The petitioner satisfies the third and/or fourth conditions in that division, and therefore is a person on whom the tax is levied. The petitioner sells goods through orders received via telephone, mail, and the Internet. While the petitioner admits that it has customers in Ohio to which it sells and ships these goods, it asserts that it has no activities or contacts in Ohio which rise to the level necessary for Ohio to constitutionally impose the tax.

Effective June 30, 2005, R.C. 5751.02(A) levies the commercial activity tax

\* \* \* on each person with taxable gross receipts for the privilege of doing business in this state. For the purposes of this chapter, "doing business" means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state.

JUN 28 2012

Pursuant to R.C. 5751.01(H), a person has "substantial nexus with this state" if the person meets any of the following conditions:

- (1) Owns or uses a part or all of its capital in this state;
- (2) Holds a certificate of compliance with the laws of this state authorizing the person to do business in this state;
- (3) Has bright-line presence in this state;
- (4) Otherwise has nexus with this state to an extent that the person can be required to remit the tax imposed under this chapter under the Constitution of the United States.

Pursuant to R.C. 5751.01(I), a person "has bright-line presence" in this state for a reporting period if the person meets any of the following conditions:

- (1) Has at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars. \* \* \*
- (2) Has during the calendar year payroll in this state of at least fifty thousand dollars. \* \* \*
- (3) Has during the calendar year taxable gross receipts of at least five hundred thousand dollars.
- (4) Has at any time during the calendar year within this state at least twenty-five percent of the person's total property, total payroll, or total gross receipts.
- (5) Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.

Division (F) of R.C. 5751.01 defines gross receipts as "the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person \* \* \* [including] [a]mounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another." Specifically excluded from gross receipts are "any receipts for which the tax imposed by this chapter is prohibited by the Constitution or laws of the United States or the Constitution of Ohio." R.C. 5751.01(F)(2)(aa) (formerly R.C. 5751.01(F)(2)(z)).

"Taxable gross receipts" is defined as gross receipts situated to this state under R.C. 5751.033. For purposes of the petitioner, division (E) applies:

Gross receipts from the sale of tangible personal property shall be situated to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has completed shall be considered the place where the purchaser receives the property. \* \* \*

The petitioner's overriding assertion is that the Commerce Clause of the United States Constitution precludes the State of Ohio from subjecting it to the commercial activity tax under the authority of R.C. 5751.01(H)(3) or (4). The petitioner contends that imposition of the tax pursuant to either (H)(3) or (H)(4) is improper because the petitioner allegedly does not have the nexus with Ohio that is required under the Commerce Clause. The petitioner asserts that the nexus required is a "physical presence" in the taxing state, which it alleges it did not have during the assessed periods.

JUN 28 2012

To the extent that the petitioner is challenging the constitutionality of R.C. 5751.01(H)(3), (4) and/or R.C.5751.01(I)(3), the Commissioner is without jurisdiction to adjudicate the constitutionality of those statutes. However, the laws of Ohio are presumed to be constitutional. See *State ex rel. Swetland v. Kinney* (1982), 69 Ohio St.2d 567. Moreover, a discussion of the constitutional issues is particularly warranted for two reasons. First, R.C. 5751.01(H)(4) requires the commercial activity tax to be imposed to the fullest extent permissible under the Constitution. Second, regardless of R.C. 5751.01(H)(4), compliance with constitutional limitations on state taxation is the sine qua non of any tax assessment.

The Tax Commissioner's assessments will be adjusted and will be computed based on the petitioner's representations of the amounts realized from its selling of goods to Ohio consumers. By the petitioner's own admission, the goods sold were delivered by common carrier to their ultimate destination in Ohio. Thus, they were "received in this state" and were "taxable gross receipts" within the meaning of R.C. 5751.033(E) and R.C. 5751.01(I)(3). For each calendar year at issue, taxable gross receipts greatly exceeded \$500,000.00, so the petitioner had "bright-line presence" pursuant to R.C. 5751.01(H)(3) and R.C. 5751.01(I)(3). Therefore, the petitioner had "substantial nexus with this state" and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year.

The petitioner contends that application of the commercial activity tax to it would violate the Commerce Clause since the petitioner allegedly does not possess the "bright-line" physical presence in Ohio required by *National Bellas Hess v. Ill. Rev. Dep't* (1967), 386 U.S. 753 and *Quill Corp. v. North Dakota* (1992), 504 U.S. 298. In *Quill*, the Court held that North Dakota's attempt to require an out-of-state mail order company with no physical presence in the state to collect and remit use tax violated the "substantial nexus" requirement of the Commerce Clause. However, in the years since *Quill*, the Court has not extended its holding to other taxes, including income taxes or gross receipts taxes. The highest court in most, but not all, states that have considered the issue, including Ohio, has found that *Quill* applies only to sales and use taxes. See *Couchot v. State Lottery Commission* (1996), 74 Ohio St.3d 417 (finding that the physical-presence requirement of *Quill* was not applicable to taxation of Ohio Lottery winnings of a nonresident, because *Quill* applied only to sales and use taxes, although the requirement would have been satisfied anyway by virtue of the winner's purchase and redemption of the winning ticket in Ohio in a prior year). See also, for example, *Geoffrey v. South Carolina* (1993), 437 S.E.2d 13, *A & F Trademark, Inc. v. Tolson* (2004), 167 N.C. App. 150, *LANCO, Inc. v. Dir., Div. of Taxation* (2006), 908 A.2d 176, *Tax Comm'r v. MBNA America Bank* (2006), 220 W.Va. 163, and *Capital One Bank v. Commissioner* (2009), 453 Mass. 1.

The petitioner contends that even if the holding of *Quill* is limited to the sales and use tax context, that holding should apply to the commercial activity tax. However, the Supreme Court of Ohio recently found that the commercial activity tax is not, as the petitioner asserts, the functional equivalent of a sales tax. See *Ohio Grocers Ass'n v. Levin* (2009), 123 Ohio St.3d 303 (holding that the tax is not an excise tax "upon the sale or purchase of food"). Therefore, the *Quill* requirement of physical presence does not apply to the commercial activity tax.

In order to be constitutionally valid, the assessments herein must still satisfy the "substantial nexus" requirement of the Commerce Clause. The petitioner's continuous and significant

JUN 28 2012

exploitation of the economic marketplace in Ohio is sufficient for this purpose. Therefore, under established Commerce Clause jurisprudence, the imposition of the tax measured by those receipts is not prohibited by the laws or Constitution of either the United States or Ohio.

Lastly, the petitioner contends that even if it was subject to the tax and required to file returns and pay the amounts due, the assessed penalties should be abated in full due to its reasonable reliance on its interpretation of constitutional principles limiting state taxation. The petitioner was assessed penalty pursuant to R.C. 5751.06(A), (B)(1), and (D). The Tax Commissioner may abate these penalties pursuant to R.C. 5751.06(F). The petitioner's contention is not well taken, although as shown below the penalties are reduced herein because each of the assessed penalties is calculated as a percentage of tax due.

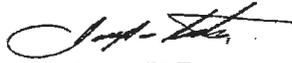
Therefore, in accordance with the actual gross receipts figures supplied, the assessments are modified as follows<sup>1</sup>:

<u>Assessment No.</u>	<u>Period</u>	<u>Tax</u>	<u>Interest</u>	<u>Penalty</u>	<u>Payments</u>	<u>Total</u>
17201131920709	04/01/10-06/30/10	\$4,559.79	\$227.37	\$2,507.89	\$0.00	\$7,295.05
17201131920707	07/01/10-09/30/10	\$4,824.93	\$191.94	\$2,653.71	\$0.00	\$7,670.58
17201131920706	10/01/10-12/31/10	\$6,502.20	\$192.39	\$3,576.21	\$0.00	\$10,270.80
17201131920704	01/01/11-03/31/11	\$5,450.42	\$108.71	\$2,997.73	\$0.00	\$8,556.86
17201131920710	04/01/11-06/30/11	\$4,816.60	\$47.51	\$2,649.13	\$0.00	\$7,513.24
17201133443985	07/01/11-09/30/11	\$5,804.27	\$8.27	\$3,192.35	\$0.00	\$9,004.89
	Total	\$31,958.22	\$776.19	\$17,577.02	\$0.00	\$50,311.42

Current records indicate that no payments have been made on these assessments. However, due to payment processing and posting time lags, payments may have been made that are not reflected in this final determination. **Any unpaid balance bears post-assessment interest as provided by law, which is in addition to the above total.** Payments shall be made payable to "Ohio Treasurer Josh Mandel." Any payment made within sixty days of the date of this final determination should be forwarded to: Department of Taxation, Commercial Activity Tax Division, P.O. Box 16678, Columbus, OH 43216-6678.

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE FINAL DETERMINATION RECORDED IN THE TAX COMMISSIONER'S JOURNAL

  
JOSEPH W. TESTA  
TAX COMMISSIONER

/s/ Joseph W. Testa

Joseph W. Testa  
Tax Commissioner

<sup>1</sup> The assessments are modified to reflect the tax due on the taxable gross receipts supplied by the petitioner. Since the petitioner has not filed returns reflecting these amounts, the figures are subject to audit and assessment of additional tax. See R.C. 5751.09(F).

IN THE OHIO BOARD OF TAX APPEALS

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L.L. BEAN, INC.,

Appellant,

vs.

JOSEPH W. TESTA,  
TAX COMMISSIONER OF OHIO,

Appellee.

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BTA No. 2010-A-2853

(Commercial Activity Tax)

Attorney Examiner:  
Carrie C. Young

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APPELLANT'S PRE-HEARING STATEMENT

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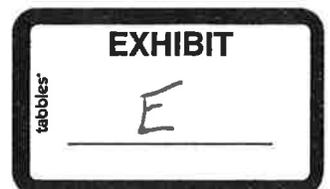
L.L. Bean, Inc. ("L.L. Bean") respectfully submits this pre-hearing statement in support of its appeal of a Final Determination of the Tax Commissioner dated August 10, 2010 (the "Final Determination") that imposed on L.L. Bean the Commercial Activity Tax (the "CAT"), plus interest and penalties, for the period of July 1, 2005 through March 31, 2008 (the "Tax Period"). For ease of reference, a copy of the Final Determination is attached hereto as Exhibit A.

**INTRODUCTION**

This case does not involve a challenge to the constitutionality of an Ohio statute. Rather, it involves L.L. Bean's claim that the imposition of the CAT on the company violates the Commerce Clause of the United States Constitution.<sup>1</sup>

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<sup>1</sup>The Board of Tax Appeals has authority to determine whether an assessment violates the Commerce Clause of the United States Constitution, because the taxpayer lacks sufficient nexus with Ohio. *See, e.g., The Country Shop, Inc. v. Limbach*, 1993 WL 15097 (Ohio Bd. Tax. App.), 10.



In short, the Commissioner seeks to impose the CAT, a gross receipts tax, on a company whose business activities occur entirely outside of the State of Ohio, something that the Commerce Clause forbids. There is not a *single* case from the United States Supreme Court, the lower federal courts, or any state court that has upheld an assessment of a gross receipts tax on a company which, like L.L. Bean, had neither property nor business activities (a “substantial nexus”) within the taxing state.

Here, the Tax Commissioner assessed L.L. Bean despite the fact that the company lacked a substantial nexus in Ohio during the Tax Period. Indeed, the Tax Commissioner put aside the question of such a presence altogether, choosing, instead, to base the legitimacy of the Final Determination on the facts as *admitted* by L.L. Bean that **(1)** L.L. Bean “had taxable gross receipts exceeding \$500,000 in each calendar year” from interstate sales to Ohio consumers [Final Determination at 3]; and **(2)** L.L. Bean sent “thousands of catalogs to Ohio residents by mail” as part of national mailings and the company’s national advertising “in various media, including print and television” reached Ohio residents. [*Id.*]. As shown herein, however, neither of these bases satisfies the Commerce Clause of the United States Constitution. *See, The Country Shop, Inc., supra.*

Indeed, from the very beginning, it has been the Tax Commissioner’s position that a physical presence of L.L. Bean in Ohio was entirely unnecessary for the state to impose the CAT, despite an unbroken line of four United States Supreme Court cases going back to 1975 holding that the Commerce Clause requires such an in-state presence in gross receipts tax cases. *See, e.g., Tyler Pipe Industries, Inc. v. Washington State Dep’t of Revenue*, 107 S.Ct. 2810, 2821 – 22, 483 U.S. 232, 250 – 51 (1987)(in a case involving a gross receipts tax, the Court held that “the crucial factor governing nexus is whether the activities

performed *in this state* on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state ...") (quoting, with approval, the decision of the Supreme Court of Washington) (emphasis added).

At the hearing, L.L. Bean will establish that it lacked a physical presence in the State of Ohio during the Tax Period. It will also be shown that the Commissioner's apparent effort to inject into the record references to Internet marketing techniques—few of which were even employed by L.L. Bean—and state budgetary issues that led to the enactment of the CAT have nothing whatsoever to do with the issues before the Board and whether the “substantial nexus” requirement of *Tyler Pipe* (and the three other United States Supreme Court cases) has been satisfied here.

## **DISCUSSION**

### **I. INTRODUCTION**

The issue before the Board is whether the Commerce Clause bars the imposition of the CAT tax on L.L. Bean during the Tax Period. Specifically, the question to be determined is whether the “substantial nexus” requirement has been met in the case of a company that had no physical presence in Ohio. *See, e.g., Tyler Pipe*, 483 U.S. at 250 (nexus for gross receipts tax only satisfied through sufficient in-state activities by, or on behalf of, the taxpayer).

Contrary to the Commissioner's position, it is well-established that a state lacks the power under the Commerce Clause to impose a gross receipts tax on a company with no physical presence in the state. *Id.; see also Standard Pressed Steel, Inc. v. Wash. Dep't of Revenue*, 419 U.S. 560, 562-64 (1975). This physical presence standard derives from constitutional principles and authorities set forth by the Court in *National Bellas Hess v. Ill.*

*Dep't of Revenue*, 386 U.S. 753 (1967), and subsequently reaffirmed in *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904 (1992).

It is likewise well-established that merely marketing and making sales to consumers in the state from locations outside of the state as part of a national business—and realizing gross receipts from such sales—is *not* a sufficient basis for a State to impose tax obligations on a company. *See Quill Corp.*, 504 U.S. at 311 (citing *Bellas Hess* for the proposition that a vendor whose only contacts with the taxing state are by the instrumentalities of interstate commerce, *e.g.*, mail or common carrier, lacks substantial nexus with the state).

For these reasons, the Commissioner's application of R.C. 5751.01(H)(3) and (I)(3) to assert CAT liability against L.L. Bean violates the Commerce Clause.

II. **THE COMMERCE CLAUSE PREVENTS OHIO FROM IMPOSING A GROSS RECEIPTS TAX, LIKE THE CAT, ON A COMPANY SUCH AS L.L. BEAN THAT HAS NO PHYSICAL PRESENCE IN THE STATE**

The Commerce Clause delegates to Congress the power “[t]o regulate commerce . . . among the several States.” U.S. CONST., Art. 1, Sec. 8, Cl. 3. It is well-established that the Commerce Clause has a corresponding “negative” or “dormant” aspect that expressly restricts the authority of a state to impose undue burdens on interstate commerce. *Oregon Waste Sys., Inc. v. Department of Env'tl. Quality*, 511 U.S. 93, 98 (1994).

Under contemporary dormant Commerce Clause analysis, a state tax on interstate commerce is invalid unless the tax satisfies each of the four prongs of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) (a state tax must be (1) applied to an activity with a substantial nexus with the taxing State, (2) fairly apportioned, (3) non-

discriminatory with respect to interstate commerce, and (4) fairly related to the services provided by the State).

This case concerns the first prong of the *Complete Auto* test—substantial nexus—which is designed to “limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce.” *Quill Corp.*, 504 U.S. at 313 and n.6.

#### **A. The Physical Presence Nexus Standard.**

More than 40 years ago, in *National Bellas Hess*, the United States Supreme Court held that, under the Commerce Clause, a state lacks the power to impose a use tax collection obligation on a company located outside the state that has no “physical presence” in the taxing state and communicates with its customers in the state solely via the instrumentalities of interstate commerce (*e.g.*, United States mail, common carrier, and, today, the Internet). *See National Bellas Hess*, 386 U.S. at 758–60.

The plaintiff, National Bellas Hess, had no facilities, property, employees or representatives in the state. *Id.* at 754. It did, however, mail catalogs and advertising flyers to recipients in the state, and sold goods via mail order to Illinois residents that were delivered to the purchasers via common carrier and the U.S. mail. *Id.* at 754–55. In striking down the Illinois tax provision, the Supreme Court upheld the “sharp distinction” established in prior cases between sellers with a physical presence in the state, and those without a presence who reached customers only via interstate commerce. *Id.* at 758. The undisputed evidence at the hearing will show that L.L. Bean fell squarely within that latter category during the Tax Period.

In 1992, the Supreme Court in *Quill Corp.* reaffirmed the bright line, physical presence requirement established in *National Bellas Hess* and again held that, under the Commerce Clause, a retailer with no physical presence in the state and whose only connection to customers in the state is by common carrier or U.S. mail cannot be obligated to collect sales and use tax. *Quill*, 504 U.S. at 313–19.

Like *National Bellas Hess*, the remote seller in *Quill* had no outlets or salespeople in the taxing state, but delivered catalogs and flyers to customers in the state via mail. In finding the statute violated the Commerce Clause’s substantial nexus requirement, the Supreme Court reaffirmed that a vendor “whose only connection with customers in the [taxing] State is by common carrier or United States mail” lacks a physical presence in the state for purposes of the “substantial nexus” requirement of the Commerce Clause. *Id.* at 314–15. The Court noted that any “artificiality” at the edges of the “bright line,” physical presence test is more than offset by a rule that “firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes” and encourages settled expectations among companies potentially subject to state tax obligations. *Id.* at 315–16. *See SFA Folio Collections, Inc. v. Tracy*, 652 N.E.2d 693, 697, 73 Ohio St. 3d 119, 123 (1995)(“Folio’s selling activity does not have a substantial nexus with Ohio because Folio does not have a physical presence in Ohio \* \* \*.”).

**B. The Physical Presence Standard Has Applied to Gross Receipts Taxes Since at Least 1975.**

Consistent with the substantial nexus principles of *Quill* and *National Bellas Hess*, the Supreme Court has made clear that a state lacks the power under the Commerce Clause to impose a gross receipts tax, like the CAT, on a company with no physical presence in the state. In 1975, the Supreme Court first applied the physical presence standard of *National*

*Bellas Hess* to state gross receipts taxes. In *Standard Pressed Steel*, the taxpayer maintained in Washington State an engineer, who consulted with the taxpayer's principal customer on a daily basis and who operated out of his home. While the employee did not take orders, his full-time activities within the state made possible the realization and continuation of valuable "contractual relations" between the taxpayer and its customer. 419 U.S. at 562. Thus, the Court held that Washington had sufficient nexus to require the taxpayer to pay its gross receipts tax. *Id.* at 562-64.

Any doubt about the applicability of the physical presence standard to state gross receipts taxes was laid to rest twelve years later, in *Tyler Pipe*, 483 U.S. 232 (1987). In that case, the taxpayer maintained sales representatives in the taxing state (Washington) that acted on a daily basis to call on taxpayer's customers and solicit orders on behalf of the taxpayer. Relying on the sales tax cases of *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), and *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977), the Court held that the daily in-state activities of the taxpayer's sales representatives in calling on customers and soliciting orders on behalf of the taxpayer established nexus for purposes of the state's gross receipts tax. *Tyler Pipe*, 483 U.S. at 250. The Court set forth the test for nexus for purposes of gross receipts tax, as follows:

"[T]he crucial factor governing nexus is whether the *activities performed in this state on behalf of the taxpayer* are significantly associated with the taxpayer's ability to establish and maintain a market in this State for the sales."

*Id.* (quoting the Washington Supreme Court, 715 P.2d 123, 126 (1986)) (emphasis added).

By approving of a standard based on "activities performed in this state on behalf of the taxpayer," the U.S. Supreme Court confirmed that the physical presence rule for determining nexus applies to gross receipts taxes. A company itself, or through its agents

or representatives, must engage in activities in the state imposing the gross receipts tax. While the Court did not specifically use the words “physical presence,” nor cite to the *National Bellas Hess* decision, it did note that the in-state activities of the sales representatives located in Washington that formed the basis for a finding of nexus were similar to those of the representatives in Florida in the sales tax collection case of *Scripto v. Carson*. See, *Tyler Pipe*, 483 U.S. at 250. The Supreme Court in *National Bellas Hess*, and later in *Quill*, similarly cited *Scripto* in setting forth the requirement of nexus. See *National Bellas Hess* 386 U.S. at 757 (noting that *Scripto* involved salespeople engaged in “continuous local solicitation” in the taxing state); *Quill*, 504 U.S. at 306 (*Scripto* and other cases all involved “some sort of physical presence within the State”). Thus, the language used by the Court in *Tyler Pipe* to describe the nexus requirement, and the same Court’s underlying reliance upon sales tax decisions requiring physical presence, compel the conclusion that the Court has adopted a similar physical presence requirement for gross receipts tax as for sales and use tax.

Other decisions of the Supreme Court further reinforce the conclusion that a taxpayer must have a physical presence in the state to be subject to a state gross receipts tax. See, e.g., *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617, 626 (1981)(citing *Bellas Hess* for threshold of state taxing power for gross receipts tax purposes, and finding sufficient presence);<sup>2</sup> see, also, *Norton Co. v. Ill. Dep’t of Revenue*, 340 U.S. 534, 537 (1951) (state lacks authority to impose gross receipts tax on a company with no “local incident” in the state). Moreover, in a post-*Tyler Pipe* decision involving an excise tax on the gross

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<sup>2</sup>In *Commonwealth Edison*, the Court noted that the object of the tax in *Commonwealth Edison* (i.e., receipts from the sale of coal mined in the state), inherently required in-state activity by the taxpayer, and thus indisputably satisfied the nexus prong of *Complete Auto*. 453 U.S. at 617.

receipts from an interstate telephone call, an analogous tax to the B & O tax in *Tyler Pipe*, the Court stated as follows: “We also doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call. *See National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U. S. 753 (1967) (receipt of mail provides insufficient nexus).” *Goldberg v. Sweet*, 488 U.S. 252, 263 (1989). The termination of a telephone call in a state is the counterpart to an Internet communication with a resident of the state or the mailing of catalogs into the state. *Goldberg* thus confirms that a state lacks the power under the Commerce Clause to require company to report and pay gross receipts tax based solely on national marketing.

### **C. Quill Confirmed the Physical Presence Rule for Gross Receipts Taxes.**

Just as in *Quill*, and *National Bellas Hess*, the gross receipts taxes cases described above make clear that the mere shipment of products into a state and the interstate marketing is insufficient to create nexus for gross receipts tax purposes. A physical presence in the state is required to satisfy the substantial nexus prong of the *Complete Auto* Commerce Clause test.

L.L. Bean anticipates that the Commissioner will argue that *Quill* rejected the physical presence requirement for nexus for gross receipts taxes. The contrary is the case: rather than retreating from its earlier gross receipts tax cases requiring physical presence, the Court in *Quill*, in fact, *relied upon them*. In upholding the physical presence requirement for sales and use taxes, the Supreme Court in *Quill* cited four of its earlier decisions involving gross receipts taxes: *Goldberg*, *Tyler Pipe*, *Standard Pressed Steel*, and *Commonwealth Edison*. *See Quill*, 504 U.S. at 311 (identifying *Goldberg* and *Commonwealth*

*Edison* as continuing the *National Bellas Hess* line of cases) and 314 (citing *Standard Pressed Steel* and *Tyler Pipe* as cases involving taxpayers who had a physical presence).

While the Commissioner asserts in an Information Release entitled “CAT 2005-02, Commercial Activity Tax: Nexus Standards” (issued in Sept. 2005, and updated in May 2011), that the Supreme Court in *Quill* stated that the physical presence standard may not apply to “other types” of state taxes, these words were taken out of context. In one such passage from *Quill*, the Supreme Court stated:

“Although we have not, in our review of **other types of taxes** articulated the same physical presence requirement that *Bellas Hess* has established for sales and use tax, that silence does not imply repudiation of the *Bellas Hess* rule.” 504 U.S. at 314 (emphasis added).

The claim that this passage precludes application of the physical presence standard to gross receipts taxes overlooks, however, the remainder of the paragraph in which this passage appeared. Earlier in the paragraph, the Supreme Court referred to “these cases” (*i.e.*, *Standard Pressed Steel* and *Tyler Pipe*) as involving “taxpayers who had a physical presence in the taxing State.” *Id.* Plainly, the Court in *Quill* did not reject the physical presence test for gross receipts tax. Rather, in citing these cases with approval elsewhere in its opinion as supporting the standard in the sales and use tax area first articulated in *National Bellas Hess* and then confirmed by *Quill*, the Court blessed the physical presence test in the gross receipts tax area.

The quoted sentence above, therefore, cannot mean that the Supreme Court has abrogated a physical presence standard for gross receipts taxes, when it cited to the two leading precedents construing the gross receipts tax as involving taxpayers who had a physical presence in the state. At most, the Supreme Court’s statement in *Quill* that “we

have not . . . articulated the same physical presence requirement” simply means that the formulation of the physical presence test has been stated somewhat differently for purposes of gross receipts taxes. Again, in *Tyler Pipe*, the Court focused on an analysis of “activities performed in this state on behalf of the taxpayer [that] are significantly associated with the taxpayer’s ability to establish and maintain a market in this State for the sales.” 483 U.S. at 250 (emphasis added).

A second passage in *Quill* referencing “other types of taxes” also does nothing to diminish the applicability of the physical presence standard to gross receipts taxes. The Court stated that:

“[a]lthough in our cases subsequent to *Bellas Hess* and concerning other types of taxes, we have not adopted a similar bright-line physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes.” 504 U.S. at 317.

The context in which this passage appears is crucial to its proper interpretation. The Court’s reference to “cases subsequent to *Bellas Hess* and concerning other types of taxes” cannot be understood to disavow the physical presence test for gross receipts taxes set forth in *Tyler Pipe* for two fundamental reasons. First, the passage follows a discussion of other precedents (the “cases subsequent to *Bellas Hess*”), all of which pre-date *Tyler Pipe*’s express requirement that there must be “activities performed in this state on behalf of the taxpayer.” Thus, it is not a rejection of *Tyler Pipe*. Indeed, the *Quill* Court’s citation to the four Supreme Court gross receipts taxes, each of which required activities in the taxing state by or on behalf of the taxpayer, compels the conclusion that *Quill* confirmed rather than rejected the physical presence standard for gross receipts taxes.

Second, after the passage quoted above, the Court in *Quill* then stated that it was expressly reaffirming the *Bellas Hess* physical presence requirement because the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law. *Id.* According to the Court, the benefits of the *Bellas Hess* rule include the recognition of substantial reliance interests and a reduction in litigation regarding state taxes. 504 U.S. at 315–17. The Supreme Court has never held that a state has the power under the Commerce Clause to impose gross receipts tax on a company based on any lesser, or different standard than the “bright line,” physical presence test of *Tyler Pipe* and *Quill*. Just as *stare decisis* was an important reason for maintaining the *Bellas Hess* physical presence test for use taxes, therefore, so too does that principle govern for gross receipts taxes and dictate the continued application of the physical presence requirement set forth in *Tyler Pipe*. Companies engaged in the interstate sale of goods, such as L.L. Bean, have been (and remain) justified in relying upon *Tyler Pipe* and its predecessor decisions as establishing the limits of state gross receipts taxing power in planning and conducting their commercial activities. *See Quill*, 504 U.S. at 315 (whatever “artificiality” may exist in specific applications of the physical presence standard, it has the demonstrable, and overriding, benefit of creating a clear rule that “firmly establishes the boundaries” of legitimate state tax authority).

Finally, the Supreme Court in *Quill* based its requirement of a physical presence, in part, on establishing a zone of protection for direct marketers like L.L. Bean—creating a “discrete realm of commercial activity that is free from interstate taxation.” *See Quill*, 504 U.S. at 314 – 15. Permitting the Commissioner to sidestep the “physical presence” requirement in a gross receipts tax case—a tax that has the same basis as sales and use

taxes, *i.e.*, gross receipts from interstate sales—would be to rely on formalistic labels and semantics to avoid a clear constitutional requirement, something that the United States Supreme Court has consistently abhorred. As the Supreme Court explained in *Quill*, it is up to Congress, not the individual states, to abrogate the physical presence requirement as it applies to sales and use and gross receipts taxes. *Id.* at 318.

In short, under established Supreme Court authority dating back decades, a state lacks the power to impose a gross receipts tax upon a remote seller with no physical presence in the state and whose only contact with the state derives from making sales to customers there. The Commissioner’s attempt to apply R.C. 5751.01(H)(3) and (I)(3) to compel L.L. Bean to pay the CAT therefore violates the Commerce Clause.

**D. The Premise That The Physical Presence Standard Must Be “Extended” To Reach the CAT Is Belied By Clear United States Supreme Court Precedent And State Court Decisions Applying That Standard In Gross Receipts Tax Cases.**

Since it was decided, *Tyler Pipe* has become a foundational block in substantial nexus jurisprudence. Numerous decisions by state courts, involving not only sales/use taxes,<sup>3</sup> but also gross receipts taxes,<sup>4</sup> have relied upon the Supreme Court’s gross receipts

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<sup>3</sup> See, e.g., *Orvis Co. v. Tax Appeals Trib.*, 654 N.E.2d 954, 957 (N.Y. 1995) (citing *Standard Pressed Steel* as defining the contours of the *Bellas Hess* physical presence requirement); *Borders Online, LLC v. State Board of Equalization*, 129 Cal. App. 4th 1179, 1196-98 (2005) (relying upon *Tyler Pipe*, as well as *Standard Pressed Steel* and *Scripto v. Carson*, 362 U.S. 207 (1960), in finding that the out-of-state retailer had sufficient physical presence through the activities of a related-company, deemed to be the taxpayer’s representative in the state); *State v. Dell International, Inc.*, 922 So.2d 1257, 1262-63 (La. Ct. App. 2006) (finding that the taxpayer had nexus as a result of services and repairs performed in the state on its behalf and relying upon *Tyler Pipe* as “expound[ing] on this test [of the nature and extent of in-state activities]” required to establish nexus under *Scripto* and *Quill*).

<sup>4</sup> For example, in *J.C. Penney Nat’l Bank v. Johnson*, 19 S.W.3d 831, 841-42 (Tenn. Ct. App. 1999), the court held that the taxpayer, J.C. Penney National Bank, was not required to pay the Tennessee gross receipts tax imposed on financial institutions because it lacked a physical presence. In rejecting the state’s argument that the tax was properly imposed on the out-of-state company in that case, the Court emphasized that the “crucial factor” in *Tyler Pipe* was that the taxpayer’s representative was physically present in the state conducting activities on its behalf.

tax precedents (*Tyler Pipe* and *Standard Pressed Steel*) to define the scope of the physical presence nexus standard applicable to out-of-state companies.

The Commissioner, in contrast, can cite to *no case* in which either the U.S. Supreme Court, or a state court, has ever held that *Tyler Pipe*, *Standard Pressed Steel*, or any other case authorizes the imposition of a state gross receipts tax under a “purely economic presence” standard based on sales or national advertising. It is likely, instead, that the Commissioner will seek to rely on a group of inapposite state court decisions concerning state income and franchise taxes — none of which concern a gross receipts tax and none of which even cite, let alone distinguish, *Tyler Pipe* and *Standard Pressed Steel* — in support of its argument that a taxpayer need not have a physical presence in the state for purposes of the Ohio CAT. Any reliance by the Commissioner on these income/franchise tax cases is misplaced for several reasons.

*First*, any attempt by the Commissioner to classify the taxes in such cases as “privilege of doing business” taxes, in an effort to analogize them to the Ohio CAT, would be unavailing. The Supreme Court has long-since discredited the “privilege of doing business” tax classification as mere non-substantive nomenclature that “served no purpose in our Commerce Clause jurisprudence, but stood ‘only as a trap for the unwary draftsman.’” *Quill*, 504 U.S. at 314 (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)). Thus, the Commissioner’s likely claim that such cases concern “privilege” taxes like the CAT, and therefore support its contention the Commissioner can subject L.L. Bean to the CAT based merely on their sales in the state and national advertising, is baseless. Each of the cases involves a state income (or franchise) tax.

The decision in *Couchot v. State Lottery Commission*, 74 Ohio St.3d 417 (1996), in which the Ohio Supreme Court upheld the imposition of an income tax on the state lottery winnings of a resident of Kentucky who purchased his ticket in Ohio, is illustrative. In *Couchot*, the court found “no indication in *Quill* that the Supreme Court will extend the physical-presence requirement to cases involving **taxation measured by income** derived from the state” and deemed *Quill* to be inapplicable. *Id.* at 425 (emphasis added). But the CAT is a gross receipts tax, not an income tax. Moreover, as the *Couchot* Court stressed, the taxpayer was physically present in Ohio both when he purchased his winning ticket, and when he redeemed it. *Id.* The case therefore provides no support for the contention that Ohio may impose its gross receipts on a company based solely on sales to Ohio residents, and not on a physical presence in the state.<sup>5</sup>

*Second*, the majority of the decisions from other states likely to be cited by the Commissioner, including *Geoffrey, Inc. v. South Carolina Tax Commission*, 313 S.C. 15, 437 S.E.2d 13 (1993), concern the specialized area of taxes on income derived from royalties received on the basis of intangible property (*i.e.*, trademarks) used within the state, and thus have no application here. *See also A & F Trademark, Inc. v. Tolson*, 167 N.C. App. 150, 605 S.E.2d 187 (2004), *cert denied*, 546 U.S. 821 (2005); *LANCO, Inc. v. Director, Division of Taxation*, 188 N.J. 380, 908 A.2d 176 (2006), *cert denied*, 551 U.S. 1131 (2007). As the

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<sup>5</sup> In general, state income taxes are subject to a different set of standards than are gross receipts taxes. For example, under Public Law 86-272, 15 U.S.C. § 381, remote sellers of tangible goods are immune from state income taxes, even where they have sales representatives physically present in a state, so long as their representatives’ activities are limited to the solicitation of orders for tangible personal property that are sent outside the state for approval and filled by common carrier or U.S. Mail from locations outside the state. *Id.* § 381(a). Indeed, if the Ohio CAT were an income-based tax, rather than a gross receipts tax, then sellers such as L.L. Bean would be immune from the CAT under federal law. Having elected to adopt a gross receipts tax instead of an income tax, Ohio must accept that the CAT is subject to the physical presence standard applicable to gross receipts taxes under *Tyler Pipe* and the other cases cited by L.L. Bean.

Court in *Geoffrey* made clear, those cases are grounded in a different strand of constitutional jurisprudence altogether. In rejecting the taxpayer's reliance on physical presence standard of *Bellas Hess* in that case, the *Geoffrey* court noted that it is "well-settled" that a physical presence in a state is not required for purposes of taxes on income earned from intangible property located in the state. *Geoffrey*, 313 S.C. at 18 (citing *International Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 441-42 (1944)). Thus, those cases which have declined to "extend" *Quill* to state income taxes on intangibles are irrelevant and in no way can be read to override the Supreme Court's decisions in *Standard Pressed Steel* and *Tyler Pipe*, adopting the *Bellas Hess/Quill* physical presence standard for state gross receipts taxes.

*Third*, the remaining cases likely to be cited by the Commissioner are also readily distinguishable. *Tax Comm'r of W.Va. v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (W. Va. 2006), *cert. denied sub nom. FIA Card Services, N.A. v. Tax Comm'r of W. Va.*, 551 U.S. 1141 (2007) and *Capital One Bank v. Commissioner*, 899 N.E.2d 76 (Mass.), *cert. denied*, 129 S.Ct. 2827 (2009). Neither case concerns a gross receipts tax; rather, both addressed state income/franchise taxes imposed on financial institutions (namely, credit card issuers). Moreover, both courts framed the issue presented as whether *Quill* should be "extended" to the income/franchise taxes at issue in those cases, an inquiry which (as demonstrated above) makes no sense in the context of gross receipts taxes already subject to the physical presence nexus standard under *Tyler Pipe* and *Standard Pressed Steel*. Indeed, neither

*MBNA* nor *Capital One* even cites, let alone distinguishes, *Tyler Pipe* or *Standard Pressed Steel*.<sup>6</sup>

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<sup>6</sup>Moreover, the rationale used by the state courts in *MBNA* and *Capital One* for rejecting the application of the *Quill* physical presence standard to the financial institution income taxes in those cases provides no support for the Commissioner's likely contention that a "purely economic presence" by the L.L. Bean is sufficient to subject them to the CAT. According to those decisions, *Quill's* reaffirmation of the physical presence requirement was grounded primarily on *stare decisis* because *Bellas Hess* had engendered substantial reliance by direct to consumer marketers (like L.L. Bean). See *MBNA*, 640 S.E. 2d at 232. As discussed in herein, in the area of gross receipts tax, the principle of *stare decisis* is equally important, in view of *Standard Pressed Steel* and *Tyler Pipe*, and thus supports L.L. Bean's position.

CONCLUSION

In sum, there is no court case, let alone a U.S. Supreme Court decision, that employs a requirement other than physical presence of the taxpayer to permit the imposition of a **gross receipts tax** on an out-of-state company such as L.L. Bean. The Board should continue to follow the U.S. Supreme Court precedent and thus rule that the Assessment is invalid, because L.L. Bean lacks a physical presence in Ohio.

Respectfully submitted,

*By SLS  
per email auth  
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**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of Appellant's Pre-Hearing Statement has been served upon the following by hand delivery and US Regular Mail on this 12<sup>h</sup> day of August, 2013:

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# OHIO BOARD OF TAX APPEALS

L.L. Bean, Inc.,

Appellant,

vs.

Richard A. Levin, Tax Commissioner  
of Ohio,

Appellee.

CASE NO. 2010-2853

(COMMERCIAL ACTIVITY TAX)

DECISION AND ORDER

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Entered **MAR 06 2014**

Mr. Williamson, Mr. Johrendt, and Mr. Harbarger concur.

This matter is considered by the Board of Tax Appeals upon a notice of appeal filed on behalf of appellant L.L. Bean, Inc. ("Bean"). Bean appeals from a final determination of the Tax Commissioner in which the commissioner modified eight commercial activity tax assessments against Bean, as a result of Bean's petitions for reassessment. The underlying assessments relate to periods from July 1, 2005 through March 31, 2008. The matter is considered by the Board of Tax Appeals upon the notice



of appeal, the statutory transcript (“S.T.”) certified to this board by the Tax Commissioner, the record of this board’s hearing (“H.R.”),<sup>1</sup> and any pre-and post-hearing briefs filed by the parties.

In its brief, Bean describes itself as “a retailer in Freeport, Maine that sells products to consumers across the United States, including consumers residing in the State of Ohio. \*\*\* It does so via twenty-six (26) retail stores, all of which are located outside of Ohio; through catalogs mailed to consumers in the United States and around the world from outside of Ohio; by an Internet website located on the company’s computer servers in Freeport, Maine; and by emails, none of which are sent from Ohio. \*\*\* Virtually all of L.L. Bean’s operations-apart from some of its retail stores-are located in the State of Maine, and none are located in Ohio. \*\*\* L.L. Bean’s offices, its warehouses (which ship products to customers exclusively by common carriers), its call centers that receive telephone orders from its customers, and the entirety of its Internet operations are located in Maine. \*\*\* The L.L. Bean retail store closest to Ohio is approximately 400 miles away in Philadelphia, Pennsylvania. \*\*\* Although about five (5) percent of L.L. Bean’s products are shipped from locations outside of Maine, none are shipped from locations in Ohio. \*\*\*” Bean Brief I, at 7.

In its notice of appeal to this board, Bean specified the following:

“1. Because L.L. Bean engages in no commercial activity within the State of Ohio and, likewise, neither owns nor leases property in the state, either directly or indirectly, the Company is not ‘doing business in the state’ under R.C. 5751.02. \*\*\*

“2. L.L. Bean lacked a ‘substantial nexus with this state’ under R.C. 5751.01(H) inasmuch as it (a) neither owned nor used ‘part or all of its capital in this state’ [R.C. 5751.01(H)(1)]; (b) lacks a ‘certificate of compliance with the laws of this state authorizing [it] to do business in this state’ [R.C. 5751.01(H)(2)]; and (c) does not ‘otherwise [have] nexus in this state \*\*\* under the Constitution of the United States.’ [R.C. 5751.01(H)(4)].

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<sup>1</sup> The board’s hearing examiner reserved ruling on whether Exhibit 6, paragraph 3 would be received into evidence. Upon review, is shall be received.

“3. L.L. Bean lacked a “bright-line presence” under R.C. 5751.01(H)(3) & (I) inasmuch as it did not have (a) ‘at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars’ [R.C. 5751.01(I)(1)]; (b) ‘during the calendar year payroll in this state of at least fifty thousand dollars’ [R.C. 5751.01(I)(2)]; (c) during the calendar year ‘taxable gross receipts of at least five hundred thousand dollars,’ inasmuch as (i) none of its gross receipts are subject to taxation in Ohio; and (ii) it had no taxable sales with the State of Ohio [R.C. 5751.01(I)(3)]; or (d) ‘during the calendar year within this state at least twenty-five per cent of the person’s total property, total payroll, or total receipts’ [R.C. 5751.01(I)(4)], was not ‘domiciled in this state as an individual or for corporate, commercial, or other business purposes.’ [R.C. 5751.01(I)(5)].

“4. L.L. Bean’s receipts are not subject to taxation because, under former R.C. 5751.01(F)(2)(z) [later R.C. 5751.01(F)(2)(aa) and now R.C. 5751.01(F)(2)(ff)], such tax is ‘prohibited by the Constitution or laws of the United States \*\*\*.’

“5. L.L. Bean’s receipts are not subject to taxation under R.C. 5751.02(A) because it lacks ‘substantial nexus with this state’ under the United States Constitution. See R.C. 5751.01(F)(2)(ff), 5751.01(H)(1)-(4), and 5751.01(I)(1)-(5).

“6. Ohio statutes should be interpreted to avoid the imposition of the CAT on L.L. Bean, inasmuch as imposing the tax on L.L. Bean would violate the Company’s rights under the Commerce Clause of the United States Constitution. \*\*\*

“7. L.L. Bean contends that, notwithstanding footnote 1 of the Determination, the Commissioner has relinquished any right to assert that the Determination should be upheld on the basis of a ‘physical presence’ of L.L. Bean in the State of Ohio, and that his attempt to reserve this claim for another Determination to be issued later in connection with the Tax Period is ineffective.

“8. Should the Board permit the Commissioner to assert a basis for the assessment not set forth or relied upon in the Determination (e.g., the ‘physical presence’ of L.L. Bean in Ohio), L.L. Bean contends that the application of the CAT to L.L. Bean would violate the Company’s rights under the Commerce Clause of the United States Constitution because L.L.

Bean does not possess the requisite 'bright-line' physical presence in Ohio. \*\*\*

"9. Even if an 'economic presence test' were to be applied to this case, the imposition of the CAT against L.L. Bean would be unlawful inasmuch as L.L. Bean lacked an economic presence in Ohio, and, instead, merely communicated with customers in Ohio via interstate commerce from locations entirely outside of the state.

"10. The tax imposed upon L.L. Bean was excessive because it was based upon an inaccurate, excessive calculation of taxable gross sales made to Ohio residents.

"11. The Commissioner and/or his agents or representatives violated L.L. Bean's confidentiality rights under R.C. 5751.12 by sending out the Determination in a manner unauthorized by law and in violation, therefore, of the Ohio Taxpayer Bill of Rights, R.C. 5703.54, which authorizes the recovery of damages and attorneys' fees where the Commissioner's actions 'are clearly unsupported under the law.'

"12. The Commissioner erred in arbitrarily and capriciously assessing penalties for each of the foresaid reasons, as well as based upon L.L. Bean's good faith reliance upon existing federal constitutional law as regards to the application of the 'substantial nexus' rule to cases involving gross receipts taxes, as well as sales and use taxes and other state taxes, and the Commissioner's unclean hands in connection with its violation of L.L. Bean's confidentiality rights. R.C. 5751.12 and 5703.54." Notice of Appeal at 8-10.

Initially, we note that the findings of the Tax Commissioner are presumptively valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121. It is incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption and establish a right to the relief requested. *Belgrade Gardens, Inc. v. Kosydar* (1974), 38 Ohio St.2d 135; *Ohio Fast Freight v. Porterfield* (1972), 29 Ohio St.2d 69; *National Tube v. Glander* (1952), 157 Ohio St. 407. The taxpayer is assigned the burden of showing in what manner and to what extent the Tax Commissioner's

determination is in error. *Federated Department Stores v. Lindley* (1983), 5 Ohio St.3d 213.

At the outset, Bean contends that “[t]his case does not involve a challenge to the constitutionality of an Ohio statute. Rather, it involves L.L. Bean’s claim that the imposition of the CAT on the company violates the Commerce Clause of the United States Constitution.” Bean Pre-Hearing Statement at 1. Bean goes on to suggest that this board “has authority to determine whether an assessment violates the Commerce Clause of the United States Constitution, because the taxpayer lacks sufficient nexus with Ohio,” citing *The Country Shop, Inc. v. Limbach* (January 15, 1993), BTA No. 1990-K-90, unreported, as support for such proposition. Bean Pre-Hearing Statement at 1, f.n. 1.

In *Country Shop*, supra, the board discussed the U.S. Supreme Court’s decision regarding nexus in *Quill Corp. v. North Dakota* (1992), 504 U.S. 298 (1992), ultimately holding that “the third element of R.C. 5741.01(H) provided that adequate nexus existed for purposes of requiring an out-of-state seller to collect use tax when that seller advertised in Ohio for the purpose of soliciting sales. While this Board may question the continuing vitality of this section of the statute [given the *Quill* discussion], it is well-established that we are without jurisdiction to declare a given statute to be unconstitutional. *S. S. Kresge Co. v. Bowers* (1960), 170 Ohio St. 405, paragraph one of the syllabus; *Herrick v. Kosydar* (1975), 44 Ohio St. 2d 128, 130; *Roosevelt Properties Co. v. Kinney* (1984), 12 Ohio St. 3d 7, 8; *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St. 3d 229, paragraph one of the syllabus. Accordingly, we review appellant’s advertising activities to determine whether these activities warrant a conclusion that it has substantial nexus with Ohio.” *Id.* at 12.

Thereafter, however, the Supreme Court, in *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St.3d 195, discussed the BTA’s role in appeals involving constitutional challenges, holding:

“The BTA understood its role to be a receiver of evidence for constitutional challenges. Accordingly, it did so, giving the parties wide latitude in presenting the evidence. The BTA determined no facts on the constitutional questions. The commissioner, however, in her Proposition of Law No. IV,

contends that the BTA not only receives evidence in this type of case, but must weigh the evidence and determine the facts necessary for the court's review of the constitutional questions. Since the BTA did not make findings of fact, the commissioner asserts that we should remand the case for the BTA to comply.

“In *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St.3d 229, \*\*\*, paragraph three of the syllabus, we held:

“The question of whether a tax statute is unconstitutional when applied to a particular state of facts must be raised in the notice of appeal to the Board of Tax Appeals, and the Board of Tax Appeals must receive evidence concerning this question if presented, even though the Board of Tax Appeals may not declare the statute unconstitutional. (*Bd. of Edn. of South-Western City Schools v. Kinney* [1986], 24 Ohio St.3d 184, \*\*\*)’

“We explained the process, 35 Ohio St.3d at 232 \*\*\*;

“When a statute is challenged on the basis that it is unconstitutional in its application, this court needs a record, and the proponent of the constitutionality of the statute needs notice and an opportunity to offer testimony supporting his or her view.

“To accommodate this court’s need for extrinsic facts and to provide a forum where such evidence may be received and all parties are apprised of the undertaking, it is reasonable that the BTA be that forum. The BTA is statutorily created to receive evidence in its role as factfinder.’

“Under *Cleveland Gear*, the BTA need only receive evidence for us to make the constitutional finding. This is because the BTA accepts facts but cannot rule on the question. On the other hand, we can decide the constitutional questions but have a limited ability to receive evidence. Thus, the BTA receives evidence at its hearing, but we determine the facts necessary to resolve the constitutional question.” *Id.* at 197-198.

Thus, based upon the foregoing, this board makes no findings with regard to the constitutional questions presented. The parties, through the presentation of

evidence and testimony and the submission of briefs to this board, have set forth their respective positions regarding the constitutional validity of the commissioner's application of the statutory provisions in question,<sup>2</sup> as well as the constitutional validity of the statutes themselves, and we find such arguments may only be addressed on appeal by a court which has the authority to resolve constitutional challenges.

R.C. 5751.02<sup>3</sup> provided in pertinent part that:

“(A) For the purpose of funding the needs of this state and its local governments beginning with the tax period that commences July 1, 2005, and continuing for every tax period thereafter, there is hereby levied a commercial activity tax on each person with taxable gross receipts for the privilege of doing business in this state. For the purposes of this chapter, ‘doing business’ means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state.”

R.C. 5751.01(H) provided, in pertinent part:

“(H) A person has ‘substantial nexus with this state’ if any of the following applies. The person:

“\*\*\*

“(3) Has bright-line presence in this state;

“(4) Otherwise has nexus with this state to an extent that the person can be required to remit the tax imposed under this chapter under the Constitution of the United States.

R.C. 5751.01(I) provided, in pertinent part:

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<sup>2</sup> Although appellant claims that it only sought review of the constitutionality of the Tax Commissioner's application of R.C. 5751.01(H), and not the statute itself, we find appellant's arguments concerning the application of the statute, in reality, attack the constitutional validity of the statute itself.

<sup>3</sup> All statutory references are to the sections that were in effect for the period of the first assessment, i.e., July-December 2005, with the acknowledgement and understanding that some were subsequently renumbered.

“(I) A person has ‘bright-line presence’ in this state for a reporting period and for the remaining portion of the calendar year if any of the following applies. The person:

“\*\*\*

“(3) Has during the calendar year taxable gross receipts of at least five hundred thousand dollars.”

With certain exceptions, including “[a]ny receipts for which the tax imposed \*\*\* is prohibited by the constitution or laws of the United States or the constitution of this state,” R.C. 5751.01(F)(2)(z), “gross receipts” is defined as:

“[T]he total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person, including the fair market value of any property and any services received, and any debt transferred or forgiven as consideration.” R.C. 5751.01(F).

In addition, “[g]ross receipts from the sale of tangible personal property shall be situated to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has been completed shall be considered the place where the purchaser receives the property.” R.C. 5751.033(E).

Thus, pursuant to the foregoing statutory framework, Bean was assessed commercial activity tax for the periods in question. The commissioner determined that Bean had a “bright-line presence” in the state because it had at least \$500,000 in taxable gross receipts for each period assessed. Bean “disclosed and does not contest the amount of the actual gross receipts it received attributable to Ohio customers for the periods assessed, \*\*\*.”<sup>4</sup> For each calendar year at issue, taxable gross receipts greatly exceeded

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<sup>4</sup> Although Bean apparently contested the amount of gross receipts attributed to assessment number 17200815829369, it did not provide any evidence or testimony relating to such issue; further, at hearing, Bean’s counsel represented that Bean does not “dispute the measure of the assessment, we do dispute the assessment.” H.R. at 54-55.

\$500,000.00, so the petitioner had 'bright-line presence' pursuant to R.C. 5751.01(H)(3) and R.C. 5751.01(I)(3). Therefore, \*\*\* [Bean] had 'substantial nexus with this state' and was subject to the tax because it had taxable gross receipts exceeding \$500,000.00 in each calendar year." S.T. at 3.

The commercial activity tax is a tax on the privilege of doing business in this state, as measured by gross receipts. Bean contends that its gross receipts cannot be taxed under the commercial activity statutes under consideration herein because it lacks an in-state presence, as required by the Commerce Clause, necessary to establish substantial nexus. See *Quill*, supra; *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987). Bean Brief I at 1, Brief II at 21. We do not read the pertinent statutes to impose an in-state presence requirement.

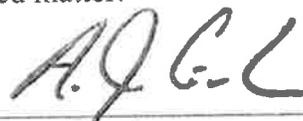
"In construing a statute, a court's paramount concern is the legislative intent in enacting the statute. \*\*\* In determining legislative intent, the court first looks to the language in the statute and the purpose to be *accomplished*.' *State v. S.R.* (1992), 63 Ohio St.3d 590, 594-595 \*\*\*. Words used in a statute must be taken in their usual, normal or customary meaning. R.C. 1.42; *Indep. Ins. Agents of Ohio, Inc. v. Fabe* (1992), 63 Ohio St.3d 310, 314 \*\*\*. In construing a statute, it is the duty of the court to give effect to the words used and not to insert words not used. *S.R.*, supra, 63 Ohio St.3d at 595 \*\*\*. 'Where the language of a statute is plain and unambiguous and conveys a clear and definite meaning, there is no need to apply rules of statutory interpretation. \*\*\* However, where a statute is found to be subject to various interpretations, a court called upon to interpret its provisions may invoke rules of statutory construction in order to arrive at legislative intent.' *Cline v. Ohio Bur. of Motor Vehicles* (1991), 61 Ohio St.3d 93, 96 \*\*\*." *State ex rel. Cassels v. Dayton City School Dist. Bd. of Edn.* (1994), 69 Ohio St.3d 217, 220. (Parallel citations omitted.)

A plain reading of the statutes under consideration provides that an entity has substantial nexus with this state if it has a bright-line presence in this state, which is defined as having taxable gross receipts of at least five hundred thousand dollars, which Bean admittedly has. While we recognize that an out-of-state seller must have

“substantial nexus” with a taxing state, *Quill*, supra, we are also cognizant of the explicit statutory language of R.C. 5751.01(H), where, by definition, substantial nexus exists if any of the elements set forth in R.C. 5751.01(H)(1)-(4) are met. While this board may be asked to opine as to the constitutionality of a statute which imposes nexus upon an out-of-state seller by virtue of the amount of its gross receipts, without consideration of its in-state presence, this board, as heretofore stated, is precluded from ultimately making such a declaration; accordingly, we are constrained to follow the mandate of the General Assembly in concluding that appellant, an out-of-state seller, has substantial nexus within this state by virtue of its gross receipts for the reporting periods in question.

Thus, it is the decision of the Board of Tax Appeals that the final order of the Tax Commissioner must be, and hereby is, affirmed.

I hereby certify the foregoing to be a true and complete copy of the action taken by the Board of Tax Appeals of the State of Ohio and entered upon its journal this day, with respect to the captioned matter.



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A.J. Groeber, Board Secretary

**CERTIFICATE OF SERVICE**

I hereby certify that the foregoing Tax Commissioner's Appendix to Motion to Dismiss was filed electronically with the Ohio Supreme Court and was served by email and ordinary US

Mail this 10 day of June, 2015, upon the following:

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