Supreme Court of Ohio Clerk of Court - Filed August 31, 2015 - Case No. 2015-0794

In the Supreme Court of Ohio

Mason Companies, Inc.,	:	
	:	Case No. 15-0794
	:	
Appellant,	:	
	:	Appeal from the Ohio
v.	:	Board of Tax Appeals
	:	
Joseph W. Testa,	:	
Tax Commissioner of Ohio,	:	
	:	BTA Case Nos. 2012-1169, 2012-2806
Appellee.	:	

MERIT BRIEF OF APPELLANT MASON COMPANIES, INC.

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INTRODUCTION

Mason Companies, Inc. ("Mason") is a family-owned company located entirely in Chippewa Falls, Wisconsin. For the past hundred years, it has sold footwear and apparel through catalogs mailed to all fifty states and, more recently, over the Internet using websites hosted on computer servers located at Mason's Chippewa Falls offices. The only connection that Mason has to the State of Ohio is that, as part of its national direct marketing business, it sells products to consumers in Ohio via instrumentalities of interstate commerce.

Beginning in 2006, Mason began receiving Commercial Activity Tax ("CAT") assessments from the State of Ohio. In timely protesting each of those assessments, Mason soon learned that the only basis for the Ohio Department of Taxation's claim that Mason owed the CAT was that Mason received payments from its Ohio customers in excess of $500,000 per year. At the heart of Mason's appeal to the Supreme Court of Ohio, therefore, lies the longstanding constitutional principle that no state can impose taxes or tax collection obligations on out-of-state retailers that do no more than communicate with in-state customers via instrumentalities of interstate commerce. That, in fact, is all that Mason has ever done.

Under the Commerce Clause of the U.S. Constitution, a tax imposed on nonresidents must satisfy the "substantial nexus" requirement of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). For over 50 years, in cases decided both before and after *Complete Auto*, the U.S. Supreme Court has held that a state's authority to impose a tax measured by gross receipts depends upon the taxpayer's presence in the state which assists the out-of-state company in some way to develop and maintain a market for the sale of its products. While such a presence may either be direct or through a third-party acting on behalf the nonresident company, and may arise from as little as the instate work of a single employee or

sales representative attending to the needs of one significant customer, an instate presence remains today the *sine qua non* of the jurisdiction to tax.

As the U.S. Supreme Court explained in *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987), in response to a challenge to the constitutionality of a state tax on the privilege of doing business in the state that was measured by gross receipts:

> [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 sales.

(Internal citation omitted.) (Emphasis added.) *Tyler Pipe*, 483 U.S. at 250-251; *see also Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626, 101 S.Ct. 2946, 69 L.Ed.2d 884 (1981) (noting that "the interstate business must have a substantial nexus with the State before *any* tax may be levied upon it"); *Std. Pressed Steel Co. v. Washington Dept. of Revenue*, 419 U.S. 560, 562, 95 S.Ct. 706, 42 L.Ed.2d 719 (1975) (taxpayer had a full-time employee located in the state who "made possible the realization and continuance of valuable contractual relations" for the company); *Gen. Motors Corp v. Washington*, 377 U.S. 436, 447-448, 84 S.Ct. 1564, 12 L.Ed.2d 430 (1964) (taxpayer's in-state activities were "decisive factors in establishing and holding the market"); *Field Ents., Inc. v. Washington*, 47 Wash.2d. 852, 856, 289 P.2d 1010 (1955), *aff'd*, 352 U.S. 806, 77 S.Ct. 55, 1 L.Ed.2d 39 (1956) (tax levy against company upheld based on the presence of a manager, employees and salespeople in the state).

Since its landmark decision in *Tyler Pipe*, the Supreme Court has never held that any different or lesser "substantial nexus" standard applies for determining the validity of a state tax measured by gross receipts. In fact, *Tyler Pipe* continues to be cited by courts throughout the country in support of the in-state activities requirement of substantial nexus. *See, e.g., New Mexico Taxation & Revenue Dept. v. Barnesandnoble.com LLC*, 2013 NMSC 023, ¶¶ 8-10, 303

P.3d 824, 827-828 (upholding assessment of New Mexico Gross Receipts Tax based on the activities of an affiliated company in the state); *Lamtec Corp. v. Dept. of Revenue*, 170 Wash.2d 838, 849-851, 246 P.3d 788, 974-995 (2011) (*en banc*) (affirming gross receipts tax assessment against company whose sales representatives visited customers in the state); *J.C. Penney Natl. Bank v. Johnson*, 19 S.W.3d 831, 841-842 (Tenn.App.Ct. 1999) (rejecting application of gross receipts tax to company with no in-state presence).

The CAT is, like the tax reviewed by the Court in *Tyler Pipe*, a tax on the privilege of doing business measured by gross receipts. *Ohio Grocers Assn. v. Levin*, 123 Ohio St.3d 303, 2009-Ohio-4872, ¶¶ 43-49; R.C. 5751.02(A). As a tax measured by gross receipts, the CAT is properly analyzed for purposes of the Commerce Clause's "substantial nexus" text in the same manner as other state taxes measured by, or levied upon, gross receipts. Yet, in the face of *Tyler Pipe* and other Supreme Court and state court decisions reinforcing the in-state presence standard for gross receipts-based taxes, the Tax Commissioner of Ohio ("Commissioner") contends that the Ohio General Assembly elected intentionally to eliminate legislatively the requirement of an in-state presence in adopting the Commercial Activity Tax ("CAT") in favor of a test based entirely on whether an out-of-state company makes at least $500,000 in sales per year to its Ohio customers. *See* R.C. 5751.01(H)(3), (I)(3). As long as a company receives a combined $500,000 or more each year from any Ohio sources, the Commissioner contends, it must pay the CAT. This is true even if a company such as Mason does nothing more than communicate with Ohio customers through instrumentalities of interstate commerce as part of a national business.

Before the Supreme Court of Ohio, as it did in proceedings before both the Commissioner and the Ohio Board of Tax Appeals, Mason disputes the constitutionality of both the Commissioner's interpretation of the CAT statute and his application of the CAT to Mason's business. Indeed, the Commissioner's interpretation of the statute, if accepted, would render the

CAT's gross receipts-level nexus provision, R.C. 5751.01(I)(3), unconstitutional on its face. Based on the in-state presence requirement as consistently described in *Tyler Pipe* and many other decisions, Mason respectfully asks this Court to reject the Commissioner's imposition of the CAT on Mason, reverse the decision of the Board of Tax Appeals ("Board" or "BTA") that affirmed the Commissioner's assessments of CAT against Mason, and order that the CAT assessments against Mason be cancelled in full.

STATEMENT OF THE CASE

The Ohio Department of Taxation (the "Department") issued twenty-four CAT assessments against Mason covering, collectively, each of the quarterly periods from July 1, 2005 to September 30, 2011 (the "Tax Period"). *See* Appx. 44-47, 57-61, Final Determination, Assessment Nos. 17201019728458–463, 17201019728391–402; Final Determination, Assessment Nos. 17201131920704, 17201131920706–707, 1721131920709–710, 17201133443985 (the "Final Determinations"). The total tax resulting from these assessments is $250,000 and the aggregate interest and penalties associated with the assessments are $29,054.64 and $138,500, respectively. *Id.* The sole basis for the assessments was that Mason's annual retail sales to Ohio customers exceeded $500,000 per year. The Department cited no activities conducted by, or on behalf of, Mason in Ohio during the Tax Period to justify its CAT assessments. *See id.*

Mason timely petitioned for reassessment, asserting that application of the CAT to Mason exceeded the State's authority under the Commerce Clause of the United States Constitution because Mason did not conduct any activities directly or through representatives in Ohio to establish or maintain an Ohio market. (Suppl. 768 , Petition for Reassessment at 2). Mason also presented statutory arguments in its petitions. For example, Mason argued that the assessments were invalid under R.C. 5751.01(F)(2)(ff), a provision that expressly provides that the term

"taxable gross receipts" excludes "any receipts for which the tax imposed by this chapter is prohibited by the constitution or laws of the United States * * *." (Suppl.772, Petitions for Reassessment at 5).

In each of his two Final Determinations which, collectively, covered all of the assessments, the Commissioner rejected all of Mason's arguments, finding that Mason's sales of more than $500,000 to Ohio customers, alone, satisfied both the CAT statute and the Commerce Clause substantial nexus requirement. Appx. 44-46, 57-59, Final Determinations at 1-3. Relying on R.C. 5751.01(H)(3), the Commissioner concluded that Mason had a statutory "substantial nexus with this state," based on the CAT definition of a "bright-line presence in this state" set forth in R.C. 5751.01(I)(3). Appx. 45-46, 58-59, Final Determinations at 2-3. The Commissioner noted that Subsection (I)(3) requires that the taxpayer during the calendar year has "taxable gross receipts of at least five-hundred thousand dollars." Appx. 46, 59, Final Determinations at 3. As to Mason's constitutional argument, the Commissioner summarily determined as follows:

> The petitioner has more than $500,000 in taxable gross receipts sitused 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.

Id. The Commissioner offered no supporting authority for this conclusion. *Id.*

Mason timely appealed the Final Determinations to the Board, raising the same constitutional and statutory arguments it raised in its petitions. Appx. 35-61, Notices of Appeal dated April 24, 2012 and August 27, 2012. The appeals were later consolidated by the Board, with one hearing held and a single Board decision issued covering both appeals. Appx. 62-66, Decision and Order entered April 20, 2015.

After extensive discovery by the Commissioner, including document requests and interrogatories (resulting in the production of virtually every marketing-related contract of Mason), a hearing was held before the Board on December 15, 2014. (Suppl. 1-57, Hearing Transcript dated December 15, 2014 (cited as "Trial Transcript")).

While the assessments and the Final Determination of the assessments were based solely on the fact that Mason's sales exceeded the $500,000 annual threshold, the Commissioner in pre-hearing filings advised that he would further argue that Mason's Internet marketing activities satisfied the Commerce Clause in-state presence test. In response, Mason presented the live and deposition testimony of the three key employees responsible for all of Mason's marketing and sales activity. The sworn testimony of these employees was admitted into evidence as Joint Exhibits KKK, LLL, and MMM by agreement of the parties and order of the Board. (Suppl. 446, Joint Stipulations dated October 24, 2014 ¶ 4; Suppl. 58-182, 183-249, 250-276, Joint Exhibits KKK, LLL, and MMM, Depositions of Jodi Bresina dated August 27, 2014, Darin Schemenauer (dated August 27, 2014), and Adam Stavn dated August 28, 2014 (cited as "JB Depo.," "DS Depo.," and "AS Depo.," respectively)). Mason also presented the expert testimony of Eric Goldman, a professor at Santa Clara University Law School and the director of the school's High Tech Law Institute. By agreement of the parties, Professor Goldman was qualified "in the areas of Internet law, intellectual property, and advertising and marketing law, as well as marketing, including Internet marketing, the use of the Internet to purchase and sell products, and the technology regarding such marketing and sales." (Suppl. 446, Joint Stipulations dated October 24, 2014, ¶ 3). Professor Goldman's sworn deposition testimony was admitted into evidence as Joint Exhibit QQQ by agreement of the parties and order of the Board. (Suppl. 277-303, Joint Exhibit QQQ, Deposition Testimony of Eric Goldman dated October 27, 2014 (cited as "EG Depo.")).

The Commissioner presented no fact witnesses, but introduced testimony from a prior hearing of Frederick Church, a state employee, concerning the nature of the CAT and its historical background. With the agreement of Mason and the authorization of the Board, the Commissioner also presented the deposition testimony of two experts—Joseph Turow, a Professor of Communications at the University of Pennsylvania, and Ashkan Soltani, a private consultant in the area of privacy, security, and behavioral economics—to discuss Mason's Internet activities. (Suppl. 446, Joint Stipulations ¶ 3; Suppl. 343-376, Joint Exhibit OOO, Deposition Testimony of Joseph Turow dated October 27, 2014; Suppl. 377-444, Joint Exhibit PPP, Deposition Testimony of Ashkan Soltani dated October 28, 2014 (cited as "JT Depo." And "AS Depo.," respectively)).

On April 20, 2015, the Board entered its Decision and Order upholding the Commissioner's Final Determination. Appx. 62-66, Decision and Order dated April 20, 2015 ("Decision"). The Board expressly declined to address Mason's as-applied constitutional challenge to the assessments, saying that it lacked the authority to decide "questions of constitutional interpretation." Appx. 65, Decision at 4. It therefore made "no findings with regard to the constitutional questions presented." *Id*. The Board rejected Mason's argument that the CAT should be construed so as not to run afoul of the well-established in-state activities requirement for gross receipts taxes under the Commerce Clause. Appx. 65, Decision at 4. Instead, it found that "under the plain language set forth therein, the pertinent CAT statutes do not impose such an in-state presence requirement." Appx. 65, Decision at 4. The Board explained that it was "constrained to follow the mandate of the General Assembly in concluding that the appellant, an out-of-state seller, has substantial nexus within this state by virtue of its gross receipts * * *. " *Id.*

Mason timely appealed the Board's decision to this Court. Appx. 1-19, Notice of Appeal dated May 19, 2015. The Commissioner cross-appealed, asserting that Mason failed to raise as a basis for appeal below the constitutionality of the CAT as applied to Mason. *See* Notice of Cross-Appeal (dated April 6, 2015). On the same ground as the cross-appeal, the Commissioner then moved to dismiss Mason's contention that the CAT, as applied to Mason by the Commissioner, violates the Commerce Clause. *See* Motion to Dismiss (dated June 10, 2015). The Court denied the Commissioner's motion to dismiss. *08/26/2015 Case Announcements*, 2015-Ohio-3427 at 4.

STATEMENT OF FACTS

A. Mason Had No Physical Presence In Ohio And Conducted No Marketing Activities In The State.

Mason is a one-hundred year old company that has mainly sold footwear and apparel from facilities located exclusively in Chippewa Falls, Wisconsin. (Suppl. 7, Transcript at 22, 25). During the tax period at issue in this appeal, it had no employees, agents, or representatives in the State of Ohio. (*Id.*, Transcript at 24). Nor did it own or lease property of any kind in Ohio. (*Id.*). Mason marketed to customers through catalogs sent from Chippewa Falls, Wisconsin to consumers across the United States, including in the State of Ohio. (*Id.*, Transcript at 27; Suppl. 121, JB Depo. at 110 (Mason's business is "catalog driven," and it mails catalogs to consumers on a monthly basis). It also marketed to customers across the United States, including in Ohio, via emails from Chippewa Falls, Wisconsin. (*Id.*, Transcript at 26–27). During the Tax Period, Mason ran a total of nine websites that were hosted in Chippewa Falls, Wisconsin. (*Id.*, Transcript at 25; Suppl. 68, JB Depo at 14). Mason's marketing efforts, which were "en masse or in bulk," did not target specific states or other geographic locations. (Suppl. 7-8, Transcript at 25–26). Mason did not use any third parties located in the State of Ohio for marketing services.

(*Id.*, Transcript at 27). The Commissioner's expert testified that in all of his review, he saw nothing by Mason that singled out the State of Ohio for any purpose. (Suppl. 364, JT Depo. at 84); *see also Id.*, JT Depo. at 84 ("Q. You saw no information in any of the investigation you did about Mason interacting in any particular and different way with Ohio consumers? A. No.")).

Mason received all product orders from its customers in Chippewa Falls, Wisconsin. (*Id.*, Transcript at 25). During the tax period, Mason had telephone representatives located only in Chippewa Falls, Wisconsin who accepted orders from consumers. (*Id.*, Transcript at 27). It fulfilled those orders by sending products to customers from its facilities in Chippewa Falls, Wisconsin. (*Id.*, Transcript at 25).

B. Mason's Internet Marketing Was Conducted Entirely From Outside Of The State Of Ohio.

In addition to resting his position on the admitted fact that Mason made in excess of $500,000 in sales per year to Ohio residents, the Commissioner raised for the first time before the Board the argument that Mason's sale of products via the Internet created a sufficient connection to Ohio to satisfy the "substantial nexus" requirement of the Commerce Clause. In this section of its Statement of Facts, Mason describes its Internet marketing activities, all of which were conducted from outside of the State of Ohio. No Internet-related activities were conducted by or on behalf of Mason in Ohio. (Suppl. 281, EG Depo. at 14). It was admitted by the Commissioner's experts that none of Mason's Internet-related activities targeted residents of Ohio. (Suppl. 358, JT Depo. at 60 ("They weren't * * * they were targeting customers. They could be in Ohio. They could be elsewhere."); ("Q. So that Mason's use of those technologies was agnostic as to what state the person resided in, correct? A. Yes."); Suppl. 412-413, AS Depo. at 141–142 ("I didn't find anything to say – to show that Mason's activities were specific to Ohio versus anywhere else.")). It was also admitted by the Commissioner's expert that all of

Mason's interactions with Ohio consumers occurred in interstate commerce, with Mason communication from locations outside of Ohio. (Suppl. 370, JT Depo. at 108–109).

1. Mason's Websites Were Not Maintained In Ohio.

As explained above, Mason's websites were hosted on computers at Mason's offices in Chippewa Falls, Wisconsin. (Suppl. 7, Transcript at 25). Customers from around the country, including in the State of Ohio, could access Mason's Wisconsin-located websites no matter where they might live. (*Id.*, Transcript at 30).

2. Mason Did Not Use Third Parties for Website Content Delivery.

Mason did not use any third parties, such as Akamai, for content delivery services. (Suppl. 8, Transcript at 26). Mason's use of Akamai was limited to warding off cyber attacks from foreign countries. (*Id.*, Transcript at 26, 50 ("So we used Akamai to help us block, for example, eastern Europe, so we put kind of like a firewall up that said we will not allow traffic from eastern Europe to come into our websites"). Mason was neither informed nor had reason to believe that Akamai would be using assets located in Ohio to fend of such attacks on Mason's Chippewa Falls, Wisconsin web sites. (*Id.*, Transcript at 29, 50). Akamai does provide another service to Internet companies called "caching," which involves storing website content at servers owned and controlled by Akamai, but Mason did not use that service during the tax period. (*Id.*, Transcript at 26).

3. Mason's Use Of Web Site Analytics Was Unsophisticated And Limited To Measuring Trends In The Usage Of Its Websites.

During the tax period, members of Mason's ten-person marketing team (which includes five support staff) used certain website related data to make marketing decisions. (*Id.*, Trial Transcript at 28–29). Use of such information is called "analytics." (*Id.*, Transcript at 28). Mason's use of website-related data was "very limited" and "unsophisticated," and was mainly

for ascertaining trends regarding the use of its websites. (*Id.*, Transcript at 28–29 ("So, as an example, we know how many people are visiting our site in a certain month."). None of Mason's very limited use of analytics involved using information concerning the geographic location of its customers. (*Id.*, Transcript at 29). One way that Mason performed analytics involved looking at the words that website visitors used to search its website, referred to as "on-site searches." (*Id.*, Transcript at 57–58). Mason would look at, for example, "what was the most common search," or "terms that didn't return search results." (*Id.*, Transcript at 58; *see also* Suppl. 72, JB Depo. at 18 (Mason used only high level usage data like, "[t]hings like visits, pageviews," conversion rates, i.e., percentage of visits that resulted in sales, and bounce rates[1])). The companies involved in providing such date did not provide any customer specific information to Mason. (Suppl. 81-83, JB Depo. at 30–32 (only aggregate high level data provided); Suppl. 365, JT Depo. at 89 ("Q. Are you aware of any companies that did analytics for Mason that did so on anything other than an aggregated basis? A. It wasn't described.")).

4. Mason Did Not Use Internet "Cookies" For Marketing Purposes Or To Collect Information About Customers.

Cookies are tiny data files containing a "short series of numbers, say, six or seven digits," that are transmitted along with other website content to a visitor's computer. (Suppl. 284-285, EG Depo. at 28–30). Cookies do not store information. (Suppl. 285, EG at 30). They are ubiquitous on the Internet and are required for the very basic functionality most people expect. [Suppl. 372, JT Depo. at 115 -16; Suppl. 285, EG Depo at 31-32). Mason did not rely on "cookies" at all for marketing purposes. (Suppl. 9, Transcript at 30–31). The company did not use "cookies" to collect data about customers. (*Id.,* Transcript at 31). Rather, the only use of

[1] The "bounce rate" is the percentage of visitors to a particular website who navigate away from the site after viewing only one page.

"cookies" was the default use of them made by Mason's website software platform, including to allow customers to place items in a shopping basket, and all such cookies disappeared after thirty days. (*Id.*; *see also* Suppl. 114, JB Depo. at 68 (the platform cookies allow customers to put something into their cart and "they leave and come back the next day, that item is still in their cart"); Suppl. 382, 384, AS Depo. at 20–21, 26–28 (describing the limited functionality of the "cookies" set by Mason's software platform), 24 (explaining that "cookies" are not used by Mason for analytic purposes)). The "cookies" sent by Mason's web platform software were the same for visitors from all states. (Suppl. 373, JT Depo. at 121). Consumers have the ability to prevent the use of cookies, as well as to delete them. (Suppl. 285-286, EG Depo. at 32–33, 37). Cookies are nontangible, without any of the attributes of a tangible, physical item. (Suppl. 286, EG Depo. at 34). Cookies do not add mass to a hard drive, they simply reconfigure existing "ones and zeros" that already exist on a formatted drive. (Suppl. 286, EG Depo. at 35–36).

5. Mason Sent Emails To Customers From Wisconsin.

As described earlier, during the Tax Period Mason sent email promotions from Chippewa Falls, Wisconsin to customers across the United States, including in Ohio. (Suppl. 8, Transcript at 26–27). It used a company located outside of Ohio called Cheetahmail to assist in the sending of such emails. (*Id.*, Transcript at 56).

6. Mason Placed Advertisements On Other Websites Via A Third Party Ad Program Offered By A Company Located Outside Of Ohio.

During the Tax Period, Mason used an advertising network managed by a company called Commission Junction to place advertising on website sites that Commission Junction represented. (Suppl. 17, Transcript at 62–63). Commission Junction recommended to Mason websites that would be "a good match or good fit" for Mason, but apart from questions of "high level" fit and the exclusion of certain kinds of sites ("there were certain things we did not want,

erotic sites"), it was left to Commission Junction to determine good websites on which Mason's advertisements would run. (*Id*., Trancript at 63–64). Commission Junction, a California company, was not located in Ohio and Mason did not know where the websites displaying its advertising were located. (*Id.*, Transcript at 112–113). Mason did not engage in any retargeting through third party websites during the tax period. (Suppl 177, JB Depo at 146; Suppl. 346, JT Depo. at 11–12 (describing retargeting and noting that it is "probably the most common activity on the part of marketers when it comes to reaching people on other websites")).

7. Mason Used Comparison Shopping Websites, Paid Search, And Social Media To Promote Its Business.

Mason used national comparison shopping websites to promote its business. (Suppl. 17-18, Transcript at 65-68). Mason also contracted with national search engines like Google for paid search advertising. (Suppl. 106, JB Depo at 59 ("paid search is where businesses or other pay search engines to appear higher in the return of search results"); Suppl. 439, AS Depo. at 248). Finally, Mason promoted its business through the national social media sites Facebook and Twitter. (Suppl. 20, Transcript at 77). Mason promoted its Internet business only through national marketing and advertising programs that were conducted outside of Ohio and did not target the residents of any particular state. (Suppl. 288-289, EG Depo. at 44–48).

C. The Commissioner's Internet Nexus Theory.

Faced with a company that did business through the Internet and engaged in no activities in Ohio, the Commissioner took the position before the Board that Mason's interstate online sales satisfied the Commerce Clause "substantial nexus" requirement.

As articulated by the Commissioner's experts, the Commissioner claims that when an Ohio consumer interacts with his or her own computer in Ohio, such interaction is a "local interaction" that takes place on the user's computer. This purported "local interaction"

supposedly creates an in-state physical presence of Mason in Ohio. The Commissioner's experts conceded that, under this theory, an online retailer would have the functional equivalent of a physical presence not only in Ohio, but in every other jurisdiction around the globe when an Internet user located there decides to visit the retailer's website. (Suppl. 426, AS Depo. at 194-195 (in stating that an alleged "local interaction" occurs, it occurs not just in Ohio but "everywhere"), 195–196 (in connection with Mason's use of the Internet to "grow and maintain a market," such activities did so everywhere, not just Ohio), 242 (Mason did not treat Ohio "differently than anywhere else")).

The reports and testimony of the Commissioner's own experts, however, make clear that a connection between an Ohio Internet user and an out-of-state Internet retailer is purely interstate in nature, not local. The customer initiates this interstate contact with the retailer, by inputting a retailer's Internet address into their browser while using the Internet (in the same way that a consumer dials a telephone number or addresses an envelope). (Suppl. 281-282, 283-284, EG Depo. at 14–18, 25–28 (describing the consumer-initated nature of Internet browsing and the information transmitted)). The out-of-state server then responds, again via interstate communication channels, by transmitting a website over the Internet for the customer to view through his or her browser. (Suppl. 282, 284, EG Depo. at 19–21, 28–29 (describing the server's role in responding to the consumer-initiated information request and the information transmitted)).

The Commissioner further argued that Internet retailers have a "virtual presence" in Ohio through "digital assets" such as "cached" images and cookies that are downloaded to the computers of Internet users as part of the Internet communication process, but this theory is as ephemeral as the purported "assets" themselves. The "cache" is simply a digital file (or file folder) kept for the benefit of the user. (Suppl. 423, AS Depo. at 183 (cache is "information

provided by the server in response to the consumer's request"); Suppl. 287, EG Depo. at 39-41). Specifically, when a user visits a website, the web browser may save certain files it needs to display the website. (*Id.*) The next time the user visits that website, the website will load faster because the consumer's browser loads an image from the hard drive rather than the slower process of downloading another copy of that same image from the retailer's server. (*Id.*) An Internet seller does not, however, access or control the visitor's cache. (*Id.*) Rather, an individual user controls his or her own cache and can delete the entire cache—or even particular items within their cache. (*Id.*)

The Commissioner also claimed that "virtual presence" in Ohio was created based upon so-called digital "cookies" sent to consumers—along with the images and text—over the Internet from the websites they visit. As explained earlier, a "cookie" is a short text file containing a string of ones and zeroes; it is not something physical that can be touched or felt. Mason's website platform software used cookies for very limited purposes of basic functionality, as described above. As Mason's expert, Eric Goldman explained, in testimony consistent with that of the Commissioner's own experts, Mason's online marketing activities were entirely agnostic geographically, and none of such activities occurred within the State of Ohio, either directly or indirectly. (Suppl. 288, EG Depo. at 42). His conclusions were that Mason "did not perform any online activities in Ohio nor did any third parties perform online activities in Ohio on [Mason's] behalf." (*Id.*, EG Depo. at 44). Further, he concluded that Mason did not own any physical property in Ohio as a result of its online activities, and that none of Mason's electronic communications with Ohio residents constituted physical property. (*Id.*, EG Depo. at 45). He also concluded that Mason's online activities placed no greater burden on Ohio's resources than any other interstate direct marketing methods. (*Id.,* EG Depo. at 47–48). Finally, Professor Goldman opined that the Commissioner's term "virtual presences" was "incoherent," offering no

parameters or boundaries around the idea "of someone being present, but only virtually." (*Id.*, EG Depo. at 290).

In sum, the factual record regarding Mason's Internet marketing during the Tax Period demonstrates that Mason had no physical presence in Ohio, and that neither Mason, nor any third parties acting on its behalf, engaged in any activities in Ohio.

LAW AND ARGUMENT

Mason challenges the CAT assessments against it on multiple, related grounds, each of which derives from the "substantial nexus" requirement for state taxation under the Commerce Clause. *Complete Auto*, 430 U.S. at 279 ("substantial nexus" test). On numerous occasions, the U.S. Supreme Court has applied the substantial nexus test to state taxes measured by gross receipts. *See, e.g., Tyler Pipe*, 483 U.S. at 250 (the "crucial factor governing nexus" is whether in-state activities by or on behalf of the taxpayer assist it to make a market in the state); *Commonwealth Edison*¸ 453 U.S. at 626 (an "interstate business must have a substantial nexus with the state before *any* tax may be levied upon it") (Emphasis sic.).

While Mason contends that there are reasonable interpretations of the CAT statute that would be consistent with the substantial nexus requirement, thereby rendering the statute inapplicable to an out-of-state company that conducts no activity in Ohio, the Commissioner takes a different view. In the pleadings in this case, the Commissioner insists that the CAT statute permits only one interpretation: that the CAT must apply to all companies that meet the $500,000 sales threshold of R.C. 5751.01(I)(3), regardless of whether they satisfy the Commerce Clause's substantial nexus test. Further he asserts that Mason's proposed interpretations of the CAT statute to preserve its constitutionality would render section (I)(3) *meaningless* and that the CAT tax applies to persons *whether or not* they have substantial nexus with the state.

Mason thus begins its argument where the Commissioner demands that it must: namely, with the contention that the CAT assessments against Mason are invalid because the "bright-line presence" provision of R.C. 5751.01(I)(3) on its face violates the "substantial nexus" requirement of the Commerce Clause. Mason then demonstrates that R.C. 5751.01(I)(3) is unconstitutional as applied to Mason. Finally, in accordance with the principle that a statute is presumed constitutional, and should therefore be interpreted by the Court so as to avoid a ruling that the statute or its application is unconstitutional, Mason offers an interpretation of the CAT that bars its application to companies, like Mason, that have no presence in Ohio and no activities conducted on their behalf in the state.

> **Proposition of Law 1**: R.C. 5751.01(I)(3) is unconstitutional on its face. According to its plain terms, the gross receipts "bright-line presence" provision of R.C. 5751.01(I)(3) requires that the CAT be imposed on a company solely because the company meets a statutory threshold of $500,000 in annual gross receipts from interstate sales to Ohio consumers, irrespective of whether the company has the in-state presence required under the "substantial nexus" standard for state taxes established by the Supreme Court under the Commerce Clause. *E.g.*, *Tyler Pipe*, 483 U.S. at 250-251; *Commonwealth Edison*, 453 U.S. at 626; *Std. Pressed Steel*, 419 U.S. at 562; *Gen Motors*, 377 U.S. at 447-448.

A. The CAT Statute, On Its Face, Imposes CAT Liability On Retailers With No Physical Presence In The State Who Make Sales To Ohio Customers In Excess Of The Statutory Gross Receipts Threshold.

The CAT is levied on "each person with taxable gross receipts for the privilege of doing business in this state." R.C. 5751.02(A). While the statute extends the reach of the tax to all "persons with substantial nexus with this state"—confusingly using the same term the Court used in *Complete Auto*—it defines the term "substantial nexus" in an unprecedented way, found nowhere in any reported decision by any court. *See* R.C. 5751.01(H)(3). Specifically, the phrase "substantial nexus with this state" includes any company that makes sales of $500,000 or more to Ohio residents during a calendar year, irrespective of how it conducts its business. It does so in the following way.

First, R.C. 5751.01(H)(3) states that a person has "substantial nexus with this state" if the person has "bright-line presence" in the state. Second, "bright-line presence" is, in turn, defined to mean, in pertinent part,[2] that a person "has during the calendar year taxable gross receipts of at least five hundred thousand dollars." R.C. 5751.01(I)(3). Third, "gross receipts" include amounts derived from the sale of goods to consumers. R.C. 5751.01(F)(1)(a). Fourth, "taxable gross receipts" are gross receipts "sitused to this State under R.C. 5751.033." R.C. 5751.01(G). Finally, gross receipts from the sale of tangible personal property are "sitused" to Ohio (meaning that the CAT statute deems Ohio to be the place at which the gross receipts are realized) if the property is received by the purchaser in Ohio. R.C. 5751.033(E). Mason's sales via the Internet and mail order, which are delivered by common carrier to its customers in Ohio from its warehouse in Wisconsin, are thereby "sitused" in Ohio, rendering all of Mason's interstate sales to Ohio residents "taxable gross receipts" under the CAT.

B. Mason Received More Than $500,000 In Gross Receipts From Sales Delivered To Ohio Customers And Therefore Has Standing To Challenge The CAT.

There is no dispute that Mason had more than $500,000 in annual gross receipts from the interstate sales of tangible goods to purchasers in Ohio for all relevant years during the Tax Period. In fact, this was the sole basis for the Commissioner's determination to assess the CAT against Mason, and the sole basis for the Final Determination and the decision of the Board. Appx. 44, 46, 57, 59, Final Determination at 1, 3; Appx. 63, Decision and Order at 2. Mason therefore has standing to challenge the constitutionality of the gross receipts "bright-line

[2] The other "bright-line presence" provisions of R.C. 5751.01(I), which are irrelevant to Mason, specify that a company will be subject to the CAT if it is domiciled in the state or has in Ohio (1) at least $50,000 in property, (2) at least $50,000 in payroll, or (3) 25% of its total property, payroll, or gross receipts. *See* R.C. 5751.01(I)(1), (2), (4), (5). Mason meets none of these standards, was not assessed based on them, and does not challenge the constitutionality of these provisions.

presence" provision of the CAT, R.C. 5751.01(I)(3). *See Palazzi v. Estate of Gardner*, 32 Ohio St.3d 169, 175, 512 N.E.2d 971 (1987) (a party within the class to whom the statute applies has standing to challenge its constitutionality).

C. Mason Satisfies The Standards For A Facial Constitutional Challenge.

1. Mason's Facial Challenge To The CAT Statute Depends Upon No Extrinsic Facts.

A facial constitutional challenge calls upon the Court to review "only the text of the statute itself" without regard to any "extrinsic facts." *Global Knowledge Training, L.L.C. v. Levin*, 127 Ohio St.3d 34, 2010-Ohio-4411, 936 N.E.2d 463 ¶¶ 17, 18, 127 Ohio St.3d 34, 38-39 (citing *Cleveland Gear Co. v. Limbach*, 35 Ohio St.3d 229, 231, 520 N.E.2d 188 (1988)). Mason contends that the "bright-line presence" provision of R.C. 5751.01(I)(3) is unconstitutional because, by its plain terms, it imposes liability for the CAT on a company based *solely* on the company making sales of at least $500,000 in a calendar year of products that are delivered to Ohio customers, and without regard to any other activities by, or on behalf of, the company. No extrinsic facts are required to evaluate this statutory "bright-line presence" provision. Indeed, the Commissioner insists, and the Board agreed below, that nothing more than gross receipts by a company in excess of the statutory threshold is required for liability under the CAT statute to attach. Appx. 65, Decision and Order at 4 (finding that under the plain language of R.C. 5751.01(H)(3) and (I)(3), a company with more than $500,000 in sales to Ohio purchasers "has substantial nexus within this state by virtue of its gross receipts").

2. The "Presumption Of Constitutionality" Cannot Preserve A Statutory Provision That Is Plainly Unconstitutional On Its Face.

This Court has explained that statutes enjoy a "strong presumption of constitutionality." *Beaver Excavating Co. v. Testa*, 134 Ohio St.3d 565, 2012-Ohio-5776, 983 N.E.2d 1317, ¶ 27. As a result, "it must appear beyond a reasonable doubt that the legislation and constitutional

provisions are clearly incompatible" before a statutory provision may be struck down as unconstitutional. (Citation omitted.) *Arbino v. Johnson & Johnson*, 116 Ohio St.3d 468, 2007-Ohio-6948, 880 N.E.2d 420, ¶ 25.

These familiar principles, however, do nothing to defeat Mason's facial challenge, nor its as-applied challenge, as set forth below. Rather, they simply reinforce the basic rule of statutory interpretation that the statute must be construed, if at all possible, to avoid rendering it unconstitutional. R.C. 1.47(A); *see SFA Folio Collections, Inc. v. Tracy*, 73 Ohio St.3d 119, 123, 652 N.E.2d 693, 697 (1995) (reading a state tax statute to "conform with the Commerce Clause" because conformity with the constitution is a "presumed legislative intention"). Thus, while a reviewing court must indulge a presumption in favor of constitutionality, the presumption simply means that "where a statute reasonably allows for more than a single construction or interpretation, it is the duty of the court to choose that construction or interpretation which will avoid rather than raise serious questions as to its constitutionality." *Buchman v. Wayne Trace Local School Dist. Bd. of Edn*., 73 Ohio St.3d 260, 269, 652 N.E.2d 952 (1995). The "presumption" of constitutionality, however, cannot cure a constitutional violation that is evident on the face of the statute. *See Peebles v. Clement*, 63 Ohio St.2d 314, 321, 408 N.E.2d 689, 693-694 (1980) (despite the strong presumption of constitutionality, the Court "in interpreting a statute, cannot simply rewrite it to make it constitutional"). Nor does it permit the Commissioner or a reviewing court to ignore established constitutional doctrine.[3]

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[3] The rationale for the presumption of constitutionality has been questioned. *See Ohio Grocers*, 2009-Ohio-4872, ¶¶ 71-72 (Pfeifer, J., dissenting) (noting that legislators may well rely on the Court to determine the constitutionality of statutory enactments). Here, section.C. 5751.31 of the CAT statute indicates that "the General Assembly explicitly anticipated the constitutional challenge" raised by Mason. *See Beaver Excavating*, 2010-Ohio-5776, ¶ 12 (citing R.C. 5751.31). In particular, R.C. 5751.31 creates a special procedure for a direct appeal to this Court of certain specific issues, including the constitutionality of the CAT statute's "substantial nexus"

Based on these basic principles, Mason has consistently urged both the Commissioner and the Board below to interpret the CAT statute so as not to apply to Mason for the very purpose of preserving the statute's constitutionality. *See* Appx. 3-4, 6-8, Notice of Appeal at 3-4, 6-8 (discussing Mason's arguments and asserted Error of Law regarding erroneous statutory interpretation). The Commissioner, however, has insisted below and in response to Mason's appeal to this Court that no such interpretation of the CAT statute is possible. *See, e.g.*, Appx. 46, 59, Final Determination at 3. He argues that the General Assembly expressly enacted a mandatory gross receipts "bright-line presence" test that creates CAT liability without regard to any constitutional limitations on the State's taxing powers. Thus, the Commissioner contends there is no saving the CAT statute if the gross receipts test for CAT liability—which permits the imposition of tax on companies with no connection to the state apart from receiving at least $500,000 per year in sales revenue—violates the Commerce Clause.

3. Mason's Facial Challenge Under The Commerce Clause Is Not Defeated By The "No Set Of Circumstances" *Salerno* Test.

In cases involving facial challenges brought under constitutional provisions other than the Commerce Clause, this Court has applied the so-called *Salerno* test in which a challenger must establish that there "exists no set of circumstances under which the statute would be valid" or, stated differently, that "the law is unconstitutional in all of its applications." *E.g., Arbino*, 2007-Ohio-6948, ¶ 26, 116 Ohio St.3d at 473 (citing *United States v. Salerno*, 481 U.S. 739, 745, 107 S.Ct. 2095, 95 L.Ed2d 697 (1987) for the "no set of circumstances" test); *State v. Romage*, 138 Ohio St.3d 390, 2014-Ohio-783, 7 N.E.3d 1156, ¶ 7 (the "unconstitutional in all of its applications" test). This Court, however, has *never* applied the *Salerno* test to a facial challenge under the Commerce Clause, even though it has applied this test when reviewing challenges

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provision, R.C. 5751.01(H)(3). Thus, when adopting the statute, the General Assembly invited review of its constitutionality.

based on other constitutional provisions. In *Columbia Gas Transm. Corp. v. Levin*, 117 Ohio St.3d 122, 2008-Ohio-511, 882 N.E.2d 400, ¶¶ 43, 53-78, this Court analyzed a Due Process claim under the "unconstitutional in all of its applications" standard, but did not apply this test to claims under the Commerce Clause. Similarly, in *Emerson Elec. Co. v. Tracy*, 90 Ohio St.3d 157, 159-160 735 N.E.2d 445, 447-448 (2000), the Court did not apply the "no set of circumstances" test to a challenge under the dormant aspect of the Foreign Commerce Clause. Indeed, the dissent in *Emerson Electric* expressly noted that the Court had chosen not to apply the *Salerno* "no set of circumstances" formulation in striking down the law challenged in that case. *See* 90 Ohio St.3d at 162-163 (Cook, J., dissenting).

The U.S. Supreme Court has likewise never applied the *Salerno* test to a facial challenge brought against a state statute, let alone a state tax statute, under the Commerce Clause. *See, e.g.*, *Comptroller of the Treasury of Maryland v. Wynne*, ___ U.S. ___, 135 S.Ct. 1787, 1801-1805, 191 L.Ed.2d 813 (2015) (evaluating challenge to state tax under applicable Commerce Clause test); *Camps Newfound/Owatonna, Inc. v. Town of Harrison,* 520 U.S. 564, 575–582, 117 S.Ct. 1590, 137 L.Ed.2d 91 (1997) (same); *Quill Corp. v. North Dakota*, 504 U.S. 298, 313-318, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992) (same); *New Energy Co. v. Limbach*, 486 U.S. 269, 274–280, 108 S.Ct. 1803, 100 L.Ed.2d 302 (1988) (same). Indeed, "[f]ollowing *Salerno*, the [Supreme] Court has repeatedly considered facial challenges simply by applying the relevant constitutional test to the challenged statute without attempting to conjure up whether or not there is a hypothetical situation in which application of the statute might be valid." *Doe v. City of Albuquerque*, 667 F.3d 1111, 1124–1125 (10th Cir. 2012) (brackets added) (collecting cases).[4]

[4] In fact, as commentators and courts have noted, including a plurality of the Supreme Court, the "no set of circumstances" formulation has "never been the decisive factor in any decision of the [Supreme Court], including *Salerno* itself." *Id.* at 1125–1126 (citing *City of Chicago v. Morales*, 527 U.S. 41, 55 n.22, 119 S.Ct. 1849, 144 L.Ed.2d 67 (1999) and collecting cases). Instead,

Furthermore, the Supreme Court itself declined to apply *Salerno* to a challenge brought to a state income tax statute under the foreign commerce prong of the Commerce Clause. *See Kraft Gen. Foods, Inc. v. Iowa Dept. of Revenue and Fin.*, 505 U.S. 71, 82–83, 112 S.Ct. 2365, 120 L.Ed.2d 59 (1992) (Rehnquist, J. dissenting) (arguing that the Court should have applied *Salerno*); *see also Emerson Elec.,* 90 Ohio St.3d at 162-163, 735 N.E.2d at 449-450 (Cook, J., dissenting) (commenting on Chief Justice Rehnquist's dissent in *Kraft*). The highest courts of at least three other states have since rejected the "no set of circumstances" test in the context of a similar facial challenge to a state tax statute. *See Conoco, Inc. v. Taxation & Revenue Dept.*, 122 N.M. 736, 742–743, 931 P.2d 730, 736–737 (1996), *cert. denied* 521 U.S. 1112, 117 S.Ct. 2497, 138 L.Ed.2d 1003 (1997); *Caterpillar, Inc. v. Commr. of Revenue,* 568 N.W.2d 695, 700 n.8 (Minn. 1997), *cert. denied*, 522 U.S. 1112, 118 S.Ct. 1043, 140 L.Ed.2d 108 (1998); *Caterpillar, Inc. v. New Hampshire Dept. of Revenue Admininistration*, 144 N.H. 253, 258, 741 A.2d 56, 60 (1999).

Even if Mason were required to show that there is no set of circumstances in which the CAT statute's gross receipts "bright-line presence" provision could be validly applied, Mason's challenge satisfies that standard. Mason contends that the gross receipts "bright-line presence" standard is *never* adequate, in and of itself, to satisfy the in-state presence requirement of substantial nexus under governing U.S. Supreme Court precedent.

Nor can reference to some other part of the CAT statute—such as the other "bright-line presence" provisions, which are based on having property or payroll (*i.e*., employees) in the state, or the provision that extends the CAT statute to include any in-state presence that is otherwise sufficient to satisfy the requirements of the Commerce Clause—save the

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application of the relevant constitutional standards to the statute's plain terms remains the paramount inquiry and dictates the nature of the Court's review.

constitutionality of the gross receipts "bright line presence" provision of R.C. 5751.01(I)(3). *See* R.C. 5751.01(H)(4) & (I)(1), (2), (4). As the Supreme Court has recently emphasized, in reviewing a facial challenge to a local law, the "[l]egislation is measured for consistency with the Constitution by its impact on those whose conduct it affects. * * * The proper focus of the constitutional inquiry is the group for whom the law is a restriction, not the group for whom the law is irrelevant." (Internal citation omitted.) *City of Los Angeles v. Patel*, ___ U.S. ___, 135 S.Ct. 2443, 2451 (2015). In fact, the Commissioner recognized in assessing Mason on the basis of R.C. 5751.01(I)(3) that this section forms a separate and segregable basis, apart from the other sections of the CAT statute, to require a company such as Mason to pay the CAT. The other provisions of the CAT statute are not relevant to a constitutional challenge to Section (I)(3).

In sum, Mason is not required to make an additional showing to demonstrate that R.C. 5751.01(I)(3) is unconstitutional on its face, beyond what is required under the applicable standards of the Commerce Clause, to which we now turn.

D. The Commerce Clause Bars Ohio From Imposing The CAT On Companies Based Solely On The Amount Of Sales Made To Customers In The State.

The Commerce Clause delegates to Congress the power "[t]o regulate commerce * * * among the several States." U.S. Consitution, Article I, Section 8, cl. 3. The Commerce Clause has a corresponding "negative" or "dormant" aspect, which expressly restricts the authority of a state to impose undue burdens on interstate commerce. *Oregon Waste Sys., Inc. v. Dept. of Environmental Quality*, 511 U.S. 93, 98, 114 S.Ct. 1435, 128 L.Ed.2d 13 (1994).

Under contemporary dormant Commerce Clause analysis, a state tax on interstate commerce is invalid under the Constitution unless the tax satisfies each of the four prongs of *Complete Auto*, 430 U.S. at 279. Under that test, to survive a challenge, 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. *Id.; Hillenmeyer v. Cleveland Bd. of Review*, 2015-Ohio-1623, ¶ 11. 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. With regard to this prong, the Supreme Court has emphasized in reviewing a tax measured by gross receipts that "[u]nder this threshold test, the interstate business must have a substantial nexus with the State before *any* tax may be levied on it." (Emphasis sic.) *Commonwealth Edison*, 453 U.S. at 626 (citing *Natl. Bellas Hess, Inc. v. Illinois Dept. of Revenue*, 386 U.S. 753, 759, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967)).

Complete Auto has become the "leading case" regarding the constitutionality of all types of state taxes. *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30, 108 S.Ct. 1619, 100 L.Ed.2d 21 (1988) (noting application of *Complete Auto* to different types of state taxes). In *Complete Auto*, the Court surveyed its Commerce Clause jurisprudence and formulated this four-pronged test for determining the constitutionality of a state tax in light of principles central to the Commerce Clause. *See* 430 U.S. at 279-286. The Court cited, in particular, four of its decisions that formed the basis for its test. *Id.* at 279 and n. 8. *Complete Auto* itself was a tax on the privilege of doing business in Mississippi based on the taxpayer's gross receipts, and the four decisions highlighted by the Court involved a variety of state taxes, including a privilege tax measured by gross receipts (*General Motors*), an income tax (*Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed. 421 (1959)), a franchise tax (*Memphis Natural Gas Co. v. Stone*, 335 U.S. 80, 68 S.Ct. 1475, 92 L.Ed. 1832 (1948)), and a dividends tax (*Wisconsin v. J.C. Penney*, 311 U.S.435, 61 S.Ct. 1475, 92 L.Ed. 267 (1940)). In each of these cases, the taxpayer engaged in significant in-state activities that satisfied the "substantial nexus"

prong of the Court's four-part test. *See Gen. Motors*, 377 U.S. at 442-446 (corporation maintained a branch office and warehouses in the state, and had employees both based in, and who travelled to, the state to call on dealers and staff the warehouse); *Northwestern States*, 358 U.S. at 454-456 (taxpayers had in-state sales and support personnel who regularly solicited orders and communicated with customers in the state); *Memphis Natural Gas*, 335 U.S. at 81 (company had 135 miles of pipeline, two compressing stations, and employees in the state who maintained the pipeline); *Wisconsin v. J.C. Penney*, 311 U.S. at 250-251 (reversing *J.C. Penney Co. v. Wisconsin Tax Comm.*, 233 Wis. 286, 289 N.W. 677, 678, 682 (1940) (state court decision invalidating dividends tax despite presence of nearly 50 retail stores operated in the state by the company)).

The in-state activities requirement embodied in these cases has deep roots. In its gross receipts tax decisions, the Supreme Court has made clear for over 50 years that a state's power to impose such a tax on a non-domiciliary company depends upon whether the out-of-state company engages in activities within the state, either directly or through third-party representatives, that assist the company in making or maintaining a market in the state. An early illustration of the rule was the Court's decision in *General Motors*, which later formed part of the basis for the *Complete Auto* test. In analyzing the constitutionality of the Washington Business & Occupation Tax ("B&O tax") under the Commerce Clause, the Court explained that "[w]here, as in the instance case, the taxing State is not the domiciliary State, *we look to the taxpayer's business activities within the State*" to determine the constitutionality of this privilege tax measured by gross receipts. (Emphasis added.) 377 U.S. at 441.[5]

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[5] In fact, the significance of a company's in-state presence to the validity of a gross receipts tax had been emphasized by the Court even before it decided *General Motors*. *See Field Ents.*, 352 U.S. 806 (per curiam), *aff'ing Field Ents. v. Washington*, 47 Wash.2d at 856, 289 P.2d at 1012 (in-state office, division manager, three district managers, four office employees and 175

The *General Motors* Court reviewed in detail the facts regarding the company's in-state activities. *Id.* at 442-446. Although General Motors was incorporated outside of Washington and had its principal regional offices in Oregon, various divisions of General Motors each had 20 or more employees located in Washington who called-on and supported an in-state network of General Motors dealers. *Id.* at 443-445. The Court found that the in-state employees "performed substantial services in relation to General Motors' functions [in the state], particularly with relation to the establishment and maintenance of sales, upon which the tax was measured." *Id.* at 447. The Court concluded that "we cannot say that the Supreme Court of Washington erred in holding that *these local incidents were sufficient to form the basis* for the levy of a tax that would not run afoul of the Constitution." (Emphasis added.) *Id.* at 447-448.

A decade later, shortly before *Complete Auto* was decided, the Court relied on *General Motors* in again sustaining the Washington B&O tax against a challenge brought by an out-of-state company with an in-state presence. *Std. Pressed Steel*, 419 U.S. at 563. In *Standard Pressed Steel*, the appellant had no offices in Washington, but maintained a full-time employee working in the state whose primary responsibility was consulting with the company's principal in-state customer, Boeing. *Id*. at 561. The Court found that the employee "made possible the realization and continuance of valuable contractual relations between appellant and Boeing." *Id.* at 562. The Court thus sustained the tax against a Commerce Clause challenge, concluding that *General Motors* was "almost precisely on point" in that the taxpayer's in-state activities were a substantial factor in establishing and maintaining its market for sales in the state. *Id.* at 563.

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salespeople in the state were "decisive factors in establishing and holding the market in this state" for company's products)); *see also Norton Co. v. Dept. of Revenue*, 340 U.S. 534, 537, 71 S.Ct. 377, 95 L.Ed. 517 (1951) (state lacks authority to impose gross receipts tax on company with no "local incident" in the state).

After *Complete Auto*, the Court continued to stress the significance of a taxpayer's in-state presence to the validity of a gross receipts tax under the "substantial nexus" standard. In 1978, the Court reiterated *Complete Auto's* four-part test in connection with a challenge to the Washington B&O tax. *Dept. of Revenue v. Assn. of Washington Stevedoring Cos.*, 435 U.S. 734, 750, 98 S.Ct. 1388, 55 L.Ed.2d 682 (1978) (Commerce Clause challenge rejected because of the "obvious nexus between Washington and respondents; indeed, respondents conduct their entire stevedoring operations within the State.") Three years later, in Commonwealth Edison, the Court found that a severance tax on the gross receipts from coal removed from Montana was properly imposed on sales made in interstate commerce under the Complete Auto test. 453 U.S. at 629. The Court noted that *Complete Auto* requires that an "interstate business must have a substantial nexus with the State before *any* tax may be levied on it." (Internal citation omitted.) (Emphasis sic.) *Id*. at 626. The Court further commented that there was no dispute regarding a sufficient in-state presence in that case, since "a substantial, in fact, the only nexus of severance of coal is established in Montana." *Id.* at 617.

Against this back-drop, the Court issued its landmark decision in *Tyler Pipe* regarding taxes measured by gross receipts. The appellant, Tyler Pipe, was a Texas-based company with no office, property or employees in Washington. 483 U.S. at 249. Although Tyler Pipe itself had no direct presence in the taxing state, the company engaged an independent contractor in Washington whose salespeople "acted daily on behalf of Tyler Pipe in calling on its customers and soliciting orders" and thereby "maintain[ed] and improve[d] the name recognition, market share, goodwill, and individual customer relations of Tyler Pipe." (Internal citation omitted.) (Brackets added.) *Id.*

The Court rejected Tyler Pipe's argument that it lacked the necessary substantial nexus with the state. Relying on two of the Court's sales and use tax precedents, the Court ruled that

the in-state presence of the sales representatives was properly attributed to Tyler Pipe despite the fact that that they were independent contractors, rather than employees. *Id.* at 250 (citing *Scripto, Inc. v. Carson*, 362 U.S. 207, 209, 80 S.Ct. 691, 4 L.Ed.2d 660 (1960) (nexus based on ten commissioned sales agents conducting continuous solicitation in the state) and *Natl. Geographic Soc. v. California Bd. of Equalization*, 430 U.S. 551, 556-558, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977) (in-state sales office unrelated to taxable sales was sufficient for nexus)). Endorsing the decision of the Washington Supreme Court below, the Court stated 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.) *Id.*

Furthermore, *Tyler Pipe* made clear that mere sales to in-state customers resulting in gross receipts are not sufficient, in and of themselves, to satisfy the substantial nexus requirement of the Commerce Clause. The Court expressly found that the company sold a "large volume of cast iron, pressure and plastic pipe and fittings, and drainage products" in the state. 483 U.S. at 249. Even with evidence of such substantial sales to in-state customers, the Court focused on the company's in-state presence as the basis for the required "substantial nexus" with the state: "We agree that *the activities of Tyler's sales representatives* adequately support the State's jurisdiction to impose its wholesale tax on Tyler." (Emphasis added.) 483 U.S. at 251.

In nearly 30 years since *Tyler Pipe* was decided, the Supreme Court has never held that a different or lesser standard than the in-state presence requirement of *Tyler Pipe* and its forebears applies to state gross receipts taxes. Meanwhile, numerous state courts have relied on *Tyler Pipe's* in-state presence requirement as the touchstone of "substantial nexus" in a variety of contexts. *E.g.*, *Travelocity.com LP v. Wyoming Dept. of Revenue*, 2014 WY 43, ¶¶ 68–83, 329 P.3d 131, 148-150 (2014) (upholding sales tax assessment against online travel sites based on the

activities conducted on their behalf by hotels in the state); *Barnesandnoble.com LLC*, 2013 NMSC 023, ¶¶ 8-10, 303 P.3d at 827-828 (upholding assessment of New Mexico Gross Receipts Tax based on the activities of an affiliated company in the state); *Scholastic Book Clubs, Inc. v. Commr. of Revenue Servs.*, 304 Conn. 204, 230, 38 A.3d 1183, 1197-1198 (2012) (in-state school teachers who assisted students in ordering books established nexus sufficient for imposition of a use tax collection obligation on out-of-state book seller); *Lamtec Corp.*, 170 Wash.2d at 849-851, 246 P.3d at 974-995 (affirming gross receipts tax assessment against company whose sales representatives visited customers in the state) ; *Wabash Power Equip., Inc. v. Lindsey.*, 897 So.2d 621, 627 (La.Ct.App. 2004) (in-state presence of employees establishes nexus for purposes of use tax); *Arizona Dept. of Revenue v. O'Connor, Cavanaugh, Anderson, Killingsworth, & Beshears, P.A.*, 192 Ariz. 200, 206, 963 P.2d 279, 285 (Ct.App. 1997) (because the purchaser had nexus for purposes of a transaction privilege tax based on its activities in the state, the service provider was exempt from obligation to collect the Arizona use tax). In fact, in *J.C. Penney Natl. Bank*, 19 S.W.3d at 841-842, the Tennessee court rejected application of gross receipts tax to a company with no in-state presence. In short, there is no decision, by the Supreme Court or any other court, in which a state gross receipts tax assessment has been sustained against a company that, like Mason, engaged in no activities in a state, either directly or through a third-party.[6] *Tyler Pipe's* in-state presence standard remains the law of the land.

[6] The in-state activities requirement for state taxes measure by gross receipts is so well-established that the Board could have applied it below. *See Marysville Exempted Village School Dist. Bd. of Edn. v. Union Cty. Bd. of Revision*, 136 Ohio St.3d 146, 2013-Ohio-3077, 991 N.E.2d 1134, ¶ 15 (the limitations on Board's jurisdiction over constitutional questions do not preclude it from giving effect to binding precedent); Appx. 25, Notice of Appeal at 6 (Error 1).

E. The In-State Presence Requirement Of Substantial Nexus Is Supported By The Supreme Court's Decisions Concerning Sales And Use Taxes.

The in-state presence requirement applied by the Court in its gross receipts tax precedents is reinforced by the Court's decisions regarding the limitations on state authority to require the collection of state sales and use taxes. Indeed, the in-state (or physical) presence requirement draws support from a series of intertwining Commerce Clause precedents concerning both taxes measured by gross receipts and sales taxes.

In *Bellas Hess, supra*, decided in 1967, the Supreme Court held that the State of Illinois lacked the power to impose a sales/use tax collection obligation on a company located outside the state whose only connection to the taxing state was communicating with customers in the state via the instrumentalities of interstate commerce (*e.g.*, United States mail, common carrier, and, today, the Internet). *See Bellas Hess*, 386 U.S. at 758–760. The company 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 754–755. 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. While the Court primarily focused on its use tax precedents, including *Scripto* (which was cited with approval in *Tyler Pipe*), as support for its ruling, the Court cited a number of other cases concerning the limitations on state taxing power, including *Central Greyhound Lines*, *Inc. v. Mealy*, 334 U.S. 653, 663, 68 S.Ct. 1260, 92 L.Ed. 1633 (1948), in which the Court held that a tax on gross receipts was unconstitutional. *See Bellas Hess*, 386 U.S. at 756-758.

The Supreme Court continued to develop and enforce the in-state presence standard of substantial nexus over the next twenty-five years. As noted above, in *Complete Auto*, the Court cited as support for its four-prong test a series of prior decisions, starting with *General Motors*—a gross receipts tax case. *Complete Auto*, 430 U.S. at 279 n.8. During the same term, the Court likewise relied upon a gross receipts tax decision, this time *Standard Pressed Steel*, along with the use tax precedent of *Bellas Hess*, in finding that a company with an in-state presence could be subjected to an obligation to collect sales/use tax on sales that were unrelated to its in-state activity. *Natl. Geographic*, 430 U.S. at 557-558. Four years later, in *Commonwealth Edison*, the Court again cited *Bellas Hess* for the proposition that an "interstate business must have a substantial nexus with the State before *any* tax may be levied on it." (Emphasis sic.) *Commonwealth Edison*, 453 U.S. at 626.

When the Court next addressed a constitutional challenge to a state tax measured by gross receipts in *Tyler Pipe*, the Court again cited two leading sales tax precedents, *Scripto* and *National Geographic*, in support of its conclusion that that "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are associated with the taxpayer's ability to make and maintain a market in this state for the sales." 483 U.S. at 250. The language used by the Court in *Tyler Pipe* to describe the nexus requirement ("activities performed in [the taxing] state"), and the Court's underlying reliance upon sales and use tax decisions requiring a physical presence in the state, conclusively demonstrate that a parallel in-state presence requirement applies to both gross receipts taxes and sales and use taxes. *See also Goldberg v. Sweet*, 488 U.S. 252, 263, 109 S.Ct. 582, 102 L.Ed.2d 607 (1989) (reviewing the constitutionality of an excise tax on the gross receipts from an interstate telephone call, and noting that "[w]e also doubt that termination of an interstate telephone call, by itself, provides a

substantial enough nexus for a State to tax a call. *See Natl. Bellas Hess, Inc. v. Dept. of Revenue of Illinois,* 386 U.S 753 (1967) (receipt of mail provides insufficient nexus.)").

Finally, in 1992, the Supreme Court reaffirmed the physical presence requirement of *Bellas Hess* and again held that, under the Commerce Clause, a retailer with no physical presence in the state cannot be obligated to collect a state's use tax. *Quill,* 504 U.S. at 313–319. Like 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 314–315. Moreover, in upholding the physical presence requirement for sales and use taxes, the Supreme Court in *Quill* cited and relied upon four of its earlier decisions involving state taxes measured by gross receipts: *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). The Court further 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 315–316.

Quill, like *Tyler Pipe*, has never been called into question by any decision of the Supreme Court. To the contrary, the Court has continued to cite *Quill* favorably with regard to the limitations on state taxing authority under the Commerce Clause. For example, in *Hemi Group,*

LLC v. City of New York, the Court rejected an effort by the City to find a creative way to "end-run its lack of authority" under *Quill*. *Id.* 559 U.S. 1, 17, 18, 130 S.Ct. 983, 175 L.Ed.2d 943 (2010) (Roberts, J., majority; Ginsburg, J. concurring). In its most recent term, the Court cited *Quill* multiple times in reviewing the constitutionality of Maryland's individual income tax, including for the proposition that the Commerce Clause places limits on the authority of a state to regulate interstate commerce, even where the requirements of the Due Process Clause are satisfied. *Comptroller of the Treasury of Maryland v. Wynne*, ___ U.S. ___, 135 S.Ct. 1787, 1798-1799, 1808, 1809, 191 L.Ed.2d 813 (2015).[7] The gross receipts, "bright-line presence" provision of the CAT statute clearly oversteps those fundamental limitations, by imposing CAT liability on an out-of-state company based solely on its gross receipts from the sale of products delivered to Ohio customers via common carrier.

F. State Court Decisions Declining To Apply The Physical Presence Standard To State Income Taxes Are Inapposite.

Several state courts have held that the *Quill* physical presence requirement does not apply to state taxes based on income. *See, e.g., KFC Corp. v. Iowa Dep.t of Revenue*, 792 N.W.2d 308, 321-328 (Iowa 2010); *Capital Bank One v. Commr. of Revenue,* 453 Mass. 1, 13, 899 N.E.2d 76 (2009); *Geoffrey, Inc. v. South Carolina Tax Comm.,* 313 S.C. 15, 23, 437 S.E.2d 13 (1993). None of these cases concern taxes measured by gross receipts or purport to show that the in-state activities standard of *Tyler Pipe* has been somehow overruled or abrogated by the Supreme Court

[7] Mason anticipates that the Commissioner will rely heavily on the concurring opinion filed by Justice Kennedy in *Direct Marketing Assn. v. Brohl*, ___ U.S. ___, 135 S.Ct 1124, 191 L.Ed.2d 97 (2015), in which he suggested that the holding of *Quill* should be reexamined. *Id.* at 1135. No other member of the Court joined Justice Kennedy's concurrence, and a few weeks later the Court issued its decision in *Wynne*, citing *Quill* favorably. *Id.* at 1798-1799, 1808, 1809. For the reasons discussed in Sections H and I, below, the physical presence standard of *Quill* and the requirement for gross receipts-measured taxes of in-state activities performed on behalf of the taxpayer that assist in the establishment and maintenance of a market in the state each embody the most basic principles of the Commerce Clause and retain their vitality in the Internet era.

sub silentio. Instead, the cases are based on the premise that the Supreme Court's decision in *Quill* demonstrates that it would not "extend" the *Quill* physical presence standard to state income taxes. *E.g., KFC Corp.*, 792 N.W.2d at 325; *Capital Bank One*, 453 Mass. at 13; *Geoffrey*, 313 S.C. at 23 n.4, 437 S.E.2d at 18 n.4.

While state court cases addressing whether a taxpayer must have a physical presence for purposes of a state tax based on income are not, for a variety of reasons, directly relevant to the question of whether the CAT is unconstitutional under the in-state activities requirement of *Tyler Pipe*, it is noteworthy that the underlying rationale of such decisions simply does not apply in the context of a gross receipts tax. The basis for the refusal by some state courts to "extend" the physical presence test to income taxes is the result of ambiguous language in *Quill* concerning "other types" of state taxes. 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.

(Emphasis added.) 504 U.S. at 314. A proper understanding of this statement, however, requires consideration of the remainder of the paragraph in which this language appeared.

Earlier in the same paragraph in *Quill*, the Supreme Court referred to "these cases" (by which the Court was referencing *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-measured taxes in describing the two leading, gross receipts tax nexus cases as reflecting companies with an in-state presence. Indeed, the Court cited with approval *Tyler Pipe* for the proposition that a state tax may pass muster under the Due Process Clause, but run afoul of the Commerce Clause. *Id*. at 313 n.7. And by citing gross receipts tax cases with approval elsewhere in its opinion as supporting the "substantial nexus" standard for use taxes articulated in *Bellas Hess*, the Court reaffirmed the parallel in-state

presence test in the gross receipts tax area. *See Quill*, 504 U.S. at 311 (identifying *Goldberg* (which post-dates *Tyler Pipe)* and *Commonwealth Edison* (which post-dates *Standard Pressed Steel*) as continuing the *Bellas Hess* line of cases).

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 test under the first-prong of *Complete Auto* 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 were "significantly associated with the taxpayer's ability to establish and maintain a market" in the state. (Emphasis added.) 483 U.S. at 250.

A second passage in *Quill* referencing "other types of taxes" also does nothing to diminish the applicability of the in-state 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. (Emphasis added.)

504 U.S. at 317. Nothing in this passage supports, or even hints at, abrogation of the *Tyler Pipe* in-state activities requirement, particularly given the citations to *Tyler Pipe* and the Court's other gross receipts tax decisions earlier in the opinion as requiring physical presence. Instead, the passage supports the conclusion that the Court has adopted a different formulation of the in-state presence requirement for gross receipts tax. In *Tyler Pipe*, the Court stated that the necessary in-state activities had to be "significantly associated with the taxpayer's ability to establish and maintain a market in this state for sales." 483 U.S. at 250. Thus, for purposes of gross receipts tax, rather than a "bright line" based on physical presence alone, the activities performed in the state must bear some relation to the taxpayer's ability to exploit the in-state market.

In short, whatever significance state courts have attached to the language of *Quill* with regard to state income taxes, there is no way to read *Quill* as overruling *Tyler Pipe*. Nor has any decision by any court upheld the imposition of a gross receipts tax against a company that lacked an in-state presence. *See J.C. Penney Natl. Bank*, 19 S.W.3d at 841-842 (overturning an assessment of a gross receipts tax and noting that "the Commissioner has pointed to no case in which the Supreme Court of the United States has upheld a state tax where the out-of-state taxpayer had absolutely no physical presence in the taxing state"); *see also O'Connor, Cavanaugh, Anderson, Killingsworth, & Beshears,* 192 Ariz. at 206, 963 P.2d at 285 (noting the assertion by the state Department of Revenue that "it has found not a single case in which a court has sustained a gross receipts tax on an out-of-state taxpayer" in the absence of a direct physical presence in the state through resident employees or facilities, but finding the necessary in-state presence in that case based on temporary visits to the state by employees to install products sold); *Short Bros., Inc. v. Arlington Cty.*, 244 Va. 520, 525–526, 423 S.E.2d 172, 175-176 (1992) (*Quill* physical presence requirement is necessary to find nexus for apportionment purposes under the business license tax, which is based on gross receipts of the taxpayer).

G. No Ohio Decision Has Ever Approved Imposing A State Tax On A Person That Lacked A Physical Presence In The State.

Notably, this Court has never issued a decision upholding a state tax against an out-of-state taxpayer that lacked a significant in-state presence. The Court's leading decision regarding the "substantial nexus" requirement of the Commerce Clause for purposes of use tax collection is *SFA Folio.* In that case, the out-of-state retailer, SFA Folio, had an in-state affiliate, Saks-Ohio, that engaged in certain activities in the state on Folio's behalf, including "accepting Folio's returns and distributing Folio's catalogs" in the state. *SFA Folio,* 73 Ohio St.3d at 123, 652 N.E.2d at 697. The Court held that such in-state activities were insufficient to constitute

substantial nexus, because they were a "minimal" part of SFA Folio's business. *Id.* No case decided after *SFA Folio* has called into question the requirement that a taxpayer must engage in sufficient in-state activities to be subject to tax.

This Court's decision in *Couchot v. State Lottery Comm.,* 74 Ohio St.3d 417, 659 N.E.2d 1225 (1996), concerning Ohio *income taxes*, is not to the contrary. The taxpayer in *Couchot*, a resident of Kentucky, travelled to Ohio to purchase an Ohio lottery ticket and, after his numbers were selected in the drawing, returned to the state to claim a cash price of over $20 million. 74 Ohio St.3d at 418. The Court expressly found that the taxpayer's trips into Ohio were sufficient to satisfy the physical presence standard of the Commerce Clause. *Id.* at 425.[8]

H. A Finding That Gross Receipts Alone Are Sufficient To Support Ohio's Authority To Tax Would Result In Nationwide Nexus For Any Internet Seller And Is Inconsistent With The Separate Nexus Standards Under The Commerce Clause And The Due Process Clause.

The substantial nexus requirement is designed to "limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce." *Quill*, 504 U.S. at 313 and n.6. A standard of substantial nexus that depends *solely* on receiving gross receipts from products that are delivered to customers in the State would remove all limitations on state taxing authority over companies doing business in interstate commerce. If gross receipts—the very objective of interstate commerce—by themselves serve as the basis for a state's power to tax (or regulate) persons engaged in such commerce, then the Commerce Clause is no restriction on state authority at all.

Moreover, it is no answer that R.C. 5751.01(I)(3) sets a threshold of $500,000 in annual gross receipts as the basis for "bright-line presence" in Ohio under the CAT statute. The

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[8] The Court in *dicta* stated that the physical presence rule of *Quill* does not extend to a state income tax. *Id.* As discussed in Section F, that statement has no application here, and this Court has never again cited *Couchot* in addressing a challenge under the Commerce Clause.

minimum level of required gross receipts set by the statute is simply a matter of state legislative choice. The General Assembly might reduce the level of required receipts at any time if it concludes, for example, that state budget difficulties require an extension of CAT liability to ever smaller companies. There is, moreover, nothing to prevent another state or locality that chooses to follow Ohio's lead from selecting a lower threshold for purported "presence" in the state. The amount of sales chosen by the State itself cannot validate the nexus standard as a matter of constitutional requirements. A decision upholding a standard of "substantial nexus" based on gross receipts would, therefore, be fundamentally at odds with the principles of the dormant Commerce Clause.

Further, the gross receipts nexus standard of the CAT statute would obliterate the established distinction between a State's jurisdiction to tax under the Due Process Clause, and the limitations on a state's power over interstate commerce under the Commerce Clause. In *Quill*, the Court expressly found that "while a state may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause." 504 U.S. at 305. In *Wynne* the Court recently quoted with approval the above passage from *Quill* (135 S.Ct. at 1788) and reaffirmed the *Quill* principle that the Commerce Clause sets a higher standard than does the Due Process Clause for state authority to tax interstate commerce. *See* 135 S.Ct. at 1789 ("the fact that a State has the jurisdictional power to impose a tax says nothing about whether that tax violates the Commerce Clause").[9] In this case, the CAT statute's gross receipts nexus standard requires only that an out-of-state company have customers in the state, a standard akin to the "minimum contacts" analysis applicable to the Due Process Clause. *See Quill*, 504 U.S. at 306-308 (solicitation of sales from outside the state

[9] Five justices joined in the majority opinion. In addition, the dissenting opinion of three Justices—Ginsburg, Scalia and Kagan—cited *Quill* with approval for the proposition that the Commerce Clause sets a higher standard than does the Due Process Clause. 135 S.Ct. at 1818.

may be adequate to satisfy the Due Process standard). The Court, however, has expressly rejected such a formulation of an "economic presence" standard as sufficient to meet the requirements of the Commerce Clause. *Id.* at 304, 311-312 (describing the lower court's conclusion that Quill's "economic presence" was sufficient to require use tax collection, and rejecting the lower court's analysis regarding the Commerce Clause). The CAT's expansive "gross receipts" nexus standard likewise fails to survive scrutiny under the Commerce Clause.

I. Fundamental Principles Regarding The Regulation Of Interstate Commerce Require Rejection Of The CAT Statute's Novel Gross Receipts Standard Of Nexus.

1. The In-State Presence Standard Of Substantial Nexus Is Grounded In The Core Principles Of The Commerce Clause.

In *Quill*, the Supreme Court explained, at length, how the physical presence rule of *Bellas Hess* is consistent with, and grounded in, the principles that underlie the "substantial nexus" requirement of the Commerce Clause. 504 U.S. at 311-314 (physical presence standard "furthers the ends of the dormant Commerce Clause."). In particular, the in-state presence requirement of substantial nexus serves as "a means for limiting state burdens on interstate commerce." *Id.* at 313. The substantial nexus test thus derives from the core objectives of the dormant Commerce Clause and is informed "by structural concerns about the effects of state regulation on the national economy," rather than concerns about fairness to any individual company. *Id.* at 312.

As the Court recognized in *Quill*, the danger of inconsistent state laws across numerous state and local taxing jurisdictions in the United States justifies the in-state presence standard of nexus reaffirmed by the Court time and again. *Id.* at 313 n.6. While state and local gross receipts taxes are less common than sales and use taxes, the expansive gross receipts "bright-line presence" standard of the CAT statute could readily be adopted in states and localities throughout the country. Indeed, in the 2015 state legislative season, at least three states adopted

or expanded a tax reporting requirement based on gross receipts. *See* Nevada S.B. 483 (enacted June 9, 2015), available at http://leg.state.nv.us/Session/78th2015/Bills/SB/SB483_EN.pdf (adopting the new "Commerce Tax" on gross revenue from engaging in business in the state); Tennessee H.B. 644 (2015), codified at Tenn. Code. Ann. § 67-4-702(27)(A)(iv)(a) ("substantial nexus in the state" includes having gross receipts in excess of $500,000 for purposes of the "Business Tax Act"); and Washington Subst. S.B. 6138 (enacted July 2, 2015), available at http://lawfilesext.leg.wa.gov/biennium/2015-16/Pdf/Bills/Session%20Laws/Senate/6138-S.SL.pdf (amending R.C.W. 82.04.066 to apply "gross receipts" nexus provision to wholesale sales for purposes of the B&O tax). Texas also has a form of gross receipts tax that is measured by a company's total revenues adjusted for certain factors. Tex. Tax Code § 171.101. Although Texas has not yet adopted a "gross receipts" nexus standard, a number of other states use a gross receipts threshold for reporting of the state's corporate income-based tax. *E.g.*, Cal. Rev. & Tax. Code § 23101(b)(2); 1 Colo. Code Regs. 201-2:39-22-301.1(2)(b)(iii); Michigan (Mich. Comp. Laws § 206.621(1); N.Y. Tax Law § 209(1)(b).

In addition, there are numerous local jurisdictions throughout the United States, including many major municipalities, with gross receipts taxes that could soon follow suit and seek to compel tax reporting by businesses with no connection other than customers residing in the city. *See, e.g.*, San Francisco Business and Tax Regulations Code, § 953 (2014) (San Francisco Gross Receipts Tax) ("every person engaging in business within the City shall pay an annual gross receipts tax measured by the person's gross receipts from all taxable business activities attributable to the City"); Los Angeles Municipal Code, § 21.43(e) (Los Angeles Business Tax) (gross receipts tax on retail sales); City of Philadelphia Business Privilege Tax Regulations, § 103(A) (2015) ("A taxpayer is subject to the Gross Receipts portion of the BPT when it has sufficient contact with the City to be taxed without violating the United States Constitution.").

Thus, the very same "structural concerns" that support the in-state activity or presence requirement of *Quill* and *Tyler Pipe* apply with equal force to the gross receipts nexus provision of the CAT statute, R.C. 5751.01(I)(3). Indeed, if Ohio is free to impose tax obligations on remote sellers based on nothing more than making sales to customers in the state, then "so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation" with power to impose such taxes, resulting in precisely the kinds of "local entanglements" and burdens on interstate commerce that the Commerce Clause is designed to prevent. *Bellas Hess*, 386 U.S. at 759-760.

2. Changes In Standards For Requiring Tax Reporting By Remote Sellers Are Properly The Purview Of Congress, Not State Legislatures.

The need to safeguard the national economic interests secured by the Commerce Clause and inherent to remote sales transactions has only increased in the years since *Tyler Pipe* and *Quill* were decided, with the growth of electronic commerce conducted over the Internet. The physical presence requirement adopted in *Bellas Hess* and reaffirmed in *Quill* was based in part on the Supreme Court's conclusion that "it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved." *See Natl. Bellas Hess*, 386 U.S. at 759. Today, the majority of remote sales are conducted online, an even more intensely interstate environment.

The goal of a single national marketplace is precisely why the framers reserved for Congress the power to regulate commerce "among the several States." *See Wynne,* 135 S.Ct. at 1794 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 325-326, 99 S.Ct. 1727, 60 L.Ed.2d 250 (1979) (the underlying concern for adoption of the Commerce Clause was the "immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations

among the Colonies and later among the States under the Articles of Confederation.”)). As *Quill* makes clear, Congress, rather than individual states or the courts, including the U.S. Supreme Court, is “better qualified to resolve” the underlying tension between the state interest in levying taxes on remote sellers and the potential burdens imposed by such tax obligations on interstate commerce. 504 U.S. at 316. In fact, there is a bill currently before Congress that would strike such a balance, including the adoption of a nexus standard with respect to state business activity taxes imposed on out-of-state companies. *See* H.R. 2584, Business Activity Tax Simplification Act of 2015, 114th Cong. (2015-2016), available at https://www.congress.gov/bill/114th-congress/house-bill/2584/text. The bill was reported out favorably by the House Judiciary Committee to the full House of Representatives on June 17, 2015. *See* https://www.congress.gov/bill/114th-congress/house-bill/2584/all-actions. Since Congress is considering the issue, “it may be that ‘the better part of both wisdom and valor is to respect the judgment of [Congress]” with regard to state taxation of interstate commerce generally, and remote sellers in particular. (Internal citation omitted.) *Quill,* at 318-319.

3. The Doctrine Of *Stare Decisis* Supports The Conclusion That The Gross Receipts Nexus Provision Of R.C. 5751.01(I)(3) Is Unconstitutional.

In the area of interstate commerce, the “settled expectations” of businesses regarding their state tax obligations is a significant factor with regard to applying the principles of the Commerce Clause. *Quill*, 504 U.S. at 316. Like the physical presence standard of *Quill,* the in-state activities rule of *Tyler Pipe* “has engendered substantial reliance and has become part of the basic framework of a sizable industry.” *See id.* In that regard, the “interest in stability and orderly development of the law that undergirds the doctrine of *stare decisis”* strongly supports continued adherence to the *Tyler Pipe* rule. (Internal citation omitted.) *Id.* Indeed, even critics of dormant Commerce Clause jurisprudence in general, such as Justice Scalia, support reliance

on *stare decisis* with regard to prior decisions applying the doctrine. *See, e.g., Wynne*, 135 S.Ct. at 1811 (Scalia, J., dissenting) (stating that *stare decisis* properly applies where a challenged tax is not distinguishable from a tax the Court has already held unconstitutional). Companies engaged in the interstate sale of goods, such as Mason, have been (and remain) justified, for purposes of planning and conducting their commercial activities, in relying upon *Tyler Pipe* and its predecessor decisions as establishing the limits of the states' power to tax gross receipts. *See id.* 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).

> **Proposition of Law 2**: The CAT statute is unconstitutional as-applied to Mason by the Commissioner. Imposition of the CAT against Mason, a company with no in-state presence in Ohio, violates the "substantial nexus" standard of the Commerce Clause as established under numerous decisions of the United States Supreme Court. *E.g., Tyler Pipe*, 483 U.S. at 250-251; *Commonwealth Edison*, 453 U.S. at 626; *Std. Pressed Steel*, 419 U.S. at 562; *Gen. Motors*, 377 U.S. at 447-448. Merely obtaining gross receipts in excess of $500,000 annually does not establish constitutional "substantial nexus" under long-standing Supreme Court authority, so applying the CAT based solely on Mason's gross receipts from sales of goods delivered to Ohio customers violates the Constitution. In addition, because Mason engaged in no business activities within the State of Ohio sufficient to satisfy the constitutional "substantial nexus" standard, application of the CAT to Mason on any other basis, whether separate from or together with its gross receipts, is also unconstitutional.

A. Mason Satisfies The Clear And Convincing Standard For An As-Applied Challenge.

Mason has consistently asserted that the CAT statute, as applied to Mason, is unconstitutional because Mason lacks the necessary in-state activities required under the Commerce Clause. Appx. 2-3, 9-10, Notice of Appeal at 2-3, 9-10.

A party challenging a statute as applied to it alleges that "the application of the statute in the particular context in which he has acted, or in which he proposes to act, would be unconstitutional." (Internal quotation and citation omitted.) *Wymsylo v. Bartec, Inc.*, 132 Ohio

St.3d 167, 2012-Ohio-2187, 970 N.E.2d 898, ¶ 22. The party making the as-applied challenge bears the burden of presenting clear and convincing evidence of a set of facts that makes the statute unconstitutional when applied to those facts. *Harrold v. Collier*, 107 Ohio St.3d 44, 2005-Ohio-5334, 836 N.E.2d 1165, ¶ 38. The evidence presented before the Board establishes that application of the CAT to Mason is unconstitutional. Mason had no facilities, property, employees, or representatives in Ohio, and no activities were performed by Mason, or on its behalf, in Ohio, let alone activities associated with making or maintaining a market in the state.

Before the Board, the Commissioner argued that Mason's Internet marketing activities were sufficient to satisfy the Commerce Clause substantial nexus requirement. Such an argument is not only at odds with the in-state activities requirement of substantial nexus under *Tyler Pipe* and numerous other cases, but also lacks support in the record. All of Mason's online marketing, whether by Mason itself or by third-party vendors providing services for Mason, was performed at locations outside of Ohio. Furthermore, the Supreme Court has long rejected the notion that state tax obligations can arise based on mere advertising delivered to recipients in a state. *See Natl. Bellas Hess*, 386 U.S. at 758 and n.11 (explaining that state tax administrators "have generally considered an advertising nexus insufficient" to require a seller to "participate in the tax collection system," and citing *State v. Lane Bryant, Inc.*, 277 Ala. 385, 171 So.2d 91 (1965)).

In addition, any argument by the Commissioner that Mason had the "functional equivalent" of in-state presence through its marketing activities is without any support in any reported decision by any Court, let alone the United State Supreme Court. Any suggestion that Mason has a constitutionally sufficient presence as a result of electronic downloads performed by Internet users through their computers or mobile devices is equally without factual basis or supporting precedent. Indeed, the Commissioner's theory that using the Internet is a "virtual presence" misses the point. The Commerce Clause test looks not at the objective or effect of

making sales, but to the nature and location of the activities that led to the sale. Upholding the Commissioner's unprecedented theory would create substantial nexus in every state where a consumer chooses to pick up a telephone to call Mason to place an order or to use his or her computer to access a remote website. In both cases, Mason does not own, control, or select the device chosen by the consumer to initiate communication with the company, *e.g.,* a laptop computer or a telephone, and the consumer is free to use the technology of his or her choice to access a call center or website. In both instances, Mason does nothing more than receive and respond to interstate communication with a prospective customer.

> **Proposition of Law 3**: The assessments against Mason are invalid under the CAT statute, when its terms are properly construed to avoid constitutional infirmities. Multiple provisions of the CAT statute may be reasonably construed so as to prevent the application of the CAT to Mason, an out-of-state retailer with no physical presence in Ohio, including R.C. 5751.02(A), R.C. 5751.01(H)(3) and (I)(3), and R.C. 5751.01(F)(2)(jj).

A. Mason Is Not "Doing Business In This State" Within The Meaning Of R.C. 5751.02(A) And 5751.01(H).

The CAT is a tax levied against companies that are "doing business in this state." R.C. 5751.02(A) provides, in pertinent part:

> For the purpose of funding the needs of this state and its local governments, 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* * * *. (Emphasis added.)

Under this provision, therefore, the CAT is imposed on any person that is "engaging in any activity in this state." *Id.* Mason is not engaged in any activity in Ohio. This interpretation of R.C. 5751.02(A) is consistent with the constitutional principle, as discussed in support of Proposition of Law 1, that a company is not subject to a state tax measured by gross receipts unless the company, or third-party representatives acting on its behalf, is performing activities in the state that assist the company to make and maintain a market for sales in the state. *Tyler Pipe*,

483 U.S. at 250. As the Court explained in *General Motors*, "[w]here, as in the instance case, the taxing State is not the domiciliary State, we look to the taxpayer's business activities within the State" to determine the constitutionality of a gross receipts tax. 377 U.S. at 441.

The Commissioner interprets the remaining language of R.C. 5751.02(A)—which provides that "[p]ersons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state"—as superseding the fundamental requirement of "engaging in any activity" in the state, quoted above. According to the Commissioner, through the interplay of R.C. 5751.01(H)(3) (defining substantial nexus to mean "a bright line presence in this state") and 5751.01(I)(3) (defining bright line presence in this state to include taxable gross receipts of at least $500,000 per year), Mason has substantial nexus under R.C. 5751.02(A) because its sales to Ohio customers exceed $500,000 even if it engages in no activity in the state. The Commissioner's interpretation would read out of the statute the primary, in-state activities requirement of R.C. 5751.02(A), and must yield to a better reading that is consistent with the language of the CAT statute as a whole.[10]

B. The CAT Statute Itself Excludes Gross Receipts That Cannot Be Taxed Consistent With The Constitutional Limitations On The State's Authority.

In fact, the CAT statute itself includes an exclusionary provision that may also reasonably be construed to avoid serious constitutional infirmities under the "substantial nexus" requirement of the Commerce Clause. Under R.C. 5751.01(F)(2)(jj), excluded from the definition of "gross receipts" are "any receipts for which the tax imposed by this chapter is prohibited by the constitution or laws of the United States * * *." The only reasonable interpretation of the exclusion is that the General Assembly wished to avoid conflict with all limitations on the

[10] Moreover, any ambiguity in the statute must be interpreted in favor of the taxpayer, Mason. *E.g., Gulf Oil Corp. v. Kosydar*, 44 Ohio St.2d 208, 218, 339 N.E.2d 820, 825-826 (1975) (franchise tax on the privilege of doing business in the state construed in favor of the taxpayer).

State's authority to impose a tax measured by gross receipts, including restrictions arising under the substantial nexus requirement of the dormant Commerce Clause. *See* R.C. 1.47(a); *SFA Folio*, 73 Ohio St.3d at 122, 652 N.E.2d at 696 (interpreting statute that imposed tax "in accordance with the Constitution of the United States" to conform to Commerce Clause requirements); *Buchman*, 73 Ohio St.3d at 269. The exclusion of R.C. 5751.01(F)(2)(jj) thereby permits an interpretation that preserves the statute by limiting its reach in accordance with the dictates of the Commerce Clause.

> **Proposition of Law 4**: No other provision of the CAT statute applies to Mason. The evidence presented before the Board clearly established that Mason lacked statutory "substantial nexus with this state" under the other provisions of R.C. 5751.01(H) and lacked "bright-line presence" in Ohio under the other provisions of R.C. 5751.01(I).

A. No Other Provisions Of The CAT Statute Required Mason To Pay The CAT.

In issuing and affirming the CAT assessments against Mason, the Commissioner relied strictly on Mason's annual gross receipts from sales to Ohio customers in excess of $500,000. Appx. 44, 46, 57, 59, Final Determination at 1, 3. While Mason has demonstrated the numerous and fundamental errors with the Commissioner's reliance on the gross receipts "bright-line presence" provision, the evidence presented to the Board also proved that Mason is also not subject to the CAT under any other provision of the statute.

Mason did not own or use "part or all of its capital in this state" and did not "otherwise [have] nexus in this state * * * under the Constitution of the United States." R.C. 5751.01(H)(1), (4). Mason likewise had no "certificate of compliance with the laws of this state authorizing [it] to do business in this state." R.C. 5751.01(H)(2). Nor did Mason have in Ohio, at any time, property with a value of at least $50,000, payroll of at least $50,000, or twenty-five percent (25%) of its total property, total payroll or total receipts. R.C. 5751.01(H)(3), (I)(1), (2), (4).

Nor did Mason ever have domicile in Ohio for any purpose. R.C. 5751.01(I)(5). In sum, Mason is not subject to the CAT.

B. Any Claim By The Commissioner That Mason Is Subject To The CAT Under The Constitutional Catch-All Provision Of R.C. 5751.01(H)(4) Is Clearly Refuted By The Evidence.

No activities were performed in Ohio on behalf of Mason that are significantly associated with Mason's ability to establish and maintain a market in Ohio. As discussed under Proposition of Laws 1 and 2, Mason therefore does not otherwise have nexus under the Commerce Clause of the U.S. Constitution. Therefore, the catch-all provision of R.C. 5751.01(H)(4) does not apply.

CONCLUSION

For the foregoing reasons, Mason respectfully requests that the Court reject the Commissioner's imposition of the CAT against Mason, reverse the decision of the Board of Tax Appeals that affirmed the Commissioner's assessments of CAT against Mason, and order that the CAT assessments against Mason be eliminated in their entirety.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that a true copy of the foregoing Appellant Mason, Inc.'s Merit Brief was served by U.S. and electronic mail to counsel of record for Appellee Tax Commissioner, Daniel W. Fausey and Christine T. Mesirow, Assistant Attorneys General, State of Ohio, 30 East Broad Street, 25th Floor, Columbus, Ohio 43215–3428, on this 31st day of August, 2015.

/s Edward J. Bernert
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NOTICE OF APPEAL FROM THE OHIO BOARD OF TAX APPEALS

In the Supreme Court of Ohio

Mason Companies, Inc.,	:	Case No. 15-0794
Appellant,	:	
v.	:	Appeal from the Ohio Board of Tax Appeals
Joseph W. Testa, Tax Commissioner of Ohio,	:	
Appellee.	:	BTA Case Nos. 2012-1169, 2012-2806

NOTICE OF APPEAL OF APPELLANT MASON COMPANIES, INC.

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BOARD OF TAX APPEALS

NOTICE OF APPEAL OF APPELLANT MASON COMPANIES, INC.

Appellant Mason Companies, Inc. ("Mason") hereby gives notice of its appeal as of right, pursuant to R.C. 5717.04, to the Supreme Court of Ohio, from the Decision and Order ("Decision") of the Board of Tax Appeals ("Board") entered on April 20, 2015, in *Mason Companies, Inc. v. Joseph W. Testa, Tax Commissioner of Ohio*, being Board Case Nos. 2012-1169 and 2012-2806. A true copy of the Decision being appealed is attached hereto and incorporated by reference herein.

INTRODUCTION

In this case, the Tax Commissioner of Ohio (the "Commissioner") assessed Appellant, Mason, the state's commercial activity tax (the "CAT"), even though neither Mason, nor any other person acting on its behalf, conducted any activities in Ohio during the relevant period. As the Board explained it in its decision, the Commissioner imposed the CAT strictly because "the [C]ommissioner determined that Mason has [statutory] substantial nexus with this state, i.e., a "bright line presence" in the state because it has at least $500,000 [per year] in taxable gross receipts for the periods assessed. R.C. 5751.01(H)(3); R.C. 5751.01(I)(3); R.C. 5751.033(E) (as such section were numbered in July 2005)." [Decision at 4 (brackets added)]. The Board concluded that, with the statutory sales threshold met and nothing more, imposition of the CAT was obligatory. [Decision at 4 ("[W]e are constrained to follow the mandate of the General Assembly in concluding that appellant, an out-of-state seller, has [statutory] substantial nexus within this state by virtue of its gross receipts for the reporting periods in question") (second bracketed term added)].

In proceedings below, Mason did not dispute, nor does it dispute here, that its gross receipts from interstate sales to Ohio consumers exceeded the statutory threshold of $500,000

annually. Mason's challenge—as asserted in its petition for reassessment before the Commissioner, in its appeal to the Board, and now—is based upon the Commerce Clause of the United States Constitution.

Mason has consistently asserted that, as applied to Mason, the CAT statute violates Commerce Clause principles, because Mason lacks "substantial nexus" with Ohio under the standards established by the Supreme Court in cases involving gross receipts taxes like the CAT, including, but not limited to, *Standard Pressed Steel, Inc. v. Wash. Dep't of Revenue*, 419 U.S. 560 (1975), and *Tyler Pipe Indus., Inc. v. Wash. Dep't of Revenue*, 483 U.S. 232 (1987). This "as applied" challenge was properly raised below. [*See, e.g.*, Decision at 3 (quoting para. 6 of Mason's notices of appeal) ("*Application of the CAT to Mason* would violate the Company's rights under the Commerce Clause of the United States Constitution * * * .") (italics added).]

As a corollary to its "as applied" constitutional challenge, Mason has consistently urged both the Commissioner and the Board that, in order to preserve the CAT statute's constitutionality, the stature should be interpreted, in the first instance, so that it does not apply to Mason. *See, e.g.*, *Buchman v. Board of Educ.*, 73 Ohio St.3d 260, 269 (1995) ("where a statute reasonably allows for more than a single construction or interpretation, it is the duty of the court to choose that construction or interpretation which will avoid rather than raise serious questions as to its constitutionality"). Mason offered interpretations of multiple provisions of the CAT that could be reasonably interpreted by the Commissioner and the Board to avoid causing the CAT statute to violate the Constitution by imposing tax on a business—Mason—that lacked "substantial nexus" with the state. [*See* Decision at 2-3 (quoting paras. 1-6 of Mason's notices of appeal).] Under these interpretations, Mason would not be liable for the CAT.

Citing its limited role in cases involving constitutional challenges, the Board declined to rule on either the constitutional issues or the related statutory interpretation arguments raised by Mason below. Instead, the Board explained that the parties "have set forth their respective positions regarding the constitutional validity of the commissioner's application of the statutory provisions in question * * * and we find such arguments may only be addressed on appeal by a court which has the authority to resolve constitutional challenges." [Decision at 4 (citation omitted).]

It is well-established that the Board's role is to receive evidence for constitutional challenges and that it may not declare a statute unconstitutional. *See, e.g., MCI Telecommunications Corp. v. Limbach*, 68 Ohio St.3d 195, 197-98 (1995).[1] However, Mason's statutory interpretation contentions would have permitted the Board to resolve the appeal *without* declaring the CAT unconstitutional on its face or as applied, consistent with the Board's duty to construe the statute in a manner to preserve its constitutionality. *E.g.*, *Buchman*, 73 Ohio St.3d at 269 (duty of tribunal to choose a construction of a statute that will avoid serious constitutional questions). Nevertheless, the Board concluded that the terms of CAT statute are unambiguous and require resolution of Mason's appeal by this Court through a declaration concerning the statute's constitutionality. [Decision at 4 ("[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").] In declining to give the CAT statute a reasonable interpretation consistent with the Constitution, the Board erred.

---

[1] In that regard, the Board over-stepped its authority in one respect in its Decision. It determined that the pertinent CAT statutes, "under the plain language set forth therein," do not require that a company have an in-state presence in order to be subject to the CAT. [Decision at 4.] Such a reading interprets the CAT in a manner which is at odds with the limitations on state taxing power under the Commerce Clause, necessarily rendering the CAT unconstitutional.

The Board also failed to recognize that it has the authority to apply binding precedent regarding the constitutionality of state statutes. *See Marysville Exempted Village Sch. Dist. Bd. of Educ. v. Union County Bd. of Revision*, 2013-Ohio-3077, ¶ 15, 136 Ohio St.3d 146, 150 (limits on Board's jurisdiction over constitutional questions do not preclude it from giving effect to binding precedent). Because the United States Supreme Court has held in multiple cases that gross receipts taxes like the CAT are subject to the constitutional standards of "substantial nexus," including specifically the "physical presence" requirement described by the Court, the Board should have applied such clear authority to invalidate the CAT assessment against Mason. *See, e.g.*, *Standard Pressed Steel*, 419 U.S. 560 (1975) and *Tyler Pipe*, 483 U.S. 232 (1987). The Board's failure to reverse the final determination of the Commissioner was error.

As a result of the proceedings below, this case arrives at the Supreme Court of Ohio with a complete evidentiary record from the Board—including exhibits and live testimony from fact witnesses and experts—on Mason's constitutional and related statutory arguments. The Court now properly has jurisdiction to determine the necessary facts and resolve all of the as-applied constitutional issues and questions of statutory interpretation presented by Mason's appeal, despite the Board's Decision not to make any findings or rulings below.

In addition, Mason hereby invokes the jurisdiction of the Court to determine whether the gross receipts "bright line presence" provision of the CAT statute, R.C. 5751.01(I)(3), on its face, violates the Commerce Clause of the Constitution. No extrinsic facts are required to make such a determination. Mason's standing as a company that satisfies the threshold of $500,000 in annual gross receipts is alone enough to establish this Court's authority to consider the issue. *See, e.g.*, *Global Knowledge Training, L.L.C. v. Levin*, 2010-Ohio-4411, ¶¶ 16, 17, 127 Ohio St.3d 34, 38 (a facial challenge to the constitutionality of a statute, which is made without regard

to extrinsic facts, may be raised initially on appeal before the Ohio Supreme Court); *Palazzi v. Estate of Gardner*, 32 Ohio St.3d 169, 175 (1987) (a party within the class to whom the statute applies has standing to challenge its constitutionality).

ERRORS TO BE REVIEWED AND PROPOSITIONS OF LAW PRESENTED

Mason complains of the following errors in the Board's Decision, and sets forth the following propositions of law concerning the constitutional and other questions as to which this Court has jurisdiction, but which the Board declined to address. Mason also asserts a facial challenge to R.C. 5751.01(I)(3).

1. The Board erred by upholding the final determination of the Commissioner against Mason because the evidence presented to the Board established that the CAT could not be imposed upon Mason consistent with the requirements of the Commerce Clause of the United States Constitution, under long-standing and binding precedent of the United States Supreme Court, including, but not limited to, *Tyler Pipe,* 483 U.S. 232 (1987), and *Standard Pressed Steel*, 419 U.S. 560 (1975). Consistent with these binding precedents, Mason lacked the in-state business activities necessary to establish the "substantial nexus" required for the State of Ohio to have constitutional authority to impose the CAT on Mason. The Board had jurisdiction and authority to apply such precedents. *Marysville Exempted Village Sch. Dist.*, 2013-Ohio-3077, ¶ 15, 136 Ohio St.3d 146, 150 (Board may give effect to binding precedent on constitutional issues).

2. The Board erred by upholding the final determination against Mason because the evidence presented to the Board established that the CAT assessments against Mason are not supported by the terms of the CAT statute, when the statute is properly construed to avoid constitutional infirmities. The Board erred in not interpreting the CAT statute to avoid

presenting serious constitutional questions regarding the statute. *See Buchman*, 73 Ohio St.3d at 269. Multiple provisions of the CAT statute may be reasonably construed so as to prevent its application to Mason, a company that lacked the in-state presence required by the Commerce Clause to permit the imposition of the CAT on its gross receipts under long-standing Supreme Court precedent, including:

(a) R.C.5751.02: Because the evidence showed that Mason engaged in no activity within Ohio, and neither owns nor leases property in the state, the company is not "doing business in this state" within the meaning of R.C. 5751.02;

(b) R.C. 5751.01(H)(3) & (I)(3): Although Mason had gross receipts from sales to Ohio residents in excess of $500,000 annually, such receipts are not "taxable gross receipts" within the meaning of R.C. 5751.01(I)(3), in that none of its gross receipts are subject to taxation in Ohio because the Commissioner lacks the authority to impose the CAT on Mason, so that Mason lacks "bright line presence" in the state under R.C. 5751.01(H)(3);

(c) R.C. 5751.01(F)(2)(jj) (formerly codified at R.C. 5751.01(F)(2)(aa)): Mason's receipts from sales to Ohio residents are not subject to the CAT because the term "gross receipts" under R.C. 5751.01(F)(2)(jj) excludes "[a]ny receipts for which the tax imposed by this chapter is prohibited by the constitution or laws of the United States." Because the Commissioner lacks the authority to impose the CAT on Mason, taxation of its receipts from sales to Ohio residents is prohibited by the Constitution.

These provisions of the CAT statute should be interpreted to avoid the imposition of the CAT on Mason. While the Board had jurisdiction to enter such an order because it would not have

involved a declaration that the CAT statute is unconstitutional, this Court now has the necessary jurisdiction and authority to interpret the CAT statute to avoid serious constitutional infirmities in the law.

3. The Board likewise erred by upholding the final determination against Mason because the evidence presented to the Board established that the CAT assessments against Mason are not supported by any of the other provisions of the CAT statute, nor did the Commissioner allege that such provisions supported the final determination. In particular, the evidence established that the following provisions did not apply to Mason:

(a) R.C. 5751.01(H)(1), (2) and (4): Mason lacked statutory "substantial nexus with this state" under R.C. 5751.01(H)(1), (2) and (4), in that Mason did not own or use "part or all of its capital in this state," lacked a "certificate of compliance with the laws of this state authorizing [it] to do business in this state," and did not "otherwise [have] nexus in this state * * * under the constitution [sic] of the United States."

(b) R.C. 5751.01(H)(3) and 5751.01(I)(1), (2), (4) & (5): Mason lacked statutory "'bright line presence' in this state" under R.C. 5751.01(H)(3) and 5751.01(I)(1), (2), (4) & (5) in that Mason did not have in Ohio at any time (i) property with an aggregate value of at least fifty thousand dollars, (ii) payroll of at least fifty thousand dollars, (iii) twenty-five or more percent of its total property, total payroll or total receipts, or (iv) domicile for corporate, commercial or other business purposes.

If any of these provisions is asserted by the Commissioner before this Court as a basis for upholding the final determination or the Board's Decision, this Court has jurisdiction and

authority to rule that none of these provisions is a basis for sustaining the assessments, final determination or Decision.

4. The Board's Decision affirming the final determination should be reversed, and the assessments cancelled, because the CAT statute is unconstitutional as applied to Mason. In particular, if interpreted to require the imposition of the CAT against Mason, R.C. 5751.01(H)(3), (I)(3), (I)(4) & (F)(2)(jj), and R.C. 5751.02, or any of them, are unconstitutional as applied. Imposition of the CAT on Mason violates the "substantial nexus" standards of the Commerce Clause of the U.S. Constitution, as established by the Supreme Court in numerous decisions. *See, e.g., Tyler Pipe*, 483 U.S. 232; *Standard Pressed Steel*, 419 U.S. 560; *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977); *National Bellas Hess v. Ill. Dep't of Revenue*, 386 U.S. 753 (1967); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617, 626 (1981); *Goldberg v. Sweet*, 488 U.S. 252, 263 (1989); *Norton Co. v. Ill. Dep't of Revenue,* 340 U.S. 534, 537 (1951). Merely obtaining gross receipts in excess of $500,000 annually does not establish constitutional "substantial nexus" under long-standing Supreme Court authority, so applying the CAT statute based solely on Mason's gross receipts violates the Constitution. Furthermore, because the evidence shows that Mason engaged in no business activities within the State of Ohio sufficient to satisfy the constitutional "substantial nexus" standards established by the Supreme Court, application of the CAT to Mason on any other basis, whether separate from or together with its gross receipts, is also unconstitutional. This Court has the jurisdiction and authority to make the necessary findings of fact and rulings of law to declare the CAT statute unconstitutional as applied to Mason. *E.g., MCI Telecommunications Corp.*, 68 Ohio St.3d 197-98 (Board of Tax Appeals receives evidence

for an as applied challenge, but this Court determines the facts and resolves the constitutional questions).

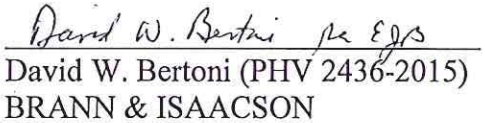
5. The Board's Decision affirming the final determination against Mason should be reversed, and the assessments cancelled, because the Ohio CAT statute is unconstitutional on its face, without regard to any extrinsic facts. By operation of the CAT statute according to its plain terms, the gross receipts "bright line" presence provision set forth in R.C. 5751.01(I)(3) requires the CAT to be imposed on a company solely because the company meets a statutory threshold of $500,000 in annual gross receipts from interstate sales to Ohio consumers, irrespective of whether the company has the in-state presence required under the "substantial nexus" standards established by the Supreme Court under the Commerce Clause. A declaration by this Court that R.C. 5751.01(I)(3) is unconstitutional and unenforceable, on its face, and a ruling striking it from the statute, will eliminate the constitutional defect in the CAT statute. The Court has jurisdiction over Mason's facial challenge. *E.g.*, *Global Knowledge Training*, 2010-Ohio-4411, ¶¶ 16, 17, 127 Ohio St.3d 34, 38 (Court has jurisdiction to consider facial challenges presented to it).

6. The Board erred by failing to abate the penalties imposed pursuant to R.C. 5751.06. Mason's non-registration, non-filing and non-payment each arose from Mason's good faith reliance upon existing federal constitutional law in regard to the application of the "substantial nexus" test to case involving gross receipts taxes, as well as sales and use taxes and other taxes. The failure to abate penalties under these circumstances constituted an abuse of discretion.

CONCLUSION

For all of the foregoing reasons, Mason respectfully requests that the Decision of the Board be reversed. Mason requests that final judgment be entered in its favor voiding the Board's Decision and the CAT assessments at issue in this appeal.

Respectfully submitted,



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Counsel for Appellant
Mason Companies, Inc.

BEFORE THE BOARD OF TAX APPEALS
STATE OF OHIO

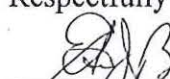
Mason Companies, Inc.,	:	
	:	Case No. _____
Appellant,	:	
	:	Appeal from the Ohio
v.	:	Board of Tax Appeals
	:	
Joseph W. Testa,	:	
Tax Commissioner of Ohio,	:	
	:	BTA Case Nos. 2012-1169,
Appellee.	:	2012-2806

PRAECIPE

TO THE OHIO BOARD OF TAX APPEALS

Demand is hereby made that the Ohio Board of Tax Appeals ("Board") prepare, transmit and file with the Supreme Court of Ohio a certified transcript of the records and proceedings of the Board pertaining to its Order in the above-styled matter; including in said certified transcript, the Board's Order, the original papers in the case or a transcript thereof, and all evidence with originals or copies of all exhibits as adduced in said proceeding considered by the Board in making its Order.

Respectfully submitted,



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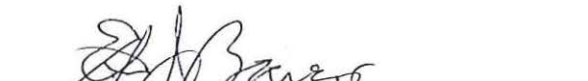
PROOF OF SERVICE UPON OHIO BOARD OF TAX APPEALS

This is to certify that the Notice of Appeal of Mason Companies, Inc., was filed by hand delivery with the Ohio Board of Tax Appeals, State Office Tower, 30 East Broad Street, 24th Floor, Columbus, Ohio as evidenced by its date stamp as set forth hereon.

Edward J. Bernert (0025808)
One of the Attorneys for Appellant
Mason Companies, Inc.

CERTIFICATE OF SERVICE

This is to certify that a true copy of the foregoing Notice of Appeal of Appellant Mason Companies, Inc. was sent by certified U.S. mail to Appellee Joseph W. Testa, Tax Commissioner of Ohio, 30 East Broad Street, 22nd Floor, Columbus, Ohio 43215; and to counsel of record for Appellee Tax Commissioner, by certified mail and hand delivery to The Honorable Mike DeWine, Attorney General of Ohio, Christine T. Mesirow and Daniel W. Fausey, Assistant Attorneys General, State of Ohio, 30 East Broad Street, 25th Floor, Columbus, Ohio 43215–3428, on this 19th day of May, 2015.



Edward J. Bernert (0025808)
One of the Attorneys for Appellant
Mason Companies, Inc.

OHIO BOARD OF TAX APPEALS

MASON COMPANIES, INC., (et. al.),

Appellant(s),

vs.

JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO, (et. al.),

Appellee(s).

CASE NO(S). 2012-1169, 2012-2806

(COMMERCIAL ACTIVITY TAX)

DECISION AND ORDER

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Entered Monday, April 20, 2015

Mr. Williamson, Ms. Clements, and Mr. Harbarger concur.

These matters are considered by the Board of Tax Appeals upon two notices of appeal filed on behalf of appellant Mason Companies, Inc. ("Mason"). Mason appeals from two final determinations of the Tax Commissioner in which the commissioner modified multiple commercial activity tax assessments against Mason, relating to periods from July 1, 2005 through September 30, 2011. This matter is considered by the Board of Tax Appeals upon the notices of appeal, the statutory transcripts ("S.T.") certified to this board by the Tax Commissioner, the record of this board's hearing ("H.R."), the joint stipulations filed by the parties, which include depositions offered in lieu of live testimony before the board, and any written argument filed by the parties. We note that the commissioner, on his post hearing brief, referenced BTA No.

2014-495 as part of the group of appeals under consideration, which is not reflective of the record; accordingly, the commissioner's reference to such case number is hereby stricken and we reiterate that the only appeals determined herein are as set forth in the case caption above.

In its brief, Mason, which is "located exclusively" in Chippewa Falls, Wisconsin, describes itself as a "family-owned mail order and Internet footwear and apparel retailer. *** From Chippewa Falls, Mason promotes its business by mailing catalogs to consumers across the United States. Consumers, if they choose to do so, can also visit Mason's retail Internet sites that reside on the company's web servers located at its Chippewa Falls offices. It is undisputed that Mason's retail business is national in scope and does not target a particular geographic area, and all of its communications with consumers and all of its product shipments originate from its facilities in Wisconsin." Mason Brief at 2. Before this board, and through deposition, Mason presented extensive testimony and evidence relating to its database/internet operations and overall marketing efforts. Mason Brief at 8; Exs. KKK, LLL, MMM.

In its notices of appeal to this board, Mason essentially specified the same errors in each, in pertinent part, as follows:

> "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 ***. ***

"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. *** 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." Notices of Appeal, at 5-7/5-8.

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.

Mason contends that "[t]he CAT assessments imposed against Mason are a tax on gross receipts generated by a company that lacks any in-state business activity. The Company's gross receipts, therefore, simply cannot be taxed consistent with the Constitution. *** In addition to violating the Constitution, including both the Commerce Clause and the Due Process Clause, the assessment against Mason violates the express terms of the CAT statute. The CAT statute expressly provides that it cannot be imposed on gross receipts where doing so 'is prohibited by the constitution or laws of the United States or the constitution of this state.' R.C. 5751[.01](F)(1)(jj). Accordingly, in violating the United States Constitution, the assessments here violate the express provisions of the CAT statute itself." Mason Brief at 13-14. Specifically, Mason claims its gross receipts are excluded from the CAT, pursuant to the U.S. Constitution, Commerce Clause and Due Process Clause, and the "substantial nexus" and corresponding "in-state presence" analysis encountered thereunder.

Upon review of the arguments raised, we find this board's pronouncement in *L.L. Bean, Inc. v. Levin* (Mar. 6, 2014), BTA No. 2010-2853, unreported, settled on appeal (Nov. 20, 2014), 11/20/2014 Case Announcements, 2014-Ohio-5119, as followed in *Crutchfield, Inc. v. Testa* (Feb. 26, 2015), BTA Nos. 2012-926, 3068, 2013-2021, unreported, appeal pending Sup. Ct. No. 2015-0386 and *Newegg, Inc. v. Testa* (Feb. 26, 2015), BTA No. 2012-234, unreported, appeal pending Sup. Ct. No. 2015-0483, to be controlling and dispositive of Mason's specifications of error. As we held in *L.L. Bean*, "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 *** and we find such arguments may only be addressed on appeal by a court which has the authority to resolve constitutional challenges." Id. at 6-7. See, also, *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St.3d 195; *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. The constitutional implications of the relevant statutory provisions must be considered by a tribunal that has jurisdiction over such questions of constitutional interpretation.

Herein, based upon the applicable commercial activity tax statutory provisions, Mason was assessed commercial activity tax for the periods in question. R.C. 5751.02(A). The commissioner determined that Mason had substantial nexus with this state, i.e., a "bright-line presence" in the state, because it had at least $500,000 in taxable gross receipts for the periods assessed. R.C. 5751.01(H)(3); R.C. 5751.01(I)(3); R.C. 5751.033(E) (as such sections were numbered in July 2005). Mason, as L.L. Bean and others before it, argues that under the Commerce Clause of the U.S. Constitution, "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 ***." Mason Brief at 16. It cites to several cases in support, including *Natl. Bellas Hess, Inc. v. Dept. of Revenue of Illinois* (1967), 386 U.S. 753, *Quill Corp. v. North Dakota* (1992), 504 U.S. 298 (1992) and *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987), contending "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." Mason Brief at 17. Even without considering the constitutional aspects of Mason's position, however, we conclude, under the plain language set forth therein, the pertinent CAT statutes do not impose such an in-state presence requirement. See *L.L. Bean*, supra.

As we stated in *L.L. Bean*, supra, "[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 ***. 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. *** [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. at 9-10.

Thus, following this board's precedent established in *L.L. Bean*, supra and its progeny, it is the decision of the Board of Tax Appeals that the final determinations of the Tax Commissioner must

be, and hereby are, affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Williamson		
Ms. Clements		
Mr. Harbarger		

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.

Kathleen M. Crowley, Board Secretary

In The Supreme Court of Ohio

FILED/RECEIVED
BOARD OF TAX APPEALS
2015 MAY 28 PM 1:5

MASON COMPANIES, INC.,	:	
Appellant,	:	Case No. 15-0794
v.	:	Appeal from the Ohio Board of Tax Appeals, BTA Case Nos. 2012-1169, 2012-2806
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO,	:	
	:	
Appellee.		

NOTICE OF CROSS APPEAL

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Joseph W. Testa, Tax Commissioner of Ohio

FILED
MAY 28 2015
CLERK OF COURT
SUPREME COURT OF OHIO

NOTICE OF CROSS-APPEAL

Joseph W. Testa, Tax Commissioner of Ohio ("Commissioner"), hereby gives notice of his cross appeal to the Supreme Court of Ohio from a Decision and Order of the Ohio Board of Tax Appeals (the "BTA") journalized in Case Nos. 2012-1169 and 2012-2806 on April 20, 2015 (hereafter "*BTA Decision and Order*"). A true copy of the *BTA Decision and Order* being appealed is attached hereto as Exhibit A and incorporated herein by reference.

This cross appeal is taken as a matter of right pursuant to Ohio Revised Code ("R.C.") 5717.04, which provides, in part, that "[i]f a timely notice of appeal is filed by a party, any other party may file a notice of appeal within ten days of the date the first notice of appeal was filed or within the time otherwise prescribed in this section, whichever is later."

Procedural Posture

In this appeal, on May 19, 2015, Mason Companies, Inc. (hereafter "Mason"), filed a notice of appeal to this Court from the *BTA Decision and Order*. Accordingly, pursuant to the above-quoted language of R.C. 5717.04, the Commissioner hereby timely files this protective cross-appeal.

The appeal by Mason and this cross-appeal filed by the Commissioner herein involve the Tax Commissioner's assessment of Commercial Activity Tax (CAT) assessment for unpaid tax for the period from 2005 to 2011 pursuant to R.C. 5751.01(H)(3). Because Mason's sales of goods to Ohio consumers produced taxable gross receipts exceeding $500,000 each year during the 2005-2011 taxable periods at issue, the Tax Commissioner applied the plain language of the bright-line statutory standard to determine that Mason had "substantial nexus with this state" as the General Assembly has defined that phrase for CAT purposes in R.C. 5751.01(H)(3) and R.C. 5751.01(I)(3) and was therefore subject to the CAT.

In its Notices of Appeal to the BTA, rather than challenging the constitutionality of the Tax Commissioner's actions or the relevant statutes, Mason pinned its argument to the statutory exclusion from gross receipts set forth in former R.C. 5751.01(F)(2)(aa) 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."

Mason argued that the U.S. Supreme Court's dormant Commerce Clause jurisprudence was incorporated through this exclusion statute as "tax . . . prohibited by the Constitution . . . of the United States." In Mason's view, R.C. 5751.01(F)(2)(aa) places a duty on the Tax Commissioner to determine whether the person who earned receipts constitutionally may be taxed. Under R.C. 5751.01(F)(2)(aa), Mason argued to the BTA that the Tax Commissioner must apply his understanding of the U.S. Supreme Court's dormant Commerce Clause jurisprudence to determine the taxability of each taxpayer, without regard to the clear-cut Ohio CAT statutes that define substantial nexus.

But the statute is an exclusion from gross receipts, not an incorporation of federal common law. And the Tax Commissioner demonstrated to the BTA that Mason's arguments didn't hold water. Contrary to Mason's reading, this division of the statute has nothing to do with the issue of whether Mason, as a business entity engaged in commercial activities, has constitutional nexus with Ohio. R.C. 5751.01(F)(2)(aa) delineates the taxability of certain receipts, as opposed to persons subject to the CAT.

The import of R.C. 5751.01(F)(2)(aa) is to exclude certain receipts that, by their very nature, may not be taxed. For example, Ohio could not collect a tax on receipts for which the federal government had already, and lawfully, excluded from state taxability under the inter-governmental tax immunity doctrine. Still, this division has nothing to do with the taxability of

the business itself—indeed, Ohio could find that some, but not all, of a person's receipts are excluded from the definition of "gross receipts" under R.C. 5751.01(F)(2)(aa).

Further, the statute cannot be construed as Mason suggests, because it would be at odds with R.C. 5751.02, which instructs that the CAT tax 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." Likewise, Mason's misinterpretation would render meaningless express language of R.C. 5751.01(H)(3) and (I) of the CAT defining "substantial nexus," and "bright-line presence," respectively, and would completely eviscerate the meaning of R.C. 5751.01(I)(3).

Thus, Mason'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.* 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, which Mason has not done in this case. As such, Mason's statutory arguments were easily dispelled by the BTA.

Further, the Tax Commissioner explained to the BTA that Mason 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's order recognized that Mason did not raise an as-applied constitutional challenge, but merely tried to incorporate the federal Commerce Clause jurisprudence as a matter of statutory construction. Accordingly, the BTA considered Mason's arguments only in the context of statutory interpretation as receipts "excluded" from the definition of "gross receipts" under (renumbered) R.C. 5751.01(F)(2)(aa): "Specifically, Mason 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." (Emphasis added). *BTA Decision and Order* at unnumbered page 3.

The BTA had no difficulty concluding that Mason'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 the constitutional aspects of Mason's position, 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* (Mar. 6, 2014), BTA No. 2010-2859.

The BTA did recognize a limit of its own jurisdiction, stating that "[t]he 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 the statutory interpretation advanced by Mason was fatally defective, this statement was mere dicta.

Moreover, and contrary to Mason's assertions, the BTA did not, in any part of its decision, hold that Mason had properly raised an as-applied constitutional challenge in its Notices of Appeal. Indeed, Mason misstates in its Notice of Appeal to this Court that the BTA

decision suggests that the "as-applied" challenge was raised below. See Mason's Notice of Appeal at 3. In support, Mason cites the BTA's Decision on page 3, wherein the BTA quotes Mason's Assigned Errors to the BTA. Id. But this is disingenuous. The BTA does not at all state that Mason raised an as-applied challenge. Instead, the decision merely reproduces, verbatim, all of Mason's assignments of error, none of which contain an as-applied challenge to the constitutionality of Ohio's CAT statutes.

This lack of an as-applied challenge in Mason's Notices of Appeal to the BTA means that this Court has no jurisdiction over such challenges. This Court has held 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 Co. v. Limbach*, 35 Ohio St. 3d 229, 229, (1988), 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, *Bd. of Educ. of S.-W. City Sch. v. Kinney*, 24 Ohio St. 3d 184, 185-187 (1986), 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." *Bd. of Educ. of S.-W. 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. *Bd. of Educ. of S.-W. 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).

It may be that Mason can raise a *facial* challenge to the constitutionality of these statutes for the first time before this Court. See, *Cleveland Gear Co. v. Limbach*, 35 Ohio St. 3d 229, 229, (1988), syllabus at 1. But Mason's *as-applied* challenge is jurisdictionally foreclosed.

Therefore no as-applied challenge to the CAT is properly before this Court. By failing to raise it at the BTA, Mason cannot raise it now.

Still, in an abundance of caution, the Tax Commissioner files this Cross-Appeal protectively and conditionally, in the event that this Court were to find that the BTA stated or held that Mason did raise an as-applied challenge to the constitutionality of the CAT statutes in its Notices of Appeal to the BTA. Hereby, the Tax Commissioner preserves his right to make challenges thereto.

Errors in the Decision of the BTA:

As cross-appellant, the Tax Commissioner complains of the following errors in the Decision and Order of the Board:

1. The BTA erred, as a matter of fact and law, to the extent that it stated or held in its BTA Decision and Order that Mason had raised an as-applied challenge to the constitutionality of any statutes in its Notices of Appeals to the BTA.
2. To the extent that the BTA stated or held in its BTA Decision and Order that Mason had raised an as-applied challenge to the constitutionality of any statutes in its Notices of Appeal to the BTA, the BTA erred, as a matter of fact and law, because, by their express terms, Mason's Notices of Appeal to the BTA contained no as-applied challenges to the constitutionality of any CAT

statutes. R.C. 5717.02; *Cleveland Gear Co. v. Limbach*, 35 Ohio St. 3d 229, 229, (1988); *Bd. of Educ. of S.-W. City Sch. v. Kinney*, 24 Ohio St. 3d 184, 185-187 (1986).

3. To the extent that the BTA stated or held in its BTA Decision and Order that Mason had raised an as-applied challenge to the constitutionality of any statutes in its Notices of Appeal to the BTA, the BTA erred, as a matter of fact and law, in failing to hold that even if Mason had attempted to raise an as-applied challenge to the constitutionality in its Notices 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).

4. Because Mason failed to specify an as-applied challenge to the constitutionality any CAT statutes in its Notices 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 Co. v. Limbach*, 35 Ohio St. 3d 229, 229, (1988); *Bd. of Educ. of S.-W. City Sch. v. Kinney*, 24 Ohio St. 3d 184, 185-187 (1986).

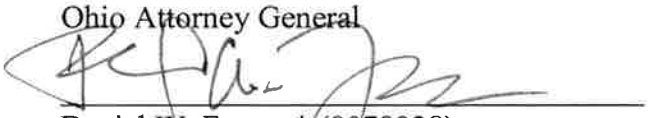
WHEREFORE,

For the above reasons, this Court should dismiss and refuse to consider Mason's Assignments of Error 1, 2, 3, and 4 on subject matter jurisdictional grounds because Mason failed to raise those errors to the BTA. To the extent that the BTA in its Decision and Order stated or held that Mason had validly

raised any as-applied challenge(s) to the constitutionality of any CAT statutes, the BTA erred as a matter of fact and law in so stating or holding.

Respectfully submitted,

Mike DeWine (0009181)
Ohio Attorney General



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Joseph W. Testa, Tax Commissioner of Ohio

OHIO BOARD OF TAX APPEALS

MASON COMPANIES, INC., (et. al.),

Appellant(s),

vs.

JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO, (et. al.),

Appellee(s).

CASE NO(S). 2012-1169, 2012-2806

(COMMERCIAL ACTIVITY TAX)

DECISION AND ORDER

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Entered Monday, April 20, 2015

Mr. Williamson, Ms. Clements, and Mr. Harbarger concur.

These matters are considered by the Board of Tax Appeals upon two notices of appeal filed on behalf of appellant Mason Companies, Inc. ("Mason"). Mason appeals from two final determinations of the Tax Commissioner in which the commissioner modified multiple commercial activity tax assessments against Mason, relating to periods from July 1, 2005 through September 30, 2011. This matter is considered by the Board of Tax Appeals upon the notices of appeal, the statutory transcripts ("S.T.") certified to this board by the Tax Commissioner, the record of this board's hearing ("H.R."), the joint stipulations filed by the parties, which include depositions offered in lieu of live testimony before the board, and any written argument filed by the parties. We note that the commissioner, on his post hearing brief, referenced BTA No.

2014-495 as part of the group of appeals under consideration, which is not reflective of the record; accordingly, the commissioner's reference to such case number is hereby stricken and we reiterate that the only appeals determined herein are as set forth in the case caption above.

In its brief, Mason, which is "located exclusively" in Chippewa Falls, Wisconsin, describes itself as a "family-owned mail order and Internet footwear and apparel retailer. *** From Chippewa Falls, Mason promotes its business by mailing catalogs to consumers across the United States. Consumers, if they choose to do so, can also visit Mason's retail Internet sites that reside on the company's web servers located at its Chippewa Falls offices. It is undisputed that Mason's retail business is national in scope and does not target a particular geographic area, and all of its communications with consumers and all of its product shipments originate from its facilities in Wisconsin." Mason Brief at 2. Before this board, and through deposition, Mason presented extensive testimony and evidence relating to its database/internet operations and overall marketing efforts. Mason Brief at 8; Exs. KKK, LLL, MMM.

In its notices of appeal to this board, Mason essentially specified the same errors in each, in pertinent part, as follows:

> "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 ***. ***

"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. *** 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." Notices of Appeal, at 5-7/5-8.

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.

Mason contends that "[t]he CAT assessments imposed against Mason are a tax on gross receipts generated by a company that lacks any in-state business activity. The Company's gross receipts, therefore, simply cannot be taxed consistent with the Constitution. *** In addition to violating the Constitution, including both the Commerce Clause and the Due Process Clause, the assessment against Mason violates the express terms of the CAT statute. The CAT statute expressly provides that it cannot be imposed on gross receipts where doing so 'is prohibited by the constitution or laws of the United States or the constitution of this state.' R.C. 5751[.01](F)(1)(jj). Accordingly, in violating the United States Constitution, the assessments here violate the express provisions of the CAT statute itself." Mason Brief at 13-14. Specifically, Mason claims its gross receipts are excluded from the CAT, pursuant to the U.S. Constitution, Commerce Clause and Due Process Clause, and the "substantial nexus" and corresponding "in-state presence" analysis encountered thereunder.

Upon review of the arguments raised, we find this board's pronouncement in *L.L. Bean, Inc. v. Levin* (Mar. 6, 2014), BTA No. 2010-2853, unreported, settled on appeal (Nov. 20, 2014), 11/20/2014 Case Announcements, 2014-Ohio-5119, as followed in *Crutchfield, Inc. v. Testa* (Feb. 26, 2015), BTA Nos. 2012-926, 3068, 2013-2021, unreported, appeal pending Sup. Ct. No. 2015-0386 and *Newegg, Inc. v. Testa* (Feb. 26, 2015), BTA No. 2012-234, unreported, appeal pending Sup. Ct. No. 2015-0483, to be controlling and dispositive of Mason's specifications of error. As we held in *L.L. Bean*, "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 *** and we find such arguments may only be addressed on appeal by a court which has the authority to resolve constitutional challenges." Id. at 6-7. See, also, *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St.3d 195; *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. The constitutional implications of the relevant statutory provisions must be considered by a tribunal that has jurisdiction over such questions of constitutional interpretation.

Herein, based upon the applicable commercial activity tax statutory provisions, Mason was assessed commercial activity tax for the periods in question. R.C. 5751.02(A). The commissioner determined that Mason had substantial nexus with this state, i.e., a "bright-line presence" in the state, because it had at least $500,000 in taxable gross receipts for the periods assessed. R.C. 5751.01(H)(3); R.C. 5751.01(I)(3); R.C. 5751.033(E) (as such sections were numbered in July 2005). Mason, as L.L. Bean and others before it, argues that under the Commerce Clause of the U.S. Constitution, "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 ***." Mason Brief at 16. It cites to several cases in support, including *Natl. Bellas Hess, Inc. v. Dept. of Revenue of Illinois* (1967), 386 U.S. 753, *Quill Corp. v. North Dakota* (1992), 504 U.S. 298 (1992) and *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987), contending "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." Mason Brief at 17. Even without considering the constitutional aspects of Mason's position, however, we conclude, under the plain language set forth therein, the pertinent CAT statutes do not impose such an in-state presence requirement. See *L.L. Bean*, supra.

As we stated in *L.L. Bean*, supra, "[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 ***. 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. *** [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. at 9-10.

Thus, following this board's precedent established in *L.L. Bean*, supra and its progeny, it is the decision of the Board of Tax Appeals that the final determinations of the Tax Commissioner must

be, and hereby are, affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Williamson		
Ms. Clements		
Mr. Harbarger		

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.

Kathleen M. Crowley, Board Secretary

CERTIFICATE OF SERVICE

I hereby certify that the foregoing Notice of Cross-Appeal was filed by hand-delivery with the Ohio Supreme Court, 65 South Front St., Columbus, Ohio 43215, and the Ohio Board of Tax Appeals, 30 E. Broad St., 24th Floor, Columbus, Ohio 43215, and was served by certified mail return receipt requested this 28 day of May, 2015, upon the following:

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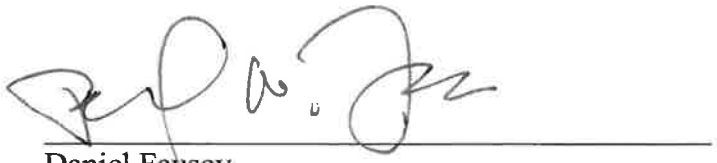

Daniel Fausey

FILED/RECEIVED
BOARD OF TAX APPEALS
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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.

NOTICE OF APPEAL

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LEGAL COUNSEL FOR APPELLANT,
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HAND DELIVERED

RECEIVED
STATE OF OHIO
AUG 27 2012
OFFICE OF THE TAX COMMISSIONER
LEGAL DIVISION

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 <u>the activities performed in this state on behalf of the taxpayer</u> 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.

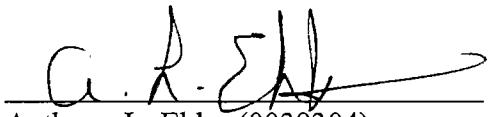
REQUEST FOR HEARING

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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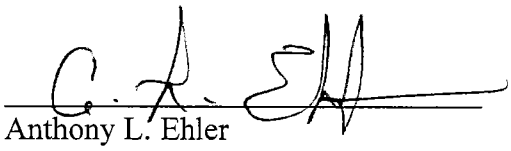
LEGAL COUNSEL FOR APPELLANT,
MASON COMPANIES, INC.

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

Ohio Department of
TAXATION
Office of the Tax Commissioner
30 E. Broad St., 22nd Floor • Columbus, OH 43215

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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:

Assessment No.	Period	Tax	Interest	Penalty	Payments	Total
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 sitused 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 sitused 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.

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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

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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[1]:

Assessment No.	Period	Tax	Interest	Penalty	Payments	Total
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

[1] 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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FILED
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BOARD OF TAX APPEALS
COLUMBUS, OHIO

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.

RECEIVED
STATE OF OHIO
APR 24 2012
OFFICE OF THE TAX COMMISSIONER
LEGAL DIVISION

NOTICE OF APPEAL

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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
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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.

Respectfully submitted,

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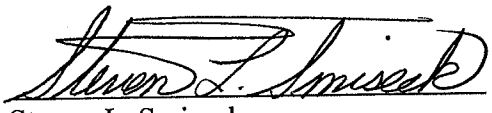
LEGAL COUNSEL FOR APPELLANT,
MASON COMPANIES, INC.

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 24th day of April, 2012.

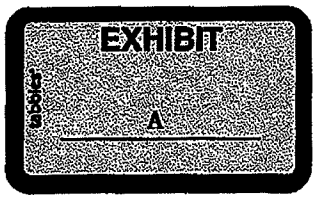


Steven L. Smiseck

Ohio Department of TAXATION
Office of the Tax Commissioner
30 E. Broad St., 22nd Floor • Columbus, OH 43216

FINAL DETERMINATION

Date: FEB 1 6 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:

Assessment No.	Period	Tax	Interest	Penalty	Payments	Total
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
	Total	$190,000.00	$27,549.98	$105,500.00	$0.00	$323,013.98

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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

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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 sitused 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 sitused 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). 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[1]:

[1] 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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Assessment No.	Period	Tax	Interest	Penalty	Payments	Total
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
	Total	$49,017.00	$5,089.44	$27,959.35	$0.00	$82,065.79

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

OHIO BOARD OF TAX APPEALS

MASON COMPANIES, INC., (et. al.),

Appellant(s),

vs.

JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO, (et. al.),

Appellee(s).

CASE NO(S). 2012-1169, 2012-2806

(COMMERCIAL ACTIVITY TAX)

DECISION AND ORDER

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Entered Monday, April 20, 2015

Mr. Williamson, Ms. Clements, and Mr. Harbarger concur.

These matters are considered by the Board of Tax Appeals upon two notices of appeal filed on behalf of appellant Mason Companies, Inc. ("Mason"). Mason appeals from two final determinations of the Tax Commissioner in which the commissioner modified multiple commercial activity tax assessments against Mason, relating to periods from July 1, 2005 through September 30, 2011. This matter is considered by the Board of Tax Appeals upon the notices of appeal, the statutory transcripts ("S.T.") certified to this board by the Tax Commissioner, the record of this board's hearing ("H.R."), the joint stipulations filed by the parties, which include depositions offered in lieu of live testimony before the board, and any written argument filed by the parties. We note that the commissioner, on his post hearing brief, referenced BTA No.

2014-495 as part of the group of appeals under consideration, which is not reflective of the record; accordingly, the commissioner's reference to such case number is hereby stricken and we reiterate that the only appeals determined herein are as set forth in the case caption above.

In its brief, Mason, which is "located exclusively" in Chippewa Falls, Wisconsin, describes itself as a "family-owned mail order and Internet footwear and apparel retailer. *** From Chippewa Falls, Mason promotes its business by mailing catalogs to consumers across the United States. Consumers, if they choose to do so, can also visit Mason's retail Internet sites that reside on the company's web servers located at its Chippewa Falls offices. It is undisputed that Mason's retail business is national in scope and does not target a particular geographic area, and all of its communications with consumers and all of its product shipments originate from its facilities in Wisconsin." Mason Brief at 2. Before this board, and through deposition, Mason presented extensive testimony and evidence relating to its database/internet operations and overall marketing efforts. Mason Brief at 8; Exs. KKK, LLL, MMM.

In its notices of appeal to this board, Mason essentially specified the same errors in each, in pertinent part, as follows:

> "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 ***. ***

"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. *** 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." Notices of Appeal, at 5-7/5-8.

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.

Mason contends that "[t]he CAT assessments imposed against Mason are a tax on gross receipts generated by a company that lacks any in-state business activity. The Company's gross receipts, therefore, simply cannot be taxed consistent with the Constitution. *** In addition to violating the Constitution, including both the Commerce Clause and the Due Process Clause, the assessment against Mason violates the express terms of the CAT statute. The CAT statute expressly provides that it cannot be imposed on gross receipts where doing so 'is prohibited by the constitution or laws of the United States or the constitution of this state.' R.C. 5751[.01](F)(1)(jj). Accordingly, in violating the United States Constitution, the assessments here violate the express provisions of the CAT statute itself." Mason Brief at 13-14. Specifically, Mason claims its gross receipts are excluded from the CAT, pursuant to the U.S. Constitution, Commerce Clause and Due Process Clause, and the "substantial nexus" and corresponding "in-state presence" analysis encountered thereunder.

Upon review of the arguments raised, we find this board's pronouncement in *L.L. Bean, Inc. v. Levin* (Mar. 6, 2014), BTA No. 2010-2853, unreported, settled on appeal (Nov. 20, 2014), 11/20/2014 Case Announcements, 2014-Ohio-5119, as followed in *Crutchfield, Inc. v. Testa* (Feb. 26, 2015), BTA Nos. 2012-926, 3068, 2013-2021, unreported, appeal pending Sup. Ct. No. 2015-0386 and *Newegg, Inc. v. Testa* (Feb. 26, 2015), BTA No. 2012-234, unreported, appeal pending Sup. Ct. No. 2015-0483, to be controlling and dispositive of Mason's specifications of error. As we held in *L.L. Bean*, "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 *** and we find such arguments may only be addressed on appeal by a court which has the authority to resolve constitutional challenges." Id. at 6-7. See, also, *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St.3d 195; *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. The constitutional implications of the relevant statutory provisions must be considered by a tribunal that has jurisdiction over such questions of constitutional interpretation.

Herein, based upon the applicable commercial activity tax statutory provisions, Mason was assessed commercial activity tax for the periods in question. R.C. 5751.02(A). The commissioner determined that Mason had substantial nexus with this state, i.e., a "bright-line presence" in the state, because it had at least $500,000 in taxable gross receipts for the periods assessed. R.C. 5751.01(H)(3); R.C. 5751.01(I)(3); R.C. 5751.033(E) (as such sections were numbered in July 2005). Mason, as L.L. Bean and others before it, argues that under the Commerce Clause of the U.S. Constitution, "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 ***." Mason Brief at 16. It cites to several cases in support, including *Natl. Bellas Hess, Inc. v. Dept. of Revenue of Illinois* (1967), 386 U.S. 753, *Quill Corp. v. North Dakota* (1992), 504 U.S. 298 (1992) and *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987), contending "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." Mason Brief at 17. Even without considering the constitutional aspects of Mason's position, however, we conclude, under the plain language set forth therein, the pertinent CAT statutes do not impose such an in-state presence requirement. See *L.L. Bean*, supra.

As we stated in *L.L. Bean*, supra, "[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 ***. 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. *** [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. at 9-10.

Thus, following this board's precedent established in *L.L. Bean*, supra and its progeny, it is the decision of the Board of Tax Appeals that the final determinations of the Tax Commissioner must

be, and hereby are, affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Williamson		
Ms. Clements		
Mr. Harbarger		

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.

_____

Kathleen M. Crowley, Board Secretary

COMMERCE CLAUSE

U.S. Const., art. I, § 8, cl. 3

The Congress shall have power *** [t]o regulate commerce with foreign nations, and among the several states, and with the Indian tribes; ***

DUE PROCESS CLAUSE

U.S. Const., amend. XIV, § 1

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

5751.01 Definitions.

As used in this chapter:

(A) "Person" means, but is not limited to, individuals, combinations of individuals of any form, receivers, assignees, trustees in bankruptcy, firms, companies, joint-stock companies, business trusts, estates, partnerships, limited liability partnerships, limited liability companies, associations, joint ventures, clubs, societies, for-profit corporations, S corporations, qualified subchapter S subsidiaries, qualified subchapter S trusts, trusts, entities that are disregarded for federal income tax purposes, and any other entities.

(B) "Consolidated elected taxpayer" means a group of two or more persons treated as a single taxpayer for purposes of this chapter as the result of an election made under section 5751.011 of the Revised Code.

(C) "Combined taxpayer" means a group of two or more persons treated as a single taxpayer for purposes of this chapter under section 5751.012 of the Revised Code.

(D) "Taxpayer" means any person, or any group of persons in the case of a consolidated elected taxpayer or combined taxpayer treated as one taxpayer, required to register or pay tax under this chapter. "Taxpayer" does not include excluded persons.

(E) "Excluded person" means any of the following:

(1) Any person with not more than one hundred fifty thousand dollars of taxable gross receipts during the calendar year. Division (E)(1) of this section does not apply to a person that is a member of a consolidated elected taxpayer;

(2) A public utility that paid the excise tax imposed by section 5727.24 or 5727.30 of the Revised Code based on one or more measurement periods that include the entire tax period under this chapter, except that a public utility that is a combined company is a taxpayer with regard to the following gross receipts:

(a) Taxable gross receipts directly attributed to a public utility activity, but not directly attributed to an activity that is subject to the excise tax imposed by section 5727.24 or 5727.30 of the Revised Code;

(b) Taxable gross receipts that cannot be directly attributed to any activity, multiplied by a fraction whose numerator is the taxable gross receipts described in division (E)(2)(a) of this section and whose denominator is the total taxable gross receipts that can be directly attributed to any activity;

(c) Except for any differences resulting from the use of an accrual basis method of accounting for purposes of determining gross receipts under this chapter and the use of the cash basis method of accounting for purposes of determining gross receipts under section 5727.24 of the Revised Code, the gross receipts directly attributed to the activity of a natural gas company shall be determined in a manner consistent with division (D) of section 5727.03 of the Revised Code.

As used in division (E)(2) of this section, "combined company" and "public utility" have the same meanings as in section 5727.01 of the Revised Code.

(3) A financial institution, as defined in section 5726.01 of the Revised Code, that paid the tax imposed by section 5726.02 of the Revised Code based on one or more taxable years that include the entire tax period under this chapter;

(4) A person directly or indirectly owned by one or more financial institutions, as defined in section 5726.01 of the Revised Code, that paid the tax imposed by section 5726.02 of the Revised Code based on

one or more taxable years that include the entire tax period under this chapter.

For the purposes of division (E)(4) of this section, a person owns another person under the following circumstances:

(a) In the case of corporations issuing capital stock, one corporation owns another corporation if it owns fifty per cent or more of the other corporation's capital stock with current voting rights;

(b) In the case of a limited liability company, one person owns the company if that person's membership interest, as defined in section 1705.01 of the Revised Code, is fifty per cent or more of the combined membership interests of all persons owning such interests in the company;

(c) In the case of a partnership, trust, or other unincorporated business organization other than a limited liability company, one person owns the organization if, under the articles of organization or other instrument governing the affairs of the organization, that person has a beneficial interest in the organization's profits, surpluses, losses, or distributions of fifty per cent or more of the combined beneficial interests of all persons having such an interest in the organization.

(5) A domestic insurance company or foreign insurance company, as defined in section 5725.01 of the Revised Code, that paid the insurance company premiums tax imposed by section 5725.18 or Chapter 5729. of the Revised Code, or an unauthorized insurance company whose gross premiums are subject to tax under section 3905.36 of the Revised Code based on one or more measurement periods that include the entire tax period under this chapter;

(6) A person that solely facilitates or services one or more securitizations of phase-in-recovery property pursuant to a final financing order as those terms are defined in section 4928.23 of the Revised Code. For purposes of this division, "securitization" means transferring one or more assets to one or more persons and then issuing securities backed by the right to receive payment from the asset or assets so transferred.

(7) Except as otherwise provided in this division, a pre-income tax trust as defined in division (FF)(4) of section 5747.01 of the Revised Code and any pass-through entity of which such pre-income tax trust owns or controls, directly, indirectly, or constructively through related interests, more than five per cent of the ownership or equity interests. If the pre-income tax trust has made a qualifying pre-income tax trust election under division (FF)(3) of section 5747.01 of the Revised Code, then the trust and the pass-through entities of which it owns or controls, directly, indirectly, or constructively through related interests, more than five per cent of the ownership or equity interests, shall not be excluded persons for purposes of the tax imposed under section 5751.02 of the Revised Code.

(8) Nonprofit organizations or the state and its agencies, instrumentalities, or political subdivisions.

(F) Except as otherwise provided in divisions (F)(2), (3), and (4) of this section, "gross receipts" means 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 the fair market value of any property and any services received, and any debt transferred or forgiven as consideration.

(1) The following are examples of gross receipts:

(a) Amounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another;

(b) Amounts realized from the taxpayer's performance of services for another;

(c) Amounts realized from another's use or possession of the taxpayer's property or capital;

(d) Any combination of the foregoing amounts.

(2) "Gross receipts" excludes the following amounts:

(a) Interest income except interest on credit sales;

(b) Dividends and distributions from corporations, and distributive or proportionate shares of receipts and income from a pass-through entity as defined under section 5733.04 of the Revised Code;

(c) Receipts from the sale, exchange, or other disposition of an asset described in section 1221 or 1231 of the Internal Revenue Code, without regard to the length of time the person held the asset. Notwithstanding section 1221 of the Internal Revenue Code, receipts from hedging transactions also are excluded to the extent the transactions are entered into primarily to protect a financial position, such as managing the risk of exposure to (i) foreign currency fluctuations that affect assets, liabilities, profits, losses, equity, or investments in foreign operations; (ii) interest rate fluctuations; or (iii) commodity price fluctuations. As used in division (F)(2)(c) of this section, "hedging transaction" has the same meaning as used in section 1221 of the Internal Revenue Code and also includes transactions accorded hedge accounting treatment under statement of financial accounting standards number 133 of the financial accounting standards board. For the purposes of division (F)(2)(c) of this section, the actual transfer of title of real or tangible personal property to another entity is not a hedging transaction.

(d) Proceeds received attributable to the repayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or marketable instrument;

(e) The principal amount received under a repurchase agreement or on account of any transaction properly characterized as a loan to the person;

(f) Contributions received by a trust, plan, or other arrangement, any of which is described in section 501(a) of the Internal Revenue Code, or to which Title 26, Subtitle A, Chapter 1, Subchapter (D) of the Internal Revenue Code applies;

(g) Compensation, whether current or deferred, and whether in cash or in kind, received or to be received by an employee, former employee, or the employee's legal successor for services rendered to or for an employer, including reimbursements received by or for an individual for medical or education expenses, health insurance premiums, or employee expenses, or on account of a dependent care spending account, legal services plan, any cafeteria plan described in section 125 of the Internal Revenue Code, or any similar employee reimbursement;

(h) Proceeds received from the issuance of the taxpayer's own stock, options, warrants, puts, or calls, or from the sale of the taxpayer's treasury stock;

(i) Proceeds received on the account of payments from insurance policies, except those proceeds received for the loss of business revenue;

(j) Gifts or charitable contributions received; membership dues received by trade, professional, homeowners', or condominium associations; and payments received for educational courses, meetings, meals, or similar payments to a trade, professional, or other similar association; and fundraising receipts received by any person when any excess receipts are donated or used exclusively for charitable purposes;

(k) Damages received as the result of litigation in excess of amounts that, if received without litigation,

would be gross receipts;

(l) Property, money, and other amounts received or acquired by an agent on behalf of another in excess of the agent's commission, fee, or other remuneration;

(m) Tax refunds, other tax benefit recoveries, and reimbursements for the tax imposed under this chapter made by entities that are part of the same combined taxpayer or consolidated elected taxpayer group, and reimbursements made by entities that are not members of a combined taxpayer or consolidated elected taxpayer group that are required to be made for economic parity among multiple owners of an entity whose tax obligation under this chapter is required to be reported and paid entirely by one owner, pursuant to the requirements of sections 5751.011 and 5751.012 of the Revised Code;

(n) Pension reversions;

(o) Contributions to capital;

(p) Sales or use taxes collected as a vendor or an out-of-state seller on behalf of the taxing jurisdiction from a consumer or other taxes the taxpayer is required by law to collect directly from a purchaser and remit to a local, state, or federal tax authority;

(q) In the case of receipts from the sale of cigarettes or tobacco products by a wholesale dealer, retail dealer, distributor, manufacturer, or seller, all as defined in section 5743.01 of the Revised Code, an amount equal to the federal and state excise taxes paid by any person on or for such cigarettes or tobacco products under subtitle E of the Internal Revenue Code or Chapter 5743. of the Revised Code;

(r) **[Applicable to tax periods beginning before 7/1/2015]**Receipts from the sale, transfer, exchange, or other disposition of motor fuel as "motor fuel" is defined in section 5736.01 of the Revised Code;

(r) **[Applicable to tax periods beginning 7/1/2015]** In the case of receipts from the sale, transfer, exchange, or other disposition of motor fuel as "motor fuel" is defined in section 5736.01 of the Revised Code, an amount equal to the value of the motor fuel, including federal and state motor fuel excise taxes and receipts from billing or invoicing the tax imposed under section 5736.02 of the Revised Code to another person;

(s) In the case of receipts from the sale of beer or intoxicating liquor, as defined in section 4301.01 of the Revised Code, by a person holding a permit issued under Chapter 4301. or 4303. of the Revised Code, an amount equal to federal and state excise taxes paid by any person on or for such beer or intoxicating liquor under subtitle E of the Internal Revenue Code or Chapter 4301. or 4305. of the Revised Code;

(t) Receipts realized by a new motor vehicle dealer or used motor vehicle dealer, as defined in section 4517.01 of the Revised Code, from the sale or other transfer of a motor vehicle, as defined in that section, to another motor vehicle dealer for the purpose of resale by the transferee motor vehicle dealer, but only if the sale or other transfer was based upon the transferee's need to meet a specific customer's preference for a motor vehicle;

(u) Receipts from a financial institution described in division (E)(3) of this section for services provided to the financial institution in connection with the issuance, processing, servicing, and management of loans or credit accounts, if such financial institution and the recipient of such receipts have at least fifty per cent of their ownership interests owned or controlled, directly or constructively through related interests, by common owners;

(v) Receipts realized from administering anti-neoplastic drugs and other cancer chemotherapy, biologicals, therapeutic agents, and supportive drugs in a physician's office to patients with cancer;

(w) Funds received or used by a mortgage broker that is not a dealer in intangibles, other than fees or other consideration, pursuant to a table-funding mortgage loan or warehouse-lending mortgage loan. Terms used in division (F)(2)(w) of this section have the same meanings as in section 1322.01 of the Revised Code, except "mortgage broker" means a person assisting a buyer in obtaining a mortgage loan for a fee or other consideration paid by the buyer or a lender, or a person engaged in table-funding or warehouse-lending mortgage loans that are first lien mortgage loans.

(x) Property, money, and other amounts received by a professional employer organization, as defined in section 4125.01 of the Revised Code, from a client employer, as defined in that section, in excess of the administrative fee charged by the professional employer organization to the client employer;

(y) In the case of amounts retained as commissions by a permit holder under Chapter 3769. of the Revised Code, an amount equal to the amounts specified under that chapter that must be paid to or collected by the tax commissioner as a tax and the amounts specified under that chapter to be used as purse money;

(z) Qualifying distribution center receipts.

(i) For purposes of division (F)(2)(z) of this section:

(I) "Qualifying distribution center receipts" means receipts of a supplier from qualified property that is delivered to a qualified distribution center, multiplied by a quantity that equals one minus the Ohio delivery percentage. If the qualified distribution center is a refining facility, "supplier" includes all dealers, brokers, processors, sellers, vendors, cosigners, and distributors of qualified property.

(II) "Qualified property" means tangible personal property delivered to a qualified distribution center that is shipped to that qualified distribution center solely for further shipping by the qualified distribution center to another location in this state or elsewhere or, in the case of gold, silver, platinum, or palladium delivered to a refining facility solely for refining to a grade and fineness acceptable for delivery to a registered commodities exchange. "Further shipping" includes storing and repackaging property into smaller or larger bundles, so long as the property is not subject to further manufacturing or processing. "Refining" is limited to extracting impurities from gold, silver, platinum, or palladium through smelting or some other process at a refining facility.

(III) "Qualified distribution center" means a warehouse, a facility similar to a warehouse, or a refining facility in this state that, for the qualifying year, is operated by a person that is not part of a combined taxpayer group and that has a qualifying certificate. All warehouses or facilities similar to warehouses that are operated by persons in the same taxpayer group and that are located within one mile of each other shall be treated as one qualified distribution center. All refining facilities that are operated by persons in the same taxpayer group and that are located in the same or adjacent counties may be treated as one qualified distribution center.

(IV) "Qualifying year" means the calendar year to which the qualifying certificate applies.

(V) "Qualifying period" means the period of the first day of July of the second year preceding the qualifying year through the thirtieth day of June of the year preceding the qualifying year.

(VI) "Qualifying certificate" means the certificate issued by the tax commissioner after the operator of a

distribution center files an annual application with the commissioner. The application and annual fee shall be filed and paid for each qualified distribution center on or before the first day of September before the qualifying year or within forty-five days after the distribution center opens, whichever is later.

The applicant must substantiate to the commissioner's satisfaction that, for the qualifying period, all persons operating the distribution center have more than fifty per cent of the cost of the qualified property shipped to a location such that it would be sitused outside this state under the provisions of division (E) of section 5751.033 of the Revised Code. The applicant must also substantiate that the distribution center cumulatively had costs from its suppliers equal to or exceeding five hundred million dollars during the qualifying period. (For purposes of division (F)(2)(z)(i)(VI) of this section, "supplier" excludes any person that is part of the consolidated elected taxpayer group, if applicable, of the operator of the qualified distribution center.) The commissioner may require the applicant to have an independent certified public accountant certify that the calculation of the minimum thresholds required for a qualified distribution center by the operator of a distribution center has been made in accordance with generally accepted accounting principles. The commissioner shall issue or deny the issuance of a certificate within sixty days after the receipt of the application. A denial is subject to appeal under section 5717.02 of the Revised Code. If the operator files a timely appeal under section 5717.02 of the Revised Code, the operator shall be granted a qualifying certificate effective for the remainder of the qualifying year or until the appeal is finalized, whichever is earlier. If the operator does not prevail in the appeal, the operator shall pay the ineligible operator's supplier tax liability.

(VII) "Ohio delivery percentage" means the proportion of the total property delivered to a destination inside Ohio from the qualified distribution center during the qualifying period compared with total deliveries from such distribution center everywhere during the qualifying period.

(VIII) "Refining facility" means one or more buildings located in a county in the Appalachian region of this state as defined by section 107.21 of the Revised Code and utilized for refining or smelting gold, silver, platinum, or palladium to a grade and fineness acceptable for delivery to a registered commodities exchange.

(IX) "Registered commodities exchange" means a board of trade, such as New York mercantile exchange, inc. or commodity exchange, inc., designated as a contract market by the commodity futures trading commission under the "Commodity Exchange Act," 7 U.S.C. 1 et seq., as amended.

(X) "Ineligible operator's supplier tax liability" means an amount equal to the tax liability of all suppliers of a distribution center had the distribution center not been issued a qualifying certificate for the qualifying year. Ineligible operator's supplier tax liability shall not include interest or penalties. The tax commissioner shall determine an ineligible operator's supplier tax liability based on information that the commissioner may request from the operator of the distribution center. An operator shall provide a list of all suppliers of the distribution center and the corresponding costs of qualified property for the qualifying year at issue within sixty days of a request by the commissioner under this division.

(ii)

(I) If the distribution center is new and was not open for the entire qualifying period, the operator of the distribution center may request that the commissioner grant a qualifying certificate. If the certificate is granted and it is later determined that more than fifty per cent of the qualified property during that year was not shipped to a location such that it would be sitused outside of this state under the provisions of division (E) of section 5751.033 of the Revised Code or if it is later determined that the person that operates the distribution center had average monthly costs from its suppliers of less than forty million

dollars during that year, then the operator of the distribution center shall pay the ineligible operator's supplier tax liability. (For purposes of division (F)(2)(z)(ii) of this section, "supplier" excludes any person that is part of the consolidated elected taxpayer group, if applicable, of the operator of the qualified distribution center.)

(II) The commissioner may grant a qualifying certificate to a distribution center that does not qualify as a qualified distribution center for an entire qualifying period if the operator of the distribution center demonstrates that the business operations of the distribution center have changed or will change such that the distribution center will qualify as a qualified distribution center within thirty-six months after the date the operator first applies for a certificate. If, at the end of that thirty-six-month period, the business operations of the distribution center have not changed such that the distribution center qualifies as a qualified distribution center, the operator of the distribution center shall pay the ineligible operator's supplier tax liability for each year that the distribution center received a certificate but did not qualify as a qualified distribution center. For each year the distribution center receives a certificate under division (F)(2)(z)(ii)(II) of this section, the distribution center shall pay all applicable fees required under division (F)(2)(z) of this section and shall submit an updated business plan showing the progress the distribution center made toward qualifying as a qualified distribution center during the preceding year.

(III) An operator may appeal a determination under division (F)(2)(z)(ii)(I) or (II) of this section that the ineligible operator is liable for the operator's supplier tax liability as a result of not qualifying as a qualified distribution center, as provided in section 5717.02 of the Revised Code.

(iii) When filing an application for a qualifying certificate under division (F)(2)(z)(i)(VI) of this section, the operator of a qualified distribution center also shall provide documentation, as the commissioner requires, for the commissioner to ascertain the Ohio delivery percentage. The commissioner, upon issuing the qualifying certificate, also shall certify the Ohio delivery percentage. The operator of the qualified distribution center may appeal the commissioner's certification of the Ohio delivery percentage in the same manner as an appeal is taken from the denial of a qualifying certificate under division (F)(2)(z)(i)(VI) of this section.

(iv)

(I) In the case where the distribution center is new and not open for the entire qualifying period, the operator shall make a good faith estimate of an Ohio delivery percentage for use by suppliers in their reports of taxable gross receipts for the remainder of the qualifying period. The operator of the facility shall disclose to the suppliers that such Ohio delivery percentage is an estimate and is subject to recalculation. By the due date of the next application for a qualifying certificate, the operator shall determine the actual Ohio delivery percentage for the estimated qualifying period and proceed as provided in division (F)(2)(z)(iii) of this section with respect to the calculation and recalculation of the Ohio delivery percentage. The supplier is required to file, within sixty days after receiving notice from the operator of the qualified distribution center, amended reports for the impacted calendar quarter or quarters or calendar year, whichever the case may be. Any additional tax liability or tax overpayment shall be subject to interest but shall not be subject to the imposition of any penalty so long as the amended returns are timely filed.

(II) The operator of a distribution center that receives a qualifying certificate under division (F)(2)(z)(ii)(II) of this section shall make a good faith estimate of the Ohio delivery percentage that the operator estimates will apply to the distribution center at the end of the thirty-six-month period after the operator first applied for a qualifying certificate under that division. The result of the estimate shall be multiplied by a factor of one and seventy-five one-hundredths. The product of that calculation shall be the Ohio delivery

percentage used by suppliers in their reports of taxable gross receipts for each qualifying year that the distribution center receives a qualifying certificate under division (F)(2)(z)(ii)(II) of this section, except that, if the product is less than five per cent, the Ohio delivery percentage used shall be five per cent and that, if the product exceeds forty-nine per cent, the Ohio delivery percentage used shall be forty-nine per cent.

(v) Qualifying certificates and Ohio delivery percentages issued by the commissioner shall be open to public inspection and shall be timely published by the commissioner. A supplier relying in good faith on a certificate issued under this division shall not be subject to tax on the qualifying distribution center receipts under division (F)(2)(z) of this section. An operator receiving a qualifying certificate is liable for the ineligible operator's supplier tax liability for each year the operator received a certificate but did not qualify as a qualified distribution center.

(vi) The annual fee for a qualifying certificate shall be one hundred thousand dollars for each qualified distribution center. If a qualifying certificate is not issued, the annual fee is subject to refund after the exhaustion of all appeals provided for in division (F)(2)(z)(i)(VI) of this section. The first one hundred thousand dollars of the annual application fees collected each calendar year shall be credited to the revenue enhancement fund. The remainder of the annual application fees collected shall be distributed in the same manner required under section 5751.20 of the Revised Code.

(vii) The tax commissioner may require that adequate security be posted by the operator of the distribution center on appeal when the commissioner disagrees that the applicant has met the minimum thresholds for a qualified distribution center as set forth in division (F)(2)(z) of this section.

(aa) Receipts of an employer from payroll deductions relating to the reimbursement of the employer for advancing moneys to an unrelated third party on an employee's behalf;

(bb) Cash discounts allowed and taken;

(cc) Returns and allowances;

(dd) Bad debts from receipts on the basis of which the tax imposed by this chapter was paid in a prior quarterly tax payment period. For the purpose of this division, "bad debts" means any debts that have become worthless or uncollectible between the preceding and current quarterly tax payment periods, have been uncollected for at least six months, and that may be claimed as a deduction under section 166 of the Internal Revenue Code and the regulations adopted under that section, or that could be claimed as such if the taxpayer kept its accounts on the accrual basis. "Bad debts" does not include repossessed property, uncollectible amounts on property that remains in the possession of the taxpayer until the full purchase price is paid, or expenses in attempting to collect any account receivable or for any portion of the debt recovered;

(ee) Any amount realized from the sale of an account receivable to the extent the receipts from the underlying transaction giving rise to the account receivable were included in the gross receipts of the taxpayer;

(ff) Any receipts directly attributed to a transfer agreement or to the enterprise transferred under that agreement under section 4313.02 of the Revised Code.

(gg)

(i) As used in this division:

(I) "Qualified uranium receipts" means receipts from the sale, exchange, lease, loan, production, processing, or other disposition of uranium within a uranium enrichment zone certified by the tax commissioner under division (F)(2)(gg)(ii) of this section. "Qualified uranium receipts" does not include any receipts with a situs in this state outside a uranium enrichment zone certified by the tax commissioner under division (F)(2)(gg)(ii) of this section.

(II) "Uranium enrichment zone" means all real property that is part of a uranium enrichment facility licensed by the United States nuclear regulatory commission and that was or is owned or controlled by the United States department of energy or its successor.

(ii) Any person that owns, leases, or operates real or tangible personal property constituting or located within a uranium enrichment zone may apply to the tax commissioner to have the uranium enrichment zone certified for the purpose of excluding qualified uranium receipts under division (F)(2)(gg) of this section. The application shall include such information that the tax commissioner prescribes. Within sixty days after receiving the application, the tax commissioner shall certify the zone for that purpose if the commissioner determines that the property qualifies as a uranium enrichment zone as defined in division (F)(2)(gg) of this section, or, if the tax commissioner determines that the property does not qualify, the commissioner shall deny the application or request additional information from the applicant. If the tax commissioner denies an application, the commissioner shall state the reasons for the denial. The applicant may appeal the denial of an application to the board of tax appeals pursuant to section 5717.02 of the Revised Code. If the applicant files a timely appeal, the tax commissioner shall conditionally certify the applicant's property. The conditional certification shall expire when all of the applicant's appeals are exhausted. Until final resolution of the appeal, the applicant shall retain the applicant's records in accordance with section 5751.12 of the Revised Code, notwithstanding any time limit on the preservation of records under that section.

(hh) In the case of amounts collected by a licensed casino operator from casino gaming, amounts in excess of the casino operator's gross casino revenue. In this division, "casino operator" and "casino gaming" have the meanings defined in section 3772.01 of the Revised Code, and "gross casino revenue" has the meaning defined in section 5753.01 of the Revised Code.

(ii) Receipts realized from the sale of agricultural commodities by an agricultural commodity handler, both as defined in section 926.01 of the Revised Code, that is licensed by the director of agriculture to handle agricultural commodities in this state.

(jj) 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 this state.

(3) In the case of a taxpayer when acting as a real estate broker, "gross receipts" includes only the portion of any fee for the service of a real estate broker, or service of a real estate salesperson associated with that broker, that is retained by the broker and not paid to an associated real estate salesperson or another real estate broker. For the purposes of this division, "real estate broker" and "real estate salesperson" have the same meanings as in section 4735.01 of the Revised Code.

(4) A taxpayer's method of accounting for gross receipts for a tax period shall be the same as the taxpayer's method of accounting for federal income tax purposes for the taxpayer's federal taxable year that includes the tax period. If a taxpayer's method of accounting for federal income tax purposes changes, its method of accounting for gross receipts under this chapter shall be changed accordingly.

(G) "Taxable gross receipts" means gross receipts sitused to this state under section 5751.033 of the

Revised Code.

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

(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.

(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:

(1) Has at any time during the calendar year property in this state with an aggregate value of at least fifty thousand dollars. For the purpose of division (I)(1) of this section, owned property is valued at original cost and rented property is valued at eight times the net annual rental charge.

(2) Has during the calendar year payroll in this state of at least fifty thousand dollars. Payroll in this state includes all of the following:

(a) Any amount subject to withholding by the person under section 5747.06 of the Revised Code;

(b) Any other amount the person pays as compensation to an individual under the supervision or control of the person for work done in this state; and

(c) Any amount the person pays for services performed in this state on its behalf by another.

(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 per cent 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.

(J) "Tangible personal property" has the same meaning as in section 5739.01 of the Revised Code.

(K) "Internal Revenue Code" means the Internal Revenue Code of 1986, 100 Stat. 2085, 26 U.S.C. 1, as amended. Any term used in this chapter that is not otherwise defined has the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes unless a different meaning is clearly required. Any reference in this chapter to the Internal Revenue Code includes other laws of the United States relating to federal income taxes.

(L) "Calendar quarter" means a three-month period ending on the thirty-first day of March, the thirtieth day of June, the thirtieth day of September, or the thirty-first day of December.

(M) "Tax period" means the calendar quarter or calendar year on the basis of which a taxpayer is required to pay the tax imposed under this chapter.

(N) "Calendar year taxpayer" means a taxpayer for which the tax period is a calendar year.

(O) "Calendar quarter taxpayer" means a taxpayer for which the tax period is a calendar quarter.

(P) "Agent" means a person authorized by another person to act on its behalf to undertake a transaction for the other, including any of the following:

(1) A person receiving a fee to sell financial instruments;

(2) A person retaining only a commission from a transaction with the other proceeds from the transaction being remitted to another person;

(3) A person issuing licenses and permits under section 1533.13 of the Revised Code;

(4) A lottery sales agent holding a valid license issued under section 3770.05 of the Revised Code;

(5) A person acting as an agent of the division of liquor control under section 4301.17 of the Revised Code.

(Q) "Received" includes amounts accrued under the accrual method of accounting.

(R) "Reporting person" means a person in a consolidated elected taxpayer or combined taxpayer group that is designated by that group to legally bind the group for all filings and tax liabilities and to receive all legal notices with respect to matters under this chapter, or, for the purposes of section 5751.04 of the Revised Code, a separate taxpayer that is not a member of such a group.

Amended by 130th General Assembly File No. TBD, HB 492, §1, eff. 9/17/2014.

Amended by 130th General Assembly File No. 41, HB 72, §3, eff. 1/30/2014.

Amended by 130th General Assembly File No. 25, HB 59, §101.01, eff. 9/29/2013 and 7/1/2014.

Amended by 130th General Assembly File No. 7, HB 51, §101.01, eff. 7/1/2013.

Amended by 130th General Assembly File No. 2, SB 28, §1, eff. 3/22/2013.

Amended by 129th General AssemblyFile No.186, HB 510, §1, eff. 3/27/2013, applicable to tax periods beginning on or after January 1, 2014 except for a taxpayer that is a corporation or any other person directly or indirectly owned by one or more insurance companies subject to the tax imposed by section 5725.18 or Chapter 5729. of the Revised Code; for such taxpayers, the amendment applies to tax periods beginning on or after January 1, 2013.

Amended by 129th General AssemblyFile No.188, HB 472, §1, eff. 12/20/2012.

Amended by 129th General AssemblyFile No.125, SB 315, §101.01, eff. 9/10/2012.

Amended by 129th General AssemblyFile No.117, HB 508, §1, eff. 9/6/2012.

Amended by 129th General AssemblyFile No.28, HB 153, §101.01, eff. 9/29/2011.

Amended by 129th General AssemblyFile No.44, HB 277, §1, eff. 10/17/2011.

Amended by 129th General AssemblyFile No.7, HB 114, §101.01, eff. 6/29/2011.

Amended by 128th General AssemblyFile No.9, HB 1, §101.01, eff. 10/16/2009.

Effective Date: 06-30-2005; 03-30-2006; 2006 HB699 03-29-2007

Related Legislative Provision: *See 130th General Assembly File No. TBD, HB 492, §4.*

See 130th General Assembly File No. 41, HB 72, §3.

See 130th General Assembly File No. 25, HB 59, §803.90.

See 129th General AssemblyFile No.186, HB 510, §5

See 129th General AssemblyFile No.186, HB 510, §4

5751.02 Commercial activity tax levied on taxable gross receipts.

(A) For the purpose of funding the needs of this state and its local governments , 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 a calendar year. Persons on which the commercial activity tax is levied include, but are not limited to, persons with substantial nexus with this state. The tax imposed under this section is not a transactional tax and is not subject to Public Law No. 86-272, 73 Stat. 555. The tax imposed under this section is in addition to any other taxes or fees imposed under the Revised Code. The tax levied under this section is imposed on the person receiving the gross receipts and is not a tax imposed directly on a purchaser. The tax imposed by this section is an annual privilege tax for the calendar year that, in the case of calendar year taxpayers, is the annual tax period and, in the case of calendar quarter taxpayers, contains all quarterly tax periods in the calendar year. A taxpayer is subject to the annual privilege tax for doing business during any portion of such calendar year.

(B) The tax imposed by this section is a tax on the taxpayer and shall not be billed or invoiced to another person. Even if the tax or any portion thereof is billed or invoiced and separately stated, such amounts remain part of the price for purposes of the sales and use taxes levied under Chapters 5739. and 5741. of the Revised Code. Nothing in division (B) of this section prohibits:

(1) A person from including in the price charged for a good or service an amount sufficient to recover the tax imposed by this section; or

(2) A lessor from including an amount sufficient to recover the tax imposed by this section in a lease payment charged, or from including such an amount on a billing or invoice pursuant to the terms of a written lease agreement providing for the recovery of the lessor's tax costs. The recovery of such costs shall be based on an estimate of the total tax cost of the lessor during the tax period, as the tax liability of the lessor cannot be calculated until the end of that period.

Amended by 130th General Assembly File No. 25, HB 59, §101.01, eff. 7/1/2014.

Amended by 130th General Assembly File No. 7, HB 51, §101.01, eff. 7/1/2013.

Amended by 128th General AssemblyFile No.9, HB 1, §101.01, eff. 10/16/2009.

Effective Date: 06-30-2005

Related Legislative Provision: *See 130th General Assembly File No. 25, HB 59, §803.90.*

See 130th General Assembly File No. 7, HB 51, §812.20.20.

See 129th General AssemblyFile No.186, HB 510, §5

See 128th General AssemblyFile No.9, HB 1, §803.70.

5751.033 Situsing of gross receipts to Ohio.

For the purposes of this chapter, gross receipts shall be sitused to this state as follows:

(A) Gross rents and royalties from real property located in this state shall be sitused to this state.

(B) Gross rents and royalties from tangible personal property shall be sitused to this state to the extent the tangible personal property is located or used in this state.

(C) Gross receipts from the sale of electricity and electric transmission and distribution services shall be sitused to this state in the manner provided under section 5733.059 of the Revised Code.

(D) Gross receipts from the sale of real property located in this state shall be sitused to this state.

(E) Gross receipts from the sale of tangible personal property shall be sitused to this state if the property is received in this state by the purchaser. In the case of delivery of tangible personal property by motor 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. For purposes of this section, the phrase "delivery of tangible personal property by motor carrier or by other means of transportation" includes the situation in which a purchaser accepts the property in this state and then transports the property directly or by other means to a location outside this state. Direct delivery in this state, other than for purposes of transportation, to a person or firm designated by a purchaser constitutes delivery to the purchaser in this state, and direct delivery outside this state to a person or firm designated by a purchaser does not constitute delivery to the purchaser in this state, regardless of where title passes or other conditions of sale.

(F) Gross receipts from the sale, exchange, disposition, or other grant of the right to use trademarks, trade names, patents, copyrights, and similar intellectual property shall be sitused to this state to the extent that the receipts are based on the amount of use of the property in this state. If the receipts are not based on the amount of use of the property, but rather on the right to use the property, and the payor has the right to use the property in this state, then the receipts from the sale, exchange, disposition, or other grant of the right to use such property shall be sitused to this state to the extent the receipts are based on the right to use the property in this state.

(G) Gross receipts from the sale of transportation services by a motor carrier shall be sitused to this state in proportion to the mileage traveled by the carrier during the tax period on roadways, waterways, airways, and railways in this state to the mileage traveled by the carrier during the tax period on roadways, waterways, airways, and railways everywhere. With prior written approval of the tax commissioner, a motor carrier may use an alternative situsing procedure for transportation services.

(H) Gross receipts from dividends, interest, and other sources of income from financial instruments described in divisions (F)(4), (5), (6), (7), (8), (9), (10), (11), and (13) of section 5733.056 of the Revised Code shall be sitused to this state in accordance with the situsing provisions set forth in those divisions. When applying the provisions of divisions (F)(6), (8), and (13) of section 5733.056 of the Revised Code, "gross receipts" shall be substituted for "net gains" wherever "net gains" appears in those divisions. Nothing in this division limits or modifies the exclusions enumerated in divisions (E) and (F)(2) of section 5751.01 of the Revised Code. The tax commissioner may promulgate rules to further specify the manner in which to situs gross receipts subject to this division.

(I) Gross receipts from the sale of all other services, and all other gross receipts not otherwise sitused

under this section, shall be sitused to this state in the proportion that the purchaser's benefit in this state with respect to what was purchased bears to the purchaser's benefit everywhere with respect to what was purchased. The physical location where the purchaser ultimately uses or receives the benefit of what was purchased shall be paramount in determining the proportion of the benefit in this state to the benefit everywhere. If a taxpayer's records do not allow the taxpayer to determine that location, the taxpayer may use an alternative method to situs gross receipts under this division if the alternative method is reasonable, is consistently and uniformly applied, and is supported by the taxpayer's records as the records exist when the service is provided or within a reasonable period of time thereafter.

(J) If the situsing provisions of divisions (A) to (H) of this section do not fairly represent the extent of a person's activity in this state, the person may request, or the tax commissioner may require or permit, an alternative method. Such request by a person must be made within the applicable statute of limitations set forth in this chapter.

(K) The tax commissioner may adopt rules to provide additional guidance to the application of this section, and provide alternative methods of situsing gross receipts that apply to all persons, or subset of persons, that are engaged in similar business or trade activities.

(L) As used in this section, "motor carrier" has the same meaning as in section 4923.01 of the Revised Code.

Amended by 129th General AssemblyFile No.127, HB 487, §101.01, eff. 6/11/2012.

Effective Date: 06-30-2005; 2006 HB699 03-29-2007

5751.31 Direct appeal on constitutional issues to supreme court.

Notwithstanding any section of law to the contrary, the tax commissioner may issue one or more final determinations under section 5703.60 of the Revised Code for which any appeal must be made directly to the supreme court within thirty days after the date the commissioner issued the determination if the primary issue raised by the petitioner is the constitutionality of division (H)(3) of section 5751.01 of the Revised Code or an issue arising under Section 3, 5a, or 13 of Article XII, Ohio Constitution. Such final determination shall clearly indicate that any appeal thereof must be made directly to the supreme court within the thirty-day period prescribed in this division.

Effective Date: 06-30-2005