IN THE SUPREME COURT OF OHIO

T. Ryan Legg Irrevocable Trust, UBS Trust Company, N.A., Trustee	:	Case No. 2015-0917
Appellant,	:	On Appeal from the Ohio Board of Tax Appeals
v.	:	
	:	BTA Case No. 2013-A-1469
Joseph W. Testa, Tax Commissioner of Ohio	:	
Appellee.	:	

MERIT BRIEF OF APPELLANT T. RYAN LEGG IRREVOCABLE TRUST, UBS TRUST COMPANY, N.A., TRUSTEE

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SUMMARY

This is an appeal from an Order of the Ohio Board of Tax Appeals ("Board") concerning a 2006 Ohio trust income tax return filed by a Delaware resident trust, the T. Ryan Legg Irrevocable Trust ("Trust") that sold stock in an Ohio-based multi-state business, Total Quality Logistics, Inc. ("TQL") with offices in Ohio and West Virginia. A cross appeal was filed by the Department on June 15, 2015. This is the First Brief filed pursuant to S.Ct.Prac.R. 16.05. It addresses three erroneous findings by the Board, two constitutional claims properly left unaddressed by the Board, and two claims the Board did not address in error. The Trust's arguments are briefly summarized here and discussed in detail *infra*.

At issue in this case is whether a non-resident trust such as appellant may be taxed in Ohio on income not attributable to the trust's activities within that state. Ohio taxes trusts on their modified Ohio taxable income, which is the sum of a trust's Ohio modified business income, qualifying trust amounts, and modified nonbusiness income. To be taxable in Ohio, therefore, income earned by a trust must fall into one of these three categories. The Board erred when it determined that the income from the Trust's sale of TQL stock was taxable to Ohio as both an Ohio qualifying trust amount and Ohio modified business income.

Income earned by a trust in a sale of stock is a qualifying trust amount only when the book value of the physical assets of the company issuing the stock is available to the trust on the last day of the year prior to the date the stock is sold. Despite overwhelming evidence that the Trust did not have access to this information, the Board erroneously found that the income from the Trust's sale of TQL stock was a qualifying trust amount. This finding must be reversed.

Income earned by a trust in a sale of stock can be classified as modified business income if it arose from a total or partial liquidation of a business. Ignoring clear evidence that TQL did not totally or partially liquidate and is in fact still an active business today, the Board erroneously found that the income was modified business income arising from the partial liquidation of TQL. Moreover, a particular amount of a trust's income cannot be classified as both a qualifying trust amount and modified business income; the Board found that the Trust's income from the sale of TQL stock was both. Accordingly, this finding must be reversed.

The Board's findings also raise an issue regarding the residency of the Trust, which is important because an Ohio resident trust must pay tax to Ohio on all of its income, and a nonresident trust pays tax to Ohio only on its income which is properly allocated or apportioned to Ohio. A trust is an Ohio resident trust when it has at least one qualifying beneficiary domiciled in Ohio during the relevant tax year. Despite clear language in the Trust Agreement that the Trust had *no* such beneficiaries in 2006 in Ohio, making it a nonresident, the Board erroneously found that the Trust was an Ohio resident trust. This finding must be reversed.

The other issues in this case are constitutional in nature, and involve whether Ohio's taxation of a nonresident trust such as appellant run afoul of the United States and Ohio Constitutions. Ohio's taxation of the Trust, a resident of Delaware, violates the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of the United States Constitution because the Trust has no nexus with Ohio. Also, under the United States Constitution, Ohio must fairly apportion any income earned by the Trust. And finally, Ohio is treating the Trust differently than similarly situated taxpayers, in violation of the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution and the Ohio Constitution.

Even if, in light of all evidence to the contrary, this Court holds that the Trust's income is taxable to Ohio as either a qualifying trust amount or modified business income and declines to hold that the Commissioner's Final Determination is unconstitutional, the tax must be abated due to the amount of property TQL had in other states, most notably West Virginia. At least a portion of the income arising from the Trust's sale of TQL must be attributable to those states, and cannot be taxed in Ohio.

STATEMENT OF FACTS

I. Ryan Legg.

A native of West Virginia, Thomas Ryan Legg ("Ryan", or "Mr. Legg"), left his hometown there in 1997 to live in Fort Thomas, Kentucky. Hr'g Tr., Ryan, p. 67.[1] In 2001, Ryan moved to Cincinnati, Ohio, where TQL's offices were then located. *Id.* He lived in Cincinnati for approximately 5 years, until mid-2006, when he moved back to West Virginia. *Id.* at pp. 67-68.

II. Total Quality Logistics.

In 1997, Ryan and his friend, Ken Oaks, formed and began operating a small, closely-held trucking logistics business, TQL, that acted as a "[t]hird party logistics provider" and "basically managed freight for companies, and * * * helped trucking companies find freight." Appellant's Ex. 10 (TQL website); Hr'g Tr., Ryan, pp. 58, 64, 66. TQL was an Ohio corporation and a Subchapter S corporation for federal income tax purposes, and Ryan and Ken Oaks each

[1] A hearing in this matter was held on May 21, 2014 before the Board. The record in this case was filed with the Ohio Supreme Court on July 7, 2015. The Hearing Record includes the Hearing Transcript and the Exhibits introduced at the hearing as well as the Statutory Transcript of evidence certified by the appellee Tax Commissioner to the Board of Tax Appeals pursuant to R.C. 5717.02. The Hearing Transcript will be cited as "Hr'g Tr." and include both the page number and the name of the individual testifying. References to Exhibits will be cited as either "Appellant's Ex. __" or "Appellee's Ex. ___" and will include a parenthetical identifying the Exhibit. The Statutory Transcript, certified to the Board by the Commissioner pursuant to R.C. 5717.02, will be cited as "S. Tr." and the page number. References to Appellant's Supplement will be cited as "Appellant's Supp. p. __" and will include a parenthetical identifying the document.

owned 50% of the company, 100 shares each. Appellant's Ex. 3 (TQL's Articles of Incorporation); Hr'g Tr., Ryan, pp. 60, 64. Ryan was TQL's Chief Executive Officer and managed the sales side of the business, while Ken Oaks was President of TQL and managed the company's operations and finances. *Id.* p. 66. Under Ryan and Ken Oaks' management, TQL grew into a successful business. As the business grew, so did the number of employees, managers, and business locations. *Id.* at pp. 60, 67. The Cincinnati-based business eventually opened a second office in West Virginia near Ryan's hometown. *Id.* at p. 60. Ryan bought a home in Cincinnati in 2001. *Id.* at p. 67.

Although business was good, the strain of operating TQL began to take its toll on the relationship between Ryan and Ken Oaks, who had conflicting ideas on how to operate and grow the business. As Ryan testified, in the 2005-2006 time period, TQL was a "[v]ery tough place to work when you don't get along with your partner." *Id.* pp. 60, 73. Thus, Ryan and Ken decided that Ken would keep the Company, and Ryan stopped going to the office or otherwise participating in the business as early as August, 2005. *Id.* at pp. 61, 95-96.

Ryan did not receive regular TQL financial statements or company documents beginning in August 2005. *Id.* at p. 61. Ryan tendered his resignation in mid-November 2005. *Id.* at pp. 60-61.

III. Estate Planning for Ryan and His Family's Future in 2005 and the Trust's Sales of Its TQL Stock in 2006.

In 2005 Ryan sought advice from his attorneys, accountants, and investment advisors regarding how to structure a possible sale and to plan for his young family's future (Ryan's first son was born in 2005). *Id.* at pp. 72, 74; Ghassomian,[2] pp. 163; Michel,[3] p. 218-19. As a result

[2] Kevin Ghassomian, Esq. testified at the May 21, 2014 hearing. For the last 15 years, Ghassomian has practiced as an attorney. Hr'g Tr., Ghassomian, at pp. 160-61. During the relevant time frame, Ghassomian was a Partner at Greenebaum Doll & McDonald PLLC

of this estate and tax planning, on November 14, 2005, Ryan, as grantor, created the Trust under the T. Ryan Legg Irrevocable Family Trust Agreement (the "Trust Agreement"). Appellant's Ex. 1 (Trust Agreement). U.S. Trust Company of Delaware ("U.S. Trust") was named Trustee. *Id.*; Hr'g Tr., Ryan, p. 56-57 The Trust is governed by Delaware law, and pursuant to Del. Code Ann. Tit. 30, § 1601(8), the Trust is a Delaware resident trust, domiciled in Delaware with a mailing address of 1300 Market Street, Suite 605, Wilmington, Delaware 19801. Appellant's Ex. 1 (Trust Agreement), §§ 5.1, 5.8; Hr'g Tr., Ryan, p. 57.

For federal income tax purposes, during the relevant time period, the Trust was classified as a complex, non-grantor trust, the taxation of which is governed by Section 661 of the Internal Revenue Code of 1986, as amended ("Code"). Appellant's Exs. 11-12 (Trust's Federal and Ohio Tax Returns); Hr'g Tr., Michel, p. 220-221. A self-described "trucker," Ryan readily

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(n/k/a Bingham Greenebaum Doll LLP) and represented both Ryan and the Trust. *Id.* at pp. 161-62. Ghassomian was part of the team of lawyers that drafted the Trust Agreement and, at one time, represented the Trust in the Tax Controversy. *Id.* at pp. 164, 199-200. In addition, Ghassomian served as a member of the Trust's Advisory Committee during the relevant time frame. *Id.* at p. 196. As a result, Ghassomian is knowledgeable about the Trust, including the Trust Agreement, and testified accordingly. *Id.* at pp. 161-162, 164, 196, 199-200. When he testified at the hearing, Ghassomian was a Partner with Dinsmore & Shohl LLP in Cincinnati, Ohio. *Id.* at p. 160-161.

[3] John Michel testified at the May 21, 2014 hearing. Michel is a Certified Public Accountant and has been employed in the financial industry for over 30 years. Between 1993 and 2009, Michel was employed with Grant Thornton LLP, one of the world's leading organizations of independent audit, tax and advisory firms. Hr'g Tr., Michel, p. 229. During the relevant time frame, Michel was a Partner with Grant Thornton and oversaw the preparation of tax returns for the Trust, TQL, and Ryan, each of which were his clients. *Id.* at pp. 217-18. Michel is familiar with the Trust, including the Trust Agreement, as part of the consulting services he provided to Ryan. *Id.* at p. 219. In fact, Michel was acquainted with the Trust prior to its formation, during its formation, and in working with the Trust after its formation. *Id.* Michel is likewise familiar with the Purchase Agreement. *Id.* at pp. 243-44. Not only did Michel review the Purchase Agreement before it was executed, Michel further analyzed it as an integral part to the preparation of both Ryan and the Trust's respective tax returns. *Id.* As a result, Michel is knowledgeable about the Trust, the Trust Agreement and the Purchase Agreement, as well as TQL, and testified accordingly. *Id.* at pp. 218, 243-44. Michel currently practices with Mowry, Marty & Bain, Inc. in Cincinnati, Ohio. *Id.* at p. 217.

characterizes the Trust documents at issue in this case as "complex" and says that he relied on his advisors (John Dovich, John Michel, and Kevin Ghassomian) to recommend an appropriate estate plan to protect his young family, as well as to oversee the plan's implementation, including the formation and management of the resulting trusts. Hr'g Tr., Ryan, at pp. 74, 77, 86, 105, 115; Ghassomian, pp. 163-64; Michel, p. 241.

The Trust Agreement required that the Trust not make any distributions during the period November 14, 2005 through January 3, 2007 ("Initial Period"): "During. . . the 'Initial Period'[ ], the trustee shall accumulate the net income of the * * * Trust and add it to principal." Appellant's Ex. 1 (Trust Agreement), § 2.1(a)(1); Hr'g Tr., Michel, 232-34. Thus, the Trust had <u>no beneficiaries</u> during the Initial Period, calendar years 2005 and 2006, *i.e.* no one who was entitled to or could receive any distribution from it under Section 2.1(a)(1) of the Trust Agreement. *Id.*; Hr'g Tr., Ryan, p. 63; Michel, 232-34. Ryan was not a beneficiary of the Trust in 2005 or in 2006. Appellant's Ex. 1 (Trust Agreement), § 2.1(a)(1).

The same day the Trust was created, November 14, 2005, Ryan funded the Trust by transferring 65 shares of TQL stock to U.S. Trust to fund the Trust's account. Hr'g Tr., Ryan, pp. 57-58; Dovich,[4] p. 122; Michel, p. 221. The Trustee, U.S. Trust, did not make any distributions in 2005. Hr'g Tr., Ryan, p. 63; Michel, p. 220; Appellant's Supp. pp. 1-2 (Affidavit of US Trust).

Within the next few weeks, on December 2, 2005, Ken Oaks entered into a Purchase

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[4] John D. Dovich testified at the May 21, 2014 hearing. For the last 27 years, Dovich has been the President and majority owner of John D. Dovich & Associates, LLC, a financial advisory firm. *Id.* at Dovich, pp. 125-26. Ryan first became a client of Dovich's in the early 2000s. *Id.* at pp. 126-27. This relationship led to Dovich serving as a member of the Trust's Advisory Committee during the relevant time frame. *Id.* at pp. 121-22; 125-26. As a result, Dovich is knowledgeable about the Trust and the Trust Agreement and testified accordingly. *Id.* at p. 122.

Agreement with the Trust for the purchase of the 65 shares of TQL stock.[5] Appellee's Ex. F (Purchase Agreement); Hr'g Tr., Ryan, pp. 75-76; Michel, pp. 243-44. Under the terms of the Purchase Agreement, Ken Oaks promised to pay the purchase price of the stock to the Trust in "cash" at the "Closing" to be held "on January 3, 2006, effective as of December 31, 2005, or at such other time and place as the parties may mutually agree. In any event a calendar month end effective date will be agreed to by Buyer and Seller." Appellee's Ex. F (Purchase Agreement), §§ 1.1, 4.1.

The Closing ultimately occurred on February 3, 2006, and the Trust sold its 65 shares of TQL for $18,525,000 – this money went into the Trust's account, not to Ryan. *Id.* at last page; Hr'g Tr., Ryan, pp. 60, 92, 115; Dovich, p. 122. Thereafter, pursuant to the Trust Agreement and at the direction of U.S. Trust, the financial advisory firm of John D. Dovich & Associates, LLC invested the funds "in a variety of marketable securities and other instruments." Hr'g Tr., Dovich, p. 122, 140. Again, U.S. Trust did not make any distributions in 2006. Hr'g Tr., Ryan, p. 63; Dovich, p. 123; Michel, p. 220.

In the summer of 2006 Ryan and his family moved back to West Virginia, eventually settling in North Carolina where he and his family now live.[6] *Id.* at pp. 68, 71-72.

IV. TQL Did Not Provide Its Books and Records To the Trust in the Normal Course of Business or Otherwise.

TQL did not provide the Trust (or U.S. Trust, Ryan, or any member of the Advisory Committee) with the book value of TQL's physical assets in Ohio and elsewhere as of the 2005 calendar year, December 31, 2005. Hr'g Tr., Ryan, p. 61-62; Dovich, p. 123; Ghassomian, p.

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5 The remaining 35 shares referenced in the Purchase Agreement are not at issue in this Appeal.

6 In 2006, Ryan owned approximately $3 million of property outside Ohio and approximately $900,000 of property located in Ohio. *Id.*, pp. 110-111. Ryan sold his Cincinnati home in July, 2007. *Id.*, p. 266.

209; Michel, pp. 225-26. Nor could the Trust (or U.S. Trust, Ryan, or any member of the Advisory Committee) otherwise determine this information because it did not have any right to inspect TQL's books and records. *Id.* at Michel, pp. 248-250.

Neither Grant Thornton nor Mr. Michel were parties to the Trust, nor were they agents thereof; rather, Mr. Michel in his capacity as partner of Grant Thornton provided tax services to the Trust. Hr'g Tr., Michel, pp. 218-19, 224. Mr. Michel in his capacity as partner of Grant Thornton also provided accounting and tax services to TQL, but *Mr. Michel was not at liberty to communicate any of the information he gleaned as TQL's CPA to the Trust. Id.* at pp. 218.

As TQL's CPA, Mr. Michel testified that he was "aware of the flow of financial information of [TQL]," "frequently [met] with the executives of [TQL] to review the financial performance of [TQL] and engage in appropriate tax planning strategies and calculations of estimated personal level and corporate level tax liabilities," and was "familiar with the internal financial statements of the company on a periodic basis," but that he was, as the Trust's CPA, "unaware of any information [as to TQL's book value of physical assets] supplied directly to the trustee by the personnel at TQL." *Id.* at pp. 224-25. With Mr. Michel's intimate knowledge of TQL's "flow of financial information," he was "unaware of any process or procedure" that required TQL to regularly provide the Trust with TQL's book value. *Id.* at p. 225. That the Trust never received this information confirms TQL had no "process or procedure" to provide it to the Trust in the ordinary course. *Id.* at Ryan, p. 61; Dovich, p. 123; Ghassomian, p. 209; Michel, pp. 225-26.

Indeed, under the terms of the Purchase Agreement, the Trust could inspect TQL's books and records only "[i]f [the Trust] reasonably believes that a Monetization Event [*e.g.*, a merger involving TQL, defined in § 2.2] has occurred." Appellee's Ex. F (Purchase Agreement), § 2.5;

Hr'g Tr., Michel, pp. 248-49. As the Trust's CPA, John Michel affirmatively stated that a Monetization Event never occurred and, therefore, under Section 2.5 of the Purchase Agreement as this Section was not "operative under the facts at hand" so that the Trust had <u>no right</u> to inspect TQL's books and records. *Id.* at p. 250.

V. The Trust Had No Ohio Beneficiaries and Made No Distributions in 2005 or 2006.

As explained above, during the 2005 and 2006 tax years (which were included in the Initial Period), the Trust had no Ohio resident beneficiaries, *i.e.*, no one who was entitled to or could receive any distribution from it under Section 2.1(a)(1) of the Trust Agreement, and the Trust did not make any distributions to any Ohio beneficiaries. Appellant's Ex. 1, § 2.1(a)(1) (Trust Agreement); Hr'g Tr., Ryan, p. 63; Dovich, p. 123; Michel, p. 220.

VI. The Trust's 2006 Ohio Tax Return.

Based upon these facts, the Grant Thornton accounting firm prepared the Trust's 2006 Ohio Fiduciary Income Tax Return (Form IT-1041). Hr'g Tr., Michel, pp. 220-21. For income tax purposes, the Trust – a Delaware resident trust – was the taxpayer that recognized the gain from the sale of the Trust's TQL stock. Appellant's Ex. 1, § 5.1 (Trust Agreement); Hr'g Tr., Ryan, p. 57. The Trust reported its federal taxable income, *i.e.*, specifically, the gain arising from the sale of its TQL stock, on its IT-1041. Appellant's Hearing Exhibit 11 (Trust's Ohio Tax Return); Hr'g Tr., Michel, pp. 222-24. The Trust's modified Ohio taxable income, however, was reported as "None" because the capital gain from the sale of TQL stock was modified non-business income of a *Delaware* resident trust. Appellant's Hearing Exhibit 11 (Trust's Ohio Tax Return); Hr'g Tr., Michel, pp. 222-24. In short, the gain was not subject to Ohio state income tax.

VII. The Initial Trustee and Successor Trustees.

Throughout the existence of the Trust, there have been several different entities who served as Trustee. Initially, U.S. Trust served as the Trustee. Appellant's Ex. 1 (Trust Agreement); Hr'g. Tr., Ryan, p. 56-57. U.S. Trust served as the Trustee during the relevant tax years for this appeal. Then, in 2008, Charles Schwab Bank ("Charles Schwab") took over as the Trustee. *Id.* p. 99; Dovich, pp. 123-124; Appellant's Supp. pp. 3-4 (Trustee succession documents). The reason for the switch was that Charles Schwab sold U.S. Trust, a wholly owned subsidiary of Charles Schwab, and John Dovich, the financial advisor with whom Ryan had worked closely through the years, remained affiliated with Charles Schwab. Hr'g Tr., Ryan, p. 116; Dovich, p. 123-124. In 2009, the Trustee changed again, this time from Charles Schwab to UBS Trust Company, N.A ("UBS Trust"). Hr'g Tr., Dovich, p. 124, Appellant's Ex. 17. UBS Trust was the Trustee when the Trust filed the Petition for Reassessment in 2009, as well as when the appeal of the Tax Commissioner's Final Determination was filed with the Board. Hr'g Tr., Ghassomian, p. 202. Finally, effective on or about August 31, 2015, UBS Trust was sold to Reliance Financial Corporation ("RFC"), at which time UBS Trust was merged into Reliance Trust Company of Delaware ("Reliance Trust"). As such, Reliance Trust is now the current Trustee of the Trust. A notice to the Court has been filed concurrently with this brief to advise of the change.

VIII. The Ohio Tax Controversy.

After the Trust filed its 2006 Ohio income tax return, an audit of the Trust's Form IT-1041 followed. In its correspondence dated July 29, 2008, the Department proposed changes [Form IT-1041C] to apportion the TQL stock gain as "business income" using the special rule for the apportionment of income of a pass-through entity investor [R.C. 5747.212] in which the three-year average of TQL's three-factor apportionment was used (which was approximately

90%)[7] to determine the Trust's income apportioned to Ohio (here, over 90%) and subject to tax thereon.[8] S. Tr. p. 46. The Department's characterization of the gain as business income necessarily entailed a determination that the gain was not a qualifying trust amount, because if it was business income as determined, it could not be a qualifying trust amount by definition. *See* Final Determination, S. Tr. p. 2.

The Trust filed a timely Protest in August, 2008, disputing the propriety of the Department's position and asserting, *inter alia*, that the TQL stock gain was nonbusiness income not allocable to Ohio, citing authority that a trust's holding and selling of stock is not a trade or business, and advancing other arguments. Appellant's Ex. 13 (Protest).

The Department issued a Notice of Assessment, Trust Income Tax, dated May 26, 2009, which did not, on its face, explain the Department's position. Appellant's Ex. 14 (Notice of Assessment). The Trust, as the taxpayer, timely appealed the assessment in its Petition for Reassessment dated July 20, 2009, reasserting its positions set forth in its Protest and requesting a hearing. Appellant's Ex.15 (Petition for Reassessment). A hearing was held on August 10, 2010. S. Tr. p. 5.

After attempts to resolve the issue, the Department issued its Final Determination on March 29, 2013. S. Tr. p. 1-4. There, the Department reversed its earlier position that the income was business income, and instead erroneously upheld the trust income tax assessment in the amount of $1,275,597.00 on the basis that the gain at issue was a "qualifying trust amount"

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7 The apportionment information was supplied by Mr. Michel in 2008 which he obtained *directly from* TQL as TQL's CPA when preparing TQL's tax return in 2007. Hr'g Tr., Michel, p. 227-228. As stated *supra*, the Trustee did not have access to this information. *Id.* at pp. 224-225.

8 "Modified business income" means "the business income included in a trust's Ohio taxable income after such taxable income is first reduced by the qualifying trust amount, if any." R.C. 5747.01(BB)(1); *see also* R.C. 5747.01(B) (defining business income).

under R.C. 5747.01(BB)(2) allocable in total (100%) to Ohio – disregarding publicly available information and information believed to be in the Department's possession (*e.g.*, TQL's 2005 Ohio tax return) that TQL had assets in other states such as West Virginia. *Id.*[9] Consequently, the Trust, as the taxpayer, timely appealed the Final Determination by filing a Notice of Appeal with the Board on May 28, 2013. (These events are collectively referred to as the "Tax Controversy.").

A hearing was held on May 21, 2014. Ryan (the grantor), John Dovich (27-year veteran in the financial industry), and John Michel (30 years of expertise in the accounting field) testified on behalf of the Trust. Not a single witness testified on behalf of the Department as to the Appeal's substantive issues. Although the Department issued a subpoena to Kevin Ghassomian to testify at the hearing, Mr. Ghassomian (attorney with 15 years experience in the areas of estate planning; former legal counsel to Trust and Ryan) provided further testimony in support of the Trust's position in this Appeal. Indeed, the Trust would have called Mr. Ghassomian as its own witness, had it not been for attorney-client privilege and work-product issues and because his testimony was anticipated to be duplicative of the Trust's other witnesses.

The Trust also attempted to issue a subpoena duces tecum to U.S. Trust, the former trustee of the Trust. However, given that U.S. Trust is an out-of-state entity who is not a party to this appeal, the Board would not issue the subpoena. The Department was able to issue a subpoena to U.S. Trust, ostensibly by telling an employee of the Board that U.S. Trust was a party to the appeal. Appellant's Supp. pp. 5-9 (Appellee's Subpoena to U.S. Trust). Counsel for the Trust, counsel for the Department, and counsel for U.S. Trust each made arrangements for each party to depose U.S. Trust at a time convenient for all involved. Appellant's Supp. p. 10 (E-

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9 The Department correctly removed the penalties that had been assessed. *Id.*

mail from Todd Swatsler, counsel to U.S. Trust). The Department was provided with an opportunity to depose U.S. Trust, but chose not do so. The Trust subsequently provided its Affidavit that affirmed the testimony given by the various witnesses at the hearing, namely, that TQL did not provide the Trust with the book value of TQL's physical assets in Ohio and elsewhere for 2005. Appellant's Supp. pp. 1-2 at ¶ 8 (Affidavit of U.S. Trust) ("TQL did not provide the Trust with the book value of TQL's physical assets in Ohio and elsewhere for the 2005 calendar year."). U.S. Trust also affirmed that it did not make any distributions during the Initial Period and there were no beneficiaries during that time. *Id.* at ¶ 9 ("The Trust, with the exception of paying duly incurred Trust expenses, made no distributions during the "Initial Period," i.e., from November 14, 2005 through January 3, 2007, consistent with Section 2.1(a)(1) of the Trust Agreement which provided that no one was entitled to or could receive any distribution from the Trust during the Initial Period.").

On May 5, 2015, the Board issued its Decision and Order. The Board correctly found "that the petition for reassessment, notice of appeal, and all pleadings filed by the trust, both before and after, were properly filed by the trust's authorized representative." Order p. 2. The Board erroneously found for the Department on the issues relating to the trust income tax return. Despite the fact that the book value of TQL's physical assets was not available to the Trust, the Board found that the gain from the stock sale was a qualifying trust amount. *Id.* p. 4. Then, although TQL was not liquidated, the Board found that the gain from the stock sale was business income resulting from the partial liquidation of a business. *Id.* pp. 4-5. And, disregarding the fact that the Trust had no Ohio beneficiaries during the tax period at issue, the Board found that the Trust was an Ohio resident trust. *Id.* p. 5. The Board did not reach the constitutional claims alleged by the Trust, nor did it address the apportionment claims at issue in the case. *Id.* p. 5.

This appeal follows.

ARGUMENT

This Court must reverse the Board's Order and hold the gain at issue not subject to Ohio tax. The Trust's gain from its sale of TQL stock is not a qualifying trust amount taxable to Ohio because the book value of TQL's physical assets was not "available" to the Trust. Nor is the gain modified business income taxable to Ohio because it did not arise from a liquidation of a business, given that TQL was not liquidated. The Trust is a nonresident Trust because it had no qualifying beneficiaries domiciled in Ohio in 2006, and its income is therefore not allocable to Ohio.

The Board's Order failed to consider the Trust's constitutional arguments that the Final Determination violates the Equal Protection Clauses of the Fourteenth Amendment of the United States Constitution and of the Ohio Constitution because it treats similarly-situated taxpayers differently, and it violates the United States Constitution because it subjects an apportionable share of an out-of-state taxpayer's income to tax when there was no unitary interest between the owner and its investment. Because the Board incorrectly applied facts to law, and because the Final Determination is unconstitutional, this Court must hold that the Trust is not subject to Ohio income tax.

Assuming *arguendo* that the gain was business income apportionable, in part to Ohio, the Board should have considered the Trust's arguments that the gain should have been apportioned at least partially outside of Ohio, because of TQL's property in West Virginia, or wholly outside of Ohio under alternative apportionment which provides an escape hatch to avoid unconstitutional taxation.

IX. Standard of Review.

The Ohio Supreme Court will "review a decision of the [Board] to determine whether it is reasonable and lawful, and * * * will reverse a decision that is based on an incorrect legal conclusion." *Gallenstein v. Testa*, 138 Ohio St.3d 240, 243 (2014), R.C. 5717.04. The "[Board] is responsible for determining factual issues and, if the record contains reliable and probative support for these BTA determinations, this court will affirm them." *Gallenstein*, 138 Ohio St. at 243. "However, when there is an absence of evidence to support the decision under review, the question becomes one of sufficiency, as opposed to weight of the evidence, and is one of which this court will take cognizance." *Citizens Fin. Corp. v. Porterfield*, 25 Ohio St.2d 53, 58 (1971). "The issue of how to apply [R.C. 5747.01(BB)] to the undisputed facts requires [this Court] to decide a purely legal issue." *AERC Saw Mill Vill., Inc. v. Franklin Cty. Bd. of Revision*, 127 Ohio St. 3d 44, 48 (2013) ([ ] supplied). The Trust submits that the Board has erred in its application of the facts to the law, and as such, this Court must reverse the Board's Order.

X. Propositions of Law.

> **Proposition of Law No. I:** The Trust's sale of corporate stock in TQL is not taxable to Ohio as a qualifying trust amount under R.C. 5747.01(BB)(2) because the book value of TQL's assets was not "available" to the Trust.

A qualifying trust amount is statutorily defined as a capital gain or loss resulting from a sale of an interest in a qualifying investee (*e.g.*, shares of S corporation stock) but "*only if*": the trust owns more than 5% of the qualifying investee, and "[t]he book value of the qualifying investee's physical assets * * * as of the last day of the qualifying investee's * * * calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, is available *to the trust*." R.C. 5747.01(BB)(2)&(2)(a) & (b) (emphasis added). "Available" means "information is such that a person is able to learn of the information by the due date plus extensions, if any, for filing the return for the taxable year in which the trust recognizes the gain or loss." R.C. 5747.01(BB)(6).

In its Order, the Board erred in finding that the gain from the Trust's sale of TQL stock was a qualifying trust amount under R.C. 5747.01(BB)(2).[10] Relying on R.C. 5747.01(BB)(6), the Board found that the book value of TQL's physical assets was "available" because that information was utilized by Trust's tax preparer, John Michel, so that "a person [was] able to learn of" it. Order, pp. 3-4. However, the Board's finding that TQL's physical asset information was available to Mr. Michel does not support the Board's resulting conclusion that such information was available *to the Trust*. Indeed, this information was *not* available to the Trust: not through Mr. Michel, whose personal knowledge cannot be imputed to the Trust and who could not share confidential financial information of another client with the Trust; and not through the Trustee, who was contractually forbidden from obtaining the information per the terms of the Purchase Agreement, and who was not provided this information in the regular course of business. This Court must reverse the Board's finding that the income from the Trust's sale of TQL stock was a qualifying trust amount because the record shows that the required information was not available to the Trust.

[10] "Qualifying trust amount" of a trust means "capital gains and losses from the sale...of ...ownership interests in...a qualifying investee [such as an S corporation, like TQL, here] to the extent included in the trust's Ohio taxable income, *but only if* * * * [a] [t]he book value of the qualifying investee's physical assets in this state and everywhere, as of the last day of the qualifying investee's * * * calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, is *available* to the trust [and] [b] [t]he requirements of section 5747.011 of the Revised Code are satisfied for the trust's taxable year in which the trust recognizes the gain or loss [this second requirement is not in issue here]. *Any gain or loss that is not a qualifying trust amount* is modified business income, qualifying investment income, or *modified nonbusiness income*, as the case may be." R.C. 5747.01(BB)(2) (2006) (emphasis and [ ] supplied). Appellant asserts that the involved gain is nonbusiness income.

(A) Information available to the Trust's CPA cannot be imputed *to the Trust,* because he was not a trustee or advisory committee member administering the Trust.

Trusts are administered by their Trustee, so it logically follows that for information to be available to a trust, it must come through their Trustee or someone else who aids in the trust's administration. *See* R.C. 5808.01. Mr. Michel was not the Trustee of the Trust. *See* Appellant's Ex. 1 (Trust Agreement) (naming U.S. Trust trustee of the Trust). Nor was he a member of the Advisory Committee. *Id.* at ¶ 4.1 (naming John Dovich and Kevin Ghassomian as members of the Advisory Committee). Mr. Michel was tasked only with preparing the Trust's tax returns and advising the Trust on tax matters. *See* Appellant's Ex. 1 (Trust Agreement); Hr'g Tr., Michel, p. 220. Therefore, to the extent Mr. Michel was in possession of relevant information obtained from TQL, one of his other tax clients, such information cannot be considered to have been in possession of or available *to the Trust.*

The Board found that "as it was utilized by the trust's tax preparer, it was therefore "available," i.e., "a person [was] able to learn of" it. R.C. 5747.01(BB)(6)." Order, p. 4. R.C. But, R.C. 5747.01(BB)(2)(a) provides that a capital gain can be a qualifying trust amount only when "[t]he book value of the qualifying investee's physical assets…is available *to the trust.*" R.C. 5747.01(BB)(2)(a). Statutes such as these must be read "*in pari materia* * * *constru[ed] together * * * [and] give[n] such a reasonable construction as to give the proper force and effect to each and all such statutes." *United Tel. Co. of Ohio v. Limbach*, 71 Ohio St. 3d 369, 372 (1994); *see also AERC Saw Mill*, 127 Ohio St. 3d 44 at 49. So, to harmonize and give full effect to both R.C. 5747.01(BB)(2)(a) and R.C. 5747.01(BB)(6), the involved trust, not just any person, must be able to learn of the information.

Applied to the facts here, a finding that such information was "available to the trust" as required by R.C. 5747.01(BB)(2)(a) could only be supported by evidence and a finding that the information was available *to the Trust*, *i.e.*, the Trustee, and nothing in the record supports a finding that the trustee, U.S. Trust, or even the Advisory Committee, Mr. Dovich or Mr. Ghassomian, could learn of, had access to or utilized that information. The Board found only that Mr. Michel utilized such information, not the Trust. Consequently, the Board's finding does *not* support the Board's conclusion that the book value of TQL's physical assets was available *to the Trust*; the Board erred in applying the facts to the law, and thus, this Court must reverse the Board.

(B) The Trust's CPA was not legally permitted to share confidential information he learned as CPA for TQL with another client, the Trust.

Mr. Michel was not permitted to provide the Trust with any information he obtained in his capacity as CPA for TQL. An accountant is not permitted to divulge privileged information about a company's financial information to another client.[11] An accountant cannot reveal the financial information of a client without their consent; to do so would compromise a relationship that is generally regarded to be built on confidentiality and discretion. *See Wagenheim v. Alexander Grant & Company*, 19 Ohio App.3d 7, 10-11 (1983) ("[A] client should be entitled to freely disclose information concerning his financial status to accountant without fear that such information will be exposed * * *.").

Accordingly, the Trust could not learn of the financial information of TQL from Mr. Michael, and as such it was not available to the Trust. *See* R.C. 5747.01(BB)(2)(a) & (6). There is no evidence in the record that TQL, which provided such information to Mr. Michel as TQL's CPA, consented to Mr. Michel providing TQL's financial information to the Trust, and there is

[11] Mr. Michel did access TQL's tax information at his accounting firm during the audit process and provided that directly to the Department to calculate the 3-factor Ohio apportionment ratio during the Commissioner's audit in July of 2008. S. Tr. p. 129-30; Hr'g Tr., Michel p. 226. Such tax information was already in the Commissioner's possession, and as such, did not create a breach of confidentiality. *See* S. Tr. pp. 90-95.

no evidence that Mr. Michel shared TQL's financial information with the Trust; to the contrary, the record shows that Mr. Michel could not and did not provide the Trust with that information. Hr'g Tr., Michel p. 226 ("Q: As a CPA for [TQL], did you have access to the book value and location of TQL's physical assets in your capacity as [TQL's] CPA? A: Yes * * *. Q: Did you pass that information along to * * * U.S. Trust? A: No.").[12]

Consequently, the evidence and the Board's factual finding that Mr. Michel, who was TQL's tax preparer, could learn TQL's physical asset book value information does *not* support the Board's necessary legal finding that the book value of TQL's physical assets was available *to the Trust* because Mr. Michel was also the Trust's tax preparer. The Trust could not learn of such information from Mr. Michel because Mr. Michel was not authorized to provide and did not share such information with the Trust. Accordingly, the Board erred in finding that because Mr. Michel learned of such information that such information was available to the Trust (since the Trust could not learn of it), and this Court should reverse the Board's finding that the income from the Trust's sale of TQL was a qualifying trust amount.

(C) The Trust was contractually forbidden from obtaining the relevant information pursuant to the Purchase Agreement; thus, the information was not available to the Trust.

The involved trust, not just any person, must be able to learn of the information under R.C. 5747.01(BB)(2)(a) and R.C. 5747.01(BB)(6), as discussed above. Here, under the terms of the Purchase Agreement by which the Trust sold the TQL stock, the Trust was contractually forbidden from learning of the book value and location of the physical assets of TQL, and thus, that information was not available to the Trust.

[12] Again, this alone is sufficient for the Court to reverse the Board's finding on Proposition of Law No. 1 and to hold for the Appellant.

Under the Purchase Agreement, the Trust could *not* inspect TQL's books and records *unless* the Trust "reasonably believe[d] that a Monetization Event [defined in § 2.2] ha[d] occurred." Appellee's Ex. F (Purchase Agreement), § 2.5; Hr'g Tr., Michel, pp. 248-49. As the Trust's CPA, John Michel, testified, a "Monetization Event" never occurred and, therefore, the Trust had no contractual right to inspect TQL's books and records:

> If the transferee, in this case effectively Mr. Oaks and his entities, were to transfer 50 percent or more of the shares of TQL subsequent to the date of this agreement [Purchase Agreement], other than a permitted transfer, or there was a merger or consolidation involving TQL, or Oaks and his progeny permit TQL to sell substantially all of their assets to a third party, so on and so forth, the enumerated five or so defined events in Section 2.2, none of which * * * [were] operative under the facts at hand.

Hr'g Tr., Michel, pp. 249-50. Thus, as confirmed by the Purchase Agreement and Mr. Michel's testimony, the Trust could not learn of the book value of the physical assets of TQL, and so, under R.C. 5747.01(BB)(2)(a)&(6), this information was not available to the Trust.[13]

(D) TQL did not provide the Trust with the relevant information in the normal course of business, so that information was not "available" to the Trust when viewed in light of *Alcan Aluminum v. Limbach* and *Random House v. Tracy.*

Crucial to determining whether the Trust's gain from the sale of TQL stock is a qualifying trust amount is determining whether the necessary information was "available" to the Trust. Such an inquiry must necessarily begin with ascertaining the definition of "available." No administrative regulations, rules or case law interpret the qualifying trust amount provision of R.C. 5747.01(BB)(2) or the definition of "available" in R.C. 5747.01(BB)(6), which the General Assembly added in 2002. So, its text is the first place to look to determine the underlying

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[13] As support for its conclusion that the book value of the TQL assets was available to the Trust, the Board cites to testimony of Ryan Legg [H.R. 118, 133]. Ryan was *not* a Trustee and *not* a member of the Advisory Committee; so, evidence about whether or not such information was available to Ryan does *not* support a conclusion that such information was available *to the Trust*. Notably, although he admittedly did not ask for it, Ryan testified that such information was *not* available to him, *i.e.*, he was not able to learn it.

legislative intent. *See Gulf Oil Corp. v. Kosydar*, 44 Ohio St.2d 208, 215-16 (1975). But, to the extent that this text is ambiguous, the "long-standing practice" is to strictly construe the provisions of taxing statutes against the Commissioner, and "any doubt must be resolved in favor of the [taxpayer] upon * * * which the burden is sought to be imposed." *Id.*

By way of comparison to the qualifying trust amount provision at issue here, over two decades ago, this Court construed the meaning of "available" in the context of its use in R.C. 5733.051. *See Alcan Aluminum Corp. v. Limbach*, 42 Ohio St.3d 121, 123 (989). For purposes of computing the taxable income of a corporation subject to taxation by Ohio (*i.e.*, with Ohio nexus), R.C. 5733.051 provides for the allocation of *nonbusiness income* (*e.g.*, certain dividends, capital gains, etc.) either to Ohio or outside of Ohio based on the location of the physical assets of the payor or in the case of a sale of a corporation, the dividend payor, *unless* such was *not available* to the taxpayer.[14] So, R.C. 5733.051's text discloses a legislative preference to allocate the nonbusiness income of an Ohio taxpayer based on the location of a payor's physical assets.

The text of R.C. 5733.051 (at issue in *Alcan*) must be contrasted with that at issue here, R.C. 5747.01(BB)(2)(a). In the former, the clear legislative preference in allocating nonbusiness income is to use location of the payor's physical assets *unless* it is "not available" [R.C. 5733.051] whereas in the latter, the clear legislative preference is just the opposite, to classify a gain as a qualifying trust amount and allocate same using the location of the physical assets of an entity owned by a trust "only if" such location was "available" to the trust [R.C.

[14] "Dividends * * * shall be apportioned to the state in accordance with the ratio which the book value of the physical assets of the payor thereof located in this state bear to the book value of the total physical assets of the payor thereof located everywhere. Dividends received from payors, the location of whose physical assets is not available to the taxpayer, shall be apportioned as provided in subdivision (8) of this division." *Alcan*, 42 Ohio St.3d at 122 (quoting R.C. 5733.051).

5747.01(BB)(2)], otherwise the income, if it is not business income, is nonbusiness income as is the case here.

This is a distinction of significance, and confirms a legislative preference to do just the opposite of what is required by R.C. 5733.051 – that is, ***not*** to treat a gain incurred by a trust as a qualifying trust amount. Stated more plainly, with regard to R.C. 5747.01(BB)(2), the *default* is that an amount is *not* a qualifying trust amount. The Department's initial determination recognized this. *See S.* Tr., p. 46.[15]

In *Alcan*, this Court "interpreted 'available' to mean 'ascertainable.'" *Id.* at 123. But, the Court did not stop there and further clarified the meaning of "available" in the context of the nonbusiness income allocation statute. The Court observed that "a fifty-percent shareholder such as Alcan would be *expected to be able to learn* of the location of the physical assets [of a 50% subsidiary corporation] at least until the date of sale." *Id.* (emphasis added; [ ] supplied).[16] The Court continued, "Information regarding the location of Kohler's physical assets would *normally* be available to Alcan * * *." *Id.* (emphasis added). Importantly, this court held that the information must be able to be learned by Alcan, *i.e.*, available to Alcan.

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[15] On audit, the Commissioner initially determined that the gain at issue was business income, which under, R.C. 5747.01(BB)(1)&(2) necessarily required a determination that the gain was *not* a qualifying trust amount.

[16] Notably, *Alcan* makes a reference, in *dictum*, to R.C. 1701.37(C), and as *dictum*, it is not binding precedent. It should also be noted that although R.C. 1701.37(C) provides a shareholder a "right to examine [a] corporation's books and records of account" [*Alcan*, 42 Ohio St. at 122], that right may only be exercised pursuant to a "proper purpose." R.C. 1701.37(C). Such a purpose must be "in furtherance of an object germane to the protection of the stockholder's interest in the corporation." *Grossman v. Cleveland Cartage Co.*, 157 N.E.2d 154, 156 (Ohio Com. Pl. 1959)]. Under the Purchase Agreement, the only proper purpose for the Trust to obtain TQL's books and records would be in the event of a Monetization Event, which had never occurred; accordingly, the relevant information could not be learned via R.C. 1701.37. It should also be noted that, R.C. 5747.01(BB)(6) makes no reference to R.C. 1701.37.

The facts of *Alcan* are quite distinguishable from the instant case. Alcan was a 50% shareholder of a subsidiary corporation, F.A. Kohler Company ("Kohler"). *Id.* at 121-22. Here, Ken Oaks, President and CEO of TQL, owned 50% of the shares of TQL stock, and the Trust owned only 32.5% (*i.e.*, 65 of 200 shares) of TQL stock. Mr. Oaks was in control of TLQ. And, not only was the Trust a minority shareholder of TQL, the Trust played no role in the corporate structure or day-to-day management of TQL. Hr'g Tr., Michel, pp. 224-26. TQL had no "process or procedure" to provide this information to the Trust in the ordinary course, and TQL did not provide the Trust (*i.e.*, the trustee, U.S. Trust, or for that matter, any member of the Advisory Committee)[17] with any financial information, including the book value of TQL's physical assets in Ohio and elsewhere as of the 2005 calendar year-end, December 31, 2005. *Id.*, Ryan, p. 61; Dovich, p. 123; Ghassomian, p. 209; Michel, pp. 225-26. Unlike Kohler in *Alcan*, TQL is not a subsidiary of the Trust.

The location of the physical assets of a corporation held as a stock investment by the Trust, which owned less than a third of TQL's stock, would *not normally* be provided to the Trust by TQL. In this regard, the Trust did not normally as a matter of course receive or obtain a state-by-state breakdown of the physical assets of TQL from TQL as might a corporation from its 50% owned subsidiary, like Alcan from Kohler. Neither was the Trust able to learn it, as discussed above. The Department's initial determination implicitly recognized this. S. Tr. p. 46; see footnote 15, *supra*.

A Board of Tax Appeals decision provides additional insight as to the meaning of "available" as used in R.C. 5733.051. *See Random House, Inc. v. Tracy*, Case No. 91-A-1329,

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[17] Mr. Dovich, as a member of the Advisory Committee for the Trust, testified that he was never provided with the book values and year-end locations of the physical assets of TQL as a matter of course, nor were any other members of the Advisory Committee. *Id.*, Dovich, p. 123. Mr. Ghassomian confirmed this as well. *Id.*, Ghassomian, pp. 208-09.

1993 WL 178269 (Ohio B.T.A. 1993). The Board decided *Random House* after *Alcan*, cited therein with approval, but it took into account the particular circumstances of the parties, as this Court did in *Alcan.* Random House, a publishing company, filed Ohio franchise tax returns claiming that its royalties should be apportioned as opposed to allocated because the location of payors activities was unavailable to Random House under R.C. 5733.051(G) and (H). "Such information was not routinely provided to [Random House] by its payors, nor was it contractually provided under the terms of [Random House's] written agreements with its clients." *Id.* ([ ] supplied). Therein the Board found that, "[T]he definition of 'available' in the context of R.C. 5733.051(G) connotes the ability, 'in the course of business', to obtain the required information. In the instant matter, it is clear that [Random House] was not able, in the ordinary course of business, to obtain the necessary information * * *." *Id.* ([ ] supplied). Consequently, such information was not available.[18]

Random House requires that an investee be able to ascertain applicable information "in the course of business" which is consistent with *Allied-Signal, Inc. v. Div. of Taxation*, 504 U.S. 768 (1992), discussed *infra*. Statutes must be given a "constitutional rather than unconstitutional construction if one is reasonably available." *United Air Lines, Inc. v. Porterfield*, 28 Ohio St.2d 97, 100 (1971).

The facts and circumstances of *Random House* are much closer to the instant case, especially as compared with the facts of *Alcan.* The Trust was a minority shareholder in TQL, not a 50% shareholder, "such as Alcan [which] would be expected to learn of the location of the physical assets" of Kohler. *Alcan*, 42 Ohio St. at 1304. As discussed above, neither the Trustee

[18] So, *Random House*, like *Alcan*, also supports the proposition that this Court must construe R.C. 5747.01(BB)(2)(a) and R.C. 5747.01(BB)(6) to require that the relevant information be available to the involved trust, not just any person.

nor any members of the Advisory Committee were involved with TQL in such a way as to receive this information in the regular course, like the taxpayer in *Alcan*; rather, like the taxpayer in *Random House*, the Trust in the instant matter did not normally as a matter of course receive the information and the Purchase Agreement, like the written agreements in *Random House*, did not contractually provide for the Trust to learn of such information; indeed, the Purchase Agreement prohibited the Trust from learning it. Accordingly, such information cannot be said to have been "available" to the Trust.

The Board in this matter has incorrectly construed and misapplied R.C. 5747.01(BB)(2)(a)&(6) to the facts herein. *See Gulf Oil Corp. v. Kosydar*, 44 Ohio St.2d 208, 217 (1975) ("It is the duty of the courts…to so construe a statute as to avoid unreasonable or absurd consequences"). As the book value of the physical assets of TQL could not be learned by the Trust, such information was *not* available *to the Trust*; consequently, the Trust's gain from the sale of the TQL stock cannot be a qualifying trust amount.[19]

> **Proposition of Law No. II:** The income from the Trust's sale of TQL stock is nonbusiness income allocated out of and not taxable to Ohio pursuant to R.C. 5747.01(C) because the income was not the result of a liquidation of a business.

In its Order, the Board erred in finding that the income from the Trust's sale of TQL stock was business income that resulted from TQL's partial liquidation under R.C. 5747.01(B).[20] According to the Board, "any income arising out of a liquidation of a business, *i.e.*, Mr. Legg's

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19 Again, this alone is sufficient for the Court to reverse the Board's finding on Proposition of Law No. 1.

20 "Business income" means "income, including gain or loss, arising from transactions, activities, and sources *in the regular course of a trade or business* and includes * * * gain * * *from * * * intangible property if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation [and] includes income, including gain or loss, from a partial or complete liquidation of a business * * *." R.C. 5747.01(B) (2005) (emphasis and [ ] supplied).

sale of his ownership interest in TQL, via his stock, constitutes 'business income' in Ohio, as a gain from the partial liquidation of his interests in TQL." Order, p. 5.

Initially, it should be pointed out that the Board in its Order found that the income at issue was both a qualifying trust amount *and* business income. Order, p. 4-5. This is a statutory impossibility. R.C. 5747.01(BB)(2), which defines qualifying trust amount, mandates that "any gain or loss that is not a qualifying trust amount is modified business income, qualifying investment income, or modified nonbusiness income, as the case may be." Necessarily, then, income of a trust cannot be both a qualifying trust amount *and* business income. This Court must reverse at least one of the Board's findings on this point, and the Trust submits it should in fact reverse both.

To begin with, the Board erred in finding that the income was business income resulting from Mr. Legg's sale of his ownership interest, because Mr. Legg's sale of stock was not at issue. Mr. Legg is not the taxpayer in this matter; the Trust is the taxpayer, and it is the Trust's sale of its TQL stock at issue. For that reason, the Board's finding was in clear error. Moreover, the law and the record clearly reflect that TQL was not liquidated, partially or fully, and thus, the gain at issue should not have been classified as business income on that basis [R.C. 5747.01(B)], but rather as nonbusiness income because the Trust's holding and sale of its stock in TQL was not a trade or business [R.C. 5747.01(C)][21] and such nonbusiness income is allocated outside of Ohio under R.C. 5747.20(B)(2)(c).

(A) TQL was not partially or fully liquidated; the Trust, which is not a business, sold its TQL stock; so, the income was not a result of a liquidation of a business and was thus not business income as the Board found in error.

Contrary to the finding of the Board, the gain from the sale of TQL stock is not business

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21 "Nonbusiness income" means "all income other than business income and may include, but is not limited to * * * capital gains * * *." R.C. 5747.01(C).

income arising from the partial liquidation of a business under R.C. 5747.01(B). The Trust's holding of TQL stock was not a business, nor was the Trust's sale of such stock the liquidation of a business, as discussed more fully *infra*. *See City Bank Farmers Trust Co. v. Helvering*, 313 U.S. 121, 126 n. 3 (1941) ("[T]he trustee's activities * * * [of] selling securities * * * [was] passive investment and not * * * carrying on a business * * *."). Moreover, TQL was not liquidated, partially or fully, and indeed remains in operation in Ohio.

The legal definition of "liquidation" is the "winding up of a corporation, partnership, or other business enterprise upon dissolution by converting the assets to money, collecting accounts receivable, paying debts, and distributing the net proceeds, if any, among the shareholders, partners, or owners of the business." *Ballentine's Law Dictionary*, 3rd Ed. (2010); *see also Consolidated Freightways Corp. v. Allred*, 1991 Ohio App. LEXIS 6045 (Ohio Ct. App. 1991) (defining "winding-up" as "the process of settling the accounts and liquidating the assets of a partnership or corporation, for the purpose of making distribution of net assets to shareholders or partners and dissolving the concern"). Partial liquidation, on the other hand, is "[l]iterally, a liquidation which does not dispose of all the property or wind up all the affairs of a corporation or an insolvent. Technically, a proceeding involving the surrender by a corporation of a portion of its capital." *Ballentine's Law Dictionary*, 3rd Ed. (2010). Ohio courts require that for a partial liquidation to occur, a corporation must be disposing of an "integral part" of the corporation's assets. *See Kemppel v. Zaino*, 91 Ohio St.3d 420, 423 (2001) (quoting *Laurel Pipe Line Co. v. Commonwealth, Bd. of Fin. & Revenue*, 537 Pa. 205, 211 (1994)). Under these definitions, a liquidation occurs when the corporation itself disposes of its all or a substantial portion of its assets (that is, TQL liquidating its assets), not a shareholder selling its stock (as this the case here, with the Trust selling its stock in TQL).

The legislative history of R.C. 5747.01(B), which did not initially define "business income" to include the partial or complete liquidation of a business, further informs its meaning; the definition of business income initially focused on whether income was derived in the normal course of a trade or business. *See Sheet Metal Workers' Internatl. Assn., Local Union No. 33 v. Gene's Refrigeration, Heating & Air Conditioning, Inc.*, 122 Ohio St. 3d 248, 253 (2009) ("We look to the language of the statute, the circumstances under which the statute was enacted, legislative history, and the consequences of a particular construction when determining the intention of the legislature."). Under the prior law, this Court determined that the full or partial liquidation of a business (*i.e.*, the dissolution of a company) could not be considered business income because it was a one-time event and thus not derived from the "normal course" of a trade. *Kemppel*, 91 Ohio St.3d at 420-23 ("In 1989 the assets of the Logan Machine Co. * * * were liquidated and the corporation dissolved. The net proceeds from the sale of the assets were distributed to the shareholders * * *."). The General Assembly responded to *Kemppel* by amending R.C. 5747.01(B) to treat as business income the net proceeds received from the partial or complete liquidation of a business. *See* 2001 Ohio SB 261, enacted June 5, 2002. However, this response was to the *winding up* of a corporation itself via selling all or an integral part of its assets. The legislative intent was to treat as business income the dissolution of a corporation or partnership via the sale of its assets as in *Kemppel, not the sale of stock by a shareholder*.

The instant matter also compares to the facts in *Allied-Signal*, discussed *infra*, where the taxpayer sold a 20.6 % stock interest in another company back to that same company, but the event was not treated as liquidation or partial liquidation. 504 U.S. at 773-74. Instead, the company sold remained in business. *Id.* at 774.

The Trust's sale of TQL stock was not the complete or partial liquidation of a business, and TQL was not dissolving as a going concern or being wound up; TQL is in fact still a business in good standing with the state of Ohio. *See* Appellant's Ex. 3 (TQL Corporate Documents). The Board erred in finding that the capital gain is business income because a trust's sale of stock in a company as the Trust sold its TQL stock here is *not* a "liquidation of a business" as that term is used in R.C. 5747.01(B). The Board erred when it incorrectly applied the law to the facts and therefore its legal finding on this issue must be reversed.

(B) The Trust's capital gain from the sale of its TQL stock is classified as nonbusiness income.

For income, such as the gain at issue, to be business income, it must, *inter alia*, "aris[e] from * * * a trade or business." R.C. 5747.01(B). Otherwise, it is nonbusiness income. R.C. 5747.01(C).

A trust's mere holding and selling of stock and securities is, as a matter of law, not a trade or business, and any income generated is likewise not business income, *i.e.*, nonbusiness income. *See City Bank Farmers Trust Co. v. Helvering*, 313 U.S. 121, 123-26 (1941). In *City Bank Farmers Trust Co.*, the U.S. Supreme Court held that a trust that bought and sold stocks and bonds was not engaged in a trade or business. *Id.* Similarly, in *Comm'r v. Groetzinger*, 480 U.S. 23, 30-31 (1987), the Court determined that "the efforts of a [] * * *trust in asset conversation and maintenance did not constitute a trade or business." Consistent with *City Bank* and *Groetzinger*, Ohio classifies the capital gain from the sale of corporate stock as nonbusiness income. *See* Appellant's Supp. p. 15. (Ohio Information Release Trust 2003-01 (Apr. 14, 2003) (Q&A #16)).[22]

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[22] Notably, Ohio Information Release Trust 2003-01 (Q&A #16) takes the position that nonbusiness income does not include income from interests in S corporations. ("Generally, modified nonbusiness income is income from investments in intangible property excluding

Here, the Board applied the incorrect law to the facts and must be reversed because the Trust did nothing more than hold and sell TQL stock. Hr'g Tr., Ryan, pp. 57-58, 60, 92, 115; Dovich, p. 122; Michel, p. 220. These actions do not constitute a trade or business under the law. By definition, therefore, the TQL stock sale gain was nonbusiness income.

(C) The Trust's Nonbusiness Income is Allocated Outside of Ohio.

Under Ohio's tax code, the nonbusiness income from the Trust's sale of TQL stock is allocated to the state of the taxpayer's domicile at the time of the sale:

> All items of ***nonbusiness income*** or deduction taken into account in the computation of adjusted gross income for the taxable year by a ***nonresident*** shall be allocated to this state as follows:
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> ***
>
> (2) All gains or losses from the sale of real property, tangible personal property, or intangible property shall be allocated as follows:
>
> ***
>
>> (c) ***Capital gains*** or losses from the sale or other transfer of intangible personal property ***are allocable to this state if the taxpayer's domicile was in this state at the time of such sale or other transfer.***

R.C. 5747.20(B)(2)(c) (emphasis added); R.C. 5747.01(BB)(4)(c)(ii).

Pursuant to the Purchase Agreement entered into on December 2, 2005, which closed on February 3, 2006, the Trust sold its TQL stock. Appellee's Ex. F (Purchase Agreement); Ryan, pp. 60, 92, 115; Dovich, p. 122. Ohio statutes in effect at the time of the sale required the gain at issue to be allocated outside of Ohio, *i.e.*, to the Trust's Delaware domicile. Until March 29, 2006, Ohio allocated a non-resident trust's nonbusiness income to the trust's domicile: "[w]ith respect to a trust or portion of a trust that is *not a resident* as ascertained in accordance with

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(ownership) interests in closely-held business, S corporations, partnerships, and limited liability companies treated as partnerships for federal income tax purposes."). However, as stated, the income at issue here is not income distributed from an S corporation, but rather it is a gain resulting from the Trust's sale of corporate stock.

division (I)(3)(d) of this section, the amount of its modified nonbusiness income satisfying the descriptions in divisions (B)(2) to (5) of section 5747.20 of the Revised Code." R.C. 5747.01(BB)(4)(c)(ii). Attached hereto as Appellant's Supp. pp. 16-28 is a copy of R.C. 5747.01(BB)(4)(c)(ii), which was in effect until March 29, 2006.[23]

Accordingly, the gain on the sale of the TQL stock is nonbusiness income and therefore properly allocable outside Ohio to the Trust's domicile of Delaware.

> **Proposition of Law No. III:** The Trust is not an Ohio resident under R.C. 5747.01(I)(3) because no qualifying beneficiaries were residents of Ohio during 2006, the taxable year at issue, and therefore all of its income is not taxable to Ohio as an Ohio resident; rather, its income is subject to allocation and apportionment as a nonresident.

The Board also erred when it found that in 2006 the Trust was an Ohio resident trust because the Trust, which was formed pursuant to Delaware law and is a Delaware resident trust under the terms of the Trust Agreement and under R.C. 5747.01(I)(3), had no qualifying beneficiary domiciled in Ohio in 2006 and was thus not an Ohio resident trust [R.C. 5747.01(I)(3)] and was instead a nonresident trust [R.C. 5747.01(J)].

(A) To be a resident trust of Ohio, R.C. 5747.01(I)(3) requires that a trust must have a qualifying beneficiary domiciled in Ohio, and because the Trust has no qualifying beneficiary domiciled in Ohio, the Trust is a nonresident trust.

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[23] The Ohio General Assembly changed the rule from allocation to apportionment, effective March 30, 2006 – nearly two months after the transaction at issue closed. R.C. 5747.01(BB)(4)(c)(ii) (added by 2006 Ohio Laws, H. 530, §§ 101.01 & 821.06(A), effective Mar. 30, 2006). The General Assembly did not evidence any intent to retroactively change the rules for or tax a transaction that had already occurred prior to the effective date of the change. The effective date provisions of the 126th General Assembly (which passed the new tax law), indicate in Section 821.06 that the amendments passed in 2006 went "into immediate effect when this act [became] law." *See* Appellant's Supp. p. 29-30 (H.B. 530). The Ohio Constitution prohibits a retroactive change of the tax law on a closed transaction. Ohio Const., art. 2, § 28 ("The general assembly shall have no power to pass retroactive laws…."); *Lakengren, Inc. v. Kosydar*, 44 Ohio St.2d 199, 200 (1975). (holding that the General Assembly may not "change[ ] existing rules of law to its benefit, and appl[y] those rules to events and transactions already completed under a different set of rules.").

A "Resident" trust is a "trust that, in whole or part, resides in this state. If only part of a trust resides in this state, the trust is a resident only with respect to that part." R.C. 5747.01(I)(3). A "trust resides in this state for the trust's current taxable year to the extent * * * that the trust consists * * * of assets * * * transferred * * * to the trust by * * * A person who was domiciled in this state for the purposes of this chapter when the person...transferred assets to an irrevocable trust, *but only if at least one of the trust's qualifying beneficiaries is domiciled in this state for the purposes of this chapter during* all or some portion of *the trust's current taxable year * * *.*" R.C. 5747.01(I)(3)&(a)(ii) (emphasis supplied).

The Board found that Mr. Legg was domiciled in Ohio during 2006 and that he was a beneficiary of the trust, stating that "the trust agreement clearly lists Mr. Legg as a beneficiary of such trust." Order, p. 5. The Board did *not* find, however, that Mr. Legg was a *qualifying* beneficiary.

The Board erred in applying the facts to the law because Ryan Legg was *not* a "qualifying beneficiary" as that term is defined by R.C. 5747.01(I)(c). Therefore, as a matter of law, the Trust *cannot* be a *resident* trust and cannot be taxed as a resident trust pursuant to R.C. 5747.01(BB)(4)(c)(i) as the Board found in error; rather, the Trust is a nonresident trust. R.C. 5747.01(J).

A "qualifying beneficiary" has the same meaning as "potential current beneficiary" as defined in section 1361(e)(2) of the Internal Revenue Code * * *." R.C. 5747.01(I)(c). Pursuant to section 1361(e)(2) if the Internal Revenue Code of 1986, as amended ("Code"), a "potential current beneficiary" is "with respect to any period, any person *who at any time during such period*, is entitled to, or at the discretion of any person *may receive*, a distribution from the principal or income of the trust." In 2006, Ryan was not entitled to, nor did he receive, a distribution from the Trust, and so, he was *not* a potential current beneficiary under the Code. Hr'g Tr., Ryan, p. 63.

In this regard, the Trust Agreement states unequivocally that during the "Initial Period," that is, the period from the Trust's creation in November 2005 until January 3, 2007, *there were to be no distributions from the Trust. See* Appellant's Ex. 1, ¶ 2.1(a) ("During the period beginning with the date of this Trust Agreement and ending on January 3, 2007 (the 'Initial Period'), the trustee shall accumulate the net income of the Family Trust and add it to the principal."). During 2006, then, under the express terms of the Trust Agreement, it was impossible for Mr. Legg to receive any distributions from the Trust. Hr'g Tr., Ryan, p. 63; Appellant's Supp. p. 2, ¶ 9 (Affidavit of U.S. Trust). Accordingly, in 2006, the Trust had no potential current beneficiaries under the Code domiciled in Ohio (as Ryan was not one) and thus no qualifying beneficiaries as defined by R.C. 5747.01(I)(3) domiciled in Ohio. Accordingly, the Trust was not an Ohio resident trust in 2006 under R.C. 5747.01(I)(3) and was instead, a nonresident trust under R.C. 5747.01(J).

Proposition of Law No. IV: The Commissioner's Final Determination violates the Due Process Clause of the Fourteenth Amendment of the United States Constitution because there is no requisite nexus to tax the subject gain under *Allied-Signal*.

(A) The Board correctly accepted evidence on but did not reach the Trust's constitutional claims.

As explained above, the Ohio Board of Tax Appeals may accept evidence to build a record regarding a constitutional claim, but the Board may not address those claims. *See Cleveland Gear Co. v. Limbach*, 35 Ohio St. 220, 231 (1988). In this case, the Board heard testimony and accepted evidence at the hearing, and the Trust properly preserved its Due Process arguments.

(B) The Department's taxation of the gain from the Trust's sale of TQL stock constitutes an extraterritorial tax on an out-of-state taxpayer in violation of the Due Process Clause of the United States Constitution.

The Due Process Clause of the Fourteenth Amendment United States Constitution requires the existence of nexus, *i.e.*, "some definite link, some minimum connection, between a state and a person, property or transaction it seeks to tax." *Allied-Signal, Inc. v. Div. of Taxation*, 504 U.S. 768, 777 (1992) (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954)); *Black's Law Dictionary* 1070 (defining nexus as "[a] connection or link…").[24] "[P]ersons * * * not within the territorial limits of a state cannot be taxed by it." 2 *Cooley on Taxation*, 42. It is well-established that "[t]he personalty owned by a citizen out of the state is taxable where he resides * * *. So are the stocks he may hold in a foreign corporation." *Id.* at 270.[25]

The prerequisite to tax embodied therein forms the basis for the fundamental principle that "a State may not tax value earned outside its borders * * *." *Allied-Signal*, 504 U.S. at 777; *see also Quill Corp. v. North Dakota*, 504 U.S. 298, 305-06 (1992). Furthermore, in *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 128 S.Ct. 1498 (2008), the Supreme Court reiterated, "The Due Process and Commerce Clauses forbid the States to tax extraterritorial values." *Id.* at 1502 (quotations omitted). Applying R.C. 5747.01(BB)(2) to classify the involved gain as a qualifying trust amount would result in Ohio taxing value earned outside of its borders, which the United States Constitution forbids.

Allied-Signal concerned New Jersey's attempt to tax a portion of Bendix Corporation's gain resulting from its sale of its 20.6% stock interest in ASARCO, a New Jersey corporation. 504 U.S. at 773-74. The Supreme Court took on the issue of "whether New Jersey can tax an apportionable part of this income." *Id.* at 774. The issue here is virtually identical and

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24 The Commerce Clause [U.S. Const., art. I, §8,cl.3, granting Congress the power "to regulated commerce * * * among the several States * * *"] also requires nexus as a prerequisite to taxation.

25 Ohio courts often cite to *Cooley on Taxation* with approval. *See, e.g., In re Estate of Morgan*, 173 Ohio St. 89, 93 (1962).

indistinguishable from that at issue in *Allied-Signal*, *i.e.*, whether Ohio can tax an apportionable part of the Trust's gain resulting from the sale of its 32.5% stock interest in TQL, an Ohio-based multistate corporation.[26]

Under the holding in *Allied-Signal*, Ohio is *not permitted* to subject an apportionable share of an out-of-state taxpayer's income to tax. But here, Ohio is attempting to do just that: the Department classified the involved gain as a qualifying trust amount in complete disregard of *Allied-Signal*'s mandate – "the necessary limit on the States' authority to tax value or income that cannot in fairness be attributed to the *taxpayer's* activities within the State." *Id.* at 780 (emphasis added; [ ] supplied). It is important to note that the focus is on the *taxpayer's* activities within the taxing state, not the activities of the *entity* in which a taxpayer has invested. It is the *Trust's* activities that are relevant, *not* the activities of TQL. Ohio has no authority to tax that which cannot be attributed to the Trust's activities within the state. In order for a state to apportion out-of-state income to a taxpayer, there must be a unitary interest between the owner and their investment. In other words, the owner must have actual control over the investment, as well as functional integration, economies of scale, and centralization of management with that investment. None of these factors are present here; the Trust, which owned 32.5% of TQL, had no actual control over TQL. The Department therefore cannot apportion the capital gain to Ohio.

Being that there was no unitary business between Bendix and ASARCO, the *Allied-Signal* Court held that, "[U]nder our precedents New Jersey was not permitted to include the gain realized on the sale of Bendix's ASARCO stock in the former's apportionable tax base." *Allied-Signal*, 504 U.S. at 790. Likewise, here, Ohio cannot include the Trust's gain realized on the

[26] That Ohio is attempting to apportion the involved gain realized by the Legg Irrevocable Trust by apportioning same by reference to TQL's assets does not change the fact that Ohio is attempting to tax an apportionable share of the Trust's income. Ohio is simply using a different apportionment methodology.

sale of its TQL stock in the former's income tax base and apportion same to Ohio based on TQL's physical asset location.

Similarly, in *Alcan* and *Random House*, the Ohio Supreme Court and the Board of Tax Appeals, respectively, recognized that "available" had to mean something more than simply "ascertainable" and entailed what could be described as a somewhat abbreviated *unitary* determination, *i.e.*, that such availability of a physical asset's location must be normally available in the course of business. *See Alcan*, 42 Ohio St.3d at 123; *Random House, supra*. Statutes must be given a "constitutional rather than unconstitutional construction if one is reasonably available." *United Air Lines*, 28 Ohio St.2d at 100. This Court has recognized that an "[Allied-Signal] inquiry * * * focuses on the guidelines necessary to circumscribe the reach of the State's legitimate power to tax." *SFA Folio Collections, Inc. v. Tracy*, 73 Ohio St. 3d 119, 124 (1995).

One could assume from the Ohio Supreme Court's comments that Alcan had some control over Kohler, another company in the case, due to Alcan's 50% ownership of Kohler's corporate stock, and thus, was unitary with it (though the Court's opinion is silent on the presence of functional integration, economics of scale and centralization of management). *Alcan*, 42 Ohio St.3d at 123 ("[A] fifty-percent shareholder such as Alcan would be expected to be able to learn of the location of the physical assets * * *."). In contrast, one could assume that Random House's royalty-producing assets did not form a part of its unitary business. *Random House*, 91-A-C1329. Here, the Trust did not have actual or potential control of TQL as the Trust owed only 32.5% of TQ, nor is there any evidence in the record of the other three "unitary" factors between the Trust and TQL.

A state's ability to tax is further limited by the Commerce Clause of the United States Constitution. U.S. Const. Art. I, Sec. 8, Cl. 3. *See Complete Auto Transit, Inc. v. Brady*, 430

U.S. 274, 277-78 (1977) (holding that a tax violates the Commerce Clause when it "does not have a sufficient nexus with the State; or that the tax discriminates against interstate commerce; or that the tax is unfairly apportioned; or that it is unrelated to services provided by the State."); *Comptroller of Maryland v. Wynne*, 135 S. Ct 1787, 1802 (2015).

Ohio's taxation of the Trust and its gain at issue here violates the limitations imposed by the United States Constitution because the Trust earned income from the sale of the stock outside the boundaries of Ohio. Hr'g Tr., Michel, p. 221. The Department is therefore prohibited from taxing the income at issue earned by the Trust outside of Ohio.

Proposition of Law No. V: Under R.C. 5747.21(C), income should be fairly apportioned to the states where the income is attributable, and because the Trust is a Delaware resident, none of the income from the sale of TQL stock is fairly apportioned to Ohio.

(A) The Board erred in failing to order alternative apportionment which is available to the Trust.

If (and only if) the Court determines that the gain on the sale of the Trust's corporate stock is subject to Ohio's trust income tax (though the Trust maintains that it is not), the Ohio tax code authorizes the application of alternative apportionment in order to fairly allocate the appropriate portion of the gain to Ohio:

> If the allocation and apportionment of a trust's income under divisions (BB)(4)(a) and (c) of this section do not fairly represent the modified Ohio taxable income of the trust in this state, the alternative methods described in division (C) of this section 5747.21 of the Revised Code may be applied in the manner and to the same extent provided in that section.

R.C. 5747.01(BB)(4)(flush text). The alternative methods include, "The employment of any other method to effectuate an equitable allocation of such business in this state." R.C. 5747.21(C)(4). As previously stated, the Trust owned 65 shares of TQL stock that it sold in February 2006. Hearing Transcript, Ryan, pp. 60, 92, 115; Dovich, p. 122.

R.C. 5747.21(C) provides a constitutional escape hatch in instances to prevent Ohio's taxation of an entity or a transaction from violating the United States Constitution. *See Allied-Signal*, 504 U.S. at 774; *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931).

> [W]e will strike down the *application* of an apportionment formula if the taxpayer can prove by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportions to the business transacted in the State or has led to a grossly distorted result.

Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169-70 (1997) (citations and quotes omitted; [ ] and emphasis supplied).

The Trust is a Delaware resident trust. *See* Appellant's Ex. 1 (Trust Agreement), ¶ 5.1 ("This Trust Agreement shall be construed and administered pursuant to the law of the State of Delaware."). It conducts no business in Ohio and during 2006, had no connection to Ohio other than owning stock in a multistate corporation based in Ohio, TQL. Apportioning to Ohio all of the tax on the capital gain related to the sale of TQL stock grossly distorts *i.e.*, does not fairly reflect, the lack of a connection with Ohio with the Trust and the stock sale. The income attributable to the Trust under the application of Ohio's apportionment methodology as assessed by the Commissioner and as upheld by the Board is clearly "out of reasonable proportion" to the Trust's lack of activity in Ohio and the lack of a connection of the transaction with Ohio. The United States Constitution dictates that the distortion must be eliminated by allocating the gain outside of Ohio, and the Board erred in so ordering.

Proposition of Law No. VI: The Commissioner's Final Determination violates the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution and Article I § 2 of the Ohio Constitution because it treats differently persons, nonresident trust shareholders, who are alike in all relevant aspects.

(A) The Board correctly accepted evidence on but did not reach the Trust's constitutional claims.

"[T]he Board of Tax Appeals is an administrative agency, a creature of statute, and is without jurisdiction to determine the constitutional validity of a statute." *Cleveland Gear Co. v. Limbach*, 35 Ohio St. 220, 231 (1988). However, the Board is empowered to accept evidence on a constitutional as-applied claim. *Id.* at 232. Where there is a record created at the Board, the question is properly preserved for review at the Ohio Supreme Court. *Id.* In the instant case, the Board heard testimony and accepted evidence from the Trust at the hearing. The Board properly did not reach the Trust's constitutional claims. Order, p. 5. However, those claims are now properly before this Court.

(B) The Department's Final Determination treats taxpayers within the same class, nonresident trusts selling corporate stock, differently, in violation of the Equal Protection Clauses of the United States and Ohio Constitutions.

In its Final Determination, the Department treats taxpayers in the same class (nonresident trusts) differently in violation of the Equal Protection Clauses of the United States and Ohio Constitutions. Despite being otherwise similarly situated, the Department is treating nonresident trusts that sell corporate stock in an S corporation differently than nonresident trusts that sell corporate stock in a C corporation. Thus the Department's position is unconstitutional.

A nonresident trust majority shareholder that sells corporate stock in a Subchapter C corporation (*i.e.*, intangible property) *does not*, for Ohio income tax purposes, *allocate to Ohio* nonbusiness income resulting from the sale. *See* R.C. 5747.01(BB)(4)(c)(ii); R.C. 5747.20(B)(2)(c). In contrast, a nonresident trust majority shareholder that sells corporate stock in a Subchapter S corporation (*i.e.*, intangible property) apportions to Ohio some portion of nonbusiness income resulting from the sale. *See* R.C. 5747.01(BB)(4)(c)(ii) (via the provision added by the 2006 Ohio Laws, H. 530, §§ 101.01 & 821.06(A)); R.C. 5747.212.[27] Such

[27] However, gains of a nonresident with less than a twenty percent stake in an S corporation, during the requisite time period, are allocated entirely outside of Ohio – no different than a sale of stock of a C corporation. R.C. 5747.212(B).

disparate treatment implicates the constitutional right to equal protection [U.S. Const., amend. XIV; Ohio Const., art. I, § 2] which prevents Ohio from treating differently persons who are alike in all relevant respects. *See MCI Telecomm. Corp. v. Limbach*, 68 Ohio St.3d 195, 200-01 (1994); *Boothe Fin. Corp. v. Lindley*, 6 Ohio St.3d 247, 249 (Ohio) ("States have great discretion in laying taxes; however, the taxing power is subject to the Equal Protection Clause").[28]

The Equal Protection Clauses impose limitations on classifications made by the General Assembly:

> Equal Protection Clause of the Fourteenth Amendment, § 1, commands that no State shall "deny to any person within its jurisdiction the equal protection of the laws." * * * The Equal Protection Clause * * * keeps governmental decision makers from treating differently persons who are all in relevant respects alike.

MCI, 68 Ohio St.3d at 199 (quoting *Nordlinger v. Hahn*, 505 U.S. 1 (1992)). Equal protection "protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class. The right is the right to equal treatment." *Boothe*, 6 Ohio St.3d at 249 (quoting *Hillsborough v. Cromwell*, 326 U.S. 522 (1946)). Thus, to withstand constitutional scrutiny, a state's classification scheme must further a legitimate state interest, cannot be arbitrary or capricious, and must be at least rationally related to further the purpose of the taxing statute. *See MCI*, 68 Ohio St.3d at 199.

In *Boothe*, Ohio attempted to treat the same class of taxpayers differently. 6 Ohio St.3d at 249. In that case, taxpayers who were similarly-situated in all relevant respects, lessors who owned equipment for lease, were treated differently depending on their status as either a manufacturer or a non-manufacturer. *Id.* The Court held that the fact that Boothe, a non-manufacturer, did not lease equipment it manufactured did not justify the disparate treatment by

[28] "Ohio's Equal Protection Clause tracks its federal counterpart * * *," making the analysis the same under both Clauses. *Am. Ass'n of Univ. Professors v. Cent. State Univ.*, 87 Ohio St.3d 55, 60 (1999).

the then-Commissioner when the property in the hands of each taxpayer was the same and the tax was a tax on the market value of the property. *Id.*

Here, the relevant persons who belong to the exact same class – *i.e.*, nonresident trusts owning corporate stock, are treated differently only because one is an owner of S corporation stock and one is an owner of C corporation stock. Ohio does not tax nonresident trusts on the sale of their shares of C corporation stock. *See* Appellant's Supp. p. 15. (Ohio Information Release Trust 2003-01 (Apr. 14, 2003) (Q&A #16)). But, the Respondent has assessed tax on a nonresident trust's sale of its shares of S corporation stock. Therefore, Ohio is treating the same class of taxpayer differently, in violation of equal protection. Just like in *Boothe*, where a non-manufacturer was treated differently than a manufacturer, there is absolutely no rational basis for the disparate treatment that denies the Trust equal protection of the law.

Proposition of Law No. VII: If the income from the Trust's sale of TQL stock is a qualifying trust amount (though the Trust maintains that it is not), it is overstated because TQL had property in West Virginia as well as Ohio, and amounts attributable to that out-of-state property are not taxable in Ohio pursuant to R.C. 5747.01(BB)(4)(b).

In computing a trust's modified Ohio taxable income, a qualifying trust amount is multiplied by the fraction of the qualifying investee's physical assets' book value in Ohio to the book value everywhere as of the last day of the calendar year immediately prior to the day the gain was recognized. R.C. 5747.01(BB)(4)(b). Therefore, if a trust invests in a company with assets both within and without Ohio, the amount of taxable income in Ohio relative to income apportionable elsewhere *must* be less than 100%.

The Department would have presumably had TQL's 2005 tax return indicating that the company had assets in states other than Ohio, namely, West Virginia, where it had additional offices. Testimony from Ryan and TQL's website show that TQL has a presence in West Virginia. Hr'g Tr., Ryan, p. 60, Appellant's Ex. 10 (TQL Website). Given that the company has assets in another state besides Ohio, the qualifying trust amount as determined by the Department is overstated, as the income cannot be attributable 100% to Ohio. Therefore, the Final Determination is erroneous and the Board erred as a matter of law in failing to order the abatement of the assessment of tax to reflect the accurate amount of income attributable to Ohio as determined by the assets in Ohio and other states.

CONCLUSION

For the foregoing reasons, the Trust respectfully requests that this Court reverse the Board's findings and hold [1] that the Trust's gain from its sale of TQL stock is not a qualifying trust amount, [2] that the gain is nonbusiness income, [3] that the Trust is a nonresident trust, and [4] that the Commissioner's Final Determination is unconstitutional. In the alternative, the Trust respectfully requests that this Court hold that the Trust is entitled to alternative apportionment to lessen its Ohio tax burden.

Respectfully submitted,

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Certificate of Service

I hereby certify that a copy of the foregoing Merit Brief of Appellant T. Ryan Legg Irrevocable Trust, UBS Trust Company, N.A., Trustee was served upon the following by certified mail on September 21, 2015.

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