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INTRODUCTION

Mason Companies, Inc. (“Mason”) is a retailer specializing in the sale of footwear and apparel through internet, phone and catalog orders. HT at 22-23.¹ From 2005 to 2011, Mason generated more than \$6 million annually in gross receipts from its business in Ohio. ST Case No. 2012-1169 at 8, Case No. 2012-2806 at 8. This was no accident—Mason acted with purpose to grow and maintain its consumer base in Ohio.

Because Mason’s sales of goods to Ohio consumers easily exceeded \$500,000 each year, the Tax Commissioner only had to apply the plain language of the bright-line statutory standard to determine that Mason had “substantial nexus with this state” for CAT purposes under R.C. 5751.01(H)(3) and R.C. 5751.01(I)(3).

Yet in this appeal, as before the BTA, Mason argues that Ohio statutory law does not require it to pay for the privilege of making over \$6 million in annual sales in Ohio, but actually *excuses* Mason from such liability. Mason pins 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 Prop. 3).

Rather than challenging the constitutionality of the Tax Commissioner’s actions or the relevant statutes, Mason insists that this statute requires the Commissioner to first determine whether Ohio has “substantial nexus” with Mason under the Constitution of the United States, as has been interpreted by the Supreme Court, *before* he can lawfully carry out his administrative duty to apply Ohio statutory law. Mason is wrong.

¹ For purposes of this brief, the statutory transcripts will be referred to as “ST ___”; the transcript of the BTA hearing will be referred to by “HT ___”; and the exhibits entered into evidence at the BTA hearing will be referred to as “Ex. ___”.

The statute, R.C. 5751.01(F)(2)(aa), is an exclusion from the definition of “gross receipts” for purposes calculating the CAT tax base. Contrary to Mason’s reading, this statute has nothing to do with the issue of whether Mason, as an entity engaged in commercial activities, has nexus with Ohio—other CAT statutes deal with that. Indeed, R.C. 5751.01(E) delineates persons who are excluded from the CAT, and R.C. 5751.02 expressly provides that the CAT applies to persons *whether or not* they have substantial nexus with the state.

Instead of *persons*, R.C. 5751.01(F)(2)(aa) deals with the taxability of certain *receipts*. Under the plain language of the statute, R.C. 5751.01(F)(2)(aa) excludes certain receipts that, by their very nature, may not be taxed.

Outside of this twisted statutory interpretation argument, Mason raised no dormant Commerce Clause challenge to any Ohio statute before the Tax Commissioner or BTA. Indeed, as the Tax Commissioner explained in his Motion to Dismiss, Mason *has never challenged the constitutionality of any CAT statute* in these proceedings, until now. Because Mason did not challenge the constitutionality of any CAT nexus provision previously, the issue is not jurisdictionally proper before this Court. Thus, once Mason’s statutory construction argument has been dispelled, no constitutional challenge remains in this case.

Mason’s failure to preserve its as-applied constitutional challenge explains the convoluted approach Mason has taken in its “facial challenge” to R.C. 5751.01(I)(3), which requires that persons who earn \$500,000 or more in Ohio-sitused gross receipts pay CAT. Mason’s “facial” challenge before this Court is really just an effort to salvage its jurisdictionally-improper as-applied challenge.

“A facial challenge to a legislative Act is, of course, the most difficult challenge to mount successfully, since the challenger must establish that no set of circumstances exists under

which the Act would be valid.” *United States v. Salerno*, 481 U.S. 739, 745 (1987). Federal and state courts apply *Salerno* to Commerce Clause cases. (See, Prop. 2, Section 1, below, collecting cases.) This Court applies the *Salerno* standard for facial challenges too. See, e.g., *Wymyslo v. Bartec, Inc.*, 2012-Ohio-2187 at ¶ 21; *Arbino v. Johnson & Johnson*, 2007-Ohio-6948 at ¶ 26.

In order to succeed, Mason would have to show that there is *no set of circumstances* under which R.C. 5751.01(I)(3) could be constitutionally applied. Mason cannot do this, because R.C. 5751.01(I)(3) easily is capable of constitutional application. For instance, any brick-and-mortar business located in Ohio with \$500,000 in Ohio-sitused gross receipts is constitutionally subject to the CAT by virtue of being physically located in Ohio.

So, in order to escape the *Salerno* standard of review for facial challenges, which would be fatal for its case, Mason asks this Court not to apply it. Mason suggests that this Court flip the *Salerno* standard on its head, and hold that if this Court can imagine *any application* of R.C. 5751.01(I)(3) that is unconstitutional, then the statute should be struck down as in *all applications*. Mason proceeds to argue that, because it had no physical presence in the state, the law is facially unconstitutional. Of course, this is merely an as-applied challenge in disguise, and is easily dispelled, as explained below.

But regardless of the standard of review, the CAT statute at issue withstands facial scrutiny, because R.C. 5751.01(I)(3) applies to all persons fairly in relation to their in-state activity and does not substantially burden interstate commerce. And, Mason has substantial nexus with Ohio by virtue of its significant economic presence alone.

The CAT’s four-part “bright-line” standard for substantial nexus in R.C. 5751.01(I) is based upon the taxpayer’s in-state activities and their enjoyment of the benefits and protections provided by Ohio. See the parties’ Joint Stipulations (“Stip.”) Ex. A at 655-664. The part of the

statute challenged by Mason, R.C. 5751.01(I)(3), utilizes the proxy of \$500,000 in gross receipts as a “measuring stick” for a taxpayer’s in-state activities.

Gross receipts are “a proxy for the scale of a business and the degree to which the business uses government services,” including physical infrastructure and the legal and economic conditions under which a market is possible. Stip. Ex. A at 662-664. Mason, like other taxpayers who generate over \$500,000 in Ohio-sitused gross receipts, must conduct significant business in the state and also derive great benefit from the physical infrastructure and legal and economic conditions that Ohio provides. Stip. Ex. A at 644. The \$500,000 threshold represents a reasonable proxy for the scale of Mason’s activity in Ohio necessary to generate that level of receipts. Across the US, there is a growing recognition that a significant economic presence in the forum state is an indicator of substantial business activity in the state, sufficient for dormant Commerce Clause purposes. See, e.g., *KFC Corp. v. Iowa Dep’t of Revenue*, 792 N.W.2d 308, 328 (Iowa 2010); *Capital One Bank v. Comm’r of Revenue*, 899 N.E.2d 76, 86 (Mass. 2009). The CAT’s \$500,000 threshold represents a substantial business presence in Ohio, and thus satisfies the Commerce Clause.

Moreover, the CAT’s four-part “bright-line” standard for “substantial nexus” in R.C. 5751.01(I) does not substantially burden interstate commerce. The “burden” on interstate commerce identified in the *Quill* case and its progeny, is not the burden on an individual taxpayer, but rather, the “effects of state regulation on the national economy.” *Quill Corp. v. N. Dakota*, 504 U.S. 298, 312 (1992). And, in *Quill*, the specific burden was “compliance with administrative regulations in the collection of sales and use taxes.” *Tax Comm’r of State v. MBNA Am. Bank, N.A.*, 640 S.E.2d 226, 233 (W.Va. 2006); *cert. denied sub nom., FIA Card Services, N.A. v. Tax Comm’r of West Virginia*, 551 U.S. 1141 (2007).

Here, the CAT's burden on interstate commerce is substantially lower (indeed, minimal) in comparison to the sales tax that was struck down in *Quill*. The CAT has a very low rate (at the most, it is \$.0026 per dollar); the CAT's four-part "nexus" standard makes it simple to determine when CAT registration and payment is required (R.C. 5751.01(I) and (H)); it is extraordinarily easy to calculate; and the rate of the tax is uniform throughout the state, not subject to multiple overlapping jurisdictions and political subdivisions like a sales tax.

Mason's purported as-applied challenge to R.C. 5751.01(I)(3) fares no better. Under the Supreme Court's dormant Commerce Clause jurisprudence, an out-of-state business entity is responsible for a state's "privilege of doing business" tax, like the CAT, when that business has "substantial nexus" with the taxing jurisdiction. *Tyler Pipe Indus. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 250-51 (1987) (discussing the "substantial nexus" prong of the four-part dormant Commerce Clause test in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)).

In *Tyler Pipe*, the Court found nexus sufficient to impose a privilege of doing business tax on a manufacturer that had hired an independent contractor to keep tabs on market conditions in the taxing state, but did not have a physical presence in the taxing state otherwise. *Tyler Pipe*, 483 U.S. at 250-51.

The Court explained that: "[T]he crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Id.* at 250. Here, the facts establish that Mason's activities in Ohio were directly associated with establishing and maintaining its internet sales market in Ohio.

Through its extensive and systematic marketing activities and other commercial activities in Ohio, Mason reaped an average of over \$6 million per year in Ohio-sitused gross receipts

from merchandise sales. Mason, as a multi-channel online retailer, leveraged all the tools of internet retailing to grow and develop its Ohio market.

This included harvesting locally-produced data from Ohioans' online activities and local interactions with Mason's website. To do so, Mason physically placed tracking devices on users' computers in Ohio and also collected data from a user's local interaction with Mason's website. The customer-produced data was warehoused by Mason for use in internal business planning. Mason used this data to predict trends, gauge product performance, to perform analytics to measure the success of its sales pitches and refine future campaigns, and to grow its customer list.

This data was also used by Mason to reach potential customers—to send website visitors targeted email messages with custom offerings and to place display advertisements for recently-viewed or similar products. Mason engaged the services of “shopping comparison” websites to feature its products alongside those of others. Further, Mason paid search engines like Google and Yahoo to have its website returned in response to Ohioans' web searches, and to place ads on other websites that would reach Mason's target audience. Mason also paid Ohioans with websites, blogs, and the like, to feature Mason's products and website on their own webpages, particularly targeting those sites that Mason and its partners believed would be visited by persons most likely to buy Mason's goods.

Mason had business partners in Ohio too. Mason hired contractors who hosted Mason's website, or parts thereof, on servers in Ohio and geographically close to Ohio (instead of on Mason's servers in Wisconsin). This served Mason's business purposes by lowering the cost for delivery of the website and increasing the speed with which the website is delivered. By these means, Mason maintained and grew its market in Ohio. It, therefore, has satisfied the criteria for

substantial nexus under established Supreme Court dormant Commerce Clause decisions, including *Tyler Pipe*.

Mason also owns property in Ohio that it uses to develop and maintain its market in this state. Namely, Mason software resides on computers and mobile devices in Ohio. Such software is tangible personal property for taxation purposes. *Andrew Jergens Co. v. Wilkins*, 2006-Ohio-2708 at ¶ 24. This software is crucial for Mason’s business – in order for a sale to occur in Ohio, and in order for Mason’s “virtual store” to exist at all, Ohioans must store Mason’s software on the hard disks of their computers and mobile devices. This software property easily satisfies the requirement of “physical presence” for “substantial nexus” with Ohio for Commerce Clause purposes. Furthermore, during the local creation of Mason’s website on Ohioans’ computers, Mason’s property, in the form of trademarked or copyrighted “assets” such as logos, images, and even computer code, were left behind in the users’ physical memory—the “cache.” And, this software is stored in Ohio by Mason’s independent contractor Akamai on local servers for Mason’s business use. Thus, from whichever perspective Mason’s activities are viewed, the inescapable result is that Mason has substantial nexus with Ohio and the CAT assessments must be affirmed.

To escape liability, Mason suggests that this Court should find that a taxpayer’s “physical presence” in Ohio is required before that taxpayer may be held responsible for paying the CAT, and that it has no physical presence in Ohio. Mason is wrong on both fronts.

No “physical presence” requirement exists in the law of privilege taxes, like the CAT; Mason is just shouting into the wind. The case relied upon by Mason is *Quill*, a sales tax case, which—by its own terms—limited its holding to sales and use taxes. *Quill*, 504 U.S. at 314. Ohio has already concluded that the reach of *Quill* is limited to sales and use tax. *Couchot v.*

State Lottery Commission, 74 Ohio St.3d 417, 424-25 (1996). And, this Court has explained that the CAT is not a sales tax, but a “privilege tax” measured by gross receipts. *Ohio Grocers Assn. v. Levin*, 2009-Ohio-4872 at ¶¶ 41-56. Accordingly, the holding of *Quill* does not apply to the CAT. Other states agree, and the U.S. Supreme Court has, so far, declined to review such state-court decisions. See, *KFC Corp*, 792 N.W.2d at 320 (collecting cases).

But even if the holding of the *Quill* decision applied to this case, it should be limited or not followed. See, *MBNA Am. Bank.*, 640 S.E.2d at 236. The *Quill* decision, already outdated when issued, is now 23 years old and hardly anticipated the coming internet revolution. For perspective, when the *Quill* decision was issued in 1990, the World Wide Web had only existed for two years, and it would still be another year before the first widely-used browser came onto the scene. Ex. 2 at 7-8. Since then, the growth of e-commerce has been staggering. *Id.*

As one member of the Supreme Court recently explained, “Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court’s holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier.” *Direct Mktg. Ass’n v. Brohl*, 135 S. Ct. 1124, 1135 (2015) (Kennedy concurring).

Further, even if a physical presence were required, Mason still would be responsible for CAT. The presence of Mason’s tangible personal property (software) in Ohio, Mason’s “virtual” presence through local interaction with Ohioans, and Mason’s in-state contractors, give Mason a physical presence in Ohio sufficient for Commerce Clause purposes. Thus, from any perspective, the inescapable result is that Mason’s in-state activities create substantial nexus with Ohio and the CAT assessments must be affirmed.

FACTS AND PROCEDURAL POSTURE

- 1. The CAT is a generally applicable, annual privilege of doing business tax measured by gross receipts imposed on persons engaged in commercial activity in Ohio, and not a transactional sales tax imposed on retail consumers.**

The CAT was enacted by the General Assembly in 2005 as one of the key components of a series of tax revisions generally designed to lessen the burden of taxation on entities engaged in business in Ohio. Am.Sub.H.B. No. 66, 151 Ohio Laws, Part II, 2868; *Ohio Grocers*, 2009-Ohio-4872 at ¶ 6. As a part of these tax revisions, the CAT phased out and replaced the existing corporate-franchise and personal-property taxes. See R.C. 5733.01(G)(1) and (2) (phasing out the corporate-franchise tax); R.C. 5711.22(E), (F), and (G) (phasing out the personal-property tax); and R.C. 5751.031 (phasing in the CAT). The enactment of the CAT has also been described as “arguably the most significant overhaul of Ohio’s tax code in the last 40 years.” Stip. Ex. A 607-718; Stip. Ex. M at 2.

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). Persons with less than \$150,000 of gross receipts in a calendar year are exempt from the tax. R.C. 5751.01(E)(1). During the relevant periods, persons with between \$150,000 and \$1 million in annual gross receipts paid a flat fee of \$150 annually. R.C. 5751.03(B). Persons with annual taxable gross receipts in excess of \$1 million were subject to the annual minimum tax of \$150 plus the product of applying the rate of .26 percent (or .0026 cents per dollar of gross receipts) to their receipts above \$1 million. R.C. 5751.03(A).

The CAT provisions explain that the CAT is not intended to be “a tax imposed directly on the purchaser.” R.C. 5751.02(A). Rather, the CAT is levied for the privilege of doing business in Ohio, and “is imposed on the person receiving the gross receipts.” R.C. 5751.02(A). Thus, the plain language of the CAT makes clear that this tax is levied upon the privilege of a

person's commercial activity in this state. The CAT is not a transactional tax imposed on retail consumers.

2. From the very outset of the legislative process, the Ohio Governor and Ohio Tax Commissioner featured the “bright-line presence” standard as a key component of the CAT.

The “bright-line nexus” provisions set forth in R.C. 5751.01(H) and (I) were a critical feature of the CAT, as introduced by then-Ohio Governor Robert Taft and as successfully advocated throughout the legislative process by the Taft Administration. The bright-line presence standard was drafted to provide “clear guidance on when an out-of-state business with taxable gross receipts in this state is required to register and remit the proposed gross receipts tax.” See Stip. Ex. A at 624-631, 710-11; L at 14.

3. Mason engages in systematic and continuous efforts to grow and maintain a market in Ohio.

Mason has been in business for 100 years and has expanded its methods of selling with the times. HT at 22-23. Mason was, and is, an active mail-order company. HT at 23, 30. As technology has evolved, so has Mason, moving into online sales. *Id.* Throughout the assessment periods, Mason maintained and grew its market by engaging in a panoply of marketing activities, including: (1) flooding Ohio consumers with millions of various Mason catalogues targeted to consumers based on their individual preferences and previous buying experiences, (2) regularly engaging in media through a variety of internet marketing activities, and (3) continuously, on a “24/7 basis,” operating an online shopping website.

Mason generated more than \$6 million annually in gross receipts from its business in Ohio during the assessment period. ST 8. To achieve this high volume of sales without brick-and-mortar stores or a sales force, Mason employed the power of digital marketing, data mining, and data analysis.

A. *Mason extensively harvested data from Ohioans, and utilized that data for internal business purposes to grow and develop its market in Ohio.*

Foremost among Mason's business activities in Ohio is the harvesting of consumer data from online users that is generated locally, by an Ohioan at his computer. Mason harvests data from activities of consumers in Ohio. Mason relies on these Ohioans to help grow and maintain its Ohio market.

One of the primary means of obtaining customer data is through the use of tracking devices such as "cookies." During the on-line interaction between Ohio users and Mason, Mason, or its business partners, place "cookies" and other tracking devices in the users' browser "cache." HT 89, 97, 108-109; Ex. CCC at 9, 13-14, 18-22; Ex. RR3, RR5, RR6. The "cache" electronically stores "assets," such as cookies, images, and software code in the physical hard drive of the Ohioans' computers. Ex. CCC at 17-18. The cookie is a unique identifier, and is associated with that particular user during the duration of his visit on the website, during subsequent visits to the website, and even as the user travels around the internet to other websites. *Id.* at 13-14, 22; HT 89. In addition to data obtained through visits to its own website, Mason also tracks and archives data on the sequence of pages clicked by users ("clickstream data") for use in business planning. Ex. CCC at 14-16, 22.

The unique customer data that is harvested by Mason in the form of name, address, phone number, and email address, is a substantial business value to Mason. A company's customer list is a valuable commodity in and of itself, as it is the primary method of reaching out to "high value" targets—people who are likely to purchase Mason's products. Mason used its customer list for mass marketing directly to customers online and offline, via email, banner ads on other websites, targeted catalogs, and the like. HT 101-113; 48; 123-127; 134-135. Further, Mason "modeled" the customer list for purposes of its catalog and mail marketing to determine which

groups of customers were more likely to respond favorably to offers and advertising, and to customize offerings to customers' perceived preferences. HT at 123-126. Additionally, Mason shared its customer list in cooperative sharing agreements with similar retailers to increase its list of potential customers. HT 123-124.

Another primary use for customer data is "data analytics." Mason and its business partners warehouse this customer-generated data for "data analytics" purposes to help Mason make business decisions and effectively advertise. Ex. CCC at 14-16, 22; HT 85-97, 113-124; Ex. A, S, X, SS, and UU. The data obtained through cookies allows Mason to make marketing plans, to make the website more effective, and to make inventory predictions and decisions. Ex. CCC at 14-16, 22; HT 83-97. Through data analytics, Mason spots trends and forecasts inventory needs by identifying top selling items and the search terms people on the website used to look for products. HT 83-97. Mason also sorts its visitors into "target markets" from which to make product and advertising decisions. HT 83; 95. Data analytics allows Mason to gauge the effectiveness of its website. HT 86-87. Data analytics depend on customer data generated in Ohio. Ex. CCC at 21-22.

Customer data is also central to Mason's online marketing, as described below.

B. Mason aggressively marketed online to grow and develop its market in Ohio. Its marketing depended on customer data harvested from user's online activities in Ohio, and Mason's marketing specifically targeted customers in Ohio.

Mason engaged in aggressive online marketing, and the online-only retailer had five or six major channels for marketing to customers, including paid search, affiliate programs, e-mail marketing, shopping comparison, and display ads. These channels were enhanced by the analytics of customer data and, in some cases, depended on customer data—produced in Ohio—in order to work at all.

- i. Mason made extensive use of email marketing and personalized emails based on the recipient's website behavior as collected by Mason or its business partners.*

Mason uses customer data to send promotional and personalized email. Once Mason obtained a customer's email address, Mason sent email to that customer offering goods and promotions, and tracked openings of those emails to gauge the effectiveness of its email offerings. HT 118-121; Ex. HH. Mason also used customer data to send "personalized" emails, based on the recipient's previous behavior on the website, also known as "behavioral" emails. HT 101-102. For example, if a user purchased a product, Mason would send that user a personalized email seeking a product review. *Id.* Similarly, Mason sent personalized email, offering products based upon a customer's profile. Ex. CCC at 21-22. Additionally, Mason sent promotional email, and tracked such email to see how recipients reacted to particular emails, i.e., whether they opened it or clicked on the links—all actions taken by the user at his computer. HT at 118-120. Mason uses this data is to gauge the effectiveness of an email campaign.

Mason found that using its own customers in its marketing efforts to potential customers was a powerful tool too. With the help of two vendors, Mason emailed customers who had made purchases, encouraging them to write reviews of their purchases for publication on the Mason websites. Mason offered discounts to reviewers to encourage them to participate, because these reviews were viewed as powerful aids in convincing other shoppers to make purchases. HT at 57, 97-103; Ex. B; Ex. DDD at 8-9. Thus, an Ohio customer who made a purchase from Mason could be instrumental in growing Mason's market by submitting a positive review of the product.

- ii. Mason used social media to aid in its marketing and customer service activities.*

Mason has a Facebook and Twitter account. HT at 73-78. Mason uses this social media presence to contact customers individually, develop a relationship, and particularly to manage

customer service and reputation issues, when a user posts a negative comment or indicates dissatisfaction with Mason. *Id.* Mason also uses Facebook page to run contests and to push special promotions. *Id.* Mason uses Twitter in the same manner. *Id.*

iii. Mason used affiliates who placed links to Mason products and webpages on their sites.

Mason used a third party to place ads for Mason's products and links to products and websites on smaller "affiliate" pages like blogs, websites, and the like. See, Ex. LL and HT 110-113. This was no small endeavor – Mason would pay for thousands of "click-through" from such affiliates each month. See, e.g., Ex. VV. These affiliates were chosen through competitive analysis to come up with the appropriate ratio of aggregate sites, such as "blogs" and "loyalty sites" that closely aligned with Mason's target customers and competition. Ex. LLL at 47-49; HT 110-113. Mason didn't check to see whether any of the affiliate websites were located in Ohio, but given the high number of affiliates, it is likely.

iv. Mason display ads that would appear as visitors browsed the web.

Mason served ads online to customers on other companies' websites. Mason reached out and negotiated individually with certain online companies for ad placement and pricing. HT at 106-107. In particular, Mason had agreements with companies that served its target market, like shoeblog.com and Mamapedia. HT 105-107. Mason also used Acerno, an ad network, during the assessment period. *Id.*; Ex. RR1, RR2, RR3. Ad networks are primarily used for smaller websites with which Mason wouldn't negotiate one-on-one. The ad network works on behalf of several small websites to sell advertising time and space.

- v. *Mason extensively engaged in “paid search,” to target its ads to appear when a visitor searches particular terms.*

Paid search is a category of advertising, wherein a company pays a search engine to include its ads on pages displayed in response to a user’s web search containing certain keywords. Mason contracted with companies like Google, MSN and Yahoo to have its products and website returned in response to keyword searches. HT 68-69, 113-118; Ex. X, FF. Mason further paid contractors to help it to optimize its paid search bids for better returns, and also to test ad campaigns for the company. HT 116-117; Ex. K, L, M, O, P, Q, R.

- vi. *Mason used shopping comparison websites, so that its products would be shown in response to searches of certain keywords by shoppers for a particular item.*

Shopping comparison websites collect data feeds from multiple merchants on a variety of products. When a shopper searches for a particular item on the shopping comparison website, the website shows the particular product as offered by a variety of merchants and the price charged by each. Mason paid eight to ten such websites to display its products in the search results. HT at 104. Mason contracted with popular shopping-comparison websites, like Bizrate, PriceGrabber, NexTag, and Shop.com. HT at 65-66, 76, 103-104; Ex. DDD at 1, 4, 6, 8-9; Ex. C. InMason’s own words “The shopping comparison engines are a very important avenue, since many moms are cost-conscious.” Ex. NN at 1.

C. *Mason had business partners in Ohio.*

During the assessment period, Mason contracted with businesses in Ohio. Mason contracts with a content distribution network (CDN) – Akamai – that stores Mason’s software locally. Ex. YY; Ex. MMM at 13-16; Ex. PPP at 100-103; Ex. CCC at 21-25. Akamai takes the source code and assets for pages from Mason’s websites and stores them on servers in Ohio (and

nearby) in order to speed delivery of the website and to save bandwidth cost. *Id.*, Goldman Depo. Tr., Apt. Ex. QQQ at 45-46, 54-59. As Mason's Chief Information Officer explained:

We use Akamai. * * * I think they're the biggest CDN.

A content delivery network basically allows us to store some of our data * * * on these guys' servers, which are spread throughout the world. * * *

[Akamai's servers are] everywhere. They're all over the world. * * *

So how it works is basically, you know, if you're a customer coming into our website, you'll basically click on one of our URLs, right. And then that will pump all that data, basically, to Akamai. So then like our brand pages, other pages like that, they'll sit in Akamai servers in what's called cachemode. * * *

* * * so what happens is then when another customer comes in and then they log in and try and hit that same page, Akamai will deliver it immediately from that particular cache site instead of coming all the way back to our servers to get that information.

So all the images, all the different pages, they ultimately get cached on all these servers, and it makes it really fast to get data back down off of the content delivery network.

Ex. MMM at 13-15.

Mason used Akamai as a CDN during this period, as testified to extensively by Mason's CIO. Ex. MMM at 13-15. Mason's contract with Akamai confirms the CIO's testimony.² Ex. YY. This contract is expressly for the provision of CDN services; Mason paid for Akamai's "Dynamic Site Accelerator," which "continuously pulls and caches fresh site content onto Akamai servers closest to users." Ex. YY at 2, Ex. CCC at 22-23. Moreover, both the Tax Commissioner's expert witness and Mason's expert witness understood that Akamai's business was content distribution. Ex. PPP at 137; Ex. QQQ at 46. Furthermore, Mr. Soltani testified that

² Although Mason claims that it did not use Akamai as a CDN during this period, this claim is unsupported, as explained. Mason claims that it used Akamai for "security" which is *also* true, see Ex. YY, but the contract between Mason and Akamai expressly provides for the CDN service as well. Mason's expert witness also testified that Akamai stored assets of Mason during this period. Ex. QQQ at 59, 62-64, 72; Goldman Expert Report at ¶ 3. Further, Mason's witness, Mrs. Bresina, testified that she did not have primary responsibility for this relationship, because "IT owned that contract," and that she never asked Akamai whether they would be using servers in Ohio. HT 29-33. Finally, it bears note that Mrs. Bresina's own testimony does not support Mason's claim, as she merely testified that Mason used Akamai "*mainly*" for security, not *exclusively*. *Id.* at 26. The BTA made no finding on this point.

he knew that, as of 1999, Akamai announced it had servers in Ohio and that it was his belief that, if Akamai had servers in Ohio, then Mason assets would be stored on those servers in Ohio for the purpose of serving Ohio customers. Ex. CCC at 22-24.

4. The Tax Commissioner issued an assessment of Ohio Commercial Activity Tax based on his audit of Mason's total Ohio taxable gross receipts.

The Tax Commissioner contacted Mason by letter in 2009, explaining that the CAT is imposed on all business enterprises making commercial sales into Ohio. ST Case No. 2012-2806 at 33. The letter advised that the Tax Commissioner had information that Mason had over \$500,000 of gross receipts in Ohio and was therefore subject to the CAT. *Id.* After receiving no response from Mason, the Tax Commissioner began issuing CAT assessments, each covering one quarterly period from July 2005 to September 2011. See, ST Case No. 2012-1169, ST Case No. 2012-2806, and ST Case No. 2014-495. These assessments were estimated, as the Tax Commissioner did not then have Mason's actual gross receipts amounts.

Mason protested the Commissioner's assessments, asserting that it did not meet the statutory requirements for imposition of the CAT. ST at 81-88. The Commissioner rejected Mason's arguments, and issued a final determination that affirmed the assessments on the actual taxable gross receipts amounts determined in the audit, as well as some estimated assessments for later periods. ST at 1-4. An appeal to the Board of Tax Appeals was taken by Mason from the Commissioner's Final Determination.

5. After a full evidentiary hearing, the Board of Tax Appeals affirmed the Commissioner's Final Determination.

On December 15, 2014, the BTA conducted an evidentiary hearing in this matter. The BTA heard testimony from seven witnesses, and received roughly 70 exhibits from the parties. The parties also submitted stipulations of facts and stipulated exhibits.

Mason provided the testimony of Jodi Bresina, Mason's Internet Business Manager (HT); Adam Stavin, Mason's Chief Information Officer (by deposition, Ex. KKK); and Darin Schemenauer, Mason's Vice President of Marketing (by deposition, Ex. MMM). Mason also provided the expert witness testimony of Eric Goldman, a Professor at the Santa Clara University School of Law, as an expert on 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. Stip. at 3.

The Tax Commissioner offered the expert testimony of Ashkan Soltani, then a private researcher and consultant, who is now Chief Technologist of the Federal Trade Commission. Mr. Soltani was part of the Washington Post team that won a Pulitzer Prize in 2014 for Public Service for their coverage of the online surveillance done by the NSA. Mr. Soltani is an expert in Internet privacy, technology and behavioral economics, with particular expertise in technology used in the gathering and analysis of information utilizing internet and mobile technology, 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. Stip. at 3

The Tax Commissioner also offered the expert testimony of Professor Joseph Turow, a former Director of the Information and Society division of the Annenberg Public Policy Center who is now an Associate Dean for Graduate Studies and a Professor of Communications at the University of Pennsylvania. Professor Turow is an expert in the field of marketing, particularly in the area of internet and mobile technology used in marketing, and the industry and ecosystem of online retailing and marketing, and data mining and use in marketing and retailing. Stip. at 3.

The Tax Commissioner's chief witness on the history and intent of the CAT and the burdens and protections provided to retailers by Ohio was Mr. Fred Church. A transcript of Mr.

Church's testimony and associated exhibits was submitted to the BTA by agreement as Exhibit "A" to the Joint Stipulations. Stip. at 1.

Mr. Church served as the Ohio Department of Taxation's long-standing Deputy Commissioner for Tax Policy and Budget. Jt. Stip. Ex. M (Church's resume). In the 1990's, in response to the *Quill* decision, a number of states joined in the Streamlined Sales Tax Project to simplify the burden on sales taxes. Ex. A at 657-658. Mr. Church was Ohio's representative on the Streamlined Sales Tax Project and is, therefore, familiar with the burdens imposed by sales tax on interstate commerce. *Id.*

In advocating for the CAT and informing the General Assembly as to its operation, the Tax Commissioner relied primarily on Mr. Church's efforts as his Deputy Commissioner for Tax Policy and Budget, and those of Fred Nicely, then-chief counsel for the Ohio Tax Commissioner. Stip. Ex. A at 608-621, M. Mr. Church aided in drafting the bill that became the CAT, created the revenue estimates for the proposal, and testified before the General Assembly at various stages of the bill's life to explain and defend various aspects of the CAT. *Id.*

In April 2005, when the Senate Ways and Means Committee took testimony on the Bill at an important pre-enactment juncture of the CAT, Fred Church was the Tax Commissioner's "point person" to advocate for the codification of a "bright line presence" standard, which had been deleted in the immediately preceding version of the bill. Stip. Ex. A at 626-630. Mr. Church provided testimony and a written presentation to the Committee in support of the "bright-line" provision. *Id.*; Stip. Ex. A at B 12. Following Mr. Church's presentation, the Senate reinserted the bright-line presence standard, subsequently enacted into law. Stip. Ex. A at 631.

Mr. Church has served as the Deputy Budget Director for Tax Policy and Revenues with the Ohio Governor's Office of Budget and Management since July of 2012 and, in that capacity,

is familiar with state provision and regulation of infrastructure. Stip. Ex. A at 664. During his testimony, Mr. Church provided documents comprising multiple requests to Ohio's Controlling Board for appropriations or grants from state funds for expansion of broadband internet service in Ohio. *Id.*, and Ex. A 1-19 to Ex. A.

After full hearing and briefing, the BTA affirmed the Tax Commissioner's assessments, based upon the plain language of the CAT statutes. See, BTA Decision. The BTA did not rule on any constitutional issues. *Id.* Mason appealed the BTA's decision to this Court on May 19, 2015. Thereafter, the Tax Commissioner filed a cross-appeal on May 28, 2015.

LAW AND ARGUMENT

Tax Commissioner's Proposition of Law Number 1:

R.C. 5751.01(F)(2)(jj) is an exclusion from the definition of "gross receipts" that excludes certain receipts from the taxpayer's taxable base because of the nature of those receipts. The exclusion does not pertain to the applicability of the CAT to that taxpayer.

R.C. 5751.01(F)(2)(jj) [formerly R.C. 5751.01(F)(2)(aa)] excludes, from the definition of taxable gross receipts, "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 argues that the General Assembly implicitly incorporated the Supreme Court's dormant Commerce Clause "substantial nexus" analysis into R.C. 5751.01(F)(2)(jj). Mason contends that this exclusion requires the Commissioner to first establish that Ohio had a "substantial nexus" with Mason under the standard derived from the dormant Commerce Clause doctrine of the U.S. Constitution and jurisprudence relating to that doctrine, before applying the plain language of R.C. 5751.01 and 5751.02. Mason claims that *all* of the company's gross receipts are excluded from the statutory definition, because dormant commerce clause jurisprudence requires that Mason have a physical presence in Ohio. Mason is wrong.

The plain language of R.C. 5751.01(F)(2)(jj) does nothing to require a “substantial nexus” inquiry. Moreover, This division of the statute is an omnibus exclusion provision—containing 36 separate exclusions from gross receipts—all based on the *nature or kind* of the receipts, not by inquiry into whether the taxpayer has nexus with the state—other statutes govern that. Indeed, Mason’s proposed reading of R.C. 5751.01(F)(2)(jj) would place the statute squarely at odds with other CAT statutes, including R.C. 5751.02, which provides that the CAT may be levied against a taxpayer whether or not they have “substantial nexus” with the state. It would also supplant, and therefore render meaningless, Ohio’s own definition of “substantial nexus” under R.C. 5751.01(H)(3) and R.C. 5751.01(I)(3). Most fundamentally, Mason’s reading is at odds with the plain language of the exclusion, which governs the exclusion of *receipts* in the taxable base, and does not pertain to the taxability of *persons* at all.

1. Mason’s statutory argument is an impossibility—it is directly negated by the CAT levy provision in R.C. 5751.02 that allows taxation of persons who do not have substantial nexus with Ohio.

Mason’s contention that R.C. 5751.01(F)(2)(jj) requires the Commissioner to establish that Mason meets the requirements of the “substantial nexus” prong of the dormant Commerce Clause doctrine is *directly refuted* by R.C. 5751.02, which reads, in pertinent part, as follows:

Persons on which the commercial activity tax is levied include, *but are not limited to*, persons with substantial nexus with this state. (Emphasis added.)

By this express language of R.C. 5751.02, the CAT levy applies not only to those persons who have “substantial nexus with this state,” but also to those who do *not* have substantial nexus with Ohio. The General Assembly cannot be said to have incorporated a requirement of finding “substantial nexus” in the exclusion from the definition of gross receipts, when the statute that *actually levies* the CAT against certain persons says the opposite. Indeed, any challenge to a lack of substantial nexus under the Constitution would necessarily entail challenging the

constitutionality of the CAT statutes governing applicability of the CAT, like R.C. 5751.02, which Mason has not done in this case.

2. Mason’s statutory argument is refuted by the statutory definition of “substantial nexus.”

Mason’s contention that the Supreme Court’s “substantial nexus” analysis is incorporated in R.C. 5751.01(F)(2)(jj) is refuted by the plain meaning of the Ohio’s statutory definition of “substantial nexus,” in R.C. 5751.01(H)(3) and R.C. 5751.01(I)(3). Indeed, Mason’s misreading of the CAT statutes would negate the utility of the four-part “bright-line” standard in R.C. 5751.01(I) and, therefore, render it entirely meaningless.

Statutorily, the General Assembly defined “substantial nexus with this state” in R.C. 5751.01(H) and (I). Under R.C. 5751.01(H)(3), a person has “substantial nexus with this state” if the person “has bright-line presence in this state.” In turn, a person “has bright-line presence” in Ohio if the person meets one of four criteria, including “[having] during the calendar year taxable gross receipts of at least five hundred thousand dollars.” R.C. 5751.01(I)(3).

Mason, a person with well over \$500,000 in Ohio-sitused gross receipts, thus had “bright-line” presence under R.C. 5751.01(I)(3) and, accordingly, had statutory “substantial nexus” under R.C. 5751.01(H)(3).

By expressly defining the meaning of “substantial nexus” in the CAT statutes, the Ohio General Assembly intended the Tax Commissioner, as the administrator of the CAT, to apply clear, objective standards for purposes of ascertaining whether a particular person has “substantial nexus with the state.” Stip. Ex. A at 624-631. Rather than relying on a *case-law* legal standard for determining what facts and circumstances constitute “substantial nexus,” the General Assembly set forth explicit, objective standards in R.C. 5751.01(H) and (I), under which taxpayers shall be determined to have “substantial nexus.”

Mason’s interpretation of R.C. 5751.01(F)(2)(jj) would render entirely meaningless R.C. 5751.01(I)(3) as well as the rest of R.C. 5751.01(H) and (I). This is so, because it would require tax administrators to ignore the General Assembly’s definition of “substantial nexus” and instead rely *solely* on a case law standard. Mason’s interpretation would require a judicial erasure of an entire “bright line presence” standard, fundamentally usurping the General Assembly’s legislative will.

The General Assembly is presumed enact meaningful, effective legislation. *State ex rel. Cleveland Elec. Illum. Co. v. City of Euclid*, 169 Ohio St. 476, 479, (1959) (“[T]he General Assembly is not presumed to do a vain or useless thing, and * * * when language is inserted in a statute it is inserted to accomplish some definite purpose[.]”). And the actual, operative meaning should be given to the words used by the General Assembly in statutes. *R.W. Sidley, Inc. v. Limbach*, 66 Ohio St.3d 256 (1993) (replacing the General Assembly’s legislative will with a court’s own is “judicial fiat”). Mason’s proposed reading would render R.C. 5751.01(I) useless and inoperative. Therefore, this Court should reject Mason’s misreading of the statute.

3. Mason confuses the taxability of receipts with the taxability of persons.

Mason’s statutory interpretation fails because it is based on a fundamental misreading of related statutory provisions of the CAT, including R.C. 5751.02(F)(2)(jj), R.C. 5751.01(G) and R.C. 5751.033.

In this regard, R.C. 5751.01(F)(1) defines “gross receipts” as including “amounts realized from the sale of a taxpayer’s property to or with another,” (clearly encompassing, for example, Mason’s sales of merchandise to Ohio consumers), and R.C. 5751.01(F)(2) excludes an enumerated list of certain kinds of gross receipts from the definition of gross receipts.

Under the plain language of R.C. 5751.02(F)(2), the list of exclusions is based on the *nature* or *kind* of the gross receipts, not on *where the activities occurred that gave rise to the gross receipts* or *who the taxpayer is*. Stip. Ex. A at 638-650. The list of exclusions is long (36 total exclusion), but a few illustrative examples include: interest income; dividends and distributions from corporations; and proceeds received attributable to the repayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or marketable instrument. Clearly, the list, by its own terms, only excludes receipts of a certain nature.

Among these exclusions is R.C. 5751.01(F)(2)(jj) [formerly R.C. 5751.01(F)(2)(aa)]. The Commissioner's Information Release concerning "Taxable Gross Receipts," namely, CAT 2005-17, explains the exclusion in R.C. 5751.01(F)(2)(jj), as follows:

If either the constitution of the United States or of the state of Ohio or other laws of the United States prohibit the state of Ohio from imposing the CAT on *certain receipts*, these receipts will not be included in the taxpayers' calculation of its gross receipts for purposes of the CAT. (Emphasis added.)

The Commissioner's interpretation of the CAT statutes, as reflected in Information Release CAT 2005-17, expressly recognizes that the exclusions from the definition of "gross receipts" set forth in R.C. 5751.01(F)(2)(jj) operate to exclude only "certain" of a taxpayer's receipts. So, for instance, if federal law prohibited a tax on receipts for medical services covered by Medicaid, then those receipts, *and only those* receipts, would be excluded from the taxpayers' total, "taxable" gross receipts. In contrast, if a taxpayer lacks a substantial nexus with Ohio under the dormant Commerce Clause jurisprudence, the *taxpayer* is immune from the tax, not its receipts, and there would be no need to determine the excludability of its receipts from the base of "gross receipts."

Mason's statutory interpretation argument is essentially a request for a limiting construction of the statute that would avoid constitutional problems—an application of the

“avoidance doctrine.” See, *Chambers v. Owens–Ames–Kimball Co.*, 146 Ohio St. 559, 566 (1946). But an “avoidance” argument cannot be applied to a statute that is unambiguous and clear on its face, like R.C. 5751.02(F)(2)(jj). *Id.* In that case, this Court has a duty to simply apply the statute’s plain terms. *Id.* Accordingly, Mason’s argument never gets off the ground.

4. Statutory construction principles buttress the plain meaning of the pertinent CAT statutes as applied by the Tax Commissioner here.

The plain meaning of the relevant CAT statutes directly refutes Mason’s claim that all of its receipts are excluded from the CAT. But even if the statutes were found to be ambiguous, the Tax Commissioner’s view would prevail.

In interpreting statutes, courts must consider the objects sought to be attained, the circumstances under which the statute was enacted, the legislative history, the consequences of a particular construction, and the administrative construction of the statute. R.C. 1.49. In this case, all of these considerations support the Tax Commissioner’s view of the laws at issue.

The purpose of the bright-line directive of the CAT is “to provide *clear* guidance on when an out-of-state business with taxable gross receipts in this state is required to register and remit the proposed gross receipts tax.” Stip. Ex. A at B 12 (*Italics in original.*) These statutory bright-line presence standards accord with the legislative objective of the CAT to minimize the administrative compliance burdens. See particularly, Stip. Ex. A 624-631; Ex. L at 14. As explained above, this understanding of the law is supported by the legislative history, and the Tax Commissioner’s own Information Release.

Moreover, the CAT is designed to reflect the degree to which business entities, whether based in Ohio or elsewhere, conduct business in Ohio. Stip. Ex. A at 663-664. Because it is based on a minimum of \$500,000 of Ohio taxable gross receipts, the specific “bright-line presence” standard in R.C. 5751.01(I)(3) embodies this fundamental tax-policy principle of the

CAT. Mason's construction would defeat these clear, bright-line rules, and therefore frustrate the purpose of the CAT. Instead of the statutory bright-line standard, Mason's reading of R.C. 5751.01(F)(2)(jj) would require resort to US Supreme Court case law every single time to determine whether the CAT applied against a particular person.

The Commissioner's application of the "bright line presence" standards in R.C. 5751.01(I)(3) accords with the objects sought to be attained, the circumstances under which the statute was enacted, the legislative history, the consequences of a particular construction, and the administrative construction of the statute. If Mason's understanding of the CAT statutes is correct, then the legislative object in clear application of a bright-line rule would be defeated and each taxpayer's case would have to be evaluated individually under the dormant Commerce Clause jurisprudence.

Tax Commissioner's Proposition of Law No. 2:

As-applied constitutional challenges must be raised before the Board of Tax Appeals in order for this Court to obtain jurisdiction over those issues. When, as here, an appellant fails to raise a constitutional challenge to the Board of Tax Appeals, this Court lacks jurisdiction to review such claims under R.C. 5717.04.

Mason has failed to impart jurisdiction on the BTA, and therefore derivatively on this Court, to consider its as-applied constitutional challenges. Specifically, Mason's putative as-applied challenges appear in assignments of error numbered 1 and 4. The Tax Commissioner has already submitted a comprehensive Motion to Dismiss on this proposition and will therefore not repeat his argument herein, but reincorporates the arguments herein by reference.

Suffice it to say, in its Notice of Appeal to the BTA, Mason raised only an issue of statutory interpretation regarding the exclusion from "gross receipts" in R.C. 5751.02(F)(jj), as described above. In its BTA appeal, Mason sought only a "limiting" construction of R.C. 5751.02(F)(aa) that would incorporate the Court's dormant Commerce Clause jurisprudence.

Mason did *not* raise a constitutional challenge, whether facial or as-applied, to the statutes that levy the CAT and make it applicable to Mason, i.e., R.C. 5751.01(I) and R.C. 5751.02.

As-applied constitutional challenges relating to Tax Commissioner Final Determinations must be raised in the first instance in the Notice of Appeal to the BTA.³ *South-Western City Sch.*, 24 Ohio St.3d 184, 185-187 (1986). Mason failed to specify an as-applied challenge to the constitutionality of any CAT statute in its Notice of Appeal to the BTA. Accordingly, this Court lacks jurisdiction over those challenges now, and must dismiss them. R.C. 5717.02; R.C. 5717.04; *Cleveland Gear Co. v. Limbach*, 35 Ohio St.3d 229, 231 (1988); *South-Western City Sch.*, 24 Ohio St.3d at 185-187.

Mason's Notice of Appeal does contain a *discussion* of dormant Commerce Clause jurisprudence, but only in support of Mason's statutory interpretation argument that the Commissioner should interpret R.C. 5751.01(F)(2)(jj) so as to exclude its receipts from the statutory definition of "taxable gross receipts" to avoid an unconstitutional application of the statute. Nowhere in the Notice of Appeal is a challenge to the constitutionality of the CAT bright-line presence provisions in R.C. 5751.01(I) and (H) or any CAT statute such as R.C. 5751.02, which levies the CAT whether or not a taxpayer has substantial nexus with Ohio.

Mason's failure to raise such challenge to the constitutionality of the CAT statutes jurisdictionally bars Mason from any such untimely challenge now. Because Mason failed to

³ This Court has suggested that facial challenges *may* be raised for the first time at the Supreme Court, when they require no factual findings for resolution. *Cleveland Gear*, 35 Ohio St. 3d at 231 ("since extrinsic facts are not needed to determine that a statute is unconstitutional on its face, the question of whether a tax statute is unconstitutional on its face may be raised initially in the Supreme Court"). While the Tax Commissioner believes that the facial challenge made by Mason *depends* on extrinsic facts, as do many facial challenges, this brief does not address the holding in *Cleveland Gear*, as it is not necessary to resolution of this case.

raise those errors in its Notice of Appeal to the BTA, this Court lacks jurisdiction to consider them as well.

Tax Commissioner's Proposition of Law No. 3:

In order to maintain a facial challenge to the constitutionality of a given statute, a challenger must prove that the statute is unconstitutional in all possible applications.

- 1. In order to prevail on a facial challenge, a challenger must show that there is no set of circumstances under which R.C. 5751.01(I)(3) could be constitutionally applied.**

Under well-settled law, in order to prevail on a facial challenge, Mason would have to show that there is no set of circumstances under which R.C. 5751.01(I)(3) could be constitutionally applied. *Wymylo*, 2012-Ohio-2187 at ¶ 21; *Arbino*, 2007-Ohio-6948 at ¶ 26. And it must do so “beyond a reasonable doubt.” *Ohio Grocers*, 2009-Ohio-4872 at ¶ 11, citing *Columbia Gas Transm. Corp. v. Levin*, 2008-Ohio-511 at ¶ 41, quoting *Yajnik v. Akron Dept. of Health, Hous. Div.*, 2004-Ohio-357 at ¶ 16.

As the Supreme Court explained: “A facial challenge to a legislative Act is, of course, the most difficult challenge to mount successfully, since the challenger must establish that no set of circumstances exists under which the Act would be valid.” *Salerno*, 481 U.S. at 745.

The standard set out in *Salerno* is still controlling law, cited by the Supreme Court as recently as 2010. *United States v. Stevens*, 559 U.S. 460, 472 (2010). Federal courts apply *Salerno* to Commerce Clause cases. See, e.g., *United States v. Trent*, 2008 WL 2897089, at * 5 (S.D. OH July 24, 2008); *Rancho Viejo, LLC v. Norton*, 323 F.3d 1062, 1077-78 (D.C. Cir. 2003); *United States v. Sage*, 92 F.3d 101, 106 (2d Cir.1996); *United States v. Van Buren*, 599 F.3d 170 (2nd Cir. 2010); *Gov't Suppliers Consolidating Servs., Inc. v. Bayh*, 975 F.2d 1267, 1283 (7th Cir. 1992).

State courts apply the *Salerno* standard to Commerce Clause cases too. See, e.g., *Whirlpool Props., Inc. v. Director, Div. of Taxation*, 26 A.3d 446, 466-68 (N.J. 2011); *Moran Towing Corp. v. Urbach*, 787 N.E.2d 624 (N.J. 2003); *Amazon.com LLC v. New York State Dep't of Taxation & Fin.*, 23 Misc. 3d 418, 424, (N.Y. Sup. Ct. 2009) aff'd as modified, 81 A.D.3d 183, 913 N.Y.S.2d 129 (2010) aff'd sub nom. *Overstock.com, Inc. v. New York State Dep't of Taxation & Fin.*, 987 N.E.2d 621 (2013); cert. denied, 134 S. Ct. 682, 187 L. Ed. 2d 549 (2013) and cert. denied sub nom. *Amazon.com, LLC v. New York State Dep't of Taxation & Fin.*, 134 S. Ct. 682 (2013). And, of course, this Court continues to apply the *Salerno* standard. See, e.g., *Wymyslo*, 2012-Ohio-2187 at ¶ 21; *Arbino*, 2007-Ohio-6948 at ¶ 26.

Some members of the Supreme Court have recently argued for a “lesser” standard, but the *Salerno* test still stands and shows no signs of being overruled. See, e.g., *Overstock.com*, 987 N.E.2d 621, 624. In any event, “all [Justices] agree that a facial challenge must fail where the statute has a “plainly legitimate sweep.”” *Washington State Grange v. Washington State Republican Party*, 552 U.S. 442, 449 (2008) (citing *Washington v. Glucksberg*, 521 U.S. 702, 739–740, and n. 7, (1997) (Stevens, J., concurring in judgments)).

But this is mostly academic. Under either standard, a challenger must show that, in large, the statute is not capable of constitutional application. This makes sense. After all, a challenge under the Commerce Clause is a challenge to the lawmaking authority of a state. If the law is capable of *some* constitutional application, it cannot be said that the General Assembly exceeded its lawmaking authority, and a facial challenge *must* therefore fail, regardless of the existence of hypothetical unconstitutional applications. See, e.g., *Glucksberg*, 521 U.S. at 739 (Stevens, J. concurring).

And either standard is fatal to Mason’s facial challenge. *See, e.g., Overstock.com*, 987 N.E.2d 621, 624. Under R.C. 5751.01(I)(3), the obligation to pay the CAT falls on all taxpayers throughout the state—whether brick and mortar retail establishments or internet retailers—when they have, “during the calendar year taxable gross receipts of at least five hundred thousand dollars.” And Ohio certainly can levy the CAT on Ohio-sitused gross receipts earned by business located within its borders under *Quill*, or any other dormant Commerce Clause analysis. Therefore, the CAT is easily capable of constitutional application, as Mason must concede.

To escape this clear bar to its facial challenge, Mason advances a radical and untested standard that seems to have been followed only by the 10th Circuit in First Amendment “overbreadth” cases. *See*, Mason’s Merit Brief at 22, *citing Doe v. City of Albuquerque*, 667 F.3d 1111, 1124–1125 (10th Cir. 2012). But, the overbreadth doctrine is limited to First Amendment cases, as it concerns government action that would chill speech. And as other federal districts have recognized “[t]he fact that a statute might operate unconstitutionally under some conceivable set of circumstances is insufficient to render it wholly invalid, since the Court has not recognized an ‘overbreadth’ doctrine outside the limited context of the First Amendment.” *Gen. Elec. Co. v. New York State Dep’t of Labor*, 936 F.2d 1448, 1456 (2d Cir. 1991) (Citing *Salerno*.)

And, in truth, Mason isn’t even attempting to apply the *City of Albuquerque* standard, but instead seeks to turn the *Salerno* analysis inside-out. Mason would like this Court to hold the statute facially invalid because it does not incorporate the facts and circumstances of particular taxpayers. *See* Mason Merit Brief at 19. In other words, Mason would like this Court to hold that the standard for a facial challenge is the same as an as-applied challenge: that the statute operates unconstitutionally as applied to a given set of facts.

Mason's reason for arguing for this through-the-looking-glass standard is obvious: it failed to make an as-applied challenge to the BTA, and therefore cannot impart jurisdiction on this Court to consider such a challenge now (as explained above and in the Motion to Dismiss). And a facial challenge under the appropriate standard of review (*Salerno*) stands no chance of success. Therefore, Mason asks this Court to adopt a wholly new, unsupportable standard, in order to save its as-applied challenge. This Court should not take the bait.

2. R.C. 5751.01(I)(3) is facially constitutional because it is fairly related to the privileges and benefits conferred by Ohio, and because Ohio's CAT does not place the same burden on interstate commerce as the tax in *Quill*.

As explained above, R.C. 5751.01(I)(3) survives facial review, because it easily meets the *Salerno* standard. But, even under Mason's inverted standard, the CAT statute at issue withstands facial scrutiny. The \$500,000 threshold for gross receipts in R.C. 5751.01(I)(3), which triggers the obligation to pay CAT, is constitutional under the "substantial nexus" prong of the *Complete Auto* test.

The CAT is a low-rate tax that is easy to calculate and comply with, and therefore does not substantially burden interstate commerce. The CAT's \$500,000 threshold is a proxy for the level of high business activity in Ohio necessary to generate such receipts, which also corresponds to a demand for state-provided benefits in the forum. Further, as many other states have recognized, a "significant economic presence" in forum state is an attendant consequence of conducting substantial business activity in the state. And the \$500,000 threshold reflects just such a significant economic presence.

A. The CAT minimally burdens commerce: it is simple for taxpayers to comply with and for the state to administer.

As the Supreme Court explained in *Quill*, the "substantial nexus" prong of the *Complete Auto* test is intended "to ensure that state taxation does not *unduly burden* interstate commerce."

Quill Corp., 504 U.S. at 313 (emphasis added). The “burden” on interstate commerce found in the *Quill* case and its predecessors, was one of “compliance with administrative regulations in the collection of sales and use taxes.” *MBNA Am. Bank.*, 640 S.E.2d at 233. The Court in *Quill* did not elaborate exactly on the “burdens” of the sales and use tax in that case, but suggested that the “compliance burdens” included an inability to identify when one might be subject to the tax, multiple overlapping taxing jurisdictions, variations in tax rates and allowable exceptions, and administrative and record-keeping requirements. *Quill Corp.*, 504 U.S. at 313, fn. 6.

In stark contrast to the sales tax at issue in *Quill*, compliance with the CAT is extraordinarily simple and not burdensome. See, e.g., *MBNA Am. Bank.*, 640 S.E.2d at 233 (“In contrast to the sales and use taxes described in *Bellas Hess* and *Quill*, the franchise and income taxes at issue in this case do not appear to cause the same degree of compliance burdens.”)

The CAT has a low tax rate. At its highest rate, the CAT costs only .0026 cents per dollar of gross receipts. (See the table below). This is miniscule in contrast with a sales tax that may be levied at a rate of .07 cents or more per dollar. Moreover, the CAT is very easy to calculate. One only need know the annual minimum payment, and the multiplier factor of .0026 per dollar.

The administrative burden of compliance with the CAT is low. In *Quill*, point of emphasis for the Court the heavy administrative burden of retail sales taxes. This emphasis led to the creation of the interstate task force on sales tax simplification known as the “Streamlined Sales Tax” effort, which has now been in existence for 13 years. Stip. Ex. A at 656.

The CAT was specifically engineered to avoid the administrative burdens of sales and use taxes noted in *Quill*. *Id.* at 658-659. For instance, rather than having dozens of taxing authorities in Ohio (every county, and every municipality, to name a few), there are no local tax

rates under the CAT, so there is no burden on the seller of needing to know tax rates or rules of sub-state political subdivisions. Further, there is a world of difference between compliance with a tax on a single sale (under *Quill*, the tax is transaction specific), versus the threshold here that is thousands of sales by the same entity (based upon a \$500,000 threshold of total gross receipts).

And, unlike a sales tax, there is no burden on the seller to know the tax status of the purchaser (i.e. exempt or not), since the tax is on the seller rather than the purchaser. Thus, the seller does not have to know whether the purchaser is an exempt entity, such as a non-profit charity, or whether the thing purchased will be used in a tax-exempt manner. The seller only needs to know its own taxable status and where its products are sold. In CAT refund cases, there is no confusion over whether the tax refund is due to the seller or the purchaser depending on whether the seller has already made a refund of tax to the consumer and is now awaiting a refund of the tax that it remitted to the state. Stip. Ex. A at 658-660.

Finally, purchasers are never liable for the CAT, whereas under the sales and use tax there are significant amounts of tax liability from companies acting as purchasers of taxable goods and services, where the companies pay under special “direct pay” or “consumer’s use” tax permits. See R.C. 5739.031.

B. The CAT’s \$500,000 threshold is a proxy for the high level of activity required to generate those amounts of receipts in the state and correlates to the benefits and protections afforded by Ohio.

Underlying the *Complete Auto* standard is the reasoning that “[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.” *Western Live Stock v. Bur. of Revenue*, 303 U.S. 250, 254 (1938); quoted with approval in *Complete Auto*, 430 U.S. at 288.

Indeed, the Court has explained that “[we] have sustained nondiscriminatory, properly apportioned state corporate taxes upon foreign corporations doing an exclusively interstate business *when the tax is related to a corporation’s local activities and the State has provided benefits and protections for those activities for which it is justified in asking a fair and reasonable return.*” *Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 108, (1975) (emphasis added) (cited with approval in *Complete Auto*, 430 U.S. at 288).

The CAT is designed to reflect the degree to which business entities, whether based in Ohio or elsewhere, conduct business in Ohio, because the applicability and rate of the CAT is measured by gross receipts from commercial activity that occurs within Ohio, as the table below demonstrates. *See, also*, Stip., Ex. A at 655-664.

<u>Taxable Gross Receipts</u>	<u>Annual Minimum Tax</u>	<u>CAT</u>
\$1 Million or less	\$150	No Additional Tax
More than \$1 Million but less than or equal to \$2 Million	\$800	0.26% x (Taxable Gross Receipts - \$1 Million)
More than \$2 Million but less than or equal to \$4 Million	\$2,100	0.26% x (Taxable Gross Receipts - \$1 Million)
More than \$4 Million	\$2,600	0.26% x (Taxable Gross Receipts - \$1 Million)

For businesses earning less than \$500,000, who have minimal property, payroll, and who are not domiciled in the state, no CAT is due at all. This reflects the reality that such businesses will likely have little business activity in the state or insignificantly burden state resources. But, for those earning more than \$500,000 in gross receipts situated to Ohio, the statute recognizes that such persons have “substantial nexus” with the state, as their high level of activity will place a demand upon the state for benefits and protections. R.C. 5751.01(I)(3) and (H)(3). The specific “bright-line presence” standard in R.C. 5751.01(I)(3) embodies this fundamental tax-policy

principle of the CAT, because it is based on a minimum of \$500,000 of Ohio taxable gross receipts.

Mason fundamentally misunderstands the \$500,000 “bright line.” For Mason the bright line amount is an imposition of CAT liability “based solely on its gross receipts.” Mason Merit Brief at 34. But that myopic view misrepresents the “measuring stick” that is gross receipts. Instead, under the CAT, gross receipts are “a proxy for the scale of a business and the degree to which the business uses government services.” Stip. Ex. A at 663. This measuring stick made the CAT “closer to a proxy” than the Corporate Franchise Tax that the CAT replaced. The Corporate Franchise Tax was measured by net income or net worth, figures that could be manipulated by creative tax planning, with the result that businesses of similar size and character paid substantially different tax amounts. Stip. Ex. A at 662-664. The CAT leveled the field.

This “proxy” reflects the modern trend among states of recognizing that nexus may exist over a party that conducts significant business in the forum state, without regard to whether that entity is physically present. *See, e.g., Scioto Ins. Co. v. Oklahoma Tax Comm’n*, 279 P.3d 782, 787 (Ok. 2012) (collecting cases); *MBNA Am. Bank.*, 640 S.E.2d at 234; *MBNA Am. Bank, N.A. & Affiliates v. Indiana Dep’t of State Revenue*, 895 N.E.2d 140, 144 (Ind. Tax Ct. 2008); *Bridges, Sec’y of Dep’t of Revenue, State v. Geoffrey, Inc.*, 984 So. 2d 115, 127 (La. Ct. App. 2007) *writ denied sub nom. Bridges v. Geoffrey, Inc.*, 978 So. 2d 370 (La. 2008); *see, also, In re Washington Mut., Inc.*, 485 B.R. 510, 519 (Bankr. D. Del. 2012).

Here, the \$500,000 threshold plainly meets that mark under a facial challenge. When a company’s business activities in the state generate hundreds of thousands of dollars, that activity is considered “substantial” the dormant Commerce Clause does not require a “form over

function” physical presence in the state. *KFC Corp*, 792 N.W.2d at 328; *Capital One Bank*, 899 N.E.2d at 86.

Moreover, the CAT reflects the degree to which the scale of business involved receives “government benefits, like physical infrastructure, regulated and reliable utilities, protections of the legal system, and maintaining an orderly marketplace for the sale of goods and services within the State. Stip. Ex. A at 664. There is no real question that Mason derives great benefit from the physical infrastructure that Ohio provides, including the road systems, landfills, telecommunication and internet lines and rights of way, electrical grids and cell towers. Stip. Ex. A at 664. This physical infrastructure greatly contributes to Mason’s ability to maintain and grow its sales to consumers in Ohio. To support the physical infrastructure, Ohio also provides essential government services that enable Mason to grow its market in the state.

Ohio also provides essential legal and financial resources that support Mason’s ability to maintain and grow its Ohio market. Banking laws and regulations ensure that credit transactions are processed properly. Ohio’s court system provides a forum for redressing legal disputes, which could include the protection of Mason’s intangible property, such as trademarks or copyrights. Ohio’s school systems provide an educated base of consumers with the ability to hold jobs that provide the monetary means to purchase goods from Mason. Stip. Ex. A at 664; *Quill Corp.*, 504 U.S. at 328-29 (White, J., dissenting).

In sum, Mason receives substantial benefits, protections and opportunities afforded by Ohio, for which Ohio incurs significant social and governmental costs. Accordingly, the \$500,000 threshold represents a proxy for the business and government services provided by the state of Ohio “for which it can ask return.” *Couchot*, 74 Ohio St.3d at 423. The bright-line standard of R.C. 5751.01(I)(3) thus facially meets the Court’s standard for “substantial nexus.”

Tax Commissioner's Proposition of Law Number 4:

Mason's actions in Ohio were entirely directed towards growing and maintaining a market in the state, and therefore, Mason owed CAT to Ohio for the privilege of doing over \$500,000 in yearly business in the state.

1. **Tyler Pipe and its progeny require those engaged in interstate commerce to pay state taxes when, as here, "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."**

The Commerce Clause of the U.S. Constitution is not only an affirmative grant of Congressional power to regulate interstate commerce among the states, but also has negative sweep that prohibits states from unduly burdening or discriminating against interstate commerce. U.S. Constitution, Art. I, Sec. 8, cl. 3; *Gibbons v. Ogden*, 22 U.S. 1 (1824); *South Carolina v. Barnwell Brothers, Inc.*, 303 U.S. 177, 185 (1938).⁴ Dormant Commerce Clause jurisprudence has evolved significantly throughout the Court's history. *Quill Corp.*, 504 U.S. at 303 (discussing the U.S. Supreme Court's dormant Commerce Clause history).

⁴ Some have observed that there is no express support for a "dormant" Commerce Clause in the Constitution at all, and that, therefore, there is no challenge that may be asserted in any case. See, e.g., *Comptroller of Treasury of Maryland v. Wynne*, 135 S. Ct. 1787, 1808 (2015) (Scalia, J. and Thomas, J. dissenting) ("the negative Commerce Clause is a judicial fraud"):

The fundamental problem with our negative Commerce Clause cases is that the Constitution does not contain a negative Commerce Clause. It contains only a Commerce Clause. Unlike the negative Commerce Clause adopted by the judges, the real Commerce Clause adopted by the People merely empowers Congress to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Art. I, § 8, cl. 3. The Clause says nothing about prohibiting state laws that burden commerce. Much less does it say anything about authorizing judges to set aside state laws they believe burden commerce.

See, also, *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me.*, 520 U.S. 564, 610 (1997) (Thomas, J.; Scalia, J., and Rehnquist, CJ, dissenting) ("The negative Commerce Clause has no basis in the text of the Constitution, makes little sense, and has proved virtually unworkable in application.") It is not this Court's role, however, to overrule the US Supreme Court on matters of the US Constitution.

When a state tax is to be analyzed under the dormant Commerce Clause, the current analysis is derived from *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Under *Complete Auto*, for a state tax to withstand dormant Commerce Clause scrutiny, the tax must: (1) apply to an activity with a substantial nexus with the taxing State; (2) be fairly apportioned; (3) not discriminate against interstate commerce; and (4) be fairly related to the services provided by the State. *Id.* at 279. The only prong of the *Complete Auto* test raised by Mason is the “substantial nexus” prong. As applied to the CAT assessment liability at issue, Mason’s activities and property in Ohio create “substantial nexus” under the dormant Commerce Clause doctrine’s *Complete Auto* standard.

A. *“Substantial nexus” arises when an out-of-state person acts to establish and maintain a market in Ohio.*

In *Tyler Pipe*, the U.S. Supreme Court addressed the “substantial nexus” prong of *Complete Auto*. *Tyler Pipe*, 483 U.S. at 250-51. The Court explained that: “[T]he crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in this state for the sales.” *Id.*

In *Tyler Pipe*, the out-of-state business had “substantial nexus” with the taxing state and therefore, the company was required to pay the state’s privilege tax. *Tyler Pipe*, 483 U.S. at 250-51. Significantly, the Court held that the in-state activities of one independent contractor was *sufficient* for non-sales tax nexus, but made no assertion that a physical presence was *necessary* for non-sales tax nexus. *Id.*

“Substantial nexus” existed between the taxpayer and the state by virtue of the taxpayer’s sole in-state activity, which was to employ an independent contractor who provided information about the company’s in-state market, such as “product performance; competing products;

pricing; market conditions and trends; existing and upcoming construction products; customer financial liability; and other critical information of a local nature.” *Id.*

Here, the facts establish that Mason does all of the same activities and much more in pursuit of its internet sales market in Ohio. During the audit period, advances in technology allowed Mason to comprehensively understand its state markets electronically and by automation, even from a distance. As comprehensively detailed in the Facts Section above, Mason used customer data produced from its interactions with Ohio consumers for business purposes such as marketing, inventory planning, and product comparison.

Moreover, during the audit period Mason also used and stored its own tangible and intangible business property in Ohio; had business partners to store its property and assets in and near Ohio; used Ohioans’ computers to process the software and code necessary to make online sales possible; and relied upon Ohio’s infrastructure and market to effectuate its business.

These in-state activities of Mason handily meet the dormant Commerce Clause standard in *Tyler Pipe*, under which Mason is required to pay Ohio CAT. Mason established and maintained a massive market in Ohio. And it did so through continual and intentional activities in Ohio, as explained below.

B. Mason’s online presence in Ohio, through its interactive marketing efforts, virtual store, and data mining—all aimed at growing and maintaining a market in this state—established substantial nexus with Ohio for purposes of a gross receipts tax.

Mason’s commercial activities create substantial nexus with Ohio. In the years at issue here, Mason reaped millions from Ohio consumers in gross receipts. It did so primarily through

the tools available to an online retailer.⁵ In that way, Mason acted systematically and continuously in Ohio to grow its market.

Mason's website offered customers in Ohio a "virtual store," superior, in many ways, to brick and mortar retail shops. Mason's virtual store allowed customers to browse and order products from Mason's inventory from their living rooms and offices.

The creation of Mason's virtual store happens in Ohio. Mason's website is rendered and assembled in Ohio, on Ohioans' computers, by Mason through the web browser (i.e. Internet Explorer or Firefox), with information gathered from all over the internet. Ex. CCC at 4-9; Ex. PPP at 58-60. During this "local interaction," Ohioans' computer memory and processing is used. *Id.* As a result of this local interaction, data is stored on Ohio computers, including material for which Mason retains property rights, such as copyright. *Id.* at 60-62; 136; Ex. QQQ at 61-62, 89-90. Moreover, storing data on users' computers allows Mason to deliver the website more quickly, and reduce its cost for bandwidth – both business purposes. Ex. PPP at 89-100.

Moreover, throughout the assessment periods, Mason maintained and grew its market by engaging in a panoply of marketing activities, including: paid search, affiliate programs, e-mail marketing, shopping comparison, and display ads. Mason's internet marketing was a powerful means by which Mason purposefully acted to establish and maintain a market in this state. Through its online marketing, Mason is able to customize offerings to customers based on their prior shopping or browsing activity. Mason sent targeted ads in email. It pays to have its products returned when users typed search terms into popular search engines like Google and

⁵ The Tax Commissioner comprehensively detailed Mason's online business activities in the Facts Section above, and for the sake of brevity will not repeat those facts in detail in this Section.

Yahoo. It pays affiliates to offer Mason products or advertising on their own websites. Mason also pays to have its advertising served to consumers who are more likely to buy its products.

Mason also harvests data from activities of consumers here in Ohio in order to grow its customer list and to engage in advertising and marketing. The data that is collected and mined is produced locally. And it has a monetizable business value. Collected customer data is accumulated into a “customer list,” which is the crown jewel of the remote-retailer’s trade. The customer list is a jealously guarded trade-secret, the life blood of the remote retailers. Walter W. Miller, Jr. & Maureen A. O’Rourke, *Bankruptcy Law v. Privacy Rights: Which Holds the Trump Card?*, 38 Hous. L. Rev. 777, 779 (2001) (“In many cases, the most valuable asset that an e-commerce company ‘owns’ is its customer database.”). Thus, just by collecting and warehousing Ohioans’ data, Mason has gained a valuable business asset, that is used to contact consumers and increase sales. Mason used this data to supplement its catalog mailings and to share with other mail-order retailers as well. Further, Mason uses customer data to spot trends, test marketing promotions, to personalize catalog mailings, and to target consumers, and grow its customer list. HT 101-113; 48; 123-127; 134-135; Ex. DDD, passim; Ex. CCC, passim.

In this case, the evidence establishes that, throughout the assessment periods, Mason used customer data for *all* of these business purposes. Using its multi-platform marketing, Mason used customer information obtained through its interactions with Ohio consumers to target individual consumers, refine its sales approach, and grow its market in Ohio.

C. Mason has business partners who acted in Ohio in efforts to grow Mason’s market.

Mason paid for services of businesses in Ohio during the audit period as well. First, Mason contracted with a content distribution network (CDN) – Akamai – to store Mason’s website software and assets closer to its customers. Ex. YY; Ex. MMM at 13-16; Ex. PPP at

100-103; Ex. CCC at 20-25. Akamai takes the source code and assets for pages from Mason's websites and stores them on servers in Ohio (and nearby). *Id.* Mason uses Akamai in Ohio for business purposes. Ex. CCC at 100-103. By having servers in Ohio, closer to Ohio customers' computers, Mason speeds up delivery of the website, which help is make more sales, and Mason saves money, due to reducing the bandwidth cost of sending information from its own, more remote servers in Wisconsin. *Id.*, Goldman Depo. Tr., Apt. Ex. QQQ at 45-46, 54-59. Mason has IP rights in this data and, as explained above, some of this data is software.

Mason also used a third party provider of affiliate websites to place advertising or a link to Mason's retail website on third-party websites. Ex. LLL at 47-49; HT 110-113. This provider likely had agreements with websites in Ohio that received a commission from Mason on any sales that are made as a result of the customer clicking the affiliate's link. *Id.*

These in-state business partners of Mason operating in Ohio demonstrate Mason's ongoing efforts to establish and maintain a market in Ohio. Such contractors help Mason maintain and establish a market in Ohio, much like the independent contractor did in *Tyler Pipe*. If Mason is right, and the "physical presence" of a contractor of the taxpayer in Ohio is required under *Quill*, these in-state business partners would provide that nexus link. See, e.g., *Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 235 (1992) (in-state sales representatives for Wrigley's who "exchanged stale gum," and "maintained a stock of gum * * * in the State for this purpose" as well as "selling gum through 'agency stock checks'" (less than 0.00007% of total sales) was deemed a "nontrivial additional connection with the State.")

This is ironic, given that Mason's business could operate without these contractors. And, it demonstrates the mismatch between *Quill's* "bright-line physical presence" requirement and the reality of how internet business is done online. Instead, Mason's own interactions with

Ohioans via its website, the internet, and email are a much more powerful, robust, and meaningful way for Mason to establish and develop a market in Ohio.

D. Mason has significant tangible personal property in the state of Ohio that creates substantial nexus for taxing purposes.

Mason claims that a “physical presence” is necessary for substantial nexus under the *Complete Auto* standard as explained in *Quill*. The Tax Commissioner disagrees with this mischaracterization of the *Quill* holding, as discussed below. As explained, the critical inquiry for a tax like the Ohio CAT 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.” *Tyler Pipe*, 483 U.S. at 250-51. Still, whether or not the physical presence standard of *Quill* applies in this context, Mason has a physical presence in Ohio by virtue of its tangible personal property in this state. Accordingly, even in if the physical presence requirement of *Quill* were applicable, it would be satisfied in this case.

Software has long been regarded as tangible, personal property in Ohio for purposes of taxation. *Andrew Jergens Co.*, 2006-Ohio-2708 at ¶ 24. Ohio is not alone in this; many other states recognize that software is tangible property, subject to sales and use taxes, gross receipts taxes, and personal property taxes. See, e.g., *Microsoft Corp. v. Franchise Tax Bd.*, 212 Cal. App. 4th 78, 87 (2012) (citing *First Data Corp. v. State, Dept. of Rev.*, N.W.2d 898, 903-904 (Neb. 2002); *Wal-Mart Stores, Inc. v. City of Mobile*, 696 So.2d 290, 291 (Ala.1996); *Comptroller of the Treas. v. Equitable Trust*, 464 A.2d 248, 261 (Md. 1983).

The leading case on whether software is tangible property is *S. Cent. Bell Tel. Co. v. Barthelemy*, 643 So.2d 1240 (La. 1994). In *South Central Bell*, the Louisiana Supreme Court explained that software is tangible property: “The software at issue is not merely knowledge, but rather is knowledge recorded in a physical form which has physical existence, takes up space on

the tape, disc, or hard drive, makes physical things happen, and can be perceived by the senses. * * * This arrangement of matter, physically recorded on some tangible medium, constitutes a corporeal body.” *Id.* at 1246 (internal citations omitted).

Similarly, the Ohio Supreme Court explained that software is tangible property, explaining that the seller transfers the property on “tape, disc, or other medium, which contains encoded computer instructions” and those instructions are “recorded on a medium, often in the form of magnetic fields.” *Andrew Jergens Co.*, 2006-Ohio-2708 at ¶ 24. In order to “use the purchased software, the purchaser transfers the encoded instructions from the medium to his or her computer” where “the instructions are stored on the hard drive of the purchaser's computer to enable the computer to perform the desired operation.” *Id.* “Thus,” the Court explained, “the encoded instructions are always stored on a tangible medium that has physical existence.” *Id.*

In this case, the same transmittal of instructions occurs as in *South Central Bell* and *Andrew Jergens*. Mason electronically sends packets of information comprising instructions to a user’s computer, which are then stored locally, on the user’s hard drive. Ex. PPP at 58-65; Ex. CCC at 1-8, 17-19.

These sets of instructions constitute software. Software has been narrowly defined as a “program, which, in turn, is defined as ‘a complete set of instructions that tells a computer how to do something.’ ” *S. Cent. Bell*, 643 So. 2d at 1246 (quoting D. Tunick and D. Schechter, *State Taxation of Computer Programs: Tangible or Intangible?*, Taxes-The Tax Magazine, Jan. 1985, at 54, 56). The Ohio Supreme Court describes software as “encoded instructions” that “are stored on the hard drive of the purchaser’s computer to enable the computer to perform the desired operation.” *Andrew Jergens Co.*, 2006-Ohio-2708 at ¶ 24.

As the hearing in this case established, Mason has several forms of software that are delivered to, and stored on, computers and mobile devices in Ohio. These include the HTML code and the JavaScript that are a part of the “source code” and enable a computer user to load Mason’s website. Ex. PPP at 60-61 (HTML code and JavaScript are software). As explained by Mr. Soltani, the HTML code and JavaScript sent by Mason instruct the user’s computer or mobile device to carry out a set of functions that will render the website in the manner desired by Mason. *Id.*; Ex. CCC at 1-8, 17-19. This property of Mason—the software—is sent to, and stored on users’ computers and mobile devices in Ohio. *Id.*

Mason’s business interests are furthered by storing the software on users’ computers: such storage makes Mason’s website load faster on subsequent visits and saves Mason the bandwidth costs of retransmitting this information. *Id.* at 63-64, Ex. QQQ at 56-57.

This software is owned by Mason and, in the “bundle of rights” Mason retains Intellectual Property (“IP”) rights over this property, and grants users a limited license to use the software. Ex. CCC. at 60-62; 136; Ex. QQQ at 61-62, 89-90.

What’s more, as part of the process of assembling its virtual store, Mason leaves valuable “assets”—copyrighted images and data on a user’s hard drive. This is property for which Mason has intellectual property rights, enforceable in Ohio for misuse. *See, CoStar Realty Info., Inc. v. Field*, 2010 WL 5391463 (D. MD Dec. 21, 2010), citing *Ticketmaster L.L.C. v. RMG Technologies, Inc.*, 507 F.Supp.2d 1096, 1105-1106 (C.D. Cal. 2007); *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 519 (9th Cir. 1993). If a user violated the license to use the data transferred via the software—or the software itself—Mason could potentially assert enforceable property rights against that user. Ex. CCC. at 60-62; 136; Ex. QQQ at 61-62, 89-90.

Moreover, Mason contracts with a content distribution network – Akamai – that stores its software locally. See, Facts Section 3.C., above. This company takes the source code and assets for pages from Mason’s websites and stores them on servers in Ohio (and nearby) in order to speed delivery of the website and to save bandwidth cost. *Id.*

In *Quill*, the fact that the out-of-state taxpayer sent only four “floppy disks” into the state was held to be “insignificant” and did not amount to “substantial nexus” with the state. *Quill Corp.*, 504 U.S. at 302, fn. 1 and 8. In this case, in stark contrast, the presence of Mason’s software is significant. It is installed (unless already saved in the browser cache) and runs on every Ohio user’s computer every time Mason’s website is visited. And, it is stored locally on Akamai’s content distribution network servers to deliver the website more quickly and reduce bandwidth costs. This software is so pervasively employed in Ohio that Mason was able to easily exceed \$500,000 in gross receipts from sales to Ohio consumers in each year at issue. See, ST at 8. Mason’s ownership and use of this software in Ohio is fundamental to its business – without placing this property on user’s computers in Ohio, Mason would be unable to carry out its business. Thus, Mason owned software in this state, which is “tangible personal property” in Ohio. This fits the physical presence requirement of *Quill*, and the tax consequences that flow from that determination.

2. The “physical presence” requirement of the *Quill* decision does not apply to Ohio’s CAT, because the holding is limited to sales and use taxes, and because Ohio’s CAT does not place the same burden on interstate commerce as the tax in *Quill*.

A. The CAT is not subject to the “physical presence” requirement applied to sales/use taxes in Quill. The Cat is a generally applicable “privilege of doing business tax,” not a transactional sales tax.

The holding of *Quill* does not apply to the CAT by its own terms. As the Court explained: “we have not, in our review of other types of taxes, articulated the same physical-

presence requirement that *Bellas Hess* established for sales and use taxes.” *Quill*, 504 U.S. at 314. See, also, *MBNA Am. Bank.*, 640 S.E.2d at 232 (“The Supreme Court appears to have expressly limited *Quill*'s scope to sales and use taxes.”); see, also, *Direct Mktg. Ass'n*, 135 S. Ct. at 1134 (Kennedy, J. concurring) (*Quill* applies to sales and use taxes). Nor has the Court required a “bright-line” physical presence standard in the context of other types of taxes.

The Ohio Supreme Court recognized this distinction over seventeen years ago, in *Couchot*, and has held that the *Quill* physical presence standard for substantial nexus does not apply to State taxes other than sales and use taxes. 74 Ohio St.3d at 424-25. The controversy in *Couchot* involved whether a non-Ohio resident’s Ohio lottery winner’s income was properly subject to Ohio income tax under the “substantial nexus” prong of *Complete Auto*.

The *Couchot* Court upheld the constitutionality of the tax against the lottery winner’s “substantial nexus” challenges under the dormant Commerce Clause and Due Process Clause of the U.S. Constitution, determining that no showing of a “physical presence” in this State was required to sustain the validity of the tax:

The Supreme Court in *Quill* reaffirmed the physical-presence requirement as to sales and use taxes. *** There is no indication in *Quill* that the Supreme Court will extend the physical-presence requirement to cases involving taxation measured by income derived from the state[.]”

74 Ohio St.3d at 424-425.

The Court concluded that the Ohio income tax was not a kind of sales or use tax, and therefore was not subject to *Quill*'s “physical presence” requirement. *Id.* Accordingly, Ohio need not establish that the non-Ohio resident lottery winner had a “physical presence” in the state. *Id.* (citing *Geoffrey, Inc. v. South Carolina Tax Comm.*, 437 S.E.2d 13, 18, fn. 4 (1993) *cert. denied*, 510 U.S. 992 (1993)).

Just as the Ohio Supreme Court in *Couchot* held that the Ohio income tax at issue there was not a “sales or use tax,” the Court likewise has so held regarding the CAT. *Ohio Grocers*, 2009-Ohio-4872 at ¶¶ 41-56. As the *Ohio Grocers* Court held, the CAT is substantively a generally applicable “privilege of doing business” tax that does not operate as a sales tax or other “transactional tax.” *Id.*

The Ohio Supreme Court’s holdings in *Couchot* and *Ohio Grocers* accord with the overwhelming majority of state cases that have similarly limited the *Quill* physical presence standard to sales and use taxes. *See, e.g., KFC Corp.*, 792 N.W.2d at 320 (collecting cases). The Supreme Court has repeatedly declined to review this issue. *Id.*

Indeed, Mason can only cite one case that “required” a physical presence for substantial nexus outside of the sales tax context – but even that court hedged its bets, and didn’t expressly rule that a physical presence was required under the dormant Commerce Clause. In *J.C. Penney Natl. Bank*, the Tennessee Court of Appeals explained: “It is not our purpose to decide whether ‘physical presence’ is required under the Commerce Clause.” *J.C. Penney Nat. Bank v. Johnson*, 19 S.W.3d 831, 842 (Tenn. Ct. App. 1999). Further, the Tennessee Court subsequently backed off this holding, observing that “[p]erhaps it would have been more accurate [in *J.C. Penney*] to say that the Supreme Court had rejected state taxes on interstate commerce where no activities had been carried on in the taxing state on the taxpayer's behalf.” *Am. Online, Inc. v. Johnson*, 2002 WL 1751434, at *2 (TN Ct. App. July 30, 2002)

3. Quill is outdated and has no ongoing viability in light of changes in technology and remote retailing.

The *Quill* decision, at 23 years old, has failed to stay viable in light of changes in commerce. For perspective, when the *Quill* decision was issued in 1990, the World Wide Web had only existed for two years, and it would still be another year before the first widely-used

browser, Mosaic, came onto the scene. See, Turow, *The Daily You*, at 41 (Yale Univ. Press 2011). Indeed, it wasn't until 1993 that a "picture" could be viewed through a browser – and rendering that image was a slow, painful process. *Id.* at 38-44. In the early 1990s, many advertisers feared the internet, but were just starting to recognize its capacity as ad space. *Id.*

The growth of e-commerce has been staggering since *Quill*, with sales growing from virtually nothing in 1992, to \$11,615 million in 1999 to \$219,417 million in 2013. See, U.S. Department of Commerce, *U.S. Electronic Shopping and Mail-Order Houses (NAICS 45411) - Total and E-commerce Sales by Merchandise Line: 2013-1999*, available at: <http://www.census.gov/econ/estats/2012/all2012tables.html> (last accessed Oct. 6, 2015).

And, the remote-order retail industry has changed significantly since *Quill* was handed down in 1992. *MBNA Am. Bank.*, 640 S.E.2d at 234 (“The development and proliferation of communication technology exhibited, for example, by the growth of electronic commerce now makes it possible for an entity to have a significant economic presence in a state absent any physical presence there.”).

Quill's justification for separating substantial nexus for purposes of Due Process and Commerce Clause analysis rests on the notion that the bright-line physical presence standard supports “settled expectations” in the business community. *Quill*, 504 U.S. at 316. But, for more than 20 years state courts have sustained the validity of generally applicable privilege of doing business taxes on out-of-state retailers, regardless of physical presence. See, e.g., *Geoffrey*, 437 S.E.2d 13, 18-19. In short, the “settled expectations” of internet and catalog sellers have changed, and sellers no longer reasonably expect to be free from taxation for the privilege of doing business within a given state. Moreover, internet retailers exploit their tax-free status as a “competitive advantage” over brick-and-mortar in-state retailers.

As Justice Kennedy recently explained, “Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier.” *Direct Mktg. Ass'n*, 135 S. Ct. at 1135 (Kennedy, J. concurring). To the extent that the Court’s holding in *Quill* might be applied to this case, that holding should be limited to its facts, or overruled based upon changes in the way business is done. *See, MBNA Am. Bank.*, 640 S.E.2d at 236 (acknowledging “the great challenge in applying the Commerce Clause to the ever-evolving practices of the marketplace.”)

CONCLUSION

For all the foregoing reasons, the final determination of the Tax Commissioner upholding the assessments of CAT issued to Mason, should be affirmed.

Respectfully submitted,

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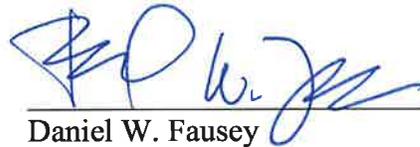
CERTIFICATE OF SERVICE

I hereby certify that the foregoing Tax Commissioner's Merit Brief was served upon the following by U.S. regular mail on this 20 day of October, 2015:

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A handwritten signature in blue ink, appearing to read 'D. W. Fausey', is written over a horizontal line.

Daniel W. Fausey