Supreme Court of Ohio Clerk of Court - Filed October 20, 2015 - Case No. 2015-0386

In the
Supreme Court of Ohio

CRUTCHFIELD, INC.,	:	Case No. 15-0386
Appellant,	:	
v.	:	Appeal from Ohio Board of Tax Appeals
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO	:	BTA Case Nos. 2012-926, 2012-3068, 2013-2021
Appellee/Cross-Appellant.	:	

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INTRODUCTION

Crutchfield, Inc. ("Crutchfield") is a retailer of consumer electronics through internet, phone and catalog orders. HT at 16[1]. From 2005 to 2012, Crutchfield generated more than $500,000[2] annually in gross receipts from its business in Ohio. ST Case No. 2012-926 at 2, Case No. 2012-3068 at 1, and 2013-2021 at 1. Indeed, Crutchfield's witness estimated that the company makes "about $230 million" annually in sales. HT at 28. Given that Ohio comprised between 3.88 and 3.64% of the US population during these years, the corresponding amount would be between $7.2 and $8.9 million in sales annually from Ohio. See, U.S. Census Bureau, Population Division, *Table 1. Intercensal Estimates of the Resident Population for the United States, Regions, States, and Puerto Rico: April 1, 2000 to July 1, 2010* (Sept. 2011). This was no accident—during this period, Crutchfield directed its actions to consumers in Ohio in an attempt to grow and maintain its consumer base in this state.

Because Crutchfield'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 Crutchfield 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, Crutchfield argues that Ohio statutory law does not require it to pay for the privilege of making millions of dollars in annual sales in Ohio, but actually *excuses* Crutchfield from such liability. Crutchfield pins its argument to the statutory

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[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. __".

[2] The Tax Commissioner's assessments were based upon estimates and the Tax Commissioner expressly found that Crutchfield earned more than $500,000 annually in gross receipts. Crutchfield has not challenged this finding of the Tax Commissioner, likely because their gross receipts far exceed $500,000 annually in Ohio. Accordingly, the Tax Commissioner perhaps far underestimated Crutchfield's total tax liability.

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." (Crutchfield Prop. 3).

Rather than challenging the constitutionality of the Tax Commissioner's actions or the relevant statutes, Crutchfield insists that this statute requires the Commissioner to first determine whether Ohio has "substantial nexus" with Crutchfield 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. Crutchfield is wrong.

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 Crutchfield's reading, this statute has nothing to do with the issue of whether Crutchfield, 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 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, Crutchfield 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, Crutchfield *has never challenged the constitutionality of any CAT statute* in these proceedings, until now. Because Crutchfield did not challenge the constitutionality of any CAT nexus provision previously, the issue is not

jurisdictionally proper before this Court. Thus, once Crutchfield's statutory construction argument has been dispelled, no constitutional challenge remains in this case.

Crutchfield's failure to preserve its as-applied constitutional challenge explains the convoluted approach Crutchfield 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. Crutchfield'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 routinely apply *Salerno* to Commerce Clause cases. (See, Proposition of Law 2, Section 1, below, collecting cases.) This Court applies the *Salerno* standard for facial challenges, too. See, e.g., *Wymsylo v. Bartec, Inc.*, 2012-Ohio-2187 at ¶ 21; *Arbino v. Johnson & Johnson*, 2007-Ohio-6948 at ¶ 26.

In order to succeed, Crutchfield would have to show that there is *no set of circumstances* under which R.C. 5751.01(I)(3) could be constitutionally applied. Crutchfield 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, Crutchfield asks this Court not to apply it. Crutchfield 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 unconstitutional in *all applications*. Crutchfield 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, Crutchfield 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 availment 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 Crutchfield, 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. Crutchfield, like other taxpayers who generate over $500,000 in Ohio-sitused gross receipts, conducts significant business in the state and also derives great benefit from the physical infrastructure and legal and economic conditions that Ohio provides. Stip. 1, Ex. A at 644. The $500,000 threshold represents a reasonable proxy for the scale of Crutchfield'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 is simple to determine if 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.

Crutchfield'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 Court's four-pronged 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 Crutchfield's activities in Ohio were directly associated with establishing and maintaining its internet sales market in Ohio.

Crutchfield reaped Ohio-sitused gross receipts well in excess of $500,000 by leveraging all of 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 Crutchfield's website. To do so, Crutchfield placed tracking devices, such as "cookies," on users' computers in Ohio and also collected data obtained from a user's local interaction with Crutchfield's website.

This data was used by Crutchfield for marketing purposes—to send website visitors targeted email with custom offerings and to follow Ohioans around the internet, placing display advertisements for recently-viewed or similar products. The data was also used by Crutchfield for internal business purposes—to grow its customer list and to perform analytics to measure the success of its sales pitches and refine future campaigns. Further, Crutchfield paid search engine companies to have its ads and a link to its website returned in response to customer searches. By these means, Crutchfield maintained and grew its market in Ohio. Crutchfield arranged to provide repairs and warranties for the products it sold in Ohio through Service Net and

SquareTrade. It, therefore, has satisfied the criteria for substantial nexus under established Supreme Court dormant Commerce Clause decisions, including *Tyler Pipe*.

To escape liability, Crutchfield 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. Crutchfield is wrong on both fronts.

First, Crutchfield has a physical presence in Ohio through its use and storage of its software on the computers and smart phones of its Ohio customers, and through a business relationship that expedited the loading of its web content on Ohioans' computers. Crutchfield contracted with the content delivery service Akamai to store parts of its website on servers in and geographically closer to Ohio, in order to deliver their virtual store faster to consumers in the Ohio area and to save itself bandwidth costs. Akamai has such servers here in Columbus, at Ohio State University.

Crutchfield also owns property in Ohio that it uses to develop and maintain its market in this state. Namely, Crutchfield 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 Crutchfield's business – in order for a sale to occur in Ohio, and in order for Crutchfield's "virtual store" to exist at all, Ohioans must store Crutchfield's software on the hard disks of their computers and mobile devices. Crutchfield also offered a mobile app for download onto Ohioans' mobile devices, such as smartphones and tablets. The mobile app is software owned by Crutchfield. All of this software is substantial and necessary for Crutchfield's marketing activities in Ohio. Furthermore, during the local creation of Crutchfield's website on Ohioans' computers, Crutchfield'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 Crutchfield's independent contractor Akamai on local servers for Crutchfield's business use.

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 Crutchfield's website on Ohioans' computers, Crutchfield'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." Thus, even under Crutchfield's mistaken contention that the dormant Commerce Clause requires a physical presence in order to subject it to the CAT, substantial nexus exists through Crutchfield's use of its property in Ohio.

Notwithstanding the existence of Crutchfield's physical presence in Ohio, no "physical presence" requirement exists in the law of privilege taxes like the CAT—again, Crutchfield is just shouting into the wind. The case relied upon by Crutchfield 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. 39 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, Crutchfield still would be responsible for CAT, given the presence of Crutchfield's tangible personal property (software) in Ohio, Crutchfield's "virtual" presence through local interaction with Ohioans, and Crutchfield's in-state contractor, Crutchfield has a physical presence in Ohio sufficient for Commerce Clause purposes. Thus, from any perspective, the inescapable result is that Crutchfield'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. 1, Ex. A at 607-718; Stip. 1 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 paying the tax. R.C. 5751.01(E)(1). During the assessment 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, and 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. 1, Ex. A at 624-631, 710-11; L at 14.

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

Crutchfield began its operations in 1974, as a mail-order company and, as technology evolved, so did Crutchfield, moving into telephone and eventually online sales. HT at 16. At the time of the hearing, Crutchfield had annual sales of $230 million. HT at 28.

Throughout the assessment periods, Crutchfield maintained and grew its market by engaging in a panoply of marketing activities, including: (1) flooding Ohio consumers with millions of various Crutchfield catalogues targeted to consumers based on their individual preferences and previous buying experiences, (2) regularly engaging in advertising through print and other media, and (3) continuously, on a "24/7 basis," operating an online shopping website. HT at 22-24, 77-82.

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

Foremost among Crutchfield's business activities in Ohio is the harvesting of consumer data from online users. That data is generated locally, by an Ohioan at his computer. Crutchfield harvests data from activities of consumers here in Ohio and depends on that data 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 Crutchfield, Crutchfield, or its business partners, place "cookies" and other tracking devices in the users' browser "cache." HT 98, 113; Ex. 38 at 18, 24-25; Ex. 50 at 11-12, 22, 54-56. The "cache" electronically stores "assets," such as cookies, images, and software code in the physical hard

drive of the Ohioans' computers. Ex. 38 at 20-26; Ex. 50 at 91. 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. Ex. 38 at 12-16; Ex. 50 at 141. Crutchfield partnered with third parties to assist in harvesting data from its Ohio website visitors while they shop on Crutchfield's website, and tracking them when they leave. Ex. 38 at 18, 22-25; HT at 95-96, 113-124; Ex. 2-6. These third-party vendors gathered click-stream data showing where Crutchfield's customers went online after leaving Crutchfield's site.

The unique customer data that is harvested by Crutchfield in the form of name, address, phone number, and email address, has a substantial business value to Crutchfield. 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 Crutchfield's products. Thus, just by collecting and warehousing Ohioans' data, Crutchfield has gained a valuable business asset, that it uses to reach consumers, make predictions, test marketing efforts, spot trends, and increase sales.

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

B. Crutchfield aggressively marketed online and offline to grow and develop its market in Ohio. Its marketing depended on customer data harvested from user's online activities in Ohio, and obtained in sharing agreements with other retailers. Crutchfield's marketing specifically targeted customers in Ohio.

Crutchfield engages in sophisticated online and catalog marketing, and the retailer used a variety of different internet channels for marketing to customers, including paid search, e-mail marketing, shopping comparison sites, retargeting and display ads. Crutchfield also makes significant catalog marketing mailings. These channels were enhanced by analytics of customer data and, in some cases, depended on customer data—produced in Ohio—in order to work at all.

Crutchfield used the customer data to personalize its webpage, ads, and emails to individual consumers. Ex. 39 at 9-13. And the data was used to build a customer profile of each specific consumer. HT 101. Crutchfield tailored its website display, emails, and catalog mailings to individual consumers based on their profile. HT 133-136; Ex. 39 at 14-15. For example, a returning customer might see a different arrangement of products based on his previous behavior on that website. Ex. 39 at 14-15. Further, Crutchfield contracted with companies like Acerno and Criteo to display ads for Crutchfield's products to customers who had navigated away from Crutchfield's site. HT 134-135; Ex. 19, 25. Based upon this profile, Crutchfield sent personalized email ads and communications to individuals for items that the customer had viewed or abandoned in his shopping cart. HT 124-126, 133-136.

In addition, Crutchfield used other marketing tools to reach Ohio consumers on the web. For instance, Crutchfield contracted with companies like Google and Yahoo to have its products and website link returned in response to keyword searches. HT 137-140; Ex. 12, 17, 18. Additionally, Crutchfield paid to have its products listed on popular shopping-comparison websites, like PriceGrabber, NexTag, and Shopping.com. HT at 136-137.

Crutchfield used these marketing tools and locally-produced data to refine its sales approach, and grow its market in Ohio, thereby easily satisfying the criteria for substantial nexus under *Tyler Pipe*.

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

Crutchfield uses customer data to send promotional and personalized email. HT at 124-127. If the customer data stored by Crutchfield indicated that an email address tended to click on more car products than home products, then Crutchfield would send more car-related emails to

that address. HT at 125-126. Crutchfield also used customer data to send "personalized" emails, based on the recipient's previous behavior on the website, also known as "behavioral" emails. *Id.* For example, if a user visited the website looking at specific product pages, or had placed items in a shopping cart, but did not complete the purchase, an email might be sent mentioning the items left in the cart or promoting similar items to those that had been viewed. *Id.* Additionally, Crutchfield tracked email to see whether recipients opened the message, and clicked on the relevant links, or ultimately purchased an item.—all actions taken by the user at his computer. This data is used to gauge the effectiveness of an email campaign.

ii. Crutchfield used the data it collected on the browsing history of its customers to "retarget" advertisements to those customers when they visited other websites.

Crutchfield performed "retargeting," which includes serving advertisements for products based on a customer's browsing history. HT at 133-134; Ex. 19, 25, Ex. 38 at 19, Ex. 39 at 15-16. Thus, if a customer looked at an item on Crutchfield's website, that customer could be shown ads on thousands of other websites for the same or similar products that had been viewed on Crutchfield's site. *Id.* Customers would be followed around the internet and offered display ads on third-party webpages for items like those they previously bought or recently viewed at Crutchfield's site. HT at 133-134.

Retargeting is done in real time, as the user is browsing, so that the user sees the Crutchfield ad after navigating away from Crutchfield's website and visiting another site, possibly a competitor's. In order to accomplish this retargeting, Crutchfield or its third parties store a cookie on the user's hard drive to gather data, such a clickstream data, to send to the retargeting vendor to display the ad.

iii. Crutchfield extensively used display ads that would appear as visitors browsed the web.

Crutchfield served ads online to target customers on other companies' websites by either buying the ads directly from a website or by contracting with a third party ad network. HT 131-132. Crutchfield buys ads directly from websites like AutoTrader or Cars.com, because those sites have visitors who are likely to be interested in car audio products, ergo, Crutchfield's offerings. *Id.* Crutchfield also contracted with ad networks, specifying the type of consumer traffic by demographic that it wants to direct to its website. The ad network would then place the ads on websites that are more likely to attract the kind of visitors that Crutchfield desires. *Id.*

iv. Crutchfield 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 web search containing certain keywords. Crutchfield bids with Google, Yahoo and Bing on certain search terms, such as "car stereo." Others are bidding on the same term. The search engine has an auction on the terms and determines which bidder's ad is ranked highest on the search results page. The page will show the results of the user's search, and a text ad that might say, "Crutchfield has car stereos," or something similar, along with a link to the Crutchfield website. HT at 127-131. Paid search relies on knowing which terms a user may select and search for when shopping or browsing the web—data generated by users in Ohio.

v. Crutchfield 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. Crutchfield paid these websites to display its products in the search results for products that it wished to promote. Crutchfield used pricegrabber.com, Nextag and shopping.com as shopping comparison sites during this time. HT at 136-137.

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

In 2009, the Department of Taxation's Nexus Unit of the CAT Division contacted Crutchfield by letter, advising Crutchfield that the Department believed that Crutchfield had more than $500,000 of gross receipts from its sales in Ohio, and was therefore subject to the CAT. ST. Case No. 2012-926 at 196. The letter further requested that Crutchfield demonstrate that it did not have $500,000 in gross receipts by responding within 20 days, or further action would follow. *Id.*

After receiving no response from Crutchfield, the Tax Commissioner began issuing CAT assessments, 27 in all, each covering one quarterly period from July 2005 to June 2012. See, ST Case No. 2012-926, 2012-3068, 2013-2012. These assessments were estimated, as the Tax Commissioner did not then have Crutchfield's actual gross receipts amounts. As explained in the introduction to this brief, these assessments were very conservative.

Crutchfield protested the Commissioner's assessments, asserting that it did not meet the statutory requirements for imposition of the CAT. The Commissioner rejected Crutchfield's arguments, and issued a final determination in each of these three consolidated appeals that affirmed the 27 assessments on the estimated gross receipts amounts. See, ST Case No. 2012-926 at 1-5, 2012-3068 at 1-4, 2013-2012 at 1-4. An appeal to the Board of Tax Appeals was taken by Crutchfield from the Commissioner's final determinations.

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

On October 20, 2014, the BTA conducted an evidentiary hearing in this matter. The BTA heard live testimony from two witnesses, and received roughly 60 exhibits from the parties. The parties also submitted stipulations of facts, and the stipulated testimony and exhibits thereto of Fred Church.

Crutchfield provided the testimony of Richard L. Stavitski, Crutchfield's Senior Vice President of Finance, and Jason E. McCartney, Crutchfield's Director of Internet Marketing. HT at 13, 36. Crutchfield also provided by deposition 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. Stip. 1 Ex. M. 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. Stip. 1, 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. 1, 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. 1, Ex. A at 626-630. Mr.

Church provided testimony and a written presentation to the Committee in support of the "bright-line" provision. *Id.* Following Mr. Church's presentation, the Senate reinserted the bright-line presence standard, subsequently enacted into law. *Id.* 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.* Crutchfield appealed the BTA's decision to this Court on March 6, 2015. Thereafter, the Tax Commissioner filed a cross-appeal on March 16, 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."

Crutchfield 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). Crutchfield contends that this exclusion requires the Commissioner to first establish that, for the

taxable periods at issue, Ohio had a "substantial nexus" with Crutchfield under the standard derived from the dormant Commerce Clause doctrine of the U.S. Constitution and jurisprudence relating to that doctrine. Crutchfield claims that *all* of the company's gross receipts are excluded from the statutory definition, because dormant commerce clause jurisprudence requires that Crutchfield have a physical presence in Ohio. Crutchfield 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, Crutchfield'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, Crutchfield'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. Crutchfield'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.

Crutchfield's contention that R.C. 5715.01(F)(2)(jj) requires the Commissioner to establish that Crutchfield 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 Crutchfield has not done in this case.

2. Crutchfield's statutory argument is refuted by the statutory definition of "substantial nexus."

Crutchfield'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, Crutchfield'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).

Crutchfield, 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."

Crutchfield'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 rely *solely* on a case law standard instead. Crutchfield'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"). Crutchfield's proposed reading would render R.C. 5751.01(I) useless and inoperative. Therefore, this Court should reject Crutchfield's misconstruction of the statute.

3. Crutchfield confuses the taxability of *receipts* with the taxability of *persons*.

Crutchfield'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, Crutchfield'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."

Crutchfield'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, Crutchfield'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 Crutchfield'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. Crutchfield's construction would defeat these clear, bright-line rules, and therefore frustrate the purpose of the CAT. Instead of the statutory bright-line standard, Crutchfield'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 Crutchfield's understanding of the CAT statutes were 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 clams under R.C. 5717.04.*

Crutchfield has failed to impart jurisdiction on the BTA, and therefore derivatively on this Court, to consider its as-applied constitutional challenges. Specifically, Crutchfield's putative as-applied challenges appear in assignments of error numbered 1 and 3(sic).[3] 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 made in his motion herein by reference.

Suffice it to say, in its Notice of Appeal to the BTA, Crutchfield raised only an issue of statutory interpretation regarding the exclusion from the definition of "gross receipts" in R.C. 5751.02(F)(jj), as described above. In its BTA appeal, Crutchfield sought only a "limiting" construction of R.C. 5751.02(F)(aa) that would incorporate the Supreme Court's dormant Commerce Clause jurisprudence. Crutchfield did *not* raise a constitutional challenge, whether facial or as-applied, to the statutes that levy the CAT and make it applicable to Crutchfield, i.e., R.C. 5751.01(I) and R.C. 5751.02. ST at 22-26.

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.[4] *Bd. of Educ. of South-*

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[3] Crutchfield has two assignments of error numbered "3;" the "second" number "3" is the as-applied challenge that is at issue.

[4] 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

Western City Sch. v. Kinney., 24 Ohio St.3d 184, 185-187 (1986). Crutchfield 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.

Crutchfield's Notice of Appeal does contain a *discussion* of dormant Commerce Clause jurisprudence, but only in support of Crutchfield'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.

Crutchfield's failure to raise such challenge to the constitutionality of the CAT statutes jurisdictionally bars Crutchfield from any such untimely challenge now. Because Crutchfield failed to raise those errors in its Notice of Appeal to the BTA, this Court lacks jurisdiction to consider them as well.

Crutchfield *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.

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, Crutchfield would have to show that there is no set of circumstances under which R.C. 5751.01(I)(3) could be constitutionally applied. *Wymsylo*, 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 (2d 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, (Sup. Ct. N.Y. 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.*, *Wymsylo*, 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).

But this is mostly academic. Under either standard, a challenger must show that, in large part, 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 Crutchfield's facial challenge. *See, e.g.*, *Overstock.com*, 987 N.E.2d at 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 Crutchfield must concede.

To escape this clear bar to its facial challenge, Crutchfield advances a radical and untested standard that seems to have been followed only by the 10th Circuit in First Amendment "overbreadth" cases. *See*, Crutchfield'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, Crutchfield isn't even attempting to apply the *City of Albuquerque* standard, but instead seeks to turn the *Salerno* analysis inside-out. Crutchfield would like this Court to hold the statute facially invalid because it does not incorporate the facts and circumstances of particular taxpayers. *See* Crutchfield Merit Brief at 19. In other words, Crutchfield 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.

Crutchfield'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, Crutchfield 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 Crutchfield'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 the inability to identify when one might be subject to the tax, the multiple overlapping taxing jurisdictions, the variations in tax rates and allowable exceptions, and the 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 extraordinarily easy to calculate. One need only know the annual minimum payment, and the multiplier factor of .0026 per dollar.

The administrative burden of compliance with the CAT is low. A point of emphasis for the Court in *Quill* was that the administrative burden of the retail sales taxes imposed by the states was heavy. This emphasis led to the creation of the interstate task force on sales tax simplification that became the "Streamlined Sales Tax" effort. Stip. Ex. A at 656. The Streamlined Sales Tax effort has been in existence now for 13 years. *Id.*

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. Bureau 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.

Taxable Gross Receipts	Annual Minimum Tax	CAT
$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 sitused 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 gross receipts.

Crutchfield fundamentally misunderstands the $500,000 "bright line." For Crutchfield the bright line amount is an imposition of CAT liability "based solely on its gross receipts." Crutchfield 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, which the CAT replaced. The Corporate Franchise Tax was measured by net income or net worth—these figures 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," and 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 Crutchfield 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 Crutchfield'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 Crutchfield to grow its market in the state.

Ohio also provides essential legal and financial resources that support Crutchfield'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 Crutchfield'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 Crutchfield. Stip. Ex. A at 664; *Quill Corp.*, 504 U.S. at 328-29 (White, J., dissenting).

In sum, Crutchfield 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 Supreme Court's standard for "substantial nexus."

Tax Commissioner's Proposition of Law Number 4:

> *Crutchfield's actions in Ohio were entirely directed towards growing and maintaining a market in the state, and therefore, Crutchfield 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).[5] Dormant Commerce Clause jurisprudence

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[5] 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.

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).

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 Crutchfield is the "substantial nexus" prong. As applied to the CAT assessment liability at issue, Crutchfield'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 Crutchfield 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 Crutchfield to understand its state markets electronically and by automation, even from a distance. As comprehensively detailed in the Facts Section above, Crutchfield used customer data produced from its interactions with Ohio consumers for business purposes such as marketing, inventory planning, product comparison, and gauging market competition.

Moreover, during the audit period Crutchfield also used and stored its own tangible and intangible business property in Ohio; had business partners in Ohio to aid in its website performance; 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 Crutchfield handily meet the dormant Commerce Clause standard in *Tyler Pipe*, under which Crutchfield is required to pay Ohio CAT. Crutchfield established and maintained a massive market in Ohio. And it did so through continual and intentional activities in Ohio, as explained below.

B. Crutchfield'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.

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

primarily through the tools available to an online retailer.[6] In that way, Crutchfield acted systematically and continuously in Ohio to grow its market. Crutchfield's website offered customers in Ohio a "virtual store," superior, in many ways, to brick and mortar retail shops. Crutchfield's virtual store allowed customers to browse and order products from Crutchfield's inventory from their living rooms and offices.

The creation of Crutchfield's virtual store happens in Ohio. Crutchfield's website is rendered and assembled in Ohio, on Ohioans' computers, by Crutchfield through the web browser, with information gathered from all over the internet. Ex. 38 at 1-9. During this "local interaction," Ohioans' computer memory and processing is used. Ex. 50 at 51-53. As a result of this local iteration, data is stored on Ohio computers, including material for which Crutchfield retains property rights, such as copyright.

Crutchfield 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. Crutchfield's internet marketing was a powerful means by which Crutchfield purposefully acted to establish and maintain a market in this state. Through its online marketing, Crutchfield was able to customize offerings to customers based on their prior shopping or browsing activity. Crutchfield sent targeted ads in email, or on webpages of others. It paid to have its ads displayed when users typed search terms into popular search engines like Google and Yahoo.

Crutchfield also harvested 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

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[6] 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.

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.").

Crutchfield 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; 126-127; 134-135. Further, Crutchfield "modeled" the customer list 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 102-106. Additionally, Crutchfield shared its customer list cooperatively with similar retailers to enhance marketing to potentially viable customers. HT 101-110.

Thus, just by collecting and warehousing Ohioans' data, Crutchfield has gained a valuable business asset, that it used to contact consumers and increase sales.

Crutchfield uses the data collected through data mining to perform data analytics to help grow its market in Ohio. As recognized by Crutchfield's own expert, through data mining and analytics, customer data is sliced and diced to spot trends, determine supply-chain logistics, refine sales pitches, test marketing promotions, and to target consumers at large, in groups, or individually. Ex. 47, 48; Ex. 39 at 9-13 and Table 3.

In this case, the evidence establishes that, throughout the assessment periods, Crutchfield used customer data for *all* of these business purposes. Using its multi-platform marketing,

Crutchfield 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. Crutchfield has a business partner who acted in Ohio in efforts to grow Crutchfield's market.

Crutchfield contracts with a content distribution network–Akamai–that stores its software locally. HT 88-89; Ex. 38 at 8, 24-26. This company takes some or all the source code and assets for Crutchfield's websites and stores them locally in Ohio (and nearby) in order to speed delivery of the website and to save bandwidth cost. *Id.*; Ex. 11 at 141-142. Mason has IP rights in this data and, as explained above, some of this data is software. Thus, contrary to Crutchfield's assertion that all of its servers are located in Virginia, it stores some of its software and assets locally, to better serve the geographic region of Ohio and to save costs.[7]

This in-state business partner of Crutchfield demonstrates Crutchfield's ongoing efforts to establish and maintain a market in Ohio. Such a contractor helps Crutchfield maintain and establish a market in Ohio, much like the independent contractor did in *Tyler Pipe*. If Crutchfield is right, and the "physical presence" of a contractor of the taxpayer in Ohio is required under *Quill*, such 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 * * *

[7] Crutchfield makes the suggestion in its brief that it did not use Akamai for content distribution during this time. Crutchfield Merit Brief at 9-10. But this is belied by Crutchfield's own witness. HT at 89 ("Q: Are you aware whether Akamai was a content distribution network for Crutchfield during that time period? A: That sounds correct, yes.") Crutchfield's own expert witness testified that they were using Akamai for CDN. Goldman Tr. at 144-145 ("Q: Do you know whether * * * Crutchfield contracted with any content distribution network during this time period? A: My understanding is that they had an agreement with Akamai."), *see also Id.* at 45, 173. The Tax Commissioner's witness also found evidence of Akamai on Newegg's own source code, and testified that Akamai was in the CDN business. Ex 50 at 30-45.

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 Crutchfield's business could operate without this contractor. Crutchfield's own interactions with Ohioans via its website, the internet, and email are a much more powerful, robust, and meaningful way in which Crutchfield established and developed a market in Ohio.

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

Crutchfield 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, Crutchfield has a physical presence in Ohio by virtue of its tangible personal property in this state. Accordingly, even 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*, 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*. Crutchfield electronically sends packets of information comprising instructions to a user's computer, which are then stored locally, on the user's hard drive. Ex. 38 at 12-16.

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, Crutchfield has several forms of software that are delivered to, and stored on, computers and mobile devices in Ohio. These include the HTML code and JavaScript that are a part of the "source code" and enable a computer user to load Crutchfield's website, and the mobile app that Crutchfield developed and distributed for users' smartphones and tablets. Ex. 38 at 12-16; HT at 54-55; Apt. Ex. 7 at 22. And, as the Tax Commissioner and Crutchfield's expert witness agreed, Crutchfield has enforceable rights as owners of that property. Apt. Ex. 11 at 156 (companies have enforceable IP rights in HTML code and JavaScript); Ex. 38 at 20-26.

Crutchfield's business interests are furthered by storing the software on users' computers: such storage makes Crutchfield's website load faster on subsequent visits and saves Crutchfield the bandwidth costs of retransmitting this information. Ex. 51 at 46-47; Apt. Ex. 11 at 169-170.

What's more, as part of the process of assembling its virtual store, Crutchfield leaves valuable "assets"—copyrighted images and data on a user's hard drive. This is property for which Crutchfield 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—Crutchfield could potentially assert enforceable property rights against that user. Apt. Ex. 11 at 156.

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 Crutchfield's software is significant. It is installed (unless already saved in the browser cache) and run on *every Ohio user's* computer *every time* Crutchfield's website is visited or the mobile app is used. Crutchfield's ownership and use of this software in Ohio is fundamental to its business – without placing this property on users' computers in Ohio, Crutchfield would be unable to carry out its business.

Thus, Crutchfield owned software in this state, which is "tangible personal property" in Ohio. This fits the physical presence requirement of *Quill*, and the taxable consequences flowing from that determination.

3. 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, as follows:

> 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[.]"

Id. 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 and, the Supreme Court has repeatedly declined to review this issue. See, e.g., *KFC Corp.*, 792 N.W.2d at 320 (collecting cases).

Indeed, Crutchfield 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 (Tenn. Ct. App. July 30, 2002)

4. 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. Ex. 38 at 7-8. Indeed, it wasn't until 1993 that a "picture" could be viewed through a browser – and rendering that image was a slow, painful process. Ex. 39 at 7-9. A 1993 essay in *Adweek* advised advertisers to "take note" of the internet, because it had "the potential to become the next great mass/personal medium." *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 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 Crutchfield should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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