

## **The Expanding Reach of Ohio's Commercial Activity Tax**

**by Justin D. Cook and Tyler J. Compton**

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An Ohio Court of Appeals recently issued a much-anticipated decision in *Greenscapes Home and Garden Products*.<sup>1</sup> In this case, the court held that Ohio may constitutionally impose commercial activity tax (CAT) on an out-of-state seller when orders are received, payment is made, and title passes at locations all outside the state of Ohio. While the result is perhaps not surprising in light of recent case law developments, the particular facts of this case illustrate the expanding scope of taxing authority asserted by states like Ohio.

<sup>1</sup> *Greenscapes Home and Garden Products Inc. v. Testa*, 2019-Ohio-384, \_\_\_ N.E.3d \_\_\_ (10th Dist.).

### Background

The CAT is imposed on the privilege of doing business in Ohio.<sup>2</sup> It is not a transactional tax like sales and use tax. Instead, it applies against a person or entity's "taxable gross receipts," which are defined as those gross receipts situated to the state of Ohio.<sup>3</sup> Gross receipts from the sale of tangible personal property are situated to the location where the property is received.<sup>4</sup>

Under Ohio's bright-line presence statute, a seller has sufficient contact with Ohio to trigger CAT liability if it has at least \$500,000 of taxable gross receipts during the calendar year.<sup>5</sup> In 2016 the Ohio Supreme Court in *Crutchfield Corp.* upheld the bright-line presence standard that does not require a taxpayer to have a physical presence in Ohio. The Court concluded that physical presence in Ohio is a "sufficient," but not a "necessary," condition to constitutionally impose a privilege tax like the CAT.<sup>6</sup>

### Greenscapes

*Greenscapes* arose against this legal backdrop. *Greenscapes Home and Garden Products Inc.* (Taxpayer) was a Georgia corporation that provided home and garden products to "big box" retailers like Walmart, Home Depot, and Lowe's. Taxpayer received orders at its offices in Georgia. Customers provided Taxpayer with a delivery address, which Taxpayer used to prepare a bill of lading. Customers arranged for delivery trucks to pick up the merchandise, and title to the

<sup>2</sup> Ohio Rev. Code section 5751.02(A).

<sup>3</sup> Ohio Rev. Code section 5751.01(G), 5751.02(A), and 5751.03(A).

<sup>4</sup> Ohio Rev. Code section 5751.033(E).

<sup>5</sup> Ohio Rev. Code section 5751.01(H), (I).

<sup>6</sup> *Crutchfield Corp. v. Testa*, 151 Ohio St.3d 278, 88 N.E.3d 900, para. 42 (2016).

merchandise passed at the moment it was loaded on the delivery trucks.

Taxpayer's customers transported the merchandise to distribution centers across the country, including several located in Ohio. Taxpayer knew some of the merchandise was being shipped to Ohio because it received a delivery address and prepared the bill of lading. However, Taxpayer could not track the shipments or verify a final delivery point.

It is important to recognize Taxpayer's minimal connection to Ohio. Taxpayer had no physical business location, employees, or agents in Ohio. None of Taxpayer's customers were organized or headquartered in Ohio. When Taxpayer billed its customers for merchandise, the bills were all addressed to corporate offices located outside Ohio. Taxpayer also never placed advertisements or marketed to customers in the state of Ohio.

Despite the minimal connections, the Department of Taxation assessed CAT against Taxpayer under Ohio's bright-line presence standard. Eventually, the appeal reached the Tenth District Court of Appeals with Taxpayer challenging the assessment under both the commerce clause and due process clause.

### Substantial Nexus and the Commerce Clause

Under the commerce clause, Taxpayer argued that it did not have substantial nexus with Ohio because its transactions occurred entirely outside the state's borders.<sup>7</sup> To support its position, Taxpayer cited the location of its headquarters in Georgia, the fact that title passed to merchandise in Georgia, and the fact that its customers were billed at corporate offices located in Georgia, North Carolina, and Arkansas. Importantly, Taxpayer did not argue that substantial nexus required a physical presence under the federal Constitution's commerce clause. Instead, Taxpayer argued that each element of the sale transaction occurred in a state other than Ohio. This subtle difference could have offered basis for distinguishing the Ohio Supreme Court's prior decision in *Crutchfield*.<sup>8</sup>

<sup>7</sup> *Greenscapes* at para. 16.

<sup>8</sup> See *Crutchfield*, 151 Ohio St.3d 278.

The court of appeals, however, rejected Taxpayer's argument, concluding that the cases Taxpayer relied upon were decided when the taxation of interstate commerce was per se unconstitutional. The court noted that Taxpayer "knew that its products were destined for Ohio at the time the orders were placed."<sup>9</sup> Further, the court reasoned that destination-based sourcing rules were consistent with taxing regimes in other states, thus paying CAT would likely not subject Taxpayer to double taxation.<sup>10</sup> Based on these factors and the high dollar-value threshold for bright-line presence, the court held that imposing CAT on Taxpayer was consistent with the commerce clause.<sup>11</sup>

### Minimum Contacts and the Due Process Clause

In addition to the commerce clause, Taxpayer argued that the assessment of CAT violated the due process clause. The court noted that the due process clause of the 14th Amendment establishes a two-prong test to guard against a state exceeding its taxing jurisdiction.<sup>12</sup> To satisfy the test, there must be both (1) a definite link or minimum connection between the state and the person, property, or transaction, and (2) the income attributed to the state must be rationally related to values connected with the taxing state.<sup>13</sup>

Applying this standard, the court noted that Taxpayer's income was earned from sales made possible because of the existence of a market for Taxpayer's products in Ohio. Further, the systematic sale of tangible personal property that was delivered to Ohio created a definite link between Taxpayer and Ohio. Therefore, because of the presence of these factors and the court's conclusion that physical presence was not required under the due process clause, the court upheld the CAT assessment against Taxpayer.<sup>14</sup>

<sup>9</sup> *Greenscapes* at para. 27.

<sup>10</sup> *Id.* at para. 29.

<sup>11</sup> *Id.* at para. 35.

<sup>12</sup> *Id.* at para. 37.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at para. 42.

## Conclusion

Aside from the constitutional claims at issue, *Greenscapes* highlights the need for detailed transaction records. As noted above, gross receipts are situated to the state where the purchaser receives the property. By statute, property is considered received “after all transportation has been completed.”<sup>15</sup> In *Greenscapes*, some of the merchandise shipped to customer distribution centers in Ohio was likely shipped by the distribution centers to retail locations in other states. Taxpayer, however, was subject to CAT on all shipments to Ohio distribution centers because it lacked evidence of a second shipment to challenge the tax commissioner’s assessment.<sup>16</sup>

For now, *Greenscapes* is binding only within Ohio’s 10th District. However, it represents an expansion of Ohio’s taxing authority, and out-of-state sellers should be mindful of this case if shipping products into the state. Taxpayer has also filed a memorandum requesting that the Ohio Supreme Court consider the matter. No further appeal has been granted thus far. ■

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<sup>15</sup> Ohio Rev. Code section 5751.033(E).

<sup>16</sup> *Greenscapes Home and Garden Products Inc. v. Testa*, BTA No. 2016-350, 2017 WL 3183334 (July 19, 2017).