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TAX ALERT

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Mark Snider
614.227.2510
msnider@porterwright.com

Dave Tumen
614.227.2260
dtumen@porterwright.com

Abby Brothers
614.227.2019
abrothers@porterwright.com

Voluntary disclosure a "crutch" available for some businesses impacted by recent CAT decision

In *Crutchfield Corp. v. Testa* and two other recent decisions, the Ohio Supreme Court has ruled that out-of-state retailers can be subject to the Ohio commercial activity tax (CAT) despite not having a physical presence in the state.[1] In all three cases, online retailers with no physical property or employees in the state were assessed the CAT on gross receipts from sales made in Ohio. The retailers appealed these assessments arguing that the state lacked the authority to impose the CAT due to the retailers' lack of substantial nexus with the state. The recent Ohio decisions are additional examples of the increasing willingness of states to extend taxing jurisdiction to nonresident taxpayers that have business, but no physical presence, in a state. It is possible that a taxpayer could appeal its decision to the U.S. Supreme Court, but there is no guarantee that the U.S. Supreme Court would agree to hear the appeal. A planning opportunity and some potential relief for impacted taxpayers are discussed below.

As a brief legal background, the Commerce Clause of the U.S. Constitution prohibits the impediment of interstate commerce by individual states. The U.S. Supreme Court has established a test for determining whether a state tax rises to the level of an unconstitutional interference with interstate

commerce. One prong of this test requires a taxpayer to have substantial nexus with a state before the state has the authority to impose a tax on the taxpayer. In the sales tax arena, the U.S. Supreme Court has held, in *Quill*

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Corp. v. North Dakota, 504 U.S. 298 (1992), that physical presence in the state is required to create substantial nexus. The U.S. Supreme Court has not expressly extended the physical presence doctrine to other types of tax, such as business privilege taxes like the CAT.

In the three recent cases, the Ohio Supreme Court indicated an unwillingness to extend the physical presence requirement to state taxes other than the sales tax. Instead, the court approved the "bright-line presence" standard for the CAT outlined in the Ohio Revised Code, which imposes the CAT on out-of-state companies with any of the following contacts with Ohio:

- Property in Ohio valued at $50,000 or more
- Payroll spending in Ohio greater than $50,000
- Ohio-sourced gross receipts of $500,000 or more
- Property, payroll or gross receipts if the Ohio portion is 25 percent or more of the company's total property, payroll or gross receipts

Implications of the decisions

There are at least three major implications of these decisions. One immediate practical consequence is that any out-of-state business that makes sales to Ohio customers and that has at least $500,000 in gross receipts from Ohio-sourced sales is subject to the CAT. No matter how tangential the business' connections are to Ohio, even if only through the internet, the business is subject to the CAT.

A second practical consequence is for businesses with non-Ohio-based affiliated companies that already file CAT returns. These businesses may want to reconsider their filing positions. A group of taxpayers with 50 percent or more common ownership must file as a "combined group," unless the group has elected to file as a "consolidated group." The advantage of a combined group is that taxpayers are required to register only those commonly owned members that have nexus with Ohio. The disadvantage of a combined group filing is that, unlike for a consolidated group, gross receipts between members of a combined taxpayer group are not excludable as taxable gross receipts. In light of *Crutchfield's* approval of a broad concept of nexus, which substantially narrows the advantage of a combined filing, affiliated groups might want to elect to file on a consolidated basis to take advantage of excluding intra-group receipts.

The broader legal implication is that Ohio joins several other states whose supreme courts have ruled that *Quill* does not apply to non-sales taxes. Some states have even attacked *Quill* directly by enacting statutes that impose ***sales*** tax collection obligations on companies that lack a physical presence in a state. Thus far, the U.S. Supreme Court has declined to step in to either expressly extend *Quill* to non-sales taxes or to overrule *Quill* entirely. This leaves the questions of whether Congress will intervene to nullify *Quill* by eliminating any physical presence requirement and whether, even without congressional input, *Quill* remains good law in the internet age.

Voluntary disclosure agreements

The Ohio Department of Taxation has a CAT voluntary disclosure program. The program is available for any business subject to the CAT that has not registered for the CAT, including those who have not registered because the business lacks a physical presence in Ohio, provided that the business has not been contacted by the Department about the CAT. The Department of Taxation can assess CAT liability against noncompliant businesses for tax years going back to when the business first had CAT liability. Under the CAT voluntary disclosure program, however, the look-back period is limited to three years and penalties are waived, which may help some non-compliant businesses avoid unpaid tax liability stemming from the CAT.

For more information please contact Mark Snider, Dave Tumen, Abby Brothers or any member of Porter Wright's Tax, Estate Planning & Personal Wealth Practice Group.

[1] *Crutchfield Corp. v. Testa*, Slip Opinion No. 2016-Ohio-7760; *Mason Companies, Inc. v. Testa*, Slip Opinion No. 2016-Ohio-7768; *Newegg, Inc. v. Testa*, Slip Opinion No. 2016-Ohio-7762.