Ohio Court Upholds Economic Nexus Standard

Mark A. Engel
Bricker & Eckler LLP

On November 17, 2016, the Ohio Supreme Court issued three decisions in which it held that remote sellers with no physical presence in the state were nevertheless subject to Ohio's commercial activity tax ("CAT"). In doing so, it rejected the taxpayers' arguments that the federal commerce clause required a physical presence in order to impose a tax for the privilege of doing business in the state and held that the substantial nexus requirement under the dormant federal commerce clause jurisprudence was satisfied by the substantial sales made by the taxpayers into the Ohio market. *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.

All three taxpayers make on-line retail sales into Ohio. During the tax years in question, those sales amounted to several million dollars each. Goods are shipped to the customers via third party common carriers. The parties agreed that none of the taxpayers had any property or payroll in Ohio; in fact, testimony in the record disclosed that Crutchfield intentionally avoided any sort of physical presence in any state but its home state of Virginia.

The commercial activity tax is a tax imposed upon the privilege of doing business in Ohio. It applies to any taxpayer having substantial nexus with Ohio, which includes "bright line presence" in Ohio. "Bright line presence" is defined to include having property or payroll in excess of $50,000 during the year; receipts from sales to customers in Ohio in excess of $500,000 during the year; or more than 25 percent of its property, payroll and sales for the year in Ohio.

The taxpayers argued that they must have substantial nexus with Ohio before Ohio may impose the CAT. Because they did not have a physical presence in Ohio, they asserted that they did not have substantial nexus with Ohio. Therefore, imposing the CAT upon them violated the commerce clause of the federal constitution.

In 5-2 decisions, the Court disagreed. It recognized that the jurisprudence of the U.S. Supreme Court indeed required a substantial nexus between a taxpayer and a state attempting to impose a tax in order to avoid the proscriptions of the commerce clause. However, the Court recognized that while the U.S. Supreme Court has imposed a physical presence test with respect to the collection obligations of a remote seller for sales tax, it has never extended that requirement to general business taxes. The Court stated: "We hold today that although a physical presence in the state may furnish a sufficient basis for finding a substantial nexus, Quill's holding that physical presence is a necessary condition for imposing the tax obligation does not apply to a business-privilege tax such as the CAT, as long as the privilege tax is imposed with an adequate quantitative standards that ensures that the taxpayer's nexus with the state is substantial." *Crutchfield*, Slip Opinion at ¶42. The Court concluded that the $500,000 threshold was sufficient for that purpose.

The dissent agreed with the taxpayers. It argued that a physical presence was indeed necessary to satisfy the substantial nexus requirement under the commerce clause.

The taxpayers will have 90 days from the date the Court issues its mandate to decide whether to seek a discretionary review by the U.S. Supreme Court.