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State and Local Tax Alert: One Small Step Closer To Some Guidance on the CAT's "Bright Line Presence" Nexus Standard: The Ohio Board of Tax Appeals Finally Rules in L.L. Bean

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On March 6, the Ohio Board of Tax Appeals (BTA) issued its long-awaited decision in *L.L. Bean, Inc. v. Levin*, Case No. 2010-2853 (Ohio BTA March 6, 2014), the lead "test case" on Ohio's controversial commercial activity tax (CAT) nexus standard. Although this is the first case in a long line of CAT nexus challenges, the BTA's decision offers very little in the way of any meaningful guidance. The decision does nothing more than tee up the pure legal issue to be resolved on appeal – namely, whether it is constitutional to impose CAT on an out-of-state business simply because the company makes more than \$500,000 in sales to customers in Ohio, or otherwise generates receipts in excess of that amount, without regard to any other in-state connections. For now, the answer to this question is still unresolved.

The CAT's 'Bright Line Presence' Test

From a constitutional standpoint, the controversial piece of the nexus standard is in R.C. 5751.01(l)(3), which imposes CAT obligations on any person that "has at any time during the calendar year taxable gross receipts of at least \$500,000." This purely economic-based nexus standard flies in the face of the United States Supreme Court's test in *Quill Corp. v. North Dakota*, 506 U.S. 298 (1992), a sales tax case which held that the Commerce Clause requires some physical presence before a state can constitutionally tax an out-of-state business. The commissioner's position is that *Quill* does not apply to a gross receipts tax like the CAT because in its view, *Quill's* rule applies only to sales taxes. Other state courts have ruled that *Quill's* test does not apply when corporate income or franchise taxes are at issue, and the United States Supreme Court has refused to review these decisions. But there are no decisions that allow a state to impose a gross receipts tax on purely economic grounds.

The Factual Background

The facts and issues in *L.L. Bean* are straightforward. L.L. Bean is a traditional catalog and internet seller based in Freeport, Maine. It has no direct contacts in Ohio. Instead, it conducts its business exclusively through interstate commerce from outside the state. While it has retail stores in several other states, it has no stores, offices, personnel or other traditional physical presence in Ohio. However, L.L. Bean's online and catalog sales to customers in Ohio exceeded \$500,000 annually during each of the periods at issue. As a result, L.L. Bean met the statutory test for "bright line presence." On this basis, the commissioner issued and affirmed assessments against L.L. Bean.

The BTA's Ruling

L.L. Bean appealed to the BTA, arguing, among other things, that the assessments against the company are (1) unconstitutional under the Commerce Clause of the United States Constitution; and (2) contrary to statute, since they seek to impose the CAT on gross receipts in violation of L.L. Bean's constitutional rights. Relying on an unbroken line of U.S. Supreme Court authorities, including both *Quill* and *Tyler Pipe, Inc. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987) -- a gross receipts tax case -- L.L. Bean argued that the CAT assessments violated the Commerce Clause because it had no in-state presence, did not engage in any activities in Ohio, and had no third-party performing any activities on its behalf there.

The BTA did not reach these constitutional questions. Instead, the BTA focused exclusively on the language of the statute, concluding that the assessment must be affirmed since L.L. Bean met the \$500,000 statutory test. The BTA simply kicked the ultimate constitutional question up the line for further review.

Observations

A long line of cases holds that the BTA's role in constitutional challenges is to receive the evidence concerning the constitutional questions presented, but may not declare the statute unconstitutional. Thus, it is not surprising that the BTA did not rule on the constitutional issues. What is surprising is that the BTA made no factual findings, even though it received evidence from several experts and business representatives. Some of that evidence related to refuting the commissioner's attempt to show that L.L. Bean had some physical presence in the state through electronic means. The evidence received at the BTA will provide the record that the Ohio Supreme Court will use to decide the constitutional question. It remains to be seen if the Ohio Supreme Court will examine the "pure" legal issue, or whether it will focus on other grounds as well.

For now, we will continue to wait and watch. To date, the commissioner has refused to hold any other protests or protective refund claims in abeyance while the legal issues are resolved, nor has the BTA put any similar pending cases there on hold while the L.L. Bean appeal proceeds. Instead, the commissioner is still aggressively enforcing and is issuing assessments and final determinations to any person who has more than \$500,000 in Ohio sales or receipts, forcing companies with no connections in Ohio to make a difficult practical decision about whether to incur the significant costs of litigating their claims. Nothing in the BTA's decision in *L.L. Bean* suggests that this will change until we get a substantive ruling on appeal.

Stay tuned ...