

Ohio Business Tax Seminar  
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# Ohio Commercial Activity Tax: The Gross Reality of Receipts and Situsing

Debora D. McGraw  
Zaino Hall and Farrin LLC

Matthew P. Shaw  
RSM US LLP

Richard B. Fry III  
Buckingham, Doolittle & Burroughs, LLC



# CAT Background – Basis for imposing gross receipts tax

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- Business activity tax imposed on the privilege of doing business in Ohio. R.C. 5751.02(A).
  - Governed by Chapter 5751 of the Ohio Revised Code.
  - Replaced the franchise and personal property taxes.
  - Shift to market-based tax.
- Broad based, low rate.
  - Measures value of privilege by gross receipts – access to Ohio market.
  - Rate: 0.26%



# Commonly-controlled entities must report as single taxpayer

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## Combined Groups

- Required for taxpayers with more than 50% common ownership
- Certain excluded persons and non-nexus person not included.
- Intercompany receipts are not excluded.

## Consolidated Elected Taxpayer

- Election available to taxpayers with 50% or 80% common ownership.
- May choose to exclude foreign entities.
- Intercompany receipts excluded.
- Election binding for eight quarters.



# Common Ownership Rules

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- Vertical ownership test based upon voting rights.
- Family attribution rules do *not* apply.
- Register, file and pay as a single taxpayer.



# Retroactive Consolidated Election

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Administrative Rule (effective Jan. 2021) – Retroactive consolidated election will be approved if:

- Due to registration error and taxpayer has filed consistent with consolidated election; or
- Request made through voluntary disclosure program before contact by the Department.

Nonfiler unable to support intent to file as a consolidated group.  
*Moose Toys Pty Ltd. Final Determination (Jan. 28, 2020).*

# Filing Methodology & Statute of Limitations

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## Three Methods:

1. Actual gross receipts by quarter
2. Rule estimation with quarterly true-up
3. Statute estimation - annual gross receipts with 4Q true-up

**Caution for Refund Claims:** Statute of limitations is four years from the date of the payment.



# Two Predominant Issues in CAT Disputes

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1. What is a “gross receipt”?
2. How are gross receipts situated to Ohio?



# What are gross receipts?

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“Total *amount realized* by a person without deduction for the cost of goods sold or other expenses incurred, that contributes to the *production of gross income* of the person...”

- Exclusions under R.C. 5751(F)(2).
- How much does Federal Income Tax or GAAP Treatment matter?

R.C. 5751.01(F)





# Gross Receipt Examples

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- Amounts realized from the sale, exchange, or other disposition of the taxpayer's property to or with another.
- Amounts realized from the taxpayer's performance of services for another.
- Amounts realized from another's use or possession of the taxpayer's property or capital.
- Any combination of the foregoing amounts.

*R.C. 5751.01(F)(1)*



Z<sub>H</sub>F

# Gross Receipts – R.C. 5751.01(F)

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- How determine whether a “gross receipt?”
  - Federal Income Tax Treatment
  - GAAP Treatment
  - Legal Treatment
  - Receipt of funds? What if received funds for another?
- GAAP and federal income tax treatment often consistent but sometimes timing issues.
- Common Issue: EITF 99-19/ASC 605-45 and ASC 606 Revenue from Contracts with Customers.



# Gross Receipts

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- *Hyundai Motor Finance Company v. Testa*, BTA No. 2015-785: The Ohio Board of Tax Appeals (the “Board”) found that federal income tax and GAAP guidance was persuasive in determining whether the taxpayer had “gross receipts” for CAT purposes and/or an exclusion applied.
- All merchant processor cases (whether merchant discount a gross receipt) no longer at the Ohio Board.
- Common issue when taxpayer acting as a “sales agent” for computer services, security services, financial products, etc.



# Exclusions for Cash Discounts, Returns & Allowances

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- Exclusion for “Returns and allowances” R.C. 5751.01(F)(2)(cc)
- Exclusion for “Cash discounts allowed and taken” R.C. 5751.01(F)(2)(bb), O.A.C. 5703-29-14(B)(1)
  - Timely payments, volume discounts, certain price adjustments
  - Tie transactions & discounts to examples in Administrative Code
- Not a one-to-one relationship to Federal 1120, line 1b



# Agent Exclusion

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R.C. 5751.01(F)(2)(I) excludes “property, money, and other amounts received or acquired by an agent on behalf of another in excess of the agent’s commission fee or other reimbursement...” from the definition of gross receipts.

- If contract lacks express agency relationship, Tax Commissioner will presume no agency relationship exists.



# Agent Exclusion

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- Common Situations – Agent is acting as conduit for Principal:
  - Agent receives funds from third-party for the sale of Principal's property / service.
  - Agent receives funds from Principal and pays obligations of the Principal.
- To determine if agency relationship exists, examine substance of relationship and contractual language.
  - Significant aspects of relationship:
    - Agent owes fiduciary duties to act in the Principal's best interest.
    - Agent has authority to bind the Principal.



# Agency Exclusion Cases Pending at the Board

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- *Aramark Corporation v. McClain*, BTA No. 2019-2975 (Hearing Completed)
  - Taxpayer manages food service operations for education, healthcare, and government institutions.
  - Customer reimburses Taxpayer for food / supply costs plus management fee.
  - Tax Commissioner found no agency relationship based on lack of control.
- *Apple, Inc. v. McClain*, BTA No. 2021-1243
  - When selling ebooks and apps, Apple retains 30% of proceeds and pays 70% to developers.
  - Does Apple owe CAT on entire amount collected or merely 30% retained?
- *In Demand L.L.C. v. McClain*, BTA No. 2021-597
  - Taxpayer argues it is an agent in the transfer and ultimate sale of movies by cable companies and, thus, may exclude gross receipts related to media partners' (i.e., studios) share of movie proceeds.
  - Taxpayer asserts it merely acted as a collection agent in receiving royalties from cable companies and transfer thereof to media partners.



# Financing & Bad Debt Exclusions

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- Gross receipts excludes:
  - Interest, except on credit sales
  - Repayment of principal of a loan or other financial instruments
  - Bad debts that (1) were previously reported; (2) have become worthless or uncollectible; (3) have been uncollectible for 6 months; and (4) can be claimed under IRC 166 and regulations adopted thereunder.
- Pending BTA Appeals:
- *Drummond Financial Services, Inc. v. McClain*, BTA Case No. 2020-700





# Situsing Gross Receipts from Services & Intangibles

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**Gross Receipts from IP:** Gross receipts from the right to use trademarks, trade names, patents, copyrights, and similar intellectual property are sitused based upon the use or right to use the property in Ohio. R.C. 5751.033(F).

**Catch-All Provision:** Gross Receipts from services and those not otherwise addressed in statute are sitused to Ohio based upon the proportion of the purchaser's benefit received in Ohio. R.C. 5751.033(I).

- **Significant factors:** The physical location where the purchaser uses or receives what is purchased.
  - Does the service / intangible pertain to specific property? If so, situs to the property's location.
  - Does the purchaser's employees use the service / intangible? Then situs to the employees' location(s).



# Pyramid of Authorities

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- R.C. 5751.033(I)
- Ohio Admin. Code 5703-29-17 contains 54 examples
  - For certain services, may elect to situs all receipts to purchaser's principal place of business.
- Cases interpreting situsing law:
  - *Defender Security Co. v. McClain*, 162 Ohio St.3d 473 (2020).
  - *NASCAR Holdings, Inc. v. McClain*, BTA Case No. 2015-263 (April 5, 2021) appeal pending OH S Ct. Case No. 2021-0578.
- Tax Commissioner Final Determinations and Information Releases



# Limits on *Defender*

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Supreme Court held that the Tax Commissioner erroneously situated Defenders' gross receipts to the location of ADT's customers, which was not the location where ADT received the benefit of the intangible customer-based contracts.

- Rejects siting to purchaser's purchasers' location, not purchaser's benefit.
- Important: Determine what the taxpayer is selling (an intangible, a service, etc.) and the benefit thereof.
- Tax Commissioner asserted the benefit Defender provided was the protection of people and property in Ohio – but this was the benefit ADT provided to its customers.

Does *Defender* extend to sales representative arrangements where the rep is selling the purchaser's service to a consumer, not an intangible (e.g. contract).

- Should / can contractual terms be modified?



# *NASCAR Holdings, Inc. v. McClain*

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- BTA upheld the Tax Commissioner's situsing of seven types of NASCAR revenue:
  - Media and broadcast revenues were sitused based on the portion of the audience located in Ohio using Nielsen Ratings.
  - License fees and sponsor fees were sitused using U.S. census data for Ohio.
  - Sanction fees, membership fees and competition revenue were sitused based on the location of the race.
- NASCAR claims broadcast revenues should be sitused to Florida where NASCAR is headquartered and where it received the revenues from its intellectual property.



# NASCAR Holdings, INC. v. McClain

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The BTA held:

- **Applicable Provision:** NASCAR's revenue streams are situated to where the payors (purchasers) used or had the right to use IP, which included Ohio. R.C. 5751.033(F).
  - In the FD, Tax Commissioner cited R.C. 5751.033(I). Even though this was not the correct provision, the BTA determined the result would have been the same.
- **Situsing Method:** The Tax Commissioner's use of Nielsen Ratings and census data to determine where the broadcasters used NASCAR's IP was reasonable.
  - Each source of revenue encompassed territory both inside and outside of Ohio.
  - NASCAR proposed a situsing methodology that apportioned virtually no revenue to Ohio (primarily to Florida).

Application of *NASCAR* decision to other situations?



# Principal Place of Business

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A vendor may elect to source receipts from the following services to the purchaser's principal place of business, as long as applied in a reasonable, consistent, and uniform manner:

Accounting

Advertising

Agency (other than for athletes / entertainers)

Collection

Data Processing

Internet / Web Hosting

Legal

Management Consulting

Market Research

Tax Preparation

Technical Assistance

# Situsing Gross Receipts from Tangible Personal Property

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- Gross receipts sitused to location where the purchaser receives the property. R.C. 5751.033(E).
  - Delivery via motor carrier or other means of transportation: Purchaser receives product where the product is ultimately received after all transportation completed.
  - What is direct delivery?
    - If directly delivered to a person or firm designated by the purchaser, *other than for purposes of transportation*, gross receipts are sitused to location of direct delivery.



## Core Issues Raised in Situsing TPP – R.C. 5751.033(E)

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**Ultimately Received:** Statute directs us to look to where property “is ultimately received” by the purchaser, not the ultimate destination.

**Initial Purchaser/Transaction:** Ultimately received by the purchaser in the transaction at issue, not subsequent transaction or subsequent purchaser.

**3rd Party/Secondary Records:** Issues with verifying, auditing, and relying upon non-contemporaneous 3rd party documents for situsing.





# Application of Siting Rules

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- If accepted by purchaser or its agent outside Ohio, but taxpayer knows products will be transported to Ohio, gross receipts are sited to Ohio.
  - *Greenscapes Home & Garden Prods. v. Testa*, 2019-Ohio-384 (10th Dist). Gross receipts sited to Ohio because taxpayer knew goods would be shipped to Ohio.
  - *Mia Shoes, Inc. v. McClain*, BTA Case No. 2016-282 (Decision and Order, Aug. 8, 2019): Taxpayer “shipped its goods to Ohio, knew it was shipping goods to Ohio, and lost visibility of the goods once” delivered to Ohio.
- To be determined...
  - If shipped to Ohio DC, does purchaser’s subsequent shipment determine location where the product is ultimately received by the purchaser?
  - Can taxpayers rely upon third-party / secondary records to establish location of ultimate receipt?



# Requesting & Supporting Alternative Situsing Methods

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If standard situsing provisions (TPP, services, transportation, etc.) don't fairly represent a taxpayer's activity in Ohio, the Tax Commissioner may require/permit alternative situsing.

- A standard situsing method that results in more taxable gross receipts than an alternative method is not necessarily unfair or inaccurate.
- Need to supply evidence showing how the standard method does not fairly represent activity.
- Need reliable evidence showing that the alternative is accurate and fair.

# Thank you for your attention.

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**Debora (Dardinger) McGraw**  
Zaino, Hall & Farrin, LLC  
614.349.4813  
dmcgraw@zhftaxlaw.com

**Richard B. Fry III**  
Buckingham, Doolittle & Burroughs  
Tax Practice Group Chair  
330.258.6423  
rfry@bdblaw.com

**Matthew P. Shaw, CPA**  
RSM US LLP  
Senior Manager, State and Local Tax  
216-622-1345  
Matthew.Shaw@rsmus.com



## Biographical Information

**Richard B. Fry III, JD, MT, Partner, Buckingham, Doolittle & Burroughs, LLC**  
**3800 Embassy Parkway, Suite 300, Akron, OH 44333**  
**(330) 258-6423 Fax: (330) 252-5524 rfry@bdblaw.com**

Richard B. Fry III is a partner in the Akron based law firm of Buckingham, Doolittle & Burroughs, LLC. Rich's practice is focused on state and local tax compliance and controversies, including Ohio and multistate sales/use tax, commercial activity tax, and personal income tax issues. He represents clients before several taxing authorities and in tax litigation matters, including currently representing taxpayers before the Ohio Board of Tax Appeals and Ohio Supreme Court. He also represents clients in negotiating and drafting agreements for commercial and real estate transactions, and advising them of the of federal and state and local tax consequences of such transactions. Rich currently serves as the Chair of the Ohio State Bar Association, Taxation Committee and has had the opportunity to present his opinions concerning tax laws and policy to Ohio legislatures on behalf of the OSBA. Rich joined Buckingham in 2008 and was elected partner in 2015. He is a member of the Firm's Business and Real Estate & Construction Practice Groups. He received his B.B.A. Finance degree from Kent State University in 2003, a Master of Taxation degree from The University of Akron in 2008, and his J.D. degree summa cum laude in 2008 from The University of Akron School of Law. He is a co-author of the Ohio State Tax Blog and has authored various tax articles appearing in Crain's Cleveland Business and the Journal of Multistate Taxation and Incentives. He has been selected for inclusion in Ohio's Super Lawyers® – Rising Stars™ (2017), as voted by his peers.

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**Matthew P. Shaw, Senior Manager, State and Local Tax, RSM US LLP**  
**1001 Lakeside Ave. E., Suite 200, Cleveland, OH 44114-1152**  
**216-622-1345 Fax: 216-522-1490 Matthew.Shaw@rsmus.com**

Matt is a Sr. Manager and currently leads the SALT practice in Cleveland, OH. Since starting his career with RSM in September 2008, Matt has gained valuable experience working with a plethora of MWD clients on an extensive list of State and Local Tax matters, including state nexus reviews, tax controversies, due diligence reporting and the identification of credits & incentives opportunities.

Matt's work includes clients with multi-state presence and complex apportionment issues, including knowledge of states allowing preferable apportionment methods for consumer products organizations and collaborating with the national SALT team to address the impact of key trends upon the consumer products industry. Additionally, Matt collaborates with his clients to review nexus requirements and coordinate efforts to assess and mitigate state tax exposure (e.g. income, franchise, sales & use tax).

He is also a member RSM's National C&I practice, working directly with client management and state/local tax authorities to secure valuable tax incentives and support the organization's growth and development initiatives. Moreover, Matt is a regular presenter at RSM's Cleveland CFO Club events, addressing current SALT issues and legislative developments.

Professional affiliations and credentials

- Ohio Society of Certified Public Accountants (OSCPA)
- American Institute of Certified Public Accountants (AICPA)
- CPA License (Ohio, effective October 2009)

Education

- Master of Science, accounting, Kent State University
- Bachelor of Science, accounting, Kent State University

## Biographical Information

**Debora (Dardinger) McGraw JD, LLM, CPA, Member, Zaino Hall & Farrin LLC**  
**41 South High Street, Suite 3600, Columbus, OH 43215**  
**614-349-4813 Fax: 614-754-6368 dmcgraw@zhftaxlaw.com**

Deb is a member of the firm's Federal and Multistate Tax Practice Group. Deb has significant experience representing clients in various state and local tax controversies, including settlement negotiations. She also assists clients with a variety of federal income tax issues. Deb has significant experience in conducting refund reviews and in assisting clients with tax planning including implementation by working with various client operational groups. Deb has worked with clients in various industry groups and has developed particular experience in the financial services and utility industries.

Prior to joining the firm, Deb was a Director at PricewaterhouseCoopers where she worked for 16 years. Prior to leaving PwC, Deb led the Columbus large company tax practice and served as the lead contact for many Columbus based companies. She assisted clients with a variety of federal and state tax considerations including tax planning, corporate restructurings, federal and state controversy, corporate compliance, financial statement audits, etc.

In particular, Deb excels at conducting federal and multi-state refund reviews for clients looking to improve cash flow or review their current tax positions. Deb led PwC's Ohio tax efforts nationally including negotiation of multiple Fortune 100 and 400 company audit settlements. She frequently used her refund review experience as offsets in Ohio and other state audits or to argue alternative positions. Deb handled the legislative analysis for the firm and acted as a national resource for other offices. She drafted updates that were circulated internally and to clients. Deb spoke regularly on client webcasts introducing new Ohio legislation, as well as, on federal and multistate tax considerations for internal PwC trainings.

Deb served as the chair of PwC's local Women's Networking Circle for two years and the board for two additional years. The group was aimed at mentoring women in public accounting and providing them networking and support opportunities. She was voted coach of the year for the Ohio-Kentucky-Indiana cluster of PwC in 2009, the first year the award was offered.

Deb is a frequent speaker and served as an adjunct professor at Capital University Law School.