In The

Supreme Court of Ohio

CRUTCHFIELD, INC.,	:	Case No. 15-0386
APPELLANT,	:	
v.	:	Appeal from the Ohio Board of Tax Appeals
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO,	:	
APPELLEE.	:	BTA Case Nos. 2012-926, 2012-3068, 2013-2021

BRIEF OF AMICI CURIAE THE NATIONAL GOVERNORS ASSOCIATION, NATIONAL CONFERENCE OF STATE LEGISLATURES, COUNCIL OF STATE GOVERNMENTS, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL LEAGUE OF CITIES, U.S. CONFERENCE OF MAYORS, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, INTERNATIONAL MUNICIPAL LAWYERS ASSOCIATION, AND GOVERNMENT FINANCE OFFICERS ASSOCIATION IN SUPPORT OF APPELLEE JOSEPH W. TESTA

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STATEMENT OF THE FACTS

The National Governors Association, National Conference of State Legislatures, Council of State Governments, National Association of Counties, National League of Cities, U.S. Conference of Mayors, International City/County Management Association, International Municipal Lawyers Association, and Government Finance Officers Association (the "Amici") adopt by reference the statement of the case and facts set forth in the Merits Brief of Joseph W. Testa ("Appellee").

STATEMENTS OF INTEREST OF AMICI CURIAE

The National Governors Association (NGA), founded in 1908, is the collective voice of the Nation's governors. NGA's members are the governors of the 50 States, three Territories, and two Commonwealths.

The National Conference of State Legislatures (NCSL) is a bipartisan organization that serves the legislators and staffs of the nation's 50 States, its Commonwealths, and Territories. NCSL provides research, technical assistance, and opportunities for policymakers to exchange ideas on the most pressing state issues. NCSL advocates for the interests of state governments before Congress and federal agencies, and regularly submits *amicus* briefs to this Court in cases, like this one, that raise issues of vital state concern.

The Council of State Governments (CSG) is the Nation's only organization serving all three branches of state government. CSG is a region-based forum that fosters the exchange of insights and ideas to help state officials shape public policy. This offers unparalleled regional, national, and international opportunities to network, develop leaders, collaborate, and create problem-solving partnerships.

The National Association of Counties (NACo) is the only national organization that represents county governments in the United States. Founded in 1935, NACo provides essential services to the nation's 3,069 counties through advocacy, education, and research.

The National League of Cities (NLC) is the oldest and largest organization representing municipal governments throughout the United States. Its mission is to strengthen and promote cities as centers of opportunity, leadership, and governance. Working in partnership with 49 State municipal leagues, NLC serves as a national advocate for the more than 19,000 cities, villages, and towns it represents.

The U. S. Conference of Mayors (USCM), founded in 1932, is the official nonpartisan organization of all United States cities with a population of more than 30,000 people, which includes over 1,200 cities at present. Each city is represented in the USCM by its chief elected official, the mayor.

The International City/County Management Association (ICMA) is a nonprofit professional and educational organization of over 9,000 appointed chief executives and assistants serving cities, counties, towns, and regional entities. ICMA's mission is to create excellence in local governance by advocating and developing the professional management of local governments throughout the world.

The International Municipal Lawyers Association (IMLA) has been an advocate and resource for local government attorneys since 1935. Owned solely by its more than 3,000 members, IMLA serves as an international clearinghouse for legal information and cooperation on municipal legal matters.

Government Finance Officers Association (GFOA) is the professional association of state, provincial, and local finance officers in the United States and Canada. The GFOA has served the public finance profession since 1906 and continues to provide leadership to government finance professionals through research, education, and the identification and promotion of best practices. Its 18,000 members are dedicated to the sound management of government financial resources.

Collectively, amici are organizations whose members include States and local governments and officials from throughout the United States. These organizations regularly file *amicus* briefs in cases, like this one, raising issues of concern for state and local governments. The ability to establish and collect taxes on companies that benefit from state and local markets is of paramount importance to state and local governments that need this revenue to provide vital benefits and services for their residents—and to avoid economic dislocations in local communities. Amici urge this Court to reject petitioners' challenge and hold that Ohio's tax is constitutional.

SUMMARY OF ARGUMENT

As explained below and in appellee's brief, the petitioners in this case are seeking a massive expansion of the rule articulated in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753, 87 S. Ct. 1389, 18 L.Ed.2d 505 (1967), and *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L.Ed.2d 91 (1992). These cases hold that states may not require out-of-state retailers to collect state sales and use taxes. But they are expressly limited to that context, and have no application to franchise taxes, income taxes, and other taxes imposed on the privilege of doing business in a state. Conversely, petitioners' argument that they cannot face even minimum doing-business tax assessments because they lack a physical presence in Ohio runs into a brick wall of precedent. And for that reason, they hope to expand *Bellas Hess* and *Quill* to a domain they have never reached before.

This Court should resist petitioners' invitation to reimagine this area of the law. It is well recognized that the rule of *Bellas Hess* and *Quill* has clear and deleterious effects on state treasuries and local economies, and that these are 20th Century cases that fit poorly in the 21st Century economy. In 2012, the estimated loss of tax revenue to states from these decisions was over $23 billion. Ohio alone lost over $628 million, and several states lost over $1 billion in receipts. These losses occur in a context where the rising costs of infrastructure improvement, education, corrections and healthcare—combined with the barriers to effective state tax collection—have left states grappling with an ever-growing challenge to maintain their fiscal health. And the negative effects of untaxed e-commerce extend beyond the state's coffers, because the effective subsidy to online retailers causes local businesses to lose revenue, which in turn dampens the local job market, causes property values to fall, and prevents the recirculation of money in the local economy. The result has been substantial criticism of the rule that *Bellas Hess* and *Quill* set out. *See, e.g.*, *Direct Mktg. Ass'n v. Brohl*, __ U.S. __, 135 S. Ct. 1124, 1134-35, 191 L.Ed.2d 97 (2015) (Kennedy, J., concurring) (noting, as one who supported *Bellas Hess* on *stare decisis* grounds in *Quill*, that both cases should now be overruled in light of legal and practical changes). In short, these are hardly rules that merit a massive expansion into the uncharted territory of doing-business taxes like Ohio's CAT.

To this point, the Supreme Court of the United States, the federal Courts of Appeals, and state Supreme Courts around the country have recognized that the rule laid down in *Bellas Hess* and (barely) reaffirmed in *Quill* is limited to the precise situation of requiring out-of-state retailers lacking a physical presence to collect sales and use taxes. This limited application makes perfect sense because, in *Quill* itself, the Supreme Court made clear that the basic principles of dormant Commerce Clause jurisprudence probably do *not* require physical presence even for sales and use tax collection, and that it would adhere to a contrary rule only as a matter of *stare decisis* and maintaining a clear bright-line rule. *See Quill*, 504 U.S. at 317-18, 112 S. Ct. 1904, 119 L.Ed.2d 91. Taking that bright-line rule—the continuation of which has been severely criticized precisely because of the harm it causes to the states—and extending it to new and different settings is not at all required by the limited rationale of *Quill*. If anything, it goes against that rationale because the main benefit of bright-line rules is that they have a precise application in a precise and limited context. Put otherwise, a proper bright-line rule needs to be bright on *both* sides of the line.

Accordingly, the key issue in this case is one that this Court has already decided: Ohio's Commercial Activity Tax (CAT) is not a sales tax, *Ohio Grocers Ass'n v. Levin*, 123 Ohio St.3d 303, 2009-Ohio-4872, 916 N.E.2d 446, ¶¶ 41-56, and thus is not controlled by *Bellas Hess* or *Quill*. Instead, it is just like the kind of privilege tax that has been consistently upheld by other courts, in opinions on which the Supreme Court of the United States has repeatedly denied certiorari. *See, e.g.*, *KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d 308, 323 (Iowa 2010), *cert. denied*, __ U.S. __, 132 S. Ct. 97, 181 L.Ed.2d 26 (2011); *Capital One Bank v. Comm'r of Revenue*, 453 Mass. 1, 12-13, 899 N.E.2d 76 (Mass. 2009), *cert. denied*, 557 U.S. 919, 129 S. Ct. 2827, 174 L.Ed.2d 553 (2009); *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992, 114 S. Ct. 550, 126 L.Ed.2d 451 (1993). The fact that Ohio's CAT is measured by reference to gross receipts proves the tax's constitutionality: it ensures that—under the settled dormant Commerce Clause test—the amount of the tax is reasonably related to "the taxpayer's ability to establish and maintain a market in this state for the sales." *Tyler Pipe Indus. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 97 L.Ed.2d 199 (1987) (citation omitted). So while petitioners consistently suggest that this case is controlled by settled precedent, Merit Br. of Appellant Crutchfield Corp. at 25-30 (Aug. 31, 2015), the fact is that the truly applicable cases (like *Tyler Pipe*) require just the opposite result, and what petitioners really want is a massive expansion of an already dubious rule from *Bellas Hess* and *Quill*.

Given the present realities of the retail industry, *Bellas Hess* makes even less sense today than it did when it received shaky support almost twenty-five years ago. But while this case perhaps gives this Court an opportunity to lend its voice to the chorus against *Bellas Hess*, there is no real need to do so. *Quill*'s decision to adhere to *Bellas Hess* on limited, *stare decisis* grounds does not constitute an endorsement of any broader principle, and this Court should avoid exacerbating the harm that *Bellas Hess* creates by extending it to new and different state-law regimes because "*[s]tare decisis* is a doctrine of preservation, not transformation," and while it "counsels deference to past mistakes, [it] provides no justification for making new ones." *Citizens United v. FEC*, 558 U.S. 310, 384, 130 S. Ct. 876 (2010) (Roberts, C.J., concurring). Accordingly, while this Court is bound to the holding of *Quill*, which refused to overrule the "bright-line rule" requiring physical presence "in the area of *sales and use taxes*," *Quill*, 504 U.S. at 317, 112 S. Ct. 1904, 119 L.Ed.2d 91 (emphasis added), it has no obligation to extend that holding to Ohio's very different, doing-business tax. Because Ohio's taxing system is outside the rule of *Bellas Hess*, and the regime otherwise places no burden on interstate commerce under recognized doctrine, this Court should affirm.

ARGUMENT

I. Ohio's Commercial Activity Tax Is Necessary To Frustrate Tax Avoidance And Ensure The State Collects The Revenue To Which It Is Entitled.

Under Ohio's tax regime, every person who does business in the State must pay a commercial activity tax (CAT) on taxable gross receipts "for the privilege of doing business in this state." R.C. 5751.02(A). The tax is "not a transactional tax" and was created primarily "[f]or the purpose of funding the needs of th[e] state and its local governments." *Id.*

The CAT imposes a tax on gross receipts from any person having gross sales of over $150,000 in the State and having a "substantial nexus" with the State. R.C. 5751.01(E), (H). The conditions that constitute a substantial nexus under the statute include a person having at least $500,000 of taxable gross receipts within the state in the calendar year. *Id.* 5751.01(I)(3). Unlike a sales tax, the CAT is charged directly to the retailer and does not appear as a separate item on billings or receipts. *See id.* 5751.02(B). The tax is charged either annually or quarterly. *Id.* 5751.02(A).

The genesis of the CAT's current incarnation was rooted in a problem of tax avoidance. The CAT tax was adopted in 2005 as a major part of Ohio's tax revisions aimed at simplifying the tax system, ensuring the system's fairness, stabilizing Ohio's revenue stream, lessening the tax system's distorting effect on economic decisionmaking, and making Ohio competitive. Transcript of Testimony of Frederick G. Church at 622-23, *L.L. Bean, Inc. v. Levin*, BTA No. 2010-A-2853, 2014 WL 1155674 (Aug. 31, 2013). Under the revisions, the current CAT was designed to phase out and ultimately replace the preexisting corporate franchise tax and personal property tax. *See* R.C. 5711.22(E)-(G) (phasing out personal property tax) and 5733.01(G)(1)-(2) (phasing out corporate franchise tax). The CAT stymied the erosion of Ohio's tax base caused by "aggressive … tax planning" by multistate enterprises. Transcript of Testimony of Frederick G. Church, *supra*, at 662-63. At the same time, by replacing the personal property tax with the CAT, Ohio eliminated a longstanding deterrent to corporate investment in the state. *Id.* at 660-61.

Creation of the CAT was thus necessary to protect the state's treasury, not only from existing designs for avoiding franchise taxes, but also from the shortfall created by *Quill*'s barrier to effective (and appropriate) state consumption taxes. Internet retail accounts for an increasingly large proportion of the money spent in the United States—the U.S. Census Bureau estimates that in the second quarter of 2015 alone, U.S. e-commerce sales totaled $83.9 billion. *Quarterly Retail E-Commerce Sales: 2nd Quarter 2015*, U.S. Census Bureau News (U.S. Dep't of Commerce, Washington, D.C.), Aug. 15, 2015, at 1. This already accounts for 7.2 percent of all sales made in the United States during that time, and the percentage is only expected to rise. *See, e.g.*, *id.* (showing quarterly increase in percentage of U.S. retail sales resulting from e-commerce from 2006 to present); Allison Enright, *U.S. Online Retail Sales Will Grow 57% by 2018; Projected Growth*, Internet Retailer (May 12, 2014), https://www.internetretailer.com/2014/05/12/us-online-retail-sales-will-grow-57-2018 (relating research that predicts e-commerce will account for 11% of all U.S. sales, worth $414 billion, by 2018). Buying from out-of-state retailers is so ubiquitous that a recent study found that 99.8% of respondents made an online purchase at least once a year, while over a quarter of respondents made at least one online purchase *every week*. Walker Sands Commc'ns, *Reinventing Retail: What Businesses Need to Know for 2015*, at 5 (2015), http://www.walkersands.com/pdf/2015-future-of-retail.pdf.

Notably, states make up very little of the tax revenue they lose to out-of-state and internet retail through the use tax, which requires their citizens to pay taxes on sales whenever the retailer has not collected the sales tax. For example, while Ohio's tax statute requires citizens to pay use taxes on purchases that they make that are not taxed at the point of sale, *see* R.C. 5741.02, the compliance rate for that use tax currently approaches zero, GAO, SALES TAXES: ELECTRONIC COMMERCE GROWTH PRESENTS CHALLENGES; REVENUE LOSSES ARE UNCERTAIN 34-35 (2000), http://www.gao.gov/new.items/g600165.pdf (noting widespread consensus that use taxes typically go unpaid); *see also Direct Mktg. Ass'n v. Brohl*, __ U.S. __, 135 S. Ct. 1124, 1135, 191 L.Ed.2d 97 (2015) (Kennedy, J., concurring) (citing estimates that California receives only about 4% of use taxes owed). The problem is structural: Sales taxes are collected at the point of sale by retailers, who have practices in place to track, report, and remit the taxes as a part of their regular daily business; use taxes are levied directly on consumers, who do not have any such practices and likely do not even realize they have a use-tax obligation. The result is millions of dollars owed to the state that go unpaid, undermining its ability to provide needed services to its citizens.

Because states are not allowed to tax sales made by interstate retailers, they lose out on billions of dollars in tax revenue each year. *See Collecting E-Commerce Taxes*, Nat'l Conf. of State Legislatures (Nov. 14, 2014), http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx ("States lost an estimated $23.3 billion in 2012 from being prohibited from collecting sales tax from online and catalog purchases."). Sales tax provides over one-third of most states' revenue, and over half for a select few. Nat'l Conf. of State Legislatures, *State Efforts to Collect Remote Sales Taxes* 1 (2014), http://www.ncsl.org/documents/statefed/MFA_intheStatesFeb2014.pdf.

The result is that many states face serious budget deficits, forcing them to curtail spending on needed programs, including education, police, and infrastructure. *See id.* (noting that between 2008 and 2013 "states closed a cumulative $527.7 billion budget gap, primarily through program reductions," and that "[r]aising taxes in the sluggish economy remains an unviable option for most states"). A 2009 study estimated that Ohio lost $1.4 billion in uncollected sales and use taxes on e-commerce between 2007 and 2012, and that nationally, $11.4 billion would be lost from uncollected sales and use taxes on e-commerce in 2012 alone. Donald Bruce et al., *State and Local Government Sales Tax Revenue Losses from Electronic Commerce* 7 tbl.1, 11 tbl.5 (2009).

Of course, we focus on the data regarding the losses caused by the sales and use tax discrepancy because it is the issue already caused by *Bellas Hess* and *Quill*, and so has already created a robust set of (very troubling) data. It stands to reason, however, that invalidating an even broader set of state taxes on out-of-state retailers would only exacerbate this set of issues. Given the size and importance of the online retail market, and the amount of sales that online retailers derive from local markets in the several states, no one can or should doubt that these retailers should share the tax burden involved in creating and sustaining the markets from which they benefit. Taxes like Ohio's CAT, which are levied on such retailers for the privilege of doing business in Ohio, are a reasonable and utterly unremarkable effort to ask those who benefit from Ohio's markets to contribute (far less) than their fair share of the benefits they derive therefrom, and do not even begin to address the set of problems created by *Bellas Hess* and *Quill*.

These taxes are particularly reasonable because the problems untaxed e-commerce causes for states do not end with the loss of state revenue; both state and local governments also suffer from unfair damage to local businesses as well. Because the rule of *Bellas Hess* and *Quill* causes state sales and use taxes to fall exclusively on local retailers while out-of-state companies avoid them, these taxes end up creating a competitive advantage for interstate retailers that local businesses cannot match. Citizens see lower prices offered by out-of-state retailers and are more likely to purchase the item from the interstate retailer. Any amount of uncollected sales or use tax stemming from out-of-state purchases is essentially a subsidy from state governments to online retailers, allowing them to charge their consumers less money at the point of sale than a local retailer for the exact same goods.[1]

The result of this implicit subsidy is a loss of revenue to local businesses, resulting in a loss of positive externalities to state and local governments such as local jobs. Multiple studies suggest that untaxed online commerce impedes local businesses' ability to hire local workers. *See, e.g.*, Richard A. Parker, *Flawed System: Online Sales Tax Collection Economic* 15 (2010) (estimating that California will lose over 34,000 local jobs due to uncollected e-commerce taxes in 2015 and over 63,000 in 2020); Elliott D. Pollack & Co., *Economic and Fiscal Impact of Uncollected Taxes on E-Commerce in Arizona*, at i (2012) (estimating that Arizona lost 5,426 jobs in 2010, resulting in a loss of $155.6 million of wages

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[1] This subsidy is merely another of the comparative advantages e-commerce retailers possess, including 24-hour access, low overhead in the absence of brick-and-mortar retail space, easy price comparison, and the ease with which consumers can shop from their own home. And because consumers often use the inventory and customer service of local retailers as a "showroom" before ultimately buying the product at a tax discount online, in-state retailers are effectively punished for employing local citizens and creating jobs and income in the local economy.

in the state). Separate studies concluded that taxing online retail would provide an increase of 13,000 jobs in Texas and over 8,500 jobs in Arizona by diverting revenue toward those companies that actually employ local citizens. *See* Angelou Economics, *Economic Impact Analysis: The Economic Benefits Achieved in Texas as a Result of Collecting Sales Taxes from Online-Only Retailers* 13 (2011); Elliott D. Pollack & Co., *supra*.

In addition to losing local jobs, state and local governments suffer a decline in property values as business shifts to interstate retailers. As local retailers lose money, their ability to pay commercial rent is similarly reduced. In Ohio, it is estimated that the loss of revenue to local retail businesses results in a $10 million reduction in commercial rent within the state each year, which in turn decreases commercial property values by $120 million. Economics Ctr., Univ. of Cincinnati, *Economic Analysis of Tax Revenue from E-Commerce in Ohio* 1, 10 (2011). This compounds the economic losses suffered by the State by "lead[ing] to further reductions in property tax revenue for communities and school districts." *Id.* at 1.

Again, granting out-of-state retailers an even further subsidy in the form of avoiding the CAT only exacerbates this problem by further advantaging out-of-state businesses over local ones. Local governments will particularly suffer from rules that create an ironic punishment for on-the-ground investment in the state from which a company's business is derived. The local businesses punished by this strange system are a bedrock of the local government tax base; they reliably support their communities through everything from little league sponsorship to volunteer firefighting; and their failure has a recognized effect in raising the cost of policing through broken windows and boarded storefronts. *See* Nicole Leinbach-Reyhle, *Why You Need to Support Small Businesses*, Forbes (Sept. 2, 2014), http://www.forbes.com/sites/nicoleleinbachreyhle/2014/09/02/why-you-need-to-support-small-businesses; Eric D. Gould et al., *Crimes Rates and Local Labor Market Opportunities in the United States: 1979-1997*, 84 Rev. Econ. & Stats. 45 (2002) (linking local labor market and crime rates). These problems can then lead to higher local taxes, reinforcing the disincentive for local investment. And this ultimately self-reinforcing cycle is part of what ultimately drives long-flourishing small towns and urban areas into increasingly perilous trouble.

Relatedly, it is well recognized that states and local governments suffer multiplying economic decline when money is siphoned out of the local economy through out-of-state sales. When local businesses earn revenue, it generates further economic activity through both increased purchases from their suppliers and through wages paid to workers who spend that money. This effect, known as an "economic multiplier," creates a compound effect bolstering the local economy:

> As a result of this increased spending, brick-and-mortar retailers must purchase goods and services from other businesses in the region, resulting in those firms increasing production. In turn, the firms supplying the retailers will need to increase purchases from their

> suppliers to meet their new orders. The sum of all these expenditures comprises the indirect spending associated with increased activity. All of the economic activity resulting from the increased sales by brick-and-mortar retailers in Pennsylvania, whether direct or indirect, results in increased employment. Some of the earnings by these new employees will be spent at businesses within the region on various goods and services, creating another round of economic activity like that described above.

Robert P. Strauss, *The Impact of Not Collecting Sales and Use Taxes from Internet Sales into Pennsylvania* 28 (2011); *see also* Economics Ctr., *supra*, at 1 ("A mechanism that would achieve tax parity between store retail and internet retail sales within Ohio could result in a recapture, based on 2011 data, of 11,000 direct retail jobs, which are among almost 15,000 total jobs from the spending and re-spending that would circulate from store retailers through Ohio's economy."). Every law that discourages local, on-the-ground investment—including a CAT that cannot be applied to anyone who meticulously avoids a physical presence while making (at least) many hundreds of thousands of dollars' worth of in-state sales—will harm the states and localities involved in many multiples of those dollars lost.

Not only does this system harm state and local governments, it also leads to simply bizarre forms of business organization across the national economy. Under the regime that petitioners ask this Court to expand, a retailer with physical presence only in Philadelphia, Pennsylvania, can advertise televisions with tax-free prices to Ohio residents in Cincinnati on an Internet marketplace, and a retailer with a physical presence only in Cincinnati can do the same with respect to the exact same televisions for Philadelphia residents, all over the exact same website. Indeed, that website is likely to prominently feature the fact that certain retailers can ship the TV to purchasers "tax-free" without even mentioning that others are offering the product (with taxes) right down the street. (The site will also likely omit that the citizen actually owes a use tax already in his home state). This can result in two identical televisions in Cincinnati and Philadelphia being packed and shipped almost 600 miles so that two citizens who live only a few miles from the respective stores can avoid hundreds of dollars in taxes. Of course, individual consumers will opt for the money-saving option, whatever costs might be borne by others elsewhere in the system. But this is recognizable waste: an inefficient expense of rubber, roads, and gasoline created entirely by government rewards for forms of business organization—including single-state presence for retailers and on-line marketplaces—that direct sales "out of state" in only the most technical sense. And, again, those incentives are only reinforced if maintaining that business organization likewise permits the retailer to avoid the CAT even when it is shipping many hundreds of high-priced televisions a year into Ohio.

Indeed, expanding the rule of *Bellas Hess* to include not only state sales and use taxes, but also traditional "privilege of doing business" taxes takes every single one of the problems discussed above and makes it much, much worse. From the perspective of state tax revenue, this further expansion of the disparity between in-state and out-of-state retailers will take more money away from states, while frustrating the very mechanism that Ohio adopted to prevent avoidance of its doing-business tax. From the perspective of state and local jobs, that decreased revenue will have even more deleterious effects such as reducing employment in education, safety, and maintenance on a multiplying basis as local dollars dry up. From the perspective of state and local markets, bricks and mortar retailers and the people they employ suffer under a regime that provides an even greater subsidy to their out-of-state competitors, and the local economy suffers even more as a result. Local property values sink and local legislative tax bases erode—as do the traditional businesses that help to support local communities and governance—not because they are out-competed, but because they cannot fight an unfair battle with a subsidized competitor. And even from the perspective of the national economy, resources continue to be frittered away on structuring businesses to maximize tax avoidance rather than to minimize cost and waste.

This approach might be justified if *Quill* and *Bellas Hess* stood for an overarching constitutional principle that required vindication in related but substantially different settings, notwithstanding the dislocations the application of that principle might create. But they do not. As explained below, those cases are rooted almost exclusively in *stare decisis* and the value of bright line rules, and this Court thus has no obligation (and, in fact, should avoid) expanding them here under their own rationales. Beyond that, it makes very little sense to take a doctrine rooted in making sure that interstate commerce only pays *its fair share* of the benefit it reaps from the local market, and turn it into a tool that prevents interstate commerce from paying *any share* of the benefit it reaps from the local market. The foregoing demonstrates that such a rule serves neither the local nor the national interest, and its expansion should be assiduously avoided.

II. This Court Should Not Extend The "Bright-Line" Rule From *Quill* And *Bellas Hess* To New Settings.

As explained above, the present regime in Ohio and other states with respect to sales and use taxes results from the distorting effect of the Supreme Court's 1967 decision in *Bellas Hess,* where the Court held that states cannot require out-of-state retailers to collect and remit state use taxes. That holding was reconsidered by the Supreme Court in 1992 in *Quill,* and received only a limited vote of confidence. In particular, the Supreme Court did not identify the practice as either (1) a form of discrimination against out-of-state retail, or (2) imposing any particular "undue burden" on interstate commerce. Rather, the Supreme Court merely concluded that its dormant Commerce Clause holding from 1967 was not completely inconsistent with the evolution of the law over the intervening twenty-five years, and that there was *stare decisis* value in retaining the "bright-line" rule that *Bellas Hess* set out. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 311, 317-18, 112 S. Ct. 1904, 119 L.Ed.2d 91 (1992). That "bright-line rule," in turn, is limited to state laws that require out-of-state retailers to collect and remit sales taxes, and has never been extended beyond that limited setting.

The "substantial nexus" requirement for state taxation—for which *Bellas Hess* requires "physical presence" only when it comes to sales and use taxes—is meant only to "ensure that state taxation does not unduly burden interstate commerce." *Quill*, 504 U.S. at 313. Of course, Ohio's CAT cannot be considered discrimination against, or an undue burden on, interstate commerce. The CAT is levied equally against both local retailers and out-of-state retailers and, as the foregoing demonstrates, is necessary to protect the State's tax revenues from activities that undisputedly benefit from the local market.[2] Quite the opposite: if this Court were to hold that the CAT could not be imposed on out-of-state retailers,

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[2] While local retailers ultimately have their CAT offset by the amount they pay in sales tax, this merely prevents local retailers from being discriminated against by paying duplicative taxes to the state. And, to the extent this offsetting functionally results in interstate retailers and local retailers paying taxes with different designations, there is nothing in that difference that makes it discriminatory. *See Ala. Dep't of Revenue v. CSX Transp., Inc.*, __ U.S. __, 135 S. Ct. 1136, 1143, 191 L.Ed.2d 113 (2015) (noting that, if imposing different regimes on two forms of commerce were sufficient to find the regime discriminatory, "*both* competitors could claim to be disfavored—discriminated against—relative to each other," and rejecting this result). If anything the CAT is less of a burden than the sales tax paid by local retailers—not only is the rate much smaller, but unlike a sales tax, the CAT does not require retailers to calculate different tax rates based on combining state and local taxes, nor does it require retailers to inquire whether customers are exempted from sales tax. *See* Transcript of Testimony of Frederick G. Church at 58-60, *L.L. Bean, Inc. v. Levin*, BTA No. 2010-A-2853, 2014 WL 1155674 (Aug. 31, 2013).

local Ohio retailers would face even *more* sweeping financial discrimination in favor of interstate retailers than they already face under the rule of *Bellas Hess*.

Nor is the burden on interstate commerce remotely "undue." The present touchstone of this inquiry is the baseline proposition that "interstate commerce may be required to pay its fair share of state taxes." *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 31, 108 S. Ct. 1619, 100 L.Ed.2d 21 (1988); *see also Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623-24, 101 S. Ct. 2946, 69 L.Ed.2d 884 (1981) ("[I]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of [the] state tax burden even though it increases the cost of doing business." (internal quotation marks and citation omitted)). Ohio's privilege tax only applies to those who provide over $150,000 worth of goods to Ohio citizens, R.C. 5751.01(E)(1), and only presumes a nexus with the state sufficient to require remittance of the tax if the retailer has $500,000 worth of receipts from Ohio in the previous year, *id.* 5751.01(I)(3). As the Deputy Budget Director for Tax Policy and Revenues of Ohio explains, a tax on gross receipts is the best metric for a company's "fair share" of taxes: "[T]he gross receipts are, in a sense, proxy for the scale of the business and the degree to which the business uses government services," such as state infrastructure and legal protections. Transcript of Testimony of Frederick G. Church, *supra,* at 663-64. Accordingly, the burden this tax imposes is entirely commensurate with the value that out-of-state retailers realize from making sales in the Ohio market. As *Quill* itself suggests, the rule in *Bellas Hess* stemmed from a far more formalistic analysis that was far less attuned to achieving a fair outcome as between local and interstate commerce. *See* 504 U.S. at 310 & n.5.

A. Numerous Courts Have Upheld Taxes Similar To Ohio's CAT And Refused To Extend The Rule Of *Bellas Hess* And *Quill*.

For this reason, consistent precedent holds that a variety of different taxes similar in form to the Ohio CAT all easily satisfy the requirements of the dormant Commerce Clause. There is thus no merit to petitioners' suggestion that the precedents that indisputably *do* apply to taxes like the CAT remotely support finding Ohio's regime unconstitutional.

In *Geoffrey, Inc. v. South Carolina Tax Commission*, 313 S.C. 15, 437 S.E.2d 13 (S.C.), *cert. denied*, 510 U.S. 992, 114 S. Ct. 550, 126 L.Ed.2d 451 (1993), the Supreme Court of South Carolina upheld a corporate income tax levied against out-of-state corporations that, like Ohio's CAT, annually required "every foreign corporation . . . having an income within the jurisdiction of th[e] State" to pay tax on a percent of its net income derived within the state.[3] *Id.* at 18 (quoting

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[3] Ohio's CAT functions much like South Carolina's tax as an annual charge derived from the amount a corporation earns from business within the state. However, Ohio replaced its former franchise tax (taxing net income) with the CAT derived from gross receipts because "there are no subtractions for costs [with gross receipts], [and] there is no apportionment of income based on a three-factor formula," making it "simpler to comply with." Transcript of Testimony of

S.C. Code Ann. § 12-7-230). The court found *Bellas Hess* inapplicable to the income tax at issue, recognizing that the Supreme Court in *Quill*, "while reaffirming its vitality as to *sales and use taxes*, noted that the physical presence requirement had not been extended to other types of taxes." *Id.* at 23 n.4. Instead, the court turned to other Supreme Court precedent, declaring it "well settled" that states can tax income without the taxpayer having a physical presence in the state: "[A] state may tax such part of the income of a non-resident as is fairly attributable . . . to events or transactions which, occurring [in the state], are within the protection of the state and entitled to the numerous other benefits which its confers." *Id.* at 23 (citing *Int'l Harvester Co. v. Wis. Dep't of Taxation*, 322 U.S. 435, 441-42, 64 S. Ct. 1060, 88 L.Ed.1373 (1944)). The court further reasoned that "any corporation that regularly exploits the markets of a state should be subject to its jurisdiction to impose an income tax even though not physically present." *Id.* (citation omitted). Notably, although this decision was reached shortly after *Quill*, the Supreme Court of the United Sates denied certiorari on a petition asserting that *Quill* should be extended to such franchise taxes—a petition that was accompanied by at least six *amicus* briefs from taxpayers making arguments indistinguishable from those petitioners advance here.

Frederick G. Church, *supra*, at 661. Ohio's CAT thus provides a relatively less burdensome process for out-of-state retailers than the tax upheld in *Geoffrey*.

Similarly the Supreme Court of Iowa has recognized that "the presence of transactions within the state that give rise to [a corporation's] revenue provide a sufficient nexus under established Supreme Court precedent" to tax that corporation's income. *KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d 308, 323 (Iowa 2010), *cert. denied*, __ U.S. __, 132 S. Ct. 97, 181 L.Ed.2d 26 (2011). As a practical matter, the court reasoned that a reversal in *Quill* could have retroactively created "a huge tax liability imposed upon out-of-state vendors for their failure to collect sales and use taxes owed by others," but that there was no similar precedent in the area of income tax creating a reliance interest.[4] *Id.* at 324-25. The Supreme Court of Iowa also recognized that an income tax does not impose the same burden on out-of-state corporations as a sales tax might. First, because there are no local taxes to contend with, there are "far fewer jurisdictions . . . involved." *Id.* at 325. Second, the corporation pays the state directly—and only periodically—instead of becoming "a virtual agent of the state in collecting taxes from thousands of individual customers." *Id.*; *see also* Resp'ts Br. in Opp'n at 21, *KFC Corp. v. Iowa Dep't of Revenue*, 132 S. Ct. 97 (2011) (No. 10-1340) (arguing that the "burdens alleged in the petition . . . for 'multistate taxpayers' . . . do not differ in type or degree from those existing for taxpayers" who are physically present in the state because "[h]aving employees or tangible property in a state does not lessen the

[4] Retroactivity is similarly inapplicable to Ohio's CAT.

‘questions and judgments that must be made in calculating a corporate income tax liability’” (citation omitted)). Once again the losing taxpayer sought certiorari, in heavy reliance on *Quill*, and accompanied by a host of *amici*. And, once again, the Supreme Court of the United States denied it.

Likewise, in upholding the application of an income-based excise tax on an out-of-state financial institution, the Supreme Judicial Court of Massachusetts found *Quill* inapplicable because it “explicitly emphasized, on more than one occasion, a narrow focus on sales and use taxes for the physical presence requirement.” *Capital One Bank v. Comm’r of Revenue*, 453 Mass. 1, 12-13, 899 N.E.2d 76 (Mass. 2009), *cert. denied*, 557 U.S. 919 (2009). Turning instead to the “substantial nexus” requirement of *Complete Auto Transit v. Brady*, 430 U.S. 274, 97 S. Ct. 1076, 51 L.Ed.2d 326 (1977), the court found the standard satisfied because the corporation “was soliciting and conducting significant . . . business” in the state, “generating millions of dollars in income.” *Capital One Bank*, 453 Mass. at 15-16. Once more, the taxpayer and a similar set of *amici* sought certiorari, relying principally on *Quill*. Once more, the Supreme Court of the United States was unmoved.

This Court, as well, has recognized the error in extending *Quill*’s holding to “cases involving taxation measured by income derived from the state.” *See Couchot v. State Lottery Comm’n*, 74 Ohio St.3d 417, 424-25, 659 N.E.2d 1225

(Ohio 1996), *cert. denied*, 519 U.S. 810, 117 S. Ct. 55, 136 L.Ed.2d 18 (1996) (recognizing that the Supreme Court has explicitly avoided extending the physical-presence requirement to other forms of taxes). In that case, too, the petitioner sought certiorari from the United States Supreme Court on the question "Does the 'physical presence' test for 'substantial nexus' . . . articulated in *Quill* . . . apply to state income taxes?" Petition for Writ of Certiorari at i, *Couchot*, 519 U.S. 810 (1996) (No. 95-1802). And, again, the Supreme Court showed no interest in extending *Quill* beyond its express terms. From this it is indisputable that the CAT—which taxes corporations based on the amount of revenue an entity derives from Ohio annually—is a valid tax.

To summarize: There are countless cases from around the country where taxes akin to the Ohio CAT have been upheld against a challenge of exactly the form at issue here. In each of those cases (as here), the petitioner argues that the tax at issue fails under *Tyler Pipe* and *Complete Auto*, and that argument is easily rejected. Then, in each of those cases (as here), the petitioner argues that the tax must fail because it mirrors the kind of tax at issue in *Bellas Hess* and *Quill*. And in each of those cases, the court rejects the suggestion that *Quill* should be extended in this fashion, and the Supreme Court of the United States shows no interest whatsoever in extending the rule, despite well-represented petitioners with armies of *amici* lobbying the Court for intervention again and again. It is thus clear that petitioners seek an expansion of *Quill* here that no court has been willing to provide. This Court should not be the one to do so.

That is particularly so because the argument for extending *Quill* has only gotten weaker over the years since it has failed so repeatedly in the past. In the meantime, compliance with regimes like Ohio's has only become less and less burdensome, given changes in the technological environment. Remote retailers already use simple software tools to verify that they are shipping to a jurisdiction in which they have no physical presence, and to comply with increasingly different rules in different states about what it means to have such a presence. Accordingly, companies already track their gross receipts in the normal course of business for purposes of filing various kinds of tax returns, and have ready-made accounting tools to comply with the tax at issue. Indeed, a simple Google search provides a number of third-party companies that offer software to automate the process of storing location of purchasers and the relevant tax. *See, e.g.*, *Sales Tax Software*, Avalara Tax Rates, http://www.taxrates.com/sales-tax-software (last visited Oct. 18, 2015). Furthermore, because other states including Hawaii and New Mexico have established gross receipt taxes, many interstate companies have infrastructure in place to collect the necessary information and calculate taxes due in applicable states.

B. A Privilege-To-Do-Business Tax Like Ohio's CAT Falls Outside The "Bright-Line Rule" Of *Bellas Hess* And *Quill*.

Because of the solid wall of precedent rejecting any dormant Commerce Clause challenge to franchise taxes like Ohio's CAT, the only way to find a dormant Commerce Clause violation in this case is to avoid the settled doctrinal questions and analogize directly to *Bellas Hess* and *Quill* instead. But doing so is inappropriate—*Quill* was self-evidently rooted in *stare decisis* and the value of a *pre-existing* bright-line rule, and not in the belief that the regime at issue there was unconstitutional as a matter of basic Commerce Clause principles or doctrine.

The language of *Quill* is quite extraordinary in this regard. For one, the Supreme Court acknowledged that, while it would not ultimately agree with the North Dakota Supreme Court's conclusion that *Bellas Hess* should be overruled, it "agree[d] with much of the state court's reasoning." *See Quill*, 504 U.S. at 301-02, 112 S. Ct. 1904, 119 L.Ed.2d 91. In particular, it affirmed the state court's view that, under subsequent precedent, the Due Process Clause plainly permitted state legislatures to regulate retailers who shipped into the state. *See id.* at 306-08. And it went far out of its way to cast doubt on *Bellas Hess*'s dormant Commerce Clause holding as well, even saying that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today." *Id.* at 311. The very most the Supreme Court would say about undue burdens was a footnote suggesting that North Dakota's (far more onerous) law "illustrate[d]" how a state tax "*might* unduly burden interstate commerce." *Id.* at 313 n.6 (emphasis added). That is not remotely an endorsement of the proposition that all regimes imposing burdens that in any way mirror those at issue in *Quill* or *Bellas Hess* should be condemned—as petitioners argue here.

The actual grounding of *Quill* is nothing more than the Supreme Court's decision to adhere—on the grounds of *stare decisis* and the value of bright-line rules—to the rule laid down in *Bellas Hess*. *See Quill*, 504 U.S. at 317-18, 112 S. Ct. 1904, 119 L.Ed.2d 91. But among the benefits of bright-line rules is that they are bright on both sides of the line. *Bellas Hess* and *Quill* prevent states from requiring out-of-state retailers to actually collect or pay *sales tax*: out-of-state companies cannot be required to collect and pay "a use tax on goods purchased for use within the State." *Id.* at 301. As this Court recognized in *Ohio Grocers Ass'n v. Levin*, 123 Ohio St.3d 303, 2009-Ohio-4872, 916 N.E.2d 446, ¶¶ 41-56, the CAT is an annual privilege-of-doing-business tax; it is not a sales-based use tax, nor does it "operate" as one. *Quill*'s preference for bright-line rules thus recommends *against* extending its holding to the very different context of a privilege-of-doing-business tax. *See Couchot*, 74 Ohio St.3d at 424-25 (declining to extend *Quill*'s reasoning to taxes owed on lottery winnings because "[t]he court pointed out that 'concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement.' There is no indication in *Quill* that the

Supreme Court will extend the physical-presence requirement to cases involving taxation measured by income derived from the state." (citation omitted)).

Thus, a decision based on whether the law in this case is *like* the kind of law presented in *Bellas Hess* and *Quill* cannot claim that its decision is justified by either *stare decisis* or a bright-line rule, and thus claims no support from *Quill* itself. In fact, the *stare decisis* effect of *Ohio Grocers* and *Couchot* counsel against extending *Quill*'s holding to a new set of circumstances. "*Stare decisis* is a doctrine of preservation, not transformation. It counsels deference to past mistakes, but provides no justification for making new ones." *Citizens United v. FEC*, 558 U.S. 310, 384, 130 S. Ct. 876 (2010) (Roberts, C.J., concurring). And, if anything, *Quill* casts doubt on whether the relevant principles would require the result that obtained *in Quill itself* if the issue were being freshly considered. For this reason, the Court should feel no obligation to extend the rule in *Quill* to a case that is not covered by its "bright-line rule," and should in fact be very hesitant to extend a rule for which the Supreme Court has expressed little to no support on the merits for fifty years.

Notably, this argument is based solely on the reasoning of the *Quill* opinion itself, and becomes even stronger if one considers how vastly different the world has become since *Quill* was decided in 1992 (let alone *Bellas Hess* in 1967). As Justice Kennedy recently and persuasively observed, the rule from *Bellas Hess* is on even shakier footing today in light of the evolution of online commerce. *See Direct Mktg. Ass'n v. Brohl*, __ U.S. __, 135 S. Ct. 1124, 1134-35, 191 L.Ed.2d 97 (2015) (Kennedy, J., concurring). In his words:

> The Internet has caused far-reaching systemic and structural changes in the economy, and, indeed, in many other societal dimensions. Although online businesses may not have a physical presence in some States, the Web has, in many ways, brought the average American closer to most major retailers. A connection to a shopper's favorite store is a click away—regardless of how close or far the nearest storefront. Today buyers have almost instant access to most retailers via cell phones, tablets, and laptops. As a result, a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term.

Id. (citation omitted).

While Justice Kennedy—who voted for *Quill* on *stare decisis* grounds—would now vote to overturn it, that is not at all necessary here. The bright-line rule in *Quill* forbids imposing *transactional sales tax* on out-of-state retailers. *Quill* does not speak to a privilege-based annual tax, and indeed *Quill* itself affirms that the Due Process Clause allows the states to regulate out-of-state businesses that transact substantial business with the state's citizenry. It likewise affirms that laws that do not discriminate or impose undue burdens on interstate commerce are constitutional. Ohio's taxation regime fits easily within these rules.

Ultimately, applying the basic principles of dormant Commerce Clause jurisprudence to this case is simple: Ohio's law does not disadvantage out-of-state retailers, but merely subjects them to the same tax burden imposed on local retailers. In so doing, Ohio's CAT does not even come close to stymying the massive *de facto* subsidy that out-of-state retailers already enjoy because of their avoidance of sales and use tax obligations. Extending that subsidy—and the tax shortfall it depends upon—only further denies necessary revenue to the states, while further *advantaging* out-of-state retail. That makes it impossible to conclude that the rule petitioners seek here is necessary either to avoid "discrimination" against interstate retailers or to avoid placing interstate commerce under an "undue burden." And *Quill*'s bright-line rule against imposing a sales-tax-collection duty on out-of-state retailers leads to the same result because this is not a transactional tax at all, and so falls on the permissible side of the bright line.

CONCLUSION

Petitioners' challenges to the Ohio CAT should be rejected and the decisions below should be affirmed.

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CERTIFICATE OF SERVICE

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