

OHIO BUSINESS TAX SEMINAR  
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# OHIO COMMERCIAL ACTIVITY TAX

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# 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%
- Is the CAT a good tax?
  - Predictable revenue stream, even in recession.
  - Imposes burden on out-of-state taxpayers.



# Two Predominant Issues in CAT Disputes

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



# General Rules for Situsing Gross Receipts

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R.C. 5751.033 provides different rules based upon the nature of the gross receipts:

1. **TPP Sales** – Location where TPP is ultimately received by the purchaser after all transportation is complete.
2. **Intellectual Property** – Location where the purchaser uses or has the right to use the IP.
3. **Services and Other Intangibles** – Location where the purchaser receives the benefit.

# 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).



# *NASCAR Holdings, Inc. v. McClain*

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- Tax Commissioner sitused gross receipts to Ohio based upon Ohio viewership / population.
  - 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.
- Ohio Supreme Court overruled the Tax Commissioner and held that certain gross receipts were not subject to CAT.

# NASCAR Holdings, INC. v. McClain

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- Applicable Provision: NASCAR's revenue streams are situated to where the payors (purchasers) used or had the right to use IP. 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 Court held that the BTA was permitted to modify the Tax Commissioner's ruling to support the assessment on a different basis.
- Siting: The Court held that NASCAR's broadcasting, revenue, licensing, and sponsorship receipts were not situated to Ohio.
  - Fixed sums for the right to use was based upon broader geographic area – the United States and its territories. There was no traceable receipts based upon the right to use in Ohio.
  - Contracts did not support causal connection between receipts and right to use NASCAR's IP in Ohio.
- Application of NASCAR decision to other situations?

# Situsing Services – Based upon Benefit Received

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- Cable/Satellite Services (#9)
- Legal Services (#32)
- Tax Preparation Services (#46)
- Waste Management Services (#54)



# Defender Security Co. v. McClain

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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 situsing 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?

# 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?  
*VVF Intervest, LLC v. McClain*, BTA Case No. 2019-1233



# Supporting an Alternative Siting Method

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

# 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).
  - Does Federal Income Tax or GAAP Treatment matter?

# Gross Receipts – Common Audit Issues

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- Revenue & Contra Revenue Accounts
- Cost of Goods Sold & Expenses
- Common Exclusions:
  - Returns & Allowances
  - Cash Discounts
  - Financial Transactions / Sale of Capital Assets
- GAAP and federal income tax treatment often consistent.





# 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.



# Financial Transactions

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- Excluded from gross receipts:
  - Interest, except on credit sale.
  - Proceeds attributable to repayment, maturity, or redemption of principal of a loan, bond, mutual fund, or other marketable instrument.
  - Principal amount of a loan.
  - 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.
- Are there any restrictions on nature of taxpayer or assignment of loan? No.



# 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.



# CAT Administration & Filing Requirements

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- **Annual Minimum Tax** – Tiered based upon previous year's receipts.
- **Record keeping** – auditors seeking records related to purchases to identify vendors with potential CAT obligation.
- **Combined & Consolidated Taxpayers**
  - **Combined Groups:** Required for taxpayers with more than 50% common ownership.
  - **Consolidated Elected Taxpayer:** Election available to taxpayers with 50% or 80% common ownership.
  - Primary Benefit – Consolidated Taxpayer exclude intercompany receipts.
  - Request for Separate Filing



# 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).*

## R&D Credit

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- Equal 7% of qualified research expenses in excess of the taxpayer's three year average of such expenses.
- Recent audit issue.
- Ohio Department of Taxation re-auditing federal concept.





# Thank you for your attention.

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## AREAS OF PRACTICE

Taxation  
Business  
Real Estate & Construction  
Nonprofit & Foundation



I am a business tax attorney who provides clients with trusted advice concerning significant transactions, tax planning, and difficult challenges encountered in their daily operations. My practice focuses on state and local tax compliance and controversies, including Ohio and multistate sales/use tax, commercial activity tax, and personal income tax issues, and in federal income tax controversies with the Internal Revenue Service. Additionally, because of my tax background, I often advise clients regarding the business and tax implications of commercial and real estate transactions. I take pride in understanding my clients' business needs and objectives so I can help them achieve their goals in the most beneficial, yet practical, manner.

As the Former Chair of the Ohio State Bar Association Taxation Committee, I have been asked to present my opinion concerning tax laws and policy to Ohio legislatures. These opportunities have given me invaluable insight into the legislative process and the practical considerations that mold tax policy.

Finally, I enjoy giving back and volunteering with several charitable organizations in Northeast Ohio. My involvement with the Boys and Girls Clubs of Northeast Ohio and Stewart's Caring Place has been particularly fulfilling.

## EXPERIENCE

- Joined the firm as an associate in 2008; was elected partner in 2015
- Serves as Chair of the Taxation Section of the Business Practice Group (2019)
- Member of Buckingham's Business and Real Estate & Construction Practice Groups
- Experience includes, representing clients on a wide variety of federal and state tax matters, real estate and other significant transactions, and business structure/organizations, with a focus on Ohio and multistate planning and controversies

### Reported Cases

- *Defender Sec. Co. v. McClain*, 2020-Ohio-4594
- *Great Lakes Bar Control, Inc. v. Testa*, Tax Comm'r of Ohio, 2018-Ohio-5207
- *Cincinnati Reds, LLC v. Testa*, Tax Comm'r of Ohio, 2018-Ohio-4669.
- *Karvo Paving Co. v. Joseph W. Testa*, Ohio BTA No. 2016-782 (January 4, 2018)
- *WCI Steel, Inc. v. Testa*, Ohio Supreme Court, 2011-Ohio-3280
- *Crown Communications, Inc. v. Testa*, 2013-Ohio-3126
- *Heartland Education Community, Inc. v. Testa*, Ohio BTA No. 2012-277 (Sept. 3, 2014)
- *Dulay v. Testa*, Ohio BTA No. 2014-2074 (Dec. 3, 2015)
- *East Manufacturing Corp. v. Testa*, Ohio BTA No. 2015-2111 (April 17, 2017)

## EDUCATION & ADMISSIONS

The University of Akron School of Law, Akron, Ohio (J.D., summa cum laude, 2008)

Assistant Editor and Associate Editor: *Akron Law Review*

The University of Akron, Akron, Ohio (Master of Taxation, 2008)

Kent State University, Kent, Ohio (B.B.A. Finance, cum laude, 2003)

### Admissions

Ohio Bar

U.S. District Court, Northern District of Ohio

U.S. Tax Court

## AWARDS & HONORS

*Listed in The Best Lawyers in America*<sup>®</sup> for Tax Law (2022-2023)

Leadership Akron, Class 38

Great Akron Chamber of Commerce 30 for the Future recipient (2021)

Law360 Rising Star, Tax (2021)

Selected for inclusion in Ohio's Super Lawyers<sup>®</sup> – Rising Stars<sup>™</sup> (2017-2022), as voted by his peers

Recipient: Ohio State Bar Association, Labor and Employment Law Student Achievement

Award

## **PROFESSIONAL & CIVIC INVOLVEMENT**

Member: Greater Akron Chamber of Commerce Board of Directors

Member: Akron Tax Club

Member, Board of Directors: Boys & Girls Club of Northeast Ohio

Member: Stewart's Caring Place Board of Directors

### **Associations**

Member: Ohio State Bar Association

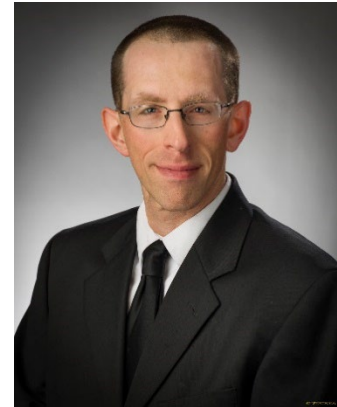
Co-Chair: Sales & Use Tax Subcommittee of Taxation Committee

Former Chair: Taxation Committee

Member: Akron Bar Association

Member: American Bar Association

State and Local Tax Committee



## **Matthew P. Shaw**

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### **Summary of experience**

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.

Previously, Matt has worked with an MWD client to initiate the process of securing \$375,000 in previously unclaimed Ohio CAT R&D credits, of which \$282,000 was refunded. Additionally, Matt has successfully worked on Ohio & California Sales & Use Tax audits for a variety of CP clients and significantly reduced client liability compared to the original assessment.

### **Professional affiliations and credentials**

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

### **Education**

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