

OHIO CAT SITUSING OF SECURITY MONITORING SERVICE CONTRACTS IS ALARMING

APRIL 22, 2019



RICHARD C. FARRIN, JD
MEMBER



JOHN R. TRIPPIER, CPA
DIRECTOR, MULTISTATE TAXES
(NON-ATTORNEY PROFESSIONAL)

The Ohio Court of Appeals, Tenth District, issued its opinion in *Defender Sec. Co. v. Testa*, 2019-Ohio-725, on February 28, 2019, holding that gross receipts from the sale of security monitoring service contracts with Ohio customers by Defender Security Company d/b/a Defender Direct (Defender) to ADT were properly sitused to Ohio for Commercial Activity Tax (“CAT”) purposes. The Court’s holding was based on its finding that the benefit of the contract was received by ADT in Ohio.

Defender was an authorized dealer of ADT security monitoring services. It originated ADT service contracts with customers in Ohio and sold the contracts to ADT. Defender had initially paid CAT on the sale of the security monitoring service contracts to ADT and filed a refund claim with the Ohio Department of Taxation claiming that the sale of the contracts should be sitused outside Ohio. Defender argued that ADT received the contracts in Colorado and provided the underlying security monitoring services to the Ohio customers from facilities located outside Ohio. As a result, Defender argued, the benefit of the contracts was received by ADT outside Ohio (see Ohio Revised Code (R.C.) 5751.033(I)). The Department denied the refund claim, determining that the benefit of the contracts was received by ADT in Ohio.

Defender appealed the denial of the refund claim to the Tax Appeals Division of the Department, which upheld the denial of the claim. Defender argued that Ohio Administrative Code (OAC) 5703-29-17 does not specifically address the sale of contracts, so OAC 5703-29-17(C)(4) should be used in situsing the sale of its contracts. OAC 5703-29-17(C)(4) provides that a taxpayer, at its election, can situs sales (of agency services) based on the “principal place of business” of the customer. In his Final Determination, the Tax Commissioner stated that “Accordingly, the situsing analysis stops at R.C. 5751.033(l). [Defender] is neither required nor permitted to analyze its facts and circumstances under R.C. 5751.033(l)’s last sentence or avail itself to O.A.C. 5703-29-17(C)(4)(c), because there is no question regarding the physical location at which ADT ultimately uses or receives the benefit of [Defender’s] service.”

Defender appealed to the Ohio Board of Tax Appeals (“BTA”), asserting that the gross receipts should be sitused outside Ohio. Defender also asserted that the situsing of the gross receipts to Ohio violated Commerce and Due Process Clause provisions. The BTA affirmed the Tax Commissioner’s determination that the gross receipts were properly sitused to Ohio under the Ohio CAT situsing statute. The BTA did not address the constitutional claims, stating that it was without jurisdiction to consider such claims.

Defender then appealed to the Tenth District Court of Appeals. The Court affirmed the BTA’s decision affirming the Tax Commissioner’s denial of the refund claim, finding that R.C. 5751.033(l) requires that the gross receipts in question must be sitused based on the benefit of the purchaser (ADT). The Court determined that ADT’s benefit of the purchased contracts was received in Ohio.

Defender also argued that the Tax Commissioner inconsistently applied the situsing rules (origin-based v. destination-based methods) found in O.A.C. 5703-29-17, which created a substantial risk of double taxation in violation of the Commerce Clause or Due Process Clause of the U.S. Constitution. The Court found that Defender fell short of meeting its heavy burden of proving that the statute was unconstitutional beyond a reasonable doubt. To the contrary, the Court found that the “multiple and extensive connections” the gross receipts had with Ohio easily met the external consistency test of the fair apportionment prong.

On April 15, 2019, Defender filed a discretionary appeal to the Ohio Supreme Court, asserting that the court of appeals erred by:

- Applying an erroneous standard of review of determinations of the Tax Commissioner;
- Erroneously affirming the situsing of Defender's gross receipts from the sale of the contracts to the location of ADT's customers; and
- Failing to find that the Tax Commissioner inconsistently applied the situsing provisions in R.C. 5751.033(l), which resulted in a significant risk of double taxation in violation of the fair apportionment prong of the Commerce Clause.

The Supreme Court does not have a deadline to accept or reject Defender's request to hear the appeal.

ZHF OBSERVATION

While not specifically addressed by the court of appeals (presumably because it was apparently not assigned as an error by Defender), we believe the Department's interpretation of R.C. 5751.033(l) and O.A.C. 5703-29-17 can be challenged on other grounds. The Department's final determination states that if you know the location of the benefit of a service, a taxpayer cannot utilize the election provided throughout O.A.C. 5703-29-17. It does not appear that such election hinges on whether a taxpayer knows the location of the benefit, but instead such election can be selected at the volition of the taxpayer.

If you would like to talk about this or any other CAT Issues, please contact Rich Farrin, John Trippier, or any other ZHF professional.

ZAINO HALL & FARRIN LLC

A T T O R N E Y S A T L A W

WWW.ZHFTAXLAW.COM

614-326-1120

855-770-1120 (toll-free)

RON AMSTUTZ

(non-attorney professional)
614-782-1545(Direct)
330-347-3533 (Mobile)
ronamstutz@zhfconsulting.com

RICHARD S. BITONTE

(non-attorney professional)
614-782-1555
rbitonte@zhfconsulting.com

RICHARD C. FARRIN

614-349-4811 (Direct)
614-634-3130 (Mobile)
rfarrin@zhftaxlaw.com

STEPHEN K. HALL

614-349-4812 (Direct)
614-284-1253 (Mobile)
shall@zhftaxlaw.com

DEBORA D. MCGRAW

614-349-4813 (Direct)
614-595-5560 (Mobile)
dmcgraw@zhftaxlaw.com

JOHN R. TRIPPIER

(non-attorney professional)
614-349-4815 (Direct)
614-203-4173 (Mobile)
jtrippier@zhftaxlaw.com

JASON W. WALKER

(non-attorney professional)
614-349-4817 (Direct)
916-533-1626 (Mobile)
jwalker@zhftaxlaw.com

STEVE C. AUSTRIA

(non-attorney professional)
614-349-4820 (Direct)
937-609-8355 (Mobile)
saustria@zhftaxlaw.com

DAN DODD

614-782-1554 (Direct)
740-973-5930 (Mobile)
dandodd@zhfconsulting.com

ADAM L. GARN

614-349-4814 (Direct)
agarn@zhftaxlaw.com

PHILLIP L. LAWLESS

(non-attorney professional)
614-349-4821 (Direct)
614-565-6098 (Mobile)
plawless@zhftaxlaw.com

BRAD W. TOMLINSON

(non-attorney professional)
614-349-4818 (Direct)
btomlinson@zhftaxlaw.com

JENNIFER R. TURNER

(non-attorney professional)
614-782-1642 (Direct)
502-594-9297 (Mobile)
jturner@zhftaxlaw.com

THOMAS M. ZAINO

614-349-4810 (Direct)
614-598-1596 (Mobile)
tzaino@zhftaxlaw.com