

AGENT OR NOT AN AGENT? THAT IS THE CAT QUESTION.

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In its opinion in *Willoughby Hills Dev. & Distrib., Inc. v. Testa*, Slip Opinion No. 2018-Ohio-4488, issued November 7, 2018, the Ohio Supreme Court addressed whether a gasoline distributor was an agent for purposes of the commercial activity tax (CAT) “agent exclusion” from gross receipts provided by Ohio Revised Code (R.C.) 5751.01(F)(2)(I). That provision excludes from gross receipts amounts received by an agent on behalf of another in excess of the agent’s fee or commission.

As we have been reporting over the past several years, the CAT “agent exclusion” has been, and continues to be, a hotly contested issue for taxpayers. With the *Willoughby* decision, we now have some guidance as to how the Court will interpret who is an agent for purposes of the exclusion.

Willoughby was a gasoline distributor that bought gasoline and various fuel products from Sunoco, Inc. and then resold the items to various

service stations (“retailers”) in Ohio. The taxpayer asserted that many of the terms in its distributor agreement with Sunoco reflected Sunoco’s control over taxpayer’s actions and, therefore, reflected an agency relationship.

The Court analyzed the CAT agent exclusion and the definition of “agent” in R.C. 5751.01(F)(2)(I) and 5751.01(P), respectively, in concluding that Willoughby was not an agent of Sunoco for CAT purposes and therefore its receipts from its sales of gasoline to gasoline retailers were not entitled to the agent exclusion.

Initially, the Court stated that it was necessary to first determine what activities of Willoughby matter for the purpose of determining whether Willoughby was an agent for CAT purposes. Willoughby argued that it was responsible for managing and protecting Sunoco’s intangible assets (i.e., trademarks, trade names, and trade dress) and therefore was Sunoco’s agent. The Tax Commissioner argued that the determination must be based on the activities that were involved in the generation of taxable gross receipts, i.e., Willoughby’s sale of gasoline. The Court agreed with the Tax Commissioner, stating that whether Willoughby is entitled to the agency exclusion “must turn on its acts of purchasing and selling gasoline, not on its responsibilities associated with managing and protecting Sunoco’s intangible assets.”

Next, the Court analyzed the definition of “agent” found in R.C. 5751.01(P) and stated that since “agent” is defined in the statute, Willoughby must meet the definition’s requirement. The Court applied the well-established rule that where a statute defines a term, that definition controls the application of the statute. R.C. 5751.01(P) defines an “agent” as “a person authorized by another to act on its behalf to undertake a transaction for the other.”

The Court first addressed the “person authorized” part of the definition by defining what “authorized” means. Since authorized is not defined in the CAT statute, the Court looked to the dictionary to define authorized to mean “endowed with authority.” It is important to note that in footnote number 3, the Court did recognize that “R.C. 5751.01(K) does provide that any term used in this chapter that is not otherwise defined has the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes unless a different meaning is clearly required,” the parties do not identify any provision of

federal-income-tax law that sheds light on how to discern the meaning of authority within the confines of agency principles.” The Court’s recognition of R.C. 5751.01(K) could be very beneficial in future cases relating to the definition of a gross receipt.

The Court proceeded to state that because the CAT statute does not define the type of authority that must be bestowed to create an agency relationship, it was appropriate to look to the common law concepts of agency. Since the Court had addressed the issue of authority in deciding the question of agency in *Cincinnati Golf Mgt., Inc. v. Testa*, 132 Ohio St.3d 299, 2012-Ohio-2846, 971 N.E.2d 929, the Court relied on the analysis in that case to determine the type of authority that must be bestowed to create an agency relationship for purposes of the CAT (even though it was a sales and use tax case).

The Court noted that in *Cincinnati Golf Mgt.*, it “observed that the proper inquiry should center on whether the company had *actual authority* to bind the city to the company’s purchases, *id.* at ¶ 23-24, and that that issue should turn on the language of the company’s management contract with the city, *id.* at ¶ 25. ‘[O]ne of the most important features of the agency relationship is that *the principal itself becomes a party* to contracts that are made on its behalf by the agent’ (emphasis sic), *id.* at ¶ 23, and ‘that the agent make the contracts on the principal’s behalf *with actual authority to do so*’ (emphasis sic), *id.* at ¶ 24. Paraphrasing the Restatement, we described actual authority as ‘an expression of intent by the principal that the agent act on behalf of the principal, along with the understanding of the agent.’ Applying these principles, we concluded that the company was not endowed with actual authority to bind the city to the company’s purchases, because the contract between the company and the city expressly disclaimed an agency relationship. *Id.* at ¶ 25.”

The Court then analyzed Willoughby’s contracts with Sunoco and Willoughby’s contract with one of its customers, Sopinski Enterprises, Inc. The Court noted that the Sunoco contract provided that Willoughby was not authorized to act as an agent and “is not authorized * * * to make to make any commitments or incur any expense or obligations of any kind on behalf of [Sunoco]’ unless Sunoco gives its approval.” The Court found that the Sopinski contract, which denominated Willoughby (not Sunoco) as the seller of the gasoline and to which Sunoco is not a

party, reinforced its determination that Willoughby was not acting as an agent of Sunoco regarding Willoughby's sales of gasoline to retailers.

Finally, the Court addressed Willoughby's argument that the control test should be applied in determining whether Willoughby was Sunoco's agent. The Court declined to follow the control test, stating that the proper focus was whether the person has actual authority to bind the alleged principal. . However, the Court stated that even if the control test were applied, Willoughby would not be Sunoco's agent. The Court pointed out that agency can attach to only a portion of a relationship between two persons (1 Restatement of Law 3d, Agency, Section 1.01, at 18), in this case the sales of gasoline to dealers, and that Willoughby did not develop any arguments or provide evidence that Sunoco exercised sufficient control over Willoughby in this regard.

Takeaways

- The case appears to give guidance that the terms in the contract are important and that actual authority must be given by the principal to the agent to substantiate an agency relationship.
- The Court did not address Ohio Administrative Code 5703-29-13 (see footnote 1) as the Department did not urge the Court to apply the rule and Willoughby asserted that the rule did not apply. How not addressing the rule will impact the Department's use of the rule, especially the control test and the ability to look outside the contract to determine the actual relationship remains to be seen.
- The Court's recognition of R.C. 5751.01(K) could be very beneficial in future cases relating to the definition of a gross receipt.
- The Court's statement that agency can attach to only a portion of a relationship between two persons may be beneficial when looking at the language of contracts.
- Taxpayers will need to carefully analyze their relationships with customers to determine if an agency relationship exists. Even further, taxpayers should attempt to be more specific with the language of their contracts if an agency relationship is desired.

ZHF Observation

Based on the Sunoco and Sopinski contracts, the Court's opinion is not unexpected. The language in those contracts cited by the Court, as well as other evidence in the case, militated against a finding of an agency relationship. Because the existence of an agency relationship will turn on the specific language of the contracts and facts in each case, and few, if any of the pending agent exclusion cases pending at the Ohio Board of Tax Appeals or the Tax Commissioner's Appeals Division have similar contracts or facts, the Court's opinion should not be viewed as adversely impacting those cases.

If you have any questions on *Willoughby Hills v. Testa* or other issues affecting your Ohio personal income tax liability, please contact [John Trippier](#), [Richard Farrin](#), or any of our [other tax professionals](#).

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