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Publications

Ohio Supreme Court Further Defines Agency Rules for CAT Exemption

On Nov. 7, 2018, the Ohio Supreme Court upheld the Ohio Board of Tax Appeals (BTA) decision in *Willoughby Hills Development and Distribution, Inc. v. Testa, Slip Opinion No. 2018-Ohio-4488*. This decision provides taxpayers with further guidance on the agency exemption from the Commercial Activity Tax (CAT). Ohio found that the taxpayer, Willoughby Hills Development and Distribution, Inc. ("WHDD"), was not entitled to claim an agency exemption under the CAT for receipts generated as a distributor of Sunoco motor fuels.

The Agency Exemption

Ohio employs a gross receipts tax, referred to as the CAT, which "is levied…on each person with taxable gross receipts for the privilege of doing business in the state" according to R.C. 5751.02(A). Unlike an income tax, the CAT has very few adjustments to the tax base of gross revenues. One important reduction is the so-called "agency exemption" which excludes receipts received "by an agent on behalf of another in excess of the agent's commission, fee or other remuneration" under R.C. 5751.01(F)(2)(I). The term "agent" is further defined by the statute as "a person authorized by another person to act on its behalf to undertake a transaction for the other" in R.C. 5751.01(P).

Look to the Contract Language

The Court's analysis in this case centered on the factors determining whether WHDD met the definition of "agent." The Court reiterated that the first place to look for support in establishing an agency relationship is the language of the contract. The fact that the contract between Sunoco and WHDD included a section labeling WHDD as an "independent contractor" which was "not authorized to act as an agent" weighed negatively against the taxpayer's argument. Such provision was deemed to be "hardly 'an expression of intent by the principal that the agent to act on behalf of the principal.'" The contract language also indicated that WHDD

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did not have any authority over Sunoco to bind Sunoco to its actions as an agent. Moreover, the contract provided that Sunoco was selling the gasoline to WHDD, and WHDD was purchasing the gasoline from Sunoco. There was no reference to WHDD selling the gasoline on behalf of Sunoco as its agent.

While the Court noted that it will look beyond the plain language of a contract to establish a true agency relationship, the taxpayer "has not pointed to anything in the record" that demonstrated evidence of Sunoco's approval of WHDD to act on its behalf. Thus, it is important to have evidence of the agency relationship, particularly evidence establishing authority to act on behalf of the principal. Best practice dictates this evidence should be supported by not only the agent but also through corroboration from the principal.

Focus on the Sales Transaction

While WHDD sought to argue that it had agency-like responsibilities – such as the responsibility to protect the intellectual property and goodwill of Sunoco – the Court stated these responsibilities had nothing to do with the sale of the gasoline which produced the receipts in question. The Court stated if WHDD was to benefit from the agency exclusion, its right to the exclusion "must turn on its acts of purchasing and selling gasoline, not on its responsibilities associated with managing and protecting Sunoco's intangible assets."

Importance of Authority

The contract between WHDD and Sunoco expressly provided that WHDD "is not authorized…to make any commitments or incur any expense or obligations of any kind on behalf of [Sunoco] unless Sunoco gives its approval." The Court noted this "provision as a departure from 'one of the most important features' of an agency relationship." This approval requirement was a key factor in determining that the taxpayer did not have "actual authority" in representing Sunoco as to the sales of gasoline to retailers.

Court Declined to Apply Control Test

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The Court declined to employ the control test "under these circumstances." The control test has been commonly used by courts to establish an agency relationship between parties, particularly in non-tax areas such as tort law. WHDD argued that Sunoco exercises control over it with respect to its involvement in different credit- and debit-card programs, which are made part of its supplier agreement. The Court instead focused on the holding in *Cincinnati Golf Management, Inc. v. Testa*, a sales-and-use tax case, which applied the actual authority test discussed above. The Court's reliance on a sales-and-use tax case may be an indication of the Court's willingness to give credence to jurisprudence under other taxes when deciding CAT cases.

Interestingly, neither WHDD nor the Commissioner argued that the administrative rule covering the agency exemption applied. See Ohio Adm. Code 5703-29-13. Since neither party argued for the rule, the Court said it did not consider it. One must wonder if the application of the rule could have impact on future cases, as the rule expressly adopts the control test ("The supreme court of Ohio has held that an agency relationship 'exists only when one party exercises the right of control over the actions of another, and those actions are directed toward the attainment of an objective which the former seeks'").

Conclusion

Taxpayers should evaluate Ohio's decision in Willoughby Hills if they intend to rely upon the agency exemption from the CAT. Taxpayers may wish to take steps to carefully negotiate contract language and business arrangements with suppliers and customers to ensure that the factors of the agency relationship are met.

For more information, contact any member of Frost Brown Todd's Tax Practice.

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