SALT BUZZ HF

Ohio Department of Taxation Proposes Changes to Rule as a Result of Nissan

January 15, 2020

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The Ohio Department of Taxation has proposed changes to Ohio Administrative Code (OAC) 5703-29-02 to address the potential impact of the Ohio Board of Tax Appeals' (BTA) decision in *Nissan North America, Inc. v. McClain*, BTA Case No. 2016-1076 (10/9/2019) and make other changes to the rule. As we discussed in our *Nissan* SALT Buzz dated October 28, 2019, the BTA granted Nissan North America, Inc. retroactive consolidated elected taxpayer (CET) status, thereby eliminating the portion of the commercial activity tax (CAT) assessment that was based on gross receipts from intermember transactions.

In *Nissan*, The BTA decided that the Commissioner abused his discretion in denying Nissan's request for retroactive election of the CET. The BTA based its decision on numerous factors:

- Taxpayers are required to request CET status in writing on the form prescribed by the Commissioner, which Nissan did.
- The statute does not foreclose retroactive application. The Commissioner provided a process for retroactive application by administrative rule (5703-29-02). Nowhere in the statute or the rule is retroactive application foreclosed by the beginning of an audit. The BTA found that the Commissioner has discretion to grant a retroactive CET status even after an audit has begun.

- The substance of Nissan's CAT returns, which excluded intercompany transactions. Nissan argued that there was no difference in the CAT liability reported on its CAT returns and the liability that would have been reported on a consolidated return, which indicated its intent to file as a CET.

- Taxpayers are permitted to amend returns to correct mistakes, citing *Procter & Gamble Co. v. Evatt,* 142 Ohio St. 373 (1943) and *First Banc Group of Ohio, Inc. v. Lindley*, 68 Ohio St.2d 81 (1981).

The proposed changes to OAC 5703-29-02 appear to address several of the factors listed above and seem designed to limit the application of *Nissan*. According to the proposed changes:

1. Any requests for retroactive application of a CET election must now be in writing and in accordance with OAC 5703-29-02(C)(5) (which has been added as part of the proposed changes).
2. Taxpayers cannot have been contacted for audit, criminal investigation action, or by a compliance program and
    a. Made a "clerical error", or
    b. Requested the retroactive CET election as part of the voluntary disclosure program.

Clerical Error - "Clerical error" is defined to mean that the original CAT returns filed reflected all taxable gross receipts of all members required to be in the CET group and the taxpayer failed to make a proper election on a form prescribed by the Commissioner. The taxpayer must demonstrate that the tax liability filed on the originally-filed returns will not be impacted by application of the retroactive CET election.

Voluntary Disclosure - the proposed changes specify two qualifications for a taxpayer to request a retroactive consolidation through the voluntary disclosure program. First, no member of the CET group was ever registered for CAT prior to requesting the voluntary disclosure. In other words, the request for voluntary disclosure and retroactive CET status must be a taxpayer's first attempt at registering for the CAT. Second, if a taxpayer elected CET status prior to its application for voluntary disclosure but has erroneously failed to include members of the group, the taxpayer can request a voluntary disclosure and amend returns reflecting the excluded members' receipts. The Department will not apply the CET status retroactively to a period prior to the initial CET registration.

ZHF Observation: It is unclear how the second situation is considered a retroactive consolidation as it appears the taxpayer has already received CET status and the Department is not applying that CET status to any periods prior to the initial election.

Based on the proposed changes, the Department is clearly attempting to narrow the impact of the Nissan decision, by disallowing taxpayers that have been contacted for audit from obtaining a retroactive CET status. The proposed changes appear to adopt the part of the Nissan decision that a taxpayer's liability doesn't change with the application of the CET status.

Other Proposed Changes

Most of the other proposed changes reflect grammatical corrections and do not represent a major change to the rule.

Rule-Making Process

The Department issued a notice on December 20, 2019, seeking comments on the proposed rule changes by January 2, 2020. To date, the Department has not filed the proposed rule with the Joint Committee On Agency Rule Review (JCARR), which is the government body that has the primary function to review proposed new, amended, and rescinded rules from over 100 Ohio state agencies to ensure the state agencies do not exceed their rule-making authority granted to them by the General Assembly. Once the proposed rule is filed with JCARR, there is typically a hearing date established for the proposed rule. JCARR has 65 days from the date the Department files the proposed rule to take action.

Next Steps

When the CAT was introduced in 2005, many businesses wanted to protect their nexus rights and chose either to not register or file as separate filers or combined filers. As a result of nexus cases (e.g., Crutchfield, Wayfair) over the years, the nexus arguments have eroded and any benefit of filing separate/combined has severely diminished. Businesses in a multiple-entity structure that haven't filed or are filing separate/combined should analyze how they are currently registered for CAT to determine if a CET election is more beneficial. There are a lot of factors to consider, including whether a retroactive CET election makes sense, what years it should cover, whether such an election would result in additional tax and/or whether amended returns need to be filed, etc. Depending on the facts at issue, it may be helpful to discuss certain factual situations with high level Department personnel and work through a solution prior to the finalization of the proposed rule.

The businesses with the biggest risk if the methodology in the proposed rule becomes a finalized rule and they are contacted for audit are those that have not been filing CAT returns in Ohio in the past. For example, out-of-state manufacturers with no connection to Ohio except for customers that pick-up goods and ship the goods to Ohio may not have been filing Ohio CAT in the past based on the erroneous premise that they were constitutionally protected. If there was also an intercompany transfer just before the customer pick-up, the Department has historically argued that both the intercompany and the third-party sale are sitused to Ohio and taxable, thereby doubling the CAT at issue. Even if such businesses have been contacted for audit, these businesses should consider filing a retroactive CET application prior to the proposed rule going into effect in order to take advantage of the Nissan decision. If the business has not been filing but has not been contacted for audit, the

business should explore whether a VDA provides the best avenue for filing the retroactive CET election.

If you would like to discuss the *Nissan* case or any other CAT issues, please contact John Trippier, Richard Farrin or any other ZHF professional.

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