

Ohio Supreme Court offers guidance on “agency exclusion” under Ohio commercial activity tax



David M. Kall | Friday, November 9, 2018

One controversial issue that commonly arises in Ohio commercial activity tax (CAT) audits is whether taxpayers qualify for the so-called “agency exclusion” for gross receipts received on behalf of others. The CAT is Ohio’s entity-level tax for the privilege of doing business in the state, as measured by the taxpayer’s “taxable gross receipts” in Ohio. Some other states impose a net income tax at the entity-level, which removes expenses from the base of the tax, or have no entity-level business tax at all.

The ability to eliminate gross receipts from the tax base for the CAT through an agency relationship has been a hot-button issue since Ohio adopted the CAT back in 2005. The Supreme Court of Ohio finally weighed in on the issue this week in [Willoughby Hills Development and Distribution, Inc. v. Testa](#). But before we review that decision, let’s take a look at the agency exclusion itself and the available administrative guidance.

THE AGENCY EXCLUSION

Ohio law, namely [R.C. 5751.01\(F\)](#), provides that “gross receipts” is broadly defined as “the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred[.]” Despite the broad definition of “gross receipts,” some items are excluded.

The agency exclusion, for one, is codified in R.C. 5751.01(F)(2)(l) and provides that the definition of “gross receipts” excludes property, money, and other amounts received or acquired by an agent on behalf of

Ohio Supreme Court offers guidance on agency exclu

another in excess of the agent's commission or fee. "Agent" is defined, in turn, to mean "a person authorized by another to act on its behalf to undertake a transaction for the other [person.]" R.C. 5751.01(P). The [Ohio Administrative Code](#) further defines "agent" for CAT purposes and four Ohio Tax Commissioner [Opinions](#) from 2008 provide additional guidance as to the meaning of an agent in contexts including construction contractors.

OHIO SUPREME COURT WEIGHS IN

If the taxpayer can exclude receipts that it receives as an agent from its tax base for the CAT, it may lower its tax burden. In the *Willoughby Hills Dev. and Distribution* case, the Supreme Court rejected the claim of a gasoline distributor, known as WHDD, that it purchased gasoline from Sunoco and resold it to retailers as an agent for Sunoco. The Supreme Court focused on the terms of the contracts between WHDD and Sunoco and between WHDD and the retailers.

Two provisions spelled doom for the taxpayer's arguments with respect to the Sunoco contract. First, the Sunoco contract provides that WHDD "is an independent contractor" and "is not authorized to act as an agent * * * of [Sunoco]." Second, the contract prohibits WHDD from incurring any expenses or obligations on Sunoco's behalf without Sunoco's approval. Obviously it is difficult to establish an agency relationship if the contract between the alleged agent and principal show that the parties did not intend to create one.

In addition to the Sunoco contract, WHDD's contracts with retailers further confirmed that WHDD was not an agent of Sunoco. The court reviewed one such contract representative of others and determined that these contracts provided that WHDD, not Sunoco, takes title to and "sells" the gasoline to the retailers.

For its part, WHDD argued that it was an agent of Sunoco due to the control that Sunoco exercised over managing and protecting its intangible assets. For example, retailers must paint buildings, poles, and curbs certain colors and WHDD must follow certain guidelines with respect to credit card equipment that Sunoco provides to WHDD. But the court rejected WHDD's "control test" for determining agency and further held that WHDD failed to show that Sunoco controlled WHDD's sale of the gasoline that gave rise to taxable gross receipts.

For these reasons and based upon the contracts before it, the Supreme Court determined that WHDD was not an agent for Sunoco and could not avail itself of the agency exclusion to gross receipts under the Ohio CAT statutes. The court therefore upheld the \$417,228 assessment that the Tax Commissioner issued to the taxpayer, WHDD.



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