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By Perry Cooper

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- Cases on tap involve Ohio warehouses, agency relationship

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The Ohio Supreme Court will consider a \$393,000 assessment against a DaVita Inc. subsidiary, in the first of four pending cases that will tease out how to apply the state's commercial activity tax.

The CAT was envisioned as a "broad-based, low-rate tax that would be able to fund the state, be easy to administer, and be minimally impactful on the business community," tax practitioner Kelvin Lawrence of Dinsmore & Shohl LLP in Columbus said. That so many CAT cases are making it up to the high court level "shows that there are serious issues that taxpayers need to have resolved in the CAT, even 20 years on," he said.

Tuesday's argument between DaVita dialysis provider Total Renal Care Inc. and Tax Commissioner Patricia Harris turns on whether Ohio can tax gross receipts from lab testing and administrative services performed out of state for the benefit of Ohio patients. The commissioner argues it can reach the receipts because the proper focus is on where the benefit is received, while TRC points to the commissioner's own regulation requiring that health-care services are attributed to the location where the service is performed.

Three other CAT cases are fully briefed and awaiting argument before the state's high court. A case involving shoe seller Nine West and one involving soap maker VVF Intervest both have to do with whether the state can tax products that are temporarily shipped to a warehouse in Ohio before distribution. Another turns how to calculate food services company Aramark Corp.'s gross receipts when it alleges an agency relationship with its customers.

Ignoring Their Regulations

Total Renal Care's case focuses on samples its clinics sent to DaVita facilities in Florida for analysis, as well as accounting, personnel, and IT services DaVita provided out of state for tax years 2012-2014. TRC paid the tax for those years then filed refund claims arguing not all of its services were performed in Ohio.

The commissioner defended her decision to deny the refund, arguing the lab work and administrative functions at issue aren't services but overhead costs, which aren't deductible under the CAT scheme. TRC only billed its patients for dialysis treatment, not for the broad range of administrative functions its parent company performed to support the service, she said.

"There's tremendous dispute there as to the definition of where the customer receives the benefit" and what service the taxpayer is providing, Lawrence said. "If the court is looking at the characterization of the receipts, that could be a ruling with broader implications."

TRC attorney's Paul Melniczak of Reed Smith LLP in Philadelphia said the company's main complaint is that the tax department is "ignoring their own regulations." Melniczak also represents Nine West and Aramark before the court.

The decision will affect other health-care companies, but more broadly it could decide whether the tax department can "promulgate a regulation and then pick and choose to apply it only when they see fit," he said. "The interesting question will be whether the court requires them to be consistent."

Warehouse Cases

The Nine West and VVF cases also involve how to source receipts to Ohio but in the context of tangible personal property shipped through the state. The CAT sources gross receipts from the sale of such property to the state if Ohio is where the property is "ultimately received after all transportation has been completed."

Nine West seeks a \$800,000 refund because it says more than 80% of the shoes it shipped through the Ohio distribution center were ultimately received by DSW stores outside the state. VVF is defending a board of tax appeals ruling partially granting a \$350,000 refund because shipping the products to Ohio was just one leg of a continuous delivery process.

The statute doesn't require companies to know the ultimate destination at the time of sale, which the board reinforced in both rulings, tax practitioner Debora McGraw of Zaino Hall & Farrin LLC in Columbus said. If the high court says taxpayers do have to know, "that could be a bad answer for some taxpayers shipping to an Ohio DC but a good answer for shipments to a non-Ohio DC," she said.

Any decision on the ultimate destination or the timing and sufficiency of shipping documentation required will affect a wide array of taxpayers as Ohio has a lot of distribution centers due to its central location, McGraw said.

Bailey Roesse of Dentons in Louisville, Ky. who filed an amicus brief on behalf of the Ohio Chamber of Commerce in the Nine West case, said the gray areas in the statutes and regulations highlight "the ongoing frustration of Ohio business taxpayers in ascertaining their liability for the CAT."

"For a tax like the CAT that is designed to tax the 'privilege' of doing business in Ohio as opposed to income earned in or sourced to the state, these cases illustrate the difficulty of properly sourcing receipts when a business is operating in interstate commerce and sells goods and services that may only have a slight Ohio connection," Roesse said.

"Notably, each of these cases also show the extreme lengths to which taxpayers must go to prove to the Department that receipts are properly sourced outside of Ohio," she said.

The taxpayers in the Nine West, VVF, and Aramark cases have requested that the full supreme court hear arguments rather than a master commissioner. The justices sometimes ask a master commissioner to handle arguments on complex legal issues including tax, but they still make the ultimate decision in those cases.

The case is Total Renal Care, Inc. v. Harris, Ohio, No. 2023-1056, argument 7/9/24 .

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