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IN THE COURT OF COMMON PLEAS
FRANKLIN COUNTY, OHIO

THE BUCKEYE INSTITUTE, ET AL.,	:	
	:	**CASE NO. 20CV-4301**
PLAINTIFFS,	:	
	:	
v.	:	**JUDGE WILLIAM WOODS**
	:	
MEGAN KILGORE, ET AL.,	:	
	:	
DEFENDANTS.	:	

REPLY MEMORANDUM OF DEFENDANT MEGAN KILGORE

I. Introduction[1]

The State of Ohio can determine its own state tax policy over its own residents. The United States Supreme Court has recognized this right of state sovereignty for over two hundred years -- "the states have full power to tax their own people and their own property." *Shaffer v. Carter*, 252 U.S. 37, 51 (1920), *citing McCulloch v. Maryland*, 4 Wheat 316.

The Ohio Supreme Court has likewise recognized that "[a] state's taxing jurisdiction may be exercised over all of a resident's income based upon the state's *in personam* jurisdiction over that person." *Corrigan v. Testa*, 149 Ohio St. 3d 18, 2016-Ohio-2805, 73 N.E.3d 381, ¶ 31 (2016). In exercising this right of state sovereignty, the Ohio Constitution grants rights to its municipalities to impose municipal taxes, subject to the Ohio General Assembly's authority to regulate how municipalities will levy and administer local income taxes. *Cincinnati Imaging Venture v. City of Cincinnati*, 116 Ohio App. 3d 1, 3-4, 686 N.E.2d 528 (1st Dist. 1996).

That is exactly the case here. The Ohio General Assembly, in enacting H.B. 197, exercised its sovereign powers over municipal taxation as it was permitted to do by the Ohio

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[1] Plaintiffs' Opposition was filed on September 9, 2020, a day late. Defendant Kilgore is filing a separate Motion to Strike, but in the event that motion is denied, submits this Reply Memorandum.

Constitution. The City of Columbus followed state law.

The Plaintiffs' Brief in Opposition to Defendant Kilgore's Motion to Dismiss ("Plaintiffs' Brief") appears to claim that state sovereignty does not apply to a state's regulation of taxes imposed on its own citizens by its own municipalities, and also claims that the City cites no authority for imposing tax "under the auspices of H.B. 197." Plaintiffs' Brief, p. 9. The Ohio courts have made clear that the State of Ohio has such sovereign rights, and H.B. 197 is the City's authority in this case.

Plaintiffs' Brief then proceeds to further obfuscate these basic precepts by trivializing principles of constitutional law in state taxation and ignoring the substantial body of law throughout the country on the taxation of service providers. Instead, the Plaintiffs take statements by Ohio courts out of context in order to misapply them to a fundamentally different set of facts.

II. The Plaintiffs' Brief relies almost entirely on its misapplication of *Hillenmeyer* and *Willacy*

The Plaintiffs' Brief references *Hillenmeyer v. Cleveland Bd. of Rev.*, 144 Ohio St.3d 165, 2015-Ohio-1623, twenty-nine times. In that case, the issue before the Court was the application of the terms of Cleveland's municipal tax to a resident of Illinois with his principal place of work in Illinois, and with his employer being an Illinois corporation without an office in Cleveland. *Hillenmeyer* did not address the constitutionality of an Ohio state statute governing municipal taxes, nor did it address the constitutionality of the Ohio General Assembly addressing the taxation of Ohio residents.

When there are issues of multi-state taxation, the exercise of rights of state sovereignty by one state must comply with the United States Constitution so as to not infringe on the rights of another state and its residents. That was the issue in *Hillenmeyer*, and that is not the issue here.

The Court in *Hillenmeyer,* in addressing the constitutionality of the City of Cleveland taxing an Illinois resident, referred to work performed within and outside of Cleveland, as would be natural to do. The Plaintiffs seize on that language in their effort to expand the holding beyond the facts at issue in that case and beyond established Due Process Clause case law.

The Plaintiffs fail to mention that the Court in *Hillenmeyer* recognized that the Due Process Clause analysis is a state level, not a municipal level, analysis:

> ***In guarding against extraterritorial taxation***, "[t]he Due Process Clause places two restrictions on ***a State's*** power to tax income generated by the activities ***of an interstate business***...The first is to require "'some definite link, some minimal connection, between ***a state*** and the person, property or transaction it seeks to tax.'"...The second restriction is that "the income attributed ***to the State*** for tax purposes must be rationally related to 'values connected ***with the taxing State***.'"... (citations omitted; emphasis added)

Hillenmeyer, ¶40 (emphasis added). The Court recognized that the Due Process Clause limitations apply to limit a state's power to tax ***inter***state business.[2] The extensive body of United States Supreme Court case law addressing the Due Process Clause applies to ***inter***state, not ***intra***state, state taxation. The Ohio Supreme Court could not, and clearly did not, expand the limitations of the Due Process Clause, limitations set by the United States Supreme Court, to restrict the State of Ohio's authority to tax its own citizens. Plaintiffs' claims to the contrary are clearly wrong.

The Plaintiffs' Brief then references *Willacy v. Cleveland Bd. of Income Tax Review*, 2020-Ohio-314, ¶ 19. *Willacy* addressed whether the City of Cleveland could tax income of a Florida resident from the exercise of stock options granted while working in Cleveland. Like *Hillenmeyer*, *Willacy* did not address the taxation of an Ohio resident, the constitutionality of an Ohio state statute, nor the State of Ohio's power to tax its own citizens. *Willacy* addressed

[2] The Court noted that its decision "corresponds with an analogous case construing and applying the state income tax. *Hume v. Limback*, 61 Ohio St.3d at 387, 575 N.E.2d 150." That case similarly dealt with the taxation of a non-resident of Ohio.

whether income from stock options was earned by the employee at the time her Cleveland employer granted the stock options to her while the employee's principal place of work was in Cleveland, or later when she exercised those options while living in Florida.

Plaintiffs claim it is "telling" that the Ohio Supreme Court did not "loosen" its Due Process requirements post-*Wayfair*, but of course there was no reason for the Court to do so. The Court recognized that there was no Due Process Clause violation in *Willacy* – the issue in that case was determining at what point in time the employee had earned the stock option income. Because the Court found that the employee had earned the income while physically present in Cleveland, there was no reason for the Court to expound upon the United States Supreme Court precedent upholding the principle that the Due Process Clause does not require a physical presence. It is not telling that the Court did not engage in an unnecessary discussion. *Hillenmeyer* and *Willacy*, which Plaintiffs cling to so desperately, do not support the Plaintiffs' claims.

Simply put, the statements from *Hillenmeyer* and *Willacy* upon which Plaintiffs rely are taken out of context and at best dicta, as Plaintiffs ignore the fact that those cases addressed interstate rather than intrastate taxation. Those cases also did not involve an emergency measure in the face of a global pandemic designed to address temporary disruptions to the workforce, nor did they involve a statute passed by the General Assembly designed to make the rules clear.

III. The Plaintiffs' Brief fails to properly apply existing Ohio law

Even before the enactment of H.B. 197, the Ohio General Assembly exercised its authority to manage municipal taxes among municipalities, creating the 20 Day Rule, the Small Employer Rule, and the 12 Day Rule. The Plaintiffs' Brief attempts to distinguish these rules by claiming they are only applicable to withholding obligations under R.C. 718.011. Plaintiffs' Brief, pp. 7-8. *But see*, R.C. 718.01(C)(16) (providing that income that is not subject to

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withholding under R.C. 718.011 is exempt); R.C. 718.01(C)(17)("Compensation to which division (C)(17) of this section applies shall be treated as earned or received at the individual's base of operation").

The Plaintiffs' Brief also incorrectly claims that the Ohio General Assembly's authority over municipal taxes is restricted to limiting those taxes, not expanding them, as Plaintiffs claim was done with H. B. 197. Plaintiffs' Brief, p. 10. Plaintiffs are wrong. Ohio courts have interpreted the Ohio Constitution to allow the General Assembly to regulate municipal taxation where necessary to police taxation among municipalities. *See*, *Cincinnati Imaging, supra.* Indeed, "a municipality may act extraterritorially where granted such authority by statute." *Time Warner Cable, Inc. v. City of Cincinnati*, 1st Dist. Hamilton No. C-190375, 2020-Ohio-4207, ¶17, and the cases cited therein. Moreover, H.B. 197 *does* limit municipalities' ability to tax, specifically the remote working municipality. Finally, Plaintiffs undermine their own claim in acknowledging that the General Assembly has authorized withholding on work done outside the municipality under the 20 Day Rule and the Small Business Rule.

The municipal tax is an annual tax, as these rules recognize. These rules are designed to manage the practical interaction among municipalities, as service providers do not statically stay in one place. As one example, a lawyer employed by a law firm in Columbus may work at a different location for weeks, days, or parts of days, whether trying a case, deposing a witness, negotiating a transaction, or counseling a client. The lawyer may work from home one day because he or she has a sick child. The scenarios are endless. The Plaintiffs do not explain if these temporary absences to escape tax are measured in six minute increments or some other way. Under Plaintiffs' views, all of these rules would violate the Due Process Clause unless each employee could obtain a tax refund for each moment the employee works outside the City.

IV. The Plaintiffs' Brief ignores state taxation of services throughout the United States and the rejection of a physical presence requirement

The issue of sourcing the taxation of services is not unique to the City of Columbus, nor to the State of Ohio. A majority of states impose a state income tax on the provision of services based on the location of the customers under market-based sourcing, regardless of where the services are performed.

Other states have also addressed the tax policy decision of taxing remote workers, with some taxing based on the location of the worker, and others taxing based on the location of the employer, and the courts have recognized that the latter approach does not violate the Due Process Clause. *See*, *Huckaby v. New York State Div. of Tax Appeals,*, 4 N.Y.3d 427 (2005) and *Zelinsky v. Tax App. Trib.*, 1 N.Y.3d 85 (N.Y. 2003), and the states listed in Defendant's Memorandum in Support, p. 11, fn.18. *See also*, State of Arkansas, Dept. of Finance and Admin., Legal Opinion No. 20200203. Even when challenges had been raised in other states, they related only to workers *in other states*, not within the same state, and even those challenges failed. Because of the inconsistencies *in tax policy* from state to state, there have been repeated efforts in Congress to force uniformity. The Plaintiffs claim actions by other states are "irrelevant", Plaintiffs' Brief, p. 14, but of course the United States Constitution applies equally to all states.

The Supreme Court, in rejecting the physical presence requirement for Commerce Clause purposes as well in *Wayfair*[3], discussed at length the changes in our economy which make a physical presence requirement a relic:

> Modern e-commerce does not align analytically with a test that relies on the sort of physical presence defined in *Quill*…The "dramatic technological and social changes" of our "increasingly interconnected economy" mean that buyers are "closer to most major retailers" than ever before "regardless of how close or far the nearest storefront."…Between targeted advertising and instant access to most consumers via any internet-enabled device, "a business may be present in a State

[3] *South Dakota v. Wayfair, Inc.*, 585 U.S. __, 2093, 138 S.Ct. 2080 (2018).

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> in a meaningful way without" that presence "being physical in the traditional sense of the term."...A virtual showroom can show far more inventory, in far more detail, and with greater opportunities for consumer and seller interaction than might be possible for local stores...This Court should not maintain a rule that ignores these substantial virtual connections to the State.

138 S.Ct. at 2095. The technological changes to the work environment, as Plaintiffs acknowledge in the Complaint and which are common knowledge, are equally compelling to illustrate the interconnectivity of employees and their employers whether the employee is working in his office, at home, at Starbucks, or somewhere else.

Ohio's commercial activities tax ("CAT") imposes tax based on the location of the customer, not the location of the service provider who may never be physically present in Ohio. Consistent with *Wayfair*, in upholding the CAT against a Due Process Clause challenge, the Tenth District Court of Appeals recognized that "[i]t is well settled that a business need not have a physical presence in a state to satisfy the demands of due process." *Greenscapes Home & Garden Products, Inc.*, 10th Dist. Franklin No. 17AP-593, 2019-Ohio-384, ¶38.

The Plaintiffs have no answer to any of that. Instead, the Plaintiffs' Brief concludes with the unsubstantiated and unexplained, if not hysterical, allegation that "[t]o uphold the City's position would lead to the risk of duplicative taxation, and chaos." To the contrary, H.B. 197, a state law, states that the work is deemed to occur at the employee's principal place of work, so it is only taxed once. There is no duplicative taxation. As to the drama of claiming H.B. 197 will lead to chaos, this law was designed to do the exact opposite, by preserving the status quo.

V. Conclusion

The Plaintiffs' Complaint is based on its misapplication of *Hillenmeyer*. The Due Process Clause does not infringe on a state's right to determine its own internal tax policy.

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Respectfully submitted,

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Counsel for Defendant Megan Kilgore, in her Official Capacity as Columbus City Auditor

CERTIFICATE OF SERVICE

I hereby certify that an exact copy of the foregoing REPLY MEMORANDUM OF DEFENDANT MEGAN KILGORE, IN HER OFFICIAL CAPACITY AS COLUMBUS CITY AUDITOR, IN SUPPORT OF HER MOTION TO DISMISS THE COMPLAINT FOR FAILURE TO STATE A CLAIM UNDER CIVIL RULE 12(B)(6), FILED AUGUST 25, 2020 was served by way of the Clerk's electronic filing system to those registered on September 16, 2020:

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