# Addendum

## Constitutionality of Proposed Ohio Amendment

Some concerns have been raised about whether the amendment to sections 308 and 310 of the Streamlined Sales and Use Tax Agreement (SSUTA) violate the Commerce Clause of the United States Constitution. The purpose of this document is to address those concerns.

Ohio levies state sales and use tax and permits counties and regional transit authorities to levy permissive (piggyback) sales and use taxes at varying rates. Under the Ohio sales tax, most sellers collect sales tax on an origin basis, that is, at the rate applicable at the seller's location. Out-of-state sellers with nexus and other out-of-state sellers that volunteer to collect Ohio tax does so at the rate applicable on a destination basis, or where the item is delivered to the consumer.

Originally, under Ohio use tax law, if an Ohio consumer purchased an item from an Ohio vendor and paid sales tax to the vendor, the purchaser would not owe use tax. This created a situation where a consumer making purchases in a high tax rate jurisdiction from an in-state seller located in a lower rate jurisdiction would pay less tax than if the purchaser bought the same item from an out-of-state seller. In *American Modulars Corp. v. Lindley* (1978), 54 Ohio St.2d 273, 376 N.E. 2d 575, the Ohio Supreme Court found this situation to be in violation of the United States Constitution as a discrimination against interstate commerce.

In response to the *American Modulars* case, the Ohio General Assembly modified the Ohio use tax statutes to apply the Ohio use tax to all sales made either in Ohio or from out-of-state. The sales tax paid effectively is now a credit against the use tax due. On an in-state sale, if a consumer purchases an item from an in-state vendor that collects sales tax at a lower rate than the rate that applies in the jurisdiction where the consumer uses the item, the consumer owes the difference between the two rates as a use tax. Thus, this eliminates the discrimination against the out-of-state seller.

In *Associated Industries of Missouri v. Lohmann* (1994), 511 U.S. 641, the United States Supreme Court found that a Missouri use tax provision establishing a flat tax rate discriminated against interstate commerce in localities where the flat rate exceeded the local sales tax rate. Under the Missouri system, the state levied a sales tax and allowed localities to levy an additional sales tax. However, for the use tax, the state levied its state rate and a flat 1.5% additional use tax on all items purchased from outside the state. This additional tax was in lieu of local use taxes. Therefore, purchasers in those jurisdictions where the local sales tax rate was lower than the statewide flat additional use tax rate, would be required to pay a higher tax on an interstate sale than on a sale from a local vendor.

This is unlike the situation in Ohio where the use tax is structured to eliminate discrimination against interstate commerce. Interestingly, in its reply brief in *Associated Industries*, the petitioner acknowledged:

> … The 15 states listing in footnote 16 of our main brief have adopted complementary use tax schemes that have produced both the desired revenue and the desired protection of local businesses without crossing the bright line drawn in the sand by the Commerce Clause.

In the list of states in the referenced footnote, the petitioner included, among others, Ohio, Kansas and Tennessee. It is worth adding that Tennessee currently has a flat rate <u>option</u> for out-of-state sellers, which has never been challenged.

Under the Ohio proposal, a state could continue to tax intrastate sales on an origin basis if it so wished. However, if the state chose to do that, it would have to provide out-of-state sellers with the option to use a single statewide rate. Note that such a seller may choose to source its sales on a destination basis or to use the single statewide rate, whichever suits its business better. This is very similar to the Tennessee system as we understand it.

However, the Ohio proposal adds features to ensure that the interstate sale is not discriminated against. For sales where the out-of-state seller collects at the single statewide rate and that rate is equal to or lower than the rate in the purchaser's jurisdiction, the purchaser will owe no additional tax. If an out-of-state seller collects tax at a rate higher than the rate applicable in the purchaser's jurisdiction, the purchaser will have the opportunity to obtain a refund for the difference.

For an in-state purchase where the rate in the seller's jurisdiction is lower than the rate in the purchaser's jurisdiction, under Ohio law the purchaser would still owe the difference in the rates in use tax pursuant to the provisions inserted after the *American Modulars* case noted above. However, if the in-state seller collecting tax on an origin basis collects tax at a higher rate than that applicable in the purchaser's jurisdiction there is no refund of the difference.

Thus, for an in-state sale, the in-state purchaser will be liable for tax at a rate no less than, but possibly more than, the rate in the purchaser's jurisdiction. For an interstate sale, the rate in the purchaser's jurisdiction will be the maximum the purchaser will be liable for. (In the latter case, the maximum rate will, in some cases, be enforced by the consumer seeking a refund.) Thus, if there is any discrimination, it will fall on sales of the in-state seller operating out of a high rate jurisdiction. To the extent this happens, discrimination against in-state sellers does not violate the Commerce Clause of the United States Constitution.

An argument may be raised that the possible discriminatory effect against some in-state sellers would violate the Equal Protection Clause of the United States Constitution. The United States Supreme Court addressed this issue in *Allied Stores of Ohio, Inc. v. Bowers* (1959), 358 U.S. 522. The Court said that, to avoid an equal protection claim against a taxing statute, the state had to show a "rational basis" for the different treatment and that such treatment is not "palpably arbitrary." The basis for this proposal is to continue to allow most in-state sellers to collect at a single origin-based rate and not have to adopt the complexity of collecting at multiple destination-based rates, while providing simplification for out-of-state sellers in the hope of increasing the collection of use tax on interstate transactions.

In summary, it appears that objections to the Ohio proposal under the Commerce Clause of the United States Constitution can be overcome. Of course, this document does not address any objections that might arise out of the provisions of any state's own constitution. Each state will have to address such matters individually.