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Court of Common Pleas

MOTION TO DISMISS
June 11, 2021 11:24

By: DIANE M. MENASHE 0070305

Confirmation Nbr. 2275126

DR. MANAL MORSY

vs.

SHARON DUMAS, ET AL.

CV 21 946057

Judge: MICHAEL P. SHAUGHNESSY

Pages Filed: 25

IN THE COURT OF COMMON PLEAS
CUYAHOGA COUNTY, OHIO

DR. MANAL MORSY, Plaintiff, vs. SHARON DUMAS, in her official capacity as Finance Director of the City of Cleveland, et al., Defendants.	)	CASE NO: CV21-946057 JUDGE: Michael P. Shaughnessy

MOTION OF DEFENDANT SHARON DUMAS, IN HER OFFICIAL CAPACITY AS FINANCE DIRECTOR OF THE CITY OF CLEVELAND, TO DISMISS THE COMPLAINT

Now comes Defendant Sharon Dumas, in her official capacity as Finance Director of the City of Cleveland, and moves, pursuant to Civ. R. 12(B)(6), to dismiss the claims asserted against her in the Complaint with prejudice for failure to state a claim upon which relief can be granted. The grounds supporting this motion are set forth in the attached Memorandum in Support.

Respectfully submitted,

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MEMORANDUM IN SUPPORT

I. INTRODUCTION

The Ohio Constitution and Revised Code authorize cities to impose an income tax. Ohio Const., Section 13, Art. 18; Section 6, Art. 13; R.C. Chapter 718. Cleveland adopted an income tax and uses the revenue to provide essential government services, many of which are for the indigent and impoverished, the people who have suffered a disproportionate share of COVID-19's impact.

On March 9, 2020, Ohio Governor Mike DeWine signed an Executive Order declaring a state of emergency in Ohio to protect the well-being of Ohioans from the dangerous effects of COVID-19. (Complaint, ¶ 32). On March 27, 2020, the Governor signed into effect House Bill ("H.B.") 197, an emergency bill created by the General Assembly which, in part, provides clarity as to how the municipal taxation rules would apply during the pandemic in order to preserve the status quo and avoid undue compliance burdens and confusion. Relevant here, Section 29 of H.B. 197 ("Section 29") provides:

> Notwithstanding section 718.011 of the Revised Code, and for the purposes of Chapter 718 of the Revised Code, during the period of the emergency declared by Executive Order 2020-01D, issued March 9, 2020, and for thirty days after the conclusion of that period, any day on which an employee performs personal services at a location, including the employee's home, to which the employee is required to report for employment duties because of the declaration shall be deemed to be a day performing personal services at the employee's principal place of work.

The municipal tax is an "annual income tax" imposed based on the "principal place of work" of the employee during that tax year. "Principal place of work" is where the employee is required to report for employment duties "on a regular and ordinary basis." R.C. 718.011(T);

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718.011(A)(7); 718.04(A)(1).[1] An employee who works outside of their principal place of work for twenty or fewer days in a calendar year is deemed to still be working at the employee's principal place of work, subject only to specified exceptions (the "20 Day Rule"). R.C. 718.011(D).[2]

Section 29 extends the existing concept of the 20 Day Rule, limiting the administrative burdens and uncertainties for both municipalities and businesses suffered as a result of the pandemic. Specifically, Section 29 avoids employers having to suddenly – and temporarily – determine the following: 1) all locations where its employees are temporarily working remotely on a given day, 2) whether or not such locations impose a tax (and if so, at what rate and terms), and 3) how to reconcile its withholding, remittance and filing obligations with the 20 Day Rule and the Small Employer Rule (discussed below). Finally, it prevents employers having to register and remit tax to each of those jurisdictions, at a time when both the public and private sectors are already facing an unprecedented, and unexpected, amount of hardship and uncertainty due to the coronavirus.[3]

H.B. 197 reflects a tax policy determination by the General Assembly to provide continuity and consistency in order to maintain the status quo given the expected temporary nature of this situation. That policy decision helps businesses as well as local government for

[1] R.C. 718 incorporates the Internal Revenue Code ("IRC") by reference, including the taxpayer's taxable year under the IRC.

[2] For example, an employee of a law firm might be at a client's location for a day or part of a day, at a deposition for one or more days, and in a trial for a longer period. Revised Code 718 also includes a "12 Day Rule" for work at a petroleum refinery. R.C. 718.011(G).

[3] These uncertainties were exacerbated by the unavoidable uncertainties created by the various categories in the March 22, 2020 Stay-at-Home Order issued by the Director of the Ohio Department of Health (Complaint, ¶ 33). The Order did not apply to "Essential Activities", "Essential Government Functions", "Essential Businesses and Operations", the Federal Government, "Minimum Basic Operations", and a variety of other exceptions, such as those living in unsafe environments and the homeless, who, in this case, remained in Cleveland to seek food and shelter provided by the City. Issues have arisen as to the interpretation and application of these categories. So what happens if an employer determines it is "essential" but one or more Cities disagree? Or the reverse? Or the Order is not followed? The confusion and risk of withholding and remitting to the wrong municipality would have been prevalent. Section 29 provides the needed clarity and simplicity.

compliance purposes and it allows the funding of essential government services in this time of heightened need for those suffering the greatest.

By this lawsuit, the Plaintiff seeks to avoid Cleveland income tax on income from her Cleveland employer while temporarily working from home, based on three claims. First, the Plaintiff claims that the General Assembly had no authority to enact Section 29 regulating municipal income taxes. Second, the Plaintiff claims the legislation violates the Due Process Clauses of the U.S. and Ohio Constitutions. Finally, she claims that the legislation violates the dormant Commerce Clause. None of these claims has merit.

II. ARGUMENT

A. Standard of Review Under Civ. R. 12 (B)(6)

Civ. R. 12(B)(6) permits a party to file a motion to dismiss a complaint for failure to state a claim for relief. A motion filed pursuant to Civ. R. 12(B)(6) tests the sufficiency of the complaint. *State ex rel. Horwitz v. Cuyahoga Cty. Court of Common Pleas, Probate Div.*, 65 Ohio St.3d 323, 325 (1992).

B. Standard of Review In Constitutional Challenges

"It is difficult to prove that a statute is unconstitutional. All statutes have a strong presumption of constitutionality." *Arbino v. Johnson & Johnson*, 116 Ohio St.3d 468, 473, 2007-Ohio-6948, 880 N.E.2d 420 ¶ 25 (2007). "Before a court may declare unconstitutional an enactment of the legislative branch, 'it must appear beyond a reasonable doubt that the legislation and constitutional provisions are clearly incompatible.'" *Id.*, quoting *State ex rel. Dickman v. Defenbacher*, 164 Ohio St. 142, 128 N.E.2d 59 (1955). To the extent Plaintiff is making a facial challenge to the statute, the Plaintiff must demonstrate that there are no set of circumstances in which the statute would be valid. *Id.* at ¶ 26. The same principle applies to

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municipal ordinances. *See State ex rel. Scott v. Cleveland*, 112 Ohio St.3d 324, 2006-Ohio-6573, ¶ 18 ("legislative enactments are presumed to be constitutional. Ordinances … are afforded the same presumption.").

Furthermore, the role of courts is not to evaluate the correctness of policy judgments made by the General Assembly. "The judiciary * * * does not appraise legislative choices. [A] court has nothing to do with the policy or wisdom of a statute." *State ex rel. Ohio Congress of Parents & Teachers v. State Bd. of Edn.*, 111 Ohio St.3d 568, 2006-Ohio-5512, ¶ 20 (internal quotations omitted).

These principles of deference to state legislatures are heightened with tax policy matters. "[I]n taxation, even more than in other fields, legislatures possess the greatest freedom in classification." *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547-8 (1983); *Riverside v. State*, 2d Dist. Montgomery No. 26840, 2016-Ohio-2881, ¶16 ("in structuring internal taxation schemes the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation."). Finally, the already deferential rational basis standard is "especially deferential in the context of classifications arising out of complex taxation law." *Park Corp. v. Brook Park*, 102 Ohio St.3d 166, 2004-Ohio-2237, ¶ 23. The "Constitution grants legislators, not courts, broad authority (within the bounds of rationality) to decide whom they wish to help with their tax laws and how much help those laws ought to provide." *Id.*, ¶ 35.

C. The Complaint Must Be Dismissed for Failure to Exhaust Administrative Remedies

Plaintiff alleges that she filed a tax refund request for 2020 on March 4, 2021 and that it was denied on an unspecified date. Complaint ¶ 11, 35, 36. She does not allege that she pursued any of the steps to appeal from that determination. Accordingly, she has failed to exhaust her

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administrative remedies by filing suit without waiting for the City to act on her refund request and to allow any appeals to conclude. R.C. 718.19 provides that a taxpayer may request a refund of taxes paid. R.C. 718.11 governs appeals of such decisions to the City's Board of Tax Review established under Cleveland City Code § 192.40, with further appeals governed by R.C. 5717.011. Plaintiff is effectively seeking an end run around the refund and appeal process established by the Revised Code. Her claim must therefore be dismissed for failure to exhaust administrative remedies. *See BP Comms. Alaska, Inc. v. Cent. Collection Agency*, 136 Ohio App.3d 807, 814-5 (8th Dist. 2000).

In *BP Comms.*, the 8th District held that the power to enjoin a tax is limited to cases which contest "the very power to lay the tax." The plaintiff in that case sought to enjoin the collection of tax from certain of its corporate affiliates which, it argued, had no tax nexus with Cleveland. It argued that application of Cleveland's tax ordinance to them would be unconstitutional. During the pendency of appeal proceedings from the tax assessment, the plaintiff brought the action for injunctive and declaratory relief. The court noted that there was no contention that Cleveland lacked the power to impose the tax – the only question was whether or not the affiliates in question were properly subjected to it. Because that issue was one that required factual development, the court held that exhaustion of administrative remedies was required.

BP Comms. is dispositive here. Plaintiff concedes that she was subject to the Cleveland tax in 2020 until she began working from home. By so doing, she concedes that Cleveland has the power to impose an income tax, both in general and as applied to her. She asserts that the circumstances regarding her asserted absence from the state of Ohio warrant a different outcome

after March 2020, but just as in *BP Comms,* her failure to exhaust her administrative remedies bars her claims here.

It is not enough that Plaintiff sought the requested refund. The Supreme Court has held that the exhaustion requirement extends to administrative appeals. *State ex rel. Teamsters Local Union 436 v. Cuyahoga County Bd. Of Commrs.*, 132 Ohio St.3d 47, 2012-Ohio-1861, ¶ 21-22 (noting that although some of the employees in question had filed a grievance, none had pursued an administrative appeal, and therefore had failed to exhaust their administrative remedies).[4]

D. The General Assembly Has the Authority to Establish Municipal Income Tax Allocation Classifications Among Ohio Municipal Corporations

Cleveland, like every municipal corporation in Ohio, has home rule powers under the Home Rule Amendment to the Ohio Constitution. Ohio Const., Sections 3 and 7, Art.18. Included in those powers is the power to impose municipal taxes, subject to the limits and the control of the General Assembly. *See*, Section 13, Art. 18; Section 6, Art. 13; *City of Athens v. McClain*, 163 Ohio St.3d 61, 2020-Ohio-5146.

Consistent with its authority, the General Assembly has, in Revised Code Chapter 718, passed regulation regarding municipal income taxes. Among other provisions, the General Assembly described what income can be subject to taxation (R.C. 718.01(B)) and described the rules for allocating income among multiple jurisdictions (R.C. 718.011). R.C. 718.011 includes the 20 Day Rule which, just like Section 29, authorizes the municipality in which the employee is required to report for employment duties "on a regular and ordinary" basis to retain the power

[4] It is worth noting that *Hillenmeyer*, cited extensively in the Complaint, came before the Supreme Court as part of an appeal process that went from the City's denial of his initial refund requests, through the Cleveland Board of Review, and the Board of Tax Appeals. 144 Ohio St.3d 165, ¶ 3.

to tax employees working elsewhere, while at the same time limiting the power of the municipality in which the employee is working, by not allowing it to impose tax.[5]

Section 29 likewise allocates work across multiple jurisdictions, in this case for employees who have been displaced by the pandemic. Just like the 20 Day Rule and the Small Employer Rule, variations of which have been in Chapter 718 for decades, Section 29 authorized the employee's "regular and ordinary" principal place of work municipality to impose tax even if the employee was physically absent from that municipality during those days as a result of the Emergency Declaration. The Ohio courts have recognized the State's right to manage the interplay among different municipalities imposing tax, which is a commonsense practical necessity in order to avoid double taxation disputes among municipalities, and overall confusion, uncertainty, and undue burden. The Plaintiff's claim that the General Assembly lacked this authority has no merit.

In *Athens*, 163 Ohio St.3d 61, the Supreme Court considered the nature of the General Assembly's powers regarding municipal income taxation. The Court rejected arguments that "limitation" should be given a narrow construction. Rather, noting that the General Assembly had the power to broadly preempt municipal income taxes if it wished, the Court held that this necessarily included the lesser power to preempt any municipal income tax that did not comply with the requirements established by the General Assembly in Chapter 718. *Id.* ¶ 49. Thus, the requirements in R.C. 718.04 dictating that municipal tax ordinances contain various provisions are, the court held, valid acts of limitation, even though they require municipalities to enact various provisions. The Court held "that the General Assembly's authority to limit the power of municipalities to tax allows it to broadly preempt municipal income taxes and to require that

[5] Similarly, R.C. 718.011(E) allows small employers to withhold and remit employee municipal taxes based on the location of the employer, not the employee ("Small Employer Rule").

such taxes be imposed in strict accordance with the terms dictated by legislation passed by the General Assembly." *Id.* at ¶ 51. This included affirmative requirements as to what must be included in a municipal tax ordinance.

Under the *Athens* decision, a municipality that wishes to impose any municipal income tax must do so in "strict accordance" with Chapter 718 of the Revised Code, which the court held was a valid exercise of the General Assembly's power of limitation. *Id.*, ¶ 51. And in Section 29, the General Assembly dictated how to determine, "for purposes of Chapter 718," the principal place of work for employees working outside their regular place of employment because of the Governor's Emergency Declaration. In other words, Section 29 not only authorizes Cleveland to apply its tax to people working from home, Section 29 *compels* it to do so. If Cleveland decided to interpret "principal place of work" differently, it would be in conflict with Section 29 and Chapter 718. *Athens* dictates that Section 29 must prevail and completely eviscerates Plaintiff's argument that Section 29 is invalid because it expanded, rather than limited, municipal taxation.

E. The Plaintiff's Due Process Clause Claims Are Without Merit

Although Plaintiff asserts that she is a Pennsylvania resident, the Complaint discloses that, prior to the pandemic, she had both worked and resided in Cleveland 4-5 days per week and would travel to Pennsylvania for the weekends. Complaint, ¶ 10. In other words, prior to the pandemic, she had been living and working more in Cleveland than she had been in Pennsylvania. She also alleges that as a result of the pandemic, she began working at home in March 2020, Complaint, ¶ 11, and further that she has not been in Ohio since March 2020. *Id.*, ¶ 29-30.[6]

[6] Plaintiff asserts that "while working from home, Dr. Morsy has performed all of her duties from Blue Bell, Ohio." Complaint, ¶ 30. Defendant assumes that this is a typographical error.

Contrary to Plaintiff's claims, the Due Process Clause[7] is not offended when the Ohio General Assembly legislates regarding someone who had been living in Ohio 4-5 days per week as well as working full time in Ohio until the pandemic began, she was plainly subject to the authority of the Ohio General Assembly.

1. There Is No Due Process Violation When The Ohio General Assembly Sets Ohio Tax Policy For Workers Living And Working In Ohio

As the United States Supreme Court stated a century ago: "The rights of the several [s]tates to exercise the widest liberty with respect to the imposition of *internal* taxes always has been recognized in the decisions of this Court…the states have full power to tax their own people and their own property…." *Shaffer v. Carter*, 252 U.S. 37, 51 (1920). "The Due Process Clause allows a State to tax '*all* the income of its residents, even income earned outside the taxing jurisdiction.' *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 463 (1995)." *Comptroller of Treas. Of Md. v. Wynne*, 575 U.S. 542, 1798, (2015) (emphasis in original).[8]

Consistent with the foregoing, the courts of Ohio recognized long ago that the tax policy decisions of the Ohio legislature are purely a matter of state sovereignty, *State ex rel. City of Toledo v. Cooper*, 97 Ohio St. 86, 91, 119 N.E. 253 (1917), and the Ohio Supreme Court stated more recently 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). The state clearly has *in personam*

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[7] Although Plaintiff asserts claims under both the state and federal Constitutions, the Supreme Court of Ohio has equated the Ohio Due Course of Law Clause, Article 1, Section 16, with the Due Process Clause of the Fourteenth Amendment to the United States Constitution. *Willacy v. Cleveland Bd. Of Income Tax Review*, 159 Ohio St.3d 383, 2020-Ohio-314, ¶ 19.

[8] *See also*, *Quill*, 504 U.S. 298, 305 (1992); *Chickasaw Nation*, 515 U.S. 450, 463, *quoting New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312-13 (1937) ("That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protections of its laws are inseparable from responsibility for sharing the costs of government…These are rights and privileges which attach to domicil within the State.").

jurisdiction over the Plaintiff, who alleges that she works for a Cleveland-based employer and worked and resided four to five days a week in Cleveland prior to the pandemic. As such, the General Assembly's resolution of the "work from home" issue during the pendency of the pandemic with respect to the Plaintiff is entirely consistent with due process.

Ohio courts have rejected Due Process Clause challenges to Ohio's right to tax nonresidents of Ohio for income tax[9] and gross receipts tax purposes where the rational relationship test is satisfied.[10] Ohio courts have applied the Due Process Clause when municipalities have inappropriately and without authority from the Constitution or a state statute taxed nonresidents of Ohio,[11] and where a city, unauthorized by state statute, imposed tax on work outside the city by workers whose base of employment was outside the city.[12] None of these cases are factually similar to the instant case. None involve a state statute directing, or the city's action over residents of Ohio, employees whose principal place of work was in the city, or the State's need to respond to the burdens and hardships caused by a pandemic.

Just a few months ago, the First District Court of Appeals ruled that it was permissible for a city's income tax ordinance to apply outside its borders if authorized by state law. In *Time Warner Cable, Inc. v. City of Cincinnati*, 1st Dist. Hamilton No. C-190375, 2020-Ohio-4207, 157 N.E.3d 941, the court considered whether the City could require the filing of a consolidated tax return that only included affiliated entities doing business within the City, or whether the taxpayer could file a consolidated return that included entities not doing business in Cincinnati.

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[9] *Couchot v. State Lottery Comm'n*, 74 Ohio St.3d 417, 659 N.E.2d 1225, 1996-Ohio-262 (nonresident of Ohio subject to tax in Ohio on lottery winnings paid by Ohio Lottery Commission).
[10] *Greenscapes, Home and Garden Products, Inc. v. Testa*, 10th Dist. Franklin No. 17AP-593, 2019-Ohio-384.
[11] *See, Hillenmeyer v. Cleveland Bd. Of Rev.*, 144 Ohio St.3d 165, 2015-Ohio-1623.
[12] *Toliver v. City of Middletown*; Butler App. No. CA99-08-147, 2000 WL 895261, at *5 (June 30, 2000); *Miley v. Cambridge*, 5th Dist. Guernsey No. 96 CA 44, 1997 Ohio App. LEXIS 32435 (June 25, 1997) (unpublished). Both cases predate *Wayfair*, fail to apply *Quill* and the current minimum contacts and rationally related tests for Due Process, and neither is precedent in the First District. In addition, they predate the adoption of current R.C. 718.04 in 2014 as part of H.B. 5.

The court held that former R.C. 718.06 required the City to permit Time Warner to include other affiliates in its consolidated tax filing, and that, to the extent that this resulted in Cincinnati's income tax ordinance having extraterritorial application, this presented no issue. In the course of its ruling, the court rejected the City's argument that former R.C. 718.06 would have impermissibly forced it to apply its taxing powers extraterritorially. *Id.*, ¶ 17 ("a municipality may act extraterritorially where granted such authority by statute…the statute requires the City to accept a consolidated filing from an affiliated group that filed as such for federal purposes, negating any concerns that the City might transgress the limits of its authority.").

Here, assuming that Plaintiff is correct that Section 29 results in the extraterritorial application of Cleveland's income tax, that treatment is permitted (indeed, it is required, given that Cleveland's tax ordinance cannot conflict with Chapter 718) by Section 29. Since the General Assembly may, by statute, authorize extraterritorial application of municipal tax ordinances, and it has done so here, there is no issue when her work from home due to the Governor's Emergency Declaration is subjected to the Cleveland income tax.

Simply put, the Due Process Clause does not limit the ability of the State of Ohio to determine tax policy for its municipalities concerning those who live and work in Ohio.

2. Physical presence is not required under the Due Process Clause

Given that this is an intrastate tax matter subject to the plenary authority of the Ohio General Assembly, that should end the matter. But even if it did not, the underlying legal premise of the Complaint is that the Due Process Clause forbids imposing tax on an individual if that individual is not physically performing the work in the taxing jurisdiction. The United States Supreme Court has repeatedly and explicitly rejected the Plaintiff's contention. As most recently stated in *South Dakota v. Wayfair, Inc.*, 585 U.S. __, 138 S.Ct. 2080, 2093 (2018):

> It is settled law that a business need not have a physical presence in a State to satisfy the demands of due process. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985). Although physical presence "'frequently will enhance'" a business' connection with a State, "'it is an inescapable fact of modern commercial life that a substantial amount of business is transacted...[with no] need for physical presence within a State in which business is conducted.'" *Quill*, 504 U.S., at 308. *Quill* itself recognized that '[t]he requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State. [13]

The Court in *Wayfair* overruled the physical presence requirement even for Commerce Clause purposes, as it characterized it as "flawed", "arbitrary', "formalistic", "anachronistic", "artificial", "unfair", "unjust", "egregious", "harmful", "unsound", and "incorrect". Hellerstein and Hellerstein, STATE TAXATION, 3d ed., ¶ 6.03[3], S-6-14 (2020). Since *Quill*, the courts have repeatedly and consistently held that the Due Process Clause does not require a physical presence for state income tax purposes. *See*, *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 313 S.C. 15, 437 S.E.2d 13 (1993), *cert. denied*, 510 U.S. 992 (1993).[14]

It is also important to note that the due process challenges in both *Quill* and *Wayfair*, both of which failed, were stronger than the due process claim here because, in the sales tax context, the tax created allegedly undue compliance burdens, whereas Section 29 *alleviates* - rather than creates - compliance burdens.

The Plaintiff's premise that physical presence is required under the Due Process Clause is wrong and inherently flawed. Even after she began working at home, her work, although performed remotely, continued to be directed into Cleveland. Plaintiff does not allege that her job duties changed in any way. As such, her physical presence for the first part of 2020,

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[13] The Court in *Quill* details the history of the Due Process Clause, noting that it "centrally concerns the fundamental fairness of government activity." 504 U.S. at 312. *See, Coniston Corp. v. Village of Hoffman Estates*, 844 Fd. 461, 467 (7th Cir. 1988) (holding that the Due Process Clause only requires that State action not be "invidious or irrational").

[14] Since *Geoffrey*, there are numerous cases throughout the country with a similar holding. *See, e.g., MBNA America Bank v. Indiana Dep't of Revenue*, 895 N.E.2d 140 (Ind. Tax Ct. 2008), and the cases cited therein.

combined with her continued direction of her remote work into Cleveland, comfortably meets the requirements of the Due Process Clause.

3. The Plaintiff Is Clearly Subject to *In Personam* Jurisdiction in Cleveland

Plaintiff complains (Complaint, ¶ 47) that Section 29 "removes the well-established requirement" that a government entity must have *in personem* [sic] jurisdiction over a person before taxing them. With regard to Plaintiff, this assertion makes no sense because she is clearly subject to *in personam* jurisdiction in Cleveland with regard to matters arising out of her employment, because the income tax is based upon the entire year. Plaintiff herself admits that she was working in Cleveland from January through March of 2020 and further that she resided in Cleveland except on weekends when she would travel to Pennsylvania. (Complaint ¶10, 11, 29-31). Under any analysis of the minimum contacts rule, Plaintiff's presence in the City of Cleveland for employment purposes establishes that she has minimum contacts here.

Moreover, even after the pandemic started, Plaintiff's employment activities are directed into Cleveland. She may be working remotely, but she is delivering her work into Cleveland even if she is not physically present for work. While working remotely she is using facilities maintained by her employer. She does not allege that her job duties have changed during this period of remote work, nor does she allege that she does not intend to return to the office when the pandemic is over. The combination of her history of working and living in Cleveland, and her remote work that is directed towards Cleveland combine to establish that she purposefully availed herself of the privilege of working in Cleveland as to have established minimum contacts there. *Burger King*, 471 U.S. at 476 ("it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is

conducted. So long as a commercial actor's efforts are "purposefully directed" toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there."); *see also Wayfair*, 138 S.Ct. at 2093.

Cleveland's income tax, like all income taxes, are "period" taxes not "transactional" taxes, calculated over a calendar year. Income, deductions, and credits are all determined on an aggregate basis over the course of the entire tax year for federal, state and municipal income tax purposes. A taxpayer establishes income tax nexus in a state for that tax year if that taxpayer has sufficient contacts with the state during that year. The Ohio municipal income taxes, being annual taxes that follow the IRC and the federal tax year, are no different. R.C. 718.011(T); 718.011(A)(7); 718.04(A)(1).

In determining the fiscal relation between a taxpayer and taxing state under the Due Process Clause, the Supreme Court has applied a two-step analysis:

> [t]he Court applies a two-step analysis to decide if a state tax abides by the Due Process Clause. First,…there must be '"some definite link, some minimum connection, between *a state* and the person, property or transaction it seeks to tax."' *Quill*, 504 U.S., at 306. Second, 'the "income attributed *to the State* for tax purposes must be rationally related to the 'values connected with *the taxing State*.'"'

(Emphasis added.) *North Carolina Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, 588 U.S. __, 139 S.Ct. 2213, 2220 (2019); *see also, MeadWestvaco,* 553 U.S. at 24; *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992) and *South Dakota v. Wayfair, Inc.*, 585 U.S. __, 138 S.Ct. 2080 (2018).[15]

[15] Due Process challenges in state income tax cases have generally failed because the minimal connection and rationally related tests are so easily satisfied. *See, e.g., International Shoe v. Washington*, 326 U.S. 310 (1945); *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292 (1944); *Moorman Mfg. Co. v. Bair,* 437 U.S. 267 (1978); *Trinova Corp. v. Michigan Dept. of Treas.*, 498 U.S. 358 (1990); *Mobil Oil Corp. v. Comm'r*, 445 U.S. 425 (1980); and *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983). That is true even with all of these cases involving ***inter***state commerce.

Here, Plaintiff ***concedes*** that she *physically* worked and resided in Cleveland in 2020 (Complaint, ¶¶ 29-31). The Plaintiff had far more than any "minimal connection" the Due Process Clause would require in order to be subject to Cleveland's income tax for the 2020 calendar year. The fact that she worked extensively within Cleveland fatally undermines her contention that she was not subject to personal jurisdiction in Cleveland. Accordingly, as to the Plaintiff, Section 29 does not remove any requirement that Cleveland have *in personam* jurisdiction over her (Complaint, ¶ 41). Rather, the Complaint affirmatively establishes that Cleveland has *in personam* jurisdiction over her by virtue of the fact of her extensive physical presence in Cleveland. It further establishes that she has continued to maintain her contacts with Cleveland remotely during the pandemic. The rationally related test is similarly met and surpassed by a wide margin, as illustrated by those facts and by the General Assembly's action alleviating the burdens and hardships which would have otherwise been incurred during this pandemic, by the public and private sectors alike.[16]

Furthermore, there is no question that Cleveland's tax is rationally related to values connected with the taxing jurisdiction. This question asks whether the jurisdiction is receiving anything for which it may ask a return. And in 2020, the City provided services to Plaintiff and her employer while she was working and residing here before the Emergency Declaration. And even after she had pivoted to working remotely from home, the City continued to provide services through the protections it offered to her employer's offices and the infrastructure her

[16] *See, T. Ryan Legg Irrevocable Trust v. Testa*, 149 Ohio St.3d 376, 75 N.E.3d 184, 2016-Ohio-8418, ¶ 69 (with respect to an Ohio resident who was a grantor of a non-resident trust, the Ohio Supreme Court held that "his own contacts with Ohio and with the business *easily* justify the imposition of the tax on the trust from the standpoint of due process." (emphasis added)); *see also, Greenscapes Home & Garden Products, Inc.*, at ¶ 38, (recognizing that imposing the Ohio Commercial Activities Tax on a nonresident of Ohio on sales to customers in Ohio did not violate the Due Process Clause, as it "is well settled that a business need not have a physical presence in a state to satisfy the demands of due process.").

employer uses to allow Plaintiff to remotely connect to the resources she needs to do her job from Pennsylvania.

4. Taxation of remote workers by other States illustrate the fallacy in the Plaintiff's claim.

As a matter of tax policy, states may impose an income tax on employees based on the location of the employer ***or*** the location of the employee, with states on both sides of that tax policy decision *before* COVID-19[17], and courts have recognized that such an approach complies with the Due Process Clause. In *Huckaby v. New York State Div. of Tax Appeals*, 4 N.Y.3d 427, 829 N.E.2d 276 (2005), New York's highest court rejected a Due Process challenge and upheld the application of New York's state income tax to all wages earned by an individual who worked only part-time in New York during the tax year. The court noted that the State of New York provided a "host of tangible and intangible protections, benefits and values" to the taxpayer and her employer, and further noted that those benefits were provided every day, regardless of whether the employee was in New York on a given day.[18]

5. State level income taxes further demonstrate the fallacy in the Plaintiff's claims

States generally impose income tax on services on one of two bases: where the services are performed (known as "cost of performance" or "COP"), or where the benefit of the services are received (known as "market based sourcing" or "MBS").[19] Like the choice of where to tax an employee's services, this too is a tax policy choice by a state. In fact, the national trend is to

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[17] For examples of states imposing tax based on the location of the employer, *see,* 20 CRR-NY 132.18; *Telecommuter COVID-19 Employer and Employee FAQ, New Jersey Division of Taxation, last updated May 27, 2020; Telecommuting and Corporate Nexus, New Jersey Division of Taxation, March 30, 2020,* https://www.state.nj.us/treasury/taxation/covid19-payroll.shtml (Retrieved March 8, 2021); 61 Pa. Code § 109.8; 30 Del. C. § 1121; Neb. Admin. R. & Regs. Tit. 316, Ch. 22, § 003.01(C); 1423 Mass. Reg. 67; TIR 20-10, 830 CMR 62.5A 3; and Conn. Gen. Stat. Ann. § 12-711.

[18] *See also Zelinsky v. Tax App. Trib.*, 1 N.Y.3d 85 (N.Y. 2003) (no due process violation).

[19] For a discussion of COP and MBS, *see,* Bloomberg Tax & Accounting, 2020 Survey of State Tax Departments Executive Summary, pp. 18-21, full report 142-144.

tax on the basis of MBS, and a majority of states now tax on the basis of MBS[20], meaning that the services are taxable in the state in which the benefit of services are received, regardless of where the services are performed and regardless of whether the service provider has a physical presence in that taxing state. Taxing based on the location of an employer is consistent with MBS, and taxing based on the location of the employee is consistent with COP. There is no due process violation under either COP or MBS, just as there is no due process violation under either approach for Ohio municipal income tax purposes.

The Ohio commercial activity tax ("CAT") imposes a gross receipts tax on service providers. That tax is sourced to the location where the benefit of the service is received, much like MBS (and Section 29).[21] The Ohio courts have recognized that the CAT does not violate the Due Process clause. *See, e.g., Greenscapes Home & Garden Products, Inc.*, 10th Dist. Franklin No. 17AP-593, 2019-Ohio-384, 129 N.E.3d 1060, ¶ 41. The Court of Appeals in *Greenscapes* also 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." *Id.* at ¶ 38.

Finally, Ohio's statute is also consistent from a Due Process standpoint with federal law with respect to nonresidents' U.S. source income. The IRC imposes tax on nonresidents on "the amount received from sources within the United States". IRC 871(a), 881. Because the Internal Revenue Service may not have personal jurisdiction over the nonresident individual, the IRC imposes a withholding obligation on the United States payor. IRC 1441, 1442. Some states

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[20] Wolters Kluwer, *Market Based Sourcing and Beyond: Lookout for New State Tax Issues in the Corporate Tax World,* October 5, 2017, http://news.cchgroup.com/2017/10/05/corporate-state-income-tax-changes/featured-articles/ (Retrieved August 24, 2020); Kentucky H.B. 366; Indiana S.B. 563; Colorado H.B. 1185; and New Jersey Division of Taxation, (2018) *Changes to the New Jersey Corporation Business Tax*, 10 December. Available at https://www.state.nj.us/treasury/taxation/pdf/pubs/tb/tb84.pdf (Retrieved August 25, 2020).

[21] Ohio Department of Taxation, *Commercial Activity Tax (CAT) – General Information*, https://tax.ohio.gov/wps/portal/gov/tax/business/ohio-business-taxes/commercial-activities/cat-general-information (Retrieved August 24, 2020).

have adopted a similar withholding or reporting obligation based on the "source" of the payment to the nonresident being from the state.[22]

In this case, the Plaintiff performed services for her employer in Cleveland, and her employer receives the benefit of those services in Cleveland. The "source" of the payment was Cleveland. There is no constitutional difference between a State's ability to determine its state level income tax policy and impose a state income tax on services based on the location of the service recipient or the source of the income, and a State's ability to determine municipal level income tax policy based on the location of the service recipient.

F. Section 29 Does Not Violate The Dormant Commerce Clause

Although the Commerce Clause of the United States Constitution grants to Congress the power to regulate interstate commerce but says nothing about state regulation of interstate commerce, U.S. Const., Art. I, § 8, cl. 3, (1), *see Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. 542, 572-3 (2015) (dissenting opinions of Justices Scalia and Thomas), the U.S. Supreme Court has recognized a so-called negative Commerce Clause that can negate state and local regulations that have too great an impact on interstate commerce. Although the vast majority of cases where Section 29 applies involve Ohio residents who work in one Ohio city but live in another, Section 29 also applies here, where Plaintiff asserts she resides in Pennsylvania, though she asserts that she resided more in Ohio pre-pandemic than she did in Pennsylvania.

The Supreme Court has clarified that the Commerce Clause does not provide interstate commerce with complete immunity from taxation. Rather, so long as the tax "(1) is applied to an activity with a substantial nexus with the taxing State," (2) is "fairly apportioned," (3) "does not

[22] Cal. Rev. & Tax Code 18662; Ark. Code Ann. 26-51-811, 812. *See also,* Hellerstein, ¶ 6.02[3], 6-9, n.11; ¶ 6.04[2], 6-27.

discriminate against interstate commerce," and (4) "is fairly related to the services provided by the State," it will be upheld. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

The first requirement, "substantial nexus," is "closely related to the due process requirement that there be some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Wayfair*, 138 S. Ct. at 2093 (quotations and citations omitted). While that nexus, under Wayfair, need not include physical presence, physical presence certainly can create nexus. Here, Plaintiff worked in Cleveland full-time prior to the pandemic, and resided in Cleveland during the work week. Section 29 ensures that a taxpayer has substantial nexus with Cleveland because it only applies to employees whose principal place of work was in Cleveland prior to the pandemic. The employee's choice to work for a Cleveland employer—including, as required by Section 29, that their principal place of work was in Cleveland, creates a connection that is much more than minimal. *Cf. Wayfair*, 138 S. Ct. at 2092-96 (abrogating physical presence requirement for obligation to collect sales tax).

Second, the tax is "fairly apportioned," because it is both internally and externally consistent. *Okla. Tax Com'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185. The tax is internally consistent because, as required, it is structured so that if every state were to impose an identical tax, no multiple taxation would result. *Id.* Specifically, if every state used the employee's primary place of work as of the Emergency Declaration to determine the location of work for income tax purposes for those displaced by the pandemic, there would be no double taxation created. Plaintiff's complaint of double taxation[23] (one tax owed to the municipality of residence and another to the municipality where the work is deemed to have occurred), is mistaken. In Ohio, every city is permitted to tax income earned by its residents and by nonresidents who work

[23] The only double taxation here would be at the municipal level. Ohio and Pennsylvania have adopted a reciprocity agreement, meaning that a resident of one state that works in the other will only pay tax to their state of residence.

within that city. Ohio law permits, but does not require, the city of residence to grant full or partial credit for taxes paid to another city. As a result, if every state adopted Ohio's scheme, those who work in one city but live in another within Ohio, would be treated the same as those who work in an Ohio city but live in another state. What Plaintiff complains of here is also the law for Ohio residents who work in one Ohio city but live in another. This is the same whether or not the city of residence is within Ohio or not. The burden on interstate commerce is thus exactly the same as the burden on intrastate commerce.

The tax is also externally consistent because it is well within the "wide latitude" accorded to States to adopt different formulas for taxing the many activities that cross state lines and thus implicate "division-of income problems." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278-9 (1978). Amidst a crisis necessitating an abrupt transition to performing many activities remotely, temporarily continuing to tax income from activity that was performed in Cleveland for Cleveland employers in the immediate pre-pandemic period, that continues to be performed for those Cleveland employers during the pandemic either using remote means does not "reach[] beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Jefferson Lines*, 514 U.S. at 185. Nor is there any significant "risk of multiple taxation" that might suggest overreaching, because most states offer their residents credits against income taxes paid to other political subdivisions, as indeed Pennsylvania does here. *Goldberg v. Sweet*, 488 U.S. 252, 262-63 (1989) ("limited possibility of multiple taxation" was "not sufficient to invalidate" tax, and actual double taxation would be avoided by credits). Indeed, since Plaintiff's municipality of residence, which imposes a 1% income tax, offers a full credit against taxes paid elsewhere, no actual double taxation exists here at all. *See Moorman*, 437 U.S. at 280 (declining to strike down tax based on "speculative concerns with multiple taxation"). In this regard,

Plaintiff is better off than many Ohio residents who work in Cleveland but reside elsewhere in Ohio, because Ohio law permits, but does not require, the city of residence to grant a credit for income that is subject to taxation elsewhere. R.C. 718.04(D), and Pennsylvania law *requires* that its municipal taxes allow a credit for tax paid out of state. *See* Pa. Code § 6924.317(e) (allowing a credit against municipal income tax in Pennsylvania for any tax paid to the political subdivision of another state).

Section 29 also readily satisfies *Complete Auto's* third prong, which prohibits discrimination against interstate commerce. 430 U.S. at 279. Section 29 applies the same regardless of whether or not an employee lives in Ohio or elsewhere. If anything, it treats Ohio's residents less favorably, because whether or not they get a tax credit from their city of residence is left to the determination of the city of residence, whereas Pennsylvania requires its cities to grant a credit for taxes paid to other political subdivisions.

Fourth and finally, the tax is "fairly related to the services provided" by Cleveland. *Complete Auto*, 430 U.S. at 279. This inquiry is "closely connected" to the requirement of a substantial nexus between the taxpayer's activities and the taxing state, *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981), and simply further requires that "the measure of the tax be reasonably related to the taxpayer's presence or activities in the State," *Jefferson Lines*, 514 U.S. at 200. The General Assembly certainly could have rationally concluded that an employee whose principal place of work was in an Ohio city pre-pandemic and who continued to perform the same duties remotely as a result of the Emergency Declaration has a connection to that city, such that it is appropriate for that city's income tax to apply to that work.

Section 29 does not unreasonably burden interstate commerce and therefore does not violate the negative Commerce Clause.

III. CONCLUSION

States and their subdivisions act with maximum discretion and authority under the Due Process Clause during times of emergency. For example, in *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 426, 444 (1934), the court upheld against challenges under the Contracts and Due Process Clauses a mortgage moratorium bill that had been enacted in Minnesota during the Great Depression. The court recognized the emergency situation and the fact that Minnesota had enacted a temporary solution to it. Here, facing a pandemic unlike anything the world has seen in over a century, the General Assembly made a thoughtful and prudent (and temporary) determination to preserve the status quo for municipal taxes and avoid undue compliance burdens, minimize confusion and uncertainty, and avoid local government disagreements and budget shortfalls when funds were needed to help those out of work and suffering from this pandemic. For those fortunate enough to have their employment unaffected over the last year, this tax policy decision simply left them in the same municipal income tax position as if the pandemic had never occurred.

The Plaintiff has no due process claim for the myriad reasons set forth above. The Plaintiff's claim is one of tax policy, and the remedy for that lies at the State House, not this Court. As aptly stated by the Supreme Court of Ohio in *Willacy v. Cleveland Bd. Of Income Tax Review*, 159 Ohio St.3d 383, 2020-Ohio-314, ¶ 33, in upholding a city income tax upon a non-resident taxpayer who, years after retiring and moving to Florida, exercised stock options she had earned while working in Cleveland:

> There may be sensible policy arguments for preferring one of these tax schemes over the other. But that is not for this court to decide. And Willacy has pointed to no authority – and we can find none – that suggests that due process requires a jurisdiction to make one of these policy choices rather than the other. Indeed, courts in other jurisdictions have rejected arguments similar to those Willacy makes here.

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The Ohio General Assembly had the authority to make this tax policy determination, and that action did not violate the Due Process or Contracts Clauses. Nor did Cleveland's implementation of it. The Complaint must be dismissed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that an exact copy of the foregoing was served by email on June 11, 2021:

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