This Week in State Tax (TWIST)

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Ohio: State Supreme Court I: Financial institutions tax with inverted rate structure based on apportioned equity capital not unconstitutional

The Ohio Supreme Court recently upheld the state financial institutions tax (FIT) against a constitutional challenge to its regressive rate structure. The FIT is imposed on the equity holdings of a bank or other financial institution, apportioned based on gross receipts from its business activities in each state. The rate structure is regressive, with the marginal rate decreasing as a bank’s Ohio-apportioned equity capital increases. The taxpayer, a chartered federal savings bank, contended that this structure violated the dormant Commerce Clause of the U.S. Constitution and requested a refund of FIT paid in open years. The Tax Commissioner and the Board of Tax Appeals both demurred, each asserting that it lacked authority to consider constitutional claims. The taxpayer appealed to the Ohio Supreme Court.

Under U.S. Supreme Court dormant Commerce Clause jurisprudence, a state may not impose a tax that discriminates against interstate commerce. The taxpayer argued that the FIT failed the internal consistency test put forth in *Complete Auto Transit* because if every state imposed such a tax, as required by the test, a taxpayer conducting multistate operations would pay more tax in the aggregate than a person conducting the same amount of business concentrated within a single state. The Ohio high court upheld the constitutionality of the FIT rate structure, concluding that the FIT neither discriminates against interstate commerce nor results in double taxation. In the court’s view, because the FIT is imposed only on Ohio-apportioned equity capital, if every state applied the FIT structure, each state would tax only the portion of equity capital attributable to the bank’s business in that state. Thus, there is no double taxation. Moreover, the tax is imposed only on the bank’s total Ohio equity capital, regardless of whether the bank operates in interstate commerce or solely in one state. Thus, there is no unfair discrimination.

The court also rejected the taxpayer’s aggregation approach to the internal consistency test. The taxpayer argued that if all states employed a structure like that in Ohio, a company that operated in several states would pay more in the aggregate than it would if it operated solely in a single state. The court found that use of an aggregation approach was unsupported by U.S. Supreme Court precedent and would prohibit the use of an inverted or regressive rate structure which the U.S. Supreme Court had never done. The Ohio court noted that the U.S. Supreme Court had previously upheld flat business fees against internal consistency challenges, even though such fees necessarily result in higher aggregate payments than would be imposed if a taxpayer operated in only a single state, as well as tax policies designed to serve as “fair encouragement of in-state business,” which the court identified as the asserted purpose of the FIT rate structure.

Contact Brandon Erwine or Heidi Newton with questions about *Dollar Bank, FSB v. Harris*.

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