

Security Co. Disputes ADT Fee Sourcing In Ohio High Court

By **Paul Williams**

Law360 (April 28, 2020, 4:28 PM EDT) -- A security company that sells residential alarm service contracts to ADT told the Ohio Supreme Court on Tuesday that the contract fees shouldn't be sourced to Ohio for tax purposes because ADT receives the contract benefits at its out-of-state headquarters.

A state appeals court wrongly found that fees Defender Security Co. received from ADT for contracts with Ohio residents were sourced to Ohio and subject to the state's corporate activity tax, a Defender attorney, Richard B. Fry III of Buckingham Doolittle & Burroughs LLC, told the justices during oral arguments. The arguments were held via teleconference amid the COVID-19 pandemic.

Ohio **statute** employs destination-based sourcing for certain intangibles, which meant the contract fees should be sourced to ADT's Colorado offices, where Defender sent the contracts to ADT, Fry argued. He asked the justices to reverse the appellate court's decision denying Defender a \$77,418 corporate activity tax refund on the fees.

Appeals Court Judge Arlene Singer, who was assigned to the case in lieu of Justice Judith L. French, who was recused, asked whether the location of the Ohio homeowners who paid ADT for the monitoring services were irrelevant to the tax's situs.

Fry responded that the justices should disregard the residential addresses because a homeowner's payment to ADT for services was a separate transaction from the fees Defender received from ADT for the contracts.

"In this case, the purchaser is ADT, so you can't look through to the homeowner's benefit," Fry said. "The tax commissioner has focused on the protection of people and property in Ohio. However, that is not the benefit that ADT receives from Defender."

Fry added that ADT had no property in Ohio. He argued that ADT's benefit was the intangible right to contract with Ohio residents, and that it received that benefit in Colorado.

Defender markets ADT residential services and installs security equipment that ADT uses to perform its monitoring services, according to court documents. In determining that the fees were taxable, Fry said that the Ohio Department of Taxation incorrectly applied an origin-based sourcing method for the contracts.

But Ohio Deputy Solicitor General Michael Hendershot, arguing for the tax commissioner, said that a state **regulation** allows receipts from certain services, such as legal services or concert promotion services, to be sourced to Ohio even if an entity might be headquartered elsewhere.

"The intangible here ... which was a right that Defender created and then sold to ADT, is something that benefits ADT in Ohio because it is a contract right that gives ADT the right to charge Ohio consumers and to monitor real property in Ohio," Hendershot said.

Additionally, Hendershot said that the corporate activity tax's situs statute provides that certain intellectual property is sourced to where the intangible is used. In the present case, the fees ADT paid to Defender for the contract right should be sourced in the same manner, he said.

The contracts have "value to ADT in Ohio" and "should be treated in the same way as a sale of a copyright or trademark or something of that nature," he said.

Fry, however, contended that there wasn't a true parallel between the ADT contracts and the licensed use of a trademark because ADT didn't place the intangibles at a physical location in the state, as he said a purchaser would do with a licensed trademark for a brand-name store.

"The tax commissioner attempts to use this look-through approach, basically attributing the real property that's owned by the consumer to ADT, which is not appropriate in this case," he said.

In Defender's opening brief to the justices in September, the company said the proper situs of intangible contract rights for Ohio corporate activity tax purposes was an issue of first impression. On Tuesday, Fry said the department applied a "but for" test, which determined the fees were taxable because Defender could not have created the contract without the Ohio residents.

But if every state were to use the same "but for" approach, the fees in dispute would be subject to tax in multiple states, and a sweeping standard would be created that would tax revenue that is only tangentially associated with a state, Fry said.

"We need to step back and arrive at a more definitive and clear test," Fry said, reiterating that he believed the test should be based upon the contract purchasers' physical locations.

Defender is represented by Richard B. Fry III and Steven A. Dimengo of Buckingham Doolittle & Burroughs LLC.

Ohio Tax Commissioner Jeffrey McClain, who succeeded Joseph Testa, is represented by Attorney General Dave Yost, Benjamin M. Flowers, Michael J. Hendershot and Christine Mesriow of the Ohio Attorney General Office.

The case is Defender Security Company, dba Defender Direct v. Joseph W. Testa [Jeffrey A. McClain], Tax Commissioner of Ohio, case number 2019-0531, in the Supreme Court of Ohio.

--Editing by Robert Rudinger.