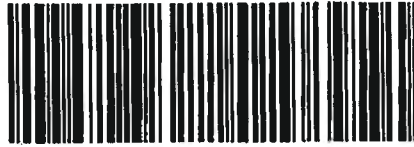




**Department of  
Taxation**

P.O. Box 182402  
Columbus, OH 43218-2402

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**For Your Reference**  
Letter ID: L0001685057  
Notice Date: April 3, 2024

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GARRY RAYANT AND KATHY FIELDS  
1902 GREEN ST  
SAN FRANCISCO CA 94123

Case ID: 360001

GARRY RAYANT AND KATHY FIELDS

Please find the Final Determination for your 2018 refund claim attached.



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## Final Determination

Date:

MAR 28 2024

Garry A. Rayant & Kathy A. Fields

1902 Green Street

San Francisco, CA 94123

Re: Refund Claim No. 0044350439

Individual Income Tax – 2018



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This is the final determination of the Tax Commissioner regarding the following individual income tax refund claim filed pursuant to R.C. 5747.11:

Tax Year	Refund Claimed
2018	\$719,492.00

### Background

Garry Rayant and Kathy Fields (the “claimants”) filed an amended 2018 Ohio individual income tax return (form “IT 1040”) and an application for Personal and School District Income Tax Refund (form “IT AR”) requesting a refund of \$719,492.00. The claimants’ original IT 1040 apportioned capital gains from the sale of Rodan and Fields (“the company”) to Ohio under R.C. 5747.212 when calculating their nonresident credit. The amended IT 1040 allocated the capital gain to California under R.C. 5747.20(A)(6), increasing their nonresident credit, and requesting the above refund. Upon review, the Department found that this income should be apportioned to Ohio under R.C. 5747.212 and adjusted the refund accordingly.<sup>1</sup> The claimants objected to the adjustment claiming that the income was not apportionable to Ohio. The

<sup>1</sup> The claimants were issued a refund of \$31,178.00 in April 2020 after the Department determined the capital gain income qualified for the business income deduction and the 3% flat rate applicable to business income.

claimants requested a hearing which was conducted by phone. This matter is now decided based upon the evidence available to the Commissioner.

The income at issue arose from the claimants selling 25% of their interest in the company. The company develops and sells skincare products throughout the country. The claimants do not dispute that the company conducts business in Ohio. Dr. Kathy Fields ("Dr. Fields") is a dermatologist who founded, developed products, and acted as a spokesperson for the company.

### Analysis

R.C. 5747.212 requires a taxpayer to apportion income from the sale of the equity interest, using the entity's apportionment ratio, if the taxpayer owns at least 20% of the entity at any time during the three-year period ending on the last day of the taxpayer's taxable year. R.C. 5747.212. The claimants acknowledge that the statute, as written, applies to their capital gain. Based on this applicability, they originally apportioned the capital gains using R.C. 5747.212.<sup>2</sup> However, the claimants now contend R.C. 5747.212 is unconstitutional as applied to them pursuant to *Corrigan v. Testa*, 149 Ohio St.3d 18, 73 N.E.3d 381 (2016).

It is well-established that the Tax Commissioner lacks jurisdiction to determine a statute's constitutionality. *Cleveland Gear Co. v. Limbach*, 35 Ohio St.3d 229, 231, 520 N.E.2d 188 (1988). Nevertheless, the legislative enactments of the Ohio General Assembly are entitled to a strong presumption of constitutionality. *N. Ohio Patrolmen's Benevolent Assn. v. Parma*, 61 Ohio St.2d 375, 377, 402 N.E.2d 519 (1980). The Ohio Supreme Court further adheres to the presumption the Tax Commissioner's application of state tax laws is constitutional. *See State ex rel. Ohio Congress of Parents & Teachers v. State Bd. of Edn.*, 111 Ohio St.3d 568, 2006-Ohio-5512, 857 N.E.2d 1148; *Swetland v. Kinney*, 69 Ohio St.2d 567, 433 N.E.2d 217 (1982). Additionally, while the Ohio Supreme Court did rule on R.C. 5747.212 in *Corrigan*, it found the statute unconstitutional *as applied* to Mr. Corrigan. *Corrigan* at ¶5. The Court did not hold

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<sup>2</sup> The claimants state on their 2018 amended IT 1040, Reason and Explanation of Corrections (form "IT RE") that they owned a combined total interest of 29.803402% in Rodan and Fields; however, in 2018, they sold 25% of their interest in the company.

that the statute was unconstitutional on its face; thus, the holding in *Corrigan* has no bearing on this matter. Therefore, R.C. 5747.212 is presumed constitutional and thus was properly applied to the claimants' capital gains, as reflected on their original return.

The claimants' facts are materially different from those in *Corrigan*. Mr. Corrigan was an investor who was not involved in the active management of his company. *Corrigan* at ¶8. In this case, Dr. Fields founded the company, developed products for the company, acted as a spokesperson for the company, and is featured prominently on the company's website.<sup>3</sup> See *T. Ryan Legg Irrevocable Tr. v. Testa*, 149 Ohio St.3d 376, 75 N.E.3d 184 (2016) (finding that the application of R.C. 5747.212 was constitutional when applied to a founder, manager and 50% owner of an entity who sold its interest as a nonresident). The claimants were also board members of the company prior to and after the sale<sup>4</sup> and received a substantial guaranteed payment from the company.<sup>5</sup> Additionally, in the claimants' refund claim, they acknowledge that Dr. Fields spent enough time with respect to Rodan and Fields to be considered an active rather than passive investors in the company.<sup>6</sup> Thus, the holding in *Corrigan* does not apply to the facts of this case.

Finally, even if R.C. 5747.212 is unconstitutional as applied to the claimants, the capital gain at issue is business income under R.C. 5747.01(B) and thus would be subject to apportionment under R.C. 5747.21(B). Ohio Substitute H.B. 515, signed into law on June 24,

<sup>3</sup> Rodan and Fields, Our Story, <https://www.rodanandfields.com/en-us/nx/our-story> (accessed January 29, 2024).

<sup>4</sup> See Letter from Rodan and Fields Chief Legal Officer, Marjorie Goux, Exhibit B.

<sup>5</sup> Information received from the Internal Revenue Service ("IRS") under authorization of IRC 6103(d), shows the claimants received \$229,864.00 of guaranteed payments in 2018 from Rodan and Fields through their grantor trust, Fields Family Living Trust.

<sup>6</sup> The claimants reported the income they received from Rodan and Fields on their 2018 Federal Schedule E as nonpassive income. The claimants also submitted their 2018 federal Net Investment Income Tax, Individuals, Estates, and Trust (federal form "8960") that reported the ordinary income or loss received from Rodan and Fields on 4a and then adjusted the income on line 4b, adjustment for income derived in the ordinary course of a non-section 1411 trade or business, since the income was nonpassive. The claimants also reported the capital gain from the sale of the company on line 5a and then adjusted the gain on line 5b as not subject to net investment income tax. IRC 1411(2) requires the income is subject to the Net Investment Income Tax if it is derived from a trade or business that is "a passive activity (within the meaning of section 469) with respect to the taxpayer \* \* \*."

2022, modified the definition of “business income” under R.C. 5747.01(B) to include the sale of an equity or ownership interest in a business.<sup>7</sup> The “sale of an equity or ownership interest in a business” means either (1) a sale treated for federal income tax purposes as an asset sale, *or* (2) a sale where the seller materially participated, as described in 26 C.F.R. 1.469-5T, in the business during the year of the sale or during any of the five preceding years. R.C. 5747.01(B)(1) and (2).

Here, the income at issue arose from the claimants selling 25% of their interest in the company in 2018. As previously mentioned, Dr. Fields founded, developed products, and acted as a spokesperson for the company. The claimants also received a substantial guaranteed payment from the company in 2018 and they acknowledge that Dr. Fields spends enough time with respect to Rodan and Fields to be considered an active investor in the company.<sup>8</sup> Thus, evidence available to the Commissioner indicates she materially participated in the company under 26 C.F.R. 1.469-5T during those years. Because Dr. Fields materially participated in the company, the capital gains from selling their ownership in the company are “business income” under R.C. 5747.01(B)(2) and are, therefore, subject to apportionment under R.C. 5747.21(B).<sup>9</sup>

Furthermore, Dr. Rayant also materially participated in the company based on his wife’s activities. *See* 26 C.F.R. 1.469-5T(f)(3) (participation in the activity by a person’s spouse is treated as participation by the person in the activity.). Because both claimants materially participated in Rodan and Fields, the capital gains from selling their ownership in the company are “business income” under R.C. 5747.01(B)(2), and thus are subject to apportionment under R.C. 5747.21(B).

## Conclusion

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<sup>7</sup> The changes apply to any audits, *refund applications*, petitions for reassessment, and appeals *pending on or after the Bill’s effective date* (September 23, 2022). The claimants’ appeals were pending before, on, and after that date.

<sup>8</sup> *See Supra*, fn. 5 and 6

<sup>9</sup> This analysis assumes that R.C. 5747.212 is unconstitutional as applied to the claimants. If R.C. 5747.212 is deemed constitutional, then this analysis is moot.

The income from the sale of an interest in the company is apportionable to Ohio under both R.C. 5747.212 and R.C. 5747.01(B). The claimants have not shown that R.C. 5747.212 is unconstitutional as applied to them. Additionally, the claimants materially participated in the company during the five years preceding the sale. Therefore, the income at issue is apportionable to Ohio under R.C. 5747.01(B).

Accordingly, the remaining refund amount is denied.

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.



I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE  
ENTRY RECORDED IN THE TAX COMMISSIONER'S JOURNAL

  
PATRICIA HARRIS  
TAX COMMISSIONER

/s/ Patricia Harris

Patricia Harris  
Tax Commissioner



Department of  
Taxation

Dear Taxpayer:

Enclosed is the Tax Commissioner's final determination regarding your case. The title is captioned either "Journal Entry" or "Final Determination."

You have the right to appeal this decision to the Board of Tax Appeals. Unlike appeals to the Tax Commissioner, proceedings before the Board of Tax Appeals are very formal, and the Board's procedures must be carefully followed. An appeal to the Board may be done in the following way:

- You have only **sixty (60) days** from the date you received this final determination to appeal.
- If you choose to appeal, you must send the Board of Tax Appeals your original notice of appeal and two copies, unless filed using an electronic method. A copy of the enclosed final determination should also be attached to each notice of appeal. Your notice of appeal must clearly state why you are appealing and include a request for the relief sought. The law requires you to describe carefully each error which you believe the Tax Commissioner made.
- You must also send the Tax Commissioner a copy of your notice of appeal and a copy of the enclosed final determination. The Tax Commissioner's copies may be mailed, delivered in person. There is no electronic option.
- The Board of Tax Appeals and the Tax Commissioner must each receive the notice of appeal and the copy of the final determination within sixty (60) days of your receipt of this final determination. In order to file your appeal on time, you must send the notices by certified mail, fax, authorized delivery service or electronic transmission and make sure that the recorded date is within sixty (60) days of your receipt of the enclosed final determination. Ordinary mail delivery is not considered received until each agency actually receives your notice of appeal. If the notice of appeal is filed by fax or electronic transmission, the date and time the notice is received by the board shall be the date and time reflected on a timestamp provided by the electronic system. Alternatively, you may personally deliver the notices before the sixty (60) days are up to be sure both agencies receive it within the sixty (60) day time limit. Appeals which are received late do not meet the requirements of the law and cannot be considered.

Ohio Revised Code Section 5717.02 is the section of the Code stating the requirements for a proper appeal to the Board of Tax Appeals. You must follow all of these mandatory requirements in order to appeal. If you don't, you may lose your right to appeal.

Send your appeal to the Tax Commissioner using one of the options listed below:

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**By Mail**

Ohio Department of Taxation  
Tax Commissioner's Office

4485 Northland Ridge Blvd  
Columbus, OH 43229-5404

The mailing address of the Board of Tax Appeals is:

30 East Broad Street  
24th Floor State Office Tower  
Columbus, OH 43215-3414



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