

## **2003 Franchise Tax Instructions – Full Text Version**

In our effort to serve Ohio taxpayers in a more cost-effective manner with limited resources the Department of Taxation has prepared two versions of the 2003 franchise tax instructions: (1) the abridged (paper) version, applicable for most taxpayers, and (2) this full text version. The abridged version was mailed to registered taxpayers (other than minimum fee taxpayers) along with the franchise tax form. This full text version is available only on the department's Web site.

If any of the preprinted information on the form (i.e., the corporation's legal name, Ohio license/charter number or federal employer identification number) is incorrect, please contact us with the correct information at any of the telephone numbers listed in the back of this booklet.

### **Recent Legislation and Significant Decisions from the Ohio Supreme Court and the Board of Tax Appeals**

#### **Legislation**

**Amended Substitute House Bill 405, 124<sup>th</sup> General Assembly, effective December 13, 2001.** This new law enacted several provisions:

- **Job retention credit.** The purpose of this new temporary nonrefundable credit is to encourage large Ohio manufacturers to retain jobs in Ohio. The credit applies to taxpayer-manufacturers that make a capital investment of at least \$200 million at a single Ohio project site during three consecutive calendar years in the period beginning January 1, 2002 and ending December 31, 2006. Credit applicants must apply to the Ohio Tax Credit Authority, and the Ohio Tax Credit Authority must approve the capital investment project. As a prerequisite, the taxpayer must employ an average of 1,000 full-time employees at the project site during each of the 12 months preceding application. In addition, the taxpayer must retain at least 1,000 full-time employees at the project site for the entire term of the credit agreement. The amount of the credit equals a percentage of the Ohio income tax withheld from the taxpayer's employees at the project site as set forth in the agreement between the taxpayer and the Ohio Tax Credit Authority; the credit percentage may not exceed 75%. The credit begins in tax year 2003 and is limited to a term of 10 years.

The job retention credit is administered by the Ohio Tax Credit Authority and the Ohio Department of Development. For additional information please contact the Ohio Department of Development's Office of Tax Incentives at

(614) 466-4551. See Ohio Revised Code (O.R.C.) Sections 5733.0610(B) and 122.171.

- **Net worth base exemption for high-tech start-up companies.** A corporation organized not more than three years before the March 31 unextended due date of each of the 2003, 2004, 2005, 2006 or 2007 franchise tax reports is not subject to the net worth base of the franchise tax or to the net worth base of the litter taxes if the corporation:
  - Conducted business during its entire taxable year as a *“qualified trade or business”* (defined below);
  - Uses more than 50% of its assets located in Ohio (based on net book value) solely to conduct activities that constitute a qualified trade or business; and
  - During the taxable year it is not a related member (as defined in O.R.C. Section 5733.042 and modified by O.R.C. Section 5733.06(C)(2)(d)) to another person treated as a corporation.

***“Qualified trade or business”*** means any trade or business that primarily involves research and development, technology transfer, biotechnology, information technology, or the application of new technology developed through research and development or acquired through technology transfer. If the corporation is engaged in a qualified trade or business and is exempt from the net worth base as a high-tech start-up company, please indicate such by checking the box on the front page of the franchise tax report. See O.R.C. Sections 5733.06(C) and 122.15.

- **Financial institutions.** This new law amended several franchise tax law provisions for financial institutions. Those changes apply to tax years 2002 and thereafter and were incorporated into the Web site version of the 2002 franchise tax instructions for financial institutions.

**Amended Substitute Senate Bill 144, 124<sup>th</sup> General Assembly, effective March 21, 2002.** This new law allows franchise taxpayers and individual income taxpayers to claim a nonrefundable credit equal to 50% of the amount of money that the taxpayer invests in O.R.C. Section 901.13 certified ethanol plants in the calendar year preceding the tax year (the investment period is the calendar year preceding the tax year regardless of whether the taxpayer's taxable year is a calendar year). The credit is limited to \$5,000 per taxpayer per certified ethanol plant regardless of the number of years in which the taxpayer makes such investments. The credit applies to tax years 2003 through 2013. Credits not used in the tax year following the calendar year in which the taxpayer makes the investment may be carried forward for three tax years. See O.R.C. Sections 5733.46, 5747.75 and 901.13.

**Amended Substitute Senate Bill 261, 124<sup>th</sup> General Assembly, effective June 5, 2002.** This new law enacted several franchise tax changes:

- **Bonus depreciation adjustment on the 2003 franchise tax report for taxpayers having a taxable year ending after June 4, 2002.** In determining Ohio taxable income a taxpayer that for federal income tax purposes claimed Internal Revenue Code (I.R.C.) Section 168(k) bonus depreciation and whose taxable year ended on or after the June 5, 2002 effective date of this new law must **add back 5/6 of its I.R.C. Section 168(k) bonus depreciation** amount. Then, **for each of the succeeding five tax years (2004 through 2008)** the taxpayer must **deduct 1/5 of the amount previously added back**. The department refers to this provision as the “**5/6 – 1/5 rule**.” The 5/6 – 1/5 rule also applies to assets acquired during taxable years ending in 2003 and 2004. The new law also covers depreciable assets that the taxpayer’ disregarded entity owns and depreciable assets that are owned by pass-through entities in which the taxpayer directly or indirectly owns at least 5%. See O.R.C. Section 5733.04(l)(17) and (18).

To the extent that the bonus depreciation add-back is attributable to property that generates allocable income or loss, the add-back and subsequent deductions are allocable in schedule C. To the extent that the add-back is attributable to property that generates apportionable income or loss, the add-back and subsequent deductions are apportionable. For apportionable deductions the apportionment ratio for the deduction year (not the add-back year) applies. The add-back and subsequent deductions have no effect on adjusted basis and thus have no effect on gain or loss. Furthermore, the taxpayer is entitled to the remaining 1/5 deductions even if the taxpayer disposes of the asset during the five taxable years following the taxable year for which the taxpayer makes the 5/6 add-back to income.

If the taxpayer is an equity investor in a pass-through entity that has claimed I.R.C. Section 168(k) bonus depreciation and if, because of the federal passive activity loss limitation rules or the at-risk limitation rules, the taxpayer is unable to fully deduct a loss passing through from the pass-through entity, then to the extent that the taxpayer does not recognize the loss the taxpayer can defer making the “5/6 add-back” until the taxable year or years for which the taxpayer deducts the pass-through entity loss and receives a federal tax benefit from the bonus depreciation amount claimed by the pass-through entity. Of course, the corporation cannot begin claiming the related deductions until the first taxable year immediately following the taxable year for which the corporation makes the 5/6 add-back.

- **Bonus depreciation adjustment for taxpayers having a taxable year ending after September 10, 2001 and before June 5, 2002.** If the taxpayer had a taxable year ending after September 10, 2001 and before June 5, 2002, and if in determining federal taxable income for that taxable year the taxpayer claimed I.R.C. Section 168(k) bonus depreciation on assets acquired after September 10, 2001, then in determining Ohio taxable income the taxpayer must apply one of the following options:

- **Option A – Elect to apply the 5/6 – 1/5 rule** to assets acquired during the taxable year ending after September 10, 2001 and before June 5, 2002. In determining Ohio taxable income a taxpayer that for federal income tax purposes claimed I.R.C. Section 168(k) bonus depreciation and had a **taxable year that ended after September 10, 2001 and before June 5, 2002** can elect to apply the 5/6 – 1/5 rule (see Section 4 of Amended Substitute Senate Bill 261, 124<sup>th</sup> General Assembly).

An election made for a taxable year that ended after September 9, 2001 and on or before December 31, 2001 affects the **2002** franchise tax report (the 5/6 add-back year) and the 2003 through 2007 franchise tax reports (the deduction years) and, as noted below, may require the filing of an amended 2002 franchise tax report. An election made for a taxable year that ended in 2002 before June 5, 2002 affects the **2003** franchise tax report (the 5/6 add-back year) and the 2004 through 2008 franchise tax reports (the deduction years).

A taxpayer can make the election for a taxable year ending before June 5, 2002 by making the adjustment on schedule B of the franchise tax report (or amended report) and writing in the margin “election to apply 5/6 – 1/5 rule” or by attaching a statement to that effect to the report.

- **Option B – Recompute federal depreciation expense** as it would have been without enactment of I.R.C Section 168(k). If the taxpayer: (a) had a taxable year that ended after September 9, 2001 and before June 5, 2002 for which it claimed I.R.C. Section 168(k) bonus depreciation and (b) for Ohio purposes does *not* elect to apply the 5/6 – 1/5 rule to that taxable year, then for franchise purposes the taxpayer must, **recompute its federal depreciation expense as it would have been without enactment of I.R.C. Section 168(k) and add to federal taxable income the difference between the taxpayer’s depreciation expense actually deducted for the taxable year and the recomputed depreciation expense.**

If the taxpayer had a taxable year that ended after September 10, 2001 and before January 1, 2002, then the option B recomputation must be reflected on the 2002 franchise tax report or an amended 2002 franchise

tax report. If the taxpayer had a taxable year that ended after December 31, 2001 and before June 5, 2002, then the recomputation must be reflected on the 2003 franchise tax report.

**Note:** With respect to assets acquired between September 11, 2001 and the last day of the taxpayer's taxable year ending prior to June 5, 2002, **the option B recomputation of depreciation expense applies only to the taxpayer's taxable year ending prior to June 5, 2002.** That is, if the taxpayer chooses option B, then with respect to assets that the taxpayer acquired between September 11, 2001 and the last day of the taxpayer's taxable year ending prior to June 5, 2002, the depreciation expense shown on the federal income tax return for all subsequent taxable years for those assets will also be the depreciation expense for Ohio tax purposes, and with respect to those assets the taxpayer may not make any further franchise tax depreciation adjustment in subsequent taxable years. **So, if the taxpayer chooses option B, then for Ohio tax purposes the taxpayer will not fully depreciate those assets acquired between September 11, 2001 and the last day of the taxpayer's taxable year ending prior to June 5, 2002.**

If federal taxable income as shown on the taxpayer's originally filed 2002 franchise tax report for the taxpayer's taxable year ending in 2001 reflects a deduction for I.R.C. Section 168(k) bonus depreciation and the franchise tax report does not reflect one of the above options, then the taxpayer must file an **amended 2002 franchise tax report**, which applies one of the options and the taxpayer must pay any additional tax, interest and penalty due. For additional information regarding the filing of an amended 2002 report, see note 2 on page 61.

- **Reason bonus depreciation does not apply to taxable year ending prior to June 5, 2002:** The new federal bonus depreciation law does not automatically apply to assets acquired in taxable years ending before the June 5, 2002 effective date of the new Ohio law. To do so without the consent of the Ohio General Assembly would be an unconstitutional delegation of legislative authority. The department's reasoning, based upon the Ohio Supreme Court's decision in *State v. Gill* (1992), 62 Ohio St. 3d 53, is as follows:
  - O.R.C. Section 5733.04 and O.R.C. Section 5747.01 both define the term "Internal Revenue Code" as used throughout Chapters 5733 and 5747 as meaning "the 'Internal Revenue Code of 1986,' 100 Stat. 2085, 26 U.S.C.A. 1, as amended."
  - In applying that definition for purposes of determining the federal taxable income starting point for Ohio purposes, each time the General Assembly amends O.R.C. Section 5733.04 (and in the case of Ohio

individual income tax each time the General Assembly amends O.R.C. Section 5747.01) the General Assembly adopts the I.R.C. as it exists on the date of enactment of the amendment and that version of the I.R.C. is used in determining Ohio taxable income until the next time the Ohio General Assembly amends O.R.C. Section 5733.04 (or 5747.01).

- Because the Ohio General Assembly did not amend O.R.C. Sections 5733.04 (or 5747.01) between the date that Congress enacted the “Job Creation and Worker’s Assistance Act” (which created the I.R.C. Section 168(k) bonus depreciation) and the Ohio General Assembly’s June 5, 2002 enactment of Amended Substitute Senate Bill 261, the bonus depreciation amount for taxable years ending before June 5, 2002 is allowable only to the extent permitted by the recently enacted Ohio law.
- Senate Bill 261 amended both O.R.C. Section 5733.04 and O.R.C. Section 5747.01 and thus adopted the current version of the I.R.C. for taxable years ending after June 4, 2002 – subject to adjustments to federal taxable income enacted by the bill.

See the following: (i) O.R.C. Section 5733.04(I)(17) and (18), (ii) Section 4 of Amended Substitute Senate Bill 261, 124<sup>th</sup> General Assembly, (iii) the department’s July, 2002 information release entitled, “Recently Enacted Ohio Legislation Affects Depreciation Deductions for Taxable Years Ending in 2001 and Thereafter”, (iv) the Department’s November, 2002 information release entitled “Ohio Bonus Depreciation Adjustment and the Internal Revenue Code’s Passive Activity Loss, Basis Limitation and At-Risk Rules” and (v) the instructions for schedule B, line 1(e).

- **Disregarded entity.** This new law defined the term “disregarded entity” and codified the department’s franchise tax policy and interpretation regarding disregarded entities. For purposes of Chapter 5733 the term “disregarded entity” means an entity that for its taxable year is by default, or has elected to be, disregarded as an entity separate from its owner pursuant to 26 C.F.R. 301.7701-3. For franchise tax purposes, a corporation’s ownership interest in a disregarded entity is treated as ownership of the assets and liabilities of the disregarded entity itself and a disregarded entity’s income, including gains or loss is included in the owner’s Chapter 5733 net income. Any sale or other disposition of an interest in a disregarded entity is treated as a sale or other disposition of the disregarded entity’s underlying assets or liabilities and the gain or loss from such sales are included in the corporation’s Chapter 5733 net income. A disregarded entity’s property, payroll and sales are included in the owner’s property, payroll and sales. If the disregarded entity has nexus

with Ohio, then the corporate owner has nexus with Ohio. See O.R.C. Section 5733.01(F) and 5745.01(D).

- **Disregarded entity and the pass-through entity tax.** This new law added the following provision to definitions applicable to the Ohio pass-through entity tax: “Distributive share’ includes the sum of the income, gain, expense, or loss of a disregarded entity” (see O.R.C. Section 5733.40(S)). The effect of this provision is that a disregarded entity single member limited liability company (LLC) is subject to the pass-through entity tax on the single member LLC’s income apportioned to Ohio if the LLC has nexus with Ohio and the corporate member does not file and pay the franchise tax and does not include in its income and apportionment data the income and apportionment data of the LLC. (That is, if a corporation whose only nexus with Ohio is through its ownership of a single member LLC that has Ohio nexus and if the corporation does not file and pay the franchise tax because the corporation claims that such nexus is insufficient to subject it to the franchise tax, then the LLC is subject to the pass-through entity tax on the LLC’s income apportioned to Ohio.)

Nevertheless, O.R.C. Section 5733.41 provides that the pass-through entity tax imposed by that section does not apply if all the members of the pass-through entity are taxpayers for purposes of O.R.C. Section 5733.04 without regard to O.R.C. Section 5733.09. **Accordingly, if the corporation files the required franchise tax report, pays the franchise tax, and does not claim that the corporation lacks nexus with Ohio, then the single member LLC is excepted from the pass-through entity tax.**

**Substitute Senate Bill 200 (Taxpayer Services II), 124<sup>th</sup> General Assembly**, effective September 6, 2002 enacted several new provisions:

- **Uniform application for refund procedure – O.R.C. 5703.70.** This new law codifies a uniform application for refund procedure applicable to franchise tax and various other taxes (but *not* individual income tax, school district income tax, withholding tax or pass-through entity tax). The procedure is as follows:
  1. If the commissioner determines that the amount of the refund to which the applicant is entitled is less than the amount that the applicant claimed, then the commissioner must notify the applicant in writing by ordinary mail of the disallowed portion claimed refund;
  2. The applicant has 60 days from the date the commissioner **mails** the notice to provide additional information and/or request a hearing;
  3. If within the 60-day period described in #2, above, the applicant neither requests a hearing nor provides additional information, the commissioner



will take no further action, and the amount denied becomes final (that is, the commissioner will not issue a final determination and the taxpayer may not appeal to the Board of Tax Appeals);

4. If within the 60-day period described in #2 above the applicant requests a hearing, the commissioner must assign a time and place for hearing. After the hearing, the commissioner may make such adjustments to the refund as the commissioner finds proper and must issue a final determination;
5. If within the 60-day period described in #2 above the applicant does not request a hearing but provides additional information, the commissioner will review the information, make such adjustments to the refund as the commissioner finds proper, and issue a final determination; and
6. The taxpayer may appeal the commissioner's final determination (see #4 and #5, above) to the Board of Tax Appeals pursuant to O.R.C. 5717.02.

Prior law did not specifically authorize a hearing before the tax commissioner upon the tax commissioner's denial of an application for refund in whole or in part. Nevertheless, the commissioner did allow such hearings.

- **Uniform Petition for Reassessment procedure** – O.R.C. Section 5703.60. This new law establishes a uniform Petition for Reassessment procedure and a uniform assessment correction procedure applicable to franchise tax, individual income tax, withholding tax, school district income tax and various other taxes. If the taxpayer has properly filed a franchise tax Petition for Reassessment, this new law permits the tax commissioner, upon receipt of additional information from the taxpayer, to correct an assessment without issuing a final determination and without a hearing. In addition, this new law permits the commissioner to correct an assessment even if the taxpayer has not filed a Petition for Reassessment or has not filed a proper Petition for Reassessment. A more in-depth summary of this new law begins on page 47.
- **Penalty for failure to pay by the date prescribed for payment**– O.R.C. Section 5733.28 and 5733.021(C). The new law provides that if a taxpayer fails to pay the amount of tax required by the date prescribed, the tax commissioner may impose a penalty not to exceed 15% of the delinquent payment (under prior law the O.R.C. Section 5733.28(A)(2) penalty for late payment could not exceed twice the interest charged under O.R.C. Section 5733.26(A)). Special rules apply to estimated payments (see below).
- **Penalty safe-harbor for estimated payments.** Substitute Senate Bill 200 (Taxpayer Services II), 124<sup>th</sup> General Assembly, effective September



6, 2002 enacted the following safe-harbor applicable to penalty on underpayment of estimated tax.

- With respect to estimated payments, the O.R.C. Section 5733.28(A)(2) failure to pay penalty applies to two periods: (1) “any period of delinquency ending prior to the first day of June of the tax year” and (2) “any period of delinquency commencing the first day of June of the tax year and concluding on the extended due date.” See O.R.C. Section 5733.021 as amended by Senate Bill 200.
- For purposes of determining the O.R.C. Section 5733.28(A)(2) failure to pay penalty for any period of delinquency ending prior to the first day of June of the tax year, the commissioner may charge penalty on the delinquent portion of the estimated tax and estimated tax means the lesser of 100% of last year’s tax or 90% of this year’s tax. See O.R.C. Section 5733.021(C)(1)(c).
- For purposes of determining the O.R.C. Section 5733.28(A)(2) failure to pay penalty for any period of delinquency commencing the first day of June of the tax year and concluding on the extended due date, the commissioner may charge penalty on the delinquent portion of the estimated tax and estimated tax means 90% of this year’s tax. See O.R.C. Section 5733.021(C)(2)(c).
- **Net operating loss carryforward.** For Ohio net operating losses incurred in taxable years beginning on or after August 6, 1997, the designated carryover period is 20 consecutive taxable years following the taxable year in which the net operating loss occurs.
- **Refund statute of limitations.** For purposes of the refund statute of limitations, payments made before the due date or extended due date for filing the report to which the payment relates are deemed to have been made on the due date or extended due date (see O.R.C. Section 5733.12 as amended by Substitute Senate Bill 200 (Taxpayer Services Bill II), 124<sup>th</sup> General Assembly, effective September 6, 2002). For addition information, please see general instruction #27.

**Substitute Senate Bill 226, 124<sup>th</sup> General Assembly**, effective September 17, 2002. This new law enacted several amendments to the Ohio lottery law (O.R.C. Chapter 3770). Generally, the new law permits the *transfer* of lottery prize installments upon prior approval of a court and establishes certain procedures for filing an application for approval of the transfer with the court.

A “*transfer*” means any form of sale, assignment, or redirection of payment of all or any part of a lottery prize award for consideration” (O.R.C. Section 3770.10(E)). A transfer agreement between the “transferor” (the prize winner) and the “transferee” (the purchaser of the winner’s right to future lottery pay-

ments) must contain a statement signed by the transferee irrevocably agreeing that the transferee corporation is subject to the franchise tax with respect to gain or income which the transferee will recognize as a result of the transfer. So, unless the transferee is exempt from franchise tax under O.R.C. Section 5733.09 or unless exempt from the net income base, a transferee having no nexus with Ohio other than as a party to the transfer agreement is subject to the franchise tax on the income that the transferee will recognize as a result of the transfer.

A transferee is required to withhold 3½% of the gross amount it pays to the transferor (that is, 3½% of the amount that the transferee pays to the winner as consideration for the future payments from the Ohio Lottery Commission), and the transferee is subject to the withholding filing and payment requirements set out in O.R.C. Section 5747.062(A)(2) to (4) (see O.R.C. Section 3770.072(C)). Also, the Ohio Lottery Commission is required to withhold 3½% from the amounts that it pays to the transferee and such withholding may be claimed as a refundable credit on the transferee's franchise tax report (see O.R.C. Section 3770.072(B), 5747.062(B)(2) and 5733.98(A)(27)).

In addition, for franchise tax purposes the new law requires the allocation to Ohio of "the amounts described in division (B)(5) of Section 5747.20 of the Revised Code" (see O.R.C. Section 5733.051(H) as enacted by this new law). Income described in O.R.C. Section 5747.20(B)(5) includes the following: (i) amounts paid by the Ohio Lottery Commission to the prize winner and (ii) a transferee's "earnings, profit, income and gain from the sale, exchange or other disposition of lottery prize awards" earned as a result of a transfer from a transferor/winner the right to receive the future installments of an Ohio lottery prize. Similar amounts from other states are allocable outside Ohio. Such income is allocable whether the income is nonbusiness or business income.

**House Bill 675, 124<sup>th</sup> General Assembly** effective December 13, 2002. This new law eliminated the interest safe-harbor (but not the penalty safe-harbor) enacted by Substitute Senate Bill 200, thus converting the interest due computation back to its pre-Senate Bill 200 calculation. Accordingly, interest is due on any underpayment of estimated tax for the period of the underpayment and without any safe-harbor (see O.R.C. Sections 5733.021 and 5733.26 as amended by HB 675).

In addition, H.B. 675 amended the pass-through entity tax (see O.R.C. Sections 5733.40 and 5733.401 as amended by H.B. 675). The amendments to the pass-through entity tax have been incorporated into the instructions to the pass-through entity tax.

### Ohio Supreme Court Decisions

***International Business Machines Corp. v. Zaino*** (2002), 94 Ohio St.3d 152. The Ohio Supreme Court held that the amount of the assessment that may be contested and refunded by filing a Petition for Reassessment is limited to the amount of the assessment that the taxpayer paid.

***Facts:***

- The tax commissioner timely assessed the taxpayer for tax year 1993 on the basis that the taxpayer failed to include certain reserves in its net worth base.
- The taxpayer objected to the assessment by timely filing a Petition for Reassessment. The basis for the taxpayer's objection was that the assessment should have been "offset" by the debit balance of the accrued tax accounts. Upon filing the petition, the taxpayer paid no portion of the assessment.
- In a letter to the tax commissioner dated October 15, 1998, the taxpayer asserted that the tax effect of the deferred tax debits not only negated the assessment in its entirety but also placed the taxpayer in an overpayment position with respect to amounts paid with the original report. The taxpayer made this assertion following the tax commissioner's hearing on the petition but before the date of the tax commissioner's final determination. The O.R.C. Section 5733.12 three-year refund statute of limitations period for taxpayer's 1993 franchise tax report had expired before taxpayer's October 15, 1998 letter.
- On January 22, 1999 the Board of Tax Appeals decided *USX v. Tracy*, BTA Nos. 92-H-1479, 92-H-1480 (1-22-99) and held that the debit balance of USX's deferred income tax account (that is, the excess of deferred tax benefits over deferred tax liability) is deductible from net worth as a negative reserve, thereby decreasing taxable net worth.
- Pursuant to the board's decision in *USX v. Tracy* the tax commissioner cancelled IBM's 1993 assessment by a Certificate of Final Determination dated April 29, 1999. The tax commissioner did not refund the claimed overpayment, and the tax commissioner's final determination did not comment upon IBM's assertion that it was entitled to a refund.
- The taxpayer timely appealed the tax commissioner's final determination to the Board of Tax Appeals.
- The Board of Tax Appeals upheld the Commissioner, and the taxpayer appealed to the Ohio Supreme Court.

***Argument and holding:***

The taxpayer argued that because it had mentioned “refund” in its October 15, 1998 letter, the taxpayer had converted the Petition for Reassessment into a timely filed application for refund. In rejecting that argument the court stated that the “additional objections” language in O.R.C. Section 5733.11 cannot be used to create a separate claim for refund in excess of the assessment. The court then held that where the tax commissioner has made an assessment under O.R.C. Section 5733.11, the amount of the assessment that may be contested and refunded under that statute is limited to the amount of the assessment that the taxpayer paid (in this instance the taxpayer paid no portion of the assessment). According to the court, no portion of the amount paid with the filing of the franchise tax returns is available for refund under the O.R.C. Section 5733.11 Petition for Reassessment statute because there is no provision within O.R.C. Section 5733.11 that grants the commissioner the authority to refund any amount greater than the amount that the taxpayer paid toward the assessment.

In contrast to the refund provision in O.R.C. Section 5733.11, which is limited to amounts paid on an assessment, the general refund provision in O.R.C. Section 5733.12 applies both to refunds of amounts paid with the franchise tax report and to refunds of amounts paid on an assessment. The court stated that in order to obtain a refund of any amount paid with its franchise tax report, IBM should have filed with the tax commissioner an application for refund within three years from the date of the illegal, erroneous or excessive payment of the tax. The court stated that the O.R.C. Section 5733.12 statutory requirements “go to the core of procedural efficiency and because IBM did not substantially comply, the Tax Commissioner had no jurisdiction to consider the refund sought.”

***Basic Distrib. Corp. v. Ohio Dept. of Taxation*** (2002), 94 Ohio St.3d 287. (Although this case is a sales tax case, it also applies to franchise tax and individual income tax.) The Ohio Supreme Court held that a taxpayer that claims that the Department of Taxation has violated the taxpayer’s O.R.C. Section 5703.54 “bill of rights” by frivolously disregarding a provision of O.R.C. Chapter 5711, 5733, 5739, 5741 or 5747, or a rule of the tax commissioner under those Chapters does not have to exhaust the administrative remedies set out in O.R.C. Chapter 5717 before bringing an action for damages pursuant to O.R.C. Section 5703.54.

The doctrine of exhaustion of administrative remedies requires a person to exhaust the statutory administrative remedies before seeking redress from the judicial system. The purpose of the doctrine of exhaustion of administrative remedies is to prevent the court’s premature interference with the administrative processes. The purpose of O.R.C. Section 5703.54 taxpayer bill of rights is to provide a remedy separate from the administrative appeal process, but only where the action taken by the department frivolously

disregards a statute or rule. Accordingly, if the complaint is in reality against the department's *interpretation* of a statute, then it is not actionable under the taxpayer bill of rights.

After considering each of the taxpayer's allegations, the court found that the taxpayer failed to prove that the Department of Taxation engaged in any frivolous conduct for which O.R.C. Section 5703.54 provides a remedy. Furthermore, the court stated that this case clearly presented issues that should have been addressed in an administrative appeal and did not rise to the level of frivolous disregard of any statute or rule. In fact, the court stated that it appears that the Department of Taxation went beyond its statutorily imposed duties in assisting Basic.

### **Board of Tax Appeals Decisions**

***A.H. Robins Company, Inc. v Tracy***, BTA No. 97-T-1215 (6-14-02). The Board of Tax Appeals held that the taxpayer, *new* A.H. Robins Company, did not succeed to the Ohio net operating losses of its successor corporation, *original* A.H. Robins Company (here referred to as Robins I) incurred during the period January 1, 1989 through December 15, 1989. The taxpayer appealed this decision to the Court of Appeals of Franklin County Ohio, Tenth Appellate Judicial District.

***Facts:***

- On July 26, 1988 the United States Bankruptcy Court confirmed the plan of reorganization of Robins I. In substance, the plan permitted American Home Products Corporation to acquire Robins I in exchange for funds that Robins I used to finance a trust that paid certain product liability claimants of Robins I.
- For the purpose of effectuating its acquisition of Robins I, American Home Products formed a wholly owned subsidiary, *new* A.H. Robins Company Inc. (here referred to as the taxpayer).
- On December 15, 1989, Robins I merged into the taxpayer in an I.R.C. Section 368(a)(1)(G) and 368(a)(2)(B) tax-free reorganization.
- Robins I filed a purported 1990 Ohio franchise tax report based on the period January 1, 1989 through the December 15, 1989 merger date. The purported franchise report reflected a \$52.8 million Ohio net operating loss (NOL) for the period January 1, 1989 through December 15, 1989.
- The taxpayer (that is, *new* A.H. Robins Company Inc.), having qualified to do business in Ohio, filed franchise tax reports for tax years 1990 through 1993 and on those reports claimed as a deduction an Ohio NOL carryforward from Robins I for the period January 1, 1989 through

December 15, 1989 and the Ohio NOL carryforwards for Robins I during earlier taxable years.

- Upon audit the department allowed the taxpayer's NOL deduction for the losses incurred by Robins I for the tax years in which Robins I was a taxpayer subject to the franchise tax (that is, for the taxable years ending in 1988 and earlier). However, the department disallowed the taxpayer's NOL deduction for the losses incurred by Robins I during the period January 1, 1989 through the December 15, 1989 merger date because Robins I was not a taxpayer for tax year 1990 and thus the period January 1 1989 to December 15, 1989 was not a taxable year for which an NOL was to be computed.

***Issue:***

Is the taxpayer entitled to a NOL deduction for the losses incurred by Robins I during the period January 1, 1989 through December 15, 1989?

***Statute (as it read for the years at issue):***

- A taxpayer can deduct from Ohio net income "any net operating loss incurred in any *taxable years* ending in 1971 or thereafter . . . This deduction shall. . . be carried over and allowed. . . until fully utilized in the next succeeding taxable year or years in which the taxpayer has net income, but in no case for more than the designated carryover period described in division (I)(1)(b) of this section."
- "Taxpayer" means a corporation subject to the tax imposed by this chapter." See O.R.C. Section 5733.04(B).
- "Taxable year" means the year or portion thereof upon the net income of which the value of the taxpayer's issued and outstanding shares of stock is determined or the year at the end of which the total value of the corporation is determined." See O.R.C. Section 5733.04(E).

***Arguments and holdings:***

- The taxpayer argued that the NOL at issue was transferred to the taxpayer under the authority of the bankruptcy court to effect the reorganization plan and that the tax commissioner's denial of the claimed deduction was an attempt to usurp the bankruptcy court's authority by nullifying the terms of the plan. The board agreed with the tax commissioner and found that the existence and extent of the taxpayer's interest in the NOLs of Robins I was one of state law, not federal bankruptcy law. The board stated that while the taxpayer did succeed to the Ohio NOLs of Robins I, the taxpayer acquired that right only to the extent that Robins I would have been able to use the losses.
- Alternatively, the taxpayer argued that the doctrine of res judicata prevents the tax commissioner from applying state law to deny the Ohio NOL

deduction. Again, the board agreed with the tax commissioner and held that res judicata and collateral estoppel do not apply because the bankruptcy court did not address the application of state law to the existence of the Ohio NOL.

- The board then proceeded to the issue of whether the taxpayer succeeded to the Ohio NOL reported by Robins I for the period January 1, 1989 to December 15, 1989. After examining the statute and applicable case law, the board agreed with the tax commissioner and held that the taxpayer did not succeed to the Ohio NOL of Robins I generated during the period January 1, 1989 to December 15, 1989 because Robins I did not have an Ohio NOL for that period to which the taxpayer could succeed and use. This was so, according to the board, because Robins I did not exist on January 1, 1990, and consequently the period January 1, 1989 through December 15, 1989 was not a *taxable year*.

The board based its finding on the above quoted statute and the decisions of the Ohio Supreme Court in *Gulf Oil Corp. v. Lindley* (1980), 61 Ohio St.2d 23, and *Litton Industrial Products, Inc. v. Limbach* (1991), 58 Ohio St.3d 169. In these cases the court held that the survivor corporation to a merger may take a deduction for the Ohio net operating loss carryover of the acquired corporation because it may do so under I.R.C. Section 381. *Gulf Oil Corp. v. Lindley* (1980), 61 Ohio St.2d 23, at paragraph one of the syllabus. Nevertheless, in both of these cases the court held that the survivor to a merger is not entitled to the net operating loss incurred by a nonsurvivor during the nonsurvivor's fiscal year ending in the merger year because the nonsurvivor did not incur the loss in a taxable year.

The board acknowledged that both of the above cases were decided before enactment of the O.R.C. Section 5733.053 transferor statute. Nevertheless, the board noted that the transferor statute, as it existed during the years here at issue, did not apply to the taxpayer because on January 1 before the December 15, 1989 merger of Robins I into the taxpayer the two corporations did not meet the ownership requirements for a combined report. (The case does not indicate the date on which American Home Products acquired Robins I, and the case does not indicate when American Home Products formed the taxpayer, but presumably these dates were after January 1, 1989.)

**Note: If current law were applied to the year at issue**, it appears that the transferor statute would apply to the taxpayer so that **the taxpayer would be entitled to deduct the net operating loss** of Robins I for the period January 1, 1989 to December 15, 1989 because (1) following the merger Robins I is not subject to the franchise tax, (2) the transfer qualifies for nonrecognition of gain or loss under the I.R.C. and (3) the requirement that the transferor and transferee meet the combined report ownership requirements on January 1 prior to the transfer has been deleted from the



law. See O.R.C. Section 5733.053 as amended by Amended Substitute Senate Bill 287, 123<sup>rd</sup> General Assembly and Amended Substitute House Bill 94 (Budget Bill), 124<sup>th</sup> General Assembly.

***The Dayton Country Club v. Zaino***, BTANo. 01-V-140 (7-26-02). The board of Tax Appeals held that the corporation was not exempt from the franchise tax as a not-for-profit corporation because as a corporation organized for-profit it possessed the capacity and authority to operate with a view for profit. The corporation's amendments to its original articles of incorporation which amendments precluded the distribution of dividends in order to gain exemption from federal income tax under I.R.C. Section 501(c)(7) fell short of changing the corporation's original for-profit status to not-for-profit. The board quoted from the decision of the Ohio Supreme Court in *Shaker Heights Country Club Co. v. Lindley* (1979), 58 Ohio St.2d 238 where the court stated that "[T]he character of a corporation, whether for profit or not for profit, is to be determined not by the manner of its actual operation, but rather by the authority it actually possessed and may exercise under its recorded Articles of Incorporation."

## **General Instructions and Information**

**Unless otherwise stated, all references are to the Ohio Revised Code (O.R.C.).**

**This instruction booklet applies to taxpayers other than financial institutions.** This instruction booklet does not apply to financial institutions because the apportionment ratio and net worth computation for financial institutions differ substantially from that of other corporations. The franchise tax instructions for financial institutions are contained in a separate instructions booklet. Financial institutions must file franchise tax form FT-1120-FI.

**This instruction booklet does apply to electric companies** and combined (electric) companies. Electric companies and combined companies are subject to the franchise tax for tax years 2002 and thereafter. Because electric companies and combined companies are subject to franchise tax deduction, add-back, apportionment, credit and tax computation provisions that do not apply to other franchise taxpayers, we have prepared supplemental schedules and instructions for electric companies and combined (electric companies). **The supplemental schedules and instructions are available on the department's Web site.**

The Ohio corporation franchise tax is an excise tax imposed on both domestic and foreign corporations for the privilege of doing business in Ohio, owning capital or property in Ohio, holding a charter or certificate of compliance authorizing the corporation to do business in Ohio, or otherwise having nexus

with Ohio during a calendar year. Unless an exemption applies (see general instruction #2), a corporation is subject to the franchise tax for each calendar year (tax year) that on the first day of January of that calendar year the corporation holds an Ohio charter, does business in Ohio, owns or uses a part or all of its capital or property in Ohio, holds a certificate of compliance authorizing the corporation to do business in Ohio, or otherwise has nexus with Ohio under the Constitution of the United States.

The calendar year in and for which the tax is paid is called the “tax year.” The tax year is also referred to as the “report year.” The franchise tax for tax year 2003 is paid for the privilege of doing business in Ohio during the calendar year 2003. The accounting period on which the tax is based is called the “taxable year” and is defined as “. . . a period ending on the date immediately preceding the date of commencement of the corporation’s annual accounting period that includes the first day of January of the tax year.” A taxable year may consist of an aggregation of more than one federal taxable year and can exceed one year in length. The franchise tax for tax year 2003 is based upon the taxpayer’s activity during its taxable year ending in 2002. (O.R.C. Sections 5733.031(A) and 5733.04(E)).

The franchise tax is levied on the value of a corporation’s issued and outstanding shares of stock. Generally a taxpayer corporation must determine the value of its issued and outstanding shares of stock under both the net income base and the net worth base and pay the tax on the base that produces the greater tax. However, different rules apply to financial institutions, qualifying holding companies and certain high-tech start-up companies:

- Financial institutions (see general instruction #1C) are not subject to the tax on the net income base but are subject to the tax on the net worth base at a higher rate than other taxpayers, and
- Qualifying holding companies and certain high-tech start-up companies are not subject to the tax on the net worth base but are subject to the tax on the net income base. See general instructions #20 and #22.

Although a corporation that dissolves its Ohio charter or surrenders its license to conduct business in Ohio during 2002 is not subject to the franchise tax for tax year 2003, such corporation may be subject to the “exit tax” (see general instruction #6 and O.R.C. Section 5733.06(H)) or the corporation’s income may be required to be included in the income of a transferee corporation (see O.R.C. Section 5733.053 and the instructions for schedule A, line 9).

## **1. WHO MUST FILE**

### **A. Corporations**

Unless an exemption applies (see general instruction #2), each for-profit

domestic corporation (a corporation organized for-profit under the laws of Ohio) and each Chapter 1729 corporation (agricultural cooperative) organized not-for-profit under the laws of Ohio is subject to the Ohio franchise tax. In addition, unless an exemption applies each foreign corporation (a corporation organized under the laws of another state, a possession or instrumentality of the United States, or a foreign country) organized for-profit, and each not-for-profit foreign agricultural cooperative organized or operating in the same or similar manner as a Chapter 1729 agricultural cooperative, for the privilege of doing business in Ohio, owning or using part or all of its capital or property in Ohio, holding a certificate of compliance with the laws of Ohio authorizing it to do business in Ohio, or otherwise having nexus with Ohio under the Constitution of the United States is subject to the franchise tax.

A corporation that is subject to the franchise tax must file an Ohio Corporation Franchise Tax Report. Financial institutions must file form FT-1120-FI; all other C corporations must file form FT-1120. Although S corporations (including S corporations that are financial institutions) and qualified subchapter S subsidiaries are generally not subject to the franchise tax, they must file a Notice of S Corporation Status, form FT-1120-S (see general instruction #2).

#### **B. Entity classification**

Any entity that is treated as a corporation for federal income tax purposes is also treated as a corporation for franchise tax purposes. Thus, if a business trust, partnership or LLC is treated as a corporation for federal income tax purposes, it also will be treated as a corporation for franchise tax purposes. (See the Income Tax Audit Division's Information Release entitled "I.R.S. 'Check-the-box' Entity Selection Regulations" dated August 19, 1997 (available on the department's Web site). Also see O.R.C. Section 5733.01 as amended by Amended Substitute House Bill 215, 122nd General Assembly and Section 222 of the Bill.)

**Any entity that is treated as a "disregarded entity" for federal income tax purposes is also treated as a disregarded entity for franchise tax purposes.** Accordingly, a single member LLC that is treated as a division of its corporate member for federal income tax purposes will be treated as a division of the corporation for franchise tax purposes. That is, for franchise tax purposes:

- If the disregarded entity has nexus with Ohio, then the owner has nexus with Ohio.
- An interest in a disregarded entity is treated as ownership of the assets and liabilities of the disregarded entity itself.

- A disregarded entity's income, including gain or loss, is included in the owner's O.R.C. Chapter 5733 net income.
- Any sale or other disposition of an interest in a disregarded entity is treated as a sale or other disposition of the disregarded entity's underlying assets or liabilities and the gain or loss from such sales are included in the owner's Chapter 5733 net income.
- A disregarded entity's property, payroll and sales are included in the owner's property, payroll and sales factor computations.

See O.R.C. Section 5733.01(F).

Nevertheless, a single member LLC is a pass-through entity as defined in O.R.C. Section 5733.04(O), and the corporate member is a qualifying investor whose distributive share includes the sum of the income, gain, expense or loss of a disregarded entity (see O.R.C. Section 5733.40(S)). So, a single member LLC with Ohio nexus is subject to the pass-through entity tax imposed by O.R.C. Section 5733.40 unless the corporate member files a franchise tax report and includes in its income the income and apportionment data of the LLC. (O.R.C. Section 5733.41 provides that the pass-through entity tax imposed by that section does not apply if all the members of the pass-through entity are taxpayers for purposes of O.R.C. Section 5733.04 without regard to O.R.C. Section 5733.09. **Accordingly, if the corporation files the required franchise tax report and does not claim that the corporation lacks nexus with Ohio, then the single member LLC is excepted from the pass-through entity tax.**) Regardless of whether or not the corporate single member complies and files a franchise tax report, the department maintains that if the LLC has nexus with Ohio, the corporate single member has nexus with Ohio, and the department will pursue and enforce that position against the corporation. See the amendments to O.R.C. Sections 5733.01 and 5733.40 as enacted by Amended Substitute Senate Bill 261, 124<sup>th</sup> General Assembly effective June 5, 2002 and the Department's July 3, 2002 information release entitled "Pass-through Entity Tax: Certain Estimated Tax Payments Due September 16, 2002."

See general instruction #2A for the treatment of qualified subchapter S subsidiaries.

### **C. Financial institutions**

A financial institution is not subject to the tax on the net income base but is subject to the tax on the net worth base at a higher rate than other taxpayers. Financial institutions must file form FT-1120-FI. The instructions for form FT-1120-FI are contained in a separate instructions booklet. O.R.C. Section 5725.01 defines a "financial institution" as any of the following:

- A national bank organized and existing as a national bank association pursuant to the “National Bank Act,” 12 U.S.C. 21;
- A federal savings association or federal savings bank that is chartered under 12 U.S.C. 1464;
- A bank, banking association, trust company, savings and loan association, savings bank, or other banking institution that is incorporated or organized under the laws of any state;
- Any corporation organized under 12 U.S.C. 611 to 631;
- Any agency or branch of a foreign depository as defined in 12 U.S.C. 3101;
- A company licensed as a small business investment company under the Small Business Investment Act of 1958, 72 Stat. 689, 15 U.S.C. 661, as amended; or
- A company chartered under the Farm Credit Act of 1933, 48 Stat. 257, 12 U.S.C. 1131(d), as amended.

Specifically excluded from the definition of a “financial institution” (and from the definition of a “dealer in intangibles”) are insurance companies, credit unions and corporations or institutions organized under the Federal Farm Loan Act and amendments thereto. In addition, for franchise tax purposes a production credit association is not a financial institution.

## **2. ENTITIES EXEMPT FROM THE FRANCHISE TAX**

### **A. S corporations and qualified subchapter S subsidiaries**

An S corporation generally is not subject to the Ohio corporation franchise tax. See O.R.C. Section 5733.09 and the department’s July 31, 1994 information release entitled “Taxation of S Corporations and Their Shareholders,” which sets forth the department’s policy interpretation of Ohio franchise tax law applicable to S corporations. The information release is available on the department’s Web site. However, an S corporation is subject to the franchise tax and must file an Ohio Corporation Franchise Tax Report (form FT-1120) if the S corporation was a C corporation during any portion of a taxable year ending in 2002. See *Sanders Health & Fitness Inc. v. Limbach*, BTA Case No. 88-E-559, June 21, 1991. Furthermore, an S corporation must file form FT-1120 and is subject to the franchise tax on the income attributed to it from a C corporation if the S corporation was the survivor of a merger with another corporation that was subject to the Ohio corporation franchise tax and the S corporation was a transferee as defined in O.R.C. Section 5733.053(A)(3). See the department’s September 24, 1992, franchise tax information release

“Application of Ohio Revised Code Section 5733.053 (Transferor Statute) to the Merger of a C Corporation into an S Corporation.” The information release is available on the department’s Web site.

If a corporation is an S corporation for any portion of calendar year 2002, the S corporation must file a Notice of S Corporation Status (form FT-1120-S) by June 30, 2003.

A “**qualified subchapter S subsidiary**” (QSSS), as defined in I.R.C. Section 1361(b)(3)(B), is exempt from the franchise tax that is based on the taxable year for which the parent S corporation makes the election under I.R.C. Section 1361(b)(3)(B)(ii). A QSSS is exempt because its separate legal existence is ignored for purposes of the franchise tax. If a corporation is a QSSS for any portion of 2002, the corporation must file by June 30, 2003 a notice of S Corporation Status separate from the Notice of S Corporation status filed by its parent S corporation.

**Note 1: S corporations and the pass-through entity tax.** For taxable years beginning after 1997 an S corporation that does business in Ohio or otherwise has nexus with Ohio is subject to the tax on pass-through entities enacted by Am. Sub. H.B. No. 215, 122nd General Assembly (Budget Bill) if one or more shareholders of the S corporation is a nonresident for any portion of the S corporation’s taxable year and the S corporation does not file a composite Ohio income tax return (form IT-4708) on behalf of all the nonresident shareholders.

**Note 2: QSSS’s and the pass-through entity tax.** For taxable years ending after June 4, 2002 a QSSS that does business in Ohio or otherwise has nexus with Ohio must pay the pass-through entity tax if its parent S corporation has shareholders that are not residents of Ohio. However, the various exemptions applying to S corporations also apply to QSSSs. Accordingly, **a QSSS is not subject to the pass-through entity tax if either: (1) the S corporation owner/shareholder irrevocably acknowledges that the S corporation has nexus with Ohio, includes in its income the income of the QSSS, and makes a good faith and reasonable effort to comply with Ohio’s pass-through entity tax or (2) the S corporation files a composite Ohio income tax return** (form IT-4708) on behalf of all nonresident shareholders and includes on that composite return the nonresident shareholder’s proportionate share of the income of the QSSS. See the following: (1) O.R.C. Sections 5733.402 and 5733.41, (2) the department’s July 3, 2002 income tax information release entitled “Pass-through Entity Tax: Certain Estimated Tax Payments Due September 16, 2002” and (3) the instructions for form IT-1140, Tax Return for Pass-through Entities. All of the above are available on the department’s Web site.

**B. Public utilities, insurance companies, credit unions and dealers in intangibles**

- Any corporation, whether foreign or domestic, owning and operating a public utility required to file reports and pay an excise tax upon its gross receipts or gross earnings under O.R.C. Chapter 5727 is not subject to the franchise tax. Railroads are subject to the franchise tax for tax years 1993 and thereafter. Electric companies and combined (electric) companies are subject to the franchise tax for tax years 2002 and thereafter.
- Insurance, fraternal, beneficial, bond investment, health maintenance organizations and other corporations required by law to file annual reports with the Superintendent of Insurance are not subject to the franchise tax.
- Credit unions and dealers in intangibles are not subject to the franchise tax.

**C. REITs, RICs and REMICs**

An entity, whether organized as a corporation or business trust, defined to be a real estate investment trust (REIT) under I.R.C. Section 856, a regulated investment company (RIC) under I.R.C. Section 851, or a real estate mortgage investment conduit (REMIC) under I.R.C. Section 860D is not subject to the franchise tax. The tax commissioner by journal entry has waived the investor reporting requirements for these entities for tax year 2003.

**D. Corporations in bankruptcy**

A corporation in bankruptcy proceedings under Chapter 7 of the U. S. Bankruptcy Code is not liable for the franchise tax for that portion of the tax year during which the corporation's franchise is impaired because of the Chapter 7 bankruptcy proceedings. See O.R.C. Section 5733.06(E). A corporation in Chapter 7 bankruptcy is not exempt from the \$50 minimum fee. A corporation in reorganization proceedings under Chapter 11 of the U.S. Bankruptcy Code is not exempt from the franchise tax because a corporation in reorganization is not equivalent to a corporation that has been adjudicated bankrupt or for which a receiver has been appointed. See *Vought Industries, Inc. v. Tracy* (1995), 72 Ohio St. 3d 261.

**E. Corporations exempt under federal law**

Certain corporations are exempt from state tax because Congress has expressly granted them immunity as a "federally chartered instrumentality." For example, federal land bank associations are exempt from state taxes under Section 2098, Title 12, U.S. Code. Certain other corporations are exempt because the United States Constitution's Supremacy Clause grants implied immunity to private corporations that



actually stand in the federal government's shoes and are so closely connected to the government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned. An Agricultural Credit Association (ACA) is not immune from state taxation as a "federally chartered instrumentality" because (i) Congress has not expressly granted immunity to ACAs and (ii) the Supremacy Clause of the United States Constitution does not grant implied immunity to ACAs. See *Farm Credit Serv. of Mid-America v. Zaino* (2001), 91 Ohio St.3d 564.

### **3. TAX RATES**

The tax rates as set out in O.R.C. Section 5733.06 are as follows:

- The first \$50,000 of Ohio net income is subject to tax at a rate of 5.1%. However, corporations that meet the ownership requirements to file a combined report must share the \$0 to \$50,000 tax bracket to which the 5.1% rate applies regardless of whether or not they actually file combined. Related taxpayers must prorate the \$0 to \$50,000 bracket on form FT-OTAS. Related taxpayers may prorate the \$0 to \$50,000 bracket amount in any amount they choose, but a taxpayer's pro-rata amount may not be less than zero. The proration, however made, applies to both the franchise tax and the litter tax.
- Ohio net income in excess of \$50,000 is subject to tax at a rate of 8.5%.
- The net worth rate for corporations other than financial institutions is four mills. In addition, the maximum net worth tax is \$150,000 per taxpayer. The \$150,000 limit applies separately to each member of a combined report; there is not an overall net worth limit for a combined group of taxpayers. The net worth rate for financial institutions is 13 mills. Financial institutions are exempt from the net income base, but the \$150,000 net worth tax limit does not apply to financial institutions.
- The net worth rate for financial institutions is 13 mills, and the \$150,000 net worth tax limit does not apply to financial institutions. Financial institutions are exempt from the net income base.
- The minimum fee is \$50.

### **4. NEXUS**

Unless an exemption applies, a corporation that has nexus in or with Ohio under the Constitution of the United States is subject to the franchise tax. A corporate investor in a pass-through entity that does business in Ohio or otherwise has nexus in or with Ohio under the Constitution of the United States is itself doing business in Ohio and has nexus with Ohio. Accordingly, a foreign corporation is subject to the franchise tax even if

the corporation's only connection with Ohio is as (i) a partner or limited partner in a partnership that has nexus with Ohio or (ii) as a member of a limited liability company that has nexus with Ohio. (A pass-through entity is defined as an S corporation, partnership, limited liability company or any other person, other than an individual, trust or estate, if the partnership, limited liability company, or other person is not classified for federal income tax purposes as an association taxed as a corporation. See the following: (1) O.R.C. Section 5733.04(O); (2) the department's September 2001 information release describing the standards the department will apply to determine whether an out of state corporation is subject to the franchise tax; and (3) the department's March 15, 2001 information release entitled "Corporation Franchise Tax Nexus for Nonresident Limited Partners Following the UCOM Decision." The information releases and the Ohio Revised Code are available on the department's Web site.

## **5. DISSOLUTION OR SURRENDER OF LICENSE**

Each corporation seeking dissolution of its charter or surrender of its license to transact business in Ohio must submit to the Secretary of State a filing fee along with various affidavits or documents evidencing that the corporation has paid or adequately guaranteed various taxes and fees. For further information regarding the requirements of dissolving a corporation's charter or surrendering a corporation's license to conduct business in Ohio, please contact the office of the Secretary of State, 180 East Broad Street, 16th Floor, Columbus, Ohio 43215 or telephone that office at (614) 466-3910 or call toll free at 1-877-767-3453. For specific information regarding obtaining a tax release from the Ohio Department of Taxation, please contact the Ohio Department of Taxation, Taxpayer Services Division, P.O. Box 182382, Columbus, Ohio 43218-2382 or call 614-995-4422.

The mere termination of business activities or voluntary dissolution does not exempt a corporation from the franchise tax. A corporation that on January 1 of the tax year holds a charter or license to transact business in Ohio is subject to the Ohio franchise tax for that tax year even if prior to the beginning of the tax year it has ceased all business activities in Ohio and has applied for certificates showing the payment or adequate guarantee of all required taxes.

**For tax years 1999 and thereafter a corporation that previously had nexus with Ohio but is not a franchise taxpayer on January 1 of the tax year (for example, because the corporation dissolved, merged out of existence or surrendered its license to conduct business in Ohio before January 1 of the tax year) may be subject to an income-based tax on its Ohio net income that was not reported on an earlier franchise tax report. See "Exit Tax" below.**

#### **6. EXIT TAX – O.R.C. SECTION 5733.06(H)**

An exiting corporation is a corporation that previously had nexus with Ohio but is not a franchise taxpayer for the tax year (for example, because the corporation dissolved, merged out of existence or surrendered its license to conduct business in Ohio prior to January 1 of the tax year). Nevertheless, if a transferee corporation (see O.R.C. Section 5733.053) is required to include in its Ohio taxable income the income of a transferor corporation that would otherwise be an exiting corporation, then the transferor is not an exiting corporation and the exit tax does not apply. An “exiting corporation” is subject to an income-based exit tax on its unreported Ohio net income that was earned in the two calendar years before the tax year to the extent that such income was not previously included on the corporation’s franchise tax report. The exit tax does not apply to an exiting financial institution. The exit tax is effective for tax years 1999 and thereafter (see Section 210 of House Bill 215). As such, the exit tax applies to corporations that exit Ohio in 1998 and thereafter.

An exiting corporation is not subject to the \$50 minimum fee and is not subject to the tax on the net worth base or to the litter tax on the net worth base. However, an exiting corporation is subject to the litter tax on the net income base. An exiting corporation is subject to the O.R.C. Section 5733.052 combination provisions and all deductions and credits applicable to franchise taxpayers. An exiting corporation must compute its exit tax on the franchise tax form applicable to the tax year following the calendar year during which the corporation exits Ohio. The corporation must file the report by May 31 of the year following the year the corporation exits Ohio. However, upon request by the exiting corporation, the tax commissioner can extend the date for filing the report, but not the date for paying the tax.

**Amended Substitute Senate Bill 287, 123<sup>rd</sup> General Assembly amended both the exit tax (O.R.C. Section 5733.06(H)) and the transferor statute (O.R.C. Section 5733.053) and established the following relationship between the two:**

- 1) If on January 1 following the transfer of substantially all the transferor’s assets to the transferee the transferor remains in existence, then the transferor is subject to the franchise tax and the transferor statute does not apply to the transferee. See O.R.C. Section 5733.053(B):  
*“The transferee shall add such income in computing its tax for the same tax year or years that such income would have been reported by the transferor if the transfer had not been made. The transferee shall add such income only to the extent the income is not required to be reported by the transferor for the purposes of the tax imposed by divisions (A) and (B) of Section 5733.06 of the Ohio Revised Code.”*

- 2) If on January 1 following the transfer of substantially all the transferor's assets to the transferee the transferor is not subject to the franchise tax (because, for example, the transferor merged into the transferee), and if for federal income tax purposes the transfer qualifies for nonrecognition of gain and loss, then the O.R.C. Section 5733.053 transferor statute applies to the transferee and the exit tax does not apply to the transferor. That is, the transferee is required to add to its income the income of the transferor and the franchise tax attributes of the transferor pass to the transferee.
- 3) If on January 1 following the transfer of substantially all the transferor's assets to the transferee the transferor is not subject to the franchise tax imposed by divisions (A) and (B) of 5733.06 (because, for example, the transferor merged into the transferee), and the O.R.C. Section 5733.053 transferor statute does not apply to the transferee (because, for example, the merger is not a tax-free reorganization) and if all other conditions of an exiting corporation apply, then the exit tax applies to the transferor. See O.R.C. Section 5733.06(H)(1)(d) and 5733.06(H)(6).

**Note:** The changes to the transferor statute and the exit tax, as set forth above, were originally to have been effective with the 2002 franchise tax report (see Section 13 of Am. Sub. S.B. 287). However, Amended Substitute House Bill 94, 124<sup>th</sup> General Assembly amended the effective date of the changes to the transferor statute and the exit tax statute made by Amended Substitute Senate Bill 287. Amended Substitute House Bill 94 provides that the amendments to the exit tax and to the transferor statute made by Am. Sub. S.B. 287 do not apply to any transfer for which negotiations began prior to January 1, 2001, and that was commenced in and completed during calendar year 2001, unless the transferee makes an election before December 31, 2001, to apply those amendments.

An exiting corporation that has a fiscal year end must include on one franchise tax report all of its unreported net income even if the income would have been included on two franchise tax reports had the corporation remained subject to the franchise tax. See O.R.C. Section 5733.06(H).

**Example:**

ABC Inc. is chartered in another state and has operated in Ohio since 1989. ABC has a January 31 fiscal year end and filed its 2002 franchise tax report based on the fiscal year beginning February 1, 2000 and ending January 31, 2001. ABC shut down its Ohio operations and legally withdrew from Ohio on December 1, 2002. ABC is not a "transferor" as defined in O.R.C. Section 5733.053 because ABC did not transfer substantially all its assets or equity to another corporation in a tax-free reorganization. Although ABC is not a franchise taxpayer on January 1, 2003, ABC is

nevertheless subject to the exit tax on its unreported Ohio net income earned during the twenty-two month period beginning February 1, 2001 and ending December 1, 2002 (the date that it withdrew from Ohio).

ABC must report its income for the entire 22-month period February 1, 2001 to December 1, 2002 on a 2003 franchise tax report even though income for the period February 1, 2002 to December 1, 2002 would have been reported on a year 2004 franchise tax report if ABC would have had nexus with Ohio on January 1, 2004 and remained subject to the franchise tax. ABC's 2003 tax report is due by May 31 and all exit tax due is payable at that time notwithstanding other provisions of Chapter 5733 to the contrary. However, upon the taxpayer's request the tax commissioner may grant an extension of time to file the report (but the law contains no provision for an extension of time to pay).

#### **7. ACCOUNTING PERIOD – TAXABLE YEAR**

For franchise tax purposes a corporation's taxable year is a period ending on the date immediately preceding the date of commencement of the corporation's annual accounting period that includes the first day of January of the tax year. Generally, a corporation's taxable year for franchise tax purposes is the same as the corporation's taxable year for federal income tax purposes. If a corporation's taxable year is changed for federal income tax purposes, the corporation's franchise tax taxable year is changed accordingly. A franchise tax taxable year may consist of an aggregation of more than one federal taxable year and can exceed one year in length. For example, a franchise tax taxable year can consist of two (or more) federal taxable years and can exceed one year in length in certain instances where the taxpayer changes its federal taxable year or the taxpayer is acquired by another corporation and then changes its taxable year. In addition, the law gives the tax commissioner authority to write rules prescribing an appropriate period as the taxable year for the following: (a) a corporation that has changed its taxable year for federal income tax purposes; (b) a corporation that as a result of a change of ownership has two or more short federal taxable years; and (c) a new taxpayer that would otherwise not have a taxable year.

Except for taxpayers that have changed their accounting period and taxpayers that have two or more federal taxable years that ended in calendar year 2002, taxpayers must determine the value of their issued and outstanding shares of stock under the net income basis and the net worth basis as follows:

**For report year 2003 taxpayers that have a calendar year end:** Use the period ending December 31, 2002.

**For report year 2003 taxpayers that have a fiscal year end:** Use the fiscal period ending in 2002. However, taxpayers filing their first report should see below.

**For report year 2003 taxpayers that are filing their first report:** Use the applicable period set forth below:

- A. If a taxpayer incorporated in Ohio during 2002 and adopted a fiscal period ending in 2002, then the taxpayer must use the accounting period commencing on the date of incorporation and concluding with the last day of the fiscal period ending in 2002.
- B. If the taxpayer is a foreign corporation and first became an Ohio taxpayer during 2002 (that is, during 2002 the corporation began doing business in Ohio, began owning or using part or all of its capital or property in Ohio, obtained a license authorizing it to do business in Ohio or otherwise established nexus with Ohio under the Constitution of the United States) and after it became an Ohio taxpayer its fiscal year ended in 2002, then the taxpayer must use the accounting period commencing on the earliest of the following: (i) the date that it began doing business in Ohio; (ii) the date that it began owning or using a part or all of its capital or property in Ohio; (iii) the date that it obtained a license authorizing it to do business in Ohio; or (iv) the date that it established nexus with Ohio under the Constitution of the United States. The accounting period will end on the taxpayer's fiscal year ending in 2002.
- C. All other new taxpayers will use the accounting period commencing with the earliest of the four dates set forth in B, above, and concluding with December 31, 2002. See paragraphs (E)(2) and (E)(4) of Tax Commissioner's Rule 5703-5-03.

**Taxpayers that have changed their accounting period and taxpayers that have two or more short federal taxable years** – The Department of Taxation has adopted the following rules regarding franchise taxpayers' taxable years and changes of accounting periods:

- 5703-5-01 – Definitions Applicable to Rules 5703-5-01 to 5703-5-05 of the Administrative Code
- 5703-5-02 – Date as of Which the Value of a Taxpayer's Issued and Outstanding Shares of Stock is Determined
- 5703-5-03 – Dates on Which a Taxpayer's Taxable Year Begins and Ends
- 5703-5-04 – Changes of a Taxpayer's Annual Accounting Period

Important features of these rules are as follows:

- Generally, a taxpayer's taxable year begins on the date immediately following the end of the taxpayer's prior taxable year and ends on the date immediately preceding the beginning of the taxpayer's annual accounting period that includes the first day of January of the tax year.
- If a taxpayer changes its annual accounting period, there is (i) no period that is not subject to tax, and (ii) no period that is subject to tax in more than one tax year.
- A franchise tax "taxable year" under certain circumstances may be more than or less than one year in length. If a taxable year is more than one year in length, it is proportionately reduced to one year by multiplying the income for the taxable year by a fraction, the numerator of which is 365 and the denominator of which is the number of days in the taxable year. If the taxable year is less than one year, annualization is not required.

If the corporation changed its taxable year in 2001 or 2002 or if the corporation had more than one federal taxable year that ended in calendar year 2002, please contact the Department of Taxation for a copy of the rules and time line illustrations of the rules. Send your request to the Ohio Department of Taxation, P.O. Box 2476, Columbus, Ohio 43216-2476, Attn: Rules. The rules are also available on the Department's Web site.

#### **8. METHODS OF COMPUTING TAX**

In determining the Ohio franchise tax due, taxpayers other than financial institutions and qualifying holding companies and certain high-tech start-up companies must compute the tax on both the net worth base and the net income base and pay the tax on the base that produces the greater tax. Financial institutions are not subject to the tax on the net income base, and qualifying holding companies and certain high-tech start-up companies are not subject to the tax on the net worth base. In any event the minimum fee is \$50.

Although an "exiting corporation" is not subject to the franchise tax, it may be subject to an income based exit tax. An exiting corporation is not subject to the \$50 minimum fee. See general instruction #6.

#### **9. TIME, PLACE AND METHOD FOR FILING AND PAYMENT**

Except as otherwise provided, if a payment or document is mailed on or before the due date but delivered after the required date, the postmark date is deemed the date of delivery. If the due date of the report or the due date of an extension or payment falls on a Saturday, Sunday or legal



holiday, then the report, extension or payment may be made on the next succeeding day that is not a Saturday, Sunday or legal holiday. Certain large taxpayers must pay by electronic funds transfer (see general instruction #9D).

**Note: Each member of a combined franchise tax report must file its own separate forms FT-1120E, FT-1120ER and FT-1120EX. Payment of all franchise tax for tax year 2003 is due by May 31, 2003, even if the taxpayer has an extension to file after that date.**

**A. Filing date/payment date**

The filing and payment of the Ohio franchise tax for report year 2003 is due between January 1 and March 31, 2003. However, if the Ohio Corporation Franchise Tax Report is not filed by January 31 and if full payment is not made by January 31, then form FT-1120E, Declaration of Estimated Corporation Franchise Tax, must be filed by January 31 along with payment of one-third of the estimated tax, but not less than the \$50 minimum fee.

**B. Extension**

The tax commissioner will grant an extension of time for filing the report until May 31 if by March 31 the taxpayer submits form FT-1120ER together with payment of the second one-third of the estimated tax due.

**Additional Extension**

The tax commissioner will grant an additional extension of time for filing the report beyond May 31 if the corporation has been granted an extension by the Internal Revenue Service and by May 31 the taxpayer submits form FT-1120EX together with the balance of the tax due. The second extension extends the filing date to the 15th day of the month following the month for which the Internal Revenue Service has granted an extension for filing the corporation's federal income tax return. The taxpayer must attach a copy of the federal extension to the franchise report, form FT-1120, when filed.

The table on the next page lists the latest possible due dates for filing the 2003 franchise tax report for the various taxable years ending in 2002. The table assumes the following:

- If the taxpayer's taxable year ended on or after August 31, 2002, the taxpayer has the maximum allowable federal extension,
- The taxpayer has timely filed franchise tax forms FT-1120E, FT-1120ER, and, where applicable, FT-1120EX, and
- The taxpayer has timely made all estimated franchise tax payments.

<b>Taxable Year Ending in 2002</b>	<b>Latest Possible Due Date for Filing the 2003 Franchise Tax Report</b>
01/31/02 through 7/31/02	05/31/2003
08/31/2002	06/15/2003
09/30/2002	07/15/2003
10/31/2002	08/15/2003
11/30/2002	09/15/2003
12/31/2002	10/15/2003

### **C. Place**

File the franchise tax report with the Ohio Department of Taxation, P.O. Box 27, Columbus, Ohio 43216-0027.

### **D. EFT method of payment**

A taxpayer must pay by electronic funds transfer (EFT) if the taxpayer's total franchise tax liability after reduction for nonrefundable credits exceeded \$50,000 for the second preceding tax year. Nevertheless, payments made with an amended report can not be made by EFT. For further EFT information see the department's July 31, 1994 Franchise Tax Information Release entitled "Recently Enacted Legislation Revises the Requirements for Corporations Paying Corporate Franchise Tax by Electronic Funds Transfer (EFT)." The information release is available on the department's Web site. Please direct questions regarding the EFT payment program to the Treasurer of State's office at 30 East Broad Street, 9<sup>th</sup> floor, Columbus, Ohio 43215 or telephone that office toll free at 1-877-EFT-Ohio (338-6446).

## **10. INTEREST ON UNDER- AND OVERPAYMENTS**

If a corporation fails to pay the tax by the due date, interest accrues on the unpaid tax. Interest on tax due is charged in addition to any penalties which may be incurred for late filing and late payment or failure to file. The period of the underpayment runs from the date the tax payment was required to be made to the date on which such payment is made. There is no safe-harbor from interest on the underpayment of estimated tax.

Interest on franchise tax overpayments runs from whichever of the following dates is the latest until the date the refund is paid:

- the date of payment,
- the 90th day after the final date the franchise tax report was required to be filed, or
- the 90th day after the date that the franchise tax report was filed.

Effective for net capital losses arising in taxable years ending on or after July 31, 1991, interest on an overpayment resulting from a net capital loss carryback is payable from the due date plus extensions for the report in which the loss arises (rather than from the report year to which the loss is carried back).

The interest rate on underpayments is the same as the interest rate on overpayments. During calendar year 2003 interest on both underpayments and overpayments will accrue at the rate of 6% per annum.

#### **11. PENALTIES FOR LATE PAYMENT, FAILURE TO FILE OR LATE FILING**

- Penalty may be imposed for failure to timely pay the tax (including estimated tax – see estimated tax safe harbor, below). Under new law (see Senate Bill 200, 124<sup>th</sup> General Assembly, the O.R.C. Section 5733.28(A)(2) late payment penalty may not exceed 15% of the delinquent payment (under prior law the O.R.C. Section 5733.28(A)(2) penalty for late payment could not exceed twice the interest charged under O.R.C. Section 5733.26(A)).
- Penalty may be imposed for failure to file or timely file a report. The penalty imposed may not exceed the greater of (i) \$50 per month up to \$500 or (ii) 5% per month of the tax due shown on the report up to 50%.
- Additional penalties may be imposed for filing a fraudulent report and for filing a fraudulent refund claim.

#### **12. PENALTY SAFE-HARBOR FOR ESTIMATED PAYMENTS**

Substitute Senate Bill 200 (Taxpayer Services II), 124<sup>th</sup> General Assembly, effective September 6, 2002 enacted the following safe-harbor applicable to penalty on underpayment of estimated tax.

- With respect to estimated payments, the O.R.C. Section 5733.28(A)(2) failure to pay penalty applies to two periods: (1) “any period of delinquency ending prior to the first day of June of the tax year” and (2) “any period of delinquency commencing the first day of June of the tax year and concluding on the extended due date.” See O.R.C. Section 5733.021 as amended by Senate Bill 200.
- For purposes of determining the O.R.C. Section 5733.28(A)(2) failure to pay penalty for any period of delinquency ending prior to the first day of June of the tax year, the commissioner may charge penalty on the delinquent portion of the estimated tax and estimated tax means the lesser of 100% of last year’s tax or 90% of this year’s tax. See O.R.C. Section 5733.021(C)(1)(c).

- For purposes of determining the O.R.C. Section 5733.28(A)(2) failure to pay penalty for any period of delinquency commencing the first day of June of the tax year and concluding on the extended due date, the commissioner may charge penalty on the delinquent portion of the estimated tax and estimated tax means 90% of this year's tax. See O.R.C. Section 5733.021(C)(2)(c).

**Note:** In addition to creating the above noted safe harbor, Senate Bill 200 amended the O.R.C. Section 5733.28(A)(2) penalty computation. The new law provides that the O.R.C. Section 5733.28(A)(2) failure to pay penalty may not exceed 15% of the delinquent payment. Prior law provided that the failure to pay penalty could not exceed twice the interest charged under division (A) of Section 5733.26.

### **13. OFFICERS, STATUTORY AGENT AND SIGNATURE**

All franchise tax reports must be signed by the president, vice-president, secretary, treasurer, general manager, superintendent or managing agent of such corporation in Ohio. If a domestic corporation has not completed its organization, one of its incorporators must sign the report. In addition, each taxpayer must list its president, secretary and treasurer along with the name and address of its statutory agent.

### **14. REPORTING FEDERAL CHANGES**

If as a result of amendment or adjustment to the taxpayer's federal income tax return by the taxpayer or by the Internal Revenue Service or, if as a result of any other recomputation or redetermination a change occurs in the taxpayer's federal tax liability or any item entering the computation of the taxpayer's federal taxable income as reported for federal income tax purposes, the taxpayer must report such change to the Ohio Department of Taxation in the form of an amended report by the earliest of the following:

- One year after final determination of the adjustment for federal income tax purposes,
- One year after the taxpayer paid the additional federal income tax as a result of the adjustment (whether or not the adjustment was agreed to) or
- One year after the taxpayer received a federal income tax refund as result of the adjustment.

This provision applies even if the three-year statute of limitations has passed and applies to amended reports that reflect overpayments as well as to amended reports which reflect underpayments. If the amended report reflects an underpayment, the amended report must be

accompanied by payment of any additional tax and interest. If the amended report reflects an overpayment, the amended report must be accompanied by either form FT-REF, Application for Refund, or by a statement that sets forth the full and complete reason for the overpayment. See *Abitibi-Price Corporation and Subsidiaries v. Tracy*, BTA No. 98-N-401 (3-12-01) and refer to general instruction # 27.

#### **15. AMOUNTS REPORTED FROM FEDERAL TAX RETURN**

Amounts reported from the federal form 1120 or 1120A, as well as Ohio adjustments and allocations, are subject to verification and audit by the Ohio Department of Taxation.

#### **16. METHODS OF ACCOUNTING**

A taxpayer's method of accounting under the net income base must be the same as its method of accounting for federal tax purposes. If the taxpayer changes its method of accounting for federal income tax purposes, the taxpayer must also change its method of accounting under the net income base. In the absence of any method of accounting for federal income tax purposes, income must be computed under such method as the tax commissioner deems proper.

The tax on the net worth base must be determined from the books of the corporation that the taxpayer must keep in accordance with a generally recognized and approved accounting system. The tax-basis method of accounting is a generally recognized and approved accounting system. See *Gray Horse, Inc. v. Limbach* (1993), 66 Ohio St. 3d 631. If a taxpayer keeps its books both in accordance with regulatory accounting principles and in accordance with generally accepted accounting principles, the value of the taxpayer's issued and outstanding shares of stock under the net worth base (division (C) of O.R.C. Section 5733.05) must be based upon those books kept in accordance with generally accepted accounting principles. See Tax Commissioner's Rule 5703-5-08.

#### **17. ROUNDING OFF TO WHOLE DOLLAR AMOUNTS**

The money items of form FT-1120 and accompanying schedules must be shown as whole dollar amounts by eliminating amounts less than 50 cents and increasing amounts from 50 cents to 99 cents to the next highest dollar.

#### **18. RECORDS RETENTION**

Every corporation must maintain books and records that substantiate the information reported on its Ohio Corporation Franchise Tax Report. These books and records must be available for inspection by agents of the Ohio Department of Taxation for a period of four years from the later of (a) the date the taxpayer filed the franchise report or (b) the date the taxpayer was required to file the report. See the line instructions for

Schedule A, line 12 for records to be maintained pertaining to net operating loss carryforwards.

#### **19. HOLDING COMPANIES OF INSURANCE COMPANIES, PUBLIC UTILITIES AND FINANCIAL INSTITUTIONS**

A taxpayer that owns at least 25% of the issued and outstanding shares of common stock of one or more financial institutions as defined in O.R.C. Chapter 5725 or a taxpayer that owns at least 80% of the issued and outstanding shares of common stock of one or more public utilities or insurance companies as defined in O.R.C. Chapters 5727 and 5725, respectively, must exclude from its sales factor the receipts from sales to such financial institutions, public utilities or insurance companies.

In addition, a taxpayer that owns at least 80% of the issued and outstanding shares of common stock of one or more public utilities or insurance companies may deduct, to the extent not otherwise allowed, the dividends received from such public utilities and insurance companies. Under prior law (applicable to tax years 1998 and earlier) taxpayers that owned at least 25% of the issued and outstanding shares of common stock of one or more financial institutions and taxpayers that owned at least 80% of the issued and outstanding shares of common stock of one or more public utilities or insurance companies were entitled to exclude from their franchise tax net worth base a portion of the taxpayer corporation's investment in such financial institution, public utility or insurance company. Under current law (for tax years 1999 and thereafter), as amended by House Bill 215, 122nd General Assembly such taxpayer corporations may no longer exclude from their net worth a portion of their investment in such financial institutions, public utilities and insurance companies.

Because of the above-noted change in the law, the franchise tax "Supplemental Franchise Tax Schedules for Holding Companies of Insurance Companies, Public Utilities, and Financial Institutions" have been eliminated. The sales factor adjustment and the dividends received adjustments for holding companies (explained above) are now reflected on the franchise tax report itself.

#### **20. QUALIFYING HOLDING COMPANY**

For tax years 1999 and thereafter a qualifying holding company is exempt from the net worth base of the franchise tax (but not the net income base). A qualifying holding company is any corporation that satisfies all six of the following requirements:

- The corporation's "intangible assets ratio" equals or exceeds 90%;
- The corporation's "investment in related members ratio" equals or exceeds 50%;

- During the taxable year the corporation's "gross income from intangible assets ratio" equals or exceeds 90%;
- The corporation is not a financial institution on the last day of the taxable year ending prior to the first day of the tax year;
- The corporation's related members adjust their net worth and debt for purposes of computing their franchise tax on the net worth base, such that the related members' debt-to-equity ratio equals the consolidated debt-to-equity ratio of the "qualifying controlled group." (A "qualifying controlled group" is defined in O.R.C. Section 5733.04(M) as two or more corporations that satisfy the O.R.C. Section 5733.052(A) ownership and control requirements to file a combined report.); and
- The corporation elects to be treated as a qualifying holding company for the tax year by filing form FT-QHC.

For further information see form FT-QHC and O.R.C. Sections 5733.04(L), 5733.05(C)(2), and 5733.06(C). A qualifying holding company is not a "quiescent holding company." See general instruction # 21.

## **21. QUIESCENT HOLDING COMPANY**

Quiescent holding company status does not apply to tax years 1999 and thereafter. Under prior case law (see *Nationwide Corp. v. Schneider* (1966), 7 Ohio St.2d 59) a taxpayer was a quiescent holding company if its business activities were not sufficient to constitute "doing business." As a quiescent holding company, a taxpayer was not required to compute a net worth base "business done" factor which in effect reduced a taxpayer's net worth "Ohio ratio" to one half of its property ratio. (Under prior law the net worth base "Ohio ratio" equaled one-half the sum of the "business done ratio" and the net worth "property ratio.") House Bill 215, 122nd General Assembly replaced the net worth base "Ohio ratio" with the net income base apportionment ratio. This law eliminates "quiescent holding company" status because, unlike the Ohio ratio, if the denominator of any factor of the net income base apportionment ratio is zero, the weight given to the other factors must be proportionately increased so that the total weight given to the combined number of factors used is 100%.

## **22. HIGH-TECH START-UP COMPANIES**

A corporation organized not more than three years before the March 31 unextended due date of each of the 2003, 2004, 2005, 2006 or 2007 franchise tax reports is not subject to the net worth base of the franchise tax or to the net worth base of the litter taxes if the corporation:

- Conducted business during its entire taxable year as a "qualified trade or business";



- Uses more than 50% of its assets located in Ohio (based on net book value) solely to conduct activities that constitute a qualified trade or business; and
- During the taxable year is not a related member (as defined in O.R.C. Section 5733.042 and modified by O.R.C. Section 5733.06(C)(2)(d)) to another person treated as a corporation.

*“Qualified trade or business”* means any trade or business that primarily involves research and development, technology transfer, biotechnology, information technology or the application of new technology developed through research and development or acquired through technology transfer.

If the corporation meets the above requirements and is claiming exemption from the net worth base as a high-tech start-up company (the statute refers to such corporations as “eligible corporations”), please check the box at the top of page 1 of the franchise tax report. Do not complete schedule F and do not complete lines (d), (i) or (l) of schedule K. See O.R.C. Sections 5733.06(C) and 122.15.

### **23. COMBINED REPORTS**

A *taxpayer* that on January 1 of the tax year owns or controls either directly or indirectly more than 50% of the voting stock of another *taxpayer* corporation may elect to combine net income with that corporation. A “*taxpayer*” is a corporation subject to the franchise tax. Taxpayers whose voting stock is more than 50% owned or controlled either directly or indirectly by another corporation or by related interests may also elect to combine net income. Brother-sister taxpayer corporations owned by an individual may elect to combine, and brother-sister taxpayer corporations owned by a parent corporation may elect to combine without inclusion of the parent corporation. However, where an election to combine is made by less than all eligible taxpayer corporations, the combined group must attach an explanation of the reason for the nonparticipation by such eligible taxpayer corporations.

An elected combination may include only taxpayers that have income [either positive income or negative income (loss)], other than dividend income, from sources within Ohio. “Income from sources within Ohio” means income that would be allocated or apportioned to Ohio if the taxpayer were not included in a combined report. Those taxpayer groups that elected to combine in prior tax years must amend their combinations to delete taxpayers that do not have income, other than dividend income, from sources within Ohio.

Taxpayers that elect to combine must do so in a timely filed franchise tax report. A timely filed report is a report filed within the time prescribed

by O.R.C. Sections 5733.02 and 5733.13. Only one member of a combined franchise tax group must satisfy the O.R.C. Section 5733.052(B) timely election requirement. A combination is timely elected if any member of the combination has complied with all of the franchise tax report deadlines even if other members have not complied timely. Thus, a taxpayer that fails to make timely estimated payments and fails to file timely extension requests may file in combination with other corporations after the due date of the taxpayer's report if another corporation in the combined group has timely made its estimated payments, has timely filed its extension requests, and has timely elected to file in combination with the taxpayer. See *Roxane Laboratories, Inc. v. Tracy* (1996), 75 Ohio St. 3d 125. Taxpayers that first filed separately may not elect to combine by filing an amended report after the due date of the report even if the amended report is filed within the three year refund statute of limitations. See *Olan Mills Inc. of Tenn. v. Limbach* (1990), 56 Ohio St. 3d 70.

Each member of a combined franchise tax report must separately file a Declaration of Estimated Tax (form FT-1120E) and Request(s) for Extension (forms FT-1120ER and FT-1120EX). See general instructions # 9A and 9B. Members of a combined report that fail to comply with the filing deadlines are subject to the applicable penalty and interest charges.

An election to combine may not be changed either in amended reports or in reports for future years without the written consent of the tax commissioner. The addition of a new member to a previously elected combination and the deletion of a member that was previously included (other than a corporation that does not satisfy the income or ownership requirements) is a change in that election. Accordingly, taxpayers that seek to add or delete member(s) to an already existing combination must receive the tax commissioner's consent. See O.R.C. Section 5733.052(B) and *Tranzonic Companies and Subs. v. Tracy*, BTA Case No. 90-M-1443, December 4, 1992. Taxpayers that request such consent must file form FT-COM, Request for Permission to File or to Amend a Combined Corporation Franchise Tax Report.

If the above-discussed 50% ownership requirements are met, the tax commissioner may require or permit a taxpayer and one or more other corporations (whether or not such corporations are taxpayers and whether or not such corporations have income from sources within Ohio) to combine their net income. A combination of this type will not be required or permitted unless it is necessary because of intercorporate transactions to properly reflect income and the tax liability.

The department will generally pursue combinations or expanded combinations only in those situations where the failure either to combine or to expand the combination will result in the filing of a corporation franchise tax report that does not properly reflect income and does not

properly reflect the tax liability imposed by O.R.C. Section 5733.06. A timely conducted I.R.C. Section 482-type study conforming with the requirements set forth in I.R.C. Section 482 and in the U.S. Treasury regulations issued under Section 482 will avoid this department's seeking either a combination or an expanded combination. See the department's June 23, 2000 information release entitled, "I.R.C. Section 482 Study: Safe Harbor to Avoid Ohio Corporate Franchise Tax Report Required or Expanded Combinations." The information release is available on the department's Web site. Taxpayers that request the tax commissioner's permission to include in the combined report corporations that are not subject to the franchise tax must file form FT-COM.

Corporations that file combined franchise tax reports must prorate combined apportioned net income to each member in the group (see form FT-1120C). Each corporation must then compute its own Ohio taxable income and net income-based tax on its own form FT-1120. Each taxpayer in a combined report must separately determine its tax on the net worth base. Net worth is not combined.

Corporations that on January 1 of the tax year meet the ownership requirements to file a combined report must share the \$0 to \$50,000 tax bracket to which the 5.1% rate applies regardless of whether or not they actually file combined. Related taxpayers must prorate the \$0 to \$50,000 bracket on form FT-OTAS.

#### **24. EXEMPTION FOR ENERGY CONVERSION FACILITIES**

Corporations that construct energy facilities, solid waste energy conversion facilities and thermal efficiency improvement facilities may be entitled to an exemption for such facilities on the Ohio Corporation Franchise Tax Report.

To qualify for the exemption, a corporation must obtain a certificate issued by the tax commissioner. For an application and information concerning the franchise tax exemption for such facilities please contact the Ohio Department of Taxation, Personal Property Tax Division, Attn: Pollution Control, 30 East Broad St., P.O. Box 530, Columbus, Ohio 43216-0530 or call (614) 466-3280.

#### **25. ENTERPRISE ZONE TAX BENEFITS**

**Amended Substitute House Bill 283, 123<sup>rd</sup> General Assembly (Budget Bill) extends through June 30, 2004 the authority for local governments to enter into enterprise zone agreements.** See O.R.C. Section 5709.62 as amended by the bill.

Businesses that establish, expand, renovate or occupy a facility pursuant to an enterprise zone agreement and that create new jobs in a certified enterprise zone without reducing employment elsewhere in Ohio may be

entitled to a series of tax benefits on their Ohio Corporation Franchise Tax Report (see O.R.C. Sections 5709.64 and 5709.65). Among these benefits are an employee training credit, a daycare credit (see credit #17 in the instructions for Schedule A-1), and exclusion of qualifying property and payroll from the numerators of the net income base property and payroll factors.

To qualify for franchise tax enterprise zone benefits, businesses must hold for the taxable year a Tax Incentive Qualification Certificate (issued by the Department of Development) and must hire new employees to fill nonretail positions at the facility. Also, at the time of employment at least 25% of the new employees must have been at least one of the following:

- Unemployed persons who had resided at least six months in the county in which the enterprise's project site is located;
- Job Training Partnership Act eligible employees who had resided at least six months in the county in which the enterprise's project site is located;
- Recipients of aid to dependent children, general relief, or unemployment compensation benefits who had resided at least six months in the county in which the enterprise's project site is located;
- Handicapped persons, as defined under division (A) of O.R.C. Section 3304.11, who had resided at least six months in the county in which the enterprise's project site is located;
- Residents for at least one year of a zone located in the county in which the enterprise's project site is located. See O.R.C. Sections 5709.64 and 5709.65.

In addition to the enterprise zone franchise tax benefits described above, a taxpayer may apply to the Director of Development for an "employee tax credit certificate" for each eligible new employee the enterprise hires after June 30, 1994 at the facility to which the enterprise zone agreement applies provided that the taxpayer is complying with an enterprise zone agreement and has not closed or reduced employment at any place of business in Ohio within the twelve months preceding the application. For more information on the Credit for Eligible New Employees in an Enterprise Zone see credit #10 in the instructions for Schedule A-1.

For a further discussion and summary of Ohio's enterprise zone program see Stempfer, "Economic Development Program Opportunities In Ohio, Summary and Update Focusing on Recent Tax-Related Legislation," *Ohio Tax Review*, vol. 8.3 (1994).

## 26. ASSESSMENTS

The tax commissioner may issue an assessment against the taxpayer for any deficiency within three years after the later of the following:

- The final date the report subject to assessment was required to be filed, or
- The date the report was filed.

However, both the assessment statute of limitations and the refund statute of limitations may be extended for an agreed upon period if both the taxpayer and the tax commissioner consent in writing to the extension by signing form FT-WAIVER.

An amended franchise tax report filed as a result of an adjustment to the corporation's federal income tax return (see general instruction #14) is deemed a report subject to assessment. However, the amended report does not reopen those facts, figures, computations or attachments from a previously filed report no longer subject to assessment or refund that are not affected, either directly or indirectly, by the adjustment to the corporation's federal income tax return. Furthermore, once the three-year refund statute of limitations has passed, the taxpayer may not offset the additional franchise tax resulting from I.R.S. audit adjustments against franchise tax that the taxpayer erroneously overpaid due to errors or mistakes unrelated to the federal adjustments. See *Gen. Motors Corp. v. Limbach* (1993), 67 Ohio St. 3d 90.

The statute of limitations does not prohibit either the tax commissioner or the taxpayer from adjusting the net operating loss carried forward from a year closed to assessment or refund to a year still open to assessment or refund; nor does the statute of limitations prohibit either the tax commissioner or the taxpayer from adjusting the unused credits carried forward from a year closed to assessment or refund to a year still open to assessment or refund. See *Consumer Direct v. Limbach* (1991), 62 Ohio St. 3d 180.

If the taxpayer does not pay the assessment within 60 days of receipt of the assessment, and does not file a Petition for Reassessment within 60 days of receipt of the assessment, interest accrues on the assessment at the rate prescribed in O.R.C. Section 5703.47 from the date the tax commissioner issues the assessment until the taxpayer pays the assessment.

If the taxpayer disagrees with an assessment, the taxpayer may object to the assessment by filing a Petition for Reassessment. See general instruction #27.

## **27. APPLICATION FOR REFUND AND PETITION FOR REASSESSMENT**

Franchise taxpayers may request a refund by filing either prescribed form FT-REF, **Application for Corporation Franchise Tax Refund**, or by filing an amended report accompanied by the full and complete reason for the refund claim. **Please do not file an application for refund if the claimed overpayment is shown on the originally filed franchise tax report.**

Franchise taxpayers may initiate review proceedings pertaining to a franchise tax assessment issued by the Department of Taxation by filing form FT-PR, Petition for Reassessment.

**Application for corporation franchise tax refund.** Form FT-REF applies to claimed overpayments by a taxpayer, whether made voluntarily or as the result of the payment of an assessment issued by the Ohio Department of Taxation. If the overpayment is not the result of an I.R.S. adjustment and the statute of limitations has not been extended by form FT-WAIVER (see general instruction #26), then the department must receive the application for refund or an amended report accompanied by the full and complete reason for the refund claim within three years of the date of the illegal, erroneous, or excessive payment. See *Abitibi-Price Corporation and Subsidiaries v. Tracy*, BTA No. 98-N-401 (3-12-01).

**New law:** Effective September 6, 2002 for purposes of the refund statute of limitations, payment made before the due date or extended due date for filing the report to which the payment relates are deemed to have been made on the due date or extended due date (see O.R.C. Section 5733.12 as amended by Substitute Senate Bill 200 (Taxpayer Services Bill II), 124<sup>th</sup> General Assembly, effective September 6, 2002).

**Prior law:** Under prior case law payments remitted with the estimated tax report (form FT-1120E) and extension requests (forms FT-1120ER and FT-1120EX) were deemed to have been made on the earlier of the date the Ohio Corporation Franchise Tax Report was filed or the due date of the report including extensions. Thus, if a franchise tax report was filed before its extended due date, the three-year refund statute of limitations began to run on the date the report was filed rather than the later extended due date. See *Hanna Mining Co. v. Limbach* (1985), 20 Ohio St. 3d 3 and *Athena Manor, Inc. v. Limbach*, BTA Case No. 91-Z-12, February 26, 1993.

**Transition from prior law to new.** If the refund statute of limitations under prior law did not expire prior to the September 6, 2002 effective date of the new law, then the new law applies, and for refund statute of limitations purposes any payments that the taxpayer made before the extended due date for filing the report are deemed to have been made on

the extended due date of the report (rather than on the earlier date on which the report was actually filed). On the other hand, if the refund statute of limitations under old law did expire before the September 6, 2002 effective date of the new law, then the old law applies, and, as to the refund statute of limitations, any payments remitted with the estimated tax report (form FT-1120E) and extension requests (forms FT-1120ER and FT-1120EX) are deemed to have been made on the earlier of the date the franchise tax report was filed or the due date of the report including extensions.

**Example:** The extended due date of the taxpayer's 1999 franchise tax report was October 15, 1999, but the taxpayer filed its 1999 franchise tax report on September 25, 1999. Under prior law the three-year refund statute of limitations as to payments submitted with the report and earlier estimated payments would have expired on September 25, 2002. Because the refund statute of limitations for the taxpayer's 1999 report did not expire before the September 6, 2002 effective date of the new law, the new law applies. Thus, the refund statute of limitations as to the taxpayer's 1999 estimated payments and payment submitted with the 1999 report expires on October 15, 2002 – three years from the report's extended due date. However, if in this example the taxpayer had instead filed its 1999 franchise tax report on September 2, 1999, then the old law applies because the September 2, 2002 statute of limitations expired before the September 6, 2002 effective date of the new law. Thus, if the taxpayer filed its 1999 report on September 2, 1999, the refund statute of limitations expired on September 2, 2002 and the tax commissioner has no jurisdiction to consider a refund claim filed after that date.

If the claimed overpayment is the result of a change in federal taxable income, then the department must receive the claim for refund within the later of the following: (a) the three-year time period set forth above, or (b) the one-year period set forth in general instruction #14. However, if the refund claim is filed outside the three-year refund statute of limitations and the statute of limitations has not been extended by form FT-WAIVER (see general instruction #26), the refund claim can include only the direct and indirect effects of the federal adjustments. See *Gen. Motors Corp. v. Limbach* (1993), 67 Ohio St. 3d 90 and *The First Federal Savings Bank v. Tracy*, BTA Case No. 94-T-1353, August 23, 1996.

Regardless of the above provisions to the contrary, a franchise tax refund claim that is based on a capital loss carryback is timely if the refund claim is filed within three years from the due date of the franchise tax report (including extensions thereof) for the taxable year in which the capital loss arose. See *Prechter v. Tracy*, BTA Case No. 95-M-1214, April 4, 1997.



A taxpayer may not appeal an assessment by filing a claim for refund unless the taxpayer has paid the assessment. For example, if the taxpayer fails to file a Petition for Reassessment within 60 days of receipt of the assessment, then the taxpayer cannot file a refund claim protesting the assessment until after the taxpayer has paid the assessment.

**New law – uniform application for refund procedure.** Substitute Senate Bill 200, 124<sup>th</sup> General Assembly, effective June 7, 2002 enacted O.R.C. Section 5703.70 to establish a uniform application for refund procedure applicable to franchise tax and various other taxes (but not to individual income tax, school district income tax, withholding tax or pass-through entity tax). If a taxpayer properly files an application for refund under a law that specifies that the O.R.C. Section 5703.70 uniform procedure applies and the commissioner determines that the amount of the refund to which the applicant is entitled is less than the amount claimed, then the tax commissioner and the taxpayer must proceed as follows:

1. If the commissioner determines that the amount of the refund to which the applicant is entitled is less than the amount that the applicant claimed, the commissioner must notify the applicant in writing by ordinary mail of the disallowed portion of the claimed refund.
2. The applicant has 60 days from the date the commissioner mails the notification to provide additional information to the commissioner and/or to request a hearing.
3. If within the 60-day period described in #2, above, the applicant neither requests a hearing nor provides additional information, the commissioner will take no further action, and the refund amount denied becomes final. That is, the taxpayer may not appeal to the Board of Tax Appeals the denied portion of the refund.
4. If within the 60-day period described in #2, above, the applicant requests a hearing, the commissioner must assign a time and place for hearing. After the hearing, the commissioner may make such adjustments to the refund as the commissioner finds proper and must issue a final determination. The taxpayer may appeal the commissioner's final determination to the Board of Tax Appeals pursuant to O.R.C. Section 5717.02.
5. If within the 60-day period described in #2, above, the applicant does not request a hearing but does provide additional information, the commissioner must review the information, may make such adjustments to the refund as the commissioner finds proper, and must issue a final determination. The taxpayer may appeal the

commissioner's final determination to the Board of Tax Appeals pursuant to O.R.C. Section 5717.02.

**Petition for Reassessment.** Form FT-PR applies only to assessments issued by the Ohio Department of Taxation. **The amount of an assessment that may be refunded under a timely filed Petition for Reassessment is limited to the amount of the assessment that the taxpayer paid. No portion of the amount paid with the filing of the franchise tax report is available for refund under the O.R.C. Section 5733.11 Petition for Reassessment statute because there is no provision within O.R.C. Section 5733.11 that grants the commissioner the authority to refund any amount greater than the amount that the taxpayer paid toward the assessment. The fact that the taxpayer raises additional objections to the assessment before the tax commissioner's final determination and the fact that the taxpayer mentions in those objections that the taxpayer is overpaid with respect to amounts paid with the original report does not convert a Petition for Reassessment into a timely filed refund claim with respect to amounts paid with the original report. See *International Business Machines Corp. v. Zaino* (2002), 94 Ohio St.3d 152.**

A taxpayer must file its petition within 60 days of receipt of the assessment. If the taxpayer sends the petition by certified mail, the date of postmark is considered the date filed. If the taxpayer sends the petition by regular mail, the date the department receives the petition is considered the date filed. The petition must specify the items of the assessment objected to and the reasons for those objections. However, a taxpayer that has timely filed a Petition for Reassessment may raise additional written objections to the assessment at any time before the date of the tax commissioner's final determination. If a taxpayer fails to file the Petition for Reassessment within the 60-day period described above, the tax commissioner will dismiss the petition as the tax commissioner has no jurisdiction to consider a late-filed petition.

The portion of an assessment that must be paid upon the filing of a Petition for Reassessment is as follows:

1. If the sole item objected to is the assessed penalty or interest, the assessed corporation must pay the entire assessment except for the penalty.
2. If prior to the date of issuance of the assessment the assessed corporation failed to file (i) the annual report required by O.R.C. Section 5733.02, (ii) any amended report required by division (C) of O.R.C. Section 5733.031 for the tax year at issue, or (iii) any amended report

required by division (D) O.R.C. Section 5733.067 to indicate a reduction in the amount of the credit provided under that section, the assessed corporation must pay the entire assessment except for the penalty.

3. If prior to the date of issuance of the assessment the assessed corporation filed (i) the annual report required by O.R.C. Section 5733.02; (ii) all amended reports required by division (C) of O.R.C. Section 5733.031 for the tax year at issue; and (iii) all amended reports required by division (D) of O.R.C. Section 5733.067 to indicate a reduction in the amount of the credit provided under that section, and if a balance of the taxes shown due on the reports as computed on the reports remains unpaid, the assessed corporation must pay only that portion of the assessment representing any unpaid balance as shown on those reports together with all related interest.
4. If the assessed corporation does not dispute that it is a taxpayer but claims the protections of Section 101 of Public Law 86-272, 73 Stat. 555, 15 U.S.C.A. 381, as amended, the assessed corporation must pay only that portion of the assessment representing any unpaid balance of taxes shown due on the corporation's annual report.
5. If none of the conditions specified in (1), (2), (3) and (4), above, apply, or if the assessed corporation claims that it is not a taxpayer (that is, if the assessed corporation disputes that it is subject to the franchise tax), the assessed corporation is not required to pay any portion of the assessment.

However, any unpaid portion of the assessment that upon final determination is found to be correct bears interest at the rate prescribed in O.R.C. Section 5703.47 from the date the Department of Taxation issues the assessment until the date the taxpayer pays the assessment. See O.R.C. Section 5733.11 as amended by Amended Substitute House Bill No. 215 (budget bill), 122nd General Assembly and Section 213 of the budget bill. If the taxpayer decides to pay the assessment in full, such payment is not acknowledgment of agreement and will not prejudice the final determination of the petition, and the taxpayer will receive interest on any refund found due. See general instruction #10 for interest on underpayments and overpayments.

**New Law: Substitute Senate Bill 200, 124<sup>th</sup> General Assembly enacted O.R.C. Section 5703.60 to establish a uniform Petition for Reassessment procedure and a uniform assessment correction procedure applicable to franchise tax, individual income tax, pass-through entity tax, withholding tax, school district income tax and various other taxes. If the taxpayer has filed a proper Petition for Reassessment for a tax whose statute specifies that the uniform**

reassessment procedure applies, this new law permits the tax commissioner, upon receipt of additional information from the taxpayer, to correct an assessment without issuing a final determination and without a hearing. In addition, this new law permits the commissioner to correct an assessment even if the taxpayer did not properly file a Petition for Reassessment or did not file a Petition for Reassessment. Set forth below is a more in-depth summary of the new law.

**A. Uniform procedure if the taxpayer properly files a Petition for Reassessment**

If a taxpayer objects to an assessment by properly filing a Petition for Reassessment under a law that specifies that the O.R.C. Section 5703.60 Petition for Reassessment procedure applies, then the tax commissioner and the taxpayer are to proceed as follows:

1. Upon review of the taxpayer's properly filed Petition for Reassessment, the commissioner must either
  - a. Issue a **final determination** that affirms, increases, cancels or reduces (without canceling) the assessment; or
  - b. Issue a **corrected assessment** that increases, cancels or reduces (without canceling) the assessment. However, if the party assessed has requested in writing that the tax commissioner not use the corrected assessment procedure, then the tax commissioner may not issue a corrected assessment; instead, after a hearing, if the taxpayer so requests, the commissioner must issue a final determination.

**Note:** A cancelled assessment is an assessment that the tax commissioner has reduced to **zero** by issuing either a corrected assessment or a final determination. If the tax commissioner **cancels** an assessment, the corrected assessment or final determination is *not* subject to further administrative review or appeal.

2. If upon review of the taxpayer's properly filed Petition for Reassessment (and after a hearing if the taxpayer so requests) the tax commissioner issues a final determination, the final determination may cancel, reduce, affirm or increase the assessment. The taxpayer may appeal the tax commissioner's final determination (other than a final determination that cancels the assessment) to the Board of Tax Appeals.

**Note:** The tax commissioner's final determination can increase the assessment even if the tax commissioner issues the determination outside the normal assessment statute of limitations

**period (three years for corporations; four years for individual income tax, pass-through entity tax and withholding tax).**

3. If upon review of the taxpayer's properly filed Petition for Reassessment the tax commissioner issues a corrected assessment, then (a) the corrected assessment nullifies the taxpayer's original petition, and (b) the original petition is not subject to further administrative review and may not be appealed to the Board of Tax Appeals. The tax commissioner must send the corrected assessment by ordinary mail. (Unlike the corrected assessment, the tax commissioner must send the original assessment by certified mail or must hand-deliver it.)

**Note: If the tax commissioner timely issued the original assessment, then the commissioner's corrected assessment is deemed timely issued even if the corrected assessment increases the original assessment outside the normal assessment statute of limitations period.**

4. If upon review of the taxpayer's properly filed Petition for Reassessment the tax commissioner issues a corrected assessment, the taxpayer may file a new Petition for Reassessment. If the taxpayer files a new petition, the taxpayer must do so within 60 days after the commissioner mails the corrected assessment. (Unlike a new Petition for Reassessment, the taxpayer must file its original petition within 60 days of receipt of the original assessment. In all other respects, a franchise taxpayer must file the new petition in the same manner as provided in O.R.C. Section 5733.11 for filing the original petition, and an individual income taxpayer in the same manner as provided in O.R.C. Section 5747.13.)
5. If upon review of the taxpayer's properly filed Petition for Reassessment the tax commissioner issues a corrected assessment and the taxpayer does not file a new petition within the 60-day period described in #4, above, then the corrected assessment becomes final. That is, the corrected assessment is not subject to further administrative review, may not be appealed to the Board of Tax Appeals, and is due and payable.
6. If upon review of the taxpayer's properly filed Petition for Reassessment the tax commissioner issued a corrected assessment that does not cancel the original assessment, and in response to the tax commissioner's corrected assessment the taxpayer files a new petition within the 60-day period described in #4, above, then upon review of the new petition and upon completion of the hearing (if the taxpayer requests a hearing) the commissioner must either:

- a. Issue a **final determination** that affirms, increases, decreases or cancels the first corrected assessment, or
- b. Issue a **second** corrected assessment that cancels the first corrected assessment in its entirety. If the commissioner cancels the first corrected assessment, the commissioner must send the cancellation by ordinary mail and the cancelled assessment is not subject to further administrative review or appeal.

**Note:** The commissioner may *not* issue a **second corrected assessment** that **reduces** but does not cancel the corrected assessment, and the commissioner may *not* issue a second corrected assessment that **increases** the first corrected assessment.

**B. Uniform procedure if the taxpayer fails to file a Petition for Reassessment or if the taxpayer fails to file a proper Petition for Reassessment**

The commissioner, on the commissioner's own motion, may issue a corrected franchise tax assessment. That is, the commissioner may issue a corrected assessment even if the taxpayer did not file a Petition for Reassessment or the taxpayer's petition is not timely or is otherwise invalid. However, this provision applies only if: (a) the assessment has not been certified to the attorney general for collection, or (b) the taxpayer has not appealed the commissioner's final determination to the Board of Tax Appeals.

If the commissioner issues a corrected assessment on commissioner's own motion, the corrected assessment may not **increase** the tax, penalty or additional charge unless the assessment statute of limitations period is still open at the time the tax commissioner issues the corrected assessment. (Unlike a corrected assessment issued on commissioner's own motion, a corrected assessment issued in response to the taxpayer's petition, may increase the original assessment outside the assessment statute of limitations period (see A-2 above). The commissioner must send a corrected assessment issued on the commissioner's own motion by ordinary mail.

**C. Refunds of amounts paid toward an assessment**

If (a) the tax commissioner issues a corrected assessment or final determination; (b) the corrected assessment or final determination reduces the assessment **below** the amount the taxpayer has already **paid** toward that assessment; and (c) the reduction is made as a result of the taxpayer's properly filed Petition for Reassessment or other written request, then the commissioner may certify any overpayment as a refund

only to the extent that a refund could have been claimed at the time the party assessed made the written request. If tax commissioner reduces an assessment on the commissioner's own motion, then the commissioner will certify any overpayment only to the extent a refund could have been claimed at the time the commissioner made the reduction.

## **28. TAXPAYER'S BILL OF RIGHTS – REQUESTS FOR AN OPINION OF THE TAX COMMISSIONER**

The Taxpayer's Bill of Rights (Senate Bill 147, 118th General Assembly) established and amended certain administrative procedures relating to Department of Taxation audits and assessments. The law provides that at or before the commencement of an audit the Department of Taxation must provide to the taxpayer a written description of the roles of the department and the taxpayer during an audit and a statement of the taxpayer's rights.

A brochure that discusses the department's interpretation of this law is available on the department's Web site. In addition, this law permits the tax commissioner to issue binding opinions regarding the taxation of proposed activities of the taxpayer. As set forth in Ohio Administrative Code (Rule) 5703-1-12, a request for an opinion of the tax commissioner must comply with the following:

- Be in writing;
- Explicitly request an "Opinion of the Tax Commissioner";
- Specifically refer to O.R.C. Section 5703.53;
- State all the facts of the activity or transaction for which the opinion is requested;
- Identify the parties involved in the activity or transaction about which the opinion is requested;
- Set out the specific legal questions for which the opinion is requested; and
- Be signed by an officer of the corporation authorized to act on its behalf.

For further information see Rule 5703-1-12, "Requests for an Opinion of the Tax Commissioner," available on the department's Web site.

## **29. SUBSTANCE OVER FORM**

The tax commissioner has authority to apply the doctrines of "economic reality," "sham transaction," "step transaction" and "substance over form."



Generally the tax commissioner bears the burden of establishing by a preponderance of the evidence that these doctrines should apply. See O.R.C. Section 5733.111.

### **30. RIGHT TO OFFSET REFUND**

The tax commissioner may apply a taxpayer's franchise tax refund against the taxpayer's indebtedness to the state of Ohio for any tax or fee and any charge, penalty or interest arising from such a tax or fee that is administered by the tax commissioner and paid to the state or to the clerk of courts. This provision applies only to the taxpayer's debts that have become "final." See O.R.C. Section 5733.121.

## **Line Instructions – Schedule A**

If the taxpayer is a member of a **combined** franchise report (form FT-1120C), please:

- See general instruction #23 and the instructions for form FT-1120C – Combined Report;
- Skip lines 2 through 5 of Schedule A, form FT-1120;
- Enter on line 6 of Schedule A, form FT-1120 the taxpayer's separate company apportionment ratio; and
- Enter on line 7 of Schedule A form FT-1120 the taxpayer's apportioned income from Schedule B (Combined), line 7 of the combined report, form FT-1120 C.

A taxpayer must compute its Ohio taxable income for its taxable year (see general instruction #7).

### **Line 1 – Federal taxable income.**

Enter the taxpayer's federal taxable income before net operating loss deduction and special deductions from federal form 1120, line 28 or federal form 1120A, line 24. **If the taxpayer is a member of a consolidated federal return compute the taxpayer's federal taxable income as if the taxpayer filed a separate federal return. The Department of Taxation maintains that the federal consolidation rules do not apply in determining federal taxable income for purposes of the franchise tax.**

### **Line 6 – Ohio apportionment ratio.**

Enter the taxpayer's apportionment ratio from Schedule D, line 4 determined on a separate company basis. Enter the taxpayer's separate company

apportionment ratio even if the taxpayer is a member of a combined franchise tax report.

**Line 9 – Income (loss) from transferor corporation.**

A taxpayer-**transferee** that receives substantially all of the assets or equity of a *transferor* corporation must include in its own Ohio taxable income the transferor's Ohio taxable income **if following the transfer the transferor is not subject to the franchise tax and the transfer qualifies for nonrecognition of gain and loss under the Internal Revenue Code. If the transferor statute applies to the transferee, then the transferor's Ohio net operating losses, unused credit amounts and other franchise tax attributes transfer to the transferee** subject to the limitations set forth in I.R.C. Sections 381 and 382.

The Ohio taxable income of a transferor corporation is determined in the same manner as if the transfer had not been made and the transferor remained subject to the franchise tax. Thus, the federal taxable income of a transferor corporation is subject to the same adjustments and must be allocated and apportioned in the same manner as if the transferor remained subject to the franchise tax. The taxpayer-transferee must include such income in computing its tax for the same tax year or years that such income would have been reported by the transferor if the transfer had not been made and the transferor had remained subject to the franchise tax. If the transferor was previously included in a combined report, the income of the transferor must be determined as if the transferor remained in the combined report.

If a taxpayer subject to O.R.C. Section 5733.053 subsequently becomes a transferor, then any income that the taxpayer would have been required to add to its income under O.R.C. Section 5733.053 is included in its income as a transferor and any credits or deductions that the taxpayer would have been entitled to under this section are available to the taxpayer as a transferor. See O.R.C. Section 5733.053 and Sections 13(A) and 13(C) of House Bill 111.

**Note:** Amended Substitute House Bill 94, 124<sup>th</sup> General Assembly (budget bill) limits the transferor statute provisions to those transfers and distributions that qualify for nonrecognition of gain and loss under the I.R.C.

Amended Substitute Senate Bill 287, 123<sup>rd</sup> General Assembly (Am. Sub. S.B. 287) amended both the transferor statute (O.R.C. 5733.053) and the exit tax statute (O.R.C. 5733.06(H)). The changes to the transferor statute and the exit tax, as enacted by Am. Sub. S.B. 287 and summarized below, were originally to have been effective with the 2002 franchise tax report (see Section 13 of Am. Sub. S.B. 287). However, Amended Substitute House Bill 94, 124<sup>th</sup> General Assembly (the budget bill) later amended the effective date of the changes to the transferor statute and the exit tax statute made by Am. Sub. S.B. 287. Amended Substitute House Bill 94 provides that the

amendments to the exit tax and to the transferor statute made by Am. Sub. S.B. 287 do not apply to any transfer for which negotiations began before January 1, 2001, and that was commenced in and completed during calendar year 2001, unless the transferee makes an election prior to December 31, 2001, to apply those amendments.

Amended Substitute Senate Bill 287 amendments to transferor statute definitions – the new law defines the terms “transfer,” “transferor” and “transferee” as follows:

- “**‘Transfer’** means a transaction or series of related transactions in which a corporation directly or indirectly transfers or distributes substantially all of its assets or equity to another corporation.” O.R.C. Section 5733.053(A)(1).
- “**‘Transferor’** means a corporation that has made a transfer.” O.R.C. Section 5733.053(A)(2).
- “**‘Transferee’** means a corporation that received substantially all the assets or equity of a transferor in a transfer.” O.R.C. Section 5733.053(A)(3).

Amended Substitute Senate Bill 287 also established the following relationship between the transferor statute (O.R.C. Section 5733.053) and the exit tax (see general instruction #6 and O.R.C. Section 5733.06(H)):

- 1) If on January 1 following the transfer of substantially all the transferor’s assets to the transferee the transferor remains in existence, then the transferor is subject to the franchise tax and the transferor statute does not apply to the transferee. See O.R.C. Section 5733.053(B): *“The transferee shall add such income in computing its tax for the same tax year or years that such income would have been reported by the transferor if the transfer had not been made. The transferee shall add such income only to the extent the income is not required to be reported by the transferor for the purposes of the tax imposed by divisions (A) and (B) of Section 5733.06 of the Ohio Revised Code.”*
- 2) If on January 1 following the transfer of substantially all the transferor’s assets to the transferee the transferor is not subject to the franchise tax (because, for example, the transferor merged into the transferee), and if for federal income tax purposes the transfer qualifies for nonrecognition of gain and loss, then the O.R.C. Section 5733.053 transferor statute applies to the transferee and the exit tax does not apply to the transferor. That is, the transferee is required to add to its income the income of the transferor and the franchise tax attributes of the transferor pass to the transferee.
- 3) If on January 1 following the transfer of substantially all the transferor’s assets to the transferee the transferor is not subject to the franchise tax

imposed by divisions (A) and (B) of 5733.06 (because, for example, the transferor merged into the transferee), and the O.R.C. Section 5733.053 transferor statute does not apply to the transferee (because, for example, the merger is not a tax-free reorganization) and if all other conditions of an exiting corporation apply, then the exit tax applies to the transferor. See O.R.C. Section 5733.06(H)(1)(d) and 5733.06(H)(6).

**Line 12 – Ohio net operating loss deduction.**

An Ohio net operating loss is calculated in the same manner as positive Ohio net income is calculated. That is, in determining the Ohio net operating loss generated in a particular taxable year the same adjustment, allocation and apportionment provisions apply as in determining positive Ohio taxable income (before the net operating loss deduction). Any net operating loss is applied to subsequent net income to reduce that income to zero or until the net operating loss has been fully used as a deduction.

For net operating losses incurred in taxable years ending on or after January 1, 1982 and before August 6, 1997 the designated carryover period is 15 consecutive taxable years following the taxable year in which the net operating loss occurs. For net operating losses incurred in taxable years beginning on or after August 6, 1997, the designated carryover period is 20 consecutive taxable years following the taxable year in which the net operating loss occurs. For purposes of calculating the carryforward period, the first year of the carryforward period is the taxable year following the taxable year in which the loss should have been reported.

A surviving corporation in a merger is permitted to use the Ohio net operating losses of a merged corporation provided that the surviving corporation for federal income tax purposes is permitted to use the federal net operating losses, if any, of the merged corporation. I.R.C. Sections 381 and 382 apply with respect to the allowable loss. A merged corporation has no Ohio net operating loss for a period if it is not subject to the Ohio franchise tax measured by income from that period. See *Litton Industrial Products, Inc. v. Limbach* (1991), 58 Ohio St. 3d 169. However, see the instructions for line 9, income (loss) from transferor corporation, above.

Each corporation filing as a member of a combined franchise tax group will have its own net operating loss deduction since each will compute its own Ohio taxable income on its own franchise tax report, form FT-1120.

For each year in which the taxpayer uses any portion of a net operating loss carryforward please attach to the franchise tax report a schedule that shows when the loss was generated, the amount of loss that was used in earlier years and the remaining carryforward amount. The taxpayer must maintain information regarding a net operating loss carryforward for at least four years after the later of the filing date or the due date of the report in which any portion of the carryforward is claimed.

The statute of limitations does not prohibit either the tax commissioner or the taxpayer from adjusting the net operating loss carried forward from a tax year closed to assessment to a year still open to assessment or refund. See *Consumer Direct v. Limbach* (1991), 62 Ohio St. 3d 180.

**Line 21 – Overpayment carryforward from 2002.**

Enter the overpayment carryforward shown on the originally filed 2002 franchise tax report that was credited to estimated tax payments for tax year 2003. An overpayment claimed on an amended report cannot be credited against the tax liability for any other year. If an amended report reflects an overpayment, the taxpayer must also submit form FT-REF, Application for Corporation Franchise Tax Refund, or a statement that sets forth the full and complete reason for the overpayment. See *Abitibi-Price Corporation and Subsidiaries v. Tracy*, BTA No. 98-N-401 (3-12-01), and refer to general instruction # 27.

**Line 22 – Estimated payments made in 2003.**

Enter the estimated payments paid during tax year 2003 with form FT-1120E, Declaration of Estimated Franchise Tax; form FT-1120ER, Application for Automatic Extension; and form FT-1120EX, Request for Additional Extension.

**Line 23 – Refundable credits.**

**New jobs credit.** Enter the new jobs credit as provided by O.R.C. Sections 5733.0610 and 122.17 and attach a copy of the certificate of verification issued by the Department of Development. The refundable new jobs credit is considered a payment made on January 1 of the tax year. The amount of the credit equals the amount of Ohio income tax the taxpayer withheld from compensation paid to “new employees” during the taxpayer’s taxable year multiplied by the percentage specified in the taxpayer’s agreement with the Tax Credit Authority.

The term “new employee” means a full-time employee first employed by the taxpayer in the project that is the subject of the tax credit agreement after the taxpayer enters into the agreement. New employees include employees hired after the Tax Credit Authority approves the taxpayer’s project but before the taxpayer signs the tax credit agreement with the Tax Credit Authority as long as the taxpayer signs the agreement within 60 days after receiving the agreement from the Department of Development. If the Authority determines that it is appropriate, a “new employee” also may include an employee rehired or called back from layoff to work in a new facility or on a new product or service.

If a taxpayer claims the refundable new jobs credit with respect to an employee, the taxpayer may not claim the nonrefundable O.R.C. Section 5709.66 enterprise zone new employee credit with respect to that same employee.

The Tax Credit Authority and the Ohio Department of Development administer this credit. Tax Credit Agreement application forms are available from the Ohio Department of Development, Economic Development Division, 77 S. High Street, 28th floor, P.O. Box 1001, Columbus, Ohio 43216-1001 or call 614-466-4551 or 1-800-848-1300.

**Credit for tax withheld by the Ohio Lottery Commission.**

Enter the amounts that the Ohio Lottery Commission withheld from its payments to the taxpayer pursuant to O.R.C. Section 5747.062(B)(2). See the line instructions for schedule C, line 6 for background information with regard to this credit.

**Line 26 – Interest and penalty.**

Enter any interest and penalty as explained in general instructions #10, #11 and #12.

**Lines 29 and 30 – Overpayment to be credited to year 2004 estimated tax and overpayment to be refunded.**

Enter the amount of overpayment to be refunded and/or to be credited against next year's tax liability. **Note:** An overpayment shown on an **amended** report cannot be credited against the tax liability for any other year. If an amended report reflects an overpayment, the taxpayer must also submit form FT-REF, Application for Corporation Franchise Tax Refund or a statement that explains the full and complete reason for the overpayment. See *Abitibi-Price Corporation and Subsidiaries v. Tracy*, BTA No. 98-N-401 (3-12-01), and refer to general instruction #27.

**Schedule B – Adjustments to Federal Taxable Income**

**Note 1:** The "aggregate" (conduit) theory of taxation applies to the franchise tax. That is, the character of all income and deductions (and adjustments to income and deductions) realized by a partnership or other pass-through entity in which the taxpayer has a direct or indirect interest retains that character for purposes of the franchise tax when recognized by the investor in the pass-through entity. For example, a partner's distributive share of partnership net interest income from exempt federal obligations is considered net interest income from exempt federal obligations when recognized by the partner and is therefore deductible. Furthermore, the taxpayer-partner's proportionate share of partnership property, payroll and sales must be included in the taxpayer-partner's apportionment formula. See *Mead Properties, Inc. v. Limbach*, BTA Case Nos. 85-D-791, 85-E-792, 85-C-793, 85-B-794, April 21, 1989. Effective for taxable years ending on or after September 29, 1997, Amended Substitute House Bill No. 215 (budget bill), 122nd General Assembly codified into the franchise tax statute the conduit theory (see O.R.C. Section 5733.057).

**Note 2:** Ohio may not tax a foreign corporation's nonunitary interest income from short-term investments acquired, managed and controlled outside of Ohio. The taxpayer has the burden of showing that the income is nonunitary. See *American Home Products Corp. v. Limbach* (1990), 49 Ohio St. 3d 158.

**Note 3:** The corporation franchise tax on gains from the sale of interest bearing federal obligations is not prohibited by either Section 3124, Title 31, U.S. Code or the constitutional doctrine of intergovernmental immunity. Furthermore, the franchise tax does not impermissibly discriminate against federal obligations in favor of state obligations. See *NACCO Industries, Inc. v. Tracy* (1997), 79 Ohio St. 3d 314.

**Note 4:** If the taxpayer is an electric company or a combined (electric) company as defined in O.R.C. Section 5733.04(P) please complete Supplemental Schedule B for Electric Companies. An "electric company" is any person engaged in the business of generating, transmitting, or distributing electricity within Ohio for use by others, but excludes a rural electric company, as defined in O.R.C. Section 5727.01(C).

**Lines 1(a) and 2(b) – Valuation limitation on gains and losses from capital assets and 1231 assets.**

A corporation must add any loss and deduct any gain resulting from the sale or other disposal of a capital asset, or an asset described in I.R.C. Section 1231, to the extent that such loss or gain occurred before the beginning of the first day of the taxpayer's Ohio corporation franchise tax taxable year that ended on or after December 20, 1971 on which the tax provided for in O.R.C. Section 5733.06 is computed on the corporation's net income. The taxpayer has a choice of two methods in determining the amount of such prior loss or gain (valuation limitation):

- The amount of such prior gain or loss is the difference between the original cost or other basis of the asset and its fair market value as of the beginning of the first taxable year on which the tax provided for in O.R.C. Section 5733.06 is computed on the corporation's net income. However, such prior period gain or loss calculated under this method may not exceed the gain or loss reported on the federal return.
- Alternatively, the amount of such prior gain or loss is determined by multiplying the gain or loss by a fraction, the numerator of which is the number of months from the acquisition of the asset to the beginning of the first taxable year on which the tax provided in O.R.C. Section 5733.06 is computed on the corporation's net income, and the denominator of which is the number of months from the acquisition of the asset to the sale or other disposal of such asset.



Corporations that are required to make this adjustment must file form FT-1120VL, which applies only to gains and losses to which the valuation limitation applies.

**Lines 1(b) and 2(f) – Losses from the sale of Ohio public obligations; interest on public obligations and purchase obligations and gains from the sale of Ohio public obligations.**

A corporation must add any loss resulting from the disposition of public obligations to the extent such losses have been deducted in determining federal taxable income. The term “public obligation” is defined below.

A corporation may deduct interest income from both purchase obligations and public obligations to the extent such amounts are included in federal taxable income. The terms “purchase obligations” and “public obligations” are defined below.

A corporation may deduct gains from the disposition of public obligations to the extent such gains are included in federal taxable income.

For purposes of these adjustments the following definitions apply:

“Purchase obligations” means interest-bearing obligations of the state of Ohio and local public or governmental entities in the state of Ohio where these obligations require payments under installment sale, lease, lease purchase or similar agreements.

“Public obligations” means:

- Public securities such as bonds, notes, certificates of indebtedness and commercial paper issued by the state of Ohio and local public or governmental entities in Ohio that evidence the obligation of the state or local public or governmental entity to repay borrowed money.
- Fractionalized interests in purchase obligations, i.e., shares or participations evidencing ownership of interests in purchase obligations. Fractionalized interests in purchase obligations are separate from purchase obligations themselves and do not include interests or shares in a unit trust, investment trust, grantor trust or regulated investment company.
- Any obligation to pay interest on public securities or on fractionalized interests in purchase obligations.

Public obligations do not include purchase obligations.

“Interest” means payments that represent consideration for forbearing the collection of money, or for deferring the receipt of payment of money to a future time as determined for federal income tax purposes. Interest includes those portions of a qualified investment trust’s distributions to its shareholders

or beneficial owners that are attributable to the trust's receipt of interest or interest equivalent.

"Qualified Investment Trust" or "Trust" means a unit investment trust, grantor trust or regulated investment company if at all times at least 50% of the value of the total assets of the trust consists of public securities or purchase obligations, or similar obligations of other states or their local public or governmental entities.

For more specific information see O.R.C. Section 5709.76.

**Line 1(c) – Amounts claimed as a credit for taxes paid by a qualifying pass-through entity.**

A corporation that claims the franchise tax credit for taxes paid by a qualifying pass-through entity in which the corporation is an investor must add to federal taxable income the amount claimed as a credit to the extent that the amount was deducted or excluded from the corporation's federal taxable income. See O.R.C. Section 5733.04(l)(14). For an explanation of the tax on qualifying pass-through entities see the instructions for form IT-1140, Ohio Pass Through Entity Tax Return. For an explanation of the credit for taxes paid by a qualifying pass-through entity see the line instructions for Schedule A-1, Nonrefundable credits.

**Lines 1(d) and 2(h) – Net loss from an "exempted investment" in a public utility and net income from an "exempted investment" in a public utility.**

For taxable years ending after September 28, 1997 a franchise taxpayer must adjust its net income or loss to the extent that the taxpayer's income or loss would include, were it not for this law, the taxpayer's proportionate share of such income or loss attributable to the taxpayer's direct or indirect ownership interest in an "exempted investment." Similarly, a taxpayer must adjust its apportionment factors and its credits to the extent that the taxpayer's apportionment factors and credits would include, were it not for this law, the taxpayer's proportionate share of such amounts attributable to the taxpayer's direct or indirect ownership interest in an "exempted investment."

An exempted investment is the taxpayer's direct or indirect investment in a pass-through entity or a "disregarded entity" (a single member LLC that is treated as a division of its owner), which is a public utility subject to the Ohio public utility excise tax on its gross receipts.

The exempted investment adjustments apply only if the taxpayer-investor in the public utility directly or indirectly owns the investment in the public utility for the public utility's entire taxable year ending with or within the taxpayer's taxable year ending immediately before the taxpayer's tax year. Furthermore, the adjustments apply only to the extent that the adjustments directly relate

to owning and operating a public utility in Ohio by a pass-through entity that is subject to the Ohio public utility gross receipts tax or a disregarded entity that is subject to the Ohio public utility gross receipts tax. See O.R.C. Section 5733.058.

**Lines 1(e) and 2(i) – Depreciation expense adjustment for I.R.C. Section 168(k) bonus depreciation.**

If the taxpayer's taxable year for the **2003** franchise report ended **after June 4, 2002** and if in determining federal taxable income for that taxable year the taxpayer claimed I.R.C. Section 168(k) bonus depreciation on assets acquired after September 10, 2001, then on line 1(e) the taxpayer must add back 5/6 of its I.R.C. Section 168(k) bonus depreciation amount. For each of the five succeeding tax years (that is, report years 2004 through 2008) the taxpayer may deduct 1/5 of the amount added back. The department refers to this provision as the "5/6 – 1/5 rule." The 5/6 – 1/5 rule also applies to assets acquired during taxable years that end in 2003 and 2004.

If the taxpayer's taxable year for the **2003** franchise report ended **before June 5, 2002** and if in determining federal taxable income for that taxable year the taxpayer claimed I.R.C. Section 168(k) bonus depreciation on assets acquired after September 10, 2001, then in determining Ohio taxable income the taxpayer must apply one of the following two options:

**A. Elect to apply the 5/6 – 1/5 rule** (that is, add-back 5/6 of its I.R.C. Section 168(k) bonus depreciation amount on line 1(e) and for each of the succeeding five tax years deduct 1/5 of the amount added back). See Section 4 of Amended Substitute Senate Bill 261, 124<sup>th</sup> General Assembly. The taxpayer can make this election by writing "5/6 – 1/5 rule election" in the margin of line 1(e) or by attaching to the report a statement that the taxpayer elects to apply the 5/6 – 1/5 rule.

or

**B. Recompute federal depreciation expense as it would have been computed without enactment of I.R.C. Section 168(k)**, and then on line 1(e) add to federal taxable income the difference between the taxpayer's depreciation expense actually deducted for the taxable year and the recomputed depreciation expense.

**Note 1:** With respect to assets acquired between September 11, 2001 and the last day of the taxpayer's taxable year ending before June 5, 2002, the **recomputation** of depreciation expense as described in option **B**, above, applies only to the taxpayer's taxable year ending before June 5, 2002. That is, if the taxpayer chooses option B, then with respect to assets that the taxpayer acquired between September 11, 2001 and the last day of the taxpayer's taxable year ending before June 5, 2002, the depreciation expense shown on the federal income tax return for all subsequent taxable years for those assets will also be the depreciation expense for Ohio tax purposes

and with respect to those assets the taxpayer may not make any further franchise tax depreciation adjustment in subsequent taxable years. **So, if the taxpayer chooses option B, then for Ohio tax purposes the taxpayer will not fully depreciate those assets acquired between September 11, 2001 and the last day of the taxpayer's taxable year ending before June 5, 2002.**

**Note 2: Amended franchise tax report for 2002.** If federal taxable income as shown on the taxpayer's originally filed 2002 franchise tax report for the taxpayer's taxable year ending in 2001 (after September 10, 2001) reflects a deduction for I.R.C. Section 168(k) bonus depreciation, then the taxpayer **must file an amended 2002 franchise tax report** that reflects either option A or option B, above, and pay any additional tax, interest and penalty due. Furthermore, note 1 applies to the 2002 franchise tax report. So, with respect to **assets acquired after September 10, 2001 during its taxable year that ends in 2001** if the taxpayer fails to make the election described in A, then the depreciation expense shown on the federal income tax return for all subsequent taxable years for those assets will also be the depreciation expense for Ohio tax purposes and the taxpayer is not entitled to any further depreciation adjustment with respect to those assets. Thus, for assets **acquired after September 10, 2001 during its taxable year that ends in 2001** if the taxpayer files an amended 2002 franchise tax report that reflects option B, then the taxpayer will not fully depreciate those assets for Ohio tax purposes.

The taxpayer can make the election described in **A** by filing an amended 2002 report and writing in the margin of any previously blank line of schedule B "5/6 – 1/5 rule election" (or by attaching a statement to that effect to the amended 2002 report) and paying the additional tax and interest. The tax commissioner will not impose the failure-to-pay penalty with respect to such amended reports if the taxpayer filed the amended 2002 tax report and paid the related increased tax and interest by November 15, 2002.

**Note 3:** The **Schedule B** bonus depreciation expense adjustment applies whether or not the depreciation expense relates to allocable income or apportionable income. To the extent that the bonus depreciation adjustment relates to income allocated within and without Ohio, the taxpayer must also make the same adjustments in schedule C as are made in schedule B.

**Note 4:** The bonus depreciation add-back and deductions have **no effect on the basis** of the assets depreciated. Thus, upon the sale of an asset on which the taxpayer claimed bonus depreciation, the gain or loss for Ohio purposes will equal the gain or loss for federal purposes whether or not at the time of sale the 5/6 amount has been fully recovered (and whether or not the taxpayer acquired an asset in a taxable year that ends prior to June 5, 2002 and chooses option B and thus will not fully depreciate an asset for

Ohio purposes). In addition, if at the time of sale the taxpayer has not fully recovered the 5/6 add-back, the taxpayer can continue to make the bonus depreciation deduction after the sale.

**Note 5:** The bonus depreciation adjustment applies not only to assets that the taxpayer owns but also to depreciable assets owned by the taxpayer's disregarded entities and to depreciable assets owned by pass-through entities in which the taxpayer holds an at least 5% ownership interest.

**Note 6:** If the taxpayer is an equity investor in a pass-through entity that has claimed I.R.C. Section 168(k) bonus depreciation and if, because of the federal passive activity loss limitation rules or the at-risk limitation rules, the taxpayer is unable to fully deduct a loss passing through from the pass-through entity, then to the extent that the taxpayer does not recognize the loss the taxpayer can defer making the "5/6 add-back" until the taxable year or years for which the taxpayer deducts the pass-through entity loss and receives a federal tax benefit from the bonus depreciation amount claimed by the pass-through entity. Of course, the corporation cannot begin claiming the related deductions until the first taxable year immediately following the taxable year for which the corporation makes the 5/6 add-back.

**If the taxpayer's 2002 franchise tax report or amended franchise tax report reflects the 5/6 bonus depreciation add-back, deduct 1/5 of the add-back on line 2(i) of the 2003 report.**

For further information please see the following: (i) the department's July 2002 information release entitled "Recently Enacted Ohio Legislation Affects Depreciation Deductions for Taxable Years Ending in 2001 and Thereafter"; (ii) the Department's November, 2002 information release entitled "Ohio Bonus Depreciation Adjustment and the Internal Revenue Code's Passive Activity Loss, Basis Limitation and At-Risk Rules"; (iii) O.R.C. Section 5733.04(I)(17) and (18); (iv) Section 4 of Amended Substitute Senate Bill 261, 124<sup>th</sup>, General Assembly; and (v) page 3 of these instructions.

**Line 2(c) – Dividends received.**

Enter the sum of the following: (1) the dividend deduction provided by I.R.C. Section 243 and (2) to the extent not otherwise allowed by the I.R.C. Section 243 dividends received deduction: (a) dividends received from an insurance company if the taxpayer owns at least 80% of the outstanding common stock of the insurance company and (b) dividends received from a public utility, except an electric company, if the taxpayer owns at least 80% of the outstanding common stock of the public utility. See O.R.C. Section 5733.04(I)(4), (I)(7) and (I)(8).

**Line 2(d) – Adjustment for targeted jobs tax credit or work opportunity tax credit.**

Deduct the wage and salary expense not otherwise deducted for federal tax purposes because of the targeted jobs tax credit and/or the work opportunity tax credit. See O.R.C. Section 5733.04(l)(10).

**Line 2(e) – Net interest income from exempt U.S. obligations.**

Deduct net interest on obligations of the United States and its territories and possessions or of any authority, commission or instrumentality of the United States. “Net federal interest” is defined as federal interest less any expenses taken on the federal tax return that would not have been allowed under I.R.C. Section 265 if such interest were exempt from federal income tax. See O.R.C. Section 5733.04(l)(11).

A January 9, 1992 Ohio Department of Taxation information release lists federal obligations, the interest from which is deductible. The information release is available on the department’s Web site. Generally interest income generated from repurchase agreements secured by federal obligations is not interest from federal obligations and therefore is not deductible. See *Nebraska Department of Revenue v. Lowenstein*, 513 U.S. 123 (1994), 115 S. Ct. 557, 1994 US Lexis 8802. Also see *Associated Estates Corp.*, AEC Management Co. and *Hirsch Electric Co. v. Limbach*, BTA Case Nos. 87-H-743, 87-G-774 and 87-D-756, May 11, 1990.

**Line 2(g) – Contributions to an individual development account program.**

Deduct the amount that the taxpayer contributed during the taxable year to an individual development account program established by a county department of human services pursuant to O.R.C. Sections 329.11 to 329.14 for the purpose of matching funds deposited by program participants. See O.R.C. Section 5733.04(l)(15). The individual development account program applies to low-income residents of a county who enter an agreement with the fiduciary organization selected to administer the program. Program participants must abide by the terms and conditions of the agreement and may use money in an individual development account only with the approval of the fiduciary organization.

**Schedule C – Allocable Income  
O.R.C. Section 5733.051**

**Note 1:** The “aggregate” (conduit) theory of taxation applies to the franchise tax. That is, the character of all income and deductions (and adjustments to income and deductions) realized by a pass-through entity retains that character for purposes of the franchise tax when recognized by the investor

in the pass-through entity. For example, a partner's distributive share of partnership net rental income is considered rental income when recognized by the partner. See *Mead Properties, Inc. v. Limbach*, BTA Case Nos. 85-D-791, 85-E-792, 85-C-793, 85-B-794, April 21, 1989. Effective for taxable years ending on or after September 29, 1997, Amended Substitute House Bill No. 215, 122nd General Assembly (budget bill) codified into the franchise tax statute the conduit theory (see O.R.C. Section 5733.057).

Because Ohio franchise tax law makes no distinction between business and nonbusiness income, net income (both positive and negative amounts) of the types listed below is allocable regardless of whether the income is earned in the taxpayer's regular course of trade or business. Net income of the types listed below that is not allocated to Ohio is allocated outside Ohio (rather than apportioned).

**Note 2:** If the taxpayer is an electric company or a combined (electric) company, as defined in O.R.C. Section 5733.04(P), please complete Supplemental Schedule C for Electric Companies. An "electric company" is any person engaged in the business of generating, transmitting, or distributing electricity within Ohio for use by others, but excludes a rural electric company, as defined in O.R.C. Section 5727.01(C).

**Note 3:** To the extent that the bonus depreciation add-back and deduction adjustments made in Schedule B relate to income allocated within or without Ohio, the taxpayer must make the same adjustments in Schedule C. See O.R.C. Section 5733.04(l)(17(c) and (l)(18(b)).

**Line 1 – Net rents.**

Net rents from real property located in Ohio are allocable to Ohio. Net rents from tangible personal property are allocable to Ohio to the extent that such property is used in Ohio. A lessor's net income or loss from I.R.C. Section 168(f)(8) safe harbor lease agreements is not allocable rental income or loss from tangible personal property. Instead, such income or loss is apportionable. See *Goodyear Tire & Rubber Co. v. Limbach* (1991), 61 Ohio St. 3d 381.

**Line 2 – Net royalties.**

Net royalties from real property located in Ohio are allocable to Ohio. Net royalties from tangible personal property are allocable to Ohio to the extent that such property is used in Ohio.

**Line 3 – Capital gains and losses and depreciation recapture.**

Capital gains and losses and 1231 gains and losses from the sale or other disposition of real property located in Ohio are allocable to Ohio. Capital gains and losses and 1231 gains and losses from the sale or other disposition of tangible personal property are allocable to Ohio if the property had a situs in Ohio at the time of sale.



Gains from the sale or other disposition of depreciable real property and depreciable tangible personal property, taxed as ordinary (recapture) income for federal income tax purposes, are considered capital gains and capital losses for purposes of allocation (see *Borden, Inc. v. Limbach* (1990), 49 Ohio St. 3d 240). Upon the sale of a depreciable asset, the amount of recapture income allocable to Ohio is not limited to the accumulated depreciation expense (on the asset sold) that the taxpayer had apportioned to Ohio in previous years because the statute contains no overt language that would serve to limit depreciation recapture in such a manner. See *Harsco Corp. v. Tracy* (1999), 85 Ohio St.3d 382. Gains and losses from the sale of aircraft and engines located outside Ohio at the time of sale are allocable outside Ohio pursuant to O.R.C. Section 5733.051(D) – not apportionable (see *Delta Airlines, Inc. v. Tracy*, BTA No. 96-T-471 & 96-T-472 (1-12-2001)).

Capital gains and capital losses from the sale or other disposition of intangible personal property that may produce dividend income are allocated on the same basis as set forth in the section below dealing with dividends. Capital gains and capital losses from the sale or other disposition of all other intangible personal property are apportioned.

**Line 4 – Dividends (not otherwise deducted and not apportionable).**

Dividends that are not otherwise deducted or excluded from net income, other than dividends from Domestic International Sales Corporations, are allocated to Ohio in accordance with the ratio that the book value of the physical assets of the payor thereof located in Ohio bears to the book value of the total physical assets of the payor thereof located everywhere. Dividends from Domestic International Sales Corporations and from payors the location of whose physical assets is not available to the taxpayer are apportionable.

**Line 5 – Net patent and copyright royalties and technical assistance fees.**

Net patent and copyright royalties and technical assistance fees, not representing the taxpayer's principal source of gross receipts, are allocable to Ohio to the extent that the activity of the payor thereof giving rise to the payment takes place in Ohio. "Principal source" means that the income from a given source is greater than the income from each other source. In determining whether or not net patent and copyright royalties and technical assistance fees represent the taxpayer's principal source of gross receipts in the instance of a combined report, it is the individual taxpayer corporation's principal source of gross receipts which is determinative rather than the combined group's principal source of gross receipts. See *E. W. Scripps Co. v. Limbach*, BTA Case No. 87-C-761, July 12, 1991.

Trademark royalties and service mark royalties are not considered patent and copyright royalties and accordingly are apportionable income. Franchise royalties, not representing the taxpayer's principal source of gross receipts,

are allocable as technical assistance fees if and to the extent that the royalties are received for technical assistance. However, if the taxpayer receives franchise royalties (that do not represent the taxpayer's principal source of gross receipts) for rendering both technical assistance and for other services or consideration and if it is impossible to break out that portion of the royalty that is for technical assistance from that portion that is not, then the entire royalty is allocable. A "technical assistance fee" is defined as "payment for mechanical, industrial, scientific or practical aid, expertise or services." See *Holiday Inns, Inc. v. Limbach* (1990), 48 Ohio St. 3d 34 and *Stanley Steamer International, Inc., v. Tracy*, BTA Case No. 91-K-1650, August 20, 1993.

Fixed rate monthly fees received from customers for software support services, which services include consultation, training and software maintenance (i.e., modifications or improvements to software that the taxpayer licensed to its customers), constitute allocable "technical assistance fees" rather than apportionable income. A technical assistance fee need not be payable in the form of a royalty (that is, based on the number of units produced by the payer-customer or based on a percentage of the payer-customer's revenue) in order to qualify as allocable income. A customer's use of the computer system at the customer's place of business is sufficient to constitute "the activity of the payer thereof giving rise to the payment" within the meaning of O.R.C. Section 5733.051(G). See *Reynolds and Reynolds Company v. Tracy*, BTA No. 96-P-447 (1-29-99).

A taxpayer may apportion its otherwise allocable net patent and copyright royalties and technical assistance fees if in the ordinary course of business the taxpayer is unable to obtain the information necessary for allocation (that is, if the taxpayer is unable to obtain the location of the payor's activity giving rise to the royalty payment) and if obtaining such information would unduly burden the industry. See *Random House, Inc. v. Tracy*, BTA Case No. 91-A-1329, May 19, 1993.

**Line 6 – State lottery income.** Income described in division (B)(5) of O.R.C. Section 5747.20 is allocable to Ohio and similar amounts from other states are allocable outside Ohio (see O.R.C. Section 5733.051(H) as enacted by Substitute Senate Bill 226, 124<sup>th</sup> General Assembly). Income described in O.R.C. Section 5747.20(B)(5) includes the following: (i) amounts paid by the Ohio Lottery Commission to a prize winner and (ii) a *transferee's* "earnings, profit, income and gain from the sale, exchange or other disposition of lottery prize awards" earned as a result of a *transfer* from a transferor/winner the right to receive the future installments of an Ohio lottery prize. Because the franchise tax statute makes no distinction between business and nonbusiness income, such income is allocable whether or not the income is nonbusiness income.

A “*transfer*” means any form of sale, assignment or redirection of payment of all or any part of a lottery prize award for consideration” (O.R.C. Section 3770.10(E)). A transfer agreement between the “transferor” (the prize winner) and the “transferee” (the purchaser of the winner’s right to future lottery payments) must contain a statement signed by the transferee irrevocably agreeing that the transferee corporation is subject to the franchise tax with respect to gain or income which the transferee will recognize as a result of the transfer. So, unless the transferee is exempt from franchise tax under O.R.C. Section 5733.09 or unless exempt from the net income base, a transferee having no nexus with Ohio other than as a party to the transfer agreement is subject to the franchise tax on the income that the transferee will recognize as a result of the transfer. The Ohio Lottery Commission is required to withhold 3½% from the amounts that it pays to the transferee and such withholding may be claimed as a refundable credit on the transferee’s franchise tax report (see O.R.C. Sections 3770.072(B), 5747.062(B)(2) and 5733.98(A)(27)).

### **Schedule D – Apportionment Formula**

#### **O.R.C. Section 5733.05(B)(2)**

**Note 1: Please complete the form FT-1120 Schedule D apportionment ratio on a separate company basis. The separate company apportionment ratio applies to the net worth base even if the taxpayer is a member of a combined report, form FT-1120C. See O.R.C. Section 5733.05(C)(3), which states that the taxpayer’s net worth is multiplied by the net income base apportionment formula computed “. . . without regard to Section 5733.052 of the Revised Code.” The taxpayer’s apportionment ratio on the combined report (Schedule D – combined) applies only to the net income base, not to the net worth base.**

**Note 2: The “aggregate” (conduit) theory of taxation applies to the franchise tax.** That is, the character of all income and deductions (and adjustments to income and deductions) realized by a pass-through entity retains that character when recognized by the investor in the pass-through entity. Furthermore, the investor’s proportionate share of the pass-through entity’s property, payroll and sales must be included in the investor’s apportionment formula. See *Mead Properties, Inc. v. Limbach*, BTA Case Nos. 85-D-791, 85-E-792, 85-C-793, 85-B-794, April 21, 1989. Effective for taxable years ending on or after September 29, 1997, Amended Substitute House Bill No. 215, 122nd General Assembly (budget bill) codified into the franchise tax statute the conduit theory (see O.R.C. Section 5733.057).

**Note 3:** Effective for taxable years ending after September 28, 1997, Amended Substitute House Bill 770, 122nd General Assembly allows and requires a

franchise taxpayer to adjust its net income (or loss), its apportionment factors and its credits to the extent that the taxpayer's income (loss), apportionment factors and credits would include, were it not for this law, the taxpayer's proportionate share of such amounts attributable to the taxpayer's direct or indirect ownership interest in an "exempted investment." An exempted investment is the taxpayer's direct or indirect investment in a pass-through entity or a "disregarded entity" (a single member LLC that is treated as a division of its owner), which is a public utility subject to the Ohio public utility excise tax on its gross receipts (see O.R.C. Section 5733.058 as amended by House Bill 770).

**Note 4: Deviation from standard allocation and apportionment.** For tax years 1999 and thereafter a taxpayer may request deviation from the statutory allocation and apportionment provisions on an original report, on an amended report filed within the statute of limitations, or on a timely filed Petition for Reassessment. The request for deviation must be in writing. An alternative method will be effective only with approval by the tax commissioner. See O.R.C. Section 5733.05(B)(2)(d) as amended by Amended Substitute House Bill No. 215, 122nd General Assembly (budget bill). Under prior law the taxpayer could request deviation only on the original report.

**Note 5: Factors weighted.** For tax years 1999 and thereafter the apportionment ratio's property, payroll and sales factors are weighted 20%, 20% and 60%, respectively. The 20%, 20%, 60% weighting does not apply to financial institutions. O.R.C. Section 5733.05(B)(2).

**Note 6:** The term "qualified research" as used below in the property and payroll factors means laboratory research, experimental research, and other similar types of research; research in developing or improving a product; or research in developing or improving the means of producing a product. Qualified research does not include market research, historical research, literary research, consumer surveys, efficiency surveys, management studies, and ordinary testing or inspection of materials and products for quality control. "Product" as used in this paragraph does not include services or intangible property.

**Note 7:** If the taxpayer is an electric company or combined (electric) company see the "supplemental franchise tax schedules and instructions for electric companies and combined companies available on the department's Web site. Sales of electricity and sales of electricity transmission and distribution services are situated in accordance with O.R.C. Section 5733.059.

### **Property Factor**

**Property owned by the corporation is valued at its original cost and the average value is determined by adding the cost values at the beginning and at the end of the taxable year and dividing the total**

**by two. The tax commissioner may require the use of monthly values during the taxable year if such values more reasonably reflect the average value of the corporation's property.** In determining average value do not include in either column 1 (within Ohio) or in column 2 (total everywhere) the following:

- Construction in progress.
- The original cost of rental property owned by the corporation and leased to others if the lessee uses the property in a trade or business. See *Illinois Tool Works, Inc. v. Lindley* (1982), 70 Ohio St. 2d 175 and *Columbia Properties, Inc. v. Limbach* (1989), 42 Ohio St. 3d 75.
- The original cost of property within Ohio with respect to which the state of Ohio has issued an Air Pollution, Noise Pollution or an Industrial Water Pollution Control Certificate.
- The original cost of property with respect to which the state of Ohio has issued an exemption certificate for a coal gasification facility, coal conversion demonstration facility, energy conversion facility, solid waste energy conversion facility or thermal efficiency improvement facility.
- The original cost of real property and tangible property (or in the case of property that the corporation is renting from others, eight times its net annual rental rate) within Ohio, which is used exclusively during the taxable year for qualified research.

Do not include in column 1 but do include in column 2 the original cost of qualifying improvements to land or tangible personal property in an enterprise zone for which the taxpayer holds a Tax Incentive Qualification Certificate issued by the Department of Development. See general instruction #25.

**Line 1(a), column 1 – Owned property within Ohio.**

Enter the average value of the corporation's real property and tangible personal property, including leasehold improvements, owned and used in the trade or business in Ohio during the taxable year.

**Line 1(a), column 2 – Owned property – total everywhere.**

Enter the average value of all the corporation's real property and tangible personal property, including leasehold improvements, owned and used in the trade or business everywhere during the taxable year.

**Line 1(b) – Rented property.**

Enter the value of the corporation's real property and tangible personal property rented and used in the trade or business in Ohio (column 1) and everywhere (column 2) during the taxable year. Property rented by the corporation is valued at eight times the annual rental rate (annual rental expense less subrental receipts).

**Line 1(c) – Total property within Ohio and everywhere.**

Add lines 1(a) and 1(b) for column 1, (within Ohio) and column 2 (total everywhere).

**Line 1(c), column 3 – Property ratio.**

Enter the ratio of property within Ohio to total everywhere by dividing column 1 by column 2.

**Line 1(c), column 5 – Weighted property ratio.**

Multiply the property ratio on line 1(c), column 3 by the property factor weighting of 20%.

**Payroll Factor**

As used below, the term “compensation” means any form of remuneration paid to an employee for personal services. Do not include either in column 1 (within Ohio) or in column 2 (total everywhere) the following:

- Compensation paid in Ohio to employees who are primarily engaged in qualified research.
- Compensation paid in Ohio to employees at a certified coal gasification or coal conversion demonstration facility.

Do not include in column 1 but do include in column 2 compensation paid in Ohio to certain specified new employees at an urban job and enterprise zone facility for which the taxpayer has received a Tax Incentive Qualification Certificate issued by the Department of Development (see general instruction #25).

**Line 2, column 1 – Payroll within Ohio.**

Enter the total amount of the corporation’s compensation paid in Ohio during the taxable year. Compensation is paid in Ohio if any of the following apply:

- The recipient’s service is performed entirely within Ohio; or
- The recipient’s service is performed both within and without Ohio, but the service performed without Ohio is incidental to the recipient’s service within Ohio; or
- Some of the recipient’s service is performed within Ohio and either the recipient’s base of operations, or if there is no base of operations, the place from which the recipient’s service is directed or controlled is within Ohio, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the recipient’s residence is in Ohio.

Compensation is paid in Ohio to any employee of a common or contract motor carrier corporation who performs his regularly assigned duties on a

motor vehicle in more than one state in the same ratio by which the mileage traveled by such employee within Ohio bears to the total mileage traveled by such employee everywhere during the taxable year. The statutorily required mileage ratio applies only to contract or common carriers. Thus, without approval by the tax commissioner a manufacturer or merchant who operates its own fleet of delivery trucks may not situs driver payroll based upon the ratio of miles traveled in Ohio to miles traveled everywhere. See *Cooper Tire and Rubber Co. v. Limbach* (1994), 70 Ohio St. 3d 347.

**Line 2, column 2 – Payroll total everywhere.**

Enter the total amount of the corporation's compensation paid everywhere during the taxable year.

**Line 2, column 3 – Payroll ratio.**

Enter the ratio of payroll within Ohio to total everywhere by dividing column 1 by column 2.

**Line 2, column 5 – Weighted payroll ratio.**

Multiply the property ratio on line 2, column 3 by payroll factor weighting of 20%.

**Sales Factor**

**Sales factor** – The sales factor includes gross receipts from sales of tangible personal property and from sales other than sales of tangible personal property. However, the following are not includable in either the numerator or the denominator of the sales factor:

- Interest (see *Incom International v. Limbach*, BTA No. 84-D-1149 (1-11-88),
- Receipts from sales or other disposals of capital assets or assets described in I.R.C. Section 1231, and receipts from those other sources of income that are specifically allocated under divisions (A) through (G) of O.R.C. Section 5733.051,
- Management fees charged to subsidiaries where such fees do not constitute an income-producing activity. Management fees do not constitute an income-producing activity if the taxpayer is not in the business of providing management services in the market place and the fees are not profit-motivated. See *The Fairchild Corporation v. Tracy*, BTA Case No. 94-T-1103, December 20, 1996, and,
- Receipts from sales to: (a) an at-least 80% owned public utility other than an electric company (b) an at least 80% owned insurance company or (c) an at-least 25% owned financial institution. See O.R.C. Section 5733.05(B)(2)(c).



**Line 3, column 1 – Sales within Ohio.**

Enter the total of such gross receipts from sales reflecting business done in Ohio, which includes the following:

- Sales of tangible personal property, less returns and allowances, received by the purchaser in Ohio. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has been completed is considered as the place at which such property is received by the purchaser. Direct delivery in Ohio, other than for purposes of transportation, to a person or firm designated by a purchaser constitutes delivery to the purchaser in Ohio, and direct delivery outside Ohio to a person or firm designated by a purchaser does not constitute delivery to the purchaser in Ohio, regardless of where title passes or other conditions of sale.

Customer pickup sales are situsable to the final destination after all transportation (including customer transportation) has been completed. See *Dupps Co. v. Lindley* (1980), 62 Ohio St. 2d 305.

Revenue from servicing, processing, or modifying tangible personal property is situsable to the destination state as a sale of tangible personal property (rather than situsable as service revenue). See *Custom Deco, Inc. v. Limbach*, BTA Case No. 86-C-1024, June 2, 1989.

- Sales, other than sales of tangible personal property if:
  - The income-producing activity is performed entirely within Ohio, or
  - The income-producing activity is performed both within and without Ohio and a greater proportion of the income-producing activity is performed within Ohio than in any other state, based on cost of performance. If the income-producing activity involves the performance of personal services both within and without Ohio, the services performed in each state will constitute a separate income-producing activity. In such case the gross receipts for the performance of services attributable to Ohio shall be measured by the ratio which the time spent in performing such services in Ohio bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligations that gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligations, as for example, time expended in negotiating the contract, is excluded from the computations.
  - The term “income-producing activity” means with respect to each separate item of income, the transaction and activity directly engaged in

by the taxpayer in the regular course of its trade or business for the purpose of obtaining gains or profits. Such activity does not include transactions and activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor.

- The term “cost of performance” means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the taxpayer’s trade or business.

**Note:** For tax years 1999 and thereafter Amended Substitute House Bill 215, 122nd General Assembly eliminated the “solicitation provision” from the sales factor. Thus, for “sales other than sales of tangible personal property,” the location of solicitation no longer controls the situs of the sale, and sales other than sales of tangible personal property are situated based on “costs of performance.” O.R.C. Section 5733.05(B)(2)(c).

**Line 3, column 2 – Sales everywhere.**

Enter the total of such gross receipts, less returns and allowances, from sales everywhere.

**Line 3, column 3 – Sales ratio.**

Enter the ratio of sales within Ohio to total everywhere by dividing column 1 by column 2.

**Line 3, column 5 – Weighted sales ratio.**

Multiply the sales ratio on line 3, column 3 by the sales factor weighting of 60%.

## **Schedule E – Balance Sheet**

**Attach to the franchise tax report a balance sheet that reflects the books of the taxpayer on a separate company basis as of the beginning and the end of the taxpayer’s taxable year.**

A taxpayer must keep its books in accordance with a generally recognized and approved accounting system. The tax-basis method of accounting is a generally recognized and approved accounting system. See *Gray Horse, Inc. v. Limbach* (1993), 66 Ohio St. 3d 631. If a taxpayer keeps its books both in accordance with regulatory accounting principles and in accordance with generally accepted accounting principles, the value of the taxpayer’s issued and outstanding shares of stock under the net worth basis (O.R.C. Section 5733.05(C)) is based upon those books kept in accordance with generally accepted accounting principles. See Tax Commissioner’s Rule 5703-5-08.

## **Schedule F – Computation of Taxable Value**

### **O.R.C. Section 5733.05(C)**

The net worth base value of issued and outstanding shares of stock is determined from the books of the corporation as of the beginning of the taxpayer's annual accounting period that includes the first day of January of the tax year. See O.R.C. Section 5733.05. For example, assume that an Ohio franchise taxpayer has a taxable year beginning July 1, 2001 and ending June 30, 2002. For tax year 2003 the taxpayer's franchise tax net value of stock for purposes of the net worth base is determined as of July 1, 2002, which is the beginning of the taxpayer's annual accounting period that includes the first day of January of the 2003 tax year. Generally, the net worth base value at the beginning of the taxpayer's annual accounting period that includes the first day of January of the tax year (in this example, July 1, 2002) will be the same as the net worth base value at the end of the taxable year concluding prior to January 1 of the tax year (in this example, June 30, 2002).

For tax years 1999 and thereafter House Bill 215, 122nd General Assembly simplified the net worth computation for taxpayers other than financial institutions. Under current law the net worth base equals assets minus liabilities adjusted by the "qualifying amount" less exempted assets (discussed below). Accordingly, for tax years 1999 and thereafter "reserves," except for those reserves that are considered appropriations of retained earnings under generally accepted accounting principles, are not included in the net worth computation. Thus, accounts such as unearned income and deferred federal income tax are not added to (or deducted from) net worth. In addition, the following "exempted assets" (under prior law) may not be deducted from net worth: goodwill, appreciation, abandoned property, investments in production credit associations and property within Ohio used exclusively in qualified research.

For tax years 1999 and thereafter (for taxpayers other than financial institutions) the tax rate on the net worth base is four mills (.004) and the net worth base tax is limited to \$150,000 per taxpayer. The \$150,000 limit applies separately to each member of a combined report (there is not an overall net worth base limit for a combined group of taxpayers). At the net worth tax rate of four mills a "taxable value" of \$37,500,000 will result in the maximum net worth tax of \$150,000.

**Qualifying holding company (QHC).** A corporation that meets the requirements to be treated as a qualifying holding company, as defined in O.R.C. Section 5733.04(L), and elects to be treated as a QHC by filing form FT-QHC, Qualifying Holding Company Election, is not subject to the franchise tax on the net worth base and is not required to complete Schedule F. (A

QHC is subject to the franchise tax on the net income base.) A corporation that elects to be treated as a qualifying holding company must attach form FT-QHC to its franchise tax report and must check the box at the top of the front page of the franchise tax report indicating the corporation has elected to be treated as a qualifying holding company. For further information see general instruction #20, O.R.C. Sections 5733.04(L), 5733.05(C)(2), and 5733.06(C) and form FT-QHC, Qualifying Holding Company Election.

**Line 1 – Net worth (assets minus liabilities).**

Enter the taxpayer's net worth (assets minus liabilities) as reflected on the taxpayer's books.

**Line 2 – Qualifying amount (if the taxpayer is a related member to a qualifying holding company) O.R.C. Section 5733.05(C)(2).**

If the taxpayer is a related member to a qualifying holding company (see above), the taxpayer must adjust its net worth and debt by the "qualifying amount."

The **qualifying amount** is the amount that, when added to the taxpayer's net worth (assets minus liabilities) and subtracted from the taxpayer's liabilities or when subtracted from the taxpayer's net worth and added to the taxpayer's liabilities, will result in the taxpayer's debt-to-equity ratio equaling the consolidated debt-to-equity ratio of the **qualifying controlled group** of which the taxpayer is a member. The consolidated debt-to-equity ratio is computed in accordance with generally accepted accounting principles on the last day of the taxpayer's taxable year ending before the first day of the tax year. The qualifying amount that is added to the taxpayer's net worth and subtracted from the taxpayer's liabilities may not exceed the amount of the taxpayer's liabilities owed to related members. Furthermore, the taxpayer's net worth after adjustment by the qualifying amount may not exceed the net book value of the corporation's assets. If the qualifying amount will be subtracted from the taxpayer's net worth, enter the qualifying amount in parenthesis. See O.R.C. Section 5733.05(C)(2).

The term "**qualifying controlled group**" means two or more corporations that meet the O.R.C. Section 5733.052(A) ownership and control requirements to file a combined franchise tax report (whether or not the corporations actually file a combined report and whether or not the corporations are subject to the franchise tax). See O.R.C. Section 5733.04(M).

The term "**related member**" is defined in the instructions for Schedule B-3, line 6.

**Line 4 – Exempted assets.**

- a. Enter the net book value of air, noise and water pollution control facilities for which the state of Ohio has issued a certificate.

- b. Enter the net book value of property with respect to a coal gasification facility, coal conversion demonstration facility, energy conversion facility, solid waste energy conversion facility or thermal efficiency improvements facility for which the state of Ohio has issued an exemption certificate.
- c. Enter the net book value of civil defense shelters within Ohio for which the state of Ohio has issued a civil defense certificate. O.R.C. Section 5502.49.
- d. Enter the net book value of "land devoted exclusively to agricultural use as of the first Monday of June in the corporation's taxable year as determined by the county auditor of the county in which the land is located pursuant to Section 5713.31 of the Revised Code."

**Line 6 – Ohio apportionment ratio.**

Enter the taxpayer's Ohio apportionment ratio determined on a separate company basis from Schedule D, line 4. **The taxpayer's net worth base apportionment ratio must be determined on a separate company basis even if the taxpayer is a member of a combined report. See O.R.C. Section 5733.05(C)(3), which states that the taxpayer's net worth is multiplied by the net income base apportionment formula computed "... without regard to Section 5733.052 of the Revised Code."**

For tax years 1999 and thereafter Amended Substitute House Bill 215, 122nd General Assembly, replaced the net worth base property and business done factors with the net income base apportionment ratio. Unlike the former net worth base property factor, the net income base property factor does not include intangible property. Thus, under current law it is unnecessary to situs intangible property within and without Ohio.

**There are no franchise tax report schedules H, I or J.**

**Tier One Litter Tax** (O.R.C. Section 5733.066) – All taxpayers except family farm corporations as defined in O.R.C. Section 4123.01 are subject to the tier one litter tax. The maximum tier one tax that a corporation (or a group of corporations filing a combined franchise tax report) must pay is \$5,000.

**Tier Two Litter Tax** (O.R.C. Section 5733.065) – **Corporations that manufacture or sell litter stream products in Ohio are subject to the second tier of the litter tax with the following limitations:**

- a. If a corporation manufactures "litter stream products," the corporation is subject to the second tier litter tax only if the corporation's sales of litter stream products in Ohio during the taxable year exceed 5% of its total sales in Ohio during the taxable year or if its sales of litter stream products in Ohio during the taxable year exceed \$10 million.

- b. If a corporation sells litter stream products in the same form that the corporation obtains the products, the corporation is subject to the second tier litter tax only if its sales of litter stream products in Ohio during the taxable year exceed 5% of its total sales in Ohio during the taxable year.
- c. If a corporation sells food or beverages that are prepared at the premises where sold for consumption off the premises and transfers possession of litter stream products in the form of sacks, bags, lids, straws, plates, wrappings, boxes or containers that contain the food or beverages, the corporation is subject to the second tier litter tax only if such sales for off premises consumption exceed 5% of the corporation's total sales during the taxable year.
- d. The maximum tier two tax that a corporation (or a group of corporations filing a combined franchise tax report) must pay is \$5,000.

Litter stream products are defined as follows:

- a. Intoxicating liquor, beer, malt beverages, wine, mixed beverages or spirituous liquor;
- b. Soft drinks;
- c. Glass, metal, plastic or fiber containers with a capacity of less than two gallons sold for the purpose of containing the beverages listed in sections **a** and **b** above;
- d. Container crowns and caps sold for the purpose of capping the containers in section **c** above;
- e. Packaging materials used to pack or contain the beverages in sections **a** and **b** above when they are sold at retail;
- f. Packaging or serving materials used or received when obtaining food to carryout, such as sacks, bags, cups, lids, straws, plates, wrappings, boxes or containers of any type. The food or beverages that are for takeout must have been prepared for human consumption by a restaurant or takeout food outlet at the premises where sold at retail, and delivered to the purchaser for consumption off the premises where such food or beverages are sold;
- g. Cigarettes, cigars, tobacco, matches, candy and gum.

### **Schedule A-1 – Nonrefundable Credits**

**O.R.C. Section 5733.98 sets forth the order in which franchise tax nonrefundable credits and unused credit carryforward amounts must**

be used. A nonrefundable credit may be used to reduce the tax liability (before considering any payments) to the \$50 minimum fee but a nonrefundable credit may not reduce the tax liability (before considering any payments) below the minimum fee. The table on page 104 lists the nonrefundable credits in the order in which you must claim them as well as the carryforward period of each credit and the sections of the Ohio Revised Code that authorize the credits. A lower ranking credit must be used before any higher ranking credit is used. The order is important if the corporation is entitled to more than one nonrefundable credit and the corporation is unable to use some portion of the total credit amount in the year the credits were generated (because the total credit amount exceeds the tax due before the credit). Nonrefundable credits that are not used in the year generated can generally be carried forward to future years. However, the carryforward period is limited and varies from credit to credit. (The carryforward period for the unused portion of the credits varies from three years to 15 years. In addition, four credits have no carryforward period, and two other credits have an unlimited carryforward period.) Any credit amount that remains unused after the carryforward period for that credit has expired is lost. The unused amount of a particular credit that is carried forward to a later year is used after any lower numbered credit listed in O.R.C. Section 5733.98 but before the same credit generated in the later year and before any higher numbered credit on the list.

**Note 1:** The new jobs credit is not included below because the new jobs credit is a refundable credit that is considered a payment of the tax. See line instructions for Schedule A, line 23.

**Note 2:** All credit computations under Chapter 5733 are to include the taxpayer's proportionate share amounts from any pass-through entity in which the taxpayer has a direct or indirect interest. See O.R.C. Section 5733.057.

**1. Credit for taxes paid by a qualifying pass-through entity** (O.R.C. Section 5733.0611) – A corporation that is a qualifying investor in a qualifying pass-through entity can claim a nonrefundable credit equal to the corporation's proportionate share of the tax paid by the qualifying pass-through entity. However, in determining Ohio taxable income, a corporation that claims this franchise tax credit must add to federal taxable income the amount claimed as a credit to the extent that the amount was deducted or excluded from the corporation's federal taxable income. To claim this credit the qualifying investor must attach to its franchise tax report a copy of the I.R.S. form K-1, which indicates the qualifying investor's proportionate share of the amount of the pass-through entity tax for which the qualifying investor seeks to claim a credit. For an explanation of the



tax on qualifying pass-through entities see the instructions for form IT-1140, Tax Return for Pass-Through Entities and Trusts.

- 2. Credit for qualifying affiliated groups** (O.R.C. Section 5733.068) – If, as a result of the related entity and related member adjustments (see Schedule B-3), an affiliated group will pay more than \$3.5 million more franchise tax than the members of the group otherwise would have paid had the members of the group not made the related entity and related member adjustment, then the members of the affiliated group may claim a credit equal to the difference between the additional tax and \$3.5 million. However, the credit is limited to \$1.5 million for the affiliated group (even if the additional tax exceeds \$5 million).
- 3. Credit for recycling and litter prevention donations** (O.R.C. Section 5733.064) – A taxpayer may claim a credit for the taxpayer's cash donations made during the taxable year to: (a) municipal corporations, counties, townships, park districts and boards of education that have received litter control and recycling grants from the Division of Recycling and Litter Prevention under O.R.C. Section 1502.05 and (b) Ohio corporations organized before January 1, 1987 that have been determined to be nonprofit corporations by the Internal Revenue Service and whose sole purpose is to promote and encourage recycling. The credit equals the lesser of one-half of the amount of the cash donation or one-half of the sum of the tier one and tier two litter taxes. For information on the litter tax see the line instructions for Schedule K.
- 4. Credit for employers that enter into agreements with child daycare centers** (O.R.C. Section 5733.36) – A taxpayer that makes periodic "support payments" to an Ohio licensed daycare center that agrees to serve a child of the taxpayer's employee for the period covered by the support payment may claim a credit equal to 50% of the support payments that the taxpayer made to the daycare center during the taxable year. The credit applies to tax years 1999 through 2003 and has no carryforward provision. The department interprets the term "child of the taxpayer's employee," as used above and in the "credit for employers that establish onsite child daycare centers" (see credit #12), to mean any child who lives in the home of an employee and an employee's natural child, stepchild or adopted child whether or not the natural child, stepchild or adopted child lives in the home of the employee.
- 5. Credit for Employers that Reimburse Employee Child Daycare Expenses** (O.R.C. Section 5733.38) – A taxpayer that reimburses its employees for dependent child daycare expenses at an Ohio-licensed daycare center may claim a credit equal to 50% of the amount that the taxpayer reimbursed its employees for such expenses, but the credit may not exceed \$750 per dependent child. In determining the credit, the

taxpayer may not include any amount incurred in connection with a cafeteria plan described in I.R.C. Section 125; nor may the taxpayer include "support payments" used to determine the credit for employers that enter into agreements with child daycare centers (see credit #4). The credit applies to tax years 1999 through 2003 and has no carryforward provision.

**6. Credit for maintaining railroad crossing warning devices** (O.R.C. Section 5733.43). Railroad companies can claim a credit for maintaining signs, signals, gates and other electrical warning devices at public highway-railway crossings in Ohio at common grade. The credit equals 10% of the sum of the annual maintenance expenditures for each active grade crossing warning device in Ohio for which such expenditures were made during the taxable year. The credit is not to exceed \$200 for each device in Ohio for which such expenditures were made during the taxable year. Unused credit amounts may not be carried forward. This new credit applies to taxable years beginning after December 31, 2000 – thus, the credit first applies to the 2002 franchise tax report.

**7. Credit for Purchases of Lights and Reflectors for Tractors** (O.R.C. Section 5733.44) – A taxpayer may claim a nonrefundable credit for purchasing lights and reflectors for installation on multi-wheel agricultural tractors in order to comply with the new lighting and reflector requirements set forth in O.R.C. Section 4513.111. (A multi-wheel agricultural tractor is an agricultural tractor that has two or more wheels on each side of one rear axle. See O.R.C. Section 4511.01(GGG)). The credit equals the lesser of \$1,000 or 50% of the cost of the lights and reflectors purchased during the period October 5, 2000 (the effective date of this law) through October 4, 2001. The taxpayer must claim the credit for the taxable year during which the taxpayer purchased the lights and reflectors. If the taxpayer is an investor in a pass-through entity that purchased the lights and reflectors to comply with the lighting and reflector requirements contained in O.R.C. Section 4513.111, the investor may claim the investor's proportionate share of the credit. Unused credit amounts may not be carried forward.

**8. Job retention credit.** The purpose of this new temporary nonrefundable credit is to encourage large Ohio manufacturers to retain jobs in Ohio. The credit applies to taxpayer-manufacturers that make a capital investment of at least \$200 million at a single Ohio project site during three consecutive calendar years in the period January 1, 2002 and ending December 31, 2006. Credit applicants must apply to and the capital investment project must be approved by the Ohio Tax Credit Authority. As a prerequisite, the taxpayer must employ an average of 1,000 full-time employees at the project site during each of the 12 months preceding application. In addition, the taxpayer must retain at least 1,000 full-time employees at the project site for the entire term of the credit agreement.

The amount of the credit equals a percentage of the Ohio income tax withheld from the taxpayer's employees at the project site as set forth in the agreement between the taxpayer and the Ohio Tax Credit Authority. However, the credit percentage may not exceed 75%. The credit begins in tax year 2003 and is limited to a term of 10 years. The credit is administered by the Ohio Tax Credit Authority and the Ohio Department of Development. For additional information please contact the Ohio Department of Development's Office of Tax Incentives at (614) 466-4551. See O.R.C. Sections 5733.0610(B) and 122.171.

**9. Second credit for purchases of new manufacturing machinery and equipment (7.5%–13.5% credit) (O.R.C. Section 5733.33).**

**Note 1:** House Bill 283, 123<sup>rd</sup> General Assembly (Budget Bill) and House Bill 640 amended the 7.5%–13.5% manufacturer's credit. Among other changes, the law extends to December 31, 2005 the purchase period for new manufacturing equipment, and for new manufacturing equipment purchased after December 31, 2000 the law requires a "qualifying controlled group" to compute the credit on a consolidated basis.

**Note 2:** That portion of the cost of equipment for which a taxpayer claimed either the original 20% credit or the alternative 20% credit does not qualify for the 7.5%/13.5% credit.

Manufacturers may claim a credit for "new manufacturing machinery and equipment" purchased during the period July 1, 1995 to December 31, 2005 provided that the manufacturer installs the equipment in Ohio by the required date. The credit also applies to taxpayers that have an interest in pass-through entities (limited liability companies and partnerships) that during the period July 1, 1995 to December 31, 2005 purchase new manufacturing machinery and equipment provided that the pass-through entity installs the machinery and equipment in Ohio by the required date. New manufacturing machinery and equipment purchased before January 1, 2001 must be installed in Ohio no later than December 31, 2001. New manufacturing machinery and equipment purchased during the calendar years 2001 through 2005 must be installed in Ohio no later than December 31, 2006.

**"New manufacturing machinery and equipment"** is manufacturing machinery and equipment the original use in Ohio of which begins with the taxpayer or a pass-through entity in which the taxpayer has an interest. Thus, for purposes of this credit, used equipment is "new" if the taxpayer or pass-through entity is the first to use the equipment **in Ohio**.

New manufacturing equipment that is manufactured or assembled primarily by the taxpayer for the taxpayer's own use is deemed to have been purchased on the date the taxpayer places the property in service in the

county for which the taxpayer will calculate the credit. New manufacturing machinery and equipment that is not manufactured or assembled primarily by the taxpayer is deemed to have been purchased on the date that the agreement to acquire the property becomes binding.

A taxpayer must separately determine the credit for each Ohio county with respect to the qualifying equipment that the taxpayer (or a pass-through entity in which the taxpayer has an interest) purchases for use in that county during each of 11 separate qualifying purchase periods that comprise the period July 1, 1995 to December 31, 2005. The 11 separate qualifying purchase periods are the six-month period July 1, 1995 to December 31, 1995 and each of the calendar years 1996 through 2005. The credit is based on purchases made during the calendar year even if the taxpayer (or pass-through entity in which the taxpayer has an interest) has a fiscal year end.

For those Ohio counties not designated as "eligible areas" the credit equals 7.5% of the amount by which the cost of qualifying equipment purchased during a qualifying period for use in an Ohio county exceeds the "base investment" for that county "Eligible areas" are those Ohio counties and municipalities annually designated and certified by the Director of the Ohio Department of Development based upon the economic criteria set forth in the law. For those Ohio counties designated as eligible areas the credit equals 13.5% of the amount by which the cost of qualifying equipment purchased during a qualifying period for use in the county exceeds the base investment for the county.

For those Ohio counties that are not designated as eligible areas but contain eligible areas within their boundaries, the credit equals the sum of the following:

- 13.5% of the lesser of: (a) the cost of qualifying equipment purchased during the calendar year for use in the eligible areas of the county or (b) the county excess (the cost of qualifying equipment purchased during the calendar year for use in the entire county minus the taxpayer's base investment for that county) and
- 7.5% of the amount by which the county excess is greater than the cost of the new manufacturing machinery and equipment purchased during the calendar year for use in the eligible areas in the county.

To determine whether a county or area is an "eligible area" please call the Ohio Department of Development at 1-800-848-1300. The department of Development has also prepared a map of "eligible areas" that is available on the Department of Development's Web site: <http://www.odod.state.oh.us> (click on: (1) "Tax Incentive Program"; (2) "Ohio Manufacturer's Machinery and Equipment Investment Tax Credit"; (3) "Eligible Investment Areas"; and (4) "Priority Investment Area Maps").

The “base investment” for a county is determined by adding the cost of new manufacturing machinery and equipment purchased for use in the county during each of three “base years” and dividing the total by three. The base years, like the purchase years, are calendar years – regardless of whether the taxpayer has a fiscal year end. The purchase periods along with their corresponding base years are as follows:

Calendar Year of Purchase	Base Years
7/1/95 – 12/31/95	1992, 1993, 1994
1996	1992, 1993, 1994
1997	1992, 1993, 1994
1998	1992, 1993, 1994
1999	1993, 1994, 1995
2000	1994, 1995, 1996
2001	1995, 1996, 1997
2002	1996, 1997, 1998
2003	1997, 1998, 1999
2004	1998, 1999, 2000
2005	1999, 2000, 2001

The credit for qualifying equipment purchased by a pass-through entity is not computed at the pass-through entity level and then passed through to the taxpayers that have an interest in the pass-through entity. Instead, taxpayers that have an interest in a pass-through entity during a qualifying period in which the pass-through entity purchased qualifying equipment must claim a proportionate share of the cost of such equipment and a proportionate share of the pass-through entity’s base investment in the county for which the qualifying equipment was purchased. For each qualifying period and for each county and eligible area such proportionate share amounts are then added to the proportionate share amounts from other pass-through entities in which the taxpayer has an interest and to the taxpayer’s own purchases of qualifying equipment and base investment. The taxpayer must compute the credit after aggregating its proportionate share amounts with the taxpayer’s own purchases and the taxpayer’s own base investment.

**Qualifying controlled group must compute consolidated credit.** For new machinery and equipment purchased after December 31, 2000 a “qualifying controlled group” (a group of corporations related by more than 50% direct or indirect stock ownership) must compute the credit **for each county** as if all taxpayers of the group were a consolidated, single taxpayer in that county. **(The consolidation provision does not eliminate the requirement to determine the credit on a county-by-county basis.)** The consolidation provision applies both to the equipment purchased after

December 31, 2000 on which the taxpayer will claim the credit and to base year purchases that determine the threshold above which the credit applies. The qualifying controlled group may allocate the consolidated credit in any manner the group chooses and the group may amend that allocation anytime before the refund statute of limitations expires (see O.R.C. Section 5733.33(I) as amended by Amended Substitute House Bill 640, 123<sup>rd</sup> General Assembly). The term "qualifying controlled group" is defined in O.R.C. Section 5733.04(M) as "two or more corporations that satisfy the ownership and control requirements of division (A) of Section 5733.052 of the Revised Code."

For new machinery and equipment purchased before January 1, 2001 a qualifying controlled group may elect to compute the credit as if the group were a consolidated, single taxpayer. The election can be made by filing an amended report and an application for refund anytime before the statute of limitations expires. Also, the election can be made by timely filing a Petition for Reassessment. The election, if made, applies to the credit computation for each county for all purchases of machinery and equipment made before January 1, 2001 and to all base years used to determine the threshold above which the credit applies for each county. That is, if a qualifying controlled group makes this election, the "consolidated, single taxpayer" computation also applies to all purchases of machinery and equipment made in earlier calendar years with respect to which the taxpayer has already filed tax reports. The election is irrevocable. The group is not required to allocate the remaining 1/7 credit amounts (the 1/7 credit amounts that must be claimed in future years) at the time the group makes the election. Rather, the group can allocate the unused 1/7 credit amounts in the tax years the group must use the credit.

A taxpayer must claim 1/7 of the credit in each of the seven tax years following the calendar year in which the taxpayer purchased the equipment. However, for qualifying equipment purchased during the period July 1, 1995 to December 31, 1995 a taxpayer could not begin to claim the 1/7 credit amounts until tax year 1997. See the table on page 105, which shows the tax years in which the one-seventh credit amounts are claimed for each purchase year.

If the taxpayer sells equipment that was purchased before January 1, 2001 or moves such equipment from the county for which the credit was originally computed, the taxpayer is not allowed any remaining 1/7 credit amounts on the equipment sold or moved. If the taxpayer sells equipment that was purchased after December 31, 2000 or moves such equipment from the county for which the credit was originally computed, the taxpayer is not allowed any remaining 1/7 credit amounts on the equipment sold or moved unless the equipment is fully depreciated for federal income tax purposes at the time the equipment is sold or moved. However under certain limited circumstances, the purchaser of a "large manufacturing facility" may claim

the unused credits of the seller of the manufacturing equipment located at that manufacturing facility.

The department has prepared a computerized spreadsheet to calculate the credit. The spreadsheet is available only through the Internet. To access the spreadsheet and download the file to your computer, visit the department on the Internet at:

*<http://www.state.oh.us/tax/>*

Then, click on: "Tax Forms" and "Corporate Franchise Tax Forms." Under 2003 forms click on "Worksheet for 7.5% and 13.5% Manufacturer's Credit Under O.R.C. Secs. 5733.33 and 5747.31."

Taxpayers who intend to claim this credit must file a "Notice of Intent" form with the Ohio Department of Development. Please send your request for the "Notice of Intent" form to the Ohio Department of Development, Office of Tax Incentives, P.O. Box 1001, Columbus, Ohio 43216-1001 or call 1-800-848-1300. The "Notice of Intent" form is also available on the Ohio Department of Development's Web site at:

*<http://www.odod.state.oh.us>*

Under the heading "Tax Incentive Program" click on "Ohio Manufacturers Manufacturing Machinery and Equipment Investment Tax Credit" and then click on "Notice of Intent" for the applicable year.

For additional information please see O.R.C. Section 5733.33 and the Income Tax Audit Division's September 22, 1995, May 6, 1996, May 7, 1996 and June 18, 1996 information releases available on the department's Web site.

**10. Credit for eligible new employees in an enterprise zone (O.R.C. Section 5709.66)** – A taxpayer may apply to the Director of Development for an "employee tax credit certificate" for each eligible new employee the enterprise hires after June 30, 1994 at a facility located in a "central city of a metropolitan statistical area" (as defined by the United States office of management and budget) or located in the "Appalachian region" (as defined by the Appalachian Regional Development Act of 1965) to which an enterprise zone agreement applies provided that the taxpayer is complying with the enterprise zone agreement and has not closed or reduced employment at any place of business in Ohio within the 12 months preceding the application. A taxpayer who is issued a tax credit certificate for an eligible employee may claim a \$1,000 nonrefundable credit for each taxable year covered under the enterprise zone agreement during which the eligible employee is employed by the taxpayer. An "eligible employee" is a new employee who at the time the employee was hired to work at the facility was a recipient of aid to dependent



children or general assistance and resided for at least one year in the county in which the facility is located.

If a taxpayer claims an enterprise zone new employee tax credit with respect to an employee, the taxpayer may not claim the O.R.C. Section 122.17 new jobs credit with respect to that employee.

Credit applications are available from the Ohio Department of Development, Office of Tax Incentives, 77 S. High Street, 28<sup>th</sup> Floor, P.O. Box 1001, Columbus, OH 43216-1001 or call (614) 466-4551 or 1-800-848-1300.

- 11. Credit for eligible costs associated with a voluntary action (Brownfield site cleanup)** (O.R.C. Section 5733.34) – A taxpayer who participates in the Ohio Environmental Protection Agency's (OEPA) Voluntary Action Program and who has received and maintained a "covenant not to sue" from the OEPA may apply to the Director of Development for this credit, which is intended to encourage the private sector cleanup and reuse of properties that have been contaminated by hazardous substances. The authority for the Director of Development to grant tax credits under this program expired on June 30, 1999. For additional information please contact the Ohio Department of Development, Office of Tax Incentives, 77 S. High Street, 28th Floor, P.O. Box 1001, Columbus, OH 43216-1001 or call (614) 466-4551, or 1-800-848-1300.
- 12. Credit for employers that establish onsite child daycare centers** (O.R.C. Section 5733.37) – A taxpayer that establishes an Ohio licensed daycare center that serves only children of the taxpayer's employees and is located at the employees' worksite may claim a credit equal to the lesser of \$100,000 or 50% of the amount the taxpayer incurred for equipment, supplies, labor, and real property, including renovation of real property, to establish the daycare center. The taxpayer can claim the credit only for the tax year immediately following the taxable year in which the child daycare center begins operations, and the taxpayer can claim the credit only for tax years 1999, 2000, 2001, 2002 or 2003. The credit amount that the taxpayer does not use in the tax year claimed may be carried forward for five taxable years. However, if the taxpayer ceases to operate the center within the five-year carryforward period, any unused portion of the credit is lost.
- 13. Ethanol plant investment credit.** (O.R.C. Sections 5733.46 and 901.13) – This nonrefundable franchise tax and individual income tax credit equals 50% of the amount of money that the taxpayer invests in O.R.C. Section 901.13 certified ethanol plants in the calendar year preceding the tax year (the investment period is the calendar year preceding the tax year regardless of whether the taxpayer's taxable year is a calendar year). The credit is limited to \$5,000 per taxpayer per certified ethanol plant

regardless of the number of years in which the taxpayer makes such investments. The credit applies to tax years 2003 through 2013. Credits not used in the tax year following the calendar year in which the taxpayer makes the investment may be carried forward for three tax years.

**14. Credit for grape production property** (O.R.C. Section 5733.32) – Grape producers may claim a credit equal to 10% of the cost of qualifying property purchased on or after January 1, 1994. Qualifying property is any property, plant, or equipment used in growing, harvesting or producing grapes in Ohio. Unused credit amounts may be carried forward for seven taxable years. The credit is subject to recapture if the taxpayer disposes of the property or ceases to use it as qualifying property within seven years after placing it in operation.

**15. Export sales credit** (O.R.C. Section 5733.069) – A taxpayer that increases its export sales and also increases either its Ohio property or its Ohio payroll may claim a credit for tax years 1993 through 2005. **However, for tax years 2001 to 2005 no new credit is generated. For tax years 2001 to 2005 only unused carryforward credit amounts from tax years 1993 to 2000 can be claimed.** If the taxpayer is claiming an export sales credit carryforward from tax year 2000 or earlier, please attach to the franchise tax report a schedule that shows the year(s) in which the credit was generated, the years in which the credit was used and the remaining carryforward.

For tax years 1993 to 2000 the tentative credit was computed by applying the following formula:

Export Sales Credit =	10% X pre-tax profit from the incremental increase in export sales X the average of the property factor and the payroll factor X the greater of (i) the Ohio payroll increase factor or (ii) the Ohio property increase factor.
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Additional information is available upon request from the Ohio Department of Taxation, P.O. Box 2476, Columbus, OH 43216-2476, Attn: Export Credit.

**16. Edison Center credit for research and development investors** (O.R.C. Section 5733.35) – Investors that provide capital to certain qualifying small, Ohio-based research and development or technology transfer companies may be eligible for a nonrefundable credit equal to 25% of the taxpayer's at-risk investment. An investor or group of investors that proposes to invest in a qualifying small, Ohio-based research and development company or technology transfer company and seeks to claim the credit must apply to one of the state's seven Edison Centers

for approval of the proposed investment. The credit application fee for a single investor is \$200 and for a group of investors is \$800. For additional information please contact the Ohio Department of Development, Technology Division, 77 S. High Street, P.O. Box 1001, Columbus, OH 43216-1001, or call (614) 466-3887 or 1-800-848-1300.

**Note:** For taxable years ending on or after June 30, 1997, Amended Substitute House Bill No. 215, 122nd General Assembly amended this credit. Taxpayers who claim this credit should see O.R.C. Sections 122.15, 122.151, 122.152, 122.153 and 122.154 as amended by this law.

- 17. Enterprise zone daycare credit** (O.R.C. Section 5709.65(A)) – If a taxpayer has received a Tax Incentive Qualification Certificate from the Ohio Department of Development and if the taxpayer reimburses certain new employees (see general instruction #25 and O.R.C. Section 5709.64(A)(2)(a) to (e)) for all or part of the cost of daycare services necessary to enable the employees to be employed at the facility for which the certificate is issued, the taxpayer may claim a credit. The credit equals the amount so reimbursed for the taxable year in which the taxpayer makes the reimbursement, up to a maximum of \$300 for each child or dependent receiving the daycare services.

**Enterprise zone training credit** (O.R.C. Section 5709.65(A)) – If a taxpayer has received a Tax Incentive Qualification Certificate from the Ohio Department of Development and if the taxpayer pays or reimburses all or part of the cost of a qualified training program for certain new employees (see general instruction #25 and O.R.C. Section 5709.64(A)(2)(a) to (e)) the taxpayer may claim for each new employee a credit equal to the amount paid or reimbursed or \$1,000, whichever is less. The taxpayer may claim the credit in the taxable year in which the new employee completes 90 days of subsequent employment.

**Note 1: Credit for qualified research expense** (O.R.C. Section 5733.351) – The credit for qualified research expense does not appear on the 2003 franchise tax report because this temporary credit no longer applies to tax year 2003. **Amended Substitute House Bill 94, 124<sup>th</sup> General Assembly (Budget Bill 2001 – 2002) delays the credit for qualified research expense previously enacted by Amended Substitute House Bill 283, 123<sup>rd</sup> General Assembly.** Under previous law the credit was to first apply to tax year 2002 for qualified research expense incurred after December 31, 2001 (see Section 180 of Amended Substitute House Bill 283). Under new law the credit generally will first apply to tax year 2004. Nevertheless, **if the taxpayer's taxable year for tax year 2002 ended before July 1, 2001, then the taxpayer can claim the credit on the 2002 report.** If the credit applies to the taxpayer's

2002 report, the credit for tax year 2002 equals 7% of the excess of qualified research expenses incurred in Ohio by the taxpayer between January 1, 2001, and the end of the taxable year, over the taxpayer's average annual qualified research expenses incurred in Ohio for the three preceding taxable years.

The credit for tax years 2004 and thereafter equals 7% of the amount by which the taxpayer's "qualified research expense" incurred in Ohio during the taxable year exceeds the taxpayer's average annual qualified research expenses incurred in Ohio for the three preceding taxable years. The term "qualified research expense" has the same meaning as in I.R.C. Section 41.

**Note 2: The job training credit (O.R.C. Section 5733.42) does not appear on the 2003 franchise tax report because this temporary credit no longer applies to tax year 2003. As a result of Amended Substitute House Bill 94, 124<sup>th</sup> General Assembly (the budget bill enacted in June 2001), the credit now applies to tax years 2001, 2004, 2005 and 2006.** Before enactment of the budget bill, the Legislature significantly amended the credit in Amended Substitute Senate Bill 287, 123<sup>rd</sup> General Assembly.

The amount of the credit for tax year 2004 equals one-half of the average of the eligible training costs paid or incurred by the taxpayer during calendar years 1999, 2000, and 2001. The amount of the credit for tax year 2005 equals one-half of the average of the eligible training costs paid or incurred by the taxpayer during calendar years 2002, 2003 and 2004. The amount of the credit for tax year 2006 equals one-half of the average of the eligible training costs paid or incurred by the taxpayer during calendar years 2003, 2004 and 2005. (The credit is based upon costs incurred during a calendar year regardless of whether the taxpayer has a fiscal year end.) The credit claimed by a taxpayer each tax year may not exceed \$100,000 and for each tax year is not to exceed \$1,000 for each eligible employee on account of whom eligible training costs were paid or incurred by the taxpayer during the calendar years applicable to that tax year.

The credit applies to franchise taxpayers that incur "**eligible training costs**" and have received a tax credit certificate from the Director of Job and Family Services with respect to an "**eligible training program.**" The credit also applies to individuals and to investors in pass-through entities that incur eligible training costs and have received a tax credit certificate from the Director of Job and Family Services with respect to an "eligible training program." Each investor in a pass-through entity on December 31 before the investor's tax year may claim a proportionate share of the pass-through entity's credit.

**“Eligible training program”** means a program to provide job skills to **eligible employees** who are unable to function effectively on the job due to skill deficiencies or who would otherwise be displaced because of their skill deficiencies or inability to use new technology or to provide job skills to eligible employees that enable them to perform other job duties for the taxpayer. Eligible training programs do not include executive, management, or personal enrichment training programs, or training programs intended exclusively for personal career development.

**“Eligible training costs”** are the sum of: (1) direct instructional costs, such as instructor salaries, materials and supplies, textbooks and manuals, videotapes, and other instructional media and training equipment used exclusively for the purpose of training “eligible employees” and (2) wages paid to eligible employees for time devoted exclusively to an “eligible training program” during normal paid working hours.

**“Eligible employees”** are individuals who are employed full time by the taxpayer in Ohio and have been so employed by the taxpayer for at least 180 consecutive days before the day an application for the credit is filed. “Eligible employees” do not include, executive or managerial personnel except for the immediate supervisors of nonexecutive, nonmanagerial personnel, employees for whom the taxpayer claims the enterprise zone training credit pursuant to O.R.C. Section 5709.65(A) or employees that are not full-time employees. See credit #17 for a summary of the enterprise zone training credit.

Taxpayers must use the credit in the order established in O.R.C. Section 5733.98 and may carry forward unused credit amounts for three tax years following the tax year for which the credit is computed.

A taxpayer that proposes to conduct an eligible training program for which the taxpayer intends to claim the credit must apply to the Director of Job and Family Services for a tax credit certificate for each tax year with respect to a calendar year in which the taxpayer incurred eligible training costs. The director may charge an application fee to cover the expenses incurred in administering the credit program, and the director may adopt rules to implement and administer the credit.

Upon receipt of an application the Director of Job and Family Services may authorize a credit by granting the applicant a tax credit certificate if the director determines that all of the following conditions are satisfied:

- i. The proposed training program is an “eligible training program,” as defined above;

- ii. The proposed training program is economically sound and will benefit the people of Ohio by improving workforce skills and strengthening the economy of Ohio;
- iii. Receiving the credit is a major factor in the taxpayer's decision to implement the program;
- iv. Authorization of the credit is consistent with the following:
  - The aggregate amount of credits authorized may not exceed \$20 million per calendar year;
  - No more than \$10 million dollars in credits per calendar year may be authorized for corporations engaged primarily in manufacturing;
  - No less than \$5 million per calendar year will be set aside for corporations engaged primarily in activities other than manufacturing and having fewer than 500 employees.

**The director will review job training credit applications and authorize credits to applicants that meet the requirements in the order in which the applicants submit complete and accurate applications. If the director issues the taxpayer a tax credit certificate and later determines that the training program fails to meet the above requirements, the director may reduce the amount of the credit previously granted. If the director reduces the credit, the director must certify the reduction to the tax commissioner, and the tax commissioner will reduce the credit accordingly. The taxpayer can appeal reduction or denial of credit to the director of the Department of Job and Family Services and can appeal the director's determination to the Board of Tax Appeals.**

## **Schedule B-2 – Foreign Source Income Deduction**

### **O.R.C. Section 5733.04(I)(2)**

Effective for taxable years ending on or after July 31, 1991 deductible foreign source income must generally be reduced by certain percentages that are deemed to be the expenses attributable to the foreign income.

#### **Line 1 – I.R.C. Section 78 and 951 Income.**

Enter the I.R.C. Section 78 foreign dividend gross-up and I.R.C. Section 951 subpart F income. This income is fully deductible.

#### **Line 2 – Foreign dividends.**

Enter dividends received from a subsidiary, associate or affiliated corporation that neither transacts any substantial portion of its business nor regularly

maintains any substantial portion of its assets within the United States. This income is fully deductible. See *Emerson Elec. Co. v. Tracy* (2000), 90 Ohio St.3d 157 and O.R.C. Section 5733.04(I)(2) as amended by Amended Substitute Senate Bill 261, 124<sup>th</sup> General Assembly.

**Line 3 – Foreign royalties.**

Multiply by 90% the royalties received from sources outside the United States. Royalties are received from sources outside the United States to the extent that the property that generated the royalty was used outside the United States.

**Line 4(a) – Income from technical and other services.**

Enter amounts received for mechanical, industrial, scientific, practical and other services performed outside the United States. Income from technical services performed in the United States for a foreign customer does not qualify for the foreign source income deduction. The situs of the service performed determines the source of service income. See *Rio Indal, Inc. v. Lindley* (1980), 62 Ohio St. 2d 283. If technical service on a project is performed both within and without the United States, income from the project must be reasonably allocated within and without the United States.

**Line 4(b) – Reimbursed expenses for personal services performed for subsidiaries.**

Enter the amount of any reimbursed expenses for technical or other services performed by employees of the taxpayer for its subsidiary, associate or affiliated corporations.

To the extent that the taxpayer shows by clear and convincing evidence a lesser amount of actual expenses attributable to deductible gross foreign source income, the taxpayer may deduct a greater amount. To the extent that the tax commissioner shows by clear and convincing evidence more actual expenses attributable to deductible foreign source income, the tax commissioner may reduce the deduction.

**Schedule B-3**  
**Related Entity and Related Member Adjustments**  
**O.R.C. Sections 5733.04(I)(12) and (I)(13)**  
**O.R.C. Sections 5733.042, 5733.054 and 5733.055**

**Note:** If the taxpayer is included in a combined franchise tax report, complete Schedule B-3 (Combined) on form FT-1120C (rather than Schedule B-3 on form FT-1120). Capital gains and capital losses attributed to a member of a combined report from a related entity's sale or other disposition of dividend producing property are separately allocable by each member. All other related entity and related member adjustments are apportionable and are computed



on a combined basis. See the May 6, 1992, Franchise Tax Information Release "Schedule B-3 (Combined) – Related Entity and Related Member Adjustments for Corporations Included in a Combined Franchise Tax Report." The information release is available on the department's Web site.

### **Related Entity Adjustments**

#### **Line 1 – Related entity gains (losses) from sale of investments.**

A taxpayer must add to (and deduct from) federal taxable income, line 28 of U.S. form 1120, the taxpayer's proportionate share of a nontaxpayer related entity's gains (and losses) from sales of investments in the stock or debt of another entity if at any time during the 24-month period commencing 12 months before the date of sale and ending 12 months after the date of sale the taxpayer and its related entities owned at least 50% of the stock or debt of the entity whose stock or debt was sold.

The term "related entity" means any of the following:

- An individual stockholder, or a member of the stockholder's family enumerated in I.R.C. Section 318, if the stockholder and the members of the stockholder's family own directly or indirectly in the aggregate at least 50% of the value of the taxpayer's outstanding stock;
- A stockholder, or stockholder's partnership, estate, trust or corporation, if the stockholder and the stockholder's partnerships, estates, trusts and corporations own directly or indirectly, beneficially or constructively, in the aggregate, at least 50% of the value of the taxpayer's outstanding stock;
- A corporation, or a party related to the corporation in a manner that would require I.R.C. Section 318 attribution of stock from the corporation to the party or from the party to the corporation, if the taxpayer owns directly or indirectly in the aggregate at least 50% of the value of the corporation's outstanding stock.

The I.R.C. Section 318 attribution rules apply to the above.

A taxpayer is a corporation subject to the Ohio corporation franchise tax. A nontaxpayer is an entity not subject to the Ohio corporation franchise tax. For each gain and each loss attributed to the taxpayer and recognized by a nontaxpayer related entity from the related entity's sale of stock or debt described above, provide a schedule containing the following information:

- a. The name of the related entity that sold the stock or debt;
- b. The name of the entity whose stock or debt was sold by the related entity and a description of the property sold;

- c. The amount of gain or loss recognized for federal income tax purposes by the related entity from each sale or other disposition;
- d. The amount of the taxpayer's proportionate share of the related entity's gain or loss from the sale of stock or debt based upon the taxpayer's direct, indirect, beneficial or constructive ownership of the outstanding stock of the related entity immediately before the direct or indirect sale, exchange or other disposition; and
- e. A description of the ownership relationship between the taxpayer and the related entity that sold the stock or debt and a description of the ownership relationship between the related entity and the entity whose stock or debt was sold by the related entity.

Enter on line 1 the total net gain or net loss from all transactions described above.

**Line 2 – Related entity gains (losses) from sale of other intangible property.**

A taxpayer must add to (and deduct from) federal taxable income, line 28 of U.S. form 1120, its proportionate share of a nontaxpayer related entity's gains (and losses) from sales of intangible property other than stock, securities and debt if the intangible property was owned or used at any time before the sale by either the taxpayer or by a related entity that was a taxpayer at any time during the related entity's ownership or use of the property.

Enter on line 2 the total net gain or net loss from all transactions described above. For each gain and each loss recognized by a nontaxpayer related entity from the nontaxpayer related entity's sale of intangible property other than stock, securities and debt described above, provide a schedule containing information similar to that required by line 1.

**Line 4 – Allocable portion of total related entity gains (losses).**

Capital gains and capital losses attributed to the taxpayer from a related entity's sale or other disposition of intangible property that may produce dividend income are allocable within and without Ohio. Gains and losses attributed to the taxpayer from a related entity's sale or other disposition of intangible property other than dividend producing property are apportionable.

In addition to the information required by line 1 of this schedule, identify each gain and each loss that is allocable. Enter on line 4 the total related entity net capital gain or net capital loss that is allocable.

**Line 10 – Related entity gains (losses) allocable to Ohio.**

Capital gains and capital losses from the sale of dividend producing property are allocable to Ohio in accordance with the ratio that the investee corporation's net book value of physical assets in Ohio bears to the investee

corporation's net book value of total physical assets everywhere. In addition to the information required by lines 1 and 4 of this schedule, for each capital gain and each capital loss that is allocable furnish a schedule showing the ratio of the investee corporation's net book value of physical assets within Ohio to net book value of physical assets everywhere. Multiply the gain or loss by the ratio. Enter on line 10 the total related entity net capital gain or net capital loss attributed to the taxpayer that is allocable to Ohio.

**Line 11 – Add excess related entity loss.**

Add each related entity loss deducted from federal taxable income on lines 1 and 2 of this schedule to the extent that the loss actually allocated and apportioned to Ohio and to other states that impose a tax on or measured by net income exceeds the total loss. The addition is limited to that portion of the loss actually allocated to Ohio on line 10 or apportioned to Ohio on line 9.

In addition to the information required by lines 1, 2, 4 and 10 of this schedule, a taxpayer claiming a deduction for related entity losses on lines 1 or 2 of Schedule B-3 must furnish a schedule containing the following information for **each** loss deducted:

- a. The name of each state in which the loss was deducted for purposes of computing a tax on or measured by net income;
- b. The apportionment ratio in each state in which the loss was deducted;
- c. The amount of the loss actually allocated or apportioned to each state that imposes a tax on or measured by net income;
- d. The amount of the loss actually allocated or apportioned to Ohio;
- e. The amount by which the loss allocated and/or apportioned to Ohio and to other states exceeds the total loss; and
- f. The smaller of the amount from line **d** or line **e**, above.

Enter on line 11 as a positive number the sum of the amounts from **f**, above.

**Line 12 – Deduct excess related entity gain.**

Line 12 grants relief in those circumstances where the related entity gain subjected to tax by Ohio and by other states exceeds the total gain. On line 12 a taxpayer may deduct each gain added to federal taxable income on lines 1 and 2 of this schedule to the extent that the gain actually taxed by Ohio and by other states which impose a tax on or measured by net income exceeds the total gain. The deduction is further limited to the portion of the gain that is actually allocated to Ohio on line 10 or apportioned to Ohio on line 9.

In addition to the information required by lines 1, 2, 4 and 10 of this schedule, a taxpayer claiming a deduction on line 12 must furnish a schedule containing the following information for **each** gain for which the deduction is claimed:

- a. The name of each state which imposed on the gain a tax on or measured by net income;
- b. The apportionment ratio in each state which imposed a tax on the gain;
- c. The amount of the gain actually allocated or apportioned to each state that imposed tax on the gain;
- d. The amount of the gain actually allocated or apportioned to Ohio;
- e. The amount by which the gain allocated and/or apportioned to Ohio and to other states exceeds the total gain; and
- f. The smaller of the amount from line **d** or line **e**, above.

Enter on line 12 the sum of the amounts from line **f**, above.

### **Related Member Adjustments**

#### **Line 6 – Interest expense and intangible expense paid to related members.**

**Note:** For tax years 1999 and thereafter Amended Substitute House Bill 215, 122nd General Assembly, made the related member adjustments applicable to both large corporations and small corporations that pay interest expense or intangible expense to certain related members. Prior law generally limited the related member adjustments to large taxpayers because the prior law applied only if the taxpayer or a member of the taxpayer's affiliated group had one or more of the following: (1) gross sales of at least \$50 million; (2) total assets of at least \$25 million; or (3) taxable income of at least \$500,000. House Bill 215 eliminated the above three limitations thereby making the adjustments applicable to small corporations as well as large corporations. In addition, House Bill 215 expanded the definition of "intangible expenses and costs" in the related member provisions to include losses from factoring transactions and discounting transactions. Intangible expenses and costs include expenses, losses and costs for, related to, or in connection with the direct or indirect acquisition, use, maintenance, management, ownership or disposition of intangible property. See O.R.C. Section 5733.042(B) as amended by House Bill 215.

A taxpayer must add to its federal taxable income interest expense and intangible expenses that it deducted for federal income tax purposes and that it directly or indirectly paid or accrued to certain "related members." Interest expense includes but is not limited to amounts deducted under I.R.C. Section 163. Intangible expenses are expenses and costs for the use

of intangible property. Such expenses include but are not limited to losses from factoring transactions and discounting transactions and royalty, patent, technical and copyright fees, licensing fees and other similar expenses deducted for purposes of determining taxable income under the I.R.C.

**A penalty for failure to pay the additional tax attributable to the related member adjustments is applicable if the additional tax is not paid within one year after the date the report is filed. The penalty equals twice the interest charged. The penalty does not apply if the additional tax (i) is less than 10% of the total franchise tax and (ii) is less than \$50,000. This penalty is in addition to any other applicable penalties and charges.**

For purposes of this adjustment the term “**related member**” means a person that, with respect to the taxpayer during all or any portion of the taxable year, is any of the following: (i) a “related entity” as defined in division (I)(12)(c) of O.R.C. Section 5733.04 (summarized in the instructions for line 1, above); (ii) a “component member” as defined in I.R.C. Section 1563(b); or (iii) a person to whom or from whom there is attribution of stock ownership in accordance with I.R.C. Section 1563(e) except that “20%” shall be substituted for “5%” wherever “5%” appears in I.R.C. Section 1563(e).

A taxpayer must add to its federal taxable income the following: (i.) all interest expense and intangible expenses that the taxpayer paid or accrued to related members described in A through F, below, and (ii) excess interest paid to related members described in G, below:

- A. A related member whose activities in any one state are primarily limited to the maintenance and management of (i) intangible investments or (ii) intangible investments of corporations, business trusts or other similar entities;
- B. A related member that is a personal holding company as defined in I.R.C. Section 542 without regard to the stock ownership requirements set forth in I.R.C. Section 542(a)(2);
- C. Any noncorporate related member that is directly or indirectly owned in whole or in part by a personal holding company as defined in I.R.C. Section 542 without regard to the stock ownership requirements set forth in I.R.C. Section 542(a)(2);
- D. Any related member that is an I.R.C. Section 552 foreign personal holding company;
- E. Any noncorporate related member that is directly or indirectly owned in whole or in part by an I.R.C. Section 552 foreign personal holding company; and

- F. Any related member if that related member or another related member directly or indirectly paid or accrued interest expenses or intangible expenses. However, this portion of the law is applicable only if within a 120-month period commencing three years before the beginning of the tax year and ending seven years after the beginning of the tax year the related member directly or indirectly paid or accrued such amounts to one of the five related members listed in A through E directly above.
- G. In addition to the adjustments for all interest expense and intangible expense paid to related members listed in A through F, above, a taxpayer must add to its federal taxable income interest expense that is paid or accrued to **any** related member to the extent that the interest is based upon an “excess interest rate.” An “excess interest rate” is an interest rate that exceeds by more than 3% the greater of (i) the annual interest rate prescribed by O.R.C. Section 5703.47 in effect at the time of the origination of the indebtedness or (ii) the annual interest rate prescribed by O.R.C. Section 5703.47 in effect at the time the taxpayer paid, accrued or incurred the interest expense. For example, the 2002 annual rate prescribed by O.R.C. Section 5703.47 is **7%**. If a taxpayer paid or accrued interest expense to a related member at the rate of 14% during 2002 on indebtedness that originated in 2002, the excess interest rate is 4% (14% minus the sum of 7% and 3%). Only the excess interest expense must be added to federal taxable income. In this example the excess interest expense is the difference between the interest paid or accrued to the related member at the 14% rate and the interest that would have been paid or accrued had the rate been 10% (7% + 3%).

If the taxpayer paid or accrued interest expense or expenses for the use of intangible property to a related member described in A through F, above, or if the taxpayer paid or accrued “excess interest” to any related member, attach a schedule containing the following information:

1. A list of all the related members to whom the taxpayer directly or indirectly paid or accrued interest expense or expense for the use of intangible property during the taxpayer’s taxable year;
2. For **each** related member listed in No. 1, above:
  - Indicate whether or not the related member is a related member described in A through F above;
  - Provide the amount of the taxpayer’s interest expense paid or accrued during its taxable year to the related member, the amount of the taxpayer’s indebtedness to the related member at the beginning and at the end of the taxpayer’s taxable year, the interest rate on the indebtedness, and the date of the origination of the indebtedness; compute the taxpayer’s excess interest expense, if any, paid or accrued during

its taxable year to each related member other than related members described in A through F, above; and

- Provide the amount of the taxpayer's expenses for the use of intangible property paid or accrued during its taxable year to each related member described in A through F above. Describe the intangible property used by the taxpayer.

The interest expense and intangible expense adjustments do not apply to the extent that the taxpayer's increased tax would have been avoided by filing a combined franchise tax report with the related member. In addition, the interest expense and intangible expense adjustments do not apply where both of the following conditions are satisfied: (i) the transaction did not have as a principal purpose the avoidance of Ohio franchise tax, and (ii) the related member to whom the taxpayer paid interest expense and/or intangible expense during the same taxable year directly or indirectly paid, accrued or incurred such amounts to persons who were not related members.

Enter on line 6 the sum of: (i) interest paid or accrued to all related members described in A through F, above, (ii) expenses for the use of intangible property paid or accrued to all related members described in A through F, above, and (iii) excess interest paid or accrued to all related members other than related members described in A through F, above.

**Line 13 – Deduct related members' net interest income and net intangible income taxed by other states.**

A taxpayer may deduct an amount equal to the sum of each related member's "net interest income" (defined below) and "net intangible income" (defined below) actually allocated and apportioned to other states that impose a tax on or measured by income. The deduction is limited to the increase in Ohio taxable income resulting from the adjustments required by Schedule B-3, line 6.

**Net interest income** is the excess of interest received by a related member from the taxpayer over interest expenses and costs paid or accrued by the related member to another related member described in A through G, above (see instructions for line 6).

**Net intangible income** is the excess of income received by a related member from the taxpayer for the taxpayer's use of intangible property over intangible expenses paid or accrued by the related member to another related member described in A through G, above.

For purposes of this deduction, related members receiving such income from the taxpayer and paying such expenses are limited to those related members described in A through G, above.



In addition to the information required by line 6 of this schedule, taxpayers who are claiming a deduction on line 13 must furnish a schedule containing the following additional information for each related member which received from the taxpayer interest income or income for the use of intangible property:

- a. The names of all other states that imposed on the related member a tax on or measured by income. For purposes of this deduction the term "other states" does not include those states under whose laws the taxpayer files or could have elected to file with the related member, or the related member files or could have elected to file with another related member, a combined income tax report or return, a consolidated income tax report or return, or any other report or return where such report or return is due because of the imposition of a tax measured on or by income and such report or return results in the elimination of the tax effects from transactions directly or indirectly between either the taxpayer and the related member or between the related member and another corporation if such other corporation, during a 120-month period commencing three years prior to the beginning of the tax year and ending seven years after the beginning of the tax year, directly or indirectly paid, accrued or incurred intangible expenses and costs or interest expenses and costs to an entity described in A through E, above (see instructions for line 6.);
- b. the related member's interest expense that it paid or accrued to other related members described in A through G, above;
- c. the related member's intangible expenses that it paid or accrued to other related members described in A through G, above;
- d. the related member's net interest income (defined above);
- e. the related member's net intangible income (defined above);
- f. the related member's apportionment ratio in each state listed in (a), above; and
- g. the related member's net interest income and net intangible income THAT it actually allocated or apportioned to each state that imposed tax on the income.

Enter on line 13 the smaller of the following:

- The sum of all related members' net interest income and net intangible income actually allocated and apportioned to other states that imposed a tax on or measured by income or
- The taxpayer's increase in Ohio taxable income resulting from the adjustments required by O.R.C. Section 5733.042 (that is, the amount

on line 6 of this schedule multiplied by the taxpayer's Schedule D Ohio apportionment ratio.)

For further information regarding the related entity and related member adjustments, please contact the Department of Taxation at P.O. Box 2476, Columbus, Ohio 43216-2476, Attn: Related Entity/ Related Member.

### **Tax Commissioner's Rules Applicable to the Ohio Corporation Franchise Tax**

- 5703-1-12 – Requests for an opinion of the tax commissioner
- 5703-5-01 – Definitions applicable to rules 5703-5-01 to 5703-5-05 of the Administrative Code
- 5703-5-02 – Date as of which the value of a taxpayer's issued and outstanding stock is determined
- 5703-5-03 – Dates on which a taxpayer's taxable year begins and ends
- 5703-5-04 – Changes of a taxpayer's annual accounting period
- 5703-5-06 – Combined reporting of the corporation franchise tax
- 5703-5-08 – Books from which the value of issued and outstanding shares of stock is determined under the net worth basis of the corporation franchise tax
- 5703-5-09 – Allocating and apportioning income of airlines  
**Note:** Rule 5703-5-09 was rescinded effective March 21, 2002 as a result of the Board of Tax Appeals decision in *Delta Airlines, Inc. v. Tracy*, BTA No. 96-T-471 & 96-T-472 (1-12-2001).
- 5703-5-10 – Corporate franchise tax; accounts maintained under Statement of Financial Accounting Standards No. 106

### **Information Releases**

Since 1991 the Income Tax Audit Division has issued the following information releases:

- "Ohio Bonus Depreciation Adjustment and the Internal Revenue Code's Passive Activity Loss, Basis Limitation and At-Risk Rules," November 2002.
- "Recently Enacted Ohio Legislation Affects Depreciation Deductions for Taxable Years Ending in 2001 and Thereafter" July 2002.
- "Pass-through Entity Tax: Certain Estimated Tax Payments Due September 16, 2002," July 3, 2002.
- "Corporate Franchise Tax – Nexus Standards," September 2001.

- “Corporation Franchise Tax Nexus for Nonresident Limited Partners Following the UCOM Decision,” March 15, 2001.
- “I.R.C. Section 482 Study: Safe Harbor to Avoid Ohio Corporate Franchise Tax Report Required or Expanded Combinations,” June 23, 2000.
- “Withdrawal of Special Instructions,” October 31, 1997.
- “Am. Sub. H.B. No. 215, 122nd General Assembly (Budget Bill), Summary of Franchise Tax & Income Tax Provisions,” September 18, 1997.
- “I.R.S. ‘Check the Box’ Entity Selection Regulations,” August 19, 1997.
- “Revisions to May 6, 1996 Information Release,” June 18, 1996.
- “Alternative 20% Credit,” May 7, 1996.
- “Examples Setting Forth the Division’s Interpretation of Ohio Revised Code Sections 5733.33 and 5747.31, ‘Second Credit for Purchases of New Manufacturing Machinery and Equipment,’ ” May 6, 1996.
- “Second Credit for Purchases of New Manufacturing Machinery and Equipment,” September 22, 1995.
- “20% Threshold Test Credit for Purchases of New Manufacturing Machinery and Equipment,” September 21, 1995.
- “Newly Enacted Investment Tax Credit Law,” October 14, 1994.
- “Recently Enacted Legislation Revises the Requirements for Corporations Paying Corporate Franchise Tax by Electronic Funds Transfer (EFT),” July 31, 1994.
- “Taxation of S Corporations and Their Shareholders,” July 31, 1994.
- “New Legislation Requires Certain Corporations to Pay Corporate Franchise Tax by Electronic Funds Transfer,” October 29, 1993.
- “Safe Harbor Leases: Franchise Tax Policy Change,” November 10, 1992.
- “Application of Ohio Revised Code Section 5733.053 (Transferor Statute) to the Merger of a C Corporation Into an S Corporation,” September 24, 1992.
- “Schedule B-3 (Combined) – Related Entity and Related Member Adjustments for Corporations Included in a Combined Franchise Tax Report,” May 6, 1992.
- “Exempt Federal Interest,” January 9, 1992.

- “Credit for Investment in Qualified Subsidiaries,” July 16, 1991.
- “Taxpayer Elected Franchise Tax Combinations,” May 15, 1991.
- “Foreign Technical Service Fee Deductions,” May 15, 1991.

Tax information releases are not “Opinions of the Tax Commissioner” within the meaning of O.R.C. Section 5703.35. Nevertheless, the releases do reflect the department’s interpretation of the law. Information releases are available on the department’s Web site.

<p style="text-align: center;"><b>Ohio Franchise Tax Forms</b></p> <p style="text-align: center;">Many of the Department's forms are available on the Internet at: <a href="http://www.state.oh.us/tax/">http://www.state.oh.us/tax/</a></p>		
		<b>Revision Date</b>
FT-COM	Request for Permission to File or to Amend a Combined Corporation Franchise Tax Report	7/00
FT-1120E	Declaration of Estimated Corporation Franchise Tax	12/02
FT-1120ER	Application for Automatic Extension	12/02
FT-1120EX	Request for an Additional Extension of Time for Filing Corporation Franchise Tax Report	12/02
FT-1120	Corporation Franchise Tax Report	12/02
FT-1120VL	Valuation Limitation on Gains and Losses from Sales or Exchanges of Property	7/00
FT-1120C	Corporation Franchise Tax (Combined Report)	12/02
FT-WAIVER	Consent to Extend the Time to Assess or Refund the Ohio Corporation Franchise Tax	5/02
FT-OTAS	Ohio Taxpayers' Affiliation Schedule	12/02
FT-EXPORT	Corporation Franchise Tax Credit for Increasing Export Sales	12/99
FT-1120-FI	Corporation Franchise Tax Report for Financial Institutions	12/02
FT-1120-S	Notice of S Corporation Status	12/02
FT-REF	Application for Corporation Franchise Tax Refund	12/02
FT-PR	Petition for Reassessment	11/02
FT-HELP	Special Handling Notice	11/02
FT-QHC	Qualifying Holding Company Election	No Revisions
FT-Electric	Supplemental Schedules for Electric Companies	12/02

Rank	Nonrefundable Credit	Carryforward Period	O.R.C. Section
1.	Credit for Taxes Paid by a Qualifying Pass-Through Entity	Unlimited*	5733.0611
2.	Credit for Qualifying Affiliated Groups (due to Related Entity and Related Member Adjustments)	Not Applicable	5733.068
3.	Credit for Recycling and Litter Prevention Donations	None	5733.064
4.	Credit for Employers that Enter into Agreements with Child Daycare Centers	None	5733.36
5.	Credit for Employers that Reimburse Employee Child Daycare Expenses	None	5733.38
6.	Credit for Maintaining Railroad Crossing Warning Devices	None	5733.43
7.	Credit for Purchases of Lights and Reflectors for Tractors	None	5733.44
8.	Job Retention Credit	Three years	5733.0610(B) & 122.171
9.	Second Credit for Purchases of New Manufacturing Machinery and Equipment (7.5%/13.5% Credit)	Three years	5733.33
10.	Credit for Eligible New Employees in an Enterprise Zone	Three years	5709.66
11.	Credit for Eligible Costs Associated with a Voluntary Action (Brownfield Site Clean-Up)	Three years	5733.34 & 122.19
12.	Credit for Employers that Establish Onsite Child Daycare Centers	Five years	5733.37
13.	Ethanol Plant Investment Credit	Three years	5733.46 & 901.13
14.	Credit for Grape Production Property	Seven years	5733.32
15.	Export Sales Credit (no new credit – carryforward amounts only)	1994-2005	5733.069
16.	Edison Center Credit for Research & Development Investors	Fifteen years	5733.35, 122.15, 122.151, 122.152 122.153, 122.154 5709.65(A)
17.	Enterprise Zone Daycare and Training Credits	Unlimited*	

\*Unused credit amounts may be carried forward until fully utilized.

**Second Credit for Purchases of New Manufacturing Machinery and Equipment (O.R.C. Section 5733.33)**

Calendar year in which qualifying equipment is purchased	Franchise tax years (report years) in which 1/7 credit amounts are claimed													Total			
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	
7/1 – 12/31/95	1/7	1/7	1/7	1/7	1/7	1/7	1/7										7/7
1996	1/7	1/7	1/7	1/7	1/7	1/7	1/7										7/7
1997		1/7	1/7	1/7	1/7	1/7	1/7	1/7									7/7
1998			1/7	1/7	1/7	1/7	1/7	1/7	1/7								7/7
1999				1/7	1/7	1/7	1/7	1/7	1/7	1/7							7/7
2000					1/7	1/7	1/7	1/7	1/7	1/7	1/7						7/7
2001						1/7	1/7	1/7	1/7	1/7	1/7	1/7					7/7
2002							1/7	1/7	1/7	1/7	1/7	1/7	1/7				7/7
2003								1/7	1/7	1/7	1/7	1/7	1/7	1/7			7/7
2004									1/7	1/7	1/7	1/7	1/7	1/7	1/7		7/7
2005										1/7	1/7	1/7	1/7	1/7	1/7	1/7	7/7

**Note:** The taxpayer claims 1/7 of the credit in each of the seven years following the purchase year. Each 1/7 credit amount that is not used in the year in which it otherwise could have been claimed may be carried forward for three years. The unused carryforward amount is used before the 1/7 amount for the subsequent year.