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Issued: October 7, 2016

Reissued: February 1, 2019

## Income Tax - Information Release\*

### IT 2016-01 – Guidance Relating to an Equity Investor’s Apportionment of a Gain from the Sale of a Closely-Held Business (R.C. 5747.212)

#### *Introduction*

On May 4, 2016, the Supreme Court of Ohio decided the case *Corrigan v. Testa*, 2016-Ohio-2805. *Corrigan* analyzed the constitutionality of R.C. 5747.212, an Ohio statute that provides special rules for apportioning the gain from a taxpayer’s ownership interest in a “closely held” investment. The Court found that R.C. 5747.212 **as applied** to *Corrigan* was unconstitutional under the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

The full text of R.C. 5747.212 can be found at: <http://codes.ohio.gov/orc/5747.212>

The full text of the decision in *Corrigan v. Testa* can be found at: <https://www.supremecourt.ohio.gov/>

Since the *Corrigan* case was decided, many taxpayers and tax preparers have contacted the Department asking for guidance relating to situations where a taxpayer was assessed or paid tax on an amount calculated under R.C. 5747.212.

#### *Observations*

After reviewing the decision in *Corrigan*, the Department has the following observations:

- The Court’s analysis and holding were confined solely to R.C. 5747.212. The analysis and holdings were not expanded to any other Ohio statute.
- The Court found that R.C. 5747.212 was unconstitutional **as applied** to Mr. Corrigan. The Court declined to find the statute unconstitutional **on its face** (i.e., the statute was not stricken down as unconstitutional in all situations; instead, it was found to be unconstitutional only in *this* situation).
- The Court found that an ownership interest in a business is an “intangible asset” and that neither Mr. Corrigan nor the sale of the asset had a taxable link to Ohio. Thus, the Court followed the general rule of law that a capital gain derived from the sale of an intangible asset is allocable to the taxpayer’s state of domicile as nonbusiness income.

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\* An information release does not create legal obligations by its own force. Only an administrative rule can “confer the force of law on a requirement.” See *Progressive Plastics, Inc. v. Testa*, 133 Ohio St.3d 490, 2012-Ohio-4759.

## Guidance

Based upon the above observations, the Department hereby issues the following guidance relating to taxpayers who utilized R.C. 5747.212 in the calculation of their income tax liability:

- If a taxpayer has already filed a refund application or petitioned an assessment relating to the applicability of R.C. 5747.212, nothing more is needed at this time; such cases will automatically be reviewed in light of the *Corrigan* decision. That said, if the taxpayer has additional information that, after reading the *Corrigan* decision, further supports the taxpayer's position, this information should be sent to your point of contact within the Department as soon as possible.
- If a taxpayer believes that s/he is entitled to a refund of amounts previously paid, based on the holding in *Corrigan v. Testa*, said taxpayer may file amended tax returns consistent with this belief per the following instructions:
  - The "Reasons and Explanation of Corrections" page accompanying each amended return must cite *Corrigan v. Testa*, 2016-Ohio-2805 as the basis for the amended return.
  - For each return, the taxpayer shall provide a detailed statement outlining the factual and legal reasons why the *Corrigan* decision is applicable to the R.C. 5747.212 adjustment reported on their original return or determined to be applicable by the Department via an audit.
  - The refund request must be for payments that are subject to refund as of the filing date of the amended return. Under Ohio law, this means any payment of income tax made within **four (4) years** of the date the refund is requested. For the full text of Ohio's income tax refund statute, see R.C. 5747.11, which can be found at: <http://codes.ohio.gov/orc/5747.11>.
  - The payments/ tax years for which the taxpayer is requesting a refund must **not** have been the subject of a Settlement Agreement with the Department.

Amended returns and requests for refund following this guidance will be reviewed in the normal course of the Department's operations. Please allow additional time for the Department's review of these filings, as tax situations involving R.C. 5747.212 tend to be very factually and legally intensive.

- Additionally, to the extent an individual taxpayer recognizes a capital gain relating to the disposition of an interest in a business entity to which R.C. 5747.212 does **not** apply, that gain is generally nonbusiness income. See R.C. 5747.01(C). *But see* R.C. 5747.01(B) (Income from the sale of a intangible asset *can* be business income "if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation.").

A nonbusiness gain is allocable to the taxpayer's state of domicile under R.C. 5747.20(B)(2)(c). Additionally, since this gain is considered nonbusiness income, it is not eligible for Ohio's Small Business Deduction for tax years 2013 and 2014, or Ohio's Business Income Deduction for tax years 2015 and forward. R.C. 5747.01(A)(31).

## Questions?

Taxpayers may visit [www.tax.ohio.gov](http://www.tax.ohio.gov). Questions may be submitted by clicking on the "Contact" link found at the top right of the page and then choosing the "Email Us" option. Taxpayers with additional questions regarding this subject may contact Individual Income Taxpayer Services at 1-800-282-1780, or at 1-800-750-0750 for the hearing impaired.