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Final Analysis
Legislative Service Commission

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(As Passed by the General Assembly)

Reps. Mottley, Distel, Aslanides

Sens. Blessing, Finan

Effective date: *

ACT SUMMARY

- Prescribes a uniform municipal income tax base for electric light companies, which is to be apportioned among municipal corporations on the basis of property, payroll, sales, and local municipal income tax rates.
- Prescribes uniform filing requirements whereby an electric light company files a single municipal income tax return with the state, and the state distributes the tax collections to municipalities.
- Prescribes uniform procedures for collection, enforcement, and appeals regarding municipal income taxation of electric light companies, similar to those for the corporation franchise tax.
- Applies to municipal income taxes paid in 2002 and thereafter.
- Modifies the "occasional entrant" rule under the municipal income tax law.
- Permits the Tax Commissioner to discuss with other states the development of a voluntary sales and use tax collection system for sellers without any physical presence in Ohio (and thus not required to collect the taxes for Ohio).
- Authorizes the Tax Commissioner to participate with other states in a pilot project to test such a system.

* *The Legislative Service Commission had not received formal notification of the effective date at the time this analysis was prepared.*

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CONTENT AND OPERATION

MUNICIPAL INCOME TAXATION OF ELECTRIC LIGHT COMPANIES

Municipal income taxation of utilities

Under continuing law, a municipal corporation cannot tax the income of public utilities that are subject to the public utility excise (gross receipts) tax. But under the electric industry deregulation act (S.B. 3), electric light companies become subject to the corporation franchise tax beginning in 2002, and will no longer be subject to the public utility excise tax. Once the companies are no longer subject to that tax, municipal corporations are free to tax their income. The



act's uniform reporting and payment provisions apply to municipal income taxes paid *for* 2003; and since the act requires estimated taxes to be reported and paid in the year preceding the year for which taxes are paid, estimated taxes are to be paid under the act's uniform provisions beginning in 2002.

The act prescribes uniform procedures for administering municipal income taxes levied on electric light companies. Generally, the act requires an electric light company to file a single tax return and pay taxes to the state, rather than filing separate returns and making separate tax payments to each municipal corporation where the company conducts business. A set of uniform procedures and enforcement remedies will apply in lieu of the various municipal procedures and remedies; the uniform procedures and remedies are substantially equivalent to those used to administer and enforce the corporation franchise tax.

Companies covered under the act

(secs. 718.02, 5745.01, and 5745.031)

The act applies to all companies known in the electric utility deregulation law (Chapter 4928.) as "electric light companies." This term encompasses not only electric utilities that generate, transmit, or distribute electricity, but nonutility companies that arrange for electricity to be supplied to a consumer through facilities owned by other companies; but these companies are covered by the act only if 50% or more of their total Ohio sales consist of electricity and other energy commodities, and the company elects to be subject to the act's provisions. If such a company elects to be covered by those provisions, the company is subject to them for five years. The act also applies to so-called "combined companies"--those that have multiple lines of utility business such as natural gas and electricity supply--but only to the extent that such companies are in the business of supplying electricity. (Hereafter in this analysis, references to electric light companies should be understood to refer to the electricity-supplying part of a combined company.)

Nonprofit companies and municipal electric utilities are not subject to municipal income taxes under the act.

Uniform tax base

(secs. 5745.01 and 5745.02)

Under prior law, each municipal corporation that levied an income tax on corporations could define taxable income in its own way, so a corporation doing business in several municipal corporations might have had to compute the tax due to each municipal corporation in a different manner.

The act prescribes a uniform tax base for electric light companies: an electric light company's income for municipal income tax purposes is its "adjusted federal taxable income," i.e., its federal taxable income minus net intangible income; minus any amount deducted under the corporation franchise tax for disposing of qualifying assets of an electric company to the extent apportioned to Ohio; plus any such amount added under the corporation franchise tax.

Each company's tax base is to be determined over its federal taxable year.

Apportionment of income

(sec. 5745.02)

The act prescribes a two-stage method for apportioning an electric light company's income to a municipal corporation. First, its adjusted federal taxable income is apportioned to Ohio. A three-factor apportionment formula is used consisting of property, payroll, and sales in Ohio as compared to everywhere. Each factor is given equal weight. If a company (other than a combined company) is involved in businesses other than electricity generation, transmission, distribution, or supply, then all of its adjusted federal taxable income is used as the base for apportionment, and the factors include all of its property, payroll, or sales regardless of whether it is employed in the electricity business. Electricity sales are apportioned in the same manner prescribed for the corporation franchise tax.

Second, a company's income as apportioned under the first stage ("Ohio net income") is apportioned to each municipal corporation in which the company uses property, employs persons, or makes sales under another three-factor formula. The factors consist of property, payroll, and sales in the municipal corporation as compared to elsewhere in Ohio. Each factor is given equal weight.

The act provides that if the provisions for apportioning income, or any of the three factors, do not fairly represent business activity in Ohio or among municipal corporations, the Tax Commissioner may adopt rules for apportioning income by an alternative method, or the company may request, or the Tax

Commissioner require, that the company's income be determined by an alternative method.

Special rule for combined companies

(sec. 5745.02(D))

If a company is a combined company (i.e., in the business of supplying electricity and some other utility, such as natural gas), then only the electricity-supplying part of the company's operations are to be included in the factors apportioned among Ohio municipal corporations.

Appealing the apportionment

(sec. 5745.13)

Municipal corporations have the right under the act to appeal the Tax Commissioner's apportionment of an electric light company's net income. To appeal, the municipal corporation must file a petition with the Tax Commissioner within 60 days after the Tax Commissioner issues notice of an audit adjustment to the affected municipal corporations. The Tax Commissioner must hold an administrative hearing (if one is requested) and must make any correction in the apportionment that is warranted. Any notice correction must be issued by ordinary mail to the electric light company and all municipal corporations affected by the corrected apportionment. A municipal corporation may not appeal the Tax Commissioner's finding.

Tax determination; distribution of taxes to municipalities

(secs. 5745.03 and 5745.05; Section 5)

An electric light company's Ohio net income, once apportioned to each municipal corporation, is multiplied by the municipal corporation's tax rate in effect on January 1 within a taxpayer's taxable year to determine the tax owed to that municipal corporation. Municipal corporations must certify their tax rates to the Tax Commissioner by January 31 each year. If a municipal corporation fails to certify its tax rate, 50% of the municipal corporation's distribution of revenue is withheld by the state until the rate is certified.

All tax collections are deposited in the state treasury to the credit of the Municipal Income Tax Fund, which is created by the act, except 1 1/2% is credited to a fund to defray the Tax Commissioner's administrative costs (up to 5% in 2002 and 2003). Distributions to municipal corporations of their apportioned shares of the taxes are paid from this fund. All investment earnings from the fund are

credited to it and apportioned among municipal corporations in proportion to their respective payments from the fund. Payments made from the fund are adjusted to reflect estimated taxes already paid from the fund to a municipal corporation, and any estimated taxes paid directly to a municipal corporation by a company.

Estimated tax payments

(secs. 113.061, 5745.04, 5745.041, and 5745.05; Section 4)

Payment and reporting of estimated taxes

The act requires electric light companies to pay estimated taxes to the state each quarter. A company must pay 100% of its previous year's total municipal tax liability or 80% of its current liability in four equal quarterly installments. Estimated tax payments and reports must be submitted to the Tax Commissioner. If any payment exceeds \$1,000, the company must remit the payment by electronic funds transfer in the same manner that several other state taxes are required to be paid.

Estimated payments in 2001 and 2002

For the first year that estimated taxes are due (2002), each electric company and combined company must pay 20% of its 2002 liability at each of the quarterly due dates. The act incorporates a "safe harbor" provision that precludes penalties and interest being charged if a company pays at least 80% of its actual liability for the year.

Each electric light company that is not an electric company or combined company and that paid a municipal income tax in 2001 must pay 25% of its total tax liability for 2001, in lieu of the estimated liability for 2002. No penalty or interest will be charged if a company pays at least 80% of its tax liability for taxable year 2001 or 100% of the tax liability for taxable year 2000.

Distribution of estimated taxes

No later than March 1, June 1, September 1, and December 1 each year, the Director of Budget and Management must distribute the estimated tax payments to municipal corporations.

Tax reports

(secs. 5745.03 and 5745.14)

Each electric light company subject to a municipal income tax must file an annual report with the Tax Commissioner by the 15th day of the fourth month of its taxable year. (If the company receives an extension for filing its Ohio corporation franchise tax report, the due date for the municipal report is extended for the same period.) The Tax Commissioner prescribes the form of the report; generally, it must elicit the same information as the corporation franchise tax report. The Tax Commissioner may require companies to file reports in an electronic format.

Municipal corporations are prohibited from requiring electric light companies to file tax returns in addition to the state report. But municipal corporations may require companies to file reports of the value of their real and tangible personal property situated in the municipal corporation, the compensation paid in the municipal corporation to employees, and sales made in the municipal corporation.

If an electric light company's municipal income tax report must be altered as a result of a change in the company's federal income tax return or Ohio corporation franchise tax report, and that alteration affects the company's municipal income tax liability, the company must file with the Tax Commissioner an amended municipal income tax report within one year after the federal or state change is determined. The company must pay any tax underpayment resulting from the alteration (plus accrued interest), and may request a refund (plus interest) for any overpayment resulting from the alteration.

Credit for tiered companies

(sec. 5745.06)

The act grants a credit against any municipal income taxes paid by certain "tiered" entities to negate any income from being taxed twice. If an electric light company subject to taxation in a municipal corporation owns a share of another electric light company organized as a pass-through entity (e.g., partnership, S corporation, or limited liability company not taxed as a corporation) that also is taxed by the same municipal corporation, then the owner of the entity may claim a nonrefundable credit for the taxes paid by the entity to that municipal corporation. Credits unused in one year may be carried over to later years until exhausted.

Administration and enforcement; penalties, interest, and refunds

(secs. 5703.053, 5703.19, 5745.07 to 5745.12, and 5745.15)

The Tax Commissioner is charged with administering and enforcing the act's provisions. The Tax Commissioner must prescribe necessary forms, provide any required notices, and adopt any necessary rules.

Penalties and interest are charged in a similar manner and for the same reasons as penalties and interest are charged under the corporation franchise tax. Money collected in the form of penalties and interest is distributed to the municipal corporations entitled to receive taxes from the electric light company.

The Tax Commissioner has the same powers to make assessments against electric light companies for municipal income taxes as for any corporation under the corporation franchise tax. The same three-year statute of limitations on assessments that applies under the franchise tax applies to assessments issued against electric light companies for municipal income taxes (there is no statute of limitation in cases of fraud or failure to file, as under the franchise tax). Electric light companies have the same right to appeal assessments as corporations have to appeal corporation franchise tax assessments (beginning with administrative appeals before the Tax Commissioner, which are appealable to the Board of Tax Appeals).

Refunds must be requested and paid in a similar manner as refunds of corporation franchise taxes are, but municipal corporations, rather than the state, are responsible for issuing refunds. Also, refunds may be credited against the company's future estimated tax payments rather than paid directly to the company. Interest would accrue on any refunds that are not paid within 90 days after a municipal corporation is notified by the Tax Commissioner that a refund is due. Refunds are charged pro rata against all municipal corporations that receive taxes from the electric light company, and deducted from the municipal corporation's next distribution of taxes.

The Tax Commissioner may adopt rules regarding the retention of records by companies, including federal income tax returns and Ohio corporation franchise tax reports. Companies must make those records available to the Tax Commissioner for inspection during normal business hours. Companies must retain records and other pertinent documents for three years after the applicable filing deadline (or the actual day it was filed, if later than the deadline), unless the Tax Commissioner allows the company to destroy the records earlier.

Confidentiality of taxpayer information

(secs. 5745.16 and 5703.21)

Under continuing law, taxpayer information gained by municipal officers and employees through the tax collection process is deemed to be confidential, and persons possessing such information are prohibited from disclosing it, except under specified circumstances (such as in accordance with a court's order, or in performing an official act that is authorized by local law). There is no penalty prescribed by state law for violations.

Since the act provides for electric light companies to file a single return that may cover its operations in several municipal corporations, the act permits certain municipal representatives to gain access to annual reports and estimated tax reports filed with the state. For this purpose, the act requires the Tax Commissioner, who keeps the reports, to adopt rules governing how the reports and related information are to be made available for inspection by municipal representatives. The rules must prohibit the disclosure of such reports or related information to anyone who is not specifically authorized by the municipal corporation to gain access to taxpayer information, and must allow disclosure of only as much information as is necessary for an authorized municipal representative to determine the share of a company's net income that is to be apportioned to that municipal corporation.

The act provides that the disclosure of taxpayer information by an agent of the Department of Taxation in accordance with the Tax Commissioner's rules is not a violation of an existing law that prohibits those agents from disclosing taxpayer information.

MUNICIPAL INCOME TAXATION OF OCCASIONAL ENTRANTS

Taxation of "occasional entrants"

(secs. 718.01(F) and 718.011)

H.B. 477 of the 123rd General Assembly prohibited a municipal corporation from taxing compensation paid to nonresident individuals who are employed in the municipal corporation on an infrequent basis. This act modifies the "occasional entrant" rule to permit a municipal corporation to tax a nonresident employee's pay for work in the municipal corporation on 12 or fewer days each year if the employee is not taxed on that pay by the municipal corporation where the employer's principal place of business is located, if it is different from the municipal corporation where the work is performed.

VOLUNTARY TAX COLLECTION SYSTEM FOR REMOTE SELLERS

Inability to tax remote sellers

With the advent of the Internet, states face the problem of collecting sales or use taxes from remote sellers who are not located in Ohio and have practically no contacts with the state, other than making sales to Ohio consumers over the Internet. The United States Constitution's Commerce Clause, Art. I, § 8, cl. 3, limits state burdens on interstate commerce and bars states from collecting sales or use taxes from remote sellers because such sellers lack the substantial nexus with the taxing states that is required by the Commerce Clause. Ohio recognizes the Commerce Clause, among other constitutional provisions, in R.C. 5739.02(B)(10), which states that the sales tax does not apply to sales not within the taxing power of Ohio under the United States Constitution.

Adding to the difficulty of proving that a remote seller has a substantial nexus with a taxing state are United States Supreme Court decisions that have limited the type of state contacts that trigger the state's ability to tax the remote seller. One such case is *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), which held that a vendor whose only connection with customers in a taxing state is by common carrier or the United States mail is free from state-imposed duties to collect sales and use taxes, because such a vendor lacks the substantial nexus with the taxing state required by the Commerce Clause. The Court came to this conclusion, despite the fact that the remote seller, a mail-order house incorporated in Delaware with no offices or employees in North Dakota, made annual sales by mail of almost \$1 million to 3,000 North Dakota customers.

On January 14, 2000, the National Conference of State Legislatures approved proposed model legislation to assist states in the development of a **voluntary**, streamlined multi-state sales and use tax collection system, as a result of increased sales via the Internet and to address the Commerce Clause conflicts that arise when states attempt to collect those taxes from a remote seller. The intent of the model legislation was to authorize the appropriate state authority to participate in discussions with other states to develop the collection system. The act contains most aspects of the model legislation and grants to the Tax Commissioner the authority to discuss the development of a voluntary collection system with other states and participate in a pilot project with them.

Discussions for development of a sales tax collection system

(Section 6(A))

The act authorizes the Tax Commissioner to discuss with other states the development of a multi-state, **voluntary**, and simplified system for the collection of the sales and use tax from remote sellers, and its administration. The discussions must focus on a system that will have the capability to determine whether a sale of goods or a service is taxable or tax exempt, the appropriate tax rate that applies to the sale, and the total tax due on the sale. The system must provide a method for collecting and remitting sales and use taxes to Ohio, and may provide compensation for the costs of collecting and remitting such taxes. Discussions between the Tax Commissioner and other states may address the following:

(1) The development of a Joint Request for Information from public and private parties governing the specifications for the system;

(2) The mechanism for compensating parties for the development and operation of the system;

(3) The establishment of minimum statutory measures necessary for state participation;

(4) Methods to preserve confidentiality of taxpayer information and the privacy rights of consumers.

Following these discussions, the Tax Commissioner may issue a Joint Request for Information.

Participation in a pilot project

(Section 6(B) and (C))

Under the act, the Tax Commissioner may participate in a sales and use tax pilot project with other states and selected businesses to test means for simplifying administration of the sales and use tax, and may enter into joint agreements for that purpose. The agreements must establish provisions for the administration, imposition, and collection of sales and use taxes resulting in revenues paid that are the same as would be paid under the existing sales and use tax law. All such agreements must terminate no later than December 31, 2001.

Parties to the agreements may be exempted from compliance with existing sales and use tax law to the extent a different procedure is required by the

agreements, except for confidentiality of taxpayer information. Return information submitted to any party acting for and on behalf of this state under the act are required to be treated as confidential taxpayer information. Disclosure of confidential taxpayer information necessary under the act must be pursuant to a written agreement between the party and Tax Commissioner. The party is bound by the same confidentiality requirements that apply to the Department of Taxation and its agents under existing law.

Progress reports regarding the discussions

(Section 6(D))

By November 1, 2000, the Tax Commissioner must provide a report on the progress of multi-state discussions to the Governor, Speaker of the House of Representatives, Senate President, Minority Leaders of the House and Senate, and chairpersons of the House's and Senate's standing committees with primary responsibility for sales and use tax legislation. Not later than March 1, 2001, the Tax Commissioner must provide a final report to these entities on the status of the multi-state discussions. If a proposed system for the collection and administration of sales and use taxes has been agreed upon by participating states, the Tax Commissioner, in the final report, is required to recommend whether Ohio should participate in the system and what legislation is needed to implement it.

HISTORY

ACTION	DATE	JOURNAL ENTRY
Introduced	10-19-99	p. 1293
Reported, H. Ways & Means	02-01-00	p. 1581
Passed House (61-32)	03-22-00	pp. 1702-1703
Reported, S. Ways & Means	05-17-00	p. 1727
Passed Senate (33-0)	05-17-00	p. 1754
House concurred in Senate amendments (83-13)	05-23-00	pp. 2023-2024

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