Bill Analysis

Bethany Boyd *Legislative Service Commission*

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(Tax provisions of Am. Sub. H.B. 66, As Passed by the House)

Sens. Amstutz, Spada, Austria, Harris

BILL SUMMARY

I. Commercial Activity Tax

- Imposes a new business privilege tax on the basis of the annual gross receipts of all forms of business organization having taxable gross receipts in excess of $40,000, other than financial institutions, public utilities, dealers in intangibles, insurance companies, and affiliates of the foregoing and nonprofit organizations with no unrelated business income.

- When fully phased in, the annual tax equals $100 on taxable gross receipts up to $1 million, plus 0.26% of taxable gross receipts in excess of $1 million, with the percentage subject to an upward or downward one-time adjustment if revenue departs by more than 10% from the target of $815 million over the first two years.

- Devotes revenue to the state General Revenue Fund for the first 13 years, to reimburse school districts and other local taxing units for the exemption from, and phase-out of, taxes on all business tangible personal property.

II. Corporation Franchise Tax

- Phases out the corporation franchise tax over five years for all corporations, other than financial institutions and their majority-owned nonfinancial affiliates.

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* *This analysis does not address appropriations, fund transfers, and similar provisions.*

- Clarifies the corporation franchise tax treatment of limited liability companies and other associations treated as corporations under federal tax law.

- Provides for a final series of payments to the Recycling and Litter Prevention Fund during FY 2006 equal to $1.5 million from the General Revenue Fund, and specifies that future litter taxes paid by corporations be used to fund recycling and litter prevention but not through the Recycling and Litter Prevention Fund.

- Limits the availability of the corporation franchise and personal income tax credits for purchases of new manufacturing and machinery and equipment to machinery and equipment purchased no later than June 30, 2005, and installed no later than June 30, 2006.

III. Personal Income Tax

- Reduces personal income tax dollar amounts and rates by 21% over five years, beginning in 2005.

- Delays yearly inflationary adjustments to the income tax bracket dollar amounts until 2010.

- Eliminates the existing personal income tax deduction for tuition and fees paid to postsecondary educational institutions located in Ohio.

- Creates a nonrefundable personal income tax credit for taxpayers having adjusted gross incomes (less exemptions) of $10,000 or less.

- Makes taxation of trust income, which is currently scheduled to end with taxable years of a trust beginning in 2004, permanent.

- Establishes additional criteria for determining the extent to which a trust is a resident of Ohio for Ohio income tax purposes.

- Specifies that the existing income tax credit for Ohio residents who incur out-of-state income tax liabilities is not available to taxpayers who deduct, or are required to deduct, their out-of-state income tax liabilities in computing their income tax bases.

IV. Property Taxes and Transfer Fees

- Permits school district voters to approve a property tax that is not subject to reduction under the "H.B. 920" tax reduction factor law.

- Requires school boards to limit the revenue growth from such a tax to a specified annual percentage of no more than 4%.

- Exempts such a tax from the H.B. 920 tax reduction factor "20-mill floor," thus permitting school districts at or near the floor to levy the tax without subjecting other current expense millage to reduction under the tax reduction factor law.

- Eliminates the 10% rollback for real property that is not classified by the county auditor as "qualifying property," which is lands and improvements thereon that are used for residential or agricultural purposes.

- Increases the real property transfer fee, from $1, or 10¢ for each $100 or fraction of $100, whichever is greater, of the value of the real property, used manufactured home, or used mobile home transferred, to the greater of $1 or 20¢ for each $100 or fraction of $100 of the value of that property or home transferred.

- Provides that the county auditor must deposit one-half of the transfer fee in the state treasury to the credit of the General Revenue Fund.

- Exempts from real property taxation certain buildings and land used by a state university.

- Provides that after December 31, 2007, municipal corporations may not create incentive districts in which real property is exempt from taxation (the date remains June 30, 2007, for townships and counties).

- Exempts newly installed machinery and equipment used in business from taxation, and phases out the taxation of existing business machinery and equipment by 2007.

- Accelerates the current phase-down of the taxation of business inventory, compressing it into a four-year phase-out.

- Phases out the taxation of all other business tangible personal property ("furniture and fixtures") over five years beginning in 2006.

- Reimburses school districts and other local taxing units for some of the revenue reductions caused by the bill's exemption and phase-out of business personal property taxation and for the accelerated phase-out of inventory taxation.

- Makes most patterns, jigs, dies, and drawings subject to property taxation.

- Makes compensating reductions in the assessment rate on tangible personal property of electric companies.

- Requires businesses that supply electricity to others as an incidental line of business to report the portion of their electricity supplying-related property in the same manner as public utility electric companies, and to continue paying taxes on that portion of the property even if it otherwise would be subject to the phase-out of taxes on machinery and equipment.

- Makes changes in the tax increment financing law to eliminate a specific benefit test, permit TIF exemptions to begin at any time, and make clarifying changes in provisions governing school board approval of TIF tax exemptions.

- Accelerates the phase-out of state reimbursement for the $10,000 business tangible personal property tax exemption, ending in fiscal year 2009, rather than fiscal year 2012.

- Specifies how new or destroyed property is to be accounted for in the equalization of real property assessments.

- Establishes a procedure to determine how property tax replacement payments are to be made to school districts or joint vocational school districts that merge with or transfer territory to other districts.

- Changes the computation used to determine the amount of money deposited each year in the Property Tax Administration Fund.

- Allows the state, when it acquires property, to pay estimated taxes on the property at the time of acquisition rather than subsequent to the acquisition as in current law.

- Reduces the rate at which interest accrues on personal property tax underpayments and overpayments.

V. Sales and Use Taxes

- Establishes a permanent sales and use tax rate of 5½%, effective July 1, 2005.
- Establishes procedures to govern the transmission to the Treasurer of State of sales and use taxes collected by common pleas court clerks with applications for certificates of title for motor vehicles, watercraft, and outboard motors.
- Exempts up to $300 worth of cigarettes per month from the use tax if they are not held for resale.

VI. Kilowatt-hour and Natural Gas Consumption Taxes

- Increases the kilowatt-hour tax by approximately 30% for all electric distribution companies, except self-assessors.
- Increases from 4% to 5% the percentage rate paid on the total price of all electricity distributed to a commercial or industrial self-assessor.
- Provides that municipal electric utilities may not retain for their general funds any part of the tax rate increase.
- Revises the percentages of kilowatt-hour tax revenues credited to the General Revenue Fund (GRF), Local Government Fund, Local Government Revenue Assistance Fund, School District Property Tax Replacement Fund, and Local Government Property Tax Replacement Fund.
- Eliminates the threshold amounts that trigger the transfer of kilowatt-hour and natural gas consumption tax revenues from the GRF to other funds.

VII. Tobacco and Alcohol Taxes

- Increases the existing cigarette excise tax from 27.5 mills (2.75¢) per cigarette to 50 mills (5¢) per cigarette, effective July 1, 2005.

- Increases the existing excise tax levied on tobacco products other than cigarettes from 17% to 30% of the wholesale price of the tobacco product, effective July 1, 2005.

- Exempts from the cigarette tax, sales of cigarettes to federally recognized Indian tribes within Indian country; sales to the U.S. government, and sales in foreign commerce.

- Establishes policies regarding taxation of cigarette sales to nontribal members within Indian country.

- Specifies who may affix tax stamps and establishes rules governing the shipping of unstamped cigarettes through Ohio.

- Requires cigarette manufacturers and importers to maintain records regarding cigarette sales and purchases, and establishes record keeping requirements that pertain to manufacturers, importers, wholesalers, and dealers.

- Allows for public disclosure of certain records pertaining to cigarette sales and purchases.

- Requires every manufacturer and importer shipping cigarettes into or within Ohio to file a monthly report with the Tax Commissioner.

- Requires that the Tax Commissioner seize and destroy cigarettes held for sale or distribution in violation of Ohio's cigarette laws.

- Authorizes the Tax Commissioner to inspect facilities and records belonging to cigarette manufacturers, importers, wholesalers, and retailers, and requires that any inspection not conducted during normal business hours be conducted pursuant to a search warrant.

- Requires that cigarette manufacturers and importers obtain a license before trafficking in cigarettes in Ohio.

- Specifies additional information to be included in applications for licenses to traffic in cigarettes in Ohio.

- Specifies from whom, and to whom, manufacturers, importers, wholesalers, and retailers may buy and sell cigarettes.

- Establishes policies and procedures governing internet and mail order sales of cigarettes.

- Exempts up to $300 worth of cigarettes per month from the cigarette excise use tax if they are not held for resale.

- Increases the value (wholesale) of untaxed cigarettes that a person may transport within Ohio without the prior consent of the Tax Commissioner, from $60 to $300.

- Doubles each of the existing taxes levied on the sale and distribution of wine, mixed beverages, cider, and beer effective July 1, 2005.

VIII. Estate Taxes

- Constructively eliminates the additional estate "sponge" tax and generation-skipping tax provisions by revising references to the Internal Revenue Code in those provisions, so that they generally incorporate any federal estate tax changes that have been made since the last time those provisions were amended.

- Repeals the estate tax deduction for family-owned businesses.

- Adopts a general definition of the Internal Revenue Code for purposes of the state estate tax law.

IX. Other Taxation Provisions

- Specifies that the capital investment projects for which a job retention credit may be granted includes project costs paid after December 31, 2006.

- Permits the Tax Credit Authority to continue entering into agreements for job retention tax credits after June 30, 2007, which, under current law, is the date on which the authority to enter into such agreements is scheduled to expire.

- Authorizes county auditors to use moneys in real estate assessment funds for estate tax enforcement.

- Reauthorizes municipal corporations to levy income taxes to be shared with an overlapping school district.

- Extends the existing tax credit for loans made to the program fund administered by the Venture Capital Authority to dealers in intangibles and public utilities, and clarifies the amount of refundable and nonrefundable venture capital tax credits that may be claimed by taxpayers for each tax reporting period.

- Increases the penalty for late estate tax payments and filings, and reduces the rate of interest accruing on unpaid estate taxes and overpayments.

- Revises motor fuel use tax permit and filing requirements.

- Clarifies the treatment of expenses and losses of a pass-through entity subject to the pass-through entity withholding tax.

- Authorizes the Tax Commissioner to require a social security number, employer identification number, or other identifying information from persons filing documents with the Department of Taxation.

- Requires that the Tax Commissioner administer a temporary tax amnesty program from November 1, 2005, to December 15, 2005, under which taxpayers who voluntarily pay outstanding state taxes, tangible personal property taxes, county and transit authority sales taxes, and school district income taxes are not required to pay penalties associated with those outstanding taxes, are excused from having to pay one-half of the interest accruing on the taxes, and are immune from criminal and civil action in connection with the taxes.

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CONTENT AND OPERATION

Overview

The bill makes numerous changes in Ohio's tax laws. It imposes a new commercial activity tax measured by gross receipts, and at the same time phases-out the corporation franchise tax for non-financial corporations. Personal income tax rates are reduced by 21% over five years, and the taxation of trust income becomes permanent.

As for property taxes, the bill phases-out the taxation of machinery and equipment, and furniture and fixtures, exempts newly installed machinery and equipment used in business, and accelerates the phase-out of business inventory taxation, but reimburses school district and other local taxing units for some of the revenue reductions caused by the exemption and phase-outs. The 10% rollback for business real property is eliminated. The bill also accelerates the phase-out of state reimbursement for the $10,000 business tangible personal property tax exemption.

Under the bill, the temporary sales and use tax rate of 6% that was set to return to 5% on July 1, 2005, instead becomes a permanent rate of 5½% on that date. The bill increases the kilowatt-hour tax for all electric distribution companies, including self-assessors, and revises the percentages of revenues from that tax that are credited to various state and local government funds. Taxes on cigarettes and tobacco products are increased, and taxes on alcohol are doubled. Estate tax credits and a deduction that are tied into federal estate tax law are eliminated. The bill makes other changes to state tax law.

I. Commercial Activity Tax

New business privilege tax

(R.C. 140.08, 5703.052, 5703.053, 5703.70, 5739.01(H); Chapter 5751.; Section 557.09)

The bill imposes a new tax on businesses and other entities that generate business income, beginning July 1, 2005. The tax, referred to as the "commercial activity tax," is an excise tax for the privilege of doing business in Ohio (like the existing corporation franchise tax), but is imposed on the basis of gross receipts instead of net worth or net income. The tax is expressly made part of the "price" for purposes of the sales and use taxes, with the effect being that, if a taxpayer under the new tax makes sales subject to the sales and use tax, the price on which the sales or use tax is based is computed without any deduction for the commercial activity tax paid by the taxpayer-seller.

The first tax return and tax payment are due February 10, 2006, based on gross receipts for the six-month period running from July 1 through December 31, 2005.

Persons subject to tax

(R.C. 5751.01(D))

The tax applies to any legal person with more than $40,000 in annual taxable gross receipts in Ohio regardless of the person's legal or organizational form (e.g., corporation, partnership, limited liability company, S corporation, sole proprietor, business trust, estate, etc.), but does not apply to "excluded persons." Nonprofit organizations are subject to the tax, but only if they generate unrelated business income that is taxable for federal income tax purposes. If a nonprofit organization, including an organization operating a hospital, does generate federally taxable unrelated business income, the organization is taxed on the basis of the taxable gross receipts underlying that income.[1] If a public utility is a combined company, it is taxed on the basis of the taxable gross receipts from its activity as an electric company, rural electric company or any other activity that cannot be attributed to the activity of a heating company or natural gas company (for which public utility excise taxes are paid).

In the first six months the tax is in effect, the $40,000 exclusion applies to a person's taxable gross receipts during all of 2005.

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[1] *Under federal income tax law, nonprofit organizations are taxed on income unrelated to their principal business, such as net income from a gift shop operated by a hospital.*

Persons not subject to the tax

(R.C. 5751.01(E))

To be an "excluded person," and therefore exempted altogether from the commercial activity tax, a legal person must either have annual taxable gross receipts under $40,000, or be a member of one of the following classes of legal persons:

- Banks and other financial institutions
- Bank holding companies
- Financial holding companies
- Savings and loan holding companies
- Financial services companies subject to state or federal supervision
- An affiliate of any of the foregoing if the affiliate is majority-owned or controlled by the foregoing (directly, or indirectly through other persons), even if the affiliate is not a financial business
- Insurance companies subject to and paying the insurance company tax
- Affiliates of such insurance companies if the affiliate is majority-owned or controlled by the insurance company (directly, or indirectly through other persons), even if the affiliate is not an insurance company
- Any person formed with the purpose of facilitating a securitization[2] or similar transaction for or by any of the foregoing (including the affiliates)
- Public utilities subject to and paying the public utility excise tax (but see below for combined companies)
- Dealers in intangibles subject to and paying the dealers in intangibles tax

[2] *Generally, securitization is the pooling and repackaging of loans into securities to be offered for sale to investors.*

Except for public utilities, dealers in intangibles, insurance companies, and persons with $40,000 or less in taxable gross receipts, all excluded persons that are C corporations remain subject to the corporation franchise tax levied under R.C. Chapter 5733. on the basis of net income or net worth.

Combined companies (i.e., companies that are both electric companies and either natural gas or heating companies) are excluded from the commercial activity tax in proportion to the company's taxable gross receipts that are directly attributable to its natural gas or heating company (i.e., nonelectric) activities.

Computation of tax

(R.C. 5751.01, 5751.03, 5751.031, 5751.032, 5751.033, and 5751.034; Sections 557.09 and 557.13)

Initial rate. The tax is levied in two parts: on the first $1 million in taxable gross receipts, the tax is $100, which is due May 15, 2006, for the first time, then paid with the fourth-quarter or annual return thereafter; on taxable gross receipts in excess of $1 million, the tax is 0.26% (2.6 mills per dollar) of those taxable gross receipts, at least for the first two years the tax is imposed.

Rate adjustments. Three tax rate adjustments are scheduled in the first five years of the new tax, as follows:

2007: The 0.26% rate on taxable gross receipts in excess of $1 million is subject to upward or downward adjustment if revenue during the first two years departs by more than 10% from the target revenue for the first two years of $815 million. By September 30, 2007, the Tax Commissioner is required to compute a rate that would have produced the target revenue over the initial two years the tax was imposed.

2008: If FY 2008 revenue exceeds projections ($859 million), the excess revenue is diverted to the Budget Stabilization Fund (BSF) and, if revenue overruns by more than 5%, to a new fund used to reduce income tax rates. If revenue overruns by more than 10%, the rate is adjusted downward to produce the projected amount, an amount equal to 5% of the projected revenue is credited to the new income tax reduction account created in the bill, and the remainder is credited to the BSF.

2010: The same kind of rate adjustment and revenue diversion applies in 2010, but the projected revenue for FY 2010 is $1.548 billion instead of $859 million.

Phase-in of tax. In recognition of the new tax being imposed at the same time as the bill phases out the corporation franchise tax (as explained elsewhere in this analysis), the bill phases in the tax for all taxpayers other than those having annual taxable gross receipts of less than $1 million (and thus owing less than $100).

The tax becomes effective July 1, 2005. In the first six months of the tax, the tax equals $50 on the first $500,000 in taxable gross receipts during that period, plus 0.06% on taxable gross receipts in excess of $500,000 during that period. (This rate results from multiplying the permanent 0.26% rate by 23%, which is the initial phase-in percentage--see immediately below--then rounding to the nearest hundredth per cent.) The return for that semiannual period must be filed not later than February 15, 2006.

In the first quarter of 2006, only 23% of the tax as normally computed is payable; for the four quarters running from April 2006 to April 2007, 40% of the normal tax is due; for the four quarters running from April 2007 to April 2008, 60% of the normal tax is due; for the four quarters running from April 2008 to April 2009, 80% of the normal tax is due; from April 2009 on, the tax is payable on the basis of the permanent computation of 0.26% (or the adjusted rate, as explained above).

"Taxable gross receipts"

(R.C. 5751.01 and 5751.032)

The tax applies to taxable gross receipts, which is the portion of a taxpayer's total gross receipts sitused to Ohio under the bill's situsing provisions. Total gross receipts is defined broadly to include the total amount realized on sales by a person, without deduction for the cost of goods sold or other expenses, in transactions that contribute to the production of gross income of the person. It includes the fair market value of any property and any services received and any debt transferred or forgiven as consideration, and the total amount realized with regard to unrelated business income of a tax-exempt organization. The bill specifies certain examples of gross receipts, including:

- Amounts realized from the sale, exchange, or other disposition of property
- Amounts realized from performing services
- Amounts realized from rentals, leases, or other use or possession of the taxpayer's property or capital

Taxpayers that are members of a commonly owned or controlled group of businesses must include their taxable gross receipts from sales or other transactions with other members of the group unless they elect to be treated on a consolidated basis (as explained below).

Gross receipts are to be calculated using the same accounting method used for federal income tax purposes. If a cash discount is allowed and is actually taken in a transaction, the discount is deductible from gross receipts. Likewise, the value of returns and similar allowances is deductible. And if a taxpayer is owed an uncollectible payment from a transaction that was previously included in taxable gross receipts the taxpayer previously paid tax on, the uncollectible amount is deductible as a bad debt. (The bill sets forth specific rules for what constitutes such a bad debt in R.C. 5751.01(F)(5)(c).) Receipts from selling accounts receivable also are deductible from gross receipts, to the extent the receipts from the underlying transaction giving rise to the account receivable were included in the taxpayer's gross receipts.

Excluded amounts. The bill specifically excludes the following amounts from the calculation of gross receipts, including:

- Interest income, except interest on credit sales
- Dividend income, distributions received, and distribution or proportionate shares from a pass-through entity
- Receipts from assets for which capital gain treatment is given under federal law but without regard to the holding period
- Proceeds attributable to the repayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or marketable instrument
- The principal amount received under a repurchase agreement or on account of any transaction properly characterized as a loan to the taxpayer
- Contributions received by a trust, plan, or other arrangement, any of which is described in section 501(a) of the Internal Revenue Code, or to any of the various pension and deferred compensation plans given favorable federal tax treatment
- Compensation received by an employee for services rendered to or for an employer, including fringe benefits and expense reimbursements

- Proceeds from the issuance of the taxpayer's own stock, options, warrants, puts, or calls, or from the sale of the person's treasury stock

- Proceeds on the account of payments from life insurance policies

- Gifts or charitable contributions, membership dues, and payments received for educational courses, meetings, meals, or similar payments to a trade, professional, or other similar association; fundraising receipts if excess receipts are donated or used exclusively for charitable purposes; and proceeds received by a nonprofit organization except those proceeds realized with regard to its unrelated business income

- Damages in excess of amounts that, if received without litigation, would be gross receipts

- Property, money, and other amounts received or acquired by an agent on behalf of another in excess of the agent's commission, fee, or other remuneration

- Tax refunds and other tax benefit recoveries

- Pension reversions

- Contributions to capital

- Sales and use taxes collected by a vendor (including out of state vendors)

- Federal and state excise taxes on cigarettes and other tobacco products paid by any person (exclusion applies only to the various classes of dealers, distributors, manufacturers, or sellers of cigarettes or tobacco products)

- Federal and state excise taxes on liquor and other alcoholic beverages paid by any person (exclusion applies only to agency stores and the various classes of permit holders; exclusion for agency stores does not apply to agency compensation)

- Federal and state excise taxes on gasoline, diesel, or other motor vehicle fuel (exclusion applies only to the various classes of motor fuel dealers)

- Pari-mutuel wagers on horse racing

- Ohio lottery ticket receipts received by a lottery ticket sales agent in excess of commission, bonus, or reimbursement

- Receipts from selling hunting, fishing, and other ODNR-issued licenses by authorized agents in excess of their $1 fee

- Receipts received by a motor vehicle dealer from sales to another motor vehicle dealer for the purpose of resale by the purchasing dealer

- Amounts received relating to transactions between an electric company and a regional transmission organization that are mandated by the Federal Energy Regulatory Commission, even if those amounts are received in the ordinary course of the taxpayer's trade or business and are a form of payment for a transaction specified under "***Taxable gross receipts***," above.

Also excluded from the calculation of gross receipts are any receipts the taxation of which is prohibited by the Ohio Constitution, the United States Constitution, or federal law.

A real estate broker's fees are included in taxable gross receipts only to the extent the fees are retained by the broker and not paid to another broker or an associated salesperson.

Situsing receipts to Ohio. Only gross receipts sitused to Ohio are taxable. The bill prescribes specific situsing rules for various kinds of gross receipts. The following kinds of receipts are sitused to Ohio as follows:

- Gross rents and royalties from real property located in Ohio

- Gross rents and royalties from tangible personal property to the extent it is located or used in Ohio

- Gross receipts from the sale of real property located in Ohio

- Gross receipts from the sale of tangible personal property if the property is received in Ohio by the purchaser; the place where tangible personal property is ultimately received after all transportation has been completed will be considered the place where the purchaser receives the property even when the purchaser accepts property in Ohio and then transports the property by common carrier or by other means of transportation to a location outside Ohio; tangible personal property that is delivered into a foreign trade zone located in Ohio to a person in that zone, solely for purposes of further delivery out of state and without regard to the passage of title and to repackaging for further shipping purposes, is sitused to the location at which the person or person's affiliated customer completes delivery of the property to a location outside Ohio (in uncodified law, Section 557.13)

- Gross receipts from the sale, exchange, disposition, or other grant of the right to use trademarks, trade names, patents, copyrights, and similar intellectual property to the extent the receipts are based on the amount of use of the property in this state; if receipts are based on the right to use property and the payor has the right to use the property in Ohio, receipts are sitused to Ohio to the extent they are based on the right to use the property in Ohio

- Gross receipts from the sale of services, and all other gross receipts not otherwise sitused as provided above, are sitused to Ohio in the proportion to the purchaser's benefit in Ohio as compared to the purchaser's benefit everywhere; where the benefit ultimately is received is "paramount" in determining this proportion

- Gross receipts from the sale of electricity and electric transmission and distribution services are sitused in the same manner as under the corporation franchise tax (see R.C. 5733.059)

If the foregoing situsing rules do not fairly represent a taxpayer's gross receipts in Ohio, alternative rules may be applied with the Tax Commissioner's approval. The Tax Commissioner also may prescribe rules providing alternative situsing rules for all taxpayers or for a subset of taxpayers in a particular trade or business.

Uncodified law in the bill (Section 557.13) provides that it is the intent of the General Assembly that the situsing provision be applied in a manner that is consistent with and identical to the situsing provisions that apply to the corporation franchise tax, and must be interpreted and applied by the Tax Commissioner in a manner that is consistent with the body of case law addressing the situsing of sales for purposes of the sales factor as determined under the corporation franchise tax law, and in a manner that is consistent with the Tax Commissioner's prior treatment of the sales factor situsing law for taxpayers under the corporation franchise tax law.

Use of revenue

(R.C. 5751.20 to 5751.22)

Revenue from the new commercial activity tax will be for the General Revenue Fund (GRF) and to reimburse school districts and other local taxing units for the phase-out of taxes from business machinery and equipment and for the acceleration in the phase-out of taxes from business inventories. Initially, revenue from the new tax is to be credited to the newly created Commercial Activities Tax Receipts Fund, and thence divided between the GRF and the newly created School District Tangible Property Tax Replacement Fund (SDRF) and Local Government Tangible Property Tax Replacement Fund (LGRF) in specified proportions until the end of fiscal year 2018, as follows:

Division of CAT revenue			
Fiscal Year	**GRF**	**SDRF**	**LGRF**
2006	83%	11.9%	5.1%
2007	37.3%	43.9%	18.8%
2008	27.7%	50.6%	21.7%
2009	36.2%	44.6%	19.1%
2010	41.8%	40.7%	17.5%
2011	36.8%	44.2%	19.0%
2012	40.0%	44.2%	15.8%
2013	42.9%	44.2%	12.8%
2014	45.7%	44.2%	10.1%
2015	48.2%	44.2%	7.6%
2016	50.6%	44.2%	5.2%
2017	52.8%	44.2%	3.0%
2018	54.8%	44.2%	1.0%
2019 and on	100%	0%	0%

The revenue credited to the School District Tangible Property Tax Replacement Fund and Local Government Tangible Property Tax Replacement Fund is to be used, in addition to GRF money, to provide the reimbursement to school districts and other local taxing units for the phase-out of taxes on business personal property, as explained under the heading "***Phase-out of tax on business personal property***."

Tax credits

(R.C. 122.17, 122.171, 5751.50 to 5751.52, and 5751.98)

The bill permits four of the credits that currently apply to the corporation franchise tax and personal income tax to be applied against the new commercial activity tax:

- The refundable jobs creation credit (currently R.C. 122.17)
- The nonrefundable jobs retention credit (R.C. 122.171)
- The nonrefundable credit for qualified research expenses (R.C. 5733.351)
- The nonrefundable credit for research and development loan payments (R.C. 5733.352)

The credits would apply against the new commercial activity tax for tax reporting periods beginning on or after July 1, 2008. The credits can no longer be claimed against the corporation franchise tax and personal income after that point; however, to the extent the credits have not been fully utilized with respect to those taxes, the credits can be carried forward and used against the commercial activity tax.

If a corporation or other person claims such a credit against the franchise or income tax, the person may not claim the same credit amount against the new tax.

Generally, the same terms and conditions that govern the credits under the corporation franchise tax and personal income tax law also govern the credits under the new tax law. One difference, however, is that some taxpayers will pay the new tax on a quarterly basis, and they may apply the credits against quarterly tax payments. However, any applicable limit on carryforward periods or on credit maximums are still on an annual basis, meaning they are not affected by the quarterly payment requirement of some taxpayers.

Registration and fee

(R.C. 5751.04)

Every legal person subject to the new tax must register with the Tax Commissioner by November 15, 2005, or within 30 days after first becoming subject to the tax. The registration must be made on a form provided by the Commissioner that must include various items of information about the taxpayer (enumerated in R.C. 5751.04(A)).

A one-time $15 registration fee is payable if the person registers electronically; if registration is not done electronically, the fee is $20. The fee is credited toward the first tax payment due. If a person registers after the due date, an additional fee may be charged of up to $100 per month, up to $1,000, which the Tax Commissioner may abate; the additional fee is not credited against the tax due. Persons that would otherwise be subject to the tax but that begin business after November 30 in any year are exempt from the fee, as are persons that do not surpass the $40,000 taxable gross receipts threshold as of December 1.

Registration fee collections are credited to a fund to defray the Commissioner's costs of administering the tax, including promoting awareness of the tax during its initial implementation.

If a taxpayer's registration is revoked, the taxpayer is barred from engaging in business in Ohio thereafter, and may not re-register without paying outstanding taxes, penalties, and interest. Nor may any other person holding at least a 10% interest in that taxpayer's business re-register or register anew unless those amounts are paid.

Any person required to have an active registration but that does not is prohibited from generating taxable gross receipts in Ohio; a violation may be prosecuted as a first degree misdemeanor for a first offense, or a fourth degree felony for subsequent offenses. Any person that fails to comply with the bill's registration, tax payment, fee payment, or tax filing requirements is prohibited from conducting business in Ohio. Violation of any provisions of the new chapter, other than the prohibition against generating taxable gross receipts without a registration, carries a fine of up to $500 or imprisonment of up to 30 days, or both.

The Tax Commissioner is required to make an electronic list available to the public identifying registered taxpayers, as well as of persons whose registration has been revoked or cancelled within the preceding four years.

Consolidation of related taxpayers

(R.C. 5751.01(B) and 5751.011)

The bill permits a group of commonly owned or controlled persons to elect to file and pay the tax on a consolidated basis in exchange for excluding otherwise taxable gross receipts from transactions with other members of the group. Gross receipts related to the sale or transmission of electricity through the use of an intermediary regional transmission organization approved by the Federal Energy Regulatory Commission must be excluded from taxable gross receipts even if the receipts are from and to the same member of the group.

Each member of the group remains jointly and severally liable for the tax and associated penalties and interest, and each member is subject to assessment.

Once made, the consolidation election means the group must file as a single taxpayer for two tax years so long as at least two members satisfy the ownership and control criteria. The election rolls over to the following two tax years unless the group cancels it before the expiration of the election. If a person is no longer under common ownership or control with the group, it must report and pay the tax as a separate taxpayer, as part of a combined taxpayer group (see below), or as a member of a different consolidated group that is eligible to file and pay tax on a consolidated basis. If a person is added to the group after the election, it must be added to the consolidated group for the purpose of paying and reporting the tax on a consolidated basis, and the group must notify the Tax Commissioner of the addition with the next return filed. The exemption for taxpayers having taxable gross receipts of $40,000 or less does not apply to consolidated taxpayers.

If a consolidation election is in effect for a group, the group must report and pay the tax on the basis of every member's taxable gross receipts, including members that do not have substantial nexus with Ohio. For this purpose, substantial nexus means a person satisfies at least one of the following criteria:

- It owns or uses a part or all of its capital in Ohio
- It holds a certificate of compliance authorizing it to do business in Ohio
- It owns or leases property in Ohio
- It has one or more individuals performing services in Ohio
- It otherwise has nexus with Ohio to the extent that the state may require the person to remit the tax under the United States Constitution.

The Tax Commissioner may require one of the members of a consolidated group to undertake the registration and tax payment requirements on behalf of the group. The registration fee is $20 for each member of the group, up to a maximum per-group fee of $200. The consolidation election must be made on a form prescribed by the Tax Commissioner, and must be accepted by the Commissioner if the group satisfies the criteria for making such an election.

Combined taxpayer group

(R.C. 5751.012)

Any group of persons subject to the new tax and also being under common ownership or control, but not electing to be treated as a consolidated taxpayer group, will be treated as a "combined taxpayer" group. Like a consolidated taxpayer group, a combined taxpayer group must report and pay the tax as a single taxpayer, and each member of the group is jointly and severally liable for the group's tax and any associated penalty and interest and is individually subject to assessment. A combined group must register as a group and is subject to the same $20 per member registration fee as a consolidated group, up to a maximum of $200. And the exemption for taxpayers having taxable gross receipts of $40,000 or less does not apply to combined taxpayers. However, unlike members of a group making the consolidation election, members of a combined taxpayer group may not exclude receipts arising from transactions between the members.

Tax year

(R.C. 5751.04 and 5751.05(A))

The new commercial activity tax is an annual tax levied on the basis of a "tax year" (which coincides with a calendar year), but taxpayers generating annual taxable gross receipts of $1 million or more are required to pay quarterly installments of the tax on the basis of quarterly taxable gross receipts. Taxpayers must report and pay the tax not later than the fifteenth day of the second month following the end of each quarterly period, which follows the calendar quarters: January through March, April through June, July through September, and October through December.

All taxpayers must pay a minimum $100 tax by February 15 following the end of the tax year and file an annual report for the tax year. Taxpayers whose taxable gross receipts exceed $250,000 for a quarter also must report and pay the tax for that quarter on the basis of the 0.26% tax rate on receipts above $250,000 per quarter. (In the first five years of the tax phase-in, the rate is a fraction of 0.26%--the "applicable tax rate.") If, when the annual report is due after the end of the tax year, a taxpayer does not have taxable gross receipts above $1 million but had taxable receipts above $250,000 for any of the quarters in the year (and paid tax on that basis), the tax paid in excess of the $100 minimum is refunded or, at the option of the taxpayer, applied to the next year's liability.

Taxpayers having estimated annual taxable gross receipts of less than $1 million may report and pay the tax on a calendar year basis, but only if the taxpayers make an election to do so. Such taxpayers are referred to as "calendar year taxpayers." The tax report and payment is due not later than the fifteenth day of the second month following the end of the calendar year. Once a calendar year taxpayer's annual taxable gross receipts reach $1 million, the taxpayer must begin to report and pay on a quarterly basis in the following year, and must continue to do so until the taxpayer again qualifies for annual reporting and payment and receives written approval to do so from the Tax Commissioner.

General administration

(R.C. 5751.04, 5751.06, 5751.07, 5751.08, 5751.081, 5751.09, 5751.10, 5751.11, 5751.12, and 5751.99)

Payments. Tax payments must be made either quarterly or annually, depending on the taxpayer's status as a quarterly taxpayer or annual taxpayer. Calendar quarter taxpayers must make payments electronically and, if the Tax Commissioner requires, file returns electronically. Such taxpayers may be excused from the electronic filing and payment requirement by applying to the Tax Commissioner, who may excuse taxpayers for good cause.

Penalties and interest. Penalties are imposed for not filing and paying the tax or for not filing and paying on time. The penalty for late filing and payment is up to $50 or 10% of the amount due, whichever is greater. In the case of underpaid tax, the penalty is up to 15% of the underpayment, including in those cases where payment is made after the taxpayer is notified of the deficiency by the Tax Commissioner. Penalties also may be imposed if taxpayers required to file and pay electronically fail to do so. The penalty is up to 5% of the payment due for the first two occasions, and 10% for subsequent occasions.

A penalty also may be imposed if a taxpayer fails to switch from being a calendar year taxpayer to a calendar quarter taxpayer once the taxpayer's annual taxable gross receipts exceeds $2 million (giving such taxpayers a $1 million margin of error). The penalty may be up to 10% of the amount of taxable gross receipts over $2 million.

A penalty is imposed on persons who have been notified of the registration requirement but that fail to register within 60 days. The penalty is up to 35% of the tax found to be due.

Interest accrues against unpaid amounts at the normal statutory rate of 3 percentage points above the current yield on marketable United States government securities having a remaining maturity of three years or less. The interest accrues from the due date to the time the tax is paid or an assessment is issued, whichever occurs first.

The Tax Commissioner is authorized to waive penalties, but not interest, and is authorized to adopt rules governing waiver of penalties.

Refunds. Refunds are available for overpaid, illegal, or erroneously paid taxes. Refunds must be applied for within the four-year statute of limitations on the issuance of assessments. Interest accrues on refund amounts at the same rate as it accrues on underpayments. Refunds also may be issued to a taxpayer that, "because of the operation of that taxpayer's business operations," is not able to exclude the full $1 million excludable annually from the 0.26% tax on receipts above $1 million. A refund may not be issued to any registered taxpayer for the $100 tax on the first $1 million in annual receipts unless the taxpayer cancels the registration before February 10 of the current year.

As with other taxes, refunds must be offset for various debts to the state, including unpaid workers compensation premiums, unemployment compensation contributions, unpaid motor vehicle fees, and incorrect medical assistance payments. The debt must be "final," meaning that any time for appealing the debt has expired without an appeal being made.

Anyone who files a fraudulent refund claim is subject to a fine of up to $1,000 or imprisonment for up to 60 days or both.

Assessments. As with other taxes, the Tax Commissioner may issue assessments for unpaid or unreported commercial activity taxes. The assessment provisions are substantially the same as for other state taxes, except the statute of limitations for issuing an assessment is four years unless fraud or failure to file is involved, in which case there is no time limit. (For comparison, the limit under the corporation franchise tax is three years except for fraud or failure to file, and the limit for personal income taxes is four years except for fraud or failure to file.) Also, since the commercial activity tax is based on gross receipts, the Tax Commissioner may use sampling in conducting an audit of a taxpayer if the Tax Commissioner has information indicating a tax underpayment. The sampling must be conducted for a representative period of time; the Commissioner must make a good faith effort to agree with the taxpayer on selecting the representative sample, and the sampling method must be one that has been prescribed by administrative rule.

Winding-up obligations. Taxpayers quitting business or transferring their business to another person must pay the commercial activity tax and file a return within 15 days afterwards. The purchaser or other successor, if there is such a person, must withhold enough money from the purchase money to cover the tax obligation until the former owner produces a receipt showing payment of the tax due or a certificate showing no tax is due. The purchaser is liable for any unpaid tax due.

Recordkeeping. The bill authorizes the Tax Commissioner to prescribe recordkeeping requirements applicable under the commercial activity tax. The bill also requires the Tax Commissioner to make an electronic list available to the public identifying registered taxpayers, as well as persons whose registration has been revoked or cancelled within the preceding four years. Information is confidential taxpayer information, except for the listing of registered taxpayers.

Violations; criminal penalties. If any person fails to pay the tax, file required returns, or pay any penalty due, the Attorney General may initiate a *quo warranto* action against the person to revoke the person's privilege to conduct business in Ohio. Criminal penalties are imposed for filing a fraudulent refund claim (as described above under "***Refunds***"), and for any other violation, which is punishable by a fine of up to $500 and imprisonment for up to 30 days.

Challenging legality of tax's application

(R.C. 5751.31)

The bill provides for taxpayer appeals directly to the Ohio Supreme Court when the Tax Commissioner issues a final determination in response to a taxpayer's challenge of an assessment and the primary issue raised by the taxpayer is one arising under provisions in the Ohio Constitution governing the General Assembly's power to tax incomes and to levy excise and franchise taxes;[3] the manner in which the General Assembly may use moneys derived from motor vehicle license and fuel taxes;[4] or the General Assembly's power to tax food for human consumption.[5] The appeal must be made within 30 days after issuance of the final determination.

II. Corporation Franchise Tax

Phase-out of corporation franchise tax

(R.C. 5733.01(G))

The bill phases out the corporation franchise tax over five years, beginning with tax year 2006, for all corporations other than banks and other financial institutions, and the affiliates of financial institutions, insurance companies, and other corporations that are not subject to the commercial activity tax because they

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[3] *Section 3, Article XII Ohio Constitution.*

[4] *Section 5a, Article XII, Ohio Constitution.*

[5] *Section 13, Article XII, Ohio Constitution.*

are "excluded persons," which will continue to be subject to the franchise tax on the basis of their net worth (at a rate of 1.3%).

The phase-out begins with tax year 2006, and the tax is eliminated for corporations other than financial institutions and "excluded persons" beginning in 2010. The phase-out is made in even increments over the intervening five years. In 2006, corporations will owe the greater of the minimum tax (which is $50 or $1,000, depending on a corporation's employment level and gross receipts)[6] or 4/5 of the tax they would otherwise owe under current law after deducting nonrefundable credits. If a corporation has refundable credits for the year, or is entitled to the credit for taxes paid on its behalf by a partnership of which it is a partner, the refundable or partnership credit is subtracted from the reduced tax.[7] Likewise, in 2007, corporations owe the greater of the minimum tax or 3/5 of the tax they otherwise would owe after deducting nonrefundable credits. Refundable credits and the partnership credit are subtracted from that amount. The fractions decline in 2008 to 2/5 and in 2009 to 1/5, and any refundable credits and the partnership credit are subtracted in the same fashion in each of those years.

The corporation franchise tax has been in place in one form or other since 1902. Originally a tax on net worth, in 1971 it was converted to a tax computed on the basis of net worth or net income, with taxpayers owing tax on whichever computation yields the higher tax. Currently, the rate of tax on general business corporations is 0.4% of net worth or 8.5% of net income (5.1% on the first $50,000).

<u>Some noncorporations treated as corporations</u>

(R.C. 5733.01(E))

The bill clarifies that any entity that is taxed as a corporation under federal income tax law (such as some limited liability companies) also is to be treated as a corporation under Ohio's corporation franchise tax law. Although this principle is stated in current law, the bill makes it clear that any equity stake in such an entity

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[6] *The $1,000 minimum tax applies to any corporation having at least 300 employees or worldwide gross receipts of $5 million or more.*

[7] *The partnership credit, known as the "qualifying pass-through entity tax credit," is a credit for taxes paid by a partnership or other pass-through entity on behalf of a corporation that is a partner or owner of a pass-through entity doing business in Ohio, but which itself does not have any taxable business presence in the state. A withholding tax is imposed on the partnership or entity to ensure that the corporation satisfies its franchise tax obligation. The corporation then is credited with the tax paid on its behalf by the entity against the corporation's individual franchise tax obligation.*

(such as a membership interest in such an LLC) is to be treated in the same manner as owning capital stock of a corporation for the purposes of the aspects of the franchise tax law referring to capital stock of corporations.

Recycling and Litter Prevention Fund

(R.C. 5733.065 and 5733.066; Section 557.10)

Continuing law levies a tax on corporations for the privilege of manufacturing or selling "litter stream products" in this state. "Litter stream products" include such things as glass, metal, plastic, and container crowns. Under current law, these taxes are credited to the Recycling and Litter Prevention Fund and are used to fund recycling and litter prevention.

The bill provides for a final series of payments to the Recycling and Litter Prevention Fund during FY 2006 equal to $1.5 million from the General Revenue Fund. The bill specifies, further, that future litter taxes paid by corporations be used to fund recycling and litter prevention but not through the Recycling and Litter Prevention Fund.

Tax credit for purchases of new manufacturing machinery and equipment not available for machinery and equipment purchased after June 30, 2005

(R.C. 5733.33 and 5747.31 (not in the bill))

Current law authorizes a tax credit against the corporation franchise and personal income taxes for new manufacturing machinery and equipment purchased and used in Ohio by corporations and other business organizations. The credit currently applies to purchases made on or before December 31, 2015. To qualify for the credit, a taxpayer must install the machinery and equipment in Ohio no later than December 31, 2016. The credit equals a percentage of a taxpayer's incremental increase in machinery and equipment investment in a county over its existing stock of machinery and equipment during a baseline period. The percentage is 7.5%, except when the machinery or equipment is purchased for use in certain economically depressed areas, in which case the percentage is 13.5%. The credit is claimed over a seven-year period. The credit is nonrefundable, but may be carried forward for three tax years, in the case of the corporation franchise tax, or three taxable years, in the case of the personal income tax.

The bill limits the availability of the credits to machinery and equipment purchased no later than June 30, 2005, and installed no later than June 30, 2006.

III. Personal Income Tax

<u>Tax rates reduced uniformly by 21%</u>

(R.C. 5747.02(A))

Current law establishes nine income tax brackets, each with a corresponding tax dollar amount and tax rate. The current income brackets and applicable tax dollar amounts and tax rates for each bracket is as follows:

Taxable income	Tax
$5,000 or less	.743%
More than $5,000 but not more than $10,000	$37.15 plus 1.486% of the amount in excess of $5,000
More than $10,000 but not more than $15,000	$111.45 plus 2.972% of the amount in excess of $10,000
More than $15,000 but not more than $20,000	$260.05 plus 3.715% of the amount in excess of $15,000
More than $20,000 but not more than $40,000	$445.80 plus 4.457% of the amount in excess of $20,000
More than $40,000 but not more than $80,000	$1,337.20 plus 5.201% of the amount in excess of $40,000
More than $80,000 but not more than $100,000	$3,417.60 plus 5.943% of the amount in excess of $80,000
More than $100,000 but not more than $200,000	$4,606.20 plus 6.9% of the amount in excess of $100,000

The bill reduces the rates and amounts within each bracket by a total of 21% over five years, beginning with taxable years beginning in 2005, in nearly even per-year increments. The resulting tax brackets for 2009 and thereafter are as follows:

Taxable income	Tax
$5,000 or less	.587%
More than $5,000 but not more than $10,000	$29.35 plus 1.174% of the amount in excess of $5,000
More than $10,000 but not more than $15,000	$88.05 plus 2.348% of the amount in excess of $10,000

Taxable income	Tax
More than $15,000 but not more than $20,000	$205.45 plus 2.935% of the amount in excess of $15,000
More than $20,000 but not more than $40,000	$352.20 plus 3.521% of the amount in excess of $20,000
More than $40,000 but not more than $80,000	$1,056.40 plus 4.109% of the amount in excess of $40,000
More than $80,000 but not more than $100,000	$2,700.00 plus 4.695% of the amount in excess of $80,000
More than $100,000 but not more than $200,000	$3,639.00 plus 5.451% of the amount in excess of $100,000
More than $200,000	$9,090.00 plus 5.925% of the amount in excess of $200,000

For each taxable year beginning after 2009, the income tax dollar amounts and rates are the same as for taxable years beginning in 2009.

Inflation adjustments delayed

(R.C. 5747.02(A))

Under existing law, beginning in July of 2005, the Tax Commissioner is to make yearly adjustments to each of the existing tax bracket income amounts to account for general price inflation. The bill postpones commencement of these yearly adjustments until 2010.

Deduction for qualified tuition and fees eliminated

(R.C. 5747.01(A)(18))

Existing law permits taxpayers to take a deduction for certain tuition costs and fees paid by them on their own behalf or on behalf of a spouse or dependent during the taxable year. The deduction is available for tuition and fees paid to a state university or other postsecondary institution located in Ohio. For taxpayers enrolled in a full-time course of study, the deduction is available for tuition and fees paid in each of the first two years of postsecondary education. For taxpayers enrolled part-time, the deduction is available for tuition and fees paid for the academic equivalent of the first two years of postsecondary education during a maximum of five taxable years. The total amount of tuition and fees that may be deducted by a taxpayer for all taxable years is $5,000. The deduction is not available to individuals filing a joint return showing a combined federal adjusted gross income[8] greater than $100,000 and is not available to single filers having federal adjusted gross income in excess of $50,000.

The bill eliminates the deduction for tuition and fees. The bill provides that the deduction is not available for any taxable year beginning after December 31, 2005.

Credit for low-income taxpayers created

(R.C. 5747.056, 5747.08, and 5747.98)

The bill creates a nonrefundable[9] credit for individuals whose Ohio adjusted gross income (less exemptions) does not exceed $10,000. The amount of the credit varies depending upon the taxable year for which it is claimed. For taxable years beginning in 2005, the credit equals $107. For taxable years beginning in 2006, the credit equals $102. For taxable years beginning in 2007, the credit equals $98. For taxable years beginning in 2008, the credit equals $93. For taxable years beginning in 2009 or thereafter, the credit equals $88.

Taxation of trust income made permanent

(R.C. 5747.01 and 5747.02(B))

Under existing law, the income tax applies to trusts for only three taxable years; namely, the taxable years of a trust beginning in 2002, 2003, and 2004. Thus, under existing law, the last year in which trusts are subject to the personal income tax is the taxable year of a trust beginning in 2004. The bill makes application of the personal income tax to trusts permanent, beginning with taxable years beginning in 2005.

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[8] A taxpayer's Ohio adjusted gross income, which is the income tax base from which Ohio income tax liability is calculated, is calculated on the basis of the taxpayer's federal adjusted gross income (R.C. 5747.01(A)).

[9] A "nonrefundable" credit is a credit that can be claimed by a taxpayer only to the extent the amount of the credit does not exceed the taxpayer's tax liability. If a nonrefundable credit exceeds a taxpayer's tax liability, the taxpayer is not entitled to a refund of the excess.

Trust residency rules

(R.C. 5747.01(I)(3)(a)(iii) and (I)(3)(d)(iii))

The residency of a trust determines the extent to which the trust's nonbusiness income is taxable by Ohio. If a trust is not a resident trust, it is entitled to a credit for taxes paid to another state on the nonbusiness income.

Under continuing law, a trust is considered a resident trust to the extent it consists of assets transferred under any of the following three conditions:

(1) With respect to certain testamentary and irrevocable inter vivos trusts, the assets were transferred by a person, a court, or a governmental entity or instrumentality on account of the decedent-transferor's death;

(2) The assets were transferred by a person domiciled in Ohio (for Ohio income tax purposes) at the time of transfer, provided at least one of the trust's beneficiaries is domiciled in Ohio (for Ohio income tax purposes) during some portion of the trust's current taxable year;

(3) The assets were transferred by a person domiciled in Ohio (for Ohio income tax purposes) when the trust became irrevocable, but only if at least one of the trust's beneficiaries was an Ohio resident (for Ohio income tax purposes) during some portion of the trust's taxable year.

The bill specifies that with respect to (3) above, a trust is considered a resident trust even when the trust became irrevocable upon the death of a person domiciled in Ohio (for Ohio income tax purposes).

Under continuing law, the extent to which a trust consists of assets transferred to it from any of the sources enumerated in (1), (2), and (3) above is ascertained by multiplying the fair market value of the trust's assets by a "qualifying ratio"[10] that is based, generally, on the relationship of the fair market value of the transferred assets at the time of transfer to the fair market value of all of the trust's assets at that time. The bill provides that the domicile of a trust's

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[10] *The first time the trust receives assets, the numerator of the qualifying ratio is the fair market value of those assets at that time and the denominator is the fair market value of all of the trust's assets at that time. Each subsequent time the trust receives assets the numerator of the qualifying ratio is the sum of (1) the fair market value of the trust's assets immediately prior to the subsequent transfer multiplied by the last qualifying ratio computed, and (2) the fair market value of the subsequently transferred assets at the time transferred. The denominator is the fair market value of all of the trust's assets immediately after the subsequent transfer.*

beneficiaries is not to be taken into account in this computation insofar as the sources are as described in (2) or (3) above.

The bill also narrows the definition of who is a qualifying beneficiary of a charitable lead trust, from current, future, and contingent beneficiaries to only current and future beneficiaries, not contingent beneficiaries. The narrowing of the beneficiary definition narrows the extent to which charitable lead trusts are subject to the income tax. As noted, a trust is taxable to the extent it "resides" in Ohio. A trust resides in Ohio if, among other things, assets were transferred to it by an Ohio-domiciled person, the trust is irrevocable, and at least one qualifying beneficiary is domiciled in Ohio.

<u>Credit for a resident's out-of-state income tax liability disallowed if the out-of-state income tax liability is deducted in computing the resident's tax base</u>

(R.C. 5747.01 and 5747.05)

Continuing law allows a credit against the personal income tax for income taxes paid by an Ohio resident to another state or the District of Columbia. The credit is equal to the lesser of the following:

(1) The amount of income tax otherwise due to Ohio on the portion of Ohio adjusted gross income (which is the tax base from which Ohio income tax liability is calculated) that is subject to taxation by another state or the District of Columbia; or

(2) The amount of income tax liability to another state or the District of Columbia on the portion of Ohio adjusted gross income that is subject to taxation by another state or the District of Columbia.

The tax base from which Ohio income tax liability is calculated, Ohio adjusted gross income, is defined under continuing law as a taxpayer's federal adjusted gross income, adjusted as prescribed under continuing Ohio law. Thus, a taxpayer's Ohio income tax base is derived from the taxpayer's federal adjusted gross income.

The bill provides that the credit for income taxes paid by Ohio residents to other states or the District of Columbia is not available to any taxpayer who has directly or indirectly deducted, or was required to directly or indirectly deduct, the amount of income taxes owed to another state or the District of Columbia in computing federal adjusted gross income. Thus, the bill precludes a resident taxpayer from claiming the credit when the taxpayer deducted, or should have deducted, the out-of-state income taxes in computing the taxpayer's federal income tax base. Because Ohio's income tax base is derived from the federal income tax base, the effect of the bill is to preclude a resident taxpayer from taking, for state income tax purposes, a deduction for out-of-state income taxes and also claiming a credit with respect to those taxes.

IV. Property Taxes and Transfer Fees

Voter approved property tax not subject to tax reduction factor

(R.C. 319.301, 323.17, 5705.02, 5705.214, 5705.219, and 5705.29)

The bill permits city, local, and exempted village school boards to levy a property tax outside the statutory 10-mill limitation on unvoted property tax rates but within the constitutional 1% limitation, which prohibits unvoted property taxes in excess of 1% of the value of the property. The tax would have to be approved by voters. As a tax within the 1% limitation, the tax would be exempt from reduction under the H.B. 920 law preventing revenue from a levy from increasing when real estate values increase. Under the bill, the school board proposing the tax must limit the revenue growth to a fixed annual percentage of up to 4%. The resolution proposing the tax and any notices announcing the election on the tax would have to specify the percentage by which revenue from real property could grow each year.

Revenue from the tax would have to be reduced in any year that real property values in either class increase by more than the growth percentage fixed by the school board. (Increases in the total value of a class do not include property newly added to the tax list.) The reduction would be made in a manner similar to the current H.B. 920 law, except that revenue would be reduced only to the level at which the revenue growth equals the school board's percentage limit. Thus, if the limit on growth is 3%, revenue raised from each class of real property could increase by only 3%; if property values in either class increase by more than 3% in a year (excluding increases attributable to new property), then a H.B. 920 tax reduction factor would have to be applied so that the revenue produced from property in that class does not exceed the preceding year's revenue by more than 3%.

Rate of tax

The total tax rate levied under the new authority could not be greater than 8 mills. This would prevent the total rate that would be exempted from the tax reduction factor, 18 mills, from exceeding 1% of true value.

Purpose of tax; submission to voters

The new tax could be levied for current expenses, for specific permanent improvements or a class of permanent improvements, or for "general ongoing" permanent improvements. The tax could be levied for a specified number of years up to seven years. The procedure for submitting the tax to voters would be substantially identical to the procedure for submitting other property taxes to voters. The ballot proposition would have to state the term of the levy and the rate of the tax. The ballot also would have to state that revenue from real property would not increase by more than the percentage fixed by the school board. The tax would be subject to existing limits on the number of times property taxes may be proposed to voters in a single year (three times).

Renewal or replacement taxes; anticipation notes

The tax could be renewed upon its expiration. The tax also could be used to replace one or more existing property taxes. Tax anticipation notes could be issued by the school board, subject to existing limitations on the principal amount of the notes (50% of the first year's revenue for current expense levies and 50% of the first five years' revenue for permanent improvement levies or for general ongoing permanent improvement levies).

Tax is exempted from H.B. 920 tax reduction factor "floor"

Revenue reductions made under the H.B. 920 tax reduction factor law are prevented from reducing property taxes for current expenses below 2% of a school district's taxable property valuation (i.e., 20 effective mills). This so-called "20-mill floor" guarantees that a school district that levies 20 mills for operating expenses raises at least 20 mills in taxes for operating expenses, even if increases in the value of property otherwise would warrant H.B. 920 tax reductions great enough to cause the level of taxation to fall below 20 mills.[11]

Once a school district's revenue has been reduced to the 20-mill floor, the school district's revenue will "grow" in the sense that the district will receive 2% of its real property valuation, regardless of how rapidly that valuation appreciates from year to year. This is in contrast to a school district receiving revenue above the 20-mill floor--such a district's revenue growth will not respond to inflationary appreciation in real property values (i.e., appreciation other than from new property development or reclassification of property). One of the implications of the 20-mill floor is that if a school district at the 20-mill floor levies an additional tax for current expenses, the additional tax revenue exposes some of the district's previously authorized tax revenue to reduction under the H.B. 920 law. Consequently, the district's revenue will not grow in response to appreciation in

[11] *If the rate of tax levied for current expenses is less than 20 mills, then the floor is equal to that lower rate.*

property values as it did before, but the district would receive more revenue from the additional tax.

Under the bill, revenue from the new tax would not be counted toward the 20-mill floor. Thus, if a school district that has its revenue reduced to the 20-mill floor levies such a tax, its existing current expense revenue would not be exposed to further reduction under the H.B. 920 law, and therefore would continue to increase with increases in real property values.

Elimination of the 10% rollback in real property taxes for certain real property

(R.C. 319.302 and 323.152; Section 557.15)

Under current law, all real property, and manufactured and mobile homes that are treated as real property for purposes of property taxation, receive a reduction of 10% of the property tax bill (known as the "rollback"). Beginning in tax year 2005, the bill requires that the county auditor classify each parcel of real property according to its principal, current use, and apply the 10% rollback only to property that is classified as "qualifying property" or to manufactured or mobile homes. Under the bill, only lands and improvements thereon that are used for residential or agricultural purposes may be classified as "qualifying property." All other lands and improvements thereon, and minerals or rights to minerals, will no longer receive the rollback. The bill requires that the Tax Commissioner adopt rules governing this classification of property, and no property may be classified except in accordance with those rules.

Under the bill, the county auditor also must reclassify each parcel of real property whose principal, current use has changed from the preceding year to reflect the use of the property as of January 1 of the current tax year.

Continuing law provides for the reduction of real property taxes on homesteads and manufactured home taxes on manufactured or mobile homes, in an amount equal to ¼ of the amount by which taxes are reduced under the 10% rollback (which equals 2½%). The bill replaces this equation with language that simply states that to provide a partial exemption, real property taxes on homesteads and manufactured home taxes on manufactured or mobile homes is 2½% of the amount of taxes to be levied on the homestead or home.

Increase in real property transfer fee

(R.C. 319.54; Section 557.18)

Continuing law requires that county auditors charge fees for transferring real property or used manufactured or mobile homes. Currently, the fee is $1, or

10¢ for each $100 or fraction of $100, whichever is greater, of the value of the real property, used manufactured home, or used mobile home transferred.

The bill increases the fee to the greater of $1, or **20**¢ for each $100 or fraction of $100 of the value of the property or home transferred. The increase applies to any conveyance of real property presented to the county auditor on or after July 1, 2005, regardless of its time of execution or delivery. The bill requires that the county auditor deposit the greater of $1 or one-half of the fee in the county treasury to the credit of the county general fund. By the 15th day of the month following the month in which the fee was received, the county auditor must forward the balance of the fee to the Treasurer of State for deposit in the state treasury to the credit of the General Revenue Fund (GRF). The county auditor must include with each balance forwarded to the Treasurer of State a report in such form as the Tax Commissioner prescribes. Upon receipt of the report, the Treasurer must date stamp the report and forward it to the Commissioner. If the county auditor fails to forward the balance by that time, the Tax Commissioner may withhold Local Government Fund money allocated to the county until the balance is forwarded. The Treasurer of State may require that the county auditor forward electronically any balances due and the reports.

The bill provides that the fee for transferring real property or used manufactured or mobile homes and the real property transfer tax levied on deeds by a county cannot ever exceed 50¢ for each $100 or fraction of $100 of the value of real property transferred.

Real property tax exemption for certain buildings and lands used by a state university

(R.C. 5709.07; Section 557.14)

Continuing law provides that public colleges and academies and all buildings connected with them, and all lands connected with public institutions of learning, not used with a view to profit, are exempt from real property taxation, but leasehold estates or real property held under the authority of a college or university of learning do not qualify for the exemption.

The bill creates a real property tax exemption for buildings and lands that satisfy all of the following:

(1) The buildings are used for housing or housing-related facilities (including parking facilities) for full-time students, faculty, or employees of a state university, or for other purposes related to the state university's educational purpose, and the lands are used for common space, walkways, and green spaces for students, faculty, or employees of a state university;

(2) The buildings and land are supervised or otherwise under the control, directly or indirectly, of a 501(c)(3) charitable organization (corporations, community chests, funds, or foundations, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals) with which the state university has entered into a joint agreement that entitles its students, faculty, or employees to use the lands or buildings;

(3) The state university has agreed under the terms of the joint agreement to make payments to the charitable organization in amounts sufficient to maintain agreed-upon debt service coverage ratios on bonds related to the lands or buildings.

The bill provides that the leasing of housing in such buildings to full-time students of the state university are not considered to be an activity with a view to profit; thus, they are exempt from real property taxation.

The bill defines a "state university" as a public institution of higher education that is a body politic and corporate, with each of the following recognized as a state university: University of Akron, Bowling Green State University, Central State University, University of Cincinnati, Cleveland State University, Kent State University, Miami University, Ohio University, Ohio State University, Shawnee State University, University of Toledo, Wright State University, and Youngstown State University.

The bill provides that this new exemption applies to all applications pending, as of July 1, 2005, for exemption under the existing provision, and to all future applications for exemption under the new provision filed on or after that date. Notwithstanding the possibility that buildings and lands may qualify for a real property tax exemption under another section of the Revised Code specifically applicable to such buildings and lands, the above-described buildings and lands are nonetheless entitled to the new exemption.

<u>Incentive districts</u>

(R.C. 5709.40, 5709.73, and 5709.78)

Under existing law, the legislative authority of a municipal corporation, by ordinance, and a board of township trustees or board of county commissioners, by resolution, may create incentive districts and declare improvements to real property within a district to be a public purpose and exempt from taxation. An "incentive district" is an area of not more than 300 acres with certain distress characteristics, including low-income residents or high unemployment. The ordinance or resolution must specify the life of the district and the percentage of improvements to be exempted, and must designate the public infrastructure improvements to be made that benefit or serve parcels in the district. Ordinances and resolutions creating incentive districts may not be adopted after June 30, 2007.

The bill provides that such ordinances and resolutions may not be adopted after December 31, 2007. This date in no way applies to ordinances or resolutions that declare improvements to real property in a municipality, township, or county to be a public purpose and exempt the improvements from taxation (the classic tax increment financing law).

Phase-out of tax on business personal property

(R.C. 5711.21, 5711.22, 5727.02, 5727.031, and 5727.06)

Exemption of new business machinery and equipment

The bill exempts from property taxation all machinery and equipment used in business that is installed (or otherwise first used in business in Ohio) after the end of 2004. The exemption applies to all such property if it was not used in business before 2005 by the property's owner or by a related member or predecessor of the owner, unless the property was the inventory of the owner, related member, or predecessor (in which case the property is subject to the phase-out described below).

Phase-out of tax on existing business machinery and equipment

For machinery and equipment used in business in Ohio before the end of 2004, taxation of the property is phased out over two years so that the property will be totally exempt in 2007 and thereafter. In 2005, the property will be taxed on 25% of its value, as provided under current law. In 2006, it will be taxed on 12-1/2% of its value. In 2007 and thereafter, it will be exempted from taxation entirely.

Accelerated phase-out of tax on business inventory

The bill accelerates the current phase-down of the taxation of business inventory. Currently, taxes on business inventory is being phased out over several years according to a schedule that is contingent, during the first few years, on a trigger requiring increasing statewide property tax collections, and that provides for an automatic two percentage point-per-year reduction in the assessment rate after 2006. Currently, the assessment rate has been reduced from 25% to 23%; the phase-down of the assessment rate has not operated for two consecutive years because statewide property tax collections have not increased year-on-year for two years.

The bill dispenses with the current triggering mechanism and the two-percentage-point automatic phase-down and replaces them with a compressed phase-down schedule, eliminating taxes on business inventory by 2010. Under the compressed phase-down, the assessment rate for 2005 and 2006 remains at 23%. In 2007, the rate declines to 21%, then to 14% in 2008, 7% in 2009, and 0% in 2010 and thereafter, effectively repealing the taxation of business inventory after 2009.

Phase-out of furniture and fixture property

The bill phases out the taxation of all other business tangible personal property ("furniture and fixtures") in equal, five-percentage-point increments, over five years beginning in 2006. All furniture and fixtures would become exempted from taxation in 2010 and would remain so thereafter. The current assessment rate is 25%.

Effect on certain taxpayers

Although the bill's phase-out of business tangible personal property taxation apparently is intended to apply to any such property regardless of ownership, the bill states that the phase-out and exemption "apply to the property of [certain "excluded persons"]." (See R.C. 5711.22(I).) An excluded person is a legal entity that is exempted from the commercial activity tax, including affiliates of financial institutions, certain financial holding companies and their nonfinancial affiliates, financial services companies, affiliates of insurance companies, affiliates of dealers in intangibles, entities created to pool and repackage loans for marketing to investors. There is the possibility this could be construed to mean that the phase-out and exemption for personal property applies only to such excluded persons under the *inclusio unius est exclusio alterius* canon of statutory construction, whereby to name on class of subjects is to exclude all other unnamed subjects.

Reimbursement of local taxing units

(R.C. 5751.21 to 5751.22)

The bill provides reimbursement to school districts and other local taxing units for some of the net revenue reduction that would result from the bill's exemption and phase-out of machinery and equipment and furniture and fixtures, and the accelerated business inventory phase-out. Reimbursement is to be paid to school districts and joint vocational school districts from the newly created School District Tangible Property Tax Replacement Fund, and to other local taxing units through the newly created Local Government Tangible Property Tax Replacement Fund. These funds are to be funded by a portion of the Commercial Activity Tax proposed by the bill. The bill prescribes specific computations and procedures for the Tax Commissioner and the Department of Education to implement the reimbursement.

School districts. Generally, the reimbursement for school districts (including joint vocational school districts) is based on the net revenue effect of the bill's property tax exemption and phase-outs after offsetting the increased state funding school districts receive when their taxable property values decline, and disregarding the effects of the previously enacted phase-down of business inventory taxes. The revenue effect of the previously enacted inventory tax phase-out is essentially subtracted from the revenue effect of the bill's exemptions and phase-outs, meaning the bill does not reimburse districts for revenue losses resulting from the previously enacted phase-down. (Nor does current law provide direct reimbursement for the previously enacted phase-down.) For the same reason, the state education aid offset incorporated in the bill's reimbursement formula does not offset state aid increases to the extent those increases result from the previously enacted inventory tax phase-down. In other words, the bill's reimbursement provision reimburses only for net revenue losses resulting from the bill's tax changes, disregarding previously enacted changes.

The reimbursable net revenue losses generally are computed on the basis of school district levies in effect in 2005 (so long as the levy was approved by voters before September 1, 2005). In the case of levies raising a fixed sum of money, such as bond levies and emergency levies, reimbursable losses are computed for as long as the district continues to impose the levy after 2005 and through 2018, including, in the case of emergency levies only, any renewals for the same amount as the original emergency levy minus the 2006 reimbursement amount. The total reimbursement for all fixed-sum levies imposed over the same territory is to within 1/2-mill worth of the reimbursable loss. The unreimbursed 1/2-mill is divided among the overlapping school districts and local taxing units in proportion to the relative rates of their reimbursable fixed-sum levies. For example, if a school district's fixed-sum levies constitute 60% of all reimbursable fixed-sum levies over a territory, 60% of the unreimbursed 1/2-mill (0.30 mills) is not reimbursed to the school district. Instead, the rate of the district's fixed-sum levies will increase by a total of 0.30 mills, and the total of the other overlapping taxing units' levies will increase by the remaining 0.20 mills.

Reimbursement for fixed-rate levies is to be paid in declining amounts through the end of fiscal year 2018. Fixed-sum levies and unvoted millage for debt are fully reimbursed through the end of fiscal year 2017. Reimbursement payments are to be made quarterly in February, May, August, and November, beginning May 2006.

Other taxing units. Reimbursement to local taxing units other than school districts and joint vocational school districts is similar in concept to the school district reimbursement except there is no offset for increases in state aid. Accordingly, local taxing units are reimbursed for the net revenue losses caused by the bill's exemption of newly installed machinery and equipment, the phase-out of taxes on existing machinery and equipment, and the incremental revenue loss from the accelerated phase-out of taxes on inventory. Revenue losses from the previously enacted phase-down of inventory taxes are not reimbursed. Levies qualify for reimbursement under the same terms as for school district levies, except local taxing units do not impose emergency levies of the sort that school districts may impose. Reimbursement for fixed-rate levies is to be paid in declining amounts through the end of calendar year 2017. Fixed-sum levies and unvoted millage for debt are to be fully reimbursed through 2017. Reimbursement payments are to be made quarterly in February, May, August, and November, beginning May 2006.

Elimination of the tax exemption for patterns, dies, jigs, and drawings

(R.C. 5701.03 and 5727.01(E)(3))

The bill terminates the existing tax exemption for certain kinds of tangible personal property. Under current law, patterns, jigs, dies, and drawings that a person holds for their own use and not for selling to others in the course of their business (including as inventory) are not taxable. The bill terminates the exemption after the end of tax year 2005, making the property taxable beginning in 2006.

Such property becomes taxable whether it is held by a business or a public utility, but an exemption remains for the cost of drawings used by most public utilities and all interexchange telecommunications companies, so long as the drawings are used to provide the utility's or company's services. To qualify for the continued exemption, the cost of the drawings must be documented. The continued exemption does not apply to drawings of electric companies or of combined companies acting as electric companies.

Reduction in assessment rate on public utility property

(R.C. 5727.01 and 5727.111)

In recognition of the terminated exemption for patterns, jigs, dies, and drawings, the bill reduces the assessment rate on electric company tangible personal property. Currently, most electric companies' transmission and distribution equipment is taxed on 88% of its value and their other property is taxed on 25% of value. The bill reduces the 88% assessment rate for transmission and distribution equipment to 85% and reduces the 25% assessment rate for all other property to 24%. The reductions take effect beginning in tax year 2006.

The bill does not change the current assessment rates on the property of rural electric companies, which are cooperatives and other organizations providing electricity to their members, primarily in rural communities.

Tax treatment of nonutility electricity providers

(R.C. 5711.21, 5711.22, 5727.02, and 5727.031)

Currently, when a business other than an electric company generates or distributes electricity for its own use, as in large manufacturing operations, and provides electricity to others (for example, when excess capacity is available), the property used to generate or distribute the electricity is treated, in effect, as partly business property and partly public utility property. This treatment recognizes that the method of deriving the value of public utility property and business property differs, as do the respective assessment rates. Under current law, the value of the property is divided into two parts each year on the basis of the relative percentage of the electricity used by the generator and by anyone else in the previous year. The part attributed to the generator is valued and assessed like business property (at 25%), and the part attributed to generation for others is treated as electric company property; i.e., the transmission and distribution component of that part is valued and assessed like that of electric companies (at 88%), and the generation component is valued and assessed like that of electric companies (at 25%).

Under the bill, businesses that generate electricity and supply some of it to others, but whose primary business is not supplying electricity, will continue to be taxed on their electricity-related property in the same manner as under current law. However, because much of the part of that property attributed to the business's own electricity use will no longer be taxable after 2009 (because of the bill's phase-out of tax on business machinery and equipment), the business will be required to report its electricity-related property as an electric company does. Its report will have to contain only the part of the value of the property attributed to supplying electricity to others (determined on the basis of the relative percentage of electricity supplied to others, as in current law). The reportable property will continue to be determined and assessed as under current law--i.e., in the same manner as for the equivalent electric company property--but at the bill's new assessment rates: 85% for transmission and distribution property, and 25% for all other property.

Leased property

(R.C. 5711.21, 5711.22, and 5727.06)

Currently, property owned by someone other than a public utility or interexchange telecommunications company but leased by that person to a public utility or interexchange telecommunications company is valued and assessed as if it were owned by the public utility or interexchange telecommunications company.

Such leased property would continue to be treated in this manner, but, from tax year 2006 and thereafter, it would have to be reported by the public utility or interexchange telecommunications company leasing the property, instead of the lessor.

Tax increment financing

(R.C. 5709.40, 5709.41, 5709.73, 5709.77, and 5709.78; Section 612.12)

The bill permits real property tax exemptions granted under the tax increment financing (TIF) law to begin at any time specified in the TIF resolution or ordinance. Under current law, the exemption begins when the increased value from the parcel first appears on the tax list (whether through development or an increase in assessed value).

The bill eliminates a test to determine whether infrastructure financed with TIF payments in lieu of taxes directly benefits a parcel receives the TIF tax exemption. Under current law, infrastructure directly benefits an exempted parcel only if the parcel "places direct, additional demand" on the infrastructure. The bill eliminates this test, but continues to require that a parcel be directly benefited by the infrastructure financed with payments in lieu of taxes derived from that parcel. (The bill's changes in this regard pertain to TIF tax exemptions granted on a parcel-by-parcel basis, not the area-wide incentive districts.)

The bill makes other modifications to the provisions governing when school districts must approve of a TIF exemption, but do not appear to change the substance of those provisions. The changes expressly acknowledge that any compensation to be paid to the school district be negotiated to be mutually agreeable, and make other technical changes.

Accelerate phase-out of state reimbursement for $10,000 business property exemption

(R.C. 321.24(G))

Continuing law exempts the first $10,000 of a business's tangible personal property from property taxation (R.C. 5709.01(C)(3)). Currently, the state reimburses local taxing districts for the resulting revenue reduction, but Am. Sub. H.B. 95 of the 125th General Assembly phases-out the state's reimbursement for the exemption, over ten years. Under the phase-out, county treasurers receive a payment each year from the General Revenue Fund that is a reduced percentage of the county's fiscal year 2003 reimbursement. The payment is then apportioned among the county's taxing districts as if levied and collected as personal property taxes. No further reimbursements are to be paid after fiscal year 2012.

The bill accelerates the phase-out period so that no reimbursement payments are made after fiscal year 2009.

Equalization of real property assessments

(R.C. 5715.24)

Under continuing law, all real property in a county is reappraised every six years for purposes of establishing its taxable value. The Tax Commissioner is required to determine whether the real property in counties that have completed a sexennial reappraisal in the current year has been properly assessed. If, upon reviewing a sexennial reappraisal, the Commissioner determines that the property is not properly listed for taxation, the Commissioner is required to increase or decrease the aggregate value of the real property, or any class of real property, by a percentage or amount that will cause it to be correctly assessed at its taxable value.

The bill provides that in determining whether a class of real property has been assessed at its correct taxable value and in determining any percent or amount by which the aggregate value of the class from a prior year should be increased or decreased to be correctly assessed, the value of new construction is not to be regarded as an increase in aggregate value from the prior year. Likewise, the value of property destroyed or demolished since the prior year is to be deducted from the aggregate value of that class for the prior year.

School district property tax replacement payments when mergers occur

(R.C. 5727.85)

Under continuing law, school districts and joint vocational school districts receive property tax replacement payments to offset the loss of revenues that occurred when the assessment rates on the tangible personal property of rural electric companies, electric companies, and natural gas companies were reduced. Those replacement payments come from a portion of the kilowatt-hour and MCF tax revenues, and are based on a district's fixed-rate levy loss and fixed-sum levy loss. The bill establishes a procedure to determine how payments are to be made to those districts that merge with or transfer territory to other districts, as follows:

Type of merger or transfer of territory:	Fixed-rate levy loss:	Fixed-sum levy loss:
Complete merger of two or more districts	Successor district receives the sum of the fixed-rate levy losses for each district merged.	Successor district receives the sum of the fixed-sum levy losses for each district merged.
Transfer of part of a district's territory to an existing district	Recipient district receives the transferring district's total fixed-rate levy loss times a fraction, with the numerator being the value of electric company tangible personal property in the part of the territory transferred, and the denominator being the total value of that property in the entire district from which the territory was transferred.	The Department of Education makes an equitable division of the fixed-sum levy losses for both districts, if the recipient district takes on debt from the other district.
Transfer of part of one or more districts' territory to form a new district between January 1, 2000, and January 1, 2005	New district receives just its current fixed-rate levy loss through August 2006. From February 2007 to August 2016, the new district receives the **lesser** of (1) an amount determined using existing law's calculation of the district's state education aid and inflation-adjusted property tax loss, or (2) the amount determined for local taxing units, which is phased-out per a schedule under existing law.	The Department of Education makes an equitable division of the fixed-sum levy losses for all the districts, if the new district takes on debt from the other district(s).

Type of merger or transfer of territory:	Fixed-rate levy loss:	Fixed-sum levy loss:
Transfer of part of one or more districts' territory to form a new district on or after January 1, 2005	New district does not receive any fixed-rate levy loss. The transferring district(s) continue to receive their current fixed-rate levy loss.	New district does not receive any fixed-sum levy loss, unless it takes on debt from the other district(s), in which case the Department of Education makes an equitable division of the losses for the districts.

The bill also changes one of the dates by which the Director of Budget and Management must transfer amounts from the School District Property Tax Replacement Fund to the General Revenue Fund, from February 2017 to May 2017.

Computation used to determine amounts deposited each year in the Property Tax Administration Fund changed

(R.C. 321.24 and 5703.80)

Continuing law provides for a percentage of real property tax rollback reimbursements to local governments to be diverted to a special fund known as the Property Tax Administration Fund to be used by the Department of Taxation to defray its costs of administering property taxation and of equalizing real property. The Department oversees the equalization of real property valuation throughout the state, and administers the assessment of all public utility property and tangible personal property of businesses operating in more than one county.

The fund is funded from a portion of the state reimbursement that otherwise is payable to taxing districts for the 10% rollback for real property. Under current law, the portion diverted to the fund is the sum of the following components:

- 0.3% of the 10% real property tax rollback reimbursement (including the rollback reimbursement for manufactured and mobile homes);
- 0.15% of the taxes charged against public utility personal property;
- 0.75% of taxes charged against tangible personal property of businesses owning property in more than one county (the property of such businesses is assessed by the Department);

The bill changes the computation used to determine the portion of the 10% rollback reimbursement to be diverted to the fund. Under the bill, the portion diverted to the fund is computed as follows:

- For fiscal year 2006:
  - 0.33% of the 10% real property tax rollback reimbursement (including the rollback reimbursement for manufactured and mobile homes); plus
  - 0.5% of the taxes charged against public utility personal property; plus
  - 0.5% of the taxes charged against tangible personal property of businesses owning property in more than one county.
- For fiscal year 2007:
  - 0.35% of the 10% real property tax rollback reimbursement (including the rollback reimbursement for manufactured and mobile homes); plus
  - 0.56% of the taxes charged against public utility personal property; plus
  - 0.56% of the taxes charged against tangible personal property of businesses owning property in more than one county.
- For fiscal year 2008 and thereafter:
  - 0.35% of the 10% real property tax rollback reimbursement (including the rollback reimbursement for manufactured and mobile homes); plus
  - 0.6% of the taxes charged against public utility personal property; plus
  - 0.6% of the taxes charged against tangible personal property of businesses owning property in more than one county.

State payment of estimated taxes for acquired property

(R.C. 319.20)

Existing law specifies that whenever the state acquires an entire parcel or a part only of a parcel of real property in fee simple, the county auditor, upon application of the grantor or the property owner or the state, must prepare an estimate of the taxes that are a lien on the property, but have not been determined, assessed, and levied for the year in which the property was acquired. The county auditor must apportion the estimated taxes proportionately between the grantor and the state for the period of the lien year that each had or would have had ownership or possession of the property, whichever is earlier. The bill requires the county treasurer to accept payment from the state for estimated taxes at the time that the real property is acquired. If the state has paid in full in the year in which the property is acquired that proportion of the estimated taxes that the Tax Commissioner determines are not subject to remission by the county auditor for such year under existing law that requires the county auditor to remit taxes that have not yet been assessed in the year the property is acquired, the bill requires that the estimated taxes paid are to be considered the tax liability on the exempted property for that year.

Interest rate reduced on personal property tax underpayments and overpayments

(R.C. 5703.47 and 5719.041)

Tangible personal property located and used in business in Ohio is subject to taxation by local taxing units. If the taxes are not paid on time, a 10% penalty is charged and interest accrues on the unpaid balance at the "rate per annum." If taxes are overpaid, interest accrues at the same rate on the overpayment until a refund is issued. Most of the interest on late payments is credited to the funds of local taxing units; interest on refunded overpayments is payable from the funds of local taxing units.

Continuing law provides that on October 15th of each year, the Tax Commissioner must determine the federal short-term rate, rounded to the nearest whole number per cent, plus 3%. That rate is the "rate per annum." The bill changes this rate for the personal property tax law. For purposes of that tax, the "federal short-term rate" is the federal short-term rate rounded to the nearest whole number per cent; thus, the bill reduces the interest rate that accrues on late personal property tax payments and on tax overpayments, by applying the "federal short-term rate," rather than the rate per annum.

V. Sales and Use Taxes

Rate change

(R.C. 5739.02, 5739.025, 5739.10, and 5741.02)

Am. Sub. H.B. 95 of the 125th General Assembly temporarily increased state sales and use taxes, from 5% to 6%. The temporary increase applies to sales occurring on and after July 1, 2003, but before July 1, 2005. Under current law, the rate is scheduled to return to 5% on July 1, 2005.

The bill establishes a permanent sales and use tax rate of 5½%, beginning July 1, 2005. This rate also applies to the vendors' excise tax for the privilege of engaging in the business of making retail sales on and after July 1, 2005. To reflect the tax rate change, the bill revises the tax rate schedules that specify how the tax is applied to fractions of dollars when sales are not in exact dollar amounts.

Transmission to the Treasurer of State of sales and use taxes collected by court clerks upon issuing certificates of title

(R.C. 1548.06 and 4505.06)

Under continuing law, applications for certificates of title for motor vehicles, watercraft, and watercraft outboard motors are filed with the clerks of the courts of common pleas, and the clerks are required to collect unpaid sales and use taxes from the applicants at the time the applications are filed. The clerks retain a poundage fee for collecting the taxes. Under existing law, the clerks forward the taxes collected by them to the Treasurer of State in a manner prescribed by the Tax Commissioner.

The bill establishes procedures to govern the transmission to the Treasurer of State of sales and use taxes collected by the court clerks. The bill provides that the clerks are to transmit sales and use taxes resulting from sales of motor vehicles, off-highway vehicles, all-purpose vehicles, and titled watercraft and outboard motors during the week to the Treasurer on or before the Friday following the close of that week. If, on any Friday, the offices of a court clerk or the state are closed, the tax must be forwarded to the Treasurer on or before the next day on which the offices are open. Every remittance of tax made by a clerk must be accompanied by a remittance report. Under the bill, the Tax Commissioner is to determine the form of this report. Upon receiving a tax remittance and report, the Treasurer is required to date stamp the report and forward it to the Tax Commissioner. The Treasurer may require the court clerks to transmit tax collections and remittance reports electronically.

If the tax due for any week with respect to titled watercraft and outboard motors is not remitted by a court clerk in accordance with the procedures outlined in the bill, the clerk must forfeit the poundage fees collected by the clerk for sales made during that week. If the tax due for any week with respect to motor vehicles, off-highway vehicles, and all-purpose vehicles is not remitted by a court clerk in accordance with the bill's procedures, the Tax Commissioner may, but is not required to, compel the clerk to forfeit the poundage fees collected by the clerk for sales made during that week.

Use tax exemption for cigarettes

(R.C. 5741.02(C)(9); Section 612.27)

The bill exempts cigarettes a person uses, stores, or consumes in Ohio from the use tax, up to $300 worth per month (wholesale value). The exemption does not apply if the cigarettes are used or stored for resale. In effect, the exemption permits a person to purchase up to $300 worth of cigarettes outside Ohio and bring them back into Ohio without incurring any legal liability for use tax. No use tax report needs to be filed for such cigarettes. Under current law, cigarettes, like other goods, brought into the state are technically subject to the use tax. (The bill has a similar exemption from the cigarette excise use tax, explained below in the Tobacco and Alcohol Taxes section.)

The exemption takes effect July 1, 2005.

VI. The Kilowatt-hour and Natural Gas Consumption Taxes

The kWh tax

Increase in the tax

(R.C. 5727.81(A) and (C)(2); Section 557.21)

A kilowatt-hour (kWh) tax is imposed on electric distribution companies for all electricity distributed by them through meters of end users, or to unmetered locations, in this state. The bill increases the kWh tax by approximately 30%, beginning in the tax measurement period that includes July 1, 2005. The tax rate increases as follows:

Kilowatt hours distributed	Tax rate per kilowatt hour under current law	Tax rate per kilowatt hour under the bill
For the first 2,000:	$.00465	$.00605
For the next 2,001 to 15,000:	$.00419	$.00545
For 15,001 and above:	$.00363	$.00472

Under current law, commercial or industrial purchasers that are self-assessing the kWh tax (because of their high-volume consumption of electricity) are required to pay the tax at a rate of $.00075 per kWh on the first 504 million kWhs distributed to them, plus 4% of the total price of all electricity distributed to them. The bill retains the rate of $.00075 per kWh on the first 504 million kWhs, but raises the percentage to 5% of the total price of all electricity, distributed to a self-assessor.

Municipal electric utilities may not retain the tax increase

(R.C. 5727.81(C)(2) and 5727.82(A)(3))

Continuing law provides that a municipal electric utility may retain in its general fund that portion of the kilowatt-hour tax on the kilowatts distributed to end users located within its boundaries, but must pay to the Tax Commissioner the tax due on kilowatt hours distributed to end users located outside the municipality. The bill provides that, in this situation, a municipal electric utility cannot retain for its general fund any part of the tax rate **increase** imposed by the bill. Instead, the amount of the increase must be paid directly to the Tax Commissioner or Treasurer of State.

Changes to distribution of the kWh tax

(R.C. 5727.84(B)(1) to (5))

Revenues from the kWh tax are deposited in the Kilowatt-Hour Tax Receipts Fund, to the credit of five funds. The bill revises the percentages of kWh tax revenues that are credited to those funds after July 31, 2005, as follows:

	Percentage credited under current law	Percentage credited under the bill
General Revenue Fund	59.976%	69.213%
Local Government Fund	2.646%	2.035%
Local Government Revenue Assistance Fund	.378%	.291%

	Percentage credited under current law	Percentage credited under the bill
School District Property Tax Replacement Fund	25.4%	19.538%
Local Government Property Tax Replacement Fund	11.6%	8.923%

Elimination of the trigger for reducing revenues credited to GRF

(R.C. 5727.84(B)(5) and (6))

Under current law, if, in fiscal years 2002-2006, the kWh tax revenues are less than $552 million, the amount credited to the General Revenue Fund (GRF) must be reduced by the amount necessary to credit to the Local Government Fund and Local Government Revenue Assistance Fund the amount each would have received if the tax did raise that amount in the fiscal year. Beginning in fiscal year 2007, if the tax revenues are less than $552 million, current law requires that the amount credited to GRF be reduced by the amount necessary to credit to all four of the other funds (in the chart above) the amount each one would have received if the tax did raise that amount in the fiscal year.

The bill removes this trigger so that, regardless of the amount of revenues raised by the kWh tax, no reduction in the amount credited to the GRF occurs, and the other funds are not credited for any shortfall.

The natural gas consumption tax

Elimination of the threshold for transferring GRF moneys to other funds

(R.C. 5727.84(C)(3))

Under current law, if, beginning in fiscal year 2007, the natural gas consumption tax (mcf tax) revenues are less than $90 million, an amount equal to the difference between the amount collected and $90 million must be transferred from the GRF to the School District Property Tax Replacement Fund and the Local Government Property Tax Replacement Fund in the same percentages as if that amount had been collected as mcf taxes. The Tax Commissioner is required to certify to the Director of Budget and Management the amounts to be transferred.

The bill eliminates this threshold so that no revenues are transferred from GRF to either of the other funds, regardless of the amount of mcf taxes collected.

VII. Tobacco and Alcohol Taxes

<u>Sale, distribution, and taxation of cigarettes</u>

<u>Cigarette tax</u>

(R.C. 5743.02 and 5743.32; Section 612.27)

Under existing law, an excise tax is levied on the sale, use, consumption, or storage in this state of cigarettes at the rate of 27.5 mills per cigarette. The bill increases the tax to 50 mills per cigarette. (A "mill" is equal to one-tenth of one cent. Accordingly, 10 mills equals one cent, 27.5 mills equals 2.75¢, and 50 mills equals 5¢. So, an excise tax of 50 mills per cigarette equates to a tax of $1 on a package of cigarettes containing 20 cigarettes.) The increase takes effect July 1, 2005.

<u>Tobacco products tax</u>

(R.C. 5743.51, 5743.62, and 5743.63; Section 612.27)

Continuing law levies an excise tax on the sale, use, consumption, or storage in this state of tobacco products other than cigarettes at the rate of 17% of the wholesale price of the tobacco product. The bill increases the tax to 30% of the wholesale price. The increase takes effect July 1, 2005.

<u>"Floor tax" on cigarette inventories</u>

(Section 557.06)

The bill requires wholesale dealers to pay the "net additional tax" resulting from the bill's increase in the cigarette tax, less the dealer discount, on stamped cigarettes and unaffixed Ohio tax stamps in their possession on July 1, 2005, the date on which the tax increase takes effect. For retail dealers, the "net additional tax" is the net additional tax resulting from the bill's increase in the cigarette tax due on all packages of Ohio stamped cigarettes and on all unaffixed Ohio cigarette tax stamps that a retail dealer has on hand as of the beginning of business on July 1, 2005.

In addition to filing the cigarette tax return, each wholesale dealer and retail dealer must file a return on forms prescribed by the Tax Commissioner showing net additional tax due and any other information the Commissioner needs to administer the tax. On or before September 30, 2005, each wholesale dealer and retail dealer must deliver the return to the Treasurer of State, together with payment of the net additional tax due. A wholesale or retail dealer may claim a credit of 5% of the net additional tax if the dealer delivers the return on or before

August 15, 2005, together with the net additional tax minus the dealer credit. The Treasurer of State must stamp or otherwise mark on the return the date on which the return and payment were received, and show on the return by stamp or otherwise the amount of the tax payment remitted with the return. Upon receipt, the Treasurer of State must immediately transmit all returns filed to the Tax Commissioner.

A dealer who fails to file a return or pay the net additional tax must pay a late charge of $50 or 10% of the net additional tax due, whichever is greater. Interest accrues on additional tax that is not timely paid. Unpaid or unreported net additional taxes, late charges, and interest may be collected by assessment.

Persons subject to Ohio laws governing sale, distribution, and taxation of cigarettes

(R.C. 5743.01)

The bill exempts certain persons from the laws governing the sale, distribution, and taxation of cigarettes in Ohio. Specifically, the bill provides that the "wholesale dealers" to which such laws apply do not include any cigarette manufacturer, export warehouse proprietor, or cigarette importer possessing a valid federal license to conduct such business if the person sells cigarettes in Ohio only to:

(1) Wholesale dealers holding a valid Ohio license to traffic in cigarettes; or

(2) An export warehouse proprietor or another manufacturer.

The bill specifies that the class of retail dealers subject to Ohio's cigarette laws includes every person, other than a wholesale dealer, engaged in the business of selling cigarettes in this state, regardless of whether the person is located in Ohio or elsewhere. Accordingly, the bill provides, further, that, for purposes of Ohio's cigarette laws, a "sale" of cigarettes includes transactions in interstate or foreign commerce.

Exempt sales

(R.C. 5743.01, 5743.021, and 5743.03)

The bill specifies that the following types of sales are exempt from the cigarette tax:

(1) Cigarettes sold to or received by members of a federally recognized Indian tribe on the tribe's Indian country;

(2) Cigarettes sold to the United States government or to any instrumentality of the United States government;

(3) Cigarettes sold into foreign commerce or for use or consumption on ships regularly engaged in foreign commerce or interstate shipping.

Cigarettes intended for sale or distribution to these entities are not required to bear a tax stamp. However, these cigarettes must bear a tax-exempt stamp, which the Tax Commissioner is to provide free of charge.

Sales to nontribal members within Indian country

(R.C. 5743.021)

The bill provides that the rate of tax on cigarettes sold to or received by nontribal members within Indian country equals the sum of the tax rates levied under continuing law by the state, counties, and convention facility authorities, less any tribal tax rate. The bill provides that the resulting tax rate cannot be less than zero, however.

Cigarettes sold or distributed to nontribal members must bear a tax stamp; however, the Tax Commissioner is permitted to periodically rebate to Indian tribal entities that comply with Ohio's cigarette laws an amount equal to the lesser of the tribal tax imposed on the sale or receipt of cigarettes or the face value of the tax stamps.

The bill directs the Tax Commissioner to prescribe rules governing the percentages of cigarette packages offered for sale by an Indian tribal entity that require tax stamps and tax-exempt stamps. The percentages prescribed by the Commissioner are to be based on the anticipated percentages of sales of cigarettes within the Indian country that are to be made to persons other than tribal members.

Tax stamps

(R.C. 5743.031)

The bill specifies that a wholesale dealer may affix tax stamps only to packages of cigarettes that the dealer received directly from a manufacturer or importer[12] of cigarettes that possesses a valid Ohio license to traffic in cigarettes. However, a wholesale dealer may affix tax stamps to packages of cigarettes that the dealer received directly from another licensed wholesale dealer if the Tax

[12] The bill defines an "importer" as any person that directly or indirectly imports finished cigarettes into the United States (R.C. 5743.01(P)).

Commissioner has authorized the sale of the cigarettes between those wholesale dealers and the wholesale dealer that sold the cigarettes received them from a manufacturer or importer that possesses a valid Ohio license.

The bill provides that only a wholesale dealer that possesses a valid Ohio license may purchase or obtain tax stamps or tax-exempt stamps. A wholesale dealer may not sell or provide tax stamps to any other wholesale dealer or other person.

Under the bill, any person shipping unstamped cigarettes into Ohio to a person other than a licensed wholesale dealer must, before shipping the cigarettes, file notice of the shipment with the Tax Commissioner. The person transporting the unstamped cigarettes into or within Ohio must carry in the vehicle used to transport the cigarettes invoices or other documentation of the shipment, which contains information regarding the cigarettes, their seller, and their purchaser. However, this requirement does not apply to any common or contract carrier transporting cigarettes through Ohio to another location under a proper bill of lading or freight bill that states the quantity, source, and destination of the cigarettes.

Records pertaining to cigarette sales and purchases

(R.C. 5743.071)

Under continuing law, every wholesale dealer and retail dealer must maintain complete and accurate records of purchases and sales of cigarettes, and must procure and retain all invoices, bills of lading, and other documents relating to purchases and sales of cigarettes. The bill extends these record-keeping duties to manufacturers and importers. The bill provides, further, that the invoices or documents must be maintained for each place of business and must show the name and address of the other party to the sale or purchase, and must show the quantity, by brand style, of the cigarettes sold or purchased.

With the Tax Commissioner's consent, a person with multiple places of business may keep centralized records. However, that person must transmit duplicates of the invoices or documents to each place of business within 72 hours after the Commissioner requests access to the records.

The bill specifies that reports submitted by license holders are to be made available to the public in accordance with Ohio's existing public records law (R.C. 149.43). However, information regarding quantities of cigarettes sold by brand style cannot be made available to anyone other than the Tax Commissioner, the United States Secretary of the Treasury, or law enforcement officials.

Manufacturer and importer reports

(R.C. 5743.072)

The bill requires that every manufacturer and every importer shipping cigarettes into or within Ohio file a monthly report with the Tax Commissioner in accordance with rules prescribed by the Commissioner. Indian tribal entities engaged in the retail sale or distribution of cigarettes must include in the report the name and address of each nontribal member that purchased cigarettes during the reporting period and the quantity of cigarettes, by brand style, purchased.

Seizure and forfeiture of cigarettes

(R.C. 5743.08)

Under continuing law, when the Tax Commissioner discovers that cigarette taxes have not been paid on cigarettes, the Commissioner may seize and take possession of the cigarettes. The bill provides that this authority extends not only to cigarettes for which taxes have not been paid, but to any cigarettes that are held for sale or distribution in violation of any of Ohio's cigarette laws.

Under current law, the Commissioner may sell cigarettes seized by the Commissioner. The bill specifies that the Commissioner is required instead to destroy the cigarettes. The Commissioner's destruction of cigarettes does not render the owner of the cigarettes immune from possible fines and penalties.

Tax Commissioner's inspection powers

(R.C. 5743.14)

Current law grants the Tax Commissioner general authority to inspect any place where cigarettes are sold or stored. The bill specifies that these inspections may be conducted by the Commissioner or the Commissioner's agents and that the Commissioner's inspection authority extends to the facilities and records of manufacturers, importers, wholesale dealers, and retail dealers. The bill provides, further, that the inspection must be conducted pursuant to a properly issued search warrant if it is conducted outside normal business hours.

The bill also authorizes the Commissioner or an agent of the Commissioner to stop and inspect any vehicle that the Commissioner or the Commissioner's agent has reasonable cause to believe is illegally transporting cigarettes.

Licenses to traffic in cigarettes

(R.C. 5743.15)

Continuing law requires that wholesale and retail businesses wishing to engage in the trafficking of cigarettes in Ohio first obtain a license to do so. The bill extends this licensing requirement to manufacturers and importers.

The bill also requires that firms, partnerships, and associations other than corporations that apply for a license state on their applications the name and address of each of their members. Likewise, corporate applicants must state the name and address of each of their officers.

Authorized sales

(R.C. 5743.20)

Current law specifies that wholesale dealers may not sell cigarettes to any person other than a licensed retail dealer. The bill adds an exception in the case of a licensed wholesale dealer who receives cigarettes directly from a licensed manufacturer or licensed importer and who, with the Tax Commissioner's permission, sells them directly to another licensed wholesale dealer. The bill requires that the Commissioner adopt rules governing such sales.

The bill also specifies that a retail dealer may not purchase cigarettes from any person other than a licensed wholesale dealer. In addition, the bill provides that a manufacturer or importer may not sell cigarettes to another person in Ohio other than to a licensed wholesale dealer. An importer is not permitted to purchase cigarettes from any person other than a licensed manufacturer or licensed importer.

Internet and mail order sales

The bill establishes policies and procedures regarding internet and mail order sales of cigarettes. These types of sales are referred to in the bill collectively as "delivery sales."

Shipment of delivery sales

(R.C. 5743.72(A) and (B), 2921.13, and 5743.73)

The bill provides that a merchant shipping cigarettes to a customer to whom the merchant has not previously shipped cigarettes must, prior to shipping the cigarettes, provide a written statement to the customer that advises the customer of age restrictions on the purchasing of cigarettes, confirms that the order was placed by the customer, advises the customer of health risks associated with smoking, and states that the sale is taxable under Ohio law. The merchant cannot proceed with the shipping of the cigarettes until the customer signs and returns the form to the merchant. If the merchant cannot independently confirm the purchaser's age using a federally or commercially available computer database, the purchaser must provide proof of the customer's age by sending the merchant a photocopy or other image of a valid government-issued identification. A customer who provides false information in connection with a delivery sale is subject to criminal prosecution for falsification, a misdemeanor of the first degree.

A merchant who is shipping cigarettes to a customer to whom the merchant has previously shipped cigarettes is not required to send the form and obtain the information described above. However, the merchant is required to verify that the information used by the merchant in the previous sale to confirm the customer's age remains valid.

Under the bill, a merchant that makes a delivery sale is required to either collect the sales tax due on the sale or to provide the customer with notice of the customer's obligation to remit sales tax with respect to the purchase. In either case, the merchant must provide the customer with a written statement of the amount of sales tax due on the sale.

The bill prohibits the delivery of cigarettes to any individual who appears to the party delivering the cigarettes to be under 27 years old without verifying that the customer is in fact 18 years of age or older using a driver's license or other identification card. All deliveries of cigarettes must be signed for at the time they are physically delivered to the customer.

Payment for delivery sales

(R.C. 5743.72(C) and (D))

The bill specifies that payment for a delivery sale must be made by check, credit card, or debit card issued in the name of the customer. The bill requires, further, that merchants submit to each credit or debit card company with which the merchant has sales such information as will result in the word "cigarettes" to be printed on the purchaser's credit or debit card statement.

Merchants to submit information pertaining to delivery sales to the Tax Commissioner

(R.C. 5743.74)

Before a merchant commences to make delivery sales, the merchant must provide the Tax Commissioner with a written statement containing the name of the merchant's business, its mailing address, the address of the merchant's principal place of business, and the addresses of each of the merchant's places of business in Ohio. A merchant must file with the Tax Commissioner a copy of the invoice for each delivery sale made to a customer in Ohio no later than the tenth day following the month in which the sale is made.

Tax Commissioner may impose penalties and seize and destroy cigarettes sold in violation of laws governing delivery sales

(R.C. 5743.75 and 5743.76)

The bill permits the Tax Commissioner to impose monetary penalties upon merchants for violating the laws governing Internet and mail order cigarette sales. The amount of the penalty that may be imposed by the Commissioner depends upon the nature of the violation and whether the violation is a repeat offense. The bill specifies that the Commissioner is to collect penalties by assessment in the same manner as the Commissioner collects cigarette taxes by assessment under continuing law. Penalties collected by the Commissioner are to be credited to the Cigarette Tax Enforcement Fund.

The bill also authorizes the Commissioner to seize cigarettes sold, or attempted to be sold, in violation of the laws governing Internet and mail order cigarette sales. The seized cigarettes are forfeited to the state upon seizure. The bill directs the Commissioner to destroy these cigarettes.

Use tax exemption for cigarettes

(R.C. 5743.33 and 5743.331; Section 612.27)

The bill exempts cigarettes a person uses, stores, or consumes in Ohio from the cigarette excise use tax, up to $300 worth per month (wholesale value). The exemption does not apply if the cigarettes are used or stored for resale. In effect, the exemption permits a person to purchase up to $300 worth of cigarettes outside Ohio and bring them back into Ohio without incurring any legal liability for the cigarette excise use tax. No excise tax report needs to be filed for such cigarettes. Under current law, cigarettes brought into the state are technically subject to the cigarette excise use tax. (The bill has a similar exemption from the general use tax, explained above in the Sales and Use Taxes section.)

The exemption takes effect July 1, 2005.

Transportation of untaxed cigarettes

(R.C. 5747.33)

Current law prohibits transporting within the state untaxed cigarettes having a wholesale value greater than $60 without the prior consent of the Tax Commissioner. The bill increases the wholesale value of untaxed cigarettes that may be transported without the Commissioner's prior consent to $300.

Beer sold in sealed bottles and cans

(R.C. 4301.42)

Under continuing law, a tax is levied on the sale of beer in sealed bottles and cans containing 12 or fewer ounces of liquid content. Currently, the tax is levied at the rate of fourteen one-hundredths (0.14) of one cent on each ounce or fractional part of an ounce of liquid content. The bill increases the tax to twenty-eight one-hundredths (0.28) of one cent.

Current law levies a tax on the sale of beer in sealed bottles and cans in excess of 12 ounces at the rate of eighty-four one-hundredths (0.84) of one cent on each six ounces of liquid content or fractional part of each six ounces of liquid content. The bill increases the tax to one and sixty-eight one-hundredths (1.68) cents.

Beer sold in containers other than sealed bottles and cans

(R.C. 4305.01)

Under current law, a tax is levied on the sale or distribution of beer in barrels or other containers that are not sealed bottles or cans at the rate of $5.58 per barrel of 31 gallons. The bill increases the tax to $11.16 per barrel.

Wine, mixed beverages, and cider

(R.C. 4301.43)

Current law levies a tax on the sale or distribution of wine containing at least 4% alcohol by volume but not more than 14% alcohol by volume at the rate of 30¢ per wine gallon. The bill increases the tax to 60¢ per wine gallon.

Under current law, a tax is levied on the sale or distribution of wine containing more than 14% alcohol by volume but not more than 21% alcohol by volume at the rate of 98¢ per wine gallon. The bill increases the tax to $1.96 per wine gallon.

Current law levies a tax on the sale or distribution of vermouth at the rate of $1.08 per wine gallon. The bill increases the tax to $2.16 per wine gallon.

Under current law, a tax is levied on the sale or distribution of sparkling and carbonated wine and champagne at the rate of $1.48 per wine gallon. The bill increases the tax to $2.96 per wine gallon.

Current law levies a tax on prepared and bottled highballs, cocktails, cordials, and other mixed beverages at the rate of $1.20 per wine gallon. The bill increases the tax to $2.40 per wine gallon.

Finally, under current law, a tax is levied on cider at the rate of 24¢ per wine gallon. The bill increases the tax to 48¢ per wine gallon.

Effective date of alcohol tax increases

(Section 612.27)

The alcohol tax increases take effect July 1, 2005.

VIII. Estate Taxes

Overview of the additional estate tax, generation-skipping tax, and the family-owned business deduction

Ohio's estate tax consists of four distinct levies: the basic tax, the additional estate tax, the generation-skipping tax, and the nonresident tax. The bill addresses the additional estate tax and the generation-skipping tax, in light of changes made in the federal estate tax law, which affects those two state taxes. The additional estate tax (R.C. 5731.18) is equal to the maximum credit allowed by federal estate tax law for paying state death taxes, while the generation-skipping tax (R.C. 5731.181) is equal to the federal credit for state taxes paid on generation-skipping transfers (of property to a person who is two or more generations below the transferor, such as from a grandparent to a grandchild). Both taxes, known as "sponge" taxes because they allow the state to absorb as much revenue from an estate as is permitted by the federal credits, are equal to the difference between state tax liability and the estate's federal credit. In effect, both sponge taxes allow Ohio to collect more tax from an estate without increasing the estate's combined federal/state tax liability, because federal tax liability is reduced by the amount of the additional estate tax and generation-skipping tax liability.

The bill also addresses the family-owned business deduction because of revisions made to the federal estate tax law, which greatly affects this deduction. Federal law permits estates to avoid federal estate taxes on any part of the estate consisting of family-owned businesses inherited by or passed to family members.

These family-owned business interests are deducted in computing the value of the estate that is subject to the federal estate tax. Ohio has a deduction modeled closely after this federal deduction, for the value of a family-owned business (including a farm) when computing the Ohio estate tax, to the extent the business is passed on to other family members. The state deduction may be claimed **only** if the federal deduction is claimed against federal estate tax liability.

Federal changes that have affected the state estate tax law

The federal "Economic Growth and Tax Relief Reconciliation Act of 2001" (the "Act") phased out the federal credits for paying state death taxes and state generation-skipping transfer taxes. These credits no longer apply, respectively, to estates of decedents dying after December 31, 2004, or to generation-skipping transfers made after that date. Under the Act's sunset clause, the credits are scheduled to be restored to their current forms in 2011, assuming Congress does not intervene before that year and repeal or revise the credits.

The Act suspended the federal deduction for family-owned business interests by providing that the deduction does not apply to estates of decedents dying after December 31, 2003. But, technically, the Act's sunset clause reinstates the deduction in 2011.

Constructive elimination of the additional estate tax and generation-skipping tax; repeal of the deduction for family-owned businesses

(R.C. 5731.01(F), 5731.14, 5731.18, and 5731.181; repeal of 5731.20; Sections 9 and 14)

The bill amends the additional estate tax and generation-skipping tax statutes by revising the references to the Internal Revenue Code (IRC) in them, thereby incorporating changes made by the Act. For purposes of the entire Ohio estate tax law, the bill defines the "Internal Revenue Code" to be the Internal Revenue Code of 1986, 100 Stat. 2085, 26 U.S.C.A. 1, as amended. Under an Ohio Supreme Court decision, *State v. Gill*, 63 Ohio St.3d 53 (1992), updating Ohio statutory references to federal law incorporates changes in the federal law occurring since the most recent amendment of the Ohio statute. Therefore, updating references to the IRC in Ohio's two sponge tax statutes has the effect of incorporating the federal Act's phase-out of the federal credit for paying state death taxes and state generation-skipping taxes. In other words, the bill constructively repeals Ohio's additional estate sponge tax and the generation-skipping sponge tax for decedents dying on and after the bill's effective date.

The bill repeals outright the Ohio estate tax deduction for family-owned businesses, since the Act revised federal law to suspend the federal deduction for family-owned business interests for estates of decedents dying after December 31, 2003.

These amendments and the repeal take effect immediately on the day the Governor signs the bill.

Temporary tax credit

(Section 3)

The bill grants a tax credit against the additional estate sponge tax to the estate of a decedent who dies on or after January 1, 2002, but before the effective date of the bill's changes. In effect, the credit retroactively gives those relatively few larger estates that are subject to the sponge tax the tax reduction they would have received if Ohio's law had reflected the phase-out of the federal credit for state estate taxes. Specifically, the credit equals the portion of the additional estate sponge tax that is over and above the sponge tax that would have been imposed if the tax had been equal to the maximum federal credit allowable for paying state estate taxes under the federal law that was in effect and applicable on the date of the decedent's death.

Additional amendments made to incorporate federal tax law changes

(R.C. 5731.01(B), (D), and (F), 5731.05(C), and 5731.131; Section 9)

The bill also revises all other IRC references in the Ohio estate tax law, with the effect of generally incorporating any applicable federal tax law changes made since the last time those state laws were amended. The actual effect of this incorporation is difficult to discern, but the substantive effect does not appear to be substantial.

These amendments take effect immediately on the day the Governor signs the bill.

IX. Other Taxation Provisions

Local Government Funds

(Section 557.12)

The bill reduces the amount of state tax revenue credited to the three state-local revenue sharing funds, and thus the amount of revenue available for distribution to counties, municipal corporations, townships, public library systems, and other special-purpose subdivisions receiving revenue sharing payments. The revenue sharing funds involved are the Local Government Fund (LGF), the Local

Government Revenue Assistance Fund (LGRAF), and the Library and Local Government Support Fund (LLGSF).

Current law

Under permanent law provisions that have been suspended since the beginning of fiscal year 2002, each of the funds was credited with a percentage of the state's major tax sources, including the income tax, sales and use tax, corporation franchise tax, public utility excise tax, and kilowatt-hour (kWh) tax. Under those suspended provisions, the LGF would have received 4.2% of revenue from those taxes (except the kWh tax) and the LGRAF would have received 0.6%; the LLGSF would have received 5.7% of the income tax. After the percentage of revenue was credited to those funds, the remaining revenue was credited to the state's General Revenue Fund (GRF). Beginning with fiscal year 2002, the percentages were suspended to reserve more of the revenue for the GRF. The revenue credited to the LGF, LGRAF, and LLGSF was fixed or "frozen" at their respective fiscal year 2001 levels.

Money in the LGF is distributed among counties, townships, municipal corporations (cities and villages), and some other special-purpose subdivisions (e.g., park districts) under a three-stage system. The bill does not affect how money is distributed among subdivisions, only the amount of money to be distributed. At the first stage, LGF money is divided into a municipal share (for municipal corporations levying an income tax) and a share for all subdivisions in a county participating in the county's LGF distribution. Under the "permanent" distribution formula as it operated before FY 2002, slightly less than 10% of the LGF was set aside for allocation only to municipal corporations levying an income tax, and the remaining 90% or so was allocated among all participating subdivisions in a county (including municipal corporations levying an income tax). This remaining subdivision allocation was then distributed under one of two formulas, with the formula yielding the higher payment for a county being applied to that county. Under either formula, the 90% subdivision share was divided into fourths, with three-fourths distributed in proportion to municipal taxable property value in the county and one-fourth distributed in proportion to county population. One formula added a third factor: the county's 1983 deposits tax revenue. Until 1983, counties received revenue from a tax on deposits held in the county at the rate of 1-3/8 mills per dollar of deposits. This second LGF formula ensured that each county received 145.45% of its 1983 deposits taxes (145.45% represents what the revenue would be if the deposits tax had been levied at a rate of two mills). The total of the counties' deposit tax portion was deducted from the counties' approximately 90% share of the LGF, and an additional $6 million was deducted. The remaining amount was then divided into fourths, with three-fourths distributed in proportion to municipal taxable property value in each county and one-fourth distributed in proportion to county population, as in the first formula.

The minimum distribution under either formula (disregarding the deposits tax portion) was $225,000 per county. Each county's share of the LGF was the higher of the two formula computations. The shares of all the counties were added together, and each county's amount was divided into the total to yield the county's percentage of the total county part of the LGF. There was a hold-harmless guaranteeing each county at least the amount it received in 1983.

In addition to a county's formula amount, each county receives five mills' worth of the eight-mill state tax on dealers in intangibles originating from dealers in that county (except certain dealers that are subsidiaries of financial institutions); this five-mill portion of the distribution is not affected by the bill. The sum of the formula amount and the five mill portion is then apportioned among the county and the townships, municipal corporations, and some special-purpose districts in the county. In almost all counties, the apportionment is based on a formula negotiated under the supervision of the county budget commission. In a few counties, the apportionment follows the statutory method, which apportions on the basis of relative "need" as defined by state law. Generally, need is measured by a subdivision's expenditures less its locally generated revenue.

The approximately one-tenth of the LGF allocated for municipal corporations levying an income tax is distributed in proportion to each municipal corporation's relative municipal income tax collections compared to total municipal income tax collections.

The pre-FY 2002 LGRAF distribution method was simpler than that of the LGF, and was based entirely on relative county populations. Each county received a percentage of the LGRAF equal to the county's percentage of Ohio's population. LGRAF distributions have been more or less frozen since the beginning of FY 2002.

The pre-FY 2002 LLGSF was distributed among counties for further distribution primarily to library systems in the county under a formula that essentially replaced the repealed intangible property tax revenue (repealed in 1986) and allowed for growth from that base amount on both an overall basis and on a per-capita basis. LLGSF distributions have been more or less frozen since the beginning of FY 2002.

Proposed reductions in LGF, LGRAF, and LLGSF

LGF and LGRAF

Deposits and distributions initially frozen, then reduced. The bill reduces the amount of state revenue credited to the LGF, LGRAF, and LLGSF in fiscal years 2006 and 2007. The reduction begins with deposits to those funds in December 2005; until then, the monthly deposits are frozen at the level for the corresponding month in FY 2005. The amount of money credited to the LGF and LGRAF in the first five months of FY 2006 is fixed or "frozen" at the amount distributed in the first five months of FY 2004, except for specified changes in deposits from the public utility excise tax and kilowatt-hour tax (which together account for less than 4% of the total deposits to the funds).

Beginning in December 2005, the amount credited to the LGF and LGRAF from their three major sources--income tax, sales and use tax, and corporation franchise tax, which account for about 96% of all deposits--is reduced below the frozen FY 2005 amount. The reduction in both LGF and LGRAF is 10% for the portion of LGF or LGRAF received by townships and villages; the reduction in LGF and LGRAF is 20% for cities, counties, and any other subdivisions receiving LGF or LGRAF money (except for townships and villages).

Any additional money required to pay for the township and village portion of LGF and LGRAF distributions is to be derived from the income tax.

A county's portion of LGF and LGRAF distributions increases by 10% if the county files a report with the Auditor of State on or before October 1, 2005, outlining past savings that have occurred from the consolidation of services or through regional cooperation and detailing future plans for the consolidation of services or additional or expanded regional cooperation. The bill requires that, on or before October 15, 2005, the Auditor of State notify the Tax Commissioner of which counties filed the report on or before the October 1, 2005, deadline.

More specifically, the report must describe the county's future plans with respect to consolidating services, including, but not limited to, consolidating fire, police, water, sewer, and solid waste services provided by the county. The report must describe any efforts already undertaken by the county to analyze how these future consolidation efforts would impact costs and effect existing collective bargaining agreements. If the county has yet to undertake such an analysis at the time the report is filed, the report must set forth a timeline for completing the analyses.

The report must also describe the county's future plans with respect to cooperating with one or more neighboring political subdivisions in the financing of operations that serve all of the subdivisions. The report also is to describe the county's future plans, if any, to cooperate with other political subdivisions in the consolidation of purchasing or construction functions.

The bill provides that the Auditor of State may use the report for informational purposes only. The Auditor of State has no authority under the bill to approve or disapprove any plan described by a county in its report.

Direct municipal distributions. The nearly 10% share of the LGF and LGRAF distributed directly to municipal corporations (i.e., cities and villages) levying an income tax is initially frozen and then reduced to reflect the freeze and reduction in the tax deposits into the LGF, except the reduction for villages is only 10%. Specifically, for each of the first five months of FY 2006, each municipal corporation entitled to a direct LGF distribution will receive the same amount it received in the corresponding month in FY 2005. Then, from January 2006 through July 2007, each village will receive 90% of its direct LGF distribution for CY 2005, and each city will receive 80% of its CY 2005 distribution.

LLGSF

Reductions also are made in the LLGSF. For the first five months of FY 2006, monthly deposits into the LLGSF are equal to the previously frozen amounts for the corresponding month in FY 2005. Then, beginning in December 2005, and extending through the end of the biennium, the monthly deposits are reduced by 5% from the previously frozen levels in FY 2005. In each month from August 2005 to July 2007, each county undivided fund will receive the same percentage of the LLGSF as it received in the corresponding month from August 2004 through July 2005. In other words, each county undivided fund will receive the same percentage of the total frozen and reduced amount credited to the LLGSF during the FY 2006-2007 biennium.

Job retention tax credit

(R.C. 122.171)

Authority to enter into agreements for job retention tax credits extended

Under continuing law, Ohio's Tax Credit Authority may enter into agreements with employers whereby the employer undertakes to retain Ohio jobs through a "capital investment project" in exchange for a tax credit against the corporation franchise tax or personal income tax. Under current law, the authority to enter into such agreements expires on June 30, 2007. The bill permits the Ohio Tax Credit Authority to continue entering into the agreements after this date.

Job retention tax credit: capital investment projects

Continuing law defines a "capital investment project" for which a job retention tax credit may be granted as an investment plan for a project site for the acquisition, construction, renovation, or repair of buildings, machinery, or equipment, or for the capitalized cost of research and product development. Eligibility for a job retention tax credit depends, in part, upon how much the employer has invested as part of the capital investment project. Under current law, project costs paid after December 31, 2006, are not to be included in computing investments in a capital investment project. The bill removes this restriction and makes project costs paid after that date part of the investments comprising a capital investment project.

County auditors authorized to use moneys in real estate assessment funds for estate tax enforcement

(R.C. 325.31 and 5731.41)

Each county treasury has within it a real estate assessment fund, the moneys in which are used by a county to defray costs associated with administering various taxes. Continuing law sets forth the specific purposes for which a county may use moneys in the fund.

The bill specifies that in addition to the purposes set forth in continuing law, counties may use moneys in real estate assessment funds to defray costs incurred in enforcing estate taxes. More specifically, the bill permits a county to use moneys in its fund to defray costs incurred in compensating estate tax enforcement agents who perform duties prescribed by the Tax Commissioner.

Reauthorization of municipal income tax sharing with school districts

(R.C. 718.09 and 718.10)

Between 1991 and the end of 2000, municipal corporations were permitted to enter into an agreement with an overlapping school district whereby the municipal corporation levied an income tax and shared at least 25% of the revenue with the school district. The tax had to be approved by voters of the municipal corporation. The municipal corporation and school district territory had to be at least 95% in common, or 90% in common if the remaining 10% of school district territory lay entirely within another municipal corporation with a population of 400,000 or more. A tax sharing agreement also could be made between a school district and two or more municipal corporations so long as the territory of the school district was at least 95% in common with all of those municipal corporations.

No such tax sharing agreements could be initiated after 2000, but any that existed by the end of 2000 could continue in effect. (According to the Department of Taxation, the City of Euclid and the Euclid City School District were the only municipal corporation and school district to have a tax sharing agreement in place when the authority was terminated.)

The bill permits municipal corporations to again levy income taxes to be shared with an overlapping school district under the same terms provided under the prior authority.

<u>Tax credits under the Ohio Venture Capital Program</u>

(R.C. 150.07, 150.10, 5707.031, 5725.19, 5727.241, 5729.08, 5733.49, and 5747.80)

<u>Credit extended to dealers in intangibles and public utilities</u>

Under the existing Ohio Venture Capital Program administered by the Ohio Venture Capital Authority, moneys in a "program fund" are invested in venture capital funds, which in turn invest in Ohio-based businesses that are in seed or early stages of development or established Ohio-based businesses that are developing new methods or technologies. The program fund is funded through investments from private investors. Some of the profits from the program are put into the Ohio Venture Capital Fund (OVCF), which is used to secure the private investors against losses. To the extent the moneys in the OVCF are not adequate to secure an investor against losses, the investor is eligible for a tax credit granted by the Authority.

Currently, the Authority is authorized to approve tax credits against only the income tax, corporation franchise tax, and insurance company franchise taxes. The bill authorizes the Authority to approve credits against two additional existing taxes--the dealers in intangibles tax and the public utility tax.

<u>Credit amounts</u>

Under continuing law, a taxpayer who receives approval from the Authority for a tax credit may elect to receive either a refundable or a nonrefundable credit. The bill clarifies the amount of credit that may be claimed for any given tax reporting period with respect to each of the taxes to which the credit can potentially apply.

Current law specifies that taxpayers who elect a refundable credit and whose tax liability for any given reporting period is less than the amount of the credit receive a refund equal to 75% of the amount by which the credit exceeds the tax liability. The bill clarifies that this 75% amount is in addition to the amount of tax against which the credit is applied for that reporting period.

The bill specifies, further, that to the extent a taxpayer's tax liability for any given reporting period exceeds the amount of refundable credit that the taxpayer is entitled to claim, the amount of credit to which the taxpayer is entitled is the full amount of refundable credit authorized by the authority.

Finally, the bill provides that for purposes of determining whether the amount of a refundable venture capital credit exceeds the taxpayer's tax liability with respect to any given reporting period, the amount of the credit is to be compared against the taxpayer's tax liability after deducting all nonrefundable credit that the taxpayer is entitled to claim for that tax reporting period.

Penalty for late payments and filings increased; change to rate applied to overpayments and underpayments of the estate tax

(R.C. 5703.47, 5731.22, and 5731.23)

Under current law, failure to timely file an estate tax return and pay the tax within nine months following a decedent's death results in a penalty, with interest accruing on the unpaid balance. If the tax paid is more than the amount of tax ultimately found to be due, the estate is entitled to interest on the overpayment. The overpayment and interest must be refunded by the cities, villages, or townships that received the overpayment, as well as from the state's general revenue fund, on a pro rata basis. Interest accrues from nine months from the date of the decedent's death or the date the tax is paid, whichever is later, to the date the overpayment is refunded.

Interest

Under current law, the rate of interest accruing on unpaid taxes, and paid on estate tax overpayments, is equal to three percentage points above the "federal short-term rate," which is a rate computed on the basis of an index of yields on short-term U.S. government securities.

The bill reduces the rate of interest that accrues on unpaid estate taxes and on estate tax overpayments. Instead of accruing at the "statutory" rate equal to the federal short-term rate plus 3%, interest will accrue at the federal short-term rate.

Penalties

Current law imposes a penalty for not paying or filing estate taxes on time equal to 5% of the tax due if the payment or filing is made within one month of the due date. If the payment or filing is more than one month late, an additional 5% is added for each additional month for up to four months, so the cumulative penalty cannot exceed 25% of the tax due. The penalty does not apply if the estate's representative shows that the late payment or filing is due to reasonable cause and not willful neglect. Also, in cases of fraud, current law requires the Tax Commissioner to impose an additional penalty of up to $10,000.

The bill changes the estate tax penalty so that it equals 10% of the unpaid tax regardless of how late the payment or filing occurs. The bill also eliminates the up-to-$10,000 additional penalty in cases of fraud.

Waiving penalties

Current law authorizes the Tax Commissioner to waive or "remit" the 5%-per-month penalty if an estate's representative shows that the late payment or filing is due to reasonable cause and not willful neglect.

The bill removes this remission authority from the Tax Commissioner and instead vests it in county auditors. Specifically, a county auditor may remit a penalty if the estate's representative applies for remission and shows that the lateness of the payment or filing is due to reasonable cause and not willful neglect. A county auditor may remit a penalty only after consulting with the county treasurer. Once the county auditor decides whether to remit a penalty, the auditor must notify the estate's representative of the decision by mail. If remission is denied, the representative may appeal the decision by applying to the Tax Commissioner, either in person or by certified mail, within 60 days after the auditor mails notice of the decision. Once the Tax Commissioner decides on the appeal, the Commissioner must notify the representative, the county auditor, and the county treasurer. If the Commissioner's decision necessitates any correction in the county estate tax records, the county auditor and treasurer must correct the records accordingly. An estate representative who appealed to the Commissioner may appeal the Commissioner's decision by filing an exception with the probate court having jurisdiction over the estate in the same manner in which exceptions may be filed under current law from other determinations by the Commissioner regarding the tax on the estate (see R.C. 5731.30).

The bill authorizes the Tax Commissioner to issue orders and instructions for implementing the bill's remission provisions, and requires county auditors and treasurers to follow those orders and instructions.

Technical correction

(R.C. 5731.23)

The bill corrects a longstanding error in a statute governing estate tax payments. In 1971, Am. Sub. 413 of the 109th General Assembly (134 Ohio Laws 821, 822-823), removed language regarding discounts for early estate tax payments, but failed to remove related language stating that early payments should be paid on an estimated basis regardless of whether a return has been filed. The bill removes this related language to correct the error.

The motor fuel use tax

(R.C. 5728.01, 5728.02, 5728.03, 5728.04, 5728.06, and 5728.08)

The fuel use tax is levied on the amount of motor fuel consumed by commercial cars and commercial trucks in Ohio, when the fuel was purchased outside Ohio. Currently, the tax is equal to the same amount as the motor fuel tax, plus 2¢ per gallon. On and after July 1, 2005, the 2¢ per gallon surcharge is eliminated, and the use tax equals the same amount as the motor fuel tax. Payment of the fuel use tax is made by purchasing in Ohio the same amount of motor fuel as is consumed while operating commercial cars or trucks on Ohio's highways, or by direct payment to the Treasurer of State with a fuel use tax return. Every person liable for the tax must annually file a fuel use permit or a single-trip fuel use permit with the Tax Commissioner.

The bill provides that a person must obtain a fuel use permit only if operating a commercial car or commercial tractor upon public highways in two or more states (including the District of Columbia and Canada). This would eliminate the requirement that commercial cars or tractors operating intrastate file a fuel use permit. The bill also provides that the prohibition of operating a commercial car or commercial tractor without a fuel use permit or single trip fuel use permit does not apply if the car or tractor is operated intrastate.

Continuing law imposes the motor fuel use tax on three-axle commercial cars, commercial cars with two axles operated as part of a commercial tandem having a weight exceeding 26,000 pounds, or commercial tractors. The bill adds "regardless of weight" to the three-axle commercial cars, and provides that the tax is on two-axle commercial cars having a weight exceeding 26,000 pounds operated alone or as part of a commercial tandem.

Under current law, farm trucks with low fuel usage may file a return and pay the tax annually. The bill eliminates this requirement. Instead, the fuel use tax must be paid quarterly the same as other commercial cars or commercial tractors.

Taxpayer audits

(R.C. 5703.50)

Under current law, various rights are granted to taxpayers that become effective when a taxpayer is subjected to an audit by the Department of Taxation or a county auditor, including the right to receive information about the Department's role in the audit and the taxpayer's right to be represented or accompanied by an attorney, accountant, tax professional, or other competent advisor. (The rights are set forth in R.C. 5703.51.) What constitutes an "audit," and therefore what invokes a taxpayer's rights, is specifically defined by current law: "audit" means the examination of a taxpayer or the inspection of the taxpayer's books, records, memoranda, or accounts for the purpose of determining tax liability. Current law, unchanged by the bill, requires that the Department notify a taxpayer when an audit is considered to have begun.

The bill changes the definition of "audit," and therefore what activity invokes a taxpayer's rights under an audit. The bill defines "audit" as a visit by an employee of the Department of Taxation to one or more of the taxpayer's business locations or other locations designated by the taxpayer to inspect the taxpayer's books, records, memoranda, or accounts for the purpose of determining tax liability. "Audit" does not include being served an assessment (i.e., formal notice of outstanding liability) or any other type of document or notification, and does not include an investigation by an enforcement agent or other Department employee to verify that a taxpayer has the appropriate license or registration, to conduct a test purchase, or to conduct a "similar" investigation.

Pass-through entity tax law: technical and conforming changes

(R.C. 5733.40; Section 557.27)

A withholding tax currently is imposed on distributive shares held by nonresident investors in pass-through entities (e.g., partnerships, limited liability companies, S corporations) that have a taxable business presence in Ohio. The tax helps ensure satisfaction of the investors' Ohio tax liabilities, especially if they lack any tax-related connection with Ohio other than their ownership of an entity doing business in Ohio. The tax is imposed on the entity on the basis of the nonresident investors' respective tax liabilities to Ohio (whether corporation franchise or personal income, depending on the status of the investor). In computing the amount of tax to be withheld, the entity's expenses and losses paid to a related entity are apportioned to Ohio under the weighted three-factor formula (sales, property, and payroll). In computing a nonresident investor's individual tax and the corresponding nonresident credit, only compensation expenses paid to a related entity are apportioned.

The bill ensures that all expenses a pass-through entity pays to a related entity are apportioned for the purposes of both the withholding tax and computing the nonresident investors' individual tax and the corresponding nonresident credit.

The bill also expressly provides that, for the purposes of the pass-through entity tax, a nonresident investor's distributive share of a pass-through entity (which is the basis for measuring the withholding tax on account of the investor) includes income amounts from a qualified subchapter S subsidiary ("QSSS"). A QSSS is a wholly-owned subsidiary of an S corporation that is treated for federal tax purposes as not being separate from the parent S corporation. The bill's treatment of QSSS distributive shares under the pass-through entity tax is consistent with the current treatment of distributive shares of a "disregarded entity," which is a company owned by a parent company but not treated as separate from the parent for tax purposes (e.g., a limited liability company with but a single member).

Tax Commissioner authorized to require identifying information from persons filing tax documents with the Department of Taxation

(R.C. 5703.057, 5703.26 (not in the bill), and 5703.99 (not in the bill))

Overview

The bill authorizes the Tax Commissioner to require any person filing a tax document with the Department of Taxation to provide identifying information requested by the Commissioner, including the person's social security number, federal employer identification number, or other identification number requested by the Commissioner. A person who is required to provide identifying information is required to notify the Commissioner of any changes with respect to that information prior to, or at the time of, filing the next tax document requiring identifying information. The bill states that the Tax Commissioner is being granted authority to request identifying information in order to increase the efficiency with which the Commissioner administers taxes and fees.

Confidentiality of social security numbers

The bill requires that the Commissioner maintain the confidentiality of individuals' social security numbers. Specifically, the bill provides that when transmitting or otherwise making use of a tax document that contains a person's social security number, the Commissioner is to take all reasonable measures necessary to ensure that the general public is unable to view the number. The bill directs the Commissioner to mask social security numbers when necessary to maintain their confidentiality.

Commissioner may impose penalties for failure to provide or update identifying information

The bill permits the Commissioner to impose penalties for failures to provide identifying information. If the Commissioner requests identifying information from a person and the person does not respond by providing valid identifying information within thirty days after the request is made, the Commissioner may impose a penalty upon that person of up to $100. If, after the expiration of the initial 30 day period, the Commissioner makes one or more subsequent requests for identifying information, and valid identifying information is not provided to the Commissioner within 30 days after the Commissioner makes the subsequent request, the Commissioner may impose an additional penalty of up to $200 for each subsequent request that a person fails to comply with in a timely fashion. The bill provides, further, that if a person required to provide identifying information fails to notify the Commissioner of a change with respect to that information within 30 days after filing the next tax document requiring the identifying information, the Commissioner may impose a penalty upon that person of up to $50.

Under the bill, penalties imposed by the Commissioner may be billed and assessed by the Commissioner in the same manner as the tax or fee with respect to which the Commissioner seeks the identifying information. The bill specifies that the penalties are in addition to any applicable criminal penalties and any other penalties that the Commissioner is authorized by law to impose.

Criminal penalties

Continuing law makes it a criminal offense to file a false or fraudulent document with the Department of Taxation with the intent to defraud the state or any of its political subdivisions. Violation of this criminal prohibition constitutes a felony of the fifth degree, which is punishable by six to 12 months of confinement and a fine of up to $5,000, upon which a court may impose an additional fine of up to $7,500. The bill specifies that the criminal prohibition for filing false or fraudulent tax documents with intent to defraud applies with respect to tax documents containing false or fraudulent identifying information.

Temporary tax amnesty program

(Section 553.01)

Program description

The bill requires that the Tax Commissioner administer a temporary tax amnesty program from November 1, 2005, to December 15, 2005, with respect to delinquent state taxes, tangible personal property taxes, county and transit authority sales taxes, and school district income taxes. The Commissioner is required to conduct the program between November 1, 2005 and December 15, 2005. The program applies only to taxes that were due and payable as of May 1, 2005, which were unreported or underreported, and which remain unpaid on the date on which the program commences. The program does not apply to any tax for which a notice of assessment or audit has been issued, for which a bill has been issued, or for which an audit has been conducted or is pending.

If, during the program, a person pays the full amount of delinquent taxes owed by the person and one-half of any interest that has accrued on the taxes, the Commissioner is required to waive all applicable penalties and the other one-half of any interest that accrued on the taxes. The bill authorizes the Commissioner to require a person participating in the program to file applicable returns or reports, including amended returns or reports. Persons owing tangible personal property taxes are required to file a return with the Commissioner listing all taxable personal property not previously listed by the person on a tangible personal property tax return.

In addition to receiving a waiver of penalties and one-half of accrued interest, a person who participates in the program is immune from criminal prosecution or any civil action with respect to the taxes paid through the program. The bill specifies, further, that no assessment may be issued against any person with respect to a tax paid through the program.

The bill requires that the Commissioner issue forms and instructions for the program, and the Commissioner is authorized to take any other actions necessary to implement the program. The bill directs the Commissioner to publicize the program so as to maximize public awareness of the program and participation in it.

Distribution of taxes collected under the program

Generally, taxes and interest collected under the program will be credited to the General Revenue Fund. However, any tax collected under the program that a taxing district would have received had the tax been timely paid is distributed to that taxing district.

State reimbursement for $10,000 business property exemption

Continuing law exempts the first $10,000 of a business' tangible personal property from property taxation (R.C. 5709.01(C)(3)). Currently, the state reimburses local taxing districts for the resulting revenue reduction.[13] The bill specifies that taxing districts will not be reimbursed for the amounts by which the exemption reduces tangible personal property taxes collected under the program.

HISTORY

ACTION	DATE	JOURNAL ENTRY
Introduced	01-18-05	p. 34

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[13] *The reimbursement for the $10,000 exemption is being phased out over the next several years. Under the bill, the reimbursement is scheduled to be completely phased-out by 2009 (see "**Accelerate phase-out of state reimbursement for $10,000 business property exemption**" above).*