Ohio Legislative Service Commission

Bill Analysis

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H.B. 510

129th General Assembly
(As Introduced)

Rep. Amstutz

BILL SUMMARY

- Replaces the existing taxes on financial institutions and dealers in intangibles with a new business-privilege tax on both classes of businesses, beginning with tax year 2014.

- Imposes the tax on the basis of the total equity capital in proportion to the taxpayer's gross receipts sitused in Ohio, with situs based on where a taxpayer's customers are deemed to benefit from the taxpayer's services.

- Sets the initial tax rate at 0.8% on the first $500 million in apportioned total equity capital and 0.25% on apportioned total equity capital in excess of $500 million, subject to adjustment after the first year if the revenue generated by those rates exceeds or falls below 10% of the "target" revenue of $225 million for 2014.

- Sets the minimum annual tax at $1,000.

- Requires financial institutions to report and pay the tax on a consolidated basis with related companies (both bank and nonbank), with the consolidation based on which entities are included in regulatory reports to federal authorities or, for institutions not subject to such federal regulatory jurisdiction, on the basis of majority ownership or control; liability for the tax is joint and several among the institutions included in a consolidated reporting group.

- Permits taxpayers subject to the new tax to claim the following tax credits if the taxpayer otherwise qualifies: job creation, job retention, venture capital loan loss, historic building rehabilitation, New Markets, and motion picture production tax credits, and the credit for regulatory assessments paid to the Department of Commerce's Division of Financial Institutions.

- Provides for how the tax is to be paid, reported, enforced, and administered.
- Provides a refundable personal income tax credit to individuals, estates, and trusts that own a pass-through interest in a financial institution that pays the Financial Institutions Tax to offset their pass-through share of that tax.
- Authorizes businesses subject to the CAT to claim the motion picture production tax credit against that tax.

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Financial Institutions Tax

Overview

The bill enacts a new tax for companies that currently are subject to the corporation franchise tax (primarily banks and other corporations classified as financial institutions) or the tax on "dealers in intangibles" (e.g., mortgage brokers, stockbrokers, finance and loan companies that are not classified as financial institutions). The tax would first apply to tax year 2014; the first tax payment, one of three estimated tax payments for tax year 2014, would be payable by August 15, 2013.

All revenue from the new financial institution tax is to be credited to the General Revenue Fund.[1]

In effect, the tax replaces the corporation franchise tax[2] and the dealers in intangibles tax.[3] The corporation franchise tax currently is imposed on financial institutions, bank holding companies, financial holding companies, savings and loan holding companies, affiliates of any of those if the affiliate is majority-owned or -controlled by any of the foregoing (directly or indirectly) and if the affiliate is engaged in a business considered by the Federal Reserve Board to be financial in nature or incidental thereto. The franchise tax also applies to any company that solely facilitates or services securitizations (i.e., transfers of assets to a third person that issues securities backed by the right to receive payment from the asset – e.g., selling loans to a person that packages loans into securities offered in a secondary market). The franchise tax is levied on the basis of net worth (capital, surplus, undivided profits, and reserves apportioned on the basis of various business presence factors, and excluding, among other items, goodwill, appreciation, and abandoned property). The rate of the tax is 1.3%. All the revenue from the franchise tax is credited to the General Revenue Fund.

The dealer in intangibles tax is levied on the basis of a dealer's shares and capital at a rate of 0.8%. Revenue from the tax is credited to the General Revenue Fund.

The bill terminates both the corporation franchise tax and the dealers in intangibles tax at the end of 2013.

Taxpayers

The tax is imposed on "financial institutions" organized for profit and doing business in Ohio "or otherwise having nexus in or with this state under the Constitution of the United States."[4] Financial institutions are defined for the purposes of the tax as either bank organizations or nonbank organizations. Bank organizations are defined to

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[1] The new tax's revenue would not affect current law's distribution of state tax revenue to the Local Government Fund or the Public Library Fund. Under current law (R.C. 131.51), the amount of money to be credited to each of those funds after FY 2013 is fixed at the proportion of tax revenue credited to each fund in FY 2013. But the new tax will not produce revenue until after FY 2013.

[2] R.C. Chapter 5733.

[3] R.C. 5707.03 and 5725.13 through 5725.17.

[4] It is not clear what the scope and extent of the taxable nexus is under the federal constitution for a business privilege tax levied on the basis of equity capital apportioned on the basis of gross receipts assigned to the place where the taxpayer's customers are deemed to receive the benefit of the taxpayer's services.

include the same classes of institutions that are currently subject to the corporation franchise tax. Holding companies of bank organizations also are classified as financial institutions subject to the tax. Nonbank organizations are substantially the same kinds of businesses that currently are classified as dealers in intangibles for the purposes of the existing tax on such dealers.[5]

Credit unions, insurance companies, and institutions organized under the Federal Farm Loan Act (or a successor) are not bank organizations subject to the new tax (and are not subject to the existing franchise tax).[6] Organizations that do not qualify as financial institutions are subject to the commercial activity tax.[7]

Tax base

The tax is levied on the "total Ohio equity capital" of financial institutions. Under the bill, a financial institution's total equity capital includes all of its equity components, including common stock, perpetual preferred stock, surplus, retained earnings, treasury stock, unearned employee stock ownership plan shares, and accumulated other comprehensive income.

"Total Ohio equity capital" is the portion of the financial institution's total equity capital that is apportioned to Ohio under the bill. The apportionment is based on the proportion of the taxpayer's gross receipts (generally, its total income without deduction for expenses) that can be apportioned to Ohio. Specifically, gross receipts are apportioned to Ohio in proportion to the benefit from services that the taxpayer's customers receive in this state as compared to the benefit from services that all of the taxpayer's customers receive everywhere. The Tax Commissioner must adopt administrative rules to provide additional guidance. The physical location where a customer ultimately receives the benefit is deemed "paramount" in determining where the proportion of benefit is received.[8] The Tax Commissioner, with or without the request of the taxpayer, may apply an alternative situsing method to the taxpayer if the

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[5] This definition includes "qualifying dealers in intangibles" that, under current law, are members of a group of companies related though majority common ownership that also includes a financial institution.

[6] R.C. 5726.01.

[7] R.C. 5711.22, 5751.01, 5751.011, and 5751.012; Section 4.

[8] This situsing method is substantially the same as the one prescribed for most services under the commercial activity tax. See R.C. 5751.033(I).

statutory method does not fairly represent the extent of taxpayer's business activity in Ohio.[9]

Tax rate

The tax rate is two-tiered: a rate of 0.8% applies to the first $500 million of a taxpayer's total Ohio equity capital, and a rate of 0.25% applies to the amount of total Ohio equity capital in excess of $500 million. If, based on these rates, a taxpayer's liability does not exceed $1,000, the taxpayer must instead pay a minimum tax of $1,000.

The bill provides for a rate adjustment mechanism that applies if revenue from the new tax in the 2014 tax year (the first year the tax is levied) is more than 110% or less than 90% of a target revenue amount of $225 million. If revenue exceeds 110% of the target revenue amount, the Tax Commissioner must decrease the tax rates for 2015 and subsequent years to the extent that the rates generated revenue above the 110% threshold. For example, if 2014 revenue exceeds the $225 million target by 15%, the rates for 2015 and thereafter would be computed to be the rates that would have raised 10% more than the target (i.e., $247.5 million). If the 2014 rates generate less than 90% of the target (i.e., less than $202.5 million), the rates for 2015 and thereafter would be adjusted upward to the rates that would have raised $202.5 million. In either case, both of the rate tiers would be adjusted by an equal percentage.[10]

Tax reporting

Each financial institution subject to the tax must file an annual report by March 31 of the tax year. If two or more financial institutions are related by ownership or control in such a way that they are required to be included in the same report to federal regulatory authorities (e.g., Federal Reserve Board), they must file the annual report and pay the tax as a consolidated group composed of all such institutions.[11] For this purpose, the federal reports are the FR-Y9 that holding companies must file with the Federal Reserve Board (and related versions of that form) and the "call report" (or consolidated reports of condition and income) that certain kinds of financial institutions must file with their respective regulatory agencies and as prescribed by the Federal Financial Institutions Examination Council. Both reports are filed on a consolidated basis. If an institution is included in both an FR-Y9 and a call report, that institution

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[9] R.C. 5701.12, 5726.01(N) and (O), 5726.04, and 5726.05.

[10] R.C. 5726.04.

[11] Under the new tax, all members of such a group would collectively be a "financial institution" and a taxpayer, so references to a financial institution or a taxpayer usually refer to the group, not individual institutions.

must be included in the annual report with the group for which the FR-Y9 is filed and excluded from the group for which the call report is filed. If a financial institution is not included in an FR-Y9 or a call report (i.e., it is a nonbank organization) but is part of a majority-owned or -controlled group of other nonbank organizations, the group must file an annual report on a consolidated basis.

The member of any consolidated group that is required to file the annual report on behalf of the whole group is the "reporting person." In the case of FR-Y9 filers, the reporting person is the top-tier holding company required to file the FR-Y9. In the case of call report filers, the entity required to file the call report is the reporting person. And in the case of a group of nonbank financial organizations, the entity that owns or controls the majority of ownership interests in the other members of the group must file the annual report if it is also a nonbank financial organization; if it is not, the group must select its reporting person from among the nonbank financial organizations in the group.[12]

Tax payments

The annual tax payment is due by March 31 of the tax year. Estimated payments are due on the preceding August 15, November 15, and February 15. The August payment must equal either the minimum $1,000 tax or one-third of the estimated annual tax, whichever is greater. The November payment must equal one-half of the remaining balance of the estimated annual tax after subtracting the amount of the August payment. The remaining February payment must equal the other remaining one-half. Any reconciliation is made with the March 31 remittance. Payments must be made by electronic funds transfer unless a taxpayer's annual tax liabilities for two consecutive years are each less than $50,000. Electronic payments must be made in a manner substantially the same as is currently required under the corporation franchise tax, and the conditions for penalizing failure to comply are substantially the same.[13]

Tax credits

The bill authorizes the following tax credits to be claimed by taxpayers subject to the new tax if the taxpayer otherwise qualifies for the credit under the specific terms of the credit as provided in the sections and chapters noted: job creation,[14] job retention,[15]

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[12] R.C. 5726.04.

[13] R.C. 5726.03 and 5726.06.

[14] R.C. 122.17 and 5726.50.

[15] R.C. 122.171 and 5726.50.

venture capital loan loss,[16] historic building rehabilitation,[17] New Markets,[18] and motion picture production tax,[19] and the credit for regulatory assessments paid to the Department of Commerce's Division of Financial Institutions.[20]

The bill does not address whether financial institutions or dealers in intangibles that currently are entitled to claim any of the nonrefundable credits may carry their existing credit over to the new tax, or whether an existing tax credit agreement is applicable to the new tax.

Administration and enforcement

The bill includes provisions for the administration and enforcement of the new tax that are substantially the same as similar provisions under the existing corporation franchise tax, as follows, except as noted otherwise:

- Penalties for failure to report or pay the tax as required by law.[21]
- Interest on unpaid taxes, including on underpaid estimated taxes, and on refund payments.[22]
- Provisions for issuing assessments to collect unpaid tax, penalty, or interest, except the statute of limitations on issuing an assessment for the new tax is four years instead of three.[23]
- Provisions for obtaining refunds of tax overpayments, except the statute of limitations on applying for a refund of the new tax is four years instead of three.[24]

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[16] R.C. Chapter 150. and 5726.53.

[17] R.C. 149.311 and 5726.52.

[18] R.C. 5725.33 and 5726.54.

[19] R.C. 122.85 and 5726.55.

[20] R.C. 5726.51.

[21] R.C. 5725.21.

[22] R.C. 5726.07 and 5726.32.

[23] R.C. 5726.32.

[24] R.C. 5703.052, 5703.053, 5703.70, 5726.30, and 5726.31.

- Provisions for cancelling the authority of noncompliant business to continue doing business in Ohio, including through a quo warranto action, and for reinstatement of such businesses.[25]

- Provisions for companies that discontinue doing business in Ohio to notify the Tax Commissioner.[26]

Municipal taxing authority

The bill specifies that municipal corporations may not levy a tax that is "the same as or similar to" the new financial institutions tax.[27] Current law prohibits municipal corporations from levying most of the kinds of taxes the state currently levies (the income tax being the major exception). If there were no such prohibition, municipal corporations would be authorized to levy taxes under their home rule authority, without authorization from the General Assembly.[28]

State retirement system investment managers and agents

Current law requires that, to qualify as an investment manager or agent for any of the state's five public employee retirement systems, a person must be subject to the dealers in intangibles tax, insurance company tax, the corporation franchise tax, or the personal income tax. The bill adds the new financial institutions tax as a qualifying tax.[29]

Offsetting personal income tax credit

The bill permits an individual, estate, or trust that owns a pass-through interest in a financial institution (e.g., owns a membership share of a dealer in intangibles organized as a limited liability company) to claim a credit against the personal income tax that offsets the owner's share of the financial institution's FIT tax payments. The owner may claim a refundable credit equal to the owner's proportionate share of the lesser of the Financial Institution Tax due or paid in a taxable year.

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[25] R.C. 5726.40 through 5726.43.

[26] R.C. 5726.36.

[27] R.C. 715.013.

[28] The doctrine of implied pre-emption was abandoned by the Ohio Supreme Court in 1998. Before then, if the state levied a certain kind of tax, municipal corporations were held to be impliedly pre-empted from levying the same kind of tax unless the General Assembly expressly authorized them to levy the tax.

[29] R.C. 145.114, 145.116, 742.114, 742.116, 3307.152, 3307.154, 3309.157, 3309.159, 5505.068, and 5505.0610.

For the purposes of determining the amount of the credit to which a taxpayer is entitled, the taxpayer must follow federal tax law principles governing the allocation of proportionate interests among partners of a partnership and beneficiaries of a trust.[30]

The bill requires a person receiving such a credit to add the amount of the credit to its income for personal income tax purposes to the extent that the credit has been deducted in computing that income.[31]

Motion picture production credit

The bill authorizes businesses subject to the commercial activity tax to claim the motion picture production credit that currently is available to persons subject to the personal income tax and to corporations regardless of whether a corporation is subject to the corporation franchise tax. The credit is a refundable credit equal to a percentage of Ohio production expenditures made by a motion picture production company. Currently, corporations that qualify for the credit may claim a "credit" against the corporation franchise tax, although nonfinancial corporations currently are not subject to the tax. In effect, nonfinancial corporations are not receiving a credit against a tax liability, they are receiving a direct payment from the General Revenue Fund. Under the bill, they would apply the credit against their CAT liability.[32]

Tax levy

Though the new Financial Institutions Tax is not imposed until 2014, the act defines a tax levy within the meaning of Article II, Section 1d, of the Ohio Constitution and therefore the provisions of law take effect immediately when it becomes law.

HISTORY

ACTION	DATE
Introduced	04-12-12

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[30] Internal Revenue Code Subtitle A, Subchapters J and K.

[31] R.C. 5747.01(A)(16) and (S)(11).

[32] R.C. 122.85 and 5751.54.