Ohio Legislative Service Commission

Bill Analysis

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Sub. H.B. 510*

129th General Assembly

(As Reported by H. Ways & Means)

Rep. Amstutz

BILL SUMMARY

- Replaces the existing taxes on financial institutions with a new business-privilege tax on financial institutions, beginning with tax year 2014.
- Eliminates the existing dealers in intangibles tax and imposes the existing commercial activities tax on dealers in intangibles except dealers that are affiliates of financial institutions.
- Exempts a financial institution's noncontrolling minority interests in other companies from the financial institution tax base unless the interest is itself a financial institution.
- Imposes the financial institutions 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 $200 million in apportioned total equity capital, 0.4% for each dollar of apportioned equity capital greater than $200 million and less than or equal to $1.3 billion, and 0.25% on apportioned total equity capital in excess of $1.3 billion, subject to adjustment after the first and third year if the revenue generated by those rates exceeds or falls below 10% of the "target" revenue of $200 million for 2014 or 1.06% of any adjusted amount for 2016.
- Sets the minimum annual tax at $1,000.

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* This analysis was prepared before the report of the House Ways and Means Committee appeared in the House Journal. Note that the list of co-sponsors and the legislative history may be incomplete.

- 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; 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, research and development, and motion picture production tax credits, and the credit for regulatory assessments paid to the Department of Commerce's Division of Financial Institutions and for qualifying (i.e., affiliated) dealers in intangibles.

- 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.

- Excludes from the financial institution tax, and subjects to the commercial activity tax, "grandfathered unitary" and "diversified" savings and loan holding companies and such companies' affiliates that are not banking organizations.

- Allows certain holding companies' affiliates that are recipients of a Job Retention Tax Credit to claim the credit against any other allowable taxes in a sequential order despite any agreement or terms to the contrary, and allows related companies to claim the credit against any such taxes.

- Prohibits the Commissioner from assessing affiliates of an insurance company for unpaid commercial activities tax before 2014, provided one of the company's affiliates paid the corporation franchise tax.

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CONTENT AND OPERATION

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) and generally subjects "dealers in intangibles" (e.g., mortgage brokers, stockbrokers, finance and loan companies that are not classified as financial institutions) to the commercial activities tax (CAT). The new tax would first apply to tax year 2014.

All revenue from the new financial institution tax (FIT) 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

[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.

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 FIT 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." Financial institutions are defined for the purposes of the tax as bank organizations. Bank organizations are defined to include the same classes of institutions that are currently subject to the corporation franchise tax. Holding companies of bank organizations, except for diversified savings and loan holding companies and unitary grandfathered savings and loan holding companies, also are classified as financial institutions subject to the tax.

Under the bill, dealers in intangibles are subject to the CAT unless the dealer is affiliated with a financial institution in such a way that it is included. A dealer affiliate is subject to the FIT as part of its parent financial institution's reporting group.

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).[4] Organizations that do not qualify as financial institutions under the bill are subject to the commercial activity tax.[5]

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. It excludes the equity of any noncontrolling minority interests in consolidated subsidiaries that are not themselves financial institutions.

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[4] R.C. 5726.01.

[5] R.C. 5711.22, 5751.01, 5751.011, and 5751.012.

"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. The apportionment factor is a fraction, the numerator of which is the total gross receipts of a financial institution in Ohio during the taxable year and denominator of which is the total gross receipts of the financial institution everywhere during the taxable year. 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.[6] The bill provides several illustrations of how specified types of receipts are to be apportioned to Ohio. For example, receipts from a financial institution's investment and trading assets and activities, including interest and dividends, are sitused to Ohio in proportion to the institution's Ohio customer base. Other examples include various kinds of receipts from loans, credit cards, and leases.

A financial institution, for the purpose of calculating the apportionment factor, is required to use the institution's method of accounting for income tax purposes, and if the institution's method of accounting for income tax purposes changes, then the institution must change accordingly its method of accounting for the apportionment factor.

The Tax Commissioner, with or without the request of the taxpayer, may apply an alternative situsing method to the taxpayer if the statutory method does not fairly represent the extent of taxpayer's business activity in Ohio.[7]

Tax rate

The tax rate is three-tiered: a rate of 0.8% applies to the first $200 million of a taxpayer's total Ohio equity capital, a rate of 0.4% applies to the amount of total equity capital greater than $200 million and less than or equal to $1.3 billion, and a rate of 0.25% applies to the amount of total Ohio equity capital in excess of $1.3 billion. 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.

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[6] 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).

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

The bill provides for a rate adjustment mechanism that applies if revenue from the new tax for the 2014 tax year is more than 110% or less than 90% of a target revenue amount of $200 million for 2014 or, for 2016, more than 110% or less than 90% of $212 million (or 1.06% of any amount adjusted from 2014). If, in 2014, revenue exceeds 110% of the target revenue amount (i.e., is more than $220 million), the Tax Commissioner must decrease the tax rates by an equal percentage across all three tiers for 2015 and subsequent years to the extent that the rates generated revenue above the target amount. If the 2014 rates generate less than 90% of the target amount (i.e., less than $180 million), only the 0.25% rate for equity capital in excess of $1.3 billion for 2015 and thereafter would be adjusted upward to the rate that would have raised $180 million. The same adjustment mechanism would occur during tax year 2016, with the same consequences for year 2017 and thereafter if the revenue deviated from the 2016 target amount of $212 million or 1.06% of any amount adjusted from 2014.[8]

Tax reporting

Each financial institution subject to the FIT must file an annual report by March 31 of the tax year, unless granted an extension by the Tax Commissioner. 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.[9] 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 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.

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

[8] R.C. 5726.04.

[9] 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.

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.[10]

Tax payments

The annual tax payment is due by March 31 of the tax year. The Tax Commissioner may extend the period of time for filing an annual report up to the 15th day of the month following the due date for filing the federal corporate income tax return, including extensions, which is currently October 15.[11] Estimated payments are due on January 31, March 31, and May 31 of that tax year. The January payment must equal either the minimum $1,000 tax or one-third of the estimated annual tax, whichever is greater. The March payment must equal one-half of the remaining balance of the estimated annual tax after subtracting the amount of the January payment. The remaining May payment must equal the other remaining one-half. The amount of estimated tax is based on the amount of the taxpayer's "qualifying net tax" for the current or preceding tax year. Qualifying net tax is the lesser of (1) the tax imposed for the current year minus any credits or (2) the amount of tax shown on the annual report minus credits. If the taxpayer fails to file a report or files a report in bad faith, the qualifying net tax is the tax imposed for the current year minus credits.[12]

The Tax Commissioner may require each taxpayer to file each annual or estimated tax report electronically using the Ohio Business Gateway or other electronic means. In addition, tax payments must be remitted electronically, but a taxpayer may apply to the Commissioner to be excused from the electronic payment requirement for good cause.[13]

Tax credits

The bill authorizes the following tax credits to be claimed by taxpayers subject to the FIT 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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[10] R.C. 5726.04.

[11] The return deadline for the federal corporate income tax return is currently March 15. Upon the grant of the maximum six-month extension, the return would be due September 15. Thus, the extended due date for the FIT return would be October 15. *See* 26 U.S.C. §§ 6072 and 6081; 26 CFR 1.6081-3.

[12] R.C. 5726.03 and 5726.06.

[13] R.C. 5726.03.

[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] motion picture production tax,[19] and research and development,[20] and the credit for regulatory assessments paid to the Department of Commerce's Division of Financial Institutions.[21]

The bill authorizes, for tax year 2014, a nonrefundable credit against the FIT for a financial institution with a dealer in intangibles in its qualifying controlled group – the group of entities grouped together for the purpose of paying the FIT. The amount of the credit equals the lesser of (1) the amount of dealers in intangibles tax the dealer paid in the preceding calendar year minus refunds or (2) the product of the financial institution's direct investment in stock of the dealer in the preceding year, the ratio of capital employed by the dealer in Ohio (as measured under the current dealer in intangibles tax), and the current dealer in intangibles tax rate (0.8%).[22] The credit allows for the fact that these dealers in intangibles pay the dealers in intangibles tax in 2014 for the preceding year while paying the FIT in 2014 for tax year 2014.

The bill allows the unused portion of the following nonrefundable credits that could have been claimed against the corporate franchise or dealers in intangibles tax before those taxes are eliminated in 2014 to be carried forward and claimed against the FIT:

- Job Retention Tax Credit.
- Credit for regulatory assessments paid to the Department of Commerce's Division of Financial Institutions.
- Historic Rehabilitation Tax Credit.
- New Markets Tax Credit.
- Research and Development Credit.[23]

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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. 5726.56.

[21] R.C. 5726.51.

[22] R.C. 5726.57.

[23] R.C. 5726.50, 5726.51, 5726.52, 5726.54, and 5726.56.

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.[24]

- Interest on unpaid taxes, including on underpaid estimated taxes, and on refund payments.[25]

- 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.[26]

- 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.[27]

- 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.[28]

- Provisions for companies that discontinue doing business in Ohio to notify the Tax Commissioner.[29]

Exclusion of certain holding companies

The bill excludes from the definition of financial institutions subject to the FIT "diversified savings and loan holding companies," according to the federal definition of those companies that existed on January 1, 2012, and "grandfathered unitary savings and loan holding companies." If the top-tier holding company of the financial institution is either of these companies, a "reporting person" for the purpose of calculating and paying the FIT (using FR Y-9s or call reports) is the holding company's

[24] R.C. 5726.03(D)(4) and 5726.21.

[25] R.C. 5726.07 and 5726.32.

[26] R.C. 5726.32.

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

[28] R.C. 5726.40 through 5726.43.

[29] R.C. 5726.36.

subsidiary bank organization. In all other cases, the financial institution reporting person remains the top-tier holding company. Under federal law, it appears that both types of companies are limited to owning only one bank organization. The bill effectively exempts direct affiliates of these holding companies that are not bank organizations from the FIT and subjects such affiliates to the CAT.

A diversified savings and loan holding company is a savings and loan holding company whose subsidiary savings association and related financial activities represented less than 50% of its consolidated net worth at the close of its fiscal year and of its consolidated net earnings for such fiscal year, as determined under federal law.[30] A grandfathered unitary savings and loan holding company is a holding company that may hold only one savings and loan subsidiary institution and may continue (after 1999) to be engaged in a broad range of nonfinancial business activities unlimited by restrictions on nonfinancial business activities that, without the grandfathering, would apply under the Bank Holding Company Act of 1956.[31] Under the bill, these holding companies are, by implication, subject to the CAT.[32]

Municipal taxing authority

The bill specifies that municipal corporations may not levy a tax that is "the same as or similar to" the new FIT.[33] 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.[34]

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

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[30] 12 U.S.C. § 1467a.

[31] 12 U.S.C. § 1467b.

[32] R.C. 5726.01(E), (I), and (O) and 5751.01(E)(3).

[33] R.C. 715.013.

[34] 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.

dealers in intangibles tax, insurance company tax, the corporation franchise tax, or the personal income tax. The bill adds the FIT and the CAT as qualifying taxes.[35]

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 FIT due or paid in a taxable year.

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.[36]

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.[37]

Motion picture production credit

The bill authorizes businesses subject to the CAT 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.[38]

Job Retention Tax Credit transfer between related persons

The bill allows any taxpayer that is an affiliate of a "diversified savings and loan holding company," according to the federal definition of those companies that existed

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

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

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

[38] R.C. 122.85 and 5751.54.

on January 1, 2012, or of a "grandfathered unitary savings and loan holding company" that holds a Job Retention Tax Credit certificate to elect to claim the credit against taxes other than those specified in tax credit agreement with the Tax Credit Authority. In addition, any taxpayer related to the certificate holder is authorized to claim all or part of the remaining credit originally granted to the holder. To claim a credit, a related taxpayer generally must bear one of certain specified ownership or control relationships with the taxpayer originally claiming the credit, either directly or through other indirect holding. However, the credit must first be claimed against the tax that the holder is subject to, and only then against the following taxes, in sequential order: the insurance premium taxes, the personal income tax, the CAT, and, finally, the FIT.

Credit recapture for nonperformance transfers to the taxpayer that actually claims the credit. The Tax Credit Authority, upon being notified by the Director of Development Services that the certificate holder did not maintain operations at the project site for the appropriate amount of time, is authorized to require related persons to refund any claimed credits. The Tax Commissioner or Superintendent of Insurance may issue an assessment against a related person for such amount. [39]

Currently, only the taxpayer that has a job retention tax credit agreement with the state may claim the credit against the particular tax to which the taxpayer is subject.

Taxation of insurance company affiliates

The bill prohibits the Tax Commissioner from assessing or holding liable for the failure to report or pay the CAT a corporation or any other person directly or indirectly owned by one or more insurance companies for any tax periods ending before January 1, 2014. To be eligible, the corporation, but not the other person or persons so owned by the insurance company or companies, must have reported and paid the corporation franchise tax but not the CAT for taxable periods before January 1, 2014.[40]

Tax levy

Though the new FIT 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.

[39] R.C. 122.171.

[40] Section 4.

HISTORY

ACTION	DATE
Introduced	04-12-12
Reported, H. Ways & Means	–-

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