

# 17<sup>th</sup> Ohio Tax Conference

## Tax & Economic Policy Next Steps

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# Commercial Activity Tax

- *Low Rate*: Importance of maintaining a low rate (or even lower rate) cannot be overemphasized.
  - Ohio facing significant budgetary challenges.
  - CAT arguably unfair in certain situations:
    - Low margin industries
    - Pass-through entities owned by individuals

# Commercial Activity Tax

- *Low Rate (con't)*
  - Other states have joined or have considered joining the gross receipts bandwagon.
  - Low rate (combined with elimination of CFT and TPP) makes CAT acceptable, and is a key to keeping Ohio competitive with other GRT states.

# Commercial Activity Tax

- Texas
  - Adopted replacement for Corporate Franchise Tax in 2006.
    - Effective January 1, 2008
  - Texas Margins Tax – Modified gross receipts tax.
    - Allows a 30% reduction or a deduction of COGS or compensation.
    - Two rates:
      - Retailers and wholesalers: 0.5%
      - All other businesses: 1.0%
    - E-Z Computation permits no deductions and lower rate.

# Commercial Activity Tax

- Texas
  - Addresses issues for low margin industries.
    - Deductions
    - Two rates
  - No personal income tax – protects pass-through entities.

# Commercial Activity Tax

- Michigan
  - Recently adopted replacement for Single Business Tax.
    - Effective January 1, 2008.
  - Michigan Business Tax – Income and Gross Receipts Base.
    - Has both an income element and gross receipts element.

# Commercial Activity Tax

- Michigan
  - Tries to address issues for low margin industries by having an income element
  - Personal income tax – still applies to pass-through entities
  - Provides significant credits for property taxes and other Michigan activity

# Conclusion

- The problems with the CAT are offset by the low rate.
- To keep Ohio's CAT competitive:
  - Rate must stay low or go lower
  - Base must remain narrow

# Commercial Activity Tax

- *Bright-Line Presence Test*
  - Is it constitutional?
    - Due process protections.
  - No published challenges yet.
    - Cost v. Benefits
    - Certainty v. Uncertainty for Both Ohio and Taxpayers.

# Commercial Activity Tax

- *CET Election: Waiver of Nexus Protections*
  - Is it constitutional?
    - Unconstitutional Conditions Doctrine
  - No published challenges yet.
    - Phase-out Having an Impact.
    - Cost v. Benefits

# Commercial Activity Tax

- *Pass-Through Entities*
  - CAT replaces Corporation Franchise Tax which was not previously imposed on pass-through entities.
  - Impact partially offset by reduction in Personal Income Tax.
    - 21% reduction.
    - But, compare Texas and Ohio's neighbors.

# Personal Income Tax

- Rate was cut 21% across-the-board beginning in 2005.
  - Fully phased in by 2009
  - Final highest rate will be 5.925%
- Business is impacted by the personal income tax.
  - Pass-through entities.
  - Investors and business owners/executives.
- Adding the municipal tax of between 0.5% and 3.0%, keeps Ohio's income tax very high.

# Municipal Income Tax

- *Committee to Study State & Local Taxes*
  1. Create a Uniform Tax Base for Net Profits Tax.
  2. Create a Uniform Withholding Base.
  3. Provide Appeals to the BTA and OSC.
  4. Create Uniform NOL Carryover Treatment.
  5. Provide Uniform Treatment of PTEs.

# Municipal Income Tax

- *Committee to Study State & Local Taxes*
  6. Provide Centralized, Web-Based Filing & Payment Options.
  7. Provide Centralized, Web-Based Extension Site for Business.
  8. Revise the Due Date of Returns and Extensions.
  9. Eliminate Three-Year Rule for Withholding Tax Purposes.

# Municipal Income Tax

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  - ✓ Create a Uniform Tax Base for Net Profits Tax.
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# Unresolved Issues

- *Treatment of Pass-Through Entities*
  - R.C. 718.14(D): Each municipality is required to specify by ordinance or rule whether its net profits tax applies to income of PTEs in the hands of the PTE or the owners.
  - Compliance with this requirement is inconsistent (at best).

# Unresolved Issues

- *Net Operating Loss Carryover*
  - Most cities permit an NOL carryover, but about 22% do not.
    - Columbus & Dayton – No carryover
    - Cincinnati & Cleveland – Allow carryover
  - The carryover periods also vary.

# Unresolved Issues

- *Centralized filing and administration*
  - OBG and appeal to BTA is a benefit.
    - OBG not fully utilized by all businesses yet, but certainly growing.
    - Benefit of BTA appeals is only just now beginning.
  - Cost of compliance is still high .
    - Example: Interpretations and application of the law.
  - Hurdle: local control v. state control.

# Municipal Income Tax

- *Local Boards of Appeals*
  - Each municipality required to have a local appeals board.
    - Rules required
  - Make-up varies dramatically.
    - Municipal employees or officials
    - Private citizens

# Conclusion

- Municipal tax system remains a burden on competitiveness, simplicity, and neutrality.
  - ✓ Rate: Range from 0.5% to 3.0%.
  - ✓ Cost of Compliance: 541 jurisdictions.
  - ✓ Net Operating Losses: Not uniform.
- Continued reforms are needed, but taxpayers must voice their concerns and measure the impacts.