Pass-Through Entity and Trust Withholding Tax

Ohio's tax laws include a provision, effective in 1998, for the collection of tax on the distributive shares of income earned by qualifying investors in any qualifying pass-through entity doing business in Ohio. The pass-through entity tax is not so much a separate tax but, rather, a mechanism designed to collect individual income tax or corporation franchise tax which is due and payable by pass-through entity investors.

Taxpayer

Qualifying pass-through entities.

Tax Base

The sum of the "adjusted qualifying amounts" of a qualifying pass-through entity's qualifying investors. A pass-through entity is an "S" corporation, partnership, or a limited liability company treated as a partnership for federal income tax purposes. (Many pass-through entities are not subject to the tax; see **Major Exemptions**). The "adjusted qualifying amount" is the net sum of the qualifying investor's distributive share of the pass-through entity's income, gain, expense, and loss apportioned to Ohio.

Rates

- 5.0% withholding tax on the adjusted qualifying amount of qualifying investors who are individuals.
- 8.5% entity tax on the adjusted qualifying amount of qualifying investors that are not individuals.
- No tax is due if the total adjusted qualifying amount is $1,000 or less.

Major Exemptions

Pass-through entities not subject to tax include (but are not limited to) the following:

- Any pass-through entity if all the equity investors are (a)Ohio corporation franchise taxpayers and/or (b)corporations exempt under Ohio Revised Code section 5733.09 from the Ohio corporation franchise tax.
- Entities having no qualifying investors.
- Pension plans and charities.
- Real estate investment trusts, regulated investment companies, and real estate mortgage investment conduits.

Pass-Through Entity and Trust Withholding Tax

A qualifying investor does not include the following:

- Individuals who are residents of Ohio for the entire year.
- Nonresident individuals on whose behalf the qualifying pass-through entity files Ohio form IT-4708, "Annual Composite Income Tax Return for Investors in Pass-Through Entities."
- Investors that are "investment pass-through entities".

(This is not a complete listing; there are many other types of investors not included in the definition of "qualifying investor.")

Revenue (In Millions)

5.0% withholding tax*(1)(2)*:

Fiscal Year	Total Tax
2000	$53.8
2001	48.7
2002	52.6
2003	59.7

8.5% entity tax*(1)(3)*:

Fiscal Year	Total Tax
2000	$6.7
2001	7.3
2002	10.5
2003	14.2

7.5% composite income tax *(2)(4)* of nonresident investors in pass-through entities (Form IT-4708):

Fiscal Year	Total Tax
2000	$60.1
2001	56.0
2002	63.1
2003	73.9
2004	75.5

Notes : *(1)These figures represent the tax liabilities reported for each tax year, according to the fiscal year payment associated with the tax year. For example, the liability for tax year 2002 was predominantly paid during Fiscal Year (FY) 2003, so the tax year 2002 tax liability data is reported as FY 2003 revenue in this table. Returns for FY 2004 have not yet been processed. (2)This revenue is counted as individual income tax. (3)This revenue is counted as corporation franchise tax.*

Pass-Through Entity and Trust Withholding Tax

Disposition of Revenue

5.0% withholding and 7.5% composite income tax revenue:
89.5% to the General Revenue Fund, 5.7% to the Library and Local Government Support Fund, 4.2% to the Local Government Fund, and 0.6% to the Local Government Revenue Assistance Fund.

8.5% entity tax revenue:
95.2% to the General Revenue Fund, 4.2% to the Local Government Fund, and 0.6% to the Local Government Revenue Assistance Fund.

Payment Dates

Qualifying pass-through entities whose total adjusted qualifying amounts exceed $10,000 must make estimated quarterly tax payments. The payments are due on the 15th day of the month following the last day of each quarter of the taxpayer's taxable year. For taxpayers with a January 1- December 31 taxable year, payments are due on April 15, July 15, October 15, and January 15.

The annual pass-through entity tax return must be filed by the 15th day of the fourth month following the end of the entity's taxable year. For taxpayers with a January 1- December 31 taxable year, the return is due on April 15. If the entity has an extension of time to file its federal tax return, the qualifying pass-through entity has the same extension to file the pass-through entity tax return. However, there is no extension of time to pay.

Special Provisions/Credits

A refundable tax credit may be claimed by qualifying individual investors in a pass-through entity against their Ohio individual income tax based upon the investor's proportionate share of the 5.0% withholding tax and 8.5% entity tax, if any.

A nonrefundable tax credit may be claimed by qualifying non-individual (corporate) investors against their Ohio corporation franchise tax, based upon the investing corporation's proportionate share of the 8.5% entity tax.

Qualifying trusts are also subject to tax.

The 8.5% entity tax does not apply to any pass-through entity to the extent the pass-through entity's distributive shares of income and gain pass through from that entity to another pass-through entity (the "investing entity"), as long as certain conditions are met.

If, for federal income tax purposes, the investor deducts the investor's proportionate share of the 5.0% withholding tax or the 8.5% entity tax, the investor must add back such tax on the Ohio individual income tax return or corporation franchise tax report.

Sections of Ohio Revised Code
Chapters 5733 and 5747.

Responsibility for Administration
Tax Commissioner.

History of Major Changes

1998
- Tax became effective at a rate of 5.0% on individual qualifying investors and 8.5% on non-individual qualifying investors.
- Certain pass-through entities that are part of multi-tier structures exempted from tax.
- Investment pass-through entities exempted from tax on investment income.

2001
- If net management fees exceed 5.0% of an investment pass-through entity's net income, such fees are subjected to tax.

2002
- Required a corporation that is a partner in a partnership or is a member of a limited liability company (LLC) to add back 5/6 of the corporation's share of the bonus depreciation deduction passed through from the entity to the corporation.
- Definition of "business income" amended to include gains and/or losses from partial or complete liquidation of a business, including, but not limited to, the gain or loss from the disposition of goodwill.
- Distributive shares expanded to include the sum of the income, gain, expense, or loss of a disregarded entity.

2003
- Required a corporation that is a partner in a partnership or is a member of an LLC to add back 5/6 of the corporation's share of "qualified Internal Revenue Code section 179" depreciation.

- Sales factor amendments and cost of performance standard replaced with market-theory approach for sales other than inventory sales of tangible personal property and real estate.

Comparisons with Other States (As of 04/05)

The Ohio pass-through entity tax is essentially a withholding tax on the distributive shares of income of qualifying investors (generally corporations and nonresident investors).

The states with a tax most closely approximating the **Ohio** pass-through entity tax are those that require withholding tax on the pass-through entity income of nonresident investors.

These states include: **California, Indiana, New Jersey, New York, Pennsylvania,** and **West Virginia.** (This listing does not reflect taxes imposed by many states on certain types of income, such as the capital gains, built-in gains and excess net passive income of "S" corporations, or any other type of entity-level tax.)