# PASS-THROUGH ENTITY TAX

*Substitute House Bill 215 (122nd General Assembly) enacted a method for the collection of tax on the distributive shares of income earned by qualifying investors from their investment in any qualifying pass-through entity doing business in Ohio. The tax became effective in 1998. The pass-through entity tax is not so much a separate tax, but rather a mechanism designed to collect individual income tax or corporate franchise tax which pursuant to Ohio tax law is otherwise due and payable by pass-through entity investors.*

## TAX BASE

Tax base is 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, below). The "adjusted qualifying amount" is the net sum of an investor's distributive share of the pass-through entity's income, gain, expense, and loss apportioned to Ohio.

## RATES

5.0 percent withholding tax on the adjusted qualifying amount of qualifying investors who are individuals.
8.5 percent 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:

- Entities having no qualifying investors.
- Pension plans and charities.
- Real estate investment trust, regulated investment companies, and real estate mortgage investment conduits.

A qualifying investor does not include the following:

- Individuals who are residents of Ohio for the entire year.
- Non-resident 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 which are "investment pass-through entities."



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## MAJOR EXEMPTIONS (con't.)

- Investors that are corporation franchise taxpayers if all investors in the qualifying pass-through entity are corporation franchise taxpayers.

(This is not a complete listing: there are many other types of investors exempted from the definition of "qualifying investor.")

## REVENUE (IN MILLIONS)

5.0% withholding tax:

| Fiscal Year | General Revenue Fund [1] | Local Gov't. Funds | Total Tax |
|---|---|---|---|
| 1999 | $32.0 | $3.8 | $35.8 |
| 2000 | 34.7 | 4.1 | 38.8 |
| 2001 | 35.5 | 4.2 | 39.7 |

8.5% entity tax:

| Fiscal Year | General Revenue Fund [1] | Local Gov't. Funds | Total Tax |
|---|---|---|---|
| 1999 | $3.7 | $0.2 | $3.9 |
| 2000 | 6.3 | 0.3 | 6.6 |
| 2001 | 4.0 | 0.2 | 4.2 |

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

| Fiscal Year | General Revenue Fund [1] | Local Gov't. Funds | Total Tax |
|---|---|---|---|
| 1999 | $32.5 | $3.8 | $36.3 |
| 2000 | 47.5 | 5.6 | 53.1 |
| 2001 | 55.8 | 6.6 | 62.4 |

[1] *This revenue is counted in the personal income tax or corporate franchise tax.*

[2] *Although the statutory rate is 7.5%, the rate in each tax year was reduced under legislation requiring the return of excess state revenue to taxpayers.*

## DISPOSITION OF REVENUE

5.0% withholding 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.

## SECTIONS OF THE REVISED CODE

Chapters 5733 and 5747.

## RESPONSIBILITY FOR ADMINISTRATION

Tax Commissioner.

## REMITTER OF TAX

Qualifying pass-through entities.

## 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 pass-through entity investors against their Ohio individual income tax, based upon the investor's proportionate share of the 5 percent withholding tax and 8.5 percent entity tax, if any.

A non-refundable 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 percent entity tax.





## SPECIAL PROVISIONS / CREDITS (con't.)

Qualifying trusts are also subject to tax.

The 8.5 percent 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 percent withholding tax or the 8.5 percent entity tax, the investor must add back such tax as income on the Ohio individual income tax return or corporation franchise tax report.

## 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 structure are exempt from tax.
- Investment pass-through entities are exempt from tax on investment type of income.

2001
- If net management fees exceed five percent of an investment pass-through entity's net income, such fees are subject to tax.

## COMPARISON WITH OTHER STATES

The **Ohio** pass-through entity tax is essentially a withholding tax on the distributive share of income of investors (generally corporations and non-resident 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 non-resident investors. These states include California, Indiana, New Jersey, 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.)