

## CORPORATION FRANCHISE TAX

### TAXPAYER

Domestic and foreign corporations that are doing business in Ohio, owning capital or property in Ohio, holding a charter or certificate of compliance authorizing the corporation to do business in Ohio, or otherwise having nexus with Ohio during the calendar year (unless specifically exempt).

### TAX BASE

The corporation franchise tax is an excise tax levied on the value of a corporation's issued and outstanding shares of stock. There are two bases for determining the value of a corporation's issued and outstanding shares: the net income base and the net worth base. A taxpayer pays tax on the base, described below, that produces the greater tax.

**1. Ohio Net Worth (taxable value):** Net book value of assets less net carrying value of liabilities yields net worth. The net book value of exempted assets is subtracted from net worth and any "qualifying amount" as reflected on the books of the corporation is added to net worth, thus yielding the net value of the stock. This amount is multiplied by the Ohio apportionment ratio to yield taxable value.

**2. Ohio Net Income (Ohio taxable income):** Begins with federal taxable income, plus or minus any Ohio adjustments. From this tax base, business income is apportioned to Ohio by the Ohio apportionment ratio and nonbusiness income is allocated in and outside Ohio based upon certain siting provisions. For taxable years ending prior to June 26, 2003, Ohio law made no distinction between business income and nonbusiness income. The total income allocated and apportioned to Ohio, plus certain additions and minus certain deductions, yields Ohio taxable income.

The Ohio apportionment ratio is the sum of a property factor (the ratio of property in Ohio to property everywhere, times 20 percent), a payroll factor (the ratio of payroll in Ohio to payroll everywhere, times 20 percent), and a sales factor (the ratio of sales in Ohio to sales everywhere, times 60 percent).

**Net income base apportionment.** For taxable years ending on or after June 26, 2003 the net income base property, payroll, and sales factors specifically exclude that portion of property, payroll, and sales otherwise includable in the factors to the extent that the portion relates to, or is used in connection with, production of nonbusiness income allocable under Ohio Revised Code section 5733.051 (see R.C. 5733.05(B)(2) as amended by Amended Substitute House Bill 95, 125th General

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Assembly); e.g., real property that generates allocable nonbusiness rental income is excluded from the denominator of the property factor, and if the property is in Ohio, it is excluded from both the numerator and the denominator of the property factor.

A market-theory approach is implemented in taxable years ending on or after December 11, 2003 for sales, other than inventory sales, of tangible personal property and real estate. The receipts from such sales are generally situated to Ohio in proportion to the purchaser's benefit, with respect to the sale, in Ohio, to the purchaser's benefit, with respect to the sale, everywhere.

**Net worth base apportionment.** For taxable years ending on or after June 26, 2003 the numerator and denominator of the net income base property, payroll, and sales factors are adjusted to include the portion of any real property and tangible personal property, payroll, and sales, respectively, relating to, or used in connection with, production of nonbusiness income allocated under R.C. 5733.051 (see R.C. 5733.05(C)(2)); e.g., real property that generates nonbusiness rental income allocated to Ohio is excluded from both the numerator and denominator of the net income base property factor, but the net worth base apportionment property factor is adjusted to include such property.

### RATES

#### **General Rate (excluding financial institutions):**

1. 4.00 mills on Ohio net worth. The maximum tax for each taxpayer on the net worth base is \$150,000.
2. 5.1 percent on the first \$50,000 of Ohio net income plus 8.5 percent on Ohio net income in excess of \$50,000. (Corporations that meet ownership requirements to file a combined report must share the tax bracket to which the 5.1 percent rate applies, regardless of whether or not the corporations filed combined.)

The minimum fee is \$50 for taxpayers having a taxable year ending on or before June 25, 2003. For taxable years ending on or after June 26, 2003, the minimum fee increased to \$1,000 if (1) the sum of the taxpayer's gross receipts from its activities in and outside Ohio during the year equals or exceeds \$5.0 million, or (2) the total number of its employees in and outside Ohio at any time during the year equals or exceeds 300. For all other taxpayers the minimum fee remains \$50.

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In addition, corporations are subject to an additional litter tax. Each corporation is subject to the Tier I litter tax, and “litter-stream” corporations are also subject to the Tier II litter tax.

### **Financial institutions rate:**

13 mills on net worth, but the \$150,000 net worth tax limit does not apply.

The minimum fee is \$50 for taxpayers having a taxable year ending on or before June 25, 2003. Effective for taxable years ending on or after June 26, 2003, the minimum fee increased to \$1,000 if (1) the sum of the taxpayer’s gross receipts from its activities in and outside Ohio during the taxable year equals or exceeds \$5.0 million or (2) the total number of its employees in and outside Ohio at any time during the taxable year equals or exceeds 300. For all other taxpayers the minimum fee remains \$50. (Neither the net income base nor the litter tax applies to financial institutions.)

### **MAJOR EXEMPTIONS**

- Nonprofit corporations.
- Dealers in intangibles (stockbrokers, mortgage companies, etc.).
- Insurance companies, HMO’s, and other corporations required to file annual reports with the Director of the Department of Insurance.
- Public utilities (except railroads, electric companies, long distance telephone companies, and beginning in 2005 all telephone companies).
- Credit unions.
- “S” corporations and qualified subchapter S subsidiaries (QSSS).
- Real Estate Investment Trusts (REIT), Regulated Investment Companies (RIC), and Real Estate Mortgage Investment Conduits (REMIC).
- Corporations in bankruptcy proceedings under Chapter 7 of the U.S. Bankruptcy Code.
- Corporations exempt under federal law.
- High-technology start-up companies are exempt from the net worth base. Subject to certain limitations, a corporation that is organized not more than three years prior to March 31 of any tax year during the 2003-2007 period is not subject to the net worth base of the franchise and litter taxes during such tax year. (Such corporations are subject to the net

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income base of the franchise and litter taxes.)

- Qualifying holding companies are exempt from the net worth base.

### REVENUE (IN MILLIONS)

<u>Fiscal Year</u>	<u>General Rev. Fund</u>	<u>Local Gov't. Funds</u>	<u>Other Funds (1)</u>	<u>Total</u>
2000	\$969.4	\$48.9	\$11.6	\$1,029.9
2001	915.3	46.1	11.6	973.0
2002	712.3	48.8	13.3	774.4
2003	747.2	47.5	13.6	808.3

**Note:** (1) Includes litter funds, and Attorney General Claims Fund.

### DISPOSITION OF REVENUE

After making any required deposits in the Attorney General Claims Fund, 95.2 percent of remaining revenue is deposited in the General Revenue Fund, 4.2 percent is deposited in the Local Government Fund, and 0.6 percent is deposited in the Local Government Revenue Assistance Fund.

For fiscal years 2002 and 2003, the two local government funds were “frozen” and each received the same amount of corporation franchise tax revenue as they received in FY 2001. The remainder was deposited in the General Revenue Fund. This “freeze” is continued in FY 2004. Refer to **Disposition of Revenue** in the **INDIVIDUAL INCOME TAX** section for information on the semi-annual reduction of the Local Government Fund and Local Government Revenue Assistance Fund deposits.

### PAYMENT DATES

January 31:	1/3 of tax liability.
March 31:	1/3 of tax liability.
May 31:	1/3 of tax liability.

### SPECIAL PROVISIONS/CREDITS

A nonrefundable credit is provided for cash donations made to municipal corporations, townships, counties, park districts, and boards of education that have received litter control and recycling grants. The credit is limited to the lesser of one-half of the cash donation or one-half of the sum of the litter taxes paid by the taxpayer.

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A nonrefundable credit is provided to state-chartered savings and loan institutions for the difference between the annual assessment paid to the state division of savings and loans and the supervisory fees paid to the federal savings and loan insurance corporation.

A nonrefundable credit is available equal to the taxpayer's proportionate share of the 8.5 percent tax paid by a pass-through entity in which the taxpayer is directly or indirectly a qualifying investor.

In addition to other applicable credits, corporations located in an "enterprise zone" may qualify for three nonrefundable credits:

1. Credit for amount reimbursed to certain employees for day-care costs – maximum of \$300 per child.
2. Credit for amount reimbursed to certain employees for job-training costs – maximum of \$1,000 per employee.
3. Credit for each new employee hired who had been a participant in the Ohio Works program, the prevention, retention, and contingency program, or the former general assistance program – \$1,000 per employee.

A nonrefundable credit may be taken for manufacturing machinery and equipment purchased between July 1, 1995 and December 31, 2015 and located in Ohio. The credit is 7.5 percent of the amount by which the cost of the qualifying equipment purchased during the qualifying period for use in an Ohio county exceeds the "base investment" for that county. For equipment that is located in certain eligible areas (areas classified as inner city, distressed, labor surplus, or in situational distress), the credit percentage is 13.5 rather than 7.5 percent.

A nonrefundable credit may be claimed by grape producers equal to 10 percent of the cost of property used in growing, harvesting or producing grapes in Ohio.

A nonrefundable credit may be granted to investors who make qualified investments in qualifying small Ohio-based research and development or technology transfer companies. The credit is 25 percent of the amount of capital invested by the taxpayer in the qualifying company.

A nonrefundable credit is provided equal to one-half of the average annual costs for an eligible job training program,

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subject to a maximum of \$1,000 per trained employee and a \$100,000 maximum per taxpayer.

A nonrefundable credit is available equal to 7.0 percent of the excess of qualified research expenses incurred during the taxable year over the average annual qualified research expenses incurred during the three preceding taxable years.

A nonrefundable credit is available to an affiliated group if the group pays over \$3.5 million in additional tax as a result of the related entity and related member adjustments. The credit is equal to the additional tax in excess of \$3.5 million but may not exceed \$1.5 million.

A nonrefundable credit is provided to railroad companies equal to 10 percent of their total maintenance expenditures during the taxable year for each grade crossing warning device in this state. But the credit for each device may not exceed \$200 per year.

A nonrefundable credit may be granted by the Director of the Department of Development equal to 10 percent of a company's costs incurred in completing a voluntary clean-up of a contaminated site (not to exceed \$500,000).

A nonrefundable credit is available to electric companies equal to \$3.0 per ton of Ohio coal used in a coal-fired electric generating unit.

A nonrefundable credit is available beginning in tax year 2004 equal to a borrower's qualified research and development loan payments during the calendar year immediately preceding the tax year. These payments represent principal and interest on a loan made to the borrower from the research and development fund administered by the Ohio Department of Development.

A nonrefundable credit is available to Ohio Venture Capital Program lenders and investors to provide some security against losses on loans to the program (this credit is not available until 2007).

In determining Ohio taxable income, a corporation claiming the pass-through entity tax credit must add to federal taxable income the amount claimed as a credit to the extent that the amount was deducted or excluded from the corporation's federal taxable income.

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Financial institutions are subject to a franchise tax net worth base that differs from the net worth base of general corporations. Financial institutions are also subject to a different apportionment formula than that used for general corporations.

A corporation that dissolves or surrenders its license to conduct business prior to January 1 of the tax year, while not subject to the franchise tax, is subject to an “exit tax” on its unreported Ohio net income (income not previously included in a franchise tax report). Under certain circumstances the income of a transferor corporation no longer subject to the franchise tax is attributed to a transferee corporation that received substantially all of the transferor corporation’s assets.

Under certain circumstances a taxpayer must add to its income certain gains and losses that were included in the federal taxable income of a related entity that is not an Ohio taxpayer. Interest expense and intangible expense paid to related members are also added to a taxpayer’s net income.

If a taxpayer is a related member to a qualifying holding company, the taxpayer must adjust its net worth and debt by the “qualifying amount.” The qualifying amount is an amount that results in the taxpayer’s debt-to-equity ratio equaling the debt-to-equity ratio of the qualifying controlled group of which the taxpayer is a member.

### SECTIONS OF OHIO REVISED CODE

Chapter 5733.

### RESPONSIBILITY FOR ADMINISTRATION

Tax Commissioner.

### HISTORY OF MAJOR CHANGES

- 1902 • Enacted at rate of 1.0 mills on value of capital stock located in Ohio.
- 1959 • Rate increased to 3.0 mills.
- 1967 • Rate increased to 4.0 mills.
- 1969 • Rate increased to 5.0 mills.
- 1971 • Income base added; 4.0 percent on first \$25,000 of net income, 8.0 percent on \$25,001 and above.

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- 1978 • Credit allowed for certain tangible property taxes.
- 1980 • Additional “litter” rates enacted for tax years 1981 through 1986:  
⇒ Litter rates for all corporations except “litter stream” corporations – 0.14 mill on net worth, or 0.11 percent on the first \$25,000 of income and 0.22 percent on income over \$25,000. Maximum tax of \$5,000.  
⇒ Litter rates for corporations manufacturing or selling “litter stream” products – 0.28 mill on net worth, or 0.11 percent on the first \$25,000 of income and 0.44 percent on income over \$25,000. Maximum tax of \$10,000.  
• 15 percent surtax imposed for tax year 1981.
- 1981 • Increase in regular corporate rates to 5.5 mills on net worth and to 4.6 percent and 8.7 percent on net income. The minimum tax was increased to \$150. Financial institutions exemption repealed; they became taxed at a 6.5-mill rate on net worth for tax years 1982 and 1983.  
• 5.75 percent surtax imposed for tax year 1982.
- 1982 • 5.75 percent surtax imposed for tax year 1983.
- 1983 • Increase in regular corporate rates to 5.82 mills on net worth and to 5.1 percent and 9.2 percent on net income plus a 5.4 percent surtax. The minimum tax was reduced to \$50.  
• Increase in financial institutions rates to 15 mills on net worth plus an additional tax of 6.47 mills on savings and loans and 1.54 mills on other financial institutions for tax years 1984 and 1985.
- 1985 • Litter tax rates continued through 1991.  
• Surtax on net income reduced to 2.7 percent in 1987, repealed in 1988.  
• “S” corporations exempted beginning in 1987.
- 1986 • Net income top rate decreased to 8.9 percent in 1988; lower bracket doubled to first \$50,000 of net income for 1989.
- 1987 • Long-distance telephone companies subject to tax in 1988.  
• Litter tax rates continued through 1993.

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- 1989
  - Corporations undergoing “F” reorganizations subject to tax.
- 1991
  - Income transferred to passive investment corporations subject to tax and certain costs and expenses paid to those corporations disallowed.
- 1992
  - Credit for increased exports enacted.
  - Credit for new jobs created.
  - Railroads explicitly subject to tax in 1993.
  - Litter tax rates extended to 1995.
- 1994
  - 20 percent investment tax credit enacted.
  - Enterprise zone employment credit created.
  - Grape production credit enacted.
  - Litter tax rates made permanent.
- 1995
  - 7.5/13.5 percent investment tax credit enacted.
  - Portion of corporation franchise tax payments made by railroads earmarked for rail development fund (expired in FY 2000).
- 1996
  - Credit given for costs incurred completing voluntary clean-up of a contaminated site.
  - Credit given for investors who make qualified investments in an Ohio early stage investment entity.
- 1997
  - Eligible period for 7.5 /13.5 percent investment tax credit extended to December 31, 2000.
  - Effective tax year 1999, net worth tax simplified, tax rate lowered to 4.0 mills and maximum liability of \$150,000; top net income tax rate also lowered to 8.5 percent. Tax on financial institutions reformed effective tax year 1998 with a 14-mill rate in tax year 1999 and 13-mill rate beginning tax year 2000. Net income tax rates imposed on qualifying pass-through entity income.
- 1999
  - Eligible period for 7.5 /13.5 percent investment tax credit extended to December 31, 2005.
  - Effective tax year 2001, credit given for increased instructional costs for employee training.
  - Effective tax year 2002, credit provided for increase in qualified research expenses.
  - Effective tax year 2002, credit available for costs of maintaining active railroad grade crossing devices.

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- Electric utilities subject to corporation franchise tax effective in 2002.
  - Credit of \$3.0 per ton of coal burned in coal-fired electric generating unit after April 30, 2001 but before January 1, 2005, effective in 2002.
- 2000
- Effective tax year 2001, credit of lesser of \$1,000 or one-half of the cost of lights and reflectors installed on agricultural tractors, if purchased between October 5, 2000 and October 4, 2001.
  - Job training credit changes enacted.
- 2001
- Job training tax credit delayed until tax year 2004 and extended through tax year 2006 (originally scheduled to expire in tax year 2004).
  - Credit for increase on qualified research expenses delayed until tax year 2004 (originally scheduled to begin in tax year 2002).
  - Effective tax year 2003, credit available on investments made by a financial institution in a dealer in intangibles.
  - Effective tax year 2003, credit available for fostering job retention.
  - Effective tax year 2003, net worth exemption for high-tech start-ups for first three years of existence.
- 2002
- Job retention credit created.
  - Net worth exemption enacted for high-tech start-up companies.
  - Credit enacted for investment in certified ethanol plants.
  - Bonus depreciation adjustment.
  - Codification of the Department of Taxation's policy and interpretation of disregarded entities.
  - Codification of uniform application for refund procedure applicable to franchise tax and various other taxes.
  - Codification of a uniform petition for reassessment procedure applicable to franchise tax and various other taxes.
  - Revision of the late payment penalty including a penalty safe-harbor for estimated payments.
  - Extension of the Ohio net operating loss carryover consistent with federal law.

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- 2003
- For taxable years ending on or after June 26, 2003, enacted business/nonbusiness income treatment:
    - ⇒ I.R.C. Section 179 depreciation adjustment;
    - ⇒ Revision of sham transaction statute;
    - ⇒ Increase to \$1,000 of the minimum fee for certain large corporations; and
    - ⇒ Permitted net worth apportionment ratio to differ from net income apportionment ratio.
  - Manufacturing and equipment credit extended 10 years to Dec. 31, 2015.
  - Research and development loan repayment credit enacted.
  - Credit allowed for losses on loans made to Ohio Venture Capital Program.
  - Sales factor amendments enacted that implement a market-theory approach for sales other than inventory sales of tangible personal property and real estate.

### COMPARISONS WITH OTHER STATES (AS OF 1/04)

#### California

8.84 percent of net income.

#### Florida

5.5 percent of net income. Corporations subject to federal alternative minimum tax pay equal to the greater of the regular 5.5 percent net income tax or 3.3 percent alternative minimum tax.

Taxpayers also subject to excise tax of 2.2 percent on the adjusted value of the federal Accelerated Cost Recovery System (ACRS) depreciation allowance.

#### Illinois

4.8 percent of net income. 2.5 percent personal property replacement tax on net income. 0.1 percent franchise tax on paid-in capital.

#### Indiana

8.5 percent of net income.



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### Kentucky

<u>Taxable Net Income</u>	<u>Rate</u>
Up to — \$25,000	4.00 percent
\$25,001 — 50,000	5.00
50,001 — 100,000	6.00
100,001 — 250,000	7.00
Over — 250,000	8.25

Plus: 0.21 percent on capital employed.

### Massachusetts

Corporations pay the greater of the following:

- 0.26 percent on taxable tangible property that is not subject to local taxation or on allocated net worth; or
- \$456 (\$400 base rate, plus a surtax of 14 percent of the net tax paid).

### Michigan

Adjusted tax base includes business income, compensation paid to employees, interest payments, and depreciation of tangible assets. For taxpayers with a fiscal year ending in December, the tax year 2003 rate is 1.8 percent.

### New Jersey

For tax year 2003, corporations pay the greater of the following:

- a minimum tax of \$500 (\$2,000 if annual payroll is at least \$5.0 million); or
- a tax of 9.0 percent if the corporation's entire net income exceeds \$100,000, 7.5 percent if the corporation's entire net income is \$50,001 to \$100,000, or 6.5 percent if the corporation's entire net income is \$50,000 or below.

### New York

7.5 percent of net income, 0.178 percent of capital, or 3.0 percent of modified net income, whichever is greatest.



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### Ohio

**Greater of 5.1 percent of the first \$50,000 of net income and 8.5 percent of net income over \$50,000, or 0.4 percent of net worth (maximum \$150,000) or minimum fee. Corporations that meet the ownership requirements to file a combined report must share the \$0 to \$50,000 tax bracket to which the 5.1 percent rate applies regardless of whether or not they actually file combined. Additional rates on all corporations except “litter stream” corporations are 0.11 percent and 0.22 percent of net income or 0.14 mills of net worth, with a maximum tax from these rates of \$5,000; additional rates on “litter stream” corporations are 0.14 mills of net worth or 0.22 percent of net income, with a maximum tax from these rates of \$5,000.**

**Notes: *The minimum fee is \$1,000 if the taxpayer's taxable year ended on or after June 26, 2003 and (1) the sum of the taxpayer's gross receipts from activities in and outside Ohio during the taxable year equals or exceeds \$5.0 million or (2) the total number of the taxpayer's employees in and outside Ohio at any time during the taxable year equals or exceeds 300. The minimum fee is \$50 for taxpayers whose taxable year ended before June 26, 2003 and for taxpayers whose taxable year ended on or after June 26, 2003 but whose gross receipts and number of employees do not exceed the thresholds discussed above.***

### Pennsylvania

9.99 percent of net income plus 0.699 percent of taxable value of capital stock.

### Texas

The greater of 0.25 percent on net taxable capital or 4.5 percent on net taxable earned surplus.

### West Virginia

9.0 percent of net income plus additional franchise tax equal to 0.7 percent on capital employed.

