If any of the preprinted information on the form (i.e. the corporation's legal name, Ohio license/charter number or federal employer identification number) is incorrect, please contact us with the correct information at any of the telephone numbers listed in the back of this booklet.

Recent Legislation and Significant Decisions from the Ohio Supreme Court and the Board of Tax Appeals

Legislation

Amended Substitute House Bill 640 (HB 640), 123rd General Assembly. This new law amends the consolidation provision of the 7.5% - 13.5% manufacturer's credit by changing the threshold that triggers the consolidated credit requirement. Under previous law (as enacted by Amended Substitute House Bill 283, 123rd General Assembly -- the 1999 Budget Bill) for new manufacturing machinery and equipment purchased after December 31, 2000, a taxpayer having a "related member" or a group of taxpayers having a related member would have been required to compute the 7.5% - 13.5% manufacturer's credit as if the taxpayer or all taxpayers of the group and all such related members were a consolidated single taxpayer. This new law changes the threshold to a "qualifying controlled group" test. That is, for new manufacturing machinery and equipment purchased after December 31, 2000 this new law requires a qualifying controlled group (a group of corporations related by more than 50% direct or indirect stock ownership) to compute the credit on a consolidated basis. See ORC section 5733.33(I) as amended by this new law.

House Bill 99, 123rd General Assembly. This new law allows a taxpayer to repay without interest or penalty an amount erroneously paid to the taxpayer by the Treasurer in excess of the overpayment claimed on a franchise tax report or on an application for refund. The new law applies only if the taxpayer pays the entire amount of the overpayment to the tax commissioner not later than thirty days after the taxpayer receives an assessment for the overpayment. See ORC section 5733.261.

House Bill 612, 123rd General Assembly (Taxpayer Services Bill). This new law amends and enacts several provisions:

- **Petition for reassessment filing period extended**. Effective for assessments <u>received</u> on and after August 30, 2000 the new law provides that a taxpayer who objects to a franchise tax assessment must file a petition for reassessment within **sixty** days of <u>receipt</u> of the assessment. Prior law required the taxpayer to file the petition for reassessment within thirty days of receipt of the assessment. See ORC section 5733.11 as amended by this new law.

  Note: The August 30, 2000 effective date was determined as follows:
  - The effective date of the bill is September 29th, 2000.
  - If an assessment's thirty day appeal period had expired before the September 29th effective date of the new law, the old thirty day appeal period applies.
  - If an assessment's thirty day appeal period had not expired before the September 29th effective date of the new law, the new sixty day appeal period applies.
  - Thirty days prior to the September 29th effective date of the bill is August 30, 2000. Thus, if the taxpayer receives an assessment on or after August 30, 2000, the taxpayer has sixty days in which to file a petition for reassessment. If the taxpayer received an assessment before August 30, 2000, the taxpayer had thirty days in which to file a petition for reassessment because the thirty day appeal period expired before the September 29th effective date of the new law.
- **Interest on assessments.** Effective for assessments <u>issued</u> (mailed) on and after August 30, 2000 the new law provides that if an assessment is not paid within **sixty** days after the assessment was issued, then interest on the assessment is due from the date the assessment was issued until the assessment is paid. Prior law contained a similar provision but the interest free period was thirty days. See ORC section 5733.11 as amended by this new law.
- **Payment requirement upon filing a petition for reassessment.** Effective for assessments issued on and after August 30, 2000 the new law allows the taxpayer to appeal the penalty portion of an assessment without payment of the penalty even if the taxpayer's only objection to the assessment is the assessed penalty. Prior law required the taxpayer to pay the assessed penalty if the taxpayer's only objection to the assessment was the assessed penalty. See ORC section 5733.11 as amended by this new law.
- **Filing period extended for appeals to Board of Tax Appeals.** Effective for tax commissioner's final determinations received on and after August 30, 2000 the new law provides that a taxpayer who objects to the tax commissioner's final determination must appeal the final determination to the Board of Tax Appeals within **sixty** days of receipt of the final determination. Prior law required the taxpayer to appeal the final determination within thirty days of receipt. See ORC section 5717.02 as amended by this new law.
- **Penalties now discretionary.** Effective for assessments issued on and after September 29, 2000 the new law gives the tax commissioner discretion whether to apply the ORC section 5733.28 penalties for failure to file, failure to pay, and fraud. In addition, the new law gives the tax commissioner discretion to apply a reduced penalty. Prior law <u>required</u> the imposition of ORC section 5733.28 penalties for failure to file and failure to pay and gave the tax commissioner no authority to charge a partial penalty.
- **Rounding.** New ORC section 5703.055 gives the tax commissioner specific statutory authority to require rounding to the nearest whole dollar on any tax return, report or other document.
- **Mail.** New ORC section 5703.056 gives the tax commissioner authority to authorize taxpayer use of delivery services other than the US Postal Service.
- **Electronic Signature.** ORC section 5703.054 gives the tax commissioner the authority to prescribe an "electronic signature" which will expand future opportunities for electronic filing.

Substitute House Bill 484, 123rd General Assembly. This new law allows Ohio franchise taxpayers and individual taxpayers to claim a nonrefundable credit for purchasing lights and reflectors for installation on multi-wheel agricultural tractors in order to comply with the new lighting and reflector requirements set forth in ORC section 4513.111, as enacted by this new law. (A multi-wheel agricultural tractor is an agricultural tractor that has two or more wheels on each side of one rear axle. See ORC section 4511.01(GGG), as amended by this new law.) The credit equals the lesser of $1,000 or fifty percent of the cost of the lights and reflectors purchased during the period October 5, 2000 (the effective date of this new law) through October 4, 2001. The taxpayer must claim the credit for the taxable year during which the taxpayer purchased the lights and reflectors. If the taxpayer is an investor in a pass-through entity (S corporation, partnership or LLC treated as a partnership) that purchased the lights and reflectors to comply with the lighting and reflector requirements contained in ORC section 4513.111, the investor may claim the investor's proportionate share of the credit. The franchise tax credit must be claimed in the order established by ORC section 5733.98. Unused credit amounts may not be carried forward. See ORC sections 5733.44 and 5747.38 as enacted by this new law.

Decisions

Ohio Supreme Court

Emerson Elec. Co. v. Tracy (2000), 90 Ohio St.3d 157. The Ohio Supreme Court agreed with the taxpayer and held that ORC section 5733.04(I)(2) -- the foreign source income provision that reduces deductible foreign dividends by 15% deemed expenses -- violates the United States Constitution's Foreign Commerce Clause because it treats dividends from foreign subsidiaries less favorably than dividends from domestic subsidiaries which are fully deductible. The Ohio Attorney General has filed a motion for reconsideration which is currently pending before the Ohio Supreme Court.

KeyCorp v. Tracy (1999), 87 Ohio St.3d 238. The Ohio Supreme Court affirmed the decision of the Board of Tax Appeals and held that for purposes of the ORC section 5733.05(A)(5)(c) net worth base "excludable investment" computation applicable to the parent holding company of a financial institution, the holding company's excess cash maintained with its wholly-owned financial institution in deposits, certificates of deposit, repurchase agreements and Eurodollar accounts are not investments in the issued indebtedness of the subsidiary financial institution.

When the parent holding company placed its excess cash in repurchase agreements, Eurodollars, and cash deposits with its subsidiary financial institution, the parent holding company was dealing with its subsidiary as a customer, rather than as an investor investing in the indebtedness issued by the subsidiary financial institution. Cash deposits, certificates of deposit, and repurchase agreements are banking customer products for the use and benefit of the customer. On the other hand, investments in indebtedness are issued for the benefit of the bank.

While a customer's deposit with a bank creates a debtor-creditor relationship between the bank and the customer-depositor, not all debt creates an excludable investment in the indebtedness of the debtor within the meaning of ORC section 5733.05(A)(5)(c). According to the Court, the investments must be "in" the indebtedness. An investment in the indebtedness of the subsidiary requires that the subsidiary first have created an indebtedness in which an investment can be made, *e.g.,* stocks, bonds, or notes. Indebtedness to which the excludable investment provision applies is limited to indebtedness <u>issued</u> by the financial institution such as stocks, bonds and notes.

Note: For tax years 1999 and thereafter Amended Substitute House Bill 215, 122nd General Assembly eliminated the excludable investment provision for all taxpayers other than financial institutions. The excludable investment provision now applies only to: (1) financial institutions which own at least 25% of the issued and outstanding shares of common stock of another financial institution, (2) financial institutions which own at least 80% of the issued and outstanding shares of common stock of a public utility as defined in ORC section 5727.01, and (3) financial institutions which own at least 80% of the issued and outstanding shares of common stock of an insurance company as defined in ORC section 5725.01.

Board of Tax Appeals

Money Access Services Corporation v. Tracy, BTA Case No. 98-M-1006 (6-2-00). Relying upon the Ohio Supreme Court's decision in *Hoover Universal v. Limbach,* (1991) 61 Ohio St.3d 63 and the Board of Tax Appeals' decision in *Customized Transportation Inc. v. Tracy*, BTA Case No. 93-K-364 (3-15-96), the Board reversed the Tax Commissioner and held that the taxable year for the taxpayer's 1993 franchise tax report was the taxpayer's short federal taxable year beginning December 4, 1992 (the day following the day all of the taxpayer's stock was transferred by the taxpayer's old parent corporation to a new parent corporation for shares in new parent in an IRC section 351 tax free exchange) and ending December 31, 1992 (the taxpayer's year end). The Board stated, ". . . As the General Assembly permits a taxpayer to use the same taxable year as that used for federal income tax purposes, a short taxable year may be used for calculating tax under the income method of calculation, provided it is the one that ends 'on the date immediately preceding the date of commencement of the corporation's annual accounting period that includes the first day of January of the tax year ***.' R.C. 5733.05(B)." Thus, the taxpayer was entitled to file its 1993 franchise tax report based on the federal taxable year December 4, 1992 to December 31, 1992. Because the taxpayer's originally filed 1993 franchise tax report erroneously included income for the taxpayer's other federal taxable year ending in 1992 (the federal taxable year beginning January 1, 1992 through December 3, 1992), the taxpayer was entitled to a refund.

The Tax Commissioner argued that for report year 1993 <u>new</u> Tax Commissioner Rules 5703-5-03 and 5703-5-04, applicable to tax years 1990 and thereafter, required Money Access Services Corporation to compute Ohio net income for the entire 1992 calendar year. Because the <u>former</u> versions of Ohio Administrative Code (Tax Commissioner Rules 5703-5-03 and 5703-5-04, pertaining to taxable year), were in effect during the 1989 tax year at issue in *Customized Transportation,* the Tax Commissioner contended that *Customized Transportation* did not apply to the 1993 tax year here at issue. The Board responded that *Customized Transportation* was controlling and that in deciding *Customized Transportation* it had given no consideration to the former rules. Instead, the Board stated that it had relied on *Hoover Universal v. Limbach* and ORC sections 5733.031(A), 5733.04(E), and 5733.05(B). The Board then stated that these same sections of the law (which remained unchanged from their 1989 versions at issue in *Customized Transportation)* permit Money Access Services Corporation to calculate its net income base 1993 franchise tax using the short taxable year December 4, 1992 to December 31, 1992, which was the taxpayer's federal taxable year ". . . preceding the date of commencement of its annual accounting period that includes the first day of January of the tax year."

Note: Effective September 29, 1997 Amended Substitute House Bill 215, 122nd General Assembly redefined "taxable year" as ". . . a period ending on the date immediately preceding the date of commencement of the corporation's annual accounting period that includes the first day of January of the tax year." The new law specifically states that a franchise tax taxable year may consist of an aggregation of more than one federal taxable year. As such, a taxable year can now exceed one year in length. In addition, the new law gives the tax commissioner specific statutory authority to write rules prescribing an appropriate period as the taxable year for the following: (1) a corporation that has changed its taxable year for federal income tax purposes, (2) a corporation that as a result of a change of ownership has two or more short federal taxable years, or (3) a new taxpayer that would otherwise not have a taxable year. Applying the current rules as if the new law had been in effect for tax year 1993, the taxpayer's taxable year for its 1993 franchise tax report would have been the entire 1992 calendar year consisting of an aggregation of the federal taxable year January 1, 1992 through December 3, 1992 and the federal taxable year December 4, 1992 through December 31, 1992.

US Telecom, Inc. v. Tracy, BTA No. 97-K-879 (5-26-00). (This is the companion case to *UCOM, Inc. v. Tracy* BTA No. 97-K-880, decided the same date.) US Telecom, Inc. and UCOM, Inc. are subsidiaries of United Telecommunications, Inc. and both are foreign corporations commercially domiciled outside Ohio. UCOM and US

Telecom hold partnership interests in US Sprint Communications Company, a limited partnership which conducts business in Ohio. US Telecom is the sole general partner and has a 50% interest in the partnership; UCOM is a 30.1% limited partner. US Telecom's only nexus with Ohio was as a general partner in the US Sprint limited partnership.

Using the ratio of the partnership's physical property in Ohio to the partnership's physical property everywhere, the Department had sitused a portion of US Telecom's interest in the partnership to Ohio for purposes of the 1990 and 1991 franchise tax net worth base property fraction. In doing so, the Department in part relied on *Mead Properties, Inc. v. Limbach*, BTA Nos. 85-D-791 to 85-B-794 (4-21-89) unreported, a case that noted the aggregate nature of partnerships in recognizing the flow through character of income under the net income base. Also, for purposes of the net worth base business done fraction the Department had sitused a portion of US Telecom's business done to Ohio based on US Telecom's proportionate share of the partnership's receipts.

The Board rejected the Tax Commissioner's argument that because of the "aggregate nature of partnerships," US Telecom's interest in the partnership had a business situs in each of the states in which the partnership did business, including Ohio. Instead, the Board held that in computing the net worth base property and business done factors for tax years 1990 and 1991 a foreign corporation commercially domiciled outside Ohio and whose only nexus with Ohio is as a general partner in a limited partnership that conducts business in Ohio is not required to situs to Ohio any portion of its interest in the partnership and is not required to situs to Ohio its proportionate share of the partnership's Ohio business done.

In so holding the Board relied upon its prior decision in *Global Industrial Technologies,* BTA No. 97-K-1072 (6-30-99) in which it held that a foreign corporation's interest in a partnership which does business in Ohio is sitused entirely outside Ohio. In *Global* the Board noted that unless an ORC section 5709.03 special situsing provision applies, a corporation's intangible property is sitused to the corporation's domicile state in accordance with ORC 5709.02. Because ORC section 5709.03 does not contain a special situsing provision applicable to an interest in a partnership, a foreign corporation's partnership interests are sitused outside Ohio. Although the *Global* decision addressed the net worth base property factor, not the business done factor, the Board then applied *Global* to US Telecom's business done factor and held that a foreign corporation commercially domiciled outside Ohio was not required to include in the numerator of the fraction any portion of the corporation's proportionate share of the partnership's Ohio business done.

Note: Effective for tax years 1999 and thereafter, the statute here at issue was amended by Amended Substitute House Bill 215, 122nd General Assembly. Under the new law a corporation's net worth is apportioned to Ohio based upon the net income base apportionment ratio. The net income base apportionment ratio specifically includes the taxpayer's proportionate share of the property, payroll and sales of any partnership in which the corporation has a direct or indirect interest. Furthermore, the net income base property factor does not include intangible property. See sections ORC 5733.057, 5733.05(B) and 5733.05(C).

UCOM, Inc. v. Tracy, BTA No. 97-K-880 (5-26-00). (This is the companion case to *US Telecom, Inc. v Tracy*, BTA No. 97-K-879, decided the same date.) UCOM, Inc. and US Telecom, Inc. are subsidiaries of United Telecommunications, Inc. and both are foreign corporations commercially domiciled outside Ohio. UCOM and US Telecom hold partnership interests in US Sprint Communications Company, a limited partnership which conducts business in Ohio. US Telecom is the sole general partner and has a 50% interest in the partnership; UCOM is a 30.1% limited partner. UCOM's only nexus with Ohio was as a limited partner in the US Sprint limited partnership.

The Board of Tax Appeals held that ownership of a limited partnership interest, by itself, did not create sufficient nexus to subject a foreign corporation to the Ohio corporate franchise tax for tax years 1990 and 1991. For those years, former R.C. 5733.01 imposed the franchise tax on a foreign corporation "for the privilege of doing business in this state, owning or using a part or all of its capital or property in this state, or holding a certificate of compliance with the laws of this state authorizing it to do business in this state." According to the Board, mere ownership of a limited partnership interest did not meet any of these activities.

Finding no evidence to suggest that UCOM was anything more than a passive investor in the limited partnership and relying upon Ohio Attorney General Opinion 89-081, the Board of Tax Appeals held that UCOM, Inc., was not subject to the franchise tax because it did not have a presence in Ohio and did not conduct business in Ohio. The Board then noted that based upon its decisions in *Global Industrial Technologies*, BTA No. 97-K-1072 (6-30-99) and *US Telecom, Inc. v. Tracy* even if UCOM were subject to the franchise tax, UCOM's interest in the limited partnership was not includable in the numerator of the net worth base property and business done factors because such interest must be sitused outside Ohio to UCOM's commercial domicile.

Note*:* The Department will follow the *UCOM* decision with regard to the franchise tax liability of a limited partner only for taxable years ending prior to September 29, 1997. **The Department will not follow *UCOM* for taxable years ending on or after September 29, 1997.** Effective that date, the General Assembly amended ORC section 5733.01 by including a new provision that subjects a foreign corporation to the franchise tax, namely: *". . . or otherwise having nexus with this state under the Constitution of the United States . . ."* ORC section 5733.01(B) now states: "A corporation is subject to the tax imposed by section 5733.06 of the Revised Code for each calendar year that it is so organized, doing business, owning or using a part or all of its capital or property, holding a certificate of compliance, *or otherwise having nexus in or with this state under the Constitution of the United States*, on the first day of January of that calendar year." The Department maintains that under the new law a foreign corporation whose only Ohio nexus is as a limited partner in a limited partnership that does business in Ohio does have nexus with Ohio under the Constitution of the United States and is subject to the franchise tax. Because the *UCOM* decision interprets the law as it existed prior to the amendment, the Department maintains that ***UCOM* does not apply under current law.**

Furthermore *UCOM* does not address the taxability of limited partnerships or other pass-through entities. For taxable years beginning after December 31, 1998 each "qualifying pass-through entity" is subject to a 5% withholding tax and an 8.5% entity tax based upon the qualifying investor's share of the qualifying pass-through entity's profits apportioned to Ohio. For more information on the Ohio pass-through entity tax please see the instructions for form IT-1140, the Ohio pass-through entity and trust tax return.

GENERAL INSTRUCTIONS AND INFORMATION

Unless otherwise stated, all references are to the Ohio Revised Code (ORC).

This instructions booklet does not apply to financial institutions because the apportionment ratio and net worth computation for financial institutions differ substantially from that of other corporations. The franchise tax instructions for financial institutions are contained in a separate instructions booklet.

The Ohio corporation franchise tax is an excise tax imposed on both domestic and foreign corporations for the privilege of 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 a calendar year. Unless an exemption applies (see general instruction #2), a corporation is subject to the franchise tax for each calendar year (tax year) that on the first day of January of that calendar year the corporation holds an Ohio charter, does business in Ohio, owns or uses a part or all of its capital or property in Ohio, holds a certificate of compliance authorizing the corporation to do business in Ohio, or otherwise has nexus with Ohio under the Constitution of the United States.

The calendar year in and for which the tax is paid is called the “tax year.” The tax year is also referred to as the “report year.” The franchise tax for tax year 2001 is paid for the privilege of doing business in Ohio during the calendar year 2001.

The accounting period on which the tax is based is called the “taxable year” and is defined as ". . . a period ending on the date immediately preceding the date of commencement of the corporation's annual accounting period that includes the first day of January of the tax year." A taxable year may consist of an aggregation of more than one federal taxable year and can exceed one year in length. The franchise tax for tax year 2001 is based upon the taxpayer’s activity during its taxable year ending in 2000. (ORC sections 5733.031(A) and 5733.04(E)).

The franchise tax is levied on the value of a corporation's issued and outstanding shares of stock. Generally a taxpayer corporation must determine the value of its issued and outstanding shares of stock under both the net income base and the net worth base and pay the tax on the base that produces the greater tax. However, different rules apply to financial institutions and qualifying holding companies:

- Financial institutions (see general instruction #1. C.) are not subject to the tax on the net income base but are subject to the tax on the net worth base at a higher rate than other taxpayers, and
- Qualifying holding companies (see general instruction #19) are not subject to the tax on the net worth base but are subject to the tax on the net income base.

Although a corporation that dissolves its Ohio charter or surrenders its license to conduct business in Ohio during 2000 is not subject to the franchise tax for tax year 2001, such corporation may be subject to the "exit tax." See general instruction # 6.

1. WHO MUST FILE

A. Corporations

Unless an exemption applies (see general instruction #2), each for-profit domestic corporation (a corporation organized for-profit under the laws of Ohio) and each Chapter 1729 corporation (agricultural cooperative) organized not-for-profit under the laws of Ohio is subject to the Ohio franchise tax. In addition, unless an exemption applies each foreign corporation (a corporation organized under the laws of another state, a possession or instrumentality of the United States, or a foreign country) organized for-profit, and each not-for-profit foreign agricultural cooperative organized or operating in the same or similar manner as a Chapter 1729 agricultural cooperative, for the privilege of doing business in Ohio, owning or using part or all of its capital or property in Ohio, holding a certificate of compliance with the laws of Ohio authorizing it to do business in Ohio, or otherwise having nexus with Ohio under the Constitution of the United States is subject to the franchise tax.

A corporation that is subject to the franchise tax must file an Ohio Corporation Franchise Tax Report. Financial institutions must file form FT-1120-FI; all other C corporations must file form FT-1120. Although S corporations (including S corporations that are financial institutions) and qualified subchapter S subsidiaries are generally not subject to the franchise tax, they must file a Notice of S Corporation Status, form FT-1120-S (see general instruction #2 .

B. Entity classification

Any entity that is treated as a corporation for federal income tax purposes is also treated as a corporation for franchise tax purposes. Thus, if a business trust, partnership or limited liability company (LLC) is treated as a corporation for federal income tax purposes it also will be treated as a corporation for franchise tax purposes. (See the Income Tax Audit Division's Information Release entitled “IRS 'Check-the-box' Entity Selection Regulations” dated August 19, 1997. Also see ORC section 5733.01 as amended by Amended Substitute House Bill 215, 122nd General Assembly and section 222 of the Bill.)

Any entity that is treated as a "disregarded entity" for federal income tax purposes is also treated as a disregarded entity for franchise tax purposes. Accordingly, a single member LLC that is treated as a division of the corporate member for federal income tax purposes will be treated as a division of the corporate member for franchise tax purposes. The corporate owner-member is subject to the franchise tax as if the LLC were a division of the corporation for both federal income tax and franchise tax purposes. See general instruction #2 for the treatment of qualified subchapter S subsidiaries.

C. Financial Institutions

A financial institution is not subject to the tax on the net income base but is subject to the tax on the net worth base at a higher rate than other taxpayers. Financial institutions must file form FT-1120-FI. The instructions for form FT-1120-FI are contained in a separate instructions booklet. ORC section 5725.01 defines a “financial institution” as any of the following:

- A national bank organized and existing as a national bank association pursuant to the “National Bank Act,” 12 U.S.C. 21;
- A federal savings association or federal savings bank that is chartered under 12 U.S.C. 1464;
- A bank, banking association, trust company, savings and loan association, savings bank, or other banking institution that is incorporated or organized under the laws of any state;
- Any corporation organized under 12 U.S.C. 611 to 631;
- Any agency or branch of a foreign depository as defined in 12 U.S.C. 3101;
- A company licensed as a small business investment company under the Small Business Investment Act of 1958, 72 Stat. 689, 15 U.S.C. 661, as amended; or
- A company chartered under the Farm Credit Act of 1933, 48 Stat. 257, 12 U.S.C. 1131(d), as amended.

Specifically excluded from the definition of a "financial institution" (and from the definition of a "dealer in intangibles") are insurance companies, credit unions, and corporations or institutions organized under the Federal Farm Loan Act and amendments thereto. In addition, for franchise tax purposes a production credit association is not a financial institution.

In order to qualify as a financial institution under prior law (applicable to tax years prior to 1998) a bank was required to maintain an Ohio office at which it accepted deposits. For tax years 1998 and thereafter that provision has been deleted from the definition of a financial institution. As such, for tax years 1998 and thereafter out-of-state banks that do business in Ohio or otherwise have nexus with Ohio but do not receive deposits at an office in Ohio are taxed as financial institutions rather than as regular taxpayers.

2. ENTITIES GENERALLY EXEMPT FROM THE FRANCHISE TAX

A. S Corporations and Qualified Subchapter S Subsidiaries

An S corporation generally is not subject to the Ohio corporation franchise tax. See ORC section 5733.09. However, an S corporation is subject to the franchise tax and must file an Ohio Corporation Franchise Tax Report (Form FT-1120) if the S corporation was a C corporation during any portion of a taxable year ending in 2000. See *Sanders Health & Fitness Inc. v. Limbach*, BTA Case No. 88-E-559, June 21, 1991. Furthermore, an S corporation must file Form FT-1120 and is subject to the franchise tax on the income attributed to it from a C corporation if the S corporation was the survivor of a merger with another corporation which was subject to the Ohio corporation franchise tax and on January 1 prior to the merger the two corporations met the ownership or control requirements for a combined franchise tax report (or if on January 1 prior to the merger the two corporations would have met the ownership or control requirements for a combined franchise tax report had both corporations existed on that date). See the Department’s September 24, 1992, Franchise Tax Information Release “Application of Ohio Revised Code Section 5733.053 (Transferor Statute) to the Merger of a C Corporation into an S Corporation.”

If a corporation is an S corporation for any portion of calendar year 2000, the S corporation must file a Notice of S Corporation Status (form FT-1120-S) by June 30, 2001.

A “qualified subchapter S subsidiary” (QSSS), as defined in IRC section 1361(b)(3)(B), is exempt from the franchise tax that is based on the taxable year for which the parent S corporation makes the election under IRC section 1361(b)(3)(B)(ii). A QSSS is exempt because its separate legal existence is ignored for purposes of the franchise tax. If a corporation is a QSSS for any portion of 2000, the corporation must file by June 30, 2001 a notice of S Corporation Status separate from the Notice of S Corporation status filed by its parent S corporation.

The Department's July 31, 1994 Information Release entitled “Taxation of S Corporations and Their Shareholders” sets forth the Department's policy interpretation of Ohio franchise tax law applicable to S corporations. The information release is available upon request from the Ohio Department of Taxation, P.O. Box 182857, Columbus, Ohio 43218-2857.

Note: For taxable years beginning after 1997 an S corporation that does business in Ohio or otherwise has nexus with Ohio is subject to the tax on pass-through entities enacted by Am. Sub. H.B. No. 215, 122nd General Assembly (Budget Bill) if one or more shareholders of the S corporation is a nonresident for any portion of the S corporation's taxable year and the S corporation does not file a composite Ohio income tax return (form IT-4708) on behalf of the nonresident shareholders. A QSSS is not subject to the tax on pass-through entities because its separate legal existence is ignored. However, the parent S corporation must include in its income the income of the QSSS. For a further explanation of the tax on pass-through entities see the instructions for form IT-1140, Tax Return for Pass-through Entities.

B. Public Utilities, Insurance Companies, Credit Unions and Dealers in Intangibles

- Any corporation, whether foreign or domestic, owning and operating a public utility required to file reports and pay an excise tax upon its gross receipts or gross earnings under Chapter 5727 of the Ohio Revised Code is not subject to the franchise tax. Railroads are subject to the franchise tax for tax years 1993 and thereafter.
- Insurance, fraternal, beneficial, bond investment, health maintenance organizations and other corporations required by law to file annual reports with the Superintendent of Insurance are not subject to the franchise tax.
- Credit unions and dealers in intangibles are not subject to the franchise tax.

C. REITs, RICs and REMICs

An entity, whether organized as a corporation or business trust, defined to be a real estate investment trust (REIT) under section 856 of the Internal Revenue Code, a regulated investment company (RIC) under section 851 of the Internal Revenue Code, or a real estate mortgage investment conduit (REMIC) under section 860D of the Internal Revenue Code is not subject to the franchise tax. The tax commissioner by journal entry has waived the investor reporting requirements for these entities for tax year 2001.

D. Corporations in Bankruptcy

A corporation in bankruptcy proceedings under Chapter 7 of the U. S. Bankruptcy Code is not liable for the franchise tax for that portion of the tax year during which the corporation's franchise is impaired because of the Chapter 7 bankruptcy proceedings. See ORC section 5733.06 (E). A corporation in Chapter 7 bankruptcy is not exempt from the $50 minimum fee. A corporation in reorganization proceedings under Chapter 11 of the U.S. Bankruptcy Code is not exempt from the franchise tax because a corporation in reorganization is not equivalent to a corporation which has been adjudicated bankrupt or for which a receiver has been appointed. See *Vought Industries, Inc. v. Tracy* (1995), 72 Ohio St. 3d 261.

3. TAX RATES

The tax rates are as follows:

- The first $50,000 of Ohio net income is subject to tax at a rate of 5.1%. However, 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% rate applies regardless of whether or not they actually file combined. Related taxpayers must prorate the $0 to $50,000 bracket on form FT-OTAS. Related taxpayers may prorate the $0 to $50,000 bracket amount in any amount they choose, but a taxpayer's pro-rata amount may not be less than zero. (Under prior law related taxpayers were required to share the $0 to $50,000 bracket only if they actually filed a combined report.) The proration, however made, applies to both the franchise tax and the litter tax.
- Ohio net income in excess of $50,000 is subject to tax at a rate of 8.5%
- The net worth rate for corporations other than financial institutions is 4 mills. In addition, the maximum net worth tax is $150,000 per taxpayer. The $150,000 limit applies separately to each member of a combined report; there is not an overall net worth limit for a combined group of taxpayers.

- The net worth rate for financial institutions is thirteen mills for tax years 2000 and thereafter. Financial institutions are exempt from the net income base, but the $150,000 net worth tax limit does not apply to financial institutions.
- The minimum fee is $50. See ORC section 5733.06

4. NEXUS

Unless an exemption applies, a corporation that has nexus in or with Ohio under the Constitution of the United States is subject to the franchise tax. A corporate investor in a pass-through entity that does business in Ohio or otherwise has nexus in or with Ohio under the Constitution of the United States is itself doing business in Ohio and has nexus with Ohio. Accordingly, a foreign corporation is subject to the franchise tax even if the corporation's only connection with Ohio is as a partner or limited partner in a partnership that has nexus with Ohio or as a member of a limited liability company that has nexus with Ohio.(A pass-through entity is defined as an S corporation, partnership, limited liability company, or any other person, other than an individual, trust, or estate, if the partnership, limited liability company, or other person is not classified for federal income tax purposes as an association taxed as a corporation. See ORC section 5733.04(O).)

Note: In *UCOM, Inc. v. Tracy,* BTA No. 997-K-880 (5-26-2000), the Board of Tax Appeals held that a foreign corporation commercially domiciled outside Ohio whose only nexus with Ohio was as a passive investor in a limited partnership that conducted business in Ohio was not subject to the franchise tax. The Department will follow the *UCOM* decision with regard to the franchise tax liability of a limited partner for taxable years ending prior to September 29, 1997. Effective that date, the Ohio General Assembly amended ORC section 5733.01 by including a new provision that subjects a foreign corporation to the franchise tax, namely: ". . . or otherwise having nexus with this state under the Constitution of the United States . . ." ORC section 5733.01(B) now states: "A corporation is subject to the tax imposed by section 5733.06 of the Revised Code for each calendar year that it is so organized, doing business, owning or using a part or all of its capital or property, holding a certificate of compliance, *or otherwise having nexus in or with this state under the Constitution of the United States,* on the first day of January of that calendar year." The Department maintains that under current law a foreign corporation whose only Ohio nexus is as a limited partner in a limited partnership that does business in Ohio does have nexus with Ohio under the Constitution of the United States and is subject to the franchise tax. As such, **the Department will not follow *UCOM* for taxable years ending on or after September 29, 1997 because *UCOM* interprets the law as it existed prior to the amendment.**

5. DISSOLUTION OR SURRENDER OF LICENSE

Each corporation seeking dissolution of its charter or surrender of its license to transact business in Ohio must submit to the Secretary of State a filing fee along with various affidavits or documents evidencing that the corporation has paid or adequately guaranteed various taxes and fees. For further information regarding the requirements of dissolving a corporation's charter or surrendering a corporation's license to conduct business in Ohio, please contact the office of the Secretary of State, 180 East Broad Street, 16th Floor, Columbus, Ohio 43215 or telephone that office at (614) 466-3910 or call toll free at 1-877 767-3453. For specific information necessary to obtain a tax release from the Ohio Department of Taxation, please contact the Ohio Department of Taxation, Taxpayer Services Division, P.O. Box 182382, Columbus, Ohio 43218-2382 or call toll free 1-888 405-4039.

The mere termination of business activities or voluntary dissolution does not exempt a corporation from the franchise tax. A corporation which on January 1 of the tax year holds a charter or license to transact business in Ohio is subject to the Ohio franchise tax for that tax year even if prior to the beginning of the tax year it has ceased all business activities in Ohio and has applied for certificates showing the payment or adequate guarantee of all required taxes.

For tax years 1999 and thereafter a corporation which previously had nexus with Ohio but is not a franchise taxpayer on January 1 of the tax year because the corporation dissolved or surrendered its license to conduct business in Ohio prior to January 1 of the tax year is subject to an income-based tax on its Ohio net income that was not reported on an earlier franchise tax report. See "Exit Tax" below.

6. EXIT TAX

For tax years 1999 and thereafter an "exiting corporation" is subject to an income-based exit tax on its unreported Ohio net income that was earned in the two calendar years prior to the tax year to the extent that such income was not previously included on a franchise tax report. An exiting corporation is a corporation which previously had nexus with Ohio but is not a franchise taxpayer because the corporation dissolved or surrendered its license to conduct business in Ohio prior to January 1 of the tax year. An exiting corporation is not subject to tax on the net worth base and is not subject to the fifty dollar minimum fee.

The exit tax does not apply to an exiting financial institution and does not apply if the exiting corporation is a "transferor" as defined in ORC section 5733.053. The exit tax is set forth in ORC section 5733.06(H) and is effective for tax years 1999 and thereafter (see section 210 of House Bill 215). As such, the exit tax applies to corporations that exit Ohio in 1998 and thereafter.

An exiting corporation is <u>not</u> subject to either the tax on the net worth base or to the litter tax on the net worth base. However, an exiting corporation is subject to the litter tax on the net income base. An exiting corporation is subject to the ORC section 5733.052 combination provisions and all deductions and credits applicable to franchise taxpayers. An exiting corporation must compute its exit tax on the franchise tax form applicable to the tax year following the calendar year during which the corporation exits Ohio. The corporation must file the report by May 31 of the year following the year the corporation exits Ohio. However, upon request by the exiting corporation, the tax commissioner can extend the date for filing the report, but not the date for paying the tax.

An exiting corporation that has a fiscal year end must include on <u>one</u> franchise tax report all of its unreported net income even if the income would have been included on two franchise tax reports had the corporation remained subject to the franchise tax. See ORC section 5733.06(H).

EXAMPLE:

ABC Inc. is chartered in another state and has operated in Ohio since 1989. ABC has a January 31 fiscal year end and filed its 2000 franchise tax report based on the fiscal year beginning February 1, 1998 and ending January 31, 1999. ABC shut-down its Ohio operations and legally withdrew from Ohio on December 1, 2000. ABC is not a "transferor" as defined in ORC section ORC 5733.053 because ABC did not transfer its assets or equity to another corporation with Ohio nexus. Although ABC is not a franchise taxpayer on January 1, 2001, ABC is nevertheless subject to the exit tax on its unreported Ohio net income earned during the twenty-two month period beginning February 1, 1999 and ending December 1, 2000 (the date that it withdrew from Ohio).

ABC must report its income for the entire twenty-two month period February 1, 1999 to December 1, 2000 on a 2001 franchise tax report even though income for the period February 1, 2000 to December 1, 2000 would have been reported on a year 2002 franchise tax report if ABC would have had nexus with Ohio on

January 1, 2002 and remained subject to the franchise tax. ABC's 2001 tax report is due by May 31, 2001, and all exit tax due is payable at that time notwithstanding other provisions of Chapter 5733 to the contrary. However, upon the taxpayer's request the tax commissioner may grant an extension of time to file the report (but the law contains no provision for an extension of time to pay).

7. ACCOUNTING PERIOD - TAXABLE YEAR

A corporation's taxable year for franchise tax purposes generally is the same as the corporation's taxable year for federal income tax purposes. If a corporation's taxable year is changed for federal income tax purposes, the corporation's franchise tax taxable year is changed accordingly. Effective September 29, 1997, Amended Substitute House Bill 215, 122nd General Assembly redefined the term "taxable year" as the ". . . period ending on the date immediately preceding the date of commencement of the corporation's annual accounting period that includes the first day of January of the tax year." Under the new law a taxable year may consist of an aggregation of more than one federal taxable year. Thus, a taxable year can exceed one year in length. In addition, the law gives the tax commissioner authority to write rules prescribing an appropriate period as the taxable year for the following: (a) a corporation that has changed its taxable year for federal income tax purposes, (b) a corporation that as a result of a change of ownership has two or more short federal taxable years, and (c) a new taxpayer that would otherwise not have a taxable year.

Except for taxpayers that have changed their accounting period and for taxpayers that have two or more federal taxable years that ended in calendar year 2000, taxpayers must determine the value of their issued and outstanding shares of stock under the net income basis and the net worth basis as follows:

For report year 2001 taxpayers that have a calendar year end: use the period ending December 31, 2000.

For report year 2001 taxpayers that have a fiscal year end: use the fiscal period ending in 2000. However, taxpayers filing their first report should see below.

For report year 2001 taxpayers that are filing their first report: use the applicable period set forth below:

A. If a taxpayer incorporated in Ohio during 2000 and adopted a fiscal period ending in 2000, then the taxpayer must use the accounting period commencing on the date of incorporation and concluding with the last day of the fiscal period ending in 2000.

B. If the taxpayer is a foreign corporation and first became an Ohio taxpayer during 2000 (that is, during 2000 the corporation began doing business in Ohio, began owning or using part or all of its capital or property in Ohio, obtained a license authorizing it to do business in Ohio or otherwise established nexus with Ohio under the Constitution of the United States) and after it became an Ohio taxpayer its fiscal year ended in 2000, then the taxpayer must use the accounting period commencing on the earliest of the following: (i.) the date that it began doing business in Ohio, (ii.) the date that it began owning or using a part or all of its capital or property in Ohio, (iii.) the date that it obtained a license authorizing it to do business in Ohio, or (iv.) the date that it established nexus with Ohio under the Constitution of the United States. The accounting period will end on the taxpayer's fiscal year ending in 2000.

C. All other new taxpayers will use the accounting period commencing with the earliest of the four dates set forth in B., above, and concluding with December 31, 2000. See paragraphs (E)(2) and (E)(4) of Tax Commissioner's Rule 5703-5-03,

Taxpayers that have changed their accounting period and taxpayers that have two or more short federal taxable years - The Department of Taxation has adopted the following rules regarding franchise taxpayers' taxable years and changes of accounting periods:

- 5703-5-01 - Definitions Applicable to Rules 5703-5-01 to 5703-5-05 of the Administrative Code
- 5703-5-02 - Date as of Which the Value of a Taxpayer's Issued and Outstanding Shares of Stock is Determined
- 5703-5-03 - Dates on Which a Taxpayer's Taxable Year Begins and Ends
- 5703-5-04 - Changes of a Taxpayer's Annual Accounting Period

Important features of these rules are as follows:

- Generally, a taxpayer's taxable year begins on the date immediately following the end of the taxpayer's prior taxable year and ends on the date immediately preceding the beginning of the taxpayer's annual accounting period that includes the first day of January of the tax year.
- If a taxpayer changes its annual accounting period, there will be (i) no period that is not subject to tax, (ii) no period that is subject to tax in more than one tax year, and (iii) no choice of accounting periods.
- A franchise tax "taxable year" under certain circumstances may be more than or less than one year in length. If a taxable year is more than one year in length, it is proportionately reduced to one year by multiplying the income for the taxable year by a fraction, the numerator of which is 365 and the denominator of which is the number of days in the taxable year. If the taxable year is less than one year, annualization is not required.

If the corporation changed its taxable year in 1999 or 2000 or if the corporation had more than one federal taxable year that ended in calendar year 2000, please contact the Department of Taxation for a copy of the rules and time line illustrations of the rules. Send your request to the Ohio Department of Taxation, P.O. Box 182857, Columbus, Ohio 43218-2857, Attn: Rules.

8. METHODS OF COMPUTING TAX

In determining the Ohio franchise tax due, taxpayers other than financial institutions and qualifying holding companies must compute the tax on both the net worth base and the net income base and pay the tax on the base that produces the greater tax. Financial institutions are not subject to the tax on the net income base, and qualifying holding companies are not subject to the tax on the net worth base. In any event the minimum fee is $50.00.

Although an "exiting corporation" is not subject to the franchise tax, it may be subject to an income based exit tax. An exiting corporation is not subject to the $50 minimum fee. See general instruction #6.

9. TIME, PLACE AND METHOD FOR FILING AND PAYMENT

A. Filing Date; Payment Date

The filing and payment of the Ohio franchise tax for report year 2001 is due between the January 1 and March 31, 2001. However, if the Ohio Corporation Franchise Tax Report is not filed by January 31 and if full payment is not made by January 31, then Form FT-1120E, Declaration of Estimated Corporation Franchise Tax, must be filed by January 31 along with payment of one-third of the estimated tax, but not less than the $50 minimum fee.

If the due date of the report or the due date of an extension or payment falls on a Saturday, Sunday or legal holiday, then the report, extension, or payment may be made on the next succeeding day which is not a Saturday, Sunday or legal holiday. Certain large taxpayers must pay by electronic funds transfer (see **general instruction 9**. D).

Except as otherwise provided, if a payment or document is mailed on or before the due date but delivered after the required date, the date postmark is deemed the date of delivery.

B. Extension

The tax commissioner will grant an extension of time for filing the report until May 31 if by March 31 the taxpayer submits form FT-1120ER together with payment of the second one-third of the estimated tax due.

Additional Extension. The tax commissioner will grant an additional extension of time for filing the report beyond May 31 if the corporation has been granted an extension by the Internal Revenue Service and by May 31 the taxpayer submits form FT-1120EX together with the balance of the tax due. The second extension extends the filing date to the 15th day of the month following the month for which the Internal Revenue Service has granted an extension for filing the corporation's federal income tax return. The taxpayer must attach a copy of the federal extension to the franchise report, form FT-1120, when filed

The table below lists the latest possible due dates for filing the 2001 franchise tax report for the various taxable years ending in 2000. The table assumes the following:

- If the taxpayer's taxable year ended on or after August 31, 2000, the taxpayer has the maximum allowable federal extension,
- The taxpayer has timely filed franchise tax forms FT-1120E, FT-1120ER, and, where applicable, FT-1120EX, and
- The taxpayer has timely made all estimated franchise tax payments.

Taxable Year Ending	Latest Possible Due Date for Filing the 2001 Franchise Tax Report
01/31/00 through 7/31/00	05/31/2001
08/31/2000	06/15/2001
09/30/2000	07/15/2001
10/31/2000	08/15/2001
11/30/2000	09/15/2001
12/31/2000	10/15/2001

Note: Each member of a combined franchise tax report must file its own separate forms FT-1120E, FT-1120ER, and FT-1120EX. Payment of all franchise tax for tax year 2001 is due by May 31, 2001, even if the taxpayer has an extension to file after that date.

C. Place

File the franchise tax report with the Treasurer of State, P.O. Box 27, Columbus, Ohio 43266-0027.

D. EFT Method of Payment

Certain large taxpayers must pay by electronic funds transfer (EFT). For tax years 1997 and thereafter a taxpayer must use EFT if the taxpayer's total franchise tax liability after reduction for nonrefundable credits exceeded $50,000 for the second preceding tax year. For further EFT information see the Department's July 31, 1994 Franchise Tax Information Release entitled "Recently Enacted Legislation Revises the Requirements for Corporations Paying Corporate Franchise Tax by Electronic Funds Transfer (EFT)." The information release is available from the Ohio Department of Taxation, P.O. Box 182857, Columbus, Ohio 43218-2857, Attn: EFT Information Release. Please direct questions regarding the EFT payment program to the Treasurer of State's office at 30 East Broad Street, 9th floor, Columbus, Ohio 43266-0421 or telephone that office at 614-466-8063 or toll free at 1-877-EFT-Ohio (338-6446).

10. INTEREST ON UNDER- AND OVERPAYMENTS

If a corporation fails to pay the tax by the due date, interest accrues on the unpaid tax. Interest on tax due is charged in addition to any penalties which may be incurred for late filing and late payment or failure to file. The period of the underpayment runs from the date the tax payment was required to be made to the date on which such payment is made.

Interest on franchise tax overpayments runs from whichever of the following dates is the latest until the date the refund is paid:

- the date of payment,
- the ninetieth day after the final date the franchise tax report was required to be filed, or
- the ninetieth day after the date that the franchise tax report was filed.

Effective for net capital losses arising in taxable years ending on or after July 31, 1991, interest on an overpayment resulting from a net capital loss carryback is payable from the due date plus extensions for the report in which the loss arises (rather than from the report year to which the loss is carried back**).**

The interest rate on underpayments is the same as the interest rate on overpayments. During calendar year 2001 interest on both underpayments and overpayments will accrue at the rate of 9% per annum.

11. PENALTIES FOR LATE PAYMENT, FAILURE TO FILE, OR LATE FILING

- Penalty may be imposed for failure to timely pay the tax (including estimated tax). The penalty imposed may not exceed twice the interest charge.
- Penalty may be imposed for failure to file or timely file a report. The penalty imposed may not exceed the greater of (i) $50 per month up to $500 or (ii) 5% per month of the tax due shown on the report up to 50%.
- Additional penalties may be imposed for filing a fraudulent report and for filing a fraudulent refund claim.

12. OFFICERS, STATUTORY AGENT AND SIGNATURE

All franchise tax reports must be signed by the president, vice-president, secretary, treasurer, general manager, superintendent, or managing agent of such corporation in Ohio. If a domestic corporation has not completed its organization, one of its incorporators must sign the report. In addition, each taxpayer must list its president, secretary and treasurer along with the name and address of its statutory agent.

13. REPORTING FEDERAL CHANGES

If as a result of amendment or adjustment to the taxpayer's federal income tax return by the taxpayer or by the Internal Revenue Service or, if as a result of any other recomputation or redetermination, a change occurs in the taxpayer's federal tax liability or any item entering the computation of the taxpayer's federal taxable income as reported for federal income tax purposes, the taxpayer must report such change to the Ohio Department of Taxation in the form of an amended report by the earliest of the following:

- One year after final determination of the adjustment for federal income tax purposes,
- One year after the taxpayer paid the additional federal income tax as a result of the adjustment (whether or not the adjustment was agreed to) or
- One year after the taxpayer received a federal income tax refund as result of the adjustment.

This provision applies even if the three-year statute of limitations has passed and applies to amended reports which reflect overpayments as well as to amended reports which reflect underpayments. If the amended report reflects an underpayment, the amended report must be accompanied by payment of any additional tax and interest. If the amended report reflects an overpayment, the amended report must be accompanied by form FT-REF, Application for Refund (please refer to general instruction # 25).

14. AMOUNTS REPORTED FROM FEDERAL TAX RETURN

Amounts reported from the Federal Form 1120 or 1120A, as well as Ohio adjustments and allocations, are subject to verification and audit by the Ohio Department of Taxation.

15. METHODS OF ACCOUNTING

A taxpayer's method of accounting under the net income base must be the same as its method of accounting for federal tax purposes. If the taxpayer changes its method of accounting for federal income tax purposes, the taxpayer must also change its method of accounting under the net income base. In the absence of any method of accounting for federal income tax purposes, income must be computed under such method as the tax commissioner deems proper.

The tax on the net worth base must be determined from the books of the corporation which the taxpayer must keep in accordance with a generally recognized and approved accounting system. The tax-basis method of accounting is a generally recognized and approved accounting system. See *Gray Horse, Inc. v. Limbach* (1993), 66 Ohio St. 3d 631. If a taxpayer keeps its books both in accordance with regulatory accounting principles and in accordance with generally accepted accounting principals, the value of the taxpayer's issued and outstanding shares of stock under the net worth base (division (C) of Ohio Revised Code section 5733.05) must be based upon those books kept in accordance with generally accepted accounting principles. See Tax Commissioner's Rule 5703-5-08.

16. ROUNDING OFF TO WHOLE DOLLAR AMOUNTS

The money items of Form FT-1120 and accompanying schedules must be shown as whole dollar amounts by eliminating amounts less than 50 cents and increasing amounts from 50 cents to 99 cents to the next highest dollar.

17. RECORDS TO BE MAINTAINED

Every corporation must maintain books and records which substantiate the information reported on its Ohio Corporation Franchise Tax Report. These books and records must be available for inspection by agents of the Ohio Department of Taxation for a period of four years from the later of (a) the date the taxpayer filed the franchise report or (b) the date the taxpayer was required to file the report. See the line instructions for Schedule A, line 12 for records to be maintained pertaining to net operating loss carryforwards.

18. HOLDING COMPANIES OF INSURANCE COMPANIES, PUBLIC UTILITIES AND FINANCIAL INSTITUTIONS

A taxpayer that owns at least 25% of the issued and outstanding shares of common stock of one or more financial institutions as defined in Ohio Revised Code Chapter 5725 or a taxpayer that owns at least 80% of the issued and outstanding shares of common stock of one or more public utilities or insurance companies as defined in Ohio Revised Code Chapters 5727 and 5725, respectively, must exclude from its sales factor the receipts from sales to such financial institutions, public utilities, or insurance companies.

In addition, a taxpayer that owns at least 80% of the issued and outstanding shares of common stock of one or more public utilities or insurance companies may deduct, to the extent not otherwise allowed, the dividends received from such public utilities and insurance companies.

Under prior law (applicable to tax years 1998 and earlier) taxpayers that owned at least 25% of the issued and outstanding shares of common stock of one or more financial institutions and taxpayers that owned at least 80% of the issued and outstanding shares of common stock of one or more public utilities or insurance companies were entitled to exclude from their franchise tax net worth base a portion of the taxpayer corporation's investment in such financial institution, public utility or insurance company. Under current law (for tax years 1999 and thereafter), as amended by House Bill 215, 122nd General Assembly such taxpayer corporations may no longer exclude from their net worth a portion of their investment in such financial institutions, public utilities and insurance companies.

Because of the above-noted change in the law, the franchise tax "Supplemental Franchise Tax Schedules for Holding Companies of Insurance Companies, Public Utilities, and Financial Institutions" have been eliminated. The sales factor adjustment and the dividends received adjustments for holding companies (explained above) are now reflected on the franchise tax report itself.

19. QUALIFYING HOLDING COMPANY

For tax years 1999 and thereafter a qualifying holding company is exempt from the net worth base of the franchise tax (but not the net income base). A qualifying holding company is any corporation that satisfies all six of the following requirements:

- The corporation's "intangible assets ratio" equals or exceeds 90%,
- The corporation's "investment in related members ratio" equals or exceeds 50%,
- During the taxable year the corporation's "gross income from intangible assets ratio" equals or exceeds 90%,
- The corporation is not a financial institution on the last day of the taxable year ending prior to the first day of the tax year,
- The corporation's related members adjust their net worth and debt for purposes of computing their franchise tax on the net worth base, such that the related members' debt-to-equity ratio equals the consolidated debt-to-equity ratio of the "qualifying controlled group." (A "qualifying controlled group" is defined in ORC section 5733.04(M) as two or more corporations that satisfy the ORC section 5733.052(A) ownership and control requirements to file a combined report.), and
- The corporation elects to be treated as a qualifying holding company for the tax year by filing form FT-QHC.

For further information see form FT-QHC and ORC sections 5733.04(L), 5733.05(C)(2), and 5733.06(C).

A qualifying holding company is not a "quiescent holding company." See general instruction # 20.

20. QUIESCENT HOLDING COMPANY

Quiescent holding company status does not apply to tax years 1999 and thereafter. Under prior case law (see *Nationwide Corp. v. Schneider* (1966), 7 Ohio St.2d 59) a taxpayer was a quiescent holding company if its business activities were not sufficient to constitute "doing business." As a quiescent holding company, a taxpayer was not required to compute a net worth base "business done" factor which in effect reduced a taxpayer's net worth "Ohio ratio" to one half of its property ratio. (Under prior law the net worth base "Ohio ratio" equaled one-half the sum of the "business done ratio" and the net worth "property ratio.") House Bill 215, 122nd General Assembly replaced the net worth base "Ohio ratio" with the net income base apportionment ratio. The new law eliminates "quiescent holding company" status because, unlike the Ohio ratio, if the denominator of any factor of the apportionment ratio is zero, the weight given to the other factors must be proportionately increased so that the total weight given to the combined number of factors used is 100%.

21. COMBINED REPORTS

A taxpayer that on January 1 of the tax year owns or controls either directly or indirectly more than 50% of the voting stock of another taxpayer corporation may elect to combine net income with that corporation. A “taxpayer” is a corporation subject to the franchise tax.

Taxpayers whose voting stock is more than 50% owned or controlled either directly or indirectly by another corporation or by related interests may also elect to combine net income. Brother-sister taxpayer corporations owned by an individual may elect to combine, and brother-sister taxpayer corporations owned by a parent corporation may elect to combine without inclusion of the parent corporation. However, where an election to combine is made by less than all eligible taxpayer corporations, the combined group must attach an explanation of the reason for the nonparticipation by such eligible taxpayer corporations.

An elected combination may include only taxpayers that have income [either positive income or negative income (loss)], other than dividend income, from sources within Ohio. "Income from sources within Ohio" means income that would be allocated or apportioned to Ohio if the taxpayer were not included in a combined report. Those taxpayer groups that elected to combine in prior tax years must amend their combinations to delete taxpayers that do not have income, other than dividend income, from sources within Ohio.

Taxpayers that elect to combine must do so in a timely filed franchise tax report. A timely filed report is a report filed within the time prescribed by ORC sections 5733.02 and 5733.13. Only one member of a combined franchise tax group must satisfy the ORC section 5733.052(B) timely election requirement. A combination is timely elected if any member of the combination has complied with all of the franchise tax report deadlines even if other members have not complied timely. Thus, a taxpayer that fails to make timely estimated payments and fails to file timely extension requests may file in combination with other corporations after the due date of the taxpayer's report if another corporation in the combined group has timely made its estimated payments, has timely filed its extension requests, and has timely elected to file in combination with the taxpayer. See *Roxane Laboratories, Inc. v. Tracy* (1996), 75 Ohio St. 3d 125. Taxpayers which first filed separately may not elect to combine by filing an amended report after the due date of the report even if the amended report is filed within the three year refund statute of limitations. See *Olan Mills Inc. of Tenn. v. Limbach* (1990), 56 Ohio St. 3d 70.

Each member of a combined franchise tax report must separately file a Declaration of Estimated Tax (form FT-1120E) and Request(s) for Extension (forms FT-1120ER and FT-1120EX). See general instructions # 9(A) and 9(B). Members of a combined report that fail to comply with the filing deadlines are subject to the applicable penalty and interest charges.

An election to combine may not be changed either in amended reports or in reports for future years without the written consent of the tax commissioner. The addition of a new member to a previously elected combination and the deletion of a member that was previously included (other than a corporation that does not satisfy the income or ownership requirements) is a change in that election. Accordingly, taxpayers that seek to add or delete member(s) to an already existing combination must receive the tax commissioner's consent. See ORC section 5733.052(B) and *Tranzonic Companies and Subs. v. Tracy*, BTA Case No. 90-M-1443, December 4, 1992. Taxpayers that request such consent must file Form FT-COM, Request for Permission to File or to Amend a Combined Corporation Franchise Tax Report.

If the above-discussed 50% ownership requirements are met, the tax commissioner may require or permit a taxpayer and one or more other corporations (whether or not such corporations are taxpayers and whether or not such corporations have income from sources within Ohio) to combine their net income. A combination of this type will not be required or permitted unless it is necessary because of intercorporate transactions to properly reflect income and the tax liability.

Note: Effective June 30, 1997 Amended Substitute House Bill No. 215 (Budget Bill), 122nd General Assembly returned the tax commissioner's authority to require related corporations to file combined reports to the state of the law as it existed prior to enactment of Section 162 of Amended Substitute House Bill 298 of the 119th General Assembly. Specifically, section 206 of HB 215 amended section 162 of Amended Substitute House Bill 298 by repealing the following paragraph in section 162:

> *For tax year 1992 and thereafter, the existence between a related member and a taxpayer of a relationship, with respect to the use of intangible property, of lessor and lessee, respectively, licensor and licensee, respectively, of creditor and debtor, respectively, or the existence between a related member and a taxpayer of any similar relationship pursuant to which the taxpayer directly or indirectly pays or accrues to a related member any expense or costs for the use of intangible property shall not by itself be sufficient grounds for the tax commissioner to require that the taxpayer and any such related member file combined returns. For purposes of this section, the term 'related member' has the same meaning as in division (A)(6) of section 5733.042 of the Revised Code as enacted by this act.*

The Department will generally pursue combinations or expanded combinations only in those situations where the failure either to combine or to expand the combination will result in the filing of a corporation franchise tax report which does not properly reflect income and does not properly reflect the tax liability imposed by ORC section 5733.06. A timely conducted IRC section 482-type study conforming with the requirements set forth in IRC section 482 and in the U.S. Treasury regulations issued under section 482 will avoid this Department's seeking either a combination or an expanded combination. See the Department's June 23, 2000 Information Release entitled, "IRC Section 482 Study: Safe Harbor to Avoid Ohio Corporate Franchise Tax Report Required or Expanded Combinations." Taxpayers that request the tax commissioner's permission to include in the combined report corporations which are not subject to the franchise tax must file Form FT-COM.

Corporations that file combined franchise tax reports must prorate combined apportioned net income to each member in the group (See form FT-1120C). Each corporation must then compute its own Ohio taxable income and net income-based tax on its own form FT-1120. Each taxpayer in a combined report must separately determine its tax on the net worth base. Net worth is not combined.

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% rate applies regardless of whether or not they actually file combined. Related taxpayers must prorate the $0 to $50,000 bracket on form FT-OTAS.

22. EXEMPTION FOR ENERGY CONVERSION FACILITIES

Corporations that construct energy facilities, solid waste energy conversion facilities and thermal efficiency improvement facilities may be entitled to an exemption for such facilities on the Ohio Corporation Franchise Tax Report.

To qualify for the exemption, a corporation must obtain a certificate issued by the tax commissioner. For an application and information concerning the franchise tax exemption for such facilities please contact the Ohio Department of Taxation, Personal Property Tax Division, Attn: Pollution Control, 30 East Broad St., P.O. Box 530, Columbus, Ohio 43266-0030 or call (614) 466-8581.

23. ENTERPRISE ZONE TAX BENEFITS

Amended Substitute House Bill 283, 123rd General Assembly (Budget Bill) extends through June 30, 2004 the authority for local governments to enter into enterprise zone agreements. See ORC section 5709.62 as amended by the bill. (Under prior law the authority for local governments to enter into enterprise zone agreements would have expired on June 30, 1999.)

Businesses that establish, expand, renovate or occupy a facility pursuant to an enterprise zone agreement and that create new jobs in a certified enterprise zone without reducing employment elsewhere in

Ohio may be entitled to a series of tax benefits on their Ohio Corporation Franchise Tax Report (see ORC sections 5709.64 and 5709.65). Among these benefits are an employee training credit, a day-care credit (see credit #16 in the instructions for Schedule A-1), exclusion of qualifying property and payroll from the numerators of the net income base property and payroll factors, and treatment of the qualifying property as an exempted asset under the net worth base.

To qualify for franchise tax enterprise zone benefits, businesses must hold for the taxable year a Tax Incentive Qualification Certificate (issued by the Department of Development) and must hire new employees to fill nonretail positions at the facility. Also, at the time of employment at least twenty-five percent of the new employees must have been at least one of the following:

- Unemployed persons who had resided at least six months in the county in which the enterprise's project site is located;
- Job Training Partnership Act eligible employees who had resided at least six months in the county in which the enterprise's project site is located;
- Recipients of aid to dependent children, general relief, or unemployment compensation benefits who had resided at least six months in the county in which the enterprise's project site is located;
- Handicapped persons, as defined under division (A) of section 3304.11 of the Revised Code, who had resided at least six months in the county in which the enterprise's project site is located;
- Residents for at least one year of a zone located in the county in which the enterprise's project site is located. See ORC sections 5709.64 and 5709.65.

In addition to the enterprise zone franchise tax benefits described above, a taxpayer may apply to the Director of Development for an "employee tax credit certificate" for each eligible new employee the enterprise hires after June 30,1994 at the facility to which the enterprise zone agreement applies provided that the taxpayer is complying with an enterprise zone agreement and has not closed or reduced employment at any place of business in Ohio within the twelve months preceding the application. For more information on the Credit for Eligible New Employees in an Enterprise Zone see credit #10 in the instructions for Schedule A-1.

For a further discussion and summary of Ohio's enterprise zone program see Stempfer, "Economic Development Program Opportunities In Ohio, Summary and Update Focusing on Recent Tax-Related Legislation," *Ohio Tax Review*, vol. 8.3 (1994).

24. ASSESSMENTS

The tax commissioner may issue an assessment against the taxpayer for any deficiency within three years after the later of the following:

- The final date the report subject to assessment was required to be filed, or
- The date the report was filed.

However, both the assessment statute of limitations and the refund statute of limitations may be extended for an agreed upon period if both the taxpayer and the tax commissioner consent in writing to the extension by signing form FT-WAIVER.

An amended franchise tax report filed as a result of an adjustment to the corporation's federal income tax return (see general instruction #13) is deemed a report subject to assessment. However, the amended report does not reopen those facts, figures, computations or attachments from a previously filed report no longer subject to assessment or refund that are not affected, either directly or indirectly, by the adjustment to the corporation's federal income tax return. Furthermore, once the three-year refund statute of limitations has passed, the taxpayer may not offset the additional franchise tax resulting from IRS audit adjustments against franchise tax that the taxpayer erroneously overpaid due to errors or mistakes unrelated to the federal adjustments. See *Gen. Motors Corp. v. Limbach* (1993), 67 Ohio St. 3d 90.

The statute of limitations does not prohibit either the tax commissioner or the taxpayer from adjusting the net operating loss carried forward from a year closed to assessment or refund to a year still open to assessment or refund; nor does the statute of limitations prohibit either the tax commissioner or the taxpayer from adjusting the unused credits carried forward from a year closed to assessment or refund to a year still open to assessment or refund. See *Consumer Direct v. Limbach* (1991), 62 Ohio St. 3d 180.

If the taxpayer does not pay the assessment within sixty days of receipt of the assessment, and does not file a petition for reassessment within sixty days of receipt of the assessment, interest accrues on the assessment at the rate prescribed in ORC section 5703.47 from the date the tax commissioner issues the assessment until the taxpayer pays the assessment.

If the taxpayer disagrees with an assessment, the taxpayer may object to the assessment by filing a petition for reassessment. See general instruction #25.

25. APPLICATION FOR REFUND AND PETITION FOR REASSESSMENT

To request a refund in connection with the Ohio Corporation Franchise Tax Report corporations **must** use prescribed form FT-REF, Application for Corporation Franchise Tax Refund.. The filing of an amended return without the application for refund is not sufficient and does not constitute the application for refund as contemplated by ORC section 5733.12. See *S. E. Nichols, Inc. v. Tracy* (Dec, 27, 1993), BTA. No. 92-A-1543. **An application for refund is not required when the claimed overpayment is indicated on the originally filed franchise tax report.** Corporations may use form FT-PR, Petition for Reassessment, to initiate review proceedings in connection with a franchise tax assessment issued by the Department of Taxation.

Application for Corporation Franchise Tax Refund. Form FT-REF applies to claimed overpayments by a taxpayer, whether made voluntarily or as the result of the payment of an assessment issued by the Ohio Department of Taxation. If the overpayment is not the result of an IRS adjustment and the statute of limitations has not been extended by form FT-WAIVER (see general instruction #24), then the Department must receive the application for refund within three years of the date of the illegal, erroneous, or excessive payment. Payments remitted with the estimated tax report (Form FT-1120E) and extension requests (Forms FT-1120ER and FT-1120EX) are deemed to have been made on the earlier of the date the Ohio Corporation Franchise Tax Report was filed or the due date of the report including extensions. Thus, if a franchise tax report is filed before its extended due date, the three year refund statute of limitations begins to run on the date the report was filed rather than the extended due date. See *Hanna Mining Co. v. Limbach* (1985), 20 Ohio St. 3d 3 and *Athena Manor, Inc. v. Limbach*, BTA Case No. 91-Z-12, February 26, 1993.

If the claimed overpayment is the result of a change in federal taxable income, then the Department must receive the application for refund within the later of the following: (a) the three-year time period set forth above, or (b) the one-year period set forth in general instruction # 13. However, if the refund claim is filed outside the three year refund statute of limitations and the statute of limitations has not been extended by form FT-WAIVER (see general instruction #24), the refund claim can include only the direct and indirect effects of the federal adjustments. See *Gen. Motors Corp. v. Limbach* (1993), 67 Ohio St. 3d 90 and *The First Federal Savings Bank v. Tracy*, BTA Case No. 94-T-1353, August 23, 1996.

Regardless of the above provisions to the contrary, a franchise tax refund claim that is based on a capital loss carryback is timely if the refund claim is filed within three years from the due date of the franchise tax report (including extensions thereof) for the taxable year in which the capital loss arose. See *Prechter v. Tracy*, BTA Case No. 95-M-1214, April 4, 1997.

A taxpayer may not appeal an assessment by filing an application for refund unless the taxpayer has paid the assessment. For example, if the taxpayer fails to file a petition for reassessment within sixty days of receipt of the assessment, then the taxpayer cannot file a refund claim protesting the assessment until after the taxpayer has paid the assessment.

Petition for Reassessment. Form FT-PR (formerly known as Application for Review and Correction, Form FT-RC) applies only to assessments issued by the Ohio Department of Taxation. A taxpayer must file its petition within sixty days of receipt of the assessment. If the taxpayer sends the petition by certified mail, the date of postmark is considered the date filed. If the taxpayer sends the petition by regular mail, the date the Department receives the petition is considered the date filed. The petition must specify the items of the assessment objected to and the reasons for those objections. However, a taxpayer who has timely filed a Petition for Reassessment may raise additional written objections to the assessment at any time prior to the date of the tax commissioner's final determination. If a taxpayer fails to file the petition for reassessment within the sixty day period described above, the tax commissioner will dismiss the petition as the tax commissioner has no jurisdiction to consider a late-filed petition.
The portion of an assessment which must be paid upon the filing of a Petition for Reassessment is as follows:

a. If the sole item objected to is the assessed penalty or interest, the assessed corporation must pay the entire assessment except for the penalty.

b. If prior to the date of issuance of the assessment the assessed corporation failed to file (i) the annual report required by section 5733.02 of the Revised Code, (ii) any amended report required by division (C) of section 5733.031 of the Revised Code for the tax year at issue, or (iii) any amended report required by division (D) of section 5733.067 of the Revised Code to indicate a reduction in the amount of the credit provided under that section, the assessed corporation must pay the entire assessment except for the penalty.

c. If prior to the date of issuance of the assessment the assessed corporation filed (i) the annual report required by section 5733.02 of the Revised Code, (ii) all amended reports required by division (C) of section 5733.031 of the Revised Code for the tax year at issue, and (iii) all amended reports required by division (D) of section 5733.067 of the Revised Code to indicate a reduction in the amount of the credit provided under that section, and if a balance of the taxes shown due on the reports as computed on the reports remains unpaid, the assessed corporation must pay only that portion of the assessment representing any unpaid balance as shown on those reports together with all related interest.

d. If the assessed corporation does not dispute that it is a taxpayer but claims the protections of section 101 of Public Law 86-272, 73 Stat. 555, 15 U.S.C.A. 381, as amended, the assessed corporation must pay only that portion of the assessment representing any unpaid balance of taxes shown due on the corporation's annual report.

e. If none of the conditions specified in (a), (b), (c) and (d) above apply, or if the assessed corporation claims that it is not a taxpayer (that is, if the assessed corporation disputes that it is subject to the franchise tax), the assessed corporation is not required to pay any portion of the assessment.

However, any unpaid portion of the assessment which upon final determination is found to be correct bears interest at the rate prescribed in ORC section 5703.47 from the date the Department of Taxation issues the assessment until the date the taxpayer pays the assessment. See ORC section 5733.11 as amended by Amended Substitute House Bill No. 215 (Budget Bill), 122nd General Assembly and section 213 of Budget Bill. If the taxpayer decides to pay the assessment in full, such payment is not acknowledgment of agreement and will not prejudice the final determination of the petition, and the taxpayer will receive interest on any refund found due. See general instruction #10 for interest on underpayments and overpayments.

26. TAXPAYER'S BILL OF RIGHTS -- REQUESTS FOR AN OPINION OF THE TAX COMMISSIONER

The Taxpayer's Bill of Rights (Senate Bill 147, 118th General Assembly) established and amended certain administrative procedures relating to Department of Taxation audits and assessments. The law provides that at or before the commencement of an audit the Department of Taxation must provide to the taxpayer a written description of the roles of the Department and the taxpayer during an audit and a statement of the taxpayer's rights.
A brochure which discusses the Department's interpretation of this law is available upon request from the Ohio Department of Taxation, P.O. Box 182857, Columbus, Ohio 43218-2857, Attn: Bill of Rights.
In addition, this law permits the tax commissioner to issue binding opinions regarding the taxation of proposed activities of the taxpayer. As set forth in Ohio Administrative Code (Rule) 5703-1-12, a request for an opinion of the tax commissioner must comply with the following:

- Be in writing;
- Explicitly request an “Opinion of the Tax Commissioner”;
- Specifically refer to section 5703.53 of the Revised Code;
- State all the facts of the activity or transaction for which the opinion is requested;
- Identify the parties involved in the activity or transaction about which the opinion is requested;
- Set out the specific legal questions for which the opinion is requested; and
- Be signed by an officer of the corporation authorized to act on its behalf.

For further information see Rule 5703-1-12, “Requests for an Opinion of the Tax Commissioner.”

27. SUBSTANCE OVER FORM

The tax commissioner has authority to apply the doctrines of "economic reality," "sham transaction," "step transaction," and "substance over form." Generally the tax commissioner bears the burden of establishing by a preponderance of the evidence that these doctrines should apply. See ORC section 5733.111.

28. RIGHT TO OFFSET REFUND

The tax commissioner may apply a taxpayer's franchise tax refund against the taxpayer's indebtedness to the State of Ohio for any tax or fee and any charge, penalty, or interest arising from such a tax or fee which is administered by the tax commissioner and paid to the State or to the clerk of courts. This provision applies only to the taxpayer's debts which have become "final." See ORC section 5733.121.

LINE INSTRUCTIONS
SCHEDULE A

A taxpayer must compute its Ohio taxable income for its taxable year (see general instruction # 7).
If the taxpayer is a member of a combined franchise report (form 1120C), skip lines 2 through 6 on Schedule A of the taxpayer's franchise tax report (form FT-1120) and enter on Schedule A, line 7 the

taxpayer's apportioned income from Schedule B, line 7 of the combined report.

Line 1 - Federal taxable income.

Enter the taxpayer's federal taxable income before net operating loss deduction and special deductions from federal form 1120, line 28 or federal form 1120A, line 24.

Note: If the taxpayer is a member of a consolidated federal return compute the taxpayer's federal taxable income as if the taxpayer filed a separate federal return. The Department of Taxation maintains that the federal consolidation rules do not apply in determining federal taxable income for purposes of the franchise tax.

Line 6 - Ohio apportionment ratio.

Enter the taxpayer's apportionment ratio from Schedule D, line 4 determined on a separate company basis.

Line 9 - Income (loss) from transferor corporation.

For taxable years ending after June 30, 1989 a taxpayer that receives substantially all of the assets or equity of a transferor corporation (defined below) must include in its own Ohio taxable income the transferor's net income if on January 1 before and on January 1 after the transfer the taxpayer and the transferor corporation would have met the ownership or control requirements for a combined report, set forth in ORC section 5733.052(A), had both corporations been in existence on those dates and the transfer not been made. The law applies to transfers made after December 31, 1988.

“Transferor” means a corporation that directly or indirectly transfers or distributes substantially all of its assets or equity to another corporation, if on the completion of the transfer the corporation no longer does business in Ohio or no longer owns or uses any capital or property in Ohio.

The Ohio taxable income of a transferor corporation is determined in the same manner as if the transfer had not been made and the transferor remained subject to the franchise tax. Thus, the federal taxable income of a transferor corporation is subject to the same adjustments and must be allocated and apportioned in the same manner as if the transferor remained subject to the franchise tax. The taxpayer-transferee must include such income in computing its tax for the same tax year or years that such income would have been reported by the transferor if the transfer had not been made and the transferor had remained subject to the franchise tax.

If the transferor was previously included in a combined report, the income of the transferor must be determined as if the transferor remained in the combined report.

If the transfer was made after December 31, 1988 and the taxpayer's taxable year ends after June 30, 1989, the taxpayer is allowed the following credits and deductions that would have been available to the transferor:

(1) credit for qualifying new investments, (2) Ohio net operating loss deduction, and (3) any other deduction or credit the disallowance of which would be absurd or unreasonable.

If a taxpayer subject to ORC section 5733.053 subsequently becomes a transferor, then any income that the taxpayer would have been required to add to its income under ORC section 5733.053 is included in its income as a transferor and any credits or deductions that the taxpayer would have been entitled to under this section are available to the taxpayer as a transferor. See ORC section 5733.053 and Sections 13(A) and 13(C) of House Bill 111.

Line 12 - Ohio net operating loss deduction.

In calculating net income pursuant to ORC section 5733.04(l), net operating losses are taken into account. Net operating losses are allocated and apportioned in and out of Ohio for the year in which the net operating loss occurs in the same manner that positive net income would have been so allocated and apportioned. Any net operating loss is applied to subsequent net income to reduce that income to zero or until the net operating loss has been fully used as a deduction.

Any unused losses incurred in a taxable year ending on or after January 1, 1982 may be carried forward for fifteen consecutive tax years. For purposes of calculating the carryforward period, the first year of the carryforward period is the tax year following the tax year in which the loss should have been reported.

A surviving corporation in a merger is permitted to use the Ohio net operating losses of a merged corporation provided that the surviving corporation for federal income tax purposes is permitted to use the federal net operating losses, if any, of the merged corporation. IRC sections 381 and 382 apply with respect to the allowable loss. A merged corporation has no Ohio net operating loss for a period if it is not subject to the Ohio franchise tax measured by income from that period. See *Litton Industrial Products, Inc. v. Limbach* (1991), 58 Ohio St. 3d 169. However, see the instructions for line 9, Income (loss) from transferor corporation, above.

Each corporation filing as a member of a combined franchise tax group will have its own net operating loss deduction since each will compute its own Ohio taxable income on its own franchise tax report, Form FT-1120.

For each year in which the taxpayer uses any portion of a net operating loss carryforward please attach to the franchise tax report a schedule which shows when the loss was generated, the amount of loss that was used in earlier years and the remaining carryforward amount. The taxpayer must maintain information regarding a net operating loss carryforward for at least four years after the later of the filing date or the due date of the report in which any portion of the carryforward is claimed.

The statute of limitations does not prohibit either the Tax Commissioner or the taxpayer from adjusting the net operating loss carried forward from a tax year closed to assessment to a year still open to assessment or refund. See *Consumer Direct v. Limbach* (1991), 62 Ohio St. 3d 180.

Line 21 - Overpayment carryforward from 2000.

Enter the overpayment carryforward shown on the originally filed 2000 report which was credited to estimated tax payments for tax year 2001. An overpayment claimed on an amended report cannot be credited against the tax liability for any other year. If an amended report reflects an overpayment, the taxpayer must submit Form FT-REF, Application for Corporation Franchise Tax Refund.

Line 22 - Estimated payments made in 2001.

Enter the estimated payments paid during tax year 2001 with Form FT-1120E, Declaration of Estimated Franchise Tax; Form FT-1120ER, Application for Automatic Extension; and Form FT-112OEX, Request for Additional Extension.

Line 23 - Refundable new jobs credit.

Enter the new jobs credit as provided by ORC sections 5733.0610 and 122.17 and attach a copy of the certificate of verification issued by the Department of Development. The refundable new jobs credit is considered a payment made on January 1 of the tax year. The amount of the credit equals the amount of Ohio income tax the taxpayer withheld from compensation paid to “new employees” during the taxpayer’s taxable year multiplied by the percentage specified in the taxpayer's agreement with the Tax Credit Authority.

The term “new employee” means a full-time employee first employed by the taxpayer in the project that is the subject of the tax credit agreement after the taxpayer enters into the agreement. New employees include employees hired after the Tax Credit Authority approves the taxpayer's project but before the taxpayer signs the tax credit agreement with the Tax Credit Authority as long as the taxpayer signs the agreement within sixty days after receiving the agreement from the Department of Development. If the Authority determines that it is appropriate, a “new employee” also may include an employee rehired or called back from lay-off to work in a new facility or on a new product or service.

If a taxpayer claims the refundable new jobs credit with respect to an employee, the taxpayer may not claim the nonrefundable ORC section 5709.66 enterprise zone new employee credit with respect to that same employee.

The Tax Credit Authority and the Ohio Department of Development administer this credit. Tax Credit Agreement application forms are available from the Ohio Department of Development, Economic Development Division, 77 S. High Street, 28th floor, P.O. Box 1001, Columbus, Ohio 43216-1001 or call 614-466-2317 or 1-800-848-1300.

Line 26 - Interest and Penalty.

Enter any interest due as explained in general instruction #10, and enter any penalty due as explained in general instruction # 11.

Lines 29 and 30 - Overpayment to be credited to year 2002 estimated tax and overpayment to be refunded.

Enter the amount of overpayment to be refunded and/or to be credited against next year's tax liability.

Note: An overpayment shown on an **amended** report cannot be credited against the tax liability for any other year. If an amended report reflects an overpayment, the taxpayer must also submit Form FT-REF, Application for Corporation Franchise Tax Refund.

SCHEDULE B
ADJUSTMENTS TO FEDERAL TAXABLE INCOME

Note 1: The "aggregate" (conduit) theory of taxation applies to the franchise tax. That is, the character of all income and deductions (and adjustments to income and deductions) realized by a partnership or other pass-through entity in which the taxpayer has a direct or indirect interest retains that character for purposes of the franchise tax when recognized by the investor in the pass-through entity. For example, a partner's distributive share of partnership net interest income from exempt federal obligations is considered net interest income from exempt federal obligations when recognized by the partner and is therefore deductible. Furthermore, the taxpayer-partner's proportionate share of partnership property, payroll and sales must be included in the taxpayer-partner's apportionment formula. See *Mead Properties, Inc. v. Limbach,* BTA Case Nos. 85-D-791, 85-E-792, 85-C-793, 85-B-794, April 21, 1989. Effective for taxable years ending on or after September 29, 1997, Amended Substitute House Bill No. 215 (Budget Bill), 122nd General Assembly codified into the franchise tax statute the conduit theory (see ORC section 5733.057).

Note 2: Ohio may not tax a foreign corporation's non-unitary interest income from short-term investments acquired, managed, and controlled outside of Ohio. The taxpayer has the burden of showing that the income is non-unitary. See *American Home Products Corp. v. Limbach* (1990), 49 Ohio St. 3d 158.

Note 3: The corporation franchise tax on <u>gains</u> from the sale of interest bearing federal obligations is not prohibited by either section 3124, Title 31, U.S. Code or the constitutional doctrine of intergovernmental immunity. Furthermore, the franchise tax does not impermissibly discriminate against federal obligations in favor of state obligations. See *NACCO Industries, Inc. v. Tracy* (1997), 79 Ohio St. 3d 314.

Lines 1(a) and 2(b) - Valuation limitation on gains and losses from capital assets and 1231 assets.

A corporation must add any loss and deduct any gain resulting from the sale or other disposal of a capital asset, or an asset described in section 1231 of the Internal Revenue Code, to the extent that such loss or gain occurred prior to the beginning of the first day of the taxpayer's Ohio corporation franchise tax taxable year which ended on or after December 20, 1971 on which the tax provided for in ORC section 5733.06 is computed on the corporation's net income. The taxpayer has a choice of two methods in determining the amount of such prior loss or gain (valuation limitation):

- The amount of such prior gain or loss is the difference between the original cost or other basis of the asset and its fair market value as of the beginning of the first taxable year on which the tax provided for in ORC section 5733.06 is computed on the corporation's net income. However, such prior period gain or loss calculated under this method may not exceed the gain or loss reported on the federal return.
- Alternatively, the amount of such prior gain or loss is determined by multiplying the gain or loss by a fraction, the numerator of which is the number of months from the acquisition of the asset to the beginning of the first taxable year on which the tax provided in ORC section 5733.06 is computed on the corporation's net income, and the denominator of which is the number of months from the acquisition of the asset to the sale or other disposal of such asset.

Corporations that are required to make this adjustment must file form FT-1120VL which applies only to gains and losses to which the valuation limitation applies.

Lines 1(b) and 2(f) - Losses from the sale of Ohio public obligations; Interest on public obligations and purchase obligations and gains from the sale of Ohio public obligations.

A corporation must add any loss resulting from the disposition of public obligations to the extent such losses have been deducted in determining federal taxable income. The term "public obligation" is defined below.

A corporation may deduct interest income from both purchase obligations and public obligations to the extent such amounts are included in federal taxable income. The terms "purchase obligations" and "public obligations" are defined below.

A corporation may deduct gains from the disposition of public obligations to the extent such gains are included in federal taxable income.

For purposes of these adjustments the following definitions apply:

"Purchase obligations" means interest-bearing obligations of the State of Ohio and local public or governmental entities in the State of Ohio where these obligations require payments under installment sale, lease, lease purchase, or similar agreements.

"Public obligations" means:

- Public securities such as bonds, notes, certificates of indebtedness, and commercial paper issued by the State of Ohio and local public or governmental entities in Ohio which evidence the obligation of the state or local public or governmental entity to repay borrowed money.
- Fractionalized interests in purchase obligations, i.e. shares or participations evidencing ownership of interests in purchase obligations. Fractionalized interests in purchase obligations are separate from purchase obligations themselves and do not include interests or shares in a unit trust, investment trust, grantor trust or regulated investment company.
- Any obligation to pay interest on public securities or on fractionalized interests in purchase obligations.

  Public obligations do not include purchase obligations.

"Interest" means payments that represent consideration for forbearing the collection of money, or for deferring the receipt of payment of money to a future time as determined for federal income tax purposes. Interest includes those portions of a qualified investment trust's distributions to its shareholders or beneficial owners that are attributable to the trust's receipt of interest or interest equivalent.

"Qualified Investment Trust" or "Trust" means a unit investment trust, grantor trust, or regulated investment company if at all times at least 50% of the value of the total assets of the trust consists of public securities or purchase obligations, or similar obligations of other states or their local public or governmental entities.

For more specific information see ORC section 5709.76.

Line 1(c) - Amounts claimed as a credit for taxes paid by a qualifying pass-through entity.
A corporation that claims the franchise tax credit for taxes paid by a qualifying pass-through entity in which the corporation is an investor 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. See ORC section 5733.04(I)(14). For an explanation of the tax on qualifying pass-through entities see the instructions for form IT-1140, Ohio Pass Through Entity Tax Return. For an explanation of the credit for taxes paid by a qualifying pass-through entity see the line instructions for Schedule A-1, Nonrefundable credits.

Lines 1(d) and 2(h) - Net loss from an "exempted investment" in a public utility and net income from an "exempted investment" in a public utility.
For taxable years ending after September 28, 1997 a franchise taxpayer must adjust its net income or loss to the extent that the taxpayer's income or loss would include, were it not for this new law, the taxpayer's proportionate share of such income or loss attributable to the taxpayer's direct or indirect ownership interest in an "exempted investment." Similarly, a taxpayer must adjust its apportionment factors and its credits to the extent that the taxpayer's apportionment factors and credits would include, were it not for this new law, the taxpayer's proportionate share of such amounts attributable to the taxpayer's direct or indirect ownership interest in an "exempted investment."
An exempted investment is the taxpayer's direct or indirect investment in a pass-through entity or a "disregarded entity" (a single member LLC that is treated as a division of its owner) which is a public utility subject to the Ohio public utility excise tax on its gross receipts.
The exempted investment adjustments apply only if the taxpayer-investor in the public utility directly or indirectly owns the investment in the public utility for the public utility's entire taxable year ending with or within the taxpayer's taxable year ending immediately prior to the taxpayer's tax year. Furthermore, the adjustments apply only to the extent that the adjustments directly relate to owning and operating a public utility in Ohio by a pass-through entity that is subject to the Ohio public utility gross receipts tax or a disregarded entity that is subject to the Ohio public utility gross receipts tax. See ORC section 5733.058.

Line 2(c) - Dividends received.
Enter the sum of the following: (1) the dividend deduction provided by section 243 of the Internal Revenue Code and (2) to the extent not otherwise allowed by the IRC section 243 dividends received deduction: (a) dividends received from an insurance company if the taxpayer owns at least eighty percent of the outstanding common stock of the insurance company and (b) dividends received from a public utility if the taxpayer owns at least eighty percent of the outstanding common stock of the public utility. See ORC section 5733.04(I)(4), (I)(7) and (I)(8).

Line 2(d) - Adjustment for targeted jobs tax credit or work opportunity tax credit.
Deduct the wage and salary expense not otherwise deducted for federal tax purposes because of the targeted jobs tax credit and/or the work opportunity tax credit. See ORC section 5733.04(I)(10).

Line 2(e) - Net interest income from exempt U.S. obligations.
Deduct net interest on obligations of the United States and its territories and possessions or of any authority, commission, or instrumentality of the United States. "Net federal interest" is defined as federal interest less any expenses taken on the federal tax return that would not have been allowed under section 265 of the Internal Revenue Code if such interest were exempt from federal income tax. See ORC section 5733.04(I)(11).
A January 9, 1992 Ohio Department of Taxation Information Release lists federal obligations, the interest from which is deductible. The list is available upon request from the Ohio Department of Taxation, P.O. Box 182857, Columbus, Ohio 43218-2857. Generally interest income generated from repurchase agreements secured by federal obligations is not interest from federal obligations and therefore is not deductible. See *Nebraska Department of Revenue v. Lowenstein*, 513 U.S. 123 (1994), 115 S. Ct. 557, 1994 US Lexis 8802. Also see *Associated Estates Corp., AEC Management Co.* and *Hirsch Electric Co. v. Limbach*, BTA Case Nos. 87-H-743, 87-G-774 and 87-D-756, May 11, 1990.

Line 2(g) - Contributions to an individual development account program.
Deduct the amount that the taxpayer contributed during the taxable year to an individual development account program established by a county department of human services pursuant to sections 329.11 to 329.14 of the Ohio Revised Code for the purpose of matching funds deposited by program participants. See ORC section 5733.04(I)(15). The individual development account program applies to low income residents of a county who enter an agreement with the fiduciary organization selected to administer the program. Program participants must abide by the terms and conditions of the agreement and may use money in an individual development account only with the approval of the fiduciary organization.

SCHEDULE C
ALLOCABLE INCOME
ORC section 5733.051

Note: The "aggregate" (conduit) theory of taxation applies to the franchise tax. That is, the character of all income and deductions (and adjustments to income and deductions) realized by a pass-through entity retains that character for purposes of the franchise tax when recognized by the investor in the pass-through entity. For example, a partner's distributive share of partnership net rental income is considered rental income when recognized by the partner. See *Mead Properties, Inc. v. Limbach*, BTA Case Nos. 85-D-791, 85-E-792, 85-C-793, 85-B-794, April 21, 1989. Effective for taxable years ending on or after September 29, 1997, Amended Substitute House Bill No. 215, 122nd General Assembly (Budget Bill) codified into the franchise tax statute the conduit theory (see ORC section 5733.057).
Because Ohio franchise tax law makes no distinction between business and nonbusiness income, net income (both positive and negative amounts) of the types listed below is allocable regardless of whether the income is earned in the taxpayer's regular course of trade or business. Net income of the types listed below that is not allocated to Ohio is allocated outside Ohio (rather than apportioned).

Line 1 - Net rents.
Net rents from real property located in Ohio are allocable to Ohio. Net rents from tangible personal property are allocable to Ohio to the extent such property is utilized in Ohio. A lessor's net income or loss from IRC section 168(f)(8) safe harbor lease agreements is not allocable rental income or loss from tangible personal property. Instead, such income or loss is apportionable. See *Goodyear Tire & Rubber Co. v. Limbach* (1991), 61 Ohio St. 3d 381.

Line 2 - Net royalties.
Net royalties from real property located in Ohio are allocable to Ohio. Net royalties from tangible personal property are allocable to Ohio to the extent such property is utilized in Ohio.

Line 3 - Capital gains and losses and depreciation recapture.
Capital gains and losses and 1231 gains and losses from the sale or other disposition of real property located in Ohio are allocable to Ohio. Capital gains and losses and 1231 gains and losses from the sale or other disposition of tangible personal property are allocable to Ohio if the property had a situs in Ohio at the time of sale.

Gains from the sale or other disposition of depreciable real property and depreciable tangible personal property, taxed as ordinary (recapture) income for federal income tax purposes, are considered capital gains and capital losses for purposes of allocation (see *Borden, Inc. v. Limbach* (1990), 49 Ohio St. 3d 240). Upon the sale of a depreciable asset, the amount of recapture income allocable to Ohio is not limited to the accumulated depreciation expense (on the asset sold) that the taxpayer had apportioned to Ohio in previous years because the statute contains no overt language which would serve to limit depreciation recapture in such a manner. See *Harsco Corp. v. Tracy* (1999), 85 Ohio St.3d 382.

Capital gains and capital losses from the sale or other disposition of intangible personal property which may produce dividend income are allocated on the same basis as set forth in the section below dealing with dividends. Capital gains and capital losses from the sale or other disposition of all other intangible personal property are apportioned.

Line 4 - Dividends (not otherwise deducted and not apportionable).
Dividends, which are not otherwise deducted or excluded from net income, other than dividends from Domestic International Sales Corporations, are allocated to Ohio in accordance with the ratio which the book value of the physical assets of the payor thereof located in Ohio bears to the book value of the total physical assets of the payor thereof located everywhere. Dividends from Domestic International Sales Corporations and from payors the location of whose physical assets is not available to the taxpayer are apportionable.

Line 5 - Net patent and copyright royalties and technical assistance fees.
Net patent and copyright royalties and technical assistance fees, not representing the taxpayer's principal source of gross receipts, are allocable to Ohio to the extent that the activity of the payor thereof giving rise to the payment takes place in Ohio. "Principal source" means that the income from a given source is greater than the income from each other source. In determining whether or not net patent and copyright royalties and technical assistance fees represent the taxpayer's principal source of gross receipts in the instance of a combined report, it is the individual taxpayer corporation's principal source of gross receipts which is determinative rather than the combined group's principal source of gross receipts. See *E. W. Scripps Co. v. Limbach*, BTA Case No. 87-C-761, July 12, 1991.

Trademark royalties and service mark royalties are not considered patent and copyright royalties and accordingly are apportionable income. Franchise royalties, not representing the taxpayer's principal source of gross receipts, are allocable as technical assistance fees if and to the extent that the royalties are received for technical assistance. However, if the taxpayer receives franchise royalties (that do not represent the taxpayer's principal source of gross receipts) for rendering both technical assistance and for other services or consideration and if it is impossible to break-out that portion of the royalty which is for technical assistance from that portion which is not, then the entire royalty is allocable. A "technical assistance fee" is defined as "payment for mechanical, industrial, scientific or practical aid, expertise or services." See *Holiday Inns, Inc. v. Limbach* (1990), 48 Ohio St. 3d 34 and *Stanley Steamer International, Inc., v. Tracy*, BTA Case No. 91-K-1650, August 20, 1993.

Fixed rate monthly fees received from customers for software support services, which services include consultation, training and software maintenance (i.e. modifications or improvements to software that the taxpayer licensed to its customers), constitute allocable "technical assistance fees" rather than apportionable income. A technical assistance fee need not be payable in the form of a royalty (that is, based on the number of units produced by the payer-customer or based on a percentage of the payer-customer's revenue) in order to qualify as allocable income. A customer's use of the computer system at the customer's place of business is sufficient to constitute "the activity of the payer thereof giving rise to the payment" within the meaning of ORC 5733.051(G). See *Reynolds and Reynolds Company v. Tracy*, BTA No. 96-P-447 (1-29-99).

A taxpayer may apportion its otherwise allocable net patent and copyright royalties and technical assistance fees if in the ordinary course of business the taxpayer is unable to obtain the information necessary for allocation (that is, if the taxpayer is unable to obtain the location of the payor's activity giving rise to the royalty payment) and if obtaining such information would unduly burden the industry. See *Random House, Inc. v. Tracy*, BTA Case No. 91-A-1329, May 19, 1993.

SCHEDULE D
APPORTIONMENT FORMULA
ORC section 5733.05(B)(2)

Note 1: Please complete the form FT-1120 schedule D apportionment ratio on a separate company basis. The separate company apportionment ratio applies to the net worth base even if the taxpayer is a member of a combined report, form FT-1120C. See ORC section 5733.05(C)(3) which states that the taxpayer's net worth is multiplied by the net income base apportionment formula computed ". . . without regard to section 5733.052 of the Revised Code." The taxpayer's apportionment ratio on the combined report (schedule D - combined) applies only to the net income base, not to the net worth base.

Note 2: The "aggregate" (conduit) theory of taxation applies to the franchise tax. That is, the character of all income and deductions (and adjustments to income and deductions) realized by a pass-through entity retains that character when recognized by the investor in the pass-through entity. Furthermore, the investor's proportionate share of the pass-through entity's property, payroll and sales must be included in the investor's apportionment formula. See *Mead Properties, Inc. v. Limbach*, BTA Case Nos. 85-D-791, 85-E-792, 85-C-793, 85-B-794, April 21, 1989.

Effective for taxable years ending on or after September 29, 1997, Amended Substitute House Bill No. 215, 122nd General Assembly (Budget Bill) codified into the franchise tax statute the conduit theory (see ORC section 5733.057).

Note 3: Effective for taxable years ending after September 28, 1997, Amended Substitute House Bill 770, 122nd General Assembly allows and requires a franchise taxpayer to adjust its net income (or loss), its apportionment factors and its credits to the extent that the taxpayer's income (loss), apportionment factors and credits would include, were it not for this new law, the taxpayer's proportionate share of such amounts attributable to the taxpayer's direct or indirect ownership interest in an "exempted investment." An exempted investment is the taxpayer's direct or indirect investment in a pass-through entity or a "disregarded entity" (a single member LLC that is treated as a division of its owner) which is a public utility subject to the Ohio public utility excise tax on its gross receipts (see ORC section 5733.058 as amended by House Bill 770).

Note 4: **Deviation from standard allocation and apportionment.** For tax years 1999 and thereafter a taxpayer may request deviation from the statutory allocation and apportionment provisions on an original report, on an amended report filed within the statute of limitations, or on a timely-filed petition for reassessment. The request for deviation must be in writing. An alternative method will be effective only with approval by the tax commissioner. See ORC section 5733.05(B)(2)(d) as amended by Amended Substitute House Bill No. 215, 122nd General Assembly (Budget Bill). Under prior law the taxpayer could request deviation only on the original report.

Note 5: Factors weighted. For tax years 1999 and thereafter the apportionment ratio's property, payroll, and sales factors are weighted 20%, 20%, and 60%, respectively. The 20%, 20%, 60% weighting does not apply to financial institutions. ORC section 5733.05(B)(2).

Note 6: The term **"qualified research"** as used below in the property and payroll factors means laboratory research, experimental research, and other similar types of research; research in developing or improving a product; or research in developing or improving the means of producing a product. Qualified research does not include market research, historical research, literary research, consumer surveys, efficiency surveys, management studies, and ordinary testing or inspection of materials and products for quality control. "Product" as used in this paragraph does not include services or intangible property.

Property Factor

Property owned by the corporation is valued at its original cost and the average value is determined by adding the cost values at the beginning and at the end of the taxable year and dividing the total by two. The tax commissioner may require the use of monthly values during the taxable year if such values more reasonably reflect the average value of the corporation's property.

In determining average value do not include in either column 1 (within Ohio) or in column 2 (total everywhere) the following:

- Construction in progress.
- The original cost of rental property owned by the corporation and leased to others if the lessee uses the property in a trade or business. See *Illinois Tool Works, Inc. v. Lindley* (1982), 70 Ohio St. 2d 175 and *Columbia Properties, Inc. v. Limbach* (1989), 42 Ohio St. 3d 75.
- The original cost of property within Ohio with respect to which the State of Ohio has issued an Air Pollution, Noise Pollution or an Industrial Water Pollution Control Certificate.
- The original cost of property with respect to which the State of Ohio has issued an exemption certificate for a coal gasification facility, coal conversion demonstration facility, energy conversion facility, solid waste energy conversion facility or thermal efficiency improvement facility.
- The original cost of real property and tangible property (or in the case of property which the corporation is renting from others, eight times its net annual rental rate) within Ohio which is used exclusively during the taxable year for qualified research.

Do not include in column 1 but do include in column 2 the original cost of qualifying improvements to land or tangible personal property in an enterprise zone for which the taxpayer holds a Tax Incentive Qualification Certificate issued by the Department of Development. See general instruction # 23.

Line 1(a), column 1 - Owned property within Ohio.
Enter the average value of the corporation's real property and tangible personal property, including leasehold improvements, owned and used in the trade or business in Ohio during the taxable year.

Line 1(a), column 2 - Owned property - total everywhere.
Enter the average value of all the corporation's real property and tangible personal property, including leasehold improvements, owned and used in the trade or business everywhere during the taxable year.

Line 1(b) - Rented property.
Enter the value of the corporation's real property and tangible personal property rented and used in the trade or business in Ohio (column 1) and everywhere (column 2) during the taxable year. Property rented by the corporation is valued at eight times the annual rental rate (annual rental expense less subrental receipts).

Line 1(c) - Total Property Within Ohio and Everywhere.
Add lines 1(a) and 1(b) for column 1, (within Ohio) and column 2 (total everywhere).

Line 1(c), column 3 - Property ratio.
Enter the ratio of property within Ohio to total everywhere by dividing column 1 by column 2.

Line 1(c), column 5 - Weighted property ratio.
Multiply the property ratio on line 1(c), column 3 by the property factor weighting of 20%.

Payroll Factor

As used below, the term "compensation" means any form of remuneration paid to an employee for personal services. Do <u>not</u> include either in column 1 (within Ohio) or in column 2 (total everywhere) the following:

- Compensation paid in Ohio to employees who are primarily engaged in qualified research.
- Compensation paid in Ohio to employees at a certified coal gasification or coal conversion demonstration facility.

Do not include in column 1 but do include in column 2 compensation paid in Ohio to certain specified new employees at an urban job and enterprise zone facility for which the taxpayer has received a Tax Incentive Qualification Certificate issued by the Department of Development (see general instruction # 23).

Line 2, column 1 - Payroll within Ohio.
Enter the total amount of the corporation's compensation paid in Ohio during the taxable year. Compensation is paid in Ohio if any of the following apply:

- The recipient's service is performed entirely within Ohio; or
- The recipient's service is performed both within and without Ohio, but the service performed without Ohio is incidental to the recipient's service within Ohio; or
- Some of the recipient's service is performed within Ohio and either the recipient's base of operations, or if there is no base of operations, the place from which the recipient's service is directed or controlled is within Ohio, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the recipient's residence is in Ohio.

Compensation is paid in Ohio to any employee of a common or contract motor carrier corporation who performs his regularly assigned duties on a motor vehicle in more than one state in the same ratio by which the mileage traveled by such employee within Ohio bears to the total mileage traveled by such employee everywhere during the taxable year. The statutorily required mileage ratio applies only to contract or common carriers. Thus, without approval by the tax commissioner a manufacturer or merchant who operates its own fleet of delivery trucks may not situs driver payroll based upon the ratio of miles traveled in Ohio to miles traveled everywhere. See *Cooper Tire and Rubber Co. v. Limbach* (1994), 70 Ohio St. 3d 347.

Line 2, column 2 - Payroll total everywhere.
Enter the total amount of the corporation's compensation paid everywhere during the taxable year.

Line 2, column 3 - Payroll ratio.
Enter the ratio of payroll within Ohio to total everywhere by dividing column 1 by column 2.

Line 2, column 5 - Weighted payroll ratio.
Multiply the property ratio on line 2, column 3 by payroll factor weighting of 20%.

Sales Factor

Sales Factor - The sales factor includes gross receipts from sales of tangible personal property and from sales other than sales of tangible personal property. However, the following are not includable in either the numerator or the denominator of the sales factor:

- Interest,
- Receipts from sales or other disposals of capital assets or assets described in section 1231 of the Internal Revenue Code, and receipts from those other sources of income which are specifically allocated under divisions (A) through (G) of Ohio Revised Code section 5733.051,
- Management fees charged to subsidiaries where such fees do not constitute an income producing activity. Management fees do not constitute an income producing activity if the taxpayer is not in the business of providing management services in the market place and the fees are not profit motivated. See *The Fairchild Corporation v. Tracy*, BTA Case No. 94-T-1103, December 20, 1996, and,
- Receipts from sales to the following: (a) an at-least 80% owned public utility, (b) an at least 80% owned insurance company or (c) an at-least 25% owned financial institution. See ORC section 5733.05(B)(2)(c).

Line 3, column 1 - Sales within Ohio.
Enter the total of such gross receipts from sales reflecting business done in Ohio, which includes the following:

- Sales of tangible personal property, less returns and allowances, received by the purchaser in Ohio. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has been completed is considered as the place at which such property is received by the purchaser. Direct delivery in Ohio, other than for purposes of transportation, to a person or firm designated by a purchaser constitutes delivery to the purchaser in Ohio, and direct delivery outside Ohio to a person or firm designated by a purchaser does not constitute delivery to the purchaser in Ohio, regardless of where title passes or other conditions of sale.

  Customer pick-up sales are situsable to the final destination after all transportation (including customer transportation) has been completed. See *Dupps Co. v. Lindley* (1980), 62 Ohio St. 2d 305.

  Revenue from servicing, processing, or modifying tangible personal property is sitused to the destination state as a sale of tangible personal property (rather than sitused as service revenue). See *Custom Deco, Inc. v. Limbach*, BTA Case No. 86-C-1024, June 2, 1989.
- Sales, other than sales of tangible personal property if:

  The income-producing activity is performed entirely within Ohio, or

  The income-producing activity is performed both within and without Ohio and a greater proportion of the income-producing activity is performed within Ohio than in any other state, based on cost of performance. If the income-producing activity involves the performance of personal services both within and without Ohio, the services performed in each state will constitute a separate income-producing activity. In such case the gross receipts for the performance of services attributable to Ohio shall be measured by the ratio which the time spent in performing such services in Ohio bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligations which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligations, as for example, time expended in negotiating the contract, is excluded from the computations.

Note: For tax years 1999 and thereafter Amended Substitute House Bill 215, 122nd General Assembly eliminated the "solicitation provision" from the sales factor. Thus, for "sales other than sales of tangible personal property," the location of solicitation no longer controls the situs of the sale, and sales other than sales of tangible personal property are sitused based on "costs of performance." ORC section 5733.05(B)(2)(c).

The term “income-producing activity” means with respect to each separate item of income, the transaction and activity directly engaged in by the taxpayer in the regular course of its trade or business for the purpose of obtaining gains or profits. Such activity does not include transactions and activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor.
The term “cost of performance” means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the taxpayer’s trade or business.

Line 3, column 2 - Sales everywhere.
Enter the total of such gross receipts, less returns and allowances, from sales everywhere.

Line 3, column 3 - Sales ratio.
Enter the ratio of sales within Ohio to total everywhere by dividing column 1 by column 2.

Line 3, column 5 - Weighted sales ratio.
Multiply the sales ratio on line 3, column 3 by the sales factor weighting of 60%.

SCHEDULE E
BALANCE SHEET

Attach to the franchise tax report a balance sheet which reflects the books of the taxpayer on a separate company basis as of the beginning and the end of the taxpayer's taxable year.
Note: A taxpayer must keep its books in accordance with a generally recognized and approved accounting system. The tax-basis method of accounting is a generally recognized and approved accounting system. See *Gray Horse, Inc. v. Limbach* (1993), 66 Ohio St. 3d 631. If a taxpayer keeps its books both in accordance with regulatory accounting principles and in accordance with generally accepted accounting principles, the value of the taxpayer's issued and outstanding shares of stock under the net worth basis (ORC section 5733.05(C)) is based upon those books kept in accordance with generally accepted accounting principles. See Tax Commissioner's Rule 5703-5-08.

SCHEDULE F
COMPUTATION OF TAXABLE VALUE
ORC section 5733.05(C)

The net worth base value of issued and outstanding shares of stock is determined from the books of the corporation as of the beginning of the taxpayer's annual accounting period that includes the first day of January of the tax year. See ORC section 5733.05. For example, assume that an Ohio franchise taxpayer has a taxable year beginning July 1, 1999 and ending June 30, 2000. For tax year 2001 the taxpayer's franchise tax net value of stock for purposes of the net worth base is determined as of July 1, 2000 which is the beginning of the taxpayer's annual accounting period that includes the first day of January of the 2001 tax year. Generally, the net worth base value at the beginning of the taxpayer's annual accounting period that includes the first day of January of the tax year (in this example, July 1, 2000) will be the same as the net worth base value at the end of the taxable year concluding prior to January 1 of the tax year (in this example, June 30, 2000).

For tax years 1999 and thereafter (for taxpayers other than financial institutions) the tax rate on the net worth base is four mills (.004) and the net worth base tax is limited to $150,000 per taxpayer. The $150,000 limit applies separately to each member of a combined report (there is not an overall net worth base limit for a combined group of taxpayers). At the net worth tax rate of four mills a "taxable value" of $37,500,000 will result in the maximum net worth tax of $150,000.

Qualifying holding company (QHC). A corporation that meets the requirements to be treated as a qualifying holding company, as defined in ORC section 5733.04(L), <u>and</u> elects to be treated as a QHC by filing form FT-QHC, Qualifying Holding Company Election, is not subject to the franchise tax on the net worth base and is not required to complete Schedule F. (A QHC is subject to the franchise tax on the net income base.) A corporation that elects to be treated as a qualifying holding company must attach form FT-QHC to its franchise tax report and must check the box at the top of the front page of the franchise tax report indicating the corporation has elected to be treated as a qualifying holding company. For further information see general instruction #19, ORC sections 5733.04(L), 5733.05(C)(2), and 5733.06(C) and form FT-QHC, Qualifying Holding Company Election.

Line 1 - Net worth (assets minus liabilities).

Enter the taxpayer's net worth (assets minus liabilities) as reflected on the taxpayer's books. For tax years 1999 and thereafter House Bill 215, 122nd General Assembly simplified the net worth computation for taxpayers other than financial institutions. Under the new law the net worth base equals assets minus liabilities minus exempted assets (discussed below). Accordingly, for tax years 1999 and thereafter "reserves," except for those reserves that are considered appropriations of retained earnings under generally accepted accounting principles, are not included in the net worth computation. Thus, accounts such as unearned income and deferred federal income tax are not added to (or deducted from) net worth. In addition, the following "exempted assets" (under prior law) may not be deducted from net worth: goodwill, appreciation, abandoned property, investments in production credit associations and property within Ohio used exclusively in qualified research.

Line 2 - Qualifying amount (if the taxpayer is a related member to a qualifying holding company) ORC section 5733.05(C)(2).

If the taxpayer is a related member to a qualifying holding company (see above), the taxpayer must adjust its net worth and debt by the "qualifying amount."

The **qualifying amount** is the amount that, when added to the taxpayer's net worth (assets minus liabilities) and subtracted from the taxpayer's liabilities or when subtracted from the taxpayer's net worth and added to the taxpayer's liabilities, will result in the taxpayer's debt-to-equity ratio equaling the consolidated debt-to-equity ratio of the **qualifying controlled group** of which the taxpayer is a member. The consolidated debt-to-equity ratio is computed in accordance with generally accepted accounting principles on the last day of the taxpayer's taxable year ending prior to the first day of the tax year. The qualifying amount that is added to the taxpayer's net worth and subtracted from the taxpayer's liabilities may not exceed the amount of the taxpayer's liabilities owed to related members. Furthermore, the taxpayer's net worth after adjustment by the qualifying amount may not exceed the net book value of the corporation's assets. If the qualifying amount will be subtracted from the taxpayer's net worth, enter the qualifying amount in parenthesis. See ORC section 5733.05(C)(2).

The term **"qualifying controlled group"** means two or more corporations that meet the ORC section 5733.052(A) ownership and control requirements to file a combined franchise tax report (whether or not the corporations actually file a combined report and whether or not the corporations are subject to the franchise tax). See ORC section 5733.04(M).

The term **"related member"** is defined in the instructions for Schedule B-3, line 6.

Line 4 - Exempted assets.

a. Enter the net book value of air, noise and water pollution control facilities for which the State of Ohio has issued a certificate.
b. Enter the net book value of qualifying improvements to land or tangible personal property in an enterprise zone for which the Ohio Department of Development has issued a Tax Incentive Qualification Certificate. See general instruction # 23.
c. Enter the net book value of property with respect to a coal gasification facility, coal conversion demonstration facility, energy conversion facility, solid waste energy conversion facility or thermal efficiency improvements facility for which the State of Ohio has issued an exemption certificate.
d. Enter the net book value of civil defense shelters within Ohio for which the State of Ohio has issued a civil defense certificate. ORC section 5502.49.
e. Enter the net book value of “land devoted exclusively to agricultural use as of the first Monday of June in the corporation’s taxable year as determined by the county auditor of the county in which the land is located pursuant to section 5713.31 of the Revised Code.” House Bill 283, 123rd General Assembly (Budget Bill) restored the net worth deduction for agricultural land that had been eliminated by House Bill 215, 122nd General Assembly.

Line 6 - Ohio apportionment ratio.

Enter the taxpayer's Ohio apportionment ratio determined on a separate company basis from Schedule D, line 4. Even if the taxpayer is a member of a combined report, do not enter the taxpayer's apportionment ratio from the combined report (form FT-1120C, schedule D - combined).

The taxpayer's net worth base apportionment ratio must be determined on a separate company basis even if the taxpayer is a member of a combined report. See ORC section 5733.05(C)(3) which states that the taxpayer's net worth is multiplied by the net income base apportionment formula computed ". . . without regard to section 5733.052 of the Revised Code."

For tax years 1999 and thereafter Amended Substitute House Bill 215, 122nd General Assembly, replaced the net worth base property and business done factors with the net income base apportionment ratio. Unlike the former net worth base property factor, the net income base property factor does not include intangible property. Thus, under the new law it is unnecessary to situs intangible property within and without Ohio.

There are no Franchise Tax Report Schedules H, I or J.

SCHEDULE K
TAX COMPUTATION

Tier One Litter Tax (ORC section 5733.066) - All taxpayers except family farm corporations as defined in ORC section 4123.01 are subject to the first tier of the litter tax. The maximum first tier tax that a corporation (or a group of corporations filing a combined franchise tax report) must pay is $5,000.

Tier Two Litter Tax (ORC section 5733.065) - **Corporations that manufacture or sell litter stream products in Ohio are subject to the second tier of the litter tax with the following limitations:**

a. If a corporation manufactures "litter stream products", the corporation is subject to the second tier litter tax only if the corporation's sales of litter stream products in Ohio during the taxable year exceed 5% of its total sales in Ohio during the taxable year or if its sales of litter stream products in Ohio during the taxable year exceed ten million dollars.
b. If a corporation sells litter stream products in the same form that the corporation obtains the products, the corporation is subject to the second tier litter tax only if its sales of litter stream products in Ohio during the taxable year exceed 5% of its total sales in Ohio during the taxable year.
c. If a corporation sells food or beverages which are prepared at the premises where sold for consumption off the premises and transfers possession of litter stream products in the form of sacks, bags, lids, straws, plates, wrappings, boxes or containers which contain the food or beverages, the corporation is subject to the second tier litter tax only if such sales for off premises consumption exceed 5% of the corporation's total sales during the taxable year.

Litter stream products are defined as follows:

a. Intoxicating liquor, beer, malt beverages, wine, mixed beverages or spirituous liquor;
b. Soft drinks;
c. Glass, metal, plastic or fiber containers with a capacity of less than two gallons sold for the purpose of containing the beverages listed in sections a. and b. above;
d. Container crowns and caps sold for the purpose of capping the containers in section c. above;
e. Packaging materials used to pack or contain the beverages in sections a. and b. above when they are sold at retail;
f. Packaging or serving materials used or received when obtaining food to carryout, such as sacks, bags, cups, lids, straws, plates, wrappings, boxes or containers of any type. The food or beverages which are for take-out must have been prepared for human consumption by a restaurant or take-out food outlet at the premises where sold at retail, and delivered to the purchaser for consumption off the premises where such food or beverages are sold;
g. Cigarettes, cigars, tobacco, matches, candy and gum.

The maximum second tier tax that a corporation (or a group of corporations filing a combined franchise tax report) must pay is $5,000.

SCHEDULE A-1
NONREFUNDABLE CREDITS

ORC section 5733.98 sets forth the order in which franchise tax nonrefundable credits and unused credit carryforward amounts must be used. A nonrefundable credit may be used to reduce the tax liability (before considering any payments) to the $50 minimum fee but a nonrefundable credit may not reduce the tax liability (before considering any payments) below the minimum fee. The table on page 30 lists the nonrefundable credits in the order in which you must claim them as well as the carryforward period of each credit and the sections of the Ohio Revised Code that authorize the credits. A lower ranking credit must be used before any higher ranking credit is used. The order is important if the corporation is entitled to more than one nonrefundable credit <u>and</u> the corporation is unable to use some portion of the total credit amount in the year the credits were generated (because the total credit amount exceeds the tax due before the credit). Nonrefundable credits that are not used in the year generated can generally be carried forward to future years. However, the carryforward period is limited and varies from credit to credit. (The carryforward period for the unused portion of the credits varies from three years to fifteen years. In addition, four credits have no carryforward period, and two other credits have an unlimited carryforward period.) Any credit amount that remains unused after the carryforward period for that credit has expired is lost. The unused amount of a particular credit that is carried forward to a later year is used prior to the same credit generated in the later year and prior to any higher numbered credit on the list.

Note 1: The new jobs credit is not included in the table because the new jobs credit is a refundable credit which is considered a payment of the tax. See line instructions for Schedule A, line 23.

Note 2: For tax years 1999 and thereafter Amended Substitute House Bill 215, 122nd General Assembly eliminated the credit for investment in qualified subsidiaries provided for in ORC section 5733.067.

Note 3: All credit computations under Chapter 5733. are to include the taxpayer's proportionate share amounts from any pass-through entity in which the taxpayer has a direct or indirect interest. See ORC section 5733.057.

1. **Credit for Taxes Paid by a Qualifying Pass-Through Entity** (ORC section 5733.0611) - A corporation that is a qualifying investor in a qualifying pass-through entity can claim a nonrefundable credit equal to the corporation's proportionate share of the tax paid by the qualifying pass-through entity. However, in determining Ohio taxable income, a corporation that claims this franchise 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.
   To claim this credit the qualifying investor must attach to its franchise tax report a copy of the IRS form K-1 which indicates the qualifying investor's proportionate share of the amount of the pass-through entity tax for which the qualifying investor seeks to claim a credit.
   For an explanation of the tax on qualifying pass-through entities see the instructions for form IT-1140, Tax Return for Pass-Through Entities and Trusts.

2. **Credit for Qualifying Affiliated Groups** (ORC section 5733.068) - If, as a result of the related entity and related member adjustments (see Schedule B-3), an affiliated group will pay over $3.5 million more franchise tax than the members of the group otherwise would have paid had the members of the group not made the related entity and related member adjustment, then the members of the affiliated group may claim a credit equal to the difference between the additional tax and $3.5 million. However, the credit is limited to $1.5 million for the affiliated group (even if the additional tax exceeds $5 million).

3. **Credit for Recycling and Litter Prevention Donations** (ORC section 5733.064) - A taxpayer may claim a credit for the taxpayer's cash donations made during the taxable year to: (a) municipal corporations, counties, townships, park districts, and boards of education that have received litter control and recycling grants from the Division of Recycling and Litter Prevention under ORC section 1502.05 and (b) Ohio corporations organized prior to January 1, 1987 that have been determined to be nonprofit corporations by the Internal Revenue Service and whose sole purpose is to promote and encourage recycling. The credit equals the lesser of one-half of the amount of the cash do-

nation or one-half of the sum of the tier one and tier two litter taxes. For information on the litter tax see the line instructions for Schedule K.

4. **Credit for Employers that Enter into Agreements with Child Day-Care Centers** (ORC section 5733.36) - A taxpayer that makes periodic "support payments" to an Ohio licensed day-care center which agrees to serve a child of the taxpayer's employee for the period covered by the support payment may claim a credit equal to 50% of the support payments that the taxpayer made to the day-care center during the taxable year. The credit applies to tax years 1999 through 2003 and has no carryforward provision.

   The Department interprets the term "child of the taxpayer's employee," as used above and in the "credit for employers that establish on-site child day-care centers" (see credit #12, below), to mean any child who lives in the home of an employee and an employee's natural child, stepchild or adopted child whether or not the natural child, stepchild or adopted child lives in the home of the employee.

5. **Credit for Employers that Reimburse Employee Child Day-Care Expenses** (ORC section 5733.38) - A taxpayer that reimburses its employees for dependent child day-care expenses at an Ohio-licensed day-care center may claim a credit equal to fifty percent of the amount that the taxpayer reimbursed its employees for such expenses, but the credit may not exceed seven hundred fifty dollars per dependent child. In determining the credit, the taxpayer may not include any amount incurred in connection with a cafeteria plan described in section 125 of the Internal Revenue Code; nor may the taxpayer include "support payments" used to determine the credit for employers that enter into agreements with child day-care centers (see credit #4, above). The credit applies to tax years 1999 through 2003 and has no carryforward provision.

6. **Credit for Purchases of Lights and Reflectors for Tractors** (ORC section 5733.44) - A taxpayer may claim a nonrefundable credit for purchasing lights and reflectors for installation on multi-wheel agricultural tractors in order to comply with the new lighting and reflector requirements set forth in ORC section 4513.111. (A multi-wheel agricultural tractor is an agricultural tractor that has two or more wheels on each side of one rear axle. See ORC section 4511.01(GGG). The credit equals the lesser of $1,000 or fifty percent of the cost of the lights and reflectors purchased during the period October 5, 2000 (the effective date of this new law) through October 4, 2001. The taxpayer must claim the credit for the taxable year during which the taxpayer purchased the lights and reflectors. If the taxpayer is an investor in a pass-through entity that purchased the lights and reflectors to comply with the lighting and reflector requirements contained in ORC section 4513.111, the investor may claim the investor's proportionate share of the credit. Unused credit amounts may not be carried forward.

7. **Credit for Purchases of New Manufacturing Machinery and Equipment** (The Original 20% Credit (ORC section 5733.31) or the Alternative 20% Credit (ORC section 5733.311)) - Note: A taxpayer that otherwise qualifies for both the original 20% credit and the alternative 20% credit may claim either the original 20% credit or the alternative 20% credit, but not both (see ORC sections 5733.311(B)(3) and 5733.98(A)(9)). Also, that portion of the cost of equipment for which a taxpayer claims either the original 20% credit or the alternative 20% credit does not qualify for the 7.5% - 13.5% credit (see ORC section 5733.33(G)).

   Original 20% Credit - Manufacturers that during the **eighteen-month period January 1, 1995 through June 30, 1996** purchase new manufacturing machinery and equipment that the taxpayer will both locate in Ohio and use as a manufacturer may claim a credit equal to 20% of the cost of such new manufacturing machinery and equipment purchased by the taxpayer during the eighteen-month period. The credit applies only if the aggregate cumulative cost of the new manufacturing machinery and equipment purchased for locations in Ohio during the eighteen-month period by the taxpayer and by the component members of the taxpayer's federal controlled group equals or exceeds a threshold of 20% of the aggregate cost of **all tangible personal property located in the United States** and owned by the taxpayer or by other component members of the taxpayer's controlled group at the close of the taxpayer's most recent taxable year ending before January 1, 1995. The maximum credit allowed to a taxpayer or to a controlled group of corporations of which the taxpayer is a component member is $500,000. The credit first applies to tax year (report year) 1996 for taxable years that end in 1995. Unused credit amounts may be carried forward for three taxable years after the last taxable year that includes any portion of the eighteen month purchase period. For additional information please see ORC section 5733.31 and the Income Tax Audit Division's October 14, 1994, September 21, 1995 and May 7, 1996 Franchise Tax Information Releases. Please address your request for the Information Releases to: Ohio Department of Taxation, P.O. Box 182857, Columbus, OH. 43218-2857, Attn: Credit for New Manufacturing Equipment.

   Alternative 20% Credit - Manufacturers that during the **seven-month period December 1, 1995 through June 30, 1996** purchase new manufacturing machinery and equipment that the taxpayer will locate in Ohio and use as a manufacturer may claim a credit equal to 20% of the cost of such new manufacturing machinery and equipment purchased by the taxpayer during the seven-month period. The credit applies only if the aggregate cumulative cost of the new manufacturing machinery and equipment purchased for locations in Ohio during the seven month period by the taxpayer and by the component members of the taxpayer's federal controlled group equals or exceeds a threshold of 20% of the aggregate cost of all **manufacturing machinery and equipment located in the United States** and owned by the taxpayer or by other component members of the taxpayer's controlled group at the close of the taxpayer's most recent taxable year ending before January 1, 1995. The maximum credit allowed to a taxpayer or to a controlled group of corporations of which the taxpayer is a component member is $500,000. The credit first applies to tax year (report year) 1996 for taxable years that end in 1995. Unused credit amounts may be carried forward for three taxable years after the last taxable year that includes any portion of the seven month purchase period. For additional information please see ORC section 5733.311 and the Income Tax Audit Division's October 14, 1994, September 21, 1995 and May 7, 1996 Franchise Tax Information Releases. Please address your request for the Information Releases to: Ohio Department of Taxation, P.O. Box 182857, Columbus, OH 43218-2857, Attn: Credit for New Manufacturing Equipment.

8. **Second Credit for Purchases of New Manufacturing Machinery and Equipment (7.5% - 13.5% Credit) - (ORC section 5733.33)**.

   Note 1: House Bill 283, 123rd General Assembly (Budget Bill) and House Bill 640 recently amended the 7.5% - 13.5% manufacturer's credit. Among other changes, the new law extends to December 31, 2005 the purchase period for new manufacturing equipment, and for new manufacturing equipment purchased after December 31, 2000 the new law

requires a "qualifying controlled group " to compute the credit on a consolidated basis.

Note 2: That portion of the cost of equipment for which a taxpayer claims either the original 20% credit or the alternative 20% credit does not qualify for the 7.5%/13.5% credit.

Manufacturers may claim a credit for "new manufacturing machinery and equipment" purchased during the period July 1, 1995 to December 31, 2005 provided that the manufacturer installs the equipment in Ohio by the required date. The credit also applies to taxpayers that have an interest in pass-through entities (limited liability companies and partnerships) that during the period July 1, 1995 to December 31, 2005 purchase new manufacturing machinery and equipment provided that the pass-through entity installs the machinery and equipment in Ohio by the required date. New manufacturing machinery and equipment purchased prior to January 1, 2001 must be installed in Ohio no later than December 31, 2001. New manufacturing machinery and equipment purchased during the calendar years 2001 through 2005 must be installed in Ohio no later than December 31, 2006.

"New manufacturing machinery and equipment" is manufacturing machinery and equipment the original use in Ohio of which begins with the taxpayer or a pass-through entity in which the taxpayer has an interest. For purposes of this credit, equipment is "new" if the taxpayer or pass-through entity is the first to use the equipment in Ohio.

New manufacturing equipment that is manufactured or assembled primarily by the taxpayer for the taxpayer's own use is deemed to have been purchased on the date the taxpayer places the property in service in the county for which the taxpayer will calculate the credit. New manufacturing machinery and equipment that is not manufactured or assembled primarily by the taxpayer, is deemed to have been purchased on the date which the agreement to acquire the property becomes binding.

A taxpayer must separately determine the credit for each Ohio county with respect to the qualifying equipment that the taxpayer (or a pass-through entity in which the taxpayer has an interest) purchases for use in that county during each of eleven separate qualifying purchase periods that comprise the period July 1, 1995 to December 31, 2005. The eleven separate qualifying purchase periods are the six month period July 1, 1995 to December 31, 1995 and each of the calendar years 1996 through 2005. The credit is based on purchases during the calendar year even if the taxpayer (or pass-through entity in which the taxpayer has an interest) has a fiscal year end.

For those Ohio counties not designated as "eligible areas" the credit equals 7.5% of the amount by which the cost of qualifying equipment purchased during a qualifying period for use in an Ohio county exceeds the "base investment" for that county "Eligible areas" are those Ohio counties and municipalities annually designated and certified by the Director of the Ohio Department of Development based upon the economic criteria set forth in the law. For those Ohio counties designated as eligible areas the credit equals 13.5% of the amount by which the cost of qualifying equipment purchased during a qualifying period for use in the county exceeds the base investment for the county.

For those Ohio counties that are not designated as eligible areas but contain eligible areas within their boundaries, the credit equals the sum of the following:

- 13.5% of the lesser of: (a) the cost of qualifying equipment purchased during the calendar year for use in the eligible areas of the county or (b) the county excess (the cost of qualifying equipment purchased during the calendar year for use in the entire county minus the taxpayer's base investment for that county) and
- 7.5% of the amount by which the county excess is greater than the cost of the new manufacturing machinery and equipment purchased during the calendar year for use in the eligible areas in the county.

To determine whether a county or area is an "eligible area" please call the Ohio Department of Development at 1-800-848-1300. The Department of Development has also prepared a map of "eligible areas" which is available on the Department of Development's Website: *http://www.odod.state.oh.us* (click on: (1) "Tax Incentive Program", (2) "Ohio Manufacturer's Machinery & Equip. Investment Tax Credit", (3) "Eligible Investment Areas" and (4) "Priority Investment Area Maps")

The "base investment" for a county is determined by adding the cost of new manufacturing machinery and equipment purchased for use in the county during each of three "base years" and dividing the total by three. The base years, like the purchase years, are calendar years – regardless of whether the taxpayer has a fiscal year end. The purchase periods along with their corresponding base years are as follows:

Calendar Year of Purchase	Base Years
7/1/95 – 12/31/95	1992, 1993, 1994
1996	1992, 1993, 1994
1997	1992, 1993, 1994
1998	1992, 1993, 1994
1999	1993, 1994, 1995
2000	1994, 1995, 1996
2001	1995, 1996, 1997
2002	1996, 1997, 1998
2003	1997, 1998, 1999
2004	1998, 1999, 2000
2005	1999, 2000, 2001

The credit for qualifying equipment purchased by a pass-through entity is not computed at the pass-through entity level and then passed through to the taxpayers that have an interest in the pass-through entity. Instead, taxpayers that have an interest in a pass-through entity during a qualifying period in which the pass-through entity purchased qualifying equipment must claim a proportionate share of the cost of such equipment and a proportionate share of the pass-through entity's base investment in the county for which the qualifying equipment was purchased. For each qualifying period and for each county and eligible area such proportionate share amounts are then added to the proportionate share amounts from other pass-through entities in which the taxpayer has an interest and to the taxpayer's own purchases of qualifying equipment and base investment. The taxpayer must compute the credit after aggregating its proportionate share amounts with the taxpayer's own purchases and the taxpayer's own base investment

Qualifying controlled group must compute consolidated credit. For new machinery and equipment purchased after December 31, 2000 a qualifying controlled group (a group of corporations related by more than 50% direct or indirect stock ownership) must compute the credit for each county as if all taxpayers of the group were a consolidated, single taxpayer in that county. The consolidation provision applies both to the equipment purchased after December 31, 2000 on which the taxpayer will claim the credit and to base year purchases that determine the threshold above which the credit applies. The qualifying controlled group may allocate the consolidated credit in any manner the group chooses and the group may amend that allocation anytime before the refund statute of limitations expires. See ORC section 5733.33(I) as amended by Amended Substitute House Bill 640, 123rd General Assembly.

Note: The consolidation provision applies to the credit computation for each Ohio county; the consolidation provision does not eliminate the requirement to determine the credit on a county-by-county basis.

For new machinery and equipment purchased before January 1, 2001 a qualifying controlled group may elect to compute the credit as if the group were a consolidated, single taxpayer. The election can be made by filing an amended report and an application for refund anytime before the statute of limitations expires. Also, the election can be made by timely filing a petition for reassessment. The election, if made, applies to the credit computation for each county for all purchases of machinery and equipment made before January 1, 2001 and to all base years used to determine the threshold above which the credit applies for each county. That is, if a qualifying controlled group makes this election, the "consolidated, single taxpayer" computation also applies to all purchases of machinery and equipment made in earlier calendar years with respect to which the taxpayer has already filed tax reports. The election is irrevocable. The group is not required to allocate the remaining one-seventh credit amounts (the one-seventh credit amounts that must be claimed in future years) at the time the group makes the election. Rather, the group can allocate the unused one-seventh credit amounts in the tax years the group must utilize the credit.

The term "qualifying controlled group", as used above, is defined in ORC section 5733.04(M) as " two or more corporations that satisfy the ownership and control requirements of division (A) of section 5733.052 of the Revised Code."

A taxpayer must claim one-seventh of the credit in each of the seven tax years following the calendar year in which the taxpayer purchased the equipment. However, for qualifying equipment purchased during the period July 1, 1995 to December 31, 1995 a taxpayer may not begin to claim the one-seventh credit amounts until tax year 1997.

If the taxpayer sells equipment that was purchased prior to January 1, 2001 or moves such equipment from the county for which the credit was originally computed, the taxpayer is not allowed any remaining one-seventh credit amounts on the equipment sold or moved. If the taxpayer sells equipment that was purchased after December 31, 2000 or moves such equipment from the county for which the credit was originally computed, the taxpayer is not allowed any remaining one-seventh credit amounts on the equipment sold or moved unless the equipment is fully depreciated for federal income tax purposes at the time the equipment is sold or moved. However under certain limited circumstances, the purchaser of a "large manufacturing facility" may claim the unused credits of the seller of the manufacturing equipment located at that manufacturing facility.

The Department has prepared a computerized spreadsheet to calculate the credit. The spreadsheets is available only through the Internet. To access the spreadsheet and download the file to your computer, visit the Department on the Internet at: *http://www.state.oh.us/tax/*
Then, click on: "tax forms" and "corporate franchise tax forms". Under 2001 forms click on "Worksheet for 7.5% and 13.5% Manufacturer's Credit under ORC secs. 5733.33 and 5747.31".

Taxpayers who intend to claim this credit must file a "Notice of Intent" form with the Ohio Department of Development. Please send your request for the "Notice of Intent" form to The Ohio Department of Development, Office of Tax Incentives, PO Box 1001, Columbus, Ohio 43216-1001 or call 1-800-848-1300. The "Notice of Intent" form is also available on the Ohio Department of Development's Website at:

http://www.odod.state.oh.us

Under the heading "tax incentive program" click on "Ohio manufacturers manufacturing machinery and equipment investment tax credit."

For additional information please see ORC section 5733.33 and the Income Tax Audit Division's September 22, 1995, May 6, 1996, May 7, 1996 and June 18, 1996 Information Releases. Please address your request for the Information Release to: Ohio Department of Taxation, P.O. Box 182857, Columbus, OH 43218-2857, Attn: Second Credit for Purchases of New Manufacturing Machinery and Equipment.

9. Job Training Credit. (ORC section 5733.42) - This new nonrefundable franchise tax credit applies to taxpayers that have received a tax credit certificate from the Director of Job and Family Services with respect to an "**eligible training program.**" The amount of the credit equals one-half of the excess of (1) the taxpayer's "**eligible training costs**" paid or incurred during the calendar year immediately preceding the tax year for which the credit is claimed over (2) the taxpayer's average annual eligible training costs for the three preceding calendar years. (This credit is based upon costs incurred during a calendar year regardless of whether the taxpayer has a fiscal year end.) The credit is temporary: it applies to eligible training costs incurred during the period January 1, 2000 to December 31, 2003 (see ORC section 5733.42(L) and section 180 of Amended Substitute House Bill 283, 123rd General Assembly). Thus, **the credit applies to the 2001 to 2004 franchise tax reports**.

The credit can not exceed $500 times the number of "**eligible employees"** for whom the taxpayer incurred eligible training costs during the calendar year immediately preceding the tax year for which the taxpayer is claiming the credit. Furthermore, the credit can not exceed the lesser of one hundred thousand dollars or one-half of the taxpayer's ORC section 5733.06 tax liability for the preceding tax year.

"Eligible training program" means a program to provide job skills to eligible employees who are unable to function effectively on the job due to skill deficiencies or who would otherwise be displaced because of their skill deficiencies or inability to use new technology.

"Eligible training costs" are the sum of: (1) direct instructional costs, such as, instructor salaries, materials and supplies, textbooks and manuals, videotapes, and other instructional media and training equipment used exclusively for the purpose of training "eligible employees" and (2) wages paid to eligible employees for time devoted exclusively to an "eligible training program" during normal paid working hours.

"Eligible employees" are individuals who are employed by the taxpayer in Ohio and have been so employed by the taxpayer for at least one hundred eighty consecutive days and on the same job for at least ninety consecutive days working at least twenty-four hours per week. "Eligible employees" do not include employees for whom the taxpayer claims the enterprise zone training credit pursuant to ORC section 5709.65(A). See page 25 for a summary of the enterprise zone training credit.

A qualifying controlled group must compute the credit as if all corporations in the qualifying controlled group were a consolidated, single taxpayer. The qualifying controlled group may allocate the credit among the group members in any amounts the group chooses and may change that allocation any time before the refund statute of limitations expires. A "qualifying controlled group" is defined in ORC section 5733.04(M) as two or more corporations that satisfy the ORC section 5733.052(A) ownership and control requirements to file a combined franchise tax report (regardless of whether or not the corporations actually file a combined report).

Taxpayers must claim the credit in the tax year immediately following the calendar year in which the taxpayer incurred the eligible training costs. Taxpayers must use the credit in the order established in ORC section 5733.98 and may carry forward unused credit amounts for three tax years following the tax year for which the credit is computed.

A taxpayer that proposes to conduct an eligible training program for which the taxpayer intends to claim the credit must apply to the Director of Job and Family Services for a tax credit certificate for <u>each</u> <u>tax</u> <u>year</u> with respect to a calendar year in which the taxpayer incurred eligible training costs. The Director may charge an application fee to cover the expenses incurred in administering the credit program, and the Director may adopt rules to implement and administer the credit. The Department of Development is to administer this new credit program until such time as the Department of Job and Family Services is established.

Upon receipt of an application the Director of Job and Family Services may authorize a credit by granting the applicant a tax credit certificate if the Director determines that all of the following five conditions are satisfied:

i. The taxpayer's primary business activity falls within one of the following classifications in the Standard Industrial Classification Manual (1987) published by the United States Office of Management and Budget:

Division D	Manufacturing
Division H	Finance, Insurance, and Real Estate
Major Group 73	Business Services
Major Group 81	Legal Services
Major Group 87	Engineering, Accounting, Research, Management, and Related Services

ii. The proposed training program is an "eligible training program," as defined above;
iii. The proposed training program is economically sound and will benefit the people of Ohio by improving workforce skills and strengthening the economy of Ohio;
iv. Receiving the credit is a major factor in the taxpayer's decision to implement the program;
v. Authorization of the credit is consistent with the following:
    - The aggregate amount of credits authorized may not exceed twenty million dollars per calendar year;
    - No more than ten million dollars in credits per calendar year may be authorized for corporations engaged primarily in manufacturing;
    - No less than five million dollars per calendar year will be set aside for corporations engaged primarily in activities other than manufacturing and having fewer than five hundred employees.

The Director will review applications and authorize credits to applicants that meet the requirements in the order in which the applicants submit complete and accurate applications. If the Director issues the taxpayer a tax credit certificate and later determines that the training program fails to meet the above requirements, the Director may reduce the amount of the credit previously granted. If the Director reduces the credit, the Director must certify the reduction to the tax commissioner, and the tax commissioner shall reduce the credit accordingly.

10. **Credit for Eligible New Employees in an Enterprise Zone** (ORC section 5709.66) - A taxpayer may apply to the Director of Development for an "employee tax credit certificate" for each eligible new employee the enterprise hires after June 30, 1994 at a facility located in a "central city of a metropolitan statistical area" (as defined by the United States office of management and budget) or located in the "Appalachian region" (as defined by the Appalachian Regional Development Act of 1965) to which an enterprise zone agreement applies provided that the taxpayer is complying with the enterprise zone agreement and has not closed or reduced employment at any place of business in Ohio within the twelve months preceding the application. A taxpayer who is issued a tax credit certificate for an eligible employee may claim a $1,000 nonrefundable credit for each taxable year covered under the enterprise zone agreement during which the eligible employee is employed by the taxpayer. An "eligible employee" is a new employee who at the time the employee was hired to work at the facility was a recipient of aid to dependent children or general assistance and resided for at least one year in the county in which the facility is located.

    If a taxpayer claims an enterprise zone new employee tax credit with respect to an employee, the taxpayer may not claim the ORC section 122.17 new jobs credit with respect to that employee.
    Credit applications are available from the Ohio Department of Development, Office of Tax Incentives, 77 S. High Street, 28th Floor, P.O. Box 1001, Columbus, OH 43216-1001 or call (614) 466-2317 or 1-800-848-1300.

11. **Credit for Eligible Costs Associated with a Voluntary Action (Brownfield Site Clean-Up)** (ORC section 5733.34) - A taxpayer who participates in the Ohio Environmental Protection Agency's (OEPA) Voluntary Action Program and who has received and maintained a "covenant not to sue" from the OEPA may apply to the Director of Development for this credit, which is intended to encourage the private sector cleanup and reuse of properties that have been contaminated by hazardous substances. The authority for the Director of Development to grant tax credits under this program expired on June 30, 1999. For additional information please contact the Ohio Department of Development, Office of Tax Incentives, 77 S. High Street, 28th Floor, P.O. Box 1001, Columbus, OH 43216-1001 or call (614) 466-2317, or 1-800-848-1300.

12. **Credit for Employers that Establish On-Site Child Day-Care Centers** (ORC section 5733.37) - A taxpayer that establishes an Ohio licensed day-care center that serves only children of the taxpayer's employees and is located at the employees' worksite may claim a credit equal to the lesser of one hundred thousand dollars or fifty percent of the amount the taxpayer incurred for equipment, supplies, labor, and real property, including renovation of real property, to establish the day-care center. The taxpayer can claim the credit only for the tax year immediately following the taxable year in which the child day-care center begins operations, and the taxpayer can claim the credit only for tax year 1999, 2000, 2001, 2002, or 2003. The credit amount that the taxpayer does not use in the tax year claimed may be carried forward for five taxable years. However, if the taxpayer ceases to operate the center within the five year carryforward period, any unused portion of the credit is lost.

13. **Credit for Grape Production Property** (ORC section 5733.32) - Grape producers may claim a credit equal to 10% of the cost of qualifying property purchased on or after January 1, 1994.

Qualifying property is any property, plant, or equipment used in growing, harvesting or producing grapes in Ohio. Unused credit amounts may be carried forward for seven taxable years. The credit is subject to recapture if the taxpayer disposes of the property or ceases to use it as qualifying property within seven years after placing it in operation.

14. **Export Sales Credit** (ORC section 5733.069) - A taxpayer that increases its export sales and also increases either its Ohio property or its Ohio payroll may claim a credit for tax years 1993 through 2005. **However, for tax years 2001 to 2005 no new credit is generated. For tax years 2001 to 2005 only unused carryforward credit amounts from tax years 1993 to 2000 can be claimed.** If the taxpayer is claiming an export sales credit carryforward from tax year 2000 or earlier, please attach to the franchise tax report a schedule which shows the year(s) in which the credit was generated, the years in which the credit was used and the remaining carryforward.

    For tax years 1993 to 2000 the tentative credit was computed by applying the following formula:

Export Sales Credit	=	10% X pre-tax profit from the incremental increase in export sales X the average of the property factor and the payroll factor X the greater of (i) the Ohio payroll increase factor or (ii) the Ohio property increase factor.

    Additional information is available upon request from the Ohio Department of Taxation, P.O. Box 182857, Columbus, OH 43218-2857, Attn: Export Credit.

15. **Edison Center Credit for Research and Development Investors** (ORC section 5733.35) - Investors that provide capital to certain qualifying small, Ohio-based research and development or technology transfer companies may be eligible for a nonrefundable credit equal to 25% of the taxpayer's at-risk investment. An investor or group of investors that proposes to invest in a qualifying small, Ohio-based research and development company or technology transfer company and seeks to claim the credit must apply to one of the state's seven Edison Centers for approval of the proposed investment. The credit application fee for a single investor is $200 and for a group of investors is $800. For additional information please contact the Ohio Department of Development, Technology Division, 77 S. High Street, P.O. Box 1001, Columbus, OH 43216-1001, or call (614) 466-3887 or 1-800-848-1300.

    Note: For taxable years ending on or after June 30, 1997, Amended Substitute House Bill No. 215, 122nd General Assembly amended this credit. Taxpayers who claim this credit should see ORC sections 122.15, 122.151, 122.152, 122.153 and 122.154 as amended by the new law.

16. **Enterprise Zone Day-Care Credit** (ORC section 5709.65(A)) - If a taxpayer has received a Tax Incentive Qualification Certificate from the Ohio Department of Development and if the taxpayer reimburses certain new employees (see general instruction #23 and ORC section 5709.64(A)(2)(a) to (e)) for all or part of the cost of day-care services necessary to enable the employees to be employed at the facility for which the certificate is issued, the taxpayer may claim a credit. The credit equals the amount so reimbursed for the taxable year in which the taxpayer makes the reimbursement, up to a maximum of three-hundred dollars for each child or dependent receiving the day-care services.

    Enterprise Zone Training Credit (ORC section 5709.65(A)) - If a taxpayer has received a Tax Incentive Qualification Certificate from the Ohio Department of Development and if the taxpayer pays or reimburses all or part of the cost of a qualified training program for certain new employees (see general instruction #23 and ORC section 5709.64(A)(2)(a) to (e)) the taxpayer may claim for each new employee a credit equal to the amount paid or reimbursed or one-thousand dollars, whichever is less. The taxpayer may claim the credit in the taxable year in which the new employee completes ninety days of subsequent employment.

The following recently enacted credits will first apply to the 2002 franchise tax report and, as such, are not included on Schedule A-1 for 2001:

Credit for Maintaining Railroad Crossing Warning Devices (ORC section 5733.43). Railroad companies can claim a credit for maintaining signs, signals, gates and other electrical warning devices at public highway-railway crossings in Ohio at common grade. The credit equals 10% of the sum of the annual maintenance expenditures for each active grade crossing warning device in Ohio for which such expenditures were made during the taxable year. The credit is not to exceed two hundred dollars for each device in Ohio for which such expenditures were made during the taxable year. Unused credit amounts may not be carried forward. This new credit applies to taxable years beginning after December 31, 2000 – thus, the credit first applies to the 2002 franchise tax report.

Credit for Qualified Research Expense. (ORC section 5733.351) - A taxpayer may claim a credit equal to 7% of the amount by which the taxpayer's "qualified research expense" incurred in Ohio during the taxable year exceeds the taxpayer's average annual qualified research expenses incurred in Ohio for the three preceding taxable years. The term "qualified research expenses" has the same meaning as in section 41 of the Internal Revenue Code. Unused credit amounts may be carried forward for seven taxable years. The credit first applies to qualified research expenses paid or incurred after December 31, 2000. As such, the credit will first apply to the 2002 franchise tax report.

A "qualifying controlled group" must compute the credit as if all corporations in the qualifying controlled group were a consolidated, single taxpayer. The qualifying controlled group may allocate the credit among themselves in any amounts they choose and may change that allocation any time before the refund statute of limitations expires. A "qualifying controlled group" is defined in ORC section 5733.04(M) as two or more corporations that satisfy the ORC section 5733.052(A) ownership and control requirements to file a combined franchise tax report (whether or not the corporations actually file a combined report).

SCHEDULE B-2
FOREIGN SOURCE INCOME DEDUCTION
ORC section 5733.04(I)(2)

Effective for taxable years ending on or after July 31, 1991 deductible foreign source income must generally be reduced by certain percentages which are deemed to be the expenses attributable to the foreign income.

Line 1 - IRC Section 78 and 951 Income.
Enter the IRC section 78 foreign dividend gross-up and IRC section 951 subpart F income. This income is fully deductible.

Line 2 - Foreign dividends. (See note below.)
Multiply by 85% dividends received from a subsidiary, associate, or affiliated corporation that neither transacts any substantial portion of its business nor regularly maintains any substantial portion of its assets within the United States.

Note: **The Ohio Supreme Court recently held that ORC section 5733.04(I)(2) -- the foreign source income provision that reduces deductible foreign dividends by 15% deemed expenses -- violates the United States Constitution's Foreign Commerce Clause because it treats dividends from foreign subsidiaries less favorably than dividends from domestic subsidiaries which can be deducted in their entirety. See *Emerson Elec. Co. v. Tracy* (2000), 90 Ohio St.3d 157. The instructions for line 2, foreign dividends, do not reflect the Court's decision because the Ohio Attorney General has filed a motion for reconsideration with the Ohio Supreme Court. At the time of printing this instructions book the Court had not decided whether it will reconsider the decision. If by the date you file the franchise tax report for tax year 2001 the Ohio Supreme Court has decided that it will not reconsider its decision and by the date you file the franchise tax report the Department has decided that it will not appeal this decision to the United States Supreme Court, then the dividends received from a subsidiary, associate, or affiliated corporation that neither transacts any substantial portion of its business nor regularly maintains any substantial portion of its assets within the United States are fully deductible on the 2001 franchise tax report (that is, not subject to the statutory 15% deemed expenses provision) notwithstanding the above instructions to the contrary. Before filing your report please visit the Department's web site at: http://www.state.oh.us/tax/ for up-to-date information regarding the status of this deduction.**

If you file the franchise tax report reflecting the 15% deemed expense and this issue is ultimately resolved in favor of Emerson Electric Company, then you may file an Application for Refund (form FT-REF) anytime within the three year refund statute of limitations as provided in ORC section 5733.12.

Line 3 - Foreign royalties.
Multiply by 90% the royalties received from sources outside the United States. Royalties are received from sources outside the United States to the extent that the property which generated the royalty was used outside the United States.

Line 4(a) - Income from technical and other services.
Enter amounts received for mechanical, industrial, scientific, practical, and other services performed outside the United States. Income from technical services performed in the United States for a foreign customer does not qualify for the foreign source income deduction. The situs of the service performed determines the source of service income. See *Rio Indal, Inc. v. Lindley* (1980), 62 Ohio St. 2d 283. If technical service on a project is performed both within and without the United States, income from the project must be reasonably allocated within and without the United States.

Line 4(b) - Reimbursed expenses for personal services performed for subsidiaries.
Enter the amount of any reimbursed expenses for technical or other services performed by employees of the taxpayer for its subsidiary, associate, or affiliated corporations.

To the extent that the taxpayer shows by clear and convincing evidence a lesser amount of actual expenses attributable to deductible gross foreign source income, the taxpayer may deduct a greater amount. To the extent that the tax commissioner shows by clear and convincing evidence more actual expenses attributable to deductible foreign source income, the tax commissioner may reduce the deduction.

SCHEDULE B-3
RELATED ENTITY AND
RELATED MEMBER ADJUSTMENTS
ORC sections 5733.04(I)(12) & (I)(13)
ORC sections 5733.042, 5733.054, & 5733.055

Note: If the taxpayer is included in a combined franchise tax report, complete Schedule B-3 (Combined) on Form FT-1120C (rather than Schedule B-3 on Form FT-1120). Capital gains and capital losses attributed to a member of a combined report from a related entity's sale or other disposition of dividend producing property are separately allocable by each member. All other related entity and related member adjustments are apportionable and are computed on a combined basis. See the May 6, 1992, Franchise Tax Information Release "Schedule B-3 (Combined) - Related Entity and Related Member Adjustments for Corporations Included in a Combined Franchise Tax Report."

Related Entity Adjustments

Line 1 - Related entity gains (losses) from sale of investments.
The related entity gains and losses adjustment applies to taxable years ending on or after July 31, 1991.
A taxpayer must add to (and deduct from) federal taxable income, line 28 of U.S. Form 1120, the taxpayer's proportionate share of a nontaxpayer related entity's gains (and losses) from sales of investments in the stock or debt of another entity if at any time during the twenty-four month period commencing twelve months prior to the date of sale and ending twelve months after the date of sale the taxpayer and its related entities owned at least 50% of the stock or debt of the entity whose stock or debt was sold.
The term "related entity" means any of the following:

- An individual stockholder, or a member of the stockholder's family enumerated in Internal Revenue Code (IRC) section 318, if the stockholder and the members of the stockholder's family own directly or indirectly in the aggregate at least 50% of the value of the taxpayer's outstanding stock;
- A stockholder, or stockholder's partnership, estate, trust, or corporation, if the stockholder and the stockholder's partnerships, estates, trusts and corporations own directly or indirectly, beneficially, or constructively, in the aggregate, at least 50% of the value of the taxpayer's outstanding stock;
- A corporation, or a party related to the corporation in a manner that would require IRC section 318 attribution of stock from the corporation to the party or from the party to the corporation, if the taxpayer owns directly or indirectly in the aggregate at least 50% of the value of the corporation's outstanding stock.

The IRC section 318 attribution rules apply to the above.

A taxpayer is a corporation subject to the Ohio corporation franchise tax. A nontaxpayer is an entity not subject to the Ohio corporation franchise tax. For each gain and each loss attributed to the taxpayer and recognized by a nontaxpayer related entity from the related entity's sale of stock or debt described above, provide a schedule containing the following information:

a. The name of the related entity which sold the stock or debt;
b. The name of the entity whose stock or debt was sold by the related entity and a description of the property sold;
c. The amount of gain or loss recognized for federal income tax purposes by the related entity from each sale or other disposition;
d. The amount of the taxpayer's proportionate share of the related entity's gain or loss from the sale of stock or debt based upon the taxpayer's direct, indirect, beneficial or constructive ownership of the outstanding stock of the related entity immediately prior to the direct or indirect sale, exchange, or other disposition; and

e. A description of the ownership relationship between the taxpayer and the related entity which sold the stock or debt and a description of the ownership relationship between the related entity and the entity whose stock or debt was sold by the related entity.

Enter on line 1 the total net gain or net loss from all transactions described above.

Line 2 - Related entity gains (losses) from sale of other intangible property.

A taxpayer must add to (and deduct from) federal taxable income, line 28 of U.S. Form 1120, its proportionate share of a nontaxpayer related entity's gains (and losses) from sales of intangible property other than stock, securities and debt if the intangible property was owned or used at any time prior to the sale by either the taxpayer or by a related entity that was a taxpayer at any time during the related entity's ownership or use of the property.

Enter on line 2 the total net gain or net loss from all transactions described above.

For each gain and each loss recognized by a nontaxpayer related entity from the nontaxpayer related entity's sale of intangible property other than stock, securities, and debt described above, provide a schedule containing information similar to that required by line 1.

Line 4 - Allocable portion of total related entity gains (losses).

Capital gains and capital losses attributed to the taxpayer from a related entity's sale or other disposition of intangible property which may produce dividend income are allocable within and without Ohio. Gains and losses attributed to the taxpayer from a related entity's sale or other disposition of intangible property other than dividend producing property are apportionable.

In addition to the information required by line 1 of this schedule, identify each gain and each loss which is allocable. Enter on line 4 the total related entity net capital gain or net capital loss which is allocable.

Line 10 - Related entity gains (losses) allocable to Ohio.

Capital gains and capital losses from the sale of dividend producing property are allocable to Ohio in accordance with the ratio which the investee corporation's net book value of physical assets in Ohio bears to the investee corporation's net book value of total physical assets everywhere. In addition to the information required by lines 1 and 4 of this schedule, for each capital gain and each capital loss which is allocable furnish a schedule showing the ratio of the investee corporation's net book value of physical assets within Ohio to net book value of physical assets everywhere. Multiply the gain or loss by the ratio. Enter on line 10 the total related entity net capital gain or net capital loss attributed to the taxpayer which is allocable to Ohio.

Line 11 - Add excess related entity loss.

Add each related entity loss deducted from federal taxable income on lines 1 and 2 of this schedule to the extent that the loss actually allocated and apportioned to Ohio and to other states which impose a tax on or measured by net income exceeds the total loss. The addition is limited to that portion of the loss actually allocated to Ohio on line 10 or apportioned to Ohio on line 9.

In addition to the information required by lines 1, 2, 4, and 10 of this schedule, a taxpayer claiming a deduction for related entity losses on lines 1 or 2 of Schedule B-3 must furnish a schedule containing the following information for **each** loss deducted:

a. The name of each state in which the loss was deducted for purposes of computing a tax on or measured by net income;
b. The apportionment ratio in each state in which the loss was deducted;
c. The amount of the loss actually allocated or apportioned to each state which imposes a tax on or measured by net income;
d. The amount of the loss actually allocated or apportioned to Ohio;
e. The amount by which the loss allocated and/or apportioned to Ohio and to other states exceeds the total loss; and
f. The smaller of the amount from line **d** or line **e**, above.

Enter on Line 11 as a positive number the sum of the amounts from line **f**, above.

Line 12 - Deduct excess related entity gain.

Line 12 grants relief in those circumstances where the related entity gain subjected to tax by Ohio and by other states exceeds the total gain. On line 12 a taxpayer may deduct each gain added to federal taxable income on lines 1 and 2 of this schedule to the extent that the gain actually taxed by Ohio and by other states which impose a tax on or measured by net income exceeds the total gain. The deduction is further limited to the portion of the gain that is actually allocated to Ohio on line 10 or apportioned to Ohio on line 9.

In addition to the information required by lines 1, 2, 4, and 10 of this schedule, a taxpayer claiming a deduction on line 12 must furnish a schedule containing the following information for **each** gain for which the deduction is claimed:

a. The name of each state which imposed on the gain a tax on or measured by net income;
b. The apportionment ratio in each state which imposed a tax on the gain;
c. The amount of the gain actually allocated or apportioned to each state which imposed tax on the gain;
d. The amount of the gain actually allocated or apportioned to Ohio;
e. The amount by which the gain allocated and/or apportioned to Ohio and to other states exceeds the total gain; and
f. The smaller of the amount from line **d** or line **e**, above.

Enter on line 12 the sum of the amounts from line **f**, above.

Related Member Adjustments

Line 6 - Interest expense and intangible expense paid to related members.

Note: For tax years 1999 and thereafter Amended Substitute House Bill 215, 122nd General Assembly, made the related member adjustments applicable to both large corporations and small corporations which pay interest expense or intangible expense to certain related members. Prior law generally limited the related member adjustments to large taxpayers because the prior law applied only if the taxpayer or a member of the taxpayer's affiliated group had one or more of the following: (1) gross sales of at least fifty million dollars, (2) total assets of at least twenty-five million dollars, or (3) taxable income of at least five hundred thousand dollars. House Bill 215 eliminated the above three limitations thereby making the adjustments applicable to small corporations as well as large corporations.

In addition, House Bill 215 expanded the definition of "intangible expenses and costs" in the related member provisions to include losses from factoring transactions and discounting transactions. Intangible expenses and costs include expenses, losses, and costs for, related to, or in connection with the direct or indirect acquisition, use, maintenance, management, ownership, or disposition of intangible property. See ORC section 5733.042(B) as amended by House Bill 215.

A taxpayer must add to its federal taxable income interest expense and intangible expenses which it deducted for federal income tax purposes and which it directly or indirectly paid or accrued to certain "related members." Interest expense includes but is not limited to amounts deducted under IRC section 163. Intangible expenses are expenses and costs for the use of intangible property. Such expenses include but are not limited to losses from factoring transactions and discounting transactions and royalty, patent, technical, and copyright fees, licensing fees and other similar expenses deducted for purposes of determining taxable income under the Internal Revenue Code.

A penalty for failure to pay the additional tax attributable to the related member adjustments is applicable if the additional tax is not paid within one year after the date the report is filed. The penalty equals twice the interest charged. The penalty does not apply if the additional tax (i) is less than 10% of the total franchise tax and (ii) is less than $50,000. This penalty is in addition to any other applicable penalties and charges.

For purposes of this adjustment the term "**related member**" means a person that, with respect to the taxpayer during all or any portion of the taxable year, is any of the following: (i) a "related entity" as defined in division (l)(12)(c) of ORC section 5733.04 (summarized in the instructions for line 1, above), (ii) a "component member" as defined in IRC section 1563(b), or (iii) a person to whom or from whom there is attribution of stock ownership in accordance with IRC section 1563(e) except that "20%" shall be substituted for "5%" wherever "5%" appears in IRC section 1563(e).

A taxpayer must add to its federal taxable income the following: (i.) all interest expense and intangible expenses which the taxpayer paid or accrued to related members described in A through F, below, and (ii) excess interest paid to related members described in G, below:

A. A related member whose activities in any one state are primarily limited to the maintenance and management of (i) intangible investments or (ii) intangible investments of corporations, business trusts, or other similar entities;
B. A related member that is a personal holding company as defined in IRC section 542 without regard to the stock ownership requirements set forth in IRC section 542(a)(2);
C. Any noncorporate related member that is directly or indirectly owned in whole or in part by a personal holding company as defined in IRC section 542 without regard to the stock ownership requirements set forth in IRC section 542(a)(2);
D. Any related member that is an IRC section 552 foreign personal holding company;
E. Any noncorporate related member that is directly or indirectly owned in whole or in part by an IRC section 552 foreign personal holding company; and
F. Any related member if that related member or another related member directly or indirectly paid or accrued interest expenses or intangible expenses. However, this portion of the law is applicable only if within a 120 month period commencing three years prior to the beginning of the tax year and ending seven years after the beginning of the tax year the related member directly or indirectly paid or accrued such amounts to one of the five related members listed in A through E directly above.
G. In addition to the adjustments for all interest expense and intangible expense paid to related members listed in A through F, above, a taxpayer must add to its federal taxable income interest expense that is paid or accrued to **any** related member to the extent that the interest is based upon an "excess interest rate." An "excess interest rate" is an interest rate that exceeds by more than 3% the greater of (i) the annual interest rate prescribed by ORC section 5703.47 in effect at the time of the origination of the indebtedness or (ii) the annual interest rate prescribed by ORC section 5703.47 in effect at the time the taxpayer paid, accrued or incurred the interest expense. For example, the 2000 annual rate prescribed by ORC section 5703.47 is 8%. If a taxpayer paid or accrued interest expense to a related member at the rate of 14% during 2000 on indebtedness that originated in 2000, the excess interest rate is 3% (14% minus the sum of 8% and 3%). Only the excess interest expense must be added to federal taxable income. In this example the excess interest expense is the difference between the interest paid or accrued to the related member at the 14% rate and the interest that would have been paid or accrued had the rate been 11% (8% + 3%).

If the taxpayer paid or accrued interest expense or expenses for the use of intangible property to a related member described in A through F, above, or if the taxpayer paid or accrued "excess interest" to any related member, attach a schedule containing the following information:

1. A list of all the related members to whom the taxpayer directly or indirectly paid or accrued interest expense or expense for the use of intangible property during the taxpayer's taxable year;
2. For **each** related member listed in No. 1, above:
   - Indicate whether or not the related member is a related ember described in A through F above;
   - Provide the amount of the taxpayer's interest expense paid or accrued during its taxable year to the related member, the amount of the taxpayer's indebtedness to the related member at the beginning and at the end of the taxpayer's taxable year, the interest rate on the indebtedness, and the date of the origination of the indebtedness; compute the taxpayer's excess interest expense, if any, paid or accrued during its taxable year to each related member other than related members described in A through F, above; and
   - Provide the amount of the taxpayer's expenses for the use of intangible property paid or accrued during its taxable year to each related member described in A through F above. Describe the intangible property used by the taxpayer.

The interest expense and intangible expense adjustments do not apply to the extent that the taxpayer's increased tax would have been avoided by filing a combined franchise tax report with the related member. In addition, the interest expense and intangible expense adjustments do not apply where both of the following conditions are satisfied: (i) the transaction did not have as a principal purpose the avoidance of Ohio franchise tax, and (ii) the related member to whom the taxpayer paid interest expense and/or intangible expense during the same taxable year directly or indirectly paid, accrued, or incurred such amounts to persons who were not related members.

Enter on line 6 the sum of: (i) interest paid or accrued to all related members described in A through F, above, (ii) expenses for the use of intangible property paid or accrued to all related members described in A through F, above, and (iii) excess interest paid or accrued to all related members other than related members described in A through F, above.

Line 13 - Deduct related members' net interest income and net intangible income taxed by other states.

A taxpayer may deduct an amount equal to the sum of each related member's "net interest income" (defined below) and "net intangible income" (defined below) actually allocated and apportioned to other states that impose a tax on or measured by income. The deduction is limited to the increase in Ohio taxable income resulting from the adjustments required by Schedule B-3, line 6.

Net interest income is the excess of interest received by a related member from the taxpayer over interest expenses and costs paid or accrued by the related member to another related member described in A through G, above (see instructions for line 6).

Net intangible income is the excess of income received by a related member from the taxpayer for the taxpayer's use of intangible property over intangible expenses paid or accrued by the related member to another related member described in A through G, above.

For purposes of this deduction, related members receiving such income from the taxpayer and paying such expenses are limited to those related members described in A through G, above.

In addition to the information required by line 6 of this schedule, taxpayers who are claiming a deduction on line 13 must furnish a schedule containing the following additional information for each related member which received from the taxpayer interest income or income for the use of intangible property:

a. The names of all other states which imposed on the related member a tax on or measured by income;

   For purposes of this deduction the term "other states" does not include those states under whose laws the taxpayer files or could have elected to file with the related member, or the related member files or could have elected to file with another related member, a combined income tax report or return, a consolidated income tax report or return, or any other report or return where such report or return is due because of the imposition of a tax measured on or by income and such report or return results in the elimination of the tax effects from transactions directly or indirectly between either the taxpayer and the related member or between the related member and another corporation if such other corporation, during a one-hundred-twenty-month period commencing three years prior to the beginning of the tax year and ending seven years after the beginning of the tax year, directly or indirectly paid, accrued or incurred intangible expenses and costs or interest expenses and costs to an entity described in A through E, above (see instructions for line 6).

b. the related member's interest expense which it paid or accrued to other related members described in A through G, above;
c. the related member's intangible expenses which it paid or accrued to other related members described in A through G, above;
d. the related member's net interest income (defined above);
e. the related member's net intangible income (defined above);
f. the related member's apportionment ratio in each state listed in (a), above; and
g. the related member's net interest income and net intangible income which it actually allocated or apportioned to each state which imposed tax on the income.

Enter on line 13 the smaller of the following:

- The sum of all related members' net interest income and net intangible income actually allocated and apportioned to other states that imposed a tax on or measured by income or
- The taxpayer's increase in Ohio taxable income resulting from the adjustments required by ORC section 5733.042 (that is, the amount on line 6 of this schedule multiplied by the taxpayer's Schedule D Ohio apportionment ratio.)

For further information regarding the related entity and related member adjustments, please contact the Department of Taxation at P.O. Box 182857, Columbus, Ohio 43218-2857, Attn: Related Entity/ Related Member.

Tax Commissioner's Rules Applicable to the Ohio Corporation Franchise Tax

5703-1-12	Requests for an opinion of the tax commissioner
5703-5-01	Definitions applicable to rules 5703-5-01 to 5703-5-05 of the Administrative Code
5703-5-02	Date as of which the value of a taxpayer's issued and outstanding stock is determined
5703-5-03	Dates on which a taxpayer's taxable year begins and ends
5703-5-04	Changes of a taxpayer's annual accounting period
5703-5-06	Combined reporting of the corporation franchise tax
5703-5-08	Books from which the value of issued and outstanding shares of stock is determined under the net worth basis of the corporation franchise tax
5703-5-09	Allocating and apportioning income of airlines
5703-5-10	Corporate franchise tax; accounts maintained under Statement of Financial Accounting Standards No. 106

INFORMATION RELEASES

Since 1991 the Income Tax Audit Division has issued the following Information Releases:

"IRC Section 482 Study: Safe Harbor to Avoid Ohio Corporate Franchise Tax Report Required or Expanded Combinations," June 23, 2000

"Withdrawal of Special Instructions," October 31, 1997

"Am. Sub. H.B. No. 215, 122nd General Assembly (Budget Bill), Summary of Franchise Tax & Income Tax Provisions," September 18, 1997

"IRS 'Check the Box' Entity Selection Regulations," August 19, 1997

"Revisions to May 6, 1996 Information Release," June 18, 1996

"Alternative 20% Credit," May 7, 1996.

"Examples Setting Forth the Division's Interpretation of Ohio Revised Code Sections 5733.33 and 5747.31, 'Second Credit for Purchases of New Manufacturing Machinery and Equipment,' " May 6, 1996

"Second Credit for Purchases of New Manufacturing Machinery and Equipment," September 22, 1995

"20% Threshold Test Credit for Purchases of New Manufacturing Machinery and Equipment," September 21, 1995

"Newly-enacted Investment Tax Credit Law," October 14, 1994

"Recently-enacted Legislation Revises the Requirements for Corporations Paying Corporate Franchise Tax by Electronic Funds Transfer (EFT)," July 31, 1994

"Taxation of S Corporations and Their Shareholders," July 31, 1994

"New Legislation Requires Certain Corporations to Pay Corporate Franchise Tax by Electronic Funds Transfer," October 29, 1993

"Safe Harbor Leases: Franchise Tax Policy Change," November 10, 1992

"Application of Ohio Revised Code Section 5733.053 (Transferor Statute) to the Merger of a C Corporation into an S Corporation," September 24, 1992

"Schedule B-3 (Combined) - Related Entity and Related Member Adjustments for Corporations Included in a Combined Franchise Tax Report," May 6, 1992

"Exempt Federal Interest," January 9, 1992

"Credit for Investment in Qualified Subsidiaries," July 16, 1991

"Taxpayer Elected Franchise Tax Combinations," May 15, 1991

"Foreign Technical Service Fee Deductions," May 15, 1991

Tax Information Releases are not "Opinions of the Tax Commissioner" within the meaning of ORC section 5703.35. Nevertheless, the releases do reflect the Department's interpretation of the law. Copies of the above Information Releases are available upon request. Send your request to the Ohio Department of Taxation, P.O. Box 182857, Columbus, OH 43218-2857, Attn: Information Release.

OHIO FRANCHISE TAX FORMS Many of the Department's forms are available on the Internet at: http://www.state.oh.us/tax/		Latest Revision Date
FT-COM	Request for Permission to File or to Amend a Combined Corporation Franchise Tax Report	7/00
FT-1120E	Declaration of Estimated Corporation Franchise Tax	12/00
FT-1120ER	Application for Automatic Extension	12/00
FT-1120EX	Request for an Additional Extension of Time for Filing Corporation Franchise Tax Report	12/00
FT-1120	Corporation Franchise Tax Report	12/00
FT-1120VL	Valuation Limitation on Gains and Losses from Sales or Exchanges of Property	7/00
FT-1120C	Corporation Franchise Tax (Combined Report)	12/00
FT-WAIVER	Consent to Extend the Time to Assess or Refund the Ohio Corporation Franchise Tax	10/98
FT-OTAS	Ohio Taxpayers' Affiliation Schedule	12/00
FT-EXPORT	Corporation Franchise Tax Credit for Increasing Export Sales	12/99
FT-1120-FI	Corporation Franchise Tax Report for Financial Institutions	12/00
FT-1120-S	Notice of S Corporation Status	12/00
FT-REF	Application for Corporation Franchise Tax Refund	2/00
FT-PR	Petition for Reassessment	9/00
FT-FLAG	Special Handling Notice	12/99
FT-QHC	Qualifying Holding Company Election	No Revisions

Rank	Nonrefundable Credit	Carryforward Period	ORC Section
1	Credit for Taxes Paid by a Qualifying Pass-Through Entity	Unlimited*	5733.0611
2	Credit for Qualifying Affiliated Groups (due to Related Entity and Related Member Adjustments)	Not Applicable	5733.068
3	Credit for Recycling and Litter Prevention Donations	None	5733.064
4	Credit for Employers that Enter into Agreements with Child Day-Care Centers	None	5733.36
5	Credit for Employers that Reimburse Employee Child Day-Care Expenses	None	5733.38
6	Credit for Purchases of Lights and Reflectors for Tractors	None	5733.44
7	Credit for Purchases of New Manufacturing Machinery and Equipment (The Original 20% Credit or the Alternative 20% Credit)	Three taxable years from the last taxable year that includes any portion of the purchase period.	5733.31 or 5733.311
8	Second Credit for Purchases of New Manufacturing Machinery and Equipment (7.5%/13.5% Credit)	Three years	5733.33
9	Job Training Credit	Three years	5733.42
10	Credit for Eligible New Employees in an Enterprise Zone	Three years	5709.66
11	Credit for Eligible Costs Associated with a Voluntary Action (Brownfield Site Clean-Up)	Three years	5733.34 122.19
12	Credit for Employers that Establish On-Site Child Day-Care Centers	Five years	5733.37
13	Credit for Grape Production Property	Seven years	5733.32
14	Export Sales Credit	1994-2005	5733.069
15	Edison Center Credit for Research & Development Investors	Fifteen years	5733.35 122 .15 122.151 122.152 122.153 122.154
16	Enterprise Zone Day Care and Training Credits	Unlimited*	5709.65(A)
*Unused credit amounts may be carried forward until fully utilized.			
Not included in the above table are the Credit for Maintaining Railroad Crossing Warning Devices and the Credit for Qualified Research Expense. Both of these new credits will first apply in report year 2002.			

OHIO DEPARTMENT OF TAXATION
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P.O. Box 182857
Columbus, Ohio 43218-2857
Phone: (614) 433-7617
Ohio Relay Service for the Hearing Impaired 1-800-750-0750

TAXPAYER SERVICES DIVISION
P.O. Box 182382
Columbus, Ohio 43218-2382
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- **Business Taxpayer Services**: 1-888-405-4039
- **Registration Unit**: 1-888-405-4089
- **Forms Requests**: 1-800-282-1782

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ZANESVILLE OFFICE
Ohio Department of Taxation
601 Underwood Street
Zanesville, Ohio 43701-3786
Phone: (740) 453-0628

Many of the franchise tax forms and the more recent franchise tax information releases are available on the Internet.
Visit the Department on the Internet at:
http://www.state.oh.us/tax/