Supplemental Ohio Corporation Franchise Tax Schedules and Instructions for Electric Companies and Combined Companies Tax Year 2003

Electric companies[1] **and combined companies**[2] **are subject to the Ohio Revised Code (O.R.C.) Chapter 5733 corporation franchise tax beginning in tax year (privilege year) 2002** (see O.R.C. Section 5733.09 and Section 12 of Senate Bill #3, 123rd General Assembly). Because of their unique nature, electric companies and combined companies are subject to franchise tax deduction, add back, apportionment, credit and tax computation adjustments that do not apply to other taxpayers. These supplemental franchise tax schedules and instructions reflect the adjustments that are unique to electric companies[3]:

- Electric companies should complete the attached supplemental schedules B, C and A-1 rather than the corresponding schedules on the 2003 Ohio corporation franchise tax report, Form FT-1120.
- Electric companies should complete the sales factor of the Form FT-1120 Schedule D apportionment ratio by situsing sales of electricity and sales revenue from transmission and distribution services based on the instructions starting on page 5 of this packet.
- Electric companies should compute the tax on Schedule A, lines 17 and 20 based on the instructions starting on page 6 of this packet.

Except for those items that are specifically covered by these instructions, please refer to the 2003 Ohio corporation franchise tax report (Form FT-1120) and the 2003 franchise tax instructions booklet. **Please check the box on page one (the top right side) of Form FT-1120 to indicate that the taxpayer is an electric company or combined company and attach the completed supplemental schedules to Form FT-1120.**

Supplemental Schedules B and C – Adjustments for Book-Tax Differential

Upon the sale or other taxable disposition of any asset shown on December 31, 2000 on an electric company's books and records kept in accordance with generally accepted accounting principles (GAAP), an electric company must increase or decrease its income for the difference between the asset's net book value on December 31, 2000 and the asset's federal adjusted basis on December 31, 2000. The assets shown on an electric company's GAAP books and records on December 31, 2000 are known as "qualifying assets." The sale or other taxable disposition of a qualifying asset is a "qualifying taxable event." The difference between a qualifying asset's net book value on December 31, 2000 and such asset's adjusted basis on December 31, 2000 is the asset's "book-tax differential." (The statutory definitions of the terms "qualifying asset," "qualifying taxable event" and "book-tax differential" begin on page 4 of this packet.)

Book-tax differential = Net book value – Federal adjusted basis

An asset's book-tax differential can be either positive or negative. If an asset's book-tax differential is negative (that is, the asset's net book value on December 31, 2000 is less than the asset's adjusted basis on that date), then in determining Ohio taxable income the book tax differential is added to federal taxable income as a positive number. If an asset's book-tax differential is positive (that is, the asset's net book value on December 31, 2000 is greater than the asset's adjusted basis), then in determining Ohio taxable income the book tax differential

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[1] An "electric company" is any person engaged in the business of generating, transmitting or distributing electricity within this state for use by others, but excludes a "rural electric company." A "rural electric company" is defined as any nonprofit corporation, organization, association or cooperative engaged in the business of supplying electricity to its members or persons owning an interest therein in an area the major portion of which is rural. See O.R.C. Sections 5733.04(P), 5727.01(D)(3) and 5727.01(C).

[2] A "combined company" is any person engaged in the activity of an electric company or rural electric company that is also engaged in the activity of a heating company or a natural gas company or any combination thereof. See O.R.C. Section 5733.04(P) and. 5727.01(L). The term "combined company," as used throughout these supplemental instructions, is not to be confused with a company included in an O.R.C. Section 5733.052 combined franchise tax return with another corporation.

[3] Unless otherwise stated in these supplemental instructions, the term "electric company" refers to both an electric company and a combined company.

is deducted from federal taxable income. If the gain or loss from the sale or other taxable disposition of a qualifying asset is apportionable within and without Ohio, then the asset's book-tax differential is apportionable. On the other hand, if the gain or loss from the sale or other taxable disposition of a qualifying asset is allocable to Ohio, then the book-tax differential is allocable to Ohio. For a discussion of allocation and apportionment of gains and losses see below. **Note:** If the gain or loss from the sale or other taxable disposition of a qualifying asset is allocable outside Ohio, then the book-tax differential adjustment does not apply with respect to that asset.

Although a qualifying asset's book-tax differential is determined as of December 31, 2000, the book-tax differential adjustment to income is not made until the qualifying asset is sold or disposed of in a qualifying taxable event (a transaction resulting in the recognition of gain or loss for federal income tax purposes). **The book-tax differential adjustment is not made on the disposal of a qualifying asset in a transaction in which gain or loss is deferred** (a transaction that results in the deferral of gain or loss is not a qualifying taxable event). Thus, if after December 31, 2000 an electric company trades in a qualifying asset for a replacement asset and the gain or loss is deferred for federal income tax purposes, then the book-tax differential is not recognized at that time. However, the replacement asset is a qualifying asset, and the book-tax differential of the replacement asset equals the book-tax differential of the asset traded in (the book-tax differential for the replacement asset does not include any additional consideration paid for the replacement asset). Upon the sale or other disposition of the replacement asset in a qualifying taxable event, an electric company must adjust its net income for the replacement asset's book-tax differential (that is, the carryover book-tax differential from the asset traded in).

As noted above, the book-tax differential adjustment applies on the sale of a qualifying asset in a transaction in which gain or loss is recognized for federal income tax purposes. However, if no gain or loss is recognized on the sale or other disposition of a qualifying asset in a qualifying taxable event solely because at the time of disposition the amount realized equals the asset's adjusted basis, the book-tax differential adjustment nevertheless applies (see O.R.C. Section 5733.0510(B)(4)). Furthermore, if for federal income tax purposes an electric company uses the installment method of accounting in recognizing gain from the sale of a qualifying asset, the franchise tax book-tax differential adjustment for that asset must be made in proportion to the gain recognized for federal income tax purposes in each corresponding taxable year in which the gain is recognized.

The book-tax differential adjustment applies only if either (1) the electric company was subject to and paid the Ohio excise tax for gross receipts received during the period May 1, 2000 through April 30, 2001, or (2) the electric company received the asset in a tax-free reorganization from an electric company that was subject to and paid the excise tax for gross receipts received during the period May 1, 2000 through April 30, 2001. Assets acquired by the taxpayer from another electric company that was a party to the reorganization and that was subject to and paid the excise tax for gross receipts received during the period May 1, 2000 through April 30, 2001 have a carryover book-tax differential and are deemed to have been acquired by the taxpayer on the same date as actually acquired by the other electric company.

Allocable Gains and Losses and Apportionable Gains and Losses

Recognized gains and losses from the sale or other taxable disposition of capital assets and Internal Revenue Code (I.R.C.) Section 1231 assets are allocable to Ohio or apportionable within and without Ohio as set forth below (see O.R.C. Section 5733.051):

- Capital gains and losses and I.R.C. Section 1231 gains and losses from the sale or other taxable disposition of real property located in Ohio and from tangible personal property located in Ohio at time of sale are allocated to Ohio.
- Ordinary gains from the sale or other taxable disposition of depreciable real property and depreciable tangible personal property that are taxed as ordinary (recapture) income for federal income tax purposes are considered capital gains for franchise tax purposes. Thus, depreciation recapture income from the sale or other taxable disposition of property located in Ohio is allocated to Ohio, and depreciation recapture income from the sale or other taxable disposition of property located outside Ohio is allocated outside Ohio. See *Borden, Inc. v. Limbach* (1990), 49 Ohio St. 3d 240 and *Harsco Corp. v. Tracy* (1999), 85 Ohio St.3d 382.
- Capital gains and capital losses from the sale or other taxable disposition of intangible personal property that may produce dividend income are allocated on the same basis as dividends. (Dividends, other than dividends

from domestic international sales corporations, are allocated to Ohio in accordance with the ratio that the book value of the physical assets of the dividend payor located in Ohio bears to the book value of the total physical assets of the dividend payor located everywhere.)

- Capital gains and capital losses from the sale or other taxable disposition of intangible personal property that does not produce dividend income are apportioned.

Recognized gains and losses from assets other than capital assets and I.R.C. Section 1231 assets are apportioned.

Supplemental Schedule B – Adjustments to Federal Taxable Income

Line 1(e). Addition for book-tax differential (for qualifying assets whose book-tax differential is negative). If the recognized gain or loss with respect to a qualifying asset sold or disposed of during the taxable year in a qualifying taxable event is apportionable and the asset's book-tax differential is negative (that is, if the asset's book value as of December 31, 2000 determined in accordance with GAAP is less than the asset's adjusted basis as of that date), then the electric company must increase its income by the absolute value of the amount of the book-tax differential for that qualifying asset. The adjustment applies regardless of the asset's location at the time of the qualifying taxable event and regardless of the location on December 31, 2000. Enter on line 1(e) as a positive number the sum of the negative book-tax differential amounts for those qualifying assets for which the gain or loss from the sale or other taxable disposition during the taxable year is apportionable.

Line 2(i). Deduction for book-tax differential (for qualifying assets whose book-tax differential is apportionable and positive). If the recognized gain or loss with respect to a qualifying asset sold or disposed of during the taxable year in a qualifying taxable event is apportionable and the asset's book-tax differential is positive (that is, if the asset's book value as of December 31, 2000 determined in accordance with GAAP exceeds the asset's adjusted basis as of that date), then the electric company must reduce its income by the amount of the book-tax differential for that qualifying asset. The adjustment applies regardless of the asset's location at the time of the qualifying taxable event and regardless of the asset's location on December 31, 2000. Enter on line 2(i) as a positive number the sum of the positive book-tax differential amounts for those qualifying assets for which the gain or loss from the sale or other taxable disposition during the taxable year is apportionable.

Supplemental Schedule C – Allocable Income

Line 6. Negative book-tax differential. If the recognized gain or loss with respect to a qualifying asset sold or disposed of during the taxable year in a qualifying taxable event is allocable to Ohio and the asset's book-tax differential is negative, then the electric company must increase its net income allocable to Ohio by the absolute value of the book-tax differential for that qualifying asset. Enter on line 6 as a **positive number** in column 1 (within Ohio) the sum of the negative book-tax differential amounts for those qualifying assets the gain or loss from whose sale or other taxable disposition during the taxable year is allocable to Ohio. Make no entry in column 2 (total everywhere).

Line 7. Positive book-tax differential. If the recognized gain or loss with respect to a qualifying asset sold or disposed of during the taxable year in a qualifying taxable event is allocable to Ohio and the asset's book-tax differential is positive, then the electric company must decrease its net income allocable to Ohio by the book-tax differential for that qualifying asset. Enter on line 7 as a **negative number** in column 1 (within Ohio) the sum of the positive book-tax differential amounts for those qualifying assets the gain or loss from whose sale or other taxable disposition during the taxable year is allocable to Ohio. Make no entry in column 2 (total everywhere).

Note: If gain or loss with respect to the sale or other taxable disposition of a qualifying asset is allocated outside Ohio, the book-tax differential adjustment does not apply with respect to that asset.

Definitions Applicable to Book-Tax Differential Adjustment (O.R.C. Section 5733.0510(A))

"Qualifying taxpayer" means either of the following:

A) a person that is an electric company or a combined company, but only if the person was subject to and paid the tax imposed by O.R.C. Section 5727.30 for gross receipts received during the period of May 1, 2000 through April 30, 2001;

B) any taxpayer not described in division (A)(1)(a) [see the paragraph above] of this section if a person described in division (A)(1)(a) of this section transfers all or a portion of its assets or equity directly or indirectly to the taxpayer, the transfer occurred as part of an entity organization or reorganization, or subsequent entity organization or reorganization, and the gain or loss with respect to the transfer is not recognized in whole or in part for federal income tax purposes under the Internal Revenue Code on account of a transfer as part of an equity organization or reorganization, or subsequent organization or reorganization. O.R.C. Section 5733.0510(A)(1).

"Qualifying asset" means any asset shown on the qualifying taxpayer's books and records on December 31, 2000, in accordance with generally accepted accounting principles, including the cost of, or any portion of the cost of, any asset acquired after December 31, 2000, where such asset was acquired as a result of a tax-free or tax-deferred exchange of a qualifying asset. O.R.C. Section 5733.0510(A)(3).

"Qualifying taxable event" means any event resulting in the recognition for federal income tax purposes of gain or loss in connection with any direct or indirect sale, direct or indirect exchange, direct or indirect transfer, or direct or indirect retirement of any qualifying asset. O.R.C. Section 5733.0510(A)(2).

"Book-tax differential" means the difference, if any, between an asset's net book value shown on the qualifying taxpayer's books and records on December 31, 2000, in accordance with generally accepted accounting principles, and such asset's adjusted basis on December 31, 2000. The book-tax differential may be a negative number. O.R.C. Section 5733.0510(A)(5).

"Qualifying regulatory asset" means those qualifying assets that, as of December 31, 2000, are no longer included in federal energy regulatory commission uniform system of accounts 101 through 106 or are deferred expenses for operation or maintenance, or deferred costs associated with leaseback transactions on generating units, that have been authorized by a regulatory agency for recovery from customers in a future period and that, as of December 31, 2000, are subject to transition cost recovery under O.R.C. Chapter 4928 or similar laws of another state. O.R.C. Section 5733.0510(A)(6).

Note: The "qualifying regulatory assets" associated with a qualifying asset are considered disposed of on the same date that the "qualifying asset" is disposed of. Thus, the book-tax differential for qualifying regulatory assets is recognized for franchise tax purposes on the same date that the book-tax differential is recognized for the associated qualifying assets even though the qualifying regulatory assets may not have been sold or disposed of in a taxable transaction.

Supplemental Schedule B – Valuation Limitation Adjustment

Lines 1(a) and 2(b). Valuation limitation on losses and gains from capital assets and 1231 assets. Make no entry on Schedule B, lines 1(a) or 2(b). The O.R.C. Section 5733.04(I)(3) "valuation limitation" adjustment applicable to I.R.C. Section 1231 assets and capital assets does not apply to "qualifying assets." For those capital assets and 1231 assets of an electric company that are qualifying assets of an electric company, in determining net income, may not deduct that portion of the gain (and is not required to add back that portion of a loss) from the sale of 1231 assets and capital assets occurring before the first taxable year on which the tax provided for in O.R.C. Section 5733.06 is computed on the corporation's net income. Furthermore, the valuation limitation adjustment does not apply to an electric company's assets that are not qualifying assets because those assets will not have been acquired ". . . prior to the first taxable year on which the tax provided for in Section 5733.06 of the Revised Code is computed on the corporation's net income" (the taxable year ending in 2001). See O.R.C. Section 5733.04(I)(3).

Schedule D Apportionment

Sales factor. Although there is not a supplemental Schedule D apportionment schedule for electric companies included within this packet, there are special sales factor situsing provisions applicable to sales of electricity and to sales of transmission and distribution services (see O.R.C. Section 5733.059). Please use the instructions below to situs on Schedule D the company's sales of electricity and sales of transmission and distribution services.

1. Electricity sales:
   - Sales of electricity are sitused within and without Ohio based on where the customer consumes the electricity. That is, sales of electricity are sitused to Ohio to the extent that the customer <u>consumes</u> the electricity in Ohio.
   - If the taxpayer sells the electricity to a related member[4] and the related member sells the electricity to a customer, the taxpayer's sale to the related member is sitused to Ohio to the extent that the related member's customer <u>consumes</u> the electricity in Ohio.
   - Sales of electricity are sitused to Ohio if the seller or the seller's related member <u>delivers</u> the electricity to a location in Ohio or delivers the electricity exactly to the border of Ohio and another state.
   - Sales of electricity are sitused to Ohio if the seller or the seller's related member <u>directs the delivery</u> of the electricity to a location in Ohio or directs the delivery of the electricity exactly to the border of Ohio and another state.
2. Sales revenue from the <u>transmission</u> of electricity is sitused within and without Ohio based on the ratio of wire miles of the taxpayer's transmission lines within Ohio to wire miles of the taxpayer's transmission lines everywhere. Transmission wire miles are weighted for the voltage capacity of each line.
3. Sales revenue from the <u>distribution</u> of electricity is sitused within and without Ohio based on the ratio of wire miles of the taxpayer's distribution lines within Ohio to wire miles of the taxpayer's distribution lines everywhere. However, unlike transmission line wire miles, distribution line wire miles are <u>not</u> weighted for the voltage capacity of each line.
4. If a contract for the sale of electricity includes the seller's or the seller's related member's obligation to transmit or distribute the electricity and the sales contract <u>separately identifies</u> the price charged for the transmission or distribution services, the price charged for the transmission and distribution of electricity is sitused within and without Ohio in accordance with the provisions for situsing transmission and distribution revenue set forth in #2 and #3, above. The remaining portion of the sales price, that is, the sale of the elec-tricity itself is sitused within and without Ohio in accordance with electricity sales provision set forth in #1, above.
5. If a contract for the sale of electricity includes the seller's or the seller's related member's obligation to transmit or distribute the electricity and the sales contract does <u>not</u> separately identify the price charged for the transmission or distribution services, the entire price charged is sitused within and without Ohio in accordance with electricity sales provision set forth in #1, above.

Sales other than sales of electricity and transmission and distribution services are sitused within and without Ohio in accordance with O.R.C. Section 5733.05(B)(2)(c) and the sales factor instructions included in the franchise tax instructions booklet.

Supplemental Schedule A-1 – Nonrefundable Credits

With two notable exceptions, an electric company is entitled to the same franchise tax credits as other taxpayers: (1) an electric company is entitled to a credit for using Ohio coal at its coal-fired electric generating units (this credit is not available to taxpayers that are not electric companies), and (2) the second credit for purchases of new manufacturing machinery and equipment (the 7.5%-13.5% manufacturer's credit) has limited applicability to electric companies.

- **Electric company credit for using Ohio coal** (O.R.C. Section 5733.39). Beginning in tax year 2002, an electric company may claim against the franchise tax a nonrefundable credit for Ohio coal used in any of its coal-fired electric generating units after April 30, 2001 but before January 1, 2005. The credit is computed at

[4] The term "related member" means a person that, with respect to the taxpayer during all or any portion of the taxable year, is a "related entity" as defined in division (I)(12)(c) of O.R.C. Section 5733.04, is a component member as defined in I.R.C. Section 1563(b), or is a person to or from whom there is attribution of stock ownership in accordance with I.R.C. Section 1563(e) except, for purposes of determining whether a person is a related member under this division, "20 percent" shall be substituted for "5 percent" wherever "5 percent" appears in I.R.C. Section 1563(e). See O.R.C. Section 5733.042(A)(6).

the rate of $3 per ton of Ohio coal burned in a coal-fired electric generating unit after April 30, 2001 during the taxable year ending immediately preceding the tax year. The credit is allowed only if both of the following conditions are met during such taxable year:

1. The coal-fired electric generating unit is owned and used by the company claiming the credit or leased and used by that company under a sale and leaseback transaction.
2. A compliance facility, as defined in O.R.C. Section 5733.39(A) is attached to, incorporated in or used in conjunction with the coal-fired generating unit.

Enter the credit on supplemental Schedule A-1, line 18.

- **Second credit for purchases of new manufacturing machinery and equipment (the 7.5%-13.5% manufacturer's credit – O.R.C. Section 5733.33).** The 7.5%-13.5% manufacturer's credit does not apply to transmission and distribution equipment, and the credit does not apply to generating equipment if 50% or more of the electricity that the property generates is consumed during the 120-month period commencing with the date the property is placed in service by persons that are not related members to the person who generates the electricity.

  Enter the credit on supplemental Schedule A-1, line 9.

Schedule A – Computation of Total Tax

Although there is not a franchise tax supplemental Schedule A, electric companies and combined companies are entitled to tax reductions that do not apply to other taxpayers.

Schedule A, Line 17. Tax due. If the electric company is not a combined company, enter on Schedule A, line 17 the greater of the amount shown on Schedule A, line 14 or the amount shown on Schedule A, line 16, but not less than the $50 minimum fee.

If the electric company is a combined company that paid Ohio public utility excise tax on its gross receipts as a natural gas company or as a heating company, then the taxpayer is entitled to a franchise tax reduction (see O.R.C. Section 5733.06(J)). The reduction applies to the tax on the net income base and to the tax on the worth base as follows:

1. Net income base
   A. Multiply the tax on the net income basis (Schedule A, line 14) by the ratio of total taxable gross receipts from public utility activity other than as an electric company to total gross receipts from all sources; and
   B. Reduce the tax on the net income basis (Schedule A, line 14) by the lesser of the amount computed in 1A, above, or the excise tax paid for the year upon which the taxable gross receipts are measured immediately preceding the tax year.[5]
2. Net worth base
   A. Multiply the tax on the net worth basis (Schedule A, line 16) by the ratio of total taxable gross receipts from public utility activity other than as an electric company to total gross receipts from all sources; and
   B. Reduce the tax on the net worth basis (Schedule A, line 16) by the lesser of the amount computed in 2A, above, or the excise tax paid for the year upon which the taxable gross receipts are measured immediately preceding the tax year.
3. Enter on Schedule A, line 17 the greatest of the following:
   - The amount determined in 1B, above;

[5] For example, the year upon which the taxable gross receipts are measured immediately preceding franchise tax year (privilege year) 2003 is the year May 1, 2001 to April 30, 2002 even if the public utility has a calendar year-end taxable year. Thus, the franchise tax reduction for tax year 2003 is limited to the excise tax that was paid for gross receipts measured during the period May 1, 2001 to April 30, 2002.

- The amount determined in 2B, above; or
- The $50 minimum fee.

Combined Franchise Tax Report – Form FT-1120C

An electric company can join in the filing of a combined franchise tax report (Form FT-1120C) with related corporations whether or not those related corporations are electric companies provided that the requirements set forth in O.R.C. Section 5733.052 and on Form FT-1120C are met.

Although the department has <u>not</u> developed a combined report form or combined report schedules specifically applicable to electric companies making the book-tax differential adjustments, electric companies included in a combined report can nevertheless make those adjustments on Form FT-1120C, Schedule B (Combined) by lining out any unused addition and any unused deduction and substituting the book-tax differential adjustment.

Please note that the franchise tax deduction, add back, apportionment, credit and tax computation adjustments set forth in these supplemental instructions for electric companies do not apply to those members of a combined franchise tax report that are not electric companies. For example, the book-tax differential adjustment does not apply to any member of the combined return that is not an electric company. (However, the effects of the electric company's book-tax differential adjustment are prorated to all members of the combined report by virtue of the "proportionate share of the factors" mechanism set forth in O.R.C. Section 5733.052(E).)