The following corrections have been made to the 2004 Ohio Corporation Franchise Tax Report Instructions:

Page 4, column 2, Minimum fee increased to $1,000 for larger corporations – For taxpayers whose taxable year ended before June 26, 2003 and for taxpayers whose taxable year ended on or after June 26, 2003 but whose gross receipts ~~or~~ and whose number of employees ~~did~~ do not equal or exceed ~~one of~~ the thresholds discussed above, the minimum fee is $50. See O.R.C. section 5733.06(E) as amended by the new law.

Page 5, column 1, Sham transaction – The new law repealed the franchise tax sham transaction provision contained in O.R.C. section 5733.111 (see section 2 of the bill) and replaced it with a more encompassing provision that applies to all taxes and fees administered by the tax commissioner. The new law gives the tax commissioner the authority to apply the doctrines of "economic reality," "sham transaction," "step transaction" and "substance over form." In general, the tax commissioner bears the burden of establishing by a preponderance of the evidence that these doctrines should apply. However, with respect to transactions between members of a *controlled group*, the taxpayer bears the burden of establishing that a transaction or series of transactions between members of the controlled group was not a *sham transaction*. If the tax commissioner disregards a sham transaction, the assessment statute of limitations is doubled. The new law applies on and after June 26, 2003 to all years open to the statute of limitations.

Page 13, column 1 – The minimum fee is $50 for taxpayers whose taxable year ended before June 26, 2003 and for taxpayers whose taxable year ended on or after June 26, 2003 but whose gross receipts ~~or~~ and whose number of employees ~~did~~ do not equal or exceed the thresholds discussed above. See O.R.C. section 5733.06(E) as amended by Amended House Bill 95, 125th General Assembly.

Page 19, column 2, Enterprise Zone Tax Benefits – Amended Substitute House Bill 95, 125th General Assembly (Budget Bill) extends through ~~June 30, 2004~~ October 15, 2009 the authority for local governments to enter into enterprise zone agreements. See O.R.C. section 5709.62 as amended by the bill.

Page 20, column 1, Assessments – 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. Furthermore, if the tax commissioner disregards a sham transaction, the assessment statute of limitations is doubled. See general instruction #29 and O.R.C section 5703.56 as enacted by Amended Substitute House Bill 95, 125th General Assembly.

Page 23, column 2, Sham Transaction, Economic Reality, Substance Over Form and Step Transactions – 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. However, with respect to transactions between members of a controlled group, the taxpayer bears the burden of establishing that a transaction or series of transactions between members of the controlled group was not a sham transaction. If the tax commissioner disregards a sham transaction, the assessment statute of limitations is doubled.

Page 39 column 1, Schedule D-2, Net Worth Base Apportionment Formula – Schedule D-2 applies for purposes of apportioning the net worth base if (1) the taxpayer's taxable year ended on or after June 26, 2003 (the effective date of the franchise tax amendments enacted by Amended Substitute House Bill 95 of the 125th General Assembly), (2) the taxpayer allocated nonbusiness in Schedule C, and (3) the taxpayer excluded from the numerator and the denominator of the net income base apportionment factors the taxpayer's property, payroll, and sales relating to the production of nonbusiness income. The numerator and the denominator of the Schedule D property, payroll, and sales factors are the starting points for determining the Schedule D-2 net worth base property, payroll and sales factors. For purposes of computing its net worth property, payroll and sales factors for taxable years ending on or after June 26, 2003, the taxpayer must add to those starting point amounts any real and tangible personal property, payroll and sales, respectively, relating to or used in connection with, the production of nonbusiness income that the taxpayer allocated in Schedule C.

The Schedule D-2 net worth apportionment instructions previously stated in relevant part as follows: ". . . in determining the net worth base sales factor make no adjustment to the net income base sales factor for proceeds from the sale of capital assets that generated nonbusiness income or for proceeds from the sale of assets described in I.R.C. section 1231 that generated nonbusiness income. That is, proceeds from the sale of capital assets and I.R.C. section 1231 assets are not included in either the net income base sales factor or in the Schedule D-2 net worth base adjusted sales factor."

The revised Schedule D-2 instructions delete the above quoted material because for taxable years ending on or after December 11, 2003 (the effective date of Substitute House Bill 127 of the 125th General Assembly) receipts from sales of intellectual property (such as trademarks, trade names, patents and copyrights) generating business income are specifically **included** in the net income base sales factor whether or not the intellectual property is a capital asset. Furthermore, because the Schedule D property, payroll and sales amounts are the starting point for Schedule D-2, receipts from the sale of intellectual property generating business income are automatically included in the net worth base sales factor whether the intellectual property is a capital asset or an ordinary asset.

No correction is required to the Schedule D net income base apportionment instructions because those instructions correctly provide as follows: (1) for taxable years ending on or after June 26, 2003, the net income base property, payroll and sales factors specifically exclude that portion of property, payroll, and sales to the extent that the portion relates to, or is used in connection with, the production of nonbusiness income allocable under O.R.C. section 5733.051, (2) for taxable years ending prior to December 11, 2003, the sales factor excludes proceeds from the sale of I.R.C. section 1231 assets and proceeds from the sale of capital assets, (3) for taxable years ending on or after December 11, 2003, the sales factor excludes receipts along with any related gains or losses from the sale or other disposal of intangible property other than trademarks, trade names, patents, copyrights and similar intellectual property, and (4) for taxable years ending on or after December 11, 2003, the sales factor excludes receipts along with any related gains and losses from the sale or other disposal of tangible personal property or real property where that property is a capital asset or an asset described in I.R.C. section 1231.

Note: For consistency, we have replaced "corporate" franchise tax with "corporation" franchise tax throughout this document.

Ohio Department of
TAXATION
P.O. Box 2476
Columbus, OH 43216-2476

2004

Ohio Corporation Franchise Tax Report Instructions

2004 Franchise Tax Instructions

In our continuing effort to serve Ohio taxpayers in a cost effective manner with limited resources the Department of Taxation did not mail this franchise tax instructions booklet with the tax form. Instead, this booklet is available on the Department of Taxation's web site: www.tax.ohio.gov. For those taxpayers that do not have access to the Internet we printed a limited number of instruction booklets that can be obtained by calling toll free 1-800-282-1782.

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.

Unless otherwise stated, all references are to the Ohio Revised Code (O.R.C.). Links to the O.R.C., Administrative (Tax Commissioner) Rules, the department's information releases, tax forms and other information are available on our web site, which can be visited at:

www.tax.ohio.gov

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

Legislation

The summaries of the legislation referred to below generally are limited to the franchise tax provisions of those bills. While most of the amendments affect the franchise tax report beginning with tax year 2004, several others begin to apply in future tax years. If a particular amendment to the law affects the 2004 franchise tax report, the amendment is also included in the line item instructions for the schedules affected. If a particular amendment does not affect the 2004 franchise tax report, the amendment is generally not included in the line item instructions. For a copy of the legislation and for a full analysis of these new laws (as prepared by the Legislative Service Commission) visit the Ohio General Assembly's web site at:

www.legislature.state.oh.us/search.cfm.

Amended Substitute Senate Bill 180, 124th General Assembly (effective April 9, 2003). Among other provisions this new law enacted the following franchise tax changes:

- **Job retention tax credit amendments** – O.R.C. sections 122.171 and 5733.0610(B). Under prior law (as enacted by Amended Substitute House Bill 405, 124th General Assembly, effective December 13, 2001) a taxpayer may claim a credit as provided in an agreement between the taxpayer and the Ohio Tax Credit Authority if pursuant to the agreement and during three consecutive calendar years in the period beginning January 1, 2002, and ending December 31, 2006, the taxpayer makes an investment in physical plant of at least $200 million toward the taxpayer's approved project at the taxpayer's approved project site and the taxpayer employs at least 1,000 full-time employees at the project site. For each of the years set out in the agreement the amount of the credit equals a percentage (as specified in the agreement, but not to exceed 75 percent) of the Ohio income tax withheld from the taxpayer's employees at the project site. The purpose of the credit is to encourage large employers to maintain jobs in Ohio.

The new law reduces the credit's eligibility requirements as follows:

– At the taxpayer's project site to which the credit applies a taxpayer may now perform "significant corporate administrative functions." Under prior law the taxpayer's primary operations at the project site were limited to manufacturing.

– If the average wage of all full-time employment positions at the project site is greater than 400% of the federal minimum wage, then the company is required to make payment toward the project of only $100 million over the three consecutive calendar year investment period. Prior law required an investment of $200 million regardless of the average wage. Current law continues to require a $200 million investment if the 400 percent federal minimum wage standard is not met.

– The taxpayer's investment project may include the capitalized costs of basic research and new product development determined in accordance with generally accepted accounting principles. Prior law required that the investment be entirely in physical plant.

– The project site may include an integrated complex of facilities located within a 15-mile radius. Prior law required that those facilities be within a five-mile radius.

Under both prior law and continuing law the tax credit agreement between the taxpayer and the Ohio Tax Credit Authority must contain a description of the project that is the subject of the agreement along with the following: (i) period over which the taxpayer must make the investment in the project; (ii) the number of full-time employment positions at the project site; (iii) the term of the credit (that is, the period over which the taxpayer is entitled to claim the credit); and (iv) the tax credit percentage. In addition, the agreement must include:

1. A requirement that the taxpayer maintain operations at the project site for at least twice the number of years as the term of the credit, and
2. A requirement that the taxpayer retain a specified number of full-time employment positions within Ohio and at the project site for the term of the credit including a requirement that the taxpayer continue to employ at least 1,000 employees in full-time employment positions at the project site during the entire term of the agreement.

Under both prior law and continuing law, if the director of the Ohio Department of Development determines that a taxpayer is not complying with certain terms of the agreement, the director can terminate the agreement for future years and under certain conditions can require the taxpayer to repay all or a portion of the credit claimed in previous years. Under prior law the director could terminate the agreement for future years and could recapture all or a portion of the credit already claimed if the taxpayer failed to meet requirement #1 in the above paragraph or if, in violation of #2, the taxpayer reduced the number of employees agreed upon by more than 10 percent. Under new law a violation of requirement #2 may not be used as a basis for recapturing the taxpayer's previous credit. However, violation of requirement #2 can be grounds for the Ohio Tax Credit Authority to amend the agreement and for taxable years following that amendment can be grounds for reducing the credit percentage or reducing the term of the credit.

In addition, for those taxpayers that violate requirement #1, the new law specifies maximum recapture percentages based on how long the taxpayer maintained operations at the project site in relation to the term of the credit as set out in the credit agreement. Prior law did not specify the amount of credit that the director of the Ohio Department of Development could recapture in the event that the taxpayer failed to comply with the agreement. (The new law continues to require that the taxpayer maintain operations at the project site for twice the term of the credit.)

Note: Amended Substitute House Bill 95, 125th General Assembly, further amended the job retention credit. See the summary of Amended Substitute House Bill 95 that follows.

- **Credit for Losses on Loans Made to the Ohio Venture Capital Program** – O.R.C. sections 150.01 to 150.10, 5733.49, 5733.98, 5747.80 and 5747.98. The new law also established the Ohio Venture Capital (OVC) program for the purpose of increasing the amount of private investment capital available to both (i) Ohio-based business enterprises in the seed or early stages of business development that require initial or early stage funding; and (ii) established Ohio-based business enterprises that require funding for developing new methods or technologies. The new law also establishes a franchise tax credit and an individual income tax credit to provide OVC lenders and investors some security against losses on their loans to the OVC program. The discussion that follows is limited to a summary of the credit for losses on loans made to the OVC program (see O.R.C. sections 5733.49 and 5733.98 for the franchise tax credit and O.R.C. sections 5747.80 and 5747.98 for the individual income tax credit).

To provide lenders some security against losses on their loans to the OVC program, the OVC authority may grant tax credits that may be applied against the lender's franchise tax, individual income tax or, if the lender is an insurance company, the insurance premiums tax. Important provisions of this new credit are set out below:

- – The credit must be authorized under a written contract between the lender and the OVC authority.
- – The contract must specify the terms under which the lender may claim the credit, including the minimum amount of loss the taxpayer must incur before the taxpayer may claim the credit.
- – The OVC authority must issue a tax credit certificate evidencing the amount of the credit and the taxpayer's right to the credit for the year specified in the credit certificate.
- – Although the OVC authority may authorize tax credits any time after it establishes its investment policy, a taxpayer may not claim those credits during the first four years of the OVC program (measured from the date the OVC authority establishes its investment policy). So, **this new credit does not appear on the 2004 Ohio franchise tax form or the 2003 individual income tax return**.
- – The OVC authority may not issue tax credit certificates exceeding $20 million in any fiscal year, and
- – The taxpayer must claim the credit before July 1, 2026.
- – The taxpayer must elect to claim the credit as either a nonrefundable credit or as a partially refundable credit.

Note: Amended Substitute House Bill 95, 125th General Assembly amended the credit for losses on loans made to the OVC program. See the summary of Amended Substitute House Bill 95 that follows.

Amended Substitute House Bill 95, 125th General Assembly (the budget bill). Among other provisions this new law enacted are the franchise tax changes set out below. Unless otherwise stated, the franchise tax amendments are effective for taxable years ending on or after the June 26, 2003 effective date of the bill.

- **Distinction between business income and nonbusiness income.** For taxable years ending on or after June 26, 2003, Ohio franchise tax law distinguishes *business income* from *nonbusiness income* and defines those terms as follows:

  – "Business income means income arising from transactions, activities, and sources in the regular course of a trade or business and includes income from real property, tangible personal property, and intangible personal property if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation. 'Business income' includes income, including gain or loss, from a partial or complete liquidation of a business, including, but not limited to, gain or loss from the sale or other disposition of goodwill" (see O.R.C. section 5733.04(Q) as enacted by the new law).

  – "Nonbusiness income means all income other than business income" (see O.R.C. section 5733.04(R) as enacted by the new law).

- **Business income is apportioned and nonbusiness income is allocated.** For taxable years ending on or after June 26, 2003, business income is apportioned regardless of its source and type and nonbusiness income is allocated regardless of source and type. Thus, for taxable years ending on or after June 26, 2003 income from the following sources is allocable only if that income is nonbusiness income: (i) net rents and royalties from real property and tangible personal property; (ii) capital gains and losses from the sale or other disposition of real property and tangible personal property; (iii) dividends; (iv) capital gains and losses from the sale or other disposition of dividend producing stock; (v) net rents and net royalties from intangible property, and net technical assistance fees not representing the taxpayer's principal source of gross receipts; and (vi) lottery income. See O.R.C. section 5733.051 as amended by the new law. In addition, for taxable years ending on or after June 26, 2003 nonbusiness income from sources and types not specifically listed in O.R.C. section 5733.051 is allocable.

  For taxable years ending on or after June 26, 2003, all income, gain, loss and expense is presumed to be apportionable business income. A taxpayer reporting any allocable income (other than the amounts from schedule B-4, lines 12 and 14) must attach to the report (i) a detailed statement setting forth support which rebuts the presumption; (ii) a list of the states for which the taxpayer treats the income as business income; and (iii) the reasons for such treatment in the other state(s).

  For taxable years ending before June 26, 2003, prior Ohio franchise tax law applies. That is, for taxable years ending before June 26, 2003, Ohio franchise tax law makes no distinction between business income and nonbusiness income.

So, for taxable years ending before June 26, 2003, the following income, as set out in O.R.C. section 5733.051, is allocable even if that income was earned in the regular course of the taxpayer's trade or business: (i) net rents and royalties from real property and tangible personal property; (ii) capital gains and losses from the sale or other disposition of real property and tangible personal property; (iii) dividends; (iv) capital gains and losses from the sale or other disposition of dividend producing stock; (v) net rents and net royalties from intangible property, and net technical assistance fees not representing the taxpayer's principal source of gross receipts; and (vi) lottery income.

- **In addition to amending the law regarding *whether* income is apportionable (business income) or allocable (non-business) income, the new law amends *how* nonbusiness income from certain sources is allocated**. That is, the (nonbusiness) allocation provisions for income from certain sources for taxable years ending on or after June 26, 2003 differ from the allocation provisions for income from those same sources for taxable years ending before June 26, 2003. As explained in more detail below, those differences exist in the allocation of (i) capital gains and losses from the sale of tangible personal property; (ii) capital gains and losses from the sale of dividend producing stock; and (iii) dividends.

  – **Allocation of gains and losses from the sale or other disposition of tangible personal property** (O.R.C. section 5733.051(D)). For taxable years ending before June 26, 2003, capital gain and losses from the sale of tangible personal property are allocable within and without Ohio based on the situs of the property at the time of the sale regardless of whether such gains and losses were earned in the regular course of business. That is, gains and losses are allocable to Ohio only if the property had an Ohio situs at the time of sale and allocable outside Ohio if the situs of the property was outside Ohio at the time of sale.

  For taxable years ending on or after June 26, 2003, nonbusiness capital gains from the sale or other disposition of tangible personal property are allocable to Ohio to the extent that such property was utilized in Ohio before the property's sale or other disposition. See O.R.C. section 5733.051(D) as amended by the new law. This amendment counters the decision of the Board of Tax Appeals in *Delta Airlines, Inc. v. Tracy,* BTA No. 96-T-471 & 96-T-472 (1-12-2001) wherein the board held that gains and losses from the sale of aircraft and engines located outside Ohio at the time of sale are allocable outside Ohio notwithstanding the fact that the aircraft and engines had been used in part in Ohio prior to the sale. Nevertheless, with the adoption of the distinction between business income and nonbusiness income this provision is likely moot because income from the sale of tangible personal property will generally be apportionable as business income.

  – **Allocation of Dividends.** For taxable years ending before June 26, 2003, dividends that are not otherwise deducted or excluded from net income, other than dividends from a Domestic International Sales Corporation, are allocable to Ohio by multiplying the dividend by the ratio of book value of the payor's physical assets in Ohio to book value of physical assets everywhere. This is so regardless of whether those dividends were earned in the regular course of business.

  For taxable years ending on or after June 26, 2003, nonbusiness dividends, other than dividends from a Domestic International Sales Corporation, are allocable in a similar fashion as dividends for taxable years ending before June 26, 2003. However, the physical assets ratio includes not only the book value of the payor's physical assets, but also: (i) the payor's proportionate share of the book value of physical assets of certain pass-through entities in which the payor has a direct or indirect interest; (ii) the book value of the physical assets of the payor's subsidiaries; and (iii) each subsidiary's proportionate share of the book value of physical assets of certain pass-through entity in which the subsidiary has a direct or indirect interest. Detailed instructions for the allocation of nonbusiness dividends for taxable years ending on or after June 26, 2003 begin on page 32 of these instructions. See O.R.C. section 5733.051(F) as amended by the new law.

  – **Allocation of nonbusiness capital gains and losses from the sale or other disposition of dividend producing property.** Nonbusiness capital gains and losses from the sale or other disposition of dividend producing property are allocable in the same manner as nonbusiness dividends as set out above but substituting "the day of the sale or disposition" for "the day on which the payor pays the dividend." See O.R.C. section 5733.051(E) as amended by the new law.

- **Property, payroll, and sales factors.**

  – **Net income base apportionment.** For taxable years ending on or after June 26, 2003, the numerator and the denominator of the net income base property, payroll and sales factors specifically **exclude** the portion of property, payroll, and sales otherwise includable in the factors to the extent that the portion relates to, or is used in connection with, the production of nonbusiness income allocable under O.R.C. section 5733.051 (see O.R.C. section 5733.05(B)(2) as amended by the new law). For example, real property that generates nonbusiness rental income is not included in either the numerator or the denominator of the net income base property factor. Furthermore, nonbusiness gross rents along with the payroll associated with those rents are excluded from the sales and payroll factors, respectively. See O.R.C. section 5733.05(B)(2) as amended by this new law.

  – **Property factor.** For taxable years ending on or after June 26, 2003, the numerator and the denominator of the property factor specifically **include** real property and tangible personal property that the corporation rents, subrents, leases or subleases to others if the income or loss from such rentals, subrentals, leases or subleases is business income. See O.R.C. section 5733.05(B)(2)(a) as amended by this new law.

  For taxable years ending on or after June 26, 2003, the following assets are <u>not</u> excluded from the property factor: the original cost of property with respect to which the state of Ohio has issued an exemption certificate for an energy conversion facility, solid waste energy conversion facility or thermal efficiency improvement facility. See O.R.C. sections 5709.20 and 5709.25(B) as amended by this new law.

  – **Net worth base apportionment.** In general, the net value of stock under the net worth base is apportioned by applying the net income base apportionment ratio. However, for purposes of apportioning net worth for taxable years ending on or after June 26, 2003, the numerator and the denominator of the property, payroll, and sales factors must be adjusted to include the portion of any real and tangible personal property, payroll, and sales, respectively, relating to, or used in connection with, the production of nonbusiness income allocated under O.R.C. section 5733.051 to the extent that such property, payroll, and sales were excluded from the net income base apportionment ratio. For example, as noted above real property that generates nonbusiness rental income is not included in either the numerator or the denominator of the net income base property factor. However, for purposes of apportioning net worth, the property factor must be adjusted to include such property in the property factor. Net worth factor adjustments are made in schedule D-2, but only if the taxpayer's taxable year ended on or after June 26, 2003 and the taxpayer had nonbusiness income. See O.R.C. section 5733.06(C)(2) as amended by the new law.

- **5/6 – 1/5 adjustment for Internal Revenue Code (I.R.C.) section 179 expense**. In determining Ohio taxable income taxpayers must add to Ohio taxable income 5/6 of the "qualifying section 179 depreciation expense" deducted in determining federal taxable income for the taxable year. Then, for each of the five tax years following the add-back year (2005 through 2009) the taxpayer must deduct 1/5 of the amount previously added back. "Qualifying section 179 depreciation expense" means the difference between (i) the actual amount of depreciation expense directly or indirectly allowed to the taxpayer under I.R.C. section 179; and (ii) the amount of depreciation expense directly or indirectly allowed to the taxpayer under I.R.C. section 179 *as that section existed on December 31, 2002*. See O.R.C. section 5733.04(I)(17)(a)(ii) as enacted by the new law. For additional information please see schedule B-4 – Bonus Depreciation and Section 179 Adjustment.

  Like the bonus depreciation adjustment, the adjustment for I.R.C. section 179 expense applies not only to assets that the taxpayer owns, but also to depreciable assets owned by the taxpayer's disregarded entities and to depreciable assets owned by pass-through entities in which the taxpayer holds an at least 5 percent ownership interest.

  Caution: The Ohio adjustment for I.R.C. section 179 expense does not technically apply to taxable years beginning after December 31, 2002 and ending before June 26, 2003 (the effective date of the new Ohio law). However, if the taxpayer fails to make the adjustment, then for Ohio tax purposes the taxpayer will not fully depreciate those assets placed in service during that taxable year. See the Department of Taxation's July, 2002 information release entitled "Recently Enacted Ohio Legislation Affects Depreciation Deductions for Taxable Years Ending in 2001 and Thereafter."

- **Net worth base exempted assets.** For taxable years ending on or after June 26, 2003, the net worth base exempted asset deduction no longer applies to air, noise and water pollution control facilities, coal gasification facilities, coal conversion demonstration facilities, energy conversion facilities, solid waste energy conversion facilities or thermal efficiency improvement facilities for which the state of Ohio has issued an exemption certificate. See O.R.C. section 5709.25(B) as amended by the new law.

  Note: Pollution control facilities and property with respect to which an "industrial water pollution control certificate has been issued continue to be excluded from the property factor. See O.R.C. section 5733.05(B)(2)(a) as amended by the new law.

- **Minimum fee increased to $1,000 for larger corporations.** For taxable years ending on or after June 26, 2003, the minimum franchise tax fee is $1,000 if (i) the sum of the taxpayer's gross receipts from its activities within and without Ohio during the taxable year equal or exceed $5 million; or (ii) the total number of the taxpayer's employees within and without Ohio at any time during the taxable year equals or exceeds 300. In determining whether or not the taxpayer's gross receipts and number of employees equal or exceed those thresholds, the taxpayer must include its proportionate share of the gross receipts of any pass-through entity in which the taxpayer has a direct or indirect ownership interest and its proportionate share of the number of employees of the pass-through entity. Furthermore, the term "gross receipts," as used here, includes receipts that generate nonbusiness income and receipts from the sale of capital assets and I.R.C. section 1231 assets whether those sales generate business income or nonbusiness income.

  For taxpayers whose taxable year ended before June 26, 2003 and for taxpayers whose taxable year ended on or after June 26, 2003, but whose gross receipts and whose number of employees do not equal or exceed the thresholds discussed above, the minimum fee is $50. See O.R.C. section 5733.06(E) as amended by the new law.

- **Refundable new jobs credit.** The new law increases the maximum term over which the taxpayer can claim the credit. The new law limits the refundable new jobs credit to a term of 15 years. Prior law limited the new jobs credit to a term of 10 years. See O.R.C. section 122.17(D)(2) as amended by the new law. For a summary of the new jobs credit see the instructions for schedule A, line 23.

- **Job retention credit amendments and new call center credit.** The new law increases the maximum term over which a taxpayer can claim the job retention credit. The new law limits the credit to a term of 15 years. Prior law limited the job retention credit to a term of 10 years. In addition:

  – Prior law prohibited the Department of Development from issuing a tax credit certificate entitling the taxpayer to the credit unless the total number of filled full-time employment positions for each day of the calendar year divided by 365 was at least 90 percent of the full-time employment positions specified in the agreement between the taxpayer and tax credit authority. The new law created an exception to that provision. The new law provides that the above provision can be waived if specified by the tax credit authority in a resolution and included as part of the credit agreement. See O.R.C. section 122.171(E)(7) as amended by the new law. See credit #5 on page 42 of these instructions for a summary of the job retention credit.

  – The new law also enacted a new credit for certain applicable corporations that are eligible for the job retention credit and operate a telephone call center in Ohio. The call center credit applies only to "applicable corporations" as defined in O.R.C. section 121.171(A)(6) and only if future amendments to O.R.C section 5733.042 (pertaining to the interest expense and intangible expense paid to related members) would increase the franchise tax before credits for an applicable corporation. See O.R.C. section 121.171(M) as enacted by the new law.

Note: The amendments to the job retention credit discussed above were also enacted by House Bill 1, 125th General Assembly.

- **Franchise tax refund offset.** A corporation's franchise tax overpayment may now be applied in satisfaction of the corporation's indebtedness to Ohio for workers' compensation premiums, unemployment compensation contributions or unemployment compensation payments in lieu of contributions and interest on such amounts. The offset can be made only if those debts have become "final." Under prior law a franchise tax overpayment could only be offset against taxes and fees administered by the tax commissioner. See O.R.C. section 5733.121 as amended by the new law.

- **Sham transaction.** The new law repealed the franchise tax sham transaction provision contained in O.R.C. section 5733.111 (see section 2 of the bill) and replaced it with a more encompassing provision that applies to all taxes and fees administered by the tax commissioner. The new law gives the tax commissioner the authority to apply the doctrines of "economic reality," "sham transaction," "step transaction" and "substance over form." In general, the tax commissioner bears the burden of establishing by a preponderance of the evidence that these doctrines should apply. However, with respect to transactions between members of a *controlled group*, the taxpayer bears the burden of establishing that a transaction or series of transactions between members of the controlled group was not a *sham transaction*. If the tax commissioner disregards a sham transaction, the assessment statute of limitations is doubled. The new law applies on and after June 26, 2003 to all years open to the statute of limitations.

  For purposes of this provision the term "controlled group" means two or more persons related in such a way that one person directly or indirectly owns or controls the business operations of another member of the group. In the case of persons with stock or equity, one person owns or controls another if it directly or indirectly owns more than 50 percent of the other person's common stock with voting rights or other equity with voting rights. The term "sham transaction" means a transaction or series of transactions without economic substance because there is no business purpose or expectation of profit other than obtaining tax benefits. See O.R.C. section 5703.56 as enacted by the new law.

- **Credit for losses on loans made to the Ohio venture capital program.** The new law allows a taxpayer to carry forward the unused portion of this new credit for a period of 10 years if the taxpayer elected to claim the credit as a nonrefundable credit. Prior law did not contain a carryforward provision. See O.R.C. section 5733.49 as amended by the new law. For a summary of this new credit please see the summary of Amended Substitute Senate Bill 180, above.

- **Telephone companies.** Local telephone companies are subject to the franchise tax for tax years 2005 and thereafter. For tax year 2005 a telephone company with a taxable year ending in 2004 must compute its Chapter 5733 franchise tax by multiplying by 50 percent, the tax otherwise due, net of all nonrefundable credits and must compute the net operating loss carried forward from tax year 2005 to a future year by multiplying by 50 percent the net operating loss otherwise computed for the taxable year ending in 2004. See O.R.C. section 5733.09(A)(3) as amended by the new law.

  In addition, the new law enacted several other provisions applicable to certain local exchange telephone companies as defined in O.R.C. section 5727.01:

  – The new law provides that the "tax commissioner may adopt rules providing for alternative allocation and apportionment methods, and alternative calculations of a corporation's base, that apply to corporations engaged in telecommunications." See O.R.C. section 5733.05(B)(2)(e) as amended by the new law. It is anticipated that by June 30, 2004, the tax commissioner will adopt such a rule for both the Chapter 5733 franchise tax and the Chapter 5745 municipal income tax.

  – The new law enacted three credits that are applicable only to certain telephone companies:

    - The credit for small telephone companies with 25,000 or fewer access lines. See O.R.C. section 5733.57;
    - The credit for eligible nonrecurring 9-1-1 charges. This credit is substantially the same as the credit granted under the public utility excise tax. See O.R.C. sections 5733.55 and 5727.39.
    - The credit for providing programs to aid the communicatively impaired. This credit is substantially the same as the credit granted under the public utility excise tax. See O.R.C. sections 5733.56 and 5727.44.

  – The new law enacted a "book-tax difference" adjustment for certain local exchange telephone companies that are subject to the franchise tax. For purposes of the telephone company book-tax difference adjustment, the term "book-tax difference" means the difference, if any, between a qualifying telephone company asset's net book value shown on the qualifying telephone company taxpayer's books and records on December 31, 2003, in accordance with generally accepted accounting principles, and such asset's adjusted basis on December 31, 2003. The book-tax difference may be a negative number.

    The telephone company adjustment is similar to the electric company adjustment set out in O.R.C. section 5733.0510. However, the telephone company adjustment, unlike the electric company adjustment, is made over a period of 10 years beginning in tax year 2010 rather than at the time of sale of each individual asset. If as of December 31, 2003 the net book value of the telephone company's assets exceeds the federal adjusted basis of the assets, then in each of the 10 years beginning in tax year 2010 the telephone company's net income is reduced by 1/10 of the book-tax difference. And if as of December 31, 2003 the federal adjusted basis of the telephone company's assets exceeds the net book value of the asset, then in each of the 10 years beginning with tax year 2010 net income must be increased by 1/10 of the absolute value of the book-tax difference. The adjustment applies regardless of when the telephone company disposes of its December 31, 2003 assets. See O.R.C. section 5733.0511 as enacted by the new law.

Amended Substitute House Bill 1, 125th General Assembly, effective July 9, 2003. Among other provisions this new law enacted the franchise tax changes set out below.

- **Research and Development Loan Repayment Credit** (O.R.C. sections 5733.352 and 166.17 to 166.21). The new law establishes the research and development loan fund program and authorizes the Department of Development to make loans from the fund. In addition, the new law enacted a franchise tax and individual income tax nonrefundable credit for the repayment of loans from that fund. This new franchise tax and individual income tax nonrefundable credit first applies to tax year 2004 regardless of whether the taxpayer's taxable year ended before the July 9, 2003 effective date of this new law. Tax credits not used in the year generated can be carried forward until fully used.

  The amount of the credit equals the borrower's *qualified research and development loan payments* during the calendar year immediately preceding the tax year. The term "qualified research and development loan payments" means payments of principal and interest on a loan made from the research and development fund. The credit is based on payments during the calendar year regardless of whether the taxpayer's taxable year is a calendar year or a fiscal year. The borrower's franchise tax credit as a result of its *qualified research and development loan payments* attributed during a calendar year may not exceed $150,000 per loan.

  A borrower is eligible to receive the tax credit regardless of whether the borrower is subject to the corporation franchise or income tax, and the borrower may assign the tax credit to any of the following: (i) the borrower's related member; (ii) the owner or lessee of the eligible research and development project; or (iii) a related member of the owner or lessee of the eligible research and development project.

  If the borrower is a pass-through entity and the taxpayer is a partner or member of the pass-through entity-borrower, the taxpayer can claim a proportionate share of the borrower's credit.

- **Edison Center credit** (O.R.C. sections 122.15, 122.151, 122.152 and 122.154). Under prior law and under continuing law, investors that provide capital to certain small, Ohio-based research and development or technology transfer companies at least 50 percent of whose employees and gross assets are in Ohio may be eligible for a nonrefundable credit equal to a percentage of the taxpayer's at-risk investment in such entities. This credit is administered by the Ohio Department of Development along with the Industrial Technology and Enterprise Advisory Council.

The new law expands the Edison Center credit as follows:

- – In the case of an investment in such an Ohio-based research and development company in a distressed area of the state, and in the case of an investment in Ohio-based research and development company that is an EDGE business enterprises, the new law increases the credit percentage from 25 percent of the taxpayer's at-risk investment to 30 percent of the taxpayer's at-risk investment. An "EDGE business enterprise" is an "Ohio entity" certified by the director of administrative services as a participant in the encouraging diversity, growth and equity program established by the governor's executive order 2002-17T. The credit percentage remains at 25 percent for investment in Ohio entities that are not in a distressed area or are not an EDGE business enterprise.

- – The new law increases the investee research and development company's gross revenue limit and net book value limit. Under prior law, the investee Ohio based research and development company could have no more than $1 million of gross revenue during its most recently completed fiscal year and the investee Ohio based research and development company could have a net book value of no more than $1 million at the end of that year. The new law increases those limits to $2.5 million of gross receipts and $2.5 million of net book value. The increased limits will increase the number of Ohio-based research and development companies eligible to receive investments for which the investor is eligible for the credit.

- – The new law increases the amount of a taxpayer's investment on which it can claim the credit to the following amounts: (i) $350,000 in the case of an investment in an EDGE business or in an Ohio based research and development company located in a distressed area of the state; and (ii) $250,000 in the case of any other qualifying Ohio based research and development company. Under prior law the amount of a taxpayer's investment on which it could claim the credit was limited to $150,000.

- – The new law increases the amount of investments that can be approved in any one qualifying Ohio based research and development company from $1 million to $1.5 million.

- – The new law increases the amount of total Edison Center tax credits that can be issued from $10 million to $20 million.

- **Job retention credit and call center credit.** House Bill 1, 125th General Assembly enacted the same amendments to the job retention credit and call enter credit as were enacted by Amended Substitute House Bill 95 discussed above.

Substitute House Bill 127, 125th General Assembly (effective December 11, 2003). Among other provisions this new law extends the purchase period for the O.R.C. section 5733.33 manufacturer's credit through December 31, 2015. Were it not for this purchase period extension, the credit could not be claimed on equipment purchased after December 31, 2005. New manufacturing machinery and equipment purchased during the qualifying purchase period must be installed in Ohio no later than December 31, 2016.

In addition, this new law enacted the following amendments to the sales factor effective for taxable years ending on or after December 11, 2003:

- The new law specifically **exclude**s from the sales factor the following amounts even if the amounts arise from transactions, activities, and sources in the regular course of a trade or business:

  - – Dividends and interest or other similar amounts received for the use of, or for the forbearance of the use of, money. Under prior case law interest was excluded from the factor (see *Incom International v. Limbach*, BTA No. 84-D-1149 (1-11-88)). In addition, under prior law dividends were excluded from the sales factor on the basis that dividends were allocable and that allocable income should not dilute the sales factor for income which is apportioned.

  - – Receipts along with any related gains or losses from the sale or other disposal of intangible property other than trademarks, trade names, patents, copyrights and similar intellectual property.

– Receipts along with any related gains or losses from the sale or other disposal of tangible personal property or real property where that property is a capital asset or an asset described in I.R.C. section 1231. For purposes of this provision the determination of whether or not an asset is a capital asset or a 1231 asset is made without regard to the holding period specified in the Internal Revenue Code.

Note: Although the above amounts are specifically excluded from the sales factor, the new law specifically states they are not presumed to be allocable nonbusiness income.

Caution: Receipts related to, or used in connection with, the production of nonbusiness income are excluded from the sales factor under this new law. The new law does not amend the business-nonbusiness concept adopted in Amended Substitute House Bill 95. Like the law for prior tax years, the new law continues to exclude from the sales factor receipts from sales to: (a) an at-least 80 percent owned public utility other than an electric company; (b) an at-least 80 percent owned insurance company; and (c) an at-least 25 percent owned financial institution.

- The new law specifically **includes** in the sales factor the following amounts when arising from transactions, activities and sources in the regular course of a trade or business: (1) receipts from the sale of real property inventory (such as lots developed and sold by a real estate developer); (2) rents and royalties from real property; (3) rents and royalties from tangible personal property; (4) receipts from the sale, exchange, disposition, or other grant of the right to use trademarks, trade names, patents, copyrights and similar intellectual property; and (5) receipt from the sale of services and other receipts not expressly excluded from the factor.

  Business income receipts from transactions, activities and sources listed in the previous paragraph are sitused to Ohio and included in the numerator of the factor as follows:

  – Receipts from the sale of real property inventory located in Ohio are sitused to Ohio.

  – Rents and royalties from real property located in Ohio are sitused to Ohio.

  – Rents and royalties from tangible personal property are sitused to Ohio to the extent the property was used in Ohio.

  – Receipts from the sale, exchange, disposition or other grant of the right to use trademarks, trade names, patents, copyrights and similar intellectual property are sitused to Ohio to the extent that the receipts are based on the amount of use of that property in Ohio. If the receipts are not based on the amount of use of that property, but rather on the right to use the property and if the payor has the right to use the property in Ohio, then such receipts are sitused to Ohio to the extent the receipts are based on the right to use the property in Ohio.

  – Receipts from the sale of services and other receipts from sales not expressly excluded from the factor are sitused to Ohio in the proportion to the purchaser's benefit, with respect to the sale, in Ohio to the purchaser's benefit, with respect to the sale, everywhere. The physical location where the purchaser ultimately uses or receives the benefit of what was purchased is paramount in determining the proportion of the benefit in Ohio to the benefit everywhere. **Note: For taxable years ending on or after December 11, 2003, the "cost of performance" provision is no longer the law.**

Like the law for prior tax years, the new law situses sales of tangible personal property based on destination.

Ohio Supreme Court Decision

LSDHC Corp. v. Zaino, 98 Ohio St.3d 450, 2003-Ohio-1911.

Issue: Is the federal protection from the franchise tax net income base afforded by P.L. 86-272 Section 381, Title 15 U.S. Code determined by the taxpayer's business activities during the tax year (the calendar year for which the tax is imposed), or, instead, by the taxpayer's business activities during the taxable year by which the net income is measured?

Holding: The Ohio Supreme Court reversed the earlier decision of the Board of Tax Appeals and held that the issue of whether or not P.L. 86-272, Section 381, Title 15, U.S. Code prohibits the imposition of franchise tax measured by the net income base is determined by the taxpayer's activities during the taxable year in which the taxpayer earned that income – not by the taxpayer's activities during the subsequent tax year or on January 1 of the tax year. If the taxpayer's activities in Ohio during the taxable year exceeded the activities protected by P.L. 86-272 but in the subsequent tax year the taxpayer's activities did not exceed the protected activities, then P.L. 86-272 offers no protection for the tax year, and for that tax year the corporation is subject to the franchise tax on the net income base. Conversely, if the taxpayer's activities in Ohio during the taxable year did not exceed the activities protected by P.L. 86-272 but in the subsequent tax year the taxpayer's activities did exceed the protected activities, P.L. 86-272 does offer protection for the tax year, and for that tax year the corporation is not subject to the franchise tax on the net income base.

Court of Appeals Decision

American Home Products Corporation, nka Wyeth, as successor in interest to A.H. Robins Company, Incorporated v. Tracy, Court of Appeals, Tenth Appellate District, No. 02AP-759 (3-27-03). The Court of Appeals here affirmed the earlier decision of the Board of Tax Appeals in *A.H. Robins Company, Inc. v Tracy*, BTA No. 97-T-1215 (6-14-02). The taxpayer appealed the Court of Appeals decision to the Ohio Supreme Court. However, the Ohio Supreme Court did not accept the case for review.

Issue: Is the taxpayer (here referred to as Robins II) entitled to an NOL deduction for the losses incurred by the *original* A.H. Robins Company (here referred to as Robins I) during the period January 1, 1989 through December 15, 1989 where Robins I was not a "taxpayer" for tax year 1990?

Facts:

- On July 26, 1988 the United States Bankruptcy Court confirmed the plan of reorganization of Robins I, the original A.H. Robins Company. In substance, the plan permitted American Home Products Corporation to acquire Robins I in exchange for funds that Robins I used to finance a trust that paid certain product liability claimants of Robins I.

- For the purpose of effectuating its acquisition of Robins I, American Home Products formed a wholly owned subsidiary, here referred to as Robins II.

- On December 15, 1989, Robins I merged into Robins II in an I.R.C. section 368(a)(1)(G) and 368(a)(2)(B) tax-free reorganization.

- Robins I filed a purported 1990 Ohio franchise tax report based on the period January 1, 1989 through the December 15, 1989 merger date. The purported franchise report reflected a $52.8 million Ohio net operating loss (NOL) for the period January 1, 1989 through December 15, 1989.

- Robins II, having qualified to do business in Ohio, filed franchise tax reports for tax years 1990 through 1993 and on those reports claimed as a deduction an Ohio NOL carryforward from Robins I for the period January 1, 1989 through December 15, 1989 and the Ohio NOL carryforwards for Robins I during earlier taxable years.

- Upon audit the Department of Taxation allowed Robins II's NOL deduction for the losses incurred by Robins I for the tax years in which Robins I was a taxpayer subject to the franchise tax (that is, for the taxable years ending in 1988 and earlier). However, the department disallowed Robin II's NOL deduction for the losses incurred by Robins I during the period January 1, 1989 through the December 15, 1989 merger date because Robins I was not a taxpayer for tax year 1990. Thus the period January 1, 1989 to December 15, 1989 was not a taxable year for which an NOL was to be computed.

- Proceedings before the bankruptcy court indicated that the property transferred from Robins I to Robins II included "such rights to use and benefit from the NOL as Robins I would have had."

Statute (as it read for the years at issue):

- A taxpayer can deduct from Ohio net income "any net operating loss incurred in any *taxable years* ending in 1971 or thereafter . . . This deduction shall . . . be carried over and allowed . . . until fully utilized in the next succeeding taxable year or years in which the taxpayer has net income, but in no case for more than the designated carryover period described in division (I)(1)(b) of this section."

- "'Taxpayer' means a corporation subject to the tax imposed by this chapter" (see O.R.C. 5733.04(B)).

- "'Taxable year" means the year or portion thereof upon the net income of which the value of the taxpayer's issued and outstanding shares of stock is determined or the year at the end of which the total value of the corporation is determined" (see O.R.C. section 5733.04(E)).

Holding:

The court found as follows:

- The Board of Tax Appeals did not err in determining the amount of NOL applicable under state law, and that this determination did not conflict with applicable provisions of the federal bankruptcy code. According to the court, the Board of Tax Appeals did not err in refusing to give res judicata effect to the confirming order of the bankruptcy court. The legal doctrine of *res judicata* does not bar the Tax Commissioner from making an independent determination of the tax matters raised and finding under Ohio law that Robins I had no NOL in 1989 to transfer to Robins II.

  While the right to transfer any NOL to which Robins I was entitled is implicit in the confirmed reorganization plan, the existence and amount of an NOL for each of the various years involved is not set forth in the bankruptcy court order. Rather, the existence and amount of an NOL must be defined under state law. While Robins II clearly retained "such rights to use and benefit from the NOL as Robins I would have had" this language is equally supportive of the converse proposition that Robins II could not succeed to any NOL rights that Robins I did not possess. While property may be allocated in a bankruptcy proceeding, the extent and nature of that property, unless specifically defined, enumerated and stipulated to before the bankruptcy court by interested parties, may yet be determined under applicable state law.

- The Board of Tax Appeals did not err in finding that neither Robins I nor Robins II was entitled to an NOL to be carried forward from 1989. If Robins I had existed on January 1, 1990, it would have been a taxpayer for the 1990 tax year, and the calendar year ending December 31, 1989, would have been a taxable year for Robins I. Since, however, Robins I was not in business on January 1, 1990, Robins I was not a taxpayer for the 1990 tax year, and the period of January 1, 1989 to December 15, 1989, was not a taxable year for Robins I. Pursuant to the Ohio Supreme Court's decision in *Gulf Oil Corp. v. Lindley* (1980), 61 Ohio St.2d 23, 30-31and *Litton Industrial Products, Inc. v. Limbach* (1991), 58 Ohio St.3d 169, 171, the loss incurred during that period did not occur in a taxable year, and neither Robins I nor its successor, Robins II, had a right to deduct the NOL.

Note: If current law were applied to the year at issue, it appears that the O.R.C. 5733.053 transferor statute would apply to Robins II so that Robins II would be entitled to deduct the net operating loss of Robins I for the period January 1, 1989 to December 15, 1989 because (1) following the merger Robins I is not subject to the franchise tax; (2) the transfer qualifies for nonrecognition of gain or loss under the Internal Revenue Code; and (3) current law no longer requires that the transferor and transferee meet the combined report ownership requirements on January 1 prior to the transfer. See O.R.C. section 5733.053 as amended by Amended Substitute Senate Bill 287, 123rd General Assembly and Amended Substitute House Bill 94 (Budget Bill), 124th General Assembly.

Board of Tax Appeals Decisions

Duramed Pharmaceuticals, Inc. v. Zaino, BTA No. 2002-V-164 (3-7-03).

Issue: Does the term "new manufacturing machinery and equipment," as defined in O.R.C. section 5733.33(A)(2), include manufacturing machinery and equipment that a manufacturer purchased during the qualifying purchase period if, prior to the purchase period for which the credit applies, the purchaser-manufacturer originally used the equipment in this state as a lessee? That is, if a taxpayer first used manufacturing machinery prior to the qualifying purchase period as a lessee, is the taxpayer entitled to the credit upon purchasing the equipment during the qualifying period?

Facts:

- Duramed leased manufacturing machinery and equipment from Ortho-McNeil Pharmaceuticals Corporation in 1994. Duramed installed the equipment in Ohio in late 1994 and first used the equipment to produce product in the first half of 1995.

- The lease contained a purchase option, which Duramed exercised in September 1997.

- The lease was apparently an operating lease (that is, the lease was not in substance a purchase by Duramed when entered into in 1994) because the board found no evidence to suggest that the lease was considered a purchase for either federal income tax purposes or under generally accepted accounting principles.

Statute:
O.R.C. section 5733.33(A) "As used in this section: . . . (2) 'New manufacturing machinery and equipment' means manufacturing machinery and equipment, the original use in this state of which commences with the taxpayer or with a partnership of which the taxpayer is a partner. . ."

Holding: The Board of Tax Appeals held that Duramed may claim the O.R.C. section 5733.33 manufacturer's credit on manufacturing equipment whose original use in Ohio began with the Duramed before the qualifying purchase period under a lease and which equipment Duramed purchased during the qualifying purchase period upon exercising an option in the lease agreement. Finding nothing in the record suggesting that the lease was treated as a purchase for federal income tax purposes or under generally accepted accounting principles, the board held that the existence of the lease does not operate to defeat the credit. The board found that the definition of "new" machinery is unambiguous and requires only that the original use in Ohio begin with the taxpayer and such original use is not restricted or limited to the qualifying purchase period.

ORIX Credit Alliance, Inc. v. Tracy, BTA No. 1996-P-500 (4-4-03). The Department of Taxation appealed this decision to the Ohio Supreme Court.

Issue: Is the income characterized on the taxpayer's federal income tax return as rental income and as gain from the sale of leased property allocable as rents and capital gain income, as contended by the Tax Commissioner? Or, instead, is such income apportionable, as contended by the taxpayer?

Facts: Orix is engaged in two-party and three-party lease transactions. In a two-party transaction Orix's customer selects equipment and then approaches Orix to secure the financing for the transaction. After establishing the terms of the transaction, Orix purchases the equipment from a dealer and leases the equipment to the customer. In a three-party lease transaction, an unrelated dealer who does not have the capital to finance the transaction leases equipment to the customer and presents the transaction to Orix, which subsequently takes an assignment of lease. In both two and three-party transactions, the customer has an option to purchase the equipment when the lease terminates and rarely is the option not exercised. On its federal income tax return, the taxpayer characterized the income in question as rents and gains from the sale of leased property. (This decision does not indicate whether the leases in question were treated as sales for federal income tax purposes and does not indicate whether the leased property was depreciated by Orix or by its lessee.)

Holding: The board agreed with the taxpayer and held that the tax commissioner erred in allocating income that the taxpayer characterized on its federal income tax return as rents and net gain or loss from the sale of business property. Applying the "true object" test to determine the substance of the lease transactions between Orix and its customers, the board found that because the taxpayer is essentially a finance company "which facilitates the purchase and leasing of equipment between unrelated parties" by means of both two-party and three-party transactions, such income should be characterized for franchise tax purposes as interest and should be apportioned pursuant to O.R.C. section 5733.051(H).

Westnovtek Corporation v. Tracy, BTA No. 1996-P-429, April 8, 2003. The Department of Taxation appealed this decision to the Ohio Supreme Court.

Issues:
- Is the taxpayer's loss from the bulk sale of inventory apportionable, as contended by the Tax Commissioner, or, instead, allocable, as contended by the taxpayer?
- Are the taxpayer's proceeds from the bulk sale of inventory includable in the sales factor, or, instead, excludable, as contended by the taxpayer?
- Did the Tax Commissioner err in failing to find that the taxpayer properly deviated from the normal apportionment provisions as permitted by O.R.C. section 5733.05(B)(2)(d)?

Facts: With facilities in Ohio and Michigan, Westnovtek (formerly known as Dura Corporation) was engaged in the business of manufacturing original equipment parts and fabricated metal products for the automotive industry. Each facility operated as a separate profit center with no centralized control. On May 29, 1987 after termination of its S corporation status the taxpayer sold to a subsidiary of Wickes Corporation substantially all of its assets other than its real property. The sale included all machinery and equipment, inventory, accounts receivable, intellectual property and goodwill.

In filing its 1988 franchise tax report the taxpayer allocated its losses from the sale of fixed assets and inventory and apportioned its gain from the sale of goodwill and intellectual property. The 1988 franchise tax report did not reflect a sales factor. That is, the report reflected no sales in Ohio and no sales everywhere. The taxpayer did not file a written request for deviation from the statutory allocation and apportionment provision with its 1988 franchise tax report as required by O.R.C. section 5733.05(B)(2)(d) as it existed for the period at issue. Upon audit the Department of Taxation included a sales factor in the apportionment formula by including the taxpayer's proceeds from the bulk sale of inventory, and then the department apportioned the loss from the sale of inventory.

Holding: Agreeing with the taxpayer and applying a business-nonbusiness test to determine whether income is apportionable or allocable, the board found that the taxpayer's loss from the bulk sale of inventory was allocable. The board stated "that the transaction at issue, in which Dura sold all of its tangible assets including a bulk sale of inventory . . . not in the ordinary course of business but in removing itself from business, falls within the rule in Borden Inc. v. Limbach (1990) 49 Ohio St.3d 240." Then, applying the same reasoning the board held that the taxpayer's proceeds from the bulk sale of inventory were not includable in the net income base sales factor. In rejecting the Tax Commissioner's argument that such proceeds must be included because the taxpayer failed to file a written request for deviation at the time it filed its franchise tax report (as was the law for the tax year at issue), the board noted that such a conclusion would lead to a harsh result in this instance because ". . . the taxpayer's omission of the four-factor formula is obvious from inspection of the return" and because the law was later amended to permit a taxpayer to request deviation from the statutory allocation and apportionment provisions with an amended return and with a petition for reassessment.

General Instructions and Information

This instruction booklet applies to taxpayers other than financial institutions. This instruction booklet does not apply to financial institutions because the law applicable to financial institutions differs substantially from that applicable to other corporations. The franchise tax instructions for financial institutions are contained in a separate instruction booklet available on the Department of Taxation's web site. Financial institutions must file franchise tax form FT 1120-FI.

This instruction booklet applies to electric companies and combined electric companies. However, because electric companies and combined electric companies are subject to franchise tax deduction, add-back, apportionment, credit, and tax computation provisions that do not apply to other franchise taxpayers, we have prepared supplemental schedules and instructions for electric companies and combined electric companies. **The supplemental instructions are not included in this instruction booklet. Rather, the supplemental schedules and instructions are available in a separate file on our Web site.** Electric companies and combined electric companies are subject to the franchise tax for tax years 2002 and thereafter.

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 2004 is paid for the privilege of doing business in Ohio during the calendar year 2004. **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 2004 is based upon the taxpayer's activity during its taxable year ending in 2003. See O.R.C. 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, qualifying holding companies and certain high-tech start-up companies:

- Financial institutions 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. See general instruction #1 C.
- Qualifying holding companies and certain high-tech start-up companies are not subject to the tax on the net worth base but are subject to the tax on the net income base. See general instructions #21 and #22.

Although a corporation that dissolves its Ohio charter or surrenders its license to conduct business in Ohio during 2003 is not subject to the franchise tax for tax year 2004, such corporation may be subject to the "exit tax" (see general instruction #7 and O.R.C. section 5733.06(H)) or the corporation's income may be required to be included in the income of a transferee corporation (see O.R.C. section 5733.053 and the instructions for schedule A, line 9).

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 (available on the Department of Taxation's web site). Also see O.R.C. section 5733.01 as amended by Amended Substitute House Bill 215, 122nd General Assembly and section 222 of the Bill.)

Disregarded entity. For purposes of Chapter 5733 the term "disregarded entity" means an entity that for its taxable year is by default, or has elected to be, disregarded as an entity separate from its owner pursuant to 26 C.F.R. 301.7701-3. **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 its corporate member for federal income tax purposes will be treated as a division of the corporation for franchise tax purposes. That is, for franchise tax purposes:

- If the disregarded entity has nexus with Ohio, then the owner has nexus with Ohio.
- An interest in a disregarded entity is treated as ownership of the assets and liabilities of the disregarded entity itself.
- A disregarded entity's income, including gain or loss, is included in the owner's O.R.C. Chapter 5733 net income.

- Any sale or other disposition of an interest in a disregarded entity is treated as a sale or other disposition of the disregarded entity's underlying assets or liabilities and the gains and losses from such sales are included in the owner's Chapter 5733 net income.

- A disregarded entity's property, payroll and sales are included in the owner's property, payroll and sales factor computations.

  See O.R.C. sections 5733.01(F) and 5745.01(D).

  Nevertheless, a single member LLC is a pass-through entity as defined in O.R.C. section 5733.04(O), and the corporate member is a qualifying investor whose distributive share includes the sum of the income, gain, expense or loss of a disregarded entity (see O.R.C. section 5733.40(S)). So, a single member LLC with Ohio nexus is subject to the pass-through entity tax imposed by O.R.C. section 5733.40 unless the corporate member files a franchise tax report and includes in its income the income and apportionment data of the LLC. O.R.C. section 5733.41 provides that the pass-through entity tax imposed by that section does not apply if all the members of the pass-through entity are taxpayers for purposes of O.R.C. section 5733.04 without regard to O.R.C. section 5733.09. **Accordingly, if the corporation files the required franchise tax report and does not claim that the corporation lacks nexus with Ohio, then the single member LLC is excepted from the pass-through entity tax.** Regardless of whether or not the corporate single member complies and files a franchise tax report, the Department of Taxation maintains that if the LLC has nexus with Ohio, the corporate single member has nexus with Ohio, and the department will pursue and enforce that position against the corporation. See the amendments to O.R.C. sections 5733.01 and 5733.40 as enacted by Amended Substitute Senate Bill 261, 124th General Assembly effective June 5, 2002 and the department's July 3, 2002 information release entitled "Pass-through Entity Tax: Certain Estimated Tax Payments Due September 16, 2002."

  See general instruction #2A 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. O.R.C. 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 "financial institution" (and from the definition of "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.

2. ENTITIES 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 O.R.C. section 5733.09 and the department of Taxation's July 31, 1994 Information Release entitled "Taxation of S Corporations and Their Shareholders," which sets forth the department's policy interpretation of Ohio franchise tax law applicable to S corporations. The information release is available on the department's web site. 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 2003. 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 that was subject to the Ohio corporation franchise tax and the S corporation was a transferee as defined in O.R.C. section 5733.053(A)(3). See the Department of Taxation'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." The information release is available on the department's web site.

If a corporation is an S corporation for any portion of calendar year 2003, the S corporation must file a Notice of S Corporation Status (form FT 1120 S) by June 30, 2004. **The due date of the notice does change even if the S corporation has an extension to file the federal 1120-S after that date.**

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 I.R.C. 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 2003, the corporation must file by June 30, 2004 a notice of S Corporation Status separate from the Notice of S Corporation status filed by its parent S corporation.

Note 1: S corporations and the pass-through entity tax. 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 all the nonresident shareholders.

Note 2: QSSS's and the pass-through entity tax. For taxable years ending after June 4, 2002, a QSSS that does business in Ohio or otherwise has nexus with Ohio must pay the pass-through entity tax if its parent S corporation has shareholders that are not residents of Ohio. However, the various exemptions applying to S corporations also apply to QSSS's. Accordingly, a **QSSS is not subject to the pass-through entity tax if either: (1) the S corporation owner/shareholder irrevocably acknowledges that the S corporation has nexus with Ohio, includes in its income the income of the QSSS, and makes a good faith and reasonable effort to comply with Ohio's pass-through entity tax or (2) the S corporation files a composite Ohio income tax return** (form IT-4708) on behalf of all nonresident shareholders and includes on that composite return the nonresident shareholder's proportionate share of the income of the QSSS. See the following: (1) O.R.C. sections 5733.402 and 5733.41; (2) the Department of Taxation's July 3, 2002 income tax information release entitled "Pass-through entity tax: certain estimated tax payments due September 16, 2002"; and (3) the instructions for form IT-1140, Tax Return for Pass-through Entities. All of the above are available on the department's web site.

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 O.R.C. Chapter 5727 is not subject to the franchise tax. Railroads are subject to the franchise tax for tax years 1993 and thereafter. Electric companies and combined electric companies are subject to the franchise tax for tax years 2002 and thereafter. Local exchange telephone companies are subject to the franchise tax for tax years 2005 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 I.R.C. section 856, a regulated investment company (RIC) under I.R.C. section 851, or a real estate mortgage investment conduit (REMIC) under I.R.C. section 860D is not subject to the franchise tax **if the REIT, RIC or REMIC provides to the Tax Commissioner by March 31, 2004 the report of the entity's investors required by O.R.C. section 5733.09(C). Except for closely held or privately held REITs, RICs and REMICs,** the Tax Commissioner by administrative journal entry dated August 5, 2003 has waived the investor report for such entities for tax year 2004. **The Tax Commissioner did not waive the 2004 reporting requirements if either the REIT, RIC, or REMIC is a related member to the taxpayer or the taxpayer is a related member to the REIT, RIC or REMIC.**

Each closely held REIT, RIC or REMIC for which the Tax Commissioner did not waive the reporting requirements must submit to the Tax Commissioner by March 31, 2004 the name of the entity with a list of the names, addresses and social security or federal identification numbers of all investors, shareholders and other similar investors who owned any interest or invested in the entity during the preceding calendar year. Taxpayers having questions regarding this matter should contact the Department of Taxation at 614-433-7862.

Send the report to the following address:

Ohio Department of Taxation
REIT-RIC-REMIC Report
P.O. Box 2619
Columbus, Ohio 43216-2619

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 O.R.C. section 5733.06(E). A corporation in Chapter 7 bankruptcy is not exempt from the 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 that has been adjudicated bankrupt or for which a receiver has been appointed. See *Vought Industries, Inc. v. Tracy* (1995), 72 Ohio St. 3d 261.

E. Corporations Exempt Under Federal Law

Certain corporations are exempt from state tax because Congress has expressly granted them immunity as a "federally chartered instrumentality." For example, federal land bank associations are exempt from state taxes under Section 2098, Title 12, U.S. Code. Certain other corporations are exempt because the United States Constitution's Supremacy Clause grants implied immunity to private corporations that actually stand in the federal government's shoes and are so closely connected to the government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned. An Agricultural Credit Association (ACA) is not immune from state taxation as a "federally chartered instrumentality" because (i) Congress has not expressly granted immunity to ACAs, and (ii) the Supremacy Clause of the United States Constitution does not grant implied immunity to ACAs. See *Farm Credit Serv. of Mid-America v. Zaino* (2001), 91 Ohio St.3d 564.

3. TAX RATES AND MINIMUM FEE

The tax rates as set forth in O.R.C. section 5733.06 are as follows:

- The first $50,000 of Ohio net income is subject to tax at a rate of 5.1 percent. However, corporations that meet the ownership requirements to file a combined report must share the $0 to $50,000 tax bracket amount to which the 5.1 percent rate applies regardless of whether or not they actually file combined. Related taxpayers must prorate the $0 to $50,000 bracket amount 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. 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 percent.

- 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 13 mills, and the $150,000 net worth tax limit does not apply to financial institutions. Financial institutions are exempt from the net income base.

- **New law:** The minimum franchise tax fee is $1,000 if the taxpayer's taxable year ended on or after June 26, 2003, and (i) the sum of the taxpayer's gross receipts from its activities within and without Ohio during the taxable year equals or exceeds $5 million; or (ii) the total number of the taxpayer's employees within and without Ohio at any time during the taxable year equals or exceeds 300. In determining whether or not the taxpayer's gross receipts and number of employees equal or exceed those thresholds, the taxpayer must include its proportionate share of the gross receipts of any pass-through entity in which the taxpayer has a direct or indirect ownership interest and its proportionate share of the number of employees of the pass-through entity. Furthermore, the term "gross receipts," as used here, includes receipts that generate nonbusiness income and receipts from the sale of capital assets and I.R.C. section 1231 assets whether those sales generate business income or nonbusiness income.

The minimum fee is $50 for taxpayers whose taxable year ended before June 26, 2003 and for taxpayers whose taxable year ended on or after June 26, 2003 but whose gross receipts and whose number of employees do not equal or exceed the thresholds discussed above. See O.R.C. section 5733.06(E) as amended by Amended House Bill 95, 125th General Assembly.

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 (i) a partner or limited partner in a partnership that has nexus with Ohio or (ii) 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 the following: (1) O.R.C. section 5733.04(O); (2) the Department of Taxation's September 2001 information release describing the standards the Department will apply to determine whether an out-of-state corporation is subject to the franchise tax; and (3) the department's March 15, 2001 information release entitled "Corporation Franchise Tax Nexus for Nonresident Limited Partners Following the UCOM Decision." The information releases and the Ohio Revised Code are available on the department's web site.

5. IMPACT OF PUBLIC LAW 86-272

Public Law 86-272, 15 U.S.C. 381-384, is federal law that restricts Ohio and all other states from imposing a tax on or measured by income derived by an out-of-state company within the state's borders if the only business activity of the company within the state consists of the solicitation of orders for sale of **tangible personal property**. This restriction is limited to orders sent outside the state for acceptance or rejection and, if accepted, filled by shipment or delivery from a point outside the state.

P.L. 86-272 does not prohibit Ohio from asserting that an out-of-state corporation has nexus with Ohio. In fact, implicit in the application of P.L. 86-272 is that an out-of-state corporation does have nexus. P.L. 86-272 merely prohibits the imposition of the Ohio corporation franchise tax based on net income in certain situations. Those situation are listed in issue IV (A) of the Department of Taxation's Information Release entitled "Corporation Franchise Tax – Nexus Standards" issued in September 2001 and revised May 19, 2003. Because the net worth base of the corporation franchise tax is not a tax on or measured by income, **P.L. 86-272 offers no protection from the Ohio corporation franchise tax based on net worth.**

The issue of whether or not P.L. 86-272, Section 381, Title 15, U.S. Code prohibits the imposition of franchise tax measured by the net income base is determined by the taxpayer's activities during the taxable year in which the taxpayer earned that income – not by the taxpayer's activities during the tax year following the taxable year or on January 1 of the tax year. If the taxpayer's activities in Ohio during the taxable year exceeded the activities protected by P.L. 86-272 but in the related tax year the taxpayer's activities did <u>not</u> exceed the protected activities, then P.L. 86-272 offers no protection for the tax year, and for that tax year the corporation is subject to the franchise tax on the net income base. Conversely, if the taxpayer's activities in Ohio during the taxable year did <u>not</u> exceed the activities protected by P.L. 86-272 but in the related tax year the taxpayer's activities did exceed the protected activities, P.L. 86-272 does offer protection for the tax year, and for that tax year the corporation is <u>not</u> subject to the franchise tax on the net income base. See *LSDHC Corp. v. Zaino,* 98 Ohio St.3d 450, 2003-Ohio-1911.

6. 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 Ohio 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 Ohio 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 regarding obtaining a tax release from the Ohio Department of Taxation, please contact the Ohio Department of Taxation, Dissolution Unit, P.O. Box 182382, Columbus, Ohio 43218-2382 or call 614-995-4422 or 1-888-405-4039.

The mere termination of business activities or voluntary dissolution does not exempt a corporation from the franchise tax. A corporation that 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. See O.R.C. section 5733.17.

For tax years 1999 and thereafter a corporation that previously had nexus with Ohio but is not a franchise taxpayer on January 1 of the tax year (for example, because the corporation dissolved, merged out of existence or surrendered its license to conduct business in Ohio prior

to January 1 of the tax year) may be 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.

7. **EXIT TAX – O.R.C. SECTION 5733.06(H)**

An exiting corporation is a corporation that previously had nexus with Ohio but is not a franchise taxpayer for the tax year (for example, because the corporation dissolved, merged out of existence or surrendered its license to conduct business in Ohio prior to January 1 of the tax year). Nevertheless, if a transferee corporation (see O.R.C. section 5733.053 and the instructions for schedule A, line 9) is required to include in its Ohio taxable income the income of a transferor corporation that would otherwise be an exiting corporation, then the transferor is not an exiting corporation and the exit tax does not apply. 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 the corporation's franchise tax report. The exit tax does not apply to an exiting financial institution.

An exiting corporation is not subject to the minimum fee and is not subject to 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 O.R.C. 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.

Amended Substitute Senate Bill 287, 123rd General Assembly amended both the exit tax (O.R.C. section 5733.06(H)) and the transferor statute (O.R.C. section 5733.053) and established the following relationship between the two:

(1) If on January 1 following the transfer of substantially all the transferor's assets to the transferee the transferor remains in existence, then the transferor is subject to the franchise tax and the transferor statute does not apply to the transferee. See O.R.C. section 5733.053(B): *"The transferee shall add 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. The transferee shall add such income only to the extent the income is not required to be reported by the transferor for the purposes of the tax imposed by divisions (A) and (B) of section 5733.06 of the Revised Code."*

(2) If on January 1 following the transfer of substantially all the transferor's assets to the transferee the transferor is not subject to the franchise tax (because, for example, the transferor merged into the transferee), and if for federal income tax purposes the transfer qualifies for nonrecognition of gain and loss, then the O.R.C. section 5733.053 transferor statute applies to the transferee and the exit tax does not apply to the transferor. That is, the transferee is required to add to its income the income of the transferor and the franchise tax attributes of the transferor pass to the transferee.

(3) If on January 1 following the transfer of substantially all the transferor's assets to the transferee the transferor is not subject to the franchise tax imposed by divisions (A) and (B) of O.R.C. section 5733.06 (because, for example, the transferor merged into the transferee), and the O.R.C. section 5733.053 transferor statue does not apply to the transferee (because, for example, the merger is not a tax free reorganization) and if all other conditions of an exiting corporation apply, then the exit tax applies to the transferor. See O.R.C. sections 5733.06(H)(1)(d) and 5733.06(H)(6).

Note: The changes to the transferor statute and the exit tax, as set forth above, were originally to have been effective with the 2002 franchise tax report (see Section 13 of Am Sub SB 287). However, Amended Substitute House Bill 94, 124th General Assembly amended the effective date of the changes to the transferor statute and the exit tax statute made by Amended Substitute Senate Bill 287. Amended Substitute House Bill 94 provides that the amendments to the exit tax and to the transferor statute made by Am Sub SB 287 do not apply to any transfer for which negotiations began prior to January 1, 2001, and that was commenced in and completed during calendar year 2001, unless the transferee makes an election prior to December 31, 2001, to apply those amendments.

An exiting corporation that has a fiscal year end must include on one 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 O.R.C. 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 2003 franchise tax report based on the fiscal year beginning February 1, 2001 and ending January 31, 2002. ABC shut down its Ohio operations and legally withdrew from Ohio on December 1, 2003. ABC is not a "transferor" as defined in O.R.C. section 5733.053 because ABC did not transfer substantially all its assets or equity to another corporation in a tax-free reorganization. Although ABC is not a franchise taxpayer on January 1, 2004 ABC is nevertheless subject to the exit tax on its unreported Ohio net income earned during the 22-month period beginning February 1, 2002 and ending December 1, 2003 (the date that it withdrew from Ohio).

ABC must report its income for the entire 22-month period from February 1, 2002 to December 1, 2003 on a 2004 franchise tax report even though income for the period from February 1, 2003 to December 1, 2003 would have been reported on a 2005 franchise tax report if ABC would have had nexus with Ohio on January 1, 2005 and remained subject to the franchise tax. ABC's 2004 tax report is due by May 31, 2004, 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).

8. **ACCOUNTING PERIOD – TAXABLE YEAR**

For franchise tax purposes a corporation's taxable year is 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. Generally, a corporation's taxable year for franchise tax purposes 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. A franchise tax taxable year may consist of an aggregation of more than one federal taxable year and can exceed one year in length. For example, a franchise tax taxable year can consist of two (or more) federal taxable years and can exceed one year in length in certain instances where the taxpayer changes its federal taxable year or the taxpayer is acquired by another corporation and then changes its taxable year. 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.

The Department of Taxation has adopted the following rules regarding franchise taxpayers' taxable years and change of accounting period:

- 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. **Note: The department recently amended Rule 5703-5-04 to clarify when a taxpayer's annual accounting period changes and to eliminate proration for periods in excess of one year in length.**

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 is (i) no period that is not subject to tax, and (ii) no period that is subject to tax in more than one tax year.
- A franchise tax "taxable year" under certain circumstances may be more than or less than one year in length.

Except for taxpayers that have changed their accounting period and taxpayers that have two or more federal taxable years that ended in calendar year 2003, 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 2004 taxpayers that have a calendar year end: Use the period ending December 31, 2003.

For report year 2004 taxpayers that have a fiscal year end: Use the fiscal period ending in 2003. However, taxpayers filing their first report should see below.

For report year 2004 taxpayers that are filing their first report: Use the applicable period set forth below:

A. If a taxpayer incorporated in Ohio during 2003 and adopted a fiscal period ending in 2003, 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 2003.

B. If the taxpayer is a foreign corporation and first became an Ohio taxpayer during 2003 (that is, during 2003 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 2003, 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 2003.

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, 2003. See paragraphs (E)(2) and (E)(4) of Tax Commissioner's Rule 5703-5-03.

If the corporation changed its taxable year in 2002 or 2003 or if the corporation had more than one federal taxable year that ended in calendar year 2003, please see the rules referred to above in determining your taxable year. For a copy of the rules visit our web site. For a copy of the rules and a time line illustrations of the rules contact the department by sending your request to: Ohio Department of Taxation, Attn: Rules, P.O. Box 2476, Columbus, Ohio 43216-2476.

9. METHODS OF COMPUTING TAX

In determining the Ohio franchise tax due, taxpayers other than financial institutions and qualifying holding companies and certain high-tech start-up 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 and certain high-tech start-up companies are not subject to the tax on the net worth base. In any event franchise taxpayers are subject to a minimum fee.

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 minimum fee. See general instruction #7.

10. TIME, PLACE AND METHOD FOR FILING AND PAYMENT

Except as otherwise provided, if a payment or document is mailed on or before the due date but delivered after the required date, the postmark date is deemed the date of delivery. 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 #10 D).

A. Filing Date; Payment Date; Declaration of Estimated Tax

The filing and payment of the Ohio franchise tax for report year 2004 is due between January 1 and March 31, 2004. However, if by January 31 the taxpayer did not file the Ohio corporation franchise tax report and if by January 31 the taxpayer did not make full payment of the tax, then by January 31 the taxpayer must file form FT 1120E, Declaration of Estimated Corporation Franchise Tax and must pay one-third of the estimated tax, but not less than the minimum fee.

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 following table lists the latest possible due dates for filing the 2004 franchise tax report for the various taxable years ending in 2003. The table assumes the following:

- If the taxpayer's taxable year ended on or after August 31, 2003, the taxpayer has the maximum allowable federal extension,
- The taxpayer timely filed franchise tax forms FT 1120E, FT 1120ER, and, if applicable, FT 1120EX, and
- The taxpayer has timely made all estimated franchise tax payments.

Taxable Year Ending In 2003	Latest Possible Due Date for Filing the 2004 Franchise Tax Report
01/31/03 through 7/31/03	05/31/2004
08/31/2003	06/15/2004
09/30/2003	07/15/2004
10/31/2003	08/15/2004
11/30/2003	09/15/2004
12/31/2003	10/15/2004

Note: Payment of all franchise tax for tax year 2004 is due by May 31, 2004, even if the taxpayer has an extension to file after that date. Each member of a combined franchise tax report must file its own separate forms FT 1120E, FT 1120ER and FT 1120EX.

C. Place

File the franchise tax report with the Ohio Department of Taxation, P.O. Box 27, Columbus, Ohio 43216-0027.

However, if the report is an amended report, please do not send it to the address above. Rather, an amended report that reflects a balance due or no change in liability should be mailed to the following address:

Ohio Department of Taxation,
Corporation Franchise Tax
P.O. Box 2476, Columbus, Ohio 43216-2476

An amended report that reflects an overpayment, should be mailed to the following address:

Ohio Department of Taxation,
Corporation Franchise Tax
P.O. Box 530, Columbus, Ohio 43216-0530

Please indicate that a report is an amended report by checking the box on the front of the report.

D. EFT Method of Payment

A taxpayer must pay by electronic funds transfer (EFT) if the taxpayer's total franchise tax liability after reduction for nonrefundable credits exceeded $50,000 for the second preceding tax year. Nevertheless, payments made with an amended report can not be made by EFT. For further EFT information see the Department of Taxation'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 on the department's web site. Please direct questions regarding the EFT payment program to the Ohio Treasurer of State's office at 30 East Broad Street, 9th floor, Columbus, Ohio 43215 or telephone that office toll free at 1-877-EFT-Ohio (338-6446).

11. 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 that 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. **There is no safe-harbor from interest on the underpayment of estimated tax.**

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 90th day after the final date the franchise tax report was required to be filed, or
- the 90th day after the date that the franchise tax report was filed.

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 2004 interest on both underpayments and overpayments will accrue at the rate of 4 percent per annum.**

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

- Penalty may be imposed for failure to timely pay the tax (including estimated tax – see estimated tax safe harbor, below). Late payment penalty may not exceed 15 percent of the delinquent payment. See O.R.C. section

5733.28(A)(2) as amended by Senate Bill 200, 124th General Assembly. Under prior law the O.R.C. section 5733.28(A)(2) penalty for late payment could not exceed twice the interest charged under O.R.C. section 5733.26(A).

- Penalty may be imposed for failure to file or to timely file a report. The penalty imposed may not exceed the greater of (i) $50 per month up to $500 or (ii) 5 percent per month of the tax due shown on the report up to 50 percent.

- Additional penalties may be imposed for filing a fraudulent report and for filing a fraudulent refund claim.

13. PENALTY SAFE-HARBOR FOR ESTIMATED PAYMENTS
Substitute Senate Bill 200 (Taxpayer Services II), 124th General Assembly, effective September 6, 2002 enacted the following safe-harbor applicable to penalty on underpayment of estimated tax.

- With respect to estimated payments, the O.R.C. section 5733.28(A)(2) failure to pay penalty applies to two periods: (1) "any period of delinquency ending prior to the first day of June of the tax year" and (2) "any period of delinquency commencing the first day of June of the tax year and concluding on the extended due date." See O.R.C. section 5733.021 as amended by Senate Bill 200.

- For purposes of determining the O.R.C. section 5733.28(A)(2) failure to pay penalty for any period of delinquency ending prior to the first day of June of the tax year, the commissioner may charge penalty on the delinquent portion of the estimated tax and estimated tax means the lesser of 100 percent of last year's tax or 90 percent of this year's tax. See O.R.C. section 5733.021(C)(1)(c).

- For purposes of determining the O.R.C. section 5733.28(A)(2) failure to pay penalty for any period of delinquency commencing the first day of June of the tax year and concluding on the extended due date, the commissioner may charge penalty on the delinquent portion of the estimated tax and estimated tax means 90 percent of this year's tax. See O.R.C. section 5733.021(C)(2)(c).

Note: In addition to creating the above noted safe-harbor, Senate Bill 200 amended the O.R.C. section 5733.28(A)(2) penalty computation. The O.R.C. section 5733.28(A)(2) failure to pay penalty now provides that the penalty may not exceed 15 percent of the delinquent payment. Prior law provided that the failure to pay penalty could not exceed twice the interest charged under O.R.C. section 5733.26(A).

14. OFFICERS, STATUTORY AGENT AND SIGNATURE
All franchise tax reports must be signed by one of the following: 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.

15. 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 dates:

- 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 a result of the adjustment.

This provision applies even if the three-year statute of limitations has passed and applies to amended reports that reflect overpayments as well as to amended reports that 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 either form FT REF, Application for Refund, or by a statement that sets forth the full and complete reason for the overpayment. See *Abitibi-Price Corporation and Subsidiaries v. Tracy*, BTA No. 98-N-401 (3-12-01) and refer to general instruction #27.

Upon completing an amended report, please check the amended report box on the front of the report. Please do not send an amended report to P.O. Box 27 (the address on the form). Rather, an amended report that reflects a balance due or no change in liability should be mailed to the following address:

Ohio Department of Taxation
Corporation Franchise Tax
P.O. Box 2476, Columbus, Ohio 43216-2476

An amended report that reflects an overpayment should be mailed to the following address:

Ohio Department of Taxation
Corporation Franchise Tax
P.O. Box 530, Columbus, Ohio 43216-0530

16. AMOUNTS REPORTED FROM FEDERAL TAX RETURN
Amounts reported from the federal form 1120 or 1120A, as well as Ohio adjustments, apportionment and allocations are subject to verification and audit by the Ohio Department of Taxation.

17. 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 that 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 principles, the value of the taxpayer's issued and outstanding shares of stock under the net worth base (O.R.C. section 5733.05(C)) must be based upon those books kept in accordance with generally accepted accounting principles. See Tax Commissioner's Rule 5703-5-08.

18. 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.

19. RECORDS RETENTION

Every corporation must maintain books and records that 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.

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

A taxpayer that owns at least 25 percent 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 percent 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 percent 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.

21. 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 percent,
- The corporation's "investment in related members ratio" equals or exceeds 50 percent,
- During the taxable year the corporation's "gross income from intangible assets ratio" equals or exceeds 90 percent,
- 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 O.R.C. section 5733.04(M) as two or more corporations that satisfy the O.R.C. 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 O.R.C. sections 5733.04(L), 5733.05(C)(2), and 5733.06(C).

22. HIGH-TECH START-UP COMPANIES

A corporation organized not more than three years before the March 31 unextended due date of each of the 2003, 2004, 2005, 2006 or 2007 franchise tax reports is not subject to the net worth base of the franchise tax or to the net worth base of the litter taxes if the corporation:

- Conducted business during its entire taxable year as a *qualified trade or business;*
- Uses more than 50 percent of its assets located in Ohio (based on net book value) solely to conduct activities that constitute a qualified trade or business; and
- During the taxable year is not a related member (as defined in O.R.C. section 5733.042 and modified by O.R.C. section 5733.06(C)(2)(d)) to another person treated as a corporation.

The term "qualified trade or business" means any trade or business that primarily involves research and development, technology transfer, bio-technology, information technology or the application of new technology developed through research and development or acquired through technology transfer.

If the corporation meets the above requirements and is claiming exemption from the net worth base as a high-tech start-up company (the statute refers to such corporations as "eligible corporations"), please check the box at the top of page 1 of the franchise tax report. Do not complete schedule F and do not complete lines (d), (i), or (l) of schedule G. See O.R.C. sections 5733.06(C) and 122.15.

23. COMBINED REPORTS

A *taxpayer* that on January 1 of the tax year owns or controls either directly or indirectly more than 50 percent 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 percent 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 O.R.C. sections 5733.02 and 5733.13. Only one member of a combined franchise tax group must satisfy the O.R.C. 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 that 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 #10 A and #10 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 O.R.C. 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 percent 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.

The Department of Taxation 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 that does not properly reflect income and does not properly reflect the tax liability imposed by O.R.C. section 5733.06. A timely conducted I.R.C. section 482-type study conforming with the requirements set forth in I.R.C. 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 of Taxation's June 23, 2000 Information Release entitled, "I.R.C. Section 482 Study: Safe Harbor to Avoid Ohio Corporate Franchise Tax Report Required or Expanded Combinations." The information release is available on the department's web site. Taxpayers that request the tax commissioner's permission to include in the combined report corporations that 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 on January 1 of the tax year meet the ownership requirements to file a combined report must share the $0 to $50,000 tax bracket amount to which the 5.1 percent rate applies regardless of whether or not they actually file combined. Related taxpayers must prorate the $0 to $50,000 bracket amount on form FT OTAS.

24. EXEMPTION FOR ENERGY CONVERSION FACILITIES

For taxable years that ended before June 26, 2003 corporations that constructed energy facilities, solid waste energy conversion facilities, and thermal efficiency improvement facilities may be entitled to a net worth deduction for such facilities on the Ohio corporation franchise tax report. To qualify for the exemption, a corporation must have obtained a certificate issued by the tax commissioner. For information concerning the franchise tax exemption for such facilities please contact the Ohio Department of Taxation, Personal Property Tax Division, Attn: Pollution Control, P.O. Box 530, Columbus, Ohio 43216-0530 or call (614) 466-3280.

For taxable years that ended on or after June 26, 2003 taxpayers may not claim a net worth deduction for such facilities. See O.R.C. section 5709.25(B) as amended by Amended Substitute House Bill 95, 125th General Assembly.

25. ENTERPRISE ZONE TAX BENEFITS

Amended Substitute House Bill 95th, 125th General Assembly (Budget Bill) extends through October 15, 2009 the authority for local governments to enter into enterprise zone agreements. See O.R.C. section 5709.62 as amended by the bill.

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 O.R.C. 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), and exclusion of qualifying property and payroll from the numerators of the net income base property and payroll factors.

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 25 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 O.R.C. section 3304.11(A), 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 O.R.C. 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 12 months preceding the application. For more information on the Credit for Eligible New Employees in an Enterprise Zone see credit #9 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).

26. ASSESSMENTS

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

- 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. Furthermore, if the tax commissioner disregards a sham transaction, the assessment statute of limitations is doubled. See general instruction #29 and O.R.C section 5703.56 as enacted by Amended Substitute House Bill 95, 125th General Assembly.

An amended franchise tax report filed as a result of an adjustment to the corporation's federal income tax return (see general instruction #15) 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 60 days of receipt of the assessment, and does not file a petition for reassessment within 60 days of receipt of the assessment, interest accrues on the assessment at the rate prescribed in O.R.C. 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 #27.

27. APPLICATION FOR REFUND AND PETITION FOR REASSESSMENT

Franchise taxpayers may request a refund by filing either prescribed form FT REF, **Application for Corporation Franchise Tax Refund**, or by filing an amended report accompanied by the full and complete reason for the refund claim. **Please do not file an application for refund if the claimed overpayment is shown on the originally filed franchise tax report.**

Franchise taxpayers may initiate review proceedings pertaining to a franchise tax assessment issued by the department of Taxation by filing form FT PR, Petition for Reassessment.

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 #26), then the Department must receive the application for refund or an amended report accompanied by the full and complete reason for the refund claim within three years of the date of the illegal, erroneous or excessive payment. See *Abitibi-Price Corporation and Subsidiaries v. Tracy*, BTA No. 98-N-401 (3-12-01).

Effective September 6, 2002 for purposes of the refund statute of limitations, payment made before the due date or extended due date for filing the report to which the payment relates are deemed to have been made on the due date or extended due date (see O.R.C. section 5733.12 as amended by Substitute Senate Bill 200 (Taxpayer Services Bill II), 124th General Assembly, effective September 6, 2002). (Under prior case law payments remitted with the estimated tax report (form FT 1120E) and extension requests (forms FT 1120ER and FT 1120EX) were 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 was filed before its extended due date, the three year refund statute of limitations began to run on the date the report was filed rather than the later 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 claim 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 #15. 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 #26), 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 a claim for refund unless the taxpayer has paid the assessment. For example, if the taxpayer fails to file a petition for reassessment within 60 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.

Uniform application for refund procedure. Substitute Senate Bill 200, 124th General Assembly, effective June 7, 2002 enacted O.R.C. section 5703.70 to establish a uniform application for refund procedure applicable to franchise tax and various other taxes (but not to individual income tax, school district income tax, withholding tax or pass-through entity tax). If a taxpayer properly files an application for refund under a law that specifies that the O.R.C. section 5703.70 uniform procedure applies and the commissioner determines that the amount of the refund to which the applicant is entitled is less than the amount claimed, then the tax commissioner and the taxpayer must proceed as follows:

1. If the commissioner determines that the amount of the refund to which the applicant is entitled is less than the amount that the applicant claimed, the commissioner must notify the applicant in writing by ordinary mail of the disallowed portion of the claimed refund.

2. The applicant has 60 days from the date the commissioner mails the notification to provide additional information to the commissioner and/or to request a hearing.

3. If the applicant neither requests a hearing nor provides additional information within the 60-day period described in #2 above, the commissioner will take no further action and the refund amount denied becomes final. That is, the taxpayer may not appeal to the Board of Tax Appeals the denied portion of the refund.

4. If the applicant requests a hearing within the 60-day period described in #2 above, the commissioner must assign a time and place for a hearing. After the hearing, the commissioner may make such adjustments to the refund as the commissioner finds proper and must issue a final determination. The taxpayer may appeal the commissioner's final determination to the Board of Tax Appeals pursuant to O.R.C. section 5717.02.

5. If the applicant does not request a hearing within the 60-day period described in #2 above but does provide additional information within that period, the commissioner must review the information, may make such adjustments to the refund as the commissioner finds proper, and must issue a final determination. The taxpayer may appeal the commissioner's final determination to the Board of Tax Appeals pursuant to O.R.C. section 5717.02.

Petition for Reassessment. Form FT PR applies only to assessments issued by the Ohio Department of Taxation. **The amount of an assessment that may be refunded under a timely filed petition for reassessment is limited to the amount of the assessment that the taxpayer paid. No portion of the amount paid with the filing of the franchise tax report is available for refund under the O.R.C. section 5733.11 petition for reassessment statute because there is no provision within O.R.C. section 5733.11 that grants the commissioner the authority to refund any amount greater than the amount that the taxpayer paid toward the assessment. The fact that the taxpayer raises additional objections to the assessment prior to the Tax Commissioner's final determination and the fact that the taxpayer mentions in those objections that the taxpayer is overpaid with respect to amounts paid with the original report does not convert a petition for reassessment into a timely filed refund claim with respect to amounts paid with the original report.** See *International Business Machines Corp. v. Zaino* (2002), 94 Ohio St.3d 152.

A taxpayer must file its petition within 60 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 of Taxation 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 that 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 60-day period described above, the tax commissioner will dismiss the petition because the tax commissioner has no jurisdiction to consider a late-filed petition.

The portion of an assessment that must be paid upon the filing of a Petition for Reassessment is as follows:

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

2. 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 O.R.C. section 5733.031(C) for the tax year at issue; or (iii) any amended report required by O.R.C. section 5733.067(D) 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.

3. If prior to the date of issuance of the assessment the assessed corporation filed (i) the annual report required by O.R.C. section 5733.02, (ii) all amended reports required by O.R.C. section 5733.031(C) for the tax year at issue, and (iii) all amended reports required by O.R.C. section 5733.067(D) 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.

4. 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.

5. If none of the conditions specified in (1), (2), (3), or (4) 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 O.R.C. section 5703.47 from the date the Department of Taxation issues the assessment until the date the taxpayer pays the assessment. See O.R.C. section 5733.11 as amended by Amended Substitute House Bill No. 215 (Budget Bill), 122nd General Assembly and section 213 of the 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 #11 for interest on underpayments and overpayments.

Uniform petition for reassessment procedure. Substitute Senate Bill 200, 124th General Assembly enacted O.R.C. section 5703.60 to establish a uniform petition for reassessment procedure and a uniform assessment correction procedure applicable to franchise tax, individual income tax, pass-through entity tax, withholding tax, school district income tax and various other taxes. If the taxpayer has filed a proper petition for reassessment for a tax whose statute specifies that the uniform reassessment procedure applies, this law permits the tax commissioner, upon receipt of additional information from the taxpayer, to correct an assessment without issuing a final determination and without a hearing. In addition, this law permits the commissioner to correct an assessment even if the taxpayer did not properly file a petition for reassessment or did not file a petition for reassessment. Set forth below is a more in-depth summary of the law.

A. **Uniform Procedure if the Taxpayer Properly Files a Petition for Reassessment**

If a taxpayer objects to an assessment by properly filing a petition for reassessment under a law that specifies that the O.R.C. section 5703.60 petition for reassessment procedure applies, then the Tax Commissioner and the taxpayer are to proceed as follows:

1. Upon review of the taxpayer's properly filed petition for reassessment, the commissioner must either:
   a. Issue a **final determination** that affirms, increases, cancels or reduces (without canceling) the assessment; or
   b. Issue a **corrected assessment** that increases, cancels or reduces (without canceling) the assessment. However, if the party assessed has requested in writing that the Tax Commissioner not use the corrected assessment procedure, then the Tax Commissioner may not issue a corrected assessment; instead, after a hearing, if the taxpayer so requests, the commissioner must issue a final determination.

Note: A cancelled assessment is an assessment that the Tax Commissioner has reduced to **zero** by issuing either a <u>corrected assessment or a final determination</u>. If the Tax Commissioner **cancels** an assessment, the corrected assessment or final determination is *not* subject to further administrative review or appeal.

2. If upon review of the taxpayer's properly filed petition for reassessment (and after a hearing if the taxpayer so requests) the Tax Commissioner issues a final determination, the final determination may cancel, reduce, affirm or increase the assessment. The taxpayer may appeal the Tax Commissioner's final determination (other than a final determination that cancels the assessment) to the Board of Tax Appeals.

Note: The Tax Commissioner's final determination can increase the assessment even if the tax commissioner issues the determination outside the normal assessment statute of limitations period (three years for corporations; four years for individual income tax, pass-through entity tax and withholding tax).

3. If upon review of the taxpayer's properly filed petition for reassessment the Tax Commissioner issues a corrected assessment, then (a) the corrected assessment nullifies the taxpayer's <u>original</u> petition, and (b) the original petition is not subject to further administrative review and may not be appealed to the Board of Tax Appeals. The Tax Commissioner must send the corrected assessment by ordinary mail. (Unlike the corrected assessment, the Tax Commissioner must send the original assessment by certified mail or must hand deliver it.)

Note: If the Tax Commissioner timely issued the original assessment, then the commissioner's corrected assessment is deemed timely issued even if the corrected assessment <u>increases</u> the original assessment outside the normal assessment statute of limitations period.

4. If upon review of the taxpayer's properly filed petition for reassessment the Tax Commissioner issues a corrected assessment, the taxpayer may file a <u>new</u> petition for reassessment. If the taxpayer files a new petition, the taxpayer must do so within 60 days after the commissioner <u>mails</u> the corrected assessment. (Unlike a new petition for reassessment, the taxpayer must file its original petition within 60 days of <u>receipt</u> of the original assessment. In all other respects, a franchise taxpayer must file the new petition in the same manner as provided in O.R.C. section 5733.11 for filing the original petition, and an individual income taxpayer in the same manner as provided in O.R.C. section 5747.13.)

5. If upon review of the taxpayer's properly filed petition for reassessment the Tax Commissioner issues a corrected assessment and the taxpayer does not file a new petition within the 60-day period described in #4 above, then the corrected assessment becomes final. That is, the corrected assessment is not subject to further administrative review,

may not be appealed to the Board of Tax Appeals, and is due and payable.

6. If upon review of the taxpayer's properly filed petition for reassessment the Tax Commissioner issued a corrected assessment that does not cancel the original assessment, and in response to the Tax Commissioner's corrected assessment the taxpayer files a new petition within the 60-day period described in #4 above, then upon review of the new petition and upon completion of the hearing (if the taxpayer requests a hearing) the commissioner must either:

   a. Issue a **final determination** that affirms, increases, decreases or cancels the first corrected assessment. The taxpayer may appeal the Tax Commissioner's final determination (other than a final determination that cancels the assessment) to the Board of Tax Appeals; or

   b. Issue a **second** corrected assessment that cancels the first corrected assessment in its entirety. If the commissioner cancels the first corrected assessment, the commissioner must send the cancellation by ordinary mail and the cancelled assessment is not subject to further administrative review or appeal.

Note: The commissioner may *not* issue a **second corrected assessment** that **reduces** but does not cancel the corrected assessment, and the commissioner may *not* issue a second corrected assessment that **increases** the first corrected assessment.

B. Uniform Procedure if the Taxpayer Fails to File a Petition for Reassessment or if the Taxpayer Fails to File a Proper Petition for Reassessment

The commissioner, on the commissioner's own motion, may issue a corrected franchise tax assessment. That is, the commissioner may issue a corrected assessment even if the taxpayer did not file a petition for reassessment or the taxpayer's petition is not timely or is otherwise invalid. However, this provision applies only if: (a) the assessment has not been certified to the attorney general for collection, or (b) the taxpayer has not appealed the commissioner's final determination to the Board of Tax Appeals.

If the commissioner issues a corrected assessment on the commissioner's own motion, the corrected assessment may <u>not</u> **increase** the tax, penalty or additional charge unless the assessment statute of limitations period is still open at the time the tax commissioner issues the corrected assessment. (Unlike a corrected assessment issued on the commissioner's own motion, a corrected assessment issued in response to the taxpayer's petition, may increase the original assessment outside the assessment statute of limitations period (see A. 2., above)). The commissioner must send a corrected assessment issued on the commissioner's own motion by ordinary mail.

C. Refunds of Amounts Paid toward an Assessment

If (a) the Tax Commissioner issues a corrected assessment or final determination, (b) the corrected assessment or final determination reduces the assessment **below** the amount the taxpayer has already **paid** toward that assessment, and (c) the reduction is made as a result of the taxpayer's properly filed petition for reassessment or other written request, then the commissioner may certify any overpayment as a refund <u>only to the extent that a refund could have been claimed at the time the party assessed made the written request</u>. If the Tax Commissioner reduces an assessment on the commissioner's own motion, then the commissioner will certify any overpayment <u>only to the extent a refund could have been claimed at the time the commissioner made the reduction.</u>

28. 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 that discusses the Department of Taxation's interpretation of this law is available on the department's web site. 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 O.R.C. section 5703.53;
- 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," available on the Department of Taxation's web site.

29. SHAM TRANSACTION, ECONOMIC REALITY, SUBSTANCE OVER FORM AND STEP TRANSACTIONS

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. However, with respect to transactions between members of a controlled group, the taxpayer bears the burden of establishing that a transaction or series of transactions between members of the controlled group was not a sham transaction. If the tax commissioner disregards a sham transaction, the assessment statute of limitations is doubled.

For purposes of this provision the term "controlled group" means two or more persons related in such a way that one person directly or indirectly owns or controls the business operations of another member of the group. In the case of persons with stock or equity, one person owns or controls another if it directly or indirectly owns more than 50 percent of the other person's common stock with voting rights or other equity with voting rights. The term "sham transaction" means a transaction or series of transactions without economic substance because there is no business purpose or expectation of profit other than obtaining tax benefits. See O.R.C. sections 5733.111 and 5703.56 as enacted by Amended Substitute House Bill 95, 125th General Assembly.

Note: House Bill 95, 125th General Assembly law repealed the franchise tax sham transaction provision contained in O.R.C. section 5733.111 (see section 2 of the bill) and replaced it with the more encompassing provision set out above. The new law applies on or after June 26, 2003 to all taxes and fees administered by the tax commissioner to all years open to the statute of limitations.

30. 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 that is administered by the Tax Commissioner and paid to the state or to the Clerk of Courts. In addition, the Tax Commissioner may apply a taxpayer's franchise tax refund in satisfaction of the corporation's indebtedness to Ohio for workers' compensation premiums, unemployment compensation contributions or unemployment compensation payments in lieu of contributions and interest on such amounts. The offset can be made only if those debts have become "final." See O.R.C. section 5733.121 as amended by Amended Substitute House Bill 95, 125th General Assembly.

LINE INSTRUCTIONS
SCHEDULE A

If the taxpayer is a member of a **combined** franchise report (form FT 1120C), please:

- See general instruction #23 and the instructions for form FT 1120C – Combined Report;
- Skip lines 2 through 5 of schedule A, form FT 1120;
- Enter on line 6 of schedule A, form FT 1120 the taxpayer's separate company apportionment ratio; and
- Enter on line 7 of schedule A, form FT 1120 the taxpayer's apportioned income from schedule B (Combined), line 7 of the combined report, form FT 1120C.

A taxpayer must compute its Ohio taxable income for its taxable year (see general instruction #8).

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. **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. Enter the taxpayer's separate company apportionment ratio even if the taxpayer is a member of a combined franchise tax report.

Line 9 – Income (loss) from transferor corporation.

A taxpayer-***transferee*** that receives substantially all of the assets or equity of a *transferor* corporation must include in its own Ohio taxable income the transferor's Ohio taxable income **if following the *transfer* the transferor is not subject to the franchise tax and the transfer qualifies for nonrecognition of gain and loss under the Internal Revenue Code. If the transferor statute applies to the transferee, then the transferor's Ohio net operating losses, unused credit amounts and other franchise tax attributes transfer to the transferee** subject to the limitations set forth in sections 381 and 382 of the Internal Revenue Code.

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 a taxpayer that is subject to O.R.C. section 5733.053 subsequently becomes a transferor, then any income that the taxpayer would have been required to add to its income under O.R.C. 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 O.R.C. section 5733.053 and Sections 13(A) and 13(C) of House Bill 111.

Note: Amended Substitute House Bill 94, 124th General Assembly (budget bill) limits the transferor statute provisions to those transfers and distributions which qualify for nonrecognition of gain and loss under the Internal Revenue Code.

Amended Substitute Senate Bill 287, 123rd General Assembly (Am Sub SB 287) amended both the transferor statute (O.R.C. 5733.053) and the exit tax statute (O.R.C. 5733.06(H)). The changes to the transferor statute and the exit tax, as enacted by Am Sub SB 287 and summarized below, were originally to have been effective with the 2002 franchise tax report (see Section 13 of Am Sub SB 287). However, Amended Substitute House Bill 94, 124th General Assembly (the Budget Bill) later amended the effective date of the changes to the transferor statute and the exit tax statute made by Am Sub SB 287. Amended Substitute House Bill 94 provides that the amendments to the exit tax and to the transferor statute made by Am Sub SB 287 do not apply to any transfer for which negotiations began before January 1, 2001, and that was commenced in and completed during calendar year 2001, unless the transferee makes an election before December 31, 2001, to apply those amendments.

The law defines the terms *transfer, transferor* and *transferee* as follows:

- "'**Transfer**' means a transaction or series of related transactions in which a corporation directly or indirectly transfers or distributes substantially all of its assets or equity to another corporation." O.R.C. section 5733.053(A)(1).
- "'**Transferor**' means a corporation that has made a transfer." O.R.C. section 5733.053(A)(2).
- "'**Transferee**' means a corporation that received substantially all the assets or equity of a transferor in a transfer." O.R.C. section 5733.053(A)(3).

Amended Substitute Senate Bill 287 also established the following relationship between the transferor statute (O.R.C. section 5733.053) and the exit tax (see general instruction #7 and O.R.C. section 5733.06(H)):

(1) If on January 1 following the transfer of substantially all the transferor's assets to the transferee the transferor remains in existence, then the transferor is subject to the franchise tax and the transferor statute does not apply to the transferee. See O.R.C. section 5733.053(B): *"The transferee shall add 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. The transferee shall add such income only to the extent the income is not required to be reported by the transferor for the purposes of the tax imposed by divisions (A) and (B) of section 5733.06 of the Revised Code."*

(2) If on January 1 following the transfer of substantially all the transferor's assets to the transferee the transferor is not subject to the franchise tax (because, for example, the transferor merged into the transferee), and if for federal income tax purposes the transfer qualifies for nonrecognition of gain and loss, then the O.R.C. section 5733.053 transferor statute applies to the transferee and the exit tax does not apply to the transferor. That is, the transferee is required to add to its income the income of the transferor and the franchise tax attributes of the transferor pass to the transferee.

(3) If on January 1 following the transfer of substantially all the transferor's assets to the transferee the transferor is not subject to the franchise tax imposed by O.R.C. sections 5733.06(A) and (B) (for example, because, the transferor merged into the transferee), and the O.R.C. section 5733.053 transferor statue does not apply to the transferee (because, for example, the merger is not a tax-free reorganization) and if all other conditions of an exiting corporation apply, then the exit tax applies to the transferor. See O.R.C. sections 5733.06(H)(1)(d) and 5733.06(H)(6).

Line 12 – Ohio net operating loss deduction.
An Ohio net operating loss is calculated in the same manner as positive Ohio net income is calculated. That is, in determining the Ohio net operating loss generated in a particular taxable year the same adjustment, allocation and apportionment provisions apply as in determining positive Ohio taxable income (before the net operating loss deduction). 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.

For net operating losses incurred in taxable years ending on or after January 1, 1982 and before August 6, 1997 the designated carryover period is 15 consecutive taxable years following the taxable year in which the net operating loss occurs. For net operating losses incurred in taxable years beginning on or after August 6, 1997, the designated carryover period is 20 consecutive taxable years following the taxable year in which the net operating loss occurs. For purposes of calculating the carryforward period, the first year of the carryforward period is the taxable year following the taxable 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. I.R.C. 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 and *American Home Products Corporation, nka Wyeth, as successor in interest to A.H. Robins Company, Incorporated v. Tracy*, Court of Appeals, Tenth Appellate District, No. 02AP-759 (3-27-03). Also, see the instructions for schedule A, 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 2003.
Enter the overpayment carryforward shown on the originally filed 2003 franchise tax report which was credited to estimated tax payments for tax year 2004. An overpayment claimed on an amended report cannot be credited against the tax liability for any other year.

Note: An overpayment shown on an **amended** report may not be credited toward a payment for another year. If an amended report reflects an overpayment, the taxpayer must also submit form FT REF, Application for Corporation Franchise Tax Refund, or a statement that sets forth the full and complete reason for the overpayment. See *Abitibi-Price Corporation and Subsidiaries v. Tracy*, BTA No. 98-N-401 (3-12-01), and refer to general instruction #27.

Line 22 – Estimated payments made in 2004.
Enter the estimated payments paid during tax year 2004 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 credits.
Refundable new jobs credit. Enter the new jobs credit as provided by O.R.C. 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 60 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 O.R.C. 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, Office of Tax Incentives, P.O. Box 1001, Columbus, Ohio 43216-1001 or call 614-466-4551 or 1-800-848-1300. The street address for the Ohio Department of Development is 77 S. High Street, 28th floor, Columbus, Ohio 43215.

Refundable credit for tax withheld by the Ohio Lottery Commission. Enter the amounts that the Ohio Lottery Commission withheld from its payments to the taxpayer pursuant to O.R.C. section 5747.062(B)(2). See the line instructions for schedule C, line 7 for background information with regard to this credit.

Line 26 – Interest and Penalty.
Enter any interest and penalty as explained in general instructions #10, #11 and #12.

Lines 29 and 30 – Overpayment to be credited to year 2005 estimated tax and/or 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, or a statement that explains the full and complete reason for the overpayment. See *Abitibi-Price Corporation and Subsidiaries v. Tracy*, BTA No. 98-N-401 (3-12-01), and refer to general instruction #27.

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 O.R.C. 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 gains 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.

Note 4: If the taxpayer is an electric company or a combined electric company as defined in O.R.C. section 5733.04(P) please complete supplemental schedule B for electric companies. **The supplemental schedule and instructions are available on the Department of Taxation’s web site.** An electric company is any person engaged in the business of generating, transmitting, or distributing electricity within Ohio for use by others, but excludes a rural electric company, as defined in O.R.C. section 5727.01(C).

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 that ended on or after December 20, 1971 on which the tax provided for in O.R.C. 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 O.R.C. 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 period 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 O.R.C. 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 a regulated investment company if at all times at least 50 percent 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 O.R.C. 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 the corporation's 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 O.R.C. 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 on page 41 of these instructions.

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 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 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 O.R.C. section 5733.058.

Lines 1(e) and 2(i) – Depreciation expense adjustment from schedule B-4.
On line 1(e) enter the sum of (i) 5/6 of the IRC section 168(k) bonus depreciation amount deducted in determining federal taxable income for the taxable year, and (ii) 5/6 of the "qualifying section 179 depreciation expense" deducted in determining federal taxable income for the taxable year as shown on line 1 of schedule B-4 – Bonus Depreciation and Section 179 Adjustment. "Qualifying section 179 depreciation expense" means the difference between (i) the amount of depreciation expense directly or indirectly allowed to the taxpayer under section 179 of the Internal Revenue Code, and (ii) the amount of depreciation expense directly or indirectly allowed to the taxpayer under section 179 of the Internal Revenue Code as that section existed on December 31, 2002 (see O.R.C. section 5733.04(I)(17)(a)(ii) as enacted by Amended Substitute House Bill 95, 125th General Assembly).

On line 2(i) enter the amount shown on line 10 of schedule B-4 – Bonus Depreciation and Section 179 Adjustment.

Note 1: The **schedule B** depreciation expense adjustment applies whether or not the depreciation expense relates to allocable income or to apportionable income. To the extent that the bonus depreciation adjustment or qualifying section 179 adjustment relates to income allocated in schedule C, the taxpayer must also make the same adjustments in schedule C as are made in schedule B. See schedule B-4 – Bonus Depreciation and section 179 Adjustment.

Note 2: The depreciation add-back and deductions have **no effect on the basis** of the assets depreciated. Thus, upon the sale of an asset on which the taxpayer claimed bonus depreciation or additional 179 expense, the gain or loss for Ohio purposes will equal the gain or loss for federal purposes whether or not at the time of sale the 5/6 amount has been fully recovered. In addition, if at the time of sale the taxpayer has not fully recovered the 5/6 add-back, the taxpayer can continue to make the depreciation deduction after the sale.

Note 3: The depreciation adjustment applies not only to assets that the taxpayer owns but also to depreciable assets owned by the taxpayer's disregarded entities and to depreciable assets owned by pass-through entities in which the taxpayer holds an at least 5 percent ownership interest.

Note 4: If the taxpayer is an equity investor in a pass-through entity which has claimed IRC section 168(k) bonus depreciation or qualifying IRC section 179 expense and if, because of the federal passive activity loss limitation rules or the at-risk limitation rules, the taxpayer is unable to fully deduct a loss passing through from the pass-through entity, then to the extent that the taxpayer does not recognize the loss the taxpayer can defer making the “5/6 add-back” until the taxable year or years for which the taxpayer deducts the pass-through entity loss and receives a federal tax benefit from the bonus depreciation or qualifying 179 amount claimed by the pass-through entity. Of course, the corporation cannot begin claiming the related deductions until the first taxable year immediately following the taxable year for which the corporation makes the 5/6 add-back.

For further information please see the following: (i) the Department of Taxation’s July, 2002 information release entitled “Recently Enacted Ohio Legislation Affects Depreciation Deductions for Taxable Years Ending in 2001 and Thereafter”; (ii) the Department’s November 2002 information release entitled “Ohio Bonus Depreciation Adjustment and the Internal Revenue Code’s Passive Activity Loss, Basis Limitation and At-Risk Rules”; (iii) O.R.C. section 5733.04(I)(17) & (18); (iv) section 4 of Amended Substitute Senate Bill 261, 124th, General Assembly; and (v) page 4 of these instructions.

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 I.R.C. section 243 dividends received deduction: (a) dividends received from an insurance company if the taxpayer owns at least 80 percent of the outstanding common stock of the insurance company and (b) dividends received from a public utility, except an electric company, if the taxpayer owns at least 80 percent of the outstanding common stock of the public utility. See O.R.C. 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 O.R.C. 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 O.R.C. 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 information release is available on the department’s web site. 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 O.R.C. 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 B-2
FOREIGN SOURCE INCOME DEDUCTION
O.R.C. 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 – I.R.C. Section 78 and 951 Income.
Enter the I.R.C. section 78 foreign dividend gross-up and I.R.C. section 951 subpart F income. This income is fully deductible.

Line 2 – Foreign dividends.
Enter 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. This income is fully deductible. See *Emerson Elec. Co. v. Tracy* (2000), 90 Ohio St.3d 157 and O.R.C. section 5733.04(I)(2) as amended by Amended Substitute Senate Bill 261, 124th General Assembly.

Line 3 – Foreign royalties.
Multiply by 90 percent the royalties received from sources outside the United States. Royalties are received from sources outside the United States to the extent that the property that 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.

The instructions for schedule B-3 – RELATED ENTITY AND RELATED MEMBER ADJUSTMENTS begin on page 48.

The instructions for schedule B-4 – BONUS DEPRECIATION AND SECTION 179 ADJUSTMENT are included on that schedule.

SCHEDULE C
ALLOCABLE INCOME
O.R.C. SECTION 5733.051

New law: The amendments to the allocation provisions enacted by Amended Substitute House Bill 95, 125th General Assembly, explained below apply to taxable years ending after June 25, 2003; they do not apply to taxable years ending before the June 26, 2003 effective date of the amendments. So, if the taxpayer's taxable year ended before June 26, 2003, income from the following sources is allocable in the same manner as it was in prior years without regard to whether that income was earned in the regular course of business: (i) net rents from real property and tangible personal property; (ii) net royalties from real property and tangible personal property; (iii) capital gains and losses and depreciation recapture from the sale or other disposition of real property and tangible personal property; (iv) capital gains and losses from the sale or other disposition of dividend producing stock; (v) dividends; (vi) net patent and copyright royalties and technical assistance fees not representing the taxpayer's principal source of gross receipts; and (vii) lottery income.

Effective for taxable years ending on or after June 26, 2003, Amended Substitute House Bill 95 enacted significant franchise tax amendments pertaining to the apportionment and allocation of income to Ohio:

- **The new law distinguishes business income from nonbusiness income and defines those terms.**
  - **"*Business income*** means income arising from transactions, activities, and sources in the regular course of a trade or business and includes income from real property, tangible personal property, and intangible personal property if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation. 'Business income' includes income, including gain or loss, from a partial or complete liquidation of a business, including, but not limited to, gain or loss from the sale or other disposition of goodwill." See O.R.C. section 5733.04(Q) as enacted by Amended Substitute House Bill 95, 125th General Assembly.
  - **"*Nonbusiness income*** means all income other than business income." See O.R.C. section 5733.04(R) as enacted by Amended Substitute House Bill 95, 125th General Assembly.

  The new law requires the apportionment of all business income and the allocation of nonbusiness income. For taxable years ending on or after June 26, 2003, all income, gain, loss, and expense is presumed to be apportionable business income. A taxpayer reporting any allocable income (other than amounts from schedule B-4, lines 12 and 14) must attach to the report (i) a detailed statement setting forth support which rebuts the presumption; (ii) a list of the states for which the taxpayer treats the income as business income; and (iii) the reasons for such treatment in the other state(s).

- **In addition to amending the law regarding whether income is apportionable business income or allocable nonbusiness income, the new law amends how certain income is allocated (if that income is nonbusiness income)**. For taxable years ending on or after June 26, 2003, the allocation provisions for nonbusiness dividends, capital gains and losses from the sale of dividend producing stock, and capital gains and losses from the sale of tangible personal property differ from the allocation provisions for income from the same sources for taxable years ending before June 26, 2003. For example, for taxable years ending on or after June 26, 2003, allocable (nonbusiness) capital gain from the sale of tangible personal property is allocated to Ohio to the extent such property was utilized in Ohio prior to the sale, but for taxable years ending before June 26, 2003, gain from the sale of tangible personal property is allocable to Ohio only if the property had an Ohio situs at the time of sale.

- **Every item of net nonbusiness income from sources other than those specified in O.R.C. section 5733.051 is allocated entirely to Ohio except to the extent the allocation of such item of net nonbusiness income entirely to Ohio is not within the taxing power of this state under the Constitution of the United States. To the extent such allocation entirely to Ohio is not within the taxing power of this state under the Constitution of the United States such nonbusiness income is apportionable.**

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 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 the conduit theory into the franchise tax statute. See O.R.C. section 5733.057.

Note 2: If the taxpayer is an electric company or a combined electric company, as defined in O.R.C. section 5733.04(P), please complete supplemental schedule C for electric companies. An "electric company" is any person engaged in the business of generating, transmitting, or distributing electricity within Ohio for use by others. However, the term "electric company" as used in Chapter 5733 does not include a "rural electric company," as defined in O.R.C. section 5727.01(C).

Schedule C Instructions
For Taxable Years Ending before June 26, 2003

(The schedule C instructions for taxable year ending on or after June 26, 2003 begin on page 31.)

If the taxpayer's taxable year ended before June 26, 2003, income from sources on lines one through seven below is allocable in the same manner as it was in prior years without regard to whether that income was earned in the regular course of business. The basis for this treatment is that for taxable years ending before June 26, 2003, Ohio franchise tax law does not distinguish business income from nonbusiness income. **If the taxpayer's taxable year ended before June 26, 2003, line 8, other nonbusiness income, does not apply.**

Line 1 – Bonus depreciation deduction.
In the Ohio column enter the amount from schedule B-4, line 12. In the everywhere column enter the amount from schedule B-4, line 14. To the extent that the bonus depreciation and qualifying section 179 add-back and deduction adjustments made in schedule B relate to income allocated within or without Ohio, the taxpayer must make the same adjustments in schedule C. See O.R.C. section 5733.04(I)(17)(c) and (I)(18)(b), and schedule B-4, bonus depreciation and section 179 adjustment.

In addition, if on the 2002 and/or 2003 franchise tax report the taxpayer made a 5/6 bonus depreciation add-back and allocated that add-back to Ohio in schedule C (because, for example, the depreciation add-back was attributed to property that generated rental income which the taxpayer allocated to Ohio), then in the five years following the add back years the taxpayer is entitled to allocate to Ohio the bonus depreciation deductions related to the 2002 and 2003 add backs on that same equipment. This is so, even if the taxpayer's taxable year for the 2004 report ended on or after June 26, 2003 and that same rental property generates apportionable business income on the 2004 report.

Similarly, if on the 2002 and/or 2003 franchise tax report the taxpayer made a 5/6 bonus depreciation add-back and allocated that add-back outside Ohio in schedule C (because, for example, the depreciation add-back was attributed to property that generated rental income which the taxpayer allocated outside Ohio), then in the five years following the add back years the taxpayer is required to allocate outside Ohio the bonus depreciation deductions related to the 2002 and 2003 add backs on that same equipment. This is so, even if the taxpayer's taxable year for the 2004 report ended on or after June 26, 2003 and that same rental property generates apportionable business income on the 2004 report.

Line 2 – 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 I.R.C. 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 3 – 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 4 – 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. Gains and losses from the sale of aircraft and engines located outside Ohio at the time of sale are allocable outside Ohio pursuant to O.R.C. section 5733.051(D), not apportionable. See *Delta Airlines, Inc. v. Tracy,* BTA No. 96-T-471 & 96-T-472 (1-12-2001.

Capital gains and capital losses from the sale or other disposition of intangible personal property that 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 5 – 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 of the book value of the payor's physical assets in Ohio to the book value of the payor's physical assets 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 6 – 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 that 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 O.R.C. section 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.

Line 7 – State lottery income.
Income described in O.R.C. section 5747.20(B)(5) is allocable to Ohio and similar amounts from other states are allocable outside Ohio (see O.R.C. section 5733.051(H) as enacted by Substitute Senate Bill 226, 124th General Assembly). Income described in O.R.C. section 5747.20(B)(5) includes the following: (i) amounts paid by the Ohio lottery commission to a prize winner and (ii) a *transferee's* "earnings, profit, income and gain from the sale, exchange or other disposition of lottery prize awards" earned as a result of a *transfer* from a transferor/winner the right to receive the future installments of an Ohio lottery prize.

A "'*transfer*' means any form of sale, assignment or redirection of payment of all or any part of a lottery prize award for consideration" (O.R.C. section 3770.10(E)). A transfer agreement between the "transferor" (the prize winner) and the "transferee" (the purchaser of the winner's right to future lottery payments) must contain a statement signed by the transferee irrevocably agreeing that the transferee corporation is subject to the franchise tax with respect to gain or income that the transferee will recognize as a result of the transfer. So, a transferee having no nexus with Ohio other than as a party to the transfer agreement is subject to the franchise tax on the income that the transferee will recognize as a result of the transfer even if the transferee is exempt from franchise tax under O.R.C. section 5733.09 and even if the transferee is otherwise exempt from the net income base. The Ohio lottery commission is required to withhold 3½ percent from the amounts that it pays to the transferee and such withholding may be claimed as a refundable credit on the transferee's franchise tax report. See O.R.C. sections 3770.072(B), 5747.062(B)(2), and 5733.98(A)(27).

Line 8 – Other nonbusiness income. If the taxpayer's taxable year ended before June 26, 2003, make no entry on this line.

Schedule C Instructions
For Taxable Years Ending on or after June 26, 2003

(The schedule C instructions for taxable year ending before June 26, 2003 begin on page 29.)

For taxable years ending on or after June 26, 2003, Ohio franchise tax law distinguishes business income from nonbusiness income and with the exception of the bonus depreciation deduction (see schedule B-4 and line 1, below) only nonbusiness income is allocated. Furthermore, for taxable years ending on or after June 26, 2003, all income, gain, loss, and expense is presumed to be apportionable business income. A taxpayer reporting any allocable income (other than amounts from schedule B-4, lines 12 and 14) must attach to the report (i) a detailed statement setting forth support which rebuts the presumption; (ii) a list of the states for which the taxpayer treats the income as business income; and (iii) the reasons for such treatment in the other state(s).

Line 1 – Bonus depreciation adjustment.
In the Ohio column enter the amount from schedule B-4, line 12. In the everywhere column enter the amount from schedule B-4, line 14.

Note: For taxable years ending on or after June 26, 2003, only nonbusiness income and the expenses attributable to that income are allocable. To the extent that the bonus depreciation and qualifying section 179 add-back and deduction adjustments made in schedule B relate to nonbusiness income allocated within or without Ohio, the taxpayer must make the same adjustments in schedule C. See O.R.C. sections 5733.04(I)(17(c) and (I)(18)(b).

In addition, if on the 2002 and/or 2003 franchise tax report the taxpayer made a 5/6 bonus depreciation add-back and allocated that add-back to Ohio in schedule C (because, for example, the depreciation add-back was attributed to property that generated rental income that the taxpayer allocated to Ohio), then in the five years following the add back years the taxpayer is entitled to allocate to Ohio the bonus depreciation deductions related to the 2002 and 2003 add backs on that same equipment. This is so, even if the taxpayer's taxable year for the 2004 report ended on or after June 26, 2003 and that same rental property generates apportionable business income on the 2004 report.

Similarly, if on the 2002 and/or 2003 franchise tax report the taxpayer made a 5/6 bonus depreciation add-back and allocated that add-back outside Ohio in schedule C (because, for example, the depreciation add-back was attributed to property that generated rental income that the taxpayer allocated outside Ohio), then in the five years following the add back years the taxpayer is required to allocate outside Ohio the bonus depreciation deductions related to the 2002 and 2003 add backs on that same equipment. This is so, even if the taxpayer's taxable year for the 2004 report ended on or after June 26, 2003 and that same rental property generates apportionable business income on the 2004 report.

If the taxpayer's taxable year ended on or after June 26, 2003, allocate within and without Ohio the income from those sources indicated in lines 2 through 8 below, only if the income is nonbusiness income.

Line 2 – Nonbusiness net rents.
Nonbusiness net rents from real property located in Ohio are allocable to Ohio. Nonbusiness net rents from tangible personal property are allocable to Ohio to the extent such property is utilized in Ohio. A lessor's nonbusiness 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 3 – Nonbusiness net royalties.
Nonbusiness net royalties from real property located in Ohio are allocable to Ohio. Nonbusiness net royalties from tangible personal property are allocable to Ohio to the extent such property is utilized in Ohio.

Line 4 – Nonbusiness capital gains and losses and depreciation recapture.
Nonbusiness 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.

Nonbusiness capital gains and losses and 1231 gains and losses from the sale or other disposition of tangible personal property are allocable to Ohio to the extent the property was used in Ohio prior to the 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.

Nonbusiness capital gains and losses from the sale or other disposition of intangible property that may produce dividend income are allocated on the same basis as set forth in the section below dealing with dividends but substituting *the day of the sale or disposition* for *the day on which the payor pays the dividend or makes the distribution.* However, if the location of the physical assets described in the section below addressing dividends is not available to the taxpayer, such gains and losses are apportionable. Nonbusiness capital gains and capital losses from the sale or other disposition of all other intangible personal property are apportioned.

Line 5 – Nonbusiness dividends (not otherwise deducted and not apportionable).
As used below, the term "payor's year" means the payor's fiscal or calendar year ending immediately before or when the payor pays the dividend or makes the distribution. For taxable years ending on or after June 26, 2003, nonbusiness dividends, other than dividends or distributions from a domestic international sales corporation, are allocated to Ohio by multiplying the dividend by a fraction. The denominator of the fraction is the sum of the amounts determined in #1 and #2 below:

1. The book value of the dividend payor's physical assets everywhere at the end of the payor's year. So, if the payor makes a dividend payment on any date other than its year end, then the payor's physical assets are determined as of the last day of the payor's year that ended before it made payment, and if the payor makes payment on the last day of the payor's year, the payor's physical assets are determined on the payment date (rather than the last day of the payor's year that ended before it made payment).

   a. If on the last day of the payor's year the payor or any member(s) of the qualifying controlled group of which the payor is a member, separately or cumulatively own, directly or indirectly, more than 50 percent of the equity of a pass-through entity, then the payor is deemed to own its proportionate share of the physical assets that the pass-through entity directly or indirectly owns. The book value of the pass-through entity's physical assets is determined on the last day of the pass-through entity's fiscal or calendar year ending with or within the payor's year.

   b. The statute and these instructions refer to a pass-through entity that owns an interest in another pass-through entity as an upper-level pass-through entity, and to the upper-level pass-through entity's investee as the lower level pass-through entity. For purposes of #1 and #1(a.), if an upper-level pass-through entity, a portion of whose physical assets the payor's subsidiary is deemed to own as set out in 1(a.) above, owns an interest in a lower-level pass-through entity on the last day of the upper level pass through entity's fiscal or calendar year ending with or within the payor's year, then the upper-level pass-through entity is deemed to own its proportionate share of the physical assets of the lower level pass-through entity on the last day of the lower level pass-through entity's fiscal or calendar year ending within or with the last day of the upper level pass-through entity's fiscal or calendar year ending with or within the payor's year.

   However, if on each day of the upper-level pass-through entity's fiscal or calendar year in which or with which ends the fiscal or calendar year of the lower-level pass-through entity the upper-level pass-through entity directly and indirectly owns less than 50 percent of the equity of the lower-level pass-through entity and if, based upon clear and convincing evidence, complete information about the location and cost of the physical assets of the lower-level pass-through entity is not available to the upper-level pass-through entity, then for purposes of #1 and #1(a), the upper level pass-through entity is deemed as owning no equity of the lower-level pass-through entity for each day during the upper-level pass-through entity's calendar or fiscal year in which or with which ends the lower level pass-through entity's fiscal or calendar year.

2. The book value of the physical assets of each corporation more than 50 percent of whose capital stock with voting rights the dividend payor directly or indirectly owns on the last day of the payor's year (whether or not those corporations are taxpayers and whether or not those corporations are included in a combined Ohio franchise tax report with the payor). These instructions refer to a corporation more than 50 percent of whose capital stock with voting rights the dividend payor directly or indirectly owns on the last day of the payor's year as the payor's subsidiaries; the statute refers to the payor along with its direct and indirect subsidiaries as a "modified qualifying controlled group." The book value of each such subsidiary's physical assets is determined on the last day of the subsidiary's calendar year or fiscal year ending with or within the payor's year.

   a. For purposes of #2, if on the last day of the payor's year the payor or any member(s) of the qualifying controlled group of which the payor is a member, separately or cumulatively own, directly or indirectly, more than 50 percent of the equity of a pass-through entity, then in determining the book value of physical assets each subsidiary of the payor is deemed to own its proportionate share of the physical assets that the pass-through entity directly or indirectly owns. The book value of the pass-through entity's physical assets is determined on the last day of the pass-through entity's fiscal or calendar year ending with or within the payor's year.

   b. For purposes of #2 and #2(a.), if an upper-level pass-through entity, a portion of whose physical assets the payor's subsidiary is deemed to own as set out in #2(a) above, owns an interest in a lower-level pass-through entity on the last day of the upper level pass through entity's fiscal or calendar year ending with or within the payor's year, then the upper-level pass-through entity is deemed to own its proportionate share of the physical assets of the lower level pass-through entity on the last day of the lower level pass-through entity's fiscal or calendar year ending within or with the last day of the upper level pass-through entity's fiscal or calendar year ending with or within the payor's year.

   However, if on each day of the upper-level pass-through entity's fiscal or calendar year in which or with which ends the fiscal or calendar year of the lower-level pass-through entity the upper-level pass-through entity directly and indirectly owns less than 50 percent of the equity of the lower-level pass-through entity and if, based upon clear and convincing evidence, complete information about the location and cost of the physical assets of the lower-level pass-through entity is not available to the upper-level pass-through entity, then for purposes of #2 and #2(a), the upper level pass-through entity is deemed as owning no equity of the lower-level pass-through entity for each day during the upper-level pass-through entity's calendar or fiscal year in which or with which ends the lower level pass-through entity's fiscal or calendar year.

The numerator of the fraction is the sum of the within Ohio book value amounts determined in the same manner.

Note: If the book values of physical assets necessary to determine the within Ohio to total everywhere fraction are not "available" to the taxpayer, then the nonbusiness dividends and the nonbusiness capital gains and losses from the sale or other disposition of dividend producing property described above are apportionable. The term "available," as used here, means information is such that a person is able to learn of the information by the due date plus extensions, if any, for filing the report for the tax year immediately following the last day of the taxable year.

Line 6 – Nonbusiness net patent and copyright royalties and technical assistance fees.
Nonbusiness net technical assistance fees along with nonbusiness net rents and royalties from intangible property are allocable to Ohio to the extent that the activity of the payor thereof giving rise to the payment takes place in Ohio.

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.

Line 7 – Nonbusiness state lottery income.
The following amounts are allocable to Ohio when that income is nonbusiness income: (i) amounts paid by the Ohio lottery commission to a prize winner, and (ii) a *transferee's* "earnings, profit, income and gain from the sale, exchange or other disposition of lottery prize awards" earned as a result of a *transfer* from a transferor/winner the right to receive the future installments of an Ohio lottery prize.

A "'*transfer*' means any form of sale, assignment, or redirection of payment of all or any part of a lottery prize award for consideration" (O.R.C. section 3770.10(E)). A transfer agreement between the "transferor" (the prize winner) and the "transferee" (the purchaser of the winner's right to future lottery payments) must contain a statement signed by the transferee irrevocably agreeing that the transferee corporation is subject to the franchise tax with respect to gain or income which the transferee will recognize as a result of the transfer. A transferee having no nexus with Ohio other than as a party to the transfer agreement is subject to the franchise tax on the income that the transferee will recognize as a result of the transfer even if the transferee is exempt from franchise tax under O.R.C. section 5733.09 and even if the transferee is otherwise exempt from the net income base. The Ohio lottery commission is required to withhold 3½ percent from the amounts that it pays to the transferee and such withholding may be claimed as a refundable credit on the transferee's franchise tax report. See O.R.C. sections 3770.072(B), 5747.062(B)(2), and 5733.98(A)(27).

Line 8 – Other nonbusiness income. If the taxpayer's taxable year ended on or after June 26, 2003, allocate entirely to Ohio on line 7 all nonbusiness income from sources other than those listed in lines 1 through 6 except to the extent the allocation of any such item of net nonbusiness income entirely to Ohio is not within the taxing power of this state under the Constitution of the United States. To the extent such allocation entirely to Ohio is not within the taxing power of this state under the Constitution of the United States, any such items of nonbusiness income are apportionable.

SCHEDULES D and D-2
APPORTIONMENT RATIO
O.R.C. SECTION 5733.05(B)(2)

Schedules D and D-2 apply as follows:

- **Schedule D** applies in apportioning **net income** regardless of the taxpayer's taxable year end. However, as explained below, the net income base apportionment instructions differ based upon whether the taxpayer's taxable year ended (i) before June 26, 2003; (ii) on or after June 26, 2003 and before December 11, 2003; or (iii) on or after December 11, 2003.
- **Schedule D** applies in apportioning **net worth** if the taxpayer's taxable year ended before June 26, 2003 regardless of whether the taxpayer has income that is not earned in the regular course of business.
- **Schedule D** applies in apportioning **net worth** if the taxpayer's taxable year ended on or after June 26, 2003 and the taxpayer does not have nonbusiness income.
- **Schedule D-2** applies in apportioning **net worth** only if the taxpayer's taxable year ended on or after June 26, 2003 **and the taxpayer has nonbusiness income.**

New law – net income apportionment. For taxable years ending on or after June 26, 2003, Ohio franchise tax law distinguishes business income from nonbusiness income and **the net income base property, payroll and sales factors specifically exclude that portion of property, payroll and sales to the extent that the portion relates to, or is used in connection with, the production of nonbusiness income allocable under O.R.C. section 5733.051.** For example, for taxable years ending on or after June 26, 2003, real property that generates allocable nonbusiness rental income is excluded from the numerator and the denominator of the net income base property factor. See O.R.C. section 5733.05(B)(2) as amended by Amended Substitute House Bill 95, 125th General Assembly. **In apportioning net income for taxable years ending before June 26, 2003, prior law and case law apply.**

New law – net worth base apportionment. For taxable years ending on or after June 26, 2003, the net worth base property, payroll and sales factors specifically include that nonbusiness property, payroll and sales excluded from the net income base factors under the paragraph above. If the taxpayer had nonbusiness income, then in apportioning net worth for taxable years ending on or after June 26, 2003 see the following: schedule D-2, the instructions for schedule D-2 (beginning on page 39 of these instructions), and O.R.C. section 5733.05(C)(2) as amended by Amended Substitute House Bill 95, 125th General Assembly.

In apportioning net worth for taxable years ending before June 26, 2003, and in apportioning net worth for taxable years ending on or after June 26, 2003 if the taxpayer does not have nonbusiness income, use the net income apportionment ratio

without adjustment. 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 O.R.C. section 5733.05(D)(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 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 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 O.R.C. section 5733.057).

Note 2: A taxpayer must 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 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 O.R.C. section 5733.058 as amended by House Bill 770).

Note 3: 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 O.R.C. 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 4: Factors weighted. The apportionment ratio's property, payroll, and sales factors are weighted 20 percent, 20 percent and 60 percent, respectively. The 20 percent, 20 percent, 60 percent weighting does not apply to financial institutions. See O.R.C. section 5733.05(B)(2).

Note 5: 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.

Note 6: If the taxpayer is an electric company or combined electric company, see the "supplemental franchise tax schedules and instructions for electric companies and combined electric companies available on the Department of Taxation's web site. Sales of electricity and sales of electricity transmission and distribution services are sitused in accordance with O.R.C. section 5733.059.

Schedule D Property Factor

The property factor is a fraction the numerator of which is the average value of the corporation's includable real and tangible personal property owned or rented, and used in the trade or business in this state during the taxable year, and the denominator of which is the average value of all the corporation's includable real and tangible personal property owned or rented, and used in the trade or business everywhere during such year.

New law: For taxable years ending on or after June 26, 2003, Ohio franchise tax law distinguishes business income from nonbusiness income. In addition, for taxable years ending on or after June 26, 2003, the property factor specifically **includes** real property and tangible personal property that the corporation rents, subrents, leases or subleases to others if the income or loss from such rentals, subrentals, leases or subleases is business income. Furthermore, for taxable years ending on or after June 26, 2003, Ohio franchise tax law specifically excludes from the factor property relating to, or used in connection with, the production of nonbusiness income allocated under O.R.C. section 5733.051.

Property owned by the corporation is valued at its original cost average value. 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 <u>not</u> include in either column 1 (within Ohio) or in column 2 (total everywhere) the following:

- Construction in progress.
- **For taxable years ending on or <u>after</u> June 26, 2003,** do not include property relating to, or used in connection with, the production of nonbusiness income allocable under O.R.C. section 5733.051. See O.R.C. section 5733.05(B)(2)(a) as amended by Amended Substitute House Bill 95, 125th General Assembly.
- **For taxable years ending before June 26, 2003**, do not include 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. **Caution: For taxable years ending on or after June 26, 2003 the numerator and the denominator of the property factor specifically include real property and tangible personal property that the corporation rents, subrents, leases or subleases to others if the income or loss from such rentals, subrentals, leases or subleases is business income.** See O.R.C. section 5733.05(B)(2)(a) as amended by Amended Substitute House Bill 95, 125th General Assembly. For taxable years ending on or after June 26, 2003, property owned by the corporation and leased to others is excluded from the property factor only if the property generates nonbusiness income.

- 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. See O.R.C. section 5733.05(B).

- **For a taxable year ending before June 26, 2003,** do not include the original cost of property with respect to which the state of Ohio has issued an exemption certificate for an energy conversion facility, solid waste energy conversion facility or thermal efficiency improvement facility. **Caution: This exclusion applies only if the taxpayer's taxable year ended before June 26, 2003. See O.R.C. sections 5709.20 and 5709.25(B) as amended by Amended Substitute House Bill 95, 125th General Assembly.**

- The original cost of real property and tangible property (or in the case of property that the corporation is renting from others, eight times its net annual rental rate) within Ohio that 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 #25.

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 percent.

Schedule D Payroll Factor

The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the taxable year by the taxpayer for compensation, and the denominator of which is the total compensation paid both within and without this state during the taxable year. As used below, the term "compensation" means any form of remuneration paid to an employee for personal services. Do <u>not</u> include 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.

- For taxable years ending before June 26, 2003, compensation paid in Ohio to employees at a certified coal gasification or coal conversion demonstration facility.

- **For taxable years ending on or after June 26, 2003, that portion of compensation paid to employees to the extent that the portion relates to the production of nonbusiness income allocable under section O.R.C section 5733.051 (see O.R.C. section 5733.05(B)(2) as amended by Amended Substitute House Bill 95, 125th General Assembly).**

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 #25).

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 the payroll factor weighting of 20 percent.

Schedule D Sales Factor

Caution: Both Amended Substitute House Bill 95, 125th General Assembly, effective for taxable years ending on or after June

26, 2003, and Substitute House Bill 127, 125th General Assembly, effective for taxable years ending on or after December 11, 2003, enacted amendments to the sales factor. For tax year 2004 those amendments necessitate three separate sales factor instructions corresponding to taxable years ending in 2003 before the effective dates of each bill. Follow the instructions that apply to your taxable year.

Schedule D Sales Factor

For Taxable Years Ending before June 26, 2003

The 2004 franchise tax sales factor instructions for taxable years ending before June 26, 2003 are consistent with the sales factor instructions for earlier tax years and do not reflect the sales factor amendments enacted by either **Amended Substitute House Bill 95, 125th General Assembly or Substitute House Bill 127, 125th General Assembly.**

The sales factor is a fraction, the numerator of which is the taxpayer's includable receipts in Ohio during the taxable year and the denominator of which is the sum of the taxpayer's within Ohio and without Ohio includable receipts during the taxable year.

The sales factor includes gross receipts from sales of tangible personal property and from sales other than sales of tangible personal property. However, for taxable years ending before June 26, 2003, the following are excluded from both the numerator and the denominator of the sales factor:

- Interest (see *Incom International v. Limbach*, BTA No. 84-D-1149 (1-11-88);
- 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 O.R.C. 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: (a) an at-least 80 percent owned public utility other than an electric company, (b) an at-least 80 percent owned insurance company, or (c) an at-least 25 percent owned financial institution. See O.R.C. section 5733.05(B)(2)(c).

Line 3, column 1 – Sales within Ohio.
Enter the total of gross receipts from sales, not otherwise excludable from the numerator and the denominator of the sales factor, to the extent the includable gross receipts reflect business done in Ohio. Sales within Ohio include the following:

- **Receipts from 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.

- **Receipts from sales of real property inventory in Ohio.**
- **Receipts from sales, other than sales of tangible personal property and real property inventory 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 (for example, time expended in negotiating the contract) is excluded from the computation.

  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 includable 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 percent.

Schedule D Sales Factor
For Taxable Years Ending on or after June 26, 2003 and before December 11, 2003.

The 2004 franchise tax sales factor instructions for taxable years ending on or after June 26, 2003 and before December

11, 2003 reflect the sales factor amendments enacted by Amended Substitute House Bill 95, 125th General Assembly but do not reflect the sales factor amendments enacted by Substitute House Bill 127, 125th General Assembly.

The sales factor is a fraction whose numerator is the taxpayer's includable business income receipts in Ohio during the taxable year and whose denominator is the sum of the taxpayer's within Ohio and without Ohio includable business income receipts during the taxable year.

For taxable years ending on or after June 26, 2003 but before December 11, 2003, the sales factor generally includes receipts attributable to business income. However, the following receipts are not includable in either the numerator or the denominator of the sales factor (see O.R.C. section 5733.05(B)(2)(c) as amended by Amended Substitute House Bill 95, 125th General Assembly):

- Receipts from sales or other disposals of capital assets or assets described in section 1231 of the Internal Revenue Code. See O.R.C. section 5733.05(B)(2)(c);
- Receipts from sales to: (a) an at-least 80 percent owned public utility other than an electric company, (b) an at-least 80 percent owned insurance company, or (c) an at-least 25 percent owned financial institution. See O.R.C. section 5733.05(B)(2)(c);
- Interest and dividends. See *Incom International v. Limbach*, BTA No. 84-D-1149 (1-11-88).;
- Receipts from sales attributable to nonbusiness income allocable under section O.R.C section 5733.051. See O.R.C. section 5733.05(B)(2) as amended by Amended Substitute House Bill 95, 125th General Assembly.

Note: For taxable years ending on or after June 26, 2003, all income, gain, loss and expense is presumed to be apportionable business income – even if the related receipts are excluded from the sales factor. A taxpayer reporting any allocable income (other than amounts from schedule B-4, lines 12 and 14) must attach to the report (i) a detailed statement setting forth support that rebuts the presumption; (ii) a list of the states for which the taxpayer treats the income as business income; and (iii) the reasons for such treatment in the other state(s).

Line 3, column 1 – Sales within Ohio.
Enter the total of gross receipts from sales not excludable from the numerator and the denominator of the sales factor, to the extent the includable gross receipts reflect business done in Ohio. Sales within Ohio include the following:

- **Receipts from 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.
- **Receipts from sales of real property inventory in Ohio.**
- **Rents and royalties from the tangible personal property to the extent the property was used in Ohio.**
- **Rents and royalties from real property located in Ohio.**
- **Receipts from sales, other than those listed above 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 that 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 (for example, time expended in negotiating the contract) is excluded from the computation.

  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 includable 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 percent.

Schedule D Sales Factor
For Taxable Years Ending on or after December 11, 2003

The 2004 franchise tax sales factor instructions for taxable years ending on or after December 11, 2003 reflect the sales factor amendments enacted by both Amended Substitute House Bill 95, 125th General Assembly and Substitute House Bill 127, 125th General Assembly.

The sales factor is a fraction whose numerator is the taxpayer's includable business income receipts in Ohio during the taxable year and whose denominator is the sum of the taxpayer's within Ohio and without Ohio includable business income receipts during the taxable year. **The sales factor specifically excludes receipts from sales attributable to nonbusiness income allocable under section O.R.C section 5733.051** (see O.R.C. section 5733.05(B)(2) as amended by Amended Substitute House Bill 95, 125th General Assembly).

For taxable years ending on or after June 26, 2003, the sales factor generally includes receipts attributable to business income. However, for taxable years ending on or after December 11, 2003, the following receipts are <u>not</u> includable in either the numerator or the denominator of the sales factor even if the receipts arise from transactions, activities and sources in the regular course of a trade or business (see O.R.C. section 5733.05(B)(2)(c) as amended by Substitute House Bill 127, 125th General Assembly):

- Interest or similar amounts received for the use of, or for the forbearance of the use of, money;
- Dividends;
- Receipts along with any related gains or losses from the sale or other disposal of intangible property other than trademarks, trade names, patents, copyrights, and similar intellectual property;
- Receipts along with any related gains and losses from the sale or other disposal of tangible personal property or real property where that property is a capital asset or an asset described in I.R.C. section 1231. For purposes of this provision the determination of whether or not an asset is a capital asset or a 1231 asset is made without regard to the holding period specified in the Internal Revenue Code; and
- Receipts from sales to: (a) an at-least 80 percent owned public utility other than an electric company, (b) an at-least 80 percent owned insurance company, or (c) an at-least 25 percent owned financial institution.

Note: Income from receipts excluded from the sales factor is not presumed to be nonbusiness income. For taxable years ending on or after June 26, 2003, all income, gain, loss and expense is presumed to be apportionable business income – even if the related receipts are excluded from the sales factor. A taxpayer reporting any allocable income (other than amounts from schedule B-4, lines 12 and 14) must attach to the report (i) a detailed statement setting forth support which rebuts the presumption; (ii) a list of the states for which the taxpayer treats the income as business income; and (iii) the reasons for such treatment in the other state(s).

For taxable years ending on or after December 11, 2003, the law specifically **includes** in the sales factor the following amounts when arising from transactions, activities and sources in the regular course of a trade or business: (1) receipts from sales of tangible personal property; (2) receipts from the sale of real property inventory (such as lots developed and sold by a real estate developer); (3) rents and royalties from tangible personal property; (4) rents and royalties from real property; (5) receipts from the sale, exchange, disposition or other grant of the right to use trademarks, trade names, patents, copyrights, and similar intellectual property; and (6) receipt from the sale of services and other receipts not expressly excluded from the factor. These amounts are situsable to Ohio as set out below.

Line 3, column 1 – Sales within Ohio.
Enter the total of gross receipts from sales not excludable from the numerator and the denominator of the sales factor, to the extent the includable gross receipts reflect business done in Ohio. Sales within Ohio include the following:

- **Receipts from 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. See *Custom Deco, Inc. v. Limbach*, BTA Case No. 86-C-1024, June 2, 1989.
- **Receipts from sales of real property inventory in Ohio.**
- **Rents and royalties from tangible personal property to the extent the property was used in Ohio.**
- **Rents and royalties from real property located in Ohio.**
- **Receipts from the sale, exchange, disposition or other grant of the right to use trademarks, trade names, patents, copyrights and similar intellectual property are sitused to Ohio to the extent that the receipts are based on the amount of use of that property in Ohio.** If the receipts are not based on the amount of use of that property, but rather on the <u>right</u> to use the property and the payor has the right to use the property in Ohio, then the receipts from the sale, exchange, disposition or other grant of the right to use such property are sitused to Ohio to the extent the receipts are based on the right to use the property in Ohio.
- **Receipts from the performance of services and receipts from any other sales not excluded from the sales factor** and not otherwise sitused within or without Ohio under the above situsing provisions are situsable to Ohio in the proportion to the purchaser's benefit, with respect to the sale, in Ohio to the purchaser's benefit, with respect to the sale, everywhere. The physical location where the purchaser ultimately uses or receives the benefit of what was purchased is paramount in determining the proportion of the benefit in Ohio to the benefit everywhere. **For taxable years ending on or after December 11, 2003, the "cost of performance" provision is no longer the law.**

Line 3, column 2 – Sales everywhere.
Enter the total of such includable 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 percent.

SCHEDULE D-2
NET WORTH BASE APPORTIONMENT FORMULA
O.R.C. SECTION 5733.05(C)(2)

This schedule applies only if the taxpayer's taxable year ended on or after June 26, 2003 and the taxpayer had nonbusiness income.

New law – Net worth base apportionment. For taxable years ending on or after June 26, 2003 for purposes of net worth apportionment, the numerator and the denominator of the net income base property, payroll, and sales factors must be adjusted to include the portion of any real property and tangible personal property, payroll, and sales, respectively, relating to, or used in connection with, the production of nonbusiness income allocated under O.R.C. section 5733.051. That is, for purposes of net worth apportionment the net income base factors must be adjusted to include that property, payroll and sales relating to nonbusiness income which property, payroll and sales have been excluded from the net income basis factors. See O.R.C. section 5733.05(C)(2) as amended by Amended Substitute House Bill 95, 125th General Assembly. For example, real property that generates nonbusiness rental income allocated to Ohio is excluded from the numerator and the denominator of the schedule D net income base property factor, but for net worth base apportionment the property factor must be adjusted to include such property.

Note: Complete the form FT 1120 schedule D-2 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 O.R.C. section 5733.05(D)(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.

On schedule D-2, lines 1(a), 1(c), 2(a), and 3(a) enter the property, payroll and sales amounts from schedule D, lines 1(a), 1(b), 2, and 3, respectively. On schedule D-2 lines 1(b), 1(d), 2(b) and 3(b), add the portion of property, payroll and sales, respectively, that the taxpayer excluded from the net income base apportionment factors because it was related to the production of nonbusiness income allocated in Schedule C.

For taxable years ending on or after June 26, 2003, enter on line 1(e) the sum of lines 1(a) through 1(d), on line 2(c) the sum of lines 2(a) and 2(b), and on line 3(c) the sum lines 3(a) and 3(b).

SCHEDULE E
BALANCE SHEET

Attach to the franchise tax report a balance sheet that reflects the books of the taxpayer on a separate company basis as of the beginning and the end of the taxpayer's taxable year.

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 (O.R.C. 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
O.R.C. 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 O.R.C. section 5733.05. For example, assume that an Ohio franchise taxpayer has a taxable year beginning July 1, 2002 and ending June 30, 2003. For tax year 2004 the taxpayer's franchise tax net value of stock for purposes of the net worth base is determined as of July 1, 2003 which is the beginning of the taxpayer's annual accounting period that includes the first day of January of the 2004 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, 2003) 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, 2003).

For taxpayers other than financial institutions the net worth base equals assets minus liabilities adjusted by the "qualifying amount" less exempted assets (discussed below). "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.

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 O.R.C. section 5733.04(L), and 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 #21, O.R.C. 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.

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

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 O.R.C. section 5733.05(C)(2).

The term **"qualifying controlled group"** means two or more corporations that meet the O.R.C. 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 O.R.C. section 5733.04(M).

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

Line 4 – Exempted assets.
New law: If the taxpayer's taxable year ended on or after June 26, 2003, the net worth exempted assets deduction no longer applies to those items listed in a. and b. below. See O.R.C. section 5709.25(B)(3) and 5709.20, as amended by Amended Substitute House Bill 95, 125th General Assembly.

a. If the taxpayer's taxable year ended before June 26, 2003, enter the net book value of air, noise and water pollution control facilities for which the state of Ohio has issued a certificate. **If the taxpayer's taxable year ended on or after June 26, 2003 make no entry on line a. See "caution" above.** Nevertheless, such property continues to be excluded from the property factor.

b. If the taxpayer's taxable year ended before June 26, 2003, 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. **If the taxpayer's taxable year ended on or after June 26, 2003 make no entry on line b. See "caution" above.**

c. Enter the net book value of civil defense shelters within Ohio for which the State of Ohio has issued a civil defense certificate. See O.R.C. section 5502.49.

d. 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."

Line 6 – Ohio apportionment ratio.
If the taxpayer's taxable year ended before June 26, 2003, or if the taxpayer's taxable year ended on or after June 26, 2003 and the taxpayer did not have nonbusiness income, enter the taxpayer's Ohio apportionment ratio determined on a separate company basis from schedule D, line 4.

If the taxpayer's taxable year ended on or after June 26, 2003 and the taxpayer had nonbusiness income, enter the taxpayer's Ohio apportionment ratio determined on a separate company basis from schedule D-2, line 4.

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 O.R.C. section 5733.05(D)(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."

SCHEDULE G
TAX COMPUTATION

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

Tier Two Litter Tax (O.R.C. 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 percent 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 $10 million.

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 percent of its total sales in Ohio during the taxable year.

c. If a corporation sells food or beverages that 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 that 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 percent of the corporation's total sales during the taxable year.

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

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 that 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.

SCHEDULE A-1
NONREFUNDABLE CREDITS

O.R.C. section 5733.98 sets out the order in which franchise tax nonrefundable credits and unused credit carryforward amounts must be used. The table on page 54 lists the nonrefundable credits in the order in which you must claim them (as prescribed in O.R.C. section 5733.98) 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 and 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. 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 after any lower numbered credit listed in O.R.C. section 5733.98 but prior to the same credit generated in the later year and prior to any higher numbered credit on the list.

A nonrefundable credit may be used to reduce the tax liability (before considering any payments) to the minimum fee but a nonrefundable credit may not reduce the tax liability (before considering any payments) below the minimum fee.

Note 1: The new jobs credit and the credit for tax withheld by the Ohio Lottery Commission are not included below because these credits are refundable credits which are considered payments of the tax. See line instructions for schedule A, line 23.

Note 2: The credit for employers that enter into agreements with child day-care centers (O.R.C. section 5733.36) and the credit for employers that reimburse employee child day-care expenses (O.R.C. section 5733.38) do not appear on the 2004 franchise tax report because these credits expired in 2003 and have no unused credit carryforward provision.

Note 3: The credit for the cost of equipping multi-wheel agricultural tractors with lights and reflectors (O.R.C. section 5733.44) does not appear on the 2004 franchise tax report because the expenditure period applicable for the credit expired on October 4, 2001 and the credit has no unused credit carryforward provision.

Note 4: Unless otherwise stated 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 O.R.C. section 5733.057.

Note 5: Amended Substitute House Bill 180, 124th Ohio General Assembly recently enacted the **Ohio Venture Capital (OVC) Program** the purpose of which is to increase the amount of private investment capital available to both (i) Ohio-based business enterprises in the seed or early stages of business development that require initial or early stage funding and (ii) established Ohio-based business enterprises that require funding for developing new methods or technologies. In addition, the General Assembly enacted a new franchise tax and individual income tax credit – the **Credit for Losses on Loans Made to the Ohio Venture Capital Program**. The purpose of the credit is to provide OVC lenders and investors some security against losses on their loans to the OVC program. Although the OVC Authority may authorize tax credits any time after the authority establishes its investment policy, the law specifically provides that taxpayers may not claim the credits during the first four years of the Ohio Venture Capital program (measured from the date the authority establishes its investment policy). So, this new credit does not appear on the 2004 Ohio franchise tax report or the 2003 individual income tax return. See O.R.C. sections 150.01 to 150.10, 5733.49, 5733.98, 5747.80, and 5747.98 as enacted by Amended Substitute Senate Bill 180, effective April 9, 2003.

1. **Credit for Taxes Paid by a Qualifying Pass-Through Entity** (O.R.C. 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 that 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. **Caution: Do not claim this credit as a refundable credit or as a payment. This credit must be claimed as a nonrefundable credit on schedule A, line 19**.

2. **Credit for Qualifying Affiliated Groups** (O.R.C. 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** (O.R.C. 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 O.R.C. 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 half of the amount of the cash donation or 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 G.

4. **Credit for Maintaining Railroad Crossing Warning Devices** (O.R.C. 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 percent 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 $200 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.

5. **Job Retention Credit –** (O.R.C. 5733.0610(B) and 122.171) The purpose of this new temporary nonrefundable credit is to encourage large Ohio manufacturers to retain jobs in Ohio. The credit applies to (1) taxpayer-manufacturers that make a capital investment of at least $200 million at a single Ohio project site during three consecutive calendar years in the period January 1, 2002 and ending December 31, 2006 and to (2) taxpayers that make a capital investment of at least $100 million at a single Ohio project site during three consecutive calendar years in the period January 1, 2002 and ending December 31, 2006 provided that the average wage of all full-time employment positions at the project site is greater than 400 percent of the federal minimum wage.

   Credit applicants must apply to the Ohio Tax Credit Authority for approval of the capital investment project. As a prerequisite, the taxpayer must employ an average of 1,000 full-time employees at the project site during each of the twelve months preceding application. In addition, the taxpayer must retain at least 1,000 full-time employees at the project site for the entire term of the credit agreement. The amount of the credit equals a percentage of the Ohio income tax withheld from the taxpayer's employees at the project site as set forth in the agreement between the taxpayer and the Ohio Tax Credit Authority. However, the credit percentage may not exceed 75 percent. The credit began in tax year 2003 and is limited to a term of fifteenth years. The Ohio Tax Credit Authority and the Ohio Department of Development administer this credit. For additional information please contact the Ohio Department of Development's Office of Tax Incentives at (614) 466-4551.

   This credit was amended by Amended Substitute House Bill 405, 124th General Assembly, effective December 13, 2001 and by Amended Substitute House Bill 95, 125th General Assembly. See "legislation" on page 1 for a summary of recent amendments to this credit.

6. **Second Credit for Purchases of New Manufacturing Machinery and Equipment (7.5 percent – 13.5 percent Credit)** – **New law:** Substitute House Bill 127, 125th General Assembly recently extended the qualifying purchase period for this credit an additional 10 years (that is, through December 31, 2015). Were it not for this amendment, the credit could not be claimed for equipment purchased after December 31, 2005.

   (O.R.C. section 5733.33) – **Manufacturers** may claim a credit for "new manufacturing machinery and equipment" purchased during the period July 1, 1995 to December 31, 2015 provided that the manufacturer installs the equipment in Ohio by the required date, explained below. The credit also applies to taxpayers that have an interest in pass-through entities (limited liability companies and partnerships) that during the same period purchase new manufacturing machinery and equipment provided that the pass-through entity is a manufacturer and the pass-through entity installs the machinery and equipment in Ohio by the required installation date.

   Required installation date: New manufacturing machinery and equipment purchased during the qualifying purchase period must be installed in Ohio no later than December 31, 2016.

   "New manufacturing machinery and equipment means manufacturing machinery and equipment, the original use in this state of which commences with the taxpayer or with a partnership of which the taxpayer is a partner. . ." (see O.R.C. section 5733.33(A)(2)). Thus, for purposes of this credit, **used equipment is "new" if the taxpayer or pass-through entity is the first to use the equipment in Ohio**. Furthermore, although the taxpayer must purchase the equipment during the qualifying purchase period and the equipment's original use in Ohio must begin with the taxpayer, the original use in Ohio is not limited to the qualifying purchase period. Accordingly, manufacturing machinery and equipment that the taxpayer purchased during the qualifying purchase period upon exercising an option in a lease agreement is new manufacturing machinery and equipment for purposes of the credit even though the original use of the equipment in Ohio began with the taxpayer-manufacturer prior to the qualifying purchase period as a lessee under an operating lease. See *Duramed Pharmaceuticals, Inc. v. Zaino*, BTA No. 2002-V-164 (3-7-03), discussed below.

   In *Duramed* the Department of Taxation argued that Duramed, a pharmaceuticals manufacturer, was not entitled to the credit on manufacturing equipment that Duramed began using as a lessee under an operating lease in 1994 (prior to the qualifying purchase period) and upon exercising an option in the lease agreement in 1997 (during the qualifying purchase period) Duramed purchased from the lessor, Ortho-McNeil Pharmaceutical Corporation. According to the Department, Duramed was not entitled to the credit on such equipment because the equipment, when purchased in 1997, was not "new manufacturing machinery and equipment," as defined in O.R.C. section 5733.33(A)(2).

   Finding no evidence to suggest that the lease was in substance a purchase in 1994 and noting that "the evidence also establishes that **the original use of the machinery and equipment in Ohio was by Duramed in 1994,**" the board agreed with Duramed and held that Duramed was entitled to the credit on the equipment purchased from the lessor, Ortho-McNeil, in 1997 because Duramed purchased "new manufacturing machinery and equipment" during the qualifying purchase period. According to the Board, "the definition of 'new machinery' under R.C. 5733.33(A)(2) is unambiguous and requires only that the original use in Ohio is by Duramed, and such original use is not restricted or limited to the qualifying period."

   The *Duramed* decision lends support to the following position: **The credit does not apply to a lessor that purchases new manufacturing machinery and equipment and leases that equipment to a manufacturer** (other than a manufacturer that is a member of the lessor's qualifying controlled group – see the consolidated credit provision in O.R.C. section 5733.33(I)). Reason: *The original use in this* *state* can begin with only one person. Because the Board of Tax Appeals held that the original use in Ohio of equipment that Ortho-McNeil purchased and leased to Duramed began with Duramed, the original use of the equipment in Ohio could not have begun with Ortho-McNeil, the original purchaser and lessor, and thus the equipment was not "new" as to Ortho-McNeil. Accordingly, a lessor that purchases manufacturing machinery and equipment and leases that equipment to a manufacturer, other than to a member of the lessor's qualifying controlled group, is not entitled to the credit because, as to the lessor, the manufacturing machinery and equipment is not "new manufacturing machinery and equipment" as defined in O.R.C. section 5733.33(A)(2).

Conversely, if the lessor, Ortho-McNeil, had been the original user of the equipment in Ohio, then Duramed would have been a subsequent user. And, as a subsequent user, Duramed would not have been entitled to the credit because Duramed would not have purchased "new" equipment. In any event, Ortho-McNeil's entitlement to the credit was not an issue in *Duramed,* and under the facts of the case Ortho-McNeil was not entitled to the credit because Ortho-McNeil purchased the equipment in 1994, prior to the beginning of the qualifying purchase period.

Correction to information release. The Department of Taxation recently issued a correction to its September 22, 1995 Information Release regarding the "Second Credit for Purchases of New Manufacturing Machinery and Equipment." Specifically, the department removed from page 3 under "Purchase" the following language indicated with strikeover: If for federal income tax purposes ~~or if under generally accepted accounting principles~~ a "lease" of qualifying equipment is considered a purchase of the equipment, the lease is also considered a purchase for purposes of the credit.

Date of purchase. 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 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.

Credit is separately determined for each county and each purchase period. 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 11 separate qualifying purchase periods that comprise the period July 1, 1995 to December 31, 2005. The 11 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 made during the calendar year even if the taxpayer (or pass-through entity in which the taxpayer has an interest) has a fiscal year end.

Credit rate and computation: For those Ohio counties not designated as "eligible areas" the credit equals 7.5 percent 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 percent 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 percent 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 percent 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.

Eligible areas: 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" that is available on their web site: http://www.odod.state.oh.us (click on: 1) "For Business"; 2) "Business Incentives"; 3) "Tax Credits"; and (4) "Priority Investment Area" under Ohio manufacturing machinery and equipment investment tax credit.

Base investment. 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

New law: Substitute House Bill 127, 125th General Assembly recently extended the qualifying purchase period for this credit an additional 10 years (that is, through December 31, 2015). The base years for each of the new purchase years roll-forward consistent with the table above. For example, for 2006 calendar year purchases the base years are 2000, 2001 and 2002.

Credit for equipment purchased by a pass-through entity that is a manufacturer. 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, each taxpayer having an interest in a pass-through entity during a qualifying period in which the pass-through entity purchased qualifying equipment must claim the taxpayer's 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 the 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. Each taxpayer then computes 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 percent direct or indirect stock ownership – see O.R.C. sections 5733.04(M) and 5733.052(A)) 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 does not eliminate the requirement to determine the credit on a county-by-county basis.)** 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 O.R.C. section 5733.33(I) as amended by Amended Substitute House Bill 640, 123rd General Assembly.

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 1/7 credit amounts (the 1/7 credit amounts that must be claimed in future years) at the time the group makes the election. Rather, the group can allocate the unused 1/7 credit amounts in the tax years the group must utilize the credit.

The Department of Taxation maintains that for purposes of the consolidated credit calculation the members of a qualifying controlled group of corporations are determined as of January 1 of the tax year immediately following the calendar year in which the taxpayers purchased the equipment for which they claim the credit. That is, **for equipment purchased after December 31, 2000 the members of the qualifying controlled group as of January 1 of the tax year immediately following the purchase year must compute the credit on a consolidated basis regardless of whether those same corporations were members of the qualifying controlled group during the baseline years, during the purchase year, or during the remaining tax years over which the taxpayers will claim the credit.**

Claiming the 1/7 credit amounts. A taxpayer must claim 1/7 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 could not begin to claim the 1/7 credit amounts until tax year 1997. Each 1/7 credit amount that is not used in the year in which it otherwise could have been claimed may be carried forward for three years. The unused carryforward amount is used before the 1/7 amount for the subsequent year. See the table on page 55, which for each purchase year shows the base years and tax years in which the 1/7 credit amounts are claimed.

Credit on equipment that is sold or moved from the county. If the taxpayer either sells equipment 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 1/7 credit amounts on the equipment sold or moved. If the taxpayer either sells equipment 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 1/7 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. See O.R.C. section 5733.33(C)(5)(b).

Spreadsheet to calculate credit. The Department of Taxation has prepared a computerized spreadsheet to calculate the credit. The spreadsheet is available only through the Internet. To access the spreadsheet and download the file to your computer, visit the department's web site at:

http://www.tax.ohio.gov

Then click on: "forms" and "corporation franchise tax forms." Under "filing year 2004 forms" click on "worksheet for 7.5 percent and 13.5 percent Manufacturer's Credit under O.R.C. sections 5733.33 and 5747.31."

Notice of Intent. 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, Economic Development Division, Office of Tax Incentives, P.O. Box 1001, Columbus, Ohio 43216-1001 or call 614-466-4551 or 1-800-848-1300. The street address for the Ohio Department of Development is 77 S. High Street, 28th floor, Columbus, Ohio 43215. The "Notice of Intent" form is also available on the Ohio Department of Development's web site at:

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

Click on : (1) "For Business", (2) "Business Incentives", (3) "Tax Credits", (4) "Ohio Manufacturers Manufacturing Machinery and Equipment Investment Tax Credit," and (5) "Notice of Intent" for the applicable year.

Additional information. For additional information please see O.R.C. section 5733.33 and the Ohio Department of Taxation's September 22, 1995, May 6, 1996, May 7, 1996 and June 18, 1996 Information Releases available on the department's web site.

7. **Job Training Credit** (O.R.C. section 5733.42). This temporary credit applies to franchise taxpayers that incurred "**eligible training costs"** and received a tax credit certificate from the Director of Job and Family Services with respect to an "**eligible training program**" for "**eligible employees**." The director will review job training credit applications and authorize credits to qualified applicants in the order in which the applicants submit complete and accurate applications. The director may not issue tax credit certificates in excess of $20 million per calendar year.

   Note: The Ohio Department of Job and Family Services will accept only on-line credit applications (submitted via the Ohio Training Tax Credit program on-line system). The Director of Job and Family Services anticipates strong competition for the $20 million in tax credits for 2004 and recommends that taxpayers interested in applying for the credit log on and accurately submit sections I and II as soon as possible after 8:00AM EST on Friday, January 2, 2004 to the following address:

   http://www.odjfs.state.oh.us/ottc/Applicant/OAIT.asp.

   The credit also applies to individuals and to investors in pass-through entities that incur eligible training costs and received a tax credit certificate from the Director of Job and Family Services with respect to an "eligible training program." Each investor in a pass-through entity on December 31 prior to the investor's tax year may claim a proportionate share of the pass-through entity's credit.

   For tax year 2004 the amount of the credit equals half of the average of the eligible training costs paid or incurred by the taxpayer during calendar years 1999, 2000 and 2001. For tax year 2005 the amount of the credit equals half of the average of the eligible training costs paid or incurred by the taxpayer during calendar years 2002, 2003 and 2004. For tax year 2006 the amount of the credit equals half of the average of the eligible training costs paid or incurred by the taxpayer during calendar years 2003, 2004 and 2005. (The credit is based upon costs incurred during a calendar year regardless of whether the taxpayer has a fiscal year end.) The credit claimed by a taxpayer each tax year may not exceed $100,000 and for each tax year is not to exceed $1,000 for each eligible employee on account of whom eligible training costs were paid or incurred by the taxpayer during the calendar years applicable to that 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 or to provide job skills to eligible employees that enable them to perform other job duties for the taxpayer. Eligible training programs do not include executive, management or personal enrichment training programs or training programs intended exclusively for personal career development.

   "Eligible training costs" are the sum of the following amounts: (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 full-time by the taxpayer in Ohio and have been so employed by the taxpayer for at least 180 consecutive days before the day an application for the credit is filed. "Eligible employees" do not include executive or managerial personnel except for the immediate supervisors of nonexecutive, nonmanagerial personnel, employees for whom the taxpayer claims the enterprise zone training credit pursuant to O.R.C. section 5709.65(A) or employees that are not full-time employees. See credit #16 for a summary of the enterprise zone training credit.

   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 each tax year 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.

   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 conditions are satisfied:

   i. The proposed training program is an "eligible training program," as defined above;

   ii. The proposed training program is economically sound and will benefit the people of Ohio by improving work force skills and strengthening the economy of Ohio;

   iii. Receiving the credit is a major factor in the taxpayer's decision to implement the program;

   iv. Authorization of the credit is consistent with the following:

      - The aggregate amount of credits authorized may not exceed $20 million per calendar year;
      - No more than $10 million in credits per calendar year may be authorized for corporations engaged primarily in manufacturing;
      - No less than $5 million per calendar year will be set aside for corporations engaged primarily in activities other than manufacturing and having fewer than five hundred employees.

   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 will reduce the credit accordingly. The taxpayer can appeal the reduction or denial of the credit to the Director of the Department of Job and Family Services and can appeal the director's determination to the Board of Tax Appeals.

   Taxpayers must use the credit in the order established in O.R.C. section 5733.98 and may carry forward unused credit amounts for three tax years following the tax year for which the credit is computed.

   The Job Training Credit did not appear on the 2003 franchise tax report because this temporary credit did not apply to tax year 2003. As a result of Amended Substitute House Bill 94, 124th General Assembly (the Budget Bill enacted in June 2001), the credit now applies to tax years 2001, 2004, 2005 and 2006. The Legislature significantly amended the credit in Amended Substitute Senate Bill 287, 123rd General Assembly.

8. **Credit for Qualified Research Expense** (O.R.C. section 5733.351) - For tax years 2004 and thereafter the credit equals 7 percent 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 expense" has the same meaning as in I.R.C. section 41.

   Note: The Credit for Qualified Research Expense did not appear on the 2003 franchise tax report because Amended Substitute House Bill 94, 124th General Assembly (Budget Bill 2001 - 2002) delayed application of this new credit. Under previous law (enacted by Amended Substitute House Bill 283, 123rd General Assembly) the credit was to first apply to tax year 2002 for qualified research expense incurred after December 31, 2001 (see section 180 of Amended Substitute House Bill 283). Under new law the credit generally first applies to tax year 2004. Nevertheless, if the taxpayer's taxable year for tax year 2002 ended before July 1, 2001, then the taxpayer can claim the credit on the 2002 report or amended report. If the credit applies to the taxpayer's 2002 report, the credit for tax year 2002 equals 7 percent of the excess of qualified research expenses incurred in Ohio by the taxpayer between January 1, 2001, and the end of the taxable year, over the taxpayer's average annual qualified research expenses incurred in Ohio for the three preceding taxable years.

9. **Credit for Eligible New Employees in an Enterprise Zone** (O.R.C. 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 12 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 O.R.C. section 122.17 new jobs credit with respect to that employee.

   Credit application forms are available from the Ohio Department of Development, Economic Development Division, Office of Tax Incentives, P.O. Box 1001, Columbus, Ohio 43216-1001 or call 614-466-4551 or 1-800-848-1300. The street address for the Ohio Department of Development is 77 S. High Street, 28th floor, Columbus, Ohio 43215.

10. **Credit for Eligible Costs Associated with a Voluntary Action (Brownfield Site Clean-Up)** (O.R.C. section 5733.34) – A taxpayer who participated in the Ohio Environmental Protection Agency's (OEPA) Voluntary Action Program and who received and maintained a "covenant not to sue" from the OEPA could apply to the Director of Development for this credit, which was intended to encourage the private sector cleanup and reuse of properties contaminated by hazardous substances. Those taxpayers that have been granted the credit can claim 1/5 of the credit in each of five tax years beginning with the tax year immediately following the calendar year in which the taxpayer and the Director of Development reached a credit agreement. Each 1/5 credit amount that is not used in the year in which it otherwise could have been claimed may be carried forward for three years. The authority for the Director of Development to grant tax credits under this program expired on June 30, 1999. So, except for carryforward amounts this credit cannot be claimed after tax year 2004. For additional information please contact the Ohio Department of Development, Economic Development Division, Office of Tax Incentives, P.O. Box 1001, Columbus, Ohio 43216-1001 or call 614-466-4551 or 1-800-848-1300. The street address for the Ohio Department of Development is 77 S. High Street, 28th floor, Columbus, Ohio 43215.

11. **Credit for Employers that Establish On-Site Child Daycare Centers** (O.R.C. 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 $100,000 or 50 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 daycare center begins operations, and the taxpayer can claim the credit only for tax years 1999, 2000, 2001, 2002 or 2003. Accordingly, no new credit is generated for tax year 2004 and thereafter. However, the credit amount that the taxpayer did not use in the tax year claimed may be carried forward for five taxable years. But, if the taxpayer ceases to operate the center within the five-year carryforward period, any unused portion of the credit is lost.

12. **Ethanol plant investment credit** (O.R.C. sections 5733.46 and 901.13) – This nonrefundable franchise tax and individual income tax credit equals 50 percent of the amount of money that the taxpayer invests in O.R.C. section 901.13 certified ethanol plants in the calendar year preceding the tax year (the investment period is the calendar year preceding the tax year regardless of whether the taxpayer's taxable year is a calendar year). The credit is limited to $5,000 per taxpayer per certified ethanol plant regardless of the number of years in which the taxpayer makes such investments. The credit applies to tax years 2003 through 2013. Credits not used in the tax year following the calendar year in which the taxpayer makes the investment may be carried forward for three tax years.

13. **Credit for Grape Production Property** (O.R.C. section 5733.32) – Grape producers may claim a credit equal to 10 percent 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 tax 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** (O.R.C. 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, Attn: Export Credit, P.O. Box 2476, Columbus, OH 43216-2476.

15. **Edison Center Credit for Research and Development Investors** (O.R.C. 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 percent 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. The credit is evidenced by a tax credit certificate and is administered by the Ohio Department of Development along with the industrial technology and enterprise advisory council.

    Note: Amended Substitute House Bill 1, 125th General Assembly (effective July 9, 2003) amended this credit by increasing the credit percentage to 30 percent in the case of investments in certain qualifying small, Ohio-based research and development or technology transfer companies in distressed areas of the state and in EDGE business enterprises. An "EDGE business enterprise" is an "Ohio entity" certified by the director of administrative services as a participant in the encouraging diversity, growth, and equity program established by the governor's executive order 2002-17T. See page 5 of these instructions for a summary of Amended Substitute House Bill No. 1.

    For additional information please see O.R.C. sections 122.15, 122.151, 122.152, 122.153, and 122.154 as amended by Amended Substitute House Bill No. 1 and 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. The street address for the Ohio Department of Development is 77 S. High Street, 28th floor, Columbus, Ohio 43215.

16. **Enterprise Zone Day-Care Credit** (O.R.C. 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 #25 and O.R.C. 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 $300 for each child or dependent receiving the day-care services.

    Enterprise Zone Training Credit (O.R.C. 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 #25 and O.R.C. 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 $1,000, whichever is less. The taxpayer may claim the credit in the taxable year in which the new employee completes ninety days of subsequent employment.

17. **Research and Development Loan Repayment Credit** (O.R.C. sections 5733.352, 5747.331, and 166.17 through 166.21) – Amended Substitute House Bill 1, 125th General Assembly, effective July 9, 2003, enacted this new franchise tax and individual income tax nonrefundable credit. The franchise tax credit first applies to tax year 2004 regardless of whether the taxpayer's taxable year ended before the July 9, 2003, effective date of this new law. The amount of the credit equals the borrower's qualified research and development loan payments during the calendar year immediately preceding the tax year (this is so regardless of whether the taxpayer's taxable year is a calendar year or a fiscal year). The term *qualified research and development loan payments* means payments of principal and interest on a loan made to the borrower from Ohio's research and development fund administered by the Ohio Department of Development.

    The borrower's credit generated as a result of its qualified research and development loan payments made during a calendar year may not exceed $150,000 per loan. The credit amount not used in the tax year immediately following the calendar year in which the credit was generated can be carried forward until fully used. A borrower is eligible to receive the tax credit regardless of whether the borrower is subject to the corporation franchise or income tax. Furthermore, the borrower, whether or not it is subject to the franchise tax, can assign the tax credit to any of the following: (i) the borrower's related member; (ii) the owner or lessee of the eligible research and development project; or (iii) a related member of the owner or lessee of the eligible research and development project. If the borrower is a pass-through entity and the taxpayer is a partner or member of the pass-through entity-borrower, the taxpayer can claim a proportionate share of the pass-through entity-borrower's credit.

SCHEDULE B-3
RELATED ENTITY AND RELATED MEMBER ADJUSTMENTS
O.R.C. SECTIONS 5733.04(I)(12) & (I)(13)
O.R.C. 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.” The information release is available on the Department of Taxation’s web site.

Related Entity Adjustments

Line 1 – Related entity gains (losses) from sale of investments. A taxpayer must add to (and deduct from) federal taxable income, line 28 of federal form 1120 or line 24 of federal form 1120A, 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 24-month period commencing 12 months prior to the date of sale and ending 12 months after the date of sale the taxpayer and its related entities owned at least 50 percent 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 I.R.C. section 318, if the stockholder and the members of the stockholder’s family own directly or indirectly in the aggregate at least 50 percent 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 percent of the value of the taxpayer’s outstanding stock;
- A corporation, or a party related to the corporation in a manner that would require I.R.C. 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 percent of the value of the corporation’s outstanding stock.

The I.R.C. 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 federal form 1120 or line 24 of federal form 1120A, 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). Enter on line 4 the total related entity net capital gain or net capital loss that is allocable.

For taxable years ending before June 26, 2003, capital gains and capital losses attributed to the taxpayer from a related entity’s sale or other disposition of intangible property that may produce dividend income are allocable within and without Ohio whether that income is business income or nonbusiness income. See the instructions for schedule C, lines 4 and 5 applicable to taxable years ending before June 26, 2003 on page 29 of this instruction booklet.

For taxable years ending on or after June 26, 2003, capital gains and capital losses attributed to the taxpayer from a related entity’s sale or other disposition of intangible property that may produce dividend income are allocable within and without Ohio only if that income is nonbusiness income. See the instructions for schedule C, lines 4 and 5 applicable to taxable years ending on or after June 26, 2003 on pages 31 and 32 of this instruction booklet.

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 that is allocable.

Line 10 – Related entity gains (losses) allocable to Ohio. Enter on line 10 the total related entity net capital gain or net capital loss which is attributed to the taxpayer and allocable to Ohio.

For taxable years ending before June 26, 2003, capital gains and capital losses from sales of dividend producing property are allocable to Ohio in accordance with the ratio that 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. See the instructions for schedule C, lines 4 and 5 applicable to taxable years ending before June 26, 2003 on page 29 of this instruction booklet.

As noted in the instructions for line 4 above, for taxable years ending on or after June 26, 2003, capital gains and capital

losses attributed to the taxpayer from a related entity's sale or other disposition of intangible property that may produce dividend income are allocable within and without only if that income is nonbusiness income. If the income attributed to the taxpayer is nonbusiness income, allocate the income by following the instructions for schedule C, lines 4 and 5 applicable to taxable years ending on or after June 26, 2003 (see pages 31 and 32 of this instruction booklet).

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 that 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 that 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 **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 that 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 that imposed on the gain a tax on or measured by net income;

b. The apportionment ratio in each state that imposed a tax on the gain;

c. The amount of the gain actually allocated or apportioned to each state that 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 $50 million; (2) total assets of at least $25 million; or (3) taxable income of at least $500,000. 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 O.R.C. 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 I.R.C. 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 percent 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 (I)(12)(c) of O.R.C. section 5733.04 (summarized in the instructions for line 1, above); (ii) a "component member" as defined in I.R.C. section 1563(b); or (iii) a person to whom or from whom there is attribution of stock ownership in accordance with I.R.C. section 1563; and (e) except that "20 percent" shall be substituted for "5 percent" wherever "5 percent" appears in I.R.C. 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 I.R.C. section 542 without regard to the stock ownership requirements set forth in I.R.C. 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 I.R.C. section 542 without regard to the stock ownership requirements set forth in I.R.C. section 542(a)(2);

D. Any related member that is an I.R.C. section 552 foreign personal holding company;

E. Any noncorporate related member that is directly or indirectly owned in whole or in part by an I.R.C. 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 percent the greater of (i) the annual interest rate prescribed by O.R.C. section 5703.47 in effect at the time of the origination of the indebtedness, or (ii) the annual interest rate prescribed by O.R.C. section 5703.47 in effect at the time the taxpayer paid, accrued or incurred the interest expense. For example, the 2003 annual rate prescribed by O.R.C. section 5703.47 is **6 percent**. If a taxpayer paid or accrued interest expense to a related member at the rate of 14 percent during 2003 on indebtedness that originated in 2003, the excess interest rate is 5 percent (14 percent minus the sum of 6 percent and 3 percent). 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 percent rate and the interest that would have been paid or accrued had the rate been 10 percent (7 percent + 3 percent).

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 member 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 that 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 that it paid or accrued to other related members described in A through G, above;

c. the related member's intangible expenses that 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 that 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 O.R.C. 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, Corporation Franchise Tax, P.O. Box 2476, Attn: Related Entity/ Related Member, Columbus, Ohio 43216-2476.

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 **Note:** Rule 5703-5-09 was rescinded effective March 21, 2002 as a result of the Board of Tax Appeals decision in *Delta Airlines, Inc. v. Tracy,* BTA No. 96-T-471 & 96-T-472 (1-12-2001).
5703-5-10	Corporate franchise tax; accounts maintained under Statement of Financial Accounting Standards No. 106

***Note: The department recently amended Rule 5703-5-04 to clarify when a taxpayer's annual accounting period changes and to eliminate proration for periods in excess of one year in length.**

Information Releases

Since 1991 the Corporation Franchise Tax Division has issued the following Information Releases:

- "Ohio Bonus Depreciation Adjustment and the Internal Revenue Code's Passive Activity Loss, Basis Limitation and At-Risk Rules," November, 2002
- "Recently Enacted Ohio Legislation Affects Depreciation Deductions for Taxable Years Ending in 2001 and Thereafter" July, 2002
- "Pass-through Entity Tax: Certain Estimated Tax Payments Due September 16, 2002," July 3, 2002
- "Corporate Franchise Tax – Nexus Standards," September, 2001
- "Corporation Franchise Tax Nexus for Non-resident Limited Partners Following the UCOM Decision," March 15, 2001
- "I.R.C. 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 and 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 Percent 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 Percent 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 O.R.C. section 5703.35. Nevertheless, the releases do reflect the Department of Taxation’s interpretation of the law. Information releases are available on the department’s web site.

Ohio Franchise Tax Forms

Many of the department's forms are available on the Internet at: http://www.tax.ohio.gov

		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	12/03
FT 1120ER	Application for Automatic Extension	12/03
FT 1120EX	Request for an Additional Extension of Time for Filing Corporation Franchise Tax Report	12/03
FT 1120	Corporation Franchise Tax Report	12/03
FT 1120VL	Valuation Limitation on Gains and Losses from Sales or Exchanges of Property	7/00
FT 1120C	Corporation Franchise Tax (Combined Report)	12/03
FT WAIVER	Consent to Extend the Time to Assess or Refund the Ohio Corporation Franchise Tax	5/02
FT OTAS	Ohio Taxpayers' Affiliation Schedule	12/02
FT EXPORT	Corporation Franchise Tax Credit for Increasing Export Sales	12/99
FT 1120-FI	Corporation Franchise Tax Report for Financial Institutions	12/03
FT 1120-S	Notice of S Corporation Status	12/03
FT REF	Application for Corporation Franchise Tax Refund	12/01
FT PR	Petition for Reassessment	11/02
FT HELP	Special Handling Notice	12/03
FT QHC	Qualifying Holding Company Election	No Revisions
FT Electric	Supplemental Schedules for Electric Companies	12/03

Rank	Nonrefundable Credit	Carryforward Period	O.R.C. 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 Maintaining Railroad Crossing Warning Devices	None	5733.43
5.	Job Retention Credit	Three years	5733.0610(B) & 122.171
6.	Second Credit for Purchases of New Manufacturing Machinery and Equipment (7.5 Percent/13.5 Percent Credit)	Three years	5733.33
7.	Job Training Credit	Three years	5733.42
8.	Credit for Qualified Research Expense	Seven years	5733.351
9.	Credit for Eligible New Employees in an Enterprise Zone	Three years	5709.66
10.	Credit for Eligible Costs Associated with a Voluntary Action (Brownfield Site Clean-Up)	Three years	5733.34 & 122.19
11.	Credit for Employers that Establish Onsite Child Daycare Centers (no new credit – carryforward amounts only)	Five years	5733.37
12.	Ethanol Plant Investment Credit	Three years	5733.46 & 901.13
13.	Credit for Grape Production Property	Seven years	5733.32
14.	Export Sales Credit (no new credit – carryforward amounts only)	1994-2005	5733.069
15.	Edison Center Credit for Research and Development Investors	Fifteen years	5733.35, 122.15, 122.151, 122.152, 122.153 & 122.154
16.	Enterprise Zone Daycare and Training Credits	Unlimited*	5709.65(A)
17.	Research and Development Loan Repayment Credit	Unlimited*	5733.352 & 166.17 thru 166.21

*Unused credit amounts may be carried forward until fully utilized.

Second Credit for Purchases of New Manufacturing Machinery and Equipment (O.R.C. Section 5733.33)

Calendar year in which qualifying equipment is purchased	Franchise tax years (report years) in which 1/7 credit amounts are claimed																Total
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	
7/1 – 12/31/95	1/7	1/7	1/7	1/7	1/7	1/7	1/7										7/7
1996	1/7	1/7	1/7	1/7	1/7	1/7	1/7										7/7
1997		1/7	1/7	1/7	1/7	1/7	1/7	1/7									7/7
1998			1/7	1/7	1/7	1/7	1/7	1/7	1/7								7/7
1999				1/7	1/7	1/7	1/7	1/7	1/7	1/7							7/7
2000					1/7	1/7	1/7	1/7	1/7	1/7	1/7						7/7
2001						1/7	1/7	1/7	1/7	1/7	1/7	1/7					7/7
2002							1/7	1/7	1/7	1/7	1/7	1/7	1/7				7/7
2003								1/7	1/7	1/7	1/7	1/7	1/7	1/7			7/7
2004									1/7	1/7	1/7	1/7	1/7	1/7	1/7		7/7
2005										1/7	1/7	1/7	1/7	1/7	1/7	1/7	7/7

Note: The taxpayer claims 1/7 of the credit in each of the seven years following the purchase year. Each 1/7 credit amount that is not used in the year in which it otherwise could have been claimed may be carried forward for three years. The unused carryforward amount is used before the 1/7 amount for the subsequent year.

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 is separately computed for each Ohio county for each purchase year;
- The credit is based upon purchases of qualifying equipment during a calendar year (the purchase year) even if the taxpayer has a fiscal year end;
- For purchases after 12/31/00 a “qualifying controlled group” must compute the credit on a consolidated basis for each county. For purchases on or before 12/31/00 a qualifying controlled group can elect to compute a consolidated credit for each county;
- If before the end of the seven-year period over which the taxpayer claims the credit the taxpayer sells the equipment or moves it out of the county for which it claims the credit and the equipment is not fully depreciated, the remaining 1/7 credit amounts are lost;
- A pass-through entity (PTE) does not compute the credit. Instead, a PTEs qualifying purchases and base investment flow through to the PTE’s investors, each of whom computes the credit.

Taxpayer Assistance

Internet: ***www.tax.ohio.gov***
Tax Forms
Instructions
Information Releases
E-mail us

Phone: Toll-free 1-888-405-4039

Walk-in: Walk-In Services are available at all Office Locations Monday through Friday, 8:00 a.m. to 5:00 p.m.

Income and Corporate Franchise Tax Division
P.O. Box 2476
Columbus, OH 43216-2476

Taxpayer Services Division
P.O. Box 182382
Columbus, OH 43218-2382

Business Taxpayer Services: 1-888-405-4039
Registration Unit: 1-888-405-4089
Forms Requests: 1-800-282-1782

Taxpayer Service Locations

Akron Taxpayer Service Center
Akron Government Center
161 South High St., Suite 501
Akron, OH 44308-1600

Cincinnati Taxpayer Service Center
900 Dalton Ave. at West 8th St.
Cincinnati, OH 45203-1171

Cleveland Taxpayer Service Center
Cleveland State Office Tower
615 West Superior Ave., Suite 570
Cleveland, OH 44113-1891

Columbus Taxpayer Service Center(s)
800 Freeway Drive North
Columbus, OH 43229 **OR**
30 East Broad St., 20th Floor
Columbus, OH 43215

Dayton Taxpayer Service Center
15 E. Fourth St., 5th Floor
Dayton, OH 45402-2162

Toledo Taxpayer Service Center
One Government Center, Suite 1400
Toledo, OH 43604-2232

Youngstown Taxpayer Service Center
242 Federal Plaza West, Suite 402
Youngstown, OH 44503-1294

Zanesville Taxpayer Service Center
601 Underwood St.
Zanesville, OH 43701-3786

For the Deaf, Hearing Impaired or Speech Impaired Who Use TTY or TDD Only: Please contact the Ohio Relay Service at 1-800-750-0750 and give the communication assistant the Department of Taxation phone number that you wish to contact.