

**Information Release - Commercial Activity Tax - “Taxable gross receipt,” defined; Revised January, 2006; Revised April, 2006
CAT 2005-17**

This is version 3 of this release. The purpose of this information release is to clarify what constitutes a “taxable gross receipt” for purposes of the commercial activity tax (“CAT”) imposed under Chapter 5751 of the Revised Code. This release has been updated to address corrections made to Chapter 5751 of the Revised Code in Am. Sub. H.B. 530, as well as to provide an example of an item that is not a gross receipt because it does not contribute to the production of gross income. As a general practice in determining taxable gross receipts, a taxpayer starts with its broad definition of gross receipts, taking into account any exclusions and/or deductions from the total gross receipts, and then situates the remaining gross receipts to determine those receipts that are “taxable gross receipts.” It is important to remember that not all gross receipts are necessarily taxable gross receipts. In general, those receipts received from purchasers located outside of Ohio are not taxable gross receipts for purposes of the CAT.

“Gross Receipts”

“Gross receipts” are broadly defined in division (F) of section 5751.01 of the Revised Code as “the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person, including the fair market value of any property and any services received, and any debt transferred or forgiven as consideration.” In other words, the term “gross receipts” is all encompassing and includes a wide variety of items.

An example of something that would not be a gross receipt because it does not contribute to the production of gross income is the receipt of cash from presenting a negotiable instrument (i.e. a check) in excess of any goods or services provided to the customer. Assume a customer purchases seventy-five dollars worth of groceries and writes the grocery store a check for one hundred dollars. The cashier of the grocery store gives the customer twenty-five dollars in cash back and applies the remaining seventy-five dollars toward the customer’s grocery bill. The grocery store is only required to include the seventy-five dollars in calculating its gross receipts. If, however, the store charged a customer a fee for the additional amount requested, such fee would be included in the grocery store’s gross receipts.

This definition broadly encompasses all receipts in money or remuneration from activities entered into by “taxpayers” as that term is defined in division (D) of section 5751.01 of the Revised Code.

Exclusions

When calculating gross receipts for the tax period, there are certain items that are specifically excluded from the definition of “gross receipts.” These exclusions, enumerated in division (F)(2) of section 5751.01 of the Revised Code, include the following:

- *Interest* – (R.C. 5751.01(F)(2)(a)) - Interest income, except for interest from credit sales is excluded from the definition of a “gross receipt”. For example, interest earned on a

savings account is specifically excluded from the definition of a “gross receipt.” However, a receipt from a monthly interest fee on a retail installment contract is included in the definition of a “gross receipt” and is therefore subject to the CAT.

- *Dividends and distributions or distributive or proportionate shares* – (R.C. 5751.01(F)(2)(b)) - Any dividend or distribution received from a corporation, distributive share received from a pass-through entity, or proportionate share received by a partner from a partnership are expressly excluded from the definition of a “gross receipt”.
- *Section 1221 or 1231 assets* – (R.C. 5751.01(F)(2)(c)) - Receipts from the sale or transfer of an asset described in either section 1221 or 1231 of the Internal Revenue Code (in general, depreciable capital assets) are excluded from the definition of a “gross receipt” regardless of the length of time the asset is held, and irrespective of gain or loss realized on the transfer. For example, a taxpayer who sells the assets of its business may exclude the portion of the resulting gross receipts attributed to the business equipment because this asset is described in section 1221 of the Internal Revenue Code. However, the business must include the portion of the gross receipts stemming from the business’s inventory, as this asset is *not* included in those described in section 1221 of the Internal Revenue Code. Please see Information Release CAT 2005-08 for a more detailed description of this exclusion.
- *Proceeds attributable to the repayment, maturity, or redemption of an intangible* – (R.C. 5751.01(F)(2)(d)) – Receipts from the repayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or marketable instrument are excluded from the general definition of a “gross receipt”.
- *Receipts from a repurchase agreement or loan* – (R.C. 5751.01(F)(2)(e)) – The amount received under a repurchase agreement or on a loan is excluded from the definition of a “gross receipt”. In simple terms, a “repurchase agreement” is a transaction in which one party sells securities to another party for a specified amount. At the same time, the selling party agrees to repurchase the equivalent securities at an agreed price at a specified future date.
- *Contributions received by a trust, plan, or other arrangement* – (R.C. 5751.01(F)(2)(f)) – Contributions received by charitable or religious trusts, plans, or similar arrangements, any of which are described in division (a) of section 501 of the Internal Revenue Code (including most plans organized under sections 501(c) and (d) and section 401(a) of the Internal Revenue Code) are excluded from the general definition of a “gross receipt”. As a general caveat, it is helpful to remember that if the plan or trust is arranged not-for-profit, any contributions received by these entities are excluded from the definition of gross receipts. If, however, the plan or trust or other arrangement operates for profit or is not organized in conjunction with section 501(a) of the Internal Revenue Code, the plan will *not* be excluded from the definition of a “gross receipt”, and may therefore be subject to the CAT. For example, the donations to an entity that is tax-exempt under I.R.C. section 501(c) or (d) and the contributions participants make to a pension plan under I.R.C. section 401(a) are excluded from gross receipts for purposes of the CAT. However, other receipts from a trade or business conducted by such organizations are not

excludable from the definition of gross receipts and may therefore be subject to the CAT. For additional information on this exclusion, please see Information Release CAT 2005-14, including paragraph (D) of proposed Adm. Rule 5703-29-10.

- *Compensation* - (R.C. 5751.01(F)(2)(g)) - All compensation received by an employee, a former employee for work as an employee, or an employee's legal successor (the employee's estate), that is reported on a W-2 (or work related travel reimbursements that may not appear on a W-2), is excluded from the definition of a "gross receipt". Compensation reported on a Form 1099, however, is not excluded from this definition and may therefore be subject to the CAT.
- *Stock issuance* – (R.C. 5751.01(F)(2)(h)) – Proceeds received from the issuance of a taxpayer's own stock, options, warrants, puts, or calls or from the sale of the taxpayer's treasury stock are excluded from the definition of gross receipts. As a general rule, the stock referenced in this section must be able to be issued by the taxpayer.
- *Life insurance proceeds* – (R.C. 5751.01(F)(2)(i)) – Any payments received from life insurance policies are excluded from the definition of gross receipts.
- *Gifts or charitable contributions; fundraising receipts when any excess receipts are donated for charitable purposes; proceeds received by a nonprofit organization* – (R.C. 5751.01(F)(2)(j)) – Any gifts or charitable contributions, membership dues, and/or payments received for educational courses, meetings, meals, or similar payments to a trade, professional, or other similar association are excluded from the definition of a "gross receipt" for purposes of the CAT. For example, an individual decides he/she wants to hold a fundraiser for cancer research. The individual organizes a golf tournament with each attendee being required to pay \$100. As long as any balance remaining, after offsetting expenses for the tournament, goes to a charitable organization (in this example, the cancer research foundation), the individual can exclude these receipts.
- *Damages from litigation* – (R.C. 5751.01(F)(2)(k)) – To the extent receipts stem from damages received as the result of litigation and those receipts are in excess of what would have been received had the taxpayer not been involved in litigation, the taxpayer may exclude the amount in excess from its calculation of gross receipts for purposes of the CAT. For example, a taxpayer normally allows other manufacturers to use its patented process in exchange for a royalty. The taxpayer discovers that a manufacturer is using its patented process without paying the royalty fee so the taxpayer files a lawsuit for patent infringement. The taxpayer wins the lawsuit and is awarded compensatory damages of \$2 million and punitive damages of \$500,000. The \$2 million is included in the taxpayer's gross receipts because it compensates the taxpayer for the royalty it would have received if the defendant had not violated the patent. However, the \$500,000 is *not* included in the taxpayer's gross receipts because this money would never have been received if there had not been a lawsuit.
- *Agent's commission, fee, or other remuneration* – (R.C. 5751.01(F)(2)(l) and 5751.01(P)) – In a principal-agent relationship, many times the agent receives a total payment from the purchaser on behalf of the principal. If a taxpayer is working as an agent on behalf of

another (the principal) and receives a commission, fee, or other remuneration for their work as an agent, the agent must only report that portion of the gross receipts attributed to the agency relationship. In order to qualify for this exclusion, the contract must clearly state that an agency relationship exists and conspicuously set out the terms of the contract. For example, an insurance company contracts with an insurance agent for the agent to sell the company's insurance coverage, with a five per cent (5%) agent commission built in for each policy sold. These terms are conspicuously set forth in a contract that is signed by both parties. The agent sells a \$300,000 life insurance policy for \$800. The agent passes \$760 (or 95%) on to the insurance company and retains its \$40 (or 5%) commission pursuant to the terms of the contract. This Department will issue a separate information release in the near future which will further clarify this agency provision.

- *Tax refunds and other tax benefit recoveries, including reimbursements for CAT tax paid* – (R.C. 5751.01(F)(2)(m)) – A taxpayer who receives a tax refund (federal, state, or local) is not required to include the amount of the refund in calculating its gross receipts for purposes of the CAT. For purposes of this section, “other tax benefit recoveries” includes refundable tax credits that may be available to a taxpayer. In addition, an entity that is reimbursed by another entity that is either included in the same combined taxpayer group or consolidated elected taxpayer group, or is not part of the combined taxpayer group or the consolidated elected taxpayer group for the CAT tax paid by that entity may exclude those receipts from its calculation of gross receipts. For example, A is the primary member of a combined taxpayer group in which B is a member. A pays the CAT tax liability for the group for the semi-annual period and B reimburses A for its portion of that amount. A may exclude the amount of B's payment from its gross receipts for purposes of the CAT during the next tax period. Similarly, A owns sixty per cent (60%) of X and Y and registers as the primary member of a combined taxpayer group. B is the minority forty per cent (40%) owner of X and Y and is not considered a common owner for purposes of the CAT. A pays the tax liability for the group, and then is reimbursed by B for B's portion of the tax paid. A may exclude that payment from its gross receipts.
- *Pension reversions* – (R.C. 5751.01(F)(2)(n)) – A pension reversion is the termination of a pension plan, undertaken by a company with an over funded pension plan in order to reclaim the surplus assets. When this occurs the amount does not need to be included in the calculation of the taxpayer's gross receipts for purposes of the CAT.
- *Contributions to capital* – (R.C. 5751.01(F)(2)(o)) – To the extent a taxpayer receives funds that are properly treated as contributions to capital, those amounts may be excluded from the calculation of the taxpayer's gross receipts for purposes of the CAT. For example, if a partner in a partnership makes a contribution to the capital of the partnership, the partnership (as a taxpayer) will not be required to include this contribution in its calculation of gross receipts.
- *Sales or use taxes collected or other taxes required to be collected to be remitted to a taxing jurisdiction* – (R.C. 5751.01(F)(2)(p)) – Receipts from the sale of tangible personal property or services, generally, are subject to the CAT, as discussed above. However, the portion of the receipt attributed to sales or use taxes collected by a vendor

or out-of-state seller from a consumer on behalf of a taxing jurisdiction are excluded from the definition of a “gross receipt” for purposes of the CAT. In addition, the vendor or out-of-state seller is not required to subtract any discounts earned when calculating this exclusionary amount because the exclusion is for the amount of tax collected. For example, a vendor sells a car for \$20,000 to an Ohio resident and also collects \$1,400 in Ohio sales tax. The vendor is only required to report gross receipts of \$20,000 (the price paid for the car) for purposes of the CAT. The \$1,400 of Ohio tax is not subject to the CAT. In addition, taxes that a taxpayer is required by law to collect directly from a purchaser and then remit to a local, state, or federal taxing authority may be excluded from the taxpayer’s gross receipts. For example, a wireless telephone company collects a tax for E911 service directly from its customer. The company is required by law to remit the payment to a governmental taxing authority. The company may exclude this amount from its gross receipts, as this amount is required to be collected directly from the customer (and is not imposed on the company, itself) and must be remitted to a taxing jurisdiction.

- *Certain excise taxes paid* – (R.C. 5751.01(F)(2)(q) to (s)) – Receipts from the sale of cigarettes or tobacco products, motor fuel, and beer or intoxicating liquor are generally subject to the CAT. However, the federal and state excise taxes may be deducted on the receipts received from those products, including excise taxes collected and remitted on cigarettes, beer and wine for the construction or renovation of certain sports facilities. Because motor fuel is excluded pursuant to a temporary law provision, no deduction is allowed on motor fuel until July 1, 2007. When determining the excise taxes that can be deducted, the deduction is only for the portion of federal and state excise taxes received from these products during the taxable period. For example, assume a beer wholesaler purchases 10,000 cases of beer during the tax period, but only sells 8,000 cases during that tax reporting period. The wholesaler can only deduct from its gross receipts the federal and state excise taxes on the 8,000 cases actually sold during the reporting period. The receipts from the remaining 2,000 cases will be claimed by the wholesaler when the cases are ultimately sold. An information release and/or rule will be issued concerning the current federal and state excise tax rates. This Department will issue a separate information release that provides the excise tax rates and further clarifies this exclusion for certain excise taxes paid.
- *Sale or transfer of motor vehicle as customer preference* – (R.C. 5751.01(F)(2)(t)) – To the extent a receipt is realized for the sale or transfer of a motor vehicle from one dealer to another for the purpose of resale by the second dealer, the gross receipt shall be excluded from the transferor-dealer’s calculation of gross receipts for purposes of the CAT *if and only if* the sale or transfer was made to meet a specific customer’s preference. It is strongly advised that such transfer be documented by both dealers to verify such transfer is excluded from the CAT upon inspection/audit by this Department. A form that dealers are strongly advised to use will be available on the department of taxation’s website at tax.ohio.gov. *It is important to note that receipts from transfers between dealers other than for customer preference are subject to the CAT.*
- *Receipts from a financial institution described in R.C. 5751.01(E)(3) for services provided to the financial institution in connection with the issuance, processing,*

servicing, or managing loans or credit accounts – (R.C. 5751.01(F)(2)(u)) – A taxpayer that (1) issues, processes, services, or manages loans or credit accounts for a financial institution; and (2) is at least 50% commonly owned, along with the financial institution, by a common owner, may exclude these receipts from calculating its gross receipts for purposes of the CAT.

- *Administration of anti-neoplastic drugs and other cancer drugs* – (R.C. 5751.01(F)(2)(v)) – Receipts attributable to the administration of anti-neoplastic drugs and other cancer chemotherapy, biologicals, therapeutic agents, and supporting drugs are excluded from the CAT to the extent the drugs were administered in a physician’s office to patients with cancer. Any other drugs or those anti-neoplastic drugs not meeting the requirements of this exclusion shall be included in the calculation of gross receipts for purposes of the CAT.
- *Funds received or used by mortgage brokers* – (R.C. 5751.01(F)(2)(w)) – This exclusion is limited to mortgage brokers who are not dealers in intangibles. This exclusion does not state that mortgage brokers are not dealers in intangibles. Instead, it provides that if a mortgage broker does not meet the definition of a dealer in intangibles under R.C. 5725.01, this exclusion may apply. With respect to a table-funding mortgage loan or warehouse-lending mortgage loan, such a mortgage broker must report fees and other consideration received as its gross receipts for purposes of the CAT, but may exclude other amounts received, such as the loan amount not being retained.
- *Property, money, and other amounts received by professional employer organizations from client employers* – (R.C. 5751.01(F)(2)(x)) – A professional employer organization (“PEO”) may exclude receipts from a client employer to the extent the receipts are in excess of the administrative fee charged by the PEO to the client employer. “Professional employer organization,” “client employer,” and other terms used in R.C. 5751.01(F)(2)(x) are specifically defined in R.C. 4125.01. Ohio PEOs are required to register with and are regulated by the administrator of the Ohio Bureau of Worker’s Compensation pursuant to R.C. 4125.05. This exclusion is narrow in its scope and is limited to the engagement of permanent rather than temporary employees pursuant to a written professional employer organization agreement of not less than a twelve-month duration. For example, a professional employer organization charges a five per cent (5%) administrative fee for the placement of any of its clients. Corporation A uses the organization to find a permanent receptionist. The organization hires individual B to fill the position and charges Corporation A \$500 for this service. When Corporation A pays the professional employer organization Individual B’s salary, it included the \$500 fee. The professional employer organization need not include the entire amount received from Corporation A in calculating its gross receipts, but rather must only include its \$500 fee.
- *Amounts retained as commissions by persons holding permits to conduct horse-racing meetings* – (R.C. 5751.01(F)(2)(y)) – Under Ohio law, a person holding a permit to conduct horse-racing meetings is required to pay a specific statutory percentage of the total of all amounts wagered as a tax, and must also set aside a specific portion of all amounts wagered as purse money. Receipts that must be paid to or collected by the tax

commissioner as a tax and the amounts to be used as purse money are to be excluded in calculating the permit holder's gross receipts for purposes of the CAT.

- *Qualifying distribution center receipts* – (R.C. 5751.01(F)(2)(z)) – Effective January 1, 2007, certain receipts of a supplier may be excluded from that supplier's gross receipts for purposes of the CAT if those receipts stem from qualified property that is shipped to a qualified distribution center. The department will issue an information release on this issue in the future.
- *Real estate brokers* – (R.C. 5751.01(F)(3)) – A person acting as a real estate broker is not required to include the entire commission amount received in conjunction with its brokerage transaction in its calculation of gross receipts for purposes of the CAT. The real estate broker can exclude the amount of the commission remitted to other brokers or real estate agents. For example, assume a real estate broker receives a commission from the sale of a \$200,000 home for its client. The broker receives a 7% commission, which it is required to split as follows: 3% to a buyer-broker; 2% to its real estate agent; and the remaining 2% is retained by the broker. The broker only needs to report \$4,000 (or its 2% commission) as a gross receipt. The seller's real estate agent must only report \$4,000 (or its 2% commission) as a gross receipt. The buyer-broker needs to report that portion of its 3% that is not passed onto the buyer-agent, for which it can deduct any amounts it is required to pay to one of its real agents for assisting in the sale of the home.
- *Temporary motor fuel exemption* – (Uncodified section 557.09.06 of Am. Sub. H.B. 66, 126th G.A.) – H.B. 66 specifically provides for a temporary exemption for receipts from the sale of motor fuel from the calculation of a "gross receipt" for purposes of the CAT. This exemption expires on June 30, 2007. It is important to note that this temporary exemption does not apply to products not used on the road (e.g. heating oil, aviation fuel, and kerosene). For more information on this temporary exemption, please refer to Information Release CAT 2005-18.
- *Temporary qualified foreign trade zone area exclusion* – (Uncodified section 557.09.09 of Am. Sub. H.B. 66, 126th G.A.) – H.B. 66 specifically provides that receipts from shipments into and/or out of a qualified foreign trade zone area are excluded from a taxpayer's gross receipts until December 31, 2006. For more information on this temporary exemption, please refer to Information Release CAT 2005-10, and for a map and a list of addresses of the locations that meet the requirements of this temporary law, please see Information Release CAT 2005-11.
- *Any receipts for which CAT is prohibited by the constitution or laws of the United States or the constitution of this state* – (R.C. 5751.01(F)(2)(aa)) – If either the constitution of the United States or of the state of Ohio or other laws of the United States prohibit the state of Ohio from imposing the CAT on certain receipts, these receipts will not be included in a taxpayer's calculation of its gross receipts for purposes of the CAT.

Deductions

After accounting for all available exclusions, the taxpayer may take any available deductions from its total gross receipts if it such amount is included in the current period, or may deduct from its taxable gross receipts if such amount was included in a prior tax period. There are only four deductions available to taxpayers. These deductions are enumerated in division (F)(4) of section 5751.01 of the Revised Code and include the following:

- *Cash discounts allowed and taken* – A taxpayer who allows its customers to receive a cash discount for timely payment, for example, may deduct the amount of the discount if the customer meets the requirements necessary to take the discount during the tax period. This deduction also applies to incentive-based rebates and discounts that are based on making timely payments and that are received by a purchaser but not by the purchaser’s customer. It is important to note, however, that the portion of the discount or rebate must have been included on the seller’s books initially in order to qualify as a deduction. Please see proposed rule 5703-29-14 for more information on this deduction.
- *Returns and allowances* – Any receipt connected to an asset that is later returned to the taxpayer by its purchaser may be deducted from the taxpayer’s gross receipts for purposes of the CAT, as long as that receipt was included in the taxpayer’s gross receipts initially.
- *Bad debts* – If the CAT imposed on receipts from bad debts was paid in a prior quarterly tax payment period, the taxpayer may deduct any bad debt amounts it suffers in the current tax period. “Bad debts” is defined in division (F)(4)(c) of section 5751.01 of the Revised Code. (This definition is similar to that under Ohio sales and use tax law.)
- *Amount realized from the sale of an account receivable* – If the receipts from the underlying transaction of an account receivable were originally included in the gross receipts of the taxpayer, any amount realized from the sale of this account receivable may be deducted from the taxpayer’s gross receipts for purposes of the CAT.

“Taxable Gross Receipts”

After a taxpayer calculates its gross receipts and subtracts any available exclusions and/or deductions, the taxpayer may then determine its “taxable gross receipts.” For purposes of the CAT, a “taxable gross receipt” is a gross receipt sitused to the state of Ohio.

As a general rule, gross receipts are sitused based on the benefit to the purchaser. Section 5751.033 of the Revised Code sets forth the rules for determining how to situs gross receipts that include, but are not limited to, the following:

- *Gross rents and royalties from and the sale of real property* – (R.C. 5751.033(A) and (D)) - If the real property is located in this state, these receipts shall be sitused to this state. Receipts from real property *not* located in this state are sitused outside of Ohio.

- *Gross rents and royalties from tangible personal property* – (R.C. 5751.033(B)) - To the extent the property is located or used in this state, these receipts shall be situated to this state.
- *Sale of tangible personal property* – (R.C. 5751.033(E)) - Receipts from the sale of tangible personal property are situated based on where the property is received. In the case of property delivered by common carrier, the place the property is ultimately received after all transportation has been completed is deemed to be the situated location. *This location must be known by the seller at the time of the sale.* For example, a Wisconsin company sells \$30,000 worth of widgets to ABC Company, an Ohio wholesaler and \$20,000 worth of widgets to XYZ Company, a Pennsylvania wholesaler, but ships the entire \$50,000 worth of widgets to a warehouse in Columbus, Ohio. XYZ Company sends a common carrier to the Ohio warehouse to pick up its widgets. Since the Wisconsin company knew *at the time of the sale* that \$20,000 worth of the widgets sold to the Ohio warehouse would be shipped to Pennsylvania, the Wisconsin company can exclude the gross receipts received from XYZ Company from its calculation of taxable gross receipts.
- *Intellectual property* – (R.C. 5751.033(F)) - Receipts from the sale, exchange, disposition, or other grant of the right to use trademarks, trade names, patents, copyrights, and similar intellectual property is situated based on either (1) the amount of use in this state; or (2) the right to use the property in this state. The first method to determine the siting of intellectual property is to look to the amount of use in this state versus the amount of use everywhere. If the property is used in this state, receipts from the sale of the property are situated to this state. If the amount of use is not available, the taxpayer should determine the situs based upon where the person having the right to use the property actually uses it. If the person who has the right to use the property uses it in Ohio, receipts from the sale of this property are situated to Ohio. If, however, the right to use the property rests with an individual in Indiana, receipts from the sale of this property should be situated to Indiana.
- *Transportation services by common carrier* – (R.C. 5751.033(G)) - Receipts from the sale of these services are situated to this state based on the ratio of the mileage traveled by the carrier during the tax period on roadways, waterways, airways, and railways in this state to the mileage traveled by the carrier everywhere.
- *Most other services* – (R.C. 5751.033(I)) - The general rule of siting services is based on the benefit to the purchaser. Receipts stemming from services performed where the benefit is to a person outside the state of Ohio are situated outside the state of Ohio and are therefore not considered in calculating taxable gross receipts and are not subject to the CAT. This Department has issued a separate information release, CAT 2005-06, which specifically addresses the siting of various services for purposes of the CAT. The physical location where the purchaser ultimately receives the benefit of the service is paramount in determining the proportion of benefit within this state to the benefit everywhere.

All gross receipts sitused to the state of Ohio are considered “taxable gross receipts” and are subject to the CAT in accordance with Chapter 5751. of the Revised Code. Those receipts not sitused to this state are *not* taxable gross receipts and are therefore not subject to the CAT.