

Miscellaneous Federal Tax Adjustments

Form IT 1140, Schedule B, line 2b, and Schedule D, line 2b

Calendar year taxpayers must add back the charitable contribution deduction, if any, relating to January, 2005 contributions to the Indian Ocean tsunami relief effort and claimed on the 2004 federal income tax return.

Reason: The Ohio General Assembly enacted amendments to Ohio Revised Code sections 5747.01 and 5733.04 which Governor Taft signed on December 30, 2004. The amendments became effective on that date (see Substitute House Bill 362, 125th General Assembly). Because of these amendments, all changes to the Internal Revenue Code enacted on or before December 30, 2004 apply to calendar year taxpayers filing the Ohio individual & fiduciary income tax, the Ohio pass-through entity tax, and the Ohio franchise tax (the web instructions for the 2005 form FT 1120 provide additional information for fiscal year corporate taxpayers). As a result, calendar year taxpayers are not required to reverse the effects of any Internal Revenue Code changes enacted by December 30, 2004.

Please note that the federal law allowing calendar year businesses to deduct in taxable year 2004 their January, 2005 contributions to the Indian Ocean tsunami relief effort was enacted subsequent to December 30, 2004. Since the federal law allowing this deduction was enacted after the December 30, 2004 date on which the applicable Ohio tax law was last amended, taxpayers must compute Ohio taxable income for their taxable year ending in 2004 as if that federal law had never been enacted. Thus, each calendar year business taxpayer which made any January, 2005 contributions to the Indian Ocean tsunami relief effort and which claimed those contributions as a deduction on its 2004 federal income tax return must add back on its 2004 Ohio tax return the amount of such deduction.

Please note that the Ohio tax add-back and deduction for IRC sections 168(k) and the 179 depreciation adjustments remain in effect in accordance with Ohio Revised Code sections 5747.01(A)(20), 5747.01(A)(21), 5733.04(I)(17), and 5733.04(I)(18).

For more information see the Department's December 2004 individual income tax information release entitled, *Income and Franchise Tax Updates* available through our website at www.tax.ohio.gov.

Instructions for Ohio Form IT 1140 Withholding Tax Return for Pass-through Entities and Trusts For Taxable Years Beginning in 2004

Purpose: Use this form to report withholding tax due on (i) pass-through entity distributive shares of income and (ii) trust distributions of income relating to real property in Ohio and tangible personal property in Ohio.

Trusts may also be required to file the Ohio Fiduciary Income Tax Return, form IT 1041, which is available on the Department of Taxation's Web site at www.tax.ohio.gov.

Important note: You can disregard these instructions if any of the following is applicable for the entire taxable year:

- The entity is a trust whose beneficiaries are limited to full-year Ohio resident individuals and/or Ohio resident estates, or
- The entity is a trust that has no real estate located in Ohio, no tangible personal property located in Ohio, and no direct or indirect investments in (i) S corporations having nexus with Ohio, (ii) partnerships having nexus with Ohio, and (iii) limited liability companies having nexus with Ohio if none of the limited liability companies are treated as partnerships for federal income tax purposes, or
- The entity is an S corporation, a partnership or a limited liability company treated as a partnership for federal income tax purposes, and such entity's investors are limited to full-year Ohio resident individuals, Ohio estates and/or corporations that are timely paying the Ohio corporation franchise tax, or
- The entity is an S corporation, partnership or limited liability company treated as a partnership for federal income tax purposes, and the entity is filing the Ohio form IT 4708 ("Pass-through Entity Composite Income Tax Return") on behalf of all of its investors who are not full-year Ohio resident individuals or Ohio resident estates, or
- The entity is either a disregarded entity or a qualifying subchapter S subsidiary and the entity's owner(s) is (are) filing with the Ohio Department of Taxation the appropriate income or franchise tax returns.

General Instructions

These instructions provide a general overview of the annual filing and payment requirements for pass-through entities and trusts. For detailed information, see Ohio Revised Code (O.R.C.) sections 5733.40, 5733.41 and 5747.40 through 5747.453. You can also call 1-614-438-5317 (Ohio Relay Service, 1-800-750-0750) for additional assistance.

Each "qualifying pass-through entity" (defined on page 2) doing business in Ohio or otherwise having nexus with Ohio under the Constitution of the United States is subject to a 5% withholding tax and an 8.5% entity tax based upon the qualifying investors' share of the qualifying pass-through entity's profits apportioned to Ohio (see "Who is a Qualifying Investor?" on page 2).

Similarly, each "qualifying trust" (defined on page 2) is subject to a 5% withholding tax based upon distributions of certain types of income (discussed on page 2) to individuals who are nonresidents of Ohio for any portion of the trust's taxable year. **This yearly withholding tax return, the Ohio form IT 1140, is due on the 15th day of the fourth month following the end of the qualifying pass-through entity's or qualifying trust's taxable year.** However, the tax is due only if the "adjusted qualifying amount" exceeds \$1,000 (see Schedule B, line 9 and Schedule D, line 3).

Which form should I use: IT 1140 or IT 4708?

Pass-through entities having as equity investors only non-resident individuals and nonresident trusts can generally choose to file either form IT 1140 or form IT 4708. The pass-through entity makes the choice (pass-through entities having other persons as equity investors generally must file form IT 1140 and may also file form IT 4708). Form 1140 is based upon the **first** day of the pass-through entity's calendar or fiscal year; form IT 4708 is based upon the **last** day of the pass-through entity's calendar or fiscal year. A pass-through entity that changes forms from year to year must make sure that all periods of income are reported and all related tax is timely and fully paid.

Example: A pass-through entity whose equity investors are composed solely of nonresident individuals has a January 31 fiscal year end. For the fiscal year beginning February 1, 2003 and ending January 31, 2004 the pass-through entity elects to file form IT 4708 for the 2004 year (this return would be due April 15, 2005 – not April 15, 2004). For the fiscal year beginning February 1, 2004 and ending January 31, 2005 the pass-through entity elects to file form IT 1140 – also for the 2004 year (this return would be due May 15, 2005.) For the fiscal year beginning February 1, 2005 and ending January 31, 2006 the pass-through entity elects to file form IT 4708 for the 2006 year (this return would be due April 15, 2007). With this fact pattern the pass-through entity will not file a 2005 Ohio return, but the pass-through entity will have reported all periods of income.

Extension of Time to File

If the qualifying pass-through entity or the qualifying trust has an extension of time to file its federal tax return (I.R.S. form 1065 or 1120S or 1041), then the qualifying pass-through entity or qualifying trust has the same extension of time to file the Ohio form IT 1140.

However, there is no extension of time for payment of the 5% withholding tax or the 8.5% entity tax. Late payments are subject to interest, penalties and interest penalties. If the qualifying pass-through entity or qualifying trust has secured from the I.R.S. an extension of time to file, use Ohio form IT 1140EXT (for taxable years beginning in **2004**) to remit any 5% withholding tax and/or 8.5% entity tax due but not paid as of the unextended due date.

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 I.R.S. or, if as a result of any other recomputation or redetermination a change occurs in any item entering the computation of the taxpayer's 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 return no later than one year after final determination of the adjustment for federal income tax purposes.

This provision applies even if the statute of limitations has passed and applies to amended returns that reflect overpayments as well as to amended returns that reflect underpayments. If the amended return reflects an underpayment, the amended return must be accompanied by payment of any additional tax and interest. If the amended return reflects an overpayment, the amended return must be accompanied 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).

Upon completing an amended return, please check the "amended return" box on the front of the return.

Estimated Withholding Tax Payments for Taxable Year Beginning in 2005

If the qualifying pass-through entity or qualifying trust has nexus with Ohio during any portion of its taxable year beginning in 2005, the qualifying pass-through entity or qualifying trust must make estimated withholding payments during the taxable year only if (i) the sum of the "adjusted qualifying amounts" for the taxable year beginning in 2004 exceeded \$10,000 **and** (ii) the sum of the "adjusted qualifying amounts" for the taxable year beginning in 2005 exceeded \$10,000. For the calculation of the **adjusted qualifying amount** see Ohio form IT 1140ES Worksheet #1 (line 9) and Ohio form IT 1140ES Worksheet #3 (line 3), available on our Web site.

These estimated payments are due on the 15th day of the month following the last day of each quarter of the taxable year. Late payments of estimated tax are subject to interest penalties (see Ohio form IT 2210). Form IT-1140ES for taxable years beginning in 2004 must accompany each estimated payment.

Definitions

A **qualifying pass-through entity** is generally a disregarded entity, a qualifying subchapter S subsidiary of an S corporation, a partnership or a limited liability company treated as a partnership for federal income tax purposes. However, a qualifying pass-through entity does not include the following:

- Disregarded entities and qualifying subchapter S subsidiaries if the entities' owner(s) is (are) filing with the Ohio Department of Taxation the appropriate income or franchise tax returns,
- Entities having no qualifying investors (see "Who is a Qualifying Investor?" on this page),

- Pension plans and charities (an entity exempt from federal income tax pursuant to Internal Revenue Code (I.R.C.) section 501(a) or 501(c)),
- Publicly traded partnerships (a partnership with equity securities registered with the U. S. Securities Exchange Commission under section 12 of the *Securities Exchange Act of 1934*),
- Entities that are real estate investment trusts, regulated investment companies or real estate mortgage investment conduits,
- Any entity treated as a "disregarded entity" for federal income tax purposes (see the "Check the Box" U.S. Treasury regulations), and
- Qualified subchapter S subsidiary (QSSS) corporations (however, if the parent S corporation has qualifying investors, the parent S corporation is a pass-through entity that must compute the tax on a consolidated basis with all of the S corporation's QSSS corporations).

A **qualifying trust** is generally any trust that meets all three of the following requirements during the trust's taxable year:

- The trust must file the I.R.S. form 1041, U.S. Income Tax Return for Estates and Trusts,
- The trust has at least one beneficiary who is neither a full-year Ohio resident individual nor an Ohio resident estate, and
- The trust makes a distribution to a nonresident beneficiary, and the distribution relates either to real estate located in Ohio or to tangible personal property located in Ohio.

Who is a Qualifying Investor?

According to O.R.C. section 5733.40(l), a **qualifying investor** is any qualifying pass-through entity investor other than those pass-through entity investors listed below:

1. Investors that are pension plans or charities (investors that are exempt from federal income tax pursuant to I.R.C. section 501(a) or 501(c)).
2. Investors that are publicly traded partnerships (investors that are partnerships with equity securities registered with the U. S. Securities Exchange Commission under section 12 of the *Securities Exchange Act of 1934*).
3. Investors that are colleges or universities (investors that are "institutions of higher education" as defined in O.R.C. section 3334.01(F)).
4. Investors that are public utilities in Ohio and required to pay the Ohio gross receipts excise tax.
5. Investors that are insurance companies, fraternal corporations, beneficial corporations, bond investment corporations, health maintenance organizations or any other corporation required to file an annual report with the Ohio superintendent of insurance.

6. Investors that are dealers in intangibles as defined in O.R.C. section 5725.01(B).
7. Investors that are real estate investment trusts, regulated investment companies or real estate mortgage investment conduits.
8. Investors who are individuals, estates or trusts, and are residents of Ohio for the pass-through entity's entire taxable year.
9. Nonresident individuals on whose behalf the qualifying pass-through entity files Ohio form IT 4708, "Annual Composite Income Tax Return for Investors in Pass-through Entities."
10. Investors that are financial institutions required to pay the corporation franchise tax in accordance with O.R.C. section 5733.06(D) on the first day of January of the calendar year immediately following the last day of the financial institution's calendar or fiscal year in which ends the qualifying pass-through entity's taxable year.
11. Investors that are themselves qualifying pass-through entities if those qualifying pass-through entities' investors during the three-year period beginning 12 months prior to the first day of the entity's taxable year are limited to those investors set forth in items #1 through #10, above (or any combination thereof).
12. Investors that are themselves pass-through entities, but only if the owners of those other pass-through entities are limited to (i) individuals who are full-year residents of Ohio, (ii) estates domiciled in Ohio, (iii) nonresident individuals on whose behalf those other pass-through entities file Ohio form IT 4708, "Pass-through Entity Composite Income Tax Return," and (iv) nonresident estates on whose behalf those other pass-through entities file Ohio form IT 4708, "Pass-through Entity Composite Income Tax Return."
13. Investors that satisfy all the following:
 - The investor submits a written statement to the qualifying pass-through entity stating that the investor irrevocably agrees that the investor has nexus with Ohio and is subject to and liable for the corporation franchise tax calculated under O.R.C. section 5733.06 with respect to the investor's distributive share of income attributable to the pass-through entity,
 - The investor makes a good faith and reasonable effort to fully comply with all of the corporation franchise tax reporting and paying requirements set forth in O.R.C. chapter 5733, and
 - Neither the investor nor the qualifying pass-through entity carries out, at any time, any transactions either with any related members of the investor or with any related member of the entity where such transactions either result in or would result in a reduction or deferral of the Ohio corporation franchise tax.
14. Investors that are either trusts or funds whose beneficiaries are limited to the following during the taxable year of the qualifying pass-through entity:
 - Persons that are or may be beneficiaries of a pension plan trust, profit-sharing trust, a stock bonus plan trust or similar retirement trust, or
 - Persons that are or may be beneficiaries of or the recipients of payments from a trust or fund that is a nuclear decommissioning reserve fund, a designated settlement fund, or any other similar trust or fund established to resolve and satisfy similar injury claims, or
 - Persons who are or may be the beneficiaries of a complex trust, but only if the trust irrevocably agrees in writing that, for the taxable year during or for which the trust distributes any of its income to any of its beneficiaries who are individuals residing outside Ohio, the trust will be withholding tax as required under the O.R.C. sections 5747.41 through 5747.453.
15. Investors that are corporations paying the Ohio corporation franchise tax but only if all the other investors in the qualifying pass-through entity are limited to: i) other corporations that are paying the Ohio corporation franchise tax and/or (ii) corporations that would be paying the Ohio corporation franchise tax if they were not eligible for the Ohio corporation franchise tax exemption set forth in O.R.C. section 5733.09 (see the second sentence of the third paragraph of O.R.C. section 5733.41).
16. Investors that are "investment pass-through entities" (defined on page 4), but only if the investment pass-through entity provides to the qualifying pass-through entity the name, address and social security number for each person who has invested in the investment pass-through entity.

Special Rules

- A. The 8.5% tax does not apply to any pass-through entity to the extent that the pass-through entity's distributive shares of income and gain pass through from that entity to another pass-through entity (hereinafter referred to as the "investing entity") if the investing entity (i) is not an investment pass-through entity (defined on page 4), (ii) irrevocably acknowledges that it has nexus with this state under the U.S. Constitution during the taxable year, (iii) makes a good faith and reasonable effort to comply with both the 8.5% entity tax law and the 5% withholding tax law, and (iv) includes in its apportionment factors (see Schedule C) its proportionate share of each lower-tiered pass-through entity's property, payroll and sales. See O.R.C. section 5733.402.
- B. Neither the 8.5% entity tax nor the 5% withholding tax applies to an investment pass-through entity's items of income listed below.

An investment pass-through entity is a pass-through entity having for its qualifying taxable year at least 90% of its

assets represented by intangible assets and having for its qualifying taxable year at least 90% of its gross income from one or more of the following sources:

- All transaction fees in connection with the acquisition, ownership or disposition of intangible property.
- Loan fees
- Financing fees
- Consent fees
- Waiver fees
- Application fees
- Net management fees (management fees that the pass-through entity earns or receives from all sources reduced by the management fees that the pass-through entity incurs or pays to any person), but only if such net management fees do not exceed 5% of the pass-through entity's profit.
- Dividend income
- Interest income
- Net capital gains from the sale or exchange of intangible property, and
- All types and classifications of income attributable to distributive shares of income from other pass-through entities.

The percentages are based upon quarterly averages calculated during the pass-through entity's taxable year. Furthermore, for purposes of determining if a pass-through entity is an investment pass-through entity, intangible assets include investments in other pass-through entities. See O.R.C. section 5733.402.

C. An investor (subsequently referred to as a "deemed investor") in an investment pass-through entity shall be deemed to be an investor in any other qualifying pass-through entity in which the investment pass-through entity is a direct investor.

Each deemed investor's portion of the qualifying pass-through entity's adjusted qualifying amount will be the adjusted qualifying amount that would otherwise pass through from the qualifying pass-through entity to the investment pass-through entity multiplied by the percentage of the deemed investor's direct ownership in the investment pass-through entity. Thus, the qualifying pass-through entity must pay the 5% withholding tax and 8.5% entity tax as if the investors in the investment pass-through entity were actual investors in the qualifying pass-through entity (hence, "deemed investors").

However, this rule applies only to the extent the investment pass-through entity provides on a timely basis to the qualifying pass-through entity the name, address and social security number or federal identification number for each investor in the investment pass-through entity.

If the investment pass-through entity does not provide on a timely basis to the qualifying pass-through entity the name, address and social security number or federal identification number for each investor in the investment pass-through entity, then (if the investment pass-through entity is a qualifying investor) the qualifying pass-through entity must pay the 8.5% entity tax with respect to the distributive share of income and gain passing through from the qualifying pass-through entity to the investment pass-through entity.

If the taxable year of the investment pass-through entity ends on a day that is different than the last day of the qualifying pass-through entity's taxable year, then this rule applies to those persons who are the direct investors in the investment pass-through entity on the last day of the qualifying pass-through entity's taxable year ending within the investment pass-through entity's taxable year. See O.R.C. section 5747.401.

Calculating the Tax

The tax is due only if the adjusted qualifying amount exceeds \$1,000 (see Schedule B, line 9 and Schedule D, line 3). The tax is generally calculated as follows:

- A 5% withholding tax is applied to the adjusted qualifying amounts for all qualifying investors in qualifying pass-through entities who are nonresident individuals for any portion of the qualifying pass-through entity's taxable year (see Schedule B) and
- An 8.5% entity tax is applied to the adjusted qualifying amounts for all qualifying investors other than nonresident individuals (see Schedule B).
- A 5% withholding tax is applied to the adjusted qualifying amounts of the qualifying trust's beneficiaries who are nonresident individuals for any portion of the qualifying trust's taxable year (see Schedule D).

Required Attachments to Form IT-1140

All qualifying pass-through entities and qualifying trusts must attach to form IT 1140 the K-1 information (discussed below).

K-1 Information

Each qualifying pass-through entity and each qualifying trust must attach to this return the K-1 Information, which is any of the following:

- A paper copy of the federal schedule K-1, which the qualifying pass-through entity or qualifying trust will issue to each qualifying investor and for each qualifying beneficiary. The K-1 **must indicate the amount of tax credits that will pass through from the qualifying pass-through entity or qualifying trust to each qualifying investor or qualifying beneficiary** (see "Tax Credits Available to Certain Investors and Beneficiaries," on this page).

- A paper listing showing the name, address and federal identification number or social security number for each qualifying investor and each qualifying beneficiary. The listing **must indicate the amount of tax credits that will pass through from the qualifying pass-through entity or qualifying trust to each qualifying investor or qualifying beneficiary** (see “Tax Credits Available to Certain Investors and Beneficiaries” on this page).
- Magnetic media meeting the specifications that the I.R.S. requires for the transmission of information by magnetic media (for more information, see I.R.S. publications 1524 and 1525). The magnetic media **must set forth the name, address and federal identification number or social security number for each qualifying investor and indicate the net amount of tax credits that will pass through from the qualifying pass-through entity or qualifying trust to each qualifying investor or qualifying beneficiary** (see “Tax Credits Available to Certain Investors and Beneficiaries” on this page).

If a taxpayer submits a 3.5 inch diskette in ASCII Comma Delimited Format, the fields must appear in the following order:

1. Federal employer identification number of the qualifying pass-through entity or trust.
2. Name of qualifying pass-through entity or trust.
3. Name of a qualifying investor or qualifying beneficiary.
4. Federal employer identification number or social security number of the qualifying investor or qualifying beneficiary set forth in field number 3.
5. Street address of the qualifying investor or qualifying beneficiary set forth in field number 3.
6. City of the qualifying investor or qualifying beneficiary set forth in field number 3.
7. State of the qualifying investor or qualifying beneficiary set forth in field number 3.
8. ZIP code of the qualifying investor or qualifying beneficiary set forth in field number 3.
9. **The amount of tax credits that will pass through from the qualifying pass-through entity or qualifying trust to the qualifying investor or qualifying beneficiary set forth in field number 3** (see “Tax Credits Available to Certain Investors and Beneficiaries” on this page).

If there is more than one qualifying investor or more than one qualifying beneficiary, repeat the sequence set forth in fields number 1 through number 9. You must repeat all nine fields for each additional qualifying investor or qualifying beneficiary.

If you use magnetic media, please affix to the outside of the magnetic media a label containing the following information in large print: (i) the name and federal employer identification number of the qualifying pass-through entity or qualifying trust,

(ii) the phrase, “IT 1140 K-1 Information,” and (iii) the phrase, “Taxable Year Beginning in 2004.”

Tax Credits Available to Certain Investors and Beneficiaries

O.R.C. sections 5733.0611 and 5747.059 provide that qualifying investors (see page 2 of these instructions) can claim an income tax or franchise tax credit based upon the investor’s proportionate share of the 5% withholding tax or the 8.5% entity tax that was paid on or with respect to the qualified investor’s direct or indirect investment in the qualifying pass-through entity. O.R.C. section 5747.059 also provides a similar credit for nonresident individual qualifying beneficiaries with respect to the 5% withholding tax that a qualifying trust has withheld in connection with that nonresident individual qualifying beneficiary.

The credit is based upon the amount of tax paid for the taxable year – even if the tax is paid after the end of the taxable year.

In order for qualifying investors and qualifying beneficiaries to claim these credits, the qualifying investor or the qualifying beneficiary must attach to the corporation franchise tax report (Ohio form FT 1120 or FT 1120FI) or to the Ohio franchise tax request for refund (Ohio form FT REF) or to the Ohio income tax return (Ohio form IT 1040 or IT 1041, or IT 4708) a copy of the I.R.S form K-1 indicating the amount of the 8.5% entity tax and/or 5% withholding tax with respect to which the qualifying investor or qualifying beneficiary seeks to claim a credit. **Accordingly, each qualifying pass-through entity or qualifying trust must separately state on the form K-1, which the qualifying pass-through entity or qualifying trust will issue to the qualifying investor or qualifying beneficiary, the following information:**

- The qualifying investor’s or beneficiary’s proportionate share of the 5% withholding tax and/or 8.5% entity tax that the qualifying pass-through entity or qualifying trust paid (net of refunds shown on this return and net of amounts shown on Schedule A, line 2b, which have been transferred to Ohio form IT 4708) and
- The qualifying investor’s or beneficiary’s proportionate share of the 5% withholding tax and/or 8.5% entity tax that passes through from another pass-through entity or trust to the qualifying pass-through entity or qualifying trust (and then passes on to the qualifying investor or qualifying beneficiary).

Note: If this pass-through entity or trust has invested in a partnership or limited liability company that also filed Ohio form IT 1140, this pass-through entity or trust is not entitled to a refundable credit equal to this pass-through entity’s or trust proportionate share of tax. This pass-through entity or trust cannot claim the credit as an estimated payment for this pass-through entity’s or trust’s taxable year. However, the pass-through entity or trust can “pass through” (via the K-1s it will issue) to its qualifying investors or to its qualifying beneficiaries the

pass-through entity's or trust's proportionate share of such tax, which the investee partnership or investee limited liability company paid on behalf of this pass-through entity or trust.

Responsible Party Liability

O.R.C. section 5747.453 imposes personal liability for failure to pay the 5% withholding tax. Set forth below is that section of the law:

An employee or beneficiary of, or investor in, a qualifying entity having control or supervision of, or charged with the responsibility for, filing returns and making payments, or any trustee or other fiduciary, officer, member or manager of the qualifying entity who is responsible for the execution of the qualifying entity's fiscal responsibilities, is personally liable for the failure to file any report or to pay any tax due as required by sections 5747.40 to 5747.453 of the Revised Code. The dissolution, termination or bankruptcy of a qualifying entity does not discharge a responsible trustee's, fiduciary's, officer's, member's, manager's, employee's, investor's or beneficiary's liability for failure of the qualifying entity to file any report or pay any tax due as required by those sections. The sum due for the liability may be collected by assessment in the manner provided in section 5747.13 of the Revised Code.

Schedule B – Tax Computation

Bonus Depreciation Add-back and Miscellaneous Federal Tax Adjustments

Line 2(a) and Schedule D, line 2(a).

O.R.C. section 5733.40(A)(5) states that in determining the "adjusted qualifying amount" each taxpayer must add back (i) five-sixths of the I.R.C. section 168(k) bonus depreciation claimed for the taxable year and (ii) five-sixths of the qualifying I.R.C. section 179 depreciation expense claimed for the taxable year. Qualifying I.R.C. section 179 depreciation expense is the excess of (i) the amount of depreciation expense directly or indirectly allowed to the taxpayer under I.R.C. section 179 over (ii) \$25,000 (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). In each of the five subsequent taxable years the taxpayer can deduct one-fifth of the amount previously added back.

This new "add-back and subsequent deduction" law also covers (i) depreciable assets acquired by the taxpayer's disregarded entities and (ii) depreciable assets that are owned by pass-through entities in which the taxpayer directly or indirectly owns at least 5% (see O.R.C. section 5747.01(A)(20)(a)).

In addition, if the taxpayer is an equity investor in a pass-through entity that has claimed such depreciation and if, because of the federal passive activity loss limitation rules or because of the federal at-risk limitation rules, the taxpayer

is unable to fully deduct a loss passing through from another pass-through entity to the taxpayer, 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 such depreciation claimed by the other pass-through entity. Of course, the taxpayer cannot begin claiming the related five-subsequent-years depreciation deduction until the first taxable year immediately following the taxable year for which the taxpayer makes the 5/6 add-back.

For detailed information regarding these adjustments, see the department's July 31, 2002 information release entitled "Recently Enacted Ohio Legislation Affects Depreciation Deductions for Taxable Years Ending in 2001 and Thereafter" by visiting: www.tax.ohio.gov. Click on the "Releases" tab at the top of the page, then click on "Information Releases" and go to the Corporate Franchise Tax section. Look for the release dated **July 31, 2001 – PI & CFT 2002-01 – Recently Enacted Ohio Legislation Affects Depreciation Deductions for Taxable Years Ending in 2001 and Thereafter**.

At the time this instruction booklet was produced, there were changes made by Congress to the Internal Revenue Code that may impact the computation of your tax. If applicable, you must enter any necessary adjustments on this line. For more information, see our Web site at www.tax.ohio.gov.

Other Adjustments

Line 2(b) and Schedule D, line 2(b).

Adjustments available to taxpayers are (i) the five-subsequent-years depreciation deduction discussed above and (ii) amounts not subject to a tax on or measured by net income.

At the time this instruction booklet was produced, there were changes made by Congress to the Internal Revenue Code that may impact the computation of your tax. If applicable, you must enter any necessary adjustments on this line. For more information, see our Web site at www.tax.ohio.gov.

Line 6

Reciprocity agreements do not apply to those nonresidents directly or indirectly owning at least 20% of the stock or other equity of the pass-through entity. That is, pass-through entities cannot use the reciprocity agreements in order to avoid adding back compensation that the pass-through entities pay to such nonresidents. See O.R.C. section 5733.40(A)(7).

Amounts Not Subject to a Tax on or Measured by Net Income

O.R.C. section 5733.40(A)(2) provides that distributive shares of income from qualifying pass-through entities and distributions from qualifying trusts shall be reduced by "any amount that, pursuant to the Constitution of the United States, the Constitution of Ohio or any federal law is not subject to a tax on or measured by net income." Set forth below is a partial listing of such items of income:

- Federal interest income that under federal law is exempt from state tax measured on or by net income (see the department's January 9, 1992 information release entitled "Corporate Franchise Tax and Personal Income Tax Information Release," which lists most types of federal interest income that is exempt). You can obtain a copy of the release by accessing the department's Web site at www.tax.ohio.gov. Click on "Releases" at the top of the screen.
- All income that the qualifying pass-through entity earns if the qualifying pass-through entity claims an exemption under U.S. Public Law 86-272 and if the qualifying pass-through entity has no related members having nexus with Ohio under the Constitution of the United States for any portion of a qualifying pass-through entity's qualifying taxable year (see O.R.C. section 5733.042(A)(6) for the definition of "related member").
- An investment pass-through entity's items of income listed on page 4.

Schedule C – Apportionment Factors

Note: When calculating the 5% withholding tax and the 8.5% entity tax, each qualifying pass-through entity and each qualifying trust investing in a partnership or an S corporation must apply the "aggregate" (conduit) theory of taxation. That is, the character of all income and deductions (and adjustments to income and deductions) realized by an S corporation or a partnership or a limited liability company (treated as a partnership for federal income tax purposes) in which the qualifying pass-through entity or qualifying trust has invested retains that character for purposes of the withholding tax and the entity tax when recognized by the qualifying pass-through entity. Furthermore, the qualifying pass-through entity and qualifying trust must include in its apportionment ratio its proportionate share of each lower-tiered pass-through entity's property, payroll and sales. See O.R.C. sections 5733.057 and 5747.231.

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.

For taxable years ending on or after June 26, 2003, the property factor specifically **includes** real property and tangible personal property that the pass-through entity 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 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 pass-through entity 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 not include in either column 1 (within Ohio) or in column 2 (total everywhere) the following:

- Construction in progress.
- Property relating to, or used in connection with, the production of nonbusiness income. See O.R.C. section 5733.05(B)(2) as amended by Amended Substitute House Bill 95, 125th General Assembly, applicable to taxable years ending on or after June 26, 2003.
- 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)(2)(a).
- 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.

Line 1(a), Column 1 – Owned Property Within Ohio

Enter the average value of the pass-through entity'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 pass-through entity'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 pass-through entity'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 pass-through entity's is valued at eight times the annual rental rate (annual rental expense less subrental receipts).

Line 1(c) – Total Property Within Ohio and Everywhere

Add lines 1(a) and 1(b) for column 1, (within Ohio) and column 2 (total everywhere).

Line 1(c), Column 3 – Property Ratio

Enter the ratio of property within Ohio to total everywhere by dividing column 1 by column 2.

Line 1(c), Column 5 – Weighted Property Ratio

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

Payroll Factor

The payroll factor is a fraction, the numerator of which is the total compensation paid in this state during the taxable year by the pass-through entity, and the denominator of which is the total compensation paid both within and without this state during the taxable year by the pass-through entity. As used below, the term “compensation” means any form of remuneration paid to an employee for personal services. Do not 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.
- Compensation paid to employees to the extent that the compensation relates to 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 Amended Substitute House Bill 95, 125th General Assembly applicable to taxable years ending on or after June 26, 2003).
- Compensation that an S corporation paid to any “investor” included in this report if the investor directly or indirectly owned at least 20% of the S corporation at any time during the year. O.R.C. section 5733.40(A) (7).

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 pass-through entity has received a Tax Incentive Qualification Certificate issued by the Department of Development.

Line 2, Column 1 – Payroll Within Ohio

Enter the total amount of the pass-through entity’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 pass-through entity’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%.

Sales Factor

The sales factor is a fraction whose numerator is the pass-through entity’s includable business income receipts in Ohio during the taxable year and whose denominator is the sum of the pass-through entity’s within Ohio and without Ohio includable business income receipts during the taxable year.

The sales factor specifically excludes receipts attributable to nonbusiness income allocable under 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 and the tax commissioner’s April 2004 information release entitled “Sales Factor Situsing Revisions”).

The following receipts are not 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 I.R.C.; and

- Receipts from sales to: (a) an at-least 80%-owned public utility other than an electric company, combined electric company, or telephone company, (b) an at-least 80%-owned insurance company, or (c) an at-least 25%-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 pass-through entity reporting any allocable income from Schedule 1, lines 4 and 8 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 pass-through entity 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, (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 situsued 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 situsued 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 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 situsued 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 situsued within or without Ohio under the above situsuing 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.

Line 3, Column 5 – Total Weighted Apportionment Ratio

Add column (5), lines 1 (c), 2 and 3). Enter ratio here and on on page 1, upper right-hand corner, and on page 1, line 6.

Payment Transfers – Schedule A, Lines 2a and 2b

If the pass-through entity or trust has used Ohio form IT-4708ES to make estimated payments in connection with the pass-through entity composite income tax, the pass-through

entity or trust can elect to apply some or all of those IT 4708ES payments to satisfy the tax due on Ohio form IT 1140. If the pass-through entity or trust so elects, please indicate on form IT 1140, Schedule A, line 2a the amount to be transferred from the IT-4708ES payments to form IT 1140. If the pass-through entity will be filing both form IT 1140 and form IT 4708, please attach to form IT 1140 a schedule setting forth (i) the dates on which the pass-through entity or trust made the IT 4708ES or IT 4708EXT payments and (ii) the amount of each payment transferred to form IT 1140.

The pass-through entity can also elect to transfer IT 1140ES payments to Ohio form IT 4708 ("Pass-through Entity Composite Income Tax Return"). To the extent that the pass-through entity elects to make such transfers, please indicate on form IT 1140, Schedule A, line 2b the amount to be transferred from the IT-1140ES or IT 1140EXT payments to the form IT 4708. If the pass-through entity will be filing both form IT 1140 and the IT 4708, the pass-through entity should attach to form IT 4708 a schedule setting forth (i) the dates of the IT 1140ES payments and (ii) the amount of each payment transferred to form IT 4708.

Preparer's Signature

I.R.S. Notice 2004-54 provides for alternative preparer-signature procedures for federal income tax paper returns that paid practitioners prepare on behalf of their clients. Paid preparers can follow those same procedures with respect to the following Ohio paper returns: Ohio school district and individual income tax returns, Ohio withholding tax returns (employer and pass-through entity) and Ohio corporation franchise tax reports. Statutory authority: O.R.C. sections 5703.262(B) and 5747.08(F).

Federal Privacy Act Notice

Because we are requesting your social security account number, the *Federal Privacy Act of 1974* requires us to inform you that your providing us your social security number is mandatory. O.R.C. sections 5703.05 and 5747.08 authorize our asking you for this information. We need your social security number in order to administer this tax. Your failure to supply any information requested on a tax form prescribed by the tax commissioner may result in the imposition of penalties for failing to file a complete tax return or the denial of a license application, if applicable.

Taxpayer Assistance

By Internet



**Ohio Department of Taxation
Internet Web site – www.state.oh.us/tax/**

**Tax Forms
Instructions
Information Releases
E-mail us**

By Phone



Toll Free Telephone Numbers:

Toll Free Business Taxpayer Service 1-888-405-4039
Toll Free Form Requests 1-800-282-1782
Toll Free Registration Unit 1-888-405-4089

Written



Ohio Department of Taxation Taxpayer Services Mailing Address:

Ohio Department of Taxation
Taxpayer Services Division
Taxpayer Services Contact Center
P.O. Box 182382
Columbus, Ohio 43218-2382

Walk-in



Ohio Department of Taxation Taxpayer Service Locations:

Taxpayer Service Center Hours
Office hours: 8:00 a.m. – 5:00 p.m.
Monday through Friday
See location listing in next column.

Ohio Department of Taxation Taxpayer Service Centers

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

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

Cleveland Taxpayer Service Center
615 W. Superior Ave.
Fifth Floor, Rm. 570
Cleveland, OH 44113-1891

Columbus Taxpayer Service Center
800 Freeway Drive North
Columbus, OH 43229

OR

30 East Broad St., 20th Floor
Columbus, OH 43215

Dayton Taxpayer Service Center
Centre City Offices
40 S. Main St., 5th Floor
Dayton, OH 45402-2043

Toledo Taxpayer Service Center
One Gov't. 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.

Volunteer Tax Assistance Program (VITA) and Tax Counseling for the Elderly (TCE): These programs help older, disabled, low-income and non-English speaking people fill in their state and federal returns. For locations in your area, call the Internal Revenue Service at 1-800-829-1040. If you received an Ohio and/or federal income tax package in the mail, take them with you when you go for help.