Ohio H.B. 510 Revises Taxation of Financial Institutions

December 19, 2012

Full text of Am. Sub. H.B. 510

The Ohio General Assembly has passed legislation that reforms and updates the manner in which Ohio taxes financial institutions. The new financial institutions tax (FIT) replaces the remaining vestiges of the corporation franchise tax and the tax on dealers in intangibles. The FIT will apply in tax years beginning on January 1, 2014. The governor is expected to sign the bill.

Under current law, banks and similar entities are taxed at a rate of 13 mills on their Ohio net worth. Dealers in intangibles, such as mortgage brokers, stockbrokers, and finance and loan companies not otherwise classified as financial institutions, are taxed at a rate of 8 mills on their Ohio shares and capital. The bill modernizes the taxation of financial institutions and lowers the rate at which they are taxed. Dealers in intangibles, except to the extent included in the tax base of a financial institution, are subjected to the commercial activity tax like other business entities.

Taxpayers. Under the law, "bank organization" means the type of banking or savings associations, whether created under state or federal law, previously taxed as financial institutions under the franchise tax.[1] A "financial institution" includes bank organizations, holding companies of bank organizations and certain nonbank financial organizations. Where two or more entities are consolidated for filing regulatory reports, such as an FR Y-9 or a call report, "financial institution" means all entities included in the report. It does not include a company charted under the "Federal Farm Loan Act," an insurance company or a credit union.[2]

A "captive finance company" generally means a person that derives at least 75 percent of its gross income for the current taxable year and two preceding taxable years from:

> (i) financing transactions with or for members of its affiliated group, or an affiliated group member's customers, distributors, franchisees or manufacturing-related suppliers;
>
> (ii) issuing bonds or other publicly traded instruments for the benefit of the affiliated group; or
>
> (iii) making short- or long-term investments with the affiliated group's cash reserves for the benefit of the affiliated group.

An "affiliated group" is a group of entities under common ownership of 50 percent or more. For example, the financing arm of a manufacturer that extends credit to dealers or retail customers of its products is a captive finance company. Captive finance companies are excluded from the FIT; therefore, they are subject to the commercial activity tax.[3]

A "nonbank financial organization" includes every person that is not a bank organization or a holding company of a bank organization and that engages in business primarily as a small dollar lender.[4] A "small dollar lender" means any person engaged primarily in the business of loaning money to individuals, provided that the loan amounts do not exceed $5,000 and the duration of the loans do not exceed 12 months. A small dollar lender does not include a bank organization, credit union or captive finance company.[5]

Entities such as dealers in intangibles and small dollar lenders that are not subject to the FIT will be subject to the commercial activity tax.

Tax Rate. The tax is imposed on each financial institution for the privilege of doing business in Ohio. It is imposed for each year that the financial institution is doing business in Ohio, or that it otherwise has nexus with Ohio under the Constitution of the United States, on the first day of January.[6] The annual tax due is the greater of the minimum tax of $1,000,[7] or the tax calculated under the following schedule:

- 8 mills on the first $200 million of Ohio equity capital; plus
- 4 mills for each dollar of the Ohio equity capital between $200 million and $1.3 billion; plus
- 2.5 mills for each dollar of Ohio equity capital in excess of $1.3 billion.

The law also contains two periods at which the tax rate may be adjusted. If the total tax actually collected for the 2014 tax year exceeds $200 million (i.e., the "first target tax amount") by more than 10 percent, then all tax rates shall be reduced by the percentage that the amount collected exceeded the first target tax amount. If the amount collected is less than 90 percent of the first target tax amount, then the top rate shall be increased by the percentage equal to the shortfall that is less than 90 percent.[8]

For the tax year beginning January 1, 2016, a similar calculation and rate adjustment is made to the extent that the tax collected exceeds or falls short of 106 percent of the first target tax amount, as adjusted if at all pursuant to the prior paragraph.[9]

Any adjustment is rounded to the nearest one-tenth of one mill per dollar. Any adjustment applies to tax years beginning on or after January 1, 2015, or January 1, 2017, respectively.

Tax Base. The "total equity capital" of a financial institution means the sum of the common stock, preferred stock, other surplus, retained earnings, treasury stock and other equity components of the financial institution.[10]

"Ohio equity capital" means the portion of the total equity capital that is apportioned to Ohio pursuant to R.C. 5726.05.[11] Under that section, equity capital is apportioned to Ohio using a factor based upon the gross receipts of the financial institution.[12] The apportionment factor is a fraction; the numerator of which is the total gross receipts in Ohio for the year, and the denominator of which is the total gross receipts everywhere for the year. Gross receipts generally are in Ohio in the proportion that the customers benefit from the services provided in Ohio; in making this determination, the location where the customer ultimately uses or receives the benefit shall be paramount in determining the proportion.

The statute[13] provides a list of examples of gross receipts that are included in the numerator of the fraction:

- Receipts from the lease, sublease, rental or sub-rental of real property located in Ohio, or of tangible personal property to the extent the property is used in Ohio;
- Interest, fees, penalties or other charges received from loans secured by real property located in Ohio or from loans not secured by real property if the borrower is in Ohio;
- Net gains, but not less than zero, from the sale of loans secured by real property located in Ohio or of loans not secured by real property if the borrower is located in Ohio;
- Interest, annual fees, penalties or any other charge from credit card receivables and from cardholders; net gains, but not less than zero, from the sale of credit card receivables; and reimbursement fees of a credit card issuer, all if the billing address of the cardholder is in Ohio;
- Receipts from merchant discounts if the merchant is located in Ohio;
- Loan servicing fees from loans secured by real property located in Ohio or from loans not secured by real property if the

borrower is located in Ohio or derived from servicing loans from other financial institutions if the borrower is located in Ohio;

- Receipts not otherwise listed if the payor of the receipts is located in Ohio.

Receipts from investment or trading assets and activities are in Ohio either to the extent the customer is in Ohio, or at the election of the taxpayer, to the extent the activities are assigned to a regular place of business in Ohio, based on where the day-to-day decisions regarding the activity are made. Once made, the election cannot be changed without the permission of the Tax Commissioner. The burden is placed on the taxpayer to establish that the activity takes place at a place of business outside Ohio.[14]

If the statutory apportionment provisions do not fairly represent the extent of a taxpayer's business activity in Ohio, the taxpayer may request and the Tax Commissioner may permit or require the use of an alternative apportionment method.[15]

If the total equity capital of a financial institution includes investment in a real estate investment trust that is and, on January 1, 2012, was traded on a public stock exchange, the portion of the equity associated with the ownership of the real estate investment trust is phased in by 20 percent increments between tax year 2014 and 2018 when the investment is fully included.[16] During the phase-in period, the gross receipts of the real estate investment trust included in both the numerator and the denominator of the apportionment factor are likewise phased in.

Reporting and Paying the Tax. The greater of the minimum tax, or one-third of the calculated tax due, must be paid by January 31 annually. If the tax due exceeds the minimum tax, additional payments of one-half of the balance are due March 31 and May 31.[17] Payments must be made electronically.[18] Special rules for computing the estimated tax apply if the taxpayer was not a financial institution for the current tax year and the two prior tax years.[19]

An annual report is due October 15 together with any unpaid tax.[20]

Penalties & Interest. The following penalties may be imposed:[21]

- For any report that is not filed timely, a penalty equal to the greater of $50 per month up to $500, or 5 percent per month up to 50 percent of the tax due;
- Except for any estimated tax payment, a penalty of 15 percent for any tax that is not paid timely;
- For a report that does not contain all information required by law or rule or that is frivolous or intended to delay or impede administration of the law, a penalty up to $500;
- For a fraudulent report or refund claim, a penalty equal to the greater of $1,000 or 100 percent of the tax due or claim made.

There is also a penalty for the failure to remit tax payments or to file reports electronically. For each of the first two failures to file electronically, a penalty of 5 percent of the amount of the tax that was required to be paid may be imposed. For the third and subsequent event, the penalty is increased to 10 percent of the payment that was required.[22]

All penalties may be abated by the Tax Commissioner.

With respect to the estimated tax, interest at the rate prescribed by R.C. 5703.47 applies to the extent the amount of estimated tax that is paid is less than the amount of tax shown to be due on the report that is filed for the tax year.[23] In addition, if any tax other than an estimated payment is not paid when due, interest at the rate prescribed by R.C. 5703.47 applies from the date the payment was due until it is paid or an assessment is issued.[24]

Assessment and Refunds. Assessment and refund provisions mirror provisions of other existing taxes. The statute of limitations for both deficiency assessments and refund claims is four years, although the periods may be extended by agreement of the taxpayer and the Tax Commissioner.[25]

In addition to assessments, a taxpayer that fails to file a report or to pay the tax may have its organizing document of creation authorizing it to do business in Ohio canceled. A taxpayer having its document of creation canceled may be reinstated upon filing all reports, paying all taxes and paying a reinstatement fee.[26]

Credits Against the Tax. The following credits may be claimed against the tax:

- The refundable credit for jobs creation or retention under R.C. 122.17 or R.C. 122.17(B)(2) or (3);[27]
- The nonrefundable credit for job retention under R.C. 122.171(B)(1);[28]
- A nonrefundable credit equal to the aggregate annual assessment paid by each member of the taxpayer to the Division of Financial Institutions of the Department of Commerce;[29]
- A refundable credit for the rehabilitation of a historic building for which a certificate is issued under R.C. 149.311;[30]
- A refundable credit for each member holding a venture capital loan certificate under R.C. 150.07.[31]
- A nonrefundable credit for a qualified equity investment under the New Markets program;[32]
- A refundable credit for a motion picture production certificate issued under R.C. 122.85;[33]
- A refundable credit for qualified research and development expenses;[34]
- A nonrefundable credit for tax year 2014 only that is for the tax paid by a dealer in intangibles that is part of the financial institution and that paid the dealers in intangibles tax during 2013.[35]

In addition, if any member of the affiliated group making up a financial institution and that includes a "diversified savings and loan holding company" or a "grandfathered unitary savings and loan holding company" (both as defined under federal law and neither of which is, itself, subject to the FIT) has a jobs retention tax credit certificate, any member of the group may claim the benefit of the credit.[36] All credits must be claimed in the order set forth in R.C. 5726.98.

Miscellaneous Provisions. The new provisions are effective for tax years beginning on or after January 1, 2014. At that time, entities that do not qualify as financial institutions, including dealers in intangibles, small dollar lenders, and captive finance companies, are subject to the commercial activity tax.[37]

The legislation prohibits municipal corporations from imposing a tax that is the same as or similar to the new FIT.[38]

A refundable credit against the personal income is provided for individuals, estates or trusts that own a pass-through interest in a financial institution that pays the FIT. The credit is equal to the owner's proportionate share of the lesser of the FIT due, or paid, in a taxable year. However, if the tax is deducted in computing net income by the owner, then the amount of the deduction must be added back to net income.[39]

Uncodified sections of the legislation[40] provide that the Tax Commissioner may not assess, or hold liable for failing to report or pay the CAT, any person directly or indirectly owned by one or more insurance companies for any tax periods prior to January 1, 2013, provided that the person, if a corporation, reported and paid the franchise tax for such periods. Such a person is subject to the CAT beginning January 1, 2013.

Finally, a number of non-substantive revisions are made to various existing laws in order to conform their terms with the FIT.

Footnotes

1. R.C. 5726.01(A)
2. R.C. 5726.01(H)

3. R.C. 5726.01(D)
4. R.C. 5726.01(M)(1)
5. R.C. 5727.01(O)
6. R.C. 5726.02
7. R.C. 5726.02(B), R.C. 5726.04(A)(1)
8. R.C. 5726.04(E)(2), (3)
9. R.C. 5726.02(E)(4), (5)
10. R.C. 5726.01(S)
11. R.C. 5726.01(T)
12. R.C. 5726.05(A)
13. R.C. 5726.05(C); this method is substantially the same as that used for most services under the commercial activity tax, *see* R.C. 5751.033(I)
14. R.C. 5726.05(D)-(F)
15. R.C. 5726.05(G)
16. R.C. 5726.041
17. R.C. 5726.06(A)
18. R.C. 5726.03(C)(1), R.C. 5726.06(B)(1)
19. R.C. 5726.06(C)
20. R.C. 5726.03(A)
21. R.C. 5726.21
22. R.C. 5726.03(C)(4)
23. R.C. 5726.07(A), (B)
24. R.C. 5726.32
25. R.C. 5726.20, R.C. 5726.30
26. R.C. 5726.40, R.C. 5726.42
27. R.C. 5726.50(A)
28. R.C. 5726.50(B)
29. R.C. 5726.51
30. R.C. 5726.52
31. R.C. 5726.53
32. R.C. 5726.54, R.C. 5725.33
33. R.C. 5726.55

34. R.C. 5726.56

35. R.C. 5726.57

36. R.C. 122.171(N)

37. R.C. 5711.22, R.C. 5751.01

38. R.C. 715.013

39. R.C. 5747.65, R.C. 5747.01(A)(16), (S)(11)

40. *See* sections 4 and 5 of the legislation.

Authors

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