

Ohio Governor DeWine Signs Biennial Budget Bill

Overview

On July 18, 2019, Ohio Governor Mike DeWine signed Amended Substitute House Bill No. 166¹ ("H.B. 166" or the "Bill"), which makes various changes to Ohio's tax laws in the areas of individual income tax, municipal income tax, pass-through entities, credits and incentives, and sales and use tax. This Tax Alert will focus on some of the more notable changes to Ohio's tax law made by H.B. 166, which include (but are not limited to):

Income Tax

- Eliminates the lowest two personal income tax brackets and continues indexing the marginal tax rates in all remaining tax brackets beginning in tax year 2020. After enactment Ohio's highest marginal tax rate will be 4.797%;
- Retains the current business income deduction, but excludes business income from lawyers and lobbyists' services as being qualified business income for purposes of the deduction; and
- Repeals the income tax credit for a pass-through entity investor's share of the financial institutions tax.

Municipal Income Tax

- Provides a tax exemption for income from any retirement benefit plan, including supplemental executive retirement plans ("SERPs"), for municipal income tax purposes.

Pass-through Entities

- Provides procedures for pass-through entities and their investors on how to report adjustments related to a federal audit.

Credits and Incentives

- Creates a new Opportunity Zone Investment income tax credit equal to 10%, up to \$1 million per biennium, of an individual, trust, or estate's investment in an Ohio Qualified Opportunity Fund.

Sales and Use Tax

- H.B. 166 also addresses its sales and use tax substantial nexus provisions in light of the *Wayfair* decision.²

This Tax Alert summarizes the key tax provisions in connection with H.B. 166 and unless otherwise noted the changes are generally effective as of the day of enactment.

Personal Income Tax

Ohio's H.B. 166 reduces personal income tax rates beginning in tax year 2019, where the top marginal rate will decrease from 4.997% to 4.797%.³ In addition, the bottom two personal income tax brackets are eliminated with no tax being due for individuals with Ohio taxable income of \$21,750 or less.⁴ Prior to tax year 2020, individuals with Ohio taxable income less than \$10,500 were not subject to income tax.⁵

¹ Amended Substitute H.B. 166, available [here](#).

² *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018).

³ Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 5747.02(A)(3).

⁴ *Id.*

⁵ Ohio Rev. Code Ann. § 5747.02(A)(3).

Ohio currently provides individual taxpayers with a deduction for business income from their federal adjusted gross income up to \$125,000 per spouse for married filing separate taxpayers, and \$250,000 for all other taxpayers.⁶ In addition, any business income in excess of the deduction is subject to a flat 3% income tax rate.⁷ H.B. 166 retains the current business income deduction for individuals and 3% flat rate. However, the Bill excludes income from a trade or business that performs either legal services provided by an active attorney or an executive agency lobbying activity, retirement system lobbying activity or actively advocating by a person required to register with the joint legislative ethics committee as being ineligible business income for purposes of the business income deduction.⁸ These amendments are effective for tax years beginning on or after January 1, 2020.

The Bill also creates a new Opportunity Zone Investment income tax credit equal to 10% of an individual's investment in an Ohio qualified opportunity fund during the preceding calendar year.⁹ This new credit is complementary with the federal Opportunity Zone Credit program. The new nonrefundable income tax credit will be limited to \$1 million per taxpayer per biennium and will be able to be claimed by individuals, trusts, estates, and or taxpayers through a pass-through entity.¹⁰ Any credit in excess of tax will be permitted to be carried forward up to five years, and, in addition, is a transferrable tax credit.¹¹ A taxpayer that holds an unclaimed credit may notify the tax commissioner, in writing, that they are transferring the right to claim the credit to another taxpayer. Once the credit is transferred to the transferee, the transferee cannot in turn transfer the credit to another taxpayer.¹² In order to qualify for the tax credit, the invested assets must be 100% invested in an Ohio opportunity zone property and taxpayers will be required to apply for the credit, each year, starting January 1st through February 1st with the Director of Development Services.¹³

Another notable change in Ohio's personal income tax regime provided by H.B. 166 is the repeal of the refundable income tax credit for a pass-through entity investor's share of the financial institutions tax ("FIT").¹⁴ This change is effective for tax year 2019. The FIT is generally imposed on all bank organizations, holding companies of bank organizations, or nonbank financial organizations and is based on the taxpayer's total Ohio equity capital which is generally the product of its total equity capital multiplied by its Ohio apportionment factor.¹⁵ Prior to H.B. 166, Ohio permitted a refundable credit equal to the lesser of a pass-through entity's FIT due or paid for the year to be passed through to its investors.¹⁶ The repeal of the FIT credit for pass-through entity investors is effective for tax years beginning on or after January 1, 2019.

Municipal Income Tax

Under Ohio's current municipal income tax regime, income from most retirement plans is exempt from municipal income tax.¹⁷ Prior to the Bill, Ohio did not define "pension" nor "retirement benefit plan". This allowed municipal corporations the opportunity to define each "pension" and/or "retirement benefit plan" to include or exclude which types of plans qualify for the municipal income tax exemption. H.B. 166 defines "pension" and "retirement benefit plan" for purposes of Ohio's municipal income tax which essentially provides that income from all retired benefit plans, including those that do not qualify for federal income tax deferral or exemption from FICA or Medicare taxes, are exempt from municipal income taxation.¹⁸ The new definition of "retirement benefit plan" includes supplemental executive retirement plans ("SERPs").¹⁹ This exemption would apply to municipal tax years beginning on or after January 1, 2020.

⁶ Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 5747.01(A)(31).

⁷ Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 5747.02(A)(4)(a).

⁸ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5747.01(B)(2).

⁹ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 122.84(B).

¹⁰ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 122.84(C)(3). The term "biennium" refers to Ohio's fiscal biennium ending June 30, 2021. The total amount of credits permitted to be claimed per biennium is limited to \$50 million for all taxpayers.

¹¹ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 122.84(C)(3), (E).

¹² Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 122.84(E).

¹³ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 122.84(A)(1), (B).

¹⁴ Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 5747.98(A)(26).

¹⁵ See Ohio Rev. Code Ann. §§ 5726.01(H), 5726.04(C).

¹⁶ Amended Substitute H.B. 166, repealing Ohio Rev. Code Ann. § 5747.65.

¹⁷ Ohio Rev. Code Ann. § 718.01(C)(3).

¹⁸ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 718.01(YY), (ZZ).

¹⁹ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 718.01(ZZ).

Commercial Activity Tax

The Bill extends to June 30, 2021 a temporary provision that allows owners of a historic rehabilitation tax credit certificate to continue to claim the credit against the commercial activity tax.²⁰

State-Specific Version of Federal Partnership Audit Procedures

In response to the federal partnership audit procedures,²¹ H.B. 166 prescribes new procedures for partnerships and limited liability companies (LLCs) taxed as partnerships to report state adjustments stemming from federal adjustments.²² Generally, for state purposes, the default method of reporting changes requires the partnership to file a federal adjustments return, notify its direct owners of the adjustments and submit a non-resident amended return that includes any additional tax due on its nonresident partner's distributive share of Ohio income.²³ These actions are required within 90 days of the final federal adjustments.²⁴ Each direct owner is generally then required to file an amended return to report the adjustments within 90 days after the partnership files the federal adjustments return.²⁵ The Bill also contains rules for reporting of federal adjustments in tiered partnerships.²⁶

Under H.B. 166, the partnership may alternatively elect to pay the additional liability stemming from the federal audit.²⁷ The Bill provides the partnership must file a partnership adjustment return and pay the additional tax, calculated as specified, within 90 days of the final federal adjustments.²⁸ Generally, the tax is calculated on allocated or apportioned shares of the adjustments for the non-residents or pass-through entities, and distributive shares of resident taxpayers.²⁹

The new partnership audit procedures apply to federal adjustments with a final determination date of October 1, 2019 or thereafter.³⁰

Sales and Use Tax

Ohio has made significant changes to its sales and use tax nexus standards in response to *Wayfair*. The following are some of the more notable changes to Ohio's sales and use tax provisions. The Bill adds a presumption of substantial nexus for sellers that have gross receipts in excess of \$100,000 from sales into Ohio or engage in 200 or more separate sales transactions into Ohio during the current or preceding calendar year.³¹ In addition, the Bill eliminates a presumption of substantial nexus for sellers with annual Ohio sales in excess of \$500,000 that either use computer software stored or distributed in Ohio to make Ohio sales or provide content distribution networks in Ohio to accelerate or enhance the delivery of the seller's website to Ohio consumers.³² Also, the Bill eliminates a presumption of substantial nexus for sellers that enter into "click-through" agreements with Ohio residents.³³

In addition to the new substantial nexus provisions, H.B. 166 adds the definition of a "marketplace facilitator" to its list of taxpayers subject to sales and use tax. Persons that own, operate, or control a physical or electronic marketplace through which retail sales are facilitated on behalf of other sellers, defined as "marketplace facilitators",³⁴ are, in general as

²⁰ Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 757.40(B).

²¹ Bipartisan Budget Act of 2015.

²² Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 5747.10(A).

²³ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5747.10(C). These procedures do not apply to adjustments required to reported for federal purposes under IRC section 6225(a)(2) or adjustments taken into account on amended returns pursuant to IRC section 6225(c).

²⁴ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5747.10(C)(2).

²⁵ *Id.*

²⁶ *Id.*

²⁷ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5747.10(C)(3).

²⁸ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5747.10(C)(3)(b)(i), (ii).

²⁹ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5747.10(C)(3)(b)(i), (ii).

³⁰ Amended Substitute H.B. 166, Section 757.70.

³¹ Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 5741.01(I)(2)(g), (h).

³² Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 5741.01(I)(2)(i).

³³ Amended Substitute H.B. 166, amending Ohio Rev. Code Ann. § 5741.01(I)(2)(g).

³⁴ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5741.01(T), (U), (V), (W).

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excepted below, required to register as a seller and collect and remit use tax due on all transactions facilitated through that marketplace.³⁵ A person, in general, providing only advertising services is not considered a marketplace facilitator.³⁶

A marketplace seller may request and shall obtain a waiver from the tax commissioner for a marketplace facilitator not to be treated as a seller if the following conditions are met: the taxpayer has annual gross receipts within the U.S. of at least one billion dollars; the taxpayer or affiliate is publicly traded on at least one major stock exchange; the taxpayer is current on all taxes administered by the department of taxation; and no waivers related to the marketplace facilitator has been revoked by the commissioner.³⁷ Both the substantial nexus and marketplace facilitator provisions go into effect on August 1, 2019.

Considerations

The preferential treatment of business income for individual taxpayers, through the business income deduction, became a point of discussion throughout the legislative session as many legislators advocated for the complete elimination of the deduction and preferential 3 percent rate, or to phase them out over an extended period. The initial budget passed by the House provided for threshold of tax exempt income to be lowered³⁸ and repealed the 3 percent rate.³⁹ Similarly, the amended Senate draft also repealed the 3 percent rate.⁴⁰ Governor DeWine was not in favor of including these concepts in the Bill, instead emphasizing consistency,⁴¹ and the Bill as enacted does not adopt the changes sought by the separate legislative chambers. This issue will be monitored moving forward through the next fiscal year.

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³⁵ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5741.07.

³⁶ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5741.01(T).

³⁷ Amended Substitute H.B. 166, adding Ohio Rev. Code Ann. § 5741.071(A).

³⁸ Substitute H.B. 166, as passed by House, amending Ohio Rev. Code Ann. § 5747.01(A)(31), available [here](#).

³⁹ Substitute H.B. 166, as passed by House, amending Ohio Rev. Code Ann. § 5747.02(A)(4).

⁴⁰ Am. Substitute H.B. No. 166, as passed by the Senate, amending Ohio Rev. Code Ann. § 5747.02(A)(4), available [here](#).

⁴¹ See Ohio CPA, *Governor, others call for action as budget discussions drag on*, available at:

www.ohiocpa.com/communities/news/2019/07/11/governor-others-call-for-action-as-budget-discussions-drag-on, accessed on August 6, 2019; see also The Statehouse News Bureau, *DeWine urges lawmakers to restore small business tax deduction to \$250,000*, publishing a portion of Governor DeWine's speech before the National Federation of Independent Business Ohio, available at: <https://www.wyso.org/post/dewine-urges-lawmakers-restore-small-business-tax-deduction-250000>, accessed on August 6, 2019;

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