

Ohio Replaces Franchise Tax for Financial Institutions and Eliminates Ohio's Dealer in Intangibles Tax

December 17, 2012 (revised January 25, 2013)

Overview

On December 13, 2012, the Ohio legislature passed Amended Substitute House Bill 510 ("H.B. 510") that included a new Financial Institutions Tax ("FIT") applicable to qualifying Ohio Banking Organizations, as discussed below. H.B. 510 was approved by the Governor on 12/20/2012 and is generally effective beginning 1/1/2014. The FIT replaces the current Ohio Franchise Tax applicable to financial institutions and also moves other taxpayers from the Franchise Tax or Dealer in Intangibles Tax ("DIT") to the Ohio Commercial Activity Tax ("CAT").

New Financial Institutions Tax to Replace Ohio Franchise Tax on Financial Institutions

Ohio H.B. 510 imposes the new financial institutions tax beginning 1/1/2014 with the first return due October 15, 2014.¹ The new FIT is on "Bank Organizations" and certain "Nonbank Financial Organizations" defined below. H.B. 510 imposes a regressive, three-bracket tax rate on the Ohio apportioned "equity capital" of Financial Institutions. The apportionment fraction applied under the FIT is a single gross receipts factor consisting of the Ohio gross receipts over total gross receipts. The financial institutions tax eliminates the requirement for financial institutions to file the Ohio franchise tax for Ohio tax years subsequent to 2013.² The new FIT will expand the definition of Bank Organizations subject to the FIT versus the existing Ohio corporate franchise tax and eliminate specific exemptions or reductions in the tax base.³ The new FIT broadened the tax base and lowered the tax rates imposed on taxable Financial Institutions. A primary goal of Ohio's legislature was to provide for Financial Institution tax reform that remained revenue neutral.

Lower Tax Rates for Largest Tax Brackets

The largest FIT brackets have the lowest tax rates. The tax rates on the apportioned "equity capital" is 0.8% on the first \$200 million dollars; 0.4% between \$200 million and \$1.3 billion; and 0.25% in excess of \$1.3 billion.⁴ The FIT tax rates are subject to adjustment after the first and third year if the revenue generated by those rates exceeds or falls below 10% of the "target" revenue of \$200 million for 2014 or 1.06% of any adjusted amount for 2016.⁵ The new FIT requires Bank Organizations to report all of their equity capital on a consolidated basis based generally on the entities included in regulatory reports such as FR Y-9 and call reports to federal authorities.⁶

¹ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.02.

² Amended Sub. H.B. 510 – O.R.C. Sec. 5751.01(E)(3), Sec. 5733.01(G)(1)(b).

³ Tax Commissioner Joseph W. Testa, Testimony on Tax Provisions of House Bill 487, House Ways & Means Committee, March 21, 2012.

⁴ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.04(A)(2).

⁵ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.04(E)(1)(b).

⁶ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(H)(1) & (H)(2).

Financial Institutions Subject to the FIT

Financial Institution means a bank organization or a holding company of a bank organization including all entities that are included in the consolidated group filing form "FR Y-9" with the Federal Reserve Board pursuant to 12 U.S.C. 1844. If two or more entities are consolidated for purposes of filing a "call report" all entities that are included in the call report must be included.⁷

Under the new FIT the following financial entities are subject to this tax including but not limited to:⁸

- a) A national bank organized and operating as a national bank association pursuant to the National Bank Act 13 Stat. 100 (1864), 12 U.S.C. 21 et seq.
- b) Federal savings association or federal savings bank chartered under 12 U.S.C. 1464.
- c) A bank, banking association, trust company, savings and loan association, savings bank, or other banking institution that is organized or incorporated under the laws of the U.S. any state or a foreign country.
- d) Any corporation organized and operating pursuant to 12 U.S.C. 611, et seq.
- e) An agency or branch of a foreign bank, as that term is defined in 12 U.S.C. 3101.
- f) Any entity licensed as a small business investment company under the "Small Business Investment Act of 1958" 72 Stat. 689, 15 U.S.C. 661, et seq.
- g) Bank holding company of a bank organization including all entities included on the consolidated group filing form FR Y-9.
- h) A company chartered under the "Farm Credit Act of 1933," 48 Stat. 257, or a successor of such a company.
- i) All entities included on the filing of a "call report."⁹
- j) A small dollar lender which is defined as those making loans primarily to individuals, provided the loan does not exceed five thousand dollars whose loan terms do not exceed twelve months.¹⁰

The FIT does **not** apply to the following entities:¹¹

- a) An institution organized under the "Federal Farm Loan Act," 39 Stat. 360 (1916), or a successor of such an institution.
- b) A diversified savings and loan holding company as defined in 12 U.S.C. 1467a, as that section existed on January 1, 2012 or a grandfathered unitary savings and loan holding company.
- c) An insurance company.
- d) A credit union.
- e) Charitable organizations (organized under IRC Sec. 501(c)(3).
- f) A Captive Finance Company.
- g) Any entity that services securitizations of a bank organization.¹²

⁷ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(H)(1) to (H)(3).

"FR Y-9" means the consolidated or parent only financial statements that a holding company is required to file with the federal reserve board pursuant to 12 U.S.C. 1844. In the case of a holding company required to file both consolidated and parent- only financial statements, "FR Y-9" means the consolidated financial statements that the holding company is required to file.

"Call report" means the consolidated reports of condition and income prescribed by the federal financial institutions examination council that a person is required to file with a federal regulatory agency pursuant to 12 U.S.C. 161, 12 U.S.C. 324, or 12 U.S.C. 1817.

⁸ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(B)(1) to (B)(7).

⁹ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(H)(2).

¹⁰ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(M)(1) to (M)(2) & Amended Sub. H.B. 510 O.R.C. Sec. 5726.01(O).

¹¹ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(B)(1) to (B)(7).

¹² Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(M)(1) to (M)(2).

“Equity Capital” Definition and the Calculation of the Gross Receipts Apportionment Fraction

“Equity capital” subject to apportionment under the FIT includes the sum of the common stock at par value, perpetual preferred stock and related surplus, other surplus not related to perpetual preferred stock, retained earnings, accumulated other comprehensive income, treasury stock, unearned employee stock ownership plan shares, and other equity components of a financial institution. Equity capital includes any non-controlling (minority) interests in consolidated subsidiaries that are financial institutions, as reported on a financial institutions FR Y-9 or call report, but shall not include such interest in consolidated subsidiaries that are not financial institutions.¹³

An Ohio FIT taxpayer invested in a Ohio-qualified real estate investment trust (“REIT”) that was traded on a public stock exchange on January 1, 2012 will phase into “Equity Capital” subject to the FIT their portion of the investment in the REIT ratably over five years beginning 1/1/2014. The FIT taxpayer will also phase in the qualifying Ohio REIT’s gross receipts into the apportionment factor ratably over five years beginning 1/1/2014.¹⁴

The “equity capital” is apportioned to Ohio using a single gross receipts factor.¹⁵ Gross receipts include all items of income without deducting expenses. If the taxpayer is a holding company “gross receipts” includes all items of income reported on the FR Y-9 filed by the holding company. If the reporting person for a taxpayer is a bank organization, “gross receipts” includes all items of income reported on the call report filed by the bank organization.¹⁶

For purposes of the single gross receipts factor, gross receipts generated by a financial institution shall be situated in Ohio in the proportion that the customers’ benefit in the state with respect to the services received bears to the customer’s benefit everywhere with respect to the services received. The physical location where the customer ultimately uses or receives the benefit of what was received shall be paramount in determining the proportion of the benefit in Ohio to the benefit everywhere. H.B. 510 provides specific examples of receipts apportioned to Ohio, and authorizes the Tax Commissioner to prescribe rules to address apportionment.¹⁷ There is also an alternative apportionment election available for the apportionment of gross receipts from trading and investment activities. Generally, this election permits an entity to source such receipts based on the regular place of business associated with the trading and investment activities.¹⁸

FIT Returns, Estimates and Due Dates

The FIT annual tax return is due on October 15.¹⁹ The taxpayer must file and remit estimated tax for one-third of the tax due by January 31 of the tax year; a second third of the annual tax due by March 31 of the tax year; and the remaining estimated tax due by May 31 of the tax year.²⁰ “Estimated tax” for purposes of calculating penalty and interest means at least 90% of the annual tax due for the current tax year if the taxpayer was not subject to the tax imposed the previous year.²¹ If the taxpayer was subject to the tax imposed during the previous year the “estimated tax” for purposes of calculating penalty and interest on

¹³ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(S).

¹⁴ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.041(A), (B) & (C).

¹⁵ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.05(A) & (B).

¹⁶ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.01(K).

¹⁷ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.05(B).

¹⁸ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.05(D).

¹⁹ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.03(A)(1).

²⁰ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.06(A)(1) to (A)(3).

²¹ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.06(C)(1).

tax due is the smaller of 100% of the tax the previous year or 90% of the tax for the current tax year.²² The taxpayer is subject to a minimum tax of \$1,000 each tax year.²³

FIT Credits

Financial institutions can claim the credit for taxes paid by a pass-through entity granted under O.R.C. Sec. 5747.65.²⁴ Financial institutions are entitled to specified tax credits identified in H.B. 510 and further information is contained in O.R.C. Sections 5726.50 through 5726.58. The authorized credits for qualifying FIT taxpayers include the job creation, job retention, venture capital loss, historic building rehabilitation, New Markets, research and development, motion picture production tax credits, credit for regulatory assessments paid to the Department of Commerce's Division of Financial Institutions and for qualifying (i.e. affiliated) dealers in intangibles.²⁵

H.B. 510 Eliminates Ohio's Dealer in Intangible Tax

H.B. 510 also eliminates Ohio's Dealer in Intangible Tax effective with the 2014 tax year. The Ohio DIT was a unique tax regime applicable to certain financial services organizations including but not limited to mortgage lenders, securities brokers and or entities extending credit or buying or selling securities and satisfying Ohio's statutory definitions.²⁶ Under H.B. 510 to the extent that such entities are not subject to the new FIT they will be subject to the Ohio CAT.

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If you have questions regarding the new Financial Institutions Tax or the elimination of the Dealers in Intangibles Tax, please contact any of the following Deloitte Tax LLP professionals.

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²² Amended Sub. H.B. 510 – O.R.C. Sec. 5726.06(C)(1).

²³ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.04(A)(1).

²⁴ Amended Sub. H.B. 510 – O.R.C. Sec. 5747.98(A)(41).

²⁵ Amended Sub. H.B. 510 – O.R.C. Sec. 5726.50 to 5726.98.

²⁶ Amended Sub. H.B. 510 – O.R.C. 5707.03(D).