



MULTISTATE INCOME/FRANCHISE TAX

Ohio clarifies tax treatment of the sale of business interest Tax Alert

Overview

On June 24, Ohio [House Bill 515](#) (H.B. 515) was signed into law. The bill provides clarification to existing law regarding the personal income taxation of gains and losses from the sale of an equity or ownership interest in a business, including the sale of a partnership or limited liability company interest.

This Tax Alert summarizes the bill's provisions and provides some taxpayer considerations.

Background

Ohio residents and nonresidents are eligible for a \$250,000 business income deduction ("BID") on the first \$250,000 of business income received (\$125,000 if married filing separately). Business income over the BID is subject to a flat tax rate of 3%, which is lower than the top graduated individual tax rate,

The tax treatment of nonbusiness income is significantly different for Ohio residents and nonresidents. Nonresidents are generally not subject to Ohio income tax on nonbusiness income resulting from the sale of an equity or ownership interest in a business, as the income is allocated to their state of domicile.

For residents, nonbusiness income is subject to a graduated income tax rate. Residents are not able to claim the BID against nonbusiness income.

Under prior law, it was unclear whether gains or losses from the sale of an equity or ownership interest in a business constituted business or nonbusiness income in Ohio. Generally, before the enactment of H.B. 515, the Ohio Department of Taxation ("Department") treated those gains or losses as nonbusiness income for Ohio personal income tax purposes.

Analysis

The bill clarifies two circumstances in which income from the sale of an equity or ownership interest in a business will be considered business income:

- For federal income tax purposes, the sale is treated as a sale of assets, or
- The seller materially participates (as defined under 26 C.F.R. § 1.469-5T) in the activities of the business during the taxable year in which the sale occurs, or during any of the five preceding taxable years.

Thus, under the new law nonresident taxpayers' gains from the sale of a business interest may be considered business income and may need to be apportioned to Ohio based on the business' activity.

Taxpayers will be able to apply the BID against the first \$250,000 of income from the sale of an ownership interest and apply the flat tax rate of 3% to the remaining balance.

Taxpayer Considerations

The provisions of this bill are remedial in nature and intended to clarify existing law. The legislation also applies to petitions for reassessment, applications for refund, pending appeals, and to any transaction under audit by the Department on or after the bill's effective date, which is 90 days from the signature date.

Taxpayers should consult with their tax advisors regarding the impact of this new legislation.

Get in touch

[David Adler](#)

[Courtney Clark](#)

[Paige Fitzwater](#)

[Keya Warfield](#)



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30 Rockefeller Plaza
New York, NY 10112-0015
United States

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