



State & Local Tax **Alert**

Breaking state and local tax developments from Grant Thornton LLP

Ohio Enacts Budget Including Expanded Sales Tax Nexus, Municipal Income Tax Changes, and Amnesty Program

The Ohio legislature recently passed biennial budget legislation including several significant tax provisions. Governor John Kasich signed the bill on June 30, 2017, vetoing several line items.¹ Notably, the legislation expands sales tax nexus, eliminates the throwback rule used to apportion business income for municipal income tax purposes, allows businesses to elect for the Ohio Department of Taxation to administer the municipal income tax, and provides for the establishment of a tax amnesty program. Further, the budget legislation eliminates the two lowest income tax brackets applicable to individual nonbusiness income and modifies several other tax provisions, including administrative rules, sales and use taxes, lodging tax, severance tax, excise tax, property tax, and credits and exemptions.²

Tax Amnesty Program

The Tax Commissioner is authorized to administer a temporary tax amnesty program from January 1, 2018 to February 15, 2018 with respect to certain delinquent taxes.³ The program applies only to taxes that were due and payable as of May 1, 2017, which were unreported or underreported, and which remain unpaid at the beginning of the amnesty period. Notably, taxes for which a notice of assessment or audit has been issued, for which a bill has been issued, that relate to a tax period that remains open under the statute of limitations, or for which an audit has been conducted or is pending, are not eligible. The terms of the program require that the Commissioner waive or abate all applicable penalties and one-half of any interest that accrued on the taxes, provided the full amount of delinquent taxes and one-half of any interest accrued on the taxes is paid during the program.

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States

Ohio

Issue/Topic

Multiple Taxes

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¹ Am. Sub. H.B. 49, Laws 2017; *Veto Message*, Am. Sub. H.B. 49, June 30, 2017.

² Modifications involving lodging taxes, severance tax, and excise taxes are not included in this Alert.

³ OHIO REV. CODE ANN. § 757.110. Notably, the amnesty program includes financial institution tax, commercial activity tax, state income tax, state and county alcohol, cigarette and tobacco excise tax, state and local sales and use taxes, and delinquent school district income tax. It does not extend to lodging taxes or resort area excise tax.

Sales and Use Tax

Several changes to sales and use taxes were included in the budget bill, the most noteworthy being the expansion of substantial nexus to include certain remote sellers.

Substantial Nexus

For purposes of sales tax nexus, effective January 1, 2018, the legislation expands the definition of “substantial nexus.”⁴ As amended, a seller will have substantial nexus with Ohio if it uses in-state software to sell or lease taxable tangible personal property or services to consumers, if the seller has more than \$500,000 of Ohio sales in the current or preceding calendar year from the sale of tangible personal property for storage, use or consumption in Ohio or from providing services the benefit of which is realized in Ohio.⁵ Similarly, a seller which enters into an agreement with another person to provide a content distribution network in Ohio to accelerate or enhance the delivery of the seller’s Web site to consumers will have substantial nexus with Ohio if the seller has more than \$500,000 of similar gross receipts.⁶ “In-state software” is defined as computer software stored on property in Ohio or distributed within Ohio for the purpose of facilitating a seller’s sales.⁷ The term “content delivery network” means a system of distributed servers that delivers Web sites and other Web content to a user based on the geographic location of the user, the origin of the Web site or Web content, and a content delivery server.⁸

Other Items

Further, the legislation makes several other changes to existing sales and use tax provisions. For example, the new law:

- Establishes a sales and use tax holiday from August 3-5, 2018 for certain clothing, school supplies, and instructional materials;⁹
- Exempts from sales and use tax digital audio works transferred for delivery through the use of a machine, such as a jukebox, that accepts direct payments to operate, automatically plays a selected digital audio work for a single play upon receipt of payment, and operates exclusively for the purpose of playing digital audio works in a commercial establishment by a jukebox or other single-play commercial music machine, beginning October 1, 2017;¹⁰
- Generally modifies the rules for siting sales and use tax related to direct mail, including defining both “direct mail” and “advertising and promotional direct mail.” The stated legislative intent of this change is to more closely conform the statute to the terms of the Streamlined Sales and Use Tax Agreement;¹¹ and

⁴ OHIO REV. CODE ANN. § 5741.01(I)(2).

⁵ OHIO REV. CODE ANN. § 5741.01(I)(2)(h).

⁶ OHIO REV. CODE ANN. § 5741.01(I)(2)(i).

⁷ OHIO REV. CODE ANN. § 5741.01(I)(6)(d).

⁸ OHIO REV. CODE ANN. § 5741.01(I)(6)(e).

⁹ OHIO REV. CODE ANN. § 757.120.

¹⁰ OHIO REV. CODE ANN. § 5739.02(B)(55).

¹¹ OHIO REV. CODE ANN. § 5739.033, effective Oct. 1, 2017.

- Allows counties and transit authorities to increase their local sales and use tax rates in increments of 0.1 percent, rather than 0.25 percent, beginning July 1, 2018.¹²

Municipal Income Tax

The new law continues Ohio's multi-year effort to simplify the administration of the state's complex municipal income tax system for businesses. Effective for tax years beginning on or after January 1, 2018, the budget bill eliminates the sales factor throwback rule and adds an election for business taxpayers to allow the state to administer all of their municipal income taxes from a single, centralized point, among other provisions.

Elimination of Throwback Rule

The legislation eliminates the throwback rule which was previously applicable in determining the municipal income tax sales apportionment factor.¹³ Gross receipts from the sale of tangible personal property solely will be situated to the municipal corporation (municipality) in which the sale occurred. Specifically, a sale of property will be situated to a municipality only if, regardless of where title passes, the property meets either of the following criteria: (i) the property is shipped to or delivered within the municipality from a stock of goods located within the municipality; or (ii) the property is delivered within the municipality from a location outside the municipality, provided the taxpayer is regularly engaged through its own employees in the solicitation and the sales result from such solicitation or promotion. Previously, under an application of the throwback rule, receipts from the sale of tangible personal property were also situated to a municipality if the property was shipped from a place within the municipality to purchasers outside the municipality if the taxpayer was not, using its own employees, regularly engaged in the solicitation or promotion of sales at the place of delivery.

Centralized State Administration

Businesses other than sole proprietors will have the ability to elect for the Department of Taxation to serve as the sole administrator of their municipal income taxes, in lieu of administration by each municipality in which they currently are conducting business.¹⁴ In order to make an initial election, a taxpayer must notify the Commissioner and each municipality in which it conducted business during the previous taxable year. The notice must be filed by the first day of the third month after the beginning of the taxpayer's taxable year using a form prescribed by the Commissioner.¹⁵ Once made, the election applies until the taxpayer notifies the Commissioner and each municipality in which it did business during the previous taxable year of its termination.¹⁶ Similar to the election process, a notification of termination must be filed on a form prescribed by the

¹² OHIO REV. CODE ANN. §§ 5739.01; 5739.023; 5739.026; 757.100.

¹³ OHIO REV. CODE ANN. § 718.02(D)(1).

¹⁴ OHIO REV. CODE ANN. § 718.80.

¹⁵ OHIO REV. CODE ANN. § 718.80(B)(1).

¹⁶ OHIO REV. CODE ANN. § 718.80(B)(2)(a).

Commissioner and is due on or before the first day of the third month of any taxable year.¹⁷

For administrative purposes, each municipality imposing an income tax is required to certify to the Commissioner by January 31 the rate of tax in effect on the first day of January of that year.¹⁸ If, after such certification has been made, the electors of a municipal corporation approve a tax rate increase, the municipality is required to certify the new rate of tax at least 60 days before the effective date of the increase.¹⁹ Also, within 90 days of receiving notification of the taxpayer's initial election, each municipality is required to submit to the Commissioner on a prescribed form: (i) the amount of any net operating loss that the taxpayer is entitled to carry forward to a future tax year; (ii) the amount of any net operating loss carryforward utilized by the taxpayer in prior years; (iii) any credits granted by the municipality to which the taxpayer is entitled, the amount of such credits, whether the credits may be carried forward to future tax years, and, if the credits may be carried forward, the applicable duration; (iv) any overpayments of tax that the taxpayer has elected to carry forward to a subsequent tax year; and (v) any other information the municipality deems relevant in order to effectuate the Commissioner's efficient administration of the tax on the municipality's behalf.²⁰

Municipalities failing to timely comply with these provisions may be penalized by the state withholding 50 percent of taxes otherwise due to each affected municipality.²¹ Conversely, the Commissioner is required to provide relevant tax administrators in May and November of each year with certain information regarding every corporation which filed its municipal income tax return, including the taxpayer's apportionment ratio, net operating loss and credit usage information.²² The Commissioner is also required to distribute the revenue collected from businesses to the appropriate municipalities on a monthly basis, retaining a half percent fee for administrative expenses.²³ Finally, the Commissioner is granted the powers to prescribe all forms necessary to administer the municipal income tax, adopt any necessary related rules, and appoint and employ necessary personnel.²⁴

The Department is required to conduct a feasibility study of accepting municipal income tax returns through the existing joint federal/state Modernized e-File (MeF) program.²⁵ The study must be completed by December 31, 2017.

Individual Due Date Modified

Beginning in 2018, the legislation extends by one month the due date by which individual taxpayers must make their fourth-quarter estimated tax payments. Previously, taxpayers

¹⁷ OHIO REV. CODE ANN. § 718.80(B)(2)(b).

¹⁸ OHIO REV. CODE ANN. § 718.80(C)(1).

¹⁹ *Id.*

²⁰ OHIO REV. CODE ANN. § 718.80(C)(2).

²¹ OHIO REV. CODE ANN. § 718.80(C)(3).

²² OHIO REV. CODE ANN. § 718.84(B).

²³ OHIO REV. CODE ANN. §§ 718.83; 718.85(B).

²⁴ OHIO REV. CODE ANN. § 718.80(D).

²⁵ OHIO REV. CODE ANN. § 757.60.

were required to submit payments by the fifteenth day of the twelfth month of the taxable year (December 15 for calendar-year taxpayers). Under the legislation, fourth quarter payments will be due on the fifteenth day of the first month of the following taxable year (January 15 of the next year for calendar-year taxpayers).²⁶

Income Tax

Individual Income and Estate Tax Brackets Modified

Effective for tax years beginning in 2017, the bottom two personal income tax brackets which were applicable to income of less than \$10,500 have been eliminated. Accordingly, the personal income tax rates range from the lowest marginal rate of 1.980 percent applicable to income from \$10,500 to \$15,800 to the highest rate of 4.997 percent applicable to income of more than \$210,600.²⁷ As a result of these changes, the low-income taxpayer credit is eliminated.²⁸

Also in 2017, estates are subject to tax at a rate of 0.7425 percent on the first \$10,500 of income. Income over this amount is subject to tax at the same rates as applied to individuals.²⁹

Increased Deduction for Certain Contributions

The maximum income tax deduction for contributions to a federally tax-advantaged college savings plan or expense savings account is doubled from \$2,000 to \$4,000 annually.³⁰ This change applies to tax years beginning in 2018.

Credits and Incentives

The bill makes several modifications to existing tax credits. For example, for purposes of the Job Creation Tax Credit (JCTC), the legislation allows employers to include compensation paid to certain “work-from-home” employees for the purposes of qualifying for and complying with terms of the credit.³¹ Other legislative language:

- Modifies Ohio’s Motion Picture Tax Credit;³²
- Changes the \$10 million annual maximum for the New Markets Tax Credit to a limit on the amount of credits that may be approved annually, rather than a limit on the amount of credits taxpayers may claim each year;³³
- Increases from five to six years the amount of time that certain operators of computer data centers have to meet the capital investment requirement related to the existing sales and use tax exemption for certain data center property;³⁴ and

²⁶ OHIO REV. CODE ANN. § 718.08(C)(1)(d).

²⁷ OHIO REV. CODE ANN. § 5747.02(A)(3).

²⁸ Repealing OHIO REV. CODE ANN. § 5747.056.

²⁹ OHIO REV. CODE ANN. § 5747.02(A)(2).

³⁰ OHIO REV. CODE ANN. § 5747.70(A).

³¹ OHIO REV. CODE ANN. § 122.17(3)(a), (c).

³² OHIO REV. CODE ANN. § 122.85.

³³ OHIO REV. CODE ANN. § 5725.33.

³⁴ OHIO REV. CODE ANN. § 122.175(A)(5)(a)(i).

- Extends a provision temporarily allowing owners of a historic rehabilitation tax credit certificate to claim the credit against the Ohio Commercial Activity Tax if the owner cannot claim the credit against another tax.³⁵

Property Tax

Significantly, the budget legislation removes the option for taxpayers to appeal property tax decisions from the Ohio Board of Tax Appeals (BTA) directly to the Ohio Supreme Court. Now, all appeals from BTA decisions are required to be made to an intermediate-level Court of Appeals.³⁶ Several other property tax changes are also included, including the addition of a property tax exemption for retail stores operated by a charitable non-profit housing corporation that sells primarily donated household items.³⁷

Commentary

Ohio's biennial budget process was relatively free from drama when compared to the sessions in nearby states like Illinois and Pennsylvania. However, it ended with the governor's veto of 46 line items, including new sales tax exemptions that would have applied for certain prescription optical aids and certain electronic services.

Although Ohio's extension of sales tax nexus to include certain online sellers was quietly enacted, sellers' protests are expected to become quite noisy. An administrative directive with similar language has been revoked by Massachusetts after the rule was challenged by remote sellers.³⁸ Ohio may face a similar challenge in this regard.

Finally, Ohio has taken a crucial step in simplifying the municipal income tax filing process for businesses. The addition of a taxpayer election to allow the state to perform the administrative role of potentially hundreds of municipalities is expected to be a welcome change. Businesses will certainly appreciate the ability to streamline what can be a tedious compliance process. The reaction that the municipalities will have to this development is less certain. Some of the municipalities facing logistical difficulties in serving as local tax authorities may look forward to taxpayers exercising elections resulting in less administrative burden. Other municipalities may be concerned that Ohio may have taken an irreversible step to exert control and infringe on the municipalities' historic powers to operate in an independent manner.

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³⁵ OHIO REV. CODE ANN. § 757.70. Previously, this provision was set to expire for periods ending in June 2015. It has been extended to apply to periods from July 1, 2015 through June 30, 2019. Without this provision, these credits would only be claimable against income tax, financial institution tax, and insurance company franchise taxes.

³⁶ OHIO REV. CODE ANN. § 5717.04.

³⁷ OHIO REV. CODE ANN. §§ 5709.12(E)(2); 757.90.

³⁸ *Directive 17-2*, Massachusetts Department of Revenue, June 28, 2017. For a discussion of revoked Directive 17-1, see [GT SALT Alert: Massachusetts DOR Revokes Directive Explaining Bright-Line Sales Tax Nexus Standard for Remote Internet Retailers](#).

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