Ohio enacts significant sales, commercial activity, and personal income tax changes

July 2, 2013

In brief

On June 30, 2013, Ohio Governor John Kasich signed Ohio House Bill 59, which makes significant changes to Ohio taxes. Sales tax changes include an increased rate; taxation of digital products; and exemptions for certain cable, video, audio, and broadcast services. Commercial activity tax changes include an increase in the minimum tax. Personal income tax changes include across-the-board rate reductions, a 50% deduction for small business investor income, and an election for certain pass-through entity investors participating in a composite tax return. The following provides a summary of the significant tax changes contained in H.B. 59.

In detail – Sales tax changes

Increase in sales tax from 5.5% to 5.75%

Effective September 1, 2013, Ohio's sales and use tax rate increases from 5.5% to 5.75%.

Taxable digital products and exempt cable, video, audio, and broadcast services

Effective January 1, 2014, Ohio sales tax applies to transactions by which a "specified digital product is provided for permanent use or less than permanent use, regardless of whether continued payment is required." Specified digital products means: (1) digital audiovisual works; (2) digital audio works; and (3) digital books.

Effective October 1, 2013, sales to or by a cable service provider, video service provider, or certain radio or television broadcast stations of cable service or programming, video or audio service or programming, or electronically transferred digital audiovisual or audio work are exempt from sales and use tax.

First steps toward Marketplace Fairness compliance

H.B. 59 enacts certain provisions with the intent that, if Congress enacts the Marketplace Fairness Act of 2013, that the Ohio General Assembly will adopt conforming legislation and require the Tax Commissioner to issue regulations enforcing the sales and use tax with respect to remote sellers. Such provisions include definitions of 'remote seller' and 'remote sale.'

In detail - Commercial activity tax

Minimum tax increase

Under current law, a commercial activity tax (CAT) taxpayer pays a $150 minimum tax on its first $1 million of taxable gross receipts and 0.26% on the rest of its taxable gross receipts.

Effective for tax periods beginning on or after January 1, 2014, the tax on the first $1 million of taxable gross receipts is graduated as follows:

Total gross receipts	Tax on 1st $1 million
$1,000,000 or less	$150
$1,000,001 - $2,000,000	$800
$2,000,001 - $4,000,000	$2,100
$4,000,001 or greater	$2,600

Elimination of $500,000 penalty on distribution operators

Current law provides a CAT exclusion for a certain percentage of receipts from the sale of tangible personal property delivered by suppliers to a qualified Ohio distribution center (QDC). A QDC operator must meet certain criteria and apply to the Tax Commissioner for a certificate to qualify QDC suppliers for the exclusion. Generally, a QDC operator that receives a certificate but fails to meet the requirements of a QDC may be liable for a $500,000 penalty.

Applicable to original returns filed on or after January 1, 2014, the $500,000 penalty will be replaced with a requirement that an ineligible operator is liable for the supplier's tax liability. Such liability equals the liability that would have been owed by the suppliers of the QDC had they not received a QDC certificate.

Motor fuel receipts tax

Effective July 1, 2014, the sale of motor fuels are subject to the newly created motor fuel receipts tax (MFRT) in lieu of the CAT. The MFRT is generally equal to 0.65% of gross receipts a supplier receives from the first transaction in which motor fuel is sold for delivery to Ohio. A 'supplier' is defined as a person that (1) imports motor fuel for sale or distribution by the person within Ohio; or (2) acquires motor fuel from a terminal or refinery rack and distributes that fuel in Ohio. The bill provides rules regarding exclusions available in determining MFRT gross receipts, as well as compliance and administration, licensing, officer and employee liability, and municipal taxation 'in lieu of' tax limitations.

In detail – Personal income tax

Pass-through entity investor may elect to file a separate return

Generally, Ohio allows a pass-through entity to file a composite return on behalf of owners whose only source of Ohio income is from the pass-through entity. Ohio allows a refundable credit against the personal income tax equal to the proportionate share of tax paid by a pass-through entity filing a composite return on behalf of an investor who determines he or she has more than one source of Ohio income and therefore must file a separate individual tax return.

Effective for taxable years beginning on or after January 1, 2013, H.B. 59 allows all investors in a pass-through entity participating in a composite return to elect to also file a separate individual income tax return and claim the refundable credit. An investor may benefit by filing a separate return due to differences in the taxation rate and rules between a composite return and a separate individual return.

Personal income tax cuts and earned income tax credit

For tax years beginning in 2013, H.B. 59 phases in a 10% reduction in income tax rates for all brackets from 2013 to 2015. Rates are generally reduced by 8.5% for 2013, 0.5% for 2014, and the remaining 1% for 2015. Current law authorizes the tax commissioner to make inflation adjustments to tax bracket amounts. Under H.B. 59, the commissioner is precluded from making adjustments for the 2013 to 2015 tax years.

Starting in 2013, H.B. 59 provides for a nonrefundable earned income tax credit for low-income taxpayers who qualify for the federal earned income tax credit. The state credit is equal to 5% of the federal credit.

50% personal income tax deduction for small business investor income

Effective for tax years beginning on or after January 1, 2013, H.B. 59 provides a personal income tax deduction equal to 50% of the taxpayer's Ohio small business investor income. The deduction is capped at $125,000 per taxpayer ($62,500 each for separate filing spouses). Pass-through entities may not claim this deduction and the deduction is not available to estates and trusts.

In detail – Credits and incentives

The bill extends the deadline for entering into 'impact facility' sales tax subsidy agreements to June 1, 2015, lowers the investment requirements to $30 million, and decreases the area in which at least 50% of the facility's expected customers must live to 50 miles.

In detail – Property tax

Property tax rollback limitations

H.B. 59 limits the application of the 2.5% and 10% property tax rollbacks applicable to non-business real property by specifying that the rollbacks may not be applied to reduce the taxes due on new or certain replacement levies that become effective in or after tax year 2014. Property tax levies effective in tax year 2013 and a renewal or substitute of that levy remains subject to the rollbacks.

The takeaway

H.B. 59 was designed by Ohio legislative leaders to continue to transition Ohio to a consumption-based tax system, which is a trend we see evolving in a number of states. Although provisions in the final bill differ from those as introduced, the sales tax rate and CAT minimum tax increases have a very similar result. An overall income tax cut with small business investor benefits is effectively paid for though the indirect tax increases.

Ohio taxpayers should evaluate the direct cost of the sales tax rate increase and digital product taxability. Pass-through business investors participating in a composite tax return should carefully evaluate their potential individual return filing election benefit, and certain cable, video, audio, and broadcast businesses should be mindful of the sales and use tax benefits included in this legislation.

The governor executed several tax line-item vetoes, some which kept certain specific sales tax and credit benefits from being enacted. The governor also vetoed provisions that would have created 'click-though' nexus, explaining that Congress should act before the policy change becomes more viable for Ohio in order to avoid litigation that has resulted in states that have enacted similar rules.

Let's talk

If you have any questions regarding H.B. 59, please contact:

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