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Ohio financial institution tax reform passes legislature: New tax on equity capital, dealers in intangibles subject to CAT

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Update. [House Bill 510 was signed by Governor Kasich on December 20, 2012.](#)

In brief

On December 11, 2012, [House Bill 510](#) passed both houses of the legislature and will be presented to Ohio Governor John Kasich's office for signature. The bill: (1) replaces the existing franchise tax on financial institutions based on net worth with a new privilege tax based on equity capital and (2) repeals the dealer in intangibles tax and subjects dealers in intangibles to the Ohio commercial activity tax (CAT). If enacted, these provisions will take effect starting in tax year 2014.

The new tax on financial institutions is imposed on Ohio total equity capital at staggered rates, as explained below. Total equity capital refers to amounts reported on the relevant institution's FR Y-9 as filed with the federal reserve and is apportioned to the state using a single gross receipts factor. If two or more entities are consolidated for the purposes of filing an FR Y-9, "financial institution" means a group consisting of all entities that are included in the FR Y-9. The nexus standards for the new tax are broadly defined as what is allowable under the US Constitution.

In detail

New tax on financial institutions

Rate and base

Under the legislation, every financial institution, for the privilege of doing business in the state, will be subject to a tax equal to the product of its "total Ohio equity capital" multiplied by: 0.8 percent on the first \$200 million of total Ohio equity capital; 0.4 percent on Ohio equity capital greater than \$200 million and less than or equal to \$1.3 billion; and 0.25 percent on total Ohio equity capital in excess of \$1.3 billion. The minimum tax is \$1,000.

Total equity capital means 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. It does not include any non-controlling (minority) interests as reported on an FR Y-9 or call report, unless the interests are in a bank organization or a bank holding company. If the reporting person for a financial institution files an FR Y-9 or call report, the total equity capital of the financial institution equals the total equity capital shown on the reporting person's FR Y-9 or call report as of the end of the taxable year. The total equity capital of all other financial institutions must be reported as of the end of the taxable year in accordance with generally accepted accounting principles. Deductions are allowed for investments in certain publicly-traded qualified real estate investment trusts.

Total Ohio equity capital is that portion of total equity capital apportioned to the state.

Apportionment

The tax base is apportioned under a single gross receipts factor formula, under which the numerator is the total gross receipts of the financial institution in the state during the taxable year and the denominator is the total gross receipts of the taxpayer everywhere during the taxable year. "Gross receipts" means all items of income, without deduction for expenses. Receipts will generally be sourced based on where the customer receives the benefit of the services received. The physical location where the customer ultimately uses or receives the benefit of the service will be "paramount" in determining where the benefit is received. The legislation provides numerous examples of how a variety of financial institution receipts will be sourced. There are special provisions available for sourcing certain investment and trading receipts, including an elective provision to assign such receipts to one of the taxpayer's regular place of business based on the related average value of assets.

If the statutory apportionment formula renders a result that does not fairly represent the extent of the taxpayer's business activity in the state, the taxpayer may petition, or the tax commissioner may require or permit, the use of an alternative apportionment formula.

Qualified financial institutions (including small lenders)

For purposes of the new tax, a financial institution means a "bank organization," a "holding company of a bank organization," or a "nonbank financial organization." A "bank organization" is defined as: (1) a national bank organized and operating as a

national bank association pursuant to the "National Bank Act;" (2) a federal savings association or federal savings bank chartered under 12 U.S.C. 1464; (3) 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 United States, any state, or a foreign country; (4) any corporation organized and operating pursuant to 12 U.S.C. 611, et seq.; (5) any agency or branch of a foreign bank, as those terms are defined in 12 U.S.C. 3101; (6) an entity licensed as a small business investment company under the "Small Business Investment Act of 1958;" or (7) a company chartered under the "Farm Credit Act of 1933," or a successor of such a company. It does not include an insurance company, credit union, or an institution organized under the "Federal Farm Loan Act," or a successor of such an institution. A nonbank financial organization subject to the new tax includes a "small dollar lender," but does not include a "captive finance company," which is subject to the CAT under the new law.

If two or more entities are consolidated for the purposes of filing an FR Y-9, "financial institution" means a group consisting of all entities that are included in the FR Y-9. If two or more entities are consolidated for the purposes of filing a call report (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), "financial institution" means a group consisting of all entities that are included in the call report and that are not included in a group included in the FR Y-9. Diversified savings and loan holding companies are not included in the definition of financial institution.

Nexus standards

A financial institution is subject to the tax in each year that it conducts business as a financial institution in the state or otherwise has nexus with the state under US Constitutional standards as January 1 of the calendar year.

Returns, payment, and statute of limitations

Annual returns and payments are due by October 15. The return should be filed and payment remitted by the reporting person for each taxpayer. "Reporting person" generally refers to the top-tier holding company required to file an FR Y-9. The legislation also requires the reporting person to file estimated reports and make estimated payments. Generally, there is a four year assessment and refund statute of limitations.

Credits

The new tax allows certain refundable and non-refundable credits. Taxpayer credits include the credits for job creation and retention, historic building rehabilitation, venture capital loan losses, new markets, research and development, motion picture production, certain regulatory assessments paid, and a credit when a dealer in intangibles is included in the controlled group of a financial institution.

Dealers in intangibles, captive finance companies, insurance companies, and others

Presently, qualified dealers in intangibles (which exclude financial institutions, insurers, and others) are generally subject to a property tax based on shares of stockholders with a presence in Ohio. Under the legislation, this tax is repealed, and except for those dealers in intangibles owned by financial organizations, these entities will be subject to the state's CAT, effective in 2014. The legislation also

specifies that a captive finance company is not a "nonbank financial organization" and thus subject to the Ohio Commercial Activity Tax. A captive finance company generally is one that conducts "financing transactions" such as making or selling loans, extending credit, leasing, and other activities specified in the legislation. There are also special provisions pertaining to securitization companies, "grandfathered unitary" savings and loan companies, credit unions, and Federal Farm Loan Act entities that become subject to the CAT as well. Finally, the legislation prohibits the Commissioner from assessing affiliates of an insurance company for unpaid CAT before 2013, provided one of the company's corporate affiliates paid the corporation franchise tax.

The takeaway

The enactment of HB 510 would complete the last major component of Governor Kasich's "Mid-Biennium Budget Review." The intent of the legislation is to level the playing field for large and small financial institutions in the tax arena by broadening the base and lowering the rate. Although the bill stalled in March as the election process heated up, the wait allowed the emergence of some important provisions. Notable enhancements to the bill since it stalled include further clarification of how dealers in intangibles, small lenders and captive finance companies will be taxed going forward, as well as some investment and trading receipt sourcing elective provisions that should be helpful to the out-of-state banks.

Let's talk

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