

OHIO STATE AND LOCAL TAX CONFERENCE 2022

Ohio Pass-Through Entity & Individual Income Tax Updates

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July 2022



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IMPORTANT



The information presented in this presentation is accurate as of the date of the presentation. Any legislative or legal changes that take place after the date of this presentation may change the accuracy of this content. Additionally, changes to facts and circumstances may impact any answer provided herein. Please contact the Department directly with any questions:

Individual Income Tax - (800) 282-1780

Business Tax - (888) 405-4039

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TOPICS

- 2022 Ohio Income & PTE Tax Legislative Updates
- Ohio PIT/ PTE Legislative Updates for 2023 & Forward
- Municipal Tax Update & Reminders

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### 2022 OHIO INCOME & PTE TAX LEGISLATIVE UPDATES

Sub. S.B. 166 (Vocational Jobs Credit)  
Sub. H.B. 515 (Ohio's Definition of "Business Income")  
S.B. 231 (Authorize Refund to Deceased Taxpayer's Fiduciary)  
Am. S.B. 246 (PTE SALT Cap Workaround)

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### VOCATIONAL JOBS CREDIT

Sub. S.B. 166  
R.C. 5747.057

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### VOCATIONAL JOBS CREDIT

- New credit for tax year 2022
- Available to employers who employ eligible employees in a work-based learning experience, internship, or cooperative education program
  - Credit equals the lesser of (a) 15% of the eligible compensation during the calendar year or (b) \$5,000 per eligible employee (subject to limitations)
  - "Eligible employee" means an employee who is 19 or younger and enrolled in an approved career-technical education program
  - "Eligible compensation" just means Ohio compensation paid on or after the effective date of the credit
- Credit is nonrefundable and is not subject to carryforward

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### VOCATIONAL JOBS CREDIT

- Tax credit program administered by Ohio Department of Education
  - Employer must apply for a certificate showing the amount of compensation paid to eligible employees during the tax year
  - The Department of Education will issue a certificate showing the amount of credit available
- Credit is available to IT 1040, IT 1041, and IT 4708 filers
  - PTE investors can claim their share of the credit
- R.C. 5747.98- Credit is 12<sup>th</sup> in order

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### "CLARIFICATION" OF OHIO'S BUSINESS INCOME DEFINITION

Sub. H.B. 515  
R.C. 5747.01(B)

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### BUSINESS INCOME DEFINITION

- Traditionally, R.C. 5747.01(B) defined "business income" as:
  - Income, including gain or loss, arising from transactions, activities, and sources in the regular course of a trade or business
  - Income, gain, or loss from real property, tangible property, and intangible property if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation
  - Income, including gain or loss, from a partial or complete liquidation of a business, including, but not limited to, gain or loss from the sale or other disposition of goodwill

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### CAPITAL GAINS AS BUSINESS INCOME

- The Department applied this definition, along with *Corrigan v. Testa* and *Kemppel v. Zaino* in reviewing capital gains reported as business income on the Ohio IT BUS
- In response to the application of the law as written and the Supreme Court of Ohio's language in *Corrigan* and *Kemppel*, the Ohio General Assembly passed H.B. 515 to "clarify" R.C. 5747.01(B)
  - Ohio G.A. stated the amendment was a "remedial measure intended to clarify existing law"
  - Change is applicable to any pending appeal or refund application, or to anything subject to Audit going forward

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### "CLARIFIED" BUSINESS INCOME DEFINITION

- Business income now expressly includes:
  - Income, including gain or loss, from... the sale of an equity or ownership interest in a business.
- Statute defines "sale of an equity or ownership interest in a business" to include either:
  - A sale treated for federal income tax purposes as the sale of assets;
  - Where the seller materially participated in the activities of the business during the year of the sale or any of the 5 tax years preceding

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### SALE TREATED AS THE SALE OF ASSETS

- A sale treated for federal income tax purposes as the sale of assets
- This phrase is not defined
  - Most likely trying address situations where a sale of stock is deemed to be an asset sale (either because of IRC requirement or because of an election)
  - Examples:
    - IRC 338 (certain stock purchases treated as asset acquisitions)
    - IRC 741 ("hot assets" from the sale of a partnership)
  - Rationale is that the sale of business assets is generally business income under R.C. 5747.01(B) (even prior to this change)
  - Taxpayers will need to show their sale was a deemed asset sale to meet this requirement

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### MATERIAL PARTICIPATION

Sales of an ownership interest in a business where the seller materially participated in the activities of the business

- Materially participate has the same meaning as in 26 C.F.R. 1.469-5T
- Seller must meet one or more of these requirements in the year of the sale or in one of the 5 preceding tax years
- Taxpayers will need to show they meet one of the 6 tests (or the catch all) to meet this requirement

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### MATERIAL PARTICIPATION

- Examples of material participation:
  1. More than 500 hours of participation in the business during the tax year;
  2. Substantially all of the participation in the business of all individuals during the tax year;
  3. More than 100 hours of participation in the business during the tax year, and such participation in is not less than the participation of any other individual during the tax year;
  4. Significant participation activity for the tax year, and the individual's aggregate participation in all significant participation activities during the tax year exceeds 500 hours;

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### MATERIAL PARTICIPATION

- Examples of material participation (con't):
  5. Material participation in the business for any 5 tax years during the 10 tax years that immediately precede the tax year at issue;
  6. Material participation in a "personal service activity" for any 3 tax years preceding the tax year; OR
  7. Based on all of the facts and circumstances, the individual participates in the business on a regular, continuous, and substantial basis during the tax year

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### CASES ON APPEAL

- The Department is currently going through its appeals looking for those impacted by this clarification
- Goal is to ensure those who filed appeals are:
  - Aware of the law change; and
  - Receive an opportunity to provide evidence/ support related to the law change
- Three situations we've identified so far:
  - Files where it is clear one of the new standards is met- Assessment will be canceled and/or refund will be granted without any further taxpayer/ practitioner intervention
  - Files where additional information is needed to substantiate the applicability of this clarification- The Department will send a letter explaining the law change and requesting additional information be provided
  - Files where the clarification does not apply- Those cases will be worked as normal
- Your patience is appreciated as we process this new law and its impact

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### AUTHORIZE REFUNDS TO DECEASED TAXPAYER'S FIDUCIARY

S.B. 231  
R.C. 5747.11

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### REFUND REISSUANCE CHANGE

- Sometimes taxpayers die during the tax year or after the tax year but before his/her Ohio return is filed for the prior year
- R.C. 5747.08(A) covers the filing of a deceased taxpayer's return:
  - "If an individual is deceased, any return or notice required of that individual... shall be made and filed by that decedent's executor, administrator, or other person charged with the property of that decedent."
- However, this section doesn't mention what to do with any refund the taxpayer is owed

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### REFUND REISSUANCE CHANGE

- R.C. 5747.11(B) allows, in relevant part:  
On filing of the refund application, the commissioner shall determine the amount of refund due and... certify such amount to the director of budget and management and treasurer of state for payment.... Payment shall be made as provided in" R.C. 126.35(C)
- R.C. 126.35(C) "...payments from the state treasury shall be made by paper warrants, electronic funds transfers, or by direct deposit payable to the respective payees."
- Neither statute addresses what to do when the "payee" is no longer alive
- IRS has Form 1310 (Statement of Person Claiming Refund Due a Deceased Taxpayer)

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### REFUND REISSUANCE CHANGE

- Newly enacted R.C. 5747.11(B)(2) addresses this issue for Ohio:
  - If an individual is deceased, a refund may be issued in the name of the decedent and of the executor, administrator, or other person charged with the decedent's property, upon request
  - Request must include any documentation, including a copy of the taxpayer's death certificate and any fiduciary or court documents, that the tax commissioner considers necessary to prove that the person making the request is qualified to receive the refund
  - If the refund was previously issued in only the decedent's name, the requester must return the previously issued check
- Change gives the Department the ability to reissue refund checks to include the fiduciary's name and make sure the refund gets to the appropriate place

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### PTE SALT CAP WORKAROUND

Am. S.B. 246  
R.C. 5747.38 and 5747.39

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### PTE SALT CAP- WHY?

- Tax Cuts and Jobs Act of 2017
  - Limited the amount of state and local taxes that could be deducted federally as an itemized deduction to \$10,000- the SALT Cap
- IRS issues Notice 2020-75
  - Lays out what types of partnership/ S Corp tax payments are subject to deduction in computing federal AGI, and which are deducted as an itemized deduction
- In short:
  - Taxes imposed on the entity are deductible in computing federal AGI (and thus circumvent the SALT Cap)
  - Taxes paid by the entity on behalf of its shareholders are deductible as an itemized deduction (and thus are subject to the SALT Cap)

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### PTE SALT CAP- OHIO BEFORE SB 246

- Historically, Ohio has had two PTE taxes
  - The PTE Withholding Tax (form IT 1140)
  - The PTE Composite Tax (form IT 4708)
- Both taxes are filed and paid by the entity, BUT are filed and paid on behalf of the entity's shareholders/ partners/ members
  - Neither tax is imposed on the entity directly
  - Thus taxes paid by a PTE using either form are deductible as an itemized deduction federally
- When/ if the investor files an Ohio IT 1040, s/he gets a credit for his/her share of the taxes paid by the PTE

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### PTE SALT CAP- SB 246

- Effective for tax year 2022, Ohio now offers a third PTE tax
  - Any qualifying PTE may elect to be subject to this entity-level tax
  - Election is made by the entity and is binding on the investors
  - The election is irrevocable for the tax year
  - A disregarded entity may not make this election
- The election will be made by filing the new tax form- the IT 4738
  - Form is still in development, but we hope to have a draft as soon as possible
  - Intend for software vendors to carry the form as soon as possible
- Tax specifically states it is meant to comply with IRS Notice 2020-75, and thus should be deducted in computing federal AGI

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**PTE SALT CAP- SB 246**

- Tax is levied on "qualifying taxable income"
  - PTE's business income subject to apportionment;
  - PTE's nonbusiness income subject to allocation; and
  - PTE adjustments in R.C. 5733.40(A)(2)- (A)(7)
    - Bonus depreciation, related member adjustments, guaranteed payment/ compensation reclassification, etc.
- Apportionment and allocation is done the same way as it is for the other PTE taxes and for Ohio's income tax
- PTE may not take any individual income tax deductions or credits allowed to its investors on the IT 1040 or the federal 1040

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**PTE SALT CAP- SB 246**

- The tax rate is 5% for 2022 and 3% for 2023 and forward
- Tax return is due April 15<sup>th</sup> of the calendar year after the year in which the taxpayer's fiscal year ends
  - For calendar year filers, the due date is the next April 15<sup>th</sup>
  - Same process as the IT 4708
- Estimated payment schedule follows the IT 1140 due dates:
  - The 15<sup>th</sup> day of the month after the close of the entity's four quarters
  - PTEs can claim estimated payments made toward the IT 1140 on the IT 4738 or vice versa
    - Payments cannot be claimed on both returns for the same year

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**PTE SALT CAP- SB 246**

- IT 4738 serves as Ohio filing for the entity's nonresident and trust investors, provided they don't have Ohio-sourced income from another source
  - Such investors may file an IT 1040/ IT 1041 if they choose
- Individuals who file the IT 1040 must add back tax amounts paid on the IT 4738 and deducted in computing FAGI
  - Trusts filing the IT 1041 must also make a similar add back
  - Done to negate the effects of deducting these amounts in computing federal AGI or federal taxable income
- Investors can claim a refundable credit for their proportionate share of the tax paid by the entity on the IT 4738 based on the PTE's tax liability
  - Similar to the credits allowed for IT 1140 and IT 4708 payments

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### PTE SALT CAP- OUTSTANDING QUESTIONS

- Some questions left unanswered by the new Bill:
  - What if an electing PTE is owned by other PTEs?
    - Does a PTE's election bind PTEs that invest in it?
    - How are credits/ deductions allocated among the electing PTE's investors?
    - Does the investor PTE need to file?
  - What if the electing PTE is owned by a C Corp or other exempt entity?
    - Can the C Corp claim the refundable credit paid by the electing entity?
- New provision requires the Tax Commissioner to adopt rules
  - Specifically mentions application of credits/ deductions flowing through multiple tiers
  - Such rules are not "regulatory restrictions" under R.C. 121.95

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### TAX CHANGES STILL ON THE HORIZON

(I.E., OHIO PIT/ PTE LEGISLATIVE UPDATES FOR 2023 & FORWARD)

Am. Sub. H.B. 95 (Beginning Farmers Credits)  
 Sub. S.B. 18 (PTE rate changes)  
 Am. Sub. H.B. 110 (New Capital Gains Deductions)

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### BEGINNING FARMERS CREDITS (H.B. 95)

- Two new credits beginning in tax year 2023
  - First credit is for beginning farmers who participate in a financial management program
  - Second credit is for specified sales or rental of agricultural assets to beginning farmers
- Tax credit program administered by Ohio Department of Agriculture (ODA)
  - Farmer must be certified as a "beginning farmer" by either the Department of Ag or a "participating land grant college" OR
  - Receive a substantially equivalent certification from the US Department of Agriculture
- Certification is valid until the requirements of a beginning farmer are no longer met

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**BEGINNING FARMERS CREDITS (H.B. 95)**

- What is a "beginning farmer"?
  - An individual who meets the certification criteria to be a beginning farmer;
  - Who has been certified as a beginning farmer; and
  - Who continues to meet the certification criteria
- Certification criteria (11 items):
  1. Be an Ohio resident
  2. Entered farming within the last ten years, or be seeking entry into farming;
  3. Farm, or intend to farm, land in Ohio;
  4. Not be a partner, member, shareholder, or trustee of the owner of the agricultural assets the individual is seeking to purchase or rent;
  5. Have a total net worth, including the assets and liabilities of the individual's spouse and dependents, of less than \$800,000 (indexed for inflation);

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**BEGINNING FARMERS CREDITS (H.B. 95)**

- Certification criteria (con't):
  6. Provide the majority of the day-to-day physical labor for and management of the farm;
  7. Have adequate farming experience or demonstrate knowledge in the type of farming for which the individual seeks assistance;
  8. Submit projected earnings statements and demonstrate a profit potential;
  9. Demonstrate that farming will be a significant source of income for the individual;
  10. Participate in an approved financial management program; AND
  11. Meet any other requirements prescribed by the Ohio Director of Agriculture

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**BEGINNING FARMERS CREDITS (H.B. 95)**

- Credit for beginning farmers who participate in a financial management program
- Credit equals the cost the of participating in an approved financial management program
  - Person claiming the credit must have a certificate from ODA
  - Credit is nonrefundable and has a 3-year carryforward period
  - R.C. 5747.98- Credit is 16<sup>th</sup> in order
  - See R.C. 901.61(E) and 5747.77(B)

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### BEGINNING FARMERS CREDITS (H.B. 95)

Credit for specified sales or rental of agricultural assets to beginning farmers

- Credit is for the owner of agricultural assets who sells or rents said assets to a "beginning farmer"
  - "Agricultural asset" includes agricultural land, livestock, facilities, buildings, and machinery used for agricultural production in Ohio
  - Rental or sale must occur during calendar year or either of the 2 preceding calendar years
  - The asset must be rented at "prevailing community rates"
- Credit equals 3.99% of:
  1. The sale price of the agricultural asset;
  2. The gross rental income received during the calendar year pursuant to a rental agreement, OR
  3. The gross rental income received during the taxable year pursuant to a share rent agreement

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### BEGINNING FARMERS CREDITS (H.B. 95)

Credit for specified sales or rental of agricultural assets to beginning farmers

- Person claiming the credit must have a certificate from ODA
- Credit is nonrefundable and has a 7-year carryforward period
- R.C. 5747.98 - Credit is 17<sup>th</sup> in order
- See R.C. 901.61(D) and 5747.77(A)

**\*\*Total cap for both beginning farmer credits is \$10m**

- Credits are only available for 5 calendar years- after that, no more applications will be accepted by ODA

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### OTHER CHANGES IMPACTING FUTURE TAX YEARS

**IT 1140 tax rates**

- All non-exempt entities (e.g., individuals, PTEs, trusts) will be taxed at a 3% rate tax years beginning on or after 1/1/2023

**Capital Gains Tax Deductions**

- Venture Capital Operating Company Deduction
  - Deduction for taxpayers who invest in Ohio venture capital operating companies
- Sale of Business Deduction
  - Deduction for certain taxpayers who sell their interest in an Ohio business that creates jobs in Ohio

Deductions are first applicable to tax year 2026

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# MUNICIPAL TAX UPDATES

Hot Topic - Employer Withholding for Remote Workforce

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## AM. SUB. H.B. 110 - MUNICIPAL TAX

In response to the COVID-19 pandemic, Ohio law permitted employers to withhold municipal income tax from employee wages as if employees are working in the office, regardless of where they have been performing their work.

That ended December 31, 2021. January 1, 2022 we returned to the "old" municipal income tax withholding rules.

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## MUNICIPAL TAX WITHHOLDING 1-1-2022

Withhold where work is performed

Occasional Entrant Rule

Small Employer Rule

Remote and Hybrid Work Environment

Fully remote - withhold for the employee's residence municipality at full rate as the workplace

Fully in office - withhold based on PPofW location (as it was pre-pandemic)

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### MUNICIPAL TAX WITHHOLDING 1-1-2022

- Hybrid schedules
  - Withhold day by day where work is performed;
  - Prorate wages between office and home, based on actual or expected schedules and withhold accordingly;
- For wages earned when working from home, the home municipality is treated like any other work location – NOT courtesy residence withholding.

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### Municipal Income Tax Withholding

Potential Impacts of Municipal Income Tax Withholding Shifts

- Who?
  - Everyone – employers; employees; and municipalities
- What?
  - New withholding obligations; employee residence tax impacts; and shifts in municipal revenue
- When?
  - 1Q 2022
  - Refunds 2023

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### MUNICIPAL INCOME TAX SHIFTS - EXAMPLE

**2021**

- o Annual Salary: \$60,000
- o Work Location: Brecksville
- o Residence Location: Shaker Heights

**2022 AND FORWARD**

- o Annual Salary: \$60,000
- o Work Location: Brecksville (1 Day, 20%)
- o Work and Residence Location: Shaker Heights (4 Days, 80%)

Description	Wages	%	Tax Amount
Brecksville Workplace Tax (100%)	\$60,000	2%	\$1,200
Shaker Heights* Residence Tax (After credit)		1.75%	\$1,050
<b>Total Muni Tax</b>			<b>\$2,250</b>

Description	Wages	%	Tax Amount
Brecksville Workplace Tax (20%)	\$12,000	2%	\$240
Shaker Heights* Workplace Tax (80%)	\$48,000	2.25%	\$1,080
<b>New Amount To Be Withheld</b>			<b>\$1,320</b>
Shaker Heights Residence Tax To Be Paid (Not Withheld)			\$210
<b>New Muni Tax Total</b>			<b>\$1,530</b>

\*Shaker Heights Tax rate is 2.25%, however, they give % credit for workplace.

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### MUNICIPAL TAX REFUNDS

- Ohio House Bill 110 made it clear that taxpayers who had tax withheld for the principal place of work municipality in 2021 while they worked from home may obtain a refund.
- Ohio House Bill 110 did not address tax year 2020 refunds for taxpayers who had tax withheld for the principal place of work municipality in 2020 while they worked from home.
- Litigation pending throughout the State to answer this question.
- Refund requests for tax year 2020 are suspended

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### MUNICIPAL INCOME TAX LITIGATION

- Buckeye Inst. v. Kilgore*, 2021-Ohio-4196 (10<sup>th</sup> Dist.) – City of Columbus
- Schaad v. Alder*, C-2100349, First District Court of Appeals – City of Cincinnati
- Curcio v. Hufford*, G-4801-CI-0202101522-000, Lucas County Common Pleas Court – Cities of Oregon & Toledo
- Morsy v. Dumas*, CV-21-946057, Cuyahoga County Common Pleas Court – City of Cleveland

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### Municipal Net Profit Tax – Old Rules, New Allocations

#### Apportioning Municipal Net Profits in 2022 With Employees Working at Home

- Property in employees' home municipalities?
  - Laptops, monitors, printers, phones, other employer equipment
- Payroll?
  - Employees' homes not owned or controlled by the employer or employer's customers.
- Sales (services)?
  - What is the employee doing?

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THANKS FOR ATTENDING!



Julie Corrigan, Plante Moran PLLC

Matt Dodovich, Ohio Department of Taxation  Department of Taxation

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