



H.B. 288

127th General Assembly
(As Introduced)

Reps. Foley and Letson, Yuko, Okey, D. Stewart, Luckie, R. Hagan, Heard, Harwood, Skindell, Brady, Mallory, Domenick, Yates, Fende, Bolon, Dyer

BILL SUMMARY

- Imposes a tax on the net income of petroleum-related corporations, including those engaged in exploration, production, refining, manufacturing, processing, transporting, and marketing of oil or gas, but excluding retail service stations.
- Tax applies to net income in excess of \$1 million.
- Earmarks revenue for the existing Advanced Energy Fund, which is used to provide financial assistance for advanced energy projects that preserve or create employment opportunities or use innovative technologies.
- Permits the General Assembly to earmark some of the revenue for the Ohio Rail Development Commission.
- Prohibits taxpayers from passing the tax through to its customers.
- Requires combined tax reporting for members of unitary business groups that include a petroleum business.

CONTENT AND OPERATION

Imposition of tax

(R.C. 5733.61)

The bill imposes a tax on the net income of petroleum businesses. The tax applies only to net income in excess of \$1 million. The tax rate is 8.5% (which equals the corporation franchise tax rate for net income in excess of \$50,000).

Taxpayers

(R.C. 5733.60 and 5733.61)

The tax is imposed on "petroleum businesses," which the bill defines to be corporations engaged in exploration, production, refining, manufacturing, processing, transportation, and marketing of oil or gas, or of any commodity, product, or feedstock derived from oil or gas. A corporation that has a direct or indirect ownership interest in a pass-through entity that is engaged in those business activities also is subject to the tax; the pass-through entity's petroleum business is attributed to the corporation to the extent of the corporation's distributive share of the entity.

To be subject to the tax, the petroleum business must be doing business in Ohio, own capital or property in Ohio, hold a certificate of compliance issued by the Secretary of State, or have some other nexus with Ohio.

A petroleum business is not subject to the tax if neither it, nor any of its affiliates, have been in the business of petroleum refining within the last five tax years. Petroleum refining is defined as refining crude petroleum into refined petroleum by fractionation, straight distillation of crude oil, cracking, or similar methods. The bill also excludes a business from the tax if its only business is the ownership or operation of a retail fuel station.

Tax base

(R.C. 5733.60, 5733.63, and 5733.64)

The tax is imposed on the net income of a petroleum business to the extent the net income exceeds \$1 million. The net income is derived from a corporation's federal taxable income and is computed in a manner similar to the computation of net income for the purposes of the existing corporation franchise tax. However, unlike the franchise tax computation, certain adjustments are not allowed, including those for some past net operating losses; for recapture of credits claimed for taxes paid on the corporation's behalf by a parent pass-through entity if those taxes were deducted in computing the corporation's taxable income; for contributions to individual development account programs; for FAS 109 book-tax differences related to electricity and telephony deregulation-related tax regime changes; and for deferral of federal bonus depreciation. Also, corporations that are part of a group of related businesses engaged in a unitary business are required to report the combined net income of the group. Under the existing franchise tax, combined reporting is allowed, or may be required by the Tax Commissioner, but it is not uniformly required. (The combined reporting requirement is addressed below.)

Net income is allocated and apportioned in the same manner as net income is allocated and apportioned under the existing franchise tax. Nonbusiness income is allocated to Ohio on the basis of existing rules considering the location or source of the income-producing assets (R.C. 5733.051), and business income is apportioned under the existing three-factor formula prescribed by R.C. 5733.05(B)(2). The apportionment formula computes the weighted average of the values of the taxpayer's property, payroll, and sales in Ohio as a proportion of the values of those factors everywhere; sales is weighted three times more heavily than each of the other two factors. The Tax Commissioner is authorized to prescribe alternative apportionment methods.

Purpose; use of revenue

(R.C. 5733.61 and 5733.66)

The tax is imposed for the purpose of promoting energy-efficient modes of transportation and advanced energy production technology. All revenue from the tax is to be credited to the existing Advanced Energy Fund, administered by the Department of Development, and expended for the same purposes authorized for money in that fund. Those purposes include providing financial, technical, and related assistance for advanced energy projects in Ohio or for economic development assistance, including through the awarding of grants, contracts, loans, loan participation agreements, linked deposits, and energy production incentives.

The General Assembly also may appropriate revenue from the tax to the Ohio Rail Development Commission.

Pass-through of tax prohibited

(R.C. 5733.62)

The bill prohibits a taxpayer from increasing the prices of its petroleum products to recapture the tax from customers. The Tax Commissioner is authorized to audit the books and records of a taxpayer to ensure compliance with the pass-through prohibition. If a taxpayer is a member of a unitary group, the Tax Commissioner may audit the books and records of the other group members.

Violation of the prohibition subjects a taxpayer to a civil penalty equal to twice the penalties imposed under the corporation franchise tax for failure to file a return, filing a false or frivolous return, or filing a late return. (The precise penalty that would apply is not clear. The maximum penalty is 15% of the tax due or \$1,000. Some clarification of the penalty computation may be required.) Interest also is charged on the penalty amount.

Administration; statutory references; effective date

(R.C. 5733.67; Section 3)

The tax is to be administered and enforced under the existing law governing the administration and enforcement of the corporation franchise tax.

The bill specifies that various sections of existing law that refer to the existing corporation franchise tax are not to be construed as referring to the tax imposed by the bill.

The bill does not specify a particular effective date, but it would take effect immediately under the constitutional provision prescribing that legislation imposing a tax takes immediate effect. (Section 3.) Under rules of construction, the tax would first apply to taxable years that include the bill's effective date.

Combined reporting

(R.C. 5733.60(J), (K), and (L), 5733.63, 5733.64, and 5733.65)

The bill requires companies related through linkages of majority ownership or control to combine their net incomes if they are part of a unitary group of companies that includes a petroleum business subject to the tax. If they combine their net incomes, they must eliminate transactions between members of the group. The purpose of combining net incomes is to reflect the combined net income of the whole group, which can eliminate or reduce distortions in the net incomes of any subset of group members. One kind of distortion that can be addressed is an Ohio corporation paying various expenses to a related corporation in another state imposing little or no income tax, thereby reducing its individual Ohio net income for tax purposes but not necessarily increasing the net income of the entire group.

Unitary group

The bill adopts a definition of unitary group employed by some other states for the purposes of their combination requirements. A unitary group is defined to be a group of corporations that are linked through majority ownership or control and that are "sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts" of the group.

"Water's edge" election

Taxpayers that are members of a unitary business group may elect to include in the combined report only domestic (United States) net income of

affiliates under a so-called "water's edge" election. If such an election is made, only the following members of the group need be included in the combination:

- Members incorporated in the United States or formed under the laws of a state, the District of Columbia, or a United States territory or possession.
- A member having, on average, at least 20% of its property, payroll, and sales in the United States as compared to everywhere;
- A member that is a domestic international sales corporation (DISC), a foreign sales corporation (FSC), or an export trade corporation.¹
- A member that does not satisfy any of the above criteria but that derives its income from sources in the United States and from its property, payroll, or sales in the United States (such a corporation must combine its income with the group only to the extent that its income is derived from such U.S.-based sources).
- A member that is a controlled foreign corporation that has certain foreign-source income that federal law requires the corporation's shareholders to include in their federal taxable income ("Subpart F income"). (Only part of such a corporation's income is combined with other members of the unitary group: the portion representing the percentage of its earnings and profits that constitutes Subpart F income).²
- A member that is receiving more than 20% of its income from intangible property or service-related activities that are deductible by other members of the group.
- A member doing business in a tax haven. A tax haven is defined according to a standard definition used by some states, and includes jurisdictions identified as such by the Organization for Economic Cooperation and Development (OECD) or exhibiting certain characteristics, such as having no tax or nominal tax on income and having either laws or practices preventing tax information exchange, a

¹ These kinds of corporations are formed pursuant to federal law granting favorable tax treatment of profits generated outside the United States.

² A controlled foreign corporation is a foreign corporation that is majority-owned by United States shareholders.

lack of transparency in their tax regime, laws permitting the establishment of foreign companies without a substantive local presence, discriminatory tax treatment against domestic businesses vis-à-vis foreign companies, or a tax regime favorable for tax avoidance.

The election must be made on a timely filed original return by every member of the group that is subject to the state's taxing jurisdiction. The election is binding for ten years, but may be withdrawn for reasonable cause based on extraordinary hardship or unforeseen changes in state tax law or policy, and then only if permitted by the Tax Commissioner. If any member of the unitary business fails to comply with the tax law's requirements, the Commissioner may disregard the election or may include other members of the group in the combined return even if the bill otherwise does not require their inclusion.

HISTORY

ACTION	DATE
Introduced	07-24-07

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