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Glossary of Commonly Used Tax Terms for H.B. 5

12 Day Occasional Entrant Rule – *Refers to the rule currently contained in R.C. 718.011 that exempts nonresident individuals from tax for personal services performed in a city on 12 or fewer days during the calendar year. As a result, the employer of such individual need not withhold tax to that occasional entrant city on those 12 or fewer days. The rule applies to any compensation for personal services, including compensation earned by sole proprietors, independent contractors, and members of boards of directors. The 12 Day Rule does not apply if: (i) the taxpayer is a professional athlete or entertainer, or (ii) if the taxpayer should have paid tax on the income to another city and did not do so.*

20 Day Occasional Entrant Rule – *Refers to the rule proposed in H.B. 5 to replace the current* ***12 Day Occasional Entrant Rule*** *(see above). Under the proposed 20 Day Occasional Entrant Rule, the number of occasional entrant days is increased from 12 to 20, an employee is treated as working in only one city on any given calendar day, the exemption from tax for the 12 days is eliminated by requiring tax to be withheld to the employee's* ***Principal Place of Work*** *(i.e., the 20 days of income will be taxed in most instances), and employers cannot rotate employees to avoid withholding obligations to the city as is done under the current 12 Day Rule.*

Alternative Apportionment – *In some limited circumstances, the statutory* ***Apportionment Formula*** *(see below) does not fairly reflect the amount of business income or loss being generated within a city. This can result because of circumstances that are unique to the taxpayer. Alternative apportionment is a mechanism that permits a taxpayer or the city tax administrator to modify the* ***Apportionment Formula*** *in such a way as to more fairly reflect income or loss generated in the city because of the taxpayer's unique circumstances.*

Apportionment – *Refers to how the income of a business that operates in multiple tax cities is allocated between such cities for tax purposes. Typically, an equally weighted three-factor formula is used to calculate an apportionment percentage for each city, without regard to the specific nature of the business (but, some exceptions apply). The total business income is multiplied by each city's apportionment percentage to determine how much income is taxable in each jurisdiction.*

Apportionment Formula – *Refers to the statutory formula used to allocate business income across multiple cities. Most states and cities use an equally weighted three factor formula (shown below). Some states modify this approach by weighting the factors or by adopting a single sales factor. The typical equally weighted three factor formula is shown here:*

$$\left(\frac{\text{Sales in the Jurisdiction}}{\text{Sales Everywhere}}\right)+\left(\frac{\text{Property in the Jurisdiction}}{\text{Property Everywhere}}\right)+\left(\frac{\text{Payroll in the Jurisdiction}}{\text{Payroll Everywhere}}\right)\div 3 = \text{Apportionment \%}$$

Assessment – *An appealable financial obligation equal to any underpaid tax, penalty or interest that results from an audit conducted by a taxing jurisdiction.*

Bright-Line Residency Test – *Refers to the Ohio residency rule contained in R.C. 5747.24 which treats an individual as a non-resident of Ohio for tax purposes if he or she has an abode outside Ohio, is in Ohio for less than 183 contact periods (i.e., overnights), and files a sworn statement that he or she is not a resident of Ohio.*

CCA – *Refers to the Centralized Collection Authority, which is an agency formed by City of Cleveland to administer the municipal income taxes of over 50 member municipalities.*

Consolidated Tax Return – *A single and comprehensive tax return filed by a group of C corporations 80% or more owned by a common "parent" corporation. A consolidated return includes the income and losses of all entities owned directly or indirectly by the "parent corporation," including the group's share of income and loss from pass-through entities.*

C-corporation – *A legal structure that businesses can choose to organize themselves under in order to isolate the legal and financial liabilities of the business from its owners. C corporations are considered separate entities from their owners. C corporation income is taxed twice for federal purposes, once at the corporate level and again when it is distributed to owners/shareholders. The double taxation of C corporations at the federal level is a drawback which compels many businesses to organize as a* ***Pass-Through***

Entity *(see below). C corporations are considered separate taxpayers for federal, state and local tax purposes (but, see "****Consolidated Tax Return****" above).*

Forced Combination – *Refers to the ability of a city tax administrator to consider unique circumstances and force a group of C corporations to file a* ***Consolidated Tax Return*** *in order to more fairly reflect the business income or net operating loss generated within the city.*

Limited Liability Company (LLC) – *A legal structure that businesses can choose to organize themselves under in order to isolate the legal and financial liabilities of the business from its owners, yet avoid the double federal taxation and other limitations associated with C corporations. LLCs are considered separate entities from their owners. Because LLCs are generally taxed as either S corporations or* *partnerships, the owners report their share of the income and loss of the entity on their personal federal and state tax returns.*

Local Boards of Tax Review – *The city board that hears administrative appeals of taxpayers from findings by a city tax administrator as a result of a city tax audit. Taxpayers may represent themselves or be represented by their tax advisors (CPAs, lawyers, practitioners, etc.) The three member board is appointed by the city, and typically consists of city officials, although some cities appoint citizens. A decision of the Local Board of Tax Review is appealable by the taxpayer or the city to the local common pleas court or the* ***Ohio Board of Tax Appeals*** *(see below).*

Net Operating Loss (NOL) – *A business loss that results because the business has incurred more expenses than revenues during a tax year.*

Net Operating Loss Carryforward (NOL Carryforward) – *Refers to the ability to utilize a* ***Net Operating Loss*** *(see above) incurred in an earlier tax year to reduce income earned in a future tax period. NOL carryovers are used by the federal government and every state which imposes an income tax, which recognizes the reality of the business cycle by permitting the averaging of business income over multiple tax years.*

Occasional Entrant Rule – See **"12 Day Occasional Entrant Rule"** and "**20 Day Occasional Entrant Rule"** above.

Offsets – *Refers to the ability of residents to offset business income flowing from a* ***Pass-Through Entity*** *owned by the resident against business losses flowing from another* ***Pass-Through Entity*** *owned by the resident when calculating the net income subject to tax for the tax year. Under current law, city rules vary widely as to whether and to what extent Offsets are permitted. Like federal and state tax treatment, H.B. 5 fully allows Offsets. However, unlike current city law, H.B. 5 does not allow* ***Federally Suspended Losses*** *to offset business income.*

Ohio Board of Tax Appeals – *The quasi-judicial board that handles various types of appeals filed by taxpayers, including appeals from municipal* ***Local Boards of Tax Review****. This level of appeal is very formal and constitutes a due process hearing, meaning that taxpayers must generally be represented by attorneys.*

Ohio Business Gateway (OBG) – *The online tax and business filing system funded by the state of Ohio. Business taxpayers may use OBG to file municipal net profit tax returns and withholding tax returns.*

Pass-Through Entity (PTE) – *A type of business entity under which business income and net operating losses pass through to the investors/owners for tax reporting purposes. Compared to a* ***C corporation*** *which incurs two layers of taxation, a Pass-Through Entity provides the advantage of incurring only a single level of taxation for federal and state tax purposes--the investors/owners report their share of the business income or net operating loss on their personal income tax returns. Pass-through entities generally include partnerships, limited liability companies, and S corporations. However, S corporations are not generally treated as pass-through entities for city tax purposes (see "****S corporation"*** *below).*

Pass-through Entity Owner – *An individual that owns an interest in a pass-through entity and that reports his or her share of the income or loss of such entity on his or her personal federal and state income tax returns.*

Principal Place of Work – *Means a permanent place of doing business in Ohio (such as an office, warehouse, storefront or similar location owned and controlled by an employer) or a **Worksite Location** at which an employee is required to report for employment duties on a regular and ordinary basis. If an employee is not required to report to a permanent place of doing business or a **Worksite Location**, then the Principal*

Place of Work is deemed to be the location in Ohio at which the employee works the greatest number of days.

RITA – *Refers to the Regional Income Tax Authority, which is officially a Regional Council of Governments. RITA provides services to collect income tax for municipalities in Ohio. RITA's Board of Trustees is authorized to administer and enforce the income tax laws of each of the participating municipalities. However, each municipal corporation retains its right to administer and enforce its own income tax laws concurrently with the Board. RITA administers the tax system for over one-third the cities (about 240 municipalities as members).*

S Corporation – *A legal structure that businesses can choose to organize themselves under in order to provide the legal protections typically available from a **C corporation**, yet avoids the double federal taxation and other limitations associated with a **C corporation**. S corporations are considered separate entities from their owners. For federal and state tax purposes, S corporations owners report their share of the business income or net operating loss of the entity on their personal federal and state income tax returns. For city tax purposes, S corporations are generally treated as C corporations (taxed at the entity level) unless the city held an election in 2000 or 2001 that approved taxing S corporation income at the owner level.*

SERP – *Refers to a Supplemental Employee Retirement Plan that is used by businesses to provide additional pension benefits to its employees because of limitations imposed by the federal government under ERISA. A SERP is not a "qualified pension plan" for federal tax purposes, but can be a pension plan for city tax purposes based on a recent Ohio Court of Appeals decision. Like a traditional pension plan (pre-ERISA), the SERP benefit is an unsecured obligation of the company and is at risk, being subject to the general claims of the employer's creditors.*

Throwback Rule – *Refers to a modification of the standard three factor **Apportionment Formula** (see above) that treats sales that are shipped to a jurisdiction that does not impose a tax as being shipped to the jurisdiction from which the goods originate. For Ohio city tax purposes, if sales are not "solicited" by a taxpayer's employees at the location to where the goods are shipped, then the goods must be treated as sales in the city from which the goods originated--even if the taxpayer is actually taxed by the destination city. A throwback rule at the state or city level is generally recognized as a competitive disadvantage for the jurisdiction because it penalizes those that locate shipping facilities in such jurisdiction compared to those that locate shipping facilities in jurisdictions without a throwback rule.*

Worksite Location – *Refers to a construction or other temporary worksite in Ohio at which an employer provides services for more than twenty days. The **20 Day Occasional Entrant Rule** does not apply to employees working at a Worksite Location. An employee's residence does not qualify as a Worksite Location.*