Porter Wright Morris & Arthur LLP
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Tax ALERT
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What is the Commercial Activity Tax (CAT)?

Major changes have occurred to the Ohio tax code that affect many Ohio business taxpayers. The most significant change is the introduction of the **Commercial Activity Tax (CAT)**, a business privilege tax measured by a business's gross receipts. Significantly, the CAT applies to all kinds of persons and business entities that meet the requirements discussed below—whether the taxpayer is an individual/sole proprietorship, C corporation, S corporation, partnership, LLC, LLP, or other person or business entity. The CAT is being phased in over five years and will replace the corporate franchise tax and the tangible personal property tax, which are being phased out over the same time period.

Registration for the CAT

The CAT came into effect on July 1, 2005. Taxpayers doing business in Ohio that are subject to the CAT and have more than $150,000 in Ohio-based gross receipts **must register by November 15, 2005**, and pay a small one-time fee. Online registration is encouraged at *obg.ohio.gov*; paper forms are available online or by calling 1-800-282-1782. At the time of registration, the taxpayer must make several important decisions that will influence the type of CAT reporting applicable to the taxpayer. One important decision concerns reporting by **commonly owned businesses** and is discussed below.

Who is Subject to the CAT?

- Businesses with Ohio-sitused gross receipts of $150,000 or more in a calendar year, whether the business is an individual/sole proprietorship, C corporation, S corporation, partnership, LLC, LLP, or other person or type of business entity. This includes service providers such as physicians, attorneys, and accountants, and persons engaged in the sale or rental of any type of property.
- Out-of-state businesses that (i) have more than $500,000 in Ohio-based gross receipts, (ii) have more than $50,000 in real or personal property in Ohio at any time during the calendar year, (iii) have more than $50,000 in yearly payroll in Ohio, **or** (iv) conduct more than 25% of their business activity in Ohio. These criteria are measured on a calendar-year basis.
- Exceptions: (i) nonprofit organizations, (ii) financial institutions and affiliates, (iii) insurance companies and affiliates, (iv) dealers in intangibles, and (v) some receipts by public utilities.

What is a Gross Receipt?

- The total amount realized from activities that contribute to the production of income without deduction for the cost of goods sold or other expenses, including other taxes. This includes gross receipts among commonly owned entities unless an election is made.
- Only Ohio-sitused gross receipts are subject to the CAT.
- Examples: (i) sales, (ii) performance of services, and (iii) rental and lease income.
- Exceptions: (i) employee compensation and wages (most individuals who do not operate a business are therefore exempt from the CAT); (ii) interest, dividends, federally defined capital gains, and distributions; and (iv) proceeds from loans, stocks, bonds, mutual funds, trusts, and pensions.
- Method of Accounting: Must be the same method the taxpayer uses for federal income tax purposes.

CAT Rate and Filing Requirements

- A tax of $150 applies to gross receipts of between $150,000 and $1 million (for 2005, a $75 tax applies to post-July 1 gross receipts of less than $500,000).
- When the full CAT rate commences in April 2009, the rate will be 0.26% of Ohio-sitused gross receipts. The rate for 2005 and the first part of 2006 is 0.06%. The rate will increase incrementally each year until 2009.
- The initial return covers the period from July 1, 2005, through December 31, 2005. The initial return is due February 10, 2006.
- Subsequent returns are due electronically on a quarterly basis if the taxpayer has annual Ohio receipts of over $1 million a year; otherwise returns are due annually on February 10.

Commonly Owned Businesses

- All taxpayers having more than a 50% common ownership with other entities must register all of these commonly owned businesses together as either a combined taxpayer group or as a consolidated elected taxpayer group.
    - The decision of whether to file commonly owned businesses as a combined taxpayer group or a consolidated elected taxpayer group must be carefully decided based on whether individual members would otherwise be subject to the CAT, the amount of intragroup gross receipts, and other factors.
    - Although the type of common group must be selected on the registration filing due on November 15, 2005, the Ohio Department of Taxation has indicated in informal advice that it will permit taxpayers to amend their selection until the 2005 return is due on February 10, 2005.
    - The determination of whether a person or entity owns or controls another entity through related interests is made using a vertical ownership test. The federal attribution rules do not apply. A vertical chain of ownership continues as long as the ownership test is satisfied, separately or in the aggregate, by any one or more members or the group. See Information Release at *tax.ohio.gov*.
    - An entity cannot be the member of both a combined taxpayer group and a consolidated elected taxpayer group. A joint venture in which an entity is owned 50/50 by two other entities may be a member of two different consolidated groups. If the decision is made not to elect to consolidate, the joint venture must register as a single entity taxpayer.
    - **Note:** The distribution of profits and losses among members should not be included in gross receipts, although sales between members would be taxable unless an election is made to file as a consolidated elected taxpayer.

- **Combined Taxpayer Group**: All taxpayers having more than a 50% common ownership with other entities and who have not elected to file as a consolidated group must register and file as a combined group.
    - Advantage: Combined taxpayers are required to register only those commonly owned members that have enough contacts in Ohio (i.e. nexus).
    - Disadvantage: Unlike a consolidated elected taxpayer group, gross receipts between members of a combined taxpayer group are **not excludable** taxable gross receipts for the group.
    - Only one $1 million exclusion (paying the $150 base tax) is permitted to each combined group.

- **Consolidated Elected Taxpayer Group**: Taxpayers with at least 50% common ownership interest with other entities may elect to consolidate all commonly owned entities into a single taxpayer group.
  - Such taxpayers may choose to include all entities that have at least a 50% common ownership or elect to only include those entities that have at least an 80% common ownership. (Note: if the 80% option is chosen, all other remaining commonly owned entities with at least a 50% common ownership will be required to file as a combined taxpayer group, discussed above).
  - The election to file as a consolidated elected taxpayer group may not be amended for eight calendar quarters. Newly acquired 50%/80% commonly owned entities, however, may be added to the group as needed.
  - Advantage: Unlike a combined taxpayer group, gross receipts between members of a combined taxpayer group are **excludable** taxable gross receipts for the group.
  - Disadvantage: Consolidated elected taxpayers are required to register and pay the CAT for all members with 50%/80% common ownership, regardless of whether an individual entity has substantial nexus with Ohio.
  - Only one $1 million exclusion (paying a $150 base tax) is permitted to each consolidated elected taxpayer group.

This Tax Alert is intended to provide general information for clients or interested individuals and should not be relied upon as legal advice. For further information or assistance concerning the commercial activity tax, you may contact the following attorneys:

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