



2006 Municipal Profile Certification Frequently Asked Questions and Other Information

Questions and Answers (Q/A) Regarding Section IV

Section IV of the Certification asks specific questions about the local provisions of the municipality's tax code as permitted by ORC. Not all municipalities treat these provisions in the same way; therefore, it is necessary for OBG to have this information in order to correctly calculate taxpayers' Net Profits Returns for each municipality.

Q. What is the “stock option exemption for employees”? (Section IV Question 2)

A. Division (F)(10) of Ohio Revised Code section 718.01 and division (A)(2)(d) of Ohio Revised Code section 718.03 provide that each city may, by resolution or ordinance, exempt from individual income tax the amount of compensation arising from the sale, exchange, or other disposition of the stock option, the exercise of a stock option, or the sale, exchange or other disposition of stock which the individual purchases under a stock option. Division (E) of Ohio Revised Code section 718.02 provides that if the employee is exempt from the individual tax on such income, then the employer corporation must “add to its net profit that was apportioned to that municipal corporation . . . the amount upon which the employee would be required to pay tax were the amount related to the stock option not exempted from taxation.”

Q. What is the Ohio Revised Code section 718.14(B) credit allowable to corporations, partnerships and LLC's? (Section IV Question 7)

A. This portion of Ohio municipal income tax law states that “any municipal corporation imposing a tax that applies to income from a pass-through entity shall grant a credit to each owner who is domiciled in the municipal corporation for taxes paid to another municipal corporation by a pass-through entity that does not conduct business in the municipal corporation” (emphasis added). Several cities allow corporations (both “C” and “S”), partnerships, and limited liability companies to claim this credit with respect to their equity investment in other partnerships and in LLC's treated as partnerships for federal income tax purposes.

Q. What is the Ohio Revised Code section 718.01(H) add-back for distributive share of losses from partnerships in which the taxpayer has invested? (Section IV Question 8)

- A. This portion of Ohio municipal income tax law states that no municipal corporation is required to allow a deduction from taxable income for losses incurred from a sole proprietorship or partnership. Several municipal corporations require taxpayers to add back any distributive share of losses which the taxpayer claimed in deriving the taxpayer's federal taxable income.

Q. What is the Ohio Revised Code section 718.14(D) exemption available to pass-through entities? (Section IV Question 9)

- A. This portion of Ohio municipal income tax law states that any municipal corporation that imposes a tax on income of or from a pass-through entity shall specify by ordinance or rule whether the tax applies to income of the pass-through entity in the hands of the entity or to income from the pass-through entity in the hands of the owners of the entity. A municipal corporation may specify a different ordinance or rule under this division for each of the classes of pass-through entity enumerated in division (A)(2) of this section. So this law states that the city income tax applies either to the equity investor in the pass-through entity or the pass-through entity itself. The tax cannot apply to both the equity investor and the pass-through entity.

See the additional information for Question 9 that follows the Q/A.

Q. What is the Ohio Revised Code section 718.14(F)(9)(d) and ORC section 718.14(D) S corporation exemption? (Section IV Question 10)

- A. The two portions of law require that, with respect to the profit of S corporations, the city can tax either the S corporation itself or the S corporation shareholders, but not both. If the municipality taxes the S corporation shareholder, then the S corporation is, itself, exempt from the municipal income tax.

See the references and excerpts that follow the Q/A.

Specific Information concerning Section IV Question 9

Issue: Pass-through entities and Ohio Revised Code section 718.14(D)

“Exempt pass-through entities from tax on account of ORC section 718.14(D) because the municipality taxes the pass-through entity income in the hands of the pass-through entity owner?”

If your municipality treats all pass-through entities the same (see discussion, below), then please provide either a “Yes” or “No” answer to the ninth question in Section IV of the certification request form.

If your municipality has different city income tax treatment for partnerships, S corporations, and limited liability companies treated as partnerships for income tax purposes, then please do NOT provide an answer to the ninth question in Section IV of the certification request form. Instead, please provide answers to each of the five questions on the 2006 Municipal Profile Certification Addendum.

Discussion: The discussion from the Q/A section above explains how ORC section 718.14(D) applies. For municipal income tax purposes most municipalities treat all pass-through entities (partnerships, S corporations, and limited liability companies treated as partnerships for income tax purposes) the same. That is, most cities will either (i) tax all such pass-through entities (and not tax the income in the hands of the owners of the pass-through entities or (ii) not tax any such pass-through entities (but tax the income in the hands of the owners of the pass-through entities).

However, ORC section 718.14(D) allows each municipality to treat partnerships, S corporations, and limited liability companies (treated as partnerships for income tax purposes) differently for city income tax purposes. For example, a city (i) might tax partnerships and limited liabilities treated as partnerships for income tax purposes (and not tax the income in the hands of the owners of partnerships) and not tax the income in the hands of the owners of limited liability companies treated as partnerships for income tax purposes) and (ii) not tax S corporations (but tax the income in the hands of the owner or owners of the S corporation).

References and Excerpts

Divisions (F)(9) and (F)(10) of Ohio Revised Code section 718.01

(F) A municipal corporation shall not tax any of the following:

* * * * *

(9) (a) Except as provided in division (F)(9)(b) and (c) of this section, an S corporation shareholder's distributive share of net profits of the S corporation, other than any part of the distributive share of net profits that represents wages as defined in section 3121(a) of the Internal Revenue Code or net earnings from self-employment as defined in section 1402(a) of the Internal Revenue Code.

(b) If, pursuant to division (H) of former section 718.01 of the Revised Code as it existed before March 11, 2004, a majority of the electors of a municipal corporation voted in favor of the question at an election held on November 4, 2003, the municipal corporation may continue after 2002 to tax an S corporation shareholder's distributive share of net profits of an S corporation.

(c) If, on December 6, 2002, a municipal corporation was imposing, assessing, and collecting a tax on an S corporation shareholder's distributive share of net profits of the S corporation to the extent the distributive share would be allocated or apportioned to this state under divisions (B)(1) and (2) of [section 5733.05](#) of the Revised Code if the S corporation were a corporation subject to taxes imposed under [Chapter 5733](#) of the Revised Code, the municipal corporation may continue to impose the tax on such distributive shares to the extent such shares would be so allocated or apportioned to this state only until December 31, 2004, unless a majority of the electors of the municipal corporation voting on the question of continuing to tax such shares after that date vote in favor of that question at an election held November 2, 2004. If a majority of those electors vote in favor of the question, the municipal corporation may continue after December 31, 2004, to impose the tax on such distributive shares only to the extent such shares would be so allocated or apportioned to this state.

(d) For the purposes of division (D) of [section 718.14](#) of the Revised Code, a municipal corporation shall be deemed to have elected to tax S corporation shareholders' distributive shares of net profits of the S corporation in the hands of the shareholders if a majority of the electors of a municipal corporation vote in favor of a question at an election held under division (F)(9)(b) or (c) of this section. The municipal corporation shall specify by ordinance or rule that the tax applies to the distributive share of a shareholder of an S corporation in the hands of the shareholder of the S corporation.

(10) Employee compensation that is not "qualifying wages" as defined in [division (A)(2) of] [section 718.03](#) of the Revised Code.

Division (H) of Ohio Revised Code section 718.01

(H) Nothing in this section or [section 718.02](#) of the Revised Code shall authorize the levy of any tax on income that a municipal corporation is not authorized to levy under existing laws or shall require a municipal corporation to allow a deduction from taxable income for losses incurred from a sole proprietorship or partnership.

Division (E) of Ohio Revised Code section 718.02

(E) If, in computing the taxpayer's adjusted federal taxable income, the taxpayer deducted any amount with respect to a stock option granted to an employee, and if the employee is not required to include in income any amount or any portion thereof because it is exempted from taxation under division (F)(10) of [section 718.01](#) of the Revised Code and division (A)(2)(d) of [section 718.03](#) of the Revised Code by a municipal corporation to which the taxpayer has apportioned a portion of its net profit, the taxpayer shall add the amount that is exempt from taxation to the taxpayer's net profit that was apportioned to that municipal corporation. In no case shall a taxpayer be required to add to its net profit that was apportioned to that municipal corporation any amount other than the amount upon which the employee would be required to pay tax were the amount related to the stock option not exempted from taxation.

This division applies solely for the purpose of making an adjustment to the amount of a taxpayer's net profit that was apportioned to a municipal corporation under divisions (A) and (B) of this section.

Division (A)(2)(d) of Ohio Revised Code section 718.03

(A)(2) "Qualifying wages" means wages, as defined in section 3121(a) of the Internal Revenue Code, without regard to any wage limitations, adjusted as follows:

* * * * *

(d) Deduct any amount included in wages if the amount arises from the sale, exchange, or other disposition of a stock option, the exercise of a stock option, or the sale, exchange, or other disposition of stock purchased under a stock option and the municipal corporation has, by resolution or ordinance, exempted the amount from withholding and tax.

Ohio Revised Code section 718.14

(A) As used in this section:

(1) "Limited liability company" means a limited liability company formed under [Chapter 1705](#). of the Revised Code or under the laws of another state.

(2) "Pass-through entity" means a partnership, limited liability company, S corporation,

or any other class of entity the income or profits from which are given pass-through treatment under the Internal Revenue Code.

(3) "Income from a pass-through entity" means partnership income of partners, membership interests of members of a limited liability company, distributive shares of shareholders of an S corporation, or other distributive or proportionate ownership shares of income from other pass-through entities.

(4) "Owner" means a partner of a partnership, a member of a limited liability company, a shareholder of an S corporation, or other person with an ownership interest in a pass-through entity.

(5) "Owner's proportionate share," with respect to each owner of a pass-through entity, means the ratio of (a) the owner's income from the pass-through entity that is subject to taxation by the municipal corporation, to (b) the total income from that entity of all owners whose income from the entity is subject to taxation by that municipal corporation.

(B) On and after January 1, 2003, any municipal corporation imposing a tax that applies to income from a pass-through entity shall grant a credit to each owner who is domiciled in the municipal corporation for taxes paid to another municipal corporation by a pass-through entity that does not conduct business in the municipal corporation. The amount of the credit shall equal the lesser of the following amounts, subject to division (C) of this section:

(1) The owner's proportionate share of the amount, if any, of tax paid by the pass-through entity to another municipal corporation in this state;

(2) The owner's proportionate share of the amount of tax that would be imposed on the pass-through entity by the municipal corporation in which the taxpayer is domiciled if the pass-through entity conducted business in the municipal corporation.

(C) If a municipal corporation grants a credit for a percentage, less than one hundred per cent, of the amount of income taxes paid on compensation by an individual who resides or is domiciled in the municipal corporation to another municipal corporation, the amount of credit otherwise required by division (B) of this section shall be multiplied by that percentage.

(D) On and after January 1, 2003, any municipal corporation that imposes a tax on income of or from a pass-through entity shall specify by ordinance or rule whether the tax applies to income of the pass-through entity in the hands of the entity or to income from the pass-through entity in the hands of the owners of the entity. A municipal corporation may specify a different ordinance or rule under this division for each of the classes of pass-through entity enumerated in division (A)(2) of this section.