

THE GENETELLI CONSULTING GROUP
State and Local Tax Services
431 FIFTH AVENUE
NEW YORK, NY 10016

(212) 684-4111
FACSIMILE: (212) 213-1020
EMAIL: rgetelli@genetelli.com

Subject: Commercial Activity Tax to Replace Corporation Franchise Tax in Ohio

Date: July 30, 2005

To Our Clients and Friends:

Ohio is imposing a new commercial activity tax ("CAT") in lieu of its present corporation franchise tax. The CAT is an annual privilege tax measured by gross receipts on business activities in Ohio. The CAT will be phased in over a five year period which will coincide with the phase out of the corporation franchise tax. When the CAT is fully phased in, the tax rate will be \$150 plus 0.26% of taxable gross receipts in excess of \$1 million.

The CAT generally applies to all types of businesses and to all entities regardless of form, including sole proprietorships, partnerships, limited liability companies, and all types of corporations. Certain types of businesses are excluded from the CAT, including financial institutions, dealers in intangibles, insurance companies, and some public utilities. A taxpayer with taxable gross receipts of more than \$150,000 per calendar year is subject to the CAT.

The CAT first applies to taxable receipts received on and after July 1, 2005. The CAT return for the first measurement period for amounts received from July 1, 2005 to December 31, 2005 is due on February 10, 2006. Beginning January 1, 2006, taxpayers with taxable gross receipts in excess of \$1 million per calendar year will file and pay the CAT quarterly. All other taxpayers will pay the CAT annually.

The due date for the CAT return is 40 days after the end of each tax period. For the 2006 tax year, all taxpayers will be required to pay the annual privilege tax of \$150 for the first \$1 million in taxable gross receipts by May 10, 2006. Taxpayers subject to quarterly tax reporting will also have to make payment of the first quarter CAT by May 10, 2006.

Taxpayers having over \$150,000 in taxable gross receipts are required to register for the CAT by November 15, 2005. If a taxpayer first becomes subject to the CAT after November 15, 2005, the taxpayer must register within 30 days thereafter.

Taxable gross receipts are broadly defined to encompass most business receipts from the sale of property or the performance of a service. Nontaxable gross receipts generally include interest, dividends, capital gains, wages, amounts in excess of commissions, or gifts. There are detailed sourcing rules with respect to taxable gross receipts.

A taxpayer may elect to file as one combined taxpayer for itself and other entities that have either 50% or more common ownership or 80% or more common ownership. The group may

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elect to have foreign corporations with the same common ownership all excluded or included in the group. Taxpayers making the election must agree that all commonly owned entities are included in the group regardless of whether Ohio nexus exists. The election is binding for two years. Intercompany receipts are eliminated among the electing group members.

If an election is not made to file as one combined taxpayer, taxpayers with common ownership of more than 50% must file as a combined taxpayer. In such instance only the Ohio nexus companies are included in the group, but intercompany receipts among the group members are not eliminated.

In light of the new CAT, taxpayers in Ohio should evaluate the tax impact and consider the appropriate planning, including whether to elect to file as one combined taxpayer. If you have any questions regarding the CAT or any other state and local tax matters, please do not hesitate to contact me.

Richard W. Genetelli
The Genetelli Consulting Group
State and Local Tax Consultants
431 Fifth Avenue, 3rd Floor
New York, NY 10016
Tel: (212) 684-4111
Fax: (212) 213-1020
Website: www.genetelli.com