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AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

BDO KNOWS: SALT

SUBJECT

OHIO DEPARTMENT OF TAXATION ISSUES GUIDANCE RELATED TO NONRESIDENT TAXPAYERS' GAIN FROM THE SALE OF A CLOSELY-HELD BUSINESS

SUMMARY

On October 7, 2016, the Ohio Department of Taxation issued a personal income tax information release that provides guidance relating to an equity investor's apportionment of gain from the sale of a closely-held business. This guidance was issued as a result of the Supreme Court of Ohio's holding in *Corrigan v. Testa*, Slip Opinion No. 2016-Ohio-2805 (May 4, 2016).

DETAILS

In the *Corrigan* case, the Supreme Court of Ohio held that Ohio Rev. Code § 5747.212, as applied to the taxpayer, was unconstitutional under the Due Process Clause of the Fourteenth Amendment of the U.S. Constitution. See the BDO SALT Alert that discusses this case. Ohio Rev. Code § 5747.212 provides special rules for apportioning the gain from the sale of a taxpayer's ownership in a closely-held business.

As a result of the decision in *Corrigan*, the Department issued Information Release IT 2016-01 on October 7, 2016, to provide the following:

- The Court's analysis and holding are confined solely to Ohio Rev. Code § 5747.212 and are not expanded to any other Ohio statute;
- The Court found that Ohio Rev. Code § 5747.212 was unconstitutional as applied to the taxpayer, but the Court did not find the statute unconstitutional on its face, thus, it was found to be unconstitutional only in this specific situation; and

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- The Court found that an ownership interest in a business is an intangible asset. The Court followed the general rule of law that a capital gain derived from the sale of an intangible asset is allocable as nonbusiness income to a nonresident taxpayer's state of domicile because neither the taxpayer nor the sale of the asset has a taxable link (or unitary relationship) to Ohio.

The Department also provided guidance for a nonresident taxpayer who was assessed or paid tax on an amount calculated under Ohio Rev. Code § 5747.212.

- If the taxpayer already filed a refund application or petitioned for review of an assessment relating to the applicability of Ohio Rev. Code § 5747.212, no further action is needed at this time and these cases will be reviewed. However, if the taxpayer has additional information that further supports the taxpayer's position as a result of the *Corrigan* decision, the additional information can be sent to taxpayer's point of contact at the Department.
- If a nonresident taxpayer believes that he or she is entitled to a refund of amounts previously paid based on the decision in *Corrigan*, the taxpayer may file amended tax returns that include:
    - A "Reasons and Explanation of Corrections" page for each amended return that cites *Corrigan v. Testa*, Slip Opinion No. 2016-Ohio-2805 as the basis for the amended return; and
    - For each return, a detailed statement specifying the factual and legal reasons why the *Corrigan* decision is applicable to the taxpayer.

BDO INSIGHTS

- A nonresident taxpayer that realized a gain from the sale of an interest in a pass-through entity should consider whether a refund opportunity may be available based upon the decision in *Corrigan* as applied to the taxpayer's specific situation. The amended return or refund claim must follow the requirements of Information Release IT 2016-01 and must be for payments of income tax made within four years of the date the refund is requested. In addition, the payments and tax years for which the taxpayer is requesting a refund must not have been the subject of a Settlement Agreement with the Department.
- If the taxpayer recognizes a capital gain and treats it as nonbusiness income because Ohio Rev. Code § 5747.212 is not applicable, the gain is not eligible for Ohio's Small Business Deduction for tax years 2013 and 2014 or Ohio's Business Income Deduction for tax years 2015 and forward. A nonresident taxpayer should consider whether this impacts the potential refund opportunity available.