SALT BUZZ HF

Proposed Change to the CAT Interest Exclusion is Worth Some Interest

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Thomas R. Fagan, JD
Associate

Debora D. McGraw, JD, CPA, LLM
Member

The “As Introduced” version of Ohio’s proposed biennial budget bill, H.B. 49, proposes to narrow the exclusion of interest from the Commercial Activity Tax (“CAT”). Under current law, CAT gross receipts exclude “interest income except interest on credit sales” (see R.C. 5751.01(F)(2)(a)). “Credit sales” is not specifically defined in the CAT chapter but is generally understood to be limited to a sale in which the vendor agrees to accept payment of the price in minimum partial payments over an indefinite period of time. H.B. 49 proposes to change the existing language to “interest, except interest on credit sales and interest on loans made in the normal course of the taxpayer’s business.”

The change is intended to apply to businesses that are primarily engaged in the business of making loans. But, the language in the Bill does not really require that the taxpayer be primarily in the business of making loans. The scope of lending covered by the proposed language is unclear because the Bill does not define the term “loan.” Likewise, it is unclear whether the phrase “normal course of the taxpayer’s business” will be interpreted as only impacting taxpayers engaged in the lending of money as their primary line of business, or interpreted more broadly to include any interest earned on a loan made by the business. If the latter, the law change could impact almost any company.

Based upon the proposed language, there are some key observations that taxpayers should consider, including:

- Taxpayers that engage in lending activities that were previously subject to the Ohio Dealer in Intangibles Tax and are now subject to CAT should consider the impact of the proposed change. For example, mortgage, automobile and other types of lenders that are not subject to the Ohio Financial Institution Tax ("FIT") would be impacted by the proposal.

- A broker/dealer (not filing as part of a FIT group) would be required to include margin interest earned from Ohio customers in CAT gross receipts.

- Businesses that have intercompany lending and have not elected to file as a consolidated elected taxpayer ("CET") or that have loans from entities not within their CET group, which is common with private equity groups and foreign-owned companies, should consider the impact of the proposed change. CAT situses gross receipts from loans based on the location where the real property securing the loan is located or where the borrower is commercially domiciled, so lending to businesses with Ohio-based operations or investments may become subject to CAT under the proposal.

- Real Estate Investment Trusts, Real Estate Mortgage Investment Conduits, or Alternative Investment Funds that hold mortgages or loans as part of the investment portfolio could now be subject to CAT on interest earned from Ohio customers based on an expansive interpretation of the proposed statute.

- Businesses will need to re-evaluate nexus conclusions if the proposed change becomes law and interest from loans is included in gross receipts. Inclusion of interest from loans may cause the business to exceed the bright-line nexus threshold of $500,000 in taxable gross receipts. In *Crutchfield Corp. v. Testa*, Slip Opinion No. 2016-Ohio-7760, Ohio's bright-line nexus standard was held to be constitutional. Ohio has been actively enforcing its bright-line nexus provision and if H.B. 49 is enacted, Ohio could focus enforcement efforts on businesses not registered for CAT that primarily earn interest from loans.

If you would like to discuss the proposed change to the CAT interest exclusion or H.B. 49 generally, please contact Tom Fagan, Deb McGraw or any of the other professionals at Zaino Hall & Farrin LLC.

ZAINO HALL & FARRIN LLC

ATTORNEYS AT LAW

WWW.ZHFTAXLAW.COM

614-326-1120
855-770-1120 (toll-free)

RON AMSTUTZ
(non-attorney professional)
614-782-1545(Direct)
330-347-3533 (Mobile)
ronamstutz@zhfconsulting.com

STEVE AUSTRIA
(non-attorney professional)
614-349-4820 (Direct)
937-609-8355 (Mobile)
saustria@zhftaxlaw.com

THOMAS R. FAGAN
614-782-1541 (Direct)
330-607-7103 (Mobile)
tfagan@zhftaxlaw.com

RICHARD C. FARRIN
614-349-4811 (Direct)
614-634-3130 (Mobile)
rfarrin@zhftaxlaw.com

ADAM L. GARN
614-349-4814 (Direct)
agarn@zhftaxlaw.com

STEPHEN K. HALL
614-349-4812 (Direct)
614-284-1253 (Mobile)
shall@zhftaxlaw.com

CHARLOTTE B. HICKCOX
(non-attorney professional)
614-349-4819 (Direct)
614-537-4339 (Mobile)
chickcox@zhftaxlaw.com

DEBORA D. MCGRAW
614-349-4813 (Direct)
614-595-5560 (Mobile)
dmcgraw@zhftaxlaw.com

BRAD W. TOMLINSON
(non-attorney professional)
614-349-4818 (Direct)
btomlinson@zhftaxlaw.com

JOHN R. TRIPPIER
(non-attorney professional)
614-349-4815 (Direct)
614-203-4173 (Mobile)
jtrippier@zhftaxlaw.com

JASON WALKER
(non-attorney professional)
614-349-4817 (Direct)
916-533-1626 (Mobile)
jwalker@zhftaxlaw.com

THOMAS M. ZAINO
614-349-4810 (Direct)
614-598-1596 (Mobile)
tzaino@zhftaxlaw.com