

Ohio Resident Credit Amnesty Program

The Amnesty program applies to individual taxpayers who claimed a credit for certain taxes paid by a pass-through entity in which the individual had an ownership interest.

The Ohio Department of Taxation in 2008 announced an amnesty program for Ohio resident taxpayers who claimed an Ohio resident credit in prior years that the Department believes was not permissible. The Amnesty program applies to individual taxpayers who claimed a credit for certain taxes paid by a pass-through entity in which the individual had an ownership interest. Specifically, the Department asserts that an individual taxpayer is not permitted to claim an Ohio resident credit for the following:

- Kentucky corporation income tax paid in 2005 and 2006 by a pass-through entity in which the individual had an ownership interest;
- For taxable years ending after June 30, 2005, other states' income taxes **imposed on a** pass-through entity (as opposed to an owner of a pass-through entity) in which the individual had an ownership interest; and
- For all years open under the applicable statute of limitations, non-net income taxes (e.g., Michigan single business tax) **imposed on a** pass-through entity in which the individual had an ownership interest.

The Department has indicated that it will waive all associated penalties for those who voluntarily pay the Ohio income tax due, plus interest, with respect to such resident credits. If

a taxpayer elects to participate in the program, it must file Form IT PAY, "Erroneously Claimed Ohio Resident Credit," when payment of the tax is made. The due date for making such payments, which has been extended twice, is March 2, 2009 (items postmarked by this date will be deemed timely). The Department has indicated it will not extend the deadline any further even though, to date, it has not received anywhere close to the level of response it expected.

Basis for the Department's position

The Department set forth its opinion on this issue in a March 2006 information release and, at that time, focused only on the Kentucky corporate income tax. The Department asserted that the credit could not be claimed for two reasons. First, it asserted that a provision of Ohio law, R.C. 5747.05(B)(4), precluded claiming the credit because that provision does not allow the credit for any tax "the taxpayer had directly or indirectly deducted, or was required to directly or indirectly deduct...in computing federal adjusted gross income." Because the Kentucky income tax was imposed directly on S corporations and LLCs, the Department asserted that the individual owners' distributive share would reflect a deduction for the Kentucky tax paid by the entity.

The Department also argued that another provision, R.C. 5747.05(B)(2), precluded a credit for the Kentucky

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tax. That provision allows the credit for “income tax liability to another state or the District of Columbia **on the portion of the adjusted gross income of a resident taxpayer** that in another state or in the District of Columbia is subjected to an income tax.” The Department asserts that this provision does not apply to the Kentucky corporate income tax because it is the entity’s income that is subject to such tax, not the individual owners’ income.

The Department’s amnesty program indicates that it is applying the foregoing analysis to any taxes similar to the Kentucky corporate income tax imposed on pass-through entities in other states. The determining factor is whether a tax is imposed directly upon the pass-through entity, and not on the individual. The Department has also indicated that it interprets the Ohio resident credit provision as

being limited to income taxes, and not applicable to the Michigan single business tax or any other type of non-net income tax.

Options for taxpayers

In our view, the Department’s position has some merit in light of existing Ohio statutory authority, but there are reasonable arguments to be made to the contrary in light of constitutional and other considerations. While we are aware of at least one matter pending before the Department involving this issue, to date there has been no case law or administrative decision directly addressing this issue.

If you have questions about your particular situation as it relates to the amnesty program or other issues involving the Ohio tax treatment of pass-through entities and/or nonresidents, please do not hesitate to contact us.

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