



Personal Income Tax Division

PERSONAL INCOME TAX INFORMATION RELEASE – PASS-THROUGH ENTITY TAX –NEXUS STANDARDS

September, 2001

The purpose of this information release is to describe the standards the Department of Taxation will apply to determine whether a pass-through entity has nexus with Ohio, thus possibly making the entity subject to the pass-through entity tax.¹ **The limitations and extent of this state's jurisdiction to impose tax is an evolving area and this information release is not intended to be an all encompassing or all inclusive description of this subject.**² This information release may be modified by changes in either federal or state laws or by decisions of the U.S. Supreme Court, the Ohio Supreme Court, the Ohio Courts of Appeals, or the Ohio Board of Tax Appeals. This information release may also be modified and reissued to incorporate nexus guidelines that may be published from time-to-time by agencies such as the Multistate Tax Commission or to clarify the Department's position. Where no conflict exists between this information release and previously published positions relating to nexus taken by the Department, those positions will remain in effect.

Unless exempt pursuant to Ohio Revised Code (hereinafter "R.C.") 5733.402, the pass-through entity tax applies to every qualifying entity having at least one qualifying investor.

ISSUES ADDRESSED

- I. What is the standard the Department of Taxation will use to determine whether an out-of-state qualifying entity is subject to Ohio's pass-through entity tax?
- II. What activities by an out-of-state qualifying entity create nexus in Ohio?
- III. Are there any safe harbor activities where nexus might exist but where the Department of Taxation will not currently require the filing of a return and the payment of the pass-through entity tax?
- IV. What is the impact of Public Law 86-272?
- V. Are these standards prospective or retroactive?
- VI. When is this information release effective?

¹ The pass-through entity tax became effective on January 1, 1998.

² The nexus standards described in this information release are identical to the corporate franchise tax nexus standards described in Information Release CFT 2001-02 (available on the Department's website by visiting <http://www.state.oh.us/tax/> and clicking on "Business").

- VII. What are the filing requirements for an out-of-state qualifying entity subject to Ohio's taxing jurisdiction?
- VIII. Once nexus is established, how long does the filing requirement last?
- IX. Can an unregistered out-of-state qualifying entity subject to these nexus guidelines request a Voluntary Disclosure Agreement?

DEFINITIONS

The following definitions are used in this information release:

- A. "Qualifying entity" means a qualifying pass-through entity or a qualifying trust.
- B. "Out-of-state qualifying entity" means a qualifying entity not organized, formed or chartered under the laws of Ohio.
- C. "Qualifying investor" means an investor as defined in R.C. 5733.40(A)(9).
- D. "Qualifying pass-through entity" means a pass-through entity as defined in E, below, excluding a person described in section 501(c) of the Internal Revenue Code, a partnership with equity securities registered with the United States securities and exchange commission under section 12 of the securities exchange act of 1934, as amended, or a person described in division (C) of section 5733.09 of the Revised Code.
- E. "Pass-through entity" means a corporation that has made an election under subchapter S of Chapter 1 of Subtitle A of the Internal Revenue Code for its taxable year under that Code, or a partnership, limited liability company, or any other person, other than an individual, trust, or estate, if the partnership, limited liability company, or other person is not classified for federal income tax purposes as an association taxed as a corporation.
- F. "Qualifying trust" means a trust subject to subchapter J of the Internal Revenue Code that, during any portion of the trust's qualifying taxable year, has income or gain from the acquisition, management, ownership, use, or disposition of tangible personal property located in this state at any time during the trust's qualifying taxable year or real property located in this state. "Qualifying trust" does not include a person described in section 501 (c) of the Internal Revenue Code or a person described in division (C) of section 5733.09 of the Revised Code.
- G. "Related member" means a person that, with respect to the qualifying entity during all or any portion of the taxable year, is any of the following:
 - 1. An individual stockholder, or a member of the stockholder's family enumerated in section 318 of the Internal Revenue Code, if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially, or constructively, in the aggregate, at least fifty per cent of the value of the taxpayer's outstanding stock; or
 - 2. A stockholder, or a stockholder's partnership, estate, trust, or corporation, if the stockholder and the stockholder's partnerships, estates, trusts, and corporations own

- directly, indirectly, beneficially, or constructively, in the aggregate, at least fifty per cent of the value of the taxpayer's outstanding stock; or
3. A corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under R.C. 5733.04(I)(12)(c)(iv), if the taxpayer owns, directly, indirectly, beneficially, or constructively, at least fifty per cent of the value of the corporation's outstanding stock; or
 4. A component member as defined in section 1563(b) of the Internal Revenue Code; or
 5. A person to or from whom there is attribution of stock ownership in accordance with section 1563(e) of the Internal Revenue Code except, for purposes of determining whether a person is a related member, "twenty per cent" shall be substituted for "5 per cent" wherever "5 per cent" appears in section 1563(e) of the Internal Revenue Code.

H. "Day" means a calendar day or any portion thereof.

ISSUES DISCUSSED

I. What is the standard the Department of Taxation will use to determine whether an out-of-state qualifying entity is subject to Ohio's pass-through entity tax?

Ohio law provides that an out-of-state qualifying entity is subject to the Ohio pass-through entity tax under any set of circumstances allowed by the Constitution of the United States. Specifically, R.C. 5733.41 sets forth the legal standard used by the Department of Taxation to determine whether an out-of-state qualifying entity is subject to Ohio pass-through entity tax. An out-of-state qualifying entity is subject to Ohio's pass-through entity tax when the out-of-state qualifying entity has nexus with this state under the constitution of the United States for any portion of the qualifying entity's qualifying taxable year, and the sum of the qualifying entity's adjusted qualifying amounts exceeds one thousand dollars for the qualifying entity's qualifying taxable year.

II. What activities by or on behalf of an out-of-state qualifying entity create nexus in Ohio?

- A. Subject to the safe harbor activities listed on pages 5-6 of this information release, an out-of-state qualifying entity has nexus in this state when the entity directly or through others acting on the entity's behalf is regularly present in this state conducting activities to establish or maintain the market for the out-of-state qualifying entity. Such others can be organizations or individuals who are agents, representatives, independent contractors, brokers or any person acting on behalf of the out-of-state qualifying entity. It is irrelevant whether or not such others reside in Ohio. Activities which create nexus, whether by the out-of-state qualifying entity or others acting on the entity's behalf, include, but are not limited to, the following:
 1. Soliciting sales in this state, including all activities listed in Issue IV on pages 6-10 of this information release (Provision L on page 6 provides a special safe harbor that may apply to this activity);

2. Making repairs or providing maintenance or warranty service in this state;
3. Collecting current or delinquent accounts related to sales in this state through assignment or otherwise;
4. Transporting passengers or property for hire in or through this state;
5. Delivering goods or having goods delivered to this state in vehicles the out-of-state qualifying entity owns, rents, leases, uses or maintains or having goods delivered to this state by a related member (Provision B on page 5 provides a special safe harbor that may apply to this activity);
6. Installing or supervising installation in this state;
7. Conducting training in this state;
8. Providing any kind of technical assistance or consulting service in this state including, but not limited to, engineering assistance, design service, quality control, product inspections, or similar services;
9. Investigating, handling, or otherwise providing assistance in this state to resolve customer complaints;
10. Having one or more employees or others acting on the out-of-state qualifying entity 's behalf in this state conducting business activity in this state;
11. Owning, renting, leasing, licensing, maintaining, or exercising the right to use any tangible personal property that is permanently or temporarily located in this state (Provision B on page 5 provides a special safe harbor that may apply to this activity);
12. Owning, renting, leasing, licensing, maintaining, or exercising the right to use any real property located in this state;
13. Employing individuals who, for the benefit of the employer or the employer's related member, own, rent, lease, use or maintain an office or other establishment in this state;
14. Having agents, representatives, independent contractors, brokers or others who own, rent, lease, use or maintain an office or other establishment in this state if this property (i) is used in the representation of the out-of-state qualifying entity in this state and (ii) is significantly associated with the qualifying entity 's ability to establish and maintain a market in this state;
15. Having a direct or indirect ownership interest as a general partner or member in a pass-through entity having nexus with this state;

16. For taxable years ending after September 28, 1997, having an interest in a limited partnership having nexus with this state or having a similar interest in any other pass-through entity having nexus with this state (For a detailed discussion of this issue, see corporate franchise tax information release CFT 2001-01); or
 17. Holding a certificate of compliance with the laws of Ohio authorizing the out-of-state qualifying entity to do business in this state.
- B. Lawyers, accountants, investment bankers, and other similar professionals that are not employees of the out-of-state qualifying entity or its related members and who in their professional capacity perform their customary services in this state for an out-of-state qualifying entity shall not be considered to be conducting activities to establish or maintain the market on behalf of the out-of-state qualifying entity. This provision only applies if the activity done on behalf of the out-of-state qualifying entity or its related members is not an activity listed in II.A, above.

III. Are there any safe harbor activities where nexus might exist but where the Department of Taxation will not currently require the filing of a return and the payment of the pass-through entity tax?

If the out-of-state qualifying entity's **only** contacts with this state are limited to one or more of the contacts listed below, the Department of Taxation will not require the filing of a return and the payment of the pass-through entity tax. Except for III.A, below, these safe harbors are not mandated by statutory or case law; rather, these safe harbors are provided for the purposes of administrative convenience.

- A. The out-of-state qualifying entity has property or representatives on the premises of a commercial printer in this state (R.C. 5733.09(D)(2)(a)-(c) sets forth the details of this statutory exemption);
- B. The out-of-state qualifying entity has tangible personal property temporarily in this state for no more than seven days, which need not be consecutive, in a calendar year;
- C. The out-of-state qualifying entity owns or uses in this state intangible property, but the use of such property in this state does not develop, maintain or enlarge the marketplace for the out-of-state qualifying entity and/or its related members;
- D. The out-of-state qualifying entity grants a license to use software in this state, but only if the out-of-state qualifying entity and its related members, agents or representatives do not provide from or at a location in this state any technical assistance or other support;

- E. The out-of-state qualifying entity maintains a website on a server or similar electronic equipment in this state, unless the equipment itself is owned, leased or rented by the out-of-state qualifying entity or its related members;
- F. The out-of-state qualifying entity conducts meetings in this state with suppliers of goods or services;
- G. The out-of-state qualifying entity conducts meetings in this state with government representatives in their official capacity;
- H. The out-of-state qualifying entity enters this state for the purposes of bringing or defending a lawsuit in a court of law in this state;
- I. The out-of-state qualifying entity has employees or others acting on the out-of-state qualifying entity's behalf attend meetings, retreats, seminars, conferences, schools or other training in this state sponsored by others;
- J. The out-of-state qualifying entity holds for the benefit of its employees or the employees of its related members retreats, seminars, conferences or other training in this state (but not board of director's meetings);
- K. The out-of-state qualifying entity holds recruiting or hiring events in this state;
- L. The out-of-state qualifying entity advertises in this state through various electronic or print media;
- M. The out-of-state qualifying entity rents customer lists to or from an entity located in this state;
- N. The out-of-state qualifying entity has employees present in this state for no more than seven days, which need not be consecutive, in a calendar year and the qualifying entity's activities in Ohio generate no more than \$25,000 in gross revenue in that same calendar year;
- O. The out-of-state qualifying entity participates in one or more trade shows in this state as an exhibitor provided that the out-of-state qualifying entity does not have employees present in this state for more than seven days in a calendar year and the qualifying entity's activities in Ohio generate no more than \$25,000 in gross revenue in that same calendar year; or
- P. The out-of-state qualifying entity attends trade shows in this state as a consumer.

IV. What is the impact of Public Law 86-272?

Public Law 86-272, 15 U.S.C. 381-384, restricts a state from imposing a tax on or measured by income derived within the state's borders if the only business activity of the entity within the state consists of the solicitation of orders for sale of

tangible personal property.³ This restriction is limited to orders sent outside the state for acceptance or rejection and, if accepted, are filled by shipment or delivery from a point outside the state.

P.L. 86-272 does not prohibit this state from asserting that an out-of-state qualifying entity has nexus. **P.L. 86-272 merely prohibits the imposition of the Ohio pass-through entity tax in those situations listed in (A) below.** Below are lists of protected activities (those that are ancillary to the solicitation of sales) and unprotected activities (those that go beyond the solicitation of sales). Ohio follows, and these lists are generally drawn from, the *Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272*. This Statement can be found on the Multistate Tax Commission's website at <http://www.mtc.gov/news&vws/Regs102000.pdf>.

- A. Subject to the "safe harbor" provisions listed in Issue III, the following activities conducted in this state by the out-of-state qualifying entity or on its behalf by its related members create nexus. However, such activities will **not** cause the loss of protection afforded by P.L. 86-272 with respect to activities related to the sale of tangible personal property:
1. Soliciting orders for sales by advertising;
 2. Soliciting orders by an employee or representative of the qualifying entity, so long as the individual does not, for the benefit of the qualifying entity, maintain or use any office or other place of business in the state other than an "in-home" office as described in Issue IV(B)(18) on page 9 of this information release;
 3. Carrying samples and promotional materials only for display or distribution without charge or other consideration;
 4. Furnishing and setting up display racks and advising customers on the display of the qualifying entity's products without charge or other consideration;
 5. Providing automobiles to sales personnel for their use in conducting protected activities;
 6. Passing orders, inquiries and complaints on to the home office;
 7. Missionary sales activities; i.e., the solicitation of indirect customers for the qualifying entity's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers is protected if such solicitation activities are otherwise immune;
 8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order;
 9. Checking of customers' inventories, without a charge therefore, for re-order (but not for other purposes, such as quality control);
 10. Maintaining a sample or display room for no more than twenty-one days, which need not be consecutive, at any one location within this state during the taxable year;
 11. Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel;
 12. Mediating customer complaints when the purpose is solely for improving the relationship between the sales personnel and the customer and facilitating requests for orders; or
 13. Owning, leasing, using or maintaining (i) personal property for use in the employee's or representative's "in-home" office, as described in Issue IV(B)(18) on page 9 of this information release, and/or (ii) an automobile that is solely limited to the conducting of protected activities. For example, the use of personal property such as a cellular telephone, facsimile machine, copier, personal computer and computer software will not subject the qualifying entity to the pass-through entity tax so long as the use of these items is limited to the carrying on of protected solicitation.
- B. Any of the following activities conducted in this state by the out-of-state qualifying entity or on its behalf by its related members are **not** protected under P.L. 86-272:

³ P.L. 86-272 does not protect entities organized, formed or chartered under the laws of Ohio.

1. Making repairs or providing maintenance or service to the property sold or to be sold;
2. Collecting current or delinquent accounts through assignment or otherwise;
3. Investigating credit worthiness;
4. Installing or supervising installation;
5. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation;
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders of tangible personal property;
7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is for improving the relationship between the sales personnel and the customer and facilitating requests for orders;
8. Approving or accepting orders;
9. Repossessing property;
10. Securing deposits on sales;
11. Picking up or replacing damaged or returned property;
12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation;
13. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel;
14. Maintaining a sample or display room in excess of twenty-one days at any one location within the state during the taxable year;
15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value;
16. Owning, leasing, using or maintaining facilities or property in this state, including, but not limited to, the following:
 - (a) a repair shop;
 - (b) a parts department;
 - (c) any kind of office other than an in-home office as described as permitted under Issue IV(A)(2) on page 7 and IV(B)(18) on page 9 of this information release;
 - (d) a warehouse;
 - (e) a meeting place for directors, officers, or employees;
 - (f) a stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation;
 - (g) a telephone answering service that is publicly attributed to the qualifying entity or to employees or agents of the qualifying entity in their representative status;
 - (h) mobile stores, *i.e.*, vehicles with drivers who are sales personnel making sales from the vehicles; or
 - (i) real property or fixtures to real property of any kind;
17. Consigning stock of goods or other tangible personal property for sale to any person, including an independent contractor;
18. Maintaining in this state, by any employee or other representative of the out-of-state qualifying entity, an office or place of business of any kind, other than an in-home office located within the residence of the employee or representative. The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described below shall, by itself, cause the loss of protection under P.L. 86-272. For these purposes it is not relevant whether the qualifying entity pays directly, indirectly, or not at all for the cost of maintaining such an in-home office. In order to qualify as a protected in-home office, the following criteria apply:
 - (a) the office cannot be publicly attributed to the qualifying entity or to the employee or representative of the qualifying entity in an employee or representative capacity;
 - (b) the use of such office must be limited to soliciting and receiving orders from customers, for transmitting such orders outside the state for acceptance or rejection by the out-of-state qualifying entity, or for such other activities protected under P.L. 86-272 or under Issue IV(A) on pages 7-8 of this information release;
 - (c) the office cannot be identified in a telephone listing or other public listing within this state as a specific address for the qualifying entity or for an employee or representative of the qualifying entity in such capacity;
 - (d) as an exception to the above, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the qualifying entity shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the qualifying entity or its employee or representative;
19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee in this state; or

20. Conducting any activity not listed in Issue IV(A) on pages 7-8 of this information release which is not entirely ancillary to requests for orders, even if such activity helps to increase sales.

V. Are these standards prospective or retroactive?

This information release applies nexus standards established by the U.S. Supreme Court from 1939 to the present. Decisions of the U.S. Supreme Court are the controlling interpretation of federal law and generally will be given full retroactive effect to all cases and years still open. Accordingly, the Department of Taxation will enforce the standards described within this information release, with the exception of the safe harbor activities enumerated in Issues III and IV(A) on pages 5-7 of this information release, for all open cases and years.

VI. When is this information release effective?

Some of the limitations enumerated in Issues III and IV(A) on pages 5-7 of this information release may not be mandated by Ohio law or U.S. Supreme Court cases. Thus, while Ohio may have a basis for requiring the filing of a return and payment of the pass-through entity tax in these instances, beginning September 1, 2001 the Department of Taxation will not require the filing of a return and payment of the pass-through entity tax if a taxpayer's contacts are limited to those safe harbor activities described in Issues III and IV(A) on pages 5-7 of this information release. The Department of Taxation reserves the right to modify and reissue this information release in order to reflect judicial decisions or to clarify the Department's position.

VII. What are the filing requirements for an out-of-state qualifying entity subject to this state's taxing jurisdiction?

An out-of-state qualifying entity which falls within this state's taxing jurisdiction will be required to file returns, and pay the appropriate tax. Information about taxpayer obligations under the pass-through entity tax is available by calling 1-888-405-4039, or from the Department's website by visiting <http://www.state.oh.us/tax/> and clicking on "Business."

The taxable year of an out-of-state qualifying entity subject to this state's taxing jurisdiction begins on the first day in which the out-of-state pass-through entity engages in nexus-creating activities. Thus, the duty to file returns and pay the pass-through entity tax commences with the day of the first nexus-creating contact and applies prospectively from that date regardless of the fact that more contacts are needed to establish a regular presence.

Example

On May 4th, 2002, an out-of-state qualifying entity with a calendar year end first enters Ohio to engage in nexus-creating activities protected by the safe harbor provisions in Issue III. In that same calendar year, the out-of-state qualifying en-

tity's activities exceed the safe harbor provisions in Issue III. The out-of-state qualifying entity must file a pass-through entity tax report for taxable year 2002 and remit the pass-through entity tax based on the taxable year of 2002.

VIII. Once nexus is established, how long does the filing requirement last?

When an out-of-state qualifying entity no longer has nexus creating contacts, the out-of-state qualifying entity will not be responsible for the pass-through entity tax after the date nexus ceased to exist. However, if the out-of-state qualifying entity reestablishes nexus by engaging in any nexus creating contacts within twelve months of its last nexus creating contact, the Department of Taxation will presume that the new contact remains part of a regular presence in this state. Thus, the out-of-state qualifying entity continued to have nexus during the interim period. The out-of-state qualifying entity will be required to pay the pass-through entity tax during the interim period.

Example

An out-of-state qualifying entity has had nexus with Ohio because it maintains a sales office and has sales representatives in Ohio. On June 15th, 2002, the out-of-state qualifying entity closes its Ohio office and ceases sending sales representatives into Ohio. Consequently, the out-of-state qualifying entity surrenders its license to the Secretary of State, and legally withdraws from this state, effective June 15th, 2002. Finding that its Ohio sales have been seriously harmed by its lack of presence in Ohio, the out-of-state qualifying entity begins sending representatives into Ohio performing unprotected nexus-creating activities on December 1st, 2002. The Department of Taxation will presume that the December 1st, 2002 contacts remain part of a regular presence within Ohio. The out-of-state qualifying entity must re-license, if applicable, with the Secretary of State, file the pass-through entity tax report, and pay the pass-through entity tax for the entire 2002 taxable year.

IX. Can an unregistered out-of-state qualifying entity subject to these nexus guidelines request a Voluntary Disclosure Agreement?

An out-of-state qualifying entity with a filing responsibility under these nexus guidelines but not yet registered with or contacted by the Department of Taxation with respect to audit or criminal investigation, is eligible to request a Voluntary Disclosure Agreement (VDA). The VDA guidelines are available on the Department's website by visiting <http://www.state.oh.us/tax/> and clicking on "Business" or by calling the Personal Income Tax Division at 1-614-433-7603.

If you have any questions regarding this matter, please call 1-888-405-4039. (Ohio Relay Services for the Hearing or Speech Impaired: 1-800-750-0750).