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Ohio House Bill 669 to Establish Tax Reduced University Zones for Certain Businesses

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Following the New York model, a proposal introduced by Rep. Stinziano (D-District 18) on November 18, 2014 as HB 669 would allow for the establishment of tax reduced zones for select businesses on vacant space on the campuses of public and private universities. The initiative is intended to attract new jobs and investment from businesses consistent with a university's academic mission.

The following is a preliminary summary of the Ohio bill. Further procedural detail will be developed as this proposal matures and if it is enacted. This summary is intended to make interested persons aware of the proposal and to engage in a dialogue with interested Ohio representatives. While this summary is detailed, it is not intended to examine every specific detail of the proposal.

I. General Overview

The bill would provide owners of pass through entities and employees of eligible businesses within startup zones with deductions against their income, and provide the businesses with certain tax benefits against sales taxes, real property taxes, commercial activity taxes and transfer taxes.

The bill is co-sponsored by Representatives Barborak (D-District 5), Duffey (R-District 21), Rogers (D-District 60) and Sheehy (D-District 46). Introduced during the lame duck session, the bill will not be advanced this year and will be reintroduced next session. It does not seem that a large advanced consensus has been developed prior to the introduction of the bill in this session, but further discussion should now occur before it is reintroduced in 2015.

II. What Group Approves and Administers Ohio Startup Zones?

The program would be administered through a three-member startup board appointed by the Ohio governor, the Ohio Senate president and the Ohio House speaker, with initial terms of two to four years.

III. Who Initiates the Establishment of a Startup Zone?

To set up a startup zone, universities submit a strategic plan to the Ohio startup board to establish a zone on vacant land or building within a university campus and to attract businesses to that zone. The strategic plan needs to emphasize, among other points:

- Space in communities where the positive economic and social impact will be the greatest,
- Likelihood that proposed startup zones will create new jobs, attract entrepreneurs and enrich the education of university students,
- Avoid startup space in communities where further development is competitive with existing businesses,
- Fostering academic enrichment opportunities for university students and describing how to ensure that the businesses are aligned with the university's academic mission, and
- The method for choosing businesses, including proposed consultation with counties, municipalities, corporations and economic

development agencies through public hearings, focus groups, meetings or otherwise.

A university can submit a strategic plan for multiple startup zones or multiple strategic plans for multiple startup zones simultaneously.

IV. What Does the Ohio Startup Board Consider in Reviewing a University's Plans?

The strategic plans submitted by universities to the Ohio startup board are said to be reviewed based on merit and not in the order received. This would seem to present a challenge for the continual review of new applications to prioritize the merits of each application. The board is to consider variances of urban, rural and suburban startup zones throughout the state and the diversity of universities. Approval of a university's plan requires two of the three board members. Rejection of a university's strategic plan is to include reasons and suggestions to obtain future approval. There is no limit on a public university's campus space eligible for startup zone status, but private colleges' and universities' aggregate area eligible for startup zone status throughout the state is limited to three million square feet.

V. What Property on a University Campus Is Eligible for Consideration Within Startup Zone?

A university cannot relocate or eliminate positions to create vacant buildings eligible for startup zone status. In effect, eligible buildings for eligible businesses need to be on land or buildings on a university campus that are vacant when the strategic plan is submitted.

Eligible campus property could be either owned or leased by the university. The aspect that any university leased property is considered part of the campus is interesting and seems to broaden the available locations through the execution of a lease arrangement. In addition, there is an exception that allows for the use of space within one mile of a university's campus that does not exceed two hundred thousand square feet. A further exception allows vacant property beyond the one-mile radius to be eligible but its application would be expected to be very limited. The further away from the university's campus, the more difficult it might be to show the alignment with a university's academic mission.

VI. What Businesses Are Eligible for Consideration by a University for Operation Within a Startup Zone?

The following businesses are ineligible for inclusion for the benefits of a designated startup zone:

- Retail
- Wholesale
- Real estate brokerage or management
- Law, accounting, medical or dental and finance or financial services
- Hospitality
- Administrative support services
- All other personal services
- Utility services, including electricity and natural gas generation and distribution
- Insurance

In addition, universities must not contract with a business that performs services similar in nature or scope to those performed by university employees within the preceding five years. The forms of eligible businesses include S corporations, limited liability companies, partnerships, C corporations and sole proprietorships.

Eligible businesses include research and technology centers, advanced manufacturing facilities, certain life sciences organizations and certain incubators. As stated in the university's strategic plan, the business must foster academic enrichment opportunities for university students and be aligned with the university's academic mission. It is not necessary for a business to be a startup business to operate within a certified startup zone.

After the Ohio startup board designates a startup zone, a university implements its plan to identify eligible businesses in consultation with governmental and public groups. The

university and selected business(es) are to enter a "partnership contract" consistent with the points reviewed in the selection of the startup zone, including:

- The business did not operate in Ohio within the preceding five years, unless it is increasing its Ohio operations and creating new jobs or is a returning business,
- The business is not a competitor of an existing business near the startup zone,
- The business has the capacity to meet the agreed performance benchmarks, including creating and retaining a certain number of new jobs for specific positions and expected start dates, and
- The business agrees not to relocate jobs from another part of the Ohio, unless the transferring employee's position is retained at its original location.

The requirements could be clearer as to whether an eligible business can add employees from another similar Ohio business with different ownership if that reduces its workforce.

VII. After Eligible, Acceptable Businesses Are Identified, What Steps Are Taken by a University to Obtain Approval of a Qualifying Business?

The agreed terms of a partnership agreement between the university and a business is submitted to the Ohio startup board for approval. The partnership contract will have an expiration date of no later than ten years.

Again, two of the three startup Ohio board members must approve. Approval results in the issuance of a startup zone certificate. If the partnership agreement is rejected, the rejection notice is to include the reasons and ways to amend for approval following resubmission.

If a university is unable to identify and enter a partnership contract with a business after reasonable efforts, a procedure is available for the university to amend and resubmit the methodology to identify acceptable businesses. Two of the three startup board members' approval is required to amend the procedure.

VIII. What Documentation Is Provided to Employees Who Work for a Qualifying Business Within a Startup Zone?

After the startup board approves the partnership contract, the partnering business awards new employee certificates to any full-time employees hired to fill a job described in the partnership agreement. The new employee certificates allows the employees to claim the tax benefits available. An employee remains entitled to the tax benefits until the earlier of (i) the employment arrangement ends, (ii) the employee is transferred outside of the startup zone, (iii) the expiration of the partnership contract, or (iv) the startup board determines that the partnering business is not complying with the partnership contract and terminates such contract. A process is available for a partnering business to apply to the Ohio startup board to authorize additional new employee certificates beyond the number initially authorized. If the startup board terminates a partnership contract for noncompliance, employees who were awarded new employee certificates can continue to claim the tax benefit for compensation received before the partnership contract terminates and will not be required to return prior tax benefits claimed.

The aggregate number of full-time employees that can claim the available tax benefits at all startup zones is capped at 10,000 for any tax year. The startup board can reduce the number of eligible new employees to fit within this aggregate cap.

IX. What Steps Can Be Taken to Assure Compliance After the Commencement of a Business Within a Startup Zone?

If a partnership business is not complying with a provision of the partnership agreement, the university can notify the startup board. The board might also develop procedures to monitor the compliance of universities and partnering businesses with the terms of the universities' strategic plans and partnership contracts.

The startup board conducts a hearing on any alleged noncompliance. If two of the board members affirm noncompliance, a range of actions can be taken from (1) suspending the partnering business startup zone certificate with an opportunity for remedial compliance to (2) complete termination and the required refund of state tax benefits realized by the partnering business. In evaluating any allegation of noncompliance, the startup board can consider market conditions on the partnering business' performance and the partnering business' other Ohio operations.

X. How Are Conflicts of Interest Issues Considered Within the Startup Zone Process?

The university must adopt a conflict of interest policy with respect to the partnering business. The conflict policy must include the procedure for disclosing and reporting conflicts and screening interested individuals.

An "interested individual" is broadly defined to include a university employee, alumnus or donor who has the ability to influence a partnership contract and who (either directly or indirectly) has (a) an ownership interest in the partnering business, (b) a compensation agreement with the partnering business, or (c) a potential ownership interest or compensation arrangement with any person with which the university is negotiating a partnership contract. The indirect aspect of this conflict covers a person who might have the necessary connection through a business, investment or family relationship.

XI. What Tax Benefits Are Available to a Partnering Business Within a Startup Zone?

A partnering business that executes a partnership contract to operate within a startup zone is entitled to the following tax benefits over the term of the contract.

A. Income tax deduction available to individual owners of pass through partnering businesses.

Individual owners of partnering businesses that are pass through entities (e.g., S corporation, partnership, LLC) can deduct a portion of the startup zone business income from Ohio adjusted gross income. The deduction is calculated pursuant to the following formula:

1. Determine the portion of a partnering business' aggregate business income that is allocated to Ohio in accordance with an existing Ohio apportionment and allocation formula.

2. For a business with multiple operations within Ohio, determine the following two fractions:

   (a) One fraction has a numerator of the average value of real and tangible personal property used in the startup zone business and a denominator of the average value of such property used throughout Ohio, and

   (b) The second fraction has a numerator of the compensation paid for services performed solely within the startup zone business and the denominator is compensation paid for services performed throughout Ohio. For businesses with partnering operations only within startup zones, use 100%.

   The compensation paid variable seems to be based only on the amount included in an individual's income for tax purposes. This means that awards of multi-year equity or cash bonuses are taken into account when included in gross income.

3. Add the two fractions in Step 2.

4. Multiply the resulting fraction from the calculation in Step 3 by 50%.

5. Apply the resulting fraction from the calculation in Step 4 against the amount from Step 1.

To illustrate this calculation, if a pass through partnering business' income is only from operations within a startup zone, then 50% of such income is excluded from Ohio taxation. If a pass through partnering business has operations throughout the United States and at multiple Ohio locations, the calculation is more involved. The above steps are limited to calculating the deduction for Ohio individuals who are allocated income from the operations of a pass through entity.

There is no requirement that the individual to whom startup zone income is allocated needs to be an active

participant of the partnering pass through entity business to be eligible for the deduction. Accordingly, a passive owner of an interest in a S corporation or general partnership, and a limited partner or LLC owner, are eligible for the deduction.

Note regarding owners of C corporations. Owners of corporations that are not pass through entities (i.e., a C corporation) with partnering business operations in startup zones can be entitled to tax benefits if they are actively involved. Dividend distributions made by a C corporation to its owners are not eligible for Ohio tax benefits. However, for owners of C corporations who are also employees, the tax benefit discussed below regarding compensation received for services performed within a startup zone from a partnering business is available.

The deduction for individual owners of pass through entities is taken into account after other Ohio deduction and exclusions available. Other deductions are currently available for owners of certain business operations within Ohio.

B. Income tax deduction available to employees working within startup zones.

1. Full-time employees who are awarded new employee certificates can deduct compensation received (up to $250,000 annually per employee) for services performed within a startup zone from a partnering business against Ohio adjusted gross income.

    a. For employees who travel and perform services outside the startup zone, compensation allocated to such services do not seem exempt.

    b. If employees receive equity awards or cash bonus awards that cover a multi-year performance period, compensation related to such awards that is received after the term of the partnering agreement or the startup zone employee certificate might not be eligible for the income tax deduction.

2. For large, publicly-held businesses within a startup zone, the elimination or reduction of Ohio taxes would be the largest attractive feature for this program. The tax benefits for business owners would not be available in this context.

3. This is an Ohio initiative, which means that the tax relief does not apply to federal income taxes or FICA taxes.

C. Transfer taxes are not applied to conveyances of real property within a startup zone to a partnering business.

D. Real property taxes are not applied to property within a startup zone used by a partnering business.

E. Sales taxes are not applied to sales of property or services to a partnering business for operations within a startup zone. The startup zone certificate functions as the exemption certificate.

F. The Ohio commercial activity tax is not applied to receipts received by a partnering business from operations within a startup zone.

The bill does not provide an exclusion from Ohio municipal taxes.

XII. What Application Might This Proposal Have to Eligible Businesses Being Developed Currently on Eligible University Campuses?

The tax benefits for employees are available only after all of the following steps have occurred: a university strategic plan is approved by the Ohio startup board, agreed-to steps are taken to identify acceptable businesses, the Ohio startup board approves the eligible business and the level of employees to whom new employee certificates can be awarded, and the full-time employees are hired.

The required actions for tax benefits to be available means that businesses being developed currently on eligible university campuses will not be eligible for the benefits available from this proposal, absent the inclusion of a legislative effective date remedy.

FOR MORE INFORMATION

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