SB 8 Reintroduces Ohio Income Tax Credit for Investments in Qualified Opportunity Zone Funds

In October 2018, Representative Schuring introduced HB 727 that provided a 10 percent Ohio income tax credit for investments by a taxpayer of at least $250,000 in an Ohio qualified opportunity fund ("OQOF"). Thompson Hine submitted a comment letter (dated October 11, 2018) (click to read comment letter) requesting that certain limitations be revised to allow for a broader application of the income tax credit. The Ohio 132nd General Assembly ended without further action on HB 727. Kirk Schuring won the election to became Senator Schuring for the new Ohio 133rd General Assembly and, on February 12, 2019, introduced SB 8, which provides an Ohio income tax credit for investments by a taxpayer of at least $250,000 in an OQOF.

Senator Schuring included some of our suggested revisions but SB 8 scaled back the overall tax benefits available, and introduced procedures for submitting applications for approval by the Ohio director of development services for the Ohio tax credit and a requirement linking a portion of the Ohio tax credit to the level of tax collections from the additional economic activity generated by the OQOF investment.

The following lists pros and cons of SB 8. Consistent with the comments submitted with the Thompson Hine letter, the pros make the Ohio income tax credit more useable by taxpayers who invest in OQOFs. The cons, however, are a significantly lower ceiling on the tax credit available, accounting-intensive reporting requirements, a 100% threshold for qualifying property and where such property is used, and a partial deferral of the tax credit. The Ohio Legislative Service Commission Analysis can be read at https://www.legislature.ohio.gov/download?key=11182&format=pdf

Questions will likely arise regarding the calculation and application of the revised tax credit, but an explanation of the tax credit is sufficient for now.

PROS

1. Carry Forward of Unused Tax Credit. The Ohio income tax credit arising from investments in OQOFs is available against taxes for the year of the investment plus a carry forward of the unused tax credit to the following five tax years.

2. Calculation of $250,000 Minimum Investment in Pass-Through Entity Context. When a pass-through entity (i.e., partnership, LLC, S corporation) invests in an OQOF, the $250,000 required minimum investment is measured at the pass-through entity level and the tax credit can be claimed by the investor member that is an individual, trust, or estate based on his proportionate or distributive share.

3. Transferability of Unused Tax Credit. Taxpayers making investments in an OQOF may transfer the Ohio income tax credit to another person. Pursuant to the required procedure to

apply to the Ohio director of development services (discussed below), taxpayers who would like to transfer the tax credit must notify the Ohio Department of Taxation in writing.
Future guidance should confirm that a taxpayer may transfer either all or part of the unused tax credit. The transferred tax credit is eligible for the remaining five-year carry forward period. The Ohio income tax credit may be transferred only once.

4. Eligible Taxpayers. The tax credit is available for individuals, trusts, and estates, along with financial institutions and insurance companies.

CONS

1. Reduced Tax Credit Amount and Timing. The nonrefundable tax credit is only 1 percent of the investment in the OQOF through a simple application process, plus a delayed additional 2 percent of the investment in the OQOF but only if there are sufficient "estimated increased tax collections" for a project operated by the OQOF.

The 2 percent tax credit becomes available in the fifth year following the completion of the project. For projects that are completed by 2021, the five year period will coincide with the timing of the taxpayer's recognition of the previously deferred gain in 2026.

2. Application Process for 1% Tax Credit. The bill introduces an application process with the Ohio director of development services for taxpayers making OQOF investments. The application must be submitted by the taxpayer on or before February 1st of the year immediately following the investment in an OQOF to be eligible for tax credits for the year that the investment was made.

The application for the 1 percent tax credit must include an officer or employee statement certifying the investment amount and describing each project and the amount of the taxpayer's investment in each project. The requirement in the proposed regulations for a schedule showing how the funds will be deployed over a 31-month period could be helpful to providing the required information. No evaluation or allocation limit is applied by the Ohio director of development services to issue certificates reflecting the 1 percent tax credit.

Within 20 days after receipt of a complete application, the Ohio director of development services is to issue a certificate of eligibility to the taxpayer stating the credit amount for the preceding tax year. The Ohio Department of Taxation certifies the amount of the tax credit to the Ohio director of development services. The tax credit certificate is to be attached to the taxpayer's tax return. The 20 day period is a tight schedule and suggest that any application be submitted sufficiently early to allow for timely receipt for claiming the tax credit on tax returns.

When the tax credit carries forward to a subsequent year, a new certificate of eligibility is issued by February 1st of each year showing the remaining tax credit available for the immediately preceding tax year.

For tax credits that are transferred, an annual certificate of eligibility will be issued to the transferee.

3. Application Process for 2% Tax Credit With respect to the potential 2 percent tax credit, taxpayers making OQOF investments may also submit an application to the Ohio director of development services by February 1st of the year following the end of the fifth year after completion of the project. Along with the information submitted with the initial application for the 1 percent tax credit, this second application requires a certified estimate by a CPA of the amount of the "estimated increased tax collections," which is defined as the state and local taxes (an open ended term) estimated to be derived from the economic activity of the project during the five-year period following completion of the project less the amount of such taxes that would have been derived from the economic activity without such project development.

Rules will be developed for the calculation of estimated increased tax collections. Tax abatements for the project and the treatment of tax incremental financing in this calculation needs to be addressed.

If the "estimated increased tax collections" are less than the 1 percent tax credit already awarded, the application for the additional 2 percent tax credit will be denied.

Within 20 days after receipt of a complete application, the Ohio director of development services is to issue a certificate of eligibility to the taxpayer stating the credit amount for the preceding tax year—which is the fifth year after completion of the project. The Ohio Department of Taxation certifies the amount of the tax credit to the Ohio director of development services. The certificate of tax credit is to be attached to the taxpayer's tax return.

Based on a plain reading of the provision, it seems that if the estimated increased tax collections exceeds the initial 1 percent tax credit already awarded, then a certificate of eligibility for the full 2 percent tax credit must be issued.

As with the initial 1 percent tax credit, the five year carry forward of any unused tax credit and the transferability of any unused tax credit are also applicable.

4. All Qualifying Property Investments and Use Must Be in Ohio Opportunity Zone. The definition of an OQOF follows the definition of a QOF from the federal Opportunity Zone tax provisions, but with the additional restriction that (a) all (rather than substantially all) of the tangible property must be "qualified opportunity zone business property" and (b) all (rather than substantially all) of the tangible property is used in a qualified opportunity zone. SB 8 provides that "all" is substituted for "substantially all" everywhere throughout Section 1400Z-2 of the Internal Revenue Code. This could be a significant limitation.

While future changes to the federal income tax regulations might be helpful, the following are two examples where the substituted "all property" requirement can deny the Ohio tax credit, even though the federal tax benefits are available.

Ex. 1. An operating partnership whose interests are owned primarily by a QOF purchases land and building and "substantially improves" the building. The land is not eligible "qualified opportunity zone business property" because it will not meet the original use requirement. However, the cost of the improved building will generally meet the 70% "substantially all" tangible property test allowed by the proposed federal income tax regulations. In contrast, the fact that the land is not "qualified opportunity zone business property" prevents the Ohio SB 8 requirement from being met.

There is hope that future IRS guidance will allow the land to also be treated as "qualified opportunity zone business property" in this example, but otherwise the "all property" requirement seems to be an obstacle with the proposed Ohio tax credit.

Ex. 2. The operating partnership whose interests are owned primarily by a QOF is engaged in a service business that uses movable equipment (e.g., a landscaping or roofing company). Beside services and equipment use provided within the opportunity zone, the business performs one job outside the opportunity zone and uses the equipment. The federal requirement that substantially all of the use of the tangible property be within a qualified opportunity zone would be met but the Ohio SB 8 requirement would not be met because of the equipment used outside the zone.

Francesco A. Ferrante | Partner| **Thompson Hine LLP**
Austin Landing I, 10050 Innovation Drive, Suite 400 | Dayton, OH 45342-4934
Office: 937.443.6740 | **Cell:** 937.470.0598 | **Fax:** 937.443.6635
Email: Francesco.Ferrante@ThompsonHine.com
Web: http://www.thompsonhine.com/professionals/ferrante-francesco

Alexis Kim | Associate | **Thompson Hine LLP**
3900 Key Center, 127 Public Square | Cleveland, Ohio 44114
O: 216.566.5732 | **M:** 216.385.3493
F: 216.566.5800 | www.ThompsonHine.com
Alexis.Kim@ThompsonHine.com