SALT BUZZ HF

Ohio Tax on Certain Non-Residents Ruled Unconstitutional

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MEMBER

• R.C. 5747.212, as applied, violates the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution

• Refund claims may be warranted for open Ohio tax years if tax paid under the "Closely-Held Statute"

Introduction and Overview of Closely-Held Statute

R.C. 5747.212 (The Closely Held Statute) imposes Ohio income tax on nonresidents with respect to the gains from the sale of debt or equity interests in certain closely held Ohio businesses. This attempt by Ohio to impose its personal income tax on a non-resident with respect to gain from the sale of an intangible that is not sitused in Ohio was found to be invalid, as applied, in *Corrigan v. Testa*, Slip Opinion 2016-OHIO-2805, issued today.

The Closely-Held Statute provides, in part, "A taxpayer, directly or indirectly, owning at any time during the three-year period ending on the last day of the taxpayer's taxable year at least twenty percent of the equity voting rights of [certain business entities] shall apportion any income, including gain or loss, realized from each sale, exchange, or other disposition of a debt or equity interest in that entity." The "apportionment" that the Ohio tax law used to calculate the alleged

Ohio sourced income of the non-resident is the underlying apportionment fraction of the sold entity. The Closely-Held Statute applies to non-residents that owned 20% or more of the entity that was sold.

Corrigan v. Testa **– Background**

Mr. Corrigan, a Connecticut resident, owned approximately 79% of the equity interests of an Ohio LLC. He had traveled to Ohio for director meetings and was somewhat actively involved in the business. Mr. Corrigan sold the membership units of the LLC and realized a capital gain, which Ohio sought to tax. Mr. Corrigan asserted that the Closely-Held Statute is unconstitutional as violating the Due Process, Commerce, and Equal Protection Clauses of the United State Constitution and the Equal Protection Clause of the Ohio Constitution. Mr. Corrigan asserted that applying R.C. 5747.212 to him is unconstitutional and that he should therefore be permitted to allocate the gain entirely outside Ohio (paying no tax to Ohio on the gain).

Corrigan v. Testa **– Ohio Supreme Court Decision**

The Supreme Court of Ohio today held "that R.C. 5747.212, as applied to Corrigan, violates the Due Process Clause of the Fourteenth Amendment to the United States Constitution * * * [and] [w]e therefore reverse the decision of the Board of Tax Appeals (BTA) and remand to the tax commissioner to grant Corrigan a refund."

The Court focused on the fundamental requirement of the Due Process Clause that there be a link "between the state and the person being taxed as well as between the state and the *activity* being taxed." Although the LLC whose interests he sold had availed itself of Ohio's protections, Mr. Corrigan (as an individual owner of the LLC) did not. The Court stated, at ¶ 36, "in this case, the activity at issue is a transfer of intangible property by a nonresident. Thus, Ohio's connection is an indirect one, whereas in *Agley* the activity being taxed was the very income derived from business activity in Ohio. Moreover, although Corrigan's availment of Ohio's protections and benefits is clear with respect to the pass-through of [the LLC's] income to him, Corrigan's sale of his interest in [the LLC] did not avail him of Ohio's protections and benefits in any direct way." Therefore, Mr. Corrigan does not owe Ohio tax on the capital gain at issue; however, he does owe Ohio tax on the Ohio sourced portion of the operational income of the LLC.

Observations and Refund Claim Opportunity

If you or your clients have paid Ohio income tax under the Closely-Held Statute, there may be opportunities to file for refunds of overpaid Ohio tax, plus applicable interest. Generally, the Ohio tax years of 2011 and forward tax years could still be open under Ohio's four-year statute of limitations to file amended returns claiming refunds. For some filers, the Ohio tax year of 2011 may be closed to filing refund claims if the 2011 return was filed by the original due date of April 15, 2012. But, if the taxpayer filed on extension, the relevant date to file an amended Ohio tax year 2011 return may be October 15, 2016. The tax years of 2012 and forward tax years should be open for refund claims for most taxpayers.

Zaino Hall & Farrin LLC professionals have advised many individuals regarding R.C. 5747.212. We would be happy to further discuss your particular facts and circumstances and how the *Corrigan* opinion may impact you.

If you would like to discuss any Ohio Tax issue, please contact any of our professionals.

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