SALT BUZZ HF

Ohio Job Creation and Retention Tax Credit Update

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For businesses locating in Ohio, the two most prevalent credits and incentives available are the Ohio Job Creation Tax Credit ("JCTC") and the Ohio Job Retention Tax Credit ("JRTC") (collectively, the "jobs credits"). As the names suggest, the JCTC is focused on new fixed-asset investment and payroll and the JRTC is focused on retaining fixed-asset investment and payroll. JRTC awards require a high threshold of investment and payroll and have been limited over the years to significant projects. The jobs credits were revamped in Amended Substitute House Bill 64 ("Am. Sub. H.B. 64" or the "budget bill"), which was signed by Governor Kasich on June 30, 2015 and generally effective ninety days later on September 29, 2015. The rules governing the job credits underwent a mandatory five year review process required of all Ohio administrative code rules. Thus, new rules were introduced reflecting the budget bill changes and other relevant changes. This article describes the changes in Am. Sub. H.B. 64, certain related changes, and the changes in the new rules.

Am. Sub. H.B. 64 Changes

Prior to Am. Sub. H.B. 64, the job credits were measured based on a percentage of the increase in the Ohio tax withheld from employee wages at the project location. However, the individual income tax rates and, therefore, the tax withholding rates in Ohio have decreased significantly over the last few years. While unintentional, the reduction in the individual income tax rates and the corresponding reduction in amounts required to be withheld under the withholding tables has decreased

the value of previously awarded job credits. Am. Sub. HB 64 converted the measurement of the job credits from employee withholding to employee payroll with a corresponding change in the percentage of the revised base to be applied. The Tax Credit Authority ("TCA") continues to consider the Ohio employee withholding for purposes of determining the amount of a job credit to be awarded. However, any job credit awarded after September 29, 2015 should no longer be impacted by subsequent changes in the Ohio individual income tax rates and/or the withholding tables.

Am. Sub. H.B. 64 also provided language allowing original JCTC agreements executed in 2014 and 2015 to be revised (upon the business' request and approval) to apply the new payroll methodology. No similar provision exists in the JRTC statute because there were no original JRTC agreements executed in 2014 and 2015. The budget bill added a withholding adjustment factor ("WAF") for job credit agreements (JCTC and JRTC) executed before 2014. The WAF is intended to provide a credit similar to the credit originally awarded. The WAF applies to the calculation of the job credits based on the company's Ohio tax withholding during 2015 and later years.

The budget bill made various other changes to the job credits. In particular, it added a provision allowing the TCA to "claw back" prior job credits if the business does not substantially meet or maintain its commitments. Those phrases are not defined in either statute. The budget bill also removed some of the language in the JRTC statute that was enacted for specific Ohio projects and is no longer relevant.

2014 and 2015 Original JCTC Agreements

The Development Services Agency ("DSA") has been working with businesses to revise any original JCTC agreements executed in 2014 and 2015 to reflect the new payroll methodology. In instances where the agreements applied a credit percentage of thirty-five to seventy-five percent of employee tax withholding in the past, the percentages based on employee payroll are approximately one to three percent. The revised agreements do not typically contain the new "claw back" provisions consistent with DSA's stated position.

The WAF

Under the budget bill, the TCA has to certify a WAF for each year. The WAF is a percentage applied to a business' Ohio employee tax withholding. The WAF is

applied to adjust the actual tax withholding to a tax withholding amount based on the individual income tax rates that applied for withholding purposes as of June 29, 2013. By adjusting the withholding for the change in the tax rates in the withholding tables, the WAF should result in a credit similar to the credit originally awarded. The withholding tables were not reduced for some of the previous income tax rate reductions, but were updated to reflect income tax reductions after June 29, 2013. Hence, the WAF calculation considers changes in the withholding tables after that date.

DSA determined the WAF to be applied to 2015 tax withholding based on the average change in individual income tax withholding in Ohio since June 29, 2013. The WAF is 12.806% and was certified in the Tax Credit Authority's meeting on February 29, 2016. The current withholding tables, however do not reflect the fully enacted income tax rate reductions that apply to an individual's income tax liability. Thus, the WAF is less than the actual tax rate reductions enacted since June 29, 2013. Also, DSA disregarded the fact that the withholding tables were not reduced in 2015 to reflect the reductions enacted in the budget bill until the end of the year, which provides a slightly higher (favorable) WAF.

The WAF will remain unchanged in 2016 and later years unless the withholding tables are updated and/or another tax rate change is enacted. Businesses will report their job and investment commitments consistent with the existing reporting practice. DSA will apply the WAF in its certification of the job credits to the business. A business must have met all its job, payroll, and investment commitments to qualify for the WAF.

The New Rules

The new rules will apply to agreements executed after the effective date of Am. Sub. H.B. 64 (September 29, 2015) and any 2014 and 2015 agreements revised under the new methodology. Any other agreements will continue to be governed by the rules that applied at the time the agreement was executed.

The new rules retain most of the same approach set forth in the existing rules, but applying employee payroll as the base, not employee withholding. The new rules also incorporate the statutory change to "metric evaluation date" rather than the previous three year commitment period. There is no language describing the WAF in the new rules. The following more pertinent changes are also included in the new rules:

- ✓ **Relocation Notice:** The statutes require that the job credit agreement con-

tain a provision that the "taxpayer" will not relocate a substantial number of employment positions from elsewhere in Ohio unless the legislative authority of the county, township, or municipal corporation have been notified. The existing rules require notice if a "substantial number" of employees are relocated from another Ohio location to the project location. "Substantial number" is already defined as employee(s) for which the aggregate payroll is $200,000 or greater. A business that does not provide notice may have its credit term or rate decreased at TCA's discretion. Many of the existing agreements contain language also prohibiting a credit with respect to payroll of employees of an affiliated entity relocated from another Ohio location.

The new rules expand the notice requirement to affiliated entities. "Affiliated entities" are defined to mean "any person that (directly or indirectly) owns or controls, is owned or controlled by, or is under the common ownership or control with, the taxpayer. For purposes of this definition, the term "own" means to own an equity interest (or the equivalent thereof) of fifty per cent or more."

✓ **Personal Computers:** The new rules delete "computers" from the definition of qualifying "fixed-asset investment." Personal computers are specifically excluded from the definition. Based on discussions with DSA, computers used in manufacturing and infrastructure will still qualify as fixed-asset investment.

✓ **New "Claw Back" Definition:** As described above, Am. Sub. H.B. 64 allows TCA (at its discretion) to "claw back" prior job credits if the business does not "substantially meet" and/or "substantially maintain" its fixed-asset investment, job, and payroll requirements. The new rules provide that these phrases mean the taxpayer must meet and maintain at least fifty percent of each commitment. The new rules do not provide any guidance on how much of the job credit may be subject to claw back. For example, if a business meets its commitments in each of the first nine years but fails to substantially maintain its commitments in the tenth year, neither the statute nor the new rules indicate how much of the credit could be at risk.

✓ **Seventy-Five Percent of Tax Withholding Limit:** The new rules retain the existing JCTC limit of seventy-five percent of employee tax withholding unless extenuating circumstances are met but modifies the language for the changes in Am. Sub. H.B. 64. It applies a new definition of "excess income tax revenue" as the employee tax withholding, which will continue to be limited to seventy-five percent in most situations. That same phrase was previously defined in the statute and in pre-Am. Sub. H.B. 64 agreements to mean the

excess tax withholding over a company's baseline tax withholding at a project location. Those two different definitions may be a little confusing, however, those prior agreements should not be governed by the new rules unless revised under the new payroll methodology. The new rules also make it clear that the seventy-five percent limit is applied when the credit is awarded. The rules currently limit awards of greater than seventy-five percent of the employee withholding at the project location to situations where the project is less than five years. The new rules delete that limitation. The JRTC statute previously contained language limiting the credit to seventy-five percent but that language was eliminated in Am. Sub. H.B. 64.

✓ **Adds Remedial Action Language:** Prior to Am. Sub. H.B. 64, TCA had the ability to reduce the credit percentage or the term of a job credit prospectively if the taxpayer did not meet and/or maintain its commitments. The new rules add language indicating that if a taxpayer relocates employment positions, TCA can "unilaterally and prospectively" reduce the credit percentage, the term, or terminate the credits "immediately."

✓ **Revises the Payroll Increase Factor ("PIF") Methodology**: Each year the TCA determines a PIF to be applied to the baseline tax withholding (baseline payroll for new agreements) used to calculate the credits. The PIF is effectively an inflation adjustment to the baseline withholding/payroll so that a business does not generate a credit based on inflation in its existing payroll. The new rules delete the existing language that determines the PIF based on the business' existing tax withholding/payroll history. Instead, the new rules provide that the PIF will be based on the "Consumer Price Index for all Urban Consumers – Midwest Urban." DSA indicated that this change reflects its existing policy.

The new JCTC/JRTC rules are effective July 28, 2016.

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