OHIO LEGISLATIVE SERVICE COMMISSION

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Office of Research and Drafting

Legislative Budget Office

H.B. 174
134th General Assembly

Bill Analysis

Version: As Introduced

Primary Sponsors: Reps. Cross and Lanese

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SUMMARY

- Authorizes a full or partial income tax deduction for capital gains received by investors in certain Ohio-based venture capital operating companies (VCOCs).
- Requires the Director of Development Services to certify eligible Ohio VCOCs.

DETAILED ANALYSIS

Ohio VCOC capital gains tax deduction

The bill allows a deduction against the state income tax for all or a portion of capital gains received by investors in certain Ohio-based "venture capital operating companies," or VCOCs. The deduction is available only for an investor's capital gains attributable to investments by a VCOC certified by the Director of Development Services. The amount of gains that may be deducted depends upon whether or not they are attributable to the VCOC's investments in certain Ohio businesses.

Eligible VCOC certification

Under the bill, the deduction is only available for investments by an eligible Ohio-based VCOC (referred to in the bill as an "Ohio VCOC"), which must be certified as such by the Director of Development Services. The bill employs the definition of a VCOC used in federal pension rules, pursuant to which a VCOC is an investment fund that invests at least 50% of its assets in operating companies or derivative investments in which the fund has direct contractual management rights. Additionally, the fund must actually exercise "management rights" with respect to at least one operating company, i.e., substantially participate in, or substantially influence the conduct of, its management.[1]

[1] R.C. 122.851(A)(1); 28 Code of Federal Regulations 2510.3-101.

To qualify its investors for the capital gains deduction, a VCOC must apply to the Director of Development Services, on a form and in the manner prescribed by the Director, to be certified as meeting both of the following requirements: (1) the VCOC must manage, or maintain capital commitments of, at least $50 million in active assets and (2) at least two-thirds of its managing and general partners must be Ohio residents.[2]

After receiving an application, the Director has 60 days to review it and notify the applicant VCOC of the Director's determination. Certification as an Ohio VCOC is valid for as long as the company continues to meet all necessary qualifications.[3]

A company that no longer qualifies as an Ohio VCOC has 30 days to notify the Director of its ineligibility from the date it ceases to qualify. After receiving this notice or otherwise determining that a company no longer qualifies as an Ohio VCOC, the Director must issue a notice revoking the Director's certification to the company and the Tax Commissioner. A company may contest the Director's revocation notice by submitting additional information or documentation to the Director and requesting reconsideration within 30 days after receiving the notice. The Director then has 30 days to review and notify the company and Tax Commissioner of the Director's final determination, which may not be appealed for further review.[4]

Reporting and administrative requirements

A certified Ohio VCOC must provide the following information to both the Director and Tax Commissioner between January 1 and February 1 of each year, as well as any other information that the Director, in consultation with the Tax Commissioner, requires to administer the deduction:

- The name, Social Security or federal employer identification number, and ownership percentage of each investor with a qualifying interest in the VCOC, i.e., a direct or indirect ownership interest in the VCOC acquired through an investment of cash in, or provision of services to the VCOC while it was certified as an Ohio VCOC.
- The amount of capital gains generated during the portion of the previous calendar year during which the VCOC was certified.
- A description of the VCOC's investments that generated the capital gains, including the date of sale and whether the investment was in an Ohio business. An Ohio business is a business with its headquarters in Ohio that employs over 50% of its full-time equivalent employees in this state, based on more than 50% of an employee's compensation being subject to Ohio income tax withholding.

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[2] R.C. 122.851(A)(2) and (B)(1).

[3] R.C. 122.851(B)(2) and (C)(1).

[4] R.C. 122.851(C)(2) to (4).

- The amount of, and basis in, any business's equity interests or securities distributed to an investor while the VCOC was certified, including reporting whether the business is an Ohio business.

The Director must review the information submitted by the Ohio VCOC, and if the VCOC either generates capital gains that qualify for the deduction or distributes equity interests or securities that, when sold, would qualify for the deduction once the income is recognized from their disposition, the Director must issue a certificate to the VCOC that includes all of the following information, in addition to any other information necessary to administer the deduction:

- The total amount of capital gains generated during the portion of the year that the VCOC was certified.
- The portion of those capital gains attributable to the VCOC's investments in Ohio businesses.
- The total amount of, and basis in, any equity interests or securities distributed during the time that the VCOC was certified and the portion of those interests and securities attributable to the VCOC's investments in Ohio businesses.
- The portion of the reported capital gains attributable to each individual with a qualifying interest in the VCOC.[5]

The Ohio VCOC must provide each person with a qualifying interest in the company a copy of this certificate as well as any other documents necessary for computing the income tax deduction. A pass-through entity that receives a certificate from an Ohio VCOC must also provide its investors with a copy of the certificate. At the request of the Tax Commissioner, a taxpayer claiming the deduction must produce a copy of that certificate, which must be retained for four years after the deduction is taken.[6]

The bill authorizes the Director, in consultation with the Tax Commissioner, to adopt any rules necessary to administer the VCOC certification process or deduction.[7] In addition, the bill expands the purposes for which the Commissioner may share otherwise-confidential tax information with the Director to include the purpose of verifying any tax information supplied to the Director in the course of administering the deduction. Continuing law provides similar exceptions for information necessary to verify compliance with loans, grants, and tax credits administered by the Director.[8]

[5] R.C. 122.851(D).

[6] R.C. 122.851(E).

[7] R.C. 122.851(F).

[8] R.C. 5703.21(C)(16).

Deduction amounts and limits

The amount of the deduction is based on the capital gains earned by a taxpayer from the sale of an investment in a certified Ohio VCOC. The deduction equals 100% of the capital gains attributable to the certified Ohio VCOC's investments in Ohio businesses and 50% of the gains attributable to its investments in other businesses.

The taxpayer must deduct any such capital gains that qualify as business income pursuant to the person's business income deduction before applying any excess towards the bill's deduction. (Under continuing law, a taxpayer may annually deduct up to $250,000 in business income, or $125,000 for spouses filing separate returns. Business income not subject to that deduction is taxed at a flat 3% rate.)

A taxpayer must add back any gains that were previously deducted but actually realized after the Ohio VCOC failed to qualify for the Director's certification described above or any gains that did not otherwise qualify for the deduction.[9]

HISTORY

Action	Date
Introduced	03-03-21

H0174-I-134/ks

[9] R.C. 5747.01(A)(33) and 5747.10.