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Shale Oil and Gas Development Fact Sheet Series

Shale Oil and Gas Payments Are Subject to Ohio Commercial Activity Tax

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Introduction

Landowners across Ohio may be surprised to learn that lease bonus and royalty dollars received for shale oil and gas leases are subject to the Ohio Commercial Activity Tax (CAT) if the payments total over \$150,000 annually. The CAT is an annual tax imposed on the privilege of doing business in Ohio, measured by taxable gross receipts from most business activities. The CAT was enacted in House Bill 66, passed by the 126th General Assembly in 2005.

Most receipts generated in the ordinary course of business are included in a taxpayer's CAT base. This tax applies to all types of businesses: e.g., retailers; service providers, such as lawyers, accountants, and doctors; manufacturers; and other types of businesses. The CAT applies to all entities regardless of form, e.g., sole proprietorships, partnerships, LLCs, and all types of corporations. The tax does have limited exclusions for certain types of businesses such as financial institutions, dealers in intangibles, insurance companies, and some public utilities if those businesses pay other specific Ohio taxes.

A person with taxable gross receipts of more than \$150,000 per calendar year is subject to this tax, which requires the person to register as a taxpayer

with the Ohio Department of Taxation. The term "gross receipts" is broadly defined to include most business types of receipts from the sale of property or in the performance of a service. Note that certain receipts are not taxable receipts and are excluded from a taxpayer's CAT base, such as dividends, capital gains, wages reported on a W-2, interest income (other than from credit sales), and gifts.

Internal Revenue Code Section 1231 provides guidance on why the oil and gas receipts are included in a taxpayer's CAT base. Specifically, the Code states that timber, coal, and iron ore are considered property used in a trade or business, assuming they are contained in the ground. Once the mineral is removed from the ground, however, it is no longer an asset used in a trade or business, and therefore receipts from the sale of this property are included in a taxpayer's CAT base.

Tax rates

So, what are the tax rates for the CAT? The rate for the first \$1 million in taxable gross receipts (from \$150,000 to \$1,000,000) is a flat \$150, and the rate for receipts above \$1 million is 0.26%. The \$150 annual minimum tax is due no later than May 10th of each

year, payable with the annual tax return for calendar year taxpayers or with the first quarter return for calendar quarter taxpayers. A calendar year taxpayer having over \$1 million in taxable gross receipts for a calendar year is required to switch to a quarterly taxpayer in the subsequent year and, if the taxpayer elects to, can switch to a quarterly taxpayer at any time during the current calendar year.

CAT example

John B. Landowner owns 400 acres in northeastern Ohio and is a teacher at the local high school. He leases his land for \$3,000 per acre, which totals a bonus payment of \$1,200,000. To calculate his CAT obligation, Mr. Landowner would pay \$150 for the first million dollars and then apply the 0.26% tax rate for the remaining \$200,000, which equals \$520. He has no other commercial business activity so his total CAT obligation would be $\$150 + \$520 = \$670$.

How to pay CAT

Electronic registration for paying the CAT is available online through the Ohio Business Gateway at <http://business.ohio.gov>. Additional instructions

on registering and paying the tax are available on Ohio's CAT website at http://tax.ohio.gov/divisions/commercial_activities.

References

Ohio Department of Taxation, Commercial Activity Tax Website

http://tax.ohio.gov/divisions/commercial_activities

Ohio Department of Taxation, Frequently Asked Questions—Commercial Activity Tax

<http://tax.ohio.gov/faqs/CAT/cat.stm>

Ohio Department of Taxation Information Release, Commercial Activity Tax: I.R.C. Section 1221 and 1231 Assets Excluded from “Gross Receipts”

http://tax.ohio.gov/divisions/communications/information_releases/CAT/documents/CAT200508.pdf

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