

Ohio Municipal Income Tax Uniformity Bill introduced in the General Assembly

On January 30, 2013, Ohio House Assistant Majority Whip Cheryl Grossman (R-Grove City) and Representative Michael Henne (R-Clayton) introduced new and improved legislation to streamline Ohio's municipal income tax system. House Bill ("H.B.") 5 was introduced in the 130th General Assembly after H.B. 601 died during the last General Assembly and was not acted upon during the lame duck session. H.B. 601 proposed similar changes to make Ohio's municipal income tax system uniform, but the new bill has some important differences intended to make the bill more appealing to municipalities.

H.B. 5 is the latest product of interested party discussions chaired by Representative Grossman and discussions will continue following the bill's introduction. The interested parties included members of the Municipal Income Tax Uniformity Coalition and several municipal tax officials. Sponsor testimony was held last week in the House Ways and Means Committee.

Similar to the former H.B. 601, the proposed language in H.B. 5 includes a comprehensive overhaul to Revised Code Chapter 718, which imposes limitations on the taxing powers of municipalities. There are several major elements to H.B. 5 which are discussed below.

The imposition of municipal income tax

H.B. 5 requires any municipal corporation that desires to continue its income tax to adopt the provisions of the new Revised Code Chapter 718 by January 1, 2015. This language is intended to ensure that municipal corporations do not change or even tweak the definitions or procedures that would be imposed if the bill is enacted. If a municipal corporation does not adopt the new provisions of Chapter 718, the municipal corporation may not impose an income tax. If a municipal corporation adopts the new provisions of Chapter 718 by January 1, 2015, the municipal corporation will not be required to have voters approve income tax rates above one percent if the rate is imposed under current ordinances. Future increases to the income tax rate above one percent will be required to be approved by voters of the municipal corporation.

The proposed bill allows each municipal corporation to continue to determine its own tax rate (subject to voter approval), the percent of a credit it will permit to residents for taxes paid to other municipal corporations, and administer, collect and enforce its own tax. As with H.B. 601, this bill does not impose any type of centralized collection for municipal income taxes.

Net operating loss carryforwards

The bill mandates a five year carryforward period for all net operating losses incurred in taxable years ending after January 1, 2014. The new carryforward period is phased-in over five years for tax years beginning after 2015, in an effort to minimize the revenue impact. Twenty percent of such losses may be used in 2016, 40 percent in 2017 and so on. In 2020, 100 percent of loss carry forwards may be utilized. If a municipal corporation allows a net operating loss

carryforward under a current resolution or ordinance, a taxpayer may continue to utilize such "pre-H.B. 5" net operating loss carryforwards for the allowed period or until fully utilized.

The bill also intends to keep net operating loss carryforwards of pass-through entities at the entity level. Therefore, such losses may not be utilized by the owner to offset income from other sources. Undoubtedly, many taxpayers that own multiple pass-through entities will be concerned by this provision. Under H.B. 5, losses flowing from one pass-through entity may not be used by an owner to offset gains flowing from another pass-through entity, even within the same tax year or within the same city. The policy reason for this treatment is to balance competing concerns between taxpayers that want net operating losses to be carried forward and municipalities that do not permit any such carryforwards. Preventing the losses of one entity from offsetting income of another entity helps mitigate the potential negative revenue impact to cities.

Pass-through entity treatment

Under current law, the municipal tax treatment of pass-through entities differs across the state. Some municipalities will tax partnerships at the owner level, but S corporations at the entity level. Even worse, some municipalities actually pick and choose whether to impose municipal net profits tax on any given partnership at either the entity or owner level. As a result, two different partnerships could be taxed differently by the same municipality.

Under the bill's proposal, the municipal income tax will be legally due at the owner level, but each pass-through entity will be required to collect tax at "the source" on behalf of each owner. Partnerships, S corporations, limited liability corporations, and limited liability partnerships will now be treated uniformly by all municipalities. Each owner will get a credit for the tax collected at "the source" for purposes of the tax imposed on individuals. If the owner of the pass-through entity is another pass-through entity, then the owner pass-through entity gets a credit for the tax collected at "the source" below (i.e., no double withholding).

Owners of pass-through entities

Under the bill, a non-resident owner of a pass-through entity whose income derived from a municipal corporation is limited to pass-through income which is collected at "the source" (at the entity level) is not required to file in that municipal corporation. Therefore, owners who derive income from pass-through entities doing business in multiple municipal corporations around the state will only be required to file a return in their resident municipal corporation and in any municipal corporation in which the owner receives income from sources other than the pass-through entity.

Definition of resident

Under current law, Ohio's bright-line residency test does not apply for municipal income tax purposes. Therefore, an individual that is a nonresident of Ohio for personal income tax purposes could be treated as a resident of an Ohio municipality for municipal income tax purposes. The bill now harmonizes the state and city tax system by providing that an individual who is a nonresident of Ohio for tax purposes is also a nonresident of any Ohio municipality for municipal

income tax purposes. If an individual is a resident of Ohio for Ohio tax purposes, then his or her residency for municipal income tax purposes will still be determined under common law.

Definition of income

The bill imposes limits on all municipal corporations by providing uniform definitions of income:

- **Intangible income:** Intangible income remains exempt under the proposal. The definition of intangible income is clarified to clearly exclude gambling winnings or any amounts required to be reported on federal schedules C, E and F from the definition of intangible income. As a result, this income would be uniformly taxable in all municipal corporations.
- **Exempt income:** Under current practice, the treatment of railroad retirement benefits and deferred compensation is inconsistent or unclear among the many municipal corporations imposing a tax on income. The bill clarifies the definition of exempt income by adding railroad retirement benefits to the list of exempt income items, such as social security and retirement benefits. Except as noted below, deferred compensation plan income is treated as exempt only if it is not included in qualifying wages (i.e., box 5 of the W-2).
- **Earnings of children:** Under current law, many municipal corporations exempt the income of children while some municipalities do not exempt such income. The bill provides that the income of individuals under 18 years of age will not be taxable unless it is included in qualifying wages (i.e., in box 5 of the W-2).
- **Exempt stock option income and deferred compensation:** While most municipalities impose tax on stock option income and deferred compensation, current law permits local officials to exempt such income in an effort to remain competitive. The bill grandfathers any municipal corporation that has already adopted an ordinance to exempt such income, but states that no new municipalities will be able to deviate from the uniform treatment. Two major cities that have this unique treatment are Cincinnati and Findlay.

Twelve day exclusion expanded to 20 days

Under current law, withholding is not required on the wages of nonresident employees that are in a municipal corporation 12 days or fewer except in limited circumstances. However, nonresident employees can be deemed to have been in more than one municipal corporation for each work day which can result in two different municipal corporations imposing tax on the same income.

H.B. 5 makes several improvements to the twelve day exclusion. First, the exclusion is extended from 12 to 20 days.

Next, the proposed law defines how a “day” is determined by using a “preponderance” test to determine in which city an employee will be considered to have worked on each day. As an example, when counting the 20 day exclusion, if an employee works two hours in Columbus, Dublin, and Westerville and three hours in Worthington on one calendar day, then under the proposed law the employee will be considered to have worked a full day in Worthington and not to have worked in Columbus, Dublin or Westerville for that day. Also, for this purpose, most types of commuting time are

considered to occur at the employee’s “principal place of work.” As a result, for purposes of the new 20 day exclusion, an employee can only work in one municipality on any given calendar day.

Although the 20 day exclusion applies, the employer must still withhold tax on the employee’s wages if the employee’s principal place of work is located in a municipality that imposes an income tax. To further the above example, assume that the “Worthington” day is the only day the employee has worked in Worthington so far that year and the employee’s principal place of work is Powell, which imposes an income tax. In that case, although the employer need not withhold tax on the employee’s wages in Worthington, it must withhold tax for Powell.

Once an employee reaches 21 days inside a municipality, withholding is only required for that municipality on that day and going forward.

If a municipality cannot require withholding because the 20 day or less exclusion applies, the municipality generally may not assess tax on those same wages in the hands of the employee. However, two exceptions apply to this general rule. First, the employee’s resident municipality may always tax wages earned in any location. Second, if the employee files a refund for tax withheld to the principal place of work location on those 20 or fewer days, then the 20 day exclusion will not apply and the “20 or fewer day” municipality may assess tax on wages earned (under the preponderance test) in the municipality on those 20 and fewer days. In this event, the employer is still protected from withholding.

Professional athletes, entertainers, public figures, and their employers, do not get the benefit of the 20 day exclusion.

Apportionment

- **Throw-back rule eliminated:** Under current law, sales delivered from a municipality to a location outside the municipality are “thrown-back” and treated as sales inside the municipality if the business does not have an employee soliciting sales at the destination location. This throw-back rule has impeded Ohio’s ability to attract Internet based companies. The bill eliminates the throw-back rule and situs the sale of tangible personal property to the location where title passes.
- **Alternative apportionment:** The bill also provides that a municipal tax administrator is permitted to approve use of alternative apportionment factors. The alternatives are separate accounting, the exclusion of any one or more of the factors, the inclusion of one or more additional factors that will fairly represent the taxpayer’s allocated or apportioned base in the municipal corporation, and a modification of one or more of the apportionment factors. However, an alternative apportionment method may only be used on an originally filed tax return if the taxpayer receives pre-approval from the tax administrator. Otherwise, the alternative method must be requested on an amended tax return.
- **Professional athletes:** Currently, Cincinnati and Columbus tax professional athletes on their wages using a duty day approach to apportion income in and out of their jurisdictions. Cleveland, however, only takes into consideration actual game days played. The bill imposes a uniform duty day approach for all municipalities.

- Lessors of real property: The bill also permits lessors of real property to elect separate accounting treatment for purposes of calculating the amount of taxable income earned in the municipal corporation. However, once a taxpayer makes this election, the election must be applied to all rental properties of the owner.
- Real estate commissions: The bill provides that the net profit relating to the sales and commissions of a real estate agent or broker shall be allocated in and out of a municipal corporation based upon the ratio of the commissions from the sales made for the sale of real estate during the taxable year within the municipal corporation to commissions from the sales of real estate wherever located during the taxable year.

Tax returns and estimated payments

- Tax return filing dates: H.B. 5 allows returns to be automatically extended, if a federal extension was requested, and returns will be due on the last day of the month to which a federal extension was granted. For example, an individual who requests a federal extension to file his or her individual Form 1040 until October 15th will be required to file the municipal income tax return by October 31st. Taxpayers that obtain a federal extension to file will no longer be required to also request a local extension and will only be required to send a copy of the extension with the actual tax return filing. A taxpayer that does not request a federal extension may request an extension of time to file for municipal income tax purposes only by filing a request with the local tax administrator. Of course, an extension only applies to filing returns; there is no extension for payment of any tax due.
- Consolidated tax returns: The legislation provides that a corporate taxpayer may elect to file a consolidated tax return. The consolidated group must be the federal consolidated group, but only one member has to have nexus with the city.
- Estimated payments: The bill proposes an annual \$200 threshold of tax due before estimated payments will be required. The due date of the estimated payments will be the same as the federal due dates, except the fourth payment shall be due in December. Safe harbors are provided that are similar to state and federal thresholds.
- De minimis test: The bill provides a *de minimis* test to limit the necessity for a business to file a net profit tax return. A taxpayer will meet the *de minimis* test if all the following thresholds, as applicable, apply:
 - The taxpayer has an apportionment percentage in the municipal corporation of less than one percent
 - The taxpayer has tax due to the municipal corporation of less than \$50, but for the application of the *de minimis* test
 - The taxpayer has paid qualifying wages of less than \$50,000 to employees for work performed in the municipal corporation
- Withholding provisions: While the bill provides that no employer may withhold in excess of the rate imposed by the city, it does permit employers to withhold for an employee’s resident city. The bill requires that all municipal corporations must require withholding on gaming winnings if federal withholding is required.

Audits, assessments and appeals

Taxpayers are often frustrated by haphazard audit, assessment and appeal procedures and related traps of Ohio’s non-uniform municipal tax system. The bill addresses this problem by proposing uniform powers for tax administrators to audit and assess municipal income tax similar to the powers available at the state level. It also provides uniform appeal procedures similar to those provided for state tax purposes.

Municipal corporation tax administrators will be required to use some new terminology, but the bill provides tax administrators more flexibility than they have under current law. For instance, H.B. 5 permits a tax administrator to issue tax assessments and, once all appeals are finalized, impose a statutory lien and pursue appropriate collection avenues. These provisions will significantly reduce the costs incurred by municipalities under current law for court filing fees and other related expenses. The bill also authorizes tax administrators to issue statutory subpoenas and provides a uniform set of penalties that may be imposed on taxpayers. Tax administrators may also abate any interest and penalties.

Taxpayers may benefit because the bill imposes clearer assessment notice and refund denial notice requirements than are currently provided by many municipalities. Assessments and refund denials may be appealed within 60 days to the local board of review (see below). The bill is intended to permit decisions of the local board of review to be appealed within 60 days by the taxpayer or the tax administrator to the Ohio Board of Tax Appeals or to the appropriate Common Pleas Court, but technical corrections are necessary to H.B. 5 to achieve this result. From the Ohio Board of Tax Appeals, either party has an appeal of right to either the appropriate Court of Appeals or the Supreme Court of Ohio.

Local board of review

The bill provides that each municipal corporation imposing an income tax is required to appoint a local board of review, which shall consider appeals by taxpayers from assessments and denials of refunds. Under current law, many municipal boards of review include only employees of the municipality, while others include non-municipal employees. The bill requires that two of the three members must not be employees of a municipal corporation. One member may be an employee of the municipal corporation, but that member must not be directly involved in municipal tax matters or be a direct subordinate of another employee directly involved in municipal tax matters. On the municipality’s website, the tax administrator is required to publish the names of each board member and an address at which the board will accept correspondence. If a tax administrator fails to post such information, the tax administrator is prohibited from imposing any penalties or interest until such information is properly posted.

Municipal tax policy board

The Municipal Tax Policy Board (MTPB) is created by the bill to empower Ohio’s municipal corporations to jointly create state-wide tax forms and Ohio administrative code (rules) provisions. Under current law, municipal tax administrators are required to accept generic forms created by taxpayers, which may result in municipalities receiving many different forms. Such cities often manually reenter those generic forms on to their own forms for purposes of inputting into their computer systems. Once the MTPB creates a single form, the extra costs associated with handling many different types

of generic forms will be eliminated. The MTPB will have seven members, all of which will be municipal tax officials. Five of the members will be tax administrators from different sized municipalities. The two remaining members will include one employee of the Regional Income Tax Authority (RITA) and one employee of the Centralized Collection Agency (CCA).

Administrative provisions

- Innocent spouse: The bill provides an innocent spouse procedure similar to that available at the state and federal level.
- Tax opinions: The bill also provides a procedure for taxpayers to request an opinion of a tax administrator, similar to the opinion of the tax commissioner procedure available for state tax purposes. Taxpayers may, in limited circumstances, also request a state-wide opinion from the MTPB. Neither the tax administrator nor the MTPB is required to issue the requested opinion. However, once issued, the opinion will bind the tax administrator until revoked. A similar procedure is currently available to taxpayers at the state and federal levels.
- Problem resolution officer: Under the bill, municipal corporations with a population of 30,000 or more are required to appoint a problem resolution officer, similar to the requirement imposed on the state tax commissioner. H.B. 5 clarifies that the problem resolution officer need not be a full-time position, and is intended to merely provide to taxpayers a specific person they can contact to address problems which the taxpayer has been unable to resolve by other means. A municipal corporation may appoint an existing employee as the problem resolution officer and does not necessarily have to hire a new employee. This provision only applies to about 35 cities.
- Statute of limitations: The bill provides a three year statute of limitations for the assessment or refund of tax. The three year period for assessment commences on the day the final return was required to be filed or the day the return was filed, whichever is later. The three year period for refunds commences on the day the tax is paid. The legislation also adopts a provision that currently applies at the state level which prevents a tax administrator from assessing tax after 10 years if no return was filed and no tax was paid.
- Interest: Under current law, interest rates vary greatly among the municipalities, with many municipal corporations imposing interest rates of 18% or more per annum. The bill requires that the interest charged on delinquent or assessed tax, as well as refund tax, be the same rate used for state tax purposes, which is the short term federal rate plus 3%.
- Jeopardy assessments: The bill provides that a tax administrator may issue jeopardy assessments against taxpayers when concerns exist as to the taxpayer inappropriately departing the state or hiding assets to avoid collection of taxes. This is similar to the jeopardy assessment powers that exist at the state level.

Attorney fees

The bill provides that municipal corporations may request reimbursement from taxpayers for reasonable attorney fees related to collection and appeal costs. Correspondingly, the bill provides that taxpayers appealing assessments or refund denials may request reimbursement for reasonable attorney fees if successful upon appeal.

Income tax revenue reporting

Currently, taxpayers and policy makers have no centralized source that gathers and publishes income tax revenues collected by all Ohio municipalities. The bill requires that municipalities imposing an income tax must submit to the MTPB and the tax commissioner the amount of tax revenue collected each year. Such information is already provided by most municipalities to the state tax commissioner, but this provision formalizes the requirement and permits more detailed reporting. The state tax commissioner is then required to publish these revenue statistics in his or her annual report. In an effort to ensure compliance with this reporting requirement, any municipality failing to provide such information will be prohibited from imposing penalties on taxpayers for the year in which such information was required to be provided.

Next Steps

Municipal officials have typically opposed state efforts to make Ohio's municipal tax system more competitive and uniform. If you are concerned about Ohio's municipal income tax system and how it impacts your business and the state, feel free to contact ZHF. ZHF is uniquely positioned to assist you in advocating for improvements to Ohio's municipal tax system. If you have questions or would like to discuss this bill, feel free to contact any member of the team at Zaino Hall & Farrin LLC:

Thomas M. Zaino, JD, CPA
(614) 349-4810
tzaino@zhftaxlaw.com

Stephen K. Hall, JD, LL.M.
(614) 349-4812
shall@zhftaxlaw.com

Richard C. Farrin, JD
(614) 349-4811
rfarrin@zhftaxlaw.com

Debora C. (Dardinger) McGraw, JD, LL.M., CPA
(614) 349-4813
dmcgraw@zhftaxlaw.com

John R. Trippier, CPA (non-attorney professional)
(614) 349-4815
jtrippier@zhftaxlaw.com

Adam L. Garn, JD, CPA, MT
(614) 349-4814
agarn@zhftaxlaw.com