

Bill to Amend Ohio Municipal Income Tax Law Passed by House and Senate

Mark A. Engel
Bricker & Eckler LLP

A bill to revise Ohio law regarding municipal income taxation, House Bill 5, has passed the Senate with amendments and obtained House concurrence. The bill proposes several changes to existing Revised Code Chapter 718, which governs the imposition of income taxes by municipalities. The bill is an effort to reach additional consistency and uniformity among communities that impose an income tax. The bill, the culmination of several months of discussions between business and municipal stakeholders, proposes some significant changes in existing law. Many of these changes are modeled on existing state law relating to the state personal income tax. This bulletin summarizes some of the more significant changes made by the bill.

Net Operating Loss: Under current law, each municipality decides whether to recognize net operating losses (NOLs), and how long to permit them to carry forward. Under the bill, net operating losses incurred in years beginning after December 31, 2016, may be carried forward up to five years. However, during the five years from 2018-2022, only 50% of the eligible NOL may be claimed and there is no additional time beyond the five year limitation to use the remaining portion of the NOL. NOLs recognized under existing laws may continue to be used as under existing law and are not subject to the 50% reduction. Losses associated with basis, at-risk and passive activity limitations are not permitted to be carried forward. NOLs may not be used to offset qualifying wages.

Income apportionment: Current law provides for the apportionment of business income according to a three-factor formula that considers property, payroll, and sales, and provides rules for determining when those items are within or without the municipality in question. Language does permit variation from this formula, but it is vague and its application varies from city to city. Under the bill, an alternative apportionment formula may be claimed on an original return, or by the filing of an amended return or a petition to contest an assessment. The request is subject to rejection by the tax administrator; the administrator may also require the use of an alternative method. In both cases, the applicable standard is that the alternative method is necessary to accurately reflect the taxpayer's business activity within the municipality. The bill revises the payroll factor slightly and retains the existing rule for sourcing sales of tangible personal property shipped from inside, but delivered outside the municipality.

Pass-Through Entities: Under current law, municipalities may elect to tax pass-through entities ("PTEs") and their owners either at the entity level, or at the individual level. Under the bill, income from PTEs (except for subchapter S corporations) must be taxed at the entity level. In addition, a municipality may also tax the distributive share of the resident owner of a PTE. If the municipality provides a credit to taxpayers for tax paid to another community, the credit must extend to the tax paid by the PTE.

Regarding subchapter S corporations, the existing treatment is retained. That is, in most cases, the income of a subchapter S corporation must be taxed at the entity level. The existing election

of about 119 municipal corporations to tax such income in the hands of the shareholders is retained.

A disregarded entity for federal income tax purposes is generally disregarded for municipal income tax purposes; the items of income and loss and apportionment factors of the disregarded entity are included in the like items for the members. A single-member LLC that is a disregarded entity may be taxed as an entity separate from its single member under certain limited circumstances.

Consolidated Returns: Under current law, each municipality may determine whether to permit taxpayers to file consolidated returns and the terms under which such election may be made. Under the bill, a taxpayer that is a member of an affiliated group of corporations may elect to file a consolidated return if at least one member of the affiliated group is subject to municipal taxation and the group filed a consolidated return for federal income tax purposes for that taxable year. All members of the consolidated group must be included in the return, and all members are jointly and severally liable for any tax that is owed. Furthermore, once consolidated status is elected, the taxpayer must continue to file in that manner until written permission to file individually is obtained from the municipality.

A combined group may elect to include, or to exclude, PTEs that are at least 80% owned by the members of the group. Items of income and expense and apportionment factors are included or excluded in the group's calculations as the case may be.

Combined groups that made an election or entered into an agreement to file on a combined basis before January 1, 2016, may continue to file according to that election or agreement.

The tax administrator may require a combined filing if the administrator finds that transactions between related members are not at arm's-length *and* shift items of income and expense.

Domicile: Under current law, each municipality is free to determine whether a taxpayer is domiciled within the city, regardless of whether the individual is domiciled in Ohio for Ohio personal income tax purposes. Under the bill, only the 25 different factors specifically listed in the statute may be used, by either taxpayers or tax administrators, to establish domicile or residency.

Transient Taxpayers: Under existing law, other than a professional athlete or entertainer, an individual may perform services within a municipality for up to 12 days before the individual's employer is required to withhold tax for that municipality. There is no guidance as to what constitutes a day for these purposes. The bill extends that threshold to 20 days. Moreover, an employee is considered to have spent a day providing services within a municipality only if the individual spends more time during the day in that municipality than in any other; there are special rules relating to how travel time during the day is considered. If an employee is based in a municipality that imposes a tax, the 20-day safe harbor applies only if tax is withheld on behalf of the municipality in which the employee is based. If an employee files a claim for refund with the municipality in which the employer is based for the reason that the employee worked outside the municipality, then the 20-day safe harbor does not apply and tax is owed to any other municipality in which work was performed. An employer must begin to withhold tax on the 21st

day that an employee spends in a municipality that imposes a tax, but there is no requirement to go back to withhold for the prior 20 days.

As is the case under existing law, this provision does not apply to professional athletes or entertainers; under the bill, public figures are also excluded from this provision.

Minimum Payments: Under the bill, no tax will have to be paid, and no refund will be granted, for amounts less than \$10. In addition, quarterly estimated payments cannot be required unless the amount of tax that is owed is \$200 or more for the year.

Winnings from Casinos and Video Lottery Terminals: New R.C. 718.031 provides that a casino operator or video lottery terminal agent shall withhold tax on the winnings for the municipality in which the facility is located. All amounts withheld must be reported and paid to the municipality by the 10th day of the following month. Annual reports to both the municipality and winners from whom amounts are withheld are also required.

Audit and Assessment Provisions: Under current law, there is no consistent period for assessment or refund purposes. The bill provides for a 3-year statute of limitations for assessments and refund claims. Uniform penalty and interest provisions are provided in the bill.

Under current law, assessment appeal procedures are largely undefined. The bill provides for the issuance of written assessments; appeals to the local board of review within 60 days of receipt of an assessment; a hearing before the local board of review within 45 days and representation by an attorney or other representative; and a written decision that must be issued within 90 days of the hearing and can be appealed to the state board of tax appeals.

Modeled on existing state law, the bill contains provisions regarding a taxpayer bill of rights; for a problem resolution officer for larger cities; for formal tax opinions; for offers in compromise; and for taxpayer suits for violation of various provisions. There is also a provision for adjustments associated with federal or state income tax audits that result in changes to items of income or expense, with the requirement of an amended return to reflect the changes.

Powers & Duties: Under current law, the authority and duties of tax administrators are virtually undefined. Under the bill, R.C. 718.30 provides express authority to promulgate rules of procedure; authority to inspect records; authority to issue subpoenas; provides a laundry list of powers and duties similar to those found in existing law for the state tax commissioner.

Study Committees: Uncodified provisions of the bill call for two separate committees. The Municipal Income Tax Net Operating Loss Review Committee is created to evaluate and quantify the potential fiscal impact to municipal corporations required to permit NOL carryforwards. By May 1, 2017, the committee is required to issue a report to the General Assembly regarding its findings and recommendations to address any revenue shortfalls.

The second committee is the Municipal Income Tax Revenue Reporting Study Committee. The committee is charged with studying the feasibility of requiring municipalities to report separately the portions of their income tax revenues derived from resident and nonresident individuals by May 1, 2015.

Implementation: Except as otherwise provided, these provisions are effective for tax years beginning after December 31, 2015. Effective January 1, 2016, no municipality may enforce any ordinance or regulation that is inconsistent with the provisions of the bill.

Summary: The bill is lengthy. Some of the provisions that are summarized here are quite involved and express provisions should be reviewed to determine their applicability to a particular taxpayer or situation. In addition, a number of other changes were made that are not included in this summary. If you have any questions or would like additional information, please contact Mark Engel at 513.870.6565 or mengel@bricker.com.