15th Annual Local Government Officials' Conference

Hosted by the Ohio Auditor of State

Pending Municipal Income Tax Legislation: Am Sub HB 5: How this legislation would impact municipalities

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History of Uniformity

- Municipal Income Tax Uniformity has been a topic of discussion for many years. As a result of prior legislative actions, many changes to municipal income tax collection and administration have occurred since 1999.
- With each attempt at uniformity, special interest carve-outs were included in language that made some areas of municipal income tax less uniform than prior to legislative action.

History of Uniformity (continued)

- HB 477, passed 7/26/00 after more than a year of meetings, changed many aspects of municipal income tax, including (but not limited to):
- Mandated the acceptance of a generic format for all income tax forms and filings.
- Municipal tax ordinances and forms must be available in an electronic format.
- Mandated credit (based on resident municipal ordinance) for tax paid by a pass through entity at the taxpayer level for a taxpayer who is domiciled in one municipality, with PTE activity taxable and reportable to another municipality.
- Established the uniform 12-day rule.
- Established a $150 deminimus threshold for withholding (removed in HB 5)
- Exempted parsonage allowances from municipal taxation.
- Provided uniform guidelines for filing an extension of time to file.
- Mandated that municipality must accept consolidated tax return from any affiliated group of corporations subject to municipal corporation's tax if that affiliated group filed a consolidated federal income tax return.
- Established uniform guidelines and due dates for estimated tax for individuals and business entities.
- Mandated that all municipalities must have a Board of Appeals process for taxpayers.

History of Uniformity (continued)

- HB 95, passed 9/26/03, also provided significant changes to municipal income tax collection and administration, including (but not limited to) the following:
- Established effective 1/1/04 that the State of Ohio would collect municipal income tax on deregulated telephone companies in the same manner as deregulated electric companies.
- Established new due date for returns filed under extension.
- Defined "qualifying wages" for withholding purposes.
- Provided a uniform due date of 4/15 for all calendar year filers of a municipal income tax return, and the 15th day of the fourth month for fiscal year filers.
- Provided additional detail for municipal Boards of Appeals.
- Defined treatment of single entity LLC's.
- Changed "business allocation formula" to "apportionment formula" for businesses and detailed how apportionment is calculated.

History of Uniformity (continued)

- HB 95 (continued):
- Specified that a nonrefundable credit for tax paid to another municipality in error will be given when it is beyond the statute of limitations for the first municipality to refund tax paid in error.
- Defined "adjusted federal taxable income" (C corporation's federal taxable income before net operating losses and special deductions as determined under the IRC, adjusted as detailed in 718.01).
- Stated that after 1/1/04, no municipal corporation may tax the net profit from a business or profession (excluding sole proprietorships) using any base other than adjusted federal taxable income.
- Allows municipal corporation to determine by Ordinance whether or not to tax stock options or nonqualified deferred compensation programs.
- Permits but does not require net operating loss carryforward.
- Determined net profit from rental activity not constituting a business or profession is taxed by the municipal corporation in which the property generating the profit is located. (But, also states that municipal corporation may impose tax on all income earned by residents of the municipal corporation).

History of Uniformity (continued)

- HB 95 (continued):
- Stated that a Board of Tax Appeals must send a copy of the final decision within fifteen days of the decision. Also provided that the taxpayer or the tax administrator may appeal the board's decision to the State Board of Tax Appeals.
- Established the Ohio Business Gateway as an acceptable vehicle for the filing and payment of certain municipal income tax filings and payments. Effective 1/1/05, businesses can file an extension of time to file and make payments. Effective 1/1/06, businesses can file municipal income tax returns and make payment through the OBG (but must still send hard copy of federal return to each municipality for audit process). Effective 1/1/07, businesses would be able to file and pay withholding tax payments to all municipalities through the OBG.
- Many other minor changes were made as a part of HB 95.

History of Uniformity (continued)

- HB 119, passed 6/30/07, exempted civilian pay on an air force military installation when the air force military installation houses members of the air force, and is a center for operations. This does not exempt civilian pay from taxation due to residence or domicile.
- Exempted payment for sickness or accident disability.
- Changed date for taxation of deferred comp to say that amounts deferred prior to 6/26/03 are not subject to any municipal corporation income tax or withholding to the extent that the deferred comp is not "qualifying wages" at the time of payment.
- Stated that the legislative authority of a municipal corporation may adopt legislation to allow the administrator to publish statistics as long as the format does not disclose confidential information related to particular taxpayers.
- HB 24, passed 12/21/07, allowed municipal corporations to allow by ordinance or resolution that taxpayers (who are individuals) may deduct contributions to HSA accounts to the extent deductible from federal form 1040, and allowed municipal corporations to allow by ordinance or resolution that taxpayers who operate a business may deduct from net profit the amount paid for medical care insurance for themselves, their spouse and qualifying dependents, to the extent deductible from the federal form 1040.

History of Uniformity (continued)

- HB 224, passed 3/24/08, changed the due date for municipal tax returns to be the same as the filing deadline for the corresponding return required by the Internal Revenue Code.
- Allowed facsimile signatures in lieu of manual signatures.
- Required that tax returns have a "check the box" for taxpayers to grant permission for their preparer to be contacted to discuss matters pertaining to the municipal income tax return.
- HB 58, passed 2/15/11, allowed a municipality to grant a nonrefundable credit when one has been established with the Ohio Department of Taxation, and also permitted a municipal corporation to allow a refundable tax credit where a refundable tax credit also exists with the Ohio Department of Taxation. These credits were specifically created for the purpose of job retention.
- HB 153, passed 5/5/11, exempted from municipal taxation highway services under a contract through a project owned by the State, and also exempted from municipal taxation any project that is a transfer of enterprise acquisition to JobsOhio by requiring such income to be deducted when calculating Adjusted Federal Taxable Income for municipal tax purposes.

History of Am Sub HB 5

- Prior to the introduction of currently pending legislation which would impact municipal taxing jurisdictions, a series of "interested parties" meetings were held by Rep. Cheryl Grossman to discuss content and impact. Attendees included the Ohio Municipal League, OSCPA, business representatives, Ohio Chamber of Commerce, municipal income tax administrators, and members of the Ohio Legislature.

History of Am Sub HB 5 (continued)

- Meetings covered a variety of topics, including:
- Uniform due dates
- Thresholds for filing, paying and refunding tax
- Clearer definitions for qualifying wages, domicile and day (for withholding purposes)
- Treatment of Pass Through Entities (PTE) and consolidated income tax return filings
- Taxpayer Bill of Rights
- Net Operating Loss Carryforwards
- 12 Day Occasional Entrant Rule

History of Am Sub HB 5 (continued)

- HB 601, co-sponsored by Rep. Cheryl Grossman and Rep. Michael Henne was introduced to the 129th Ohio General Assembly on 10/30/12. Touted as a bill to provide uniformity, simplicity and conformity, this bill included many changes to municipal income tax that would negatively impact revenue.
- Upon introduction, many municipalities began legislative action to pass Resolutions opposing HB 601. These municipalities include: Akron, Ashland, Athens, Bedford, Blue Ash, Brunswick, Centerville, Clayton, Dayton, Englewood, Evendale, Fremont, Greenhills, Hamilton, Hartsville, Hicksville, Holland, Huron, Kettering, Lakewood, Louisville, Loveland, Miamisburg, Middletown, Napoleon, Oakwood, Olmstead, Orville, Piqua, Reading, Sharonville, Sidney, Springfield, Trotwood, Vandalia, West Carrollton, Whitehall, among others.

History of Am Sub HB 5 (continued)

- Municipalities began preparing Impact Analysis Statements, intended to show the potential negative impacts to revenue from provisions of this pending legislation.
- These municipalities include: Troy, Dayton, Englewood, Franklin, Kettering, Lakewood, Louisville, Miamisburg, Napoleon, Oakwood, Brookville, Union, Vandalia, City of Cleveland CCA, RITA, among others.

History of Am Sub HB 5 (continued)

- After many hours of opponent and proponent testimony, HB 601 met its end with the close of the 129th General Assembly.
- HB 5, again co-sponsored by Rep. Grossman and Rep. Henne was introduced to the 130th General Assembly on 1/30/13, and included provisions not originally included in HB 601. Municipalities again began the process of passing legislation in opposition to this new version of the bill. The previous *Municipal Income Tax Uniformity Coalition* now began calling itself the *Municipal Income Tax Reform Coalition*, moving from uniformity of municipal income tax to reform of municipal income tax.

History of Am Sub HB 5 (continued)

- Municipalities opposing HB 5 include (but are not limited to): Akron, Athens, Clayton, Dayton, Englewood, Granville, Heath, Mansfield, Miamisburg, Mt Gilead, Napoleon, New Carlisle, North Canton, Oakwood, Piqua, Sharonville, Sidney, Springfield, Tiffin, Troy, Westerville.
- Press conferences in opposition to this legislation were held in Cleveland, Dayton and Cincinnati regions, and many municipalities across the State began adopting Resolutions or Ordinances supporting an alternate plan being provided by the Dayton Area Mayors and Managers, in conjunction with the Ohio Municipal League.

History of Am Sub HB 5 (continued)

- HB 5 resulted in many additional hearings, interested parties meetings. The House Ways and Means Committee and Chair Peter Beck began a thorough review of the bill, in an effort to bring both sides together.
- Throughout the summer recess of 2013, representatives of the municipal jurisdictions met once or twice each week with Chairman Beck to craft language acceptable to the municipal representatives, and to achieve the uniformity and simplicity sought with the legislation.

History of Am Sub HB 5 (continued)

- On 10/23/13, a substitute bill was introduce which included some language proposed by the municipal representatives, but which reflected revised language of which the municipalities had no previous knowledge. This new language was also negatively impactful to revenue.
- Despite the impact statements provided by municipal representatives in opponent hearings, the House Ways and Means Committee voted to pass Sub HB 5 to the House floor for a vote.
- The Ohio House of Representatives voted on 11/13/13 to pass Am Sub HB 5, at which point it was assigned to the Senate Finance Committee, where it awaits hearings and action.

QUICK REFERENCE GUIDE

REVIEW OF AM SUB HB 5 (AS PASSED BY THE HOUSE) AS RELATES TO MUNICIPAL REVENUE
ANALYSIS UPDATED FEBRUARY 18, 2014

AM SUB HB 5	ISSUE	IMPACT
517 - 583	**NET OPERATING LOSS CARRY-FORWARD** **Am Sub HB 5 mandates a five year NOL carry-forward for all municipal corporations.** An NOL Study Committee is formed to study the effects of the NOL on revenue.	**REVENUE LOSS:** For municipalities with less than five year NOL, revenue loss; substantial revenue loss municipalities with zero NOL; impacts revenue in same manner from JEDD or JEDZ; creates NOL committee to study impact while harmful language remains intact. Impact analysis has been completed by many municipalities based on NOL only, and annual estimated losses include: Athens - $60,000; Napoleon - $263,722; Kettering - $275,000; Dayton - $2,500,000; Vandalia - $731,268; Trotwood - $703,700; Louisville - $40,000; Troy - $438,000 to $731,000; Franklin - $280,685 to $375,591. Language requiring forced 5 year NOL should be removed, pending the results of the NOL Study Committee, and any future legislative action would then be dependent upon the results of this study.
4426 - 4431	**MUNICIPAL NOL STUDY COMMITTEE** **(also see Net Operating Loss Carry-forward)**	**PROBLEMATIC LANGUAGE:** Leaves harmful NOL language in place, while study committee formed to determine effects of NOL prepares a report to be issued May 1, 2015. Mandated NOL language should be removed pending results of study committee and future legislative action. Participation in the study committee should not be limited to hand-picked municipalities, and the "representative sample" should come from cities with no current NOL, or less than five year NOL, and should include a sampling based on region, size of community, and those who can readily draw together data.
277 - 284	**OFFSETS** **Allows offsetting of expenses against income from net profits, double deductions of losses, and multiple NOL based on same activity.**	**REVENUE LOSS: Allows individuals to possibly take deductions more than once, in multiple municipalities, with multiple NOL carry-forwards from the same losses.** For example: A Columbus resident with a reportable gain from a pass through entity in a township and a loss from a Westerville partnership will be able to use the Westerville partnership loss (already reported in Westerville and carried forward in Westerville) against the gain reportable to Columbus. Should the loss be great enough to more than offset the Columbus gain, any leftover loss could again be carried forward in Columbus against any future reportable gain.

Quick Reference Guide (continued)

418 - 444 and Section 718.011	**OCCASIONAL ENTRANT RULE** **Creates complications in the occasional entrant rule which will result in more difficulty in compliance for businesses, and loss of revenue for municipalities.** Provides language that increases 12 day rule to 20 day rule, eliminates the retroactive component for taxing employees back to day one, provides opt-in or out language for employers to withhold, gives exemption to employers who have gross receipts under $500,000 in previous taxable year. Gives employee an exemption from taxation on wages that are currently taxed by municipal corporations.	**REVENUE LOSS:** Creates tax-free days for nonresident employees working in a municipality; exempts income from tax where work is performed (if withholding is not required); creates confusion for business as to when to report / pay withholding tax; changes currently uniform provisions for purposes of reducing withholding tax responsibility; requires the employer to withhold only for principal place of work location for first 20 days; does not provide for tax to be withheld retroactively back to day one when 20 day threshold is exceeded (current law requires withholding back to day one when 12 day threshold is exceeded).
PAGE 40, LINE 1206	**THROWBACK** **Eliminates municipal taxation on sales currently sitused to the location where goods are shipped from, creating in many cases a significant loss of revenue for municipalities.**	**REVENUE LOSS** Changes current uniform provision to create tax break for businesses; allows currently reportable and taxable sales to be excluded from municipal taxation through the removal of the requirement that a W-2 employee must be engaged in regular solicitation of sales at the point of destination of goods. Greatest impact in those communities home to distribution or fulfillment centers.
2096 - 2150	**CONSOLIDATED RETURN LANGUAGE** **Am Sub HB 5 provides new language, defining "affiliated group of corporations" and "incumbent local exchange carriers", and excludes them from "Consolidated federal taxable income" definition, and provides special tax treatments and lack of uniformity.**	**REVENUE LOSS, LOSS OF AUTHORITY TO DETERMINE PROPER FILING METHOD:** Creates non-uniformity by providing for special treatment for certain businesses in the opportunity to shift income to avoid municipal tax. Allows an opt-in / opt-out provision which provides special interest treatment, different treatment from federal purposes, without prior approval of the local tax administrator, and possible income shifting to avoid municipal tax. This new language provides special treatment at the request of AT&T, not provided to other taxpayers.
2185 - 2211	**CONSOLIDATED RETURN LANGUAGE - TREATMENT OF PASS THRU ENTITY** **Am Sub HB 5 provides option to include or exclude PTE profit or loss from the consolidated federal taxable income of the affiliated group, contrary to current law.**	**REVENUE LOSS:** Allows PTE income / expenses to be included in consolidated fed tax return if it provides opportunity to avoid municipal tax. Allows taxpayer the option to include or exclude pass through entity income regardless of where the gains and losses were incurred allowing for cherry picking the best scenario to avoid municipal income tax.
3365 - 3368	**AMENDED CONSOLIDATED RETURN LANGUAGE** **Am Sub HB 5 provides language contrary to current law regarding the filing of an amended consolidated return.**	**ADMINISTRATIVE BURDEN, POTENTIAL REVENUE LOSS:** Bypasses the authority of the local tax administrator, changes currently uniform provisions; allows taxpayer to choose method which provides least muni tax liability. Current law requires that, unless they are now filing an amended return as a consolidated return for the first time (original return was not a consolidated return), the taxpayer must obtain permission to file the consolidated return. This allows the taxpayer to bypass the authority of the tax administrator, and to file an "amended" consolidated municipal income tax return without the prior approval.

Quick Reference Guide (continued)

1132 - 1142	**ALTERNATIVE APPORTIONMENT** **Allows the taxpayer to notify the tax administrator prior to using an alternative apportionment. Current law requires tax administrator approval.**	**REVENUE LOSS, LOSS OF MUNICIPAL AUTHORITY:** Allows business taxpayers to choose filing method that will allow least tax liability; removes the tax administrator's authority to deny the use of an alternative apportionment formula which does not accurately reflect activity within the jurisdiction; removes language of current law requiring approval of the tax administrator to use an alternative apportionment method.
321	**SERP / NONQUALIFIED DEFERRED COMP ISSUE** **Previous language that would have exempted SERPS and Nonqualified Deferred Comp ("pension payments and benefits") language has been changed to now only show "pensions" as being exempt from taxation.**	**IMPACT UNCLEAR:** Language was added that exempts from qualifying wages "any amount that is exempt income", requiring additional review on whether or not this will impact this issue. There are currently several actions pending at the State level regarding the character of this income.
837 - 854	**WRITTEN DETERMINATION** **Bill removes "written finding of tax administrator" language, but issues exist in current version.**	**ADMINISTRATIVE BURDEN, INCREASED COSTS:** Adds burden of certified mailing costs, and time to prepare mailings, intended to deter municipalities from properly auditing returns. Language does not clarify that a "written determination" is not an audit or assessment, or a correction to a tax return submitted. Provides that a refund submitted on an amended return filing would trigger the "written determination" procedure, prompting certified mail notification to taxpayer of any change to the refund request.
2819 - 2875	**CERTIFIED MAIL PROCESS FOR WRITTEN DETERMINATION** **Am Sub HB 5 provides cumbersome language for specifics in certified mailing process**	**INCREASED COSTS, ADMINISTRATIVE BURDEN:** Additional postage costs and time to process; burdensome process for certified mailing process. If language regarding audit and assessment is not clarified, this process could apply to those kinds of notices as well.
445 - 448	**NEWLY EXEMPTED INCOME** **Board of Director's Fees exempt from municipal taxation.**	**REVENUE LOSS:** Exempts income currently uniformly taxable.
1001 - 1007	**DOMICILE** **Language has been removed from Municipal Coalition draft that clarified language, creating difficulty in administration and a possible loophole resulting in costly litigation.**	**POSSIBLE INCREASED COST OF LITIGATION:** Clarifying language from Muni Coalition draft has been removed, creating uncertainty. Language removed allowing the taxpayer to rebut the conclusion of domicile if the tax administrator unreasonably concluded domicile, and only requires a preponderance of the evidence to determine domicile, when clearly some factors are weighted differently than others.
1843, 1893, etc.	**DEMINIMUS THRESHOLD** **Municipal Coalition draft language provided $5 deminimus for balances due and refunds, Am Sub HB 5 provides for $10 deminimus. This is NOT offset by the provision that municipalities do not have to issue refunds in the amount of ten dollars or less.**	**REVENUE LOSS** State minimum due is $1, but HB 5 suggests $10 for municipalities in the areas of both liabilities and refunds.

Quick Reference Guide (continued)

2023 - 2029	**STATE TAX COMMISSIONER TO PROVIDE DOCUMENTS** **This provision increases the amount of time (from 30 to 60 days) for the State Tax Commissioner to provide documentation to municipal corporations relative to municipal filings on deregulated electric and telephone companies collected by the State.**	**INCREASED COSTS (Interest paid on refunds not processed timely), ADMINISTRATIVE BURDEN:** Language to freeze statute of limitations for issuing refunds due to document request is necessary. Municipalities receive no documentation from the State Tax Commissioner when municipality is required to issue a refund. Allowing the State Tax Commissioner additional time to comply is not an issue as long as the statute of limitations on issuing a refund by the municipality is frozen during the period when the State Tax Commissioner is complying with the municipal request for documentation.

HOME RULE and the GESLER DECISION

Article XVIII, Sections 3 and 7: Ohio municipalities have the right to exercise all powers of local self-government.

Article XIII, Section 6: The General Assembly shall provide for the organization of cities, and incorporated villages, by general laws, and restrict their power of taxation, assessment, borrowing money, contracting debts and loaning their credit, so as to prevent the abuse of such power.

Article XVIII, Section 13: The General Assembly may enact laws to:

- Limit the power of municipalities to levy taxes and incur debts for local purposes, and
- Require reports from municipalities as to their financial condition and transactions.

Gesler v. City of Worthington, 2013-Ohio-4986

In a carefully worded opinion, the Ohio Supreme Court held that a State Board of Tax Appeals decision violated the Ohio Constitution's home rule provisions as the Board's decision to deny a refund conferred powers on the General Assembly beyond those provided by the Constitution.

The Court made the following holdings:

- A conflict analysis is not necessary when the municipality exercises a power of local self-government, which includes the power of taxation.
- The state law provision to which Worthington relies is not a limitation or restriction and, therefore, the state provision did not prevent Worthington from exempting schedule C income.

BASIC FACTS:

- Worthington local tax ordinance clearly provided for an exemption from the Worthington net profits tax (local income tax on business income) for income that was required to be reported on schedule C, schedule E, or schedule F.
- Worthington argued that the state statute defining net profits for purposes of municipal taxation required inclusion of the schedule C income and, therefore, a conflict existed and the state provision preempted its local ordinance.
- The Court found that the State Board's decision that the provisions of ORC 718 trumped the local ordinance impermissibly infringed on Worthington's powers of local self government.
- In municipal tax disputes, the Ohio Constitution must also be considered along with local ordinance and regulations to reach a proper legal conclusion.

How does this impact Am Sub HB 5?

Legal minds differ on the impact of this legislation, however, it is certain to be a part of the ongoing discussion as to whether or not local ordinance will trump State code for municipal income tax purposes.

HB 5 as it relates to the role of Municipal Finance Directors

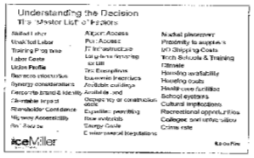
- ORC 5705.36(A)(2)
- "(U)pon a determination by the fiscal officer of a subdivision that the revenue to be collected by the subdivision will be greater or less than the amount included in an official certificate…"
- Optional updates: ORC 5705.36(A)(2)
- Mandatory updates: ORC 5705.36(A)(3)
  - If the estimate is too low and the legislative authority intends to appropriate the excess revenue, you must certify the amount of the excess to the County Budget Commission.
  - If the estimate is too high and the amount of the deficiency will reduce available resources below the level of current appropriations, you must certify the amount of the deficiency to the County Budget Commission.

  If the current legislation as it stands does pass, depending on the timing of passage and implementation dates, it may cause revenue estimates to be too high, requiring certification of the deficiency.

Debunking the Myth – How Site Selectors Make the Decision on Where to Locate.

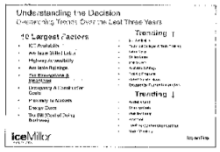
- During the course of many meetings with Rep. Grossman and Coalition members, it was discussed that site selectors viewed the municipal income tax as either number one or number two on the list of deterrents to moving to Ohio.
- In a presentation to the Manufacturers Education Council in January, 2014, a presentation titled "Incentives: Corporate Site Selection – How Far Do Economic & Tax Incentives Move the Needle?", Chris Magill, Economic Development Director for Ice Miller, LLP discussed this topic.
- The next few slides will outline the factors involved in making the decision to locate in a particular place, and where the "tax bill" ranks in the decision-making process.
- Keep in mind that the "tax bill" includes all tax obligations, including property tax, sales tax, State income tax, local municipal income tax, and any other tax that may be a factor in the overall "tax bill".

Debunking the Myth: What site selectors really say about locating in Ohio



Understanding the Decision: The "Master List" of Factors:

Skilled Labor	Available land
Unskilled Labor	Occupancy or construction costs
Training Programs	Expedited permitting
Labor Costs	Raw materials
Union Profile	Energy costs
Business Interruption	Environmental Regulations
Synergy Considerations	Market placement
Corporate brand and identity	Proximity to suppliers
Charitable impact	I/O shipping costs
Shareholder Confidence	Tech schools and training
Highway accessibility	Climate
Rail Service	Housing availability
Airport Access	Housing costs
Port Access	Healthcare facilities
IT Infrastructure	School systems
Long-term financing	Cultural implications
Tax Bill	Recreational opportunities
Tax Exemptions	Colleges and universities
Economic Incentives	Crime rate
Available buildings	



Understanding the Decision: Overarching Trends over the Last Three Years:

10 Largest Factors
- ICT Availability *(related to emerging technologies)*
- Available skilled labor
- Highway accessibility
- Available buildings
- Tax exemptions and incentives
- Occupancy and Construction Costs
- Proximity to Markets
- Energy Costs
- **Tax Bill (Cost of Doing Business)**

QUESTIONS?

For questions after the conference, please feel free to contact us:

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