

Ohio Auditor David Yost
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HB5-Municipal Income Tax Reform Update

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Impact to Ohio Municipalities

House Bill 5 will impact taxing municipalities in one or more of the following ways:

- Legislatively
 - Powers of local self-government, updated ordinances and rules and regulations
- Administratively
 - Changes in processes and procedures and updated systems and forms to accomplish these
- Financially
 - Reduced revenue, delayed cash flow

HB5 Legislative Basics

*Signed by the Governor December 19, 2014

*Effective date of the legislation is March 20, 2015

*Most provisions go into effect January 1, 2016 or for tax years beginning on or after January 1, 2016

*Text of the Bill and the Legislative Service Commission Analysis available
http://archives.legislature.state.oh.us/bills_dfm?ID=13_HB_5

Impact on Municipal Home Rule

- R.C. 715.013(A) and (B), explicitly prohibits municipalities from levying an income tax unless it is levied in accordance with Chapter 718.
- R.C. 718.04, municipal income tax ordinances must contain certain specific provisions and may not be inconsistent with Chapter 718.
- Section 6, General Assembly “exercises its authority under [Section 6 of Article XIII and Section 13 of Article XVIII of the Ohio Constitution] to restrict the taxing powers of municipal corporations” by requiring municipal income tax to be levied in accordance with H.B. 5 and any provision of Chapter 718 remaining unchanged by H.B. 5.

Ordinance Rewrites to Comply with New State Mandates

- Anticipate that your municipal income tax ordinances and rules and regulations will need to be substantially amended or even rewritten as a result of H.B. 5.
- Plan to have those amendments and rewrites completed and enacted by January 1, 2016 as areas exist that need municipal direction
 - Treatment of taxpayers under age 18, mandatory filing requirements, electronic filing requirements for certain employers, taxation of stock options and nonqualified deferred compensation, etc...

Administrative Changes to Local Boards of Tax Review

- As is the case now, municipalities that impose a tax must maintain a board to hear appeals of decisions of the tax administrator.
- H.B. 5 now dictates the makeup of local boards of tax review
 - Three member makeup - two members appointed by the legislative authority (no employees, elected officers or contractors of the municipality), one member appointed by the top administrative official of the municipality – municipal employee okay but not the Finance Director, Tax Administrator or other employee involved in tax administration.

Boards of Tax Review

- Local boards of tax review will be more active going forward, hearing appeals of “assessments”.
- Assessment is a written finding of the tax administrator that commences a taxpayer’s time to appeal to the local board of tax review and has “ASSESSMENT” written in all capital letters at the top of such finding.
- Taxpayer has 60 days to appeal an Assessment to the local board of tax review, which then must hold a hearing within 60 days.
- Boards must issue a final determination within 90 days of the final hearing.

Board of Tax Reviews New Triggers For Increased Appeals

Tax administrators will be required to issue appealable assessments when:

- Fully or partially denying refund requests on amended returns
- Denying a taxpayer’s request to use a method other than the statutorily prescribed method for allocating net profits to a municipality, or imposing a method
- Requiring net profit filers to make a consolidated filing

Appeals

- Appealable assessments must be served by personal service, certified mail, delivery service, or email if the taxpayer consents to email service.
- Appealable assessments do NOT include:
 - Billing statements
 - Requests for additional information
 - Informal notices denying refund requests on originally filed returns*
 - Notifications of math errors and other general correspondence

*When fully or partially denying a refund request on an originally filed return must notify the taxpayer how to request an appealable assessment

Additional Administrative Requirements

- Forms, instructions and e-filing/payment applications may need modifications to address
 - New filing thresholds and frequencies for employers
 - New occasional entrant provisions
 - New minimum estimate requirements
 - New net operating loss phase-in provisions and gain/loss offsetting if not currently permitted
- All written correspondence from a municipality with a population > 30,000 must contain the name and contact information of a person who can receive inquiries about the correspondence.

Additional Administrative Requirements, cont.

- Computer programs and software used to calculate penalty and interest to be updated
 - Current rates may be imposed for anything due to be filed or paid before 1/1/16 but paid after that date
 - New penalty and interest rates imposed for anything due to be filed or paid after 1/1/16
- Billing schedules may need to change due to new due dates for estimated payments
- H.B. 5 provides for municipalities to recover *post-judgment* costs and fees, including attorneys' fees, from taxpayers – this may change municipalities' processes for referring matters to outside collection firms, or for moving unpaid balances to litigation

Financial Impact The State of Ohio's Analysis

The Legislative Service Commission (LSC) fiscal analysis of the impact of H.B. 5 on municipalities finds that:

“Though total revenue losses to municipalities are undetermined, and delayed to future fiscal years, they may be significant, potentially millions of dollars annually.”

(LSC Fiscal Note & Local Impact Statement, December 9, 2014, p.1)

Net Operating Loss Carry-Forward Largest Source of Reduced Revenue

NOL Carry Forward

- All municipalities must permit a five year Net Operating Loss Carry Forward beginning with losses incurred in tax year 2017, with the deduction of losses to be phased in at 50% over five years.
- Many municipalities currently do not allow losses to be carried forward, or allow them for fewer than five years (Examples – Cities of Columbus, Dayton, Dublin do not allow a carry forward, Cities of Akron and Canton allow only three years for carry forward)

Reduced Revenue Changes to Offsetting

Offset of Gains and Losses

- When calculating their taxable income for their resident municipality, resident taxpayers with schedule income (sole proprietors, rental income, etc...) and/or income from partnerships or other pass through entities will be permitted to use losses from any of these activities to offset gains from others.
- Most municipalities do not currently allow such extensive offsetting of gains and losses, resulting in reduced revenues for municipalities.

Reduced Revenue New 20 Day Rule

Occasional Entrant Rule

- Increases from 12 to 20 the number of days an individual performs services in a municipality before the employer must withhold tax. Tax due from the 21st day forward. Will result in some municipal revenue loss.
- Defines a day for purposes of determining where an employee is performing services.
- Contains an exception for “small employer” who will withhold tax only in the municipality of its fixed location.

**Reduced Revenue
Uniform P&I**

Penalty and Interest Rates

- Uniform interest rate on unpaid tax of Federal short-term rate + 5%
- Uniform penalties on unpaid tax
 - 15% flat penalty for individuals and net profit filers
 - 50% flat for employer withholding

Rates represent a substantial decrease for many municipalities

Likely result – fewer abatements of penalty and/or interest granted by municipalities

**Reduced Revenue
Unquantifiable Sources**

Provisions that will likely result in revenue loss, but are difficult to quantify

- New flexibility granted to consolidated net profit filers (five year opt-in/opt-out, annual inclusion or exclusion of pass-through income)
- Net profit taxpayers' use of alternate methods of apportioning net profits without prior approval of the tax administrator

**Reduced Revenue
Soft Costs**

- Reprogramming tax administration software
- Developing new forms and instructions
- Reprogramming of e-filing applications
- Educating your taxpayers about new rules, filing dates, thresholds, etc...

Delayed Cash Flow

Estimated Payment Deminimus

Individual and net profit filers are not required to make estimated payments throughout the year unless the estimated liability is at least \$200.

Impact - most municipalities will experience negative cash flow during the first year that this new deminimus is in place. Funds that would normally come in during 2016 as estimated payments will be delayed until April of 2017, when the TY 2016 return is due


