

Ohio Auditor of State
Local Government Officials Conference
March 23, 2016

Municipal Income Tax:
“What You Don’t Know Can Hurt You!”

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HB 5 - BACKGROUND

- Signed by the Governor December 19, 2014
- Third piece of comprehensive legislation impacting Ohio’s municipal income tax within the past 20 years (HB 5 probably the most comprehensive; HB 95 – 2004; HB 477 – 2000)
- Most provisions go into effect January 1, 2016 or for tax years beginning on or after January 1, 2016 (Exception: NOL CF)
- Changes to HB 5 were included in H.B. 64, the state’s biennium budget bill, this past June.
- HB 5 provisions (inclusive of HB 64 changes) are available at: <http://codes.ohio.gov/orc/718>

MAJOR TAX PROVISIONS
& “FIRST-UP CHANGES”

- Uniform Remittance & Refund Thresholds:**
 - **Individual / Net Profit:** No remittance of tax is required with a return if the amount shown to be due is \$10 or less.
 - **Refunds:** Will not be issued for \$10 or less.
 - **Challenge:** What to do with the less than \$10 amounts?

☐ Uniform Thresholds – Estimated Payments:

- Estimated tax payments are not required unless tax due will exceed \$200 for the year (after withholding & credits).
 - **Safe Harbors:**
 - 90% of current year tax liability;
 - 100% of prior year tax liability (assuming a full year); or
 - The taxpayer was not domiciled in the municipal corporation on January 1st of the taxable year.
 - **Waiver:** Municipalities may waive the requirement for taxpayers to make estimated payments.

☐ R.C. 718.08 – Estimated Payment Due Dates:

- New estimated payment due dates starting in 2016
 - 1st quarter due April 15th
 - 2nd quarter due June 15th
 - 3rd quarter due September 15th
 - 4th quarter due December 15th
- RITA has addressed the new threshold and due dates in the Tax Year 2015 forms and instructions
- **Challenge** – Taxpayers who still want to make estimated payments

☐ Uniform Annual Return Due Dates:

Establishes uniform annual tax return filing deadlines:

- **Annual Individual Tax Returns and Annual Net Profit Tax Returns:** Due on the same due date that applies for state personal income tax purposes (i.e., April 15th for calendar year taxpayers).

Makes consistent with federal, state and current municipal law the due date for entities with a fiscal year end other than a calendar year end.

☐ Uniform Due Dates & Thresholds - Withholding:

- **Default:** remit quarterly by the 15th day of the month following the end of the quarter.
- Withholding of > \$2,399 in the previous calendar year or >\$200 per month in any month of the preceding calendar quarter -- **remit monthly, due the 15th day of the following month.**
- **BUT**, Municipalities **may require semi-monthly remittance** if withholding > \$11,999 in the preceding calendar year or > \$1,000 in any month of the preceding calendar quarter.
- Annual reconciliations due February 28th of the following year.
- RITA notified employers and payroll providers of the new filing dates and thresholds via Post Card mailing; see HB 5 W/H info. on RITA's website at: <http://www.ritaohio.com/businesses/hb-5/>

☐ Uniformity - Extensions & "Mail Box Rule":

- **Extensions:** If a federal extension has been requested, then the municipal due date is automatically extended and no notice to the municipality is required.

Requires tax administrators to accept a taxpayer's request for a 6-month extension in filing deadline regardless of whether or not a taxpayer requested a federal extension.
- **Mail Box Rule:** Applies to all documents and payments required to be filed before a prescribed date under the new Chapter 718, except for payment of withholding taxes.
 - i.e., must be put into the U.S. Mail by the due date

☐ R.C. 718.27 – Uniform Penalty and Interest Rates:

- The interest rate charged to taxpayers will be the federal short-term rate, rounded to the nearest whole percent, plus 5% per annum.
- Flat penalty of:
 - 15% of unpaid, or late paid, income tax.
 - 50% of unpaid, or late paid, withholding taxes.
 - \$25 per month late fee capped at \$150 (i.e. 6 months late), for each failure to file, except for estimated payments
- Municipalities may impose on the taxpayer any post-judgment collection costs and fees, including attorney fees.

Residency / Domicile:

- Currently determining domicile is under common law (that place to which, whenever one is absent, he intends to return).
- Bill now codifies a list of 25 factors that may be considered when determining domicile in a municipal corporation.
 - Examples:
 - Location of law/accounting firms and medical care givers;
 - Voter registration and driver's license;
 - Number of contact periods in the municipality; and
 - Location of abodes and of employment.

Net Operating Loss Carryforward:

- All municipalities must permit a 5-year net operating loss carryforward **beginning with losses incurred in tax year 2017**, with the deduction of losses to be **phased in** at 50% over 5 years.
 - Begins with losses incurred in tax year 2017
 - 50% of losses available to be used tax years 2018 thru 2022 (phase-in provisions)
 - 100% beginning in tax year 2023
 - Resident individual taxpayers allowed NOL CF for Schedule C, E, or F for residence tax purposes.
 - NOL CF may not offset Qualifying Wages

NOL CF Review Committee:

- Municipal Income Tax NOL Review Committee:
 - Will study impact of 5-yr NOL CF, based on municipal data from tax years 2011-2013
 - Committee report due to General Assembly & Governor by May 1, 2017
- **Challenge:**
 - Deadline to form committee: May 1, 2015
 - Deadline to prescribe method to estimate impact: November 30, 2015

Pass-through Entities:

- Taxed at entity level for net profit purposes.
 - Municipalities may tax the income that passes through to a resident individual owner.

- Resident owners of PTE:
 - Report to resident community (S corp limitations still apply).
 - Subject to residence tax credit provided (tax credit for net profit tax paid by PTE flows through to resident owners).
 - All municipalities required to permit current-year PTE losses/gains to offset any other PTE, Schedule C, E or F income, and vice versa.

Gain and Loss Offsets:

- **Residents:** Gains and losses generated by a resident individual's PTEs or by the taxpayer's own efforts (Schedules C, E or F) may offset each other during the year in which such gains and losses were generated, regardless of the situs of activities.
 - Losses of S corporations do not flow to an owner unless the owner lives in a municipality whose voters approved taxation of S corporation owners in 2003 or 2004.
 - Qualifying wages may not be offset by these business losses.

Gain and Loss Offsets:

- **Nonresidents:** Gains and losses generated by multiple PTE's owned by nonresident individuals are not authorized to offset the income and loss of such PTEs in the year such losses were generated (because nonresidents may only be taxed on their direct [i.e., Schedule] net profits generated in a nonresident municipality).
 - Some municipalities currently permit nonresident owners to file tax returns that offset income and losses of multiple PTEs operating in the municipality. In most instances, such municipalities do not permit a carryforward of NOLs.
 - Under the new law, each of those PTEs and Schedule activities will be permitted to carryforward the resulting NOL for five years.

☐ Occasional Entrant Rule:

- **Extends** from 12 to 20 the number of days an individual must perform services in a municipality before the employer is required to withhold tax.
 - If threshold not exceeded, employer withholds for principal place of work municipality.
 - If 20-day threshold is exceeded, tax from day 21 in the municipality in which the services are performed.
- **Defines a day** for purposes of determining where an employee is performing services -- employee can only be considered to be working in one municipality on any given calendar day.

☐ Occasional Entrant Rule:

- Contains an exception for a “small employer” who will withhold tax only in the municipality of its fixed location.
 - **“Small Employer”** means an employer that had less than \$500,000 of *total revenue* during the preceding taxable year.
 - **“Total Revenue”** is broadly defined to mean any type of receipt.
 - Small Employer excludes any governmental entity.
 - The Ohio Legislative Service Commission has reported that 90% of Ohio businesses have gross receipts less than \$500,000.

☐ Supplemental Executive Retirement Plans (“SERPS”):

- Nothing in the Bill directly determines whether SERPs, a type of nonqualified deferred compensation plan, are exempt from municipal income tax.
- **Cleveland & Shaker Heights Cases**
 - Same Taxpayer involved (Cleveland – Employment Tax; Shaker – Residence Tax)
 - Shaker Hts’ case: **Pensions are exempt** based on ordinance language
 - Cleveland case: State BOR hearing held November 4th 2015
- **Columbus case – Nationwide Insurance – decided by Ohio Board of Tax Appeals May 12, 2015**
 - Columbus ordinance does not exempt “pensions”, but...
 - Columbus ordinance does not require employer to withhold when nonqualified deferred compensation is reported for FICA/Medicare purposes

Consolidated Returns:

- **Opt-Out Ability:** Permits consolidated filers to “opt out” of consolidated filing after 5 years - without tax administrator approval
 - Election is binding for five years.

- To opt out after five years, an election to discontinue must be made in the first year following the last year of the five-year consolidated return election period.
 - An election to deconsolidate is effective for five years.

- Corporations that made an election to file consolidated, or entered into an agreement with a municipal corporation before 2016 to file a consolidated or combined tax return, may continue to do so in accordance with that pre-2016 election or agreement.

Consolidated Returns:

- **Affiliated PTEs:** Consolidated filers may choose to include or exclude 80% or more owned PTEs from the group.
 - If the PTEs are included, then their income and loss, as well as their apportionment factors, are included in the consolidated group’s calculation of municipal taxable income.
 - The net profit and apportionment factors of PTEs that are owned less than 80% must be excluded from the consolidated group.

- **Forced Consolidation:** If a taxpayer files a federal consolidated tax return, the tax administrator may require the taxpayer to file a consolidated return for municipal tax purposes if it is determined, by a preponderance of the evidence, that:
 - Intercompany transactions have not been conducted at arm’s length, and
 - There has been a distortive shifting of income or expenses with regard to allocation of net profits to the municipal corporation.

Items Not Included in H.B. 5:

- Centralized collection
- Uniform rates/credits
- Creation of one “uniform tax form” - generic forms are still acceptable
- Elimination of “Throwback Rule” for situsing net profit sales
- Required Use of “Duty days” – litigation was pending re. the Cleveland “Jock Tax” Cases:
 - Hunter Hillenmeyer – Chicago Bears’ Linebacker
 - Jeff Saturday – Pro Bowl Center for Indianapolis Colts

Assessments:

- Assessment: A written finding by a municipal tax administrator that commences a taxpayer's time to appeal to the local board of tax review.
- Assessments examples:
 - Full or partial denial of refund requests on amended returns.
 - Denial of taxpayer request to use a method other than the statutorily prescribed method for allocating net profits to a municipality, or tax administrator's requirement to do so.
 - Requiring net profit filers to make a consolidated filing.

Assessments:

- Assessments **are not**:
 - Billing statements;
 - Requests for additional information;
 - Informal notices denying refund request on originally filed returns;
 - Notifications of math errors; or
 - Other general correspondence.
- The statute of limitations for collections is tolled while appeals are pending before local boards of review, or higher reviewing authority.

Assessments:

- **An "Assessment" must:**
 - Have the word "ASSESSMENT" printed at the top in all capital letters;
 - Be served by personal service, certified mail, delivery service, or email if the taxpayer consents; and
 - Advise taxpayer of appeal rights and how to appeal.

☐ Civil / Criminal Actions:

- Municipalities may still employ civil and criminal enforcement provisions for non-payment and non-filing.
- Municipalities may recover *post-judgment* costs and fees, including attorneys’ fees, from taxpayers.
- Sets forth criminal sanctions for violations of certain provisions and permits municipalities to prosecute other offenses not specifically stated in Chapter 718.

☐ Taxpayer Litigation Rights:

- Permits taxpayers “aggrieved by an action or omission” to bring an action against the municipal corporation for damages *if all* of the following apply:
 - In the action or omission the individual *frivolously disregards* a provision of Chapter 718 or a rule or instruction of the tax administrator;
 - The action or omission *occurred with respect to* an audit or an assessment and the review and collection proceedings connected with the audit or assessment; and
 - The individual *did not act* manifestly *outside the scope* of employment and did not act *with malicious purpose*, bad faith or in a wanton or reckless manner.

☐ Local Boards of Review:

- The Bill dictates the makeup of local boards of tax review - 3 member makeup:
 - 2 members appointed by the legislative authority - **no employees**, elected officials or contractors of the municipality at appointment or in the preceding 5 years; and
 - 1 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**.

Local Boards of Review and Assessments:

- Local boards of tax review (BOR) may be more active going forward, hearing appeals of “assessments.”
 - Taxpayer has 60 days to appeal an assessment to the local BOR.
 - BOR then must hold a hearing within 60 days.
 - Taxpayer may waive a hearing or hearings may be continued if agreed to by the parties.
 - BOR must issue a final determination within 90 days of the final hearing.

HOW H.B. 5 PLAYS WITH CASE LAW

- *Gesler v. Worthington Income Tax Bd. Of Appeals*
 - Decided by the Ohio Supreme Court on November 19, 2013
 - Important Home Rule Case
- *MacDonald v. City of Shaker Heights and vs. Cleveland*
- *Panther II Transportation v. Village of Seville, Ohio*
 - Decided by the Ohio Supreme Court on March 19, 2014
 - Important Home Rule Case

Gesler :

Facts:

- Mr. Gesler was a professional accountant providing tax advisory services through a sole proprietorship, and prior to the tax years at issue, a client granted Mr. Gesler stock options as payment for tax services.
- In 2005, 2006 and 2007, Mr. Gesler exercised the stock options and reported Schedule C business income on his federal income tax returns.
- The Geslers filed Worthington tax returns for those years, reported the Schedule C income, and paid Worthington tax.
- The Geslers then filed refund claims with Worthington for each year.

Gesler :

Facts:

- Worthington’s Income Tax Ordinance imposed tax on “net profits.”
 - Worthington defined “net profits” by ordinance as “the individual’s profit *other than* amounts required to be reported on Schedule C***.” (Emphasis added.)
- The Worthington Tax Department denied the Geslers’ refund claims; the Worthington Board of Tax Appeals ruled in favor of the City stating:
 - (i) The Geslers failed to prove their case with competent and probative evidence that the taxation of Schedule C income is in error; and
 - (ii) The City’s determination is supported by a preponderance of the evidence and is in accordance with law.

Gesler :

Facts:

- Ohio Board of Tax Appeals ruled in favor of Worthington.
 - Worthington’s Ordinance clearly and unambiguously did not impose tax on Schedule C business income; City Council wrote the Ordinance as City Council intended. There was no scrivener’s error on the City Council’s part.
 - **However**, Ohio Revised Code Section 718.01(A)(7) required municipalities imposing income tax to define “net profits” to include Schedule C business income; **AND**
 - The Ohio Statute overrode Worthington’s Ordinance, so Worthington was required to impose Worthington income tax on the Geslers’ Schedule C business income notwithstanding Worthington’s Ordinance to the contrary.

Gesler :

Ruling:

- The Ohio Supreme Court **overturned** the Ohio Board of Tax Appeals, in favor of the Geslers.
 - Worthington’s decision not to tax Schedule C business income was a **valid exercise of home rule powers** granted to Worthington by the Ohio Constitution.
 - The Ohio General Assembly “**cannot command Worthington to impose tax on Schedule C income when Worthington has chosen not to tax that income...**”
 - As a matter of constitutional law, the Ohio statutes at issue could not be used to block a tax exemption provided by Worthington. The Court ordered Worthington to issue the Geslers’ refund with statutory interest.

Gesler :

Takeaways:

- The Ohio General Assembly *only limits or restricts* municipal taxing authority
- Implications for H.B. 5?
At present, the line between the municipal taxing power and the General Assembly’s authority to limit that power is not well defined. This area of Ohio law will undoubtedly require further illumination by the Court.

MacDonald:

- Ohio Supreme Court decides procedural issue – what is the appropriate standard of review to be applied by the Ohio BTA when reviewing decisions of local municipal income tax boards of review? – in favor of taxpayer’s argument of “de novo review”
- Underlying issue was the taxation of SERPs, a form of nonqualified deferred compensation – taxable wages or tax exempt pensions?
- Similar case pending at the Ohio BTA for the City of Cleveland (same Taxpayer, different ordinance; slide 21)
- City of Columbus case vs. Nationwide Insurance decided 5/12/15 (slide 20)
- Implications for H.B. 5?

Panther:

Facts:

- Panther II Transportation, Inc. (“Panther”) is registered with the Ohio Public Utilities Commission (“PUCO”) as a motor carrier for hire.
- Panther had a place of business in Seville, and filed net profits tax returns with Seville for tax years 2005 and 2006.
- Panther requested refunds of such tax because state law (i.e., R.C. 4921.25) preempted Seville from imposing net profits tax on Panther.
- CCA denied Panther’s refund claims.

Panther.

Facts:

- In June 2008 the Seville Board of Tax Appeals ruled in favor of Seville.
 - The state law TP cited to claim preemption dated back to the 1920s, prior to the existence of the municipal income tax in Ohio
 - So, the State could not have expressly exempted municipal income taxes on motor carriers for hire
- In August 2011, the Ohio Board of Tax Appeals ruled in favor of Panther, and in August 2012, the Ohio Court of Appeals for the 9th District ruled in favor of Panther.

Panther.

Ruling:

- In March 2014 the Ohio Supreme Court ruled in favor of Panther holding:
 - Motor carriers for hire, as regulated by the Ohio PUCO, are exempt from municipal net profit tax as imposition of this tax is expressly preempted by state statute.
- Implications for H.B. 5?

U.S. Supreme Court Weighs in....

- **Comptroller of the Treasury of Maryland v. Wynne (May 18, 2015)**
- U.S. Supreme Court sides with taxpayer, declares Maryland's denial of residence tax credit for income taxed by other states for Maryland "County Tax" purposes violates "dormant Commerce Clause" by discriminating against interstate commerce
 - Maryland not allowed to deny full residence tax credit on income taxed by other states, since Maryland also taxes non-residents on income earned in Maryland.
 - Maryland's tax is not "Internally Consistent" - if every other state used the same taxing scheme, interstate commerce would be taxed at a higher rate than intrastate commerce
