



# Memorandum

**To:** RITA Member Municipalities  
**CC:** Member Services and Don Smith, Executive Director  
**From:** Amy L. Arrighi, Amber E. Greenleaf and Robert Meaker  
**Date:** 12/12/2014  
**Re:** Substitute House Bill 5

Substitute House Bill 5 (the "Bill") has now passed both the Ohio House and Senate and is expected to be signed by the Governor at any time. Most provisions of the Bill go into effect January 1, 2016. Over the course of the next several months the Agency will be developing a model income tax ordinance and rules and regulations that incorporate the necessary provisions of the Bill and will be providing various educational opportunities to its members and other municipal officials as we prepare to administer the new provisions.

Set out in this memorandum is a brief summary of the provisions that are deemed to have the most significant impact on municipal income tax revenues and administration, and those that were the most heavily debated during the legislative process. We will soon be providing to our members a more comprehensive analysis of all of the provisions of the Bill, with line number and code section references that will assist you in navigating this very large piece of legislation. For your further reference, the Legislative Service Commission has issued its analysis of the Bill, which can be found at <http://www.lsc.state.oh.us/analyses130/h0005-rs-130.pdf>

## **General Assembly Restrictions/Home Rule Provisions**

The Bill specifically restricts the taxing powers of municipalities by prohibiting municipalities from levying an income tax unless that income tax is levied in accordance with Chapter 718 of the Ohio Revised Code.

## **Net Operating Loss Carryforward**

All municipalities will be required to allow a 5-year net operating loss carryforward ("NOL CF") beginning with losses incurred in tax year 2017. For those municipalities that do not have a NOL CF in place now, this means that CF losses will be allowed to offset current year taxable income beginning in tax year 2018.

For losses incurred in tax years 2017 through 2021, deductions for NOL CFs will be limited to 50% for tax years 2018 through 2022, and, to the extent not exhausted, will be allowed at 100% beginning with tax year 2023. All municipalities will apply this 50% phase-in, even those currently offering a 5-year NOL CF.



The Bill establishes the Municipal Income Tax Net Operating Loss Review Committee and membership on the Committee. The Committee is to evaluate and quantify the potential fiscal impact on municipalities of allowing the 5-year NOL CF and report its findings to the Ohio House and Senate leadership no later than May 1, 2017. The Committee is also to make recommendations to address or mitigate municipal revenue shortfalls that result from the NOL CF requirements.

### **Pass-Through Entities**

All pass-through entities (“PTEs”) will be taxed at the entity level. Individual owners of PTEs will report PTE gains and losses in their resident community, subject to the credit provided by the resident municipality.

### **Current-Year Offsets**

All municipalities will be required to allow resident individuals to offset current-year PTE losses against PTE gains and any other Schedule C, E or F income (and vice-versa) when calculating their municipal taxable income for residence tax purposes. Distributive share losses from an S-Corporation may only be allowed as a deduction if S-Corporation distributive gains are subject to tax in the municipality.

### **Transient Taxpayers (a.k.a. Occasional Entrant Rule)**

With some limited exceptions, non-resident employers will not be required to withhold municipal income tax from the wages of a non-resident employee for services performed in a municipality on 20 or fewer days in a calendar year. Once an employee reaches the 21<sup>st</sup> day of services performed in the municipality, the employer must withhold tax for the municipality beginning with the 21<sup>st</sup> day. The employer must withhold tax for the municipal corporation of the employee’s principle place of work for the first 20 days. The Bill defines a day for purposes of applying the rule.

An employer with less than \$500,000.00 of total revenue in the preceding year (defined as a “small employer”) is not required to withhold municipal income tax for any municipality other than the employee’s principal place of work, regardless of the number of days employees spend working in other municipalities.

### **Qualifying Wages**

The Bill makes several changes to the now uniform definition of “qualifying wages.” Qualifying wages is the uniform wage base for municipal income tax payment and withholding.

One change will require each municipality to ensure that its income tax ordinance, by December 31, 2015, is clear as to the municipality’s intent for the taxation or exemption of nonqualified deferred compensation plans and stock options.

The Bill also adds a new deduction of exempt income from the qualifying wage calculation, to the extent exempt income is included in the qualifying wage base. Items of income that are exempt from municipal income tax are contained in a separate section of the Bill.

### **Supplemental Executive Retirement Plans (SERPs)**

Nothing in the Bill directly determines whether SERPs (a type of nonqualified deferred compensation plan) are taxable wages or tax exempt pensions.

### **Assessments**

The Bill defines an “assessment” as being a written finding by the tax administrator that commences the taxpayer’s time to appeal a matter to the municipality’s local board of review and describes the notice requirements for any such assessment. An assessment does not include billing statements, requests for additional information, notifications of mathematical errors and the like. Tax administrators will be required to issue appealable assessments when denying refund claims made on an amended tax return. When denying refunds claimed on originally filed returns, tax administrators will not be required to issue an appealable assessment, but will be required to notify the taxpayer how the taxpayer can request an appealable assessment related to that refund denial.

### **Income Apportionment**

The Bill permits a net profit taxpayer to request the use of an alternative apportionment method on an originally filed or amended net profit return if the request is in writing and accompanies the return. The tax administrator may deny the request by issuing an appealable assessment to the taxpayer.

### **Local Board of Tax Review**

As is the case in existing law, municipalities must maintain a local board of tax review to hear taxpayer appeals. Beginning January 1, 2016, the makeup of these boards must be consistent with the Bill. The boards will be required to have three (3) members, two (2) of whom will be appointed by the legislative authority of the municipal corporation and one (1) who will be appointed by the top administrative official of the municipality. The two (2) appointed by the legislative authority may not be employees, elected officials or contractors of the municipality at any time during their term or the five (5) years immediately preceding the date of appointment. The member appointed by the top administrative official may be an employee of the municipal corporation, but may not be the director of finance, the tax administrator or any other employee involved in the administration of the municipal income tax.

### **Consolidated Returns**

The Bill makes significant changes to the way in which consolidated net profit returns are to be administered. Consolidated net profit filers will be permitted to decide, each tax year, whether or not the consolidated group will include certain profits/losses from PTEs in its filings. This will create uncertainty and complexity. The Bill also permits consolidated filers to opt-out of consolidated filing after five (5) years without the permission of the tax administrator.

### **Residency and Domicile**

The Bill codifies 25 factors that may be considered when determining whether or not an individual is domiciled in a municipal corporation for purposes of municipal income tax. Only these factors may be considered. One (1) factor includes consideration of the number of “contact periods” the individual has with the municipal corporation, but contains no number threshold above which the taxpayer is deemed to be domiciled in a municipality.



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### **Audits**

An “audit” is defined in the Bill as the examination of a person or the inspection of the books, records, memoranda or accounts of the person for the purpose of determining liability for a municipal income tax. The Bill also contains a separate section detailing the taxpayer’s rights before, during and after an audit.

Outside of the scope of an audit, the Bill is clear that tax administrators have the right to examine books, records, state and federal tax returns and to compel attendance and production of documents by subpoena in order to determine municipal income tax liability when a taxpayer has failed to file a municipal income tax return.

### **Increase to Minimums**

Under the Bill, no amounts under \$10 will be refunded or collected.

### **\$200 Minimum Estimates**

The Bill requires estimated payments only from taxpayers whose estimated liabilities exceed \$200.00. Estimated payments will be due quarterly on the 15th day of the fourth, sixth, ninth and twelfth months. This represents an acceleration of the final quarterly payment. The estimated payment deminimus provision will result in a negative impact on cash flow for tax year 2016 as payments that would otherwise be received as estimates during 2016 will be delayed until the filing of the tax year 2016 income tax return in April, 2017.

### **Gambling and Lottery**

The Bill provides that all winnings from lottery, gambling, sweepstakes, games of chance, prizes or awards, and the like, will be taxable. Only professional gamblers are permitted to take deductions against these winnings.

### **Taxpayers Under 18 Years of Age**

The Bill permits municipalities to grandfather their treatment of taxpayers under the age of 18 years. In municipalities that first impose a tax after January 1, 2016, the income of taxpayers under the age of 18 years will be taxable.

### **Throwback of Sales**

The Bill makes no modification to the sales throwback provision as it exists in current law.

### **Compliance and Enforcement Provisions**

The Bill maintains current enforcement options through the courts, with the same statutes of limitation in place today. The statutes of limitation will be tolled (the clock stops running) during the time period that a matter is under appeal at a local board of review or higher. Parties to litigation are responsible for their own attorney fees and litigation expenses; however, a municipality may recover from a taxpayer its post-judgment collection costs.



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The Bill provides uniform penalty (15% of tax for individuals and net profit filers, 50% of tax for withholders) and interest rates (Federal short-term rate plus 5%) and provides that any interest that must be paid to a taxpayer on a late-issued refund will be subject to the same interest rate that the municipality may charge for unpaid/late paid tax.

### **Uniform Filing Dates and Thresholds**

The Bill establishes uniform filing dates and thresholds for income tax withholding by employers and permits municipalities to require electronic submission from employers if the employer is required to make electronic submission at the federal level. The Bill ties the due date of the annual municipal income tax return to the due date for the state individual income tax return. And with respect to extensions, taxpayers receive an automatic extension at the municipal level if such an extension is taken at the federal level. Extended returns will be due on the same date that they are due at the federal level, which represents an acceleration of the due date as compared to current law. Under current law taxpayers on extension have an additional 46 days after the federal extension to file the extended municipal return.

Should you have any questions regarding the legislation, please contact the Member Services Department at 866.252.0913.