Municipal Tax Reform coming to Ohio

SUMMARY OF KEY PROVISIONS of Am. Sub. H.B. 5

Prepared by The Ohio Society of CPAs

- Requires municipal corporations levying an income tax as of January 1, 2016 to amend their existing income tax ordinances to include certain statements incorporating the bill's limitations.

- Establishes a uniform tax base applicable to all municipal corporations levying an income tax (with a few exceptions) by further defining the income that municipal corporations can tax and the income that they may not tax.

Net Operating Loss (NOL) Carryforward

- Requires all municipal corporations to allow businesses to deduct new net operating losses (NOL) and to allow a five-year carryforward of such losses first incurred in taxable years beginning on and after January 1, 2017, and permits pre-existing losses to continue to be carried forward if current ordinances allow.

- Phases in the NOL carryforward provision over a five-year period, with a 50% per year limit beginning in taxable year 2018 and delaying full utilization of carryforwards until taxable year 2023.
  - Creates a 13-member Municipal Income Tax Net Operating Loss Review Committee to quantify and recommend ameliorations for the potential fiscal impact to municipal corporations of requiring each to allow net operating losses to be carried forward for five years.

- NOL carryforwards will be calculated and applied on a pre-apportionment basis, but net operating losses will not include losses that are suspended for federal tax purposes (unutilized losses resulting from passive activity loss limitations, at-risk limitations, and basis limitations).

Pass-Through Entities

- Imposes the municipal net profits tax on a pass-through entity ("PTE") at the entity level, with the owner needing to file only in their city of residence. A major exception: allows the 119 municipalities who previously voted to tax resident S corporation owners at the shareholder level to continue that treatment.
- Gains and losses that are generated by a resident taxpayer's different pass-through entities and such taxpayer's own net profit reported on schedules C, E & F may offset each other during the year in which such gains and losses were generated. The offset provision only applies to resident individuals.
- Ensures that NOLs may be carried forward for five years by resident individuals, and that NOLs carried forward by a pass-through entity must be ignored for the purposes of calculating the amount of net profit passed through to the owner. Also, ensures that NOLs may be used by a taxpayer only once.

Occasional Entrant Treatment

- Modifies the "casual" entrant exemption to increase the number of days, from 12 to 20 per year, that an individual may work in a non-principle-place-of-business municipality without incurring income tax liability there, defines a day (preponderance standard – only withhold to one municipality per calendar day), and to further define how the exemption does not apply to professional athletes, entertainers, and public figures.
- Provides that the casual entrant rule applies to all compensation, and creates a separate exemption that prohibits the taxation of income of employees of businesses with less than $500,000 in annual revenue by any municipality other than the municipality where the business' fixed location is located.
- Requires a business that reasonably anticipates that it will be providing services in a municipality for 21 days or more in a calendar year to withhold municipal income taxes in that city for all employees from day one.
- Makes changes to the definition of principal place of work to provide a mechanism to determine how to allocate qualifying wages for employees who work the same number of days in two or more municipal corporations.
- Authorizes employers to voluntarily withhold from day one even if the 20-day rule would otherwise apply, and grandfathers existing agreements that were in effect prior to HB 5 and also allows employers and municipalities to enter into future agreements governing withholding without regard to the rule.

Administrative Procedures

- Allows a municipal corporation to treat an individual as a resident for municipal income tax purposes only if the individual is domiciled there, and adopts 25 generally recognized common law factors for determining an individual's domicile for municipal income tax purposes. This is different from the State of Ohio's "bright line" test.

- Authorizes taxpayers to use an alternative method of apportioning income and expressly allows tax administrators to require the use of an alternative method if the statutory formula does not fairly represent the extent of the taxpayer's business activity in a municipal corporation.
  - Prescribes that taxpayers will receive an automatic municipal tax filing extension if they timely filed a federal extension.

- Prescribes an income tax employer withholding schedule (monthly vs. quarterly) for all municipal corporations that depends on recent withholding amounts. Taxes must be remitted monthly if collected taxes exceeded $2,399 in the previous calendar year or exceeded $200 in any month during the previous calendar quarter. Otherwise the tax must be remitted quarterly. Municipalities can require taxes be remitted semimonthly if withheld taxes exceeded $11,999 – or $1,000 during any month – during the prior calendar year. Taxpayers with estimated annual tax liability to a city that is under $200 can pay annually.

- Requires all municipal corporations levying an income tax to comply with a uniform annual tax return filing schedule, with some exceptions. Synchronizes municipal return filing dates with state filing dates.

- Prescribes more specific rules for the filing of consolidated income tax returns by affiliated groups of corporations, including a requirement that such returns be prepared in the same manner as consolidated federal income tax returns. Grandfathers existing nexus combined elections and filing agreements in place prior to 2016.

- Requires municipal corporations to collect estimated taxes from all taxpayers whose estimated annual tax liability, will be more than $200 (or $50 per quarter) after subtracting for amounts to be withheld from the taxpayer's compensation. Does not apply if the taxpayer is a member of an exempted class or the tax administrator waives the requirement. Taxpayers with estimated annual tax liability to a city that is under $200 can pay annually.

- Provides that a municipal income taxpayer may receive a refund of overpaid taxes only if the amount overpaid is more than $10. Likewise, income and net profit taxpayers will not be required to remit tax due that is less than $10. However, even if the tax due is less than $10, taxpayers must still file the tax return.

- Bars civil actions to collect municipal income taxes after three years or, if an appeal was made, one year and 60 days after the appeal is finally determined.
- Limits the amount of penalties and interest (federal short-term rate plus 5%) that may be charged for the failure to file returns or pay taxes on time, and makes all penalties discretionary.
- Requires a municipal corporation to deliver final assessments to taxpayers via certified mail similar to the delivery of final assessments to state income taxpayers. No other mailings must be sent via certified mail.
- Prescribes municipal income tax audit procedures, limitations on the conduct of audits, and rights and remedies available to taxpayers subject to an audit similar to state laws
- Includes the full version of the state's Taxpayer Bill of Rights at the local level, including the offers in compromise process.
- Provides that Form 2106 expenses (unreimbursed employee business expenses) are deductible to the extent deducted for federal tax purposes.
- Adopts the "Mailbox Rule" for annual tax returns as well as for quarterly estimated tax returns, meaning taxpayers are considered to timely file any tax return if it is placed in the mail and postmarked by the due date.
- Creates the Municipal Income Tax Revenue Reporting Study Committee to study the feasibility of requiring municipal corporations to report the amount of revenue received from residents and non-residents.
- Retains the current law's "throwback" rule used by municipal corporations for sales factor apportionment purposes.
- Does not directly address the taxation of SERPs. As a result, the courts will decide whether a SERP is a "pension" (and, therefore, exempt) or not a pension (and, therefore, taxable).