

**Testimony of Thomas M. Zaino, CPA, JD**  
**on behalf of the**  
**Municipal Tax Reform Coalition**  
**Amended Substitute House Bill 5 – As Passed by the House**  
**Senate Finance Committee**  
**June 3, 2014**

Chairman Oeslager, Ranking Member Sawyer, and members of the Senate Finance Committee, thank you for this opportunity to appear before you today on behalf of the Municipal Tax Reform Coalition (“the Coalition”). My name is Tom Zaino. I am an attorney and CPA and I am very active in both the Ohio Chamber of Commerce and The Ohio Society of CPAs (“OSCPA”), having the honor of currently serving as Chair-elect for the Executive Committee of the Ohio Chamber and being nominated to serve next year as Chair-elect for OSCPAs Executive Board. Joining me today is Dan Navin of the Ohio Chamber of Commerce, Chris Ferruso of the National Federation of Independent Business/Ohio (NFIB), and Andrea Ashley of the Associated General Contractors of Ohio. We thank you for the opportunity to provide proponent testimony on Amended Substitute House Bill 5 (“Sub. H.B. 5” or “the Bill”), a dramatic piece of legislation that will enhance Ohio’s economic competitiveness, ensuring the ability of Ohio to attract, grow and retain jobs. I will provide some background and history regarding the development of Am. Sub. H.B. 5, summarize the major provisions contained in the Bill, and discuss a couple provisions in detail. My fellow presenters will provide more detail on specific provisions in the bill, especially as they relate to their members.<sup>1</sup>

Am. Sub. H.B. 5 simplifies and adds fairness to the municipal tax system, while also ensuring stable revenues for local government and making Ohio’s tax system more competitive with other states. These principles of simplicity, fairness, stability and competitiveness are cornerstones for a quality tax system.<sup>2</sup> Am. Sub. H.B. 5 creates a much better economic and business climate for present and future taxpayers in our state.

**Background:** The municipal income tax proliferated in the 1960s. As far back as 1967, policy makers were concerned about this proliferation of local taxes and its impact. The Ohio Tax Study Commission issued a report warning that “*local earned-income taxes have posed problems that are likely to become increasingly troublesome, in view of the growing number of communities employing the tax.*”<sup>3</sup> That prediction was prescient. Ohio is now one of only ten (10) states where municipalities assess and collect an individual and business income tax. However, these ten states, except Ohio and Pennsylvania, have no more than a handful of cities that impose a municipal income tax.

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<sup>1</sup> Throughout our testimony, we may use the terms “municipality,” “municipal corporation,” or “city.” Such terms are meant to be all-inclusive and to generally refer to both cities and villages, collectively.

<sup>2</sup> See: *Report of the Committee to Study State and Local Taxes*, generated in accordance with Am. Sub. Senate Bill 261 of the 124th General Assembly, March 1, 2003, page 6.

<sup>3</sup> Ohio Tax Study Commission Report 1967, June 8, 1967, at page 10. The Ohio Tax Study Commission was established by Amended House Bill No. 261 of the 106<sup>th</sup> General Assembly. The Commission consisted of member appointed by the Governor, Senate President and Speaker of the House, and hired research staff and consultants to assist in its comprehensive review of Ohio’s state and local tax structure.

<b>States with Cities that Assess and Collect Municipal Income Tax on both Individuals and Businesses<sup>4</sup></b>	
<b>STATE</b>	<b>NO. OF CITIES</b>
Alabama	3
Colorado	3
Delaware	1
Kentucky	8
Maryland	1
Michigan	22
Missouri	2
New York	2
Ohio	593 <sup>5</sup>
Pennsylvania	2,492 <sup>6</sup>

By comparison, about 600 municipalities impose the tax in Ohio.<sup>7</sup> Ohio is the only state where each municipality is permitted to create its own definition of income, to set its own rules and regulations, to mandate information required on its forms, and to establish its own audit and assessment process.

<b>No. of Municipalities that Impose a Tax<sup>8</sup></b>	<b>No. of Municipalities that participate in <i>Ohio Business Gateway</i><sup>9</sup></b>	<b>No. of Municipalities that do not participate in <i>Ohio Business Gateway</i><sup>9</sup></b>
592	572	20

Municipal income tax reform has long been a legislative priority for many in the business community. The current tax structure is an economic development barrier to retaining and attracting

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<sup>4</sup> Source: The Ohio Society of CPA's summary of Tax Foundation analysis - *Local Income Taxes: City- and County-Level Income and Wage Taxes; August 31, 2011.*

<sup>5</sup> This number does not include Joint Economic Development District (JEDD) or Joint Economic Development Zone (JEDZ) Tax Jurisdictions. Including such jurisdictions would increase the number of municipalities with an income tax to over 600.

<sup>6</sup> Although Pennsylvania has many more municipalities imposing a tax, essentially only three different local tax systems exist-- 1.) Philadelphia, 2.) Pittsburg, and 3.) all other cities.

<sup>7</sup> Approximately one-third of Ohio's cities and villages do not impose an income tax and would not be directly impacted by Am. Sub. H.B. 5 (based on information available on the Secretary of State's website dated April 13, 2011).

<sup>8</sup> *2013 Brief Summary of Ohio's Taxes*, Ohio Department of Taxation, p. 90. This amount includes cities and villages, but does not seem to include JEDDs or JEDZs, which would push the number of jurisdictions to over 600.

<sup>9</sup> Ohio Business Gateway, downloadable file containing data from all participating municipalities, <http://business.ohio.gov/efiling/help/MuniContact/MuniContactsList.aspx>. Note: Even though all cities are required to participate on OBG, twenty have ignored this requirement and have chosen to not participate.

jobs, as well as a costly regulatory burden for business and individual taxpayers. International site selectors have even identified our state's complex local tax structure as one of the top barriers to economic development in Ohio.<sup>10</sup>

The compliance burden is particularly acute for small businesses who cannot afford to hire dedicated staff or outside professionals to research the potentially 600 different definitions, rules and regulations. This adds an expense to doing business in Ohio that does not exist in any other state. In fact, for taxpayers who prepare and file their taxes in multiple municipalities, it is not uncommon for the cost of complying with the law to exceed the tax liability. Keeping up and complying with the myriad of differing definitions, rules, and regulations cost existing employers important resources that could be redirected to growing their businesses and creating more jobs, and puts Ohio at an economic disadvantage for attracting new employers and jobs. I think it is fair to note that two groups in Ohio are explicitly excluded from dealing with this complex and unmanageable municipal income tax system—the General Assembly members and staff, as well as certain judges.<sup>11</sup> All other state agencies and constitutional offices are required to comply with the municipal tax system.

**The Coalition:** Formed in 2012, the Municipal Tax Reform Coalition is a group of 33 state and local trade and professional associations and state and regional Chambers of Commerce (see Attachment A for a complete list of Coalition members). These members stand united behind one important goal—driving reform of Ohio's municipal income tax system in order to make Ohio more economically competitive and a more attractive place to invest and create jobs. Collectively, Coalition members represent over 365,000 Ohio business and professionals who are the lifeblood of Ohio's economy and are impacted most by the current structure.

**The Process:** The Coalition approached municipal income tax reform with the following criteria in mind:

- Parallel the state and federal tax law and definitions as much as possible, which adds to both uniformity and simplicity.
- Identify changes that will make Ohio's municipal tax system more competitive when compared to other states, making Ohio a better place to start and grow a business.
- Strive for overall statewide, revenue neutrality, to the extent possible and measurable.

Of course, many changes will not satisfy each criteria—criteria often compete against each other. In a political environment, proposed changes must be weighed against all the criteria and compromise must be achieved. Am. Sub. H.B. 5 represents such a compromise. Early in the process, the Coalition recognized that because there are so many existing variances from jurisdiction to jurisdiction, reform would necessarily result in some municipalities gaining revenue and others

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<sup>10</sup> Based on a 2012 Conference call between House leaders and international site selectors in New York and Chicago.

<sup>11</sup> R.C. 718.04(A)'s language was originally adopted in 1967 and provides that General Assembly members (including the Lt. Gov.) and its staff are only subject to municipal tax on their state wages in their city of residence. In 2009, R.C. 718.04(B) was adopted, which provides that justices of the Supreme Court are only taxed in their city of residence and the city of Columbus; and that judges sitting by assignment of the chief justice or as a district court of appeals judge sitting in multiple locations within the district, may only be taxed in their city of residence.

losing revenue. There is no getting around that fact if Ohio is to achieve greater municipal tax uniformity and simplicity. The Coalition absolutely did not approach this issue through the lens of mitigating individual and business tax liability. Our focus has been on making the tax system better and more competitive from a compliance perspective.

With these criteria in mind, for two and a half years Coalition members, represented by The Ohio Society of CPAs, the Ohio Chamber of Commerce, and NFIB, have worked with the bill's sponsors, Reps. Cheryl Grossman and Mike Henne, with representatives of the Ohio Municipal League, with many city tax and elected officials,<sup>12</sup> with the Regional Income Tax Authority (“RITA”) which collects taxes for over 200 Ohio municipalities, other business associations and their members, and many other interested parties.

Those lengthy negotiations culminated in the introduction of House Bill 601<sup>13</sup> (“H.B. 601”) in October 2012. Parties involved in the negotiations understood that H.B. 601 would not move before session ended later that year, but recognized that by introducing the bill, a broader constituency would have the opportunity to review and comment on their work. We all knew that H.B. 601 was a work in progress and that changes would continue to be negotiated and that the bill would be improved. That process culminated with the introduction during this General Assembly of H.B. 5 in January 2013. In spite of what you may have heard, the As Introduced version of H.B. 5 was NOT the same as H.B. 601, just as Am. Sub. H.B. 5 is not the same as its As Introduced version. The version of municipal tax reform that sits before this committee reflects years of effort and a tremendous amount of compromise by the Coalition. While we believe Am. Sub. H.B. 5 could still be significantly improved, we also know that the current version will go a long way to make Ohio's municipal income tax system more competitive.

Am. Sub. H.B. 5 reflects a long list of compromises made by the Coalition to address many of the concerns voiced by cities and villages across Ohio with regard to the H.B. 601 and the As Introduced version of H.B. 5. Below is a list of thirty points on which the Coalition has compromised. Disappointingly, I have yet to see a list of any compromises by municipal representatives.

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#### **List of Concessions by Municipal Tax Reform Coalition**

1. Instead of the originally proposed 20 year NOL carryforward (as currently provided for federal and state tax purposes), the carryforward period was limited to 5 years.
2. Delayed implementation of the NOL carryforward one more year and phased it in over 5 years.
3. Instead of a 30 day occasional entry rule (similar to currently pending federal legislation), the occasional entrant rule is limited to 20 days.
4. Language was added to treat temporary worksite locations or construction sites differently for purposes of the 20 day occasional entrant rule to address municipal concerns.

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<sup>12</sup> Just to name a few, officials from Akron, Athens, Bay Village, Bratenahl, Cleveland, Columbus, Dayton, Dublin, Indian Hill, Oakwood, and Upper Arlington have participated in this process with the Coalition.

<sup>13</sup> House Bill 601 of the 129<sup>th</sup> General Assembly.

5. Eliminated mandatory 100% credit requirement for taxes paid by PTEs to other municipalities and allows city to set own credit rate.
6. Eliminated language that specifically exempted SERPs from municipal income tax.
7. Eliminated several procedural provisions objected to by the municipalities, even those that would reduce the cost of administration for cities.
8. Eliminated requirement that a tax assessment which triggers a taxpayer's appeal period be sent by certified mail and clearly be marked as "Written Determination."
9. Removed statutory lien process, which would reduce cost of administration for municipalities.
10. Allowed cities to use local courts to enforce tax collections.
11. Eliminated Municipal Tax Policy Board.
12. Eliminated Problem Resolution Officer requirement for cities with more than 30,000 residents.
13. Eliminated cause of action for damages to a taxpayer which result from a tax agent improperly disclosing taxpayer information.
14. Permitted ability to appeal from a local board of tax review to the common pleas court (as well as the BTA).
15. Eliminated rule that would allow attorney fees to be awarded to the party (either the taxpayer or the municipality) that wins a tax appeal.
16. Eliminated uniform tax treatment for professional athletes.
17. Eliminated a minimum net profits threshold before filing is required.
18. Increased interest rate from long term federal rate plus 3% (as used by Ohio) to long term federal rate plus 5%.
19. Added requirement for state tax commissioner to provide data on municipal taxes of electric and telephone companies (which are collected by the tax commissioner) within an established time frame.
20. Replaced bright line presence test with a broad common law test for residency, meaning individuals who are not residents of Ohio can be taxed as residents of Ohio cities or villages.
21. Throwback rule was substantially reinstated.
22. Removed exemption of rental income from residency tax.
23. Added lottery winnings to tax base and eliminated ability to offset gambling wins and losses.
24. Allowed cities to decide whether to tax wages of those under 18.
25. Eliminated deduction for patronage dividends.
26. Added a notice requirement before a taxpayer can use an alternative apportionment formula.

27. Eliminated requirement that cities amend their tax ordinances to specifically adopt R.C. 718 by reference.
  28. Allowed members of local boards of tax review to be reappointed indefinitely.
  29. Required corporations to add back to income amounts paid as stock option income if the city exempts stock option income.
  30. Provides that the municipal members of the OBG Steering Committee will be appointed from a list provided by OML.
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I know that many opponents to the Bill will warn you and your Senate colleagues of dire budget challenges for Ohio cities if the integrity of the municipal income tax is undermined. We agree that the integrity of the municipal tax system must stay intact, which is one reason why we have agreed to no centralized collection. I have heard city advocates point to the fact that many non-Ohio cities have recently experienced devastating budget crises and expressed that Ohio's municipal tax system has helped Ohio cities to avoid such problems. Harrisburg, Pennsylvania and Detroit, Michigan, are certainly two major non-Ohio cities that come to mind when thinking about cities that have had significant financial troubles. I would like to point out, though, that it wasn't the lack of a municipal income tax that led to Harrisburg's and Detroit's problems. In fact, it must be noted that these two cities have robust municipal income tax systems. The Coalition certainly has no desire to negatively impact the financial integrity of our cities. Ohio cities have leaders that are very good stewards. Because of that, the Coalition knows that Am. Sub. H.B. 5 will not put our cities at financial risk.

Another important fact for you to weigh as you hear from opponents to the Bill, is that most of the changes impact the calculation of municipal income tax on the net profit of a business. Please note that, based on my understanding, the net profits tax generally accounts for roughly 10% to 20% of a typical municipality's income tax revenue. The other 80% to 90% is generally generated from the income tax on individuals, principally wages.<sup>14</sup> Therefore, when you hear city officials from your district tell you that the NOL and offset provisions will put cities "out of business," please clarify with them what percentage of their net profits tax they are estimating will be negatively impacted by these changes. If the amounts they use equate to substantial portions of their net profit's tax, then I would suggest that their estimates are in error. Ohio businesses make profits and will continue to be successful. Some estimates seem to assume that Ohio businesses will never make a profit—ever. Obviously, if this happens, Ohio will have a lot more problems than just the competitiveness of its municipal tax system.

**Important Elements:** Attachment B compares the original H.B. 5's major provisions to Am. Sub. H.B. 5's major provisions, makes observations about each provision, and provides the Coalition's position on each provision. As you can see, the Bill makes many changes to current law. I would like to highlight four major areas of change that you likely have already heard

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<sup>14</sup> Comprehensive and centralized data is not available. However, this range is based on 2012 Financial Statements of the Centralized Collection Authority (which administered the municipal income tax for 54 communities located in 19 counties) and CAFRs from Columbus, Dublin and Upper Arlington).

about, and that are very important to the Coalition because these areas directly impact the major barriers to economic development that result from Ohio’s current municipal tax system. These areas include the creation of uniform net operating loss carryovers, expansion of the occasional entrant rule from 12 to 20 days, simplification of pass-through entity treatment, and implementation of fair assessment and appeal procedures. I will also highlight a few other provisions contained in Am. Sub. H.B. 5 that are of concern to the Coalition.

**Net Operating Losses Carryforwards**

I would like to first explain what is meant by "Net Operating Loss (“NOL”) Carryforward." Michael Mazerov is a Senior Fellow at the Center on Budget and Policy Priorities. As you may also know, Mr. Mazerov is a noted commentator on state tax policy and is generally no friend of taxpayers. Yet, in a 2009 paper, even Mr. Mazerov acknowledged the purpose of permitting the carryforward of net operating losses.<sup>15</sup> In his paper, he offers the following:

*“[t]he basic rationale for allowing losses to be carried forward . . . flows from the recognition that businesses generally are established with the goal of making a profit over the life of the business rather than in any particular year.”*

He goes on to explain how the carryforward of losses permits, in essence, an averaging of income over a period of time. He provides a terrific example as to why carryforwards should be allowed, which I summarize as follows.

**Example:** If a business experiences 5 years of losses of \$1,000 per year, followed by 5 years of profits of \$1,000 per year, that business would pay income tax in the last half of that ten year period. However, if another company simply broke even each of those ten years, that company would owe no income tax. So, over a ten year period, each company made the same amount of profit (zero), but the first company paid income taxes and the other company did not. The following chart illustrates this example.

	<b>Company #1</b>	<b>Company #2</b>
<b>Year 1</b>	(\$1,000)	\$ 0.00
<b>Year 2</b>	(\$1,000)	\$ 0.00
<b>Year 3</b>	(\$1,000)	\$ 0.00
<b>Year 4</b>	(\$1,000)	\$ 0.00
<b>Year 5</b>	(\$1,000)	\$ 0.00
<b>Year 6</b>	\$1,000	\$ 0.00
<b>Year 7</b>	\$1,000	\$ 0.00
<b>Year 8</b>	\$1,000	\$ 0.00
<b>Year 9</b>	\$1,000	\$ 0.00
<b>Year 10</b>	\$1,000	\$ 0.00
<b>Total Profit</b>	<b><u>\$ 0.00</u></b>	<b><u>\$ 0.00</u></b>
<b>Tax Paid in City with No Carryforward</b>	<b>\$100</b>	<b>\$ 0.00</b>

<sup>15</sup> Mazerov, Michael, *Minority of States Still Granting Net Operating Loss “Carryback” Deductions Should Eliminate Them Now*, Center on Budget and Policy Priorities, Revised May 11, 2009, p. 3.

Is it fair for Company #1 to pay income tax and Company #2 to pay no income tax over that same 10 year period? Of course not. This is certainly the reason why the federal government, and every single state (that's 44 states plus the District of Columbia) that imposes an income tax, permit NOLs to be carried forward. That is also why it is so important for all Ohio cities to provide for a uniform NOL carryover.

About two-thirds of Ohio's cities already provide for some net operating loss ("NOL") carryforward period. Of those, nearly 85% provide a five-year carryforward period. The federal government and Ohio provide for a 20 year carryforward period.<sup>16</sup> The chart below provides more detail on municipal treatment of NOL carryforwards.<sup>17</sup>

<b>NOL Carryover Period</b>	<b>No. of Cities</b>	<b>Percentage of All Cities that Provide for NOL Carryovers</b>	<b>Percentage of All Cities that Impose an Income Tax</b>
0	174	n/a	32%
1	5	1%	1%
2	1	0.25%	0.2%
3	53	14%	10%
4	1	0.25%	0.2%
5	313	84%	57%
7	1	0.25%	0.2%
10	1	0.25%	0.2%

As you can see, two-thirds of Ohio's cities acknowledge the importance and fairness of this treatment because they currently provide for an NOL carryover. The average NOL carryover period for cities is nearly five years.<sup>18</sup> The Bill provides for a uniform five year NOL carryforward period for all municipalities.

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<sup>16</sup> See I.R.C. 172(b)(1)(A) and R.C. 5741.01(A). Federal tax law generally provides for the carryback of losses to two prior tax years, and then the carryforward of losses to the following 20 tax years, until fully utilized. Ohio adopts this treatment for individuals by incorporating the definition of federal adjusted gross income in R.C. 5751.01(A). Ohio also generally permitted a 20 year carryforward of losses for corporation franchise tax purposes in R.C. 5733.04(l)(1)(a).

<sup>17</sup> Source: *Ohio Business Gateway*, accessed October 28, 2013, <http://business.ohio.gov/efiling/help/MuniContact/MuniContactsList.aspx>.

<sup>18</sup> Source: *Ohio Business Gateway*, accessed October 28, 2013, <http://business.ohio.gov/efiling/help/MuniContact/MuniContactsList.aspx>.

The Coalition has supported three important changes from its original proposal that are contained in Am. Sub. H.B. 5. These changes are specifically designed to mitigate potential negative revenue impacts for those cities that do not currently provide for the carryover of NOLs.

- The NOL carryforward provision is delayed one year, meaning the Bill only applies to new NOLs generated in tax year 2016, rather than 2015. As a result, the first time a business's income or a city's revenue would be reduced by an NOL carryforward would be tax year 2017.
- The NOL carryover provision is further phased in at a 50% level over the following 5 years, from 2017 through 2021. With the one year delay, this provides a six year phase in, allowing cities to adjust to this change. The first year in which an NOL carryforward could be fully utilized is not until tax year 2022.
- The Bill provides for the creation of the Municipal Income Tax Net Operating Loss Review Committee ("Review Committee"). This committee will analyze actual municipal tax data from 2011 through 2013 and evaluate the potential impact of the NOL carryforward provisions on Ohio municipalities beginning in 2017 and going forward. The Review Committee will present its findings and any recommendations to address revenue impacts by May 1, 2015. Then, the General Assembly can act on those recommendations in the next biennial budget.

The Coalition supports these changes to the net operating loss carryover provisions of the As Introduced version of H.B. 5.

### **Occasional Entrant Rule**

Am. Sub. H.B. 5 provides a 20 day occasional entrant rule to replace the current law's 12 day rule. This 20 day rule goes a long way to protect employers that periodically, but not regularly, have employees working in a city, as well as employees that occasionally, but not frequently, work in a city. Such employers will not be required to withhold taxes on employees working less than 20 days per year inside a municipality. However, the employer will be required to withhold taxes for such days to the city in which the employee's "principal place of work" is located. Therefore, in almost all cases, tax will be collected and paid to an Ohio municipality, thus preserving overall city revenues.

The Bill also makes changes agreed to by the Coalition that address concerns raised by many city officials.

- Once an employee exceeds 20 days working in a municipality, the Bill permits employers to elect to withhold taxes for such employees back to the first day. Although this is not "uniform," providing flexibility on this treatment makes a lot of sense.
- The Bill ensures that tax will be withheld by contractors that operate a construction site or temporary worksite in a municipality for more than 20 days. Further, the Coalition agrees that this language could be improved by requiring contractors that reasonably expect to be

operating at the construction site for more than 20 days to withhold from the first day on its employees' wages.

- The Bill ensures that city income tax will be withheld and paid by the employee in almost all cases, either to the city in which the employee's principal place of work is located or the city of the employee's residence. The **ONLY** situation in which the first 20 days will go untaxed is if the employee's principal place of work is located in a nontaxable Ohio jurisdiction (like a township) AND the employee resides in a nontaxable jurisdiction. That situation is no different than what is experienced today under Ohio's 12 day occasional entrant provision.

Am. Sub. H.B. 5 also adds a feature recommended by municipal officials that was not contained in the As Introduced version of the Bill. A small business, one that has less than \$500,000 of gross receipts, will only be required to withhold taxes on its employees to the city in which the small business has its fixed location.

### **Pass-Through Entity ("PTE") Treatment**

Am. Sub. H.B. 5 also provides substantial changes to the treatment of pass-through entities<sup>19</sup> when compared to current law or when compared to the As Introduced Version of H.B. 5. Under the Bill, partnerships are taxed only at the entity level. The only exception to this rule is that flow-through income of a partnership is permitted to also be taxed in the hands of the partner (i.e., the owner) by the partner's city of residence. Of course, the partner may or may not receive a credit for taxes paid by the partnership to other municipalities on such income. S corporations will be treated the same as they are now treated under current law.

One aspect of these changes which I am sure you have or will hear about from city officials, is the treatment of gains and losses of pass-through entities which flow to resident owners. This concept is intertwined with the net operating loss provisions, but I will try to simplify things by discussing the offset as separate from the NOL provisions. The Bill provides that gains and losses flowing to resident owners will be permitted to offset each other in the year such gains and losses are incurred, similar to what is permitted at the federal and state level. City officials will question why losses incurred outside Ohio or even in another city should offset gains. However, these same officials see no problems with taxing gains generated outside Ohio or even in another city. Why is it appropriate tax policy to include all gains from wherever they are generated, but exclude all losses from wherever they are generated? When considering this question, please note two important points:

1. The offset provision only applies to tax imposed at the owner level and only with regard to the city in which the owner resides; and
2. The pass-through entity itself will be subject to municipal net profits tax on any income generated by that entity in a municipality.

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<sup>19</sup> The term "pass-through entity" is meant to include partnerships and limited liability companies not treated as an association taxable as a C corporation for federal income tax purposes, S corporations, and any other class of entity from which the income or profits of the entity are given pass-through treatment for federal and Ohio income tax purposes. "Pass-through entity" does not include trusts, estates, grantors of a grantor trust, or disregarded entities.

As a result of the Bill's changes, the municipal tax treatment of pass-through entities is greatly simplified. Chris Ferruso will provide more detail about how this simplifies filings and record keeping.

I would like to point out that Am. Sub. H.B. 5 significantly mitigates revenue concerns with the offset and net operating loss provisions by limiting the use of losses to true economic losses, not unrecognized paper tax losses. The mechanism used to address this concern is to prohibit losses that are "suspended" for federal tax purposes from being utilized to offset gains from other sources. Such "suspended losses" include losses resulting from federal basis limitations, at-risk limitations, and passive activity loss limitations. Please realize that most municipal corporations currently allow these paper types of losses to offset current year gains—therefore, this provision will result in a revenue increase for such municipalities.

### **Assessment and Appeal Procedures - Taxpayer Rights**

Am. Sub. H.B. 5 made significant changes to this part of the As Introduced version of H.B. 5. The changes proposed by municipalities that permit a higher interest rate and enhance tax penalty provisions certainly address many city concerns about ensuring enforcement of their tax; these changes are acceptable to the Coalition. However, the Coalition believes the taxpayer rights and the administrative appeal provisions have been substantially watered down. The Coalition strongly encourages that these basic due process rights—rights currently provided at the state level—should be reinstated by the Senate. Why would the General Assembly provide these basic rights to taxpayers at the state level, but not provide these same basic rights to taxpayers at the local level?

### **Other Provisions**

Am. Sub. H.B. 5 contains many other important provisions, including those that address the treatment of consolidated tax returns, the determination of residency, and filing thresholds. The Coalition is not entirely in agreement with many of the changes made in these areas either.

**Consolidated Tax Returns:** The Bill provides that a tax administrator may force taxpayers to file on a combined basis in certain situations. While the Coalition acknowledges that this type of authority is appropriate, the criteria provided in the statute is much too broad and needs narrowed to avoid overzealous use of this provision.

**Residency:** The Bill's residency provisions provide very little clarity to taxpayers or cities when compared to current common law. The Coalition supported a bright-line residency test, similar to that used at the state level. It is difficult for taxpayers to understand how they can be a resident of Ohio city when they are not a resident of Ohio. The Bill does nothing to clarify this dilemma. In fact, I believe the Bill actually leads to less certainty than current law.

**Filing thresholds:** The House failed to include *deminimus* filing and payment thresholds for net profits tax purposes. Such thresholds should be adopted in order to ensure that the cost of compliance does not exceed the actual tax due from taxpayers.

Technical Corrections: There is a need for some technical corrections to the Bill. We are expecting to meet with city officials to discuss the truly technical problems and will present solutions to the Committee.

**Conclusion:** I believe, at this point, that the members of this Committee understand the barriers the current municipal tax system creates for businesses and individuals. I testified three times in the House on H.B. 5, have attended many other hearings in the House, and I attended last weeks hearing before this Committee. One question that I did not hear asked in any of these hearings was why Ohio must maintain a municipal tax system that is so unique in all the nation and so burdensome on individual and business taxpayers? We don't—Am. Sub. H.B. 5 represents a positive step to resolving this question.

The provisions of Am. Sub. H.B. 5 will benefit taxpayers, Ohio municipalities, and the state of Ohio. Taxpayers will enjoy greater consistency across all taxing municipalities, easing their compliance costs. Municipalities will enjoy the benefits of improved taxpayer compliance because the system will be simpler and municipal tax officials will have new tools to ensure taxpayer compliance. The state of Ohio will enjoy a more competitive tax system, allowing it to better compete for the jobs our state needs to grow and thrive.

Thank you for allowing me this time to discuss the Coalition's view of Am. Sub. H.B. 5. Mr. Chairman, once we all complete part of this testimony, we would be happy to answer any questions of you or other members of the committee. At this time, I would like to introduce Dan Navin of the Ohio Chamber of Commerce to continue our testimony.

Attachment A

*Municipal Tax Reform Coalition Members*

- The Ohio Society of CPAs
- Ohio Chamber of Commerce
- National Federation of Independent Business/Ohio
- Ohio Council of Retail Merchants
- Ohio Manufacturers' Association
- Ohio Association of REALTORS
- Ohio Contractors Association
- Associated General Contractors of Ohio
- Associated Builders and Contractors of Ohio
- Ohio Trucking Association
- Ohio Newspaper Association
- Ohio Cable Telecommunications Association
- Ohio Oil and Gas Association
- Ohio Restaurant Association
- Ohio Insurance Institute
- Ohio Home Builders Association
- The Ohio Nursery & Landscape Association
- National Electrical Contractors Association - Central Ohio, Greater Cleveland, and North Central Ohio Chapters
- Ohio Automobile Dealers Association
- Ohio Produce Growers & Marketers Association
- Ohio State Bar Association
- Ohio State Medical Association
- Greater Ohio Policy Center
- Columbus Chamber of Commerce
- COSE
- Cincinnati USA Regional Chamber of Commerce
- Dayton Area Chamber of Commerce
- Toledo Regional Chamber of Commerce)
- Ohio Pharmacists Association
- Ohio Grocers Association
- Professional Independent Agents Association of Ohio