Ohio House Ways and Means Considers Substantially Watered-Down Municipal Income Tax Reform

By
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This year, the Ohio House Ways and Means Committee has the opportunity to consider changes to their municipal income tax code, which is the most complex local income tax structure in the United States. Unlike any other state that levies local individual income taxes, Ohio problematically allows over 600 municipalities to define tax bases and set their own rules for collection, auditing, and income calculation.

This creates substantial compliance burdens associated with income tax filing, withholding, and accounting which are especially prevalent in industries where employees travel between municipalities in the course of their duties. As an example, one Ohio electrical contractor once filed 221 W-2 forms for 19 employees, along with 39 business returns, most having a tax charge of $5 or less.¹

One bill, HB5, has been in the Ohio House Ways and Means Committee for several months and represents a start at addressing some of the more uniquely egregious portions of the state’s municipal income tax practices.²

In recent days, a substitute bill (LSC 130 1581-2) has been introduced that substantially alters many of the provisions of HB5, keeping just a few positive aspects and changing many provisions for the worse. Here, we list the substantive changes and provide commentary on how the changes will affect reform efforts this year and in years to come.³

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³ For a fuller analysis, see Ohio Legislative Service Commission, Sub. Bill Comparative Synopsis of H.B. 5. 130th General Assembly (House Ways & Means), Doc. R-130-2278.
Substitute Bill Retains Few Beneficial Provisions of Original

Both bills:

- Require municipalities to eventually allow a five year carryforward of net operating losses. These provisions allow businesses and individuals with cyclical income to have tax rates that track their average income and thus permit them to avoid being sharply taxed during highly productive years. Still, a five year standard is very short compared to the nation-wide standard of twenty years.

- Include a casual exemption rule, which means that municipalities may not tax the income of employees who work fewer than twenty days in a municipality. However, there are several nuances to this law. For example, an employer may elect to withhold taxes for all days a nonresident works in the municipality (including the first twenty days), and the taxpayer would have to seek a refund later if the tax ends up not being owed.

The Substitute Bill Substantially Limits Many Positive Reforms of Original

The substitute bill:

- Eliminates the Municipal Tax Policy Board set forward in HB5, which would be tasked with bringing uniformity to the municipal forms and other documents in an aim to reduce compliance costs of taxation.

- Allows pass-through entities to be taxed at the entity level and also allows owners to be taxed on a share of their profits. This double taxation was avoided in HB5, which eliminated taxation of pass-throughs at the entity level.

- Would allow non-uniform taxation of employees under eighteen years of age by allowing, but not requiring, municipalities to exempt their income from taxation.

- Eliminates the requirement that individuals be both domiciled in a municipality and be an Ohio resident under the state’s "bright-line" residency test in order to be treated as a resident for municipal income tax purposes. The substitute bill only requires that an individual be domiciled in a municipality.

- Retains the five year net operating loss carryforward provision but slows the phase-in of the rule from 2020 until 2022. Further, instead of phasing in gradually between 2015 and 2020, taxpayers will only be allowed to deduct half of the net operating losses between 2017 and 2021, with the full carry-forward beginning in 2022.
Many Poor Tax Practices in Ohio’s Local Income Taxes Remain Overlooked

Neither HB 5 nor the proposed substitute bill include:

- A provision to prevent taxation in multiple jurisdictions on the same dollar of income. Currently, municipalities are allowed to choose whether or not to offer a credit against taxes paid to other municipalities, resulting in double taxation if a municipality does not offer credits.

- A uniform structure for how credits should be calculated when they are given. This increases compliance costs on tax filers and adds confusion for professionals who must file in multiple jurisdictions.

- A cap on municipal tax rates that are customary in most states’ local income and sales tax codes.

- Reasonable filing thresholds. Both HB5 and the substitute bill require taxpayers to file a return to a municipality even when they do not owe enough tax to meet the minimum payment threshold ($5 in HB5, $10 in the substitute bill). This results in situations where taxpayers are filling out tax forms for unreasonably low tax bills.

Conclusion

Of the seventeen states that levy local income taxes, Ohio subjects its taxpayers and businesses to the most complex laws. In Maryland, the local income tax compliance is just five simple lines on the state income tax form. By contrast, Ohioans spend valuable time and money each year complying with a system that lacks uniformity or concrete rationale. The consideration of municipal income tax reform was the bright spot of tax discussions in Ohio this year, but this recent effort represents a watered-down attempt to declare victory on a complex issue that deserves real legislative attention.
## Appendix

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<th>HB 5 as Proposed</th>
<th>Substitute Version LSC 130 1581-2</th>
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<tr>
<td><strong>1) Taxation of Pass-through Entities</strong></td>
<td><strong>a) The bill would end municipal taxation of pass-through entities at the entity level. Municipalities would be prohibited from levying a tax on corporations at the entity level. Pass-through entities doing business in a municipality that levies an income tax would be required to withhold and pay the tax on behalf of all of the owners of the entity. (§§718.01(D)(4), 718.43)</strong></td>
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<td><strong>2) Net Operating Loss Carry Forward</strong></td>
<td><strong>a) Municipalities would be required to allow a 5 year carryforward of net operating losses. The requirement would be phased in over 5 years starting in 2015 and would begin in full in 2020. (§718.01(E)(8))</strong></td>
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<td><strong>3) Individuals Under 18</strong></td>
<td><strong>a) Would exempt from taxation all income earned by individuals under 18, except for qualifying wages. (§718.01(C)(14))</strong></td>
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<td><strong>4) Nonresident Income Exemption</strong></td>
<td><strong>a) No provision</strong></td>
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<td><strong>5) Residence and Domicile</strong></td>
<td><strong>a) A municipality may only treat an individual as a resident for municipal income tax purposes if the individual is domiciled in the municipality and is an Ohio resident for state income tax purposes. Ohio residency is determined under the state's &quot;bright-line&quot; residency test. (§718.01(J))</strong></td>
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<td><strong>6) Casual Entrant Rule</strong></td>
<td><strong>a) Prohibits a municipality from taxing the income of a nonresident individual who works in the municipality for 20 days or fewer in a year. (§718.01(C)(15)). There are nuances to this provision that make the 20 day rule somewhat complicated.</strong></td>
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<td><strong>7) Minimum Payment and Filing Threshold</strong></td>
<td><strong>a) Provides that an individual is only required to pay tax to a municipality if the taxpayer owes more than $5. However, even if the taxpayer owes less than $5 they must still file the return. (§§718.05(F)(1), 718.19).</strong></td>
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