

*The Greater Dayton Mayors and Managers Association in collaboration with the Dayton Area Tax Administrators Association, has analyzed areas of non-uniformity in local tax laws related to municipal income tax collections, enforcement, penalties and compliance. The following discussion outlines areas of non-uniformity and proposed ways to bring all southwest Ohio communities into consensus. It is envisioned that these proposed changes, once adopted by southwest Ohio communities, will serve as a model that the state of Ohio Legislature can apply statewide. Note that “City Option” discussions are areas where there needs to be non-uniformity to minimize significant negative revenue impact to municipalities.*

## **I. Due Dates**

Current Situation: Currently, there is no uniformity between communities regarding due dates for municipal income tax filings. Communities have adopted different due dates suited to their individual needs.

Proposed Uniformity: Make all municipal return filings consistent with federal due dates. For simplicity of preparation (for the business / preparer) and administration (by each municipality), due dates for tax return filings, estimated tax payments and returns filed under extension should follow the same due dates as the corresponding filing for federal purposes. Current law provides for due dates that may vary from federal dates. Uniform due dates have been suggested for the following:

- Returns filed under extension through the Ohio Business Gateway (business) (ORC 718.051)
- Returns filed under extension with individual cities or TPA's (Third Party Administrators) - (business and individual) (ORC 718.05)
- Tax returns filed through the Ohio Business Gateway (business) (ORC 718.05)
- Returns filed with individual cities or TPA's (business and individual). (ORC 718.05)
- Estimated tax payments for businesses (ORC 718.08)
- Estimated tax payments for individuals (ORC 718.08)
- Withholding tax payments (ORC 718.03) (See separate section)
- Reconciliation of Returns (ORC 718.03) (See separate section)

### Impact:

This will have minimal impact on municipalities, and will benefit taxpayers and preparers by providing consistency.

### Proposed Regional Ordinance Language:

*Each person who engages in business or other activity or whose qualifying wage, commissions, other compensation and other taxable income is subject to the tax imposed by this Chapter, and every resident shall, whether or not a tax be due thereon, make and file a return on or before the corresponding due date for the Federal income tax return, with the Tax Administrator a Municipal tax return on a form prescribed by and acceptable to the Tax Administrator, whether or not a tax is due. When the return is made for a fiscal year or other period different from the*

*calendar year, the return shall be due on or before the corresponding due date for the Federal income tax return.*

This proposed language requires that all business net profit and individual tax returns are due by the corresponding due date for the Federal income tax return.

Proposed Regional Ordinance Language:

- A. *The Tax Administrator may determine, by Administrative Rule or Ordinance, the frequency by which an employer is required to remit withholding tax to the Municipality. Such withholding may be required on a monthly, quarterly or semi-monthly basis. The Tax Administrator may determine, by Administrative Rule or Ordinance, the threshold by which an employer would be required to remit under each frequency, and which frequencies would apply to the Municipality. Due dates for remittance of withholding tax shall be:*
- a. *Monthly Withholding. When Monthly Withholding is required, each employer shall, on or before the fifteenth day of each month, make a return and pay to the Tax Administrator the amount of taxes so deducted during the preceding month.*
  - b. *Quarterly Withholding. When Quarterly Withholding is required, each employer shall, on or before the fifteenth day of each month following the calendar quarters ending March 31, June 30, September 30 and December 31, make a return and pay the tax withheld during the preceding calendar quarter.*
  - c. *Semi-Monthly Withholding. When Semi-Monthly Withholding is required, each employer shall, on or before the fifth business day following the fifteenth and the last day of each month, make a return and pay to the Tax Administrator the amount of taxes so deducted during the preceding semi-monthly period.*

This proposed language allows the municipality to determine the withholding frequency and thresholds, but requires uniform dates for those frequencies.

Proposed Regional Ordinance Language:

- A. *Withholding Return; List of Employees. Each employer shall file a withholding tax reconciliation showing the sum total of all compensation paid all employees, the portion of which, (if any) was not subject to withholding along with an explanation for same, and the portion of which was subject to withholding, together with the amount of such withholdings remitted. Such return shall include information concerning each employee from whom the Municipal tax was withheld, showing the name, address, zip code and social security number of each such employee, the total amount of compensation paid during the year and the amount of Municipal tax withheld. A copy of each employee W-2 is required. If the total tax withheld from any employee-included tax withheld and remitted to another municipality, the amount of same shall be separately shown on the return of information to the Municipality concerning each employee. The withholding tax reconciliation shall be filed by each employer on or before February 28 following the end of such calendar year. The Tax Administrator may require the filing of such reconciliations and employee information by alternate media.*

- B. In addition to the wage reporting requirements of this section, any person required by the Internal Revenue Service to report on Form 1099-Misc. payments to individuals not treated as employees for services performed shall also report such payments to the Municipality when the services were performed in the Municipality. The information may be submitted on a listing, and shall include the name, address and social security number (or federal identification number), and the amount of the payments made. Federal form(s) 1099 may be submitted in lieu of such listing. The information shall be filed annually on or before February 28 following the end of such calendar year.*

This proposed Ordinance language provides that all Reconciliation of Returns will be due by February 28<sup>th</sup> of each year for reporting of the previous calendar year, and this section also provides for the mandatory requirement that Form 1099's issued services performed in the Municipality also be remitted by February 28<sup>th</sup> of each calendar year for reporting of the previous calendar year.

Proposed Ordinance Language for due dates as specified for returns filed through the Ohio Business Gateway, returns filed under extension, and estimated tax payments for businesses and individuals cannot be drafted until statutory changes are made to ORC 718 accordingly.

#### DUE DATES

Statutory language should be drafted to provide for the following changes in due dates in Ohio Revised Code Section 718:

1. Returns filed through the Ohio Business Gateway. Returns filed by any business entity through the Ohio Business Gateway are required to be due on the same date that the corresponding federal income tax return is due. An electronic copy of the federal return must be sent via electronic format to the municipality on the same day. This can be accomplished by e-mail attachment, or through a portal to be created by the Ohio Business Gateway to accept a pdf copy of the federal return. The Ohio Business Gateway must provide a pdf attachment to be sent by the taxpayer, and transmitted via the Gateway to each municipality. The Ohio Business Gateway will provide this function with all business entity returns filed on and after 1/1/14. This will allow a taxpayer to attach an electronic copy (pdf) of their federal return to the Gateway filing, and this electronic copy (pdf) of the tax return will be transmitted to each municipality.
2. Returns filed under extension. Taxpayers must secure an approved Federal Extension for this section to apply. Each municipality will accept a copy of the federal extension as an attachment to the filing of the city income tax return. The due date for any return filed under extension will be the due date for the corresponding federal income tax return filed under extension. No extension request will be required prior to the filing of the city return which is automatically extended due to the approved federal extension. Where an extension has been secured electronically, a printed copy of the confirmation will be required as an attachment to the city income tax return. Any city return filed beyond the original due date of the city return will be required to have a copy of the federal extension request and/or confirmation as an attachment. Failure to include these with the filing of the return will require the automatic assessment of applicable penalty, interest and late

filing fee charges for failure to timely file the municipal income tax return. An extension of time to file will not extend the due date for applicable payments to be made.

3. Due dates for estimated tax payments for business entities and individuals will follow the same due dates as the corresponding payments for federal purposes. A taxpayer will be required to have 90% of their current year liability or 100% of previous tax year's liability met by January 31<sup>st</sup> of each year for the preceding calendar year, or by the end of the 13<sup>th</sup> month for the previous fiscal year in order to avoid applicable charges for underpayment of estimated tax.

## ***II. Extensions***

Current Situation: Ohio Revised Code Section 718 requires that an extension of time to file an annual income tax return must be filed with each municipality by the original due date of the tax return. If an individual files an extension of time to file, the extension must be received by 4/15. The return is due to the IRS by 10/15 and additional time is allowed to 11/30 to file the city return.

Proposed Uniformity: Returns filed under extension will follow federal due dates. Currently, there is 45 days allowed beyond the federal due date but this will be eliminated. Extension requests will not have to be filed by the original due date. A copy of the Federal extension needs to be attached to the filing. Payments will still need to be paid by the due date. Extension requests will be an attachment to the return when it is filed under extension. Changes will require legislation to change ORC 718.

### Impact:

This will have a negative impact for those municipalities who currently begin their delinquency projects prior to November of each year. Since the municipality will not know which taxpayers have an extension, and which have just failed to file their tax return, sending delinquency letters for failure to file a tax return cannot be sent out until after the extended due date. Sufficient time will be necessary to process all of the returns that are received under extension. Only then will a municipality be able to determine who has failed to file a tax return, and delinquency processes can begin. Because of this delay, and the fact that municipalities have a strict Statute of Limitations under which to pursue either a known balance due or a non-filed tax return, this delay will shorten the amount of time that a city has to pursue delinquency under the Statute of Limitations. It does not make this impossible to pursue, it just creates a shorter window of opportunity under which to perform delinquency work. As an administrative benefit, it lessens the burden of each municipality to process separate extension request forms during peak filing season, allowing more time to focus on incoming tax return filings.

For taxpayers, this is a cost savings (since the request will not have to be filed separately by the original due date) and for preparers, it will save them considerable time during the tax season, as they will not have to prepare extension requests and remit prior to the original due date.

Proposed Ordinance Language for due dates as specified for returns filed under extension cannot be drafted until statutory changes are made to ORC 718 accordingly.

Statutory language should be drafted to provide for the following changes for returns filed under extension in Ohio Revised Code Section 718:

Returns filed under extension. All tax returns filed, by any method, will be required to adhere to the same provisions. (Section 718.051 of the ORC should be repealed). Taxpayers must secure an approved Federal Extension for this section to apply. Each municipality will accept a copy of the federal extension as an attachment to the filing of the city income tax return. If the return is filed electronically, or via the Ohio Business Gateway, the copy of the extension request must also be included. The Ohio Business Gateway will, by 1/1/2014, provide a method by which a pdf version of the secured extension request or confirmation may be sent to each municipality with the filing of the tax return. A taxpayer sending a return electronically directly to the municipality will be required to provide verification upon request of the tax administrator of the secured extension request, or the tax administrator may provide a method by which the taxpayer will be required to remit the verification with the tax filing. The due date for any return filed under extension will be the due date for the corresponding federal income tax return filed under extension. No extension request will be required prior to the filing of the city return which is automatically extended due to the approved federal extension. Where an extension has been secured electronically, a printed copy of the confirmation will be required as an attachment to the city income tax return. Any city return filed beyond the original due date of the city return will be required to have a copy of the federal extension request and/or confirmation as an attachment. Failure to include these with the filing of the return will require the automatic assessment of applicable penalty, interest and late filing fee charges for failure to timely file the municipal income tax return. An extension of time to file will not extend the due date for applicable payments to be made.

### ***III. Estimated Tax Payments***

Current situation: Historically, there have been a few changes to the due dates for estimated tax payments and some cities have elected to leave their dates as previously stated. This creates confusion for taxpayers and preparers who need consistency in estimated payment due dates.

Proposed Uniformity: For business and individual filers, estimated tax payments will be due the same as federal estimated tax payment due dates.

Impact:

This will have minimal impact on municipalities, and will benefit taxpayers and preparers by providing consistency.

Proposed Ordinance Language for due dates as specified for estimated tax payments for businesses and individuals cannot be drafted until statutory changes are made to ORC 718 accordingly.

Statutory language should be drafted to provide for the following changes for estimated tax

payments in Ohio Revised Code Section 718:

Due dates for estimated tax payments for business entities and individuals will follow the same due dates as the corresponding payments for federal purposes. A taxpayer will be required to have 90% of their current year liability or 100% of previous tax year's liability met by January 31<sup>st</sup> of each year for the preceding calendar year, or by the end of the 13<sup>th</sup> month for the previous fiscal year in order to avoid applicable charges for underpayment of estimated tax.

#### ***IV. Withholding***

Current situation: Each city has the ability to determine whether they require monthly, quarterly or semi-monthly withholding payments, or any other frequency that they wish. Cities vary in their threshold (i.e., the minimum amount due before withholding is required) for requiring different frequencies, but this difference is due to cash flow needs of the municipality. More confusing for taxpayers and preparers is the differences in due dates. For example, cities that require a monthly withholding might be due on the 10<sup>th</sup>, 15<sup>th</sup>, 20<sup>th</sup> or last day of the following month. This inconsistency of the due is the biggest concern when it comes to compliance.

#### Proposed Uniformity:

- All monthly payments will be due by the 15<sup>th</sup> of the month following the month subject to withholding, quarterly will be due by the 15<sup>th</sup> of the month following the quarter subject to withholding, and semi monthly will be due within five business days after the 15<sup>th</sup> and the end of each month.
- City option: Cities will have the option to determine the threshold for withholding frequency. For example, a city can determine to require monthly withholding once the amount withheld exceeds \$100 in a month. Another city may determine that all withholding accounts remit on a monthly basis. The due dates, which have been inconsistent in the past, will now be uniform for all cities based on the frequency of withholding.

#### Impact:

Tax preparers will need to know the frequency and thresholds required for each municipality. This will provide much greater consistency when a preparer files in multiple cities, as due dates are consistent. Currently, municipalities may require monthly filers to pay by the 10<sup>th</sup>, 15<sup>th</sup>, 20<sup>th</sup>, or last day of the month. With this change, as long as the preparer knows the City option, all monthly payments for all cities are due on the same date. For municipalities, this will have slight cash flow implications for the first year with the change in dates, but will be minimal.

#### Proposed Regional Ordinance Language:

- B. The Tax Administrator may determine, by Administrative Rule or Ordinance, the frequency by which an employer is required to remit withholding tax to the Municipality. Such withholding may be required on a monthly, quarterly or semi-monthly basis. The*

*Tax Administrator may determine, by Administrative Rule or Ordinance, the threshold by which an employer would be required to remit under each frequency, and which frequencies would apply to the Municipality. Due dates for remittance of withholding tax shall be:*

- d. Monthly Withholding. When Monthly Withholding is required, each employer shall, on or before the fifteenth day of each month, make a return and pay to the Tax Administrator the amount of taxes so deducted during the preceding month.*
- e. Quarterly Withholding. When Quarterly Withholding is required, each employer shall, on or before the fifteenth day of each month following the calendar quarters ending March 31, June 30, September 30 and December 31, make a return and pay the tax withheld during the preceding calendar quarter.*
- f. Semi-Monthly Withholding. When Semi-Monthly Withholding is required, each employer shall, on or before the fifth business day following the fifteenth and the last day of each month, make a return and pay to the Tax Administrator the amount of taxes so deducted during the preceding semi-monthly period.*

This proposed language allows the municipality to determine the withholding frequency and thresholds, but requires uniform dates for those frequencies.

#### ***V. Annual Reconciliation of Returns***

Current situation: Cities have consistently used two different due dates for employers to submit an annual Reconciliation of Returns with copies of employee W-2's: either 1/31 or 2/28. Employers are required to have W-2's to their employees no later than 1/31. Additional time to prepare the annual Reconciliation should be provided so that employers have sufficient opportunity to remit a complete annual Reconciliation of Returns to each municipality.

#### Proposed Uniformity:

Returns will be due 2/28 of each year. If the number of W-2's submitted exceeds 100, the Reconciliation should be filed electronically based on the Federal Annual Reconciliation format. This achieves uniformity and is business friendly.

#### Impact:

This has no cash flow impact to municipalities, and provides consistency for preparers who now have to comply with either a January 31<sup>st</sup> or February 28<sup>th</sup> due date from city to city. For municipalities that input each individual W-2 into their tax system for comparison during the filing season, it will create some difficulty in getting this accomplished.

#### Proposed Regional Ordinance Language:

- C. Withholding Return; List of Employees. Each employer shall file a withholding tax reconciliation showing the sum total of all compensation paid all employees, the portion of which, (if any) was not subject to withholding along with an explanation for same, and the portion of which was subject to withholding, together with the amount of such withholdings remitted. Such return shall include information concerning each employee*

*from whom the Municipal tax was withheld, showing the name, address, zip code and social security number of each such employee, the total amount of compensation paid during the year and the amount of Municipal tax withheld. A copy of each employee W-2 is required. If the total tax withheld from any employee-included tax withheld and remitted to another municipality, the amount of same shall be separately shown on the return of information to the Municipality concerning each employee. The withholding tax reconciliation shall be filed by each employer on or before February 28 following the end of such calendar year. The Tax Administrator may require the filing of such reconciliations and employee information by alternate media.*

- D. In addition to the wage reporting requirements of this section, any person required by the Internal Revenue Service to report on Form 1099-Misc. payments to individuals not treated as employees for services performed shall also report such payments to the Municipality when the services were performed in the Municipality. The information may be submitted on a listing, and shall include the name, address and social security number (or federal identification number), and the amount of the payments made. Federal form(s) 1099 may be submitted in lieu of such listing. The information shall be filed annually on or before February 28 following the end of such calendar year.*

This proposed Ordinance language provides that all Reconciliation of Returns will be due by February 28<sup>th</sup> of each year for reporting of the previous calendar year, and this section also provides for the mandatory requirement that Form 1099's issued services performed in the Municipality also be remitted by February 28<sup>th</sup> of each calendar year for reporting of the previous calendar year.

## ***VI. Twelve Day Rule***

Current situation: The 12-day rule as outlined in ORC 718 is uniform. Confusion exists in determining a "day" for purposes of calculating when the 12 days apply. This change will require a legislative change to ORC 718.

### Proposed Uniformity:

- Clarify language specifying that employees working twelve (12) days or less in any taxing jurisdiction would not be subject to the tax. The definition of "a day" has been established to prevent any employee from being subject to multiple taxing jurisdictions on the same day.
- Clarify language in defining a "day," which should be where the employee spends the preponderance of their day. Only when the employee has spent the preponderance of their day in a given municipality does that day then count as "day" toward determining the 12 day rule.

### Impact:

No matter how many days / hours are required prior to tracking, there will always be a requirement to track. This will, however, eliminate the requirement to withhold and pay on those employees who do not meet the "preponderance of a day" test. For example, the florist



who sends an employee to various cities throughout the day, but the driver also arranges flowers, they will only count their day in the location where they spend the preponderance of their day. In most cases, this will be where the shop is located. This will relieve the burden tremendously for those employers who have employees who travel in and out of cities each day to withhold for each location, again based on the “preponderance” test. This will have a negative impact on revenue, as the current law does not define a day, requiring any portion of a day to count as one day. There is no way to calculate a definitive percentage of revenue loss. It is not estimated to be significant.

Proposed Ordinance Language for 12-Day Rule cannot be drafted until statutory changes are made to ORC 718 accordingly.

Statutory language should be drafted to provide for the following changes in the 12-Day Rule in Ohio Revised Code Section 718:

This section shall not apply when a taxpayer is working in their principal place of employment only. This section shall only apply to taxpayers who are required to work in multiple work sites to perform their job specific duties, and shall not apply for taxpayers whose only travel is for meetings or conferences, unless their specific responsibilities are to administer meetings or conferences. Travel or in transit time between municipalities is not considered when determining preponderance of a day. Statute shall provide that a taxpayer, for municipal income tax purposes, must spend a preponderance of their day in a given municipality to be considered as their taxable situs for that day. For these traveling taxpayers, only one municipality per day shall be considered as their taxable place of employment, based on a preponderance of a day. When days worked inside a municipality exceeds 12 days, the employer shall be responsible for reporting and paying withholding tax on the first 12 days with the payment required for the period where the 13<sup>th</sup> day occurs. When it is clear that an employer is aware that days worked inside a specific municipality will exceed 12 days, and withholding does not begin until after 12 days is achieved, the employer may be subject to applicable penalty and interest charges for failure to properly withhold and report municipal tax earned inside the municipality.

## ***VII. Rental Property for Individuals***

Current situation: Individuals file and report rental property based on where the property is located. Language is needed to clarify how to deal with common expenses related to rental properties that should be allocated between properties.

### Proposed Uniformity:

The net profits on rental properties for individuals shall be based on the location of the property. Any common expenses incurred by the individual related to the rental properties will be allocated based upon the gross receipts generated by the properties.

### Impact:

This is much easier for the taxpayer and the preparer to understand, and is easier to administer. It is impossible to determine if there is any actual impact on revenue based on this change.

Proposed Ordinance Language for Rental Property for individuals cannot be drafted until statutory changes are made to ORC 718 accordingly.

Statutory language should be drafted to provide for the following changes regarding rental property for individuals in Ohio Revised Code Section 718:

Common expenses incurred for multiple properties, and reported on a combined basis, shall be apportioned in the same manner related to the gross receipts generated by the subject properties. This common expenses apportionment method shall be in lieu of an actual breakdown of expenses. The municipality retains the right to request and require the property owner to provide, in review, a detail of expenses and allocation between properties of common expenses to ensure accurate apportionment of common expenses.

### ***VIII. Qualifying Wages***

Current situation: Qualifying wages as defined in ORC 718 allows for the elimination of Section 125 cafeteria plans from inclusion in qualifying wages. This change will require a legislative change to ORC 718.

Proposed Uniformity:

- Modify O.R.C. 718.03 to eliminate the deduction of IRC 125 (Cafeteria Plans) as an adjustment to "Qualifying wages".
- City option: Municipalities may determine whether or not to tax stock options and non-qualified deferred compensation.

Impact:

Previous changes in state law made exceptions to remove Section 125 from qualifying wages. Without the City Option, the qualifying wages definition is more uniform, including the taxation of Section 125 plans, stock options and nonqualified deferred compensation. The City Option would allow those few cities to continue to exempt stock options from taxation. A preparer needs only to know the few City Options that exist in order to prepare the city return for any given municipality. For municipalities, there is extremely minimal revenue enhancement by Section 125 plans, but revenue neutral on the stock option and nonqualified deferred comp question, as municipalities have already had this option in place.

Proposed Ordinance Language for qualifying wages cannot be drafted until statutory changes are made to ORC 718 accordingly.

Statutory language should be drafted to provide for the following changes in withholding taxes from qualifying wages in Ohio Revised Code Section 718:

**718.03 Withholding taxes from qualifying wages.**

(A) As used in this section:

(1) “Other payer” means any person, other than an individual’s employer or the employer’s agent, that pays an individual any amount included in the federal gross income of the individual.

(2) “Qualifying wages” means wages, as defined in section 3121(a) of the Internal Revenue Code, without regard to any wage limitations, adjusted as follows:

(a) Deduct the following amounts:

~~(i) Any amount included in wages if the amount constitutes compensation attributable to a plan or program described in section 125 of the Internal Revenue Code;~~

~~(ii) (i)~~ For purposes of division (B) of this section, any amount included in wages if the amount constitutes payment on account of sickness or accident disability.

(b) Add the following amounts:

~~(i) Any amount included in wages if the amount constitutes compensation attributable to a plan or program described in section 125 of the Internal Revenue Code;~~

~~(ii) (ii)~~ Any amount not included in wages solely because the employee was employed by the employer prior to April 1, 1986;

~~(iii) (iii)~~ Any amount not included in wages because the amount arises from the sale, exchange, or other disposition of a stock option, the exercise of a stock option, or the sale, exchange, or other disposition of stock purchased under a stock option and the municipal corporation has not, by resolution or ordinance, exempted the amount from withholding and tax. Division (A)(2)(b)~~(ii) (iii)~~ of this section applies only to those amounts constituting ordinary income.

~~(iii) (iv)~~ Any amount not included in wages if the amount is an amount described in section 401(k) or 457 of the Internal Revenue Code. Division (A)(2)(b)(iii) of this section applies only to employee contributions and employee deferrals.

~~(iv) (v)~~ Any amount that is supplemental unemployment compensation benefits described in section 3402(o)(2) of the Internal Revenue Code and not included in wages.

(c) Deduct any amount attributable to a nonqualified deferred compensation plan or program described in section 3121(v)(2)(C) of the Internal Revenue Code if the compensation is included in wages and has, by resolution or ordinance, been exempted from taxation by the municipal corporation.

(d) Deduct any amount included in wages if the amount arises from the sale, exchange, or other disposition of a stock option, the exercise of a stock option, or the sale, exchange, or other disposition of stock purchased under a stock option and the municipal corporation has, by resolution or ordinance, exempted the amount from withholding and tax.

(B) For taxable years beginning after 2003, no municipal corporation shall require any employer or any agent of any employer or any other payer, to withhold tax with respect to any amount other than qualifying wages. Nothing in this section prohibits an employer from withholding tax on a basis greater than qualifying wages.

(C) An employer is not required to make any withholding with respect to an individual's disqualifying disposition of an incentive stock option if, at the time of the disqualifying disposition, the individual is not an employee of the corporation with respect to whose stock the option has been issued.

(D)(1) An employee is not relieved from liability for a tax by the failure of the employer to withhold the tax as required by a municipal corporation or by the employer's exemption from the requirement to withhold the tax.

(2) The failure of an employer to remit to the municipal corporation the tax withheld relieves the employee from liability for that tax unless the employee colluded with the employer in connection with the failure to remit the tax withheld.

(E) Compensation deferred before June 26, 2003, is not subject to any municipal corporation income tax or municipal income tax withholding requirement to the extent the deferred compensation does not constitute qualifying wages at the time the deferred compensation is paid or distributed.

Effective Date: 09-26-2003; 2007 HB119 07-01-2007

### ***IX. Municipal Taxation of Pass-through Entities (Partnerships, S Corporations) "Paid on behalf of partners, members, and owners method"***

Current situation: Confusion exists in the treatment of pass-through entities, especially with S Corporations. In order to tax S Corps distributive shares at the shareholder level, each municipality had to take ballot language to their residents to continue taxing S Corporations in this manner. For the remainder, the S Corporation is taxed at the entity level. Any change would have to be made in ORC 718. However, for municipalities that took this issue to the ballot, this language may not be able to be changed. Non-uniformity may have to continue to exist. To provide some consistency in treatment and reporting at the partner, member or owner level to the resident municipality, the proposed changes are as recommended below.

Proposed Uniformity:

- Modify ORC 718 to require that each pass-through entity pay municipal income tax on behalf of its partners, members, and owners (“Qualified owners”). This income will then be reported by the partner, member or owner to the municipal jurisdiction in which such partner, member or owner resides. An example of how this would work is as follows:
  - A partnership located in Dayton will pay the tax as an entity to Dayton, and the individual partners will file in each city that they live in and take a non-refundable credit for tax paid on their behalf. This tax was paid to Dayton, but the partners are allowed to take credit on their resident returns, just as a withholding tax on employees is allowed as a credit on the resident returns. This credit is always limited to the amount of credit allowable by the resident city.
- Repeal the current exemption language (and voter approval) for S-Corporations. If a municipality took ballot language to their residents, and the residents approved taxing S Corporation income at the resident owner level, (2002 – 2004) then their treatment is different than as outlined in ORC 718. A change in local Ordinance will not repeal a change voted in by the residents of a municipality. To provide uniform treatment of S-Corporations at the entity level, a change in ORC 718 and considerable legal research would be necessary.

Impact:

This could have different impacts based on a municipality’s business base. Impacts to revenue are difficult to calculate. This does provide ease of preparation, as returns for the entity are filed with the municipality where located.

Proposed Ordinance Language for pass through entities cannot be drafted until statutory changes are made to ORC 718 accordingly, and differences in treatment of S Corporations as voted in by the electorate cannot be change by statute.

Statutory language should be drafted to provide for the following changes regarding pass through entities in Ohio Revised Code Section 718:

With the passage of legislation, every pass-through entity will be required to pay the tax on income as it is calculated under Adjusted Federal Taxable Income, found in ORC 718.01(A)(1), on behalf of each and all owners, partners, members, on all business performed or other services performed in the municipality. Each owner, partner, member shall be required to file and report all pass-through entity income on their personal income tax return to their municipality of residence, and shall be permitted to use a non-refundable credit for taxes paid by the pass-through entity on behalf of the owners, partners, members, on the portion of their income subject to this payment made on their behalf. Such credit will be limited to the amount of credit allowable by their residence municipality.

***X. Unreimbursed Business Expenses (2106)***

Current situation: Municipalities allow a deduction for Employee Business expenses, either as 100% of the amount reported on Form 2106, or the amount actually deducted for federal purposes on Schedule A (which is limited to only the amount above the 2% AGI). This is a federal deduction on Schedule A, intended to reduced federally taxable income. It is not available for everyone to take, only those taxpayers who qualify to itemize their deductions. The State does not permit a deduction for employee business expenses. In audits, most municipalities find serious issues with the employee business expenses stated on this form, as they either do not qualify as expenses, or no documentation exists to substantiate the expenses. A change to the treatment of employee business expenses would require legislation to change ORC 718.

Also, the ORC allows municipalities to allow a deduction for Health Savings Accounts (HSAs) and Medical Savings Accounts (MSAs). To date, only one municipality in Ohio has chosen to allow this deduction. For uniformity, these options should be eliminated, and would require legislation to change ORC 718 to implement.

Proposed Uniformity:

- Eliminate the deduction for Federal Form 2106 unreimbursed employee business expenses from offsetting employee wages.
- Eliminate the option of municipalities allowing deductions for Health Savings Accounts (HSAs) and Medical Savings Accounts (MSAs) against income of a sole proprietor.

Impact:

This eliminates a deduction currently allowed for individuals. For preparers, it provides ease of preparation. For municipalities, it provides fewer issues and conflicts with audits, as municipalities find a large number of 2106 Employee Business Expense forms filed with expenses that do not qualify, expenses that cannot be documented, expenses that are fabricated, or expenses that could have been reimbursed by the employer, eliminating them again from deduction on the form. Currently some municipalities limit the 2106 deduction by 2% of AGI (as deducted for federal purposes) and some municipalities allow the full deduction. The State of Ohio does not permit this deduction for State purposes. For the HSA deduction, only one municipality in Ohio currently offers the option to allow the deduction for the HSA deduction, so this would provide uniformity of application with no option.

Proposed Ordinance Language for Employee Business Expenses (Form 2106) cannot be drafted until statutory changes are made to ORC 718 accordingly.

Statutory language should be drafted to provide for the following changes in unreimbursed employee business expenses in Ohio Revised Code Section 718:

ORC 718.01 (E)(2) and (E)(3)

(E)(1) The legislative authority of a municipal corporation may, by ordinance or resolution, exempt from withholding and from a tax on income the following:

(a) Compensation arising from the sale, exchange, or other disposition of a stock option, the exercise of a stock option, or the sale, exchange, or other disposition of stock purchased under a stock option; or

(b) Compensation attributable to a nonqualified deferred compensation plan or program described in section 3121(v)(2)(C) of the Internal Revenue Code.

~~(2) The legislative authority of a municipal corporation may adopt an ordinance or resolution that allows a taxpayer who is an individual to deduct, in computing the taxpayer's municipal income tax liability, an amount equal to the aggregate amount the taxpayer paid in cash during the taxable year to a health savings account of the taxpayer, to the extent the taxpayer is entitled to deduct that amount on internal revenue service form 1040. Effective with tax returns filed on and after 1/1/2013, no municipality shall allow a deduction for an amount equal to the aggregate amount the taxpayer paid in cash during the taxable year to a health savings account of the taxpayer. Such deduction previously permitted if adopted by Ordinance of the municipality is terminated effective 12/31/2012.~~

~~(3) The legislative authority of a municipal corporation may adopt an ordinance or resolution that allows a taxpayer who has a net profit from a business or profession that is operated as a sole proprietorship to deduct from that net profit the amount that the taxpayer paid during the taxable year for medical care insurance premiums for the taxpayer, the taxpayer's spouse, and dependents as defined in section 5747.01 of the Revised Code. The deduction shall be allowed to the same extent the taxpayer is entitled to deduct the premiums on internal revenue service form 1040. The deduction allowed under this division shall be net of any related premium refunds, related premium reimbursements, or related insurance premium dividends received by the taxpayer during the taxable year. Effective with tax returns filed on and after 1/1/2013, no municipality shall allow a taxpayer to deduct from net profit the amount that the taxpayer paid during the taxable year for medical care insurance premiums for the taxpayer, the taxpayer's spouse and dependents. Such deduction previously permitted if adopted by Ordinance of the municipality is terminated effective 12/31/2012.~~

ORC 718.01(F)

~~(F) If an individual's taxable income includes income against which the taxpayer has taken a deduction for federal income tax purposes as reportable on the taxpayer's form 2106, and against which a like deduction has not been allowed by the municipal corporation, the municipal corporation shall deduct from the taxpayer's taxable income an amount equal to the deduction shown on such form allowable against such income, to the extent not otherwise so allowed as a deduction by the municipal corporation. Effective with tax returns filed on and after 1/1/2013, No individual shall be permitted to include a deduction for municipal purposes for deductions reportable on the taxpayer's form 2106 for federal purposes.~~

### ***XI. Net Operating Loss Carry-Forward Period***

Current situation: Municipalities have the option to allow or not allow a net operating loss (NOL) carry-forward for business net profit income tax returns. In this region, most cities do not allow a net operating loss carry-forward. Across the State, 151 municipalities do not allow a NOL, so to require a municipality to adopt an NOL where one does not exist would be a serious revenue loss for each municipality. Cities have determined, based on the needs of their respective municipalities, what is the appropriate course of action in deciding whether to allow an NOL. This should remain an option for each municipality.

Proposed Uniformity:

- Narrow the categories of time during which a municipality can recognize NOL to zero, one, three, or five year net operating loss carry-forward (NOL)
- City Option: It will be a local discretion as to which of the four categories listed above a municipality may recognize.

Impact:

In Southwest Ohio, there should be no impact from the proposals above, as all offer an NOL in one of the four categories. Statewide, there is one municipality that recognizes two year NOL and one municipality that recognizes four year NOL.

Proposed Regional Ordinance Language:

- A. *The Municipality is not required allow a net operating loss carryback or carryforward.*
  1. *The Municipality may, by Administrative Order or Ordinance, permit a 0, 1-, 3- or 5-year net operating loss carryforward.*
  2. *The net operating loss carryforward will be permitted for business entities only; an individual with Schedule losses may not carry such loss forward.*
  3. *The amount of loss to be carried forward shall be calculated using the apportionment formula, and only the apportioned loss shall be permitted to be carried forward. Any business entity return with an incomplete apportionment formula shall have any loss carryforward denied until such time that a complete return is submitted to the Municipality, subject to applicable statute of limitations.*
- B. *Losses from federal schedules and other sources reported for federal income tax purposes cannot be used to offset qualifying wages, commissions, other compensation and other taxable income earned or received by residents or nonresidents of the Municipality.*
  1. *If an individual is engaged in two or more taxable and reportable business activities to be included in the same return, the net loss of one unincorporated business activity may be used to offset the profits of another (except any portion of a loss or profit separately reportable for municipal tax purposes to another taxing entity) for purposes of arriving at overall net profits or net operating loss.*
  2. *The offset is limited to:*
    - a. *Like or same schedules may offset.*
    - b. *Activity must be located within the same municipality or may be in a non-taxing*



*jurisdiction.*

- c. Schedules must be in the name of the same individual. In the case of rental property jointly owned, only the individual's portion of the schedule shall be considered when offsetting other qualifying schedules.*

This Proposed Regional Ordinance Language provides for a municipality to determine whether or not they will allow a loss carryforward, and restricts the options for the period allowable by Ordinance. It also provides for the proper apportionment of a loss to be carried forward, and provides that failure to provide such proper apportionment will result in the denial of the loss carryforward until such time that the proper apportionment is provided, subject to applicable statute of limitations.

The second section of this Proposed Regional Ordinance Language provides that no loss can offset qualifying wages, commissions, other compensation and other taxable income earned or received by residents or nonresidents of the Municipality, and provides restrictions under which schedules may be used to offset other schedules.

## ***XII. Statute of Limitations***

Current situation: When a tax matter is pending either through an administrative appeals process or through a judicial appeals process, the Statute of Limitations for pursuing legal action to collect may expire. In order to allow the taxpayer their right to appeal, and protect the municipality's right to collect after final determinations through the appeals or judicial process, the Statute should be "frozen" during this action, also known as 'tolling.' This change would require legislation to change ORC 718.

### Proposed Uniformity:

When a tax matter is in an administrative or judicial appeal, deadlines or statute of limitations by which time a municipality can collect should be frozen or tolled.

### Impact:

This is an administrative change that provides cases to move forward through the appeals process without losing the ability to collect because of the statute of limitations.

## ***XIII. Alternative Assessment Procedure***

Current situation: A Third Party Tax Administrator (in this region, Vandalia and Hamilton both collect tax for other municipalities) is required to pursue legal action on behalf of its member cities in each municipality's court system. This is very inefficient and time consuming process, and disincentivizes municipalities to regionalize its tax administration through collaborations and share service agreements. By contrast, the State of Ohio can currently file all actions in Columbus, even when the action is against a taxpayer in another part of the State.

### Proposed Uniformity:

- Provide to third party administrators the same or similar elective assessment and collection procedure that state income tax administrators follow.

Impact:

This proposal should be revenue neutral. This provides an alternate method for third party administrators which may or may not be implemented, but would result in the ability to establish a procedure to file cases in one jurisdiction rather than multiple jurisdictions. For example:

- The City of Vandalia is a third party administrator. They could elect to follow this different alternative language so that they could file statutory liens in one court instead of multiple jurisdictions, where their city customers are located. This allows them to not have to travel from jurisdiction to jurisdiction to file legal matters. This language provides an option for third party administrators, but is not required.

#### ***XIV. Innocent Spouse Relief***

Current situation: When a joint income tax return is filed, each spouse has equal responsibility to pay the debt and each can be pursued for collection of the debt. In the case of divorce or death, a surviving spouse may be left with a joint debt that was based on the other spouse's income. This provision would allow for the return to be "separated", and the surviving spouse would be relieved of responsibility for the other spouse's debt. Many municipalities in this region already administratively apply such a principle, but language would ensure this protection.

Proposed Uniformity:

- To provide in chapter 718 "innocent spouse relief", using language which is the same as the law for state income tax innocent spouse relief.
- This would allow the separation of a joint return in the case of either death or divorce when the innocent party may not have actual liability for tax, but there is an outstanding balance related to the other party.

Impact:

Revenue impact is minimal to municipalities, but provides relief for a spouse who may, through divorce or death, been left responsibility for a liability based on income they did not earn.

Proposed Ordinance Language for Innocent Spouse Relief cannot be drafted until statutory changes are made to ORC 718 accordingly, as ORC 718 specifically prohibits a municipality from exempting income from taxation, and a tax return filed jointly provides that both taxpayers can be held individually responsible for the liability on such return.

Statutory language should be drafted to provide for the following changes regarding injured spouse relief in Ohio Revised Code Section 718:

**Injured Spouse Relief:**

Where a joint municipal income tax return has been filed establishing a liability, and due

to the death or divorce of one party to this tax return filing the remaining spouse is wholly responsible for any outstanding liability, a taxpayer may request that the jointly filed municipal income tax return be amended as two separate tax filings, separating all income and credits as previously reported on the return. This request shall be in writing, and shall state with specificity why the remaining spouse should be considered to be an injured spouse for purposes of this section. (A similar claim under Internal Revenue Code Section 6105 would be required as substantiation of this claim.) Such request must be made within ninety (90) days (or a timeframe determined to be reasonable by the tax administrator) after the death or divorce, and the taxpayer must provide documentation to support. The statute of limitations as provided for in this Section for the collection of an unpaid liability shall be suspended through the duration of this process (beginning with the taxpayer notification in writing to the tax administrator), and duly documented, and begin again with the date of the amended return for purposes of collection of any unpaid liability on behalf of the remaining spouse. Estimated tax payments that may have been included with the original filing shall be credited against all outstanding liability for both spouses, allocated proportionally.

#### ***XV. Penalty & Interest***

Current situation: Each municipality can determine penalty, interest and late filing penalty rates. These rates vary not only throughout the region, but across the State.

Proposed Uniformity:

- Standardize uniform penalty and interest charges to be utilized by municipalities for the late payment of outstanding local individual and business taxes.
- The interest rate may be tied to an index to allow for consistent rates to be charged and the penalties will be punitive enough to provide the incentive to file and pay timely. An option may be provided for waiver of penalty under extenuating circumstances that can be documented. An example uniform P & I provision might look like the following:
  - Interest: On any outstanding tax due (including employee withholding, balance due on net profit income tax return for business, balance due on individual income tax return, underpayment of estimated tax due) = Federal short term rate plus 3%, to be updated annually (effective 1/1 of each year) but published by each municipality no later than November 30<sup>th</sup> for the next calendar year. (The Federal short term rate is the rate of the average market yield on outstanding marketable obligations of the United States with remaining periods of maturity of three years or less, as determined under section 1274 of the Internal Revenue Code, and updated annually.)
  - Penalty: For failure to pay employee withholding tax due or to underpay withholding tax due, the penalty is 50% of the tax remaining unpaid after the due date. Employee withholding tax is to be held in trust by an employer. This penalty shall be punitive in nature, as the funds do not belong to the employer.
  - Penalty: For failure to pay the balance due on an income tax return filing for a business or individual, and for underpayment of estimated tax due, the penalty is 25% of the tax remaining unpaid after the due date.

- Late filing penalty: A late filing penalty shall apply to any filing which is received after the due date, regardless of whether or not a liability is shown. The penalty is \$25.00 per month for each month that the filing is not remitted, not to exceed \$300.00 for each failure.

Impact:

Provides consistency in application of penalty and interest rates throughout the region, provides the ability for tax preparers to calculate penalty and interest on returns filed after the due date, no calculable impact to revenue.

Proposed Ordinance Language for penalty and interest rates, including late filing penalties would appear as outlined above, and the Tax Administrator would be granted authority, upon good cause shown, to make abatement of all or part of the penalty and interest assessed.

Proposed additions to 718 regarding penalty and interest are as shown above.

***XVI. Other Proposed Regional Ordinance Language Items***

**Raise the minimum final tax liability amount due and refund amount to a consistent regional amount of \$5.00.**

Proposed Regional Ordinance Language:

A. *Payments with Returns.* The taxpayer making a return shall, at the time of the filing thereof, pay to the Tax Administrator the amount of taxes shown as due. However, credit shall be allowed for:

1. Any portion of the tax so due which shall have been deducted at the source pursuant to the provisions of Section \_\_\_\_\_; and
2. Any portion of said tax which shall have been paid by the taxpayer pursuant to the provisions of Section \_\_\_\_\_; and
3. Credit to the extent allowed by Section \_\_\_\_\_ for tax paid to another municipality.

Subject to the limitations contained in Section \_\_\_\_\_ of this Tax Code, any taxpayer who has overpaid the amount of tax to which the Municipality is entitled under the provisions of this Tax Code may have such overpayment applied against subsequent liability hereunder or, at his election indicated on the return, such overpayment (or part thereof) shall be refunded, provided that no additional taxes or refunds of less than five dollars (\$5.00) shall be collected or refunded.

**Cities may require electronic funds transfer of withholding payments.**

A. *The Tax Administrator may determine, by Administrative Rule or Ordinance, that*

*withholding payment remittance be required by electronic funds transfer, or other electronic method.*

**All municipalities will tax lottery / gambling / games of chance, etc.**

- 1. On all income derived from anywhere from prizes, awards, gaming, wagering, lotteries, gambling, or schemes of chance by a resident, and on all income derived from prizes, awards, gaming, wagering, lotteries, gambling, or schemes of chance by a nonresident when such income is won or received from sources within the Municipality.*

**Minimum Age to pay tax: Age 16.**

**Exclusions from municipal taxation:**

- 1. Personal earnings of all persons under sixteen (16) years of age.*

**Municipal Taxation on covenants not to compete and cancellation of indebtedness.**

- 1. On covenants not to compete and on cancellation of indebtedness to the extent includible on the taxpayer's federal return.*

***Self Employment (SE) Tax.***

*Self employment tax (SE Tax) is a Social Security and Medicare tax primarily for individuals who work for them selves. Small business owners pay this tax into the Social Security system to provide with retirement benefits, survivor benefits and Medicare benefits.*

*½ Self Employment tax is allowed as a deduction from the Adjusted Gross Income on the federal return. As AGI is the basis for State Return this deduction is part of various allowable expenses.*

**Current Situation**

*Prior to 2004 some cities in the South West Ohio Region allowed this as an allowable deduction from the reported income of Schedule C for City Income tax*

**Proposed Uniformity**

Allow ½ Self Employment tax to be deducted from the City portion of income per Schedule SE.

Statutory language should be drafted to provide for the following changes to allow an option to allow ½ SE tax deduction in Ohio Revised Code Section 718:

**½ SE Tax Deduction:**

For purposes of determining reportable and taxable Schedule C net profit, a municipality may choose to allow, by Ordinance, a deduction for ½ Self Employment Tax Deduction, as taken as an adjustment to federal taxable income from Form 1040, however, nothing shall require a municipality to allow such deduction.

**Impact**

*This will impact revenue.*