

Ohio bill proposes substantial reforms to municipal taxation

March 1, 2013

In brief

House Bill 5, introduced on January 30, 2013, would implement meaningful changes to Ohio's municipal income tax law. The changes address NOL carryovers, consolidated return elections, apportionment modifications, treatment of pass-through entity taxation and withholding, audit and appeal related administration and rules, and other municipal tax matters. Unless otherwise noted, H.B. 5 would be effective for tax years beginning on or after January 1, 2015, and each municipality must incorporate these provisions in their ordinances by specified dates. [[Ohio House Bill 5](#), introduced 1/30/13]

In detail

If enacted as introduced, H.B. 5 would make substantial modifications to how Ohio's municipalities impose and administer their income tax. Significant elements to H.B. 5 include the following.

Five-year net operating loss carryforward

Currently, a municipality has the option to allow an NOL carryforward. H.B. 5 would impose a mandatory five-year carryforward for NOLs incurred in taxable years beginning after 2014 to be phased-in over a five year period starting in taxable years beginning after 2015. Existing municipal NOL carryovers, if allowed by the municipality, would be deducted first using the carryover rules existing in the years the NOLs were generated. Certain at-risk

and passive activity loss limitations are also addressed.

Pass-through entity withholding and taxability

Generally, tax would be imposed on pass-through entity (PTE) owners and PTEs would have quarterly withholding requirements that can be utilized as a credit on owners' returns.

However, if 80% or more of a PTE's net profit or loss is included in an affiliated group's federal consolidated return of a taxpayer that has elected to file a municipal consolidated tax return, then withholding is not required for the income included in the group tax return. All other business-owned PTE profit is subject to withholding at the PTE level. No additional tax return filing obligation with

a municipality is specified by the language of H.B. 5.

Pass-through entity loss limitation for individuals

For residents, losses from an investment as a partner in a PTE shall only be allowed as a deduction against the resident's PTE income and other specified income.

For nonresidents, losses from an investment as a partner in a PTE shall only be allowed as a deduction against the nonresident's distributive share of PTE income. If a taxpayer's only source of income in a municipality is from a PTE, the owner would not be required to file a return.

Based on the Ohio Legislative Service Commission's [Bill Analysis of H.B. 5](#), it is possible

that other revisions may be made to the loss limitation rules.

Throwback eliminated

Under current law, if a seller does not have an employee regularly soliciting sales where goods are delivered, the sales are attributed to the place where the goods are shipped from. H.B. 5 would eliminate this 'throwback' provision and source the sale to the place where the purchaser receives title to the goods.

Sourcing of services

Gross receipts from the sale of services are sourced to a municipality to the extent that such services are performed in the municipality.

Alternative apportionment

The proposed legislation would permit taxpayers to request the use of an alternative apportionment method on an originally filed or amended return if the three-factor formula does not "fairly represent the extent of the taxpayer's business activity" in the municipality. An alternative apportionment could include separate accounting, the inclusion or exclusion of one or more factors, or a modification of one or more of the factors. Existing alternative apportionment requests appear to remain intact. Note that certain non-business rental activities will be allowed to use separate accounting upon request.

Election to file consolidated return

A taxpayer filing a federal consolidated tax return may elect to file a 'full' consolidated municipal income tax return so long as one member of the group is subject to the municipal tax. The income and apportionment factors of a PTE would be included if at least 80% of that PTE's net profit or loss is included in the group's consolidated federal

income. The election is binding unless permission is granted to change, and H.B. 5 would retain existing 'similar' taxpayer consolidated return elections unless permission is given to change.

Withholding exclusion extended to 20 days

A municipality would be prohibited from taxing or requiring municipal income tax withholding on nonresident individuals who work 20 (currently 12) or fewer days in the municipality during a calendar year. Additionally, a taxpayer's payroll factor would be adjusted to exclude certain wages covered by the 20-day exclusion, as well as certain other wages unless performed at specified locations.

Certain deferred compensation taxation and withholding

Nonqualified deferred compensation or employee stock option-related compensation would continue to be or become exempt after 2014, but only if allowed by a resolution or ordinance adopted by the municipality before 2015.

Residency requirements

Currently, an individual may be a resident for municipal income tax purposes but not a resident for Ohio tax purposes. Under H.B. 5, an individual would be a resident of a municipality only if the individual is both: (1) domiciled in the state under Ohio's individual income tax 'bright line' resident rules, and (2) domiciled in the subject municipality.

Other return filing requirements

H.B. 5 would provide the following administrative filing requirements:

- an annual municipal income tax return is required, with the same due date as for state income tax returns

- the annual return is automatically extended upon the receipt of a federal extension
- no return is required if a resident's credit from another municipality exceeds the liability due to the resident's municipality
- no filing or payment is due if the taxpayer's liability is under \$50, total apportionment or allocated net profit to the municipality is less than 1%, and the total amount of wages paid in the municipality is under \$50,000
- an amended return is due within 60 days after a federal change.

Penalties

Current law does not limit a municipality's authority to impose penalties. H.B. 5 would establish uniform and exclusive penalties relating to unpaid taxes and failures to file.

Centralized administration, local boards of review, and audit & appeal procedures

The bill creates a seven member Municipal Tax Policy Board to enable municipalities to establish state-wide forms and administrative rules. Audit and appeal procedure enhancements would include implementing: a problem resolutions officer in larger municipalities, audit procedure and notice requirements for the municipalities to provide taxpayers, record retention rules, and written opinion requirements for both the municipalities and the newly created Municipal Tax Policy Board along with confidentiality rules. Additionally, the bill permits appeals of local boards of review decisions only to the Ohio Board of Tax Appeals whereas previously appeals were also allowed to the court of common pleas. Finally, the bill requires municipalities to appoint non-

employees to two of its three local board of review members' positions.

The takeaway

Reforming Ohio's municipal tax system is a concern to any company doing business in Ohio due to the administrative burdens relating to over 550 municipal income tax filing obligations. H.B. 5 applies to all individuals and most businesses, but it is important to note that the changes do not apply to the electric and local telephone exchange businesses subject to tax under Ohio Revised Code Section 5745.

H.B. 5 is similar to H.B. 601, which was introduced on October 30, 2012, and never made it out of Ways and Means Committee review ([click here](#) for our summary of H.B. 601).

However, H.B.5 includes some important differences from H.B. 601, including: (1) providing flow-through treatment for certain pass-through entities in a consolidated return; (2) sourcing services based on where services are performed rather than to the place of the purchaser's benefit; (3) establishing wage definition and withholding rule changes; and (4) prohibiting municipalities from levying a tax that is similar to State of Ohio's commercial activity gross receipts tax.

There remain several questionable aspects and open issues regarding H.B. 5, for example, (1) whether product sales factor sourcing should be driven by 'title' transfer versus destination concepts; (2) whether the consolidated return provisions should clarify additional filing method

aspects including pre- and post-apportionment as well as 'Joyce' concepts; (3) whether factor flow-through concepts should also apply to all business-owned pass-through entities; and (4) if certain individual-owned pass-through entity loss limitations and S corporation owner tax increases are acceptable as part of the overall legislative package.

Taxpayers are encouraged to closely review the changes proposed by H.B. 5 to determine the effect it will have on their municipal tax liability and compliance obligations, and decide whether to pursue actions to address their open issues. PwC has deep experience with Ohio municipal taxation, and can assist you in understanding and evaluating those provisions and the impact on your business.

Let's talk

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