MUNICIPAL TAX REFORM COALITION
Less paperwork. Better compliance. More jobs.

Testimony of Thomas M. Zaino, CPA, JD
on behalf of the
Municipal Tax Reform Coalition
House Bill 5 – As Introduced
House Ways and Means Committee
May 7, 2013

Chairman Beck, Ranking Member Letson, and members of the House Ways and Means Committee, thank you for this opportunity to reappear before you today on behalf of the Municipal Tax Reform Coalition ("the Coalition"). In their opponent testimony last week, various city representatives and the Ohio Municipal League (OML) made a number of claims and representations about what provisions are contained in House Bill 5 ("HB 5") and how they would impact cities in general and some cities in particular. I believe this creates a cloud of confusion as to what the actual text of the bill provides. I would like to take the opportunity to briefly review just ten of the claims made by cities and set the record straight about what is in HB 5; there are many other claims that I could also clarify, but in the interest of time, I will limit my examples to ten. We can all agree or disagree with the policies of the text, but we need to eliminate confusion over what the bill actually provides.

1. **CITY CLAIM: Changing the 12-Day rule into a 20-Day rule will result in more "tax free days."**

    - **CLARIFICATION**: HB 5 indeed converts the 12-day occasional entrant rule to a 20-day rule, but I want to make sure that the entirety of the rule is understood:

        - Unless the principal place of work (PPW) is not in an Ohio municipality that imposes an income tax, there are ZERO tax free days (not 19, not 11 --- zero free days) for work that would otherwise be taxed in the "fewer than 20 day" municipality.

            - REASON: The bill requires withholding at the PPW if principal place of work location is in a taxable jurisdiction. (See lines 686 - 693)

        - A PPW can never be located outside Ohio. Therefore, non-Ohio employers will be required to collect tax at an Ohio PPW located in any Ohio municipality that imposes an income tax. (See lines 617 - 636)

- The ONLY situation in which there are "twenty tax free days" is if all of the following three circumstances exist simultaneously:

    - PPW is in a non-taxing Ohio jurisdiction; AND
    - Employee does not live in an Ohio taxing jurisdiction; AND
    - Employee works in an Ohio Taxing Municipality for fewer than 20 days.

        - This scenario is similar to current law and HB 5 admittedly adds 8 additional tax free days—but not 20. And that's only because the PPW jurisdiction chose not to impose an income tax or could not impose an income tax (i.e., a township).

- Conclusion: Except in very limited circumstances and as a general concept, the new 20 day rule will result in the same cumulative overall tax being withheld for municipal taxing authorities in total.

2. **CITY CLAIM: All correspondence from a municipality must be sent via certified mail, thereby increasing postage costs significantly.**

    - **CLARIFICATION**: HB 5 only requires "Assessments" to be sent certified mail.

        - Only two types of written communication qualify as "assessments."

            1. A document that commence the deadline to file an appeal to the local board of appeal (See lines 585-590) and has the word "ASSESSMENT" written across the top of the correspondence. (See lines 591 - 592)

            2. A document that denies "qualified refund claim" (i.e., a refund claim made on timely filed amended return). (See lines 593 - 594)

        - By definition, any other written correspondence from a tax administrator to a taxpayer is NOT required to be sent by certified mail. (See lines 595 - 601)

        - Each municipality may assess costs of collection, including costs related to appeals, against the taxpayers. (See lines 2990-2996) If necessary, this could be clarified that it applies to certified mail costs of assessments.

3. **CITY CLAIM: Bill doesn't include a requirement that all taxpayers provide 1099-MISC or W-2s to municipalities.**

    - **CLARIFICATION**: This statement is factually correct, but incomplete – a city may absolutely require such information be provided.

- Current ORC Chapter 718 does not require that 1099-MISC or W-2s be issued to a municipality.

- HB 5 does expressly provide that municipalities may enact any ordinance "necessary for the administration of the tax, provided that the provision does not conflict with any provision of" Chapter 718 or rule of the MTPB. (See lines 1315 - 1318)

    - HB 5 does not prohibit a municipality from enacting an ordinance requiring taxpayers to provide copies of 1099-MISC to municipalities.

- Note: Adding such a requirement was considered, but some cities did not want to be inundated with that information.

4. **CITY CLAIM: Losses of a pass-through entity can be used to offset wages, thereby reducing city revenues.**

    - **CLARIFICATION:** H.B. 5 does contain a technical drafting error that could lead one to this result. However, this result was never intended. We have amendment language that will ensure that losses from pass-through entities or any business activity cannot be used to offset wage income. (see line 70)

5. **CITY CLAIM: Because of language in the bill at lines 2928-2930, taxpayers who file late 2013 returns will be permitted to offset pass-through entity losses against wage income; therefore, there is an incentive for the taxpayer to file a late 2013 return in order to use the "old" rules.**

    - **CLARIFICATION**: The quoted line numbers relate to the computation of interest on underpayments and late payments. This language does not have anything to do with offsetting losses of pass-through entities.

6. **CITY CLAIM: Cities with populations greater than 30,000 must appoint a problem resolution officer ("PRO") which may cause some municipalities to hire additional employees or incur overtime costs.**

    - **CLARIFICATION**: The purpose of the PRO is simply to provide citizens a point person to assist them with city tax problems—something such cities do today each and every day. The bill does not require a fulltime person fill that role, nor does it require overtime be incurred. HB 5 clearly states that the PRO can be a current employee (see lines 3142-3143) and can have any other duties (see lines 3151-3158).

7. **CITY CLAIM: Penalty and interest assessments may be appealed which adds administrative burden to the municipal tax department, and boards of review may now be required to meet weekly.**

   - **CLARIFICATION**: This is NOT a change in the law.

     - Current R.C. 718.11 provides, in part: "* * * Any person who is aggrieved by a decision by the tax administrator and who has filed with the municipal corporation the required returns or other documents pertaining to the municipal income tax obligation at issue in the decision may appeal the decision to the board created pursuant to this section by filing a request with the board. The request shall be in writing, shall state why the decision should be deemed incorrect or unlawful, and shall be filed within thirty days after the tax administrator issues the decision complained of."

   - I am not aware of any municipal tax ordinance that does not permit penalty and interest to be appealed in this manner. Fundamental due process rights permit taxpayers the right to appeal assessments of tax, penalty and interest.

8. **CITY CLAIM: The limitations on the amount of interest and penalties that may be imposed will hinder enforcement and also results in lower revenue because many cities impose higher interest rates and penalties than would be permitted in HB 5.**

   - **CLARIFICATION**: This statement is accurate, but requires some perspective.

     - The penalty and interest language used in HB 5 came from certain municipal tax officials. (See lines 2881 – 2998)

     - While many cities want to impose 18% interest on delinquent taxes, those same cities do not want to pay 18% interest on overpaid taxes or refunds. HB 5 requires interest to be paid on both delinquent taxes and overpaid taxes that are not timely refunded. (See lines 2236-2246; 3340-3353; 2361-2366; and 2579-2602)

     - Interest is compensation for the *time value of money*, not for purposes of encouraging enforcement. Penalties are for enforcement.

     - The bill adds new tools for tax administrators to enforce compliance with the tax system that are generally not available currently, including:

       - Subpeona powers (see lines 2781-2793)
       - Statutory judgments (see lines 2354-2360)

- Note: HB 5's interest limitations are computed the same way as interest is computed for state tax purposes – the federal short term rate plus 3% (currently, that equals 3%).

9. **CITY CLAIM: The NOL carryforward provision is an unfunded mandate and tax deferment plan, which results in significant losses once fully implemented.**

   - **CLARIFICATION**: Those opponents that testified and provided estimates admitted that the measurement period used to measure NOL carryforward impact includes the worst economic period in our country's history since the Great Depression.

   - Federal tax law and Ohio's former corporation franchise tax law provides for a 20 year carryforward.

   - Observation: Those municipalities that currently allow a five year NOL carryforward will experience revenue gains because new NOLs will be limited during the phase-in of the carryforward provision. (See lines 237-267)

10. **CITY CLAIM: HB 5 requires municipalities to hand over administrative control of the local income tax to the state of Ohio.**

    - **CLARIFICATION**: HB 5 does not transfer administrative control of the local income tax to the state of Ohio. At lines 474 through 489 of the bill, "Tax administrator" is defined to mean:

> *the individual charged with direct responsibility for administration of an income tax levied by a municipal corporation in accordance with this chapter, and also includes the following:*
> *(1) A municipal corporation acting as the agent of another municipal corporation;*
> *(2) A person retained by a municipal corporation to administer a tax levied by the municipal corporation, but only if the municipal corporation does not compensate the person in whole or in part on a contingency basis;*
> *(3) The central collection agency or the regional income tax agency or their successors in interest, or another entity organized to perform functions similar to those performed by the central collection agency and the regional income tax agency, if, in any case, the agency or entity administers municipal income taxes on behalf of at least thirty-one municipal corporations.*

    - Nowhere in HB 5 is a state employee included in the definition of tax administrator.

- I respectfully challenge any opponent to identify to the members of this Committee the name of the state employee or employees that would now administer the local income tax system in Ohio as a result of HB 5, including the line number of the bill—if that person exists, then this Committee can fix that. However, I don't see any provision for this in HB 5, nor do I see anything in the budget of any state agency, nor do I see any appropriation for this in the pending biennial budget. This claim is simply false.

Conclusion

In conclusion, these ten items are just a sampling of the disingenuous claims that create confusion about HB 5. I hope my clarifications and observations will add transparency as to is in the bill.

As I mentioned in response to various questions last week, I believe Ohio is very close to reforming its municipal tax system. While HB 5 is the result of significant compromise, some areas of contention remain. The primary areas of contention seem to be the following items, many of which already reflect significant compromise:

1. NOL carryforward treatment
2. Pass-through entity treatment
3. Municipal tax policy board
4. Elimination of throwback
5. Twenty-day occasional entrant rule
6. Domicile rule
7. Problem resolution officer

I strongly believe that there is room for all parties to compromise on a number of these seven issues. The Coalition stands ready to negotiate a final round of compromises with municipal tax officials in an effort to obtain true and rapid municipal tax reform through passage of HB 5.

Mr. Chairman, thank you again for the opportunity to address the Committee. I would be happy to answer any questions by you or other members of the Committee.

11. **CITY CLAIM: At least one city that does not tax S corporations at the owner level has testified that a negative revenue impact will occur from being able to tax the distributive share of income that flows through to the owners.**

    - **CLARIFICATION: T**his makes no sense because the city's tax base for resident owners of a pass-through entity will now increase, not decrease. The city would now be able to now tax all the income that passes through to owners that are residents. The city would actually experience a tax revenue increase. This is one reason many in the business community are not satisfied with HB 5.

    - Observation: This compromise that permits the taxation of pass-through entities at the owner level apparently is of no value to most municipalities in their eyes. Therefore, the Coalition may seek an amendment to permit taxation only at the entity level.

12. **CITY CLAIM: The "de minimis" exception from filing and paying a net profits tax for those who would owe less than $50, AND have less than 1% apportionment, AND have less than $50,000 of payroll in the municipality will have a revenue impact.**

    - **CLARIFICATION**: I do not refute the estimated revenue losses. I simply want to point out the practical problems with the idea that taxpayer meeting all three of the requirements of this provision should remit the tax. (See lines 1462 - 1476) Taking one city's revenue estimate that it will cost $2,300 per year and assuming that the average amount that would otherwise be due is $25, let's consider the following:
        - Ninety-two businesses will not have to file in that city.
        - According to one mayor that testified last week, it can cost a taxpayer between $30 - $50 to prepare and file a municipal tax return.
        - If those 92 returns were filed, city employees would have to process and audit the returns.
        - Adding up the business' costs of filing the returns ($2,760) and the city's cost of processing and auditing the returns ($__?__), a negative economic benefit has been created.