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Board of Directors
Grove City Area Chamber of Commerce
Grove City, Ohio

RE: SCOLI report – Municipal Income Tax Reform

Board members,

As you are aware, the SCOLI committee (Committee) was originally appointed by then President Darlene Murphy to review and respond to various discussions and studies being conducted with respect to Ohio municipal tax reform. A report dated June 1, 2012 was presented to the Board in response to President Murphy's request.

H.B 5 was introduced by Representatives Grossman and Henne dealing with Municipal Tax Reform. Accordingly, Chamber President Allen Houk charged the Committee to evaluate the bill, solicit feedback and update and re-issue the report concerning Municipal Income Tax Reform.

Our report below summarizes resources considered, background and overview information, and our final opinion and comments.

RESOURCES CONSIDERED

The Committee obtained H.B. 5, the Bill Analysis and the Fiscal Note & Local Impact Statement; was presented with an article written by Melinda Frank, Columbus Income Tax Division Administrator appearing in the July/August 2013 Cities and Villages magazine; conducted extensive internet and article research for updated data and positions regarding Municipal income tax reform including Municipal Tax Reform Coalition, OSCPA, Regional Income Tax Agency, Ohio Municipal League, NFIB, Tax Foundation, Policy Matters Ohio, various other Chambers of Commerce as well as many others; solicited input from City of Grove City key officials; and previously had been presented with an article appearing in the March/April publication of The Ohio Society of Certified Public Accountants (CPA Voice); correspondence dated March 21, 2012 written to Joseph W. Testa, Tax Commissioner for the Ohio Department of Taxation, and signed by 16 different Mayors/City Managers representing various communities in Franklin County, including Grove City Mayor Richard "Ike" Stage; and Grove City Council proposed Resolution CR-12-12 introduced May 7, 2012.

BACKGROUND

The history and highlights of Municipal income taxation and the related potential reform is summarized in the following points and is an important starting point with respect to any type of action to be taken.

- Municipal corporations were granted authority to tax as an aspect of their home rule powers conferred by Article XVIII, Section 3, of the Ohio Constitution.
- Municipal income taxation in Ohio has been limited by Ohio Revised Code, Chapter 718. The limitations under current Ohio law are very general in nature and have not been updated in a manner that provides an effective guide, method of monitoring or control over the administering of municipal income taxes. Accordingly, we have evolved to a complex system which is neither uniform nor fair in many cases.
- Ohio is 1 of 10 states that currently assess business and individual municipal income taxes, with Ohio being the only state which allows each municipality (over 600) to establish their own rules and regulations.
- Municipal income tax uniformity and simplicity has been discussed and sought after by some groups for over 20 years.
- The Municipal Income Tax Uniformity Coalition, who indicate they support tax reform in Ohio, was recently formed and includes at least 28 partner organizations. This group currently includes OSCPA, NFIB, Ohio Chamber of Commerce, Cincinnati USA Regional Chamber, Associated General Contractors of Ohio, Columbus Chamber of Commerce, Dayton Chamber of Commerce, Greater Ohio Policy Center, Ohio State Bar Association, Ohio State Medical Association, Toledo Regional Chamber as well as many other industry organizations (NECA, Realtors, Auto Dealers, Cable Telecommunications, Contractors, Retail Merchants, Builders, Insurance, Manufacturers', Newspapers, Nursery & Landscaping, Produce Growers, Restaurant, and Trucking industries).
- A majority of municipal corporations have expressed opposition to the reform as proposed, as well as several local government councils, and several other groups such as Ohio Municipal League and Policy Matters Ohio.
- The Regional Income Tax Agency would also fall into the oppose category. RITA currently is the largest administrator of income taxation for various municipalities throughout Ohio, including the City of Grove City.
- There does seem to be some common ground between the supporters and opponents in that most will agree that municipal tax reform in needed with respect to mandating uniform sets of rules and forms to be utilized and with several of the provisions outlined below. However, there are some strong differing opinions with respect to a handful of items being proposed in the current legislation.

<u>OVERVIEW</u>

The following overview presents the highlights of the major provisions of H.B. 5, which is currently under consideration in the Ohio House of Representatives.

- The bill requires all municipal corporations who levy an income tax to repeal existing tax ordinances and re-enact tax ordinances which comply with the bill's limitations. The revised ordinances must be completed by January 1, 2015 or the ability to levy a tax on income could be lost.
- The bills continues to require tax rates in excess of 1% be approved by voters, however, municipalities who revise their ordinances will be allowed to keep existing tax rates even if in excess of the 1% ceiling without voter approval.
- The bill also continues to require municipalities to post online versions of ordinances, rules, instructions and forms.
- The bill creates a Municipal Tax Policy Board responsible for establishing rules, forms, instructional materials and other actions needed to administer and enforce state-wide municipal income taxation. This board is required to include members representing varying sizes of municipal corporations based on population and further stipulates no board member will be paid.
- The bill establishes uniform definitions of taxable income on which income tax can be levied by a municipality. Income not previously taxed by most municipalities include wages and earned income of those under age 18, certain deferred compensation and stock option related income and self-employment income of religious leaders. Income removed from the exemption list by the bill and now taxable include shareholders' portion of net profits (S corps) and transit employees' pay.
- The bill requires all municipalities to permit taxpayers to deduct net operating losses (NOL) and further permit unused net operating losses to be carried forward for five (5) years. The NOL deduction is phased in over a five (5) year period. Accordingly, NOL deductions incurred in tax years beginning in 2015 cannot exceed 20% of the total loss for that year. The phase in continues in 20% increments until 2019 when the full NOL would be deductible. It is estimated 66.67% of all municipalities currently already allow NOL's, but Grove City is not one of those who currently permit NOL deductions.
- The bill eliminates the deduction for employee business expenses (business vehicle, travel, entertainment, etc. expenses) currently permitted by municipalities.
- The bill establishes that municipalities can treat an individual as a resident for municipal tax purposes only if the individual is an Ohio resident as determined for state income tax. There is no current provision with respect to determination of one's residency other than what each municipality has adopted within their own ordinances.
- The bill extends the casual entrant rule from 12 days to 20 days. Currently municipalities cannot tax income of non-resident individuals if they earn income in the locality 12 days or less in a given year. The bill also provides specific language and rules to test when an employee has spent a "day" in a municipality.

<u>OVERVIEW</u> (Continued)

- The bill provides specific definitions to those who are exempt from claiming the above casual entrant rules. Accordingly, professional athletes and entertainers continue to be exempt from claiming casual entrant status and continue to be subject to taxation. The bill adds "public figure" individuals to the above groups who will be subject to taxation of municipalities.
- The bill prohibits the taxation of pass-through entities (S-Corporations, partnerships, LLC's) other than single member LLC's. However, the income passed through to the individual partners, shareholders or members will be subject to tax as part of their individual income.
- The bill provides several changes to the manner in how net profits are to be allocated if earned in multiple jurisdictions. The bill keeps the factors; payroll, sales and property; but changes how these factors are used. The payroll factor is changed by including only compensation paid for work done at specific locations in the determination of total payroll. The bill changes the determination of the sales factor by redefining when a sale is considered consummated within a municipality. Goods are considered sold within a municipality only if the purchaser received the goods within that same municipality. The property factory will be changed by adding the value of rented or leased tangible personal property to the existing value of real estate.
- The bill also permits municipalities to approve alternative forms of income allocation only if the standard three (3) part formula does not fairly present the extent of the taxpayer's business activity.
- The bill also outlines specific allocation rules for specific groups including professional athletes, rental income, real estate commissions and gambling winnings.
- The bill also provides guidelines with respect to withholdings, due dates, return filings, extensions, estimated taxes, assessments, notices, penalties, interest, appeals, statute of limitations, audits and record retention.
- The bill requires municipal corporations with a population in excess of 30,000 to appoint a problems resolution officer.

<u>OPINION AND COMMENTS</u>

The mission of the Grove City Area Chamber of Commerce is to create a positive environment for the development and success of business. The following opinions and comments are provided with this underlying principle in mind.

The Committee unanimously agrees a need exists to reform the current municipal income tax system. The Committee believes reform is needed to enable Ohio to better compete for business and enable Ohio to be more business friendly. Currently businesses and individuals alike are subjected to frivolous nuances caused by the burdensome municipal income tax structure, which continues to place us in the minority when compared to most other states in the country. An enormous amount of time, energy and money is spent annually by businesses and individuals attempting to comply with the inconsistent, varying rules and regulations and the maneuvers conducting by taxing agencies and tax administrator groups.

OPINIONS AND COMMENTS (Continued)

The SCOLI committee unanimously recommends support of H.B. 5 as further discussed in the following points.

- In our prior report we expressed our belief that municipal income taxation needs to become more uniform. Accordingly, we believe H.B. 5 works to unify municipality taxation by requiring one set of forms, rules, due dates, penalty structure, appeals, etc. H.B. 5 also works to establish what income is to be taxed and what income is to be exempted and speaks to allowable deductions that are also outlined within the bill.
- We believe the establishment of a Municipal Tax Policy Board will be a mechanism by which new municipal tax policies, administration of municipal taxation and enforcement processes will become and remain uniform and consistent. This also will provide Municipalities a voice in determining municipal tax policies, rather than allowing municipal taxation to be mandated and controlled by the state.
- H.B. 5 does not impede municipalities from continuing to set their tax rate and tax credit for taxes paid to other localities structure. It would require any future increase in tax to be voted upon (if rate if above 1%) by the population. The bill also does not impose a centralized collection group, which the committee believes is beneficial given the concerns expressed by various municipalities, including the City of Grove City.
- We believe allowing net operating losses to be deducted and carried forward if not used is beneficial to business. The deduction is phased in over a five (5) year period to ease the burden and lost income municipalities will face. The allowance of net operating losses does not remove the requirement for businesses to continue to pay local payroll taxes on wages earned in a municipality. This is one of the most contested issues of H.B. 5 as municipalities fear this will cause a large source of lost revenue, which could impact their budgets and ability to provide services. While we understand the concerns of the municipalities, we also understand businesses and individuals have been hit with and dealt with declining incomes and business losses for the past 5-7 years. We believe businesses will re-invest the dollars saved in lower income taxes into their respective businesses, which will ultimately bring dollars back to the municipalities.
- It is our opinion that H.B. 5 works to simplify who is a resident and who is a non-resident as well as who is a casual worker for municipal income tax purposes. We believe this will help to lessen the enormous burden on certain businesses who are required to track daily activity of an employee. The bill also makes clear who cannot claim casual worker status and therefore pay municipal taxes.
- The removal of taxation on pass through entities again takes steps to make municipal income taxation more uniform. The tax will continue to be paid, but at the individual level rather than at each entity level. The provision should not impact municipalities as tax would still be due on where the income was earned rather than where the individual resides.

- We believe the bill works to simplify and make uniform the allocation methods used to determine potions of income to be taxed when working in multiple localities. This is another burdensome area for businesses who continue to spend dollars to track and allocate the payroll, sales and property factors each year. While the bill does not greatly reduce this burden, it does work toward uniformity and does attempt to simplify how the factors are determined. Income allocation is another highly contested area among municipalities. They believe the changes to the sales factor could cause substantially lower allocation percentages being allocated to their respective municipality and therefore a lower tax revenue source. Again, we understand there is potential for lost revenue in this area to certain municipalities, but we also would argue other municipalities could in fact see an increase to their sales factor due to the proposed new sales factor.
- Several municipalities have expressed concern over potential increase in costs to comply with H.B. 5 from an administration and implementation standpoint. While we agree there very well may be implementation costs, we believe it to be a cost of progress and an investment into the business climate of Ohio.

In summary, we are respectful of the varying opinions of municipalities and groups who oppose H.B. 5 and understand their concerns of increase in costs to comply and potential lost revenue as their budgets continue to be subject to other cuts. However, there are no reliable dollar amounts that can be attached to these items as they require predictions about future activities that can and will change drastically. Even the largest tax administrator (RITA) is unable to provide reliable estimates to support the amounts. The Fiscal Notes & Local Impact Statement of the bill does disclose that costs may increase and revenues decrease for certain municipalities, while other municipalities may see a windfall and yet others see little to no change.

We represent business and business owners and believe H.B 5 to be a necessary and needed piece of legislation to assist Ohio business by lessening what is a real municipal tax burden as well as enabling them to become more competitive with non-Ohio businesses. We also believe this will attract business to Ohio and will spark existing Ohio business to invest in their respective communities.

Respectfully submitted,
SCOLI Committee

Grove City Area Chamber of Commerce

Timothy R. Harris, Chairman
Robert Halley
Allen R. Houk
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