

Dear Administrator:

Recently enacted law in Ohio creates uniform provisions for municipal income tax laws in Ohio.¹ The changes mentioned in this correspondence are generally first effective with respect to taxable year 2004 for filings that occur in 2005. For informational purposes only, the following is a summary of the changes that occurred. This letter is not intended to be a comprehensive review of every law change from the recent legislation, but does cover the major changes in the area of municipal income taxation. The changes are in seven general categories as follows:

1. Adopted a uniform definition of taxable income for net profits tax returns - This change, first effective for taxable year 2004, will require all municipalities to adopt the following definition of income for net profits taxpayers:

Begins with Federal Taxable Income (FTI), before net operating losses and special deductions, (currently line 28 of the federal 1120) and then makes the following adjustments:

- i. Deduct intangible income to the extent it is included in FTI;
- ii. Add 5% of the amount deducted as intangible income, but not the portion of the intangible income related to the sale, exchange or disposition of property described in section 1221 of the Internal Revenue Code (IRC);
- iii. Add any losses allowed in the computation of FTI if the losses relate to the sale, exchange, or disposition of property described in section 1221 or 1231 of IRC;
- iv. Except for depreciation recapture described in section 1245 or 1250 of IRC, deduct income and gain included in FTI to the extent the income and gain relate to the sale, exchange or disposition of an asset described in section 1221 or 1231 of IRC;
- v. Add taxes on or measured by net income allowed as a deduction in the computation of FTI;
- vi. In the case of a real estate investment trust or regulated investment company, add all dividends, distributions, or amounts set aside for the benefit of investors and allowed as a deduction in the computation of FTI;
- vii. In the case of a taxpayer that is not a C corporation and is not an individual, the taxpayer shall compute FTI as if the taxpayer were a C corporation and, in addition to the above adjustments, shall not be allowed a deduction for guaranteed payments, payments to a qualified self-

¹ Am. Sub. H.B. 95 was signed into law on June 26, 2003, and contains certain delayed effective dates.

employed retirement plan, payments for health or life insurance for an owner or owner-employee, or federal self-employment tax.

- viii. Uses apportionment formula to apportion profit to each municipality using an equally weighted formula of property, payroll, and sales (the property factor uses original cost instead of net book value). If the apportionment formula does not produce an equitable result, another basis may be substituted, under uniform regulations.

- 2. Adopts a uniform withholding base / Employee compensation tax base - The tax and withholding base begins with the Medicare wage base (Box 5) and makes the following mandatory adjustments:

- i. Add supplemental unemployment compensation benefits described in section 3402(o)(2) of IRC;
- ii. Add compensation of pre-1986 employees exempt from Medicare that is not in the Medicare wage base solely because of the Medicare grandfathering provision.
- iii. Please note that IRC section 125 cafeteria plans are not taxable.

The required base may be modified, on a municipality-by-municipality basis, if the municipality, by resolution or ordinance, exempts from the tax and from withholding (i) stock options and/or (ii) non-qualified deferred compensation amounts.

- 3. Elimination of de minimis withholding safe harbor - Under prior law, a municipality could not require a nonresident employer (not situated in the municipality) to withhold tax from employee compensation unless the total amount required to be withheld from all the employer's employees in that municipality exceeded \$150 for the calendar year. Under the law change, the safe harbor is eliminated beginning in taxable year 2004.
- 4. Uniform due dates – Unless extended, all due dates will be the fifteenth day of the fourth month following the end of the taxpayer's taxable year (personal income and net profits tax).
- 5. Extensions - A federal extension will extend the municipal due date to the last day of the month following the month to which the due date of the federal return has been extended. A copy of the federal extension must be filed with the appropriate local tax administrator(s) on or before the original due date for filing the return.

(Note: Beginning January 1, 2005, Ohio Revised Code Section 718.051(B) provides that the due date for *net profits* tax returns will be extended to the last day of the month to which the due date of the federal return has been extended, provided the taxpayer notifies the tax commissioner of the federal extension through the *Ohio Business Gateway* on or before the original due date for filing the return. In that situation, nothing needs to be filed with the local tax administrator(s) to obtain the extension. Furthermore, please note that subsequent legislation may be introduced to correct this unintended discrepancy between the extension period allowed with respect to a paper request and the extension period allowed with respect to an electronic request.)

- 6. Appeals - Following an appeal to a local board of appeal, a municipal income tax appeal may be made to either common pleas court or to the Ohio Board of Tax Appeals. Please note that

this change first applies for *matters* with respect to *taxable years 2004* and thereafter. Therefore, for matters relating to taxable years 2003 and prior, a municipal income tax matter may not be appealed to the Ohio Board of Tax Appeals, and must be appealed, if at all, to a common pleas court.

7. *Ohio Business Gateway* - Provisions were enacted that will allow taxpayers, at their option, to file certain tax documents electronically through the *Ohio Business Gateway* (an Internet-based electronic filing system currently in use for certain state-level taxes). The change affects the following documents under the following time frames:

- i. Extension requests – beginning January 2005.
- ii. Estimated net profits payments – beginning January 2005.
- iii. Net profits tax returns – beginning January 2006.
- iv. Employer withholding returns – beginning January 2007.

Because of the electronic filing provisions added to the law, Ohio municipalities (and specifically the tax and finance departments) will be consulted regarding certain technological and banking issues over the next 12 to 18 months as the enhancements to the *Ohio Business Gateway* are performed. Furthermore, representatives of municipalities will be appointed to the Ohio Business Gateway Steering Committee, which directs the development of the *Ohio Business Gateway*.

Very truly yours,

The Ohio Department of Taxation