THE OHIO SOCIETY OF CPAs
ADVANCING THE STATE OF BUSINESS

Interested Party Testimony
Prepared for House Bill 157
The Ohio House Ways & Means Committee
March 16, 2021

Chair Merrin, Vice Chair Riedel, Ranking Member Sobecki, and Members of the Ohio House Ways & Means Committee, thank you for this opportunity to offer interested party testimony on behalf of our 27,000 members. I am Greg Saul, Director of Tax Policy for The Ohio Society of CPAs (OSCPA).

The COVID-19 pandemic has been difficult for all Ohioans, particularly those who have lost loved ones. It has also created many new challenges for employers, employees, and government entities alike. We have heard from several cities that want the temporary withholding provision to continue for years to keep that revenue stream flowing, and from businesses with legitimate concerns about needing adequate time to update processes to track withholding for an expected increase in the number of post-pandemic remote workers. But what I would like to focus on today are the unfair tax challenges impacting employees addressed in the legislation now before you. House Bill 157 solely seeks to repeal Sec. 29, H.B. 197 (133rd GA). Sec. 29 is really a temporary withholding provision and not a statement as to taxability – the location of where the tax is ultimately due. Historically, any employee has been able to receive a refund of taxes on the basis that the employee did not actually perform services in the municipality for which the taxes were withheld.

I encourage you to read the attached legal opinion written by Zaino Hall & Farrin for OSCPA that outlines why remote workers should continue to be eligible for refunds from municipalities where they neither work nor live. Tom Zaino is here with me in case you have any questions about the conclusions of that legal opinion. Here are some of the highlights:

Occasional Entrant Rule (20-Day Rule). Sec. 29, H.B. 197 only specifically references one Ohio Revised Code section – 718.011 – which addresses the 20-day withholding rule. In essence, Sec. 29 expanded the operation of the 20-day withholding rule until 30 days after the Governor's declared state of emergency order is revoked. The 20-day rule prohibits a municipality from taxing the compensation paid to a nonresident individual who worked in the municipality for 20 days or fewer in a year, or from requiring employers to withhold taxes against such individuals' wages. As soon as an employee hits day 21, then the employer has a withholding obligation to those municipalities. Common jobs affected by the 20-day rule are in construction, plumbing, HVAC repair, UPS delivery and other jobs where workers must travel to provide goods

or services. After twenty days of the pandemic, employers would have been required to withhold to many work-from-home locations due to stay-at-home orders. To prevent this, the legislature eased the administrative burden on employers by allowing the withholding to continue at the principal place of work location and not count the days worked at the work-from-home location toward the 20-day threshold. Of course, none of us thought it would still be in place a year later.

Small Business Employer Rule. The Sec. 29, H.B. 197 withholding provision is currently how the "small business employer rule" – ORC 718.01(TT) and 718.011(E) – has operated since the enactment of House Bill 5 (130th GA), which "requires employers with under $500,000 in annual revenue to withhold and remit taxes on all nonresident employee compensation only to the municipal corporation in which the employer has its sole fixed location. This rule applies regardless of the number of days that an employee works in other municipalities in a year. However, an employee that works in other municipalities may receive a refund of taxes withheld on compensation paid for work performed in the other municipalities." Source: House Bill 5 (130th GA), LSC final analysis, page 23.

Employee refunds. The process for requesting refunds is in ORC Sec. 718.19. "If a nonresident individual's employer withholds taxes under the 20-day rule for the municipal corporation in which the individual's principal workplace is located, the individual may receive a refund of those taxes on the basis that the employee did not work in that municipality. Similarly, if a small business employer withholds taxes for a nonresident employee for the municipal corporation in which the employer has its fixed location, the employee may receive a refund of those taxes to the extent that the taxes were withheld on compensation earned for work performed in a different municipality. **If an employee receives a refund in either case, the compensation upon which the refund is based becomes taxable in the municipality in which the work was performed."** Source: House Bill 5 (130th GA), LSC final analysis, page 23.

Courts have found that a municipality cannot tax a nonresident's income that is not earned in that municipality and that taxpayers are entitled to a refund of tax withheld on that income. This prohibition arises from due process protections – the Ohio Supreme Court has held that a municipal corporation taxing nonresident income may violate constitutional due process if there is no "fiscal relation" between the tax and the protections, opportunities, and benefits provided by the taxing municipality to the nonresident (e.g., police and fire protection). See also: House Bill 157, LSC bill analysis, page 2.

We understand that the Committee wants to protect Ohioans. Simply repealing Section 29 does not really achieve that goal. As we outlined above, Section 29 does have significant benefits for employers. The best way to address the concern of all Ohioans would be to clarify that the original intent of Sec. 29 was that refunds will be issued by the principal place of work city if the services are/were being performed elsewhere. In addition, the legislature could retain the withholding protections through the end of the

year — giving businesses time to set up new systems to track employees and comply with the municipal income tax. This intent should apply back to March 9, 2020 (when the state of emergency order was issued) and would clarify that H.B. 197 only dictated where the withholding would take place and not where the tax was ultimately due.

Net Profits Tax. Another benefit of Sec. 29 is that employee wages are counted toward businesses' payroll factor at a single location. Payroll is one of three factors – along with property and sales – that determines whether, and the extent to which, an employer's own income is subject to municipalities' tax on net profits. If Sec. 29 is modified or repealed, the legislature should clarify that withholding to employees' work-from-home locations, or employees who request refunds, would not impact the location of the employers' net profits tax obligation. More specifically, the payroll factor when calculating apportionment should remain at the principal place of work city (where the Sec. 29 withholding originally took place).

While we agree that the pandemic has had a significant impact on municipal revenue streams and will create challenges related to the ability of employers to keep up with administrative demands of municipal tax withholding once the state of emergency has been lifted, we believe employees should not be left with the financial burden of owing tax to a city for periods when they neither worked nor lived there. In fact, the Constitution prevents it. At the same time, employers should be given some certainty as they gear up for meeting their municipal withholding tax obligation in a post-pandemic world.

On behalf of the OSCPA, thank you for allowing me the opportunity to share our thoughts on House Bill 157. I would be happy to answer any of your questions.

ZAINO HALL & FARRIN LLC

ATTORNEYS AT LAW

MEMORANDUM

DATE: March 15, 2021
TO: The Ohio Society of CPAs
FROM: Thomas M. Zaino, JD, CPA
RE: Section 29 of Am. Sub. H.B. 197

You have requested that we discuss the impact of Section 29 of Am. Sub. H.B. 197 ("Section 29") on the right of certain employees to obtain a refund of withheld municipal income taxes. This memorandum only addresses the validity of Section 29 as applied to an individual who is a nonresident of the city in which his or her principal place of work is located.

Background

Chapter 718 of the Revised Code provides the structural framework that municipalities must use to impose their own municipal income tax. Chapter 718 does not impose the income tax, only local ordinances may enact and levy the tax. Each local ordinance must be levied in accordance with the provisions and limitations specified in Chapter 718.[1] Historically, an employer's withholding responsibility for employees has been separate and apart from the responsibility of an employee who owes tax. As a result, nonresident employees have always been permitted to obtain refunds of tax withheld to a municipality by an employer when the employee did not actually work in such municipality for portions of the year.[2]

As a result of the COVID-19 pandemic ("the Pandemic"), many companies requested their employees to work from home ("WFH"). The WFH requirement was generally in response to Governor DeWine's declaration of an emergency, but even "essential" businesses that were permitted to operate throughout the Pandemic have required WFH for some employees. Although the Pandemic was only expected to last two or three months, requiring employees to WFH created significant potential municipal income tax compliance burdens upon employers because the law generally required employers to withhold income taxes to any municipality in which an employee works more than twenty days. Employers would have been required to identify each municipality in which its employees resided, register for that city's withholding tax, and commence remitting withholding tax to those jurisdictions.

Legislative Response

On March 27, 2020, the General Assembly enacted Am. Sub. H.B. 197, which adopted various policies and protections related to the Pandemic, including provisions related to municipal tax withholding. Uncodified Section 29 of the bill provided the following:

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[1] R.C. 718.04(A).

[2] For example, see City of Columbus 2019 *Instructions for Form IR-25*, Part D: Adjustments to Taxable Wages, page 4 which provides in part: "Complete these lines only if you are a nonresident employee who worked part of the year outside of Columbus but your employer withheld Columbus tax." All cities have similar provisions, which allow for refunds to be claimed for tax withheld on wages earned outside the municipality.

> *Notwithstanding section 718.011 of the Revised Code, and for the purposes of Chapter 718. of the Revised Code, during the period of the emergency declared by Executive Order 2020-01D, issued on March 9, 2020, and for thirty days after the conclusion of that period, any day on which an employee performs personal services at a location, including the employee's home, to which the employee is required to report for employment duties because of the declaration shall be deemed to be a day performing personal services at the employee's principal place of work.*

This language is not a model of clarity and has created some misconceptions as to its impact. What is clear is that the language of Section 29 applies to employer withholding by protecting employers amidst the Pandemic, allowing them (but not requiring them) to continue withholding to the original workplace of the employer (i.e., the employee's principal place of work) until 30 days after the Pandemic's emergency order ends. Section 29 achieved this result by effectively expanding the employer's ability to use the 20-Day Occasional Entrant Rule under R.C. 718.011 and its related benefits contained in Chapter 718.[3] As a result, employers did not need to quickly register in each WFH city amid the Pandemic, track the employee's actual work location, and remit municipal income tax to all the jurisdictions in which the employees lived/worked.

Section 29 Does Not Determine "Taxability" of Employees Wages

Some municipalities have erroneously interpreted Section 29 to apply more broadly than just the withholding obligation of employers, arguing that Section 29 also prevents employees from obtaining refunds for income tax withheld to their principal place of work municipality even though the wages were actually earned elsewhere, including the employee's city of residence. This aggressive interpretation of Section 29 by some municipalities ignores the context of Section 29's actual words and generates many practical problems for employers and cities. Perhaps more importantly, such interpretation suspends the traditional rule that a nonresident is only subject to a city's income tax for work done within the city—that rule is reflected in most city tax ordinances[4] and is informed by case law under the Due Process Clauses of the U.S. and Ohio Constitutions, which prohibit cities from imposing their income taxes on nonresidents on income earned outside the city's borders. This is referred to in the case law as extraterritorial taxation. See *Hillenmeyer v. Cleveland Bd. of Rev*., 144 Ohio St.3d 165, 2015-Ohio-1623, ¶ 39, discussed below in more detail.

[3] R.C. 718.011 is optional for employers and provides that employers may choose to only withhold to the principal place of work even if the employee is working in other cities so long as the employee works in the other city on 20 or fewer "days" during the tax year. By deeming the WFH days as occurring at the principal place of work, Section 29 expanded the 20-Day Occasional Entrant Rule's 20-day limit with regard to the WFH location (i.e., the employee's home). If an employer does not opt to use the 20-Day Occasional Entrant Rule under R.C. 718.011, then the employer must withhold pursuant to R.C. 718.03, which requires that tax be withheld for any city in which wages were actually earned.

[4] On December 17, 2020, the City of Columbus quietly enacted an ordinance that incorporated the provisions of Section 29 "by reference." The ordinance, which seems to have not been posted to the Columbus Tax Division's website until January 7, 2021, coyly avoids stating that it imposes tax on income earned outside Columbus, but that is the clear implication. Ordinance No. 2967-2020, amending Chapter 362. We have not determined what other municipalities have adopted similar provisions prior to December 31, 2020.

The Context of Section 29's Words: The language of Section 29 deems that a "day" worked at home is deemed a "day" worked in the principal place of work city. The term "day" only has relevance with regard to an employer's withholding requirements under R.C. 718.011 and 718.03, not the taxation of the employee's income as described in R.C. 718.01. For nonresidents, municipal taxable income is defined as "income reduced by exempt income."[5] "Income" is then defined, in relevant part, as follows:

> *In the case of nonresidents, all income, salaries, qualifying wages, commissions, and other compensation from whatever source earned or received by the nonresident for work done, services performed or rendered, or activities conducted in the municipal corporation, * * *.*[6]

As a result, income may be taxed only if the income is earned for conducting any of the following three activities within a municipality: 1.) work done; 2.) services performed or rendered; or 3.) activities conducted. Nothing in this section refers to a "day." Section 29 does not deem that an employee's income is for services performed inside the principal place of work city. It merely deems it a "day" of work inside the PPW city—which is only relevant in the context of the 20-Day Occasional Entrant Rule (i.e., the withholding safe harbor for employers). In other words, the WFH city never hits day 1, let alone more than 20 days. Without Section 29, employers would be required to begin withholding for the WFH city on the 21st day.

Unlike the withholding sections of Chapter 718, nothing in the tax definition sections of Chapter 718 (cited above) refers to a "day." If the General Assembly had intended for Section 29 to "relocate" where the income should be ultimately taxed, it should have used the tax provisions' wording and stated that the income (not the "day") is deemed to be earned or received for "work done, services performed or rendered, and activities conducted" in the principal place of work city.

Why "For Purposes of Chapter 718" is Relevant: Some municipalities may point out that Section 29's provisions apply "and for purposes of Chapter 718," and therefore show an intent to apply to Chapter 718's taxability provisions. However, that position ignores the first part of the sentence, which provides: "Notwithstanding the provisions of 718.011, and for purposes of Chapter 718, * * *." Because Section 29 overrides and effectively expands R.C. 718.011's 20-Day Occasional Entrant Rule, it is necessary to add the phrase "and for purposes of Chapter 718" to ensure that the temporary change is reflected in other provisions of Chapter 718 that reference or rely on R.C. 718.011.

For example, the following other provisions of Chapter 718 are impacted as follows by the expansion of R.C. 718.011's 20-Day Occasional Entrant Rule:

- R.C. 718.01(C)(16), which defines exempt income of an individual/employee, provides that wages deemed earned in the principal place of work city are exempt from tax by other cities unless the employee files a refund claim with such principal place of work city.
- R.C. 718.02(A)(2), which applies to the employer's net profit tax returns, provides that wages withheld in accordance with R.C. 718.011 (but actually earned in the WFH city) do not need to be included in the numerator of the employer's payroll factor for the WFH city.

[5] R.C. 718.01(A)(1)(c).

[6] R.C. 718.01(B)(2).

- R.C. 718.03(A)(1), which requires employers to withhold taxes for cities in which their employees work, provides an exception to that general rule if the tax is withheld in accordance with the 20-Day Occasional Entrant Rule of R.C. 718.011.
- R.C. 718.82(A)(2), which applies to the net profit tax returns of an employer that elects to centrally file with the Ohio Department of Taxation, provides that wages withheld in accordance with R.C. 718.011 (but actually earned in the WFH city) do not need to be included in the numerator of the employer's payroll factor for the WFH city.

As can be seen, Section 29's reference to "for purposes of Chapter 718" is necessary to clarify that the expansion of the 20-Day Occasional Entrant Rule applies to all the other provisions in Chapter 718 that reference or rely on R.C. 718.011.

Expanded Interpretation Violates Due Process Clause:

The Due Process Clause of the Ohio and U.S. Constitutions and past rulings by Ohio courts preclude a municipality from imposing a tax on income of a nonresident not earned in the municipality. See *Hillenmeyer v. Cleveland Bd. of Rev.*, 144 Ohio St.3d 165, 2015-Ohio-1623, ¶ 39; and *Toliver v. City of Middletown*, 12th Dist. Butler Cty. No. CA99-08-147 (June 6, 2000).

Interpretating Section 29 as redirecting where the income was earned and is taxable cannot withstand the holding of the Ohio Supreme Court in *Hillenmeyer*. In *Hillenmeyer*, the Court addressed the jurisdiction of a taxing authority to impose its income tax on nonresidents. Specifically, the Court considered whether the City of Cleveland exceeded its jurisdiction to tax income of a nonresident professional football player by using a games-played method. Finding that the professional football player was paid for services performed from the beginning of the pre-season to the end of the post-season ("duty days"), the Court held that the use of the games-played method resulted in taxing income of the player that was earned for services performed outside the city. Id. Use of the duty-days method resulted in approximately 1.25 percent of the player's income being allocated to Cleveland. Use of the games-played method resulted in approximately 5 percent of his income being taxed by Cleveland, which constituted extraterritorial taxation. Id. at ¶ 46. The Court held that "Cleveland's power to tax reaches only that portion of a nonresident's compensation that was earned by work performed in Cleveland. The games-played method reaches income for work that was performed outside of Cleveland, and thus Cleveland's income tax violates due process * * *." Id. See also, *Saturday v. Cleveland Bd. of Rev.*, 142 Ohio St.3d 528, 2015-Ohio-1625.

In *Toliver v. City of Middletown*, 12th Dist. Butler Cty. No. CA99-08-147 (June 6, 2000), the Court of Appeals rejected the City's attempt to tax 100% of the income of nonresident truck drivers whose trips began and ended in the City but occurred primarily outside the City: "We therefore conclude that the city of Middletown did not validly exercise its power to tax under Section 890.03(a)(2) and violated the due process clause to the extent that the tax was imposed on the MG Drivers' salaries attributable to "work done" outside the city of Middletown."

The municipalities' aggressive interpretation of Section 29 will result in subjecting income earned by nonresident individuals for work performed outside a city to that city's income tax. The General Assembly has no power to confer upon cities a power of taxation that exceeds the cities' power under the Due Process Clause. *Hillenmeyer* held unequivocally that under the Due Process Clause, a city's "power to tax reaches only that portion of a nonresident's compensation that was earned by work performed in [the city]." Id. at ¶ 39. On July 2, 2020, The Buckeye Institute and several of its employees filed a declaratory judgment action in the Franklin County Court of Common Pleas challenging the validity of Section 29 of HB 197, claiming that it violated the Due Process Clauses of the U.S. and Ohio Constitutions. The case is scheduled for hearing this summer, but a ruling on a motion to dismiss the complaint has yet to be ruled upon. Even assuming that Section 29 is ambiguous as to whether it subjects nonresident individuals to a municipality's tax on income for worked performed outside the municipality, R.C. 1.47(A) requires that it be construed in a manner that complies with the constitutions of the state and of the United States.

Gesler v. City of Worthington Income Tax Bd. of Tax Appeals

Even absent the Due Process Clause constraints, the General Assembly cannot require a city whose ordinance imposes its tax only on income of nonresidents for work performed in the city to impose tax on nonresidents for work not performed in the city. Most city ordinances contain such language. Although the General Assembly has the authority under Article XVIII, Section 13 and Article XIII, Section 6 to limit or restrict the power of taxation of municipal corporations, this authority does not permit the General Assembly to require municipal corporations to impose a tax on income that the municipal ordinance does not tax.

In *Gesler v. City of Worthington Income Tax Bd. of Tax Appeals*, 138 Ohio St.3d 76, 2013-Ohio-4986, the Ohio Supreme Court addressed a City Ordinance that, because of a drafting error, did not tax income reported on federal Schedule C. Gesler paid tax to the City on Schedule C income and later requested a refund for such tax paid. The City denied the refund, relying on former R.C. 718.01(E), which stated that municipal corporations were required to include Schedule C income in their tax base. The Court rejected the City's argument, holding that "the General Assembly cannot command Worthington to impose a tax on Schedule C income when Worthington has chosen not to tax that income, because such a requirement is not an act of limitation. Id. at ¶ 22. Just as the General Assembly could not require Worthington to impose its tax on federal Schedule C income, it cannot require cities to impose tax on compensation of nonresidents that a city's ordinance does not tax. Therefore, if the particular city only taxes income of nonresidents for work performed in the city, Section 29 cannot be relied upon by the city to tax compensation of nonresidents for work performed outside the city.

Conclusion

Municipalities should not use Section 29 as a tool to prevent nonresident employees from obtaining refunds of tax withheld to their principal place of work amidst the Pandemic because this position is not supported by the language of Section 29 and would be unconstitutional under existing Ohio Supreme Court precedent.