

**Before the Ohio House of Representatives**  
**Finance Committee**

**Testimony of:**  
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Chairman Smith, Vice Chairman Ryan, Ranking Member Cera, and members of the House Finance Committee. My name is Melinda Frank and I am the Income Tax Administrator for the City of Columbus. Thank you for affording me the opportunity to speak to you today regarding that language in House Bill 49 which impacts the municipal net profits tax. I have perhaps a unique perspective on actions taken by the State of Ohio with regard to the municipal income tax as I have held my present position since September 1987.

I listened to the testimony offered March 7, 2017 to the House Ways and Means Committee and to the testimony offered to your subcommittee on State Government and Agency Review March 14 and March 21, 2017. I feel that I must make several comments to you as a result of that testimony. Please note that some of my comments reference testimony previously offered to the Ways and Means Committee as well as to your Subcommittee.

Testimony has been offered which infers that municipalities have no idea of their cost to administer and collect the local tax. It imperative to recognize that no municipal representatives were contacted as information was gathered for the formulation of reports which have

been used to support the Department of Taxation's position with regard to centralized collection of the municipal net profit tax. In fact, the assertion was made in testimony before the House Finance Subcommittee on March 14, 2017 that there was no need to do so as all of the information required could be found in a municipality's CAFR (Comprehensive Annual Financial Report) or budget. Unfortunately, many municipalities must include in their budget an estimate of refunds to be issued for the year, as well as include the total refunds issued in their CAFR reported expenditures for office operations. The City of Troy, for example, included \$319,894.19 in its expenses to cover refunds issued in 2015. This figure is shown only in the budget and not in the CAFR. That amount was included in the "Total Expenditures" of \$755,708 related to collection of income tax revenues (reported in the CAFR for Troy at page 105). If one would look only at page 105 of the Troy CAFR to find income tax collections, the number shown for 2015 is \$15,117,366. However, that is not the total for income tax revenues collected. It is necessary to continue to page 107 of the Troy CAFR to see the additional income tax revenues of \$2,519.443 which were collected and designated as "Safety Income Tax". Applying the composite "Total Expenditure" number to the partial "Income Taxes" number results in a 4.9% cost to administer the tax as reported by the Department of Taxation. However, the true expenditure to operate the Troy Income Tax offices for 2015, when referring to the budget, was \$397,545 and the total income tax collections for 2015 were actually \$17,636,009. Using these figures, the calculation for the cost to administer and collect the tax for 2015 yields 2.2%. (Copies of referenced material are attached to my testimony.)

The validity of the information provided to this body's subcommittee as

well as to the House Ways and Means Committee with regard to costs to administer the income tax in each of 96 municipalities is questionable at best, and for those communities that include the amount of refunds issued in their reported expenditures, just flat out wrong. Utilizing numbers found in reports without knowledge of the basis of those numbers yielded results used in support of the position proposed by H.B. 49 that administration and collection of the municipal net profits tax by the Department of Taxation would be more cost effective for municipalities. As municipalities testified before the Ways and Means Committee March 7, 2017, any fee charged by the State of Ohio to administer and collect a municipal business net profit tax, will be over and above the current expenses to operate the local office which would continue to perform the functions of administering and collecting the other forms of local income tax. In the case of the City of Columbus, in 2016 slightly in excess of \$1.9 million dollars was collected in business net profit taxes which represents 12.3% of the total income tax revenue collected which was a net of \$839,913,000. The cost to operate the Division of income tax in 2016 was slightly in excess of \$9.6 million or 1.14% of net collections. The additional charge by the Department of Taxation would be \$109,000, which would have the effect of increasing our overall costs of administration and collection.

As relates to the tax itself, with the passage of H.B. 49 as proposed, it would no longer be a municipal net profit tax. It would be a state tax utilizing a municipal rate. The ability of municipalities to impose a net profit tax is stripped by H.B. 49 as demonstrated by the repeal of those sections of ORC 718 related to the imposition of a municipal net profit tax. Municipalities will have no standing with regard to the tax. "The Redbook" at page 10 of "Catalog of Budget Line Items" in the "Purpose"

for 7095 110995 *Municipal Income Net Profits Tax* , states : “This fund is used to distribute taxes collected by the state from electric companies and telephone and telecommunications companies to the local governments to which these taxes are owed. **Under an executive proposal in the main operating budget bill, the appropriation item appears in State Revenue Distributions and would be used to distribute revenue from a new tax administered by the Department that would replace taxes of municipal governments on business income (emphasis added)”.**

There is no ability for a municipality to audit, no ability to question a filing or a refund request, no ability to question or appeal a finding of the State Commissioner. As it would not be a municipal tax, there is no basis to allow municipalities to view filings or verify any information provided by the taxpayer. Confidentiality restrictions would prohibit municipal viewing of filing information. Testimony has been offered in reference to a portal for property tax Homestead exemption information as an example of what might be able to be provided for municipalities with regard to access to net profits filing information. “Might” is the operative word as municipalities will no longer be the tax authority and will not be entitled to that confidential information. Indeed, if the information is made available, to what purpose may it be put in light of the fact that municipalities have no standing with regard to the tax. Keep in mind that property tax information is not afforded the confidentiality of income tax information.

Municipalities are actively involved in the processing of business net profit returns.

In light of the proposal contained in the biennial budget recently submitted to the House by Governor Kasich, providing for filing of municipal net profit returns and making of related payments through the Ohio Business Gateway, the following information has been pulled from the City of Columbus Income Tax database and represents adjustments made to refunds, liabilities and credits reflected on business returns filed in 2014, 2015 and 2016 as the result of review and/or audit by the City of Columbus, Income Tax Division of all business net profit returns filed in the referenced years.

With regard to filings for the **2014** tax year:

- Refunds adjusted (reduced) 114 accounts  
\$299,860.26
- Liabilities adjusted (increase in tax due) 88 accounts  
\$134,103.80
- Credits adjusted (reduced) 248 accounts  
\$369,590.24

**The total impact to 2014 revenue - \$803,554.30**

With regard to the filings for the **2015** tax year:

- Refunds adjusted (reduced) 98 accounts  
\$216,899.20
- Liabilities adjusted (increase in tax due) 84 accounts  
\$201,882.33
- Credits adjusted (reduced) 282 accounts  
\$578,006.02

**Total impact to 2015 revenue - \$996,787.55**

With regard to the filings to date for the **2016** tax year:

- Refunds adjusted(reduced) 115 accounts  
\$305,250.27
- Liabilities adjusted (increase in tax due) 41 accounts  
\$42,609.00
- Credits Adjusted (reduced) 243 accounts  
\$752,198.67

**Total impact to 2016 revenue to date - \$1,100,057.94**

The Division audits all refund requests prior to actually authorizing the issuance of refunds. Adjustments to liabilities and credits are the result of all returns received by the Division being audited for accuracy and completeness. The Governor proposes that municipal filings and payments to be made through the Ohio Business Gateway, auditing returns “when appropriate”. Clearly, the information above indicates that an audit of **all** net profit returns is appropriate. The receipt of business returns by the Division serves a broader purpose than merely that of an annual filing. The information from those returns is compared to annual local withholding reconciliations filed by those same entities which could result in adjustments to wage figures included in the formula used when calculating tax due on the net profit return.

Municipalities also have established discovery and notification methods for those businesses subject to their tax. For the City of Columbus, one project, which examines unreported rental income resulted in additional net profit account payments of \$1,000,018 in 2015 and

\$1,526,348 in 2016. Audit projects similar to this are conducted throughout the year. Often the businesses are filing with the wrong jurisdiction. This is common if the corporation owning the property and receiving rents is not local and the appropriate taxing jurisdiction is assumed to be based upon the mailing address of the property which, in large – and not so large – metropolitan areas may have no relationship to the taxing jurisdiction in which the property is located.

On March 7, 2017 of Scott Drenkard of the Tax Foundation offered interested party testimony to the House Ways and Means Committee. He referenced the method used by the State of Maryland for the administration and collection of local tax. Maryland utilizes the State return for the reporting and payment of local income tax. Mr. Drenkard failed to mention that the State of Maryland misdirected more than \$21 million as the result of misclassifying the proper taxing districts. To be fair, a large percentage of the tax paid was directed to the appropriate jurisdictions. The misdirection occurred due to “special tax districts that have irregular boundaries”. (A copy of the related article from the Baltimore Sun has been provided.) This presence of irregular boundaries describes the JEDZs (Joint Economic Development Zones) and JEDDs (Joint Economic Development Districts) that abound in Ohio. It also would apply to those areas annexed during the tax year by municipalities. The Columbus Income Tax Division has experienced taxpayers filing and remitting tax to improper jurisdictions due to their reliance on the State of Ohio “Finder”. Its information is not accurate, even with regard to existing addresses. I also have been advised in the past, that the State Finder is updated only annually. Perhaps this is now not the case.

Testimony offered before The House Finance subcommittee on March 14, 2017 advised that with regard to sales tax distribution, there is sometimes misdistribution for a business close to a county line. Without an accurate and continuously updated geo-data base, inappropriate distributions of business net profit tax to municipalities will be made. Municipalities update geographic data bases as annexations occur, and contact those taxpayers in recently annexed areas to educate them and ensure compliance. Additionally, reliance on a mailing address to determine the correct jurisdiction of a taxpayer is not possible in densely populated areas with large cities and suburbs that share Post Office services and Zip Codes. The City of Columbus sends approximately 65,000 notices out annually to individual and business addresses that are located in Columbus but have suburban mailing addresses.

A “one time cash flow shift” has been referenced as one of the results of the adoption of the proposed language with regard to the distribution of collected tax to municipalities. It is not a cash flow shift, but a cash flow loss. The language of proposed §5718.10 provides that prior to the first day of March, June, September and December, the amount to be paid to each municipality will be certified by the tax commissioner. However, §5718.08(C)(1)(a) through (d) provides that; the 1<sup>st</sup> quarter payments are not due until the 15<sup>th</sup> day of the fourth month of the taxable year, the 2<sup>nd</sup> quarter payments are not due until the 15<sup>th</sup> day of the 6<sup>th</sup> month of the taxable year, the 3<sup>rd</sup> quarter payments are due the 15<sup>th</sup> day of the 9<sup>th</sup> month of the taxable year, and the 4<sup>th</sup> quarter net profit due date is on or before the 15<sup>th</sup> day of the twelfth month of the taxable year. Each due date falls into the following quarter’s certification resulting in the municipalities waiting for no less

than 90 and most likely 120 days to receive funds from the previous quarter. For the City of Columbus, utilizing 2016 net profit collections, this would represent a delayed distribution in excess of \$27 million dollars. The delay of a calendar quarter in sending cash to the cities would force the cities into cash flow borrowing in order to meet the expenditure requirements during that period. This cash flow delay is a grave concern for all cities. It also should be noted that payments related to business net profit tax are not received by municipalities only on or shortly after the dates outlined in proposed §5718.08. Net profit tax payments are received monthly, weekly or even daily by self-administered municipalities. Currently, third party administrators remit tax collected to contract municipalities on a twice-monthly or monthly basis, depending upon the administration and collection agreement terms.

Please also note that no provision is made in the proposed ORC 5718 for the administration and collection of tax due from fiscal year filers.

Unfortunately, the Ohio Department of Taxation must be unaware of the problems that have plagued that portion of the Gateway that serves municipal filers. Of course the Gateway can handle the Department of Taxation filings...the use for which the Gateway was primarily designed. It uploads bulk files for the filing and payment of employer withholding. Most of the municipal transactions via the Gateway cited in previous testimony offered relate to employer withholding transactions. As mentioned by several municipal representatives providing testimony last week, and found in the "Building for Ohio's Next Generation" summary (attached), only 4000 businesses operating in Ohio utilize the Gateway for filing net profit

returns. This is not the fault of the municipalities. When the language of Amended Substitute H.B. 95 was passed by the 125<sup>th</sup> General Assembly, a uniform net profits base was established and effective for tax year 2004 forward, municipalities could not tax a business's net profit using any base other than Adjusted Federal Taxable Income. Additionally the Bill mandated the acceptance by municipalities of filings and payments from business taxpayers through the Ohio Business Gateway. In light of the expense that municipalities had to incur to accept filings and payments thorough the Gateway, the legislature determined that there should be no charges assessed with this use of the Gateway. Municipalities have contacted the Gateway relating problems experienced by users. Unfortunately, this may be a case of "you get what you paid for".

Columbus, like many municipalities in our state, has its own e-file/e-pay application. As of March 1, 2017 Ohio Business Gateway Transactions numbered 6,200 for 3,486 distinct accounts with related payments of \$13,723,909.79, while the number of transactions made to the Columbus application totaled 58,211 for 16,169 distinct accounts with related payments of \$91,053,503.72. Annual figures for 2016 show there were 31,496 transactions for 4,437 distinct accounts with related payments of \$82,209,835.62 submitted through the Gateway by Columbus taxpayers, compared to 335,857 transactions for 23,266 distinct accounts with related payments of \$527,093,514.17 submitted through Columbus' e-file/e-pay option. Clearly businesses in Columbus prefer to use the Columbus application with regard to their filings and payments.

Testimony offered by municipalities to the House Ways and Means

Committee has demonstrated the inability of the Gateway to function efficiently and reliably as evidenced by the frequent notifications issued to municipalities. These notifications are most assuredly not benign correspondence and range from notification that there “is a delay in daily activity and payment processing” instructing not to process ACH files sent to the municipality’s bank until notification is received of a resolution to the issue – which often is a balancing problem on the part of the Gateway, to the Gateway having made duplicate withdrawals from taxpayer accounts which were passed to the municipalities. The latter situation occurred with regard to the City of Columbus in May and September in 2016. In May, the Gateway sent Columbus two files, one for \$131,629.32 and another for \$120,481.23. The Gateway advised us that the \$120,481.23 was a duplicate payment and expected Columbus to return it. This matter required the involvement of our City Treasurer, JP Morgan Chase (the bank that handles transmissions for the Gateway to municipalities), the companies that had tax payments deducted from their accounts twice and the Lt. Governor’s office. Unfortunately, the same situation occurred again in September 2016. But, due to our learning experience in May, a repeat of the chaos was avoided in September due to the fact that we reviewed the files prior to posting, and were able to deny the file to allow the Gateway to resolve the matter. In this case one taxpayer made duplicate payments to 38 municipalities.

As mentioned, a majority of the Gateway problems arise from not being “in balance”. For that reason there are numerous notifications that ACH files sent to our banking partner are not to be processed. This prevents the posting of funds related to that day and delays the creation of daily reports. In short, the Gateway issues hold up the

business processes of the City. There have been several instances where the City has been unable to post payments for several days due to Gateway imbalances (e.g. notification sent 7-8-16/ resolution email 3:54 PM 7-11-16). On occasion there have been two issues with the Gateway at one time as an earlier issue was not resolved before the second occurred. Often, we have not been informed of OBG problems until late morning or early afternoon which prevents our office from posting the day. This inability to post relates to all payments received by the Income Tax Division, not just the OBG transmission, as we are unable to balance without the OBG information and payments. I have archived more than 183 emails from 2016 related to Gateway delays in daily activity and payment processing. Again, to be fair, not quite half of those communications advise of a resolution, although a number of the communications are subsequent notifications of the ongoing problems apologizing for any inconvenience caused and thanking us for our patience. The Department of Taxation may not have been made aware of these issues and the shortcomings of the Gateway with regard to municipal payment processing, but the Lt. Governor's office is more than aware of these shortcomings.

A question was posed during March 14, 2017 testimony before the House Finance subcommittee regarding what incentive the State would have to ensure compliance. What incentive is there indeed to timely audit and issue refunds? Currently, the State, in the administration and collection of the municipal utilities net profits tax, frequently sends notice of refunds, which it has approved and municipalities must issue, well beyond the three year statute of limitations. If indeed a net profits refund is not issued within 90 days of the date the filing is due, or if an amended return is filed resulting in a refund for a prior period, it is the

municipality that is penalized by having any statutorily imposed interest for late payment of the refund automatically deducted from its State distribution despite the fact that the municipality has no control over the actions taken with regard to that refund request. (proposed §5718.22(B)(2)(b)) Columbus does not place itself in the position where interest payments to taxpayers are required.

Note: I would also like to point out that § 5718.22 moves from subsection (B) to subsection (D) with no subsection (C).

I would like to speak briefly to the concept of being “business friendly”. Municipalities across the State of Ohio interact and cooperate daily with businesses within their jurisdictions as well as with those businesses which might potentially locate within their jurisdictions.

Consider the numerous municipal tax credit agreements that are currently in place. These agreements and related information must be monitored by the related city Development Department and audited by the Income Tax offices to determine what credit, if any the business is entitled to against net profit liability. It is imperative that the business returns be received and reviewed by the municipal party to these agreements. A majority of these agreements provide for a 10 year period and include property tax abatements in addition to the income tax credits. With regard to those agreements to which the City of Columbus is a party, the entity receiving the property tax abatement and income tax credit agrees to file its Columbus City return and is instructed within the agreement as to where to place the credit on the return and what additional documentation must be attached to the return to be used in the verification, through audit by the Division, of eligibility. Proposed § 5718.15 removes from a municipality the ability

to verify eligibility for any tax credit. Further, it authorized to Tax Commissioner to “adopt rules to delineate the documentation necessary to verify a credit...”. At this time, the City of Columbus is party to 24 Job Creation Tax Credit (JTCT) Agreements. \$1,193,086 in JCTC credits were utilized by participating entities in 2015 against net profit liabilities and \$715,362 in 2016. One participating entity alone has, over a 7 year period, received \$2,084,379 in tax credits as a result of its agreement with the City of Columbus. Information from the City of Cincinnati indicates that there are between 40 to 50 active Job Creation Tax Credit Agreements to which that city is a party.

With reference to proposed §5718.22(D) which provides: “Nothing in this section permits a taxpayer to carry forward any refundable amounts to a future taxable year”, such language would require that all existing credits held by municipalities under the direction of taxpayers be refunded. This would place many jurisdictions in fiscal emergency. Requiring the refund of voluntary overpayments by taxpayers is not “business friendly”. Municipalities are well aware of the tax planning aspects of the credits that are maintained by those businesses operating within their jurisdictions. And too, if an overly large estimate payment is submitted by a taxpayer, that taxpayer will most likely be contacted prior to the deposit of that payment to ensure that it has not been made in error. This is the human touch employed by municipalities not found in automation and attaining economies of scale advocated by the Department of Taxation.

Finally, as previously mentioned, about 4,000 business net profit tax returns are filed annually via the Ohio Business Gateway. Columbus had a total of 28,494 net profit returns filed in 2016. During 2016, 228

business accounts used the Gateway for the filing and payment of estimates, credits, liabilities or zero returns, only 40 of which were annual net profit return filings. It is most likely that the Gateway was used primarily to make quarterly estimated payments. Cincinnati has 13,000 net profit return filers with an estimated 25 of those filers utilizing the Ohio Business Gateway. The Regional Income Tax Agency processed 71,341 net profit returns in 2015, 197 of which were received through the Ohio Business Gateway. The Central Collection Agency has 38,606 business net profit filers. This number represents those filers in Cleveland as well as those in the other jurisdictions administered by CCA. Looking only at net profit returns filed with these four (4) administering bodies, an additional 151,441 net profit returns and any related payments would be directed to the Ohio Business Gateway. During testimony offered to the house Ways and Means Committee on March 7, 2017, it was indicated that should the Gateway not be prepared to accept the electronic filings of business net profit returns as of January 1, 2018 as mandated by proposed House Bill 49, the Department of Taxation would accept paper filings. Before this body's subcommittee, testimony was offered that it would not be necessary to have the filing application up and running by January 1, 2018 as annual filings would not be due until the following year. Delinquent returns and related payments are received by local offices on a regular basis. If the Department of Taxation is not prepared to accept electronic filing of business net profit returns due prior to 1-1-18 it would appear that the businesses will have to submit paper filings. This situation would be bureaucratically burdensome and definitely not business friendly. State administration of municipal net profit returns will result in a disservice to municipalities and taxpayers.

Hopefully, my comments have assisted you in gaining an understanding of municipal use of business filer information, how and when net profit payments are received at the local level, as well as with regard to cash flow needs of municipalities, the reporting of municipal revenues and expenditures and the benefit of working relationships between municipal tax office staff and business taxpayers.

I urge the removal of all language relating to the municipal income tax as found in H.B. 49. I would be happy to answer any questions.