Policy Matters Ohio

Executive Summary
January 2013

Municipal Income Tax "Fix" is a Flub

Legislators should cut tax avoidance, not invite it

Zach Schiller

A major rewrite of the state law governing Ohio municipal income tax is being discussed in Columbus. Increasing the uniformity of municipal income taxes across the state is a laudable objective. Unfortunately, the legislation proposed so far leaves loopholes in the current law untouched and creates new ones. It also could cost cities significant amounts of money. A major effort to overhaul Ohio's municipal income tax should crack down on tax avoidance, guarantee a broad tax base, and ensure that those most able to pay are in fact doing so. When this issue is taken up in the next General Assembly, legislators should address those objectives.

Key findings

- Proposed change in state law could cost cities significant money.
- The proposal ignores or even invites tax avoidance; preserves special carve-outs; and gives boutique arrangements to the wealthiest.
- Legislators should instead close current loopholes, prevent new tax breaks, and ensure that municipalities are not clobbered by a new round of tax cuts.

This brief examines some of the ways that the proposal ignores or even invites tax avoidance instead of restraining it. For example:

- Companies can now reduce the municipal tax on their profits by making payments for the use of intangible property – for instance, using a trademark – to affiliated passive investment companies (PICs). Since municipalities can't tax intangible income, even if these PICs are located in the same city, the income goes untaxed. A 2003 Ohio taxation department memorandum estimated that municipalities could gain $27.9 million in Fiscal Year 2004 from restricting this tactic.
- Similarly, by making payments to related entities that aren't taxable, companies can reduce their municipal tax liability.
- The bill prevents municipalities from taxing income from the shipment of products to other cities where a company does not have sales agents, income that today is taxed in the home city. The city of Columbus found recently a single company paid $385,000 in such tax.
- HB 601 would preserve special carve-outs for stock-option income and deferred compensation paid to residents of Cincinnati and Findlay, allowing wealthy executives of Procter & Gamble and Marathon Petroleum to pay less municipal income tax on their pay.
- It would adopt a narrow state definition of who is an Ohio resident, allowing affluent residents who spend significant time out of state to avoid municipal tax.

The bill would preserve the right of Indian Hill and a handful of other municipalities to continue taxing unearned or intangible income, something that others in Ohio are not and will not be permitted to do. Unearned income includes income from dividends, interest, sales of stocks and bonds, and other sources. Indian Hill is one of the most affluent communities in Ohio. The vast majority of the 181 Ohio school districts levying income taxes cover unearned income. The General Assembly should consider allowing all Ohio municipalities to tax this source of income.

Though the sponsors of House Bill 601 said they attempted to achieve "substantial revenue neutrality," the Legislative Service Commission concluded that revenue losses from the bill could be significant. Cities and villages have already been hammered by reductions in state aid in the current budget, with hundreds of millions of dollars more each year to be lost because of the repeal of the estate tax. The General Assembly should ensure that municipalities aren't clobbered again. It should close current loopholes that allow tax avoidance and prevent the creation of new ones.