

## Ohio: Appeals court upholds centralized collection of municipal net profits tax



David M. Kall | Thursday, February 7, 2019

We have been following a legal challenge to the new process in Ohio for businesses to file their municipal net profits tax returns centrally with the Ohio Department of Taxation rather than with several separate municipalities. In the latest development, the Franklin County Court of Appeals **upheld** the centralized collection process against a challenge from dozens of municipalities. A discretionary appeal to the Ohio Supreme Court could be forthcoming.

### Background

Due to the heavy administrative burden businesses face to comply with many municipal income taxes in Ohio, the General Assembly enacted a law change in 2017 that allows for the centralized administration of the tax. The Department of Taxation **estimated** that business taxpayers could save up to \$800 million per year in compliance costs under the new process.

Business taxpayers now have the option of filing one municipal net profits tax return with the Department of Taxation and having the tax administered there. That means the tax department would perform audits and hear initial appeals. Municipalities still administer the municipal income tax for individuals, municipal employer withholding tax, and municipal net profits tax for non-electing taxpayers.

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Electing businesses have until the first day of the third month of their taxable year to make the election, so March 1 for calendar year taxpayers. Taxpayers making the election must provide notice of their election to each municipality in which they did business during the prior year. The election remains in effect for subsequent years until terminated.

### Legal Challenge Rejected

Over 140 municipalities **brought a legal challenge** to the state law allowing for the centralized collection process, as well as a 2014 state law (**House Bill 5**) that promoted uniformity in municipal income taxation. Primary among their concerns are the potential loss of tax revenue and the 0.5 percent fee the tax department receives for administering the centralized collection process. The fee, however, compensates the tax department for its administration services and presumably reduces the costs to municipalities to administer their net profits taxes.

The legal theories municipalities advanced contested the new collection process and other tax law provisions on the ground that the laws unconstitutionally interfere with local control over taxation and municipal “Home Rule” powers. **Article 18, Section 7 of the Ohio Constitution** allows municipalities “all powers of self-government,” including the power to tax. Another constitutional provision, however, allows the Ohio General Assembly to “limit the power of municipalities to levy taxes.” The crux of the dispute in the case centered around the definition of the word “levy” and whether it included the centralized collection process at issue.

After reviewing the history of municipal Home Rule in Ohio, the Tenth District Court of Appeals found that dictionaries contemporaneous with the Ohio Constitution provisions at issue define the word levy to mean “to raise or collect by assessment.” The Court therefore found the Ohio General Assembly’s power over municipal taxation extended to the collection and administration functions at issue. The Court additionally rejected the Home Rule challenge to the limits on taxation that the General Assembly passed in 2014 through HB5. The Court further rejected legal theories alleging that the collections process violated the rule limiting legislation to one subject, interfered with existing municipal contracts with third-party administrators, and violated “due course” guarantees regarding the administration of refund claims for prior years.

One member of the three-judge panel, Judge Gary Tyack, dissented. He stated that the fee for the collection process amounted to an unlawful state tax on municipalities. He also disagreed with the Court majority’s analysis of the One Subject Rule challenge.

### Another Appeal Likely

The dispute is not over yet, as appeal window remains open for the coalition of municipalities to take an appeal to the Ohio Supreme Court. The Supreme Court, however, has the discretion to reject any such appeal. We will continue to report on the latest developments as they occur.



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