Ohio Tax Talk: Rethinking The Work-From-Home Tax

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Now more than ever, companies and organizations are evolving to allow employees to work from home. Some companies are even mandating telework. If remote work is the way of the future, Ohio and its municipalities are going to need to rethink their method of income taxation.

Just as many Ohio businesses have been adversely impacted by the coronavirus pandemic, so have local government treasuries as they work to manage reduced tax receipts. In an apparent attempt to quell concerns about reduced municipal income taxes and filing compliance, the Ohio General Assembly included Section 29[1] in its emergency legislation, H.B. 197, which was signed into law by Gov. Mike DeWine on March 27.

Essentially, Section 29 of H.B. 197 attempts to tax employees who work from home during the coronavirus state of emergency as if they were working at their old workplaces, pre-coronavirus. This applies to wages and income earned for the period beginning March 9 and extending until 30 days after the emergency period declared by DeWine's Executive Order 2020-01D. The emergency period remains in effect as of the date of this article and it is unclear when it will be lifted.

Ohio Municipal Income Tax and the 20-Day Rule

It is worth noting how municipal income taxation generally works in Ohio. Municipal income tax is withheld from employee paychecks and paid to the municipality in which the employee's principal place of work[2] is located. Residents of Ohio municipalities are also subject to municipal income tax on all income derived and received by that resident — subject to certain exemptions.[3]

Some municipalities, but not all, will issue an income tax credit to its residents for municipal income taxes paid to another municipality — e.g., the municipality where they work. This helps taxpayers avoid being double taxed by two separate municipalities on the same

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income.

Moreover, prior to the passage of H.B. 197, Ohio already had a procedure in place for employees who occasionally worked from home. This was called the 20-day rule.

Under the 20-day rule, municipal income tax must be withheld for the employee's principal place of work for the first 20 days an employee works in another Ohio municipality — the nonprincipal place of work municipality.[4] After the first 20 days, municipal income tax must be withheld and paid to the employee's nonprincipal place of work municipality.

The Effect of H.B. 197

With this backdrop in mind, one can see how the work-from-home trend can significantly impact a municipality's income tax revenues.

But for the passage of H.B. 197, any employees who work from home more than 20 days would not have been subject to the municipal income tax in the location of their former principal place of work. With the passage of H.B. 197, the Ohio General Assembly seeks to retroactively freeze an employee's principal place of work to be where it was before March 9.

The passage of H.B. 197 would not impact a person who lives and works in the same municipality. However, for someone who lives in a place with low or no municipal income tax, i.e., a township, and used to work, before March 9, somewhere with higher taxes, H.B. 197 does have an impact because they are potentially paying additional income tax to a municipality that they neither live nor work in anymore.

On the government side, municipalities are being impacted as well. Certain municipalities with a low resident base, but a large commuter and business base, would stand to benefit from the passage of H.B. 197 because they will continue to collect a withholding tax on wages.

This may be why certain municipalities, such as Cincinnati, have come forward and publicly made clear that they will be complying with the terms of H.B. 197. In an April 14 memo to city council, the

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former City Manager Patrick Duhaney clarified that, in accordance with H.B 197, days worked at the employee's home due to the declaration of emergency are considered days performing personal services at the employee's principal place of work. This means that the employer does not need to change its method for withholding taxes or filing its returns. It also prohibits employees who are required to work from home due to the declaration from claiming a refund based on days worked outside the principal place of work.

The importance of continuing to collect income taxes from workers is obvious as cities across Ohio are struggling to manage limited budgets and expected revenue shortfalls in the wake of the pandemic.

Other municipalities with a high resident base, but a low a commuter and business base, may be harmed by H.B. 197. This latter category of municipalities could be harmed because, even though a greater number of residents are working there and using more community services, the municipality might still be unable to collect its fair share of tax due to the credit permitted for taxes paid to another municipality.

As mentioned above, not every municipality does allow for residents to take the credit for taxes paid to another municipality, but many do.

Beyond the personal and governmental issues, businesses are also forced to comply with the terms of H.B. 197 and the changing locations of their workforces. One key benefit of H.B. 197 is the level of security it created for businesses who are tasked with managing employee tax withholdings. H.B. 197 made it easier to comply with their withholding requirements and continue to withhold tax based on an employee's workplace as of March 9 even as employees are changing their principal places of business.

The Buckeye Institute Case

On July 2, a group of taxpayers filed suit against the state of Ohio and the city of Columbus challenging the constitutionality of H.B. 197.[5] A Columbus-based nonprofit think tank named the Buckeye Institute and three other individuals are the named plaintiffs in the

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case, The Buckeye Institute v. Megal Kilgore, Columbus city auditor, and Dave Yost, Ohio attorney general. In summary, the plaintiffs make two requests for relief in the case.

The first request is for a declaratory judgment that would void, in its entirety, Section 29 of H.B. 197. The plaintiffs' argument is based upon the due process protections afforded by the Fifth and 14th Amendments to the U.S. Constitution. The plaintiffs argue that there is no "fiscal relation" between the municipality, the taxpayer and the income being taxed:

In this case, the City of Columbus, pursuant to authority purportedly arising under Sec. 29 seeks to tax income of nonresidents that was earned outside the city limits, where there is neither nexus nor fiscal relation between the city and the income being taxed.

The complaint also alleges that the Buckeye Institute, as an Ohio employer, "is required to participate in this unconstitutional violation" by virtue of the employer withholding requirements of Section 718.03(A)(1).

The plaintiffs' second request is for the court to enjoin the city of Columbus from collecting any further municipal income tax in this manner and require them to refund all withholding payments erroneously collected thus far.

The defendants, the Columbus city auditor and Ohio attorney general, have not yet filed a response in this case. It remains to be seen whether any additional plaintiffs will file suit in a similar manner or be added to this case.

Conclusion

The complaint filed in Buckeye Institute may well serve as a warning to municipalities across the state of Ohio. While it is uncertain as to whether the plaintiffs will succeed in this particular case, it is becoming clear that methods of municipal income taxation will need to evolve in order to keep up with the changing patterns of the workplace.

Municipalities should carefully consider how they would defend any action similar to the one brought against the city of Columbus in the

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Buckeye Institute case and how their tax revenue projections, and budgets, would be impacted in the event that Section 29 of H.B. 197 were deemed unconstitutional and overturned.

For more information, contact any member of Frost Brown Todd's Tax Practice.

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[1] Section 29 of H.B. 197 reads as follows:
SECTION 29. 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.
[2] Ohio Revised Code ("O.R.C.") 718.011(A)(7). "Principal place of work" means the fixed location to which an employee is required to report for employment duties on a regular and ordinary basis. If the employee is not required to report for employment duties on a regular and ordinary basis to a fixed location, "principal place of work" means the worksite location in this state to which the employee is required to report for employment duties on a regular and ordinary basis. If the employee is not required to report for employment duties on a regular and ordinary basis to a fixed location or worksite location, "principal place of work" means the location in this state at which the employee spends the greatest number of days in a calendar year performing services for or on behalf of the employee's employer.
[3] O.R.C. 718.01(B)(1).
[4] O.R.C. 718.011(D).
[5] The Buckeye Institute, et. al. v. Megal Kilgore, Columbus City Auditor, and Dave Yost, Ohio Attorney General, Franklin County Court of Common Pleas, Case No. 20 CV 004301 (filed July 2, 2020).

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