Ohio Tax Talk: Telework Case Shows Tax Grounds Eroding

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Over two years after the onset of the COVID-19 pandemic, labor markets continue to see disruption on the way employers traditionally conducted business. With a large population of employees working on a remote basis much longer than initially anticipated, many states and localities have issued guidance regarding the income tax treatment of remote work.

As states like Ohio continue to monitor the long-term effects of remote work, controversial policies have invited challenges by individuals and businesses who are at the forefront of navigating these changes.

Now, in Schaad v. Alder, the Ohio Supreme Court is considering whether taxpayers can claim refunds for municipal taxes paid during 2020 to their employers' principal place of work as opposed to the municipality of their home office.

For Ohio businesses — particularly those that are small or midsized — the outcome of this case can greatly assist with the administratively cumbersome withholding requirement and compliance burdens of municipal income taxes.

For Ohio employees, the outcome of this case can potentially clarify the amount of tax liability they can expect to recover via income tax refunds from withholding jurisdictions that withheld municipal income taxes based on the location of their employer's principal place of work as opposed to their home office or city of residence.

Summary

In a merit brief submitted Aug. 15, Josh Schaad argued that the Ohio General Assembly does not have the authority to expand a municipal authority's power to tax through Section 29 of H.B. 197, which temporarily allowed cities to tax telecommuting employees performing their work in other municipalities during the COVID-19

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emergency declaration.[1]

Schaad urged the court to reverse the decision of the Ohio Court of Appeals, First Appellate District, which held that Schaad was liable to the city of Cincinnati for municipal income taxes accrued when he worked at home during the COVID-19 emergency declaration.

Schaad is represented by attorneys with the Buckeye Institute, an independent research and educational institution that has initiated and assisted in several cases challenging violations of the Ohio and U.S. Constitution based on its belief that the Ohio Supreme Court's directive has been misapplied and infringes on the due process rights of workers.[2]

Prior to the COVID-19 pandemic, Schaad, a resident of the Blue Ash, Ohio, would often work out of his home despite having a physical office located in Cincinnati. Schaad's employer withheld Cincinnati municipal income taxes from his pay, and at the end of the year Schaad requested and received proportional refunds for his work performed outside Cincinnati city limits.

In response to the COVID-19 pandemic and Ohio Gov. Mike DeWine's COVID-19 emergency declaration, the Ohio General Assembly enacted H.B. 197 to provide continuity and consistency to municipal taxes. In essence, the law extended Ohio's existing 20-day rule under Ohio Revised Code 718.011(D).[3]

Section 29 of H.B. 197 deemed nonresidents working from home due to the pandemic were, for municipal tax purposes, still performing their work at their principal place of business — typically a major city. This enactment required workers like Schaad to pay municipal income taxies in cities where they had neither lived nor worked during the pandemic.

Between June and December 2020, when COVID-19 restrictions became more stringent, Schaad was working exclusively from his home office in Blue Ash. In January 2021, when Schaad applied for a refund for the days he worked form home during the emergency declaration, Cincinnati denied his request.

In his initial complaint, Schaad challenged the validity of Section 29 of H.B. 197 under the due process clause, because it permits a

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municipality to tax nonresidents for work performed outside that municipality's limits. Schaad also asserted that Section 29 of H.B. 197 does not apply to him because he was working from his home office prior to any emergency declaration.

The Hamilton County Court of Common Pleas concluded that Section 29 of H.B. 197 was constitutional as it provided uniform rules regulating the circumstances in which a municipality can and cannot tax; therefore, the court granted Cincinnati's motion to dismiss.

On Feb. 7, the First Appellate District Court of Appeals affirmed the decision in a 3-0 ruling, determining that Section 29 of H.B. 197 was permissible as a temporary measure mitigating the economic impact of the COVID-19 pandemic, adopting the same reasoning articulated in a similar case decided in 2021, Buckeye Institute v. Kilgore.[4]

On June 7, the Ohio Supreme Court accepted jurisdiction of the case to review the appellate court's Feb. 7 decision.

Amicus Briefs

On July 25, officials from Lebanon, Ohio, submitted an amicus brief to the Ohio Supreme Court in support Schaad, stating that during the COVID-19 pandemic, although larger cities like Cincinnati may have temporarily seen a decrease in population, communities like Lebanon experienced an increase and "Section 29 of H.B. 197 taxes Ohio citizens at unjust levels and requires some communities to provide services without the funding to do so."[5]

Lebanon's brief noted:

> If, for example, a Lebanon resident drives to Procter Gamble headquarters in Cincinnati
> for work and needs emergency services, it will be those of Cincinnati and not those of
> Lebanon that will provide immediate support.[6]

Adding that "taxing an individual for neither working nor living in city is unjust," Lebanon contends that during the enforced work-from-home period, when workers were deemed to be working in the

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municipalities of their employers' offices, the actual municipalities in which they lived had to pick up the slack while their citizens were being unfairly taxed.

On Aug. 15, the Ohio Chamber of Commerce, National Federation of Independent Business, Ohio Society of Certified Public Accountants, National Taxpayers Union Foundation and Independent Women's Law Center also filed amicus briefs, supporting Schaad's position that there must be a reasonable relationship between the tax system and "value gained in process" in order for a government to tax beyond its borders.[7]

Implications

Ohio is often touted as having one of the most muddled state and local tax systems.[8] The COVID-19 pandemic brought to light the increasingly scrutinized controversy surrounding municipal income taxation of remote workers, now that more individuals are working from home.

In 2021, the Ohio Senate passed H.B. 110, which reversed Section 29 of H.B. 197 by reverting to the prior 20-day rule and allowing remote employees refunds of taxes paid to principal-place-of-work municipalities for days when the employee worked elsewhere.

In a report written by the Greater Ohio Policy Center, nonresidents were responsible for 69% of municipal income taxes paid to Ohio's six largest cities in 2017.[9]

As noted by the Buckeye Institute, the rationale behind the municipal income tax was for cities to tax those individuals who benefit from relying on a municipality's services, such as police, fire, ambulance, etc., while they are at work.[10] However, with the increasing rise in remote workers, as opposed to those who traditionally commute to an office, this rationale may no longer justify a city's ability to tax those who work outside their jurisdictions.

The Ohio Supreme Court will determine whether taxpayers can claim refunds for municipal taxes they paid in 2020 to their employer's principal place of work, as opposed to the location of

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their home office or city of residence.

As noted in the Buckeye Institute's amicus brief in support of Schaad, the importance of this issue is becoming increasingly prevalent in today's society, and a ruling must be made to "prevent precedent that any worker anywhere in Ohio can be taxed by one of its cities, even with incredibly minimal or long-past contacts."[11]

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

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[1] See, e.g., *Schaad v. Alder*, 1st Dist. Hamilton No. C-210349, 2022-Ohio-340.
[2] More information can be found at https://www.buckeyeinstitute.org.
[3] 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 city. After the first 20 days, municipal income tax must be withheld and paid to the employee's non-principal place of work municipality. See O.R.C. 718.011(D).
[4] See, e.g., Buckeye Institute v. Kilgore , 10th Dist. Franklin No. 21AP-193, 2021-Ohio-4196.
[5] Amicus Brief of the City of Lebanon, Ohio in Support of Appellant Josh Schaad. Supreme Court of Ohio, pg. 1.
[6] Id. at 6.
[7] See, e.g., Brief Amicus Curiae of the Ohio Chamber of Commerce in Support of Appellant Josh Schaad. Supreme Court of Ohio; Brief Amicus Curiae National Federation of Independent Business, Ohio Society of Certified Public Accountants, North Central Ohio Chapter of the National Electrical Contractors Association, Greater Cleveland Chapter of the National Electrical Contractors Association, and the Manufacturing Policy Alliance in Support of Appellant Josh Schaad. Supreme Court of Ohio; Brief Amicus Curiae of the National Taxpayers Union Foundation in Support of Appellant Josh Schaad. Supreme Court of Ohio; Brief Amicus Curiae of the Independent Women's Law Center in Support of Appellant Josh Schaad. Supreme Court of Ohio.
[8] In the state tax battle, The tar heels soar above the Buckeyes Forbes (2013),

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https://www.forbes.com/sites/realspin/2013/09/23/in-the-state-tax-battle-the-tar-heels-soar-above-the-buckeyes/?sh=36f809d02f2a (last visited Jul 28, 2022).
[9] Greater Ohio, GOPC presents rebuttal to measures that seek to undo Ohio's long-standing income tax structure Greater Ohio Policy Center (2021), https://www.greaterohio.org/publications/income-tax-rebuttal (last visited Jul 28, 2022).
[10] Ohio's local income tax system, The Buckeye Institute, https://www.buckeyeinstitute.org/issues/detail/ohios-local-income-tax-system
[11] Id.

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