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External Multistate Tax Alert
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Ohio Supreme Court upholds centralized collection system for net-profits taxes

Overview

In a unanimous opinion issued on November 5, 2020, the Ohio Supreme Court upheld a Court of Appeals for Franklin County (the Court of Appeals) decision that ruled the state's centralized collection system constitutional for municipal net-profits taxes.[1] The Ohio Supreme Court's decision was in response to two separate suits brought by various taxing municipalities to stop the state's newly created centralized collection system. The Ohio Supreme Court also ruled that the retention of 0.5 percent of that net-profits tax collection by the state was unconstitutional, as an act that exceeds the authority of the General Assembly to levy taxes over municipalities in Ohio.[2] By upholding the regime as constitutional, the Ohio Supreme Court upholds this initiative, which began with the passing of H.B. 49, and subsequent statutes, while keeping the power of the General Assembly within its limits under the Ohio Constitution.

Businesses with net-profits tax liabilities in Ohio will continue to have the ability to elect to use the centralized administration system, in which Taxpayers only file a single composite tax return with the state tax department for all municipal net-profits tax liabilities.

This Tax Alert outlines Ohio's centralized administration system and summarizes the Ohio Supreme Court's decision upholding the net-profits tax centralized collection system.

Centralized administration system

As of June 24, 2020, over 600 municipalities in Ohio levied a net-profits tax.[3] In 1957, the Ohio General Assembly enacted law R.C. Chapter 718, which imposed a uniform tax rate and set other limits on municipal taxation.[4] Although the General Assembly continued to add sections to this chapter periodically making the taxation scheme more uniform, including enacting a law that forced municipalities to conform to R.C Chapter 718 to continue imposing and collecting income taxes,[5] taxpayers encountered the administrative burden of having to pay and file in potentially hundreds of municipalities annually.

In 2017, the General Assembly enacted Am.Sub.H.B. No. 49 ("H.B. 49") which aimed to greatly reduce the administrative burden on taxpayers in the state.[6] Under H.B. 49, beginning with tax year 2018, eligible taxpayers had the option, under R.C 718.80, to "elect to be subject" to the newly enacted sections of R.C. 718.[7] Under these new sections, after electing to use this new filing option, taxpayers only have to file one net-profits tax return annually with the Ohio Department of Taxation.[8] All further administrative tasks, including determining liabilities for each municipality and remitting those amounts to the municipalities in question, would be tasks performed by the Department itself.[9]

Ohio Supreme Court decision

On November 5, 2020, the Ohio Supreme Court partially affirmed and partially reversed the Tenth District Court's City of Athens and City of Akron's separate appeals.[10] The first issue before the Supreme Court was whether the

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[1] *Athens v McClain,* Slip Opinion No. 2020-Ohio-5146 (Nov. 5, 2020), at 2. A copy of the Ohio Supreme Court's decision is available here.
[2] *Athens v McClain* at 2, ¶3.
[3] Ohio Department of Taxation Fiscal Year 2019 Annual Report at 117.
[4] *Athens v McClain* at 3 ¶5, citing Am. Sub.S.B. No. 133, 27 Ohio Laws 91.
[5] 2014 Sub.H.B. No. 5 (2014). Pursuant to H.B. 5, all municipalities in Ohio were preempted from imposing, and therefore collecting, any income taxes unless they adopted R.C. Chapter 718, which had already had a uniform rate in place, among other safeguards for taxpayers.
[6] A copy of the Tax Alert for Am.Sub.H.B. No. 49 is available here.
[7] Ohio Rev. Code Ann. §718.80(A) (2018).
[8] Ohio Rev. Code Ann. §718.86 (2018).
[9] *Athens v McClain* at 3-5 ¶¶9-11; Ohio Rev. Code Ann. §718.80 - §718.95 (2018).
[10] *Athens v McClain* at 1, 7. Case No. 2019-0693; Case No. 2019-0696.

General Assembly acted within its constitutional authority when it enacted H.B. 49. The two municipalities ("Plaintiffs) argued that the centralized administration system violated the Home Rule Amendment of the Ohio Constitution.[11] The Athens plaintiff stated the following:

> The Home Rule Amendment grants municipal corporations a general power of municipal taxation, and where a State law engulfs municipal corporations' general power of taxation, that State law is unconstitutional."[12]

In its rejection of this argument, the Ohio Supreme Court explained: "In the area of taxation, the Ohio Constitution specifically authorizes the General Assembly to limit municipal home-rule power."[13] The Court further provided that under Article XVIII, Section 13, the General Assembly can pass laws to "limit the power of municipalities to levy taxes and incur debts for local purposes."[14] According to the Court, both the dictionary definition and the use of the term 'levy' in other provisions of the Ohio Constitution support a broad interpretation of the term, so that it includes administrative functions encompassed in the carrying out of this power.[15] Also, the Court provided that it agreed with the Tenth District's statement that because the General Assembly can limit municipalities' power to levy taxes, it can also enact legislation that helps to accomplish such an aim.[16]

Having addressed the Home-Rule Amendment, the Ohio Supreme Court turned its attention to the 0.5 percent appropriation as a valid act of limitation. The state argued that fee is constitutional, claiming that unless the power of taxation includes the right to keep the revenues, the power is illusory.[17] In rejecting this argument, the Court reasoned that the fee is not constitutional because the act of imposing the fee "cannot be seen as a legitimate exercise of…the power to limit or restrict municipal taxation" thus it does not fall under the General Assembly's authority.[18]

In its holding, the Supreme Court affirmed the Court of Appeals' decision upholding the centralized administration system but reversed the decision allowing the state to collect a 0.5 percent fee on the taxes that it collects.[19]

Considerations

The Supreme Court's decision remands the matter to the trial court to enter and effectuate the findings. While the centralized administration system will remain in place in Ohio, the funding mechanism does not. Therefore, this may be an expenditure which is considered by the General Assembly when drafting the next state budget.

Contacts:

If you have questions regarding this Ohio Supreme Court decision or other Ohio tax matters, please contact any of the following Deloitte professionals:

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[11] *Id.* at 7.
[12] *Id.* at 7, citing Athens plaintiffs; case No. 2019-0696.
[13] *Id.* at 8.
[14] *Id.* at 8.
[15] *Id*. at 10-11, ¶30; 2019-Ohio-277, 119 N.E.3d 469, ¶44.
[16] *Id*. at 20 ¶51; 2019-Ohio-277 at ¶51.
[17] *Id*. at 21 ¶53.
[18] *Id*. at 22 ¶56.
[19] *Id*. at 24 ¶61.

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