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To: All Tax Preparers

From: Diane Haas, Tax Administrator, Village of Ottawa Hills

Netting of Business Income and Losses for Resident Individuals

Beginning for tax year 2016, Ohio Revised Code 718 requires all cities to allow resident individuals to net business incomes with business losses, and to allow joint returns for taxpayer and spouse. Business sources eligible for netting include Schedules C, E, and F from the Federal 1040, as well as income reported on 1099-MISC, and other business sources. Wages are not considered business income, and therefore cannot be reduced by losses, either current or prior year losses carried forward. Copies of the 1040 are now required to be attached to the local returns. It is important, therefore, that all business income schedules, with their supplementary worksheets, are attached for proper treatment and application of losses. Ottawa Hills still will not tax S-Corp owners on their share of pass-through income or loss; S-Corp amounts included on the Schedule E page 2 will need to be adjusted out. Other cities that have been taxing S-Corp owners on their pass-through income will continue to do so; a listing of how the cities you work with treat these taxpayers will be helpful. In the interest of simplifying the use of prior year Village losses for tax years 2016 and future, the primary/secondary loss categories currently on our system will be compressed into a single remaining loss amount per year. This remaining loss amount is then available for use against business income earned by either the taxpayer or spouse. Spouses wishing to file separately, will be posted onto separate accounts to preserve each taxpayer's losses.

2106 Deductions for Employee Business Expenses

Wages can be reduced by federally deductible employee business expenses reflected on Form 2106, reduced by the 2% AGI on the Schedule A. To qualify for the 2106 deduction, attach copies of the 1040 (pages 1 & 2), Schedule A, and the 2106 form with any worksheets verifying expenses. Significant expenses taken may require backup schedules to substantiate valid deductions. Use of the Standard Deduction on the 1040 will disqualify the 2106 expense deduction. Reduction of wages for 2106 expenses also requires reduction of the credit on the tax withheld.

Adjusting Credits

The Village continues to provide credit to residents for other city tax withheld or paid up to ½ the lower rate. Income reduced by losses or deductions require reducing the other city credit accordingly. Verification of the tax paid or withheld must be attached to the return (W-2s and/or city returns). For business source netting, sources in the same city are first netted; net income for that city is eligible for credit by the percentage to total taxable business income. Therefore, when there is a total business income taxed to the Village, each city's percentage of that total is calculated to determine the eligible credit. (For more details, see <http://www.bgohio.org/departments/finance-department/income-tax-division/> for PDF handouts from the 2016 Tax Preparer Seminar.)

Attachments to the Village Return

As stated above, Federal returns are required attachments to the local returns. Individuals must attach the full 1040 to the Village return. Partnership and trust K-1s are no longer required to be attached, but can be requested to verify work city credits, deductions, and the like. To avoid requests for additional information, please include all forms, schedules, listings, and supplemental information that verify information on the Village return.

Partnership Resident City Filing on Behalf of All Partners

It is now mandated that partnerships file and pay local tax at the entity level in the partnership's resident city. This tax is then to be allocated to each partner for his/her share of city tax paid. It is no longer optional to decide whether the entity will file and pay, or whether the partners file and pay; the partnership is required to file and pay tax where the partnership is located, as well as where it is conducting business.

Review of Employer Withholding Rules

ORC 718 has set forth rules for when employers with employees working in various cities must withhold local tax for the city where the employee is working. The rules provide for small employer exemptions from withholding at work site locations, and define various locations used for determining the preponderance of a day and the 20-day exemption. Below is a brief summary of these rules. (For more information, use the link on page 1 for details covered at the NWOTCA 2016 Tax Preparer Seminar.)

Small Employer Exemption

Small employers, defined as having prior year gross revenue of less than \$500,000, qualify for exemption from withholding requirements for employees working in various municipalities. Cities where the employees are working may require the employer to provide a copy of the prior year's business return for verification of this exemption. Small employers are to withhold the local tax on their employees where the business is residing (fixed location), but are not required to track and withhold local tax for other cities where the employees are working. A small employer residing in the township is not required to withhold any local tax. The employees may be working in a city for more than the preponderance of a day and for more than 20 days, but the employer is not required to withhold that city's tax. Employers may withhold the employee's resident tax, if they choose to.

Preponderance of a Day Rules

The rules for the preponderance of a day determine one city per work day for the employee. All travel times between jobs, delivery of materials, and the like are attributed to the principal place of work (the location where the employee is required to report each day). Therefore, in order to meet the preponderance of a day, an employee must be performing work in a work city for a longer time than the time spent in any other work city, as well as exceeding all the travel time plus time spent at the business location (principal place of work).

20 Day Rule

When the preponderance of a day has been reached for an employee for a day in a work city, the employer may not be required to withhold work city tax until the employee has reached the preponderance of a day for more than 20 days. Once the preponderance of a day is reached for the 21st day, the employer is required to begin withholding work city tax starting on the 21st day. The first 20 days are exempt under these rules. Exceptions to the 20 day rule include situations when the employer knows from the beginning that the job is expected to last more than 20 days (presumed worksite – employer is required to withhold from the first day), or if the worksite qualifies for a principal place of work for the employee, meaning that the employee is required to report for work to the worksite each day. As stated above, the city where the employer resides will require withholding on all employees working in the city. There is no small employer exemption for the business' resident city, nor will the 20 day rule apply. The only time the business' resident city tax is not withheld on an employee is if the employer is required to withhold another city's tax per the preponderance of a day and 20 day rules.

Non-Resident Refund Claims for Local Work City Tax Withheld

Employees who work outside the business' resident city (fixed location) may request refund of this city's withholdings. However, if the employee worked in another Ohio city, he/she will then be required to file and pay tax for each of those cities where the work was actually performed, even if the employer was not required to withhold to those cities. Information sharing is permitted among the cities. In essence, the employee is to pay tax to either the city he/she worked in or the city the business is residing in. If work was performed in a township or outside of Ohio, the employee's withholdings can be refunded without triggering additional tax or filings elsewhere.