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To: All Tax Preparers

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

Business Income, Netting and Loss Treatment for Resident Taxpayers

Business sources of income are under new rules as to taxability, netting with current year business losses and reduction by prior year losses. Business incomes for individuals will all tie to amounts reflected on the Federal 1040, and supported by schedules within the 1040, which now must be attached to the local return. Individuals must include Federal 1040, Schedule 1, Schedules C, E (pages 1 and 2 if both apply), F, Farm Rental 4835, ordinary gains reflected on the 4797, as well as income reflected on Line 21 of the 1040 Schedule 1 (1099-MISC, Fiduciary fees, Gambling/Lottery winnings, taxable portions of HSA distributions, etc.). Supporting schedules may also be necessary in various cases. For Ottawa Hills, a full listing of all the pass-through entities (whether on Schedule E page 2 or a supplementary schedule) is necessary to ensure all S-Corp effects are excluded; these entities are treated as corporations, therefore, their income or loss is not passed to the owners for the Village return.

Resident individuals are now permitted to net business incomes and losses, even between spouses on joint returns, as well as using prior year losses. Wages are not considered business income and cannot be reduced by either current or prior year losses. Spouses wishing to file separately

will be assigned a separate account to preserve each taxpayer's losses.

While capital gains and losses as shown on the Schedule D continue to be exempt from local tax, ordinary gains relating to 1245 and 1250 property as reflected on the 4797 are taxable and must be included when they are related to business income taxed by the Village. In the event these ordinary gains originate from an S-Corp, documentation of the connection will allow for netting out those gains.

Non-Resident Businesses

Beginning with tax year 2017, non-resident businesses required to file net profit returns in cities where they conduct business will *record their losses at the gross amount for carry forward*. While this will cause complexities on the 2018 and subsequent returns when using losses recorded prior to 2017 (Pre-2017 losses), this will be temporary until the pre-2017 losses are either used or expire. These complexities will be explained below.

Use of Business Losses Against Current Business Income

For 2018 there are new rules for applying business losses incurred in 2017 and future. Non-resident businesses which incurred losses prior to 2017 recorded those losses at each city's allocation percentage as determined in the 3-factor formula. Losses recorded for the 2017 tax year were to be recorded in total, before applying the allocation percentage. In addition, Ohio Revised Code specifies that these losses are subject to a 50% limitation during the 5-year phase-in period (2018-2022). Due to the complexities in applying these losses correctly, the Village form has been redesigned and expanded to a third page. Page 3 contains several worksheets in which to list all applicable losses and apply them in the correct manner. While this worksheet is not the only way to apply the losses, it will provide a guide in working through the calculations. Reasonable alternatives may also be accepted as long as proper worksheets and documentation are submitted with the return.

Attachments to the Village Return

As stated above, Federal returns are required attachments to the local returns. Individuals are to attach the 1040 to the Village return, with any additional schedules, forms, or worksheets pertaining to and verifying earned income and losses subject to local taxes to avoid requests for missing information. 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. Businesses are to attach the applicable federal return.

Adjusting Credits

The Village continues to provide credit to residents for work city tax withheld or paid up to ½ the lower rate. Income reduced by losses or deductions require reducing the work 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, income and loss sources in the same city are first netted. All incomes/losses not attributable to another city or lacking verification of tax paid will be netted in the no city column. Groupings with net losses and use of prior year losses will first be applied to no city net incomes, then city incomes whose city rate is less than 1.5%, and then finally, any remaining losses will be used to reduce incomes for cities with 1.5% or greater. Any reduction of other city income with losses will reduce eligible credits.

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 could then be required to file and pay tax for each of those cities where the work was 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 resides 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.

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 will 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.

2106 Deductions for Employee Business Expenses

Form 2106 is no longer a part of the Federal 1040 and therefore no longer an allowed deduction on the local return.