


September 17, 2021

FOR YOUR INFORMATION

To: Mayor and Members of City Council

From: Paula Boggs Muething, City Manager 

Subject: Update on the City's Income Tax Refund Liability for Tax Year 2021

The FY 2021 Carryover to FY 2022 Report (Document #202102726) details the City Administration's recommendations regarding the use of the FY 2021 carryover balance and application of the Stabilization Funds Policy. Included in that report is a recommendation to create an income tax reserve for refunds to address the City's liability for income tax refunds to non-residents whose employers withheld municipal income tax for the City notwithstanding that some income may not be taxable by the City if work has been performed outside the City.

This memorandum is in response to inquiries related to the FY 2021 carryover process. It provides additional information on the City's income tax refund liability for tax year 2021 and the manner in which the liability will be addressed in both FY 2021 and FY 2022, since the tax year 2021, which aligns with the calendar year, impacts both fiscal years for the City.

Income Tax Refund Liability for FY 2021

The State of Ohio's temporary municipal income tax withholding rule allows employers to continue to remit employee withholding taxes through December 31, 2021, based on the "principal place of work" of an employee prior to COVID-19 pandemic restrictions. However, the state legislature failed to make the actual tax law congruent with the temporary withholding rule, so individual non-residents who work remotely outside of the City during calendar year 2021 may be able to seek a refund from the City when they file individual income tax returns in the spring of 2022. To address this liability, the City recommends setting aside from the FY 2021 carryover approximately \$50.0 million in an income tax reserve for refunds, which represents 30% of the income tax revenue collected through withholdings during the first half of calendar year 2021 (January 1, 2021-June 30, 2021—i.e. the second half of the City's FY 2021).

Income Tax Refund Liability for FY 2022

Following the City's passage of the Approved FY 2022 General Fund Operating Budget, the state legislature passed the law establishing the temporary withholding rule for calendar year 2021, discussed above. Similar to the liability that accrued during the first half of calendar year 2021, so long as hybrid and remote work models persist during the second half of calendar year 2021 (July 1, 2021-December 31, 2021—i.e. the first half of the City's FY 2022), additional refund liability will continue to accrue to the City, as employers will continue to withhold income tax that the City may be unable to properly tax. Since the temporary withholding rule established under state law will expire on January 1, 2022, the accrual of additional liability for refunds should all but cease at that time; however, the City is likely to see a direct reduction in income tax revenue collections, assuming remote work practices persist and employers determine that they must change their withholding practices.

In total, \$67.5 million in one-time emergency funding from the American Rescue Plan (ARP) Act was included in the Approved FY 2022 General Fund Operating Budget. The ARP resources will be used to reimburse COVID-19 related expenses and to fund government services to the extent permitted under guidance from the U.S. Department of the Treasury. This \$67.5 million is comprised of an originally projected \$33.5 million operating budget deficit and an additional subsequently projected \$34.0 million operating deficit, with the \$34.0 million additional deficit based upon an analysis from the University of Cincinnati Economics Center that reduced the FY 2022 income tax estimate as a direct result of the projected impact of remote work on city income tax collections.

If budget projections are accurate, the City can expect that during FY 2022 the City will accrue additional refund liability in the second half of calendar year 2021 (first half of FY 2022) and will experience actual direct reductions in income tax collections during the first half of calendar year 2022 (second half of FY 2022) that together equate to a \$34.0 million reduction in revenue. The operating expenses in FY 2022 that would typically be funded by that \$34.0 million will instead be funded by the appropriated \$67.5 million in ARP funds. The remaining \$33.5 million in ARP funds will fund other ARP-eligible operational expenses. The \$67.5 million in ARP funds will allow the City Administration to set aside a portion of withholdings that will be collected in the second half of calendar year 2021, so that these funds can be refunded in the spring of 2022 when individual income taxes are filed.