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State and Local Tax Alert: Ohio Supreme Court Issues Decision Holding the Ohio General Assembly's Constitutional Powers Do Not Trump Worthington's Constitutional Power to Levy Taxes

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The Vorys state and local tax group scored an important municipal income tax victory for taxpayers. The decision also helps clarify a complex area of Ohio Constitutional law. *Gesler et al. v. City of Worthington Income Tax Board of Appeals et al.* involved competing Ohio Constitutional provisions. On one hand, the Ohio Constitution confers upon home rule municipalities all powers of local self-government which includes the power to levy taxes. On the other hand, the Ohio Constitution confers upon the Ohio General Assembly the power to limit home rule municipalities' power to levy taxes.

On November 19, the Supreme Court of Ohio released a carefully worded decision in *Gesler, Slip Opinion No. 2013-Ohio-4986*. The Court ruled in favor of James and Angeline Gesler and reversed the Ohio Board of Tax Appeals (Board). The Court held the Board's decision violated the Ohio Constitution's home rule provisions because the Board's decision to deny a refund impermissibly conferred powers upon the Ohio General Assembly beyond those provided by the Ohio Constitution.

Mr. Gesler was a professional accountant providing tax advisory services through a sole proprietorship. Prior to the tax years at issue, a client of Mr. Gesler's granted Mr. Gesler stock options as payment for tax services. In 2005, 2006 and 2007, Mr. Gesler exercised the stock options and reported schedule C business income on his federal income tax returns. The Geslers filed Worthington tax returns for those years, reported the Schedule C income, and paid Worthington tax. Thereafter, the Geslers filed refund claims with Worthington for each year noting the pertinent Worthington tax ordinance indicated that Worthington imposed tax on "net profits," and that Worthington defined "net profits" by ordinance as "the individual's profit *other than* amounts required to be reported on schedule C***." (Emphasis added.) Worthington denied the Geslers' refund claims. The Geslers appealed to the Board. The Board held that although Worthington's ordinance clearly and unambiguously did not impose tax on schedule C business income, Ohio statute R.C. 718.01(A)(7) required municipalities imposing

income tax to define "net profits" to include schedule C business income. According to the Board the Ohio statute overrode Worthington's ordinance so Worthington was required to impose Worthington income tax on the Geslers' schedule C business income notwithstanding Worthington's ordinance to the contrary.

The Vorys legal team comprised of Dave Froling, Jeffrey Miller and Steven Smiseck argued to the Ohio Supreme Court that the Ohio Constitution's Home Rule Amendment vested Worthington with all powers of local self government, and that the Ohio Constitution vested the General Assembly with only a negative power to "limit" Worthington's exercise of its taxing powers. Dave Froling argued before the Court that Worthington's decision *not* to tax schedule C business income could not be trumped by the General Assembly's mandate that municipalities must tax Schedule C income. Under circumstances where Worthington chose not to exercise its taxing power by excluding certain subject matter from its tax, there was no exercise of Worthington's taxing power for the General Assembly to "limit." In that regard, the Board's decision that Ohio statute R.C. 718.01(A)(7) trumped Worthington's ordinance impermissibly infringed on Worthington's powers of local self government. The Court agreed holding Worthington's decision not to tax schedule C business income was a valid exercise of the powers granted to Worthington by the Ohio Constitution, and that the Ohio General Assembly "cannot command Worthington to impose tax on Schedule C income when Worthington has chosen not to tax that income***." *Gesler* at ¶22. As a matter of constitutional law, the Ohio statutes at issue could not be used to block a tax exemption provided by Worthington. The Court ordered Worthington to issue the Geslers' refund with statutory interest.

Gesler affirms the Court's landmark decision in *Cincinnati Bell Telephone Company v. City of Cincinnati*, 81 Ohio St.3d 599 (1998). *Gesler* itself is a landmark case because *Gesler* expands on the Court's legal analysis in *Cincinnati Bell*. *Gesler* provides tax practitioners and municipalities with further clarity regarding how to navigate competing Ohio Constitutional provisions. That said, *Gesler* does not answer all the questions. Indeed *Gesler* raises questions not apparent in *Cincinnati Bell*.

The Court's analysis in *Gesler* has ramifications beyond the facts presented therein. At minimum *Gesler* makes clear that when a home rule municipality exercises its taxing power under its constitutionally granted powers of local self government, its powers are broad. *Gesler* at ¶20. Conversely the Ohio General Assembly's powers of limitation are not as broad. Indeed, the Ohio General Assembly's powers to limit the home rule municipality's exercise must be "interpreted in a manner consistent with the purpose of home rule." *Id.* citing *Cincinnati Bell* at 605. "In the absence of an express statutory limitation demonstrating the exercise, by the General Assembly, of its constitutional power, acts of municipal taxation are valid." *Id.* citing *Cincinnati Bell* at 606.

The Court's statement that the General Assembly lacks the authority to command a municipality to impose tax on certain types of income raises questions of whether, and to what extent, the General Assembly may have already overstepped its authority in portions of Ohio Revised Code Chapter 718. Similarly, given that the Court in *Gesler* declined to address whether Worthington ordinance actually conflicted with the applicable Ohio statutes, the holding of the Court raises a broad question as to the proper interplay between Chapter 718 and municipal income tax ordinances. **Indeed, *Gesler* raises questions regarding the Constitutionality of certain draft provisions within Am. Sub. H.B. 5 that is currently pending in the Ohio Senate's Finance Committee.**

At the present, the line between the municipal taxing power and the General Assembly's authority to limit that power is not well defined. Thus, this area of Ohio law will undoubtedly require further illumination by the Court. From a practical perspective, practitioners should understand that Ohio is an unusual state in that certain municipalities have constitutionally granted home rule powers that may not be infringed upon by the state. Thus, in municipal tax disputes, in addition to ordinances, regulations, city charters and statutes, the Ohio Constitution may also bear on the proper legal conclusion. Under circumstances where the question involves a facial conflict between an Ohio statute and city tax ordinance, *Gesler* makes clear that a threshold question is which body of law is dominant. That question is answered by reference to the Ohio Constitution.

Given the complexity of municipal tax law, obtaining experienced advice is prudent. The Vorys team is well versed in state and municipal tax law, and regularly defends audits and represents taxpayers in administrative and judicial forums. If you need assistance, please contact one of Vorys' state and local tax attorneys.