



Sub. H.B. 142

126th General Assembly
(As Reported by H. Ways & Means)

Reps. Willamowski, C. Evans, J. McGregor, Seitz, Raga, Latta, Hartnett,
Gibbs

BILL SUMMARY

- Authorizes the Tax Commissioner to collect from state income tax refunds certain debts owed to courts, counties, municipal corporations, and townships.
- Waives joint and several liability for Ohio income taxes for "innocent spouses" under terms similar to the terms for which federal innocent spouse relief may be granted.

CONTENT AND OPERATION

Tax Commissioner authorized to use income tax refunds to satisfy debts owed to courts and local governments

Overview

The bill authorizes the Tax Commissioner to use all or a portion of an individual's income tax refund to satisfy a fine, fee, restitution, or forfeiture owed by the individual to a court, county, municipal corporation, or township. Before a debt can be satisfied from an individual's income tax refund, the debt must remain unpaid for at least 45 days from the date payment was due.

Certification to the Tax Commissioner for collection

(R.C. 5747.124(B))

A court, county, municipal corporation, or township may certify a debt that remains unpaid for at least 45 days to the Tax Commissioner for collection. At least 20 days prior to certification of a debt, the court or local government certifying the debt must notify the debtor in writing of its intent to certify the debt to the Commissioner, the basis of the certification, and the debtor's right to pay the

debt. If the debtor does not pay the debt within ten days after receiving the notice or does not file an action contesting the debt and certification,¹ the court or local government may certify the debt to the Commissioner by providing the Commissioner with a description of the debt along with the name, address, and social security number or federal employer identification number of the debtor.

Collection of debts

(R.C. 5747.124(C)(1) and (2))

A debt that has been certified to the Tax Commissioner is collected from any refund of state income taxes, or from the refundable part of any refundable tax credit, that is payable to the debtor. The Commissioner sends the amount collected to the court or local government that certified the debt, and notifies the debtor of the amount thus collected and of the particular court, county, municipal corporation, or township that certified the debt. If the debtor pays the debt any time after it has been certified to the Commissioner, the court or local government is required immediately to notify the Tax Commissioner of the payment. The Commissioner thereupon is required to stop collecting the debt.

If the amount of debt certified to the Commissioner exceeds a debtor's income tax refund, the Commissioner is permitted to apply the refund in partial satisfaction of the debt. Conversely, if the amount of the refund owed to the debtor exceeds the amount of the debt, the debtor is entitled to that excess.

Refunds first used to satisfy other obligations

(R.C. 5747.12 (not in the bill), 5747.121 (not in the bill), 5747.122 (not in the bill), 5747.123 (not in the bill), and 5747.124(C)(2))

Under continuing law, the Commissioner is required to use income tax refunds to satisfy debts owed to the state, to satisfy unpaid child support obligations, to recover overpayments of public assistance, and to recover overpaid child support. Under the bill, any reduction of a refund for one of these purposes takes precedence over a reduction to satisfy a debt certified to the Commissioner by a court or local government.

¹ *The bill provides that except with respect to complaints regarding joint income tax returns (see "**Joint returns**," below), any action contesting the use of an income tax refund to pay a debt owed to a local government must be brought by the complainant against the court, county, municipal corporation, or township that certified the debt to the Commissioner for collection (R.C. 5747.124(G)).*

However, the bill specifies that debts certified by courts and local governments take precedence over other refund reductions. For instance, under the bill, refunds first must be used to satisfy debts certified by courts and local governments before they can be contributed to the Natural Areas and Preserves Fund, the Nongame and Endangered Wildlife Fund, or both under the existing income tax refund contribution system. Likewise, refunds first must be used to satisfy certified court and local government debts before they can be credited against tax due in a subsequent year.

Joint returns

(R.C. 5747.124(D))

The bill specifies that in the case of a joint return, only the portion of the refund that the Commissioner determines is due to the debtor may be used to satisfy the debt certified to the Commissioner for collection. A debtor's spouse is permitted to object to the Commissioner's determination of the portion of the refund due to the debtor by filing a complaint with the Commissioner within 21 days after receiving the Commissioner's notification (see "Collection of debts," above). The bill requires that the Commissioner afford the spouse an opportunity for a hearing on the complaint. After the hearing, the Commissioner must make a final decision as to what portion of the refund may be applied against the debt.

Settlement

(R.C. 5747.124(C)(1) and (E))

Within 30 days after the end of each calendar quarter, the Commissioner must settle with each court and local government that has certified a debt to the Commissioner for collection. Each settlement must note the opening balance of debts certified to the Commissioner, any additions to or deletions from that balance, the amounts of debts collected, and the ending balance at the close of the settlement period. The bill permits the Commissioner to withhold a percentage of the amounts collected as compensation for administrative costs incurred by the Commissioner, but the amount withheld is not to exceed 2%.

Tax Commissioner to exercise rulemaking authority

(R.C. 5747.124(F))

The bill requires that the Commissioner establish, by rule, procedures to implement the income tax refund debt collection system created in the bill. The bill provides, further, that if the Commissioner chooses to use a portion of the debts collected by the Commissioner to pay the Commissioner's administrative

costs, the Commissioner must establish, by rule, the percentage of each debt that will be withheld to pay those costs.

Effective date

(Section 3(B))

The income tax refund debt collection system created in the bill takes effect January 1, 2006.

"Innocent spouse" relief

(R.C. 5747.08(E) and 5747.082)

The bill waives the joint and several liability for Ohio income tax for a spouse who receives federal "innocent spouse" relief or who satisfies criteria similar to the federal criteria for relief. The waiver of liability is modeled on the "innocent spouse" relief (and similar forms of spousal relief) provided under federal income tax law for understatements of tax due with a joint return. Under current law, joint and several liability currently is imposed on spouses filing joint tax returns.² If spouses file a joint return, they are jointly and individually liable for the tax due, including any penalties or interest. This means each spouse is liable for the entire tax due from both spouses, even for the tax due for income actually earned or received by only one of the spouses. The relief provided under the bill applies to a spouse who filed a joint return for a taxable year even if the spouses filing the return are no longer married when relief is sought.

The bill's innocent spouse relief may be obtained in two ways: for spouses who have obtained federal innocent spouse relief, and for spouses who have not obtained federal relief but who the Tax Commissioner finds eligible for relief under criteria similar to federal criteria. Both forms of relief may not be sought for the same tax liability.

Spouses obtaining federal relief

(R.C. 5747.082(B))

Relief from Ohio liability must be provided for any spouse who has received one of the three forms of federal innocent spouse relief (the forms of federal relief are explained below). The Tax Commissioner has no discretion over whether to provide this relief: if a spouse has received the relief from liability for federal income tax, the spouse is entitled by law to relief from liability for Ohio

² *Spouses filing joint federal returns are required by Ohio law to file joint Ohio returns.*

income tax (including any penalty or interest) for the same income item for which federal liability was waived. For this purpose, an income item is an item of income, gain, loss, credit, deduction, or other "erroneous item" of income included in the computation of the spouse's Ohio tax or that otherwise affects the computation of the spouse's Ohio tax. An erroneous item is an unreported item of reportable income or an improper deduction, credit, or basis computation.

The bill provides a four-year look-back for spouses who have obtained federal innocent spouse relief within the four years preceding the bill's effective date. (Section 3(A).)

Spouses not obtaining federal relief

(R.C. 5747.082(C))

The bill also authorizes the Tax Commissioner independently to provide relief to a spouse who has not received federal innocent spouse relief but who qualifies for relief under criteria, specified in the bill, that are similar to the criteria for federal innocent spouse relief. The bill's criteria are three-fold, and a spouse must satisfy all three conditions:

- (1) The spouse, when signing the joint return, did not know, and had no reason to know, of the understatement of tax;
- (2) It would be unfair to hold the spouse liable for the tax when all the circumstances are considered;
- (3) The spouses did not transfer assets among themselves as part of a fraudulent scheme to avoid reporting or paying Ohio income tax.

If the Tax Commissioner finds that a spouse satisfies all these criteria, relief from liability for the understatement of tax must be provided.

"Allocable share" of joint liability. If relief from liability for Ohio tax is granted to a spouse who did not receive relief from federal liability for the same understatement of tax, the Ohio relief applies to the spouse's "allocable share" of the total joint liability of both spouses. Generally, the spouse's allocable share is the portion of the total joint liability attributable only to the spouse who is granted relief. This is computed by determining the share of the total tax that would be due if the spouses had filed separate returns instead of a joint return, and by determining the percentage of that total tax that would be due from the spouse seeking relief if that spouse had filed a separate return. Relief is granted for that percentage of the joint liability.

Each spouse's separate tax is computed before deducting credits the spouse would be entitled to individually and before crediting tax withholding or estimated tax payments toward the spouse's separate liability. Any exemption claimed for a child or other dependent (excluding either spouse, if claimed as a dependent) is divided equally among the spouses' separate liabilities unless the claim for the exemption contributes to the tax understatement for which relief is sought. Similarly, if a deduction or addition is attributable specifically to a child or other dependent (excluding either spouse) and affects the computation of taxable income, each spouse must deduct or add one-half of that amount in computing their respective separate liabilities unless the addition or deduction contributed to the understatement of tax for which relief is sought. Examples of deductions that might be attributable solely to a dependent are the medical expense deduction and the higher education expense deduction.

Applying for relief

(R.C. 5747.082(D))

Regardless of whether a spouse received federal innocent spouse relief, a spouse seeking relief from Ohio liability must apply within two years after collection activity begins. Although the bill does not specify what constitutes collection activity, the same term is used for the purposes of the federal innocent spouse relief, and it includes, for federal purposes, garnishment of wages and applying a refund to a prior year's tax liability.

Application must be made in a manner and form to be prescribed by the Tax Commissioner. However, the bill authorizes the Tax Commissioner to apply the innocent spouse relief to any person who qualifies, even if the person does not apply for the relief.

The Tax Commissioner must notify, in writing, each person applying for relief of the Tax Commissioner's decision regarding the relief granted or denied and of the person's right to appeal the Commissioner's decision.

Appeal if relief is denied

(R.C. 5747.082(D))

If the Tax Commissioner denies the relief sought, the spouse seeking the relief may seek an administrative redetermination by filing a petition with the Tax Commissioner. The manner of petitioning is the same as that for filing for redeterminations of other income tax matters. The petition must be filed within 60 days after the Tax Commissioner's notice of denial is sent. The petition, if filed properly and before the deadline, entitles the spouse to an administrative hearing

before the Department of Taxation. A spouse may appeal the administrative redetermination in the same manner as any other income tax-related redetermination--i.e., by filing an appeal with the Ohio Board of Tax Appeals.

Federal innocent spouse relief

(26 U.S.C. 6015; 26 C.F.R. 1.6015-1 et seq.; I.R.S. Publication 971)

Relief from joint and several liability for federal income tax for spouses filing joint federal tax returns is authorized in three forms: "innocent spouse" relief, relief by separation of liability, and equitable relief. Eligibility for relief and the kind and extent of relief differs somewhat under each of the forms. Eligibility criteria and the relief available are summarized below. For a more detailed description, including examples, consult the Code of Federal Regulations sections and IRS publication cited above.

(1) "Innocent spouse" relief:

- Applies to a spouse who filed a joint return on which there was an understatement of tax attributable to erroneous items of the other spouse, and the spouse seeking relief, when signing the return, did not know, and had no reason to know, of the understatement, and it would be inequitable to hold the spouse liable for the tax due.
- Relieves the "innocent" spouse of liability for the tax due on the unpaid tax or for the part of the tax attributable to erroneous items the spouse had no knowledge of and had no reason to know of.

(2) Relief by separation of liability:

- Applies only to divorced, separated, or widowed spouses or to spouses living apart.
- Unpaid tax is allocated among the spouses, and the spouse requesting relief is liable only for the unpaid liability not allocated to the other spouse; refunds may not be issued if the tax was paid or collected.
- The spouse requesting relief must not have known of the erroneous items on the joint return for which relief is sought.

(3) Equitable relief:

- Applies only if innocent spouse relief or relief by separation of liability is not granted; there was no fraudulent intent; an unpaid liability is outstanding; there was no transfer of assets to avoid tax or as part of a fraudulent scheme; the unpaid tax for which relief is sought is attributable to the other spouse; and it would be unfair, considering all the circumstances, to hold the spouse seeking relief responsible for the unpaid tax.
- Relieves the spouse of liability for the unpaid tax, at the discretion of the IRS; refunds may not be issued if the tax was paid or collected.

HISTORY

ACTION	DATE	JOURNAL ENTRY
Introduced	03-22-05	p. 352
Reported, H. Ways & Means	10-11-05	pp. 1717-1718

H0142-RH-126.doc/jc