

**TESTIMONY BEFORE
OHIO HOUSE OF REPRESENTATIVES
October 10, 2017**

My name is Jeffrey S. Senney. I am an attorney with Pickrel, Schaeffer & Ebeling Co LPA. We represent hundreds of small businesses that operate pass-thru entities sole proprietorships, LLCs, partnerships or “S” corporations. Some of these small businesses engage a professional employer organization (“PEO”) to handle their payroll, employee benefits and other administrative burdens. Others do not. The primary question we face here today is whether small business owners who engage a PEO to handle payroll, employee benefits and other administrative burdens of their small business should be treated differently than those small business owners who do not.

Under ORC section 5747.01(A)(31), each 20% owner of a qualifying pass-thru entity (“QPE”) is entitled to deduct the Ohio small business deduction (“SBD”) from his or her Ohio taxable income. The amount of the SBD is limited to the lesser of a percentage of the owner’s “distributive share” of income from the QPE or a specified dollar amount.

In 2013 and 2014, the maximum SBD was equal to the lesser of 50% of the owner’s small business income or \$125,000. In 2015, the maximum was equal to the lesser of 75% of the owner’s small business income or \$187,500. In 2016 and thereafter, the maximum SBD is equal to the lesser of 100% of the owner’s small business income or \$250,000.

Small business owners receive taxable income from their QPE in two ways. One way is receipt of W-2 salary or guaranteed payments (“Compensation”). The other way is the owners’ distributive share of QPE income. The Compensation paid to the owner is an expense of the QPE and reduces the amount of the QPE’s reported income. As a result, the larger the Compensation paid to the owner, the smaller the QPE’s reported income and the smaller the owner’s distributive share.

But the legislature intended the SBD to protect each small business owner from Ohio taxation of the first \$250,000 of income the owner realized from his or her QPE (whether in the form of salary, guaranteed payment or distributive share). Therefore, the legislature enacted ORC section 5733.40(A)(7).

Under ORC section 5733.40(A)(7), in calculating the SBD amount, the amount of “guaranteed payments or compensation paid to investors by a qualifying entity” are treated as part of the distributive share of income from the QPE. This provision was necessary, if the SBD amount was to be calculated based on an owner’s total income from the QPE since the owners of “S” corporations, LLCs and partnerships take part of their income in the form of a distributive share and part in the form of W-2 compensation or guaranteed payments.

The Ohio Tax Department (“OTD”) has taken the position that owners of QPEs who engage a PEO to handle payroll and administrative services for the QPE’s employees and owners should be treated differently than those who do not. The OTD thinks it relevant for some reason that the

money to pay the owner's W-2 wages or guaranteed payment went from the QPE thru the conduit of the PEO to the owner. That is, under the PEO contract, the QPE paid money to the PEO, and the PEO in turn wrote a check to pay the owner his wages or guaranteed payment.

OTD (and no one else to my knowledge) has set forth any rationale for treating QPEs that use a PEO for payroll any differently from those that do not. The fact is there is NO reason to treat QPEs that use a PEO differently from those that do not.

In fact, ORC section 4125.042(A)(1) clearly states that a client employer who has engaged a PEO is be entitled to the benefit of any tax credit, economic incentive and similar benefit arising as the result of the client employer's employment of employees it shares with a PEO.

There is nothing in the ORC or the Ohio Administrative Code or case law that requires the interpretation of ORC section 5733.40(A)(7) that ODT is taking. In my opinion, the ODT position is contrary to legislative intent, contrary to the express language of ORC section 4125.042 and contrary to common sense.

The legislature is to be commended for its actions in quickly addressing this problem. HB 334 (and the companion bill SB 186) include language that makes it clear that for purposes of calculating the Ohio SBD, QPEs that engage a PEO to handle payroll for owners and employees will not be treated differently than those that do not.

All or most affected taxpayers claimed the maximum Ohio SBD starting in 2013. It is therefore critically important for this legislative fix to be retroactive to January 1, 2013 and all years starting thereafter. A fix that does not go back to 2013 is really no fix at all.

Thank you for your time and attention.

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