

Proponent Testimony on Senate Bill 186
Crystal Faulkner, CPA on behalf of The Ohio Society of CPAs
Ohio Senate Ways & Means Committee
September 27, 2017

Chairman Eklund, Vice Chair Terhar, Ranking Member Williams and members of the Senate Ways & Means Committee, thank you for this opportunity to speak as a proponent for Senate Bill 186. I'm Crystal Faulkner, a partner and the market leader in the Cincinnati office of MMC CPAs and advisors, a CPA firm with offices in Ohio, Kentucky and Indiana. Our firm represents numerous small businesses operating in Ohio and all over our entire footprint. I'm also on The Ohio Society of CPAs' Executive Board and Government Relations Advisory Council as well as a longtime member of the Ohio CSI Small Business Advisory Council and the Ohio Gateway Steering Committee.

The intention of Ohio's small business deduction (SBD), which later became the business income deduction (BID), was to enable Ohio pass-through business owners to retain more of their own money so that they could reinvest those funds in expanding their Ohio footprint, buying new equipment, hiring more workers, and so on. It was also an effort to put pass-through entities on a more comparable taxation level as C corporations.

My PTE clients owning 20% or more of their businesses have been using the SBD and BID tax deductions over the past four tax years (2013–2016). However, several of them have been dealing with uncertainty and significant bills from the Ohio Department of Taxation (ODT) for SBD and BID audits. Today I'd like to focus on challenges faced by my business owners who retain the services of a Professional Employer Organization (PEO). In a nutshell, PEOs are companies that handle HR responsibilities for businesses that contract with them – services such as payroll and benefits management that otherwise would take up a lot of a business owner's time – and enable a business to provide richer benefits to employees. I am very familiar with PEOs having served on the Board of a large PEO for several years.

The ODT in the past year or so took the position that a PTE business owner who utilizes the services of a PEO is for some reason now not considered a "business owner" for purposes of the BID. Current Ohio law states that a person who owns more than 20% of a business can include their compensation along with any undistributed income from a PTE as qualified business income for purposes of the \$250,000 BID threshold. For example, I have one client who is a 100% owner of her business. She has 25 employees, and engaged the services of a PEO because she not only wanted to provide richer benefits to her employees, but she felt it was a better use of her time to outsource time-consuming HR tasks such as payroll processing and benefits management. Her employees could be in more than 50 different communities performing services in any given week. Outsourcing her HR tasks to a PEO in no way changed the reality that she still owns 100% of her company, even though she now receives a W2 from the PEO as a result of the payroll processing.

S.B. 186 specifies that wages and 'guaranteed payments' paid by a PEO to an investor in a PTE that is a client employer of the PEO qualifies for the BID and 3% tax rate. Prior to the introduction of this legislation, ODT was auditing hundreds of small businesses utilizing PEO services and was retroactively going back and excluding the business owner's compensation from the calculation. Thankfully, ODT has suspended audits as of September 7, 2017 pending the outcome of this legislation.

Since ODT was going back retroactively and causing many small businesses to pay large amounts of back taxes, I'm grateful that S.B. 186 also applies to taxable years beginning on or after January 1, 2013 (the first year the SBD/BID was effective). It's not fair to change the rules after the fact. Significant numbers of small businesses all over Ohio were being audited causing them to pay thousands of dollars in back taxes. The cost to Ohio from 2013-2016 should already be included in the SBD/BID numbers since businesses utilizing PEO's were previously claiming the SBD/BID during the past four years. If the laws change prospectively that is one thing. Businesses can plan and make decisions if they know the rules. It simply is not fair to change the way the ODT views this deduction after the fact.

Thank you again for this opportunity to offer proponent testimony on Senate Bill 186. I'm available to answer any of your questions.