THE GENERAL ASSEMBLY OF THE STATE OF OHIO

HOUSE OF REPRESENTATIVES

REPRESENTATIVE GARY SCHERER
HOUSE DISTRICT 92

H.B. 467
Sponsor Testimony
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Chairman Merrin, Vice Chair LaRe, and members of the Ways and Means Committee, thank you for this opportunity to provide sponsor testimony on H.B. 467, the Pass-Through Entities Withholding Rate Adjustment.

For those of you unfamiliar with pass-through entities, I will begin by providing a bit of background on this concept. On the federal level, a pass-through entity is generally a subchapter S corporation, partnership, or limited liability company (LLC) that is taxed as either a partnership (federal form 1065) or as an S corporation (federal form 1120s) for tax purposes. The main advantage of electing to be taxed as a pass-through entity rather than as a regular "C" corporation is the ability to avoid double taxation. The net income that is attributable to a PTE is allocated to its owners or investors and those persons then pay the taxes on such attributed income and the PTE is relieved of that tax burden at the corporate or partnership level.

On the state level in Ohio, each qualifying pass through entity is required to withhold the Ohio income tax that is ultimately owed the non-resident investors ("NRI") in the pass-through entities. Operationally what occurs is that the pass through entity is required to withhold from payments and distributions made to such NRI at a codified set rate and then pay that withheld amount directly to the government on behalf of that non-resident investor. The practical reasoning is to ensure that the state of Ohio can be partially assured that it is receiving the taxes that may be ultimately due from the NRI. There can be two types of NRI, an individual and non-individual. Currently in Ohio, there are separate rates that are required for withholding purposes depending on whether the NRI is an individual or non-individual.

H.B. 467 proposes to lower both these two rates so the tax withheld on behalf of nonresident owners of Ohio-operating PTEs will be more equitable with the current income tax rates – the ultimate tax due.

Specifically, the bill reduces the rate of tax withheld by PTEs on a percentage of its nonresident investors' distributive income: from 5% to 4% for individual investors and from 8.5% to 4% for non-individual investors. The state income tax rate on business income above $250,000 is currently 3%, and the top individual rate for tax year 2019 is 4.797%. The proposed 4% withholding rate strikes a balance between these two income tax rates.

Former S.B. 288 (131st GA) proposed providing a single withholding rate of 3% (instead of the current 5% and/or 8.5%). The single 3% withholding rate was also included in the House version of H.B. 166, but was later removed in the budget process. During H.B. 166, LSC noted the fiscal effect does not actually change any taxpayer's tax liability, but merely reduces the amount of withholding taxes collected.

The current disparity between the withholding rates and the income tax rates has led to an unnecessary tax burden – PTEs must withhold at a rate far higher than the rate at which the individuals will be ultimately taxed, and then, the individuals must personally file with Ohio to seek refunds. This legislation is arguably long overdue: the current pass-through entity withholding regime was enacted in 1997 by the 122nd General Assembly. Much has changed in Ohio's taxation provisions since 1997, but the pass-through entity withholding statute has not followed suit. This bill will ultimately lower the pass-through entity withholding rate to be more in line with Ohio's current income tax rate.

This bill specifically targets non-resident pass-through entity owners. However, it is important to note that even though they are non-residents, these are Ohio-based businesses employing Ohioans and making positive contributions to Ohio's economy. The investment capital is better served being retained in the Ohio economy rather than sitting in a state account collecting interest on the over-withheld money, only to be refunded back to businesses months later (usually 12-18 months).

Please join me as I seek a much-needed fix, consisting of long-overdue modifications to bring Ohio's pass-through entity nonresident withholding statute in line with the individual income tax provisions.

Thank you for this opportunity to provide this testimony on H.B. 467, and I welcome any questions you may have.