

**As Passed by the Senate**

**132nd General Assembly**

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**S. B. No. 186**

**Senator Peterson**

**Cosponsors: Senators Eklund, Terhar, Hackett, Jordan, Wilson, Balderson,  
Beagle, Burke, Coley, Gardner, Hoagland, Hottinger, Huffman, Lehner, Manning,  
Oelslager, Uecker**

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**A BILL**

To amend section 5733.40 of the Revised Code to  
provide that wages and guaranteed payments paid  
by a professional employer organization to the  
owner of a pass-through entity that has  
contracted with the organization may be  
considered business income.

**BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF OHIO:**

**Section 1.** That section 5733.40 of the Revised Code be  
amended to read as follows:

**Sec. 5733.40.** As used in sections 5733.40 and 5733.41 and  
Chapter 5747. of the Revised Code:

(A) (1) "Adjusted qualifying amount" means either of the  
following:

(a) The sum of each qualifying investor's distributive  
share of the income, gain, expense, or loss of a qualifying  
pass-through entity for the qualifying taxable year of the  
qualifying pass-through entity multiplied by the apportionment

fraction defined in division (B) of this section, subject to 17  
section 5733.401 of the Revised Code and divisions (A) (2) to (7) 18  
of this section; 19

(b) The sum of each qualifying beneficiary's share of the 20  
qualifying net income and qualifying net gain distributed by a 21  
qualifying trust for the qualifying taxable year of the 22  
qualifying trust multiplied by the apportionment fraction 23  
defined in division (B) of this section, subject to section 24  
5733.401 of the Revised Code and divisions (A) (2) to (7) of this 25  
section. 26

(2) The sum shall exclude any amount which, pursuant to 27  
the Constitution of the United States, the Constitution of Ohio, 28  
or any federal law is not subject to a tax on or measured by net 29  
income. 30

(3) For the purposes of Chapters 5733. and 5747. of the 31  
Revised Code, the profit or net income of the qualifying entity 32  
shall be increased by disallowing all amounts representing 33  
expenses, other than amounts described in division (A) (7) of 34  
this section, that the qualifying entity paid to or incurred 35  
with respect to direct or indirect transactions with one or more 36  
related members, excluding the cost of goods sold calculated in 37  
accordance with section 263A of the Internal Revenue Code and 38  
United States department of the treasury regulations issued 39  
thereunder. Nothing in division (A) (3) of this section shall be 40  
construed to limit solely to this chapter the application of 41  
section 263A of the Internal Revenue Code and United States 42  
department of the treasury regulations issued thereunder. 43

(4) For the purposes of Chapters 5733. and 5747. of the 44  
Revised Code, the profit or net income of the qualifying entity 45  
shall be increased by disallowing all recognized losses, other 46

than losses from sales of inventory the cost of which is 47  
calculated in accordance with section 263A of the Internal 48  
Revenue Code and United States department of the treasury 49  
regulations issued thereunder, with respect to all direct or 50  
indirect transactions with one or more related members. For the 51  
purposes of Chapters 5733. and 5747. of the Revised Code, losses 52  
from the sales of such inventory shall be allowed only to the 53  
extent calculated in accordance with section 482 of the Internal 54  
Revenue Code and United States department of the treasury 55  
regulations issued thereunder. Nothing in division (A) (4) of 56  
this section shall be construed to limit solely to this section 57  
the application of section 263A and section 482 of the Internal 58  
Revenue Code and United States department of the treasury 59  
regulations issued thereunder. 60

(5) The sum shall be increased or decreased by an amount 61  
equal to the qualifying investor's or qualifying beneficiary's 62  
distributive or proportionate share of the amount that the 63  
qualifying entity would be required to add or deduct under 64  
divisions (A) (20) and (21) of section 5747.01 of the Revised 65  
Code if the qualifying entity were a taxpayer for the purposes 66  
of Chapter 5747. of the Revised Code. 67

(6) The sum shall be computed without regard to section 68  
5733.051 or division (D) of section 5733.052 of the Revised 69  
Code. 70

(7) For the purposes of Chapters 5733. and 5747. of the 71  
Revised Code, guaranteed payments or compensation paid to 72  
investors by a qualifying entity that is not subject to the tax 73  
imposed by section 5733.06 of the Revised Code shall be 74  
considered a distributive share of income of the qualifying 75  
entity. Division (A) (7) of this section applies only to such 76

payments or such compensation paid to an investor who at any 77  
time during the qualifying entity's taxable year holds at least 78  
a twenty per cent direct or indirect interest in the profits or 79  
capital of the qualifying entity. For the purposes of this 80  
division, guaranteed payments and compensation shall be 81  
considered to be paid to an investor by a qualifying entity if 82  
the qualifying entity in which the investor holds at least a 83  
twenty per cent direct or indirect interest is a client employer 84  
of a professional employer organization, as those terms are 85  
defined in section 4125.01 of the Revised Code, and the 86  
guaranteed payments or compensation are paid to the investor by 87  
that professional employer organization. 88

(B) "Apportionment fraction" means: 89

(1) With respect to a qualifying pass-through entity other 90  
than a financial institution, the fraction calculated pursuant 91  
to division (B) (2) of section 5733.05 of the Revised Code as if 92  
the qualifying pass-through entity were a corporation subject to 93  
the tax imposed by section 5733.06 of the Revised Code; 94

(2) With respect to a qualifying pass-through entity that 95  
is a financial institution, the fraction calculated pursuant to 96  
division (C) of section 5733.056 of the Revised Code as if the 97  
qualifying pass-through entity were a financial institution 98  
subject to the tax imposed by section 5733.06 of the Revised 99  
Code. 100

(3) With respect to a qualifying trust, the fraction 101  
calculated pursuant to division (B) (2) of section 5733.05 of the 102  
Revised Code as if the qualifying trust were a corporation 103  
subject to the tax imposed by section 5733.06 of the Revised 104  
Code, except that the property, payroll, and sales fractions 105  
shall be calculated by including in the numerator and 106

denominator of the fractions only the property, payroll, and 107  
sales, respectively, directly related to the production of 108  
income or gain from acquisition, ownership, use, maintenance, 109  
management, or disposition of tangible personal property located 110  
in this state at any time during the qualifying trust's 111  
qualifying taxable year or of real property located in this 112  
state. 113

(C) "Qualifying beneficiary" means any individual that, 114  
during the qualifying taxable year of a qualifying trust, is a 115  
beneficiary of that trust, but does not include an individual 116  
who is a resident taxpayer for the purposes of Chapter 5747. of 117  
the Revised Code for the entire qualifying taxable year of the 118  
qualifying trust. 119

(D) "Fiscal year" means an accounting period ending on any 120  
day other than the thirty-first day of December. 121

(E) "Individual" means a natural person. 122

(F) "Month" means a calendar month. 123

(G) "Partnership" has the same meaning as in section 124  
5747.01 of the Revised Code. 125

(H) "Investor" means any person that, during any portion 126  
of a taxable year of a qualifying pass-through entity, is a 127  
partner, member, shareholder, or investor in that qualifying 128  
pass-through entity. 129

(I) Except as otherwise provided in section 5733.402 or 130  
5747.401 of the Revised Code, "qualifying investor" means any 131  
investor except those described in divisions (I)(1) to (9) of 132  
this section. 133

(1) An investor satisfying one of the descriptions under 134

section 501(a) or (c) of the Internal Revenue Code, a 135  
partnership with equity securities registered with the United 136  
States securities and exchange commission under section 12 of 137  
the "Securities Exchange Act of 1934," as amended, or an 138  
investor described in division (F) of section 3334.01, or 139  
division (A) or (C) of section 5733.09 of the Revised Code for 140  
the entire qualifying taxable year of the qualifying pass- 141  
through entity. 142

(2) An investor who is either an individual or an estate 143  
and is a resident taxpayer for the purposes of section 5747.01 144  
of the Revised Code for the entire qualifying taxable year of 145  
the qualifying pass-through entity. 146

(3) An investor who is an individual for whom the 147  
qualifying pass-through entity makes a good faith and reasonable 148  
effort to comply fully and timely with the filing and payment 149  
requirements set forth in division (D) of section 5747.08 of the 150  
Revised Code and section 5747.09 of the Revised Code with 151  
respect to the individual's adjusted qualifying amount for the 152  
entire qualifying taxable year of the qualifying pass-through 153  
entity. 154

(4) An investor that is another qualifying pass-through 155  
entity having only investors described in division (I)(1), (2), 156  
(3), or (6) of this section during the three-year period 157  
beginning twelve months prior to the first day of the qualifying 158  
taxable year of the qualifying pass-through entity. 159

(5) An investor that is another pass-through entity having 160  
no investors other than individuals and estates during the 161  
qualifying taxable year of the qualifying pass-through entity in 162  
which it is an investor, and that makes a good faith and 163  
reasonable effort to comply fully and timely with the filing and 164

payment requirements set forth in division (D) of section 165  
5747.08 of the Revised Code and section 5747.09 of the Revised 166  
Code with respect to investors that are not resident taxpayers 167  
of this state for the purposes of Chapter 5747. of the Revised 168  
Code for the entire qualifying taxable year of the qualifying 169  
pass-through entity in which it is an investor. 170

(6) An investor that is a financial institution required 171  
to calculate the tax in accordance with division (E) of section 172  
5733.06 of the Revised Code on the first day of January of the 173  
calendar year immediately following the last day of the 174  
financial institution's calendar or fiscal year in which ends 175  
the taxpayer's taxable year. 176

(7) An investor other than an individual that satisfies 177  
all the following: 178

(a) The investor submits a written statement to the 179  
qualifying pass-through entity stating that the investor 180  
irrevocably agrees that the investor has nexus with this state 181  
under the Constitution of the United States and is subject to 182  
and liable for the tax calculated under division (A) or (B) of 183  
section 5733.06 of the Revised Code with respect to the 184  
investor's adjusted qualifying amount for the entire qualifying 185  
taxable year of the qualifying pass-through entity. The 186  
statement is subject to the penalties of perjury, shall be 187  
retained by the qualifying pass-through entity for no fewer than 188  
seven years, and shall be delivered to the tax commissioner upon 189  
request. 190

(b) The investor makes a good faith and reasonable effort 191  
to comply timely and fully with all the reporting and payment 192  
requirements set forth in Chapter 5733. of the Revised Code with 193  
respect to the investor's adjusted qualifying amount for the 194

entire qualifying taxable year of the qualifying pass-through 195  
entity. 196

(c) Neither the investor nor the qualifying pass-through 197  
entity in which it is an investor, before, during, or after the 198  
qualifying pass-through entity's qualifying taxable year, 199  
carries out any transaction or transactions with one or more 200  
related members of the investor or the qualifying pass-through 201  
entity resulting in a reduction or deferral of tax imposed by 202  
Chapter 5733. of the Revised Code with respect to all or any 203  
portion of the investor's adjusted qualifying amount for the 204  
qualifying pass-through entity's taxable year, or that 205  
constitute a sham, lack economic reality, or are part of a 206  
series of transactions the form of which constitutes a step 207  
transaction or transactions or does not reflect the substance of 208  
those transactions. 209

(8) Any other investor that the tax commissioner may 210  
designate by rule. The tax commissioner may adopt rules 211  
including a rule defining "qualifying investor" or "qualifying 212  
beneficiary" and governing the imposition of the withholding tax 213  
imposed by section 5747.41 of the Revised Code with respect to 214  
an individual who is a resident taxpayer for the purposes of 215  
Chapter 5747. of the Revised Code for only a portion of the 216  
qualifying taxable year of the qualifying entity. 217

(9) An investor that is a trust or fund the beneficiaries 218  
of which, during the qualifying taxable year of the qualifying 219  
pass-through entity, are limited to the following: 220

(a) A person that is or may be the beneficiary of a trust 221  
subject to Subchapter D of Chapter 1 of Subtitle A of the 222  
Internal Revenue Code. 223



(b) A person that is or may be the beneficiary of or the recipient of payments from a trust or fund that is a nuclear decommissioning reserve fund, a designated settlement fund, or any other trust or fund established to resolve and satisfy claims that may otherwise be asserted by the beneficiary or a member of the beneficiary's family. Sections 267(c)(4), 468A(e), and 468B(d)(2) of the Internal Revenue Code apply to the determination of whether such a person satisfies division (I)(9) of this section.

(c) A person who is or may be the beneficiary of a trust that, under its governing instrument, is not required to distribute all of its income currently. Division (I)(9)(c) of this section applies only if the trust, prior to the due date for filing the qualifying pass-through entity's return for taxes imposed by section 5733.41 and sections 5747.41 to 5747.453 of the Revised Code, irrevocably agrees in writing that for the taxable year during or for which the trust distributes any of its income to any of its beneficiaries, the trust is a qualifying trust and will pay the estimated tax, and will withhold and pay the withheld tax, as required under sections 5747.40 to 5747.453 of the Revised Code.

For the purposes of division (I)(9) of this section, a trust or fund shall be considered to have a beneficiary other than persons described under divisions (I)(9)(a) to (c) of this section if a beneficiary would not qualify under those divisions under the doctrines of "economic reality," "sham transaction," "step doctrine," or "substance over form." A trust or fund described in division (I)(9) of this section bears the burden of establishing by a preponderance of the evidence that any transaction giving rise to the tax benefits provided under division (I)(9) of this section does not have as a principal

purpose a claim of those tax benefits. Nothing in this section 255  
shall be construed to limit solely to this section the 256  
application of the doctrines referred to in this paragraph. 257

(J) "Qualifying net gain" means any recognized net gain 258  
with respect to the acquisition, ownership, use, maintenance, 259  
management, or disposition of tangible personal property located 260  
in this state at any time during a trust's qualifying taxable 261  
year or real property located in this state. 262

(K) "Qualifying net income" means any recognized income, 263  
net of related deductible expenses, other than distributions 264  
deductions with respect to the acquisition, ownership, use, 265  
maintenance, management, or disposition of tangible personal 266  
property located in this state at any time during the trust's 267  
qualifying taxable year or real property located in this state. 268

(L) "Qualifying entity" means a qualifying pass-through 269  
entity or a qualifying trust. 270

(M) "Qualifying trust" means a trust subject to subchapter 271  
J of the Internal Revenue Code that, during any portion of the 272  
trust's qualifying taxable year, has income or gain from the 273  
acquisition, management, ownership, use, or disposition of 274  
tangible personal property located in this state at any time 275  
during the trust's qualifying taxable year or real property 276  
located in this state. "Qualifying trust" does not include a 277  
person described in section 501(c) of the Internal Revenue Code 278  
or a person described in division (C) of section 5733.09 of the 279  
Revised Code. 280

(N) "Qualifying pass-through entity" means a pass-through 281  
entity as defined in section 5733.04 of the Revised Code, 282  
excluding: a person described in section 501(c) of the Internal 283

Revenue Code; a partnership with equity securities registered 284  
with the United States securities and exchange commission under 285  
section 12 of the Securities Exchange Act of 1934, as amended; 286  
or a person described in division (C) of section 5733.09 of the 287  
Revised Code. 288

(O) "Quarter" means the first three months, the second 289  
three months, the third three months, or the last three months 290  
of a qualifying entity's qualifying taxable year. 291

(P) "Related member" has the same meaning as in division 292  
(A) (6) of section 5733.042 of the Revised Code without regard to 293  
division (B) of that section. However, for the purposes of 294  
divisions (A) (3) and (4) of this section only, "related member" 295  
has the same meaning as in division (A) (6) of section 5733.042 296  
of the Revised Code without regard to division (B) of that 297  
section, but shall be applied by substituting "forty per cent" 298  
for "twenty per cent" wherever "twenty per cent" appears in 299  
division (A) of that section. 300

(Q) "Return" or "report" means the notifications and 301  
reports required to be filed pursuant to sections 5747.42 to 302  
5747.45 of the Revised Code for the purpose of reporting the tax 303  
imposed under section 5733.41 or 5747.41 of the Revised Code, 304  
and included declarations of estimated tax when so required. 305

(R) "Qualifying taxable year" means the calendar year or 306  
the qualifying entity's fiscal year ending during the calendar 307  
year, or fractional part thereof, for which the adjusted 308  
qualifying amount is calculated pursuant to sections 5733.40 and 309  
5733.41 or sections 5747.40 to 5747.453 of the Revised Code. 310

(S) "Distributive share" includes the sum of the income, 311  
gain, expense, or loss of a disregarded entity or qualified 312

subchapter S subsidiary.	313
<b>Section 2.</b> That existing section 5733.40 of the Revised Code is hereby repealed.	314 315
<b>Section 3.</b> The amendment by this act of section 5733.40 of the Revised Code is intended to clarify the law as it existed before the enactment of this act and shall be construed accordingly. The amendment shall apply to taxable years beginning on or after January 1, 2013.	316 317 318 319 320