

As Reported by the Senate Ways and Means Committee

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S. B. No. 186

Senator Peterson

Cosponsors: Senators Eklund, Terhar, Hackett, Jordan, Wilson

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
section 5733.401 of the Revised Code and divisions (A) (2) to (7)

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 entity in which it is an investor, before, during, or after the qualifying pass-through entity's qualifying taxable year, carries out any transaction or transactions with one or more related members of the investor or the qualifying pass-through entity resulting in a reduction or deferral of tax imposed by Chapter 5733. of the Revised Code with respect to all or any portion of the investor's adjusted qualifying amount for the qualifying pass-through entity's taxable year, or that constitute a sham, lack economic reality, or are part of a series of transactions the form of which constitutes a step transaction or transactions or does not reflect the substance of those transactions.

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

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

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

(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 227
claims that may otherwise be asserted by the beneficiary or a 228
member of the beneficiary's family. Sections 267(c)(4), 468A(e), 229
and 468B(d)(2) of the Internal Revenue Code apply to the 230
determination of whether such a person satisfies division (I)(9) 231
of this section. 232

(c) A person who is or may be the beneficiary of a trust 233
that, under its governing instrument, is not required to 234
distribute all of its income currently. Division (I)(9)(c) of 235
this section applies only if the trust, prior to the due date 236
for filing the qualifying pass-through entity's return for taxes 237
imposed by section 5733.41 and sections 5747.41 to 5747.453 of 238
the Revised Code, irrevocably agrees in writing that for the 239
taxable year during or for which the trust distributes any of 240
its income to any of its beneficiaries, the trust is a 241
qualifying trust and will pay the estimated tax, and will 242
withhold and pay the withheld tax, as required under sections 243
5747.40 to 5747.453 of the Revised Code. 244

For the purposes of division (I)(9) of this section, a 245
trust or fund shall be considered to have a beneficiary other 246
than persons described under divisions (I)(9)(a) to (c) of this 247
section if a beneficiary would not qualify under those divisions 248
under the doctrines of "economic reality," "sham transaction," 249
"step doctrine," or "substance over form." A trust or fund 250
described in division (I)(9) of this section bears the burden of 251
establishing by a preponderance of the evidence that any 252
transaction giving rise to the tax benefits provided under 253
division (I)(9) of this section does not have as a principal 254
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
Section 2. That existing section 5733.40 of the Revised	314
Code is hereby repealed.	315
Section 3. The amendment by this act of section 5733.40 of	316

the Revised Code is intended to clarify the law as it existed	317
before the enactment of this act and shall be construed	318
accordingly. The amendment shall apply to taxable years	319
beginning on or after January 1, 2013.	320