

Proponent Testimony  
Prepared for House Bill 138  
The Ohio House Ways & Means Committee  
May 2, 2023

Chair Roemer, Vice Chair Merrin, Ranking Member Troy, and Members of the Ohio House Ways & Means Committee, thank you for this opportunity to offer proponent testimony on House Bill 138 on behalf of The Ohio Society of CPAs. My name is Tom Zaino and I'm the Managing Member of Zaino Hall & Farrin LLC.

The OSCPA is pleased to support H.B. 138 and its objectives to clarify the definition of "business income" to include guaranteed payments received by all owners of a pass-through entity ("PTE") treated as a partnership, regardless of the percentage of an individual owner's interest in the PTE.

The issue that this legislation addresses arose because of Ohio Department of Taxation ("ODT") audit policy. The term "guaranteed payments" is not a defined term in the Ohio Revised Code. Therefore, ODT should generally defer to the federal definition of guaranteed payments. Guaranteed payments are payments made by a partnership to a partner for services or the use of capital so long as the payment is determined without regard to the income of the partnership. I.R.C. Sec. 707(c); Treas. Reg. 1.707-1(c). Guaranteed payments are regarded by the IRS as a partner's distributive share of the partnership's income. Treas. Reg. 1.707-1(c). Because partnership income is generally derived by business operations, it should be treated as business income for Ohio personal income tax purposes. R.C. 5747.231; see also *Agley v. Tracy*, 98 Ohio St.3d 265 (1999).

To be clear, ODT treats guaranteed payments received by 20% or more owners as business income. However, ODT has taken a position on audit that the language enacted in 1997 to mitigate income stripping attempts by 20% or more nonresident owners of a PTE must be interpreted to treat guaranteed payments received by less than 20% owners as "nonbusiness income."

The proposed language is technical in nature and clarifies that all guaranteed payments are "business income" without regard to ownership levels.

Similar to H.B. 515 (134<sup>th</sup> GA), which dealt with the sale of a business and the BID, H.B. 138 is a remedial measure intended to clarify existing law and apply to any income that is subject to an ODT audit or appeal on or after the effective date. The goal is to clarify the law so it can be applied to currently pending audits or appeals.

On behalf of the OSCPA, thank you for allowing me the opportunity to share our support for House Bill 138. I would be happy to answer any of your questions.