### As Passed by the Senate

## **132nd General Assembly**

# Regular Session 2017-2018

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

## A BILL

| То | amend section 5733.40 of the Revised Code to    | 1 |
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|    | provide that wages and guaranteed payments paid | 2 |
|    | by a professional employer organization to the  | 3 |
|    | owner of a pass-through entity that has         | 4 |
|    | contracted with the organization may be         | 5 |
|    | considered business income.                     | 6 |

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

| <b>Section 1.</b> That section 5733.40 of the Revised Code be  | 7  |
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| amended to read as follows:                                    | 8  |
| Sec. 5733.40. As used in sections 5733.40 and 5733.41 and      | 9  |
| Chapter 5747. of the Revised Code:                             | 10 |
| (A)(1) "Adjusted qualifying amount" means either of the        | 11 |
| following:   | 12 |
| (a) The sum of each qualifying investor's distributive         | 13 |
| share of the income, gain, expense, or loss of a qualifying    | 14 |
| pass-through entity for the qualifying taxable year of the     | 15 |
| qualifying pass-through entity multiplied by the apportionment | 16 |

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| fraction defined in division (B) of this section, subject to     | 17 |
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| 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 |
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(4) For the purposes of Chapters 5733. and 5747. of the44Revised Code, the profit or net income of the qualifying entity45shall be increased by disallowing all recognized losses, other46

United States department of the treasury regulations issued

construed to limit solely to this chapter the application of

section 263A of the Internal Revenue Code and United States

department of the treasury regulations issued thereunder.

thereunder. Nothing in division (A)(3) of this section shall be

| than losses from sales of inventory the cost of which is         | 47 |
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| 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 equal to the qualifying investor's or qualifying beneficiary's distributive or proportionate share of the amount that the qualifying entity would be required to add or deduct under divisions (A)(20) and (21) of section 5747.01 of the Revised Code if the qualifying entity were a taxpayer for the purposes of Chapter 5747. of the Revised Code.
- (6) The sum shall be computed without regard to section 5733.051 or division (D) of section 5733.052 of the Revised Code.
- (7) For the purposes of Chapters 5733. and 5747. of the

  Revised Code, guaranteed payments or compensation paid to

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  investors by a qualifying entity that is not subject to the tax

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  imposed by section 5733.06 of the Revised Code shall be

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  considered a distributive share of income of the qualifying

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  entity. Division (A) (7) of this section applies only to such

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| payments or such compensation paid to an investor who at any     | 77  |
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| 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

Revised Code as if the qualifying trust were a corporation

subject to the tax imposed by section 5733.06 of the Revised

Code, except that the property, payroll, and sales fractions

shall be calculated by including in the numerator and

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| denominator of the fractions only the property, payroll, and     | 107 |
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| 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

| section 501(a) or (c) of the Internal Revenue Code, a          | 135 |
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| 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 |
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- (2) An investor who is either an individual or an estate and is a resident taxpayer for the purposes of section 5747.01 of the Revised Code for the entire qualifying taxable year of the qualifying pass-through entity.
- (3) An investor who is an individual for whom the qualifying pass-through entity makes a good faith and reasonable effort to comply fully and timely with the filing and payment requirements set forth in division (D) of section 5747.08 of the Revised Code and section 5747.09 of the Revised Code with respect to the individual's adjusted qualifying amount for the entire qualifying taxable year of the qualifying pass-through entity.
- (4) An investor that is another qualifying pass-through entity having only investors described in division (I)(1), (2),(3), or (6) of this section during the three-year period beginning twelve months prior to the first day of the qualifying taxable year of the qualifying pass-through entity.
- (5) An investor that is another pass-through entity having

  no investors other than individuals and estates during the

  qualifying taxable year of the qualifying pass-through entity in

  which it is an investor, and that makes a good faith and

  reasonable effort to comply fully and timely with the filing and

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| payment requirements set forth in division (D) of section      | 165 |
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| 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 to calculate the tax in accordance with division (E) of section 5733.06 of the Revised Code on the first day of January of the calendar year immediately following the last day of the financial institution's calendar or fiscal year in which ends the taxpayer's taxable year.
- (7) An investor other than an individual that satisfies all the following:
- (a) The investor submits a written statement to the 179 180 qualifying pass-through entity stating that the investor 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 to comply timely and fully with all the reporting and payment requirements set forth in Chapter 5733. of the Revised Code with respect to the investor's adjusted qualifying amount for the

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| entire qualifying taxable year of the qualifying pass-through    | 195 |
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| 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

Internal Revenue Code.

| (b) A person that is or may be the beneficiary of or the         | 224 |
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| recipient of payments from a trust or fund that is a nuclear     | 225 |
| decommissioning reserve fund, a designated settlement fund, or   | 226 |
| 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 233 234 that, under its governing instrument, is not required to 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

245 For the purposes of division (I)(9) of this section, a 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 |
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| 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

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| Revenue Code; a partnership with equity securities registered    | 284 |
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| 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,

gain, expense, or loss of a disregarded entity or qualified

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| 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     |