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# OHIO LEGISLATIVE SERVICE COMMISSION

Office of Research  
and Drafting

Legislative Budget  
Office

H.B. 138  
135<sup>th</sup> General Assembly

## Bill Analysis

**Version:** As Introduced

**Primary Sponsors:** Reps. King and T. Young

Mackenzie Damon, Attorney

### SUMMARY

- Classifies guaranteed payments paid to a pass-through entity (PTE) investor, regardless of their ownership interest, as “business income” and therefore eligible for the business income deduction and flat income tax rate.

### DETAILED ANALYSIS

#### Taxation of guaranteed payments

The bill modifies the income tax treatment of guaranteed payments made to an investor in a pass-through entity (PTE), such as an LLC or partnership, for services rendered to the LLC. Guaranteed payments are payments made to an investor that, like a salary, are not based on the PTE’s profits. Since the investor is not an employee of the PTE, the payments are considered self-employment income for federal tax purposes.

The bill removes a limitation on when guaranteed payments are considered “business income” and, therefore, are eligible for Ohio’s business income tax deduction and flat tax. Under continuing law, individuals with business income may deduct the first \$250,000 of such income on their Ohio tax return. Income above that amount is taxed at a flat rate of 3%.

Under current law, any compensation paid to a PTE investor is considered business income only if the investor owns at least a 20% interest in the business. The bill removes this ownership limitation with respect to guaranteed payments, provided the payment is actually reported as federal self-employment income. Consequently, any reported guaranteed payments made to an investor, regardless of their ownership interest, will qualify for the business income deduction and flat tax.<sup>1</sup>

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<sup>1</sup> R.C. 5747.01(B).

## **Effect on PTE withholding tax**

Under continuing law, PTEs with nonresident investors are required to withhold income taxes on behalf of those investors, including on certain guaranteed payments made to such investors. The bill does not change current law as it applies to this withholding tax. Under the bill, as under current law, a PTE is only required to withhold taxes on guaranteed payments made to an investor who owns at least a 20% interest in the PTE. Taxes will not be withheld on guaranteed payments made to investors with a lower ownership percentage.<sup>2</sup>

## **Effective date**

The bill states that the change in the tax treatment of guaranteed payments is intended to clarify existing law, and that it applies to any petition for reassessment, appeal, application for refund, or audit that is pending on the bill's 90-day effective date.<sup>3</sup>

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## **HISTORY**

Action	Date
Introduced	03-28-23

ANHB0138IN-135/ts

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<sup>2</sup> R.C. 5733.40, not in the bill.

<sup>3</sup> Section 3.