



TESTIMONY REGARDING SENATE BILL 288  
Ohio Senate Ways and Means Committee  
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Ohio Society of Certified Public Accountants  
April 20, 2016

Good morning: Chairman Peterson, Ranking Member Tavares, and members of the Senate Ways & Means Committee. My name is Courtney Clark. I am a certified public accountant and an active member of the Ohio Society of Certified Public Accountants (“OSCPA”). I have been a CPA for thirteen years and currently work as a Multistate Tax Services Senior Manager for Deloitte Tax LLP. At Deloitte Tax, I assist clients from around the world with Ohio taxation issues and concerns.

On behalf of the OSCP, I am pleased to provide testimony in support of SB 288, and its objectives regarding Ohio’s taxation of income generated from pass-through entities, such as partnerships and S-corporations. SB 288 provides language to streamline the calculation, remittance and tracking of tax paid on behalf of nonresident owners of Ohio-operating pass-through entities.

This legislation is arguably long overdue: the current pass-through entity withholding regime was enacted in 1997 by the 122<sup>nd</sup> General Assembly. Much has changed in Ohio’s taxation provisions since 1997, but the pass-through entity withholding statute has not followed suit. The purpose of this bill is to unify the Ohio income tax and pass-through entity withholding provisions.

Ohio Amended Sub. H.B. 64 enacted a highest marginal income tax rate of 3% to be applied to an individual’s share of pass-through entity business income. However, the current statute provides that pass-through entities must withhold on behalf of nonresident individuals at 5%. This disparity has led to an upfront and unnecessary tax burden – pass-through entities must withhold at a rate far higher than what the individuals will be ultimately taxed at, and then, the individuals must personally file with Ohio to seek refunds.

Another serious issue under current law is that Subchapter C Corporations’ tax representatives too often discover that their corporations were inadvertently withheld upon by their pass-through entity investments at a rate of 8.5% – and that the erroneously paid tax is not refundable. This is an issue because Subchapter C Corporations have generally not been subject to Ohio’s income tax in six years. This erroneous withholding was not caused by a taxpayer mistake. Rather, a pass-through entity correctly followed the current withholding statute, which provides that if a pass-through entity does not have knowledge of its ultimate ownership, it must withhold upon its next immediate owner at the old Ohio corporate franchise tax rate. Unfortunately, if that next immediate owner is owned by a Subchapter C Corporation, there is no apparent mechanism in Ohio’s current law to provide for a tax refund. Similarly, if the next immediate investor is a not-for-profit entity, an insurance company, or other exempt investor, no provisions exist for the erroneously withheld income tax to be refunded.

This erroneous withholding issue is unique to Ohio’s current law and is encountered frequently by the private equity industry, which often uses tiered partnership/corporate structures for their investments. Attached to this testimony, please find a simple example of a sample private equity structure, which illustrates the issue at hand. Ohio’s nonresident withholding tax law should mirror the state’s overall intention of attracting private equity investments: not serve as a deterrent.

To remedy the individual income tax, erroneous withholding on behalf of entities not subject to income tax, and other administrative issues, the OSCPA participated in interested party meetings with Senator Eklund in conjunction with the Ohio Department of Taxation. As a result, important provisions of Senate Bill 288 include:

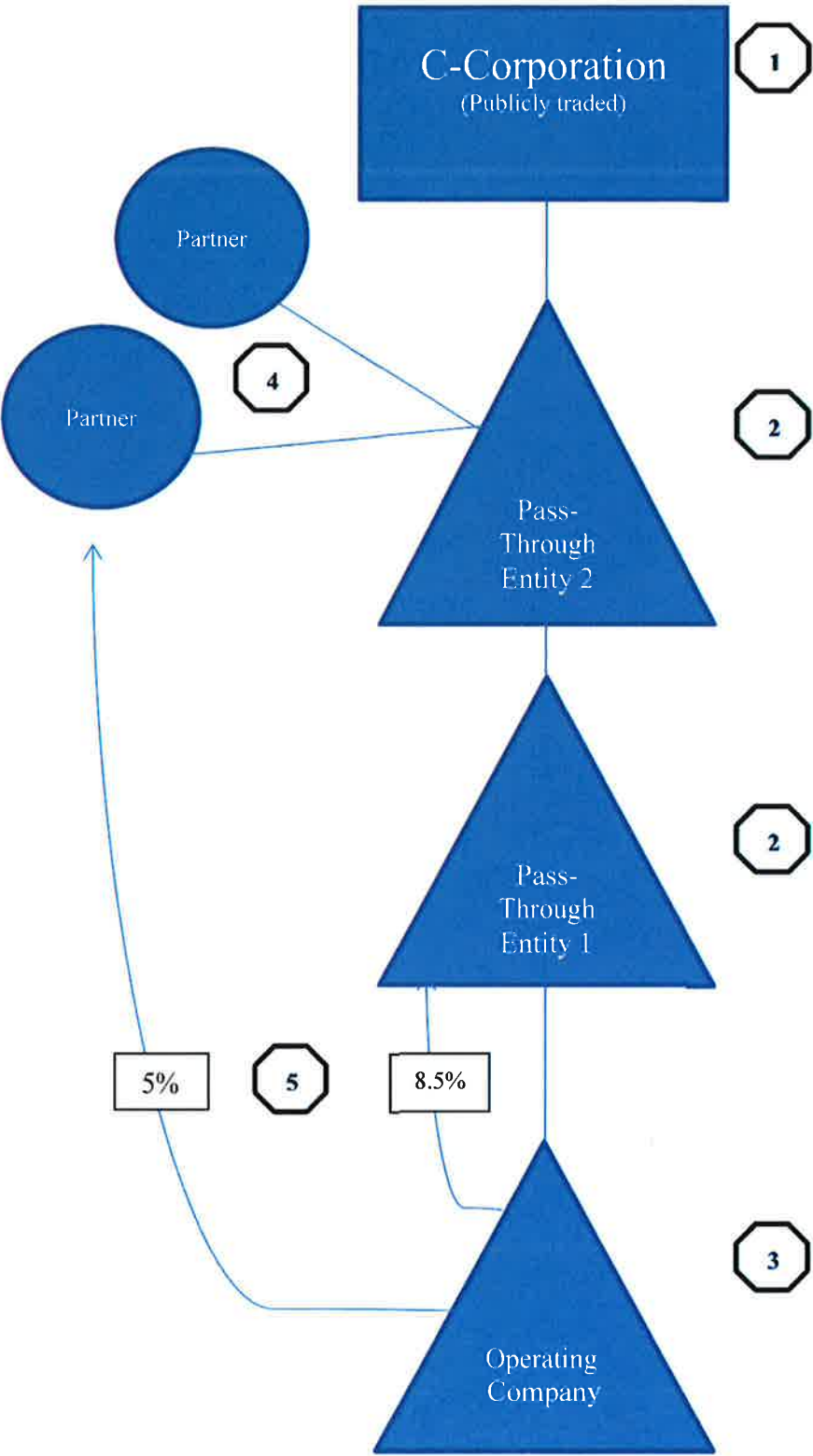
- Each pass-through entity having nexus in Ohio will now be required to file a composite return unless all of its investors are Ohio residents or otherwise exempt from the composite tax. The composite tax is computed at 3%, which mirrors the Ohio business income tax rate.
- The composite tax is paid on behalf of a pass-through entity's next immediate owners. If the next immediate owner is a non-resident individual, it is administered under current law that he would have no further filing or tax requirement if his investment in the pass-through entity was his only Ohio activity. However, in order to benefit from the small business income exemption amount of \$250,000 among other Ohio deductions and credits, he would file his own Ohio Individual Income Tax return to report his distributive share of Ohio-source income and composite tax paid, and potentially seek a tax refund.
- If the pass-through entity's next immediate owner is another pass-through entity, the first entity files a composite return and remits tax at 3% on behalf of the second entity. The second entity must then complete its own composite return to move the composite tax paid to its own investors or seek a refund of the composite tax paid on its behalf. The refund would occur if it has exempt or Ohio resident investors, or if it has other Ohio-sourced losses. The ability of the second entity to seek a refund is new to SB 288.
- An additional refund mechanism is also provided so that C Corporations, not-for-profits, insurance companies and other exempt entities may receive refunds of taxes erroneously withheld on their behalf on a prospective basis.
- Please note that the bill does not currently address monies that were previously, erroneously, withheld and are currently sitting with the State of Ohio – instead of being returned to the hands of those businesses and charities to which the refunds should be due. We encourage the Committee to consider adopting a measure to permit refunds of prior erroneous pass-through entity withholding on behalf of exempt investors for the open years under Ohio's income tax refund statute of limitations.
- The compliance provisions of the bill will increase transparency, so that taxpayers and the Ohio Department of Taxation will have similar expectations with respect to composite tax remitted on a taxpayer's behalf. Presumably, this will decrease the amount of information-seeking notices sent by the Ohio Department of Taxation.

As you may expect with any highly technical and complicated piece of legislation, some unintended consequences may have arisen during the drafting process. The OSCPA and our members are currently working with Senator Eklund regarding potential language modifications that may be needed to ensure the proposal stays true to the goals of fairness and simplicity. However, SB 288 should be considered as a much needed fix, consisting of long-overdue modifications bringing Ohio's pass-through entity nonresident withholding statute into line with the individual and corporate income tax provisions – or lack thereof.

On behalf of the Ohio Society of Certified Public Accountants, I appreciate your time and consideration. I welcome any questions that you or the Committee may have.

**Appendix A**

**Sample Private Equity Simplified Structure**



**Appendix A Cont.**  
**References**

1. Entity is taxed as a C-corporation for federal tax purposes. Publicly traded, and not subject to Ohio income tax.
2. Partnership for federal tax purposes, "Investment Pass-Through Entity" for Ohio withholding purposes, so therefore does not file an IT 1140 withholding form.
3. Partnership for federal tax purposes, "Qualifying Pass-Through Entity" for Ohio withholding purposes, so therefore files an IT 1140 withholding form.
4. Individual owners. Would be subject to Ohio tax on their distributive share of Ohio income from the Pass-Through Entity 2.

If Operating Company knows who its ultimate investors are, it reports withholding upon those investors at 5%. If it does not, it withholds upon Pass-Through Entity 1 8.5%.