# Ohio Legislative Service Commission

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# Fiscal Note & Local Impact Statement

**Bill**: H.B. 186 of the 129th G.A.

**Date**: May 25, 2011

**Status**: As Introduced

**Sponsor**: Rep. R. Adams

**Local Impact Statement Procedure Required**: No

**Contents**: Makes changes to the Professional Employer Organization Law

## State Fiscal Highlights

- The bill adds financial reports to the list of documents that Professional Employer Organizations (PEOs) must file when applying for or renewing workers' compensation coverage. This could result in increased administrative costs for the Bureau of Workers' Compensation (BWC). Any additional costs would be paid from Workers' Compensation Fund (Fund 7023) line item 855409, Administrative Services.
- The bill specifies the conditions under which a "shared" employee is considered an employee of a client employer or a PEO for calculating tax credits or other economic incentives based on employment. This could increase the amount of revenue lost to the state from certain tax credits.
- The bill could potentially exempt certain employment services contracts from the sales and use tax. If so, there could be a loss in sales and use taxes revenue. Tax revenues are distributed to the GRF and two local funds.

## Local Fiscal Highlights

- If the bill exempts certain employment services contracts from the sales and use tax, there may be a loss in sales and use taxes collected by counties, including the County Permissive Sales Tax and the Transit Authority Sales Tax. Also, potential lower taxes collected as a result of tax credits taken under the bill would reduce distributions to the Local Government Fund and the Public Library Fund.

# Detailed Fiscal Analysis

## Overview

The bill makes changes to the Professional Employer Organization (PEO) Law with regard to financial statements supplied to the Bureau of Workers' Compensation (BWC) and certain related tax provisions. A PEO provides payroll, human resources, workers' compensation, and employee benefits administration services to other companies, referred to as "client companies." This is generally accomplished by hiring a client company's employees and then leasing those employees back to their original employer; employees that are leased back to their original employer are referred to as "shared employees." The bill also allows multiple PEOs to register together as one entity, referred to as "PEO reporting entities," and permits an independent assurance organization, similar to a third-party administrator, to act on behalf of a PEO in complying with the PEO Law. According to the U.S. Census Bureau, there were approximately 240 PEOs in Ohio in 2007, employing approximately 47,900 workers as shared employees and reporting operating revenues of approximately $2.1 billion during that year.[1] Overall, the bill could increase administrative expenses for BWC, which under the bill would have to review various financial documents submitted by PEOs. The tax provisions in the bill could also result in revenue losses to the state and political subdivisions.

## BWC

The bill requires PEOs or PEO reporting entities to file financial statements along with their initial workers' compensation registration and annual renewal application. If a financial statement demonstrates that a PEO is in a deficit position, it must submit proof to the Bureau that it has obtained sufficient credit to cover the deficit. Under certain circumstances, if a PEO's financial position warrants, the bill authorizes BWC to provide the PEO with limited registration and coverage. Additionally, the bill requires PEOs to report any transfer of employees between related PEO entities or PEO reporting entities to BWC within 14 days after the transfer. According to U.S. Census Bureau data for 2007, there were approximately 240 PEOs in Ohio.

[1] U.S. Census Bureau, "2007 Economic Census: Summary Statistics for the US, States, Metro and Micro Areas, Metro Divisions, Consolidated Cities, Counties, and Places," available at web site: http:// factfinder.census.gov/servlet/IBQTable?_bm=y&-fds_name=EC0700A1&-_industry=561330&-ib_type= NAICS2007&-_lang=en&-geo_id=04000US39&-NAICS2007=561330&-search_results=01000US&-ds_name= EC0756A1 (August 20, 2010), last visited May 20, 2011.

Overall, BWC could incur some minimal new costs for reviewing the financial statements and conducting financial audits under the bill. Currently, these financial reviews and audits apply only to self-insured employers, of which there are 1,180 according to BWC's FY 2010 annual report. Any additional costs for overseeing records submitted by PEOs would be paid from Workers' Compensation Fund (Fund 7023) line item 855409, Administrative Services. The FY 2012 appropriation for this line item is $101.7 million.

### Tax credits

The bill provides that, for the purpose of calculating tax credits and other economic incentives based on employment, a client employer, exclusively, shall be entitled to use "shared" employees in the calculation of the tax or economic incentives. The provision thus expands the definition of "employees" to include contracted employees in the form of shared employees, possibly increasing the number of employees that would qualify employers for credits such as the job creation and job retention tax credits. The result is that the bill potentially increases the state revenue loss from various tax incentives. Tax revenue is distributed to the General Revenue Fund, the Local Government Fund, and the Public Library Fund. Any reduction in tax revenues from the expansion of the definition of "employees" for purposes of tax credits will reduce distributions to these funds.

### Sales tax

Under current law, employment service is a transaction subject to sales and use tax. That is, the purchaser of the service pays the sales tax on the employment service contracts, unless it is excluded.[2] Generally, the seller of taxable employment services collects the combined state and local permissive sales tax and remits it to the state. Various changes to the statute have been made since January 1993.

The bill requires shared employees, whose services are currently subject to the sales tax, to be considered the employees of the client company for purposes of collecting and levying sales tax. The bill would shift, for shared employment service, the party responsible for collecting and remitting the sales tax from the PEO to the client employer. No employer pays sales tax on the services provided by its own employees. Classifying shared employees as employees of the purchaser of employment service has the potential to exempt certain employment services contracts from the sales and use tax. As a result, the bill may create a revenue loss from state and local government sales and use taxes.

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[2] The Department of Taxation provides the definition of employment services and examples of transactions that are not taxable, available at http://tax.ohio.gov/divisions/communications/information_releases/sales/st199308.stm.

## Department of Taxation

The bill also contains provisions specifying PEO reporting requirements with the Department of Taxation. Under the bill, PEOs and PEO reporting entities would be required to file a report with the Department within 30 days after commencing business in Ohio or within 30 days of the bill's effective date. The report would include specified PEO, PEO reporting entity, and client employer information and would be updated quarterly. The Department of Taxation could incur some minimal administrative costs to process these reports.

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