

SENATE BILL REPORT

SB 6671

As Reported By Senate Committee On:
Ways & Means, February 16, 2006

Title: An act relating to clarifying the application of taxes to the financial activities of professional employer organizations.

Brief Description: Clarifying the application of taxes to the financial activities of professional employer organizations.

Sponsors: Senators Doumit, Delvin, Rasmussen and Parlette.

Brief History:

Committee Activity: Ways & Means: 2/2/06, 2/16/06 [DPS].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Substitute Senate Bill No. 6671 be substituted therefor, and the substitute bill do pass.

Signed by Senators Prentice, Chair; Fraser, Vice Chair, Capital Budget Chair; Doumit, Vice Chair, Operating Budget; Zarelli, Ranking Minority Member; Brandland, Fairley, Kohl-Welles, Parlette, Pridemore, Rasmussen, Roach, Rockefeller and Schoesler.

Staff: Dean Carlson (786-7305)

Background: The business and occupation (B&O) tax is imposed on the gross receipts of business activities without any deduction for the costs of doing business. However, a business that acts as an agent for another business is not liable for B&O tax on amounts that merely "pass through" the agent as reimbursement for expenses incurred by the agent on behalf of the agent's client. For example, an attorney might pay court costs on behalf of a client. When the attorney is reimbursed for those costs by the client, the attorney is not liable for B&O tax on the reimbursements. The attorney is only liable for B&O tax on amounts charged as fees for the attorney's services.

Some businesses utilize the services of other firms to provide employee related services, such as human resource management, payroll and employee tax compliance, and employee fringe benefit packages. The firms providing these services charge their clients amounts which include both payments to the employees and fees charged for the employee related services. These firms have been paying B&O tax on the amounts received as fees for the employee services but not on the amounts received for payment to the employees as wages and benefits.

In December 2002, the Washington Supreme Court decided a case that clarified when payments can be treated as a "pass through" and when tax is applied to the entire amount. The decision involved taxes imposed by the City of Tacoma, but the logic of the court's opinion applies equally to state B&O taxes.

Summary of Substitute Bill: A professional employer organization is a firm providing employee related services to clients where the client's employer rights, duties, and obligations have been allocated between the client and the professional employer organization.

Professional employer organizations pay B&O tax at the 1.5 percent service rate. A deduction is provided from gross income for amounts representing the actual cost of wages and salaries, benefits, workers compensation, payroll taxes, withholding, and other assessments paid on behalf of the client. Cities must provide professional employer organizations the same tax treatment under their B&O taxes.

Professional employer organizations are not liable for sales and use taxes not properly collected on selling activities by their clients.

Clients, and not the professional employer organization, are eligible for various credits, exemptions, and other tax incentives. The client, and not the professional employer organization, is responsible for filing surveys related to tax incentives.

Substitute Bill Compared to Original Bill: A technical change was made to clarify that the provisions of the bill only applied to B&O taxes and not taxes administered by Employment Security and L&I.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: The bill takes effect on July 1, 2006.

Testimony For: This is a problem resulting from a court decision and is no change in current law. Forty-five million dollars flowed into our account and \$43 million flowed immediately out in wages, taxes, and benefits. We paid \$27,000 in taxes. Without this bill, we would have paid over \$600,000 and would no longer be in business. The small business community needs the PEO option to support our businesses. The PEO solution allowed us to immediately begin business in Washington. We are concerned that there is overly broad language that has unintended consequences for employment and workers compensation taxes and we have worked on language to fix that.

Testimony Against: None.

Who Testified: PRO: Jim Halstrom, Nat'l Association of Professional Employers Organizations; John Heaton, Pay Plus Benefits; Drew Thorensen, Human Resource Novations; Andrea Mchenry, Administaff; Carol Stults, Jag Consulting; Jill Will, ESD; Carl Hammersburg, L&I.