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**Proponent Testimony on Senate Bill 186
Before the Senate Ways and Means Committee
Melissa Kelly, Director of State Government Affairs
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Chairman Eklund, Vice Chairman Terhar, Ranking Member Williams and members of the Senate Ways and Means Committee, my name is Melissa Kelly and I am here on behalf of the National Association of Professional Employer Organizations (NAPEO). Thank you for the opportunity to appear before you this morning and testify in support of Senate Bill (SB) 186.

President Pro Tempore Peterson, thank you for your sponsorship of this important legislation and your leadership in the related negotiations between the legislature, Department of Taxation and stakeholders. I'd also like to acknowledge and thank the department for their willingness to be engaged in discussions and work toward resolution.

NAPEO is the national trade association of the professional employer organization (PEO) industry. The association has 300 PEO members, ranging from start-ups to large publicly held companies. In Ohio, our footprint includes 100 members who report doing business in the state and 2.5 billion dollars in worksite wages.

PEOs are an administrative construct designed to help small and mid-sized businesses with human resources (HR) services. PEOs administer employee benefits and workers' compensation insurance, prepare payroll and remit employment taxes, and assist with state and federal compliance. By providing these comprehensive services, PEOs allow small businesses to focus on their core mission. Small businesses that use PEOs grow faster, have lower employee turnover, and are less likely to go out of business than small businesses that do not.

The average PEO client has between 10-15 workers. Through a PEO, these employees gain access to big business employee benefits such as: 401(k) plans; health, dental, life, and other insurance; and other benefits they might not typically receive as employees of a small company.

When the small business deduction (now the business income deduction) became available in 2013, Ohio business owners using a PEO claimed the deduction in the same fashion as any other business owner. And, they have continued to do so in the subsequent years since.

In 2016, we became aware that some of these individuals were audited by the Department of Taxation and informed that because the monies were “paid” to them by the PEO (as the W-2 employer) they were ineligible for the deduction unless they met certain criteria. Amongst other things, they are required to own at least 20 percent of the PEO with whom they contract. Given the nature of the PEO-client relationship, that requirement in essence deems these small business owners ineligible. The businesses of a PEO and a client company are not typically tied together financially.

Small business owners who use a PEO to ensure state and federal compliance, to offer competitive benefits to their employees and for other HR services should not be penalized by denial or lack of access to the business income deduction. We do not believe that was the intent of the legislature when the enabling legislation was passed.

SB 186 would remedy this technicality and ensure these business owners’ eligibility. The bill is consistent with Ohio Revised Code 4125, which governs the employment relationship between a PEO and client company and includes a provision designed to ensure PEO client companies’ access to tax benefits is not jeopardized.

You will hear about the various facets of this issue in additional detail from subsequent witnesses. In closing, NAPEO believes the clarification SB 186 provides is critical to the Ohio PEO industry and the small businesses they serve. This bill is common sense, addresses a fairness issue and will bring current practice in line with legislative intent and existing code. As such, we respectfully request you provide SB 186 with a favorable report.

Thank you again for the opportunity to testify. I’d be happy to take any questions.