



707 North St. Asaph Street
Alexandria, Virginia 22314

T 703 836.0466
F 703 836.0976
www.napeo.org

**Opponent Testimony on Senate Bill 201 Before the
Ohio Senate Transportation, Commerce and Workforce Committee
Michael Kreiter, Director of State Government Affairs
National Association of Professional Employer Organizations
January 22, 2020**

Chairman McColley, Vice Chairman Johnson, Ranking Member Antonio and members of the Senate Transportation, Commerce and Workforce Committee, thank you for the opportunity to appear before you today. My name is Michael Kreiter and I represent the National Association of Professional Employer Organizations (NAPEO), the national trade association that serves the professional employer organization – or PEO – industry. On behalf of NAPEO, I am testifying in opposition to Senate Bill 201 relating to so-called Alternate Employer Organizations (“AEOs”). NAPEO has grave concerns with the AEO Model and the loss of important protections from the IRS by small businesses should Ohio allow AEOs or other third-party payors to file federal payroll taxes under the client employer’s EIN.

Senate Bill 201 would implement a model that operates similarly to a PEO called an Alternate Employer Organization (AEO) with one conspicuous difference: the federal payroll taxes are filed under the client’s FEIN. A PEO, on the other hand, as the employer of record, files federal payroll taxes under the PEO’s FEIN. NAPEO believes the filing of federal taxes under the PEO’s FEIN is essential to being a PEO and in establishing a co-employment relationship. This bill would diminish the core principles of co-employment by creating confusion for small businesses that arise due to lack of uniformity among PEO business practices, and would allow entities holding themselves out as PEOs to operate in a manner more akin to payroll providers, third-party administrators or unlicensed insurers.

Over the years, attempts have been made to allow companies to file federal payroll taxes under a client’s FEIN and have been rejected by the legislature and by the Ohio Bureau of Workers’ Compensation multiple times. I would also like to note that no other state contains nor has considered language similar to the AEO proposal in this bill.

Tax Issues

NAPEO has serious concerns with the so-called AEO Model and the loss of important protections from the IRS by small businesses should Ohio allow PEOs, AEOs or other third-party payors to file federal taxes under the client employer’s FEIN.

As a supplement to this testimony, I have attached a legal analysis drafted by NAPEO’s external counsel Randy Hardock at Davis & Harman – Randy is a well-respected attorney and former Benefits Tax Counsel

in the Office of Tax Policy at the U.S. Department of the Treasury. The analysis finds that under the proposed AEO Model, client employers are not protected by joint liability under federal tax law if a third-party payor reports wages under the client employer's FEIN. Joint liability with respect to a third-party payor does not apply in certain situations specifically described in Treasury Regulation § 31.3504-2. Critically, a third-party payor is not liable for its failure to pay employment taxes on behalf of a client employer if the "wages or compensation are reported on a return filed under a client's employer identification number." Simply claiming joint liability in a client service agreement between an AEO and a client, or writing such liability into Ohio law, would not be enough to protect the client employer should the IRS seek enforcement action. The IRS does not enforce any such state laws or contractual protections, leaving the client employer or the state to pursue relief through expensive and time-consuming litigation or other enforcement action.

In the Bill Analysis for SB 201, the Ohio Legislative Service Commission dedicated an entire comment section related to the possible tax liability issues with this measure. They stated the following:

Federal payroll taxes are governed solely by federal law. Therefore, the bill's requirements with respect the filing of and liability for federal payroll taxes may not be enforceable.

Moreover, federal law specifies three circumstances where a third party (such as a PEO or AEO) may file employment taxes for a client employer and share in the liability for those taxes:

- 1. The third party is a certified professional employer organization (CPEO) under federal law;*
- 2. The third party is an agent designated under federal law;*
- 3. The third party is a payor designated under federal law.*

Under all of the above circumstances, federal law requires that the third party use its own tax identification number when filing federal payroll taxes for a client employer, not the client employer's number.

The three circumstances described above appear to be the only circumstances under federal law in which a third party is liable for a client employer's federal payroll taxes. Because an AEO under the bill would not be filing in accordance with those circumstances, an AEO may not be liable for the taxes under federal law. However, the bill creates AEO liability for a client employer's federal payroll taxes under state law. That liability would be enforceable in state courts.

Should Ohio allow an AEO or other third-party payor to file federal taxes under the client employer's FEIN, as this bill does, there will be a substantial reduction in important federal protections for client employers in the event that the third-party payor fails to pay federal taxes on behalf of its client. We hope that this Committee will carefully consider the unintended consequences of passing this proposal and we urge you to reject the AEO Model and other similar proposals, as it has done before, so that client employers and employees continue to enjoy the existing protections afforded to them under federal law.

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

Sincerely,

A handwritten signature in black ink, appearing to read "MKreiter". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Michael Kreiter
Director of State Government Affairs, NAPEO
Phone: 703-739-8170
Email: mkreiter@napeo.org

Enclosure: Davis & Harman Letter to M. Kreiter on Federal Tax Law Implications of Entity Claiming to be a PEO Reporting Employment Taxes under Client's EIN