

HOUSE BILL REPORT

SHB 3059

As Passed House:

February 11, 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: By House Committee on Finance (originally sponsored by Representatives Grant, Condotta, Cody and Kessler).

Brief History:

Committee Activity:

Finance: 2/1/06, 2/6/06 [DPS].

Floor Activity:

Passed House: 2/11/06, 91-3.

Brief Summary of Substitute Bill

- Provides a business and occupation tax deduction for amounts representing wages and salaries, benefits, workers compensation, payroll taxes, withholding, and other assessments received by professional employer organizations from their clients.

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives McIntire, Chair; Orcutt, Ranking Minority Member; Roach, Assistant Ranking Minority Member; Ahern, Condotta, Conway, Ericks, Santos and Shabro.

Minority Report: Do not pass. Signed by 2 members: Representatives Hunter, Vice Chair and Hasegawa.

Staff: Rick Peterson (786-7150).

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 receive funds 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 the tax incentives.

Appropriation: None.

Fiscal Note: Available.

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

Testimony For: (In support) This bill is not a change in tax policy. It results from a court case and a change in tax administration. Up to now, professional employer organizations paid taxes only on the administrative fee charged to the clients and not the wages, benefits,

retirement, and other compensation passed through to the client's employees. Washington is the only state to tax the gross amount. Other states only tax the administrative fee. Professional employer organizations provide their clients a cost effective source of human resource management. Professional employer organizations provide the expertise to allow their clients to start up quickly while complying with workers compensation taxes and providing a full benefit package to their employees. The average client firm size is 15 employees. It is difficult for a firm this small to provide health insurance benefits comparable to those provided by large firms. This bill is critical to continuing this service. Professional employer organizations administrative fee is only about 3 percent the total. If the B&O tax applies to the wages and benefits provided to the client's employees it will make business in Washington untenable.

(Concerns) Section 8 of the bill is overly broad and should be limited to taxes collected by the Department of Revenue.

Testimony Against: None.

Persons Testifying: (In support) Representative Santos, prime sponsor; Jim Halstrom and Todd Cohen, National Association of Professional Employer Organizations; John Heaton, Pay Plus Benefits; Drew Thoresen, Human Resource Novations, Inc; Leslie Nielsen, Xenium Resources; Andrea McHenry, Administaff; and Carol Stults, JAG Consulting.

(With concerns) Jill Will, Department of Employment Security; and Carl Hammersburg, Department of Labor and Industries.

Persons Signed In To Testify But Not Testifying: None.