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SFA BILL ANALYSIS

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House Bill 5403 (Substitute H-1 as reported by the Committee of the Whole)
Sponsor: Representative Gary A. Newell
House Committee: Tax Policy
Senate Committee: Finance

CONTENT

The bill would amend the Single Business Tax Act to provide that, for tax years beginning after 2003, for purposes of determining compensation of a "professional employer organization" (PEO), compensation would include payments by the PEO to the officers and employees of an entity whose employment operations were managed by the PEO. Further, the compensation of the entity would not include compensation paid by the PEO to the entity's officers and employees.

A "professional employer organization" would be an organization that provided the management and administration of the human resources and employer risk of another entity, by contractually assuming substantial employer rights, responsibilities, and risk through a PEO agreement that established an employer relationship with the leased officers or employees assigned to the entity by doing all of the following: maintaining the right of direction and control employee's work, although the responsibility could be shared with the entity; retaining the right to hire and fire employees; paying wages and employment taxes of the employees out of the PEO's accounts; and reporting, collecting, and depositing State and Federal employment taxes for the employees.

Under the Act, compensation must be calculated for inclusion in a taxpayer's tax base. "Compensation" includes all wages, salaries, fees, bonuses, commissions, or other payments made on behalf of or for the benefit of the taxpayer's employees, officers, or directors.

MCL 208.4 Legislative Analyst: George Towne

FISCAL IMPACT

The bill would reduce single business tax (SBT) revenue to the General Fund/General Purpose budget by less than $0.5 million annually beginning in FY 2003-04. Under the bill, compensation paid to the officers of companies that hire a professional employee organization would be included in the SBT base of the PEO and not in the base of the company where the officers work. According to the Treasury Department's interpretation of current law, except for compensation paid to officers, all of the compensation paid to workers of a business that uses a PEO to manage its human resources tasks is counted as compensation paid by the PEO. This bill would treat compensation paid to officers just like all other compensation payments.

It is estimated that this bill would generate a loss in SBT revenue because the companies for which the officers work tend to calculate their SBT liability using the standard value added computation, which includes compensation paid to employees, while PEOs tend to use the alternative gross receipts calculation, which is based on gross receipts and not compensation paid to employees. As a result, under the bill, companies that hire PEOs would realize a reduction in their SBT to the extent that they are currently including the officers' compensation in their tax base. Including the officers' compensation as compensation paid by the PEO, would have no impact on the SBT liability of PEOs because their tax base is most likely based on gross receipts and not compensation payments.

The fiscal impact of this bill would be larger if many businesses that use PEOs did not have a different interpretation of current law and were not already treating compensation paid to officers like the compensation paid to all other employees, as they apparently are doing.

Date Completed: 12-10-02 Fiscal Analyst: Jay Wortley