



Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536


BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1037 (Substitute S-2 as passed by the Senate)
Senate Bill 1038 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Alan L. Cropsey (S.B. 1037)
Senator Jason E. Allen (S.B. 1038)
Committee: Commerce and Tourism

Date Completed: 11-29-10

RATIONALE

Professional employer organizations (PEOs) are independently established businesses that provide employees to a client entity and pay the employees' wages and benefits. Through such arrangements, PEOs enable businesses to concentrate on their core mission while leaving personnel and administrative issues to the PEOs. The PEO industry reportedly is growing at a rate of about 15% annually nationwide. For several years, regulation of the industry has been a contentious issue for various reasons, including the practice of "SUTA dumping" (i.e., shifting personnel to another employer in order to avoid responsibility for the full amount of an employer's unemployment insurance rate). Whether workers are employees of the PEO or its clients is crucial to the calculation of unemployment and workers' compensation rates, and affects other administrative concerns. Reportedly, at least 30 states already regulate PEOs, and many people believe that Michigan also should enact a regulatory framework for these emerging business entities.

CONTENT

Senate Bill 1037 (S-2) would create the "Michigan Professional Employer Organization Regulatory Act" to do all of the following:

- Prohibit a person from holding itself out as a providing professional employer services in Michigan unless licensed as a professional employer organization.
- Prohibit a person with a felony conviction relating to the operation of a PEO from owning or controlling a PEO doing business in Michigan.
- Specify requirements for the operation and licensure of PEOs, including financial reporting and auditing.

- Require each PEO operating in Michigan on the proposed Act's effective date to apply with the Department of Energy, Labor, and Economic Growth (DELEG) for a license within 180 days.
- Require a PEO not operating in Michigan on the Act's effective date to apply for licensure before commencing operations in the State.
- Establish fees for initial licensure and renewal of a PEO license.
- Provide for limited licensure of certain PEOs domiciled outside of Michigan.
- Establish working capital and bonding requirements for PEOs.
- Establish requirements for professional employer agreements between PEOs and their clients, including the responsibility for complying with the Worker's Disability Compensation Act.
- Prescribe responsibilities of PEOs and their clients with regard to supervision of employees, legal liability, pay and benefits, and payment of taxes.
- Provide that neither the Act nor a professional employer agreement would affect certain rights, agreements, or requirements.
- Specify certain prohibitions, sanctions, and criminal penalties.

Senate Bill 1038 (S-1) would amend the Michigan Employment Security Act to require a PEO to elect and use either client-based reporting or PEO-based reporting for employer reporting and contributions required under the Act, and establish requirements for both reporting methods.

Senate Bill 1037 (S-2) would take effect on July 1, 2011. Senate Bill 1038 (S-1) would

take effect on January 1, 2011, and is tie-barred to Senate Bill 1037.

Senate Bill 1037 (S-2) would define "professional employer organization" as any person engaged in the business of providing professional employer services regardless of its use of a descriptive term other than "professional employer organization" or "PEO". "Professional employer organization" would not include the following:

- A provider of temporary help services as defined under the Michigan Employment Security Act (MCL 421.29).
- An arrangement in which a person, whose principal business activity is not entering into professional employer agreements and does not hold itself out as a PEO, shares employees with a commonly owned company within the meaning of Section 414(b) and (c) of the Internal Revenue Code (which deal with employees of a controlled group of corporations and employees of trades or businesses under common control).
- Independent contractor arrangements by which a person assumes responsibility for the product produced or service performed by that person or his or her agents and retains and exercises primary direction and control over the work performed by the individuals whose services are supplied under the arrangements.

Senate Bill 1037 (S-2)

License Requirement; Application

Except as otherwise provided in the proposed Act, a person could not provide, advertise, or otherwise hold itself out as providing professional employer services in Michigan, unless licensed or exempt from licensure under the Act.

A person who had been convicted of a felony related to the operation of a PEO could not own or control a PEO doing business in Michigan.

An applicant for licensure would have to submit to DELEG the license fee imposed in the Act and a completed application providing the following information:

- The name or names under which the PEO conducted business.
- The address of the PEO's principal place of business and the address of each office it maintained within Michigan.
- The PEO's taxpayer or employer identification number.

- A list by jurisdiction of each name under which the PEO had operated within the preceding five years, including any alternative names, names of predecessors, and, if known, successor business entities.
- A statement of ownership, including the name and evidence of the business experience of any person, individually or acting with one or more others, owning or controlling, directly or indirectly, 10% or more of the PEO's equity interest.
- A statement of management, which would have to include the name and evidence of the business experience of any person who served as president or chief executive officer, or otherwise had the authority to act as the PEO's senior executive officer.
- A financial statement describing the financial condition of the PEO or PEO group.
- A financial audit of the applicant.
- A certification that the PEO had made a reporting method election under the Michigan Employment Security Act (as it would be amended by Senate Bill 1038 (S-1)).

("PEO group" would mean two or more PEOs that are majority owned or commonly controlled by the same entity, parent, or controlling person.)

The financial statement would have to be prepared in accordance with generally accepted accounting principles and audited by an independent CPA licensed to practice in the jurisdiction where he or she was located, and would have to be without qualification as to the going concern status of the PEO. A PEO group could submit combined or consolidated audited financial statements to meet these requirements. A PEO that had not had sufficient operating history to have audited financials based upon at least 12 months of operating history would have to meet the financial capacity requirements described in the Act and present financial statements reviewed by a licensed CPA.

At the time of applying for an initial PEO license, for the financial audit requirement, the applicant would have to submit the most recent audit, which could not be older than 13 months. After that, a PEO or PEO group would have to file a succeeding audit on an annual basis, within 270 days after the end of the PEO's or PEO group's fiscal year. An applicant could apply for an extension with DELEG but any request would have to be accompanied by a letter from the auditors stating the reasons for the delay and the anticipated audit completion date.

Professional employer organizations in a PEO group could satisfy reporting and financial requirements on a combined or consolidated basis if each member of the group guaranteed the obligations under the Act of each other member. In the case of a PEO group that submitted a combined or consolidated audited financial statement, including entities that were not PEOs or that were not in the PEO group, the controlling entity of the PEO group under the consolidated or combined statement would have to guarantee the obligations of the PEOs in the group. The Department would have to determine whether these requirements were satisfied.

To the extent practical, DELEG would have to allow the acceptance of electronic filings, including applications, documents, reports, and other filings required under the proposed Act. The Department could allow for the acceptance of electronic filings and other assurance by an independent and qualified assurance organization that provided satisfactory assurance of compliance acceptable to DELEG consistent with, or in lieu of, certain requirements under the Act.

The Department would have to allow a PEO to authorize an assurance organization, approved by the DELEG Director, to act on the PEO's behalf in complying with the Act's licensure requirements, including electronic filings of information and payment of license fees. Use of an approved assurance organization would be optional. Authorization to use an assurance organization would not limit or change DELEG's authority to license; rescind, revoke, or deny a license; or investigate or enforce any provision of the Act.

Licensure

Each PEO operating within Michigan on the proposed Act's effective date would have to file its completed application and submit the license fee within 180 days after that date. Initial licensure would be valid until the end of the PEO's first fiscal year that was more than one year after the Act's effective date. A PEO not operating with Michigan on the Act's effective date would have to submit its initial licensure application before commencing operations within the State.

Within 180 days after the end of a licensee's fiscal year, the PEO would have to renew its license by submitting to DELEG a renewal application providing any changes in the information provided in the prior application.

The Department would have to maintain a list of PEOs licensed under the Act. The list would have to be readily available to the public by electronic or other means.

The Department could charge an application fee for initial licensure, of up to \$1,500 for an individual license and \$1,500 for a PEO group license.

Except for an initial license, a license would be for a term of three years. The per-year license fee would be \$1,500 for an individual license and \$1,500 for a PEO group license. The renewal license fee would have to include the license fee representing the three-year term.

The Department could adjust the license fees every three years by an amount determined by the State Treasurer to reflect the cumulative annual percentage change in the Detroit consumer price index.

Limited Licensure

The Department could issue a limited PEO license. A PEO seeking limited licensure would have to submit to DELEG a properly executed and completed application on a form provided by the Department, and a license fee. A PEO would be eligible for a limited license if it:

- Were domiciled outside of Michigan and were licensed or otherwise regulated as a PEO in another state.
- Did not maintain an office in Michigan or directly solicit clients located or domiciled within Michigan.
- Did not have more than 50 covered employees employed or domiciled in Michigan on any given day.

A limited license would be valid for one year and could be renewed. Applicants for limited licensure would not be subject to requirements of the Act regarding reporting to DELEG on positive working capital in Michigan and providing a bond, letter of credit, or securities.

PEO Capital/Bonding Requirements

Unless otherwise exempt under the Act, each PEO or PEO group would have to submit to DELEG evidence of and maintain at least \$100,000 in working capital, as defined by generally accepted accounting principles, as reflected in the financial statements submitted to DELEG with the initial licensure and each annual renewal. A PEO or PEO group with less than \$100,000 in working capital at renewal would have 180 days to eliminate the deficiency in a manner acceptable to DELEG.

During that period, the PEO or PEO group would have to submit to DELEG quarterly financial statements accompanied by an attestation of the chief executive officer that it had paid all wages, taxes, workers' compensation premiums, and employee benefits.

Alternatively, the PEO or PEO group could submit to DELEG evidence of and maintain a bond, irrevocable letter of credit, or security with a market value of at least \$100,000 that was acceptable to the Department. The bond would have to be held by a depository designated by DELEG to secure payment by the PEO of all taxes, wages, benefits, or other entitlement due to, or regarding, covered employees, if the PEO or PEO group did not make those payments when due. For a PEO or PEO group whose financial statements did not indicate positive working capital, the bond amount would have to be \$100,000 plus an amount sufficient to cover the deficit in working capital.

Professional Employer Agreements

"Professional employer agreement" would mean a written contract by and between a client and a PEO that provides for coemployment of covered employees, the allocation of employer rights and obligations between the client and the PEO with respect to the covered employees, and assumption of responsibilities by the PEO and the client as required by the proposed Act.

Each professional employer agreement would have to include the responsibility of the PEO to pay wages to covered employees; to withhold, collect, report, and remit payroll-related and unemployment taxes; and, to the extent the PEO had assumed responsibility in the agreement, to make payments for employee benefits for covered employees. For purposes of these requirements, wages would not include any obligation between a client and a covered employee for payments beyond, or in addition to, the employee's salary, draw, or regular rate of pay, including bonuses, commissions, severance pay, deferred compensation, profit sharing, or vacation, sick, or other pay for paid time off, unless the PEO expressly agreed to assume liability for those payments in the professional employer agreement.

A professional employer agreement also would have to include the hiring, disciplining, and termination by the PEO of a covered employee, as necessary to fulfill the PEO's responsibilities under the Act and the agreement. The client

also could hire, discipline, and terminate a covered employee.

In addition, an agreement would have to include the responsibility of the client and the PEO to comply with the Worker's Disability Compensation Act.

Each professional employer agreement would have to require the PEO to provide written notice to each covered employee affected by the agreement regarding the general nature of the coemployment relationship between and among the PEO, the client, and that employee.

"Covered employee" would mean an individual having a coemployment relationship with a PEO and a client who has received written notice of coemployment with the PEO and has created a coemployment relationship pursuant to a professional employer agreement. The term would include individuals who are officers, directors, shareholders, partners, and managers of the client to the extent the PEO and the client have expressly agreed in the professional employer agreement that those individuals are considered covered employees and they act as operational managers or perform day-to-day operational services for the client.

"Coemployment relationship" would mean a relationship that is intended to be an ongoing relationship rather than a temporary or project-specific one, where the rights, duties, and obligations of an employer arising out of an employment relationship have been allocated between coemployers pursuant to a professional employer agreement.

PEO/Client Relationship

Except to the extent otherwise expressly provided for by a professional employer agreement, the following would apply:

- A client would be solely responsible for the quality, adequacy, or safety of the goods or services produced or sold in the client's business.
- A client would be solely responsible for directing, supervising, training, and controlling the work of the covered employees with respect to the client's business activities and would be solely responsible for the employees' acts, errors, or omissions regarding those activities.
- A client would not be liable for the acts, errors, or omissions of a PEO or of any covered employee of the client and a PEO when the employee was acting under the express direction and control of the PEO.

- A PEO would not be liable for the acts, errors, or omissions of a client or of any covered employee of the client when the employee was acting under the express direction and control of the client.

A covered employee would not, solely as the result of being a covered employee of a PEO, be an employee of the PEO for purposes of general liability insurance, fidelity bonds, surety bonds, employer's liability not covered by workers' compensation, or liquor liability insurance carried by the PEO, unless covered employees were included by specific reference in the professional employer agreement and applicable prearranged employment contract, insurance contract, or bond.

A PEO would not be considered engaged in the sale of insurance or in acting as a third-party administrator by offering, marketing, selling, administering, or providing professional employer services that included services and employee benefit plans for covered employees.

A client and a PEO would each be considered an employer for purposes of sponsoring retirement and welfare benefit plans for its covered employees. A fully insured welfare benefit plan offered to the covered employees of a single PEO would have to be treated, for purposes of State law, as a single employer welfare benefit plan.

For purposes of the State or any political subdivision of the State and except as otherwise specifically provided for PEO arrangement by law, covered employees whose services were subject to sales tax would be considered the employees of the client for purposes of collecting and levying sales tax on those services. The proposed Act would not relieve a client of any sales tax liability with respect to its goods or services.

Except as otherwise specifically provided for PEO arrangement by law, a tax or assessment imposed upon professional employer services, or any business license or other fee that was based upon gross receipts, would have to allow a deduction from the gross income or receipts of the business derived from performing professional employer services that was equal to that portion of the fee charged to a client that represented the actual cost of wages and salaries, benefits, workers' compensation insurance, payroll taxes, withholding, or other assessments paid to, or on behalf of, a covered employee by the PEO under a professional employer agreement.

Except as otherwise specifically provided for PEO arrangement by law, a tax assessed, an assessment, or a mandated expenditure on a per capita or per employee basis would have to be assessed against the client for covered employees and against the PEO for its employees who were not covered employees co-employed with a client. Benefits or monetary consideration that met the requirements of mandates imposed on a client and that were received by covered employees through the PEO, either through payroll or through benefit plans sponsored by the PEO, would have to be credited against the client's obligation to fulfill those mandates.

Except as otherwise specifically provided for PEO arrangement by law and in the case of a tax or an assessment imposed or calculated upon the basis of total payroll, the PEO would be eligible to apply any small business allowance or exemption available to the client for the covered employees for the purpose of computing the tax.

Prohibitions & Sanctions

A person who did one or more of the following would be subject to penalties:

- Practiced fraud or deceit in obtaining or renewing a license.
- Aided or abetted another person in the unlicensed practice of an occupation.
- Engaged in regulated activities without obtaining a license or demonstrating exemption from licensure under the proposed Act.
- Was convicted of a crime relating to the operation of a PEO, in the case of a licensee or an officer of a licensee.
- Engaged in false advertising.

After notice and opportunity for hearing under the Administrative Procedures Act, DELEG would have to take one or more of the following actions upon the determination of a violation of the proposed Act, a rule adopted under it, or an order issued under it:

- Placement of a limitation on a license.
- Suspension of a license.
- Denial of a license or renewal of a license.
- Revocation of a license.
- Imposition of an administrative fine to be paid to DELEG, not to exceed \$5,000.
- Imposition of censure.
- Placement on probation.
- A requirement that restitution be made, based upon proofs submitted to and findings made by the hearing examiner after a contested case.

A person who knowingly and willfully violated the proposed Act, or who aided and abetted a violation, would be guilty of a misdemeanor punishable by up to one year's imprisonment and/or a maximum fine of \$10,000.

Scope of the Act

The bill specifies that neither the proposed Act nor a professional employer agreement would affect, modify, or amend any collective bargaining agreement, or the rights or obligations of any client, PEO, or covered employee under any State or Federal law.

In addition, neither the Act nor any professional employer agreement could do either of the following:

- Diminish, abolish, or remove rights of covered employees owed to a client or obligations of that client to a covered employee regarding rights or obligations existing before the effective date of the professional employer agreement.
- Affect, modify, or amend any contractual relationship or restrictive covenant between a covered employee and any client that was in effect at the time a professional employer agreement became effective or that was entered into subsequently between a client and a covered employee.

Neither the Act nor any professional employer agreement could affect, modify, or amend any State, local, or Federal licensing, registration, certification, or other regulatory requirement applicable to any client or covered employee. A PEO would not be considered to be engaged in any occupation, trade, profession, or other activity that was subject to licensing, registration, or certification requirements, or was otherwise regulated by a governmental entity, solely by entering into and maintaining a coemployment relationship with a covered employee who was subject to those requirements or regulations.

Unless otherwise provided by law and with respect to a bid, contract, purchase order, or agreement entered into with the State or a political subdivision of the State, a client company's status or certification as a small, minority-owned, disadvantaged, or woman-owned business enterprise or as a historically underutilized business would not be affected due to the client company's execution of an agreement with a PEO or the use of the services of a PEO.

The Department would have to promulgate rules considered necessary to implement the proposed Act.

Senate Bill 1038 (S-1)

PEO Reporting & Contributions

Under the bill, a PEO could elect and use only one of the two reporting methods described below for employer reporting and contributions required under the Michigan Employment Security Act. All PEOs that were commonly owned, managed, or controlled would have to elect and use the same reporting method. Except as otherwise provided in the bill, the reporting method elected would have to apply to all subsequent tax years.

Client-Based Reporting. The PEO would have to file a quarterly wage report and unemployment contribution report or reimbursing employer quarterly payroll report as the employer of its covered employees based on the account information of each client employer. The PEO would have to provide the Unemployment Insurance Agency (UIA) with a schedule listing the covered employees and unemployment insurance employer account number of each client employer as part of each report. Each calendar quarter, the PEO would have to pay the Agency the total amount due from all of its client employers for covered employees, based on the individual contribution payments or reimbursement payments in lieu of contributions, itemized by client employer account number. A PEO would have to notify the UIA within 30 days after any employer became a client of the PEO and within 30 days after the PEO discontinued an association with a client employer.

Notwithstanding the rate established under the Act, the rates described below would apply to a business entity that was a contributing employer and was a client employer of the PEO on the date that the PEO changed to client-based reporting, or a client that transferred from a PEO that elected PEO-based reporting to a PEO that elected client-based reporting. Except as otherwise provided in the bill, the contribution rate of the client employer for the next two tax years would have to be the greater of the client employer's most recently calculated contribution rate during the 24 calendar quarters immediately before becoming a client of the PEO or 2.7%. The rate for the third and subsequent years would have to be calculated as if the client employer had more than four consecutive years of liability.

If the business entity were a client employer of the PEO for less than eight full calendar quarters and the client employer's most recently calculated contribution rate before becoming a client employer of the PEO were less than 2.7%, the contribution rate for the next two tax years would have to be the client employer's most recently calculated contribution rate. The rate for the third and subsequent years would have to be calculated as if the client employer had more than four consecutive years of liability.

If a client employer did not have a contribution rate at any time during the 24 calendar quarters immediately before becoming a client employer of the PEO, the contribution rate for the next two tax years would be 2.7%. In the third succeeding tax year, the client employer's contribution rate would be one-third of the client employer's chargeable benefits component calculated under the Act, plus 1.8%. In the fourth succeeding tax year, the client employer's contribution rate would be two-thirds of the client employer's chargeable benefits component, plus 1.0%. In the fifth and subsequent tax years, the client employer's contribution rate would be the client employer's chargeable benefits component, plus the client employer's calculated account building component, plus its calculated nonchargeable benefits component.

A business entity that became a client employer of a PEO on or after January 1, 2011, would have to retain its existing contribution rate or establish a new rate as provided under the Act, if the client employer were a contributing employer.

PEO-Based Reporting. The PEO would have to make quarterly reports and payments of contributions, penalties, and interest on wages for covered employees under its own employer number and rate.

Within 30 days after the inception of each new professional employer agreement, a PEO that elected PEO-based reporting would have to provide the UIA with the name and employer ID number of the new client employer, and include a list of each active or inactive employment insurance account number associated with that client employer and an explanation of each client employment insurance account that would remain open.

Within 30 days after the termination of a professional employer agreement, the PEO would have to give the UIA the name and employer ID number of each client employer

separated under the terminated agreement and the date of separation.

If the PEO were operating in Michigan on January 1, 2011, by March 31, 2011, it would have to give the UIA the name and employer ID number of each of its current client employers, including each active or inactive unemployment insurance account number associated with each client employer and an explanation of each client employer account that would remain open.

Other Provisions

A PEO that was operating in Michigan on January 1, 2011, and was neither fully experience rated as provided in the Act nor under common ownership, management, or control with another PEO that was fully experience rated, would have to report using client-based reporting.

A PEO that was using PEO-based reporting in Michigan on January 1, 2011, could not elect and use the client-based reporting method before 2013 unless it gave the UIA an affidavit making the election by February 15 of the year for which it intended to use that method.

A report required under the Act could be submitted electronically.

The bill specifies that it would not preclude the UIA from enforcing any provision of the Act based on any act or omission by a PEO that occurred before January 1, 2011.

Proposed MCL 421.13m (S.B. 1038)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

A professional employer organization is a service provider that allows businesses to outsource such administrative functions as payroll, workers' compensation, human resources, and employee benefits. Reportedly, there are about 700 PEOs operating in all 50 states, covering as many as 3 million workers. According to the National Association of Professional Employer Organizations (NAPEO) website, the PEO industry, which is only about 30 years old, is growing rapidly. The organization estimates that, in 2008, the PEO industry grew by about \$5.0 billion to \$68.0 billion in gross revenue.

At least 30 states require licensure or registration of PEOs, according to NAPEO. In testimony before the Senate Commerce and Tourism Committee, a NAPEO official said it is important that Michigan establish a regulatory framework because many PEOs look to states that have clear roles for the organizations, and Michigan's unregulated status may be keeping some PEO operations out of the State. Smart, reasonable regulation like the bills propose would establish minimum standards for operating in Michigan in order to assure that PEOs were capable and competent to provide the services they advertise. In addition, licensing and regulating PEOs would help to clear up confusion in the way public agencies have interpreted this emerging business sector, allowing the PEO industry to grow in Michigan.

Response: While regulation and licensure of PEOs are desirable, the bills would not go far enough to establish an effective regulatory framework. For instance, the penalties in Senate Bill 1037 (S-2) should be more stringent, particularly for engaging in unlicensed activity; the limited licensure provision is not strong enough; and the bills lack a "good moral character" standard for licensure that is included in other regulatory statutes.

Supporting Argument

For several years, there has been confusion over how to enforce business regulations with regard to PEOs. For instance, SUTA dumping laws were enacted on the Federal level in 2004 and on the State level in 2005 to address situations in which an employer attempts to avoid its full unemployment tax liability, which is based on the employer's unemployment experience, by shifting its employees to another company that has a more favorable experience rating. Under such a scheme, an employer is able to "dump" its large, old tax rate for a smaller, new rate. Although Michigan's SUTA dumping laws (Public Acts 16 through 19 of 2005) do not expressly address PEOs, at the time that legislation was before the Senate, the Department of Labor and Economic Growth (now DELEG) estimated that about 60% of the shortfall in Michigan's Unemployment Compensation Fund was due to employers that used PEOs to avoid paying their full share of unemployment taxes. Concerns regarding Michigan's compliance with Federal SUTA dumping laws have continued, and the U.S. Department of Labor has even requested the Michigan law be amended to conform explicitly with the Federal requirements. Part of the difficulty in assessing the extent to which PEOs may have engaged in and affected SUTA dumping, is that there is no settled

definition in law as to what constitutes a PEO. By requiring the licensure of PEOs and establishing a consistent framework for the State's regulation of them, the bills would help to clarify the manner in which PEOs operate in Michigan, including their reporting for unemployment insurance purposes.

Response: The bills could further clarify reporting and unemployment insurance requirements by mandating a system of client-based reporting for PEOs, rather than giving PEOs another reporting option. Using a PEO-based reporting and contribution system, as Senate Bill 1038 (S-1) would allow, could enable some PEOs and their clients to avoid paying their full share of unemployment taxes, thereby circumventing SUTA dumping prohibitions.

Supporting Argument

Senate Bill 1038 (S-1) would establish an innovative mechanism for employer reporting and contributions required under the Michigan Employment Security Act that would satisfy all PEOs operating in Michigan. Under that arrangement, a PEO could elect and use either client-based reporting or PEO-based reporting. This would allow each PEO to report in a manner that best suited its business practice, based either on its clients' account information or on its own employer number and rate.

Response: The bifurcated reporting system could be confusing and cumbersome. According to testimony before the Senate committee, only a minority of PEOs in Michigan would opt to use PEO-based reporting. An Unemployment Insurance Agency official also testified that the Agency would prefer only client-based reporting. That approach would set a stronger public policy and be easier to enforce.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

Senate Bill 1037 (S-2)

This bill would create a new licensure program within the Department of Energy, Labor, and Economic Growth for professional employer organizations. According to DELEG, there are over 600 PEOs that would be subject to licensure. The bill would set application fees at \$1,500 for individual PEOs and for PEO groups. The bill also would require an annual license fee of \$1,500 per individual and per group. These would be paid on a three-year renewal cycle. The Department would be authorized to adjust the level of fees every three years based on changes in the Detroit consumer price index. Revenue from application fees is

estimated at \$900,000. License fee revenue is estimated at \$2.7 million every three years. This revenue would be available for the administrative costs of the Bureau of Occupational Regulation. Department staff have indicated that administering the new licensure program would increase costs by approximately \$100,000 to \$150,000 per year and require the addition of 1.0 to 1.5 full-time equivalent employees.

The bill would provide for administrative fines of up to \$5,000 for violations of the proposed Act. Any fine revenue received would be deposited in the General Fund. The amount of revenue would depend on the number of violations and the amount of the fines assessed.

In addition, the bill would establish a criminal penalty schedule for violation of the proposed Act. There are no data to indicate how many offenders would be convicted of the proposed misdemeanor. Local governments would incur the costs of incarceration in local facilities, which vary by county. Any additional penal fine revenue generated under the bill would benefit public libraries.

Senate Bill 1038 (S-1)

The bill would permit professional employer organizations to elect one of two allowable methods for reporting wages and unemployment contributions to the Unemployment Insurance Agency, and, for certain PEOs, would create alternative unemployment contribution tax rates during a transitional period. State unemployment taxes are paid by employers and deposited into the Unemployment Compensation Fund, which is used to pay unemployment benefits to unemployed workers who meet eligibility requirements.

Currently, PEOs report wages and unemployment contributions for client employers at the PEO level and pay unemployment taxes based on the PEO's contribution rate. The bill would permit PEOs to report wages and unemployment contributions that were either PEO-based or client-based; however, a PEO operating as of January 1, 2011, that was not fully experience rated (that is, a PEO in the first four years of operation) or in business with a PEO that was fully experience rated, would be required to use client-based reporting.

For PEOs adopting client-based reporting, the bill would provide for different contribution rates, depending on the client employer's own

experience and the length of time the client employer was with a PEO that selected client-based reporting. In general, these transitional rates would treat some companies as fully experience rated after two years of experience instead of the four years required currently. The impact of these changes on unemployment tax revenue would depend on the selections made by PEOs and the experience ratings of their individual client companies. Over time, a shift to client-based reporting would link contribution rates more closely to client employers' actual unemployment experience and tend to increase revenue to the Unemployment Compensation Fund.

Due to the extended period of high unemployment experienced in Michigan, the Unemployment Compensation Fund is currently in deficit. As of November 22, 2010, the outstanding loans from the Federal government totaled \$3.81 billion.

Fiscal Analyst: Matthew Grabowski
Elizabeth Pratt

A0910/s1037b

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.