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Senate Bills 1037 and 1038 (as enacted)
Sponsor: Senator Alan L. Cropsey (S.B. 1037)
Senator Jason E. Allen (S.B. 1038)
Senate Committee: Commerce and Tourism
House Committee: Regulatory Reform

PUBLIC ACTS 370 & 383 of 2010

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CONTENT

Senate Bill 1037 creates the "Michigan Professional Employer Organization Regulatory Act" to do all of the following:

- Prohibit a person from holding itself out as providing professional employer services in Michigan unless licensed as a professional employer organization (PEO).
 - Specify requirements for the operation and licensure of PEOs, including financial reporting and auditing.
 - Require each PEO operating in Michigan on the Act's effective date to apply with the Department of Licensing and Regulatory Affairs (LARA) 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.
 - Prohibit a person with a felony conviction relating to the operation of a professional employer organization from owning or controlling a PEO doing business in Michigan.
 - 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 may affect certain rights, agreements, or requirements.
 - Specify certain prohibitions, sanctions, and criminal penalties.

Senate Bill 1038 amended the Michigan Employment Security Act to require that PEOs file a report with the Unemployment Insurance Agency (UIA) for a determination of their status as a liable employing unit and employer; and to establish a method for PEOs that are liable employers to report to the UIA.

Senate Bill 1037 will take effect on July 1, 2011. Senate Bill 1038 took effect on January 1, 2011, and was tie-barred to Senate Bill 1037.

Senate Bill 1037 defines "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" does 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 that 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

License Requirement; Application

Except as otherwise provided in the Michigan Professional Employer Organization Regulatory Act, a person may 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 has been convicted of a felony related to the operation of a PEO may not own or control a PEO doing business in Michigan.

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

- The name or names under which the PEO conducts business.
- The address of the PEO's principal place of business and the address of each office it maintains within Michigan.
- The PEO's taxpayer or employer identification number.
- A list by jurisdiction of each name under which the PEO has 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 must include the name and evidence of the business experience of any person who serves as president or chief executive officer, or otherwise has 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 has made a reporting method election under the Michigan Employment Security Act (as amended by Senate Bill 1038).

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

The financial statement must 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 is located, and must be without qualification as to the going concern status of the PEO. A PEO group may submit combined or consolidated audited financial statements to meet these requirements. A PEO that has not had sufficient operating history to have audited financials based upon at least 12 months of operating history must meet the financial capacity requirements described in the new 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 must submit the most recent audit, which may not be older than 13 months. After that, a PEO or PEO group must 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 may apply for an extension with LARA but any request must 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 may satisfy reporting and financial

requirements on a combined or consolidated basis if each member of the group guarantees the obligations under the Act of each other member. In the case of a PEO group that submits a combined or consolidated audited financial statement, including entities that are not PEOs or that are not in the PEO group, the controlling entity of the PEO group under the consolidated or combined statement must guarantee the obligations of the PEOs in the group. The Department must determine whether these requirements are satisfied.

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

The Department must allow a PEO to authorize an assurance organization, approved by the LARA 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. Authorization to use an assurance organization will not limit or change LARA'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 Act's effective date must file its completed application and submit the license fee within 180 days after that date. Initial licensure will be valid until the end of the PEO's first fiscal year that is more than one year after the Act's effective date. A PEO not operating within Michigan on the Act's effective date must 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 must renew its license by submitting to LARA a renewal application providing any changes in the information submitted in the prior application.

The Department must maintain a list of PEOs licensed under the Act. The list must

be readily available to the public by electronic or other means.

The Department may 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 must be issued for a term of three years. The per-year license fee will be \$1,500 for an individual license and \$1,500 for a PEO group license. The renewal license fee must include the license fee representing the three-year term.

The Department may 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 may issue a limited PEO license. A PEO seeking limited licensure must submit to LARA a properly executed and completed application on a form provided by the Department, and a license fee. A PEO will be eligible for a limited license if it:

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

A limited license will be valid for one year and may be renewed. Applicants for limited licensure will not be subject to requirements of the Act regarding reporting to LARA 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 must submit to LARA 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 LARA with the initial licensure and each annual renewal. A PEO or PEO group with

less than \$100,000 in working capital at renewal will have 180 days to eliminate the deficiency in a manner acceptable to LARA. During that period, the PEO or PEO group must submit to LARA quarterly financial statements accompanied by an attestation of the chief executive officer that it has paid all wages, taxes, workers' compensation premiums, and employee benefits.

Alternatively, the PEO or PEO group may submit to LARA evidence of and maintain a bond, irrevocable letter of credit, or security with a market value of at least \$100,000 that is acceptable to the Department. The bond must be held by a depository designated by LARA 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 does not make those payments when due. For a PEO or PEO group whose financial statements do not indicate positive working capital, the bond amount must be \$100,000 plus an amount sufficient to cover the deficit in working capital.

Professional Employer Agreements

The Act defines "professional employer agreement" as 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 Act.

Each professional employer agreement must provide for 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 has assumed responsibility in the agreement, to make payments for employee benefits for covered employees. For purposes of these requirements, wages do 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 has expressly agreed to assume liability for those payments in the professional employer agreement.

A professional employer agreement also must provide for 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 may hire, discipline, and terminate a covered employee.

In addition, an agreement must provide for the responsibility of the client and the PEO to comply with the Worker's Disability Compensation Act.

Each professional employer agreement must 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" means 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 includes 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" means 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 apply:

- A client will be solely responsible for the quality, adequacy, or safety of the goods or services produced or sold in the client's business.
- A client will be solely responsible for directing, supervising, training, and

controlling the work of the covered employees with respect to the client's business activities and solely responsible for the employees' acts, errors, or omissions regarding those activities.

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

A covered employee will not be, solely as the result of being a covered employee of a PEO, 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 are included by specific reference in the professional employer agreement and applicable prearranged employment contract, insurance contract, or bond.

A PEO will 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 include services and employee benefit plans for covered employees.

A client and a PEO each will 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 must 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 are subject to sales tax will be considered the employees of the client for purposes of collecting and levying sales tax on those services. The Act will 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 is based upon gross receipts, must allow a deduction from the gross income or receipts of the business derived from performing professional employer services that is equal to that portion of the fee charged to a client that represents 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 must be assessed against the client for covered employees and against the PEO for its employees who are not covered employees co-employed with a client. A benefits or monetary consideration that meets the requirements of mandates imposed on a client and that is received by covered employees through the PEO, either through payroll or through benefit plans sponsored by the PEO, must 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 will 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 does one or more of the following will be subject to penalties:

- Practices fraud or deceit in obtaining or renewing a license.
- Aids or abets another person in the unlicensed practice of an occupation.
- Engages in regulated activities without obtaining a license or demonstrating exemption from licensure under the Act.
- Is convicted of a crime relating to the operation of a PEO, in the case of a licensee or an officer of a licensee.
- Engages in false advertising.

After notice and opportunity for an administrative hearing, LARA must do one or more of the following upon the

determination of a violation of the Act, a rule adopted under it, or an order issued under it:

- Place a limitation on a license.
- Suspend a license.
- Deny a license or renewal of a license.
- Revoke a license.
- Impose an administrative fine to be paid to DELEG, not to exceed \$5,000.
- Impose censure.
- Place the violator on probation.
- Require 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 violates the Act, or who aids and abets a violation, will 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 Act specifies that neither it nor a professional employer agreement affects, modifies, or amends 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 may 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 is in effect at the time a professional employer agreement becomes effective or that is entered into subsequently between a client and a covered employee.

Neither the Act nor any professional employer agreement may 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 will not be considered to be engaged in any occupation, trade, profession, or other activity that is subject to licensing, registration, or certification requirements, or is otherwise

regulated by a governmental entity, solely by entering into and maintaining a coemployment relationship with a covered employee who is 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 will not be affected due to the client company's execution of an agreement with a PEO or the use of A PEO's services.

The Department must promulgate rules considered necessary to implement the Act.

Senate Bill 1038

The bill requires a PEO that has not previously filed, to file a report with the UIA for a determination of its status as a liable employing unit and employer in accordance with R 421.121 and R 421.190 of the State Administrative Code (described below). A PEO determined to be a liable employer must complete an electronic employer registration in the manner approved by the UIA to register its employer liability.

Except as otherwise provided for a PEO that was operating in Michigan before January 1, 2011, a PEO that is a liable employer must use the method described below for reporting wages and paying unemployment claims. A PEO that is a liable employer and was operating in Michigan before January 1, 2011, may elect to use that reporting method before January 1, 2014, and must use it on and after that date.

A PEO must comply with all requirements of the Michigan Employment Security Act that apply to a contributing employer. The PEO must file a single quarterly wage report and unemployment contribution report and pay contributions of its client employers based on the account information of each client employer. The UIA must convert a reimbursing employer to a contributing employer beginning with the calendar quarter in which the employer becomes a client employer of a PEO. The PEO must file reports required under R 421.121 and make contribution payments by electronic reporting and payment methods approved

by the UIA. The PEO must notify the UIA within 30 days after any employer becomes its client employer and within 30 days after any client employer discontinues its association with the PEO.

For a client employer that is a contributing employer and was a client employer of the PEO on the date that the PEO changed to the reporting method outlined in the bill, the following rates apply:

- If the client employer reported no employees or no payroll to the UIA for eight or more quarters, the client employer's unemployment tax rate will be the new employer tax rate.
- If the client employer was a client employer of the PEO for less than eight full calendar quarters, the client employer's unemployment tax rate will be based on the client employer's prior account and experience.
- If the client employer's account has been terminated for more than one year or if the client employer never previously registered with the UIA, the client must be separately registered using a method approved by the UIA within 30 days after the employer becomes a client employer of the PEO, and the client employer must be assigned the new employer unemployment tax rate.

A business entity that is a contributing employer and becomes a client employer of the PEO on or after January 1, 2011, must retain its existing unemployment tax rate or establish a new rate pursuant to the Act.

A PEO that is a liable employer is the employer for purposes of claims management and hearings under the Act on behalf of the client employer.

A PEO that reports under the reporting method outlined in the bill must confirm the mailing address of the client employer, which may be stated as that of the PEO or of the client employer. The PEO must disclose to the UIA the business address of the client employer, which must be the physical address of the client employer.

Either the PEO that reports under the method outlined in the bill or the PEO's client employers, but not both, must file a quarterly wage detail report electronically, and must file a quarterly contribution payment in a manner approved by the UIA.

The UIA must issue a FUTA certification in accordance with the Internal Revenue Code, and regulations, rulings, instructions, and directives of the Internal Revenue Service. ("FUTA" refers to the Federal Unemployment Tax Act.)

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

(Under R 421.121 of the State Administrative Code, an employing unit that becomes a contributing employer must prepare and file a contribution report quarterly, or monthly if required by the UIA. Under R 421.190, if two or more related corporations concurrently employ the same individual and compensate him or her through a common paymaster, the corporations may report wages and pay unemployment taxes through a common paymaster and be considered to be a single employing unit. The common paymaster must be the corporation that has the highest Michigan unemployment tax rate. Also, an employee leasing company that meets certain requirements is a liable employer and is responsible to pay unemployment taxes on the employees leased to the client entity.)

MCL 338.3721-338.3747 (S.B. 1037)
421.13m (S.B. 1038)

BACKGROUND

Professional employer organizations 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. A PEO 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 website, the PEO industry, which is 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. In 2009, the industry grew to \$71.0 billion in gross revenue.

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). ("SUTA" refers to State unemployment tax act.) 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, more than 30 other states regulate PEOs.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

Senate Bill 1037

This bill creates a new licensure program within the Department of Licensing and Regulatory Affairs for professional employer organizations. According to LARA, there are over 600 PEOs that will be subject to licensure. The bill sets application fees at \$1,500 for individual PEOs and for PEO groups. The bill also requires an annual license fee of \$1,500 per individual and per group. This fee will be paid on a three-year renewal cycle. The Department will 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 will be available for the administrative costs of the Bureau of Occupational Regulation. Department staff have indicated that administering the new licensure program will 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 also provides for administrative fines of up to \$5,000 for violations of the Act. Any fine revenue received will be deposited in the General Fund. The amount of revenue will depend on the number of violations and the amount of the fines assessed.

In addition, the bill establishes a criminal penalty for violation of the Act. There are no data to indicate how many offenders will

be convicted of the new misdemeanor. Local governments will incur the costs of incarceration in local facilities, which vary by county. Any additional penal fine revenue generated under the bill will benefit public libraries.

Senate Bill 1038

The bill requires PEOs that were in existence before January 1, 2011, to implement client-based reporting of payroll and tax payments by January 1, 2014. They may choose to use the client-based reporting method prior to that date. This method requires unemployment tax payments for PEOs to be based on the experience ratings of their client companies, as determined by the procedures in the bill. In the past, PEOs have reported wages and unemployment contributions for client employers at the PEO level and paid unemployment taxes based on the PEO's contribution rate.

Over time, a shift to client-based reporting will link contribution rates more closely to client employers' actual unemployment experience and tend to increase revenue to the Unemployment Compensation Fund.

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.

Due to the extended period of high unemployment experienced in Michigan, the Unemployment Compensation Fund is currently in deficit. As of April 22, 2011, the outstanding loans from the Federal government totaled \$3.84 billion.

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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.