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The Honorable Vern Buchanan
Chair
Small Business/Pass Throughs Tax Reform
Working Group
Committee on Ways and Means
United States House of Representatives
Washington, D.C. 20515

The Honorable Allyson Schwartz
Vice Chair
Small Business/Pass Throughs Tax Reform
Working Group
Committee on Ways and Means
United States House of Representatives
Washington, D.C. 20515

Dear Representatives Buchanan and Schwartz:

On behalf of the National Association of Professional Employer Organizations (NAPEO), I appreciate the opportunity to present the association's views on tax reform.

NAPEO is the national trade association for the professional employer organization (PEO) industry. NAPEO has approximately 350 PEO members operating in all 50 states, representing more than 85 percent of the industry's estimated \$92 billion in gross revenues. NAPEO's members range in size from start-up PEOs to large, publicly held companies with years of success in the industry. PEOs provide comprehensive HR solutions for small businesses - paying wages and taxes and assuming responsibility and liability for compliance with myriad state and federal laws and regulations. In addition, PEOs provide big-businesses benefits to small business employees, such as 401(k) plans, health, dental and life insurance, dependent care and more. Approximately 250,000 small and mid-sized businesses and 2.5 million people are part of PEO arrangements.

PEOs help small and mid-sized businesses with human resources, compensation, and employee benefits issues through a co-employment arrangement where the PEOs assume W-2 employer status for the client's worksite employees. Employer responsibilities for those worksite employees are shared or allocated between the client and the PEO. Through economies of scale, PEOs improve compliance with federal and state tax and benefits laws and often provide retirement and health benefits that were not available to the workers prior to the PEO arrangement. PEOs collect employment taxes from their clients and remit the taxes to the federal government under the PEO's Employer Identification Number (EIN). This facilitates tax administration by reducing the number of returns processed and by reducing errors in calculating employment taxes. In addition, compliance is improved by accelerating the timing of collection of employment taxes because PEOs deposit taxes more quickly than their small business clients.

On September 19, 2011, the Treasury Inspector General for Tax Administration (TIGTA) released a report, *Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed* (2011-40-103), on efforts to implement the Small Business Health Care Tax Credit. One of the findings of the report was that small businesses using PEOs were "unnecessarily" falling into an IRS compliance program

designed to identify and audit employers who are not paying their employment taxes, when in fact their PEOs were handling the tax issues correctly. TIGTA called this “a waste of IRS resources” and “an increased burden on those affected taxpayers,” i.e., businesses using PEOs. In 2007, TIGTA issued another report, *Improvements Have Been Made to Monitor Employers That Use Professional Employer Organizations, But More Can Be Done* (2007-30-169), which recognized that PEO clients and the IRS are vulnerable to non-payment of federal employment taxes by PEOs, because under the regulations, the IRS’s only recourse in the event of PEO failure to remit employment taxes is to collect the amounts due from the PEO’s clients.

NAPEO has long supported legislation to formally recognize the ability of PEOs to collect and remit payroll taxes. Most recently, in the 112th Congress, Representatives Kevin Brady (R-TX) and Mike Thompson (D-CA) introduced the Small Business Efficiency Act of 2011 (H.R. 2466). This legislation would recognize the ability of PEOs to collect and remit federal payroll taxes. It also addresses one of the major concerns raised by TIGTA by creating a voluntary certification program for PEOs within the IRS. Under H.R. 2466, certified PEOs would take on sole liability for the collection of federal employment taxes for worksite employees performing services for their PEO clients. Small and mid-sized business clients that contract with certified PEOs would be assured that they would not be liable for employment taxes when the PEO has accepted that responsibility.

This legislative proposal is narrowly targeted, making clear that except for payment of employment taxes as provided in the legislation, there is no inference regarding any other provisions under the law. As is the case today, small businesses working with a PEO could continue to participate in retirement and health plans sponsored by the PEO, and these small businesses could continue to qualify for tax credits such as the Small Business Health Care Insurance Tax Credit if they are otherwise eligible. TIGTA has made legislative recommendations similar to the language in H.R. 2466, and President Obama has included comparable proposals in his budget, as did former President Bush.

NAPEO and its members strongly support enactment of the Small Business Efficiency Act, and believe that its addition to tax reform is warranted. The PEO certification process will prevent wasteful and unwarranted IRS enforcement actions for small businesses that use certified PEOs and will result in improved compliance with federal tax law by providing legal status within the federal tax code for PEOs. It will also provide needed certainty for small business, allowing that sector to better focus on growth and job creation.

Once again, NAPEO appreciates the opportunity to comment on tax reform. We look forward to working with the Committee to improve and modernize the tax code.

Sincerely,

Pat Cleary
President and CEO

Thom Stohler
Director, Federal Government Affairs