

SPECIAL NOTICE

June 2, 2006

For further information contact:
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1-800-647-7706 or (360) 705-6676

Alternate Formats (360) 705-6715
Teletype 1-800-451-7985

Professional Employer Organizations - Deduction

Professional employer organizations (PEO) are eligible for a business and occupation (B&O) tax deduction from gross income for qualifying costs paid to or on behalf of covered employees effective July 1, 2006. (Substitute Senate Bill 6671, Chapter 301, Laws of 2006)

A PEO is any person engaged in the business of providing professional employer services. Typically, a PEO contracts to manage a business' employer-related responsibilities. The PEO and client establish an ongoing, rather than a temporary or project-specific, relationship. The rights, duties, and obligations of an employer that arise out of an employment relationship are allocated between the PEO and the client in a written professional employer agreement.

Qualifying Costs

"Qualifying costs" are the actual costs of wages and salaries, benefits, workers' compensation, payroll taxes, withholding, or other assessments paid to or on behalf of a covered employee by the PEO under a professional employer agreement.

Covered Employees

"Covered employees" are individuals who are co-employed by a PEO and the PEO's client. An employee is a covered employee when:

- The individual has received written notice of co-employment with the PEO, and
- The individual's co-employment relationship is pursuant to a professional employer agreement between the PEO and its client.

The client's directors, shareholders, partners, and managers may be covered employees if the PEO and the client have expressly agreed in the professional employer agreement that such individuals are covered employees and they are operational managers or perform day-to-day operational services for the client.

Professional Employer Services

"Professional employer services" means the service of entering into a co-employment relationship with a client in which all or a majority of employees (formerly employed solely by the client) become covered

co-employees of the PEO and the client. Examples of activities performed under a professional employer agreement include management of:

- Human resources
- Employee benefits
- Payroll
- Workers' compensation

Professional employer services **do not include** the following:

- Staffing services – a business that typically:
 - Recruits and hires its own employees;
 - Assigns their employees on a temporary basis to perform work or services for other organizations.
- Makes arrangements wherein a person, whose principal business activity is not entering into professional employer arrangements and who does not hold itself out as a professional employer organization, shares employees with a commonly owned company within the meaning of section 414(b) and (c) of the Internal Revenue Code of 1986, as amended;
- Handles independent contractor arrangements where a person assumes responsibility for the product produced or service performed by such 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 such arrangements.

Tax Return Reporting

PEOs are subject to the B&O tax on income they receive for providing professional employer services. Gross income received (including amounts qualifying for deduction) is reported under the Service and Other Activities classification of the B&O tax. An "Other" deduction is taken for qualifying costs with the following explanation: "PEO covered employee costs."

Responsibility for Sales Tax

The client (not the PEO) is the seller and responsible for collecting and remitting sales tax when a covered employee performs activities that are retail sales.

Eligibility for Tax Incentives

The client (not the PEO) is eligible for any tax credit, exemption, or other tax incentive as the result of the employment of covered employees.

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