

**MEMORANDUM**

**TO:** Shadya Yazbak, Bureau of Workers' Compensation

**FROM:** Paula Steele, Regulatory Policy Advocate

**DATE:** October 3, 2013

**RE:** **CSI Review – Professional Employer Organization (PEO) Rules** (OAC 4123-17-15, 4123-17-15.1, 4123-17-15.2, 4123-15-15.3, 4123-17-15.4, 4123-17-15.5, 4123-17-15.6, 4123-17-15.7, and 4123-14-06)

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On behalf of Lt. Governor Mary Taylor, and pursuant to the authority granted to the Common Sense Initiative (CSI) Office under Ohio Revised Code (ORC) section 107.54, the CSI Office has reviewed the abovementioned administrative rule package and associated Business Impact Analysis (BIA). This memo represents the CSI Office's comments to the Agency as provided for in ORC 107.54.

**Analysis**

This rule package consists of nine Ohio Bureau of Workers' Compensation (BWC) draft rules, and contains seven new and two amended rules which govern the way the Bureau regulates Professional Employer Organizations (PEOs). The rule package was filed with the CSI Office on June 13, 2013, and the comment period for the rule closed on July 5, 2013. Two groups provided comments during the public comment period.

The Bureau and the Industrial Commission of Ohio (IC) comprise the Ohio workers' compensation system, which includes state-fund and self-insuring employers. Under the state-fund program, the Bureau pays compensation directly to injured workers. Self-insuring employers, which the Bureau monitors, pay their own workers' compensation claims. A PEO is a business entity that enters into an agreement with client employers for the purpose of co-employing all or part of the client employer's workforce at the client employer's work site. PEOs manage human resource elements for client employers and can include payroll, taxes, health insurance, retirement programs, and

workers' compensation.

According to the BIA, in 2011 the Bureau initiated a comprehensive early stakeholder outreach process for the rules' five-year review that included various PEOs, third party administrators, employer representatives, trade associations including the National Association of Professional Employer Organizations (NAPEO) and the Employer Services Assurance Corporation (ESAC).

In December 2012, Senate Bill 139 was signed into law. The legislation established certain financial capacity requirements for professional employer organizations, clarified rights and liabilities of professional employer organizations and client employers, and made other changes to the professional employer organization law for the purpose of enhancing financial oversight of PEOs. As a result, the proposed rules incorporate the changes made in SB 139.

During the CSI review period, comments were received from NAPEO as well as from MinuteMen Select, an Ohio-based PEO. The CSI Office also met with both commenters and engaged in significant discussion with the commenters and BWC staff in attempts to understand and resolve the concerns expressed about the rules, as well as BWC's justification for the relevant rule provisions as drafted. Because the concerns of the two commenters were largely unrelated to each other, the follow-up happened along two separate tracks.

The NAPEO comments expressed general support for the rules as proposed by BWC, but expressed concern with several more specific aspects of the rules, all of which related to self-insured PEOs. The concerns included language dealing with partial-lease agreements, consolidated financial statements, language which duplicated statute, and attestation requirements of a PEO's chief executive officer. In all cases, the BWC was able to demonstrate that the provisions in question were either required by the Ohio Revised Code or necessary to promote the public purpose of the rules. In the case of partial leases, the rule language is intended to protect against abuses of the system whereby a self-insured PEO could manipulate its rates by bringing low-risk employees under its workers' compensation plan while forcing higher-risk (and more expensive) employees into the State Fund. Again, in all cases BWC staff expressed that it had the flexibility in its rules to work with a company to resolve any unique circumstances that might arise in the implementation of the rules.

In the case of MinuteMen Select, the concern focused on a proposed amendment to OAC 4123-17-15 which states, "Shared employee wages must be paid by and reported under the tax identification number of the PEO for federal tax purposes."<sup>1</sup> MinuteMen Select reports its employee wages using the tax identification numbers of its client employers and expressed concern about the impact of the proposed rule on its business model. According to MinuteMen Select, it is the only self-insured PEO in Ohio to operate in this manner.

The CSI Office engaged in significant dialogue with both BWC staff and representatives of

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<sup>1</sup> Proposed OAC 4123-17-15(D)(2)

MinuteMen Select, and reviewed a number of supporting documents provided by both parties. According to the BWC, the reason for the provision is to ensure that true co-employment (“the sharing of the responsibilities and liabilities of being an employer”<sup>2</sup>), which is a prerequisite to being a PEO, is present in the relationship between the PEO and the client employer. According to IRS guidance provided by BWC staff, reporting under the PEO’s tax identification number is necessary to establishing the PEO’s liability for the client’s tax obligations. In contrast, MinuteMen Select provided separate IRS guidance that it believes supports its assertion that liability is established through the agreement between the PEO and the client, and not through the manner in which it files with the IRS.

Ultimately, the disagreement between the BWC and MinuteMen Select is a difference in interpretation of the Internal Revenue Code. It is not the role of the CSI Office to resolve legal disputes, nor do we have the expertise to do so. It is clear that by statute, co-employment is a defining feature of a PEO, and that shared liabilities are required for a co-employment relationship. As such, any provision of the draft rules which are necessary to establish and ensure the existence of a co-employment relationship justify the adverse impact to businesses. The CSI Office does recognize that the proposed language could have a significant and negative impact on businesses that have historically filed under the client employer’s tax identification number. However, absent clear legal precedent either way, the CSI Office must defer to the BWC if it has determined that the language in question is a necessary part of the regulation.

After reviewing the proposed rules and revised BIA, the CSI Office has determined that the rule package satisfactorily meets the standards espoused by the CSI Office, and the purpose of the rules justifies the adverse impact identified in the BIA.

### **Recommendations**

For the reasons described above, the CSI Office has no recommendations regarding this rule package.

### **Conclusion**

Based on the above comments, the CSI Office concludes that the Bureau should proceed with the formal filing of this rule package with the Joint Committee on Agency Rule Review.

cc: Stephen Buehrer, Administrator/CEO, Ohio Bureau of Workers’ Compensation  
Mark Hamlin, Lt. Governor’s Office

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<sup>2</sup> ORC 4125.01(C)