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October 16, 2017

Delivered via email to Lanita.VanDyke@irs.gov

Ms. Laurie Brimmer
Internal Revenue Service
Room 6526
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comment Request Relating to Certified Professional Employer Organization (CPEO) Forms

Forms 14737, 14737-A, 14751, and 8973

OMB Number: 1545-2266

Dear Ms. Brimmer:

On behalf of the National Association of Professional Employer Organizations (NAPEO),[1] thank you for the opportunity to submit comments pursuant to the Paperwork Reduction Act (PRA) on the Internal Revenue Service's (IRS) collection of information in connection with the following CPEO forms: (1) Form 14737, Request for Voluntary IRS Certification of a Professional Employer Organization (Application); (2) Form 14737–A, CPEO Responsible Individual Personal Attestation (RIPA); (3) Form 14751, Certified Professional Employer Organization Surety Bond; and (4) Form 8973, Certified Professional Employer Organization/Customer Reporting Agreement.[2]

Our comments below focus on changes to the forms that we believe would be helpful in improving their clarity and usability, as well as changes to the application process that would increase the functionality and efficiency of the CPEO program.

[1] The National Association of Professional Employer Organizations (NAPEO) is The Voice of the PEO Industry. PEOs provide payroll, benefits, regulatory compliance assistance, and other HR services to small and mid-sized companies. PEOs work with between 156,000 to 180,000 businesses employing between 2.7 and 3.4 million people, and the industry generates between $136 and $156 billion in gross revenues annually. For more information about the PEO industry and NAPEO, please visit www.napeo.org.

[2] 82 Fed. Reg. 39,156 (August 17, 2017).

TIME-SENSITIVE ISSUE RELATED TO THE APPLICATION AND RIPA

- **Online Annual Verification Process**

  Section 2.02 of Rev. Proc. 2017-14 describes a process for annual verification under which CPEOs are required to "submit a properly completed and executed online annual verification" in order to maintain their certification. We anticipate that this online process will likely be added or connected to the IRS's CPEO online application portal, including potentially the RIPA. The deadline for submitting an annual verification is 30 days before the anniversary of the date on which a CPEO's certification became effective, which will be December 2, 2017 for the first group of CPEOs whose certification effective date was January 1, 2017.

  To date, we are not aware that this annual verification process has been established and/or made available for CPEOs to review. In order to allow CPEOs with a December 2, 2017 annual verification deadline the time necessary to complete all requirements that the process may entail, we urge the IRS to publish the annual verification process as soon as possible. This is especially critical in the event that annual verification may require any sort of action from a CPEO's Responsible Individuals,[3] which will require a much greater amount of coordination and outreach on the part of the CPEO.

  If the online annual verification process is not made available by the end of October 2017, then we would further urge the IRS to provide additional time for those CPEOs certified effective January 1, 2017 to complete the process.

COMMENTS ON THE APPLICATION, RIPA, AND THE APPLICATION PROCESS

- **Separate CPEO-by-CPEO Applications**

  Section 301.7705-2T(a)(1) of the proposed regulations requires that, in order to be certified, a person must submit a properly completed and executed application for certification as a CPEO in the time and manner prescribed by the regulations and any further guidance issued by the IRS. Section 2.02 of Rev. Proc. 2016-33 provides that if more than one member of a controlled group seeks to be certified as a CPEO, each such member must submit a separate CPEO Application and joint applications are not allowed.

  As we have indicated in previous comments, we do not believe that the requirement that each PEO apply independently is the correct reading of the statute. Nor was it the intent of Congress to have each CPEO Applicant in a controlled group seeking certification be required to apply separately. The Treasury/IRS guidance does not appropriately take into account the varied, but not uncommon, business structures of PEOs and their controlled groups. For various legitimate business reasons unrelated to the certification program, many

[3] Terms not defined herein have the meaning ascribed to them in the final and temporary or proposed regulations for the CPEO program.

PEOs (like other businesses) have established multiple subsidiaries or brother/sister organizations to provide PEO services to their customers.

The requirement that each CPEO Applicant submit its own application is not the most efficient or effective way to implement the PEO certification program and has substantially increased the burden of the application process on many CPEO Applicants. NAPEO has received feedback from numerous members that the separate application requirement made the application process cumbersome and repetitive. CPEO Applicants were required to input the same data over and over, such as tax identification numbers, addresses, and the names of every related entity or controlled group member. In most cases, the Responsible Individuals for an entity with multiple PEO subsidiaries will report the other members of the group as Related Entities, and the Responsible Individuals will generally be identical (or nearly identical) for each CPEO Applicant subsidiary. For an entity with 25 PEO subsidiaries in different states, for example, it makes little sense for the IRS to review each of those applications independently. Moreover, CPEO Applicants in the same controlled group that seek certification will already be required to coordinate the bond and financial statement requirements, and that can be better accomplished and administered through a single application. These issues are addressed more fully in NAPEO's July 5, 2016 comment letter under the PRA, which is attached hereto as Appendix A.

We would also note that the level of user fee was very carefully considered by the authors of the enabling legislation and was specifically increased in order to ensure that the PEO certification legislation would result in a net positive revenue score under the congressional budget rules. As such, the scope of the rule was an important consideration for Congress. The revenue estimates from the Joint Committee on Taxation were most certainly not based on the assumption that every one of the PEO subsidiaries across the nation would have to apply for certification independently. The fact that the fee contained in the enabling legislation was already well in excess of the typical fee imposed under many state PEO licensure laws is further proof of congressional intent, and the bill's authors set the fee for certification at a level that would not discourage certification or require PEOs to unnecessarily modify their business structures.

For all these reasons, we believe that the better and more efficient approach is to permit those CPEOs in a controlled group to apply under a single application.

We strongly urge the IRS to provide clarification that Rev. Proc. 2016-33 will be interpreted to allow a single application for all CPEO Applicants in a controlled group, consistent with the requirements for bonding and annual audits, and include the following:

- A parent entity should be able to apply for certification on behalf of itself and any of its PEO subsidiaries within the same controlled group that are identified in a single application.
- Two or more PEOs within a controlled group (sibling entities) may jointly apply for certification (even if the parent is not requesting certification).

We note that Rev. Proc. 2016-33 provides that the status of other CPEO Applicants and CPEOs in the controlled group is not affected if the CPEO Applicant is denied certification because the annual audited financial statements reflect that the working capital requirement is not satisfied. We assume that rule would extend to other failures by a CPEO in a controlled group (other than the bonding and financial requirements where the statute requires all CPEOs in the controlled group to be treated as a single entity). However, if, as we request, the Treasury/IRS were to clarify that combined applications would be accepted in the limited cases identified above, we would understand if the certification of all the members of the controlled group were jeopardized through the failure of any member of the controlled group. Essentially, there would be a single CPEO Applicant consisting of multiple members of the controlled group.

- **Functionality of the Online CPEO Application System**

  NAPEO received feedback from many of its members in 2016 expressing that, despite some initial systems challenges in particular, the application system was generally viewed as being fairly simple and reasonable. However, in comments submitted on December 22, 2016, NAPEO described a few process areas where members had expressed the need for improvement. Because it is not clear to us that these issues have been addressed, we repeat them here.

  - *Issues with saving data* – Many CPEO Applicants experienced difficulties with the application system failing to save data that had already been entered and having to re-enter the lost data. For example, one CPEO Applicant lost the state licensing information that it had entered midway through the process and had to start over with respect to completing that section.
  - *Ability to retrieve information following submission* – NAPEO received feedback that a CPEO Applicant's application summary is not saved in the system and must be printed or saved immediately following the submission of an application. Similarly, uploaded file attachments are also not saved. Members who have applied for certification have requested that the system save and allow for the subsequent retrieval of such information by a CPEO Applicant.
  - *Limitations in uploading documents* – NAPEO members expressed concern about the systems limitations they encountered in uploading required documents. For example, one CPEO Applicant faced additional challenges when the information the CPEO Applicant needed to upload was contained in more than one PDF file, yet the system would only accept a single file upload. In addition, CPEO Applicants found that the size limitation on the PDF files that could be uploaded (currently limited to 2 MB) was too restrictive, forcing applicants to take additional steps to reduce the size of their files prior to successfully uploading them.
  - *Process for adding additional input boxes* – CPEO Applicants that were required to enter information with respect to multiple state licenses or affiliates noted that the placement of the "Add" button that must be clicked on in order to add additional boxes in which to input the required information could be improved by moving the

button to the bottom of the page. As currently designed, CPEO Applicants must continually scroll up to the top of the page after adding each additional entry, which makes for a cumbersome process for those users needing to add several dozen entries.

- *Process for incorporating all elements of the application* – NAPEO received feedback that some CPEO Applicants were confused over the process for incorporating all application items such as the Individual Identify Verification Process and all RIPAs into a single CPEO Application, and that additional clarifying guidance would be helpful as the process was not very intuitive.

- **Application of Certain Suitability Requirements to Responsible Individuals of Related Entities**

The Treasury and IRS indicated in the preamble to the final and temporary regulations[4] that they are considering whether to expand the category of individuals who must authorize the IRS to conduct comprehensive background checks and submit fingerprint cards to include certain directors, officers, and owners of a CPEO Applicant's or CPEO's Related Entities.

As we have previously expressed, extending the suitability requirements to Responsible Individuals of Related Entities would impose potentially monumental paperwork burdens on PEOs, Responsible Individuals, and the IRS, without any meaningful improvement in the effectiveness of the PEO certification program. These problems would be particularly acute for very large publicly traded CPEOs and CPEO Applicants, but they could create serious difficulties for even smaller PEOs. In some cases, the CPEO or CPEO Applicant might not even have the influence to compel certain Responsible Individuals of Related Entities to provide the requisite information.

The definition of "Responsible Individual" in the final and temporary regulations broadly encompasses individuals with responsibility for and knowledge of the CPEO or CPEO Applicant's operations and financial wherewithal. Expanding the category of individuals who must authorize background checks or meet other requirements beyond what Treasury/IRS has currently provided for in the regulations will, at most, marginally improve the quantity or quality of information with which the IRS may evaluate a CPEO or CPEO Applicant. However, we are very concerned that expanding the requirements to certain individuals of Related Entities will substantially increase the burden for CPEOs and CPEO Applicants by drawing dozens or even hundreds of additional Responsible Individuals into the process. Such a result would be contrary to the goal of having a workable certification program with manageable burdens for PEOs that are fit to be certified. The contemplated expansion would be even more complicated for publicly traded companies that include PEO subsidiaries. Those entities already satisfy SEC and other statutory disclosure rules. The expansion would also be very complicated for private equity-held companies with vast portfolios that could contain Related Entities with no realistic relationship to a CPEO or CPEO Applicant other than the common private equity firm. Moreover, the imposition of across-the-board disclosure burdens (including fingerprint requirements) on Responsible

[4] 81 Fed. Reg. 27,319 (May 6, 2016).

Individuals of Related Entities would unnecessarily and inappropriately hamper normal business transactions, such as business acquisitions by Related Entities.

We note that the final and temporary regulations already contemplate that the application process will obtain information from the CPEO Applicant or CPEO regarding Related Entities. In instances where the IRS review of a Related Entity raises questions or concerns, we believe the IRS would have the authority to request further information from the CPEO or CPEO Applicant. Moreover, to the extent there are concerns that an outside party unrelated to the CPEO or CPEO Applicant is really in control, the current Responsible Individual definitions are sufficiently broad to sweep in any such individual since the definitions include any individual, regardless of title, with ultimate responsibility for (1) implementing the decisions of the CPEO's governing body; (2) supervising the management, administration, or operation of the organization; or (3) managing the organizations finances.

- **Clarification on Confidentiality of Submissions**

  As part of the application process, CPEO Applicants, Related Entities, Precursor Entities, and Responsible Individuals must submit to the IRS certain confidential information and allow the IRS to conduct background checks. These entities and individuals may be concerned that such information submitted on the CPEO Application or the RIPA, or obtained through background and other checks, not be made public.

  The IRS should issue guidance stating that, except as specifically provided in the regulations, information submitted to or obtained by the IRS as part of the certification application process will be kept confidential and will not be made available to the public. Submitted information that will be kept confidential should include, but not be limited to:

  - Financial statements and other financial information of a CPEO Applicant, its Related Entities and Precursor Entities, and Responsible Individuals;
  - Results of background, credit, and other checks performed on Responsible Individuals; and
  - Except as provided in the regulations, responses provided by Responsible Individuals on the RIPA or through any other submission.

- **Information Required on the Application**

  - *"License/Registration Date" of each state registration* – As we have previously noted, NAPEO has received feedback that the work required to look through a PEO's numerous records, some dating several decades old, was very labor intensive. Members questioned whether such information about registration dates is critical enough to the IRS's review process to warrant its collection on the CPEO Application.

- *Form in which financial information is submitted* – NAPEO members have urged that the IRS be willing to accept financial information in different forms. CPA firms issue audited financials in varying forms, and although some general consistencies will result, no CPA firm issues financials in exactly the same form as another firm. It would add significant expense and burden to the certification process if CPEOs and CPEO Applicants were required to rework financial statements simply due to variations in their form.

COMMENTS ON FORM 14751 (SURETY BOND)

NAPEO and its members appreciate that the IRS has addressed many of the concerns that NAPEO and the Surety & Fidelity Association of America expressed with respect to the draft surety bond forms in the final Form 14751. However, NAPEO continues to request that the following outstanding issues be addressed:

- **Prohibition on Collateral**

  NAPEO appreciates that the IRS has provided an FAQ stating that the mere retention by a surety of the right to seek collateral does not violate the "no collateral" requirement established by the regulations. However, in the event that a surety exercises its right to seek collateral, we would request that such action be treated as simply one factor that the IRS considers in its evaluation of the CPEO's initial and ongoing certification and not as an event that precludes certification or, as is currently specified in the FAQ, as an event that in all cases will result in the revocation of the CPEO's certification. This change is especially important with respect to small CPEOs and small CPEO Applicants (i.e., those with a required bond amount of under $1 million).

- **Conditional Nature of the Obligation**

  Form 14751 states that the surety agrees to pay a claim under the bond "within thirty (30) calendar days of receiving written demand for payment of the claim from [the IRS]." NAPEO continues to request that the language be revised to underscore that the surety's liabilities do not arise pursuant to a mere demand for payment. For example, the form should clarify that the surety agrees to pay the claim "within thirty [30] days of receiving written notice of the claim from Obligee with sufficient evidence to establish the Principal's liability under Subtitle C of the Code and the Surety's liability under this Bond."

COMMENTS ON FORM 8973 (CPEO/CUSTOMER REPORTING AGREEMENT)

As detailed in our previous comments, we continue to believe that it is clear that Code § 3511(g), which gives the IRS the authority to impose appropriate rules, regulations, and procedures <u>on CPEOs</u>, does not authorize imposing the Form 8973 customer signature burden on the many thousands of CPEO customers – and especially not on those who will not in any way benefit from or be covered by the provisions of Code §§ 3511(a) or (c). Nevertheless, to the extent that the IRS continues to apply customer/client signature requirements in certain situations, NAPEO appreciates the efforts that have been made to improve the workability of the Form 8973 relative to the original draft versions of the form that were initially considered. We further appreciate the provision of several FAQs that address some of the questions that have more recently arisen with respect to Form 8973.

Although a number of the concerns we have previously expressed have been addressed, the following issues and questions with respect to Form 8973 remain outstanding:

- **Electronic Signatures**

  In a recent FAQ, the IRS stated that it does not currently accept electronic signatures or facsimile signatures (i.e., a rubber stamp, mechanical device, or computer software program) on Form 8973. Although we appreciate the recently published FAQs that provide procedures for CPEOs that are unable to secure all of their customers' signatures before the filing deadline for Form 8973, we believe that further guidance expressly permitting electronic customer/client signatures would better help to achieve the IRS's stated objectives in obtaining customer/client signatures on Form 8973. It would also ease unnecessary administrative burdens imposed upon NAPEO's members and, more importantly, their small business customers and clients. For example, the acceptance of a customer's electronic signature would reduce the number of Form 8973 filings without a customer signature and allow CPEOs to avoid the cumbersome procedures required when filing a Form 8973 without a customer signature.

  The CPEOs that received their notice of certification on June 1, 2017 are now more than four months into the six-month period in which they must obtain physical signatures on the Form 8973 from all of their existing clients/customers. The IRS's prohibition on electronic signatures has created substantial logistical problems for these CPEOs, who in many cases have hundreds or thousands of clients and customers across the country. Even when a CPEO is able to provide the Form 8973 in person, the client/customer often wants additional time to review and sign the form, forcing the CPEO to rely on the client/customer to sign the form later and then return it to the CPEO via mail. The overall burden imposed by this reporting requirement could be significantly eased by allowing for the use of electronic signatures.

  In 2000, Congress passed the E-SIGN Act, which makes electronic signatures as enforceable and valid as their handwritten counterparts. We understand that the IRS has generally been cautious in authorizing the use of electronic signatures on specific documents or forms because the reduced administrative burden must be balanced against the risk of disavowal by the signer.

  However, in the instant case, the risk of disavowal by the customer/client with respect to the Form 8973 acknowledgement would have no legal consequences. The Form 8973 customer/client signature does not affect the legal status of any CPEO contract described by Code § 7705(e) or any § 31.3504-2(b)(2) service agreement between a CPEO and its clients. The customer/client signature merely acknowledges that the customer/client information provided on Form 8973 is true and correct to the best of the customer's or client's knowledge and belief. The customer/client signature does not affect the treatment of the underlying CPEO-customer or CPEO-client relationship.

A customer that entered into a CPEO contract would have no reason to disavow that it was the signer of Form 8973 and, even if it did, the only consequence would be that the customer would lose the favorable treatment afforded under Code § 3511. If, on the other hand, a client that is subject to a § 31.3504-2(b)(2) service agreement attempted to disavow the signature on Form 8973, that would not change the client's legal position and liability in any way since § 31.3504-2(b)(2) deals exclusively with the liability of the PEO.

Moreover, in the case of Form 8973, there is an additional and critical safeguard. The Form 8973 still would require a signature by the CPEO under penalty of perjury acknowledging that, to the best of the CPEO's knowledge, Form 8973 is "true, correct, and complete." This declaration obviously includes an acknowledgement by the CPEO signer (under penalty of perjury) that the CPEO has no reason to believe that the customer's or client's electronic signature is invalid.

The IRS can derive further assurances from the CPEO's accompanying filing of the Consent to Disclosure of Tax Information. If a CPEO were, for some reason, attempting to evade its responsibilities to use its best efforts to obtain valid customer/client signatures, that fraudulent course of action would not be any easier with electronic signatures. Moreover, any CPEO acting upon electronic customer/client signatures that it knows are invalid would not only be subjecting itself to penalty of perjury, but it would be misreporting employment taxes each quarter and, thus, subjecting itself to penalties and the potential loss of its certified status. Those activities would eventually be easily identified through the authorized disclosure of tax information to the customer/client.

- **Electronic Submission of Form 8973**

  Forms 8973 are currently required to be filed by mailing the forms to a physical address. It would be helpful and more efficient if the IRS were to also provide for an option to file the form electronically, such as by uploading the form through the CPEO portal or in another similar manner.

- **Other Outstanding Questions**

  Additional questions that NAPEO members have raised and for which guidance from the IRS would be helpful include the following:

  - Will the IRS provide confirmation to a CPEO that the IRS has received a Form 8973?
  - May CPEOs add form fields in order to pre-populate the Form 8973 for a customer/client?

* * * * *

We appreciate your consideration of our comments on the CPEO forms. Should you have any questions with respect to the issues discussed herein or any other related matters, please contact me at (202) 347-2230 or Thom Stohler of NAPEO at (703) 739-8167.

Sincerely,

Randolf H. Hardock
Davis & Harman LLP
(on behalf of the National Association of Professional Employer Organizations)

Cc: via email

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July 5, 2016

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Office of Management and Budget
Attn: Desk Officer for the Department of the Treasury
Office of Information and Regulatory Affairs
Washington, DC 20503

Re: Comments on the Collection of Information with respect to Treasury/IRS Regulations Establishing a PEO Certification Program

Dear Sir/Madam:

On behalf of the National Association of Professional Employer Organizations (NAPEO),[1] I would like to convey NAPEO's appreciation for the opportunity to submit comments pursuant to the Paperwork Reduction Act (PRA) on the collection of information contained in the proposed rulemaking[2] published by the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) to establish a certification program for professional employer organizations (PEOs). The Treasury and the IRS were directed to establish such a program under the Small Business Efficiency Act (SBEA), which was enacted as part of The Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014.

NAPEO and its members further appreciate the substantial effort and resources that the Treasury and the IRS have invested in developing an entirely new certification program for PEOs. The guidance released to date makes significant strides toward the implementation of a certification program that we are hopeful will accommodate PEOs of all sizes, as Congress intended. Although much of the guidance released thus far appears to set forth an appropriately scoped and workable structure for a PEO certification program, we believe that, in accordance with the goals of the PRA, certain aspects of the program as currently proposed should be streamlined, and reporting burdens reduced, and that such actions could be done in a manner that would not

[1] The National Association of Professional Employer Organizations (NAPEO) is The Voice of the PEO Industry. PEOs provide payroll, benefits, regulatory compliance assistance, and other HR services to small and mid-sized companies. PEOs work with between 156,000 to 180,000 businesses employing between 2.7 and 3.4 million people, and the industry generates between $136 and $156 billion in gross revenues annually. For more information about the PEO industry and NAPEO, please visit www.napeo.org.

[2] 81 Fed. Reg. 27,360 (May 6, 2016).

compromise the IRS's ability to ensure the collection of federal employment taxes from certified PEOs (CPEOs).

Two of the PRA's express purposes that are especially relevant to our comments are (1) to minimize the paperwork burden for individuals, small businesses, and other persons resulting from the federal government's collection of information, and (2) to minimize the cost to the federal government of the creation, collection, maintenance, use, dissemination, and disposition of information.[3] In this regard, our comments focus on two key aspects of the proposed certification program where we urge that changes be made in order to reduce the burdens on and costs to both PEOs and the government:

1. The requirement that each PEO member of a controlled group must submit a separate application for certification will impose an inordinate, unnecessary, and potentially counterproductive amount of largely duplicative work for controlled groups with multiple CPEO Applicant subsidiaries or brother/sister entities to complete and for the IRS to sort through and examine. This requirement should be changed to allow joint applications among PEOs in the same controlled group.
2. The scope of the required reporting on the proposed revised Schedule R related to information about non-CPEO service contracts will create an unjustified reporting burden on CPEOs and should be eliminated. In addition, the requirement that CPEOs report the commencement and termination of non-CPEO service contracts, which derives from the Schedule R requirement, should likewise be eliminated.

1. Requirement that Each Member of a Controlled Group Submit Separate Applications

Requirement: Section 301.7705-2T(a)(1) of the final and temporary regulations requires that, in order to be certified, a person must submit a properly completed and executed application for certification as a CPEO in the time and manner prescribed by the regulations and any further guidance issued by the IRS.[4] Section 2.02 of Revenue Procedure 2016-33 provides that if more than one member of a controlled group seeks to be certified as a CPEO, each such member must submit a separate application on Form 14737 and joint applications are not allowed.

Requested Change: We strongly urge that, instead of requiring a separate application for each PEO entity, the IRS should allow a single application for all CPEO Applicants[5] in the same controlled group according to the following parameters:

[3] 44 U.S.C. § 3501(1), (5).

[4] 81 Fed. Reg. 27,324. The proposed regulations propose to adopt, by cross-reference, the text of the temporary regulations.

[5] Terms not defined herein have the definition ascribed to them in the proposed PEO certification program regulations, final and temporary PEO certification program regulations, or Rev. Proc. 2016-33, as applicable.

- A parent entity should be able to apply for certification on behalf of itself and any of its PEO subsidiaries within the same controlled group that are identified in a single application.
- Two or more PEOs within a controlled group (sibling entities) may jointly apply for certification (even if the parent is not requesting certification).

(As we noted to the IRS in an initial comment letter on the proposed regulations and Rev. Proc. 2016-33, we would understand if, as a result of adopting our requested change, the certification of each member of the controlled group applying as part of the same joint application was jeopardized through the failure of any one member included on the same application.)

Discussion: A requirement that each CPEO Applicant in a controlled group submit its own application would be a very inefficient way to implement the PEO certification program and is not required by the statute. The requirement for separate applications fails to take into account the wide range of existing business structures of PEOs and their controlled groups – structures that were developed for a variety of legitimate business reasons unrelated to the PEO certification program. For example, it is very common for PEOs to establish up to 10, 20, or even hundreds more subsidiaries or brother/sister organizations to provide PEO services. One reason for such a business structure is the differences in PEO regulations among the states, and PEOs frequently establish separate entities for purposes of operating in and complying with the rules of the various states.

Requiring multiple members of the same controlled group (each of which is a PEO seeking certification) to separately apply will not result in additional information being provided to the IRS than if a single joint application were allowed, but it will result in an enormous volume of unnecessary duplicate information being submitted to the IRS. For example, consider a PEO entity that has created 25 PEO subsidiaries. In many cases, the Responsible Individuals, Related Entities, and Precursor entities will be the same or substantially the same among all members of the controlled group. If each subsidiary entity seeks certification and is required to separately apply, then 25 CPEO applications will be required, each containing substantially identical information. In addition, information with respect to Related Entities and Precursor Entities will be submitted in duplicate potentially numerous times. Since the application process will all be completed electronically and cannot be done on paper, it may even be necessary to manually fill out the forms 25 times online. If joint applications were allowed, all of that information could be consolidated in a single application for the controlled group, saving hundreds of hours of application time and providing the IRS with a much more streamlined application to review.

The concept of coordinating PEO members in a controlled group is already present in the statute: CPEO Applicants and CPEOs in the same controlled group are required to coordinate with respect to both the bond and the audited financial statement requirements. Providing an option to use a single, joint application for members of a controlled group would not only reduce the application process burden for all reviewed and reviewing parties, but it would also serve to make the required coordination among controlled group members with respect to the bond and financial statement requirements more administrable.

The rationales described above for eliminating the separate application requirement – reducing the burden stemming from submitting duplicate information and assisting with the coordination of the bond and financial statement requirements – are supported by the PRA. Allowing for joint applications among controlled group members would dramatically reduce the burden on PEOs (including small PEOs that may have only a few members in a controlled group). In addition, joint applications would substantially minimize the cost to the IRS with respect to the collection, maintenance, use, and dissemination of information contained in the applications for certification by dramatically reducing the amount of duplicate information that must be sorted through and reviewed.

Equally important, the combined applications for CPEOs in the controlled group could still gather all the same information and could be processed more efficiently and effectively by the IRS. The IRS will already have to track all CPEO Applicants in the same controlled group in order to apply the law's provisions that require certain financial and bonding requirements be satisfied under the assumption that all CPEOs in the controlled group are treated as a single entity.

As further support for allowing joint applications within a controlled group, we would note that the level of the certification program's user fee (up to $1,000 per year) was very carefully considered by Congress and was specifically set at that level in order to ensure that the PEO certification legislation would result in a net positive revenue score under the congressional budget rules. As such, the scope of the rule was an important consideration for Congress. The revenue estimates from the Joint Committee on Taxation were most certainly not based on the assumption that every one of the potentially thousands of PEO subsidiaries across the nation would have to apply for certification independently. The fact that the fee contained in the enabling legislation was already well in excess of the typical fee imposed under many state PEO licensure laws is further proof of congressional intent, and the bill's authors set the maximum allowed fee for certification at a level that would not discourage certification or require PEOs to unnecessarily modify their business structures.

The IRS's own figures support this view, as the estimated number of recordkeepers set forth in its reporting burden estimates is 275, a number that we believe is a very appropriate estimate if all CPEO members of a controlled group are treated as one recordkeeper. However, that number of recordkeepers would be off by hundreds or even thousands if each individual CPEO entity is to be treated separately, including for purposes of the application for certification.

2. Unnecessary Reporting Burdens with respect to Treas. Reg. § 31.3504-2(b)(2) Service Agreements

Requirement: Section 31.3511-1(g)(3)(ii) of the proposed regulations provides that CPEOs must report (on a revised version of the Schedule R) remuneration paid to Covered Employees on a customer-by-customer basis. That reporting is extended to any CPEO clients covered under service agreements described in Treas. Reg. § 31.3504-2(b)(2).[6] The preamble explains that the reason is so that the IRS can "better reconcile the total amounts of wages and taxes reported on Forms 940 and 941 with the amounts of wages and taxes reported on the attached Schedule R."[7] Section 31.3511-1(g)(3)(i) of the proposed regulations requires CPEOs to report to the IRS the commencement or termination of any CPEO contract or § 31.3504-2(b)(2) service agreement.

Requested Change: Revised Schedule R reporting requirements should not apply with respect to CPEO clients covered under non-CPEO contract service agreements described in Treas. Reg. § 31.3504-2(b)(2). In addition, because the only reason provided in the preamble for the requirement that CPEOs report information related to the commencement or termination of § 31.3504-2(b)(2) service agreements is related to the requirement that information about such agreements be reported on the revised Schedule R,[8] we further request that this related reporting requirement be eliminated. As a result, CPEO reporting on revised Schedule R and with respect to the commencement or termination of a contract would only apply to the CPEO contracts governed by the SBEA provisions.

Discussion: The revised Schedule R reporting requirements are not yet available as of the due date for filing comments. Nonetheless, the types of information that the IRS seems to be indicating that will be required on the revised Schedule R would seem to be consistent with the legislative intent with respect to CPEO contracts with customers that are governed by the SBEA. The extension of Schedule R reporting to CPEO clients covered under § 31.3504-2(b)(2) service agreements will impose unnecessarily burdensome and ineffective reporting requirements on CPEOs. In particular, the detailed client-by-client Schedule R reporting requirement with respect to § 31.3504-2(b)(2) service agreements has no bearing on any of the factors relevant to the PEO certification program under Code § 3511 or § 7705. Under the Treasury/IRS guidance issued to date, the identification of and/or information related to § 31.3504-2(b)(2) service agreements are relevant for the following purposes:

- Determining the required bond amount during the first two years of certification;
- The definition of "substantial asset transfer," which is pertinent for purposes of identifying any Precursor Entities of a CPEO Applicant; and
- Notifying clients that the service agreement is not a CPEO contract covered by § 3511 and does not alter the client's liability for federal employment taxes on remuneration remitted by the CPEO to employees covered by the agreement.

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[6] As described in the final and temporary regulations, "A service agreement described in § 31.3504-2(b)(2) is a written or oral agreement pursuant to which the payor: (1) Asserts it is the employer (or 'co-employer') of individuals performing services for the client; (2) pays wages or compensation to the individuals for services the individuals perform for the client; and (3) assumes responsibility to collect, report, and pay, or assumes liability for, any employment taxes with respect to the wages or compensation paid by the payor to the individuals performing services for the client." 81 Fed. Reg. 27,317 n.2.

[7] 81 Fed. Reg. 27,368.

[8] *Id.*

The regular reporting of information regarding § 31.3504-2(b)(2) service agreements on the Schedule R is not necessary whatsoever in order for CPEOs and CPEO Applicants to comply with the items listed above and therefore has no relevance to the ongoing certification of a PEO entity. As a result, none of the above items justifies a permanent reporting rule with respect to § 31.3504-2(b)(2) service agreements.

Furthermore, Schedule R reporting with respect to § 31.3504-2(b)(2) service agreements will not materially improve the IRS's ability to reconcile amounts reported on Forms 940 and 941 with the attached Schedule R, which is the sole reason provided by the IRS for introducing this requirement. Because CPEOs will report federal employment taxes on Forms 940 and 941 with respect to employees under § 31.3504-2(b)(2) service agreements on line 18 of the Schedule R (or its equivalent on the revised Schedule R), the IRS will be able to reconcile the total amounts of wages and taxes reported. The ability to do so marginally "better" does not justify a permanent reporting requirement, especially where no added purposes are served.

Due to the lack of utility with respect to collecting information about § 31.3504-2(b)(2) service agreements on the Schedule R and the ability of CPEOs to avoid the requirement altogether through the strategic use of their business structure (or a change to a new structure), we believe that eliminating the requirements as described above is appropriate under and would further the purposes of the PRA. At a minimum, reporting with respect to § 31.3504-2(b)(2) service agreements should be limited to information regarding total federal employment taxes paid under such agreements during periods when that information is relevant (i.e., during the two-year period for determining the initial required bond amount, or when it is relevant to identifying Precursor Entities). Quarterly client-by-client employment tax reporting is a burden that is not supported by the statute.

* * * * *

We appreciate your consideration of our comments and your review of the proposed PEO certification program guidance in light of the express purposes of the PRA. Should you have any questions with respect to the issues discussed herein or any other related matters, please contact me at (202) 347-2230 or Thom Stohler of NAPEO at (703) 739-8167.

Sincerely,

Randolf H. Hardock
Davis & Harman LLP
(on behalf of the National Association of
Professional Employer Organizations)

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