Bill Number:	S. 0311 Amended by Senate Labor, Commerce, and Industry on February 28, 2023
Author:	Gambrell
Subject:	Professional Employer Organizations
Requestor:	Senate Labor, Commerce, and Industry
RFA Analyst(s):	Jolliff and Miller
Impact Date:	March 6, 2023

Fiscal Impact Summary

This bill as amended provides that a qualifying client company that contracts with a professional employer organization (PEO) may be eligible to claim job development credits and job retraining credits for assigned employees provided by a PEO. The bill limits total job development credits for these client companies to $10,000,000 in a calendar year.

This bill will have no expenditure impact on the Department of Revenue (DOR), the S.C. Department of Commerce's (Commerce) Coordinating Council for Economic Development (CCED), or the South Carolina Board for Technical and Comprehensive Education (Tech Board) as the agencies can administer the increase in job development credits and job retraining credits within existing appropriations. Additionally, this bill clarifies that a PEO may not sell insurance or act as a third-party administrator and that sponsoring and maintaining employee benefit plans for assigned employees is not considered selling insurance. This provision will have no impact for the Department of Insurance (DOI) as it does not change current practice.

The bill will decrease General Fund individual income tax revenue by up to $10,000,000 annually beginning in FY 2023-24 for the increase in allowable job development credits. Further, the bill may decrease General Fund individual income tax revenue by an additional $126,000 beginning in FY 2023-24 for the increase in job retraining credits, for a total reduction of up to $10,126,000. The bill states that a claim for a retraining credit pursuant to Section 12-10-95 must be treated the same as a job development credit under Section 12-10-108. However, because the bill limits total job development credits but does not specifically limit job retraining credits, it is not clear that the limit will apply to claims for job retraining credits. Therefore, we have addressed the impact on retraining credits separate from the limit. If the limit is interpreted to apply to both credits, the impact would be reduced.

This bill also creates a $300 administrative fee, which is to be paid by client companies claiming job development tax credits. Proceeds from the fee are to be split equally between DOR and Commerce to cover the administrative costs of administering the provisions of this section. The maximum revenue impact resulting from the $300 fee is approximately $101,000 in FY 2023-24, of which DOR and Commerce would each receive half. Based upon this analysis, Other Funds revenue of DOR and Commerce would increase by up to $50,676 each year beginning in FY

2023-24. The actual revenue impact of this provision is likely to be less, depending upon the number of client companies applying for job development tax credits pursuant to this section.

Explanation of Fiscal Impact

Amended by Senate Labor, Commerce, and Industry on February 28, 2023
State Expenditure
This bill provides that a qualifying client company that contracts with a PEO may be eligible to claim job development credits and job retraining credits for assigned employees provided by a PEO. Job development credits are managed by the CCED under the Department of Commerce. To claim job retraining credits, a taxpayer must negotiate with a technical college with approval from the Tech Board.

Department of Commerce. CCED currently manages certain aspects of job development tax credits under the Enterprise Zone Act as part of its normal operations. While this bill may lead to more companies claiming these credits, Commerce does not expect there will be an expenditure impact as a result of these additional applicants.

Department of Revenue. DOR currently manages certain aspects of job development tax credits under the Enterprise Zone Act as part of its normal operations. The bill may increase workload to administer the credit limit. However, the agency will manage the changes required by the bill within existing appropriations. Therefore, the bill is not expected to impact expenditures for DOR.

Department of Insurance. This bill states that a PEO may not sell insurance or act as a third-party administrator and that sponsoring and maintaining employee benefit plans for assigned employees is not considered selling insurance. This reiteration will have no impact on the normal practices of DOI. Therefore, this bill will not have a fiscal impact on DOI.

State Board for Technical and Comprehensive Education. This bill may increase the number of companies requesting job retraining credits. However, the Tech Board anticipates that the increase will be able to be managed with staff and resources currently managing these credits.

State Revenue
This bill would allow a qualifying client company that contracts with a PEO to be eligible to receive tax credits and other economic incentives provided by this State or another governmental entity as the result of the employment of assigned employees of the client company. A PEO provides various services related to human resources management, such as payroll processing, benefit management, and regulation compliance, for a client company that leases employees. The PEO assigns employees to the client firm, and the PEO becomes the employer of record of the employee for tax and insurance purposes. Currently, a qualifying client company would be eligible for these tax credits and economic incentives only if the company hires an employee directly. The client company, however, is not eligible for these incentives if the employee is hired through a PEO.

This bill provides that a qualifying client company means a person or entity that contracts with a licensee and that is assigned employees under that contract. The term also means a person or entity that employs twenty or fewer employees of this state. Based on these definitions, a client company that contracts with a PEO would potentially be eligible to claim job development credits for assigned employees provided by a PEO under this bill. The client company would receive a job development credit against employee withholding pursuant to Sections 12-10-80 and 12-10-81 and a revitalization agreement. The maximum job development credit a qualifying business may claim for new employees is based on a graduated scale of hourly wage rates for the employee and ranges from two percent to five percent of the withholding tax paid to the State pursuant to Section 12-10-80(B)(1). The credit can be claimed for no more than fifteen years, although CCED generally limits a business to collecting a job development credit for ten years. Furthermore, the credit is limited according to the tiered county system as detailed in Section 12-10-80(D)(1).

As of 2019, the Department of Consumer Affairs reported 117 active PEOs in the state with 3,325 client companies and 44,787 leased employees. These figures grew to 133 active PEOs in the state with 4,973 client companies and 189,737 leased employees as of 2021. Based on these figures, reported client companies grew by 824 per year, and leased employees grew by approximately 72,475 per year from 2019 to 2021. The client company data includes companies that are not domiciled in SC, but have employees that are living in SC working remotely. Data are not available to distinguish domiciled companies.

Job development credits can only be claimed for jobs created in the taxable year in which a qualifying business enters into a preliminary revitalization agreement. Therefore, RFA anticipates that this bill will only have an effect for new employees hired by a qualifying business through a PEO, not employees that currently work at a qualifying business. Further, only client companies that are qualifying businesses such as manufacturing facilities, processing facilities, warehousing facilities, and similar qualifying businesses under Section 12-10-50(A) will qualify for credits. Additionally, the location of the business will also impact the credit amount based on the tiered county system. DOR did express concerns that the bill does not expressly address a situation in which a company that currently employs its employees directly, then transfers them to a leasing company. The bill does not specify that the transfer of the jobs does not create "new jobs." However, the impact would still be limited by the total job development credits allowed.

A business must be engaged in manufacturing, processing, tourism, warehousing, banking, distribution, research and development, agribusiness operations, or agricultural packaging, or must be a qualifying service-related facility, corporate office facility, technology intensive facility, or professional sports team, or an extraordinary retail establishment to qualify for the job tax credit. A retail facility or service-related industry located in a Tier IV county may also qualify for the credit.[1]

[1] SC Department of Revenue, SC Tax Incentive for Economic Development, p 22
https://dor.sc.gov/resources-site/lawandpolicy/Documents/SCTIED-2022-Complete%20Manual.pdf

The table below outlines the percentage of PEO clients by major industry group.[2] Assuming South Carolina follows a similar pattern, we would expect that the clients in the industries noted below are the most likely to qualify for credits. These industries total approximately 41 percent of PEO clients. Multiplying 41 percent times the total 72,475 jobs added annually from 2019 to 2021 results in a maximum of 29,715 jobs in potentially qualifying businesses.

PERCENTAGE OF PEO CLIENTS, BY MAJOR INDUSTRY GROUP

Industry	Percentage of All PEO Clients	Potentially Qualifying Industry
Professional, Scientific, and Technical Services	22	*
Manufacturing	13	*
Construction	12	
Health Care and Social Assistance	11	
Other Services	8	
Real Estate and Rental/Leasing	6	
Retail Trade	6	
Administrative/Support and Waste Management	4	
Wholesale Trade	4	*
Accommodation and Food Services	3	
Arts, Entertainment, and Recreation	3	
Finance and Insurance	3	
Educational Services	2	
Information	2	
Transportation and Warehousing	2	*
Agriculture, Forestry, Fishing, Hunting	Less than 0.5	*
Mining, Quarrying, Oil/Gas	Less than 0.5	
Management of Companies	Less than 0.5	
Utilities	Less than 0.5	

The maximum allowable job development credit that may be claimed is calculated as a percentage of the gross wages of each new employee. Gross wages are defined in Section 12-10-30(4) as wages subject to withholding. However, the Council generally limits the amount of job development credits to no more than $3,250 per employee per year.[3] In 2022, the average hourly wage of the manufacturing sector in South Carolina was $30.99 and weekly hours averaged 40.59 hours. The average hourly wage of the professional services sector in South Carolina was

[2]*Analysis of PEO Clients,* The National Association of Professional Employer Organizations https://www.napeo.org/docs/default-source/white-papers/analysisofpeo_whitepaper-fin.pdf?sfvrsn=eff132d4_4
[3] SC Department of Revenue, SC Tax Incentive for Economic Development, - p 54 https://dor.sc.gov/resources-site/lawandpolicy/Documents/SCTIED-2022-Complete%20Manual.pdf

$31.53 and weekly hours averaged 38.46 hours.[4] Based on the 2023 gross hourly wage figures, these wage levels would qualify to retain 5 percent.

As an example, if the estimated 29,715 new employees work for a qualifying client company located in a Tier IV county, then the total amount of new wages eligible for the credit in FY 2023-24 at an average wage and weekly hour rate equals 29,715 x $31.27 x 39.52 hours x 52 weeks, or $1,909,853,000 in wages. Multiplying $1,909,853,000 times 5 percent equals $95,493,000 in potential credits. Dividing this amount by 29,715 employees, this would total $3,214 per employee. In this instance, credits could total up to $95,493,000. Alternatively, if the companies were all located in a Tier I county, then the total potential credits would be 55 percent of the allowable credits, or $52,521,000. However, it is highly unlikely that all companies will qualify for credits and total job development credits are limited to $10,000,000 by the bill. Based on the limit in the bill, the provision may reduce General Fund individual income tax by up to $10,000,000 annually beginning in FY 2023-24 for job development credits. For reference, current job development credits totaled $74,283,765 in FY 2020-21.

Client companies would also be eligible for the job retraining credit, pursuant to Section 12-10-95. This credit is available to approved existing businesses retraining qualifying existing employees. A qualifying business may claim a job retraining credit equal to $1,000 a year for each qualifying employee retrained for up to a 5-year period. A business may not, however, claim a job retraining credit in excess of $5,000 over a 5-year period for any single employee being retrained and may not claim the job retraining credit and the job development credit on the same employee. Further, the job retraining credit claimed may not exceed the total employee withholding for the qualifying business. The recent history of job retraining credits is detailed in the table below.

Job Retraining Credits - History

Year	Amount
2016-17	$1,623,955
2017-18	$2,021,614
2018-19	$1,651,178
2019-20	$1,426,313
2020-21	$905,244
Average	*$1,525,661*

Source: Department of Revenue Annual Report

The bill states that a claim for a retraining credit pursuant to Section 12-10-95 must be treated the same as a job development credit under Section 12-10-108. However, because the bill limits total job development credits but does not specifically limit job retraining credits, it is not clear that the limit will apply to claims for job retraining credits. Therefore, we have addressed the impact on retraining credits separate from the limit. If the limit is interpreted to apply to both credits, the impact would be reduced.

[4] U.S. Bureau of Labor Statistics, Current Employment Statistics

Based on the 189,737 leased employees as of 2021 noted from Consumer Affairs, if we then multiply this figure by the estimated 41 percent of client companies in qualifying industries, approximately 77,792 employees may be newly eligible for job retraining credits under this bill. This figure is approximately 14.0 percent of total state employment in these industries. Based on these figures, expanding job retraining credits by 14.0 percent from FY 2020-21 would increase credits by approximately $126,000 annually. Based on these estimates, the bill may reduce General Fund individual income tax revenue by $126,000 beginning in FY 2023-24 for additional job retraining credits. In total, the bill may reduce General Fund individual income tax revenue by up to $10,126,000 beginning in FY 2023-24.

This bill also creates a $300 administrative fee, which is to be paid by client companies claiming job development tax credits. Proceeds from the fee are to be split equally between DOR and the Department of Commerce to cover the administrative costs of administering the provisions of this section. Because of the limit on total credits, it is unclear how many companies will be claiming credits and what the total administrative fees will be. If a similar 41 percent of the 824 new client companies per year received credits, there would be approximately 338 companies. In this case, the maximum revenue impact resulting from the $300 fee is approximately $101,000 in FY 2023-24, of which DOR and Commerce would each receive half. Based upon this analysis, Other Funds revenue of DOR and the Department of Commerce would increase by up to $50,676 each year beginning in FY 2023-24. This revenue impact is not incremental since the fee is not required to be paid annually. The actual impact of this provision is likely to vary depending upon the number of client companies applying for job development tax credits pursuant to this section.

Local Expenditure
N/A

Local Revenue
N/A

Frank A. Rainwater, Executive Director