

MARYLAND COMMISSION TO STUDY THE REGULATION OF
PAYROLL SERVICES
David F. Roose, Chairman

January 15, 2014

Senator Thomas M. Middleton
Senate Finance Committee
3 East
Miller Senate Building
Annapolis, Maryland 21401

Delegate Dereck E. Davis
House Economic Matters Committee
Room 231
House Office Building
Annapolis, Maryland 21401

Dear Senator Middleton and Delegate Davis:

The Maryland Commission to Study the Regulation of Payroll Services has completed its work and is forwarding to you its findings. Created by Chapter 344 of the Acts of 2013, the Maryland Commission's charge was to

[M]ake recommendations for regulating payroll service companies in the State, including: (i) the best practices for preventing fraud by payroll service companies in the collection and payment of taxes; and (ii) the feasibility and cost of establishing State licensure or registration of payroll service companies, including requiring qualifying examinations and the potential benefits of licensure or registration.

After thoughtful consideration, we present to you the following three recommendations:

- That the Comptroller implement an electronic verification system that will allow employers to use an online tool to verify that their taxes have been paid;
- That the Comptroller send notices confirming a change of employer's address to both the old and new addresses; and
- That the Comptroller, Department Labor, Licensing and Regulation, and Department of Assessments and Taxation, along with the payroll service industry, work to increase employer awareness of the risks associated with using a third-party payroll service provider.

Letter to Honorable Thomas M. Middleton and
Dereck E. Davis
January 15, 2014

Without additional resources, the Comptroller's Office will be unable to implement the first two recommendations in a timely fashion. Even with additional resources, sending notices to an employer's old and new address may be extremely difficult to implement in the Comptroller's legacy tax system.

Attached is the report of the Commission, which is supplemented by the Commission's website, www.csrps.maryland.gov. All presentations, testimony, meeting minutes, and other relevant material is available on the website.

I would also like to take the opportunity to thank the members of the Commission who spent many long hours in meetings reviewing the issues. In addition, the Commission members would like to thank the staff of the Comptroller's Office who worked hard to provide quality information.

We hope that you find our work helpful and would be pleased to make ourselves available if you should have any questions.

Sincerely,



David F. Roose
Chairman

cc: Honorable Thomas V. "Mike" Miller
Honorable Michael E. Busch



**Report
Of
The
Maryland
Commission to Study the Regulation
of Payroll Services**

David F. Roose, Chairman
January 15, 2014

Table of Contents

Introduction.....	1
Background.....	1
Payroll Service Regulation in Other States.....	2
Proposals Endorsed by the Commission.....	3
Implement an electronic verification system for employers.....	3
Send notices confirming change of address to employers.....	3
Increase employer awareness.....	4
Proposals Discussed But Not Endorsed.....	4
Bonding.....	4
Licensing or Registration.....	4
Quarterly Reconciliation.....	5
Conclusion.....	5
Appendix 1: Commission Members to Study the Regulation of Payroll Services.....	6
Appendix 2: Link to written testimony presented at September 19 and October 24, 2013 meetings.....	7

Introduction

The Maryland Commission to Study the Regulation of Payroll Services (“Commission”) was created by Chapter 344, Commission to Study the Regulation of Payroll Services, during the 2013 Session of the General Assembly. The 9-member Commission includes legislators, State officials, and representatives of the business community, local governments, and the public (**Appendix 1**). The Commission’s charge was to

[M]ake recommendations for regulating payroll service companies in the State, including: (i) the best practices for preventing fraud by payroll service companies in the collection and payment of taxes; and (ii) the feasibility and cost of establishing State licensure or registration of payroll service companies, including requiring qualifying examinations and the potential benefits of licensure or registration.

The Commission was explicitly directed to study:

- (i) the function, size, and structure of the payroll services industry operating in the State;
- (ii) the role of the payroll services industry in the tax payment system at the State and federal levels; and
- (iii) the nature, oversight, and regulation of payroll service companies in other jurisdictions, including any licensing, permitting, and bonding requirements.

The Commission first met on September 19, 2013 and had one additional meeting on October 24, 2013. Detailed information, including presentations, expert testimony, meeting minutes, public testimony and other relevant material is available on the Maryland Commission to Study the Regulation of Payroll Services website, www.csrps.maryland.gov.

This document serves as the Commission’s final report of its findings and recommendations, statutorily required to be delivered on or before December 15, 2013 to the Senate Finance Committee and the House Economic Matters Committee in accordance with § 12-1246 of the State Government Article.

Background

The Commission was formed to identify methods to prevent fraud or theft committed by payroll service companies against their clients. One example of an allegedly fraudulent payroll service company occurred in early 2013 in Harford County, Maryland. Senate Bill 1068 was passed shortly thereafter during the 2013 Session of the General Assembly.

Accu-Pay, Inc. (“Accu-Pay”) was a payroll service provider in Bel Air, Maryland. The Baltimore Sun reported that Accu-Pay was sued by two of its clients who claimed significant losses, and alleged that Accu-Pay failed to make their tax payments. The Bel Air Police Department investigated this incident. After its investigation, the Bel Air Police Department turned the case over to the Internal Revenue Service. No criminal charges have been filed yet.

On May 5, Senator Barbara Mikulski introduced the Small Business Payroll Protection Act of 2013, which would (1) establish registration and bonding requirements for payroll tax deposit agents, (2) mandate certain disclosure statements by payroll tax deposit agents to their clients, and (3) require the Internal Revenue Service to mail notices confirming change of address to a taxpayer’s old and new addresses (S. 900, 113th Cong. (2013)). The bill was referred to the Senate Committee on Finance, which has taken no action. The Comptroller of Maryland has worked with taxpayers to waive interest and penalties for taxpayers who claim to have been victims of Accu-Pay’s allegedly fraudulent activity, and Senator Mikulski urged the Internal Revenue Service to do the same.

Proceedings

On September 19, 2013 the Commission met for the first time. The charge of the Commission was reviewed and staff presented initial research regarding steps the federal government and other states have undertaken to regulate payroll service companies.

A second and final meeting was held on October 24, 2013. During this meeting, committee members, industry representatives, and the public presented testimony about their proposed regulations or policies that would reduce theft by payroll service companies. A link to all written testimony presented at this meeting is included in **Appendix 2**.

Payroll Service Regulation in Other States

Only nine states currently have a statute, regulation, or administrative policy relating to the regulation of payroll service companies. A Maine statute requires that payroll service companies be licensed and bonded in order to operate in the state. No other state requires licensing, permitting, or bonding.

Alabama, Arizona, and Minnesota require that payroll service companies register with each state’s Department of Revenue. Connecticut allows for optional registration. Georgia requires that all third-party payroll service companies that prepare or remit returns on behalf of 250 or more employers must file electronically and pay via electronic funds transfer (EFT). West Virginia has a special EFT form for payroll service companies. Illinois has an optional program that allows payroll service companies to electronically file and pay employment taxes, withholding, and unemployment insurance. A Rhode Island statute imposes joint and several liability on payroll service companies

for the amount withheld but not paid over to the state. Details of these findings are provided in **Appendix 3**.

Proposals Endorsed by the Commission

Implement an electronic verification system for employers

The Internal Revenue Service (“IRS”) recently implemented its Electronic Federal Tax Payment System (“EFTPS”), which permits businesses to verify tax payments made to the IRS by accessing their IRS account online. This allows an employer to verify that the amount its payroll service took from its bank account matches the amount remitted to the IRS on its behalf. New IRS regulations require payroll service providers to notify each client at least once per quarter that as employers, they are liable for taxes even if they use a payroll service company and that the IRS EFTPS exists to allow employers to verify their tax payments. The Commission proposes implementing a similar online verification system in Maryland.

The Comptroller’s computer system currently is not able to permit businesses to verify tax payments made to the Comptroller by accessing their Comptroller account online. Accordingly, this proposal will require additional information technology (“IT”) resources to implement.

Send notices confirming change of address to employers

If an employer does not pay the full amount of withholding tax that is due, the Comptroller mails a notice of delinquency directly to the address it has on file for the employer. However, one problem that has contributed to the perpetuation of theft by payroll service companies occurs because the payroll service company will change the address on file so the employer does not receive notices of delinquency. The Commission recommends mailing a change of address confirmation letter to both the old and new addresses of the employer. In the event of a malicious address change by a third party, this is will allow an employer to correct the address change and question its payroll service company.

The Comptroller’s computer system currently is not able to mail the same notice to two different addresses. This proposal will require additional, perhaps substantial, IT resources to implement.

Increase employer awareness

The Commission recommends that the Comptroller's Office, the Department of Labor, Licensing and Regulation, and the State Department of Assessments and Taxation increase publicity to make employers aware of both the risks of using a third party to administer tax payments and the means to verify tax payments made on its behalf. This information should be included in newsletters, publications, and on the agencies' websites. The Commission also recommends that payroll service companies be required to educate employers. The following standard disclosure is now required by the IRS:

“The employer is ultimately responsible for the deposit and payment of federal and state tax liabilities, even if a third party is making the deposits. The IRS recommends that employers enroll in and use EFTPS (Electronic Federal Tax Payment System) to confirm payments made on their behalf. Enroll online at www.eftps.gov or call 800-555-4477 for an enrollment form.

State tax authorities generally offer similar means to verify tax deposits. Contact the applicable state offices directly for details.”

This proposal can be implemented by the agencies with existing resources, through regular means of communications to employers.

Proposals Discussed But Not Endorsed

Bonding

The Commission does not support a bonding requirement at this time. A surety bond provides compensation up to a certain capped amount if the principal fails to act as promised. This would provide limited payment if a payroll service company steals from its clients. There is concern among industry representatives and some Commission members that bonding would be prohibitively expensive and would drive small payroll service companies out of business and create a barrier to entry for new payroll service companies.

Licensing or Registration

The Commission does not support a licensing or registration requirement at this time. Industry representatives raised concerns that employers will believe that state-licensed payroll service companies are trustworthy, and therefore employers will be less vigilant in monitoring payroll service companies. Moreover, based on our review of

other states' activities, it does not appear that licensing is the most effective way to regulate the industry.

Quarterly Reconciliation

The Internal Revenue Service requires employers to reconcile their withholding accounts each quarter on a Form 941. Currently, employers in Maryland are required to reconcile their withholding liability and withholding amounts paid once a year on the Form MW508. If Maryland were to require quarterly reconciliation, the Comptroller's Office could verify that employer withholding of income tax was calculated and paid correctly more frequently throughout the year, and notify employers of any liability due before the end of the year. Earlier notice of a liability would permit employers to identify and resolve any issues with the payroll service company quickly. Quarterly reconciliation would, however, substantially increase the administrative burden on both employers and the Comptroller's Office.

Conclusion

The Commission recommends that the Comptroller's Office implement an online verification tool to allow employers to view the amount of withholding tax that has been remitted to the Comptroller on the employer's behalf. The Commission also recommends that the Comptroller take steps to prevent or mitigate theft by payroll service companies, including increasing awareness among employers and providing notice to employers of address changes. The Commission does not support bonding, licensing or registration requirements, or quarterly withholding reconciliation. These steps will provide employers the tools they need to protect their interests and raise awareness of the need to do so.

Appendix 1: Commission Members to Study the Regulation of Payroll Services

Appointed by Senate President

Senator Barry Glassman

Appointed by House Speaker

Delegate Mary-Dulany James

Designated by Comptroller

David F. Roose

Designated by Director of State Department of Assessment and Taxation

Robert E. Young

Designated by Attorney General

Brian L. Oliner

Maryland Chamber of Commerce

George Whitehouse

Designated by Secretary of Labor, Licensing and Regulation

Juan M. Sempertegui

Appointed by the Governor **Public Member**

Margaret Shattuck, EA

Appointed by the Governor **Public Member**

Kathleen Strakes

Staff

Wallace A. Eddleman
Comptroller's Office

**Appendix 2: Link to written testimony presented at
September 19 and October 24, 2013 meetings**

<http://www.csrps.maryland.gov/meetings/default.asp>

State	State Agency	Statute citation	Regulation citation	Licensing	Requires:			Other	Source	Notes
					Permitting	Bonding				
Alabama	Alabama Department of Revenue		Reg. 810-3-74-.01(7) and Reg. 810-1-6-.13	No	No	No	Registration required w/AL Dept of Rev	http://revenue.alabama.gov/withholding/bulkfl.cfm		
Alaska	Not regulated									
Arizona	State of Arizona Department of Revenue	Arizona Rev. Statutes, Title 43, Chapter 4, Article 2, Sec. 43-419		No	No	No	Registration required w/AZ Dept of Rev	http://www.azdor.gov/EServices/PayrollServiceProviders.aspx		
Arkansas	Not regulated									
California	Not regulated									
Colorado	Not regulated									
Connecticut	Not regulated							http://www.ct.gov/drs/cwp/view.asp?a=1433&Q=401986&PM=1	Optional registration w/CT Dept of Rev as Third Party Bulk Filer	
Delaware	Not regulated									
District of Columbia	Not regulated									
Florida	Not regulated									
Georgia	Georgia Department of Revenue	Georgia Code, Title 48, Chapter 2, Article 2, 48-2-32(f)(4)		No	No	No	Every third-party payroll provider who prepares or remits, or both, Georgia withholding tax for more than 250 employers must pay the taxes by electronic funds transfer.	https://etax.dor.ga.gov/efit/index.aspx#require		
Hawaii	Not regulated									
Idaho	Not regulated									
Illinois	Not regulated							http://tax.illinois.gov/TaxProfessionals/ElectronicFiling/fset.htm	Optional FSET program for payroll companies to electronically file and pay Illinois employment taxes, and returns and payments for state withholding and unemployment insurance.	
Indiana	Not regulated									
Iowa	Not regulated									
Kansas	Not regulated									
Kentucky	Not regulated									
Louisiana	Not regulated									
Maine	Dept of Professional & Financial Regulation	Title 10 Maine Revised Statutes Annotated, Chapter 222, Section 1495		Yes	No	Yes		http://www.maine.gov/pfr/financialinstitutions/payroll/statute.htm		
Maryland	Not regulated									
Massachusetts	Not regulated									
Michigan	Not regulated									
Minnesota	Minn Dept of Revenue	Minn. Stat. § 290.92 Subd. 30 (2012)		No	No	No	Registration required w/ Minn Dept of Rev	http://www.revenue.state.mn.us/tax_prof/Documents/wfs5.pdf		
Mississippi	Not regulated									
Missouri	Not regulated									
Montana	Not regulated									
Nebraska	Not regulated									
Nevada	Not regulated - no tax levied on individual, business or corp tax									
New Hampshire	Not regulated									
New Jersey	Not regulated									
New Mexico	Not regulated									
New York	Not regulated									
North Carolina	Not regulated									
North Dakota	Not regulated									
Ohio	Not regulated									
Oklahoma	Not regulated									
Oregon	Not regulated									
Pennsylvania	Department of Revenue (income tax) and Department of Labor and Training (unemployment)	General Laws of RI, 44-30-71.4(3)(b)		No	No	No	Joint & several liability	http://webserver.rilin.state.ri.us/Statutes/TITLE44/44-30/44-30-71.4.HTM	Payroll company is jointly and severably liable for the amount withheld and not paid to the state for income tax or unemployment tax.	
Rhode Island	Not regulated									
South Carolina	Not regulated									
South Dakota	Not regulated									
Tennessee	Not regulated									
Texas	Not regulated									
Utah	Not regulated									
Vermont	Not regulated									
Virginia	Not regulated									
Washington	Not regulated									
West Virginia	State Tax Department							http://www.state.wv.us/taxrev/publications/efit6.pdf	No regulation, but special EFT form for payroll service companies.	
Wisconsin	Not regulated									
Wyoming	Not regulated									