

**HB 848**

**HD 2**

NEIL ABERCROMBIE  
GOVERNOR

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## SENATE COMMITTEE ON WAYS AND MEANS

### TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB 848 HD 2 RELATING TO GENERAL EXCISE TAX

**TESTIFIER:** **FREDERICK D. PABLO**, DIRECTOR OF TAXATION (OR  
DESIGNEE)  
**COMMITTEE:** WAM  
**DATE:** MARCH 17, 2011  
**TIME:** 9:00AM  
**POSITION:** **OPPOSED**

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This measure's stated intent is to expand the common paymaster exemption; however, it also appears to expand the related entities exemption.

The Department of Taxation (Department) is **opposed**.

It is the Department's understanding that the bill's intent is to expand the related entities exemption under HRS § 237-23.5 in two ways: (1) by diluting the requirements in order for two entities to be deemed "related," and (2) by expanding the types of services which qualify for the exemption.

The Department is opposed to expanding the related entities exemption in either of these two ways. However, if it is the committee's intent to move the bill forward, the Department recommends the bill be entirely re-written, using workable language which explains exactly to what extent the committee would like the common ownership requirements diluted and to what extent it wants the definition of "services" expanded. The Department also questions the need to expand the very narrow provisions of the federal common paymaster definition.



**Testimony to the Senate Committee on Ways and Means  
Thursday, March 17, 2011  
9:00 a.m.  
Conference Room 211, State Capitol**

**RE: HOUSE BILL NO. 848 HD2 RELATING TO THE GENERAL EXCISE  
TAX**

Chair Ige, Vice Chair Kidani, and Members of the Committee:

The Chamber of Commerce of Hawaii ("Chamber") supports HB 848 HD2, which expands the applicability of the common paymaster exemption from the General Excise Tax ("GET").

The Chamber is the largest business organization in Hawaii, representing more than 1,100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

Many businesses consist of a group of entities under common ownership. Employees of the business often do work for more than one of the entities, but for sake of convenience, one of the entities is designated as "paymaster" to handle payroll. The paymaster pays the employee salaries on behalf of all of the entities, and receives reimbursement from the other entities for their allocable shares.

Under current law, the paymaster entity is usually subject to GET on the reimbursements it receives from the related entities, even though it realizes no real benefit from those amounts, but simply passes them on to the employees. This creates an unsolvable dilemma for Hawaii businesses -- they must either bear the administrative cost of having multiple entities handle payroll, or bear the increased cost of GET on the intercompany reimbursements. There is no justification for this tax result. It just creates inefficiency for Hawaii businesses and discourages job creation.

HB 848 HD2 would make the common paymaster exemption less restrictive, and make it more applicable to the general business community in Hawaii. Because HB 848 would remove an inefficiency in current tax law, we support this measure.

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SUBJECT: GENERAL EXCISE, Expand common paymaster exemption

BILL NUMBER: HB 848, HD-2

INTRODUCED BY: House Committee on Finance

**BRIEF SUMMARY:** Amends HRS section 237-23.5 to provide that the general excise tax shall not apply to amounts received by a common paymaster that are disbursed as remuneration to employees of two or more related persons where the common paymaster is making such remunerations on behalf of the related persons. Such amounts received or disbursed by the common paymaster shall include payments of payroll taxes and employee benefits that the common paymaster is making on behalf of the related persons and are payments which the for the employees are being remunerated.

Requires each related person using a common paymaster or multiple common paymaster to keep separate payroll records and other documentation required to prove the existence of concurrent employment. The records and documents shall be available for inspection by the director of taxation during normal business hours.

Defines "common paymaster" and "related persons" for purposes of the new subsection. The latter definition would include those persons who qualify as related persons under Code section 267.

EFFECTIVE DATE: July 1, 2112

**STAFF COMMENTS:** Currently the common paymaster general excise tax exemption is applicable to: (1) an affiliated group of corporations within the meaning of section 1504 (with respect to affiliated group defined) of the federal Internal Revenue Code of 1986, as amended; (2) a controlled group of corporations within the meaning of section 1563 (with respect to definitions and special rules) of the federal Internal Revenue Code of 1986, as amended; (3) those entities connected through ownership of at least **eighty** percent of the total value and at least **eighty** percent of the total voting power of each such entity (or combination thereof), including partnerships, associations, trusts, S corporations, nonprofit corporations, limited liability partnerships, or limited liability companies; and (4) any group or combination of the entities described in paragraph (3) constituting a unitary business for income tax purposes.

The proposed measure expands the common paymaster provisions to include IRC section 267 entities. While section 267 entities are entities connected through ownership of at least **fifty** rather than **eighty** percent of the total value and at least **fifty** rather than **eighty** percent of the total voting power of each such entity (or combination thereof), if this measure is adopted and expands the common paymaster general excise tax exemption, such transactions should be examined to ensure that only those common paymaster transactions are exempt. Further, as drafted, the changes being proposed in this bill may have unintended consequences for those companies that meet the eighty percent test insofar as the application of Code sections 1504 and 1563. Instead of tagging the Section 267 entities onto the common

paymaster provisions, consideration might be given to adding a new paragraph to HRS section 237-24.7 where the reimbursement of payroll and employee benefits by a related company is addressed. It should be noted that when the common paymaster provisions were established by Sections 1504 and 1563 in 1988, the eighty percent ownership was a critical test as to the applicability of the exemption. To now dilute that test raises questions about the appropriateness of the exemption. In short, the drafting of this version of the bill reflects a lack of understanding of the strict bright line in determining who shall be entitled to the common paymaster exemption and fails to justify extending the exemption without a clear rationale for this preference for all other taxpayers.

By appending the new subsection which would use Code Section 267, the amendment adds confusion to the exemption for common paymasters under Code sections 1504 and 1563. Again, if it is the intent and policy to exempt common paymaster activities for related companies that do not meet the strict Code 1504 standards, then the proposed exemption should be set off in a section of its own, a section like HRS 237-24.7.

If, in fact, this is a simple reimbursement of costs for payroll and employee benefits without any additional consideration, then the transaction is already exempt under HRS Sec. 237-20, provided there is no additional fee or remuneration for the disbursing paymaster for providing that service. Therefore, it appears that these particular related companies are indeed compensating the paymaster for this service and, therefore, are seeking this special treatment.

Digested 3/15/11