

**STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS**

830 PUNCHBOWL STREET, ROOM 321
HONOLULU, HAWAII 96813

<http://labor.hawaii.gov>

February 12, 2013

To: The Honorable Angus L.K. McKelvey, Chair,
The Honorable Derek S.K. Kawakami, Vice Chair, and
Members of the House Committee on Consumer Protection & Commerce

Date: February 13, 2013
Time: 2:30 p.m.
Place: Conference Room 325, State Capitol

From: Dwight Y. Takamine, Director
Department of Labor and Industrial Relations (DLIR)

Re: H.B. 144 H.D. 1 Relating to Professional Employer Organizations

I. OVERVIEW OF PROPOSED LEGISLATION

The intent of H.B. 144 H.D. 1 is to rectify the conflict between existing statutory requirements relating to professional employer organizations (PEO) by: 1) repealing Chapter 373K, HRS; and 2) amending Chapter 373L, HRS, and Section 237-24.75, HRS, to clarify PEO responsibilities for purposes of qualifying for the state general excise tax exemption. This measure seeks to balance PEO business interests with state regulatory oversight by establishing a resolute and balanced registration process to qualify for tax incentives while protecting employees' rights and benefits.

The Department strongly supports this measure, which retains the essential elements and objectives of current PEO laws but facilitates compliance by identifying and overcoming those barriers that have frustrated efforts to fully implement those laws. This proposal includes the recommendations of the various stakeholders, following internal deliberations and discussions since the veto of SB2424 in 2012.

II. CURRENT LAW

Chapter 373K was enacted in 2007 to allow PEOs to become eligible for the tax exclusion under section 237-24.75, whereas Chapter 373L was adopted in 2010 to regulate the PEO business by enforcing registration and bonding requirements. Effective implementation of both laws has been hampered by incompatible language, ill-defined goals and a lack of a common appreciation of the benefits intended or results to be realized.

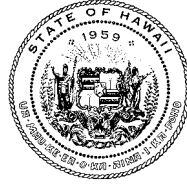
III. COMMENTS ON THE HOUSE BILL

H.B. 144 H.D. 1 is a collaborative effort between the Department of Taxation, Department of Labor and PEOs to enhance implementation by clarifying inconsistencies between two separate but interrelated chapters in the HRS and limiting regulatory controls to only those critical to maintaining the integrity of the PEO industry and the statutorily mandated benefits and protections of Hawaii's labor laws.

DLIR believes that the stakeholders with interest in current PEO legislation are mostly in agreement with the needed changes to reconcile the two PEO chapters. All parties are in accord with the concept that the monitoring functions required by Chapter 373L would be best enforced by tying compliance to the general excise tax exemption, that the registration requirements for PEOs should be less burdensome and that essential information should be included in the notification to DLIR and to covered employees in PEO agreements.

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1530
FAX NO: (808) 587-1584

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

To: The Honorable Angus L.K. McKelvey, Chair
and Members of the House Committee on Consumer Protection & Commerce

Date: Wednesday, February 13, 2013
Time: 2:30 a.m.
Place: Conference Room 325, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. 144 H.D.1 Relating to Professional Employer Organizations

The Department of Taxation (Department) supports the tax-related amendments proposed in H.B.1441 HD1. The Department defers to the Department of Labor and Industrial Relations (DLIR) on the merits of this measure and provides the following information and comments for your consideration.

H.B. 144 H.D. 1 amends the general excise tax exemption for professional employer organizations at section 237-24.75, Hawaii Revised Statutes (HRS), to provide that the exemption is not applicable upon the occurrence of certain specified events. The measure is effective upon approval.

With respect to the general excise tax exemption, the Department supports the suggested changes, as it will clarify the timing and circumstances under which the general excise tax exemption will be denied to a professional employer organization.

Thank you for the opportunity to provide comments.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Professional employer organizations

BILL NUMBER: HB 144, HD-1

INTRODUCED BY: House Committee on Labor & Public Employment

BRIEF SUMMARY: Amends HRS section 237-24.75 to replace the term “professional employment organization” with “professional employer organization.” Clarifies that the general excise tax exemption shall not apply to a professional employer organization if: (1) the professional employer organization fails to properly register with the department of labor and industrial relations; or (2) the professional employer organization fails to pay any tax withholding for covered employees or any federal or state taxes for which the professional employer organization is responsible.

Makes other nontax amendments to simplify the regulation of the professional employer organization law and clarify the application of existing laws.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: In 2007 the legislature, by Act 225, established HRS chapter 373K to provide that amounts received by a professional employment organization from a client company in the course of providing professional employment services that are disbursed as employee wages, salaries, payroll taxes, insurance premiums, and benefits are exempt from the general excise tax. Act 129, SLH 2010, established registration requirements for the professional employment organizations and established a new HRS chapter 373L. However, this measure repeals HRS chapter 373L and strengthens the provisions of HRS 373K and also clarifies the general excise tax exemption for professional employment organizations.

Digested 2/12/13

February 12, 2013

TO: The Honorable Angus L.K McKelvey, Chair
The Honorable Derek S. K. Kawakami, Vice Chair
Members of the House Committee on Consumer Protection &
Commerce

Date: Wednesday, February 13, 2013
Time: 2:30pm
Place: State Capitol, Conference Room 325

**Re: House Bill 144 HD1 Relating to Professional Employer Organizations
("PEO")**

Dear Chair McKelvey and Vice-Chair Kawakami,

Our names are Matthew S. Delaney, Co-Founder, CEO and President and Scott Meichtry, Co-Founder and Executive Vice-President of Hawaii Human Resources, Inc. ("HiHR"), a locally owned and operated Professional Employer Organization ("PEO"). On behalf of HiHR, we would like to thank you for this opportunity to share with you and the committee our comments as they relate to HB 144 HD1. While HiHR supports the intent of these measures, as noted below, HiHR requests the Committee's consideration of certain amendments to insure fairness in the bonding requirement and clarity in the definitional section. HiHR looks forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry.

HiHR is one of the 3 largest PEOs in the State of Hawaii. We currently service 375 different businesses and approximately over 7,000 client worksite employees on all of the major Hawaiian Islands. We formed this company in January 2009 to provide an alternative option for small and medium-sized businesses of Hawaii to outsource their human resource needs and focus on their core businesses. Prior to HiHR entering the market, the market was controlled by two large companies.

We support the concept of registration and reasonable regulation of PEOs. In fact, we founded our company based on the principles of full disclosure and transparency, which are differentiating points.

Overview of Existing Laws (373L, 373K and Act 129)

The State has currently struggled with implementing the existing conflicting laws (373L and 373K) in a meaningful way, especially as Act 129 (2010)



required regulatory functions and expertise outside of the scope of the DLIR’s existing scope of regulation.

HB 144 HD1 Summary

HB144HD1 would repeal Chapter 373L, Hawai‘i Revised Statutes (“HRS”), in its entirety and make certain targeted amendments to other provisions of the PEO law, HRS Chapter 373K, to simplify and improve the implementation of the law, and to clarify and amend the statutory responsibilities between a client company and the PEO. In addition, the bill would simplify the regulation of PEOs by empowering the Director of the Department of Labor and Industrial Relations to notify the Department of Taxation when the GET tax exemption under HRS Section 237-24.75 is being denied for a PEO that violates Chapter 373K, HRS.

Requests for Amendments to HB 144 HD1:

We support the intent of HB 144 HD1 but ask the Committee to consider two amendments:

1) Scalable Bonding Requirements

There are only four (4) states in the entire United States that require mandatory bonds: Hawai‘i, North Dakota, New Mexico and South Carolina. The other twenty (20) states only require a bond (\$100,000 maximum) if the PEO does not meet a minimum net worth or working capital requirements (on average the net worth or working capital requirement is \$50,000 to \$100,000). Hawai‘i currently has a mandatory bond of \$250,000, which is the highest in the entire country of any state requiring a mandatory bond or a voluntary bond when a PEO does not meet minimum net worth requirements. North Dakota, New Mexico and South Carolina all have mandatory bonding requirements of \$100,000 and none of these states requires audited or reviewed financial statements, because a mandatory bond is in place.

In the spirit of compromise we support a scalable bond per the following schedule:

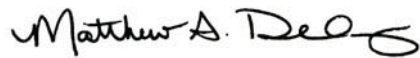
<u>Annual PEO Payroll ¹</u>	<u>Bond Amount</u>
\$150,000,001 or higher	\$250,000.00
\$25,000,001 to \$150,000,000	\$ 50,000.00
\$0 to \$25,000,000	\$ 10,000.00

¹ Source: IRS Form 941

2) We support amendments to the “definition” section (please refer to HAPEO’s testimony for this hearing for specific definitional amendments).

Mahalo for your time and consideration. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,



Matthew S. Delaney
CEO/President



Scott Meichtry
Executive Vice-President





February 11, 2013

The Honorable Angus L.K. McKelvey, Chair
The Honorable Derek S.K. Kawakami, Vice Chair
Committee on Consumer Protection and Commerce
State Capitol
Honolulu, Hawaii 96813

Subject: House Bill 144, February 13, 2013, 2:30 p.m.
Strong Opposition

Dear Rep. McKelvey and Rep. Kawakami:

My name is Barron Guss, President and second-generation owner of ALTRES, Inc., a 43-year old Hawaii company and Hawaii's oldest Professional Employer Organization (PEO). I am writing you today in strong opposition to HB 144.

The authors of HB 144 would like you to believe that the current law (Act 129) regulating PEO activities in the State is over-burdensome and not needed. They claim that there are more than ample controls in place to ensure consumer protection via current law and regulation, as well as oversight by DLIR and insurance carriers, which is simply not true. On a federal level, there are no statutes in place that regulate the PEO third party employer relationship. Hence, that is why 39 other states, in addition to Hawaii, have passed registration, bonding and audit requirements similar to Act 129.

Laws and regulations regarding licensing and consumer protection are created to protect the public and provide a reasonable expectation that the person or entity that holds themselves out to be professional is qualified to do so. Whether it is a physician, CPA, hair stylist, financial institution or PEO, not everyone will qualify. Act 129 is doing what it was designed to do -- create a *threshold of entry* into the industry and not an "*anti-competitive*" barrier, as suggested by those seeking its repeal.

The PEO industry in Hawaii touches more than 25,000 Hawaii employees for the purposes of payroll, health benefits and taxes, and controls more than \$1 billion in associated monies. For this legislature to repeal the modest oversight of the current law which has barely had time to take effect would be irresponsible. This would be similar to introducing legislation to remove banking regulation and the FDIC.

The proponents of HB 144 further justify this legislation because they claim the payroll industry moves similar amounts of money yet goes unregulated. Again, this is simply not true. In the client payroll service bureau relationship there is federal oversight via the Reporting Agent authority by which a client company turns over payroll, taxes and associated monies to be remitted by the Reporting Agent. Once the client turns over the monies to the Reporting Agent in good faith, the IRS holds the Reporting Agent responsible in the event of default.

On the other hand, the PEO relationship has no such federal regulation and relies on the State governments to provide the much-needed consumer protection and clarification in this area. The PEO industry falls through the cracks because we are not a payroll agent, nor are we an insurance company or a bank that has their own regulatory bodies.

In addition to some housekeeping items including grammatical changes and clarifications, the balance of HB 144 addresses the complex subject of successor employers for UI purposes. I would urge the committee to refrain from making any decisions about this area of the law, as unemployment insurance, rate promulgation and its funding have far-reaching effects and deserve a separate bill and discussion.

For the purpose of providing an in-depth understanding, I have provided some additional information below.

Background

The PEO industry originated on the mainland in the 1970s and found its way to the islands via my firm, ALTRES, in 1980.

PEOs are businesses that partner with existing small businesses (employers) to enable them to cost-effectively outsource the management of human resources, payroll, employee benefits and workers' compensation so that PEO clients can focus on their core competencies to maintain and grow their businesses.

An added benefit is that by forming an employment relationship with these small businesses and their employees, PEOs are able to offer enhanced access to employee benefits while saving money for both the business and the employees.

Legislative Background

Upon the industry's inception, Hawaii's employment and general excise tax laws did not match the operational needs of the industry. One example is that under the G.E.T., our clients' payroll monies, taxes and insurances, when passed through the PEO, were subject to 4% general excise tax, while our service fee was only 3%. In other words, the tax outstripped any fee income we were to earn on the transaction. The only way to remedy this was through legislation. For 16 years, I and others worked tirelessly with the legislature, various administrations, along with their tax directors and attorney generals, to finally get appropriate relief through the implementation of Act 225 in the 2007 legislative session.

PEO Failures

Throughout the history of the PEO industry, there have been multiple failures on a national level. Some states, like Florida, are very dense with PEOs, where at one time approximately 80% of the population in Bradenton County was employed through a PEO. This was because PEOs were able to bring financial relief to businesses in crisis in the areas of high workers' compensation premiums and unattainable health insurance. Many of those fledgling PEOs got

in over their heads and could not deliver on their promises and, in some cases, mismanaged the affairs and monies of their client companies. Some of these failures were actual fraud and some were simply the result of naiveté regarding the complexities of running a PEO. It was not uncommon to hear of PEOs losing multiple tens of millions of dollars, closing their doors in the middle of the night and leaving town with trails of unpaid taxes and insurance premiums in their wake.

Hawaii had one such close call about four years ago when a mainland PEO commenced business here through an unscrupulous local agent who committed fraud and stole \$2 million of tax and insurance money that was to be paid to the federal and Hawaii state government. It was fortunate that the mainland PEO understood the local ramifications of the situation and quickly made restitution.

From the above illustration, you can see the need for regulation in this industry.

In the ensuing years, various issues arose, including some consumer protection questions that were handed down from national bodies such as NCOIL (National Council of Insurance Legislators) and others. It was agreed by members of the legislature (with concerns), DLIR, DOT, DOI, DCCA and others that the industry should pursue registration with consumer protection components similar to what has been implemented in 39 other states.

In 2010, the legislature enacted Act 129, the PEO Registration Act, which provides for registration and bonding requirements, under the supervision of the Department of Labor, to be implemented on July 1, 2011.

Current Status

Today DLIR estimates that there are approximately 40 PEOs operating in the state. Of this number, more than half are mainland based. Of the locally based PEOs, only six are registered with the Department of Labor, with the balance failing to file, either under protest of the law or claiming that the bond and audit requirements are too costly.

Specifically, the contested components of the current law are the bond amount and the audit requirement. Let me address these items below:

Bond

The initial introduction of the PEO Registration Act required a \$1 million bond, and through deliberation, testimony, collaboration and compromise, the current \$250,000 level was decided upon because of a mutual concern that the \$1 million bond would create a barrier to entry into the market for small and start up PEOs.

It is important to note that a \$250,000 bond does not cost \$250,000. Traditionally, a bond requirement would be met by applying to a surety carrier and paying a nominal percentage of the face value of the bond. For example, ALTRES pays \$1,700 per year to meet the \$250,000 requirement of the law.

The idea of posting a bond is not so much about the amount of the bond as it is the process and due diligence of the surety who posts the bond on behalf of the business. The surety process is a very thorough and complex one in which the underwriters will review every financial aspect of the business as well as background information of the principles and the overall condition of the organization. As you can imagine, this is a very arduous undertaking not only for the surety underwriter, but the PEO registrant as well.

Nationally, the trend is for \$50,000 to \$100,000 bonds as well as net worth requirements. I believe this number is simply too low because it is very easy for the average business operator to arrange assets in a way to post this moderate amount and forego the scrutiny of the bond process. With the number at a more business-like amount of \$250,000, a PEO operator will look to the financially viable process of purchasing a bond from a surety with a moderate cash outlay as compared to tying up \$250,000 in cash. This path of bond posting provides an additional level of consumer protection.

Audit requirements

The current law requires PEOs to maintain audited financial statements under GAAP, which is not uncustomary for any organization that is in the financial sector, which PEOs are. Opponents have said that this is burdensome for a number of reasons.

There has been testimony that audited financial statements are too costly for these small businesses. Fees for an independent audit are scaled according to the size of the business. A small PEO with relatively simple accounting, as compared to a large one, could pay as little as \$5,000 a year. The benefits of this audit to the PEO operator are many, including an understanding of cash flow, long term debt and the effect that unforeseen circumstances can have on their business. It is important to note that the current law is not giving the DLIR intrusive access or even oversight into the operations of the business. Instead, the PEO operator employs their own CPA/auditor to provide this valuable insight into the operation and financial health of their business. It provides the PEO operator comfort in knowing whether or not they are doing things right. Because many small PEO operators most likely do not have the staff on hand with credentials to maintain strong internal controls, it becomes even more important for them to hire an independent auditor.

February 11, 2013
Page Five

In Conclusion

Although not perfect, the current law provides a strong foundation to ensure proper oversight. A small handful of PEOs should not be allowed to ignore the law just because they don't agree with it. Allowing them to do so sends the wrong message to all law abiding citizens.

I urge this legislature to allow the current law a chance to take effect and do what it was designed to do.

Sincerely,

A handwritten signature in dark ink, appearing to read "Barron L. Guss", with a long horizontal flourish extending to the right.

Barron L. Guss
President and CEO



February 11, 2013

TO: The Honorable Angus L.K McKelvey, Chair
The Honorable Derek S. K. Kawakami, Vice Chair
Members of the House Committee on Consumer Protection & Commerce

Date: Wednesday, February 13, 2013
Time: 2:30pm
Place: State Capitol, Conference Room 325

Re: House Bill 144HD1 Relating to Professional Employer Organizations (“PEO”)

Dear Chair McKelvey and Vice-Chair Kawakami,

My name is Matthew S. Delaney, President of the Hawaii Association of Professional Employer Organizations (“HAPEO”). On behalf of HAPEO, I would like to thank you for this opportunity to share with you and the committee HAPEO’s comments as they relate to HB144HD1.

This measure was amended by the Committee on Labor and Public Employment by deleting the language of HB144 and replacing it with the language contained in S.B. No. 510. HAPEO is prepared in the spirit of cooperation and compromise to work with HB144HD1. While HAPEO supports the intent of these measures, as noted below, HAPEO requests the Committee’s consideration of certain amendments to insure fairness in the bonding requirement and clarity in the definitional section. HAPEO looks forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry.

Background of PEOs

By way of background, PEOs are businesses that partner with existing small businesses to enable them to cost-effectively outsource the management of human resources, employee benefits, payroll, and workers’ compensation. This allows PEO clients to focus on their core competencies to maintain and grow their bottom lines. By forming an employment relationship with these small businesses and their employees, PEOs are able to offer enhanced access to employee benefits, as well as helping small businesses comply with federal and state payroll tax laws, insurance laws, employment laws, and many other mandates required of employers.

History of HAPEO

The people and businesses of Hawaii have a long history of working together, the islands offer a warm and welcoming environment energized by aloha and collaboration. True to this heritage, the Hawaii Professional Employer Organization (“PEO”) industry has developed a positive culture of shared ideas and goodwill. In 2012, a core group of smaller and medium sized Hawaii PEO’s formalized their alignment with the establishment of the Hawaii Association of



Professional Employer Organizations (“HAPEO”). Our organization was founded on the principles of transparency and support for the thousands of small businesses in Hawaii.

HAPEO Membership

HAPEO represents approximately twenty (20) local members that collectively service over 1,000 small to medium sized businesses in Hawaii and represent over 10,000 worksite employees. HAPEO represents ninety-three percent (93%) of the State’s PEOs.

Overview of Existing Laws (373L, 373K and Act 129)

The State has currently struggled with implementing the existing but conflicting statutory provisions (HRS Chapters 373L and 373K) in a meaningful way, especially as Act 129 (2010) required regulatory functions and expertise outside of the scope of the DLIR’s legal competence.

HAPEO has worked with various stakeholders since SB2424 SD2HD2CD1 was vetoed at the end of the 2012 legislative session. We have worked with DLIR, DCCA, Chamber of Commerce, SHRM, NAPEO, PACE, various neighbor island and community based Chamber of Commerce organizations, Hawaii based insurance companies, and dozens of other business and community groups to obtain input and feedback on reasonable registration and regulation requirements that should be applied to the PEO industry that will be fair and equitable to PEOs of all sizes, large and small.

HB144HD1 Summary

HB144HD1 would repeal Chapter 373L, Hawai’i Revised Statutes (“HRS”), in its entirety and make certain targeted amendments to other provisions of the PEO law, HRS Chapter 373K, to simplify and improve the implementation of the law, and to clarify and amend the statutory responsibilities between a client company and the PEO. In addition, the bill would simplify the regulation of PEOs by empowering the Director of the Department of Labor and Industrial Relations to notify the Department of Taxation when the GET tax exemption under HRS Section 237-24.75 is being denied for a PEO that violates Chapter 373K, HRS.

Specific Requests for Amendments to HB144HD1:

HAPEO supports the intent of HB144HD1 but asks the Committee to consider two amendments:

1) Scalable Bonding Requirements

There are only four (4) states in the entire United States that require mandatory bonds: Hawaii, North Dakota, New Mexico and South Carolina. The other states only require a bond if the PEO does not meet a minimum net worth or working capital requirements (on average the net worth or working capital requirement is \$50,000 to \$100,000). Hawaii currently has a mandatory bond of \$250,000, which is the highest in the entire country of any state requiring a mandatory bond or a voluntary bond when a PEO does not meet minimum net worth



requirements. North Dakota, New Mexico and South Carolina all have mandatory bonding requirements of \$100,000 and none of these states requires audited or reviewed financial statements, because a mandatory bond is in place.

Of the other approximate twenty (20) states that have bonding requirements when the PEO does not meet minimum net worth requirements or bonds that are specific to PEO's that provide self-insured workers compensation or other insurances, the maximum bond for PEOs of all sizes is \$100,000.

HAPEO and many of the other stakeholders we have met and deliberated with are in agreement with the concept of a scalable bond. In the spirit of compromise we support a scalable bond per the following schedule:

<u>Annual PEO Payroll</u> ¹	<u>Bond Amount</u>
\$150,000,001 or higher	\$250,000.00
\$25,000,001 to \$150,000,000	\$ 50,000.00
\$0 to \$25,000,000	\$ 10,000.00

Letter of Credit

HAPEO suggests that a Letter of Credit may be used as a substitute for a surety bond.

2) HAPEO supports amendments to the “definition” section:

- A. The definition of assigned employee should be amended to add language that equates an assigned employee with a leased employee as defined in Section 414(n) or the IRS Code.
- B. "Department" means the department of labor and industrial relations.
- C. Clarify that “Offsite employer of record” means a professional employer organization pursuant to a professional employer agreement to which is contractually assigned the financial and administrative duties of a client company, including human resources administration, payroll and payroll taxes, workers’ compensation and temporary disability coverage, state unemployment, and prepaid health care coverage of assigned employees.
- D. “Work site employer” mean the client company, pursuant to a professional employer agreement, that retains workplace management and supervisory control and responsibility of the assigned employees including compliance with labor or employment laws, (with the exception of the four areas listed above under the Offsite Employer of Record definition: workers’ compensation and temporary disability coverage, state

¹ Source: IRS Form 941



unemployment, and prepaid health care coverage of assigned employees), or other laws with respect to the protection and rights of employees under the Hawaii Employment Relations Act and the Employment Practices laws of chapters 377 and 378.

2013 Legislative Session

We are looking forward to working collaboratively with all stakeholders to improve the current laws that were passed back in 2010—laws that have still not been implemented in their entirety as a result of challenges with bonding requirements, audited financials, and some other factors. HAPEO is committed to working with both the DLIR and DCCA to assist in the implementation of the registration process.

HAPEO is also committed to working together with the larger PEOs in the State to insure that consumers are protected by some measure of financial responsibility coupled with healthy competition in the industry.

We have attached suggested changes to HB144HD1 for your review and consideration.

Mahalo for your time and consideration. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

Matthew S. Delaney
President of the Board
HAPEO



William L. Wong, CPA, PFS
Lauren M. Smith, CPA, PFS
Nona L. Nishina, CPA
Hye C. Harper, CPA
Iris A. Wong, MBA

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Rep. Angus L. K. McKelvey, Chair
Rep. Derek S. K. Kawakami, Vice Chair
Committee on Consumer Protection and Commerce
House of Representatives
Hawaii State Capitol
Honolulu, HI

February 11, 2013

RE: **HB144**
Relating to Professional Employer Organizations

Ladies and Gentlemen:

I am a financial planner and tax consultant, CPA, real estate developer and an owner of a small Professional Employer Organization (PEO). I very much recognize that the existing PEO law must be revised to allow small PEO owners to comply with the law, to streamline the enforcement of the law by the Department of Labor and Industrial Relations (DLIR) and the Department of Taxation and to ease the standards of compliance on smaller local companies.

Although I favor parts of this bill, I strongly suggest that the attached revisions be made to the bill. These revisions are summarized as follows:

1. If the definition of co-employer is being eliminated, it is critically important that responsibilities of employers (the PEO and the client company) be allocated in terms of functionality and control over the workplace and employees. In professional employer organization agreements, client companies have total control over how employees are supervised and treated with respect to employment relations with employees, unfair labor practices, discrimination, equal pay, unlawful practices with employees, suspension, discharge and other employment practices. A PEO, on the other hand, acts as the offsite employer in charge of carrying out the administrative, wage and hour, employee benefits, tax, insurance coverage and financial reporting duties for the client company. As a result, the PEO cannot become the sole employer in the case of all employment relations and practices, as **HB144** is drafted. By doing so would wrongfully allow client companies to abrogate their employer responsibilities, simply by entering into a contract with a PEO. This will limit DLIR enforcement on a perpetrator, the client company, of the unlawful labor practice. This may also allow client companies to hire independent contractors, when they are lawfully employees, to escape coverage from various employment laws.

To ensure compliance with the requirements imposed by IRS Circular 230 (31 C.F.R part 10), you are hereby advised that any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting marketing or recommending to another party any tax-related matter(s) addressed herein.

2. A PEO actually helps client companies comply with payroll laws by employing assigned employees of client companies. A PEO also educates client companies on compliance with labor and tax laws and assists client companies with safety plans, hazard communication, drug testing, etc. to promote a safer workplace. However, PEOs do not have control over the worksite of the client company and therefore must rely on the client company to carry out its employer obligations with employees. **HB144** may have dangerous and unintended consequences of relieving client companies of certain obligations to its employees and transferring these obligations to the PEO.
3. **HB144** obviously tries to preserve the bonding requirements of PEOs. However, the main reason for the veto of SB2424 in the last session was that the existing law unfairly punishes small PEOs, especially locally owned companies, by draining all working capital and cash of the PEO as collateral for a bond. To date, only three large companies (the other eight are related to these three companies) in Hawaii have been able to procure bonds. If **HB144** insists on some amount of bonding, no matter the size of the company, it should instead amend the provision so that the amount of the bond is based on the size of the PEO measured by the total payroll processed by the PEO. This will certainly allow a fairer assessment and requirement for the PEO and allow smaller PEOs to compete in the marketplace.
4. With regard to bonding, a change should be made to allow a letter of credit equivalent normally contained in Hawaii State leases. Also, the bond should be called only if there are proven damages incurred by the client company.
5. Notification to the DLIR of each client company that is a party to a professional employer organization should be changed from five days to thirty days to allow sufficient time for delivery of agreements.
6. The restoration fee should be deleted as the bill is very ambiguous as to whether a purposeful lapse or expiration of the registration would constitute imposing a restoration fee of \$1,500 or initiate a new registration at \$500.
7. Finally, the PEO should be held responsible as an offsite employer and registration information for only assigned employees covered under the PEO agreement. Oftentimes, client companies knowingly hire independent contractors which are NOT reported to the PEO as an employee, despite the contractor having characteristics of being an employee. A client company, although contractually forced to cover all or certain classes of employees under the PEO agreement, may exclude certain independent contractors that the PEO has no enforceable method or access to capture these arrangements under the EO agreement.

I respectfully request the attached amendments be made to **HB144**.

Respectfully Submitted,

William L. Wong

William L. Wong CPA, PFS
Certified Public Accountant
Personal Financial Specialist

STATE OF HAWAII

A BILL FOR AN ACT

RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The legislature finds that Act 225, Session
2 Laws of Hawaii 2007, created a new chapter on professional
3 employment organizations that provided a general excise tax
4 exemption to business entities the department of taxation
5 determined as qualified professional employer organizations.
6 The legislature further finds that Act 129, Session Laws of
7 Hawaii 2010, established a new professional employer
8 organizations chapter that required registration with the
9 department of labor and industrial relations to ensure
10 compliance with federal and state labor laws. The legislature
11 notes that the two separately established statutes, while
12 intended to operate interdependently for the mutual benefit and
13 common public purposes of the department of labor and industrial
14 relations and the department of taxation, could be implemented
15 more effectively by clarifying any existing incompatible and
16 ambiguous language.



1 The purpose of this Act is to clarify professional employer
2 organization responsibilities, including meeting the statutory
3 requirements of chapter 373L, Hawaii Revised Statutes, and the
4 nexus between the registration of professional employer
5 organizations and qualification for the state general excise tax
6 exemption.

7 SECTION 2. Chapter 373L, Hawaii Revised Statutes, is
8 amended by adding four new sections to be appropriately
9 designated and to read as follows:

10 "§373L- ~~Registration required.~~ No person within the
11 purview of this chapter shall use the terms "professional
12 employer organization", or "PEO", or other similar name unless
13 the person is registered and in compliance with this chapter and
14 the rules and regulations of the director.

15 §373L- Professional employer agreements; notification to
16 covered employees; notification to department. (a) During the
17 term of the agreement between a professional employer
18 organization and its client company, the professional employer
19 organization shall be deemed the ~~offsite employer of record~~ ~~for~~
20 all assigned employees ~~as defined in section 373L-1.~~ As the
21 employer of the assigned employees, the professional employer
22 organization, not the client company, shall be solely

1 responsible for complying with all statutory provisions relating
2 to the unemployment insurance, workers' compensation, temporary
3 disability insurance, and prepaid health care programs with
4 respect to the assigned employees.

5 **§373L- Payroll cost exemption.** At the end of each
6 calendar year, the department shall provide the names, date of
7 registration, and contact information of all professional
8 employer organizations that have successfully complied with the
9 requirements of this chapter to the department of taxation. The
10 exemption provided under section 237-24.75(3) shall only apply
11 to professional employer organizations that fulfill and maintain
12 the registration requirements under this chapter.

13 **§373L- Fees.** No applicant shall be allowed to register
14 pursuant to this chapter unless the appropriate fees have been
15 paid. Effective July 1, 2013, the director shall collect fees
16 pursuant to this chapter as follows:

17	<u>(1) Registration fee</u>	<u>\$500</u>
18	<u>(2) Biennial renewal fee</u>	<u>\$750</u>
19	<u>(3) Restoration fee</u>	<u>\$1500</u>

20 until such time as the director amends the fees by rulemaking
21 pursuant to chapter 91. The fees shall be deposited into the
22 state general fund."

1 SECTION 3. Section 237-24.75, Hawaii Revised Statutes, is
2 amended to read as follows:

3 **"§237-24.75 Additional exemptions.** In addition to the
4 amounts exempt under section 237-24, this chapter shall not
5 apply to:

6 (1) Amounts received as a beverage container deposit
7 collected under chapter 342G, part VIII;

8 (2) Amounts received by the operator of the Hawaii
9 convention center for reimbursement of costs or
10 advances made pursuant to a contract with the Hawaii
11 tourism authority under section 201B-7[+]; and[+

12 +] (3) Amounts received[+] by a professional [~~employment~~]
13 employer organization that is registered with the
14 department of labor and industrial relations pursuant
15 to chapter 373L, from a client company equal to
16 amounts that are disbursed by the professional
17 [~~employment~~] employer organization for employee wages,
18 salaries, payroll taxes, insurance premiums, and
19 benefits, including retirement, vacation, sick leave,
20 health benefits, and similar employment benefits with
21 respect to assigned employees at a client company;
22 provided that this exemption shall not apply to

1 amounts received by a professional [employment]
2 employer organization [upon failure of the
3 ~~professional employment organization to collect,~~
4 ~~account for, and pay over any income tax withholding~~
5 ~~for assigned employees or any federal or state taxes~~
6 ~~for which the professional employment organization is~~
7 ~~responsible.]~~ after:

8 (A) Notification from the department of labor and
9 industrial relations that the professional
10 employer organization has not fulfilled or
11 maintained the registration requirements under
12 this chapter; or

13 (B) A determination by the department that the
14 professional employer organization has failed to
15 pay any tax withholding for assigned employees or
16 any federal or state taxes for which the
17 professional employer organization is
18 responsible.

19 As used in this paragraph, [~~professional employment~~
20 ~~organization"], professional employer organization,~~

21 "client company", and "assigned employee" shall have

22 the meanings provided in section [~~373K-1.~~] 373L-1."

1 SECTION 4. Section 373L-1, Hawaii Revised Statutes, is
2 amended as follows:

3 1. By adding ~~two~~ four new definitions to be appropriately
4 inserted and to read:

5 "Assigned employee" means an employee of the professional
6 employer organization who is assigned to perform services at the
7 worksite of a client company. Assigned employee has the same
8 meaning as the term "leased employee" as defined in section
9 414(n) (with respect to employee leasing) of the Internal
10 Revenue Code of 1986, as amended.

11 "Department" means the department of labor and industrial
12 relations."

13 "Offsite employer of record" means a professional employer
14 organization pursuant to a professional employer agreement to
15 which is contractually assigned the financial and administrative
16 duties of a client company, including human resources
17 administration, payroll and payroll taxes, workers' compensation
18 and temporary disability coverage, state unemployment, and
19 prepaid health care coverage of assigned employees.

20 "Work site employer" mean the client company, pursuant to a
21 professional employer agreement, that retains workplace
22 management and supervisory control and responsibility of the

1 assigned employees including compliance with labor or employment
2 laws, collective bargaining rights, anti-discrimination
3 provisions, or other laws with respect to the protection and
4 rights of employees under the Hawaii Employment Relations Act
5 and the Employment Practices laws of chapters 377 and 378.

6 2. By amending the definitions of "client company",
7 "professional employer agreement", and "professional employer
8 organization" to read:

9 "Client company" means any person [~~who enters into a~~
10 ~~professional employer agreement with a professional employer~~
11 ~~organization.] that enters into a professional employer
12 agreement with a professional employer organization and is
13 assigned employees to its worksite by the professional employer
14 organization under that agreement.~~

15 "Professional employer agreement" means a written contract
16 by and between a client company and a professional employer
17 organization that provides for the following:

- 18 (1) [~~The co-employment of covered employees; and]~~
19 Assignment of employees to the worksite of the client
20 company;
21 (2) [~~The allocation of employer rights and obligations~~
22 ~~between]~~ Description of duties and responsibilities of

1 the client company and the professional employer
2 organization with respect to the ~~[covered]~~ assigned
3 employees~~[-]~~; and

4 | (3) ~~Clarification of the P~~professional employer
5 organization as the employer of the assigned employees
6 for purposes of complying with all statutory
7 provisions relating to the unemployment insurance,
8 workers' compensation, temporary disability insurance,
9 and prepaid health care programs with respect to the
10 assigned employees.

11 "Professional employer organization" or "organization"
12 means ~~[any person that is a party to a professional employer~~
13 ~~agreement with a client company regardless of whether the person~~
14 ~~uses the term or conducts business expressly as a "professional~~
15 ~~employer organization", "PEO", "staff leasing company",~~
16 ~~"registered staff leasing company", "employee leasing company",~~
17 ~~"administrative employer", or any other similar name.] a~~
18 business entity that assigns employees to the worksites of its
19 client companies on a long-term, rather than temporary or
20 project-specific basis. The term does not include temporary
21 help services or other similar arrangements."

1 3. By deleting the definitions of "co-employment" and
2 "covered employee".

3 ~~["Co-employment" means a relationship that is intended to~~
4 ~~be an ongoing relationship rather than a temporary or project-~~
5 ~~specific one, wherein the rights, duties, and obligations of an~~
6 ~~employer that arise out of an employment relationship have been~~
7 ~~allocated between the client company and the professional~~
8 ~~employer organization pursuant to a professional employer~~
9 ~~agreement and this chapter.~~

10 ~~"Covered employee" means an individual having a co-~~
11 ~~employment relationship with a professional employer~~
12 ~~organization and a client company who meets all of the following~~
13 ~~criteria:~~

14 ~~(1) The individual has received written notice of co-~~
15 ~~employment with the professional employer~~
16 ~~organization; and~~

17 ~~(2) The individual's co-employment relationship is~~
18 ~~pursuant to a professional employer agreement subject~~
19 ~~to this chapter. Individuals who are officers,~~
20 ~~directors, shareholders, partners, and managers of the~~
21 ~~client company shall be covered employees to the~~
22 ~~extent that the professional employer organization and~~

1 ~~the client company have expressly agreed in the~~
2 ~~professional employer agreement that the individuals~~
3 ~~shall be covered employees; provided that the~~
4 ~~individuals meet the criteria of this definition and~~
5 ~~act as operational managers or perform day-to-day~~
6 ~~operational services for the client company."]~~

7 SECTION 5. Section 373L-2, Hawaii Revised Statutes, is
8 amended to read as follows:

9 "~~{}~~**§373L-2**~~{}~~ **Registration required.** (a) Every
10 professional employer organization shall register with the
11 director by providing all of the information required by this
12 section and by rules adopted by the director pursuant to chapter
13 91 prior to entering into any professional employer agreement
14 with any client company in this State. Registration shall not
15 be approved unless all of the applicable provisions of this
16 chapter have been met~~to the satisfaction of the department.~~

17 (b) Registration information required by this section
18 shall include:

- 19 (1) The name or names under which the professional
20 employer organization conducts or will conduct
21 business;

- 1 (2) The address of the principal place of business of the
2 professional employer organization and the address of
3 each office that the professional employer
4 organization maintains in this State;
- 5 (3) The professional employer organization's general
6 excise tax number;
- 7 (4) A copy of the certificate of authority to transact
8 business in this State issued by the director of
9 commerce and consumer affairs pursuant to title 23 or
10 title 23A, if applicable;
- 11 (5) A list, organized by jurisdiction, of each name under
12 which the professional employer organization has
13 operated in the preceding five years, including any
14 alternative names; names of predecessors; and, if
15 known, names of successor business entities;
- 16 (6) A statement of ownership, which shall include the name
17 of each person who, individually or acting in concert
18 with any other person or persons, owns or controls,
19 directly or indirectly, twenty-five per cent or more
20 of the equity interests of the professional employer
21 organization;

- 1 (7) A statement of management, which shall include the
2 name of any person who serves as president or chief
3 executive officer or who otherwise has the authority
4 to act as a senior executive officer of the
5 professional employer organization;
- 6 (8) Proof of valid workers' compensation coverage of
7 assigned employees in compliance with all laws of this
8 State;
- 9 (9) Proof of compliance with the Hawaii temporary
10 disability insurance law for all assigned employees;
- 11 (10) Proof of compliance with the Hawaii prepaid health
12 care act for all assigned employees [~~as regards all~~
13 ~~employees of the professional employer organization~~];
- 14 (11) ~~Proof of compliance with the Hawaii employment~~
15 ~~security law, including payment of any applicable~~
16 ~~employer liability pursuant to chapter 383;~~ [and]
- 17 (12) [~~A financial statement prepared in accordance with~~
18 ~~generally accepted accounting principles, audited by~~
19 ~~an independent certified public accountant licensed to~~
20 ~~practice in the State, and without qualification as to~~
21 ~~the going concern status of the professional employer~~
22 ~~organization.] The name, address, and phone number of~~

1 the financial institution utilized by the professional
2 employer organization for payroll purposes that
3 operates and maintains branches in the State; and
4 (13) The name of each client company that is party to a
5 professional employer agreement with a professional
6 employer organization to the department on a form
7 approved by the department within ~~five-thirty~~ business
8 days of the initiation of the agreement and within
9 ~~five-thirty~~ business days of the termination of the
10 agreement.

11 (c) Registration under this section shall expire on
12 ~~[December 31]~~ June 30 of each ~~[odd-numbered]~~ even-numbered year.
13 Before ~~[December 31]~~ June 30 of each ~~[odd-numbered]~~ even-
14 numbered year, the director or the director's authorized
15 delegate shall mail a renewal application for registration to
16 the address on record of the registrant. In connection with
17 renewal of registration, a professional employer organization
18 shall provide all of the information required by subsection (b).
19 Failure to renew a registration shall result in termination of
20 that registration. ~~Registrations that have been terminated~~
21 ~~pursuant to this section shall be required to pay the~~
22 ~~restoration fee.~~

1 (d) The director shall establish fees and requirements for
2 registration, [~~maintenance of registration,~~] renewal, and
3 restoration of registration for professional employer
4 organizations by rule pursuant to chapter 91."

5 SECTION 6. Section 373L-3, Hawaii Revised Statutes, is
6 amended to read as follows:

7 [[§373L-3]] Bond required. (a) No professional
8 employer organization shall enter into a professional employment
9 agreement with a client company in the State unless the

10 professional employer organization posts a performance or
11 payment bond or a letter of credit equivalent to the required
12 bond amount, based on total payroll of the professional employer
13 organization as follows:

14 (i) For payroll from \$0 to \$10,000,000, the bond amount
15 shall be \$10,000;

16 (ii) For payroll from \$10,000,001 to \$25,000,000, the
17 bond amount shall be \$25,000;

18 (iii) For payroll from \$25,000,001 to \$50,000,000, the
19 bond amount shall be \$50,000;

20 (iv) For payroll from \$50,000,001 to \$100,000,000, the
21 bond amount shall be \$100,000;

1 (v) For payroll over \$100,000,000, the bond amount
2 shall be \$250,000.
3 ~~in the amount of \$250,000, which is a performance or financial~~
4 ~~guaranty type bond naming t~~The director shall be named as the
5 obligee and the bond shall be called only if the department has
6 proven damages with respect to the client company for
7 nonperformance by the professional employer organization, other
8 than non-payment by the client company of its obligations under
9 the professional employer organization agreement. and The
10 bond~~which~~ may be canceled only if the professional employer
11 organization gives ~~sixty~~ thirty days prior written notice to the
12 surety or if the surety gives thirty days prior written notice
13 to the director of cancellation of the bond. The requirements
14 of this section shall be satisfied by a single bond. If a
15 professional employer organization has more than one branch
16 location, the bond shall cover all locations.

17
18 (b) The bond or its letter of credit equivalent required
19 by this section shall be issued by a surety or federally insured
20 lending institution authorized to do business in the State ~~to~~
21 ~~indemnify a client company who may suffer loss as a result of~~
22 ~~nonperformance by a professional employer organization.~~

1

2 (c) Upon cancellation or expiration of the bond, the
3 surety or insurer shall remain liable for any claims against the
4 bond for a period of six months; provided that:

5

6 (1) The ~~debts were~~ loss was incurred by the client company
7 while the bond was in effect; and

8

9 (2) The director notifies the surety, ~~or~~ insurer, or
10 lending institution as the case may be, of any claims within
11 ninety days of discovery of any claims.

12

13 (d) The surety, ~~or~~ insurer, or lending institution is not
14 required to release any moneys or collateral to the professional
15 employer organization during the six months after cancellation
16 of the bond.

17

18 (e) Failure to have in effect a current bond shall result
19 in automatic forfeiture of registration pursuant to this chapter
20 and shall require the professional employer organization to
21 immediately cease doing business in the State. A professional
22 employer organization whose registration is forfeited shall

1 apply as a new applicant for registration in order to resume
2 business in the State.

3 | SECTION ~~67~~. Chapter 373K, Hawaii Revised Statutes, is
4 | repealed.

5 | SECTION ~~78~~. This Act does not affect rights and duties
6 | that matured, penalties that were incurred, and proceedings that
7 | were begun before its effective date.

8 | SECTION ~~89~~. In codifying the new sections added by section
9 | 2 of this Act, the revisor of statutes shall substitute
10 | appropriate section numbers for the letters used in designating
11 | the new sections in this Act.

12 | SECTION ~~910~~. Statutory material to be repealed is
13 | bracketed and stricken. New statutory material is underscored.

14 | SECTION ~~1011~~. This Act shall take effect upon its
15 | approval.

16

INTRODUCED BY: _____

Report Title:

Professional Employer Organizations; Registration; Fees

Description:

Repeals chapter 373L, Hawaii Revised Statutes. Clarifies professional employer organization responsibilities with respect to meeting the statutory requirements of the repealed chapter 373L, Hawaii Revised Statutes, and the nexus between the registration of professional employer organizations and qualification for the state general excise tax exemption.

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.



February 12, 2013

TO: The Honorable Angus L.K McKelvey, Chair
The Honorable Derek S. K. Kawakami, Vice Chair
Members of the House Committee on Consumer Protection & Commerce

Date: Wednesday, February 13, 2013
Time: 2:30pm
Place: State Capitol, Conference Room 325

Re: House Bill 144 HD1 Relating to Professional Employer Organizations (“PEO”)

Dear Chair McKelvey and Vice-Chair Kawakami,

My name is Jesus Menendez, Co-Founder, COO of HRBenefix a locally owned and operated Professional Employer Organization (PEO). On behalf of HRBenefix I would like to thank you for this opportunity to share with you and the committee our comments as they relate to HB 144 HD1. This measure was amended by the House Committee on Labor and Public Employment by deleting the language of HB 144 and replacing it with the language contained in SB 510. While we support the intent of this measure, as noted below, we request the Committee’s consideration of certain amendments to insure fairness in the bonding requirement and clarity in the definitional section. HRBenefix looks forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry.

HRBenefix was formed in December 2010 and currently service over 80 different businesses and approximately over 1,000 client worksite employees on all major Hawaiian Islands mainly in the Big Island. We formed this company to provide an alternative option for small and medium sized businesses of Hawaii to outsource their human resource needs and focus on their core businesses.

We support the concept of registration and reasonable regulation of PEOs.

Overview of Existing Laws (373L, 373K and Act 129)

The State has currently struggled with implementing the existing conflicting laws (373L and 373K) in a meaningful way, especially as Act 129 (2010) required regulatory functions and expertise outside of the scope of the DLIR’s existing scope of regulation.

HB 144 HD1 Summary

HB144HD1 would repeal Chapter 373L, Hawai‘i Revised Statutes (“HRS”), in its entirety and make certain targeted amendments to other provisions of the PEO law, HRS Chapter 373K, to simplify and improve the implementation of the law, and to clarify and amend the statutory responsibilities between a client company and the PEO. In addition, the bill would simplify the regulation of PEOs by empowering the Director of the Department of Labor and Industrial Relations to notify the Department of Taxation when the GET tax exemption under HRS Section 237-24.75 is being denied for a PEO that violates Chapter 373K, HRS.

Requests for Amendments to HB 144 HD1:

We support the intent of HB 144 HD1 but ask the Committee to consider two amendments:

1) Scalable Bonding Requirements

There are only four (4) states in the entire United States that require mandatory bonds: Hawai‘i, North Dakota, New Mexico and South Carolina. The other twenty (20) states only require a bond (\$100,000 maximum) if the PEO does not meet a minimum net worth or working capital requirements (on average the net worth or working capital requirement is \$50,000 to \$100,000). Hawai‘i currently has a mandatory bond of \$250,000, which is the highest in the entire country of any state requiring a mandatory bond or a voluntary bond when a PEO does not meet minimum net worth requirements. North Dakota, New Mexico and South Carolina all have mandatory bonding requirements of \$100,000 and none of these states requires audited or reviewed financial statements, because a mandatory bond is in place.

In the spirit of compromise we support a scalable bond per the following schedule:

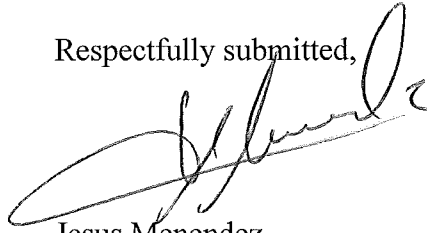
<u>Annual PEO Payroll</u> ¹	<u>Bond Amount</u>
\$150,000,001 or higher	\$250,000.00
\$25,000,001 to \$150,000,000	\$ 50,000.00
\$0 to \$25,000,000	\$ 10,000.00

2) We support amendments to the “definition” section (please refer to HAPEO’s testimony for this hearing for specific definitional amendments.

¹ Source: IRS Form 941

Mahalo for your time and consideration. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Jesus Menendez', written over a horizontal line.

Jesus Menendez
Chief Operating Officer
HRBenefix



February 12, 2013

To: The Honorable Angus L.K. Mc Kelvey Chair
The Honorable Derek S.K. Kawakami Vice Chair
Members of the House Committee on Consumer Protection & Commerce

Re: House Bill 144HD1 Relating to Professional Employers Organization (PEO)

Dear Chair McKelvey and Vice-Chair Kawakami,

My Name is Jennifer Brittin-Fulton; I have lived in Hawaii for over 40 years, and have been in the Employment Agency business for over 30 years. I have owned and operated Employers Options for over 20 years. Employers Options is a small, local, woman owned business. Employers Option's employs over 500 people on the island of Maui. PEO business allows us to operate in the black and make a profit.

Employers Options has never had a complaint filed against it for non-payment of payroll or payroll taxes. Employers Options has a different operating structure than most other PEO companies. For the last seventeen years we have had a unique agreement with Sterling National Bank of New York. Sterling National bank has close to 3 billion dollars in assets, and has been in business for over 75 years. Per our contract with Sterling National bank, they pay our payroll and all payroll taxes and collect on the amount from the client. Thus our clients' money is held in an account similar to a trust account.

If the purpose of the bond and audit is to insure that the PEO companies has the money to pay payroll and taxes, then I believe those concerns would not apply to my company.

I do not believe there has been the scope of consumer fraud to the extent that would warrant this type of bonding. It will make the cost of doing business so expensive for small companies that we won't be able to compete with the large PEO companies. A few years back, before the GET exemption was offered to every PEO company in the state, several of the large PEO companies did not charge their clients the GET tax or pay the tax to the state. Thus my company could not compete with their pricing as I had to charge and pay 4.167% more than they did.

If I have to pay upwards of \$30,000 or more to get an audit and then come up with a bond for \$250,000 which to date I have not been able to get for a reasonable amount; or put up \$250,000 cash to get a bond my expenses are sky high. I will have to add these additional costs on for my clients that will price me out of the market. No small business can absorb these costs and survive.

As this letter states I am in support of **NO AUDIT, NO Bond, or a Sliding Scale Bond. However, I must categorically state that I am opposed to the existing \$250,000 bond and any audit requirement.**

I do not believe that a small PEO company should be required to have the same bond as a company doing 10X or more in business as I do. Is the magnitude relevant and does it correlates with the scope of the \$250,000 bond requirement. I would also like you to consider the fact that if my client pays me for payroll and my checks bounce, he will most likely not give me next week's payroll money. So the reality is that the most a PEO could steal is not much more than one week's payroll.

Please consider that HB144HSI would repeal Chapter 373 K, Hawai'i Revised Statutes (HRS), in it's entirely and makes certain targeted amendments to the other provisions of the PEO law, HRS Chapter 373K, to simplify and improve the implementation of the law, and to clarify and amend the statutory responsibilities between a client company and the PEO. In addition, the bill would simplify the regulation of the PEOs by empowering the Director of the Department of Labor and Industrial Relations to notify the Department of Taxation when the GET tax exemption under HRS section 237-24.75 is being denied for the PEO that violates chapter 373K, HRS.

Please consider two amendments:

1. Scalable Bonding Requirements

There are only (4) states in the entire United States that require mandatory bonds: Hawaii, North Dakota, New Mexico and South Carolina. The other states only require a bond if the PEO doesn't meet a minimum net worth or working capital requirement (on average the net worth or working capital requirement is \$50,000 to \$100,000). Hawaii currently has a mandatory bond of \$250,000, which is the highest in the entire country of any state requiring a mandatory bond or voluntary bond when a PEO does not meet the minimum net worth requirements. North Dakota, New Mexico and South Carolina all have mandatory bonding requirements of \$100,000 and none of these states require an audited or reviewed financial statement, because a mandatory bond is in place.

Of the other approximate twenty (20) states that have bonding requirements when a PEO does not meet the minimum net worth requirement or bonds are specific to the PEO's that provide self-insured workers compensation other insurance the maximum bond for PEO's of all sizes is \$100,000.

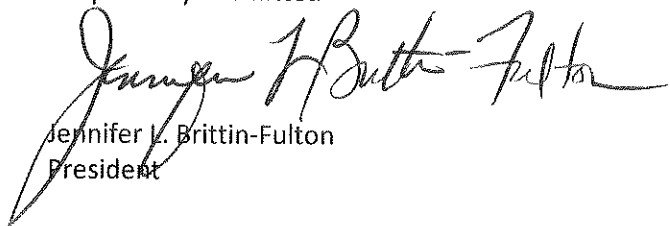
In a spirit of compromise I support a scalable bond per the following Schedule:

Annual PEO payroll	Bond Amount
\$150,000,001 or higher	\$250,000.00
\$25,000,001-150,000,000.00	\$50,000.00
\$0 to \$25,000,000.00	\$10,000.00

I suggest that a letter of credit may be used as a substitute for a surety bond. The State could also require a tax clearance.

There also are some definition chances that need to be addressed. I thank you for taking the time to review my concerns. I appreciate the chance to have my voice heard and ask for your support.

Respectfully submitted



Jennifer L. Brittin-Fulton
President



February 12, 2013

TO: The Honorable Angus L.K McKelvey, Chair
The Honorable Derek S. K. Kawakami, Vice Chair
Members of the House Committee on Consumer Protection & Commerce

Date: Wednesday, February 13, 2013
Time: 2:30pm
Place: State Capitol, Conference Room 325

Re: House Bill 144 HD1 Relating to Professional Employer Organizations (“PEO”)

Dear Chair McKelvey and Vice-Chair Kawakami,

My name is Sanjay Mirchandani, and I am the owner of Talent HR Solutions LLC, a locally owned and operated Professional Employer Organization. I am also a founding member of the board of directors for HAPEO. The existing laws do not promote competition and it stifles innovation and entrepreneurship. There are many Hawaii small and medium sized businesses that prefer working with a boutique PEO rather than a large PEO where they would not get as much personalized attention. The 250K bonding and audit requirements are not only the highest in the country, but is also NOT attainable by smaller boutique PEO's. The annual audit cost of approximately \$25,000 plus is simply unaffordable by small PEO's. The total annual cost of the surety bond would be a \$250,000 collateral cash deposit at a financial institution, plus banking and bonding insurance company fees, plus loss of interest on deposit. I would like to thank you for this opportunity to share with you and the committee our comments as they relate to HB 144 HD1. This measure was amended by the House Committee on Labor and Public Employment by deleting the language of HB 144 and replacing it with the language contained in SB 510. While we support the intent of this measure, as noted below, we request the Committee's consideration of certain amendments to insure fairness in the bonding requirement and clarity in the definitional section (please reference testimony submitted by HAPEO for definition amendments).

Overview of Existing Laws (373L, 373K and Act 129)

The State has currently struggled with implementing the existing conflicting laws (373L and 373K) in a meaningful way, especially as Act 129 (2010) required regulatory functions and expertise outside of the scope of the DLIR's existing scope of regulation.



HB 144 HD1 Summary

HB144HD1 would repeal Chapter 373L, Hawai‘i Revised Statutes (“HRS”), in its entirety and make certain targeted amendments to other provisions of the PEO law, HRS Chapter 373K, to simplify and improve the implementation of the law, and to clarify and amend the statutory responsibilities between a client company and the PEO. In addition, the bill would simplify the regulation of PEOs by empowering the Director of the Department of Labor and Industrial Relations to notify the Department of Taxation when the GET tax exemption under HRS Section 237-24.75 is being denied for a PEO that violates Chapter 373K, HRS.

Requests for Amendments to HB 144 HD1: Our honorable Governor in his Veto letter of SB2424, said to make the new bond law fair to small and large PEO's. THE SCALABLE BOND PROPOSED BY HAPEO achieves that objective. The larger PEO's have been around for 30-40 years and their annual payroll is around 300-400 million. The average boutique PEO does around 10-12 million in payroll per year. The larger PEO's do around 20-30 times in payroll per year than your average boutique PEO. The larger PEO's did not have to put up a bond in the last 30-40 years so they had time to save for a \$250,000 collateral bond. If it was a fair bond, the larger PEO's should have to put up a **7.5 million cash collateral bond**. Certainly, the state of Hawaii would not want only three PEO's to exist because if one of those PEO's went out of business, it would be an economic disaster. If a smaller PEO's went out of business, there would be less impact. We need smaller PEO's to pick up the slack and provide more of a one on one service for business owners.

We support the intent of HB 144 HD1 but ask the Committee to consider two amendments:

1) Scalable Bonding Requirements

There are only four (4) states in the entire United States that require mandatory bonds: Hawai‘i, North Dakota, New Mexico and South Carolina. The other twenty (20) states only require a bond (\$100,000 maximum) if the PEO does not meet a minimum net worth or working capital requirements (on average the net worth or working capital requirement is \$50,000 to \$100,000). Hawai‘i currently has a mandatory bond of \$250,000, which is the highest in the entire country of any state requiring a mandatory bond or a voluntary bond when a PEO does not meet minimum net worth requirements. North Dakota, New Mexico and South Carolina all have mandatory bonding requirements of \$100,000 and none of these states requires audited or reviewed financial statements, because a mandatory bond is in place.

In the spirit of compromise we support a scalable bond per the following schedule:



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<u>Annual PEO Payroll</u> ¹	<u>Bond Amount</u>
\$150,000,001 or higher	\$250,000.00
\$25,000,001 to \$150,000,000	\$ 50,000.00
\$0 to \$25,000,000	\$ 10,000.00

2) We support amendments to the “definition” section (please refer to HAPEO’s testimony for this hearing for specific definitional amendments).

Mahalo for your time and consideration. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

DocuSigned by:
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¹ Source: IRS Form 941