

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

830 PUNCHBOWL STREET, ROOM 321
HONOLULU, HAWAII 96813

<http://labor.hawaii.gov>

February 25, 2013

To: The Honorable Sylvia Luke, Chair,
The Honorable Scott Y. Nishimoto, Vice Chair,
The Honorable Aaron Ling Johanson, Vice Chair, and
Members of the House Committee on Finance

Date: Monday, February 25, 2013
Time: 11:00 a.m.
Place: Conference Room 308, State Capitol

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

Re: H.B. No. 144 H.D. 2 Relating to Professional Employer Organizations

I. OVERVIEW OF PROPOSED LEGISLATION

HB144 HD2 combines and amends provisions of Chapter 373L and Chapter 373K, Hawaii Revised Statutes (HRS), presumably to clarify responsibilities of the client company and the professional employer organization (PEO), as well as to relieve the onerous financial and administrative requirements contained in the existing statutes, for which the department does not have the experience or expertise to oversee.

The DLIR has struggled with implementing the conflicting laws (373L, 373K) in a meaningful way, especially as Act 129 (SLH, 2010) required regulatory functions and expertise outside the scope of the department's existing scope of regulation. Therefore, the DLIR has engaged in internal deliberations and discussions with various stakeholders since the passage of SB2424 SD2HD2CD1, which was vetoed, in order to provide recommendations for the Legislature to deliberate this session.

Overall, the Department supports the intent of HB144 HD2, but has serious concerns about provisions pertaining to the scope of the regulatory functions, the allocation of responsibilities regarding compliance with labor laws, and the proposed amendments to section 383-66(b)(1) affecting an employer's experience rating in Unemployment Insurance (UI) law. Consequently, the Department prefers the language contained in the previous House draft (HD1), which addresses the major concerns of PEOs while maintaining sufficient oversight to protect employees' rights and benefits. The HD1

clarifies inconsistencies between two separate, but interrelated chapters in the HRS and limits regulatory controls to only those essential to preserving the integrity of the PEO industry and the statutorily required benefits and protections of Hawaii's labor laws.

II. CURRENT LAW

Chapter 373K was enacted in 2007 for purposes of qualifying PEOs for the state general excise tax exemption under section 237-24.75, whereas Chapter 373L was passed in 2010 to regulate the PEO industry by enforcing registration and bonding requirements. Effective implementation of both laws has been hampered by incompatible language, obscure objectives and lack of a common appreciation for the benefits intended or results to be realized.

III. COMMENTS ON THE HOUSE BILL

DLIR believes that the stakeholders with interest in current PEO legislation are mostly in agreement that changes are needed to reconcile the two PEO chapters. All parties concur that the regulatory functions required by Chapter 373L would be best enforced by tying compliance to the general excise tax exemption provided for in §237-24.75, that the registration requirements for PEOs should be lessened, and the notification to DLIR and covered employees in professional employer agreements.

However, one major area of difference is the amendments under section 383-66(b)(1), which HB144 HD2 is proposing, that would require overhauling the entire Hawaii UI tax system at an estimated cost of at least \$23 million to accomplish automation of the experience rating process. Considering the prohibitive costs, limited staff resources, competing ongoing IT projects, and the impractical option of alternative manual processing involved, this measure, as is, cannot be implemented without significant sacrifice to current operations.

Another area of difference amongst the parties is the language describing the rights and responsibilities allocated between the PEO and the client companies. DLIR's position, consistent during the deliberations in the 2012 legislative session and all HD and SD drafts of SB2424 and reflected in the previous House draft, is that the PEO is the exclusive employer for the purposes of workers' compensation, temporary disability insurance, prepaid healthcare and unemployment insurance laws.

This clarification will be in jeopardy with the inclusion of contentious definitions and references to "co-employees", "assigned employees", "covered employees", "co-employment", "offsite employer of record" and "worksite employer" that will make enforcement of labor laws untenable and create insurmountable administrative obstacles rather than remedy the existing conflicts in the PEO statutes, as this bill intends.

February 24, 2013

TO: The Honorable Sylvia Luke, Chair
The Honorable Scott Y. Nishimoto, Vice Chair
The Honorable Aaron Ling Johanson, Vice Chair
Members of the House Committee on Finance

Date: Monday, February 25, 2013
Time: 11:00 a.m.
Place: State Capitol, Conference Room 308

**Re: House Bill 144 HD2 Relating to Professional Employer Organizations
("PEO")**

Dear Chair Luke and Vice-Chairs Nishimoto and Johanson,

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, I would like to thank you for this opportunity to share with you and the committee HiHR's comments as they relate to H.B. No. 144 HD2. **HiHR strongly supports HB 144 HD2.** HiHR believes that this measure will generate new registration fees for the state and will not burden the state with any additional expense. 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. HiHR is a member of the Hawaii Association of Professional Employer Organizations ("HAPEO").

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.

HiHR's Priorities

Overall, HAPEO strongly supports H.B. No. 144 HD2, but has concerns about provisions pertaining to the scope of the regulatory functions and the allocation of responsibilities regarding compliance with labor laws that may be out of our direct control.

HAPEO and HiHR have the following three (3) priorities regarding the proposed PEO legislation:



- (1) We agree with the Scalable Bond in H.B. No. 144 HD2- It is HAPEO and HiHR's priority to have a scalable bond as we have detailed out in our prior testimony to equitably represent the sizes of PEOs in annual taxable payroll. We suggest language be inserted that reads: "The total payroll of the professional employer organization shall be the amount reported on the Internal Revenue Service Form W-3, Transmittal of Wage and Tax Statements, filed with the federal government in the year in which the bond is to become effective."

Letter of Credit

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

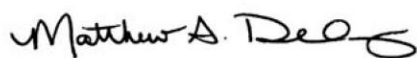
- (2) No Financial Audit – We and the DLIR strongly supports H.B. No. 144 HD2 as currently written with no requirement for audited financial statements.
- (3) Definitional Section – HAPEO and HiHR have been working diligently with DLIR on suggested language changes. DLIR has been open and agreed to some of the suggested changes and has disagreed with other changes. Our dialogue and interaction has been very professional and with the same intent of clearly defining the rights and responsibilities between the DLIR, the PEO and their clients.

We strongly support the language currently in HB144 HD2.

Co-employment language – Based on testimony previously submitted, the Hawaii PEO industry has fundamental concerns about imposing liabilities on the PEOs activities in which the PEO is unable to control at the Client company worksite. Currently SB510 SD1 defines PEOs as "leasing companies" who hires employees and then assigns them to the client's worksite. This is an inaccurate and antiquated depiction of the current PEO contractual and business model. PEOs operate on a co-employment model in which the employer responsibilities are delineated between the PEO (Administrative Employer) and the Client (Worksite Employer). HAPEO as well as PEO of all sizes share this concern.

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

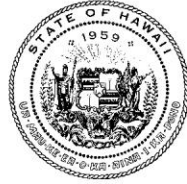


Scott Meichtry
Executive Vice-President



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 Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Monday, February 25, 2013
Time: 11:00 a.m.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 0144, H.D.2 Relating to Professional Employer Organizations

The Department of Taxation (Department) defers to the Department of Labor and Industrial Relations (DLIR) on the merits of this measure, but provides the following information and comments for your consideration.

As it relates to tax, H.B. 144 H.D.2 amends the general excise tax (GET) 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 becomes effective July 1, 2112.

With respect to the general excise tax exemption, the Department notes that it has no means of knowing whether a Professional Employer Organization (PEO) is excluding otherwise coverable persons; whether the PEO has failed to properly register with DLIR or to pay any required fees; or, whether the PEO is otherwise in compliance with chapter 373K, HRS. These determinations are solely within the province of the DLIR. Therefore, the Department can only suspend the GET exemption upon notification from DLIR that the PEO has failed to comply with its rules and regulations.

To address these concerns, the Department suggests amending this measure to include the GET exemption-related language set forth in HB144 HD1. The Department's recommendations in the HD1 draft relate to the timing and notification of the loss of exemption, as well as other clarifying amendments. An explanation of the amendments included in the HD1 are explained more fully below.

The amendments to section 237-24.75, HRS, clearly set forth the timing of the loss of the exemption upon the occurrence of one of the listed events in subsection 3(D). There is no such timing indicator for the events contained in subsections (3)(A) and (3)(B). Therefore, the

Department suggests that subsection 3 of section 237-24.75 be amended to read as follows to address the timing issues contained in this paragraph and the notification issues mentioned in the previous paragraph:

" ~~[-](3) Amounts received[-] by a professional [employment] employer organization from a client equal to amounts that are disbursed by the professional [employment] employer organization for employee wages, salaries, payroll taxes, insurance premiums, and benefits, including retirement, vacation, sick leave, health benefits, and similar employment benefits with respect to [assigned] covered employees at a client company; provided that this exemption shall not apply to a professional [employment] employer organization [upon failure of the professional employment organization to collect, account for, and pay over any income tax withholding for assigned employees or any federal or state taxes for which the professional employment organization is responsible.]~~
after:

(A) Notification from the department of labor and industrial relations that the professional employer organization has, by or through any contract between a client company and any professional employer organization, or otherwise, excluded employees from any employee rights or employee benefits required by law to be provided to covered employees of the client company by the professional employer organization;

(B) A determination by the department that the professional employer organization has failed to pay any tax withholding for covered employees or any federal or state taxes for which the professional employer organization is responsible;

(C) Notification from the department of labor and industrial relations that the professional employer organization has failed to properly register with the director of labor and industrial relations or to pay fees as required by chapter 373K; or

(D) Notification from the department of labor and industrial relations that the professional employer organization is not in compliance with chapter 373K.

As used in this in paragraph, [~~"professional employment organization";~~] "professional employer organization", "client company", and [~~"assigned employee"~~] "covered employee" shall have the meanings provided in section 373K-1."

The Department further recommends that subsection (d) of section 373K-2, HRS, on page 20 of the bill be amended to read as follows to make the two provisions, related to the general excise tax exemption, consistent:

"(d) The general excise tax exemption under section 237-24.75 shall not apply to the professional ~~[employment] employer~~ organization ~~[if]~~ after:

(1) Notification from the department of labor and industrial relations that the professional employer organization has, by or through any contract between a client company and any professional employer organization, or otherwise, excluded employees from any employee rights or employee benefits required by

- law to be provided to covered employees of the client company by the professional employer organization;
- (2) A determination by the department that the professional employer organization has failed to pay any tax withholding for covered employees or any federal or state taxes for which the professional employer organization is responsible;
- (3) Notification from the department of labor and industrial relations that the professional employer organization has failed to properly register with the director of labor and industrial relations or to pay fees as required by chapter 373K; or
- (4) Notification from the department of labor and industrial relations that the professional employer organization is not in compliance with chapter 373K."

Lastly, the Department recommends the following amendment to make the subsection consistent with section 237-24.75, HRS:

Page 20, line 10, delete "assigned" and insert "covered" in lieu thereof.

The Department expects that if the bill were to become law, there would be no material effect on tax revenues.

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-2

INTRODUCED BY: House Committee on Consumer Protection & Commerce

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: July 1, 2112

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 2/23/13



February 24, 2013

TO: The Honorable Sylvia Luke, Chair
The Honorable Scott Y. Nishimoto, Vice Chair
The Honorable Aaron Ling Johanson, Vice Chair

Members of the House Committee on Finance

Date: Monday, February 25, 2013

Time: 11:00 a.m.

Place: State Capitol, Conference Room 308

**Re: House Bill No. 144 HD2 Relating to Professional Employer Organizations
(“PEO”)**

Dear Chair Luke and Vice-Chairs Kidani and Johanson,

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 H.B. No. 144 HD2. **HAPEO strongly supports HB 144 HD2.** HAPEO believes that this measure will generate new registration fees for the state and will not burden the state with any additional expense. 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 be in compliance with federal and state payroll tax laws, insurance laws, employment laws, and many other required mandates 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 evolved 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 supporting the thousands of small businesses in Hawaii.

HAPEO Membership

HAPEO represents approximately twenty (20) local members, which 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.

HAPEO’s Priorities

Overall, HAPEO strongly supports H.B. No. 144 HD2, but has concerns about provisions pertaining to the scope of the regulatory functions and the allocation of responsibilities regarding compliance with labor laws that may be out of our direct control.

HAPEO has the following three (3) priorities regarding the proposed PEO legislation:

- (1) We agree with the Scalable Bond in H.B. No. 144 HD2– It is HAPEO’s priority to have a scalable bond as we have detailed out in our prior testimony to equitably represent the sizes of PEOs in annual taxable payroll. We suggest language be inserted that reads: “The total payroll of the professional employer organization shall be the amount reported on the Internal Revenue Service Form W-3, Transmittal of Wage and Tax Statements, filed with the federal government in the year in which the bond is to become effective.”

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We strongly support the language currently in HB144 HD2.

Co-employment language – Based on testimony previously submitted, the Hawaii PEO industry has fundamental concerns about imposing liabilities on the PEOs activities in which the PEO is unable to control at the Client company worksite. Currently a similar bill in the Senate (SB510 SD1) defines PEOs as “leasing companies” who hires employees and then assigns them to the client’s worksite. This is an inaccurate and antiquated interpretation of the current PEO contractual and business model. PEOs operate on a co-employment model in which the employer responsibilities are delineated between the PEO (Administrative Employer) and the Client (Worksite Employer). HAPEO as well as the two large PEOs in the state share this concern. The majority of the states across the country recognize co-employment and the delineation between the PEO and the client and its employees.

2013 Legislative Session

We will continue to work collaboratively with all stakeholders to improve the current laws that were passed back in 2010, and which have still not been implemented in their entirety as a result of challenges with bonding requirements, audited financials, and some other factors. HAPEO is also 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. 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 that reads "Matthew S. Delaney". The signature is fluid and cursive, with a prominent initial "M" and a long, sweeping tail.

Matthew S. Delaney
President of the Board
HAPEO



February 24, 2013

TO: The Honorable Sylvia Luke, Chair
The Honorable Scott Y. Nishimoto, Vice Chair
The Honorable Aaron Ling Johanson, Vice Chair

Members of the House Committee on Finance

Date: Monday, February 25, 2013

Time: 11:00 a.m.

Place: State Capitol, Conference Room 308

Re: **House Bill 144 HD2 Relating to Professional Employer Organizations (“PEO”) –Strong Support**

Dear Chair Luke and Vice-Chairs Nishimoto and Johanson,

My name is Sanjay Mirchandani, and I am the Owner of Talent HR Solutions, a locally owned and operated PEO. **I submit this testimony in support of HB 144 HD2.**

The existing laws do not promote competition and it stifles innovation and entrepreneurship. Larger PEO's are at more risk if their clients default on payment or if the PEO has any major tax filing blunders. We are in full support of a scalable bond.

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. 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



We believe that PEOs, like most employers, are already regulated by civil and criminal laws and are subject to department of labor and industrial relations penalties for failure to comply with payroll and labor laws. Additional regulatory enforcement of PEOs by the DLIR needs to be simplified.

HB 144 HD2 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 (co-employment) between a client company and the PEO. HB 144 HD2 also includes a scaled bonding requirement which is fair for PEOs of all sizes.

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.

Mahalo for your consideration and hoped for passage of this important measure.

Respectfully submitted,

DocuSigned by:
Sanjay Mirchandani
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Sanjay Mirchandani

Owner, Talent HR Solutions