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GOVERNOR

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STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
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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: Monday, March 18, 2013  
Time: 2:30 p.m.  
Place: Conference Room 325, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

Re: S.B. 0510, S.D.2, H.D.1 Relating to Professional Employer Organizations

The Department of Taxation (Department) **appreciates the intent** of S.B. 0510, S.D.2, H.D.1, 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.

As it relates to tax, S.B. 0510, S.D.2, H.D.1 amends the general excise tax exemption for professional employer organizations that is set forth under 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 has a defective effective date of 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 the measure to clarify the timing and notification of the loss of the exemption. The suggested amendments and their explanations are provided below.

Currently, S.B. 0510, S.D.2, H.D.1 amends section 237-24.75, HRS, to 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, HRS, be amended to read as follows to address the timing issues contained in this previous 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."

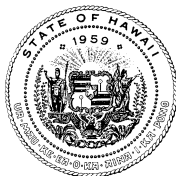
The Department further recommends that subsection (d) of §373K-2, HRS, on page 20 of the bill be amended to read as follows to make the two provisions, both related to the general excise tax, consistent:

- (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.

The Department estimates that the bill will have no material effect on tax revenues.

Thank you for the opportunity to provide comments.



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

830 PUNCHBOWL STREET, ROOM 321  
HONOLULU, HAWAII 96813

<http://labor.hawaii.gov>

March 18, 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: Monday, March 18, 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: SB510 SD2HD1 Relating to Professional Employer Organizations**

**I. OVERVIEW OF PROPOSED LEGISLATION**

SB510 SD2HD1 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.

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. Those recommendations are contained in SB510 SD2.

Overall, the Department supports the intent of SB510 SD2HD1, but prefers SB510 SD2, which addresses the major concerns of PEOs while maintaining sufficient oversight to safeguard employees' rights and benefits. SB510 SD2 is a collaborative effort, endorsed by its legislative sponsor, the Department of Taxation, and the Department of Labor & Industrial Relations to facilitate implementation by clarifying inconsistencies between two separate, but interrelated chapters in the HRS and limiting 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 (GET) exemption (GET) 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 of the benefits intended or results to be realized.

## III. COMMENTS ON THE SENATE BILL

DLIR understands that the stakeholders with interest in current PEO legislation are in agreement with the need to reconcile the two PEO chapters and 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. The department also maintains that the statutes must be simplified and procedures streamlined for PEO registration to proceed and effectively accomplish its objectives.

However, in its present form, SB510 SD2HD1 contains provisions that challenge these presumptions, including:

- 1) **Proposed amendments under section 383-66(b)(1) relating to transfer of experience records from the client company to the PEO.** As these transactions cannot be accomplished under the existing UI tax system, these provisions would require overhauling the entire experience rating process at a cost of approximately \$23 million. Considering the prohibitive costs, limited staff resources, competing ongoing IT projects, and the inconceivable option of alternative manual processing of the amendments to section 383-66(b)(1), this measure, as is, cannot be implemented.
- 2) **New proposed language describing the rights and responsibilities allocated between the PEO and the client companies.** It is inevitable that, by including equivocal definitions of "assigned employee", "leased employee", "co-employee", "covered worker", "co-employment", "work site employer" and "offsite employer of record", the PEO registration process will be stifled and the essential protections of affected employees will be undermined. Though apparently distinguishable to the bill's drafters, the ambiguities created by the multiple definitions will make enforcement of labor laws untenable and result in insurmountable administrative obstacles rather than remedy the

existing conflicts in the PEO statutes, as this bill intends.

- 3) **Additional enforcement responsibilities for the department without funding for positions.** Although prior measures requested a minimum of \$177,500 out of state general revenues to carry out its purposes, a similar appropriation is absent in SB510 SD2HD1. More significantly, the DLIR does not have the experience or expertise to oversee the regulatory controls over businesses as provided in:
- a. Section 373K-E to hold chapter 91 hearings in every case in which the director denies, suspends, revokes or denies renewal of a PEO registration.
  - b. Section 373K-F to process judicial reviews filed by PEOs aggrieved by the final decision and order by the director or hearings officer in contested cases.
  - c. Section 373K-G to monitor the posting of bonds by PEOs and take necessary legal action to require PEOs that fail to have a current bond in effect to immediately cease doing business in the State.

The department has consistently supported limited enforcement authority that favors sanctions relating to the GET exemption in lieu of issuing cease and desist orders. Moreover, it is DLIR's understanding that all the parties have already agreed to take these provisions off the table and use the GET exemption as the teeth of the law.

- 4) All the parties have already also agreed that the written notice provided to the department should be 21 days and not 30 as in the HD1 (Pg. 6, line 20).

Twenty-Seventh Legislature  
Regular Session of 2013

HOUSE OF REPRESENTATIVES  
Committee on Consumer Protection & Commerce  
Rep. Angus L.K. McKelvey, Chair  
Rep. Derek S.K. Kawakami, Vice Chair  
State Capitol, Conference Room 325  
Monday, March 18, 2013; 2:30 p.m.

**STATEMENT OF THE ILWU LOCAL 142 ON S.B. 510, SD2, HD1  
RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS**

The ILWU Local 142 supports the intent of S.B. 510, HD1, which requires the registration and regulation of professional employer organizations. We fully support the regulation of Professional Employer Organizations (PEOs). However, we support the Department's preference for S.B. 510, SD2.

One reason is that SD2 requires that covered employees be notified about the PEO relationship. To protect the interests of employees, workers must be fully informed about who their employer is. Workers who are unionized have representation to ensure that the proper employer meets its obligations, but non-union workers have to go it alone. If they lack English language skills or are unfamiliar with the laws, they are at the mercy of both the PEO and the client company.

We would like to cite an example of what can happen. A seed corn company, part of a multi-billion dollar global industry, contracted with a PEO which served as the employer for the assigned employees. One of the workers, a former member of the ILWU in her 60's and for whom English is a second language, was fired by the PEO for not being able to come to work. She explained to the person who supervised her in the fields that the person who had been providing her transportation to work quit his job. She no longer had a way to work and the jobsite was at least a half mile from the nearest bus stop. She applied for unemployment insurance but was denied because she failed to notify her employer about her transportation issues and did not show up for work.

In the hearing to appeal the Unemployment Division's disqualification, the PEO said if they knew about her transportation problems, they could have helped her find a solution. The worker explained that she told her supervisor. Only in the course of the hearing did it become clear that the PEO was her employer and all employment-related issues were to be directed to the employer (the PEO), not the supervisor in the company which hired her and whose name appears at her place of employment. Very few of the employees, it seems, knew about the role the PEO played in their employment.

As more employers attempt to relieve themselves of employment-related legal responsibilities to their employees, it is vitally important that professional employer organizations are stringently regulated and that laws are enforced. Employees need every protection possible to ensure that they do not suffer losses because of arrangements made by those who hire them.

The ILWU urges the committee to restore the language in S.B. 510, SD2 and pass the amended bill. Thank you for the opportunity to testify on this measure.



March 17, 2013

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

Date: Monday, March 18, 2013

Time: 2:30 p.m.

Place: State Capitol, Conference Room 325

**Re: Senate Bill No. 510 SD2 HD1 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 S.B. No. 510 SD2 HD1. **HAPEO strongly supports SB No. 510 SD2 HD1.** 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 approximately ninety-three percent (93%) of the State's PEOs.

### **HAPEO's Priorities**

Overall, HAPEO strongly supports S.B. No. 510 SD2 HD1, 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 S.B. No. 510 SD2 HD1 – 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."

#### Letter of Credit

HAPEO 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 S.B. No. 510 SD2 HD1 as currently written with no requirement for audited financial statements.
- (3) Definitional Section – HAPEO has 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 S.B. No. 510 SD2 HD1.



Maintaining Co-employment language in S.B. No. 510 SD2 HD1 as it is currently written is of utmost importance to the PEO industry – 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. PEOs provide only the administrative responsibilities for clients’ employees with which the client hires and maintains the workplace relationship.

Currently a similar bill in the Senate (HB144 HD2 SD1) defines PEOs as “employee 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 contract and business model. PEOs operate on a co-employment model in which the employer responsibilities are fairly 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,

Matthew S. Delaney  
President of the Board  
HAPEO

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Professional employer organizations

BILL NUMBER: SB 510, 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: 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 3/15/13



March 15, 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: SB510, SD2, HD1, March 18, 2013, 2:30 p.m., Room 325

Dear Reps. McKelvey and Kawakami:

My name is Barron Guss, President and second-generation owner of ALTRES, Inc., a 44-year old Hawaii company and Hawaii's oldest Professional Employer Organization (PEO). I am writing you today not in favor or opposition, but with concern that the responsible consumer protection measure of Act 129 is being dissolved in favor of the inadequate companion bills SB510 and HB144, both of which are traveling through the House and Senate.

As you are aware, Act 129 has stringent and responsible bonding and audit requirements. As a result of public outcry, SB510, in its current form, drastically reduces oversight and financial responsibility by the elimination of the audit requirement and the introduction of scalable bonding.

The concept of scalable bonding is not new, as Act 129 also has this flexible provision, but at more appropriate levels. In contrast, SB510 has brought the bonding levels much lower and introduces thresholds of increase at milestones which have no relevance to the market or the exposure.

My testimony today is to urge you to take a second look at the levels and adjust the schedule accordingly. For instance, the average PEO in the Hawaii Association of Professional Employer Organizations (HAPEO) has an annual revenue volume of no more than \$5million. Is it truly appropriate to let these businesses grow by more than 500% before you ask them to post a bond of more than \$25,000? All one has to do is perform a Google search for PEO fraud and you will see why true consumer protection is needed and that SB510 is not only insufficient, it's a slap in the face of those who rely on government protection.

In this session, the HAPEO members have also managed to have this legislature remove the audit requirement. In short, the biggest benefactor of the audit is the PEO itself. An audit will give the PEO operator assurance, guidance and, in the event of looming failure, provide ample notification to make adjustments. I feel the audit requirement on a business is akin to having routine and preventive maintenance on an airplane. If you showed up at the airport and had a choice between an aircraft that received routine maintenance (audit) or one with a parachute (\$25,000 bond) under the seat, which would you choose?

March 15, 2013  
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Please forgive me for what I am about to say and the way it sounds. I am the foremost authority in the State on PEOs and their operations. I have operated a PEO for more than 30 years. I have sat as a Board member of the National Association of Professional Employer Organizations (NAPEO) for three terms. I am a founding Board member of the Employer Services Assurance Corporation (ESAC). ESAC is the equivalent of the FDIC for banks and is the entity that audits, scrutinizes and provides bonding to qualifying PEOs. I have worked tirelessly and funded every bit of PEO legislation that has been passed in the State of Hawaii. Finally, it was I who brought my concerns about consumer protection to the DLIR as well as members of the legislature long before many of the current PEOs were even in business. Yet, in spite of my experience and breadth of knowledge, not once have I been contacted personally for my input by any member of the legislature or DLIR this session.

I am close to giving up my fight to get the legislature to put appropriate consumer protection ahead of dissident outcry. For a small group of PEO operators who are not complying with the law (under protest rather than meet their obligations) to have wielded this kind of influence over the legislature is stunning.

My testimony to your committee today is my last-ditch effort to get you to listen to reason and prevent this legislature from letting its guard down and creating bad law.

Respectfully submitted,



Barron L. Guss  
President and CEO

March 17, 2013

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

Date: Monday, March 18, 2013  
Time: 2:30 p.m.  
Place: State Capitol, Conference Room 325

**Re: Senate Bill No. 510 SD2 HD1 Relating to Professional Employer Organizations (“PEO”)**

Dear Chair McKelvey and Vice-Chair Kawakami,

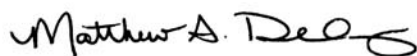
Our names are Matthew S. Delaney, Co-Founder, CEO and President and Scott Meichtry, Co-Founder and Executive Vice-President of Hawaii Human Resources, Inc. (“HiHR”), a locally owned and operated Professional Employer Organization (“PEO”) and member of the Hawaii Association of Professional Employer Organizations (HAPEO). On behalf of HiHR, we would like to thank you for this opportunity to share with you and the committee HiHR’s comments as they relate to S.B. No. 510 SD2 HD1.

**HAPEO members’ priorities are in line with this bill as it is currently written and we strongly support the language currently in S.B. No. 510 SD2 HD1.**

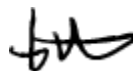
HiHR is one of the 3 largest PEOs in the State of Hawaii. We currently service 385 different businesses and approximately over 7,000 client worksite employees on all of the major Hawaiian Islands. We formed this company in January 2009 to provide an alternative option for small and medium-sized businesses 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”).

Mahalo for your time and consideration. We look forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry. 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

