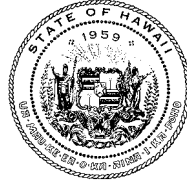


NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



LATE

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To: The Honorable David Y. Ige, Chair
and Members of the Senate Committee on Ways and Means

Date: Friday, February 22, 2013
Time: 9:00 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. No. 0510, S.D.1 Relating to Professional Employer Organizations

The Department of Taxation (Department) supports the tax-related amendments proposed in S.B. 510, S.D.1. The Department provides the following information and comments for your consideration, and defers to the Department of Labor and Industrial Relations as to the merits of this measure.

As it relates to tax, this measure 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 is effective upon approval.

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

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

Thank you for the opportunity to provide comments.



February 21, 2013

TO: The Honorable David Y. Ige, Chair
The Honorable Michelle N. Kidani, Vice Chair
Members of the Senate Committee on Ways and Means

Date: Friday, February 22, 2013

Time: 9:00 a.m.

Place: State Capitol, Conference Room 211

**Re: Senate Bill No. 510 SD1 Relating to Professional Employer Organizations
("PEO")**

Dear Chair Ige and Vice-Chair Kidani,

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 HD1. While HAPEO supports the intent of this measure, as noted in our testimony, HAPEO requests the Committee's consideration of certain amendments to insure fairness and clarity in the definitional section. 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 supports the intent of S.B. No. 510 SD1, 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 SD1– 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.

Letter of Credit

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

- (2) Removal of the Audit – We and the DLIR strongly supports S.B. No. 510 SD1 as currently written with the elimination of the audited financial statements.
- (3) Amendments to the “definition” 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.

Suggested Definitional Changes:

- (i) 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.



- (ii) 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.
- (iii) “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, collective bargaining rights, anti-discrimination provisions, 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 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

LATE



*William L. Wong CPA
& Associates, Inc.*
CERTIFIED PUBLIC ACCOUNTANTS

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Senator David Y. Ige, Chair
Senator Michelle N. Kidani, Vice Chair
Ways and Means Committee
Hawaii State Capitol
Honolulu, HI

February 21, 2013

RE: **SB510, SD1, SD1**
Relating to Professional Employer Organizations

Ladies and Gentlemen:

I am a financial and tax consultant, CPA, real estate developer and an owner of a small Professional Employer Organization (PEO) serving all four islands. 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. Please note that of the eleven PEO companies that are registered in Hawaii, only the two largest local PEOs, ProService and Altres, were able to meet the requirements of the law.

I am in favor of **SB510, SD1**, with certain revisions that need to be made, a redlined copy of which is attached to this testimony.

SB510, SD1, SD1

1. If the definition of co-employment is eliminated from existing law by this bill, 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 a professional employer organization agreement, the client company is the worksite employer that has 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, it is very important to distinguish the worksite employer, the client company, from the offsite employer, the PEO, and these important definitions must be added to **SB510, SD1**. The bill must be carefully worded to prevent client companies from abrogating their employer responsibilities, simply by entering into a contract with a PEO. If the language is not clear, DLIR enforcement of the perpetrator, the client company, may be impaired. 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.



Personal Financial Specialist

MEMBER OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS



America Counts on CPAs

2. A PEO actually helps client companies comply with payroll and tax 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. **SB510, SD1** may have dangerous and unintended consequences of relieving client companies of certain obligations to its employees and transferring these obligations to the PEO.
3. **SB510, SD1** preserves the bonding requirements of PEOs but provides for a sliding scale bond amount based on the size of the payroll of the PEO. Surety bonds are superfluous to already harsh criminal, civil sanctions, tax penalties and interest charges that are assessed against any employer who violates payroll and tax laws. If the Senate should insist on such a bond, a change should be made to allow substitutions by a PEO of a letter of credit equivalent to the bond amount. These letters of credit equivalents are normally contained in Hawaii State leases where surety or performance bonds are required. Without this change, a PEO must only deal with an insurance company rather than a bank that normally issues letters of credit.

Respectfully Submitted,

William L. Wong

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

A BILL FOR AN ACT

~~RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS.~~

~~RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS.~~

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

SECTION 1. The legislature finds that Act 225, Session Laws of Hawaii 2007, created a new chapter on professional employment organizations that provided a general excise tax exemption to business entities the department of taxation determined as qualified professional employer organizations.

The legislature further finds that Act 129, Session Laws of Hawaii 2010, established a new professional employer organizations chapter that required registration with the department of labor and industrial relations to ensure compliance with federal and state labor laws. The legislature notes that the two separately established statutes, while intended to operate interdependently for the mutual benefit and common public purposes of the department of labor and industrial relations and the department of taxation, could be implemented more effectively by clarifying any existing incompatible and ambiguous language.

The purpose of this Act is to clarify professional employer organization responsibilities, including meeting the statutory requirements of chapter 373L, Hawaii Revised Statutes, and the

nexus between the registration of professional employer organizations and qualification for the state general excise tax exemption.

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

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

§373L-B Professional employer agreements; notification to covered employees; notification to department. ~~(a)~~ During the term of the agreement between a professional employer organization and its client company, the professional employer organization shall be deemed the [offsite employer of record](#) for all assigned employees ~~as defined in section 373L-1~~. As the employer of the assigned employees, the professional employer organization, not the client company, shall be solely responsible for complying with all statutory provisions relating to the unemployment insurance, workers' compensation, temporary disability insurance, and prepaid health care programs with respect to the assigned employees.

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

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

(1) Registration fee \$500

(2) Biennial renewal fee \$750

~~(3) Restoration fee \$1500~~

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

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

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

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

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

[+](3) Amounts received[+] by a professional [~~employment~~ employer organization that is registered with the department of labor and industrial relations pursuant to chapter 373L, from a client company 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 employees at a client company; provided that this exemption shall not apply to amounts received by 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 not fulfilled or maintained the registration requirements under this chapter; or

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

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

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

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

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

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

"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.

"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, collective bargaining rights, anti-discrimination provisions, 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.

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

"Client company" means any person [~~who enters into a professional employer agreement with a professional employer organization.~~] that enters into a professional employer agreement with a professional employer organization and is

assigned employees to its worksite by the professional employer organization under that agreement.

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

- (1) [~~The co-employment of covered employees; and~~] Assignment of employees to the worksite of the client company;
- (2) [~~The allocation of employer rights and obligations between~~] Description of duties and responsibilities of the client company and the professional employer organization with respect to the [covered] assigned employees[-]; and
- (3) Clarification of the p~~Professional employer organization as the employer of the assigned employees for purposes of complying with all statutory provisions relating to the unemployment insurance, workers' compensation, temporary disability insurance, and prepaid health care programs with respect to the assigned employees.~~

"Professional employer organization" or "organization" means [~~any person that is a party to a professional employer agreement with a client company regardless of whether the person uses the term or conducts business expressly as a "professional employer organization", "PEO", "staff leasing company", "registered staff leasing company", "employee leasing company", "administrative~~

~~employer", or any other similar name.] a business entity that assigns employees to the worksites of its client companies on a long-term, rather than temporary or project-specific basis. The term does not include temporary help services or other similar arrangements."~~

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

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

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

- ~~(1) The individual has received written notice of co-employment with the professional employer organization; and~~
- ~~(2) The individual's co-employment relationship is pursuant to a professional employer agreement subject to this chapter. Individuals who are officers, directors, shareholders, partners, and managers of the client company shall be covered employees to the extent that~~

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

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

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

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

- (1) The name or names under which the professional employer organization conducts or will conduct business;
- (2) The address of the principal place of business of the professional employer organization and the address of

each office that the professional employer organization maintains in this State;

- (3) The professional employer organization's general excise tax number;
- (4) A copy of the certificate of authority to transact business in this State issued by the director of commerce and consumer affairs pursuant to title 23 or title 23A, if applicable;
- (5) A list, organized by jurisdiction, of each name under which the professional employer organization has operated in the preceding five years, including any alternative names; names of predecessors; and, if known, names of successor business entities;
- (6) A statement of ownership, which shall include the name of each person who, individually or acting in concert with any other person or persons, owns or controls, directly or indirectly, twenty-five per cent or more of the equity interests of the professional employer organization;
- (7) A statement of management, which shall include the name of any person who serves as president or chief executive officer or who otherwise has the authority to act as a senior executive officer of the professional employer organization;

- (8) Proof of valid workers' compensation coverage of assigned employees in compliance with all laws of this State;
- (9) Proof of compliance with the Hawaii temporary disability insurance law for all assigned employees;
- (10) Proof of compliance with the Hawaii prepaid health care act for all assigned employees [~~as regards all employees of the professional employer organization~~];
- (11) Proof of compliance with the Hawaii employment security law, including payment of any applicable employer liability pursuant to chapter 383; [~~and~~]
- (12) [~~A financial statement prepared in accordance with generally accepted accounting principles, audited by an independent certified public accountant licensed to practice in the State, and without qualification as to the going concern status of the professional employer organization.~~] The name, address, and phone number of the financial institution utilized by the professional employer organization for payroll purposes that operates and maintains branches in the State; ~~and~~
- (13) The name of each client company that is party to a professional employer agreement with a professional employer organization to the department on a form approved by the department within ~~fivetwenty-one~~ business days of the initiation of the agreement and

within ~~fivetwenty-one~~ business days of the termination of the agreement; and

(14) A copy of the Internal Revenue Service Form W-3, Transmittal of Wage and Tax Statements, filed with the federal government, which shall be used for obtaining a bond pursuant to section 373L-3.

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

~~(d)~~ Notwithstanding that a registration under this section has not expired, a professional employer organization shall submit to the department a copy of the Internal Revenue Service Form W-3, Transmittal of Wage and Tax Statements, filed with the federal government on an annual basis no later than June 30 of each year. If the amount of the total payroll has changed to an amount that requires a different bond amount than posted with

the department, the professional employer organization shall obtain a new bond to satisfy the requirements of section 373L-3.

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

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SECTION 6. ~~Chapter 373K~~Section 373L-3, Hawaii Revised Statutes, is ~~repealed-~~amended by amending subsection (a) to read as follows:

"(a) No professional employer organization shall enter into a professional employment agreement with a client company in the State unless the professional employer organization posts a surety bond [~~in the amount of \$250,000, which is a performance or financial guaranty type bond naming the]~~ or a letter of credit equivalent to the required bond amount, that is based on the previous year's ~~certified~~ total payroll of the professional employer organization. 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. The bond required under this section shall be on a sliding bond scale as follows:

(1) For professional employer organizations with a total payroll up to and including \$25,000,000, a bond of \$25,000;

(2) For professional employer organizations with a total payroll of \$25,000,001 to \$150,000,000, a bond of \$75,000; and

(3) For professional employer organizations with a total payroll of \$150,000,001 and higher, a bond of \$250,000.

The director shall be named as the obligee in which the bond or a portion of the bond or letter of credit equivalent shall be called by the obligee only upon the department proving damages with respect to assigned employees of the client company caused by the failure of the professional employer organization to comply with chapter 373L, other than non-payment by the client company of its obligations to the professional employer organization under the professional employer organization agreement. ~~and which and [which] t~~The bond may be canceled only if the professional employer organization gives sixty days prior written notice to the surety or if the surety gives thirty days prior written notice to the director of cancellation of the bond. The requirements of this section shall be satisfied by a single bond. If a professional employer organization has more than one branch location, the bond shall cover all locations."

SECTION 7. Chapter 373K, Hawaii Revised Statutes, is repealed.

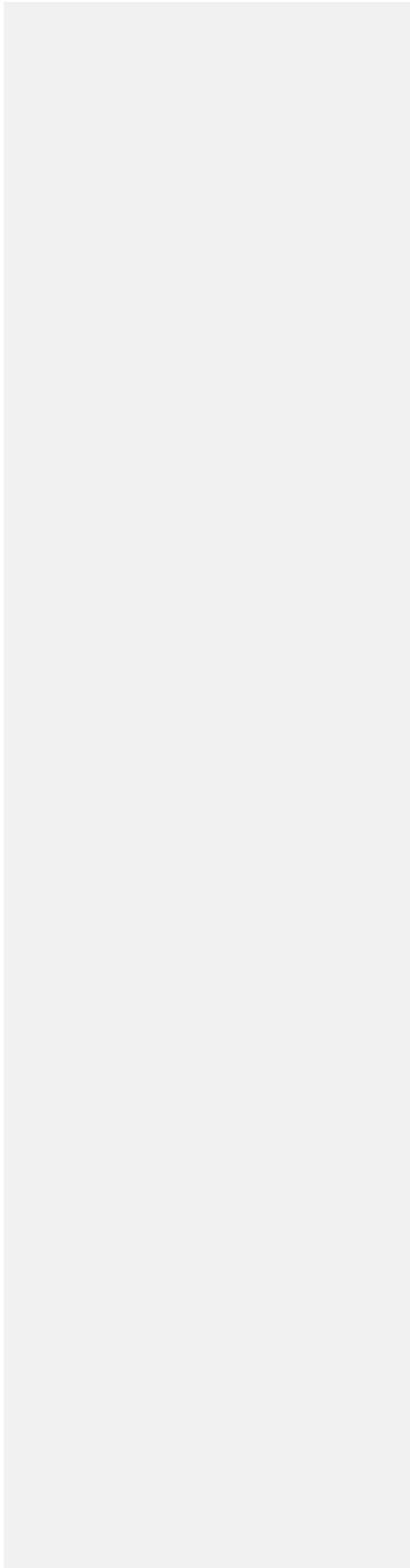
SECTION 8. This Act does not affect rights and duties that matured, penalties that were incurred, and proceedings that were begun before its effective date.

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

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

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

~~INTRODUCED BY:~~ _____



Report Title:

Professional Employer Organizations; Registration; Fees; Bond

Description:

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

Requires professional employer organizations to obtain a bond on a sliding scale that is based on total payroll amount. (SD1)

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