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LETTER RULING NO. 2010-31
[REDACTED TEXT]
[REDACTED TEXT]
[REDACTED TEXT]
[REDACTED TEXT]

December 1, 2010

RE: APPLICATION OF P.E.O. GENERAL EXCISE TAX EXEMPTION TO [REDACTED TEXT]

Dear [REDACTED TEXT]:

This letter responds to your May 26, 2010 request for a letter ruling submitted on behalf of your client, [REDACTED TEXT] (the Company), confirming that certain of its gross receipts are exempt from the general excise tax (GET) as a professional employment organization (PEO).

STATEMENT OF FACTS

The Company is a Hawaii limited liability company that was formed in [REDACTED TEXT] and is wholly owned by [REDACTED TEXT] ("[PARENT]"). The Company's address is [REDACTED TEXT], with a FEIN number of [REDACTED TEXT] and a GET number of [REDACTED TEXT]. The Company reports its income and expenses on a [REDACTED TEXT] basis.

[PARENT] was formed in [REDACTED TEXT] to acquire [REDACTED TEXT] (collectively, the "[INVESTMENT]"). [PARENT] is treated as a partnership for income tax purposes. From its inception, [PARENT] formed several single member LLC entities to conduct different operational functions for the [INVESTMENT].

Upon acquisition of the [INVESTMENT] by [PARENT], approximately half of all existing employees were under a collective bargaining agreement with the [REDACTED TEXT] (the "Union"). [PARENT] and the Union concluded that because of the collective bargaining agreement in place and the previous employer's practices, it was more efficient for [PARENT], the Union, and the employees to have one of the [PARENT]'s single member LLC's, the Company, as the employment organization of record for all of the employees of these [PARENT] client entities.

A. [PARENT] and the Operating Entities

The Company's employees were assigned to the following 100% [PARENT]-owned companies (collectively, the "Operating Entities"):

- [SMLLC 1] - [REDACTED TEXT];
- [SMLLC 2] - [REDACTED TEXT]
- [SMLLC 3] - [REDACTED TEXT] and
- [SMLLC 4] - [REDACTED TEXT].

The LLC entities above are treated as disregarded entities for income tax purposes. [SMLLC 4]; however, is treated as a corporation for income tax purposes. [PARENT] fully funds the Company's payroll obligations for the Operating Entities through capital contributions to the Company. [SMLLC 2] and [SMLLC 3] generate funds from operations to make distributions to [PARENT] from time to time. There are no formal agreements in writing for the provision of the Company's employees to the Operating Entities. Nevertheless, the provision of the Company's employees was pursuant to verbal agreements and understanding of the parties. The Company represents that the agreements and understanding of the Company and the Operating Entities are enforceable contractual arrangements. The Company further represents that the verbal intercompany workforce agreements are on terms standard in the industry.

B. [FORMER INVESTMENT]

The Company's employees were also assigned to the following 50% owned company:

- [FORMER INVESTMENT] - [REDACTED TEXT].

[FORMER INVESTMENT] was owned 50% by [PARENT] and 50% by a third party unrelated to [PARENT] or the Company, until [REDACTED TEXT], when [PARENT] sold its entire interest to its existing 50% partner. Upon the sale of [PARENT]'s interest in [FORMER INVESTMENT], the Company entered into a workforce agreement to provide employment services for [FORMER INVESTMENT].

The Company's employment arrangement with [FORMER INVESTMENT] is documented in an agreement dated [REDACTED TEXT] between the Company as employment organization and [FORMER INVESTMENT] as client company (the "Workforce Agreement").

The Workforce Agreement provides for the reimbursement of all salary, hourly wages, payroll taxes, workers compensation insurance, employee benefits, and any other approved

employee costs. The Workforce Agreement also provides for set management fees which are payable to the Company on a monthly basis.

Historically, [FORMER INVESTMENT] has generated sufficient revenues to fund wages and payroll taxes for the Company's employees. The Company and the owners of [FORMER INVESTMENT] have instructed [REDACTED TEXT] (payroll service provider) to direct debit the [FORMER INVESTMENT] checking account for all wages and payroll taxes related to employees provided by the Company to [FORMER INVESTMENT]; however, the Company still advances and collects a direct reimbursement for these employees' benefits on a monthly basis.

For the period [REDACTED TEXT] to current, the Company reported and paid the 4% GET on the full amount of the wage and payroll tax amounts received from [FORMER INVESTMENT]. The Company did not pay the GET on reimbursements from [FORMER INVESTMENT] for related employee benefits such as health insurance, workman's compensation, life insurance, and company matching retirement payments.

QUESTION PRESENTED

Whether amounts received by the Company from:

(1) [PARENT] for employees provided to the Operating Entities; and

(2) [FORMER INVESTMENT] for employees provided to [FORMER INVESTMENT];

are exempt from the general excise tax under Section 237-24.75, Hawaii Revised Statutes (HRS).

BRIEF ANSWER

For amounts received on or after July 1, 2007, the Company qualifies for the general excise tax exemption for certain disbursed amounts received by a PEO from a client company because the amounts qualify for the exemption under HRS § 237-24.75(3), as discussed in more detail below.

LAW & ANALYSIS

Hawaii law provides an exemption from the general excise tax for certain amounts received by a PEO. Section 237-24.75, HRS, exempts from the GET "[a]mounts received by a [PEO] from a client company equal to amounts that are disbursed by the [PEO] for employee wages, salaries, payroll taxes, insurance premiums, and benefits...with respect to assigned employees at a client company." HRS § 237-24.75(3). Operative terms used in the PEO exemption have the same meanings as terms in HRS § 373K-1.

A "professional employment organization" is "a business entity that offers to co-employ employees that are assigned to the worksites of its client companies." HRS § 373K-1.

A "client company" is "a person that contracts with a professional employment organization and is assigned employees by the professional employment organization under that contract." *Id*.

An "assigned employee" is "an employee under a professional employment organization arrangement whose work is performed in the State. The term does not include an employee hired to support or supplement a client company's workforce as temporary help." *Id*. "Temporary help" means "an arrangement by which an organization hires its own employees and assigns them to a client company to support or supplement the client's workforce in a special situation, including . . . [a]n employee absence; . . . [a] temporary skill shortage; . . . [a] seasonal workload; or . . . [a] special assignment or project." *Id*.

The Company is a PEO, as represented, because it co-employs employees that are assigned to work sites of [FORMER INVESTMENT] and the Operating Entities. Co-employment is not defined in Chapter 237 or Chapter 373K, HRS. "Under the common law doctrine of co-employment, a worker may have the status of an employee with respect to more than one employer if the service to one does not involve abandonment of service to the other. Therefore, two employers may employ a worker simultaneously." CCA 200415008. The Department interprets co-employment to include situations where an employee may have one employer that is the "Statutory Employer," and another employer that is the "Common Law Employer." In this situation, Statutory Employer is typically the employer of record for employment tax purposes and other human resource matters. Common Law Employer, on the other hand, is the employer with control over the employee's work environment. Such a situation constitutes co-employment within the meaning of HRS § 237-24.75(3) because the employee does not abandon its rights and obligations to either employer and proceeds to carry out its employment simultaneously between the two employers. The Company represents that, between the Company and the Operating Entities, a division of the statutory and common law rights and obligations of the employers has occurred that is consistent with the doctrine of common law co-employment. Therefore, the Company qualifies as a PEO because it is one employer involved in the co-employment of its employees.

The Company's employees qualify as assigned employees because they perform work in Hawaii and fill permanent, not temporary, positions at [FORMER INVESTMENT] and the Operating Entities. [FORMER INVESTMENT] and each of the Operating Entities are considered a client company because they have workforce agreements with the Company, a PEO, and were assigned employees by the Company under their respective agreements with the Company. HRS § 373K-1 does not expressly require written contracts in order to enjoy the PEO GET exemption. Though the Company's workforce agreements with the Operating Entities are verbal, the Company represents that such arrangements are enforceable as a matter of contract law.

Therefore, based on the foregoing discussion, the Company is a PEO and is exempt from the GET on monies received from [FORMER INVESTMENT] and the Operating Companies (through their parent [PARENT]) for the assigned employee payroll, benefits, and other exempt expenses as of July 1, 2007, the effective date of HRS § 237-24.75(3).

Amounts received by the Company not expressly discussed in this letter may be subject to the general excise tax unless expressly exempt by law. For example, the management fee received by the Company from [FORMER INVESTMENT] is subject to the general excise tax. Amounts received that qualify as nontaxable reimbursements under HRS § 237-20 or nontaxable capital contributions will be treated accordingly; however are not analyzed for purposes of this letter.

The conclusions drawn in this letter are contingent upon the Company at all times being considered a PEO under Chapter 373K, HRS. The conclusions drawn in this letter also do not take into consideration the impact of Act 129, Session Laws of Hawaii (SLH) 2010. Act 129 SLH 2010 institutes a registration requirement for PEOs beginning July 1, 2011; however also has exemptions from the registration requirement. Should the facts change so that the Company no longer constitutes a PEO within the meaning of Chapter 373K, HRS, the Company will no longer qualify for the PEO GET exemption.

CONCLUSION

Based upon the discussion above, for amounts received on or after July 1, 2007, the Company qualifies for the PEO GET exemption under HRS § 237-24.75 for amounts it receives from its client companies for amounts disbursed for employee wages, salaries, payroll taxes, insurance premiums, and other exempt expenses. This conclusion is contingent upon the Company maintaining its status as a PEO under Chapter 373K, HRS. The Company will lose the PEO GET exemption if it loses PEO status or fails to collect, account for, and pay over any income tax withholding for any assigned employees as provided by law.

This ruling is applicable only to the Company and shall not be applied retroactively. It may not be used or cited a precedent by any other taxpayer. The conclusions reached in this letter are based on our understanding of the facts that you have represented. If it is later determined that our understanding of these facts is not correct, the facts are incomplete, or the facts later change in any material respect, the conclusion in this letter will be modified accordingly.

The Company has reviewed and agreed that the redacted version of this ruling attached as Exhibit A will be available for public inspection.

If you have any further questions regarding this matter, please call me (808) 587-1569. Additional information on Hawaii's taxes is available at the Department's website at www.state.hi.us/tax.

Very truly yours,

JOSEPH B. TICHY
Administrative Rules Specialist

APPROVED BY:

JOHNNEL NAKAMURA
Rules Officer