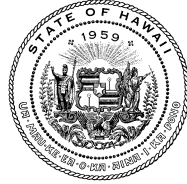


NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR



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FREDERICK D. PABLO
DIRECTOR OF TAXATION

RANDOLF L. M. BALDEMOR
DEPUTY DIRECTOR

September 19, 2012

LETTER RULING 2012-13

[Redacted Text]
[Redacted Text]
[Redacted Text]
[Redacted Text]

Re: Application of the PEO and Related Entities General Excise Tax Exemptions

Dear [Redacted Text]:

By letter dated December 16, 2011, [Redacted Text], through you, requested a ruling from the State of Hawaii Department of Taxation (the "Department") on whether the Company qualifies: (1) under Hawaii Revised Statutes ("HRS") § 237-24.75 for an exemption from Hawaii general excise tax ("GET") for reimbursements as a professional employment organization ("PEO") with respect to its co-employment of employees working for [Redacted Text], a Hawaii limited liability company ("Subsidiary") of which the Company is the sole member; and (2) under HRS § 237-23.5 for an exemption from GET for reimbursements from Subsidiary for administrative services provided by the Company.

FACTS REPRESENTED BY THE TAXPAYER

[Redacted Text] (the "Company") is a Hawaii corporation engaged in the wholesaling and retailing of [Redacted Text]. It has been in business for over [Redacted Text] years and has operations throughout the state of Hawaii.

In 2011, the Company organized [Redacted Text], a Hawaii limited liability company (the "Subsidiary"), to acquire the assets of and operate a business located on the island of [Redacted Text]. The Company is the sole member of Subsidiary. For federal and state income tax purposes, Subsidiary is a disregarded entity and treated as part of the Company.

The Company and Subsidiary have entered into a written Services Agreement whereby the Company will: (1) co-employ certain employees that will be assigned to Subsidiary's work site; and (2) provide Subsidiary with certain managerial, administrative and support services. A redacted version of the Agreement was provided for the Department's inspection.

Professional Employment Organization Services

Pursuant to the Agreement, the Company will provide to Subsidiary employees for the

operation of Subsidiary's business (the "Work Site Employees"). The Work Site Employees will devote all of their working time to the business of Subsidiary. The Company will be the employer of record of the Work Site Employees for employment tax purposes and other human resources matters. The Subsidiary will have the authority to direct, supervise, train and assign work schedules, duties and assignments to the Work Site Employees in connection with the operation of its business, subject to and in accordance with the employment policies of the Company.

The Subsidiary will reimburse the Company for all wages, salaries, bonuses, benefits or rights granted to the Work Site Employees under the terms of any pension, profit sharing, employee benefit and similar plans, if any, applicable to the Work Site Employees, or any employment contract with regard to any of the Work Site Employees, the employer's portion of social security taxes, Medicare taxes, employer's federal and state unemployment insurance tax contributions and assessments, workers' compensation and other insurance, temporary disability insurance, payments for vacation and sick leave, and employee benefit plan contributions (collectively, the "Work Site Employee Costs"). The Work Site Employee Costs charged to Subsidiary will be the actual costs incurred by the Company and will not include any markup, additional fees or profit.

Administrative Services

Pursuant to the Agreements, the Company will provide certain managerial, administrative and support services to Subsidiary, including services relating to billings and collections, human resources, information technology, insurance, financial and accounting, and taxes (collectively, the "Administrative Services"). The Company will employ the personnel necessary to provide the Administrative Services.

Subsidiary will pay to the Company a fee in the amount of **[Redacted Text]** per month (the "Administrative Services Fee") for the Administrative Services provided by the Company. The Administrative Services Fee will be reviewed and appropriate adjustments will be made on a quarterly basis. Subsidiary will also reimburse the Company for the actual out-of-pocket costs and expenses incurred by the Company on behalf of Subsidiary in providing the Administrative Services (e.g., computer maintenance fees paid to a third party provider, tax preparation fees paid to an outside accountant, etc.).

LAW AND ANALYSIS

I. Professional Employment Organization Exemption from GET

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." § 237-24.75(3), HRS. Operative terms used in the PEO exemption have the same meanings as terms in § 373K-1, HRS.

Letter Ruling 2012-13

[Redacted Text]

September 19, 2012

Page 3 of 4

A “professional employment organization” is “a business entity that offers to co-employ employees that are assigned to the worksites of its client companies.” § 373K-1, HRS. 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 the work sites of Subsidiary. 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 § 237-24.75(3), HRS, 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 Subsidiary, 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. Company is the statutory employer as it will remain the employer of record for employment tax and other human resources matters and Subsidiary is the common law employer as it has the authority to direct, supervise, train and assign work schedules, duties and assignments to the Work Site Employees. Therefore, the Company qualifies as a PEO because it is an employer involved in the co-employment of its employees who are assigned to the work site of Subsidiary.

The Company's employees qualify as assigned employees to the extent that the employees perform work in Hawaii and fill permanent, not temporary, positions at Subsidiary's work site. Subsidiary is considered a client company because it has a written Services Agreement with Company, a PEO, and is assigned employees by the Company under the Services Agreement.

Therefore, based on the foregoing discussion, the Company is a PEO and is exempt from GET on monies received from Subsidiary for the assigned employee payroll, benefits, and other exempt expenses. The PEO exemption under § 237-24.75(3), HRS, has an effective date of July 1, 2007. Amounts received by the Company not expressly discussed in this letter may be subject

to the GET unless expressly exempt by law.

II. Related Entities Exemption from GET

Hawaii law provides an exemption from GET for amounts received, charged, or attributable to services furnished by one related entity to another related entity or to imputed or stated interest attributable to loans, advances, or use of capital between related entities. § 237-23.5(a), HRS. For the purposes of § 237-23.5, HRS, related entities includes, “[t]hose entities connected through ownership of at least eighty per cent of the total value and at least eighty per cent of the total voting power of each such entity (or combination thereof), including partnerships, associations, trusts, S corporations, nonprofit corporations, limited liability partnerships, or limited liability companies.” *Id.*

“Services” means legal and accounting services, the use of computer software and hardware, information technology services, database management, and those managerial and administrative services performed by an employee, officer, partner, trustee, sole proprietor, member, or manager in the person’s capacity as an employee, officer, partner, trustee, sole proprietor, member, or manager of one of the related entities and shall include overhead costs attributable to those services. *Id.*

Company and Subsidiary are related entities because Company has one hundred percent of the ownership and voting power as the sole member of Subsidiary. The Administrative Services Fee received by Company attributable to the Administrative Services furnished to Subsidiary are exempt from GET under § 237-23.5(a), HRS, to the extent that the Administrative Services that Company provides to Subsidiary are “services” under § 237-23.5(a), HRS.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayers and accompanied by penalty of perjury statements executed by appropriate parties. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

Except for the specific ruling above, we express or imply no opinion concerning the tax consequences of the facts of this case under any other provision.

The Taxpayer has reviewed the redacted version of this ruling and agreed that it will be available for public inspection and copying.

If you have any further questions regarding this matter, please call me at [Redacted Text].

Sincerely,

TED S. SHIRAISHI
Administrative Rules Specialist