



National Payroll Reporting Consortium

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Testimony of the National Payroll Reporting Consortium

Money Transmission Act - Chapter 612, Laws 2010
California Assembly Banking & Finance Committee Hearing
March 11, 2013

The National Payroll Reporting Consortium (NPRC) appreciates this opportunity to provide comments for consideration by the Assembly Banking & Finance Committee concerning the Money Transmission Act, and in particular, whether it should apply to the payroll processing industry.

NPRC is a non-profit trade association whose member organizations provide payroll processing and related services to over 1.5 million employers nationwide, covering over one-third of the private sector work force. Payroll service providers have long served an important role in our nation's tax collection system as a conduit between employers and government tax authorities. Payroll service providers improve the efficiency of government tax collection and improve tax compliance.

Following is background on the payroll services industry; discussion of the potential impact of the Act on payroll service providers and their employer clients, and suggestions for improvements to the statute.

It is the position of the California Department of Financial Institutions (DFI or Department) that licensing of those payroll service providers that, in connection with such services, transfer funds, will be necessary under the Act. However, the relevant provisions and stated purpose of the law is to improve consumer protection. Payroll service providers generally do not sell money transmission services or instruments to consumers. Our customers are employers.

The Money Transmission Act is appropriately focused on consumer transactions. However, application of the law seems to go well beyond protection of consumers, and includes many business-to-business, non-consumer transactions, despite the apparent intent of the law. Broad definitions of money transmission and other terms may inadvertently include activities well beyond the intent of the California legislature, pursuant to the legislative findings and declaration (Section 1801 of Assembly Bill 2789/Chapter 612), to address over-the-counter money transmission. Application of the Money Transmission Act would impose substantial new costs on service providers and California employers, and could significantly disrupt the smooth functioning of payroll processing arrangements that have been in place for decades.

Payroll Services Industry Background

The payroll services industry provides human resources administrative services to employers, including payroll processing and employment tax payment and filing services. The industry acts as a third party between employers and employees. At the most basic level, an employer



contracts with a payroll service provider to perform the gross-to-net payroll calculations and maintain the proper compliance for those calculations. As such, payroll companies typically do not interact with or sell anything directly to employees (consumers). There are over 14,000 registered payroll service businesses nationwide according to the IRS.

Payroll processing arrangements vary widely. Many provide basic payroll calculations with executable checks drawn on client (employer) accounts. Some take the form of off-the-shelf software, and may have options permitting employers to delegate various payment and reporting functions to the payroll service firm. Others are more comprehensive, and include, for example, transfer of payroll tax withholding and other employer obligations to state and federal taxing authorities; remittance of child support and garnishment amounts withheld to obligees, and payment of net payroll amounts to employees via checks, direct deposit to a bank account and/or stored value instruments (payroll debit cards).

Since the early 1980's, at least 20% of California employers, who collectively employ roughly 35% to 40% of California workers, have come to rely on such services to assist them in complying with the many laws and regulations governing payroll administration.

Payroll Service Organizations are Already Required to Comply with Stringent Federal Regulations, Including Disclosure Requirements

Payroll service providers must provide initial and ongoing disclosures to clients, as defined in Internal Revenue Service (IRS) Revenue Procedure 2012-32. Such firms must notify their clients in writing at least quarterly that the employer remains liable for payment of employment taxes; must recommend that the employer use the IRS EFTPS system to periodically confirm that all tax funds have been timely deposited, and must advise that state tax authorities offer similar verification programs.

The disclosure serves an important function in reminding employers to be cautious in the selection and monitoring of any service provider entrusted with the administration of payroll and employment taxes.

Payroll service providers that originate funds transfers through the Automated Clearing House (ACH) are also required to perform annual audits of control systems.

Consumers (Employees of Payroll Service Clients) Are Already Well Protected by California Labor Laws

California employees enjoy some of the strongest protections afforded by Labor statutes in any state. The Department of Industrial Relations aggressively enforces workers' right to prompt payment of wages. Any difficulties in negotiating payroll checks or stored value instruments would fall under existing Labor code sections, and employers remain liable for any employee costs or difficulties as well as penalties for violations. Payroll service provider responsibilities to clients for errors in providing such services are set forth in payroll service contracts.

In our view, existing protections are so compelling that problems in the area of payment of wages to employees who are recognized as such and added to an employer's payroll system



(as opposed to workers deemed by an employer to be an independent contractor, who are paid outside of employer payroll systems) are rare, and incidents are rapidly rectified. Consequently, application of the California Money Transmission Act to payroll payments would be duplicative, causing confusion and unwarranted costs.

Many Elements of the Money Transmission Act Do Not Work in Non-Consumer Contexts

Several examples follow:

Chapter 6. Consumer Disclosures. Section 2100 requirements for receipts are redundant and/or inapplicable in non-cash, bank-to-bank transmissions where other sources for evidence of the transactions exist. Employers require very detailed reports identifying each transaction, each deduction from each paycheck, and aggregate totals for the various amounts arising from every payroll processing. Reports that function in part as receipts are routinely provided on a pay-period basis, as well as quarterly and annual summaries. Deductions and remittances for net payroll checks, tax withholding, garnishments, employer taxes, insurance deductions and so forth are routinely documented to both employers in the reports referenced above and to the employees in the form of payroll statements (“pay stubs”) and Forms W-2. Such reports and related statements from bank transactions serve as receipts. Thus, the receipt requirements of the Act are redundant in the context of payroll services.

Section 2101 requires that funds be forwarded within 10 days “unless otherwise ordered by his or her customer”. The vast majority of payroll funds are disbursed on or immediately after each pay day. However, many state tax authorities do not permit or provide any means to remit tax amounts other than on the established payment schedule; e.g., unemployment insurance taxes.

A critical reason that employers hire a payroll service provider in the first place is so that the service provider can assume responsibility for paying all related obligations when due. Determination of due dates can be complex and often carries significant penalty exposure. Businesses do not want to be put in the position of advising that funds should be forwarded on some specific future date.

Section 2102 requires that funds be refunded upon request unless the funds have been forwarded or committed within 10 days of receipt, or the customer instructs that the funds be remitted beyond 10 days. This section provides for a specific disclosure statement which is clearly designed for consumers, and provides for a cause of action for money received, court costs, attorney’s fees and penalties. This section could introduce significant conflicts and complexities. For example, tax payments are often established, formatted and committed long before the actual due date, which may not be apparent to a client who is only aware of a payment deadline. This could lead to confusion and disputes to the extent a business believes that the Money Transmitter Act may apply. Businesses are almost universally free to terminate payroll processing services and request refunds of undeposited funds, the detailed provisions of which are spelled out in service contracts. Consumers are unaffected.

Section 2104 requires prominent posting in a conspicuous location in the unobstructed view of the public within the premises or statements in letters not less than one-half inch in height that payment instruments are not insured.

First, payroll service providers are not generally open to the public. Consumers/employees do



not visit payroll service offices other than to pick up reports and checks on behalf of the employer on occasion. Such posting requirements would serve no purpose, but could confuse clients (employers).

Secondly, payroll checks and stored value instruments typically enjoy FDIC insurance and other consumer protections far in excess of limits generally applicable to consumer accounts. Payroll debit cards are covered under Federal Regulation E, which requires many consumer protection provisions, including FDIC insurance, transaction and periodic statements, dispute resolution procedures and protection from losses due to fraudulent use.

Section 2039 requires the submission of several annual and quarterly reports to the DFI, including the total volume of activities, number of transactions conducted, and outstanding money transmission obligations categorized by type of transmission, average daily liabilities, etc. Although such reports are certainly feasible, without further consideration and modification for the context of payroll processing, such reports would likely serve no beneficial purpose and would add substantial costs that would ultimately be borne by California employers. Reporting requirements are primarily focused on payment instrument sales to consumers and do not adequately contemplate electronic money transfers or application in a payroll processing context.

Section 2042 provides for an annual assessment based on the aggregate face amount of payment instruments and stored value issued, which clearly did not contemplate applicability to aggregate annual earnings of California workers. Any assessment using this basis would impose substantial new costs on California employers and introduce a substantial disincentive from using payroll service providers.

In summary, the Committee asked whether the Money Transmission Act is working as intended. We believe that the answer is no, with respect to payroll services. Broad definitions appear to include activities well beyond the intended over-the-counter money transmission that the law was intended to regulate. Strict application of the statute to California constituents is likely to cause substantial harm.

The statute should be modified to clarify its intended purpose, which, in accordance with the apparent intentions of the California legislature, should be limited to governing over the counter cash-based individual consumer money transmission activities; e.g., sale of payment instruments directly to individuals. Consistent with the Act's intended purpose, we ask that the committee modify the legislation to establish a clear exemption from the Act for payroll services.

Specifically, we would recommend that following changes to the California Money Services Act:

Section 2003 of the Financial Code

(o) "Money transmission" means any of the following:

(1) Selling or issuing payment instruments.

(2) Selling or issuing stored value.

(3) Receiving money for transmission, **primarily for personal, family, or household purposes.**



Section 2010 of the Financial Code

(j) A person or entity that provides services to deliver money on behalf of employers to employees by check or deposit in a checking or savings account at the bank, saving bank, savings and loan association or credit union, or stored value account, or facilitates the payment of payroll taxes to state and federal agencies, makes payments for employee benefit plans, makes distribution of other authorized deductions from employee's wages or salary, or transmits other funds on behalf of an employer.