



STATE OF CALIFORNIA

Department of Business Oversight

GOVERNOR Gavin Newsom • COMMISSIONER Jan Lynn Owen

IN REPLY REFER TO:
FILE NO: _____

April 18, 2019

Re: _____ – Request for Interpretive Opinion

Dear Mr. _____:

Thank you for _____’s letter to the Department of Business Oversight (“Department”) dated February 4, 2019. You have asked the Department to confirm that certain payroll processing activities related to payments made to 1099-independent contractors and conducted by _____ (“_____”), an affiliate of _____ (“_____”), meet the payroll processing exemption¹ in the Money Transmission Act (“MTA”)².

I. BACKGROUND

_____ is currently a money transmitter licensee. _____ is not a licensee.

_____ offers payroll solutions for small business customers through the _____ and _____ brands. These software platforms are services which enable a small business employer (“Client”) to set up and manage company payrolls. _____’s services enable Clients to handle wage and salary payments regardless of whether their workers are designated by the Client as statutory employees (i.e., W-2 employees) or independent contractors (i.e., 1099-independent contractors). The processing of payroll (i.e., flow of funds) with respect to wage and salary payments to both types of workers is the same. Generally, the process is as follows. Client provides its payroll file to _____. _____ then creates two automated clearing house (“ACH”) files for processing: a debit file to pull funds from the Client and a credit file to initiate payroll payments to the Client’s workers. In addition, _____ has structured its business model such that the ACH credit file is processed before the ACH debit file. Thus, if for any reason, the ACH debit of the

¹ Fin. Code, § 2010, subd. (j).

² Fin. Code, § 2000 et seq.

Client fails, the workers still get paid. _____ (and its banking partner) only have recourse against the Client to recover funds already paid to workers.

In addition, _____'s services are not intended to be used by Clients to make payments to vendors or suppliers. The 1099-independent contractor payments at issue here refer solely to payments made to a Client's workers that do not qualify as employees but nonetheless are individuals engaged in activity analogous to the activity ordinarily performed by employees. For example, a 1099-independent contractor may be a temporary worker hired by the employer to stand in for an employee who is on medical leave. These 1099-independent contractors are therefore "functional equivalents" of employees.

II. MONEY TRANSMISSION ACT

Financial Code section 2003, subdivision (q), defines "money transmission" to include receiving money for transmission. Section 2003, subdivision (u), defines "receiving money for transmission" to mean receiving money or monetary value in the United States for transmission within or outside the United States by electronic or other means.

Financial Code section 2030 prohibits a person from engaging in the business of money transmission in this state unless the person is licensed or exempt from licensure or is an agent of a person licensed or exempt from licensure.

Financial Code section 2010, subdivision (j), exempts from the MTA:

A person that delivers wages or salaries on behalf of employers to employees or facilitates the payment of payroll taxes to state and federal agencies, makes payments relating to employee benefit plans, makes distribution of other authorized deductions from employees' wages or salaries, or transmits other funds on behalf of an employer in connection with transactions related to employees. Notwithstanding this subdivision, a person described herein that offers money transmission services or provides stored value cards directly to individual customers shall comply with this division to the extent of that activity.

A. Payments to W-2 Employees

_____ has requested the Department to confirm that the delivery of wages to W-2 employees on behalf of Clients and the payment of payroll taxes to state and federal agencies by _____ are exempt from the MTA under the Financial Code section 2010(j). The Department hereby confirms that _____'s activities as they relate to W-2 employees are exempt from the MTA.

B. Payments to 1099-Independent Contractors

_____ has also requested that the Department find that wage payments made to 1099-independent contractors fall within the payroll processing exemption.

While the express statutory language of Section 2010(j) references “employers” and “employees,” the Department interprets the exemption to include payments to 1099-independent contractors where such payments are the functional equivalent of wage and salary payments to W-2 employees. This interpretation is supported by the legislative history of the exemption.

The legislative history provides insight into the scope and purpose of the exemption.³ For example, the July 1, 2013 Senate Banking and Financial Institutions Analysis clarified the purpose of the payroll processing exemption. Specifically, it provided:

AB 786 proposes to exempt payroll providers from the MTA, except when they issue stored value cards or offer money transmission services directly to individual consumers. Payroll providers would require MTA licenses to engage in those activities, but would only be regulated under the MTA to the extent of those activities. [T]he MTA was designed to regulate the transfer of money between individual consumers; it was not contemplated as a regulatory regime for business-to-business transactions.⁴

The September 5, 2013 Assembly Floor Analysis confirmed that AB 786 “exempts from the MTA payroll processors unless they offer money transmission or stored value cards directly to customers.” The analysis also explained that “modern payroll processing can involve numerous activities,” such as payment of taxes and benefits, and management of withholdings and deductions. These activities fall under “the umbrella of payroll processing.” Therefore, “naming payroll processing as an exempted activity includes the subset of activities that a payroll processor might engage in.”

Based on the legislative history, it appears that the spirit and intent of the payroll processing exemption is to exempt payroll processors when they are engaged in activities related to the payment of wages and salaries for tasks typically performed by employees. Moreover, when engaged in permitted activities, payroll processors should be exempt so long as they are not issuing stored value cards or offering money transmission services directly to individual consumers.

The payroll processing service that _____ provides to its Clients is the same whether the recipient of the payment is a W-2 employee or a 1099-independent contractor. Significantly, _____’s services are not intended to be used by its Clients to make payments to vendors

³ The payroll exemption was introduced in Assembly Bill No. 786, Session Year 2013-2014.

⁴ July 1, 2013 Senate Banking and Financial Institutions Analysis, p. 5.

or suppliers. The 1099-independent contractor payments for which _____ seeks an exemption refer solely to payments made to employers' workers that do not qualify as employees but nonetheless are individuals engaged in activity analogous to the activity ordinarily performed by employees. For example, a 1099-independent contractor may be a temporary worker hired by the employer to stand in for an employee who is on medical leave. These 1099-independent contractors are therefore "functional equivalents" of employees. _____ processes payments to these temporary workers using the same procedures as payments made to W-2 employees. _____'s services enable employers to enter hours worked to generate paychecks regardless of whether the person is designated as a W-2 employee or a 1099-independent contractor. Therefore, as a payment processor, _____ is making payments to 1099-independent contractors under the "umbrella of payroll processing."

For foregoing reasons, the Department concludes that _____'s processing of payments to 1099-independent contractors, who are the functional equivalent of employees, fall within the subset of activities in which a payroll processor might engage. The activity is of a type that the exemption was intended to cover and, therefore, is within the scope and purpose of the exemption. Supporting this determination is the fact that _____ is not issuing stored value to 1099-independent contractors, nor is _____ offering money transmission services directly to individual consumers as part of this activity. A further safeguard is that _____ is structured such that workers are paid regardless of whether the Client's debit (to fund the payment) clears.

III. CONCLUSION

The Commissioner finds that _____'s processing of payments on behalf of employer clients to 1099-independent contractors is exempt from the MTA pursuant to Financial Code section 2010(j).

This opinion is based solely on the facts as represented in your correspondence, and the Department's understanding of those representations. The Department may reach a different conclusion under other facts and circumstances.

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Please contact me at (____) _____ if you have any questions.

Sincerely,

Jan Lynn Owen
Commissioner
Department of Business Oversight

By /s/

Senior Counsel

cc: Department of Business Oversight, Money Transmitter Division, San Francisco