

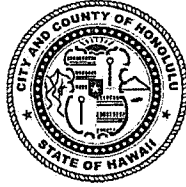
DEPARTMENT OF BUDGET AND FISCAL SERVICES

KA 'OIHANA MĀLAMA MO'OHELU A KĀLĀ

CITY AND COUNTY OF HONOLULU

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September 3, 2024

The Honorable Tommy Waters
Chair and Presiding Officer
and Members
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawai'i 96813

Dear Chair Waters and Councilmembers:

SUBJECT: Resolution 24-197 – Relating to the Establishment of a
Compensation Plus Program, or Similar Accountable
Reimbursement Plan, for Officers and Employees of the Honolulu
Police Department

Compensation Plus Services, Inc. (CP+ Plus) is an "accountable reimbursement plan" for Honolulu Police Department (HPD) officers, whereby the Internal Revenue Service (IRS) will allow an employee an above-the-line deduction for expenses paid or incurred, in conjunction with services performed as an employee, under a reimbursement or other expense allowance agreement with the employer. Pursuant to the Internal Revenue Code § 62(c), an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if: (1) the arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement; or (2) the arrangement provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement (IRS Rev. Rul. 2003-106). Under § 1.62-2(c)(1) of the Income Tax Regulations, a reimbursement or other expense allowance arrangement satisfies the requirements of IRC § 62(c) if it meets the requirements set forth in paragraphs (d), (e), and (f) of § 1.62-2 (business connection, substantiation, and return of excess). If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan (Reg. § 1.62-2(c)(2)(i)). Amounts paid under an accountable plan are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes

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(§§ 31.3121(a)-3, 31.3306(b)-2, 31.3401(a)-4 of the Employment Tax Regulations, and 1.6041-3(h)(1) of the Procedure and Administration Regulations).

CP+Plus proposes that it will provide “third party administration” services in this “accountable reimbursement plan” for participating HPD officers/SHOPO members. They will be requiring the City, through the Department of Budget and Fiscal Services (BFS) and HPD Payroll sections, to deduct from the participant’s paycheck on a pre-tax basis the amount elected by the participant for anticipated unreimbursed business-related expenses from the participant’s “spending account.” When the participant incurs an unreimbursed business-related expense, he/she will submit the receipt(s) to CP+Plus, and CP+Plus in turn will reimburse the participant from the participant’s “spending account.” CP+Plus will handle the receipt reimbursement review and administration of the plan for a fee of \$4 per pay check per employee. The arrangement will be set forth in an agreement between CP+Plus and SHOPO and its participating HPD officers/members. The City will NOT be a signatory to this agreement/plan according to CP+Plus.

In 2019, under the prior administration, the City (BFS, DHR, COR and PUR) reviewed the CP+ Plus opportunity and determined that there were numerous uncertainties and issues that could not be easily resolved, including payroll and procurement issues. For that reason, the City declined to participate in further discussions.

The opportunity was raised with the current Administration by CP+ Plus in 2021, and again in 2023. For over a year, BFS, the Department of Human Resources (DHR), HPD and the Department of the Corporation Counsel (COR) reviewed the proposal and had multiple meetings with representatives of CP+Plus and SHOPO. Despite repeated requests for a demonstration of their product, CP+Plus failed to show the City how the application works. The City requested a demonstration of the CP+Plus system, and provided a list of questions and concerns. The City coordinated a meeting on October 11, 2023 with HPD Finance, BFS, DHR, COR, CP+Plus CEO and SHOPO. CP+Plus failed to provide the demonstration and did not provide answers to all of our questions. Another meeting was requested by CP+Plus representatives and SHOPO which was held on June 14, 2024. Again the City’s HPD Finance, BFS, DHR, and COR were all present expecting to see a demonstration of the CP+Plus system, as well as follow up answers to our list of questions. No demonstration was given and our questions were not fully answered.

The City tried to find out the level of interest in this type of program from SHOPO members. SHOPO responded it has not polled their membership.

Based on the months of review and analysis, BFS, HPD, DHR and COR agree that the City should not participate in CP+Plus program and note the following questions and concerns:

- According to the CP+Plus website (<https://mycpplus.com/how-it-works/>), it appears that the “employer” is very much involved in the administration of the reimbursement program:

The employee (or employer) estimates the business related spending for each employee and allocates a portion of their wages. The employer holds these funds, setting them aside for the employee. Throughout the year, the employee substantiates their spending by submitting receipts directly to CP+Plus.

The employer releases the funds to the employee throughout the year as they spend their own money on business expenses. CP+Plus works with each employee to coordinate systems so that the employee will receive reimbursement conveniently through payroll without being taxed. This also means as an employer, you never have to handle the receipts and validation of expenses for these items.

- This description from CP+Plus seems to indicate that the City (BFS/HPD) will be administering the plan, which includes withholding the plan deductions, setting up a “spending account” for each employee and then processing the reimbursements to the employees. It will require the BFS/HPD payroll team to conduct additional accounting, tracking, monitoring, and reconciling. HPD payroll would be responsible for administering the plan. The plan will require HPD/BFS personnel to handle this additional work, including administering a benefits plan that is outside their normal scope. Unlike the City’s “flexible spending account” plan (FSA) that allows participating City employees to allocate a specific amount of his/her wages on a pre-tax basis to pay for eligible health care and dependent/child care expenses incurred during the plan year, all of which must be paid out during the plan year (i.e., “use it or lose it”), the CP+Plus “spending account” arrangement does not appear to have a forfeiture or “use it or lose it” requirement. This may result in the unused and excess amounts in the “spending account” to be recharacterized as taxable wages for which the City now needs to make appropriate state and federal tax withholdings. Further, depending on when

recharacterization occurs, the City and participating employees may incur penalties and interests for not making the appropriate withholdings and even file amended Form W-2s for participating HPD officers. Nothing in the information provided by CP+Plus indicates that it would defend and indemnify the City or participating HPD officers for any adverse tax consequences that may be incurred. It will also put the burden on the City to collect the appropriate taxes and withholdings from employees and if these employees have separated from the City, it may result in the City absorbing that expense if we are not able to recover it.

- How does the arrangement work with expenses for which HPD officers already receive an allowance under the SHOPO collective bargaining agreement? For example, officers receive a Firearms Maintenance Allowance of \$1,000 per year. If reimbursement is sought and substantiated, is the officer able to seek reimbursement in the amount of \$200 in ammunition costs under the CP+Plus arrangement even though the officer received the allowance to cover such an expense?
- Do officers have to declare/state/attest/verify that the business expense reimbursement claims are for themselves only? Nothing presented to the City provided assurances that participants may submit other people's receipts for reimbursement so the money will avoid being taxed.
- If reimbursement is denied, does the participant have any right to appeal a determination by CP+Plus? If so, who hears the appeal?
- Because the City is NOT a plan sponsor or a plan fiduciary in any way with respect to this arrangement, CP+Plus must specify the work/tasks that it expects the City/HPD to undertake if this program is allowed:

Other than the specified tasks, the City expects CP+Plus to handle all other plan fiduciary tasks associated with the program, such as (1) developing all compliant documents the plan is legally required to have or are necessary for the functioning of the plan — including summary plan descriptions, plan documents, enrollment and reimbursement forms, open enrollment materials and flyers, etc.; (2) obtaining any approvals needed for the plan and plan documents; (3) printing and distributing all open enrollment materials, and printing and distributing materials for new employees; (4) receiving directly from employees the enrollment forms and reimbursement forms and materials; (5) determining, without City assistance, whether a requested reimbursement has sufficient

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documentation and is permissible under the applicable laws/regulations;
(6) advising the City and participants of any changes in the law that affects the plan, and (7) updating the plan and documents (if needed), and informing eligible employees about the changes.

There is also the issue of manually re-characterizing funds at the end of each fiscal year which have not been spent by the employee for the purpose of business purchases under the CP+Plus plan. This together with the aforementioned items place a potentially costly administrative burden on City staff which the City is not able to estimate and thus, not prepared to undertake.

CP+Plus has not provided any assurances that it will handle these critical tasks for and on behalf of participants.

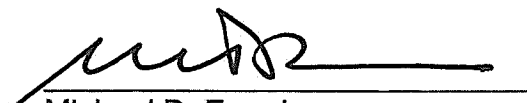
Given these significant questions and concerns and the failure of CP+Plus to answer or address the same, BFS, HPD, DHR, and COR recommends against the City participating in the CP+Plus "accountable reimbursement plan" for HPD officers at this time.

Thank you for the opportunity to provide testimony on Resolution 24-197.

Sincerely,


Andrew T. Kawano
Director

APPROVED:


Michael D. Formby
Managing Director