HOUSE BILL REPORT
HB 2246

As Reported by House Committee On:
Commerce & Labor

Title: An act relating to ensuring employers pay the contribution rate they have earned.

Brief Description: Concerning employer contribution rates.

Sponsors: Representatives Conway and Wood; by request of Employment Security Department.

Brief History:
Committee Activity:
Commerce & Labor: 3/2/05 [DPS].

Brief Summary of Substitute Bill

- Adds new definitions and clarifies language in the unemployment insurance law concerning temporary services agencies, staffing companies, professional employer organizations, employee leasing agencies, and other similar entities.
- Modifies the requirements for determining successor employer unemployment contribution rates by, among other things, prohibiting transfers of experience from the predecessor employer if the business acquisition was solely or primarily for the purpose of obtaining a lower contribution rate.
- Modifies the penalties applicable to employers that file untimely or incomplete unemployment tax reports and to employers and other persons who intend to evade the successorship provisions.

HOUSE COMMITTEE ON COMMERCE & LABOR

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 4 members: Representatives Conway, Chair; Wood, Vice Chair; Hudgins and McCoy.

Minority Report: Do not pass. Signed by 3 members: Representatives Condotta, Ranking Minority Member; Sump, Assistant Ranking Minority Member; and Crouse.

Staff: Chris Cordes (786-7103).

Background:

Federal Requirements for States' Unemployment Insurance Laws

The unemployment insurance system is a federal/state program under which employers pay contributions to fund unemployment compensation for unemployed workers. These payments are made under state unemployment tax acts (SUTA) and the Federal Unemployment Tax Act (FUTA). The FUTA allows the states' employers to receive a tax credit against their federal unemployment tax, and the state receives a share of the FUTA revenues for administration of its unemployment insurance system, only if the state maintains an unemployment insurance system in conformity with federal law. Washington's program is administered by the Employment Security Department (ESD).

In August 2004, the federal "SUTA Dumping Prevention Act of 2004" (SUTA Dumping Act) was enacted. According to the United States Department of Labor, this law is intended to: (1) address a concern that some employers and financial advisors were finding ways to manipulate state experience rating systems so that these employers could pay lower SUTA taxes than their unemployment experience would otherwise allow; and (2) prohibit the following two methods of SUTA dumping:

- An employer escapes high experience rates by setting up a shell company with a lower tax rate and then transferring some or all of its workforce to the shell company.
- An entity starting business purchases an existing business with a tax rate that is lower than the new business tax rate. Typically, the new business ceases the business activity of the transferred business.

Under the SUTA Dumping Act, the states' unemployment insurance laws must be certified as in conformity with the SUTA dumping requirements by a certain date. For Washington, this requirement will apply beginning with the 2006 tax rate year. Among other things, the federal SUTA Dumping Act requires the states' unemployment insurance laws to:

- require mandatory transfer of experience when there is substantial common ownership, management, or control of two employers, and one of these employers transfers all or part its business to the other;
- prohibit transfers of experience, and instead assign a new employer rate, when a person who is not an employer acquires an existing employer, and the acquisition was solely or primarily for the purpose of obtaining a lower contribution rate;
- adopt meaningful civil and criminal penalties for persons who knowingly violate or attempt to violate these requirements; and
- establish procedures for identifying SUTA dumping.

Covered Employers

Most employment in the state is covered for unemployment insurance. Each covered employer is required to pay contributions on a percentage of his or her taxable payroll, except for certain employers who reimburse the ESD for benefits the agency pays to these employers' former workers. Covered employment includes personal services performed for a third party under a contract with a temporary services agency, employee leasing agency, or other similar entity. If the entity is responsible for paying wages to the employees, then that employment is deemed to be employment for the entity.

Contribution Rates

For most covered taxable employers, unemployment insurance contribution rates are determined by the combined rate assigned to the employer based on layoff experience, social costs, and solvency surcharge, if any. The highest contribution rate varies but may not exceed 6.5 percent plus a solvency surcharge, if any.

Some covered taxable employers are not qualified to be assigned a combined rate. These unqualified employers include employers who are new employers and certain successor employers who were not employers at the time of acquiring a business. Until a new employer becomes a qualified employer, the rate is the average industry rate, plus 15 percent of that amount, with a 1 percent minimum rate. For a successor employer who was not an employer at the time of the business transfer, the rate is the rate assigned to the predecessor new employer rate in that industry.

Legislation adopted in 2003 changed the rate determination for certain successor employers engaging in a business transfer on or after January 1, 2005. If a new successor employer has substantial continuity of ownership or management of the predecessor's business, the successor is not permitted to use the new employer rate. Instead, these employers must pay at the rate assigned to the predecessor employer, and will have the experience of the predecessor employer transferred to the successor as part of its rate beginning in January following the transfer.

Penalties

Unemployment insurance tax penalties were also revised in 2003 and 2004. Under these revisions, if an employer fails to file unemployment tax reports in a timely and complete manner, the employer is subject to a penalty, as determined by the Commissioner of the ESD, of up to $250 or 10 percent of the quarterly contributions, whichever is less. Under the ESD rules, a report that is filed late is subject to a $25 penalty, unless waived. If the report is incomplete or filed in the incorrect format, the employer's penalty ranges from $75 to $250 depending on which standard was violated and whether the violation is the first or a subsequent occurrence.

The 2003 legislation added a penalty for an employer that is delinquent in paying unemployment taxes because of an intent to evade the successorship requirements and for any business that promotes such evasion. This penalty was modified in 2004 to require assigning these employers, or other persons violating this requirement, the highest contribution rate, plus 2 percent, for that calendar year in which the Commissioner makes the penalty determination.

Another change in 2003, added a penalty for knowingly misrepresenting the amount of payroll on which contributions are based. In this case, the employer is liable to the state for 10 times the difference between the contributions paid and the amount that should have been paid and the reasonable costs of auditing the employer's books and collecting the penalty.

It is a gross misdemeanor, with a fine of up to $5,000 and/or up to one year in prison, if a person who is required to collect and pay unemployment contributions willfully fails to pay the contributions or willfully attempts to evade payment.

Summary of Substitute Bill:

Determination of "Employer"

A temporary services agency, staffing company, services referral agency, or other similar entity is considered the employer, for purposes of the unemployment insurance law, with respect to services performed under contract for a third party client when the entity is responsible for wage payments. A temporary staffing agency or a staffing company is defined as an individual or entity, other than a professional employer organization, that hires its own employees and assigns them temporarily to a client to supplement the client's workforce.

If services are performed for a third party client under a contract with a professional employer organization or an employee leasing organization, or other similar entity, the employer for purposes of the unemployment insurance law is the client. An employee leasing agency is an individual or entity that for a fee places the employees of the client on its payroll and leases the employees back to the client. A professional employer organization is an individual or entity that provides employment-related administrative services, including benefit options and employer liability management.

A common pay agent or paymaster is not the employer for unemployment insurance purposes. A common pay agent is an independent third party who contracts with and represents two or more employers and who files a combined tax report for these employers. A common paymaster is two or more employers in which one of them has been designated to disburse wages to concurrently employed individuals of any of the related companies.

Individuals or entities defined as employee leasing agencies, professional employer organizations, or common pay agents or common paymasters may not participate in joint accounts.

Successor Employers

An employer that acquires the operating assets or the employees of the predecessor, whether part or substantially all, is considered a successor employer for purposes of determining wages subject to contribution.

For successor employers who are employers at the time of the business transfer, the successor's contribution rate beginning on January 1, following the transfer is based on a combination of the successor's and the predecessor's relevant layoff experience. If a sole or primary purpose of the transfer was to obtain a reduced rate, then the experience rating accounts of the employers involved are combined into a single account, and the employers are assigned the higher of the predecessor or successor rate effective as of the transfer date.

For transfers on or after January 1, 2005, where the successor employer is not an employer at the time of the business transfer:

- the contribution rate that will apply to the successor employer beginning in January following the transfer will be the rate based on the combination of the experience

transferred from the predecessor and the successor's experience if, by including the transferred experience, the successor is a qualified employer; if the successor is not qualified, then the new employer rate will apply until the successor qualifies; and
- the experience attributable to the predecessor employer is not transferred if the successor acquired the business solely or primarily to obtain a lower rate. Instead, the new employer rate will be assigned.

The prohibition for a new successor employer to use the new employer rate when there is substantial continuity of ownership or management of the predecessor's business is extended to cover situations in which there is substantial continuity of control.

References to determining the applicable new employer rate are changed from the Standard Industrial Classification Code to the North American Industry Classification System.

Penalties

The maximum penalty of $250 or 10 percent of the quarterly contributions for failure to file a timely or complete report is modified. If an employer fails to file a timely report, the penalty is $25, unless waived. The Commissioner of the ESD may waive penalties for an employer's failure to file a complete report, as well as a timely report, if the failure was not due to the employer's fault.

If an employer files an incomplete report or incorrectly formats the report, the employer will receive a warning letter for the first occurrence. For subsequent occurrences, the employer is subject to a penalty of:
- if no contributions are due, $75 for the second occurrence, $150 for the third occurrence, and $250 for subsequent occurrences.
- if contributions are due, 10 percent of the quarterly contributions due but not less than the following amounts: $75 for the second occurrence, $150 for the third occurrence, and $250 for subsequent occurrences.

A delinquent employer whose assessment is due to an intent to evade the successorship provisions is required to pay, in addition to the contribution rate penalty, the ESD's reasonable audit and collection expenses.

A person who is not an employer and who is evading the successorship provisions, or promoting the evasion, is subject to the gross misdemeanor penalty as if the person were an employer, and to paying the ESD's reasonable audit and collection expenses.

"Knowingly" is defined to mean having actual knowledge of or acting with deliberate ignorance or reckless disregard for the prohibition involved, including intent to evade, misrepresentation, or willful nondisclosure.

Rule-making Authority

The Commissioner of the ESD must establish procedures to enforce these penalties, and may adopt such other rules as are necessary to implement the bill's provisions.

Substitute Bill Compared to Original Bill:

The substitute makes various technical changes, including: (1) making consistent references to "staffing companies," "employee leasing companies," and other such entities; (2) clarifying when an employee leasing agency, professional employer organization, or common pay agent or paymaster may not participate in a joint unemployment account; and (3) requiring assignment of the higher of the predecessor or successor unemployment rate when the sole or primary purpose, rather than a substantial purpose, of the business transfer was to obtain a reduced rate.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: (In support) The bill has two purposes: federal confirmity with unemployment insurance law and fairness to employers. The state must conform to federal requirements or risk losing administrative funding and employer tax credits. Washington knew about the concerns over SUTA dumping and made changes in the last few years to address many of the issues. This bill does not adopt the federal model language because experience has shown that the model language is sometimes withdrawn. The changes in the bill are intended to complete the process to be in conformity. The bill adds that layoff experience must be transferred when there is substantial control of the two companies and makes clear that transfers of employees may trigger transfer of experience also. It also addresses the need for meaningful penalties for knowing violations by employers and by those who give advice to employers. It attempts to define who the employer is and who the employer's agent is, which is something that the federal agency has indicated should have been taken care of before now. The penalties address some anomalies, such as very small penalties that have to be levied under the current law. The bill would permit a warning for the first offense and promote education to avoid these problems. The Department is committed to working with the parties to resolve any concerns.

(Concerns) Washington businesses have had a concern about SUTA dumping for some time and have worked closely with others on the issue. The definition of "staffing companies" comes directly from the industry. However, the question of "who is the employer" is a complex issue that is being reviewed in other contexts. Any change here should be consistent with changes being made by the Department of Revenue for B&O tax purposes. There is concern that the definition of "knowingly" differs from the state's usual definition. The section of the bill dealing with professional employer organizations (PEOs) changes the methodology for these companies. PEOs have been filing a single report for all their client companies and sending in one check for the taxes. Under the bill, they would have to file a separate report for each client. This is not something that the federal bill requires. The PEOs use a rate that

is a conglomerate rate of all their clients' experience. The PEOs believe that the system benefits now when a new client is added to the PEOs account.

Testimony Against: None.

Persons Testifying: (In support) Annette Copeland, Employment Security Department.

(With concerns) Jan Gee, Washington Staffing Association; Jim Halstrom, National Association of Professional Employer Organizations; and Drew Thoresen, Human Resource Novations Incorporated.

Persons Signed In To Testify But Not Testifying: None.