

HOUSE BILL REPORT

HB 1406

As Reported by House Committee On:
Commerce & Labor

Title: An act relating to reporting, penalty, and corporate officer provisions of the unemployment insurance system.

Brief Description: Regarding reporting, penalty, and corporate officer provisions of the unemployment insurance system.

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

Brief History:

Committee Activity:

Commerce & Labor: 2/2/07, 2/26/07 [DPS].

Brief Summary of Substitute Bill

- Adds services performed by corporate officers to covered employment for purposes of unemployment compensation, unless made exempt by corporations.
- Makes corporate officers personally liable for certain contributions owed by corporations that have gone out of business.
- Charges certain benefits resulting from an employer's reporting errors to the employer's experience rating account.
- Modifies penalties for employers who file untimely, incomplete, and incorrectly formatted tax and wage reports.
- Increases weeks of disqualification and adds penalties for claimants who make false statements involving material facts.
- Specifies that personal services performed for a client under an agreement with a professional employer organization are employment for the client.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

HOUSE COMMITTEE ON COMMERCE & LABOR

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 5 members: Representatives Conway, Chair; Wood, Vice Chair; Green, Moeller and Williams.

Minority Report: Do not pass. Signed by 2 members: Representatives Condotta, Ranking Minority Member and Chandler, Assistant Ranking Minority Member.

Staff: Jill Reinmuth (786-7134).

Background:

Corporate Officer Coverage

Services performed by corporate officers are not considered covered employment for purposes of unemployment compensation unless the corporation elects coverage. Corporate officers are persons appointed as officers under the requirements of the Washington Business Corporation Act. They include those officers described in the corporation's bylaws or appointed by the board of directors under the bylaws.

Corporate Officer Liability

Corporate officers and other individuals are not personally liable for contributions owed by corporations or limited liability companies.

Reporting Penalties

Employers must file complete and accurate tax and wage reports every quarter, including the amount of remuneration paid and the number of hours worked for each worker. If employers fail to file timely and complete quarterly unemployment tax reports, they are subject to penalties of \$250 or 10 percent of the contributions, whichever is less.

Reporting Errors

When employers fail to report the number of hours worked, that number is computed based on the amount of remuneration paid and the state minimum hourly wage rate. Claimants may be determined to be eligible for benefits based on computed hours. Claimants subsequently may be determined to be ineligible based on credible evidence of actual hours worked. Benefits paid to claimants who are subsequently determined to be ineligible are not charged to the experience rating accounts of employers who failed to report the number of hours worked. Instead, they are socialized among all contribution-paying employers.

Claimant Fraud Penalties

Individuals who knowingly make false statements involving material facts or who knowingly fail to report material facts are disqualified from benefits for that week and for an additional 26 weeks. This disqualification does not apply more than two years after the determination of disqualification.

Professional Employer Organizations and Third Party Payers

Personal services performed for third parties under contracts with temporary services agencies, employee leasing agencies, service referral agencies, or other entities are considered to be services for the agencies when the agencies are responsible for payment of wages for these services.

A temporary services agency is one that furnishes people who work part-time or on a temporary basis for a third party. An employee leasing agency is one that places employees of a client on the agency's payroll for a fee and leases the employees back to the client. A service referral agency is one that provides people to do specific tasks for a third party.

Summary of Substitute Bill:

Corporate Officer Coverage

Services performed by corporate officers are considered covered employment for purposes of unemployment compensation, unless one of the following exceptions applies.

Personal services performed by bona fide corporate officers for certain corporations are not considered services in employment, unless the corporation elects to provide coverage. These corporations are ones for which all personal services are performed only by bona fide corporate officers.

Services performed by corporate officers are not considered services in employment if the corporation exempts the officers from coverage. Public companies may exempt bona fide officers who are voluntarily elected or appointed, are shareholders, and exercise substantial control in the company's daily management, and whose primary duties do not include manual labor. Private corporations may exempt eight or fewer bona fide officers who agree to be exempt from coverage, are voluntarily elected or appointed, and exercise substantial control of the corporation's daily management, and any number of corporate officers who are related by blood within the third degree or marriage. Corporations may reinstate coverage at specified intervals.

Corporate officers who own 10 percent or more of the outstanding stock or who are family members of such officers are not unemployed during their term of office or ownership, even if wages are not being paid. Corporate officers are unemployed if the corporation dissolves or if they permanently resign or are permanently removed from office.

When employers register with the Employment Security Department (Department), the registrations must include names and Social Security numbers of owners, partners, members, and corporate officers, as well as mailing addresses and telephone numbers. They must also include the percentage of stock owned by each corporate officer, delineated as 0 percent, less than 10 percent, or 10 percent or more. Employers must report any changes in owners, partners, members, and corporate officers within 30 days, and must report changes in stock ownership at intervals prescribed by the Commissioner of the Department.

Corporate Officer Liability

When corporate or limited liability companies go out of business, corporate officers, members, and owners who had control or supervision of the payment of contributions are personally liable for the payment of unpaid contributions, and any interest and penalties on unpaid contributions, if they: (1) willfully sought to evade taxes; (2) willfully destroyed records; or (3) willfully failed to truthfully account for the financial condition of the business. In addition, they are liable only if the contributions became due while they were responsible for their payment, and there is no reasonable means of collecting the contributions owed directly from the corporation or limited liability company. "Willfully" means "an intentional, conscious, and voluntary course of action."

Reporting Penalties

Penalties for filing untimely or incomplete quarterly unemployment tax and wage reports are modified as follows:

- Employers who fail to file timely reports are subject to a penalty of \$25 per violation.
- Employers who file incomplete or incorrectly formatted reports receive a warning letter for the first occurrence. The warning letter must either provide instructions for accurate reporting or notify the employer how to obtain technical assistance from the Department.

If no contributions are due, employers are subject to the following penalties for repeat occurrences within five years of the last occurrence:

Second occurrence Penalty of \$75

Third occurrence Penalty of \$150

Fourth occurrence and Penalty of \$250
occurrences thereafter

If contributions are due, employers are subject to the following penalties:

Second occurrence Penalty equal to 10 percent of contributions
Not less than \$75 or more than \$250

Third occurrence Penalty equal to 10 percent of contributions
Not less than \$150 or more than \$250

Fourth occurrence and Penalty of \$250
occurrences thereafter

The Commissioner of the Department may waive penalties for good cause if the failure to file timely, complete, and correctly formatted reports or pay timely contributions was not the employer's fault.

Reporting Errors

Benefits paid using computed hours are not considered an overpayment and are not subject to collection. For contribution-paying employers, benefits are charged to their experience rating accounts. For reimbursable employers, benefits must be reimbursed.

Claimant Fraud Penalties

Individuals who knowingly make false statements involving material facts or who knowingly fail to report material facts are disqualified from benefits for that week. They are also disqualified for additional weeks and subject to penalties as follows:

First time Disqualification for 26 additional weeks

Second time Disqualification for 52 additional weeks

Additional penalty equal to 25 percent of overpayment

Third and Disqualification for 104 additional weeks

subsequent times Additional penalty equal to 50 percent of overpayment

Professional Employer Organizations and Third Party Payers

Various terms, including the following, are defined:

- "Professional employer organizations" are persons that enter into agreements with one or more client employers to provide services such as human resource functions, risk management, or payroll administration, in a coemployment relationship.
- "Third-party payers" are entities that enter into agreements with one or more employers to provide administrative, human resource, or payroll administration services, but not in an employment relationship. "Third-party payers" do not include professional employer organizations, temporary staffing services companies, services referral agencies, and labor organizations.
- "Temporary staffing services companies" are entities that: (1) recruit and hire their own employees; (2) find other organizations that need the services of those employees; and (3) assign the employees on a temporary basis to perform work or services for a client. "Temporary staffing services companies" do not include professional employer organizations, permanent employee leasing, or permanent employee placement services.
- "Client employers" are employers who enter into professional employer agreements with professional employer organizations.
- "Coemployers" are professional employer organizations and client employers that have entered into professional employer agreements.

Client employers are assigned individual contribution rates based on their own experience. They are liable for the payment of any taxes, interest, or penalties. Professional employer organizations (PEOs) may collect and pay taxes due from client employers. If such payments

have been made to PEOs by client employers, the Department must first attempt to collect contributions due from PEOs.

The PEOs are required to register with the Department and to ensure that their client employers are also registered with the Department. The PEOs must provide the Department with: (1) the names, addresses, Unified Business Identifier numbers, and Employment Security Department account numbers of client employers; (2) the names and Social Security numbers of corporate officers and owners of client employers; and (3) the business location in Washington where payroll records of client employers will be available for review or inspection.

The PEOs must: (1) notify the Department within 30 days each time they add or terminate a relationship with a client employer; (2) provide evidence authorizing them to act on behalf of client employers for unemployment insurance purposes; (3) file quarterly reports with separate and distinct information for each client employer; and (4) maintain accurate payroll records for client employers and make these records available for review or inspection.

Personal services performed for an employer who utilizes a third-party payer constitutes employment for the employer. The third-party payer is not considered the employer.

Substitute Bill Compared to Original Bill:

Corporate Officer Coverage

The provisions making services performed by corporate officers covered for purposes of unemployment insurance are modified to include an exception and an "opt out" exemption. The provision specifying which corporate officers are "not unemployed" is narrowed. Reporting requirements regarding stock ownership for corporate officers are established.

Corporate Officer Liability

The provisions making corporate officers, members, and owners personally liable for unpaid contributions are narrowed.

Civil Penalties

A requirement that warning letters for first occurrences include certain instructions is added. A five-year period in which occurrences are considered to be "repeat occurrences" that trigger higher penalties is established.

Professional Employer Organizations

Definitions are added. Registration, notification, and reporting requirements for professional employer organizations are added. Provisions specifying that client employers are assigned individual contribution rates based on their own experience, and are responsible for contributions, interest, and penalties are added.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The act takes effect 90 days after adjournment of session in which bill is passed, except sections 5 and 6, relating to unemployment of corporate officers, sections 10 through 12, relating to professional employer organizations and third party payers, which takes effect January 1, 2008, and section 4, relating to corporate officer coverage, which takes effect January 1, 2009.

Staff Summary of Public Testimony:

(In support) All of the elements of this bill are designed to make improvements to the system and to help us be efficient as an agency. This bill will reduce socialized costs and improve equity and fairness.

This bill will help hold employers responsible for errors that result in unrecoverable costs each year. It will help clean-up the penalties, by avoiding tiny penalties and making minor changes requested by both business and labor. It will create stronger deterrents against claimant fraud. It will close loopholes used by corporate officers, and bring corporate liability provisions in line with the Department of Labor and Industries and the Department of Revenue. The professional employer organization provision has attracted attention, and we are working closely to understand this business model and share our perspectives. Overall, this bill is intended to protect the experience rating system and keep costs down.

This bill completes unfinished business from 2003 and 2006. It reduces socialized costs in the system and ensures uniformity of treatment. Corporate officer coverage is currently voluntary, and that has resulted in socialized costs. Corporate liability will be made the same as for workers' compensation. The key to the professional employer organization piece is to maintain an experience-rated system. Blended rates reduce the incentive to care about individual rates. We are working with other stakeholders on the provisions relating to corporate officer coverage, corporate officer liability, and penalties.

(Opposed as written) Although we oppose the bill as it is written, there is a lot that we support. We are working with the Employment Security Department and the labor community to see if we can each agree. Key provisions relate to penalties, corporate officer liability, and corporate officer coverage.

This bill does not address the issue of repeat claimants.

The bill requires small businesses to pay for coverage, but prevents them from collecting unless they fold. We would prefer that coverage provisions for unemployment insurance match coverage provisions for workers' compensation.

This bill doesn't make clear how reporting errors are counted. A lot of small reporting errors could result in a very large penalty. The Commissioner should have greater waiver authority.

We oppose Sections 8 through 12 dealing with professional employer organizations. There is a lack of information about the impact of PEOs on the unemployment insurance system. The Department's study did not provide adequate information on which to base policy decisions.

This bill would put a noose around the industry's neck. This bill is based on unsubstantiated claims of problems. The Department did not complete its study of PEOs because it could not gather accurate data.

An option is to add language that would create transparency, but there is no need to make other changes. We are willing to register with the Department, report who our clients are, and report each client as it is acquired or as it departs.

This bill conflicts with the federal government's reporting requirements. All of the reports must be submitted under the PEO's federal number. This bill would require that all of the reports be submitted under the clients' state numbers. But state and federal reports must be reconciled.

This bill assumes that there is a problem with socialized costs. But our records for the past nine years show that \$3.2 million in taxes were paid, and only \$1.8 million in benefits were charged to our account. The PEOs help with socialized costs because we stand in place of inactive accounts. We also help the system by ensuring that reports and payments are on time. We would glad to provide more information about our operations.

There are 34 PEOs that operate in Washington, and three of them are domiciled here.

(Opposed) We oppose Sections 3 and 4, and Sections 13 and 14.

Persons Testifying: (In support) Karen Lee, Employment Security Department; and Jeff Johnson, Washington State Labor Council.

(Opposed as written) Dan Fazio, Washington Farm Bureau; Mellani McAleenan, Association of Washington Business; Carolyn Logue, National Federation of Independent Business; Jim Halstrom and Todd Cohn, National Association of Professional Employer Organizations; Drew Thoresen, Human Resource Novations, Inc.; and John Heaton, Pay Plus Benefits.

(Opposed) Larry Stevens, National Electrical Contractors Association and Mechanical Contractors Association.

Persons Signed In To Testify But Not Testifying: None.