Legislative Analysis

Mitchell Bean, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

SUTA DUMPING PROHIBITION

Senate Bill 171 with House committee amendment
Sponsor: Sen. Jason E. Allen

Senate Bill 174 with House committee amendment
Sponsor: Sen. Dennis Olshove

House Bill 4414 with House committee amendment
Sponsor: Rep. Robert Gosselin

House Bill 4415 with House committee amendment
Sponsor: Rep. David Robertson

House Committee: Employment Relations, Training, and Safety
Senate Committee: Commerce and Labor

First Analysis (3-10-05)

BRIEF SUMMARY: Federal law requires that states amend their laws governing unemployment programs to prohibit the practice known as "SUTA dumping," which generally refers to the transfer of employees to a different employing company solely or primarily for the purpose of obtaining a lower experience rating and thus a lower state unemployment tax rate. (The term SUTA refers to "state unemployment tax act.")

Each of the bills would amend the Michigan Employment Security Act to address this subject. The bills are tie-barred and would take effect on July 1, 2005. The lead bill, Senate Bill 171, contains the statement that "it is intended to be interpreted and applied in a manner so as to meet the minimum requirements of the [federal] SUTA Dumping Prevention Act of 2004 . . . and implementing regulations."

FISCAL IMPACT: The Department of Labor and Economic Growth (DLEG) estimates that the Federally-mandated prohibition of SUTA dumping will increase revenue for the Unemployment Compensation Fund by a range of $62 million to $95 million, plus an additional but indeterminate amount for new penalty and interest provisions. In addition, the State will avoid the loss of Federal administrative funds totaling approximately $80 million for the unemployment compensation program. The bills impose additional investigative and reporting requirements on DLEG, which will add an indeterminate administrative cost

THE APPARENT PROBLEM:

States are required to conform to a recent federal law known as the SUTA Dumping Prevention Act of 2004 or face financial penalties. A representative from Kelly Services, Inc., the staffing services firm, has succinctly described the problem the federal and state laws address as follows.

SUTA dumping occurs when employers take steps to disguise their true unemployment experience for purposes of evading unemployment insurance taxes. Though many and varied, all SUTA dumping techniques have three things in common. First, they all involve a transfer of payroll. Second, they cost state trust funds revenue. Third, they all end up sticking other employers with cost the dumpers manage to leave behind.

The principle under attack is a simple one. Employers fund the unemployment safety net based on their past layoff experience. If your former workers access the system frequently, you pay more. If you rarely lay off workers, you pay less. It is a true user tax, and one of the fairest that businesses pay. The problem we face today is that some employers have figured out ways to get around this principle. When they do that, other employers have to make up the difference. (Testimony provided to the House Committee on Employment Relations, Training, and Safety, March 8, 2005)

Legislation has been introduced to amend the Michigan Employment Security Act to bring Michigan into conformance with federal law and regulations.

THE CONTENT OF THE BILL:

Federal law requires that states amend their laws governing unemployment programs to prohibit the practice known as "SUTA dumping," which generally refers to the transfer of employees to a different employing company solely or primarily for the purpose of obtaining a lower experience rating and thus a lower state unemployment tax rate. (The term SUTA refers to "state unemployment tax act.")

Each of the bills would amend the Michigan Employment Security Act to address this subject. The bills are tie-barred and would take effect on July 1, 2005. The lead bill, Senate Bill 171, contains the statement that "it is intended to be interpreted and applied in a manner so as to meet the minimum requirements of the [federal] SUTA Dumping Prevention Act of 2004 . . . and implementing regulations."

The bills would amend state law to do the following:

- Prohibit a person from transferring all or part of a trade or business solely or primarily for the purpose of reducing the contribution rate or reimbursement payments in lieu of contributions required under the act (i.e., "SUTA dumping").

- Prohibit a person from acquiring all or part of a trade or business solely or primarily to obtain a lower contribution rate than otherwise would apply under the act.

- Prescribe sanctions against a person who knowingly violated or attempted to violate these provisions.

- Require the unemployment insurance agency to recalculate the contribution rates of both employers if an employer transferred its trade or business to another

employer and there were substantially common ownership, management, or control of the two employers.

- Require the agency to assign a new employer contribution rate to a person who was not an employer under the act at the time of a transfer and who acquired a trade or business solely or primarily to obtain a lower contribution rate.

- Require the money recovered under these provisions be credited to the unemployment compensation fund.

- Require the agency to report annually to the both Houses of the Legislature regarding SUTA dumping, beginning January 1, 2006.

- Specify that a transfer of an employer's assets would be a "transfer of business" under criteria described in the act if there were not substantially common ownership, management, or control of the transferor and transferee.

The following is a more detailed description of the bills.

Senate Bill 171

Prohibitions and Rate Recalculation. The bill would prohibit a person from doing either of the following:

- Transferring the person's trade or business, or a portion of it, to another employer for the sole or primary purpose of reducing the contribution rate or reimbursement payments in lieu of contributions required under the act (which the bill would define as SUTA dumping).

- Acquiring a trade or business, or a part of a trade or business, for the sole or primary purpose of obtaining a lower contribution rate than otherwise would apply under the act.

The following two provisions would apply to the assignment of rates and transfer of the unemployment experience of a trade or business to prevent or remedy those transfers that violate the provisions above.

If an employer transferred its trade or business, or a portion of it, to another employer and there were substantially common ownership, management, or control of the two employers at the time of the transfer, the unemployment experience attributable to the transferred trade or business would have to be transferred to the transferee employer. The agency would recalculate the contribution rates of both employers and apply the new rates in the same manner as for a transfer of business under the act. If, after a transfer of experience, however, the agency determined that a substantial purpose of the transfer of trade or business was to obtain reduced liability for contributions, then the employers'

experience rating accounts would have to be combined into a single account and a single rate assigned to the account.

If the agency determined that a person who was not an employer under the act at the time of a transfer acquired a trade or business, or a portion of a trade or business, solely or primarily for the purpose of obtaining a lower contribution rate, the agency would have to assign that employer the applicable new employer rate under the act.

Transfer of Trade or Business. The bill would require the agency to establish procedures to identify the transfer or acquisition of a trade or business, or part of a trade or business, for the bill's purposes. The bill specifies that this would not grant the agency the authority to promulgate rules to define SUTA dumping.

The bill also would require the agency to determine whether a transfer was made for the sole or primary purpose of obtaining a lower contribution rate using objective factors, such as the cost of acquiring the business, continuity in operating the business enterprise of the acquired business, the length of time the business enterprise continued to operate, and the number of new employees hired to perform duties unrelated to the business activity or trade conducted before the acquisition.

The bill would specify that "trade or business" could include the employer's employees, but the transfer of some or all of an employer's employees to another employer would have to be considered a transfer of trade or business for the purposes of the bill if, as a result of the transfer, the transferring employer no longer performed trade or business with respect to the transferred employees and that trade or business were performed by the transferee employer.

Sanctions. If a person knowingly violated or attempted to violate the bill's prohibitions, or if a person knowingly advised another person in a manner that caused a violation, the sanctions would depend in part on whether the person was an employer. A person who was not an employer would be subject to a civil fine of up to $5,000. If the person were a transferring or acquiring employer, the employer would have to be assigned the higher of the following contribution rates:

- The highest contribution rate assignable under the act for the rate year during which the violation or attempted violation occurred and for the three rate years immediately following that rate year.
- If the employers' business already were at the highest rate assignable for a year in which the violation occurred, an additional penalty rate of two percent of taxable wages for that year.

Money recovered under the bill as contributions, reimbursements in lieu of contributions, civil fines, civil penalties, or interest would have to be credited to the unemployment compensation fund.

Annual Report. Beginning January 1, 2006, the agency would have to provide an annual written report to the chairpersons of the Senate and House Appropriations subcommittee having jurisdiction over legislation pertaining to unemployment compensation. The report would have to include all of the following in a format that did not identify individual employers:

- The procedures the agency had adopted to prevent SUTA dumping.
- The number of SUTA dumping investigations opened during the year.
- The average length of time to resolve a SUTA dumping investigation and the number of investigations pending for more than six months and for more than one year.
- The number of cases brought before an administrative law judge or the board of review and the agency's success rate in those cases.
- The amount of money recovered as a result of implementing the bill.
- The amount of the balance or deficit in the unemployment compensation fund.
- The estimated fiscal impact of SUTA dumping on the Fund balance and the factual basis for the estimate.
- The number of full-time employees assigned to, and the number of employee hours devoted to, SUTA dumping prevention, investigation, and remediation.
- The number of employee leasing companies operating in Michigan.
- The number of SUTA investigations that involved the transfer of employees to or from an employee leasing company.
- The number of investigations in which an employee leasing company was found to have participated in SUTA dumping.

Reimbursing and Contributing Employers. Notwithstanding any other provisions, the following would apply to changes in status between reimbursing and contributing employers:

- If a contributing employer elected to be to become a reimbursing employer, any negative balance the employer incurred while a contributing employer would have to be paid to the agency before the employer could become a reimbursing employer.

- Any benefits charges incurred as a result of services performed as a contributing employer that were charged to that employer's account after it became a reimbursing employer would be transferred to the employer's reimbursing account and paid by means of reimbursement to the agency.

If a reimbursing employer applies to become a contributing employer and the agency permits it, or if the agency converts a reimbursing employer to a contributing employer, then the employer would continue to pay the agency reimbursement payments as those benefit charges were incurred based on wages paid while the employer was a reimbursing employer. Benefit charges incurred based on wages paid after the reimbursing employer became a contributing employer would be used to calculate the employer's contribution rate.

House Bill 4414

The bill would amend the act to specify that a transfer of an employer's assets would be a "transfer of business" under criteria described in the act only if there were not substantially common ownership, management, or control of the transferor and transferee.

The bill also would delete a provision under which a transfer is a "transfer of business" if an employer transfers any of the assets of the business, by any means other than in the ordinary course of trade, to any transferee substantially owned or controlled by the same interests that owned or controlled the transferor.

House Bill 4415

Under the Michigan Employment Security Act, the unemployment compensation fund is separate from all public money or state funds, and is administered exclusively for the purposes of the act. House Bill 4415 would amend the act to include in the unemployment compensation fund all money collected under Senate Bill 171, including fines, civil penalties, and interest. (Currently, the fund does not contain interest, penalties, and damages collected under the act and would still not contain interest, penalties, and damages under other provisions of the act.

Senate Bill 174

The bill would amend the act's definition of "employer" to refer to any individual, legal entity, or employing unit that became a transferee of business assets by any means other than in the ordinary course of trade from an employer, if there were substantially common ownership, management, or control of the transferor and transferee at the time of the transfer. (This would replace a reference to a provision that House Bill 4414 would delete.)

HOUSE COMMITTEE ACTION:

The House Committee on Employment Relations, Training, and Safety made no substantive changes to the package of bills as passed by the Senate. The committee reported out House Bill 4414 in place of Senate Bill 173 and House Bill 4415 in place of Senate Bill 172, and altered the tie-bars accordingly. For additional information on this topic, see the Senate Fiscal Agency analysis of the Senate-passed package dated 3-4-05.

ARGUMENTS:

For:

Proponents of this package say that it adequately addresses the issue of SUTA dumping and puts Michigan in full compliance with federal law. Supporters in the business community say that the bills treat law abiding employers fairly, while appropriately penalizing those involved in SUTA dumping. States are required to comply with federal

anti-SUTA dumping standards by January 1, 2006. This bill accomplishes that. Additional provisions are unnecessary at this time.

The harm done by SUTA dumping to the state's employers and the unemployment insurance trust fund include the following (based on a fact sheet from the state unemployment insurance agency:

** SUTA dumping goes against the fundamental tenet of an experience-rated tax system widely supported by the employer community. The unemployment tax rate is based on an employer's history of benefit charges. With SUTA dumping, an employer with a high UI tax rate attempts to hide behind a different company with a lower rate and "dump" UI costs on all other employers.

** This creates a competitive cost advantage for employers practicing UI tax evasion.

** As a result, money in the state's UI trust fund is reduced, causing an increase in unemployment tax for all employers. Losses to Michigan's trust fund from SUTA dumping are estimated at between $62 million and $95 million this year, and the amount is growing. Because the state was unable to meet a required trust fund threshold level, employers were denied a 10 percent across-the-board cut in UI taxes.

** The practice reduces the amount available to pay unemployment benefits to unemployed workers; rewards employers able to "dump" their UI responsibility; and penalizes employers who maintain steady employment for their workers.

Against:

Critics of this package, while conceding that it is an improvement over current law, say that it does not go far enough to prevent SUTA dumping, particularly in the area of the use of professional employer organizations. The Department of Labor and Economic Growth has estimated that PEO's "are at least 40 percent of the problem in Michigan." A representative from the Employers' Unemployment Compensation Council (an organization that includes representatives from the Michigan Manufacturers Association), has said:

[The bill] does not address one of the most significant areas where employers can SUTA dump. Over the past decade, employee leasing has become a popular way in which employers can reduce their business taxes, including unemployment taxes. Employee Leasing Companies (ELCs) also known as Professional Employer Organizations (PEOs) take on the client employees and then lease them back to the company. For unemployment tax purposes, if there is less than a 75% asset transfer when the client employees are transferred to the PEO, there will not be a transfer of [unemployment] experience unless the PEO requests the partial transfer. [The package] specifically continues to allow employers that do not have substantially common ownership, management, or control to continue to SUTA dump.

A representative from the Michigan Association of Retailers, similarly, has argued:

It is imperative that a business' experience rating must follow that business throughout—even when it uses a Professional Employer Organization. That is the only way to ensure that our unemployment system is fairly and adequately funded. Anything less would be cheating the thousands of Michigan businesses that pay their fair share of the UI burden. This issue is about protecting the interests of employers who are playing by the rules. And make no mistake, the price of inaction or incomplete action will be to reduce the number of private-sector jobs in our state.

Some people have also argued that the legislation should require companies to file registration reports or discontinuance reports before a business transfer could take place in order to combat the SUTA dumping that results from intentionally omitting information or failing to file require forms. Without full and accurate reporting, the state unemployment agency cannot properly determine the liability of employers.

Response:

A representative from the National Association of Professional Employer Organizations (NAPEO) has said that attempts to broaden the anti-SUTA dumping proposal, in particular attempts to impose certain reporting requirements on PEOs, "would place an onerous regulatory burden on the PEO industry absent any credible data suggesting that such a requirement is warranted." There is no special treatment of PEOs in the package of bills; they would be treated in the same manner as all other firms. NAPEO has said it welcomes discussing with the legislature a comprehensive approach to PEO regulation. A representative has said: "A PEO statute in Michigan would allow regulators to gain a full understanding of the number and types (i.e., captive, public) of PEOs operating in the state. Such basic information would be useful in crafting effective public policy impacting PEOs."

A consortium of business groups who support the Senate-passed version of the proposal have addressed this topic as follows:

We are opposed to amendments that would require employers—including Professional Employer Organizations (PEOs) to submit registration and discontinuance reports in order to track SUTA dumping. . . . . for several reasons: 1) the burden of proof should remain with the Unemployment Insurance Agency to prove that SUTA dumping is taking place as opposed to creating a new reporting burden on employers to prove they are not dumping; 2) any reporting requirement exceeds federal requirements; 3) the unemployment insurance agency has not demonstrated that they can keep up with the reporting requirements found under current law; 4) initial research shows that no other state . . . includes a reporting requirement; and 5) reporting requirements drive up the cost and burden of doing business in the state. (From a memorandum by the Detroit Regional Chamber, the Michigan Chamber of Commerce, the Michigan Grocers Association, the Michigan Restaurant Association, the National Federation of Independent Business, and the Small Business Association of Michigan.)

POSITIONS:

The following are among the organizations that have indicated support for the proposal in the form that it passed the Senate and that it was reported from House committee: The Michigan Chamber of Commerce; the Association of Michigan PEOs; the National Federation of Independent Business; the National Association of Professional Employer Organizations; ADP Total Source; the Michigan Grocers Association; the Michigan Restaurant Association; and the Small Business Association of Michigan.

The following are among organizations would prefer that stronger language be adopted regarding the transfer of employees to professional employer organizations (PEOs): the Department of Labor and Economic Growth; the Employers' Unemployment Compensation Council (which includes among its membership the Michigan Manufacturers Association and the Michigan Health and Hospital Association); Kelley Services, Inc.; and the Michigan Retailers Association.

The Michigan AFL-CIO submitted testimony indicating that the organization does not support "any legislation that addresses the issue of SUTA dumping without also addressing the woefully inadequate level of unemployment compensation benefits in Michigan."

Organizations that have indicated opposition to the bills include: The International Union, UAW; the Service Employees International Union (SEIU); and the National Employment Law Project.

Legislative Analyst: E. Best
Chris Couch
Fiscal Analyst: Richard Child

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.