

---

**Commerce & Labor Committee**

---

**HB 2246**

**Brief Description:** Concerning employer contribution rates.

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

**Brief Summary of Bill**

- Adds new definitions and clarifies language in the unemployment insurance law concerning temporary services agencies, 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.

**Hearing Date:** 3/2/05

**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 federal 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 U.S. 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 compensation 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 state's unemployment compensation 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 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 (Commissioner), of up to \$250 or 10 percent of the quarterly contributions, whichever is less. Under 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 Bill:**

#### Determination of "Employer"

A temporary services agency, staffing company, services referral agency, or other such entity is considered the employer, for purposes of the unemployment compensation law, with respect to services performed under contract for a third party client. 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, 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.

The Employment Security Department (ESD) may not establish joint unemployment insurance accounts for individuals or entities defined as employee leasing agencies, professional employer organizations, or their client employers, or common pay agents or common paymasters.

### 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 1st following the transfer is based on a combination of the successor's and the predecessor's relevant layoff experience. If a substantial 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 assigned the higher of the predecessor or successor rate effective as of the transfer date.

For transfers on or after January 1, 2005, if the successor employer is not an employer at the time of the business transfer, 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 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 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 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 must establish procedures to enforce these penalties, and may adopt such other rules as are necessary to implement the bill's provisions.

**Appropriation:** None.

**Fiscal Note:** Available.

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