

# HOUSE BILL REPORT

## SHB 2604

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**As Passed House:**

February 18, 2002

**Title:** An act relating to new and successor employer unemployment contribution rates.

**Brief Description:** Modifying new and successor unemployment contribution rates.

**Sponsors:** By House Committee on Appropriations (originally sponsored by Representatives Clements, Conway, McMorris and Wood).

**Brief History:**

**Committee Activity:**

Commerce & Labor: 1/30/02, 2/7/02 [DP];

Appropriations: 2/9/02, 2/11/02 [DPS].

**Floor Activity:**

Passed House: 2/18/02, 53-44.

**Brief Summary of Substitute Bill**

- Changes the unemployment insurance contribution rate for certain unqualified employers to the average industry rate plus 20 percent.
- Requires the Employment Security Department to report to the Legislature on the effectiveness of the new rate by December 31, 2005.

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### HOUSE COMMITTEE ON COMMERCE & LABOR

**Majority Report:** Do pass. Signed by 6 members: Representatives Conway, Chair; Wood, Vice Chair; Clements, Ranking Minority Member; Chandler, Kenney and Lysen.

**Staff:** Chris Cordes (786-7103).

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### HOUSE COMMITTEE ON APPROPRIATIONS

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 25 members: Representatives Sommers, Chair; Doumit, 1st Vice Chair; Fromhold, 2nd Vice Chair; Sehlin, Ranking Minority Member; Alexander, Boldt, Buck, Clements, Cody, Cox, Dunshee, Grant, Kagi, Kenney, Kessler, Linville, Lisk, Mastin, McIntire, Pearson, Pflug, Ruderman, Schual-Berke, Talcott and Tokuda.

**Staff:** Heather Flodstrom (786-7391).

**Background:**

*Unemployment Insurance Contribution Rates*

For most covered employers, unemployment insurance contribution rates are determined by the rate in the employer's assigned rate class under the unemployment insurance tax schedule in effect for that calendar year. Rates under the 2002 tax schedule range from 0.47 percent to 5.4 percent, not including various statutory surcharges.

Some covered employers, however, are not qualified to be assigned a rate class. Unqualified employers include those who do not report enough periods of employment during the previous three years. These employers pay the average industry rate in their industry, as determined by the commissioner of the Employment Security Department, but not less than 1 percent. (Under the Federal Unemployment Tax Act, states must set a 1 percent minimum rate for unqualified employers to maintain the credit that employers in the state may take against their federal unemployment insurance tax.)

The average industry rate also applies to certain successor employers who were not employers at the time of acquiring a business. Until a new successor employer becomes a qualified employer, the rate for these successor employers is the lower of the rate assigned to the predecessor employer or the average industry rate with a 1 percent minimum rate.

*Inactive Accounts and Socialized Costs*

Employers who go out of business, become insolvent, or for other reasons no longer maintain an active unemployment insurance account in Washington may continue to have benefit charges that result from benefits paid to their former employees. If the employer's previous tax payments are less than these charges, the charges become part of the system's "socialized costs" that are borne by all active employers.

In 1998 the Employment Security Department contracted for a study of various issues in the unemployment insurance tax system. The study's author, Wayne Vroman, concluded that employers in Washington's unemployment insurance system exhibited an unusually high degree of turnover. The data indicated a high rate of new employer formation and inactivation of employer accounts, but a low rate of successorship. Dr. Vroman suggested further research, concluding that "...we do not know how much of this turnover reflects the normal functioning of Washington's labor market and how much reflects 'gaming' by employers looking to secure lower [unemployment insurance] tax rates."

**Summary of Substitute Bill:**

The unemployment insurance contribution rate for certain unqualified employers is modified. The rate is changed from the average industry rate to a rate that is the average industry rate plus 20 percent (with the minimum rate remaining at 1 percent). The maximum rate that may be assigned to these employers is the rate that applies in rate class 20 for the rate year (5.4 percent for 2002).

These provisions apply to employers who:

- are not qualified to be in the tax array (except for those disqualified for nonpayment of contributions); and
- are successor employers who were not employers at the time the business was transferred and whose contribution rate is lowest when using the option of the average industry rate plus 20 percent.

These changes in the contribution rate apply beginning January 1, 2003. The Employment Security Department must report to the appropriate committees of the Legislature by December 31, 2005, on the effectiveness of these new rates.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Testimony For:** (Commerce & Labor) The new employer rate needs to be adjusted to reduce the incentive for employers to "game" the unemployment insurance system by closing their business and then reopening it in another form. This problem in the system was identified in a study conducted a few years ago. It appears that the new employer rate is artificially low.

**Testimony For:** (Appropriations) Representatives from all of the major industries support this bill.

(Concerns) This bill causes concern because it charges a 25 percent surtax on new businesses trying to get into the system.

**Testimony Against:** (Commerce & Labor) None.

**Testimony Against:** (Appropriations) None.

**Testified:** (Commerce & Labor) Clif Finch, Association of Washington Business.

**Testified:** (Appropriations) Clif Finch, Association of Washington Business.

(Concerns) Gary Smith, Independent Business Association.

