

HOUSE BILL REPORT

ESSB 5373

As Passed House:

April 6, 2007

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: By Senate Committee on Labor, Commerce, Research & Development (originally sponsored by Senators Kohl-Welles, Prentice, Keiser, Franklin and Kline; by request of Employment Security Department).

Brief History:

Committee Activity:

Commerce & Labor: 3/20/07, 3/29/07 [DP].

Floor Activity:

Passed House: 4/6/07, 64-30.

Brief Summary of Engrossed Substitute Bill

- Adds services performed by corporate officers to covered employment for purposes of unemployment compensation, with certain exceptions.
- 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.

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.

- Designates professional employer organizations and client employers as co-employers.

HOUSE COMMITTEE ON COMMERCE & LABOR

Majority Report: Do pass. Signed by 5 members: Representatives Conway, Chair; Wood, Vice Chair; Green, Moeller and Williams.

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

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 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 Employment Security 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 the 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; and (3) maintain accurate payroll records for client employers and make these records available for review or inspection. The PEOs may file single electronic reports containing separate and distinct information for client employers, or separate paper reports for client employers.

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

The Department must collect contributions, penalties, and interest due from PEOs. If amounts due are not paid by the PEOs within 10 days, the Commissioner may collect these amounts from client employers.

The Department must report on the implementation of sections relating to PEOs to the Unemployment Insurance Advisory Committee and appropriate legislative committees by December 1, 2010. The report must examine impacts on PEOs, small businesses, and the unemployment insurance system.

Appropriation: None.

Fiscal Note: Available.

Effective Date: 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, and 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) This legislation has changed quite a bit since the Employment Security Department first discussed it with the Committee. The bill before you today is a product of numerous discussions with business and labor. There is general agreement with most provisions of the substitute bill.

The professional employer organization (PEO) sections remain the main area of opposition. We have closed the gap a great deal, but there are two unresolved issues. First, should PEOs be considered the sole employer for purposes of the unemployment insurance system? Second, should client companies ultimately be responsible for their own tax liability? PEOs want to be considered the sole employer. The Department needs to ensure that taxes are paid. The current substitute bill defines PEOs and clients as co-employers. It also provides that the Department will collect taxes first from PEOs, and then from clients.

There have been significant negotiations and significant changes to the bill. The bill preserves the Department's essential functions and gives them needed tools. With respect to PEOs, we believe that both the experience rating and the ultimate responsibility for taxes should stay with the client.

There have been major changes to every section of this bill. Our concerns have been neutralized and we are comfortable with the language before you now. With respect to PEOs, we want to make sure that benefits are not socialized among other employers.

(With concerns) One significant issue is related to penalties for reporting errors. If you repeat an error within five years, you are subject to penalties. Instead of five years, it should be amended to two years.

Another issue is related to corporate officer coverage. We are concerned with the stock ownership reporting requirement, and believe that this information could be gathered when corporate officers apply for unemployment insurance.

(Opposed) We have had extensive dialogue with the Employment Security Department and have resolved some issues (e.g., experience rating).

Whether PEOs are designated as the employer, as in current law, or a co-employer, as in the bill, is an outstanding issue. In 33 states, PEOs are the sole employer for purposes of unemployment insurance taxes.

A change in how PEOs are designated for purposes of unemployment insurance calls into question how PEOs are designated for other purposes. If PEOs are designated as co-employers, both parties are liable. The PEOs will not be able to assume reporting and financial responsibilities for our clients as in other states. The PEOs will also not be able to sponsor employee group medical plans. Clients need certainty so they can focus on their core operations and leave their unemployment insurance responsibilities to PEOs.

This change also increases the costs of administering unemployment insurance for clients. Either our clients will have to do it on their own, or we will have to pass those costs on to our clients. Neither option is good for business.

The Employment Security Department has not brought forth any compelling data that PEOs have been a problem and that a wholesale change in the law is needed.

Persons Testifying: (In support) Karen Lee and Jill Will, Employment Security Department; Jeff Johnson, Washington State Labor Council; and Mellani McAleenan, Association of Washington Business.

(With concerns) Carolyn Logue, National Federation of Independent Business; and Gary Smith, Independent Business Association.

(Opposed) Jim Halstrom and Todd Cohn, National Association of Professional Employer Organizations; John Heaton, Pay Plus Benefits; Mel Sorenson, ADP Total Source; Andrea McHenry, Administaff; Barry Savage, Resource Management, Inc.; and Rick Lang, LMC Resources.

Persons Signed In To Testify But Not Testifying: Drew Thoreson, HRnovations; and Rebecca Gottschalk, Inserve.