

# SENATE BILL REPORT

## ESSB 5373

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As Passed Senate, March 12, 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:** 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:** Labor, Commerce, Research & Development: 1/22/07, 2/27/07 [DPS, DNP].

Passed Senate: 3/12/07, 36-11.

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### SENATE COMMITTEE ON LABOR, COMMERCE, RESEARCH & DEVELOPMENT

**Majority Report:** That Substitute Senate Bill No. 5373 be substituted therefor, and the substitute bill do pass.

Signed by Senators Kohl-Welles, Chair; Keiser, Vice Chair; Franklin, Murray and Prentice.

**Minority Report:** Do not pass.

Signed by Senators Clements, Ranking Minority Member, Hewitt and Holmquist.

**Staff:** Jennifer Strus (786-7316)

**Background:** When unemployment insurance (UI) benefit overpayments are caused by a redetermination of benefits, those benefits paid cannot be collected from the claimant. Those benefit amounts are also not charged to the employer, so benefits paid that should not have been are deemed an administrative overpayment and the cost of those benefits is socialized to all employers.

Any employer who fails to file a timely tax and wage report is subject to a penalty to be determined by the Commissioner of the Employment Security Department (ESD) but not to exceed \$250 or 10 percent of the employer's quarterly contributions for each failure.

Corporations may elect not to cover their officers for purposes of UI. If the corporation elects not to cover officers, it must notify those officers in writing that they are ineligible for

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unemployment compensation benefits. If the employer fails to notify the officer of its decision not to cover officers, those officers are eligible for UI benefits.

If an employer fails to report the number of hours worked by employees during a reporting period, the number of hours will be computed by ESD based upon a formula.

A claimant is disqualified to receive benefits for any week he or she has knowingly made a false statement or representation involving a material fact or knowingly failed to report a material fact, the result of which is the claimant received benefits. The disqualification must last for 26 weeks.

A professional employer organization (PEO) generally provides human resource management functions, including employment benefits, payroll administration, workers' compensation, and unemployment insurance services to businesses. When the business contracts with the PEO for these kinds of services, the unemployment taxes paid are based on the PEO's experience rating rather than that of the client company.

**Summary of Engrossed Substitute Bill: Reports:** Employers must include the full names and social security numbers of, and total hours worked by, each of their employees in reports to ESD. Any benefits paid using computed hours are not considered an overpayment of benefits and are not subject to collection if the correction of computed hours results in an invalid or reduced claim. However, the experience rating account of an employer who fails to report the number of hours its employees worked will be charged for all benefits paid based on computed hours. Furthermore, a reimbursable employer who fails to report the number of hours worked must reimburse the trust fund for all benefits paid that are based on computed hours.

If a UI benefit claim by an employee is later determined to be invalid because the employer failed to report or inaccurately reported the hours an employee worked, that claim will be charged to the experience rating account of the employer. A reimbursable employer who fails to report or inaccurately reported the hours an employee worked must reimburse the trust fund for all benefits paid as a result of the erroneous report.

An employer who fails to file a timely tax and wage report will receive a warning letter offering technical assistance for the first occurrence. For subsequent occurrences the following applies: if no contributions are due the fine is \$75 for the second occurrence, \$150 for the third occurrence, and \$250 for the fourth and subsequent occurrences; when contributions are due, for the second occurrence, the penalty is 10 percent of the quarterly contributions due but not less than \$75 and not more than \$250; for the third occurrence, the penalty is 10 percent of the quarterly contributions due, but not less than \$150 and not more than \$250; and for the fourth and any subsequent occurrences, the penalty is \$250. The Commissioner may waive any penalties if he or she determines that the employer's failure to file timely, complete, and correctly formatted reports or pay timely contributions was not the employer's fault.

**Corporate Officers:** The provision allowing a company to elect not to cover its officers for purposes of unemployment compensation is retained as long as the officers agree in writing.

An officer of a corporation who owns 10 percent or more of the outstanding stock of the corporation or the officer's family member, whose claim for UI benefits is based upon wages

received from that corporation, is not considered unemployed for any week during the officer's term of office or ownership. He or she is considered unemployed if the corporation dissolves and the officer permanently resigns or is permanently removed from his or her appointment and responsibilities with the corporation.

A bone fide corporate officer may be exempt from UI coverage if he or she: (1) is voluntarily elected or appointed; (2) is a shareholder of the corporation; (3) exercises substantial control in the daily management of the corporation; and (4) whose primary duties do not include performance of manual labor.

A corporation that is not a public company may exempt from coverage eight or fewer officers who voluntarily agree to be exempted, are voluntarily elected or appointed; exercise substantial control in the daily management and any number of officers if all exempted officers are related by blood within the third degree or marriage.

Upon the termination, dissolution, or abandonment of a corporation or limited liability company, any officer, member, manager or another having control or supervision of the payment of UI taxes or responsibility for filing UI reports or payments may be personally liable for unpaid UI taxes. The person is personally liable only if he or she willfully fails to pay or cause to be paid, any taxes owing. These persons are not liable if the failure to pay taxes was beyond their control as determined by ESD in rule or all the assets of the company have been applied to its debts through bankruptcy or receivership.

Corporate officers are liable for unpaid taxes if the officer willfully evades any contributions imposed by Title 50, willfully destroys records, willfully fails to truthfully account for or makes under oath any false statement relating to the financial condition of the company.

Employer Registration: Every employer must register with ESD and obtain an employment security account number. To register, the employer must provide the following information: the names and social security numbers of the owners, partners, members or corporate officers of the business along with their mailing address, telephone numbers, and other information required by ESD by rule. If the owners, partners, members, or officers change, the employer must notify ESD of this fact within 30 days

Fraud: For decisions mailed after January 1, 2008, the penalties for claimant fraud are increased for the second and third time a claimant has fraudulently claimed benefits. The second time fraud occurs, the claimant is ineligible to receive benefits for 52 weeks and is also assessed a monetary penalty of 25 percent of the benefits improperly paid. For the third and subsequent offenses, the claimant is ineligible to receive benefits for 104 weeks and is assessed a monetary penalty of 50 percent of the overpaid benefits.

Professional Employer Organizations (PEOs): All PEOs must register with ESD and provide the names, addresses, and employment security account numbers of its client companies. PEOs must also notify ESD within 30 days each time a client is added or deleted. The definition of PEO recognizes a co-employment relationship with its clients.

Before a PEO can act on behalf of a client company for UI purposes, it must enter into a power of attorney or confidential information authorization. PEOs must also file separate quarterly wage and contribution reports for each client company as well as maintaining accurate payroll records for each client company. The PEO can file either a single electronic

report containing separate and distinct information for each employer or separate paper reports for each client employer. PEOs must make these records available for inspection by ESD.

The client company, not the PEO, is the employer for unemployment tax liability and the experience rating of the client company follows the client when they enter or leave a contractual relationship with the PEO. The client employer is liable for any taxes, interest or penalties due. The PEO may collect and pay taxes due to the department from its client employers. If the payments have been made to the PEO, the department is to first try to collect the payments from the PEO. The department must follow the collection procedures in RCW 50.24. If the PEO has not paid the taxes, penalty or interest within ten days, the collection procedures contained in RCW 50.24 must be followed. After the ten day period, if the PEO has not paid the total amount owing, the Commissioner may also pursue the client company to collect.

PEOs may not have joint accounts.

The department is to report on the implementation of the portions of the bill dealing with PEOs and its impacts on PEOs, small businesses, and the integrity and operations of the UI system. The department is to report its findings to the Unemployment Insurance Advisory Committee and the Legislature no later than December 1, 2010.

**Appropriation:** None.

**Fiscal Note:** Available.

**Committee/Commission/Task Force Created:** No.

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

**Staff Summary of Public Testimony on Original Bill:** PRO: The changes in the bill share a common theme: efficiency, fairness, and administrative efficiency. The bill encapsulates a lot of unfinished business that bills in the last several sessions have not covered. It provides consistency across state agencies in the powers they have with certain problems in the system. With regard to corporate officers, 84 percent of the time there is no proof that these officers received notice that they would not be covered for UI purposes. As a result, they were provided benefits and the cost to do that was socialized across employers. Because there is a high business closure rate in this state and ESD has difficulty collecting taxes that should have been paid, it is important to allow ESD to be able to collect from the officers even though the business closes. This bill is not about challenging the PEO business model - it is really about consistency in the way that employers are treated. PEOs currently file separate information with both Labor & Industries and Department of Revenue; the same should apply in unemployment compensation reports.

CON: The bill would significantly alter the core business of a PEO by removing its status as an employer and replacing it with that of an agent. The bill could also call into question the ability of a PEO to sponsor other valuable benefit plans for their employees as an employer which could result in the loss of health insurance, dental coverage, life insurance, and dependent care for thousands of Washington employees. Most PEOs pay into the UI system far more than their employees claim each year. ESD said it would do a study last year of PEOs. To date it has produced nothing in writing and yet, it has proposed a bill to remedy the

issues with PEOs that their study failed to substantiate. The penalty portion of the bill will hurt small businesses. What these businesses need is technical assistance from ESD as to how to properly fill out their forms, not a fine.

OTHER: There are grave concerns about the section making corporate officers liable. The current corporation law allows a court to determine whether piercing the corporate veil is appropriate. That should be the preferred method to deal with this issue. If corporations did not pay into the UI trust fund, why is ESD paying their corporate officers benefits? There should be a time limit to the penalties so if a business made mistakes one year and then again in six years, the penalties are not cumulative. Requiring another registration process is overwhelming to small business; they are required to register enough places already.

**Persons Testifying:** PRO: Karen Lee, ESD; Jeff Johnson, Washington State Labor Council.

CON: Jim Halstrom, National Association of Professional Employers Organization (NAPEO); Todd Cohn, NAPEO; John Heaton, Pay Plus Benefits, Inc.; Drew Thoresen, Human Resource Innovations.

OTHER: Mellani McAleenan, Association of Washington Business; Carolyn Logue, National Federation of Independent Business; Gary Smith, Independent Business Association.