

CONSOLIDATION OF UNEMPLOYMENT ACCOUNTS

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

Senate Bill 12 as passed by the Senate
Sponsor: Sen. Mark C. Jansen
Senate Committee: Economic Development
House Committee: Commerce

Complete to 5-16-11

A SUMMARY OF SENATE BILL 12 AS PASSED BY THE SENATE 05-03-11

Senate Bill 12 would amend the Michigan Employment Security Act to prohibit the Unemployment Insurance Agency (UIA) from consolidating the experience accounts of separate employers or consolidating the contribution (state unemployment tax) rates of separate employers, except in either of the following circumstances:

1. There is a transfer of trade or business in violation of Section 22b(1) of the act.
2. The employers disregard their separate legal status by commingling assets and failing to conform to corporate formalities in furtherance of an unlawful purpose.¹

The bill further provides that it would not prohibit the UIA from transferring or combining the experience accounts of employers, if the transfer of a trade or business is made after July 1, 2005, [the effective date of the act's SUTA dumping provisions under Section 22b] for the sole or primary purpose of reducing reimbursement payments² or the contribution (tax) rate as provided in Section 22b, or if the employers disregard their separate legal status by commingling assets and failing to conform to corporate formalities in furtherance of an unlawful purpose.

Section 22b of the act prohibits "SUTA dumping." Specifically the act prohibits employers from doing either of the following:

1. Transferring a trade or business for the sole or primary purpose of reducing contribution rates or reimbursement payments.

¹ See, generally, Sections 15(g) and 22 of the Michigan Employment Security Act, MCL 421.15(g) and MCL 421.22. See, also, *UIA Form 1027 (Business Transferor's Notice to Transferee of Unemployment Tax Liability and Rate)*, [http://www.michigan.gov/documents/uia_UC1027_76086_7.pdf]. See, also, *UIA Schedule B (Successorship Questionnaire) Form*, [http://www.michigan.gov/documents/uia_ScheduleB_147024_7.pdf]. See, also, *UIA form 1184-1 (Report and Agreement on Partial Transfer of Business Certifications)*, [http://www.michigan.gov/documents/uia_UC11841_76108_7.pdf]. See, also, *UIA Form 1184 (Employer's Report on Partial Transfer of Business)*, [http://www.michigan.gov/documents/uia_UC1184_76107_7.pdf],

² There are essentially two types of employers paying into the state unemployment trust fund, contributing employers and reimbursing employers. Most employers are "contributing" employers who make quarterly state UI tax payments. "Reimbursing" employers reimburse the unemployment trust fund, on a dollar-for-dollar basis, based on the amount of unemployment benefits paid to the former employees of reimbursing employers. Reimbursing employers include the state, most local governments, most school districts, and many nonprofit organizations.

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

Under Section 22b, if an employer transfers its trade or business to another employer with substantially common ownership, management, or control, the experience ratings for the two employers are combined.

The bill would also prohibit the UIA from consolidating or combining the experience or unemployment accounts of employers, or from assessing a consolidated contribution (tax) rate, while a request for a redetermination,³ an appeal before the Michigan Employment Security Board of Review,⁴ or an appeal before the circuit court or appellate courts⁵ is pending. If the MES Board of Review or the courts reverse a decision by the UIA to consolidate or combine the accounts or tax rate of employers, the prevailing party (employers) would be awarded court costs and reasonable attorney fees.

BACKGROUND INFORMATION:

Under the Michigan Employment Security Act, an employer's state unemployment tax rate is based on its "experience rating" where, in general, employers that have more former employees receiving unemployment benefits have a higher tax rate than those employers with fewer former employees receiving benefits.⁶ In recent years, some employers have used a variety of tax planning strategies aimed at reducing their state unemployment tax burden. Common "SUTA dumping" strategies include creating a new business (a firm with a high tax rate creates a new company, typically subject to a lower rate, and transfers employees to the new firm); transferring employees to a subsidiary with a lower tax rate; or acquiring a business with a lower tax rate in a shell transaction where the new business does not engage in the same business as the old one.

Prohibitions against SUTA dumping were added to the federal Social Security Act with the enactment of the SUTA Dumping Prevention Act of 2004, PL 108-295, 42 USC 503(k).⁷ In general, the act requires that states, as a condition of receiving federal funding for the administration of state unemployment insurance programs, enact laws

³ See, Section 32a of the Michigan Employment Security Act, MCL 421.32a. See, *A Guide to Unemployment Insurance Appeals Hearings*, [http://www.michigan.gov/documents/uia_UC1800_76144_7.pdf].

⁴ See, Sections 33-36 of the Michigan Employment Security Act, MCL 421.33 to MCL 421.36. See, also, the MES Board of Review's website, [http://www.michigan.gov/dleg/0,1607,7-154-10576_17488---,00.html]. The board of review hears and decides appeals from decisions and orders issued by UIA referees in contested unemployment benefits programs.

⁵ See Section 38 of the Michigan Employment Security Act, MCL 421.38.

⁶ The state UI tax rate ranges from 0.06% to 10.3%, exclusive of any penalties imposed. The chargeable benefits component (CBC) of the state UI tax rate is based on the amount of benefit charges for the 60-month period ending on the previous June 30th.

⁷ See, *State Unemployment Taxes and SUTA Dumping*, Congressional Research Service, RS22069 (May 27, 2005), available publicly at, [<http://lost-contact.mit.edu/afs/sipb/contrib/wikileaks-crs/wikileaks-crs-reports/RS22069.pdf>]. See, also, *Unemployment Fraud and Abuse*, Hearing before the U.S. House of Representatives, Committee on Ways and Means, Subcommittees on Oversight and Human Resources, June 19, 2003, Serial No. 108-25, [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_house_hearings&docid=f:91420.pdf]. See, also, *Implementation of the SUTA Dumping Prevention Act of 2004*, Hearing before the U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Human Resources, June 14, 2005, Serial No. 109-18.]

prohibiting SUTA dumping and imposing "meaningful" penalties for knowingly violating (or attempting to violate) state SUTA dumping prohibitions.⁸ Following enactment of PL 108-295, the Michigan Legislature and governor enacted Public Act 18 of 2005 (SB 171), amending the Michigan Employment Security Act to prohibit SUTA dumping.⁹ However, the U.S. Department of Labor has indicated to the Unemployment Insurance Agency that the state's SUTA dumping law – Section 22b of the Michigan Employment Security Act, MCL 421.22b – needs to be further amended to conform to federal law.¹⁰

In addition, provisions concerning the "transfer of business" are contained in Section 22 of the Michigan Employment Security Act. The act provides that upon a transfer of business, the UIA shall assign the transferor's experience account, or a prorated share based on insured payroll, to the transferee. The assignment is to be made as of the date of the transfer or as of June 30th of the year in which the transfer was made, whichever is earlier. Penalty provisions are contained in Sections 54 to 54c of the act. The penalties vary based on the amount of the benefit received by committing the violation, but range up to a penalty of three times the amount of the benefit.

FISCAL IMPACT:

The bill, itself, would have an indeterminate, but negative, fiscal impact on the state. The language added by the bill awarding reasonable costs and attorney fees to the prevailing party (employers) would generally serve to increase the costs of the UIA in pursuing alleged SUTA dumping claims, to the extent that costs are not awarded already under applicable court rules.

The provisions prohibiting the agency from consolidating the accounts or tax rates while an appeal of the determination is pending would, apparently, have no fiscal impact. By law, the employer has 30 days to file a written protest to the determination. After the appeal process has been exhausted or when a settlement has been reached, if applicable, adjustments will be made to the employer account.

⁸ Specifically, the act, 42 USC 503(k)(1)(a), requires that state unemployment insurance (UI) laws provide "that if an employer transfers its business to another employer, and both employers are (at the time of transfer) under substantially common ownership, management, or control, then the unemployment experience attributable to the transferred business shall also be transferred to (and combined with the unemployment experience attributable to) the employer to whom such business is so transferred."

⁹ See, *Implementation of the SUTA Dumping Prevention Act of 2004*, Hearing before the U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Human Resources, June 14, 2005, Serial No. 109-18, [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_house_hearings&docid=f:36662.pdf]. See, also, *Evaluation of State Implementation of Section 303(k), SSA*, ETA Occasional Paper 2008-05, prepared for the U.S. Department of Labor, Employment and Training Administration by Coffey Communications and the Urban Institute, [http://wdr.doleta.gov/research/FullText_Documents/Evaluation%20of%20State%20Implementation%20of%20Section%20303%28K%29%20SSA--Final%20Report.pdf].

¹⁰ For additional information on federal SUTA dumping requirements, see Department of Labor guidance letters UIPL 30-04 (August 13, 2004), [http://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=1596] and UIPL 30-04, Change 1 (October 13, 2004), [http://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=1610].

The provision restricting the UIA's authority to consolidate or combine experiences accounts except for violations of law would generally serve to reduce state UI tax revenue. Given the UIA's continued need to rely on Title 12 advances (loans) from the U.S. Department of Labor, a reduction in the amount of state UI taxes would generally require the UIA to receive additional advances in order to continue to pay required UI benefits to displaced workers. Any additional borrowing increases the amount of interest payable by the agency from state (non-trust fund) resources.

In 2010, the UIA opened 115 investigations concerning possible SUTA dumping violations under Sections 22(b), 22b, and 54b of the Michigan Employment Security Act. During the year 17 cases were heard before an administrative law judge, with the UIA recovering \$2.3 million in underpaid state unemployment insurance taxes.

The bill refers to violations of Section 22b – the state's SUTA dumping prohibitions – which the U.S. Department of Labor has determined to be out of conformity with federal SUTA dumping requirements.¹¹ Since enactment of federal and state SUTA dumping prohibitions, the U.S. Department of Labor has raised a few concerns with the UIA regarding the state's implementation of PL 108-295. The issue revolves largely around MCL 421.22b(1)(a), which prohibits the transfer or acquisition of a business "for the sole or primary" purpose of reducing the unemployment tax rate.¹² In a March 2009 letter to the UIA, the U.S. Department of Labor stated, "introduced SB 5 [the identical Senate bill from the prior legislative session] will create an additional issue because its provisions apply 'unless there has been a transfer of trade or business in violation of' Section 421.22b. As noted, Section 421.22b impermissibly limits the mandatory transfer of experience. Therefore SB 5 will not mandate the transfer of experience as required by Section 303(k), SSA." The long-term consequence of Section 22b in Michigan's statute failing to conform to federal requirements is the withholding of federal administrative funds for the UIA and increased federal UI taxes on Michigan employers.

Legislative/Fiscal Analyst: Mark Wolf

■ 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.

¹¹ The Federal Unemployment Tax Act (FUTA) and Title III of the federal Social Security Act generally require the Department of Labor to certify that state unemployment insurance laws meet certain requirements specified in the respective acts. These requirements include, among other things, the prohibitions against SUTA dumping as required under PL 108-295.

¹² Legislation to bring the SUTA dumping provision into compliance with federal requirements was last considered – although not enacted – by the Legislature in the 2007-08 legislative session. See HB 6386, introduced by Rep. Bob Constan, <http://legislature.mi.gov/doc.aspx?2008-HB-6386>.