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BILL



ANALYSIS

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Senate Bills 171 and 174 (as enrolled)  
House Bills 4414 and 4415 (as enrolled)  
Sponsor: Senator Jason E. Allen (S.B. 171)  
Senator Dennis Olshove (S.B. 174)  
Representative Robert Gosselin (H.B. 4414)  
Representative David Robertson (H.B. 4415)  
Senate Committee: Commerce and Labor  
House Committee: Employment Relations, Training and Safety

**PUBLIC ACTS 18 & 19 of 2005****PUBLIC ACTS 17 & 16 of 2005**

Date Completed: 6-2-05

**RATIONALE**

In August 2004, President Bush signed the SUTA Dumping Prevention Act. ("SUTA" refers to state unemployment tax act.) That Act requires states, as a condition of eligibility for Federal unemployment insurance system administration grants, to adopt legislation to deter an employer's manipulation of its unemployment tax rate through practices that have come to be known as "SUTA dumping": a tax-evasion scheme under which an employer avoids its full unemployment tax liability, which is based on the employer's unemployment experience. Under one such scheme, an employer buys another company that has a more favorable experience rating with respect to unemployment, or creates a new company, solely or primarily for the purpose of transferring payroll to the lower-tax company in order to reduce unemployment taxes. While there is no substantive change in ownership, management, or business activity, the employer is able to "dump" its old tax rate. It was suggested that Michigan enact SUTA dumping legislation in order to thwart these tax-rate manipulation schemes, ensure proper balances in the Unemployment Compensation Fund, and comply with eligibility requirements for Federal funds for the administration of the State's unemployment compensation system.

**CONTENT**

**The bills amend the Michigan Employment Security Act to do all of the following:**

- **Prohibit a person from transferring all or part of a trade or business solely or primarily for the purpose of reducing the contribution rate or reimbursement payments in lieu of contributions required under the Act (i.e., "SUTA dumping").**
- **Prohibit a person from acquiring all or part of a trade or business solely or primarily to obtain a lower contribution rate than otherwise would apply under the Act.**
- **Prescribe sanctions against a person who knowingly violates or attempts to violate these provisions.**
- **Require the Unemployment Insurance (UI) Agency to recalculate the contribution rates of both employers if an employer transfers its trade or business to another employer and there is substantially common ownership, management, or control of the two employers.**
- **Require the UI Agency to assign a new employer contribution rate to a person who is not an employer under the Act at the time of a transfer and who acquires a trade or business solely or primarily to obtain a lower contribution rate.**

- **Require that money recovered under these provisions be credited to the Unemployment Compensation Fund.**
- **Require the UI Agency to report annually to the Legislature regarding SUTA dumping, beginning January 1, 2006.**
- **Specify that a transfer of an employer's assets is a "transfer of business" under criteria described in the Act if there is not substantially common ownership, management, or control of the transferor and transferee.**
- **Establish requirements concerning the payment of a balance, the transfer of benefit charges, and the continuation of reimbursement payments, that apply to a change in status between reimbursing employer and contributing employer.**

The bills are tie-barred and will take effect on July 1, 2005.

### **Senate Bill 171**

#### **Prohibitions; Rate Recalculation**

The bill prohibits a person from doing either of the following:

- Transferring the person's trade or business, or a portion of it, to another employer for the sole or primary purpose of reducing the contribution rate or reimbursement payments in lieu of contributions required under the Act (which the bill defines as SUTA dumping).
- Acquiring a trade or business, or a part of a trade or business, for the sole or primary purpose of obtaining a lower contribution rate than otherwise would apply under the Act.

(The bill defines "SUTA" as the state unemployment tax act.)

Under the bill, if an employer transfers its trade or business, or a portion of it, to another employer and there is substantially common ownership, management, or control of the two employers at the time of the transfer, the unemployment experience attributable to the transferred trade or business must be transferred to the transferee employer. The UI Agency must recalculate the contribution rates of both employers and apply the new rates in the

same manner as for a transfer of business under the Act. If, after a transfer of experience, however, the UI Agency determines that the sole or primary purpose of the transfer of trade or business was to obtain reduced liability for contributions, then the employers' experience rating accounts must be combined into a single account and a single rate assigned to the account.

The bill provides that, if the UI Agency determines that a person who is not an employer under the Act at the time of a transfer acquires a trade or business, or a portion of a trade or business, solely or primarily for the purpose of obtaining a lower contribution rate, the Agency must assign that employer the applicable new employer rate under the Act.

#### **Transfer of Trade or Business**

The bill requires the UI Agency to establish procedures to identify the transfer or acquisition of a trade or business, or part of a trade or business, for the bill's purposes. The bill specifies that this does not grant the Agency the authority to promulgate rules to define SUTA dumping.

The bill also requires the UI Agency to determine whether a transfer is made for the sole or primary purpose of obtaining a lower contribution rate using objective factors, such as the cost of acquiring the business, continuity in operating the business enterprise of the acquired business, the length of time the business enterprise continues to operate, and the number of new employees hired to perform duties unrelated to the business activity or trade conducted before the acquisition.

The bill specifies that "trade or business" includes the employer's employees, but the transfer of some or all of an employer's employees to another employer must be considered a transfer of trade or business for the purposes of the bill if, as a result of the transfer, the transferring employer no longer performs trade or business with respect to the transferred employees and that trade or business is performed by the transferee employer.

## Sanctions

If a person knowingly violates or attempts to violate the bill's prohibitions, or if a person knowingly advises another person in a manner that causes a violation, the sanctions depend in part on whether the person is an employer. A person who is not an employer is subject to a civil fine of up to \$5,000. If the person is a transferring or acquiring employer, the employer must be assigned the higher of the following contribution rates:

- The highest contribution rate assignable under the Act for the rate year during which the violation or attempted violation occurs and for the three rate years immediately following that rate year.
- If the employers' business already is at the highest rate assignable for a year in which the violation occurs, or if the highest rate assignable would result in an increase of less than 2% of taxable wages, an additional penalty rate of 2% of taxable wages for that year.

These penalties are in addition to any sanction available under Section 54(b) or 54b of the Act. (Section 54(b) prescribes civil and criminal penalties for certain violations involving false statements made knowingly or within the intent to defraud. Section 54b prescribes civil penalties for violations involving conspiracy.)

Money recovered under the bill as contributions, reimbursements in lieu of contributions, civil fines, civil penalties, or interest must be credited to the Unemployment Compensation Fund.

(The bill defines "knowingly" as having actual knowledge of, or acting with deliberate ignorance or reckless disregard for, the prohibition involved.)

## Annual Report

The bill requires the UI Agency, beginning January 1, 2006, to provide an annual written report to the chairpersons of the Senate and House Appropriations subcommittee having jurisdiction over legislation pertaining to unemployment compensation. The report must include all of the following:

- The procedures the Agency has adopted to prevent SUTA dumping.
- The number of SUTA dumping investigations opened during the year.
- The average length of time to resolve a SUTA dumping investigation and the number of investigations pending for more than six months and for more than one year.
- The number of cases brought before an administrative law judge or the Board of Review and the Agency's success rate in those cases.
- The amount of money recovered as a result of implementing the bill.
- The amount of the balance or deficit in the Unemployment Compensation Fund.
- The estimated fiscal impact of SUTA dumping on the Fund balance and the factual basis for the estimate.
- The number of full-time employees assigned to, and the number of employee hours devoted to, SUTA dumping prevention, investigation, and remediation.
- The number of SUTA dumping investigations that involved the transfer of employees to or from an employee leasing company.
- The number of investigations in which an employee leasing company was found to have participated in SUTA dumping.
- The number of employee leasing companies operating in Michigan.

## Reimbursing & Contributing Employer Status

Under the bill, the provisions described below apply to changes in status between reimbursing employer and contributing employer, notwithstanding any other provision of the Act. (Under the Act, employers are required to pay a percentage of total wages as a contribution (unemployment tax) to the Unemployment Compensation Fund, on a quarterly basis. The State, political subdivisions, school districts, and nonprofit organizations, however, may elect to become reimbursing employers, which reimburse the State's unemployment system annually for unemployment claims paid. Indian tribes are considered reimbursing employers unless they elect to become contributing employers.)

If a contributing employer, including an Indian tribe that had elected to be a contributing employer, elects to become a

reimbursing employer, any negative balance the employer incurred while a contributing employer must be paid to the UI Agency before the employer may become a reimbursing employer.

Any benefit charges incurred as a result of services performed for a contributing employer that are charged to the employer's account after it has become a reimbursing employer, must be transferred to the employer's reimbursing account and paid by means of reimbursement to the Agency.

If a reimbursing employer or an Indian tribe applies to become a contributing employer and the Agency permits it to do so, or if the Agency converts a reimbursing employer to a contributing employer, then the employer must continue paying the Agency as reimbursement payments those benefit charges that were incurred based on wages paid while the employer was a reimbursing employer. Benefit charges incurred based on wages paid after the reimbursing employer became a contributing employer must be used to calculate the employer's contribution rate.

#### Intent

The bill states that it "is intended to be interpreted and applied in a manner" that meets the minimum requirements of the Federal SUTA Dumping Prevention Act of 2004 and implementing Federal regulations.

#### **House Bill 4414**

Under the Act, if an employer transfers any of the business's assets by any means other than in the ordinary course of trade, the transfer is deemed a "transfer of business" if both of the following apply:

- The transferee is an employer subject to the Act on the transfer date, has become subject to the Act as of the transfer date, or elects to become subject to the Act as of the transfer date.
- The transferee has acquired and used the transferor's trade name or good will, or has continued or, within 12 months after the transfer, resumed all or part of the business of the transferor either in the same establishment or elsewhere.

Under the bill, such a transfer is a "transfer of business" only if there is not substantially

common ownership, management, or control of the transferor and the transferee.

The Act also provides that a transfer is a "transfer of business" if an employer subject to the Act transfers any of the business's assets, by any means other than in the ordinary course of trade, to any transferee or transferees substantially owned or controlled by the same interest or interests that owned or controlled the transferor at the time of the transfer. The bill deletes that provision.

Under the Act, in the case of a transfer of business, the UI Agency must assign the transferor's rating account, or a pro rata part of it, to the transferee. (The bill refers to experience account, rather than rating account.) The Agency also must transfer a proportionate share of the amount of the total wages subject to contributions under the Act paid by the transferor and properly allocable to the transfer of business. The transferred account is chargeable for all benefit payments based on employment in the business or portion of the business transferred.

#### **Senate Bill 174**

The Act includes in its definition of "employer" any individual, legal entity, or employing unit described as a transferee in the provision that House Bill 4414 deletes. The bill instead would refer to any individual, legal entity, or employing unit that becomes a transferee of business assets by any means other than in the ordinary course of trade from an employer, if there is substantially common ownership, management, or control of the transferor and transferee at the time of the transfer.

The bill also replaces the term "crew leader" with the term "farm labor contractor" in provisions that identify the employer of an individual performing agricultural services. ("Farm labor contractor" has the same definition as "crew leader".)

#### **House Bill 4415**

Under the Michigan Employment Security Act, the Unemployment Compensation Fund is separate from all public money or State funds, and is administered exclusively for the purposes of the Act. The Fund consists of all of the following:

- All contributions and payments in lieu of contributions collected under the Act as well as reimbursement payments by the Federal government for its portion of sharable extended benefits.
- Interest earned on any money in the Fund.
- Any property or securities acquired through the use of money belonging to the Fund, and all earnings of that property or securities.
- Amounts transferred from the Contingent Fund (into which all solvency taxes and all interest on contributions, penalties, and damages collected under the Act are deposited.)

The bill includes in the Unemployment Compensation Fund all money collected under Senate Bill 171, including fines, civil penalties, and interest.

Presently, the Fund also contains any other money received by the UI Agency for unemployment compensation, except interest, penalties, and damages collected under the Act. The bill refers to the "other" provisions of the Act.

MCL 421.22b (S.B. 171)  
 421.41 (S.B. 174)  
 421.22 (H.B. 4414)  
 421.26 (H.B. 4415)

## **ARGUMENTS**

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

### **Supporting Argument**

The practice of SUTA dumping enables an employer to evade paying its proper unemployment compensation tax, results in a shortfall in the Unemployment Compensation Fund, and endangers the benefits available to unemployed workers. There are several ways in which SUTA dumping harms employers, the Fund, and workers in Michigan. SUTA dumping conflicts with the fundamental tenet of the experience-rated UI tax system that is widely favored by employers, creates an unfair competitive cost advantage for employers that use SUTA dumping schemes, and disadvantages those employers who try to manage their work and maintain steady employment for their employees. SUTA dumping also reduces money in the

Unemployment Compensation Fund, causing overall increases in employers' taxes and the loss of discounts to employers that are triggered when the Fund balance reaches certain levels. In addition, SUTA dumping reduces the funds available to pay unemployment benefits to Michigan's unemployed workers. Left unchecked, SUTA dumping could result in insufficient future balances to cover the payment of those benefits.

Although only a small number of Michigan employers engage in SUTA dumping, the loss to the Fund amounts to between \$60 million and \$95 million annually, according to testimony before the Senate Commerce and Labor Committee on behalf of the Department of Labor and Economic Growth (DLEG). The cost of that shortfall then is borne by the State's other employers, since the Fund's revenue is derived from taxes levied upon employers. Indeed, last year, the Fund reportedly was about \$70 million to \$80 million short of the threshold necessary to trigger a 10% tax credit for employers, so employers not engaging in SUTA dumping paid more in UI taxes than they otherwise would have paid.

Senate Bill 171 prohibits employers from participating in SUTA dumping schemes, such as transferring or acquiring a trade or business solely or primarily for the purpose of reducing required UI taxes. The bill also will prevent employers from switching between contributing and reimbursing status in order to escape UI liability. The bill contains sanctions that include assigning an employer either the highest possible UI tax rate or an additional penalty rate of 2% of taxable wages. Also, a person who is not an employer but knowingly advises an employer to engage in SUTA dumping is subject to a civil fine of up to \$5,000. The sanctions are in addition to civil and criminal penalties otherwise available under the Act.

Also, Senate Bill 172 provides for all money collected under Senate Bill 171, including fines, civil penalties, and interest, to be deposited in the Unemployment Compensation Fund. This will help to protect the Fund's balance against shortfalls caused by SUTA dumping.

By prohibiting SUTA dumping schemes, empowering the UI Agency to establish SUTA dumping identification procedures,

establishing rate recalculation requirements, and imposing sanctions on those who violate SUTA dumping prohibitions, the bills will help ensure that all Michigan employers pay their proper share of unemployment taxes, based on their unemployment experience, and will protect the financial integrity of the Unemployment Compensation Fund. As a result, Michigan employers will be taxed fairly and the Fund will have sufficient resources to provide unemployed workers with needed unemployment insurance benefits.

### **Supporting Argument**

In an effort to deter employers from engaging in SUTA dumping activities, Congress passed and the President signed into law the SUTA Dumping Prevention Act. The Federal law mandates that states enact minimal SUTA dumping restrictions as a condition of receiving Federal funding for the administration of their unemployment compensation programs. The bills bring Michigan into compliance with the Federal requirements and ensure that the State remains eligible for the Federal grants.

### **Opposing Argument**

The bills do not go far enough toward preventing SUTA dumping by Michigan employers. According to DLEG, a sizeable portion of the SUTA dumping problem is attributable to professional employer organizations (PEOs), yet the bills do not directly address the PEO issue. Also known as employee leasing companies, PEOs are independently established businesses that provide employees to a client entity and pay the employees' wages. One SUTA dumping technique involves transferring an employer's payroll to a PEO, and perhaps between PEOs. According to DLEG officials, approximately 60% of the shortfall in the Unemployment Compensation Fund is due to employers that use PEOs to avoid paying their full share of unemployment taxes.

One of the 25 largest PEOs in the country, Kelly Services, a Michigan-based staffing services firm, was a leader in bringing the SUTA dumping problem to the attention of Congress and other Federal officials. According to testimony before the Senate Commerce and Labor Committee by the company's president and chief operating officer, PEOs deserved special attention in this legislation because they are a significant part of the SUTA dumping problem. The

official testified that accounting firms have urged his company for several years to engage in SUTA dumping. Reportedly, the company was even told that it had a fiduciary responsibility to its shareholders to practice SUTA dumping because the firm's competitors were doing so. Despite the financial allure of being able to save about \$30 million annually, including \$3.5 million per year in Michigan, Kelly Services refused to engage in SUTA dumping because it undermines the experience-rating nature of the unemployment compensation system.

The bills should have included special reporting requirements for PEOs, so that the UI Agency could effectively monitor the transfer of employees to and between these companies. The problem of SUTA dumping will be fully addressed only when PEOs are stopped from undermining the experience rating of the UI tax system.

**Response:** The bills meet the Federal mandate, which does not require special reporting by PEOs. Under the bills, PEOs will be treated the same as any employer. Moreover, despite DLEG's claims and the anecdotal testimony on behalf of Kelly Services, there appears to be no public documentation that PEOs cause a disproportionate share of the SUTA dumping problem. Also, PEOs are an evolving industry and there is no settled definition of what constitutes a PEO. Addressing these businesses in future legislation, if necessary, would be more appropriate than treating them differently at this time.

### **Opposing Argument**

The legislation should have required companies to file registration reports or discontinuance reports before any business transfer could take place. Purposely omitting information or failing to file required forms is a known type of SUTA dumping. Also, without full and accurate reporting, the UI Agency cannot properly determine the liable employer.

**Response:** Such a reporting requirement would be burdensome to employers and would encompass much activity not related to SUTA dumping. In addition, the Act already prescribes penalties for intentional misrepresentations.

### **Opposing Argument**

The bills should have done more to ensure that unemployed workers receive adequate benefits. As a result of a cap placed on

unemployment benefits in 1995, the weekly benefit level for Michigan workers has lagged behind that of other states, including other Great Lakes area states. Legislation should increase the weekly benefit level by at least \$68, exempt unemployment benefits from State income taxes, and exclude severance pay from consideration as wages.

The bills also should have provided for the collection of all employer contributions and reimbursements in lieu of contributions previously unpaid as a result of SUTA dumping activities. These funds then could have been used to help support increased unemployment benefits.

In addition, many states offer unemployment benefits to domestic violence victims who leave their job to evade their batterer or for various other reasons. Some states spread the cost of these benefits over all employers so that the claims do not adversely affect the victims' employers' experience rating. Michigan should follow the lead of more than 18 other states by making domestic violence victims automatically eligible for UI benefits.

**Response:** The bills are designed to comply with the Federal mandate that states prohibit and penalize SUTA dumping, and to address the problem in Michigan. Introducing other UI issues into this legislation would have been inappropriate.

Legislative Analyst: Patrick Affholter

## **FISCAL IMPACT**

In order to avoid the loss of Federal administrative funds for the unemployment compensation program, Michigan must comply with the Federal requirements by July 1, 2005. Federal administrative funds for the unemployment insurance program are approximately \$79.1 million in FY 2004-05.

Department of Labor and Economic Growth staff estimate that by prohibiting SUTA dumping, the bills will increase revenue to the Unemployment Compensation Fund between \$62 million and \$95 million annually. An additional but unknown amount of revenue will be paid to the Fund under the penalty and interest provisions. The Department will incur undetermined additional administrative costs to comply

with the investigative and reporting requirements of the bills.

For calendar year 2003, the Unemployment Insurance Trust Fund reported employer contributions of \$1,093,178,466, regular benefits charged to the Fund of \$1,895,239,323, and total funds available for benefits of \$1,106,458,508.

Local governments that elect to change between contributing and reimbursing employer status will experience higher costs under the bills.

Fiscal Analyst: Elizabeth Pratt

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.