Written Testimony for Senate Bill 485
Family and Medical Leave Insurance Program – Modifications

I would like to thank the committee for considering my testimony. My name is John Werner, I am a tax attorney and current State employee. I am not providing this testimony in connection with my employment, and the opinions expressed in my testimony are my own and not intended to represent the Agency that I work for, or any other State employee.

The Family and Medical Leave Insurance (FAMLI) Program will be a fantastic safety net for Maryland families. I strongly support the Department of Labor's efforts in this bill to increase the administrability and efficacy of the program. Unfortunately, this bill does little to address the ample opportunities for fraud and abuse within the program, specifically with regard to self-employed individuals.

My background is not in insurance or labor, but in tax. Although the vast majority of small business owners are honest, there is a significant group that take advantage of the inherent difficulties in administering tax laws with imperfect information. When a process relies on the honesty of individuals, that process is susceptible to fraud, especially when money is involved. In my testimony I intend to illustrate the problem in current law, as well as offer several solutions that the General Assembly may wish to consider in the future.

As currently constructed, there is no method of identifying fraud or abuse from self-employed individuals. Self-employed individuals are not paid on a regular, predictable schedule, and in some instances can have *negative* income.These factors allow self-employed individuals the opportunity to structure their income and expenses in a way that maximizes their benefit while minimizing, or even negating completely, their liability.

I strongly support the language in this bill amending the current law setting an individual's benefit based on "the last 680 hours for which the covered individual was paid" to the slightly less malleable wages received "in the highest of the previous four completed calendar quarters for which quarterly reports have been required, divided by 13." However, this still provides ample opportunity for abuse.

Consider an individual, Alice, doing seasonal contracting work during the spring and summer months. It would not be unusual for expenses and income to occur at different times, even across quarters. Alice could, in Q2 of Year 1, have $10,000 in expenses and $3,000 in income. In Q3, having purchased all of the materials she needs for the job, she has $0 in expenses and receives the remaining $17,000 payment. Because she does not operate in Q1 or Q4, this is the full year. Following the annual reconciliation, Alice pays contributions based on her net income of $10,000. In Q1 of Year 1, Alice applies for benefits to care for her chronically ill family member. Alice does not typically operate in Q1, but that's not relevant to the benefit application. Her benefits are calculated based on her highest quarter of earnings, $17,000. She receives benefits throughout Q1 - a period in which she would not have earned any income - and repeat

the process beginning in Q2 of Year 2. The contribution amount is set at a total of 0.90%, a self-employed individual pays the full amount of the contribution.

For an individual with an average weekly wage no more than 65% of the State average weekly wage, benefits are 90% of the individual's average weekly wage. For individuals with a higher average weekly wage, benefits are 90% of the individual's wage up to 65% of the State average weekly wage plus 50% of the individual's average weekly wage in excess of the State average weekly wage. The State average weekly wage for the fiscal year ending June 30, 2023 is $1,456.00.

$1,465.00	multiplied by	65%	equals	$946.40
$ 946.40	multiplied by	90%	equals	$851.76

The formula for calculating benefits with current information would therefore be .9(W) or 851.76+.5(W-946.40) where W is an individual's average weekly wage.

For our fictitious individual, contributions would come to $90 per year with an average weekly wage of $1,308. Her benefit calculation would be:

$1,308	minus	$946.40	equals	$361.60
$361.60	divided by	2	equals	$180.80
$851.76	plus	$180.80	equals	$1,032.56

Because current law limits benefits to a maximum of $1,000, Alice would receive the maximum weekly benefit of $1,000 for 12 weeks for a total of $12,000, more than doubling her annual income.

Beatrice, an employee of an employer for the full year making the same $10,000 per year would have a contribution amount of $45 (employees are only responsible for half of the total contribution amount) and an average weekly wage of $192. Her benefit calculation would be:
$192 multiplied by 90% equals $173.
Despite earning and paying contributions on the same income amount, Beatrice would receive a total of $2,076 in benefits, nearly $10,000 less than Alice.

Catherine, an employee of an employer for the full year making $68,000 per year, would pay $306 in contributions and have an average weekly wage of $1,308. Her benefit calculation would be the same as Alice's and she would receive the same total benefit amount of $12,000. Between Catherine's $306 contribution and her employer's $306 contribution, the total contribution amount on Catherine's income is nearly 7 times Alice's contribution amount.

Unlike in Alice's case, Catherine would be receiving benefits for a period of time where she would typically be earning money. She would be required to either reduce her income by $308 per week ($3,696 over 12 week) or use her accrued leave to make up the difference.

This clearly illustrates a problem. The scenario as described is simple enough to happen by accident, let alone be created by fraudulent design. There are, however, some solutions to address this:

First, exclude self-employed individuals from the program. Many states do not provide a benefit to self-employed individuals, and the complexity associated with including them is significant. I don't believe this is the best option, because as I said the vast majority of self-employed individuals are just trying to live their lives and they deserve a safety net.

Second, the General Assembly could create a defined benefit more akin to any other insurance program. It could be based on the State's average weekly wage, minimum wage, or a tiered system. A self-employed individual would still be required to participate for 3 years and pay a premium of 0.9% of the wage base used to calculate the benefit, and would receive a benefit based on that same wage base. There would be no need to even attempt to verify their income because it would be a static calculation. The drawback for this solution would be that a self-employed individual may be required to pay contributions after they have gone out of business. 3 years is an eternity in the life of a small business and this solution would not take into account quarterly or year over year differences in income.

Finally, Maryland could follow what states such as Colorado have chosen to do: base the contribution and benefit amounts on the self-employed individual's annual income for the previous year. Colorado even allows self-employed individuals to decide whether to use gross or net income in determining their contribution and benefit amounts. This method would eliminate the ability and incentive to structure income and expenses in a way to maximize benefits while minimizing contributions without punishing a small business having an off year.