Department of Legislative Services
Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1567 (Chairman, Economic Matters Committee)
(By Request – Departmental – Labor, Licensing, and Regulation)

Economic Matters Finance

Unemployment Insurance - State Unemployment Tax Avoidance

This departmental bill prohibits State unemployment tax avoidance (SUTA) dumping in an effort to conform with federal legislation. The bill makes specified changes to the unemployment tax rate applicable to an employer when a business transfer occurs. If a business transfer occurred primarily to obtain a reduced rate, a punitive rate will be assigned to the employers and the employers are subject to specified penalties.

The bill takes effect July 1, 2005 and applies to the assignment of contribution rates effective on or after January 1, 2006.

Fiscal Summary

State Effect: The civil and criminal penalty provisions of this bill are not expected to significantly affect State finances or operations. Failure to enact conforming legislation could result in the loss of $50 million in federal funds.

Unemployment Insurance Trust Fund (UITF): Trust fund revenues could increase significantly beginning in FY 2006 as a result of limiting companies from improperly obtaining lower unemployment insurance (UI) tax rates. Limiting the use of lower tax rates will then increase the amount of tax revenue collected.

Local Effect: The civil and criminal penalty provisions of this bill are not expected to significantly affect State finances or operations.

Small Business Effect: The Department of Labor, Licensing, and Regulation (DLLR) has determined that this bill has minimal or no impact on small business (attached).

Legislative Services concurs with this assessment. The attached assessment does not reflect amendments to the bill.

Analysis

Bill Summary: If a successor employer has any common ownership, management, or control with the predecessor employer, regardless of whether it was in existence prior to the transfer, the contribution rate of the successor employer is based on the successor employer's experience in combination with the predecessor employer's experience, whether or not the predecessor employer remains in business. If there was only a partial transfer of business, and the predecessor employer remains in business, the successor rate would be based on its rate in combination with the proportionate share of the predecessor's rate.

If two or more successor employers are involved in a transfer, the rate of contribution of each successor employer is based on its experience in combinations with the proportionate share the predecessor employer rate, whether or not the predecessor employer remains in business.

If an employer knowingly violates the bill's provisions, the employer will be assigned the highest rate during the year violated and the three years immediately following, or if the employer is already assigned the highest rate, or the above rate increase would be less than 2%, then a 2% penalty rate will be imposed for that year. The employer is also guilty of a misdemeanor and on conviction is subject to maximum penalties of imprisonment for one year and/or a fine of $10,000. If a person knowingly advises an employer to violate the bill's provisions, that person is subject to a civil penalty not to exceed $5,000. The person is also guilty of a misdemeanor and on conviction is subject to maximum penalties of imprisonment for one year and/or a fine of $10,000.

DLLR must establish procedures to identify the transfer or acquisition of a trade or business for the purpose of identify SUTA dumping.

Current Law: Monies are paid into the UITF through a basic tax on employers paid on the first $8,500 of each employee's annual income. The basic tax is experience rated, with employers with the least turnover paying the minimum tax of 0.3% and employers with the highest turnover paying a maximum tax of 7.5%. A new employer is charged a rate that is based on the higher of 1%, the State's five-year benefit cost rate, or the rates assigned to employers with the lowest rate for that year with a maximum of 2.3%. The new employer rate for calendar 2004 was 1.9%.

A successor employer is defined as an employer that acquires, by sale or otherwise, all or part of the assets, business, organization, or trade of another employer including the employer's workforce. When a business transfer occurs, if a successor employer does not have any common ownership, management, or control with the predecessor employer the successor employer's contribution rate is the rate assigned to a new employer.

If an employer was not an existing company prior to a business transfer, the successor employer is considered a new employer and could elect to have either the predecessor's rate or a new employer rate apply. If the successor employer existed before the transfer, a proportionate share of the successor's existing rate and the rate of the predecessor employer is used.

Background: This legislation is mandated under the federal SUTA Dumping Prevention Act of 2004. SUTA dumping is a tax evasion scheme involving the manipulation of an employer's UI tax rate to achieve a lower rate. Employers avoid taxes by offloading benefit charges to accounts that may be closed and no longer reporting or by constantly moving the majority of their payroll to accounts that have lower tax rates. The federal legislation also concentrates on alleged promotion of SUTA dumping by accounting firms and requires not only penalties for employers who SUTA dump but also for those who advise employers to SUTA dump.

States failing to enact conforming legislation within roughly the first six months of the first regularly scheduled session of the state legislature, after August 2004, will not be eligible to receive their federal administrative funds. The U.S. Department of Labor is required to study the implementation of the federal legislation, assess state actions, and report its findings by July 15, 2007.

SUTA dumping occurs when a business transfers payroll out of an existing company to a new or different company solely to reduce taxes. There are three methods used to accomplish this:

- vertical – create a new employer that is assigned a new employer tax rate which can be significantly lower, then transfer payroll to the new employer;
- horizontal – transfer payroll to a subsidiary with a lower tax rate; and
- acquired rate – find another employer with a low tax rate and arrange to transfer payroll to that employer.

The federal legislation requires states to implement a program to identify situations where SUTA dumping occurs. North Carolina, in cooperation with the federal government, is developing a computer program, a National New Hire Database, to aid in identifying such situations. The use of this database will be made available to all states for a fee.

Under the Federal Social Security Tax Act, state unemployment insurance programs are required to administer their programs within certain federally mandated guidelines. When certain provisions are added to the Federal Social Security Act or the Federal Unemployment Tax Act, they must be added to states' laws. States failing to comply with these conforming issues risk losing their UI administrative grant. In Maryland, the UI grant fully funds the administration of the UI program. In the federal fiscal 2005, the UI grant is approximately $50 million.

UITF: Revenues could increase beginning in fiscal 2006. The actual increase cannot be reliably estimated at this time but could be significant. DLLR began its own detection of potential SUTA dumping and discovered 12 employers that were erroneously assigned a new employer tax rate. The reclassification of these employers led to the assessment of an additional $600,000 in UI taxes. It is expected, with the use of the federal detection software, that UI tax collections could increase significantly. DLLR estimates that revenues could increase by $600,000 in fiscal 2006, $1.5 million in fiscal 2007, and $2 million each year thereafter but indicates that the increase could be greater if more SUTA dumpers are found than anticipated.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Labor, Licensing, and Regulation; Department of Legislative Services

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