

## **State SUTA Dumping Proposals**

### **Many bills falling short at protecting state trust funds, workers and employers**

*by National Employment Law Project*

Most states have proposed anti-SUTA dumping legislation for consideration in the 2005 state legislative session. SUTA dumping is a scheme by which employers dodge unemployment insurance taxes by “selling” their companies to new related entities in order to receive a much lower UI tax rate. In August of 2004, President Bush signed federal legislation (P.L. 108-295) which requires states to have laws against SUTA dumping in place by 2006, and to impose penalties for violation of the state law provisions on both employers and on tax advisors.

SUTA dumping means states are losing hundreds of millions of dollars in taxes -- possibly as much as a billion dollars -- each year:

- The state of Michigan recently recovered \$2.4 million in its first anti-SUTA dumping action against the giant Aramark Corporation. Other states' experience is similar: the average SUTA-dumping case actually investigated and reported to GAO in 2002 cost states over \$630,000. Connecticut has discovered a loss of \$4 million since October 2003, and has dozens of cases pending. North Carolina collected \$9 million in just 12 cases, with 250 cases still pending.
- States that have estimated losses from SUTA dumping are finding that their losses are in the tens of millions. Colorado estimates losses from SUTA dumping in excess of \$40 million. California estimates its losses at \$100 million in 2003. Michigan estimates that SUTA dumping costs it \$60-\$90 million a year.
- Kelly Services, a major proponent of SUTA dumping legislation, estimates it could have saved \$30 million in taxes in one year if it had engaged in SUTA dumping.

The federal Department of Labor drafted model legislation for the states to follow, on both the issues of substantive liability for SUTA dumping and on penalties. NELP has reviewed 26 of the proposed state laws. NELP has identified four critical trends that state policy-makers and advocates should address as they finalize their SUTA dumping policies.

- **Federal and state bills fail to address PEO SUTA-dumping.** Neither the federal bill, nor most state bills offer solutions to SUTA dumping by employers who use “professional employee organizations,” which, for a fee, take workers onto their payroll and essentially sell them back to an employer. Two million workers nationwide work through PEOs, which are operated by some of the nation’s biggest staffing firms like Manpower and Adecco, as well as numerous smaller operators. Several states, including Michigan, Minnesota, North Dakota, Washington and Pennsylvania, have attempted to address this issue.
- **States proposing weaker civil penalties on SUTA dumping firms than recommended by U.S. DOL.** U.S. DOL recommends that SUTA dumping firms be subject to the maximum tax rate (or a

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2% increase, whichever is higher) for 4 years. Eight of the state laws we surveyed are proposing penalties that are weaker than this DOL model.

- **Inadequate civil penalties for non-“employers.”** The DOL model SUTA dumping language submits entities that are not “employers” under the law, (generally including those who have no “employees” or those who are new employers) to a \$5,000 maximum penalty. In many cases, this may be the maximum penalty that can be imposed on the tax-advising entities, an amount insufficient to deter SUTA dumping. Most states follow this inadequate approach, and five states have even lower penalties. However, six states (Alabama, Arizona, California, Kentucky, Minnesota and North Dakota) have improved on the model by imposing specific penalties on tax advisors, or by increasing the penalties.
- **Entrepreneurial SUTA dumpers buying firms to get a lower tax rate face no meaningful penalty.** In all but one proposed state law (Vermont), persons caught buying an existing unemployment account to start a new business with a lower tax rate would get the same tax rate as any other law-abiding new employer. In these states, there is no real disincentive to SUTA dumping.

Below, NELP outlines recommendations in each of these areas under which policy makers can take action as they finalize or amend their SUTA dumping laws.

**Cover SUTA dumping from businesses into PEOs.** The business of using a professional employee organization in order to save money on payroll taxes is large and growing. PEOs provide “payrolling” services, allowing a company to move part or all of their regular workforce on to the official payroll of the PEO which handles all benefits and taxes. PEOs are different from payroll services, because the workforce becomes official employees of the PEO. PEOs are run by some of the nation’s largest staffing companies and numerous smaller operators. The 2002 Economic Census results reported PEO gross revenue more than doubled from \$24 billion in 1997 to \$55 billion in 2002. Staffing Industry News projected 2003-2005 PEO revenue would grow 8% per year. PEOs’ business model is to profit by reducing benefit and tax costs – and a number of PEOs have been accused of violating workers’ comp and pension laws in their efforts to do so.<sup>1</sup> These patterns raise real concerns about PEOs impact on the UI system.

The model language being advanced by the U.S. Department of Labor (and found in many state bills) does not cover the practice of firms leasing their employees to a professional employee organization in order to rid themselves of their unemployment insurance tax experience. Under this arrangement, employees are “dumped” from an existing business to a PEO, but since the two businesses are not under “common ownership or control,” the PEO would not be forced to combine its experience with the new firm. Thus, the main firm is able to rid itself of its unemployment tax experience.

Proposed legislation in Michigan, Minnesota, North Dakota, Pennsylvania and Washington has sought to address this loophole, but these portions of the bills in question have been opposed by some legislators and lobbyists, and none appears likely to be part of the final law of the state. As other SUTA dumping schemes are cut off, PEOs may become a more attractive option to firms looking to artificially lower their

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<sup>1</sup> See *PEOs and Payrolling: A History of Problems, a Future without Benefits*, Center for a Changing Workforce, December 2001. Available at [www.cfcw.org/peo.pdf](http://www.cfcw.org/peo.pdf) or “Employee Leasing: Implication for State Unemployment Programs” Unemployment Insurance Occasional Paper 97-1, available at [http://workforcesecurity.doleta.gov/dmstree/op/op97/op\\_01-97.pdf](http://workforcesecurity.doleta.gov/dmstree/op/op97/op_01-97.pdf).

unemployment tax expenses. We encourage states to look at this issue as they revise and finalize their SUTA dumping bills. Suggested language:

Any person that contracts with a taxpaying employer to have that person obtain the taxpaying employer's workforce and provide workers to the taxpaying employer for a fee shall, as of the effective date of the contract, be assigned for the duration of the contract the taxpaying employer's account. That tax account must be maintained by the person separate and distinct from every other tax account held by the person and identified in a manner prescribed by the commissioner. The tax account shall, for the duration of the contract, be considered that person's account for all purposes of this chapter. The workers obtained from the taxpaying employer and any other workers provided by that person to the taxpaying employer must be reported on the wage detail report under that tax account, and that person shall pay any taxes due at the tax rate computed for that account.  
(Minnesota HB898)

**Impose adequate civil penalties on employers.** The Department of Labor draft SUTA dumping bill suggests that employers who are caught "knowingly" violating the SUTA dumping law should be subject to maximum UI taxes allowable under a state system for four years. If the employer is already paying the maximum rate, DOL suggests that the penalty be the maximum plus 2%. Most state bills adopt this approach. However, Oklahoma's bill provides for 10% of actual taxes due for one year, rather than the four years maximum tax rate covered under the DOL model bill, and some bills, such as Michigan's and Wyoming's, do not add any penalties to those already in state law.

Proposed language: States should use the DOL language for penalties for employers who violate their SUTA dumping laws:

If the person is an employer, the person shall be assigned the highest rate assignable under this chapter for the rate year during which the violation or attempted violation occurred and the three rate years immediately following this rate year. If the person's business is already at the highest rate for any year, or if the amount of increase in the person's rate would be less than two percent for that year, a penalty rate of contributions of two percent of taxable wages shall be imposed for that year.<sup>2</sup>

**Impose specific, adequate penalties on tax advisors.** The DOL model imposes these maximum penalties on "persons" who "knowingly" violate or attempt to violate the law. It is not clear whether these penalties will attach to tax advisors. Even if the penalties do apply to most tax advisors, they will apply only with respect to the tax advisor's own payroll, rather than to the payroll of the SUTA-dumping company. If these penalties do not apply, the only penalty that attaches to a tax advisor is a maximum \$5,000. This amount is clearly not sufficient to deter tax advisors to encourage companies to dump their payroll taxes, given the amounts of money at stake. The California law provides for penalties of \$5,000 or 10% of the taxes unlawfully underpaid specifically on tax advisors. Similarly, Alabama and North Dakota have proposed more stringent penalties. North Dakota (HB 1195) proposes penalties of up to \$25,000, and an earlier draft bill in Arizona provided for specific penalties of a percentage of taxes underpaid.

Proposed language: If a person knowingly attempts to make or makes a transfer of business for the purpose of obtaining a lower rate of contribution or if another person aids such a person in evading or defeating a contribution or its payment, the Department shall assess against the person a civil penalty of

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<sup>2</sup> Model legislation can be found at U.S. Department of Labor, UI Program Letter 30-04.

five thousand dollars or fifty per cent of the amount of any taxes that are underpaid, whichever is greater.  
(Arizona H.B. 2616<sup>3</sup>)

**Make sure that state law adequately addresses “new employer” issues.** The DOL language on new employers who acquire a business for the purposes of lowering taxes provides that such employers shall be assigned a state’s “new employer” tax rate. Adoption of this language has uneven consequences in states, and can actually result in a benefit to an employer who engages in SUTA dumping. This is because state “new employer” tax rates vary widely. For example, the “new employer” rate in South Dakota is 1%, but in New Mexico it is the maximum rate of 5.4%. Therefore, because both states’ bills have adopted the DOL language, a SUTA dumping employer in South Dakota might get a rate of 1%, and in New Mexico, the employer might get a rate of 5.4%.

This portion of state SUTA dumping laws refer to “persons”—not existing employers—buying a firm for its low tax rate as opposed to starting out with the new employer rate. (Think of an entrepreneur starting a new construction firm who buys a failing flower shop to acquire a low tax rate for their new business). Under the DOL model, the worst that can happen to such SUTA dumpers is they get the same tax rate (the new employer rate) that they would have received by playing by the rules. Clearly, this is not a real disincentive to individuals considering SUTA dumping.

Proposed language: Only one state, Vermont has adequately dealt with the new employer issue. Its bill can be a model for the states. It says: Whenever a person who is not an employer under this chapter at the time it acquires the trade or business of an employer, the unemployment experience of the acquired business shall not be transferred to such person if the commissioner finds that such person acquired the business solely or primarily for the purpose of obtaining a lower rate of contributions. Instead, that person shall be assigned the highest rate assignable under this chapter until being subject to this chapter for a sufficient period of time to have his or her rate computed under this title.  
(Vermont H. 71)

Notes: Several of the state bills provide for criminal penalties for firms and tax advisers. We focus on the civil penalty provisions because they are easier to enforce.

There are additional areas of interest related to SUTA dumping. For background see: *State SUTA Dumping Legislation: A First Step Towards UI Program Integrity* (October 2004) and *The Whole Truth: Employer Fraud and Error in the UI System* (December 2003) both available at [www.nelp.org/ui](http://www.nelp.org/ui).

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<sup>3</sup> Arizona has two bills pending in its legislature. This bill has been held in committee; the second bill, HB 2093, is included in the attached chart.

**State SUTA dumping proposals – Proposed and Enacted Legislation  
March 31, 2005**

	Penalties on Employers			Penalties on Non-employers		
	DOL model	Higher penalties	Lower penalties	DOL Model	Higher penalties	Lower penalties
Alabama HB 148	X				X	
Arizona HB 2093	X			X		
California AB 664 (passed)			X		X	
Colorado HB 1092		X		X		
Hawaii HB 708	X			X		
Idaho HB 2 (passed)			X	X		
Indiana SB 612 (passed)	X			X		
Kansas SB 108	X			X		
Kentucky SB 113 (passed)	X				X	
Michigan HB 4174			X			X
Minnesota HB898			X		X	
Mississippi HB 944	X			X		
Missouri HB 500	X			X		
Montana HB 159			X	X		
Nebraska LB 484	X			X		
New Hampshire HB 170	X			X		
NMexico HB 520 (passed)	X					X
North Dakota HB 1195	X				X	
Ohio SB81	X			X		
Oklahoma SB 763			X	X		
S. Dakota SB 13 (passed)	X			X		
Utah HB 10 (passed)			X	X		
Vermont H 0071	X			X		
Virginia H 2137 (passed)			X	X		
Washington HB 2246			X			X
Wyoming SB 80 (passed)	X				X	
<b>Total</b>	<b>16</b>	<b>1</b>	<b>8</b>	<b>17</b>	<b>6</b>	<b>3</b>

**Chart notes: States proposing higher penalties than DOL model for employers who violate law:** CO(maximum tax rate plus 2.7%); **States proposing lower penalties than DOL model for employers who violate law:** CA (max tax rate plus 2% but only for 3 years); ID (10% taxable wages for 1 year); MI (no additional penalties in proposal); MN (\$5,000 or 2% of payroll for 1 quarter for notification violation); MT (6% taxable wages for 1 year); OK (10% taxes due for 4 quarters); UT (max rate for 2 years); VA (max rate for two years) WA (max rate plus 2% for 1 year, plus costs of audit)

**States proposing higher penalties than DOL model for non-employer tax advisors who violate law:** AL (\$10,000 or 10% of taxes underpaid); CA (\$5,000 or 10% of taxes underpaid, specifically applies to tax advisors); KY (\$5,000 plus higher tax rate for “persons,” whether or not they are “employing units”); MN (\$5,000 or 2% of quarterly payroll for notification violation); ND (\$25,000); WY (\$50,000). **States proposing lower penalties than DOL model for non-employers who violate law:** MI (no additional penalties in proposal); NJ (no additional penalties); NM (\$3,000 maximum); WA (no new penalties).