



EVALUATION OF STATE IMPLEMENTATION OF SECTION 303(K), SSA

FINAL REPORT

Prepared for:

U.S. Department of Labor
Employment and Training Administration

Prepared by:



Coffey Communications, LLC
Bethesda, Maryland



Urban Institute
Washington, D.C.

Authors:

Lester Coffey, Project Director
Wayne Vroman, Ph.D., Lead Principal Investigator
Michael Ye, Ph.D., Co-Principal Investigator
E.A. "Rett" Hensley, Task Leader
Richard Sullivan, Task Leader
William F. Sullivan, Jr., Senior Researcher
Lawrence Chimerine, Ph.D., Contributing Author

This project has been funded, either wholly or in part, with Federal funds from the Department of Labor, Employment and Training Administration under Contract Number DOLJ061A20365, Task Order #3. The contents of this publication do not necessarily reflect the views or policies of the Department of Labor, nor does mention of trade names, commercial products, or organizations imply endorsement of same by the U.S. Government.

ACKNOWLEDGEMENTS

The contributors to this report were many. From the Office of Policy Development and Research, Kevin Culp, David Balducchi, and Wayne Gordon provided overall direction and perspective that helped to refine the scope of the study. We are also grateful to the Office of Workforce Security, in particular, Gerard Hildebrand, Steven Massey, Thomas Crowley, and Bill Whitt for their invaluable assistance and support throughout the project.

In addition, we thank Timothy Tucker, Director of Government Affairs, National Association of Professional Employer Organizations (NAPEO); Russell Noack, Industry Representative in the California Legislature, Public Policy Associates; Gregory L. Packer, President, The Association of Michigan PEOs; Abram Finkelstein, President of the Florida Association of Professional Employer Organizations (FAPEO); Mike Miller, Attorney, FAPEO; and all of the Professional Employer Organization (PEO) industry representatives who participated in this project by attending round table discussions with the Coffey Communications team in Texas, Michigan, California, and Florida

We are also deeply grateful to the state of Texas for serving as the pilot state in this project and to Michigan, Utah, New Hampshire, California, Washington, and Florida for taking the time to allow the Coffey team to visit and discuss at length the SUTA dumping detection and enforcement practices in each state. Finally, we thank all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands for their promptness in completing the survey and providing the data and information necessary to conduct the study. Their 100 percent participation is an excellent indicator of how serious the State Workforce Agencies view SUTA dumping and this research project.

TABLE OF CONTENTS

Executive Summary	i
Chapter 1: Introduction and Background	1
▪ Study Approach	1
▪ Background	2
▪ Tax Avoidance Activity and Preventive Legislation	3
▪ Section 303(k) of the Social Security Act	5
▪ Effectiveness of the Legislation	7
▪ States' Recommendations for New Federal Legislation	8
▪ The SUTA Dumping Detection System	10
▪ Literature Providing Impetus for Interest in SUTA Dumping	11
Chapter 2: State Agency Enforcement—Structure and Resources	12
▪ General Observations	12
▪ State Enforcement Structure	12
▪ State Staffing and Resource Issues	14
▪ Staff Training	18
▪ Ongoing Costs of Implementation	19
Chapter 3: Evaluation of Implementation Strategies	20
▪ Introduction	20
▪ SUTA Dumping Enforcement Process	21
▪ Analysis of Cases and Results Reported by States	23
▪ Employers Determined to Be in Violation of Section 303(k), SSA	25
▪ Assessments and Recoveries	29
▪ Appeals	32
▪ Summary	32
Chapter 4: Impacts of Section 303(k), SSA, on the PEO Industry	34
▪ Description of the PEO Industry	34
▪ Unemployment Compensation Experience Rating and the PEO Industry	38
▪ Estimated Financial Impact of PEOs on State Accounts in the Unemployment Trust Fund and on Operations of the UC Agency	42
▪ Prevention of SUTA Dumping: PEO Case Violations Detected and Investigated Since the Enactment of Section 303(k), SSA, and Implementation of Related State Laws	43
▪ Principal Findings	44
Chapter 5: Findings and Conclusion	45
▪ State Implementation of Section 303(k), SSA	45
▪ Impacts of Section 303(k), SSA, on Professional Employer Organizations	47
Bibliography	48
Appendix A: SUTA Dumping Prevention Act of 2004	49

Appendix B: Legislation	52
Appendix C: SUTA Dumping Detection Systems	58
Appendix D: Training	60
Appendix E: UI Experience Rating and PEOs – Who is the Employer of Record	62
Appendix F: Fifty-Three-State Survey	64
Appendix G: Acronyms	78

EXECUTIVE SUMMARY

Purpose of the Study

This report is written in response to a requirement of the SUTA Dumping Prevention Act of 2004 (the Act) signed into law by President Bush on August 9, 2004, to curtail a tax avoidance practice known as SUTA dumping.¹ The Act amended Federal unemployment compensation (UC) law by adding Section 303(k) to the Social Security Act and required states to amend their UC laws to prohibit certain tax avoidance schemes by January 1, 2006. States were also required to establish procedures for detecting these schemes. Congress required the Secretary of Labor to conduct a study on the status and appropriateness of state actions to implement the Act, and to submit a report.

The data collection for the study consists primarily of information regarding implementation activities between January and September 30, 2006. The information and data presented in the Executive Summary and body of this report represent a snapshot in time when most states were still in the implementation process. Accordingly, while every state enacted conforming legislation, the available data are too limited to conclusively assess the effectiveness of the Act. However, the data do offer useful information on preliminary trends identified during the implementation process.

Background

UC taxation in the United States is based on an experience rating system that is designed to set tax rates for individual employers liable for the payment of state unemployment taxes based on the employer's experience with unemployment. Most states use UC benefits paid to an employer's former employees, which are subsequently charged to the employer's UC account, as a factor for determining the employer's experience rate. Other states also use contributions paid as an additional factor in determining UC experience. Such systems operate like an insurance program where employers with a higher risk of creating unemployment pay higher taxes.

SUTA dumping refers to tax rate manipulation schemes used by some employers, including those following recommendations of advisors, to avoid or "dump" their benefit charges in order to pay lower state UC taxes than their unemployment experience would otherwise allow. SUTA dumping is accomplished by merger, acquisition, or restructuring schemes that shift workforce/payroll so that the employer escapes poor unemployment experience and a high tax rate. In the short term, these schemes cause a loss of tax revenue for the state. However, over a period of years, they increase the "socialized costs" added into the tax rate computation for most state employers to offset the loss of revenue.

Leading up to the passage of the SUTA Dumping Prevention Act of 2004, the U.S. Department of Labor was concerned with a variety of tax avoidance schemes that resulted in increased socialized costs. As a result, the Employment and Training Administration (ETA) contracted

¹ SUTA is an acronym for State Unemployment Tax Act, which represents a shorthand designation of the set of laws promulgated by all 53 state unemployment insurance agencies in conformance with Federal law.

with the KRA Corporation to conduct a study entitled *Employee Leasing: Implications for State Unemployment Insurance Programs*. This 1996 study, which began as a review of the employee leasing industry, concluded that tax rate manipulation schemes were also being conducted by some employers in other industries that normally have high employee turnover and high UC costs. The KRA study was followed by a U.S. Department of Labor, Office of Inspector General, Final Audit Report number 03-98-007-03-315, which also concluded that SUTA dumping could occur across all industries with a history of high employee turnover and high UC costs.

In addition, during June of 2003, the General Accounting Office presented testimony to the Subcommittees on Oversight and Human Resources, House Committee on Ways and Means, and discussed findings regarding the extent of SUTA dumping discovered, based on its survey of 53 state UC administrators.

Scope of the Study

This study examines “the implementation of the provisions of section 303(k) of the Social Security Act (as added by subsection (a)) to assess the status and appropriateness of state actions to meet the requirements of such provisions” (section 2(b) of Public Law 108-295). It also attempts to analyze state law that pertains to the experience rating provisions for client companies entering and exiting employee leasing contracts with Professional Employer Organizations (PEOs). PEOs are organizations that provide client companies with a broad range of human resource services, such as filing payroll tax reports and providing employee fringe benefit packages. The National Association of Professional Employer Organizations currently estimates that 2 to 3 million workers in the U.S. are covered by PEO contracts (<http://www.napeo.org/peoindustry/faq.cfm#8>).

With respect to status and appropriateness of state actions, all states enacted conforming legislation, and most states have implemented a SUTA dumping detection system (SDDS) to help discover potential SUTA dumping activities. However, the SDDS’s of a few states were not fully operational at the time of this study. As noted earlier, with respect to the time frame of this study, states were in the early implementation stage of their SUTA dumping initiatives, and many did not have a full year of stable, reliable data on cases detected, investigations undertaken, or violations found. In fact, 16 states had not yet investigated a SUTA dumping case or assessed additional taxes due.

Accordingly, the effectiveness of the Act on a national scale is difficult to determine. Most state laws were not effective until January 1, 2006, and the majority of states did not have an operational SDDS until the third quarter of 2006. The data collection survey was designed to accommodate a report to Congress by July 15, 2007, and therefore asked states to provide data through the third quarter of 2006. Twenty-four state laws did not become effective until January 1, 2006, which limited the potential available data to three quarters. Additionally, forty percent of the states did not operationalize their SDDS until after September 30, 2006, further limiting the data available to examine.² As a result, given the limitations of the data collection in the

² There were 16 states that did not have a SDDS in operation until after September 30, 2006, as shown in Appendix C. There were nine states that did not install the SDDS until the third quarter 2006.

survey, it is not possible (1) to determine on a national scale if all states are effectively using their laws to identify and stop the practice of SUTA dumping; or (2) to assess whether or not SUTA dumping penalties levied on employers are effective. Thus, it is not yet feasible to determine the current effectiveness of Federal and state laws regarding SUTA dumping.

Methodology of Study

The study design for this project included the following activities:

1. Determining what information was needed from whom; what questions needed to be asked and what process needed to be used to address the questions; and what procedures were required for gathering the data necessary to provide meaningful information on states' implementation of the Act. This led to the development of a plan to conduct on-site visits with a pilot state and six additional states and the development of a *Site Visit Guide* and a draft survey instrument (informed by the pilot state visit) to be sent to all 53 state UC agencies, which for the purposes of Federal program administration includes the District of Columbia, Puerto Rico, and the Virgin Islands.
2. Obtaining input from the U.S. Department of Labor, Employment and Training Administration (ETA) and approval from the Office of Management and Budget for the survey to be sent to the states. The survey was sent to all 53 UC agencies and was completed and returned by all 53 in June 2007.
3. Conducting a pilot test of the *Site Visit Guide* and the survey instrument in the state of Texas in August 2006, leading to modifications in both.
4. Conducting case study site visits with unemployment officials in six states: California, Michigan, New Hampshire, Utah, Washington, and Florida between October and December 2006. During the visits to Texas, California, Michigan, and Florida, meetings with representatives of the PEO industry were held, as well. Site visit reports were prepared and submitted to ETA following each state visit.
5. Developing a database of the information collected from the survey of 53 states. Information from the database was utilized in preparing the final draft report for this project.

Study Findings

Based on information collected from the site visits to six states and from the survey responses from the 53 states, the study offers the following preliminary findings:

1. While the states have all enacted conforming legislation to Section 303(k), SSA, there is significant variation in the amount of resources being devoted to the identification of SUTA dumpers. At the time of the study, state UC agencies were at different early stages of implementing organizational structures; assigning and training staff; setting policies, rules, and procedures; utilizing their detection system; and pursuing cases resulting in

collections or other dispositions. Thirty of the 53 states determined that violations of SUTA dumping legislation have occurred involving at least one employer.

2. States' experience in assessing penalties on employers, and advisors to employers, has been limited.
3. When asked to assess the need for any further Federal legislation, states responded with various suggestions for combating tax avoidance schemes in general. Some states mentioned the need to ensure that more attention is devoted to employers who report payroll in multiple states and who transfer the payroll between UC accounts in different states to manipulate experience-rating accounts. Some states indicated a desire for further legislation relating to PEOs. However, there appeared to be little agreement or consensus at this early stage of the implementation process regarding the status of PEOs and state experience rating laws.
4. State law determines whether or not the PEOs in the state are treated as the employer under its UC law. Thirty-six states permit the PEO to be the employer and report a client's payroll under a PEO account. However, 17 states are now requiring the PEO to report the payroll under the client account. This is an increase from the KRA study of the mid-1990s, which reported nine states requiring the client remain as the employer of record when engaged in a PEO relationship.
5. States have assigned significant resources to SUTA dumping through the utilization of 208 full-time equivalent positions to detect, investigate, and prosecute SUTA dumping cases.
6. States have trained a total of 3,364 staff members and have investigated 1,640 SUTA dumping cases through September 30, 2006.
7. These investigations have found 787 SUTA dumping violations by employers and have yielded additional tax assessments of \$102,298,336. Of this amount, the states have collected \$52,456,899.
8. While only 48 SUTA dumping determinations have been appealed nationwide, 34 of those cases have been upheld at the first level of appeals; four cases were reversed; and ten cases were still undetermined at the time of this writing. The states' interpretation of law was, therefore, upheld in 89 percent of cases determined at the lower level.
9. Fifty-one states responded that they were "satisfied" or "very satisfied" with the provisions of Section 303(k), SSA.

CHAPTER 1: INTRODUCTION AND BACKGROUND

Public Law 108-295, known as the SUTA Dumping Prevention Act of 2004 (the Act), was signed into law on August 9, 2004, by President George W. Bush.³ The Act amended Federal unemployment compensation (UC) law by adding Section 303(k) to the Social Security Act (SSA) to curb UC tax rate manipulation activities known as SUTA dumping. Some employers have used SUTA dumping methods to pay lower state UC taxes than their earned unemployment experience would otherwise allow. States were required by the Act to execute conforming legislation by January 1, 2006, modifying state UC laws to meet the minimum standards for detecting and eliminating SUTA dumping activities.

The Act further required the Secretary of the U.S. Department of Labor (DOL) to conduct a study of the status and appropriateness of state efforts to implement the Act and the effectiveness of it. Through a competitive solicitation, Coffey Communications, LLC, (Coffey) was awarded a contract to conduct the required study. The Act required the secretary to submit the findings of the study, and to make further recommendations, if any, to improve the effectiveness of the Act by July 15, 2007. Due to delays in collecting certain data, the report was delayed. This report summarizes the findings from the study.

Study Approach

In order to conduct the study required by Public Law 108-295, Coffey needed to first assemble a team of senior researchers and subject matter experts. In order to successfully complete the study, members of this team needed knowledge of both state and Federal unemployment insurance laws, of the experience rating system in the U.S., and of methods used by some employers to manipulate the tax rate structure. Since a review of how the Act impacted the operation of the Professional Employer Organizations industry was to be included in the study, specific knowledge of that industry was required, as well. Once gathered, the Coffey team then began the process of developing a project plan, which included five salient components:

1. A determination of what information was needed from whom, what questions needed to be asked, and what processes should be used to obtain the answers and gather the data necessary to provide DOL meaningful information on states' implementation of the Act. This led to the development of a plan to conduct on-site visits with a pilot state and six additional states and to draft a survey instrument to be sent to all 53 state UC agencies, including the District of Columbia, Puerto Rico, and the Virgin Islands.
2. Approval of the developed survey, which was requested and received from the Office of Management and Budget. The survey was then sent to all 53 UC agencies and was completed and returned by all 53 in June 2007.

³ SUTA is an acronym for State Unemployment Tax Act, which represents a shorthand designation of the set of laws promulgated by all 53 state unemployment insurance agencies in conformance with Federal law.

3. A pilot test of the *Site Visit Guide* and the survey instrument, which was conducted in the State of Texas in August 2006 and which led to adjustments in both the *Site Visit Guide* and the survey instrument.
4. Case study site visits to six states: California, Michigan, New Hampshire, Utah, Washington and Florida. These were conducted between October and December of 2006. Meetings with employers in the PEO industry were included in the visits to Texas, California, Michigan, and Florida. Site visit reports were prepared and submitted to the Employment and Training Administration following each state visit.
5. The development of a database for the acquired information, which was completed and from which the final draft report was prepared.

Background

The Federal-state UC program was created by the Social Security Act of 1935 and is designed to provide for partial wage replacement to individuals who are unemployed due to a lack of work. Employers generally pay two forms of UC taxes required by law—a Federal Unemployment Tax Act (FUTA) tax and a State Unemployment Tax Act (SUTA) tax. The FUTA tax is a flat tax collected by the Internal Revenue Service (IRS). It generally pays for Federal administration and oversight of the UC program and the costs of administering the UC and Job Service programs; it pays the Federal share of extended benefits; and it builds reserves to loan money to a state when the state's account in the unemployment trust fund is depleted. The SUTA tax is collected by states and is used to pay benefits to unemployed workers. The SUTA tax rate is based on an experience rated system under which an employer who lays off fewer workers will generally pay lower unemployment insurance (UI) tax than an employer who lays off more workers.

Federal UC law is primarily contained in FUTA and the SSA, and it sets forth certain minimum requirements that state UC laws must include in order for employers in that state to be eligible for a credit against the Federal tax. DOL oversees conformity and compliance with Federal law, sets broad policies for program administration, monitors state performance, and distributes administrative funds to the states. Subject to the requirements of Federal law, state law determines benefit and eligibility provisions, coverage provisions, the taxable wage base, and the experience rating system used to set tax rates.

Experience Rated System of Financing the UC Program

Unique among UC programs in developed countries, the U.S. program utilizes an experience rating system to set tax rates for individual employers that are liable for the payment of state unemployment taxes. In all other countries, a flat tax is applied to finance the UC program. Three reasons are generally offered for why an experience rating system is used: 1) it encourages stable employment by creating a disincentive to lay off workers in the form of higher taxes; 2) it generally places the attribution of costs of UC benefits on the employer responsible for the unemployment; and 3) it creates an incentive for employers to participate actively in policing the UC program to protect the accuracy of their experience rating. However, there is a disadvantage to an experience rating system: since it is an insurance system, an unscrupulous employer can

obtain an unfair advantage over competitors by manipulating his experience history to obtain a more favorable rate. The Act was designed to reduce the ability of unscrupulous employers to do so.

Socialized Costs

Experience rating tax provisions vary from state to state. In all states, however, experience rated employers with higher UC benefit charges usually pay higher UC taxes than their counterparts with lower benefit charges. Experience rating, as practiced by the state UC programs, does not mean that every dollar of benefit payouts is assigned to a liable employer. All states limit charges to individual employers by having a maximum UC tax rate. The excess of benefit charges over tax payments made by employers taxed at the maximum state tax rate becomes a “socialized charge” that results in other employers paying higher UC taxes than their own unemployment experience would otherwise have required in order to fully finance the system.

Socialized charges also occur when employers cease operations and their former employees receive UC benefits. Benefits charged to these inactive employers are considered to be “ineffective” because the employer is no longer paying unemployment taxes for benefits paid. Employers may also be relieved of charges for which they are not responsible when those charges arise from employees who have, for example, voluntarily quit for health reasons or other non-disqualifying personal reasons under state law.

In the aggregate, ineffective charges, charges against inactive accounts, and non-charged benefits typically account for 30 to 40 percent of total UC benefit payouts. Because a substantial share of total benefits is socialized, i.e., not assigned back to the individual employer, the U.S. system of experience rating is described as a partial or imperfect experience rating system. Employers with higher benefit payouts generally pay higher UC taxes, but the amount of taxes paid does not necessarily correlate to the amount of UC paid to their former employees.

Tax Avoidance Activity and Preventive Legislation

While the basic UC system has remained predominantly unchanged since its inception, some employers and financial advisors have found ways to manipulate the state experience rating systems to pay lower state UC taxes than their unemployment experience would otherwise allow. The variability of tax rates across individual employers has generated incentives to avoid some part of UC taxes through different tax manipulation activities. Some of these activities include (but are not limited to) the following:

1. ***Employee Misclassification***: Self-employed individuals and independent contractors are not covered for UC purposes, and employers may avoid paying UC tax by misclassifying employees as independent contractors. This has been a major issue for both the state UC agencies and the IRS for over 30 years, and it continues today. The IRS reported that utilization of Form 1099MISC (used by employers to indicate that remuneration for services was made to a worker who was not in employment) increased by 4.8 million

between the years 1999 and 2002. In 2002, the IRS processed 79.3 million 1099MISC forms.⁴

2. ***Underreporting Payroll:*** Employers who do not report all of their employees or their wages can go undetected for long periods of time. This kind of underreporting is often detected through the “blocked claim” investigative process, when laid-off employees file claims for benefits and find that their wages have not been reported to the UC agency. Underreporting of payroll may also be discovered through the field audit program, which DOL policy mandates in every state. All state laws prohibit the underreporting of payroll, although provisions for penalties vary among states.
3. ***Payrolling or Payroll Parking:*** Payrolling occurs when two or more businesses that are totally unrelated agree, for a set fee, to have all wages reported under the company with the lowest unemployment tax rate. This activity is illegal in all states because the actual “employer” of the individual workers is responsible for the payment of taxes on their wages.
4. ***Buffering:*** Buffering is a common technique used by an employer that is planning to reorganize and/or downsize by forming a subsidiary company and moving (transferring) the wages of employees who are to be laid off into the new subsidiary company. Once the employees that have been transferred have no wages in the base period of the parent company and are laid off, any claims filed would be charged against the subsidiary (receiving) account. The parent company then closes the subsidiary account with the state UC agency and the charges become “ineffective” because the subsidiary account is no longer in business and is no longer paying taxes. The charges will be “socialized” and other employers will pay additional taxes as a result. This practice is illegal only in states that require an employer to have a single account or that require employees engaged in a “unity of enterprise” to be reported under a single account.
5. ***Failure to Report Successions:*** In this case, an employer closes a business with a high UC tax rate and opens a new one that provides the same goods and services, with substantially the same assets, but fails to report this activity to the UC taxing authority. Since the new employer rate is generally less than a high experience rate, the employer would pay less UC tax. Many state laws require a successor who obtains the total business of a predecessor to assume the experience of the predecessor, but this activity may avoid detection.
6. ***Affiliated Shell Transaction:*** An established company with an existing UC account number forms a subsidiary company, applies for a UC account number, and then reports one or more employees under the subsidiary account until it has earned a reduced experience rate.⁵ Once the reduced rate is established, the original company will move large amounts of payroll into the lower rated subsidiary account. The employer has engaged in an affiliated shell transaction.

⁴ Questionable Employment Tax Practices Initiative, Washington, DC, September 27, 2005

⁵ Unemployment Insurance Program Letter No. 34-02 (revised) December 31, 2002

7. ***Purchased Shell Transaction:*** In a purchased shell transaction, a new company, not previously assigned an account with a state UC agency, purchases a company for the sole purpose of obtaining a reduced experience rate.⁶

Before enactment of the SUTA dumping law, almost all states prohibited employer fraud practices such as intentional misclassification of employees, underreporting of payroll, payroll parking, and the failure to report successions. Some states laws prohibited the practice of “buffering” by requiring that an employer must report all payroll under a single account number or that require employees engaged in a “unity of enterprise” to be reported under a single account. The Act was intended to prohibit the type of manipulation activity found in affiliated and purchased shell transactions.

Section 303(k) of the Social Security Act

Legislative Review:

Section 303(k), SSA—Minimum Requirements

Section 303(k), SSA, required states to amend their UC laws in several respects.⁷ State laws needed to be amended to mandate the transfer of unemployment experience in one circumstance (mandatory transfer provision), to deny the transfer of experience in another (prohibited transfer provision), to provide civil and criminal penalties for persons who engage in these SUTA dumping practices, and to establish procedures for identifying the transfer or acquisition of a business. All states had to enact the required legislation by January 1, 2006, to be in conformity with Federal UC law. A brief discussion of the minimum requirements follows

Mandatory Transfer of UC Experience

The SUTA Dumping Prevention Act of 2004 was designed to address the final two types of tax rate manipulation schemes mentioned in the list above—the affiliated shell transaction and the purchased shell transaction.⁸ The Act required state UC laws to mandate the transfer of experience when there is a transfer of trade or business between entities with substantially common ownership, management, or control.⁹ The mandatory transfer provision prohibits an employer from engaging in the “affiliated shell transaction” where an employer escapes poor experience (and high experience rates) by setting up a shell company and then transferring some or all of its workforce (and the accompanying payroll) to the shell company after the shell has earned a low experience rate.

⁶ Unemployment Insurance Program Letter No. 34-02 (revised) December 31, 2002

⁷ DOL issued guidance for the states in Unemployment Insurance Program Letter (UIPL) 30-04 on August 13, 2004, regarding the legislative requirements of Section 303(k), SSA, including a description of the Act, a question and answer section, proposed draft language to achieve conformity, the text of the Act, and a checklist for review. DOL issued UIPL 30-04, Change 1, on October 13, 2004, to provide additional guidance

⁸ PL 108-295 is Appendix A

⁹ Section 303(k)(1)(A), SSA.

As shown in Appendix B-1, all states amended their UC laws to provide for a mandatory transfer of experience. Some states exceeded the minimum Federal requirement by mandating the transfer of experience whenever there was a transfer of trade or business between entities with “any” common ownership, management, or control.

Prohibited Transfer of UC Experience

The Act required states to amend their UC law to prohibit the transfer of unemployment experience when a person who is not an employer under state UC law acquires an employer solely or primarily to obtain a lower rate of contributions.¹⁰ The prohibited transfer provision prohibits the “purchased shell transaction” which involves an entity commencing a business by purchasing a low UC tax rated employer, and then transforming the business by operating an activity that normally would have higher UC tax costs.

Appendix B-1 shows that all states enacted conforming legislation and provides the state law citation that implements this requirement.

Authority for Future Federal Regulations

To ensure that if additional types of tax rate manipulation schemes, not contemplated by this Act, occur in the future, the Secretary of Labor has been provided with the authority to write and issue Federal regulations to specifically address the activity. This authority is contained in Section 303(k)(1)(C), SSA.

Penalty Provision

The Act requires that state law provide meaningful civil and criminal penalties for persons who “knowingly” violate, attempt to violate, or advise others to violate the transfer of experience provisions that implement the mandatory and prohibited transfer provisions of Section 303(k), SSA.¹¹ The Act defined “knowingly” to mean that the person committing the violation is acting with “actual knowledge of or acting with deliberate ignorance of or reckless disregard for the prohibition involved.” Appendix B-2 shows that all states enacted the required civil and criminal penalties for persons who violate, attempt to violate, or advise another to violate the transfer of experience provisions; it also provides a reference to the specific provision of state law implementing the requirement.

During the course of this study, several states indicated that enforcing the penalty provisions of this law has proven to be very difficult. While states do not have to prove “intent” by the employer to enforce the “mandatory” transfer of experience provision, they do have to prove that the employer or advisor “knowingly” acted to violate the law. Because employers often allege good business reasons for reorganizing, reasons that are not associated with unemployment insurance, it is difficult to prove they acted with “reckless disregard.” Consequently, many cases of SUTA dumping have been detected, investigated, and corrected; but “meaningful” penalties

¹⁰ Section 303(k)(1)(B), SSA.

¹¹ Section 303(k)(1)(D), SSA.

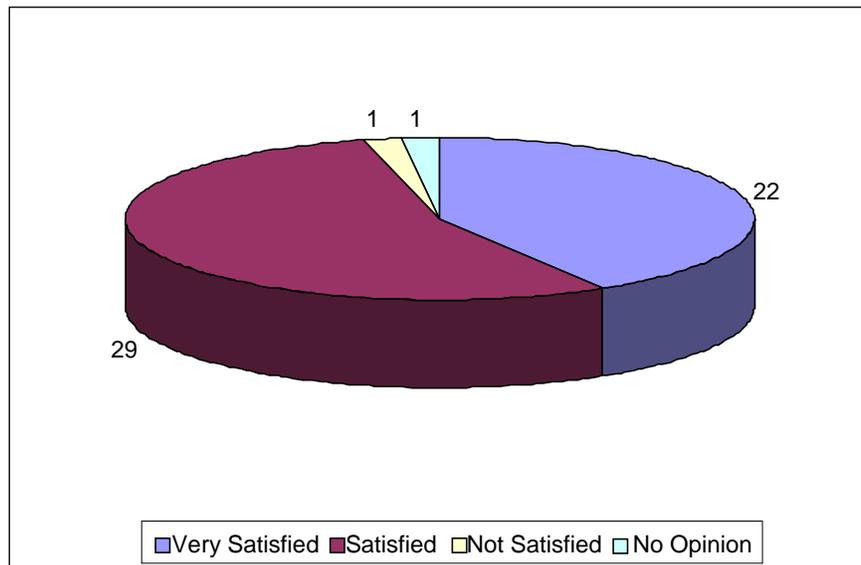
have not been invoked. Of the 53 state UC programs surveyed, only nine states cited an instance in which an advisor was penalized for illegal activity.

Effectiveness of the Legislation

Survey responses received from 51 of the 53 State Workforce Agencies indicated they were “satisfied” or “very satisfied” with the provisions of the SUTA Dumping Prevention Act of 2004. Many states also responded that the Act deterred SUTA dumping activity and improved the integrity of the program. Only one state, Arizona, indicated dissatisfaction with the Act. Arizona stated in the survey that “. . . lack of sufficient administrative funding resources for implementing SDDS activities prevents it from making an informed evaluation of the effectiveness of the Federal legislation. . . .” They also indicated that “Adequate administrative funding to effectively operate the UI Tax function as well as to implement the SUTA dumping laws is the most important action Congress could take. Any additional unfunded Federal mandates would be counterproductive, as Arizona would still lack the resources necessary to implement them.” One other state had no opinion on the effectiveness of the law.

Figure 1.1 provides a graphical view of the satisfaction of the states with the effectiveness of the Act.

Figure 1.1: Effectiveness of Section 303(k) of the Social Security Act



State UC agencies responded that the Act is beneficial in several respects. Forty-five states responded that the environment for detection, investigation, and prevention of SUTA dumping and other tax manipulation activities has changed substantially since the law became effective. In addition, 44 states responded positively that SUTA dumping detection and enforcement activity is a productive and worthwhile investment of resources. States reported a new awareness from both state UC agency employees and state employers regarding tax rate manipulation activity and what it means. A sampling of survey comments on these issues is shown below:

- *Since the passage of the Act, we have had significant prospective reporting and compliance.*
- *The Act raised awareness nationally, thereby making it easier to deter subsequent activities. Since our detection efforts began in late 2003, we have billed approximately \$8.3 million in additional UC contributions, interest and penalties, which far exceed our expenditures to date.¹²*
- *The automated process/systems allows wider discovery of fraud. Awareness by employers of the detection system forces them to be more cautious.*
- *SUTA dumping in the form of experience rating manipulation as we know it no longer exists in our state. In 2004, we identified 25 employer accounts (there were many more) that accounted for \$75 million in lost revenue to the trust fund that year.¹³ In terms of a replenishment tax rate impact, just this small group of employers caused all employers' tax rates to increase by 0.1 percent (one tenth of one percent or \$9.00 for every employee earning over \$9,000). We estimate that in total, SUTA dumping during 2004 contributed to approximately 0.2 percent of the 0.67 percent replenishment tax rate. It was not uncommon to see a series of commonly-owned companies with names like ABC I, Inc., ABC II, Inc., ABC III, Inc., etc., with the payroll being transferred from one to the others each year [we had no mandatory transfer on partials (prior to passage of the Act)], leaving all the charges behind while moving the payroll into minimally rated entities. This was a common practice in this state and others as well. Immediately after the Federal law became effective, we observed, anecdotally, an immediate decline in the number of successor accounts with common ownership, even though our state SUTA dumping legislation was not yet effective. Today, with both Federal and State SUTA dumping laws in place, the number of successions from commonly-owned employers is [at a] minimum, and primarily for other legitimate business reasons.*

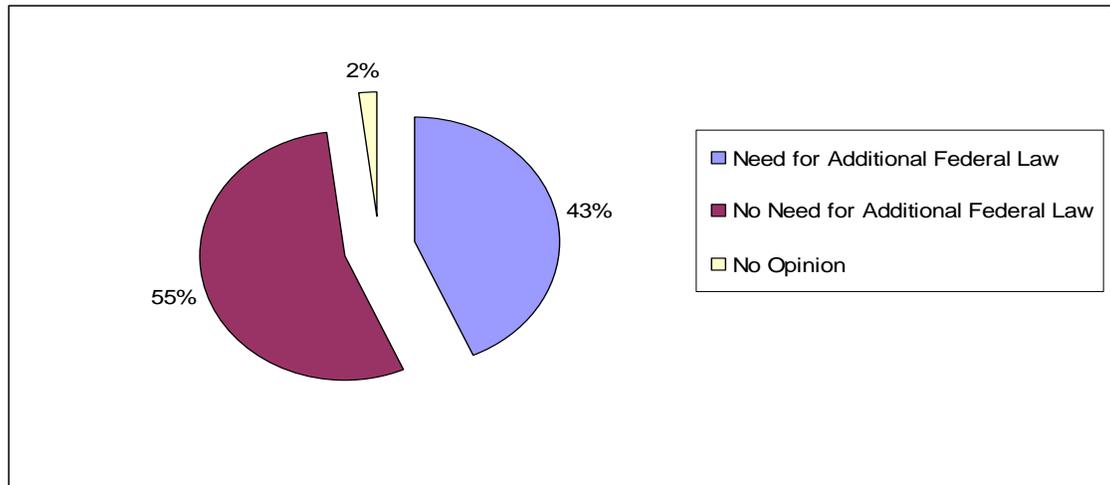
States' Recommendations for New Federal Legislation

Section 303(k), SSA, required the Secretary of Labor to conduct this study and to make a recommendation to Congress as to whether or not further legislation is required to improve the effectiveness of the Act. In order to assist the Secretary in this endeavor, the survey asked states whether additional Federal legislation should be enacted to prevent SUTA dumping and similar schemes. Figure 1.2 shows that 22 states (43 percent) responded that additional Federal legislation is needed to further assist with deterring tax avoidance schemes.

¹² This amount includes both pre- Section 303(k), SSA, and post Section 303(k), SSA, activity.

¹³ This amount includes legal activity prior to the passage of section 303(k) that was not legal after the state law was passed.

Figure 1.2: Need for Additional Federal Legislation



However, when these responses were analyzed, most seemed directed to general tax avoidance issues and not directly to improvements in the Act. Further, it should be noted that some of the state recommendations for change or additional legislation could possibly be handled through amendments to state laws, interstate agreements, and/or DOL directives/regulations. They are summarized below because they were specifically mentioned by state UC programs:

1. Massachusetts and Oregon responded that more prescriptive language should be provided at the Federal level defining what constitutes “knowing” violations and “misrepresentation” in order to trigger penalties. The current law has not demonstrated success in securing for states the ability to prove “intent” in order to impose penalties
2. Montana, Ohio, Puerto Rico, Utah, and Washington responded that consideration should be given to requiring the disclosure of information between and among states when employers have accounts in neighboring states, thus helping to eliminate “state line jumping.”
3. Thirteen states, in response to the survey, indicated that Federal clarification is needed regarding the role of PEOs and their status. Six states (Montana, North Dakota, New York, South Carolina, Tennessee, and Virginia) expressed the opinion that Federal legislation is needed in this area to make the handling of PEOs more uniform. One state, Colorado, believes that the PEO should be the reporting entity and all tax reports should be submitted under the PEO account number. Six states (Idaho, Iowa, Michigan, Minnesota, Ohio, and Missouri) believe that the client company should be considered the employer and all tax reports should be submitted under the client account number. Michigan and New York both stated that unemployment experience should be transferred between a client company and a PEO when entering and exiting a contractual relationship.
4. One state, California, indicated that Federal legislation was needed to require that monetary penalties, derived from SUTA dumping cases, be prohibited from being added to the employer’s reserve account balance in those states with “reserve ratio” experience

rating systems. Without such a prohibition, penalties can be converted into a contribution to the employer's reserve account, thus negating having penalized the employer.

The SUTA Dumping Detection System

Congress and DOL recognized that enacting legislation to prevent SUTA dumping would not resolve the problem unless it also addressed the states' ability to detect tax avoidance activity. Therefore, the Act required state law to specify that the state would establish procedures to identify the transfer or acquisition of a business for the purpose of detecting SUTA dumping.

To assist the state UC agencies, ETA contracted with the state of North Carolina's Employment Security Commission to develop, pilot test, and distribute an automated system of detection known as the North Carolina-developed SUTA Dumping Detection System (NC SDDS).

The NC SDDS is a PC-based, stand-alone system that uses data from a series of extract files that are downloaded from a state's automated employer and wage records files. Simply put, the system searches quarterly employee wage records and annual UC tax account information to detect movement of employees from one employer account to another. The system displays the employer account from which employees were transferred, the employer account(s) they transferred into, the quarter they moved, the number of employees involved in the move, the amount of wages, the age of the accounts, and whether or not a documented succession occurred. The display also shows the employer tax rates, taxable wages, taxes paid, and, in some states, voluntary contributions that may have been paid (a procedure to achieve a reduced tax rate in a reserve ratio state).

The 44 states that use the NC SDDS can view tax information for a particular employer account they suspect of SUTA dumping, or they can find any number of accounts that meet certain criteria as defined by filter options available in the system. The filter options available include the following: 1) employer size by number of employees; 2) the number of employees transferred; 3) percent change in number of employees; 4) percent change in wages; 5) maximum age of the employer (in quarters) that the employees were transferred into; 6) documented successors; 7) type of ownership; 8) voluntary contributions used to lower tax rates; 9) industry codes; 10) change in tax rates for both the exit account and the entry account; 11) employer name (including a string search, e.g., Joe Block 1, Joe Block 2, Joe Block 3, etc.); 12) employer address; and 13) employer telephone number. These screens and searches are designed to help UC staff determine whether further investigation of an identified employer is recommended for SUTA dumping detection purposes.

While the system was designed in response to SUTA dumping, as defined in the SUTA Dumping Prevention Act of 2004, it has proven to be of great value in discovering the other types of tax avoidance activity mentioned previously, such as payroll (or payroll parking), buffering, and failure to report successions. It may also assist states in learning of new employee leasing arrangements by detecting the movement of a client company's employees into a PEO.

Professional Employer Organizations

One way employers have responded to increases in costs of doing business (e.g., health insurance, workers' compensation, taxes, etc.) is through the use of both temporary help agencies and PEOs providing staff through an employee leasing arrangement. How SUTA dumping legislation impacted the PEO industry is included in this study and is discussed in detail later in Chapter 4.

Literature Providing Impetus for Interest in SUTA Dumping

A significant body of relevant literature predates the current attention to SUTA dumping. States and ETA have studied alternative employer-employee working arrangements, such as employee leasing, at least since the mid-1990s. For example, in the mid-1990s, ETA contracted with KRA Corporation to conduct a study entitled *Employee Leasing: Implications for State Unemployment Insurance Programs* (<http://wdr.doleta.gov/owsdrr/97-1/97-1.pdf>). KRA conducted case studies in Florida, Maryland, Oklahoma, and Texas. In June 2003, the General Accounting Office (GAO) presented testimony to the Subcommittees on Oversight and Human Resources, House Committee on Ways and Means, and discussed findings of the extent of SUTA dumping based on its survey of state UC administrators in the 53 states and four consulting firms (<http://www.washingtonwatchdog.org/documents/gao/03/GAO-03-819T.html>). The GAO also completed a study on employee leasing in 1998. California, Florida, Michigan, Texas, and North Carolina have been among the states actively involved with employee leasing activities of the PEO industry.

Some of the following studies informed the need for legislative remediation to prevent SUTA dumping. A study conducted by the Department of Labor, Office of Inspector General, entitled *Effect of Employee Leasing on the State of Georgia Unemployment Insurance Trust Fund (Final Audit Report 03-98-007-03-315)*, concluded that tax rate manipulation schemes, such as those known as SUTA dumping, have resulted in lost UC tax revenues. This translated into socialized costs that are paid by other employers, since they are required to pay additional UC taxes in order to offset this loss of unemployment tax revenue. The audit made a clear and very important point that such schemes could occur not only in the employee leasing industry, but also in any industry that normally has high unemployment costs. These, along with other studies and concerned employers and employer organizations, led to a conclusion that UC tax rate manipulation was a very serious issue.

CHAPTER 2: STATE AGENCY ENFORCEMENT—STRUCTURE AND RESOURCES

General Observations

States established various structures to allocate and direct resources for SUTA dumping prevention, detection, and investigation. Most states chose a centralized organizational design whereby decisions are made and work performed at the central office level. Generally, states use existing budgets for UC tax operations to fund enforcement activities. A limited number of states added resources to launch the SUTA dumping compliance effort. Overall, states expended significant resources to train tax personnel in the requirements of the law and in using detection tools to identify transfers and acquisitions in order to detect SUTA dumping.

State Enforcement Structure

Organizational Structure

Field visits by the Coffey Communications team to seven states provided detailed information on each state's SUTA dumping detection capability, the scope of effort being expended, and the location of the program leadership and investigations staff in the organization. As stated, central office teams led most of the SUTA dumping enforcement activities. Table 2.1 shows the organizational element responsible for the overall effort as well as (a) the unit responsible for detection and selection of cases to pursue and (b) the unit or individuals responsible for investigating cases opened.

Table 2.1: Responsibility for SUTA Dumping Enforcement Activities (2006)

Organization	Responsibility for Detection and Selection of Cases	Responsibility for Investigations
Florida Department of Revenue	Compliance Support Unit	Account Management Unit (Status)
Utah Unemployment Insurance Agency (UIA), Field Audit Section	SUTA Dumping Enforcement Unit	Account Examiners
New Hampshire Department of Employment Security, UC Bureau	Contributions Chief Tax Unit Supervisor	Tax Unit Supervisor
Washington State Employment Security Division (ESD), UI Tax	Tax Investigations Unit	Tax Investigations Unit
California Employment Development Department (EDD) Tax Branch, Field Audit and Compliance Division	UI Rate Manipulation Team	UI Rate Manipulation Team (majority); Field Auditors (some)
Michigan Unemployment Insurance Agency (UIA), Tax and Employer Compliance Division	SUTA Dumping Detection Unit	SUTA Auditors
Texas Workforce Commission (TWC), Unemployment Insurance Tax Division	Status Section	Status Section

Program Management

During its site visits, the Coffey team examined the operation and management of SUTA enforcement units in state UC agencies. Two of these states are discussed below.

Michigan has enthusiastically pursued SUTA dumping. When Michigan established a SUTA detection unit within the Unemployment Insurance Agency (UIA), it began investigations on experience rating violations that occurred prior to July 1, 2005. The agency established a team that is well organized, trained, and directed to pursue violations of Section 303(k), SSA, and Michigan-specific statutory requirements.¹⁴ The SUTA dumping detection unit identifies, tracks, investigates, and resolves cases involving violations of its transfer of experience provisions on a weekly basis. The SUTA unit has a full-time manager, who has direct access on a weekly basis to key policy makers and executives who direct all UIA activities. In addition, Michigan's Office of the Attorney General participates in the team's weekly meeting. "Front line" auditors present their cases to the executive review group on "SUTA Mondays." Cases requiring action by the auditors, the pursuit of critical documents, assistance from legal personnel, advice from the Office of the Attorney General, or analysis by rate setting experts, are carefully monitored to assure timely completion.

California is another state that effectively manages its SUTA dumping cases. It estimated an annual loss of \$100 million to its account in the UC trust fund from SUTA dumping. The team operates under a Project Charter for the UI Rate Manipulation Team drafted on August 5, 2004. The team consists of a project manager and eight staff members who developed methods for detecting SUTA dumping; developed marketing and outreach materials; provided training for other Employment Development Department staff; reviewed the current law; worked with other units to improve the employer registration process; and completed investigations on 50 cases during 2005. California continues to operate in the post-Section 303(k), SSA, environment as it did prior to its passage.¹⁵ During the November 2006 site visit, the UI Rate Manipulation Team had about 50 active cases. Presentations regarding rate manipulation schemes are coordinated by the team. Changes to the new employer registration process make it more difficult for manipulators to obtain additional account numbers. The Contribution Rate Group coordinates with the team to identify inappropriate requests for reserve account transfers; the group helps to recalculate rates after discovery of a violation. Employers found to be manipulating rates were monitored for prospective reporting problems.

¹⁴ Michigan law requires that an employer have only one UC tax account. When Michigan discovers an employer with more than one account, it collapses the accounts into a single account and assigns a rate based upon a blend of experience. In this regard, Michigan's approach is similar to an "any" commonality standard for mandatory transfers of experience under Section 303(k), SSA

¹⁵ Like Michigan, California has used other provisions of its UC law to enforce laws that prevent SUTA dumping. California law requires the transfer of experience when payroll transfers between entities with a "unity of enterprise." This is similar to the mandatory transfer of experience required under Section 303(k), SSA. Also, in determining penalties under its law, California assesses whether or not the failure to properly report payroll is an act of fraud by the employer.

Evolving Structure

Several states evolved their SUTA dumping enforcement organizational structure after initial enforcement activities were underway. Some states prefer a decentralized approach, such as those found in Tennessee and Iowa.^{16, 17} However, most states responding to the survey prefer a centralized approach. Some states have experimented with both a decentralized and centralized approach as their units evolved.¹⁸ Overall, the pattern in most states reflects a general belief by management that centralized control over SUTA dumping detection activities is most appropriate during the initial implementation of these new state and Federal laws.

State Staffing and Resource Issues

Staffing

Staff devoted to prevention, detection, and investigation of SUTA dumping varies significantly among the 53 UC programs, primarily differing in direct proportion to the size of the state. Some larger states have allocated substantial resources to this effort.¹⁹ Medium-sized states have employed fewer personnel.²⁰ Smaller states usually employ just one or two FTE's for their

¹⁶ Tennessee has (1) placed the fact-finding and determination responsibility in the hands of the field auditors; (2) provided a series of procedures to be followed for each case referred; and (3) established criteria an auditor can use to determine whether or not a transfer of a business was made for the sole purpose of obtaining a lower rate of premiums (i.e., tax contributions). Once a case has been selected during the SDDS search, the auditor performs a preliminary investigation of the employer's account. Based on these results, a full investigation may be ordered and management then assigns it to a field investigator. The manager of Employer Accounts reviews and approves the report and decision issued by the auditor. The auditor then issues a decision letter. Completion of cases may take a year, depending on the complexity of issues and the cooperation of the employer involved.

¹⁷ In Iowa, all applications to establish accounts are investigated by field auditors. Part of the investigation is to determine if there is commonality of ownership, management, or control; a decision is issued accordingly. Staff has been trained in how to document commonality between a predecessor and a successor in a change in ownership, and the results are presented in a Synopsis of Investigation.

¹⁸ For example, Utah's enforcement unit was initially housed in its field audit group, was then moved to compliance specialists in Employer Accounts in the central office, but returned to field audit by the end of 2006. In California, the UI Rate Manipulation Team utilized the regular field audit group to investigate some potential cases but found that approach to be less effective than centralized investigations by staff with experience and special training in investigating and documenting rate manipulation schemes.

¹⁹ Michigan's SUTA Dumping Detection Unit consists of seven full-time staff with expertise in liability analysis and tax financial reporting and eight SUTA auditors who were recently hired and trained to conduct SUTA dumping investigations. In California, initially nine staff members were assigned to the UC Rate Manipulation Team. In May 2007, the team working on SUTA dumping consisted of 16.2 FTEs, including 12.2 who were added as a result of a special budget request. In Washington, the UI Tax and Wage Operations Division supports a Tax Investigations Unit that analyzes and investigates both the "underground economy" and SUTA dumping violations. Initially, the pilot SUTA dumping investigations effort involved only one full-time investigator and resulted in assessments of over \$1 million. Four underground economy investigators and three SUTA dumping investigators have been working under the supervision of a manager since June 2006. Additional information technology and legal positions are being contemplated. The Tax Investigations Unit Manager assigns priorities to all referrals and holds investigators accountable for cases assigned. About 125 new accounts are assigned to investigators each quarter.

²⁰ North Carolina reported that a five-person SUTA team is supported by a half-time staffer from their legal unit. Ohio is devoting the equivalent of 15 FTEs to SUTA dumping activities. States such as Massachusetts that did not previously require transfers of the experience rate in both partial and total successions are expending significant resources on new business transfer units.

SUTA dumping enforcement unit.²¹ Some states do not differentiate SUTA dumping prevention, detection, and investigation efforts from routine tax investigations.

Nationwide, the total effort devoted to implementing Section 303(k), SSA, is currently estimated by the states at 208.4 staff years, equivalent to about \$13 million in annual personnel costs. States are committing, on average, the equivalent of 3.93 full-time staff to enforcing the law. Some are dedicating far more. To accomplish this, states have primarily reallocated existing UC staff to implement Section 303(k), SSA, and related state legislation. Only 14 states reported that net additional staff was added to implement SUTA dumping activities, totaling 57.4 FTEs.

Staff members working primarily in registration, liability determinations, audit, and tax investigations activities are focused on this work, although not necessarily full-time. The FTEs breakdown of staff dedicated by organizational units is shown in Table 2.2.

**Table 2.2: State Staff Dedicated to Detection, Investigation and Prevention of SUTA Dumping (2007)
(53 States Reporting)**

Organizational Unit	Number of Full Time Equivalents
Liability and Registration	75.15
Investigation and Audit	82.13
Enforcement/Collection	16.17
Legal	7.48
Information Technology	12.37
Integrity Unit	6.10
Other	9.00
Total FTEs	208.40

States’ responses to the survey reflect a perception that additional resources are needed to combat SUTA dumping. Forty-nine states responded that “financial/staffing” issues are a barrier to enforcing their new SUTA dumping statute, and 41 states identified it as the “greatest barrier to enforcement” encountered during the initial implementation period. Nineteen states identified difficulties in gaining access to information technology resources as the second most prevalent barrier to enforcement.

Evidence of competition for resources was widely reported by states. Some states indicated the need to restrict reviews of transfers of payroll because of staffing issues.²² Other states indicated that investigations could not be completed because of staffing issues.²³ At least two states

²¹ Delaware, Idaho, and Rhode Island have each devoted the equivalent of one to two FTEs to detect, investigate, and prevent SUTA dumping. New Hampshire relies primarily on the analytical expertise and investigatory skills of the chief of contributions and the supervisor of the status unit. The lead staffer is also responsible for other areas, e.g., independent contractors and PEO accounts. However, even a large state may not employ a large number of personnel. New Jersey reported devoting less than one FTE to the SUTA dumping implementation effort.

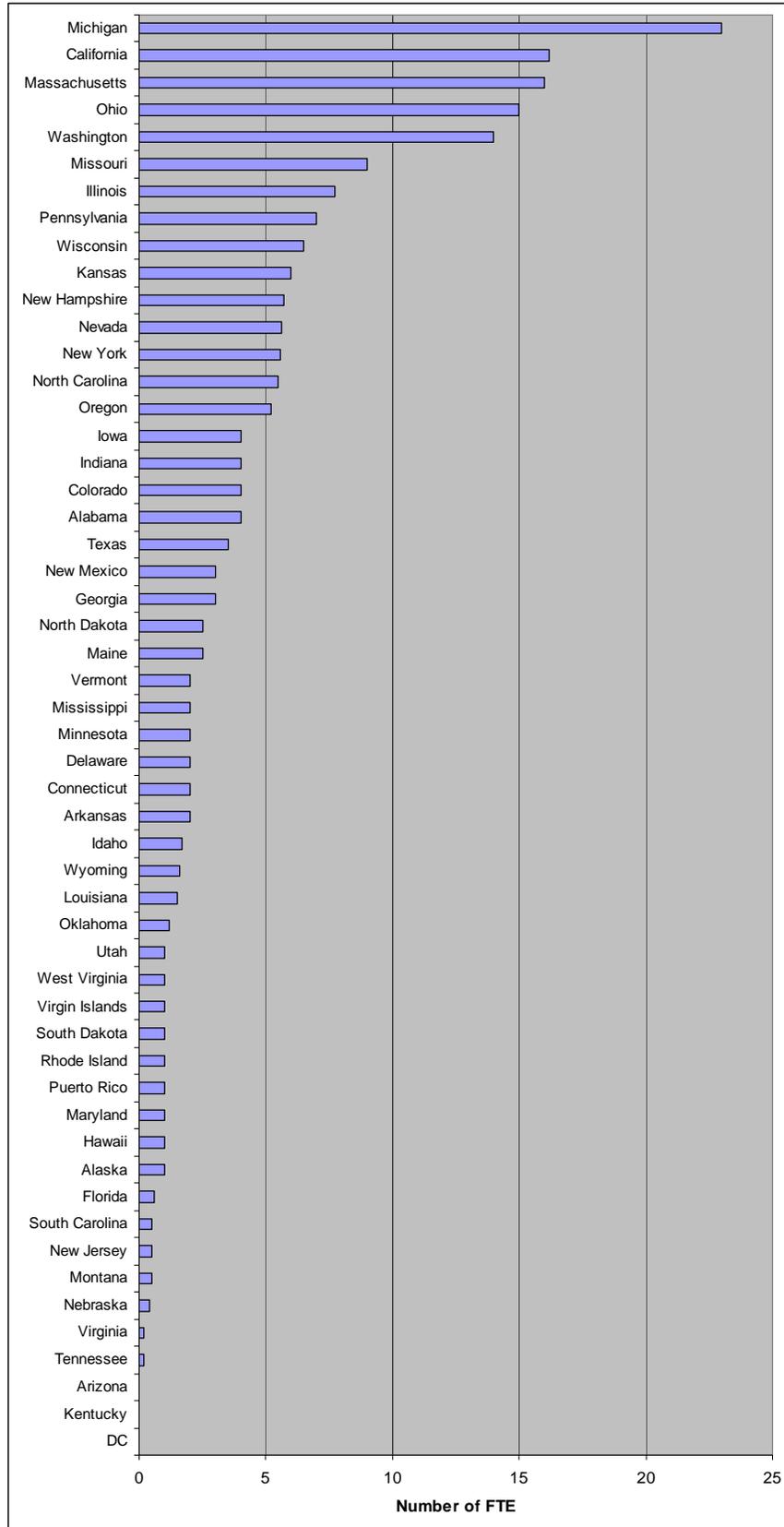
²² New York reported that the selection criteria for reviewing transfer of payroll in the SDDS system had to be adjusted to accommodate a workable caseload for existing staff in its Fraud Unit.

²³ Nevada’s new Employer Rate Unit reported an inability to perform the research and investigation necessary to “search out” and monitor rate manipulation activities while also implementing mandatory transfer requirements for the first time.

indicated that implementation and use of the SUTA Dumping Detection System was delayed because of staffing concerns.²⁴ Figure 2.2 portrays the number of FTEs devoted to investigating SUTA dumping activity.

²⁴ Wisconsin reported that, due to position reductions and other priorities, the formal procedures developed to follow up on queries using the SDDS detection software have not yet been implemented. Arizona reported that the state lacks the resources necessary for implementing SDDS activities.

Figure 2.2: State FTEs Being Utilized on SUTA Dumping Activity



Staff Training

Types of Training

States allocated significant resources to train personnel in the tools provided to assist in the implementation of Section 303(k), SSA. All but one state reported involving staff in SUTA dumping detection and investigation training during 2005–06. Training for state staff using the SDDS developed by North Carolina occurred at the National Tax Conference and at three conferences sponsored by ETA. At all four events, experts from North Carolina explained the selection options made possible by the software and showed how different filters could be utilized when tracking movements of employer workforces to detect quarterly reporting behavior requiring further investigation.

Most state efforts went beyond simply training a few staff members in new automated detection tools. Some states made significant efforts to train field auditors, collection staff, and other central office personnel in SUTA dumping.²⁵ Some state training has occurred beyond tax units to reach all members of the UC program.²⁶

Number of Personnel Trained

The training of staff in SUTA dumping prevention, detection, and investigation has primarily focused on employer liability and audit personnel. The number of states conducting training along with the number of staff trained is summarized in Table 2.3.

**Table 2.3: Staff Training Completed as Part of Initial Implementation
(53 States Reporting)**

Unit	States Conducting Training for Unit	Number of Staff Trained
Liability	44	958
Audit	39	1,288
Collection	23	327
Legal	17	53
Appeals	10	66
UI Integrity	8	58
Other*	26	614
Total		3,364
* Including all 304 staff trained in California		

²⁵ In Michigan, UIA staff members assigned to conduct SUTA investigations and regular field auditors who assist in these matters have been trained in the new law, SUTA dumping issues, and the agency's requirements for determining that a SUTA dumping violation has occurred. This issue was a featured part of the statewide auditors' conference held in September 2006. In Washington, the state's Employment Security Division (ESD) trained over 100 auditors/collectors in ten district offices. ESD developed an online training module that is designed for auditors from the three state agencies involved in employer compliance activities. In addition, 41 personnel in the central office have been trained in SUTA dumping detection and enforcement issues

²⁶ In Texas, status unit managers trained over 400 Texas Workforce Commission (TWC) staff in the meaning and potential impact of the new law. In California, approximately 60 presentations have been made to internal and external groups by members of the UI Rate Manipulation Team. An informational fact sheet was developed and a SUTA dumping website was constructed

Fewer than half the states conducted training for collection personnel, and only 17 reported training legal staff. Only ten states conducted training for appeals personnel.

Time Devoted to Training

Initial efforts on the part of states to implement training required them to make a substantial investment in sharing knowledge and developing skills. Some large states, such as Pennsylvania, have invested more than 1,800 hours in staff training. Ohio had six staff trained in the use of the North Carolina SDDS software and provided two days of training to 63 auditors. Massachusetts reported over 1,400 hours and California reported 1,064 hours spent training 304 staff. Tennessee and Missouri each invested more than 1,200 hours in staff training.

Additional Training Needs

Forty-four states reported a continuing need for staff training, most frequently requesting four topics in particular: methods for using the SDDS software more effectively; a general overview and updates on SUTA dumping implementation; updated information about successful detection and investigation techniques and practices; and preparation for hearings and subsequent appeals.

States also reported that the following staff were most in need of additional training: auditors, status analysts and liability personnel, legal department staff, and enforcement/compliance staff.

In their survey responses, the majority of states expressed a preference for state personnel to conduct the training. However, more than 20 states requested national and regional office personnel and Web-based training options.

Ongoing Costs of Implementation

Fifteen states identified a need for financial support in the area of software, ranging from less than \$1,000 in Minnesota to \$50,000 in Alaska and Washington. Ten other states reported ongoing costs for hardware, ranging from \$1,200 in North Dakota to \$17,500 in Illinois. Staff development was the main focus in eight states, with reported needs ranging from \$2,862 in Puerto Rico to \$25,000 in North Carolina. Many states indicated that no ongoing support will be required. However, staffing remains the primary need, as described earlier. For example, California has prepared a budget request for 56.6 additional FTEs to be educated on identifying, investigating, litigating, and collecting additional contributions due on rate manipulation cases.

CHAPTER 3: EVALUATION OF IMPLEMENTATION STRATEGIES

Introduction

This chapter evaluates the actions taken and the results achieved by states in their implementation of Section 303(k), SSA. Using information and data provided to the study team through a survey completed by all 53 states and from site visits to seven states, the team documented the extent to which states have implemented applicable provisions of the Act. The overall objective of the chapter is to demonstrate what the states have achieved in this implementation.

As noted previously, the effectiveness of the Act on a national scale is difficult to determine. Most state laws were not effective until January 1, 2006, and it was not until the third quarter of 2006 that the majority of states had their SDDS operational. The data collection survey was designed to accommodate a report to Congress by July 15, 2007, and therefore asked states to provide data through the third quarter 2006. Because nearly half of the state laws did not become effective until January 1, 2006, this limited the potential available data to three quarters.²⁷ Additionally, 40 percent of the states did not begin operating their SDDS until after the data collection ended, providing an additional limitation on the data to be examined. These data limitations must be remembered when reading this section.

In initiating their enforcement programs, some states conducted preliminary analyses to determine whether or not the potential SUTA dumping cases were significant enough to warrant devoting resources to either retrieve lost contributions from misapplication of experience rating or to prevent even greater opportunity for losses, or both. Some states decided that their resources were so thin that they could not immediately devote any additional manpower to pursuing SUTA dumping. Other states decided to learn more about the successes and challenges that the early enactors experienced and to learn from states that had SUTA dumping prevention provisions in their state laws prior to enactment of Section 303(k), SSA. Many states had to establish units to track and analyze business transfers, so partial and total transfers could take place as required by the new legislation. Finally, a few states delayed implementation activities for various reasons, such as difficulty in getting their SDDS installed and operational, lack of funding, and lack of training for staff.

Interestingly, the states achieving success in identifying SUTA dumping, conducting investigations, making determinations, issuing assessments of taxes due, and collecting assessed taxes approached the initiative with a strategic plan that aligned their goals and tactics to take advantages of their organizational strengths, while shoring up areas of weakness. A few examples follow of states reporting success implementing the Act.

Texas is an example of a state that has maximized efficiency in its enforcement effort. It quickly grasped the power inherent in the NC SDDS and how it could aid its continuous improvement efforts to make its UC program both more cost efficient and effective. The state took advantage of its favorable laws and regulations, technology, and staff talent to organize a system to detect and collect amounts deemed to be SUTA dumping. Texas collected millions of dollars using a

²⁷ There were 24 such states as shown in Appendix B-1.

centralized approach and primarily uses one staff person to identify and determine the amount of assessments recommended for approval by TWC management.

New Hampshire uses a model similar to that of Texas in that enforcement involves limited staffing. Small portions of the time of the Chief of Contributions and the Supervisor of the Tax Unit (Status Section) are devoted to the state's SUTA dumping efforts. Although the dollar amounts of assessments and collections are smaller than those for Texas, the recovery per hour of resources expended compares favorably.

California is employing the most comprehensive, strategic approach to SUTA dumping detection, prosecution, and prevention. This approach makes sense given the state's size and complex legacy computer systems. It understandably needed a more robust SDDS than the North Carolina system. Because its legacy systems cannot be replaced or significantly improved in the short-run, California is implementing a workaround by building various data warehouses and connecting them to decision support systems, allowing the state to make relevant data available in almost real time. This makes it possible for California to make supportable decisions that otherwise could not be made for extended periods of time. According to the state, progress is being made while it continues to pursue SUTA dumping with a combination of standard operating procedures and new ones emerging from the ongoing implementation.

Utah started its program with limited, designated resources; and the state did not realize significant outcomes. However, after strengthening its commitment to eliminating SUTA dumping, assigning new staff, and taking advantage of peer-to-peer learning, the state realized large recoveries from its detection, investigation, and enforcement efforts.

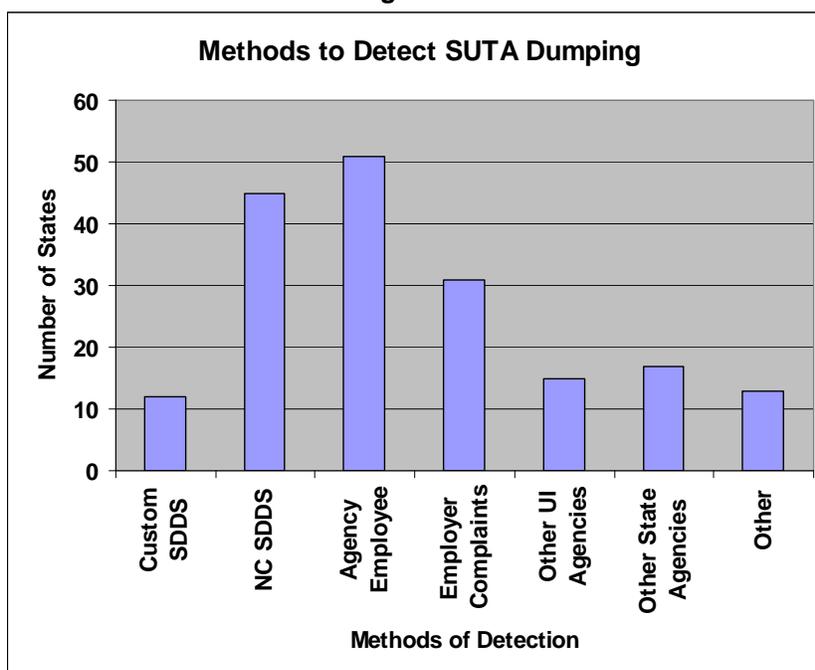
The remainder of the chapter consists of a descriptive analysis of the findings from the surveys completed by the states. Where appropriate, conclusions have been drawn from the survey data.

SUTA Dumping Enforcement Process

Discovery of SUTA Dumping

States reported using a variety of methods to detect SUTA dumping, including leads from agency employees and complaints from employers. See Figure 3.1. However, a common method is the automated detection system that was either made available by DOL/ETA (developed under contract with the North Carolina Employment Security Commission) or one that was developed by the applicable state or a third-party. Survey responses from the states indicated that 70 percent rated the NC SDDS and custom-built SDDS as being the most effective method for identifying employers requiring investigation. Automated detection systems are widely used and widely viewed as the most effective systems.

Figure 3.1



Sixteen states reported that their automated detection systems are also effective at detecting other types of tax rate manipulation activities not addressed by Section 303(k), SSA. The states ranked referrals from agency employees as the second most effective method for detecting SUTA dumping. In addition to tax unit referrals, states reported that referrals from Labor Market Information staff were also beneficial.

Forty-four states (83 percent of UC programs) have implemented the NC SDDS as a key tool for SUTA dumping management. The technology enables many states to detect and track the shifting of employees by employers between and among entities/UC accounts for the first time.

Despite the overall satisfaction with the NC SDDS, states responded with suggestions for how it could be improved to enhance the usefulness of the software:

- Incorporate more current data. Currently, the SDDS is updated quarterly; however, the data are lagging by two quarters. Data need to be more current to detect current changes in employee movement; therefore, data should be loaded more frequently.
- Provide the capability to retrieve the current quarter so that the SDDS can be used (1) as a case management/tickler system to track money discovered in previous and upcoming quarters due to SUTA detection efforts, and (2) to query many accounts at one time.
- Identify employers that just disappear and do not have an entry account. The current software does not identify the drop-off of wages from an exit company unless it has a corresponding entry account (data pairs).
- Provide the ability to print selected text or pages in a search. At present, only the entire search can be printed; in many cases this yields multiple pages of instances where small numbers of employees have changed employers, which can be consistent with normal turnover.

- Improve search functions to provide the ability to search addresses of all business locations, not just the indexed (mailing) address, and to search “doing business as” (DBAs), not just indexed names, such as sole proprietors.
- Allow the system to query accounts by inactive dates.
- Allow parameter changes on filter searches and standard searches.
- Provide the ability to cross-match on the names of owners, partners, or officers, Social Security Numbers, etc., and generate a report of those owners and officers who are common.
- Establish a link to SDDS databases in contiguous states. This would improve detection of employers moving payroll between states.
- Provide the ability to search by specific North American Industry Classification System (NAICS) codes.
- Provide a “help” function that defines various fields.
- Enable users to detect taxable amounts identified as transferred wages.

Analysis of Cases and Results Reported by States

Case Investigations

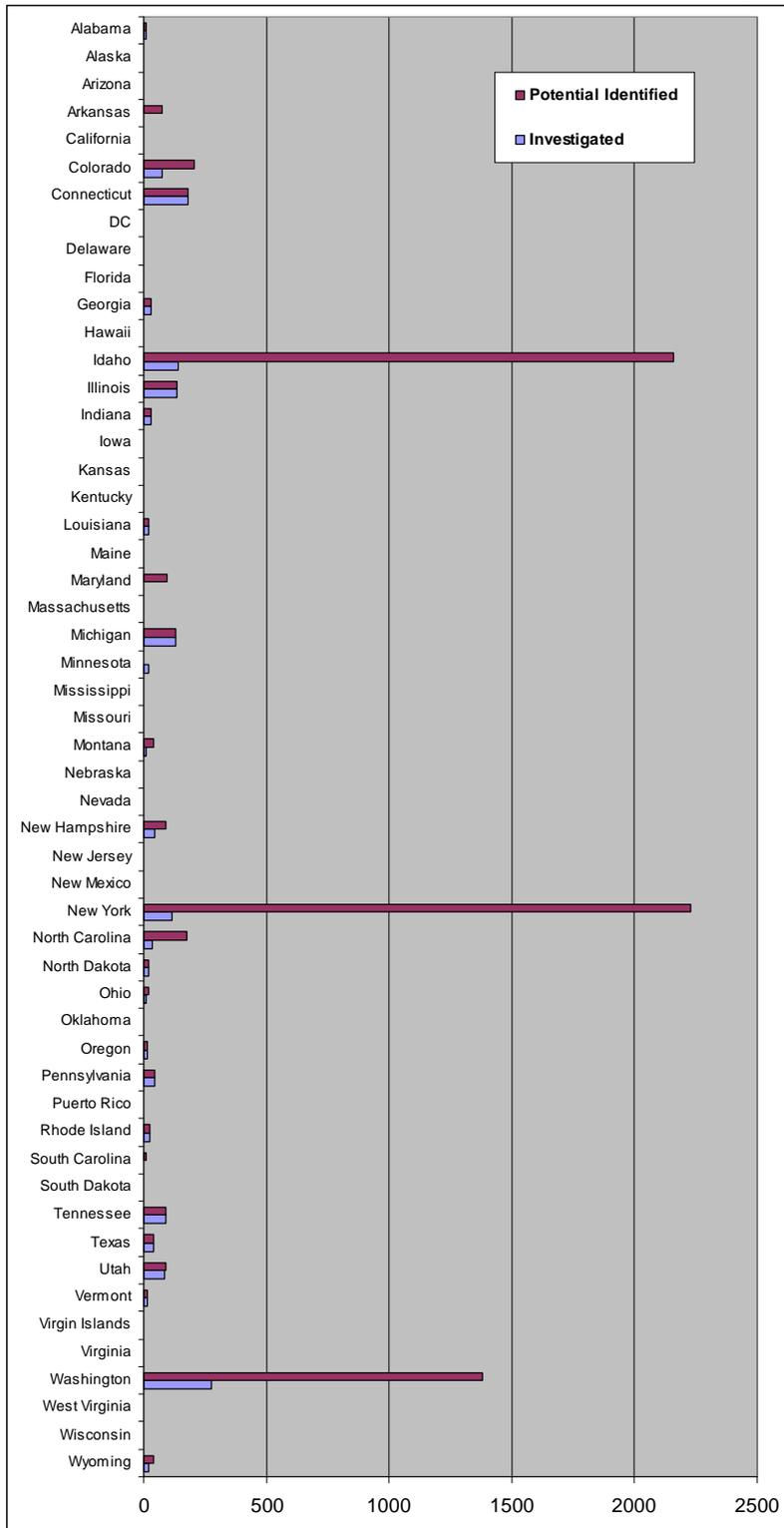
Although most state laws were not effective until January 1, 2006, states were asked in the May 2007 survey to submit data on detection and investigations activity for the period July 2005 to September 2006. States responded by identifying a total of 7,425 potential SUTA dumping cases and 1,640 investigations occurred. See Table 3.1.

Table 3.1: Investigations by Quarter

Time Period	Number Investigated
July to September 2005	382
October to December 2005	201
January to March 2006	333
April to June 2006	265
July to September 2006	459
Total	1,640

The highest quarter for investigations activity was the quarter ending September 2006. However, one large state began operating its SDDS during that quarter, and this apparent trend may not continue in future years. The number of potential cases identified and investigated by state is shown in Figure 3.2.

Figure 3.2: Numbers of Potential Cases Identified and Investigated²⁸



²⁸ The figure does not show any investigations in California or Massachusetts. California uses a different provision of its UC law relating to unity of enterprise. The absence of investigations reported only means that California did not explicitly use the SUTA dumping provision of their law. Massachusetts was unable to provide a count of identified and investigated cases.

The pursuit of cases for Section 303(k), SSA, violations was not uniform across the UC program. States such as Idaho, New York, and Washington reported large volumes of potential cases identified, while 23 states reported no activity or were unable to report accurately on their detection and investigation activities during the study period. The lack of activity reported may be a function of delays in installing the SDDS in the states.

Employers Determined to Be in Violation of Section 303(k), SSA

States reported a total of 775 cases of violations of the *mandatory transfer* provisions (involving common management, control, or direction between transferor(s) and transferee(s)) of the law and 12 cases where employers violated the *prohibited transfer* provisions (acquisitions for purpose of lowering a tax rate and not for a legitimate business purpose). Violations were reported by 30 states, although only eight states reported prohibited transfer violations. Fifteen states reported no violations, while eight other states were unable to report the number of violations found.

Of the states that reported mandatory transfer violations, only 17 provided details on the industries of the violators. Of the 775 mandatory transfer violations reported, 514 occurred in these 17 states. Figure 3.3 shows the industrial mix of the mandatory transfer violators reported. The largest category listed is “other” (320 of the 514 cases), an indication of prevalence across much of the industrial structure. The remaining categories show that 23 percent of the cases were from construction, nine percent from employee leasing, and seven percent from the hospitality industry.

Figure 3.3: Number of Mandatory Transfer Violations, by Industrial Sector

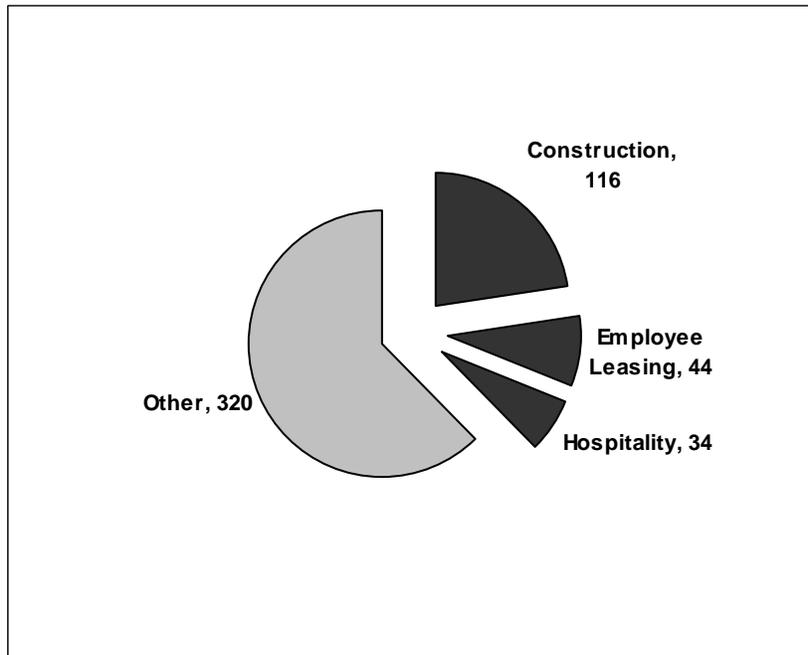
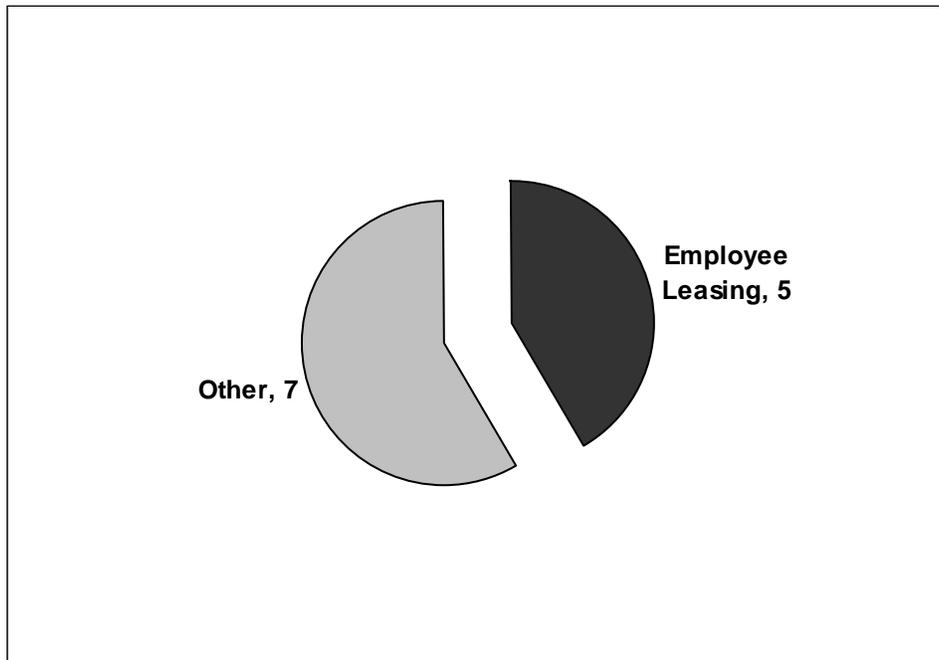


Figure 3.4 shows that 5 of the 12 prohibited transfer violation cases were from the employee leasing industry.

Figure 3.4: Number of Prohibited Transfer Violations, by Industrial Sector

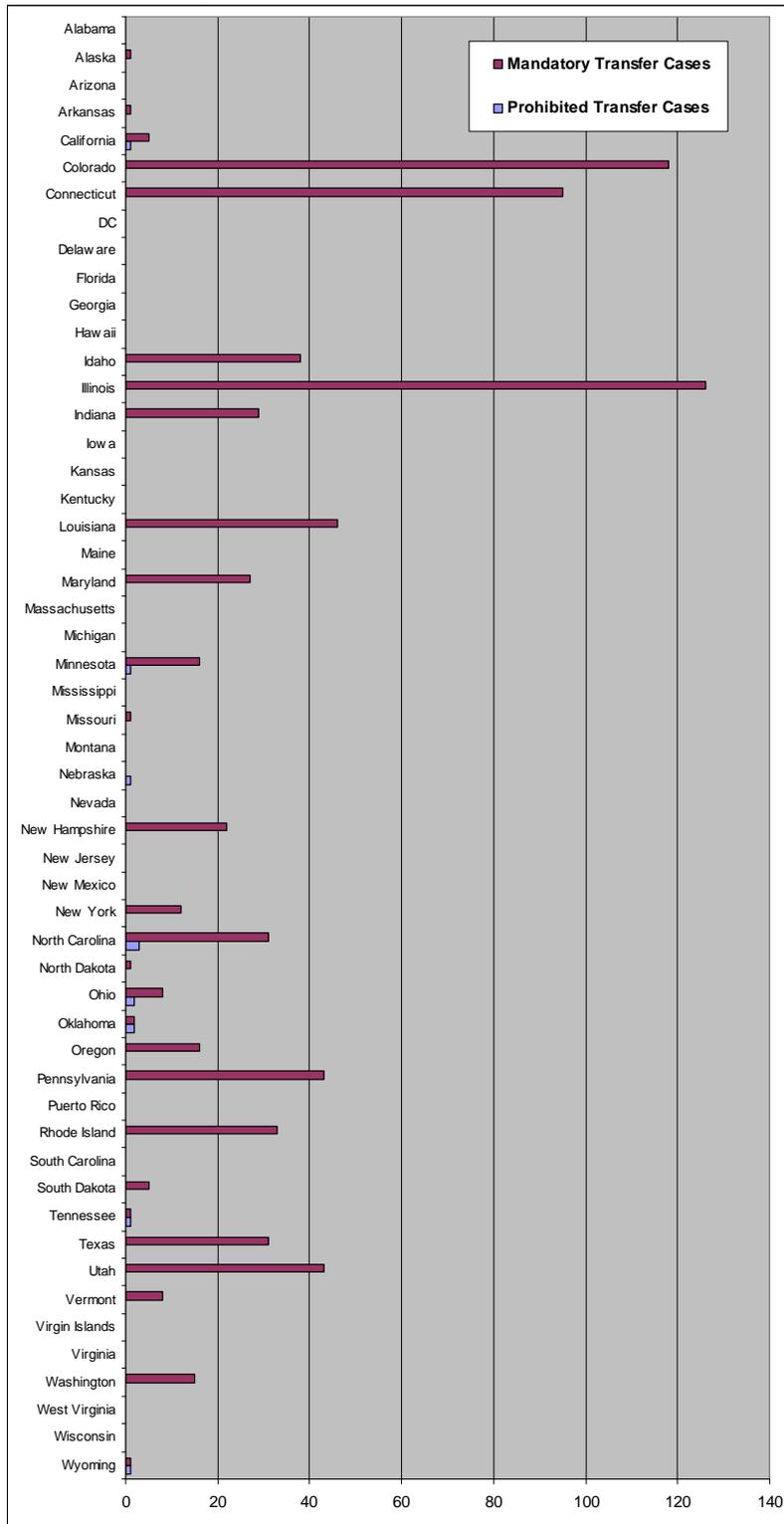


It should be noted that the small number may reflect a longer tax avoidance process for prohibited transfers vis-à-vis mandatory transfers. A mandatory transfer violation occurs at the time of the transfer and is identified by the movement of employees to a different employer account. Under a prohibited transfer, workers and payroll are transferred to a new account, but increased benefit charges start to accrue to that account in later periods. There will often be a lag in discovery, and the UC agency will often face a burden-of-proof issue in determining that the transfer was undertaken to avoid UI taxes, as opposed to other possible business reasons for the transfer. Since the empirical data offered here refer to the first nine months of 2006, these lags may have been operating to reduce the number of prohibited transfer cases identified at the time the states were responding to the survey.

Completed cases with findings of violations are not confined to one state or region of the U.S. States documenting 40 or more mandatory transfer violations included Colorado, Connecticut, Illinois, Louisiana, Pennsylvania, and Utah. Eight different states had completed a case involving prohibited transfers.

Figure 3.5 displays the distribution of mandatory and prohibited transfer violation cases reported by the states.

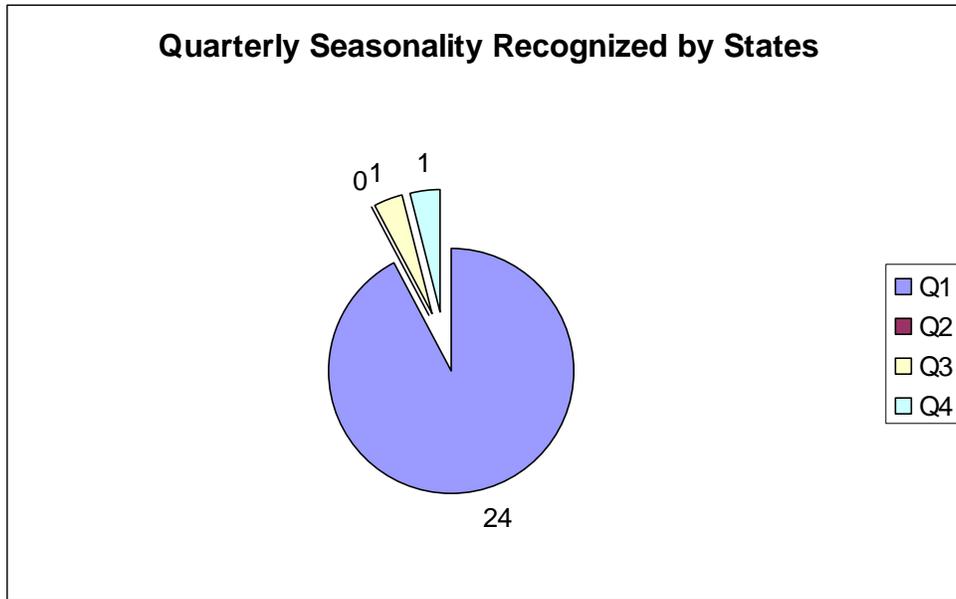
Figure 3.5: Mandatory and Prohibited Transfer Violation Cases Reported²⁹



²⁹ The table does not show any violations discovered in Massachusetts or Michigan. The absence of violations reported for Michigan only means that it did not explicitly use the SUTA dumping provision of its law to mandate the transfer of experience. Massachusetts was unable to supply a count of mandatory or prohibited transfer violations.

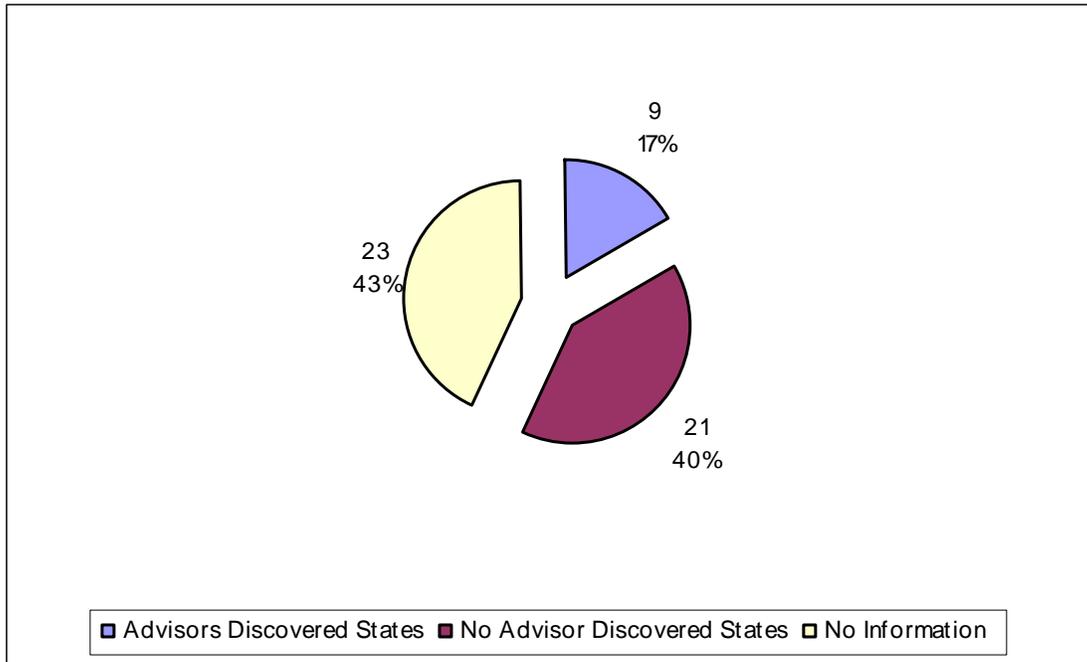
Conducting the SUTA dumping investigations requires a substantial expenditure of staff resources during the period when wage records for the first quarter are loaded into the SDDS system. The survey of the states asked about the quarterly pattern of cases and 32 states provided detail. Of the 26 states that identified a single high quarter, 24 indicated it was the first quarter. The first quarter was also identified by the five states that identified two high quarters of violations. Figure 3.6 displays the quarterly pattern among the 26 states that identified a single high quarter, 24 in the first quarter and one each in the third and fourth quarter.

Figure 3.6



Despite the availability for the first time of a penalty directed at those who advise employers to evade the law, only 9 of the 30 states that reported one or more SUTA violations cited the involvement of a financial advisor in a SUTA dumping scheme. See Figure 3.7.

Figure 3.7: Percentage of States with Advisors Discovered



Assessments and Recoveries

Reports submitted by 53 UC agencies indicate that 27 states assessed employers an additional \$102,298,336 in contributions, penalty, and interest for violating state SUTA dumping statutes.³⁰ Details are presented in Table 3.2. A majority of the assessments (i.e., 72 percent) occurred on mandatory transfer violations. Penalties have been assessed by seven states, although some states may have utilized pre-Section 303(k), SSA, statutes to assess them. No state reported penalty assessments in cases of prohibited transfers.

Table 3.2: Amount Determined Due for the Period Ending September 2006

Type of Penalty	Mandatory Transfers	Prohibited Transfers
Additional Taxes Due	\$79,019,215	\$20,345,123
Fines	\$0	\$0
Other Penalties	\$1,085,932	\$0
Interest Payment	\$1,554,009	\$294,057
Total	\$81,659,156	\$20,639,180

Reports on the collection of assessed amounts indicate that 22 states obtained \$52,456,899 in contributions, penalty, and interest. See Table 3.3. While collections normally lag behind assessments, especially when cases become the subject of an appeal, initial tax recoveries on mandatory transfer violations amounted to 58 percent of assessed contributions, and collected

³⁰ Of the 30 states that identified SUTA dumping violations, three (Alaska, Vermont and Wyoming) did not assess penalties or did not indicate the amounts in their survey responses.

penalties equaled 62 percent of assessed penalties. However, the collection of contributions on prohibited transfer violations amounted to only 17 percent of assessments.

Table 3.3: Amount Collected for the Period Ending September 2006

Type of Penalty	Mandatory Transfers	Prohibited Transfers
Additional Taxes Due	\$45,849,670	\$3,343,704
Fines	\$0	\$0
Other Penalties	\$675,542	\$0
Interest Payment	\$2,452,983	\$135,000
Total	\$48,978,195	\$3,478,704

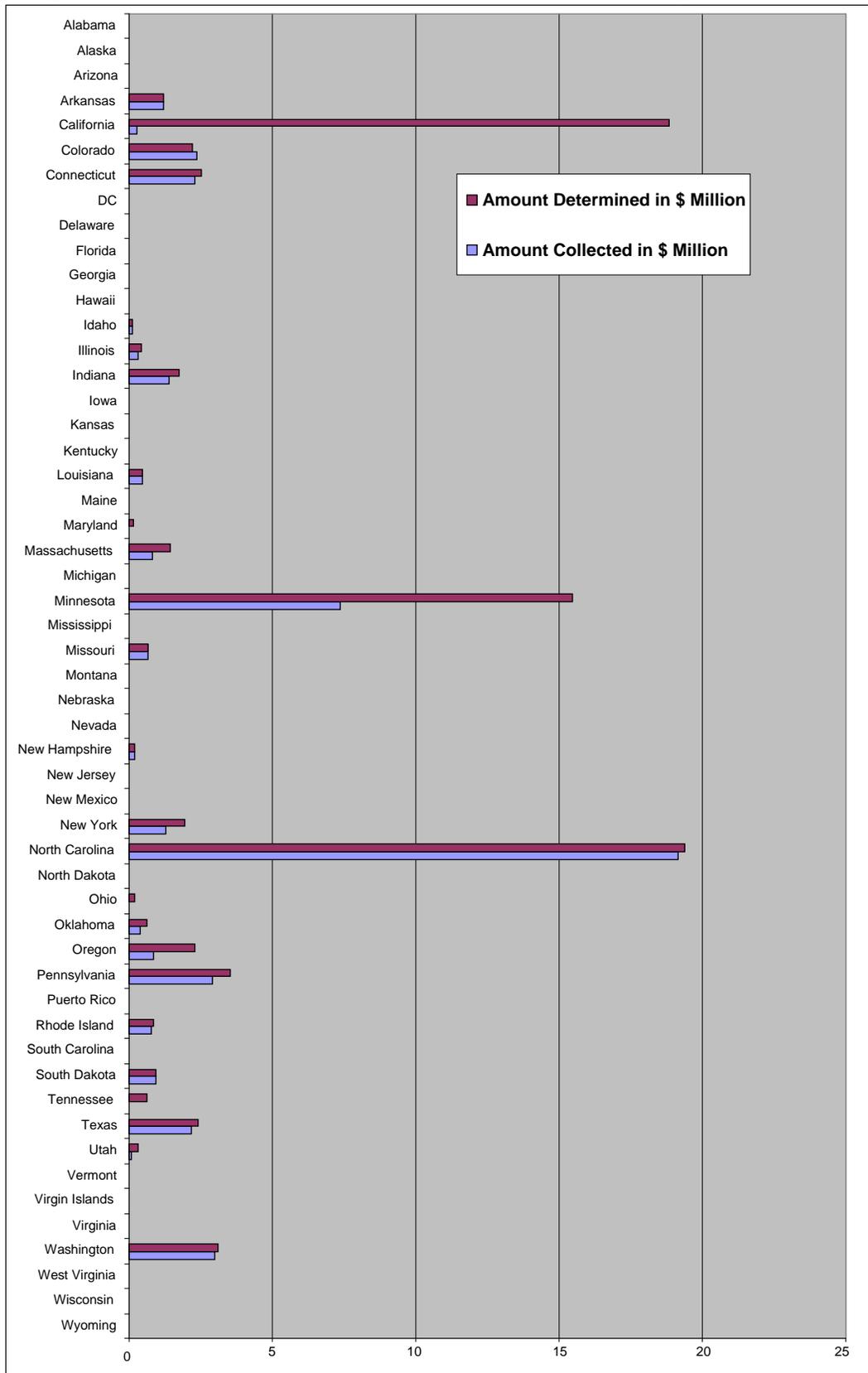
Although mandatory transfer cases are more numerous than prohibited cases, their average value is substantially less than the average value for prohibited transfer cases. See Table 3.4.

Table 3.4: Total Number of Violations and Average Dollars per Case

	# Violations	\$ Determined	Avg.\$/Case	\$ Recovered	Avg.\$/Case
Mandatory	775	\$81,659,156	\$105,367	\$48,978,195	\$63,198
Prohibited	12	\$20,639,180	\$1,719,932	\$3,478,704	\$289,892
Total	787	\$102,298,336	\$129,985	\$52,456,899	\$66,654

While several states reported fairly high collection rates, other states have been limited in the amounts they have been able to recover because of appeals and the inability to collect following affirmation of a determination of liability. Figure 3.8 shows amounts assessed and collected by the states.

Figure 3.8: Amounts Determined and Collected from Mandatory Transfer Cases



Determinations and Recoveries per Staff Year

The average amount of tax revenue recovered per staff dedicated to SUTA dumping implementation in the states was \$251,713, about four times the national cost of a tax staff year. Table 3.5 shows the average assessment and recovery by FTE staff.

Table 3.5: Average Assessments and Recoveries per Staffyear

	Total	Average \$ Determined Per FTE Staff	Average \$ Recovered Per FTE Staff
FTE Staff	208.40	\$490,875	\$251,713

Appeals

The Appeals Process

In most states, the UC law provides for two levels of hearings on liability determinations. The first hearing is usually held before a hearings officer appointed by the UC agency director or a state agency set up to provide fair hearings for several state agencies. The second appeal opportunity normally takes place before an appeals panel that is often independent of the UC agency. Appeals to court involve the legal department of the UC agency and may involve the office of the attorney general in the state. Appeals by employers cited for SUTA dumping violations will follow this route.

Appeals Activities and Results

Preliminary data provided by the states indicate a low volume of appeals activity nationwide. Thirteen states reported appeals to SUTA dumping determinations, but 25 of the 48 cases appealed by employers to date have originated in two states. UC agency determinations have been upheld at the first level of appeals at a rate of 89 percent. However, it is too early in the implementation process to form any conclusions about the results reported by states. See Table 3.6.

Table 3.6: Results of Appeals of SUTA Dumping Determinations and Assessments (53 States Reporting)

Appeals	Number of Cases	Decisions Issued	Determination Affirmed	Percent Affirmed
Lower Level	48	38	34	89%
Higher Level	10	9	7	78%
Court	4	4	4	100%

Summary

During the initial period following the enactment of state laws, most of the states successfully implemented an automated detection system. A total of 787 potential violations were identified and investigations were undertaken in about 22 percent of the cases. Sixteen states were unable to report any activity, either because they did not maintain the case processing data that was requested in this study or they had not undertaken any investigations. The overwhelming focus

has been on violations of the mandatory transfer provisions of Section 303(k), SSA. Overall \$102,298,336 has been assessed by 26 states and \$52,456,899 recovered. Liability determinations issued to employers after investigations have been upheld when challenged, for the most part, but appeals activity was very limited during the initial implementation period.

CHAPTER 4: IMPACTS OF SECTION 303(K), SSA, ON THE PROFESSIONAL EMPLOYER ORGANIZATION INDUSTRY

The study also examined experience rating in the Professional Employer Organization (PEO) industry as part of the broader review of tax avoidance activities by employers. The PEO industry primarily provides to owners and operators of small businesses (“client companies”) assistance with their fringe benefit programs, human resources functions, and payroll tax matters. The National Association of Professional Employer Organizations (NAPEO) estimates that 2.0–3.0 million workers in the U.S. are covered by PEO contracts.

After enactment of the SUTA Dumping Prevention Act, the Subcommittee on Human Resources of the House Ways and Means Committee conducted a hearing on its implementation.³¹ During this hearing, several members of the Subcommittee expressed interest in the relationship between PEOs and experience rating, and how state laws vary regarding the treatment of PEOs.

For purposes of the UC program, a matter of interest is whether the PEO is the employer or whether the individual client remains the employer. In some states, the client remains the employer for UC purposes. As explained in more detail below, other states allow the PEO to be considered the employer for UC purposes. In these states, the PEO generally receives one contribution rate annually, based on its UC experience in the state, and applies that rate to the taxable wages paid to all workers at client companies. Without the PEO, the client companies would have faced UC experience rates based on the claims experience of the individual company.

The sections that follow include a description of the PEO industry, a summary of state experience rating provisions that affect PEOs, a discussion of the financial impact of PEOs on state accounts in the unemployment trust fund and on the operations of UC agencies, the status of investigations into SUTA dumping law violations, and the initial impact of state laws required by Section 303(k), SSA, on the PEO industry.

Description of the PEO Industry

What Are PEOs?

Professional Employer Organizations, or PEOs, primarily provide owners and operators of small businesses assistance with their fringe benefit programs, human resources functions, and payroll tax matters. In return for a negotiated percent of total payroll, client companies receive payroll preparation services, Federal and state employment tax filing services, and assistance in implementing employee relations and employee fringe benefit programs. Most often, the workforce at the client company is also covered for health insurance, workers compensation, and unemployment insurance through the PEO. In some cases, the employees are also offered an opportunity to participate in 401(k) plans, buy disability insurance, and access other pre-tax benefits. PEOs primarily deliver services to small businesses. The survey of states conducted

³¹ The hearing was held on June 14, 2005. The transcript of the hearing is available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=3192>

for this research revealed average employee sizes at client companies ranging from 6 to 24 in the 13 states that provided data.

As noted above, for purposes of the UC program, a matter of interest is whether the PEO is the employer or whether the individual client remains the employer. Some states require that all workers of an employer, including any subsidiary, be reported under a single UC account number. Thus, PEOs are not permitted to group employees from clients in multiple UC tax accounts in these states, and they receive an experience rate based upon all client employees reported under the single account. Many states allow the PEO to be considered the employer of the workforces in their clients. Some states also permit subsidiaries of PEOs to be treated as employers for UC purposes. As a result, some PEOs register multiple subsidiary corporations with a state and obtain a UC tax account number for each subsidiary. According to industry representatives, these subsidiaries allow the PEO to group together clients with similar risk profiles, thus protecting clients from cost increases for UC or workers compensation that would result if they were grouped with higher cost clients.

Current Scope of PEO Operations in the States

The size of the PEO industry in the U.S. is difficult to measure because of the various methodologies used by states to identify and count PEOs operating within a state. For the purposes of this report, the PEO estimate is based on the employer count by state UC agencies. Table 4.1 shows the estimates of PEOs in the state made by the state UC agencies using available UC data. It should be noted that BLS, using its Quarterly Census of Employment and Wages (QCEW) reports a larger number of PEOs than reported in the survey used for this report.³²

In 1996, KRA Corporation published the results of a 1994 survey of 53 states (KRA, 1997). Twenty-four states provided estimates of the number of leased employees, who would now be described as being in a PEO arrangement, resulting in an estimated U.S. total of 608,198 workers. Twenty-nine states provided estimates of the number of employee leasing companies operating in their state in 1993. The U.S. total was estimated to be 3,665 firms.

These numbers are rising. Responding to the survey of State UC officials in May 2007, 45 UC agencies reported a total of 9,698 PEOs, even though eight states were unable to supply an estimate from their administrative records. Michigan, Florida, California, and Ohio reported the largest number of PEOs. The estimates by states are included in Table 4.1.

³² For example, BLS reported 13,648 PEOs for the 2006 calendar year. In the survey, Delaware reported no PEOs in the state because they do not recognize PEOs as the employer of any client worker. BLS methodology determined 16 such PEOs exist in Delaware.

**Table 4.1: State Estimates of the Number of PEOs Operating in 2007
(53 States Reporting)**

State	#	State	#	State	#	State	#	
Alabama	169	Illinois	300	Montana	36	Puerto Rico	65	
Alaska	42	Indiana	425	Nebraska	50	Rhode Island	173	
Arizona	INA*	Iowa	47	Nevada	147	South Carolina	65	
Arkansas	63	Kansas	436	New Hampshire	48	South Dakota	2	
California	819	Kentucky	100	New Jersey	114	Tennessee	262	
Colorado	504	Louisiana	187	New Mexico	INA	Texas	200	
Connecticut	30	Maine	52	New York	137	Utah	101	
Delaware	0	Maryland	190	North Carolina	125	Vermont	37	
District of Columbia	INA	Massachusetts	70	North Dakota	43	Virgin Islands	INA	
Florida	865	Michigan	1,480	Ohio	700	Virginia	INA	
Georgia	223	Minnesota	183	Oklahoma	INA	Washington	275	
Hawaii	4	Mississippi	INA	Oregon	111	West Virginia	INA	
Idaho	120	Missouri	304	Pennsylvania	165	Wisconsin	180	
						Wyoming	49	
							TOTAL	9,698

* INA is information not available.

State UC officials were asked in the 2007 SUTA dumping implementation survey to report the industries in their states that *most frequently* contracted with PEOs. Only 14 states (Florida, Colorado, Illinois, Kansas, Maine, Minnesota, Mississippi, Missouri, New Hampshire, New York, North Dakota, Tennessee, Utah, and Wyoming) were able to supply estimates of both client companies and their related workforces by industry. See Table 4.2.

**Table 4.2: Estimates of the Number of Client Companies and Related Workforces in Selected Industries that Most Frequently use the Services of PEOs
(14 States Reporting)**

Selected Industrial Sector	Number of Client Companies	Estimated Total Worksite Employees	Average Employees per Worksite
Health Care and Social Assistance	1,239	17,351	14
Construction	11,795	96,295	8
Real Estate	821	4,703	6
Manufacturing	931	17,501	19
Finance and Insurance	1,101	7,017	6
Administrative and Waste Services	661	11,635	18
Professional and Technical Services	1,657	20,343	12
Retail Trade	2,049	24,945	12
Wholesale Trade	58	408	7
Accommodation and Food Services	570	9,146	16
Transportation	229	1,476	6
Other Services	2,929	42,819	15
Leisure and Hospitality	1,953	35,527	18

Regulation of the PEO Industry by States

PEOs that employ staff who work within a state are required to register with the UC agency in order to pay contributions on their wages and maintain a UC account for claims purposes. As private businesses, PEOs also have to register with the secretary of state, the state tax department, and other agencies. However, some states also specifically require PEOs to register with an additional state agency in order to do business in that state. Within the seven states visited for this study, six of them require (by law or regulation) PEOs to register with an agency other than the UC agency. One state with substantial PEO activity, California, does not require this registration. Florida, New Hampshire, and Texas require both a license to operate as a PEO and registration. Results from the survey are included in Table 4.3

Table 4.3: Regulation of the PEO Industry in Site Visit States

State	Licensing Required	Registration Required beyond UC Account	UC Reporting: Client Company Lists Required	UC Reporting: Workers by Client/Worksite	UC Reporting: New Clients
California	No	No	No	No	No
Florida	Yes	Yes	Yes	Yes	Yes
Michigan	No	Yes	No	No	Yes
New Hampshire	Yes	Yes	Yes	Yes	Yes
Texas	Yes	Yes	Yes	No	No
Utah	No	Yes	Yes	Yes	No
Washington	No	Yes	No	No	No

Reporting Requirements of PEOs to the UC Agency

In response to the 2007 survey of UC officials, 34 states (Table 4.4) reported that they require special registration of PEOs as a condition for doing business.

**Table 4.4: States Requiring PEOs to Register with a State Agency other than the UC Agency as a Condition of Operating (2007)
(53 States Reporting)**

State		State		State		State	
Alabama	X	Illinois	X	Montana	X	Puerto Rico	X
Alaska	X	Indiana	X	Nebraska		Rhode Island	X
Arizona	X	Iowa		Nevada	X	South Carolina	X
Arkansas	X	Kansas		New Hampshire	X	South Dakota	
California		Kentucky	X	New Jersey	X	Tennessee	X
Colorado	X	Louisiana	X	New Mexico		Texas	X
Connecticut		Maine		New York	X	Utah	X
Delaware		Maryland		North Carolina	X	Vermont	X
District of Columbia		Massachusetts		North Dakota	X	Virgin Islands	X
Florida	X	Michigan	X	Ohio	X	Virginia	
Georgia	X	Minnesota	X	Oklahoma		Washington	X
Hawaii	X	Mississippi		Oregon	X	West Virginia	
Idaho		Missouri	X	Pennsylvania	X	Wisconsin	
						Wyoming	

PEOs in these states are required to register with agencies such as the Department of Insurance (North Carolina), the Department of Consumer Affairs (South Carolina), and the Department of

Commerce (Minnesota). They meet special reporting, financial, governance, and/or other compliance standards imposed specifically on PEOs. Failure to continue to meet those standards places a PEO's operation in that state at risk.

Unemployment Compensation Experience Rating and the PEO Industry

Determination of the Employer

States have generally taken three approaches to experience rating employers that enter into contracts with PEOs:

1. The PEO is treated as the employer of their clients' workforces for experience rating purposes once a contract is signed.
2. The PEO replaces the client company as the entity that is assigned a contribution rate only under very special circumstances.
3. The client company remains the employer for experience rating purposes, despite the existence of a contract with a PEO.

The May 2007 survey of 53 UC programs requested UC officials to report if the state recognizes (by law, regulation, or policy) the PEO as the employer of client company workforces for experience rating purposes and requires the PEO to pay contributions under its own UC tax number, based on its unemployment experience. The most common approach to experience rating, as reported by 36 states, is to consider the PEO as the employer of worksite employees for tax rate assignment purposes.

Table 4.5: States that Treat the PEO as the Employer for Experience Rating Purposes

State	By Statute	By Regulation, Rule, and/or Policy
Alabama	X	
Arizona	X	
Arkansas	X	
California		x
Colorado	X	
District of Columbia		x
Florida	X	
Georgia	X*	
Hawaii	X	
Idaho	X	
Illinois	X	X
Indiana		X
Kansas	X	
Louisiana	X*	
Maine	X	
Maryland		X
Michigan		X
Missouri	X	X
Montana	X	
Nevada	X	
New Hampshire	X	
New Mexico	X	
New Jersey	X	
New York	X	
North Carolina	X	
Ohio		X
Oklahoma	X	
Oregon		X
Puerto Rico	X	
Tennessee	X	
Texas	X	
Utah	X	X
Washington	X*	
West Virginia	X	
Wisconsin	X	
Wyoming	X	

* Georgia requires a bond in order for the PEO to be treated as the employer.
 * Louisiana law requires the PEO to purchase a \$100,000 surety bond in order to be recognized as the rated employer.
 * Washington State law will change effective January 1, 2008.

This treatment of PEOs by the UC system reflects an increase from the 1990s, when only 27 states reported that PEOs were treated as the employer (KRA, 1997). The geographic distribution of states in this category of treatment is broad, covering all regions in the U.S. Nine of the ten largest UC programs (in terms of subject employers) allow the PEO to become the employer for experience rating purposes. Pennsylvania is the only one of the ten largest states that does not treat the PEO as the employer.

In some states, special conditions have to exist in order for the UC program to recognize a PEO as the experience-rated entity. In Idaho, where the PEO and the client company are considered co-employers, the PEO becomes the liable employer only if the PEO elects to do so. California regards the PEO as the employer only when seven factors detailed in California Unemployment Insurance Code (CUIC) Section 606.5 are met. Michigan requires PEOs to meet the requirements of Administrative Rule 190, including not owning more than 20 percent of any client company, and retain the right to hire, fire and discipline workers. In Arkansas, bonded PEOs must report the workforce of new clients under the client’s account and rate for three consecutive years before reporting the workers under the PEO’s account. In Colorado, a PEO can report client workforces under its account number and rate *or* under the number and rate of the worksite employer.

In contrast, 17 (Table 4.6) states consistently treat the client company as the rated employer, despite the existence of a contract with a PEO. Contributions paid by the PEO on the taxable wages paid to workers at the client’s workplace are calculated at the client’s tax rate and credited to each client’s UC account number. Insofar as state law provides, benefits paid are charged to that same client account so that the liable employer is charged. This finding represents a measurable increase from the 1990s when from nine to 14 states (the exact number cannot be precisely determined) treated the client company as the employer (KRA, 1997).

Table 4.6: States that Treat the Client Company as the Employer for Experience Rating Purposes

State	By State Statute	By Regulation, Rule, and/or Policy
Alaska	X	
Connecticut	X	
Delaware	X	
Iowa	X	
Kentucky	X	
Massachusetts		X
Minnesota	X*	
Mississippi	X	
Nebraska	X	
North Dakota	X*	
Pennsylvania	X	
Rhode Island	X	
South Carolina	X	
South Dakota	X*	
Vermont	X	
Virgin Islands	X	
Virginia	X	
<p>* In Minnesota, for contracts enacted on or after January 1, 2006, PEOs are recognized as the employer, but they must report wages paid and pay contributions on behalf of each client company under a separate account for that client company and at a rate assigned to the client.</p> <p>* North Dakota's law became effective as of July 1, 2005.</p> <p>* South Dakota recognizes a PEO if the PEO has a legal right to control worksite employees and has an onsite supervisor.</p>		

The latest state to adopt this approach is Washington, which enacted legislation in April 2007. The new law, effective January 1, 2008, will require UC contributions to be paid on behalf of a

client company using the contribution rate assigned to the client company, based on its experience.

State Experience Rating Provisions Applied to PEOs and Clients

The 2007 SUTA dumping implementation survey requested data regarding the transfer of unemployment experience when companies enter into and exit from a PEO contract. Generally, responses from the states indicate that there is no attempt in the UC program to transfer experience when an employer decides to enter into the contract with a PEO.

In most of the 36 states where the PEO is treated as the employer for experience rating purposes, UC experience is not transferred when clients enter into or exit from a contract with a PEO. Movement from one PEO to another follows the same pattern. When a client company exits from a PEO contract and enters into a contract with another PEO, the client's UC experience established while under contract usually remains with the original PEO.

However, there are exceptions to the national pattern. Six states require experience attributable to the client company to be transferred from the PEO to the client when a contract ends. When a contract is signed in Maryland, Oklahoma, or Wyoming, the PEO is considered a successor to the client company and the unemployment experience is transferred to the PEO. In Indiana, a transfer of experience is required when a client company enters into or exits from a contract with a PEO. In Washington, when a contract is signed or severed, a predecessor/successor relationship is established and the employees involved are considered assets. Therefore, the unemployment experience must be transferred. In New Jersey, when a contract ends, if the PEO contract has been in effect for less than two years, the experience attributable to the client during the time period is transferred from the PEO to the client. In Idaho, the state requires transfer (total or partial) of a client company's UC experience to the PEO whenever a PEO elects to report a client under the PEO's account number. A transfer of experience is also required when the client company exits from the contract.

Assignment of a Contribution Rate

In states that usually treat the PEO as the employer of record, the management of the client company's UC account usually follows the practice used by most states when a company ceases operations and subsequently decides to reemploy a workforce. In 30 states, when a client company enters into a PEO contract, the client's UC account is immediately suspended if the client no longer pays any wages. If the client returns to the UC system as an employer within approximately two years, an experience rate is calculated and assigned if there is a basis in state law for doing so. However, if the client company returns beyond a period set by state UC law (usually two or three years), the company's unemployment experience is disregarded and the state's newly subject employer rate is assigned to the client.

Estimated Financial Impact of PEOs on State Accounts in the Unemployment Trust Fund and on Operations of the UC Agency

PEO Impacts on UC Benefit Financing and UC Administrative Costs

Under the experience rating requirements of the UC program nationwide, total unemployment trust fund revenues will, over time, be the same, with or without tax rate manipulation schemes. Benefit outlays in a state must be financed by a corresponding inflow of revenue (Vroman, 1990). However, in those states where the PEO is considered the employer, the share of the total contributions paid by the PEO industry versus other industries will be affected by both direct benefit charges and the magnitude of socialized costs. In Texas, California, Michigan and Florida, when a business contracts with a PEO, the unemployment experience of the client company is left behind. If the client company no longer pays wages, the account is treated the same as if it had ceased operations. Ineffective benefit charges attributable to that client company become socialized costs.

State UC officials differed in their perceptions of the impact of PEO operations on financing of the unemployment insurance program. Texas officials acknowledged that net additional contributions flow to the state's account in the unemployment trust fund when a PEO acquires a client in the third or fourth quarter of the calendar year or a client company re-enters the system as an employer in the second half of the year. However, other state officials believe net revenue to the state's account in the unemployment trust fund could actually decrease over time in this situation when the PEO enjoys a lower tax rate than the recently acquired client company. California officials do not believe there are significant additional contributions paid as a result of a PEO having to pay contributions on the same wage base because most PEO contracts start in the first calendar quarter. Michigan UC officials did not provide estimates of the effects of PEOs on total revenue in the state's account in the unemployment trust fund.

PEO representatives nationwide present a different picture of the impact of PEOs on the solvency of state accounts in the unemployment trust fund. PEOs maintain that they are minimizing the number of claims improperly paid by agencies; that they are carefully managing UC claims and that they use effective human resources policies to reduce employee separations. Further they maintain that many client companies encounter higher UC tax costs upon contracting with a PEO. For example, the National Association of Professional Employer Organizations (NAPEO) representatives argued that the inability of PEOs to take credit for contributions paid earlier in a calendar year results in substantial additional flow of revenue to state accounts in the unemployment trust fund (Ernst and Young, 2006).³³ However, PEO industry representatives acknowledged during site visits that the majority of new clients are placed under contract in the first quarter of the calendar year.

³³This study references the executive summary of and the Ernst and Young report findings to help evaluate the state treatment of PEOs in Michigan and Florida. Neither Florida nor Michigan requires the transfer of experience, including credits toward the taxable wage base, when the client enters a PEO relationship. However, it should be noted that other states do require the transfer of experience when a client enters into a PEO relationship, or when a client workforce moves from one PEO to another. In this scenario, the PEO would be credited with payments made to the taxable wage base

Industry representatives and UC officials were unable to provide certain data on the impact of PEOs on administrative costs. PEO industry representatives stressed the administrative savings accruing to states when PEOs file for multiple businesses. Additionally, having a central site for auditors should result in costs savings. They also assert an improvement in tax compliance by client companies.

UC officials in Texas and Michigan estimated some savings in billing, cash management, report processing, and collections activities. However, they pointed to burdensome tasks associated with re-establishing tax accounts when a PEO ceases operations and cautioned that not all PEOs have good histories of providing timely and accurate reports. California officials were unable to quantify any administrative savings realized when a PEO reports multiple client accounts under one PEO account number. However, California's Employment Development Department (EDD) officials expressed concern about the agency's ability to set up and administer thousands of new employer accounts if PEOs accelerate the recent trend toward disaggregation of UC accounts. Officials maintain that current resources at EDD are not adequate for taking on this workload.

Prevention of SUTA Dumping: PEO Case Violations Detected and Investigated Since the Enactment of Section 303(k), SSA, and Implementation of Related State Laws

State UC officials (California, Florida, Michigan, and Texas) interviewed in 2006 reported the following illegal rate manipulation practices:

- Creation of new PEO accounts to escape a high tax rate assigned to an existing PEO due to substantial benefit charges
- Acquisition of an existing business with a low tax rate, followed by a transfer of workforces from client companies to the newly acquired entity
- Transfer of client company workforces among existing PEO subsidiary corporations so that taxable wages can be reported under the account number with the lowest tax rate

All four states visited in 2006 were dealing with the initial implementation of changes in the law due to Section 303(k), SSA. As a result, compliance and enforcement activities described to the research team focused almost exclusively on PEO industry behavior **prior to** passage of Federal and state legislation designed to deter and detect rate manipulation schemes. Therefore, it is too early to determine whether Section 303(k), SSA, and the corresponding state laws, have effectively curbed or eliminated the rate manipulation schemes described above.

Industry Concentration of SUTA Dumping Cases Currently under Investigation

Previous studies of tax rate manipulation schemes found a concentration of state investigations in the construction, employee leasing, and hospitality industries (ETA, 2002). Thirty states, responding to the survey in May 2007, reported finding violations of the new law. Fifteen other states reported no violations and eight states were unable to respond to the survey request.

Of the 30 states with violations, 17 were able to report violations by industry. These 17 states indicated that 45 percent of the cases under investigation come from the construction, employee leasing and hospitality industries.

Table 4.7: SUTA Dumping Investigations by States in Certain Industries Since the Enactment of State Laws Required by Section 303(k), SSA (17 States Reporting)

Selected Industrial Sector	NAICS Code	Mandatory Transfer Cases	Prohibited Transfer Cases
Construction	236, 237, 238	116	0
Employee Leasing	56133	44	5
Hospitality	721	34	0
Other Industries		320	7
Total		514	12

In these 17 states, PEOs represented nine percent of the 526 case investigations undertaken during the initial implementation of SUTA dumping prevention legislation.

Principal Findings

Based on reports from the 53 states of their implementation of the SUTA dumping detection requirements, the following findings are offered:

- A. Thirty-six states (UC programs) allow the PEO to be treated as the employer. The other 17 UC programs require the PEO to pay UC contributions under each client company’s account number and at the tax rate assigned to the client, based on its unemployment experience.
- B. Thirty-four states require PEOs to register with a state agency other than the UC agency.
- C. Preliminary state data revealed that 44 PEOs had been found in violation of the law. The PEO industry total represented nine percent of the mandatory transfer violations of Section 303(k), SSA, that were found in the 17 states that reported on the industry of the violators.
- D. Generally, state UC experience rating requirements do not require the transfer of unemployment experience when a client signs a contract with a PEO, moves from one PEO to another, or exits from a contract and establishes a UC tax account.

CHAPTER 5: FINDINGS AND CONCLUSIONS

State Implementation of Section 303(k), SSA

Effectiveness of Implementation by the States

All 50 states, the Virgin Islands, Puerto Rico, and the District of Columbia enacted conforming legislation that became effective in either 2005 or 2006. Twenty-eight states (53 percent) reported that they were *very satisfied* with the provisions of their state SUTA dumping laws and 23 others reported that they were *generally satisfied*. Forty-five states reported that the environment for detection, investigation, and enforcement of SUTA dumping laws has improved since the enactment of section 303(k), SSA. Not only has the enactment of the Federal law raised the awareness of employers regarding the illegality of SUTA dumping activities, it has also raised the level of attention state UC agency employees give to this issue. Also, 44 states reported that using resources to detect and prevent SUTA dumping has constituted a worthwhile investment and has served to improve the integrity of the UC tax system.

The new detection tools made available by ETA have enabled most states to efficiently identify shifts in workforces among registered employing units for the first time. Forty-four states have implemented the automated detection software developed by North Carolina, and other states have invested resources to develop a system that will serve their needs.

States have dedicated an average of almost four staff years to implement their laws, principally by reallocating existing staff to this task. Most states have centralized SUTA dumping activities in this early phase of implementation and some of the larger states have assigned full-time staff to the function. A substantial staff training effort has already taken place and states have identified additional training needs.

Most states have begun to analyze the results of their quarterly detection runs and to assign cases for investigation. The 1,640 investigations that have been undertaken have yielded over \$102 million in assessments during the time period of this study. Twenty-two states have collected an additional \$52,456,899 in UC taxes. The majority of states have focused on violations of the “mandatory transfer” provisions of Section 303(k), SSA; however, additional taxes of \$3,478,704 have been collected from cases that violated the “prohibited transfer” portion of the Act. Some of the large states are still devoting considerable resources to investigating and pursuing SUTA dumping activities that occurred prior to the passage of Section 303(k) of the Social Security Act.

Barriers to Effective Implementation of State Laws

Forty-nine states identified a lack of adequate financial and staffing resources as a barrier to effective implementation of Section 303(k), SSA, and 41 of those reported it as the greatest barrier to enforcement. Most states diverted staff from other assignments to implement SUTA dumping detection and enforcement activities.

Lack of access to information technology (IT) resources was the second highest barrier noted, with 36 percent of the states citing access to IT as a barrier. Complications involving legal and procedural issues were cited as barriers in approximately 30 percent of the responses

Need for Additional Federal Legislation and/or Other Federal Action

Twenty-three states (43 percent) indicated that additional Federal legislation and/or other action [Unemployment Insurance Program Letter (UIPL/Federal Regulations, etc.)] is needed to improve the effectiveness of SUTA dumping detection, prevention, and enforcement. States were asked to identify additional actions that should be taken to prevent SUTA dumping; they consider Federal action to be most appropriate in the following areas:

1. Massachusetts and Oregon responded that more prescriptive language should be provided at the Federal level defining what constitutes “knowing” violations and “misrepresentation” in order to trigger penalties. They believe that current law has shown limited success in the ability to prove intent in order to impose penalties
2. Montana, Ohio, Puerto Rico, Utah, and Washington responded that consideration should be given to requiring the disclosure of information between and among states when employers have accounts in neighboring states; this disclosure would help to eliminate “state line jumping.”
3. In response to the survey, 13 states indicated that Federal clarification is needed regarding the role of PEOs and their status. Six states (Montana, North Dakota, New York, South Carolina, Tennessee, and Virginia) expressed the opinion that Federal legislation is needed to make the handling of PEOs more uniform. One state, Colorado, believes that the PEO should be the reporting entity and all tax reports should be submitted under the PEO account number. Six states (Idaho, Iowa, Michigan, Minnesota, Ohio, and Missouri) believe that the client company should be considered the employer and all tax reports should be submitted under the client account number. Michigan and New York both stated that unemployment experience should be transferred between a client company and a PEO when entering and exiting a contractual relationship
4. One state, California, indicated that Federal legislation was needed to require that monetary penalties, derived from SUTA dumping cases, be prohibited from being added to the employer’s reserve account balance in “reserve ratio” experience rating states. Without such a prohibition, this amounts to converting a penalty into a contribution to the employer’s reserve account.

Need for Technical Assistance and/or Training

Almost all states have indicated a need for additional training. Listed below are the training needs identified:

- Strategies for more effectively using SDDS software
- General overview and updates on SUTA dumping prevention, detection and enforcement implementation

- Successful detection and investigation techniques and practices
- Preparation for hearings and subsequent appeals

States most often cited a need for both technical assistance and training in the use and implementation of the NC SDDS. The expertise of staff assigned to use the SDDS varies significantly. Therefore, it is essential that timely, effective technical assistance be provided. To that end, ETA has facilitated two user group conference calls to provide updates on the current status of work in progress and proposed short-term and long-term projects.

Impacts of Section 303(k), SSA on Professional Employer Organizations

Based on reports from the 53 states of their implementation of the SUTA dumping detection requirements, the following findings are offered:

- A. Thirty-six states (UC programs) allow the PEO to be treated as the employer. The other 17 UC programs require the PEO to pay UC contributions under each client company's account number and at the tax rate assigned to the client, based on its unemployment experience.
- B. Thirty-four states require PEOs to register with a state agency other than the UC agency.
- C. Preliminary state data revealed that 44 PEOs had been found in violation of the law. The PEO industry in total represented nine percent of the mandatory transfer violations of Section 303(k), SSA, found in the 17 states that reported on the industry of the violators.
- D. Generally, state UC experience rating requirements do not require the transfer of unemployment experience when a client signs a contract with a PEO, moves from one PEO to another, or exits from a contract and establishes a UC tax account.
- E. UC tax treatment of PEOs under individual state laws has remained largely unchanged to date. No new regulatory burden has been promulgated as a result of Federal or state SUTA dumping legislation. The PEO industry continues to expand. Subsequent research will be required to determine whether Section 303(k), SSA, and the corresponding state laws, have effectively curbed or eliminated the rate manipulation schemes described by state UC officials.

BIBLIOGRAPHY

Bureau of Labor Statistics. *Quarterly Census of Employment and Wages*.
<http://stats.bls.gov/cew/peoplebox.htm#6>.

Ernst and Young. *Impacts of Professional Employer Organizations on State Unemployment Taxes*. Prepared for the National Association of Professional Employer Organizations. June 1, 2006.

KRA Corporation. *Employee Leasing: Implications for State Unemployment Insurance Programs*. Unemployment Insurance Occasional Paper 97-1, U. S. Department of Labor, Employment and Training Administration, 1997.

Michigan Department of Labor and Economic Growth, Unemployment Insurance Agency. *State Unemployment Tax Act (SUTA) Dumping Annual Report*, January 2006.

NAPEO Website. <http://www.napeo.org/peoindustry/industryfacts.cfm> (accessed on March 6, 2007).

Texas Labor Code, Subtitle E. Regulations of Certain Occupations, Chapter 91. Staff Leasing Services, Subchapter A. General Provisions, section 91.001.

U. S. Census Bureau. 2002. NAICS Definitions. <http://www.census.gov/cgi-bin/epcd/srchnaics02defs>.

U. S. Department of Labor, Employment and Training Administration. Unemployment Insurance Program Letter No. 34-02, August 9, 2002.

Vroman, Wayne. *Unemployment Insurance Trust Fund Adequacy in the 1990s*. Kalamazoo: W. E. Upjohn Institute, 1990.

APPENDIX A: SUTA DUMPING PREVENTION ACT OF 2004

TEXT OF P.L. 108-295

An Act

To amend titles III and IV of the Social Security Act to improve the administration of unemployment taxes and benefits.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the 'SUTA Dumping Prevention Act of 2004'.

SEC. 2. TRANSFER OF UNEMPLOYMENT EXPERIENCE UPON TRANSFER OR ACQUISITION OF A BUSINESS.

(a) IN GENERAL-Section 303 of the Social Security Act (42 U.S.C. 503) is amended by adding at the end the following:

`(k)(1) For purposes of subsection (a), the unemployment compensation law of a State must provide--

`(A) 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,

`(B) that unemployment experience shall not, by virtue of the transfer of a business, be transferred to the person acquiring such business if--

`(i) such person is not otherwise an employer at the time of such acquisition, and

`(ii) the State agency finds that such person acquired the business solely or primarily for the purpose of obtaining a lower rate of contributions,

`(C) that unemployment experience shall (or shall not) be transferred in accordance with such regulations as the Secretary of Labor may prescribe to ensure that higher rates of contributions are not avoided through the transfer or acquisition of a business,

`(D) that meaningful civil and criminal penalties are imposed with respect to--

`(i) persons that knowingly violate or attempt to violate those provisions of the State law which implement subparagraph (A) or (B) or regulations under subparagraph (C), and

`(ii) persons that knowingly advise another person to violate those provisions of the State law which implement subparagraph (A) or (B) or regulations under subparagraph (C), and

`(E) for the establishment of procedures to identify the transfer or acquisition of a business for purposes of this subsection.

`(2) For purposes of this subsection--

`(A) the term 'unemployment experience', with respect to any person, refers to such person's experience with respect to unemployment or other factors bearing a direct relation to such person's unemployment risk;

- `(B) the term `employer' means an employer as defined under the State law;
- `(C) the term `business' means a trade or business (or a part thereof);
- `(D) the term `contributions' has the meaning given such term by section 3306(g) of the Internal Revenue Code of 1986;
- `(E) the term `knowingly' means having actual knowledge of or acting with deliberate ignorance of or reckless disregard for the prohibition involved; and
- `(F) the term `person' has the meaning given such term by section 7701(a)(1) of the Internal Revenue Code of 1986.'

(b) STUDY AND REPORTING REQUIREMENTS-

(1) **STUDY-** The Secretary of Labor shall conduct a study of the implementation of the provisions of section 303(k) of the Social Security Act (as added by subsection (a)) to assess the status and appropriateness of State actions to meet the requirements of such provisions. (2) **REPORT-** Not later than July 15, 2007, the Secretary of Labor shall submit to the Congress a report that contains the findings of the study required by paragraph (1) and recommendations for any Congressional action that the Secretary considers necessary to improve the effectiveness of section 303(k) of the Social Security Act.

(c) **EFFECTIVE DATE-** The amendment made by subsection (a) shall, with respect to a State, apply to certifications for payments (under section 302(a) of the Social Security Act) in rate years beginning after the end of the 26-week period beginning on the first day of the first regularly scheduled session of the State legislature beginning on or after the date of the enactment of this Act.

(d) DEFINITIONS- For purposes of this section--

- (1) the term `State' includes the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands;
- (2) the term `rate year' means the rate year as defined in the applicable State law; and
- (3) the term `State law' means the unemployment compensation law of the State, approved by the Secretary of Labor under section 3304 of the Internal Revenue Code of 1986.

SEC. 3. USE OF NEW HIRE INFORMATION TO ASSIST IN ADMINISTRATION OF UNEMPLOYMENT COMPENSATION PROGRAMS.

Section 453(j) of the Social Security Act (42 U.S.C. 653(j)) is amended by adding at the end the following:

`(8) INFORMATION COMPARISONS AND DISCLOSURE TO ASSIST IN ADMINISTRATION OF UNEMPLOYMENT COMPENSATION PROGRAMS-

`(A) IN GENERAL- If, for purposes of administering an unemployment compensation program under Federal or State law, a State agency responsible for the administration of such program transmits to the Secretary the names and social security account numbers of individuals, the Secretary shall disclose to such State agency information on such individuals and their employers maintained in the National Directory of New Hires, subject to this paragraph.

`(B) CONDITION ON DISCLOSURE BY THE SECRETARY- The Secretary shall make a disclosure under subparagraph (A) only to the extent that the Secretary determines that the disclosure would not interfere with the effective operation of the program under this part.

`(C) USE AND DISCLOSURE OF INFORMATION BY STATE AGENCIES-

`(i) IN GENERAL- A State agency may not use or disclose information provided under this paragraph except for purposes of administering a program referred to in subparagraph (A).

`(ii) INFORMATION SECURITY- The State agency shall have in effect data security and

control policies that the Secretary finds adequate to ensure the security of information obtained under this paragraph and to ensure that access to such information is restricted to authorized persons for purposes of authorized uses and disclosures.

`(iii) PENALTY FOR MISUSE OF INFORMATION- An officer or employee of the State agency who fails to comply with this subparagraph shall be subject to the sanctions under subsection (l)(2) to the same extent as if such officer or employee was an officer or employee of the United States.

`(D) PROCEDURAL REQUIREMENTS- State agencies requesting information under this paragraph shall adhere to uniform procedures established by the Secretary governing information requests and data matching under this paragraph.

`(E) REIMBURSEMENT OF COSTS- The State agency shall reimburse the Secretary, in accordance with subsection (k)(3), for the costs incurred by the Secretary in furnishing the information requested under this paragraph.'

APPENDIX B: LEGISLATION

Appendix B-1: Legislation

State	Date Law Enacted	Effective Date of Law	Mandatory Transfer	Prohibited Transfer
Alabama	08/05/2005	08/05/2005	Sec. 25-4-8(c)(1)	Sec.25-4-8(c)(2)
Alaska	05/18/2006	01/01/2006	Sec. 23.20.297(a)(1)	Sec. 23.20.297(a)(2)
Arizona	04/22/2005	08/11/2005	Sec.23-733.01(A)	Sec.23-733.01(B)
Arkansas	03/17/2005	03/17/2005	Sec.11-10-723(a)(1)	Sec.11-10-723(b)
California	09/28/2004	01/01/2005	Sec.1061(a)(1)&(a)(2)	Sec.1052
Colorado	05/25/2005	01/01/2006	Sec.104(2)(b)	Sec.104(l)(c)
Connecticut	06/2/2005	01/01/2006	Sec.31-223b.(c)	Sec.31-223b.(b)
Delaware	07/12/2005	01/01/2006	Sec.3353(1)	Sec.3353(2)
District of Columbia	03/23/2006	01/01/2006	D.C. Official CodeSec.51-103(3)(n)(1)	D.C. Official Code Sec.51-103(3)(n)(2)
Florida	06/10/2005	07/01/2005	Sec.443.131(3)(g)(1)(a)	Sec443.131(3)(g)(2)
Georgia	05/10/2005	07/01/2006	Sec.34-8-153(g)(1)	Sec.34-8-153(g)(2)
Hawaii	06/09/2005	06/09/2005	Sec.383-66(b)(1)	Sec.383-66(b)(2)
Idaho	02/18/2005	07/01/2005	Title 72-1351A(1)(a)	Title 72-1351A(2)
Illinois	07/21/2005	01/01/2006	820 ILCS 405/Sec.1507.1(A)(1)	820 ILCS 405/Sec.1507.1(B)
Indiana	04/26/2005	01/01/2006	Chapter 11.5-7(a)(b)(c)	Chapter 11.5-8(a)(1)&(2)
Iowa	05/03/2005	07/01/2005	Sec.96.7(2)(b)(2)	Sec.96.7(2)(b)(3)
Kansas	04/15/2005	01/01/2006	Chapter 44- Article 710a.(b)(1)(A)	Chapter 44- Article 710a.(b)(B)(3)
Kentucky	03/02/2005	06/20/2005	Chapter 341.540(2)	Chapter 341.540(6)(b)
Louisiana	07/01/2005	08/15/2005	RS 23:1539.1(B)(1) & RS 23:1539.1(E)	RS.23:1539.1(B)(2)
Maine	05/18/2005	06/29/2005	Sec.1221 5(A)A(1)	Sec.1221 5(A)B
Maryland	05/26/2005	01/01/2006	Sec.8-631(e)(1)	Sec.8-613(c)
Massachusetts	11/22/2005	01/01/2006	Chapter 151A, Sec14N(a)	Chapter 151A, Sec.14(N)(b)(1)
Michigan	05/04/2005	07/01/2005	Sec.421.22(b)(2)(a)	Sec.421.22(b)(2)(b)
Minnesota	05/26/2005	08/01/2005	Sec.268.051 Subdivision 4(a)(1)&2 and (b)(1)and (2)	Sec.268.051 Subdivision 4a(a)(3)
Mississippi	03/16/2005	01/01/2005	Sec.71-5-355(3)(a)(1)	Sec.71-5-355(3)(b)
Missouri	07/06/2005	01/01/2006	Sec.288.110.2	Sec.288.110.3
Montana	04/28/2005	01/01/2006	Sec.39-51-1219(1)(a)	Sec.39-51-1219(5)(a)(i) and (ii)
Nebraska	06/02/2005	01/01/2006	48-654.01(2)(a)	48-654.01(2)(b)
Nevada	05/19/2005	01/01/2006	612.550.9(a)	612.550.9(c)
New Hampshire	07/14/2005	01/01/2006	282-A:91-a(l)(a)(1)	282-A:91-a(l)(b)
New Jersey	12/18/2005	12/15/2005	43:21-7(c)(7)(D)	43:21-7(c)(7)(F)

State	Date Law Enacted	Effective Date of Law	Mandatory Transfer	Prohibited Transfer
New Mexico	04/06/2005	09/18/2005	51-1-11(H)(4)	51-1-11(H)(5)
New York	08/02/2005	01/01/2006	581.7(a)(1)	581.7(b)
North Carolina	09/20/2005	12/01/2006	G.S.96-9(c)(4)(a)(1) and (2)	G.S.96-9(c)(4)a
North Dakota	04/25/2005	07/01/2005	52-04-08.2.1(a)	52-04-08.2.2
Ohio	06/02/2005	9/05/2005	Sec.4141.24(G)(1)	Sec.4141.24(G)(2)
Oklahoma	05/16/2005	11/01/2005	Sec.40-3-111.1(A)(1)	Sec.40-3-111.1(A)(2)
Oregon	05/13/2005	01/01/2006	Sec.657.480(1)	Sec.657.480(2)(a)
Pennsylvania	06/15/2005	01/01/2006	Sec.301(d)(1)(B)	Sec.301(d)(1)(A)
Puerto Rico	09/16/2005	07/01/2005	Law74,Sec.8(g)(1)(A)	Law74,Sec.8(g)(2)
Rhode Island	07/15/2005	01/01/2006	Sec.28-43-35(a)	Sec.28-43-35(c)
South Carolina	05/03/2005	05/03/2005	Sec.41-31-125(A)	Sec.41-31-125)B)(1)(2)&(3)
South Dakota	02/15/2005	02/15/2005	Sec.61-5-32.1(1)	Sec.61-5-32.1(2)
Tennessee	06/07/2005	01/01/2006	Sec.50-7-403(b)(2)(C)	Sec.50-7-403(b)(2)(D)
Texas	06/18/2005	09/01/2005	Sec.204.083	Sec.204.084(f)
Utah	03/01/2005	03/01/2005	Sec.35A-4-304(3)(a)	Sec.35A-4-304(4)(a)
Vermont	06/07/2005	07/01/2005	Sec.21.1325(d)(1)	Sec.21.1325(d)(2)
Virginia	03/21/2005	01/01/2006	Sec.60.2-536.1(A)	Sec.60.2-536.1(B)(1)
Virgin Islands	09/08/2005	01/01/2006	Title 24,Chapter 12,Sec.309(1)(i)(2)A)	Title 24,Chapter 12,Sec.309(1)(i)(3)
Washington	03/14/2006	01/01/2006	RCW 50.29.062(2)(b)(ii)	RCW 50.29.063(1)
West Virginia	09/28/2005	09/28/2005	21A-5-10c(a)(1)	21A-5-10c(b)
Wisconsin	12/28/2005	01/01/2006	Sec.108.16(8)(e)1	Sec.108.16(8)(im)
Wyoming	03/02/2005	07/01/2005	Sec.27-3-507(c)	Sec.27-3-507(e)

Appendix B-2: Penalty Legislation

State	Civil Penalties	Criminal Penalties	Knowingly Violated Law
Alabama	Sec.25-4-8(c)(3)(a)(1) and 2	Sec.25-4-8(c)(3).b(iv)	Sec.25-4-8(c)(3).b(i)
Alaska	Sec. 23.20.297 (b)(1) and (2) and (c)	Sec. 3.20.299(b)(c)(d)&(e)	Sec.23.20.310(9)
Arizona	Sec.23-733.01(C)(1)	Sec.23-733.01(C)(3)	Sec.23-733.01(G)(1)
Arkansas	Sec. 11-10-723(c)(1)	Sec.11-10-723(c)(6)(A)	Sec.11-10-723(4)
California	Sec.977(c)	Sec.2101.06(a)&(b)	Sec.977(c)
Colorado	Sec.104(10)(a)	Sec.104(10)(d)	Sec.104(11)(a)
Connecticut	Sec.31-223b(d)&. (d)(1)&(d)(2)	Sec.3-223b.(e)	Sec.31-223b.(a)(1)
Delaware	Sec.3353(3)a.1&2	Sec.3353(3)a.2.d	Sec.3353(3)a.2.b
District of Columbia	D.C. Official Code Sec.51-104(4)(P)(2)A)&(B)	D.C. Official Code Sec.51-104(4)(P)(3)	D.C. Official Code Sec.51-104(4)(P)(1)(A)
Florida	Sec.443.131(3)(g)(3)&(3)(g)(3)(a)&(3)(g)(3)(b)	Sec.443.131(3)(g)(5)	Sec.443.131(3)(g)(4)(a)
Georgia	Sec.34-8-153(h)(1)	Sec.34-8-153(h)(6)	Sec.34-8-153(h)(2)
Hawaii	Sec.383-66(b)(3)(A)	Sec.383-66(b)(7)	Sec.383-66(b)(6)(A)
Idaho	Title 17-1351A(3)(a)(i)-(iv)&(3)(b)(ii)	Title 72-1351A(4)	Title 72-1351A(5)(b)
Illinois	820 ILCS 405/Sec.1507.1(C)&.1(C)(1) &.1(C)(2)&.1(D)	820 ILCS 405/Sec.1507.1(E)	820 ILCS 405/Sec.1507.1(G)
Indiana	Chapter 11.5-9(a)&(b)(1)&(2)(A)(B)	Chapter 11.5-10	Chapter 11.5-6(1)
Iowa	Sec.96.16(5)	Sec.96.16(5)	Sec.96.16(5)
Kansas	Chapter 44-Article 719(f)(1)(A) & (B)	Chapter44-Article 719(f)(4)(B)	Chapter 44-Article 719(f)(2)
Kentucky	Chapter 341-540(7) & Chapter 341.999(9)	Chapter 341.540(8)	Chapter 341-540(1)(c)
Louisiana	RS 23:1539.1(C) & .1(C)(2)	RS 23:1539.1(D)	RS 23:1539.1(A)(1)
Maine	Sec.1221 5(A)(C)&5(A)C(1)	Sec.12215(A)(C)	Sec.1221 5(A)D(1)
Maryland	Sec.8-614(c)&(d) & (c)(1)	Sec.8-614(f)&(g))	Sec.8-614(a)(2)
Massachusetts	Chapter 151A, Sec.14N(g)(1) & (g)(1)(i) and (iii) & (g)(1)(ii)and(iii)	Chapter 151A, Sec.47	Chapter 151A, Sec.14N(g)(2)
Michigan	Sec.421.22b(2)(c)(i)(A)(B) and (ii)	Sec.421.22b(2)(c)	Sec.421.22b(5)(a)
Minnesota	Sec.268.184 Subdivision 1a.(a)(b)(c)	Sec.268.184 Subdivision 2.(1)(2) and (3)	Not Defined
Mississippi	Sec.71-5-355(3)(c)(i)	Sec.71-5-355(3)(c)(iv)	Sec.71-5-355(3)(c)(ii)
Missouri	Sec.288.110.4(1)	Sec.288.110.4(2)	Sec.288.110.5(2)
Montana	Sec. 39-51-1219(7)&(7)(a)&7(b)	Sec. 39-51-1219(7)(c)	Sec. 39-51-1219(8)(a)
Nebraska	48-654.01(3)(a)	48-654.01(3)(b)	48-654.01(1)(a)
Nevada	612.732(2) and (3)	612.730.1 and 2	612.732(6)(b)

State	Civil Penalties	Criminal Penalties	Knowingly Violated Law
New Hampshire	282-A:91-a(l)(f)(1)&a(l)(f)(1)(A)&a(l)(f)(1)(B)	282-A:91-a(l)(f)(1)(B)(2)	282-A:91-a(l)(h)(1)
New Jersey	43:21-16(b)(3)	43:21-16(e)(2)	43:21-16(b)(3)&(e)(2)
New Mexico	51-1-11(H)(8)	51-1-11(H)(8)	51-1-11(H)(1)(f)
New York	581.7(c)(1) and (2)	581.7(c)(2)	581.7(1)(c)(3)
North Carolina	105-236(2)(6)	105-236(a)(7),(9),(9a)	G.S.96-8(28)
North Dakota	52-04-08.2.3	52-04-08.2.4	52-04-001.3
Ohio	Sec.4141.48(C)	Sec.4141.99(F)	Sec.4141.48(G)(1)
Oklahoma	Sec.40-3-111.1(B)(1)	Sec.40-3-111.1(B)(4)	Sec.40-3-111.1(B)(2)
Oregon	Sec.657.480(3)(a) and (b)	Sec.657.990(3)	Sec.657.480(3)(c)
Pennsylvania	Sec.802.1(a)(2)-(4)	Sec.802(a)(1)	Sec.802(d)
Puerto Rico	Law74,Sec.15(c)	Law74,Sec.15(b)	Law74,Sec.8(a)(12)
Rhode Island	Sec.28-43-35(d)&(d)(i)&(d)(ii)	Sec.28-43-35(d)(4)	Sec.28-43-35(d)(2)
South Carolina	Sec.41-31-125(D)	Sec.41-41-30	Sec.41-31-125(D)
South Dakota	Sec.61-5-32.2	Sec.61-5-32.2	Sec.61-5-32.2
Tennessee	Sec.50-7-403(b)(2)(G)	Sec.50-7-403(b)(2)(G)(III)	Sec.50-7-403(b)(2)(H)(i)
Texas	Sec.204.087(a)&(b)&(c)	Sec.204.087(e)	Sec.204.081(6)
Utah	Sec.35A-4-304(5)(a)	Sec.35A-4-304(5)(b)(i)	Sec.35A-4-304(1)(a)
Vermont	Sec.21.1325(d)(3)&(d)(3)(A)&(d)(3)(B)	Sec.21.1325.(d)4(C)	Sec.21.1325(d)4(B)
Virginia	Sec.60.2-536.3(A)	18.2-204.3(A)	Sec.60.2-536.5
Virgin Islands	Title 24,Chapter 12,Sec.309(1)(i)(4)(A)	Title 24, Chapter 12,Sec.309(1)(i)(4)(D)	Title 24, Chapter 12,Sec.309(1)(i)(4)(B)
Washington	RCW 50.29.063(2)	RCW 50.29.063(2)(b)	RCW 50.29.063(4)(a)
West Virginia	21A-5-10c(c)(1)	21A-5-10c(c)(4)	21A-5-10c(c)(2)
Wisconsin	Sec.108.16(8)(m)	Sec.108.16(8)(m)(3)	Sec.108.16(8)(m)
Wyoming	Sec.27-3-706(a)	Sec.27-3-706(a)(iii)	Sec.27-3-706(a)

Appendix B-3: Miscellaneous Legislative Provisions

State	Detection Procedures	Definition of Person	Interpretation
Alabama	Sec.25-4-8(c)(3).b(iv)	Sec.25-4-8(c)(3).b(iii)	Sec.25-4-8(c)(3).b(iv)
Alaska	Sec.23.20.310	Not defined	Sec. 23.20.297(d)
Arizona	Sec.23-733.01(F)	Sec.23-733.01(G)(2)	Sec.23-733.01(E)
Arkansas	Sec.11-10-723(d)	Sec.11-10-723(e)(1)	Sec.11-10-723(f)
California	Sec.336	Sec.1145(b)	Sec.1061(b)
Colorado	Sec.104(6)	Sec.104(11)(b)	Did not contain
Connecticut	Sec.3-223b.(f)	Sec.31-223b.(a)(2)	Sec.31-223b.(g)
Delaware	Sec.3353(4)	Sec.3353(5).a	Sec.3353(6)
District of Columbia	D.C. Official Code Sec.51-103(3)(n)(1)	D.C. Official Code Sec.51-104(4)(P)(1)(B)	D.C. Official Code Sec.51-104(4)(P)(4)
Florida	Sec.443.131(3)(g)(6)	Sec.443.131(3)(g)(7)(a)	Sec.443.131(3)(g)(8)
Georgia	Sec34-8-153(h)(7)	Sec.34-8-153(h)(4)	Not adopted
Hawaii	Sec.383-66(b)(8)	Sec.383-66(b)(6)(C)	Sec383-66(b)(9)
Idaho	Title 72-1351A(6)	Title 72-1351A(5)(c)	Title 72-1351A(7)
Illinois	820 ILCS 405/Sec.1507.1(F)	Not defined	820 ILCS 405/Sec.1507.1(H)
Indiana	Chapter 11.5-11(a)	Chapter 11.5-3	Chapter 11.5-11(b)
Iowa	Sec.96.7(2)(b)(3)	Not defined	Not adopted
Kansas	Chapter 44- Article 719(f)(5)	Chapter44- Article 719(f)(6)(A)	Chapter 44- Article 719(f)(7)
Kentucky	Chapter 341.540(9)	Not defined	Not adopted
Louisiana	RS 23:1539.1(F)	RS 23:1539.1(A)(2)	RS 23:1539.1(G)
Maine	Sec.1221 5(A)E	Sec.1221 5(A)D(2)	Sec.12215(A)F
Maryland	Sec.8-614(e)	Sec.8-613(a)(3)	Not adopted
Massachusetts	Chapter 151A, Sec.14N(i)	Chapter 151A, Sec14N(k)	Chapter 151A, Sec14N(h)
Michigan	Sec.421.22b(2)(e)	Sec421.22b(5)(b)	Sec.421.22b(6)
Minnesota	Not specified	Sec.268.035 Subdivision 21	Sec268.184 Subdivision 15
Mississippi	Sec.71-5-355(3)(d)	Sec.71-5-355(3)(e)(i)	Sec.71-5-355(3)(f)
Missouri	Sec.288.110.6	Not defined	Sec.288.110.7
Montana	Sec. 39-51-1219(9)	Sec. 39-51-1219(8)(b)	Sec. 39-51-1219(10)
Nebraska	48-654.01(4)	48-654.01(1)(b)	Not adopted
Nevada	612.732(a)&(b)	612.732(6)(a)	Not adopted
New Hampshire	282-A:91-a.(I)(g)	282-A:91-a.1(h)(2)	282-A:91-a(II)
New Jersey	43:21-11(1)	Not defined	Not adopted
New Mexico	51-1-11(H)(7)(b)	Not defined	Not adopted
New York	581.7(d)	581.7(e)	Not adopted
North Carolina	G.S.96-9(c)(4)(a)(2)	Not defined	Not adopted

State	Detection Procedures	Definition of Person	Interpretation
North Dakota	52-04-08.1	Not defined	52-04-08.1
Ohio	Sec.4141.24(H)	Sec.4141.48(G)(2)	Not adopted
Oklahoma	Sec.40-3-111.1(C)	Sec.40-3-111.1(D)(1)	Sec.40-3-111.1(E)
Oregon	Sec.657.480(4)	Not defined	Sec.657.480(4)
Pennsylvania	Sec.201(a)	4(j)(1) defines employer consistent w "person" (IRC of 1986)	Not adopted
Puerto Rico	201(A)	Law74,Sec.8(a)(14)	Not adopted
Rhode Island	Sec.28-43-35(e)	Sec.28-43-35(f)(1)	Sec.28-43-35(g)
South Carolina	Sec.41-31-125(E)	Not defined	Not adopted
South Dakota	Sec.61-5-33.3	Sec.61-5-32.4	Sec.61-5-32.5
Tennessee	Sec.50-7-403(b)(2)(I)	Sec.50-7-403(b)(2)(H)(III)	Sec.50-7-403(b)(2)(J)
Texas	Sec.204.088	Sec.204.081(2)	Sec.204.089
Utah	Sec.35A-4-304(6)	Sec.35A-4-304(1)(b)	Sec.35A-4-304(7)
Vermont	Sec.21.1325(d)5	Sec.21.1325(d)4(C)	Not adopted
Virginia	Sec.60.2-536.1(D)	Sec.60.2-536(5)	Sec.60.2-536.4
Virgin Islands	Title 24,Chapter 12,Sec.309(1)(i)(5)	Title 24,Chapter 12,Sec.309(1)(i)(6)(A)	Title 24,Chapter 12,Sec.309(1)(i)(7)
Washington	RCW 50.29.063(8)	RCW 50.29.063(4)(b)	Not adopted
West Virginia	21A-5-10c(d)	21A-5-10c(e)(1)	21A-5-10c(f)
Wisconsin	Sec.108.16(8)(n)	Not defined	Sec.108.16(8)(o)
Wyoming	Sec.27-3-507(f)	Not defined	Not adopted

APPENDIX C: SUTA DUMPING DETECTION SYSTEMS

State	Date Detection System Operational	Type of Detection System	
		NC/SDDS	Other
Alabama	04/2006	X	
Alaska	01/2007		ON-Point AWARE System
Arizona	07/2006	X	
Arkansas	07/2006	X	
California	06/2005		ESD Wage Link Detection System
Colorado	06/2006	X	
Connecticut	06/2006	X	
Delaware	05/2006	X	
District of Columbia	06/2007	X	
Florida	Limited		FLASUDDS
Georgia	08/2006	X	
Hawaii	09/2006		MANUAL – AGENCY WKR
Idaho	07/2005	X	Query Based 7-2005
Illinois	10/2006	X	
Indiana	02/2006	X	
Iowa	12/2005	X	
Kansas		X	
Kentucky	Anticipate 09/2007		State Customized ON-Point AWARE
Louisiana	06/2006	X	
Maine	Planned 9/2007	X	
Maryland	Software installed; not operational	X	
Massachusetts	09/2006; upgrade installed 01/12/07	X	
Michigan	09/2005	X	
Minnesota	05/2006		Database Query included in UI redesign
Mississippi	In process of becoming operational	X	
Missouri	11/2006	X	
Montana	01/2006	X	
Nebraska	2004 (participated as small state pilot)	X	
Nevada	11/2006	X	
New Hampshire	02/2006		NH SDDS
New Jersey	05/2007	X	
New Mexico	06/2007	X	

State	Date Detection System Operational	Type of Detection System	
		NC/SDDS	Other
New York	07/2006		NY SDDS
North Carolina	07/2005	Developed SDDS	
North Dakota	05/2006	X	
Ohio	03/2006	X	
Oklahoma	05/2006	X	
Oregon	08/2006		Oracle database search engine
Pennsylvania	02/2006	X	
Puerto Rico	01/2007	X	
Rhode Island	Spring 2005	X	
South Carolina	06/2006	X	
South Dakota	07/2006	X	
Tennessee	10/2005	X (limited-licensing issue)	
Texas	09/2005	X	
Utah	01/2006	X	
Vermont	10/2006	X	
Virginia	11/2004	X	
Virgin Islands	10/2006	X	
Washington	09/2004	X (Pilot State)	
West Virginia	01/2007	X	
Wisconsin	08/2006	X (supplemented by state system)	
Wyoming	05/2007	X	

APPENDIX D: TRAINING

State	Number of Staff Trained on SUTA Dumping		
	Tax	Legal	Appeals
Alabama	16	0	0
Alaska	25	0	0
Arizona	4	0	0
Arkansas	2	0	0
California	304*	0	0
Colorado	58	0	0
Connecticut	2	0	0
Delaware	16	0	0
District of Columbia	2	0	0
Florida	2	2	0
Georgia	120	0	0
Hawaii	0	0	0
Idaho	82	0	0
Illinois	108	3	5
Indiana	71	0	0
Iowa	50	0	0
Kansas	49	0	0
Kentucky	51	0	0
Louisiana	76	2	0
Maine	2	0	0
Maryland	20	0	0
Massachusetts	52	1	45 (includes 10 higher authority)
Michigan	162	10	8
Minnesota	36	0	0
Mississippi	59	1	0
Missouri	151	1	6
Montana	20	2	1
Nebraska	24	2	0
Nevada	32	1	2
New Hampshire	30	5	4
New Jersey	30	0	0
New Mexico	56	0	0

State	Number of Staff Trained on SUTA Dumping		
	Tax	Legal	Appeals
New York	57	0	0
North Carolina	30	3	0
North Dakota	32	0	0
Ohio	153	0	0
Oklahoma	45	1	0
Oregon	8	0	0
Pennsylvania	372	4	0
Puerto Rico	2	0	0
Rhode Island	23	1	0
South Carolina	4	1	0
South Dakota	60	3	4
Tennessee	152	0	0
Texas	300	0	0
Utah	10	0	1
Vermont	14	0	0
Virginia	2	0	0
Virgin Islands	1	0	0
Washington	41	0	0
West Virginia	3	0	0
Wisconsin	62	0	0
Wyoming	21	0	0
* California trained 304 staff; unable to separate out by activity.			

APPENDIX E: UI EXPERIENCE RATING AND PEOs—WHO IS THE EMPLOYER OF RECORD

State	PEO	PEO under Special Conditions	Client Company
Alabama	X		
Alaska			X
Arizona	X		
Arkansas		X	
California		X	
Colorado		X	
Connecticut			X
Delaware			X
District of Columbia	X		
Florida	X		
Georgia	X		
Hawaii	X		
Idaho		X	
Illinois	X		
Indiana	X		
Iowa			X
Kansas	X		
Kentucky			X
Louisiana	X		
Maine	X		
Maryland	X		
Massachusetts			X
Michigan		X	
Minnesota			X
Mississippi			X
Missouri	X		
Montana	X		
Nebraska			X
Nevada	X		
New Hampshire	X		
New Jersey	X		
New Mexico	X		
New York	X		
North Carolina	X		
North Dakota			X
Ohio	X		
Oklahoma	X		
Oregon	X		
Pennsylvania			X
Puerto Rico	X		
Rhode Island			X
South Carolina			X
South Dakota			X
Tennessee	X		
Texas	X		
Utah	X		
Vermont			X
Virgin Islands			X

State	PEO	PEO under Special Conditions	Client Company
Virginia			X
Washington	X		
West Virginia	X		
Wisconsin	X		
Wyoming	X		

Evaluation of State Implementation of Section 303(k),
Social Security Act

**SUTA Dumping
Implementation Survey**

State of _____

{REVISED DRAFT}

Coffey Communications, LLC
4720 Montgomery Lane, Suite 1050
Bethesda, Maryland 20814
(301) 907-0900

August 28, 2006

SUTA DUMPING IMPLEMENTATION SURVEY

Background and Purpose of the Survey:

The SUTA Dumping Prevention Act of 2004 stipulates that State Unemployment Insurance (UI) programs monitor and penalize employers that engage in the practice of SUTA dumping. Section 303(k) of the Social Security Act addresses SUTA dumping and requires the U.S. Department of Labor to conduct a study of state implementation of this law and to provide Congress with a report that summarizes the findings of the study, no later than July 15, 2007.

To comply with the reporting requirements of this law, the U.S. Department of Labor, Employment and Training Administration, contracted with Coffey Communications, LLC, in collaboration with its subcontractor, the Urban Institute, to conduct the required study. This survey was designed to collect the data and other necessary information to allow the Secretary of Labor to fulfill her responsibilities under the law

Instructions for Completion:

The attached survey is being sent to the Agency Administrators in each state. After completing the survey we request that it be signed and returned to Coffey Communications at the address provided on the cover page of this survey. In addition, responses may be returned by email (lcoffey@coffeycom.com) or by returning the CD to the Coffey Communications address.

Four types of answers to survey questions are expected:

- Questions followed with *hollow circle bullets* have multiple choice answers. For these, you may simply check the correct choice(s).
- Questions with *solid bullets* list various aspects or categories that require responses.
- Tables with empty cells are to be filled in.
- Underlined spaces have been included for you to provide additional answers, comments, explanations, citations of related documents, etc. There is no space limit for these items. Should it be necessary, you may attach related documents or cut and paste the related sections.

Some research will be required in order to answer certain questions, and it is expected that you will need to consult with staff and colleagues in developing some answers. We request that you answer all questions. When you are not sure about your answer, please explain your uncertainty. If you would like clarification regarding a particular question, please contact Mr. Rett Hensley at rhensley@coffeycom.com, or by telephone at (941) 755-9304.

Due date for survey responses: Thirty days after receipt of the survey.

**EVALUATION OF THE IMPLEMENTATION OF SECTION 303(k) OF THE
SOCIAL SECURITY ACT
SUTA DUMPING IMPLEMENTATION SURVEY**

Part A. Legal Elements

A.1 Please provide the citation (“cite”) and effective date of any Rule, policy, directive or procedure that has been issued as a result of the SUTA Dumping Prevention Act of 2004. Please attach a copy or provide an explanation of each.

- Rule: _____
- Policy, Directive or Procedure: _____

A.2 Did your state legislature enact any other law or regulations that you believe enhances your ability to prevent SUTA dumping, other than those required by Section 303(k), SSA.

- Yes, please provide cite: _____
- No

Part B. Operational Elements

B.1 The Employment and Training Administration (ETA) contracted with the State of North Carolina to develop the SUTA Dumping Detection System (SDDS). Is your state utilizing this system for the detection of SUTA dumping?

- Yes, date it became operational _____
- No, describe the system being used and the date it became operational

B.2 State UI programs may use a variety of methods to detect SUTA dumping. Please identify all methods used by your state:

- State-developed automated SDDS system
- North Carolina developed automated SDDS system
- Agency Employee; i.e.: field auditor, examiner, etc.
- Complaints from other employers
- Other State UI Agencies
- Other State Agencies; i.e., Revenue; Secretary of State
- Other sources (specify) _____

B.3 Which of the preceding methods in question B.2 are most effective in your state?

- State-developed automated SDDS system
- North Carolina developed automated SDDS system
- Agency Employee; i.e.: field auditor, examiner, etc
- Complaints from other employers
- Other State UI Agencies
- Other State Agencies; i.e., Revenue; Secretary of State
- Other sources (specify) _____

Comments: _____

B.4 Which of the methods identified in question B.3 are most effective in detecting previously unreported successions or partial successions?

- State-developed automated SDDS system
- North Carolina developed automated SDDS system
- Agency Employee; i.e.; field auditor, examiner, etc
- Complaints from other employers
- Other State UI Agencies
- Other State Agencies; i.e., Revenue; Secretary of State
- Other sources (specify) _____

Comments: _____

B.5 Is your state SDDS system effective in detecting other types of tax rate manipulation activities that are not specifically addressed in Section 303(k), SSA?

- Yes
- No

Explain: _____

B.6 What changes could be made to improve the detection system currently in use?

B.7 How many estimated state Full Time Equivalent (FTE) positions are currently being used in all activities related to the detection, investigation and prevention of SUTA dumping? Please complete the following Table B.1

Table B.1

<i>Unit</i>	<i>Number of FTEs</i>
Liability and Registration	
Investigation & Audit	
Enforcement/Collection	
Legal	
Information Tech	
Integrity Unit	
Other (Specify)	

What was the net addition to staff (FTE's) devoted to these activities? _____

B.8 Will your state have ongoing costs for the detection and prevention of SUTA dumping beyond those described above in B.7 (FTEs)? If so, please indicate the estimated amount.

- Software support _____
- Hardware support _____
- Training _____
- Other _____

B.9 Has your state participated in any training for staff on SUTA dumping law, regulations, policies and procedures during 2005-2006?

- Yes
 No

If yes, which of the following units were trained and for how many hours? Please complete the following Table B.2

Table B.2

<i>Unit</i>	<i>Trained Yes/No</i>	<i>Number of Hours</i>	<i>Number of Staff</i>
Liability			
Audit			
Collection			
Legal			
Appeals			
UI Integrity			
Other (Specify)			

B.10 Is additional training needed?

- Yes
- No

If yes:

- Please identify the topics and personnel to be trained.

Topics: _____

Personnel: _____

- Any additional training needed should be conducted by:

- State personnel
- USDOL Regional office personnel
- USDOL National office personnel
- Web Based

Part C: Congressional Elements

C.1 How satisfied is your agency with the provisions of Section 303(k), SSA?

- Very satisfied
- Generally satisfied
- Not really satisfied with the provisions of the law

Please identify any specific area(s) of dissatisfaction:

C.2 How satisfied is your agency with the provisions of your state SUTA dumping law?

- Very satisfied
- Generally satisfied
- Not really satisfied with the provisions of the law

Please identify any specific area(s) of dissatisfaction:

C.3 Do you believe additional Federal legislation should be enacted in order to further assist your state and others in preventing SUTA Dumping and similar schemes?

- Yes
- No

If yes, please identify the additional actions you think Congress should take to prevent SUTA dumping: _____

C.4 What barriers to enforcing your state SUTA dumping law have you encountered? Check all that apply

- Financial/Staffing
- Legal
- Procedural
- Access to IT
- Interest Group Opposition
- Other (specify) _____

Explain _____

C.5 Which of those in question C.4 has been the greatest barrier?

- Financial/Staffing
- Legal
- Procedural
- Access to IT
- Interest Group Opposition
- Other (specify) _____

C.6 Which stakeholders has your state taken special efforts to inform about SUTA dumping legislation and enforcement activity? Check all that apply:

- All Employers
- State Legislature
- State UI Advisory Council
- Business organizations
- Labor organizations
- Taxpayer foundations
- Accounting professionals
- Bar Associations
- UI Advisory Companies
- Third Party Payroll Services
- Professional Employer Organizations (PEO) Associations
- Construction Industry

- Accommodation and Food Services
- Other (specify)

Comments: _____

C.7 Overall, has the passage and initial implementation of your new SUTA dumping law had any unexpected/unintended consequences for your state UI operation?

- No, explain: _____
- Yes, explain: _____

C.8 Is the environment for detection, investigation and prevention of SUTA dumping (tax manipulation activities) different today versus the situation prior to the enactment of the Federal SUTA Dumping Prevention Act of 2004?

- Yes, explain: _____
- No, explain: _____

C.9 Do you believe SUTA Dumping detection and enforcement has been a productive and worthwhile investment of resources for your state?

- Yes, explain: _____
- No, explain: _____

Part D. Elements Related to Professional Employer Organizations (PEOs)/Employee Leasing

D.1 One function of PEOs is to provide labor services to employers through an employee leasing arrangement wherein they hire all or some of the existing employees of a firm and then lease the employees back to the firm, now a client firm of the PEO. In addition to registering for an unemployment account number, are PEOs required to register elsewhere (the Department of Revenue or some other agency of state government) as a condition of doing business in the state?

- Yes
- No

If yes:

- What is the name of the other Agency: _____
- Please list the regulatory requirements of the other Agency: _____

D.2 How many Employee Leasing/PEO companies are currently active employers in your state? _____

D.3 Which industries in your state commonly use the services of Employee Leasing/PEO firms in your state? Please list only the top five in size in the following table D.1.

Table D.1

<i>Industrial Sector</i>	<i>Number of Client Companies</i>	<i>Total Employees Leased</i>
Health Care and Social Assistance		
Construction		
Real Estate		
Accommodation and Food Services		
Manufacturing		
Others (Specify)		

D.4 Does your state recognize by law, regulation, or policy, the PEO as the “employer” of record for experience rating purposes and require the “PEO” to pay UI taxes based on its own experience under its own account number?

- Yes
- No

If yes, please provide cite or explain policy: _____

D.5 If the answer to question D.4 is yes, does your state close the “client company” account when the PEO and the client company enter into a contractual relationship and all employees of the client are moved to the PEO?

- Yes
- No

D.6 Does your state recognize by law, regulation, or policy, the “client company” as the employer and require the “client” to pay UI taxes based on its own experience under its own account number?

- Yes
- No

If yes, please provide the cite or explain the policy: _____

D.7 Does your state consider the client company and the PEO to be “jointly liable”?

- Yes
- No

Explain the state position on joint liability: _____

D.8 Does your state require by law, regulation, or policy, the transfer of experience from a client firm to the PEO when clients enter into a contractual relationship with the PEO?

- Yes
- No

Explain the state’s policy on this and how it is accomplished: _____

D.9 Does your state require experience attributable to the client to be transferred from the PEO to the client when the contract ends?

- Yes
- No

- If yes, please explain the state’s policy on this and how it is accomplished: _____

- If no, please explain how the client is rated after the contract ends (i.e., new employer rate, reversions of previously assigned rate): _____

Part E. Data Elements

E.1 What is the total number of potential SUTA dumping cases that have been identified in your state and are being investigated since the passage of your SUTA dumping legislation? Please complete Table E.1

Table E.1

<i>Time Period</i>	<i>Number Identified</i>	<i>Number Investigated</i>
July to September 2005		
October to December 2005		
January to March 2006		
April to June 2006		
July to September 2006		

E.2 How many of the investigated cases have been determined to have violated the “mandatory” transfer of experience provisions of state law in the following industry sectors? (The mandatory transfer provision refers to instances where employers transfer either all, or a portion of their business to another employer and both employers, at the time of transfer, were under substantially (or any) common ownership, management, or control.) Please complete Table E.2.

Table E.2

<i>Industrial Sector</i>	<i>Number of Cases</i>
Construction (NAICS Codes 236, 237, 238)	
Employee Leasing (NAICS Code 56133)	
Hospitality (NAICS Code 721)	
Other (NAICS Code _____)	

E.3 How many of the investigated cases have been determined to have violated the “prohibited” transfer of experience provisions of state law in the following industry sectors? (The prohibited transfer provision refers to instances when a person who is not an employer acquires a business solely or primarily for the purpose of obtaining a lower rate of contributions.) Please complete Table E.3

Table E.3

<i>Industrial Sector</i>	<i>Number of Cases</i>
Construction (NAICS Codes 236, 237, 238)	
Employee Leasing (NAICS Code 56133)	
Hospitality (NAICS Code 721)	
Other (NAICS Code _____)	

E.4 What is the total amount of additional contributions due from all cases of SUTA dumping detected in your state since your state law changed, broken down by type of penalty with respect to “mandatory” and “prohibited” transfer cases? Please complete Table E.4.

Table E.4

<i>Type of Penalty</i>	<i>Mandatory Transfers</i>	<i>Prohibited Transfers</i>	<i>Quarter/year owed</i>
Additional Taxes Due			
Fines			
Other Penalties			
Interest Payment			

Of the above amounts, how much has been recovered? Please complete Table E.5

Table E.5

<i>Type of Penalty</i>	<i>Mandatory Transfers</i>	<i>Prohibited Transfers</i>	<i>Quarter/year collected</i>
Additional Taxes Due			
Fines			
Other Penalties			
Interest Payment			

- E.5 Has your state discovered that an “advisor” was involved in helping to create the SUTA dumping arrangement? (An advisor, as used here, is a person who knowingly advises another person to violate provisions of state law that relate to SUTA dumping.)
- Yes How many instances? _____
What is the total amount of penalties invoked? _____
- No
- E.6 In which quarter of the year have SUTA dumping activities been the most prevalent in your state?
- First Quarter (January, February and March)
- Second Quarter (April, May and June)
- Third Quarter (July, August and September)
- Fourth Quarter (October, November and December)
- E.7 What has been the state’s initial experience of appellate bodies upholding the state UC agency determination that entities have engaged in SUTA dumping? Please complete Table E.6

Table E.6

<i>Category</i>	<i>Number of Cases</i>	<i>Cases Upheld</i>	<i>Cases Reversed</i>
Lower Level Appeals			
Higher Level Appeals			
Appeals to Court			
Other			

***** Thank You for completing this survey. *****

Please provide the name, phone number and email address of the person(s) completing the survey:

<u>Name</u>	<u>Phone Number</u>	<u>Email Address</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____

Submitted and Approved by:

Signature: _____ Date: _____

Name (please print): _____ Title: _____

Phone Number: _____ Email Address: _____

Address: _____

APPENDIX G: ACRONYMS

AMPEO	Association of Michigan Professional Employer Organizations
ASO	Administrative Services Only
AWARE	Aggregate Workforce Analytics Reporting Engine
CUIC	California Unemployment Insurance Code
DBA	Doing Business As
DES	Department of Employment Security (State of New Hampshire)
DUA	Department of Unemployment Assistance
EDD	Employment Development Department (State of California)
ESD	Employment Security Department (State of Washington)
ETA	Employment and Training Administration (U.S. Department of Labor)
FACD	Field Audit and Compliance Division
FAPEO	Florida Association of Professional Employer Organizations
FTE	Full Time Equivalent
FUTA	Federal Unemployment Tax Act
GAO	General Accounting Office
IRS	Internal Revenue Service
IT	Information Technology
ITSC	Information Technology Support Center
LMI	Labor Market Information
NAICS	North American Industry Classification System
NAPEO	National Association of Professional Employer Organizations
NASWA	National Association of State Workforce Agencies
OMB	Office of Management and Budget
PEO	Professional Employer Organizations
SDDS	SUTA Dumping Detection System
SSA	Social Security Act
SUTA	State Unemployment Tax Act
SWA	State Workforce Agencies
TDLR	Texas Department of Licensing and Regulation
TWC	Texas Workforce Commission
UC	Unemployment Compensation
UI	Unemployment Insurance
UIA	Unemployment Insurance Agency (States of Michigan and Utah)
UIPL	Unemployment Insurance Program Letter
USDOL	U.S. Department of Labor