HOUSE
RESEARCH
ORGANIZATION bill analysis 4/14/2005

HB 3250
Ritter

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SUBJECT: Restricting businesses from "dumping" unemployment claim experience

COMMITTEE: Economic Development — favorable, with amendment

VOTE: 7 ayes — Ritter, B. Cook, Anchia, Deshotel, Kolkhorst, McCall, Seaman

0 nays

WITNESSES: For — Garry Bradford, Texas Leadership Council of the National Association of Professional Employer Organizations (NAPEO); Rick Levy, Texas AFL-CIO; Robert Rice, NAPEO; (*Registered, but did not testify:* James S. Childress, Texas Leadership Council of NAPEO, Marc House, UAW Local 218 United Auto Workers; Becky Moeller, Texas AFL-CIO)

Against — None

On — Steve Riley, Texas Workforce Commission

BACKGROUND: The Texas Workforce Commission (TWC) collects unemployment insurance taxes to pay unemployment benefits. The unemployment insurance tax that companies pay is made up of a number of components including an experience-rated portion of the tax, which is based on benefits that have been paid to former employees of the company and charged to the company's account. This element of the tax increases sharply when a firm lays off employees who then claim unemployment compensation. An "experience-rated" company is one that has "compensation experience" (i.e., has paid unemployment benefits).

State unemployment tax act (SUTA) dumping is a practice by which an experience-rated company forms a new subsidiary for the purpose of decreasing its unemployment insurance tax rate. By shifting most of its workers to the subsidiary, the original company can take advantage of the subsidiary's low "new company" unemployment insurance experience rating. Companies also lower their unemployment insurance ratings through mergers or acquisitions with companies that have lower unemployment insurance rates.

Anti-SUTA dumping legislation is designed to prevent such manipulation of state experience rating systems. The federal SUTA Dumping Prevention Act of 2004 (PL 108-295) requires states by 2006 to enact laws prohibiting certain forms of SUTA dumping as a condition of states receiving administrative grants for their unemployment compensation programs.

Sections 204.081 through 204.086 of the Labor Code address the transfer of compensation experience ratings during mergers and acquisitions. In general, the compensation experience of acquired companies transfers to the acquiring company if there is an owner in common. TWC may deny an application if it determines that the acquisition took place primarily to qualify for a reduced unemployment insurance tax rate.

DIGEST:

HB 3250, as amended, would revise the rules governing the transfer of unemployment compensation experience between companies during business acquisitions.

Activities between companies with substantial ownership or management in common. In a transfer of business from an experience-rated acquired company to an acquiring company, the bill would require that compensation experience also be transferred to the acquiring company. If the acquiring company was an experience-rated employer on the date of the acquisition, it would make contributions at a rate computed by using the prior 36-month combined compensation experience of the acquired company and the acquiring company.

If the acquiring company was not an experience-rated employer on the date of the acquisition, it would make contributions from that date to the end of the calendar year at the highest rate that could be attached to the acquired company. The rate would be computed in the years following the acquisition as follows:

- Year 1 — the acquiring company's compensation experience plus the acquired company's 24-month compensation experience ending on September 30 preceding the year of acquisition, combined with the acquired company's compensation experience from that date to the date of the acquisition.
- Year 2 — the acquiring company's compensation experience plus the acquired company's 12-month compensation experience, ending on September 30 preceding the year of acquisition,

combined with the acquired company's compensation experience from that date to the date of the acquisition.

- Year 3 — compensation experience available to the acquiring company plus the acquired company's compensation experience from that date to the date of the acquisition.
- All subsequent years — the acquired company's compensation experience would be computed without regard to the transfer of compensation experience.

For a partial acquisition in which TWC could determine the compensation experience for the segment of the company that was acquired, the compensation experience for the remainder of the partially acquired company would enter the calculation for the acquiring company's contribution rate. If the acquiring company was an experience-rated employer on the date of the acquisition, it would make contributions from that date to the end of the calendar year based on the compensation experience transferred from the acquired company plus that of the acquiring company. If the acquiring company was not an experience-rated employer on the date of the acquisition, it would make contributions from that date to the end of the calendar year at the highest rate that could be attached to the acquired company.

Activities between companies with no substantial ownership or management in common. In a partial transfer of business from an experience-rated acquired company to an acquiring company, the two companies could apply to TWC in writing to transfer the compensation experience of the part of the acquired company to the acquiring company. TWC could deny such a transfer if it deemed that the companies were attempting to engage in SUTA dumping.

If the acquiring company was an experience-rated employer on the date of the acquisition, or during the period preceding the acquisition, it would make contributions from that date to the end of the calendar year at its rate on the acquisition date. If the acquiring company was not an experience-rated employer on the date of the acquisition, it would make contributions from that date until the next contribution rate computation date at the highest rate that could be attached to the acquired company.

Activities deemed SUTA dumping by TWC. Regardless of whether acquisitions, in part or whole, involved companies that shared substantial ownership or management in common, if TWC determined that a transfer was made for the purpose of obtaining a lower contribution rate, the acquiring company's contribution rate would be the greater of that year's rate for the company's statutorily assigned major industry group or 2.7 percent.

Penalties. A person who knowingly violated the provisions of this bill would be subject to a class A misdemeanor (up to one year in jail and/or a maximum fine of $4,000) and civil penalties. An employer who committed an offense could receive a fine equal to 2 percent of wages paid during the year of the offense and the three following years. A person other than an employer who committed an offense could be fined $5,000 per offense. Penalties assessed would be deposited in the unemployment compensation special administration fund.

Other provisions. TWC would establish procedures to identify experience-rating transfers made for the purpose of SUTA dumping and would administer the provisions of the bill in conformity with federal regulations related to SUTA dumping.

The bill would take effect September 1, 2005, and would apply to acquisitions that occurred on or after that date.

SUPPORTERS SAY:

Companies that have laid off a number of employees increasingly have chosen to avoid sharp increases in state unemployment taxes by engaging in SUTA dumping. In an effort to stop this trend, recent federal legislation requires states to tighten their laws by imposing penalties on companies that engage in SUTA dumping and on their financial advisors. HB 3250 would bring Texas into compliance with the federal SUTA Dumping Prevention Act.

Because SUTA taxes are levied on a per-worker basis, "dumping" employees through an acquisition or transfer can result in big savings for companies — millions of dollars in many cases. But any success these companies have in avoiding unemployment taxes results in higher levies on the state's other employers. Widespread SUTA dumping can boost taxes so high that they can drive law-abiding employers out of the state. HB 3250 would stop companies guilty of dumping from gaining unfair business advantages and would prevent increased unemployment compensation tax rates for the ethical businesses that did not engage in such practices.

When high-turnover companies do not pay their share of taxes, it creates a shortage in the unemployment insurance trust fund, which may force other employers to pay as much as 10 percent more than they should. States are losing hundreds of millions of dollars to SUTA dumping. A survey earlier this year indicated that 14 states had lost a total of $120 million over the past three years because of the practice. HB 3250 would help alleviate these problems in Texas.

SUTA dumping has been driven by a small number of accountants, lawyers, and consultants who maintain that the practice is not illegal. This bill would clarify the state's position regarding the illegality of SUTA dumping.

OPPONENTS SAY:

HB 3250 specifically should address professional employer organizations (PEOs), also known as staff leasing services companies. PEO staff handle the management of human resources, employee benefits, payroll, and workers' compensation for client companies. PEOs can serve as a shelter for companies with high unemployment insurance ratings, enabling such companies to pay less in unemployment taxes. Michigan, for example, estimates that PEOs account for as much as 40 percent of SUTA dumping in that state.

The criminal penalty imposed by this bill should be a felony, not a misdemeanor. Doing so would bring the penalty for SUTA dumping in line with evading income taxes. At least one other state has made SUTA dumping a felony.

NOTES:

The committee amendment would conform HB 3250 with requirements in federal law that transfer of experience is mandatory whenever there is a substantial common ownership. The amendment also would revise the definition of "knowingly," cite a different section of the Labor Code in conjunction with the civil penalty that could be assessed to employers, and strike sections of code that the bill changed or made obsolete.

The companion bill, SB 1231 by Fraser, was referred to the Senate Business and Commerce Committee on March 21.

According to the fiscal note, the bill would result in an estimated savings of $78.5 million per year from fiscal 2006 through fiscal 2010 to the Unemployment Trust Fund Account.