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To: The Honorable Marcus R. Oshiro, Chair
and Members of the House Committee on Finance

Date: Thursday, April 2, 2009
Time: 3:00 p.m.
Place: Conference Room 308, State Capitol

From: Darwin L.D. Ching, Director
Department of Labor and Industrial Relations

**Testimony in Strong Support
of
S.B. 947 SD 1 - Relating to Unemployment Contribution Rates**

I. OVERVIEW OF PROPOSED LEGISLATION

S.B. 947 is an Administration bill that proposes to amend section 383-66(b), Hawaii Revised Statutes (HRS), to make all total and partial business transfers under subsections (a) and (b) effective beginning with the calendar year immediately following the transfer. This proposed revision will make all total and partial transfers, whether mandatory or voluntary, to be treated the same and would still be in accordance with federal conformity requirements in regards to the state's experience rating system.

Further, a technical correction is needed to section 383-66(b)(6)(C), HRS, to change the federal law citation from section 6601(a)(1) to section 7701(a)(1) of the Internal Revenue Code, as amended.

II. CURRENT LAW

In 2004, Congress passed and President Bush signed Public Law 108-295 which established a nationwide minimum standard to curb "SUTA" dumping. SUTA dumping, also referred to as state unemployment tax avoidance, is a tax evasion scheme involving the manipulation of an employer's unemployment insurance (UI) tax rate to achieve a lower rate, and thereby pay less UI taxes. SUTA dumping is accomplished through a variety of methods such as transfers of workforce and payroll, restructuring, acquisitions, mergers, and shell transactions.

All states use an "experience rating" system to assign tax rates to employers based on their history of unemployment insurance claims. Generally an employer with a large number of unemployment claims will have a high experience rating and a correspondingly high tax rate. Employers who engage in SUTA dumping unfairly shift their costs to other employers causing an inequitable distribution among employers and adversely affect tax rates for all employers, eliminate the incentive for employers to stabilize their workforce, and cost the UI trust fund millions of dollars each year.

Public Law 108-295 required all states to change their unemployment laws to end SUTA dumping tax evasion schemes. It also allowed civil and criminal penalties to be imposed on persons and advisors who knowingly violate or attempt to violate the SUTA dumping law.

In 2005, Hawaii responded to the federal law by passing legislation (Act 114) which sought to close loopholes permitting SUTA dumping. Act 114 provides the following:

- **Mandatory transfers.** Unemployment experience must be transferred whenever there is substantially common ownership, management or control of two employing units, and one employing unit transfers its trade or business (including its workforce), or a portion thereof, to the other employing unit. Notification of the transfer to the UI Division is required from both parties within thirty days after the date of transfer. The rates of both employing units will be recalculated effective with the calendar quarter immediately following the date of the transfer. The mandatory transfer requirement does not apply when one employing unit acquires another employing unit and at the time of the acquisition, they are not under common ownership, management or control. The "successor" company still has the option to transfer or not transfer the "predecessor" company's experience to the "successor" company.
- **Prohibited transfers.** Unemployment experience may not be transferred, and a new employer rate will be assigned, when a person who is not an employing unit acquires the trade or business of an existing employing unit primarily for the purpose of obtaining a lower rate of contribution. Notification of the acquisition to the UI Division is required from both parties within thirty days after the date of acquisition.

- **Penalties for SUTA dumping violations.** Any employing unit who knowingly violates the law will be subject to the highest tax rate for the current and following 3 years. If the employing unit is already at the highest tax rate or if the amount of the rate increase is less than 2%, a penalty equal to contributions of 2% of taxable wages will be imposed for the current and following 3 years. Any person who is not an employer who knowingly violates or provides SUTA dumping advice may be subject to a civil penalty of up to \$5,000. In addition, a criminal misdemeanor charge with a fine of up to \$10,000 may be imposed for each false statement or violation of the law and each day may be considered to be a separate offense.

Currently, the recalculation of UI tax rates under section 383-66(a), HRS, is effective beginning the following year resulting in only one calculation in a year. Under section 383-66(b), HRS, the recalculation of UI tax rates begins the following quarter. Given the inconsistent time periods in these two sections, there can be multiple recalculations within a given year. This bill is necessary to avoid these multiple recalculations.

III. HOUSE BILL

The Department strongly supports S.B. 947 SD 1 for the following reasons:

1. This measure is a housekeeping measure intended to conform Hawaii's unemployment insurance law to federal law in order to provide uniform application to all experience rating transfers for employers.
2. Doing one tax calculation is more efficient and will consolidate administrative actions, costs and controls for both the State and employers.
3. The current UI tax system can accommodate tax rate changes on a yearly basis without system modifications and reprogramming. However, it is unable to accommodate mid-year tax rate changes, requiring an overhaul to the UI tax system at estimated cost of approximately \$23 million.
4. This proposal will also provide a more uniform application of the experience rate transfers thus making it less complicated for employers to understand. In addition, employers will not have to reprogram their own accounting systems in order to deal with multiple, mid-year rate changes.