

Stop Employer Tax Evasion with Laws against “SUTA Dumping”



What is it?

Some employers, following the advice of major accounting firms, have engaged in schemes to dodge their unemployment insurance taxes by “selling” their companies to a new related entity in order to receive a much lower UI tax rate. This practice is called “SUTA dumping” (SUTA stands for State Unemployment Tax Assessment) and it undermines the integrity of the unemployment insurance system.

SUTA dumping involves the transfer of a business in a way that results in lower UI tax rates. For example, a temporary services agency (Company A) may set up a shell company (Company B) that has no employees and therefore a low, or even zero, tax rate. Company A transfers all of its business to Company B in order to get the low tax rate. This scheme could be repeated, so that once Company B’s tax rate rises due to layoffs, the business is once again transferred to a new shell company.



Key arguments in favor

Federal law requires that states enact new law. On August 9, 2004, President Bush signed the SUTA Dumping Prevention Act of 2004 (P.L. 108-295). This new federal law requires states to have laws against SUTA dumping in place by 2006. Federal law also requires states to impose meaningful civil and criminal penalties for violation of the state law provisions on both employers and on tax advisors. Finally, the new federal law requires the Department of Labor to study and report on state implementation of the laws against SUTA dumping.

SUTA dumping denies the unemployment system needed revenue. In a recent GAO survey, 14 states reported that they had identified SUTA dumping schemes that cost state unemployment trust funds at least \$120 million in lost revenue. Moreover, this may only be the tip of the iceberg. For example, California recently estimated that \$100 million in state revenue was lost to SUTA dumping by some 29 companies with payrolls of between \$10 million and \$1.6 billion. Most states reported that their laws do not adequately protect against the problem.

SUTA dumping hurts law-abiding employers. Employers who play by the rules suffer a competitive disadvantage in marketing their services. For example, Kelly Services reports that they could have saved \$5 million a year if they had engaged in SUTA dumping.

SUTA dumping compromises experience rating systems. By insulating employers from the UI tax impact of their lay-offs, SUTA dumping reduces the incentive for employers to keep employees working and to recall claimants to work as soon as possible. If employers successfully can “dump” the higher tax rate, they can lay off workers without seeing their tax rates rise.

States must impose meaningful civil and criminal penalties for SUTA dumping. The Department of Labor recommends that states assign the maximum UI tax rate for four years to offending employers, in some cases with an additional 2 percent penalty, and that states impose criminal penalties.



Key arguments against and responses to them

Opponents say: States shouldn't adopt proposals that are more stringent than federal law mandates.

Response: The Department of Labor's guidance to states on SUTA dumping legislation specifically advises states that they may enact more stringent protections than those outlined in its model language.

Opponents say: The Department of Labor's suggested penalties on tax advisors are too harsh.

Response: In North Carolina, a leading state combating SUTA dumping, the state has collected an average of over \$500,000 per company from nine different companies that engaged in SUTA dumping. The Department of Labor's suggested maximum penalty of \$5,000 for tax advisors who violate the law is a wholly inadequate penalty to deter SUTA dumping. California has recently adopted a law that imposes more stringent penalties on tax advisors.



Which states do it?

Because the federal law was signed in August 2004, only California has passed new state legislation. However, some states, including North Carolina and Washington, had begun to address SUTA dumping prior to enactment of the federal law. In addition, DOL has published a model for states' use, available at http://www.ows.doleta.gov/dmstree/uipl/uipl2k4/uipl_3004a2.htm.

The Department of Labor specifically advises states that they may enact more stringent protections than those outlined in its model. DOL's model can be improved upon in two ways:

- Impose higher penalties for accountants who advise their clients to SUTA dump; the DOL model suggests a maximum of \$5,000.
- Apply penalties broadly to cover other kinds of cheating by employers. Washington State's SUTA dumping law does this by broadly applying penalties to all kinds of underpayments of taxes, including those caused by misclassification of employees as independent contractors.



Model legislation

The following language is modeled on the Department of

Labor sample but includes some changes. When the wording set forth below deviates from DOL model, the gist of the change is explained in brackets.

RULES FOR TRANSFER OF BUSINESS

[Language is added for business transfers to a new employer engaged in the same business as prior employer.]

(A) If an employer transfers its business, or a portion thereof, to another employer, and, at the time of the transfer, there is substantially common ownership, management, or control of the two employers, then the unemployment experience attributable to the transferred trade or business shall be transferred to the employer to whom such business is so transferred.

(B) Whenever a person is not an employer subject to this title at the time it acquires a business, the unemployment experience of the acquired business shall be transferred to the new employer only where the employer continues operating the same business enterprise as before the transfer. (C) The unemployment experience shall not, by virtue of the transfer of a business, be transferred to the person acquiring such business if the State agency finds that the transfer was made for the purpose of obtaining a lower rate of contributions. In determining whether the transfer was for the purpose of obtaining a lower rate of contributions, the State agency shall use objective factors including the cost of acquiring the business, whether the person continued the business enterprise of the acquired business, how long such business enterprise was continued, or whether a substantial number of new employees were hired for performance of duties unrelated to the business activity conducted prior to acquisition.

TAX PREPARERS [Definition of "tax preparer" added in order to make it clearer on the face of the law that they are subject to the new provisions.]

The term "person" under this title has the meaning given such term by section 7701(a)(1) of the Internal Revenue Code of 1986. In addition, "person" includes a contribution tax return preparer. As used in this subsection, a 'contribution tax return preparer' is a person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this Title or any claim for refund of tax imposed by this Title. For purposes of this definition, the completion of a substantial portion of a return or claim for refund is treated as the preparation of the return or claim for refund. The term does not include a person merely because the person (i) furnishes typing, reproducing, or other mechanical assistance, (ii) prepares a return or claim for refund of the employer, or an officer or employee of the employer, by whom the person is regularly and continuously employed, (iii) prepares as a fiduciary a return or claim for refund for any person, or (iv) represents a taxpayer in a hearing regarding a proposed assessment.

SAMPLE CIVIL AND CRIMINAL PENALTIES

Criminal Penalties [States should consider whether their current criminal penalty structure is adequate, and make appropriate changes.]

Knowing Attempt to Evade or Defeat Tax. Any person who knowingly attempts to make or makes a transfer of business for the purpose of obtaining a lower rate of contribution, or any person who aids or abets such person to evade or defeat a contribution or its payment, shall, in addition to other penalties provided by law, be guilty of a felony.

Intentional Failure to Collect, Withhold, or Pay Over Tax. Any person required to collect, withhold, account for, and pay over any contribution who intentionally fails to collect or truthfully account for and pay over the contribution shall, in addition to other penalties provided by law, be guilty of a misdemeanor.

Intentional Failure to File Return, Supply Information, or Pay Contribution. Any person required to pay any contribution, to make a return, to keep any records, or to supply any information, who intentionally fails to pay the contribution, make the return, keep the records, or supply the information, at the time or times required by law, or rules issued pursuant thereto, shall, in addition to other penalties provided by law, be guilty of a misdemeanor.

Civil Penalties [States should consider higher penalties on tax preparers than provided in DOL model.]

In addition to any other penalties imposed by law, any person who intentionally evades or attempts to evade, including by misrepresentation, in any manner the contribution provisions of this title is subject to the following penalties:

(A) If the person is an employer,
(1) the State agency shall assign the maximum contribution rate provided for by law for the rate year during which such violation or attempted violation occurred and the three rate years immediately following this rate year. However, if the employer's business is already at such highest rate for any year, or if the amount of increase in the person's rate would be less than 2 percent for such year, then a penalty rate of contributions of 2 percent of taxable wages shall be added to the assigned tax rate for such year.

(2) the State agency shall assess an additional penalty of fifty percent of the amount of any contribution underpaid or attempted to be underpaid.

(B) If the person is not an employer, such person shall be subject to a civil money penalty of \$5,000, or fifty percent of the amount of any taxes underpaid or attempted to be underpaid, whichever is greater.

(C) For purposes of this section, "knowingly" means having actual knowledge or acting with deliberate ignorance or reckless disregard for the prohibition involved.

(D) For purposes of this section, "intentional" means consciously and deliberately engaging in the conduct that leads to the violation or attempted of this title.

PROCEDURES TO IDENTIFY UNLAWFUL BUSINESS TRANSFERS [Include procedures for detection of other unlawful tax schemes.] The State agency shall establish procedures to identify unlawful business transfers and other unlawful practices that avoid payment of unemployment insurance contributions. In particular, the State shall establish audit procedures for new employers who change the nature of a business enterprise after acquisition of the business.

References

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Congressional Budget Office Cost Estimate, SUTA Dumping Prevention Act, H.R. 3224, 42 U.S.C. § 503 (2004).

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EMPLOYMENT AND TRAINING ADMINISTRATION ADVISORY SYSTEM, U.S. DEP'T OF LABOR, UNEMPLOYMENT INSURANCE PROGRAM LETTER NO. 30-02 (August 13, 2004), available at <http://www.ows.doleta.gov>.