

**UNEMPLOYMENT INSURANCE TASK FORCE**

**LABOR CAUCUS RECOMMENDATIONS**

**JANUARY 4, 2006**

## **LABOR CAUCUS U.I. RECOMMENDATIONS**

- 1. MAKE PERMANENT THE RESTORATION OF 2 QUARTER AVERAGING OF UI WEEKLY BENEFITS AND LIBERAL CONSTRUCTION ON THE UI LAW.**
  
- 2. RESTORE GOOD CAUSE QUIT LANGUAGE ON JOB SEPARATIONS DUE TO MARITAL AND DOMESTIC RESPONSIBILITIES AND RESTORATION OF TEN-WEEK DURATIONAL DISQUALIFICATION.**
  
- 3. RESTORE EMPLOYMENT SECURITY DEPARTMENT'S DISCRETIONARY AUTHORITY WHEN MAKING ELIGIBILITY DETERMINATIONS DUE TO WORK-RELATED VOLUNTARY QUIT FACTORS.**
  
- 4. ENACT SUTA DUMPING LEGISLATION, INCLUDING LANGUAGE ON PROFESSIONAL EMPLOYEE ORGANIZATIONS (PEOs), WHICH REQUIRES ALL EMPLOYERS TO PAY THEIR FAIR SHARE OF EXPERIENCE RATED TAXES.**
  
- 5. PROVIDE THE EMPLOYMENT SECURITY DEPARTMENT WITH THE TOOLS AND THE FUNDING NECESSARY TO CRACK DOWN ON EMPLOYERS WHO ENGAGE IN TAX AVOIDANCE, WHICH OTHERWISE CREATES MORE COST TO BE PLACED ON HONEST EMPLOYERS.**

## **ACHIEVING BALANCE IN WASHINGTON'S U.I. SYSTEM**

The intent section to Engrossed House Bill 2255 recognizes that “the unemployment insurance system was created to set aside unemployment reserves to be used for the benefit of persons who are unemployed through no fault of their own and to maintain purchasing power and limit the social consequences of unemployment.” It is important to always keep in mind that mitigating the individual and social hardship of unemployment and stabilizing the economy are the primary goals of an unemployment insurance system.

The legislature also recognized that our system was falling short of these goals by failing to “recognize the importance of applying liberal construction” and by not “reinstating a weekly benefit calculation based on wages in the two quarters of the claimant’s base year in which wages were the highest.”

Finally the legislature recognized the “desirability of managing the system to take into account the goal of reducing costs to foster a competitive business climate.” While the labor community believes that there is no evidence to prove that unemployment insurance costs have any significant impact on competitiveness, **it is important to note that the legislature found that the balance between the meeting the primary goals of the system and the desirability of reducing costs was to restore the liberal construction of the law and to restore two-quarter averaging as the basis for weekly benefit calculations.**

### **RECOMMENDATIONS:**

#### **1. MAKE PERMANENT THE RESTORATION OF 2 QUARTER AVERAGING AND LIBERAL CONSTRUCTION OF THE LAW.**

- We estimate that workers lost over \$ 75 million in benefits and the economy lost over \$ 175 million in purchasing power between January 2004 and April 2005 due to the imposition of 3 Quarter and 4 Quarter averaging of weekly benefit amounts.
- 46 other states liberally construe their unemployment insurance laws either explicitly in statute through case law. Liberal construction is both the federal and state standard for the legal construction of remedial laws like unemployment, workers’ compensation and employment laws.
- Dr. Wayne Vroman, national expert on UI, cites “the highest priority is to restore 2 quarter averaging as a permanent feature” of our UI system.

**2. RESTORE GOOD CAUSE QUIT LANGUAGE ON JOB SEPARATIONS DUE TO MARITAL AND DOMESTIC RESPONSIBILITIES AND RESTORATION OF TEN-WEEK DURATIONAL DISQUALIFICATION.**

- According to the study released by the Washington State Employment Security Department the 2003 law change on what constitutes “good cause” for voluntarily separating from employment for domestic or marital responsibilities revealed a substantial gender bias in denials for women.
- The main reasons for voluntary quits due to domestic or marital responsibilities were losing child care, job transfer of the spouse, illness of a family member, and the loss of ten-week durational disqualification.

**3. RESTORE EMPLOYMENT SECURITY DEPARTMENT’S DISCRETIONARY AUTHORITY WHEN MAKING ELIGIBILITY DETERMINATIONS DUE TO WORK-RELATED VOLUNTARY QUIT FACTORS.**

- The current scope for what constitutes “good cause” for quitting is so narrow that wages, hours, or working conditions can deteriorate to the point of “unreasonable hardship or abuse” but not rise to the level necessary for “good cause.”

**4. ENACT SUTA DUMPING LEGISLATION, INCLUDING LANGUAGE ON PROFESSIONAL EMPLOYEE ORGANIZATIONS (PEOs), WHICH REQUIRES ALL EMPLOYERS TO PAY THEIR FAIR SHARE OF EXPERIENCE RATED TAXES**

- According to a 2003 GAO report SUTA dumping in 14 states accounted for over \$120 million in lost UI tax revenues for those states and three out of four accounting firms encourages SUTA dumping as a way to avoid UI taxes.
- California reports that have of its \$ 100 million yearly losses due to SUTA Dumping is the result of PEOs. All businesses that use PEOs need to pay their earned experience rating to prevent other businesses from unfairly picking up the costs.

5. PROVIDE THE EMPLOYMENT SECURITY DEPARTMENT WITH THE TOOLS AND THE FUNDING NECESSARY TO CRACK DOWN ON EMPLOYERS WHO ENGAGE IN UI TAX AVOIDANCE, WHICH OTHERWISE CREATES MORE COSTS PLACED ON HONEST EMPLOYERS.

- Retain all penalty and interest money, both employee and employer shares, within the Employment Security Department to create a fund source for cracking down on SUTA Dumping and investigating the underground economy.
- Use 75% of the penalty and interest money to do targeted audits of businesses that fit the SUTA Dumping profile and to investigate businesses that are suspected of being a part of the underground economy or of misclassifying their workers as independent contractors to avoid paying UI taxes.
- Focus 90% of ESD's efforts on targeted audits of tax avoiders with the remaining 10% fulfilling the federal mandate of at least 10% random audits.
- Treat corporate officers the same under UI law as they are under Revenue and under L&I, holding them accountable for past due taxes; and tightening eligibility requirements for receiving benefits.

What follows is text supporting these recommendations as well as the context from which they were derived.

## COMPETITIVENESS

In June of 2003 a radical piece of unemployment insurance legislation, ESSB 6097, passed the state legislature without ever having had a public hearing. In fact the bill was unavailable to the public until after it passed. In years past, attempts had been made to address a problem of tax inequity in the U.I. financing system. ESSB 6097 radically departed from this approach by making a general argument that anything that reduces an employer's cost in any way and in any amount makes that employer more competitive. Under the notion of competitiveness, the foundation of our U.I. system was upended.

In July 2005 several southern U.S. states, including Alabama, Arkansas, and Tennessee lost a bidding war for the new Toyota RAV-4 plant. These states had offered Toyota some of the nation's lowest unemployment insurance taxes and benefits, extremely low corporate taxes, and several hundred million dollars in tax incentives.

The Toyota Corporation decided to locate the new production facility in Woodstock, Ontario despite the fact that Canada's unemployment insurance taxes and benefits were significantly higher than those in the southern states.

Toyota said they chose Canada because the skill level of Canada's workforce was significantly higher than that of our southern states and because health care costs are significantly lower.

How can this be? **Because unemployment insurance taxes really have nothing to do with competitiveness.**

Former Secretary of the Treasury and CEO of the ALCOA Corporation, Paul O'Neill, put it this way:

**I never made an investment decision based on the Tax Code...**[I]f you are giving money away I will take it. If you want to give me inducements for something I am going to do anyway, I will take it. But good business people do not do things because of inducements, they do it because they can see that they are going to be able to earn the cost of capital out of their own intelligence and organization of resources.

Closer to home, addressing the National Conference of State Legislatures this past August in Seattle, Bill Gates answered the question how do you best make the state competitive by saying, for his industry, it was not about taxes: "...there are some very specific issues. But, if you took one that when you stepped back and had to look at it that kind of trumps all the others, it absolutely is K through 12 education and university education."

Why do those corporate leaders feel taxes are insignificant? Because according to the U.S. Department of Labor federal and state unemployment insurance taxes represent

no more than 1% of total labor costs and according to the Internal Revenue Service all taxes combined represent only about 1.2% of a typical company's cost of doing business.

All of the above is consistent with what site location experts point to as primary factors in location decisions. Companies want to locate in areas with a high quality of life, strong educational systems and a skilled workforce, and strong transportation and energy infrastructures. Taxes in general are secondary factors and unemployment taxes don't even register on the scale.

## **LIBERAL CONSTRUCTION AND 2 QUARTER AVERAGING**

ESSB 6097 removed "liberal construction" from the law. A bedrock principle of both state and federal law is that employment legislation is remedial in nature and therefore liberally construed. This basic tenet of law recognizes that the employer is the agent that causes the negative action and the function of the law is to soften the blow on the worker. In the case of unemployment insurance, liberal construction mitigates against the harshness of being unemployed. Liberal construction of the law is an attempt to level the playing field, requiring the employer to meet the burden of proof in close calls.

ESSB 6097, by calculating benefits over three-quarters of a year in 2004 and then over all four-quarters of a year through April 2005, caused over 80% of unemployed claimants to lose benefits. Three-quarter averaging caused an average drop in benefits of 8%, while four-quarter averaging caused an average drop of 16% in benefits. What these averages mask, however, is the fact that thousands of workers lost between \$100 and \$200 a week in benefits, placing them in jeopardy of losing their cars, houses, and families.

Though almost all workers were impacted by these changes, not all were impacted equally. Hardest hit were workers in agriculture, construction, and the clerical industries; women and workers of color were disproportionately hit; and workers in rural areas were adversely impacted.

It is estimated that between January, 2004 and April, 2005, as a result of how benefits were calculated, workers lost over \$ 75 million in benefits and the economy lost over \$175 million in purchasing power. Workers and their families were dramatically impacted. The bottom lines of many businesses were negatively impacted. Job creation was negatively impacted.

## **GOOD CAUSE VOLUNTARY QUILTS**

The change in Washington law around "good cause" for voluntary quits has had a profoundly discriminatory impact on women recipients of unemployment insurance.

First the denial rate for voluntary quits rose from 61% to 73 percent. Second, while voluntary quit issues represent a small number of UI claims overall, the higher denial rates impact women more than men. Under the new law, of the total 16,825 voluntary quit decisions, 1,989 decisions had negative outcomes due to the change in the law, a difference in outcome in nearly 12 percent of cases. Sixty-one percent of voluntary quit denials have been issued to women; the remaining 38.6 % to men. Under the old law, 52 percent of denials were to women and 48% to men. This represents a 9.4 % percentage point increase in the proportion of denials issued to women under the new law.

## **COST SAVINGS AND AVERAGE UI TAXES**

What became clear over the course of the past few months is that average UI taxes in Washington State are not 200% to 300% of the national average UI tax. According to Dr. Vroman average UI taxes in Washington State compared to the national average for the period 1995 – 2004 is 1.91 or 191%. If however you calculate in the changes from continued cost savings derived from ESSB 6097 and EHB 2255, assuming we stay permanently at 2 quarter averaging and other states experiences stay the same, Washington's ratio drops to 1.61 or 161%.

The fact that we are still higher than the national average can be explained by a combination of factors including: our unemployment rate is historically 1 percentage point above the national average; Washington is a relatively high wage/high skill state and so benefits are naturally higher; and the cost of living in Washington State is higher than the national average.

We also learned that if we permanently restore 2 quarter averaging, the business community will **save over a billion dollars in taxes over the next five years**. In addition, due to way Washington's social cost factor is calculated, businesses will save an additional \$ 110 million in 2009 and \$ 61.8 million in 2010. On top of this the trust fund is strong and solvent.

## **REPEAT CLAIMS AND MAXIMUM UI TAXES**

At this time it is our position that we do not think that we have a solid enough analysis to understand the ramifications of, or the need for, penalties applied to workers, who through no fault of their file claims in successive years, or to the employers for whom they work and who are responsible for the lay-offs.

## INCREASING TAX EQUITY

Preventing UI tax evasion is a critical component of a fair and balanced UI system: if employers are not paying their fair share, they cause others to make up the difference. Moreover, failure to collect all taxes owed can threaten the solvency of the system.

When Dr. Wayne Vroman first studied the Washington UI system in 1997, he identified socialized costs due to inactive accounts as an issue. In 2004, Washington's "death rate" for firms is the highest in the nation, and Vroman suspects that some "gaming" of the system; i.e., firms going out of business and re-establishing themselves in order to gain lower rates, is occurring. Vroman estimates that the cost to the state trust fund of socialized charges to these inactive accounts averaged \$13.6 million per year from 2000 through 2004.<sup>i</sup>

Two ways to address these issues are to incorporate stronger language in to Washington's anti-SUTA dumping statute, including addressing issues raised by employers' use of professional employee organizations, and to target audits of employers in order to reduce tax evasion.

Washington was one of the first states to enact legislation that took a closer look at transfers of businesses between companies that result in a lower UI tax rate ("SUTA dumping"). Since then several states have in place systems addressing tax rate pooling by professional employee organizations, or "PEOs," companies that "lease" back employees of businesses to perform long-term work for those businesses. These states require businesses that use PEOs to have their own individual experience rating, rather than pooling experience rating. Washington does this in its workers' compensation system, but current UI law allows PEOs to report UI taxes based on the pooled experience of their clients, rather than on the client's own experience. Washington should require all companies to report their own experience, whether or not they contract with a PEO, as it does in its workers' compensation system.

In 2000, a USDOL study found that over 10 percent of Washington employers audited had misclassified employees as independent contractors, thereby exempting themselves from the payment of UI taxes.<sup>ii</sup> Washington should use funds from its penalty and interest account to target investigations to industries that commonly violate the law: services, construction, manufacturing and agriculture.

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<sup>i</sup> Id., slides 48, 50 and 51.

<sup>ii</sup> Planmatics, Inc., (for US DOL, Employment and Training Administration), *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs*, (February 2000), Figure 5.1.