SUTA DUMPING

AND

STRATEGIES FOR HANDLING A MICHIGAN

UNEMPLOYMENT INSURANCE AGENCY

TAX AUDIT

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I. INTRODUCTION.

Michigan utilizes a gross wage record system, reported quarterly by employers, to determine entitlement to unemployment benefits for unemployed workers and employment taxes and contributions by employers. The Michigan Unemployment Insurance Agency ("***UIA***") administers the payment of unemployment benefits and the collection of unemployment taxes and contributions from employers under the Michigan Employment Security Act (the "***MES Act***"). See, MCL 421.1, et seq.

A. A Liable Employer.

Generally, a liable employer is an "employing unit" that either (1) employed 1 or more employees in each of any 20 different weeks in a calendar year; or (2) paid $1,000 or more in payroll in a calendar year to employees covered by the MES Act; or (3) acquired the trade, organization, or business, or a portion (previously at least 75%) of the assets of a liable employer.

B. The UI Payroll Tax Base.

The Michigan unemployment insurance ("***UI***") tax base is the first $9,000.00 of covered compensation paid to each employee each year. The federal minimum UI tax base is $7,000.00 established in 1983.

The UI payroll tax is a "per worker" tax. If a worker holds a given job all year, the employer pays the UI tax once. If two workers hold the job (one quits in June of 2006 and a new employee is hired in July of 2006), the employer pays the tax twice (once for each worker).

C. Gross Wages.

Wage detail information must be provided for every covered employee to whom wages were paid during the calendar quarter.

Wages that were earned, but not actually paid, are not reported until the wages are paid. "Wages" include amounts paid in either cash or in a medium other than cash, such as the cash equivalent of meals furnished on an employer's premises and the cash equivalent of lodging provided by an employer as a condition of employment unless the meals or lodging are solely for the benefit of the employer. Wages includes commissions and bonuses, awards and prizes,

vacation and holiday pay, sick pay when paid to liquidate a worker's balance of sick pay at the time of separation from employment, tips actually reported by the worker to the employer, and the cash value of a cafeteria plan if the employee has the option under the plan to choose cash.

"Wages" (MCL 421.44(2)) do not include the following payments:

- Severance Pay
- Profit sharing
- Sick pay paid under an employer plan on account of sickness
- Contributions to a retirement plan
- Discounts on purchases from the employer, or
- Reimbursements to employees for expenses incurred on behalf of an employer.

D. UI "Experienced" Tax Rates.

Except for new employers, UI payroll tax rates are experience rated, which generally means that an employer's tax rate is tied to the unemployment claims paid to the prior employees of that employer. Experience rating requires UIA to trace UI benefits received by a worker to a particular employer.

Early each year, the UIA issues a Form 1771 (Tax Rate Determination for Calendar Year 20__). Form 1771 states the employer's prior Actual Reserve, benefits charged and contributions paid since the last annual determination, and the employer's new actual reserve. It also shows the employer's 12-month total and taxable payrolls, and the required reserve, as well as the employer's 60-month taxable payroll, and the benefit charges during that 60-month period. It then shows the calculated amount of each component of the employer's tax rate, and the new IU tax rate.

Generally, in the first two years of an employer's liability, the UI tax rate is set by law at 2.7%, except for employers in the construction industry, whose rate in the first two years is that of the average employer in the construction industry which average construction rate is announced by UIA early each year. In recent years, the new construction rate has ranged from 6.8% to 8.1%.

The rates in the third and fourth years of an employer's liability are based partly on the employer's own history of benefit charges and taxable payroll. This history is known as an employer's UI "experience". Beginning in the fifth year of liability, the UI tax rate is made up of three components which are computed separately and then added together to figure the yearly UI tax rate. The three components are the Chargeable Benefits Component, the Account Building Component, and the Nonchargeable Benefits Component.

The Chargeable Benefits Component and the Account Building Component are affected by the employer's actual payroll, and the unemployment benefit charges to the employer's account. Since these components reflect each employer's experience, they are known as the "experience components", and the entire taxing computation is known as "experience rating".

For 2006, the maximum UI tax rate in Michigan is 10.3% (plus penalties).

E. Reporting Requirements.

Once registered and determined liable under the MES Act, employers are required to provide wage detail information on a quarterly basis to the UIA for each covered employee paid wages during the calendar quarter. The Wage Detail Report may be submitted using any one of the following methods: (1) internet; (2) tape cartridge or (3) paper (UIA Form 1017).

F. Why Experience Rate?

1. Equity/Fairness. Employers who burden the system with layoffs and benefit payments are charged for the benefit payments.

2. Efficiency. Avoid subsidizing employers and industries that layoff many workers and support industries offering stable employment.

G. Experience Rating and State Unemployment Tax Act ("***SUTA***") Dumping.

Experience rating creates an incentive for some employers with bad layoff experience and a high UI tax rate to "dump" their tax liability on other employers, using one of three basic approaches:

1. "Vertical" SUTA Dumping. An employer creates a new entity (typically a limited liability company) that carries the new employer tax rate (2.7%) and transfers all or most of the employer's workers to the new entity.

2. "Horizontal" SUTA Dumping. An employer transfers some of its employees to an existing subsidiary entity with a better layoff experience and a lower UI tax rate.

3. "Transfer" SUTA Dumping. An employer transfers some of its employees to another employer with a better layoff experience and a lower UI tax rate, and the employees are then leased back to the former employer. The old entity continues to exist with the higher UI tax rate, but the old employer has little or no remaining payroll and therefore pays less UI tax. This is the technique sometimes used by professional employer organizations and employee leasing companies.

II. UIA's AUDIT PROCESS AND ISSUES.

A. Common UI Audit Issues.

- SUTA Dumping, which is UIA's number one priority
- Detecting and dealing with Professional Employer Organizations ("***PEOs***") and Employee Leasing Companies ("***ELCs***")
- Successor Liability cases
- Detecting and dealing with Business Reorganizations

- Detecting and dealing with Business Sales and other "transfers of business"
- Employer failures to include all taxable wages in the UI tax base
- Detecting Unregistered Employers
- Misclassification of workers as "independent contractors" rather than as "employees".

B. UIA's Audit Process and Priorities.

1. Detection by UIA:

- IRS information sharing
- U.S. Department of Labor's SUTA Dumping Detection System ("***SDDS***")
- SDDS and information sharing with other States
- Tips from competitors
- Tips from disgruntled former/current employees

2. UIA's Audit Priorities and the Use of its Resources:

- Michigan's July 2005 Anti-SUTA Dumping legislation (2005 P.A. 18), discussed below, has had a significant impact on UIA's priorities and the use of its resources.

- Michigan's 2005 Anti-SUTA Dumping legislation requires UIA to provide an annual written report to the Michigan Legislature regarding UIA's procedures, use of its resources, and its success in pursuing SUTA Dumping cases.

- UIA's January 2006 SUTA Dumping Report to the Michigan Legislature disclosed the following:

  (i) 162 SUTA Dumping investigations were opened by UIA during 2005;

  (ii) The average length of time taken to resolve a SUTA dumping investigation during 2005 was 6 months;

  (iii) During 2005, 22 SUTA investigations were pending for more than six months;

  (iv) During 2005, 25 SUTA investigations were pending for more than one year;

  (v) During 2005 only 1 SUTA Dumping case was appealed by an employer to an administrative law judge ("***ALJ***"). UIA won the appeal, which case included the imposition of a negligence penalty on the employer and the employer's advisor;

  (vi) During 2005, no SUTA Dumping cases were appealed by employers to the Board of Review;

(vii) During 2005, no money was recovered by UIA as a result of implementing the July 2005 Michigan Anti-SUTA Dumping legislation;

(ix) During 2005, 11 full time UIA workers were assigned to UIA's SUTA Dumping Unit;

(x) During 2005, 56 SUTA dumping investigations involved the transfer of employees to and/or from an employee leasing company;

(xi) During 2005, 54 investigations involved employee leasing companies that were found to have participated in SUTA dumping; and

(xii) As of December 31, 2005, UIA had identified 1,420 PEOs and employee leasing companies operating in Michigan.

3. Investigation by UIA:

- UIA analysts/auditors meet with an employer's decision makers
- UIA requests and gathers documentation, including the following:

  - UIA Forms 1772 (Discontinuance or Disposition of Business or Assets)
  - UIA Forms 1027 (Business Transferor's Notice To Transferee of Unemployment Tax Liability And Rate)
  - UIA Forms 1184 (Employer's Report on Partial Transfer of Business)
  - UIA Forms 1184-1 (Report and Agreement on Partial Transfer of Business Certification)
  - UIA Forms 1045 (Status Questionnaire for Employee Leasing Companies)
  - UIA Forms 1045-A (Disclosure Statement for Employer Leasing/Client Companies with Common Officers/Ownership/Family Members)
  - Michigan Department of Treasury Form 518 (Registration for Taxes), including Schedule A (Liability Questionnaire) and B (Successorship Questionnaire)
  - IRS Forms 940 (Employer's Annual Federal Unemployment (FUTA) Tax Return)
  - IRS Forms 941 (Employer's Quarterly Federal Tax Return)
  - IRS Forms W2 (Wage and Tax Statement)
  - IRS Forms W3 (Transmittal of Wage and Tax Statement)
  - IRS Forms 8832 (Entity Classification Election)
  - IRS Forms 1120 (U.S. Corporation Income Tax Return)
  - IRS Forms 1120S (U.S. Income Tax Return for an S Corporation)
  - IRS Forms 1065 (U.S. Partnership Return of Income)
  - IRS Form 851 (Affiliated Company Schedule) attached to a corporation's IRS Form 1120. UIA obtains entity information when any subsidiary is located in Michigan.

- ❖ IRS Form SS-4 (Application for Employer Identification Number). Newly issued federal EINs (derived from Forms SS-4 filed with IRS) may disclose new "employers" who should have registered for UI taxes and/or a SUTA Dumping transaction.
- ❖ IRS Forms 1099-MISC. Multiple Forms 1099-MISC filed with the IRS may disclose taxable "wages" and that an employer is not registered for UI taxes.
- ❖ Employer's e-mails and internal memos
- ❖ Bills of Sale for transferred assets and businesses
- ❖ Corporate minutes describing the formation of the new entity(s). New entities are typically formed as limited liability companies.
- ❖ Bank account names and numbers for payroll and operating expenses
- ❖ Notice of Coverage of Worker's compensation insurance coverage
- ❖ Notice to employees of fringe benefits (such as health, life, disability and/or retirement benefits)
- ❖ Real estate and equipment leases between new entity(s) and former company
- ❖ Management/service agreements between new entity(s) and former company
- ❖ Telephone listings of new entity(s) and former company
- ❖ Internet Web domains of new entity(s) and former company
- ❖ Collective bargaining agreements ("***CBA***") with unions

4. <u>UIA Post-Investigative Conference with Employer and Its Advisors</u>:

- ➢ UIA's auditors and SUTA Dumping analysts ask the employer's executives, accountants and/or attorneys for admissions/comments regarding the UIA's tentative factual and legal conclusions, such as:

  - ❖ Why did you set up the new entity(s)?
  - ❖ Who advised or assisted you in restructuring your business? Your accountant or lawyer?
  - ❖ Who advised you to set up the new entity(s)? Your accountant or lawyer?
  - ❖ Is the new entity disregarded for federal income and Michigan single business tax purposes?
  - ❖ What are the federal TINs of all of the entities?
  - ❖ How is the new entity a distinct and severable portion of the former company? How is the new entity administered or managed?
  - ❖ How many employees (and what percentage of your total employees) were transferred to the new company? Why?
  - ❖ What company name(s) appear on invoices, payroll checks, bank accounts, contracts, letterhead, phone book, Internet web pages, etc?
  - ❖ Has the new entity obtained bank loans independently of the former company?
  - ❖ Other than SUTA taxes, which entity(s) report and remit quarterly income tax withholding and payroll taxes to the IRS, Michigan and cities?

- ❖ Are retirement and fringe benefit packages handled differently after the change in business structure?
- ❖ How are retirement and fringe benefits being handled now?
- ❖ Were workers informed of the business restructuring?
- ❖ Why don't these facts demonstrate a "transfer of business"?
- ❖ Why don't these facts demonstrate the employer's negligence or intentional disregard of the law?

- ➢ Common employer explanations:

  - ❖ "The Michigan Department of Treasury allows PEOs/employee leasing companies to minimize single business taxes."
  - ❖ "We need to have separate accounting for possible future litigation."
  - ❖ "We need to have separate accounting for the future sale of our business."
  - ❖ "Our union required that we separate our union and non-union employees"
  - ❖ "Our business purpose was ..…"

5. UIA Negotiates, Settles and/or Assesses Taxes, Interest and Penalties:

- ➢ UIA will assess UI taxes, interest and penalties for all open tax periods.

- ➢ Penalties (discussed below under Michigan's July 2005 Anti-SUTA Dumping legislation).

- ➢ The statute of limitations for assessments is 3 years. See, MCL 421.15(j).

- ➢ The statute of limitations for refunds of UI taxes is also generally 3 years. See, MCL 421.16.

6. Administrative Appeals:

- ➢ Within 30 days after an adverse UIA determination, employers have the right to appeal an adverse "determination" to the State Office of Administrative Hearings And Rules ("***SOAR***") for a an evidentiary hearing before an ALJ. See, MCL 421.32a; MCL 421.33.

- ➢ Within 30 days after an ALJ's adverse determination, employers have the further right to appeal the referee's determination to the Michigan Employment Security Board of Review. See, MCL 421.33(2); MCL 421.34 and .35.

- ➢ The Board of Review's consideration of an adverse determination is generally based solely on the factual record created by the employer before the UIA and the ALJ.

7. Litigation and Appeals to Circuit Court:

- Employers have the right to appeal adverse determinations by the Michigan Employment Security Board of Review to Circuit Court. See, MCL 421.38.
- Generally, an appeal to Circuit Court must be filed within 30 days of the Board of Review's adverse determination. See, MCL 421.38(1).

- Circuit Court review of the Board of Review's determination is based solely on the factual record created by the employer before the UIA.

- The Circuit Court can only reverse the Board of Review if the agency decision is "contrary to law or is not supported by competent, material, and substantial evidence on the whole record." See, MCL 421.38(1).

III. MANAGING THE UIA'S AUDIT OF AN EMPLOYER.

A. Plan for the UIA Audit. Well thought out audit practices and procedures should be implemented by the professional advisor in managing the UIA's audit of an employer, including early recognition that administrative and judicial appeals may be pursued by the employer.

B. Manage the UIA Audit. The professional advisor's procedures should typically include the following:

1. Before UIA contacts the employer (and before an audit has begun), consider having the employer file for UIA's "voluntary"/quasi-amnesty SUTA Dumping program. UIA's "voluntary" SUTA dumping program is discussed below.

2. Once the UIA has contacted the employer, promptly file a Power Of Attorney (Michigan Department of Treasury Form 151) with the UIA.

3. Interview the employer's executives and employees in order to assemble the documents and information needed to analyze the factual and legal issues, and to respond to UIA auditor's requests for information.

4. Analyze the documents and information received from the employer. If the documents disclose or suggest a serious UI problem, do not produce documents to UIA until after the employer has consulted with legal counsel to assist in the audit (and possible future administrative appeals and litigation).

5. Develop a business purpose for employee transfers, assets transfers and/or corporate restructuring other than UI tax savings arising from a reorganization, business transfer and/or employee transfers.

6. Generally, respond to UIA requests for information in a prompt manner.

7. Meet the UIA auditors and supervisors at location(s) other than the employer's place of business. Meetings can be held at the UIA's offices or at the advisor's office.

Generally, the client should not be present at the meetings with the UIA's auditors and analysts.

8. Retain a duplicate copy of all documents and records provided to the UIA auditor or the SUTA Dumping Analyst.

9. Remind the employer that a timely (typically, within 30 days) written response (or appeal) must be filed to any "determination"(s) issued by the UIA. The employer should be cautioned to immediately provide its professional advisors with a copy of all letters and determinations issued by the UIA to the employer.

10. Consider filing a Freedom Of Information Act ("***FOIA***") request with UIA to obtain UIA settlements of UI tax disputes involving similarly situated employers. The North Carolina Attorney General has ruled that N.C. must disclose settlements of UI SUTA Dumping cases in response to a FOIA request.

11. Attempt to negotiate a possible settlement or compromise of UI taxes, interest and/or penalties.

12. If unable to resolve/settle the case, consider filing an administrative appeal to an ALJ with the SOAR. It is essential that the employer make a complete factual record at the hearing before the ALJ.

13. If unsuccessful with the appeal to the ALJ, consider an administrative appeal to the Michigan Employment Security Board of Review.

14. If unsuccessful with the appeal to the Board of Review, consider appealing the adverse determination to the Circuit Court in the county where the employer is headquartered.

IV. FEDERAL SUTA DUMPING PREVENTION ACT OF 2004.

A. Introduction. On August 9, 2004, President Bush signed the SUTA Dumping Prevention Act (the "***Federal Act***"). Under the Federal Act, states must adopt legislation to prevent SUTA dumping to qualify for federal unemployment insurance system administration grants.

B. Congressional Intent. Congress determined that there are a number of ways in which SUTA dumping harms the federal government, employers, states and workers.

SUTA dumping conflicts with the fundamental tenet of the experience-rated UI tax system, creates an unfair competitive cost advantage for employers that use SUTA dumping schemes, and disadvantages those employers who try to manage their work and maintain steady employment for their employees. SUTA dumping also reduces money in state unemployment compensation funds, causes overall increases in employers' taxes, and the loss of discounts to

employers that are triggered when state fund balances reach certain levels. SUTA dumping also reduces the funds available to pay unemployment benefits to unemployed workers.

C. Federal SUTA Dumping Regulations. The U.S. Department of Labor, Employment and Training Administration has issued two sets of regulations (in a question and answer format) under the Federal Act. See, Vol. 69, No. 187 Federal Register page 58550 (September 30, 2004), and Vol. 69, No. 219 Federal Register page 65654 (November 15, 2004).

D. Transfers of Only Employees Under the Federal Regulations. The U.S. Department of Labor Regulations make clear that the transfer of only employees from one entity to another entity can constitute SUTA Dumping. The federal Regulations state:

> "The transfer of some or all of any employer's workforce to another employer shall be considered a transfer of trade or business when, as the result of such transfer, the transferring employer no longer performs trade or business with respect to the transferred workforce, and such trade or business is performed by the employer to whom the workforce is transferred.
>
> Care should be taken to assure the state law does not require transfers of experience where an employee is 'moved' from one employer to another, without any transfer of trade or business, See Q & A 1-7…" (November 8, 2004 Regs, Question & Answer No. 1-2).

E. Substantially Common Ownership, Management or Control Under the Federal Regulations. The federal Regulations also take a broad view of what "substantially common ownership, management, or control" means under the Federal Act. The Regulations state:

> "[T]he Department is not defining a 'bright line" test of what constitutes 'substantially common ownership, management, or control.' …Therefore, 'substantially' could include less than 50% common ownership, management, or control. 'Substantial' common management, for example, might even occur where Company A and Company B share only one manager, but that one manager exercises pervasive control as the chief executive officer of both companies." (November 8, 2004 Regs, Question & Answer No. 1-3)

F. July 2005 Michigan Anti-SUTA Dumping Legislation. In response to the Federal Act, effective on July 1, 2005, the Michigan Legislature adopted Anti-SUTA dumping legislation (2005 Public Acts 16, 17, 18 and 19) (collectively, the "***Michigan Act***").

1. UI Tax Revenues. The Michigan Department of Labor and Economic Growth estimates that, by prohibiting SUTA dumping, the Michigan Act will increase revenue to the Michigan Unemployment Compensation Fund between $62 million and $95 million annually.

2. Michigan Legislature's Intent. The Michigan Legislature intended the Michigan Act "to be interpreted and applied in a manner so as to meet the minimum requirements of the SUTA Dumping Prevention Act of 2004, Public Law 108-295, and implementing federal regulations." (emphasis added) (2005 P.A. 18; MCL 421.22b(6)).

V. FEDERAL SUTA DUMPING DETECTION SYSTEM.

A. Introduction. The Federal SUTA Dumping Detection System ("***SDDS***") is an Internet based computer system developed by North Carolina in cooperation with the U.S. Department of Labor. SDDS is designed to aid States in tracking and auditing various kinds of SUTA activities.

B. SDDS Pilot Program. Seven states participated in the SDDS Pilot project (Nebraska, North Carolina, Rhode Island, Texas, Utah, Virginia and Washington).

The goal of the pilot project was to develop computer software to detect employer attempts to artificially lower their UI tax rates. One of goals of the SDDS pilot project was to incorporate the needs of all of the states into one computer program. Each state uses various criteria or filters to search the SDDS database. Employee payroll information and data on all employers who report information to their home states and their quarterly (and/or initial) reports are uploaded into the SDDS system.

C. Michigan and SDDS. Michigan participates in the SDDS system. Michigan received a $112,035 grant from the U.S. Department of Labor to help Michigan detect, prevent SUTA Dumping and implement the SDDS in Michigan.

D. The SDDS System is a Powerful Anti-SUTA Dumping Tool. The SDDS system enables states to conduct elaborate on-line computer searches using criteria to monitor employer compliance with federal and state SUTA laws, including the following:

- The movement of employees from one employer to another employer
- Employer UI tax rate changes (for example, from a higher UI rate to a lower UI rate)
- Employer tax rate histories
- Employer contact information
- Employer demographics (for example, multiple companies using the same TIN numbers, phone numbers, names and social security number of the owner(s) of employers, UI taxes paid, benefits charged, and number of employees employed by quarter)
- Worker demographics (for example, employee social security numbers, taxable wages, benefits claimed, dates of birth, education levels, genders, addresses, race and ethnicity).
- Top employers by growth rate (measured by number of employees and payroll)
- Top employers by benefit charges
- Top employers by total wages with no taxable UI wages

VI. UIA'S "VOLUNTARY" SUTA COMPLIANCE PROGRAM.

A. UIA's Quasi-Amnesty Program. The UIA has established a "voluntary"/quasi-amnesty SUTA Dumping program. According to the UIA, employers who "suspect that [they] may have been involved in a SUTA dumping plan … may avoid or reduce potential penalty and/or interest charges by voluntarily coming forward and contacting UIA…"

To "voluntarily" take part in a SUTA review, the employer must complete and file a UIA Form 1945 (Application For SUTA Dumping Program).

VII. MICHIGAN'S 2005 ANTI-SUTA DUMPING LEGISLATION.

A. The July 2005 Legislation. The Michigan Anti-SUTA Dumping Act amended the MES Act to do all of the following:

- Prohibit a person from transferring all or part of a trade or business solely or primarily for the purpose of reducing an employer's contribution rate or reimbursement payments in lieu of contributions required under the MES Act (i.e., SUTA dumping).

- Prohibit a company from acquiring all or part of a trade or business solely or primarily to obtain a lower contribution rate than otherwise would apply under the MES Act.

- Require that the UIA use objective factors to make the foregoing determinations, such as the cost of acquiring the business, continuing in operating the business enterprise of the acquired business, the length of time the business enterprise continues to operate, and the number of new employees hired to perform duties unrelated to the business activity or trade conducted before the acquisition.

- Prescribe sanctions and penalties against persons who knowingly violate or attempt to violate the Michigan Act.

- Require the UIA to recalculate the contribution rates of both employers if an employer transfers its trade or business to another employer and there is substantially common ownership, management or control of the two employers.

- Require the UIA to assign a new employer contribution rate to a person who is not an employer under the MES Act at the time of a transfer and who acquires a trade or business solely or primarily to obtain a lower contribution rate.

- Require that money recovered under these provisions be credited by UIA to the Michigan Unemployment Compensation Fund.

- Require the UIA to report annually to the Legislature regarding SUTA dumping.

- Establishes requirements concerning the payment of a balance, the transfer of benefit charges, and the continuation of reimbursement payments, that apply to a change in status between reimbursing employer and contributing employer.

B. No Special Treatment for PEOs. The Michigan Act does not specifically address SUTA dumping attributable to PEOs and/or employee leasing companies.

PEOs are independently established businesses that provide employees to a client entity. Typically, the client transfers its workers (and their related payroll) to the PEO who then leases the workers back to the former employer. If the transfer of workers to the PEO is respected by UIA and PEO has a lower UI tax rate than its client, SUTA taxes will have been minimized.

According to Department of Labor and Economic Growth, approximately 60% of the shortfall in the Michigan Unemployment Compensation Fund is due to employers that use PEOs to avoid paying their full share of unemployment taxes.

C. Pre-July 2005 MEA Act Bars SUTA Dumping. The UIA has been asserting in audits that the pre-July 2005 MES Act prevents SUTA Dumping, including the transfers of workers by employing units to PEOs and employee leasing companies. See, Pre-July 2005 MCL 421.22(a), (b) and (c) [each subsection deals with the "deemed" "transfer[s] of business" by an employer].

D. Retroactive Application of the Michigan Act by UIA. The UIA appears to be applying post-July 2005 Section 22b [MCL 421.22b(6) (2005 P.A. 18)], as well as the related Anti-SUTA dumping legislation (i.e., 2005 P.A. 16, P.A. 17 and P.A. 19), to tax years prior to the July 1, 2005 effective date of the Michigan legislation.

Michigan appellate courts have not yet determined whether (1) the Legislature intended that the July 2005 legislation be applied retroactively, and, if so, (2) whether it is constitutional for UIA to apply the legislation to tax years prior to the July 1, 2005 effective date of that legislation.

E. Penalties for Violating the Michigan Act. No penalties are associated with merely moving employees from one employer to another, even if both employers are under substantially common ownership, management or control. If, however, a transferring or acquiring employer knowingly violates or attempts to violate the prohibitions set forth in MCL.22b(1), then the employer will be assigned the higher of the following UI contribution rates:

1. The highest contribution rate assignable under the Michigan Act for the rate year during which the violation or attempted violation occurs and for the three rate years immediately following that rate year (currently 10.3%), or

2. If the employer's business is already at the highest rate assignable for a year in which the violation occurs or if the highest rate assignable would result in an increase of less than 2% of taxable wages, an additional penalty rate of 2% of taxable wages for that year.

3. The Michigan Act (MCL 421.22b(5)(a)) defines "knowingly" as "having actual knowledge of, or acting with deliberate ignorance or reckless disregard for, the prohibition involved."

4. In addition, penalties may be imposed for the underpayment of employment taxes, negligence (5% penalty), intentional failure to comply with the MES Act (5% penalty), fraud (50% penalty) and/or for the making of a false statement or willful and knowing failure to disclose a material fact.

5. The penalty imposed for a willful violation or intentional failure to comply is equal to tax avoided plus damages equal to three times that amount and may include criminal prosecution. See, MCL 421.54(a)(i) and (ii).

6. The penalty imposed for making a false statement or the knowing and willful failure to disclose a material fact is equal to the tax avoided plus damages equal to four times that amount and may also include criminal prosecution. See, MCL 421.54(b)(i) and (ii).

7. If a person knowingly violates or attempts to violate P.A. 18's prohibitions, or if a person knowingly advises another person in a manner that causes a violation, a civil fine of up to $5,000 may be imposed.

8. These penalties are in addition to any sanction available under Section 54(b) or 54b of the MES Act. Section 54(b) prescribes civil and criminal penalties for certain violations involving false statements made knowingly or within the intent to defraud.

VIII. UIA's RECENT SUTA DUMPING SUCCESSES.

A. Public SUTA Dumping Announcements by UIA. In April 2006, UIA announced that it had imposed $281,416 of UI taxes, penalties and interest on two companies. One case involved an employer in the construction industry and the other was a PEO. The construction company had attempted to avoid UI taxes by opening a new company and shifting its employees from the original construction company (with a high unemployment tax rate) to the new construction company with a much lower tax rate. The company was assessed $109,913 in UI taxes, penalties and interest.

The second case involved a PEO that had multiple movements of employees between employer accounts. Employees were moved from a company with a higher UI tax rate to one with a lower rate, without disclosing the transferring of employees to the UIA. $171,503 in UI tax, penalties, and interest were assessed against the employer.

In December 2005, UIA announced that three companies had reached settlements with the UIA. One of the companies was an accounting and consulting firm and was the first Michigan advisor to pay a fine for a case involving SUTA Dumping. According the UIA, the

CPA firm reached a negotiated settlement and paid a $25,000 penalty. In addition, the CPA firm agreed not to offer inappropriate unemployment tax advice to clients in the future.

The second employer was a trucking company and paid $4,200 in UI taxes and interest. The company had set up a "captive" leasing arrangement by forming its own employee-leasing company, to which it shifted its employees and then leased them back to itself, thereby purportedly avoiding some unemployment taxes.

The third employer was a furniture company. It agreed to pay $13,000 in UI taxes plus interest. The furniture company closed its unemployment tax account and transferred its employees to a new company at the "new" employer tax rate of 2.7 percent, which was lower than the company's former tax rate. UIA assessed $13,100 against the company.

In October 2005, an employer agreed to pay in excess of $500,000 to UIA. The construction company employer set up a "captive" leasing arrangement, forming its own employee-leasing companies from which it leased its employees. UIA became aware of the case through one of its field auditors, who discovered the company was no longer reporting wages although it was clearly still in business. UIA determined that the employer intentionally avoided its unemployment tax experience (by shifting its employees from the construction firm to three leasing companies it owned). UIA assessed UI taxes of $513,500.

The second case involved QCR Tech LLC, a Madison Heights-based automotive and aerospace prototyping business. QCR cooperated with the UIA and paid approximately $32,000 in UI taxes. In this case, on the advice of professionals, QCR purchased another company and structured the purchase to avoid assuming the seller's higher unemployment tax rate and the resulting higher UI tax payments.

In August 2005, UIA announced that it had assessed $55,000 in unpaid UI taxes, penalties and interest against three employers. The three cases involved a Detroit area landscaping firm, a Canadian computer technology firm with Michigan operations, and a western Michigan agricultural business. Each of these cases were brought to UIA's attention by tips.

The landscaping firm agreed to pay UIA $10,000 in unpaid taxes, penalties and interest. The firm had set up two accounts with the UIA and would periodically shift its employees between the two accounts to pay less in unemployment taxes.

The computer technology firm was purchased by a Canadian business, which established a new employer tax account with the agency and transferred the technology firm's employees to the new account with a new (2.7%) unemployment tax rate. The firm paid more than $28,000 in UI taxes, penalties and interest.

The agricultural company established a new employer account and, after a period of time, moved some employees to the new business with a 2.7% tax rate. UIA assessed $17,000 in unpaid unemployment taxes, penalties and interest.

Finally, in February 2005, the UIA announced that it had assessed $2.4 million in UI taxes in a case against Aramark Services Management of Michigan, Inc. that involved eight separate businesses that had transferred all of their employees to a single organization as part of a corporate restructuring. The eight companies had moved their employees to one entity to receive a lower UI tax rate. The reorganization was done without transferring assets between the companies. Aramark Services agreed to pay $2.4 million to cover the unpaid UI taxes, while UIA agreed to waive all interest and penalties.