

**UNEMPLOYMENT
INSURANCE
AGENCY**

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SUTA Dumping

Manipulating unemployment tax rates to pay less in taxes

What is SUTA Dumping?

SUTA (state unemployment tax act) Dumping is a tax evasion practice involving the manipulation of an employer's unemployment insurance (UI) tax rate to achieve a lower rate, and thereby pay less UI taxes. Typically, SUTA Dumping occurs when a business transfers payroll out of an existing company or organization to a new or different organization solely or primarily to reduce UI taxes.

How can the UI tax rate be manipulated?

There are three common ways, along with many variations, that are most often used to manipulate the tax rate. They are:

- **Vertical method** – Create a “new” employer that is assigned a “new” employer tax rate of 2.7%, and then transfer payroll to the new employer.
- **Horizontal method** – Transfer payroll to a subsidiary with a lower UI tax rate.
- **Acquired rate method** – Find another employer with a low UI tax rate and arrange to transfer payroll to that employer.

What is the harm in SUTA Dumping?

There are several ways in which SUTA Dumping harms employers and the state's UI trust fund.

- SUTA Dumping goes against the fundamental tenet of an experience-rated tax system that is widely supported by the employer community. The UI tax rate is based on an employer's history of benefit charges. With SUTA Dumping, an employer with a high UI tax rate attempts to hide behind a different company with a lower tax rate and dump their UI costs on all other employers.
- SUTA Dumping creates a competitive cost advantage for employers practicing UI tax evasion.
- SUTA Dumping reduces money in Michigan's UI trust fund, causing an increase in unemployment tax rates for all employers. Losses to Michigan's trust fund, because of SUTA Dumping, range between \$62 and \$95 million this year.
- SUTA Dumping has already affected Michigan employers by reducing the tax dollars going into the UI trust fund. As a result, the state was unable to grant employers a 10% across-the-board cut in UI taxes because the trust fund failed to meet the required threshold level.
- SUTA Dumping reduces funds available to pay unemployment benefits to unemployed workers.
- SUTA Dumping puts those employers at a disadvantage who try to manage their work and maintain steady employment for their employees.
- SUTA Dumping rewards employers for dumping their UI responsibility for past benefit charges on the rest of employers.

Although only a small percentage of employers are involved in SUTA Dumping, all employers are impacted because the “escaped responsibility for benefits paid” ends up with the rest of Michigan's employers.

What is the penalty for engaging in SUTA Dumping?

If you participate in a SUTA Dumping practice and are discovered, you run the risk of paying a penalty that would amount to **four times any savings** you would have received by manipulating your tax rate. Your UI tax rate would also be increased to the maximum tax rate (but not less than a 2% increase), for the year in which we determined that you engaged in SUTA Dumping, and for the next three years. A new civil penalty of up to \$5,000 will apply if the person who engaged in SUTA Dumping is not an employer.

What should you do if you believe you may be SUTA Dumping?

If you have or think you have been taken in by someone's tax advice, or if you would like the

Fact Sheet

Unemployment Insurance Agency (UIA) to review your account, please call the agency's Employer

Customer Relations hotline at **1-800-638-3994**. If you *voluntarily* request an audit determination, any penalties you may be assessed for SUTA Dumping could be substantially reduced.

Many businesses become involved with SUTA Dumping because of a suggestion or recommendation from a consultant or accountant. Such illegal advice is usually disguised with terms like "tax management" or "tax avoidance."

What is Michigan doing to combat SUTA Dumping?

Legislation

- On May 4, 2005, Gov. Jennifer Granholm signed into law several changes to the *Michigan Employment Security Act* that make it more difficult for employers to engage in SUTA Dumping. These changes became effective July 1, 2005, and will, in combination with existing law provisions:
 - Prevent an employer from forming a new business and then transferring existing employees to that business and claiming the 2.7% "new employer" tax rate for the sole or primary purpose of reducing the employer's UI tax rate.
 - Require an employer's UI tax liability to follow employees when they are shifted to a different business owned or controlled by the same persons or interests that operated the first business for the sole or primary purpose of reducing the employer's UI tax rate.
 - Require a nonprofit, governmental unit, or an Indian tribe, that is a "contributing" employer and pays UI taxes quarterly, to pay its previous UI debt and its experience account balance before being allowed to convert to reimbursing status. Also, if an employer applies for conversion from reimbursing to contributing status, it must continue to pay its outstanding unemployment benefit payments that were charged to its reimbursing account. A reimbursing employer reimburses UIA dollar-for-dollar for unemployment benefits paid to its former employees.
 - Increase an employer's UI tax rate to the highest possible rate for the current and following three years, if the employer engages in SUTA Dumping. A new civil penalty of up to \$5,000 will apply if the person who engaged in the SUTA Dumping is not an employer.
 - Impose on those, who advise their clients to SUTA dump, the current fraud penalty of four times the amount of avoided taxes. The four times penalty, within the *Act's* fraud provisions, continues to apply to employers who engage in SUTA Dumping.
 - The U.S. Department of Labor (USDOL) notified the UIA in October 2006 that the SUTA section of Michigan's MES Act is out of conformity with federal law and must be amended. The UIA is working on corrective legislation.

Detection

- Michigan implemented software developed by the USDOL to detect SUTA Dumping. UIA is also using other screening methods. A referral list of those possibly engaged in SUTA Dumping has been growing, and a UIA team is pursuing those engaged in the practice.

Education

- Michigan has implemented an information program to educate employers about the harm of SUTA Dumping, the law prohibiting it and the statutory penalties.

Enforcement

- UIA has assembled a team to investigate and aggressively enforce the anti-SUTA Dumping provisions of the MES Act.

SUTA Dumping is a national problem

Michigan is not alone in its efforts to combat SUTA Dumping. Other states are also involved in their own efforts to fight the problem, and Michigan is partnering with those states in our effort to detect SUTA Dumping. Michigan is one of seven states being studied by the USDOL on the effects of SUTA Dumping. This study should be completed and available July 2007.

For more information about SUTA Dumping

To learn more about SUTA Dumping, or if you suspect another employer is engaging in SUTA Dumping, visit UIA's website at www.michigan.gov/uia, or call our Employer Customer Relations Unit at 1-800-638-3994.



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