

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 5036-02
Bill No.: Perfected HCS for HB 1756
Subject: Employees-Employers; Labor and Industrial Relations, Department of; Labor and Management; Taxation and Revenue-General.
Type: Original
Date: April 7, 2016

Bill Summary: This proposal establishes the Employee Reclassification Act.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
General Revenue	(\$109,210)	\$0	\$0
Total Estimated Net Effect on General Revenue	(\$109,210)	\$0	\$0

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Total Estimated Net Effect on <u>Other</u> State Funds	\$0	\$0	\$0

Numbers within parentheses: () indicate costs or losses.

This fiscal note contains 7 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
UI Administration Fund	\$0 or (\$38,000,000)	\$0 or (\$38,000,000)	\$0 or (\$38,000,000)
Wagner Peyser Fund	\$0 or (\$12,000,000)	\$0 or (\$12,000,000)	\$0 or (\$12,000,000)
Total Estimated Net Effect on <u>All</u> Federal Funds	\$0 or (\$50,000,000)	\$0 or (\$50,000,000)	\$0 or (\$50,000,000)

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Total Estimated Net Effect on FTE	0	0	0

Estimated Net Effect (expenditures or reduced revenues) expected to exceed \$100,000 in any of the three fiscal years after implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Local Government	\$0	\$0	\$0

FISCAL ANALYSIS

ASSUMPTION

House Amendment 1

Officials at the **Department of Labor and Industrial Relations (DOLIR)** assume this amendment will have a negative fiscal impact on their organization based on the following. The federal and state governments are jointly responsible for administering the unemployment insurance (UI) system. State laws must meet certain federal requirements for the state agency to receive the administrative grants needed to operate its UI program and for employers to qualify for certain tax credits.

The bill adds a new section 285.517, which requires the department to afford employers the same relief provisions afforded to employers under Section 530 of the Internal Revenue Code of 1978 (Safe Harbor).

A previous review of this bill by the United States Department of Labor (USDOL) has identified issues that will affect certification of Missouri's unemployment insurance (UI) program.

Non-conformity with federal law could jeopardize the certification of Missouri's UI program. If the program fails to be certified, Missouri would lose approximately \$38 million in federal funds the state receives each year to administer the UI program. Additionally, Missouri would lose the approximately \$12 million in federal funds each year the Department of Economic Development - Division of Workforce Development uses for Wagner-Peyser reemployment services.

Oversight assumes the proposed language may result in conformity issues with federal law. Oversight will show the loss of federal funds as \$0 (the proposal would be implemented in a way that does not conflict with federal technical requirements) or the amount estimated by DOLIR, \$38 million (Missouri fails to comply with federal regulations) to the Unemployment Insurance Administration Fund and \$0 or \$12 million to the Wagner Peyser Fund.

DOLIR notes that the Federal Unemployment Tax Act (FUTA) imposes a 6.0% payroll tax on employers. Most employers never actually pay the total 6.0% due to credits they receive for the payment of state unemployment taxes and for paying reduced rates under an approved experience rating plan. FUTA allows employers tax credits up to a maximum of 5.4% against the FUTA payroll tax if the USDOL's Secretary of Labor approves the state's UI law. However, if this proposal causes Missouri's program to be out of compliance or out of conformity, Missouri employers would pay the full 6.0%, or approximately an additional \$917 million per year.

ASSUMPTION (continued)

This proposal raises two issues with federal law. First, section 285.517 raises a required coverage issue with federal law. This section requires that the DOLIR afford employers the same relief afforded to employers under Section 530 of the IRC of 1986, as amended. This reference to Section 530 of the IRC is to the "safe harbor" provision. However, the safe harbor provision is solely a tax relief provision. It does not amend the definition of "employee" under Section 3306(i), FUTA, which determines the scope of the mandatory coverage requirement of Section 3304(a)(6)(A), FUTA, for purposes of determining an employer-employee relationship. Internal Revenue Service (IRS) Revenue Procedure 85-18, published on April 1, 1985, clearly states that the safe harbor provision does not change the status of these workers from employees to self-employed. Specifically, Section 3.08 of the IRS Revenue Procedure, states:

"Section 530 does not change in any way the status, liabilities, and rights of the worker whose status is at issue. Section 530(a)(1) terminates the liability of the employer for the employment taxes but has no effect on the workers. It does not convert individuals from the status of employee to the status of self-employed."

Therefore, Missouri is not permitted to offer the same relief as provided in Section 530, since this would permit Missouri to deny UC coverage when such services are performed in an employment relationship for state and local governmental entities, certain nonprofit organizations, and federally recognized Indian tribes. The denial of coverage in these circumstances would raise a conformity issue because services performed in an employment relationship for these entities are required to be covered.

Second, terminating the employer's liability at one percent due to the Safe Harbor provision will cause the initiation of proceedings by the United States Department of Labor (USDOL) to disallow contributing employers from taking additional credits they currently receive on their federal unemployment taxes. As a result, Missouri employers would pay an additional federal unemployment tax estimated at \$340 million in 2016; \$291 million in 2017; \$365 million in 2018; and \$419 million in 2019 and each year following. The loss of the additional federal unemployment tax credit would cause employers with lower state unemployment tax rates to pay a larger share than those with higher state unemployment tax rates.

Section 3303(a)(1), FUTA, requires, as a condition for employers in a state to receive the additional credit against the federal tax, that state law provide:

ASSUMPTION (continued)

"...no reduced rate of contributions to a pooled fund is permitted to a person (or group of persons) having individuals in his (or their) employ except on the basis of his (or their) experience with respect to unemployment or other factors bearing a direct relation to unemployment risk...."

An employer's experience rating is measured based upon the entire workforce of an employer, and payroll and benefit charges made against the employer's account are factors that determine the tax rate assigned to the employer's account. A tax rate is assigned based upon all of the aggregate experience in that account.

If the application of the safe harbor provision would be to reduce certain employers' UI tax liability to a maximum of one percent, even though services are required to be covered under the state UI law, Missouri would be using a different method of measuring experience in the account of employers to which the amendment applies, and a special rate would be assigned to these employers versus all other employers in the state. This provision violates the requirement that states use a uniform method in measuring experience in the state experience rating system and may not single out certain employers or industries for a different method of experience rating.

Since this legislation will result in the loss of all federal funding available for the administration of the Unemployment Insurance program, it is assumed the program would cease to exist.

Following are the assumption used in arriving at the fiscal impact:

- The agency will investigate (as they do now) and determine the outcome to be independent contractors (IC) or employees and act accordingly.
- The agency will still pursue and report the wages.
- Based on the high level requirements, we need to design a new letter, make changes to some existing determination letters, and make changes to certain screens and batches for tax, penalty, and interest.
- Major change in the Federal findings section related to a special rate for the ICs (capped to 1%) that will be a huge impact on the application.
- There will be a team of 4 people involved in Requirement, Design, and Development along with some effort in testing and implementation.

Also, DOLIR assumes this amendment will require 853.20 hours at a rate of \$128 per hour for ITSD support to implement a new system resulting in a total fiscal impact of \$109,210.

Officials at the **Office of Administration - Personnel**, the **Department of Revenue**, the **Department of Economic Development** each assume this amendment will not have a fiscal impact to their respective organizations.

<u>FISCAL IMPACT - State Government</u>	FY 2017 (10 Mo.)	FY 2018	FY 2019
GENERAL REVENUE FUND			
<u>Costs - DOLIR</u>			
ITSD Expense	<u>(\$109,210)</u>	<u>\$0</u>	<u>\$0</u>
ESTIMATED NET EFFECT TO GENERAL REVENUE FUND	<u>(\$109,210)</u>	<u>\$0</u>	<u>\$0</u>
 UNEMPLOYMENT ADMINISTRATION FUND			
<u>Loss - DOLIR</u>			
Potential non-conformity with federal law	\$0 or <u>(\$38,000,000)</u>	\$0 or <u>(\$38,000,000)</u>	\$0 or <u>(\$38,000,000)</u>
ESTIMATED NET EFFECT TO THE UNEMPLOYMENT ADMINISTRATION FUND	\$0 or <u>(\$38,000,000)</u>	\$0 or <u>(\$38,000,000)</u>	\$0 or <u>(\$38,000,000)</u>
 WAGNER PEYSER FUND			
<u>Loss - DOLIR</u>			
Potential non-conformity with federal law	\$0 or <u>(\$12,000,000)</u>	\$0 or <u>(\$12,000,000)</u>	\$0 or <u>(\$12,000,000)</u>
ESTIMATED NET EFFECT TO THE WAGNER PEYSER FUND	\$0 or <u>(\$12,000,000)</u>	\$0 or <u>(\$12,000,000)</u>	\$0 or <u>(\$12,000,000)</u>
 <u>FISCAL IMPACT - Local Government</u>			
	FY 2017 (10 Mo.)	FY 2018	FY 2019
	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

FISCAL IMPACT - Small Business

A direct negative fiscal impact to small businesses would be expected as a result of this proposal.

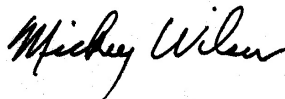
FISCAL DESCRIPTION

This bill specifies that for a taxpayer undergoing an audit by the Department of Labor and Industrial Relations regarding classification of an individual as an independent contractor or employee, if the taxpayer has been granted relief from the imposition of federal employment taxes under Section 530 of the federal Revenue Act of 1978, as amended, for an individual, with the result that the taxpayer can continue to classify the individual as an independent contractor for purposes of federal employment taxes, the department must allow the taxpayer to classify the individual as an independent contractor for purposes of Missouri employment taxes. These provisions terminate the employer's liability for the Missouri employment taxes but must have no effect on the worker whose status is at issue.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Labor and Industrial Relations
Office of Administration - Personnel
Department of Revenue
Department of Economic Development



Mickey Wilson, CPA
Director
April 7, 2016

Ross Strobe
Assistant Director
April 7, 2016