Approved: <u>February 18, 2005</u>
Date

MINUTES OF THE SENATE COMMERCE

The meeting was called to order by Chairperson Karin Brownlee at 8:35 A.M. on February 9, 2005 in Room 123-S of the Capitol.

Committee members absent:
Senator Susan Wagle-excused

Committee staff present:
Helen Pedigo, Revisor of Statutes
Susan Kannarr, Legislative Research
Jackie Lunn, Committee Secretary

Conferees appearing before the committee:
Matt Jordan, Department of Commerce
Steve Kelly, Department of Commerce
Secretary Garner, Department of Labor

Others attending:
See attached list

Chairperson Brownlee opened the meeting by introducing Matt Jordan and Steve Kelly from the Department of Labor to give a presentation on "Programs that Provide Tax Incentives and Tax Credits". Steve Kelly was the first to speak. He offered information on the tax incentives programs covering FY 01 through FY 04 (Attachment 1) along with a chart (Attachment 2) which gives a description of different programs offered with background information on each. Mr. Kelly explained the summary sheets listing data on each program along with their stats.

There was discussion by the committee with Mr. Kelly and Mr. Jordan regarding KIT/KIR programs' contractual agreements and the outcome if these agreements are not met. Mr. Kelly stated with these two programs the money is given on a reimbursement basis. There was also discussion about the numbers on attachment 1, Mr. Kelly stated they are the actual job numbers right now.

The discussion continued moving to KEOIF and KEIEP and the fact monies are paid out before you know the performance. Mr. Kelley stated that these two programs are set up with the company based on the company predicts their performance will be over a 5 year period.. These predictions are spelled out in the contractual agreement. Once the contract is in place, the funds can be expended on the front end. If they don't meet their contract agreement they must pay it back. There was also discussion on the report given by the Department of Revenue and the report of the Department of Commerce. Mr. Jordan stated with the passage of **SB 13** the Department of Revenue and the Department of Commerce would be able to share information which would allow better tracking of this information. The question was raised regarding a way to track wages and verify that these companies are paying higher wages as agreed upon and how the Department of Commerce tracks and obtains this information at the present time. Mr,. Jordan stated these companies are obligated to report annually. The Department of Commerce also can verify against the KDHR information.

<u>Chairperson Brownlee recognized Senator Barone to introduce a bill, 5RS0879 dealing with agritourism owners having to become licensed food service providers. Motion to introduce this bill was made by Senator Barone and seconded by Senator Schodorf. Motion passed.</u>

Chairperson Brownlee introduced Helen Pedigo to explain **SB 108**. Ms. Pedigo explained the bill and provided written copy. (Attachment 3)

Chairperson Brownlee opened the hearing on **SB 108** by introducing Secretary Jim Garner, Department of Labor to give his testimony. Secretary Garner stated that the Department of Labor supports **SB 108**. This bill has three major areas of changes which have been reviewed and approved by the Employment Security Advisor Council. Secretary Garner provided information on the members of the Kansas Employment Security Council (Attachment 4) Secretary gave a overview of the three major areas of change. (Attachment 5) Secretary Garner stated he did not need any amendments and the **SB 108** was ready to go as written.

MINUTES OF THE Senate Commerce at 8:30 A.M. on February 9, 2005 in Room 123-S of the Capitol.

Chairperson Brownlee closed the hearing on **SB 108**.

Chairperson Brownlee announced a planning meeting for the Commerce Committee with Senator Jordan, Senator Kelly and Chairperson in her office at 4:00 p.m. today.

Meeting was adjourned at 9:25 a.m. with the next meeting scheduled for Thursday, February 10, 2005 at 8:30 a.m. in room 123S.

Senate Commerce Committee
Guest List
Date: February 9, 2005

PAUL BICKNELL	KDOL
BART SPRAGUE	KENSINGER AND ASSOCIATES
JIM GARNER	KDOL
Beth MARTIN	KDOL
J.P. SMALL	KOCH INDUSTRIES
SHANE BOOS	UNITED ROTARY BRUSH
Tom Burgess	URB
Richard Samniego	Kearney & Assoc
James Bartle	Dept. of Revenue
Kathleen Smith	"
Pamela L. Gunter	Kansas Gas Service, Wichita
HOSSFELD, DON	KANSAS GAS SERVICE, OVERLAND PARK
Mike Murray	Sprint Topeka
Paula Kafka	Intern (Wysong)
Ron Healy	Hein Law Firm
Joanne Goodwin	City of Wichita
Marlee Carpenter	Kansas Chamber
Kevin Barone	KTLA

Senate Commerce 2-9-05 Attachment 1-1

KANSAS
DEPARTMENT OF COMMERCE

Financial Incentive Programs

February 2005

Program Name & Brief Description	Agreement Time Period	Min/Max Awards	Match Requirements	Funding Source
Ag Products Grants/Loans. This competitive loan program focuses on providing financial assistance to individuals, producer groups, and other business entities that utilize and add value to Kansas agricultural commodities. The program provides funding for commercialization projects (equipment, bricks and mortar, etc.) as well as market development projects. Applicants must provide a dollar-for-dollar match. Applications are accepted throughout the year and evaluated on business merit and benefit to Kansas agriculture. Loans are interest free for a period of 24 months. After 24 months, interest then compounds quarterly at a simple rate, equal to prime +1. The annual amount for this loan program is $400,000, and there is no minimum or maximum award amount.	24 months	None	50%	EDIF
Attraction Development Grants. The purpose of the program is to assist with building the state's destination attraction capacity to meet the demands of travel customers in the highly competitive tourism marketplace, thus resulting in sustained revenue and job creation opportunities within Kansas. For-profit, not-for-profit, and governmental entities are eligible to apply for grant funding. The grant is a reimbursement grant with the grant recipient funding 60 percent of the cost of the grant project.	18 months	$25,000 For-profit $75,000 Non-profit	60%	EDIF
Community Service Tax Credits. Authorizes tax credits for cash, property, and/or service contributions for qualified community services that benefit children and families, health care, or crime prevention. A total of $4.1 million in tax credits is authorized per fiscal year.	18 months	Max $250,000	None	Tax Credit
Kansas International Trade Show Assistance. This program encourages Kansas companies to explore foreign markets through participation in trade shows. Upon approval prior to the trade show, the program will reimburse one-half of a company's eligible direct expenses up to $3,500 per show.	State fiscal yr.	$1,500 to $7,000	50%	EDIF
Main Street Incentives Without Walls. Available to designated Kansas Main Street downtown areas, funds are available in two competitive and one open round per year. Funds can be used for a variety of downtown business needs. Loans are encouraged over grants.	Up to 18 months	$1,000 to $15,000	75%	EDIF
High Performance Incentive Program. This program provides tax credits and other incentives to companies that pay above-average wages and have a strong commitment to skill development for their workers. Other requirements may also apply. This program encourages companies to remain competitive through capital investment in facilities and technology, and continued training and education for their employees. With approval, credits may be used over a ten-year time period.	24 months to 36 months	10% of Capital Investment	None	Tax Credit
Investments in Major Projects and Comprehensive Training. This program has two major components: State of Kansas Investments in Lifelong Learning (SKILL) and the Major Project In[illegible]ent (MPI) funds. SKILL funds are used for workforce training costs and can cover training cos[illegible]milar to the KIT program. MPI funds cover other expenses associated with business expansion or relocation. Under certain circumstances, IMPACT may also be used as a job retention tool.	Up to 10 years	Tied to jobs/wages	None	Bond

KANSAS
DEPARTMENT OF COMMERCE

Financial Incentive Programs

February 2005

Senate Commerce 2-9-05 Attachment 1-2

Program Name & Brief Description	Agreement Time Period	Min/Max Awards	Match Requirements	Funding Source
Kansas Economic Opportunity Initiatives Fund. This program is used to address opportunities or emergencies that may have substantial impact on the Kansas economy. Eligible projects may include: major expansion of an existing Kansas commercial enterprise, potential location of a major employer to Kansas, matching a significant federal or private-sector grant, departure or substantial reduction of the operations of a major employer, and the closing of a major federal or state institution. These performance based loans may have all, or a portion of, the principal forgiven over a five-year period if specific employment and payroll commitments are met.	5-year Loans	None	None	EDIF
Kansas Existing Industry Expansion Program. This program addresses the expansion needs of existing Kansas businesses. This is a performance-based program that stresses business growth as well as job retention and creation. Companies are required to commit to specific employment and payroll performance levels. These performance-based loans may have all, or a portion of, the principal forgiven over a five-year period if specific employment and payroll commitments are met.	5-year Loans	None	None	EDIF
Kansas Industrial Training. This program provides training assistance to manufacturing, multi-state wholesale distribution, and regional or national service firms, adding one or more new jobs to a new or existing Kansas facility. KIT can pay the negotiated cost of pre-employment, on-the-job, and classroom training expenses. Training-related expenses such as curriculum planning, instructor salaries, travel, training aids, and textbooks can also be paid for through this program.	12 months to 18 months	Max $2,000 per trainee	None	EDIF
Kansas Industrial Retraining. This program provides retraining assistance to manufacturing, multi-state wholesale distribution, and regional or national service firms that have one or more employees who are likely to be displaced because of obsolete or inadequate job skills. The KIR program can pay for training costs similar to those eligible under the KIT program. KIR requires matching funds from the participating company.	12 months to 18 months	Max $2,000 per trainee	50%	EDIF
Kansas Partnership Fund. This fund provides financial assistance to Kansas cities and counties by making low-interest loans for infrastructure projects that attract new business or expand local businesses. This revolving loan fund is available to all cities and counties throughout the state.	10 years	None	None	EDIF

Senate Commerce
2-9-05
Attachment 2-1

Fiscal/Training Programs Performance FY 01 Thru FY04

FY 01

Tax Credit Programs

Program	When	Certifications	Projects	Investment	Tax Credits
HPIP	Certification Starts	78	77	$ 819,511,128	$ 81,566,113

Job Creation is not an HPIP reporting criteria

Forgiveable Loan Programs		Jobs			Payroll			Obligations vs. Expenditures			Capital Investment		
	# of projects	Projected	Actual	Percent	Proposed	Actual	Percent	Obligations	Expenditures	Percent	Projected	Actual	Percent
*KEOIF	13	3,810	3,007	79%	$ 126,750,805	$ 129,982,701	102.5%	$ 1,820,000	$ 1,819,532	100.0%	173,742,000	244,214,763	140.6%
*KEIEP	14	2,949	2,753	93%	$ 93,474,662	$ 91,480,230	97.9%	$ 776,550	$ 776,550	100.0%	$ 48,243,690	$ 22,919,194	47.5%
Total	27	6,759	5,760	85%	$ 220,225,467	$ 221,462,931	100.6%	$ 2,596,550	$ 2,596,082	100.0%	$ 221,985,690	$ 267,133,957	120.3%

*KEOIF and KEIEP projects have a 5 yr report span. FY01 projects have at least 1 more year to report actual numbers.

Training Programs		*Jobs			Payroll			Obligations vs. Expenditures			Match		
	# of projects	Projected	Actual	Percent	Proposed	Actual	Percent	Obligations	Expenditures	Percent	Proposed	Actual	Percent
KIT	52	3,551	2,908	82%	$ 88,822,344	$ 76,106,056	86%	$ 2,031,871	$ 1,514,779	75%	$ 2,147,704	$ 2,029,000	94%
KIR	39	3,717	3,594	97%	$ 122,763,680	$ 119,710,240	98%	$ 1,212,686	$ 1,023,733	84%	$ 2,996,445	$ 1,930,641	64%
IMPACT	8	2,517	1,589	63%	$ 68,951,022	$ 47,462,896	69%	$ 5,131,500	$ 3,711,288	72%	$ 4,378,259	$ 2,727,483	62%
Total	99	9,785	8,091	83%	$ 280,537,046	$ 243,279,192	87%	$ 8,376,057	$ 6,249,800	75%	$ 9,522,408	$ 6,687,124	70%
Total Loans & Training Programs		**16,240**	**13,776**	**85%**	**$ 500,762,513**	**$ 464,742,123**	**93%**	**$ 10,972,607**	**$ 8,845,882**	**81%**			
		16,240	**13,776**	***Net Jobs**									

FY 02

Tax Credit Programs

Program	When	Certifications	Projects	Investment	Tax Credits
HPIP	Certification Starts	92	84	$ 580,983,091	$ 57,678,309

Job Creation is not an HPIP reporting criteria

Forgiveable Loan Programs		Jobs			Payroll			Obligations vs. Expenditures			Capital Investment		
	# of projects	Projected	Actual	Percent	Proposed	Actual	Percent	Obligations	Expenditures	Percent	Projected	Actual	Percent
*KEOIF	10	2,988	1,795	60%	$ 92,052,909	$ 61,957,741	67%	$ 1,335,000	$ 1,335,000	100%	63,857,186	61,325,373	96%
*KEIEP	5	1,074	860	80%	$ 33,205,990	$ 25,145,578	76%	$ 240,000	$ 239,593	100%	$ 22,006,896	$ 4,152,787	19%
Total	15	4,062	2,655	65%	$ 125,258,899	$ 87,103,319	70%	$ 1,575,000	$ 1,574,593	100.0%	$ 85,864,082	$ 65,478,160	76%

*KEOIF and KEIEP projects have a 5 yr report span. FY2 projects have at least 2 more years to report actual numbers.

Training Programs		*Jobs			Payroll			Obligations vs. Expenditures			Match		
	# of projects	Projected	Actual	Percent	Proposed	Actual	Percent	Obligations	Expenditures	Percent	Proposed	Actual	Percent
KIT	46	2,011	1,329	66%	$ 55,367,832	$ 40,244,630	73%	$ 1,622,117	$ 1,130,157	70%	$ 1,837,088	$ 1,258,374	68%
KIR	58	5,246	4,409	84%	$ 176,632,160	$ 145,664,480	82%	$ 1,843,470	$ 1,322,237	72%	$ 4,967,031	$ 2,431,605	49%
IMPACT	6	3,926	3,879	99%	$ 255,031,234	$ 250,027,710	98%	$ 3,263,018	$ 3,004,124	92%	$ 6,514,626	$ 3,076,759	47%
Total	110	11,183	9,617	86%	$ 487,031,226	$ 435,936,820	90%	$ 6,728,605	$ 5,456,518	81%	$ 13,318,745	$ 6,766,738	51%
Total Loans & Training Programs		**15,245**	**12,272**	**80%**	**$ 612,290,125**	**$ 523,040,139**	**85%**	**$ 8,303,605**	**$ 7,031,111**	**85%**			
		14,876	**12,138**	***Net Jobs**									

FY 03

Tax Credit Programs

Program	When	Certifications	Projects	Investment	Tax Credits
HPIP	Certification Starts	71	55	$ 309,556,433	$ 30,680,643

Job Creation is not an HPIP reporting criteria

Forgiveable Loan Programs

		Jobs			Payroll			Obligations vs. Expenditures			Capital Investment		
	# of projects	Projected	Actual	Percent	Proposed	Actual	Percent	Obligations	Expenditures	Percent	Projected	Actual	Percent
*KEOIF	15	6,027	3,052	51%	$ 234,283,655	$ 129,134,128	55%	$ 1,699,000	$ 1,599,000	94%	45,439,340	71,119,560	157%
*KEIEP	4	215	129	60%	$ 7,309,890	$ 4,581,148	63%	$ 100,000	$ 98,870	99%	$ 9,680,000	$ 703,630	7%
Total	19	6,242	3,181	51%	$ 241,593,545	$ 133,715,276	55%	$ 1,799,000	$ 1,697,870	94%	$ 55,119,340	$ 71,823,190	130%

*KEOIF and KEIEP projects have a 5 yr report span. FY03 projects have 3 more years to report actual numbers.

Training Programs

		*Jobs			Payroll			Obligations vs. Expenditures			Match		
	# of projects	Projected	Actual	Percent	Proposed	Actual	Percent	Obligations	Expenditures	Percent	Proposed	Actual	Percent
KIT	48	1,889	1,774	94%	$ 66,106,560	$ 61,289,280	93%	$ 1,922,353	$ 1,341,210	70%	$ 2,304,575	$ 1,575,936	68%
KIR	69	5,259	3,505	67%	$ 176,958,080	$ 110,171,360	62%	$ 1,696,546	$ 1,056,680	62%	$ 2,546,856	$ 1,892,830	74%
IMPACT	9	2,173	1,354	62%	$ 78,815,360	$ 54,593,760	69%	$ 4,806,785	$ 3,245,760	68%	$ 3,954,378	$ 2,958,712	75%
Total	126	9,321	6,633	71%	$ 321,880,000	$ 226,054,400	70%	$ 8,425,684	$ 5,643,650	67%	$ 8,805,809	$ 6,427,478	73%

	Jobs Projected	Jobs Actual	Percent	Payroll Proposed	Payroll Actual	Percent	Obligations	Expenditures	Percent
Total Loans & Training Programs	**15,563**	**9,814**	**63%**	**$ 563,473,545**	**$ 359,769,676**	**64%**	**$ 10,224,684**	**$ 7,341,520**	**72%**
	15,232	**9,570**	***Net Jobs**						

FY 04

Tax Credit Programs

Program	When	Certifications	Projects	Investment	Tax Credits
HPIP	Certification Starts	58	52	$ 208,073,457	$ 20,547,346

Job Creation is not an HPIP reporting criteria

Forgiveable Loan Programs

		Jobs			Payroll			Obligations vs. Expenditures			Capital Investment		
	# of projects	Projected	Actual	Percent	Proposed	Actual	Percent	Obligations	Expenditures	Percent	Projected	Actual	Percent
*KEOIF	15	2,148	397	18%	$ 76,339,465	$ 17,086,549	22%	$ 1,229,500	$ 1,123,449	91%	37,545,320	29,468,191	78%
*KEIEP	3	693	0	0%	$ 18,977,080	$ -	0%	$ 80,000	$ 80,000	100%	$ 3,942,760	$ -	0%
Total	18	2,841	397	14%	$ 95,316,545	$ 17,086,549	18%	$ 1,309,500	$ 1,203,449	92%	$ 41,488,080	$ 29,468,191	71%

*KEOIF and KEIEP projects have a 5 yr report span. FY04 projects have at least 4 more years to report actual numbers.

Training Programs

		*Jobs			Payroll			Obligations vs. Expenditures			Match		
	# of projects	Projected	Actual	Percent	Proposed	Actual	Percent	Obligations	Expenditures	Percent	Proposed	Actual	Percent
KIT	41	1,711	666	39%	$ 52,991,266	$ 23,677,389	45%	$ 1,477,419	$ 519,763	35%	$ 2,097,732	$ 805,705	38%
KIR	53	4,976	2,163	43%	$ 171,067,520	$ 74,531,205	44%	$ 1,590,000	$ 480,409	30%	$ 2,229,120	$ 714,915	32%
IMPACT	6	2,342	1,454	62%	$ 88,506,080	$ 44,399,202	50%	$ 5,375,000	$ 1,894,930	35%	$ 4,812,587	$ 3,961,561	82%
Total	100	9,029	4,283	47%	$ 312,564,866	$ 142,607,796	46%	$ 8,442,419	$ 2,895,102	34%	$ 9,139,439	$ 5,482,181	60%

	Jobs Projected	Jobs Actual	Percent	Payroll Proposed	Payroll Actual	Percent	Obligations	Expenditures	Percent
Total Loans & Training Programs	**11,870**	**4,680**	**39%**	**407,881,411**	**159,694,345**	**39%**	**9,751,919**	**4,098,551**	**42%**
	11,787	**4,593**	***Net Jobs**						

Senate Commerce
2-4-05
Attachment 2-2

HPIP Investment

Companies demonstrate foreknowledge of HPIP by submitting a description of anticipated investment before committing to that investment. To earn credits, such pre-defined investment must occur while the company's worksite is qualified (certified) for HPIP. A company can begin any number of investment projects while its worksite is qualified, or none. There is no deadline on when to submit the paperwork to qualify a worksite. Looking at the investment according to when the certification paperwork is processed probably provides a better feel for how use of the program is growing over time. But looking at investment according to the timeframe of the related certification period gives a better feel for the tax impact each fiscal year, remembering that these numbers will change as new certifications are processed.

KEIEP/KEOIF

KEIEP and KEOIF projects are structured as 5-year forgivable loans. Therefore, companies have 5 years to create the total number of contractual job and payroll levels. The jobs, payroll, and capital investment listed on this report represent "To Date" totals. In the event that a company falls short of these numbers, repayment is required.

Training Programs

The charts show by fiscal year the projected numbers and actual numbers to date for each category. Please note that all fiscal years still have active projects, so the "actual" numbers provided for jobs, expenditures, match, and payroll are the numbers to date and not final numbers for that fiscal year.

Net Jobs Explanation

At times, companies may be involved in multiple incentive programs. Due to this, jobs created or retained for a project involved in multiple programs will be counted by each program and added to that programs ROI. To assure that jobs were counted only one time when finding the net job total, Commerce cross referenced projects and counted each job only once.

NORMAN J. FURSE, ATTORNEY
REVISOR OF STATUTES

JAMES A. WILSON III, ATTORNEY
FIRST ASSISTANT REVISOR

LEGAL CONSULTATION—LEGISLATIVE COMMITTEES AND LEGISLATORS
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To: Senate Commerce Committee

From: Helen Pedigo, Assistant Revisor

Date: February 9, 2005

Re: SB 108 SUTA dumping prevention

The bill does four things:

1. Effective January 1, 2006, payments to health savings accounts are not treated as wages for unemployment insurance tax purposes (Sec. 1. p. 16, l. 29 – 32).

2. Effective January 1, 2006, the legislation prevents manipulation of State Unemployment Tax Acts (SUTA) to avoid payment of unemployment taxes. Generally, the more claims a company has historically, the higher their experience rating and therefore its tax rate. Under present law, companies can form a new corporation and use the new company's lower rate or buy a different firm and use the purchased business' rate, at significant savings to the company (Sec. 2, p. 28, l. 11 – p. 30, l. 2). The bill provides for:

   a. Transferring the experience rating when work and employees are transferred and the transferring company no longer performs trade or business with respect to the transferred workforce and the receiving company performs that business or function;
   b. combining experience rating accounts into a single account with a single rate assigned to the account following a transfer of experience, if the secretary determines that a substantial purpose of the transfer or business was to obtain a reduced liability for contributions.
   c. striking the automatic provision for percentage acquisitions; the application provision and criteria remains;
   d. establishing the effective date of rate changes as the first day of the next calendar quarter following the date of transfer of trade or business; and
   e. assigning the experience rating of the transferring company or the applicable industry rate for a new employer when the employing unit is not an employer at the time it acquires the trade or business of an employer. The Secretary considers certain factors to determine whether the business was acquired primarily for the purpose of obtaining a lower rate of contribution.

3. Effective July 1, 2005, the bill grants authority to the Department of Labor to use funds in the penalty and interest account to cover the processing fee for employers filing their unemployment insurance taxes electronically (Sec. 3, p. 32, l. 39 – p. 33, l. 2).

4. Effective January 1, 2006, the language provides penalties for violation of dumping prevention provisions (Sec. 4, p. 34, l. 42 – p. 36, l. 13).

   The bill provides penalties for a knowing violation, transfer or acquisition primarily for the purpose of obtaining a lower rate of contribution. If the person is an employer, the penalty is the highest rate assignable for the year the violation occurred and the three rate years immediately following. If the employer is already paying at the highest rate, the increase would be less than 2% per year plus a penalty rate of 2% of taxable wages each year. If the person is not an employer, then such person is subject to a civil fine of up to $5,000. Violations constituting crimes may be prosecuted by the local prosecutor or the attorney general. The criminal penalty is a severity level 9 nonperson felony.

Kansas Employment Security Advisory Council
(revised December 15, 2004)

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Senate Commerce Committee
2-9-05
Attachment 4-1

KANSAS
DEPARTMENT OF LABOR
Jim Garner, Secretary

KATHLEEN SEBELIUS, Governor

Testimony before the
Senate Commerce Committee
In Support of S.B. 108
Secretary Jim Garner, Kansas Department of Labor
9 February 2005

Chairpersons Brownlee and Jordan and Members of the Committee:

Thank you for the opportunity to appear and testify in support of S.B. 108, which makes changes to the Kansas Employment Security Act. The changes reflected in this bill have all been considered and unanimously endorsed by the Employment Security Council (ESAC). The ESAC was created by K.S.A. 44-714(d). The Council consists of 12 members: 4 employer representatives, 4 employee representatives and 4 members representing the general public. The Council assists in formulating policies related to the administration of the Kansas Employment Security Act. Over the years, the Council has been a valuable, impartial sounding board for the Legislature on legislation impacting the Employment Security Act. Attached is the list of the current members of the Council.

Senate Bill 108 contains three changes to current law: (1) Changes required in Kansas law to bring Kansas into conformity with the requirements of recently enacted federal law aimed at preventing avoidance of Unemployment Insurance (UI) taxes (SUTA Dumping); (2) language to grant permanent authority for the use of Penalty and Interest funds to cover the costs to employers to pay their UI taxes electronically; and (3) language to make clear that employers' contributions to employees' health savings account will not be treated as wages for UI tax purposes.

<u>SUTA Dumping</u>
Some employers and financial advisors have found ways to manipulate state experience rating systems so that these employers pay lower state unemployment insurance (UI) taxes than their unemployment experience would otherwise allow. This practice is known as SUTA dumping (SUTA refers to state unemployment tax acts). Frequently this practice involves merger, acquisition or restructuring schemes, particularly those involving shifting of workforce/payroll. The "SUTA Dumping Prevention Act" of 2004 was signed by President Bush on August 9, 2004. All states will need to amend their UI laws to conform to the new federal legislation. I have attached a couple of news articles

that discuss the recent federal legislation and the events (particularly in North Carolina) that led to this federal action.

The changes reflected in Sections 2 and 4 of SB 108 (reflected on pages 28-30 and 34-36) are necessary to bring Kansas law into conformity with the requirements of the newly enacted federal law. The changes are intended to prohibit two methods of SUTA dumping.

1) An employer escapes high experience rates by setting up a shell company and transferring some or its entire workforce to the shell company which has earned a low experience rate.
2) An entity commencing a business purchases an existing small business with a low experience rate. Instead of being assigned the higher new employer rate, the entity receives the small business's lower rate. Typically, the new business ceases the business activity of the purchased business.

The federal legislation requires state laws to prohibit these forms of SUTA dumping as a condition of states receiving administrative grants for the unemployment program. It also requires states to impose penalties for knowingly violating the provisions of state law, including both civil and criminal penalties. These sanctions are included in the bill. We have forwarded this proposed language to the Regional office of the US Department of Labor and they have approved the language and indicate that it meets the requirements of the new federal law. The US Dept. of Labor is developing software for the states to use in the implementation of this new law. We will have a one time expense to make the necessary IT upgrades to conform to this law.

<u>Use of Penalty and Interest Funds</u>
Senate Bill 108 also adds a new subparagraph (f) to K.S.A. 44-716a (found in Section 3 of the bill on pages 32-33) which provides for the authorization of the use of funds in the special employment security fund (sometimes referred to as the Penalty and Interest Fund) for the payment of fees assessed for the electronic payments or credit card payments of contributions, benefit cost payments or reimbursing payments in lieu of contributions made by employers.

The UI division continues its efforts to improve customer service and to promote online filing of unemployment insurance taxes for Kansas employers. The agency has developed the capability to process the tax reports and take payment of unemployment taxes electronically. In 2003, around 200 employers were using this service. We initiated an effort to inform employers of this service and this past fall more than 4,000 employers used our online system to file their tax reports. In addition, in 2004 we expanded the service to operate 24-hours a day, seven days a week. This will allow employers to go online any time day or night and file their reports.

Employers were previously charged a processing fee in addition to their taxes if they chose to pay their taxes electronically. The fee was an impediment to encouraging more employers to use this convenient option. In the last quarter of 2004, we began using some of the funds in the Penalty and Interest account to cover the processing fees for employers using online filing. The agency collects penalty and interest from delinquent employers. Under Senate Bill 108, we will be able to provide an appropriate payment benefit to those employers who choose to pay timely and electronically.

Simple Clarifying Language

Changes in Section 1 of Senate Bill 108 (reflected on page 16) simply make clear that payments to employees' health savings accounts under federal law will not be treated as wages for UI tax purposes. This change is proposed so that Kansas law aligns with the Federal Unemployment Tax Act so that the exemption will apply to both Federal and State Laws – thus creating less confusion for employers.

Conclusion

Again, all of the components of SB 108 have been reviewed by and approved by the Employment Security Advisory Council. I ask that the Committee take favorable action on this bill. Thank you for the hearing on this bill and for the opportunity to appear and testify in support of SB 108. I would be glad to stand for any questions that the committee may have.

The Charlotte Observer
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www.charlotte.com

Bush signs bill to halt ploy to avoid taxes

N.C. toughened law last year to crack down on accounting practice

By Tony Mecia
Staff Writer

President Bush this week signed into law a measure designed to crack down on a controversial accounting practice that's drawn the attention of N.C. investigators.

The "SUTA Dumping Prevention Act of 2004," signed Monday, requires states to ensure that employers are not improperly slicing the amount they pay in unemployment insurance taxes.

The accounting move occurs when a company creates subsidiaries that have lower unemployment-tax rates than the parent company ordinarily does. State officials regard them as shell companies that serve no legitimate purpose other than to dodge taxes.

State officials said Tuesday they don't anticipate changing N.C. law, which legislators toughened last year.

"Essentially, the federal law was modeled on ours," said David Clegg, deputy chairman of the N.C. Employment Security Commission.

It was unclear whether South Carolina will be required to change its laws as a result of the new federal mandate.

North Carolina is providing technical assistance to other states on how to detect and penalize companies engaged in the practice, Clegg said.

The ESC has reached settlements with 10 companies and recovered nearly $7 million, and it is actively investigating an additional 50 companies.

Kelly Services, the nation's No. 2 staffing company, applauded the new legislation, which passed the House and Senate unanimously. The Troy, Mich.-based firm lobbied lawmakers for the measure because it believed competitors were using the accounting maneuver to gain an unfair advantage.

"Once states enact and enforce these requirements, employers are going to have to start paying their fair share," said Matt Harvill, Kelly Services' vice president of unemployment compensation. "Clearly, it levels the playing field if our competitors have been involved in the practice."

Last week, the Wall Street Journal reported that the Securities and Exchange Commission is looking into SUTA dumping at the world's largest staffing company, Adecco SA, as part of an investigation into accounting issues. The Journal cited unnamed sources familiar with the probe. Adecco has 25 N.C. offices, according to its Web site.

Clegg declined to say whether N.C. officials were investigating Adecco.

Of the six companies publicly accused by N.C. officials of using the accounting practice, two are in the staffing industry. Fayetteville-based Mega Force Staffing Group Inc. settled with the state in January for $681,000 and admitted no guilt, and Charlotte-based AdminSolutions Inc. is still negotiating over about $1 million the state says it owes, according to state records.

The new federal law mandates that states specifically prohibit the practice, establish procedures to identify questionable corporations, and impose "meaningful civil and criminal penalties" on people caught violating the law. Last year, the N.C. General Assembly explicitly outlawed the maneuver and made the practice a felony.

The federal law might not end the maneuver.

"This provides major tools for addressing the problem," said Eric Oxfeld, president of UWCStrategic Services on Unemployment and Workers' Compensation, a Washington employers association that studies the issue. "It will still be up to states to implement the law."

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Attachment 5-4

Stateline.org

Politics & policy news, state by state

MONDAY, AUGUST 9, 2004

Bill would help states fight unemployment tax fraud

By Colin Quinn, special to Stateline.org

States may soon have a new tool to keep businesses from dodging unemployment taxes, a practice that is estimated to collectively cost states many millions of dollars a year.

The tool is a bill (HR 3463) that passed Congress last month and is now awaiting President George W. Bush's signature. Sponsored by Republican U.S. Rep. Wally Herger, it closes a loophole that allows companies to avoid paying high unemployment taxes, a practice known as SUTA dumping.

SUTA is an acronym for State Unemployment Tax Acts. The Congressional Budget Office estimates the SUTA Dumping Prevention Act could save state unemployment funds and small businesses $498 million over five years.

"I'm very excited," Herger told *Stateline.org.* "This is a win-win situation for everyone."

Herger's home state of California had identified 29 companies with payrolls between $10 million and $1.6 billion who practiced SUTA dumping, costing the state's unemployment fund nearly $100 million annually.

The practice works like this: when an employee is laid off, he or she can go to the state to receive unemployment benefits, which are paid for from a fund partially financed by employers. The more claims a company has historically, the higher its tax rate. To skirt the tax, companies under present law can do one of two things: form a new corporation and use the fledgling company's lower rate or buy a different firm and use the purchased businesses' rate. In both cases, companies can save a huge chunk of money.

"We basically had some unscrupulous business entities that were taking advantage of the system," Herger said. "[They were] changing the name of the company and getting out of paying normal rates they should have been paying. Other companies were paying the tab for them."

Nearly 30 state unemployment insurance administrators said their laws were inadequate to stop SUTA dumping, Robert J. Cramer, managing director of the The Government Accountability Office's, formerly known as the General Accounting Office, special investigations group, told a congressional hearing in 2003.

Arkansas, Maine North Carolina and Washington passed legislation in 2003 to impose fines on businesses that manipulated their unemployment tax rates, but they were the exception rather than the rule.

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Attachment 5-5

Herger, who chairs the U.S. House Ways and Means Subcommittee on Human Resources, decided to act. He held hearings and listened to testimony from CEOs before writing legislation. Herger said the bill received wide bipartisan support.

The bill does not dictate to states how to enforce the law or provide specific penalties for companies found guilty of SUTA dumping. That decision will be left to the states to decide.

"It's telling states they need to change their individual state laws," Herger said. "The message is that companies know they can no longer get away with this."

The bill also goes after people who fraudulently claim unemployment benefits. Savings will be routed back to state unemployment benefit accounts.

Milan P. Yager, executive vice-president of the National Association of Professional Employer Organizations, said it was critical to working people that the federal and state governments work to protect the integrity of the tax rating system.

"The small businesses are out there trying to sell hammers and dresses," Yager said. "They don't know why their rates are going up… the job of protecting the system is for state legislators."

Send your comments on this story to letters@stateline.org. Selected reader feedback will be posted in the Letters to the editor section.

See related *Stateline.org* story:

Unemployment tax cheats on states' radar

Contact Colin Quinn at cquinn@stateline.org

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Attachment 5-6