Prepared by the North Dakota Legislative Council staff for the Industry, Business, and Labor Committee
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UNEMPLOYMENT INSURANCE TAX RATE STRUCTURE - BACKGROUND MEMORANDUM

House Concurrent Resolution No. 3040 (attached as an appendix) directs a study of the unemployment insurance tax rate structure; the structure's impact on the unemployment insurance trust fund, with special focus on the impact of the current unemployment insurance tax structure on new businesses; the historical cyclical risks faced by the industries in which new businesses are beginning to operate; and whether the unemployment insurance tax impact is reasonably favorable to the desired economic development of the state.

Testimony from the standing committees indicated the resolution was introduced, in part, to address the differences in rates charged to new businesses. The testimony suggested that certain employers such as home builders have been negatively affected by having to pay a higher new business rate attributable to the construction business while generally having a lower rate of unemployment than other sectors of the construction industry.

BACKGROUND

The federal Social Security Act of 1935 included provisions for the creation of a program for the payment of benefits to unemployed individuals. Under the federal law, payments are made to states with approved unemployment compensation laws under which the state administers an unemployment compensation program through public employment offices. The state program administration must conform with rules established by the federal government. The state of North Dakota has provided unemployment insurance to its residents since 1937 through the state and federal partnership. North Dakota Century Code (NDCC) Section 52-02-01 provides that Job Service North Dakota is responsible for administering the unemployment program in this state.

Unemployment Compensation Fund

North Dakota Century Code Section 52-03-01 provides for the establishment of an unemployment compensation fund to be administered by Job Service North Dakota. That section provides that the fund consists of:

1. All contributions collected under the North Dakota Unemployment Compensation Law.
2. All fines collected pursuant to the provisions of the North Dakota Unemployment Compensation Law.
3. Interest earned upon any money in the fund.
4. Any property or securities acquired through the use of money belonging to the fund.
5. All earnings of the property or securities.
6. All money recovered on losses sustained by the fund.
7. All money received from the federal unemployment account in the unemployment trust fund in accordance with Title XII of the Social Security Act.
8. All money credited to this state's account in the unemployment trust fund, pursuant to Section 903 of the Social Security Act.
9. All money received from the federal government as reimbursements, pursuant to Section 204 of the Federal-State Extended Compensation Act of 1970.
10. All money received for the fund from any other source.

North Dakota Century Code Section 52-03-03 requires that Job Service North Dakota maintain a clearing account, the unemployment trust fund account, and a benefit account within the unemployment compensation fund. After clearance of all funds, the funds must be deposited in the United States Treasury to the credit of the state in the unemployment trust fund. The benefit account consists of all money requisitioned from the state's account in the unemployment trust fund to be used for the payment of benefits. Section 52-03-07 provides that money credited to the account of the state in the unemployment trust fund may be used for administration of the unemployment compensation program.

North Dakota Century Code Section 52-02-17 was amended by the Legislative Assembly in 2001 to require Job Service North Dakota to report to the Legislative Council before March 1 of each year the actual trust fund balance and the targeted, modified average high-cost multiplier, as of December 1 of the previous year. In addition, the report must include a projected trust fund balance for the next three years. Before the 2001 amendment to Section 52-02-17, that section provided that the trust fund balance must be maintained at a level of at least $40 million.

Contributions and Ratesetting

North Dakota Century Code Chapter 52-04 addresses contributions required of employers under the North Dakota Unemployment Compensation Law and the determination of contribution rates. Section 52-04-01 provides that contributions accrue and become payable by each employer with respect to wages paid for employment.

Statutory provisions for the determination of rates were amended significantly by the Legislative Assembly in 1999 in an attempt to raise the unemployment trust fund balance. House Bill No. 1135 (1999) provided a seven-year timeframe to achieve targeted unemployment compensation fund reserve goals based in part on a national economic model that estimates the funds needed to pay unemployment claims for a one-year recessionary period based on current wages and historical claims.

The Legislative Assembly in 2005 revised the formula for determining unemployment compensation tax rates. House Bill No. 1027 (2005) adjusted the formula to provide that a proportionately greater responsibility is shifted to negative balance employers for that portion of the unemployment insurance tax burden which represents the amount of revenue necessary to make due progress toward the unemployment insurance compensation fund solvency target that was established by 1999 House Bill No. 1135. House Bill No. 1027 also provided that after the solvency target is reached, the calculation of the solvency target must be continued and, if the trust fund reserve as of December 31 of any year is less or greater than the solvency target, the rates must be adjusted so that one-fifth of the difference between the solvency target and the current trust fund reserve is estimated to be collected in the following rate year.

North Dakota Century Code Section 52-04-05 establishes the formula for determining the trust fund solvency target. That section provides, in part:

> Progress toward achieving the solvency target is measured by reducing any difference between one and the average high-cost multiple of the state by an amount that is at least equal to the ratio of the number of years left to reach the solvency target to the difference between the trust fund reserve and the targeted amount. In setting tax rates, the amount of the trust fund reserve may not be allowed to fall below three hundred percent from a standard margin of error for the targeted amount of the trust fund reserve.

That section authorizes the executive director of Job Service North Dakota to make reasonable adjustments to the tax rates set for a calendar year to prevent significant rate variations between calendar years.

North Dakota Century Code Sections 52-04-05 and 52-04-06 set forth the variables used in determining rates. Under subsection 5 of Section 52-04-05, rates must be determined as follows:

a. The income needed to pay benefits for the calendar year must be divided by the estimated taxable wages for the calendar year. The result rounded to the next higher one one-hundredth of one percent is the average required rate needed to pay benefits.

b. If the positive employer maximum rate necessary to generate the amount of income needed to pay benefits is at least one percent, the positive employer minimum rate necessary to generate the amount of income necessary to pay benefits is the foregoing positive employer maximum rate, minus nine-tenths of one percent. If the positive employer maximum rate necessary to generate the amount of income needed to pay benefits is less than one percent, the range for the positive employer minimum rate necessary to generate the amount of income needed to pay benefits must be at least one-tenth of one percent and must be less than two-tenths of one percent, with the positive employer maximum rate necessary to generate the amount of income needed to pay benefits equal to the positive employer maximum rate, as used in this subsection, minus a multiple of the increment one-tenth of one percent as provided in subsection 2 of section 52-04-06 to fall within the range described above. Within the table of rate schedules to be utilized for each calendar year to establish the tax rates necessary to generate the amount of income needed to pay benefits, a rate schedule may not be used if it would generate less income than any rate schedule preceding it on the table of rate schedules. The negative employer minimum rate needed to generate the amount of income needed to pay benefits is the positive employer maximum rate as described in this subsection plus five and one-tenth percent.

c. The positive employer maximum rate necessary to generate the amount of income needed to pay benefits must be set so that all the rates combined generate the average required rate for income needed to pay benefits, multiplied by the ratio, calculated under subdivision d, needed to reach the solvency balance. The negative employer maximum rate necessary to generate the amount of income needed to pay benefits is the negative employer minimum rate necessary to generate the amount of income needed to pay benefits plus three and six-tenths percent. However, the maximum rate must be at least five and four-tenths percent.

d. The tax rate necessary to generate the amount of income needed to reach a solvency balance must be calculated by dividing the solvency balance by the amount of income estimated as needed to pay benefits and multiplying the resulting ratio times each rate, within the positive and negative rate arrays, as determined under this section to meet the average required rate needed to pay benefits as defined by subdivision a. The ratio calculated under this subdivision must also be multiplied by any rate calculated as required by subsection 6 to arrive at a final rate for a new business. All results calculated under this subdivision must be rounded to the nearest one-hundredth of one percent.

North Dakota Century Code Section 52-04-05 further provides that unless otherwise provided, an employer's rate may not be less than the negative employer minimum rate for a calendar year unless the employer's account has been chargeable with benefits throughout the 36-consecutive-calendar-month period ending on September 30 of the preceding calendar year. In addition, if an employer in construction services has not been subject to the law as required, that employer qualifies for a reduced rate if the account has been chargeable with benefits throughout the 24-consecutive-calendar-month period ending September 30 of the preceding calendar year. If an employer in nonconstruction services has not been subject to the law as required, the employer in nonconstruction services qualifies for a reduced rate if the account has been chargeable with benefits throughout the 12-consecutive-calendar-month period ending September 30 of the preceding calendar year.

With respect to a new employer, NDCC Section 52-04-05 provides that for each calendar year, the new employer must be assigned a rate that is 150 percent of the positive employer maximum rate or a rate of 1 percent, whichever is greater, unless the employer is classified in construction services. However, an employer must be assigned within the negative employer rate ranges for any year if, as of the computation date, the cumulative benefits charged to that employer's account equal or exceed the cumulative contributions paid on or before October 31 with respect to wages paid by that employer before October 1 of that year. A new employer in construction services must be assigned the negative employer maximum rate.

Under NDCC Section 52-04-05, the executive director of Job Service North Dakota is authorized to provide any negative employer whose contributions paid into the trust fund are greater than the benefit charges against that employer's account, for a minimum of three consecutive years immediately preceding the computation date or subject to the law as required, with up to a 30 percent reduction to that employer's rate for any year if that employer has in place a plan approved by Job Service which addresses substantive changes to that employer's business operation and ensures that any rate reduction provided will not put the employer account back into a negative status.

North Dakota Century Code Section 52-04-06 addresses the determination of rate groups. That section provides that an employer's reserve ratio is the difference between the six-year contributions paid by that employer on or before October 31 of any year, with respect to wages paid by that employer before October 1 of that same year, and the six-year benefits charged to that employer's account before October 1 of that year, divided by the average annual payroll. Job Service North Dakota is required to assign an employer whose cumulative contributions exceed cumulative benefits within the positive employer rate groups. An employer whose cumulative contributions are equal to or less than cumulative benefits must be assigned within the negative employer rate groups.

Under NDCC Section 52-04-06, Job Service North Dakota is required to establish, for each calendar year, a schedule of positive employer rate groups within the positive employer minimum rate and the positive employer maximum rate determined under Section 52-04-05. Each successive rate group for positive employer rate groups must be assigned a rate equal to the previous group's rate plus one-tenth of 1 percent. The number of rate groups in the positive employer schedule must be the number required to provide for a rate group at each one-tenth of 1 percent interval between the positive employer minimum rate and the positive employer maximum rate determined under Section 52-04-05. In addition, for each calendar year, Job Service is required to establish a schedule of negative employer rate groups with the negative employer minimum rate and the negative employer maximum rate determined under Section 52-04-05. Each successive rate group for negative employer rate groups must be assigned a rate equal to the previous group's rate plus four-tenths of 1 percent. The number of rate groups in the negative employer schedule must be the number required to provide for a rate group at each four-tenths of 1 percent interval between the negative employer minimum rate and the negative employer maximum rate determined under Section 52-04-05.

North Dakota Century Code Section 52-04-06 further requires Job Service North Dakota to assign positive employers to the rate in the positive employer rate schedule in the rank order of their reserve ratios with the highest reserve ratio positive employers assigned to the first positive employer rate. Job Service is required to assign each successively ranked positive employer to a rate within the positive employer rate schedule so that each rate within the rate schedule is assigned the same proportion of the positive employer's prior year's taxable wages. That section includes similar assignment requirements for negative employers.

Under NDCC Section 52-04-08, an employing unit that in any manner acquires all or part of the organization, business, trade, workforce, or assets of another employer and continues essentially the same business activity of the whole or part transferred, may request to be transferred the whole or appropriate part of the experience record, reserve balance, and benefit experience of the predecessor employer, unless Job Service finds that the employing unit acquired the business solely or primarily for the purpose of obtaining a lower unemployment insurance tax rate.

North Dakota Century Code Section 52-04-09 requires Job Service to determine an employer's rate for a calendar year on the basis of the employer's experience with contribution payments and benefit charges as of October 1 of the preceding year. Under Section 52-04-10, Job Service is required to promptly make a determination and notify each employer of the employer's rate of contributions as determined for each ensuing year by the end of the first full week of December, but not later than December 10, of the preceding year.

The Legislative Assembly in 2005 adopted House Bill No. 1195, which established the terms under which a staffing service may be required to pay unemployment insurance taxes. Portions of that bill were codified as NDCC Sections 52-04-08.2 and 52-04-24.

North Dakota Century Code Section 52-04-08.2 provides that if an employer transfers all or a part of its trade or business to another employer and at the time of the transfer there is substantially common ownership, management, or control of the two employers, the unemployment experience attributable to the transferred trade or business is transferred to the employer to which the business is transferred. However, the rates of both employers must be recalculated and made effective on the first day of the quarter in which the transfer took effect. That section further provides that if a person, who at the time of acquisition is not considered an employer, acquires the trade or business of an employer, the unemployment experience of the acquired business may not be transferred to that person if Job Service finds that the person acquired the business solely or primarily for the purpose of obtaining a lower unemployment insurance tax rate. In that case, the person must be assigned the applicable new employer rate calculated under Section 52-04-05.

North Dakota Century Code Section 52-04-24 provides that if a staffing service exclusively provides temporary staffing services, the staffing service is considered to be the employee's employer and the staffing service is required to pay unemployment insurance taxes at the staffing service's unemployment insurance tax rate. However, if a staffing service provides temporary and long-term employee staffing services, the staffing service is subject to the reporting and tax requirements associated with the type of employee provided to the client company. That section also provides other conditions under which long-term staffing services may be considered to be the employee's employer.

POSSIBLE STUDY APPROACH

In undertaking this study, the committee should seek input from representatives of Job Service North Dakota regarding the tax rate structure and the solvency of the unemployment insurance trust fund. In addition, the committee should seek comments from various classes of employers, particularly employers in the construction industry, regarding the effect of the new employer classification on the establishment of new businesses.

ATTACH:1