

Commission on Unemployment Compensation  
September 10, 2008  
Richmond, Virginia

Chapter 33 of Title 30 states that the purpose of the Commission on Unemployment Compensation is to monitor and evaluate Virginia's unemployment compensation system relative to the economic health of the Commonwealth. Its power and duties include evaluating the impact of existing statutes and proposed legislation on unemployment compensation and the Unemployment Trust Fund, assessing the Commonwealth's unemployment compensation programs and examine ways to enhance effectiveness, and monitoring the current status and long-term projections for the Unemployment Trust Fund. The General Assembly in the 2008 Session also directed the Commission to examine House Bill 1314, which would transfer the Virginia Employment Commission's tax collection responsibilities to the Tax Department, and to study, pursuant to House Joint Resolution 51, whether the Commonwealth should exclude workers in seasonal industries from eligibility for unemployment compensation benefits.

### Employment Data

The national economy is expected to experience growth in the gross domestic product of 1.8 percent in 2008 and 1.0 percent in 2009. These rates are substantially slower than the 3.0 percent average annual growth seen over the past two decades. While the economic slowdown is detrimentally affecting employment data across the country, Virginia is performing better than the nation as a whole. Virginia's job rate growth is expected to be 0.3 percent in 2008 and 0.2 percent in 2009, while the average unemployment rate for those years is forecast to be 3.9 and 4.0 percent, respectively.

Virginia's unemployment rate in July 2008 was 4.4 percent, the highest monthly rate since July 2003. Total initial year-to-date claims for unemployment benefits through July 2008 are up 12 percent from the same period in 2007 and up 16.9 percent from the same period in 2006. Projected initial claims are projected to total 355,986 in 2008 and 414,607 in 2009.

First payments of unemployment insurance benefits from January through July 2008 are up 13.3 percent compared to the first seven months of 2007 and up 22 percent from the corresponding period in 2006. The average duration for receipt of unemployment benefits was 12.6 weeks in July of this year; for the same month last year, the average duration was 12.4 weeks. Final payments of benefits in the first seven months of 2008 are up 15.9 percent from the same period in 2007. The exhaustion rate, which reflects the percentage of unemployment compensation recipients who use up all of the weeks that they are eligible to receive benefits, was 35.4 percent in July 2008; in July 2007, it was 34.1 percent.

For claims filed after the first week of July 2008, Virginia's maximum weekly unemployment benefit is \$378. The new maximum weekly benefit reflects a weekly benefit replacement rate of 44 percent of the state's average weekly wage. Legislation enacted in the 2008 Session (House Bill 547, patroned by Delegate Nixon) increased the maximum benefit to this level from its previous limit of \$363.

## Unemployment Trust Fund Solvency

The Unemployment Trust Fund is funded by state unemployment taxes, which are paid by employers at a rate that varies depending on the solvency level of the Trust Fund and the employer's claims experience. Its solvency level is calculated by dividing the balance in the Trust Fund on June 30 of each year by an amount, determined in accordance with a statutory formula, that represents an adequate balance. VEC Commissioner Dolores Esser reported that the Unemployment Trust Fund solvency level is projected to be 64.4 percent as of June 30, 2008; one year ago it was 70.4 percent. The solvency level is projected to decline to 43 percent in 2009 and to 34 percent in 2010 as a result of increased benefits payments and declining tax revenue. Thereafter, it is expected to rise to 44 percent in 2011 and 61 percent in 2012. In years that the solvency level falls below 50 percent, employers will be assessed a fund builder tax of 0.2 percent of the first \$8,000 of each employee's wages. The balance in the Unemployment Trust Fund is projected to fall from \$708.2 million on January 1, 2008, to \$553.9 million at the end of the year.

The average annual state unemployment tax paid by Virginia's employers, on a per-employee basis, is projected to be \$88 in 2008, which is less than the averages of \$121 in 2007, \$155 in 2006, and \$162 in 2005. Between 2009 and 2012, the average tax per employee is projected to increase to \$96 in 2009, \$140 in 2010, \$157 in 2011, and \$163 in 2012. The increase in the average tax per employee in 2010 and subsequent years is attributable in part to assessment of the fund builder tax. Virginia's average tax per employee for the year ending September 30, 2007, of \$112 is the lowest among the six jurisdictions in the Fourth Appellate Circuit. The average tax in the other five jurisdictions ranges from \$153 in Maryland to \$338 in North Carolina; the national average is \$267.

## Administrative Funding

After Deputy VEC Commissioner Nicholas Kessler briefed the Commission on state and federal legislative issues, he outlined concerns with declining administrative funding provided by Congress. None of the agency's administrative expenses are appropriated from the general fund. The VEC receives funding to administer the unemployment insurance, job service, labor market information, and veterans employment service programs from allocations of Federal Unemployment Tax Act (FUTA) payments by Virginia employers to the federal government. The FUTA tax is imposed at a rate of 0.8 percent of each employee's first \$7,000 of wages, for a cost of \$56 per employee per year. The federal government's reductions in the FUTA payments that are returned to the Commonwealth for program administration continues to cause concerns.

In fiscal year 2006, Virginia received from the federal government \$57 million for administration of the VEC's programs, or 27.6 percent of the amount of FUTA taxes paid in by Virginia's employers. In fiscal years 2005 and 2004, Virginia received \$60 million and \$63 million, respectively, exclusive of \$12 million of Reed Act allocations. Virginia ranks 52nd of 53 jurisdictions in terms of the percentage of FUTA funds returned by the federal government.

Reasons given for Virginia's low level of administrative funding include the relative low statewide unemployment rate and the efficiency of the VEC. The VEC and Office of the

Secretary of Commerce and Trade continue to lobby Virginia's Congressional delegation to increase the percentage of FUTA taxes returned to the Commonwealth. Congressman Tom Davis has written to the General Accounting Office asking that it examine the resource justification model currently used to allocate administrative funds among the states. The VEC has worked through a national association of similar agencies to require that Congress provide each state with at least 50 percent of the FUTA taxes paid in by its employers, while holding harmless those states currently receiving a greater percentage. Members of the Employer Advisory Committee and the Virginia Chamber of Commerce are also actively involved in the effort to raise the percentage of FUTA funds returned to Virginia

Two items of federal legislation were brought to the Commission's attention. The Unemployment Insurance Modernization Act, patroned by Congressman McDermott, has passed the House of Representatives but is not expected to gain Senate approval. The measure would provide \$65 million in Reed Act funds for Virginia. Also, the 2008 legislation that provided extended unemployment benefits included \$110 million for program administration by states, of which Virginia received approximately \$1 million.

The Commission was advised that the VEC is anticipating administrative funds from FUTA taxes will pay for 80 percent of the VEC's administrative costs. In anticipation of the projected shortfall, the VEC has closed offices, laid off employees, and eliminated 80 positions.

#### House Bill 1314

Delegate Kathy Byron introduced House Bill 1314 in the 2008 Session. The bill, which the House Commerce and Labor Committee asked the Commission to study, transfers responsibility for collection of employment taxes from the VEC to the Department of Taxation. Delegate Byron told the Commission that the bill sought to spur an examination of whether the current system was the most efficient way to deliver services. She stated that the "cost-cutting caucus" anticipated that the transfer would generate savings by allowing the VEC to focus on its core mission while taking advantage of the Tax Department's expertise in collecting taxes.

Analyses of House Bill 1314 were provided by the VEC and Tax Department. The VEC observed that employers are required to file quarterly payroll and tax reports. The VEC collects on average \$411 million annually in unemployment insurance (UI) taxes, which are deposited in the Unemployment Trust Fund. Of the \$57 million received from the federal government to administer VEC programs, \$33-\$36 million is for UI administration, of which 26 percent, or \$9.7 million, is earmarked for UI-related tax activities.

Commissioner Esser noted that transferring the UI tax program will not save the VEC administrative funds, because the funding for these activities would flow to the agency responsible for the function. Any savings achieved from a transfer would benefit the federal government. While implementing the transfer would involve substantial start-up costs, federal funds would not be available to defray them. Moreover, a transfer would increase administrative complexity by involving two agencies in the tax collection process, which involves receiving and processing quarterly wage and payroll reports and reconciling reports. Finally, the VEC is in the process of evaluating bids for a new integrated UI benefits and tax system and transferring the UI

tax program would require re-scoping the project and would delay the project by at least 12 months.

VEC and the Department of Taxation analyzed House Bill 1314 as being capable of three interpretations. Under the first, the entire UI tax program (including rate setting and return processing) would be transferred. Under the second interpretation, the Tax Department would be given responsibility for providing "lockbox services" (including receiving non-electronic payments and returns and collection of delinquencies). Under the third interpretation, the Tax Department would provide "lockbox services" and process returns. The first interpretation was estimated to require 103 full-time employees (which it was assumed would be transferred between the agencies), start-up costs of over \$3.8 million, and ongoing costs of between \$7.5 million and \$9 million. The other two alternatives were substantially less costly, with estimated ongoing costs in the range of \$4.1 million and \$4.3 million, respectively, by 2015.

Joe Mayer, Lead Tax Policy Analyst at the Department of Taxation, cautioned that it is unclear that the Commonwealth would benefit from any savings that would occur from the transfer of functions from the VEC. While there may be savings in the Tax Department's taking over the processing of payments and returns from the VEC, the set-up and programming costs may be more expensive for the Tax Department. He noted that the cost estimates do not include costs of continued operation of the VEC systems until it is proven that the Tax Department's systems are operating acceptably. While savings may result at present from use of the Tax Department's up-to-date technology, the VEC is in the process of acquiring a new system that may provide similar savings. While the Tax Department has legal powers not available to other agencies (including lien and garnishment powers), it is not looked at as an outsourcing agency for other state agencies' tax collection duties other than collecting delinquencies.

In her closing remarks, Delegate Byron noted that the current FUTA funding system punishes VEC for its efficiency, and that the need exists to start looking for alternatives to address the agency's looming funding shortfall. The chairman noted that the Commission will meet again prior to the 2009 Session, and intends to place the issue on the agenda for a vote at that time.

#### House Joint Resolution 51

House Joint Resolution 51 of the 2008 Session, introduced by Delegate Harvey Morgan, directs the Commission to study the need for limitations on the eligibility of seasonal or temporary employees for unemployment compensation benefits. In its study, the Commission is directed to examine the impact on employers, employees, and the solvency of the Unemployment Trust Fund of reinstating a seasonality provision in the Commonwealth's unemployment compensation laws, and whether a seasonality provision should be limited to specific categories of employment.

Currently, a claimant's last 30-day employer is chargeable for the claimant's unemployment compensation benefits. Allowing employees who lose seasonal jobs upon the end of the season to receive unemployment benefits arguably penalizes the employers who hired them by raising the employer's state unemployment tax rate. The rate of the state unemployment tax (SUTA) paid by an employer depends on its experience rating, as well as such factors as the solvency

status of the Unemployment Trust Fund. For new for-profit employers generally, the SUTA rate is 2.5% of the first \$8,000 of wages per employee. This rate remains in effect until the VEC provides a computed tax rate based upon claims made against the employer, with employers having more claims paying a higher SUTA rate.

There are two situations where Virginia provides that workers in two seasonal employment categories - educational institutions and professional athletics - are ineligible for unemployment benefits. For other seasonal jobs, an employee is not ineligible for unemployment compensation benefits when the term of the job ends, even if the employee is informed and understands at the commencement of employment that the job will end on a fixed date.

This result was upheld in Hutter, Inc. v. VEC, Va. Ct. App., No. 0537-07-2 (November 6, 2007), where the Court of Appeals affirmed a circuit court holding that a claimant who enters into an employment contract for a specific term does not leave employment voluntarily when that term expires. This case involved an individual who entered into a written employment contract with a tax return preparation firm. The contract stated that the employment was temporary and would end on April 15. When the job ended, the claimant sought unemployment benefits. The employer argued that the claimant had effectively resigned because the employment was acknowledged to be temporary when the job was accepted. The VEC held that the claimant became unemployed because the employer no longer needed her services, and that the layoff amounts to a no fault discharge. The circuit court affirmed the VEC's holding, and the Court of Appeals agreed.

The Court of Appeals mentioned contrasting public policy concerns raised by the employer and the VEC. The employer had argued that under the VEC's interpretation, employers, in return for providing good seasonal jobs, "will be rewarded with the highest, most burdensome unemployment tax possible." The VEC responded that if the court adopted the employer's position, "unemployed individuals would be discouraged from taking part-time work because they would be excluded from obtaining unemployment compensation." The court declined to address the public policy arguments, noting that "a court may not second-guess the lawmakers on matters of economics, sociology and public policy."

The seasonal employment issue has been addressed previously by the General Assembly. In 1948, the General Assembly enacted legislation establishing a process for the VEC to designate an employer as a seasonal employer. The bill provided that no seasonal worker shall be paid benefits except for unemployment occurring during the operating season determined for his base period seasonal employer. The measure did not specify what industries were "seasonal." The VEC was required to determine whether an applying employer's industry, as a whole or in any separate division, establishment or department, was a seasonal employer based on whether "because of the seasonal nature of its operations, it is customary to operate only during a regularly recurring period or periods of not less than thirteen weeks nor more than forty weeks within any calendar year." (Code § 60.1-54) A seasonal employer was required to post and maintain notices that the individuals employed there were performing services in seasonal employment.

Virginia's seasonal worker provisions were repealed in 1978. The specific reason for the measure's repeal is not known. Possible reasons include difficulty in administration and inconsistent results depending on whether a particular employer applied for designation as seasonal.

The VEC's Chief Administrative Law Judge Coleman Walsh reported that in the 1940's as many as 33 states had laws that limited UI eligibility for workers in seasonal occupations. A majority of these laws have since been repealed. Fears that such laws were necessary to avoid depletion of UI trust funds and that seasonal workers would have high tax rates were not generally realized, and the provisions proved difficult to administer. In 1996, the Congressionally-created Advisory Council on Unemployment Compensation recommended that seasonality provisions be abolished.

Currently 15 states have laws that limit unemployment compensation benefits based on seasonal work. One category of such laws, in effect in eight states, applies to industries that customarily operate during regularly recurring periods of less than a certain duration, which ranges from 16 to 41 weeks. The other category of such laws, in effect in seven states, applies to specific industries, such as processing agricultural or seafood products, and may include a requirement that a certain percentage of the workforce is laid off.

Judge Walsh identified several policy issues relating to seasonality provisions. Some seasonal workers are among the lower paid members of the workforce and may not be able to save money to offset lost income during the off-season. Unemployment because a season is over is not the fault of the worker or the employer. Some seasonal employers use UI as a fringe benefit to attract and retain workers. The loss of UI benefits for seasonal employment may shift some workers to public assistance programs funded through the general fund. He offered that two existing measures provide alternatives to seasonality provisions. First, the two-quarter earnings requirement effectively screens out workers with limited base period employment that is concentrated in less than 15 weeks. Second, diligent enforcement of the work search requirement ensures that claimants are available for work and actively looking for work.

One member of the Commission voiced a concern that the outcome of the Hutter case seems to abrogate the intent of the employment contract, which contained an acknowledgement that the work was seasonal and would end on a fixed date. Virginia law provides that any waiver of the right to UI benefits is void. The opinion of the Attorney General regarding the impairment of contract issue will be requested. Senator Watkins also voiced concern that the court's decision may encourage employers to use independent contractors rather than employees, which may result in a decline in withholdings of income and other taxes.

During the public comment portion of the meeting, the president of the employer in the Hutter case observed that while UI benefits are intended to address an unexpected loss of employment, the loss of seasonal work is not unexpected. Thomas Hudson cautioned the Commission that this is a complicated subject, and it should be mindful of unintended consequences of any action it may recommend. For example, denying seasonal workers the ability to draw UI benefits would impede the ability of the VEC to recommend seasonal work to unemployed persons who are receiving benefits. It may also affect the ability of workers to draw UI benefits if they are

separated from employment at industries that regularly shut down operations for a few weeks each summer, if such shutdowns render them seasonal employers.

#### Future Meeting

The Commission will hold a meeting later in the year, at which the VEC will be asked to present figures on the Trust Fund's actual June 30 solvency level. The Commission will also complete its examination of the issues raised by House Bill 1314 and House Joint Resolution 51.

The Honorable John C. Watkins, Chairman

For information contact:

Franklin Munyan, Staff Attorney, Division of Legislative Services