Employment Development Department
State of California

INFORMATION SHEET

SUTA DUMPING AND UNEMPLOYMENT INSURANCE RATE MANIPULATION

One of the bigger issues facing the Unemployment Insurance (UI) program are tax evasion schemes of which SUTA (State Unemployment Tax Act) dumping is the most prevalent. This scheme includes acts to manipulate state account numbers and the UI experience rating process. When a low UI tax rate is obtained, payroll from another entity with a high UI tax rate is shifted to the account with the lower rate. The entity with the higher UI tax rate is then "dumped." Such abusive schemes leave other employers making up for the unpaid UI tax. SUTA dumping is also referred to as state unemployment tax avoidance and unemployment tax rate manipulation.

What Harm Does SUTA Dumping Cause?

Under the experience rating system, employers pay UI taxes at rates commensurate with benefit claims filed by their employees. Employers with high unemployment activity pay higher UI tax rates, and employers with lower activity pay less. Employers, who engage in SUTA dumping (or other tax manipulation schemes) to avoid paying their share, unfairly shift their costs to other employers. SUTA dumping is harmful because it:

- Compromises the integrity of the UI system.
- Creates an unfair competitive advantage for employers who participate in SUTA Dumping.
- Eliminates the incentive for employers to avoid layoffs.
- Adversely affects UI tax rates for all employers.
- Costs the UI trust fund millions of dollars each year.

SUTA dumping hurts everyone – employers, employees, and taxpayers who must make up the difference in higher taxes, lost jobs, and higher costs for goods and services.

SUTA Dumping Schemes

There are many variations on the schemes businesses use to inappropriately lower their UI tax rate. Employers should become aware of these schemes and their potential legal ramifications. The following are some examples of SUTA dumping schemes:

1. **Purchased Shell Transaction**
   A business with a large payroll and a high UI tax rate purchases a corporate shell with a low UI tax rate and transfers its payroll to the purchased entity.

2. **Affiliated Shell Transaction**
   A new corporation is registered, and a small payroll is reported each year until a low or minimum UI tax rate is achieved. Once the low UI tax rate is achieved, large payroll amounts are transferred from another related corporation into this account.

3. **New Employer Rate**
   An employer with a high UI tax rate files a registration form requesting a new employer payroll tax account number, which has a lower UI rate (new employers pay 3.4 percent in California), then the payroll is transferred to the new account.

4. **Payroll Parking**
   Two unrelated businesses negotiate (for a fee) to have all or part of the higher UI tax rate employer's payroll "parked" in the other's account and reported at the lower UI tax rate.

5. **Buffering Potential Negative Reserve Account Charges**
   A company that hires temporary workers forms a new entity and obtains a separate employer payroll tax account number. The temporary workers are paid through this account. When they are laid off and file UI claims, the newly formed company goes out of business, and the negative reserve account charges get distributed to other businesses in the state. This typically occurs when a labor action is contemplated, and temporary workers are hired knowing they will be laid off after the labor action. Another variation on this scheme is when a company is planning to downsize. Employees to be laid off are transferred to a subsidiary account. This practice protects or buffers the reserve account of the initial company from UI charges.

Is SUTA Dumping Illegal?

Employers who engage in SUTA dumping or other tax rate manipulation schemes knowingly misrepresent facts about their business. It is illegal under the California Unemployment Insurance Code to knowingly make false statements and omit material facts on UI tax documents in order to reduce UI taxes. Below are laws passed to combat SUTA dumping:

- **SUTA Dumping Prevention Act of 2004 –** This law requires each state to enact laws to prevent employers from inappropriately lowering their UI tax rates. The law not only bans SUTA dumping but also imposes heavy penalties on those who engage in or promote such abusive practices.

- **Assembly Bill 664 –** Effective January 1, 2005, California became one of the first states in the nation to enact legislation in response to the federal SUTA Dumping Prevention Act. This law stipulates that employers who are caught illegally lowering their UI tax rates must then pay at the highest UI tax rate provided by law plus an additional 2 percent. The law also provides for a penalty of the greater of $5,000 or 15 percent of the combined amount of underreported contributions, penalties, and interest for anyone knowingly advising another person or business to violate California's UI tax rate and reporting laws. It also makes changes in the law regarding the application and transfer of UI reserve account balances. It specifies that whenever an employer transfers its business to another employer, the reserve account will be transferred if they are under common ownership, management, or control. The law also provides that if the acquisition was for the purpose of getting a lower UI tax rate, the transfer will be denied.

What Is the Employment Development Department (EDD) Doing to Fight SUTA Dumping?

The EDD regularly conducts outreach with employers and tax advisors to ensure they are aware of these schemes and to help them avoid future UI tax liabilities or audit and compliance actions. In addition, the EDD aggressively pursues and prosecutes employers who participate in SUTA dumping and other tax manipulation schemes and has the authority to subpoena records and individuals in its investigations.

How to Report SUTA Dumping

If you think someone is committing fraud or engaging in SUTA dumping, please report it to the EDD immediately. All allegations are taken seriously. Please provide as much information as possible, including:

- Employer names, addresses, and phone numbers.
- Employer payroll account number(s).
- What they are doing.
- When they started doing it.
- Your name, address, and phone number (optional).

To Report Fraud:

- Call: 1-800-528-1783.
- Email: ueo@edd.ca.gov
- Submit a Fraud Reporting Form online at **https://askedd.edd.ca.gov/Fraud.aspx**.
- Mail an *Underground Economy Operations Lead Referral/Complaint Form*, DE 660 (English) or DE 660/S (Spanish).

Additional Information

- *Information Sheet: California System of Experience Rating*, DE 231Z.
- *Information Sheet: Unity of Enterprise*, DE 231UE.
- *Managing Unemployment Insurance (UI) Costs*, DE 4527.
- *Help Us Fight Fraud*, DE 2370.

For further assistance, please contact the Taxpayer Assistance Center at 1-888-745-3886 or visit the nearest Employment Tax Office listed in the *California Employer's Guide*, DE 44, and on the EDD website at **www.edd.ca.gov/Office Locator/**. Additional information is also available through the EDD's no-fee payroll tax seminars and online courses. View the in-person and online course offering on the EDD website at **www.edd.ca.gov/Payroll_Tax_Seminars/**.

The EDD is an equal opportunity employer/program. Auxiliary aids and services are available upon request to individuals with disabilities. Requests for services, aids, and/or alternate formats need to be made by calling 1-888-745-3886 (voice) or TTY 1-800-547-9565.