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FISCAL IMPACT REPORT

ORIGINAL DATE 02/28/11

SPONSOR Beffort LAST UPDATED _____ HB _____

SHORT TITLE Salary Sharing for Certain Employers SB 545

ANALYST Peery-Galon

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
		\$1,100.0		\$1,100.0	Nonrecurring	Federal Funding
		\$319.5	\$319.5	\$639.0	Recurring	Federal Funding

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Economic Development Department (EDD)
 Attorney General's Office (AGO)
 Workforce Solutions Department (WSD)

No Responses Received From

Municipal League
 Association of Counties

SUMMARY

Synopsis of Bill

Senate Bill 545 proposes to allow the Workforce Solutions Department (WSD) and private employers to enter into salary-sharing agreements that permit the temporary employment of individuals receiving unemployment insurance (UI) benefits. The bill stipulates the following conditions under which a salary-sharing agreement would be effective:

- The negotiated salary will not be less than one-half of the average salaries reported to WSD by the employer in the previous calendar year for employees with similar duties (or a salary agreed upon by WSD and the employer if the employer did not have employees with similar duties during the previous calendar year);
- The employee will receive one-half of the weekly unemployment benefits during the contractual employment period;
- The contractual employment period will not extend beyond 26 weeks after the employee becomes eligible to receive unemployment benefits;

- The employer may terminate the employment or offer the employee continued employment at an agreed upon salary at the end of the contractual employment period; and
- The employer or employee may terminate employment at any time during the contractual employment period.

The proposed legislation sets forth guidelines for rules to be adopted by WSD for the operation of the salary-sharing program. The hiring of an employee pursuant to a salary-sharing agreement will not impair existing contracts for services or collective bargaining agreements. Upon a violation by an employer of a salary sharing agreement, WSD can have a cause of action against the employer for UI benefits paid to an employee during the contractual unemployment period. The proposed legislation states any eligibility requirements or other inconsistent provisions of UI law will not apply to an employee during the contractual employment period of a salary-sharing agreement. For purposes of determining compliance with federal, state, or local minimum wage laws, the wages paid to an employee hired based upon a salary-sharing agreement will be the sum of the salary paid by the employer plus the UI benefits received by the employee. The effective date of the legislation is from July 1, 2011 to July 1, 2013.

FISCAL IMPLICATIONS

WSD reported the fiscal impact to the department is estimated to be \$1.5 million. The total fiscal impact includes the cost of \$1.14 million for information technology (IT) related system changes and three FTEs (one for the tax program and two for the claims program) at a cost of \$319,488 to implement the program, maintain the database, and ensure employer compliance for two years (calculated at \$16/hour for two years plus benefits and indirect costs).

WSD is in the process of replacing its legacy claims and tax systems with a new integrated system. If the proposed legislation is enacted, both the legacy claims system will need to be modified. Additionally, the new integrated UI tax and claims system design and code will need to be updated. A breakdown of IT costs is included in the following paragraphs.

UI Claims System: 1) Legacy UI Claims System: Contract Staff: 3 months of work for a project team to conduct the analysis, develop the solution, test the result, and deploy is estimated to cost \$170,000 (1 FTE – Database Analyst \$40,000; 2 FTE – Application Developers \$80,000; 1 FTE – Business Analyst/Test Lead \$25,000; and 1 FTE – Project Manager \$25,000); and 2) New UI Systems Modernization – Claims: the initial estimated cost for this change, which could also affect the implementation schedule, is \$400,000.

Total Cost – UI Claims Component: \$570,000

UI Tax System (both Legacy and New UI Systems Modernization): Outside of the basic functionality required to provide for salary sharing, there may be an added component to track employers through the UI tax system to determine if they are reporting termination of employees at full wages and replace them with salary-sharing wages. This work will also impact the legacy tax system as well as the new UI tax system from Deloitte.

Total Cost – UI Tax Component: \$570,000

Total System enhancement: \$1.14M

SIGNIFICANT ISSUES

WSD noted the most important issue raised by the proposed legislation is whether it would be in conformance with both federal and New Mexico UI law. As part of the federal-state partnership established by Congress under the Social Security Act of 1935, New Mexico UI law is subject to review by the U.S. Department of Labor (USDOL) to determine whether it is in compliance with federal law. The federal government's role is further prescribed by the Federal Unemployment Tax Act (FUTA). FUTA also sets conditions for approval of state UI laws so that the state may receive administrative funds and employers a tax credit. A recent response to a USDOL review states that UI benefits may not be used as part of a salary-sharing agreement. This is due to lack of conformity with federal law. Their rationale is stated in the following paragraphs.

Since the inception of the federal-state UI program, federal law has permitted participating states to make payment of UI benefits only with respect to an individual's unemployment. Put another way, federal law prohibits the payment of UI benefits to an individual who is not unemployed for some portion of the week in which UI is claimed, unless specifically authorized by federal law. As a result, states' attempts to develop innovative models to assist UI recipients' return to work must adhere to this requirement. The following is a discussion of this requirement, its implications, and some options available to states.

- *Unemployment fund dollars may only be used to pay UI.* Section 3304(a)(4), FUTA, requires, as a condition for employers in a state to receive credit against the federal tax, that state law provide that “. . .all money withdrawn from the unemployment fund of the State shall be used solely in the payment of unemployment compensation, exclusive of expenses of administration, and for refunds of sums erroneously paid into such fund. . ..”
 - Section 303(a)(5) of the Social Security Act (SSA) contains the same requirement as a condition for states receiving administrative grants. Section 3306(h), FUTA, defines compensation as "cash benefits payable to individuals with respect to their unemployment." Taken together, these provisions are referred to as “the withdrawal standard.” Under the withdrawal standard, money may only, with statutorily-authorized exceptions, be withdrawn from a state's unemployment fund for the payment of UI to an individual “with respect to [an individual's] unemployment.”
- *UI may only be paid to an individual.* As explained in Unemployment Insurance Program Letter (UIPL) No. 45-89, amounts may be withdrawn from a state's unemployment fund only to pay UI directly to individuals. Amounts may not be withdrawn to pay an employer as a subsidy for wages or as an incentive to provide employment. (Statutorily-authorized exceptions are also discussed in UIPL No. 45-89.)
- *UI may only be paid if the individual is unemployed.* As noted above, amounts may be withdrawn from the unemployment fund for payment to individuals with respect to an individual's “unemployment.” The 1935 Senate Report on the original SSA creating the program also emphasized that UI may be paid only with respect to an individual's unemployment in that “unemployment compensation differs from relief in that payments are made as a matter of right not on a needs basis, but only while the worker is involuntarily unemployed. . . . Payment of compensation is conditioned upon continued involuntary unemployment.” [S. Rep. No. 628, 74th Cong., 1st Sess. 11 (1935).]

WSD reported during the debate on the passage of the SSA, the original sponsor, Senator Wagner, stated that, “the only important requirement [of the Social Security Act's unemployment compensations provisions] is that the State law shall be genuinely protective, and that its revenues shall be devoted exclusively to the payment of insurance benefits”, 79 Cong. Rec. 9284 (June 14, 1934).

WSD noted because UI may only be paid to individuals with respect to their unemployment, it may not be paid to individuals who have not experienced unemployment during the week claimed. Similarly, UI may not be paid as a subsidy for employment (e.g. to make up the difference in hourly wages between the individual's former job and the individual's new, lower paying job) or as a stipend since it is not a payment "with respect to unemployment," but is instead a payment with respect to being employed. In addition, money may not be withdrawn from the unemployment fund to make incentive payments to employers to hire UI claimants. Doing so would create two problems. First, the amount would not be paid to the individual whose unemployment is being compensated. Second, the withdrawal would be made with respect to a program for incentivizing the hiring of workers by employers rather than "with respect to [the individual's] unemployment." WSD stated the proposed legislation creates conformity issues with federal law.

AGO stated that given that federal government funding substantially supports the payment of state unemployment benefits and such monies are tied to complex federal regulations on topic, some concern whether such employment may negate employees eligibility for unemployment, although concern is minimal as law specifically allows eligibility for unemployment benefits to continue.

AGO noted the provision in Section C wherein the employer becomes ineligible to hire another employee under the salary sharing agreement when the employer terminates the employment of a salary sharing employee in a similar position seems overly strict as it does not distinguish between cause or no cause terminations and would bar employer from a benefit.

EDD noted that the state of Washington changed its unemployment compensation laws to allow companies to keep employees part-time rather than lay them off entirely. Washington pays a percentage of the employees benefit to cover the lost time. Washington claims this has saved jobs.

PERFORMANCE IMPLICATIONS

EDD noted that in regards to job retention, the state of Washington has already implemented a similar measure and claims it has saved many jobs by giving employers an alternative to laying off the employee.

EDD noted that in regards to business retention if the New Mexico unemployment trust fund becomes insolvent, an increase in unemployment insurance tax costs to business may cause some to close.

ADMINISTRATIVE IMPLICATIONS

WSD noted to be eligible for participating in the salary-sharing program, employer and claimant rules and requirements governing eligibility (separation issues and claimant eligibility to the benefit balances) would need to be developed and implemented.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 545 has a relationship with House Bill 59 and Senate Bill 279 which both address solvency of the New Mexico unemployment insurance trust fund by increasing employer contribution rates and reducing unemployment insurance benefits.

TECHNICAL ISSUES

AGO noted that while the heading of the proposed legislation indicates that the salary sharing agreement will be between the state and private employers, the body of the proposed legislation does not contain such a restriction meaning that it may leave open the possibility of the employer being another state agency.

OTHER SUBSTANTIVE ISSUES

Employer taxes are collected by WSD and deposited in the federal treasury in the New Mexico UI trust fund. Just three years ago the NM UI trust fund was among the most solvent in the United States, with a balance of \$553.3 million. If New Mexico's UI trust fund becomes insolvent, the state will be required to take out a loan from the U.S. Department of Labor and pursuant to Section 51-1-11 NMSA 1978 employer taxes will automatically go from schedule 1 to schedule 6 at an estimated average yearly cost of \$512 per employee, an increase of \$298 per employee from schedule 1. While the principal for the U.S. Department of Labor loan can be paid from future tax revenue, the interest earned must be repaid by non-federal funding. If no action is taken to address the declining fund balance during the 2011 legislative session, WSD may be required to implement contribution schedule 6 early on in 2012. Also, if the New Mexico UI trust fund becomes insolvent, all New Mexico contributing employers will lose Federal Unemployment Tax Act (FUTA) credit in accordance with 26 U.S.C. 3302 (c). This will result in New Mexico employers facing increased federal unemployment taxes.

WSD is currently in the process of converting to a new integrated tax and claims system. If the proposed bill is enacted, the salary-sharing agreement would take effect July 1, 2011, which is before the new systems will be in operation. As a result, the proposed changes would require the development of an application for both the old and the new systems.

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