

APPENDIX B

ETA'S RESPONSE


U.S. Department of Labor

Employment and Training Administration
200 Constitution Avenue, N.W.
Washington, D.C. 20210



AUG 28 2017

MEMORANDUM FOR: ELLIOT P. LEWIS
Assistant Inspector General for Audit

FROM: BYRON ZUIDEMA 
Deputy Assistant Secretary

SUBJECT: Response to Office of Inspector General (OIG) Draft Audit Report
No. 04-17-001-03-315, *ETA Should Do More to Help States
Curtail Unemployment Insurance Tax Avoidance Practices*

Thank you for the opportunity to respond to the subject Draft Audit Report related to tax avoidance practices. The Employment and Training Administration (ETA) has provided guidance and technical assistance to states on addressing unemployment insurance (UI) tax avoidance practices for many years. Since the passage of the State Unemployment Tax Act (SUTA) Dumping Prevention Act of 2004, ETA has focused more attention on this specific area of UI program integrity. In addition, prevention of worker misclassification has been another major ETA focus for state UI agencies. We have attached two summaries of ETA's efforts over several years to help strengthen state UI tax integrity programs in both areas – SUTA dumping prevention and worker misclassification prevention (see two attachments).

As you know, the UI program is a Federal-state partnership and states have significant ownership of and responsibility for administering UI tax integrity activities. State UI tax program staff working with employer registrations and conducting field audits work to identify experience rating manipulation schemes and to implement counter measures to protect the integrity of the state UI tax financing system(s). Each state's UI systems and procedures are unique, spanning from employer registration requirements to assignment of experience rates, and integrity initiatives to address SUTA tax avoidance must address the specific conditions within each state. That said, ETA agrees that sharing best practices among states is very valuable as such practices can generally be adapted to fit within the framework of other state tax programs.

ETA continues to support training efforts, quarterly reviews of state UI tax data, and outreach activities to assist states with their UI tax integrity initiatives. The ETA-funded UI Information Technology Support Center (ITSC) provides technical support to states for the ITSC-supported SUTA Dumping Detection System (SDDS) and maintains a repository for states to access in using SDDS. ETA supports the UI Community of Practice on the WorkforceGPS web site, which continues to evolve as a forum for states to share successful and promising practices. Also, a principal component of ETA's strategic plan for UI integrity is ongoing support for the UI Integrity Center (Integrity Center), which supports both UI benefits and tax program integrity, and is discussed more specifically below in our responses to the OIG's

recommendations. Each of these efforts advance ETA's goals for assisting states to address SUTA tax avoidance schemes.

One specific item in the report warrants comment. On page 9, the report raises concerns about states reporting of SUTA dumping data, stating that "States could not support 599 of 9,478 (6 percent) reported transfers and under-reported \$3.9 million of \$78.4 million (5 percent) of net contributions due." During the exit conference, OIG staff indicated that these data issues primarily reflected issues in one large state and thus this concern was not necessarily representative of all states.

We also note that the period of review for this audit began during the aftermath of the Great Recession when claims loads remained extremely high and state UI programs continued to be stressed. The temporary Emergency Unemployment Compensation program did not end until December 31, 2013. This may have impacted states' capacity to manage tax operations as well as benefit operations.

Below are the OIG's recommendations contained in the draft report and ETA's responses:

1. Develop and offer additional training opportunities for states related to worker misclassification and SUTA dumping.

ETA Response: ETA agrees with this recommendation and continues to actively engage with states and develop effective strategies related to worker misclassification and SUTA dumping investigations. As mentioned above, one of the principal strategies of ETA's UI integrity strategic plan is the establishment of the UI Integrity Center. The Integrity Center was created in October 2012 to be a state-driven source of innovative UI program integrity strategies to prevent and detect improper payments, reduce fraud, and promote integrity in both benefits and tax program areas. The Integrity Center is being operated through a cooperative agreement with the State of New York, in partnership with the National Association of State Workforce Agencies (NASWA).¹

Several of the Integrity Center's core strategies are focused on UI tax issues. In February 2017, the Integrity Center launched a UI National Integrity Academy.² The Academy provides a series of inter-related certificate programs that currently include tracks for UI Operations Integrity, UI Fraud Investigations, UI Data Analytics, and UI Program Leadership. The Academy has now begun working with subject matter experts to add a UI Tax Integrity certificate track to its curriculum. The first online module, UI Integrity Fundamentals for Tax, was introduced in June 2017.³ Additional tax training, including modules focused on misclassified workers, fictitious employers, and SUTA dumping investigations are in development and will be released on a rolling basis throughout Fiscal Year (FY) 2018.

¹ <http://integrity.naswa.org/>

² <http://integrity.naswa.org/national-integrity-academy/national-integrity-academy-intro>

³ https://integrity.naswa.org/sites/default/files/NIA%20Does/Academy_Course_Catalog_June_2017.pdf

Additionally, ETA will be conducting tax-related workshops at the upcoming state UI Directors' Conference hosted by NASWA in November 2017. One workshop will address strategies and efforts to prevent UI tax avoidance activities.

2. Work with states to share best practice techniques for both worker misclassification and SUTA dumping investigations and promote the availability of such information on the Workforce GPS website.

ETA Response: ETA agrees with this recommendation and is actively working with the ITSC, the UI Integrity Center, and states to collect and share best practices that have been developed by states related to their integrity efforts to address tax avoidance practices. Based on state information, employer and worker outreach campaigns have been a common strategy employed to address such practices. ETA continues to support the UI Community of Practice on WorkforceGPS, which continues to evolve as a forum for states to share successful practices.

ETA and the ITSC co-hosted a SUTA dumping prevention webinar during March of 2017. The webinar provided technical assistance and training to states and allowed for the capturing of suggestions by states for enhancements to the ITSC-supported SUTA Dumping System and its application. The webinar proved beneficial to the ITSC, ETA, and states, and also informed plans for further SUTA dumping support and training.

In addition, the UI Integrity Center is engaged in the following activities to share and promote best practices and information sharing related to UI tax operations:

- Digital Library: In July 2017, the Integrity Center launched a Digital Library for the exchange of promising state practices and information related to UI program integrity.⁴ The Digital Library has 20 published resources pertaining to UI tax issues, including tax fraud investigations, SUTA dumping enforcement, and recovery efforts.⁵ Additional resources will be published to the Digital Library on an ongoing basis.
- State Portfolio Database: In August 2017, the Integrity Center will publish a State Portfolio Database that includes a “model” integrity operations blueprint for states highlighting integrity practices that should be part of state UI Modernization efforts, including state successful practices, return on investment information, and “how-tos” in areas such as benefits and tax collections, fraud identification, data cross matching activities, and identifying fictitious employers.⁶ The State Portfolio Database includes information obtained by the Integrity Center through annual assessments of specific and current state UI practices, tools, and strategies.⁷ The Integrity Center is also working to begin a UI tax-focused assessment later this year and plans to publish the results in late FY 2018. Once complete, the UI tax assessment will provide additional information that will be added to the State Portfolio Database.

⁴ <http://integrity.naswa.org/digital-library/digital-library-intro>

⁵ https://uidl.naswa.org/search-filter?field=subject&starts_with=t

⁶ <http://integrity.naswa.org/state-portfolio-database/state-portfolio-database-intro>

⁷ <https://integrity.naswa.org/reports-and-presentations>

3. Develop and implement adequate controls to ensure quarterly SUTA dumping data are reported accurately.

ETA Response: ETA continues to routinely monitor state-reported data on SUTA dumping activities and is working with states to address data concerns. ETA has developed and will conduct a webinar before September 30, 2017, to provide additional training to states on the ETA-581, Contribution Operations Report, which includes reporting on SUTA dumping activities.

In addition, ETA recently developed training for states on SUTA dumping prevention operations. This training will be scheduled before the end of calendar year 2017. ETA will also develop training to enhance the evaluation of SUTA dumping prevention activities through the Tax Performance System (TPS) reviews, which include verification of states' SUTA dumping prevention activities. ETA plans to develop and offer this training by the end of the second quarter of calendar year 2018.

4. Reconsider how Effective Audit Measure, Factor 3, is used to evaluate state performance.

ETA Response: ETA partially agrees with this recommendation, given that it is prudent to continually monitor the impact of performance measures. ETA has been evaluating the overall Effective Audit Measure (EAM) since its inception. Historically, Factor 3, which measures the percentage of total wages audited, has been reviewed and revised based on state feedback concerning the relationship between Factor 3 and states' efforts to address worker misclassification. In FY 2015 (using calendar year 2013 data), ETA revised Factor 3, reducing it from 2 percent to 1 percent, based on state feedback. Further reduction in the percentage of total wages audited may negatively impact the integrity of the tax audit operations. The threshold value of Factor 3 stemmed, in part, from the level of significance, or confidence value, when included with the other EAM factors, that is necessary to provide a level of statistical assurance that state field audit operations reviewed a sufficient number of employers to make inferences about the quality and accuracy of employer wage reporting, tax contributions, and trust fund solvency. However, ETA will continue to monitor states' performance and will develop training materials on strategies that states can employ to help them successfully meet the minimum requirements outlined for each factor of the EAM. These materials will be distributed to states by the end of the third quarter of calendar year 2018.

Again, we appreciate the opportunity to respond to your draft report and its recommendations. If you have questions, please contact Gay M. Gilbert, Administrator, Office of Unemployment Insurance, at (202) 693-3029.

Attachments

- SUTA Dumping Guidance and Technical Assistance Activities (2009 forward)
- Worker Misclassification Prevention & Detection Guidance and Technical Assistance Activities (2007 forward)

**State Unemployment Tax Act (SUTA) Dumping Guidance and Technical Assistance
Activities (2009 forward)**

Date	Activity	Description of Activity
August 11, 2009	Unemployment Insurance Program Letter (UIPL) No. 33-09	UIPL notified states of changes to the collection and reporting of data on the ETA-581 report and the Tax Performance System (TPS).
August 18, 2009	Unemployment Insurance (UI) National Tax Conference	The Employment and Training Administration (ETA) conducted a workshop on SUTA dumping.
February 16, 2010	UIPL 13-10	UIPL notified states of requirement for state TPS reviewers to review the state's activities regarding the state's use of its SUTA dumping detection system, and the state's investigations of employers that may be engaging in SUTA dumping.
February 24 and 25, 2010	Conference call with states	ETA and the Information Technology Support Center (ITSC) convened conference calls to advise states of maintenance and support available for the North Carolina/ITSC SUTA Dumping Detection System (SDDS).
November 9, 2010	UIPL 02-11	UIPL notified states of changes to the ETA-581 report, which required states to report their activity to detect SUTA dumping beginning with the first quarter of 2011.
November 30, 2010	Webinar on revised ETA-581 report	ETA provided guidance to states on changes to the ETA-581 report as announced in UIPL 02-11.
March 29, 2011	Conference call with states	ETA convened a conference call with the ITSC and states to provide updated information on revisions to the SDDS and facilitate discussion of state experiences regarding their SUTA Dumping detection efforts.
Ongoing	Quarterly review of SUTA dumping activities reported by states	ETA National Office staff reviewed quarterly SUTA dumping activity reported by states and coordinated technical assistance calls through the ETA regional offices, as needed.
Ongoing since the 4th quarter of 2011	Quarterly ETA-581 Outlier Reports	ETA reviewed data for states that continuously reported zero activity on ETA-581 reports to inquire and explore reasons why no SUTA dumping activity has been reported.

Date	Activity	Description of Activity
June 19 and 20, 2012	Webinar/Training	ETA conducted a webinar addressing the following: (a) summarized state responsibilities for using a SDDS to prevent and detect SUTA dumping; (b) provided a status of the SDDS supported by the ITSC; (c) discussed states' measurement of SUTA dumping activities via the TPS reviews and reporting on the ETA-581 Contributions Operations Report; (d) discussed the advantages of using the UI Community of Practice website to share information on best practices, tools, and other resources that can help states with their SUTA dumping activities; and (e) presentations from representatives in Oregon and Texas on their experiences with their SDDS.
March 15, 2013	Webinar	ETA and the ITSC provided updates on the SDDS activity. A roundtable discussion of state issues/concerns was held.
June 17, 2014	Webinar	ETA and the ITSC provided updates on the SDDS activity. A roundtable discussion of state issues/concerns was held.
November, 2014	Webinar	ETA conducted a webinar on the following: (a) states' responsibilities to use a SDDS to detect and prevent SUTA dumping; (b) differences between SUTA dumping schemes; (c) different methods to find SUTA dumpers; (d) each area of the ETA-581 related to SUTA dumping.
December, 2014	One-on-one state calls to address problems	ETA convened calls to examine efforts to detect SUTA dumping with states which regularly reported zero activity on ETA-581 reports.
March, 2015; ongoing	One-on-one state calls with states	ETA conducted follow-up to the December 2014 calls – If the state continued to have no reported SUTA dumping activity on the ETA-581 report for the first quarter of 2015, ETA discussed the efforts needed to detect SUTA dumping.
2015 and ongoing	UI Community of Practice	A SUTA dumping activity summary was posted to the UI Community of Practice (CoP) website that cataloged SUTA dumping topics by category and provided links for UI CoP users to access the information.

**Worker Misclassification Prevention & Detection Guidance and Technical Assistance Activities
(2007 forward)**

Date	Activity	Description of Activity
2007 - 2013	Questionable Employment Tax Practices (QETP) Team	The QETP Team, comprised of Employment and Training Administration (ETA), Internal Revenue Service (IRS), and state volunteers, met recurrently to monitor trends and issues, create uniform state processes, and draft and promote legislative changes in an effort to encourage some nationwide standardization.
March 25, 2010	Federal-State Meeting	Misclassification Task Force Meeting
August 17 - 31, 2010	Three Worker Misclassification Forums	Worker Misclassification Forums: 1) Dallas, TX (108 attendees); 2) Philadelphia, PA (31 attendees); and 3) Dallas, TX (77 attendees). All states, except California, Hawaii, Massachusetts, Virgin Islands and West Virginia sent at least one attendee to a forum. The Philadelphia (Region 2) and Dallas (Region 4) regional offices co-hosted the forums.
September 2, 2010	Unemployment Insurance Program Letter (UIPL)	UIPL No. 30-10: "Proposed Effective Audit Measure for State Unemployment Insurance (UI) Employer Audit Programs"
December 30, 2010	UIPL	UIPL No. 03-11: "Implementation of the Effective Audit Measure"
2011 – ongoing	USDOL Misclassification Initiative	Supported Memoranda of Understanding (MOUs) between USDOL's Wage and Hour Division (WHD) and states (including State Unemployment Insurance [UI] agencies) to share information in support of state efforts to identify and address worker misclassification.
February 22, 2011	Webinar/Training	ETA conducted a Worker Misclassification Webinar.
October 11, 2011	Voluntary Classification Settlement Program (VCSP) IRS – Conference Call	Coordinated a conference call to provide states information on VCSP, whereby the IRS allows taxpayers to reclassify their workers as employees for future tax periods for employment tax purposes with partial relief from federal employment taxes. The VCSP has no direct effect on state UI taxes and coverage.
October 19, 2011	Presentation	ETA staff presented at the 2011 National UI Directors' Conference and Information Technology/Legal Issues Forum: "Effective Methods to Detect and Deter Worker Misclassification"
May 22 - 23, 2012	Webinar/Training	ETA conducted a webinar for states on the topic of QETP.
August 16, 2012	Webinar/Training	ETA conducted a Worker Misclassification Webinar for states on Auditing Techniques for Detection and Enforcement.
October 24, 2012	Presentation	ETA staff presented at the National Association of State Workforce Agencies (NASWA) UI Directors' Conference on a Worker Misclassification Panel.
September 22, 2013	Presentation	ETA conducted the 2013 National UI Tax Conference (agenda included Worker Misclassification topics related to detection and enforcement efforts).
July 16, 2014	UIPL	UIPL No. 18-14: "Fiscal Year 2014 Unemployment Insurance Worker Misclassification Prevention and Detection Supplemental Funding Opportunity"

Date	Activity	Description of Activity
July 28, 2014	Webinar/Training	ETA conducted a webinar for states on UIPL No. 18-14 concerning the supplemental funding opportunity to enhance detection and prevention efforts to address Worker Misclassification.
2014 - ongoing	Information Return Analysis System (IRAS) for States– Testing	Three states (Connecticut, Maryland, and Rhode Island) are testing IRAS before roll-out to all states. IRAS is a Microsoft Access database program developed by the IRS. States may import W-2 and 1099-MISC data into the program in order to conduct searches, filtering, sorting and matching to assist with selecting audits or examinations of employers that may be misclassifying workers.
2015 – ongoing	USDOL – Wide	USDOL developed a worker misclassification webpage to educate employers and workers about the impact and consequences of worker misclassification. https://www.dol.gov/featured/misclassification/
March 25, 2015	Governmental Liaison Data Exchange Program (GLDEP) IRS – Conference Call	ETA discussed the file extracts, including 1099-MISC, that states can obtain from the IRS to perform computer matches, which result in identification of non-filers and under reporters.
June 25, 2015	Presentation on Worker Misclassification	UI and Worker Misclassification– National Association of UI Appellate Professionals Training Conference (related to hearings held on Worker Misclassification cases under appeal).
October 21, 2015	USDOL Worker Misclassification Webinar	ETA participated in a joint webinar with WHD to discuss efforts to address worker misclassification with state workforce agencies.
Ongoing	State Specific Technical Assistance	Ongoing technical assistance is provided to states. One recent example, in 2016, ETA staff assisted one state in obtaining state practices from other states and assisted the state in reviewing and revising their strategies on education and outreach programs on the topic of worker misclassification.
Ongoing	State Worker Misclassification Task Forces	ETA continues to promote and support states in creating an inter-agency task force to develop and implement plans to prevent and detect worker misclassifications.
Ongoing	Quarterly review of worker misclassification activities reported by states	ETA National Office staff review quarterly worker misclassification activity reported by states and convene technical assistance calls through ETA regional offices, as needed.