So You Want to Transfer Employees ... Now What?

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When clients request our assistance in creating a management company, to house all employees who are then leased back to the entities for which they perform services, the benefits are clear. The main goals are often to streamline payroll and personnel management into one management entity, to reduce the paperwork associated with quarterly and annual filings, and to insulate employment liabilities into an entity separate from the asset holding company. The transfer of employees also arises when clients acquire a business and agree to employ the seller's current employees, to maintain consistency in operations and avoid the hassle of finding new staff to learn and perform each role.

The risks with transfers of employees are less apparent and can trap the new employer into tax liabilities and obligations, along with penalties for SUTA dumping, upon failure to properly report the transfer.

What tax liabilities and obligations does a new employer assume?

Every employer with employees performing services in Michigan, whether a new operation or having gained employees through an acquisition, is required to pay both Michigan income tax to the Michigan Treasury and unemployment taxes to the Michigan Unemployment Insurance Agency ("UIA").

Employers report a new business and employees by filing the Michigan Treasury Form 518 – Registration for Michigan Taxes along with the UIA Schedule A (Liability Questionnaire), which must be completed by all employers. If the new employer acquires any assets, trade, or business (including employees) from another employer or a related entity, it must also complete UIA Schedule B (Successorship Questionnaire). Through this series of filings, the State of Michigan becomes aware of the taxes owed by the new entity and assigns the appropriate unemployment tax rate to the new employer.

An unemployment tax rate is established based on myriad factors, including the experience of the prior employer, such as the amount paid in unemployment taxes less any benefits charged (actual reserve), the experience rating, and the payroll tax base. In 2019, the Michigan unemployment tax rate generally ranged between .06% to 10.3%. Employers can limit increases in this tax rate through implementing strategic employment practices that properly deny benefits to employees who are not eligible, and to engage in practices that retain employees with a low turnover rate.

When employees transfer from one entity to another, the new employer may be liable for unpaid unemployment taxes and interest, and may receive the unemployment tax rate, penalty and the benefit charges of the seller/transferor. In essence, if the seller/transferor had a negative account balance, meaning that the amount of unemployment benefits paid to former employees was greater than the amount of unemployment taxes contributed, the new employer will carry the burden of that deficit by either having an increased tax rate or by paying the UIA to balance the reserve.

What is SUTA dumping and how do new employers avoid it?

New employers learn the unemployment tax history of a seller/transferor when it receives the UIA Form 1027 – Business Transferor's Notice to Transferee of Unemployment Tax Liability and Rate. This form is completed by the seller/transferor, at least two days before an offer to transfer is accepted, and discloses any outstanding tax liability, unreported unemployment tax liability, tax payments, tax rates, cumulative benefit charges for the last 5 years, a list of all employees currently employed by seller/transferor, and a list of all employees who separated from employment within the last 12 months. After a sale, the former employer would complete the UIA Form 1772 – Discontinuance or Transfer of Payroll or Assets in Whole or Part.

Employers who fail to complete the appropriate UIA schedules and forms neglect to put the UIA on notice that a transfer has occurred, and a tax rate may be assigned to the new employer without accounting for the history/experience on the prior UIA account. This is unlawful SUTA dumping, essentially tax avoidance, which may result in increased contribution rates/taxable wages, penalties (up to 4 times the amount of taxes evaded, plus interest), and fines of up to $5,000.

It is critical that employers complete the required forms upon transfer or sale of a business. Depending on the entity, additional forms may also be required (e.g., UIA 1045 and 1045A for employee leasing companies and professional employer organizations). At Maddin Hauser, our corporate and employment teams guide clients through this process to lawfully accomplish their goals.