

Considerations in increasing the filing frequency of state unemployment insurance wage reports

Prepared for the National Payroll
Reporting Consortium, Inc.



About this study

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Executive summary

The National Payroll Reporting Consortium, Inc. (NPRC) engaged Ernst & Young LLP to provide an independent and objective analysis of the current quarterly state unemployment insurance (UI) wage reporting system, the challenges that are likely to arise from increasing the filing frequency to monthly, and the limitations in the use of UI wage data for income verification by various public programs. In particular, Illinois recently enacted legislation that shifted the frequency of wage reporting to monthly, and this study focuses in part on the impact of this legislation. Our findings are based on an analysis of the current wage and employment tax reporting requirements, U.S. Department of Labor (DOL) surveys, Illinois census data and our experience in assisting clients in meeting these obligations.

Key findings

Untimely wage information is a national concern requiring a national solution

While there has been consideration given to *accelerating the due date* of wage and employment tax returns, so far there has been no significant federal initiative to require *more frequent filing* of wage reports. In fact, federal wage reporting was significantly decreased (from quarterly to annually) in the late 1970s and has stayed consistent since that time.

The National Directory of New Hires (NDNH) is rapidly evolving to resolve some of the demand for timely employment and wage information. Federal and state law now require that virtually all employers report the hiring or rehiring of employees within a few days of the first day of work. State workforce agencies supplement the NDNH by uploading information gathered from employers' quarterly UI wage reports. The NDNH effectively improves the ability of federal and state government agencies to identify employment change events that may affect benefits eligibility. Some state agencies are still learning how best to take advantage of the NDNH's benefits, and determining how best to independently verify NDNH data with employers is an ongoing issue. In fact, the DOL only this year launched an electronic employer verification system (SIDES) for use in determining eligibility for UI benefits, and its full potential in satisfactorily augmenting the NDNH has yet to be realized.

Federal, state and local policymakers continue to express a desire for speedier access to wage and employment information; however, most are proceeding cautiously in changing the existing employer reporting requirements because they realize the importance of giving careful consideration to the needs and requirements of all stakeholders. The IRS, for instance, is still in the process of soliciting commentary concerning its vision for a "real-time tax" concept that would accelerate the filing due date of annual Forms W-2.

State wage reporting systems are interconnected for qualified nationwide access; therefore, hastily creating new or different wage reporting and income verification systems that benefit a small constituency could prove costly and inefficient in the long run.

Most employers need several weeks to prepare a UI wage report

States have been reluctant to accelerate the UI wage reporting filing because of the time it takes employers to accurately compile data. The 1997 data obtained by the DOL showed that most employers required two to three weeks to accumulate and format wage reports for filing purposes. If anything, the time involved in compiling and filing this data has increased since 1997. This is not to say that it takes an employer a full 15 to 25 days to prepare the report. However, it takes this long to obtain the data due to the need to secure third-party data, determine the value of noncash fringe benefits, process and review tax setup, post adjustments, and reconcile data.

Under a monthly UI wage reporting scheme, the cycle for obtaining and perfecting this data could consume the greater portion of the reporting period. For instance, based on the 1997 data secured by the DOL, 51% of employers would be perpetually in the process of preparing monthly UI reports, assuming a 40-hour workweek (See Figure 3 on page 20.)

Executive summary

Cost may outweigh the benefits

In 2004, the DOL sponsored a survey that included the annual cost incurred by employers in computing quarterly UI wage reports. While this study does not take the place of a current analysis of employer costs, it provides a starting point for making some projections. If the monthly UI filing requirement is extended to all employers (a step necessary to cover small business employment), Illinois businesses alone would incur an additional cost in preparing UI wage reports in excess of \$115 million per year, with 95% of these costs incurred by small companies with 1 to 99 employees. This projection does not include programming costs required in the start-up year, which are likely to be substantial for many employers.

In relationship to the significant projected costs of monthly reporting, it is important to understand the additional benefits that are likely to be derived from this effort. In performing this evaluation, the following inherent limitations of monthly UI wage reports should be considered.

Speed of access

Changing the UI reporting frequency from quarterly to monthly will not necessarily increase by a substantial sum the speed at which public agencies will have access to current wage information. Assuming that monthly wage reports are required to be filed toward the end of the month following the month that wage payments are made, there are eight months in the year where there is either no change in lag or a gain of only one month from quarterly reports.

Even under a monthly UI wage reporting system, it could take up to two months before current wage information is available for income verification purposes. For instance, the wage information for an employee hired on April 1 would not be available until the end of May. (See Table H on page 21.)

It bears asking what percentage of reduction in fraudulent benefits is likely to be achieved when, even under a monthly reporting frequency, there could be a significant lag in obtaining access to current wage information.

Paper filing reduces benefit of monthly UI reporting

There would be little benefit in allowing for the paper filing of monthly UI reports because of the length of time it would take for state workforce agencies to migrate paper into a usable electronic format. This is likely the reason that the Illinois law taking effect in 2013 limits the monthly wage reporting requirement to employers required to file electronic UI returns (those with 250 or more employees). Currently, only seven states mandate electronic filing of UI wage reports by all employers. The remainder continue to allow paper filing by small businesses.

Unless states are willing and able to mandate electronic UI reporting for all employers, a large percentage of the workforce will not be included in monthly UI wage reports. Consequently, an important consideration in moving from quarterly to monthly UI wage reporting is the extent to which state workforce agencies have the technology and capacity to accept and process large volumes of employer data on a recurring basis. Also important in this consideration is the extent to which those electronic systems are easily accessed by employers of all sizes and technological capabilities.

Not actionable absent independent employer verification

The merit of monthly UI wage reports is particularly questionable when considering the lack of new or useful information they provide for income verification purposes. The states already have access to quarterly UI wage information for covered workers. They also have access to new hire information within days of the date of hire and, under Illinois law, will have additional data concerning the projected earnings of new hires. The combination of these two reporting systems has historically met the need for wage and employment data, but it is understood that the data falls short of being actionable for benefit eligibility purposes absent independent employer verification of wages due to the following factors:

- ▶ UI wage definitions do not match the wage definitions of Medicaid and other welfare programs.
- ▶ Some noncash fringes are reported in periods other than when they were earned (e.g., personal use of company automobile).
- ▶ Some earnings are, by their nature, variable (e.g., tips, bonuses, commissions, stock).

A monthly wage reporting system increases the frequency of the data flow for a subset of the workforce but does little to address the underlying factors that give rise to the need for independent employer verification.

Policy considerations and alternatives in using employer reporting for income verification

Clarify underlying policy goals to develop effective reporting solutions

For Medicaid eligibility purposes, it seems likely that it is more important to capture and evaluate significant changes in *employment status* rather than collect UI wage reports more frequently. States already have access to quarterly wage information for the population of workers covered for UI purposes. Earnings usually don't fluctuate dramatically within a quarter unless there are corresponding changes in employment status, and such status events are contained in the NDNH. Whether the states have exhausted the full potential of these existing wage and employment information systems merits further investigation.

Whether the data provided on UI wage reports is congruent with Medicaid eligibility rules is another significant concern that needs to be explored. For instance, would an agency actually shift claimants on and off Medicaid coverage from month to month based on variations in monthly wages? If so, to what extent might Medicaid enrollees, public policy advocates and others challenge this policy? Perceived income fluctuations within a quarter could result from employers uploading certain compensatory items as a lump sum. For instance, the IRS allows that personal use of automobiles and certain other noncash fringe benefits be reported at any frequency the employer chooses so long as they are included in the annual wages for the tax year.

If it is the intent of a Medicaid agency to identify individuals with income increases from month to month and then to disqualify them from coverage, the existing UI wage report is inadequate for this purpose. Rather, employers would need to allocate reportable earnings equally to each month, or they would need to report estimated future values of unpredictable compensation, such as tips, commissions, bonuses and stock options, so that non-recurring payments do not routinely cause eligible individuals to be removed from coverage. All of these requirements, if imposed, would create a significant discrepancy between wages reported for Illinois UI purposes and wages reported for other tax administration purposes (e.g., Forms W-2).

Conduct study to determine if existing systems adequately meet program eligibility requirements

Given the sizable effort required of employers and state workforce agencies if required to produce monthly UI reports, studies should be conducted to ascertain the percentage of the UI wage report information that historically has been relied on by public agencies for income verification purposes. Such study would be beneficial in ascertaining if the existing systems of quarterly wage reporting, new hire reporting and ad hoc employer income verification are already adequate for Medicaid program administration purposes.

Expand use of DOL's SIDES and eSIDES for ad hoc verification of income

In lieu of monthly UI wage reports, authorized public agencies could be given access to SIDES for electronic verification of wage and employment data. For more information concerning SIDES, see page 5.

If monthly UI wage reports are required, do not use them for UI purposes

If it is decided to continue to require monthly UI reports, they should not be considered as taking the place of the quarterly UI wage report, and therefore should not be matched against the quarterly UI wage report, Form 940 or any other tax return. This will eliminate unproductive employer and agency reconciliation workload, reduce employer processing time and help ensure that the integrity of current employment and withholding returns is not compromised in the effort of using the data for purposes outside the original scope.

Simplify UI wage reporting

The 19 states that have not done so (see Table E, page 15) should consider adopting the uniform reporting standard of the National Association of State Workforce Agencies (NASWA) to simplify the reporting process for multi-state employers.

Section 1: Federal framework for wage and employment reporting

Almost without exception, the requirement for wage and employment data has its roots in federal legislation.



Over the years, various governmental programs have required employers to submit statements, returns and other files containing employee wages and employment detail for program administration and enforcement purposes. (See Table A.) Almost without exception, the requirement for wage and employment data has its roots in federal legislation.

The first such federal law was the Social Security Act of 1935, which triggered two federal programs dependent on employee wage data: Social Security retirement and unemployment insurance.

In 1943, legislation was passed to mandate the withholding of federal income tax and to furnish employees and the IRS with a statement of earnings and tax withheld (Form W-2). In subsequent years, state and local income tax authorities have come to also rely on the Form W-2 for income tax administration and enforcement purposes.

Under the welfare reform legislation of 1996, authorization was provided for the creation of the NDNH, with the mandate that all states require employer reporting of information concerning newly hired employees such as employee name, address, Social Security number (SSN) and date of hire, as well employer name, address and Federal Employer Identification Number (FEIN). The required information has been expanded over time. Each state workforce agency (SWA) is also required to furnish employer-provided quarterly wage information to the NDNH as well as information pursuant to individuals who have received or applied for UI benefits.

The NDNH is used primarily in locating parents with family support obligations and, consequently, is operated by the federal Office of Child Support Enforcement and located at the National Computing Center (NCC) of the Social Security Administration (SSA). NDNH data may also be used by various other federal, state and local governmental agencies as authorized under the Social Security Act.

Table A: Sample of current uses of employer-provided employee earnings and tax information

| Governmental agency | Use of data | Source of data |
|---|---|---|
| Social Security Administration | Benefits calculation and income verification | Annual Form W-2 and National Directory of New Hires |
| State workforce agencies | Unemployment insurance benefits calculation and eligibility verification | Quarterly UI wage report and National Directory of New Hires |
| Internal Revenue Service | Federal income tax enforcement (income matching programs) | Annual Form W-2 and National Directory of New Hires |
| State (and local) income tax authorities | State (and local) income tax enforcement; tax levies and other "warrants" for wage attachment | Annual Form W-2 and quarterly UI wage report |
| Title IV-D state family support enforcement agencies | Enforcement of family and medical support garnishment orders | Quarterly UI wage report and National New Hire Registry |
| State health and welfare | Income verification for health and financial aid to economically disadvantaged | Quarterly UI wage report and National Directory of New Hires |
| Federal loan programs (e.g., Department of Education and Department of Housing and Urban Development) | Income verification and debt collection | Annual Form W-2, UI wage report and National Directory of New Hires |

1-A: Filing frequencies have remained consistent and simplification a recent trend

Since the original inception of employer reporting, the frequency at which employers must file employee wage and employment data has been either annually or quarterly. The 1996 welfare reform law created a centralized ad hoc reporting system through the NDNH that is triggered by the hiring of new employees. Finally, employers have always responded to UI benefits qualification inquiries from states on an ad hoc basis, but there is a new national electronic system (SIDES) emerging to facilitate this process.

Table B: Wage and employment filing tax filing frequencies for tax year 2012

| Jurisdiction and tax type | Form | Filing frequency |
|--|------------------------|-------------------------------------|
| IRS – unemployment insurance | Form 940 | Annually |
| All states – unemployment insurance* | Various | Quarterly |
| IRS – income tax withholding | Form W-2 | Annually |
| All states – income tax withholding** | Form W-2 or equivalent | Annually |
| All states – new hire reporting | Varies | Ad hoc – triggered by date of hire |
| All states – UI income and employment verification | Varies | Ad hoc – triggered by benefit claim |

* Illinois has passed legislation to require monthly wage reporting effective in 2013 (see page 8).

** Some state income tax authorities do not require the filing of Forms W-2.

Filing frequency should not be confused with the filing due date. For instance, the federal Form 941 is filed quarterly and is due on the last day of the month following the close of the quarter. Similarly, the current filing frequency for state quarterly returns is quarterly, with the due date ranging from the 25th to the last day of the following month. (See Table B above.)

Table C: Quarterly employment tax return filing frequency and due dates*

| Return description | Quarter 1 January – March due date | Quarter 2 April – June due date | Quarter 3 July – September due date | Quarter 4 October – December due date |
|------------------------|--|---------------------------------------|---|---|
| Federal Form 941** | April 30 | July 31 | October 31 | January 31 |
| Michigan SUI | April 25 | July 25 | October 25 | January 25 |
| New Jersey SUI | April 30 | July 30 | October 30 | January 30 |
| SUI – all other states | April 30 | July 31 | October 31 | January 31 |
| Total returns | 52 | 52 | 52 | 52 |

* In general, if the due date falls on a Saturday, Sunday or legal holiday, the due date is the next business day.

** The due date may be extended to the 10th of the subsequent month if all Form 941 taxes were paid on time and for the full amount.

While there has been consideration given to accelerating the due date of wage and employment tax returns, so far there has been no significant federal initiative to require more frequent filing of wage reports. In fact, the amount of federal wage reporting required of employers was decreased in the late 1970s and has stayed consistent since then. Additionally, newer employer reporting systems implemented at a federal level emphasize the trend in centralization and standardization. For instance, new hire reports are maintained centrally (NDNH) and a nationwide response system for UI benefit verification information (SIDES) was created. (See page 6 for more information concerning SIDES.)

Section 1: Federal framework for wage and employment reporting

Form 941 quarterly wage detail reporting eliminated

Prior to 1978, employers filed with the IRS Form 941, Schedule A, showing by SSN the Social Security wages for each employee. Forms W-2 were filed annually with the IRS. Effective in 1978, and under current law, Form 941 is filed quarterly with the IRS without employee wage detail, and Forms W-2 are filed annually with the SSA. (*SSA RM 01101.003, Employer Wage Reporting – General; P.L. 94-202.*)

Standardization of state quarterly wage reporting

In 1984, federal legislation was enacted requiring that states obtain quarterly wage information from employers for purposes of verifying eligibility for various means-tested federal benefit programs. (*Deficit Reduction Act of 1984, Senate Print 98-169.*) States that obtain this data quarterly through their UI systems are eligible for federal reimbursement as a UI program cost.

Prior to enactment of this legislation, 45 states required employer quarterly wage reports, 42 of them as part of the UI system. States that had not previously required employer quarterly wage reports for UI purposes verified benefits eligibility on a claimant-by-claimant basis. New York, for instance, first required quarterly wage reporting in July 1978 through its Department of Taxation and Finance and was the last state, in 1999, to obtain these reports through its UI system. Prior to July 1995, New York verified eligibility of UI benefits on a case-by-case basis. (*A History of UI Legislation in the US and NYS, 1935-2007, page III-32.*)

As demonstrated by the federal policies currently governing wage and employment reporting, there has been a consistent federal effort since 1978 to maintain an annual and quarterly wage reporting frequency, to standardize reporting systems and to minimize redundancy in these systems.

Single-state reporting of new hires

Because the NDNH is centralized, it was possible to simplify new hire reporting for multi-state employers by stipulating under federal law that when filing magnetically or electronically, a multi-state employer may choose one state in which to file. Further, redundancy in employer filing wage information was avoided by requiring that SWAs upload quarterly UI wage information directly to the NDNH, rather than requiring separate wage reporting by employers.

Standardized reporting of UI benefit verification data

This year, the DOL, in partnership with state UI agencies, launched two free electronic systems for employers and third-party administrators (TPAs) to use in responding to requests for UI benefit verification information. These new services, State Information Data Exchange System (SIDES) and SIDES E-Response, provide a secure, electronic and nationally standardized format in which to respond to UI information requests, attach documentation when needed and receive a date-stamped confirmation of receipt. Employers and TPAs in states implementing the SIDES and SIDES E-Response systems can adopt an electronic standardized format to better anticipate and supply the data needed for UI information requests, reduce follow-up phone calls and streamline their UI response processes, thereby reducing paperwork while saving time and money.

In addition to the administrative cost savings offered by SIDES and SIDES E-Response, both options address two of the largest causes of UI benefit overpayments: incorrect initial eligibility decisions (job separation issues) and employees working while receiving UI benefits.

The DOL expects that 42 states (including Illinois) will be using SIDES and SIDES E-Response by September 30, 2012.¹

As demonstrated by the aforementioned federal policies currently governing wage and employment reporting, there has been a consistent federal effort since 1978 to maintain an annual and quarterly wage reporting frequency, to standardize reporting and reporting systems (e.g., SIDES) and to minimize redundancy in these systems (e.g., NDNH).

¹ Go to the US DOL website for more information at <http://search.usa.gov/search?query=SIDES&affiliate=u.s.departmentoflabor>

1-B: Current initiatives to accelerate access to wage information

Particularly since the onset of the most recent recession, there has been a significant increase in claimants for jobless benefits and other forms of financial aid, thereby increasing the need for more rapid and reliable sources for employment and income verification. Identity theft is also on the rise, increasing the potential for fraudulent tax refunds and other similar losses in public revenue. For these reasons, some federal and state policymakers have explored the potential for accelerating the speed at which employers provide employee wage detail to governmental agencies.

Federal initiative to accelerate due date of annual Form W-2 information returns

On January 25, 2012, stakeholders provided testimony in a public meeting concerning the IRS vision for a Real Time Tax System (RTTS) in which federal information returns such as Forms W-2 and 1099 would be available to the IRS at the start of the tax season, rather than after the fact. For instance, under the current compliance model, businesses are required to issue taxpayer copies of Forms W-2 and 1099 by January 31, but the IRS and SSA copies aren't required to be filed until February 28, or March 31 in the case of electronic filers. The IRS believes that accelerating the W-2/1099 return filing gap by up to two months is necessary to achieve accuracy and tax refund fraud prevention. As of the release of this report, the IRS was continuing to weigh stakeholder commentary.

State workforce agency initiatives to accelerate filing due date of quarterly wage reports

To avoid delays and additional administrative burden for government and employers, some states have considered requiring that employers file quarterly wage information sooner; however, because of feedback from stakeholders, there have been no recent mandatory changes in the due date for filing quarterly wage reports.

For instance, the South Carolina Department of Employment and Workforce hoped to accelerate the due date for quarterly wage reports from the end of the month following the quarter that wages are paid to the 15th of the month following the close of the quarter. Thus far, compliance with the earlier due date of the 15th of the month is voluntary for South Carolina employers.

Under a study commissioned by the DOL in 1997, Planmatics Inc. reported that Massachusetts was the only state that had accelerated its UI wage reporting deadline to the 15th of the month. Since that report, Massachusetts has repealed the earlier due date and now requires wage reports at the end of the month following the close of the quarter.

In fact, only two states currently require UI wage reports before the end of the month following the close of the quarter:

- ▶ **Michigan** – the 25th day following the quarter wages are paid (*MICH. ADMIN. CODE R 421.121 (2011)*.)
- ▶ **New Jersey** – the 30th day following the quarter wages are paid (*New Jersey Employer SUI Handbook, p. 1.*)

The IRS believes that accelerating the W-2/1099 return filing gap by up to two months is necessary to achieve improvements in accuracy and tax refund fraud prevention.



To avoid delays and additional administrative burden for government and employers, some states have considered requiring that employers file quarterly wage information sooner; however, because of feedback from stakeholders, there have been no recent mandatory changes in the due date for quarterly returns.

Section 1: Federal framework for wage and employment reporting



Illinois legislation requiring monthly UI wage reporting

On June 14, 2012, Illinois passed unparalleled legislation mandating that effective January 1, 2013, large employers file their UI wage reports monthly instead of quarterly. The monthly reporting requirement doesn't apply to paper filers. Under current Illinois law, businesses with 250 or more employees in the previous calendar year are not allowed to file on paper. There is reportedly consideration of passing legislation that would expand the electronic filing mandate – and hence the monthly wage reporting mandate – to employers with as few as 25 employees.

The law also adds “employees' projected monthly wages” to the new hire reporting data that employers are required to provide. (*The SMART Act, Public Act 097-0689.*)

The SMART Act was passed in an effort to address abuses in the state's Medicaid and Children's Health Insurance Program and, according to legislative budget estimates, is projected to save the state \$1.6 billion in fiscal year 2013. (*Illinois Government News Network, Press Release, June 14, 2012.*) It is not clear how much of these savings would be derived from accelerating the filing frequency of UI wage reports.

Regulations were pending at the time of this report; therefore, details concerning implementation of the requirement are uncertain. For instance, it is not clear if the monthly wage reports will be collected in addition to or in lieu of the quarterly UI wage reports.

We have found no documentation of public hearings or studies confirming the net budget impact of monthly UI wage reporting.

1-C: The focus of this report

This report focuses on the existing framework of wage and employment reporting as it pertains to meeting tax and other policy goals, the challenges businesses face in meeting those goals, and the magnitude of effort that is likely to be involved in adapting the current tax-driven system for use in income and employment verification outside of the UI system. Key to this discussion is an examination of the limitations of UI wage reporting for income verification, the need for a cost-benefit justification for increasing wage reporting burdens and alternatives to consider in providing information that is useful in determining income eligibility for various public programs.

Section 2: Business processes in meeting wage reporting deadlines

Employer wage reporting systems rely on the accuracy of a number of data elements, most of which are dynamic. Further, employers are ultimately liable for the accuracy of each of these elements even if the task of payroll and employment tax is outsourced to a third party. The primary processes involved in wage reporting are:

- ▶ Employee data maintenance
- ▶ Pay and deduction configuration
- ▶ Tax setup
- ▶ Payroll data and “negative wages”
- ▶ Third-party interfaces and intercompany wage transfers
- ▶ Tax filing

Work location is an important element that must be managed for UI reporting purposes because it has the potential of changing the state of UI coverage.

2-A: Employee data maintenance

The accuracy of wage reporting depends on the correct identification of the employee’s resident and work locations. Also required of employees are federal, state and local withholding allowance and/or tax exemption certificates that are necessary for the employer to compute the correct amount of income tax withholding. If the employee is subject to local tax, additional setup information is required of employees and employers, namely geocoding that determines the location of the employee’s resident and work addresses in relationship to the applicable local taxing jurisdictions.

Temporary and multiple work locations

Work location data can be the most challenging to maintain as some employees may frequently change work location or be assigned to multiple work locations within a reporting period. If the payroll system is unable to allocate wages to multiple work locations within a single payroll period, it may be necessary for the employer to make manual adjustments to the employee’s state and local wages and taxes withheld prior to the close of the reporting period (currently, the quarter or year). Additionally, states are increasingly establishing and enforcing withholding and tax reporting obligations on nonresident employees and their employers for brief temporary work assignments. Thus, employers with workers who travel must often produce many separate Forms W-2 to reflect earnings and taxes attributable to each state and locality in which an employee worked during the year.

Wage transfers

Wage transfers further complicate the reporting process. For UI purposes, all states except Louisiana and Minnesota allow the employer to transfer year-to-date UI taxable wages when an employee of an employer transfers to another state. (*Louisiana H.B. 482, Act 239, 2005; Minnesota Law, 268.051 Subd.2 (b)(d), 268.051 Subd.5, 268.051 Subd.5 (b), 268.051 Subd.8, and 116L.20.*) In the event of a merger or acquisition, a transfer of wages paid by the predecessor to the successor may also be allowed for federal and state withholding and UI purposes. Some state UI reporting systems have difficulty correctly calculating UI taxable wages where wages have transferred from another state or another employer. For all of these reasons, there can be a period subsequent to a transfer of employees that states have incorrect employee wage information.

Section 2: Business processes in meeting wage reporting deadlines

2-B: Pay and deduction code configuration

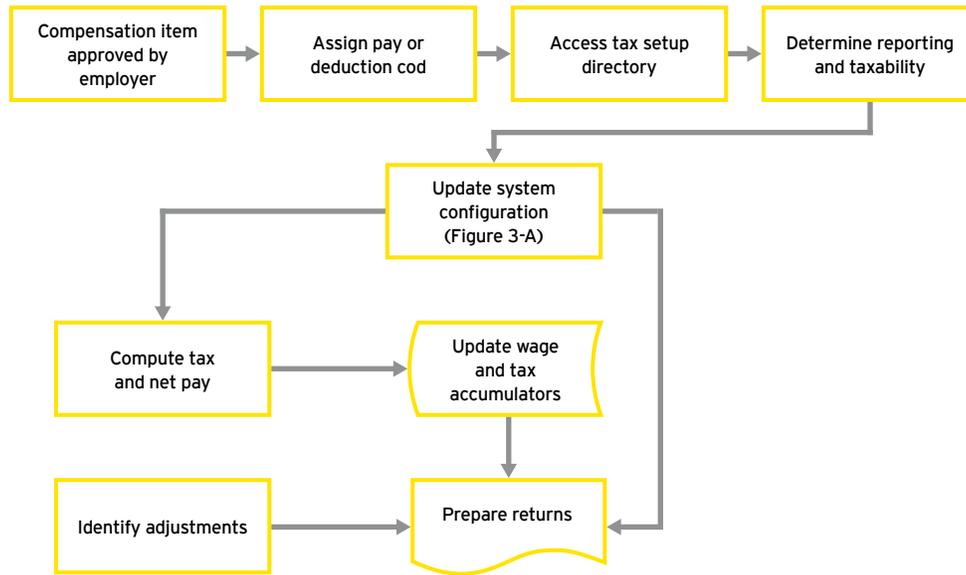
Each taxing jurisdiction maintains its own statutory or regulatory definition of “taxable wages” and “reportable wages,” sometimes requiring special reporting, such as box 12 of Form W-2. For this reason, employers need to accurately identify each type of compensation provided to employees and correctly map each item of compensation to each jurisdiction’s wage definition and reporting requirements. In some instances, deductions may also need to be considered when arriving at taxable wages and their reporting requirements. For example, pretax deductions under a cafeteria or transportation fringe benefit plan may need to be included in taxable wages for some jurisdictions, and pretax retirement plan contributions may require special reporting, such as box 12 of Form W-2. (See Figures 1-A below and 1-B on page 11.)

Example: The employer has employees in Los Angeles and Philadelphia. The employer chooses to add adoption assistance as a pretax option to its cafeteria plan. Shown in Figure 1-A are the federal, state and local parameters that are associated with the adoption assistance pretax deduction code. Figure 1-B illustrates the process involved in establishing and accounting for this benefit on wage and tax returns.

Figure 1-A: Sample tax configuration for adoption assistance pretax

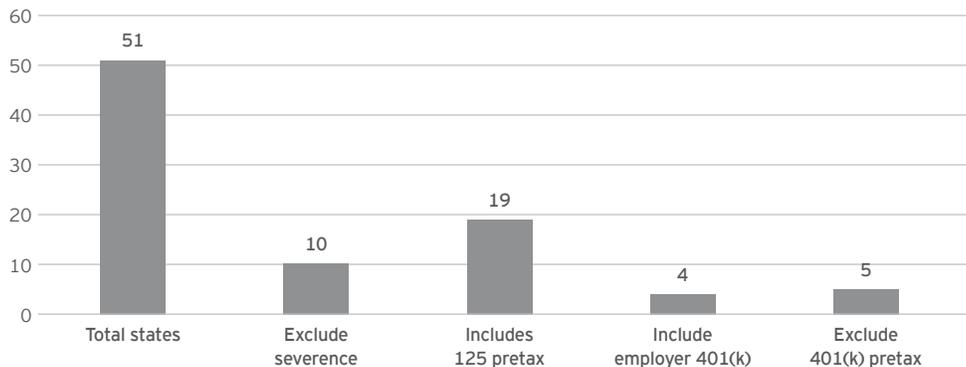
| Tax and reporting requirement | Subject | Tax-free limit – 2012 | Period |
|---|---------|-----------------------|--------------|
| Federal income taxable wages | No | \$12,650 | Per adoption |
| Federal income tax withholding | No | \$12,650 | Per adoption |
| Social Security | Yes | N/A | N/A |
| Medicare | Yes | N/A | N/A |
| Form W-2 box 12 | Code T | N/A | N/A |
| California state income taxable wages | No | \$12,650 | Per adoption |
| California state income tax withholding | No | \$12,650 | Per adoption |
| California state unemployment insurance | Yes | N/A | N/A |
| California disability insurance | Yes | N/A | N/A |
| Pennsylvania state income taxable wages | Yes | N/A | N/A |
| Pennsylvania state unemployment insurance | Yes | N/A | N/A |
| Philadelphia local EIT taxable wages | Yes | N/A | N/A |

Figure 1-B: Overview of pay and deduction code configuration in the wage reporting process



States vary as to their definitions and requirements for reporting and taxability of certain items of compensation. The ambiguity concerning the taxability of compensatory items is particularly prominent in the states' definition of taxable wages for UI purposes. (See Figure 2 below and Appendix B on page 27 for a sample of state UI taxability variations.)

Figure 2: SUI wage definition sample variations from federal



Section 2: Business processes in meeting wage reporting deadlines

Compliance with constructive receipt may be difficult – even impossible – if there is a delay between the date of constructive receipt and the date on which the value of the benefit is ascertained.

2-C: Payroll data and “negative wages”

With limited exception, wages are subject to tax and reporting in the period paid (“constructive receipt”). For instance, wages earned through September 30 but paid on October 1 are reported in the fourth quarter, not the third quarter. Similarly, adjustments such as void checks and wage corrections also must be reflected in the proper reporting period. When payroll data is not posted to the proper period, amended returns must generally be filed. Amended returns are one of the primary causes of wage reporting errors and reconciliation-related notices and assessments.

Fringe benefits requiring valuation

Compliance with constructive receipt may be difficult – even impossible – if there is a delay between the date of constructive receipt and the date on which the value of the benefit is ascertained. This situation may arise with certain taxable stock transactions, dependent care assistance and personal use of an automobile, to name a few. Assume for instance that an employer subsidizes the cost of day care for an employee on December 31. The total value of the dependent care assistance is not known until January.

Of interest in the discussion concerning timing differences between the date wages are earned and reported is the value of personal automobile use where the reported wages may be delayed by a calendar year. Under the IRS special accounting rule, a business is allowed to treat the value of personal use of an automobile received in November and December as paid in the following tax year. While the provision offers substantial relief to employers in meeting their tax and reporting deadlines, it can create anomalies in the income verification process. (*IRS Announcement 85-113, 1985-31 IRB 31; Ernst & Young LLP Payroll Newsflash, Vol. 11, #223, November 22, 2010.*)

For many employers, it is a manual and time-consuming process to identify and correct negative wages. For this reason, and as a reporting compliance matter, negative wages are generally resolved as part of the quarterly or annual tax reconciliation process.

Negative wages

At times, wage payments and their related reversals are incorrectly posted to two separate payroll periods, and if those payroll periods cross a quarter or tax year, a manual adjustment must be made. Consequently, until the manual adjustment is made, the employee's wages for the reporting periods may show a negative balance. It is never acceptable to report negative wages on the UI wage report or the Form W-2.

For instance, a stop payment (void check) may have been posted on June 29; however, the reissued payment (also dated June 29) wasn't posted until the next semimonthly pay period, or July 13. For both income tax and UI reporting purposes, the payment posted to July 13 must be offset against the second-quarter wage reversal so that negative wages aren't incorrectly shown on the second-quarter UI wage report.

2-D: Third-party interfaces and intercompany wage transfers

Because of the increased regulation and oversight of numerous fringe benefits, a significant number of employers use third-party plan administrators for a variety of benefits including disability pay, qualified retirement, nonqualified deferred compensation, stock plans, employee relocation, health insurance and COBRA, medical and dependent care flexible spending accounts, and transportation fringes. Additionally, compensatory items may be provided outside of the payroll system requiring a transfer of wage data to the payroll system. Examples of such data transfers include items processed through accounts payable such as taxable living and travel expenses, and recognition awards provided through point/merchandise award systems. A large corporate employer may have more than 50 compensatory items that need to be carefully gathered and added to the payroll system before wage reports can be filed. See Table D on page 14.

Due diligence in using UI wage data for Medicaid income eligibility would require that employers gather every element of reportable compensation monthly rather than quarterly. To prevent inadvertent benefit disqualifications, employers may also need to estimate and allocate monthly amounts of compensation that normally are input only quarterly or annually.

Example: Assume that a large, multi-state corporate employer makes its last biweekly wage payment on Friday, December 23, 2011. Assume further that this employer provides all of the benefits listed in Table E on page 15. Although the last regular wage payment was made on December 23, this employer must generally wait until after December 31 to begin collecting information for 50 or more items of compensation that may have been provided between December 23 and December 31. It is the task of the payroll or employment tax department to coordinate the collection of this information with at least 50 different points of contact, making sure that all of the contacts have provided information in order to meet the first tax reporting deadline of January 31.

Coordinating the timing of interfaces

Additionally, ambiguity concerning the role of the third party may also lead to reporting delays and errors. In many cases the third-party arrangement cannot be avoided, meaning that employers frequently have no choice of performing certain tasks internally where greater control may be exercised over the timing at which information is available. Refer to the highlighted areas in Table D on page 14. Stock transactions, for instance, generally are handled by a broker, credit card statements are needed to identify taxable items, investment companies provide participant and account information for nonqualified deferred compensation plans, and disability payments made to a third-party state or private fund are required to be included wages for most taxing jurisdictions.

A large corporate employer may have more than 50 compensatory items that need to be added to the wage and tax system before quarterly and annual returns can be processed.

Due diligence in using UI wage data for Medicaid income eligibility would require that employers gather every element of reportable compensation monthly rather than quarterly. To prevent inadvertent benefit disqualifications, employers may also need to estimate and allocate monthly amounts of compensation that normally are input only quarterly or annually.

Section 2: Business processes in meeting wage reporting deadlines

Table D: Common wage adjustment items for mid-to-large employers

| Reportable element | Employer | Third party | Reportable element | Employer | Third party |
|---------------------------------------|---|-------------|----------------------------------|----------|-------------|
| 401(k) – W-2 box 13 indicator | | ✓ | Expatriate wage update | ✓ | ✓ |
| Adoption assistance | ✓ | ✓ | Gift cards | ✓ | ✓ |
| Athletic club memberships | ✓ | ✓ | Gifts – noncash | ✓ | |
| Award – length of service | ✓ | ✓ | Gross-up – federal tax | ✓ | ✓ |
| Award – recognition | ✓ | ✓ | Gross-up – local nonresident tax | ✓ | ✓ |
| Award – safety | ✓ | ✓ | Gross-up – state nonresident tax | ✓ | ✓ |
| Business expense – non-accountable | ✓ | | Insurance – annuity | | ✓ |
| Club memberships | ✓ | | Jury duty – offset | ✓ | |
| Credit card – non-accountable | | ✓ | Living expenses | ✓ | |
| Deferred compensation – distributions | | ✓ | Loans – forgiven | ✓ | |
| Deferred compensation – earnings | | ✓ | Loans – interest income | ✓ | ✓ |
| Dependent care facility | | ✓ | Medical debit card | | ✓ |
| Dependent care flexible spending | ✓ | ✓ | Non-cash award | ✓ | ✓ |
| Dining hall – executive | ✓ | | Parking | ✓ | ✓ |
| Disability pay – Hawaii | | ✓ | Relocation – domestic | ✓ | ✓ |
| Disability pay – New Jersey | | ✓ | Relocation – foreign | ✓ | ✓ |
| Disability pay – New York | | ✓ | Scholarships | ✓ | ✓ |
| Disability pay – private fund | | ✓ | Settlement awards | ✓ | ✓ |
| Disability pay – Puerto Rico | | ✓ | State disability offset | ✓ | ✓ |
| Disability pay – state offset | ✓ | ✓ | Stock – W-2 box 12 indicators | | ✓ |
| Discounts – merchandise | ✓ | | Stock – ESPP | | ✓ |
| Discounts – services | ✓ | | Stock – ISO | | ✓ |
| Educational assistance | ✓ | ✓ | Stock – nonqualified | | ✓ |
| Expatriate totalization | ✓ | ✓ | Stock – restricted | | ✓ |
| Expatriate taxes | ✓ | ✓ | Transit benefits | ✓ | ✓ |
| | Outsourcing is necessary due to the nature of the compensation. | | | | |

2-E: Tax filing

Tax filing has grown increasingly complicated as the vast majority of taxing jurisdictions migrate to paperless reporting. Rather than complete agency-specific forms, as once was the case, many employers are now required to comply with jurisdiction-specific file layout specifications for filing income tax withholding and UI returns. Because file format specifications and allowable methods of reporting periodically change, additional time must be reserved in the returns processing schedule for researching current jurisdictional reporting requirements. When changes have to be made in either the method of reporting or in the format, the time needed to prepare the returns is increased. When returns are not properly formatted, they can be rejected by the taxing authority, creating filing delays.

State unemployment reporting variations

The time and complexity of employer UI wage reporting is increased by the variations in state filing formats. To address this issue, NASWA published a standard format for UI reporting based on the SSA's EFW2 format. Close to half the states (19), shown in Table E below, have not accepted the NASWA standard format for UI reporting as of October 2011.

Table E: States not accepting NASWA's standard format for UI reporting*

| | |
|-------------|---------------|
| Alaska | Nevada |
| Connecticut | New Hampshire |
| Delaware | New Jersey |
| Florida | New York |
| Hawaii | Oregon |
| Idaho | Rhode Island |
| Louisiana | Utah |
| Maine | New York |
| Michigan | Wyoming |
| Nebraska | |

* Based on Ernst & Young LLP survey, October 2011.

For tax year 2011, only two states were in complete conformity with the SSA's EFW2 record layout specifications for Form W-2 reporting, including the addition of the RV record.

Close to half the states (19) did not accept the NASWA standard format for UI reporting as of October 2011.

Section 3: Business challenges in meeting employee wage reporting deadlines

Widespread availability of current technologies has created a more user-friendly reporting environment for small companies. An employer with fewer than 100 employees doing business in 1 or 2 states is more likely to benefit from such advances as web-based applications that allow for direct input and transmittal of wage and tax information or inexpensive software solutions that facilitate the processing of employment tax returns and wage and tax statements. The smaller business is also more likely to outsource the payroll and employment tax function because the cost of outsourcing small payrolls generally is less than the cost of hiring full-time employment tax specialists.

Given the government's expanded use of and reliance on wage and tax information, it is vitally important that more focus be placed on the challenges large employers face in timely and accurately filing UI returns. While multi-state employers comprise only 1% to 2% of employers, the largest 1% of businesses employ more than half of the private sector workforce. (*State Calculation of Taxable Wages and Tax Due, UI Wage and Tax Reporting Work Group, December 10, 2009.*)

Similarly, increased focus is needed on the challenges facing employment tax service providers because they are responsible for the employment tax filing of almost 50% of businesses with fewer than 500 employees. (*2009 Salaries and Payroll Profession Survey, American Payroll Association.*)

In order of their significance, the following factors frequently create challenges in the wage reporting process for businesses responsible for reporting in multiple jurisdictions:

1. Electronic and magnetic media filing
2. Inconsistent and/or vague wage definitions
3. Non-standard data elements
4. Wage amounts not readily ascertainable (e.g., valuation of the compensatory item)
5. Third-party payments (e.g., compensation administered by a third party)
6. Adjustments and amendments

Electronic filing systems allow jurisdictions to more quickly and efficiently process wage and tax data; however, for large employers, such systems have complicated the filing process and, in some cases, have slowed the speed at which returns are filed.

Section 3-A: Electronic and magnetic media filing

Electronic filing systems allow jurisdictions to more quickly and efficiently process wage and tax data; however, for large employers, such systems have complicated the filing process and, in some cases, have slowed the speed at which returns are filed. The issues that electronic filing systems create for businesses are well-summarized by the National Payroll Consortium, Inc.:

“With the exception of single-state employers that can key in employee SSNs, names and wage amounts to an agency website one employee at a time, special software is needed to comply with each agency's file formatting and upload specifications. States generally use well-established reporting formats, such as the EFW2, as a starting point, but security features, edits and file transfer protocols tend to vary from state to state. In addition, file formats, edits, registration requirements and upload specifications change frequently as systems evolve, often requiring annual software updates.”

For state UI purposes, seven states require electronic filing for all employers. (See Table F.)

Table F: SUI paperless reporting mandated for all employees*

Alabama

Maine

Massachusetts

Minnesota

New Jersey

Oklahoma

Pennsylvania

*Based on Ernst & Young LLP October 2011 survey data.

System edits and file rejections

In some cases, jurisdictions reject files for exceptions such as a missing SSN (e.g., Michigan), name formatting errors and incorrect addresses. For UI reporting purposes, some states recalculate the UI taxable wages, rejecting files where employees' UI taxable wages do not agree with their calculations. Rejecting files that don't contain "fatal errors" creates unnecessary filing delays and exposes businesses to late filing penalties. (*Recommendations and Considerations for Designing UI Electronic Filing Systems, NPRC, April 2010.*)

The National Payroll Consortium, Inc., provides the following illustrations:

In the new electronic filing environment, tax authorities can reject employment tax returns, wage reports and W-2s for correction and resubmission. Although the core data being reported is relatively common (e.g., SSNs, employee names, addresses), there is little consensus among the states as to edit standards. Many states restrict punctuation, spacing, numerics and special characters in employee wage or W-2 reports. A few examples:

- ▶ *California, Connecticut and Kansas don't permit tildes in names (e.g., "Muños")*
- ▶ *Some states, such as Nevada, reject names with any punctuation (e.g., "Jones, Jr.")*
- ▶ *Some states prohibit apostrophes (e.g., O'Hara), while others (e.g., Washington) prohibit blanks separating single-letter prefixes (e.g., O Hara)*

This diversity is often made more problematic because such edits tend to be undocumented in agency specifications, so the only way to determine a state's error criteria is to actually receive a rejection. This can obviously jeopardize an employer's ability to meet reporting deadlines.

In some cases, administrative guidance concerning the benefits and wage payments included or excluded from SUI taxable wages is vague, leaving employers to invest extensive financial and human resources to remain in compliance.

Section 3-B: Inconsistent and/or vague wage definitions

The wage definition for state UI purposes is complex, with many states deviating from the Internal Revenue Code for a broader range of wage payments and fringe benefits. (See Figure 2 on page 11.) In some cases, administrative guidance concerning the benefits and wage payments included or excluded from UI taxable wages is vague, leaving employers to invest extensive financial and human resources to remain in compliance.

Section 3-C: Non-standard data elements

When a jurisdiction requests a data element that is not included in the files that are generally linked to the return, special queries or input steps are necessary in creating the jurisdiction's return, all of which extend the preparation time. For example, Vermont requires that the UI wage report include whether employees are hourly or salaried and their hourly rate and gender.

Section 3-D: Wage amounts not readily ascertainable

Noncash items that require a fair market value determination, such as personal use of company cars, or any item of compensation where there is a necessary delay between constructive receipt and the date on which the taxable wage amount is ascertained (e.g., nonqualified deferred compensation and taxable stock transactions) create delays in meeting filing requirements. Additionally, income tax withholding and reporting may be required in instances where the value of the benefit is necessarily ascertained after the close the quarter or year. In the latter case, adjustments and amendments may be required in addition to more complex processes such as gross-ups or tax advances, all of which further delay the reporting process. (See Table D on page 14.)

Section 3: Business challenges in meeting employee wage reporting deadlines

Because information concerning taxable amounts must be transferred to the employment tax area and posted to the payroll system for wage reporting, there may be delays in finalizing the data needed for employment tax reporting purposes, and worse, may not be known until after the cutoff for filing returns, resulting in adjustments and amendments.

Section 3-E: Third-party payments

Third-party payments are defined as items of compensation that are made outside of the payroll system and include external sources such as third-party sick pay, qualified and nonqualified retirement contributions and distributions, relocation reimbursements, health plan reimbursements, prizes and awards, etc. (See Table D on page 14 for a sample list of these compensatory items.) Because the information concerning the taxable amounts must be transferred to the employment tax area and posted to the payroll system for wage reporting, there may be delays in finalizing the data needed for employment tax reporting purposes, and worse, the information may not be known until after the cutoff for filing returns, resulting in adjustments and amendments. The latter situation is more likely to arise for employers that outsource the employment tax reporting to a third party because cutoff dates for finalizing wage and tax files may be further ahead of the actual return due dates.

Section 3-F: Adjustments and amendments

Two issues arise in dealing with adjustments to quarterly or annual wage and tax data. The first is identifying whether the adjustment will be reflected on the current period return or whether amendments to previous returns are necessary. The second is correctly identifying those returns affected. This process is most time-consuming when there are variations in tax jurisdiction due dates (e.g., monthly versus quarterly wage reports for Illinois).

The filing of original returns is likely to be given priority over the filing of amendments, creating a delay in reporting the correct wage amount to jurisdictions.

Adjust current return or amend prior return

Assume, for instance, that an adjustment affecting federal income tax withholding is discovered on February 2. This adjustment is required to be reflected on the Form 941 filed by January 31, the state Forms W-2 filed by February 1, and the federal Forms W-2 to be filed on March 31. Consequently, an adjustment is made to the federal Form W-2 file; however, amendments are necessary for the Form 941 and state Forms W-2. In addition, the filing of original returns is likely to be given priority over the filing of amendments, creating a delay in reporting the correct wage amount to jurisdictions.

Correctly identifying returns affected by adjustments or corrections

A correction in wages or taxes can affect all federal and state withholding and employment tax returns. Consequently, for multi-jurisdictional employers, identifying all of the jurisdictions and returns that need to reflect adjustments can be complex and time-consuming, resulting in both delays in filing returns and in reporting the correct wage and tax detail.

Section 4: Impact and limitations of monthly UI wage reporting

Given the current focus on more rapid access to current wage data, there is the possibility that the recent Illinois legislation requiring monthly UI wage reporting may be viewed as favorable precedent by federal, state and local lawmakers. Consequently, the impact of UI monthly reporting needs to be considered not only for Illinois stakeholders, but all stakeholders nationwide. For the purposes of this report, stakeholders for wage reporting includes:

- ▶ Employers liable for tax and reporting (including schools, municipalities and other government entities)
- ▶ Agents responsible for reporting
- ▶ Public entities responsible for implementation, enforcement and administration of reporting
- ▶ Public entities relying on the data processed by these systems
- ▶ Individuals who are the subject of the wage report

The existing framework of quarterly and annual wage reporting has been in place for almost 75 years. Hence, significant adjustments to this system would not be prudent without carefully weighing the overall effort and expense against the benefit likely to be gained.

Section 4-A: The anticipated employer effort and cost in filing monthly wage reports

According to the 1997 study sponsored by the DOL, “only 59% of employers can report wages earlier than the last day of the month following the close of the quarter and only 45% can report by the 15th of the month.” (*Impact of the Alternative Base Period on Employers, Vol. III, Planmatics, Inc.*) This study is consistent with state UI wage reporting history. Massachusetts is the only state that has enacted legislation requiring employers to file quarterly UI returns by the 15th of the month. Within a short time the law was repealed because most employers could not meet the deadline. In 2010, South Carolina also considered a UI filing deadline of the 15th of the month; however, because of unfavorable commentary the state has not pursued the mandate.

As of the date of this study, only Michigan and New Jersey impose a quarterly UI return filing due date that is sooner than the last day of the month. Michigan’s filing due date is the earliest – the 25th of the month.

Estimated increase in employer processing time

States have been reluctant to accelerate the filing due date for UI wage reporting because of the time it takes employers to accurately compile data. The 1997 data obtained by the DOL showed that most employers required two to three weeks to accumulate and format wage reports for filing purposes. If anything, the time involved in compiling and filing these reports has increased since 1997, for the reasons articulated in this report. This is not to say that it takes an employer a full 15 to 25 days to prepare the report. However, it takes this long to obtain the data due to the need to secure third-party data, determine the value of noncash fringe benefits, process and review tax setup, and reconcile data.

Under a monthly UI wage reporting scheme, the cycle for obtaining and perfecting this data could take the greater portion of the reporting period. For instance, based on the 1997 data secured by the DOL, 51% of employers would be perpetually in the process of preparing monthly UI reports assuming a 40-hour workweek. (See Figure 3 on page 20.)

The current framework of quarterly and annual wage reporting has been in place for almost 75 years. Hence, significant adjustments should not be made to this framework without carefully weighing the overall effort against the maximum benefit likely to be gained.

Under a monthly UI wage reporting scheme, the process of obtaining and perfecting these data could be almost perpetual for most employers. For instance, based on the 1997 data secured by the DOL, it could be estimated that 51% of employers would in fact be perpetually processing monthly UI reports, assuming a 40-hour workweek.

Section 4: Impact and limitations of monthly UI wage reporting

Figure 3: Estimated days per year to process UI wage reports (monthly vs. quarterly)

| Percentage of employers * | Processing days for wage report | Quarter/annual total days | Monthly/annual total days |
|---------------------------|---------------------------------|---------------------------|---|
| 49% | 15 days | 60 | 180 |
| 51% | 25 days | 100 | 300 (260 hours based on 40-hour workweek) |

*Based on DOL study, *Impact of the Alternative Base Period on Employers*, Vol. III, Planmatics, Inc.

Estimated increase in employer costs

In 2004, the DOL sponsored a survey that included the annual cost incurred by employers in compiling quarterly UI wage reports. While this study does not take the place of a current analysis of employer costs, it provides a starting point for making some projections. As shown in Table G below, and if the UI monthly reporting requirement is expanded to cover all employers, Illinois private-sector businesses alone would incur an additional UI wage reporting expense in excess of \$115 million per year, with 95% of these costs incurred by small companies with 1 to 99 employees. This projection does not take into account the substantial programming costs likely to be required in the start-up year.

Table G: Projected Illinois private-sector industry costs in filing monthly UI wage reports (based on 2004 DOL survey data)

| Size of employer by number of employees | Annual wage reporting cost ¹ | Estimated revised annual cost at 200% increase ² | Increase in cost quarterly to monthly | Number of Illinois private-sector employers with employees ³ | Cost increase to Illinois private-sector employers |
|---|---|---|---------------------------------------|---|--|
| 1 to 19 | \$200 | \$600 | \$400 | 228,023 | \$91,209,200 |
| 20 to 99 | \$272 | \$816 | \$544 | 33,146 | \$18,031,424 |
| 100 to 249 | \$352 | \$1,056 | \$704 | 5,431 | \$3,823,424 |
| 250+ | \$480 | \$1,440 | \$960 | 2,096 | \$2,012,160 |
| Total | | | | 268,696 | \$115,076,208 |

¹ Source: DOL, *Employer Costs for Additional Unemployment Insurance Wage Report Elements*, October 2004, page 44.

² The increase from 4 wage reports to 12 yields a 200% annual filing increase.

³ Illinois Department of Employment Security, *Census of Employment and Wages*, 2011 first quarter.

While it may be possible for employers to meet the demands of a monthly reporting frequency, it requires a deeper analysis of cost versus benefit to conclude that this level of effort by businesses and state workforce agencies is practical. Part of a cost-benefit analysis should take into account the limitations of using UI wage for general use in income and employment verification, as discussed in Section 4-B.

Section 4-B: Limitations in using UI wage reports for wage and employment verification

The incentive in accelerating the frequency of UI wage reports is the perceived value they hold for public entities seeking to verify income. Consequently, vital to a cost-benefit analysis is consideration of the limitations in using UI wage reports for purposes other than UI program administration.

Speed of access

Changing the UI reporting frequency from quarterly to monthly will not necessarily substantially increase the speed at which public agencies will have access to current wage information. Assuming that monthly wage reports are due toward the end of the month following the month that wage payments are made, there are eight months in the year where there is either no change in lag or a gain of only one month from quarterly reports. (See Table H below.)

Even under a monthly UI wage reporting system, it could take up to two months before current wage information is available for income verification purposes. For instance, the wage information for an employee hired on April 1 would not be available until the end of May.

It bears asking what percentage of reduction in fraudulent benefits is likely to be achieved when, even under a monthly reporting frequency, there could be a significant lag in obtaining access to current wage information.

Table H: Lag between monthly pay data and UI wage report – monthly vs. quarterly filing

| Monthly period | Quarterly filing deadline | Monthly filing deadline | Month time gain |
|----------------|---------------------------|-------------------------|-----------------|
| January | April | February 28 | 2 |
| February | April | March 31 | 1 |
| March | April | April 30 | 0 |
| April | July | May 30 | 2 |
| May | July | June 30 | 1 |
| June | July | July 31 | 0 |
| July | October | August 31 | 2 |
| August | October | September 30 | 1 |
| September | October | October 31 | 0 |
| October | January | November 30 | 2 |
| November | January | December 31 | 1 |
| December | January | January | 0 |

Section 4: Impact and limitations of monthly UI wage reporting

Paper filing reduces benefit of monthly UI reporting

There would be little benefit in allowing for the paper filing of monthly UI reports because of the length of time it would take for state workforce agencies to migrate paper into a usable electronic format. This is likely the reason that the Illinois law taking effect in 2013 limits the monthly wage reporting requirement to employers required to file electronic UI returns (those with 250 or more employees). Currently, only seven states mandate electronic filing of UI wage reports by all employers. The remainder continue to allow paper filing by small businesses. (See Table F on page 16.)

Unless states are willing and able to mandate electronic UI reporting for all employers, a large percentage of the workforce will not be included in the monthly UI wage reports. Consequently, an important consideration is the limited usefulness of a database that provides data for only a portion of the workforce.

Not actionable absent independent employer verification

The merit of monthly UI wage reports is particularly questionable when considering the lack of new or useful information they provide for income verification purposes. The states already have access to quarterly UI wage information for covered workers. They also have access to new hire information within days of the date of hire and, under Illinois law, will have additional data concerning the projected earnings of new hires. The combination of these two reporting systems has historically met the need for wage and employment data, but it is understood that the data fall short of being actionable for benefit eligibility purposes absent independent employer verification of wages due to the following factors:

- ▶ UI wage definitions do not match the wage definitions of Medicaid and other welfare programs.
- ▶ Some noncash fringes are reported in periods other than when they were earned (e.g., personal use of company automobile).
- ▶ Some earnings are, by their nature, variable (e.g., tips, bonuses, commissions, stock).

A monthly wage reporting system increases the frequency of the data flow for a subset of the workforce but does little to address the underlying factors that give rise to the need for independent employer verification.

Section 5: Policy considerations and alternatives

There is no question that numerous public agencies need current and timely access to employment and wage information. UI wage reports, whether filed monthly or quarterly, are not promptly available for income verification purposes (there could continue to be up to a two-month lag). Further, because the wages reported conform to UI requirements, they will not always be actionable for other benefit programs. For these reasons, it is important to review current policy and potential alternatives to reaching those policy goals.

Section 5-A: Policy considerations

Clarify underlying policy goals to develop effective reporting solutions

For Medicaid eligibility purposes, it seems likely that it is more important to capture and evaluate significant changes in *employment status* rather than collect UI wage reports more frequently. The states already have access to quarterly wage information for the population of workers covered for UI purposes. Earnings usually don't fluctuate dramatically within a quarter unless there are corresponding changes in employment status, and such status events are contained in the NDNH. Whether the states have exhausted the full potential of these existing wage and employment information systems merits further investigation.

Whether the data provided on UI wage reports is congruent with Illinois Medicaid eligibility rules is another significant concern that needs to be explored. For instance, would an agency actually shift claimants on and off Medicaid coverage from month to month based on variations in monthly wages? If so, to what extent might Medicaid enrollees, public policy advocates and others challenge this policy? Perceived income fluctuations within a quarter could result from employers uploading certain compensatory items as a lump sum. For instance, the IRS allows that personal use of automobiles and certain other noncash fringe benefits be reported at any frequency the employer chooses so long as they are included in the annual wages for the tax year.

If it is the intent of a Medicaid agency to identify individuals with income increases from month to month and then to disqualify them from coverage, the existing UI wage report is inadequate for this purpose. Rather, employers would need to allocate reportable earnings equally to each month, or they would need to report estimated future values of unpredictable compensation, such as tips, commissions, bonuses and stock options, so that non-recurring payments do not routinely cause eligible individuals to be removed from coverage. All of these requirements, if imposed, would create a significant discrepancy between wages reported for UI purposes and wages reported for other tax administration purposes (e.g., Forms W-2).

Conduct study to determine if existing systems adequately meet program eligibility requirements

Given the sizable effort required of employers and state workforce agencies if required to produce monthly UI reports, studies should be conducted to ascertain the percentage of the UI wage report information that historically has been relied on by public agencies for income verification purposes. Such study would be beneficial in ascertaining if the existing systems of quarterly wage reporting, new hire reporting and ad hoc employer income verification are already adequate for Medicaid program administration purposes.

Expand use of DOL's SIDES and eSIDES for ad hoc verification of income

In lieu of monthly UI wage reports, authorized public agencies could be given access to SIDES for electronic verification of wage and employment data. For more information concerning SIDES, see page 6.



Section 5: Policy considerations and alternatives

Section 5-B: Alternatives to monthly UI wage reporting

Table I: Alternatives in using employer wage reports for income verification purposes *

| Challenge or limitation | Policy consideration |
|---|---|
| Perform electronic ad hoc wage and employment verification using existing SIDES | In lieu of monthly UI wage reports, authorized public agencies could be given access to SIDES for making wage information inquiries. Employers would respond electronically through SIDES. |
| Maximize use of existing employer reporting systems | Determine if quarterly wage reports, the National Directory of New Hires and independent employer verification don't already provide a complete and comprehensive view of the current workforce. |
| Keep monthly wage reports separate from the UI and income tax reporting systems | If it is decided to continue to require monthly UI reports, they should not be considered as taking the place of the quarterly UI wage report, and therefore should not be matched against the quarterly UI wage report, Form 940 or any other tax return. This will eliminate employer reconciliation, reduce employer processing time and help ensure that the integrity of current employment and withholding returns are not compromised in the effort of providing wage reports more frequently. |
| Simplify UI wage reporting | States that have not already done so should consider adopting the National Association of State Workforce Agencies' uniform reporting standard to simplify the reporting process for multi-state employers. |

Appendix A: Employment and withholding tax returns by due date*

| State | Form W-2 – employee copy | Form W-2 – state copy | Form W-2 – state copy extended due date electronic filers | Fourth-quarter SUI/SIT return | Form 940 | Form 941 |
|----------------|--------------------------|-----------------------|---|-------------------------------|----------|----------|
| Federal | 31-Jan | 28-Feb | 31-Mar | | 31-Jan | 31-Jan |
| Alabama | 31-Jan | 28-Feb | | 31-Jan | | |
| Alaska | | | | 31-Jan | | |
| Arizona | 31-Jan | 28-Feb | | 31-Jan | | |
| Arkansas | 31-Jan | 28-Feb | | 31-Jan | | |
| California | 31-Jan | | | 31-Jan | | |
| Colorado | 31-Jan | 28-Feb | 31-Mar | 31-Jan | | |
| Connecticut | 31-Jan | 28-Feb | 31-Mar | 31-Jan | | |
| Delaware | 31-Jan | 28-Feb | 31-Mar | 31-Jan | | |
| DC | 31-Jan | 31-Jan | 28-Feb | 31-Jan | | |
| Florida | | | | 31-Jan | | |
| Georgia | 31-Jan | 28-Feb | | 31-Jan | | |
| Hawaii | 31-Jan | 28-Feb | | 31-Jan | | |
| Idaho | 31-Jan | 28-Feb | | 31-Jan | | |
| Illinois | 31-Jan | 31-Mar | 31-Mar | 31-Jan | | |
| Indiana | 31-Jan | 28-Feb | | 31-Jan | | |
| Iowa | 31-Jan | | | 31-Jan | | |
| Kansas | 31-Jan | 28-Feb | | 31-Jan | | |
| Kentucky | 31-Jan | 31-Jan | | 31-Jan | | |
| Louisiana | 31-Jan | 28-Feb | | 31-Jan | | |
| Maine | 31-Jan | 28-Feb | 31-Mar | 31-Jan | | |
| Maryland | 31-Jan | 28-Feb | | 31-Jan | | |
| Massachusetts | 31-Jan | 28-Feb | 31-Mar | 31-Jan | | |
| Michigan | 31-Jan | 28-Feb | | 25-Jan | | |
| Minnesota | 31-Jan | 28-Feb | | 31-Jan | | |
| Mississippi | 31-Jan | 31-Jan | 28-Feb | 31-Jan | | |
| Missouri | 31-Jan | 28-Feb | | 31-Jan | | |
| Montana | 31-Jan | 28-Feb | | 31-Jan | | |
| Nebraska | 15-Feb | 1-Feb | | 31-Jan | | |
| Nevada | | | | 31-Jan | | |
| New Hampshire | | | | 31-Jan | | |
| New Jersey | 15-Feb | 28-Feb | | 30-Jan | | |
| New Mexico | 31-Jan | 28-Feb | | 31-Jan | | |
| New York | 15-Feb | | | 31-Jan | | |
| North Carolina | 31-Jan | 28-Feb | 31-Mar | 31-Jan | | |
| North Dakota | 31-Jan | 28-Feb | 31-Mar | 31-Jan | | |
| Ohio | 31-Jan | 28-Feb | | 31-Jan | | |

Appendix A: Employment and withholding tax returns by due date*

| State | Form W-2 – employee copy | Form W-2 – state copy | Form W-2 – state copy extended due date electronic filers | Fourth-quarter SUI/SIT return | Form 940 | Form 941 |
|----------------|--|-----------------------|---|-------------------------------|----------|----------|
| Oklahoma | 31-Jan | | | 31-Jan | | |
| Oregon | 31-Jan | 31-Mar | 31-Mar | 31-Jan | | |
| Pennsylvania | 31-Jan | 31-Jan | | 31-Jan | | |
| Rhode Island | 31-Jan | 28-Feb | | 31-Jan | | |
| South Carolina | 31-Jan | 28-Feb | | 31-Jan | | |
| South Dakota | | | | 31-Jan | | |
| Tennessee | | | | 31-Jan | | |
| Texas | | | | 31-Jan | | |
| Utah | 31-Jan | 28-Feb | 31-Mar | 31-Jan | | |
| Vermont | 31-Jan | 28-Feb | | 31-Jan | | |
| Virginia | 31-Jan | 28-Feb | | 31-Jan | | |
| Washington | | | | 31-Jan | | |
| West Virginia | 15-Feb | 28-Feb | | 31-Jan | | |
| Wisconsin | 31-Jan | 31-Jan | | 31-Jan | | |
| Wyoming | | | | 31-Jan | | |
| Totals | 43 | 39 | 12 | 51 | 1 | 1 |
| | No state income tax | | | | | |
| | Filing of Forms W-2 with state not required | | | | | |
| | Due date is extended to February 29 in a leap year | | | | | |

*Based on Ernst & Young LLP survey of December 2011.

Appendix B: Sample SUI wage definition variations*

| State | Exclude certain severance payments | Include Sec. 125 pretax | Include employer 401(k) | Exclude employee 401(k) pretax | Authority |
|---------------|------------------------------------|-------------------------|-------------------------|--------------------------------|---|
| Alabama | ✓ | ✓ | | | Alabama Employer Handbook, p. 22 |
| Alaska | ✓ | ✓ | | ✓ | Alaska UI Tax Handbook, p. 13-14 and 19-20 |
| Arkansas | | | ✓ | | Arkansas UI Handbook for Arkansas Employers, p. 7 |
| California | ✓ | | | | California Employer's Guide (DE-44), p. 18, 26-35 |
| Colorado | | ✓ | | | Colorado UI Handbook for Employers, p. 7-8 |
| Connecticut | | ✓ | | | Connecticut: An Employer's Guide to UI, p. 11 |
| Delaware | | ✓ | | | Delaware UI Handbook for Employers, p. 15 |
| Illinois | | | ✓ | | Illinois UI Law Handbook, p. G-12-G-13 |
| Iowa | | ✓ | | | Iowa UI Handbook for Employers, p. 36 |
| Kansas | | | | | Kansas UI Employer Handbook, p. 7-8 |
| Kentucky | ✓ | | | | Kentucky UI Employer Guide, p. 15-16 |
| Massachusetts | | ✓ | ✓ | | Massachusetts Guide to Covered Wages (Fact Sheet P-1614) |
| Michigan | ✓ | ✓ | | | Michigan Employer Guide to Wage Reporting, p.22 |
| Minnesota | | ✓ | | | Minnesota UI Employer Handbook, p. 6-8 |
| Mississippi | | | | | Mississippi SUI FAQs (website) |
| Missouri | | | | | Types of Payments (website) |
| Montana | | ✓ | | | Montana UI Employer Handbook, p. 4-8 |
| Nevada | | ✓ | | | Nevada Employer Handbook, p. 13-16 |
| New Hampshire | | ✓ | | | New Hampshire SUI FAQs (website) |
| New Jersey | | ✓ | | | New Jersey Employer Handbook, p. 19-20 |
| New York | ✓ | ✓ | | | New York NYS-50, p. 12-13 |
| North Dakota | | ✓ | | | North Dakota Employer Handbook, p. 10-11, 14 |
| Oklahoma | ✓ | | | | Oklahoma Employer's Guide to UI, p. 12-13 |
| Rhode Island | | | | ✓ | Rhode Island Employer Handbook, p. 6 |
| South Dakota | ✓ | | | | South Dakota UI Handbook for Employers, p. 7-8 |
| Tennessee | | ✓ | | | Tennessee Handbook for Employers, p. 25-26 |
| Vermont | | ✓ | | | Vermont Employer Informational Manual , p. 9-10; Cafeteria and 401(k) FAQ (website) |
| Virginia | | | | | Virginia Wage definition FAQ (website) |
| Washington | | ✓ | | | Washington UI Tax Information, p. 4 |
| West Virginia | ✓ | ✓ | | | West Virginia Handbook for Employers, p. 11-12 |
| Wyoming | ✓ | | | | Wyoming Cafeteria plan FAQ (website); Severance pay FAQ (website) |
| 51 | 10 | 19 | 3 | 2 | |

*Based on Ernst & Young LLP survey of July 15, 2011.

Ernst & Young LLP was engaged by the National Payroll Consortium, Inc. to conduct an independent, objective and factual analysis of the challenges raised in changing the frequency of UI wage reports from quarterly to monthly. This report expresses no position on any legislative or regulatory activity of the National Payroll Consortium, Inc.

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