State Calculation of Taxable Wages and Tax Due

Study and Recommendations for State Workforce Agencies

UI Wage and Tax Reporting Work Group

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State Calculation of Taxable Wages and Tax Due

I. Executive Summary

All states administer unemployment insurance (UI) benefit programs that are funded by an employer tax. The tax is calculated as a percentage of wages paid to each employee annually, up to a taxable wage limit. The taxable wage limit varies by state, from $7,000 to over $30,000 annually. Each employer files reports on a quarterly basis detailing wages paid to each covered worker, as well as the total wages, total taxable wages and tax due for the employer.

A simple example appears below. In this example, an employer has one employee to report to a state that has a taxable wage limit of $7,000. The employer would calculate taxable wages for the four quarters this year as follows:

Employer ACME Corp.	**EIN: 99-9999**			
	Wages Paid	**Wages Paid**	**Wages Paid**	**Wages Paid**
Name/SSN	**Quarter 1**	**Quarter 2**	**Quarter 3**	**Quarter 4**
John Smith/***-**-9999	$4,000	$12,000	$12,500	$13,000
Taxable wages	$4,000	$ 3,000	$ 0	$ 0
Tax due (5%)	$ 200	$ 150	$ 0	$ 0

Historically, employers have been responsible for performing this calculation and reporting the results and tax due. However, with improvements in technology, State Workforce Agencies (SWAs) are able to perform this calculation for employers, and most web-based systems now include this feature. Employers using such systems need only to update the state website with wages paid to each worker, and the SWA calculates taxable wages and tax due by summing wages paid to each worker (by Social Security Number) throughout the year. Calculation of taxable wages by the state is an improvement and benefit for many small employers, some of whom overpaid UI taxes in the past because they didn't understand the annual taxable wage limitation.

However, there can be discrepancies between an employer's calculation and the respective state's calculation, especially for larger employers with locations in more than one state. For example, almost all states permit employers to take credit for wages paid in other states in the same calendar year. In the example above, if ACME Corp (a multi-state employer) transferred John Smith to his current work state in March, and in January and February ACME had paid Mr. Smith wages of $8,000 in another state, ACME could apply the $8,000 previously paid in the other state to the current state's taxable wage calculation. Thus, no tax would be due for the first or second quarter in the current state. But the current state generally does not know about the wages previously paid in the other state, so the state's and employer's calculation of taxable wages would differ under these circumstances. This multi-state wage issue has induced some states to begin requiring employers to report the wages paid in other states on quarterly wage reports. However, no standard approach exists as yet, and most payroll software does not support such reporting.

Other reasons that may result in differences between the employer and state calculations of taxable wages include: Unprocessed amended wage reports; unprocessed mergers, successions and partial successions; and missing or changed social security numbers. This report studies the sources of discrepancies and makes recommendations for state policymakers and wage reporting system developers.

II. Study Group to Focus on Fixed Format File Upload/Transmission Systems

A joint public-private sector group[1] was established to study state calculation of taxable wages and tax due based on wages reported, and to develop non-binding recommendations on how UI wage reporting systems could be designed that would enable states to perform this calculation with minimal discrepancies.

Most states already have substantial experience with employer filing websites designed for smaller, single-state employers. These systems are very flexible and are designed to interact directly with employers, who enter employee names, SSNs and wages to file the return. Any calculation problems must typically be resolved before the state system accepts the return. These systems are very helpful and appropriate for the intended audience.

However, taxable wage calculations for wage file uploads pose entirely different issues and complications. File upload systems require employers and their software and/or service providers to format large electronic files for submission that cannot be easily revised. Data elements and formats, edit criteria and filing protocols often vary from state to state. Program features and format changes take substantial time for both the states and the private sector to accommodate. It is important for optimal acceptance and participation by employers who rely on software and/or service providers to comply with wage reporting requirements that formats be relatively consistent and changes be kept to a minimum.

There is more than one way to design systems to perform the taxable wage calculation and address out of state (OOS) wages. It was thought that states and other stakeholders would benefit from an assessment of the alternative system designs, since state UI programming resources are already strained. No one wants a system that has to be reworked, or an e-file system that will create new workload.

III. Study Goals and Criteria

The task group set a goal of documenting key alternatives with their associated costs and benefits, and to provide an objective assessment of the OOS wages issue and other considerations..

For the purposes of the study we assumed that a state calculates taxable wages for employers; however, this should not be viewed as a recommendation. The benefits for doing so will be discussed below, as well as the associated costs involved. Each state determines whether and to what degree to calculate taxable wages for employers. Assuming a state wishes to perform this calculation, we determined that alternatives should be gauged against the following criteria:

- The system should calculate the appropriate amount of tax.
- The solution should effectively prevent or minimize discrepancies.
- The solution should minimize burden, costs and workload, including programming and transition costs, and ongoing staff workload.

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[1] The group was comprised of representatives from eight state workforce agencies, the U.S. Department of Labor, NASWA, five large payroll service providers and others. See the Appendix for participants.

  - Employer burden/costs and other factors such as ease of use and customer service experience should be given some weight in the consideration.
  - Although employer service and software providers are not direct stakeholders in the system as employers are, consideration should be given to the effect of the various options on this community. For example, if the solution is overly complex, service and software providers who primarily serve single-state employers may not adopt the changes.

- Opinions varied on whether the system should produce verifiable results. Some states participating in the work group thought it critical that any employer claims of credit for OOS wages should be verifiable (e.g., by checking with the other state in question). Others thought that an affirmative employer override, check-box entry or statement from the employer would be sufficient, along with the normal field audit policy of checking taxable wage calculations during an audit of the employer.

IV. Cost-Benefit Synopsis

Many SWA UI wage and tax systems do not reconcile wage reports to employer taxable wage totals. However, several states have implemented new systems that do perform this reconciliation. States that have opted to calculate or verify employer calculations of taxable wage totals for employers have done so in anticipation of certain benefits, and with the understanding that certain new costs would be incurred.

The benefits were generally in the nature of strengthening UI Integrity:

- Some employer errors or intentional understatements would be prevented
- Generally, tax systems should calculate and/or verify tax due to the extent possible
- Improve automation/reduce discrepancies
- Possibly reduce the workload for the UI Audit function

States expected additional costs and workload, such as:

- Electronic filing system error conditions and handling, if employer wage and tax reports are not accepted with discrepancies; or,
- Post-filing correspondence to determine the reason for discrepancies.
- Reprogramming systems to receive and process new data such as prior taxable wages paid in other states

Opinions varied as to whether, especially in the context of file upload systems, it was cost-beneficial to require/force employer taxable totals to reconcile to wage reports. Some states thought that it would make sense to treat discrepancies as a “warning,” in terms of severity, as opposed to rejecting the employer’s report. The severity assigned to discrepancies may change the cost-benefit for states.

A key question is: What percentage of discrepancies will be caused by valid reasons, such as wages paid in other states or amended returns in process, versus employer error or even fraud? In other words, how often will the error detection be valid? The group did not have sufficient data on this question. The group reviewed a handful of known sources of discrepancies to

estimate the volume of discrepancies that a state might experience, and the impact to SWA workload. Those sources are described in separate sections that follow, and include:

I. Wages paid in other states
II. Missing Social Security Numbers (SSNs)
III. Changes to SSNs
IV. Amended wage reports
V. Successorships

I. Wages Paid in Other States

As explained above, every state (except Minnesota) permits employers to take credit for wages previously paid in other states, when calculating UI taxable wages and tax due. One critical question asked by state UI wage reporting systems designers:

"How often do employers take credit for prior wages paid in other states?"

The answer may drive a fundamental systems design decision, which is whether to accommodate OOS wage reporting in core wage reporting systems, or to create alternative or exception solutions.

I. Statistics

The U.S. Census Bureau found that 586,000 of the 144 million employed population changed states (.4%) in 2007-2008.

- How many were corporate transfers? (Permanent job relocations to another state while continuing to work for the same employer)
  - One National Payroll Reporting Consortium (NPRC) member analyzed a northeastern state with 180,000 employers and reported similar results: 1 in 200 workers had prior out-of-state wages as of September 30, 2008.
  - To be conservative, our functional estimate for the purposes of this study was between 300,000 – 400,000 workers annually (.2% to .3% of the U.S. work force).
  - This estimate may vary significantly from region to region.

Relatively Few Employers are Affected, but They Tend to be Large

This issue does not affect single-state employers. Multi-state businesses make up 1% to 2% of employers, but the largest 1% of businesses employs over half of the private sector workforce. While States must recognize the needs of larger employers, States also need to balance the needs of smaller and medium sized businesses as they are more apt to not have the software or capabilities to report this kind of wage and employment data. Interested states should forecast their expected incidence to decide whether to modify core systems or create an exception process.

II. Alternatives: What are the Possible Approaches?

We determined that the alternatives for addressing OOS Wages can be categorized as follows:

1. Modify employer tax summary reports
   - Lump sum for all employees
   - Check-box if wages were paid in other states
   - Identify other states in which OOS wages were paid
2. Modify employee detailed wage report
   - Lump sum for each applicable employee

    - Wages paid in all other states for this employee
    - Report wages paid by state(s) for each employee
    - Identify other applicable states (SWA would look up OOS wages)
3. Solutions not involving modifications to reports
    - Resolve discrepancies after the fact
    - Exception request process
    - Accept the employer's calculation

III. What Have States Done To Date?

The group discussed how a number of states have addressed OOS Wages, and made preliminary assessments as to pros and cons.

a. Minnesota: Unique state law that resolves discrepancies after the fact

Minnesota was the first state to calculate taxable wages for employers using reported employee wages. Their unique state law doesn't allow credit for wages paid in other states, yet one service provider reported recent discrepancy volume of more than 2% of employers. (The agency issues a notice and assessment if the employer's taxable wage calculation is less than the state's.) Possible causes may include employers taking credit inappropriately, wage records with missing Social Security Numbers, and timing issues (yet to be discussed).

b. Florida: Possible reporting of wages paid by state(s) for each employee

Florida proposed new wage record elements to accommodate OOS wages; namely wages paid in other states (separate amounts by state). This was thought to be the most detailed alternative, with the most burden, complexity & difficulty. For example, although it may be rare, some workers may be transferred to different states more than once within a year, so multiple records per worker are possible. Florida requested space in the "FSET" XML reporting format, and is planning to implement the requirement for 2010.

c: Arkansas: Modified employer tax report – Aggregate OOS wages for all employees

Arkansas began calculating taxable wages for employers in 1Q2009. They added a new item to the employer tax report for aggregate wages paid this year in other states. The group noted that this would be a relatively easy change to make, but it would not be verifiable. An equivalent approach would be to permit employers to override state calculations, noting that they had done so intentionally. (This may be a valid approach, especially for states in which a small volume of OOS wages is expected.)

d. Massachusetts: Resolve discrepancies after the fact; Exception request process

Massachusetts will calculate taxable wages for employers beginning 2010. Although they will accept a return if the employer's calculation is different, they will issue a notice and assessment for the difference after the fact. If an employer paid OOS wages, they will need to separately claim the credit.

e. Washington: Identify other applicable states (look up OOS wages)

Washington ESD asks employers to identify other state(s) in which wages were previously paid, for the applicable employee(s). The agency will then confirm that wages have been reported to the other state(s) identified. ESD representatives said that the agency would not permit credit if the OOS wages were not verified. This is a very interesting concept which sparked many questions; e.g., (1) Is verification achieved through ICON or the New Hire Directory? (2) Is it easy and inexpensive for states to check these databases to verify OOS wages? (3) What if the OOS wages were paid earlier in the same quarter? OOS wages would probably not be available when the ESD is processing their report. (4) How would an employer report more than one state per employee?

f. Iowa: Reporting of wages paid by state(s) for each employee

Iowa will be following a format similar to Florida. Iowa is proposing new wage record elements to accommodate OOS wages; namely wages paid in other states (separate amounts by state). Iowa is utilizing the "FSET" XML reporting format for secure file transfer, and will be implementing the requirement starting with first quarter filing in 2010. This corresponds with the launch of Iowa's new tax system, "My Iowa UI."

Also see the appendix for SWA questions and answers on OOS wages.

IV. Discussion

One state that considered adding "out of state wages" to quarterly wage reports envisioned that employers would identify the related amounts to be reported separately, by state (example A below). Clearly, the vast majority of instances would represent workers who permanently moved to work in another state one time within a year, while working for the same employer. However, a small percentage[2] would involve two, three or even more states. One critical question is, *should SWAs require detailed reporting of wages paid by state, or a single amount representing wages paid in all other states (Example B below)?*

Example A - Reporting *by State*:

			Gross Wages	Taxable Wages
4Q2009 FL Wage Report:				
999-99-9999	Joe Smith	4Q2009 FL Wages	$7,000	$0
Possible new wage report		YTD GA wages*	$8,000	$1,500
element: Prior taxable wages		YTD SC wages	$8,000	$7,000

* In this example, the individual worked first in SC, then GA, then FL. GA has an $8,500 taxable wage limit.

This example assumes that these moves were permanent in nature and not temporary and transitory.

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[2] Census Bureau statistics indicate that .4% of the workforce moves to a different state in any year. The percentage of workers who permanently change states more than once within a year while remaining with the same employer may be very small; e.g., .4% x .4%: In the ballpark of 2,300 workers nationally.

Example B - Reporting an Aggregate Total for Wages Paid in all Other States:

			Gross Wages	Taxable Wages
4Q2009 FL Wage Report:				
	Joe Smith	FL Wages	$7,000	$0
		YTD Other state taxable wages	$16,000	$8,500

Alternative: Identify the other state in which wages were previously paid (Example C below)

At least one state (WA) asks employers to identify any other states in which wages were paid for a particular worker, as shown below.

Example C - Identification of other states in which wages were paid:

		Gross Wages	Taxable Wages
4Q2010 FL Wage Report:			
Joe Smith	FL Wages	$7,000	$0
If prior taxable wages were paid in another state this year, identify state			**SC**

The group discussed whether, if other states were identified in which wages were previously paid, could SWAs *verify* wages paid in the identified states through ICON, or the National New Hire Directory (NDNH)? USDOL determined that states do have access to wage records of other states in the NDNH database. However, the exchange of information is accomplished through weekly file transfers between the state and NDNH. It is not an inquiry system like IBIQ or any state wage record inquiry systems.

States send their inquiries in a fixed-length record file to NDNH. The file contains information that identifies each record and tells NDNH the data the state wants in the return file. See USDOL UIPL 03-07, Change 1, February 27, 2008, for additional information concerning NDNH usages for Benefit Accuracy Measurement (BAM) audits. Although the application is different, the processes are the same, and the UIPL provides file descriptions for both inbound and outbound file structures.

Considerations for each alternative follow.

Reporting by State (example A):

- If separate reporting by state were required (as in example A above), the agency would have to discontinue all fixed format files such as EFW2 or ICESA. Only variable formats such as XML would be able to repeat data fields such as OOS wages within a wage

record. One alternative would be to require identification of one other state, but permit an entry of "MU" for multiple states.

- Some payroll systems and software would not be modified to report multiple states unless customer demand for the product became apparent. Service providers and software developers that cater to small employers may never perceive this as a priority enhancement, which could result in permanent new SWA workload to support exception processing for employers that manually request refunds of overpaid UI taxes.

Reporting a Lump-sum for Wages Paid in all Other States (example B):

- Reporting an aggregate total per employee may not be as easily verifiable or auditable; i.e., a state would not know which other state's wage files to check.
- Employer input to payroll systems in general does not presently identify the *reason* for credit taken, or the state(s) to which wages and UI taxes were previously paid. Without additional data, "prior taxable wages paid" may represent wages paid in other states, or by a related employer in the same state (where permitted), or by a predecessor employer, etc.

Identification of other states in which wages were paid (example C):

- This alternative would appear to require additional manual or programming steps to verify the wages reported in other states.
- It would be less difficult for employers than the other options

Considerations for all alternatives:

- What is the impact to the agency if a state makes the data fields available, but some employers do not report OOS wages when applicable, because their present payroll system does not accommodate such reporting, and/or the expense of purchasing new payroll software or reprogramming their payroll systems?
    - These employers may ask for refunds, possibly requiring a new exception process. Some group members said that employers would have to comply with electronic OOS wage reporting requirements in order to claim the credit for wages paid in other states. Others noted that if state law requires that the employer be given credit for wages paid in other states, it might be difficult to condition the credit on proper reporting.

States will weigh the costs and benefits of reporting wages paid in other states and make a decision appropriate for them. State and private sector systems could be modified to accommodate detailed state-specific reporting, but the complexity and cost would be substantially greater than a relatively standard national approach to accommodate OOS wage reporting. See the Appendix on Out of State Wages for a summary chart of alternatives and their respective pros and cons.

V. Wage Definitions

Definitions and guidance to employers should specify that *prior taxable wages paid this year* must be reported. Otherwise, if wages were previously paid in a state with a lower taxable

wage limit, the current state could process a credit for wages reported upon which no tax was paid.

Example

- Assume a current state taxable wage limit of $8,000.
- Wages were previously paid in a state with a taxable wage base of $7,000.
- If the employer reported *total* subject wages previously paid in the other state (e.g., $10,000), no additional tax would appear to be due.
- If the employer reported *taxable* wages paid in the other state ($7,000), an additional $1,000 would be taxable.

State laws also vary as to their definitions for "employer," "employment" and "wages." Certain types of compensation can be exempt from UI in some states and subject to UI in others; e.g., severance pay, sick pay, meals, cafeteria plans, etc. Certain types of workers (e.g., students, fishermen, corporate officers) are similarly exempt from UI in some states and subject in others.

- E.g., A yacht salesman paid by commission (exempt from UI in MD) transfers to NJ mid-year
    - The NJ branch of the employer should not report OOS wages for that worker, since they paid no UI taxes on the Maryland wages.

Specifications and guidance to employers should be clear on this issue, or employers may report OOS wages regardless of whether such wages were subject to UI reporting and tax in the other state.

One state asks employers who report wages paid in other states whether such wages were paid before, or after, wages were paid in the current state. Specifying that only *prior taxable wages paid in other states this year* can be reported would seem to resolve this.

VI. Taxable or Excess Wages should be Reported

Taxable wage discrepancies and related assessments may generate significant workload for states and employers. In most states[3], employers report total wages paid to each employee, and taxable wages are only reported at the employer tax report level. Thus, if a state's calculation of total taxable wages differs from that of the employer, neither party will know which employee(s) caused the discrepancy. Because taxes are based on the taxable wage calculation, employers are likely to insist on understanding the basis for any additional tax due. This would result in increased customer service demands, as employers call to inquire about the state's calculation.

States that plan to calculate taxable wages for employers should consider requiring reporting of UI taxable wages or excess wages for each worker, in addition to total UI-subject wages, to enable the state to identify the wage records with discrepancies. If employers report UI taxable or excess wages per employee, the SWAs would be able to return a warning message to the employer identifying the employee(s) in question and the taxable amount calculated by the

[3] Thirteen states collect taxable or excess wages for each employee (CT, DC, FL, IA, KS, MT, NM, OH, OK, SD, UT, VA and WY). AZ, IN, ME, TN and WA also receive taxable wages at employee level, but it appears to be optional and/or only applicable if wage reports are filed electronically.

state. Some study group members disagreed with this point, noting that accommodating a separate data element (taxable wages) would be a significant additional data collection burden for the states.

Example – Required Reporting of Taxable Wages per Employee:

1Q2010 Wage Report	Gross Wages	Taxable Wages*
Joe Smith	$10,000	$7,000
Jane Smith	$14,000	$5,000
John Cotter	$11,000	$7,000
Employer-reported totals	$35,000	$19,000
SWA calculation		$21,000

Assumes the state has a $7,000 taxable wage limit

In this example, if the employer was not required to report the taxable wages of each employee, the state would not know which employee had a credit applied for OOS wages. If the state assessed additional tax for the apparent discrepancy, it would not be able to identify the employee. Upon receipt of the assessment, employers may call the SWA to get such details.

Options:

1. Assuming a state has decided to calculate or verify taxable wage totals for employers, the SWA must still assess its own priorities and goals and conduct a cost-benefit analysis to determine how to handle wages paid in other states. The summary options include:

- Modifying employee wage reports (highest cost & complexity but verifiable)
    - Lump sum for taxable wages paid in all other states for each worker
    - Report wages paid by state(s) for each employee
    - Identify other applicable states
- Modifying employer tax reports (moderate cost; not as easily verifiable)
    - Report total OOS wages for all employees
    - A check-box if wages were paid in other states
    - Identification of other states in which wages were paid
- No modifications to reports (Lowest cost & least complex; verifiable by correspondence/audit)
    - Resolve discrepancies after the fact
    - Exception request process
    - Accept the employer's calculation

2. If OOS wages are to be reported, definitions and guidance to employers should specify that *prior taxable wages paid this year* must be reported.

II. Missing Social Security Number (SSNs)

Since taxable wage calculations rely on SSNs, wage records reported without SSNs cause calculation errors. Most employer payroll systems require a valid SSN in order to add a worker to the payroll system. These edits reduce the number of missing SSNs. However, employers often circumvent the system to pay a worker who has not provided an SSN.

There are circumstances in which work-authorized immigrants are not able to obtain an SSN before they begin work. In recent years, SSA has adopted a system for screening and verifying identity and work authorization in cooperation with the Department of Homeland Security, but it may take several weeks to validate such individuals and issue SSNs. In the meantime, work is permitted under an "Applied For" status. For some percentage of these cases, wages are paid and must be reported to the applicable SWA before an SSN is issued. Some missing SSNs are valid; i.e., the employer and employee may have done everything possible to comply, and yet still not have an SSN in time for reporting. Consequently, it may be difficult to adopt a firm policy prohibiting wage records with missing SSNs. On the other hand, the group generally thought that most missing SSNs are not valid, and are more typically caused by employer errors and/or undocumented workers.

Sidebar: Individual Taxpayer Identification Numbers (ITINs)

Individuals with U.S. income tax liability who do not qualify for a SSN obtain ITINs from the IRS. ITINs are not valid for employment purposes. Anyone eligible to be employed in the U.S. should be able to obtain a SSN.

ITINs are formatted the same as SSNs (999-99-9999) but begin with a "9," and the 4th position is either "7" or "8". Some states consider ITINs to be invalid for wage reporting purposes, and treat them as missing. States that are planning taxable wage calculation systems should consider how ITINs (or any other conditions deemed invalid) might affect the system.

The SSA EFW2 and "ICESA" electronic wage reporting specifications provide for reporting of such wages when SSNs are missing -- usually by reporting zeros in the SSN field.

States are faced with difficult choices in addressing this issue, especially considering that some larger employers may have multiple records to report without SSNs.

- Some states assign temporary or internal numbers to wage records reported without SSNs, to enable taxable wage calculations. In subsequent quarters, the employee appears to the state to be newly hired, so the state system does not include prior wages reported for the individual in the taxable wage calculation.
    - In this case, if the employer obtains an SSN from a worker in midyear, the employer must amend the prior wage report to correct the SSN before the subsequent wage report is filed.
- One state rejects the employer's entire wage and tax report if there are any records with missing SSNs, in effect requiring employers to strip off any such records prior to reporting. Importantly, this results in no UI taxes being paid on covered wages that

could not be reported.

- State formatting requirements vary for reporting wage records with missing SSNs. Most states require zeros in the SSN field, but some require 9's, blanks or some other entry.

Recommendations

The group discussed how a number of states have handled missing SSNs[4], and made preliminary assessments as to pros and cons. The states have two alternatives; accept wage records with missing SSNs, or reject them. Most group members suggested accepting them, with employer incentives to correct and prevent missing SSNs.

- Accept the wage record: Missing SSNs are generally assigned a unique number in place of the SSN within the SWA system.
    - Taxable wages are calculated on these records as though they were new employees; i.e., no effort is made to search for a wage record by employee name in prior quarter wage reports.
        - In effect, the employer pays a "penalty" of additional UI taxes, up to the annual wage base limitation *each quarter*.
    - A warning notice is issued to the employer instructing them how to correct the missing SSN.
- Reject the wage record:
    - The SWA will know how many wage records went unreported, and the associated tax may not be paid.
    - The SWA would be able to follow up with the employer to prompt for corrections.
- Reject the employer wage report: (2 states do this as of 2009):
    - Employers may quickly learn to delete any wage records with missing SSNs prior to submission.
    - The SWA will not know how many wage records went unreported, and the associated tax may not be paid. The SWA would not know whether the employer files a supplemental or amended wage and tax report once a missing SSN becomes available.

Policymakers may want to analyze the volume of missing SSNs in the wage reporting system and consider the impact to any taxable wage calculation system.

[4] See the Appendix on State Responses on Missing SSNs Consolidated for detailed SWA commentary on the subject.

III. Social Security Number (SSN) Corrections

As mentioned above, UI taxable wages are calculated based on SSNs, so any *changes* to SSNs applied to an existing worker in mid-year would generate a different taxable wage result. An employer would know that the worker was the same person, and would calculate taxable wages based on total wages paid to the person. However, a worker whose SSN was changed from one quarter to another would appear to the SWA to be a newly hired employee with no prior wages. There is a fairly high volume of SSN corrections applied to payroll systems in mid-year due to employee and/or employer transcription errors.

There are also timing issues with amended wage reports. When an employer recognizes that a wage report should be amended to correct a SSN, the change is immediately effective on the employer's system. But in order to avoid a taxable wage discrepancy, the amended report correcting the SSN would have to be *received and processed* by the state before the SWA processes the subsequent wage report. This may be difficult if the employer learns of the SSN correction from the employee late in a quarter; e.g., on June 28th.

One national payroll service provider analyzed amended wage reports filed affecting calendar year 2007 to change SSNs reported. They found that .5% of employer wage reports had to be amended to correct one or more SSNs. 5.6 percent of those amended wage reports were initiated within six weeks of the subsequent quarter's wage report filing deadline.

If those statistics hold true across the broader employer population, in a state with roughly 180,000 employers, there would be about 3,500 amended wage reports annually just to correct SSNs. Roughly 200 of these would be submitted to the agency for processing within six weeks of the subsequent quarter's filing deadline (i.e., after June 15th for an amendment to a first quarter wage report. The second quarter report is due on July 31st). Depending how automated the state's system might be and how quickly the amendments could be processed, such SSN corrections could cause a discrepancy between the employer's taxable wage totals and the SWA's calculation.

Some state systems were designed to permit employers to amend wage reports electronically, through the state website or otherwise. To the extent that amendments can be received electronically, any communications or processing delays would be in the control of the employer.

IV. Routine Amendments to Wage Reports

Employers apply the effects of routine changes ("amendments") to previously filed wage reports immediately, for the purpose of current-quarter taxable wage calculations, but agency processing of amended reports may be delayed by the normal mailing and SWA document processing time, which can cause discrepancies between the taxable wage amounts calculated by the SWA and the employer.

> For example, an employer may amend a first quarter wage report in June to increase the wages reported for an employee for the first quarter from $6,000 to $8,000. If this amendment is not received and processed by the SWA before the second quarter wage and tax return is processed, the employer's taxable wage total for the second quarter may be $2,000 less than the amount calculated by the SWA.

Statistics: One national payroll service provider analyzed amended wage reports for 2007.

- About four percent of wage reports[5] are subsequently amended.
    - Employers apply the effects of amendments immediately for the purpose of taxable wage calculations, but state processing of amended reports may be delayed.
- Over 20% of these amendments were filed within six weeks of the subsequent quarter's filing deadline (e.g., after June 15th for an amendment to a first quarter wage report.)
    - If the states do not process amended reports before receiving the subsequent wage report, a discrepancy will result.

As an illustrative example, a state with roughly 180,000 employers:

- Would receive about 30,000 amended wage reports annually to correct wage amounts reported (4.2% x 720,000 wage reports).
- Roughly 6,600 would be submitted to the agency within six weeks of the subsequent quarter's filing deadline.
- Depending on when they were submitted and how quickly the amendments could be processed, this issue may cause as many as 6,600 discrepancies between employers' taxable wage calculations and the state's calculations.

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[5] Large employers may have very different characteristics than small employers. Small employers tend to have simple compensation plans that rarely require amendments once filed. Large employers, on the other hand, offer very diverse forms of reportable compensation and benefits, and routinely amend employment tax reports; typically to add additional payments that were made 'offline' by manual checks; to add reportable compensation from outside the stream of normal wage payments (such as stock options, third party sick pay, value of company vehicles or travel, etc.; or to delete paychecks that were generated in error to terminated employees.)

Best practices for minimizing discrepancies and workload

- Delay any notices by a reasonable period to permit amendments in process to resolve discrepancies. (Some disagreed with delaying notices to employers, which is a valid concern to be weighed against potential inquiry volume from employers.)

- Assess whether a received amendment would automatically cause a recalculation of a subsequent quarter tax calculation. If not, a separate claim procedure may be needed.

- Some states allow employers to amend their wage reports electronically, through the state website or otherwise. To the extent that amendments can be received electronically, there should be no delay and no differences created.

  - Large employers are likely to amend wage reports through a payroll service or software (as opposed to updating a state website with changes directly) so that their electronic payroll records remain current. Even if the amended wage reports are output from the service/software provider in electronic format, there may be a minor processing delay in this case.

V. Reporting by Successor Employers

Similar timing problems may occur in predecessor-successor situations, when an employer notice and request for account transfer, or agency processing of an account transfer is pending. In mergers and acquisitions, payroll and employment tax reporting departments are often advised that an acquisition has occurred after the fact. They may be advised to take credit for wages paid by the predecessor organization, in anticipation of approval by the SWA, before the state has even been notified of the transaction.

The employer may be in the process of filing the appropriate applications and notices to the SWA to advise of the transaction and request a transfer of experience. In the meantime, the current UI wage tax reports may be due. The state may not be aware of the pending predecessor-successor application at the time that they calculate the employer's taxable wage totals. In this case, all of the transferring employees will appear to be newly hired, subject to UI taxes from the first dollar reported by the organization.

The annual volume of such transactions is relatively low; however, larger employers are likely to be affected, potentially creating significant discrepancy amounts.

Recommendation for Handling Successors

- Delay any notices by 30 – 45 days to permit applications in process to resolve discrepancies

VI. Summary and Recommendations for Further Study:

In summary, the group agreed that automatically calculating taxable wages benefits employers who interact with the state's electronic filing system directly (i.e., entering wage information via a website, one wage record at a time).

Separate consideration is warranted for wage reporting via file upload systems, since it may be necessary to change legacy computer systems and fixed-file formats (such as ICESA or EFW2), and create new error and warning messages and handling. Some changes may require employers to add new database fields to their payroll and wage reporting systems. SWAs that are considering taxable wage calculation functionality in new electronic filing systems should outline their objectives, and assess the costs and benefits.

Potential benefits include:

- Strengthening UI Integrity:
    - Prevent employer errors or intentional understatements
    - Automate calculations of tax due
    - Accelerate availability and improve accuracy of wage records
    - Improve automation/reduce discrepancies
    - May facilitate employer audit function

Potential costs include:

- One-time conversion costs, such as reprogramming systems to receive and process new data, if applicable
- New and ongoing state workload in the form of:
    - Correspondence and/or customer service staff demands to work with affected employers to resolve routine discrepancies, such as:
        - Wages paid in other states
        - Missing SSNs and changes to SSNs
        - Timing issues with amended wage reports and successorships
    - Electronic filing system error conditions and handling, if employer wage and tax reports are rejected due to discrepancies
    - Possibility of exception/manual processes to accommodate employers whose payroll or wage reporting software does not adopt the changes.
- Burden/costs imposed on employers to accommodate changes.

If applicable, each SWA should consider the pros and cons outlined in the alternatives to address wages paid in other states.

Further Study

A more formal statistical study may be warranted to confirm how often OOS wages occur, and how often more than two states are involved. A useful next step would be to draft possible changes to ICESA and EFW2 fixed format layouts for OOS wages, so that employers do not have to make different changes to wage reporting systems for each state. SWAs should also consider variable XML formats such as FSET.

Wage and Tax Reporting Work Group

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Appendix: Wages Paid in Other States - Q&A Excerpts

How have you addressed OOS wages with your online (Web interface) e-file systems?

- In our current system we do not address Out of State (OOS) wages. This system calculates the taxable wages for each employee based on only [in-state] wages. If the employer has out of state wages, they either need to file a paper report or a wage adjustment (after filing online).

- In developing our future system the taxable wages will be calculated by the system, regardless if the report is filed on paper, secure file transfer (XML based), or online. Employers will be allowed to enter OOS wages for credit against taxable wages.

- On our current online application we provide an entry point for the employer to enter OOS wages per individual on a Year-to-Date basis. These wages are then taken into consideration when the taxable wages are calculated for the quarter.

- Employers are asked if they have OOS wages. If the answer is yes, then they must provide detail by individual so that our system can calculate taxable wages.

- If the employer overrides the calculated excess wage amount, the employer can indicate if the change was due to out of state wages, but does not give any detail.

- When filing the tax report, on the excess wage amount line, there is a drop down box for the amount and state for the out of state wages included in the excess wages.

How have you addressed OOS wages in your file transfer-e-file systems?

- In order to take credit for out of state wages, the file must include each state and taxable wages reported for each state.

- The electronic files submission requires an ICESA format with some slight modifications. This will include a flag on the E record for the employer to indicate they had OOS wages. If that flag is present, [the system] will not calculate the taxable wages, but rather accept the taxable wages as reported on the T record. This process is the same regardless of the media used for the file submission.

- If they upload a file through our [___] system the employer must provide an extra column with the OOS wages detailed by individual. If the employer sends in a tape or CD then they simply indicate if they have multi-state employment via the ICESA format. Taxable wages are not calculated by these e-file systems.

- Our Bulk Filing method does not include any feature to report the out of state wages. Future enhancements will include the ability to accept out of state wage information by employee level detail.

- We allow the credit for out of state wages; however, we must receive the information from the employer to take the credit. Our current system will balance the tax and wage forms and indicate an out of balance. A Tax Specialist must research the account and

make the entries to balance the account. In the redesign of our new Tax System we hope to incorporate the ability to capture the information from the employer so that the system can balance the account.

Pros and cons?

- PRO: System correctly calculates total and taxable wages for employers, accurate wage record file.
- CON – OOS employers misunderstand the information needed and enter OOS quarter wages rather than the YTD wages, causing the calculation of [our state's] taxable wages to be incorrect.
- CON – OOS wage indicator flag forces us to accept the employer calculated taxable wages which may or may not be correct.
- Con – Instate employers with no OOS wages hit the wrong answer and get confused – this is rare but it does happen.
- CON – OOS employers misread the question and answer based on employees that should be reported to another state and not [our state] – again this is rare but it does happen.
- We are still getting total amounts and are not broken down by employee level, so that we still must verify the individual employee wages. If we do not get the information, we do not allow the credit and will bill the employer.

What recommendations would you make to other states?

- Require the actual OOS wages per individual for all electronic filing to always ensure accurate taxable wage calculation.
- Require employers who have OOS wages to file electronically and not by paper.
- Eliminate the contribution (tax) report altogether for paper filing and calculate taxable wages strictly from the wage report.
- Eliminate the OOS wage credit…but we have doubts about whether the political climate would support such an initiative.
- Employers are very reluctant to accept changes to paper forms that require extensive re-programming of their reporting systems. Changes to electronic reporting systems seem to be better tolerated. If you have to change a paper document, make all the changes you need at one time and do not make any more for at least 5 years. Employers get very attached and used to the paper forms and the arrangement of data fields. Even small changes can make a big difference to paper filers.

Appendix: State Responses on Missing SSNs Consolidated

How have you handled wage records without valid SSNs with your online (Web interface) e-file systems?

- The system rejects the whole record (one SSN), but not the whole file, which makes the account short.
- Our new tax system will accept either the social security number or the name. Obviously, the preference would be both pieces of data.
- An employer cannot submit a wage report online if it has a missing SSN field or a number other than nine digits. If the employer does not know the SSN, they either have to submit a paper report, or leave the unknown employee off the online report and amend it at a later date.
- Our online system only accepts valid SSNs. Employers are forced to file using another method,

Other than missing SSNs, does your system consider certain SSN entries to be invalid (e.g., some states accept ITINs and some do not).

- Our online system does not accept invalid SSN including those that start with 8's or 9's.
- Our system doesn't accept ITINs
- Our system will look for incorrectly formatted numbers such as 123-45-6789 or numbers that are repeated (all 4's, 5's etc.)

How have you addressed missing SSNs in your file transfer e-file systems?

- The system rejects the whole record, but not the whole file, which makes the account short.
- Secure File Transfer will look for incorrectly formatted numbers such as 123-45-6789 or numbers that are repeated (all 4's, 5's etc.)
- Employers without valid SSNs must either use QuickFile*, CD or cartridge magnetic media or paper documents to file wage information.
  - * QuickFile is a wage reporting program provided by the agency used by employers, agents and payroll providers representing multiple clients. QuickFile is designed to transfer wage data in the ICESA, MMREF-1, comma-delimited or fixed-length formats. QuickFile analyzes a file created by the user's payroll program. It validates the format, identifies potential problems and allows the user to make corrections before transmission. After the payroll file is validated, the user accesses the Internet and transmits the report to the agency.
- Our new tax system will accept either the social security number or the name. Obviously, the preference would be both pieces of data.
- Once the file is uploaded and sent to the system for wage record processing, any missing SSN will be assigned a unique ID in place of the SSN when the record is posted to the system. This number is internal to the system only and is not viewable on any screens. If the SSN is invalid (validated against pre-defined SSA requirements), the process is the same.
  - The taxable wages are then calculated on these records as though they were new employees for the quarter.

- A letter is generated to the employer informing them of the error and the possibility of taxable wages being incorrect and instructs the employer to go online or submit an amendment form to correct the SSN.
- If these same employees are reported again in subsequent quarters with missing/invalid SSN's, they will be assigned a separate unique ID and again be treated as new or first time employees when calculating taxable wages.

What would you recommend to other states as the best solution?

- Accept all numbers through their online system
- Charge the employer a penalty for invalid SSNs
- Calculate taxes on total wages each quarter for any employee without a valid SSN
- Reject the whole file, until SSN are provided.
- We would accept all numbers through the online system, charge the employer a penalty for invalid SSNs and calculate taxes on total wages each quarter for any employee without a valid SSN. However, in execution it is much trickier. A penalty for an insufficient report is the same for a delinquent report which is $35 or a percentage… based on the days delinquent or insufficient) whichever is greater. The penalty is computed based on total wages in the period for which the report was due.

Is this a significant problem? What is the "normal" volume?

- 1% for I-File and magnetic media (disk and CDs)
- Paper has the highest amount of invalid SSNs (10%)
- Not sure of the volume. I know it is a major problem for us, especially with 3rd party providers. This would also be a major problem when benefit claims are filed.
- Yes, this is a significant problem. Unknown volume

What are the implications for state taxable wage calculation systems?

- Since our state taxable wage is not automatically calculated by the system, there would be no implications.
- Very difficult to calculate and verify taxable wages. Causes errors in contributions collected which could cause the state to have to issue refunds.

Other Perspectives:

- (From a SWA participant) "What an employer doesn't have, they can't give. If an employer does not let a person work until they have completed the I9, then they would not have this problem. Having done the books for a construction company I can say that when you are desperate, you try people out. When they never return after the first day you might not be able to fill in the blanks. "
- No accounting firms in the state have voiced concern over this issue. The concerns all seem to be coming from the large payroll reporting firms.

Appendix: Out-of-State Wages

Alternative: Modify Employee Wage Report to Collect OOS wages

	PROS	**CONS**
General Considerations	Verifiable	Cost: Major change Not all payroll software may accommodate
Aggregate OOS wages (all states) for each applicable employee E.g.: SSN, name, wages, OOS wages	Effective Less costly and complex than detailed reporting Most multi-state workers would only have one other state involved. Auditors would have advanced notice and be prepared to investigate OOS wages	Not verifiable w/o identifying OOS states? No more useful than having the employer designate that there are OOS wage present. State would need to add data elements and storage space to accommodate this data.
OOS Wages paid, by state, for each employee E.g.: SSN, name, wages, OOS state, OOS wages (OOS state 2, OOS-2 wages …)	No burden on SWA to verify OOS wages in identified state(s)? Would rely on the use of the ICON System to verify wages. Unsure of ultimate reliability of ICON.	Complex – multiple records per worker Most costly alternative State would need to add data elements and storage space to accommodate this data. This option would require variable fields instead of fixed fields for the agency. The benefits involved in capturing this data may exceed the costs.
Identify other applicable states for each employee. E.g.: SSN, name, wages, OOS state (OOS state 2…)	Least cost & difficulty	Places some burden on SWA to verify OOS wages in identified state(s)? Without wages, would be difficult to verify. Waste of time and programming effort. System with all wage data that can be searched by SSN would be much better.

Out-of-State Wages

Alternative: Modify Employer Tax Reports

	PROS	CONS
General Considerations	Verifiable Modest change; less cost	Need to change paper and electronic employer contribution returns Not verifiable[7]
Lump sum for all employees	Easy figure for state to retain. Alerts audit staff that OOS wages exist.	Does not tell us much – this is the same as if they just checked the box that wages were paid in other states. Takes more data entry and storage space than a check the box.
Check-box if wages were paid in other states	Easy item for state to retain. Alerts audit and review staff that OOS wages exist.	Staff would still need to investigate problems.
Reason code: identify why state and employer taxable wages may vary	May be more comprehensive: OOS wages is one of several reasons for discrepancies (e.g., successors) Electronically this could provide significant information and audit sources for the state.	There could be a variety of reasons why the numbers are different – would require additional data entry and retention space.
Identify other states in which OOS wages were paid	SWAs can verify OOS wages via interstate wage query if they know the OOS state. Lets the auditor know in advance that multi-state wages are an issue.	A national SSN wages search would be more helpful, but this does not appear to be available.

[7] States could ask employers via after-the fact correspondence to provide details on a sample/audit basis, for some or all employers who have identified that OOS wages (or some other reason) applies.

Out-of-State Wages

Solutions Not Involving Modifications to Reports

	PROS	**CONS**
General Considerations	Least impact/cost to wage reporting systems May be most appropriate for small states with minimal OOS wage activity	May create some ongoing costs to issue inquiries
Ask about discrepancies after the fact	Closest to current systems; minor change Would generate information as to what causes discrepancies, possibly permitting further improvements in the future Could be used as audit candidates	Uses employers time and employer could be charged by accountant for time spent. Additional space and time would be needed to record correct results.
Exception employer credit request process Employers would pay amount due as calculated by the state, and request credits by separately reporting OOS wages via a claim form	Minimizes impact to wage reporting systems Would also help identify problems within an agency's system.	Burdensome for employers Costly for the state. States do not have the personnel to be able to handle such requests. States may be open to criticism due to data entry errors – even a 1% error rate is going to be significant.
Do nothing (Permit employers to calculate taxable wage totals, including any OOS wages)	No change: No programming, reformatting or transition costs, no employer discrepancies to work through, no correspondence or customer service costs.	Not verifiable - employers could miscalculate taxable wages.

Notes: Several states commented that most miscalculations are in the favor of the state; e.g., small employers unfamiliar with the taxable wage limitation pay UI taxes on *all* wages paid. Ultimately, we could spend money to capture and correctly calculate this and potentially reduce revenues.