OLR RESEARCH REPORT

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UNEMPLOYMENT INSURANCE QUESTIONS

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You asked the following questions about unemployment benefit eligibility: (1) how is independent contractor status determined under state and federal labor law, (2) what is the reasoning behind different tests to determine independent contractor status, (3) do other states use the "ABC test" for this purpose, (4) what impacts could abandoning the ABC test have, (5) how are state and federal unemployment taxes determined, (6) under what circumstances can an employee voluntarily quit a job and still collect unemployment benefits, and (7) do benefit eligibility exceptions for voluntary quits vary among states.

SUMMARY

Connecticut unemployment law uses the "ABC test" to determine if a worker is an employee or independent contractor. By using the ABC test, instead of the "common law test," Connecticut's unemployment law makes it easier for workers to be considered employees and thus eligible for unemployment benefits. It also subjects more employers to unemployment taxes. The state's Department of Labor and courts have interpreted the test as a way to broaden the protections against unemployment provided under the law.

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Using only the common law test in unemployment law could make certain workers currently considered employees ineligible for unemployment benefits and make their employers no longer liable for paying their related unemployment taxes. In doing so, it could also increase the unemployment taxes paid by those employers who were not affected by the change.

Unemployment taxes are determined by combining an employer's experience rate (based on an employer's history of layoffs) and the fund balance rate (charged to all employers to maintain the unemployment compensation trust fund's solvency). Currently, unemployment taxes can range from 1.9% to 6.8%. In addition, employers have been paying increased federal unemployment taxes and special assessments to repay the roughly $1 billion that Connecticut borrowed from the federal government when the state's unemployment trust fund became insolvent in 2009.

State law generally does not provide unemployment benefits to employees who voluntarily leave employment. These employees, however, can receive benefits if they leave for good cause related to their employer or nine other non-employer related reasons, such as caring for an ill family member or escaping domestic violence. Most other states allow for the same, or similar, exceptions.

INDEPENDENT CONTRACTORS

In general, state and federal labor laws apply to "employers," and "employees," in an employment relationship. They do not apply to "independent contractors" and those who contract for their services. How these terms are defined can determine a worker's eligibility for the statutory protections and benefits provided to an employee and an employer's obligations to provide benefits (e.g. pay unemployment taxes and maintain workers' compensation insurance).

Most federal and state labor laws rely on the common law definition of an employee and independent contractor, which focuses on an independent contractor's ability to independently control his or her work; workers who do not have such control are considered employees. Connecticut's unemployment compensation law includes the common law definition, but also broadens the definition of an employee by using what is commonly referred to as the "ABC test" to determine if a worker is an independent contractor, and not an employee.

Common Law Test

Under common law rules, an employer-employee relationship exists when the business for which services are performed has the right to direct and control the worker who performs the services. This control includes the means and details by which the final result is achieved. An "employee" is subject to such control. An independent contractor, on the other hand, contracts to do a piece of work according to his or her own methods, and except for the end result, is not subject to the control of the business for which he or she is providing the service.

The common law definition of an employee and independent contractor applies under the state's employment regulation (CGS § 31-12 et seq.), wage (CGS § 31-58 et seq.), and workers' compensation (CGS § 31-275 et seq.) laws, whenever their respective statutes do not provide specific definitions of the terms (see *Keeny v. Old Saybrook*, 237 Conn. 135 (1996) and *Hunte v. Blumenthal*, 238 Conn. 146 (1996) on the application of common law when a statute does not provide specific guidance; regarding workers' compensation, see *Bourgeois v. Cacciapuoti,* 138 Conn. 317 (1951); regarding employment regulation, see *Young v. City of Bridgeport,* 135 Conn. App. 699 (2012)).

Federal tax and labor laws also use the common law definitions for employees and independent contractors, although federal unemployment law allows state unemployment laws to differ if the state's law provides greater benefit eligibility.

The ABC Test

Since 1971, the state's unemployment compensation law (CGS § 31-222 et seq.) has defined "employment" using what is commonly called the "ABC test." Under the law, a worker's service to an employer is considered employment, and subject to the act's requirements, unless:

(A) the person performing the service has been and will be free from any control or direction related to performing the service, both under the contract of hire and in fact;
(B) the service performed is outside the employer's usual course of business or outside the employer's places of business; and
(C) the person performing the service is customarily engaged in an independently established trade, occupation, profession or business of the same nature as the service being performed.

While part A of the test essentially codifies the common law test, parts B and C create additional requirements. An employer must prove all three criteria for a worker to be considered an independent contractor, not an employee. Otherwise, the law considers the worker an employee by default. The employer is not required to pay unemployment taxes for an independent contractor and the independent contractor is not eligible for unemployment benefits.

Interpretation of the ABC test has also been influenced by other statutes and case law. CGS § 31-274(c) requires that the unemployment law's provisions be construed, interpreted, and administered in a way that presumes coverage, eligibility, and nondisqualification in doubtful cases. The courts have also interpreted the unemployment law as "remedial legislation… to be construed liberally as regards beneficiaries to accomplish its purpose… which is to ameliorate the tragic consequences of unemployment" (*Reger v. Administrator*, 132 Conn 647, at 650 (1947)).

Part C's requirement that an independent contractor be customarily engaged in an independently established trade, occupation, profession, or business has come to be seen as a particularly important element of the unemployment law's purpose, which the state Supreme Court has determined "is to protect those who are at risk of unemployment if their relationship with a particular employer is terminated" (*JSF Promotions, Inc. v. Administrator, Unemployment Compensation Act*, 265 Conn. 413 (2003)).

This emphasis on protecting individuals against the hardships of being unemployed continues to be upheld by the state Department of Labor (DOL) and the courts. Relying on the Supreme Court's reasoning in the *JSF* case, a recent Superior Court ruling found that part C requires workers "to be actively supplying the same kind of services to third persons [other than the employer] in order to be considered independent contractors. Such service to third persons ensures protection from unemployment" (*Labor & Logistics Management v. Administrator, Unemployment Compensation Act,* Superior Court, Judicial District of Hartford, No. HHDCV094042142, October 3, 2012, 2012 WL 5205557 (Conn. Super.)).

ABC Test in Other States

In addition to Connecticut, 23 other states use the ABC test to determine a worker's status as an independent contractor. The other states are: Alaska, Arkansas, California, Delaware, Florida, Hawaii,

Illinois, Indiana, Louisiana, Massachusetts, Maryland, Nebraska, New Hampshire, New Jersey, New Mexico, Nevada, Oklahoma, Rhode Island, Tennessee, Virginia, Vermont, Washington, and West Virginia.

Another eight states use a test that includes part "C" in combination with other factors (Colorado, Georgia, Idaho, Minnesota, Oregon, Pennsylvania, South Dakota, and Utah).

Potential Effects of Using Only the Common Law Test for Unemployment

Because the ABC test broadens the number of workers potentially eligible for unemployment benefits, using only the common law test would leave workers who were newly defined as independent contractors without access to unemployment benefits.

Such a change could also decrease the number of employers subject to unemployment taxes and the amount of those taxes employers subject to the law have to pay. For some employers, this could mean reduced taxes and operating expenses, potentially leading to further economic development and increased hiring. Because all employers subject to unemployment taxes pay into a collective unemployment trust fund that supports the payment of benefits, reducing the number of contributors and amounts contributed could also potentially increase the unemployment taxes for other employers who do not necessarily benefit from the change. This effect could be negated by the simultaneous decrease in number of employees eligible for benefits.

Reducing the number of taxable employers and amounts contributed, would also similarly redistribute the additional unemployment taxes levied by the federal government in order to repay loans from the federal government (see below for a further explanation of the loan repayment). In effect, a decrease in the employers repaying the federal loan could require the remaining employers to pay more in order to repay the debt.

We have asked DOL for estimates on the numbers of employees and employers who could be affected and will provide them upon receipt.

UNEMPLOYMENT TAXES

An employer's unemployment tax liability typically depends on three factors: (1) the amount of wages it paid that are included in its taxable wage base, (2) the amount of unemployment benefits paid to the employer's workers (the experience rate), and (3) the solvency of the

unemployment trust fund (the fund balance rate). Since 2011, the state's employers must also repay the principal and interest on loans from the federal government.

The Taxable Wage Base

Both federal and state unemployment laws establish a level of wages subject to taxation. The Federal Unemployment Tax Act (FUTA) taxable wage base is $7,000 (i.e., the first $7,000 paid to each employee of each year) (26 U.S.C. § 3306(b)(1)). A state's taxable wage base must be at least this high. Connecticut's taxable wage base is currently $15,000. An employer's experience rate and fund balance tax rate are both calculated as percentages of the employer's taxable wage base.

The Experience Rate

FUTA requires states to use an experience rating system to assess employers for unemployment taxes and requires that the experience period be at least three years (26 U.S.C. § 3303(a)). Within these constraints, states may structure their own tax systems. Connecticut uses a benefit ratio system, under which tax rates are based on a three year ratio of an employer's benefit charges to its payroll. Under state law, an employer's experience rate cannot be lower than .5% or higher than 5.4%. Federal law prohibits a state from setting the maximum experience rate lower than 5.4%.

The Fund Balance Rate

In addition to the experience rate, each employer is charged the same flat tax rate known as the fund balance rate. This rate is based on the state's unemployment trust fund's solvency and is set each year by the labor commissioner. When the amount in the fund is at its statutorily determined goal or above, the rate can be reduced. When the fund is significantly below its goal, the rate can reach a maximum of 1.4%, which is the current fund balance rate.

An employer's total contribution rate is the sum of the experience rate and fund balance tax rate. Under current requirements, an employer's total contribution rate can be between 1.9% and 6.8%.

FUTA Taxes and Special Assessments

Employers must also pay a federal FUTA tax to help pay for the costs of administering the unemployment system. This rate is set at 6.2%, however under normal circumstances, prior to 2011, the state qualified for a 5.4% tax deduction, leaving an effective 0.8% FUTA rate in addition to an employer's total contribution rate. In July 2011, the FUTA rate was decreased from 6.2% to 6.0%, leaving an effective 0.6% FUTA rate after applying the 5.4% deduction.

When the state's unemployment trust fund became insolvent in October 2009, the state began borrowing from the U.S. Department of Labor so that it could continue paying unemployment benefits. In total, the state borrowed roughly $1 billion. In 2011, because the state owed the federal government for unemployment loans for 2 consecutive years, federal law reduced the size of the FUTA deduction from 5.4% to 5.1%. The extra 0.3% goes toward paying the principal on the federal loans and applied to payroll from 1/1/11 through 12/31/11. It was payable by the end of January 2012. Combined with the July 2011 FUTA tax decrease, this meant that the effective FUTA rate for the first half of 2011 was 1.1% (0.8% + 0.3%) and then 0.9% (0.6% + 0.3%) for the second half.

To continue paying the loan principal, the 2012 FUTA deduction will be decreased an additional 0.3%, from 5.1 to 4.8%, increasing the effective FUTA tax rate from 0.9% to 1.2%. This new rate applies to payroll from 1/1/12 through 12/31/12. Employers pay the standard 0.6% either quarterly or annually with their regular unemployment payments. The additional 0.6%, which goes toward the loan principal, is due by January 31, 2013. Under federal law, the FUTA deduction will continue to decrease 0.3% annually until the loan is repaid. DOL estimates that loan repayments will continue for at least another two to three years.

In addition to paying off the loan's principal, federal law also requires repayment of interest. The federal American Recovery and Reinvestment Act of 2009 waived the interest on these loans through 2010. However, the state had to begin repaying interest on the loans in 2011.

In August of 2011, DOL issued a special assessment on employers of approximately $1.70 per thousand dollars of taxable payroll to repay $30 million in interest on the loan. This equated to about $25.50 per full-time employee, and applied to all employers subject to unemployment taxes. In August 2012, DOL issued a second special assessment of $1.30 per thousand dollars of taxable payroll (about $19.50 per full time

employee) to pay $23 million in interest on the $630 million in loans that remained outstanding. The special assessment amount decreased as a result of repaying some of the principal and lower interest rates. Annual special assessments will continue until the loans are repaid in full.

For additional information on the special assessments and FUTA deductions, see: http://www.ctdol.state.ct.us/uitax/EmplNotices/2012/EmplNotice0912.pdf, and http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/FUTA-Credit-Reduction.

VOLUNTARY QUITS

The state's unemployment law generally provides benefits only to those employees who have become unemployed through no fault of their own. However, the law allows benefits to employees who voluntarily left a job for good cause attributable to an employer and for several other reasons that are not work related.

Good Cause

A former employee can receive unemployment benefits if he or she left a job for good cause attributable to the employer. According to DOL's "Guide to Your Rights & Responsibilities when Claiming Unemployment Benefits in Connecticut," good cause must somehow relate to the former job's wages, hours, or working conditions. It could include a change in conditions created by the employer, a breach of an employment agreement that substantially and adversely affects an employee, or a job condition that adversely affects an employee's health.

Regardless of the reason for leaving, in most cases good cause can only be found if the employee took reasonable steps to inform the employer of his or her dissatisfaction and sought to remedy the problem before quitting. The former employee has the burden of proving the good cause for leaving. For additional information, see: http://www.ctdol.state.ct.us/progsupt/unemplt/claimant-guide/uc-288.pdf.

Other Exceptions

In addition to leaving for good cause, the law allows an employee to voluntarily quit work and collect unemployment benefits:

1. to care for a spouse, child, or parent with an illness or disability;
2. if the employee's means of transportation, other than a personally-owned vehicle, has been discontinued, and no other resonable alternative is available;
3. if the employee became unemployed after accepting employment while on layoff from his or her regular work and then left the other employment after being recalled to the former job;
4. if the employee became unemployed after leaving work that was outside his or her regular apprenticable trade to return to work in his or her regular apprenticeable trade;
5. if the employee left work solely due to governmental regulation or statute;
6. if the employee became unemployed after leaving part-time work to accept full-time work;
7. to protect the employee, a child, spouse, or parent from becoming or remaining a victim of domestic violence, provided the employee made reasonable efforts to preserve the employment;
8. to accompany a spouse who was required to relocate while on active duty with the U.S. armed forces; and
9. to accompany a spouse to a place from which it is impractical to commute due to a change in the spouse's employment location.

Other States

In all of the states, employees who voluntarily leave their work must have good cause to remain eligible for unemployment benefits. Thirty-eight of them, including Connecticut, require the cause to be connected with the work, attributable to the employer, or involve fault by the employer.

Like Connecticut, the other states also have a variety of other exceptions which allow benefits to employees who voluntarily left their jobs under certain circumstances. Those similar to the other exceptions allowed in Connecticut include:

1. 20 states that allow an employee to quit to care for an ill or disabled immediate family member;
2. one other state, Arizona, that allows an employee to quit due to transportation difficulties;

3. 40 states that allow an employee to quit to accept other work (similar to exceptions 3, 4, and 6 above);
4. 37 states that allow an employee to quit to escape domestic violence; and
5. 21 states that allow an employee to quit to follow a spouse to a location from which it is impractical to commute, and an additional 10 states that limit this exception to military spouses.

The other states have also created numerous exceptions that are not recognized in Connecticut. These include exceptions for quitting:

1. due to a unilateral and permanent reduction in full time work hours over 20% or a pay reduction over 15% (NC);
2. by accepting a voluntary layoff so that other coworkers can keep their jobs (AK, CA, CO, DE, IL, IA, ME, NE, NY, OK, PA, TN, & UT); and
3. "unsuitable" work within a certain period after beginning the work (IL, MI, MN, MO, NH, NY, ND, WI).

For additional information on eligibility criteria for voluntary quits in other states, see: http://workforcesecurity.doleta.gov/unemploy/pdf/uilawcompar/2012/nonmonetary.pdf.

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