July 24, 2000
L-2000-24

TO : Ronald Russo
Director of Policy and Systems

FROM : Steven A. Bartholow
General Counsel

SUBJECT : Experience Rating - Defunct and New Employers

This is in response to your May 8, 2000 request for a legal opinion concerning the treatment of compensation of defunct and new employers under section 8(a) of the Railroad Unemployment Insurance Act (RUIA) (45 U.S.C. § 358(a)), which provides for the computation of employer contribution rates.

As you know, Public Law 100-647, the Railroad Unemployment and Retirement Improvement Act of 1988, introduced an experience rating formula for determining payroll tax rates for railroad employers under the RUIA, based in part, on the actual unemployment experience of the employer's workforce. The contribution rate established under experience rating consists of a basic rate, plus 0.65 percent to cover the administrative expenses incurred by the Railroad Retirement Board, plus the amount of any surcharge that becomes applicable when the balance to the credit of the Railroad Unemployment Insurance (RUI) Account declines to specified levels. The overall basic contribution rate has three aspects: 1) a railroad specific rate based upon benefit payments paid to the employer's workers; 2) an overall industry rate to cover costs which cannot be attributed to any one employer; and 3) a "risk-shared" rate which is designed to recapture any revenue lost in cases where the statutory cap on the tax rate is less than the rate that would be calculated for a rail employer. The monthly compensation amount which is subject to taxation for each employee is currently $1,050.00. The employer tax rate is limited by statute to 12 percent, unless the surcharge tax is in effect, in which case the statutory limit is 12.5 percent.

Several computations used in the experience rating formula use the "system compensation base." The system compensation base is computed as of June 30 of each year and is the sum of the employers' "one-year compensation bases." (An employer's one-year compensation base is computed as of June 30 and is the amount of compensation with respect to which the employer is liable for contributions in the twelve-month period ending on such June 30.) You question the treatment of defunct and new employers in computing the system compensation base.

DEFUNCT EMPLOYERS

According to your memorandum, compensation from defunct employers is presently included in the system compensation base. You inquire whether compensation of defunct employers may be excluded from the system compensation base, arguing that the inclusion of such compensation corrupts the data used to compute the unallocated charge, pooled charge ratio, pooled credit ratio and surcharge rate.

Provisions governing the computation of the system compensation base are found in section 8(a), which provides in pertinent part as follows:

> (11) The system compensation base as of any given June 30 shall be determined by adding together the amounts of the 1-year compensation bases of all employers and employee representatives subject to this Act, computed in accordance with paragraph (5), as of such June 30. (Emphasis added). 45 U.S.C. § 358(a)(11).

It is my opinion that the proposed exclusion of compensation of defunct employers in the computation of the system compensation base is permissible under a literal reading of the above provision.

Under the rules of statutory construction, it can be presumed that the phrase "subject to this Act" was included in the subparagraph quoted above for a specific reason. It can also be presumed that the phrase was not included to exclude employers outside of the railroad industry, as it would be unreasonable for anyone to presume that the provisions of the RUIA applied to such employers. It is reasonable to conclude that the phrase "subject to this Act" was used to limit the

system compensation base to the one-year compensation bases of those employers subject to the RUIA at the close of the period for which the system compensation base is computed. Such a limitation would not include the one-year compensation base of a defunct employer, as an employer is no longer subject to the RUIA once a determination has been made by the Board that an employer is a defunct employer.

A review of the statutory provisions regarding the unallocated charge, pooled charge ratio, pooled credit ratio and surcharge rate also indicates that the proposed exclusion of the compensation of defunct employers from the system compensation base is not inconsistent with the goal of the experience rating provisions. These elements of the experience rating formula are discussed below.

C **Unallocated Charge** - The "system unallocated charge balance" is the mechanism to account for the income and outgo of the Railroad Unemployment Insurance (RUI) Account that cannot be directly assigned as benefit charges, or adjustments, to the cumulative benefit balance of a particular employer. It is cumulative from January 1, 1990 and is distributed among employers through the unallocated charge. The unallocated charge for an employer as of any given June 30 is the amount that, as of such June 30, bears the same ratio to the system unallocated charge balance as the employer's one-year compensation base bears to the system compensation base. See 45 U.S.C. § 8(a)(9).

As demonstrated in the example provided in your memorandum, the inclusion of the one-year compensation bases of defunct employers in the system compensation base results in a sum of unallocated charges which does not equal the system unallocated charge balance. This result occurs because an employer's share of the unallocated charge balance is determined by multiplying the balance by a fraction, the numerator of which is the employer's one-year compensation base and the denominator of which is the system compensation base. See 45 U.S.C. § 8(a)(9). As noted earlier, the system compensation base presently includes the one-year compensation bases of defunct employers. The inclusion of the one-year compensation bases of defunct employers in the system compensation base essentially results in computing an unallocated charge for defunct employers. Such a result appears to be inconsistent with the intent behind the experience-rating method of determining an employer's contribution rate, as a portion of the unallocated charge balance is never actually apportioned since defunct employers are no longer subject to the RUIA.

! **Pooled Charge Ratio** - If applicable, the pooled charge ratio is a pro-rata increase in the rate of contribution assigned to each employer that is not already paying contributions at the maximum rate. The charge is used to recoup income lost to the RUI Account because some employer contributions are calculated at the maximum contribution rate rather than at the higher experience-based rate that their benefit charges would otherwise require. The pooled charge ratio for a calendar year is the same for all employers whose rate is less than the maximum.

As noted in your memorandum, step 4 of the computation of the pooled charge ratio found at section 8(a)(13)(D) provides as follows:

> Divide the aggregate amount arrived at under step 3 by the system compensation base as of the preceding June 30 as computed under paragraph (11) minus the one-year compensation base of those employers whose rates computed through step 6 of paragraph (1)(C) exceeded the maximum contribution rate computed under paragraph (20). 45 U.S.C. § 358(a)(13)(D).

As you note, the statute specifically excludes from the system compensation base the one-year compensation base of employers with experience-based contribution rates over the maximum. Presumably, the one-year compensation base of such employers is excluded because the maximum precludes increasing their contribution rates for the pooled charge. You argue that the one-year compensation of defunct employers should not be included in the system compensation base for the same reason. That is, because they are defunct employers not subject to the RUIA, it is not possible to increase their rate of contribution for the pooled charge.

I agree with your opinion. An argument could be made against excluding the compensation of defunct employers on the basis that, if Congress intended such compensation to be excluded in step 4 of the computation of the pooled charge, it would have specified such, as it did with employers whose experience-based contribution rates are over the maximum. However, if it is presumed, as discussed earlier, that Congress never anticipated the inclusion of the one-year compensation base of defunct employers in the system compensation base, there would be no reason to provide language which would exclude such compensation.

! **Pooled Credit Ratio and Surcharge Rate -** The pooled credit, if applicable, is a pro-rata decrease in the rate of contribution assigned to each employer. The ratio is computed by reference to the accrual balance to the credit of the RUI Account as of the preceding June 30. The surcharge rate, if applicable, is an increase in the employer's rate of contribution of 1.5, 2.5 or 3.5 percent which is applied when the accrual balance of the RUI Account as of the preceding June 30 falls within a range of balances set by statute.

The pooled credit ratio and the surcharge rate are computed only if statutory trigger levels are attained. The calculations for both components index the trigger levels by comparing the current system compensation base to the system compensation base as of June 30, 1991. Where the trigger level for the pooled credit ratio is met, the computation of the pooled credit ratio uses a fraction, the denominator of which is the system compensation base.

You suggest exclusion of the compensation of defunct employers from the system compensation base used as the denominator in the pooled credit ratio formula. As to the trigger levels, you see no compelling reason to exclude the payroll of defunct employers for purposes of determining the trigger levels, as long as the 1991 system compensation base and the current compensation base are computed consistently. Finally, you note that the pooled credit ratios or surcharges that the system has had to date would not have changed had such compensation been excluded from the system compensation base in both trigger determinations and the pooled credit determination.

As previously stated, it is my opinion that the statute may be read to mean that the compensation of defunct employers should not be included in the system compensation base. However, if this interpretation is adopted, it must be applied consistently throughout section 8. This would mean that the system compensation base, whenever used in a computation in section 8 of the RUIA, should not include the compensation of defunct employers. Under this interpretation, the system compensation base used in the denominator in the pooled credit ratio formula should exclude the compensation of defunct employers, as should the system compensation base used to index the trigger levels, including the present system compensation base and the system compensation base as of June 30, 1991.

NEW EMPLOYERS

! **System Compensation Base** - As noted previously, the system compensation base, as computed under section 8(a)(11) of the RUIA, is the sum of the employers' one-year compensation bases. Section 8(a)(5) of the RUIA defines the one-year compensation base as of any given June 30 as "the aggregate compensation with respect to which contributions were paid by the employer" in the 4 calendar quarters ending on such June 30. 45 U.S.C. § 358(a)(5). You indicate that you believe section 8(a)(5) contradicts the provisions of section 8(a)(1)(D)(vi)(II), and therefore question the proper method to calculate a new employer's one-year compensation base.

The two provisions noted above are not contradictory. The introductory paragraph to section 8(a)(1)(D) provides as follows:

> Notwithstanding subparagraphs (B) and (C), the contribution rate applicable to a new employer who does not become subject to this Act until after December 31, 1989, shall be determined as follows:

Therefore, the special method of calculation as provided in subparagraph (D) of section 8(a)(1) applies only when computing the contribution rate of a new employer. Otherwise, the one-year compensation base of a new employer is computed in accordance with the provisions of section 8(a)(5) of the RUIA. As the provisions are not in conflict, I agree with your statement that the special method of calculation should continue to be limited to new employer calculations.

! **New Employer Contribution Rate for the 1st Calendar Year** - The new employer contribution rate for the first calendar year under section 8(a)(1)(D)(i) is the average contribution rate paid by all employers during the 3 calendar years preceding the calendar year before the calendar year in which the compensation is paid. This average is calculated using the ratio of contributions paid by all employers to the corresponding compensation in three prior calendar years. At present, you indicate compensation and contributions are used for all employers not defunct in that calendar year's quarters. I concur with your opinion that including the compensation and contribution of all active employers in each quarter will produce the most accurate rate for new employers.