

Your Unemployment Funding Choices

By Dennis Walsh CPA

Under traditional state unemployment insurance programs, an employer's tax contributions are irrevocably forfeited to the unemployment insurance fund to the extent unemployment benefits never become payable to separated employees. Several decades ago Congress mandated that state programs must provide Section 501(c)(3) nonprofit employers with the option to essentially self insure for the benefit claims of their separated employees. Congress felt that nonprofits should not be forced to subsidize for-profit employers operating in industries that draw disproportionately greater amounts from state unemployment insurance pools.

This preference to nonprofits creates an opportunity in some instances to conserve vital financial resources that might be unnecessarily paid into the unemployment insurance fund. However, this opportunity to choose between two separate funding options necessitates a prerequisite understanding of the alternatives, and then an application of this understanding to a periodic review of your specific situation.

In this article I have attempted to briefly outline the essential basics and provide a few additional points to help facilitate such analysis in your organization. As dreary as this process might seem to someone other than an accountant, remember this is about enhancing the financial stability needed to assure the continuing accomplishment of your worthy mission.

The basics ...

Any nonprofit employer in North Carolina with 4 or more employees each having worked at any time during 20 weeks in a calendar year becomes subject to unemployment compensation coverage and must register with the NC Employment Security Commission ("ESC"). The 20 weeks required for each employee need not be consecutive. The employer is assigned an initial tax rate under one of the two methods explained below. Tax is then paid on the first \$18,600 (2008 wage base) of wages per employee each calendar year (i.e. "covered wages"). Section 501(c)(3) employers are never subject to the counterpart federal unemployment tax (FUTA).

Methods of payment

At the time you become a covered employer you have the option to choose from two different methods of payment, either the experience-rated or reimbursement method.

Experience-rated method

If this method of payment is requested, an initial rate of 1.2% is assigned for all or part of 2 calendar years. In making this rate assignment, the ESC will look back at your actual payroll experience for the last 3 fiscal years. Your covered wages paid during a fiscal year ending in June of each year are used for this purpose.

Any increase or decrease in either your payroll or tax payments credited to your account could cause the tax rate to change. Each year a ratio is taken between these two factors in order to determine what the rate will be for the following calendar year. Benefit charges, late payments or increased wages could affect the ratio. Currently, the lowest rate is 0% and the highest is 6.84%.

Reimbursement method

A non-profit with recognized 501(c)(3) status can agree to maintain 1% of its covered wages in an account with the ESC. You pay initially at 1% for a year or two, depending on the date you become a covered employer. After you have contributed the initial 1% of wages, the rate is assigned at 0% thereafter. In other words, if your payroll does not increase and you never pay out benefits, you have no further liability for payment.

Since you have agreed to maintain a balance equal to 1% of your covered wages, your account is reviewed once a year (November 15) to see if higher wages or benefits paid to separated employees have decreased your account balance to less than the 1% requirement. If this is the case, you will be billed to bring the account up to the newly determined balance, with full payment due in 60 days (ouch!). Conversely, if your account balance exceeds the 1% of covered wages requirement, you are issued a refund for such excess.

Changing methods

If circumstances warrant, you can elect to change your method of payment after using a particular method for at least four years. This must be done before December 1 of the year prior to the year for which the change is to be effective. You must send a signed statement to the ESC to effect such an election. If you are switching from the experience rated method to the reimbursement method and your current rate is less than 2.7%, you may receive credit for your current reserve balance, thereby reducing initial contributions to the newly established reimbursement account.

Which method is preferable?

Ahh ... if one only had a crystal ball. At one end of a continuum is a nonprofit with a small paid staff and no history of employee turnover, well established with an endowment large enough to assure perpetual fiscal stability. At the other end

of the continuum is a small startup lacking consistent funding sources, resulting in regular staff layoffs due to frequent changes in programming level as a result of such fiscal instability.

Clearly, the first organization should be under the reimbursement method, while the latter needs the fiscal protection afforded by the experience rated method. Most organizations fall somewhere between these extremes. You will need to weigh the potential costs and benefits of each method based on your evaluation of past and anticipated staffing needs as well as the degree of fiscal reserves and stability present in your organization.

A private sector alternative

In more recent years a private sector “hybrid” plan has emerged that offers nonprofits potential savings by combining benefits of the reimbursement method (self insurance) with the fiscal protection of the experience rated method (risk pooling). Under this arrangement, you first elect the reimbursement method with the state and then join an independently sponsored plan comprised of member nonprofits. Participants pool funds to meet reimbursements to the state required as a result of benefit claims. For the services of the plan you pay an administration fee. You retain a refundable ownership interest in funds contributed but not paid out in benefits to employees. One such plan claims to be economical for organizations with as few as ten employees. Information about such arrangements may be found on the Internet and on the websites of various nonprofit support organizations.

For more information

For more on these issues and to obtain the latest updates on changes in tax rates and UC law relevant to nonprofits, you should call or email the [NC Employment Security Commission](#). You may also submit questions to the [Financial Management HelpDesk](#).

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