Understanding Your Legal Right To Opt OUT of State Unemployment Insurance

an Executive Briefing
prepared by:

501(c) Agencies Trust
www.501cTrust.org
800.442.4867
10080 N Wolfe Road
SW3, Suite 250
Cupertino CA 95014

Did You Know…

In 1972 the Federal Unemployment Tax Act was changed with little notice. That change dramatically affects 501(c)(3) organizations and allows them an option which – when exercised – can shrink the cost of State unemployment insurance (SUI) *without* reducing the benefits in any way.

35 years later, many nonprofits are still unaware of this option. No conspiracy at play. Just that the IRS is more about enforcement than education.

> **Here's the Federal Unemployment Tax Act code:**
> (Chapter 23 - sections 3301 through 3311 - of Title 26 of the United States Code)
> http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC3309
>
> **Here's what it says:**
> …requires that approved State unemployment programs allow a "religious, charitable, educational, or other organization described in Section 501(c)(3) which is exempt from income tax under section 501(a)" to elect whether (a) to contribute to the State program in accordance with State law or (b) to pay into the State program annually an amount equal to the actual unemployment benefits paid out by the State program on account of employment services previously provided to the organization.

To simplify the tax code for non-lawyers:
As a nonprofit organization **you can choose** to pay into your State unemployment insurance fund, *or*
You can elect to pay as you go… reimburse the State for only those unemployment benefits actually paid on your behalf.

What does that really mean to you?

With your State unemployment insurance fund every year you pay into a pool of money set aside to fund unemployment benefits. Each employer in the State – for-profit, government, nonprofit – pays into the fund at rates determined by State law. Some States have maximum rates up to 10%.

On the surface treating every employer the same (i.e., using the same taxable ratio) seems fair.

But ***averages*** can be misleading. You can get an average of 50 by adding together 40 and 60. You will also get that same average (50) adding together 10 and 90.

Historically nonprofits have lower turn-over and, hence, a **lower than average** claim rate.

What that means is: as a nonprofit you pay in more than what you take out… consistently, predictably.

Rather than over-pay into the State unemployment fund – effectively subsidizing for-profit companies - wouldn't it be more true to your mission (and your donors) to allocate that wasted overhead to your programs and services?

Many organizations logically conclude so.

Nationwide, nonprofits on average pay $2.20 into State unemployment funds for every $1 the State pays out in actual claims.
You put $2.20 in,
you take $1.00 out.

That's a wide gap between taxes paid in and benefits paid out don't you think?

Nonprofits exist to close – or at least narrow – gaps. Gaps in medical services. Gaps in youth programs. Gaps in essential food, clothing and shelter needs.

For every $1.00 in unemployment claims generated, nonprofits pay $2.20 into State unemployment tax funds.

Where does the money go...

The money you pay into your State unemployment tax fund covers four costs:

1. Actual benefits paid on your behalf
2. Contribution to claims paid on behalf of for-profit companies in your State (since nonprofits incur less claims on average than for-profit organizations, you're effectively subsidizing their claims)
3. Labor, skill and infrastructure to process and pay benefits (administration)
4. Socialized costs for companies that go out of business, overpayments by the State, and relief of employer charges allowed by the State

By slicing out #2 and #4 (i.e., not subsidizing for-profit claims and socialized costs) you bring your cost more in line with your true expense. **You narrow the gap**.

How to give less...
Get more...
Without doing more work…

John Huckstadt was a nonprofit executive who also has an insurance background. He was serving as the Executive Director of United Cerebral Palsey when the tax law was changed giving nonprofits the option of becoming self-reimbursing employers.

He saw the savings benefit of opting out of the State unemployment insurance plan. As Executive Director he had first hand experience with the high cost of SUI tax.
But he also recognized the risk - no ceiling on exposure to potential claims.
And he acknowledged that the administration task required was not insignificant.

He conceived of a way to...

- **Claim those cost savings AND…**
- **Put a cap on the risk AND…**
- **Take the burden of administration off individual organizations.**

The State unemployment model is an insurance model. In the world of insurance, the cost of individual claims are shared by the pool of premiums. In other words: everyone makes the pie, but not everyone gets a slice… or even a bite for that matter.

In a given year, a majority of premium payers have claims that amount to **less than** the premiums they pay. And a minority of premium payers have claims exceeding what they pay.

An insurance company doesn't care so much about who makes a claim as much as it cares that the premiums collected exceed the cost of claims paid. As long as that happens, they make their profit.

For example...
Take medical insurance. Say your yearly premium is $2,200. You get a checkup that cost $200. Simple math – you would have saved $2,000 by using a pay-as-you-go model rather than buying the insurance.

But what if you had an accident during the year and you racked up $20,000 in medical expenses (easy to do these days). In this case the pay-as-you-go model would have cost you $17,800 more in out-of-pocket expenses compared to the insurance model.

Insurance would have limited your personal risk and cost to $2,200 and spread the remaining $17,800 cost across premiums paid by others.

You choose to buy insurance because you want to limit your risk should you experience an unexpected large expense. Naturally you're relieved when insurance "covers" you. But you're not so happy when you **pay in** much more than you **get out**… year after year.

With health insurance you have the flexibility to choose among a range of policies. For the person with a history of very low medical expenses, they can pay a much lower premium for a high deductible plan. That way they're covered for the **un**expected without over-paying for the expected.

Your State doesn't offer you a choice in unemployment insurance plans… there's only one.

But the IRS allows you to opt out of your State unemployment insurance plan.

Creating an alternative plan that closes the gap...

John Huckstadt combined both models (pay-as-you-go and insurance) giving the benefits of each: **cost savings AND risk protection**.

He created an alternative plan that uses a Grantor Trust. It's been working beautifully since he started it with a small group of 14 United Way agencies in 1982.

The IRS gives you the option to become a reimbursing employer and opt out of your State unemployment plan

Here's how the Trust works:

➤➤ A reserve account is created in the Trust by you. (***You own the account***. If you decide to leave 501(c) Agencies Trust, you take the balance with you. This is not true with your State unemployment fund. Those funds will never be returned to you.)

➤➤ You'll make quarterly deposits into your reserve account. The amount will be calculated for you based on your claims history and gross annual payroll. ***This smoothes out your cash flow***.

➤➤ If you should have any claims during the year, our professional claims staff will oversee them. They'll ensure that only valid claims are paid. They'll reimburse your State for claims from your reserve account. ***Professional administration and oversight.***

➤➤ An independent professional asset management firm invests your reserve funds in conservative instruments earning a return on your account. (The return over the past 5 years has averaged 10%). ***Return on your account decreases your cost.***

➤➤ Stop loss insurance protects you from unusually high claims. You'll know before the beginning of the year how much your quarterly payments into your reserve account will be. If your claims exceed your reserve account goal (deductible), the insurance is there for you to cover the gap. ***Risk protection***.

The Trust is audited yearly by an independent CPA firm abiding by Generally Accepted Accounting Principals (GAAP) rules. The Board of Trustees - composed of 20 executives from nonprofits throughout the United States – reviews the financial performance and unemployment claims quarterly. ***Financial oversight.***

The Trust Takes Compliance Issues Off My Shoulders

Member Highlight

Chuck Fernandez saw the logic in opting out of the State unemployment program after listening to Ellen Johnson, Membership Director of 501(c) Agencies Trust speak at a Rural Health Round Table Meeting.

At the time he was with a small organization that didn't have an in-house dedicated HR staff. Before completing his enrollment, he had an opportunity to "test" the HR consultants with 501(c) Agencies Trust. They helped him out of a sticky situation to his relief.

His "logical" decision to become a member based on projected unemployment cost savings was quickly rewarded by the top-notch service 501(c) Agencies Trust provides members.

When he moved to a larger organization – Mendocino Community Health Center – he was quick to enroll them.

Mendocino Community Health Center is large enough to warrant a dedicated HR staff member – Carolynn Hansen.

For Ms. Hansen, 501(c) Agencies Trust "takes a lot of work off my desk and compliance issues off my shoulders." She's relieved with the assurance that she can rely on the Trust professionals to know all the ins and outs of unemployment regulations.

Opting OUT of State Unemployment Insurance:
Key Concerns…

When considering whether to opt out of your State unemployment insurance plan and become a 501(c) Agencies Trust member there are three key concerns:

* **Cost Savings**
* **Security**
* **Administration and Service**

Cost Savings

- The first way you save money is by lowering your unemployment benefits costs
- The second way is with claims oversight so you pay only valid claims
- A third way is by shifting administration to experienced professionals that represent your interests
- A fourth way is investment returns paid to your account
- A fifth way is you make quarterly deposits to your account rather than a larger lump sum at the beginning of the year
- A sixth way is by having a professional Human Resources department available for consultation (more on this service below)

Security

Naturally, you want to be sure your funds and your organization can experience reduced costs without any increase in risk. That's not only a personal concern for you. It's also your fiduciary responsibility.

501(c) Agencies Trust was formed 25 years ago. We started reducing unemployment costs to nonprofit organizations when Ronald Reagan was President, a first class stamp was 20 cents and the unemployment rate was 9.7%.

Our company leaders have a blend of nonprofit and for-profit business experience. (http://www.501cTrust.org/about/trustmanager) We're further guided by our 20-member Board of Trustees. (You can read about our board members on our website http://www.501cTrust.org/about/trustees)

Cost Savings

Security

Administration and Service

When 501(c) Agencies Trust was formed (a merger of the Joint Agencies' Trust and the Northwest Agencies' Trust), the core purpose was to reduce cost WITHOUT increasing risk. Reducing cost was the easy part. Limiting risk required a more tailored use of insurance.
As a member of 501(c) Agencies Trust you're protected against a season of heavy claims with Stop Loss insurance. The insurance kicks in if your claims exceed your deductible.

We were instrumental in getting this type of insurance created.
This was the key that turned the possible (opting out of SUI) into the prudent by covering the risk.

Administration and Service

* Unemployment claims are scrutinized, validated and when appropriate, challenged. Our claims administrators work directly with your State. You don't need to dedicate any additional staff time. We represent you. We're your virtual agent.

* All those federally mandated programs… Family Leave, Pregnancy Leave, Medical Leave, Personal Leave, Family Medical Leave… 501(c) Agencies Trust has a library of guidelines and forms for you. We keep up on all the recent rulings.

We also have you covered for HIPAA requirements, ADA guidelines, COBRA administration, Employee Assistance programs, immigration issues, employee handbooks, discipline guidelines, privacy laws, and any other HR related issues or questions you experience.

Our HR professionals can be reached through a toll-free hotline. Whether you're completely stumped about a particular issue or you want a confirming second (or third) opinion, we bring that depth and expertise to you.

Additionally, our HR experts can train your managers and supervisors on best practices and procedures.

What about your (former) employees?

Opting out of your State unemployment plan **is not** opting out of your mandated unemployment benefit responsibility.

For an employee that loses their job they have:
exactly the same right to file an unemployment claim…
in exactly the same way through their State unemployment office.

Their interface – before **and** after you become a member - is with the State office. And ultimately their claim is approved or disapproved by that office.

Our team of unemployment specialists provide more oversight of your claims than the State folks. We're not "rubber stampers".

For any claim we feel is questionable, we – <u>with your permission</u> – challenge it with your State office. On claims we protest, we have an 85% win rate.

The HR Support Team is Well Versed In Their Jobs
Member Highlight

Arc-San Joaquin was in the first group of nonprofits that joined the Trust.
Cathy Casteel, Director Corporate & Employee Administration wasn't with the organization when they joined in 1982, but she's had plenty of opportunities to be grateful that her predecessor chose to become a member.

Arc has 100 staff members and serves 300 developmentally disabled adults in Stockton California.

Ms. Casteel thinks handing off the unemployment claims administration makes sense. But more than that she finds the HR support "great". They "know what they're doing and are well versed in their jobs".

You don't get any support from the State. 501(c) Agencies Trust has provided Arc managers with specialized training, helped Ms Casteel sort through and decipher policy issues, supplied Arc with sample policies and the backup and rationale, rendered second opinions and acted as a sounding board.

Aware of how valuable and comforting having this resource is, Ms Casteel is certain if she moved to another nonprofit, she'd sign them up immediately.

Let's take a quick review…

- You make quarterly payments: better cash flow
- You pay only for actual claims: lower costs
- You own your reserve account: present savings build to further lower future costs
- Claims made are professionally scrutinized and managed: claims are minimized without any administration or expertise on your part
- Your reserve account is put to work for you by professional investment managers: your money earns money which decreases your cost
- You have immediate access to professional HR assistance: you avoid the cost of in-house help or third party consultants saving you time, money and possible snags with HR issues

➡ You have a team of professional and friendly people to lessen the cost and burden of administration in your organization: more of your resources are available for your mission

An invitation to join the insiders…

We have over 1,600 member organizations in 501(c) Agencies Trust. They're saving over $50 million a year compared to what they would pay with SUI taxes.

Additionally – and not insignificantly – the HR support we provide brings expertise to your organization that you would otherwise need to fund with staff and professional consultants.

It reduces staff time and organizational requirements to fund your unemployment needs. **Reduced cost, reduced risk, increased services**.

Our members include large and small independent nonprofits as well as the affiliates of large national organizations such as the American Association of Museums, America's Second Harvest, Boys and Girls Club of America, National Human Services Assembly, National Rural Health Association, Points of Light Foundation, United Way, YMCA and YWCA and more

We have members in 46 States and the District of Columbia. Some have been with us for 25 years, some joined this year.

Test us:

If you'll take **less than 30 seconds** to answer 5 easy yes/no questions, you'll know if your organization can benefit by being a member of the 501(c) Agencies Trust.

If the answer is YES, one of our Trust Consultants will contact you and prepare a custom estimate for your individual organization showing how much you can save by opting out of your State unemployment insurance plan and becoming a member of the Trust.

You'll quickly be able to see for yourself if becoming a member makes sense to you, to your organization and to your mission.

Click on the link below.

Go there now.
There's no obligation. The choice is yours and it takes little time to discover your options.

http://www.501cTrust.org/selfassessment