State Unemployment Insurance Explained

State Unemployment Insurance (SUI) 101

The Social Security Act, passed in 1935, requires for-profit employers to provide a maximum of 26 weeks of unemployment to separated employees through state-run unemployment insurance programs. States pay unemployment benefits from pools of funds they reserve for qualified unemployment benefits payouts (unemployment insurance claims). States raise these funds by levying a payroll tax (benefits premium) on most employers. What an employer pays in taxes is based on state-by-state standards that include varying tax rates, layoff histories, and taxable wages.

Every year states produce a tax table with a range of tax percentages. Every employer in the state is assigned an annual tax rate (based largely on past unemployment experience - history of layoffs – and other state and national economic factors.) The revenue collected through these state unemployment insurance (SUI) taxes (unemployment insurance premiums) are reserved and pooled together. The states use the pooled funds to cover unemployment expenses for all employees.

It wasn't until 1972 that Social Security Act was amended to require *all* employers (not just for-profit employers) provide unemployment benefits. However, the amendment gave three classes of employers the legal right to manage their unemployment benefits outside of the state-run programs:

1. 501(c)(3) Public Charities
2. Public/Government Entities
3. Tribal-Owned Businesses

Because the federal government believes that these three employer groups layoff fewer employees, they are granted the legal option to manage their unemployment outside of the state-run unemployment insurance programs. Unemployment benefits are still paid directly by the state. After the state pays benefits (claims) to an unemployed employee, it then bills the past employer(s) for reimbursement. The employer is not assessed an unemployment insurance tax (benefits premium) on their taxable payroll. They do not send funds to the state unemployment insurance pool.

Becoming a Reimbursing (pay-as-you-go) Employer

Tens of thousands of qualified employers have elected to switch status from being a merit rated employer (paying an unemployment insurance tax) to being a reimbursing employer (paying only for the unemployment claims of their separated employees). In the nonprofit sector, about 35 percent of 501(c)(3) nonprofits have made this selection and possibly a higher percentage in the public/government sector.

In all states but California, there is a once a year deadline to switch from a merit rated employer to a reimbursing employer. (See specific state deadlines here.)

To become a reimbursing employer, employers must

· File required state specific paperwork 30 days (recommended) before the state deadline;
· Secure a state-required bond. (Fifteen states require reimbursing employers to put up a security bond. See the list of bond states here.)

After the state reviews the paperwork, they notify the employer of the change and issue a new state tax identification number that indicates the new reimbursing status.

Claims Administration – How it Works

When a 501(c)(3) nonprofit decides to become an unemployment insurance reimburser, unemployment insurance claims administration becomes more important to them. Their new reimbursing status means they must only pay the unemployment claims for which they are legally liable. Every year the Department of Labor reports that billions of dollars of unemployment benefits are mistakenly paid due to fraud and error. Having a robust claims administration process becomes strategically and financially more valuable than when the employer was just paying state unemployment insurance taxes.

The internal – or outsourced – unemployment claims administration process needs to have three parts.

- First, a reimbursing employer should have reserve funds set aside to pay for all claims for which the employer is liable.
- Second, the employer should have a robust auditing process to review the unemployment claims timely and insure they have been calculated properly and are owed.

- Lastly, the employer needs access to unemployment insurance professionals who can provide the proper expertise to appeal incorrect or disputed claims.

Not having a strong unemployment claims administration process can undermine the budget savings an employer is enjoying through not paying state unemployment insurance taxes.