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Municipal Law Report No. 5

Dennis W. Huffer
University of Tennessee, Knoxville

MUNICIPAL LAW REPORT

No. 5

UNEMPLOYMENT COMPENSATION: PREMIUM PAYING VERSUS REIMBURSING

by Dennis W. Huffer

The University of Tennessee
MUNICIPAL TECHNICAL ADVISORY SERVICE
in cooperation with The Tennessee Municipal League

The Municipal Technical Advisory Service (MTAS) is a statewide agency of The University of Tennessee's Institute for Public Service. MTAS operates in cooperation with the Tennessee Municipal League in providing technical assistance services to officials of Tennessee's incorporated municipalities. Assistance is offered in areas such as accounting, administration, finance, public works, ordinance codification, and wastewater management.

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ABSTRACT

A municipality can opt to either pay employee premiums or reimburse employee costs under current Tennessee law. This report provides details on these two options and outlines the advantages and disadvantages of each.

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THE UNIVERSITY OF TENNESSEE
MUNICIPAL TECHNICAL ADVISORY SERVICE

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Dear Municipal Official:

It is a pleasure to present to you this Municipal Law Report No. 5, *Unemployment Compensation: Premium Paying Versus Reimbursing*, as prepared by The University of Tennessee's Municipal Technical Advisory Service (MTAS).

This Municipal Law Report has been prepared to help municipalities understand the options under unemployment compensation laws to be either premium paying or reimbursing employers. Whether a municipality should elect to be a premium paying employer or a reimbursing employer depends on its particular employment situation. *Unemployment Compensation: Premium Paying Versus Reimbursing* outlines the advantages and disadvantages of each option.

Special recognition is given to Mr. Dennis W. Huffer, MTAS Intergovernmental Affairs Consultant, who has prepared this Municipal Law Report. His research and efforts in preparing this report are appreciated.

Copies of this and other MTAS Municipal Law Reports are available on a complimentary basis to officials of all Tennessee municipalities and on a limited basis to state and federal government offices. Others wishing to obtain copies may do so on a pre-paid basis. An order form can be obtained by contacting our Knoxville office at (615) 974-5301.

We at MTAS hope you find this Municipal Law Report of assistance to you, and look forward to receiving your comments and suggestions.

Sincerely,

C. L. Overman

C. L. Overman
Executive Director

CLO:dkl

UNEMPLOYMENT COMPENSATION:

PREMIUM PAYING VERSUS REIMBURSING

INTRODUCTION

Municipalities have the option under unemployment compensation laws to be either premium paying or reimbursing employers. Premium paying employers pay a quarterly premium that goes into the state's unemployment trust fund. The premium is a percentage of the first $7,000.00 paid to each eligible employee during a calendar year. Reimbursing employers do not pay the quarterly premium. Instead, they reimburse the state trust fund for the entire cost of unemployment benefits paid their former employees. Whether a municipality should elect to be a premium paying employer or a reimbursing employer depends on its particular employment situation. This report is designed to help municipalities in making the decision to be premium paying or reimbursing employers, by outlining the advantages and disadvantages of each option.

BACKGROUND FACTS

Unemployment benefits are paid to eligible former employees from the state's trust fund, a fund created and maintained by premiums paid by employers. Benefits are paid to the former employees of reimbursing employers under the same conditions as those paid to employees of premium paying employers. Reimbursing employers are billed monthly for the benefits paid. Unemployed workers are paid benefits according to what they earned in their "base period" (the first four of the last five completed quarters). The employers that unemployed workers worked for during the base period, and not necessarily at the time they were laid off, are charged for those benefits. Generally, employees who are laid off because of lack of work are eligible for benefits. Employees who quit or are fired are not eligible, unless they requalify later by being re-employed and then laid off.

For municipalities that choose to be premium paying employers, the beginning premium is 1.5% of the first $7,000.00 paid to each employee during a calendar year or $105.00 per year for each employee earning $7,000.00 or more. However, after three consecutive years, ending on December 31, as a premium paying employer the premium will be based on the particular municipality's employment experience. Rates based on experience become effective each July 1. If the municipality has low employee turnover and has had few charges against its account in the trust fund, the rate should be lowered. If there have been numerous lay-offs by the municipality, the rate should be increased. The minimum rate is 0.3% and the maximum is 3.0% of the first $7,000.00 of each employee's wages.

The average weekly benefit amount paid in Tennessee as of December 1986, was $90.73. The maximum weekly benefit amount a claimant can receive is $145.00. The average number of weeks that an unemployed worker draws benefits is twelve weeks. The maximum duration is twenty-six weeks. Benefits are extended for thirteen additional weeks during economic recessions (periods when the thirteen week average insured unemployment rate is (a) at least 5.0% <u>and</u> 120.0% of the average rate for the last two years <u>or</u> (b) 6.0%). During extended benefit periods, the federal government pays 50.0% of the benefits that would have been charged to premium paying or reimbursing municipalities.

Advantages Of The Premium Paying Option

The advantages of the premium paying option are:

1. Since your city is paying a flat rate premium based on your eligible employee payroll, you can determine in advance, for budget purposes, exactly what you will pay each year.

2. If your city pays more in premiums than is paid in claims, you would qualify for a lower rate (to a minimum of 0.3%).

3. Your city's liability is limited, because even if benefits paid exceed premiums you have paid, your tax rate can never exceed the maximum allowed by law, which is now 3.0%.

Disadvantages Of The Premium Paying Option

The disadvantages of the premium paying option are:

1. If your city has a low employee turnover rate, you might pay more in premiums than is necessary to pay claims. These premium payments are never refunded to the employer, but the rate will be lowered if there are few claims.

2. If there are a great number of claims against your city's account, your rate will be increased. The maximum rate as indicated above, is 3.0% of the first $7,000.00 of each employee's wages.

Advantages Of The Reimbursing Option

The advantages of the reimbursing option are:

1. If the municipality has a low turnover rate, and thus has few claims, costs for reimbursement might be substantially less than those under the flat rate premium paying option.

2. Those selecting reimbursement will pay back to the state the actual amount paid out in benefits, whereas those using the premium paying option might pay in more than is paid out in benefits.

Disadvantages Of The Reimbursing Option

There are several potential disadvantages of the reimbursing method:

1. Your city's potential liability is much greater under this option. A high level of claims might cause you to pay more than would have been paid under a flat rate premium. Although the premium paying employer's liability is limited to a percentage of his payroll, there is <u>no</u> limit on the reimbursing employer's liability.

2. It is not possible under this option to determine exactly what the impact on your city's budget is going to be, and payments might vary greatly depending on the number of claims.

3. When economic conditions worsen, triggering extended benefits, reimbursing employers must pay these extended benefits also. However, the federal government pays 50.0% of these benefits that are charged to the reimbursing municipality.

4. It is not possible to receive a "non-charge" when the reimbursing employer falls within the base period (and has fired an employee or the employee quits and the employee later becomes eligible for unemployment benefits). The "non-charge" is available only to premium paying employers. To be "non-charged" means that the payments to the employee are not charged against the employer's account in the trust fund, or, in the case of reimbursing employers, would mean that benefits would not be charged to the employer. Since the reimbursing employer has made no payments into the trust fund and has paid none of the administrative costs of providing unemployment compensation, policy-makers felt it was fair that reimbursing employers not be afforded the "non-charge" privilege.

5. It is not possible to be paid back for erroneous benefit payments paid from the trust fund unless the erroneous benefits are recovered from a claimant. Since the reimbursing employer has made no payments into the trust fund, it would not be fair to pay the reimbursing employer back with funds paid by premium paying employers.

Although the list of disadvantages to the reimbursing option looks forbidding, the most important consideration is whether or not the municipality will save money under it. For example, one medium-sized city that started as a premium paying employer paid premiums totalling $7,371.00 in 1978 and $10,517.00 in 1979. Since switching to reimbursing, the city has never paid more than $1,815.00, and in most years has paid considerably less than that.

ESTIMATING PAYOUT

In order to estimate your municipality's payout under each method, do the following:

Estimated Payout Under Premium Paying Option

To estimate your payout under the premium paying option, use this formula:

($105.00[1] X Total number of eligible employees[2] who make $7,000.00 or more per year) + (.015[3] X Total salaries of eligible employees[2] who make less than $7,000.00 per year[3]) = Total yearly payment under premium paying option.

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[1]$105.00 is 1.5% of $7,000.00, which is the annual premium for employees making $7,000.00 or more per year.

[2]"Eligible employees" does not include city judges, elected officials such as mayors and members of the governing body, employees serving on a temporary basis in cases of emergency, or employees serving in a major nontenure policy-making or advisory position or a policy-making or advisory position in which the duties ordinarily do not require more than eight hours per week.

[3]This is 1.5% expressed as a decimal.

Estimated Payout Under Reimbursing Method

To estimate your payout under the reimbursing method, use this formula:

> Estimated number of terminations for the coming year[4] X $90.73[5] X 12[6] = Total estimated yearly payment under reimbursing options.

The estimated payout under the above formula is extremely tenuous because any of the average components could turn out to be grossly over or under the mark. Yogi Berra's statement that it is hard to make predictions, especially about the future, turns out to be true in this case as in others. But using average figures is the best that can be done and should not be too far off the mark in most cases.

Another way premium paying municipalities who are thinking of becoming reimbursing employers can estimate their payout under the reimbursing method, is to look at previous charge statements to determine what the cost of reimbursing would be. Had they been reimbursing at the time, they would have had to reimburse the department for every dollar that was "charged and non-charged" to their account as a premium paying employer.

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[4]Probably the best way to do this is to come up with the average number of terminations for the past several years. It should be noted that education personnel, both professional and nonprofessional, are not eligible for unemployment benefits during holiday and vacation periods if they have a reasonable assurance they will be rehired after the holiday or vacation. The estimated number of terminations should include only "eligible employees." See the premium paying formula for those who are not eligible.

[5]$90.73 is the average weekly benefit amount paid in Tennessee as of December 1986. This is the weekly benefit amount for which an employee making $10,500.00 per year would be eligible. If most of your employees make more than that, your potential liability is more. If they make less, it is less. The latest session of the General Assembly increased the maximum weekly benefit from $130.00 to $145.00. Therefore, the average weekly benefit amount will increase somewhat.

[6]Twelve is the average number of weeks that an unemployed worker draws benefits. Depending on earnings of an employee during the base period, the employee may draw benefits for a maximum of twenty-six weeks during normal economic times. During a recession, benefits are extended for thirteen additional weeks.

SWITCHING OPTIONS

A municipality that decides it would be better off under the reimbursing option may switch to that option, and vice versa, under certain conditions. A municipality may not change its original option (whether reimbursing or premium paying) until it has been under that option for at least twelve consecutive months ending on June 30. A municipality that is premium paying, switches to reimbursing, and wants to switch back to premium paying cannot switch back until it has been a reimbursing employer for at least twenty-four consecutive months ending on June 30.

A municipality that is reimbursing, switches to premium paying, and wants to switch back to reimbursing cannot switch back until it has been premium paying for at least twelve consecutive months.

A new municipality or premium paying municipality that wishes to become a reimbursing employer must notify the Tennessee Department of Employment Security in writing at least thirty days before the beginning of the taxable year (July 1). Likewise, a reimbursing municipality that wishes to become a premium paying employer must file a written notice requesting termination of its status as a reimbursing employer at least thirty days before July 1.

Approval by the municipality's governing body for a switch either way, may be in the form of either a motion or resolution directing the mayor or other appropriate municipal official to write the Tennessee Department of Employment Security requesting a change in status. The letter by the mayor or other official should indicate the municipality's account number with the Department. To facilitate action by the municipality, a sample resolution and a sample letter are presented in Appendix B.

A reimbursing employer who becomes a premium paying employer is still liable for payment of benefits charged as a result of wages paid when the employer was a reimbursing employer. In effect, the municipality could be paying both its premium, and reimbursing the trust fund for some of its former employees for a substantial period of time.

A municipality that has always been a reimbursing employer and switches to premium paying will be assigned the new employer rate (1.5% of the first $7,000.00 of each employee's wages), and will retain that rate until it has been a premium paying employer for three consecutive years ending December 31. Thereafter, the municipality's rate will be adjusted according to its employment experience. As noted above, the minimum rate is 0.3% and the maximum is 3.0%.

A municipality that once was a premium paying employer, switched to being a reimbursing employer, and then switched back to being a premium paying employer will assume the same reserve it had when it was a premium paying employer before, and this reserve will be used to determine its premium rate if it is subject to experience rating. If the municipality is not eligible to be experience rated, it will be assigned the governmental new employer rate of 1.5% until it is eligible to have a rate based on its own experience.

TIPS FOR EMPLOYERS

Municipalities can take several actions that will help ensure that they and their accounts will not be charged for any unnecessary benefits:

1. Keep accurate records. If a former employee claims he was paid more than he actually was, the municipality should have proof of his actual earnings.

2. Have all new employees sign copies of employment rules and their job descriptions so there will be a clear understanding of what is expected of them from the first. Keep copies of all reprimands and warnings as well as records of tardiness and absences from work. This will document circumstances relating to a dismissal and provide information to unemployment compensation claims offices when claims are filed.

3. The municipality will be notified by the Department of Employment Security if a former employee has filed for unemployment compensation. Answer requests for separation notices promptly. If the employee voluntarily quits or was discharged for misconduct, the Department mails a Notice of Claim Filed and Request for Separation Information to the employer. This form gives the municipality an opportunity to request a predetermination hearing or to submit written information within seven days. Failure to respond to this notice might result in an unnecessary charge.

4. Appeal any determinations of eligibility you do not feel are correct. You will receive a notice of determination. To appeal, the notice must be returned within fifteen days of the date it was mailed.

5. File all reports when due. Failure to do so results in penalties of $10.00 per month up to a maximum of $50.00. Pay benefit charges on time to avoid interest charges. Interest on late payments is 1.5% per thirty day period.

6. Notify the local claims office when the municipality has suitable work for former employees.

7. Reduce employee turnover as much as possible. For example, work hours could be reduced for all employees to cut costs rather than laying off a few. Also, reduce part-time or temporary work as much as possible.

8. Screen applicants before hiring to ensure they can do the job and will be permanent employees.

9. Rehire laid-off employees who are receiving benefits whenever possible.

10. Use "New Hire" cards. The "New Hire" program was instituted by the Department to curb overpayments. The cards notify the Department that a particular person has been employed and is no longer eligible for unemployment compensation. These cards may be obtained from the local claims office or your employer accounts auditor. A "New Hire" card should be filled out on each new or rehired employee and on each job applicant who refuses a job offer. These cards should be returned to the claims office immediately. The claims office then checks social security numbers against its claimant file to see if unemployment checks need to be stopped.

11. Report any cases of fraud to the Employment Security Help Line number. Calls may be anonymous and all tips are investigated by the Department. The toll-free help line number is 1-800-344-8337.

12. If you need help, call an employer accounts auditor. An employer accounts auditor will come to your office to assist you with your reports and to answer your questions.

13. Do not report workers who are students involved in a co-op program. Employers do not report wages earned by a student who is enrolled at a nonprofit or public educational institution that combines work experience with academic instruction in a full-time program for credit at the institution.

Municipalities should be aware that there are private firms that can help them with unemployment insurance and attendant personnel and management issues. These firms provide such services as investigating questionable unemployment compensation claims, representing the municipality at administrative hearings, and filing protests on erroneous benefit charges. In addition to help with claims administration, these companies can provide consultations and reports, educational activities, and workshops to supervisors and others on the unemployment effects of their activities.

If you have questions about your municipality's employer status for unemployment insurance purposes or questions about changing status, get in touch with *Lee Lankford, Employer Status Unit, Tennessee Department of Employment Security, 313 Cordell Hull Building, Nashville, TN 37219. Phone: (615) 741-2486.*

APPENDIX A

SELECTED PUBLICATIONS

Appendix A
Selected Publications

SELECTED PUBLICATIONS

Following is a list of publications which provide additional information on unemployment insurance.

1. Tennessee Department of Employment Security. *Employer Fact Sheet To Assist In Administering Unemployment Insurance (Reimbursing Employers)*, 7 p.

   This publication explains who may be reimbursing employers and explains the benefit process, how benefits are charged, employer's responsibilities for benefit charges, and actions reimbursing employers can take to help ensure they will not be charged for unnecessary benefits.

2. Tennessee Department of Employment Security. *Handbook for Employers*, 61 p.

   This book provides a simplified explanation of the premium and benefit provisions of the Tennessee Employment Security Law. It also contains a list of forms of interest to Tennessee employers, a list of useful telephone numbers, employer accounts offices, claims offices, and job service offices.

3. Tennessee Department of Employment Security. *Tennessee Employment Security Law With Regulations*, 138 p.

   This book contains a verbatim printing of the Tennessee Employment Security Law, along with regulations and an index.

4. Vaughn, J. L. "Unemployment pay --- choose options wisely." *Tennessee Town and City*, May 1981.

   This article explains some of the things that must be taken into account in choosing between the reimbursing and premium paying options for unemployment insurance.

APPENDIX B

SAMPLE FORMS

Appendix B
Sample Forms

SAMPLE RESOLUTION

RESOLUTION NO.

A RESOLUTION directing the Mayor to write the Tennessee Department of Employment Security relative to the municipality's employer status for unemployment compensation purposes.

BE IT RESOLVED by the ______(governing body)______ of the TOWN (or CITY) of ___(name of town or city)______ that the Mayor is directed to write the Tennessee Department of Employment Security to request that the municipality's employer status for unemployment compensation purposes be changed from that of ___(premium paying or reimbursing)___ to that of ___(premium paying or reimbursing).

ADOPTED this ____________ day of ____________, 19____.

____
Mayor

____
Recorder or Clerk

SAMPLE LETTER

Tennessee Department of Employment Security
Room 313, Cordell Hull Building
Nashville, TN 37219

Re: TOWN (or CITY) of __(name of town or city)__ Account No. ____________

Ladies and Gentlemen:

As Mayor of the TOWN (or CITY) of (name of town or city) I request that the municipality's employer status for unemployment compensation purposes be changed from that of a (premium paying or reimbursing) to that of a (premium paying or reimbursing) employer.

Your kind attention to this matter will be greatly appreciated.

Very truly yours,

____
Mayor