

# Handling Unemployment Claims the Legal Way

Under the Federal Unemployment Tax Act (FUTA) and state laws, employers are obligated to pay payroll taxes to provide unemployment compensation to employees who lose their jobs.

FUTA sets the federal tax rate, while the state tax rate varies by state. By understanding how the system works, you may be able to cut your state tax rate through efficient claims control.

The joint federal/state program on unemployment insurance (UI) originated in the Social Security Act of 1935. The system is financed almost exclusively by a payroll tax on employers. No taxes are withheld from employees' paychecks.

Workers are eligible to receive unemployment benefits if they have become unemployed through no fault of their own and meet any other requirements of state law. While drawing unemployment, workers must make themselves available for work and must actively seek a job. In most states, 26 weeks is the maximum payment period for an unemployed worker. Extended benefits, funded on a shared basis with the federal government, are available during periods of high unemployment.

## Federal tax set by law

Under FUTA, you must pay federal unemployment insurance taxes in these circumstances:

- You employ one or more individuals for some portion of a day during any 20 weeks in the current or preceding year or you paid wages of \$1,500 or more in any calendar quarter.
- For household employees, you're subject to FUTA tax only if you paid total cash wages of \$1,000 or more (for all household employees) in any calendar quarter in the current or preceding year.
- For farm workers, you must pay FUTA tax if you paid cash wages of \$20,000 or more during any calendar quarter or you employed 10 or more farm workers for at least some part of a day during any 20 weeks in the current or preceding year.

The FUTA tax rate is 6.2 percent, which applies to the first \$7,000 paid to each employee in wages during a calendar year. However, you may receive a credit of up to 5.4 percent of taxable wages against your FUTA tax rate if you pay your state unemployment tax on a timely basis. Therefore, if you consistently pay your state tax on time, your net federal tax rate would be .8 percent. This would then cost you \$56 per employee per year in federal tax (.008 x \$7,000).

## How states determine your taxable wage base

Employers pay UI tax based on wages paid to each employee. Each state sets a taxable wage base. For example, Maryland's base is \$8,500. New Jersey's base is \$27,700. State legislatures periodically change these figures.

Taxable wages may include other types of remuneration. For example, tips and employer-paid off-premises meals and lodging are taxable, while discounts on goods and other privileges are not.

## Setting your tax rate

For new employers, a new account rate is set, based on the average of the rates for all employers in the state. For example, Virginia's new-employer rate is currently 2.5 percent; Florida's is 2.7 percent.

An experience rate is set after you have paid employees for a specified period: for example, two fiscal years in Maryland, 10 quarters in Florida. The state may add a percentage to the rate to ensure solvency of the UI fund. Frequent charges to your account result in a high UI tax rate in proportion to reported taxable wages. A low rate reflects fewer claims charged against your account.

For example, in New Jersey the experience rates range from 0.8125 percent to 5.4 percent on the first \$27,700 earned by each employee. Virginia's minimum is 0.10 percent and its maximum is 6.2 percent, on a wage base of \$8,000.

## Charges against your account

Generally, the state will first determine: (1) the employee's wages during a base period, (2) the employee's reasons for leaving the company and (3) the percentage of employer liability:

**1. Determining the base period:** State laws vary. For example, Maryland defines base period as the first four of the last five completed calendar quarters prior to the filing of the claim. California omits the most recent four-to-six-month period before a claim is filed and looks back 16 to 18 months to determine the quarter in which the highest wages were paid.

**2. Reasons for leaving employment:** Your account won't be charged if your employee:

- Quit voluntarily without good cause.
- Quit voluntarily for a better job.
- Quit voluntarily to attend approved training.
- Was fired for gross misconduct.

Workers may be disqualified, permanently or temporarily, if they refuse suitable work or are unemployed because of a labor dispute. State law may set other disqualifying reasons.

**3. Percentage of liability:** You are 100 percent liable if you are the worker's only employer. Charges are prorated if the worker had more than one employer.

## Reporting requirements

Employers are required to deposit FUTA taxes quarterly and file reports of wages paid. Data for each employee must include name, Social Security number, gross wages paid during the quarter and the number of base weeks earned by the employee during the quarter.

If your FUTA tax liability for any calendar quarter exceeds \$100, you must deposit the tax by electronic funds transfer or in an authorized financial institution using Form 8109 (Federal Tax Deposit Coupon). You report federal unemployment tax on Form 940 (Employer's Annual Federal Unemployment Tax Return) or, if you qualify, on Form 940-EZ.

*Note:* You can be assessed penalties for late filing or failure to file. Filing is compulsory even if you had no employees during a quarter.

For household employees, you're not required to deposit FUTA taxes unless you report their wages on Form 941 or 943. If you don't use these forms, you report the tax for these employees on Schedule H (Form 1040), Household Employment Taxes.

## Lower Your Unemployment Taxes

Here are some tips to help lower your unemployment tax rate:

- **Use work-sharing programs.** A state work-sharing program may make it cheaper to keep employees on at reduced hours than to lay them off. For example, Florida prorates unemployment benefits for employees whose hours and pay have been reduced to avoid total layoff.
- **Document unsatisfactory work performance.** If you contest an unemployment claim, you need proof of the employee's unsatisfactory work or misconduct.
- **Keep accurate, complete records.** You may protest the awarding of benefits, your share of liability or your tax rate. You must have specific facts and documentation to support your case.
- **Verify each statement of benefits charged to your account.** Promptly answer requests for information to avoid unnecessary benefit charges. Follow up to make sure that corrections are made and penalties are not assessed.
- **Appeal claims decisions promptly.**
- **Don't turn a voluntary termination into a constructive discharge.** If you do, the worker will then qualify for unemployment benefits.
- **Expand slowly.** When you expand into a new state, start with a small, stable staff. Don't add to the payroll until you've established a low claims rate. That will reduce the tax rate when you send in the rest of the staff.
- **File jointly.** Your company and its affiliates or subsidiaries probably have different employee turnover rates. If you calculate your liability collectively, you might end up with a net savings.
- **Pay extra tax.** Make voluntary contributions to your reserve account. How this pays off: Generally, your company's unemployment tax rate depends on the status of your reserve balance. That's the amount of tax you pay less unemployment claims. A voluntary contribution to boost your reserve balance could result in a lower tax rate—and the savings might exceed the amount of the extra contribution.
- **Segregate seasonal workers.** Organize a separate corporation to employ seasonal workers. That way, your seasonal unemployment tax rate won't be applied to your regular staff.

## Challenging an Unemployment Claim

As the employer, you will receive notice when a former employee is determined to be eligible for benefits. You then have the right to appeal the decision. You typically have a very tight deadline to file the appeal, so watch for eligibility determinations in the mail and respond to them immediately.

Employers should carefully consider whether they want to contest an unemployment claim and, ideally, consult an employment law expert about the best course of action. This is true especially if you suspect the employee might file a discrimination lawsuit against your company. What you say about your organization's actions can come back to haunt you, especially if the former employee's attorney is using the relatively low-stakes unemployment setting to fish for information for a later lawsuit against you. What you say about why an employee was fired may bind you in a later, high-stakes lawsuit.

For example, if you testify that you fired an employee because of her frequent absences, the records you produce about it can be used later to show you violated the Family and Medical Leave Act (FMLA) when you counted a sick-child call-off as an unexcused absence.

That's why it's best to run your expected testimony and documentary evidence by an attorney before you

represent your employer in a hearing. You don't want to say something now that will be used against you later, or be silent about something now that will prevent you from putting on evidence later.

Sometimes, it may be best to have an attorney handle the entire UI case. Other times, if you and your attorney think there's a good chance that the former employee will file a state or federal discrimination lawsuit, it may be better to forgo a hearing to avoid showing your cards too early. Not contesting an unemployment claim won't prevent you later from showing you fired the employee for a legitimate reason.