



Unemployment Tax Alternatives for 501(c)(3)s

The following discussion is provided for informational purposes only and is not intended to serve as legal or tax advice. For specific information about unemployment taxes for 501(c)(3) organizations, consult an attorney or tax advisor.

In 1972, the Federal Unemployment Tax Act was changed to allow 501(c)(3) organizations to choose between paying into the state unemployment insurance fund or essentially becoming self-insured and reimbursing the state unemployment fund for those unemployment benefits actually paid on behalf of the organization.

The law requires that State unemployment laws allow an organization exempt under Section 501(c)(3) to elect whether: (a) to contribute to the State program in accordance with State law or (b) to pay into the 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 501(c)(3) organization.

Here is what the NH Department of Employment Security's Employer Handbook has to say:

“Most nonprofit organizations, even if exempt from FUTA taxes under the Internal Revenue Code, are subject to the New Hampshire law if they have one or more employees. These organizations have the option of reimbursing the trust fund for benefits paid to their former employees or of paying quarterly taxes on wages. Non-profit organizations may change from one option to the other by making written application to the Commissioner before January 1 of the applicable year. Once an employer changes its election, it must remain with that status for an irrevocable three (3) calendar year period. Reimbursing employers must also file an Employer Quarterly Tax and Wage Report in a timely fashion each quarter.”

The advantages of paying unemployment taxes include: a tax-paying employer knows the tax rate for the coming year and can project the annual cost based on their taxable payroll. If your claims are more than the unemployment taxes you pay, the state unemployment department will still cover the claims (you can expect a tax increase in future years). During the past five years of unusually high unemployment, paying state taxes has provided good security for agencies that experienced staffing cuts.

The disadvantage of paying unemployment taxes include: the cost; under current NH Law the annual taxable wage base is \$14,000 per employee. Because of the great recession, NH Unemployment tax rates remain much higher than they were before the recession. This means a



nonprofit is probably paying much more in taxes than the state is paying for its claims. Nationally, nonprofits typically pay \$2.20 in taxes for every \$1 in claims.

The disadvantage of becoming a reimbursing employer is that the organization becomes responsible for all the unemployment claims paid to their former employees by the state, no matter the amount. A reimbursing employer can only anticipate liability for claims. Your organization could find itself facing an unexpectedly large tax bill. Also, reimbursing employers (as with taxpaying employers) do not get "relief of charges." Thus, if an employee resigned from your organization, went to work for another company, was terminated, and filed for unemployment, your nonprofit could be charged for a portion of that employee's benefits (even though the employee voluntarily left you).

The reimbursement option works best for organizations that have stable employment and relatively low unemployment claims based on the size of the organization. Nonprofits with fewer than 10 employees or organizations, which have regular layoffs, may not be the best candidates for reimbursing status. Nonprofits with an annual gross payroll of \$500,000 or more, can conceivably realize substantial savings over a period of years.

Many nonprofits belong to different grantor trusts throughout the country. These trusts have additional features an organization may not be able to get on its own. They help the nonprofit file the paperwork with its state to become a reimbursing employer, and they handle the reimbursement payments to the state. Other features vary by trusts, but may include member-owned reserve accounts, stop-loss insurance (which protects the members' account from unusually high claims), and claims management services. You can search the Web for grantor trusts that provide unemployment programs for nonprofit organizations.

The bottom line on unemployment coverage is to investigate your opportunities. For many larger employers becoming a reimbursing employer will likely be much less costly than paying taxes in the long run.