U. S. Department of Labor Employment and Training Administration Washington, D.C. 20210	CLASSIFICATION UI/FUTA
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DIRECTIVE : UNEMPLOYMENT INSURANCE PROGRAM LETTER NO. 44-93

TO: : ALL STATE EMPLOYMENT SECURITY AGENCIES

FROM : BARBARA ANN FARMER
Administrator
for Regional Management

SUBJECT : Sections 3304(a)(6)(B) and 3309(a)(2) of the Federal Unemployment Tax Act Relating to Liabilities of Reimbursing Employers

1. Purpose. To advise States of the Department of Labor's position regarding State options concerning (1) establishing collective liability for reimbursing employers and (2) preventing loss of interest and recovering interest lost to State unemployment funds due to the reimbursement method.

2. References. Sections 3304(a)(6)(B) and 3309(a)(2) of the Federal Unemployment Tax Act (FUTA); Unemployment Insurance Program Letter (UIPL) No. 21-80 dated February 29, 1980; UIPL No. 14-86 dated February 6, 1986; and the Draft Legislation to Implement the Employment Security Amendments of 1970 . . . H.R. 14705 ("1970 Draft Legislation").

3. Background. Section 3304(a)(6)(B), FUTA, requires that nonprofit organizations described in Section 501(c)(3) of the Internal Revenue Code and all State and local governmental entities must be liable for contributions under State law. However, this section also provides that these entities must be given, under State law, the option of electing to make payments in lieu of contributions (i.e., reimbursements) as the method of financing their liability for unemployment compensation (UC) costs, on the basis set forth in Section 3309(a)(2), FUTA. Section 3309(a)(2), FUTA, provides that:

> (2) the State law shall provide that a governmental entity or any other organization (or group of governmental entities or other organizations) which, but for the requirements of this paragraph, would be liable for contributions with respect to service to which paragraph (1) applies may elect, for such minimum period and at such

RESCISSIONS None	EXPIRATION DATE September 30, 1994

> time as may be provided by State law, to pay (in lieu of such contributions) into the State unemployment fund amounts equal to the amounts of compensation attributable under the State law to such service. The State law may provide safeguards to ensure that governmental entities or other organizations so electing will make the payments required under such elections.

Initially, the Department of Labor took the position that Section 3309(a)(2) required reimbursing employers to reimburse all UC costs based on services performed for these employers. This position was modified by the Secretary of Labor in a 1979 conformity proceeding involving the States of Delaware, New Jersey and New York. Specifically, the Secretary found that whether the UC paid out is attributable to service in the employ of a reimbursing employer (and, therefore, whether the UC costs must be reimbursed by that employer) is to be determined under provisions of State UC laws which reasonably interpret and implement Section 3309(a)(2), FUTA.

UIPL No. 21-80, dated February 29, 1980, transmitted this decision of the Secretary to the States and provided guidance on the application of the decision. One of the effects of the Secretary's decision was that there was now the possibility of large amounts of unrecovered UC costs when costs were not attributed to a particular reimbursing employer. As a result, UIPL No. 21-80 discussed the establishment of "collective liability" for reimbursing employers. UIPL No. 21-80, in relevant part, provided that the States should be aware of:

> a. [their] responsibility for assuring that reimbursing employers pay a fair share of their benefit costs. As a means of doing so, the States may wish to adopt a principle whereby benefits are attributed to service in the employ of reimbursing employers collectively when, under specified conditions, they are not attributable to service in the employ of a particular reimbursing employer. The collective liability may be discharged by requiring (or allowing, if optional) reimbursing employers to pay, at specified times and at specified rates, amounts attributed collectively. If the allocation of individual amounts due to discharge a collective liability should place upon a reimbursing employer a larger obligation that [sic] it would have had as a contributing employer, such an obligation is not inconsistent with the reimbursement option. That is a risk inherent in election of such an option.

In recent years, the Department has learned that not all States are aware of the option of establishing collective liability. As a result, State unemployment funds are sometimes incurring substantial losses.

This UIPL expands on the guidance provided in UIPL 21-80 concerning the establishment of collective liability. It also addresses the prevention of loss of interest and recovering interest lost due to the reimbursement method.

4. Liability for Unrecovered UC Costs.

a. Establishment of Collective Liability. As noted above, UIPL 21-80 gave States the option of establishing "collective liability" in order to assure that reimbursing employers pay a fair share of unrecovered UC costs. This principle was based on Section 3309(a)(2), FUTA. The words "compensation attributable" as used in Section 3309(a)(2), FUTA, permit States to include the employer's share of all UC costs not recovered through reimbursements, as well as those benefits specifically attributable to service for that employer. Although nothing in Federal law prohibits contributory employers from subsidizing reimbursing employers, this broad reading of Section 3309(a)(2), FUTA, permits States to take steps to minimize such subsidizing, thereby preventing a drain on State unemployment funds. This would be accomplished by permitting States to require that all reimbursing employers bear their fair share of the costs of UC. See UIPL No. 21-80.

Collective liability may be discharged by requiring reimbursing employers to pay, at specified times and at specified rates, amounts attributed collectively through establishment of a separate payment. As noted in UIPL No. 21-80, if the allocation of individual amounts due to discharge a collective liability places a larger obligation upon a reimbursing employer than it would have had as a contributing employer, this obligation is a risk inherent in electing the reimbursement option.

Any payments established to discharge the collective liability required of reimbursing employers must not exceed the actual amount of collective liability for such employers. Collective liability may be up to one hundred percent of unreimbursed UC costs, but reimbursing employers may not be singled out and required to pay more than one hundred percent of UC costs as this would discourage employers from electing the reimbursing option. Such action would be contrary to Section 3309(a)(2), FUTA.

b. Payments From Contributing and Reimbursing Employers. Collective liability may also be discharged through socializing

unrecovered UC costs among all employers, without regard to whether the employer was a contributing or reimbursing employer. Since, in this case, a uniform rate would be applied to both contributing and reimbursing employers, reimbursing employers would not be singled out and there would be no conflict with Section 3309(a), FUTA, when:

(1) provisions of State law relating to charging of reimbursing employers are either the same as they are for contributing employer or serve to decrease the liability of reimbursing employers when compared to contributing employers; and

(2) unrecovered UC costs, as a percentage of total UC costs, are not greater for contributing than reimbursing employers.

If either of these two conditions is not met, reimbursing employers would improperly subsidize the contributing employer's unrecovered UC costs. In the event a State chooses this uniform payment method, the Department will require the State to demonstrate that the above two conditions are met.

c. Distinctions between Reimbursing Employers. Just as contributing employers need not subsidize reimbursing employers, reimbursing employers with only small amounts of unrecovered UC costs need not subsidize reimbursing employers with large amounts of unrecovered costs. Therefore, States may distinguish among groups of reimbursing employers on this basis. To be acceptable, any distinction must be based upon differences relating only to unrecovered UC costs, so that each employer bears its fair share of unrecovered UC costs. For example, a State may assign one payment rate for "high risk" employers based on the total of such employers' unrecovered UC costs and another payment rate to "low risk" reimbursing employers based on the total of their unrecovered UC costs. Left to the State are the number of payment rates based on "risk" categories.

5. Lost Interest. Reimbursing employers retain the use of moneys between the time the State pays UC from its unemployment fund and the employer reimburses the fund. During this time, the unemployment fund loses interest it would otherwise have earned. Although Section 3309(a)(2), FUTA, is silent on the matter of interest loss, sound cash management principles dictate that the solvency of the State unemployment fund be protected. States may, therefore, prevent this loss to the unemployment fund by requiring either advance payments or additional payments.

a. Advance Payments. Section 3309(a)(2), FUTA, has been interpreted to permit a State to require a reimbursing employer to make advance payments of potential reimbursing liability for immediate deposit into the State's unemployment fund, based on the estimated amount of UC likely to be attributed to the employer for an upcoming period. In addition, the last sentence of Section 3309(a)(2), FUTA, provides that "[t]he State law may provide safeguards to ensure that governmental entities or other organizations so electing will make the payments required under such elections." Requiring payments in advance is just such a safeguard. The 1970 Draft Legislation, pages 76-79 and 98-99 provided for the making of optional advance payments.

Under this option, reimbursing employers may be required to make advance payments at the beginning of a period (for example, a calendar quarter or a calendar year) based upon estimated UC costs that will likely be attributable to that employer during that period. At the end of the period, the advance payment is reconciled with actual UC payments determined to be attributable to the employer for purposes of determining if the advance payment is too great or too small, and adjustments (e.g., credits toward future advance payments, refunds, or additional payments received in order to obtain full reimbursement) are then made as appropriate. A somewhat similar scheme, with a requirement for an annual accounting and for authorization to collect unpaid balances and dispose of excessive payments, is described in detail in the 1970 Draft Legislation, pages 76-79.

b. Additional Payments For Lost Interest. Alternatively, States may require reimbursing employers to make additional payments to the unemployment fund to cover any interest lost.

Under this approach, States assess interest for the period from the date a UC payment is made to the date the employer reimburses the unemployment fund for that payment. A State may determine this liability separately for each employer or for reimbursing employers as a whole. In the latter case, an identical payment rate would be assessed each employer and applied to the amount of reimbursements made by such employer. The State will need to determine the period between the time UC is paid and reimbursement is received. States may use the actual time lag or a reasonable estimate of the time lag. For example, when liability is determined for reimbursing employers as a whole, the State may estimate the average time lag based on a sample of reimbursing employers. Under this approach, employers who reimburse promptly will subsidize those who are delinquent. To avoid this, a State may assign different payment rates based on the time lag, or a reasonable estimate of the time lag, which applies to prompt or

delinquent employers. For example, employers who pay promptly may be assigned one payment rate while delinquent employers may be assigned a higher payment rate.

Reimbursing employers may not be assessed an additional cost not related to the reimbursement option as this would discourage election of the reimbursement option in conflict with Section 3309(a)(2), FUTA. Concerning additional interest payments, this means that, ideally, a State would not assess a payment rate which produces more revenue than the interest rate that would have been applicable had the moneys remained in the State unemployment fund. However, because the interest rate for the Unemployment Trust Fund (UTF) is not available until after the end of the quarter to which the rate pertains, this is impossible. A State may instead use the average rate of earnings in the UTF for the prior calendar year, for the last quarter of the prior calendar year, or for a more recent quarter.

6. Sharable Benefits. When a State's unemployment fund is reimbursed for UC costs by the Federal government, as in the case of sharable benefits under the Federal-State Extended Unemployment Compensation Act of 1970, as amended, a reimbursing employer may be relieved of liability to the extent that the unemployment fund is reimbursed by the Federal Government. Refer to 20 CFR 615.10(b) and also to UIPL 14-86, page 9.

7. Action Required. Administrators are requested to provide the above information to appropriate staff.

8. Inquiries. Direct inquiries to the appropriate Regional Office.