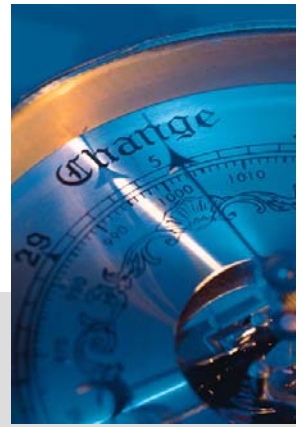


SERVICE BULLETIN



Why Contest an Unemployment Claim?

TO: Our National Clients
FROM: Kris Thorngren
RE: Why Contest an Unemployment Claim?
DATE: May 28, 2008

It can be difficult to clearly see the impact that an unemployment claim may have on a company's unemployment tax payments. A reasonable person might struggle to identify any correlation between unemployment benefit charges and tax increases or decreases. Other factors may impact on your tax rate in the near term, masking the effect of benefit charges. I have occasionally observed a tax rate actually decrease in the calendar year following an increase in benefit charges. Why invest time and effort into monitoring and contesting unwarranted claims? Even if one accepts the premise that unemployment claims can have a negative influence on tax rates, does one chargeable claim here and there really matter?

It does indeed matter, and more than you might realize. When your unemployment tax account is charged for a claim, the actual tax consequences will likely be greater than the amount of benefit charges, for the reasons explained below. In general, you can expect to pay future taxes in the range of thirty per cent (30%) **more** than the benefit charges resulting from an approved unemployment claim (assuming that your company stays in business so that taxes can be collected from you).

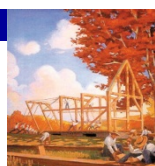
The rapidity with which a state unemployment agency reacts to increase your tax rate in response to benefit payments depends on the state experience-rating formula. The recoupment of costs from you, via higher taxes, will generally occur within three or four years in benefit-ratio states such as Texas, Florida, and Illinois, and more slowly in reserve-ratio states such as New York, California, or Ohio. This cause-and-effect delay can make it difficult to see the connection.

There are four reasons why your tax payments must significantly exceed your benefit charges. First, employer tax payments must necessarily be greater than the amount of benefit payouts just so the state unemployment trust funds can remain solvent throughout economic cycles. Ideally, each trust fund should maintain a balance sufficient to absorb the cost of increased payouts when the rate of unemployment increases. Occasionally a state trust fund is forced to borrow federal funds, or find another source of funding, such as the bond market, to keep disbursing benefit payments. Of course there are costs associated with having to borrow, and it is preferable to avoid having to do so. The U.S. Department of Labor has assisted the states by developing a model to determine an appropriate level of solvency, given the state's prior experience.


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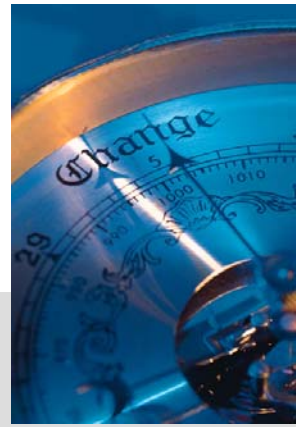
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To maintain a target level of solvency, the state unemployment laws contain mechanisms to increase tax revenue from employers in response to high benefit payouts, either through higher tax rate tables or higher adjustment factors. The more solvent a state's trust fund is, the more taxes have been collected from you relative to benefit payouts. At the end of 2007, the state trust funds contained over \$38 billion. In other words, employers have paid into the system, through all the economic cycles since 1935, \$38 billion more than claimants have drawn out.

The remaining three reasons for the "premium" you pay over benefit charges all relate to the fact that some unemployment claims are not charged or are ineffectively charged to employer accounts, yet they must be funded. Your tax payments must recover these "pooled costs" as well as the costs of benefits charged directly to your account and the cost of maintaining a cushion in the state trust fund.

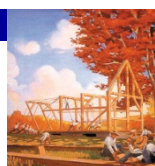
The first pooled cost relates to benefits that are paid but are not charged directly to any specific employer's account. For calendar year 2007, 13.99% of all unemployment benefits were "noncharged." Every state law except Alaska's law contains provisions for relieving an employer's account from charges under certain circumstances. (Alaska's experience-rating system does not involve benefit charges). Commonly, an employer's account may be relieved from charges when a claimant terminates under disqualifying circumstances, such as a voluntary quit for personal reasons, but then removes the disqualification after working for another employer. Additionally, erroneous and/or fraudulent benefit payments are usually noncharged.

Another pooled cost is referred to as "ineffectively charged" benefits. Some employers are assigned the maximum possible tax rate in their state, but still pay less taxes than their employees receive in unemployment benefits. These are usually employers in seasonal businesses, declining industries, or project-oriented businesses such as construction companies. To the extent that the benefits paid exceed the tax payments made by such companies, the benefits are ineffectively charged. These benefits totaled 14.65% of all benefit payments in 2007.

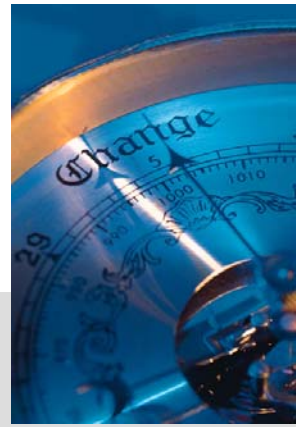
The third category of pooled costs consists of benefits paid to former employees of companies which have gone out of business. Such companies will pay no more unemployment taxes because they have no further payroll, but the benefit payments can linger on for several quarters. Benefits charged to inactive employer accounts amounted to 0.74% of total benefits.



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In sum, the noncharged, ineffectively charged, and inactive benefits totaled over \$11 billion in 2007, or 29.38% of total benefits paid in 2007. These outflows do not usually impact your tax rate calculation directly, but they must be accounted for in the tax scheme. Adding in the consideration for trust fund solvency, this tells us that your tax payments will be about 30% higher than benefit charges over time.

Each state law is different, so the impact of pooled costs is less in some states and greater in others. For example, the pooled costs amounted to 9.63% of benefit payments in Illinois and 59.36% in Vermont, according to information provided to us by the U.S. Department of Labor.

In a few states, some or all of the pooled costs are recognized as a separate component of your tax rate. In a few cases they are assessed even if you incur no benefit charges. However, the vast majority of pooled costs are linked to your experience, in terms of increasing your benefit ratio or decreasing your reserve ratio. To the extent of this linkage, the pooled costs increase the impact of each and every claim that is actually charged directly to your account.

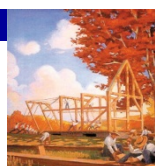
The basic premise of the experience-rating system in the United States is that those employers who cause the greatest use of the unemployment system should pay the most tax. Except in Alaska, benefit charges (or a derivative called benefit wage charges in Oklahoma and Delaware) are a key component in your tax rate calculation. The discussion about pooled costs should not cause us to lose sight of the fact that the state unemployment agencies will recover from you the costs of benefits paid to your former workers who are separated for non-disqualifying reasons resulting in direct charges to your account. The direct charges have a much greater impact than the pooled costs, as they represent approximately 70% of all benefits paid. Your own company's experience, however it is measured, generally has a far more significant effect on your tax rate than the pooled costs.

I will concede that some employer accounts are assigned the lowest possible tax rate in their state, and their experience may be so favorable that it is unlikely that an unemployment claim will ever cause their tax rate to increase. Similarly, some employer accounts are assigned the highest possible tax rate in their state, and their experience is so unfavorable that a positive outcome on an unemployment claim may never cause their tax rate to decrease.


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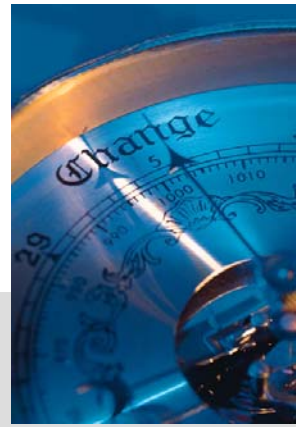
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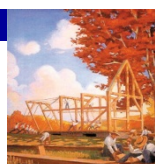
Finally, I will note that some companies are sold in situations where there is no transfer of unemployment experience, so that the past history of benefit charges does not carry forward to the new employer, resulting in recent claims having no impact on a tax rate.

For the rest of us, there is no free lunch. When your tax account is charged for an unemployment claim, the impact on your taxes will occur, each and every time, as long as your company is experience-rated. The timing of the transformation and magnification of a claim into a tax payment cannot be predetermined because other factors affect your experience-rating calculation, such as changes in your company's taxable payroll and tax payments. The cost will absolutely be incurred, even though it may be hidden by changes in tax rate tables and state adjustment factors. When you successfully contest an unwarranted claim, you will reduce your future tax payments, and the tax savings will likely exceed the benefit charges which you avoided.



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