

## Beware hazards when calculating N.C. unemployment insurance tax

The North Carolina unemployment insurance tax is a payroll tax paid by employers and used to fund unemployment benefits for qualified unemployed workers. Employers pay a quarterly tax based on a percentage of their payroll.

The Employment Security Commission (ESC) annually sends a letter to notify employers of their official tax rates. Depending on an employer's experience rating (i.e., its claims history), the official tax rate can vary from 0% of payroll to as high as 6.84%. Most newly liable or startup employers are assigned the standard beginning tax rate of 1.2%.

Problems can arise when an employer is not truly a "startup" or when two employers combine by merger or other acquisition forms. Over the past few years, this has become particularly true in light of significant amendments to the unemployment insurance tax laws. Companies that incorrectly handle their unemployment insurance tax obligations can quickly accrue large tax liabilities, interest charges and statutory penalties.

Historically, the ESC assigned every new employer a discrete unemployment insurance tax account. When companies merged, the account of the nonsurviving entity was transferred to the surviving entity only upon consent of the parties to the acquisition. In 1988, the Legislature amended the law to mandate transfer of the nonsurviving entity's account when the surviving entity was acquiring substantially all of the nonsurviving entity. When only a discrete portion or division of a company was being acquired, the transfer remained optional.

### Restructuring for better rate

In February 2003, the ESC issued a tax alert to all employers about an improper practice being used by some employers. The practice was dubbed State Unemployment Tax Avoidance (SUTA). Essentially, some employers, to avoid high unemployment insurance

tax rates, would create new business entities (with 1.2% tax rates) and transfer their employees (or even discrete portions or divisions of their businesses) to the new entities. This of course burdened all other employers that did not engage in this practice with higher tax rates.

The ESC took the position that such deliberate tax avoidance amounted to a misrepresentation of the purpose of the new entity when the employer filed its quarterly tax returns. This conduct was classified as a Class 1 misdemeanor by statute.

As a result of SUTA practices, the North Carolina General Assembly made several amendments to the unemployment insurance tax laws. In May 2003, it added the following provision:

"A new employing unit shall not be assigned a discrete employer number when there is an acquisition or change in the form or organization of an existing business enterprise, or severable portion thereof, and there is a continuity of control of the business enterprise. That new employing unit shall continue to be the same employer for the purposes of this Chapter as before the acquisition or change in form."

The amendment further provides that a "continuity of control" will exist "if one or more persons, entities or other organizations remain in control of the business enterprise after an acquisition or change in form." Control may occur by means of ownership of the organization, ownership of assets necessary to the business, lease arrangements, contracts and other arrangements.

Thus, an employer or the owner of an employer can no longer create a new entity with a lower tax rate, even if the entity is for a wholly new purpose. Practically all related entities, as long as they are all North Carolina employers, are now treated as the same entity for purposes of assignment of a tax rate.

For those familiar with the specific

and strict elements of proof typically necessary to treat related companies as functional alter egos, this may seem odd.

However, it appears that the General Assembly intended for this much-easier means of combining companies when addressing unemployment insurance tax liability.

### More legislative action

In 2005, the Legislature again amended the unemployment insurance tax laws: "On or after January 1, 2006, whenever part of an organization, trade, or business is transferred between entities subject to substantially common ownership, management, or control, the tax account shall be transferred...."

This amendment created an exception to the historical rule that a partial merger or acquisition results in an optional transfer of accounts. When the transacting entities are related, the "optional" transfer becomes mandatory. The portion of the account that is transferred is determined from the percentage of payroll, if any, that is actually transferred.

Employers must report changes in the form of an organization on the ESC's "Change in Status Report, NCUI 101-A-1." The details of mergers and partial acquisitions should be reported on the "Employer Status Report, NCUI 604."

### Applying for UI tax today

Today, a startup company in North Carolina should apply for its own unemployment insurance tax account only when it has no related companies employing personnel in the state.

Existing related companies that still maintain separate tax accounts should take careful stock to make sure they were in compliance when corporate changes and the various amendments to the law were made.

Partial acquisitions, too, bear careful scrutiny, particularly where there is some common control between the involved entities.