UNEMPLOYMENT COMPENSATION

BACKGROUND

The nation's unemployment compensation (UC) system is a federal-state partnership. Federal law sets the framework. The federal tax law, the Federal Unemployment Tax Act (FUTA) is used to collect taxes to fund the federal and states' administrative costs, half of "regular*"extended benefits (EB), and to fund a loan program for the states, if they do not collect enough revenues to cover the costs of the benefits they provide in their states.

Each state designs its own UC program within the framework of the federal requirements. The state statute sets forth the benefit structure (e.g., eligibility/disqualification provisions, benefit amount) and the state tax structure (e.g., state taxable wage base and tax rates).

Most states currently pay a maximum of 26 weeks. In periods of very high and rising unemployment in individual states, benefits are payable for up to 13 additional weeks (20 in some cases), up to a maximum of 39 weeks (or 46), these are the "regular" EBs.

States assess their own payroll taxes on employers to fund regular UC benefits and the state share (half) of the "regular*" EB program. These state UC tax rates are "experience-rated," in which employers generating the fewest claimants have the lowest rates. The state unemployment tax rate on an employer is, in most states, based on the amount of UC paid to former employees. Generally, in most states, the more UC benefits paid to its former employees, the higher the tax rate of the employer, up to a maximum established by state law.

The states have to have a minimum wage base of at least equal to the FUTA wage base. (This ties into some proposed relief for the states, described below.) Forty-six states have adopted for the collection of their unemployment funds, a higher taxable wage base than the $7,000 now provided in FUTA for federal tax purposes. For 2010, Washington's taxable wage base was the highest at $36,800. As to state rates, for the latest year available (2009), the preliminary estimated U.S. average tax rate was 0.6 percent of total wages, ranging from a high of 1.3 percent in Rhode Island (taxable wage base of $18,000) to a low of 0.08 percent in the Virgin Islands (taxable wage base of $22,100).

The federal FUTA tax rate is 6.2 percent of taxable wages. The taxable wage base is the first $7,000 paid in wages to each employee during a calendar year. Employers who pay the state unemployment tax on a timely basis, receive an offset credit of up to 5.4 percent regardless of the rate of tax they pay the state. Therefore, the net FUTA tax rate is generally 0.8 percent (6.2 percent - 5.4 percent), for a maximum FUTA tax of $56.00 per employee, per year (.008 X $7,000. = $56.00). FUTA is paid on an annual basis and the reporting form is Form 940.

Some employers in certain states will say, "Hey, I am not getting that full federal credit." The credit against the federal tax may be reduced if the state has an outstanding loan from the federal government to cover its unemployment benefit shortfalls, To assure that these loans are repaid, federal law provides that when a state has an outstanding loan balance on January 1 for two consecutive years, the full amount of the loan must be repaid before November 10 of the second

year or the credit available to employers will be reduced until the loan is repaid. (There will be more about these loans below.) The 5.4 percent credit is reduced in successive increments of a minimum 0.3 percent for each year in which a loan or loans remain unpaid (reducing the overall credit from 5.4 to 5.1, to 4.8, to 4.5 percent, etc.). Additional offset credit reductions may apply to a state beginning with the third and fifth taxable years if a loan balance is still outstanding and certain criteria are not met.

For fiscal year 2010, the UC system numbers looked like this:

- Number of workers covered - 127.0 million
- Number of beneficiaries (all programs) - 16.3 million
- Benefits paid (all programs) - $157.1 billion
- Subject employers - 7.6 million
- Administrative costs (total) - $5.9 billion
  (State part of those costs - $4.4 billion)
- Payroll taxes – FUTA - $6.8 billion
- Payroll taxes – State - $44.5 billion

CURRENT SITUATION

So this gets us to the "loans" and the current problems the states are encountering.

States have been dipping into the federal loan fund to cover their unemployment benefits at a rapid rate. The current outstanding balances (expressed in $millions unless otherwise noted) are:

State	Balance
Alabama	$230
Arizona	$266
Arkansas	$330
California	$9.8 billion
Colorado	$500
Connecticut	$651
Delaware	$428
Florida	$2 billion
Georgia	$634
Hawaii	$14
Idaho	$202
Illinois	$2.5 billion
Indiana	$2 billion
Kansas	$100
Kentucky	$858
Massachusetts	$57
Michigan	$3.7 billion
Minnesota	$572
Missouri	$789
Nevada	$676
New Jersey	$1.6 billion
New York	$3.2 billion
North Carolina	$2.5 billion
Ohio	$2.3 billion
Pennsylvania	$3.2 billion
Rhode Island	$229
South Carolina	$933
Vermont	$50
Virgin Islands	$18
Virginia	$398
Wisconsin	$1.4 billion

This adds up to over $42 billion and the U.S. Department of Labor projects this will increase to $65 billion by 2013. For employers, the important fact to remember is that an outstanding loan balance triggers a reduction in the offset credit applied to the FUTA liability for employers in that state.

The states also owe interest on the loans that is not covered by the funds raised by the reduction in the offset credit. There is also a penalty. A state will lose all offset credit (5.4 percent) for any year in which all interest due under law is not paid by the date on which such interest is required to be paid. The state would also lose all grants for costs of administration until interest due has been paid.

Michigan, Indiana and South Carolina have already triggered the employer's reduction in the offset credit applied to FUTA liability. The rest will soon follow if they do not get their loan balances down.

(*The most recent rounds of extensions of unemployment benefits were fully funded by the federal government (or as I prefer to think of it, by all of us as taxpayers.) so they are not the "regular" extended benefits. While the recent extensions might have some impact on the state of the states' unemployment funds, they are probably not major contributors to the states' situation.)

PRESIDENT'S PROPOSAL

In his proposed budget, the President makes a recommendation for helping the states return to unemployment fund solvency. The President's proposal is to increase the FUTA wage base. This would force the states to raise their wage bases. As noted above, most states already have a higher wage base, so it would have to be pushed high enough to make a difference. The proposal is to increase it to $15,000.

The proposal would also decrease the FUTA tax rate. This is where this gets a little hard to follow. What this means is that the FUTA itself would not raise any additional funds for the federal government for its UC purposes. The idea is to force the states to raise more funds more quickly by raising their bases. So it is not a federal tax increase, but a state tax increase.

The President's budget does call for a deferral of interest and penalty payments due on the states' loans owed to the federal government.

OUTLOOK

The President's proposed budget is just that – a proposal. Congress is not required to consider it and rarely does – even when Congress is controlled by the same party as the President.

Some states do like idea of the wage base increase, especially if they get the interest and penalty deferral too. The logic is that while it is an increase in their state tax, they can blame it on the federal government.