
Recessionary Impact on Unemployment Insurance Taxes—2009 and Beyond

By Lori Roberts

Lori Roberts explores the negative effects the recession is having on the ability of states to fund unemployment insurance taxes, including a list of states that are in jeopardy of losing their Federal Unemployment Tax Act (FUTA) credit.



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It is well known that the troubled economy is still impacting workers, as job loss numbers continue to rise, as well as the national unemployment rate—now at 9.5 percent. Much has been published about the American Recovery and Reinvestment Act of 2009 (ARRA) (P.L. 111-5) bolstering the nation's Unemployment Insurance (UI) program. ARRA provides federal and state benefit extensions for the unemployed by providing incentive funding to states that amend their laws so more workers such as part-timers and recent workforce entrants may have access to UI benefits. However, far less understood and discussed is the adverse recessionary impact on UI trust fund solvency and on employers whose taxes fund the UI program. With many state trust funds already operating in the red, the stage is set for historic UI tax increases on businesses.

UI Financing 101

The UI program is financed almost entirely from employer payroll taxes at both a federal and state level. The federal UI tax rate (FUTA) is 6.2 percent of the first \$7,000 of employee wages, or \$434 per employee. However, employers receive a 5.4-percent credit, if they pay state UI taxes (SUI) timely and in full, for a net FUTA tax rate of 0.8 percent, or \$56 per employee.

FUTA taxes collected go into three accounts dedicated to specific purposes. The Employment

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Security Administration Account (ESAA) covers state UI program administration costs; the Extended Unemployment Compensation Account (EUCA) pays the federal share of extended UI benefits; and the Federal Unemployment Account (FUA) provides loans to states whose UI trust funds become insolvent.

SUI taxes collected by each state are deposited in the U.S. Treasury and are used to pay benefits to eligible unemployed workers. The SUI trust fund balance, in many cases, determines a state’s annual tax schedule, which normally contains a range of tax rates. The UI tax rate assigned to each business is generally based on an employer’s “experience”—the amount of UI benefits charged to the employer and the amount of taxes paid in ratio to the employer’s payroll. The experience-rating system is fashioned to keep state trust funds solvent, so if a state’s fund balance is low it will trigger a higher rate schedule and employer tax rates will increase.

The Recession and SUI Trust Funds

Trust fund solvency is analyzed by the U.S. Department of Labor (USDOL) *via* a standard measure known as the Average High Cost Multiple (AHCM). A SUI trust fund with an AHCM of 1.0 or more is considered to be “adequately reserved” by the USDOL. A multiple of 1.0 indicates a state’s trust can support 12 months of UI benefit payments based on the average high cost payout from the last three severe recessions in the state over the past 20 years.

The weak economy is adversely impacting state UI trust funds across the nation. Presently, there are 15 states taking federal loans under Title XII of the Social Security Act due to insolvent UI trust funds.

Title XII of the Social Security Act provides for advances (loans) when a state determines their unemployment fund will not have adequate funding to allow for the payment of unemployment benefits during any three-month period. The Governor of the affected state must apply for an advance no earlier

than the first day of the month proceeding the first month of the three-month period and must supply the Secretary of Labor with an estimate of the amount of advances needed for each month of such three-month period. These advances are made from the Federal Unemployment Account (FUA) in the Unemployment Trust Fund, which was established for such purposes.

The following table details Title XII loan balances:

State	Loan Balance (as of 07/01/2009)
Arkansas	\$70,047,406
California	\$2,030,666,939
Idaho	\$26,972,625
Indiana	\$909,319,303
Kentucky	\$301,900,000
Michigan	\$2,184,200,000
Missouri	\$185,883,102
New Jersey	\$324,850,833
New York	\$1,316,887,391
North Carolina	\$742,845,556
Ohio	\$862,537,799
Pennsylvania	\$527,945,040
Rhode Island	\$70,270,572
South Carolina	\$348,415,177
Wisconsin	\$435,547,245
Total Outstanding Loans	\$10,338,288,988
Remaining FUA Fund	\$5,871,348,861

Seven additional states are potentially at risk of incurring Title XII loans, since their AHCM values are at or below 0.40—Alabama, Florida, Illinois, Minnesota, South Dakota, Tennessee and Texas. It is expected an additional 10-15 states may have to seek federal advances by the end of this year.

The Recession and FUTA

Remembering that employers generally enjoy a 5.4-percent tax credit against their FUTA tax rate of 6.2 percent, for a net rate of 0.8 percent, federal Title

XII loans represent a substantial risk to this employer tax credit.

States are required to repay Title XII loans within two years. If loan balances are outstanding after this period, employers in the affected state lose 0.3 percent of the 5.4-percent FUTA credit for every year the Title XII loan remains unpaid.

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Michigan, for example, has an unemployment rate of 14.1 percent and federal loan balance of over \$2 billion. Despite the fact that ARRA made Title XII loans interest free for 2009 and 2010, the loan balance is expected to still be outstanding after two years. This means Michigan employers should anticipate a FUTA credit reduction of 0.3 percent in 2009 and 0.6 percent in 2010. In terms of dollars, this translates into increased tax costs of \$21 per employee for the first year of the credit reduction and \$42 per employee for the second year.

The following table lists the states in jeopardy of losing FUTA credit:

Title XII Loans State	Percentage of Taxable Payroll	Potential FUTA Credit Reduction		
		2009	2010	2011
Michigan	1.99%	X	X	X
Indiana	2.06%		X	X
South Carolina	1.40%		X	X
Arkansas	3.39%			X
California	3.83%			X
Kentucky	1.90%			X
Missouri	3.26%			X
New Jersey	2.04%			X
New York	2.33%			X
North Carolina	5.52%			X
Ohio	3.40%			X
Pennsylvania	2.87%			X
Rhode Island	0.22%			X
Wisconsin	2.10%			X

UI Tax Outlook

The current strain on unemployment trust fund balances is prompting state UI agencies to review all options for increased tax revenues to help restore and maintain trust fund solvency. Potential options may include changes in unemployment wage bases, increases in tax tables and additional surcharges.

As an example, Tennessee recently passed legislation that increases the taxable wage base and employer tax rates retroactive to January 2009, in hopes of avoiding Title XII loans. Florida also passed legislation that will mean an average 70-

percent tax increase to employers in 2010. It is also projected that more states will join Michigan in a FUTA credit reduction next year, with possibly 14 or more states losing credit by 2011.

Employers seeking solutions to the recessionary impact on UI taxes in the coming years must continue to analyze and understand any unemployment program changes. A proactive approach to UI cost projections and budgeting may not prevent tax increases, but it will allow employers to *avoid unanticipated ones*.

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