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# FEDERAL UNEMPLOYMENT TAXES

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**STATE UNEMPLOYMENT TAXES**

Unlike federal unemployment taxes, which fund the unemployment system's administration, state unemployment taxes support the state's unemployment trust fund. Funded entirely by employer taxes, the fund pays benefits during an unemployed person's first 26 weeks of unemployment. When benefit eligibility was extended to 99 weeks during the recent recession, the federal government paid for the extended benefits.

An employer's state unemployment tax rate generally depends on (1) the unemployment benefits paid to the employer's former workers over the past three years (the experience rate), and (2) the solvency of the state's unemployment trust fund (the fund balance rate). Both rates are applied against the first $15,000 paid to each of the employer's employees (the employer's taxable wage base).

## ISSUE

This report describes federal unemployment taxes, including the tax increases and special assessments related to repaying federal loans to the state's unemployment trust fund.

## SUMMARY

Employers pay unemployment taxes to both the state and federal governments. While the taxes paid to the state fund the state's unemployment trust fund (see sidebar), the taxes paid to the federal government primarily help (1) pay the costs of administering the unemployment system and (2) provide a central fund from which states can borrow, if needed, to pay benefits.

The Federal Unemployment Tax Act (FUTA) and related provisions in the federal tax code require employers to pay a 6% FUTA tax on the first $7,000 of each employee's wages. However, under normal circumstances (prior to 2011), Connecticut's employers qualified for a 5.4% FUTA tax deduction, leaving an effective 0.6% FUTA rate.

In the wake of the 2008 recession, the state's unemployment trust fund became insolvent and the state borrowed close to $1 billion from the federal government so that it could continue to provide unemployment benefits to the unemployed. Once the loan was made, federal law applied different mechanisms for recovering the loan's principle and interest.

Under federal law, repayment of the loan began in 2011 through annually increased FUTA taxes to repay the loan principle. As a result, employers' FUTA taxes increased from $42 per full-time employee in 2010 to $189 in 2015. The law also requires employers to repay the loan's interest through annual special assessments, which began at $25 per full-time employee in 2011 and decreased to $3 per employee in 2015 as the loan principle and interest rates decreased over time. In total, employers' loan-related total annual charges increased from $42 per full-time employee in 2010 to $192 in 2015.

The state Department of Labor (DOL) currently estimates that the federal loan will be fully repaid by June 2016. If this occurs, employers may have to pay a final minimal special assessment to cover any interest accrued since the 2015 assessment, but FUTA rates for the 2016 tax year will return to 0.6%.

## FUTA TAX

The Federal Unemployment Tax Act requires employers to pay a 6% tax to the federal government to help pay for the costs of administering the unemployment system. The FUTA tax rate is applied to the first $7,000 of each employee's wages. Under normal circumstances, prior to 2011, the state's employers qualified for a 5.4% tax deduction, leaving an effective 0.6% FUTA rate ($42 per full-time employee).

## FUTA TAX INCREASES (FEDERAL LOAN REPAYMENT)

When the state's unemployment trust fund became insolvent in October 2009, the state began borrowing from the U.S. Department of Labor so that it could continue paying unemployment benefits. In total, the state borrowed almost $1 billion. (Because of the nationwide jump in unemployment claims during the recession, many states borrowed similar sums.) In 2011, because the state's unemployment loan remained outstanding for 2 consecutive years, federal law reduced the size of the FUTA credit by 0.3% (from 5.4% to 5.1%). The extra 0.3% raised by the credit reduction pays the principal on the loan. Because federal law reduces the credit an additional 0.3% each year that the loan remains outstanding, the effective FUTA tax rate increases 0.3% each year until the loan is repaid. By 2015, after five years of 0.3% FUTA credit reductions, the effective FUTA tax rate on employers has increased from 0.6% to 2.1%. According to the U.S. Department of Labor (USDOL), Connecticut is one of three states that still had outstanding loans as of November 2015.

Federal law also imposes a Benefit Cost Ratio (BCR) add-on tax on states (like Connecticut) that have outstanding loans for five consecutive years. The additional revenue raised by the BCR increase also goes toward paying down the loan principle. According to the USDOL's "Final 2015 FUTA Credit Reductions" data, Connecticut's 2015 BCR is 0.6%, which increases the total FUTA tax rate from 2.1% to 2.7% for the 2015 tax year. This amounts to a total FUTA tax of $189 per full-time employee.

Although federal law allows states to receive a waiver from a BCR increase, Connecticut was the only state with outstanding loans that did not apply for one in 2014 and 2015. According to DOL, the state did not seek a waiver because the additional BCR payment reduces the long term costs by (1) shortening the amount of time over which the state's employers will be repaying the loan through annual FUTA tax increases and (2) reducing the interest payments on the loan. The department currently estimates that the loan will be fully repaid by June 2016, at which time employers' FUTA tax rate for the 2016 tax year will return to 0.6%.

## SPECIAL ASSESSMENTS (FEDERAL LOAN INTEREST)

In addition to paying off the loan's principal, federal law also requires interest payments. The federal American Recovery and Reinvestment Act of 2009 waived the interest on these loans through 2010 but required the state to begin paying interest in 2011. Because the law prohibits the state from using the unemployment trust fund to pay the interest, DOL repays each year's interest by levying an annual special assessment on employers. The initial special assessment in 2011 was for approximately $1.70 per thousand dollars of taxable payroll to repay $30 million in interest on the loan. This equated to about $25 per full-time employee, and applied to all employers subject to unemployment taxes.

Since 2011, the special assessment has decreased each year as a result of repaying some of the principal and lower interest rates. The 2015 special assessment amounted to roughly $4 million, or $3.00 per employee.

## TABLE OF RATES AND CHARGES

Table 1 shows the FUTA credit reductions and special assessments related to the outstanding federal loan since 2010 and the resulting charge on employers for each full-time employee.

**Table 1: FUTA Credit Reductions and Special Assessments Related to the Federal Unemployment Loan**

| *Tax Year* | *Effective FUTA Rate* | *FUTA Tax Charge** | *BCR Rate** | *BCR Rate Charge** | *Special Assessment*** | *Total Annual Charges for Federal Loan*** |
|---|---|---|---|---|---|---|
| 2010 | 0.6% | $42 | N/A | N/A | N/A | $42 |
| 2011 | 0.9% | $63 | N/A | N/A | $25 | $88 |
| 2012 | 1.2% | $84 | N/A | N/A | $19.50 | $103.50 |
| 2013 | 1.5% | $105 | N/A | N/A | $15 | $120 |
| 2014 | 1.8% | $126 | 0.5% | $35 | $7.50 | $168.50 |
| 2015 | 2.1% | $147 | 0.6% | $42 | $3.00 | $192 |

*per employee paid at least $7,000 for the year

**per employee paid at least $15,000 for the year

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