OFFICE OF LEGISLATIVE RESEARCH
Objective Research for Connecticut's Legislature

Issue Brief

Funding the Unemployment System

Who Pays for the Unemployment System and How?

Employers pay both Connecticut and federal unemployment taxes to fund the unemployment insurance (UI) system. In general, state UI taxes support the state's unemployment trust fund, which pays UI benefits during an unemployed person's first 26 weeks of unemployment. Federal unemployment taxes, paid under the Federal Unemployment Tax Act (FUTA), primarily pay the costs of administering the unemployment system and support a federal fund from which states can borrow.

How Are State UI Taxes Determined?

An employer's state UI tax liability typically depends on the employer's experience rate (based on the amount of benefits paid to its former employees) and the fund balance rate (based on the solvency of the state's unemployment trust fund). The sum of these two rates, which can range from 0.5% to 6.8%, is then applied to the employer's taxable wage base (the amount of wages it paid that are subject to state UI taxes).

Experience Rate

- Varies by employer
- Generally depends on the amount of UI benefits received by former employees
- Ranges from 0.5% (for employers whose employees have received the least amount of benefits) to 5.4%
- Under Executive Order 7W, experience rates will not be increased for benefits paid because of COVID-19
- CGS § 31- 225a

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Fund Balance Rate

- *A flat rate paid by all employers*
- *Calculated to ensure that the UI trust fund maintains a statutorily determined amount of funding, but cannot exceed 1.4%*
- *If the fund exceeds its goal, the next year's rate must be reduced to eliminate the excess*
- *CGS § 31-225a*

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Taxable Wage Base

- The employee wages on which an employer must pay state UI taxes
- The first $15,000 of each employee's taxable wages
- Can potentially range from $75 to $1,020 for each employee paid at least $15,000 per year
- CGS § 31-222

How Are FUTA Taxes Determined?

In addition to state UI taxes, employers must pay federal unemployment taxes under the FUTA. An employer's annual FUTA tax is generally 6% on the first $7,000 of each employee's annual wages. However, employers typically receive a 5.4% credit against the FUTA tax, leaving their effective FUTA tax rate at 0.6% (typically, $42 per employee). In order to qualify for the 5.4% tax credit, a state's unemployment system must conform to numerous requirements contained in §§ 3303 and 3304 of the federal Internal Revenue Code.

Structural Imbalance

Under the state's current UI system, the value of UI benefits paid automatically adjusts with inflation because they are based on the wages earned by UI claimants. But the state's taxable wage base does not adjust with inflation and has been at $15,000 since 1999.

What Happens if the UI Trust Fund Becomes Insolvent?

If a state's unemployment trust fund lacks enough funds to pay benefits, federal law allows the state to receive a loan from the federal unemployment fund so it can keep paying UI benefits (42 U.S.C. § 1321). However, if the loan remains outstanding after two consecutive years, the law reduces the size of the FUTA tax credit by 0.3% (e.g., from 5.4% to 5.1%) each year that the loan remains outstanding. This increases the employers' effective tax rate and the extra revenue generated pays the principal on the federal loan. An additional Benefit Cost Ratio (BCR) add-on tax applies if the loan remains outstanding after a certain period (26 U.S.C. § 3302(c)). Plus, the state department of labor (DOL) issues annual special assessments on employers to pay off the annual interest on the loans.

UI Insolvency in the Great Recession

In the wake of the 2008 "Great Recession," Connecticut had to borrow nearly $1 billion from the federal unemployment fund to continue paying UI benefits. Because the state was unable to fully repay the federal loan until 2016, FUTA taxes for the state's employers eventually increased from $42 to $192 per employee, plus annual special assessments imposed by DOL to pay the interest. The table below shows the FUTA credit reductions and special assessments related to the federal loan and the resulting charge on employers for each full-time employee.

FUTA Credit Reductions and Special Assessments Related to the Great Recession 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

Learn More

"OLR Backgrounder: State and Federal Unemployment Tax," OLR Report 2019-R-0227

"Unemployment Systems in Connecticut and Nearby States," OLR Report 2020-R-0145

"Federal Unemployment Taxes," OLR Report 2015-R-0275

State Unemployment Insurance Trust Fund Solvency Report 2020, U.S. Department of Labor

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