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The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States

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Congressional Research Service

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The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States

Abstract

[Excerpt] During some recessions, current taxes and reserve balances were insufficient to cover state expenditures for unemployment compensation (UC) benefits. UC benefits are an entitlement, and states are legally required to pay benefits even if the state account is insolvent. Some states may borrow funds from the Federal Unemployment Account (FUA) within the Unemployment Trust Fund (UTF) in order to meet UC benefit obligations. The 2009 stimulus package (The American Recovery and Reinvestment Act of 2009, P.L. 111-5 § 2004) temporarily waives interest payments and the accrual of interest on these loans to states from the FUA.

This report summarizes how insolvent states may borrow funds from the federal account within the UTF in order to meet their UC benefit obligations. Outstanding loans listed by state may be found at the Department of Labor's website: <http://www.workforcesecurity.doleta.gov/unemploy/budget.asp#tflans>.

Michigan has just completed its first year of a credit reduction. As a result, the credit reduction was applied retroactively to tax year 2009 earnings and the net FUTA tax during 2009 for Michigan employers is 1.1% on the first \$7,000 of each employee's earnings. No other state currently has a credit reduction; thus, in all other states the net FUTA 2009 tax was 0.8%.

This report will be updated to reflect major changes in state UTF account solvency.

Keywords

Unemployment Trust Fund, UTF, Federal Unemployment Account, FUA, budget, public policy, credit reduction, state insolvency

Comments

Suggested Citation

Whittaker, J. M. (2010). *The Unemployment Trust Fund (UTF): State insolvency and federal loans to states*. Washington, DC: Congressional Research Service.
http://digitalcommons.ilr.cornell.edu/key_workplace/699



The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States

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January 12, 2010

Congressional Research Service

7-5700

www.crs.gov

RS22954

Summary

During some recessions, current taxes and reserve balances were insufficient to cover state expenditures for unemployment compensation (UC) benefits. UC benefits are an entitlement, and states are legally required to pay benefits even if the state account is insolvent. Some states may borrow funds from the Federal Unemployment Account (FUA) within the Unemployment Trust Fund (UTF) in order to meet UC benefit obligations. The 2009 stimulus package (The American Recovery and Reinvestment Act of 2009, P.L. 111-5 § 2004) temporarily waives interest payments and the accrual of interest on these loans to states from the FUA.

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Unemployment Compensation and the Unemployment Trust Fund

Unemployment Compensation (UC) is a joint federal-state program financed by federal taxes under the Federal Unemployment Tax Act (FUTA) and by state payroll taxes under the State Unemployment Tax Acts (SUTA). The underlying framework of the UC system is contained in the Social Security Act (SSA). Title III of the SSA authorizes grants to states for the administration of state UC laws, Title IX authorizes the various components of the federal Unemployment Trust Fund (UTF), and Title XII authorizes advances or loans to insolvent state UC programs.

Originally, the intent of the UC program, among other things, was to help counter economic fluctuations such as recessions.¹ This intent is reflected in the current UC program's funding and benefit structure. When the economy grows, UC program revenue rises through increased tax revenues, whereas UC program spending falls as fewer workers are unemployed. The effect of collecting more taxes while decreasing spending on benefits dampens demand in the economy. This also creates a surplus of funds or a "cushion" of available funds for the UC program to draw upon during a recession. In a recession, UC tax revenue falls and UC program spending rises as more workers lose their jobs and receive UC benefits. The increased amount of UC payments to unemployed workers dampens the economic effect of lost earnings by injecting additional funds into the economy.

Unemployment Taxes

UC benefits are financed through employer taxes.² The federal taxes on employers are under the authority of FUTA, and the state taxes are under the authority given by SUTA. These taxes are deposited in the appropriate accounts within the UTF.

Federal Unemployment Taxes

FUTA imposes a 6.2% gross tax rate on the first \$7,000 paid annually by employers to each employee. Employers in states with programs approved by the federal government and with no delinquent federal loans may credit 5.4 percentage points against the 6.2% tax rate, making the minimum net federal unemployment tax rate 0.8%. Currently, Michigan employers will face a retroactive credit reduction for tax year 2009 and will pay a higher net FUTA tax on account of unpaid loan balances. (Previously, the New York employers' rate was higher for 2004 and 2005 because of unpaid loan balances.)

Because all states currently have approved programs and Michigan is the only state with a continuous unpaid loan balance of over two years, 0.8% is the effective federal tax rate for every state except Michigan. The 0.8% FUTA tax funds both federal and state administrative costs as

¹ See, for example, President Franklin Roosevelt's remarks at the signing of the Social Security Act at <http://www.ssa.gov/history/fdrstmts.html#signing>.

² For a detailed description of UC financing, see CRS Report RS22077, *Unemployment Compensation (UC) and the Unemployment Trust Fund (UTF): Funding UC Benefits*, by Julie M. Whittaker and Kathleen Romig.

well as the federal share of the Extended Benefit (EB) program, loans to insolvent state UC accounts, and state employment services. Michigan's effective federal unemployment tax rate for 2009 is 1.1%.

Broad Guidelines for State Unemployment Taxes

Federal laws and regulations provide broad guidelines on state unemployment taxes. States levy their own payroll taxes on employers to fund regular UC benefits and the state share of the 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 of 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 experience rating is intended to ensure an equitable distribution of UC program taxes among employers and to encourage a stable workforce. State ceilings on taxable wages in 2009 range from \$7,000 (seven states and Puerto Rico) to \$35,700 (Washington). The minimum rates range from 0% (10 states and the Virgin Islands) to 1.9% (Connecticut). The maximum rates range from 5.4% (15 states and Puerto Rico) to 10.96% (Massachusetts). Approximately \$31.0 billion in SUTA taxes were collected in FY2009. In comparison, states spent an estimated \$75.0 billion on regular UC benefits and \$4.1 billion on extended benefit payments in FY2009.

Most States Plan to Increase State Unemployment Taxes for 2010

A recent survey conducted by the National Association of Workforce Agencies found that a SUTA increase is expected in 35 states for 2010. Six states indicated tax rates in their state are currently adjusted on employers due to a solvency tax already in state law.³ A total of 27 states and Puerto Rico indicated the tax schedule in their state will see a state unemployment tax increase in 2010 compared to the same period one year earlier.⁴ All of these states, except Georgia, indicated that the increase in the tax schedule is automatic (based on the level of reserves in the trust fund). Georgia will see a discretionary increase in the state tax schedule implemented at the option of the commissioner of labor.

Furthermore, in 10 states, the state was currently at the highest tax rate schedule.⁵

Of the 51 state programs surveyed, four states (Idaho, Kentucky, Oklahoma, and West Virginia) freeze or adjust indexed benefits in response to a general increase to UC tax rates or a low level of reserves in the UC trust fund.

³ Arkansas, California, Connecticut, Florida, Hawaii, and Massachusetts.

⁴ Alabama, Alaska, Arizona, Colorado, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Maryland, Massachusetts, Minnesota, Montana, Nebraska, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oregon, Pennsylvania, Puerto Rico, Virginia, Vermont, Wisconsin, and Wyoming.

⁵ California, Connecticut, Delaware, Kentucky, Michigan, Missouri, North Carolina, Rhode Island, South Carolina, and Tennessee.

Table I. Summary of Expected State Unemployment Tax Increases for 2010

State	Indexed Wage Base	Tax Schedule Increase	Indexed (Frozen/Decreasing) Benefits	Legislative Changes/ Other
Alabama		Yes		
Alaska	Yes			
Arizona		Yes		
Arkansas		Yes		Increased taxable wage base.
California		Already at highest schedule.		
Colorado		Yes		
Connecticut		Already at highest schedule.		
Delaware		Already at highest schedule.		
District of Columbia ^a				
Florida				Temporarily increased taxable wage base. Revised state tax schedule trigger.
Georgia		Yes		Tax schedule increased.
Hawaii	Yes	Yes		
Idaho	Yes	Yes	When taxes rise, maximum benefit decreases.	
Illinois		Yes		
Indiana				Increased taxable wage base. Increased taxes on employers with poor experience ratings.
Iowa	Yes	Yes		
Kansas		Yes		
Kentucky		Already at highest schedule.	Benefit is frozen if trust fund reserves are below specified level.	
Louisiana				Tax increase was not specified in survey but state asserted a tax increase for 2010.
Maine		Yes		
Maryland		Yes		
Massachusetts		Yes		

State	Indexed Wage Base	Tax Schedule Increase	Indexed (Frozen/Decreasing) Benefits	Legislative Changes/ Other
Michigan		Already at highest schedule.		Solvency tax enacted in 2008 continues to be in effect.
Minnesota	Yes	Yes		
Mississippi				
Missouri		Already at highest schedule.		
Montana	Yes	Yes		
Nebraska		Yes		
Nevada	Yes			
New Hampshire		Yes		Increased taxable wage base. Revised state tax schedule trigger. Increased taxes on employers with poor experience ratings.
New Jersey	Yes	Yes		
New Mexico	Yes			
New York		Yes		
North Carolina	Yes	Already at highest schedule.		
North Dakota	Yes	Yes		
Ohio		Yes		
Oklahoma	Yes		Yes	
Oregon	Yes	Yes		
Pennsylvania		Yes		
Rhode Island		Already at highest schedule.		
South Carolina		Already at highest schedule.		
South Dakota				
Tennessee		Already at highest schedule.		Increased taxable wage base. Retroactive to tax year 2009. Revised state tax schedule trigger.
Texas				
Utah	Yes			
Vermont		Yes		

State	Indexed Wage Base	Tax Schedule Increase	Indexed (Frozen/Decreasing) Benefits	Legislative Changes/ Other
Virginia		Yes		Solvency Socialized Tax increased.
Washington	Yes			
West Virginia			Benefits are frozen.	Temporarily increased taxable wage base. Retroactive to 2 nd quarter of 2009. Once certain criteria are met, the base will be indexed to annual wages. Required benefit freeze to remain in effect until trust fund reserves reach a specified level.
Wisconsin		Yes		
Wyoming	Yes	Yes		

Source: “UI Trust Fund Solvency Survey, December 2009.” Conducted by the National Association of State Workforce Agencies (NASWA), <http://www.workforceatm.org/sections/pdf/2009/NASWA%20Solvency%20Survey%20Summary%20of%20State%20Responses.pdf>.

- a. The District of Columbia did not participate.

Adequate Trust Fund Balances

Whether a state trust fund balance is adequate is ultimately a matter up to each state as there is no statutory requirement of an adequately funded state UC program. However, the U.S. Department of Labor (DOL) suggests that, to be minimally solvent, a state’s reserve balance should provide for one year’s projected benefit payment needs on the basis of the highest levels of benefit payments experienced by the state over the last twenty years. This is called the average high-cost multiple (AHCM). A ratio of 1.0 or greater prior to a recession indicates a state is minimally solvent. States below this level are vulnerable to exhausting their funds in a recession. DOL provides the AHCM in its *Quarterly Program and Financial Data* report in the summary of financial data. These reports are available online at <http://www.workforcesecurity.doleta.gov/unemploy/finance.asp>.

Table 2 provides financial information for the unemployment trust fund accounts. The first data column lists the amount of state taxes collected in the previous 12 months. The second column lists the balance each state’s account in the UTF at the end of the 12-month period. The third column calculates the ratio of the trust fund balance to the estimated sum of wages earned by employees in jobs covered by the UC system. The final column lists the AHCM where a number less than 1 does not meet DOL’s definition of minimally solvent.

**Table 2. State Unemployment Trust Fund Accounts:
Financial Information by State, 3rd Quarter 2009**

State	Revenues Last 12 Months (thousands of \$)	Trust Fund Balance (thousands of \$)	Trust Fund Ratio to Total Covered Wages	Average High Cost Multiple (AHCM)
Alabama	217,451	7,752	0.01	0.39
Alaska	118,233	320,998	2.97	1.07
Arizona	259,032	372,212	0.45	1.00
Arkansas	266,892	14,480	0.05	0.17
California	4,612,643	107,664	0.02	0.07
Colorado	367,492	191,011	0.22	0.65
Connecticut	623,400	62,890	0.09	0.40
Delaware	90,365	72,663	0.48	0.69
District of Columbia	123,415	366,615	1.32	1.09
Florida	859,839	179,892	0.08	0.65
Georgia	522,005	269,419	0.20	0.70
Hawaii	55,880	213,740	1.27	1.43
Idaho	126,624	3,221	0.02	0.21
Illinois	1,599,575	19,024	0.01	0.28
Indiana	501,804	18,963	0.02	N.A.
Iowa	356,008	480,569	1.15	0.85
Kansas	216,089	264,155	0.58	0.83
Kentucky	394,806	6,631	0.01	0.08
Louisiana	161,781	1,271,179	2.10	0.89
Maine	95,533	366,175	2.46	1.51
Maryland	425,062	312,375	0.36	0.59
Massachusetts	1,550,838	450,709	0.32	0.47
Michigan	1,415,834	115,633	0.09	N.A.
Minnesota	787,750	9,872	0.01	0.34
Mississippi	102,073	526,398	1.89	1.54
Missouri	573,543	13,913	0.02	0.12
Montana	75,464	177,533	1.56	1.38
Nebraska	101,136	207,186	0.83	1.17
Nevada	321,403	104,086	0.25	0.79
New Hampshire	79,651	68,040	0.33	0.75
New Jersey	1,884,710	36,448	0.02	0.16
New Mexico	94,143	347,225	1.55	1.61
New York	2,405,697	53,831	0.02	0.00
North Carolina	819,919	19,249	0.02	0.11

North Dakota	51,643	101,028	1.10	0.74
Ohio	1,099,241	108,705	0.07	0.02
Oklahoma	138,461	595,465	1.28	1.40
Oregon	578,762	1,286,625	2.58	1.48
Pennsylvania	2,077,727	129,167	0.07	0.19
Puerto Rico	170,817	442,747	2.71	0.95
Rhode Island	194,199	1,938	0.01	0.17
South Carolina	268,909	11,633	0.02	N.A.
South Dakota	30,060	3,821	0.04	0.33
Tennessee	590,577	273,563	0.33	0.37
Texas	1,183,090	40,433	0.01	0.31
Utah	126,689	565,709	1.60	1.40
Vermont	71,201	46,872	0.60	0.91
Virgin Islands	1,034	276	0.03	0.41
Virginia	329,445	129,441	0.10	0.55
Washington	985,501	3,030,135	2.95	1.58
West Virginia	165,227	167,375	0.88	0.40
Wisconsin	672,777	27,184	0.03	0.11
Wyoming	53,208	182,239	2.01	1.12

Source: U.S. Department of Labor.

Notes: Total covered wages are based on extrapolated wages for the most recent 12 months.

N.A.= Not Applicable; Indiana, Michigan, and South Carolina have outstanding debt exceeding their fund balances.

Insolvency: Insufficient UTF Reserve Balances

During economic slowdowns or recession, some states have found that current state unemployment taxes and UTF reserve balances were insufficient to cover state expenditures for UC benefits.

Insolvent States Required to Pay UC Benefits

States have a great deal of autonomy in how they establish and run their unemployment system. However, the framework established by the federal government requires states to actually pay the UC benefits as provided under state law. If the state does not pay the UC benefits, federal law is quite explicit. The state will not have a UC program meeting federal requirements and thus the federal tax on employers would be a net tax of 6.2% (with no credit for state unemployment taxes) rather than 0.8% if the state UC program paid benefits and had no outstanding loans.

In budget terms, UC benefits are an entitlement (although the program is financed by a dedicated tax imposed on employers and not by general revenues). Thus, even if a recession hits a given state and as a result that state's trust account is depleted, the state remains legally required to

continue paying benefits. To do so, the state will be forced to borrow money from the dedicated loan account, the FUA, within the UTF or from outside sources. If the state chooses to borrow funds from the FUA, not only will the state be required to continue paying benefits, it will also be required to repay the funds (plus any interest due) it has borrowed from the federal loan account. Such states will probably be forced to raise taxes on their employers or reduce UC benefit levels, actions that dampen economic growth, job creation, and consumer demand. In short, states have strong incentives to keep adequate funds in their trust fund accounts.

Mechanism for Receiving a Loan

In order for a loan to be made to a state account, the governor of the state (or the governor's designee) must apply to the Secretary of Labor for a three-month loan. Once the loan is approved by the Department of Labor, the funds are placed into the state account in monthly increments.

Interest Charges on Loans

Since 1982 (P.L. 97-35), states are charged interest on new loans that are not repaid by the end of the fiscal year in which they were obtained. Under previous law, states could receive these loans interest-free. The interest is the same rate as that paid by the federal government on state reserves in the UTF for the quarter ending December 31 of the preceding year, but not higher than 10% per annum. States may not pay the interest directly or indirectly from funds in their state account with the UTF.

States still may borrow funds without interest from the FUA during the year. To receive these interest-free loans, the states must repay the loans by September 30. No loans may be made in October, November, or December of the calendar year of such an interest-free loan. Otherwise, the "interest-free" loan will accrue interest charges. However, the 2009 stimulus package temporarily extends the period in which interest-free loans are available.

Temporary Waiver of Interest in 2009 Stimulus Package

The 2009 stimulus package (The American Recovery and Reinvestment Act of 2009, P.L. 111-5 § 2004) temporarily waives interest payments and the accrual of interest on advances to State unemployment funds by amending section 1202(b) of the Social Security Act. The interest payments that come due from the time of enactment of the proposal until December 31, 2010, are deemed to have been made by the State. No interest on advances accrue during the period. Although interest will not accrue during this period, this does *not* absolve states from repaying the underlying loans. If a state does not pay back funds within the prescribed amount of time or make good progress as determined by the Labor Secretary, the state tax credit will be reduced, as described below.

Federal Tax Increases on Outstanding Loans Through Credit Reductions

States with outstanding loans must repay them fully by November 10 following the second consecutive January 1 on which the state has an outstanding loan. If the outstanding loan is not repaid by that time, the state will face federal unemployment tax increases through a credit

reduction. This means that a state may have from approximately 22 to 34 months to repay the loan without a federal tax increase, depending on when it obtained the outstanding loan. If the state does not repay fully by November 10, it becomes subject to a reduction in the amount of credit applied against the federal unemployment tax beginning with the preceding January 1 until the state repays the loan fully. That state's employers must pay the additional federal taxes resulting from the credit reduction no later than January 31 of the next calendar year. The provisions of the 2009 stimulus package do *not* change the timetable for federal tax increases resulting from a state's outstanding loans.

The additional federal taxes are then deposited into the appropriate state account. Thus the amount of the loan (or the funds the state must continue to borrow) is reduced by the additional federal taxes paid by the state employers.

Credit Reduction

The credit reduction is initially 0.3 percentage points for the year beginning with the calendar year in which the second consecutive January 1 passes during which the loan is outstanding and increases by 0.3 percentage points for each year there is an outstanding loan. (For example, in the first year, the credit reduction results in the net federal tax rate increasing from 0.8% to 1.1%—an additional \$21 for each employee; in the second year, it would increase to 1.4%—a cumulative additional \$42 for each employee. Michigan has just completed its first year of a credit reduction. As a result, the credit reduction was applied retroactively to tax year 2009 earnings. No other state currently has a credit reduction.)

There are two potential additional credit reductions (on top of the cumulative 0.3 percentage point increases) during the ensuing calendar years in which a state has an outstanding loan: (1) in the calendar years after which the third and fourth consecutive January 1s pass and (2) in the calendar years after which the fifth or more consecutive January 1s pass. The first additional credit reduction (programmatically referred to as the “2.7 add-on”) uses a statutory formula that takes into consideration the average annual wages and average employment contribution rate. The second credit reduction (programmatically referred to as the Base Credit Reduction, or BCR, add-on) replaces the 2.7 add-on and uses the five-year benefit cost rate as well as average wages in its calculation.⁶ **Table 3** present these reductions and the subsequent net FUTA tax faced by state employers as a result of these unpaid loans.

⁶ The 2.7 add-on formula is: $[(2.7\% \times 7000 / \text{U.S. Annual Average Wage}) - \text{Average Annual State Tax Rate on Total Wages}] \times \text{State Annual Average Wage} / 7000$. The BCR add-on formula is $\text{Max} [\text{five-year State Average Cost/Taxable Wages}, 2.7] - \text{Average Annual State Tax Rate on Total Wages}$.

Table 3. Schedule of State Tax Credit Reduction and Net Federal Unemployment Tax Act (FUTA) Tax

Loan Year	Credit Reduction	Additional Reductions	Net FUTA Tax
Year 1 of outstanding loan	0.0%	None	0.8%
Year 2 (applied retroactively at end of calendar year)	0.3%	None	1.1%
Year 3	0.6%	2.7 Add-on	1.4% or more
Year 4	0.9%	2.7 Add-on	1.7% or more
Year 5	1.2%	BCR Add-on	2.0% or more
Year 6	1.5%	BCR Add-on	2.3% or more
Year 7	1.8%	BCR Add-on	2.6% or more
Year 8	2.1%	BCR Add-on	2.9% or more
Year 9	2.4%	BCR Add-on	3.2% or more
Year 10	2.7%	BCR Add-on	3.5% or more
Year 11	3.0%	BCR Add-on	3.8% or more
Year 12	3.3%	BCR Add-on	4.1% or more
Year 13	3.6%	BCR Add-on	4.4% or more
Year 14	3.9%	BCR Add-on	4.7% or more
Year 15	4.2%	BCR Add-on	5.0% or more
Year 16	4.5%	BCR Add-on	5.3% or more
Year 17	4.8%	BCR Add-on	5.6% or more
Year 18	5.1%	BCR Add-on	5.9% or more
Year 19	5.4%	BCR Add-on	6.2%

Source: U.S. Department of Labor, Employment and Training Administration.

Notes: 2.7 Add-on= $[(2.7\% \times 7000 / \text{U.S. Annual Average Wage}) - \text{Average Annual State Tax Rate on Total Wages}] \times \text{State Annual Average Wage} / 7000$.

Base Credit Reduction (BCR) Add-on= $\text{Max} [\text{five-year State Average Cost/Taxable Wages}, 2.7] - \text{Average Annual State Tax Rate on Total Wages}$.

How the Credit Reduction May be Mitigated: Avoidance or Cap

States may reduce the amount of credit reduction applied in a year by meeting certain statutory criteria. States must apply to the Secretary of Labor for approval for the credit reduction.

Avoidance

The most straightforward way to avoid the credit reduction is to repay the loan before November 10 of the second year in which there was an outstanding loan on January 1.

Section 272 of P.L. 97-248 allows a delinquent state the option of repaying—on or before November 9—a portion of its outstanding loans each year through transfer of a specified amount from its account in the UTF to the FUA. The state also must repay all loans for the most recent one-year period ending on November 9, plus the potential additional taxes that would have been imposed for the taxable year. In addition, the state must have sufficient amounts in the state account of the UTF to pay all compensation for the last quarter of that calendar year without receiving a loan. Finally, the state must also have altered its state law to increase the net solvency of its account with the UTF. If the state complies with all these requirements, the credit reduction is reduced by a statutory formula.

Cap

Once a state begins to have a credit reduction, the state may apply to have the reductions capped if the state meets four criteria:

1. No legislative or other action in 12 months ending September 30 has been taken to decrease state unemployment tax effort.
2. No legislative or other action has been taken to decrease the state trust account's net solvency.
3. Average state unemployment tax rate on total wages must exceed the five-year average benefit cost rate on total wages.
4. Balance of outstanding loans as of September 30 must not be greater than the balance three years before.

Waiving the BCR Add-on

The BCR add-on may be waived if a state does not take legislative or other actions to decrease the state trust account's net solvency. The 2.7 add-on would then replace the BCR add-on.

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