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Julie M. Whittaker
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) 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 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>.

Keywords

Unemployment Trust Fund, UTF, Unemployment Compensation, UC, recession, state insolvency

Comments

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

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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) 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 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#tfloans>.

In 2011, 20 states and the Virgin Islands had a state tax credit reduction applied to the calculation of the federal unemployment tax (FUTA): Michigan (0.9), Indiana (0.6), Arkansas (0.3), California (0.3), Connecticut (0.3), Florida (0.3), Georgia (0.3), Illinois (0.3), Kentucky (0.3), Minnesota (0.3), Missouri (0.3), North Carolina (0.3), New Jersey (0.3), Nevada (0.3), New York (0.3), Ohio (0.3), Pennsylvania (0.3), Rhode Island (0.3), Virginia (0.3), Virgin Islands (0.3), and Wisconsin (0.3). As a result, in Michigan, a credit reduction of 0.9 was applied retroactively to tax year 2011 earnings and the net FUTA tax during 2011 for Michigan employers was 1.5% on the first \$7,000 of each employee's earnings. In Indiana (with a credit reduction of 0.6), the net FUTA tax during 2011 for Indiana employers was 1.2% on the first \$7,000 of each employee's earnings. In the other 19 states (with a 0.3% credit reduction), the net FUTA tax for 2011 was 0.9%. For all other states, the net FUTA tax was 0.6%.

H.R. 650 would extend the suspension of interest accrual on federal loans to states through 2012. H.R. 3346 and S. 1804 would also allow states to enter into an agreement with the U.S. Department of Labor (DOL) to temporarily suspend the accrual of interest for FY2012. In addition, states that otherwise have employers facing a decreased state tax credit on federal unemployment taxes would be able to opt to suspend the reduction in credit for tax year 2012. To have these options available to the state, the state would be required to continue to calculate regular unemployment benefit entitlements (both in weekly amount and total weeks available) as required by state law on the date of enactment of this proposal. States with no outstanding unemployment loans within the UTF would earn an additional two percentage points in interest on the (positive) average daily balance in the state's UTF account.

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

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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 6.0% 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 6.0% tax rate, making the minimum net federal unemployment tax rate 0.6%.

Because all states currently have approved programs, 0.6% is the effective federal tax rate.³ The 0.6% FUTA tax funds both federal and state administrative costs as well as the federal share of the Extended Benefit (EB) program, loans to insolvent state UC accounts, and state employment

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.

³ The net FUTA tax through June 2011 was 0.8%. Thus, the *average* net FUTA tax rate for most employers 2011 will be more than 0.6% but less than 0.8%.

services.⁴ In 2011, 20 states and the Virgin Islands were subject to a credit reduction: Michigan (0.9), Indiana (0.6), Arkansas (0.3), California (0.3), Connecticut (0.3), Florida (0.3), Georgia (0.3), Illinois (0.3), Kentucky (0.3), Minnesota (0.3), Missouri (0.3), North Carolina (0.3), New Jersey (0.3), Nevada (0.3), New York (0.3), Ohio (0.3), Pennsylvania (0.3), Rhode Island (0.3), Virginia (0.3), Virgin Islands (0.3), and Wisconsin (0.3).

As a result, in Michigan, the credit reduction (0.9) was applied retroactively to tax year 2011 earnings and the net FUTA tax during 2011 for Michigan employers was 1.6% on the first \$7,000 of each employee's earnings. In Indiana (with a credit reduction of 0.6), the net FUTA tax during 2011 for Indiana employers was 1.2% on the first \$7,000 of each employee's earnings. In the other 19 states with a 0.3% credit reduction, the net FUTA tax for 2011 was 0.9%. For all other states, the net FUTA tax was 0.6%.⁵

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 2011 ranged from \$7,000 (Arizona, California, Florida, and Puerto Rico) to \$38,800 (Hawaii). The minimum rates ranged from 0% (Iowa, Missouri, Nebraska, South Dakota) to 2.98% (Pennsylvania). The maximum rates ranged from 5.4% (Arkansas, California, Florida, Georgia, Hawaii, Mississippi, Nevada, Oregon, and Puerto Rico) to 13.5% (Maryland). A projected \$47.8 billion in SUTA taxes will be collected in FY2012. In comparison, states are projected to spend \$51.7 billion on regular UC benefits and \$0.02 billion on extended benefit payments in FY2012.

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.⁶

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

⁴ P.L. 111-5, as amended (most recently by P.L. 112-96), temporarily sets the share of EB paid by the federal tax to 100% rather than 50%. This temporary measure will expire on December 31, 2012.

⁵ Employers would have paid an additional 0.2% to any earnings paid to employees before July 2011. This temporary surtax was most recently authorized by P.L. 111-92 and expired on June 30, 2011.

⁶ On September 17, 2010, funding goals for the states' accounts were approved in federal regulations. These goals apply only to conditions for a state's receipt of interest-free. This rule will begin to be phased in beginning in 2014 with the full effect of the rule beginning in 2019. These goals determine whether short-term loans to the states are interest-free loans or if they immediately begin to accrue interest. These requirements are discussed in this report in the "Interest Charges on Loans" requirements.

levels of benefit payments experienced by the state over the past 20 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 1 provides recent 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 of 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 fourth column lists the AHCM where a number less than 1.0 does not meet DOL's definition of minimally solvent. The fifth column reports the outstanding trust fund loan (if any).

The sixth column lists the per employee loan amount (total loans divided by total covered employees). This statistic gives a sense of how much in state taxes per employee would have to be raised if a state were to have repaid the entire loan amount in the fourth quarter of 2011. The final column lists the ratio of total loans to total covered wages. This ratio aids in the comparison of the size of the loan to the general wage profile in the state.

**Table I. State Unemployment Trust Fund Accounts:
Financial Information by State, 2nd Quarter Calendar Year 2012**

| State | Revenues Past 12 Months (\$ in thousands) | Trust Fund Balance (\$ in thousands) | Ratio of Trust Fund to Total Covered Wages | Average High Cost Multiple (AHCM) | Outstanding Trust Fund Loan (\$ in thousands) | Loan per Covered Employee | Percentage of Loans to Yearly Total Wages in Covered Employment |
|-------------------------|--|---|---|--|--|--|--|
| Alabama | 513,062 | 104,634 | 0.18 | N.A. | — | — | — |
| Alaska | 188,392 | 235,125 | 2.02 | 0.92 | — | — | — |
| Arizona | 428,920 | 10,939 | 0.01 | N.A. | 240,730 | 101 | 0.29 |
| Arkansas | 410,424 | 176,969 | 0.53 | N.A. | 310,373 | 273 | 0.94 |
| California | 6,201,491 | 57,064 | 0.01 | N.A. | 8,968,937 | 618 | 1.43 |
| Colorado | 1,451,986 | 526,826 | 0.59 | N.A. | — | — | — |
| Connecticut | 865,727 | 200,773 | 0.26 | N.A. | 632,026 | 391 | 0.82 |
| Delaware | 124,292 | 23,924 | 0.15 | N.A. | 76,412 | 192 | 0.49 |
| District of Columbia | 144,273 | 305,575 | 1.00 | 0.97 | — | — | — |
| Florida | 2,181,795 | 31,108 | 0.01 | N.A. | 676,556 | 94 | 0.28 |
| Georgia | 839,031 | 370,640 | 0.27 | N.A. | 745,303 | 200 | 0.54 |
| Hawaii | 316,967 | 47,301 | 0.28 | 0.05 | — | — | — |
| Idaho | 327,638 | 224,941 | 1.35 | N.A. | — | — | — |
| Illinois | 3,228,323 | 0 | 0.00 | N.A. | 1,138,264 | 205 | 0.51 |
| Indiana | 794,141 | 15,935 | 0.02 | N.A. | 1,716,825 | 622 | 1.96 |
| Iowa | 652,389 | 573,626 | 1.29 | 0.80 | — | — | — |
| Kansas | 426,216 | 46,459 | 0.10 | N.A. | — | — | — |
| Kentucky | 509,962 | 200,716 | 0.38 | N.A. | 954,213 | 553 | 1.84 |
| Louisiana | 249,306 | 806,890 | 1.30 | 1.32 | — | — | — |
| Maine | 181,219 | 268,501 | 1.74 | 0.93 | — | — | — |
| Maryland | 1,113,996 | 804,697 | 0.88 | 0.38 | — | — | — |

| State | Revenues Past 12 Months (\$ in thousands) | Trust Fund Balance (\$ in thousands) | Ratio of Trust Fund to Total Covered Wages | Average High Cost Multiple (AHCM) | Outstanding Trust Fund Loan (\$ in thousands) | Loan per Covered Employee | Percentage of Loans to Yearly Total Wages in Covered Employment |
|----------------|---|--------------------------------------|--|-----------------------------------|---|---------------------------|---|
| Massachusetts | 1,935,282 | 491,445 | 0.33 | 0.07 | — | — | — |
| Michigan | 1,887,425 | 840,792 | 0.60 | N.A. | — | — | — |
| Minnesota | 1,340,974 | 101,775 | 0.11 | N.A. | — | — | — |
| Mississippi | 280,215 | 435,103 | 1.54 | 1.24 | — | — | — |
| Missouri | 686,666 | 31,012 | 0.04 | N.A. | 562,805 | 220 | 0.69 |
| Montana | 157,866 | 130,756 | 1.08 | 0.73 | — | — | — |
| Nebraska | 204,774 | 325,606 | 1.27 | 1.45 | — | — | — |
| Nevada | 488,984 | 21,438 | 0.05 | N.A. | 720,432 | 650 | 1.82 |
| New Hampshire | 216,964 | 148,546 | 0.67 | 0.33 | — | — | — |
| New Jersey | 2,950,892 | 32,197 | 0.02 | N.A. | 1,052,178 | 281 | 0.62 |
| New Mexico | 215,434 | 87,916 | 0.39 | 0.33 | — | — | — |
| New York | 3,259,668 | 27,614 | 0.01 | N.A. | 2,860,487 | 337 | 0.73 |
| North Carolina | 1,018,852 | 225,692 | 0.18 | N.A. | 2,567,222 | 673 | 2.05 |
| North Dakota | 96,954 | 126,827 | 0.96 | 1.05 | — | — | — |
| Ohio | 1,513,099 | 177,794 | 0.11 | N.A. | 1,791,716 | 362 | 1.11 |
| Oklahoma | 540,614 | 628,428 | 1.24 | 0.90 | — | — | — |
| Oregon | 1,041,147 | 1,220,131 | 2.31 | 0.85 | — | — | — |
| Pennsylvania | 3,085,610 | 31,356 | 0.02 | N.A. | 2,592,680 | 472 | 1.34 |
| Puerto Rico | 207,591 | 382,883 | 2.38 | 0.84 | — | — | — |
| Rhode Island | 255,333 | 1,098 | 0.01 | N.A. | 224,646 | 507 | 1.57 |
| South Carolina | 496,673 | 238,979 | 0.45 | N.A. | 782,188 | 444 | 1.48 |
| South Dakota | 48,102 | 41,621 | 0.41 | 0.69 | — | — | — |
| Tennessee | 770,557 | 561,768 | 0.63 | 0.34 | — | — | — |
| Texas | 2,796,772 | 1,290,263 | 0.30 | N.A. | — | — | — |

| State | Revenues Past 12 Months (\$ in thousands) | Trust Fund Balance (\$ in thousands) | Ratio of Trust Fund to Total Covered Wages | Average High Cost Multiple (AHCM) | Outstanding Trust Fund Loan (\$ in thousands) | Loan per Covered Employee | Percentage of Loans to Yearly Total Wages in Covered Employment |
|----------------|---|--------------------------------------|--|-----------------------------------|---|---------------------------|---|
| Utah | 346,235 | 420,847 | 1.13 | 0.88 | — | — | — |
| Vermont | 130,093 | 75,114 | 0.92 | N.A. | 77,732 | 264 | 0.96 |
| Virgin Islands | 2,633 | 2,066 | 0.19 | N.A. | 36,523 | 870 | 3.36 |
| Virginia | 773,911 | 76,415 | 0.05 | N.A. | — | — | — |
| Washington | 1,450,078 | 2,626,165 | 2.37 | 1.13 | — | — | — |
| West Virginia | 233,502 | 140,008 | 0.69 | 0.33 | — | — | — |
| Wisconsin | 1,252,741 | 11,373 | 0.01 | N.A. | 926,239 | 347 | 1.14 |
| Wyoming | 134,216 | 188,039 | 2.06 | 1.23 | — | — | — |

Source: Employment and Training Administration, U.S. Department of Labor, *Unemployment Insurance Data Summary*, 2nd Quarter 2012 Report, Washington, DC, 2012, Table: Financial Information by State for CYQ 2012.2 and individual state reports, http://ows.doleta.gov/unemploy/content/data_stats/datasum11/DataSum_2012_2.pdf.

Notes: Total covered wages are based on extrapolated wages for the most recent 12 months. Trust Fund Balance does not include outstanding debt. States may have obligated some portion of their UTF funds and may be borrowing to fund unemployment benefits even if the state's UTF balance appears to be positive. N.A. = Not Applicable: these states have outstanding debt that exceed their fund balances. Conversely, "—" = no outstanding federal loan (states may have additional loans financed outside of the UTF).

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 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 6.0% with no allowable state tax rate rather than 0.6% 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 either from the dedicated loan account, the FUA, within the UTF or from outside sources. Some states borrow from sources outside the UTF and thus are not subject to the loan restrictions described below but rather are subject to the terms within that outside loan agreement.

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

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 DOL, 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. The interest rate for calendar year loans is determined by Section 1202(b)(4) of the SSA. The interest rate for a calendar year is the earnings yield on the UTF for the quarter ending December 31 of the previous calendar year. The Treasury Department calculated the fourth

quarter earnings yield to be 2.943%. Thus, new loans made in calendar year 2012 will be subject to a 2.943% interest rate.⁷

States may not pay the interest directly or indirectly from funds in their state account with the UTF. If states do not repay the interest, or pay the interest with funds from SUTA taxes, the Department of Labor is required by federal law to refuse to certify the state program in compliance with federal law.⁸ Not being in compliance with federal unemployment law would mean that the state would not be eligible to receive administrative grants and its state employers would not receive the state unemployment tax credit in the calculation of their federal unemployment taxes.

States may borrow funds without interest from the FUA during the year. To receive these interest-free loans, the states must meet three conditions:

1. The states must repay the loans by September 30.
2. For those loans to maintain their interest-free status, there cannot be any loans made to that state in October, November, or December of the calendar year of such an interest-free loan. If loans are made in the last quarter of the calendar year, the “interest-free” loans made in the previous fiscal year will retroactively accrue interest charges.
3. The states must meet funding goals relating to their account in the UTF, established under regulations issued by DOL.

Until recently, there were no funding goals for state accounts within the UTF. On September 17, 2010, DOL issued a final rule to implement federal requirements conditioning a state’s receipt of interest-free loans upon the state meeting funding goals, established under regulations issued by the Secretary of Labor.⁹ This rule will begin to be phased in beginning in 2014 with the full effect of the rule beginning in 2019.

By 2019, states must have had at least one year in the past five calendar years before the year in which advances are taken where its AHCM was greater than or equal to 1.0. Additionally, states must meet two criteria for maintenance of tax effort in every year from most recent year the AHCM was at least 1.0 and the year in which advances are taken:

- The average state unemployment tax rate (the ratio of total state tax amount collected over the total taxable wages) was at least 80% of the prior year’s rate; and,
- The average state unemployment tax rate is at least 75% of the average benefit-cost ratio over the preceding five calendar years, where the benefit-cost ratio for a year is defined as the amount of benefits and interest paid in the year divided by the total covered wages paid in the year.

⁷ *Unemployment Insurance Program Letter No. 9-12*, http://wdr.doleta.gov/directives/attach/UIPL/uipl_9_12_acc.pdf.

⁸ 42 C.F.R. §503(c)(3) and 26 U.S.C. §3304(a)(17).

⁹ Employment and Training Administration, Labor, “Federal-State Unemployment Compensation Program Funding Goals for Interest-Free Loans,” *75 Federal Register* 57146, September 17, 2010.

Expired Provision: Temporary Waiver of Interest in 2009 Stimulus Package

The 2009 stimulus package (the American Recovery and Reinvestment Act of 2009, P.L. 111-5 Section 2004) temporarily waived 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 were due from the time of enactment of the proposal until December 31, 2010, were deemed to have been made by the state. No interest on advances accrued during the period.

Although interest did not accrue during this period, this did *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.

Since January 1, 2011, the calculation of interest has reverted to permanent law on interest charges as described in the previous paragraphs.

Representative Peter Welch introduced H.R. 650 on February 10, 2011. The bill would extend the interest accrual on federal loans to states through 2012. Senator Durbin introduced S. 386, the Unemployment Insurance Solvency Act of 2011, on February 17, 2011. Among many other items, S. 386 would extend the suspension of interest accrual on federal loans to states through 2012.

Loan Repayment

States with outstanding loans from the FUA 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 an effective federal tax increase. Thus, a state may have approximately 22 to 34 months to repay the loan without a federal tax increase, depending on when it obtained the outstanding loan.

As of September 18, 2012, just over \$25.9 billion in federal UTF loans to the states were outstanding. A current list of states with outstanding loans may be found at DOL's website, <http://www.workforcesecurity.doleta.gov/unemploy/budget.asp#tflans>.

Federal Tax Increases on Outstanding Loans Through Credit Reductions

If the state does not repay a loan fully by November 10 of that second year, 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.¹⁰ *The provisions of the 2009 stimulus package did not change the timetable for federal tax increases resulting from a state's outstanding loans.*

¹⁰ Interest payments can be delayed up to nine months (and no interest on the unpaid interest would accrue) if the most recent 12-month average unemployment rate (from September of the previous year to August of that year) is 13.5% or higher (42 U.S.C. §1322(b)(9)). If the state's January through June average insured unemployment rate in the previous year is 6.5% or higher, the state would be required to pay 25% of that current year's interest that is due. The state the (continued...)

In 2010, three states had a credit reduction: Michigan (0.6), Indiana (0.3), and South Carolina (0.3). As a result, the credit reduction was applied retroactively to tax year 2010 earnings, and the net FUTA tax during 2010 for Michigan employers was 1.4% on the first \$7,000 of each employee's earnings. In Indiana and South Carolina the net FUTA tax during 2010 for their employers was 1.1% on the first \$7,000 of each employee's earnings. In all other states the net FUTA 2010 tax was 0.8%.

In 2011, 20 states and the Virgin Islands had a state tax credit reduction: Michigan (0.9), Indiana (0.6), Arkansas (0.3), California (0.3), Connecticut (0.3), Florida (0.3), Georgia (0.3), Illinois (0.3), Kentucky (0.3), Minnesota (0.3), Missouri (0.3), North Carolina (0.3), New Jersey (0.3), Nevada (0.3), New York (0.3), Ohio (0.3), Pennsylvania (0.3), Rhode Island (0.3), Virginia (0.3), Virgin Islands (0.3), and Wisconsin (0.3). As a result, in Michigan, a credit reduction of 0.9 was applied retroactively to tax year 2011 earnings and the net FUTA tax during 2011 for Michigan employers was 1.5% on the first \$7,000 of each employee's earnings. In Indiana (with a credit reduction of 0.6) the net FUTA tax during 2011 for its employers was 1.2% on the first \$7,000 of each employee's earnings. In the other 19 states with a credit reduction, the net FUTA tax for 2011 was 0.9%. For all states not subject to the credit reduction, the net FUTA tax was 0.6%.

The additional federal taxes attributable to the credit reduction 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.

If any January 1 passes without an outstanding balance, the year count starts over with the next loan. The U.S. DOL maintains a list of potential reduced credit states at http://ows.doleta.gov/unemploy/docs/reduced_credit_states.xls.

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 0.6% to 0.9%—an additional \$21 for each employee; in the second year, it would increase to 1.2%—a cumulative additional \$42 for each employee.¹¹

There are two potential additional credit reductions (in addition to 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 (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

(...continued)

would pay the remaining 25% in each of the next three years. The (75%) remainder of the interest payment would be not be subject to additional interest calculations (42 U.S.C. §1322(b)(3)(C)).

¹¹ For 2011 this calculation will be slightly different. For the first \$7,000 on wages earned through June 2011, the net FUTA tax is 0.8%; for any remaining portion of the first \$7,000 of wages earned in 2011 after June, the FUTA tax is 0.6%. Any state tax credit reduction (for example, in the first year) would follow the same pattern of an increase net FUTA tax of 0.3%.

additional credit reduction (referred to as the Benefit Cost Ratio, 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.¹² **Table 2** presents these reductions and the subsequent net FUTA tax faced by state employers as a result of these unpaid loans.

Table 2. Schedule of State Tax Credit Reduction and Net Federal Unemployment Tax Act (FUTA) Tax for July 2011 Onwards

| Loan Year | Credit Reduction | Additional Reductions | Net FUTA Tax |
|--|------------------|-----------------------|--------------|
| Year 1 of outstanding loan | 0.0% | None | 0.6% |
| Year 2 (applied retroactively at end of calendar year) | 0.3% | None | 0.9% |
| Year 3 | 0.6% | 2.7 Add-on | 1.2% or more |
| Year 4 | 0.9% | 2.7 Add-on | 1.5% or more |
| Year 5 | 1.2% | BCR Add-on | 1.8% or more |
| Year 6 | 1.5% | BCR Add-on | 2.1% or more |
| Year 7 | 1.8% | BCR Add-on | 2.4% or more |
| Year 8 | 2.1% | BCR Add-on | 2.7% or more |
| Year 9 | 2.4% | BCR Add-on | 3.0% or more |
| Year 10 | 2.7% | BCR Add-on | 3.3% or more |
| Year 11 | 3.0% | BCR Add-on | 3.6% or more |
| Year 12 | 3.3% | BCR Add-on | 3.9% or more |
| Year 13 | 3.6% | BCR Add-on | 4.2% or more |
| Year 14 | 3.9% | BCR Add-on | 4.5% or more |
| Year 15 | 4.2% | BCR Add-on | 4.8% or more |
| Year 16 | 4.5% | BCR Add-on | 5.1% or more |
| Year 17 | 4.8% | BCR Add-on | 5.4% or more |
| Year 18 | 5.1% | BCR Add-on | 5.7% or more |
| Year 19 | 5.4% | BCR Add-on | 6.0% |

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

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

Benefit Cost Ratio (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

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

¹² 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: $\text{Max} [\text{five-year State Average Cost/Taxable Wages}, 2.7] - \text{Average Annual State Tax Rate on Total Wages}$.

from its account in the UTF to the FUA. If the state complies with all the requirements listed below, the potential credit reduction is avoided (there is no reduction). 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 tax year based upon a state tax credit reduction.

- 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.

In FY2011, South Carolina was the only state with outstanding advances to meet these requirements. As a result, employers in South Carolina were not subject to a state tax credit reduction in the calculation of their FUTA taxes. (Employers in South Carolina would have generally paid more in state unemployment taxes to meet these requirements.)

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:

- No legislative or other action in 12 months ending September 30 has been taken to decrease state unemployment tax effort.
- No legislative or other action has been taken to decrease the state trust account's net solvency.
- Average state unemployment tax rate on total wages must exceed the five-year average benefit cost rate on total wages.
- 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 the Secretary of Labor determines that the state did 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.

Current Status of Outstanding Loans, Accrued Interest Owed, and State Tax Credit Reductions

Table 3 lists all states that have outstanding loans. The table also includes information on accrued interest payments for FY2012. The third column provides information on whether a state was subject to a credit reduction for 2011. The last column provides the net FUTA tax faced by employers in each state that had an outstanding loan. This table was created on December 30, 2011, and may change based upon state actions in the following weeks. If a state is not listed on this table, the state did not have outstanding loans on December 28, 2011, did not have outstanding interest accruals, and was not subject to a state tax credit reduction on the calculation of the net FUTA tax.

Table 3. Outstanding Loan Balances, Interest Owed, and Potential State Tax Credit Reduction

| State | Outstanding Balance January 9, 2012 | Accrued FY2012 Interest | 2011 State Tax Credit Reduction | 2011 Net FUTA Tax ^a |
|----------------|--|-------------------------------------|------------------------------------|-----------------------------------|
| Alabama | \$41,171,959.18 | \$301,264.18 | N.A. ^b | 0.6 |
| Arizona | 375,494,654.70 | 3,762,253.61 | N.A. | 0.6 |
| Arkansas | 330,853,382.53 | 3,647,631.74 | 0.3 | 0.9 |
| California | 9,989,135,462.02 | 103,208,378.26 | 0.3 | 0.9 |
| Colorado | 353,527,081.05 | 4,107,288.26 ^c | N.A. | 0.6 |
| Connecticut | 709,875,582.98 | 8,811,655.92 | 0.3 | 0.9 |
| Delaware | 62,523,367.88 | 689,315.07 | N.A. | 0.6 |
| Florida | 1,792,100,000.00 | 18,956,417.80 | 0.3 | 0.9 |
| Georgia | 721,080,472.00 | 7,949,853.80 | 0.3 | 0.9 |
| Illinois | 2,185,410,158.28 | 22,095,629.00 | 0.3 | 0.9 |
| Indiana | 1,994,007,775.40 | 21,164,706.91 | 0.6 | 1.2 |
| Kansas | 70,976,936.12 | 541,659.71 | N.A. | 0.6 |
| Kentucky | 948,700,000.00 | 6,048,353.63 | 0.3 | 0.9 |
| Michigan | 26,124,483.61 | 31,634,097.32 | 0.9 | 1.5 |
| Minnesota | 202,787,883.60 | 1,909,248.21 | 0.3 | 0.9 |
| Missouri | 739,476,912.89 | 8,002,565.35 | 0.3 | 0.9 |
| Nevada | 780,799,054.49 | 30,711,423.52 ^c | 0.3 | 0.9 |
| New Jersey | 1,513,819,882.72 | 15,288,754.70 | 0.3 | 0.9 |
| New York | 3,516,408,575.89 | 35,264,826.86 | 0.3 | 0.9 |
| North Carolina | 2,702,990,739.25 | 16,302,399.67 | 0.3 | 0.9 |
| Ohio | 2,095,695,131.00 | 10,529,287.30 | 0.3 | 0.9 |
| Pennsylvania | 3,347,251,595.03 | 34,396,333.98 | 0.3 | 0.9 |
| Rhode Island | 237,983,447.28 | 2,400,748.62 | 0.3 | 0.9 |
| South Carolina | 782,456,436.93 | 8,920,201.67 | N.A. | 0.6 |
| Vermont | 77,731,860.63 | 856,987.47 | N.A. | 0.6 |
| Virginia | 288,253,000.00 | 2,687,021.89 | 0.3 | 0.9 |
| Virgin Islands | 30,799,690.81 | 317,112.57 | 0.3 | 0.9 |
| Wisconsin | 1,268,412,281.85 | 13,092,878.76 | 0.3 | 0.9 |
| Totals | \$37,185,847,808.12 | \$413,598,295.78^c | 21 | — |

Source: Congressional Research Service table prepared using data from the U.S. Bureau of Public Debt, http://www.treasurydirect.gov/govt/reports/tfmp/tfmp_advactivitiesched.htm, and the U.S. Department of Labor http://ows.doleta.gov/unemploy/content/reduced_credit_states.xls.

- a. These net rates uses a net FUTA rate of 0.6% that was effective beginning in July 2011 for states that did not have outstanding loans on two consecutive January 1s. For earnings before July 2011, the underlying net FUTA rate was 0.8%.
- b. N.A. = not applicable because the state has not had outstanding balance on two consecutive January 1s.
- c. Includes deferred interest from FY2011.

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