Employers in 20 states will soon face higher unemployment tax rates

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As the national unemployment rate remains around 9 percent and state rates range as high as 13.4 percent (Nevada), many states are struggling just to continue paying out unemployment benefits. A new report out from the Federal Funds Information for States (FFIS) explains how employers in many states now face higher unemployment taxes and a long road ahead toward recovery.

During the recession and following, unemployment insurance trust funds – the accounts used to pay out unemployment benefits – have been depleted in many states. In September 2006, Michigan became the first state in recent history to borrow money from the federal government so that it could continue to send out unemployment checks.

As of November 25, twenty-six states plus the Virgin Islands were borrowing about $37.9 billion from the federal unemployment trust fund. Thanks to a provision in the American Recovery and Reinvestment Act, those borrowed funds came interest and penalty free until the first of this year. Now that provision has expired and states that haven’t paid off to their debts – and employers in those states – are paying a price.

On November 10, states that have been borrowing from the federal fund since 2009 were required to pay off the outstanding balances on those loans. Employers in states that did not make this payment or did not qualify for exemption saw what is effectively[1] a 0.3 percentage point increase in their federal unemployment tax rate. This year, 20 states and the Virgin Islands were unable to pay off their 2009 balances by the November deadline – which means employers in those states will face a tax increase in 2012.

Data Source: Federal Funds Information for States (FFIS) [2], UI Update: Credit Reductions and New Legislative Proposals, Issue Brief 11-41, November 23, 2011

Employers in 18 states plus the Virgin Islands will see an effective a 0.3 percentage point increase in their tax rate. Indiana failed to pay off its balance from 2008, making its loans two years past the repayment deadline, which means an effective tax hike of 0.6 percentage points. For Michigan – which has failed to repay its outstanding balance for three years – the effective tax increase is the highest: 0.9 percentage points.

Three additional states, Alabama, Idaho, and South Carolina, took out federal loans in 2009. However, both Alabama and Idaho repaid their outstanding balances by the deadline and thus avoided the tax increase. South Carolina qualified for an exemption from the increase (called credit reduction avoidance) per DOL’s regulations.[2]

[1]The federal component of unemployment is funded by a 6.0% tax rate on the first $7,000 paid
annually by employers to each employee. Employers in states that have unemployment programs approved by the Department of Labor (DOL) and no outstanding loan balances may credit 5.4 percentage points against the 6.0% tax rate, so that the net effective federal tax rate becomes 0.6%. The “effective” tax increase mentioned above is actually a decrease to the 5.4 percentage point credit applied to the tax rate.

Before June 30, 2011, this federal tax rate was 6.2% annually because of a temporary 0.2% surcharge that was added in the 1970s. The additional 0.2% surcharge expired at the end of June, making the tax rate what it is now, 6.0% (or 0.6% after full credit). This means that from January 1, 2011 to June 30, 2011, the tax rate with the full credit was 0.8% per employee but converted to 0.6% for July 1, 2011-December 31, 2011.

[2]According to FFIS, “to qualify for credit reduction avoidance, a state must pay the amount that the credit reduction would produce prior to November 10 of the year for which avoidance is to apply, repay all loans received during the one-year period prior to November 10, or increase solvency for the taxable year through legislative action by an amount equal to or greater than the amount of the credit reduction, and not borrow from the federal fund for a three-month period (November 1-January 31).”

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