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LEGISLATIVE UPDATE

Eye on Washington

UNEMPLOYMENT INSURANCE TAX INCREASES EXPECTED THROUGH 2014

As the economy continues to recover from the most recent recession, employers could experience some dramatic Unemployment Insurance (UI) cost increases through at least 2014. UI cost increases will mainly be driven from the following three sources:

1. State surcharges to replenish depleted UI trust funds and/or repay federal UI loans
2. Federal Unemployment Tax Act (FUTA) increases (AKA "Credit Reduction")
3. State Bond and/or Interest assessments

Each is explained below. FUTA tax increases had not been invoked in more than a few states since the mid-1980's. As a result, many businesses were surprised to learn of significant additional tax liabilities imposed for 2011. Employers should reevaluate their 2012 and future UI tax forecasts in light of these potential increases.

1. State UI Surcharges

At least 23 states have depleted state UI trust funds, and have had to draw from a special federal UI loan fund as of May 21, 2012. Many other states emerged from the recent recession with minimal UI trust fund balances and tax revenues marginally greater than UI benefit payments. To rebuild depleted UI trust funds and/or pay off federal loans, many states have reduced UI benefits and/or increased UI taxes. State legislatures are increasingly recognizing the need to rebuild UI trust funds and some have assessed in some cases substantial UI tax surcharges.

For additional information on UI surcharges, review your most recent UI tax rate assignment notice or contact the applicable State Workforce Agency.

2. Federal FUTA Tax Expected to Double or Triple in Some States by 2014

Although the FUTA tax is often not viewed as a significant expense relative to other employment costs (*i.e.*, normally $42 per employee annually), in states with outstanding federal UI loans the FUTA tax is expected to nearly triple, to an average of $124 per employee by 2014.

As background, employers pay federal and state UI taxes on wages paid to employees. The FUTA tax is nominally 6%; however, employers generally receive a FUTA credit of 5.4% for payment of state UI taxes, making the effective FUTA tax rate 0.6% (.006) of taxable wages up to a limit of $7,000 per employee annually. When state unemployment insurance funds are depleted, as has occurred in many states in recent years, states draw from a federal loan account. If any loans are not repaid within two years, FUTA tax rates on wages paid in the affected states automatically increase due to the decrease in the amount of credit allowed ("Credit Reduction") in order to facilitate repayment of such loans.

When this situation occurs, the credit given for payment of state UI taxes is reduced – resulting in the FUTA tax increasing - typically by 0.3%, or $21 per worker, each year. The increase is payable in January of the following calendar year at the time an employer submits its Form 940 to the Internal Revenue Service. *The credit continues to be further reduced by .3% annually until federal UI loans are repaid*.

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The states in which the increased FUTA tax rates will apply for 2012 will not be finalized until mid-November, because states have until that time to repay federal UI loans or take other action to avoid Credit Reduction. Several states, including Alabama, Kansas, Michigan, Minnesota and Virginia, have already repaid their loans for 2012. These states could still be subject to the FUTA Credit Reduction if additional federal UI loans prove necessary later this year.

The table below provides an estimate of expected FUTA taxes on a per-employee basis, by state, for 2012 - 2014. The tax rates and amounts are subject to change.

Example

An employee works for ABC Corp. beginning in January 2012, receiving wages of $60,000 annually. ABC Corp's FUTA tax due for 2012 would normally be $42 ($7,000 x 0.6%).

If the employee worked in Arizona, a "new" Credit Reduction state, the total FUTA tax due for 2012 would be $63 ($7,000 x .9%).

If the employee worked in California, a Credit Reduction state for a second year, the total FUTA tax due for 2012 would be $84 ($7,000 x 1.2%).

States with Potential FUTA Credit Reductions 2012 - 2014 — *estimated - subject to change*

Annual FUTA Tax per Employee				Increase over normal FUTA tax
State	**2012**	**2013**	**2014**	
Arizona	$63	$84	$105	150%
Arkansas	$84	$105	$126	200%
California	$84	$105	$126	200%
Colorado	$63	$84	$105	150%
Connecticut	$84	$105	$126	200%
Delaware	$63	$84	$105	150%
Florida	$84	$105	$126	200%
Georgia	$84	$105	$126	200%
Illinois	$84	$105	$126	200%
Indiana	$105	$126	$147	250%
Kentucky	$84	$105	$126	200%
Missouri	$84	$105	$126	200%

Annual FUTA Tax per Employee				Increase over normal FUTA tax
State	**2012**	**2013**	**2014**	
Nevada	$84	$105	$126	200%
New Jersey	$84	$105	$126	200%
New York	$84	$105	$126	200%
North Carolina	$84	$105	$126	200%
Ohio	$84	$105	$126	200%
Pennsylvania	$84	$105	$126	200%
Rhode Island	$84	$105	$126	200%
South Carolina	$105	$126	$147	250%
Vermont	$63	$84	$105	150%
Virgin Islands	$84	$105	$126	200%
Wisconsin	$84	$105	$126	200%

Source: *U.S. Dept. of Labor, Employment and Training Administration, UI Program Statistics*

In addition to the amounts due through 2014 set forth above, there are provisions for additional Credit Reductions in the fourth and subsequent calendar years in which a state has an outstanding loan. There are also special provisions by which states can limit or avoid such Credit Reductions.

If ADP is responsible for filing Form 940 on behalf of your organization, you will receive an invoice in January 2013 for any applicable 2012 FUTA Credit Reduction amounts due.

3. State Bond Assessments and Interest Assessments

Some states have issued bonds in order to repay federal loans and avoid the FUTA Credit Reduction status described above. Where applicable, employers in a state that has issued bonds for this purpose may be subject to a separate assessment related to the bond repayment. This assessment will be billed separately by the agency. For example, Texas issued bonds to repay their federal loans. A FUTA Credit Reduction tax increase would therefore not apply in Texas, but employers may be subject to a separate bond repayment assessment.

Finally, states with outstanding federal UI loans must pay interest on the loans, and must generally assess employers separately for interest payments (*i.e.*, interest cannot be paid from UI trust funds or UI tax collections). More than half of the states are expected to assess employers for this interest in 2012.

Example

Connecticut recently announced a special interest assessment of about $25.50 per employee, to be billed on August 1 and due on August 31, 2012.

Source: *Connecticut Department of Labor Employer Information Notice*, March 2012

The United States Department of Labor (USDOL) estimated that $1.3 billion in interest was paid in FY2012, and another $1 billion will be assessed for FY2013.

To determine whether to expect an interest assessment, check the USDOL website below. If a state in which your organization has workers has a loan balance, it is likely that the state will notify you of interest due between June and August 2012.

http://www.ows.doleta.gov/unemploy/budget.asp#tfloans

In summary, employers should plan for potentially substantial increases in UI taxes and related assessments over the next few years. In particular, businesses should anticipate FUTA tax increases, which will be calculated and paid in January 2013 for 2012.

Unemployment Insurance remains the only payroll tax that employers can control, at least in part, by prudent Human Resource management and careful handling of UI claims. Employers' tax rates typically increase as a result of an increase in unemployment claims filed. If you would like more information on how to better manage UI claims or have questions regarding your UI taxes, please contact your ADP representative.

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