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LEGISLATIVE UPDATE

Eye on Washington

FEDERAL UNEMPLOYMENT TAX (FUTA) TAXES TO INCREASE FOR 2011 AND 2012

Employers in twenty states and the Virgin Islands will pay increased Federal Unemployment Tax (FUTA) taxes in January 2012, for wages paid in 2011, in order to repay state unemployment insurance loans.

As background, employers pay federal and state unemployment insurance taxes on wages paid. The Federal FUTA tax is nominally 6%; however, the IRS grants a credit of 5.4% for payment of state UI taxes, making the effective FUTA tax rate 0.6 percent (.006), up to the taxable wage limit of $7,000. When state unemployment insurance funds are depleted, as occurred in many states in recent years, states draw from a designated federal loan account. If such loans are not repaid within two years, employers lose part of this FUTA tax credit, in effect increasing the FUTA tax rate for wages paid in the affected states.

When this "credit reduction" applies, the federal FUTA tax typically increases by 0.3%, or $21 per worker, payable in January of the following calendar year with IRS Form 940. The FUTA Credit Reduction increases annually by .3% until loans are repaid. For example, Indiana employers had a net FUTA tax rate of 1.1% (.8% + .3%) for 2010, but will pay a net FUTA tax of 1.4% on wages paid through June 2011.

The FUTA tax rate was reduced by 0.2% effective July 1, 2011, and is now 0.6% of wages paid, up to the taxable wage limit of $7,000, or $42 per employee per year. This FUTA rate reduction partially offset the 2011 FUTA Credit Reduction assessments, but complicated the IRS Form 940 somewhat by assessing different tax rates on wages paid through June and wages paid from July 1 through December 31, 2011.

The IRS has issued the 2011 Form 940, which identifies the states that are subject to FUTA Credit Reduction for 2011. The states and territories that are subject to additional FUTA taxes ("Credit Reduction") for 2011 include:

STATES

- Arkansas
- California
- Connecticut
- Florida
- Georgia
- Illinois
- Kentucky
- Minnesota
- Missouri
- Nevada
- New Jersey
- New York
- North Carolina
- Ohio
- Pennsylvania
- Rhode Island
- Virginia
- Virgin Islands
- Wisconsin

* *States with federal loans had until November 10th to repay such loans or take other action to avoid the FUTA credit reduction. Alabama repaid their loan, and South Carolina met other qualifications to avoid credit reduction status for 2011.*

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In these states, the net FUTA tax rate will be 1.10% for wages paid up to the $7,000 FUTA taxable wage limit through June and 0.9% for FUTA taxable wages paid from July 1 through December 31, 2011.

EXAMPLE

An employee works for ABC Corp. beginning in January 2011, receiving wages of $60,000 for the year. ABC Corp's FUTA tax due for 2011 would be $56 ($7,000 x 0.8%). If the employee worked in Florida, a Credit Reduction state, the total FUTA tax would be $77 ($7,000 x 1.1%).

However, if the employee began work for ABC Corp. in June, receiving wages of $2,000 through June 30, ABC Corp's FUTA tax due for the year would be $46 ($2,000 x 0.8%, plus $5,000 x 0.6%). If the employee worked in Ohio, a Credit Reduction state, the total FUTA tax would be $67 ($2,000 x 1.1%, plus $5,000 x 0.9%).

The net FUTA tax rate will be even higher in Indiana and Michigan because these states depleted and failed to repay their unemployment insurance funds for consecutive years.

Indiana: This is the second year of FUTA Credit Reduction status for Indiana, which will consequently have a net FUTA tax rate of 1.4% for FUTA taxable wages through June, and a net FUTA rate of 1.2% for FUTA taxable wages paid from July 1 through December 31, 2011.

Michigan: This is the third year of FUTA Credit Reduction status for Michigan, which will consequently have a net FUTA tax rate of 1.7% for FUTA taxable wages through June, and a net FUTA rate of 1.5% for FUTA taxable wages paid from July 1 through December 31, 2011.

If ADP is responsible for filing Form 940 for your organization, you will receive an invoice for Credit Reduction amounts due shortly after January 16, 2012.

WHAT TO EXPECT FOR 2012: FUTA TAXES, INTEREST AND CREDIT REDUCTION

The FUTA tax rate is scheduled to remain at 0.6% of wages paid, up to the taxable wage limit of $7,000, or $42 per employee per year. Nevertheless, employers in Credit Reduction states should plan on increased FUTA taxes in 2012 (payable in January 2013). Again, unless a state pays off the loan or takes other actions specified by federal law, their FUTA Credit Reduction will increase annually by 3% (003).

For example, in November 2011, Illinois enacted SB 72, which authorized the issuance of bonds in 2012 to pay off outstanding loans. Assuming they do so, Illinois employers will not be subject to FUTA credit reduction in 2012. However, Illinois employers would then be subject to separate assessments for interest and repayment of the bond. Other states (e.g., Texas) also issued bonds to repay their federal loans, and hence avoid Credit Reduction status.

Additional states, including CO, DE, KS, and VT, are expected to become Credit Reduction states for 2012.

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Interest Assessments

Employers should plan for annual interest assessments from states with outstanding loans. Interest on federal loans to states was waived through 2010 by the American Recovery and Reinvestment Act of 2009, but is in effect for 2011 and future years. More than half of the states are expected to assess employers for interest in 2012.

Unemployment Insurance remains the only payroll tax that employers can control by prudent Human Resource management and careful handling of UI claims. Employers' tax rates rise in direct proportion to unemployment claims of former workers. ADP can assist employers in managing UI claims and help to keep UI taxes as low as possible in this difficult environment.

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Automatic Data Processing, Inc.
1 ADP Boulevard
Roseland, NJ 07068
adp.com

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