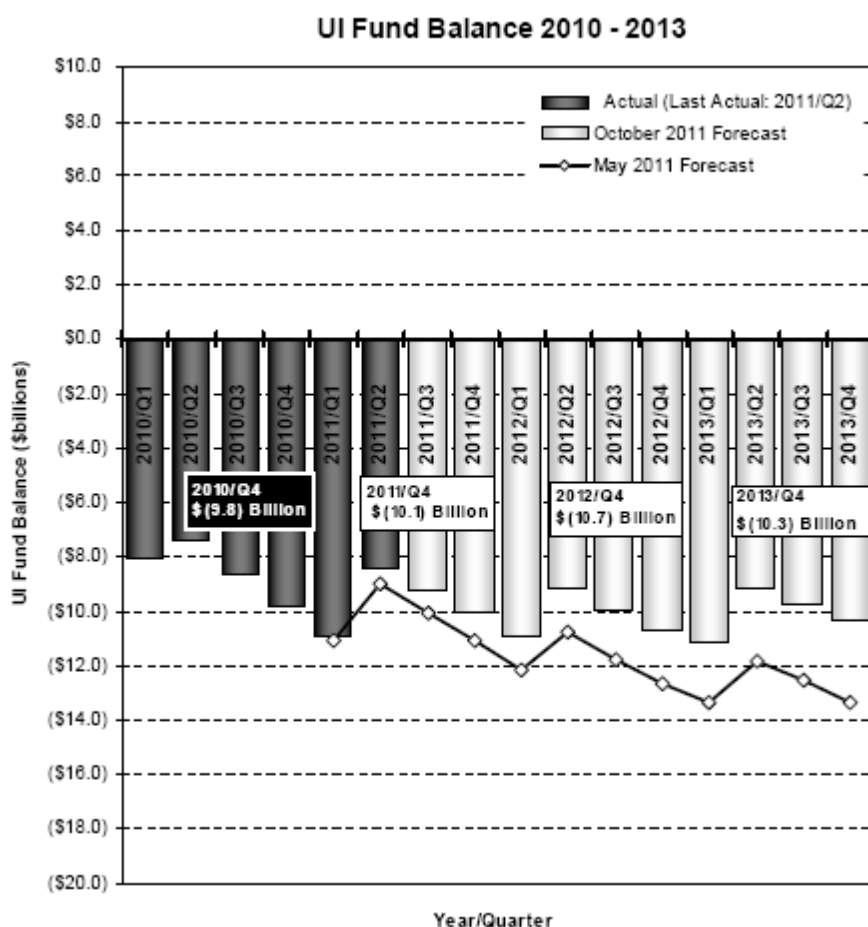


UNEMPLOYMENT INSURANCE: UNEMPLOYMENT INSURANCE FUND PROJECTS DEFICIT OF \$10.1 BILLION

The Unemployment Insurance (UI) Fund has a revised projected deficit of \$10.1 billion by the end of 2011, according to the Employment Development Department's (EDD) [October 2011 UI Fund Forecast](#).

This is "good" news, considering that the EDD previously projected that the fund would be \$13.4 billion in the red (in its [October 2010 UI Fund Forecast](#)). The other "good" news is that the EDD's projection of the UI Fund deficit by the end of 2012 is now \$10.7 billion, instead of its previous estimate of \$16 billion. The EDD also projects a deficit of \$10.3 billion by the end of 2013, if changes are not made to the financing structure.



Source: EDD's [October 2011 UI Fund Forecast](#).

Federal Incentive Payment and ABP

The EDD has reduced its deficit estimates because it is counting \$839 million in incentive funds that it received from the federal American Recovery and Reinvestment Act (ARRA) of 2009. Of the \$839 million, the EDD used \$791 million to offset the 2011 deficit, and appropriated \$48 million for the administration of the Alternate Base Period

(ABP) program. The ABP program would allow more workers to qualify for UI benefits, by taking more recent wages into account when determining eligibility. The EDD believes that an additional 26,000 unemployed workers may become eligible for unemployment benefits with the implementation of ABP.

The federal ARRA appropriated \$7 billion for states to expand their UI coverage by adopting the use of ABPs, among other things. The federal government provides the incentive payments to states in two lump sums: the first one-third will be provided to a state once it authorizes the use of an ABP in determining UI eligibility, and the remaining two-thirds will be provided once the ABP is implemented and the state meets two of four additional expanded coverage requirements.

The ARRA also included \$500 million for state grants, intended to help states upgrade their information technology systems and/or the administration of the program.

The EDD expects to implement the new ABP in April, as required under **AB 119** (Ch. 11-31). The federal deadline for implementation is September 2012.

Federal Loan

The UI Fund became insolvent in January 2009, and the fund ended that year with a deficit of \$9.8 billion. Since the beginning of 2009, EDD has been obtaining quarterly loans from the federal government to cover the deficit, thus allowing the EDD to make payments to UI claimants without interruption.

The ARRA waived interest that states owed on borrowed funds through December 2010. So, interest began accruing on January 1, 2011, with a payment due to the U.S. Department of Labor on September 30, 2011. California made its interest payment on time by borrowing from another source – the 2011-12 state budget used \$303.5 million from the Unemployment Compensation Disability Fund. Estimated interest due to the U.S. Department of Labor on September 30, 2012, is \$406.2 million, and another \$417.2 million will be due in 2013.

FUTA Surtax Sunset

The 6.2 percent FUTA tax rate includes a permanent tax rate of 6 percent and a "temporary" surtax of 0.2 percent (the "temporary" surtax has been on the books since 1976, and has been extended by Congress eight times).

The 0.2 percent surtax (finally) expired this summer. This lowered the FUTA tax rate from 6.2 percent to 6 percent. (The Obama administration wants to permanently extend the surtax, but Congress has not yet agreed.)

The FUTA taxable wage base is the first \$7,000 paid in wages to each employee during a calendar year. Currently, California and four other states have a taxable wage base at the federal minimum. California's current maximum state tax per employee is \$434 (.062 x \$7,000) per year, compared to the national average of \$995 per year.

Employers who pay state unemployment tax on time can claim a credit against their FUTA of up to 5.4%. So, the effective FUTA tax rate is 0.8% for the first \$7,000 of wages paid to each employee for the first half of 2011. With the surtax sunset, the effective rate is reduced to 0.6% for the second half of 2011.

Higher Taxes on Employers

California has relied on a federal loan for two consecutive years. Under federal law, this means that California employers likely will face a federal tax increase – starting with 2011 – via a reduction in the allowable FUTA credit (the U.S. Department of Labor will give California the official word on November 10). The federal credit of 5.4 percent will be reduced to 5.1 percent for 2011. The credit reduction schedule is 0.3 percent for the first year and an additional 0.3 percent for each succeeding year until the state loan is repaid. For subsequent years, the credit is reduced further.

The result of the credit reduction equates to a federal tax increase of \$21 per employee for 2011, going up to \$42 per employee for 2012, and so on.

An employer's effective FUTA tax rate will increase from 0.8 percent to 1.1 percent for the first half of 2011; and, due to the FUTA surtax sunset, the effective rate will be adjusted to 0.9 percent for the second half of 2011. This means that employers will need to segregate wages paid, by employee, for the first and second halves of the year (the 2011 IRS Form 940 will accommodate this segregation).

Employers must prepay their FUTA tax for first three quarters of the year. So, the credit reduction amount will be incurred in the fourth quarter, payments of which are due by January 31.

The EDD estimates that the increase in federal taxes will cost California employers an additional \$290 million in the 2011 tax year. Unless the U.S. Department of Labor says otherwise on November 10, these tax increases will come even as some elected officials and interest groups are discussing the possibility of imposing additional tax hikes that would hit California employers.

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