

Update: February 2011

## Tax Intelligence

### The Unemployment Financing Crisis – Federal Solvency Provisions

#### Situation

The unemployment financing crisis has reached a turning point in 2011. With 32 states currently borrowing \$42.6 billion in Title XII loans as of February 16, 2011, the unemployment system is essentially insolvent. On February 14, 2011, the Administration's 2012-2013 budget was submitted to Congress and included three key provisions for restoring solvency.

#### Solution

The budget must be approved by the House and Senate before any of these provisions would be implemented. Therefore, it is possible that these items may be changed or completely removed from the final budget that is approved.

#### Federal Title XII Loan Interest Suspension

- The budget provides for an additional two-year waiver of interest on Title XII loans for calendar years 2011 and 2012

The American Recovery and Reinvestment Act waived interest for Title XII loans in 2009 and 2010. As of January 1, 2011, interest has begun to accrue. States are not allowed to pay the interest due for Title XII loans from state unemployment tax revenue. As such, most states have a supplemental method in place to recover these interest costs from employers.

- Special Assessment Process - a certain percentage is assessed against the employer's prior year's taxable or total payroll to compute a pro-rata amount due by each employer. Florida sent bills to employers at the beginning of February and payments must be made by June 30, 2011.
- Rate Surcharge - an additional component is added to an employer's total unemployment tax rate specifically to raise funds to cover interest costs. For example, South Carolina adds between 0.043% and 0.549% to an employer's rate.
- No Current Provision - some states, such as California, have no provisions in place currently and will need to provide guidance to employers as to how the funds would be collected.

If interest payments on Title XII loans are waived pursuant to the current proposal, issues will arise with respect to those states in which employers may have already paid the special assessments, or have paid at a higher rate with a surcharge. However, until the budget is approved and legislation enacted, both the state workforce agencies and employers must anticipate the imposition of interest and plan accordingly. *Employers should be aware of and plan for either situation.*

#### Federal Unemployment (FUTA) Credit Reduction Suspension

- The budget provides for a two-year waiver of FUTA credit reductions

In general, FUTA credit reductions increase the rate by 0.3% each year in which Title XII loans have been outstanding for two years or more. In 2010, Indiana, Michigan, and South Carolina had FUTA credit reductions. In 2011, 22 additional states may be subject to FUTA credit reductions, unless the requisite amounts of the Title XII loans are paid back or the waiver is approved.

#### FUTA Wage Base Increase and Indexing

- The budget provides for an increase in the FUTA wage base from \$7,000 to \$15,000 beginning in 2014 and to permanently index the wage base annually thereafter.
- The President's proposal would reduce the FUTA rate to an effective rate of 0.38% to mitigate any federal tax increase.

The significant indirect impact of the proposal to raise the FUTA wage base is an increase in state unemployment taxable wage bases. The taxable wage base for state unemployment taxes has to at least equal the FUTA wage base. There are currently 34 states with unemployment tax wage bases below \$15,000. Because of this, employers must anticipate significantly increased costs, unless state legislatures take action to modify states programs for the impact of the federal wage base change.

#### Value

Employers must be alert to what is happening in at both the federal and state level. Understanding the changes being considered is necessary to be able to effectively budget for planned increases, be aware of possible relief, and identify possible tax savings. For more information, please contact Pete Krieshok at (314) 214-7325 or [pkrieshok@talx.com](mailto:pkrieshok@talx.com) or visit our corporate blog at <http://blog.talx.com>. You can also attend our webcast on March 1<sup>st</sup> or 2<sup>nd</sup> titled "Will 2011 Be the Turning Point in the Unemployment Financing Crisis?" for additional details on the budget provisions, state interest assessments, and an economic update.