Conformity Requirements for State UC Laws

FUTA Tax Credit System

Background

The Federal and state governments are jointly responsible for administering the UC system. In general, each state is free to establish its own tax structure, qualifying requirements, benefit levels, and eligibility and disqualification standards. However, state laws must meet certain Federal requirements for employers to qualify for credits against the tax imposed under the Federal Unemployment Tax Act (FUTA). The taxing provisions of FUTA greatly influence state coverage provisions because employers who pay contributions on services under an approved state law may credit their state contributions against the Federal tax.

Federal Law

Section 3301, FUTA, imposes a payroll tax on every employer, equal to a specified percentage of total wages paid during a calendar year. FUTA currently provides that the tax rate is 6.0 percent.

Wages subject to the tax are defined in Section 3306(a), FUTA. This section currently provides that wages consist of the first $7,000 paid to an employee in a calendar year. Thus, the maximum FUTA tax an employer would owe for an employee is $420 ($7,000 x .06.)

This total may be reduced by two credits based on the amount the employer has paid in state unemployment taxes. Section 3302(c)(1), FUTA, limits the total amount of credit a taxpayer may receive to 90 percent of the tax against which the credits are allowable. Thus the effective FUTA tax rate is 0.8 percent or $56 ($7000 X .008.)

The Normal Tax Credit

Section 3302(a)(1), FUTA, provides that employers may take a credit against their FUTA tax equal to “the amount of contributions paid by him into an unemployment fund maintained during the taxable year under the unemployment compensation law of such a State . . . ”

In order for employers to qualify for the normal credit, the state law must be certified under Section 3304, FUTA.

The Additional Tax Credit

Section 3302(b), FUTA, provides for an additional credit “equal to the amount, if any, by which the contributions required to be paid by him with respect to the taxable year were less than the contributions such taxpayer would have been required to pay if throughout the taxable year he had been subject under such State law to the highest rate applied thereunder . . . or 5.4 percent, whichever rate is lower."

This additional credit provision allows employers with good experience ratings (and thus a lower state contribution rate) to avoid paying more Federal tax than those employers with bad experience ratings. In order for employers to qualify for the additional credit, the state law must meet the experience rating requirements in order to be certified under Section 3303, FUTA.

Frequently Asked Questions

1. What effect on the tax credits would a maximum state tax rate of less than 5.4 percent have for employers?

The total credit available to employers (normal and additional) would be capped at the highest rate in the tax schedule based on experience rather than at 5.4 percent and employers would have a higher effective FUTA tax rate. For example, if the highest state tax rate was 4 percent, the effective FUTA tax rate for employers would be 2.2 percent rather than 0.8 percent.

2. What effect does an assigned state tax rate of zero (0) percent have for purposes of the tax credits?

The taxpayer would not have paid any taxes to apply toward the normal credit, but would be able to take the full 5.4 percent credit in the additional credit. As long as the taxpayer has a rate assigned based on its experience with unemployment, and pays that amount timely, even if the assigned rate is zero, the taxpayer is eligible for the total amount of credit available to taxpayers in the state.

3. How does a state taxable wage base that is higher than the FUTA taxable wage base affect an employer's FUTA taxes?

The normal tax credit is for contributions paid into the state unemployment fund. If the state taxable wage base is high, the amount of state contributions paid, even at a relatively lower rate, could equal (or exceed) the amount of FUTA taxes owed. While all employers **would receive the full credit available**, the amount of the additional credit would be less than in states where the taxable wage base is lower. Thus, employers in states with a high taxable wage base might not be eligible for any additional credit even if they have a relatively good experience rating because the normal credit meets or exceeds that available under FUTA.

References

UIPL 30-83. Discusses the relation between Federal unemployment tax credits and experience rating.