



# Introduction to Unemployment Insurance Financing

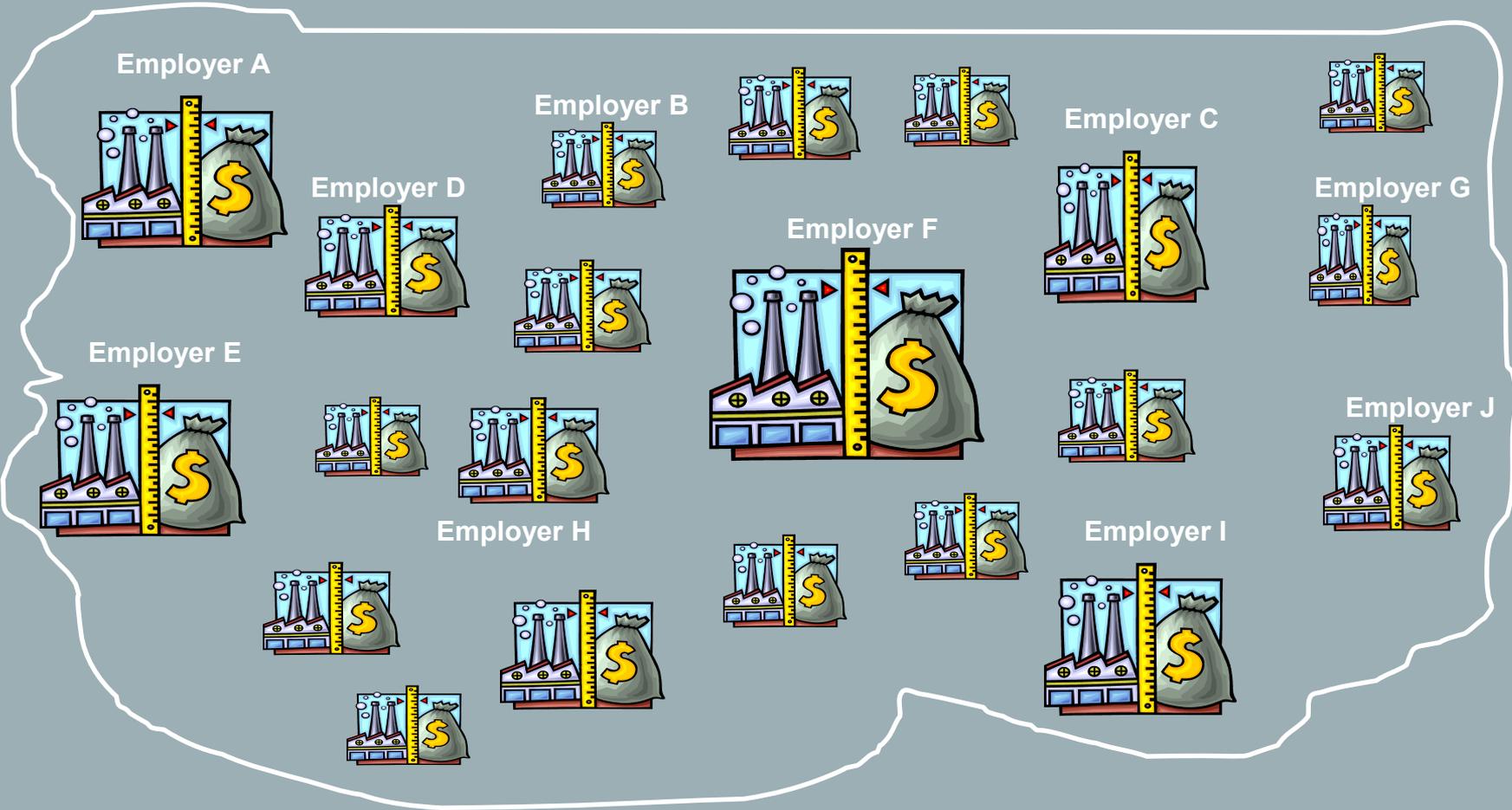
UI Benefit Financing Seminar  
Division of Fiscal and Actuarial Services  
U.S. DOL/ETA/OUI  
October 23- 26, 2018



# State Financing Topics

- Federal Requirements for State UI Financing
- Understanding Your State's Key Financing Features

# Individual Employer Severance Accounts



# FUTA Tax

6.0% FUTA  
Tax

On \$7,000  
wages

Acceptable  
UI Program



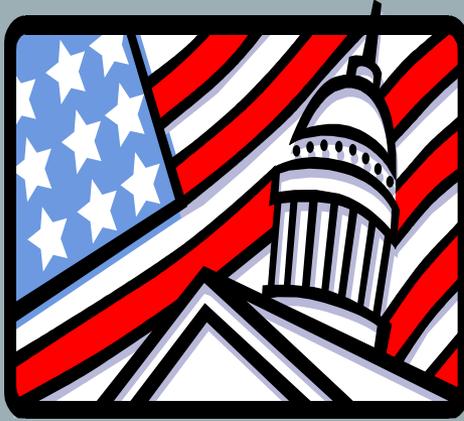
5.4% Credit

Covered  
Employers

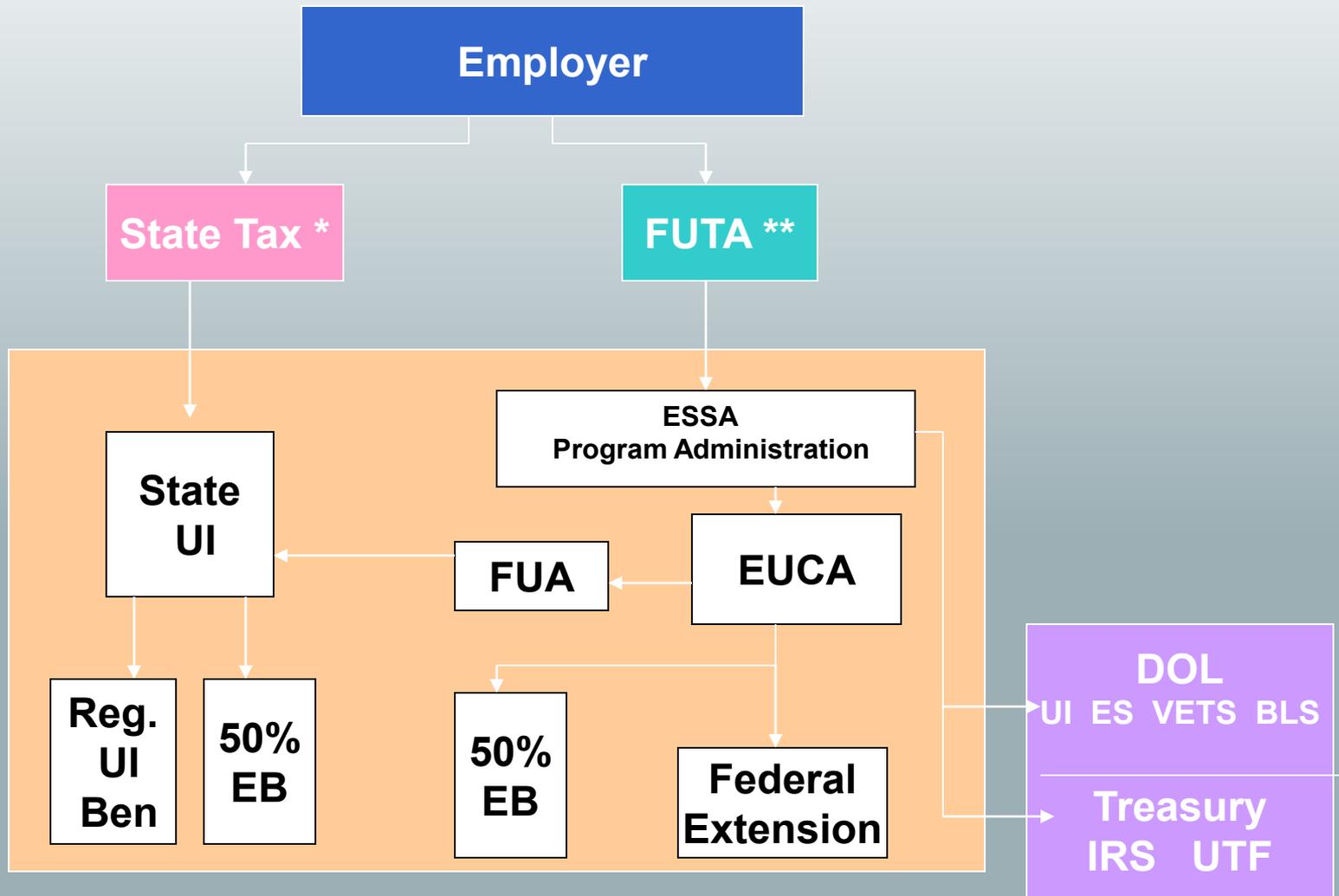


.6%

On  
\$7,000  
wages



# Federal/State UI System





# FUTA Tax

- The maximum FUTA tax payable for each employee receiving full credit is:

Full FUTA       $6.0\% \times \$7,000 = \$420$

With Credit       $.6\% \times \$7,000 = \$42$

- FUTA Tax collected once a year from taxable employers
- FUTA Tax will increase (credit reduction) if States borrow without repaying

# History of FUTA Tax

Year	FUTA Wage Base	FUTA Rate	FUTA Credit	Final FUTA Employer Rate
1940	\$3,000	3.0%	2.7%	.3%
1961	\$3,000	3.1%	2.7%	.4%
1972	\$4,200	3.2%	2.7%	.5%
1978	\$6,000	3.4%	2.7%	.7%
1983	\$7,000	6.2%	5.4%	.8%
2011	\$7,000	6.0%	5.4%	.6%

# History of Coverage

1935

Eight or more workers



1954

Four or more workers



1970

One or more workers



The UI amendments of 1970 and 1976 also expanded coverage to nonprofit organizations employing 4 or more workers and to all state and local government employees.

# Citations in FUTA

## Conditions for normal credit

See 3302(a)(1)&(2)

Certified according to 3304



## Conditions for additional credit

See 3302(b)

Certified according to 3303 -- especially see (a)(1)

Note – no requirement for a specified degree or level of experience rating

## Limit on tax credits

See 3302(c)(1) & 3302(c)(3)(B)(1)

## Wage base

See 3306(b)





# Federal Unemployment Tax Act (FUTA, 1935)

## Acceptable State UI Program

- **The Standard Rate must be at least the value of the credit amount 5.4% (.6% from 6.0%).**
- **Any reduction in awarded rates must be based on an employers experience with unemployment.**



# Major Differences in State UI Tax Structures

- **Four types of experience rating mechanisms.**
- **Fourteen states charge the most recent or principal employer, thirty-four states charge in proportion to base period wages.**
- **Wage Base varies from \$7,000 to \$49,000.**
- **Three states with employee taxes.**
- **Twenty-three states with voluntary contributions.**
- **Three states have no benefit charging.**



# Primary Features of State UI Tax Systems

## 1) Taxable Wage Base

(\$7,000 - \$49,000)

## 2) Experience Rating Method

(Reserve Ratio/ Benefit Ratio /Benefit Wage / Payroll Decline)

## 3) Solvency Tax (Table) Triggers

(Reserve Ratio/ Benefit Cost Multiple / Dollar value of the fund)



# Experience Rated Tax System

1) Taxable Wage Base = \$7,000 – \$49,000

# Experience Rated Tax System

1) Taxable Wage Base = \$10,000

% of Taxable  
Wages

Good	.5
Experience-	1.0
Low Rates	1.5
2) Employer	2.0
Experience	2.5
Factor	3.0
	4.0
Bad	4.5
Experience-	5.4
High Rates	

# Experience Rated Tax System

1) Taxable Wage Base = \$10,000

## 3) Schedule of Rates Based on Measure of Trust Fund Balance

High Fund  
Low Rates

Low Fund  
High Rates

Good  
Experience-  
Low Rates

.5	.6	.7	.8	.9
1.0	1.1	1.2	1.3	1.4

2) Employer  
Experience  
Factor

1.5	1.6	1.7	1.8	1.9
2.0	2.1	2.2	2.3	2.4
2.5	2.6	2.7	2.8	2.9
3.0	3.1	3.2	3.3	3.4

Bad  
Experience-  
High Rates

4.0	4.1	4.2	4.3	4.4
4.5	4.5	4.6	4.7	4.8
5.4	5.5	5.6	5.7	5.8

# State New Caledonia

Taxable Wage Base: \$6,000

<u>Industry</u>	>6% TUR	>4% TUR	< 4% TUR
Construction	5.4%	5.0%	4.8%
Manufacturing	4.0%	3.8%	3.6%
Apparel	3.0%	2.8%	2.6%
Financial	1.0%	.8%	.6%
Insurance/Other	0.0%	0.0%	0.0%

# State New Caledonia

Taxable Wage Base: \$6,000 < \$7,000

<u>Industry</u>	>6% TUR	>4%TUR	< 4% TUR
Construction	5.4%	5.0%	4.8%
Manufacturing	4.0%	3.8%	3.6%
Apparel	3.0%	2.8%	2.6%
Financial	1.0%	.8%	.6%
Insurance/Other	0.0%	0.0%	0.0%

↑  
Individual  
Employer  
Experience  
w/layoffs

← 5.4%



# State Taxable Wage Base

Maximum Taxable Wage Base:

That portion of yearly wages against which tax rates are applied. To receive Full FUTA credit the wage base must be at least the value of the Federal Base:

$$\begin{array}{rcccl} \text{State Tax} & * & \text{Taxable} & & \text{Contributions} \\ \text{Rate} & & \text{Wages} & = & \text{Due} \end{array}$$

# State Taxable Wage Base

<http://www.workforcesecurity.doleta.gov/unemploy/comparison2014.asp>

## Comparison of State Unemployment Laws

The Comparison of State Unemployment Insurance Laws provides state-by-state information on workers covered, benefit eligibility, methods of financing and other areas of interest in the UI program. It also includes information on the temporary disability programs operated in six states. The Comparison is published annually. This edition reflects the status of state laws enacted as of January 1, 2012.

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# State Taxable Wage Base

	State Tax Rate	*	Taxable Wage Base	=	Contrib. per Employee
State 1	1.0%	*	\$7,000	=	\$70
<hr/>					
State 2	.35%	*	\$20,000	=	\$70

Higher Base –  
lower Rate -  
Same  
Revenue

## Low Base – Higher Proportion of Wages

	Wage Base	Employ.	Avg. Wage	Total Wages	Taxable Wages	% of Wages Taxed
Low Wage	\$7,000	10	\$15,000	\$150,000	\$70,000	47%
<hr/>						
High Wage	\$7,000	10	\$80,000	\$800,000	\$70,000	9%

# Indexing the Taxable Wage Base

- 19 States Multiply the prior year's (or second prior year) average annual wage by a specified proportion – 50% - 100%.
- 5 States set the Wage Base based on the size of the UI Trust Fund:

example: State Reserve Ratio	Wage Base
> 1%	\$7,000
>.5% < 1%	\$8,000
< .5%	\$9,000

- May assign different wage base to a different group of employers

# State Taxable Wage Bases

## Indexed Wage Base States

State	% Of State Average Annual Wage
Alaska	75%
Hawaii	100%
Idaho	100%
Iowa	67%
Minnesota	60%
Montana	80%
Nevada	67%
New Mexico	60%
North Carolina	50%
North Dakota	70%
Oklahoma	50%
Oregon	80%
Rhode Island	47%
Utah	75%
Wyoming	55%
Washington	115% of Prev.Wage Base
New Jersey	28 Times AWW

## Fixed Low Wage Base States

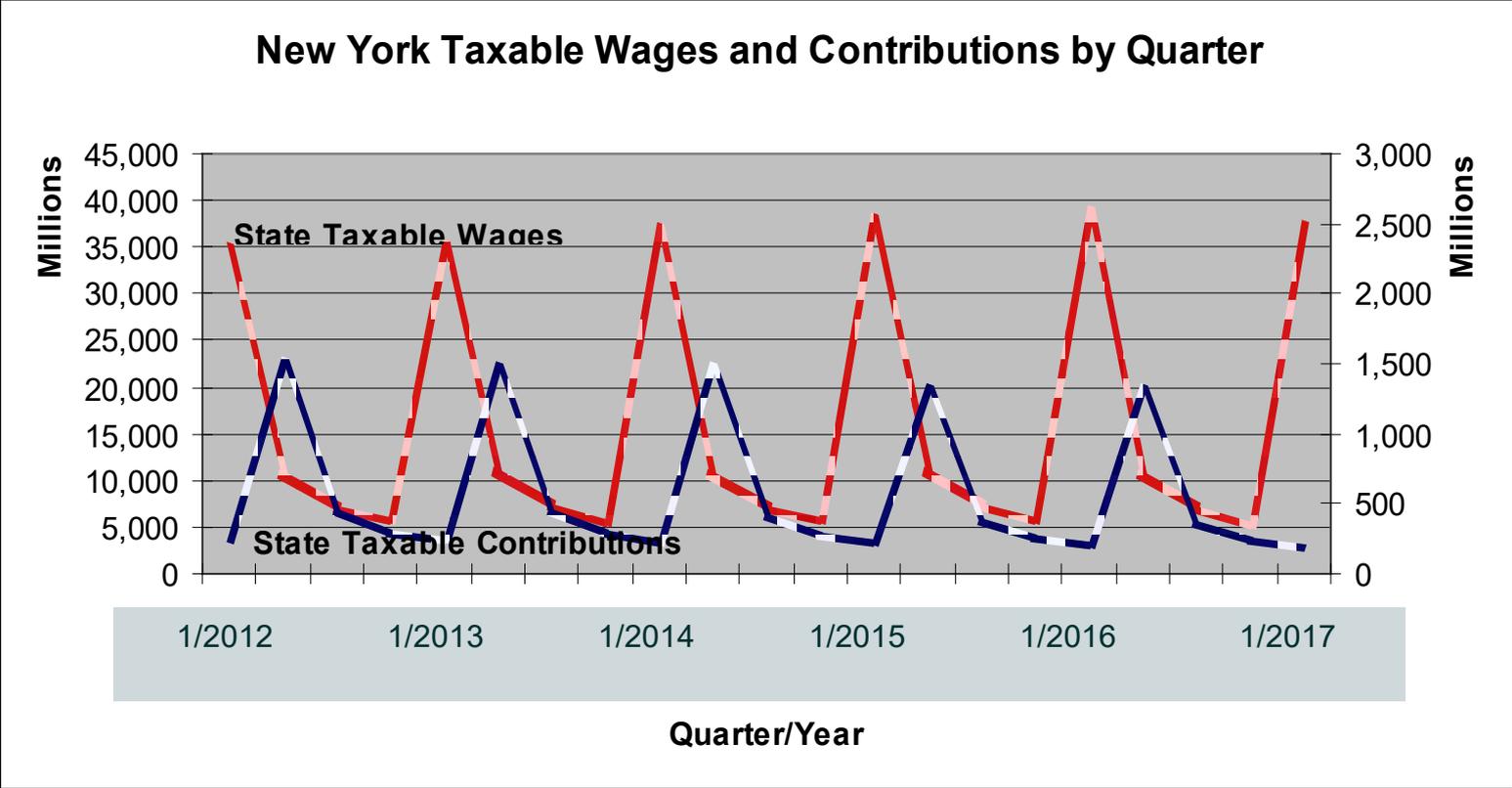
State	Wage Base
Arizona	\$7,000
California	\$7,000
Puerto Rico	\$7,000
Florida	\$7,000

# State Taxable Wage Base (2018)

Alabama	\$8,000	Nebraska	\$9,000
Alaska	\$39,500	Nevada	\$30,500
Arizona	\$7,000	New Hampshire	\$14,000
Arkansas	\$10,000	New Jersey	\$33,700
California	\$7,000	New Mexico	\$24,200
Colorado	\$12,600	New York	\$11,100
Connecticut	\$15,000	North Carolina	\$23,500
Delaware	\$16,500	North Dakota	\$35,500
Dist. Of Columbia	\$9,000	Ohio	\$9,500
Florida	\$7,000	Oklahoma	\$17,600
Georgia	\$9,500	Oregon	\$39,300
Hawaii	\$45,900	Pennsylvania	\$10,000
Idaho	\$38,200	Puerto Rico	\$7,000
Illinois	\$12,960	Rhode Island	\$22,400
Indiana	\$9,500	South Carolina	\$14,000
Iowa	\$29,900	South Dakota	\$15,000
Kansas	\$14,000	Tennessee	\$7,000
Kentucky	\$10,200	Texas	\$9,000
Louisiana	\$7,700	Utah	\$34,300
Maine	\$12,000	Vermont	\$17,600
Maryland	\$8,500	Virgin islands	\$24,200
Massachusetts	\$15,000	Virginia	\$8,000
Michigan	\$9,000	Washington	\$47,300
Minnesota	\$32,000	West Virginia	\$12,000
Mississippi	\$14,000	Wisconsin	\$14,000
Missouri	\$12,500	Wyoming	\$24,700
Montana	\$32,000		

# Impact of a Low Taxable Wage Base

- A high proportion of yearly tax revenue is collected in the first quarter.



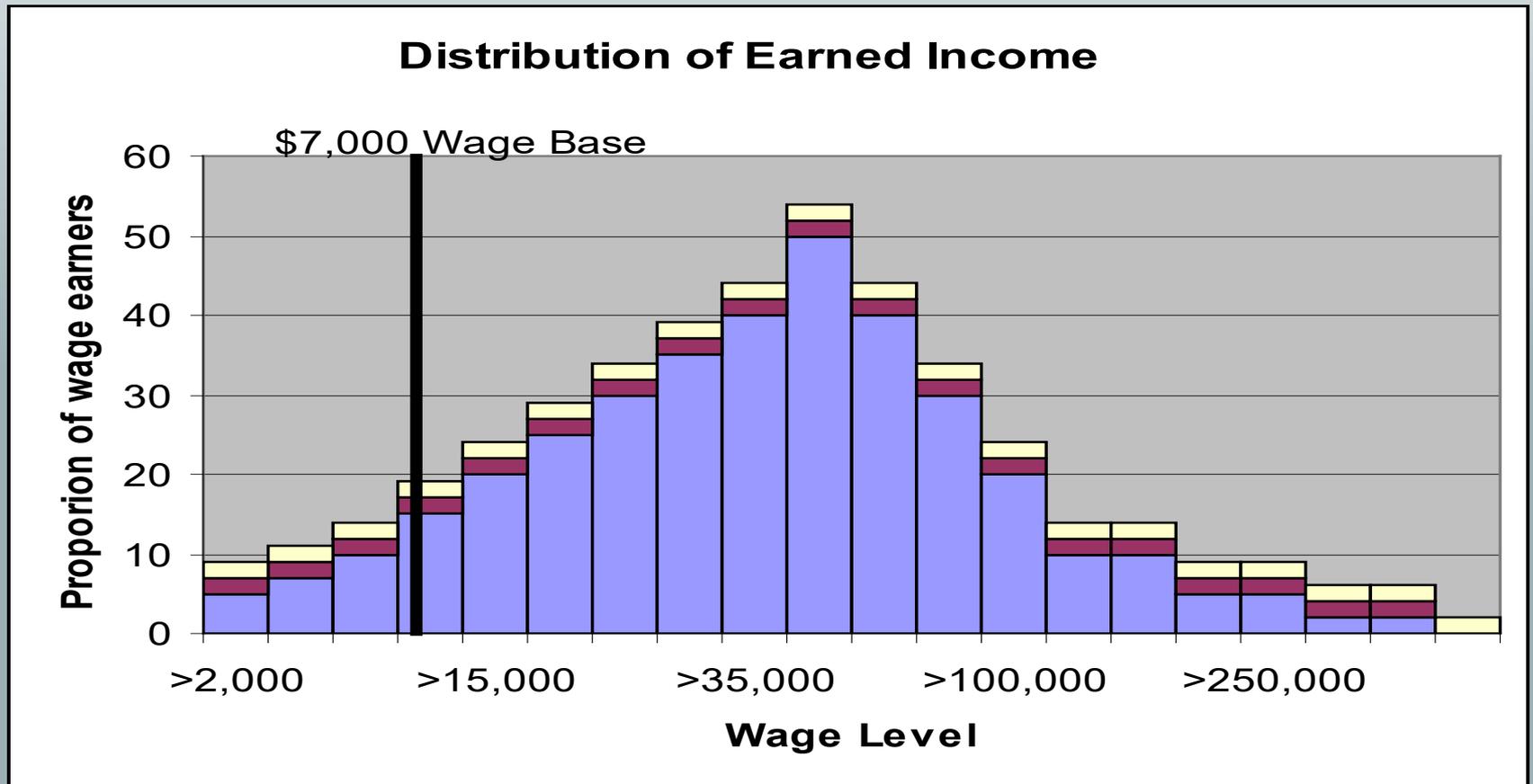
# Impact of a Fixed Taxable Wage Base

- The proportion of wages that are subject to tax declines each year.



# Impact of a Low Taxable Wage Base

- Low Wage firms will pay taxes on a higher proportion of wages.





# §3303(a)(1) FUTA

## The Federal Experience Rating Requirement:

No reduced rate of contributions to a pooled fund or a partially pooled account is permitted to a person (or group of persons) having individuals in his (or their) employ except on the basis of his (or their) experience with respect to unemployment or other factors bearing a direct relation to unemployment risk during not less than the 3 consecutive years preceding the computation date.



# Basic Principles of Experience Rating

- Reduced rates based on factors *directly* related to experience with unemployment risk.
- Risk is the *worker's risk*.
- All employers must be rated throughout same period of time using the factor.

# UI Experience Rating Methods

Reserve Ratio:  $\frac{\text{Beg. Balance} + (\text{Contributions} - \text{Benefits})}{\text{Taxable Wages}}$   
(33)

Benefit Ratio:  $\frac{\text{Benefits Charged (previous 3 years)}}{\text{Taxable Wages}}$   
(17)

Benefit Wage:  $\frac{\text{Benefit Wages}}{\text{Taxable Wages}}$   
(2)

Payroll Decline:  $\frac{(\text{Average Difference in Qtr. Payroll})}{\text{Taxable Wages}}$   
(1)

# State Experience Rating

<http://www.workforcesecurity.doleta.gov/unemploy/comparison2012.asp>

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# Reserve Ratio Experience Rating Method

Reserve Ratio =

$$\frac{\text{Beg. Balance} + (\text{Contributions} - \text{Benefits Charged})}{\text{Avg. 3 Years Total Taxable Wages}}$$

- Higher Reserve Ratio leads to lower tax rate – Lower Reserve Ratio leads to higher tax rate, ( Lower negative reserve leads to higher the tax rate).
- Higher employer wages (taxable) – leads to lower Reserve Ratio and higher tax rates.
- Slower response to increase in Benefit Charges.



# Benefit Ratio Experience Rating Method

Benefit Ratio =

$$\frac{\text{Benefits Charged (Last 3 to 5 years)}}{\text{Agg. Total Taxable Wages (Last 3 to 5 years)}}$$

- Higher Benefit Ratio leads to higher tax rate – Lower Benefit Ratio leads to lower tax rate.
- Higher employer wages (taxable) – leads to lower Benefit Ratio and lower tax rates.
- Faster response to higher benefit charges

# Benefit Ratio Tax Table

## Method 1

Benefit Ratio Interval	Tax Rate
5.5% - 6.0%	6.4%
5.0% - 5.5%	6.0%
4.5% - 5.0%	5.0%
4.0% - 4.5%	4.5%
3.0% - 4.0%	4.0%
2.0% - 3.0%	3.0%
1.0% - 2.0%	2.0%
0.0% - 1.0%	1.0%

## Method 2

Employer Benefit Ratio

+

Social Rate Adjustment

+

Solvency Rate Adjustment

---

Final Tax Rate

(within Max. and Min. limit)

# Benefit Wage Ratio Experience Rating Method

Benefit Wage Ratio =

$$\frac{\text{Benefit Wages of Beneficiaries Charged (Last 3 years)}}{\text{Agg. Total Taxable Wages (Last 3 years)}}$$

- No benefits charged to individual employers
- Higher Benefit Wage Ratio leads to higher tax rate – Lower Benefit wage Ratio leads to lower tax rate.
- Higher employer wages (taxable) – leads to lower Benefit Wage Ratio and lower tax rates.

# Payroll Decline Experience Rating Method

Payroll Decline Method =

$$\frac{\text{Difference in Aggregate Payroll in each Qtr. (Last 3 yrs.)}}{\text{Agg. Total Taxable Wages (Last 3 years)}}$$

- No benefits charged to individual employers
- Higher decline quotient leads to higher tax rate – Lower Decline Quotient leads to lower tax rate.
- Higher employer wages (taxable) – leads to lower Decline Quotient and lower tax rates.

# Fixed Revenue Methods

Twelve States pre-determine the level of annual revenue they desire based on the level of their trust fund. (North Dakota, Idaho, Iowa, Alaska, Oregon, Vermont, Maine, Nebraska, Nevada, Montana, Nebraska, South Carolina).

Each of these states first formulates a desired funding level then converts it to an average tax rate on taxable wages, then distributes the tax rates (Array method) so that they will receive the desired level.



# Using the Array Method for Assigning UI Tax Rates

## Relative vs. Fixed Ranking

- Assigning tax rates to specified intervals of cumulative taxable payroll, not based on a fixed set of predetermined intervals.
  - Taxable payroll cumulated according to employers' experience factors- Reserve Ratio/Benefit Ratio/Payroll Decline.
- Advantage
  - Easy to project revenue
- Disadvantage
  - Cumbersome to determine to which array cell an employer belongs

# Fixed Interval Ranking of Employers

Employer Reserve Ratio		Tax Rate
10 %	- 8%	.5%
8%	- 6%	1.0%
6%	- 4%	2.0%
4%	- 2%	3.0%
2%	- 0%	4.0%
0%	- -5%	5.0%
-5%	- -10%	6.0%

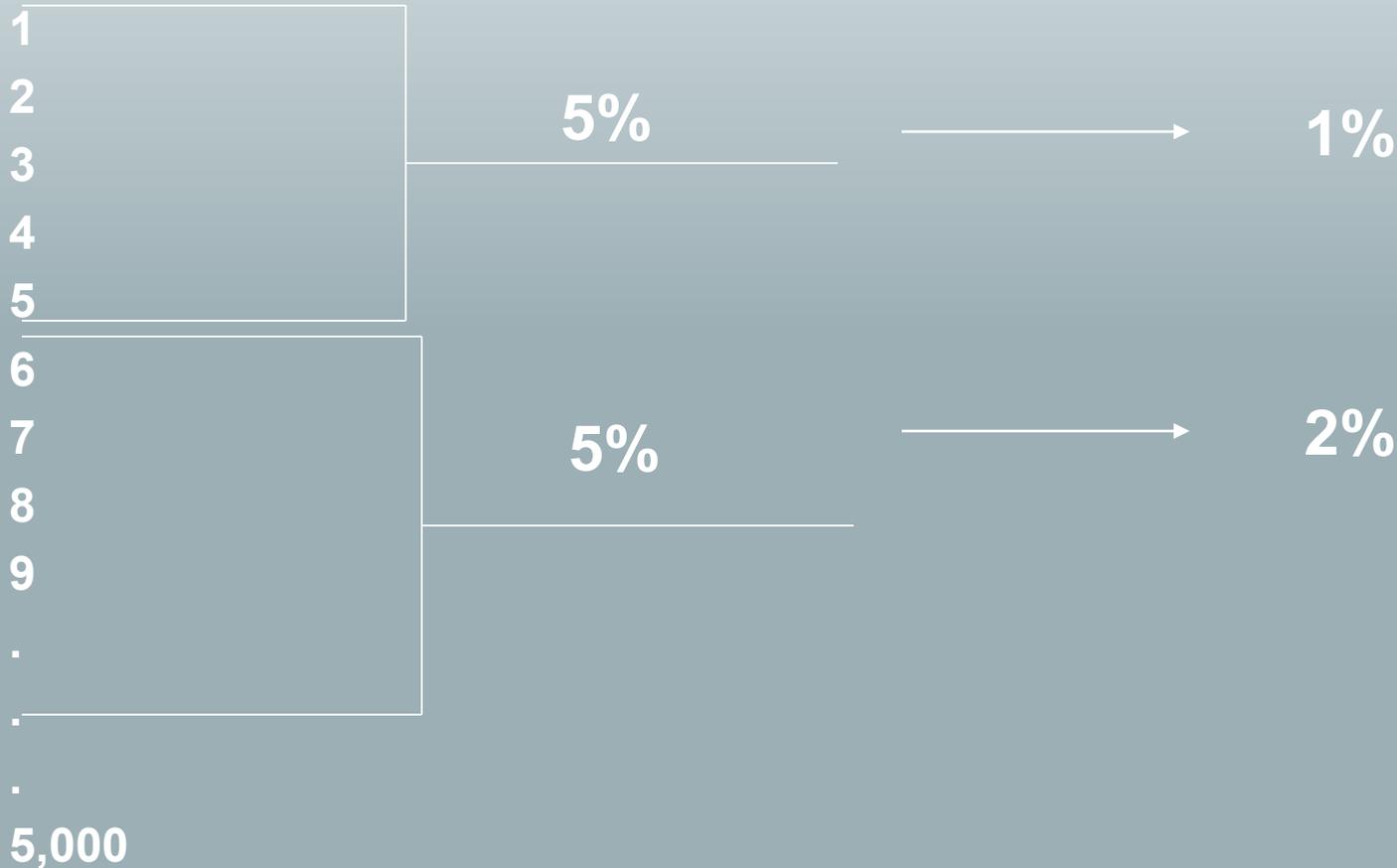
# Array System - Relative Ranking of Employers

(North Dakota, Idaho, Alaska, Oregon, Vermont, Utah, Kansas, Maine, Nebraska, Montana, Nebraska)

Ranking of  
Employers by  
Experience Rate

Proportion of  
Employers  
(wages)

Tax Rate



Benefit Ratio Rank	Approximate Cumulative Taxable Pay- roll Limit	Contribution Rate Tables							
		1	2	3	4	5	6	7	8
1	4.8%	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2	9.5%	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3	14.3%	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
4	19.0%	0.4	0.3	0.3	0.2	0.1	0.1	0.1	0.1
5	23.8%	0.6	0.5	0.4	0.3	0.3	0.2	0.1	0.1
6	28.6%	0.9	0.8	0.6	0.5	0.4	0.3	0.2	0.1
7	33.3%	1.2	1.0	0.8	0.6	0.5	0.4	0.3	0.2
8	38.1%	1.5	1.3	1.0	0.8	0.6	0.5	0.3	0.2
9	42.8%	1.9	1.5	1.2	0.9	0.7	0.6	0.4	0.3
10	47.6%	2.1	1.8	1.4	1.1	0.8	0.6	0.5	0.3
11	52.4%	2.5	2.0	1.6	1.3	1.0	0.7	0.5	0.3
12	57.1%	3.0	2.4	1.9	1.5	1.1	0.9	0.6	0.4
13	61.9%	3.6	2.9	2.4	1.8	1.4	1.1	0.8	0.5
14	66.6%	4.4	3.6	2.9	2.2	1.7	1.3	1.0	0.6
15	71.4%	5.3	4.3	3.5	2.7	2.0	1.6	1.1	0.7
16	76.2%	6.3	5.2	4.1	3.2	2.4	1.9	1.4	0.9
17	80.9%	7.0	6.4	5.2	4.0	3.0	2.3	1.7	1.1
18	85.7%	7.5	7.5	7.0	5.4	4.1	3.1	2.3	1.5
19	90.4%	8.0	8.0	8.0	7.3	5.6	4.2	3.1	2.0
20	95.2%	8.5	8.5	8.5	8.0	7.6	5.8	4.3	2.8
21	100.0%	9.0	9.0	9.0	9.0	8.5	8.0	7.5	7.0

Unemployment Insurance Reports

§ 96.7 Iowa ¶ 4037



# Tax Table Triggers

3) All States vary the level of their tax rates based on their annual UI Trust Fund.

High Fund  
Low Rates

Low Fund  
High Rates

2) Employer  
Experience  
Factor

	.5	.6	.7	.8	.9
	1.0	1.1	1.2	1.3	1.4
	1.5	1.6	1.7	1.8	1.9
	2.0	2.1	2.2	2.3	2.4
	2.5	2.6	2.7	2.8	2.9
	3.0	3.1	3.2	3.3	3.4
	4.0	4.1	4.2	4.3	4.4
	4.5	4.5	4.6	4.7	4.8
	5.4	5.5	5.6	5.7	5.8

# State Tax Table Trigger

<http://www.workforcesecurity.doleta.gov/unemploy/comparison2012.asp>

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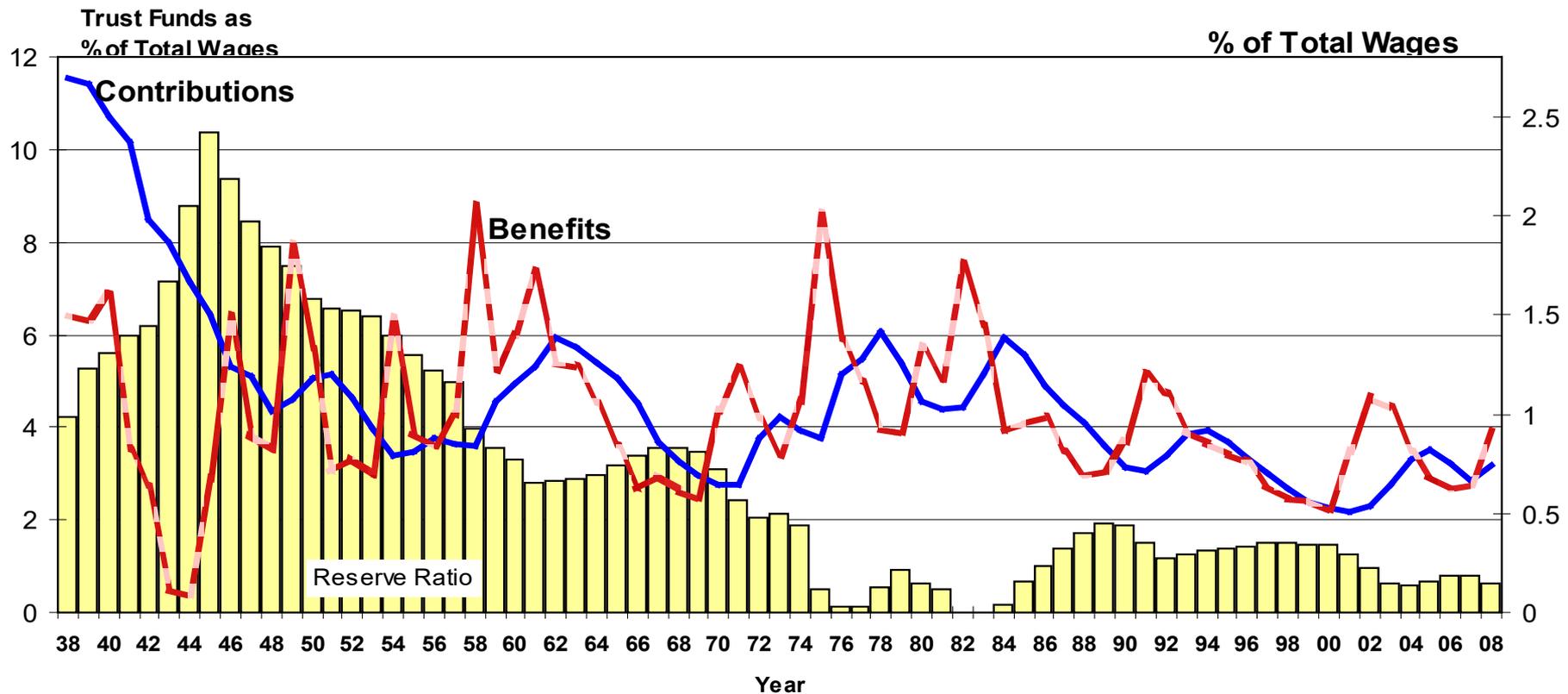
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# Tax Table Triggers

Automatic switches that put in place higher and lower tax schedules.

Aggregate State Benefits, Contributions and Reserve Ratio



# State Tax Schedule Triggers

Formula used to Trigger on higher and lower tax schedules:

1) Difference From Adequate Fund -	8	} Measure of Past Benefit Costs
2) Reserve Multiple -	9	
3) Benefit Ratio -	9	
4) Reserve Ratio -	19	Measure of Wage Growth and Liabilities
5) Dollar Balance -	6	Size of Trust Fund



# Difference in Tax Table Triggers

<p><b>Fund Adequacy Measure</b></p> <p>Calibrates Revenue to Desired Fund Level</p>	<p><b>Historical Benefit Costs</b></p> <p>Accounts for (High) payouts from the system</p>	<p><b>Reserves To Wages</b></p> <p>Accounts for growth in liabilities</p>	<p><b>Dollar Value</b></p> <p>Loses relative value over time</p>



# States with More Effective Solvency Features in their UI Tax Systems

## 1) Taxable Wage Base

Indexing 100% of prior wages – (Idaho)

## 2) Experience Rating Method

Array System – Maine

Maximum Rate – Michigan / Louisiana

Minimum Rate – Massachusetts

## 3) Tax Table Triggers

Adequate Funding Level - Mississippi

## Avoid

Low Fixed/ Big Changes-(CA)

Aggregation of Emp.

High Ineffective Charges

“0” Tax rates

Dollar Value of the Fund