



FUTA Tax Increases

Why You Need to Plan Right Now!

Employers and business owners can do little to affect the outcome of state legislative actions.

However, they can do a great deal to anticipate and prepare for the projected increases in FUTA tax costs.

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Ongoing FUTA Tax Increases:

Why You Need To Plan Now!

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A LITTLE HISTORY

Employers in California have been bearing the brunt of the ongoing indebtedness of the state to the federal government for additional unemployment insurance (UI) funding since 2009. While California was not the only state that had to rely on federal assistance in the face of the recent recession, it is still just one of only nine states still paying. The other sixteen have succeeded in paying off their individual UI debts to the federal government.

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WHAT IS FUTA?

An entry in Wikipedia provides a concise explanation of the Federal Unemployment Tax Act, or FUTA, as it is commonly referred to:

The Federal Unemployment Tax Act (or FUTA) is a United States federal law that imposes a federal employer tax used to help fund state workforce agencies. Employers report this tax by filing an annual Form 940 with the Internal Revenue Service. In some cases, the employer is required to pay the tax in installments during the tax year.

FUTA covers a federal share of the costs of administering the unemployment insurance (UI) and job service programs in every state. In addition, FUTA pays one-half of the cost of extended unemployment benefits (during periods of high unemployment) and provides for a fund from which states may borrow, if necessary, to pay benefits.



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RISING UNEMPLOYMENT AND LOWERING TAX REVENUES

This was one of the starkest results of the recession that began ostensibly in 2008-2009. As the unemployment rate spiked dramatically and jobs became increasingly scarce, Congress voted to extend UI benefits. In June 2008, when the recession was just hitting hard and the unemployment rate was 5.6%, Congress approved a 13-week extension. As the recession deepened, Congress passed additional expansions.

At its peak, California had offered 63 weeks of unemployment benefits, with most other states offering between 43 to 63 weeks. Those extensions officially came to an end on December 28, 2013 for states still offering them. In the meantime, beginning in January 2009, California began borrowing to cover the shortfall for their own 26 weeks of benefits as well as for the additional 37 weeks being provided.

The funds came from the Federal Unemployment Account (FUA) which serves as a loan fund for state unemployment programs to ensure a continued flow of benefits during times of economic downturn. As of March 3, 2015 California's Trust Fund Loan balance was at \$8,787,572,349.59 which represents over half of the total outstanding loan balance for eight states and the Virgin Islands.

Outstanding state loans balances as of March 3, 2015:

State	Current Loan Balance	Began Borrowing
Arizona	\$60,922,428.41	July 2014
California	\$8,787,572,349.59	Jan. 2009
Connecticut	\$431,865,449.89	Oct. 2009
Indiana	\$869,658,294.34	Dec. 2008
Kentucky	\$364,593,283.84	Jan. 2009
New York	\$1,605,354,579.97	Jan. 2009
North Carolina	\$305,933,041.59	Feb. 2009
Ohio	\$1,378,605,822.81	Jan. 2009
South Carolina	\$195,476,046.24	Dec. 2008
Virgin Islands	\$76,883,684.31	Aug. 2009
Total	\$14,076,864,980.99	

Source: *U.S. Dept. of Labor, Employment and Training Administration*

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AND THAT'S NOT ALL

The problem goes beyond the lowered FUTA tax credits for each year the state is insolvent. There is also the issue of additional funds borrowed in 2011 and 2012 to pay outstanding interest on the debt to the federal government. According to the LA Times in a November 2013 article:

In the meantime, each year California employers have to forgo hundreds of millions of dollars' worth of federal tax credits, which are reduced when the state cuts its repayments to the federal government. And their federal unemployment tax bill could more than quadruple in 2015 compared with the 2012 level, the EDD forecast said.

State taxpayers, meanwhile, are saddled with the interest payments on the debt to the federal government. The state has paid \$871 million in the last three years and will pay an estimated \$431 million in the next two years, the EDD said.

And how does the California State Legislature plan to resolve this shortfall? The same article goes on to state that:

There's no mystery about how to right the fund, analysts say. Employers, who provide 100% of the funds for the state safety-net program, could increase contributions. California is one of a handful of states in the nation that levy the payroll tax on only a worker's first \$7,000 of annual income.

Much of that interest had to be paid with other borrowed money: \$612 million from the state disability insurance fund, which comes due in 2016 and 2017.

Alternatively, laid-off workers could get lower payments or be excluded from benefits by tightening eligibility requirements. Or, there could be some combination of the two.

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THE LOOMING PROBLEM FOR CALIFORNIA EMPLOYERS

The FUTA tax levies a federal tax on employers covered by a state's Unemployment Insurance (UI) program. The standard FUTA tax rate is 6.0 percent on the first \$7,000 of wages that are subject to FUTA. The funds from this FUTA tax create what is known as the Federal Unemployment Trust Fund, which is administered by the United States Department of Labor, or DOL.

Generally, employers may receive a credit of 5.4% when they file their [Form 940](#) to result in a net FUTA tax rate of 0.6 percent, or 6.0 percent tax rate less the 5.4 percent credit. However, when a state's own UI funds are depleted, the state can borrow from the Federal

Unemployment Account (FUA), and if such loans are not repaid within two years that state is designated as a "credit reduction state".

This means that part of the 5.4% FUTA tax credit is reduced, thereby increasing the effective FUTA tax rate in affected states. When this "credit reduction" is applied, the FUTA tax typically increases by 0.3%, or \$21 per employee. The tax credit continues to be reduced annually by 0.3% until loans are repaid.



So far, California is now in its fourth year as credit reduction state with little hope of seeing its balance paid in the short term. In addition, because California has had an outstanding FUTA debt for five years now, the state is subject to a special "Benefit Cost Ratio (BCR)" add-on tax since 2014. If applied, it would have added another 1.5%, for a total of 3.3%. The combination of credit reduction and BCR could result in a five-fold increase over the normal FUTA tax rate.

Fortunately, the state submitted an application requesting a waiver for the BCR add-on which was granted for tax year 2014. But this process will need to be repeated each year going forward until the loan balance is repaid.

California's effective FUTA rate already increased from 1.5% to 1.8% due to the credit reduction for 2014. If the waiver had been refused, the BCR add-on tax would have added another 1.5%, for a total of 3.3%. The combination of credit reduction and BCR would have resulted in a five-fold increase over the normal FUTA tax rate.

These gradual reductions in the tax credit represent a loss of 0.3 percent FUTA credit for 2011, 0.6 percent for 2012, 0.9 percent for 2013 and 1.2 percent for 2014. By 2018, the year that the state's UI fund loan should be repaid in full, employers can expect to pay an additional \$2.3 billion in federal employment taxes. California's UI fund will then be "in the black", and the state can begin to build a reserve. This reserve will be depleted again, however, when the next recession hits California, unless changes are made to California's UI financing structure.

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WHAT THIS CAN MEAN IN REAL DOLLARS

Tax year 2015 may prove to be problematic for many California employers. If a company had, say, one employee the cost would be noticeable if not debilitating. For example:

Small Business, Inc. has one employee on the payroll. They pay wages of \$40,000 to their sole employee for 2015. The FUTA tax due on that employee's wages for 2015 would normally have been \$42 calculated by multiplying the first \$7,000 by 0.6%.

But, because California is a credit reduction state (it will most likely have a 1.5% tax credit reduction in place for a total tax rate of 2.1%), that amount is now \$147. If the BCR add-on tax of 1.5% is not waived this year and deemed to apply, the total FUTA tax would be \$252 (\$147 + BCR of \$105).

However, let's say we are talking about an employer with 100 employees. Now we are looking at a potential FUTA tax of almost \$25,200 for 2015. This is more than \$21,000 above what the same employer would have been paying prior to 2009.

[FUTA Tax Calculator](#): Calculate now the impact of the possible 2015 FUTA Tax Rate!

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CALCULATED AS FOLLOWS:

Company Payroll	FUTA Tax Rate Percentage	One Employee	Ten Employees	Fifty Employees
FUTA Tax (Standard)	0.6%	\$42	\$420	\$2,100
FUTA + Credit Reduction Tax For 2012	1.2% (0.6 + 0.6)	\$84	\$840	\$4,200
FUTA + Credit Reduction Tax for 2013	1.5% (0.6 + 0.9)	\$105	\$1,050	\$5,250
FUTA + Credit Reduction Tax for 2014	1.8% (0.6 + 1.2)	\$126	\$1,260	\$6,300
FUTA + Credit Reduction Tax for 2015 + BCR	3.6% (0.6 + 1.5 + 1.5)	\$252	\$2,520	\$12,600

For additional information FUTA tax rates, read this IRS [article](#)

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THE NEXT STEPS FOR CALIFORNIA EMPLOYERS

Employers and business owners can do little to affect the outcome of state legislative actions. However, they can do a great deal to anticipate and prepare for the projected increases in FUTA tax costs. While a good budget and fiscal plan will already incorporate FUTA and other taxes, knowing that these in particular are certainly going to increase allows an employer to adjust and plan accordingly.

A simple formula would be to add an additional \$21 for each employee earning at least \$7,000 in 2014. If you employ 50 people, and they all earn in excess of \$7,000 that would be an increase of \$1,050 in your payroll budget. This is a “best case” scenario. For employers with 500 or more employees, this can still represent an additional \$10,500 and more above what they had to pay for tax year 2014. Again, this is the least amount that will be imposed for 2015.

If you want to ensure that you are covered for the “worst case” situation – the possibility of being hit with an additional tax penalty in the form of the BCR add-on – you can increase your budgeted amount by an additional \$105 per employee. This means factoring in a total of \$126 in unemployment fund taxes for each person you employed in 2015.

For a company with 50 employees earning more than \$7,000 for the year, that adds up to a total of almost \$6,000 to plan for in your budget process. For the roughly 20,000 businesses in California that have over 500 employees this is an increase of at least \$115,500 or more above what they were paying prior to 2009.

According to the California Legislative Analyst’s Office, there were approximately 17,620,000 privately employed individuals in California as of January, 2015. That number represents almost \$2.5 billion in increased FUTA taxes that will be paid out by private sector employers for the 2015 tax year. If the BCR add-on penalty were to be imposed, and not waived as before, that dollar amount would approach \$21 billion dollars!

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BE PREPARED

It's not too late to begin planning for and budgeting for another annual increase in your FUTA obligations that will come due in January 2016. And, while the additional penalty of the "Benefit Cost Ratio (BCR)" add-on tax may not be imposed, it would be prudent to plan for that possibility. At the very least you will have the funds to cover it and if it is not required, you will have a surplus to carry over for 2016 when the next FUTA credit reduction takes effect.

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Jim Ruhland co-founded Accuchex Corporation in 1990 and has been active in the management since the company's inception. Jim has led Accuchex to and through each new aspect of evolving the business to become a modern, highly efficient enterprise, without losing the high service level with which the company prides itself on. Jim was responsible for helping to develop and deploy one of the first, real-time payroll applications named Time2Pay to the web in 2003.

Jim is a member of the American Payroll Association as well as an active leader in the Independent Payroll Processors Association.

Over the last 25 years Accuchex, headquartered in Marin CA, has developed a reputation as a premier provider of comprehensive workforce management solutions, including payroll processing, payroll tax services, Time and Attendance management, insurance and employee benefits, and human resource outsourcing.

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RELATED ARTICLES

1. [Urgent FUTA Update for Payroll Managers](#)
2. [FUTA Credit Reductions for 2015](#)

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Online Calculator

[FUTA Online Calculator](#) – Follow this link to calculate the impact of the potential 2015 FUTA Tax Rate on your business.

