2011 FUTA tax complicated

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The FUTA tax rate computation for 2011 is shaping up to be the most difficult one in years due to the expiration of the FUTA surtax on July 1 and the likelihood that employers in many states will see a reduction in their state unemployment tax credits used to offset the FUTA tax.

FUTA surtax. Beginning with wages paid on July 1, 2011, the 0.2% federal unemployment tax (FUTA) surtax is no longer in effect (see Federal Taxes Weekly Alert 07/07/2011). The surtax was part of the 6.2% gross unemployment tax rate that employers paid on the first $7,000 of wages paid annually to each employee (6% permanent tax rate, 0.2% temporary surtax). (Code Sec. 3301) Before July 1, the 0.2% surtax had been in effect each year since '76, when it was enacted by Congress on a temporary basis.

Effective for wages paid beginning July 1, 2011, the FUTA tax rate, before consideration of state unemployment tax credits, is 6.0%. Most employers are allowed to claim 5.4% in state unemployment tax credits (known as the “normal credit”) against the FUTA tax rate if they timely pay their state unemployment taxes, making the net FUTA rate 0.6% beginning with wages paid on July 1. (Code Sec. 3302(a)) The net rate was 0.8% on wages paid from January 1 to June 30, 2011.

> **Observation:** FUTA taxes are paid in quarterly deposits, and the next quarterly payment is due on Aug. 1, 2011. However, this payment is based on taxable wages paid through June 30, so it will be computed using the 6.2% FUTA tax rate. The following payment is due on Oct. 31, 2011, and it will be computed using the 6.0% FUTA tax rate under current law.

State unemployment tax credits. Under Title XII of the Social Security Act, states with financial difficulties can borrow funds from the federal government to pay unemployment benefits. However, if a state defaults on its repayment of the loan, the normal credit available is reduced. This effectively increases the employer's FUTA tax rate by 0.3% beginning with the second consecutive January 1 in which the loan isn't repaid, then an additional 0.3% annually thereafter. Thus, the net FUTA tax rate paid by an employer in a state that has had an unpaid loan with the federal government for two consecutive years will be 0.3% higher than the net 0.6% rate used by employers in states without past due loans. The net FUTA tax rate continues to rise 0.3% for each additional year that the loans remain unpaid.

As of July 16, 2011, 29 states and the Virgin Islands have borrowed money from the federal government to help keep their unemployment insurance (UI) trust funds solvent. Many of these states have had outstanding loans with the federal government for two or more consecutive years. If these loans are not repaid by the Nov. 10, 2011 due date, employers in these states will not be eligible to claim the full 5.4% in state unemployment tax credits against the FUTA tax rate.

Possible 2011 FUTA tax rates. Employers in states with no outstanding federal loans will have a net FUTA tax rate of 0.8% in the first half of 2011, and a net FUTA tax rate of 0.6% in the second half of 2011. Employers in states with outstanding federal loans, as described above, will be subject to a higher rate. Here is what the tax rates look like, based on information available as of July 20, 2011:

- *States currently eligible for a net FUTA tax rate of 0.8% in the first half of 2011, and a net FUTA tax rate of 0.6% in the second half of 2011.* Employers in Alaska, Arizona, Colorado, Delaware, the District of Columbia, Hawaii, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Montana, Nebraska, New Hampshire, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, and Wyoming are all currently eligible for these rates because, as of Jan. 1, 2011, these states did not have outstanding loans with the federal government for two consecutive years. Therefore, they are entitled to the full 5.4% normal credit, resulting in a 0.8% net rate for the first half of 2011 and a 0.6% rate for the remainder of the year.

- *States currently scheduled to pay a net FUTA tax rate of 1.1% in the first half of 2011, and a net FUTA tax rate of 0.9% in the second half of 2011.* Employers in Alabama, Arkansas, California, Connecticut, Florida, Georgia, Idaho, Illinois, Kentucky, Minnesota, Missouri, Nevada, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, the Virgin Islands, Virginia, and Wisconsin will pay these rates unless the federal loans are repaid by Nov. 10, 2011 because, as of Jan. 1, 2011, these states had outstanding loans with the federal government for two consecutive years (i.e., the loans were presumably made in 2009 and currently remain unpaid). Therefore, they are entitled to a reduced 5.1% credit (5.4% less 0.3%), resulting in a 1.1% net rate for the first half of 2011 and a 0.9% rate for the remainder of the year.

- *States currently scheduled to pay a net FUTA tax rate of 1.4% in the first half of 2011, and a net FUTA tax rate of 1.2% in the second half of 2011.* Employers in Indiana and South Carolina will pay these rates unless the federal loans are repaid by Nov. 10, 2011 because, as of Jan. 1, 2011, these states had outstanding loans with the federal government for three consecutive years (i.e., the loans were presumably made in 2008 and currently remain unpaid). Therefore, they are entitled to a reduced 4.8% credit (5.4% less 0.6%), resulting in a 1.4% net rate for the first half of 2011 and a 1.2% rate for the remainder of the year.

- *Michigan employers currently scheduled to pay a net FUTA tax rate of 1.7% in the first half of 2011, and a net FUTA tax rate of 1.5% in the second half of 2011.* Michigan employers will pay these rates unless the federal loans are repaid by Nov. 10, 2011 because, as of Jan. 1, 2011, Michigan had outstanding loans with the federal government for four consecutive years (i.e., the loans were presumably made in 2007 and currently remain unpaid). Therefore, they are entitled to a reduced 4.5% credit

(5.4% less 0.9%), resulting in a 1.7% net rate for the first half of 2011 and a 1.5% rate for the remainder of the year.

> **Observation:** Thus, in Michigan, an employer may end up paying an extra $63 per employee as compared to an employer in a state with no outstanding loans. This reflects the $7,000 subject to FUTA, multiplied by the 0.9% difference between the rate that Michigan employers pay (1.7% for the first half and 1.5% for the second half of 2011) and the rate that employers in states without unpaid federal loans pay (0.8% for the first half and 0.6% for the second half of 2011).

To further complicate matters, it's possible that legislation could be enacted that would retroactively reinstate the FUTA surtax, effective July 1, 2011.

> **Observation:** President Obama's 2012 budget proposal included, among other things, eliminating the FUTA credit reduction in 2011 and 2012.