Eye On Washington

Legislative Update

A more human resource.

Likely 2016 FUTA "Credit Reductions"

Employers in California and the U.S. Virgin Islands will likely pay substantially increased Federal Unemployment Tax Act (FUTA) taxes in January 2017, due to unpaid federal loans.

Background

For-profit employers pay federal (FUTA) and state unemployment insurance (UI) taxes on wages paid. The FUTA tax rate is 6.0%, but employers receive an offsetting credit of 5.4% for payment of state UI taxes. This makes the effective FUTA tax rate 0.6 %, which applies to wages paid up to a limit of $7,000 per worker, or $42 per employee per year. However, when state UI trust funds are depleted, states draw from a designated federal loan account, and if such loans are not repaid within two years, part of the 5.4% FUTA tax credit is incrementally reduced each year – a.k.a., credit reduction. This increases the effective FUTA tax rate in affected states.

When this "credit reduction" applies, the FUTA tax rate typically increases by 0.3%, or $21 per employee. This increase is payable in January of the following calendar year with the Internal Revenue Service (IRS) FUTA tax return, Form 940. This credit is further reduced each year by 0.3% until loans are repaid.

In addition, California and the Virgin Islands are potentially subject to a special "Benefit Cost Rate" (BCR) Add-on tax because they have had outstanding FUTA debt for five or more years. This could increase their FUTA tax by more than the typical 0.3% per year. However, both California and the Virgin Islands requested a waiver from the BCR Add-on tax for 2016, and the U.S. Department of Labor (DOL) customarily grants BCR waiver requests.

Connecticut and Ohio repaid their loans in 2016 and will not be subject to a 2016 FUTA credit reduction, as long as their loans remain at zero on the crucial measurement date of November 10. However, the table below includes both states for full disclosure in the unlikely event that they have a loan balance on November 10. Connecticut did not request a waiver from the BCR Add-on tax and would be subject to the BCR (0.1%) for 2016 if it has an outstanding loan balance on November 10, 2016. Connecticut is not expected to borrow again in 2016.

DOL has identified the states that could be subject to the FUTA BCR Add-on tax and/or credit reduction for 2016. They are:

		Potential				Likely	
State	Normal FUTA Rate	2016 FUTA Credit Reduction	2016 BCR Add-On	Total 2016 FUTA Rate	FUTA Tax Per Employee	2016 FUTA Rate (with no BCR Add-on tax)	2016 FUTA Tax (with no BCR Add-on tax)
California	0.6%	1.8%	0.4%	2.8%	$196	2.4%	$168
Connecticut	0.6%	1.8%	0.1%	2.5%	$175	0.6%	$42[1]
Ohio	0.6%	1.8%	0.3%	2.7%	$189	0.6%	$42[2]
Virgin Islands	0.6%	1.8%	1.3%	3.7%	$259	2.4%	$168

Source: **U.S. Department of Labor Press Release, August, 2016**

1 Assumes zero federal loan balance on November 10, 2016.
2 Assumes zero federal loan balance on November 10, 2016.

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Employers in these three states and the U.S. Virgin Islands will pay an increased FUTA tax rate in January 2017, if there is a loan balance on November 10. This increase will be based on FUTA taxable wages paid in the affected jurisdictions during 2016. eduction Add-on FUTA rate Employee Normal Rate Over 2013

Example:

ABC Corporation has ten California employees in 2016. ABC Corporation's FUTA tax due on each employee's wages paid in 2016 would normally be $42 ($7,000 x 0.6%). But since California is a credit reduction state and will likely receive a waiver for the BCR Add-on rate, the total FUTA tax owed per worker will likely be $168 ($7,000 x 2.4%); a 14.3% increase over the FUTA tax paid per worker for 2015, and a 300% increase over the normal FUTA payment of $42 per full-time worker.

Affected Employers Should Plan for the Additional Tax Payment in January 2017

In the affected states, the credit reduction would represent the vast majority of FUTA taxes due for 2016. Normally, employers accrue and pay at the normal 0.6% rate during the year, with the additional amounts (in California's case, an additional 1.8%) calculated and paid in January 2017 for 2016. Employers in California and the Virgin Islands will likely pay an additional $126 per employee in January ($168 minus the $42 per employee already collected for 2016).

If ADP is responsible for filing the IRS Form 940 for your organization, ADP will automatically calculate and pay the additional FUTA tax due as a result of FUTA credit reductions. You will receive an invoice in mid-January 2017 to advise you of any additional liability for the BCR (if applicable) and/or credit reduction amounts due with your 2016 IRS Form 940.

Planning for 2017 (FUTA Amounts Due in January 2018)

If the states in the chart above continue to have outstanding loans through November 10, 2017, an additional 0.3% credit reduction may apply, along with the potential for an additional BCR Add-on tax.

For additional information, view this linked article from the IRS.

ADP Compliance Resources

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