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2010 Payroll Fact Sheet

Facts about the Federal Unemployment Tax Act (FUTA) Credit Reduction

Michigan is a Federal Unemployment Tax Act credit reduction state. The current FUTA credit reduction went into effect January 01, 2009.

Federal law provides for a reduction in the FUTA tax credit when a state has outstanding federal loans for two years. The reduction in the FUTA tax credit is 0.3% for the first year, and an additional 0.3% for each succeeding year until the loan is repaid. Michigan has had outstanding loans from the federal government for two consecutive January 1st dates beginning in 2008.

The FUTA credit reduction results in a net increase in FUTA taxes and applies to all Michigan contributing employers (except to Indian Tribes, nonprofit organizations, and governmental entities).

The FUTA tax is a flat rate of 6.2%, but employers who pay their state unemployment tax timely and in full receive a 5.4% credit. Therefore, the net FUTA rate is normally 0.8%, however, the total FUTA tax for 2009 will be 1.1%; therefore, the total credit allowed will be 5.1% instead of the usual 5.4%.

This FUTA credit reduction results in an additional \$21 per employee ($\$7,000 \times 0.3\% = \21) in the first year that loans are un-repaid, and an additional \$21 in each succeeding year that loans are not repaid.

History of the FUTA Credit Reduction

From its inception in 1936 through the early 1970's, the unemployment compensation system in Michigan has been able to produce revenues sufficient to fund benefits.

High levels of unemployment throughout the 1970s caused by a series of recessions, depleted trust fund reserves. Michigan began borrowing in 1975 to finance benefits, one of 23 states to borrow during this time. Borrowing continued until 1977, by which time the accumulated debt had reached \$624 million. Statutory changes, which included several increases in the taxable wage base and maximum tax rate, together with an upturn in the economy, permitted the state to repay its debt by the end of 1979.

However, in the early 1980's, the state's economy took another downturn and unemployment levels increased. In 1980, Michigan again began borrowing, one of 32 states to borrow between 1980 and 1985.

Because of these federal loans to Michigan's Unemployment Trust Fund in the early 1980s, employers lost a portion of their FUTA credit and paid higher FUTA taxes in 1982, 1983 and 1984. FUTA tax penalties are used to reduce the outstanding loan balance. These FUTA tax penalties are also known as FUTA Credit Reductions.

Due to higher unemployment and lower tax payments by employers (fewer employees in covered employment), the state began borrowing again in 2006, but for 2006 & 2007, the state was able to fully repay the federal loans. The State has had outstanding loans from the federal government for two consecutive January 1st dates beginning in 2008.

Given the depth and breadth of this recession, 31 of the 50 states (62%) are borrowing from the federal government (data as of March 2010). The United States Department of Labor predicts that up to 40 states will be borrowing soon.

Federal law governs the loan repayment process. Under the Federal Unemployment Tax Act (FUTA), there is a reduction in the FUTA tax credit when a state has outstanding federal loans for two years. The reduction in the FUTA tax credit is 0.3% for the first year, and an additional 0.3% for each succeeding year until the loan is repaid.