

Unemployment insurance basics and trends

October 12, 2017



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Today's agenda

- ▶ A tax director's perspective
- ▶ Unemployment insurance sourcing
- ▶ Unemployment insurance basics
- ▶ Federal policy and federal unemployment insurance (FUTA) credit reduction
- ▶ Elections, due diligence and transactions
- ▶ UI integrity and claims management
- ▶ Tax rate management and forecasting
- ▶ Hurricane Disaster Zone (HDZ) Employee Retention Credit
- ▶ Connect with us



A tax director's perspective



Let's talk unemployment tax performance

Unemployment insurance (UI) cost can be significant

- ▶ 2017 base rates range from 0% to 14.3%
- ▶ 2017 wage bases range from \$7,000 to \$45,000
- ▶ 2016 total payments \$33.1B*
- ▶ 2016 benefit overpayments \$3.9B*
- ▶ 2016 improper payment rate 11.65%*

* US DOL statistics available [here](#)

Employers directly influence their UI tax rates

- ▶ Organizational behavior and management practices have direct impact on tax rates
- ▶ Tax performance depends on teamwork across functions and disciplines

The tax director's bottom line

- ▶ An employer's unemployment tax position affects profitability and job growth
- ▶ Unemployment tax rates generally transfer to buyers, potentially affecting your market worth
- ▶ Assisting states in paying only qualified UI benefits isn't just good for business, it's the law
- ▶ Unemployment tax should be considered in both structural planning and implementation

A performance evaluation is likely necessary if:

- ▶ Transactions occurred involving bankruptcy or movement of employees across tax accounts or state lines
- ▶ UI claims have been loosely managed or the employer has not been routinely collaborating with your third-party claims service provider
- ▶ Those experienced in unemployment tax are not regularly reviewing your tax position in all applicable states

Polling question 1

Does the company's tax director request information concerning your unemployment insurance tax performance?

- A. Don't know/doesn't apply
- B. Yes
- C. No
- D. It's an approach worth considering

Determining the work
state for payroll taxes



State unemployment insurance sourcing rules (the four-prong test)

Employer

- ▶ Where wages are paid, **and**
- ▶ There is a covered employee

Covered employee

- ▶ Applies only in one state at a time
- ▶ Temporary work incidental to main job location is not considered

The SUI state is where the employee performs some work, and (in this order):

- ▶ Where the work is localized;
- ▶ The employee's base of operations; or
- ▶ The employee's place of control.
- ▶ If none of the above:
 - ▶ The employee's residence

US Department of Labor, [Program Letter 20-04](#)

Unemployment insurance sourcing

Example

Employer

- ▶ Headquarters office is New York
- ▶ Employment and employees are UI covered in all states

Employee

- ▶ Works across two states, Texas and Louisiana
- ▶ Home office is in Texas
- ▶ General manager is in New Mexico

The employee work state is (in this order):

- ▶ Where the work is localized (N/A)
- ▶ Employee's base of operations (Texas)
- ▶ Employee's place of control (New Mexico)

If none of the above:

- ▶ Employee's residence

Since work is not localized in one state and Texas (rather than New York) is the base where the employee normally receives instructions, mail, etc., Texas is the SUI state.

Unemployment insurance basics



Federal policy

- ▶ The Social Security Act of 1935 (Titles III and IX) establishes a joint federal-state program of unemployment insurance (UI):
 - ▶ Provides state guidelines for the payment of temporary benefits to employees who are unemployed through no fault of their own (as defined under state law)
 - ▶ Establishes that employers make contributions to the state program
 - ▶ Sets the state minimum taxable wage base at \$7,000

Did you know?

Wisconsin was the first state, in 1932, to enact a state unemployment insurance program.

Federal policy (cont.)

- ▶ The Social Security Act of 1935 (Titles III and IX) establishes a joint federal-state program of unemployment insurance (UI):
 - ▶ Provides extended benefits
 - ▶ Most states allow for a maximum of 26 weeks of regular benefits
 - ▶ Makes loans available to states for the payment of benefits (Title XII of the Social Security Act)
 - ▶ Certifies that states are in compliance with federal guidelines

Did you know?

Arkansas, Florida, Georgia, Illinois, Michigan, Missouri, North Carolina and South Carolina enacted legislation to reduce the maximum benefits weeks to less than 26.

Unemployment insurance overview

Federal Unemployment Insurance (FUTA)



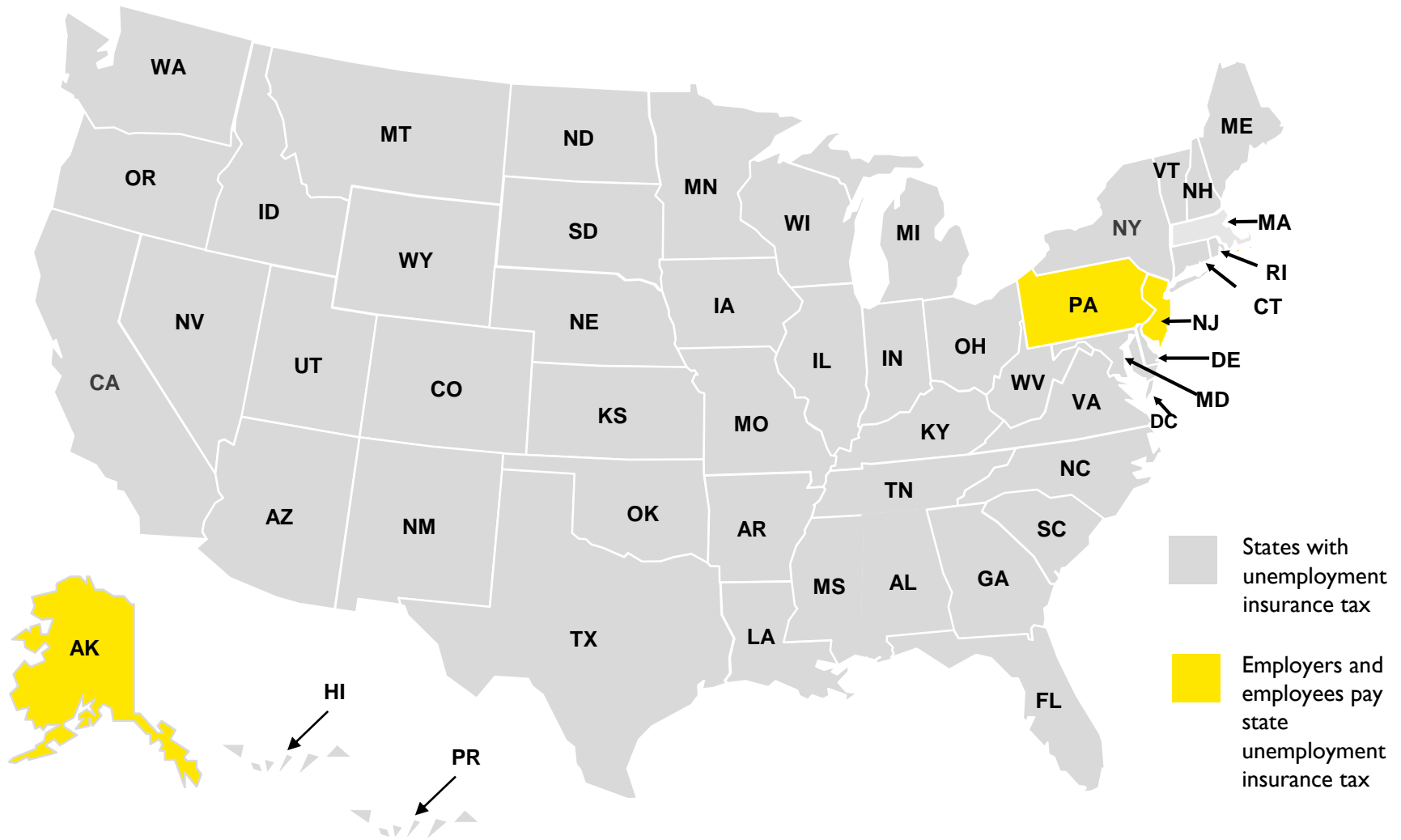
- ▶ Pays for administration of state unemployment insurance program
- ▶ Employer paid at 6.0% with maximum credit of 5.4% allowed (for net normal rate of 0.6%)
- ▶ Wage base is fixed at \$7,000 per covered employee per year

State unemployment insurance (SUI)



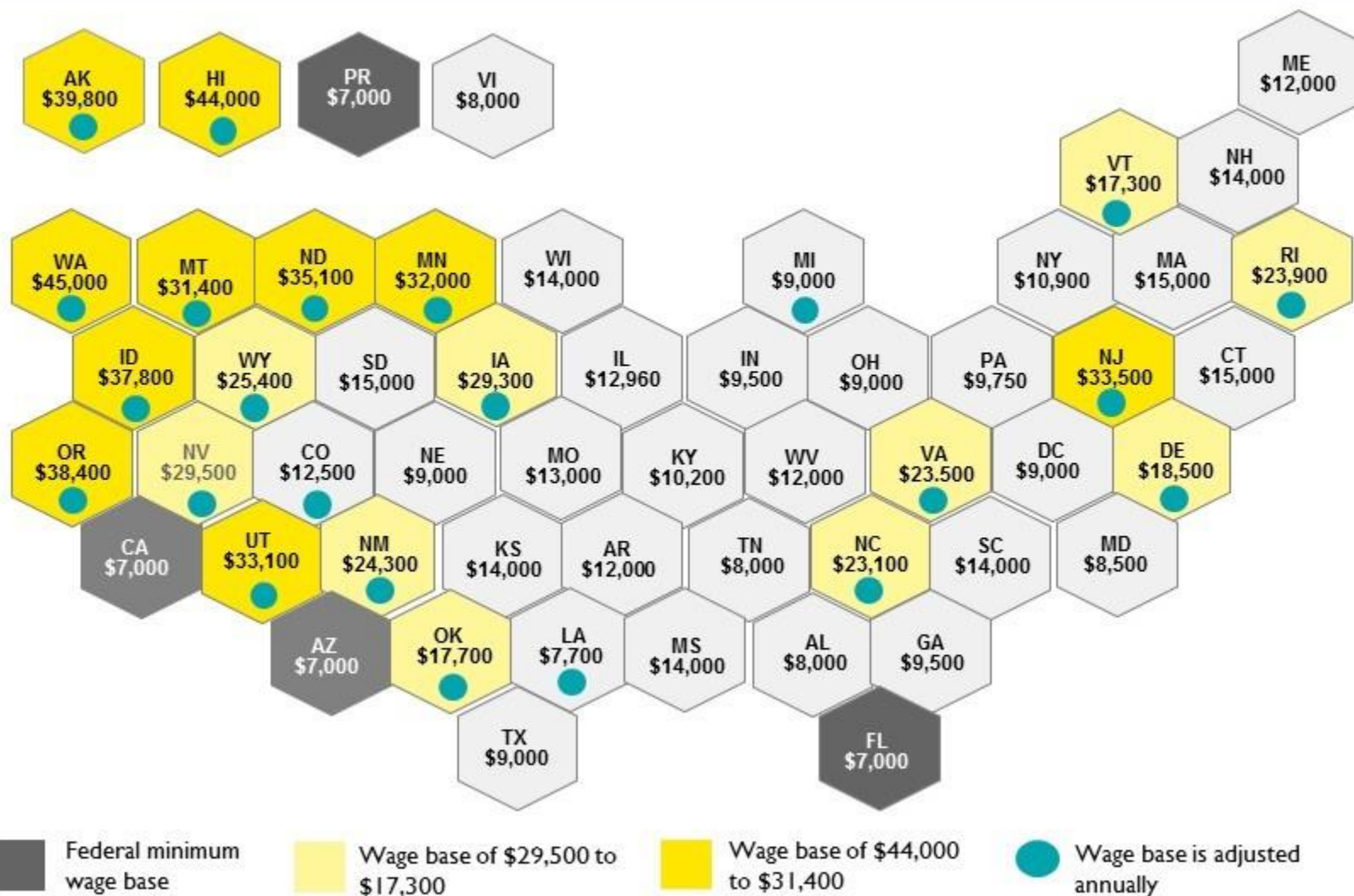
- ▶ Funds state unemployment trust fund which pays benefits to qualified unemployed persons
- ▶ Paid only by employers (except in Alaska, New Jersey and Pennsylvania)
- ▶ Wage base varies by state but cannot be less than \$7,000
- ▶ Tax rates vary by state and by employer based partially on SUI benefits paid to qualified workers and “charged” to the employer’s state account

State unemployment insurance (SUI)

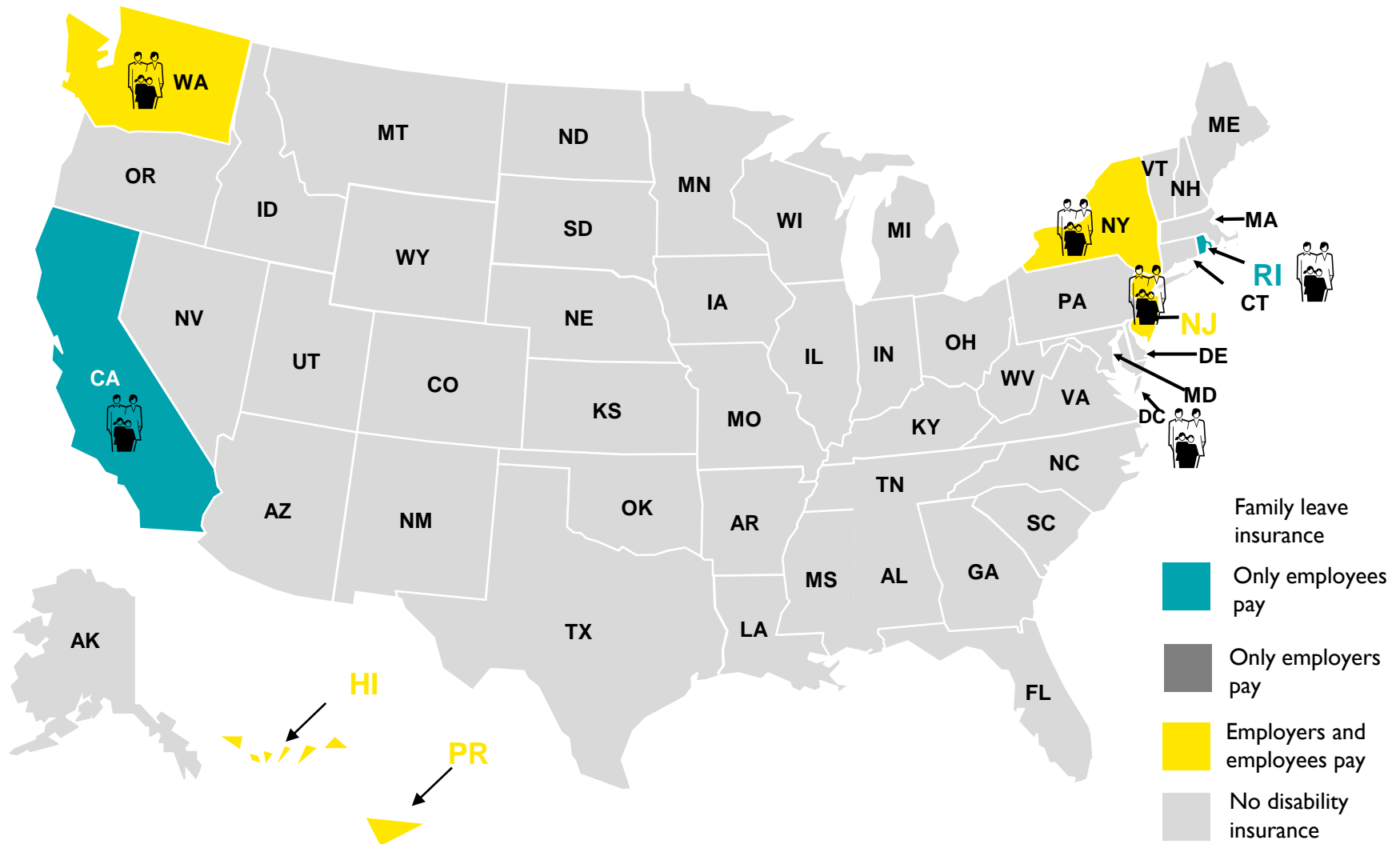


State unemployment insurance

2017 wage bases at a glance



Jurisdictions with disability insurance (SDI) and family leave insurance



How do your work states rate?

This can affect the state UI rate schedule that applies

Jobless rate

The national jobless rate dropped from 4.7% to 4.3% between May 2016 and May 2017

2017 highest 10

State	Jobless rate as of May 2017	Ranking
Ohio	4.9%	22
Kentucky	5.0%	23
Pennsylvania	5.0%	23
Arizona	5.1%	24
Louisiana	5.7%	25
District of Columbia	6.0%	26
New Mexico	6.6%	26
Alaska	6.7%	27
Virginia	10.2%	28
Puerto Rico	11.0%	29

(↑) or (↓) compared to May 2016 jobless rates

2017 lowest 10

State	Jobless rate as of May 2017	Ranking
Colorado	2.3%	1
North Dakota	2.5%	2
Hawaii	2.7%	3
Nebraska	2.9%	4
New Hampshire	2.9%	4
South Dakota	2.9%	4
Iowa	3.1%	5
Vermont	3.1%	6
Wisconsin	3.1%	6
Idaho	3.2%	7

For state specifics and to benchmark your SUI rates against others in your state or industry go [here](#).

State unemployment insurance basics

Federal law sets guidelines

Number of weeks benefits will be paid and weekly benefit amount

Qualifying weeks, qualifying wages in determining benefits

Who is eligible for benefits

SUI tax rating system

Standard maximum of benefit weeks is generally 26; however, Arkansas, Florida, Georgia, Illinois, Michigan, Missouri, North Carolina and South Carolina enacted legislation to reduce the maximum benefit weeks to less than 26

States govern specifics

Primary SUI tax rating systems used by states

Reserve ratio = $\frac{\text{SUI taxes paid less SUI benefits charged}}{\text{Average taxable payroll}}$

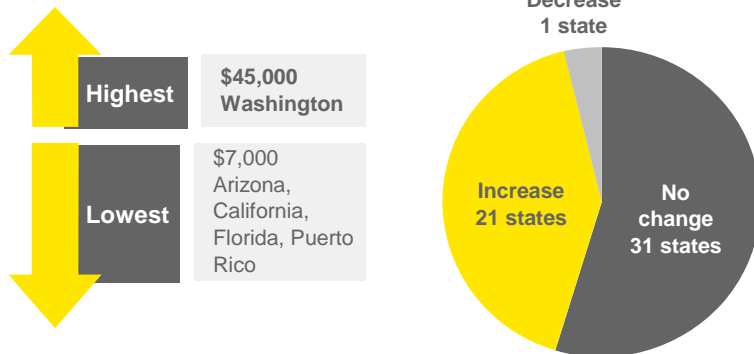
Benefit ratio = $\frac{\text{SUI benefits charged}}{\text{Total taxable payroll}}$

Delaware and Oklahoma use the benefit wage ratio method, and Alaska uses a method called “payroll variation.” Michigan and Pennsylvania use a combination of the reserve and benefit ratio methods

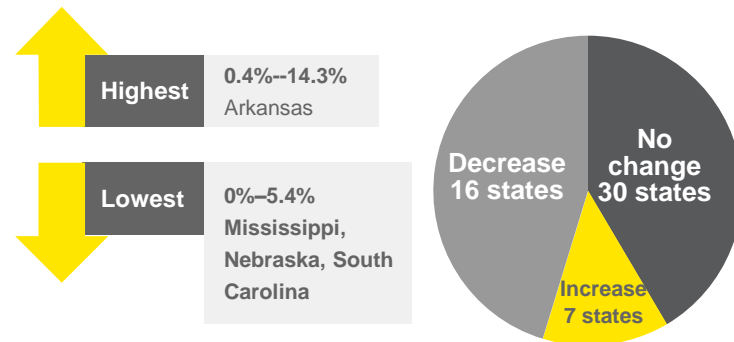
2017 SUI costs at a glance

States and the District of Columbia, Puerto Rico and Virgin Islands

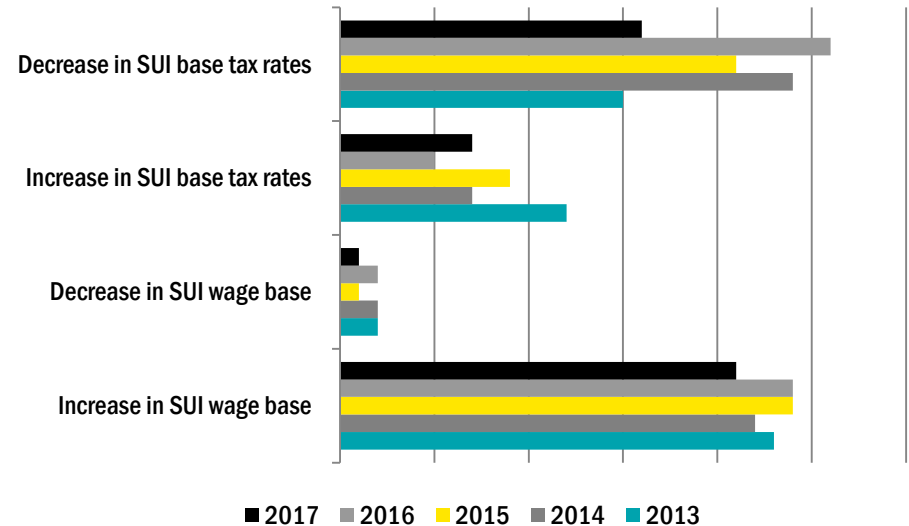
2017 state wage base



2017 state base tax rates



Wage base and base tax rates trends 2013 to 2017



For state specifics and to benchmark your SUI rates against others in your state or industry go to www.uifactfinder.ey.com

Federal policy and the FUTA credit reduction



FUTA tax rate basics

FUTA tax

- ▶ Maximum tax of 6.0%
- ▶ Maximum credit of 5.4%
- ▶ Net normal tax rate of 0.6%

FUTA credit reduction

- ▶ Applies to individual employer that has not paid minimum SUI in full and at minimum amount
- ▶ Applies to all employers in a state that has not met certain federal standards
- ▶ Applies to all employers in a state carrying a federal FUTA loan balance for two or more years

States with an outstanding federal FUTA loan also must pay interest by each 30 September

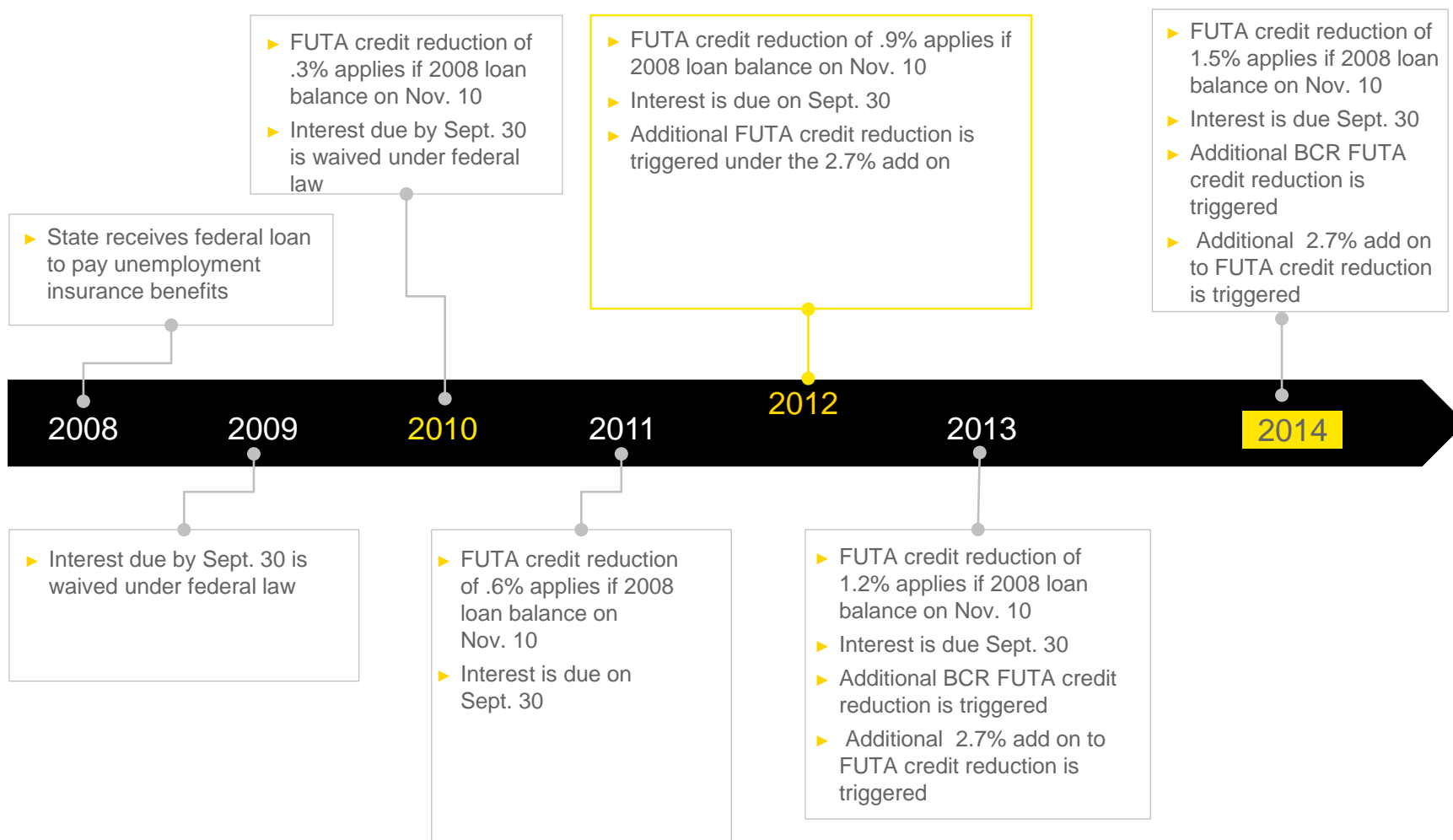
Loan-related FUTA credit reduction

- ▶ Starting in year 2 a standard +0.3% is added each year (i.e., 0.3%, 0.6%)

Plus 1 or 2 below

1. Starting in year 3 a 2.7 add on (*cannot be waived once triggered*)
2. Starting in year 5 a Benefit Cost Rate (BCR) add on (*waiver must be requested by July 31*)

Federal UI loan balance life cycle



2016 FUTA credit reduction states

As of August 1, 2017



Jurisdiction	First year of loan	2016 FUTA credit reduction	Net 2016 FUTA rate	2017 projected FUTA credit reduction	2017 projected Benefit Cost Rate (BCR) add-on	2017 Minimum FUTA rate	2017 net FUTA rate	Year of loan payoff
California	2009	1.8%	2.4%	2.1%	0.1%	0.6%	2.8%	Expected in 2018
Virgin Islands	2009	1.8%	2.1%	2.1%	1.1%	0.6%	3.8%	Not known

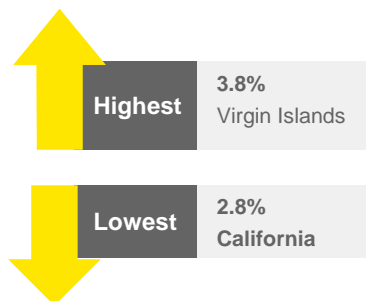
10 November is key

The final determination of FUTA credit reductions is made after 10 November of each calendar year and the final outcome depends on if the state has an outstanding federal loan balance on that day

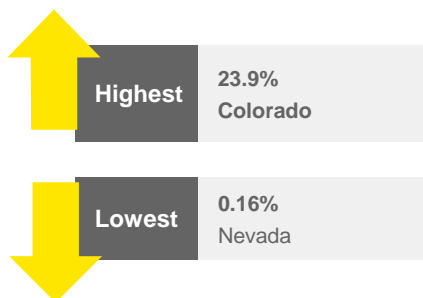
FUTA refers to the Federal Unemployment Tax Act.

SUI trust fund financing at a glance

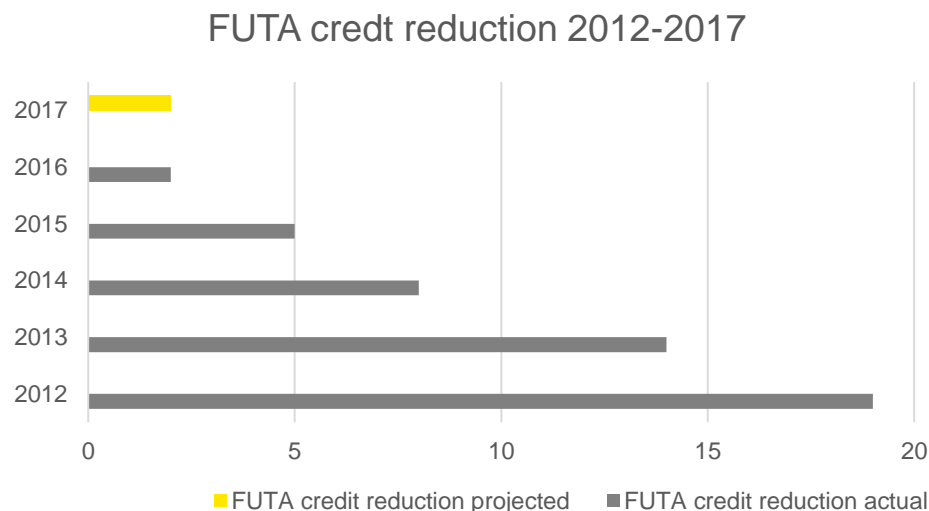
2017 FUTA rates projected over 0.6%



2017 state interest or bond assessment rates (6 states, down from 7 in 2016)



States with outstanding FUTA loan balances 2012 to 2017



States have been slow to repay loans or bonds issued due to the markets' collapse of 2008. Employer UI costs increase if FUTA loan balances and bonds linger.

For state specifics and to benchmark your SUI rates against others in your state or industry go to www.uifactfinder.ey.com

Federal proposed legislation

► President's FY 2016 proposals

Proposed federal law	Potential effect on employers
Reinstate and make permanent the 0.2% temporary surtax	Increases the FUTA tax rate from 6% to 6.2% beginning in 2016
Effective in 2016, states would be required to impose a minimum tax rate on employers that is equivalent to roughly \$70 per employee.	Employers with employment in states having a low wage base and that also have a low SUI tax rate could see an increase in their costs This would also be a significant legislative undertaking for a number of states with complex rate schedules
Increase FUTA wage base to \$40,000 in 2017 and reduce net FUTA rate to 0.165%. Adjust the FUTA wage base annually based on the average wage	Would increase SUI tax in the those states that have a taxable wage base of less than \$40,000

Did you know?

For 2017, all states except Hawaii and Washington have a wage base under the proposed minimum of \$40,000.

Polling question 2

Has your employer acquired other businesses in the last three years?

- A. Don't know/doesn't apply
- B. Yes
- C. No
- D. We plan to

Elections, due diligence and transactions



Six manageable SUI tax variables

How much SUI tax an employer pays depends on how it manages each of these variables

1

Transactions and statutory elections

2

Covered wage exclusions

3

Covered employee exclusions

4

Disqualifying wages

5

Penalty rate assessment

6

Claims charged to the employer's account

Transactions

- ▶ Merger
- ▶ Acquisition
- ▶ Reorganization
- ▶ Bankruptcy
- ▶ Employee transfers
- ▶ Business closing
- ▶ Business start up

Statutory elections that can lower rates

- ▶ Voluntary contributions
- ▶ Joint accounts
- ▶ Credits
- ▶ Business relocation incentives
- ▶ Voluntary transfer of experience

These variables can have the greatest impact on an employer's SUI tax rate

When employees change their work state

- ▶ When an employer transfers employees from one state to another within the same calendar year and under the same FEIN, most states allow a credit for wages paid in the previous state up to that state's wage limit
 - ▶ **Example:** Assume an employee earned \$16,000 in Kansas through June 2016. Wages up to the Kansas wage base of \$14,000 are credited against the wage base in the state of transfer. Therefore, if the employee moved to Arizona in July 2016 with a wage base of \$7,000, no SUI tax would be owed in Arizona for this employee for the remainder of the year.

Did you know?

Louisiana, Minnesota (and Montana effective in 2014) don't allow for the transfer of wages under these circumstances. Therefore, if the Kansas employee moved to Minnesota in 2016, UI tax is due on the first \$32,000 of covered wages paid in Minnesota.

Statutory elections

The two most commonly known

Voluntary contributions

- ▶ For 2016, allowed in 26 states (*eliminated in New Mexico effective in 2015 , Rhode Island joined in 2016*)
- ▶ Employers can “buy down” their SUI rates with certain restrictions
- ▶ Some states will notify the employer if the voluntary contribution was insufficient to lower its UI rate (however, the voluntary contribution is not refunded once it is made)

Joint accounts

- ▶ Allowed in 12 states
- ▶ By mathematically combining their unemployment experience, the members of a joint account can share their reserves, effectuating an overall reduction in SUI rates
- ▶ Duration of joint account varies by state (e.g., for California the election is permanent)
- ▶ A joint account does not alter the corporate structure

Careful analysis is necessary to ensure elections will have a positive influence on current and future SUI rates. Elections must be made by the statutory deadline which is frequently triggered by the date the annual SUI rate notice is issued.

Statutory elections (cont'd)

Some less commonly known

Direct tax credits

- ▶ Qualifying fully-merit-rated Michigan employers were able to apply for a tax credit against their Michigan SUI for additional FUTA tax they paid due to the FUTA credit reduction in calendar years 2009 through 2011
 - ▶ Michigan will continue to accept refund requests pursuant to this provision

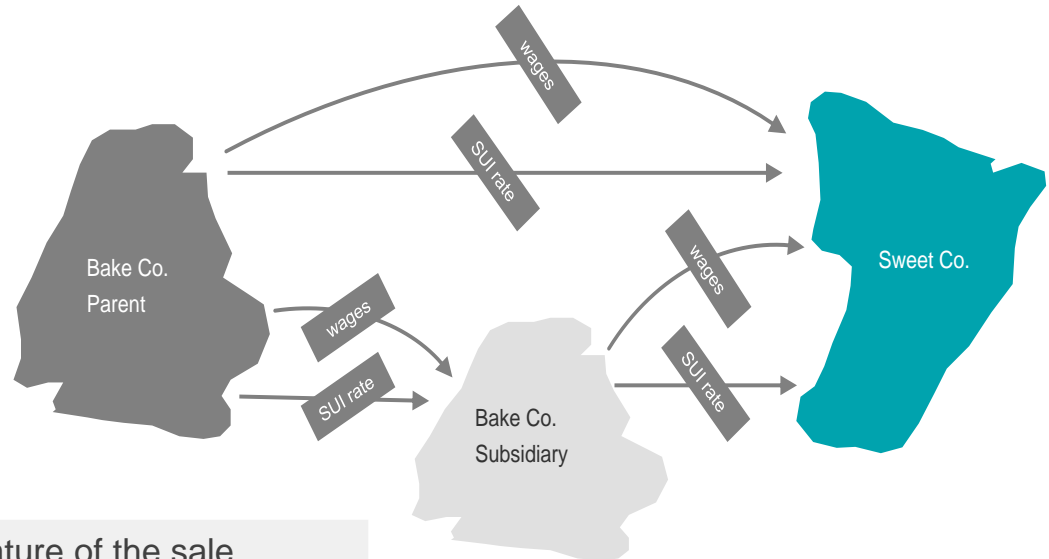
Business relocation incentives

- ▶ Some states will allow new businesses entering into the state to bypass the higher new employer SUI rate by factoring into the rate calculation a more favorable experience in the previous state
- ▶ Kansas and Tennessee adopted provisions in 2014

Working with unemployment insurance tax professionals who are knowledgeable of state unemployment insurance laws and aware of law changes is important in managing SUI costs.

Mergers, acquisitions and transfers

- 1 Do the wages paid by the predecessor transfer to the successor employer in determining if the employee wage base is reached?
- 2 Is the SUI rate of the predecessor taken into account in determining the SUI rate of the successor?



- ▶ Analysis of state law
- ▶ Knowledge of state enforcement practices
- ▶ Identification and understanding of relevant case law
- ▶ Adequate documentation of facts and authority supporting the tax position
- ▶ Timely state registrations and business change notices

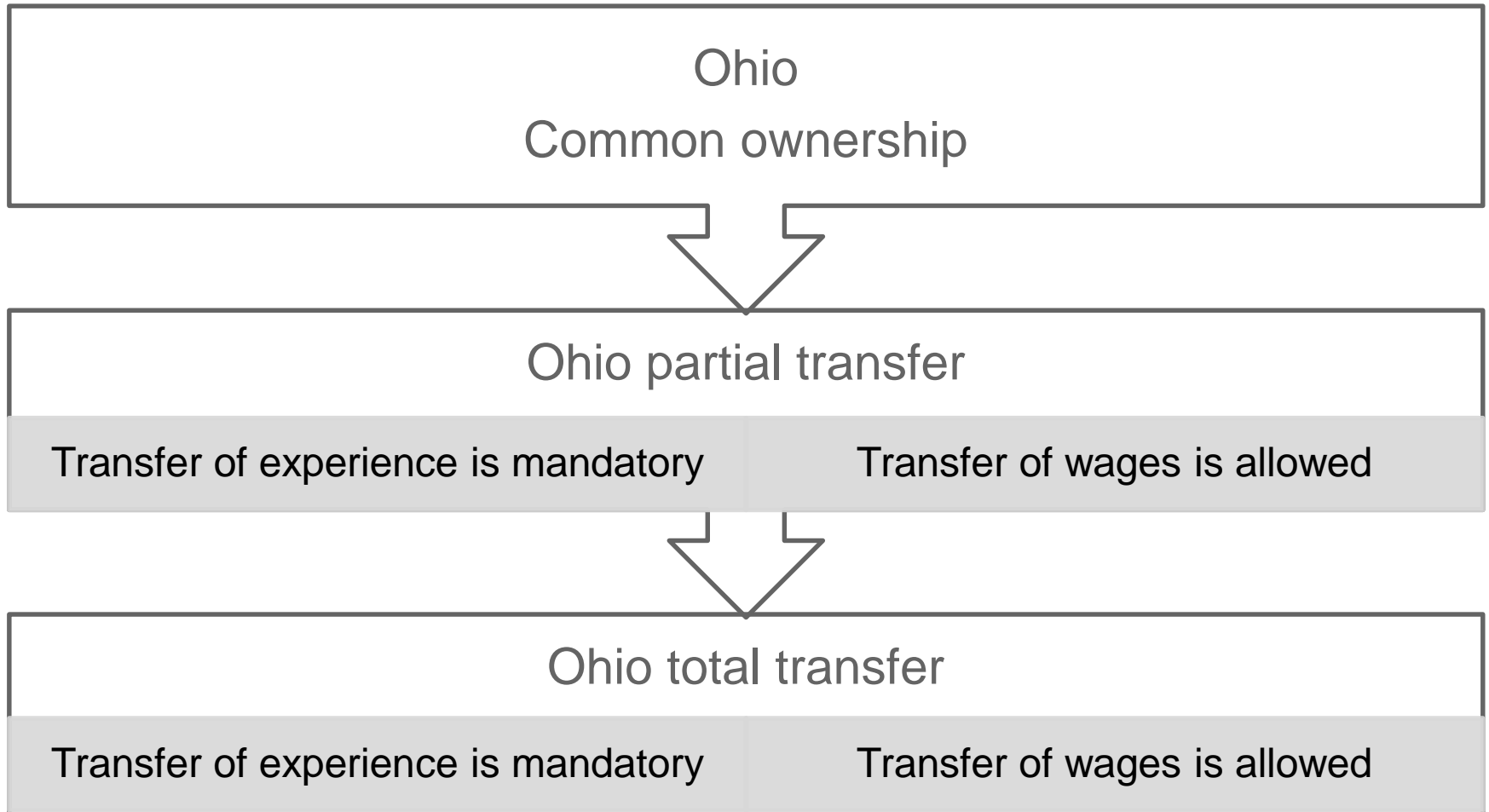
Employer implementation

- ▶ Nature of the sale
- ▶ Partial or total transfer
- ▶ Common ownership, management or control
- ▶ Bankruptcy or other special circumstances
- ▶ The transaction dates

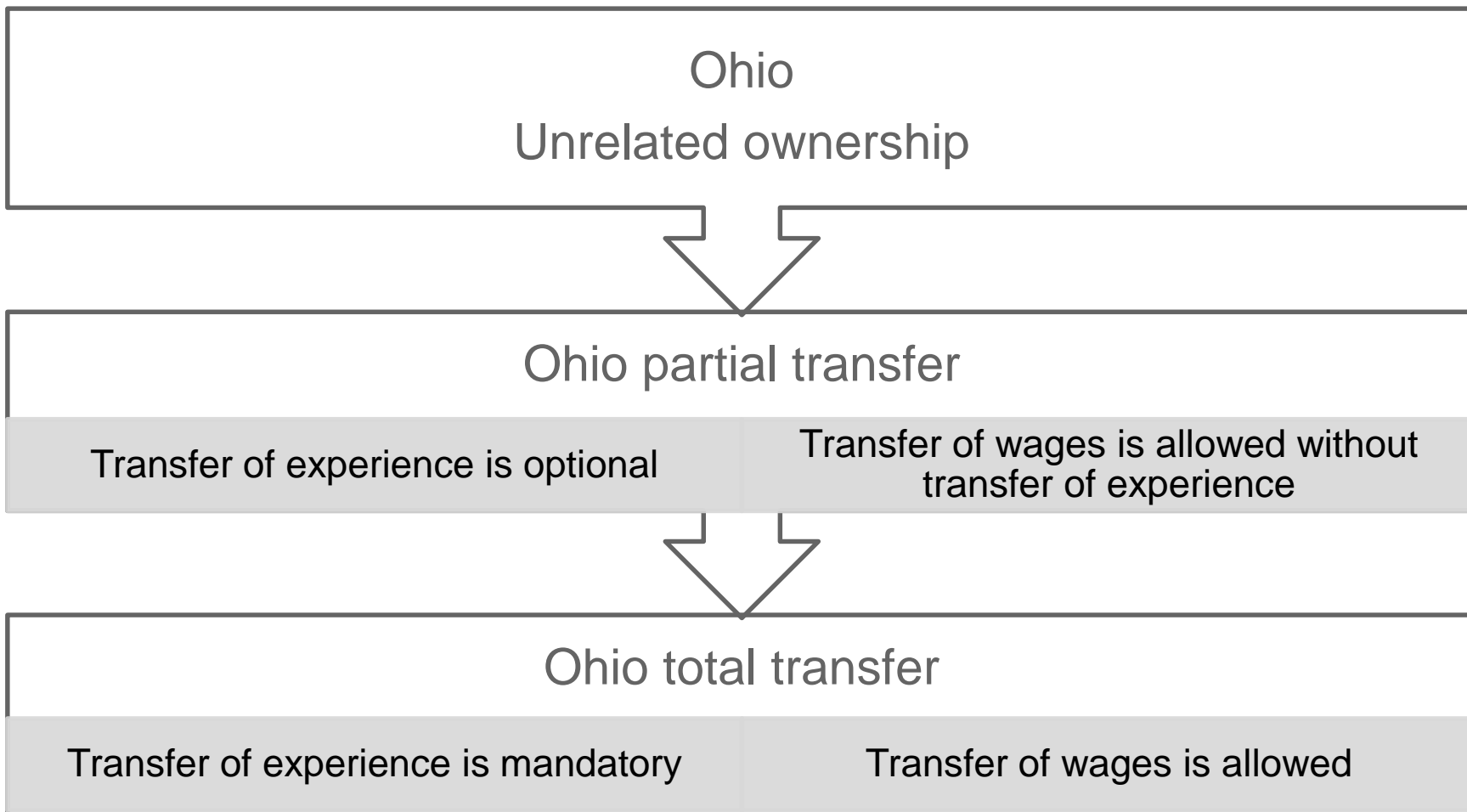
Conditional factors

Whether the transfer of wages or experience is mandatory or voluntary depends on state law and various factors. Successful implementation is the responsibility of the employer.

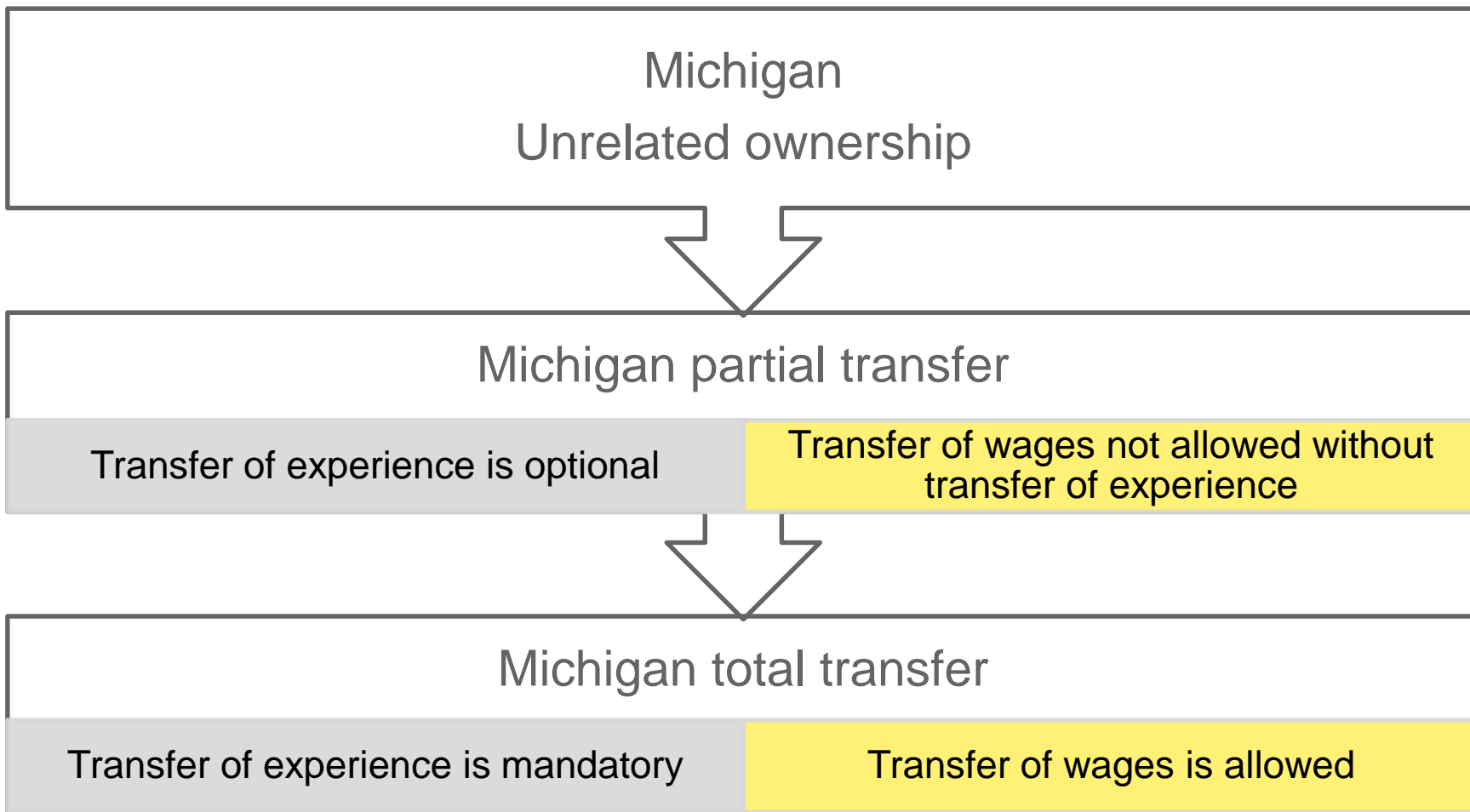
Mergers, acquisitions and transfers (cont.)



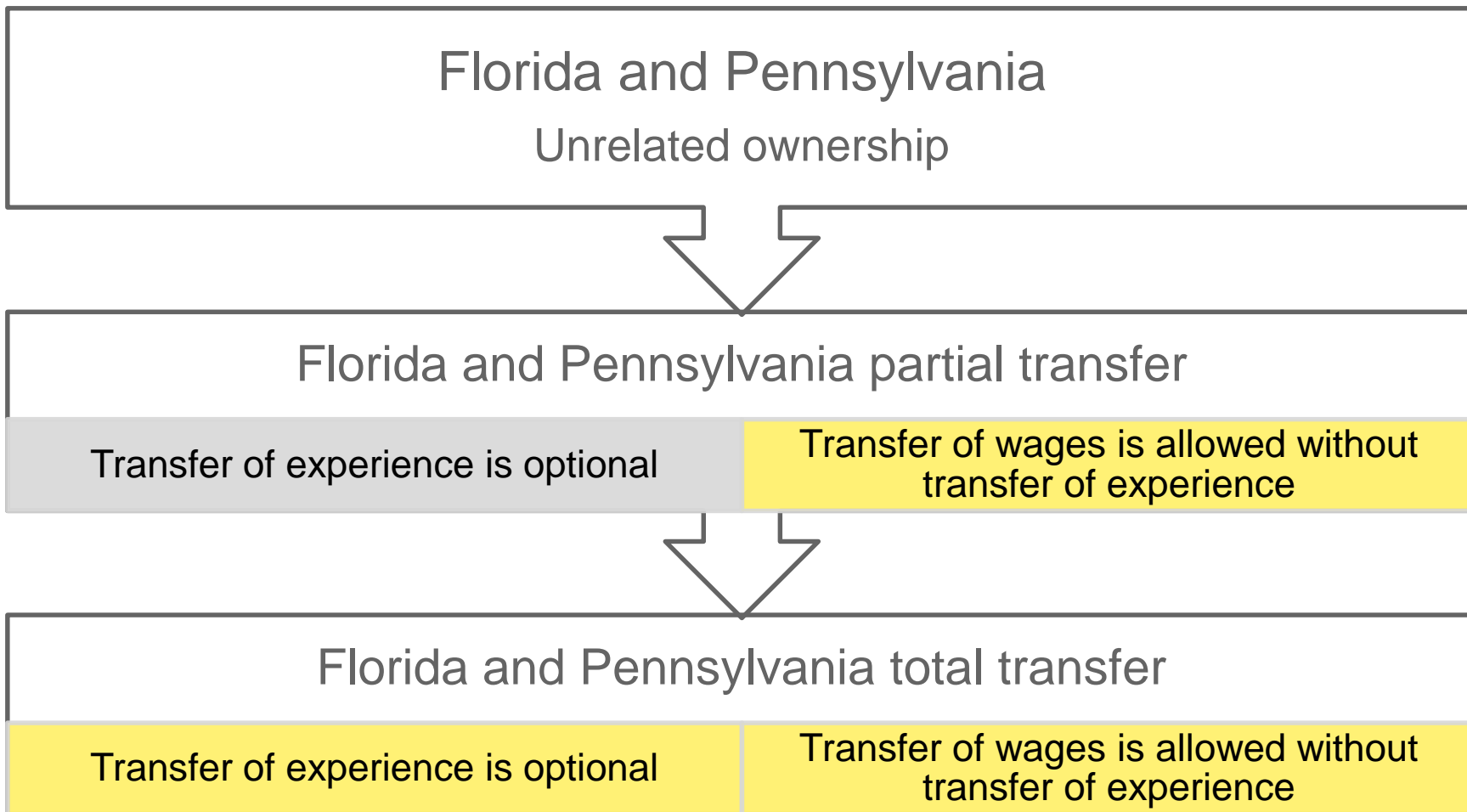
Mergers, acquisitions and transfers (cont.)



Mergers, acquisitions and transfers (cont.)

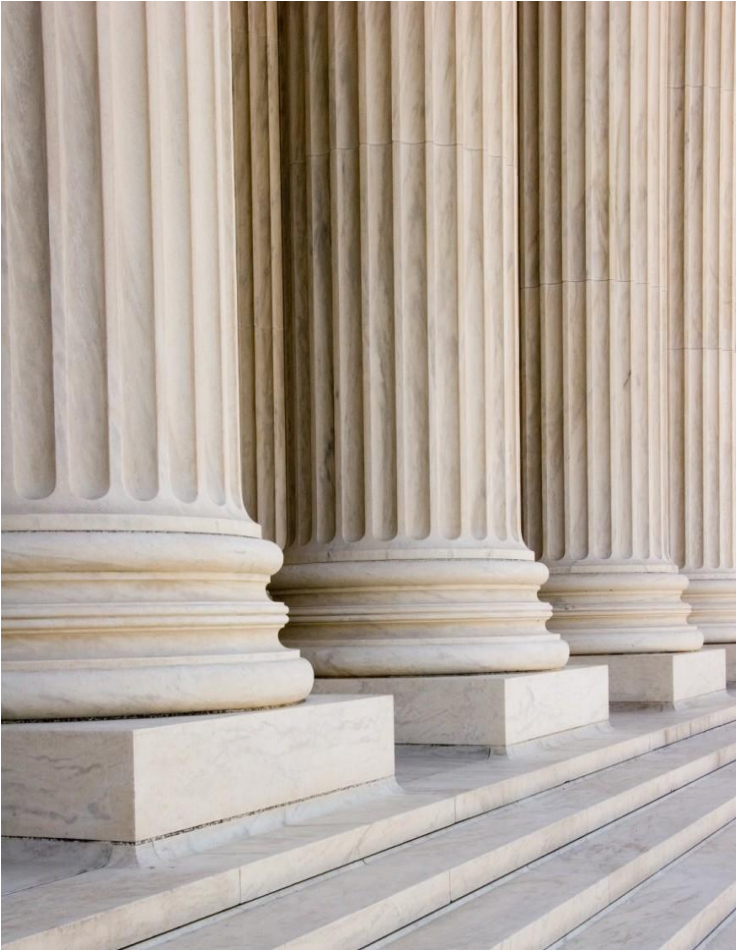


Mergers, acquisitions and transfers (cont.)



Case in point 1

Common management or control

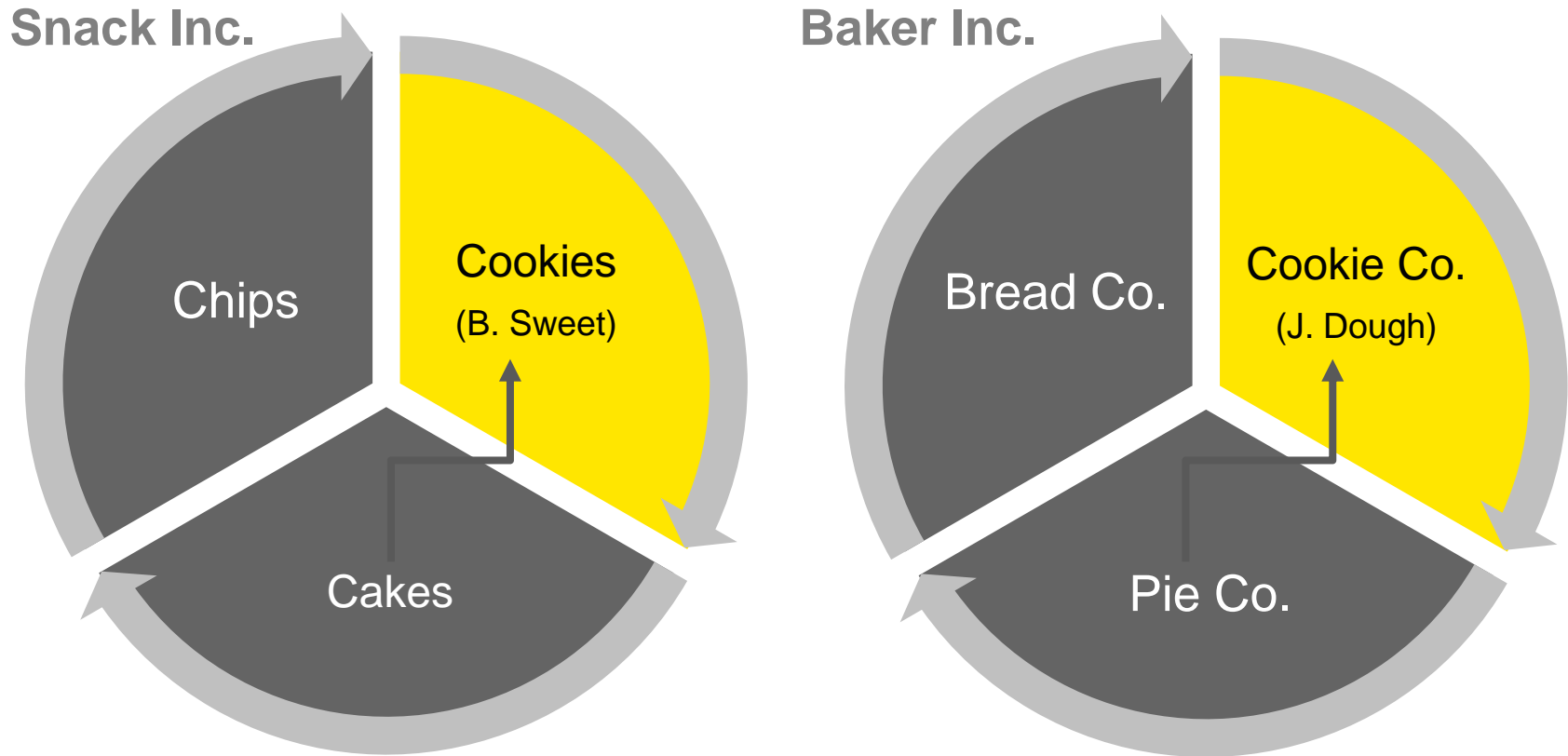


The Minnesota Court of Appeals ruled that the Minnesota Department of Employment and Economic Development incorrectly set the state unemployment insurance (SUI) rate for a newly-formed employing unit at 8.3% rather than the new employer rate of 3.4%.

At issue in the case was whether the department was correct in asserting that partial experience of the predecessor employer was required to be transferred to the successor employer because the entities were under substantially common management or control. (*Continental Hydraulics Incorporation v. Department of Employment and Economic Development*, No. A12–1654, 10 June 2013)

Transfer of UI experience in partial acquisition

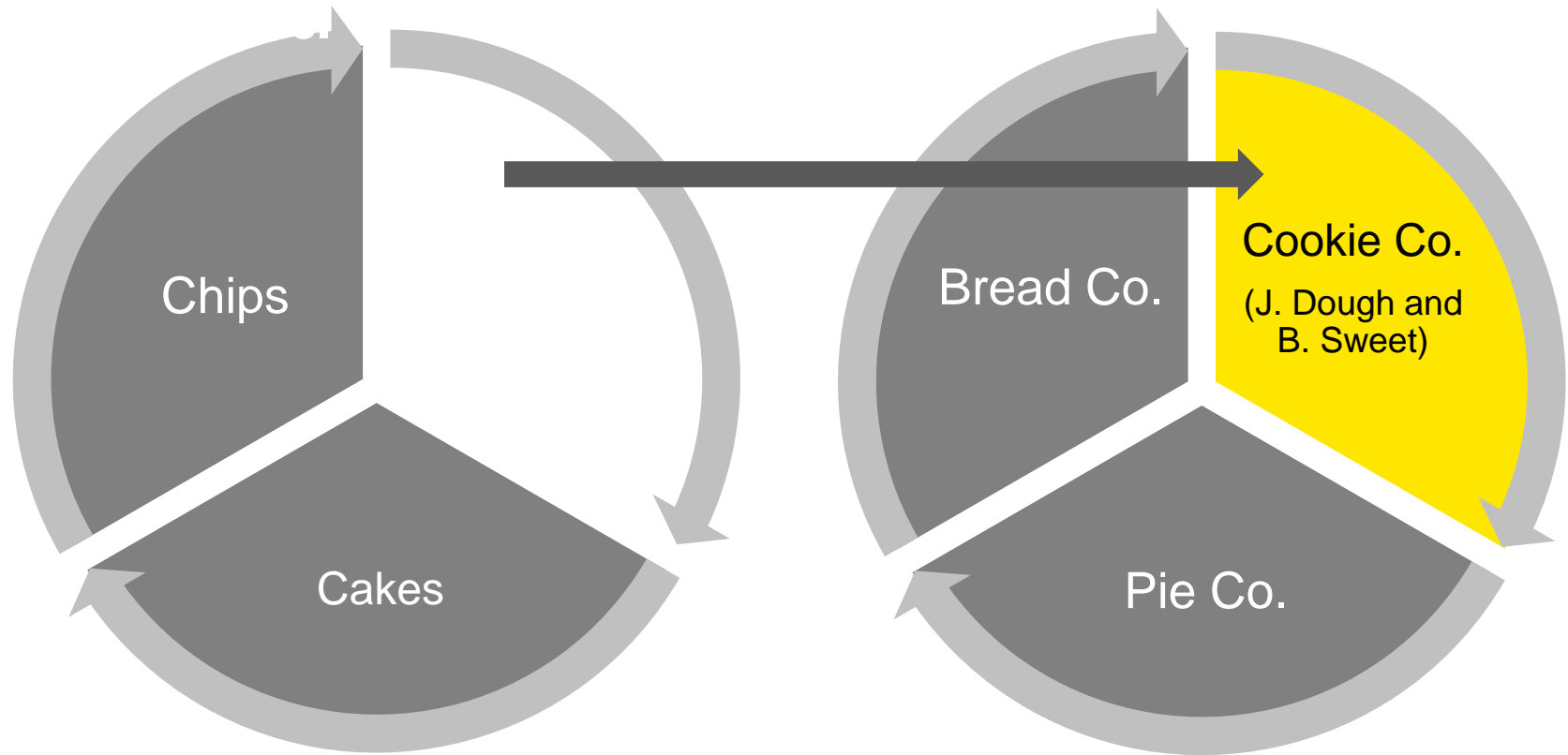
(March 2016 – prior to acquisition)



In preparation for the sale on 1 April, Snack Inc. transfers B. Sweet to the cookie division and Baker Inc. creates Cookie Co. and transfers its employee, J. Dough, from Pie Co. to head the new company. Prior to the sale, there is common management between Snack Inc. and Cookie Co.

Transfer or UI experience in partial acquisition

(1 April 2016 – day of acquisition)



Transaction analysis matters

- ▶ Here are just three recent examples of how transaction analysis had a significant unemployment tax impact



Polling question 3

Has a tax professional reviewed your prior year employment tax history in the last three years to identify refunds or errors?

- A. Don't know/doesn't apply
- B. Yes
- C. No
- D. I'd like more information

UI integrity and claims management



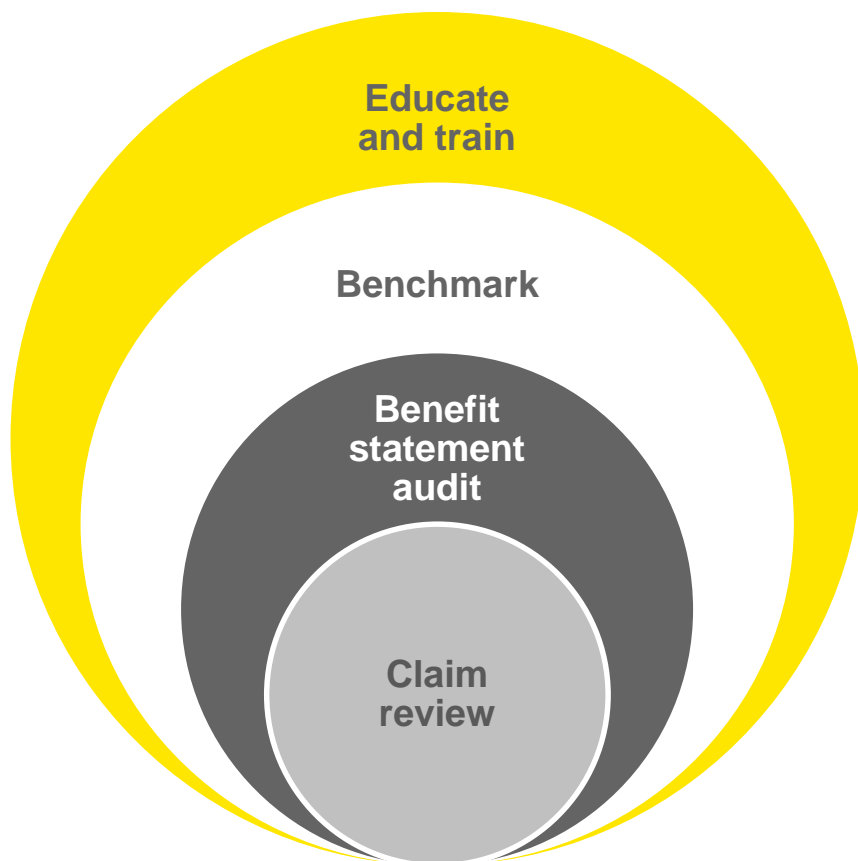
Responding to UI claim notices is the law

- ## Many states aggressively enforce UI integrity law



Claims management overview

The four components of claims management

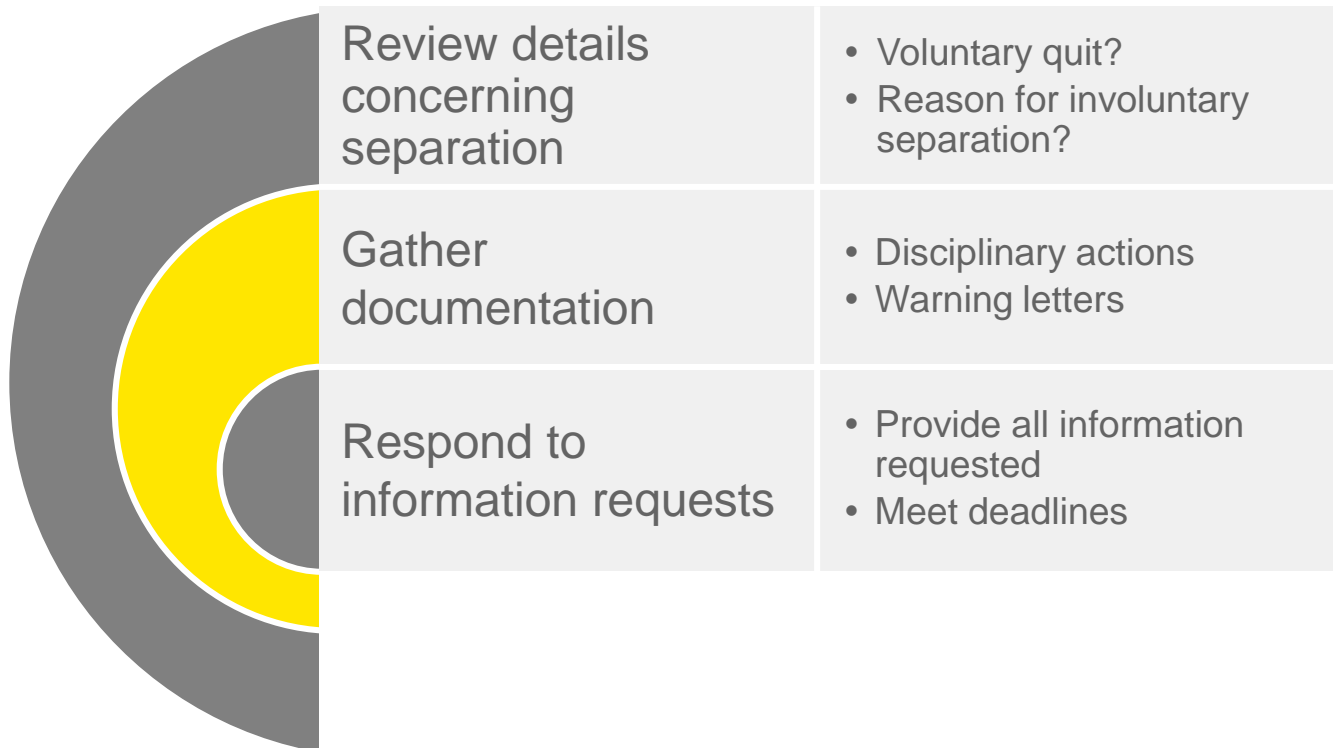


6 key elements of a successful UI claims management system

1. Even if claims management is outsourced, assign at least one person in the organization with the task of supervising and evaluating performance
2. Require adequate augmentation of electronic UI notice response systems
3. Expect your third-party service provider to regularly intervene for at-risk claim notices
4. Confirm proper collection, storage and access to employment records relevant to a UI claim
5. Require training programs for human resources and field personnel
6. Implement and maintain benchmarking and goals-based performance review for field personnel, human resources and third-party service providers

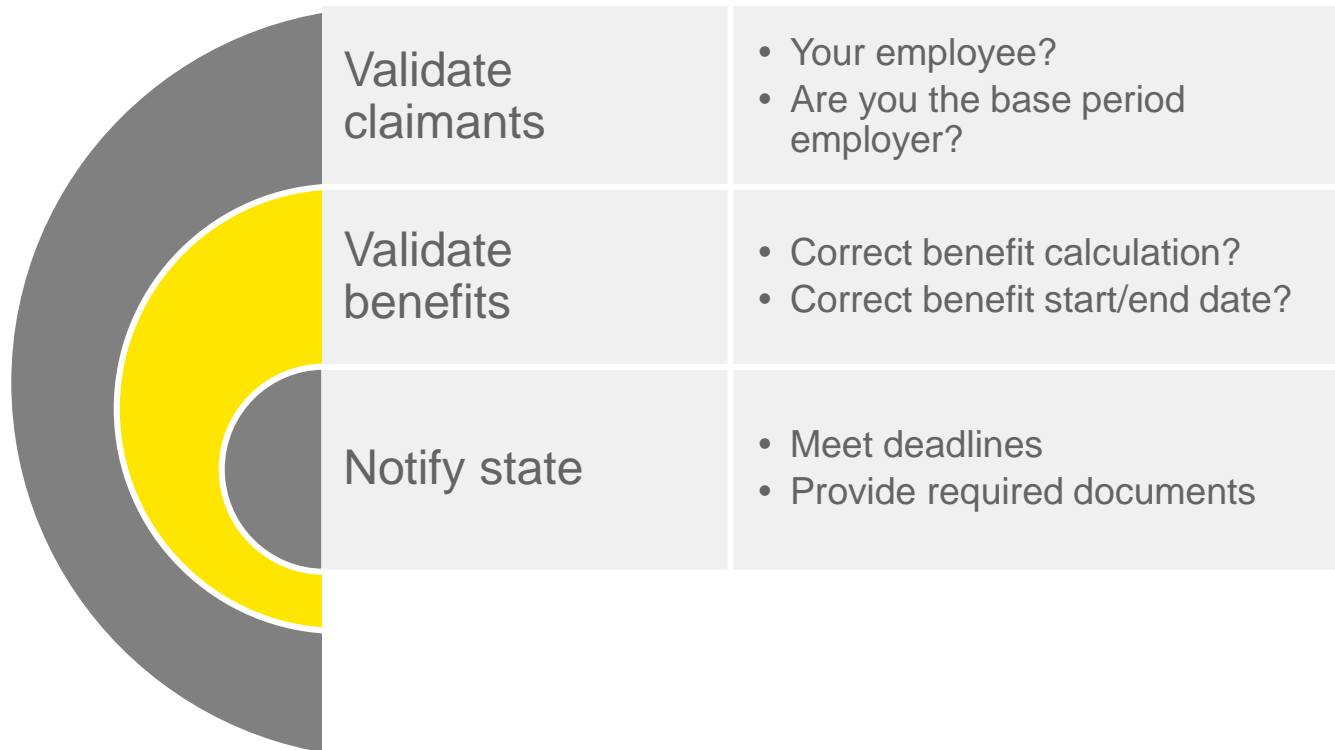
Claims management (continued)

► Claim review



Claims management (continued)

► Benefit statement audit



Claims management (continued)

► Benchmark



Claims management (continued)

► Educate and train



Polling question 4

Have you evaluated as yet how your claims activity will affect your unemployment tax rates for next year?

- A. Don't know/doesn't apply
- B. Yes
- C. No
- D. We plan to

Tax rate management and forecasting



Tax rate management

Additional surcharges or special assessments

- ▶ In addition to the basic UI rate, a number of states also impose surcharges or special assessments (e.g., interest surcharge for outstanding federal UI loan)
 - ▶ Generally, assessments that are made in addition to the basic SUI rate are not treated as SUI contributions for purposes of determining if the maximum 5.4% FUTA credit applies
 - ▶ Be certain to correctly identify surcharges that are not counted toward the FUTA credit (as reported on Form 940), in particular, if they are not separately billed

Did you know?

Starting in 2013, Virgin Islands' employers pay an interest assessment of \$25 for each employee reported in the first quarter of the year.

Tax rate management

Penalty rates for late filers/payers

State	
Alaska	Ohio
Florida	Pennsylvania
Indiana	Utah
Michigan	Virginia
Mississippi	Washington
Montana	Wyoming
Nebraska	

Penalty rates give employers a substantial monetary incentive to file and pay on time. It is important to review the cause of penalty rate assignments, negotiate to have them eliminated and to prevent them whenever possible.

Tax rate management

Protesting rates

- ▶ There are numerous elements and calculations necessary to arrive at an employer's UI tax rate
- ▶ Any number of errors can occur in the UI rate calculation
- ▶ Employers can contribute to errors by not making timely and correct elections pursuant to mergers, acquisitions, transfers and statutory elections
- ▶ States provide a limited time in which to protest incorrect SUI rates and to request a refund of resulting SUI tax overpayments

Did you know?

Benefit statement audit findings are integral to the tax rate review.

Tax rate management

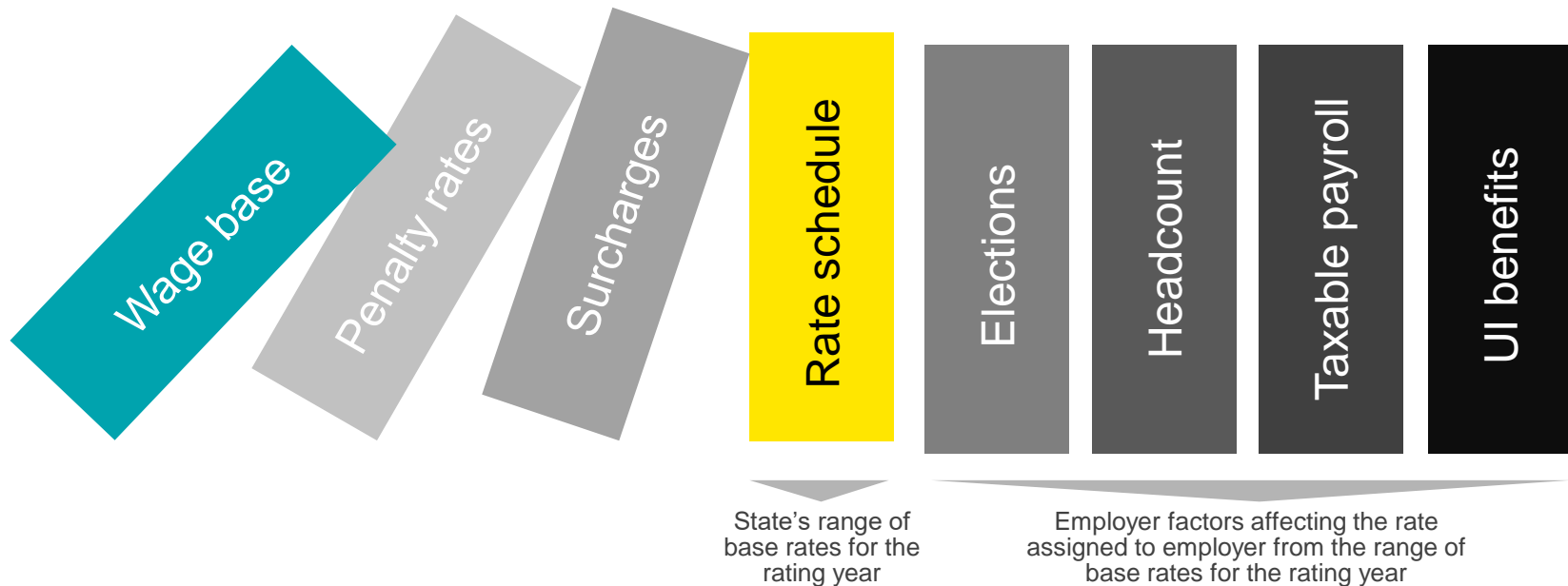
Common rate calculation errors

► Common errors in UI rate calculations

State error	Employer error
Assignment of penalty rate in error	Failing to transfer previous state wages when employee moves to another state
All employer contributions not posted	Failing to take into account wages paid by predecessor
Benefits charged incorrectly to account	Failing to notify state of a total or partial acquisition
Taxable payroll and reserve balances not timely or correctly transferred	Not taking advantage of statutory elections
Incorrect or untimely posting of statutory elections	Not timely dissolving joint accounts that are no longer advantageous
Computer or other error in arriving at the UI rate	Failing to notify the state of disqualifying wages such as severance pay in some states
Enforcement practices not consistent with law	Insufficient documentation to support a tax position

UI cost forecasting

Factors to consider in UI budget forecasting



Did you know?

Some states (e.g., New Jersey) assign rates on a fiscal year, rather than a calendar year basis. This too needs to be considered when budgeting for UI costs.

Polling question 5

In which of the following areas do you believe your organization is in the greatest need for improvement?

- A. Responding to state separation notices
- B. Reviewing benefit charge statements
- C. Reviewing and protesting rate assignments
- D. None of the above because we are just that good!

Hurricane Disaster Zone (HDZ) Employee Retention Credit



Significant impact, extraordinary employer response

Many businesses experienced substantial disruption from Hurricanes Harvey, Irma and Maria. A large number provided cash benefits to help their employees with their disaster-related expenses. These cash outlays are in addition to wages some continued to pay employees during periods of work location inoperability.

Hurricane Harvey and Irma: September 19, 2017 webcast polling results

Has your workforce been affected by Hurricane Harvey and Irma? *(1,337 respondents)*

No	32%
Harvey only	14%
Irma only	13%
Both	41%

Which of these disaster relief benefits did you provide to your employees? *(1,262 respondents)*

Disaster relief payments	27%	Leave sharing	10%
Employer foundation payments	19%	Leave-based donations	14%
Below-market loans	9%	None of these	21%

HDZ federal Employee Retention Credit

Benefits and considerations

Who benefits from the employee retention credit?

Businesses inoperable due to Hurricanes Harvey, Irma and/or Maria and who pay their employees during the “down” period can get a federal tax credit for those wages ([HR 3823](#))

- 1 The federal tax credit is 40% of qualified FUTA wages up to \$6,000 per qualified employee whose principal place of employment was in the qualified disaster area
- 2 The Work Opportunity Tax Credit (WOTC) cannot be claimed for the same employees during the qualifying period
- 3 Available only to businesses inoperable in covered disaster areas that file a US income tax return (e.g., not to exempt organizations)
- 4 Covered wages are defined as FUTA wages paid to employees during the coverage period

HDZ Employee Retention Credit

Disaster zone covered areas

To be covered, the work location must be posted by FEMA as a major disaster area eligible for individual assistance or individual and public assistance.

Covered area information is located in the FEMA links below:

Florida ([Irma](#))

Georgia ([Irma](#))

Puerto Rico ([Irma](#))

Puerto Rico ([Maria](#))

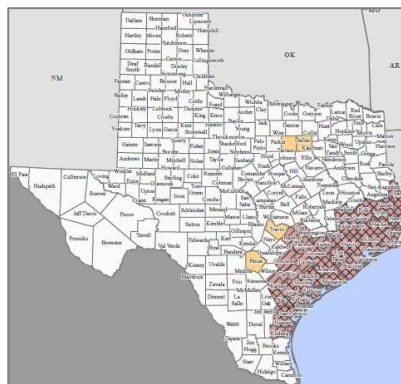
Seminole Tribe of Florida ([Irma](#))

Texas ([Harvey](#))

US Virgin Islands ([Irma](#))

US Virgin Islands ([Maria](#))

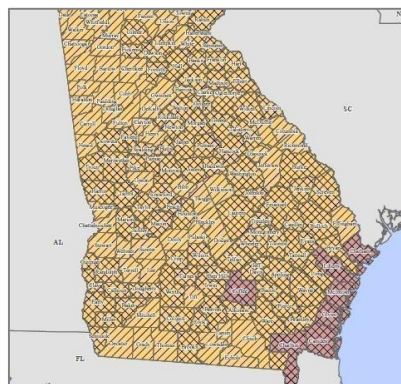
FEMA maps show qualified major disaster areas in red



Texas for Hurricane Harvey



Florida for Hurricane Irma



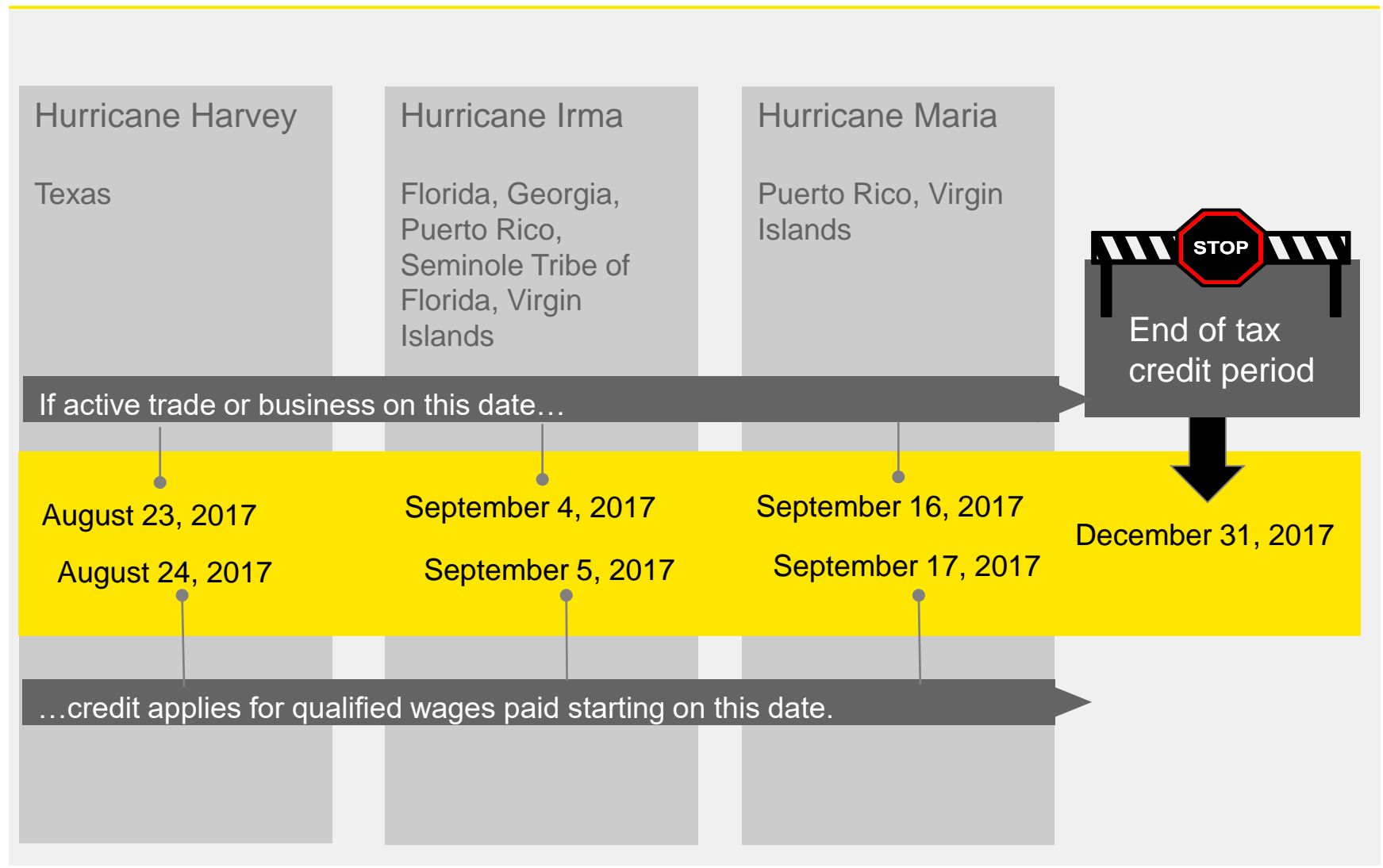
Georgia for Hurricane Irma



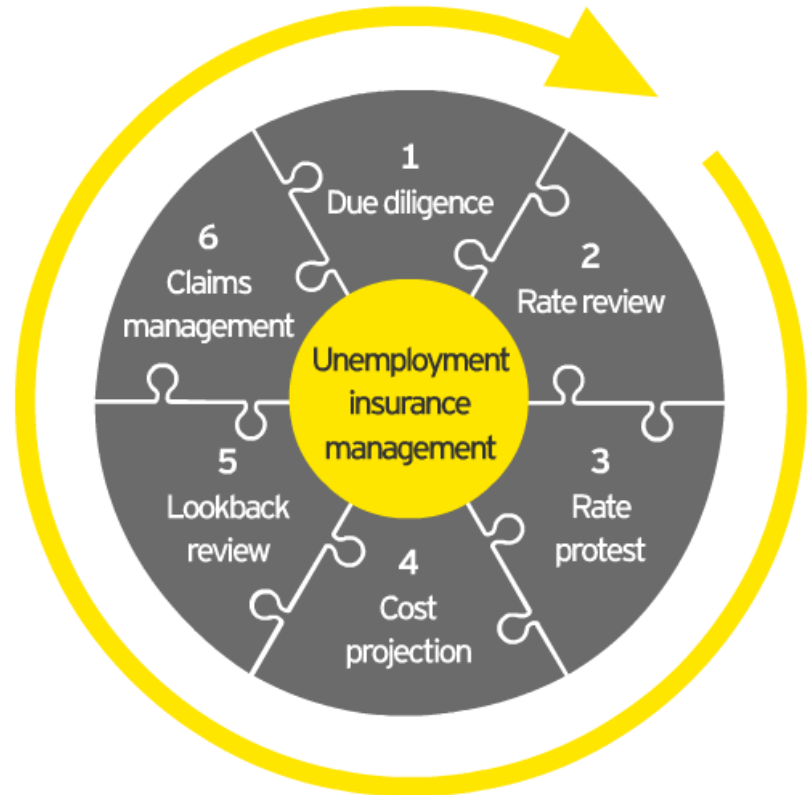
Puerto Rico and US Virgin Islands for Hurricane Maria

HDZ Employee Retention Credit

Coverage period



Recap

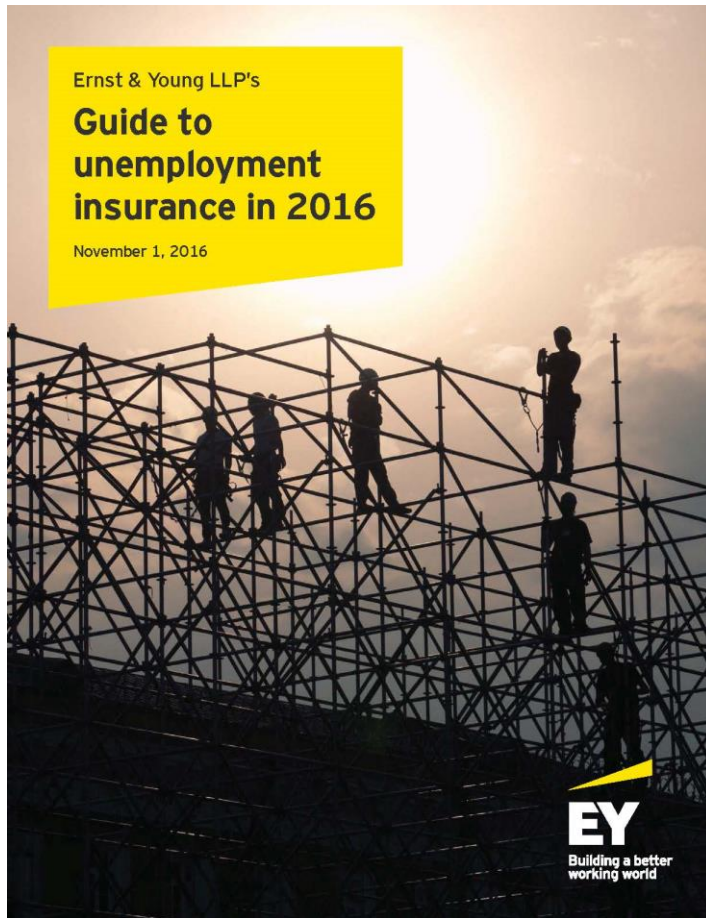


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Questions?









Read our guide for more information



Get more information about how unemployment insurance works and the latest trends in the [Ernst & Young LLP Guide to Unemployment Insurance](#).

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