

TRAINING AND EMPLOYMENT NOTICE	NO. 35-13
	DATE June 27, 2014

TO: STATE WORKFORCE AGENCIES

FROM: PORTIA WU /s/
Assistant Secretary

SUBJECT: Statutory Provisions for Relief from Interest Charges and Federal Unemployment Tax Act (FUTA) Credit Reductions Resulting from Title XII Advances.

1. **Purpose.** To review statutory provisions providing relief from interest charges and FUTA credit reductions related to states obtaining advances from the Federal Unemployment Account (FUA) and to remind states of application deadlines for relief and the phase-in of additional requirements in 2014 for an interest-free advance.

2. **References.**
 - Social Security Act (SSA), Title XII, Section 1202(b)(2)(C);
 - 20 CFR part 606 subparts C, D, and E;
 - Federal Unemployment Tax Act (FUTA), Section 3302;
 - Public Law No. 98-21, Sections 511-514; and
 - Unemployment Insurance Program Letter (UIPL) No. 41-83.

3. **Background.** When states have insufficient reserves in their unemployment fund to meet state benefit obligations, they may obtain advances from the FUA. Interest accrues on a daily basis over a Federal fiscal year and is due and payable on September 30 each year. The interest rate applicable to a calendar year is the rate of interest paid on state accounts in the Unemployment Trust Fund (UTF) for the fourth quarter of the prior calendar year. (For calendar year 2014, the applicable interest rate is 2.3874 percent.) Interest may not be paid directly or indirectly from funds in a state's UTF account. By taking an advance from the FUA, a state accepts the obligation to pay interest timely. Failure to do so can result in a state losing its unemployment compensation administrative grant, per section 303(c)(3), SSA. In addition, section 3304(a)(17), FUTA, requires timely payment of interest on advances from the FUA in order for a state's law to be certified. Without certification, a state's employers lose the tax credit provided in FUTA.

Under FUTA, employers in all states are assessed a tax of 6.0 percent on the first \$7,000 of each employee's wages. However, when specified conditions are met, employers receive a tax credit equal to 5.4 percent, resulting in a net FUTA tax rate of 0.6 percent.

If a state takes advances from the FUA and does not repay the advances by a specified time, the state's employers begin to lose the FUTA tax credit in increments of at least 0.3 percentage points per year (this is informally referred to as the basic credit reduction).

Specifically, if a state has outstanding advances on two consecutive January firsts and does not fully repay all advances prior to November 10 of the year in which the second January first occurs, the FUTA credit for that taxable year for the state's employers is reduced by 0.3 percentage points. For each succeeding year in which a balance of advances exists on January 1 and is not fully repaid prior to November 10, the reduction is at least an additional 0.3 percentage points (i.e., 0.6, 0.9, 1.2 percent, etc.). FUTA sec. 3302(c)(A)(ii). Two additional credit reductions are assessed on employers in states with three or more consecutive January firsts having outstanding advances without fully repaying before November 10. FUTA sec. 3302(c)(2)(B). The first, the 2.7 Add-on, is assessed during the third and fourth years using the following equation:

$$2.7 \text{ Add-on} = [(2.7\% \times 7000/\text{US AAW}) - \text{ST ATR}_{\text{tot}}] \times (\text{ST AAW}/7000)$$

Where ST AAW = the state estimated average annual wage (current year)

US AAW = United States estimated average annual wage (current year)

ST ATR_{tot} = the state average tax rate on total wages (prior year)

The other additional credit reduction, the "Benefit Cost Rate (BCR) add-on", is assessed when a state has had five or more consecutive January firsts with an outstanding balance. This add-on may be waived upon application if certain criteria are met; however, if the BCR Add-on is waived, the 2.7 Add-on applies. The BCR Add-on is calculated using the following equation:

$$\text{BCR Add-on} = (\text{higher of: BCR}_{\text{tax}} \text{ or } 2.7\%) - \text{ATR}_{\text{tax}}$$

Where ATR_{tax} = the state average tax rate on taxable wages (prior year)

BCR_{tax} = the state 5-year average benefit costs (ending second prior year) as a percent of taxable wages (prior year). The computation includes only benefits that are chargeable to a state's UTF account (e.g., regular benefits, state share of Extended Benefits, additional benefits) and does not include benefits chargeable to reimbursable employers.

4. **Interest Relief.** U.S. Department of Labor regulations provide for four options by which states can obtain relief from interest charges accruing on unpaid FUA advances: 1) cash flow loans; 2) May/September delay; 3) high unemployment deferral; and 4) high unemployment delay.

Cash Flow Loans: Under 20 CFR 06.32(b), when a state repays all advances taken from January 1 through September 30 of a calendar year prior to October 1 of the same calendar year, those advances will qualify as interest-free if the state does not take an additional advance for the remainder of the calendar year and satisfies the requirements of the funding goal which is being phased-in from 2014 through 2019. The funding goal has two parts: 1) a solvency threshold; and 2) a maintenance of tax effort measure. When fully implemented in 2019, the solvency threshold requirement is met based on an average high cost multiple (AHCM) of at least 1.00 on December 31 in one of the five years prior to the year in which the cash flow loan

is requested. An AHCM of 1.00 means the state's UTF account has sufficient funds to pay benefits for one year at an average recessionary level without taking in any receipts. The funding goal phase-in requires a solvency threshold of at least 0.50 for 2014 interest-free loan requests. The solvency threshold will increase by 0.10 each year after 2014 until it reaches 1.00 for 2019, when the funding goal criteria will be fully implemented.

In addition to meeting the solvency threshold, states must demonstrate maintenance of tax effort by meeting two criteria for each calendar year between the last year the solvency threshold was met and the year in which the interest-free advance is requested:

a) The first criterion requires a state's average tax rate on total wages (ATR) must be at least 80 percent of the prior year's rate.

b) The second criterion requires the ATR for a year must be at least 75 percent of the five year average benefit cost rate (ABCR) with the five year period ending with the year before the year the ATR is computed. The benefit cost rate for a year is computed by dividing benefits paid under state law from a state's account in the UTF which would not be reimbursed (i.e., benefits paid to former employees of reimbursing employers) plus interest paid during the year on advances from the FUA by total wages (see 20 CFR 606.3). The ABCR is computed by dividing the sum of the five benefit cost ratios by 5 (see 20 CFR 606.21 (d)).

To obtain a cash flow loan, the Administrator of a state agency must notify the Secretary of Labor no later than September 10 of the advances that will be deemed cash flow loans. This notification must include the date and amount of each loan made beginning January 1 through September 30 of the same calendar year, and a copy of documentation sent to the Secretary of the Treasury requesting loan repayment transfer(s) from the state's account in the UTF to the FUA in the UTF.

May/September Delay: Under 20 CFR 606.40, payment of interest accrued on advances taken in May through September may be delayed until December 31 of the following calendar year. Interest continues to accrue on the delayed amount. To obtain a delay, the Governor of a state must notify the Secretary of Labor by September 1 of the year with respect to which the delay is applicable, that the state will use this delay.

High Unemployment Deferral: Under 20 CFR 606.41, a state may defer interest payments if its average insured unemployment rate (IUR) equals or exceeds 7.5 percent for the first 26 weeks of the preceding calendar year where the first week includes January 1. The state must pay one-fourth of the interest due on September 30 and one-third of the remaining interest balance on September 30 in each of the three years following the first payment. No interest accrues on deferred interest. The Governor must apply for deferral no later than July 1 of the year for which

deferral is requested. At the state's option, payment of deferred interest may be accelerated.

High Unemployment Delay: Under 20 CFR 606.42, a state may request a delay of interest payment for nine months after September 30 if the total unemployment rate (TUR) averaged 13.5% or higher for the most recent 12 month period for which data are available. The state must pay interest in full by July 1 of the following year. At the state's option, payment of delayed interest may be accelerated. No interest accrues on delayed interest, but it continues to accrue on unpaid principal. The Governor must apply no later than July 1 of the year for which the delay is requested.

For further details related to relief from interest charges, see 20 CFR Part 606 Subparts D and E.

5. **Relief from FUTA Credit Reduction.** Under Federal regulations, there are three ways a state can get relief for its employers from FUTA tax credit reduction: 1) avoidance; 2) cap; and 3) the BCR add-on waiver.

Avoidance: To avoid the entire FUTA credit reduction for a taxable year, the Governor must submit an application to the Secretary of Labor no later than July 1 of the year for which avoidance is requested. To obtain avoidance, the state must meet four conditions: 1) make a voluntary repayment of an amount equal to the amount of potential additional taxes (FUTA credit reduction); 2) repay all advances received under Title XII, SSA, during the one-year period ending November 9 of the taxable year; 3) increase net solvency for the taxable year through legislative action, since the date the first advance was obtained, by an amount equal to or greater than the amount of potential additional taxes (FUTA credit reduction); and 4) have adequate funds to pay all benefits without receiving any Title XII advances through at least February 1 of the following year. The Governor is also required to notify the Department of Labor on or before October 15 of the year for which avoidance is requested of any actions impacting the state's application occurring after the initial submission and on or before November 10. If a state qualifies for avoidance for any year, that year and the January first of that year to which avoidance applies will be taken into account for the purposes of determining reduction of tax credits for subsequent taxable years. See 20 CFR 606.23.

Cap: To qualify for a cap on credit reductions, which holds the credit reduction at the higher of 0.6 percent or the credit reduction applied to the previous year, the Governor must submit an application to the Secretary of Labor no later than July 1 of the year for which a cap is requested. To receive the cap the state must: 1) take no action (legislative, judicial, or administrative) during the 12 month period ending September 30 of the year for which a cap is requested that would reduce tax effort; 2) take no action (legislative, judicial, or administrative) that would reduce solvency for the 12 month period ending September 30 of the year for which the cap is requested; 3) have an average tax rate on total wages for the taxable year that equals

or exceeds the average benefit cost ratio for the five calendar years ending with the preceding taxable year that the cap is requested (calculated in the same manner as the ABCR discussed under the funding goal above); and 4) have a loan balance on September 30 of the taxable year that is less than or equal to the loan balance on September 30 of the third preceding taxable year. If a state qualifies for a cap for any year, that year and the January first of that year to which the cap applies will not be taken into account for the purposes of determining reduction of tax credits for subsequent taxable years. See 20 CFR 606.20 – 606.22.

BCR add-on waiver: The additional tax credit reduction that is assessed when a state has five or more consecutive January firsts with outstanding advances (BCR add-on) shall be waived and the 2.7 Add-on shall be substituted, if the Governor submits an application to the Secretary of Labor no later than July 1 of the year for which the waiver is requested and the state takes no action (legislative, judicial, or administrative) during the 12 month period ending September 30 of the year for which the waiver is requested that would reduce solvency for the 12 month period ending September 30. See 20 CFR 606.25 – 606.26.

For further details related to relief from FUTA credit reductions, see 20 CFR Part 606 Subpart C.

6. Notification Dates Summary. This section summarizes the important notification dates contained in this guidance.

<u>Credit Reduction</u>	<u>Notification Due Date</u>
- Avoidance of FUTA Credit Reduction	July 1
- Avoidance of FUTA Credit Reduction (follow up)	October 15
- BCR Add on Waiver	July 1
- Cap on FUTA Credit Reduction	July 1
- Cash Flow Loan	September 10
- High Unemployment Deferral	July 1
- High Unemployment Delay	July 1
- May/September Delay	September 1

7. Action Requested. Administrators shall advise their Governors of the options available and the deadlines for applying for relief from interest charges and FUTA credit reduction.

8. Inquiries. Direct inquiries to the appropriate Regional Office.