# **ACCT 1130**

# **CHAPTER 5 – UNEMPLOYMENT TAXES**

The Social Security Act of 1935 ordered every state to set up an unemployment compensation program in order to provide payments to workers during periods of temporary unemployment.

Payroll taxes at both the federal and state levels fund this unemployment insurance program.

Federal Unemployment Tax Act (FUTA) imposes a tax on ***employers*** based on wages ***paid*** for covered employment. It is ***not*** collected or deducted from employees’ wages.

The funds collected by the federal government pay the cost of administering both the federal and the state unemployment insurance programs. The FUTA tax collected is ***not*** used for the payment of weekly unemployment benefits.

Benefits are paid by funds collected by each **state’s** unemployment tax fund.

Who is an employer under FUTA laws

A person or business who pays wages of $1,500 or more during any calendar quarter in the current or preceding calendar

or

A person or business who employs one or more persons, on at least some portion of one day, in each of 20 or more calendar weeks during the current or preceding taxable year.

As soon as an employer meets **either** test, the employer becomes liable for the FUTA tax for the entire calendar year, even if the test is not met until the last pay period of the year.

Once attained, the employer status continues until the employer fails to meet the test for coverage during a year. In this case, liability under FUTA would end as of January 1 of the next year.

An employer may be an individual, corporation, partnership, company, association, trust, or estate.

Remember, that partners are **not employees**, nor are independent contractors. Refer to 5-1c for other exclusions from FUTA coverage.

FUTA coverage extends to U. S. citizens working abroad for American employers.

## Interstate Employees

Some businesses employ persons who work in more than one state. In these cases, the employer must determine which state covers the workers for unemployment compensation purposes.

To prevent employers from duplicating contributions on the services of interstate employees, several factors are used to determine coverage of interstate employees in the following order:

1. place where the work is localized
2. location of the base of operations
3. location of place from which operations are directed or controlled
4. location of employee’s residence

Reciprocal agreements between states provide unemployment insurance coverage to interstate workers when coverage cannot be determined by the above 4 factors, states may enter into arrangements under which the employer may elect coverage of the employee in one state. Under Interstate Reciprocal Coverage Arrangements, an employer can elect to cover the services of a worker in any one state in which (a) the employee performs any work, (b) the employee maintains a residence, or (c) the employer maintains the place of business. Once the employer choose the state in which all the services of the interstate workers are to be covered and the employee consents to the coverage, this state approves the election of coverage. Then the appropriate agencies of the other states in which services are performed are notified so that they can agree to the coverage in the state of election.

Another aspect of reciprocal agreements concerns the transfer of employees from one state to another during the same calendar year. An employer can include, for purposes of determining the taxable wage base in the second state, wages paid an employee with respect to employment covered by the unemployment compensation law of the previous state. This only applies to employees who continue to work for the same employer, but in another state.

## FUTA TAXES

Taxable wages are the first **$7,000** **paid or constructively paid** by an employer to an employee. Taxable wages include advances, cash and noncash prizes for doing outstanding work, bonuses, commissions, Christmas gifts (unless nominal value); refer to the list at 5-1f.

The taxable wage base applies **separately** to each employee.

Also, if an employee has more than one employer, **each** of those employers must pay FUTA on the first $7,000 paid to the employee at each job--unless one employer transferred the business to the other.

Gross FUTA rate is 6%. ***However a maximum credit of 5.4% may be used if an employer is making timely SUTA payments, therefore resulting in a net FUTA tax of .6%***

For example, if an employer’s SUTA rate is 3%. The credit against FUTA would be 3%. There will be an additional credit of 2.4%, giving the employer a total credit of 5.4% (the maximum credit)

If the employer is late in making its SUTA payments, the credit for the **SUTA rate is limited to 90% of the amount that would have been allowed as a credit if the late contributions had been paid on time**. However the additional credit is still applicable--it is not subject to the 90% limitation.

Reminder: the **maximum** credit that may be claimed against the FUTA tax is 5.4%, no matter what the state rate is.

SUTA rates are determined on an employer by employer basis based on experience ratings. An employer’s favorable experience rate (employment record) qualifies the employer for a SUTA rate less than 5.4%. Remember that FUTA provides for a credit against the 6% gross rate equal to the employer’s SUTA rate plus an additional credit so that the full 5.4% credit still applies.

States that are unable to pay unemployment benefits may borrow funds from the federal government under the Title XII of the Social Security Act. These are called Title XII advances. Under the repayment provisions, if a state defaults in its payments, the credit against the gross FUTA tax is reduced by 0.3% beginning the second taxable year after the advance.

SUTA rates vary among states. Some states require ***employee*** contributions. Refer to Figure

5-1 for examples.

Employer’s SUTA rates are based on an experience rating based on its history of employment stability. The lower the employee turnover, the lower the tax rate will be. Adversely, higher turnover leads to higher SUTA tax rates.

Each employer has a record with the state. Contributions (unemployment taxes paid) are entered onto the record as well as benefits paid out and employer’s payroll. To compute the reserve ratio, refer to the information below:

Contributions Paid In by Employer to State - Benefits Paid Out/Average Payroll

Employers who have built up a balance in their reserve account are sometimes referred to as **positive-balance** employers. The larger the positive balance in a company’s reserve account, the lower its tax rate will be.

Some states allow employers to make voluntary contributions in order to increase their reserve ratio to the level that would effect a lower tax rate. Usually the employer must determine the amount of the contribution needed in order to obtain a lower contribution rate. In some states, the agencies provide worksheets that aid employers in determining the amount of voluntary contributions required. California and Ohio compute the voluntary contribution amount needed and include it in the rate notices sent to all employers.

## Unemployment Compensation Reports

**Annual** return of federal unemployment 940 must be filed no later than January 31 following the close of the calendar year. If deposits have been made timely that paid the FUTA tax liability in full, filing can the delayed until February 10. Return may be filed on the next business day if the deadline falls on a holiday, Saturday, or Sunday. As long as the return is postmarked as having been mailed on or before the due date, it is considered timely filed regardless of when it is received.

If a company has ceased doing business, a final Form 940 must be completed (check box on Form 940 to indicate a final return) and the balance of the tax paid.

FUTA tax should be deposited electronically on a quarterly basis by multiplying .6% by the portion of the first $7,000 earned by each employee. If the employer’s tax liability exceeds $500, the employer must deposit electronically on or before the last day of the month following the end of the quarter.

If the tax liability for the first quarter $500 or less, a deposit is not required. However the employer must add the liability to the amount subject to deposit for the next quarter, in order to compare to test if the total liability has reached $500. The first quarter that the cumulative liability exceeds $500, a deposit should be made on or before the last day of the month following the end of the quarter.

At the time of filing the annual return on Form 940, the employer pays the balance of tax owed for the prior year and not yet deposited. If the amount of the tax reportable on Form 940 exceeds by more than $500 the sum of amounts deposited each quarter, the employer must deposit the total amount owed electronically on or before January 31 following the year for which Form 940 is filed. If the amount owed is $500 or less, the employer may remit it with the annual form.

The same penalties in chapter 3 apply to late or unpaid FUTA taxes.

State reports vary from state to state as to deadlines, rules, etc.