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# Unemployment Compensation (UC) and the Unemployment Trust Fund (UTF): Funding UC Benefits

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## Summary

This report provides a summary of how Unemployment Compensation (UC) benefits are funded through the Unemployment Trust Fund (UTF). The UTF in the U.S. Treasury is designated as a trust fund for federal accounting purposes. Although the UTF is a single trust fund, it has 59 accounts: the Employment Security Administration Account (ESAA), the Extended Unemployment Compensation Account (EUCA), the Federal Unemployment Account (FUA), 53 state accounts, the Federal Employees Compensation Account (FECA), and two accounts related to the Railroad Retirement Board.

Federal unemployment taxes are credited to the ESAA; each state's unemployment taxes are credited to the state's unemployment account. Federal taxes pay for administration grants to the states. State unemployment taxes are dedicated to pay for regular UC benefits. The extended benefits (EB) program is funded 50% by the federal government and 50% by the states.

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# The Unemployment Compensation Program

Unemployment Compensation (UC) is a joint federal-state program financed by federal taxes under the Federal Unemployment Tax Act (FUTA) and by state payroll taxes under the State Unemployment Tax Acts (SUTA). The underlying framework of the UC system is contained in the Social Security Act (SSA). Title III of the SSA authorizes grants to states for the administration of state UC laws; Title IX authorizes the various components of the federal Unemployment Trust Fund (UTF); and Title XII authorizes advances or loans to insolvent state UC programs.

## Federal Unemployment Tax Act

If a state UC program complies with all federal rules, the net FUTA tax rate for employers is 0.6% on the first \$7,000 of each worker's earnings. The 0.6% FUTA tax funds both federal and state administrative costs as well as the federal share of the Extended Benefit (EB) program, loans to insolvent state UC accounts, and state employment services. Federal law defines which jobs a state UC program must cover for the state's employers to avoid paying the maximum FUTA tax rate (6.0%) on the first \$7,000 of each employee's annual pay.

## Expired Provision: FUTA Surtax

Congress first passed a temporary FUTA surtax in 1976, and since 1983 this surtax had been applied as 0.2% on the first \$7,000 of employee wages until July 1, 2011.<sup>1</sup> As of July 1, 2011, the authorization of the FUTA surtax lapsed. Thus, since July 1, 2011, the effective FUTA tax on employers for each employee is 0.6% (a decrease from 0.8%) on the first \$7,000 of wages.

## State Unemployment Tax Acts

States levy their own payroll taxes on employers to fund regular UC benefits and the state share of the EB program. The SUTA tax rate of an employer is, in most states, based on the amount of UC benefits paid to former employees. Generally, the more UC benefits paid to its former employees, the higher the tax rate of the employer, up to a maximum established by state law.

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<sup>1</sup> P.L. 94-566 first imposed the 0.2% surtax, increasing the net FUTA tax from 0.5% to 0.7% on the first \$6,000 of earnings. The surtax was to be eliminated when all advances to the states had been repaid. P.L. 97-248 extended the surtax (increasing the net FUTA tax from 0.6% to 0.8%, on the first \$7,000 of earnings) until the EUCA (Emergency Unemployment Compensation Account dedicated to funding the extended benefit program) loans were repaid. P.L. 100-203 extended the 0.2% surtax for three years—until January 1991. P.L. 101-508 extended the surtax for five years—until January 1996. P.L. 102-164 extended the surtax for an additional year—until January 1997. P.L. 103-66 extended the surtax for an additional two years—until January 2000. P.L. 105-34 extended the surtax for an additional nine years—until January 2008. P.L. 110-140 and P.L. 110-343 each extended the surtax for one additional year. P.L. 111-92 extended the authorization of the FUTA surtax through June 2011.

## The Unemployment Trust Fund

The UTF is designated, by law, as a trust fund in the U.S. Treasury. The designation as a trust fund is a federal accounting mechanism to directly link revenues and distributions connected to the UC programs. The UTF accounts include the Employment Security Administration Account (ESAA), the Extended Unemployment Compensation Account (EUCA), the Federal Unemployment Account (FUA), 53 state accounts,<sup>2</sup> the Federal Employees Compensation Account (FECA), and two accounts related to the Railroad Retirement Board.<sup>3</sup> Federal unemployment taxes are credited to the ESAA; each state's unemployment taxes are credited to the state's unemployment account. Federal taxes are dedicated to pay for UC administration grants to the states—including administration of the EB program—and the federal share of EB. State taxes are dedicated to pay for regular UC benefits and the state share of EB. Typically, the EB program is funded 50% by the federal government and 50% by the states, however, P.L. 111-5, as amended, temporarily provided for 100% federal funding of EB from February 22, 2009, through December 31, 2013.<sup>4</sup>

Although the UTF contains 59 separate accounts (often referred to as *book accounts*) to attribute and distribute the monies based on program purpose, the UTF is a single trust fund. The use of separate accounts solely means that revenues and distributions are directly linked to UC program purpose. The use of a single trust fund (the UTF) for all UC programs permits a balance to carry over surplus spending authority to subsequent years. The balance represents reserve spending authority available to these programs in addition to the spending authority provided by the automatic appropriation of current tax receipts. This reserve spending authority is used during recessions when UC outlays exceed UTF tax revenues; that is, when current spending exceeds current receipts. Like many of the UTF's other transactions, the balance is effectively a bookkeeping entry.

## The Unemployment Trust Fund and the Federal Budget

All UC tax receipts and outlays for benefits and administration flow through the Treasury, and thus affect federal revenue, outlays, and the overall financial position (deficit or surplus) of the federal government. The UTF accounts for all UC and EB financial transactions. This accounting device (designation as a trust fund) is used to accumulate legal spending authority that is available automatically when needed. However, the UTF does not contain financial resources. The required cash the federal government needs to pay benefits or administrative costs must be drawn from current resources through either taxation or borrowing. The revenue and the expenditures of the UC system are counted in the federal budget.

Federal unemployment taxes are deposited into the unemployment trust fund. Following federal law, the Treasury invests all receipts in federal securities that bear interest. This investment

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<sup>2</sup> The District of Columbia, Puerto Rico, and the Virgin Islands are considered to be states under federal UC law.

<sup>3</sup> For the purposes of this report, the Railroad funds will be ignored.

<sup>4</sup> P.L. 111-5, as amended, also included a change in the financing structure of the Emergency Unemployment Compensation program (EUC08); P.L. 111-5 had EUC08 benefits paid by the general fund of the Treasury (previous to the enactment, the benefits were paid out of the federal accounts within the UTF). P.L. 111-5, as amended, also created the temporary \$25 weekly Federal Additional Compensation (FAC) benefit, which was paid by the general fund of the Treasury and not by the UTF. The authorization for the FAC expired on June 2, 2010.

increases the federal debt. When these securities are redeemed to pay for administration of the program, to lend funds to the states, or to pay for extended benefits, this investment decreases the federal debt.

State unemployment taxes are deposited into the unemployment trust fund. Following federal law, the Treasury invests all state unemployment tax receipts in federal securities that bear interest. This investment increases the federal debt. When states pay UC benefits to unemployed individuals, the Treasury redeems those securities held within that state's unemployment trust fund account. Thus, the payment of regular state UC benefits decreases the federal debt.

If states do not have enough reserves in their UTF account, Title XII of the SSA allows the states to borrow funds from the FUA within the UTF. (States may borrow from other sources although some states are prohibited from doing so under state laws.) The issuing of loans to the state would require that the FUA redeem securities. This redemption would decrease the federal debt. If the FUA is insolvent and the other federal accounts within the unemployment trust fund do not have sufficient balances to lend the funds that states need (as occurred in FY2010, FY2011, FY2012, and FY2013), Title XII of the SSA allows the FUA to borrow funds from the Treasury. If the Treasury issues new securities in order to lend funds to the FUA, this will increase the federal debt. When a state pays back the state loan from the FUA, the FUA would then use those funds to repay its debt to the Treasury and the federal debt would be decreased.

## **Unemployment Trust Fund Revenues and Distributions**

The UTF is credited<sup>5</sup> with revenues from three primary sources:

- state unemployment taxes on employers,
- federal unemployment taxes on employers, and
- U.S. government agency transfers.

Although UC benefits are taxable and are fully subject to the federal income tax, those revenues do not support the UC system and are not credited to the UTF.<sup>6</sup> These three types of revenues are depicted at the top of **Figure 1**.

### **State Unemployment Tax Revenues Are Credited to the State Unemployment Accounts Within the Unemployment Trust Fund**

States are authorized to designate that these funds be used to pay UC benefits. State unemployment account funds that are attributable to state unemployment taxes may only be used for unemployment benefits and the state's portion of EB payments. Administrative costs are funded through distributions from the ESAA to the state unemployment accounts. At the end of FY2013, states were estimated to have collected \$50.7 billion while expending \$40.9 billion in regular UC benefits.

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<sup>5</sup> All revenues associated with UC are deposited to the U.S. Treasury, and all UC distributions (payments) are made by the U.S. Treasury. The revenues and distributions made by the U.S. Treasury are linked to the different UC programs and purposes through the federal accounting mechanism of the UTF and its separate accounts.

<sup>6</sup> This differs from funds from the taxation of Social Security benefits where the revenue is used to support the Social Security and Medicare programs.

## **Federal Unemployment Taxes Are Credited to the ESAA**

Each fiscal year, funds are appropriated through the federal budget process to make distributions from the ESAA for the states' costs of administering their unemployment compensation programs, and for the federal costs of administration. The Secretary of Labor determines (certifies) the amount of the administrative payments, and permits the Secretary of the Treasury to make the payments to the states. The Secretary of Labor in certifying a state for payment takes into account that (1) the state's UC programs contain specific provisions related to the payment of monies from the state unemployment system, (2) the state agency's specific responsibilities in administering the UC program and UC benefits, and (3) the rights and responsibilities of the UC benefit recipients.

## ***Each Month, the ESAA Distributes 20% of the Net Monthly Activity to the EUCA***

Net monthly activity is the sum of revenues credited to the ESAA less distributions for refunds of FUTA taxes and additional taxes attributable to a reduced credit for SUTA taxes. By the end of FY2013, the federal accounts had collected an estimated \$5.3 billion; the ESAA had a net balance of \$1.39 billion. Since the ceiling for the ESAA was \$1.74 billion, no excess funds were transferred to the EUCA. By the end of FY2013, the ESAA had distributions totaling \$3.55 billion to the states for UC administrative costs.

If states have an active EB program, EUCA distributions are made for the federal portion (50% in permanent law; 100% as required during this period by P.L. 111-5, as amended) of EB benefits. Prior to the passage of P.L. 111-5, the EUC08 program funds were also are paid out of EUCA.<sup>7</sup> At the fiscal year end after any required distribution from the ESAA, the balance in the EUCA is determined. The EUCA balance is limited to the maximum of \$750 million or 0.5% of covered wages.<sup>8</sup> If the EUCA balance exceeds the limitation, the excess is distributed to the FUA. At the end of FY2013, an estimated \$0.12 billion was expended to pay for the federal share of EB benefits, and approximately \$25.7 billion was expended on the EUC08 program. (The EUC08 expenditures were paid from general Treasury funds and not from FUTA revenue. They are not loans and do not need to be repaid by the UTF.) The EUCA net balance was an estimated shortfall of (negative) \$18.8 billion (a cash balance of \$0.2 billion, \$19.22 billion owed to the general fund of the Treasury and \$0.2 billion owed to EUCA from FUA/ESAA). The EUCA ceiling was \$25.11 billion; thus, there was no fund transfer to the FUA.

### UTF Revenues

#### State Unemployment Taxes

Employers required to pay state unemployment taxes may remit their state unemployment taxes to states on a monthly, quarterly, annual, or another basis as determined by state laws and regulations. States, in turn, remit the collected taxes to the Treasury. These funds are credited to the appropriate state unemployment account in the UTF.

#### Federal Unemployment Taxes

Employers may also be required to pay FUTA taxes on a quarterly basis. If the estimated quarterly federal tax is less than \$500, an employer may roll the liability over to the next quarter until the liability is \$500 or more. At that point, the employer must pay the FUTA taxes to the Treasury. An annual tax return reconciles the quarterly deposits to the actual tax liability. The ESAA is credited with the federal unemployment taxes.

#### U.S. Government Agency Transfers

Each federal agency is responsible for unemployment compensation for federal employees (UCFE) paid on the agency's behalf. Each agency must budget for the unemployment benefits paid and reimburse the UTF for unemployment compensation paid on its behalf by states. The funds are credited to the FECA.

In addition to any EUCA distribution, the FUA is credited with the additional taxes paid by employers when a reduced credit against federal taxes exists because the state has an outstanding unpaid loan from FUA. FUA funds are distributed as loans to states, through the state unemployment accounts. (See the discussion below on “Loans to Insolvent Accounts” for a more detailed explanation of these loans.) The FUA balance is limited to the maximum of \$550 million or 0.5% of covered wages. At the end of FY2013, the estimated net FUA balance was an estimated \$11.27 billion (\$8.42 billion owed to the general fund of the Treasury, \$19.96 billion borrowed by the states, and \$0.4 billion owed to ESAA/EUCA, and an end of year *cash* balance of \$0.13 billion). The balance was lower than the \$25.11 billion ceiling and so no Reed Act transfer occurred.

Distributions are made to the state unemployment accounts from the FECA to reimburse the states for employment compensation paid to former federal employees. Each federal agency reimburses the UTF for its share of federal workers' UC benefits.

<sup>7</sup> With the passage of P.L. 111-5, the EUC08 program was 100% financed by the federal government through general funds within the U.S. Treasury until EUC08 authorization terminated in December 2013.

<sup>8</sup> P.L. 105-33 increased the statutory ceiling on the FUA from 0.25% to 0.5% of covered wages, effective October 1, 2001. P.L. 102-318, had lowered the FUA from 0.625% to 0.25% and increased the ceiling for EUCA from 0.375% to 0.5%. P.L. 100-203, had raised the EUCA ceiling from 0.125% to .375% and increased the FUA ceiling from 0.125% to 0.625%.



## **Other Unemployment Trust Fund Expenditures (Reed Act Distributions)**

At the end of the fiscal year, there is a limitation on the balance in the ESAA—the account balance cannot exceed 40% of the prior fiscal year’s appropriation by Congress. If the balance in the ESAA exceeds this limitation, the excess is distributed to EUCA. After the distribution, if the balance in the EUCA exceeds the limitation, the excess is distributed to the FUA. If after the distribution from the EUCA, the FUA balance exceeds the limitation, the excess is distributed, as a Reed Act distribution, to the states.<sup>9</sup> At the end of FY2013 there was no Reed Act distribution.

## **Loans to Insolvent Accounts**

The Treasury can write checks for a state unemployment account, provided that legal spending authority exists for such spending if the state unemployment account has a positive balance. During the most recent recession, current taxes and reserve balances were insufficient to cover expenditures for UC benefits.<sup>10</sup> Many state unemployment accounts required and/or continue to require “loans” to pay for state UC benefits.

The state unemployment accounts can borrow from the FUA. If states do not increase their SUTA taxes to repay the loan, federal law requires that the principal of the loan is repaid by reducing federal tax credits for SUTA taxes and crediting those increased revenues to the FUA.<sup>11</sup> The state cannot pay the interest on such loans using the state unemployment account but must pay the interest through state general revenues or other measures.

Federal law also authorizes appropriations if balances in the federal accounts are insufficient to cover their expenditures. For example, if the states’ borrowing needs exceed the available FUA balance, Congress is authorized to appropriate additional spending authority to cover the amount needed. Such appropriations require discretionary action by Congress and the President. Since FY2009, the FUA has had to borrow funds from the Treasury in order to loan funds to the state accounts.

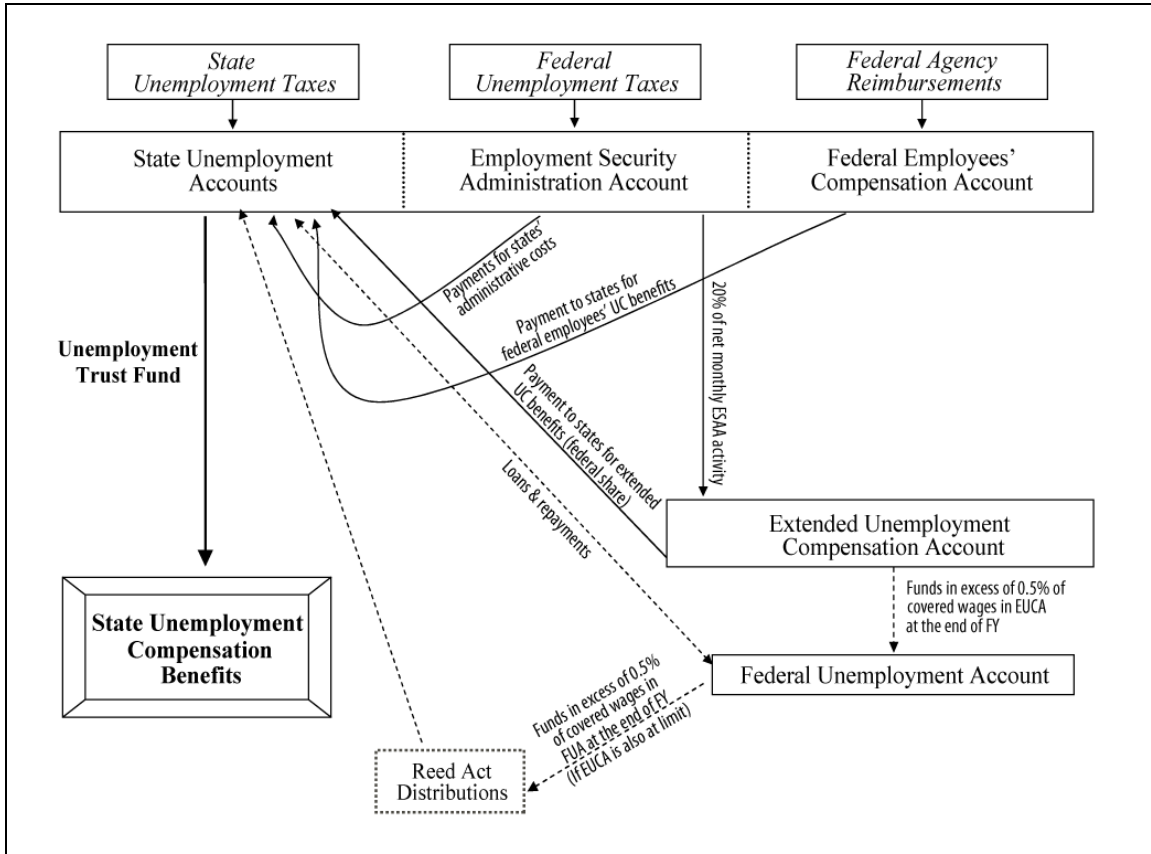
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<sup>9</sup> For more information on Reed Act distributions, see CRS Report RS22006, *The Unemployment Trust Fund and Reed Act Distributions*, by Julie M. Whittaker.

<sup>10</sup> For details on loans to insolvent accounts, see CRS Report RS22954, *The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States*, by Julie M. Whittaker.

<sup>11</sup> For a list of current advances of funds to the states, see <http://ows.doleta.gov/unemploy/budget.asp>.

**Figure 1. The Unemployment Trust Fund**



Source: Figures prepared by the Congressional Research Service (CRS).