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The Voice of Small Business

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Testimony on the Unemployment Insurance Tax Crisis in Michigan Before the House Commerce Committee Tuesday, November 29, 2011

My name is Charlie Owens and I am the State Director for the National Federation of Independent Business, an advocate for Michigan small businesses owners since 1943. We are here today to give you a small business perspective on the Unemployment Insurance Tax crisis facing Michigan employers.

State Unemployment Insurance taxes paid by employers are deposited in the state's Unemployment Insurance Trust Fund. The fund is designed to operate under the assumption that benefit liabilities are funded in advance of actual payment. This allows for the systematic accumulation of benefit reserves in the trust fund during periods of economic growth in order to have sufficient assets to pay unemployment benefits during periods of economic decline.

When Michigan's Unemployment Insurance Trust Fund runs out of money to pay benefits, loans from the Federal Unemployment Insurance system trigger on in order to continue benefit payments. At its' worst, Michigan was in debt to the Federal Unemployment Insurance system for almost $3.9 billion last year. On a per capita basis Michigan leads the nation in federal borrowing to pay unemployment insurance benefits.

Recent increases in state trust fund collections have reduced the amount of state debt to about $3.2 billion, but state employers will be assessed penalty and solvency taxes to repay these loans and interest. This increase in payroll taxes will have a negative affect on the ability of business to create jobs.

Beginning in 2012, federal (FUTA) penalties on employers will be $63 per employee per year. Negative balance employers will also pay an additional $67.50 per year. Another assessment is necessary to pay off outstanding interest on the federal loans and could be as much as $46 per employee per year. Beginning in 2013, additional federal penalties (called the "BCR add-on") are possible in future years for up to $231 per employee per year. Total cost = $340 for positive balance employers and $408 for negative balance employers – per employee per year.[1]

These penalties are **in addition** to regular state UI tax payments and could continue for years until all loans are repaid. Some projections show that in 2017-2018 the loans may be repaid, however at this point the Trust Fund balance would be zero with no reserves for another economic downturn. If another downturn occurs – the cycle repeats and borrowing resumes and so does another round of penalties and employer payroll assessments.

The business community urges the legislature and this committee to take a proactive approach to avoid these federal penalties and restore an adequate trust fund balance that will make it less likely that another deficit crisis will recur.

We support a combination of cost-saving reforms and funding solutions including a bonding approach that would eliminate the federal debt to avoid looming employer penalties and legislative and administrative reforms that will strengthen the integrity of the system and modernize many of its' processes.

We look forward to working with the legislature and the administration to pursue these changes to prevent this crisis from stalling Michigan's economic recovery engine: Small business.

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[1] FUTA penalty of $63 represents third year outstanding loan penalty of .03% reduction in the FUTA credit times federal wage base = .03 X 7000 = $21 X 3 years = $63. Federal BCR add-on formula is Max [five-year State Average Cost/Taxable Wages, 2.7] - Average Annual State Tax Rate on Total Wages. Current UA estimates of this amount is .033. .033 X 7000 = $231. Current maximum solvency tax on negative balance employers is $67.50 per employee per year. The $46 interest charge is derived by adding total estimated interest on federal debt of $136 million per year divided by 3,039,103 employees currently in the UI system.

Michigan Unemployment Insurance Taxes
Challenges and Options

Background

- Michigan's Unemployment Insurance system was created by the Michigan Employment Security Act. The system is administered by the Unemployment Agency (UIA). It is designed to provide unemployment benefits to workers after they have become unemployed through "no fault of their own". Traditionally this has meant that they are laid off due to lack of work.

- Michigan's Unemployment Insurance system is 100 percent employer financed through payroll taxes. There is no taxpayer money from the general public or general fund used to support the program.

- Almost every business in the state that has employees is required to participate in the Unemployment Insurance system and pay the payroll tax.

- Michigan's system (State Unemployment Tax Act – SUTA) works in tandem with the federal system (Federal Unemployment Tax Act - FUTA). Employers in Michigan pay two taxes on their payroll to support the federal-state (FUTA – SUTA) unemployment insurance system.

- The SUTA tax rate is experience rated and ranges from 0.06 up to 10.3 percent on the first $9,000 of each employee's annual wages (the SUTA Wage Base).

- Employers also pay a federal unemployment tax (FUTA) to the Internal Revenue Service. The tax is paid annually on IRS Form 940.

- The Unemployment Agency keeps an "account" for each employer and the account keeps track of taxes paid and benefits charged. Employers that have more money in their accounts than have been paid out in benefits are called "Positive Balance Employers" and employers that have less money in their accounts than have been paid out in benefits are called "Negative Balance Employers".

Benefits

- To make a claim, a worker must establish a benefit year. A worker must earn $2,871 in a 3 month period and at least $4,306.50 in a "base" period (roughly a 1 year period preceding the filing of the claim).

- Unemployed workers now receive 4.1 percent of high quarter earnings plus $6 per dependent (limited to five) up to $362 a week. Beginning in 2012, an unemployed worker can collect up to 20 weeks of state benefits during a 52-week benefit year.

- During periods of high unemployment, unemployed workers may become eligible for an additional 13 weeks of federal extended benefits. This is determined by Congress working with the federal Department of Labor.

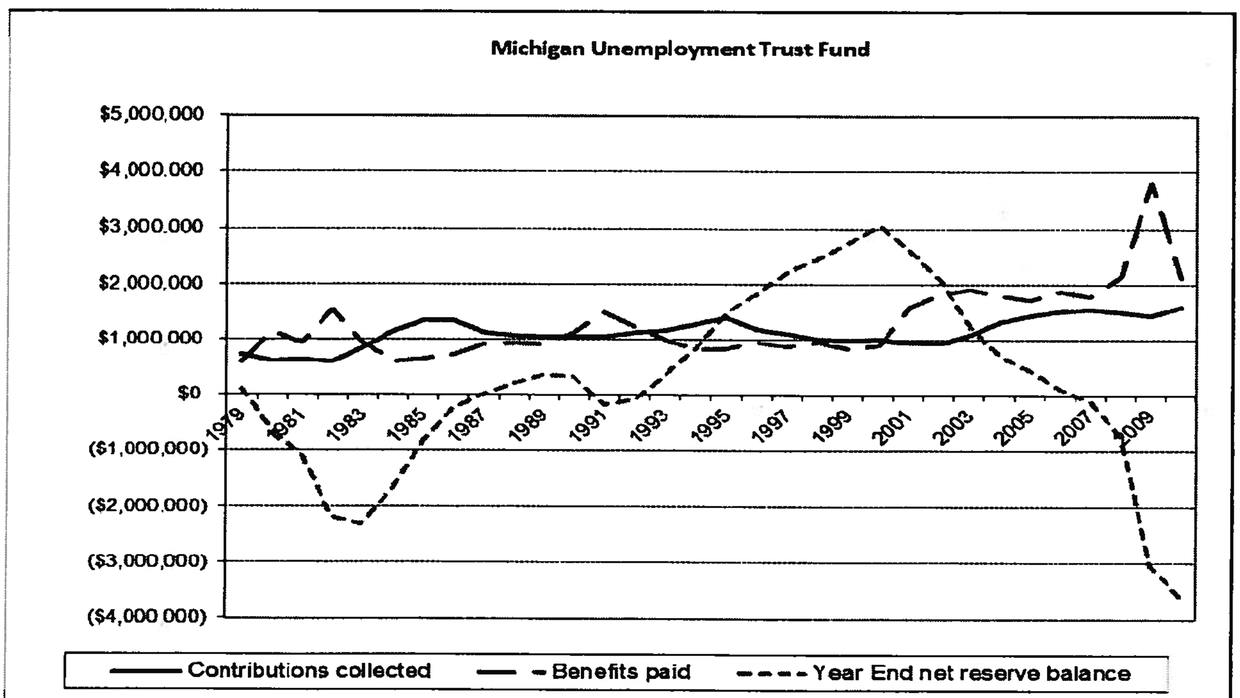
❖ Currently, up to 99 *weeks of total unemployment* benefits have been available for qualifying claimants due to multiple federal extensions. While federal extended benefits are not charged to an individual employer's state UI account, they are paid for from funds collected through the FUTA or federal unemployment tax assessed on all employers and could result in higher employer FUTA taxes in the future.

The Problem

❖ State UI taxes paid by employers are deposited in the state's Unemployment Insurance Trust Fund. The fund is designed to operate under the assumption that benefit liabilities are funded in advance of actual payment. This allows for the systematic accumulation of benefit reserves in the trust fund during periods of economic growth in order to have sufficient assets to pay unemployment benefits during periods of economic decline.

❖ When Michigan's Unemployment Insurance Trust Fund runs out of money to pay benefits, loans from the Federal Unemployment Insurance system trigger on in order to continue benefit payments. At its' worst, Michigan was in debt to the Federal Unemployment Insurance system for almost $3.9 billion. On a per capita basis Michigan leads the nation in federal borrowing.

❖ Recent increases in state trust fund collections have reduced the amount of state debt to about $3.2 billion, but state employers will be assessed penalty and solvency taxes to repay these loans and interest. This increase in payroll taxes will have a negative affect on the ability of business to create jobs.



Source: U.S. Department of Labor, Employment and Training Administration, *ET Financial Handbook 394;* Michigan Unemployment Insurance Agency; U.S. Department of Treasury, Bureau of the Public Debt

- ❖ Beginning in 2012, federal (FUTA) penalties on employers will be $63 per employee per year. Negative balance employers will also pay an additional $67.50 per year. Another assessment is necessary to pay off outstanding interest on the federal loans and could be as much as $46 per employee per year. Beginning in 2013, additional federal penalties (called the "BCR add-on") are possible in future years for up to $231 per employee per year. Total cost = $340 for positive balance employers and $408 for negative balance employers – per employee per year.[1]

- ❖ These penalties are **<u>in addition</u>** to regular state UI tax payments and could continue for years until all loans are repaid. Some projections show that in 2017-2018 the loans may be repaid, however at this point the Trust Fund balance would be zero with no reserves for another economic downturn. If another downturn occurs – the cycle repeats and borrowing resumes and so does another round of penalties and employer payroll assessments.

<u>Proposed Solution</u>

- ❖ The business community supports a proactive approach to avoid these federal penalties and restore an adequate trust fund balance that will make it less likely that another deficit crisis will recur.

- ❖ We support a combination of cost-saving reforms and funding solutions that will continue to provide an adequate level of benefits to employees, who are temporarily unemployed through no fault of their own, and keep UI costs affordable for job providers and competitive with other states.

- ❖ Funding solution: Issue a 10 year tax exempt bond repaid by an employer financed obligation assessment. The proceeds from these bonds would be used to pay all federal debt and accumulated interest. This would immediately end all federal penalties and the solvency tax on employers. The cost of the bond service would be a predictable assessment on all employers tied to their experience rating and at a cost below possible federal penalties and interest. The trust fund would also be near a $2.5 Billion balance by the end of 2019. The taxable wage base would also be increased beginning in 2012 from $9,000 to $9,500 with a float provision based on trust fund balance.

- ❖ Cost-Saving Reforms: A combination of legislative and administrative reforms that will strengthen the integrity of the system and modernize agency processes. These reforms would include strengthening suitable work & seeking work requirements, providing for disqualification for voluntary quits & misconduct and updating the seasonal employer designation.

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