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## A FUTA credit reduction is projected to apply in seven jurisdictions in 2022; most states have not imposed federal interest surtaxes on employers

### Summary

- *As of October 11, 2022, California, Colorado, Connecticut, Illinois, New Jersey, New York and the Virgin Islands have the potential of a 2022 FUTA credit reduction if they continue to have a federal unemployment insurance (UI) balance on November 10, 2022.*
- *Except for the Virgin Islands, states with a federal UI loan balance on November 1, 2022 will pay a net FUTA at the rate of 0.9%, rather than a net FUTA rate of 0.6%.*
- *The additional FUTA tax owed due to the FUTA credit reduction will be shown on the 2022 Form 940, and the increase in FUTA tax is due on January 31, 2023.*

As of October 11, 2022, the US Treasury Department shows that a federal unemployment insurance (FUTA) credit reduction potentially applies for calendar year 2022 to seven jurisdictions (California, Colorado, Connecticut, Illinois, New Jersey, New York and the Virgin Islands) unless they repay their loan balances by November 10, 2022. (*US Treasury [website](#); US DOL [website](#).*)

See the chart on the following pages for a recap of the projected 2022 FUTA tax rate and whether employers are subject to a state federal interest surcharge.

Under federal law, if all or a portion of a federal UI loan is still outstanding after two years, employers are required to make payments toward the outstanding federal UI loan balance in the form of a FUTA credit reduction that increases the FUTA taxes employers pay. These extra FUTA contributions are used to pay the principal balance of the federal unemployment insurance (UI) loan. For the states that began borrowing

in 2020, and still have an outstanding loan balance as of November 10, 2022, a FUTA credit reduction of 0.3% would go into effect for 2022, with the increased amount due January 31, 2023.

UI benefit payouts in connection with COVID-19 were substantial in 2020-2021, placing an unprecedented strain on the state UI trust funds. Twenty-two jurisdictions (California, Colorado, Connecticut, Delaware, Georgia, Hawaii, Illinois, Indiana, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, New Jersey, New Mexico, New York, Ohio, Pennsylvania, Texas, Virginia, the Virgin Islands and West Virginia) had the need in 2020 to request and receive federal UI loans when their trust fund balances became insolvent attempting to meet the demand. Approximately half of these states repaid their federal UI loan balances throughout 2020 and 2021.

According to the US Department of Labor's [2022](#) state solvency report, as of January 1, 2022, only 16 of 53 jurisdictions had state UI trust funds that met the Department's recommended minimum solvency standard. This is an increase from 2021, when only 13 state trust funds met the standard. At the start of 2020, 31 states met the minimum solvency standard.

Many of the borrowing states used (or plan to use) federal COVID-19 stimulus money and/or state general funds to pay off their federal UI loan balances. For example, Texas enacted legislation in late 2021 ([SB 8](#)) that authorized the appropriation of roughly \$7.2 billion for deposit to the state's UI trust fund to pay off the state's federal UI trust fund loan and return the UI trust fund to a level that would hold down UI tax rates in 2022.

The Virgin Islands was the only jurisdiction with a FUTA credit reduction for 2021 because it continued to have an unpaid federal UI loan balance as of November 10, 2021. Virgin Islands employers paid at a FUTA tax rate for calendar year 2021 of 3.9%, composed of a FUTA credit reduction rate of 3.3% and the 0.6% minimum FUTA tax rate. Virgin Islands employers have been subject to a FUTA credit reduction since 2011. (*EY Tax Alert [2021-2156](#), 11-30-2021.*)

## Interest assessments

Under the American Rescue Plan Act (ARPA) (*P.L. 117-2*), interest on federal UI loans starting in 2020 began to accrue as of September 7, 2021 (extended from January 1, 2020, by the Families First Coronavirus Response Act (*P.L. 116-127*)) and from March 16, 2021, under the Appropriations Act (*P.L. 116-260*).

States that carry a loan balance as of October 1 are required to pay interest on September 30. States can impose additional state UI taxes on employers to recover the interest charged on their federal UI loan balances.

Although most states passed this interest cost on to employers in the form of additional UI interest surcharges, many of the states that incurred federal interest charges in 2021 and 2022 did not require employers to bear that cost. (See *U.S. Department of Labor Program Letter No. 14-21*.) See *EY Tax Alerts [2021-1997](#)*, 11-2-2021 and [2022-0033](#), 1-7-2022 for more information.

## Background

The Social Security Act requires a reduction in the FUTA tax credit when a jurisdiction has an outstanding federal UI loan balance on January 1 of the second consecutive year and if the loan balance is not repaid in full by November 10 of that year. The reduction in the FUTA tax credit is 0.3% for the first year and an additional 0.3% (or more) for each succeeding year until the loan is repaid.

Federal law discourages states from carrying their federal UI loan balances over several years by further reducing the FUTA credit beginning in the fifth year of the loan. This add-on to the FUTA credit reduction is referred to as the Benefit Cost Rate (BCR). The BCR penalty may be waived if the jurisdiction's governor submits an application to the U.S. Secretary of Labor no later July 1 of the penalty year and the jurisdiction takes no action (legislative, judicial, or administrative) during the 12-month period ending September 30 that would reduce UI trust fund solvency during that same time period.

Should the BCR add-on be waived, as is normally the case if the conditions are met, another penalty, referred to as the "2.7 add-on," can apply if the jurisdiction's average unemployment insurance tax rate is inadequate. The 2.7 add-on penalty rate cannot be avoided or waived once activated.

**Potential 2022 FUTA credit reduction states; how 2022 federal interest charges were paid**

State	First year of loan	Federal UI loan balance as of October 7, 2022	2022 potential FUTA credit reduction in outstanding loan balance as of 11-10-2022	2022 potential Benefit Cost Rate (BCR) add-on	Net 2022 potential FUTA rate	How or whether the state plans to repay the federal loan in 2022	How 2022 interest charges were paid
California	2020	\$18,024,984,694.22	0.3%	N/A	0.9%	Plans to pay down with \$1b in state general funds; will not fully repay in 2022	Paid with state general funds
Colorado	2020	\$33,089,860.58	0.3%	N/A	0.9%	Plans to pay down with federal stimulus funds	Paid with federal stimulus funds
Connecticut	2020	\$102,150,049.85	0.3%	N/A	0.9%	Will not fully repay in 2022	Governor Lamont has obligated \$30m in federal ARPA funds to pay the interest due from September 2022 through September 2026.

State	First year of loan	Federal UI loan balance as of October 7, 2022	2022 potential FUTA credit reduction in outstanding loan balance as of 11-10-2022	2022 potential Benefit Cost Rate (BCR) add-on	Net 2022 potential FUTA rate	How or whether the state plans to repay the federal loan in 2022	How 2022 interest charges were paid
Illinois	2020	\$1,362,645,002.82	0.3%	N/A	0.9%	Plans to pay off in 2022 with federal stimulus funds and state general funds	Should be paid by the state's special administrative account
New Jersey	2020	\$0.00	N/A	N/A	0.6%	Paid off as of May 2022 but may need to borrow again; pending legislation would pay for any remaining balance with federal stimulus funds.	Under <a href="#">Senate Bill 2023</a> , amounts are appropriated from the Unemployment Compensation Auxiliary Fund (the Fund) to pay interest due on federal UI loans if the Commissioner of Labor determines that there are sufficient amounts in the Fund to repay all or a portion of the interest amount due on September 30 of that calendar year.

State	First year of loan	Federal UI loan balance as of October 7, 2022	2022 potential FUTA credit reduction in outstanding loan balance as of 11-10-2022	2022 potential Benefit Cost Rate (BCR) add-on	Net 2022 potential FUTA rate	How or whether the state plans to repay the federal loan in 2022	How 2022 interest charges were paid
New York	2020	\$7,982,447,852.60	0.3%	N/A	0.9%	Unknown	Pending legislation would repeal statute that requires employers to pay an interest assessment. Otherwise, for 2022 the interest assessment is 0.23%, or approximately \$27.60 per employee.
Virgin Islands	2009	\$96,046,936.75	3.6%	0.3%	3.9%	Unknown	Employer interest assessment of \$25 per employee applies

## Contact us for more information

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