# UNEMPLOYMENT INSURANCE PROGRAM
# TAX AND FINANCING REFORM

## EXECUTIVE BRIEF
***Discussion Draft***

*The Administration is not pursuing comprehensive unemployment insurance (UI) program reform legislation in 2004 due to states' reluctance to take on new financial responsibility at a time when many state budgets are under great stress.*

*However, the Administration remains committed to reform. Described below is a variation on the 2003 proposal to reform UI tax and administrative funding. <u>This proposal has not been adopted as Administration policy</u> and is presented only to initiate discussion and consultation with states.*

### ❖ The State Choice Proposal

The Administration is committed to a 21st century make-over for the nation's critical UI program which would:

- Promote job creation and strengthen the economy by lowering federal payroll taxes.

A new approach to achieving this reform is to give states the *option* to secure significant federal payroll tax cuts for their businesses and greater flexibility in delivering unemployment benefits by taking primary responsibility for funding administration of their UI programs.

### ❖ Job Creation and Strengthening the Economy

- To promote business investment and job growth, the proposal reduces the effective federal unemployment tax (FUTA):
  - from 0.8% to 0.6% on January 1 of the first year following enactment in all states, cutting taxes by 25%,
  - in states that opt to fund their UI program's administration, to 0.4% the first year, and 0.2% the second year and thereafter.
- Streamlines FUTA forms and filing through a technical change to federal law, allowing the IRS to simplify the federal unemployment tax form. (Under that change, the calculation of taxes due would take into account that all states assign rates of at least 5.4%.) In addition, FUTA and state unemployment quarterly tax reporting periods would be specified in law.

- **New State Option**

  - Note: For illustrative purposes in the following outline, we assume enactment in CY 2005 with the initial FUTA tax cut effective in CY 2006 and transfer of funding to states beginning with FY 2007 at the earliest.

  - For electing states, gradually transfers primary responsibility for financing administration of the UI program from the federal government to state governments beginning with FY 2007 at the earliest.

  - For electing states, provides federal assistance during a transition period.

    - Continues to fund costs until election is effective.

    - Transfers a portion of $4.0 billion to electing states' accounts (based on states share of FUTA taxable wages) in the Unemployment Trust Fund (UTF), earliest FY 2005.

    - Provides grants equal to ¾ of the Resource Justification Model (RJM) level for the first year (earliest 2007) after election and ½ of the RJM level for the second year (earliest FY2008).

    - Ensures that a special Reed Act distribution would be triggered to make up any difference between the amount based on RJM and the amount appropriated.

  - For electing states, provides hold-harmless funding. If the cost of administration of the UI program should ever exceed the tax savings to states' employers, the federal government would provide funding to make up any difference.

    - Beginning with the third year (earliest FY 2009) after election, a state's hold-harmless funding would be the difference between its most recent full federal funding level, adjusted for inflation and UI workload (designated the target level), and estimated revenues from a 0.4% tax on a $7,000 taxable wage base.

    - Thereafter, the target level would be adjusted only for workload changes to arrive at the target level for each year and the hold-harmless funding would be calculated as above.

  - Allows electing states to hold their UI administrative funds in the state or in a sub-account in the state's UTF account.

- Continues federal discretionary grants to states not electing to take primary responsibility for funding.

- Continues federal grants to all states for federal activities such as federal unemployment claims, required reports, and BLS statistical programs. Also continues UI national activities, which support the states collectively, such as the Interstate Connection (ICON) telecommunications network.

- Provides administrative grants to states for innovative proposals such as improving administrative efficiency or reducing erroneous payments.

❖ **New State Flexibility**

- Gives states access to the National Directory of New Hires for quick detection of individuals who have gone back to work, but continue to collect UI.

- Permits states to pay for certain tax collection activities by maintaining compensating balances in the banks performing the activities.

- Makes technical changes so that states will follow state, rather than federal, requirements for Reed Act appropriations by state legislatures.

- Clarifies that UI claimants are not required to present proof of citizenship **in person** when they claim benefits that include federal funds.

- Allows states greater flexibility in the use of proceeds from the sale of federal equity in real property.

❖ **Federal Role**

- Continues the federal government's role of monitoring conformity/compliance and state programs' performance.

- Retains the federal requirements related to prompt and proper payment of benefits, fair hearings, coverage of services, etc.

- Continues such federal activities as technical assistance, collection and dissemination of program statistics, and oversight of federal programs.

❖ **Key Miscellaneous Provisions**

- Replaces federal requirements relating to eligibility for extended benefits with state law provisions regarding eligibility for regular compensation.

- Prohibits states from reducing benefits due to pension rollovers that are not deemed income for federal income tax purposes.

- Repeals a provision that results in certain individuals performing federal service under contract being denied UI in cases where private sector (or state) workers performing the same services would be eligible.

- Makes technical changes to the Short Time Compensation program, which will allow states to continue operating these programs as they currently exist.

- Closes a loophole that permits some employers to pay less than their fair share of state UI taxes.