

State Seeking Changes to Unemployment Compensation Tax Structure

Connecticut's unemployment compensation system is under severe strain as a result of the recession and global downturn. A rapid rise in jobs lost, a record number of business closings, and a high volume of benefits paid out of the system have caused the state's unemployment trust fund to become insolvent this year. What's more, economists forecast continued joblessness resulting from the recession to continue well into the next decade.

As a result of trust fund insolvency, the Connecticut Department of Labor (CTDOL) has borrowed from the federal government, and is anticipated to continue borrowing up to \$1 billion, in order to meet unemployment benefit obligations.

So far, 25 other states, including New York, New Jersey, Pennsylvania and Rhode Island, are facing similar crises and have also borrowed from the federal government to achieve or maintain UC Fund solvency; another 15 states are expected to follow suit in the near future.

In light of the above, and to address both short-term and long-term insolvency issues, the CTDOL is proposing to change the way that Connecticut employers are taxed for unemployment benefits, and they have asked the business community to consider these proposals.

CBIA believes that before we look at how to raise taxes, the UC system should be repaired so it is fair and balanced.

Fix the system first

Certainly, any major changes to the state UC tax structure will impact Connecticut employers and the state economy. Therefore the efficacy of any proposal ultimately rests on determining the appropriate amount of revenue needed to both make the UC Fund solvent and to balance the public policy goals of the unemployment compensation system to ensure that necessary policy reforms accompany tax changes. Specifically:

- Eligibility standards must ensure that benefits are awarded only to those claimants who have lost work through no fault of their own;
- Benefit eligibility criteria must reflect the realities of today's economy, so

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that individuals are encouraged to return to work as soon as possible;

- The distribution of benefits should be fair, balanced and appropriate for the current pool of available jobs; and
- The benefits distribution system must be improved to make sure that people receiving benefits are actively seeking meaningful work.
- Safeguards must be implemented to secure the unemployment compensation trust fund from unrelated and unnecessary state spending.

How the system is currently funded

Connecticut's unemployment compensation system is funded entirely by employers who pay taxes into the state UC Fund (non-profit employers do not pay taxes but reimburse the Fund for benefits paid). These taxes are based on two primary factors:

- (1) **Taxable wage base**—the amount of wages on which employers are required to pay unemployment compensation taxes for each of their employees. (Note: Wages earned above the base are not subject to the UC tax). The federal government sets the minimum taxable wage base at the first \$7,000 of an employee's wages. However, states may set higher wage bases than federally required. Connecticut has had a wage base of \$15,000 since 1999 and it is one of the highest in the nation.
- (2) **Experience rate** (also known as the merit or contribution rate) —this rate is established on a yearly basis, and is based on the amount of benefits actually paid to an employer's workers for the last three years. This

rate ranges from a statutory minimum of 0.5% to a maximum of 5.4%.

Basically, the amount an employer pays into the Trust Fund is calculated by multiplying the total of their taxable wages by the employer's experience rate.

- (3) **Solvency tax** (or, fund reserve tax) —a flat tax assessed on every employer as a percentage of their taxable wage base when the fund drops below the fund reserve goal. This additional tax can be as high as 1.4% and is added onto an employer's experience rate. (This tax is currently being applied at its maximum level)
- (4) **Special assessment**—a special tax may be imposed to repay principal and interest on loans taken to pay benefits during times of Fund insolvency.

What the DOL is proposing

To address the UC Fund shortfall, the Connecticut Department of Labor is proposing to change the state UC tax structure in several ways:

- **Increase the taxable wage base:** the CTDOL proposes to increase the taxable wage base from \$15,000 to \$20,000 in 2011, and then increase the base by \$1,000 per year through 2017 up to a maximum taxable wage base of \$26,000. According to the CTDOL, increasing the taxable wage base in this way will create a significant revenue boost to the UC Fund, allowing the Fund to become solvent.
- **Increase the UC Fund reserve goal to \$1.1 Billion in 2010:** The Fund reserve goal is used by states to determine the ideal level of funding needed to withstand future cycles of unemployment and other economic conditions affecting the UC Fund. The current UC Fund reserve goal is \$626 million, but based upon continued and anticipated benefit payment projections, the goal is expected to be less than what is needed to cover benefits obligations. Consequently, the CTDOL

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proposes to increase the Fund reserve goal to \$1.1 billion in 2010 based upon a formula that would set the reserve goal to a level equal to the average amount of UC benefits paid out during the three worst recessionary years over a 20-year period. According to the CTDOL this formula, although its currently used by only five states in the nation, is the best way to cover current and future insolvency.

Evaluating the DOL proposals

While Connecticut's unemployment outlook appears bleak in the near future, economists agree that the current recession is one of the longest and deepest since the Great Depression. Consequently, developing long-term insolvency plans based on today's historic economic downturn would not be prudent.

Accordingly, Connecticut must be cautious about increasing UC taxes for employers beyond what is absolutely needed to ensure and maintain trust fund solvency.

With this in mind, businesses should

keep the following in mind when considering the CTDOL proposals:

- **The CTDOL taxable wage base annual incremental increases could lead to indexing.** In the past, long-term increases of state taxes and fees often become permanent annual increases imposed on employers.
- **Connecticut already has one of the highest taxable wage bases in the nation.** Our current wage base is higher than most competing states, even after many states recently enacted legislation to address UC Fund insolvency. Increasing Connecticut's taxable wage base to \$26,000 would make it the 8th highest in the nation and likely would negatively affect our business competitiveness.
- **Setting the Fund reserve goal too high drains valuable dollars from the state economy.** Raising UC taxes too high will negatively impact the state economy by taking away money needed by businesses for job growth and creation, capital investment and economic development. At a time when many Connecticut businesses are

struggling to survive and compete, taking money out of the state economy may ultimately slow our economic recovery.

- **Setting the Fund reserve goal too high may create a surplus, leaving the Fund vulnerable to other state spending, especially during recessionary times.** Although both federal and state law provides that payments into the UC Fund may only be used for unemployment purposes, the term "unemployment purposes" has been broadly interpreted by other states to justify routing UC funds to uses only marginally related to the payment of unemployment benefits.

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