

CHAPTER 3J

UNEMPLOYMENT INSURANCE TAX

HIGHLIGHTS

- Purpose Funds unemployment benefits for former employees who are currently unemployed.
- Tax Base First \$7,000 of each employee's annual wage.
- Tax Rate The Unemployment Insurance (UI) rate schedule in effect for 2006 will be Schedule "F+". This is Schedule F plus a 15% emergency surcharge and provides for UI tax rates from 1.5% to 6.2%. In addition, employers with a positive reserve account balance as of the calculation date must pay the employment training tax of 0.1%.
- Revenue

2002-03	\$2.91 billion*
2003-04	\$4.04 billion*
2004-05	\$4.88 billion*
- Disbursements

2002-03	\$6.51 billion*
2003-04	\$5.75 billion*
2004-05	\$5.02 billion*
- Administration Employment Development Department (EDD)

*Source: EDD

1. TAX OVERVIEW

The **unemployment insurance tax** funds the cost of benefits for the UI program administered by California's EDD. It is levied on employers who have paid in excess of \$100 in total wages during any calendar quarter. The tax is levied on the first \$7,000 of wages paid by an employer to an employee.

All taxes paid are deposited in the UI Trust Fund maintained by the State Treasury. EDD draws down funds from the UI Trust Fund as needed to pay UI benefits to California workers. The UI tax revenues may be used only for payment of program benefits.

An individual account, called a reserve account, is maintained for each employer by EDD. The reserve account is a paper (or so-called "book") account only and cannot be

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reimbursed to the employer. This account is used to compute the employer's tax rate, as discussed below.

The **employment training tax** funds training programs in targeted industries in order to retrain workers and to help improve California's competitiveness. Like the UI tax, the employment training tax is imposed on employers and is levied on the first \$7,000 of wages paid by an employer to an employee. Only employers with a positive reserve account balance as of the calculation date are subject to the employment training tax. However, employers found guilty of tax evasion are assessed the employment training tax, along with any penalties, interest, and other fines for the offense, regardless of the condition of their reserve account. The Employment Training Panel administers the employment training funds collected and has the discretion to allocate the funds to economic development, special employment training, and/or welfare to work.

2. TAX RATE

Unemployment Insurance Tax. New employers pay a basic tax rate of 3.4% for their first three tax years of business. Each employer's subsequent tax rate is based on that individual employer's "experience rating" and on the tax rate schedule in effect for all employers during the year.

- Tax Rate Schedules. There are seven different tax rate schedules (AA, A, B, C, D, E, and F, ranging from lowest to the highest) and 38 different rates within each schedule. Depending on the schedule in place, UI rates can range from a low of 0.1% to a high of 5.4%.

The tax rate schedule in effect for any given year depends on the balance in the UI Fund and total wages paid in California. Generally speaking, when the balance in the UI Fund decreases, a higher tax rate schedule is triggered. When the balance in the Fund increases, a lower tax rate schedule is triggered. A change in tax rate schedule affects the rates applied to all employers.

The UI rate schedule in effect for 2006 will be Schedule "F+". This is Schedule F plus a 15% emergency surcharge. Rounded to the nearest tenth, Schedule "F+" provides for UI tax rates from 1.5% to 6.2%.

- Experience Ratings. The experience rating system measures the relationship between UI taxes paid by an individual employer, benefits paid to that employer's workers, and growth in an employer's work force. Generally, employers who maintain stable work forces and timely file and pay UI taxes have more favorable experience ratings (and therefore lower UI tax rates) than employers who experience high turnover, large fluctuations in payroll, and/or are late in filing and paying their UI taxes.

An employer's experience rating is based on that employer's reserve ratio.

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The reserve ratio is calculated as follows:

- a) An employer's UI reserve account is credited with UI taxes paid by the employer;
- b) The value of UI benefits paid to the employer's former employees is subtracted from the employer's reserve account, except in certain special circumstances. Under certain circumstances, law specifies that benefits not be charged against a former employer but must instead be charged to all employers who participate in the UI fund. These benefits are called socialized benefits. One example of benefits in this category is those paid to employees who become unemployed as a result of the need to escape domestic violence. Other examples include benefits that are paid out erroneously, such as in cases when a claimant leaves employment voluntarily and without good cause, is discharged for misconduct, or leaves work voluntarily to accompany a spouse to a place where it would be impracticable to commute.
- c) Interest earned on the entire UI Fund is credited to the reserve account of each employer on a proportionate allocation basis. Allocation is made based on the size of each employer's reserve account relative to the total.
- d) Socialized benefits are debited on a proportionate basis from each employer's reserve account.
- e) The resulting reserve account balance is then divided by the employer's average annual taxable payroll for the preceding three years. The result equals the reserve ratio.

A high reserve ratio --- high reserves and few benefits paid --- produces a lower experience rating and thus a lower UI tax. A low reserve ratio --- few reserves and many benefits paid --- produces a higher experience rating and thus a higher UI tax.

Employers may make voluntary contributions to their reserve accounts to obtain a lower UI tax rate for a given year, although rate reductions triggered by voluntary contributions cannot lower an employer's rate by more than three rate steps (i.e., a few tenths of one percent). Furthermore, voluntary contributions are only allowed during relatively good economic times; they are not allowed during years when the two highest rate schedules (E and F) are in effect.

Each December, EDD automatically notifies all eligible employers of the exact amount of voluntary payments needed to lower their UI tax rates, together with the UI tax rate reductions that would result from voluntary

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payments.

- o SUTA Dumping Tax Evasion Schemes. EDD has identified a scheme to manipulate the UI tax rate and evade proper imposition of the UI tax under the State Unemployment Tax Act (SUTA). This scheme, known as SUTA dumping, involves manipulation of an employer's reserve account and experience rating. **For example**, when an employer develops a high experience rating and reports a low (or negative) reserve account balance, a new entity will be formed. When the new entity establishes a lower experience rating (and lower UI taxes), the payroll from the old entity will be "dumped" into the new entity.

The harm associated with SUTA dumping include: eliminating the incentive for employers to avoid layoffs, thereby adversely impacting the tax rates of all employers and creating an unfair advantage for participating employers; and compromising the integrity of the UI system, costing the UI trust fund millions of dollars each year.

California was one of the first states to enact laws to prevent employers from illegally lowering their UI contribution (tax) rates. EDD actively fights SUTA dumping schemes through education and outreach to employers and payroll tax advisors as well as aggressive pursuit and prosecution of employers that participate in SUTA dumping or other tax manipulation schemes

Employment Training Tax. All employers subject to the employment training tax, as discussed above, are assessed an additional 0.1% regardless of their UI tax rate.

3. EXEMPTIONS

There are several reasons why the wages earned by an individual may be exempt from UI taxes. Some of the more common types of exemptions include wages earned by:

- o Certain family members in family employment;
- o Elected officials acting in their official capacity;
- o Employees performing services for a church;
- o Certain students, student nurses, newspaper carriers, and golf caddies; and
- o Certain domestic workers who receive less than \$1,000 in cash wages during a calendar quarter.

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Generally, employers who are not required to pay UI taxes for certain employees are allowed to elect such payments. The primary exception to this rule involves elected officials, whose employers may not make UI payments on their behalf.

4. BENEFITS

Unemployment insurance benefits are payable to employees who become unemployed through no fault of their own, are able and available to work, are actively seeking work, and have earned sufficient wages in the "base period". The base period is the first four of the last five or six quarters, depending upon the month in which a claim for benefits is filed, as shown below.

MONTH CLAIM IS FILED

BASE PERIOD

January, February, or March
April, May, or June
July, August, or September
October, November, or December

October 1 through September 30
January 1 through December 31
April 1 through March 31
July 1 through June 30

An employee who leaves a job voluntarily may also claim UI benefits if he or she had good cause (e.g., the working conditions were dangerous).

The employer's reserve account is credited with the tax contributions and, in most cases, charged with benefits paid to former employees. An employer who receives a notice of claims made by former employees may file a protest with EDD if he or she believes that the employee is not entitled to the benefits claimed.

The weekly benefit amount is based on the quarter within the base period in which the employee's wages were the highest. In 2003, benefit amounts ranged from \$40 to \$370 per week. The maximum benefit increased to \$410 in 2004 and \$450 in 2005. The employee may draw up to 26 weeks of benefits during a one-year period.

However, EDD can extend the benefit period during periods of severe unemployment based on criteria specified in law. For example, when at least 6% of California's UI work force becomes unemployed, up to 13 additional weeks of UI benefits are available to those who have exhausted their regular UI benefits. Responsibility for funding the additional UI payments is shared equally between the state UI Fund and the federal government.

5. FEDERAL TAXATION

The federal government imposes a federal unemployment tax (FUTA) on employers equal to 6.2% of the first \$7,000 in wages they pay each qualifying employee. However, the federal government gives employers in states with approved unemployment insurance

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programs a credit of 5.4% against the federal tax. Thus, California employers are subject to a federal tax of 0.8%.

6. REVENUE

Unemployment insurance tax revenues totaled \$2.91 billion in fiscal year (FY) 2002-03, \$4.04 billion in FY 2003-04, and \$4.88 billion in FY 2004-05.

7. ADMINISTRATION

Any employer who pays in excess of \$100 in total wages during any calendar quarter is required to register with EDD. Employers are required to make quarterly UI payments on the last day of the month following the close of each calendar quarter. An annual return in which employers must reconcile their quarterly payments with the amounts of tax actually due for the year must be filed by January 31 of each year. Penalties and interest are imposed on delinquent amounts.

8. CODE

Unemployment Insurance Code Sections 100-2129