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## **Mitigating Unemployment Comp Tax Increases Facing Employers *Using Cost Saving Recommendations to Help Pay Federal Loan Obligations and Enacting Reforms Can Help***

Florida employers have recently been hit with very large increases in their unemployment compensation taxes and more increases are on the horizon. In 2010, Florida's unemployment rate reached double digits and, for the first time in recent history, the state paid out more in unemployment benefits than it collected. When the trust fund used to provide benefits to jobless Floridians ran out, the state took out \$2 billion in loans from the federal government to make up the shortfall.

Now, the first interest payment on those loans is about to come due and Florida employers are on the hook to pick up the tab. Interest is expected to total \$213.5 million over the life of the loans. Florida's 464,500 employers are now facing additional tax hikes to replenish the trust fund and

### **Summary of Findings**

- The record level of unemployed persons in Florida led to the state UC trust fund running out of money in 2009. Florida has borrowed \$2 billion from the federal government to keep it solvent.
- On January 1, 2011, the minimum UC tax increased from \$25.20 to \$72.10 per employee.
- An additional \$9.52 per employee will be due in June 2011. This assessment is for the first interest payment due to the federal government for loans to the state's UC trust fund.
- In 2012, the minimum tax will increase to \$207 per employee. Because the wage base will also be increased, all employers will see a tax increase.
- Because Florida's loans will be delinquent in November, employers will likely begin to have their credit against federal UC taxes reduced. This will cost employers \$882 million over three years.
- **Florida employers are facing a total \$4 billion UC tax increase over three years.**
- Using state general revenue, made available by implementing cost savings, to pay federal interest charges and some of the principal can help lessen the tax hike without reducing benefits.
- The legislature should also enact reforms to focus the system on re-employment and help limit payments to those who should not qualify for UC benefits.

pay back the federal loans, as well as a special assessment to cover the interest on the money borrowed beginning in June.

Alternatively, the state should seek to repay the principle and interest over the next two years without discouraging job creation in the state and thereby threatening Florida's economic recovery through raising taxes on employers. Florida should use the billions of dollars that can be saved by improving efficiency in state government to pay the federal obligations and save Floridians the potentially harmful negative economic impact of rising unemployment taxes. This approach, along with enacting UC reform legislation currently being considered by the Florida Legislature, can help expedite the restoration of Florida's unemployment compensation system.

Even in this extraordinarily tight budget year – which, like the unemployment compensation shortfall, was caused by the effects of the Great Recession on government revenue collections – billions in cost savings can be found in the recommendations of the Florida TaxWatch Government Cost Savings Task Force for Fiscal Year 2011-12. This on-going task force is made up of more than 40 current and former government officials, business leaders, organizational experts, and renowned academics and has compiled a list of 125 ways to generate significant savings, savings which can be used to avoid these potentially harmful tax hikes.

## **Introduction**

The “Great Recession” has hit Florida's job market particularly hard. The state's unemployment rate was 12 percent in December 2010, which represents 1.1 million Floridians out of work. This is the same unemployment rate as in January 2010 and is up from 8.7% in January 2009. The record level of unemployment in Florida has meant that the state Unemployment Compensation (UC) Trust Fund has been paying out more for unemployment benefits than it has been collecting from employers. Before the onset of the Great Recession (in late 2008) Florida's UC Trust Fund had never before been insolvent, consistently carrying \$1.5 billion to \$2 billion balances; but the fund became overwhelmed by benefit payouts and dipped into the red in August 2009. Since then the state has received \$2.12 billion (as of March 1, 2010) in federal advances in order to cover the benefits. Under current law, it is estimated Florida's federal loan balance will peak at \$2.5 billion during FY 2011-12.

Florida employers pay a state Unemployment Compensation (UC) tax, the proceeds of which are deposited in the state UC Trust Fund to pay unemployment benefits. The deficit in the UC Trust Fund and the federal loan repayment schedule has meant that Florida employers have recently been hit with very large increases in their unemployment taxes and more increases are on the horizon. Effective January 1, 2011, the minimum tax rate (paid by nearly half of all employers) increased from 0.36 percent (or \$25.20 per employee) to 1.03 percent (or \$72.10 per employee), an increase of \$46.90 per employee. This minimum tax rate was only 0.12 percent (\$8.40 per

employee) during 2009. Also, this month, all employers were notified of an additional \$9.52 per employee that will be due in June 2011. This assessment is needed to satisfy the first interest payment due to the federal government for loans to keep Florida’s UC Trust Fund solvent. Tax rates are slated to go even higher next year.

The need to restore solvency in the trust fund and pay back federal loans is leading to large UC tax increases. Total state UC taxes are expected to increase by almost \$400 million from FY 2009-10 to the current year (FY 2010-11). Taxes are expected to increase another nearly \$780 million next year, totaling \$2.3 billion. Federal UC taxes will also likely increase beginning later this year.

**Estimated Florida Unemployment Compensation Taxes**

	2009	2010	2011	2012	2013	2014	2015
Minimum Rate	0.12%	0.36%	1.03%	2.43%	2.05%	1.70%	1.22%
Minimum Tax*	\$8.40	\$25.20	\$72.10	\$206.60	\$174.30	\$144.50	\$85.40
Maximum Rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.40%	5.40%
Maximum Tax*	\$378	\$378	\$378	\$459	\$459	\$459	\$378
Wage Base	\$7,000	\$7,000	\$7,000	\$8,500	\$8,500	\$8,500	\$7,000
Tax Trigger	on	off	off	on	on	on	on

\* per employee

Source: Florida TaxWatch, using data from the Florida Office of Economic and Demographic Research and the Florida Legislature, March 2011.

**Huge Tax Increase Postponed in 2010; the Bill is Now Coming Due**

The recession has driven up unemployment all across the nation. Florida is certainly not alone in experiencing insolvency in its trust fund. Thirty-five states have drawn down advances from the federal government and thirty-one states currently have outstanding balances totaling \$44.0 billion (as of March 1, 2011). Florida’s balance of \$2.12 billion is the eight largest in the nation. California has the largest balance – just under \$10 billion. The states have incurred interest of \$283.5 million. This interest has accrued since only January 1, 2011, due to a provision in the American Recovery and Reinvestment Act of 2009 providing that federal advances did not accrue interest through December 2010. The interest rate for 2011 is 4.0869 percent. It is estimated that Florida will pay \$213.5 million in interest over the life of the loans.

Facing a looming UC trust fund deficit, the 2009 Legislature enacted an increase in the wage base from \$7,000 to \$8,500 for five years and increased the tax increase “trigger” from 3.75% to

4.0%. This meant that if the trust fund balance drops below 4% of the total taxable state payrolls as of June 30th, an adjustment factor is triggered to increase the employer contribution rates.

But as unemployment in Florida continued above expected levels, the tax increases facing employers in 2010 were much bigger than anticipated when the 2009 legislation was passed. The minimum rate was set to increase from \$8.40 per employee to \$100.30 per employee. The maximum rate was to increase from \$378 to \$459.

Responding to employers concerns, the 2010 Legislature passed a bill to delay the huge UC tax increase. The bill, which is now current law, postponed the increase in the wage base to \$8,500 for two years. It will go to \$8,500 in 2012 and then go back to \$7,000 after three years. It also suspended the tax increase “trigger” for two years, keeping the rate lower than what it otherwise would have been in 2010 and 2011. The legislation also authorized an assessment to pay interest on the federal loans.

But the 2010 legislation only postponed the tax increase, so taxes are on the way up. As of January 1, 2011, employers paying at the minimum rate will have a tax rate of 1.03% (\$72.10 per employee), up from 0.36% (\$25.20 per employee) in 2010. This is an increase of \$46.90 per employee. The maximum rate of \$378 and the new employer rate of 2.7 percent (\$189 per employee) will not change.

Some employers face even greater increases because they have laid off more employees and the resultant UC claims credited against their accounts increased their experience rating. Generally, an employer’s layoffs lead to an increased UC tax rate. Therefore, more employers are paying above the minimum rate. (For more information on how this works and a description of Florida’s unemployment system, see Appendix A.)

Two other factors have further driven up tax rates. First, more and more layoffs have resulted in an increasing number of Florida’s employers that are paying UC taxes at the maximum rate (5.4%). There are now 89,000 employers at the maximum rate, up from 34,000 in 2008, despite a drop in the total number of employers of 37,000 (7.3%) over that time. Once an employer reaches the maximum rate, additional layoffs cannot be charged to that employer so the maximum rate does not cover the cost of UC claims being filed against those employers. The remaining cost of claims filed is distributed among all employers. These “excess payments” totaled \$1.3 billion in the 2011 rate setting process, more than double the \$612 million incurred for 2010.

Secondly, the number of employers and employees has significantly decreased. In 2010, the Department of Revenue (DOR) reported that 75,832 employers went out of business. Because there are fewer employers paying UC taxes on fewer employees, existing employers will have to contribute more than they otherwise would have had to in order to restore the UC Trust Fund.

State taxes are also expected to continue rising (see above table). In 2012, the “trigger” will be turned on. The minimum tax rate will go to 2.43%—or \$206.60 per employee—an increase of 187%. In addition, since the wage base will go to \$8,500, all employers will experience a tax increase. The maximum tax rate will stay the same, but it will result in a per employee tax of \$459, a \$71 (21%) increase. Similarly, employers at the initial rate of 2.7 percent will have a tax of \$229.50 per employee, a \$40.50 increase (21%).

State UC taxes, at least at the minimum rate, should start to go down again in the 2013 tax year, but will not get back to current levels anytime soon.

### **Increased Taxes Due to Federal Loans**

In addition to the increase of \$44.90 for 2011, employers will also face a special assessment of \$9.52 per employee in order to make a payment on the interest owed to the federal government for loans made to Florida’s Unemployment Compensation System. The first payment of \$61.5 million is due next September. Next year’s assessment should be even larger, since the estimated interest due is \$91.2 million.

Then there are federal UC taxes (see Appendix for more information). If Florida does not pay back the federal loans by November 2011, employers will be subject to a loss of .3% of their federal credit for each year the loans remain unpaid. This would result in the amount of federal tax rate for Florida employers to increase from .8% to 1.1%. This will keep adding another \$21 per employee each year until the loan is repaid (under current law, it is currently projected Florida will not pay off the federal loans until FY 2013-14).

In summary, it is currently estimated that over the next three years, Florida employers will pay more than a cumulative \$3 billion in increased state UC taxes over the FY 2009-10 level. Add to that \$882 million for federal tax increases and more than \$200 million in interest payments and **Florida is facing a \$4 billion UC tax increase over three years.**

### **Using Cost Savings to Help Lower UC Taxes**

Unemployment taxes in Florida are currently low relative to other states, but the huge tax increases facing Florida businesses, will be difficult. The minimum state UC tax rate alone is expected to increase nearly 25-fold from 2009 to 2012. This will make it even more difficult for them to hire new employees—or even keep all current ones—and help turn the economy around.

One way to do this is to use state general revenue to pay the federal interest obligations, and perhaps even pay down the loan principal. Of course, Florida is facing a large budget shortfall and money is scarce. However, the Legislature has never had so many cost savings ideas available for its consideration.

Florida TaxWatch has proposed more than 125 specific cost reductions from the state budget, which could save as much as \$4.6 billion. These solutions were put together by the Florida TaxWatch Government Cost Savings Task Force and they provide constructive

recommendations for pension reform, health care reform, criminal and civil justice reform, procurement reform. Many of these proposals are reflected in the Governor's recommended budget.

In addition to the Florida TaxWatch recommendations, the Governor included billions of dollars of budget reductions in his recently released budget proposals. The legislature and state agencies have also spent the last couple years looking for ways to stretch scarce state dollars. The amount of scrutiny the base budget has received is probably unmatched in the state's recent history. There are certainly options.

Reducing taxes (or even reducing the magnitude of scheduled tax increases) will be difficult in a tight budget year. But the Governor issued a balanced budget proposal that included \$700 million in general revenue tax cuts for the upcoming budget year, in addition to a more than \$500 million state payment to replace a school property tax cut. The Governor's budget recommendations also included paying the first two interest payments due on the federal advances with state general revenue, which would cost another \$150 million. While the Legislature has not been too receptive to the tax cut proposals, or some of the budget reductions, the Governor has provided some options to explore that could free up money to help pay down the federal loans.

If the legislature does intend to provide any tax relief, UC taxes should be where it focuses its attention. It is one of the most broad-based taxes because it affects all employers, even those with as few as one employee, and is most directly related to jobs and employment.

According to a recent survey by the Nielsen Company, nearly 68 percent of Floridians support making hard decisions on cutting spending and inefficiency to repay the \$2 billion unemployment compensation loan to the federal government. The survey polled 1,220 Floridians between January 3-16, 2011 with a margin of error of +/- 3.0% percent.

Using cost savings generated by recommendations of the Florida TaxWatch Government Cost Savings Task Force and others to help pay down the loans and mitigate the tax increases facing Florida businesses can help the state leave as much money as possible in the hands of employers so that they may grow their business and their workforce. This also will not reduce UC benefits. We encourage the legislature to consider all of the Task Force's 125 solutions to reduce state government spending. The full report is available at [www.FloridaTaxWatch.org](http://www.FloridaTaxWatch.org).

### **Other UC System Reforms are Needed**

There are also opportunities to reforming the UC system to hold down future costs by helping to ensure that only those who should be receiving benefits are receiving them and helping Florida's system to better focus on re-employment rather than the granting of benefits.

Florida TaxWatch participated in a coalition of state wide organizations that developed a set of recommendations to reform the state's UC system. These organizations include the Florida Retail Federation, Associated Industries of Florida, the Florida Chamber of Commerce, the National Federation of Independent Business-Florida, the Florida United Business Association, Florida Ready to Work, and the Florida Association of Professional Employer Organizations.

The recommendations:

**Neutral rule of construction** – Florida statutes currently required that the UC law be "liberally construed in favor of the claimant". The law should be construed so it "does not favor or disfavor claimant." This would allow for a fair determination of benefits.

**Facilitate a culture change to focus on re-employment** – Place a greater emphasis on training and skills assessments, using existing, free resources and emphasizing an active search for employment.

**Strengthen the definition of misconduct** - Employers should not be charged for benefits when an employee has been fired for cause, has committed theft or other crime connected to work or becomes incarcerated. Change the standard to show misconduct from "willfull" (a high standard) to "conscious" (a lower standard).

**Drug testing** – Offer UC tax incentives for drug testing and reporting, similar to those used in the workers' compensation system.

**Evidence** - Allow for those adjudicating claims appeals to consider all of the relevant evidence and make a fair decision regarding the granting of benefits.

**Taxes** - Reduce most employers' tax rates by reducing their benefit ratio calculation--which is used to compute the tax rate-- by 10%. The idea is to immediately quantify the longer-term savings from the other recommendations.

**Benefits** - Reduce the maximum number of benefit weeks from 26 to 20 and tie the number of weeks available to the unemployment rate. The higher the unemployment rate the more weeks would be available, if the unemployment rate drops, the number of weeks would be reduced. The short-term effect of reducing the number of benefit weeks will be lessened by the current availability of federal UC benefits. After the state-provided 20 weeks, the UC recipient will automatically move into the four federal tiers and a period of temporary extended benefits that are available for 58 weeks. This means the total state and federal benefit is 78 weeks. However, the eligibility for the federal tiers is scheduled to expire January 1, 2012, and any tier a claimant is in after that date is phased out completely by June 9, 2012.

The Governor included unemployment compensation legislation in his budget proposals that contained most of these concepts. The House and Senate have already been discussing UC reform during the pre-session interim committee meetings and legislation (HB 7005 and SB 728) has been introduced that also contains many of these reforms.

The state should make every reasonable effort to reduce future UC tax increases, balanced with the need to restore the health of the UC Trust Fund and supply the state's unemployed with needed benefits. Many of the reforms being considered by the Legislature are needed and should be enacted. However, while mitigating a small part of the pending UC tax increases, they will not help reduce the federal loan balance. Using cost savings to help meet federal loan obligations is a way to help the state's employers without reducing benefits for the unemployed.

The state's Unemployment Compensation Trust Fund must be replenished and made solvent. The methods to accomplish this all involve some pain. Taxes and benefits will have to be examined. Employers have already incurred tax increases and additional increases are unavoidable. While reducing UC benefits is a difficult decision, the Legislature is right to examine that as well.

Using state dollars to pay the federal loans would reduce the pressure on both tax increases and benefit reductions. This approach, along with enacting UC reform legislation currently being considered by the Florida Legislature, can help expedite the restoration of Florida's unemployment compensation system.

## **Appendix A**

### **Unemployment System Overview**

The purpose of the unemployment compensation system is to provide benefits for eligible individuals who become unemployed through no fault of their own. The system is a federal-state partnership. While the system is based on federal law, it is administered by states under state law. States have some flexibility in areas such as benefit eligibility requirements, the amount and duration of benefits and the state tax structure, as long as state law does not conflict with federal law.

Florida's UC program was created by the Legislature in 1937. The Agency for Workforce Innovation administers Florida's UC system and the Florida Department of Revenue is responsible for unemployment tax collection.

#### **Benefits**

Based on a UC recipient's length of prior employment and the amount of wages earned, benefits range from a minimum of \$32 per week to a maximum weekly benefit amount of \$275 for up to 26 weeks. An unemployed person may receive UC benefits equal to 25 percent of wages, but not more than \$7,150 in one year.

Fully federally funded extended and emergency benefits programs currently add 58 weeks to the maximum benefit period. There are four federal "tiers". Eligibility for the federal tiers is scheduled to expire January 1, 2012, and any tier a claimant is in after that date is phased out completely by June 9, 2012.

In order to continue to receive benefits, an individual must be ready, willing, and able to work and must be actively and continually seeking work. Free re-employment assistance is available for UC recipients, provided by One-Stop Career Centers operated by local regional workforce boards. These services include job search counseling and workshops, employment counseling and testing, employability skills enhancement, occupational and labor market information, referrals to potential employers, and job training assistance. When their UC claims are filed, recipients are automatically registered with their local One-Stop Career Center and are required to report to their center.

Claimants can be disqualified from receiving benefits for voluntarily leaving the job without good cause attributable to the employer or when the employee has been discharged for misconduct connected with the job.

## **Taxes**

Florida employers' UC tax obligations are comprised of two separate levies – state and federal. The state tax pays for UC benefits to unemployed Floridians. The federal tax pays for administrative costs, advances (loans) to insolvent state trust funds, one-half of the cost of extended unemployment benefits during periods of high unemployment, and job service programs.

For state taxes, under current law, an employer pays taxes on the first \$7,000 of an employee's wages. The wage base will increase to \$8,500 in 2012 and stay there for three years, then returning to \$7,000. New employers are taxed at the initial rate of 2.7 percent. After an employer is subject to benefit charges for eight calendar quarters, the tax rates are automatically adjusted every year, determined by several factors. The maximum tax rate is 5.4 percent, and the minimum rate could go as low as 0.1 percent, but the minimum rate is currently at 1.03 percent.

The federal tax rate is 6.2 percent, but employers get a credit of 5.4 percent for state taxes paid. This means Florida employers pay a federal tax rate of 0.8%. The federal wage base is also \$7,000.

If a state UC trust fund borrows from the federal government and the loan becomes delinquent, the federal tax credit for the state's employers is reduced by 0.3 percent a year until the loan is repaid. The increased federal tax goes towards repayment of the federal loan principal.

Florida employers are expected to incur a reduction in the federal UC tax credit. The Office of Economic and Demographic Research (EDR) estimates that the loss of the federal credit will cost employers \$139.8 million in January 2012, \$290.4 million in January 2013, and \$451.8 million in January 2014, for a total of \$882 million. The forecast estimates that the federal advances will be completely repaid in 2014.

So states such as Florida are facing a double tax increase--increased state taxes to restore the UC trust fund and increased federal taxes to repay federal advances.

## **Calculating Tax Rate Changes**

Florida's UC tax system is designed to respond to changing economic conditions. An individual employer's tax rate determined by three factors – an experience rating, socialized costs and a trust fund solvency factor.

The most significant factor in determining an employer's tax rate is the benefit ratio--referred to as the experience rating. The employer has some control over this factor because it reflects

benefit payments to former employees. Layoffs result in increased benefit payments which in turn result in a higher experience rating and a higher tax rate. Employers who lay off the most workers pay the highest tax rates and employers with no layoffs pay the minimum rate. This promotes the concept that employers with higher unemployment compensation costs should contribute more to provide benefits. The experience rating is based on an employer's prior three years experience.

Socialized costs are those costs that are cannot charged to a particular employer. These include excess benefit payments that are attributable to employers at the maximum tax rate and benefits paid in error. These costs are spread to all other employers (except those at initial rate). As more employers reach the top tax rate, taxpayers below that tax rate increasingly subsidize the costs attributable to taxpayers at the maximum tax rate.

Tax rates are also affected by automatic adjustments to keep the UC Trust Fund solvent. Triggers are used to increase rates if the Trust Fund balance drops below a certain percentage of the tax base and to decrease rates if the balance rises above a certain threshold.

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Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: in its first two decades alone, policymakers and government employees implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than \$6.2 billion -- approximately \$1,067 in added value for every Florida family, according to an independent assessment by Florida State University.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It is the only statewide organization devoted entirely to Florida taxing and spending issues. Its research and recommendations are reported on regularly by the statewide news media.

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