Potential 2016 Federal Unemployment Tax Act (FUTA) Credit Reductions

Updated: August 2016

These states had Title XII advance balances on January 1, 2016 and are potentially subject to a reduction in FUTA credit on their IRS Form 940 for 2016, if the outstanding advance is not repaid by November 10, 2016:

State[1]	2016 Potential Credit Reduction Due to Outstanding Advance[2]	Preliminary Estimate 2016 Potential "2.7 add-on" [3]	Preliminary Estimate 2016 Estimated "BCR add-on"[4]	Preliminary Estimate 2016 Potential Total Credit Reduction[5]	Applied For FUTA Credit Reduction Relief [6]
California	1.8%	0.0%	0.4%	2.2%	BCR Waiver
Connecticut	1.8%	0.0%	0.1%	1.9%	
Ohio	1.8%	0.0%	0.3%	2.1%	BCR Waiver
Virgin Islands	1.8%	0.0%	1.3%	3.1%	BCR Waiver

(1) These states have passed at least two consecutive January 1's with an outstanding Federal advance and are therefore subject to a FUTA credit reduction.

(2) For each consecutive January 1 a state passes with an outstanding advance, following the second one, employers in the state are subject to an additional 0.3% reduction in their FUTA credit.

(3) Following their third consecutive January 1 with an outstanding advance states are subject to an additional FUTA credit reduction called the 2.7 add-on. A description of this add-on is in FUTA 3302(c)(2)(B). This value was preliminarily estimated based on extrapolated wages and tax contributions for the third and fourth quarter of 2015.

(4) These states are also potentially subject to the Benefit Cost Rate (BCR) additional credit reduction formula for having passed five consecutive January 1's with an outstanding Federal advance- FUTA section 3302 (c) (2). This value was preliminarily estimated based on extrapolated wages and tax contributions for the third and fourth quarter of 2015.

(5) The potential FUTA credit reduction for 2016 is calculated by adding the credit reduction due to having an outstanding advance plus the reduction from the 2.7% add-on or the BCR add-on, which can be waived and replaced by the 2.7 add-on, FUTA section 3302(c)(2)(C).

(6) A state may apply for relief from a reduction in its FUTA credit under section FUTA 3302. The deadline for application of relief for all types was July 1, 2016. Final determination of the FUTA credit reduction will not be made until following the Nov. 10, 2016 repayment deadline.

FUTA Credit Reduction and what it encompasses.

What is a credit reduction state?

A state is a credit reduction state if it has taken loans from the federal government to meet its state unemployment benefits liabilities and has not repaid the loans within the allowable time frame. A reduction in the usual credit against the full FUTA tax rate means that employers paying wages subject to UI tax in those states will owe a greater amount of tax.

The FUTA tax levies a federal tax on employers covered by a state's UI program. The standard FUTA tax rate is 6.0% on the first $7,000 of wages subject to FUTA. The funds from the FUTA tax create the Federal Unemployment Trust Fund, administered by the United States Department of Labor (DOL).

Generally, employers may receive a credit of 5.4% when they file their Form 940 (PDF), Employer's Annual Federal Unemployment (FUTA) Tax Return, to result in a net FUTA tax rate of 0.6% (6.0% - 5.4% = 0.6%).

Some states take Federal Unemployment Trust Fund loans from the federal government if they lack the funds to pay UI benefits for residents of their states.

If a state has outstanding loan balances on January 1 for two consecutive years, and does not repay the full amount of its loans by November 10 of the second year, the FUTA credit rate for employers in that state will be reduced until the loan is repaid.

The reduction schedule is 0.3% for the first year the state is a credit reduction state, another 0.3% for the second year, and an additional 0.3% for each year thereafter that the state has not repaid its loan in full. Additional offset credit reductions may apply to a state beginning with the third and fifth taxable years if a loan balance is still outstanding and certain criteria are not met.

DOL runs the loan program and announces any credit reduction states after the November 10 deadline each year. DOL has information about the credit reduction states and loan balances on the UI Statistics page of its Department of Labor website.

How does the credit reduction affect employment taxes?

The result of being an employer in a credit reduction state is a higher tax due on the Form 940.

For example, an employer in a state with a credit reduction of 0.3% would compute its FUTA tax by reducing the 6.0% FUTA tax rate by a FUTA credit of only 5.1% (the standard 5.4% credit minus the 0.3% credit reduction) for an effective FUTA tax rate of 0.9% for the year.

Any increased FUTA tax liability due to a credit reduction is considered incurred in the fourth quarter and is due by January 31 of the following year.

Employers who think they may be in a credit reduction state should plan accordingly for the lower credit. The IRS includes the credit reduction states, the applicable credit reduction rates, and an example in the

Schedule A (Form 940) (PDF), Multi-State Employer and Credit Reduction Information. The Instructions for Form 940 (PDF) also has information about the credit reduction and deposit rules.

Reporting the credit reduction

Employers calculate the credit reduction using the Schedule A (Form 940).

On Schedule A (Form 940), every state has:

- A checkbox (to be checked if an employer paid state unemployment taxes to that state)
- A box for the FUTA taxable wages the employer paid in that state (to be filled in if the state is a credit reduction state and the employer paid wages subject to UI tax in the state).

The following employers use the Schedule A (Form 940):

- Employers that paid FUTA taxable wages and UI tax in more than one state
- Employers that paid FUTA taxable wages and UI tax in any credit reduction state, even if the employer is a single-state employer. These employers report the FUTA taxable wages and multiply by the credit reduction rate (0.3%, 0.6%, 0.9%, etc) to calculate the total credit reduction, which the employer carries forward to Form 940.

If an employer paid UI taxes to more than one state, it must check all of those states on Schedule A (Form 940), whether the states are credit reduction states or not. Additionally, for states that are credit reduction states, employers must enter the FUTA taxable wages the employer paid in that state, even if the employer paid wages in only one state. However, FUTA taxable wages that are excluded from UI are not subject to credit reduction. For more information, see the Instructions for Schedule A (Form 940) (PDF).

Reference: IRS.GOV *Last Reviewed or Updated: 02-Jun-2016*