



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
CHIEF COUNSEL

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The Honorable Arlen Specter
United States Senator
9400 Federal Building
600 Arch Street
Philadelphia, PA 19106

Attention:

Dear Senator Specter:

I am responding to your inquiry, dated February 9, 2009, on behalf of your constituent, _____, asked about the federal unemployment tax and the Pennsylvania state unemployment tax. While we cannot provide specific answers to his questions relating to Pennsylvania state unemployment tax issues, we have provided contact information for the state.

Unemployment Insurance System

Unemployment insurance is a joint federal-state government program designed to provide cash benefits during temporary periods of unemployment. The Unemployment Trust Fund (UTF) provides a portion of extended unemployment benefits during high unemployment, provides a loan fund for states when state unemployment funds are insufficient to pay state unemployment benefits, and funds federal and state administrative costs for operating the unemployment insurance system. Taxes the federal government collects under the Federal Unemployment Tax Act (FUTA), fund the UTF [sections 3301 - 3311 of the Internal Revenue Code (the Code)]. Taxes a state collects finance the unemployment benefits for unemployed workers in that state.

Wages and Exemptions

The amount of wages an employer pays for employment during the year determines the FUTA tax an employer owes for the calendar year. The FUTA and the states may have different definitions of "employment," "employee," "employer," and "wages." Thus

certain payments may be exempt from FUTA while subject to state unemployment tax. You can find information on FUTA tax and payments exempt from FUTA in *Publication 15 (Circular E), Employer's Tax Guide*, available on www.irs.gov.

Tax Rates and Wage Bases

The amount of FUTA tax is equal to a percentage of total wages paid during the year for employment. The FUTA tax rate is 6.2 percent. The 6.2 percent rate is the sum of the 6.0 percent base rate and the 0.2 percent surtax. In calculating liability for FUTA tax, an employer generally receives credit for contributions into state unemployment funds up to a maximum of 90 percent of the 6.0 percent base rate, or 5.4 percent. Thus, the net federal tax rate becomes 0.8 percent (6.2 percent - 5.4 percent = 0.8 percent) [sections 3301 and 3302(c) of the Code].

States may tax employers at varying rates based on the individual employer's experience with unemployment. The state unemployment tax rate may be called an "experience rate" or "contribution rate."

FUTA tax applies to the first \$7,000 of taxable wages paid during a calendar year to each employee [section 3306(b)(1) of the Code]. The \$7,000 wage amount is called the federal wage base. The state wage base may be different, often higher than the federal wage base.

Form 940

Employers use *Form 940*, Employer's Annual Federal Unemployment Tax Return, to report FUTA wages and to compute the tax. Generally, an employer will multiply FUTA wages by .008 (0.8 percent) to determine FUTA tax liability. Beginning in 2006, employers make some adjustments using the worksheet in the *Instructions for Form 940* rather than directly on the *Form 940*. An employer will use the worksheet, if some of the taxable FUTA wages an employer paid were excluded from state unemployment tax or if the employer paid state unemployment taxes late. Both the *Form 940* and the *Instructions for Form 940* are available on www.irs.gov.

Credit for State Unemployment Tax Paid to a State Unemployment Fund

In calculating liability for FUTA tax, an employer gets a credit for amounts paid to a state unemployment fund. State unemployment taxes are sometimes called "contributions." These contributions are payments that a state requires an employer to make to its unemployment fund for the payment of unemployment benefits. They do not include:

- Any payments deducted or deductible from employees' pay;

- Penalties, interest, or special administrative taxes; and
- Voluntary amounts paid to get a lower assigned state experience rate.

An employer may receive an additional credit above the amount actually paid to the state if the employer's experience rate (and thus the tax paid to the state) is below the state's normal tax rate or 5.4 percent, whichever is lower [section 3302(b) of the Code].

The amount of the credit is reduced if the state has not timely repaid loans from the UTF. To calculate the credit and any credit reduction, see *Form 940*, the worksheet in the *Instructions for Form 940*, and *Schedule A (Form 940)*, Multi-State Employer and Credit Reduction Information.

Pennsylvania Unemployment Tax

For information regarding Pennsylvania's contribution rate, wage base, and exemptions, including whether certain exemptions are no longer allowed, I suggest contact the Pennsylvania Department of Labor & Industry at:

Pennsylvania Department of Labor & Industry
7th and Forster Street
Harrisburg, PA 17121-0001
(717) 787-7679
www.dli.state.pa.us

I hope this information is helpful. If you need further information, please contact me or
at () .

Sincerely,

By:

Nancy J. Marks
Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)