Members Brief

An informational brief prepared by the LSC staff for members and staff of the Ohio General Assembly

Author: Kelly Bomba, Attorney
Reviewer: Julie Rishel, Division Chief

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Financing Unemployment Benefits

This brief explains how unemployment benefits are funded under normal conditions and funding options for when Ohio's Unemployment Compensation Fund is unable to pay benefits.

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Background – federal-state partnership

The unemployment compensation system is funded through a federal-state partnership. If an employer pays contributions into an "approved" state system, the employer receives a 90% credit on the tax levied under the Federal Unemployment Tax Act (FUTA).[1] Additionally, the federal government pays a share of a state's administrative costs to run an approved state program. Approval requires adherence to various federal law and U.S. Department of Labor regulations.[2] Ohio has an approved unemployment compensation system.[3] Thus, Ohio employers currently receive the full FUTA tax credit.

[1] 26 United States Code (U.S.C.) 3301 et seq.

[2] 26 U.S.C. 3301, 3302, and 3304 and 42 U.S.C. 502 and 503.

[3] R.C. Chapter 4141.

How the system is funded under "normal" conditions

For employers to receive the FUTA tax credit and the state to receive administrative funding, a state must establish a state unemployment compensation fund to pay for unemployment benefits. That fund, with certain exceptions, must be funded by employers based on an experience-rating system by which individual employers' contribution rates are based on their "experience" with the risk of unemployment.[4] The fund Ohio uses to pay unemployment benefits is known as the Unemployment Compensation Fund.[5]

Ohio's unemployment system has two types of employers: contributory employers and reimbursing employers. Employers who are assigned a contribution rate and make contributions to the fund, as discussed below, are contributory employers. Most private sector employers are contributory employers.[6] Certain employers are allowed to reimburse the fund after benefits are paid; they are known as "reimbursing employers."

Employer contributions

In accordance with federal law, the fund is funded by employer contributions based on an experience rating system. There are various formulas that states use to determine an employer's experience with unemployment. Ohio uses a formula known as the "reserve-ratio formula" to determine employer experience (the majority of states use a reserve-ratio formula). Under a reserve-ratio formula, experience is generally determined as follows:

$$\frac{\textit{The employer's contributions} - \textit{Benefits attributable to the employer}}{\textit{The employer's taxable payroll}}$$

The reserve ratio is then applied to a rate schedule to determine the employer's base contribution rate.[7] Ohio exempts new employers that do not have enough experience with the unemployment system from experience rating. Instead, exempt new employers are assigned a standard contribution rate. Contribution rates are determined annually on July 1 (the "computation date") and apply to the following calendar year.[8]

The Director of Job and Family Services, who administers Ohio's unemployment compensation system, maintains a separate account for each employer to keep track of each employer's contributions, benefits attributable to that employer, and the employer's payroll.

[4] 26 U.S.C. 3302, 3303, and 3304.

[5] R.C. 4141.09.

[6] R.C. 4141.01(L).

[7] R.C. 4141.25 and U.S. Department of Labor, Comparison of State Unemployment Laws 2022: Financing (PDF), which is available on the website of the Department's Employment and Training Administration, dol.gov/agencies/eta, by clicking on "Program Areas: Unemployment Insurance," followed by "UI Legislation," then "Comparison of State UI Laws," and finally "Most Recent Comparison of State UI Laws."

[8] R.C. 4141.25 and 4141.01(T) and (U).

Ohio allows an employer to make voluntary contributions to the employer's account, which can lower the employer's contribution rate.[9]

To determine the amount of an employer's contribution, an employer's contribution rate (taken together with any solvency-related taxes described below) is applied to the wages of each of the employer's employees. Contributions are payable on employee wages only up to the "taxable wage base," which is currently the first $9,000 of an employee's wages paid in a year. Wages paid by an employer to a particular employee that exceed the taxable wage base are not subject to contribution. Contributions are paid on a quarterly basis.[10]

Reimbursing employers

A reimbursing employer reimburses the fund (after the fact) for any benefits attributable to the employer. Reimbursements to the fund from a reimbursing employer are known as "payments in lieu of contributions."[11] Only three types of employers may elect to be reimbursing employers: public employers, Indian tribes, and nonprofit organizations. These employers are not subject to the FUTA tax, so they would not benefit from the FUTA tax credit available to employers that make contributions to an approved state system.[12]

Federal law requires states to allow these employers to make this election to maintain the FUTA tax credit for the state's employers and administrative funding for the state's unemployment system.[13] It appears that a state may not expand the types of employers who may be a reimbursing employer without jeopardizing the state's FUTA tax credit and administrative funding because federal law generally requires employers to make contributions based on experience unless an exemption applies.[14]

The status of being either a contributory or reimbursing employer each has advantages and disadvantages. But from a systemic point of view, the reimbursing option has a disadvantage because no "cushion" of money is added to a state's unemployment compensation fund to help deal with the higher payout of benefits during a deteriorating economy.

Mutualized account and mutualized tax

Ohio has other mechanisms to help maintain fund solvency. Ohio law creates a mutualized account within the fund that generally is used to keep the fund balance at a safe level and to cover the payment of unemployment benefits when responsibility for that payment, although justified, cannot be attributed to an individual employer. A "mutualized tax" (a type of surtax) is applied uniformly to all contributory employers when, as of July 1, the charges to the mutualized account exceed credits to the account. The excess charges are recovered in the following tax year by the mutualized tax. The mutualized tax does not affect an employer's

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[9] R.C. 4141.24.

[10] R.C. 4141.01(G) and 4141.25 and Ohio Administrative Code 4141-9-02 and 4141-11-02.

[11] R.C. 4141.01(L), 4141.241, 4141.242, and 4141.25.

[12] 26 U.S.C. 3306(c)(7) and (8).

[13] 26 U.S.C. 3304(a)(6)(B) and 3309(a)(2).

[14] 26 U.S.C. 3303(a).

experience rating.[15] From the start of the COVID-19 pandemic in March 2020, through November 29, 2020, unemployment benefits paid as a result of the pandemic were charged to the mutualized account, rather than to individual contributory employer accounts.[16] As a result, a mutualized tax rate of 0.5% was triggered for 2021 and 2022.[17]

Minimum safe level tax

Also, Ohio law includes a requirement for calculation of a minimum safe level (MSL). If the fund, as of July 1, is above or below the MSL, the contribution schedule specified in statute for the next calendar year is adjusted based on the percentage that the fund balance is above or below the calculated MSL.[18] This additional cost to employers is known as the MSL tax. The fund is more than 60% below the minimum safe level as of the computation date for 2022 rates. As a result, there was an across-the-board MSL tax increase for 2022 to help rebuild the fund. The MSL tax revenue is split equally between the mutualized account and the employer's account.[19]

What happens if Ohio's Unemployment Compensation Fund is unable to pay benefits?

Despite all the features designed to ensure that money to pay unemployment benefits is readily available when needed, several periods of distressed economic conditions have existed that pushed states' unemployment compensation funds into insolvency.

What happens if such a serious situation develops? Are people denied benefits? No. It appears that, under the federal-state partnership, a state must find some way to pay unemployment benefits. FUTA allows states to determine the amount of unemployment benefits they will pay. However, for a state system to comply with FUTA, it would appear that the state has to be able to pay whatever unemployment benefit amount the state establishes.[20]

Potential immediate funding options if the fund is insolvent

To continue paying unemployment benefits if the fund is insolvent, Ohio must find a way to immediately inject funds into the system. Two sources appear to need legislative action: (1) using funds from another state source or (2) issuing bonds.

However, tapping other state revenue sources could risk the state losing its "approved" status, if the funding mechanism does not satisfy federal requirements regarding how a state's system must be established for employers to receive the FUTA tax credit. Furthermore, the state may not be able to use other sources because Ohio limits how those other sources may be spent.

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[15] R.C. 4141.24 and 4141.25.

[16] Section 19 of H.B. 197 of the 133rd General Assembly.

[17] Ohio Department of Job and Family Services, Contribution Rates, which is available by conducting a keyword search for "mutualized rate" on the Department's website: jfs.ohio.gov.

[18] R.C. 4141.25.

[19] Ohio Department of Job and Family Services, Contribution Rates.

[20] See 26 U.S.C. 3304, which requires a state to establish an unemployment compensation fund and to use that fund, with some exceptions, only for the purpose of paying unemployment benefits.

For example, the Ohio Constitution and implementing statutes limit using the State Insurance Fund for purposes unrelated to workers' compensation.[21]

Also, based on an Ohio Supreme Court decision, it does not appear that Ohio could issue bonds to cover the shortfall without amending Ohio's Constitution. In the late 1980s, the General Assembly amended the Unemployment Compensation Law to permit the issuance of bonds to repay the outstanding federal loans Ohio received. The Supreme Court held that the bonds to be issued did not fall under any exception to the prohibition against creating debt that exceeds $750,000, and thus the debt would violate Ohio's Constitution.[22]

Another option, however, which does not require constitutional amendment or legislation, is to obtain an advance (loan) from the federal government to pay unemployment benefits, as discussed below.

Obtaining a federal advance

Federal law permits a state's governor, or the governor's designee (in Ohio, the Director of Job and Family Services) to apply to the U.S. Secretary of Labor to receive three-month advances for payment of unemployment benefits if the amount in the state's unemployment compensation fund is insufficient to pay those benefits.[23] Federal law requires states to repay federal advances according to specified deadlines. Interest accrues on the advances unless certain circumstances apply.[24] If a state has an outstanding advance balance as of January 1 for two consecutive years, the state has until November 10 of the second year to pay off that balance. If the state does not pay off the balance by that date, the FUTA tax credit for employers in that state is gradually reduced every year that the state continues to carry the balance. To avoid certain increases in the reduction, the state cannot take any action, whether legislative, administrative, or judicial, that results in either (1) a reduction in the state's unemployment tax effort or (2) a decrease in the net solvency of its unemployment compensation system.[25] Ohio currently does not have any outstanding advances.[26]

Ohio's recent history with federal advances

Ohio has borrowed federal advances in the recent past to pay unemployment benefits. In January 2009, the fund became insolvent after an increase in unemployment during the Great

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[21] See, e.g., Ohio Const., Art. II, Sec. 35; R.C. 4123.30; and *Thompson v. Industrial Commission*, 1 Ohio St.3d 244 (1982); *Corrugated Container v. Dickerson*, 171 Ohio St. 289 (1960); *Welsh v. Industrial Commission*, 136 Ohio St. 387 (1940)).

[22] *Shkurti v. Withrow*, 32 Ohio St.3d 424 (1987).

[23] 42 U.S.C. 1321; 20 Code of Federal Regulations (C.F.R.) 606.4; and R.C. 4141.43(F).

[24] 42 U.S.C. 1322. See also 20 C.F.R. 606.32.

[25] 26 U.S.C. 3302(c)(2) and (f) and 20 C.F.R. 606.20 and 606.21.

[26] U.S. Department of Labor, UI Budget, which is available on the website of the Department's Employment and Training Administration, dol.gov/agencies/eta, by clicking on "Program Areas: Unemployment Insurance," followed by "UI Budget."

Recession. Ohio borrowed a total of $3.39 billion[27] from the federal government in 2009 through 2014 and paid interest on the loan totaling $257.7 million.[28] This debt was repaid on August 30, 2016, following the passage of H.B. 390 of the 131st General Assembly. That act required a one-time loan from unclaimed funds to pay off the debt, and required each experience-rated contributory employer to pay an increased contribution rate in 2017 to repay the loan from unclaimed funds.[29]

The FUTA tax rate, before factoring in any credit against the tax, is 6% on the first $7,000 of each employee's taxable wage ($420 per employee). When a state has an approved system and no outstanding advances, the state's employers receive a tax credit of 5.4%, resulting in a 0.6% FUTA tax rate ($42 per employee). In contrast, before Ohio paid off the balance of the advances in 2016, the FUTA tax credit for Ohio employers was gradually reduced. In 2015, Ohio's employers were subject to a 2.1% FUTA tax rate ($147 per employee).[30]

The fund became insolvent again in 2020 as a result of unprecedented unemployment during the beginning of the COVID-19 pandemic. Beginning in June 2020, Ohio began using federal advances to pay for unemployment benefits. By August 2021, Ohio had an outstanding federal loan balance of close to $1.5 billion. This debt was repaid on September 1, 2021, following the passage of H.B. 168 of the 134th General Assembly. That act used money provided under the federal American Rescue Plan Act (ARPA) to repay the debt.[31] The debt was repaid before a gradual loss of the FUTA tax credit for Ohio's employers could be triggered. Although the debt was repaid, the fund remains in a precarious position. Due to the low amount of reserves, a recession could deplete the fund.[32]

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[27] U.S. Department of Labor, State Unemployment Insurance Trust Fund Solvency Report 2019 (PDF), which is available on the Unemployment Insurance Data Dashboard of the Employment and Training Administration, oui.doleta.gov/unemploy/DataDashboard.asp, click on "Trust Fund Solvency: State Solvency Report."

[28] See page 52 of LSC's Greenbook: LSC Analysis of Enacted Budget: Department of Job and Family Services August 2017 (PDF), which is available on LSC's website, lsc.ohio.gov, by clicking on "Budget Central," and then on "Previous General Assemblies: 132nd General Assembly (2017-2018)."

[29] Section 741.10 of H.B. 390 of the 131st General Assembly.

[30] 26 U.S.C. 3301 and 3302 and U.S. Department of Labor, Historical FUTA Credit Reductions, which is available on the website of the Department's Employment and Training Administration at oui.doleta.gov/unemploy/futa_credit.asp."

[31] Laura A. Bischoff, The Columbus Dispatch, Ohio using federal money to pay back $1.5B to the feds for unemployment compensation loan, September 1, 2021, which is available by conducting a keyword search of "unemployment compensation loan" on the Columbus Dispatch's website: dispatch.com.

[32] U.S. Department of Labor, State Unemployment Insurance Trust Fund Solvency Report 2022 (PDF), which is available on the Unemployment Insurance Data Dashboard of the Department's Employment and Training Administration, oui.doleta.gov/unemploy/DataDashboard.asp, click on "Trust Fund Solvency: State Solvency Report."