

Raise and Index Taxable Wage Bases: Stronger Financing for UI



What is it?

Only a portion of employee wages are subject to UI payroll taxes. That portion is called the “taxable wage base.” Federal law requires that states use an annual taxable wage base of at least \$7,000 per employee. A majority of states have kept their UI taxable wage bases low, at or below \$10,000 of wages per year.

Higher taxable wage bases provide a stronger financing foundation for UI. Raising taxable wage bases gives states the ability to replenish their trust funds more quickly. Indexing – the yearly adjustment of state taxable wage bases – helps state trust funds keep pace with growth in wages. In contrast to the majority of states with fixed wage bases, 16 states have indexed taxable wage bases. As a group, these 16 states have higher taxable wage bases, bigger trust fund reserves, and better-financed unemployment programs than states without indexing. While indexing is the best practice for strong UI financing, no state has adopted indexing for its taxable wage base since 1986. If indexing is not feasible, states with less solvent UI trust funds should consider raising their taxable wage bases as the next best step toward improved UI financing.



Key arguments in favor

Indexing keeps program financing in line with growth in benefits. The risk insured under UI programs is the loss of wages. Wages grow overall each year and, as a result, weekly unemployment benefit amounts grow each year as well. In fact, a majority of states index their weekly maximum benefit amounts to growth in average wages, thus tying growth in benefit levels directly to rising wage levels. A low taxable wage base means that a state must finance higher benefit payments on a narrower portion of its wages; this causes increasing tension between benefit levels and revenue-generating capacity over time.

Higher taxable wage bases provide a stronger financial footing for UI programs. Over time, the ability of a state’s UI financing mechanism to produce sufficient revenue is greatly assisted by subjecting more of its wages to UI taxation. States with higher taxable wage bases can recover from or avoid insolvency better than states with lower taxable wage bases. Indexing has a proven record in raising taxable wage bases. In 2003, all states with taxable wage bases over \$15,000 were states with indexing. None of the 31 states with taxable wage bases at \$10,000 or below used indexing.



Key arguments against and responses to them

Opponents say: Raising taxable wage bases is nothing more than a tax hike.
Response: Employer groups typically oppose either indexing or raising taxable wage bases, arguing that this amounts to a tax increase. Not necessarily, as any

increased revenues resulting from higher wage bases quickly reduce tax rates, depending upon each state's UI financing mechanisms. Moreover, higher taxable wage bases distribute UI taxes more fairly across employers, reducing the disproportionate tax load on lower-wage employers.

Opponents say: Tax bases should be raised by state legislatures only when needed, not automatically indexed each year.

Response: State legislatures have great difficulty adjusting taxable wage bases due to employer resistance. As a result, the majority of states tax a very low proportion of wages under UI and this proportion declines each year. History shows that indexing is the best way for states to ensure an adequate taxable wage base.

References

Phillip B. Levine, *Financing Benefit Payments*, in, *UNEMPLOYMENT INSURANCE IN THE UNITED STATES: ANALYSIS OF POLICY ISSUES*, (Christopher J. O'Leary & Stephen A. Wandner, ed., Upjohn Institute, 1997).

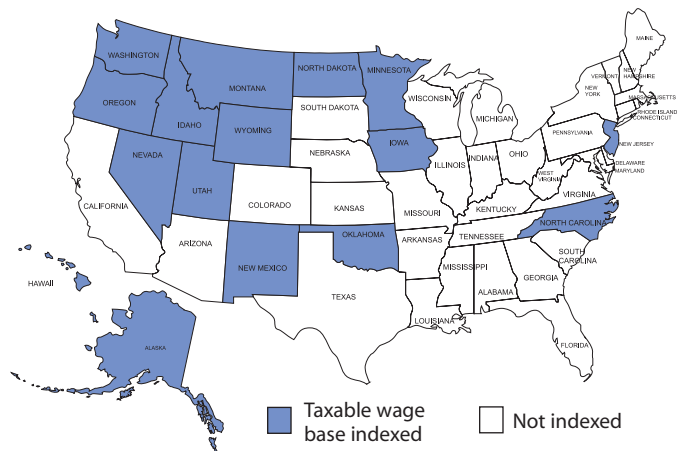
INDEXED STATE TAXABLE WAGE BASES: TAKING A SIGNIFICANT STEP TOWARD BETTER UI FINANCING, NATIONAL EMPLOYMENT LAW PROJECT FACTSHEET (2004), available at www.nelp.org.

Wayne Vroman, *TOPICS IN UNEMPLOYMENT INSURANCE FINANCING*, (Upjohn Institute 1998).



Which states do it?

In 2004, 16 states used indexed taxable wage bases in their UI programs. Of these, Hawaii and Idaho index their wage bases at 100 percent of their state average annual wage, while other states use different indexing formulas ranging downward to 50 percent of average wages (North Carolina and Oklahoma).



Model legislation

Hawaii

(b) [T]he term "wages" does not include remuneration paid with respect to employment to an individual by an employer during any calendar year which exceeds the average annual wage, rounded to the nearest hundred dollars, for the four calendar quarter period ending on June 30 of the preceding year. The average annual wage shall be computed as follows: on or before [pick date depending upon state agency's collection of wage data] of each year the total remuneration paid by employers, as reported on contribution reports on or before such date, with respect to all employment during the four consecutive calendar quarters ending on June 30 of such year shall be divided by the average monthly number of individuals performing services in such employment during the same four calendar quarters as reported on such contribution reports and rounded to the nearest hundred dollars.

HAW. REV. STAT. § 383-61