

## Key Elements of the U.S. Tax System

What is the unemployment insurance trust fund, and how is it financed?

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**Q. What is the unemployment insurance trust fund, and how is it financed?**

**A. Unemployment insurance assists workers who become involuntarily unemployed and meet specified eligibility requirements. Unemployment insurance programs are run as federal-state partnerships financed through payroll taxes.**

The federal unemployment insurance (UI) trust fund finances the costs of administering unemployment insurance programs, loans made to state unemployment insurance funds, and half of extended benefits during periods of high unemployment. Unemployment insurance programs pay benefits to covered workers who become involuntarily unemployed and meet specified eligibility requirements, such as actively looking for work.

UI is structured as a partnership between the federal government and states and territories. States and territories set the parameters of their unemployment programs within federal guidelines, including payroll tax rates and wage bases for covered workers. State unemployment insurance taxes are paid by employers and remitted to the federal UI trust fund, where each state has a separate account for covering normal unemployment insurance benefits.

In addition, a 6 percent federal payroll tax, known as the Federal Unemployment Tax Act (FUTA) tax, is levied on the first \$7,000 of covered workers' earnings. Employers remit the tax but can claim credits against 5.4 percentage points of FUTA taxes paid in states with unemployment programs that meet federal standards (currently all states). The effective FUTA tax rate thus shrinks to 0.6 percent, or a maximum of \$42 per worker. The federal fund is used to cover administrative expenses, make loans to states that deplete their own reserves, and cover half of extended unemployment benefits made available when states experience prolonged periods of high unemployment. (States cover the other half of these extended benefits.)

States can borrow from the federal fund if their own reserves are insufficient. When the Great Recession and the long period of high unemployment that followed hit state UI reserves particularly hard, 36 states borrowed from the federal fund. By the start of 2018, all states but California (and the US Virgin Islands) had repaid their outstanding balances. Loans from the federal fund can be

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repaid by reducing the credit employers can claim against FUTA taxes and through other add-ons. States can also take private loans to shore up reserves. At the beginning of 2018, three states—Michigan, Pennsylvania, and Nevada—had outstanding private loans.

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### Further Reading

Office of Unemployment Insurance. "[Unemployment Insurance Tax Topic.](#)" Updated July 10, 2015. Washington, DC: US Department of Labor.

———. 2020a. "[State Unemployment Insurance Tax Measures Report, 2019.](#)" "[Significant Measures of State Unemployment Tax Systems: 2017.](#)" Washington, DC: US Department of Labor.

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