OFFICE OF THE CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Dear :

I am responding to your inquiry about the Federal Unemployment Tax Act (FUTA) tax rate for Nevada businesses in 2012. Senator Reid wrote to us on your behalf and asked us to respond directly to you. In particular, you asked whether delays Nevada has had in paying back federal loans would reduce credits available to Nevada businesses to apply against the FUTA tax rate in 2012. Unfortunately, the Department of Labor (DOL) has not yet determined whether Nevada will have a credit reduction for 2012. However, I can provide the following general information about the law, which I hope is helpful.

The FUTA provides for cooperation between the federal and state governments in the establishment and administration of a federal-state unemployment compensation program. Under this dual employment compensation system, the federal and state governments levy payroll taxes against employers. Each state establishes its own tax rates, taxable wage base, and reporting requirements. For 2012, the FUTA tax rate is 6 percent and applies to the first $7,000 in wages that an employer pays to each employee during the year. The employer reports FUTA tax to the federal government on Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return.

Generally, an employer can take a credit against its FUTA tax for the year for amounts it paid as state unemployment tax. The credit may be as much as 5.4 percent of the generally applicable 6 percent FUTA tax rate. If an employer is entitled to the maximum 5.4 percent credit, the employer's FUTA tax rate after the credit is 0.6 percent.

Generally, an employer is entitled to the credit (up to the lesser of the state unemployment tax rate paid or 5.4 percent) if the employer paid its state unemployment taxes in full, on time, and on the same wages as are subject to FUTA tax, and as long as the state is not determined to be a credit reduction state.

A “credit reduction” state is a state that has not repaid the money it borrowed from the federal government to pay unemployment benefits. If an employer is entitled to the maximum 5.4 percent credit, but has a requirement to pay state unemployment tax in a credit reduction state, the employer must reduce its credit by a certain amount. As a result, the FUTA tax rate of an employer that pays wages subject to the unemployment tax laws of a credit reduction state will be higher than 0.6 percent.

As I mentioned earlier, the DOL determines the credit reduction states for each year. The list of credit reduction states and each state’s credit reduction rate are generally available in November of the relevant year. Employers in credit reduction states must use the Schedule A (Form 940) to compute the credit reduction and attach the Schedule A to Form 940. More information on credit reduction, including an example on how to calculate the credit reduction, is available on the Schedule A (Form 940).

I hope this information is helpful. If you have additional questions, or need further information, please call , identification number , at .

Sincerely,

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Paul J. Carlino
Chief, Employment Tax Branch 1
Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)

cc: Senator Harry Reid