

State Unemployment Insurance – Significant Increases Require Immediate Attention and Planning By Hawaii Businesses

With all of the talk in the news about how the income tax, TAT, conveyance tax, tobacco tax, etc., are all going up because of legislative action, there has been less focus about taxes that are going to go up because of inaction. But they will hit us also, and soon.

One example of this is one that the newspapers have picked up. Currently there is an exemption from the general excise tax on ethanol-blended gasoline. When the law was last amended in 2007, a sunset date of June 30, 2009, was placed on the exemption. That means when it is a minute past midnight on July 1st, the exemption disappears, and gasoline is once again subject to the general excise tax. The gasoline retailers all know this, so we all can expect some more pain at the pump when that day dawns.

Another, lesser known but no less dramatic, tax increase is going to affect all Hawaii employers on January 1, 2010. This increase affects the “contributions” – actually a tax because employers are forced to pay them – that go into the state unemployment insurance (SUI) fund. Here’s why.

In 2007, the Legislature passed and the Governor signed Act 110. This Act temporarily increased state unemployment benefits from 70% to 75% of the average weekly wage. Perhaps to placate employers who were concerned about paying for those benefits, the Act also made certain temporary reforms to the SUI tax. The Act temporarily freezes the maximum taxable wage base at \$13,000. It also redefined the “adequate reserve fund” at 12 months rather than 18 months of expected benefits payable. This number, the adequate reserve fund level, is important because the ratio of current reserve fund (what the State actually has on hand to pay these benefits) to the adequate reserve fund is used to set the SUI tax rate.

Act 110 sunsets at the end of 2010, at which point the old taxable wage base, and old definition of adequate reserve fund, kicks in. The wage base, however, is unfrozen if the current reserve fund falls below the adequate reserve fund level. The current reserve fund recently has had lots of payouts because of workers who have lost their jobs due to the current economy. The Hawaii Employers’ Council has told us, and the Department of Labor and Industrial Relations has confirmed, that the reserve fund has in fact dropped below the adequate amount this year. What that means is that effective January 1, 2010, the maximum number of dollars per employee that will be subject to SUI tax will rise from \$13,000 to something closer to \$40,000.

Furthermore, prior to the recent spate of layoffs, the current reserve fund was large enough so that the rate schedule used was Schedule A, the lowest rate (on a scale of A through H.) Given that the current reserve fund has dropped below

the adequate reserve fund level, we will be in Schedule D, at best, next year. The Department, however, is speculating that we might be using Schedule E or F.

Finally, we should keep in mind that absent legislative intervention, the adequate reserve fund number goes back to 18 months of benefits in 2011. This means that 2011 is likely to be another year in a high tax schedule even if the 2010 tax increase replenishes the fund to its former glory: recall that in 2006, before these “temporary reforms” were enacted, we were in Schedule C.

What does this all mean? We have put together a few scenarios to illustrate this graphically. We assume an employer with 100 employees, all of whom make \$40,000 or more. In 2009, only \$13,000 per employee was taxed under Schedule A. We look at a new employer (reserve ratio of zero), employers with favorable experience ratings (reserve ratios of +5% and +10%), and employers which paid out more than they contributed (reserve ratios of -5% and -10%). Here is what they would have paid in 2009 in SUI tax:

2009	RESERVE RATIO	RATE "A"	EST TAXABLE PAYROLL	EST TAX
NewCo	0.00%	1.70%	1,300,000.00	22,100.00
GoodCo	5.00%	1.10%	1,300,000.00	14,300.00
VeryGoodCo	10.00%	0.10%	1,300,000.00	1,300.00
BadCo	-5.00%	2.50%	1,300,000.00	32,500.00
VeryBadCo	-10.00%	2.90%	1,300,000.00	37,700.00

We now see what happens if the taxable wage base goes up to \$35,000 and the rate goes up to Schedule E:

2010 (BAD)	RESERVE RATIO	RATE "E"	EST TAXABLE PAYROLL	EST TAX	TAX SAVINGS / (INCREASE)
NewCo	0.00%	3.40%	3,500,000.00	119,000.00	(96,900.00)
GoodCo	+5.00%	2.60%	3,500,000.00	91,000.00	(76,700.00)
VeryGoodCo	+10.00%	1.60%	3,500,000.00	56,000.00	(54,700.00)
BadCo	-5.00%	4.40%	3,500,000.00	154,000.00	(121,500.00)
VeryBadCo	-10.00%	5.00%	3,500,000.00	175,000.00	(137,300.00)

This is what happens if the taxable wage base goes up to \$40,000 and the rate goes to Schedule F:

2010 (WORSE)	RESERVE RATIO	RATE "F"	EST TAXABLE PAYROLL	EST TAX	TAX SAVINGS / (INCREASE)
NewCo	0.00%	4.00%	4,000,000.00	160,000.00	(137,900.00)
GoodCo	+5.00%	3.20%	4,000,000.00	128,000.00	(113,700.00)
VeryGood	+10.00%	2.20%	4,000,000.00	88,000.00	(86,700.00)
BadCo	-5.00%	5.00%	4,000,000.00	200,000.00	(167,500.00)
VeryBadCo	-10.00%	5.40%	4,000,000.00	216,000.00	(178,300.00)

Employers, therefore, should be expecting significant SUI increases next year. What can you do to cope with it? We have three things for you to consider.

First, being forewarned is being forearmed. Having read this far, you now know what is coming, and why it is coming. Now you can plan ahead.

Second, if you have just bought a company in Hawaii, review that acquisition carefully. If you have taken over substantially all of its workforce, you may be entitled to take over the target company's reserve fund as well. However, if the target's reserve fund is depleted or negative, the law does not require you to take it. We can help you analyze whether you could benefit from the target company's reserve fund, and can assist you in executing the proper steps to take it over.

Third, if you own substantially all (at least more than 50%) of more than one employing unit, and those units have different rates, you may be able to benefit from having some or all of those units rated together. It is most commonly seen in consolidated corporate groups, but this strategy is also available to partnerships, LLC's, or other groups where common ownership can be shown. Joint rating may be elected retroactively to the beginning of the year. Choosing the optimal combination of units to achieve the best joint rate(s) is a complex mathematical process, which can result in substantial savings. We have considerable experience doing joint rate calculations and can do an initial estimate at no cost to you.

In any event, your client service team at Accuity can bring you the resources that you may need to cope with this development. Please do not hesitate to contact your client service team for more information.