Alaska Department of Labor and Workforce Development

Research and Analysis Section ~ Unemployment Insurance Research

Alaska Unemployment Insurance Tax System

Frequent Q & A's

Why do we have an Unemployment Insurance System?
The Unemployment Insurance System in the United States was created in the early 1930's, as America was trying to recover from the great depression. It was felt that the country could no longer afford to suffer through the normal economic "boom and bust" cycles that had existed for over a century. Our political leaders wanted to control some of the factors that caused the crash of 1929, as well as lessen some of the economic impacts of business downturns.

Does the Unemployment Insurance System help businesses?
The purpose of the UI system is economic stability for both businesses and individuals. Although benefits are paid to unemployed workers, almost every dollar is quickly returned to the economy, strengthening the business climate and stabilizing the work force.

Is UI a National or State program?
The Unemployment Insurance System was created as part of the 1935 Social Security Act. However, each state administers its own program, approved by the U.S. Department of Labor. There are a wide variety of state laws covering eligibility, benefits amounts, and financing. The law governing Alaska's UI program is the Employment Security Act (first enacted in 1937).

Is the UI system financially sound?
The Alaska UI system adheres to actuarial principals of trust fund management by both seeking to recoup cost born by the program and maintain a reserve necessary to weather most recessions deemed plausible.

Who pays for the cost of Alaska's UI benefits?
Employers and employees. Alaska is one of three states in which employees share the cost of benefits paid. Employers pay for 73% of the benefit costs, and 27% is paid for by employees.

Where does the tax money go?
The employer and employee taxes, which are submitted each quarter, are deposited in the Unemployment Insurance Trust Fund. The funds are held by the U.S. Treasury. Funds are drawn out continuously as needed to pay for benefits.

How much of the trust fund is used for administrating the UI program?
None. Tax receipts in the UI Trust Fund are used **ONLY** for the payment of benefits. The

cost of administrating Alaska's UI program is paid by a grant from the U.S. Department of Labor.

Do Alaska employers pay any federal UI taxes?

Yes. Employers in every state pay FUTA (Federal Unemployment Tax Act) taxes. The FUTA tax rate is 6.0% on the first $7,000 of each employee's wages. However, there is also a 5.4% credit for contributions to an approved state UI program. Therefore, the effective FUTA tax rate is now .6% - a maximum of $42 per employee. A portion of the FUTA tax revenues is used to fund the administrative grants for state UI programs.

What if Alaska did not have an approved UI program?

If Alaska did not have a federally approved UI financing system, employers would pay the full FUTA tax rate of 6.0%, or up to $420 per employee.

How much money is currently in the trust fund?

On September 30, 2019, the UI Trust Fund had a balance of **$493.6 million**.

What is considered solvent?

The basic measure of solvency, the **UI Trust Fund Reserve Rate**, is the relationship between the level of fund reserves and the amount of total statewide payroll.

$$\text{Trust Fund Reserve Rate} = \frac{\text{Trust Fund Balance on September 30}}{\text{Total Payroll (of taxable employers) in the last State Fiscal Year}}$$

The goal is to maintain a reserve rate between 3.0% and 3.3%. At this level, the fund is deemed able to meet the benefit demands of a severe economic recession (like 1986-1987). As of the end of September 2019, the reserve ratio was 3.82%.

Does keeping a proper fund reserve help employer tax rates?

Yes. To maintain the solvency of the UI trust fund, the tax system must cover the cost of the benefits being paid. The level of employer and employee contributions (taxes) is based on the **Average Benefit Cost Rate**, the relationship between benefit costs and the total payroll of taxable employers. Data for multiple years are used in the calculation of the Benefit Cost Rate, thereby "smoothing out" sudden changes to the system and making the rate somewhat counter cyclical. Counter-cyclical financing allows the fund to weather an economic slump, while resisting sudden changes in tax rates during a period of high benefit demands.

How are the tax rates calculated?

There are three components in the UI tax rate calculations:

1. **Average Benefit Cost Rate (ABCR)**
2. **Employer's Experience Rating Factor**
3. **Trust Fund Solvency Adjustment Factor (TFSA)**

The calculations of the employer and employee tax rates are:

Employer UI Tax Rate = (0.73 x ABCR x Experience Rating Factor) + TFSA
Employee UI Tax Rate = (0.27 x ABCR)

The tax rate is applied to a wage base, which changes annually, and is determined by the statewide average earnings in Alaska.

For the actual 2019 tax rate calculations, see Tax Rate Calculation for 2019.

... Average Benefit Cost Rate (ABCR): Tax Calculation Component 1

The measure of the cost of benefits, the Average Benefit Cost Rate, is calculated as follows:

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                          Cost of Benefits / Total Payroll (taxable firms)
                          in last 3 SFY's    in first 3 of last 4 SFY's
Benefit Cost Rate  =  ------------------------------------------------
                          Taxable Payroll / Total Payroll (taxable firms)
                          last SFY         last SFY

                          Note: SFY = State Fiscal Year
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... Employer's Experience Rating Factor: Tax Calculation Component 2

Experience rating systems classify employers based on their impact on the UI trust fund. All states, except Alaska, have some form of "charge back" benefits financing system, in which employer experience is measured by actual benefits paid, or some approximation of actual benefits paid. Alaska uses the **payroll decline quotient** system. Instead of looking at direct benefit costs, it measures changes in individual employer payrolls over time as an approximation of benefit costs. Employers are ranked according to their experience and assigned to one of the 21 rate classes. Each rate class carries an experience factor, which is used in the calculation. See below for more details.

... Trust Fund Solvency Adjustment (TFSA): Tax Calculation Component 3

Sometimes tax rates based on the Average Benefit Cost Rate are not adequate to maintain the desired trust fund reserve rate. The Trust Fund Solvency Adjustment is an adjunct to assist in this process. The Trust Fund Solvency Adjustment (TFSA) is a surcharge, or credit, applied to employer tax rates, according to statutory schedule, based on the trust fund reserve rate. The TFSA ranges from -0.4% to 1.1%, and can only increase by 0.3% or less each year.

Is the payroll decline method of experience rating effective?

Alaska's payroll decline quotient system has proven its effectiveness and has advantages over other direct "charge back" systems. Alaska's trust fund has remained solvent while many other states have been forced to borrow from the federal government, with interest. Alaska's experience rating system is much simpler and cheaper to administer than systems which are forced to track every dollar of benefits paid back to an individual employer.

How are the experience factors calculated?

... Experience Rating: Three Classes of Employers

Alaska has three classes of employers in its experience rating system.
E-rated firms have at least 4 quarters of wage history to qualify for experience rating.
I-rated firms lack the needed wage history and are assigned an industry average tax rate.
P-rated firms are delinquent in filing quarterly reports, or in paying contributions, and are assigned the maximum (Penalty) tax rate.

... Experience Rating: Ranking the E-rated firms

The experience factor assignment for E-rated firms begins with the calculation of the average payroll decline quotient for the last 12 quarters. Firms are then ranked by the decline quotient. The ranking list is then divided among 20 classes, with each containing approximately 5% of the total statewide payroll. Class 21 contains the final .01%. Each class is assigned a statutory experience factor.

What is the taxable wage base?

The Employer's (and employee's) tax rates are expressed as a percent of each worker's wages. The amount of each worker's wages subject to UI taxation is called the taxable wage base. The taxable wage base is defined as 75% of the statewide average annual earnings of workers covered by the UI program. **The taxable wage base for 2020 is $41,500.**

Are there some employers who are not in tax system?

Some employers covered by the UI system are not included in the tax system. These "reimbursable" employers pay back the trust fund for the benefit costs of their former employees. Reimbursable employers are generally large organizations with stable work forces, such as state and municipal governments, but also include private non-profit organizations.

Last update: 11/25/2018

Our Web Site: laborstats.alaska.gov (go to Unemployment, Research)
This File: Alaska UI Tax Finance Overview.pdf