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MINNESOTA'S UNEMPLOYMENT COMPENSATION TAX

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TAX STUDY COMMISSION  
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## I. INTRODUCTION

Minnesota's unemployment compensation (UC) tax uses the benefit ratio method. In its pure form the benefit ratio method used by Minnesota would theoretically restore to the fund all benefits paid out, if all employers maintained a constant total wage. Obviously, all employers do not maintain a constant total wage base. Some go out of business and some substantially reduce their work force. Such employers would pay into the fund less than is taken out by their employees. In addition, the Minnesota UC tax does not use a pure benefit ratio method. Not all benefits are chargeable to the employer, (e.g., voluntary quits). Also there is a 7.5% maximum tax. Such deviations from the pure benefit ratio method result in a net drain on the fund.

The experience portion of the UC tax is designed to have employers pay in tax an amount that is essentially equal to the amount of benefits paid to their employees. Since the experience portion of the UC tax does not raise all of the money that is taken out of the fund for benefits, the UC tax contains a "social tax" that raises the additional revenue required. Its function is to raise revenue rather than to have employers replace money drawn from the fund by their employees. In the Minnesota UC tax there are two distinct portions to the social tax. They are a minimum tax that all employers pay and a 25% surcharge on the experience portion of the UC tax.<sup>(1)</sup> The minimum tax is currently 1%.

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(1)

Minnesota Statutes § 268.06 defines the term "experience ratio" in a manner that includes a 25% surcharge. To avoid confusion this report will avoid using the statutory term. References to the experience portion of the UC tax are references to what the experience ratio would be without the 25% surcharge

To fully understand how the Minnesota UC tax system works, it is helpful to look at the benefit ratio system in its pure form and then one by one examine the various complicating factors we have added. By doing so the impact due to each separate factor can be identified.

## II. EXPERIENCE PORTION OF UC TAX

Under a pure benefit ratio system the experience portion of an employers UC tax is determined in the following manner. The benefits paid to the employees of an employer during the experience period (the previous three years)<sup>(2)</sup> are divided by the wages paid by the employer during that period. The resulting percentage is applied to the current wages paid by the employer to obtain the UC tax. Having the experience period contain three years rather than one year serves to dampen fluctuations in the rates. An additional effect is that it takes three years rather than one to repay the benefits taken from the fund.

The relationship between the benefits charged to an employer and the tax paid by the employer can be seen by examining the examples represented in Tables 1, 2 and 3.

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(2)

The three years in the experience period are actually fiscal years rather than calendar years. Thus, the period used in determining the tax rate for 1980 runs from July 1, 1976 to June 30, 1979, rather than from January 1, 1977 to December 31, 1979. For purposes of simplicity the examples represented in Tables 1 through 6 will assume that the experience period uses calendar years rather than fiscal years.

In Table 1, the wages paid by the employer are \$100,000 in each of the years from 1971 to 1979. Since the experience period wages for any year are the total wages paid in the three previous years, the experience period wages for each year from 1974 to 1979 are \$100,000 + \$100,000 + \$100,000 or \$300,000. In the example, benefits were paid only in 1975. These benefits show up as experience period benefits in the following three taxable years, 1976, 1977 and 1978. For those three years the percentage that constitutes the tax rate would be  $\$3,000 \div \$300,000$  or 1%. In each of the other years the tax rate would be zero because there were no experience period benefits in those years. The UC tax for any year is determined by multiplying the tax rate times the wages paid in that year. In any year that the tax rate is zero there would be no tax. In 1976, 1977 and 1978, the wages were \$100,000 the tax rate would be 1%, and therefore, the UC tax would be \$1,000. The total tax for those three years would be \$3,000.

It is important to note that in the ideal situation where the wages paid by the employer remain constant, the total tax paid by him is exactly equal to the total benefits chargeable to him. If there is a deviation from this ideal situation, the employer will pay either more or less in taxes than the amount of benefits charged to him. The way in which the employer's tax either increases or decreases can be seen by slightly modifying the previous example. Tables 2 and 3 are identical to the first example except

TABLE I

	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
Wages Paid in Year	\$100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Experience Period Wages				\$300,000	300,000	300,000	300,000	300,000	300,000
Benefits Paid in Year	-0-	-0-	-0-	-0-	\$3,000	-0-	-0-	-0-	-0-
Experience Period Benefits				-0-	-0-	\$3,000	3,000	3,000	-0-
Tax Rate				-0-	-0-	1%	1%	1%	-0-
Tax				-0-	-0-	\$1,000	1,000	1,000	-0-

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for changes in wages paid in 1976, 1977 and 1978 the three years which have experience period benefits. In Table 2, the wages paid in those three years are doubled to \$200,000. In Table 3, the wages paid in those three years are cut in half to \$50,000. For simplicity, only the years 1975 through 1978 are included in the chart.

TABLE 2

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Wages Paid in Year	\$100,000	200,000	200,000	200,000
Experience Period Wages	\$300,000	300,000	400,000	500,000
Benefits Paid in Year	\$ 3,000	-0-	-0-	-0-
Experience Period Benefits	-0-	\$ 3,000	3,000	3,000
Tax Rate	-0-	1%	.75%	.60%
Tax	-0-	\$ 2,000	1,500	1,200

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TABLE 3

Wages Paid in Year	\$100,000	50,000	50,000	50,000
Experience Period Wages	\$300,000	300,000	250,000	200,000
Benefits Paid in Year	\$ 3,000	-0-	-0-	-0-
Experience Period Benefits	-0-	\$ 3,000	3,000	3,000
Tax Rate	-0-	1%	1.2%	1.5%
Tax	-0-	\$ 500	600	750

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As can be seen from Table 2, an employer whose wages in a given year are higher than the average wages in the experience period will pay more in taxes than the amount of benefits charged to him.

In the example in Table 2, the wages paid by the employer in 1976, 1977 and 1978 were exactly double the yearly wages which the employer had previously paid. The total tax paid by the employer as a result of the \$3,000 in benefits charged to him was \$4,700. This is an increase of more than 50% from the amount the employer would have paid had his annual wages remained the same.

As might be expected the results shown in Table 3, are exactly opposite from those shown in Table 2. In Table 3, the employer's wages decrease from the average yearly wages paid in the experience period. In the example in Table 3, the wages paid by the employer in 1976, 1977 and 1978, were exactly one half of the yearly wages which the employer had previously paid. The total tax paid by the employer as a result of the \$3,000 in benefits charged to him was \$1,850. This is less than two-thirds of the amount of benefits drawn by the employer's former employees.

A general rule is that in a pure benefit ratio system:

1. If the employer's annual wages remain essentially constant, his taxes will be approximately equal to the benefits paid to his employees.
2. If the employer's annual wages increase, the taxes paid by the employer will be greater than the benefits paid to his employees.
3. If the employer's annual wages decrease, the taxes paid by the employer will be less than the benefits paid to his employees.

### III. EFFECT OF MAXIMUM TAXABLE WAGE

Currently there is a maximum taxable wage of \$8,000. Wages paid by an employer to a given employee which are in excess of this amount are not subject to the UC tax. The relationship between the general rule and the maximum taxable wage produces some interesting results.

Consider the impact of the maximum taxable wage on the hypothetical employer as shown in Tables 4, 5 and 6. Assume that the employer pays \$200,000 in wages to ten employees each of whom receive \$20,000 per year. Assume \$6,000 in benefits charged against the employer in 1975. Finally, assume that there is no wage inflation. Table 4, represents what would happen if there was a \$10,000 maximum taxable wage in every year. Table 5 represents what would happen if there was no maximum taxable wage. Table 6 represents what would happen if the maximum taxable wage were changed from \$10,000 to \$20,000 or more in 1976.

TABLE 4

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Wages Paid in Year	\$100,000	100,000	100,000	100,000
Experience Period Wages	\$300,000	300,000	300,000	300,000
Benefits Paid in Year	\$ 6,000	-0-	-0-	-0-
Experience Period Benefits	-0-	\$ 6,000	6,000	6,000
Tax Rate	-0-	2%	2%	2%
Tax	-0-	\$ 2,000	2,000	2,000

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TABLE 5

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Wages Paid in Year	\$200,000	200,000	200,000	200,000
Experience Period Wages	\$600,000	600,000	600,000	600,000
Benefits Paid in Year	\$ 6,000	-0-	-0-	-0-
Experience Period Benefits	-0-	\$ 6,000	6,000	6,000
Tax Rate	-0-	1%	1%	1%
Tax	-0-	\$ 2,000	2,000	2,000

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TABLE 6

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Wages Paid in Year	\$100,000	200,000	200,000	200,000
Experience Period Wages	\$300,000	300,000	400,000	500,000
Benefits Paid in Year	\$ 6,000	-0-	-0-	-0-
Experience Period Benefits	-0-	\$ 6,000	6,000	6,000
Tax Rate	-0-	2%	1.5%	1.2%
Tax	-0-	\$ 4,000	3,000	2,400

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First comparing Tables 4 and 5, it can be seen that with or without a maximum taxable wage, the total tax assessed against the employer is the same. It is \$6,000, the same amount as the benefits charged against the employer. In Table 4, because of the maximum taxable wage, the experience period wages are \$300,000, one half of the experience period wages in Table 5, where there is no maximum taxable wage. Since the tax rate is determined by dividing the experience period wages into the experience period benefits, the tax rate in Table 4 is twice the tax rate in Table 5. However,

the wages to which this tax rate is applied are also different in the two tables because of the maximum taxable wage. In Table 4, the taxable wages are only one half of the taxable wages in Table 5. The effect of the maximum taxable wage is to proportionally raise the tax rate and lower the taxable wages. Thus, the actual tax remains the same.

The tax in Table 6 is greater than the tax in Table 4. This is because in years 1973, 1974 and 1975, the maximum taxable wage limited the taxable wages thus causing the tax rate to rise in those later years which have any of these years in the experience period, just as it did in Table 4. However, because the maximum taxable wage rose in 1976, the taxable wages, to which the high tax rate was applied, were not lowered as the taxable wages had been in Table 4. Thus, the total tax was higher in Table 6 than it was in Table 4.

In effect the employer in Table 6 is in the same position as the employer in Table 2. In Table 2, the employer's annual wages doubled in 1976. As a result the employer paid more in taxes than the amount of benefits charged against him. In Table 6, the employer's actual payroll did not change. However, because of the change in the maximum taxable wage, the employer's taxable wage doubled. Since it is the taxable wage that is used in the tax computations the two employers are in the same position. Each pays more in tax than the amount of the benefits charged against him.

While the employer whose wages are above the maximum taxable wage may be substantially affected by raising or eliminating the maximum,

this will not be true for the employer who does not pay wages above the maximum. He will not be affected at all. For the employer who pays some but not all of his employees above the maximum, there will be the increase in his tax described above but the effect will not be as great as it would be if all of his employees were paid above the maximum. The amount of the increase will depend on the percentage of employees who are paid above the maximum.

Similarly if an employer pays his employees above the old maximum taxable wage but below the new taxable wage there will be the increase in his tax described above, but not as much of an increase as that paid by an employer who pays wages above the new maximum. The amount of the increase depends on how much the wages paid by the employer exceed the old maximum. The greater the amount by which the wages exceed the old maximum the greater the increase in the tax will be.

The maximum taxable wage has a second effect on the UC tax. This relates to the effect of inflation. The example in Table 2 shows that if an employer's taxable payroll increases above the level of the payroll in the experience period, the employer will pay somewhat more in UC taxes than the benefits charged to him in the experience period. With inflation, an employer will have his payroll increase even though his workforce remains constant. For employers who pay wages below the maximum taxable wage, the employer's payroll is the employer's taxable payroll. Thus, inflation causes these employers to pay more in tax than their employees receive in benefits. However, for employers who pay

wages above the maximum taxable wage the employer's payroll is not the employer's taxable payroll. No matter how much the total payroll is pushed up by inflation the maximum taxable wage keeps the taxable payroll constant as long as the workforce remains constant. Thus, the maximum taxable wage protects the high wage employer from this adverse affect of inflation on the UC tax but does not so protect the low wage employer.

A final effect on the experience portion of the tax relates to the interaction between the maximum taxable income and the maximum UC tax rate. As shown in Tables 4 and 5, the existence of a maximum taxable rate artificially raises the tax rate for an employer who pays wages in excess of the maximum. This artificial raising of the rate is accompanied by an equivalent lowering of the taxable wages to which this rate is applied and there is no net change in the tax paid. However, if the maximum UC tax rate prevents the full amount of this artificially higher rate from being applied to the lower taxable wages, the employer will pay less tax. This benefit is available only to employers who pay high wages and additionally have a high UC tax rate.

#### IV. REASONS FOR SHORTFALL IN REVENUE RAISED BY EXPERIENCE PORTION OF UC TAX.

As stated earlier the experience portion of the UC tax does not raise all of the needed revenue. There are several factors that contribute to this shortfall. Some are quantifiable, some are not. For those factors that are quantifiable, the Department of Economic Security (Department) has calculated the effect of the factor. It has done so on the basis of the three proceeding years.

One factor can be thought of as a cash flow problem. The benefits a recipient receives are proportional to his wages. Thus, with a constant rate of unemployment, as the average wage raises, the total benefit payout will also raise and be greater than the benefit payout in each of the three previous years. Since the lower benefits in the previous three years are used to set the tax rate for the current year, the experience rating portion of the tax is not sufficient to raise the taxes necessary to pay the current years benefits. If there was no maximum taxable wage so that the total taxable wage base would also raise with inflation this cash flow problem would not exist.

A second factor that causes the shortfall is related to the example described in Table 3. If a business suffers a downturn and so reduces its workforce, the taxes it pays in succeeding years will be less than the benefits charged to it. The extent to which this factor causes a shortfall is unclear except in the extreme case where the business has gone out of business and so pays no tax. The drain on the fund due to firms that have gone out of business was calculated by the Department to be equal to 8% of the regular benefits for 1980 and 6% of the benefits for 1977 through 1979.

A third factor that causes the shortfall is the setting of 7.5% as the maximum tax. With the current 1% minimum rate, the effective maximum rate for the experience portion of the UC tax is 6.5%. The Department has calculated the drain on the fund for 1980 due to the maximum rate to be 18% of the regular benefits. There has been a steady rise in this percentage since 1977 when the figure was 14%.

A fourth factor that causes this shortfall is the provision that limits the amount by which an employer's rate may increase to 1.5%. The Department has calculated the drain on the fund for 1980 due to this provision to be 5% of the regular benefits. The drain on the fund during the years 1977 to 1979 ranges between 3% and 5%.

A fifth factor that causes the shortfall is the fact that certain benefits are not charged to the employer. There are several circumstances under which benefits are not charged to an employer. They include, the individual has requalified after voluntarily quitting or being discharged for misconduct, and the individual quit for a better job. The Department has calculated the drain on the fund due to this factor to be 16% in 1980, down from 23% in 1978. The reason for the sharp drop is a provision enacted in 1977 which provides that a person who quits or is discharged for misconduct is not eligible for benefits until he requalifies by working a certain period of time. Since the Department's calculation is based on the three previous fiscal years, the 1980 figure does not represent the full impact of this change in the law. In 1981 and thereafter when the full impact of the change is felt it is estimated that the percentage will drop to about 10%.

The shortfall due to noncharged benefits would substantially increase if extended benefits go into effect. Extended benefits are not charged against an employer. When they have been in effect the state share has been approximately equal to 12% of the benefits.

## V. SOCIAL TAX

Since there is a total drain on the fund of almost 50% of the benefits paid in a year, it is necessary to raise this money in other ways. The two ways that have been chosen are a 25% surcharge on the experience portion of the UC tax and a 1% minimum rate which all employers pay. The Department has calculated that the amount of revenue raised by the 25% surcharge has been equal to about 13% of benefits paid out. The amount raised in 1979 by the minimum tax of 1% was 49% of the total revenue raised that year or approximately one hundred million dollars.

Generally over 50% of the employers have no experience period benefits charged to their account. Thus, their experience portion of the UC tax is zero and so they pay no surcharge.

An employer whose experience portion of the UC tax is 5.2% pays the maximum rate of 7.5%. He pays a 1% minimum rate plus 5.2% for the experience portion of the UC tax plus 1.3% in surcharge (25% of 5.2% = 1.3%). An employer whose experience portion of the UC tax is 6.5% pays no surcharge because when the 1% minimum tax is added the employer is at the 7.5% maximum rate. Similarly, an employer whose experience portion of the UC tax is greater than 5.2% but less than 6.5% pays some but not all of the 25% surcharge. The higher the experience portion of his UC tax is, the lower the amount of surcharge he pays.

On its face the minimum tax has the appearance of a payroll tax. In fact, however, the minimum tax acts more like a head tax on

employees than a payroll tax. This is because the minimum rate of 1% is only applicable to the taxable income which currently is subject to a maximum of \$8,000. Thus, for all employees with wages over \$8,000 the employer pays a tax of \$80. Since the average annual wage in this state is well over \$8,000, employers will pay a minimum tax of \$80 for a substantial majority of their employees regardless of how high the wages of these employees are.

Even for full time employees paid at the current minimum wage, the employer will pay a minimum tax of slightly more than \$60 per full time employee because each such employee earns slightly more than \$6,000 annually. In 1982 when the minimum wage is scheduled to rise to \$3.35 per hour, full time employees paid the minimum wage rate will earn almost \$7,000 and thus the minimum UC tax paid on the wages of such employees will be nearly \$70.

The effect of having a maximum taxable income of \$8,000 is that an employer whose employees are paid less than \$8,000 annually is taxed at a rate of 1% of his total payroll while an employer whose employees are paid a wage that is greater than \$8,000, is taxed at a rate that is less than 1% of his total payroll. For example, if the employer's average annual wage is \$12,000 the minimum tax is .66% of the total payroll, if it is \$16,000 the percentage drops to .5% and if it is \$20,000, the percentage drops to .4%.

Finally, raising the maximum taxable wage will affect only those employers whose employees earn in excess of \$8,000. For employers who pay less than that amount, an increase in the maximum taxable wage will have no effect on their minimum tax.

## VI. METHODS OF REDUCING THE MINIMUM TAX

At its meeting, the Sales, Excise and Miscellaneous Tax Subcommittee expressed interest in taking steps that would allow the minimum tax rate to be reduced below the current rate of 1%. While there is more than one method of doing so, all methods relate to making up the revenue lost from such a reduction. Failure to make up the lost revenue would lead the fund into a deficit condition (it will probably go into a deficit condition even if there is no reduction in the minimum rate). If the fund remains in a deficit condition, federal law provides for a payback mechanism. From the employers' point of view the payback mechanism has the effect of raising the minimum tax even though it is related to a reduction in the employers' credit against the federal UC tax. Thus, any attempt to reduce the minimum tax without replacing the lost revenue from other sources would be self defeating.

In 1979, the minimum tax at a rate of 1% raised 49% of the total UC revenue. Thus, each .1% raises roughly 5% of the total revenue and so for each .1% the minimum tax rate is to be reduced there must be a change that increases revenue by roughly 5%. This is only a rough approximation since the amount of benefits paid in any year may change substantially with the unemployment rate. It should be noted that because of the projected fund deficit, any change made to bring in revenue lost by a reduction of the minimum rate would have to be in addition to the changes needed to keep the fund solvent.

There are essentially five ways to increase revenue to make up for a reduction in the minimum rate.

1. REMOVE THE PROVISION THAT LIMITS THE CHANGE IN RATE TO 1.5%.

The limitation of the maximum rate change to 1.5% has caused a drain on the fund of between 3% and 5% over the last four years. By removing the rate change limitation the fund would have enough additional revenue to reduce the minimum rate by almost .1%. The original purpose of the provision was to protect small employers. An employer with only a handful of employees could easily go from the minimum rate to the maximum rate. It was assumed that with much larger wage bases, larger employers would rarely, if ever, be able to take advantage of the limitation. Considering the size of the revenue lost due to this provision, it seems probable that the original assumption concerning large employers was wrong, and that large employers as well as small employers are able to take advantage of this provision.

2. INCREASE THE MAXIMUM RATE.

The Department has projected the revenue affect of increasing the maximum tax rate to an amount above 7-1/2%. Their projections are based on 1979 and are contained in the following table. With a 1% minimum rate the current highest experience ratio (experience portion of an UC rate plus surcharge) used in determining a total tax rate of 7.5% is 6.5%.

2. (Continued)

<u>HIGHEST EXPERIENCE RATIO</u>	<u>PERCENT INCREASE</u>
6.5%	-
7.0%	3.3%
7.5%	5.5%
8.0%	7.7%
8.5%	9.8%
9.0%	12.0%
9.5%	14.3%
10.0%	15.7%

From this Table it can be seen that in order to replace the revenue lost by reducing the minimum rate by .1% it would be necessary to raise the maximum rate from 7.5% to 8.5%. If the minimum rate were to be reduced by .2% or .3% the maximum rate would have to be raised to 9.5% or 11% respectively.

3. BEGIN TO CHARGE EMPLOYERS FOR BENEFITS THAT ARE CURRENTLY NOT CHARGED AGAINST THE EMPLOYER.

If the law is changed so that benefits are charged to an employer regardless of reason for the termination of employment, revenue will be increased. The amount of this increase will be about 10%. If the change in the law is effective beginning July 1, 1980, one third of this 10% will appear in the 1982 rate. An additional one third of the 10% will appear in the 1983 and 1984 rates.

3. (Continued)

The apparent reason that employers are not charged for benefits in certain cases is arguably that the employer is not really "at fault" for the unemployment as he would be if the employee had simply been laid off. Therefore, it is reasoned all employers should share this burden equally.

4. INCREASE THE 25% SURCHARGE TO SOME LARGER PERCENTAGE.

The surcharge could be increased to produce additional revenue. Currently, the surcharge of 25% brings in revenue equal to about 13% of benefits. Thus, the surcharge would have to be increased by at least 10% for each .1% decrease in the minimum rate. As stated before, the surcharge is paid only by those employers who have base period benefits and whose experience portion of the UC tax is less than 6.5%. This is less than 50% of employers.

5. INCREASE THE \$8,000 CEILING ON TAXABLE WAGES.

The last source of replacement revenue is an increase in or an elimination of the maximum taxable wage. A total elimination of the maximum on taxable wages is essentially the same as a very large increase in the maximum taxable wage. Thus, for purposes of simplification, the analysis of this topic will deal primarily with an increase in the maximum. References to a total elimination of the maximum will not be made unless needed for clarification or emphasis.

5. (Continued)

Raising the maximum taxable wage will have only two revenue effects. The first effect is that wages paid in excess of the current \$8,000 will be subject to the minimum tax.

The Department estimates that currently only slightly more than one half of the wages paid in the state are subject to the minimum tax. Because of inflation, this percentage will continue to drop unless the maximum is raised. The second effect is that those employers who currently pay wages in excess of the maximum taxable wage will feel the adverse affects shown in Tables 2 and 6. They will pay more in tax than the amount of the benefits charged to them because their taxable wages will be higher than their taxable wages in the experience period.

The effect on the minimum tax of raising the maximum taxable wage is quite straight forward. The taxable wage is simply the base to which the minimum tax rate is applied. Thus, the tax will rise as the taxable wage is permitted to rise. For example, if the minimum rate would remain at 1% and the maximum taxable wage would be increased to \$16,000, the minimum tax paid by employers would either remain the same or would increase as indicated in the following table.

TABLE 7

<u>WAGES OF EMPLOYEE</u>	<u>PRESENT TAX</u>	<u>TAX WITH MAXIMUM TAXABLE WAGE OF \$16,000</u>	<u>PERCENT BY WHICH NEW TAX EXCEEDS OLD TAX</u>
\$6,000	\$ 60	\$ 60	0%
7,000	70	70	0
8,000	80	80	0
10,000	80	100	25
12,000	80	120	50
14,000	80	140	75
16,000	80	160	100
20,000	80	160	100
32,000	80	160	100
64,000	80	160	100

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As can be seen by Table 7, under these conditions the tax on all wages at or below \$8,000 remains unchanged. The tax on all wages greater than \$16,000 increases by 100% to \$160. The tax on all wages between \$8,000 and \$16,000 increases by up to 100% or by up to \$80. The percentage by which the tax increases is the percentage by which the employee's wage exceeds the old maximum taxable wage.

If the maximum were completely eliminated the only change in Table 7 would be for wages in excess of \$16,000. The tax would be \$200 for a wage of \$20,000, \$320 for a wage of \$32,000 and \$640 for a wage of \$64,000.

5. (Continued)

Since raising the maximum taxable wage will bring in additional revenue, that revenue could be used to reduce the minimum rate. The extent to which the minimum rate could be reduced would depend on the amount of additional revenue raised by increasing the maximum taxable wage. This will in turn depend on the amount by which the average wage exceeds \$8,000.

For the purposes of Table 8, it will be assumed that raising the taxable wage to \$16,000 would permit a reduction in the minimum rate of .2% to a new rate of .8%.

TABLE 8

<u>WAGES OF EMPLOYEE</u>	<u>PRESENT TAX</u>	<u>TAX WITH RATE OF .8% AND MAXIMUM TAXABLE WAGE OF \$16,000</u>	<u>PERCENT BY WHICH NEW TAX EXCEEDS OLD TAX</u>
\$ 6,000	\$ 60	\$ 48	- 20%
7,000	70	56	- 20%
8,000	80	64	- 20%
10,000	80	80	0%
12,000	80	96	+ 20%
14,000	80	112	+ 40%
16,000	80	128	+ 60%
20,000	80	128	+ 60%
32,000	80	128	+ 60%
64,000	80	128	+ 60%

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5. (Continued)

Under this example the tax on wages under \$8,000 is reduced by 20%. The tax on wages between \$8,000 and \$10,000 would be reduced by between 0 and 20%. The tax on a wage of \$10,000 would be the same. The tax on wages between \$10,000 and \$16,000 would be increased by between 0 and 60%. Finally, the tax on wages over \$16,000 would be increased by 60%.

If the maximum were completely eliminated the only change in Table 8 would be for wages in excess of \$16,000. The tax for wages of \$20,000, \$32,000 and \$64,000 would be \$160, \$256 and \$512 respectively.

In addition to its effect on the minimum tax, raising or eliminating the maximum placed on taxable wages will affect the experience portion of the UC tax. However, the primary effect will be relatively short lived. As shown in Table 6, raising or removing the maximum placed on taxable wages will cause the experience portion of the UC tax to jump sharply for employers who pay wages substantially above the current maximum of \$8,000. These employers will pay more in taxes than the amount drawn in benefits by their employees during the three years following the year the maximum was raised. Tables 4 and 5 show that once the temporary effect of raising the maximum rate has worn off, the employer who pays extremely high wages will be in the same position as he would be if the maximum taxable income had not been changed. The experience portion of his UC tax will be essentially the same as the benefits drawn by his employees.

5. (Continued)

In addition to this major effect, raising the maximum taxable wage will result in two other relatively minor effects on the experience portion of the fund. These are effects previously discussed in the section on the effects of the maximum taxable wage. One relates to inflation. With a low maximum taxable wage the taxable payroll for high wage employers is insulated from the effects of inflation. Their taxable payroll does not increase even though inflation causes their total payroll to increase. As the maximum taxable wage increases fewer and fewer employers receive this inflation protection. The other effect relates to the maximum rate. Having a ceiling on taxable wages artificially increases the experience ratio for a high wage employer as it lowers the taxable wage to which the experience ratio is applied. If the maximum rate prevents a portion of the increased rate from being applied, the employer saves money. As the maximum taxable wage is raised, the artificial increase in an employers experience ratio is diminished and so fewer employers are protected by the maximum rate.

In summary, the effects of raising the maximum taxable wage are as follows:

- A. The high wage employers will pay a larger minimum tax because their taxable wages, against which the minimum rate is applied, will increase.

5. (Continued)

B. In the three years following the increase in the maximum taxable wage employers will have the experience portion of their UC tax increased in the manner shown in Table 6.

C. Certain minor benefits which high wage employers derive from having a maximum taxable wage will be lessened or eliminated. These benefits are not available to employers who pay wages below the maximum taxable wage.