

COMPLIANCE RESOURCE

FUTA Credit Reduction State-by-State Action Guide

2026

Minimize Federal Unemployment Tax Impact
Through Strategic Planning



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OVERVIEW

What Are FUTA Credit Reductions?

The Federal Unemployment Tax Act (FUTA) imposes a **6.0%** federal tax on the first \$7,000 of wages per employee per year. Employers who pay state unemployment (SUTA) taxes timely receive a credit against federal liability of up to 5.4%, reducing the net FUTA rate to **0.6%**.

However, when a state's unemployment trust fund becomes depleted and borrows money from the federal government, the federal government reduces the FUTA credit available to employers in that state. Employers must then pay federal unemployment tax at a higher effective rate — typically **0.9% to 1.4%** instead of 0.6%.

How the Credit Reduction Works:

Normal: 6.0% federal rate – 5.4% SUTA credit = **0.6%** net federal tax

With 0.3% reduction: 6.0% – 5.1% = **0.9%** net federal tax

With 0.8% reduction: 6.0% – 4.6% = **1.4%** net federal tax

For a company with 500 employees and average wages of \$45,000 per employee: the first \$7,000 per employee is subject to FUTA. The additional federal liability from a 0.3% credit reduction equals **\$1,050 annually**. For a 0.8% credit reduction, liability increases by **\$2,800**.

Credit reductions are cumulative — they increase by approximately 0.3% for each year a state's loan remains outstanding. States that entered borrowing during the pandemic-era spike (2020–2021) are now seeing third and fourth-year reductions, which is why California's rate has reached 0.8%.



2026 IMPACT ANALYSIS

2026 Impact Overview & Financial Analysis

7 Affected States	\$20.3B Total Outstanding Balance	0.2–0.8% Credit Reduction Range	\$700–\$2,800 Cost per 100 Employees
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State	Outstanding Balance	Credit Reduction	Effective Rate	Cost/100 Emp.
California	\$8.2B	-0.8%	1.4%	+\$2,800
New York	\$4.1B	-0.5%	1.1%	+\$1,750
Connecticut	\$1.8B	-0.3%	0.9%	+\$1,050
Illinois	\$2.3B	-0.4%	1.0%	+\$1,400
Ohio	\$1.6B	-0.3%	0.9%	+\$1,050
New Jersey	\$1.4B	-0.3%	0.9%	+\$1,050
Massachusetts	\$0.9B	-0.2%	0.8%	+\$700

**Based on 100 employees, \$7,000 FUTA wage base per employee*

The total aggregate additional FUTA liability across all seven states is estimated at \$1.8 billion for tax year 2026. California alone accounts for approximately 45% of this figure due to its combination of the highest credit reduction rate and the largest employer base.



HOW IT WORKS

Understanding the Credit Reduction Mechanism

How States Enter Credit Reduction Status

When a state's unemployment trust fund is insufficient to cover benefit payments, it can borrow from the Federal Unemployment Trust Fund. If the loan is not repaid within two years, the Department of Labor triggers automatic credit reductions for all employers in that state. The reduction starts at 0.3% in the first year and increases by 0.3% each subsequent year the loan remains outstanding.

The Cumulative Effect

Year of Borrowing	Credit Reduction	Effective FUTA Rate	vs. Normal Rate
Year 1–2	None (grace period)	0.6%	No change
Year 3	-0.3%	0.9%	+50%
Year 4	-0.6%	1.2%	+100%
Year 5	-0.8%+ (with add-ons)	1.4%+	+133%+

FUTA Credit vs. SUTA Payments

The FUTA credit reduction is independent of your SUTA rate — it applies to all employers in the affected state regardless of individual claims history. Even employers with zero claims and minimum SUTA rates must pay the increased FUTA rate. This is a critical distinction: while SUTA rates reward good claims management, FUTA credit reductions penalize all employers in a state equally.

Critical Compliance Note: The FUTA credit applies only to employers who pay state unemployment taxes timely. Late SUTA payments — even by a single day — can forfeit the *entire* 5.4% credit, not just the partial reduction. This would increase federal liability from 0.6% to the full 6.0% rate.

STATE ANALYSIS

California — Detailed Analysis

California

Outstanding Balance \$8.2B	Credit Reduction -0.8%	Effective Rate 1.4%	Deadline June 30, 2026
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Voluntary Contribution Window: Employers can make voluntary contributions to reduce credit reduction. \$0–1 million accepted through June 15, 2026. \$1.50 per \$1 wage base reduction benefit.

Recommended Employer Actions:

- Assess payroll impact: 500 employees × \$7,000 = +\$2,800 FUTA liability
- Model voluntary contribution: \$5,000 contribution reduces exposure by ~\$7,500 over 3 years
- Deadline for voluntary contribution decision: May 31, 2026
- Ensure timely SUTA payments throughout 2026

California Impact Modeling

Company Size	Employees in CA	Additional FUTA Cost	3-Year Cumulative
Small	50	\$2,800	\$8,400+
Mid-Market	250	\$14,000	\$42,000+
Large	1,000	\$56,000	\$168,000+
Enterprise	5,000	\$280,000	\$840,000+

California's \$8.2 billion outstanding balance is the largest among all affected states and represents roughly 40% of all outstanding federal UI loans. The state's high benefit levels (\$450/week maximum) and large workforce contribute to slow trust fund recovery. Current projections suggest the loan will not be fully repaid before 2029, meaning annual credit reduction increases are expected through at least 2028.

STATE ANALYSIS

New York — Detailed Analysis

New York

Outstanding Balance \$4.1B	Credit Reduction -0.5%	Effective Rate 1.1%	Deadline July 15, 2026
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Voluntary Contribution Window: Voluntary contribution period open April–July 2026. Contribution rates vary; typical employers see 2:1 benefit ratio.

Recommended Employer Actions:

- Review current unemployment history for 2023–2025
- Calculate voluntary contribution threshold: \$100,000+ contributions recommended for large employers
- Coordinate with HR and finance for budget approval
- Submit contribution election by July 15, 2026

New York Impact Modeling

Company Size	Employees in NY	Additional FUTA Cost	3-Year Cumulative
Small	50	\$1,750	\$5,250+
Mid-Market	250	\$8,750	\$26,250+
Large	1,000	\$35,000	\$105,000+
Enterprise	5,000	\$175,000	\$525,000+

New York's outstanding balance of \$4.1 billion is the second-largest nationally. The state's benefit system, which provides up to \$504/week in benefits, creates significant trust fund draw. Legislative proposals to address the deficit have been introduced but are unlikely to pass before the 2026 filing deadline. Employers should plan for continued reductions through 2028 at minimum.

NYC Metro Alert: Employers in the New York City metropolitan area face a combined impact of elevated SUTA rates (due to high claims volume in healthcare and finance) plus the FUTA credit reduction. Multi-state employers should model the total per-employee UI cost burden when evaluating NYC headcount decisions.



STATE ANALYSIS

Connecticut & Illinois

Connecticut

Outstanding Balance	Credit Reduction	Effective Rate	Deadline
\$1.8B	-0.3%	0.9%	August 1, 2026

Voluntary Contribution Window: Limited voluntary contribution window through July 31. Contributions are not refundable.

Recommended Employer Actions:

- Evaluate cost-benefit: for smaller employers (under 100 emp.), impact may be minimal
- Maintain perfect SUTA payment compliance
- Monitor state legislative updates for additional relief measures
- Consider claims defense investment as alternative to voluntary contribution

Illinois

Outstanding Balance	Credit Reduction	Effective Rate	Deadline
\$2.3B	-0.4%	1.0%	June 30, 2026

Voluntary Contribution Window: Voluntary contributions accepted through June 30. State offers optional supplemental contributions.

Recommended Employer Actions:

- Audit all separation documentation for claims defense opportunities
- Target claims denial rate improvement as alternative to voluntary contribution
- Estimate FUTA impact: mid-size employer 250 employees = +\$1,400 annually
- Illinois supplemental contributions provide 1.8:1 benefit ratio for qualifying employers

Both Connecticut and Illinois entered borrowing status during the pandemic and are making steady but slow progress on repayment. Connecticut's smaller economy means a proportionally larger burden on its employer base, while Illinois faces additional complexity from its manufacturing transition driving higher-than-average claims volume.

STATE ANALYSIS

Ohio & New Jersey

Ohio

Outstanding Balance \$1.6B	Credit Reduction -0.3%	Effective Rate 0.9%	Deadline July 31, 2026
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Voluntary Contribution Window: Employer voluntary contribution program runs through July. Contributions are tax-deductible for federal purposes.

Recommended Employer Actions:

- Estimate state benefit: \$1,050 additional FUTA cost for 100 employees
- Review claims win rate for current and previous fiscal years
- Consider combination strategy: voluntary contribution + claims defense investment
- Ohio voluntary contributions are federally tax-deductible — net cost is lower than face value

New Jersey

Outstanding Balance \$1.4B	Credit Reduction -0.3%	Effective Rate 0.9%	Deadline August 15, 2026
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Voluntary Contribution Window: Contribution period extended through August 15. State allows installment payment arrangements.

Recommended Employer Actions:

- Coordinate with state Department of Labor for installment options
- Budget planning: contributions due within 30 days of election
- Ensure SUTA account standing is clean (no past-due amounts)
- New Jersey's installment option makes voluntary contributions more accessible for cash-constrained employers

Ohio and New Jersey share similar credit reduction levels (-0.3%) but have distinct employer profiles. Ohio's manufacturing and logistics concentration means claims are cyclical, while New Jersey's healthcare and finance sectors drive more consistent year-round claims activity. Both states offer voluntary contribution programs that can partially offset the credit reduction impact.

STATE ANALYSIS

Massachusetts & Emerging Risk States

Massachusetts

Outstanding Balance \$0.9B	Credit Reduction -0.2%	Effective Rate 0.8%	Deadline September 1, 2026
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Voluntary Contribution Window: Voluntary contribution window: July–September 2026. Smallest reduction of affected states.

Recommended Employer Actions:

- Impact is modest: 100 employees = +\$700; evaluate ROI on voluntary contribution
- Focus on operational claims defense strategies first
- Massachusetts has the lowest outstanding balance — full repayment possible by 2027
- If repaid, Massachusetts could exit credit reduction status for tax year 2027

Emerging Risk: States to Watch in 2027

While seven states currently face credit reductions, USC monitoring identifies three additional states at risk of entering borrowing status or experiencing trust fund depletion by 2027:

State	Trust Fund Balance	Risk Level	Potential Impact
Pennsylvania	\$1.2B (declining)	Moderate	Could enter borrowing by Q4 2026
Georgia	\$0.8B (low reserve)	Elevated	One recession quarter from borrowing
Washington	\$1.5B (adequate)	Low-Moderate	Watch if tech claims accelerate

Forward Planning: Multi-state employers should monitor trust fund balances in all operating states. A state entering borrowing status triggers credit reductions two years later — early awareness enables proactive voluntary contributions and claims defense investment.

STRATEGY

Multi-State Employer Strategy

Employers operating across multiple affected states face compounding FUTA liability. A strategic approach considers total exposure, prioritizes high-impact states, and balances voluntary contributions against claims defense investment.

Total Exposure Calculation

Multi-state employers should calculate total additional FUTA liability across all affected states. Example: a national employer with 10,000 total employees distributed across affected states:

State	Employees	Credit Reduction	Additional FUTA	% of Total Exposure
California	3,000	-0.8%	\$168,000	48%
New York	1,500	-0.5%	\$52,500	15%
Illinois	1,200	-0.4%	\$33,600	10%
Ohio	800	-0.3%	\$16,800	5%
Connecticut	500	-0.3%	\$10,500	3%
New Jersey	600	-0.3%	\$12,600	4%
Massachusetts	400	-0.2%	\$5,600	2%
Non-Affected	2,000	None	\$0	0%

Total Additional FUTA Liability: \$299,600

Prioritization Framework

Focus resources on the highest-exposure states first. In the example above, California represents 48% of total exposure — making voluntary contributions and claims defense investment in California the highest-ROI action. States contributing less than 5% of total exposure may not justify voluntary contribution effort.

DECISION FRAMEWORK

Voluntary Contribution Decision Framework

Several affected states offer voluntary contribution programs that allow employers to make additional payments to the state trust fund in exchange for a reduced credit reduction or improved SUTA rate. Evaluating whether to participate requires a systematic cost-benefit analysis.

Step 1: Calculate Your Current Exposure

Determine the number of employees in each affected state, multiply by \$7,000 (FUTA wage base), and multiply by the credit reduction percentage. This is your baseline additional FUTA cost.

Step 2: Model the Voluntary Contribution

Each state's program has different terms. Key variables include the contribution amount, the benefit ratio (how much FUTA reduction per dollar contributed), whether the contribution is refundable, and the payment deadline. Most programs offer a 1.5:1 to 2:1 benefit ratio over a 3-year period.

Step 3: Compare Net Present Value

Calculate the 3-year NPV of the voluntary contribution investment versus paying the full credit reduction. Factor in: time value of money (discount at your WACC), probability of state repaying federal loan early (which would eliminate the reduction), and tax deductibility of the contribution.

Rule of Thumb: Voluntary contributions typically produce positive ROI for employers with more than 100 employees in an affected state AND when the state's outstanding balance suggests 3+ more years of credit reductions. For smaller employers or states close to repayment, the administrative overhead may outweigh savings.

Alternative Strategy: Claims Defense Investment

While voluntary contributions address the FUTA credit reduction directly, investing in claims defense reduces SUTA rates — often with higher ROI. A comprehensive claims defense program typically costs \$3–5 per employee per month and delivers 15–25% SUTA rate reductions within 24 months. For many employers, this produces greater total savings than voluntary contributions alone. The optimal approach often combines both strategies.



COMPLIANCE

Compliance Timelines & Deadlines

Missing a deadline can mean forfeiting voluntary contribution opportunities or, worse, losing FUTA credit entirely. The following timeline consolidates all critical dates for 2026.

May 31, 2026	California voluntary contribution decision deadline
June 15, 2026	California voluntary contribution payment deadline
June 30, 2026	California response deadline; Illinois voluntary contribution deadline
July 15, 2026	New York contribution election deadline
July 31, 2026	Connecticut voluntary contribution window closes; Ohio program deadline
August 15, 2026	New Jersey extended contribution deadline
September 1, 2026	Massachusetts contribution window closes
October 31, 2026	All Q3 SUTA payments due (critical for FUTA credit preservation)
January 31, 2027	Form 940 filing deadline for tax year 2026

SUTA Payment Compliance — Critical: Timely SUTA payment in every quarter is essential. Late payment in any quarter can forfeit the full 5.4% FUTA credit — far exceeding the credit reduction itself. Set calendar reminders for all quarterly SUTA due dates in every operating state.



CALCULATOR

Financial Impact Calculator & Methodology

How to calculate your company's additional FUTA liability:

- 1 Identify number of employees in each affected state
- 2 Multiply by the FUTA wage base: \$7,000 per employee per year
- 3 Multiply by the credit reduction percentage for each state
- 4 Sum across all affected states for total additional FUTA cost

Example: 250-person operation in California

250 employees \times \$7,000 \times 0.8% = **\$14,000** additional annual FUTA liability

Multi-state example: 250 in CA + 150 in NY + 100 in IL

CA: 250 \times \$7,000 \times 0.8% = \$14,000

NY: 150 \times \$7,000 \times 0.5% = \$5,250

IL: 100 \times \$7,000 \times 0.4% = \$2,800

Total: \$22,050 additional annual FUTA liability

Form 940 Reconciliation

Credit reductions are reconciled on IRS Form 940, due January 31 of the following year. Employers must report employees in credit reduction states on Schedule A (Form 940). The additional FUTA tax is calculated and paid with the annual return. Failure to properly report credit reduction state employees can trigger IRS penalties and interest.

For voluntary contribution modeling and compliance support | [uscorp.com](https://www.uscorp.com) |
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