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Federal Taxation of Unemployment Insurance Benefits

Unemployment Insurance Benefits Are Taxable Income

Unemployment insurance (UI) benefits have been fully subject to federal income taxation since the passage of the Tax Reform Act of 1986 (P.L. 99-514, 26 U.S.C. §85 and 26 C.F.R. §1.85-1). For the purposes of federal income taxation, the definition of UI benefits includes regular state Unemployment Compensation (UC) benefits, Extended Benefits (EB), Trade Adjustment Assistance (TAA) benefits, and Disaster Unemployment Assistance (DUA), as well as railroad unemployment benefits, and has included all temporary UI benefits since UI benefits became taxable.

The American Rescue Plan Act of 2021 (P.L. 117-2) allows taxpayers with modified adjusted gross income (AGI) of less than \$150,000 to exclude up to \$10,200 in UI benefits from 2020 taxable income. This applies to all UI benefits including the temporary UI benefits discussed below. For 2009, Congress provided an exclusion from taxable income for up to \$2,400 in UI benefits.

Coronavirus Disease 2019 (COVID-19) Temporary UI Programs

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136, as amended) provided four additional temporary UI benefits, each of which is also subject to federal income taxation. These are

- Pandemic Emergency Unemployment Compensation (PEUC),
- Pandemic Unemployment Assistance (PUA),
- Federal Pandemic Unemployment Compensation (FPUC), and
- Mixed-Earner Unemployment Compensation (MEUC).

Additionally, Lost Wages Assistance (LWA) payments are subject to federal income taxation. (On August 8, 2020, President Trump issued a presidential memorandum creating LWA, a grant program that supplemented the weekly benefits of certain eligible UI claimants through September 5, 2020.)

State UC Agencies Must Inform Beneficiaries That Payments Are Taxable

The tax code treats UI benefits like other ordinary income, such as wages. States are required to inform beneficiaries that state UC payments are included in the individual's gross income for federal income tax purposes and that the individual will receive Internal Revenue Service (IRS) Form 1099-G to file with their income tax return.

Income Tax Withholding from UI Payments

Individuals may have the option to elect to have states withhold federal (and in some cases, state) income tax from

some types of UI benefits. Alternatively, individuals may opt to pay estimated federal taxes on UI benefits using IRS Form 1040-ES or pay such taxes when filing a federal income tax return.

According to the U.S. Department of Labor (DOL), Employment and Training Administration (ETA) 2112-UI Financial Transaction Summary Report data, states reported that approximately 4.5% of all UI benefits (\$1.2 billion out of \$27.4 billion) were withheld for the payment of federal taxes in 2019. (During 2019, these UI benefits predominately would have been UC payments.) In contrast, the percentage withheld decreased to approximately 3.7% of all UI benefits (\$19.9 billion out of \$532.4 billion) from April 2020 through December 2020 (when CARES Act benefits were available). These data imply that CARES Act UI claimants may be less likely to have taxes withheld than claimants of permanent-law UI benefits.

Federal Tax Withholding: Regular UC and EB

Since 1997, federal tax law (26 U.S.C. §3304(a)(18)) has required state UC agencies to offer regular UC and EB beneficiaries the opportunity to elect federal income tax withholding at the time the claimant first files for UC benefits. Claimants who elect to have federal income tax withheld from their regular UC benefits must file IRS Form W-4V, Voluntary Withholding Request unless the state agency has its own form for requesting federal income tax withholding; if so, the claimant should use that state form. The current withholding rate for federal income tax is 10% of the gross UI payment.

Federal Tax Withholding: PEUC

States also must offer PEUC recipients the opportunity to elect federal income tax withholding. DOL applies 26 U.S.C. Section 3304(a)(18) to PEUC based upon Section 2107(a)(4)(B) of the CARES Act, which requires that state and federal UC laws apply to PEUC claims and payments to the extent practicable.

Federal Tax Withholding: PUA

The CARES Act does not require that states offer PUA claimants the opportunity to elect to withhold taxes. However, as in the case of all UC payments, DOL requires state UC agencies to inform individuals that the CARES Act UI benefits are subject to federal income taxation. State agencies are encouraged by DOL to provide a withholding option for PUA beneficiaries.

State agencies must inform PUA recipients that PUA benefits are included in the individual's gross income for federal income tax purposes and that the individual will receive IRS Form 1099-G to file with their income tax return. This information may be distributed to the

individual by several different methods, including on the Notice of Monetary Determination, in the Benefit Rights Information packet, or as the state deems appropriate.

Federal Tax Withholding: FPUC and MEUC

DOL applies 26 U.S.C. Section 3304(a)(18) to FPUC and MEUC. Thus, states must offer individuals receiving FPUC and MEUC the opportunity to withhold taxes from FPUC and MEUC payments.

Federal Tax Withholding: LWA

States were required to notify individuals that LWA payments were subject to federal income taxation but were not required to provide the option to withhold federal income taxes.

State Tax Withholding

In addition to being subject to federal income taxes, in most states that have an income tax, UI benefits are taxed. Federal law does not require that states offer state income tax withholding to UC beneficiaries, although, according to DOL, many do offer this option. Beneficiaries may opt to pay quarterly estimated taxes if a state does not offer state income tax withholding.

State Unemployment Agencies Report UI Benefits Through Form 1099-G

State unemployment agencies must provide UI claimants IRS Form 1099-G, showing the total amount of benefits paid and the amount of federal taxes withheld for the previous tax year, by January 31 of each year.

Identity Theft and Fraudulent UI Payments

On January 28, 2021, the IRS advised taxpayers who receive an IRS Form 1099-G with incorrectly reported unemployment benefits to contact the issuing state UC agency. These taxpayers should request a revised Form 1099-G, showing they did not receive the incorrectly reported benefits. The IRS advised taxpayers who are unable to obtain a timely, corrected form from states to file an accurate tax return that reports only the UI income received. The IRS advised that taxpayers will still need to obtain a corrected Form 1099-G showing zero (or accurate) UI benefits in cases of identity theft to avoid an unexpected federal tax bill for unreported income.

Tax Exclusion Authority for UI Benefits

Since it began to treat all UI benefits as fully taxable income, Congress has taken action once to exclude a portion of UI benefits from taxable income. The American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5, §1007) included a temporary exclusion on the first \$2,400 of UI benefits per individual for the purposes of the federal income tax. This exclusion applied only for the 2009 tax year. The Joint Committee on Taxation (JCT) estimated that this exclusion reduced federal receipts by approximately \$4.7 billion.

The American Rescue Plan Act of 2021 (P.L. 117-2, §9042) allows taxpayers with modified adjusted gross income (AGI) of less than \$150,000 to exclude up to \$10,200 in UI benefits from income in 2020. The \$150,000 AGI threshold applies regardless of the taxpayer's filing status (i.e., married filing jointly, single, or head of household). JCT

estimates this exclusion will reduce FY2021 revenues by \$25.0 billion.

Taxpayers Reporting Unemployment Benefits by Income

Table 1 shows the estimated number of federal income tax returns reporting unemployment benefits by AGI in tax year 2018 (the most recently available data). Approximately 1.45 million tax returns (almost one-third) of all tax returns reporting UI payments did not have a taxable return (i.e., they did not owe income taxes) and thus, their filers paid no taxes on UI benefits for tax year 2018.

Table 1. Tax Returns with Reported Unemployment Insurance (UI), Tax Year 2018

Adjusted Gross Income (AGI)	Number of Returns	UI Income (millions)	Share of UI Income (%)
Total returns	4,517,744	\$21,998.2	100.0%
Nontaxable returns	1,450,151	\$6,486.6	29.5%
AGI Category (thousands)			
Under \$15K	495,268	\$1,720.7	7.8%
\$15K - under \$30K	1,041,683	\$4,578.3	20.8%
\$30K - under \$50K	897,053	\$4,516.4	20.5%
\$50K - under \$100K	1,270,536	\$6,577.8	29.9%
\$100K - under \$200K	651,052	\$3,613.1	16.4%
\$200K - under \$1 million	158,877	\$968.1	4.4%
\$1 million and above	3,273	\$23.9	0.1%

Source: CRS table using IRS Statistics of Income data, Table I.4.

Notes: Adjusted gross income (AGI) is total income minus statutory adjustments. Data are IRS estimates based on a sample of tax returns. UI income is rounded to nearest \$100,000.

IRS Table I.4 applies the term of "Unemployment Compensation" when referring to UI benefits.

In 2018, income from UI was received by taxpayers across the income distribution. An estimated 49.2% of UI income was received by taxpayers with an AGI of less than \$50,000 in 2018. An estimated 20.9% of UI income went to taxpayers with an AGI of at least \$100,000 in 2018.

Resources

- CRS Report R46687, *Current Status of Unemployment Insurance (UI) Benefits: Permanent-Law Programs and COVID-19 Pandemic Response*
- CRS Report RS21356, *Taxation of Unemployment Benefits*

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