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SUMMARY

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Unemployment insurance (UI) benefits have generally been fully subject to federal income taxation since the Tax Reform Act of 1986 (P.L. 99-514). For federal income tax purposes, UI benefits include regular state Unemployment Compensation (UC), Extended Benefits (EB), Trade Adjustment Assistance (TAA) benefits, Disaster Unemployment Assistance (DUA), railroad unemployment benefits, and all temporary UI benefits created in response to recessions (such as the now-expired COVID-19 UI benefits). A special provision allowed up to $10,200 of UI benefits paid in 2020 to be excluded from federal taxable income for some taxpayers.

This report describes the federal taxation of UI benefits, including federal income tax withholding requirements related to the now-expired COVID-19 UI benefits. It also provides Internal Revenue Service (IRS) data on the estimated number of federal income tax returns reporting unemployment benefits by adjusted gross income (AGI) in tax year 2019 (the most recent data year available). These data show that in tax year 2019, UI income was concentrated among middle- and lower-income tax filers (those with an AGI of less than $50,000). Almost 30% of tax returns reporting UI payments in 2019 (1.29 million, representing approximately 26% of UI payments) did not have a taxable return; these tax filers did not owe income taxes and paid no taxes on their UI benefits for that year.

The report uses data collected by U.S. Department of Labor (DOL) to describe recent patterns of optional federal income tax withholding of UI benefits. States reported to DOL that approximately 5.1% of all UI benefits were withheld for the payment of federal income taxes in 2019, compared with approximately 4.2% in 2020 and 4.1% in 2021 (i.e., years when the now-expired COVID-19 UI benefits were authorized). The lower reported percentages of UI benefits withheld for the payment of federal taxes in 2020 and 2021 suggest that UI claimants may have been less likely to have taxes withheld from COVID-19 UI benefits than other types of UI benefits. Because the COVID-19 UI benefits provided higher levels of income replacement than permanent-law UI benefits (often exceeding previously reported weekly wages) and some states did not provide federal income tax withholding opportunities for certain types of COVID-19 UI benefits, some individuals may have had unexpectedly high federal income taxes due at the end of tax years 2020 and 2021.

This report also explains the federal income tax exclusion authorized for UI payments made in 2020. The American Rescue Plan Act of 2021 (P.L. 117-2) allowed taxpayers with modified AGI of less than $150,000 to exclude up to $10,200 in UI benefits from 2020 taxable income. This federal income tax exclusion applied to all UI benefits, including the now-expired COVID-19 UI benefits. UI benefits paid in 2021 or later do not qualify for this tax exemption, even in situations of delayed benefit payments based on a period of unemployment in 2020.

Finally, this report summarizes state income tax treatment of UI benefits, including whether a state offers to withhold state income taxes from UI benefits and the state's withholding rate. Most states that have state income taxes include UI benefits in taxable income, and many of them offer state income tax withholding to UI claimants. Many states that tax UI benefits also provided a temporary tax exclusion for these benefits in 2020 similar to the temporary federal exclusion. A few states have extended this option for the 2021 tax year.

For more information on UI benefits, including the now-expired COVID-19 UI benefits, see CRS Report R46687, *Unemployment Insurance (UI) Benefits: Permanent-Law Programs and the COVID-19 Pandemic Response*.

For the legislative history on the taxation of UI benefits, see CRS Report RS21356, *Taxation of Unemployment Benefits*.

Contents

Tables

Contacts

Introduction

Congress enacted several temporary, now-expired Unemployment Insurance (UI) benefits for workers unemployed due to the COVID-19 pandemic and the resulting disruption of the economy and labor market. These temporary UI programs (1) augmented all UI benefits, (2) created additional weeks of benefits, and (3) expanded coverage to new groups of workers through a new benefit. Both the potential benefit duration (i.e., a maximum of more than 17 months) and the unprecedented magnitude of benefit augmentation had potential tax implications for UI recipients.

The COVID-19 UI benefits authorized from March 2020 through September 2021 provided higher levels of income replacement than UI benefits paid during 2019. Benefits often exceeded previous weekly wages. For some individuals, higher UI benefit payments raised concerns about higher-than-anticipated federal income tax liabilities. Some states did not provide federal income tax withholding opportunities for certain types of COVID-19 UI benefits, further contributing to this concern.

This report provides information on the federal taxation of UI benefits, including federal income tax withholding requirements related to the now-expired COVID-19 UI benefits. The report also discusses the federal income tax exclusion authorized for UI payments in 2020, which allowed 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. It also provides information from the Internal Revenue Service (IRS) on the amounts of UI benefits that were taxed in 2019 as well as program data on the percentage of all UI benefits that was withheld for the payment of federal income taxes in 2019 through 2021. Finally, the report summarizes state income tax treatment of UI benefits, including whether a state offers to withhold state income taxes from UI benefits, the state's withholding rate, and whether the state matched the temporary federal tax exclusion on up to $10,200 of UI benefits in 2020.

UI Benefits: the COVID-19 Pandemic Response

The UI system's two main objectives are to provide temporary and partial wage replacement to involuntarily unemployed workers and to stabilize the economy during recessions. The two permanent-law UI benefits—Unemployment Compensation (UC) and Extended Benefits (EB)—are countercyclical, with spending and weekly benefit payments that increase automatically during a recession. Congress often supplements these permanently authorized economic stabilization measures by enacting temporary UI benefit expansions during recessions.[1]

In response to the recent recession[2] and the economic disruption caused by the COVID-19 pandemic, Congress enacted several temporary, now-expired UI programs through the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136). Congress extended these programs through Division N, Title II, Subtitle A (the Continued Assistance for Unemployed Workers Act of 2020, or "Continued Assistance Act") of the Consolidated Appropriations Act, 2021 (P.L. 116-260); and further extended them through Title IX, Subtitle A,

[1] For pre-2020 temporary UI benefit expansions, see CRS Report RL34340, *Extending Unemployment Compensation Benefits During Recessions*.

[2] The National Bureau of Economic Research dates the beginning of the COVID-19 recession to February 2020. The recovery began two months later in April 2020; see https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions.

of the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2).[3] The programs included the following:

- **Federal Pandemic Unemployment Compensation (FPUC)** first provided a temporary, additional $600-a-week benefit financed by the federal government[4] that augmented most weekly UI benefits for weeks of unemployment beginning on March 29, 2020,[5] through July 25, 2020.[6] No FPUC benefits were payable for weeks of unemployment that began after July 25, 2020,[7] until the reauthorization[8] (and reestablishment) of the temporary FPUC benefit at a lower amount of $300 per week (by the Continued Assistance Act). The lower $300 weekly FPUC payments were available for weeks of unemployment beginning on or after December 26, 2020,[9] through September 4, 2021.[10]
- **Pandemic Emergency Unemployment Compensation (PEUC)** provided a total of 49 additional weeks of federally financed UI benefits at an amount equivalent to regular state UI benefits for individuals who exhausted state and federal UI benefits and were able to work, available for work, and actively seeking work, subject to COVID-19-related flexibilities, from March 29, 2020,[11] through September 4, 2021.[12]
- **Pandemic Unemployment Assistance (PUA)** provided a total of 75 weeks of a temporary, federal UI program for individuals who were (1) not otherwise eligible for UI benefits (e.g., self-employed, independent contractors, gig economy workers); (2) unemployed, partially unemployed, or unable to work due to a specific COVID-19-related reason; and (3) not able to telework and not receiving any paid leave. The PUA benefit was designed to approximate what workers would have received if their employment had been covered by the UI

[3] For details on these temporary programs, see CRS Report R46687, *Unemployment Insurance (UI) Benefits: Permanent-Law Programs and the COVID-19 Pandemic Response*.

[4] Permanent-law UC benefits are financed by the states; under permanent law, the EB program is financed 50% by the states and 50% by the federal government.

[5] March 30, 2022, in New York. For the purposes of UI programs and benefits, New York defines *week* as Monday to Sunday; every other state defines *week* as Sunday to Saturday. Therefore, the benefit expiration date in New York falls one calendar day later than in other states.

[6] These included regular UC, Pandemic Unemployment Assistance (PUA), Pandemic Emergency Unemployment Compensation (PEUC), EB, Disaster Unemployment Assistance (DUA), Short-Time Compensation (STC), Trade Readjustment Allowance (TRA), and Self Employment Assistance (SEA). For information on TRA, see CRS Report R44153, *Trade Adjustment Assistance for Workers and the TAA Reauthorization Act of 2015*. For information on SEA, see CRS Report R41253, *The Self-Employment Assistance (SEA) Program*.

[7] July 26, 2020, in New York.

[8] For U.S. Department of Labor (DOL) guidance on the FPUC extension in the Continued Assistance Act, see DOL, Employment and Training Administration (ETA), "Continued Assistance for Unemployed Workers (Continued Assistance) Act of 2020—Federal Pandemic Unemployment Compensation (FPUC) Program Reauthorization and Modification and Mixed Earners Unemployment Compensation (MEUC) Program Operating, Reporting, and Financial Instructions," UIPL No. 15-20, Change 3, January 5, 2021, https://wdr.doleta.gov/directives/corr_doc.cfm?docn=6122.

[9] December 27, 2020, in New York.

[10] September 5, 2021, in New York.

[11] March 30, 2020, in New York.

[12] September 5, 2021, in New York.

program. PUA was payable for weeks of unemployment beginning on February 2, 2020,[13] through September 4, 2021.[14]

The Continued Assistance Act authorized an additional, temporary UI benefit:

- **Mixed Earner Unemployment Compensation (MEUC)** provided, at state option, a $100-per-week benefit augmentation for unemployed workers with income from both wage-and-salary jobs and self-employment who were not currently receiving PUA. MEUC was available in most states for weeks of unemployment beginning on or after December 27, 2020, through September 4, 2021.

Additionally, President Trump issued a presidential memorandum[15] that created a short-term temporary benefit:

- **Lost Wages Assistance (LWA)** was paid as a $300-per-week supplement to individuals with underlying weekly UI benefit amounts of at least $100; or if a state chose to contribute an additional $100 a week in state funds, the total supplement would have been $400 a week.[16] LWA was not available to those receiving Disaster Unemployment Assistance (DUA). The first week of unemployment covered by LWA began on July 26, 2020,[17] and all states ended LWA payments for the weeks of unemployment ending on or before September 6, 2020.[18]

UI Benefits: Taxable Income Under Federal Tax Law

UI benefits have been fully subject to federal income taxation since 1987.[19] The two underlying rationales for fully subjecting UI benefits to income tax are (1) to treat the benefits the same as wages and (2) to eliminate the work disincentive caused by the previously favorable tax treatment for UI benefits relative to wages.[20] This federal tax treatment means unemployment benefits are

[13] February 3, 2020, in New York.

[14] September 5, 2021, in New York.

[15] White House, "Memorandum on Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019," August 8, 2020, available at https://trumpwhitehouse.archives.gov/presidential-actions/memorandum-authorizing-needs-assistance-program-major-disaster-declarations-related-coronavirus-disease-2019/.

[16] South Dakota and American Samoa did not participate in LWA. Guam, Kentucky, and Montana supplemented LWA with an additional $100 weekly payment. All jurisdictions participating in LWA provided up to six weeks of benefits with the following exceptions: the Commonwealth of Northern Mariana Islands agreed to provide up to three weeks, Florida provided up to four weeks, Idaho provided up to five weeks, and the U.S. Virgin Islands provided up to three weeks. (Email exchange between CRS and FEMA, Office of External Affairs, February 6, 2021.)

[17] July 27, 2020, in New York.

[18] LWA was potentially available for weeks of unemployment between July 26, 2020, and December 27, 2020, but the memorandum required that the program be terminated earlier if either (1) Congress had enacted supplemental COVID-19 pandemic-related unemployment compensation (e.g., reestablished the FPUC authority, which did not occur during that period) or (2) certain conditions were met related to the balance of the Disaster Relief Fund (DRF). By the week ending September 6, 2020, the balance of the DRF required that the LWA be terminated. (Email exchange between CRS and FEMA, Office of the Chief Financial Officer, November 9, 2020).

[19] As required under the Tax Reform Act of 1986 (P.L. 99-514, enacted October 22, 1986). For the history of the federal income tax treatment of UI benefits, see CRS Report RS21356, *Taxation of Unemployment Benefits*.

[20] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress;* P.L. 99-514*)*, JCS-10-87, May 4, 1987, pp. 29-30.

treated the same as wages and other ordinary income with regard to federal income taxes. However, UI benefits are not subject to payroll taxes, including Social Security and Medicare taxes, because the benefits are not considered to be wages.[21]

For the purposes of federal income taxation,[22] the definition of UI benefits includes regular state UC benefits, EB,[23] Trade Adjustment Assistance (TAA) benefits,[24] DUA,[25] and railroad unemployment benefits,[26] and has included all temporary UI benefits (e.g., FPUC, PEUC, PUA, MEUC, and LWA) since UI became taxable.[27] In addition to being subject to federal income taxes, unemployment benefits are taxed in most states that have an income tax.[28]

UI Replacement Rates

Most state UC benefit calculations generally replace half of a claimant's average weekly wage up to a weekly maximum (cap) for up to 26 weeks.[29] Before the COVID-19 pandemic, the average ratio of UI benefits to prior earnings generally ranged from 30% to 50%.[30] In general, workers with higher earnings would have lower replacement rates than average in state UC calculations, in part because of the cap on maximum benefits.

Weekly UI benefits in 2020 and 2021 often provided significantly higher levels of gross income replacement than had previously been the case, as the underlying UI benefit was augmented by temporary measures (e.g., the $600 or $300 weekly FPUC benefit, the $300 weekly LWA benefit, the $100 weekly MEUC benefit). For example, when authorized from April through July 2020,

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21 For more information on payroll taxes, see CRS Report R47062, *Payroll Taxes: An Overview of Taxes Imposed and Past Payroll Tax Relief* .

22 For the full definition of UI benefits under tax law, see 26 U.S.C. Section 85. See also 26 C.F.R. §1.85-1.

23 For more information on UC and EB, see CRS Report R46687, *Unemployment Insurance (UI) Benefits: Permanent-Law Programs and the COVID-19 Pandemic Response*.

24 For more information on TAA, see CRS In Focus IF10570, *Trade Adjustment Assistance for Workers (TAA)*.

25 For more information on DUA, see CRS Report RS22022, *Disaster Unemployment Assistance (DUA)*.

26 For more information on railroad unemployment benefits, see CRS Report RS22350, *Railroad Retirement Board: Retirement, Survivor, Disability, Unemployment, and Sickness Benefits*.

27 For more information on historical, temporary UI benefits created by Congress in response to prior responses, see CRS Report RL34340, *Extending Unemployment Compensation Benefits During Recessions*. For more information on the now-expired COVID-19 UI benefits, see CRS Report R46687, *Unemployment Insurance (UI) Benefits: Permanent-Law Programs and the COVID-19 Pandemic Response*.

28 **Table 2**, below, provides detailed information on how states treat UI benefits in their state income tax systems.

29 Although there are broad requirements under federal law regarding UC and EB benefits and financing, the specifics are set out under each jurisdiction's laws, resulting in 53 different UC programs operated in the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. DOL provides oversight of state UC programs and state administration of federal UI benefits. States operate their own permanent-law UC and EB programs and also administer any temporary federal UI benefits. Each state's UC laws determine the weekly benefit amount and the number of weeks of UC available to an unemployed worker. The UC benefit amount is used for the purposes of EB and most temporary federal UI benefit extensions (e.g., PEUC). Most states provide up to 26 weeks of UC to eligible individuals who become involuntarily unemployed for economic reasons and meet state-established eligibility rules.

30 For a summary of each state's benefit calculation, see Table 3-5 "Weekly Benefit Amounts" in DOL, *Comparison of State Unemployment Insurance Laws*, Chapter 3. Monetary Entitlement, Washington, DC, 2021, p. 72, https://oui.doleta.gov/unemploy/pdf/uilawcompar/2021/complete.pdf#page=72. For historical average replacement rates, see Figure 4. "Regular UI Wage Replacement Rate in the United States, 1938–2018," in Christopher J. O'Leary and Stephen A. Wandner, *An Illustrated Case for Unemployment Insurance Reform*, W.E. Upjohn Institute for Employment Research, Upjohn Institute working paper, 19-317 , Kalamazoo, MI, January 22, 2020, p. 16, https://research.upjohn.org/up_workingpapers/317/.

the $600 weekly FPUC supplement coupled with the underlying UI benefit was estimated to replace more than 100% of pre-pandemic earnings for more than 75% of UI beneficiaries.[31] The estimated replacement rate for workers receiving the $600 FPUC varied significantly, with a median replacement rate of 145%, and exceeding 300% for UI beneficiaries with the lowest 10% of earnings.[32]

Federal Income Tax Withholding from UI Benefits

Since 1997, state UI agencies, which administer all UI benefits, have been required to offer claimants receiving regular UC the opportunity to elect federal income tax withholding at the time the claimant first files for UC benefits. [33] The option, if selected, must continue onto other UC-based benefits (e.g., EB). Additionally, states are required to inform beneficiaries that state UC and EB payments are included in their gross income for federal income tax purposes and that they will receive IRS Form 1099-G to file with their income tax return. States have the option to offer to withhold state income tax. Alternatively, individuals may opt to pay estimated federal taxes on UC and EB benefits using IRS Form 1040-ES or pay such taxes when filing a federal income tax return.

Under federal tax law, the current withholding rate for federal income tax is 10% of the gross UI payment. The 10% rate applies to all filing statuses—single, married filing jointly, married filing separately, head of household—and is not conditional on the number of dependents. Typically, this low withholding rate would be sufficient to cover federal income tax liability for most unemployed individuals, as they would be expected to have significantly lower income (due to job loss and the average 30%-50% replacement rate of UI). However, it may not have been sufficient when an individual's UI income replacement was greater than their pre-pandemic earnings (as was the case for a period in 2020—as discussed above in the "UI Replacement Rates" section). As a result, during the periods when FPUC, MEUC, and LWA were supplementing UI benefits, individuals with lower earnings histories may have been subject to a higher federal income tax bracket in which the 10% withholding rate might have been insufficient to prevent additional federal income tax being due.

Federal Tax Withholding: Pandemic-Related Benefits

Withholding requirements varied across the different pandemic-related UI programs.

- **PEUC:** States were required offer PEUC recipients the opportunity to elect federal income tax withholding. DOL applied 26 U.S.C. Section 3304(a)(18) to PEUC based on Section 2107(a)(4)(B) of the CARES Act, which required the application of state and federal UC laws to PEUC claims and payments to the extent practicable.[34]

[31] Peter Ganong, Pascal Noel, and Joseph Vavra, "US unemployment insurance replacement rates during the pandemic," *Journal of Public Economics*, vol. 191, no. 104273 (September 30, 2020), https://www.sciencedirect.com/science/article/pii/S0047272720301377.

[32] Ibid., Figure 3.

[33] 26 U.S.C. §3304(a)(18). Claimants who elect to have federal income tax withheld from their regular UC (and EB) 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.

[34] Information provided by email communication from DOL, ETA to CRS on March 2, 2021.

- **PUA:** States were not required to offer PUA recipients the opportunity to withhold taxes. However, state agencies were required to inform PUA recipients that these benefits would be included in their gross income for federal income tax purposes and that they would receive IRS Form 1099-G to file with their income tax return.[35] Additionally, state UI agencies were encouraged by DOL to provide a withholding option for PUA beneficiaries.
- **FPUC and MEUC:** States were required to offer individuals receiving FPUC (and MEUC if applicable) the opportunity to withhold federal taxes.[36] There is some indication that not all states were able to meet this requirement.[37]
- **LWA**: States were required to notify individuals that LWA payments were subject to federal income taxation but were not required to provide them with the option to withhold federal income taxes from LWA payments.[38]

Data on UI Income from Federal Income Tax Returns

The IRS publishes annual sample statistics related to "the operation of internal revenue laws" through the Statistics of Income (SOI) program.[39] Using the most recently available SOI data, **Table 1** shows the estimated number of federal income tax returns reporting unemployment benefits by AGI in tax year 2019,[40] during which 2.8% of tax returns filed reported UI income.[41] Of returns reporting UI payment income, approximately 30% (1.29 million) were not taxable and reported 26.2% of all UI payments. Taxpayers in this group did not owe income taxes and paid no taxes on their UI benefits for tax year 2019.

[35] DOL, ETA, "Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 – Pandemic Unemployment Assistance (PUA) Additional Questions and Answers," Unemployment Insurance Program Letter (UIPL) No. 16-20, Change 2, July 21, 2020, see Question #5 on p. I-3, https://wdr.doleta.gov/directives/attach/UIPL/UIPL_16-20_Change_2.pdf.

[36] DOL stated that 26 U.S.C. Section 3304(a)(18) also applied to FPUC and MEUC; information provided by email communication from DOL, ETA to CRS on March 2, 2021. Also see DOL, ETA, "Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 - Federal Pandemic Unemployment Compensation (FPUC) Program Operating, Financial, and Reporting Instructions," UIPL No. 15-20, April 4, 2020, see Section D.6 on p. I-6, https://wdr.doleta.gov/directives/attach/UIPL/UIPL_15-20.pdf.

[37] For example, according to the California Employment Development Department, "This withholding option was not available for the $600 pandemic additional compensation payments, which needed to be quickly implemented at the time to get benefit funding to eligible claimants in need of them"; see Megan Leonhardt, "Some Americans owe thousands in taxes on enhanced unemployment benefits: 'They threw us to the fishes'," *CNBC.com*, March 2, 2021. Also see Karin Price Mueller, "If you get the $600 expanded unemployment benefit, you may also have a tax issue," *NJ.com*, https://www.nj.com/coronavirus/2020/05/if-you-get-the-600-expanded-unemployment-benefit-you-may-also-have-a-tax-issue.html.

[38] Federal Emergency Management Agency (FEMA), "FEMA Supplemental Lost Wages Payments under Other Needs Assistance," Frequently Asked Questions, February 2022, p. 17, https://www.fema.gov/sites/default/files/documents/fema_supplemental-lost-wages-payments-under-other-needs-assistance_022022.pdf.

[39] For more information on the IRS SOI program, see https://www.irs.gov/statistics/soi-tax-stats-purpose-and-function-of-statistics-of-income-soi-program.

[40] IRS SOI data for 2020 and 2021 are not yet available. IRS SOI data on individual income tax returns are made available at https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-return-form-1040-statistics.

[41] For 2019, an estimated 157,769,807 returns were filed (IRS SOI data 2019, Table 1.4).

Overall, among individuals with UI-covered job losses, an estimated 49.0% of UI income was received by tax filers with an AGI of less than $50,000. In contrast, an estimated 16.8% of total income for all taxpayers was reported on returns with an AGI of less than $50,000. Thus, UI income is more concentrated than total income reported by lower- and moderate-income taxpayer groups.

An estimated 21.0% of UI income went to tax filers with an AGI of at least $100,000 in 2019.[42] States are prohibited from restricting UI benefit eligibility on account of income level except to use income sources deemed related to unemployment. Thus, because general individual or household income level would not be considered to impact the fact or cause of unemployment, DOL requires that states pay compensation for unemployment to all eligible beneficiaries regardless of their income level.[43]

Table 1. Tax Returns with Reported Unemployment Insurance Income, Tax Year 2019

	Number of Returns	UI Income (thousands)	Share of UI Income
Total returns	4,363,590	$21,395,491	100.0%
Nontaxable returns	1,290,181	$5,608,461	26.2%
Adjusted Gross Income (AGI) Category			
Under $15,000	427,951	$1,388,204	6.5%
$15,000–under $30,000	965,945	$4,383,174	20.5%
$30,000–under $50,000	940,566	$4,711,128	22.0%
$50,000–under $100,000	1,220,445	$6,424,492	30.0%
$100,000–under $200,000	647,735	$3,469,142	16.2%
$200,000 and above	160,948	$1,019,354	4.8%

Source: Created by CRS using IRS Statistics of Income data 2019, Table 1.4.

Notes: AGI is total income minus statutory adjustments. Data are IRS estimates based on a sample of tax returns. UI income is rounded to the nearest $1,000. IRS Table 1.4 applies the term "Unemployment Compensation" when referring to UI benefits.

Amount of UI Benefits Withheld for Federal Income Taxes in 2020 and 2021

UI program data provide information on taxes withheld from UI benefits for 2020 and 2021. According to DOL's Employment and Training Administration (ETA) 2112 - UI Financial

[42] States are prohibited from restricting UI benefit eligibility based upon an individual's or household's income level because of a 1964 DOL decision that precludes states from means-testing to determine regular UC eligibility; see Letter from Robert C. Goodwin, DOL administrator, to all state employment security agencies, October 2, 1964, http://oui.doleta.gov/dmstree/uipl/uipl_pre75/uipl_787.htm. The determination was in response to a South Dakota law that required longer waiting periods for unemployment benefits for individuals with higher earnings. The Labor Secretary expanded the restriction on means-testing to severely limit the factors states may use to determine UC entitlement. Under this interpretation, federal law requires entitlement to compensation to be determined from facts or causes related to the individual's state of unemployment.

[43] Although the above 1964 decision directly pertains to the UC program, all other UI programs except for Disaster Unemployment Assistance (DUA) use the same eligibility requirements.

Transaction Summary Report,[44] states reported that approximately 5.1% of all UI benefits were withheld for the payment of federal income taxes in 2019.[45] During the period when the majority of COVID-19 UI benefits would have been paid, the percentage withheld decreased to approximately 4.2% of all UI benefits in 2020 and to 4.1% in 2021.[46] The lower percentages of reported benefits withheld for the payment of federal taxes in 2020 and 2021 suggest that COVID-19 UI claimants may have been less likely to have taxes withheld. This trend may be attributable in part to states not being required to offer individuals who received PUA the option to withhold federal income tax from those benefits. Also, as mentioned previously, some states did not consistently offer to withhold federal income taxes from FPUC.[47]

Temporary Federal Income Tax Exclusions for UI Benefits

Since it began to treat all UI benefits as fully taxable income, Congress has taken action twice to exclude a portion of those benefits from taxable income. The first time was via the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5, §1007), which included a temporary exclusion on the first $2,400 of UI benefits per individual for federal income tax purposes. 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.[48]

In the second, and more recent, instance, the American Rescue Plan Act of 2021 (P.L. 117-2, §9042) allowed taxpayers to exclude up to $10,200 in UI benefits from income on their federal tax returns in 2020. This exclusion was limited to taxpayers with modified AGI of less than $150,000 and applied regardless of the taxpayer's filing status (i.e., married filing jointly, married filing separately, single, or head of household). In the case of married individuals filing a joint tax return, this exclusion of up to $10,200 applied to each spouse. The legislative intent of the exclusion was to mitigate unexpected taxes due to the $600 FPUC payment (as $600 x 17

[44] CRS calculations of ETA 2112 data extracted on April 7, 2022; available at https://oui.doleta.gov/unemploy/DataDownloads.asp.

[45] In 2019, a total of $1.4 billion out of $27.9 billion in UI benefits were reported by the states as withheld for federal income taxes. During 2019, these UI benefits predominately would have been UC payments as no state met their requirements to trigger on to EB in 2019. This percentage would suggest approximately 45% of all beneficiaries opted to withhold 10% of their UI benefits for federal tax purposes. States do not report to DOL on the amount of state taxes withheld from UI benefits.

[46] In 2020, a total of $22.9 billion out of $541.6 billion in UI benefits were reported by the states as withheld for federal income taxes. In 2021, a total of $13.3 billion out of $323.2 billion in UI benefits were reported by the states as being withheld for federal income taxes.

[47] See footnote 35. Additionally, see "Why were you not able to withhold taxes from the $300 week per payments?" at https://mn.gov/uimn/applicants/needtoknow/year-end-tax/.

[48] The Joint Committee on Taxation, *ERRATA "GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 111TH CONGRESS"*, 111th Cong., 1st sess., March 23, 2011, JCX-20-11, p. 3.

weeks=$10,200).[49] JCT estimated this exclusion would reduce federal receipts by approximately $25.0 billion.[50]

Temporary Tax Exclusion Does Not Apply to 2020 Benefits Paid in 2021

One question regarding the 2020 exclusion relates to circumstances in which UI benefit payments are delayed. UI benefit payments might be delayed for a variety of reasons, such as state administrative delays and claimant appeals. The IRS has released guidance on this issue. If the UI benefit was paid to the individual after 2020, the payment cannot be excluded from income tax for 2020 even if the underlying (delayed) benefit was based on a period of unemployment in 2020.[51]

State Income Tax Withholding of UI Benefits

Most states have some form of personal income taxation (eight do not). In states with personal income taxation, five do not consider UI benefits taxable income.[52] Federal law allows but does not require states to offer to withhold state income taxes from UI payments. **Table 2** provides information on state tax treatment of UI benefits, including whether the state offers to withhold state income taxes from UI benefits and the state's withholding rate.

Table 2. General State Income Tax Treatment of UI Benefits and Withholding Rate

	Had State Income Tax in 2020?	State Typically Taxes UI Benefits?	Withholds State Income Tax from UI Benefits?	Withholding Rate on UI Benefits
Alabama	Yes	No, with exceptions	N/A	N/A
Alaska	No	N/A	N/A	N/A
Arizona	Yes	Yes	Yes	1%
Arkansas	Yes	Yes	N/A	N/A
California	Yes	No	N/A	N/A
Colorado	Yes	Yes	Yes	4%

[49] Section 9042 of ARPA was based on S. 175 and H.R. 685 (117th Congress). In a press release for S. 175, Senator Dick Durbin's office directly linked the $10,200 of tax relief to the 17 weeks that the $600 FPUC benefit had been available; see Office of U.S. Senate Democratic Whip Dick Durbin (D-IL), "Durbin, Axne Introduce Legislation To Provide Tax Relief For Unemployed Americans," press release, February 2, 2021, https://www.durbin.senate.gov/newsroom/press-releases/durbin-axne-introduce-legislation-to-provide-tax-relief-for-unemployed-americans.

[50] The Joint Committee on Taxation, *Estimated Revenue Effects Of H.R. 1319, The "American Rescue Plan Act Of 2021," As Amended By The Senate, Scheduled For Consideration By The House Of Representatives*, 117th Cong., 1st sess., March 9, 2021, JCX-5-22, p. 1, https://www.jct.gov/publications/2021/jcx-14-21/.

[51] See A6 of IRS, "IRS updates 2020 unemployment compensation exclusion FAQs," Fact Sheet FS-2022-21, March 2022, https://www.irs.gov/pub/taxpros/fs-2022-21.pdf#page=3, which states: "Q6. I was unemployed in 2020, but payment of my unemployment compensation was delayed until 2021. Do I qualify for the unemployment compensation exclusion? *A6. No, the American Rescue Plan provides unemployment compensation exclusion relief only for unemployment compensation received in 2020. The exclusion does not apply to unemployment compensation that was received in 2021.*" [Italics added.]

[52] Indiana and Wisconsin exempt UI from taxation if a taxpayer's federal AGI is under a base amount of either $18,000 (married filing jointly) or $12,000 (single, married filing separately and did not live with spouse for entire year). If federal AGI exceeds the base amount, then the exemption is the lesser of UI received or 50% of the amount above the base amount.

Connecticut	Yes	Yes	Yes	3%
Delaware	Yes	Yes	No	No
District of Columbia	Yes	Yes[a]	Yes[a]	5%[a]
Florida	No	N/A	N/A	N/A
Georgia	Yes	Yes	Yes	6%
Hawaii	Yes	Yes	Yes	5%
Idaho	Yes	Yes	No	N/A
Illinois	Yes	Yes	Yes	4.95%
Indiana	Yes	Special treatment[b]	Yes	4%
Iowa	Yes	Yes	Yes	5%
Kansas	Yes	Yes	Yes	3.5%
Kentucky	Yes	Yes	Yes	4%
Louisiana	Yes	Yes	No	No
Maine	Yes	Yes	Yes	5%
Maryland	Yes	Yes	Yes	7%
Massachusetts	Yes	Yes	Yes	5%
Michigan	Yes	Yes	Yes	4.25%
Minnesota	Yes	Yes	Yes	5%
Mississippi	Yes	Yes	No	No
Missouri	Yes	Yes	No	No
Montana	Yes	No	N/A	N/A
Nebraska	Yes	Yes	Yes	5%
Nevada	No	N/A	N/A	N/A
New Hampshire	No, with exceptions	N/A	N/A	N/A
New Jersey	Yes	No	N/A	N/A
New Mexico	Yes	Yes	No	No
New York	Yes	Yes	Yes	2.5%
North Carolina	Yes	Yes	Yes	Beneficiary choice[c]
North Dakota	Yes	Yes	Yes	2%
Ohio	Yes	Yes	No	N/A
Oklahoma	Yes	Yes	Yes	3%
Oregon	Yes	Yes	Yes	6%
Pennsylvania	Yes	No	N/A	N/A
Rhode Island	Yes	Yes	Yes	2.5%
South Carolina	Yes	Yes	Yes	7%
South Dakota	No	N/A	N/A	N/A
Tennessee	No	N/A	N/A	N/A

Texas	No	N/A	N/A	N/A
Utah	Yes	Yes	Yes	5%
Vermont	Yes	Yes	Yes	2.4%
Virginia	Yes	No	N/A	N/A
Washington	No	N/A	N/A	N/A
West Virginia	Yes	Yes	No	N/A
Wisconsin	Yes	Special treatment[b]	Yes	5%
Wyoming	No	N/A	N/A	N/A

Source: Created by CRS. Underlying citations are available to congressional clients upon request.

a. Beginning in 2021, UI benefits are exempt from taxation in the District of Columbia.

b. State has a UI exemption if a taxpayer's federal AGI is under $18,000 (married filing jointly) or $12,000 (single, married filing separately and did not live with spouse for entire year). If federal AGI exceeds the base amount of $18,000 or $12,000, then the exemption is the lesser of UI received or 50% of the amount above the base amount. (This matches the now-repealed federal tax treatment first created in the Tax Equity and Fiscal Responsibility Act of 1982 [P.L. 97-248]).

c. The beneficiary's choice must be a whole percentage (e.g., 2.0% not 2.1%).

State Tax Responses to the Federal 2020 UI Benefit Exclusion

When the temporary $10,200 UI benefit tax exclusion for federal income taxes was enacted, some states automatically followed that exclusion for their state income taxes in 2020, and others enacted temporary income tax exclusions that were identical or similar. **Table 3** lists whether a state typically taxes UI income and whether the state tax treatment of UI benefits received in 2020 was temporarily changed. A total of 27 states (out of a potential 37) altered their 2020 tax treatment of UI benefits. In addition, four states expanded these temporary exclusions to the 2021 tax year, and the District of Columbia permanently altered its tax law beginning in 2021 to exclude UI benefits from taxable income.[53]

Table 3. State Income Tax Exclusion of UI Benefits in 2020 and 2021

	General State Tax Treatment of UI Benefits	Followed Federal $10,200/Special Tax Exclusion in 2020?	Special Tax Exclusion in 2021?
Alabama	No UI taxation	N/A	N/A
Alaska	No income tax	N/A	N/A
Arizona	Taxes UI	Yes	No
Arkansas	Taxes UI	All UI excluded	All UI excluded
California	No UI taxation	N/A	N/A
Colorado	Taxes UI	No	No
Connecticut	Taxes UI	Yes	No
Delaware	Taxes UI	All UI excluded	All UI excluded

[53] Government of the District of Columbia, Office of the Chief Financial Officer, *2021 District of Columbia (DC) Individual Income Tax Forms and Instructions*, D-40 All Individual Income Tax Filers, 2021, p. 2, https://otr.cfo.dc.gov/sites/default/files/dc/sites/otr/publication/attachments/52926_D-40_12.21.21_Final_Rev011122.pdf#page=2.

	General State Tax Treatment of UI Benefits	Followed Federal $10,200/Special Tax Exclusion in 2020?	Special Tax Exclusion in 2021?
District of Columbia	Taxed UI	Yes	Permanent change: all UI excluded beginning in 2021
Florida	No income tax	N/A	N/A
Georgia	Taxes UI	No	No
Hawaii	Taxes UI	No	No
Idaho	Taxes UI	No	No
Illinois	Taxes UI	Yes	No
Indiana	Special treatment, partially exempt	No	No
Iowa	Taxes UI	Yes	No
Kansas	Taxes UI	Yes	No
Kentucky	Taxes UI	No	No
Louisiana	Taxes UI	Yes	No
Maine	Taxes UI	Yes	No
Maryland	Taxes UI	Yes, additionally exempts all UI benefits for individuals making <$70,000 or married couples making <$100,000	Exempts all UI benefits for individuals making <$70,000 or married couples making <$100,000
Massachusetts	Taxes UI	$10,400 exempt for individuals with income under 200% of the federal poverty level (FPL)[a]	$10,400 exempt for individuals with income under 200% FPL
Michigan	Taxes UI	Yes	No
Minnesota	Taxes UI	Yes	No
Mississippi	Taxes UI	No	No
Missouri	Taxes UI	Yes	No
Montana	No UI taxation	N/A	N/A
Nebraska	Taxes UI	Yes	No
Nevada	No income tax	N/A	N/A
New Hampshire	No UI taxation	N/A	N/A
New Jersey	No UI taxation	N/A	N/A
New Mexico	Taxes UI	Yes	No
New York	Taxes UI	No	No
North Carolina	Taxes UI	No	No
North Dakota	Taxes UI	Yes	No
Ohio	Taxes UI	Yes	No

	General State Tax Treatment of UI Benefits	Followed Federal $10,200/Special Tax Exclusion in 2020?	Special Tax Exclusion in 2021?
Oklahoma	Taxes UI	Yes	No
Oregon	Taxes UI	Yes	No
Pennsylvania	No UI taxation	N/A	N/A
Rhode Island	Taxes UI	No	No
South Carolina	Taxes UI	Yes	No
South Dakota	No income tax	N/A	N/A
Tennessee	No income tax	N/A	N/A
Texas	No income tax	N/A	N/A
Utah	Taxes UI	Yes	No
Vermont	Taxes UI	Yes	No
Virginia	No UI taxation	N/A	N/A
Washington	No income tax	N/A	N/A
West Virginia	Taxes UI	Yes	No
Wisconsin	Special treatment, partially exempt	No	No
Wyoming	No income tax	N/A	N/A

Source: Created by CRS. Underlying citations are available to congressional clients upon request.

a. The Department of Health and Human Services (HHS) determines the FPL guideline amounts annually. The 2020 FPL is provided at https://aspe.hhs.gov/topics/poverty-economic-mobility/poverty-guidelines/prior-hhs-poverty-guidelines-federal-register-references/2020-poverty-guidelines.

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