

**Unemployment Insurance Demonstration Projects  
Questions and Answers**

**Q - 1. May a state use Reed Act or special distribution funds remaining in its account in the Unemployment Trust Fund (UTF) to pay the costs of a demonstration project, including subsidies for employer-sponsored job training, under the Middle Class Tax Relief and Job Creation Act of 2012 (the Act)?**

**A - 1.** The use of Reed Act funds depends upon the particular authority for the distribution of the various funds transferred to the state. Reed Act monies were transferred to states under various provisions of Section 903 of the Social Security Act (SSA). These include Section 903(c) (Traditional Reed Act distributions), Section 903(d) (Special Transfer in Fiscal Year 2002), Section 903(f) (Unemployment Compensation (UC) Modernization Incentive payments), Section 903(g) (Special Transfer in Fiscal Year 2009 for Administration), and three Reed Act distributions “capped” at \$100 million in Fiscal Years 1999, 2000, and 2001 under section 5403 of the Balanced Budget Act of 1997, Pub. L. 105-33. (The SSA provision transferring these “capped” distributions and governing their use has since been repealed.) For the most part, these funds are available for use to pay UC or, if appropriated by the state legislature, for administration of a state’s UC law and public employment offices.

Under Section 3304(a)(4) of the Federal Unemployment Tax Act (FUTA), and Section 303(a)(5), SSA (the “withdrawal standard”) a state participating in the Federal-state UC program may only withdraw money from its unemployment fund for the payment of UC, with enumerated narrow exceptions and conditions. Under Section 305(c), SSA, as added by Section 2102 of the Act, the Secretary of Labor may grant a state’s request for a waiver of the withdrawal standard when approving the state’s application “to the extent . . . the Secretary of Labor (Secretary) considers necessary to enable the State to carry out a demonstration project . . . .” We interpret this authority as allowing the Secretary to approve a state application for a demonstration project using those funds in the state’s account in the UTF available for payment of UC. As explained in Unemployment Insurance Program Letter (UIPL) No. 32-09, funds available to pay UC include Reed Act distributions under Section 903(c), (d), and (f), SSA, but do not include special distributions of funds for solely administrative purposes provided under the Balanced Budget Act of 1997 and Section 903(g), SSA.

Section 2101 of the Act also added Section 305(h), SSA, to provide that “[F]unding certified under section 302(a) may be used for an approved demonstration project.” Because funds certified under Section 302(a), SSA, are for the administration of the state’s UC law, and Reed Act funds for UC administration were intended to supplement those grant funds, the Secretary interprets this authority to permit states to use those funds that are available for the administration of a state’s UC law to be available for use for an approved demonstration project. Thus, Reed Act funds that may be used for the administration of the state UC law may be used for an approved demonstration project.

However, if a state has funds remaining from the \$500 million special administrative transfer in 2009 provided for in the Recovery Act, it may not use these amounts to fund an approved

demonstration project. Section 903(g)(3), SSA, as added by the Recovery Act, specifically limits the use of such funds by providing that they may be used by a state “only in the payment of expenses incurred by it for”:

- Implementing and administering the provisions of state law that qualify the state for the [UI modernization] incentive payments;
- Improved outreach to individuals who might be eligible by virtue of these provisions;
- The improvement of UC benefit and tax operations, including responding to increased demand for UC; and
- Staff-assisted reemployment services for UC claimants.

Because Federal law authorizes these funds to be expended only for these purposes, which do not include the payment of UC or the administration of the state UC law, the waiver authority in Sections 303(c) and (h), SSA, do not apply to these funds.

Note that a state applying for approval of a demonstration project must, as required by Section 305(b)(4), SSA, provide assurances that a demonstration project “would not result in any increased net costs to the State’s account in the Unemployment Trust Fund” and include an analysis supporting that conclusion in its application. That analysis should include the effect of the program on all funds in the state’s account that are available to pay UC, including any Reed Act or UI Modernization funds.

Finally, there is an important limitation that states should consider when determining whether to use Reed Act funds for an approved demonstration project. As required by Section 1201(a)(3)(B), SSA, if there are unobligated Reed Act funds in a state’s account in the UTF and the state requests a Title XII advance while operating a demonstration project, these funds will be taken into account as being available for the payment of compensation when the Department of Labor (Department) is determining whether to approve a Title XII advance. The state will have to use all available funds, including any Reed Act funds that were intended for use for an approved demonstration project, for the payment of UC before being able to obtain a Title XII advance.

**Q - 2. May my state use Title III, SSA grant funds to pay employment services (ES) employees to conduct, or work on, a demonstration project?**

**A - 2.** Yes. Section 305(h), SSA, provides that “Funding certified under section 302(a) [Title III grant funds] may be used for an approved demonstration project.” We interpret that provision to permit use of Title III UI administrative funds to pay the administrative costs of operating the demonstration project, and do not interpret it to require that only certain staff, such as UI agency staff, be permitted to work on the project. However, to the extent that inherently governmental functions are performed on a demonstration project by persons in positions funded by Title III

grant funds, those positions must be merit staffed. Therefore, a state agency may not contract out any inherently governmental function to an agency or entity that does not have a merit system of personnel administration. We note that Title III funds may be used to pay ES staff, consistent with Section 305(h), SSA, but only to pay for the actual work performed by ES employees directly on the demonstration project. If ES employees are working on a demonstration project on a part-time basis, Title III funds may not be used to pay for the employees' other activities.

**Q - 3. My state wants to propose a demonstration project that will provide subsidies for employer-provided training. In addition to the actual wage subsidies, may we pay for related expenses of operating the demonstration project, such as workers' compensation and child-care subsidies to or on behalf of participants, from amounts in the state's account in the UTF?**

**A - 3.** Yes. Subsection 305(c), SSA, permits the Secretary to waive the requirements of Sections 3304(a)(4), FUTA, and 303(a)(5), SSA, known as the "withdrawal standard," to the extent necessary to enable the state to carry out a demonstration project. Subsection 305(e), SSA, limits the activities in a demonstration project for which state unemployment fund dollars may be used to "subsidies for employer-provided training, such as wage subsidies" and "direct disbursements to employers . . . to pay part of the cost of wages that exceed the unemployed individual's prior benefit level."

We interpret these provisions together to mean that, when the Secretary waives the withdrawal standard *to the extent necessary to carry out a demonstration project*, that waiver extends to the payment of necessary related expenses such as workers' compensation, child care expenses, or transportation.

As a reminder, Section 305(b)(4), SSA, requires, for approval, that a state demonstrate that operation of a demonstration project will not result in any increased net costs to the state's account in the UTF. If the related expenses are paid from the state's account in the UTF, those expenses must be taken into account when determining whether the state may make the required assurance that the demonstration project will not result in increased net costs to the state's account in the UTF, as those expenses reflect payments that would not otherwise have been paid from the state's unemployment fund and have the potential to increase the cost of conducting a demonstration project. States should consider whether the payment of related expenses will accelerate reemployment of UI beneficiaries sufficiently to reduce benefits paid out and make the demonstration project more likely to result in no increased net costs to the state's account in the UTF.

**Q - 4. My state's legislature is out of session and doesn't meet again until January 2013. If my state's law must be amended for the state to have authority to conduct a demonstration project, will the Secretary approve my state's application before state law is amended, or before the effective date of any amendment, to permit operation of a demonstration project that would require a waiver of the "withdrawal standard" (section 3304(a)(4), FUTA, and**

**section 303(a)(5), SSA) or “methods of administration” (section 303(a)(1), SSA) requirement?**

**A - 4.** No. Section 305(b), SSA, requires that states include in their applications “a general description of the proposed demonstration project, *including the authority (under the laws of the State) for the measures to be tested.* . . . [emphasis added].” An application for approval to operate a demonstration project is incomplete and will be denied if the state does not yet have authority under its law to waive the withdrawal standard and/or methods of administration requirement and to conduct the demonstration project. We do not have the authority to approve an application predicated on future authority in state law to operate the demonstration project; state law must be in effect at the time we receive the application, or must have been enacted before the state’s application is received, with an effective date before the date the state plans to begin operation of the demonstration project.

We note, however, that some states may have authority to interpret their laws or to promulgate regulations to permit operation of a demonstration project without enacting a new statute. In that case, we will accept written assurances from the state’s Attorney General or other authorized legal official that state law permits operation of the demonstration project, along with copies of regulation or policy guidance.

**Q - 5. How does the Department define “layoff” for purposes of worker protections in paragraph 8.g of UIPL No. 15-12, which provides that demonstration project participants may not work in a job for which another “individual is on layoff from the same or substantially equivalent position.”**

**A - 5.** For purposes of the worker protections discussed in paragraph 8.g of UIPL No. 15-12, a “layoff” is a temporary separation from employment either for an indeterminate period of time, or where the worker has an anticipated return-to-work date. That is, the worker has neither quit nor been discharged from employment, but both the worker and the employer consider the employment relationship to be of a continuing nature. In many states, in the context of worker protections, “layoff” is applied to more recent temporary separations (in the last few months), and not those that occurred well in the past, such as a year ago.

**Q - 6. My state is currently operating a reemployment program similar to one of those described in Section 2102 of the Middle Class Tax Relief and Job Creation Act of 2012 (Pub. L. 112-96), either to provide wage subsidies for employer-provided training or to provide direct disbursements to employers who hire individuals receiving UC. Does the state have to make any changes, or may the current program be approved under this provision?**

**A - 6.** Whether the Secretary may approve an existing program without any modifications, except for the source of funds for the subsidies or reimbursements, depends on whether the current program meets all of the statutory requirements of Section 305, SSA, as explained in UIPL No. 15-12. Attached to that UIPL is a checklist of the statutory requirements and the

Secretary's priorities to assist states in the development of a complete application. A state with an existing program should consider using the checklist to determine the extent to which the program, as it currently exists, meets all of the statutory requirements for approval of a demonstration project. If it determines that the existing program meets the statutory requirements to permit the Secretary to waive the withdrawal standard or the methods of administration, the state would need to submit an application as set out in UIPL No. 15-12. We encourage states applying to implement existing programs to use information collected on participant outcomes when analyzing whether the program will not result in any increased net costs to the State's account in the UTF.

**Q - 7. My state has an existing reemployment program that provides, as a direct subsidy to employers who hire an unemployed individual, a fixed dollar amount of subsidy, regardless of the wage paid to the individual or the individual's weekly benefit amount. May the Secretary approve such a program as a demonstration project under Section 2102 of the Middle Class Tax Relief and Job Creation Act (Pub. L. 112-96)?**

**A - 7.** Section 305, SSA, explicitly limits the activities that may be pursued under a demonstration project to "... (2) direct disbursements to employers who hire individuals receiving unemployment compensation, *not to exceed the weekly benefit amount for each such individual, to pay part of the cost of wages that exceed the unemployed individual's prior benefit level.*" (Emphasis added.) Thus, to be approved, a demonstration project must be designed to ensure this statutory limit is not exceeded. If this statutory requirement cannot be met because the fixed amounts that would be disbursed to employers would exceed this limit, then the existing reemployment program could not be approved as a demonstration project. When determining the amount of the disbursements to employers, we encourage states to consider how the amount impacts the state's ability to provide the required assurance that the program will not result in any increased net cost to the state's account in the UTF.

**Q - 8. My state has outstanding Title XII advances. If my state operates a demonstration project that results in a loss or does not achieve the anticipated savings to the state's account in the UTF, will that affect the state's ability to avoid FUTA credit reduction for its employers?**

**A - 8.** Regulations at 20 CFR 606.23 and 606.24 set out the criteria for an avoidance of FUTA credit reductions and the application process. Under the terms of FUTA and the cited regulations, any decrease in solvency resulting from the demonstration project would have the same impact on FUTA credit avoidance as any other state legislative action that decreases solvency and/or increases the amount of Title XII advances.

**Q - 9. If operation of the demonstration project results in increased costs or does not achieve the anticipated savings to the state's account in the UTF, will that affect a state's ability to qualify for a cap on FUTA credit reductions for its employers?**

**A - 9.** Regulations at 20 CFR 606.20 through 606.22 set out the criteria for qualifying for a cap on FUTA credit reductions and the application process. Under the terms of FUTA and the cited regulations, any decrease in solvency resulting from the demonstration project would have the same impact on the cap on FUTA credit reduction as any other state action that decreases solvency and/or increases the amount of Title XII advances.