



The Work Opportunity Tax Credit (WOTC)

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Summary

The Work Opportunity Tax Credit (WOTC), which was authorized by the Small Business Job Protection Act of 1996, is meant to induce employers to hire members of families receiving benefits under the Temporary Assistance to Needy Families (TANF) program and other groups thought to experience employment problems regardless of general economic conditions (e.g., food stamp recipients and ex-felons). Shortly thereafter, Congress passed the Welfare-to-Work (WtW) tax credit in the Taxpayer Relief Act of 1997 to focus specifically on more disadvantaged TANF recipients. About ten years later, the 109th Congress folded the WtW credit into a revised WOTC as part of the Tax Relief and Health Care Act of 2006.

Provisions to increase the minimum wage and to provide tax relief to small businesses were included in emergency supplemental appropriations during the 110th Congress. The U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Act of 2007 was signed into law on May 25, 2007. P.L. 110-28 extends the WOTC for three-and-one-half years through August 31, 2011. It also expands the definition of WOTC-eligible veterans to persons entitled to compensation for service-connected disabilities (a) with a hiring date not more than one year after having been discharged or released from active duty in the Armed Forces or (b) having been unemployed for at least six months during the one-year period ending on the hiring date, and doubled (to \$12,000) the maximum wage against which the subsidy rate could be applied for this component of the veterans group. Additionally, the law expands the age range of high-risk youth from 18 to 24-year-olds to include 25 to 39-year-olds and renamed the WOTC-eligible group "designated community residents." It also clarifies the definition of vocational rehabilitation referrals, adds "rural renewal county" to the places of residence for designated community residents, and allows the WOTC and tip credit against the AMT.

Subsequently during the 110th Congress, legislation concerning the WOTC was introduced to, among other things, extend the credit's expiration from August 28, 2007, to December 31, 2009, for firms who hire "Hurricane Katrina employees" to work in the disaster area. Such a provision was part of the Emergency Economic Stabilization Act of 2008 (P.L. 110-343).

Most recently, the WOTC has been mentioned in the context of the economic recovery package under development by the 111th Congress. The Chairman of the House Committee on Ways and Means announced on January 15, 2009, that as part of providing tax relief to businesses he is proposing to expand the WOTC to "disconnected youth" and unemployed, recently discharged veterans.

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Very few provisions in the Internal Revenue Code focus directly on employing individuals. Two temporary income tax credits—the Work Opportunity Tax Credit (WOTC) and the Welfare-to-Work (WtW) tax credit—were initiated in the mid-1990s to encourage for-profit employers to hire from groups thought to experience difficulties in the labor market both in good and bad economic times. About a decade later, the 109th Congress incorporated the WtW credit into the WOTC, and the 110th Congress made additional changes to the WOTC that it extended through August 31, 2011.

This report explains what type of subsidy the WOTC is and examines the credit’s immediate predecessor, the Targeted Jobs Tax Credit, with which the WOTC shares features. A detailed description of the WOTC and WtW credit follows. Next, activity under the tax incentives as well as their costs are presented. The report closes with a discussion of legislative activity during the current Congress and policy actions taken by prior Congresses in connection with the WOTC and WtW.

What Kind of Wage Subsidy Is the WOTC?

The WOTC is a *selective* or *categorical* hiring subsidy; that is, it attempts to steer employers toward hiring members of prescribed groups from whom they would otherwise have shied away. By its very nature, a selective subsidy favors individuals from the designated population over other jobseekers. And more generally, as an employment subsidy, it favors labor-intensive over capital-intensive enterprises.

Selective employment programs often focus on workers believed to have relatively low skill levels. Because low productivity makes them less attractive to employers than other labor force participants, the groups have comparatively high unemployment rates and low wages regardless of aggregate economic conditions. A subsidy—in the instant case, a tax expenditure rather than a direct (appropriated) expenditure—lessens the productivity gap between target group members and other workers. It thus is intended to make businesses more willing than they otherwise would have been to hire from the designated population(s).

The WOTC is *not* an incremental subsidy. Because employers do not have to create new jobs (i.e., increase the size of their workforces) in order to get the credit, the program’s design does not benefit faster- over slower-growing firms. It does, however, favor companies that normally experience rapid labor turnover or companies that are willing to fire ineligible employees and replace them with eligible workers.¹ At the time the WtW credit was being considered, some Members expressed concern about the chance for displacement of the working poor in light of contemporaneous efforts to move large numbers of welfare recipients into jobs.² The results of a report the General Accounting Office issued in 2001 suggested that the likelihood of employers engaging in churning³ or displacement to maximize receipt of the WOTC is low.⁴

¹ The willingness of companies to fire ineligible employees and replace them with eligible job applicants is likely to be influenced by labor market conditions or by hiring and training costs.

² Robert Pear, “Clinton Will Seek Tax Break to Ease Path Off Welfare,” *New York Times*, January 28, 1997, p. A1. For more information on displacement in the context of welfare reform, see CRS Report 97-360, *Welfare Reform and Subsidized Public Sector Jobs*, by Linda Levine, pp. 7-10 (out of print; available only from author).

³ “Churning” refers to hiring eligible group members and then firing them when they no longer are eligible (e.g., their salary has reached the WOTC’s \$6,000 earnings limit).

Some members of the public policy community also were mindful of the experience with a similar program in effect from 1978 to 1994, the Targeted Jobs Tax Credit (TJTC). The TJTC was criticized for the extent of windfall gains: The credit was not a factor in the hiring decisions of most employers who claimed it, in part because they normally hired persons like those in the eligible groups (i.e., low-skilled, low-wage workers); thus, taxpayers appear to have largely subsidized firms for doing what they would have done in the absence of the program. TJTC also was criticized for the degree of assistance it provided individuals for whom the credit was claimed: The hope was that through work experience and on-the-job training received while in subsidized positions the workers would be better able to subsequently obtain unsubsidized, higher-paying jobs; however, the short tenure of many TJTC hires made it unlikely that subsidized employment much improved their future job prospects.⁵

The WOTC was designed to try to mitigate these criticisms. Some target groups were reformulated with the intention of focusing more narrowly on those who truly need a credit for firms to risk hiring them. The certification process was modified toward the same end, that is, to minimize windfall profits. In addition, the minimum period a target group member must remain on the payroll in order for an employer to claim a credit was lengthened from 120 hours or 90 days under the TJTC to enable eligible hires to get the kind of work experience that would improve their long-term job opportunities. However, some analysts were skeptical that these program changes would prove effective at remedying the problems.⁶ Since the WOTC's inception, changes have been made that make it more closely resemble the TJTC (e.g., the retention period was reduced to 120 hours from 400 hours or 180 days).

A Description of the Credits

WOTC

Through August 31, 2011, for-profit employers are entitled to a credit against their federal income tax liabilities for hiring members of the following eligible groups after May 25, 2007 (the date of enactment of H.R. 2206, the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Act of 2007, P.L. 110-28):

- members of families receiving benefits under the Temporary Assistance to Needy Families (TANF) program for any nine months during the 18-month period ending on the hiring date;⁷

(...continued)

⁴ U.S. General Accounting Office, *Work Opportunity Credit: Employers Do Not Appear to Dismiss Employees to Increase Tax Credits*, GAO-01-329, March 2001. (Hereafter cited as GAO, *Work Opportunity Credit*.)

⁵ For more information on the TJTC, see CRS Report 95-981, *The Targeted Jobs Tax Credit, 1978-1994*, by Linda Levine (out of print; available only from author).

⁶ U.S. Congress, Joint Economic Committee, *The Welfare-to-Work Tax Credit*, March 1997. (Hereafter cited as Joint Economic Committee, *The Welfare-to-Work Tax Credit*.)

⁷ The group's definition was altered by the Taxpayer Relief Act of 1997 (P.L. 105-34). Previously, group members had to have been receiving benefits for nine consecutive months. Note: Members of families are only those persons taken into account when determining eligibility for the TANF program (i.e., those specifically listed on the grant).

- qualified veterans are (a) members of families receiving benefits under a food stamp program under the Food Stamp Act of 1977 for at least a three-month period during the 12-month period ending on the hiring date or (b) entitled to compensation for a service-connected disability and (1) having a hiring date that is not more than one year after having been discharged or released from active duty in the Armed Forces or (2) having aggregate periods of unemployment of at least six months during the one-year period ending on the hiring date;⁸
- 18 to 39-year-olds who are members of families receiving food stamp benefits for the six-month period ending on the hiring date, or receiving benefits for at least three months of the five-month period ending on the hiring date in the case of able-bodied adults without dependents who cease to be eligible for assistance under the work requirement at Section 6(o) of the Food Stamp Act of 1977;⁹
- designated community residents (formerly high-risk youth), defined as 18 to 39-year-olds whose principal place of abode is an empowerment zone (EZ), an enterprise community (EC), a renewal community (RC), or a rural renewal county (RRC);¹⁰
- summer youth (i.e., 16 to 17-year-olds hired for any 90-day period between May 1 and September 15 whose principal place of abode is an EZ, EC, or RC);
- ex-felons with hiring dates within one year of the last date of conviction or release from prison;¹¹
- vocational rehabilitation referrals (i.e., individuals with physical or mental disabilities that result in substantial handicaps to employment who have been referred to employers upon, or at any time after, completing or while receiving rehabilitative services pursuant to an individualized written plan for employment under a state plan for vocational rehabilitative services approved under the Rehabilitation Act of 1973, a vocational rehabilitation program for veterans carried out under Chapter 31 of Title 38, U.S. Code, or an individual work plan developed and implemented by an employment network pursuant to subsection (g) of Section 1148 of the Social Security Act with respect to which the requirements of such subsection are met);¹² and

⁸ For veterans hired after May 25, 2007, P.L. 110-28 extended the group's definition to (b). Note: Members of families are those persons taken into account when determining eligibility for a food stamp program under the Food Stamp Act of 1977.

⁹ The Tax Relief and Health Care Act of 2006 (P.L. 109-432) expanded the group's definition from 18 to 24-year-olds to 18 to 39-year-olds hired on or after January 1, 2007.

¹⁰ The group's name was changed by P.L. 110-28 and expanded to include 18 to 39-year-olds hired after May 25, 2007. The act also adds residents of a rural renewal county, which is defined as any county outside a metropolitan statistical area that during the five-year periods 1990 to 1994 and 1995 to 1999 had a net population loss.

¹¹ P.L. 109-432 eliminated the requirement that group members be "economically disadvantaged" for persons hired on or after January 1, 2007. Economically disadvantaged was defined as having an annualized family income of 70% or less of the lower living standard income level (LLSIL). After the U.S. Bureau of Labor Statistics eliminated the LLSIL along with other living standards levels many years ago, the Employment and Training Administration updated the LLSIL annually by applying an inflation factor.

¹² P.L. 110-28 clarified the group's definition by adding the language concerning employment networks.

- Supplemental Security Income (SSI) recipients who have received benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

For eligible hires (except eligible veterans entitled to compensation for a service-connected disability and summer youth) who remain on a firm's payroll at least 400 hours, an employer can claim an income tax credit of 40% of the first \$6,000 in wages paid during the worker's first year of employment. For eligible hires (except eligible veterans entitled to compensation for a service-connected disability and summer youth) who remain employed from 120 hours to 399 hours, the subsidy rate is 25%. Thus, the minimum employment period under the WOTC is 120 hours.¹³

For members of the veterans group eligible because they receive compensation for service-connected disabilities, the maximum wage to which the subsidy rates can be applied is the first \$12,000 earned. For summer youth hires, the maximum wage is the first \$3,000 earned in any 90-day period between May 1 and September 15.

The actual value of the WOTC to the employer could be less than \$1,500-\$2,400 per typical eligible worker depending on the firm's tax bracket.¹⁴ The tax deduction a business can take for wages and salaries must be reduced by the amount of the credit. The credit cannot exceed 90% of a company's annual income tax liability. But, if after certain other nonrefundable credits have been taken, 90% of an employer's remaining income tax liability for the current year is less than the amount of the WOTC, the excess can be carried back one year and forward 20 years. In addition, for credits determined in tax years beginning after December 31, 2006, the WOTC and the credit for taxes paid with respect to employee cash tips are allowed against the Alternative Minimum Tax (AMT).

State Employment Security (ES) agencies, in cooperation with participating agencies,¹⁵ are charged with certifying whether newly hired workers belong to the prescribed groups. If a request for certification is rejected, the state ES agency must provide a written explanation of its decision to the employer.

The eligibility determination process can follow one of two paths described below, but the second route is thought to be followed more often than the first.

- (1) An eligible group member obtains a conditional certification (ETA Form 9062) from a participating agency. The jobseeker then uses it to market herself to an employer.¹⁶ The employer completes a pre-screening/certification request (IRS Form 8850) by the date a job offer is made and mails it to the state's WOTC coordinator within 28 days after the new hire

¹³ In the WOTC's initial version (i.e., for persons hired from October 1, 1996 through September 30, 1997), the minimum employment period was 400 hours or 180 days, and the subsidy rate was 35%. Note: For an anecdotal account of the difficulty firms had retaining WOTC-eligibles for 400 hours, see Rochelle Sharpe, "Great Expectations: A Tax Credit Designed to Spur Hiring Seems Promising—At First," *Wall Street Journal*, April 21, 1997, p. A1.

¹⁴ The credit maximums are \$3,000-\$4,800 per a veteran eligible by virtue of receiving compensation for a service-connected disability and \$750-\$1,200 per summer youth hire.

¹⁵ Participating agencies (e.g., one-stop career centers, job corps centers, vocational rehabilitation agencies, local welfare agencies, veterans' affairs offices, and food stamp program agencies) determine the economic eligibility of most group members. State ES agencies determine the economic eligibility of ex-felons.

¹⁶ There is limited evidence which suggests that advertising oneself as a member of a subsidized group could actually reduce one's chance of getting a job. Gary Burtless, "Are Targeted Wage Subsidies Harmful? Evidence from a Wage Voucher Experiment," *Industrial and Labor Relations Review*, vol. 39, no. 1, October 1985.

starts working. The employer must also fill-in and submit to the ES the bottom of the ETA form.

(2) An employer completes IRS Form 8850 by the date a job offer is made to an applicant believed to belong to the WOTC population. The IRS form must be mailed to the state's WOTC coordinator within 28 days after the new hire starts working.¹⁷ The employer can fill-in individual characteristics information (ETA Form 9061) either during or after the selection process for submission to the ES.

“Employer representatives” are permitted to help firms screen job applicants for credit eligibility and complete required paperwork. These management assistance or services companies arose after enactment of the TJTC to inform the business community of the program and perform credit-related administration for firms. As was the case with the TJTC,¹⁸ these consultants play a considerable role not only in securing WOTC certifications for large firms that hire many eligible persons, but also in lobbying for reauthorization and modification of the credit.¹⁹

WtW Tax Credit

The Welfare-to-Work Tax Credit was inserted as a separate provision in the Internal Revenue Code to help the federal effort to move welfare recipients onto payrolls. It is meant to encourage employers to hire particularly disadvantaged members of the TANF group, namely, long-term recipients. Specifically, the definition of long-term family assistance recipient is

- a member of a family that has received benefits for at least the 18 month period ending on the hiring date;
- a member of a family that has received benefits for a total of 18 months beginning after the credit's enactment (August 5, 1997); and
- that has a hiring date that is not more than two years after the end of the earliest such period; or
- a member of a family that no longer is eligible for assistance after August 5, 1997 because of any federal- or state-imposed time limit, and
- that has a hiring date that is not more than two years after the date of benefit cessation.

For hiring an eligible long-term family assistance recipient before January 1, 2007, a firm may claim a WtW credit against its federal income tax liability equal to 35% of the first \$10,000 earned during the individual's first year of employment, and 50% of the first \$10,000 earned during the following year of employment. Qualified wages include not only gross earnings, but also certain tax-exempt amounts received under accident and health plans as well as under educational or dependent assistance programs. As in the WOTC's initial version, employers must retain WtW-eligible workers hired before January 1, 2007, at least 400 hours or 180 days in order to receive the credit. The WtW credit's certification procedure follows that of the WOTC as

¹⁷ Before January 1, 2007, employers had 21 days to mail IRS Form 8850 to their state's WOTC coordinator.

¹⁸ Christopher Howard, *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States* (Princeton, NJ: Princeton University Press, 1997), pp. 164-165, 171-172.

¹⁹ Ben Wildavsky, “Taxation: Taking Credit,” *National Journal*, March 29, 1997. (Hereafter cited as Wildavsky, *Taxation: Taking Credit*.)

described above. A firm cannot claim a WtW credit and a WOTC for the same individual in the same taxable year.

Reflecting simplification recommendations made by the Joint Committee on Taxation, among others, the 109th Congress in the Tax Relief and Health Care Act of 2006 (P.L. 109-432) made many changes to the WtW credit—including incorporating the separate provision for long-term family assistance recipients into the WOTC. For long-term family assistance recipients hired after January 1, 2007,

- employers can claim a credit equal to 25% of the first \$10,000 earned during the first year of employment if individuals are retained between 120 and 399 hours;
- employers can claim a credit equal to 40% of the first \$10,000 earned during the first year of employment if individuals are retained at least 400 hours;
- employers can claim a credit of 50% of the first \$10,000 earned for retaining long-term family assistance recipients during a second year; and
- qualified wages are cash wages.

(For additional information, see the 109th Congress section of “Legislative Activity,” which appears later in this report.)

Program Activity

The U.S. Employment Service in the Employment and Training Administration (ETA) collects figures on the number of certifications issued to employers disaggregated by state, hourly wage and broad occupational group. *The number of certifications could well be more than the number of employees for whom employers claim credits because not all eligible hires fulfill the retention requirement.* The government does not collect statistics on the number of individuals for whom the credits actually are claimed. It would be difficult to reconcile the number of certifications and the number of credits claimed *in a given year* because companies that receive a certification for an eligible individual hired late in one year may not claim a credit for them until the following year, when the retention requirement has been met. In addition, credits claimed for persons certified in one year may be applied against income tax liabilities in past or future years.

WOTC

State ES agencies issued 123,407 WOTC certifications to employers in FY1997, 285,322 in FY1998, 335,707 in FY1999, 370,835 in FY2000, 383,357 in FY2001, 377,310 in FY2002, 403,243 in FY2003, 244,445 in FY2004,²⁰ 598,101 in FY2005, 325,178 in FY2006,²¹ and 612,052 in FY2007. The considerably higher figures in recent years compared to FY1997 likely are related to the program’s very slow start up at the state level, modifications of the credit that made it more attractive to employers (e.g., the shortened retention requirement and modified definition of AFDC/TANF recipients) and to tightening in the labor market through much of the period.

²⁰ The unusually low figure for FY2004 is due to the credit’s nine-month hiatus.

²¹ The unusually low figure for FY2006 is due to the credit’s 13-month hiatus.

Although in much of the past certifications most often were issued for hiring members of the TANF group, 45% of all certifications in FY2007 were for 18 to 24-year-olds in families receiving food stamps, and 28% were for members of the AFDC/TANF group. The share of high-risk youth had been on the rise through FY2004, but then began to decline and fell to 8% of the total in FY2007. Ex-felons have accounted for a steadily growing proportion of WOTC certifications, going from 3% in FY1997 to over 7% in FY2007.²² The share of SSI recipients (an eligible group added in 1998) increased through FY2002, when it dropped from almost 8% to 6% in FY2003, and remained much the same in the following four years. In contrast, the share of the vocational rehabilitation group decreased almost steadily over the entire period and measured under 4% by FY2007. The remaining two groups—veterans and summer youth—together accounted for a little over 2% of certifications in FY2007.

Not surprisingly, many of the certifications issued likely have been for hiring women. Men who face obstacles to employment were expected to be hired through the youth food stamp and high-risk groups. This gender pattern prompted proposals in Congress to extend the upper age limit of the two groups. (See section below on legislative activity in the 109th Congress for more information.)

WtW Tax Credit

In the nine months the credit was in operation in FY1998 (January-September), state ES agencies issued 46,580 certifications. The figure for FY1999 was 104,998. The number of certifications in FY2000 was 50% higher at 154,608. This represents 22,340 fewer certifications than were issued to employers for hiring WOTC-eligible TANF recipients in FY2000, or 12.6% less. One year earlier, in contrast, WtW certifications were 41.6% below WOTC certifications for TANF-eligibles (or 74,713 less). The marked improvement in employers' willingness to hire long-term family assistance recipients is particularly notable in light of their initially expressed reluctance toward utilizing the WtW credit versus the WOTC because of the former's longer retention requirement and more disadvantaged eligible group. The tightening labor market through 2000 likely was a contributory factor.

The number of WtW certifications subsequently declined as the economy experienced a recession and a "jobless recovery" through summer 2003. In FY2001, WtW certifications were 97,072; in FY2002, 46,652; and in FY2003, a still lower 33,068.

The low number of WtW certifications in FY2004—15,601—reflects the expiration of the credit during much of the period. Certifications rebounded to 32,817 in FY2005. The decrease to 13,859 in FY2006 once again reflects the credit's expiration during the year before its retroactive reauthorization. In FY2007, in contrast, WtW certifications numbered 21,771.

Program Costs

Most of the cost to the government from tax credits is in the form of revenue forgone rather than appropriated funds.²³ According to the U.S. Department of the Treasury, about \$16 million in

²² The increase long predated the definition of ex-felons no longer being limited to "the economically disadvantaged."

²³ Spending for ES administration of the two programs generally has been less than \$20 million per fiscal year.

Work Opportunity credits was earned on individual and corporate tax returns in 1996. The WOTC’s low usage in that year likely is attributable to the start-up of the program on October 1, 1996 and to the initial length of the retention requirement. In contrast, almost \$150 million in Work Opportunity credits was earned on returns in 1997. In 1998, the value of the hiring credits claimed by employers rose substantially: \$291 million, in the case of the WOTC, and \$24 million in the case of the WtW credit.

As further shown in **Table 1**, WOTC credits claimed dipped slightly in tax year 1999 (\$285 million) before spurting upward in 2000 (\$400 million). Possibly reflecting the recession, the value of WOTC credits claimed on federal income tax returns dropped in 2001 (\$267 million). The amount of WtW credits claimed followed a different—steadily expanding—pattern, from \$91 million in 1999, to \$114 million in 2000, and \$128 million in 2001.

Table 1. Value of WOTC and WtW Credits Claimed on Federal Income Tax Returns
(\$ in millions)

Year	WOTC			WtW Credit		
	Total	Corporations	Individuals	Totals	Corporations	Individuals
1996	\$15.8	\$7.3	\$8.5	\$0.0	\$0.0	\$0.0
1997	149.6	134.1	15.5	0.0	0.0	0.0
1998	290.9	261.8	29.0	24.2	21.6	2.6
1999	285.2	253.1	32.1	91.4	86.0	5.4
2000	399.6	369.2	30.4	114.0	103.4	10.6
2001	267.3	234.1 ^a	33.2	127.9	111.7	16.2

Source: Data compiled by the Department of Treasury, Office of Tax Analysis, from Internal Revenue Service Statistics of Income (SOI) data for individuals and corporations.

Note: Data on credits claimed on amended tax returns are not included.

a. Corporate data for 2001 are based on preliminary SOI data.

Even before any actual figures became available for the WtW credit, there was speculation that they would likely be low because businesses that frequently had claimed employment tax credits seemed less than enthusiastic about its target population and retention period when the program was first proposed.²⁴ A report issued by the Joint Economic Committee at the time the WtW credit was being considered noted that its larger subsidy compared to either the TJTC or the WOTC might “only offset the higher potential risk associated with hiring long-term welfare recipients.”²⁵ Moreover, the maximum amount of the WtW credit might rarely be received by employers given the historically low wage levels (less than the credit’s \$10,000 annual cap) and limited fringe benefits associated with subsidized jobs as well as their short-term nature (less than the credit’s two-year limit).

²⁴ Wildavsky, *Taxation: Taking Credit*.

²⁵ Joint Economic Committee, *The Welfare-to-Work Tax Credit*.

Evaluations of the WOTC and WtW Tax Credit

Studies of the two employment tax credits have been limited in purpose or scale. Shortly after the State Employment Security Agencies (SESA) began implementing the WOTC in late 1996, the United States Department of Labor (DOL) contracted for an evaluation of its administrative process (which, as noted above, is the same as the WtW credit's). Among other things brought out in the August 1997 study, state WOTC coordinators recommended that the paperwork burden on employers be reduced and Form 8850 be made less confusing so that small employers particularly and all for-profit employers generally would be more inclined to participate.²⁶

In March 2001, the General Accounting Office (GAO) surveyed a sample of employers who utilized the WOTC program in two states with high certification levels, namely, California and Texas. The study's chief goal was to ascertain whether employers fire workers who never were eligible for the WOTC or who no longer are eligible for the WOTC in order to maximize credit receipt. The GAO concluded that—while it could not definitely determine the extent of displacement and churning, respectively, across all employers who participate in the program—the sample data suggest that employers do not view the practices as cost-effective and therefore presumably would not engage in them much, if at all. GAO's estimate that the WOTC offsets less than one-half of the cost of recruiting, hiring and training credit-eligible workers, on average, supports the employers' belief that the practices are not cost-effective. Regarding churning specifically, certified workers in the two states were found to be no more frequently terminated when their earnings totaled about \$6,000 (the credit-maximizing level).²⁷

A study of the WOTC/WtW credit that was undertaken for the DOL also was released in March 2001. Interviews of 16 establishments that had used the credits were conducted in five states (California, Georgia, Maryland, Missouri, and Wisconsin). As in the case of the GAO study, the authors emphasized that their findings cannot be extrapolated to all other user firms. Among the report's results:

- “the tax credits play little or no role in [the 16 employers'] recruitment policies,” suggesting that employers would have hired members of the target groups even if the programs were not available;
- as credit-eligible hires' job performance, work readiness, attendance and punctuality were like those of ineligible employees in similar positions, most of the interviewed employers thought there was no need for special training or counseling programs;
- the target-group members who were hired exhibited the high rates of turnover typical of low-wage workers,²⁸ which meant that the interviewed employers were able to claim the maximum credit for relatively few eligible hires;
- the 16 employers gave the programs a positive assessment, although they offered some suggestions for improvement having to do with program administration

²⁶ Westat, *Process Evaluation of the WOTC Program* (DOL, Employment and Training Administration, Office of Strategic Planning and Policy Development, August 1997).

²⁷ GAO, *Work Opportunity Credit*.

²⁸ WOTC/WtW hires generally were paid the same entry-level wages as other hires, which largely ranged between \$5.15 and \$8.00 an hour.

(e.g., consolidate and streamline the forms), program design (e.g., broaden target-group eligibility criteria)²⁹ and promotion of the program (e.g., increase use of conditional certifications).³⁰

The report's authors recommended among other things that a study with a larger, representative sample of employers be conducted, as

these observations do raise a question about the extent to which the tax credit is serving the purpose for which it is intended—to serve as an economic incentive to encourage employers to hire individuals from specified target groups whom they would not have hired in the absence of the credit.³¹

An October 2002 analysis of participation rates for the WOTC's two largest eligible groups—TANF recipients and food stamp youth—estimated that relatively few eligible new hires have the credit claimed for them. In 1999, employers were estimated to have claimed the WOTC for less than one-third of newly employed persons from the TANF group and for less than one-fifth of newly employed persons from the food stamp youth group. Participation rates did increase considerably between 1997 and 1999; however, this was due not just to an increase in credit-claiming, but also to a substantial decrease in the size of the eligible populations during implementation of welfare reform. The author suggested various reasons for the low participation rates, including that the fairly short job tenure of the credit-eligible population (like that of other low-wage individuals) translates into a small tax credit value per WOTC-eligible hire. In other words,

Employers may be discouraged by the low returns to WOTC/WtW participation for those workers whose employment ends before the 40 percent credit is reached [i.e., before the individual has worked 400 hours or more].³²

In a December 2002 report, the GAO attempted to examine specifically the few tax incentives available for hiring, retaining, and accommodating workers with disabilities. Persons with disabilities are the focus of two WOTC-eligible groups, namely, vocational rehabilitation referrals and Supplemental Security Income (SSI) recipients. Based upon an analysis of 1999 tax year data from the Internal Revenue Service (IRS), the GAO found that relatively few employers utilize the WOTC. Data on employer usage by WOTC-eligible group are not available from IRS data, however. According to the agency's interviews with government officials and academic experts, fairly few persons with disabilities may have the credit claimed for them because WOTC eligibility is limited to disabled individuals receiving publicly funded vocational rehabilitation or SSI benefits. Perhaps not surprisingly, then, interviewees supported expanding the WOTC's coverage of disabled persons. The agency also identified two national surveys related to disability employment issues which determined that a very small share of supervisors of employees with disabilities were aware of employment tax incentives and that human resource managers regarded business tax incentives as less effective than any of the following measures in reducing obstacles

²⁹ These two recommendations echo those made in the 1997 process evaluation.

³⁰ See the section on Program Administration (*supra*) for the definition of a conditional certification and why it may be little used.

³¹ Westat and Decision Information Resources, Inc., *Employers' Use and Assessment of the WOTC and Welfare-to-Work Tax Credits Program* (DOL, Employment and Training Administration, Office of Policy and Research, March 2001).

³² Sarah Hamersma, "The Work Opportunity Tax Credit: Participation Rates Among Eligible Workers," *National Tax Journal*, vol. 56, no. 4 (December 2003), p. 736.

to the employment of persons with disabilities: top-management commitment, staff training, mentoring, on-site consultation and technical assistance, and short-term outside assistance.³³

A more recent study analyzed the wage and tenure effects of the tax provisions by comparing WOTC- and WtW-certified workers in Wisconsin with eligible but uncertified workers in the state. A small absolute impact on earnings was estimated, but the difference of \$121 per quarter represents a non-negligible share (more than 10%) of the eligible population's average quarterly earnings of \$1,150. Hamersma extrapolated from the Wisconsin data that "the average worker receives perhaps 40 percent of the value of the credit as an earnings premium; the rest remains with the employer."³⁴ The study found no tenure effect, which coincides with results from the 2001 GAO report that suggest employers do not terminate eligible hires when the subsidy period ends.

Legislative Activity

The WOTC is a temporary provision of the Internal Revenue Code. Since its initiation, Congress allowed the credit to lapse many times before reauthorizing it retroactive to its expiration date as part of large tax-related measures. The relatively short extensions of the WOTC and its frequent expiration has caused consternation among employers who utilize the credit.

During the 111th Congress

The WOTC has been mentioned in the context of the economic recovery package that is under development. The Chairman of the House Committee on Ways and Means announced on January 15, 2009, that as part of providing tax relief to businesses he is proposing to expand the WOTC to "disconnected youth" and unemployed, recently discharged veterans.

From the 104th Congress Through the 110th Congress

104th Congress: Creation of the WOTC

As authorized in Section 1201 of the Small Business Job Protection Act of 1996 (P.L. 104-188), for-profit employers were entitled to a WOTC against their federal income tax liabilities for hiring members of seven specifically designated groups from October 1, 1996, through September 30, 1997.

105th Congress: Several Revisions

The Taxpayer Relief Act of 1997 (P.L. 105-34) substantially revised the program by shortening the minimum employment requirement to 120 hours and creating a two-tier subsidy based on length of retention. It also extended the temporary measure for nine months from October 1,

³³ GAO, *Business Tax Incentives to Employ Workers with Disabilities Receive Limited Use and Have an Uncertain Impact*, GAO-03-39, December 2002.

³⁴ Sarah Hamersma, "The Work Opportunity and Welfare-to-Work Tax Credits," *Tax Policy Issues and Options*, no. 15, October 2005, p. 5.

1997, through June 30, 1998, added an eighth group (Social Security Income recipients) and modified the definition of one group (see footnote 7).

After an almost four-month lapse, the WOTC was reauthorized for one year (through June 30, 1999) retroactive to its expiration date in the Omnibus Consolidated and Emergency Appropriations Act, 1999 (P.L. 105-277).

106th Congress: Expansion of WOTC-Eligible Groups

The credit subsequently was reauthorized retroactive to its expiration date and extended through December 31, 2001 in the Ticket to Work and Work Incentives Improvement Act of 1999 (P.L. 106-170).

The 106th Congress later expanded the definition of the “high risk” and “summer youth” groups to include renewal communities (effective January 1, 2002) through passage of the Consolidated Appropriations Act, 2001 (P.L. 106-554), which incorporated the Community Renewal Tax Relief Act of 2000 (H.R. 5662). Employers must coordinate claiming the WOTC with claiming another employment tax credit equal to 15% of the first \$10,000 in qualified wages paid to renewal community residents who perform substantially all employment services within the areas.

107th Congress: 2002-2003 WOTC Expansion to Cover New York Liberty Zone Employees and Authorization of the WtW Credit

After about a two-month lapse, the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147) reauthorized the WOTC. It was extended through December 31, 2003 for eligible persons hired after December 31, 2001.

New York Liberty Zone Employees

The economic stimulus measure also amended the WOTC’s eligible population to add “New York Liberty Zone business employees.” Qualified businesses were defined as firms with 200 or fewer employees located in the vicinity of the World Trade Center as well as those that, due to property destruction or damage associated with the September 11 terrorist attack, had to relocate to other sections of New York City. While the other WOTC group members must be new hires in order for firms to claim a credit, New York Liberty Zone business employees were both existing and newly hired employees. The number of workers for whom firms that relocated elsewhere in New York City could claim the credit was limited to those on the employers’ payrolls as of September 11, 2001; the cap did not apply to firms that remained in the zone or that moved into the zone. A qualified business could claim the WOTC for an eligible employee in 2002, 2003, or both years. The portion of the WOTC associated with the new target group was allowed against the alternative minimum tax.

Limited information is available regarding employer utilization of the WOTC for Liberty Zone employees.³⁵ Some 3,196 taxpayers claimed the WOTC in 2002 for hiring members of the group, according to the Internal Revenue Service. (Taxpayers include corporations, partnerships, and

³⁵ No information on certifications for Liberty Zone employees because they were exempt from the WOTC’s usual certification procedure.

individuals who run their own businesses.) For 2003, the preliminary number of taxpayers that claimed the WOTC for Liberty Zone employees is 3,502.

The Welfare-to-Work Tax Credit

The Personal Responsibility and Work Opportunity Act (P.L. 104-193) requires parents to work after a maximum of two years of receiving TANF benefits, and Congress authorized the WtW credit in the Taxpayer Relief Act of 1997 (P.L. 105-34) to help achieve that objective. It initially was to have expired on April 30, 1999, but it, like the WOTC, was extended in P.L. 105-277 (through June 30, 1999), P.L. 106-170 (through December 31, 2001), and P.L. 107-147 (through December 31, 2003).

108th Congress: A Lengthy Lapse

The first bill taken up by the 108th Congress that contained a WOTC-related provision was H.R. 743 (the Social Security Protection Act of 2003). It passed the House on April 2, 2003. The Senate subsequently passed the legislation, and on March 2, 2004, it was signed into law (P.L. 108-203). Among many other things, the act modified the definition of the WOTC's vocational rehabilitation referral-eligible group in light of the Ticket to Work and Work Incentives Improvement Act of 1999. It effectively expanded the group to include disabled individuals with individualized work plans who are referred to employers not only by a state vocational rehabilitation agency (as was the case under prior law), but also by "employment networks" that were created by the Ticket to Work legislation.

On September 23, 2004, the House and Senate passed the conference report for H.R. 1308 (The Working Families Tax Relief Act of 2004). Following the 10-month lapse of the credits, Congress extended the WOTC and the WtW credit retroactive to their expiration and through December 31, 2005. As originally introduced and passed by the House in March 2003, however, H.R. 1308 (then called the Tax Relief, Simplification, and Equity Act of 2003) did not mention the employment tax credits. Neither did the amended version of the bill (The Relief for Working Families Tax Act of 2003) that the Senate passed in June 2003. Conferees were appointed in 2003, and on September 23, 2004, the conference report (H.Rept. 108-696)—with a two-year extension of the otherwise unrevised WOTC and WtW credit—was filed.

109th Congress: Hurricane Disaster Relief, Modifying the WOTC, and Incorporating the WtW Credit into the WOTC After Another Long Lapse

The 109th Congress made two substantial changes to the tax provisions. Some changes were temporary; others, permanent.

Hurricane Disaster Relief

As it did after the September 11 attack on the World Trade Center, Congress temporarily expanded the WOTC eligible-groups to include "a Hurricane Katrina employee" as part of its emergency response. P.L. 109-73 added to the WOTC-eligible groups persons whose principal place of abode on August 28, 2005 was in the core disaster area and who,

- beginning on such date and to August 28, 2007, is hired for a position principally located in the core disaster area; and
- beginning on such date and to December 31, 2005, is hired for a position regardless of its location.

The WOTC's rule denying its application to wages of employees who had worked for the same employer at any prior time (except for those on the employer's payroll on August 28, 2005) is waived, as is the usual certification process.³⁶

Modifying the WOTC and Incorporating the WtW Credit into the WOTC

The two credits expired on January 1, 2006. They were substantively revised after the 109th Congress passed H.R. 6111 (the Tax Relief and Health Care Act of 2006) in December 2006. Title I of P.L. 109-432 reauthorized the WOTC for two years (from its expiration date to December 31, 2007). Other changes to the WOTC and to the WtW credit became effective for persons hired after December 31, 2006. They are as follows:

- WOTC-eligibility for ex-felons was expanded by eliminating the requirement that they are members of economically disadvantaged families;
- WOTC-eligibility of food stamp recipients was expanded from 18 to 24-year-olds to include 25 to 39-year-olds;
- employers can file the required paperwork with their state's WOTC coordinator within 28 (rather than 21) days of an eligible-hire starting to work for them; and
- the WtW credit was repealed as a separate tax provision, with its eligible-group of long-term family assistance recipients uniquely handled under the WOTC effective January 1, 2007.

More specifically, employers who hire long-term family assistance recipients can claim a credit if individuals are retained for a minimum of 120 hours (rather than the WtW credit's 400-hour or 180-day requirement). The 25% subsidy rate for WOTC group members employed from 120 to 399 hours was applied to long-term family assistance recipients, and the WtW credit's 35% rate for those employed at least 400 hours during their first year of employment was raised to 40%, as is the case for WOTC-eligible hires. Employers continue to be able to claim a credit for retaining long-term family assistance recipients during a second year at the WtW's subsidy rate of 50%.

³⁶ P.L. 109-73 also created an employee retention credit for eligible employers whose trade or business in the core disaster area became inoperable after August 28, 2005, and before January 1, 2006, because of damage sustained by Hurricane Katrina. Such employers could claim a credit equal to 40% of qualified wages up to \$6,000 per person whose principal place of employment had been with such employers on August 28, 2005. Eligibility for the retention credit initially was limited to small employers (i.e., employers cannot have employed an average of more than 200 employees on business days during the taxable year), but P.L. 109-135 (the Gulf Opportunity Zone Act of 2005) dropped the employer size limit and extended the retention credit to employers harmed by hurricanes Rita and Wilma. The retention credit could be applied against wages paid or incurred by an eligible firm from the time it became inoperable after August 28, 2005, until it resumes significant operations at the eligible employee's principal place of employment or before January 1, 2006. Qualified wages were those paid regardless of whether an eligible employee performed services; performed services at a place of employment other than his or her worksite on August 28, 2005; or performed services at his or her worksite on August 28, 2005, before significant operations resumed there. A business could not claim a retention credit for an employee during any period for which it claimed a Work Opportunity Tax Credit for such employee.

The subsidy rates for long-term family assistance recipients continue to be applied against up to \$10,000 earned in each of the first and second years of employment. The definition of qualified wages of long-term family assistance recipients was narrowed to that of WOTC-eligible hires—namely, cash wages (i.e., certain benefits can no longer be included).

110th Congress: Focus on Eligible Groups and Credit Extension

Expansion of Certain Eligible Groups and Extension to August 2011

The WOTC was considered as part of a package of business tax incentives meant to offset the impact of an increase in the federal minimum wage. The minimum wage bill that the House passed on January 10 (H.R. 2 the Fair Minimum Wage Act of 2007) did not include tax benefits. But, the Senate Finance Committee marked up S. 349 (the Small Business and Work Opportunity Act of 2007) on January 22 and incorporated it in the version of H.R. 2 that the Senate passed on February 1. H.R. 2 (as amended) extended the WOTC for five years to December 31, 2012. It also expanded the WOTC-eligible group of veterans to persons entitled to compensation for service-connected disabilities incurred after September 10, 2001, and raised from \$6,000 to \$12,000 the definition of qualified wages that applies to these individuals. The high-risk youth group covered 18 to 39-year-olds (rather than 18 to 24-year-olds) living in an EZ, EC, or RC and renamed the group “designated community residents.” The definition of the vocational rehabilitation referral group was expanded as well, to include any person certified by a designated local agency as having a physical or mental disability that is a substantial handicap to employment and who is referred to the employer while receiving or after completing an individual work plan developed and implemented by an employment network pursuant to subsection (g) of Section 1148 of the Social Security Act. The JCT estimated that these amendments to the WOTC could have revenue effects of some \$2.5 billion over the FY2007 to FY2012 period.

H.R. 976 (the Small Business Tax Relief Act of 2007), which the House passed on February 16, was meant as an alternative to the tax incentives added by the Senate to H.R. 2. Among the tax benefits in H.R. 976 was a one-year extension of the WOTC to December 31, 2008. It expanded and renamed the high-risk youth group and clarified the vocational rehabilitation referral group as in H.R. 2 (as amended). H.R. 976 also expanded the WOTC’s veterans group, but in a different way than the Senate: the group was extended to persons entitled to compensation for service-connected disabilities with a hiring date not more than one year after having been discharged or released from active duty in the Armed Forces or having been unemployed for at least six months during the one-year period ending on the date of hire. H.R. 976 set qualified wages for this component of the WOTC-eligible veterans group at \$12,000. In addition, the bill allowed the WOTC and the credit for taxes paid with respect to employee cash tips against the Alternative Minimum Tax (AMT). The JCT estimated that these amendments to the WOTC could have less costly revenue effects of almost \$1.1 billion over the FY2007 to FY2012 period.

On March 29, the Senate added its further amended version of H.R. 2 to the emergency supplemental appropriations bill, H.R. 1591. After a House-Senate conference committee agreed to a less costly small business tax relief plan and the President vetoed the bill over troop withdrawal language, the President signed H.R. 2206 (the U.S. Troop Readiness, Veterans’ Care, Katrina Recovery, and Iraq Accountability Act of 2007, P.L. 110-28) into law on May 25, 2007. P.L. 110-28 combines somewhat modified elements of H.R. 976, H.R. 2 (as amended), and H.R. 1591. It contains a compromise on extension of the WOTC to three-and-one-half years through

August 31, 2011, raises the age limit for “designated community residents” to less than 40-year olds, and clarifies the definition of vocational rehabilitation referrals. The act also adds “rural renewal county,” which first appeared in H.R. 1591, to the places of residence for designated community residents. The law adopts the definition of disabled veterans in H.R. 976 and its allowance of the WOTC and tip credit against the AMT. The estimated cost of these amendments to the WOTC is almost \$2.8 billion between FY2007 and FY2012.

“Hurricane Katrina Employees”

In P.L. 110-343 at Division C (the Tax Extenders and Alternative Minimum Tax Relief Act of 2008), Congress extended the WOTC’s expiration from August 28, 2007, to December 31, 2009, for firms who hire “Hurricane Katrina employees” to work in the disaster area. The JCT estimated the extension would cost \$14 million in FY2009 and \$8 million in FY2010.

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