



Employment Tax Incentives to Promote Recovery from the COVID-19 Recession: Policy Options

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Some Members of Congress and the Trump Administration have [shown interest in additional tax benefits](#) to encourage employee retention or hiring as a response to the Coronavirus Disease 2019 (COVID-19) recession. The Coronavirus Aid, Relief, and Economic Security ([CARES Act](#)) (P.L. 116-136), signed into law on March 27, 2020, created an [employee retention tax credit](#) equal to 50% of qualified wages paid by eligible employers to qualifying employees between March 12, 2020, and December 31, 2020. This refundable payroll tax credit can be claimed for up to \$10,000 in wages, making the maximum credit per employee \$5,000. The Health and Economic Recovery Omnibus Emergency Solutions ([HEROES Act](#)) (H.R. 6800), as passed in the House on May 15, 2020, would increase the amount of the credit.

Employer tax relief is one option for supporting employment and promoting economic recovery from the COVID-19 recession. This Insight highlights some considerations that may inform the policy debate regarding this approach, and examines the federal government's past experience with hiring tax incentives.

Promoting Employment Using Tax Policy: Considerations

If employers have laid off employees due to lack of consumer demand, employers may be slow to hire, even with employment subsidies. Economic theory tends to indicate that demand-side stimulus, rather than supply-side (like employer tax relief), is the most effective tool for boosting employment during periods of economic weakness. While the pandemic decreased consumer demand for some goods and services (e.g., in-person dining at restaurants and shopping in retail stores), demand in other industries has increased (e.g., the information technology sector).

As patterns of demand shift, labor markets can be expected to reallocate the distribution of workers among industries over time. [Some have suggested](#) that policies to facilitate a worker reallocation might be more effective in promoting a return to work than those that try to keep workers in sectors with declining

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demand. One policy option for fostering such reallocation is an employment tax credit that favors hiring as opposed to retention.

In the past, Congress has used employee retention and hiring tax incentives to respond to different circumstances. [Employee retention credits](#) were enacted as part of previous disaster tax relief legislation, where the goal was to reduce the cost to employers of keeping employees on their payrolls during the recovery from the disaster. Natural disasters often produce a [V-shaped economic recovery](#), where employment levels bounce back to predisaster levels. Employee retention credits can help employers maintain payrolls during the sharp, but brief, downturn. If the COVID-19 recession is prolonged, as [some economists expect](#), hiring tax incentives may be considered. Past experience with hiring credits is discussed in the next section.

A [study of state hiring credits](#) (which allow for cross-state comparisons and comparisons over time) during and after the Great Recession found that tax credits for hiring with certain characteristics (refundable and targeted at the unemployed) could be successful in increasing job growth, although credits may also be associated with churning of jobs rather than net job creation. Another [study of a French job credit](#) found that it was effective if unanticipated, temporary, and focused on low-wage workers and small firms.

There is substantial uncertainty with respect to [economic conditions in the coming months](#); the economy will be best positioned for recovery [when the public health crisis is addressed](#). If what were initially viewed as temporary furloughs were to become permanent jobs losses, policymakers may choose to consider tax incentives that focus on hiring as opposed to retention. The objective of hiring tax credits, broadly, is to increase employment. Their effectiveness, however, may be affected by measures employers take to prevent a return to work from increasing the risk of COVID-19 community transmission.

Hiring Tax Incentives: Past Experience

Congress has twice created hiring tax incentives to help stimulate job growth during recoveries from economic downturns. The Hiring Incentives to Restore Employment (HIRE) Act of 2010 (P.L. 111-147) created a job creation tax credit and an employer payroll tax reduction. In the late 1970s, hiring was subsidized by the New Jobs Tax Credit (NJTC). A separate tax credit, the [Work Opportunity Tax Credit](#) (WOTC), encourages employers to hire individuals from designated disadvantaged groups, without encouraging job creation. As a result, it is not discussed here.

HIRE Act Jobs Tax Incentives

The HIRE Act contained two incentives for hiring and retaining workers:

1. **Payroll tax forgiveness for hiring unemployed workers.** The employer's share of Social Security payroll taxes (6.2% of wages, up to \$106,800 in 2010) was forgiven for wages paid to eligible employees between March 18, 2010, and January 1, 2011. Eligible employees were persons hired after February 3, 2010, who previously had been unemployed or worked limited hours in the previous 60 days.
 2. **Credit for retention of newly hired workers.** Employers could claim a nonrefundable income tax credit equal to the lesser of 6.2% of an eligible worker's wages or \$1,000, for workers who (1) qualified for the payroll tax forgiveness provision, and (2) remained employed for a year at a firm (52 weeks in a tax year ending after March 18, 2010). A qualified worker's wages during the last 26 weeks had to be at least 80% of her or his wages during the first 26 weeks.
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It is unclear how these two tax incentives affected hiring decisions and employment in 2010 and 2011. [Economists have mixed views](#) on whether hiring tax incentives can be effective, and in what circumstances. Specific features of past hiring credits might have limited their effectiveness. The HIRE Act tax credit was nonrefundable and could not be carried back to previous tax years. Its design was complicated, which may have deterred some small firms from claiming it. A lack of awareness among smaller businesses may also have affected the credit's efficacy.

New Jobs Tax Credit

The NJTC, which was available from mid-1977 to the end of 1978, was a temporary and nonrefundable income tax credit designed to encourage employers to hire employees above a base amount. The credit was equal to 50% of the first \$4,200 in wages paid to a newly hired worker, provided the employer's total wages rose by more than 2% above the previous year's total. The annual credit limit per employer was \$100,000. Because the credit applied to only the first \$4,200 of wages, it encouraged the hiring of low-wage workers.

Tax policy experts [have observed](#) that several of the credit's features [limited its efficacy](#). More employers may have used the credit if they had been aware of it, and if the credit's design had been simpler. Because only employers with an increase in total wages were eligible, it was more valuable to growing employers than to firms whose workforces remained the same or declined. Because of the credit's design and because it was claimed annually, employers often did not know if they would be eligible for the credit when making hiring decisions, limiting the credit's effectiveness as a hiring incentive. Because the NJTC was a nonrefundable income tax credit, nonprofit employers were not eligible, and businesses that were not profitable received no immediate benefit.

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