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The Work Opportunity Tax Credit (WOTC) and the Welfare-to-Work (WtW) Tax Credit

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Summary

The Work Opportunity Tax Credit (WOTC) and the Welfare-to-Work (WtW) Tax Credit are meant to induce employers to hire members of families receiving benefits under the Temporary Assistance to Needy Families (TANF) program. The WOTC also is available to for-profit employers who hire others thought to experience employment problems in both good and bad economic times (e.g., qualified veterans and youth who are members of families receiving food stamp benefits, high-risk youth, Supplemental Security Income recipients, and economically disadvantaged ex-felons).

The Work Opportunity Tax Credit and Welfare-to-Work Tax Credit are temporary provisions of the Internal Revenue Code. Since their initiation in the mid-1990s, the Congress has allowed the credits to lapse four of the five times they were up for reauthorization. In each instance, they were reinstated retroactive to their expiration dates as part of large tax-related measures. The employment tax credits never have been addressed independently of broader legislation.

Most recently, the 108th Congress took up legislation related to the WOTC in early 2003. It did not address both credits' then-upcoming expiration on January 1, 2004. The Social Security Protection Act of 2003 (P.L. 108-203) ultimately was enacted into law in March 2004. It included language that effectively expanded the WOTC's vocational rehabilitation referral group. Then, some 10 months after the credits' expiration, the House and Senate passed the conference report (H.Rept. 108-696) for H.R. 1308 (The Working Families Tax Relief Act of 2004); it included a two-year extension of the Work Opportunity Tax Credit and Welfare-to-Work Tax Credit retroactive to their expiration and through December 31, 2005. Neither the House- nor Senate-passed versions of the bill had mentioned the two employment credits.

As it has in the past, the President's FY2006 budget request would repeal the WtW tax credit after incorporating a modified version of it in the WOTC. The Administration's proposal also would extend the consolidated credit for one year (through December 31, 2006). As introduced in the 109th Congress, H.R. 1272/S. 595 also would fold a revised WtW tax credit into the WOTC. The bills would, in contrast to the President's proposal, make the consolidated credit permanent. In addition, they effectively would expand eligibility for three groups: ex-felons no longer would be required to be economically disadvantaged, and the upper age limit of young food stamp recipients and of high-risk youth would be raised. Other bills introduced thus far during the current Congress would add eligible groups to the WOTC.

This report will be updated as legislative activity occurs.

Contents

What Kind of Wage Subsidies Are the WOTC and WtW Credits? 1

A Description of the Credits 3
WOTC 3
WtW Tax Credit 5

Program Activity 6
WOTC 7
WtW Tax Credit 7

Program Costs 8

Evaluations of the WOTC and WtW Tax Credit 9

Legislative Activity 12
From the 104th Congress Through the 108th Congress 12
104th Congress 12
105th Congress 12
106th Congress 12
107th Congress 12
108th Congress 13
Legislative Activity During the 109th Congress 14

List of Tables

Table 1. Value of WOTC and WtW Credits Claimed on Federal Income Tax Returns 9

The Work Opportunity Tax Credit (WOTC) and the Welfare-to-Work (WtW) Tax Credit

Two income tax credits — the Work Opportunity Tax Credit (WOTC) and the Welfare-to-Work (WtW) tax credit — intended to encourage for-profit employers to hire from groups that experience difficulties in the labor market both in good and bad economic times most recently expired on January 1, 2004, after the 108th Congress went out of session without taking action. On September 23, 2004, the House and Senate agreed on the conference report for H.R. 1308 (the Working Families Tax Relief Act of 2004, P.L. 108-311), which among other things provides a two-year extension of the otherwise unmodified employment tax credits (from Jan. 1, 2004 through Dec. 31, 2005). This mirrors what happened to the two credits during the 107th Congress, when they expired for about two months before being reauthorized retroactive to their expiration date.

This report explains what type of subsidies these tax provisions are and refers to criticisms of their immediate predecessor, the Targeted Jobs Tax Credit, with which they share features. It then moves on to a detailed description of the WOTC and WtW credit (e.g., target groups, subsidy rate, retention period, and certification process). Next, activity under the programs as well as their costs are presented. The report closes with a brief legislative history and a discussion of current policy action.

What Kind of Wage Subsidies Are the WOTC and WtW Credits?

They are *selective* or *categorical* hiring subsidies; that is, they attempt 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 and the WtW credit are *not* incremental subsidies. Because employers do not have to create new jobs (i.e., increase the size of their workforces)

in order to get the credits, the programs' 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 suggest that the likelihood of employers engaging in churning[3] or displacement to maximize receipt of the WOTC is low.[4]

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 and WtW credit were 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 400 hours or 180 days under the WtW credit. This also was briefly the case under the original version of the WOTC. The reason for extending the retention period beyond the TJTC's requirement was to enable eligible hires to

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[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*, Jan. 28, 1997, p. A1. For more information on displacement in the context of welfare reform, see archived CRS Report 97-360, *Welfare Reform and Subsidized Public Sector Jobs*, by Linda Levine, pp. 7-10 (available 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).

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

[5] For more information on the TJTC, see archived CRS Report 95-981, *The Targeted Jobs Tax Credit, 1978-1994*, by Linda Levine (available from author).

get the kind of work experience that would improve their long-term job opportunities. However, some analysts have been skeptical that these program changes will prove effective at remedying the problems.[6]

A Description of the Credits

WOTC

At present, for-profit employers are entitled to a credit against their federal income tax liabilities for hiring members of the following eligible groups:

- members of families receiving benefits under the Aid to Families with Dependent Children (AFDC) or its successor (Temporary Assistance to Needy Families, TANF) program for any nine months during the 18-month period ending on the hiring date;[7]
- qualified veterans who are 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 15-month period ending on the hiring date;[8]
- 18- to 24-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;
- high-risk youth (i.e., 18- to 24-year-olds whose principal place of abode is an empowerment zone, EZ, an enterprise community, EC, or a renewal community, RC);
- 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);

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

[7] This is the group whose 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 AFDC or TANF program (i.e., those specifically listed on the grant).

[8] A qualified veteran is one who has served on active duty for more than 180 days or who has been discharged or released from active duty for a service-connected disability. Note: Members of families are only those persons taken into account when determining eligibility for a food stamp program under the Food Stamp Act of 1977.

- economically disadvantaged[9] ex-felons with hiring dates within one year of the last date of conviction or release from prison;
- 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 or through a vocational rehabilitation program for veterans carried out under Chapter 31 of Title 38, U.S. Code); and
- 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 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 summer youth) who remain employed from 120 hours to 399 hours, the subsidy rate is 25%. For summer youth hires, the 25% or 40% subsidy rate is applied against the first $3,000 earned in any 90-day period between May 1 and September 15. Thus, the minimum employment period under the WOTC currently is 120 hours.[10]

The actual value of the WOTC to the employer could be less than $1,500-$2,400 per eligible worker ($750-$1,200 per summer youth hire) depending on the firm's tax bracket. A business' tax deduction 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 for workers hired on or after January 1, 1998. (Previously, the carry-back and carry-forward periods were three years and 15 years, respectively).

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[9] "Economically disadvantaged" is defined as having an annualized family income of 70% or less of the lower living standard income level (LLSIL). The U.S. Bureau of Labor Statistics developed and subsequently eliminated the LLSIL along with other living standards levels. In the many years since then, the U.S. Employment and Training Administration has been updating the LLSIL by applying an inflation factor.

[10] In the WOTC's initial version (i.e., for persons hired from Oct. 1, 1996 through Sept. 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*, Apr. 21, 1997, p. A1.

State Employment Security (ES) agencies, in cooperation with participating agencies,[11] 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.[12] 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 21 days after the new hire 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 21 days after the new hire starts working. 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,[13] 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.[14]

WtW Tax Credit

The Welfare-to-Work Tax Credit was initiated as part of the federal effort to move welfare recipients onto payrolls.[15] It is intended to encourage employers to hire particularly disadvantaged members of the TANF group, namely, long-term

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[11] 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.

[12] 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, Oct. 1985.

[13] 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.

[14] Ben Wildavsky, "Taxation: Taking Credit," *National Journal*, Mar. 29, 1997. (Hereafter cited as Wildavsky, *Taxation: Taking Credit*.)

[15] For more information on prior employment tax credits with welfare recipients as their designated population, see archived CRS Report 96-738, *Welfare Recipients and Employer Wage Subsidies*, by Linda Levine (available from author).

recipients. Specifically, the WtW credit's 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 which 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 which is not more than two years after the date of benefit cessation.

For hiring an eligible long-term family assistance recipient, 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. The actual value of the WtW credit may be less than $3,500 in the first year and $5,000 in the second year of an eligible hire's employment (for elaboration see the WOTC program description).

Qualified wages under the WtW tax provision are defined more broadly than under the WOTC. They 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.

The WtW credit's minimum employment period also differs from the WOTC's current requirement of 120 hours. As in the WOTC's initial version, employers must retain eligible workers 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 described above. A firm cannot claim a WtW credit and a WOTC for the same individual in the same taxable year.

As it is required to do annually under the Internal Revenue Code, the Joint Committee on Taxation issued a report in 2004 to the House Committee on Ways and Means and the Senate Committee on Finance that includes simplification proposals. One proposal involves combination of the WOTC and the WtW credit such that they would be governed by one set of rules pertaining to such things as length of retention, definition of wages, level of subsidy rates, and limits on annual salaries against which the rates are applied.

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, and 403,243 in FY2003. 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.

Certifications most often have been issued for hiring members of the AFDC/TANF group (e.g., 40% in FY2003). Another 27% of certifications in FY2003 were for 18- to 24-year-olds in families receiving food stamps. The share of high-risk youth has been on the rise, and it accounted for 13% of the total in FY2003. The share of SSI recipients (an eligible group added in 1998) had been increasing through FY2002, when it dropped from almost 8% to 6% in FY2003. In contrast, the share of the vocational rehabilitation group had been decreasing steadily before remaining flat at almost 5% in FY2002 and FY2003. The remaining groups (i.e., ex-felons, veterans, and summer youth) together accounted for over 9% of certifications in FY2003, with the majority issued to employers for hiring ex-felons (over 6%).

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 young food stamp recipient and high-risk youth groups. This gender pattern has prompted proposals in the Congress to extend the groups' upper age limit.

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. In contrast to this marked downward trend in WtW certifications, WOTC certifications fluctuated over the period.

Program Costs

Spending for ES administration of the two programs generally has been less than $20 million per fiscal year. For example, the Consolidated Appropriations Act of 2005 (P.L. 108-447) provided almost $17.9 million after application of an across-the-board reduction.

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

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.[16] 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".[17] 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).

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[16] Wildavsky, *Taxation: Taking Credit*.

[17] Joint Economic Committee, *The Welfare-to-Work Tax Credit*.

Table 1. Value of WOTC and WtW Credits Claimed on Federal Income Tax Returns

Year	WOTC (in millions)			WtW Credit (in millions)		
	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.

Evaluations of the WOTC and WtW Tax Credit

To date, studies of the 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.[18]

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

[18] Westat, *Process Evaluation of the WOTC Program* (DOL, Employment and Training Administration, Office of Strategic Planning and Policy Development, Aug. 1997).

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).[19]

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 were:

- "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,[20] 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 (e.g., consolidate and streamline the forms), program design (e.g., broaden target-group eligibility criteria)[21] and promotion of the program (e.g., increase use of conditional certifications).[22]

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.[23]

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[19] GAO, *Work Opportunity Credit*.

[20] 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.

[21] These two recommendations echo those made in the 1997 process evaluation.

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

[23] 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, Mar. 2001).

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 have worked 400 hours or more].[24]

In a December 2002 report, the GAO attempted to specifically examine 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 to the employment of persons with disabilities: top-management commitment, staff training, mentoring, on-site consultation and technical assistance, and short-term outside assistance.[25]

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

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

Legislative Activity

The Work Opportunity Tax Credit and Welfare-to-Work Tax Credit are temporary provisions of the Internal Revenue Code. Since their initiation in the mid-1990s, the Congress has allowed the credits to lapse four of the five times they were up for reauthorization. In each instance, they were reinstated retroactive to their expiration dates as part of large tax-related measures. The credits never have been addressed independently of broader legislation.

From the 104th Congress Through the 108th Congress

104th Congress. 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. 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, 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. 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. 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. 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 have 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.

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 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. 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 credits' 10-month lapse, it 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. The JCT estimated that revenue losses from the extension might total $603 million for the WOTC and $122 million for the WtW credit over the FY2005-FY2009 period.

The House previously passed another measure concerning the WOTC and the WtW credit on November 20, 2003. H.R. 3521 (the Tax Relief Extension Act of 2003) dealt not only with temporary tax provisions but also other matters (e.g., rulings by the World Trade Organization (WTO)). It would have extended the two employment credits through 2004 and covered Liberty Zone business employees in 2004 as well. A bill with the same title, S. 1896, was introduced in the Senate on November 19, 2003; it focused only on extending temporary tax benefits. It would have extended the WOTC and the WtW credit through June 30, 2004.

Two other bills with provisions concerning the WTO rulings also dealt with the two employment credits. H.R. 4520 (the Jumpstart Our Business Strength Act) was passed on June 17, 2004. It, like H.R. 1308, would have extended both the WOTC and WtW credit through December 31, 2005. In contrast, S. 1637, which passed the Senate on May 11, 2004, would have adopted the provisions in H.R. 2047/S. 1180 concerning the WOTC and WtW credit. On July 15, the Senate passed H.R. 4520 after substituting the language in S. 1637. While making the WOTC a permanent tax benefit effective after December 31, 2003, H.R. 4520/S. 1637 would have changed and incorporated the WtW credit for long-term TANF recipients into the WOTC as follows: (1) the WOTC's tiered subsidy rates (25% and 40%) based on hours worked during the first year of employment would be applied to the WtW credit's eligible group (long-term TANF recipients); (2) employment of long-term TANF recipients for a second year would continue to allow employers to claim a 50% credit; (3) in both the first and second year of employment of long-term TANF recipients, the subsidy rate would be applied against their cash wages of $10,000 rather than the WtW credit's current definition of earnings which includes certain benefits. (The lower wage limit for WOTC groups would remain unchanged as would the subsidy's application to only a WOTC-eligible hire's first year of employment.) Other modifications would have: (1) eliminated the requirement that ex-felons be members of relatively low-income families; (2) expanded the food stamp youth group from 18- to 24-year-olds to include 25- to 39-year-olds; and (3) similarly, extended the high-risk youth group to include 25- to 39- year-olds as well as renaming the group "designated community residents."

Legislative Activity During the 109th Congress

With the WOTC and WtW Tax Credit now set to expire on January 1, 2006, legislation has been introduced in the 109th Congress to extend and otherwise amend them. Some Members have again shown interest in simplifying and otherwise modifying the credits through their introduction of H.R. 1272/S. 595, for example. In addition to:

- making the WOTC permanent,
- expanding eligibility of ex-felons beyond those who are economically disadvantaged,
- expanding eligibility of young food stamp recipients by including 25- to 39-year-olds, and
- renaming high-risk youth as "designated community residents" while expanding their eligibility to include 25- to 39-year-olds,

the Encouraging Work Act of 2005 would repeal the WtW credit as a separate tax provision. Instead, as in legislation described above from the 108th Congress, long-term family assistance recipients would become a uniquely handled eligible group under the WOTC. More specifically,

- employers who hire long-term family assistance recipients could claim a credit if individuals are retained for a minimum of 120 hours (rather than the current 400 hours or 180 days);
- the 25% subsidy rate for WOTC group members employed from 120 to 399 hours would apply 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 would be raised to 40% as is currently the case for WOTC-eligible hires;
- employers would continue to be able to claim a credit for retaining long-term family assistance recipients during a second year at the WtW's current subsidy rate of 50%;
- the subsidy rates for long-term family assistance recipients would continue to be applied against up to $10,000 earned in each of the first and second years of employment; and
- qualified wages of long-term family assistance recipients would become the same as those of WOTC-eligible hires, namely, cash wages (i.e., certain benefits could no longer be included).

The Administration has included in its FY2006 budget request, the same changes to the two employment tax credits that were submitted in its FY2004 and FY2005 budget requests. Both the Administration's proposal and H.R.1272/S. 595 would similarly consolidate the WtW credit within the WOTC. It differs from the bills, however, by extending the WOTC for one year (through December 31, 2006) and by modifying the definition of the ex-felon group only.

Other legislation introduced thus far that relates to the WOTC includes adding eligible groups (e.g., qualified small business employees, and qualified veterans of the military operations in Afghanistan or Iraq and their qualified dependents).