

# CRS Report for Congress

Received through the CRS Web

## The Work Opportunity Tax Credit and the 105<sup>th</sup> Congress

Linda Levine  
Specialist in Labor Economics  
Economics Division

### Summary

The Work Opportunity Tax Credit (WOTC) was initiated in the Small Business Job Protection Act of 1996 (P.L. 104-188). It is a temporary measure intended to encourage for-profit employers to hire members of specifically designated groups thought to experience recurring problems in the labor market. The Taxpayer Relief Act of 1997 (P.L. 105-34) modified the employment credit and extended it through June 30, 1998. H.R. 3125 would extend WOTC for 3 years, through June 30, 2001; other bills would increase the number of eligible groups, apply WOTC to the employment taxes of tax-exempt organizations, and allow the credit against the alternative minimum tax. P.L. 105-34 also initiated a new credit, the Welfare-to-Work Tax Credit (WWTC), to promote employment of long-term welfare recipients. It is authorized to run through April 30, 1999. In its FY1999 budget request, the Administration has proposed extending the WOTC and WWTC through April 30, 2000.

### What is WOTC?

WOTC is a *selective* hiring subsidy, that is, it is intended to encourage employers to hire members of prescribed groups. By their very nature, selective hiring subsidies favor individuals from the prescribed groups over other jobseekers. Members of these groups are believed to be low skilled, such that their productivity does not warrant employers paying them the going wage, which in turn results in the groups' members having chronically low incomes or high unemployment rates. A subsidy — in the instant case offered as a credit against an employer's federal income tax liability as opposed to a direct payment to an employer — serves to narrow the gap between the productivity of these individuals and the going wage for a particular job.

WOTC is not an incremental subsidy, that is, firms do not have to increase the size of their workforces in order to get the credit. Consequently, employers can claim the credit by hiring eligible group members to fill either newly created or already existing positions. The availability of WOTC could thus prompt some firms to deliberately

displace ineligible employees in order to fill their jobs with eligible workers, or to favor eligible over ineligible job applicants when new positions are created or when vacant positions develop through voluntary employee turnover. Some Members of Congress have been concerned about the prospect for *displacement* in light of ongoing efforts to move welfare recipients into jobs.<sup>1</sup>

### **WOTC: Its Current Form**

Under WOTC as authorized by the Small Business Job Protection Act of 1996 (P.L. 104-188), for-profit employers were entitled to a credit against their federal income tax liabilities for hiring members of 7 specifically designated groups. The Taxpayer Relief Act of 1997 (P.L. 105-34) added an eighth group and modified the definition of one group. It also shortened the retention period, changed the subsidy rate, and extended the temporary measure for 9 months through June 30, 1998. The amendments apply to eligible individuals hired after September 30, 1997.

WOTC's eligible groups currently are as follows:

- 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 9-month period ending during the 18-month period ending on the hiring date;<sup>2</sup>
- 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 3-month period during the 15-month period ending on the hiring date;<sup>3</sup>
- 18-24 year olds who are members of families receiving food stamp benefits for the 6-month period ending on the hiring date, or receiving benefits for at least 3 months of the 5-month period ending on the hiring date in the case of family members no longer eligible for assistance under section 6(o) of the Food Stamp Act of 1977;
- high-risk youth (i.e., 18-24 year olds whose principal place of abode is an empowerment zone or an enterprise community);

---

<sup>1</sup> For more information on displacement in the context of welfare reform, see: U.S. Library of Congress. Congressional Research Service. *Welfare Reform and Subsidized Public Sector Jobs*. CRS Report 97-360 E, by Linda Levine. pp. 7-10.

<sup>2</sup> Members of families are only those persons taken into account when determining eligibility for the AFDC or TANF program. Previously, group members had to have been receiving benefits for 9 *consecutive* months.

<sup>3</sup> 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. 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.

- summer youth (i.e., 16-17 year olds hired for any 90-day period between May 1 and September 15 whose principal place of abode is an empowerment zone or an enterprise community);
- Supplemental Security Income recipients who have received benefits for any month ending within the 60-day period ending on the hiring date;<sup>4</sup>
- economically disadvantaged<sup>5</sup> ex-felons with hiring dates within 1 year of the last date of conviction or release from prison; and,
- 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 completion of or while receiving rehabilitative services under the Rehabilitation Act of 1973 or through a program carried out under chapter 31 of title 38, United States Code).

An employer can claim an income tax credit of 40% of the first \$6,000 in wages paid to eligible group members (except summer youth) during their first year of employment, if the employees are retained for at least 400 hours. The subsidy rate is 25% for eligible-hires (except summer youth) who remain on the payroll between 120 and 399 hours. Thus, the minimum retention period is 120 hours.<sup>6</sup>

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. The actual value of the credit to the employer could be less than \$1,500-\$2,400 per eligible worker (or \$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 as well. And, the credit cannot exceed 90% of a firm'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 WOTC, the excess can be carried back 3 years and carried forward 15 years.

Local Employment Service (ES) offices are charged with certifying the eligibility of jobseekers. This can occur in two different ways: (1) either a firm must receive a written certification from the ES that a new-hire belongs to a WOTC group on or before the day the individual begins to work for the employer; or, (2) the employer must complete a "pre-screening notice" (Form 8850) on or before the day the jobseeker is offered a position and then must submit the notice (signed by the employer and new-hire under penalties of perjury) to an ES office within 21 days after the new-hire begins to work for the

---

<sup>4</sup> This is the group added by P.L. 105-34.

<sup>5</sup> Economically disadvantaged is defined as having an annualized family income of 70% or less of the lower living standard income level.

<sup>6</sup> In WOTC's initial version, the minimum retention period was 400 hours or 180 days. The subsidy rate was 35%.

employer.<sup>7</sup> If the ES rejects a firm's request for certification, the office must provide a written explanation of its decision to the employer.

The ES issued 126,113 WOTC certifications to employers in FY1997. Most (60%) were for members of the AFDC/TANF group. Another 21% were for members of the group comprised of 18-24 year olds in families receiving food stamps. The high-risk youth and vocational rehabilitation groups each accounted for nearly 7% of the certifications. A little over 3% were for the ex-felon group. Slightly more than 1% of the certifications applied to members of the veterans group and slightly less than 1% to members of the summer youth group.

The great majority of WOTC's cost to the government comes from revenue forgone rather than from appropriated funds. According to the Administration's FY1999 budget documents, the revenue loss to the treasury associated with P.L. 105-34's extension and modification of WOTC could total \$340 million between FY1999 and FY2003.<sup>8</sup> In contrast, the Labor Department's appropriation for FY1998 (P.L. 105-78) earmarked \$20 million for ES administration of the program. The same appropriation level has been requested for FY1999.

### **Legislation Pending Before the 105<sup>th</sup> Congress**

As part of its FY1999 budget request, the Administration has proposed that WOTC and the Welfare-to-Work Tax Credit (WWTC) be extended through April 30, 2000. It is estimated that the proposal to extend WOTC from June 30, 1998 through April 30, 2000 could cost the treasury \$778 million in revenue forgone between FY1999 and FY2003; and, to extend WWTC from April 30, 1999 through April 30, 2000, \$169 million over the 5-year period.

On January 28, 1998, H.R. 3125 was introduced. It would extend WOTC for 3 years, through June 30, 2001.

On April 30, 1998, H.R. 3772 and S. 2018 were introduced. The former would allow WOTC against the alternative minimum tax for years beginning after December 31, 1997. The latter would permit firms in certified economic dislocation areas to receive the credit for hiring qualified dislocated workers after December 31, 1998.

Just before the close of the 105<sup>th</sup> Congress' first session, the Community Employment Partnership Act of 1997 (H.R. 2995) was proposed. It would permit tax-exempt organizations (excluding governmental units as well as agencies or instrumentalities of governmental units) to apply a modified version of WOTC against their quarterly *employment* taxes. Instead of WOTC's 40% subsidy rate applicable to for-profit employers who retain eligible-hires at least 400 hours, H.R. 2995 would substitute

---

<sup>7</sup> Under WOTC's predecessor, the Targeted Jobs Tax Credit, the first method was used infrequently.

<sup>8</sup> The estimated revenue loss due to firms hiring long-term welfare recipients under the WWTC is \$90 million between FY1999 and FY2003. For information on the WWTC, see: U.S. Library of Congress. Congressional Research Service. *The Welfare-to-Work Tax Credit: A Fact Sheet*. CRS Report 97-784 E, by Linda Levine.

a 30% rate for tax-exempt employers; and, instead of WOTC's 25% rate applicable to taxable firms who retain eligible-hires between 120 and 399 hours, the bill would substitute a 20% rate for tax-exempt employers. Tax-exempt organizations who hire WOTC-eligibles could reduce their quarterly employment tax payments by the amount of the subsidy they expect to be entitled to claim during the calendar year. At year end, adjustments would be made to reflect the actual as opposed to estimated hours of work of eligible-hires during the calendar year, and consequently, actual as opposed to estimated reductions in prior quarterly employment tax payments.

WOTC also is incorporated in legislation introduced earlier in the first session of the 105<sup>th</sup> Congress. Bills that focus on providing assistance to distressed communities would do such things as expand WOTC's high-risk youth and summer youth groups to include individuals living in renewal communities (H.R. 1031/S. 432), add to the credit's eligible groups graduates of specialized academies located in education zones who are hired within 6 months of graduation (H.R. 1512), and apply an increased subsidy rate of 50% to the wages of eligible-hires during their first 3 years of employment (S. 23).