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# Supplemental State Work Opportunity Tax Credit (General Fund Taxes -- Income and Franchise Taxes)

[LFB 2021-23 Budget Summary: Page 206, #6]

## BACKGROUND

The federal work opportunity tax credit (WOTC) can be claimed to offset federal income taxes and is equal to a specified percentage of wages paid to new employees who are members of certain target groups. The Department of Workforce Development (DWD) is responsible for the administration of the federal WOTC, including the certification process (described below), promoting the program to employers, and reporting program data on a quarterly basis to the U.S. Department of Labor (USDOL). DWD receives federal grant funding from USDOL in the amount of $335,089 in federal fiscal year (FFY) 2019 and $344,514 in FFY 2020 to support 3.0 Fed positions to administer the federal program. DWD does not receive state funds to administer the program.

Employers may claim the federal WOTC for up to 40% of the wages paid to eligible workers employed at least 400 hours and up to 25% for those employed for at least 120 hours, but less than 400. In general, the maximum qualified first-year wages are limited to $6,000, and no credit is allowed for the second year of employment. Thus, in general, the maximum credit is $2,400 for those employed 400 hours or more (40% of $6,000) and $1,500 for those employed at least 120 hours, but less than 400 (25% of $6,000).

The wage limit (and maximum credit) differs based on the type of targeted group member. For example, for disabled veterans, qualifying wages are limited to $12,000, and thus the maximum federal credit is: (a) $3,000 (25% of $12,000) for those employed for at least 120 hours but less than 400 hours; and (b) $4,800 (40% of $12,000) for those employed for 400 or more hours. For unemployed disabled veterans, qualified wages are limited to $24,000, and for unemployed veterans, wages are limited to $14,000. For long-term family assistance recipients, the WOTC may be earned for the first two years of employment, except that wages are limited to $10,000, and employers may claim up to 40% for those employed at least 400 hours in the first year ($4,000 maximum credit) and 50% for those employed at least 400 hours in the second year ($5,000 maximum credit).

To claim the WOTC, the employer and applicant must first complete a federal pre-screening form and a verification form when the applicant is hired. The forms must be sent to DWD at least 28 days after the employee begins in order to obtain certification that an individual is a member of a targeted group. In FFY 2019, DWD provided WOTC certification for 1,850 employers eligible for up to $120,807,400 in total tax credits. In FFY 2020, DWD provided WOTC certification for 1,672 employers eligible for up to $96,272,400 in total federal tax credits. Employers may claim credits on their federal return after the employee has worked the requisite number of hours. Note that credits claimed for persons certified in one year may be applied against income tax liabilities in past or future years, and therefore credits need not be used in the year claimed.

Targeted group members, whose employment authorizes the employer to be eligible for the WOTC, are the following:

a. *TANF Recipients.* A member of a family receiving assistance under the temporary assistance for needy families (TANF) block grant program for any nine months of the last 18-month period ending on the hiring date.

b. *Qualified Veterans.* A veteran who is one of the following: (a) a member of a family that has received assistance under the supplemental nutrition assistance program (SNAP) for at least three of the previous 15 months prior to the hiring date; (b) entitled to compensation for a service-connected disability, and who has a hiring date of not more than one year after discharge or release from active duty, or has been unemployed for an aggregate period totaling at least six months during the one-year period ending on the hiring date; (c) has aggregate periods of unemployment during the one-year period ending on the hiring date which equal or exceed four weeks, but are less than six months; or (d) has aggregate periods of unemployment during the one-year period ending on the hiring date which equal or exceed six months.

c. *Ex-felons.* An individual convicted of a felony under federal or state law, released from prison within one year of the date of hire.

d. *Designated Community Residents.* A resident, aged 18 to 39 as of the hiring date, of a federal empowerment zone, enterprise community, renewal community, or rural renewal county. According to DWD, currently there are no such designated areas in Wisconsin. However, as indicated in the table below, 43 individuals lived in such areas outside the state and worked for Wisconsin-based companies.

e. *Vocational Rehabilitation Referrals.* An individual with a disability serious enough to be a barrier to employment and who was referred to the employer after completing, or while receiving, rehabilitation services under a state rehabilitation plan, or a program approved by the federal Department of Veteran's affairs. The rehabilitation services must have been received within two years of the hire date.

f. *Summer Youth Employees.* An individual who is 16 or 17 years old, who performs services for an employer between May 1 and September 15, and is a resident of a federally designated empowerment zone, enterprise community, or renewal community. The credit may be claimed for wages earned for up to 90 days between May 1 and September 15.

g. *SNAP Recipients.* An 18 to 39-year-old member of a family that has received SNAP assistance for the past six months, or for at least three of the past five months but is no longer eligible to receive them.

h. *SSI Recipients.* An individual who received supplemental security income (SSI) benefits for any month within 60 days from the hiring date.

i. *Long-term Family Assistance Recipients.* An individual who is a member of a family that: (a) received TANF payments for at least 18 consecutive months ending on the hiring date; (b) received such family assistance for a total of 18 months (consecutive or nonconsecutive) after August 5, 1997, if the individual is hired within two years after the 18-month total is reached. Alternatively, an individual would qualify if he or she became ineligible for assistance after August 5, 1997, due to federal or state law limitations, and the individual's hiring date was not more than two years after eligibility for assistance ends.

j. *Long-term Unemployed.* An individual who has been unemployed for a period not less than 27 consecutive weeks and received unemployment compensation during some of this period under state or federal law.

The following Table shows the targeted group members in Wisconsin certified in FFY 2020, based on data from USDOL, and the maximum amount of creditable wages available for each group. The largest targeted group certified is SNAP Recipients, who comprise more than half of participants. For comparison, according to USDOL, nationally, 68.3% of participants are SNAP recipients and 3.1% are TANF recipients. TANF-recipients in Wisconsin account for a higher proportion of certifications than they do nationally. However, DWD indicates that this may be a statistical anomaly as it counts TANF Recipients that are members of multiple targeted groups solely as TANF recipients.

**WOTC Certifications in Wisconsin by Target Group in FFY 2020**

| | Target Population | Number | Percent | Maximum Creditable Wages |
|---|---|---|---|---|
| a. | TANF Recipients | 6,937 | 17.5% | $6,000 |
| b. | Qualified Veterans | 2,324 | 5.8 | $6,000 to $24,000 |
| c. | Ex-felons | 3,848 | 9.7 | $6,000 |
| d. | Designated Community Residents | 43 | 0.1 | $6,000 |
| e. | Vocational Rehabilitation Referrals | 1,458 | 3.7 | $6,000 |
| f. | Summer Youth Employees | 0 | 0.0 | $3,000 |
| g. | SNAP Recipients | 21,104 | 53.1 | $6,000 |
| h. | SSI Recipients | 1,671 | 4.2 | $6,000 |
| i. | Long-term Family Assistance Recipients | 1,772 | 4.5 | $10,000 per year for up to two years |
| j. | Long-term Unemployed | 571 | 1.4 | $6,000 |
| | Total | 39,728 | 100.0% | |

## DISCUSSION POINTS

### Policy Considerations

1. The premise of the federal WOTC is that providing employment opportunities for certain chronically unemployed groups that have been disadvantaged in the workforce will reduce poverty. This includes not only the short-term benefit of a targeted individual earning wages while participating in the program, but also improving their long-term employability by providing a work history, on-the-job training, and improving soft skills that assist in obtaining and maintaining employment, as well as increased earnings, by advancing in a career. Further, the intent is that targeted individuals will reduce their reliance on public assistance programs after they become employed.

2. Providing a tax credit as a subsidy for employment is intended to incentivize employers to hire targeted individuals. Because a subsidy (generally up to $1,500 or $2,400) is only available for hiring targeted individuals, and the credit amount increases for employees working more than 120 and more than 400 hours, the program is highly cost effective for employing individuals from those groups. For comparison, the Department of Children and Families (DCF) estimates that the average cost per participant in the Transform Milwaukee and Transitional Jobs programs (a state program that subsidizes employment of certain persons by way of payment to employers) is $10,000 per year.

3. Further, the tax credit is intended to leverage private funds to increase the reach of the program and the benefits provided to each participant. The subsidy becomes more cost effective the longer an employee's tenure extends beyond the maximum hour and wage thresholds incentivized.

4. Various studies have found that employment tax credits can be an effective market support for employing targeted individuals. For example, a study of WOTC subsidies for disabled veterans found that the WOTC generated a two percentage point increase in employment, and increased wage income by approximately 40%, compared to other groups (including veterans who were not eligible for the WOTC, other persons eligible for the WOTC, and other persons not eligible for the WOTC). The study found that the credit accounted for roughly 32,000 additional employed disabled veterans nationwide in both 2007 and 2008.

5. However, the effect on long-term employment has been mixed. A study of the federal WOTC and another previously available federal employment subsidy program in Wisconsin found that TANF recipients were 5.9% more likely to be employed in the second quarter of participation in WOTC than TANF recipients that did not participate, but that there was no significant difference in employment after one year. Further, participants earned 9% more than non-participants after their jobs began. That difference in wages for WOTC recipients represents 38% of the value of the tax credit. However, there was no measurable effect on job tenure.

6. On the other hand, the U.S. Government Accountability Office examined the WOTC program and found that employers generally do not terminate participating employees when their subsidies run out in order to obtain more credits by hiring different targeted individuals. The cost and difficulty of recruiting employees was found to not be worth the potential tax benefit.

**Supplemental State WOTC**

7. Assembly Bill 68/Senate Bill 111 (AB 68/SB 111) would create a supplemental state tax credit, with credit equal to roughly half of the federal WOTC, for employers in taxable years beginning after December 31, 2020. Credits could not be claimed on wages exceeding the wage limits, discussed above, that are set under the federal WOTC. Thus, in general, the maximum supplemental state WOTC would be $1,200 for those employed 400 hours or more (20% of $6,000) and $750 for those employed at least 120 hours, but less than 400 hours (12.5% of $6,000).

8. Together with the federal credit, an eligible employer could generally claim a maximum of: (a) $3,600 for each targeted individual employed for 400 hours or more for $6,000 in wages or more (credits equal 60% of qualified wages paid); and (b) $2,250 for each targeted individual employed for at least 120 hours, but less than 400 hours, for $6,000 in wages or more (37.5% of qualified wages paid).

9. The state WOTC would have to be claimed at the same time as the federal credit, equal to up to one of the following amounts: (a) 20% of qualified first-year wages, as defined in the federal WOTC, paid during the taxable year to a targeted group member, as defined under the federal WOTC, who has performed at least 400 hours of services for the claimant in this state; (b) 12.5% of the qualified first-year wages paid during the taxable year to a targeted group member who has performed at least 120 hours, but less than 400 hours, of services for the claimant in this state; or (c) 25% of the qualified second-year wages paid during the taxable year to a long-term family assistance recipient (as defined under the federal WOTC) who has performed at least 400 hours of services for the claimant in this state. Claimants would not be able to claim the state WOTC for wages paid for services performed outside this state.

Partnerships, limited liability companies (LLCs), and tax-option (S) corporations would not be permitted to claim the credit, but the eligibility for, and the amount of, the credit would be based on their payment of the wages. A partnership, LLC, or S corporation would have to compute the amount of credit that each of its partners, members, or shareholders could claim and provide that information to each of them. The partners, members, and shareholders would be able to claim the credit in proportion to their ownership interests.

DOR would be authorized to administer the credit, and take any action, conduct any proceeding, and proceed as authorized under state income and franchise tax laws. State tax provisions related to timely claims, assessments, refunds, appeals, collection, interest, and penalties would apply to the credit. By contrast, DWD would not be authorized to administer the state WOTC (which would instead rely on the federal certification process). Further, DWD would not be provided with funding to promote the state program to employers.

Under current law, the federal WOTC will sunset after tax year 2025. The proposed supplemental credit under AB 68/SB 111 would follow federal law, such that the state WOTC would also sunset after 2025. In the event that the federal WOTC were to be extended, as it recently was under the federal Consolidated Appropriations Act of 2020, then the state WOTC would be similarly extended under the bill.

The proposed credit would incorporate the requirements and limitations of the federal WOTC for purposes of the state WOTC, including the following.

First, an individual could not be treated as a member of a targeted group unless: (a) on or before the day on which that individual begins work for the employer, that employer has received a certification from a designated local agency (such as a state employment security agency) that the individual is a member of a targeted group; or (b) on or before the day the individual is offered employment with the employer, a prescreening notice is completed by the employer with respect to such individual, and not later than 28 days after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for a certification. “Pre-screening notice” would mean a document which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group. If an individual has been certified by a designated local agency as a member of a targeted group, and that certification is incorrect because it was based on false information provided by the individual, then the certification would be revoked. Wages paid by the employer after the date on which notice of revocation is received by the employer could not be treated as qualified wages. If a designated local agency denies a request for certification of membership in a targeted group, the agency would have to provide to the individual making such a request a written explanation of the reasons for such denial.

A veteran would be treated as having the required aggregate periods of unemployment for being a qualified veteran if the veteran is certified by such agency as being in receipt of unemployment compensation under state or federal law for a period of either: (a) not less than six months during the one-year period ending on the hiring date; or (b) not less than four weeks (but less than six months) during the one-year period ending on the hiring date.

Second, remuneration paid by an employer to an employee during any taxable year would be taken into account only if more than one-half of the remuneration paid is for services performed in a trade or business of the employer.

Third, certain individuals would not be eligible. No wages would be taken into account with respect to any individual if, prior to the hiring date, the individual had been employed by the employer at any time. Further, in the case of an individual who has performed at least 120 hours, but less than 400 hours, of service for the employer, the wage limit would be 25% rather than 40% (as discussed above). No wages would be taken into account with respect to any individual unless such individual has performed at least 120 hours of service for the employer. Further, no wages would be taken into account with respect to an individual who: (a) bears a relationship to the taxpayer, as defined under the Internal Revenue Code (IRC), including a child, brother, father, or mother, or, if the taxpayer is a corporation, to an individual who owns, directly or indirectly, more than 50% in value of the outstanding stock of the corporation, or, if the taxpayer is an entity other than a corporation, to any individual who owns, directly or indirectly, more than 50% of the capital and profits interests in the entity; (b) if the taxpayer is an estate or trust, is a grantor, beneficiary, or fiduciary of the estate or trust, or is an individual who bears a relationship to a grantor, beneficiary, or fiduciary of the estate or trust, as defined under the IRC; (c) is a dependent (as defined under the IRC) of the taxpayer; or, if the taxpayer is a corporation, is a dependent of an individual described above in "(a)"; or, if the taxpayer is an estate or trust, is a dependent of a grantor, beneficiary, or fiduciary of the estate or trust.

In the case of a successor employer, the determination of the amount of the credit with respect to wages paid by the successor employer would be made in the same manner as if such wages were paid by the predecessor employer. No credit would be determined with respect to remuneration paid by an employer to an employee for services performed by such employee for another person unless the amount reasonably expected to be received by the employer for such services from such other person exceeds the remuneration paid by the employer to such employee for such services.

**Fiscal Effect**

10. Based on federal tax data on amounts used under the federal WOTC in tax year 2017 and growth rate estimates from the Joint Committee on Taxation for the extension of the sunset date of the WOTC, the administration estimated that the state WOTC under Alternative 1 would reduce state tax collections by $27,800,000 in 2021-22 and $24,100,000 in 2022-23.

11. For comparison, these estimates are substantially smaller than half of the maximum amounts certified by DWD for federal credits (which certified 1,672 employers as eligible for up to $96,272,400 in total federal credits in 2020). As noted, state credit amounts certified would be about half the amount of federal credits certified.

However, these certifications are the maximum amounts that could be earned and do not necessarily reflect the amounts actually earned, claimed, or used to offset income by claimants. Further, federal law permits the WOTC credits to be used in the previous tax year, or carried forward to be used in the following 20 tax years. Thus, the fiscal effect in any particular year may be less than the maximum amounts earned for nonrefundable credits.

12. The administration's estimates appear to be reasonable given recent estimates of nationwide use of the federal WOTC by the federal Office of Budget and Management in federal fiscal year 2018-19 and estimates prepared by the Joint Committee on Taxation.

**Alternatives to State WOTC**

13. As stated in the administration's Budget in Brief, the supplemental state WOTC is intended to increase the incentive for employers to hire targeted individuals and move these individuals into the labor force. As stated above, only 1,672 Wisconsin employers were certified to use the program in 2020. Increasing the credit amount be creating a supplemental state credit may increase participation by employers, and thereby increase in number of positions statewide that are available for targeted individuals certified to participate in the program.

14. Further, the amount of long-term unemployed persons has substantially increased during the COVID-19 pandemic. The Bureau of Labor Statistics estimated in its April, 2021, report that 2.7 million people have been unemployed for 52 weeks or longer (29% of the unemployed). The long-term unemployed generally have great financial difficulties and face difficulty in finding employment compared to similar persons seeking employment who are currently employed or who have more recently become unemployed. The state supplement could provide much needed assistance for

businesses to hire members of this group as the economy improves through 2021.

15. Also, as discussed in LFB Paper #200, participation in Wisconsin Works paid employment placements increased substantially in 2020 in response to the economic disruption caused by the COVID-19 pandemic. As shown above in the Table on page 3, 6,937 TANF recipients in Wisconsin were certified for the WOTC in FFY 2020. For comparison, there were a total of 12,213 participants in paid positions in W-2 in 2020. Thus, the majority of TANF recipients appear to be further assisted in finding employment in the private sector with businesses utilizing the WOTC program. Therefore, expanding the federal WOTC by providing a state supplement could assist more TANF recipients move into private employment as the inoculation campaign reduces COVID-19 caseloads and the economy improves.

16. Thus, the Committee could find that the federal WOTC is a cost effective way of providing employment for certain individuals who may otherwise have difficulty finding employment and, therefore, create a supplemental state WOTC to enhance the current program (Alternative 1).

17. Further, the Committee could choose to provide $100,000 GPR annually to DWD to promote the state supplemental WOTC (Alternative 2). According to DWD, it cannot expend federal funding provided to promote the federal program to also promote the state supplemental WOTC. Absent state funding to advertise the supplemental state credit, employers not currently participating in the program may not become aware of the supplemental credit.

18. On the other hand, because AB 68/SB 111 would create the state WOTC as a supplement substantially identical to the federal WOTC, the credit would only be successful in achieving its stated purpose to the extent it increases participation in the program by employers for which the current federal credit amounts were insufficient to incent them to participate. Otherwise, the state supplement rewards activities already occurring because current participants would receive the enhanced credit amounts without increasing the number of targeted individuals they hire or the length of time they retain them.

19. Thus, the Committee could alter the conditions for earning the state WOTC in order to extend the benefits provided by the current program, rather than enhance the current benefits, and incent employers to retain targeted individuals for longer periods of time (Alternative 3). Specifically, the Committee could require an employer to retain the targeted individual for at least 500 hours before qualified wages under the state WOTC were to accrue (compared to the 120 and 400 hour thresholds for the federal WOTC). Similar to the federal credit, this would require the targeted individual to be employed for another 100 hours prior to earning tax benefits, thereby incenting employers to retain the individual for a longer period. Further, the Committee could specify that no state WOTC would be allowed against the first $6,000 of wages paid (compared to the federal WOTC, which is available for all wages up to a maximum limit of $6,000).

20. In addition to providing an incentive to retain targeted individuals for longer periods of time, these changes would enhance the cost effectiveness of the federal program by ensuring that the enhanced credit amounts would not provide a windfall for those employers that would already use the federal program at the current credit amounts.

21. Because these changes would limit the amount of credit available to the extent employers fail to reach the thresholds for the supplement, the estimated cost of the state WOTC would decrease by an unknown amount.

22. Alternatively, for the following reasons, the Committee could decline to create a state WOTC (Alternative 5). First, as a nonrefundable tax credit, the program is only effective for employers with a state tax liability. Thus, nonprofits would have little, if any, incentive to participate in the state WOTC program. The federal WOTC is available to certain tax-exempt organizations for hiring qualified veterans (but not for other targeted individuals) for their share of payroll taxes (such as Social Security). However, this option would not be available for the state supplement, and thus would be of little use to new or currently participating nonprofits. Likewise, the incentive for businesses to participate would vary by tax year, depending on whether they are profitable or if they have little tax liability due to other tax credits and deductions (such as the manufacturing and agriculture tax credit). The issue is somewhat mitigated for businesses because the state proposed WOTC could be carried forward for up to 15 years for use in a future tax year when they may be profitable. However, due to the time value of money, the incentive is reduced the longer the credit is carried forward.

23. Second, the WOTC is not designed to create new jobs, but to incent hiring targeted individuals. As a result, the credit's effectiveness is limited in areas where there are insufficient numbers of preexisting, unfilled jobs for targeted individuals. This makes it difficult to scale the use of the program into the areas of the state where it would most be needed.

24. Thus, rather than create a new state tax credit, the Committee could decide to provide $27,800,000 GPR in 2021-22 and $24,100,000 GPR in 2022-23 to DCF to expand the Transform Milwaukee and Transitional Jobs programs to the targeted individuals outlined above (Alternative 4). As discussed in LFB Paper #201, the Transform Milwaukee and Transitional Jobs Programs offer subsidized work to low-income individuals for up to 1,040 hours (six months, full-time) and provide employers with a wage subsidy to offset their hiring costs. Providing state funding for this preexisting program would make use of current programs already available in the state designed to achieve a similar objective.

**ALTERNATIVES**

1. Create a nonrefundable income and franchise tax credit for taxable years beginning after December 31, 2020, as a supplement to the federal WOTC. It is estimated that the state WOTC would reduce state tax revenues by $27,800,000 in 2021-22 and by $24,100,000 in 2022-23. [See discussion point #9 for additional detail.]

| **ALT 1** | **Change to Base** |
|---|---|
| GPR-Tax | -$51,900,000 |

2. Create a biennial appropriation and provide $100,000 annually for DWD to promote and

administrate the state and federal WOTC. This alternative may be adopted in addition to either Alternative 1 or 3.

| ALT 2 | Change to Base |
|---|---|
| GPR | $200,000 |

3. Adopt Alternative 1, but with the modification to require an employer to retain the targeted individual for at least 500 hours before the state WOTC accrues for qualified wages. Further, the Committee could specify that no state WOTC would be allowed against the first $6,000 of wages paid (compared to the federal WOTC, which is available for all wages up to a maximum limit of $6,000).

| ALT 3 | Change to Base |
|---|---|
| GPR-Tax | - $51,900,000 |

4. Create an annual appropriation under DCF and provide $27,800,000 GPR in 2021-22 and $24,100,000 GPR in 2022-23 to expand the Transform Milwaukee and Transitional Jobs programs to provide subsidized employment to the targeted individuals eligible for the federal WOTC program.

| ALT 4 | Change to Base |
|---|---|
| GPR | $51,900,000 |

5. Take no action.

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