

[COMMITTEE PRINT]

DESCRIPTION OF PROVISIONS AND  
PROPOSALS

RELATING TO

**EMPLOYMENT TAX CREDITS**

LISTED FOR A JOINT HEARING

BY THE

SUBCOMMITTEE ON ADMINISTRATION OF THE  
INTERNAL REVENUE CODE

OF THE

COMMITTEE ON FINANCE

AND THE

SELECT COMMITTEE ON  
SMALL BUSINESS

ON JULY 18 AND 26, 1978

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PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

AND THE

SELECT COMMITTEE ON SMALL BUSINESS

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION



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## I. INTRODUCTION

The provisions and proposals described in this pamphlet, relating to employment tax credits, have been scheduled for joint hearings on July 18 and 26, 1978, by the Subcommittee on Administration of the Internal Revenue Code of the Senate Committee on Finance and the Senate Select Committee on Small Business.

In connection with these hearings, the staff of the Joint Committee on Taxation has prepared a description of the provisions. The description indicates the present law treatment, an explanation of the proposals, their estimated revenue effect, and background information.



## II. PRESENT LAW

### *New Jobs Tax Credit*

#### *General credit*

The Tax Reduction and Simplification Act of 1977 provided a new jobs tax credit for 1977 and 1978. The credit is 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The FUTA base for 1977 consisted of wages paid of up to \$4,200 per employee.<sup>1</sup> The employer's deduction for wages is reduced by the amount of the credit. Therefore, although the maximum gross credit for each new employee is \$2,100, the effective, per-employee credit ranges from \$1,806 (for a taxpayer in the 14-percent tax bracket) to \$630 (for a taxpayer in the 70-percent bracket).

The total amount of the credit has four limitations: (1) the credit cannot be more than 50 percent of the increase in total wages paid by the employer for the year above 105 percent of total wages paid by the employer in the previous year, (2) the credit must be no more than 25 percent of the current year's FUTA wages, (3) the credit for a year cannot exceed \$100,000, and (4) the credit cannot exceed the taxpayer's tax liability. Credits which exceed tax liability for a year may be carried back for 3 years and carried forward for 7 years.

Although most employers are able to use the returns they file for purposes of complying with FUTA as a basis for claiming the credit, special rules are provided for businesses, such as farms and railroads, not covered under FUTA.<sup>2</sup> Special rules also are provided for computation of the credit by groups of companies under common control, for businesses with employees working abroad, and for businesses affected by acquisitions, dispositions, and other changes in business form. Additional rules are provided for allocating the credit among members of a partnership and of a subchapter S corporation. The non-elective nature of the credit, in conjunction with the reduction of the deduction for wages, can have the result of increasing the tax liability of members of such entities which show a loss for a given taxable year.

Extension of the existing new jobs credit would reduce income tax receipts by \$0.7 billion in fiscal year 1979 and \$2.5 billion in fiscal year 1980.

<sup>1</sup> For 1978, the FUTA wage base went up to \$6,000. In order to make the 1978 wage base comparable with 1977 for purposes of the jobs credit, present law requires that only the first \$4,200 of the FUTA wage base for each employee be included in the computation.

<sup>2</sup> Generally, employers who employ one or more employees in covered employment for at least 20 weeks in the current or preceding calendar year or who pay wages of \$1,500 or more during any calendar quarter of the current or preceding calendar year are covered under FUTA.

*Credit for employment of handicapped*

Present law (adopted in the 1977 Act) also provides an additional nonincremental credit equal to 10 percent of the first \$4,200 of FUTA wages paid to handicapped individuals (including handicapped veterans) who receive vocational rehabilitation. The credit is based on the first \$4,200 of wages paid to a handicapped individual whose first FUTA wages from the employer are paid in 1977 or 1978. Only wages paid during the 1-year period beginning when the individual is first paid FUTA wages by the employer are taken into account in computing the 10-percent credit. The credit for handicapped workers cannot be greater than one-fifth of the regular 50-percent credit which would have been allowable without regard to the \$100,000 limitation. However, the special 10-percent credit is not itself subject to any specific dollar limitation.

***WIN and Welfare Recipient Employment Tax Credits***

A separate provision included in present law is the work incentive (WIN) credit and the associated welfare recipient tax credit. Under these provisions, employers can receive a tax credit equal to 20 percent of the wages paid during the first 12 months of employment to individuals who have received AFDC for at least 90 days or who are placed in employment under the WIN program. The WIN credit is limited to employees of a trade or business, while the welfare recipient credit also is available for up to \$5,000 of nonbusiness wages per taxpayer. The amount of the credit available to any employer is limited to \$50,000 of tax liability plus one-half of tax liability in excess of \$50,000. The WIN credit generally is not available if the employment is terminated without cause within a certain period after the employment starts (generally six months), although the welfare recipient credit is available for all employees who have been employed at least 30 days on a substantially full-time basis. In addition, under both credits, wages and benefits must be no less than wages and benefits paid to other employees of the employer for similar jobs, the employee for whose wages the credit is taken must not displace any individual from employment, and the employee must not be a close relative, dependent or major stockholder of the employer. The welfare recipients credit expires January 1, 1980.

Several changes, designed to encourage employers to participate in the credit program, were made by the Tax Reform Act of 1976. First, the limitation based on tax liability was increased from the previous \$25,000 of tax plus one-half the excess. Second, the period an employee must be retained for the WIN credit to be available was reduced from 2 years to 180 days. Third, an exception to this retention rule was provided if dismissal results from a substantial reduction in business. Fourth, both WIN and welfare agencies were allowed to certify eligibility for the welfare recipient credit, rather than just the welfare agency as under previous law.

It is estimated that these provisions will reduce income tax receipts by \$15 million in both fiscal years 1979 and 1980.



### III. TARGETED EMPLOYMENT CREDIT PROPOSALS

#### *Administration Proposal*

The Administration did not propose to extend the existing jobs tax credit and made no other jobs credit proposal in conjunction with its tax reduction and reform package. However, as part of its urban policy, the Administration proposes to replace the general jobs tax credit with a targeted jobs credit for the hiring of disadvantaged youth and handicapped individuals. Eligible employees would be (a) individuals between the ages of 18 and 24 who reside in a family with an income less than 70 percent of the Bureau of Labor Statistics lower living standard, as certified by the local agencies ("prime sponsors") which administer funds provided by the Comprehensive Employment and Training Act (CETA) and (b) handicapped individuals referred to the employer under a vocational rehabilitation plan.

The credit would be one-third of FUTA wages paid during the first year of employment and one-fourth of FUTA wages paid during the second year. (FUTA wages, the base for the tax levied under the Federal Unemployment Tax Act, are the first \$6,000 of wages per employee per year.) Wages eligible for the credit would be limited to 20 percent of the total FUTA wages paid by an employer. Employees would be required to work for a minimum of 75 days and to work full time in order to be eligible for the credit. The amount of the credit would reduce the deduction for wages paid. The credit would be limited to 90 percent of tax liability (with a 3-year carryback and a 7-year carryforward).

#### *Effective date*

The proposal would be effective for taxable years beginning after December 31, 1978.

#### *Revenue effect*

The Administration estimates that this proposal would reduce income tax receipts by \$0.2 billion in fiscal year 1979 and \$0.8 billion in fiscal year 1980.

#### *Long-Moynihan-Cranston Proposal*

Senators Long, Moynihan and Cranston have proposed revising and expanding the present welfare recipient credit so that the credit would be 50 percent of wages for the first 12 months of employment (with a maximum credit of \$3,000), 33 $\frac{1}{3}$  percent for the second 12 months (maximum credit of \$2,000) and 25 percent for the third 12 months of employment (maximum credit of \$1,500).<sup>1</sup> The maximum credit would be increased to 10 percent above these levels in 1980 and to 20 percent above these levels in 1981. The credit also would be

<sup>1</sup> This proposal is part of a welfare package which was released at a press conference on June 29, 1978. A bill embodying this proposal has not yet been introduced.

available for hiring disabled recipients of Supplemental Security Income (SSI). Appropriations would be authorized for payments in lieu of a credit to nonprofit organizations that hire welfare recipients.

*Effective date*

The proposal would be effective for taxable years beginning after December 31, 1978.

***Baker-Bellmon-Ribicoff-Danforth Proposal***

Senators Baker, Bellmon, Ribicoff and Danforth, as part of their welfare package (S. 2777), have proposed revising the existing general jobs credit by making the credit allowable only with respect to the hiring of (a) AFDC recipients, people unemployed for 26 weeks, or unemployed youth 18, 19, and 20 years old, all of whom would be eligible only after 90 days of job search, and (b) former CETA public service job holders who have completed their CETA assignment and have sought work for 30 days. Only employees who work more than 30 hours per week, and are paid the wage prevailing in their occupation, would be eligible. The credit would equal \$1.00 times the excess of the hours of new eligible employees over 102 percent of such hours during the preceding year. Employers could choose either the tax credit or a similar job voucher program.

***Ullman Proposal***

Representative Ullman has suggested a proposal which would replace the existing jobs credit and the WIN and welfare recipient credits and provide a targeted jobs credit of 50 percent of FUTA wages paid within the first 12 months of employment of any of the following categories of employees: handicapped individuals (as under the existing general jobs credit); AFDC recipients who register for the WIN program; and individuals ages 18 through 24 who are members of households which are eligible for food stamps. Wages eligible for the credit would be limited to 20 percent of the total FUTA wages paid by an employer. The amount of the credit would reduce the deduction for wages paid. The credit also would be limited to 100 percent of tax liability (with a 3-year carryback and a 7-year carryforward).

*Effective date*

The proposal would be effective for taxable years beginning after December 31, 1978.

*Revenue effect*

It is estimated that the proposal would reduce income tax receipts by \$0.4 billion in fiscal year 1979 and \$0.8 billion in fiscal year 1980.

#### IV. BACKGROUND INFORMATION

##### *Unemployment Statistics*

Employment tax credits are intended to assist in reducing the unemployment rate of all workers or particular groups of workers. The first two columns of Table 1 provide two indicators of the extent and severity of unemployment: the overall unemployment rate and the percentage of the labor force unemployed 15 weeks or longer. Even in a severe recession year, such as 1975, this second measure is less than one-third of the overall unemployment rate, indicating that many of the unemployed find jobs before they have been unemployed for that length of time.

TABLE 1.—*Unemployment Rates of Civilian Labor Force*

Year	Age 16 and above	Unemployed 15 weeks or longer <sup>1</sup>	Age 16 to 17	Age 18 to 19	Age 20 to 24	Labor force age 16 to 24 as percent of total labor force
1967	3.8	0.6	14.7	11.6	5.7	20.0
1968	3.6	.5	14.7	11.2	5.8	20.2
1969	3.5	.5	14.5	10.5	5.7	20.9
1970	4.9	.8	17.1	13.8	8.2	21.6
1971	5.9	1.4	18.7	15.5	10.0	22.3
1972	5.6	1.3	18.5	14.6	9.3	23.1
1973	4.9	.9	17.3	12.4	7.8	23.8
1974	5.6	1.0	18.3	14.2	9.0	24.1
1975	8.5	2.7	21.4	18.9	13.6	24.0
1976	7.7	2.5	21.1	17.4	12.0	24.2
1977	7.0	2.0	20.0	16.2	10.9	24.3
1978 (June)	5.7	1.2	16.7	12.9	9.2	24.3

<sup>1</sup> As percent of civilian labor force.

SOURCE.—U.S. Department of Labor.

The remaining columns in Table 1 indicate that unemployment rates for teenagers and young adults are consistently higher than the rate for the overall labor force, but that the rates are lower for the 20-24 year old workers than for teenagers. The unemployment rates for these groups tend to be more responsive to movement in the economy than is the overall unemployment rate. Unemployment rates for teenagers and young adults have tended to move upward over the 10-year period for which data is shown in Table 1. This is partly a result of the recent increase in the share of the labor force consisting of individuals between the ages of 16 and 24.

Although the unemployment rate for youth is considerably higher than the rate for the overall labor force, several statistics indicate

that the aggregate unemployment statistics may overstate the problem. Table 2 shows that a majority of the teenage unemployed are either new entrants or re-entrants into the labor force; the much larger number of youth in these categories accounts for the bulk of the difference between the 7.0 overall unemployment rate and the 17.7 percent rate for teenagers in 1977. It is possible that for individuals in these categories unemployment is not as disruptive as for job losers and leavers, who have become accustomed to receiving earnings from employment. Furthermore, of the unemployed between ages 16 and 21 in 1977, 40 percent were either going to school as their major activity or were looking only for part-time work. Another indication of the severity of unemployment is its duration. Unemployed youth on the average suffer unemployment less time (4.9 weeks) for each spell of unemployment than the overall labor force (7.0 weeks).

TABLE 2.—*Unemployment Rate, by Reason for Unemployment, 1977*

Reason	Total civilian labor force	Age 16 to 19
Job losers.....	3.2	3.4
Job leavers.....	.9	1.7
Reentrants into labor force.....	2.0	5.1
New entrants into labor force.....	1.0	7.6
<b>Total.....</b>	<b>7.0</b>	<b>17.7</b>

Table 3 indicates that, for the 16 to 24 age group, high school dropouts who are not enrolled in school had the highest (24.6 percent) unemployment rate during October 1976. This category comprised 25.1 percent of the unemployed persons in this age group. High school graduates had the largest number of unemployed in this category, but their unemployment rate was significantly lower (12.1 percent). The remaining 32.6 percent of the 16 to 24 year old unemployed either had some college, and a significantly lower unemployment rate, or were attempting to increase their level of educational attainment.

TABLE 3.—*Unemployment of Persons 16 to 24 Years, by School Enrollment Status and Educational Attainment, October 1976*

Education situation	Percent of unemployed	Unemployment rate (percent)
Enrolled in school.....	31.3	14.0
Not enrolled in school.....	68.7	13.9
High school dropouts.....	25.1	24.6
High school graduates.....	32.3	12.1
College, 1 to 3 years.....	7.8	9.9
College, graduates.....	3.2	7.1
<b>Total.....</b>	<b>100.0</b>	<b>13.9</b>

Minority youth have a significantly higher unemployment rate than white youth. In June, 1978, minority individuals between the ages of 16 and 19 had a 37.1 percent unemployment rate, while whites of the same age had an 11.6 percent rate.

#### ***Related Nontax Job Programs***

The Comprehensive Employment and Training Act (CETA) authorizes bloc grants to local units of government ("prime sponsors") to provide training and employment to unemployed, underemployed and economically disadvantaged individuals.

In fiscal year 1979, CETA prime sponsors will receive general grants for approximately 430,000 slots for training and work experience opportunities at a cost of \$1.9 billion. Total enrollment in fiscal year 1977 was approximately 1.4 million persons. Roughly half of the participants in these activities are under age 22; approximately the same proportion have fewer than 12 years of schooling. In addition, special programs for youth will involve outlays of an additional \$2.3 billion for various training and employment programs, such as Job Corps and Young Adult Conservation Corps.

The largest component of CETA consists of approximately 720,000 subsidized public service jobs, at a cost of \$6.2 billion. In fiscal year 1977, the average cost per full-time, full-year job was approximately \$8,575. Under 1976 amendments to CETA, individuals unemployed 15 or more weeks are given priority for most of the public service jobs.

The WIN program provides job placement and counseling services, training, child care and other supportive services, to recipients of Aid to Families with Dependent Children (AFDC), the principal Federal cash payment program for needy families with children. The WIN office is generally a division of the State Employment Service and the welfare agency. All AFDC recipients must participate in the WIN program, except a mother whose youngest child is under age 6, children below age 16 or attending school full time, a person who is ill, incapacitated, or of advanced age, a person who is caring for another ill member of the household, a person who lives far from a WIN office, or mother in an intact family whose husband is participating in the WIN program. Exempt individuals may volunteer to participate in the WIN program if they wish to do so. It is estimated that about 270,000 persons will be placed in nonsubsidized jobs under WIN in 1979.

#### ***Recent Evaluation of General Jobs Tax Credit***

The general jobs tax credit was adopted as a 2-year experimental program. Since its enactment in May 1977, two surveys have attempted to evaluate the effect of the credit on 1977 employment growth.

In February 1978, the Bureau of Census surveyed a random sample of employers with questions concerning knowledge of the credit and its effect on the employers' hiring decisions. Preliminary analysis of the results indicates that 34 percent of employers were aware of the credit by February 1978. Among these firms, however, 20 percent said they believed that they qualified for tax credits and only 6 per-

cent said they made a conscious effort to increase employment as a result of the credit. This last group represents about 2 percent of all employers.

The National Federation of Independent Businesses conducted, in January 1978, a survey of a sample of its membership. The results of this survey generally are consistent with those of the Census Bureau. Specifically, 42 percent of the firms were aware of credit and 1.4 percent reported that the jobs credit served as an incentive to create jobs for their firm.

It should be noted that these conclusions for 1977 may not be an accurate indication of the effect of the existing general new jobs credit in 1978. Awareness of the existence of the credit should increase as businessmen consult their tax advisers and prepare their 1977 tax returns in early 1978. In addition, businessmen will become more familiar with the provisions of the credit, which then may have more influence on hiring decisions.

#### ***Recent Evaluation of WIN and Welfare Recipient Tax Credits***

An evaluation of the effectiveness of the WIN and welfare recipient tax credits in promoting the hiring of eligible employees was sponsored by the Labor Department and was completed in March 1977. Surveys indicated that the tax credits were a significant incentive in only a small percentage of hiring decisions. Among employers who claimed the tax credit, 95 percent said that the employees would have been hired even if no tax credit had been available. Furthermore, knowledge of the credits has not been widespread. Only about 25 percent of employers who hire eligible employees claimed the tax credit to which they are entitled, either because employers were not aware of the credit or because employees did not identify themselves as welfare recipients.

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