Corporate Tax Credits Considered for Social Policy

The Intentions and Limitations of Corporate Income Tax Credits as a Policy Tool

A tax credit is a payment to an individual or business administered through the tax system. Tax credits have become one of the prominent tools used to implement social policy at the federal government level and more recently at the state government level. The number of tax credits potentially available to individuals and corporations have greatly increased over the past decade. During the 1999 Georgia legislative session, two corporate income tax credits that affect families and children were considered. The first was HB 610, Income Tax Credit for Employer Provided or Sponsored Child Care which was signed into law (hereafter referred to as the Child Care Credit). This law is intended to increase the accessibility and affordability of child care in the state. The second corporate income tax credit was HB 598, the Georgia Welfare to Work Tax Credit which will carry over for consideration during the 2000 legislative session (hereafter referred to as the Welfare to Work Credit). This proposed legislation is intended to encourage employers to hire Temporary Assistance to Needy Families (TANF) recipients. The following analysis will discuss the intended consequences of each of these tax credits. In addition, the limitations of using tax credits to achieve social policy objectives and alternative approaches will be provided.

Employer Provided Child Care Credits

The Child Care Credit is a tax credit against corporate tax liability to employers who provide or sponsor child care for employees. The credit has two provisions. Under the first provision, the amount of the tax credit is seventy-five percent of the cost of the child care program less any amount paid by employees during the tax year. If the tax credit is greater than half of the tax liability, the unused credit may be carried forward for up to five years. This encourages employers to subsidize the cost of child care available to their employees. The second provision allows a corporation to take a tax credit based on the cost of all qualified child care property purchased and placed in service. The credit can be claimed at a rate of ten percent per year for a total of ten years. Again, the credit may not exceed half of the corporation’s income tax liability, and unused credit can be carried forward for up to three years. This provision encourages the development of on-site child care. The law also contains recapture provisions so that if the property becomes ineligible for the tax credit the company may be required to pay back a portion of the credit.

Although child care issues are complex and wide ranging, they generally center around three issues: accessibility, affordability and quality. If successful, the Child Care Credit will primarily increase the availability and affordability of child care.

For corporations that take advantage of the child care tax credit, the credit effectively lowers the cost of providing child care in that the government takes on a portion of the cost of child care. As the cost of providing child care decreases, firms may be more willing to provide this service. In effect the government is subsidizing either the provision of the child care facility or the cost paid by the consumer (parent) or both.

The credit could potentially affect the market price of child care in two ways. First, as the supply of child care increases, the market price for child care (of the same quality) should decrease for all consumers. Second, depending on the level at which corporations subsidize child care, consumers of corporate child care may pay a lower price relative to child care from other providers. As a result, employees may substitute employer-provided child care for private, public or informal child care services. Both of these effects are good for consumers in that they face a lower price for child care services. Since the tax credit applies only to corporate facilities, other types of child care providers may be adversely affected in that the demand for child care services from these other types of providers may decrease.

The cost of child care includes not only the price that must be paid for the service but also costs, in terms of time and money, incurred when transporting the child to and from the child care center.
Employer provided and/or sponsored child care is accessible and convenient, and may be less expensive for the employee, depending on whether or not the employer subsidizes the price paid by its employees.

Research has shown that lack of access to childcare inhibits the transition from welfare to work. In one of the most comprehensive surveys of welfare reliant and low-wage mothers, Edin and Lein (1997) interviewed 379 low-income mothers (214 welfare reliant and 165 wage reliant) and found that lack of access to low-cost child care is the most serious obstacle preventing welfare reliant mothers from working. The length of time that these women were eligible to receive a childcare subsidy (one year) was not long enough for their wages to increase sufficiently to afford market child care. Women with young children who were working did so because they had relatives who watched their children, or they found an unlicensed provider who accepted less than the market rate for childcare.

The availability of childcare influences a woman’s decision to remain in or enter the workforce after childbirth. Research has shown that the labor force participation decisions of women are influenced by the cost of childcare that they face. Women who have to pay a relatively high price for childcare are, other things equal, less likely to work. Kimmel (1993) estimates that a 10 percent increase in the price of childcare increases the probability of working for low-income single mothers by 3.4 percent. Connely (1992) estimates that for married mothers a 10 percent decrease in the cost of childcare increases the probability of working by 2 percent. Although no comprehensive analysis exists of the number of corporations providing and/or sponsoring child care facilities by industry, anecdotal evidence suggests that on-site child care centers are less likely to be offered in retail and service industries which hire a higher proportion of low-wage workers. As a result, these tax credits may not be useful to the types of employees that would benefit the most from on-site child care centers.

On-site childcare improves employee productivity. On-site childcare centers help corporations recruit employees and reduce absenteeism, tardiness and labor turnover. For example, as reported in Fishman (1995), the turnover rate for employees using NationsBank's child care subsidy program in Charlotte, NC is less than half of that for other workers in the same job categories. Neville Industries, a hospital manufacturer in North Carolina, has an on-site child care center and subsidizes 40 percent of the cost that parents pay. The employee turnover rate is about 34 percent, which is less than half of the industry average. There is much anecdotal evidence to support claims that employer provided childcare increases productivity. Yet, only a small number of corporations offer on-site childcare. As referenced in a 1998 U.S. Treasury report, there were approximately 8,000 on-site childcare centers in U.S. companies in 1998. According to the 1998 Business Work Life Study survey of 1,057 companies, nine percent offered childcare at or near the work site and 12 percent of the companies were considering offering child care.

Welfare to Work Tax Credits

The Welfare to Work Credit, if passed in current form, would allow an employer who hires a TANF recipient to claim a credit against corporate income tax liability. The credit is 25 percent of the first $10,000 in wages paid during the first year of employment and 15 percent of the first $10,000 in wages during the second year of employment. Employers located in Tier 1 counties, the least developed counties in the state, are eligible to receive an additional $175 for each full month that the employee works for up to 24 months. The maximum credit that can be claimed for any worker is $4,600. The tax credit can not exceed the corporation’s tax liability. Unused credit can be carried forward for up to five years. To claim the credit, the employer must provide evidence of the eligible employee’s wages and TANF status at the time of hire.

For example, a business hiring a TANF recipient to work 40 hours per week for fifty weeks at minimum wage pays the worker $10,300 per year and is eligible for a tax credit of $2,500 in year one and $1,300 in year two. Using the scenario above, employers in Tier 1 counties could also claim the supplementary credit of as much as $1,925 applicable to both years of employment. This particular Tier 1 employer’s first year tax credit for hiring a TANF recipient would be $4,425 or nearly 50% of the total wages paid to the employee.

Georgia’s Welfare to Work Credit is basically a targeted wage subsidy for corporations. The purpose of the credit is to encourage businesses to hire TANF recipients. The basic idea is to reduce the cost to employers of hiring TANF recipients, thereby stimulating demand for these workers and raising their employment rates, though not necessarily their earnings. The credit may not affect the wages of the former TANF recipients. For example, firms claiming the credit are not required to pay higher than minimum wage or to provide basic benefits. So, the worker may earn the same wage as the minimum wage in many cases — that they would have earned even if the corporation had not taken the credit.

Through the credit, the government effectively pays a portion of the wages of this type of worker. Since this credit is not limited to half of tax liability like other corporate income tax credits in Georgia, it is potentially more valuable to firms. The two-year time period is meant to encourage employers to retain these workers. However, the credit is a lower proportion of wages in the second year which may provide an incentive for “churning” where firms maximize the credit by hiring a TANF recipient then terminating them in the second year to hire another TANF recipient to continually take advantage of the higher credit. Likewise, churning may occur if firms terminate TANF recipients after two years and hire another to take advantage of the credit. The likelihood of this occurring depends in part on the cost of hiring and training a new worker.
If the cost of hiring and training a new worker is less than the credit for which the corporation would qualify, then the corporation is more likely to "churn" workers.

Tight labor markets reduce the effectiveness of targeted employment tax credits because firms do not need an incentive to hire the "targeted workers." In such a situation, the state is paying a corporation for hiring workers that would have been hired anyway, so the credit acts as a form of corporate welfare. The unemployment rate in Georgia has been at a historic low over the past few years. It was 4.2 percent in March 1999. However, the variability across counties is substantial ranging from 1.2 percent in Oconee County to 11.3 percent in Hancock County for January 1999. Since labor is in short supply in many areas of the state, businesses are likely to hire many of these workers even without the credit.

Criticisms and Limitations of Corporate Income Tax Credits

The tax system is increasingly used to encourage firms to engage in certain activities. During 1998, 20 states offered some form of employer child care tax credit and nine states offered some form of tax credit for hiring welfare recipients, yet the effectiveness of such credits in achieving their intended objectives is a highly debatable issue.

Participation rates in corporate income tax credit programs are low historically. As shown below in Table 1, the federal government has offered a variety of employment tax credit programs over the past several decades, and the participation rates have been quite low, ranging from 3 to 13 percent. There is little evidence that participation rates in state tax credit programs are much higher. Table 2, page 4, shows the number of firms and total amount of credit claimed for tax credits that are offered under Georgia’s Business Expansion Support Act. Faulk (1998) estimates that only 19 percent of eligible firms participated in Georgia’s Job Tax Credit (JTC) program between 1993 and 1995. Many of these establishments are small, having less than 100 employees. Table 3 and 4, on pages 5, show establishments filing for the JTC by the number of employees. Since 1994, only a handful of Georgia corporations took advantage of the Child Care Tax Credit offered as part of the Georgia Business Expansion Support Act. Some of the reasons for this lack of participation are discussed further.

One reason that participation rates in corporate tax credit programs are so low is that many firms do not have any corporate income tax liability. In 1996, 77.5 percent of Georgia corporations had no taxable income. This lack of tax liability severely limits the effectiveness of corporate income tax credits. Consider also the link between state and federal corporate income tax systems. Corporations can deduct state corporate income tax on their federal corporate income tax returns. Since state tax credits reduce state corporate income tax liability, less state taxes are reported on the federal return, so in effect state tax credits increase federal corporate income tax liability. This interaction between state and federal tax systems reduces the value of state corporate income tax credits. Also, filing information for the tax credit claim must be maintained and tracking systems developed. Compliance costs for targeted employment tax credits such as the welfare to work credit are higher because the worker has to be identified as belonging to a specific group. Finally, employment tax credits are a small proportion of the payroll of participating firms. Faulk (1998) estimates that the JTC is less than one percent of the payroll for the average firm that filed for the tax credit between 1993 and 1995. The maximum was 8.1 percent.

<table>
<thead>
<tr>
<th>PROGRAMS AND YEARS OF IMPLEMENTATION</th>
<th>APPLICATION</th>
<th>BASE</th>
<th>SUBSIDY 'RATE'</th>
<th>PARTICIPATION RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Work Incentive Program (WIN) 1973-82</td>
<td>Targeted</td>
<td>Welfare recipients enrolled in the Work Incentives Program</td>
<td>50% and 25% of first $6000 in wages, respectively, for first and second years of employment.</td>
<td>3% of firms familiar with the program participated</td>
</tr>
<tr>
<td>New Job Tax Credit (NJTC) 1977-78</td>
<td>Broad-based</td>
<td>Increase in wages</td>
<td>50% if wage base above 102% of previous year's wage base up to $4200 per employee.</td>
<td>6.1% of participating firms made a conscious effort to increase employment</td>
</tr>
<tr>
<td>Targeted Job Tax Credit (TJTC) 1978-96</td>
<td>Targeted</td>
<td>Unemployed disadvantaged workers</td>
<td>40% of first $6000 in wages for first year of employment ($2400 max)</td>
<td>13% of firms familiar with the program participate</td>
</tr>
<tr>
<td>Work Opportunity Tax Credit 1997-99</td>
<td>Targeted</td>
<td>Unemployed disadvantaged workers</td>
<td>35% of first $6000 for first year wages ($2100 max)</td>
<td>Not available</td>
</tr>
<tr>
<td>Welfare-to-Work Tax Credit 1998</td>
<td>Targeted</td>
<td>Long-term family assistance recipients</td>
<td>30% of the first $10,000 of wages for the first year of employment and 50% of the first $10,000 in wages for the second year of employment.</td>
<td>Not available</td>
</tr>
</tbody>
</table>

*Includes handicapped individuals, qualified youth, Vietnam veterans, welfare recipients, ex-convicts, general assistance recipients, work incentive employees, qualified summer youth.

A common criticism of corporate income tax credits is that they provide tax relief to firms that would have undertaken the activity in the absence of the credit. Estimates for various corporate income tax credit programs indicate that a large portion of the activity would have occurred without the credit. Bishop and Montgomery (1993) estimate that 70 percent of the tax credits granted to employers under the federal Targeted Job Tax Credit (TJTC) program were for workers who would have been hired even without the subsidy. Faulk (1999) estimates that 59 to 72 percent of the jobs (2301 to 3299 jobs) credited between 1993 and 1995 under Georgia’s Job Tax Credit program would have been created without the credit.

The tax expenditure for jobs that would have been created in the absence of the credit totaled $2.9 to $3.6 million for this period. An analysis to determine if firms offering childcare facilities would offer them in the absence of the child care credit has not been conducted.

A criticism of targeted employment tax credits is that they stigmatize workers. Targeted wage subsidies identify a worker as belonging to a particular group. In the case of the Welfare to Work Credit, it identifies workers as being former welfare recipients.

An employer may believe that welfare recipients are less productive, require more training, or have higher turnover rates, all of which are deterrents to hiring TANF recipients. However, in a tight labor market this may not matter because employers can not be as selective when hiring workers. In one of the few studies that address stigma and participation in targeted employment tax credit programs, Bishop and Kang (1991) find that 72 percent (of 2621 firms interviewed) believe that employees eligible for the TJTC were at least as productive workers as the average worker. They also find that there is a strong negative correlation between stigmatizing beliefs about eligible workers and employer use of the TJTC, which suggests that firms, which believe eligible workers are less productive, are not likely to use the credit.

Another criticism of corporate tax credits is the belief that government should not interfere with the private sector. Childcare is a service that is often provided through private providers. One might argue that the quantity of childcare services available should be determined through market forces of supply and demand.

Typically government would not be involved in the provision unless an under supply exists. In Georgia, however, there is evidence of market failure in providing an adequate supply of childcare.

According to calculations from the Budgetary Responsibility Oversight Committee, 131 counties in the state are meeting 72 percent or less of the demand for monitored child care for ages 0-4 and 81 counties are meeting 41 percent or less of the demand for monitored child care for ages 5-12. Monitored childcare refers to regulated or registered childcare providers. Southeast rural Georgia is particularly under served by monitored childcare. The quality and sources of unmonitored care are not known. Such a situation can have a large impact on the quality of childcare. In turn, the care received by children has significant social consequences. Another consideration is the current welfare reform measure, which requires TANF recipients to work. Adequate childcare must be available for the welfare-to-work transition to be successful. The large proportion of children in unmonitored care in many parts of the state indicates that government intervention is needed. By increasing the supply and quality of childcare and potentially decreasing the cost to the parent, the childcare credit may reduce the child care problems faced by many families.

**Table: 2 Initial Employment In Business Establishments Filing for Georgia’s JTC Between 1993* and 1995**

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>1993 and 1995</th>
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<tr>
<td>&lt;100</td>
<td>47%</td>
</tr>
<tr>
<td>100 to 200</td>
<td>16%</td>
</tr>
<tr>
<td>200 to 500</td>
<td>16%</td>
</tr>
<tr>
<td>&gt;500</td>
<td>21%</td>
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*Note: At the time that the data was collected, many of the JTC claims for 1995 were still under review and are not reflected in this total.
Table: 3 Number of Corporations Filing for Georgia’s Income Tax Credits

![Number of Corporations Filing for Georgia’s Income Tax Credits*](chart)

Table: 4 Total Credit Allowed

![Total Credit Allowed](chart)

*Note: These credits were authorized under the Business Expansion Support Act of 1994.

**Other Options**

Twelve states offer some form of dependent care tax credit to individuals. Georgia does not. These policies reduce the cost of childcare to families and operate on the demand side of the childcare market rather than the supply side. Such a policy would ease the welfare to work transition. The credit makes childcare more affordable because the government subsidizes the cost of childcare.

Thirteen states offer an earned income tax credit or some form of low income tax credit to individuals. Georgia offers a small low-income credit through the individual income tax system. Research has shown that the federal earned income tax credit has been particularly effective in increasing the level of labor force participation and hours worked among the working poor. Implementation of a state refundable earned income tax credit would ease the welfare-to-work transition and may be more effective than a Welfare to Work Credit for employers.

While corporate income tax credits have laudable goals, their effectiveness has been quite limited. In the case of childcare credits, participation rates in these credit programs have been very low. Only four firms participated in Georgia’s program in 1996. However, the new child care credit is more generous and since labor markets are so tight, firms are looking for ways to increase benefits to attract and retain employees. The Child Care Credit may serve as an impetus to sponsor childcare centers. In the case of the welfare to work tax credit, participation rates in targeted employment tax credit programs have been low historically, and these credits are inefficient in that firms would have hired many of the targeted employees in the absence of the credit. There is no evidence that such credits increase the wages of the targeted workers.

Finally, the very nature of a tax credit, unless it is refundable, suggests that firms with little tax liability have little incentive to apply for the credit. The large proportion of corporations in the state with no tax liability greatly limits the potential response to such tax credits. Evidence suggests that corporations that do claim the credit would have engaged in much of the targeted activity without the credit. As a result of such deficiencies, tax credits reduce the tax liability of participating corporations, and also reduce government funds available to finance roads, schools and other public services.

In contrast, providing the same amount of tax relief directly to low or moderate income working families would reduce poverty among Georgia’s children.
Works Cited


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Author: Dagney Faulk, Ph.D
Fiscal Research Program
School of Policy Studies
Georgia State University

Editor: Laurie Iscaro
Project Director,
State Fiscal Analysis Initiative,
Georgians for Children
3091 Maple Drive, Suite 114
Atlanta, GA 30305
404.365.8949
1.800.KIDS.772

Georgians For Children
3091 MAPLE DRIVE, N.E.
SUITE 114
ATLANTA, GA 30305-2614

Fiscal Research Program
Andrew Young School of Policy Studies
Georgia State University
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