

2005 Income Tax Credit Review

**Joint Legislative Income Tax
Credit Review Committee**

December 14, 2005

JLBC Staff

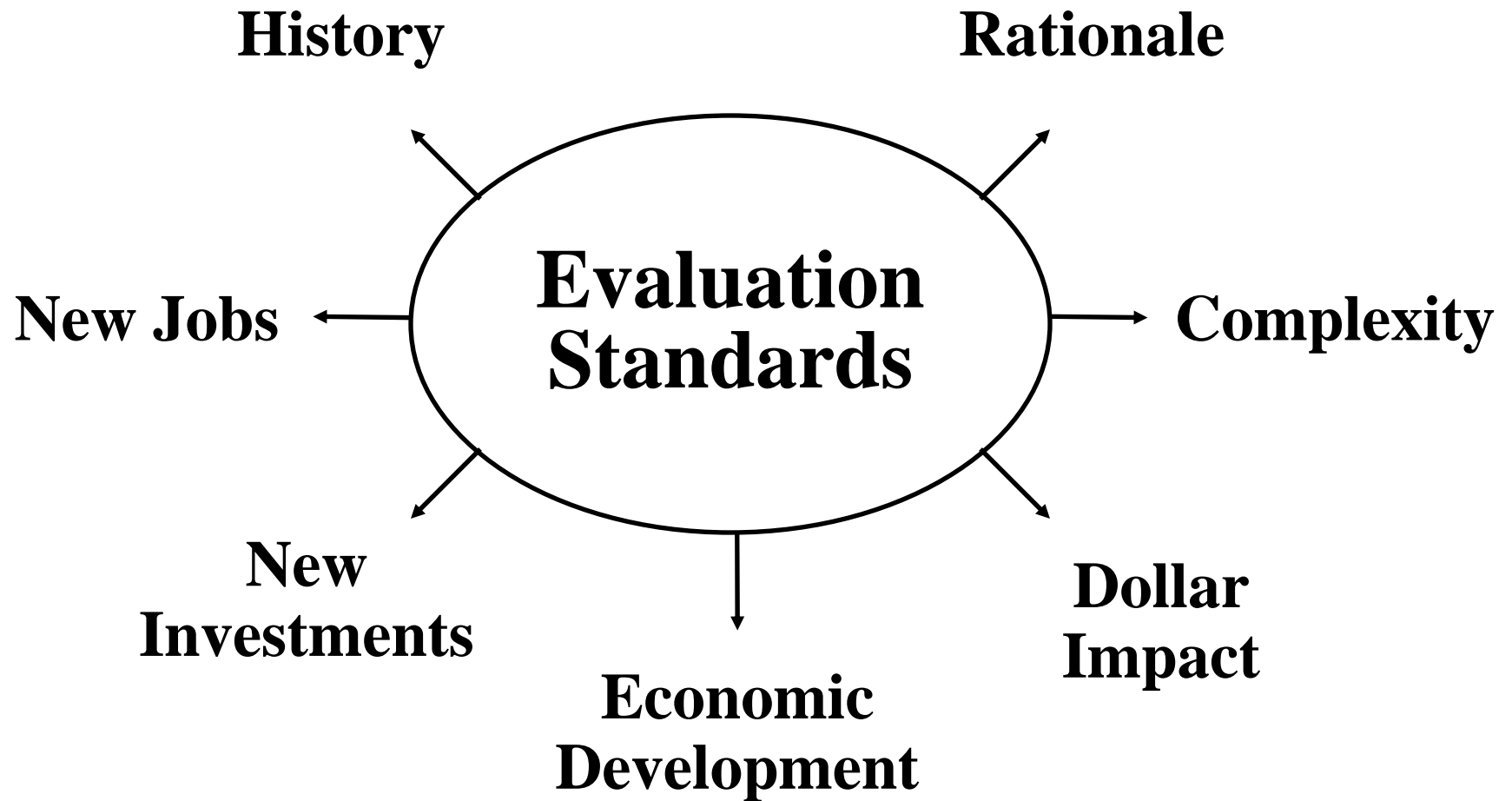
Joint Legislative Income Tax Credit Review Committee

- Annually reviews credits as determined in statute.
- This year's review includes:
 - Employment of Temporary Assistance for Needy Family Recipients
 - Contributions to Charitable Organizations that Provide Assistance to the Working Poor

Role of the Committee

- Determine original purpose of tax credit.
- Establish standards for evaluating and measuring success or failure.
- Recommend changes.

Statute Provides Possible Standards



Issues Affecting Evaluation

- Confidentiality.
- Timeliness of data.
- Lack of performance measures.

Employment of TANF Recipients Credit Summary

Cost - \$430,000 in 2003.

Purpose – to encourage employers to hire TANF recipients into permanent jobs and reduce their reliance on public assistance.

Complexity – relatively simple to use and administer, with some reporting and record-keeping requirements.

Performance Measures – none in statute.

Employment of TANF Recipients Credit

- Corporate and individual income tax credit for employing TANF recipients.
- Credit of up to \$500 in the first year of employment, \$1,000 in the second year, and \$1,500 in the third year.
- Jobs must be full-time and offer wages and benefits comparable to other employees.
- 5-year carry-forward.
- The credit is relatively modest compared to similar federal income tax credits.

Related Federal Income Tax Credits

- The Work Opportunity Tax Credit (WOTC) provides a credit of up to \$2,400 in the first year of employment for hiring a person from 8 targeted groups, including TANF recipients.
- The Welfare-to-Work (WTW) credit provides up to \$3,500 in the first year and up to \$5,000 in the second year for hiring a TANF recipient. A new employee may be claimed for either credit but not both.

Federal and State Credits: Example

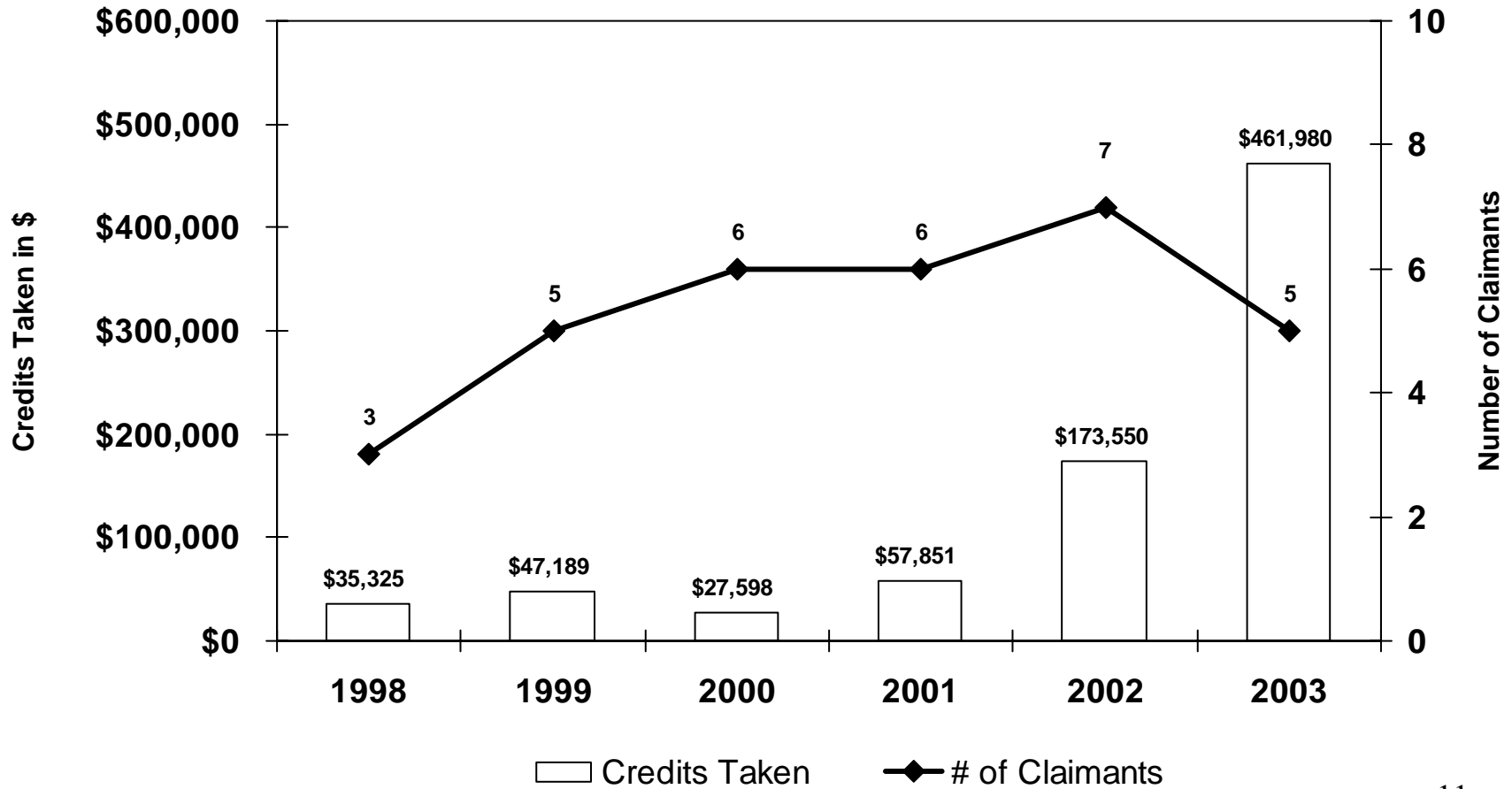
• Full-time minimum wage:	\$10,700
• Federal WTW tax credit – Year 2:	\$5,000
• State TANF recipient credit – Year 2:	<u>+ \$1,000</u>
• Gross value of tax credits:	\$6,000
• Net value of credits after taxes:	
– Federal	\$3,200
– State	<u>+ \$600</u>
• Total:	\$3,800
• Net cost to employer – Year 2:	\$6,900

Federal and State Credits: Example (Continued)

- The year 2 net cost of the state credit is approximately \$(600).
- The cost of the credits is substantially less than the average benefit per TANF recipient (approximately \$3,325).
- Former TANF recipients may have found employment regardless of the income tax credits, depending on labor market conditions.

Employment of TANF Recipients

Amount of Credits Taken & Number of Claimants



Employment of TANF Recipients Credit

Recent Trends

- The number of employees claimed under the credit increased dramatically after the last recession ended.
- A very small number of taxpayers have claimed the credit.
- Usage of the tax credit for individuals has been negligible.
- It cannot be determined whether the credit has induced a permanent reduction in reliance on public assistance.

Employment of TANF Recipients Credit

Potential Performance Measures

- 2- and 3-year retention rates for employees claimed under the credit.
- The value of wages and benefits paid to former TANF recipients employed by companies claiming the credit.
- Growth in compensation for employees retained for two or more years.
- The length of unemployment of TANF recipients that are hired by companies claiming the credit.

Helping The Working Poor Tax Credit Summary

Cost - \$3.6 million in tax year 2004.

Purpose – encourage increased cash contributions to charities that help the working poor.

Complexity – easy for charities but difficult for taxpayers.

Performance Measures – none in statute.

Helping the Working Poor Tax Credit

Description of Credit

- Credit is available to individuals who make cash contributions to charities that provide help to the working poor.
- Qualifying charity is required to:
 - 1) be a 501(c)(3) or designated community action agency, and
 - 2) spend $\geq 50\%$ of its budget on services to TANF recipients or low income residents.

Helping the Working Poor Tax Credit

Description of Credit (cont.)

- To qualify, a charity sends a letter to DOR self-certifying that it meets the statutory requirements.
- No documentation is required to prove eligibility.
- More than 600 charitable organizations are currently listed on DOR's web site.

Helping the Working Poor Tax Credit

Maximum Allowable Credit

- \$200 for individuals filing as single or head of household.
- \$300 for married couples filing joint return for tax year 2005.
- \$400 for married couples filing joint return for tax year 2006 and thereafter.

Helping the Working Poor Tax Credit

Eligibility for Credit

To be eligible for the credit, a taxpayer must first:

- Establish a “baseline” year and amount.
- Baseline year is the first year after 1995 in which the taxpayer itemized charitable contributions.
- Credit can be claimed earliest one year after the baseline year.
- Credit is figured on the amount over and above the baseline amount.

Helping the Working Poor Tax Credit

Credit Calculation

- Total contributions must exceed the baseline amount.
- Individual contributions made to particular charities in the baseline year are not required to be exceeded.
- Credit is not refundable.
- Credit can be carried forward for up to 5 years.

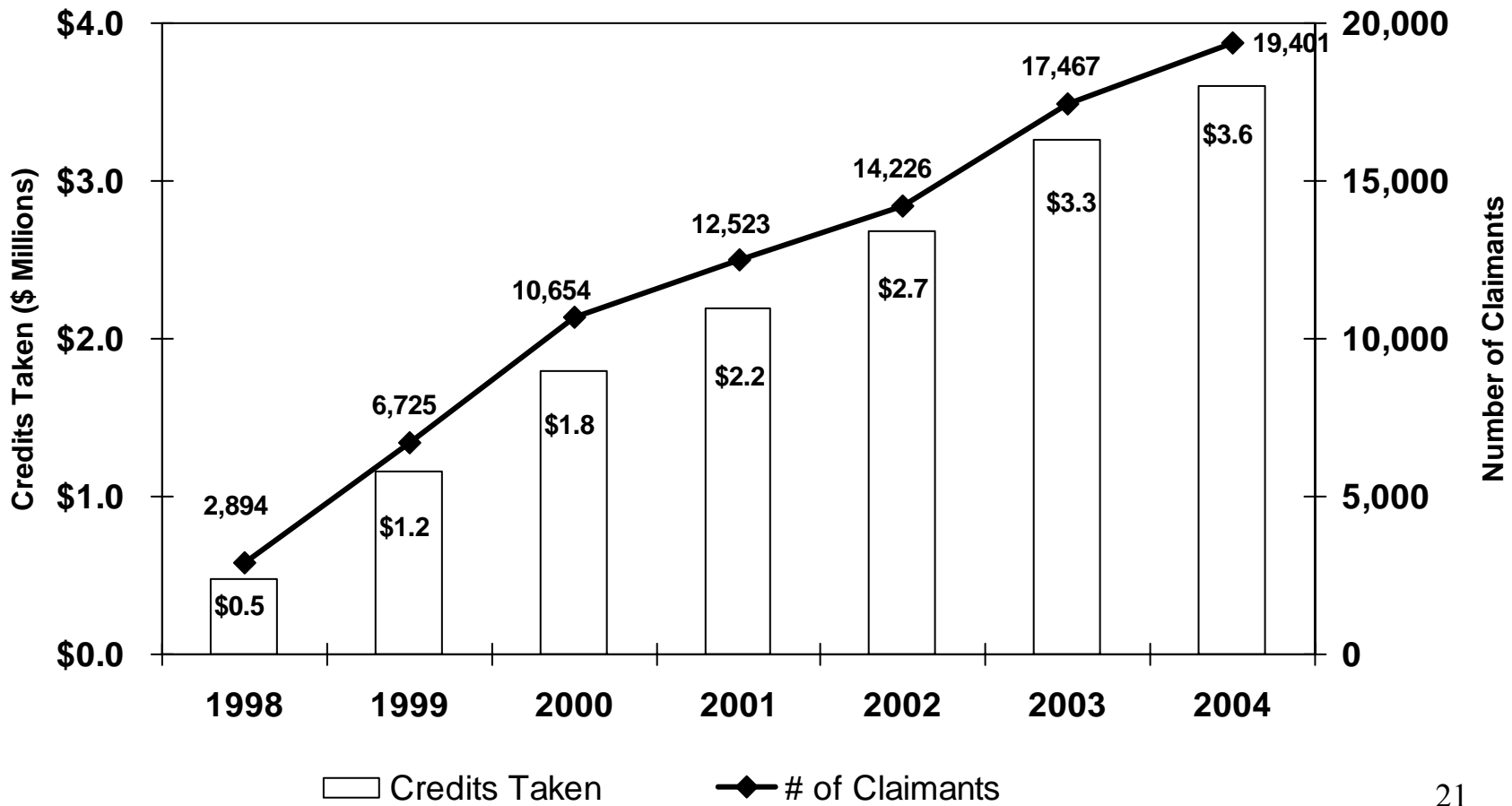
Helping the Working Poor Tax Credit Credit May Not Always Lead to An Increase in Low-Income Charitable Donations

Example of Credit Calculation

	Baseline Year	Example 1 – Second Year	Example 2 – Second Year
Charitable Organization	<u>Donations:</u>	<u>Donations:</u>	<u>Donations:</u>
Qualified Charity (e.g., Salvation Army)	\$200	\$400	\$200
Ineligible Charity (e.g., Phoenix Symphony)	\$300	\$300	\$500
Total Contributions	\$500	\$700	\$700
Credit Available	\$0	\$200	\$200

Helping The Working Poor Tax Credit

Amount of Credits Taken & Number of Claimants



Helping the Working Poor Tax Credit Reported Contributions to Qualifying Charities

In the period between 1998 and 2001:

- United Way received 21.2% of contributions to qualifying charities.
- Salvation Army, St. Vincent de Paul, and Habitat for Humanity together received 16.3%.
- Of the over 600 eligible charities, the top 12 received over 45% of the contributions.

Helping the Working Poor Tax Credit Benefits to the Arizona Economy

- While the credit may increase charitable giving, its impact on economic development, investments, and job creation/retention in Arizona is probably minimal.
- Available data does not indicate how much of donations to qualifying charities truly represent new or additional giving.
- Credit may encourage some donors to reallocate their contributions for tax purposes.

Helping the Working Poor Tax Credit Application of Credit Is Complex

- Charities report that many taxpayers find credit calculation difficult and confusing.
- Charities speculate that the complexity of the credit has deterred many individuals from taking advantage of it.
- Credit could be made less complex by:
 - eliminating requirement to establish a baseline year and amount.
 - establishing a “rolling” base year, under which only incremental amounts of giving could be claimed.

Helping the Working Poor Tax Credit Self-Certification Is Easy and Without Oversight

- A charity is required to provide DOR with a written certification that it meets the eligibility criteria.
- No supporting documents are required.
- DOR reports that many self-certified charities do not appear to provide “immediate basic needs” to individuals.
- Unclear if charities meet the required 50% budget expenditure on services to the working poor.

Helping the Working Poor Tax Credit Potential Performance Measure

- Require all qualifying charities to report on the percentage of people served that are either TANF recipients, or whose household income is less than 150% of the federal poverty level.