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TAX INCENTIVES AS A PUBLIC HEALTH TOOL

Policy Brief

Employment Tax Incentives and Ex-Offender Health

Introduction

Tax incentives, in the form of tax credits or tax deductions, can be an effective legal intervention for advancing the public's health. Tax credits are a direct reduction in tax liability. For example, a $1,000 tax credit saves a taxpayer $1,000 in taxes. In contrast, a tax deduction lowers taxable income and the exact tax savings depends on one's tax bracket.

The power to tax is a tool available to all levels of government, federal, state, and local. As a result, it can be utilized in a variety of inventive ways. This brief is the first in a series of policy briefs that examine interesting tax incentives that seek to address critical public health challenges. Each brief will provide an overview of the targeted public health issue and survey the varying tax incentives adopted by the federal, state, and/or local governments.

Ex-Offender Health[1]

The United States has the largest prison population in the world.[2] Our federal and state correctional facilities housed 1,526,792 individuals in 2015.[3] Our country's jails, locally operated short-term facilities,[4] confined an estimated 721,300 inmates on an average day in 2015.[5]

Prisoners experience incredibly high rates of mental illness,[6] chronic disease, and infectious disease.[7] Inmates in federal and state prisons, as well as local jails, are at an increased risk for conditions including stroke, diabetes, heart problems, asthma, tuberculosis, hepatitis, HIV/AIDS, and other STDs.[8] For example, the prevalence rate of tuberculosis in federal and state prisoners is 12 times higher and the rate of heart problems is more than three times higher than the general population rate.[9] This poor health is not just a result of imprisonment; since these individuals come to prison in poor health. Among inmates who reported having a chronic health condition, 73 percent of the state and federal prisoners and 77 percent of jail inmates reported the condition at admission.[10]

Upon release, ex-offenders continue to face these health challenges. One study found that upon returning to their communities nearly all ex-offenders — approximately 80 percent of men and 90 percent of women — had health conditions that required treatment or management. [11] Unsurprisingly, ex-offenders utilize hospital resources at a much higher rate than the general population.[12] There is also evidence that ex-offenders die prematurely at three and a half times the rate of the general population after their release.[13]

Chronic Unemployment

One of the key barriers to improving the health status of ex-offenders is the inability to secure employment because of their conviction status. The impact of conviction status is considerable with research revealing that between 60-75 percent of ex-offenders are jobless up to a year after release.[14] This chronic unemployment brings with it a range of health implications.

First, unemployment is associated with negative health conditions and behaviors.[15] The unemployed suffer from poorer mental health including elevated levels of depression, anxiety and stress. [16] Unemployment is also associated with increased chronic disease.[17] For example, the unemployed experience a greater risk of myocardial infarction.[18] Unhealthy behaviors — like increased tobacco and alcohol consumption — are also associated with unemployment.[19]

Second, lack of employment reduces access to healthcare. Despite the expansion of Medicaid under the Affordable Care Act, ex-offenders struggle to obtain medical coverage.[20] The reality is that the majority of Americans rely on their employer for health insurance. Recent data shows that 55.7 percent of Americans, approximately 177.5 million people, still obtain insurance through their employer. [21]

Third, unemployment often results in poverty, which affects an ex-offender’s health by limiting access to important resources like healthy housing and adequate healthy food.[22] Some states limit an ex-drug felon’s access to economic support programs like the Supplemental Nutrition Assistance Program (SNAP) or Temporary Assistance for Needy Families (TANF), further curtailing ex-offenders’ access to resources for food and housing.[23]

Fourth, employment status is one of many factors that may affect recidivism rates.[24]

Federal Government Work Opportunity Tax Credit

The federal government created the Work Opportunity Tax Credit (WOTC) to encourage private employers to hire individuals from chronically unemployed populations. Employers can get a federal income tax credit for wages paid to employees from one of ten targeted groups. These groups include unemployed veterans, recipients of TANF benefits, recipients of SNAP benefits, designated community residents (residents of Rural Renewal Counties or Empowerment Zones), and qualified ex-felons.[25]

For an ex-felon to qualify for the program, he or she must have been convicted of a felony under state or federal law and must be hired within one year of their conviction or release from prison.[26] If an employer wishes to claim a tax credit for hiring a qualified ex-felon, it must receive a certification from the state employment security agency that the individual is indeed a qualified ex-felon.[27] This certification process applies to all of the targeted populations.[28]

Once certified, the employer can claim a tax credit on the first $6,000 in wages paid to the qualified ex-felon in his or her first year of employment, if the ex-felon works at least 120 hours in the first year of employment.[29] In addition, the value of the credit increases the longer the ex-felon works for the employer. If an ex-felon works between 120 and 399 hours in his or her first year of employment, the employer receives a tax credit of 25 percent of the first $6,000 in wages.[30] If the ex-felon works 400 or more hours, the employer receives a tax credit of 40 percent of the first $6,000.[31] As a result, the maximum tax credit an employer can receive per qualified ex-felon is $2,400.

Despite the tax incentive and the public health benefits, ex-felons do not account for a large portion of employees for whom employers are obtaining WOTC tax benefits. According to the Department of Labor's 2014 statistics, only 30,062 ex-felons were certified.[32] This represented only 2.3 percent of the certifications issued that year.[33]

State Tax Incentives

A few states also utilize tax incentives in an attempt to improve ex-offender employment rates. There is considerable variation between state approaches to this legal intervention. This policy brief examines key differences between the tax incentives in California, Illinois, Iowa, and Louisiana.

Credit vs. Deduction

Not every state follows the federal government's example by offering a tax credit. For example, Iowa offers employers a tax deduction of 65 percent of the wages paid to a qualifying ex-felon for the first year of employment.[34]

Who qualifies as an ex-offender?

States also tailor their incentives by defining qualified ex-offenders in different ways. Some states limit the tax credit to specific types of ex-offenders. For example, the individual income tax credit in Louisiana only covers the employment of first time drug offenders under the age of 25 at the time of initial employment.[35] Illinois excludes anyone who would be required to register as a sex offender.[36]

States also vary on how recent the criminal action must have occurred for an ex-offender to qualify for the incentive. For example, in Illinois the employer must hire the ex-offender within three years of their release from an Illinois correctional facility.[37] Conversely, California does not require any time frame.[38]

States also distinguish between ex-offenders that work full-time and part-time. California and Louisiana only provide the tax incentive for full-time employment of ex-offenders,[39] while Illinois and Iowa provide their incentives for part-time employment and full-time employment.[40]

Which employers can apply for the tax incentive?

California is the only state that places restrictions on the type of employer that can apply for the ex-offender tax incentive. Tax credits are not available to retail establishments, temporary staffing agencies, food service establishments, drinking establishments, casinos, or sexually oriented businesses that provide live nude entertainment.[41]

How is the tax incentive calculated?

There are two basic approaches to calculating the ex-offender tax incentive: flat rate and percentage of wages paid. Louisiana offers employers a flat tax credit of $144 for each qualified ex-offender.[42] In contrast, Illinois offers employers a 5 percent tax credit on wages paid to a qualified offender up to $1,500 of tax credit per hire.[43]

Geographic Restrictions

In an effort to focus on vulnerable communities, California targets its tax incentive to work performed by ex-offenders in a designated census tract or economic development area.[44] A designated census tract is a state census tract that is determined to be within the top 25 percent of all state census tracts for poverty and unemployment.[45] An economic development area is another type of economically distressed area; the exact contours of the definition are complex and exceed the scope of this fact sheet.[46]

Intervention Effectiveness

Chronic unemployment of ex-offenders has severe public health implications that will require a broad spectrum of legal interventions. Tax incentives for hiring members of this vulnerable population are an interesting legal intervention utilized by the federal government and some states in attempt to address this challenge. However, does this type of tax incentive promote the hiring and retention of ex-offenders or does it simply provide a windfall for the employers that traditionally hire from this population?

Research into the effectiveness of the WOTC is limited and the results are mixed.[47] One study found little evidence that employers consider the tax incentive in their hiring decisions.[48] However, this study did find that employees certified under the WOTC had slightly higher earnings than non-certified but eligible employees did.[49] It is important to note that this research focused on welfare recipients and food stamp youth (workers aged 18 to 24 who receive food stamps), rather than ex-offenders.[50] While this research does not speak directly to the effect on ex-offenders, it provides helpful data on potential impact of WOTC.

In addition, it is clear that participation rates in this tax incentive program are low, meaning employers are not claiming the tax credit for the vast majority of employees that qualify.[51] There is speculation that the low participation rate is the result of employers' lack of awareness regarding the incentive program or concerns that participation in the program will place an employer on the internal revenue services "radar", leaving them more susceptible to the tax audit process.[52]

However, research links employer participation and job duration distribution.[53] Employers cannot claim the credit if the targeted employee does not work at least 120 hours in the first year of employment and the higher tax credit rate does not take effect until the employee has worked 400 hours. Research shows that participation in the program is higher when an employer has a greater percentage of employees with job durations that qualify for the benefit.[54] Again, this research focused on welfare and food stamp recipients rather than ex-felons.[55] It also suggests that hour requirements may discourage participation. Any state considering an ex-offender employment tax incentive should be cognizant of this potential effect.

At one point, there was a concern that the WOTC would encourage employee displacement and churning. Employee displacement is the practice of dismissing employees who are ineligible for the tax credit in favor of workers who qualify for the WOTC. Employee churning is the practice of dismissing employees whose WOTC eligibility has lapsed, because of the credit's one-year time limit, and replacing them with new workers who qualify for the credit.[56] A study by the General Accounting Office (now the Government Accountability Office) found that 93 percent of employers reported that displacement or churning would not be cost effective because the WOTC covers, on average, 47 percent of their recruiting, hiring, and training costs.[57] Unsurprisingly, this study found no evidence of employee churning.[58] The agency's data did not allow it to conduct the same evaluation of displacement practices but the agency asserted, "we would not expect employers to undertake a practice that they said was not cost-effective."[59]

Finally, there is little data on the effectiveness of the state tax incentives. As a result, it is important for perspective states to include a procedure for evaluating the effectiveness of the intervention at generating new work opportunities for ex-offenders.

If you have any questions on this topic, or any other public health law issues please contact the Network for Public Health Law.

Supporters:

Robert Wood Johnson Foundation

This document was developed by Mathew Swinburne, J.D., Associate Director, Network for Public Health Law – Eastern Region Office at the University of Maryland Francis King Carey School of Law. The Network for Public Health Law is a national initiative of the Robert Wood Johnson Foundation. The Network provides information and technical assistance on issues related to public health. The legal information and assistance provided in this document does not constitute legal advice or legal representation. For legal advice, please consult specific legal counsel.

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