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# Credits & Incentives talk with Deloitte

## Congress extends and expands WOTC to fight unemployment

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*CREDITS & INCENTIVES TALK WITH DELOITTE*

# Congress Extends and Expands WOTC to Fight Unemployment

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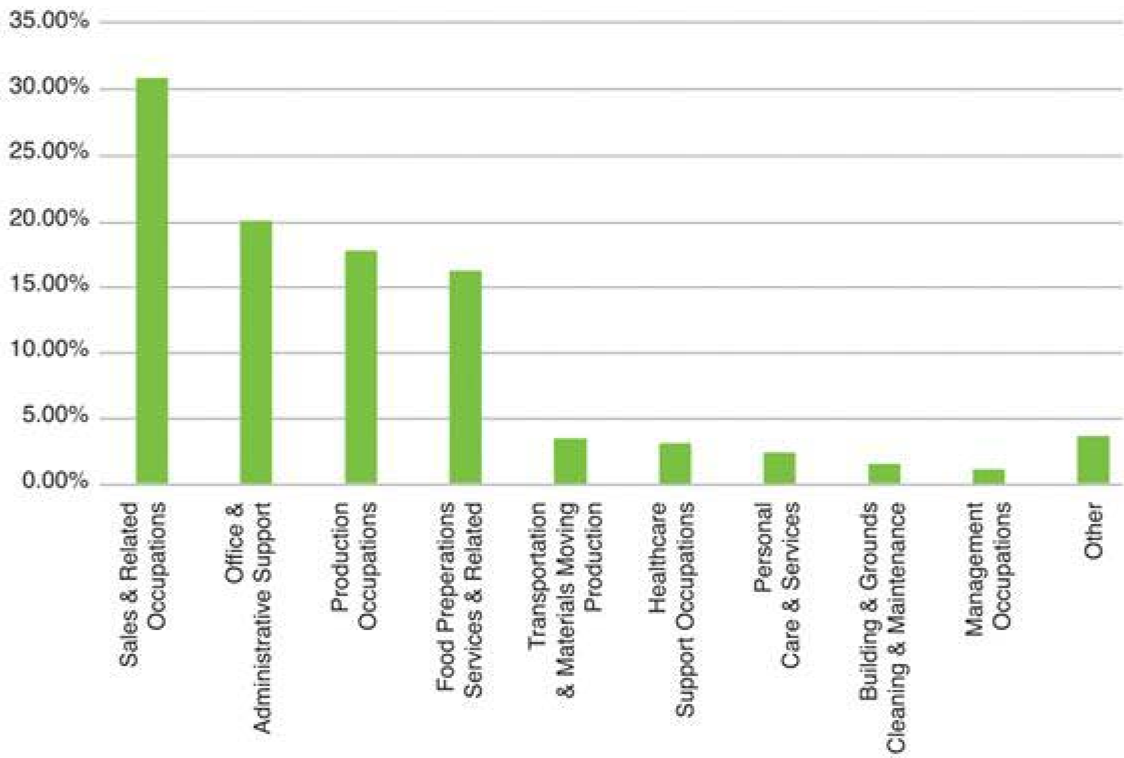
As of January 2016, 7.8 million people were considered unemployed in the U.S. which created an unemployment rate of 4.9 percent,[1] numbers essentially unchanged from the prior month.[2] The persistent unemployment was one reason that Congress took action in December 2015 to extend the Work Opportunity Tax Credit and certain other tax incentives.

The Work Opportunity Tax Credit (WOTC) Program was created by the Small Business Job Protection Act of 1996[3] to facilitate access to jobs for American workers. WOTC was intended to be broadly applicable to employers regardless of size, geography, or industry (see Exhibit 1 for certification by occupational category) and was designed to streamline the eligibility process of prior tax credit programs.

Exhibit 1. Sept. 2013-Sept. 2014 WOTC Certifications by Occupational Category

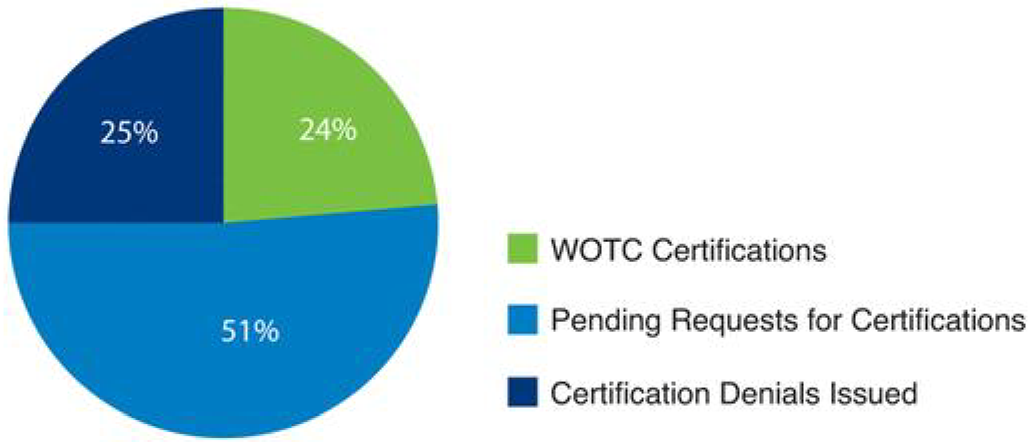



Source: ETA Enterprise Business Support System, Fiscal Year State Quarterly Reports as of 2/12/16

The WOTC federal income tax credit, ranging between $2,400 and $9,600 for each qualified newly hired employee, is available to employers for hiring individuals from certain target groups who have historically faced barriers to employment. WOTC assists targeted individuals in their employment-search process to become wage-earners on their way to economic independence. In 1997, P.L. 105-34 changed WOTC to a two-tiered credit based upon the number of hours an individual works.

Slightly different from other tax credit programs, responsibility for WOTC is shared between the Department of Treasury, through the Internal Revenue Service (IRS), and the Department of Labor, through the Employment and Training Administration (ETA). While this is a federal tax credit, certifications are issued by the State Workforce Agencies (SWAs). (See Exhibit 2 for Fiscal Year 2014 National WOTC Certifications & Denials.) The WOTC falls under the general business credit and is, therefore, subject to the net tax liability limitation of Section 38 of the Internal Revenue Code (IRC) and the carryback and carryover rules of IRC Section 39.

Exhibit 2. Sept. 2013-Sept. 2014 Total WOTC Certifications and Denials Issued




Source: ETA Enterprise Business Support System, Fiscal Year State Quarterly Reports as of 2/12/16

## Protecting Americans from Tax Hikes Act of 2015 (PATH) extends and expands WOTC

Since the initial enactment in 1996, WOTC has expired and been extended numerous times. On several occasions, WOTC has been expired for months at a time awaiting reauthorization by Congress. Most recently in 2015, WOTC and certain other tax incentives remained expired for much of the tax year. However, on December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015 (PATH),[4] which includes the following modifications:

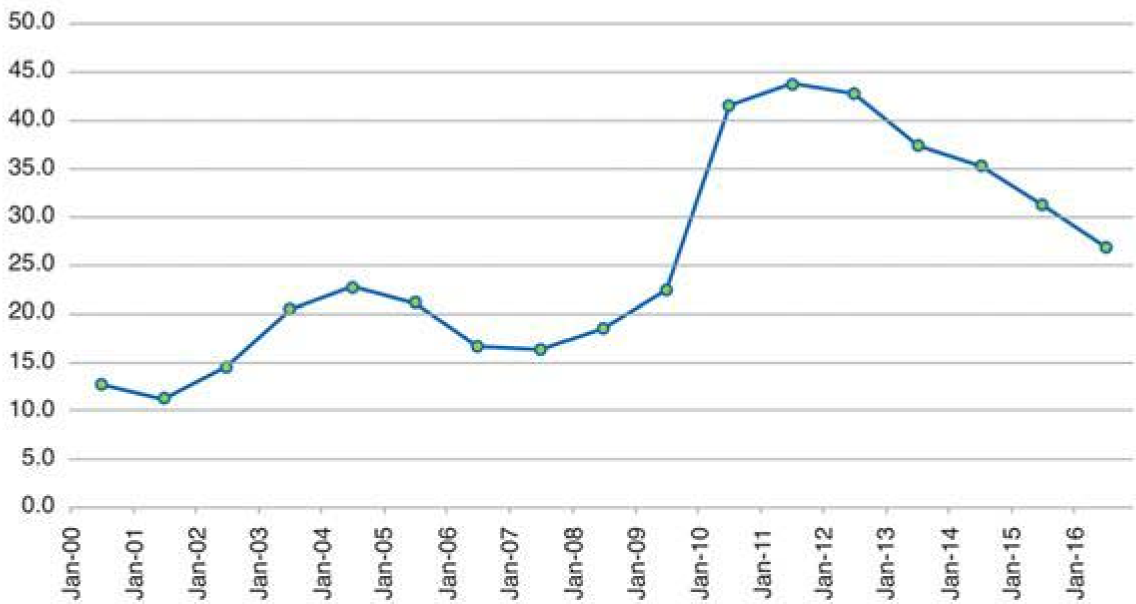
- A five-year extension of the Work Opportunity Tax Credit (WOTC).
- A new target group added to the WOTC.
- A two-year extension to the Empowerment Zone (EZ) hiring incentives.
- A two-year extension to the Indian Employment Tax Credit (IETC).

These law changes were made retroactively effective to December 31, 2014, unless specified otherwise in the discussion that follows.

PATH Section 142 extends the WOTC from December 31, 2014, through December 31, 2019.[5] Section 142 also modified the WOTC to make it available to businesses that hire "qualified long-term unemployment recipients" who begin work for an employer after December 31, 2015.[6] The term "qualified long-term unemployment recipient" is defined as "any individual who is certified by the designated local agency as being in a period of unemployment which-(A) is not less than 27 consecutive weeks, and (B) includes a period in which the individual was receiving unemployment compensation under State or Federal law." [7]

The addition of the "qualified long-term unemployment recipient" target group is an effort to address those individuals who have been unemployed for over 27 consecutive weeks, a number that currently stands at 2.1 million based on the latest labor statistics.[8] This long-term unemployed target group has continued to grow in relative amounts with individuals in this target group accounting for 26.9 percent of the unemployed in January 2016 versus 12.7 percent in 2000[9] (see Exhibit 3).

## Exhibit 3. Unemployed 27 weeks or longer as a percent of total unemployment, seasonally adjusted




Source: US Bureau of Labor Statistics as of February 5, 2016

After the passage of PATH, the following fourteen WOTC target groups now exist:[10]

1. Long-Term Temporary Assistance for Needy Families (TANF) Recipient (8.5%)
2. Short-Term TANF Recipient (4.7%)
3. Supplemental Nutrition Assistance Program (Food Stamp) Recipient (70.7%)

4. Designated Community Resident (DCR) (4.4%)
5. Vocational Rehabilitation (VR) Referred Individual (1.4%)
6. Ex-Felon (2.3%)
7. Supplemental Security Income (SSI) Recipient (1.1%)
8. Summer Youth Employee (0%)
9. Qualified long-term unemployment recipients (0%)
10. Qualified Veteran receiving SNAP benefits (0.8%)
11. Disabled veteran entitled to compensation for a service-connected disability, who has been hired within 1 year of discharge or release from active duty (0.2%)
12. Disabled veteran entitled to compensation for a service-connected disability, who has been unemployed for at least 6 months in the year ending on the hiring date (0.8%)
13. Veteran who has been unemployed for at least 4 weeks in the year ending on the hiring date (1.4%)
14. Veteran who has been unemployed for at least 6 months in the year ending on the hiring date (2.9%)

In addition to extending and expanding the WOTC, PATH also extended several other federal hiring incentives. PATH Section 171 extends from December 31, 2014, to December 31, 2016, the period for which an Empowerment Zone (EZ) designation shall be in effect for certain economically depressed census tracts.[11] The EZ hiring credit program provides an annual federal income tax credit of up to $3,000 per EZ resident hired.[12]

In addition, PATH Section 161 extends through December 31, 2016, the federal income tax credit for the hiring of qualified persons that work and live on or near an Indian reservation.[13] The program provides an annual tax credit of up to $4,000 based on wages and health insurance costs paid to qualified employees.[14]

## WOTC program process and timing is important

While WOTC was intended to simplify the process over prior programs like the Targeted Jobs Tax Credit (TJTC),[15] a process continues to exist for employers to certify employees and claim the credit on their returns. For an individual to be treated as a qualified member of a target group, the employer must have received a certification from an SWA that the individual is a member of the target group, on or before the day the individual begins work for the employer.[16]

If the employer does not feel it can meet the aforementioned requirement, it also has the option to pre-screen the applicant on or before the day an individual is offered employment[17] as long as the employer submits notice to the SWA no later than the 28th day after the individual begins work for the employer.[18]

With the difficulty of pre-certifying applicants before beginning employment, many employers focus on pre-screening the applicant on or before the day an individual is offered employment[19] and submitting notice to the SWA no later than the 28th day after the individual begins work for the employer.[20] Under this approach the employer will file IRS Form 8850 along with the ETA Form 9061. The Office of Management and Budget (OMB) has officially approved the Department of Labor's (DOL) request to extend these WOTC forms through August 31, 2018, allowing employers to use the current forms through this date.

In the past, when there was an extension of the WOTC or creation of new "target groups" the ETA has provided guidance to assist employers and SWAs with understanding the impact of those changes on the certification process. As of January 2016 the ETA is working with the IRS to issue a Training and Employment Guidance Letter (TEGL) regarding the PATH Act extension for WOTC and the new target group.

In the interim, the following instructions were issued by the ETA on January 26, 2016, to SWAs:

1. **Processing WOTC Applications Filed During the 2015 Authorization Lapse.** SWAs are being instructed to take the following actions upon receipt of this document: (a) Issue all final determinations processed during the 2015 authorization lapse that were filed pending a retroactive extension. (b) Process all timely filed certification requests for individuals who began to work for an employer on or after January 1, 2015, and issue employers or their representatives the respective certifications or denials.
2. **Processing Applications for All WOTC Target Groups, Except the New Target Group.** SWAs should continue the uninterrupted processing of employers' timely filed certification requests and issuance of determinations (certifications or denials) for individuals that began to work for an employer **after** December 31, 2014, for all currently reauthorized target groups.
3. **Processing Certification Requests for the New Target Group.** ETA and IRS are working together to modify the WOTC Forms, ETA Form 9061 and IRS Form 8850, to include the new "Long-term Unemployment Recipient" target group. To help employers and their representatives screen eligible new hires for the New Target Group, ETA plans to modify ETA Form 9061 for statutory requirements for the New Target Group. The IRS Form 8850 is also expected to be revised for the

New Target Group. In the interim, employers and their representatives are encouraged to postpone certification requests for the New Target Group until the revised forms are available. States may accept applications for the New Target Group using the current forms ETA forms 9061 or 9062, yet must postpone processing those certification requests until ETA issues additional guidance. *Note: ETA will notify states when employers are to start using the new forms.* **Until then, SWAs may accept current Forms 9061 or 9062 (expiration date: August 31, 2018) that indicate "Long-term Unemployment Recipient" in the top margin, right corner underneath the expiration date.**[21]

## How to calculate the credit and claim the credit

The WOTC is calculated based upon a number of factors, the target group, the number of hours worked, and the wages earned. For employees working at least 120 hours but less than 400 hours a 25 percent rate applies when calculating the credit; for employees working 400 hours or more, a 40 percent rate applies when calculating the credit. The WOTC amount for most targeted groups can be up to $2,400 per employee, or 40 percent of the employee's first-year qualified wages up to $6,000.

The first-year qualified wages are limited to $6,000 for most qualified groups, which amounts to a yearly credit of up to $2,400.[22] The wage limit for disabled veterans is $12,000, if hired within one year of leaving the service, or $24,000, if unemployed for at least 6 months, amounting to yearly credits of up to $4,800 and $9,600, respectively.[23] The wage limit for a qualified veteran who has been unemployed for at least six months is $14,000, amounting to a yearly credit of up to $5,600.[24] Employers claim the WOTC as a general business credit on Form 3800 against their income tax. The WOTC is calculated using Form 5884.

It is important to note that tax-exempt 501(c) organizations may claim a credit against payroll taxes for hiring qualified veterans. Similar to the credit computation for taxable organizations, the credit is calculated based on target group, number of hours worked, and wages earned. If the employee worked at least 120 hours, but less than 400 hours, a 16.25% rate applies when calculating the credit[25] and if the employee worked 400 hours, a 26% rate applies when calculating the credit.[26]

The first-year qualified wages are limited to $6,000 for veterans certified as being a member of a family receiving assistance under a supplemental nutrition assistance program for at least a 3-month period ending during the 15-month period ending on the hiring date and for veterans certified as having aggregate periods of unemployment of at least 4 weeks but less than 6 months in the year prior to being hired. The wage limit for disabled veterans is $12,000, if hired within one year of leaving the service, or

$24,000, if unemployed for at least 6 months. The wage limit for a qualified veteran who has been unemployed for at least six months is $14,000.

Qualified tax-exempt organizations will claim the credit on Form 5884-C, *Work Opportunity Credit for Qualified Tax-Exempt Organizations Hiring Qualified Veterans*, as a credit against the employer's share of Social Security tax. The credit will not affect the employer's Social Security tax liability reported on the tax-exempt organization's employment tax return.

## Conclusion

Congressional supporters continue to look to the WOTC program as a tool to reduce the ranks of unemployed, focusing on supporting veterans, those transitioning out of the military and now the long-term unemployed.

While the WOTC has historically been extended for one or two years, the current five-year extension provides employers with a higher degree of long-term certainty around the program allowing employers to evaluate the process and technology utilized in their WOTC program. With the existence of the WOTC program at least through December 31, 2019, employers may feel more comfortable making investments in technology to support the WOTC program as part of their hiring process, whether that is investments in new applicant-tracking systems or confirming that those applicant-tracking systems enable the 79 plus percent of American adults aged 18-49 using smartphones can more easily apply for jobs directly from their smartphone.[27]

Although this increased certainty around the program is helpful for employers, as of January 2016, employers are still awaiting further guidance about the "Long Term Unemployment Recipients" target group as well as information regarding the potential of transition relief related to the 49-week period in 2015 during which the WOTC had lapsed. In prior instances, the ETA temporarily waived the 28-day application deadline for WOTC applications not submitted timely during the program's lapse. Such transition relief has allowed employers who did not screen or claim the WOTC credit during prior WOTC hiatus periods to screen and claim the WOTC for employees hired during the period for which the WOTC was retroactively reinstated.

# Addendum

After this column was submitted for publication, the Internal Revenue Service (IRS) issued Notice 2016-22, on March 7, 2016, providing guidance to employers claiming the WOTC under IRC §§ 51 and 3111(e). In Notice 2016-22 the IRS acknowledges that the PATH's retroactive extension of the WOTC may cause employers to "need additional time to comply with the requirements of IRC § 51(d)(13)(A)[,]" namely, the filing of Form 8850 *(Pre-screening Notice and Certification Request for the Work Opportunity Credit*) with a Designated Local Agencies (DLA).[28] To address this concern, Notice 2016-22 provides transitional relief applicable to the timing for filing Form 8850 by employers that hire a member of a targeted group on or after January 1, 2015, and on or before May 31, 2016, and employers that hire a member of the new targeted group, qualified long-term unemployment recipients,[29] on or after January 1, 2016 and on or before May 31, 2016. As specified in the Notice, employers will be considered to have satisfied the requirements of § 51(d)(13)(A)(ii) if they submit the completed Form 8850 to the applicable DLA to request certification not later than June 29, 2016.

[1] Bureau of Labor Statistics, Employment Situation Summary, February 5, 2016.

[2] For the prior reporting period, 7.9 million people were considered unemployed, creating an unemployment rate of 5.0 percent. Bureau of Labor Statistics, Employment Situation Summary, January 8, 2016.

[3] P.L. 104-188.

[4] H.R. 2029, 114th Cong. (1st Sess. 2015). *See* Deloitte Tax LLP's *Tax News & Views* (Dec. 18, 2015) (http://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-taxnewsandviews-151218.pdf) for more details on this federal legislation.

[5] PATH Sec. 142(a), amending IRC § 51(c)(4)(B).

[6] PATH Sec. 142(b), amending IRC § 51(d).

[7] *Id*.

[8] Bureau of Labor Statistics, Employment Situation Summary, February 5, 2016.

[9] Bureau of Labor Statistics, Current Population Survey, January 15, 2016.

[10] ETA Enterprise Business Support System-Fiscal Year State Quarterly Reports provided by the Department of Labor. Note the percentages denoted in the parentheticals represent the WOTC certifications and denials in 2014 for each target group relative to the total WOTC certifications and denials in 2014.

[11] PATH Sec. 171(a), amending IRC § 1391(d)(1)(A)(i).

[12] IRC § 1386(c)(2).

[13] PATH Sec. 161(a), amending IRC § 45A(f).

[14] IRC § 45(a).

[15] The TJTC, enacted in 1977 and ended effective December 31, 1994, incentivized employers to hire certain disadvantaged individuals facing barriers to employment.

[16] 26 U.S.C. § 5126 U.S.C. § 51 (d) (13)(A)(i).

[17] 26 U.S.C. § 5126 U.S.C. § 51 (d) (13)(A)(ii)(I).

[18] 26 U.S.C. § 5126 U.S.C. § 51 (d)(13)(A)(ii)(II).

[19] 26 U.S.C. § 5126 U.S.C. § 51 (d)(13)(A)(ii)(I).

[20] 26 U.S.C. § 5126 U.S.C. § 51 (d)(13)(A)(ii)(II).

[21] Information and Interim Instructions for the State Workforce Agencies on the Recent WOTC Reauthorization by the Protecting Americans from Tax Hikes Act of 2015 (Pub. L. 114-113) (Jan. 26, 2016) (emphasis consistent with text of Interim Instructions).

[22] 26 U.S.C. § 51(b)(3)26 U.S.C. § 51(b)(3).

[23] 26 U.S.C. § 51(b)(3)26 U.S.C. § 51(b)(3).

[24] 26 U.S.C. § 51(b)(3)26 U.S.C. § 51(b)(3).

[25] IRC § 3111(e)(3)(B).

[26] IRC § 3111(e)(3)(A).

[27] PEW Research Center: Combines analysis of Pew Research Center surveys conducted December 4-7 and 18-21, 2014.

[28] Notice 2016-22.

[29] The term qualified long-term unemployment recipient is defined as "any individual who is certified by the designated local agency as being in a period of unemployment which-(A) is not less than 27 consecutive weeks, and (B) includes a period in which the individual was receiving unemployment compensation under State or Federal law." PATH Sec. 142(b), amending IRC § 51(d).