

Taking the bite out of higher payroll costs

by John M. Tarras

Congress, in an attempt to help underemployed individuals, has once again passed a job hiring tax incentive program called the Work Incentive Tax Credit. This article will provide a brief review of the law and offer planning tips for hospitality firms which wish to reduce their payroll costs.

The hospitality industry has always been known for employing many unskilled workers, utilizing many of these individuals in positions from dishwashers to hotel maids. The labor cost is a major operating expense for all hospitality firms. Congress and the President have signed into law a provision that will help reduce the cost of hiring certain qualified individuals through a income tax credit known as the "work opportunity tax credit."¹ This may sound like the now-expired targeted jobs tax credit and, in many ways it is, but there are some significant differences.

The new law takes effect on the hiring of qualified individuals after September 30, 1996. The "work opportunity tax credit" differs from targeted jobs credit by having fewer targeted groups, an increased minimum period in which a targeted group member must work for an employer, and a credit percentage of 35 percent rather than 40 percent of the first \$6,000 of wages paid to each targeted group member during the first year of employment.

The work opportunity credit will not apply to individuals beginning work for an employer after September 30, 1998, unless an extended provision is later enacted. This is a popular program with Congress and has been extended once; the odds are very good that the program will be extended again in the future.

The new work opportunity credit allows a hospitality employer to claim a credit of 35 percent of qualified wages paid to employees hired from one or more of seven targeted groups. The credit is limited to the first \$6,000 of wages paid to each targeted group individual during the first year of employment. Thus, the maximum credit per individual is

\$2,100. In the case of qualified summer youth employees, however, the credit is 35 percent of the first \$3,000 of wages attributable to services performed during any 90-day period between May 1 and September 15, for a maximum credit per employee of \$1,050.

As in the case of the former targeted jobs credit, an employer's deduction for wages is reduced by the amount of the work opportunity credit. Also, wages taken into account in computing the work opportunity credit are not taken into account in computing any empowerment zone employment credit that would be allowed.

Example: Wendy's hires Tom Smith, a certified targeted group member, on December 1, 1996. It pays \$1,000 of wages to Smith in December 1996 and \$12,000 of wages to him in 1997. The restaurant is a calendar-year taxpayer. Its 1996 work opportunity credit is \$350 ($\$1,000 \times 35\%$). Wages of \$5,000 paid in 1997 are also eligible for the credit since Smith was hired before the October 1, 1997, expiration date. Wendy's 1997 credit is \$1,750 ($\$5,000 \times 35\%$). Its business deductions for wages paid are \$650 ($\$1,000 - \350) in 1996 and \$10,250 ($\$12,000 - \$1,750$) in 1997.

Generally, a credit is more valuable to a hospitality firm because a tax credit reduces the taxes owed dollar by dollar. As shown in the example, a credit will result in the taxes owed being reduced by \$350. This is known as a dollar for dollar reduction in taxes. It is not important what the tax bracket is of the hospitality firm, since the benefit of the credit is the same at any tax bracket. Deductions from income, on the other hand, require the taxpayer to know what tax bracket he is in order to calculate the benefit of the deduction. For example, a \$100 deduction for someone in the 15 percent tax bracket will only benefit his firm by \$15. However, the same \$100 deduction for someone in the 35 percent bracket would result in a benefit of \$35.

No credit is allowed unless the individual is employed for at least 180 days (20 days for a qualified summer youth employee) or completes at least 400 hours of services for the employer (120 hours in the case of a qualified summer youth employee). This is to prevent employers from hiring individuals just to take advantage of the credit and then firing them and replacing them with new qualified employees.

Targeted groups cover broad range

Although the rules as to who belongs to targeted group are somewhat complicated, appropriate state government agencies should be more than willing to assist the hospitality firm in qualifying the targeted employees and many cases will go as far as to bring the qualified applicants and hospitality firm together. The following individuals are members of targeted groups eligible for the work opportunity credit:

- Aid to Families with Dependent Children (AFDC) recipient,
- a qualified veteran
- a qualified ex-felon
- a high risk youth
- a vocational rehabilitation referral
- a qualified summer youth employee
- a qualified food stamp recipient
- SSI recipients

The former targeted jobs credit had 10 targeted groups. The new work opportunity credit eliminates youths participating in cooperative education programs, general assistance recipients, and involuntarily terminated CETA employees. Changes were also made to most of the remaining six targeted groups categories so it is important to carefully review the new requirements for qualification.

• **Aid to Families with Dependent Children (AFDC) recipient²:** A qualified AFDC recipient is an individual who is certified as a member of a family receiving assistance under a state plan approved under part A of title IV of the Social Security Act (Aid to Families with Dependent Children) for at least a nine-month period ending during the nine-month period ending on the hiring date.

• **Qualified veteran²:** A qualified veteran is one who is certified as a member of a family that receives AFDC assistance for at least a nine-month period ending during the 12-month period ending on the hiring date, or receives assistance under the Food Stamp Act of 1977 for at least a three-month period ending during the 12-month period ending on the hiring date.

The veteran must also have served on active duty (other than for training) in the Armed Forces for more than 180 days or have been discharged or released from active duty for a service-connected disability. A veteran who was on extended active duty on any day during the 60-day period ending on the hiring date does not qualify. A veteran is considered to be on extended active duty if on active duty (other than for training) for a period of more than 90 days. This restriction prevents employers from receiving the credit for hiring current members of the Armed Forces or those discharged within 60 days before they are hired.

• **Qualified ex-felon⁴:** A qualified ex-felon is an individual who is certified as having been convicted of a felony under any state or Federal law, as being a member of a family whose income is 70 percent or less of the Bureau of Labor Statistics lower living standard, and as having a hiring date not more than one year after the individual's last date of conviction or release from prison.

The employee determines whether the income requirement is satisfied by measuring the family income for the six months preceding

the income determination or preceding the month of the hiring date, if that's earlier. This measured income then is computed on an annualized basis. The income determination is valid for a 45-day period beginning on the date of the determination.

- **High-risk youth⁶:** A high risk youth is an individual who is certified as being at least 18 but less than 25 years old on the hiring date and as having a principal place of abode within one of nine designated empowerment zones or 95 designated enterprise communities. The credit may not be claimed on wages paid or incurred for services performed while the youth's principal place of abode is outside of an empowerment zone or enterprise community. An empowerment zone is an area singled out by the government as an area in need of special tax breaks due to the economic distress of the area. An enterprise community is similar to an empowerment zone except that it encompasses an entire community. There are currently nine empowerment zones and 95 enterprise communities designated in this country.

- **Vocational rehabilitation referral⁶:** A vocational rehabilitation referral is an individual certified as having a physical or mental disability that constitutes or results in a substantial handicap to employment. The certification must indicate that the individual was referred to the employer while receiving, or after completing, vocational rehabilitation services pursuant to an individualized written plan under either a state plan approved under the Rehabilitation Act of 1973 or a program for veterans under Chapter 31 U.S.C. The work opportunity credit did not change any of the former jobs credit rules for qualifying as vocational rehabilitation referral. This is one of the most popular programs for many fast food operations that hire back-of-the-house personnel who are mentally challenged.

- **Qualified summer youth employee⁷:** A qualified summer youth employee is an individual who performs services between May 1 and September 15 and who is certified as being 16 or 17 years old on the hiring date (or, if later, on May 1 of the calendar year involved) and as having his principal place of abode within an empowerment zone or enterprise community. Again, as with high risk youth, the credit is only available on wages paid or incurred for services performed while they have a place of abode inside of an empowerment zone or enterprise community.

The credit for a qualified summer youth employee applies only to the first \$3,000 of wages earned during any 90-day period. If the youth has been certified as a member of another targeted group, the limitation on first-year wages as a member of the new targeted group will take into account wages paid while a summer youth employee. In other words, an employee can not double dip as a summer youth and another qualified target group.

Under the former jobs credit, a qualified summer youth employee did not need to live in an empowerment zone or an enterprise community but was required to be a member of an economically disadvantaged family.

• **Qualified food stamp recipient⁸:** A qualified food stamp recipient is an individual who is certified as being age 18 but not age 25 on the hiring date. Additionally, the individual must be a member of a family receiving food stamp assistance for the six-month period ending on the hiring date. Or if a member of a family that has ceased to be eligible for food stamp assistance, he/she must have received food stamps for at least three months of the five-month period ending on the hiring date.

The secretaries of the Treasury and Agriculture are instructed to enter into an agreement to provide information to designated local agencies on participation in the food stamp program.

Certification must be secured for groups

An employer must obtain certification from a state employment security agency (a "designated local agency") that an individual is a member of a targeted group. An individual may not be treated as a member of a targeted group unless an employer obtains written certification to that effect from the designated local agency on or before the day the individual begins work. If the employer believes that the individual to be hired will qualify under one of the targeted groups, then he may hire that individual if a prescreening notice is filled out before the individual is hired. The notice must indicate the information provided by the individual that forms the basis for the employer's belief that the individual qualifies as a member of a targeted group. Both the employer and the individual must sign the notice under penalty of perjury.

A prescreening notice must be submitted as part of its written request for certification from the designated local agency no later than the 21st day after the individual begins work for the employer.

If a designated local agency denies an employer's request for certification of an individual as a targeted group member, it is required to provide a written explanation of the reasons for its adverse finding.

The rules regarding revocation of incorrect certifications based on false information provided by an employee are unchanged. Thus, no credit may be claimed with respect to wages paid to such an employee after notice of revocation of the certification is received.

This new law is a welcome relief to the hospitality industry, especially with the recent increase in labor costs through the minimum wage. Hospitality firms were heavy users of the old jobs credit and there is no reason to assume that they will not make frequent use of this new wage credit. It is important to keep in mind that the

employee must be certified or that at least the employer must have prepared a prescreening notification before the employee begins work.

States have been most eager to provide qualified applicants to the hospitality industry. Because of the recent welfare reform movement sweeping the country, states are under increasing pressure to help find work for such individuals. A hospitality firm has an opportunity not only to cut its labor expenses through the "Work Opportunity Tax Credit," but also to help a segment of society in need of work.

References

- ¹ IRC Sec. 51
- ² IRC Sec. 51 (d)(1)(A)
- ³ IRC Sec. 51 (d)(1)(B)
- ⁴ IRC Sec. 51 (d)(1)(C)
- ⁵ IRC Sec. 51 (d)(1)(D)
- ⁶ IRC Sec. 51 (d)(1)(E)
- ⁷ IRC Sec. 51 (d)(1)(F)
- ⁸ IRC Sec. 51 (d)(1)(G)

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