

Work Opportunity Tax Credit: What Business Owners Need to Know

The Work Opportunity tax credit ("WOTC") is a federal income tax credit that's available to businesses that hire members of certain "targeted" groups. Here's how your business may be able to benefit from this potentially lucrative tax break.

The Basics

The WOTC encourages businesses to hire from certain categories of workers who face significant barriers to employment. The allowable credit amount is based on a portion of wages paid to an eligible worker during the first year of employment or, in some cases, during the first two years.

Businesses can claim the credit for eligible workers whose employment begins before January 1, 2020. But there are numerous rules and restrictions, including the following provisions:

Minimum hours of work. No credit is available unless the worker completes at least 120 hours of work. The credit is reduced if the individual works at least 120 hours but less than 400 hours.

Rehired workers. The credit is available only for *new* hires. Wages paid to an individual who was previously employed by your business and is rehired don't qualify.

Related parties. Wages paid to certain individuals who are related to the employer or business owner don't qualify.

In addition, a business can't claim a compensation deduction for any portion of wages claimed as a WOTC. For instance, if the allowable credit for an employee is \$2,400, you can't deduct that amount of wages as a business expense. Wages above \$2,400 can be deducted as employee compensation expense, however.

WOTC at Work

Calculating the Work Opportunity tax credit (WOTC) can be confusing. Here's an example to illustrate how it works.

Suppose that on December 1, 2017, your business hires a qualified veteran who's entitled to compensation for a service-connected disability. He was discharged from active duty on September 30, 2017. Your business pays him \$4,000 of wages in 2017 and \$44,000 of wages for the period from January 1, 2018, to November 30, 2018.

For 2017, your business is entitled to a WOTC of \$1,600 ($\$4,000 \times 40\%$). For 2018, your business is entitled to a WOTC of \$3,200 ($\$8,000 \times 40\%$).

Important note: The total amount of WOTC-eligible first-year wages is limited to \$12,000. Your business would be eligible for a credit based on \$4,000 of wages paid in 2017, leaving the remaining \$8,000 of WOTC-eligible wages for 2018.

10 Targeted Groups

Current law provides the following categories of WOTC-eligible workers:

1. Qualified IV-A Temporary Assistance for Needy Families (TANF) recipients;
2. Unemployed veterans, including disabled veterans;
3. Ex-felons;
4. Designated community residents living in empowerment zones or rural renewal counties;
5. Vocational rehabilitation referrals;
6. Summer youth employees living in empowerment zones;
7. Supplemental Nutrition Assistance Program (SNAP) recipients;
8. Supplemental Security Income (SSI) recipients;
9. Long-term family assistance recipients; and
10. Qualified long-term unemployment recipients.

The last targeted group was added to the list under the Protecting Americans from Tax Hikes Act of 2015. Since January 1, 2016, the WOTC has been available for hiring long-term unemployment recipients, defined as those who have been unemployed for a period of at least 27 weeks and who received state or federal unemployment benefits during all or part of that time.

Certifying Eligible Employees

Individuals who are members of a targeted group generally must be certified by a designated local agency by the day the individual begins work or shortly thereafter. In addition, employers should complete a prescreening notice with the applicable local agency on or before the day an individual is offered employment to maintain eligibility for the WOTC if a new hire isn't certified on or before the day he or she begins work.

The employer also must submit additional forms to the Department of Labor. The paperwork can be a little overwhelming, so it's important to consult your tax professional for assistance.

Calculating the Credit

How much can you save with the WOTC? In most cases, the credit equals 40% of eligible wages paid to an employee during the first year of employment, up to a maximum of \$6,000 of wages. That translates into a maximum credit of \$2,400 per employee. However, there are several exceptions to this general rule.

The credit for a qualified summer youth employee equals 40% of eligible first-year wages, up to a maximum of \$3,000 of wages. This translates into a maximum credit of \$1,200 per employee. The employee's period of service must be between May 1 and September 15.

The WOTC for a long-term family assistance recipient equals 40% of eligible first-year wages up to a maximum of \$10,000 (for a maximum first-year credit of \$4,000) *plus* 50% of eligible second-year wages up to a maximum of \$10,000 (for a maximum second-year credit of \$5,000).

Furthermore, the WOTC can be based on more than \$6,000 of first-year wages for several categories of qualified veterans. First-year wages means eligible wages paid for services rendered during the one-year period beginning on the day the individual starts work for the employer. The increased first-year wage amounts for qualified veterans are as follows:

- \$12,000 for a qualified veteran who's certified as being entitled to compensation for a service-connected disability and who is hired not more than one year after being discharged or released from active duty in the U.S. Armed Forces. This translates into a maximum credit of \$4,800 per employee.
- \$14,000 for a qualified veteran who's certified as being unemployed for at least six months during the one-year period ending on the hiring date. This translates into a maximum credit of \$5,600 per employee.
- \$24,000 for a qualified veteran who's certified as being entitled to compensation for a service-connected disability *and* who was unemployed for at least six months during the one-year period ending on the hiring date. This translates into a maximum credit of \$9,600 per employee.

Save Taxes by Helping Others

When businesses hire veterans and people who are down on their luck, they help their local communities and engender goodwill. As an added bonus, they might qualify for the WOTC. Contact your tax professional if you have questions or need help with the forms required to claim this potentially lucrative credit.

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