Matching Companies, Communities, and Incentives

Can the Systemized Administration of Employment Tax Credits Help to Maximize Tax Credit and Incentive Opportunities?

ADP Tax Credit Services

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I. INTRODUCTION

The administration of employment tax credits might easily lead you to conjure up thoughts of a monumental paper shuffle. In many places, that may well be the norm. One thing is for sure: administering tax credits requires knowledge and focus, consumes resources and time, creates an expense, and needs a strategy to succeed. It also requires you to acquire the mindset that you are dealing with a moving target at all times – from federal, state, and local legislation that can add or delete credit opportunities tomorrow, next month or next year, to following the compliance rules of promulgating authorities that require strict adherence to forms and flow.

To say that tax credit administration is a daunting task is an appropriate example of a proverbial understatement. There are currently more than 2,000 federal, state, and local tax credits in effect representing a cumulative value in the billions of dollars. To benefit from these credits, and in particular, employment tax credits, employers must identify the credits for which they may be eligible, apply for them using the correct forms and procedures, and follow up with the appropriate government agencies during the certification or application process until the certification is complete.

The focus of this white paper is to determine if there is a better way, or ways, that can trim both time and toil from the administration of employment tax credits, while maximizing tax credit savings and related incentive opportunities.

What is the most efficient way to determine eligibility? Can you efficiently replace manually driven tasks with automation? Is it more cost-effective to handle tax credit administration in-house or through a third-party provider? Can tax credits appreciably improve profitability?

To answer these questions, it is best to begin with a brief review of the basics: what employment tax credits are, what they are designed to achieve, and how they reward employers.

II. WHAT ARE EMPLOYMENT TAX CREDITS?

Employment tax credits are essentially equivalent to a payment toward what an employer owes to a specific tax authority. Unlike a tax deduction – which actually reduces your taxable *income* – a tax credit cuts your tax *liability* on a dollar-for-dollar basis.

Federal, state, and local tax jurisdictions have the authority to issue tax credits to employers for a number of reasons that typically encompass incentives for business in exchange for providing a benefit to the public interest. Some of the most prevalent *federal* employment credits include: Work Opportunity Tax Credit (includes Welfare-to-Work), Empowerment Zone Employment Credit, Renewal Community Employment Credit, and the Federal Indian Employment Credit.[1]

- ***Work Opportunity Tax Credit (WOTC)*** – federal tax credit to encourage employers to hire job seekers from "targeted" groups: welfare recipients, qualified veterans, supplemental security income recipients, low income ex-felons, qualified summer youth, vocational rehabilitation referrals, food stamp recipients (18-39 years of age), residents of empowerment zones, and residents of Hurricane Katrina disaster areas. Under Bill H.R. 6111, which President Bush signed into law on December 20, 2006, Welfare-to-Work (WtW) target groups have been

incorporated into the WOTC program. This targeted group provides employers an incentive to hire extended-term family assistance recipients.

- ***Empowerment Zone (EZ) Employment Credit*** – federal tax credit that gives businesses an incentive to hire individuals who live and work within designated empowerment zones. There are currently over 80 such zones throughout the country. The federal empowerment zone program was designed to provide communities with growth and revitalization opportunities, utilizing economic advancement through job creation as a top priority.

- ***Renewal Community (RC) Employment Credit*** – federal tax credit that allows incentives to businesses that retain employees who live and work within areas designated as renewal communities by the Secretary of Housing and Urban Development (HUD). There are more than 35 RC areas across the country.

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1 ""Tax Incentives for Distressed Communities," *Publication 954*, Internal Revenue Service, U.S. Department of the Treasury.

- ***The Federal Indian Employment Credit (IEC) –*** benefits businesses located on federally recognized Indian reservations that hire Native Americans who live on or near a reservation.

These represent only a portion of the reservoir of available credits. State and local tax credits can also have a favorable impact on an eligible employer's tax liability. State programs range from enterprise zones and job creation efforts to sales and use tax credits. Among the more prevalent state employment tax credits are Point-of-Hire Credits and State Training and Retraining expenditure opportunities.

- ***State Point-of-Hire Credits –*** allow employers to take a tax credit for hiring employees who fall into certain qualifying categories, i.e., employees who are receiving Temporary Assistance for Needy Families (TANF) at the time of hire or vocational rehab referrals. These tax savings vary from state to state and often follow the same criteria as WOTC.

- ***Training/Retraining Expenditures*** – award a certain dollar amount per employee to employers that provide or sponsor an approved training or retraining program.

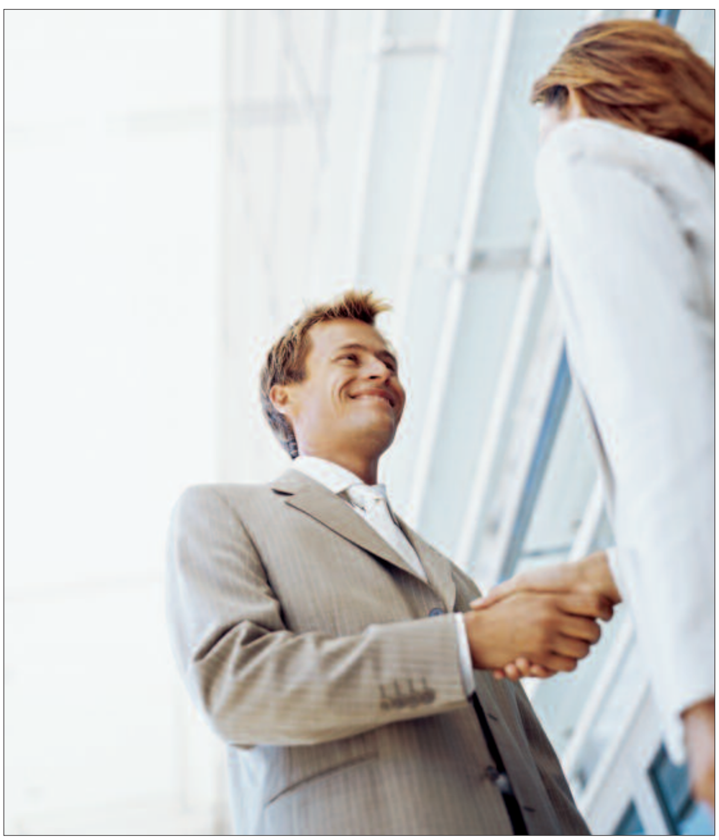
Local programs include property tax abatements, bond financing, community development block grants, and other incentives that are negotiated. Companies are frequently awarded multi-million dollar tax credit and incentive packages for various business activities they are conducting, such as expansions, relocations, consolidations, investment, and growth.

III. ARE THE BENEFITS OF TAX CREDITS WORTH THE AVERAGE EMPLOYER'S EFFORT?

- *WOTC tax credit* savings can total up to $2,400 per eligible new hire. Potential savings for the WtW target group were recently increased up to $9,000 per eligible employee. While the second year credit will remain at 50% of the first $10,000 in wages, the 1st year credit increases to 40% of the first $10,000 for the WtW target group.[2]

- *EZ and RC Employment Credits* can total up to $3,000 and $1,500, respectively.

- *Federal Indian Employment Credits* have a value of up to $4,000 per new hire.



The issue with these and other employment tax credits is that they are not awarded automatically. The responsibility of earning tax credits clearly rests with the employer. Capturing employment tax credits requires accurate administration of an application process that would successfully conclude with a state authority's certification of the tax credit. One of the biggest challenges of employment tax credit administration is successfully navigating the first step in the process: identifying your eligibility to earn certain credits.

2 House Resolutions 6111 and 6408, The United States Library of Congress, December 7, 2006.

IV. THE BASIC CYCLE AND INHERENT COMPLEXITIES OF EMPLOYMENT TAX CREDIT ADMINISTRATION

Employment tax credit administration involves the establishment of an administrative cycle. In its most bare-bones state, the cycle (for WOTC purposes, for example) begins with identifying the credits that are available to a business, screening employees at time of hire to determine if they are a member of an eligible target group, completing and sending the right documentation to the state agency that processes and approves the tax credit, and securing certification of the tax credit so it can be legally claimed as a credit on a specific tax form. With most tax credit applications, time is of the essence. Employers must shoulder the burden of filing the necessary forms within certain timeframes, and compliance issues are compounded for decentralized companies.

The core document that serves as a pre-screening notice and certification request for WOTC is the Form 8850 of the Internal Revenue Service. When completed, it is a written request to a tax authority to certify an individual as a member of a targeted WOTC group.

Completing the Form 8850 for each new hire is the initial step toward tax credit certification. Because of its lynchpin role in the administrative process, some employers have wisely incorporated its completion as a requirement for employee onboarding. By systemically integrating employment-based tax credit screening into the application process, all eligible employees can help to accumulate credits for the employer.

While circumstances vary from employer to employer, all businesses share a common requirement when it comes to tax credits. Just as you would to administer any program promulgated by legislation (COBRA, Flexible Spending Accounts, et. al.), keeping abreast of tax credits takes constant vigilance because laws and regulations are subject to change. As one New Jersey CPA firm wrote in its annual tax guide to clients and prospects: "If you want to take full advantage of these credits, you need to regularly monitor changes in federal law. Some credits are temporary opportunities while others are subject to annual Congressional renewal."[3]

Tax credit life cycles and amended rules and regulations associated with tax credits add serious complexity to the administrative process. It is not a "straight-line" experience. Like many other regulations and rules established by government agencies, employment tax credits are also subject to renewal and amendment.[4] For example, the WOTC target group expansion to assist with the employment of victims displaced by Hurricane Katrina terminates on August 28, 2007.

So how can you confidently go about identifying and securing the tax credits to which your business is entitled? Unlike most activities related to government tax authorities, you actually have a *choice*. You can do it yourself or buy an administrative solution from a service provider.

3 *2006 Tax Planning Guide*, Cowan, Gunteski & Co., P.A., www.cowangunteski.com
4 "Congress's Last Acts Include Tax Breaks," *The Washington Post*, Jonathan Weisman and Stephen Barr, December 10, 2006.

V. BUILD AND MAINTAIN INTERNAL PROCESSES OR BUY A SERVICE: WHICH PROVIDES THE MOST VALUE?

Before you decide whether you should administer employment tax credits with in-house resources or outsource the application to a service provider, first consider some of the processes and tasks involved with bringing an employment tax credit to fruition:

- Assessment of Identification/ Eligibility – What tax credits are available to the business? Who determines if you are eligible? Who is responsible for managing employment tax credit administration in your business? Who keeps up with ever-changing legislation? Who trains managers and staff concerning their roles in employment tax credit administration?

- New Hire Screening – How do you pre-screen new hires? Are you screening ALL new hires? Do managers at field locations understand their role in the pre-screening process? Do you conduct pre-screening as part of the job application process or employee orientation? Who reviews completed pre-screening questionnaires? Who determines if an employee triggers your eligibility for a tax credit?

- Timely Filing/Compliance – Who completes and submits proper documentation to the state authority, such as the Form 8850? Who will work on reversing improper denials by the state authority? Who do you consult when a problem arises?

- Reports/Managing the Administrative Process – Who compares the number of new hires with the number of tax credit screenings? Who tracks each tax credit from screening and submission to certification? What critical information should be shared with your C-Level executives and field managers to help improve tax credit administration throughout the enterprise? How do you identify new tax credit opportunities in the coming year?

Now overlay this information over the benefits offered by each option.

The In-house Option

This approach appeals to employers who are willing to build, staff, support, and manage a system internally that administers employment tax credits.

An in-house staff bears the sole responsibility for maintaining the most current body of knowledge of applicable laws and regulations. While this responsibility sometimes becomes easier to undertake in larger companies, it becomes a less attractive strategic course of action for small- and mid-size firms. Staffing and systems support requires a long-term commitment.

Another perspective is the sophistication of the system and methods an employer uses to administer employment tax credits. Manual administration is the least preferable because it is prone to be less time efficient and more prone to human error.

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V. BUILD AND MAINTAIN INTERNAL PROCESSES OR BUY A SERVICE: WHICH PROVIDES THE MOST VALUE? (CONTINUED)

Many companies have attempted to administer their tax credit programs in-house, only to meet with limited success. Among other things, they have found that it is difficult to ensure that all new hires are screened by holding field managers accountable for participating in the screening program. In addition, the process of reporting statistics and results for corporate and field offices is a formidable challenge that can easily evolve into a major disappointment for senior management.

The Outsourcing Option

This approach appeals to employers that prefer a "minimalist" approach to overhead. Just as they are likely to use a payroll service, or utilize the offerings of a financial business process outsourcer, they would apply the same principles to employment tax credit administration. There are no worries about building the most current body of knowledge, or working around the absence of an employee who is essential to the function.

There are virtually no costs of system ownership. Costs to acquire the benefits can be paid in a variety of ways – from monthly to when the employer receives certification of tax credits applied for. The administrative burden rests with the service provider – as do any related compliance burdens.

Another key benefit of outsourcing your tax credit program is the added value that available automation brings to the process. Some tax credit vendors offer their tax screening interview online. Companies can use the online interview in stand-alone mode, or it can be seamlessly integrated into an automated hiring system. By automating the screening process, companies can benefit from a decreased administrative burden, shortened interview times, and improved certification rates with GIS technology to ensure accurate addresses.

Just as important, when the tax credit process is integrated with an automated hiring system, companies can realize 100% screening compliance, which can incrementally improve overall tax savings. In one documented case, a fast food franchiser with 5,200 company-owned stores and about 100,000 new hires annually was realizing only a 60-70% screening compliance from its in-house tax credit program. When the franchiser outsourced the function to a large service provider with integrated capabilities, screening compliance rose to 98%.[5]

5 "Maximize your company's tax credits," ADP Tax Credit Services, www.taxcredits.adp.com.

VI. ASSESSING THE VALUE OF A THIRD-PARTY RESOURCE

The obvious threshold measurement is whether a third-party can achieve equal or better results with a more cost-effective process. They must have the resources in terms of systems and knowledgeable staff to provide you with timely and accurate tax credit assistance. In this day and age of Sarbanes-Oxley compliance, they should also have attained compliance with SAS70 regulations. Ask to see their documentation and make sure that it covers the tax credits line of business.

The over-arching value you derive from utilizing a qualified outsourcer resides in all the processing-related tasks they can relieve you and your accountant of doing. While an employer's CPA or accounting firm may be a prime resource to help identify likely tax credits for a client, accountants are increasingly devoting more of their time to activities that generate higher professional fees – such as business consulting – and less time to physically handling the processing of task-driven functions. We see this trend clearly emerging in the diminishing number of accountants that are physically calculating tax returns and processing payrolls, once staples in the accountant's diet.[6]

Service providers have recognized this trend as an opportunity and have stepped in to fill the gap.

ADP[7] – the market leader in outsourced payroll, HR, and benefits administration, is a major provider of outsourced employment tax credit administration services. ADP's tax credit product offering features a five-step process to maximize available tax credits and includes a custom "Annual Incentive Analysis" that focuses-in on the credits each client is eligible to earn. Its pricing model is also among the best in the industry because its services are based upon contingency fee pricing. That is, clients pay for ADP's services once credits are certified and ready to be applied to a tax return. Emphasizing the added value of its products and services, ADP says its solution is designed to appeal to not only tax departments, but also the human resources areas of client companies. Tax departments derive additional tax savings and relief from ADP's thorough administrative filings and follow up with state agencies. HR departments integrate the tax credit screening process into the hiring process through a variety of methods that suit client needs. Different screening methods include: Mail-In, Call-In (by either interactive voice response or live operator), and a Web-based solution that is available stand-alone or integrated with an automated hiring system.

<u>It is obvious that the administration of employment tax credits can be systemized cost-effectively.</u> However, the answer actually comes in two options – in-house management or an outsourced solution. A company's culture, strategic financial plan, and management perspective usually dictate which flavor is best for its needs.

Outsourcers that make a strong case for the service option, point to the steady adoption of outsourced solutions. Studies and surveys continue to indicate that their trend assessment is accurate.[8]

6 "Outsourcing by CPAs: Are We a Business or a Profession?" The CPA Journal, Andrew B. Blackman, Mitchell Freedman and John Levy, May 3, 2006.
7 ADP provides market-leading business processing services to employers in the United States and globally.
8 "An Examination of Trends in Shared Services and Outsourcing in Public Sector Organizations," EquaTerra, December 2006.

VII. IS YOUR BUSINESS A CANDIDATE FOR OUTSOURCED EMPLOYMENT TAX CREDIT ADMINISTRATION?

If after reading this white paper you're still uncertain about outsourcing the administration of employment tax credits, take a few additional moments to answer these questions:

1) Do I have a system in place to help me identify all tax credits that may be available to my business from the federal, state, and local governments?

2) Do I conduct Form 8850 prescreening during the new hire onboarding process?

3) Do I enforce a 100% screening policy for all new hires? At all locations?

4) Do my managers know their role in the administration of employment tax credits?

5) Am I always on time in filing Form 8850 Pre-Screening Notices?

6) Do I have a designated consultant concerning changes to legislation and regulations?

7) Has my business, for any reason, never lost a significant opportunity to benefit from tax credits?

8) Do I have a staff member who is responsible for tracking each employment tax credit from submission to certification?

9) Do I have a mechanism in place to help me reverse improper denials of tax credit applications to realize full benefits?

10) Am I certain that my current system maximizes profitability better than an outsourced tax credit management solution can?

If you responded "no" to any of these questions, your business may be a good candidate for outsourced employment tax credit administration.

VIII. CONCLUSION AND TAKE-HOME POINTS

Here is a review of key points that you should take away from reading this white paper:

A) There are more than 2,000 tax credits available to eligible employers from federal, state, and local authorities. Determining tax credit eligibility requires not only knowledge of existing laws but how those laws apply specifically to your business.

B) Most tax credits are subject to renewal and amendment.

C) Employment tax credit administration is a complex and time-consuming process. It requires well-trained and knowledgeable people to: 1) administer, screen, and submit forms to state agencies, 2) calculate anticipated credits, 3) track forms from submission to certification, and 4) keep abreast of legislative and regulatory changes, as well as changes to your business that would allow new opportunities to apply for additional credits and maximum tax savings.

D) While accountants may provide their clients valuable consultation concerning employment tax credits, they are increasingly less inclined to directly perform the processing and administration of these tax credits.

E) Businesses can choose to manage tax credit administration in-house or outsource administration to a qualified service provider.

F) Outsourcing is a growing trend. The pressure on profits makes it difficult for businesses to justify added overhead and resources to support in-house functions. The "pay-as-you-go" or "pay-upon-certification" pricing models of leading outsourcers have emerged as an increasingly attractive and affordable feature for corporate decision-makers.

G) When tax credit screening is integrated with an automated hiring system, companies can realize 100% screening compliance which, in turn, improves overall tax savings.

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