BUSINESS OF TAX

Giving Credits Where Credits Are Due

by Jonathan Curry

Tax Notes' The Business of Tax column covers industry trends and notable developments involving the operations of tax law and accounting firms and tax representation generally.

The tax code offers generous tax incentives for all kinds of activities, but sometimes taxpayers need some extra help claiming those benefits. That's where tax credit consultants come in.

The complexity associated with determining eligibility for tax incentives has spawned an industry whose primary, and in some cases exclusive, function is to help taxpayers claim these credits. But when the incentives are regularly caught up in Congress's haphazard legislative schedule for reauthorizing the provisions underpinning the credit programs, the uncertainty can make tax credit consultants squirm.

"We're nervous as all hell, because everything is politics," said Brian Kelly, managing partner of Cost Management Services LLC. Kelly's firm specializes in screening applicants and processing claims for the work opportunity tax credit (WOTC), the largest of the federal employment-related tax incentives.

Kelly noted that while the WOTC is generally popular, it was on the chopping block during the legislative negotiations over the Tax Cuts and Jobs Act as lawmakers debated which business-friendly provisions to eliminate in exchange for a lower tax rate on businesses.

The WOTC survived, yet now that credit is one of many that's scheduled to expire at the end of 2019. But for those in the tax credit consulting industry, a legislative hiatus is nothing new.

"It's business as usual," said Max Shenker, vice president of Tax Credit Co., which offers credit consulting and processing services for several federal and state business tax incentives. He noted that recently the WOTC has more often than not had to be retroactively renewed.

"It's a messy way of doing it, and nobody likes it, but it's become pretty common," he said.

How It Works

The WOTC provides employers with a tax credit for hiring employees from a set of targeted groups, such as qualified veterans, Temporary Assistance for Needy Families recipients, or ex-felons. To claim the credit, the employer must have the employee certified for the credit program by a state workforce agency and then retain that employee for a specified amount of time.

Tax credit consultants like Kelly contract with companies to handle the administrative side of claiming the credits. "We work for employers, and what we do is screen every new hire that a company brings on board to determine if they're eligible for the WOTC or not," he said.

When it comes to the WOTC, these consultants will often integrate into a company's applicant tracking software, explained Kerstin Nemec, principal at Synergi Partners. For example, when a person applies for a job online or at an in-store kiosk, a series of pre-screening questions that take only a few minutes to answer will come up to determine if that applicant is likely to be eligible for the credit.

She said the answers to the questions are confidential, but the employer gets to see if that applicant is potentially eligible. Then, if the applicant is hired, they'll sign the official forms to apply for certification by the relevant state workforce agency and handle any necessary follow-up, such as tracking and receiving the certifications or denials or appealing the denials if warranted.

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Synergi's services extend beyond the WOTC to include business incentives at both the federal and state level, including disaster relief credits for retaining employees, Indian employment credits, the research credit, and the new paid family leave credit, which was enacted for two years as part of the TCJA.

The paid family leave credit, however, "has not taken off as much as we'd hoped," perhaps because the thresholds on income are too limiting, said Nemec. "We've had *Fortune* 500 companies that will give us all the data, and it's just not a lot [of credit] there," she said.

Audit defense is a standard part of most tax credit consultants' contracts, although depending on the type of credit involved, they typically don't get much resistance from the IRS, according to Nemec. For the WOTC, eligibility is already determined at the state level before the credit is claimed, "so once you get that certification, there's not a whole lot of room for error in interpreting that," she said.

Shenker further explained that because of those "built-in safeguards," the IRS audits are usually limited to ensuring the employer actually has certificates for the credits they've claimed and that they've done the calculations correctly.

Tax credit processing services also aren't limited to boutique firms.

In a letter to the Senate Finance Committee's employment and workforce development task force, Big Four firm EY explained that it not only claims WOTCs for itself for hiring autistic individuals as part of its Neurodiversity Center of Excellence — "the tax credit becomes a valuable offset for the training and development involved," it says — but that it has itself served as a third-party WOTC administrator that has "processed millions of WOTC applications."

Economist Aparna Mathur of the American Enterprise Institute said it shouldn't be surprising that a cottage industry has developed around processing federal tax credits, given that the rules for credit eligibility "tend to be administratively complicated."

Demonstrating compliance isn't easy, so "it doesn't surprise me that tax professionals are involved in allowing companies or individuals to take full advantage of the programs on offer," Mathur told *Tax Notes*.

Everybody Wins

The empirical evidence of the success of credits like the WOTC has been mixed, Mathur said. Some studies seem to suggest that there are positive gains in employment for disadvantaged workers, while others suggest those gains are short-lived. And the credit may be subsidizing firms that would have already hired a WOTC-eligible worker in the first place, she said.

For now, the WOTC enjoys broad bipartisan support. The Senate task force that looked into the merits of the credit and other employment incentives received 65 comments on the WOTC, all in favor of keeping or expanding on the provision.

In a report on its findings, the task force didn't make an up-or-down recommendation on the future of the WOTC, but it agreed that generally, short-term temporary solutions to tax policies have "significant negative effects," particularly when those policies must be extended retroactively.

"To the extent practicable, the taskforce members feel that tax policy should be enacted with long-term time horizons, if not on a permanent basis," the task force concluded.

William A. Signer, a lobbyist with the Carmen Group Inc., credited a report by professor Peter Cappelli of the Wharton School for helping build bipartisan congressional support for the WOTC. That report concluded that the WOTC saves states and the federal government far more than they spend on the program because it reduces spending on government assistance.

Signer, who advocates on behalf of the National Employment Opportunity Network, a group dedicated to supporting the WOTC, said he wasn't concerned about the task force's lack of an explicit statement in support of extending the program.

He said it likely suggests the lawmakers were unable to reach a consensus about which credits should be permanent and which should be extended long term because they know permanence would be costly.

"I think it reflects reality more than it reflects desire," Signer added.

Sitting Tight

For Signer, the reality is that "this has not been an easy Congress to get things across the finish line."

The concern for Signer and the tax credit consultants is that if legislation extending or making the WOTC permanent doesn't pass before the end of this year, very little will happen legislatively during the 2020 election year. And if a new president takes over or the House or Senate flips, "it's going to be six months into 2021 before you can get legislation."

"That's a long time to have a hiatus," Signer added.

There have been a dozen extensions of the WOTC since the program was first enacted in 1996, and of those, eight applied retroactively after the program's authority had already lapsed. The most recent action was a five-year extension included in the Protecting Americans From Tax Hikes (PATH) Act of 2015 that became law December 18, 2015, and retroactively renewed the program from January 1 of that year through December 31, 2019.

Often, those lapses in authority can last a year or more. The 2015 PATH Act extension retroactively covered 12 months. The program was also retroactively renewed for one year in 2014, and before that, it was extended for two years in 2013, one of which was retroactive. In each of those cases, the WOTC program authorization had lapsed for at least 12 months before it was renewed.

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"It's aggravating, but it doesn't have any immediate impact for a few reasons," said Shenker. The state workforce agencies that certify WOTC claims usually have a backlog in processing applications, which means they'll continue to issue certifications on applications filed before the date that the WOTC's authorization lapsed.

Nemec likewise said that when a tax credit expires, her firm's operations are still "going, going, going," continuing to screen applicants and get paperwork ready. Then, when the program is renewed, "you have just a massive flood of paperwork going in," she said.

However, since 2012, many states have significantly sped up their processing of applications because the IRS authorized the use of e-signatures and shifted most of the process online, "so the impact will be felt much more quickly if the program does go into hiatus," according to Shenker.

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'Nerve-Racking'

But the longer hiatuses take a toll on both the program and the tax credit consultants.

The EY letter observed that the repeated cycle of expiration followed by retroactive renewal is associated with "irregular staffing levels" at the state agencies responsible for issuing certifications, which adds to the processing delays when the program is renewed.

And most tax credit consultants aren't paid until their clients' businesses receive credits, so once the backlogs clear, cash flow is affected, which is "where the stress comes in," according to Nemec.

"We're privately held and control our own destiny, and we're used to the roller-coaster ride of all this," Nemec said. "But if you're not, it can be nerve-racking."

Shenker similarly said his firm offers other services, and that it plans ahead for these lapses in authorization to mitigate their impact.

However, if the WOTC is ever left to expire permanently, "it would be a very serious blow to the business," he said. ■