Important Aspects About WOTC and ERC Explained

Table of contents

The Work Opportunity Tax Credit (WOTC) has been around since 1996, and in 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) introduced the Employee Retention Credit (ERC).

These are just two of the lesser-known corporate tax credits. You would expect that because of their substantial positive impact on the tax bill and how long they have been around, most businesses would have already taken advantage of them. But most people don't know about them, let alone use them. That means several organizations are leaving lots of money on the table.

This article will go over everything there is to know about WOTC and ERC. This includes their eligibility criteria and their differences. Towards the end, we will go over the most frequently asked questions about WOTC and ERC to ensure you fully understand their concepts. It is the only way to take full advantage of these corporate tax breaks.

What Is WOTC?

(Work Opportunity Tax Credit)

WOTC are federal tax credits available to employers who hire people from certain targeted groups. People in this group usually face barriers to employment and include ex-felons, vets, and disabled individuals.

How much is the WOTC?

The amount of credit depends on the amount paid as wages to the employee and the targeted group. It lies anywhere between $2400 and $9600. Generally, the credit is 40% of qualified wages paid to the employee up to $6,000 if they work more than 400 hours, or 25% if they worked more than 120 hours but less than 400 in their first year working.

A taxable business may apply for the credit against its business income tax liability. In contrast, for a tax-exempt organization, the credit is limited to the amount of employer Social Security tax owed on wages paid to all employees for the period the credit is claimed.

Employer qualification

All taxable and certain tax-exempt employers in the U.S. or U.S. territories are eligible to claim the WOTC. Taxable employers claim the WOTC as a general business credit against their income taxes. Tax-exempt employers claim the WOTC against their payroll taxes. Estimate your WOTC to know how much refund you are likely to receive.

Qualified wages

The WOTC is available for wages paid to the targeted individuals who begin work on or before December 31, 2025. Targeted individuals have been certified to belong to one of the following groups:

1. The formerly incarcerated or those previously convicted of a felony
2. Recipients of state assistance under part A of title IV of the Social Security Act (SSA)
3. Veterans
4. Residents in areas designated as empowerment zones or rural renewal counties
5. Individuals referred to an employer following completion of a rehabilitation plan or program
6. Individuals whose families are recipients of supplemental nutrition assistance under the Food and Nutrition Act of 2008
7. Recipients of supplemental security income benefits under title XVI of the SSA
8. Individuals whose families are recipients of state assistance under part A of title IV of the SSA
9. Individuals experiencing long-term unemployment

What Is ERC?

(Employee Retention Credits)

ERC are refundable credits that employers can claim on qualified wages. This includes specific health insurance costs, paid to employees who are not working to retain them.

ERC encourages employers to keep paying their full-time employees, even if they are not working during the covered period due to the effects of the coronavirus outbreak.

How much is the ERC?

The number of credits employers can claim depends on when they retained the full-time employees.

If they retained a full-time employee who wasn't working between March 13 and December 31, 2020, ERC provides a refundable credit of 50% of the qualified wages (including certain health plan costs) up to $10,000.

If they retained a full-time employee between January 1 and June 30, 2021, they can claim a refundable tax credit equal to 70% of the qualified wages (including certain health plan costs) up to $14,000.

Employer qualification

To qualify as an employer, you should meet one of the following requirements:

- Your gross receipts fell below 50% (for 2020) or below 80% (for 2021) compared to the corresponding quarter in 2019. If the employer was not in business in 2019, they measure the decline using the corresponding quarter in 2020. Additionally, for the first and second quarters of 2021, employers can choose to measure the decline using the immediately preceding quarter in the manner provided by the IRS guidance.
- If the government ordered you to shut down operations fully or partially.

You can claim your ERC by directly reducing the payroll taxes sent to the IRS. However, if your credits exceed your taxes, claim a refund from the IRS. Estimate your ERC to know how much refund you are likely to receive.

Qualified wages

The number of full-time employees you retain per year determines which employees you can claim for the credit.

For 2020, if you averaged more than 100 full-time employees during the year, you can only claim wages of those who you retained but were not working. If you averaged 100 or fewer employees during the year, you can claim wages for all employees whether they were working or not.

For 2021, the threshold is 500 full-time employees. If you averaged more than 500 employees through the year, you can only claim wages for the workers you retained but were not working. If you averaged 500 or fewer full-time employees, you can claim wages for all employees.

What's the difference between WOTC and ERC?

Despite having some similarities, WOTC and ERC are entirely different. Here are a few differences between them:

1. The purpose of ERC is to encourage employers to keep their employees on the payroll even if they aren't working during the covered period to avoid making them redundant. The purpose of WOTC is to incentivize workplace diversity and facilitate access to good jobs for all Americans.
2. Employers can only claim WOTC for a specific group of employees with barriers to finding employment. However, they can claim ERC for all workers.
3. ERC applies to full-time employees online, while WOTC applies to full-time and part-time employees.
4. The WOTC amount an employer can claim depends on the number of hours worked in the first year while the ERC amount is a fixed percentage.
5. Employers can only claim WOTC for working employees while they can only claim ERC for employees they are retaining but are not working.
6. The ERC expired towards the end of 2021 with the passage of the infrastructure bill. The WOTC was extended to 2025 by the Omnibus Spending Bill in December 2020.

2022 changes in tax credits

On November 15, 2021, the president signed the Infrastructure Investment and Jobs Act. The bill changed the expiration date of the ERC from December 31, 2021, to September 30, 2021, for all businesses except Recovery Startup Businesses, cutting short the ERC.

But that doesn't mean one cannot apply for ERC anymore. Businesses have three years after the program ends to look back at wages paid after March 12, 2020, to determine eligibility. So, if your business recovered from a substantial decline in gross receipts and you did not claim the credit, you can claim it in 2022.

Recovery startup businesses are employers that:

- Began carrying on any trade or business after February 15, 2020,
- Had average annual gross receipts under $1,000,000 for the 3-taxable-year period ending with the taxable year that precedes the calendar quarter for which the credit is determined.
- Do not meet the other eligibility criteria.

FAQs

Is WOTC available for part-time workers?

Yes, whether the worker is part-time or full-time, as long as they are members of the qualifying targeted groups, they are eligible for the WOTC. However, they need to have worked for at least 120 hours before applying for the certification.

Is ERC available for part-time workers?

No, it is not. Unlike WOTC, ERC is only available for full-time workers.

Are the benefits of the ERC and WOTC the same for large and small employers?

ERC benefits small employers more than it does large employers. Under the 2021 rules, small employers with less than 500 employees can claim credit for all their employees. Larger employers with more than 500 employees can only claim credit for the employees that aren't working during the eligibility period.

For WOTC, the benefits per employee are the same for small and large employers. But, in total, they could be more for the large employer because there is no limit to the number of employees employers can hire as part of the program. For instance, if both the large and small employers' entire workforces consist of employees that are all part of the program because the former has more workers, they claim more credit.

When do the ERC and WOTC programs expire?

The ERC program expired on September 30, 2021. However, businesses have three years after the program ends to look back at wages paid after March 12, 2020, to determine eligibility. So, you can claim it in 2022.

The WOTC expires on 12/31/2025.

Do the ERC and WOTC have to be paid back?

No, they don't. Tax credits are not loans and don't have to be paid back.

Do churches and other religious organizations qualify for ERC and WOTC?

Yes, they do. They qualify as long as they meet the employer qualifications we discussed above.

Summary

Employers looking to cut down expenses should first look into tax credits. Although the government introduces them to spur a particular type of corporate action, most of these actions are usually beneficial in the long term. And since they also lead to tax savings, it's an all-around win for the business.

Are you looking to maximize your tax savings from WOTC and/or ERC?

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