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The 1977 Tax Reduction and Simplification Act created the New Jobs Credit. The purpose of this credit is to stimulate employment by giving employers a tax advantage for hiring additional employees in years beginning in 1977 and 1978. If used appropriately this innovation can be a most important new rule, although no provision has been made for continuing this credit for years beginning in 1979 and after.

Computation of the Credit

The new jobs credit for a taxable year beginning in 1977 or 1978 is 50 percent of the increase in individual wages. Job tax credit (JTC) wages are the first $4,200 in wages paid to an employee covered by unemployment insurance under the Federal Unemployment Tax Act (FUTA). This $4,200 wage base is applicable for both 1977 and 1978 (even though the FUTA wages increase to $6,000 in 1978) and is based on calendar year wages regardless of the employer's fiscal year. Employers with fiscal years beginning in 1977 use calendar year 1977 to compute the credit, for fiscal years beginning in 1978, calendar year 1978 is used.

The limitations of this credit in 1977 are computed as follows:

105 percent Limitation

50 percent of the excess of the *total* wages paid during calendar year 1977 to employees covered by unemployment insurance over 105 percent of the *total* wages paid to employees covered by unemployment insurance during calendar year 1976.

The reason for this limitation is to insure that the credit is based on actual increases in employment rather than splitting full-time jobs into part-time jobs. It makes it necessary to have increases in total wages of at least 5 percent before receiving any credit.

102 percent Limitation

50 percent of the excess of the job tax credit (JTC) wages paid during calendar year 1977 over the *greater of* a) 102 percent of the JTC wages paid during calendar year 1976 or b) 50 percent of the JTC wages paid in calendar year 1977.

The 102 percent limitation eliminates credits on the normal 2 percent increase in employment. The 50 percent of current year's wages restricts credits to new or rapidly expanding businesses.

$100,000 Limitation

There is an overall $100,000 limitation on the amount of new jobs credits that may be deducted in any one year.

Example:

In 1976 Rodco, Inc. had 20 employees with a total payroll of $200,000 (all employees earned at least $4,200). During 1977 Rodco gave salary increases totaling $10,000 and also hired five new employees at an annual salary of $6,000 each. All employees are covered by FUTA. The new jobs credit for Rodco for 1977 would be $9,660 (assuming that Rodco had at least $9,660 in taxes due, after deducting other tax credits), calculated as follows:

105% Limitation

Total wages paid in 1977	$240,000
Total wages paid in 1976	200,000
105% X $200,000	210,000
Excess of total 1977 wages over 105% of total 1976 wages	30,000
50%	15,000

102% Limitation

JTC wages paid in 1977 (25 x $4,200)	105,000
JTC wages paid in 1976 (20 x $4,200)	84,000
a) 102% of 1976 JTC wages	85,680
b) 50% of 1977 JTC wages	52,500
Excess of 1977 JTC wages over the greater of (a) or (b)	19,320
50%	9,660

The limitations are the same in 1978 as for 1977 except that JTC wages and the total wages for calendar years 1977 and 1978 are used in place of those for 1976 and 1977.

The amount of the credit is also limited to the tax liability for the current year. The portion of the credit that is unused due to this limitation is not refundable. An important factor is that this credit can be carried back three years and forward seven years to offset income taxes. It must be carried to the earliest available year first.

Credits that must be taken before the

new jobs tax credit are:

Code Section 33 - Foreign Tax Credit
Code Section 37 - Credit for the Elderly
Code Section 38 - Investment Credit
Code Section 40 - WIN Credit
Code Section 41 - Credit for Political Contributions
Code Section 42 - General Tax Credit
Code Section 44A - Expenses for Household and Dependent Care Services Necessary for Gainful Employment

The new jobs credit cannot be used to offset any of the following taxes:

Code Section 56 - Minimum Tax for Preferences
Code Section 72(m) (5) (B) - 10% Tax on Premature Distributions to Owner-employees
Code Section 408 (f) - Additional Tax on Income from Certain Retirement Accounts
Code Section 402 (e) - Tax on Lump-sum Distributions
Code Section 531 - Accumulated Earnings Tax
Code Section 541 - Personal Holding Company Tax
Code Section 1378 - Tax on Certain Capital Gains of Subchapter S Corporations
Code Section 1351 (d) (1) - Recoveries of Foreign Expropriation Losses

Wage Deduction Reduced by Amount of Credit

No Deduction will be allowed for wages paid to the extent that the new jobs tax credit is allowable in a taxable year, determined without regard to the limitation based on the tax.

Example:

Franklin Company had new jobs tax credits of $30,000 allowable in 1977 (determined without regard to the limitation based on the amount of income tax). Taxable income was $50,000 and income taxes were $24,900 before credits. Assuming no other credits, the new jobs tax credit will be limited to $24,900, with $5,100 available to be carried back or forward.

Taxable income before jobs credit	$50,000
New jobs credits allowable	30,000
Taxable income	80,000
Income tax, before utilizing new jobs credit (.21 x $50,000 + .48 x $30,000)	24,900
New jobs credits utilized in 1977	24,900
Tax payable	—0—
Credit available for carryback or carryover ($30,000 - 24,900)	$ 5,100

Partnerships, Subchapter S Corporations and Trusts and Estates

The new jobs tax credit is passed through pro rata to a partner, a Subchapter S corporation shareholder, or a beneficiary, but only to offset the income taxes resulting from his share of income from the generating entity, not income from other sources.

Formula for calculating credit limit from each entity is as follows:

income tax, before deducting new jobs credit, times portion of taxable income attributable to interest in generating entity, divided by taxable income for year, reduced by zero bracket amount

Example:

A partner's income taxes for the year are $10,000 before taking into account investment tax credits of $800 derived from the partnership, a general tax credit of $180 and investment tax credits of $420 derived from another business. His taxable income is $36,000 and income allocable to his interest in the partnership is $18,000. The jobs credit allowed to him for the year cannot exceed $4,300.

($10,000/1,400) x ($18,000/$36,000)

If the partner's share of the jobs tax credits from the partnership for the year is $4,500, the credit allowed for the year is $4,300. The balance of $200 could be carried back three years or forward seven years to offset income taxes.

Controlled Group of Corporations

All employees of all corporations in the same controlled group of corporations will be treated as if employed by the same employer. The credit to be applied against taxes should be allocated to each member company in the ratio of its increase in JTC wages to the total increases in JTC wages giving rise to the credit. For purposes of the jobs tax credit, the term 'controlled group of corporations' has the meaning given by section 1563 (a), except that the 80 percent ownership test is replaced by a 50 percent test.

Common Controlled Groups

All employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer. The credit allowable with respect to each trade or business shall be its proportionate contribution to the increase in JTC wages giving rise to such credit.

Other Special Rules

There are other special rules for the computation of the credit for companies affected by acquisitions or dispositions, for changes in business form and for companies with employees working abroad.

Planning Strategies to Best Benefit from the Credit

New Business
DT Company will begin operation on July 1, 1978. They will need thirty employees by the end of their first year of operations, but they will need at least twenty immediately. The average annual salary is $10,000 per employee.

	30 employees	20 employees
105% Limitation		
Total wages paid in1978	$150,000	$100,000
Total wages paid in 1977	-0-	- 0 -
105% x 0	-0-	- 0 -
Excess of total 1978 wages over 105% of total 1977 wages	150,000	100,000
50%	75,000	50,000
102% Limitation		
JTC wages paid in 1978	126,000	84,000
JTC wages paid in 1977	- 0 -	- 0 -
a) 102% of 1977 JTC wages	- 0 -	- 0 -
b) 50% of 1978 JTC wages	63,000	42,000
Excess of 1978 JTC wages over the greater of (a) or (b)	63,000	42,000
50%	31,500	21,000

Part-time vs. full-time employees

ABC Company has 20 employees each earning at least $4,200. The total wages paid in 1977 were $200,000, and the total wages for 1978 will be $250,000, including raises to current employees and an increase in the labor force of 2 full-time employees at $10,000 each or 4 part-time employees at $5,000 each.

If two full-time employees are hired in 1978 for $10,000 each the jobs tax credit is $3,360, but hiring four part-time employees for $5,000 each results in a tax credit of $7,560 or an additional savings of $4,200.

Hiring part-time employees rather than full-time could yield a larger credit for the same payroll costs. This is true because each extra employee increases the amount of wages that are paid within the $4,200 limit. Up to $2,100 credit per additional employee can be received if at least $4,200 is paid.

	Two Full-time Employees	Four Part-time Employees
105% Limitation		
Total wages paid in 1978	$250,000	$250,000
Total wages paid in1977	200,000	200,000
105% x $200,000	210,000	210,000
Excess of total 1978 wages over 105% of total 1977 wages	40,000	40,000
50%	20,000	20,000
102% Limitation		
JTC wages paid in 1978	92,400	100,800
JTC wages paid in 1977	84,000	84,000
a) 102% of 1977 JTC wages	85,680	85,680
b) 50% of 1978 JTC wages	46,200	50,400
Excess of 1978 JTC wages over the greater of (a) or (b)	6,720	15,120
50%	3,360	7,560
Jobs tax credit allowable	3,360	7,560

Additional 10 Percent Credit for Vocational Rehabilitation Referrals

Ten percent of the JTC wages of all newly hired handicapped individuals, who have received vocational rehabilitation, are allowable as an additional credit. This credit is limited to 20 percent of the credit determined for new jobs credit before applying the $100,000 limitation.

Only the first $4,200 in wages attributable to services rendered during the one-year period beginning with the vocational rehabilitation referral employee's first payment of wages by the employer after the beginning of such individual's rehabilitation plan are taken into account and only if such payment occurs after December 31, 1976.

"The term 'vocational rehabilitation referral' means any individual who —

(A) has a physical or mental disability which, for such individual, constitutes or results in a substantial handicap to employment, and

(B) has been referred to the employer upon completion of (or while receiving) rehabilitative services pursuant to - (i) an individualized written rehabilitation plan under a State plan for vocational rehabilitation services approved under the Rehabilitation Act of 1973, or (ii) a program of vocational rehabilitation carried out under chapter 31 of title 38, United States Code."[1]

This additional credit for hiring handicapped should make it more palatable for certain employers who are required to hire handicapped under government contracts.

Examples:

1st $4,200 wage limitation
Rehab Company hired A in November, 1977 and B in December, 1977 (both of whom were vocational rehabilitation referrals) and they were paid $1,200 and $600, respectively, in 1977 and each is to receive $7,200 in 1978. The credit against taxes would be $180 in 1977 and $660 and 1978, calculated as follows:

1977

A's wages (up to $4,200)	$1,200
B's wages (up to $4,200)	600
	1,800
	x 10%
	$ 180

A's wages (up to $4,200 paid in 1978)	
$4,200 - $1,200 (paid in 1977)	
	$3,000
B's wages (up to $4,200 paid in 1978)	
$4,200 - $600 (paid in 1977)	
	3,600
	6,600
	x 10%
	$ 660

20 percent limitation

Voca, Inc. paid $30,000 in vocational rehabilitation referral wages in 1977 (none over $4,200). Voca has also paid sufficient new wages to be entitled to a new jobs credit of $11,500. Voca's vocational rehabilitation credit would be $2,300, calculated as follows:

$30,000 x 10% =	$3,000
$11,500 x 20% =	2,300
Limitation	$2,300

If the new jobs credit had been $115,000 (before the $100,000 limitation) Voca could have been entitled to a maximum vocational rehabilitation wage credit of $23,000 ($115,000 x .20).

Jobs Credit Combined with WIN Credit

The new jobs credit can be in addition to the 20 percent WIN credit and neither credit is reduced by the other (except that the WIN credit must be applied first). As an example, an employer could hire a WIN employee and pay him, $4,500 in wages and be entitled to the following credits:

$900 WIN credit ($4,500 x 20%) and $2,100 new jobs credit ($4,200 x 50%) = total credits of $3,000.

The total after-tax cost for this new employee would be $300, assuming a 50 percent tax bracket for this employer, calculated as follows:

Wages	$4,500
Tax saving ($4,500 - $2,100) x .50	(1,200)
WIN credit	(900)
New jobs credit	(2,100)
After-tax cost	$ 300

If this new employee was also handicapped and qualifying for the vocational rehabilitation credit, the after-tax cost to hire this employee would be $90.

Wages		$4,500
Tax saving ($4,500 - $2,100) - 420) x .50		(990)
WIN credit		(900)
New jobs credit:		
Regular	$2,100	
Handicapped	420	(2,520)
After-tax cost		$ 90

Thus in this instance the employer will have only $90 additional cost by hiring this employee (this, of course, does not take into consideration the various employment taxes to be paid on these wages).

Form 5884

The Internal Revenue Service has made available form 5884 which facilitates the computation and the claiming of the new jobs credit.

Example:

XYZ Corp. paid total wages of $100,000 and $120,000 in 1976 and 1977, respectively, and JTC wages of $50,000 in 1976 and $60,000 in 1977. The company hired one vocational rehabilitation referral employee during 1977 who was paid wages of $7,000. The company's income taxes for 1977 were $19,000 after deducting investment tax credit of $1,000 and before any deduction investment tax credit of $1,000 and before any deduction for new jobs tax credit.

Conclusion

The new jobs credit should not be overlooked as a tax planning technique. The credit can be easily calculated from the employer's annual federal unemployment tax report - there is no additional record-keeping required. The credit is not recaptured if the employee is later discharged. An employer can qualify for both the WIN credit and the new jobs credit and neither credit is reduced by the other.

Timing is of the essence, there is no provision for continuing this credit for fiscal years beginning in 1979 and later. Since credits for fiscal years in 1978 are based on the JTC wages for the 1978 calendar year, it is important to start tax planning now. ■

1. Code Section 51 (f)(4), Internal Revenue Code

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