

The Application of Federal Tax Incentives Supporting the Americans with Disabilities Act

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Introduction

Congress has passed a number of laws seeking to achieve equal access to employment and market opportunities for individuals with a disability.¹ In particular, the Americans with Disabilities Act (ADA) has a broad reach across both public and private enterprises. It mandates access standards in a number of different areas: Title I) Employment, Title II) State and Local Government Activities, Title III) Public Transportation, Title IV) Public Accommodations, Title V) Telecommunications Relay Services, and Title VI) Miscellaneous. Congress recognized that this mandated approach brought with it costs to businesses.

One of the ways in which Congress seeks to mitigate the costs of these provisions and encourage achieving the objective of access is through tax provisions.² The three primary business-based tax incentives included in the Code are the following: 1) Section 190 “Expenditures to remove architectural and transportation barriers to the handicapped and elderly” (Access Deduction), 2) Section 44 “Expenditures to provide access to disabled individuals” (Access Credit), and 3) Section 51 “Work Opportunity Credit” (WOTC). These tax incentives are targeted towards the hiring of individuals with disabilities and meeting the requirements of the structural environment.

In 2002, the Government Accountability Office (GAO) produced a study entitled “Business Tax Incentives: Incentives to Employ Workers with Disabilities Receive Limited Use and Have an Uncertain Impact” that examined the use of these tax incentives. The study found that these provisions were not well understood and were not frequently utilized. A portion of the challenge was found to be the complicated nature of the requirements and the unclear situational application. One conclusion was that further education might encourage and increase use of these credits.

Since the 2002 report, there have been developments in the ADA statutory and regulatory authority related to the tax incentives. In 2004, the Access Board issued updated access guidelines (2004 ADAAG). In 2010, the Department of Justice (DOJ) issued updated government and public accommodations regulations incorporating the 2004 ADAAG building standards. These regulations also

¹ These laws include the Americans with Disabilities Act, the Telecommunications Act of 1996, the Fair Housing Act, Air Carrier Access Act, Voting Accessibility for Elderly and Handicapped Act of 1984, National Voter Registration Act of 1993, Civil Rights of Institutionalized Persons Act, Individuals with Disabilities Education Act, Rehabilitation Act, and the Architectural Barriers Act.

² The Joint Committee on Taxation gave this justification for creating the Access Credit, “The committee is concerned that the requirements contained in the Americans with Disabilities Act of 1990 may impose a severe financial burden on certain small businesses. Consequently, the committee believes that it is appropriate to provide these small businesses with a nonrefundable income tax credit for a portion of the expenditures that are incurred in complying with the requirements of the Americans with Disabilities Act of 1990.”

express the DOJ's position on the status of websites as public accommodations. In 2008, Congress passed the ADA Amendments Act of 2008 that overturned court decisions that had taken a restrictive view of the definition of disability.

The implementation of the tax incentives is directly based on the scope of the statutory and regulatory rules. Therefore, changes in these rules result in corresponding effects in the application of tax incentives. The objectives of this paper are to add to the educational resources facilitating an understanding of the tax rules and to explore the potential changes due to recent statutory and regulatory developments.

The remainder of this paper is organized as follows: 1) Explanation of the mechanics of the provisions, 2) Interaction of provisions with ADA rules and regulations, and 3) Summary and Conclusions.

Mechanics of the Tax Provisions

At its root, the federal income tax computation is taxable income multiplied by the appropriate tax rate to arrive at the total tax. Tax payments are subtracted from this amount to arrive at the amount payable to the government from the taxpayer. This structure dictates the latitude Congress has in incorporating incentive provisions into the tax code. An incentive can decrease taxable income (a deduction), decrease the tax rate (for example, the lower tax rate for long-term capital gains), or provide for a direct offset against the tax payable (a credit).

The primary disability-related tax incentives are a tax deduction and two tax credits. Both the Access Credit and the Work Opportunity Credit are aggregated with other business credits as components of the General Business Credit.

Access Deduction (Section 190)

Internal Revenue Code Section 263 provides the tax accounting rule that the default treatment of long-lived assets is to capitalize and recover the cost over time. Generally, architectural types of improvements have longer depreciable lives than equipment and software. Absent Section 190, improvements designed to make the business more accessible would be deductible over a period of years.³

Section 190 allows an immediate deduction for up to \$15,000 of qualifying expenses. The access deduction applies to businesses of all sizes; whereas, the access credit is only available to "eligible small

³ Recent stimulus provisions have increased immediate expensing options under both Section 179 and 168. However, these liberalized rules generally apply to personal property rather than real property. Section 190 affords immediate deduction for expenditures that may not qualify under these provisions.

businesses". Under the language at enactment, the term "architectural and transportation barrier removal expenses" means an expenditure for the purpose of making any facility or public transportation vehicle owned or leased by the taxpayer for use in connection with his trade or business more accessible to, and usable by, handicapped and elderly individuals." The regulations under Section 190 reflect this broad application of the term qualifying expenditure.

The primary requirement for qualifying expenditure is that it meets the requirements of the "Architectural and Transportation Barriers Compliance Board" (Reg. 1.190-1). The "Architectural and Transportation Barriers Compliance Board" was the forerunner of the current "United States Access Board" (<http://www.access-board.gov/about/history.htm> accessed September 4, 2011). Therefore, as discussed further below, modifications made by a business consistent with updated Access Board standards should qualify for the deduction.

Access Credit (Section 44)

The credit is available for "Eligible Access Expenditures"⁴ paid or incurred by an "eligible small business for the purpose of enabling such eligible small business to comply with applicable requirements under the Americans With Disabilities Act of 1990 (as in effect on the date of the enactment of this section)." An "eligible small business" is any business if gross receipts of the business for the preceding taxable year did not exceed \$1,000,000, or the business employed not more than 30 full-time employees during the preceding taxable year.

For an "eligible small business", the credit amount is 50 percent of so much of the "eligible access expenditures" for the taxable year as exceed \$250 but do not exceed \$10,250.

Ex. Joe's flower shop incurs \$20,000 in costs qualifying as "eligible access expenditures". The business is allowed a credit of \$5,000 for these expenses $((\$10,250 - \$250) * .5)$. In addition, the business can deduct \$10,000 as an access deduction $(\$15,000 - \$5,000)$. The remaining amount can be capitalized and depreciated.

⁴ **Eligible Access Expenditures:**

- (A) for the purpose of removing architectural, communication, physical, or transportation barriers which prevent a business from being accessible to, or usable by, individuals with disabilities,
- (B) to provide qualified interpreters or other effective methods of making aurally delivered materials available to individuals with hearing impairments,
- (C) to provide qualified readers, taped texts, and other effective methods of making visually delivered materials available to individuals with visual impairments,
- (D) to acquire or modify equipment or devices for individuals with disabilities, or
- (E) to provide other similar services, modifications, materials, or equipment.

As discussed further below, the linkage of Section 44 to the ADA requirements may limit its applicability; the Access Deduction is broader providing further opportunities.

Work Opportunity Tax Credit (Section 51)

The WOTC allows employers to claim up to a 40 percent credit for the “first year” of “qualified wages” for an employee hired from a targeted group. The term “first year” refers to the period beginning on the date of employment of the individual. “Qualified wages” is a very broad measure of the value of the total compensation paid to the employee.

The credit is 25% of qualified first-year wages for those employed at least 120 hours but fewer than 400 hours and 40% for those employed 400 hours or more. The amount of qualified wages is generally \$6,000. This amount differs for certain targeted groups. For instance, the amount of first year qualifying wages is \$12,000 for disabled veterans.

The WOTC targets underemployment in a number of different circumstances. For purposes of an incentive for hiring an individual with a disability, the WOTC includes disabled veterans and individuals referred to employers from a state approved vocational rehabilitation program. The employer must receive certification from the state workforce agency that the employee is an eligible individual.

Ex. Joe’s Flower Shop hires a qualifying individual with a disability on January 1, 2011. The business pays the individual \$20,000 in wages for 2011. Of the \$20,000; \$6,000 is qualifying wages for purposes of the WOTC. Therefore, the credit is \$2,400 ($\$6,000 \times .4$). The credit is in addition to the tax deduction for the wages of 20,000. Assuming the business is in the 25% marginal tax bracket, the after-tax cost of the individual’s wages is \$12,800 ($\$20,000 - \$2,400 \text{ credit} - \$5,000 \text{ value of wage deduction}$).

The WOTC is aggregated with other business credits (including the Access Credit) and is subject to the General Business Credit limit. This limit is explained in more detail below.

General Business Credit Rules

Both the Access Credit and the Work Opportunity Credit are components of the General Business Credit. The General Business Credit (GBC) rules aggregate a large number of business-related non-

refundable credits into a unified treatment.⁵ An overall limitation is applied to the use of the credits. The use of the credit is limited to the lesser of the following:

- 1) The excess of regular tax over tentative minimum tax, or
- 2) Regular tax exceeding 25% of regular tax exceeding \$25,000.

Ex. Joe's Flower Shop has a General Business Credit of \$13,000 (\$6,000 Access Credit and \$7,000 Work Opportunity Credit). The business has a regular tax liability of \$30,000; and a tentative minimum tax of \$24,000. The limitation on the use of the General Business Credit is the lesser of \$6,000 ($\$30,000 - \$24,000$) or \$28,750 ($\$30,000 - 1,250 ((\$30,000 - \$25,000)) * .25$).

Any unused GBC can be carried back one year and forward up to 20 years. This rule puts a severe restriction on the actual tax benefit from these credit provisions. The carryback and carryforward amounts are subject to the same restriction in the year to which they are carried.

Congress has "off and on" again liberalized these rules to allow for greater usage of the credits. For tax years beginning in 2010, Congress allowed taxpayers to treat the Tentative Minimum Tax as zero for purposes of this computation. The effect of this provision on the above example would be that limitation is increased from \$6,000 to \$28,750. It is uncertain if Congress will extend this provision to tax years beginning in 2011.

Tax Provision Interaction with ADA Provisions

The correspondence of the availability of the tax incentives to the ADA creates some potential "traps for the unwary" for taxpayers seeking to utilize these provisions. The discussion below will highlight some of the situations taxpayers have encountered with the IRS.

Access Credit Expenditures must be for Compliance with the ADA

The IRS has taken a fairly restrictive view of "to acquire or modify equipment or devices for individuals with disabilities". The reason for this restrictive view is the requirement that the expenditures must be for compliance with the ADA. If the taxpayer is already in compliance, even at a minimal level, the expenditures cannot be treated as qualifying for credit (Chief Counsel Advice 200411042).

In the Chief Counsel Advice (CCA) memorandum, the IRS cites a case that qualified for the credit and one that did not. In *Fan v. Commissioner*, 117 T.C. 32 the taxpayer (a dentist) claimed a credit for expenditure for a piece of sophisticated x-ray imaging equipment. A feature of the equipment was that

⁵ A "nonrefundable" credit can only be used up to the amount of the current tax liability.

it allowed for on-screen communication and highlighting of issues with patients. The doctor asserted that this capability allowed him to communicate more effectively with deaf patients. He was already using hand-written notes, as needed, with his patients. The IRS disallowed the credit stating the dentist was already in compliance the ADA via the hand-written notes. The Tax Court agreed with the IRS holding that the purchase of the equipment was not required for compliance with ADA standards.

In the second case, *Hubbard v. Commissioner*, T.C. Memo. 2003-245 the taxpayer (an optometrist) claimed a credit for an automatic refractor system. The system takes measurements of the patient's eyes and provides an estimate of the corrective prescription. This piece of equipment took the place of the manual approach of reading charts from a distance. Prior to the purchase of this equipment, the optometrist was unable to treat many disabled patients due to the physical constraints of the manual system.

The Tax Court held that the optometrist purchased the equipment to provide better access to his disabled patients and to come fully into compliance with the ADA. The fact that the equipment provided a major benefit to treating all patients was not determinative of qualification for the credit. The key difference with the *Fan* case was that the optometrist could not treat many of his disabled patients without the equipment.

These cases illustrate the importance of the "facts and circumstances" of the purchase of equipment and incurring expenditures. A business would be well served to document the need for the expenditure and how it relates to meeting the needs of patients with disabilities.

A key point raised in the cases and the CCA is the determination of the rules under the ADA. The IRS defers to the DOJ regulations regarding the requirements of the ADA. At the time of CCA 200411042, the DOJ held that the ADA only applied to a physical environment. This interpretation has evolved regarding the Internet, as discussed below.

Website as a non-physical environment

The commercial importance of the Internet was not envisioned at the time of the passage of the ADA in 1990. The growth and development has brought questions regarding the applicability of the Act to the Web. Court cases have come down on both sides of the disputes.

The IRS has followed suit with its implementation of the tax law in this area. In CCA 200411042 , the Service held that the language of the ADA referred to a physical environment. Therefore, web-based expenditures were not eligible for either the Access Credit. However, in this analysis the IRS reiterated that the DOJ promulgates the regulations interpreting the Act.

Subsequent to the writing of the CCA, the DOJ broadened its interpretation of the ADA to websites. For instance, included below is the wording from the Department's most recent regulations:

"The Department has consistently interpreted the ADA to cover Web sites that are operated by public accommodations and stated that such sites must provide their services in an accessible manner or provide an accessible alternative to the Web site that is available 24 hours a day, seven days a week. The final rule, therefore, does not impose any new obligation in this area. The accessibility of Web sites is discussed in more detail in the section entitled "Other Issues."

Based on the Department of Justice's regulations and the IRS's deferral to these rules, there is a strong argument that costs incurred to enable website accessibility qualify for the credit.

A business can access resources to assist in developing an accessible website. For instance, the Job Accommodation Network (JAN) has recently developed tips on designing an accessible website (<http://askjan.org/media/webpages.html> accessed August 26, 2011). The guidance provides self-assessment "SNAP" tools to gauge the degree of accessibility.

Department of Justice Regulations Incorporating the Access Board's 2004 Guidelines

On September 15, 2010, the Department of Justice issued new regulations relating to ADA Titles II and III (28 CFR Part 36). These regulations provide updated guidance on building accessibility standards. The major outcome of the regulations is incorporating the Access Board's 2004 ADA Accessibility Guidelines. The regulations also provide a timeline for compliance with the regulations.

The regulations provide a transition period for moving from the prior accessibility standards to the 2010 Standards (which include the 2004 guidelines). If a facility currently meets the pre-2004 accessibility guidelines, they are not required to make building modifications to reach the 2010 Standards. For new construction, and alterations prior to March 15, 2012, organizations have a choice of following the current standards or immediately adopting the 2010 Standards (Reg. 36.204(d)(2)(i)).

Implications to Tax Incentives

The 2010 facility standards will likely not have any incremental impact on the availability of the Access Credit for a business. The transition rules do not require a business to immediately upgrade spaces to the 2010 standards. Therefore, as in *Fan v. Commissioner*, existing compliance with the ADA precludes taking a credit for expenses that moves the business to a higher degree of compliance.

The regulations implementing the 2010 Standards do offer some opportunities relative to the Access Deduction. The fact that the 2010 Standards are based on the Access Board's 2004 ADAAG should qualify any voluntary expenditure consistent with these rules for the Access Deduction. The

deduction does not require the expenses be incurred to comply with the ADA, but rather that they be consistent with Access Board guidance.

Summary and Conclusion

The Access Credit, Access Deduction, and WOTC provide businesses with incentives for statutory compliance and fostering an inclusive business environment. However, as noted in the GAO's 2002 report the tax provisions are complicated and may not result in a large dollar tax benefit. This result is exacerbated when considering the value of the incentives in 2011 dollars compared to 2002 and the original value of the Access Credit in 1991.

Even with the restrictions on benefit, there are some opportunities to keep in mind. The Access Deduction is broader in implementation for barrier removal than the Access Credit. The Access Credit requires a barrier removal expenditure be for compliance with the ADA. The Access Deduction does not have this restriction. However, the Access Credit is available for a wider range of compliance expenditures (communication devices, etc.). It also appears that the DOJ's position on website provides an opportunity for businesses to upgrade their website in a way that qualifies for the Access Credit.

The WOTC provides a strong benefit for hiring individuals with disabilities as well as individuals from other eligible groups. The WOTC is calculated on a per individual basis. Therefore, the total potential credit can be quite large. However, the General Business Credit provisions can put a cap on the amount of credit allowed for the year.

Due to the dollar amount and the potential caps, the most likely businesses to make use of the incentives are those in the small- to medium-size category. These organizations can take some steps utilize the tax incentives such as website design, barrier removal, and hiring individuals qualifying for the WOTC.