HIRE Act to Help California Businesses

Phillip L. Jelsma
Partner
858.720.6333
pjelsma@luce.com
www.luce.com/phillipjelsma

On March 18, 2010, President Obama signed into law the Hiring Incentives to Restore Employment Act of 2010 to help businesses hire and retain new employees. The Act features a $13 billion tax credit to encourage businesses to hire workers who have been unemployed for at least 60 days, and an extension of increased expensing limits for small businesses.

Incentives for Hiring and Retaining Unemployed Workers.

To encourage employers to hire new employees in 2010, the Act combines Social Security tax forgiveness for newly added employees and a tax credit for retaining those employees for at least 52 consecutive weeks.

Payroll Tax Forgiveness.

The 2010 Hire Act effectively exempts a qualified employer from paying the 6.2% OASDI Social Security tax for wages paid for any 2010 period beginning after March 18, 2010 (the date of enactment) through December 31, 2010, for new employees if certain conditions are met. To qualify for the exemption, each employee must be a "qualified individual." A qualified individual is an employee: (1) who begins work for a qualified employer after February 3, 2010, and before January 1, 2011; (2) who has not been employed for more than 40 hours during the 60-day period ending on the date employment begins; (3) is not employed to replace another employee of the employer unless the other employee separated from employment voluntarily or for cause; and (4) cannot be related to the employer or own more than 50% of the business. Generally, a "qualified employer" is any business, other than a governmental entity.

A qualified employer may elect not to apply the payroll tax forgiveness. Note that a qualified employer may not claim the work opportunity tax credit on any wages paid to a qualified individual during the 1-year period beginning on the hiring date of the employee if those wages qualify the employer for payroll tax forgiveness, unless the employer opts out of payroll tax forgiveness as to that employee.

The reduction in taxes due for wages paid in the first calendar quarter of 2010 is treated as a payment against the second 2010 calendar quarter taxes otherwise due.

Business Credit Increase for Retention of Newly Hired Individuals in 2010.

The 2010 HIRE Act allows taxpayers to increase their business credit by the lesser of $1,000 or 6.2% of wages for a 52-week period for each retained worker that satisfies a minimum employment period. A retained worker is defined the same as a "qualified individual" for purposes of the payroll tax forgiveness provision, which is discussed above. In addition, the worker must be employed by the employer for at least 52 consecutive weeks, and receive wages for the last 26 weeks of the 52-week period that are at least 80% of the wages paid during the first 26 weeks.

This increase to the business credit is effective for new hires beginning on March 18, 2010, and cannot be carried back to a taxable year that began prior to this effective date. Note that employers can claim both the work opportunity tax credit and the retention credit on the same qualified employee.

Election to Expense Depreciable Business Assets.

The Act extends the higher $250,000 limit for small business expensing for another year. The $250,000 amount applies to the cost of depreciable tangible personal property purchased for use in the active conduct of a trade or business (including off-the-shelf computer software placed in service before 2011) for taxable years beginning in 2010. The maximum amount that the taxpayer may deduct is increased from $125,000 to $250,000. This $250,000 amount is reduced, however, by the amount by which the cost of the qualifying property placed in service during 2010 exceeds $800,000. Note that the deduction amount continues to be limited to the taxpayer's taxable income derived from the active conduct of the trade or business. Any amount that exceeds the taxable income limitation may be carried forward to succeeding taxable years.

Corporate Estimated Taxes.

To help pay for the legislation, the Act increases the required corporate estimated tax payment for large corporations (those with assets exceeding $1 billion) due in July, August or September 2014 to 124.75% of the estimated tax payment otherwise due. Payments due in July, August or September 2015 must be 121.5% of the payment otherwise required. Payments due in July, August or September 2019 must be 106.5% of the payment otherwise required. For the 2015 and 2019 payments, a corporation's next required installment is correspondingly decreased.

Mandatory Withholding on Foreign Accounts.

Effective January 1, 2013, a U.S. entity that makes virtually any type of payment to a foreign financial institution will be required to withhold and remit 30% of the payment to the IRS. The types of payments subject to this requirement include interest, dividends, royalties, premiums, annuities, wages, and proceeds from the sale of property that can produce interest or dividends. The recipient foreign financial institution may avoid this 30% withholding by entering into an agreement with the IRS to identify all its account holders who are U.S. taxpayers and providing such identifying information to the IRS.

The delayed effective date is designed to give the IRS sufficient time to establish a program under which foreign financial institutions may enter into agreements to avoid the 30% withholding. You should begin to contact any foreign financial institutions with which you do business, to determine whether they intend to enter into an agreement with the IRS, or if it will be necessary for you to withhold on payments made to them.

Repeal of Foreign Exceptions to Registered Bond Requirement.

In 1982, the United States curtailed the use of "bearer" (i.e., unregistered) bonds by U.S. taxpayers, because they could be too easily used for tax evasion purposes. An exception was made for certain bonds held by non-U.S. taxpayers, but the IRS found that this exception was also subject to abuse. As a result, the Act denies an interest deduction for interest paid on any unregistered bond, effective for bonds issued after the date that is two years after the date of enactment.

Disclosure of Foreign Financial Accounts.

The Bank Secrecy Act requires that U.S. taxpayers file an annual report with the U.S. Treasury of any foreign financial accounts with an aggregate value of more than $10,000 at any time during the year. This is commonly known as the "FBAR" requirement. The Act, for the first time, makes this requirement part of the Internal Revenue Code, thereby transferring to the IRS the authority to both interpret and enforce this provision. The Act provision differs from the Bank Secrecy Act in that it applies the reporting requirements only if the account value exceeds $50,000; it remains to be seen how the IRS integrate this with the Treasury reporting requirement, which will continue to have a $10,000 threshold.

HIRE Act to Help California Businesses

Penalties for Failure to Disclose Foreign Accounts.

In addition to the new reporting requirements, the Act imposes new penalties for both the failure to disclose a foreign financial account and for any understatement of tax that results from an undisclosed foreign financial account. These penalties will make it very costly for taxpayers who attempt to conceal income generated by foreign accounts.

Extended Statute of Limitations for Undisclosed Foreign Accounts.

The IRS normally has three years in which to audit a tax return after it has been filed. The Act extends that period to six years in the case of certain unreported income from a foreign financial account.

Increased PFIC Reporting.

The Act imposes new reporting requirements for passive foreign investment companies (PFICs). A PFIC is a foreign corporation that generates passive income, i.e., interest and/or dividends, and is often used as an investment vehicle. Foreign hedge funds are usually PFICs. The government is concerned that U.S. taxpayers are not properly reporting their PFIC income, and the Act requires that U.S. shareholders in PFICs file an annual report with the IRS.

Electronic Reporting.

The Act authorizes the IRS to impose electronic reporting requirements on financial institutions that are withholding agents, even if the institution files less than 250 information returns (the current threshold). This provision is designed to better capture information from institutions that currently do not file electronically.

Foreign Trust Enforcement.

Due to concerns that U.S. taxpayers are using foreign trusts to avoid U.S. tax, the Act makes a number of changes in the rules governing foreign trusts. Under prior law, a foreign trust was subject to U.S. tax if it was established by a U.S. taxpayer and it had a U.S. beneficiary. The Act expands the classes of persons considered trust grantors and beneficiaries, thereby bringing more foreign trusts under U.S. tax jurisdiction.

The Act also requires that any person who is taxable as the owner of a foreign trust must provide such information about the trust as the IRS may require. It backs up this requirement with stiff new penalties.

Taxation of Dividend Equivalents.

Dividends paid by U.S. corporations to foreign individuals and entities are generally subject to a 30% withholding tax, although that tax rate is usually reduced by an applicable tax treaty between the U.S. and the resident country of the recipient. Foreign shareholders have attempted to avoid the withholding tax by taking “dividend equivalents,” such as securities lending transactions, sales-repurchase agreements, or notional principal contracts, in lieu of actual dividends. The Act makes it clear that such dividend equivalents are to be treated as U.S.-source dividends for tax purposes.

If you would like additional information about the Act, please contact Phil Jelsma at 619.699.2565 or pjelsma@luce.com.