PUBLICATION

Obama's HIRE Act -- Explaining The Tax Provisions

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President Obama signed the Hiring Incentives to Restore Employment Act (the HIRE Act) on March 18, 2010. The HIRE Act provides $18.6 billion in tax provisions including $13 billion in tax breaks for hiring and retaining qualified workers. Additionally, the HIRE Act increases the expensing limitations under Section 179 of the Code for 2010 and expands the Build America Bonds program. Congress offset the costs of these tax benefits by increasing the disclosure and withholding requirements for certain foreign accounts and assets, increasing certain estimated tax payments for large corporations, and delaying the implementation of a law intended to help multinational taxpayers avoid double taxation on interest income. This Alert summarizes many of the tax provisions in the HIRE Act.

I. Tax Benefits

A. Hiring Incentives. The HIRE Act contains two hiring incentives. The first incentive is in the form of a payroll tax exemption and the second incentive is an increased business tax credit.

1. Payroll Tax Exemption. The HIRE Act amends Section 3111 of the Internal Revenue Code (Code) by adding a payroll tax exemption for certain qualified individuals. Specifically, the HIRE Act exempts private sector employers from having to pay the employer's share of Social Security payroll tax with respect to the wages of each qualified individual from March 19, 2010 through December 31, 2010.

For purposes of the HIRE Act, a qualified individual is any person who (1) begins work for the employer after February 3, 2010, and before January 1, 2011, (2) certifies by signed affidavit, under penalties of perjury, that such person has not been employed for more than 40 hours during the 60 day period ending on the date the employment begins, (3) is not employed to replace another employee of such employer unless such other employee separated from employment voluntarily or for cause, and (d) is not a related party to the employer pursuant to Section 51(i)(1) of the Code.

The HIRE Act also contains a prohibition preventing an employer from "double dipping" by receiving the work opportunity tax credit pursuant to Section 51 of the Code on any wages that qualify for the payroll tax exemption. An employer may, however, still receive the work opportunity tax credit pursuant to Section 51 of the Code on any wages that would qualify for the payroll tax exemption by electing not to have the payroll tax exemption apply to that individual.

2. Increased Business Tax Credit. The HIRE Act increases an employer's general business tax credit by the lesser of (1) $1,000, or (2) 6.2% of the wages (as defined in Section 3401(a) of the Code) paid by the employer to each retained worker during the 52 week period after the retained workers hire date. For purposes of the HIRE Act, a retained worker is any qualified individual (as defined above with respect to the payroll tax exemption provision of the HIRE Act) who (1) is employed by the employer on any date during the taxable year, (2) who was employed by the employer for at least 52 consecutive weeks, and (3) whose wages (as defined in Section 3401(a) of the Code) during the last 26 weeks of such period are at least 80% of the wages for the first 26 weeks of such period.

The HIRE Act does not allow the increased business tax credit to be carried back to a prior taxable year.

B. Section 179 Expensing. For taxable years beginning in 2010, the HIRE Act amends Section 179 of the Code by increasing the expense limitation for qualified property placed in service for the taxable year from $125,000 to $250,000. The HIRE Act also increases the phase-out from $500,000 of qualifying property placed in service in the taxable year to $800,000.

C. Expansion of Build America Bonds Program. The HIRE Act allows issuers of certain bonds issued after March 18, 2010 to make an irrevocable election on or before the issue date to receive a refundable credit under Section 6431 of the Code in lieu of providing a tax credit to the holder. The refundable credit is limited to the lesser of (1) the amount of interest payable under such bond on such date, or (2) the amount of interest which would have been payable under such bond on such date if such interest were determined under Section 54A(b)(3) of the Code.

Bonds qualifying for this credit include (1) new clean renewable energy bonds, (2) qualified energy conservation bonds, (3) qualified zone academy bonds issued after October 3, 2008, and (4) qualified school construction bonds.

II. Revenue Provisions

Congress included a number of revenue provisions in the HIRE Act to offset the cost of its tax benefits and spending provisions. The HIRE Act's revenue provisions include new requirements designed to hinder the ability of U.S. taxpayers to use foreign accounts to shelter income from U.S. tax. The HIRE Act also increases certain estimated tax payments for large corporations and further delays the implementation of a law intended to help multinational taxpayers avoid double taxation on interest income.

A. Foreign Financial Institution and Account Reporting Compliance Procedures. As we explained in our August 5, 2009 alert, the U.S. government has aggressively pursued efforts to collect financial information about foreign accounts owned by U.S. taxpayers in recent years. The HIRE Act continues these efforts, imposing new penalties on foreign financial institutions, trusts, and corporations that refuse to share information with the IRS and expanding the requirements for disclosure of foreign accounts on U.S. tax returns.

1. Withholding Tax on Payments to Foreign Financial Institutions, Trusts and Corporations. Effective January 1, 2013, the HIRE Act essentially forces foreign financial institutions, trusts, and corporations to choose between either agreeing to provide the IRS with information about their U.S. account holders, grantors and owners, or subjecting themselves to a 30% withholding tax on almost any payment they receive from a U.S. payor. The rules applicable to foreign financial institutions differ from those that apply to foreign trusts and corporations.

Foreign Financial Institutions. The HIRE Act creates Chapter 4 (Taxes to Enforce Reporting on Certain Foreign Accounts) under Subtitle A of the Internal Revenue Code, specifically Code Sections 1471-1474. These provisions require withholding agents to deduct and withhold 30% of any withholdable payments made to a foreign financial institution (FFI), which includes foreign banks and most foreign securities firms and investment funds, unless the FFI enters an agreement with the IRS requiring the FFI to provide information about United States accounts and serve as a withholding agent for certain payments passing through the FFI.

"United States accounts" are financial account held by one or more "specified United States persons" or "United States owned foreign entities." A "specified United States person" means any United States person other than a corporation whose stock is regularly traded on an established securities market or a member of an expanded affiliated group of such a corporation, a tax-exempt organization under Code Section 501(a) or an individual retirement plan, the U.S. government or a U.S. agency, a state or local government or agency, a bank, a REIT, a regulated investment company, a common trust fund or a charitable trust.

A "United States owned foreign entity" means any foreign entity that has one or more substantial U.S. owners. A substantial U.S. owner is a specified United States person that owns, directly or indirectly, more than 10 percent of the stock of a corporation (by vote or value), more than 10 percent of the profits interests or capital interests in a partnership, or is treated as an owner of any portion of a trust under the grantor trust rules or holds, directly or indirectly, more than 10 percent of the beneficial interests of a trust.

A "withholdable payment" is generally defined as a U.S.-sourced payment of fixed or determinable annual or periodical (FDAP) income that is not effectively connected with a U.S. trade or business, which includes most U.S. source interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments and other fixed or determinable annual or periodical gains, profits and income. It also includes gross proceeds from the sale of property that is of a type that can produce U.S.-source dividends or interest, such as stock or bonds issued by a U.S. corporation.

In general, "withholdable payments" to an FFI are subject to the 30% withholding tax unless the FFI enters into an agreement with the Treasury Secretary requiring the FFI to:

- Obtain sufficient information from every holder of every account maintained by the FFI to determine whether the account is a United States account.
- Comply with the verification and due diligence procedures that the IRS and U.S. Treasury may require regarding identification of United States accounts.
- Provide annual reports on each United States account maintained by the FFI, which must include:
  - The name, address, and TIN of each account holder which is a specified U.S. person and, in the case of any account holder which is a U.S.-owned foreign entity, the name, address, and TIN of each substantial U.S. owner of such entity;
  - The account number;
  - The account balance or value; and
  - Except as provided by the Treasury Secretary, the gross receipts and gross withdrawals or payments from the account.
- Deduct and withhold a tax equal to 30% of any "passthru" payment by the FFI to either a "recalcitrant account holder," which is a U.S. account holder who withholds information from the FFI, or another FFI that does not meet the requirements necessary to avoid the 30% withholding tax.
- Comply with requests by the Treasury Secretary for additional information about any United States account held by the FFI.
- If foreign law would prevent the required reporting on United States accounts, attempt to get a valid waiver, if one is available under the applicable foreign law, from the account holder, and close the account if a waiver is not obtained within a reasonable period of time.

Certain alternatives are available to FFI's instead of entering into an agreement with the Treasury Secretary. For example, the FFI will generally meet the requirements and will not be subject to 30% withholding under the HIRE Act if the FFI complies with IRS procedures which ensure that it does not maintain U.S. accounts. In addition, an FFI can elect to be subject to the same reporting requirement as a U.S. financial institution if the FFI is a U.S. person and each U.S. account holder is a specified U.S. person or U.S. owned foreign entity that is a natural person and a U.S. citizen. Finally, an FFI can elect to have a U.S. withholding agent or another participating FFI withhold 30% of payments made to the electing FFI, but the electing FFI must waive its rights under any U.S. treaty and thus is ineligible for lower treaty rates, agree to notify the withholding agent regarding each payment that is covered under its agreement with the Treasury Secretary, and provide the information required to determine the amount to be deducted.

Foreign Entities that are not Foreign Financial Institutions. The new Code Section 1472 also requires 30% withholding on withholdable payments made to nonfinancial foreign entities, unless the withholding agent is provided with certification either (1) that the foreign entity has no substantial U.S. owners or (2) that identifies the name, address, and TIN of each substantial U.S. owner.

Payments to corporations whose stock is regularly traded on an established securities market or of an expanded affiliated group of such corporations, to entities organized under the laws of a U.S. possession and owned entirely by bona fide residents of that U.S. possession, to foreign governments and central banks, and to international organizations are not subject to 30% withholding under Code Section 1472.

2. Required Disclosure by Individuals of Foreign Financial Accounts, Increased Penalties, and Extension of Statute of Limitations. The HIRE Act requires individual taxpayers who have an interest in a "specified foreign financial asset" to attach a statement to their income tax return if the aggregate value of all such assets during any year is greater than $50,000. "Specified foreign financial assets" include depository and custodial accounts at foreign financial institutions, stock or securities issued by foreign persons, any other financial instrument or contract held for investment that is issued by or has a counterparty that is not a U.S. person, and any interest in a foreign entity. These disclosure requirements do not replace the disclosure requirements for interests in, or signature authority over, a financial account in a foreign country containing more than $10,000 on a Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, commonly known as an FBAR).

Required Disclosure. The taxpayer must disclose:

- In the case of any account, the name and address of the financial institution in which such account is maintained and the number of such account.
- In the case of any stock or security, the name and address of the issuer and such information as is necessary to identify the class or issue of which such stock or security is a part.
- In the case of any other instrument, contract, or interest, such information as is necessary to identify such instrument, contract, or interest, and the names and addresses of all issuers and counterparties with respect to such instrument, contract or interest.
- The maximum value of the asset during the taxable year.

Penalties. There are new penalties for both the failure to disclose a foreign financial account and for understatements of tax attributable to undisclosed foreign financial assets.

The HIRE Act imposes a $10,000 penalty for failure to furnish the required information when due. If the taxpayer fails to correct such failure for more than 90 days after receiving notice of the failure, an additional $10,000 penalty is imposed for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period following the notice, up to a maximum penalty of $50,000.

In addition, the HIRE Act increases the penalty on of any portion of an underpayment of tax that is attributable to any undisclosed foreign financial asset understatement from 20% of the understatement to 40% of the understatement.

Extended Statute of Limitations for Undisclosed Foreign Accounts. The HIRE Act extends the statute of limitations for audits of certain unreported income from a foreign financial account from three years to six years.

3. Repeal of Foreign Exceptions to Registered Bond Requirement. The HIRE Act denies an interest deduction for interest on any unregistered bond (typically these will be bearer bonds), effective for bonds issued after second anniversary of the date of enactment.

4. PFIC Reporting. In addition to the reporting already required from shareholders of a passive foreign investment company (PFIC), effective as of March 18, 2010 the HIRE Act requires that each United States person who is a shareholder of a PFIC file an annual report containing such information as the Secretary may require. A foreign corporation that generates passive income (typically interest and/or dividends) is classified as a PFIC if (a) 75% or more of the corporation's gross income is passive income for purposes of the CFC rules or (b) 50% or more of the average value of the corporation's assets produce, or are held for the production of, passive income.

5. Electronic Reporting by Financial Institution Withholding Agents. The HIRE 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).

6. Foreign Trust Changes. The HIRE Act makes a number of changes in the rules governing foreign trusts. A transferor to a foreign trust that has a U.S. beneficiary is treated as owner for U.S. tax purposes of the portion of the trust payable to or accumulated for the benefit of a U.S. beneficiary. The HIRE Act provides that an amount is treated as being accumulated for the benefit of a U.S. beneficiary even if the U.S. person is only a contingent beneficiary or if any person has the discretion to distribute from the trust to any person unless the trust specifically identifies the class of permitted beneficiaries and none of the members of the class are U.S. persons.

Loans to a U.S. person or allowing a U.S. person to use trust property are also treated as payments to or accumulations for the benefit of a U.S. person unless the U.S. person repays the loan at a market rate of interest within a reasonable period of time or pays fair market value for the use of the property.

The HIRE 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. Penalties for failure to comply with the foreign trust reporting requirements were also increased, effective for returns required to be filed after December 31, 2009.

7. Taxation of Dividend Equivalents. The HIRE Act provides that dividend equivalents used in lieu of dividends to avoid 30% withholding on FDAP income, such as securities lending transactions, sales-repurchase agreements, and notional principal contracts, are treated as U.S.-source dividends for U.S. tax purposes.

B. Other Revenue Offsets.

1. Delay in Application of Worldwide Allocation of Interest. In 2004, Congress modified the interest expense allocation and apportionment rules for affiliated groups to allow a worldwide affiliated group to determine the foreign source income of the group by allocating and apportioning interest expense on a worldwide basis for domestic members of the group and controlled foreign corporations in the group as if they were a single corporation. The worldwide interest allocation rules were previously scheduled to take effect for tax years beginning after December 31, 2010. In 2009, Congress delayed their implementation for seven more years, until tax years beginning after December 31, 2017. The HIRE Act further delays their implementation until tax years beginning after December 31, 2020.

2. Increased Quarterly Estimated Tax Payments For Large Corporations in 2014, 2015 and 2019. Corporations are generally required to make quarterly estimated tax payments. In 2009, Congress increased the estimated payment due from large corporations (those with assets of $1 billion or greater as determined at the end of the preceding tax year) in July, August or September of 2014 to 100.25% of the tax otherwise due. In 2009, Congress increased the estimated payments due from large corporations in July, August or September of 2014 by an additional 33 percentage points. The HIRE Act increases the estimated payments due from large corporations in July, August or September of 2014 by an additional 23 percentage points, resulting in estimated tax payments for large corporations for that period of 57.75% more than they would have otherwise paid. The HIRE Act also provides for similar increases in the amount of any required installment of corporate estimated tax which is otherwise due in July, August, or September of 2015 to 121.5% of such amount, and in July, August or September of 2019 to 106.5% of such amount. In each case, the next quarterly estimated tax payment will be reduced to reflect the increased payment.

Should you have any questions or otherwise wish to discuss any tax provisions in the HIRE Act, please contact any attorney in the Firm's Tax Department.