



Onshore jobs,
offshore compliance
Tax provisions in the
Hiring Incentives to
Restore Employment Act

Overview

President Obama on March 18, 2010, signed into law the Hiring Incentives to Restore Employment (HIRE) Act, a \$17.6 billion jobs-creation package that provides a payroll tax holiday for employers who hire displaced workers, boosts the current-year general business credit for employers who retain those workers, extends the increased small-business expensing limits under section 179, and expands the Build America Bonds program.

To pay for this tax relief, the HIRE Act imposes new information reporting requirements, withholding requirements, and penalties to curb abuses of offshore financial accounts. It also delays the effective date of the worldwide interest allocation election until 2021, and modifies certain required estimated tax payments for corporations with assets of \$1 billion or more.

This publication examines the tax provisions in the legislation and their tax planning implications for businesses and individuals.

Employment tax relief & business retention credit

In an effort to promote job creation and sustained employment, the HIRE Act provides employers with incentives for hiring and retaining workers.

Payroll tax forgiveness

The Act exempts from the employer share of OASDI tax those wages paid by employers to qualified individuals beginning after the date of enactment and ending on December 31, 2010. Qualified employers do not include federal, state, or local government employers, but do include tax-exempt organizations under section 501(a), as long as the employee's services are made in furtherance of activities related to the organization's exempt purpose. A qualified employer also generally includes a public institution of higher education.

This incentive would be available to qualified employers hiring individuals who:

- Begin employment after February 3, 2010, and before January 1, 2011;

- Certify by signed affidavit that they were employed for no more than 40 hours during the 60-day period ending on the date they begin the new employment;
- Are not employed to replace another employee for reasons other than voluntary or for-cause termination; and
- Are not related to the employer.

Under a special rule, any amount that would have been provided to the employer as a result of the exemption during the first quarter of 2010 will be credited against the employer's payroll tax liability for the second quarter of 2010. This is intended to give payroll tax administrators and software vendors time to alter their payroll software.

Employers who elect the payroll tax forgiveness and who also are eligible for the Work Opportunity Tax Credit (WOTC) must forgo the WOTC on any wages paid during the one-year period beginning on the employee's hiring date. Employers may elect not to have the payroll tax forgiveness apply.

The Act also includes similar exemption provisions that apply to Railroad Retirement taxes.

Business retention credit

The Act increases the general business credit under section 38(b) by the lesser of \$1,000 or 6.2 percent of the wages paid by the employer over 52 consecutive weeks for each worker that qualifies for the payroll tax exemption and:

- Is employed on any date during the taxable year;
- Is employed for at least 52 consecutive weeks; and
- Is paid wages during the last 26 weeks of that 52-week period equal to at least 80 percent of wages for the first 26 weeks of the period.

Like other general business credits, this retention credit can be carried forward 20 years, but may not be carried back to a taxable year that begins before the date of enactment.

U.S. possessions

The Act instructs the Treasury Department to compensate possessions of the United States (for example, the Commonwealths of Puerto Rico and the Northern Mariana Islands) that have mirror tax systems for any amounts lost by reason of this provision.

For possessions that do not have a mirror tax system, Treasury will estimate the amounts lost and provide compensation equal to an amount determined as if the possession had a mirror tax code in place. In order to receive the compensation, a possession must have a plan, approved by Treasury, under which the possession will promptly distribute the payments.

To coordinate payments received by possessions with other possible credits allowed against U.S. income taxes, the Act prevents an employer from taking advantage of the increased business credit if that employer: (1) also qualifies for a credit against taxes imposed by the possession or (2) is eligible for a payment made to possessions without mirror tax systems.

Extension of enhanced small business expensing (section 179)

The Act extends through 2010 the increased section 179 expensing limit of \$250,000 and investment phase-out of \$800,000 originally enacted in the Economic Stimulus Act of 2008.

Election to convert tax credit bonds to Build America Bonds

The HIRE Act expands on a provision in the American Recovery and Reinvestment Act of 2009 (ARRA) that provides tax credit bonds to qualifying issuers for certain school and energy projects. Tax credit bonds provide the bond holder a federal tax credit in lieu of interest. Build America Bonds, as enacted in the ARRA, provide qualifying issuers a direct payment from the Treasury for a portion of the interest paid on the bond for government works projects.

The HIRE Act allows qualifying issuers of the following tax credit bonds the option of issuing tax credit bonds under current law, or utilizing the direct-subsidy Build America Bond structure for bonds issued after the date of enactment:

- Qualified School Construction Bonds (QSCBs);
- Qualified Zone Academy Bonds (QZABs);
- Clean Renewable Energy Bonds (CREBs); and
- Qualified Energy Conservation Bonds (QECBs).

For QSCBs and QZABs, the direct payment is equal to the lesser of: (1) the interest paid by the issuer on each interest payment date or (2) the amount of interest that would have been payable had the issuer selected the tax credit option and the interest was determined using the applicable rate of the tax credit.

For new CREBs and QECBs, the direct payment is equal to the lesser of: (1) the interest paid by the issuer on each interest payment date, or (2) 70 percent of the amount of interest that would have been payable had the issuer selected the tax credit option and the interest was determined using the applicable rate of the tax credit.

Observation: This provision will help governmental entities and other qualified tax credit bond issuers raise capital from tax-insensitive bond investors (e.g., banks, insurance companies, and other corporate investors with net operating losses) by offering higher yields but at a lower cost of borrowing because a portion or all of the yield on these bonds will be subsidized directly by the federal government.



Foreign account compliance

On the revenue side, the HIRE Act raises an estimated \$8.7 billion over 10 years through a number of provisions designed to address perceived “tax haven” abuses by U.S. individuals with foreign accounts. These provisions are based on the Foreign Account Tax Compliance Act introduced in October 2009 by then-House Ways and Means Committee Chairman Charles Rangel, D-N.Y., and Senate Finance Committee Chairman Max Baucus, D-Mont.

Reporting certain foreign accounts

The Act adds several new code sections devoted to the enforcement of information reporting. New chapter 4 of the Internal Revenue Code provides for information reporting by third parties of certain U.S. accounts held in foreign financial institutions (FFIs), which include virtually all foreign investment vehicles. Information reporting is enforced through the withholding of tax on payments to FFIs unless the FFI enters into and complies with an information reporting agreement with Treasury. New chapter 4 generally applies to payments made after December 31, 2012, but “obligations” that are outstanding on the date which is two years after the date of enactment are grandfathered and not subject to withholding.

Not all U.S. account holders in FFIs are subject to information reporting. Generally, U.S. individuals and privately held U.S. taxable entities will be subject to information reporting by FFIs, while U.S. tax-exempt entities, certain regulated entities, and publicly held corporations and affiliates will be excluded.

Observation: All foreign investment vehicles that receive, directly or indirectly, any U.S.-source income, including sales proceeds, will be affected by chapter 4. The definition of FFI is quite broad, and appears to include virtually all foreign investment vehicles regardless of whether they are offered or traded publicly. Moreover, because there is no de minimis rule for foreign investment vehicles, FFIs can include small family-owned and -managed funds as well as large professionally managed hedge funds and private equity funds. In addition, it should be noted that FFIs that have entered into qualified intermediary (QI) or similar agreements with the U.S. Treasury under section 1441 are still required to meet the requirements of section 1471 in addition to any other requirements imposed under the QI or similar agreement. The complexity of chapter 4 and its compliance burden will be significant and ongoing.

The agreement would require the financial institution to obtain information from account holders to determine which accounts are U.S. accounts and to comply with verification and due diligence procedures issued by Treasury on how to identify those accounts. The Treasury will need to clarify the standards for determining the U.S. status of financial accounts. The agreement also would require institutions to request waivers from account holders of any applicable foreign secrecy law and to close any account for which the holder refuses to provide such a waiver. Reporting would not be required for account holders that are public corporations, tax-exempt organizations, banks, real estate investment trusts, or regulated investment companies.

Information required to be reported annually includes the name, address, taxpayer identification number (TIN), account number, and the account balance or value for specified U.S. persons and U.S.-owned foreign entities. The bill defines a U.S.-owned foreign entity as any foreign entity having at least one substantial U.S. owner. A substantial U.S. owner is a specified U.S. person that owns more than 10 percent of the vote or value of stock in a corporation or more than 10 percent of the profits or capital interest of a partnership. However, that 10 percent threshold is reduced to zero for foreign corporations or partnerships that engage primarily in investing or trading activities, so that any ownership by a specified U.S. person would cause the foreign entity to be a U.S. account and subject to an annual reporting to Treasury of its substantial U.S. owners.

Under a separate but related provision in chapter 4, a withholding agent is required to deduct and withhold a tax equal to 30 percent of any withholdable payment made to a nonfinancial foreign entity (NFFE) if the beneficial owner of such payment is a nonfinancial foreign entity that does not meet certain requirements. An NFFE is any foreign entity that is not a financial institution.

Payments made to an NFFE will not be subject to the imposition of 30 percent withholding tax if the payee or the beneficial owner of the payment provides the withholding agent with either a certification that the foreign entity does not have a substantial U.S. owner, or provides the withholding agent with the name, address, and TIN of each substantial U.S. owner. Additionally, the withholding agent must not know or have reason to know that the certification or information provided regarding substantial U.S. owners is incorrect, and the withholding agent must report the name, address, and TIN of each substantial U.S. owner to the Treasury.

U.S. persons who are not specified U.S. persons would not be subject to reporting to the Treasury. Generally, the result is that U.S. individuals and privately held U.S. taxable entities will be subject to information reporting by NFFEs, while U.S. tax-exempt entities, certain regulated entities, and publicly held corporations and affiliates will be excluded. There are additional exceptions for certain entities.

Observation: There should be coordinating rules for application of the withholding provisions applicable to FFIs and to foreign entities that are NFFEs. It is possible, for example, that a wholly-owned foreign entity which itself is only a holding company for a single stock or partnership interest could be either an FFI or an NFFE. While it might not be treated as engaged in the business of investing or trading, it could be treated as holding financial assets – although that term is not defined in chapter 4 – and therefore a “financial institution.” Alternatively, if it is not a “financial institution” but is a foreign entity, then it would be treated as an NFFE. The determination would be important for both the foreign entity and the withholding agent since the requirements are different.

Withholding would not be required for income connected with U.S. business and taken into account under sections 871(b)(1) or 882(a)(1).

These provisions are effective for payments made after December 31, 2012, but “obligations” that are outstanding on the date which is two years after the date of enactment are grandfathered and not subject to withholding.

Nonregistered bonds

The Act amends section 163(f) to remove the foreign targeted obligation exception on the denial of deductions for interest on bonds not issued in registered form. It also repeals portfolio interest treatment for nonregistered foreign targeted bonds under section 871(h). These provisions are effective for obligations issued two years after the date of enactment.

Individual reporting requirement

Under a new section 6038D, an individual holding an interest in a foreign financial asset in any taxable year is required to attach a disclosure statement to his or her tax return for that year if the aggregate value of all such assets exceeds \$50,000. Applicable assets include financial accounts, foreign stock and securities, interests in foreign entities, and other financial instruments and contracts.

Failure to disclose for any taxable year would subject the individual to a \$10,000 penalty. If the individual were to continue such failure after notification by the Secretary, an additional \$10,000 penalty would apply for each 30-day period following the 90-day period after the Secretary mails the notice. The “continuation” penalty is capped at \$50,000. A penalty exception applies for reasonable cause.

Any entity “formed or availed of for purposes of holding” such assets is treated as if the entity were an individual.

These requirements are effective for taxable years beginning after the date of enactment.

Penalties

The HIRE Act amends section 6662 to make the underpayment penalty applicable to understatements attributable to undisclosed foreign financial assets. For such understatements, the penalty imposed by section 6662 is 40 percent, rather than 20 percent. The Act also extends the statute of limitations on assessments to six years for significant omissions of income attributable to foreign financial assets.

PFICs and trusts

The Act requires any person who is a shareholder of a passive foreign investment company (PFIC) to file an annual return, regardless of whether the shareholder has income or a gain from the sale of PFIC stock.

Section 679 is amended to provide that a trust would be treated as having a U.S. beneficiary even if the U.S. person's interest is contingent. A trust also would be treated as having a U.S. beneficiary if any person has the discretion to determine beneficiaries, unless the trust identifies the class of persons to whom distributions may be made and none of those persons are U.S. persons. If a U.S. person transfers property to a foreign trust, there would be a presumption that a foreign trust has a U.S. beneficiary unless the person discloses all required information and satisfies other requirements of section 679.

The penalty under section 6677 for failure to report foreign trusts also is amended to impose a minimum \$10,000 penalty for failing to file the required information return.

Dividend equivalent payments

In addition, the legislation defines dividends to include substitute dividends, dividend equivalent payments made pursuant to specified notional principal contracts, and similar payments, and requires withholding to the extent the dividend on property underlying the contract is from U.S. sources. This provision is effective 180 days after enactment.

Worldwide interest allocation election

The HIRE Act delays the effective date of the worldwide interest allocation election until tax years beginning after December 31, 2020. This provision is estimated to raise \$9.9 billion over 10 years.

The election, which was enacted as part of the American Jobs Creation Act of 2004 (AJCA), would permit taxpayers to take advantage of a liberalized rule for allocating interest expense between U.S. and foreign sources for purposes of determining their foreign tax credit limitation. As enacted in the AJCA, the election was scheduled to take effect for taxable years beginning after December 31, 2008, but that effective date has already been delayed twice in subsequent legislation (most recently until 2018 in the Worker, Homeownership, and Business Assistance Act of 2009).

Corporate estimated tax payments

The Act increases estimated tax payments for corporations with assets of \$1 billion or more to:

- 157.75 percent of the amount otherwise due during July, August, or September of 2014;
- 121.5 percent of the amount otherwise due during July, August, or September of 2015; and
- 106.5 percent of the amount otherwise due during July, August, or September of 2019.

Each increase in estimated tax payments is offset by a corresponding decrease in the following quarter.



Next steps

Congressional leaders are framing the HIRE Act as just one part of a larger jobs agenda that they intend to pursue in the run-up to the midterm elections. House and Senate leaders are mapping out a path to compromise on legislation to extend temporary business and individual tax incentives that expired at the end of 2009. By addressing the so-called “extenders” provisions – such as the research and experimentation tax credit, the New Markets Tax Credit, 15-year straight-line cost recovery for qualified leasehold improvements, the exception for active financing income under subpart F, and lookthrough treatment of payments between related controlled foreign corporations – lawmakers hope to spur jobs creation by providing taxpayers a measure of certainty in their business planning.

For their part, House taxwriters are also moving on a jobs bill targeted primarily to small businesses. Additional proposals are likely to emerge from both chambers in the coming months.

As it did with the HIRE Act, however, Congress is likely to insist on adhering to pay-as-you-go budget rules to finance additional tax relief for the business community this year, which means taxwriters will be scouring the Internal Revenue Code for revenue offsets.

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Onshore jobs, offshore compliance: Tax provisions in the Hiring Incentives to Restore Employment Act was prepared by the Tax Policy Group of Deloitte Tax LLP in Washington, D.C., under the direction of Jeff Kummer, Director of Tax Policy.

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