

Tax Changes in the Hiring Incentives to Restore Employment (HIRE) Act

To our Clients and Friends:

With relatively little fanfare, the Hiring Incentives to Restore Employment Act (the HIRE Act) became law on March 18, 2010. The legislation includes three business tax breaks intended to boost hiring along with a package of changes intended to tighten the screws on offshore transactions and entities that Congress thinks can be used to hide income and assets from the IRS. This letter summarizes what we think are the key points.

Business Breaks

Generous Section 179 Deduction Rules Extended through 2010. The HIRE Act extends the generous \$250,000 Section 179 first-year depreciation write-off for one year, to cover tax years beginning in 2010. The new law also extends the \$800,000 threshold for the Section 179 deduction phase-out rule to cover tax years beginning in 2010. Other favorable Section 179 deduction rules also apply in 2010. For example, Section 179 deductions can still be claimed for purchased software.

Note: For tax years beginning in 2011, the maximum Section 179 deduction will fall all the way back to \$25,000 unless Congress takes further action. The phase-out threshold will fall all the way back to \$200,000. Also, some of the other favorable Section 179 rules end after 2010.

Temporary Employer Social Security Tax Exemption for Wages Paid to New Hires. Wages paid by a *qualified employer* to a *qualified new employee* for employment between 3/19/10 and 12/31/10 are exempt from the 6.2% employer portion of the Social Security tax. However, there's no exemption for the 6.2% *employee* portion of the tax, and there's no break for individuals who pay self-employment tax.

The maximum amount of employer Social Security tax savings for a high-paid employee is \$6,621.60 (6.2% × \$106,800 Social Security tax ceiling for 2010). Savings will be less for lower-paid employees and for higher-paid workers who are paid less than \$106,800 for employment between 3/19/10 and year-end.

Qualified employers include private-sector businesses, tax-exempt not-for-profits, and eligible public higher-education institutions.

Qualified new employees are full-time or part-time workers who start work between 2/4/10 and 12/31/10 and who were not employed more than 40 hours during the 60-day period ending on their start dates. However, the new worker cannot replace another worker unless that person quit voluntarily or was discharged for cause.

To give both employers and the IRS time to gear up for this new Social Security tax exemption deal, the benefit of the exemption for any eligible wages paid during March will be reflected as a credit on the employer's federal employment tax return (Form 941) for the second quarter of 2010. The first quarter return is unaffected.

Temporary Tax Credit for Retaining Qualified New Employees. Above and beyond the temporary Social Security tax exemption explained above, employers can also claim a temporary new tax credit of up to \$1,000 for wages paid to each *qualified new employee*, using the same definition as for the Social Security tax exemption.

There are some additional requirements for the credit. The worker must be kept on the payroll for at least 52 consecutive weeks, and wages during the second 26 weeks of the 52-week period must equal at least 80% of wages paid during the first 26 weeks of that period.

The credit amount equals the lesser of 6.2% of wages paid during the 52-consecutive-week period or \$1,000. To claim the maximum \$1,000 credit, the worker must be paid at least \$16,130 during the 52-week period.

The credit can only be claimed for the tax year ending after 3/18/10 during which the 52-week requirement is first met for the applicable worker. So, the credit is a one-time deal for each eligible worker, based on wages paid during the 52-week period that starts with the worker's employment date.

Because the 52-week requirement cannot be met until February of 2011 at the soonest, the credit can't be claimed on a calendar-year 2010 return. Instead, you'll have to wait until your calendar-year 2011 return is filed. If your business uses a fiscal tax year, you too will have to wait a while to collect your rightful credit. Even so, hiring a qualified new employee now and retaining that individual for at least 52 weeks can generate a credit that will eventually save taxes.

Strict New Rules to Clamp Down On Offshore Tax Evasion

Individuals Must Disclose Foreign Financial Assets. For tax years beginning after 3/18/10, the new law will require new tax return disclosures from individuals with interests in "specified foreign financial assets" if the aggregate value of such assets exceeds \$50,000. Specified financial assets include depository and custodial accounts at foreign financial institutions; foreign stocks and securities that are not held in such accounts; certain other financial instruments and contracts that are held for investment but that are not held in such accounts; and interests in foreign entities that are not held in such accounts. Failure to make required disclosures can result in a \$10,000 penalty. Failure to provide required disclosures for more than 90 days after the IRS notifies the taxpayer of such a failure to disclose can result in additional penalties of \$10,000 per 30-day period or any part of a 30-day period.

New 40% Penalty on Tax Understatements Attributable to Undisclosed Foreign Financial Assets. For tax years beginning after 3/18/10, the HIRE Act imposes a stiff 40% penalty on any understated amount of tax that is attributable to an undisclosed foreign financial asset. An understatement is considered attributable to an undisclosed foreign financial asset if it is attributable to *any transaction* involving such an asset.

New Six-year Statute of Limitations on Tax Understatements Attributable to Foreign Financial Assets. Usually, the IRS only has three years after a tax return for a particular year is filed to assess additional taxes for that year. After this three-year "statute of limitations" period expires, the taxpayer is generally off the hook for that year. The new law establishes a six-year statute of limitations period for tax understatements attributable to certain understated income from foreign financial assets. The understated income must exceed \$5,000.

Statute of Limitations Suspended for Failures to Report Foreign Financial Assets. The HIRE Act suspends the statute of limitations period if the taxpayer fails to make required tax return disclosures for foreign financial assets.

Unfavorable New Rules for Foreign Trusts. Effective 3/18/10, the new law creates a more expansive definition of "beneficiary" for purposes of determining when a foreign trust is treated as a grantor trust owned by a U.S. beneficiary. This is important because taxpayers treated as grantors must report their shares of foreign trust income on their federal income tax returns.

In general, for transfers of property after 3/18/10 by a U.S. taxpayer to a foreign trust, the HIRE Act creates a rebuttable presumption that the trust is a grantor trust owned by a U.S. beneficiary. This unfavorable presumption applies unless the U.S. taxpayer is able to rebut it by submitting information that proves no part of the trust income or corpus has accrued to the benefit of a U.S. person.

For tax years beginning after 3/18/10, the new law requires U.S. taxpayers that are treated as grantors (owners) of foreign trusts to report whatever information about such trusts as the IRS may mandate. This is on top of the pre-existing requirement for U.S. grantors to ensure that such trusts comply with return filing and information reporting requirements.

For failures to file required returns and notices due after 12/31/09 for foreign trusts, the HIRE Act imposes a minimum \$10,000 penalty.

There's Much More: Please Contact Us for Details

The HIRE Act starts off with some good news for business taxpayers. Then, it puts the hammer down on taxpayers with offshore investments and transactions. In this letter, we have only covered what we think are the most important of these unfavorable changes. There's much more that some taxpayers will need to know to keep the IRS happy. Please contact us if you have questions or want more detailed information.