WATKINS | MEEGAN

Hiring and Business Stimulus Provisions in the HIRE Act of 2010

The Hiring Incentives to Restore Employment (HIRE) Act has been passed by Congress and awaits the President's signature. The HIRE Act encourages companies to hire (and retain) unemployed workers by creating an employer "payroll tax holiday" of sorts for hiring unemployed workers in 2010 and an employer tax credit if these new hires are retained for at least one year. The Act increases expensing for 2010 and permits certain bond issues to elect to receive a payment in lieu of providing a tax credit to the bondholders. The Act also contains new anti-offshore tax abuse measures, and other revenue raising provisions. Below is a summary of the domestic portions of the Act. Please contact us directly to obtain information on the offshore abuse measures.

Payroll Tax Holiday in 2010 for Hiring Unemployed Workers

Employers who hire members of certain targeted groups before September 2011 may claim a work opportunity credit (WOTC) equal to a percentage of up to $6,000 of first-year wages per employee, $12,000 for qualified veterans, and $3,000 for qualified summer youth employees. If the employee is a long-term family assistance recipient, the credit is a percentage of first- and second-year wages, up to $10,000 per employee.

The Act provides relief from the employer share of FICA taxes (the 6.2% portion only) for employers that hire unemployed workers. The relief applies to employers in the private and not-for-profit sectors, not to public sector employers other than public institutions of higher education. The relief applies to wages paid to qualified individuals beginning on the day after the enactment date and ending on December 31, 2010.

A qualified individual is anyone who:

(1) Begins employment with a qualified employer after February 3, 2010, and before January 1, 2011. Although a qualified employee who begins work after February 3, 2010, can be eligible for the payroll tax holiday, only the employer's portion of OASDI on his wages paid with respect to employment after the enactment date will be forgiven.

(2) Certifies by signed affidavit, under penalties of perjury, that he hasn't been employed for more than 40 hours during the 60-day period ending on the date the individual begins employment with the qualified employer.

(3) Isn't employed to replace another employee of the qualified employer unless that other employee separated from employment voluntarily or for cause.

(4) Isn't related to the employer. Thus, there's no payroll tax holiday for hiring a relative such as the qualified employer's child or descendant of a child; a stepchild; sibling, stepbrother, or stepsister; parent or stepparent; niece, nephew, uncle or aunt; or in-laws.

An employer may qualify for the payroll tax holiday when it hires an otherwise qualified individual to replace one who was terminated for cause or due to other facts and circumstances, such as where a factory is closed due to lack of demand. When the factory reopens, the payroll tax holiday can be claimed both for rehiring old workers and hiring new workers. However, an employer who terminates an employee without cause in order to claim the payroll tax holiday for hiring the same or another employee doesn't qualify.

Procedurally, the payroll tax holiday doesn't apply for wages paid during the first calendar quarter of 2010. Instead, the amount by which the qualified employer's FICA tax for wages paid during the first calendar quarter of 2010 would have been reduced if the payroll tax holiday had been in effect for that quarter is treated as a payment against the qualified employer's FICA tax for the second calendar quarter of 2010. The payment is treated as made on the date when the employer's second-quarter FICA tax is due.

An employer may elect not to have the payroll tax holiday apply. Unless the employer elects out of the payroll holiday, wages paid or incurred to a qualified individual won't qualify for the Work Opportunity Tax Credit (WOTC) during the one-year period beginning on the date that the qualified employer hired the individual. The WOTC is in many cases more valuable than the payroll tax holiday, especially for low-wage employees, because it is generally 40% of “qualified first-year wages” of up to $6,000, for maximum credit of $2,400 per worker. The payroll tax holiday is equal to 6.2% of wages, and applies only to wages paid through December 31, 2010. However, the WOTC is harder to qualify for, because the employee must be certified by an agency as belonging to a targeted group. The main qualification for payroll tax holiday is that the employee has been unemployed for 60 days, and the employee's affidavit is sufficient for this purpose.

New Up-to-$1,000 Credit for Each “Retained Worker”

For any tax year ending after the enactment date, the Act provides an up-to-$1,000 credit for “retained workers.” A retained worker is defined as any qualified individual, as defined for purposes of the payroll tax holiday (see above):

(1) who was employed by the taxpayer on any date during the tax year,

(2) who was so employed by the taxpayer for a period of not less than 52 consecutive weeks, *and*

(3) whose wages for that employment during the last 26 weeks of the period (described in item (2) above) equaled at least 80% of the wages for the first 26 weeks of that period.

The credit which is part of the current year business credit for the tax year is the *lesser* of:

> . . . $1,000; <u>or</u>
>
> . . . 6.2% of the wages paid by the taxpayer to the retained worker during the 52-consecutive-week-period. Thus, if a retained worker's wages during the 52-consecutive-week-period exceed $16,129.03, the increase to the current year business credit for that retained worker will be $1,000.

Unfortunately, no portion of the unused business credit for any tax year that is attributable to the up-to-$1,000 increase in the current year business credit can be carried to a tax year *beginning* before the enactment date.

Expensing Limits Increased For 2010

For tax years beginning in 2008 and 2009, the maximum amount that could be expensed under Code Sec. 179 was $250,000, and the maximum deductible expense was reduced (i.e., phased out, but not below zero) by the amount by which the cost of Code Sec. 179 property placed in service during tax year 2008 or 2009 exceeded $800,000. The $250,000 and $800,000 amounts were not adjusted for inflation.

Under pre-Act law, for tax years beginning in 2010, the maximum amount that could be expensed under Code Sec. 179 was $134,000, and the maximum deductible expense had to be reduced (i.e., phased out, but not below zero) by the amount by which the cost of Code Sec. 179 property placed in service during the 2010 tax year exceeded $530,000 (i.e., the beginning-of-phaseout amount). The 2010 amounts reflected statutory inflation adjustments.

For tax years beginning after 2010, the maximum expensing amount under Code Sec. 179 is $25,000, the beginning-of-phaseout amount is $200,000, and neither amount is adjusted for inflation.

The Act increases for one year (2010) the amount a taxpayer can expense under Code Sec. 179. The maximum amount a taxpayer can expense for a tax year beginning in 2010 is $250,000 of the cost of qualifying property placed in service for that tax year. The $250,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during 2010 exceeds $800,000.

Issuers of Certain Tax Credit Bonds Can Elect to Receive Direct Payment In Lieu of a Tax Credit to the Bondholder

As an alternative to traditional tax-exempt bonds, state and local governments may issue qualified tax credit bonds. Qualified tax credit bonds allow the bondholder (i.e., investor) to claim a nonrefundable tax credit in lieu of receiving interest.

Instead, for bonds originally issued after the enactment date, the Act allows an issuer of new qualified tax credit bonds to make an irrevocable election on or before the issue date of the bonds to receive a payment in lieu of providing a tax credit to the holder of the bonds.

Interest paid to the holder of the bond is includible in the holder's gross income. The issuer's direct payment option for qualified tax credit bonds is in lieu of the credit for the holder, and the bondholder can't claim the tax credit that otherwise would be available under the qualified tax credit bond rules.

For specified tax credit bonds, the amount that IRS will pay to the issuer (or to any person making interest payments on the issuer's behalf) for any interest payment due under the bond is equal to the lesser of:

(1) the amount of interest payable under the bond on that date, or

(2) the amount of interest that would have been payable under the bond on that date if the interest were determined at the applicable credit rate determined under Code Sec. 54A(b)(3).

Thus, the amount of the payment to the issuer of a specified tax credit bond that is a new qualified tax credit bond is a function of the market-determined interest rate on the bond and not a rate set by IRS.

Watkins Meegan LLC