

AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

# BDO KNOWS:

## FEDERAL TAX



### ► SUBJECT

## HIRING INCENTIVES TO RESTORE EMPLOYMENT ACT

### ► SUMMARY

On March 18, 2010, President Obama signed H.R. 2847, the Hiring Incentives to Restore Employment (HIRE) Act (the "Act"), as Pub. L. No. 111-147. The Act contains a number of tax provisions intended to promote hiring and encourage business investment. The Act also contains substantial new compliance requirements related to foreign accounts.

### ► DETAILS

**Payroll Tax Exemption.** The Act exempts employers from paying the employer share of Social Security employment taxes (6.2 percent of the first \$106,800 of wages) for wages paid in 2010 with respect to an employee hired after February 3, 2010, and before January 1, 2011. The exemption is available only if the new employee (i) was previously unemployed (had not worked more than 40 hours during the 60-day period ending on the date that employment begins) and (ii) does not replace another employee of the employer, unless the replaced employee left employment voluntarily or for cause. The exemption does not apply to the United States, any state or any political subdivision of a state, or any instrumentality of the foregoing. State colleges and universities are, however, eligible employers.

**Incentive to Retain Employees.** To encourage employers to retain these new employees, the Act provides a new business tax credit with respect to each retained employee. The credit is the lesser of \$1,000 or 6.2 percent of the wages paid to the retained employee during the 52-consecutive-week period. The new credit may not be carried back.

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**Extension of Enhanced Small Business Expensing.** In 2009, small businesses were able to write off \$250,000 of capital expenditures, with a phase-out if the amount of qualifying property exceeded \$800,000. This provision expired on December 31, 2009, and the dollar amounts were to have reverted to historically lower levels. The Act extends the \$250,000 expensing level (and the \$800,000 phase-out limitation) through December 31, 2010.

**Direct Payment Option for Certain Tax Credit Bonds.** The American Recovery and Reinvestment Act of 2009 authorized states and local governments to issue special purpose tax credit bonds. The federal government subsidizes these tax credit bonds by providing investors with a tax credit in place of the interest that would otherwise be payable on the bonds. The Act allows issuers of qualified bonds to elect to receive a direct payment from the federal government equal to the amount of the federal tax credit that would otherwise be provided for these bonds.

**Delay Worldwide Allocation of Interest.** In 2004, Congress provided taxpayers with a one-time election to determine foreign source taxable income by allocating and apportioning interest expense as if all members of the group were a single taxpayer. This provision was originally to have been effective for taxable years beginning after 2008, but the effective date was twice postponed until taxable years beginning after 2017. The Act further postpones the effective date until taxable years beginning after December 31, 2020.

## FOREIGN ACCOUNT TAX COMPLIANCE

**Withholding Tax on Certain Payments to Foreign Financial Institutions.** The Act imposes a 30-percent withholding tax on any “withholdable payment” to a foreign financial institution unless the foreign financial institution agrees to report certain information regarding its “United States accounts.” The withholding is required on payments of interest, dividends, rents, royalties, salaries, wages, premiums, and other fixed or determinable annual or periodical gains, profits, and income (or “FDAP” income), and gross proceeds from the sale or exchange of any property which can produce United States source interest or dividends.

A “foreign financial institution” is any entity that (i) accepts deposits in the ordinary course of a banking business, (ii) as a substantial portion of its business, holds financial assets for the account of others, or (iii) is engaged primarily in investing, reinvesting or trading in securities, partnership interests, commodities or any interest (including a futures or forward contract or option) in securities, partnership interests, or commodities.

A “United States account” includes any account held by one or more United States persons or held by a foreign entity which is more than 10-percent owned by a United States person. There are exceptions for accounts held by publicly-traded corporations, tax-exempt organizations, the federal, state, or local governments, banks, real estate investment trusts, regulated investment companies, and common trust funds.

A foreign financial institution can avoid the withholding tax by entering into an agreement with the Service to: (i) determine whether each of its accounts is a United States account, (ii) comply with verification and due diligence procedures with respect to its United States accounts, (iii) annually report the name, address, and taxpayer identification number of the United States account holder, the account number, the account balance, and

the gross receipts and gross withdrawals or payments from the account to the Service; (iv) comply with requests from the Service for information with respect to its United States accounts; and (v) obtain a waiver from each United States account holder of any confidentiality provisions of foreign law with respect to the United States account or, if a waiver is not obtained, to close the account. These provisions will be effective for payments made after December 31, 2012. However, withholding will not be required from any payment on any obligation that is outstanding on the date that is two years after the date of enactment, or from the gross proceeds of such an obligation.

**Withholding Tax on Dividend Equivalent Payments.** The Act provides that “dividend equivalent payments” determined by reference to an underlying United States equity security and made as part of a securities lending transaction, a sale-repurchase transaction or a “specified notional principal contract” will be treated as United States source income. Consequently, the payment will be subject to United States withholding tax of 30 percent (as modified by any applicable treaty) in the same manner as dividend income. A “dividend equivalent” is any substitute dividend made pursuant to a securities lending or sale-repurchase transaction, or under a specified notional principal contract, that is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States.

A “specified notional principal contract” is any notional principal contract that has one of the following five characteristics: (1) in connection with entering the contract, any long party transfers the underlying security to any short party to the contract; (2) in connection with the termination of the contract, any short party to the contract transfers the underlying security to any long party to the contract; (3) the underlying security is not readily tradable on an established securities market; (4) in connection with entering into the contract, any short party to the contract posts the underlying security as collateral with any long party to the contract; or (5) the Service identifies the contract as a specified notional principal contract. This provision is effective for payments made on or after 180 days after enactment.

**New Reporting Obligations.** Any United States individual who holds specified foreign financial assets with an aggregate value in excess of \$50,000 must report the ownership to the Service on the individual’s tax return. A “specified foreign financial asset” is a depository or custodial account with a foreign depository financial institution, and, to the extent not held at a financial institution, (i) stocks or securities issued by a foreign person, (ii) any other financial instrument or contract held for investment that is issued by or has a counterparty that is not a United States person, and (iii) any interest in a foreign entity. The reporting obligations are similar to the reporting required on Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (“FBAR”), but are broader than, and are in addition to, the FBAR reporting. The penalty for noncompliance is \$10,000, and can be increased for non-compliance after a notice from the Service. Although the provision applies only to individuals, the Service can issue regulations requiring reporting by a domestic entity which is formed or availed of to hold specified foreign financial assets. The provision is effective for taxable years beginning after the date of enactment.

**Penalty for Undisclosed Foreign Financial Assets.** The Act adds a new accuracy-related penalty equal to 40 percent of any underpayment of tax attributable to an undisclosed foreign financial asset. The penalty is subject to the same defenses as exist under current law for an accuracy-related penalty, such as reasonable cause or adequate disclosure. The provision is effective for taxable years beginning after the date of enactment.

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**Statute of Limitations for Omission of Income from Foreign Financial Assets.** The general statute of limitations for assessment of any tax is three years from the time the return is filed. The Act provides for a six-year statute of limitations for the assessment of tax on understatements attributable to foreign financial assets. The extended statute of limitations will apply if the omission of gross income is greater than \$5,000 and the gross income is attributable to a foreign financial asset which should have been but was not disclosed on the taxpayer's return. The provision is effective for taxable years beginning after the date of enactment.

**Presumption with Respect to Transfers to Foreign Trusts.** The Act provides that if a United States person directly or indirectly transfers property to a foreign trust (other than a deferred compensation or charitable trust), the Service may treat such trust as having a United States beneficiary unless the United States person submits such information as the Service may require with respect to such transfer, and demonstrates to the satisfaction of the Service that (i) under the terms of the trust, no part of the income or corpus of the trust can be paid or accumulated during the taxable year to or for the benefit of a United States person, and (ii) if the trust terminates during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of a United States person. The provision is effective for transfers of property after the date of enactment.

**Minimum Penalty with Respect to Failure to Report Certain Foreign Trusts.** The Act establishes a minimum penalty of \$10,000 for the failure to file required information returns with respect to foreign trusts and provides that the penalty can be imposed even when the gross reportable amount is not known by the Service. The penalty will not be imposed if it can be shown that the failure to file was due to reasonable cause and not due to willful neglect. The provision is effective for notices and returns required to be filed after December 31, 2009.

**Treat Certain Uncompensated Use of Foreign Trust Property as a Distribution.** The Act provides that the use of trust property by the United States grantor, United States beneficiary, or any United States person related to a United States grantor or United States beneficiary, is treated as a distribution of the fair market value of the use of the property to the United States grantor or United States beneficiary, except when the trust is paid within a reasonable period of time the fair market value for the use of any trust property other than a loan of cash or marketable securities. This provision is effective for loans made and uses of property after the date of enactment.

**Expanded PFIC Reporting.** The Act requires each United States person who is a shareholder of a passive foreign investment company to file an annual information return containing the information required by the Service. This provision is effective on the date of enactment.

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