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President Signs HIRE Act - Provides For Business Tax Incentives and New Withholding and Reporting Requirements For Foreign Financial Institutions

The Hiring Incentives to Restore Employment Act (the "Act") was signed into law (P.L. 111-147) by the President on March 18, 2010. The Act includes a number of tax incentives designed to encourage employers to hire and retain workers and purchase new equipment. The Act also includes a revenue offset imposing new withholding and reporting obligations on foreign financial institutions in an effort to combat the failure of U.S. persons to report income through the use of foreign financial accounts. This Client Advisory highlights key changes below. (All section references are to the Internal Revenue Code (the "Code") unless otherwise indicated.)

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Tax Incentives

Employer social security payroll tax is forgiven through 2010 for employers that hire unemployed workers. Up-to-$1,000 business credit for 2011 will be available to employers for each "retained worker". Under the Act, the social security tax on employers will not apply to wages paid to qualified individuals by qualified employers from March 19, 2010 through December 31, 2010. Qualified individuals must begin employment sometime after February 3, 2010 and must have been unemployed for at least 60 days. As an additional incentive, the Act also provides a 2011 business credit in the amount of 6.2% of the wages paid (up to $1,000) by the qualified employer to a retained worker. A retained worker is any qualified individual who was employed by the taxpayer for a period of not less than 52 consecutive weeks, and whose wages for that employment during the last 26 weeks of the period equaled at least 80% of the wages for the first 26 weeks of that period.

Code Sec. 179 $250,000 deduction limit and $800,000 phaseout start are extended through 2010. The Act provides a one-year extension to the enhanced expensing rules, which allow qualifying businesses the option to currently deduct the cost of business machinery and equipment. The $250,000 maximum amount is reduced by the cost of qualifying property placed in service during 2010 that exceeds $800,000.

Off-Shore Financial Accounts

New withholding rules for payments to foreign financial institutions and other foreign entities. Payments of fixed or determinable annual or periodical ("FDAP") income (e.g., interest, dividends, rents, annuities, etc.) from U.S. sources are subject to a 30% withholding tax unless a lower rate of withholding applies under an income tax treaty or an exemption applies (e.g., the exemption for portfolio interest). A non-U.S. person claims an exemption or reduced rate of withholding by supplying the withholding agent with a certification on IRS Form W-8. Form W-8 also exempts a non-U.S. person from information reporting and backup withholding rules that apply to U.S. persons. A payor who pays to a U.S. person interest or dividends of at least $600 is required to issue IRS Form 1099 to the payee. In order to avoid backup withholding tax of 28%, a U.S. payee must provide the payor with the payee's name and taxpayer identification number on IRS Form W-9. The information reporting, backup withholding and non-U.S. person withholding rules apply to any financial institution or other payor, including foreign financial institutions that receive U.S. source income. However, under pre-Act law, these reporting and withholding requirements were often difficult to enforce when the payor was a foreign financial institution that had no connection to the U.S. In an effort to obtain information on accounts owned (directly or indirectly) by U.S. persons, the Act imposes a 30% withholding tax on foreign financial institutions with respect to certain income from U.S. financial assets held by a foreign institution unless the foreign financial institution discloses the identity of U.S. individuals with accounts at the institution and reports annually on the account balance, gross receipts and gross withdrawals/payments from such accounts. A foreign financial institution may avoid the 30% withholding tax by entering into a Code Section 1471(b) agreement with the IRS (there are a number of ways in which a foreign financial institution may be deemed to have met the Code Section 1471(b) requirements, e.g., when the foreign financial institution complies with IRS procedures to ensure that it does not maintain U.S. accounts). When a foreign financial institution does not enter into a Code Section 1471(b) agreement with the IRS, the withholding agent with respect to such payment is required to deduct and withhold from such payment a tax equal to 30% of the amount of such payment. Under the Act, foreign financial institutions are also required to disclose and report on foreign entities that have substantial U.S. owners. These rules are generally effective for payments made after December 31, 2012.

New reporting requirement for individuals with foreign assets. Under the Bank Secrecy Act ("BSA"), every U.S. person who has a financial interest in or signature, or other authority over any financial account in a foreign country is required to file a Report of Foreign Bank and Financial Account ("FBAR") if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year. The IRS is responsible for enforcement of the FBAR requirements. However, except for questions included on IRS Form 1040, Schedule B, an individual taxpayer is not required to disclose the information included on FBAR on his/her return. Since the FBAR requirements arise under the BSA rather than the Internal Revenue Code, information on income tax returns regarding foreign bank accounts was not readily accessible to those in the IRS responsible for FBAR compliance. The Act attempts to remedy this disconnect by requiring any individual who holds any interest in a "specified foreign financial asset" to attach to his/her income tax return for that tax year certain required information with respect to each asset if the aggregate value of all the individual's "specified foreign financial assets" exceeds $50,000. "Specified foreign financial asset" means any financial account maintained by a foreign financial institution and any stock or security issued by a person other than a U.S. person, any financial instrument or contract held for investment that has an issuer or counterparty that is other than a U.S. person and any interest in a foreign entity. The following information must be included in the required statement for any asset: (1) in the case of any account, the name and address of the financial institution in which the account is maintained and the number of the account; (2) 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 the stock or security is part; (3) in the case of any instrument, contract or interest, such information as is necessary to identify the instrument, contract or interest and the names and addresses of all issuers and counterparties with respect to the instrument, contract or interest; and (4) the maximum value of the asset during the tax year. The new reporting requirement is *not* intended as a substitute for compliance with FBAR reporting requirements, which are unchanged by the Act.

An individual who fails to furnish this information for any tax year will be required to pay a penalty of $10,000. If the failure continues for more than 90 days after the day on which the Internal Revenue Service mails notice of the failure to such individual, the individual will be subject to an additional penalty of $10,000 for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period. The penalty imposed for any failure cannot exceed $50,000. No penalty will be imposed where the taxpayer demonstrates that the failure is due to reasonable cause and not due to willful neglect.

New six-year limitations period. Under pre-Act law, the statute of limitations on assessment is 3 years unless there is a substantial understatement of income (i.e.,

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more than 25% of the amount that was properly includable in gross income), in which case the statute of limitations is 6 years. However, the Act authorizes a new six-year limitations period for assessment of tax on understatements of income attributable to foreign financial assets. Specifically, the Act provides that tax may be assessed at any time within 6 years after the return was filed if the taxpayer omits from gross income an amount properly includible in gross income and such amount is (1) attributable to one or more assets for which information is required to be reported under new Code Section 6038D (relating to mandatory self-reporting of specified foreign financial assets (discussed above)), or would be so required if Code Section 6038D were applied without regard to the $50,000 threshold and without regard to any exceptions provided in Code Section 6038D and (2) in excess of $5,000. The extended limitations period rules for foreign financial asset omissions apply to returns filed after March 18, 2010 and to any other return for which the assessment period has not expired as of March 18, 2010.

Accuracy related penalty imposed for undisclosed foreign financial asset understatements. Under current law, a 20% accuracy-related penalty applies to the portion of any underpayment attributable to (1) negligence or disregard of the rules or regulations and (2) any substantial understatement of income tax. Under the Act, the portion of an underpayment attributable to any undisclosed foreign financial asset understatement is subject to a 40% accuracy-related penalty, i.e. double the normal penalty.

Annual information reporting by PFIC shareholders. Under pre-Act law, a U.S. shareholder of a passive foreign investment company ("PFIC") was required to file IRS Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualifying Electing Fund, for each tax year in which he (1) recognized gain on a direct or indirect disposition of PFIC stock, (2) received certain direct or indirect distributions from a PFIC, or (3) made a reportable election. Under the Act, unless otherwise provided by the IRS, each U.S. person who is a PFIC shareholder is required to file an annual report containing the information required by the IRS. The requirement that a U.S. shareholder of a PFIC file an annual report is effective as of March 18, 2010.

Note that this Client Advisory highlights only a few of the changes that may affect your business planning. If you have any questions regarding the tax law changes summarized in this Advisory or other provisions of the Act, and how these changes and provisions may affect your business, please contact one of the members of our Tax Department listed below.

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This advisory is for guidance only and is not intended to be a substitute for specific legal advice. If you would like further information, please contact the Edwards Angell Palmer & Dodge LLP attorney responsible for your matters or one of the following members of the Tax Department:

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