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HIRING INCENTIVES TO RESTORE EMPLOYMENT ACT (HIRE ACT)

The HIRE Act, signed into law as Public Law 111-147 by President Obama on March 18, 2010, creates a temporary payroll tax forgiveness/job retention credit, increases temporarily the direct expensing allowance known as Section 179, extends some infrastructure spending and expands the Build America bond program.

Payroll Tax Forgiveness/Retention Credit

The law reduces the current payroll tax obligation for an employer that hires a qualified unemployed individual and the law permits the employer to take a one time credit if the employer retains the individual for at least a year.

An employer may forego paying the employer's share (6.2 percent) of the social security portion of Federal Income Contributions Act (FICA) taxes for a "qualified individual" for the rest of this calendar year. Since it is "forgiveness" of the social security portion of FICA, it is limited to no more than 6.2 percent of $106,800 of wages per qualified employee, since that is the cap on wages for the purposes of the social security portion of FICA.

The definition of a qualified employer is a broad one. The Internal Revenue Service (IRS) has already noted that "Businesses, agricultural employers, tax-exempt organizations and public colleges and universities all qualify to claim the payroll tax benefit for eligible newly-hired employees. Household employers cannot claim this new tax benefit."

While the law provides that a qualified employee is one that is employed after February 3, 2010, the "forgiveness" is for wages beginning on the day after the date of enactment. The date of enactment is March 18, 2010.

There is a special rule on how to handle the fact we are already deep into the first quarter of the year. Basically, an employer can apply the first quarter's "forgiveness" to the second quarter's payroll liability.

A "qualified individual" means any individual who begins employment with an employer after February 3, 2010, and before January 1, 2011, certifies by signed affidavit, under penalties of perjury, that he or she has not been employed for more than 40 hours during the 60-day period ending on the date such individual begins such employment, is not employed by the employer to replace another employee of such employer unless such other employee separated from employment voluntarily or for cause, and is not related to a majority owner of the business.

The IRS has indicated that it will publish a "certification" that newly hired employees can use to fulfill the "Yes, I have been unemployed" requirement and will also revise the necessary payroll tax forms for employers.

(PS Trade associations are eligibility for the "forgiveness," but services performed by the individual must be "in furtherance of the activities related to the purpose or function constituting the basis of the employer's exemption." So the new employee should not be performing unrelated business income tax (UBIT) work.)

The second part of the incentive package is the credit for retaining the employee. A business will be entitled to a business tax credit for each retained worker of the lesser of

$1,000, or 6.2 percent of the wages paid by the business to such retained worker during a 52 consecutive week period.

The term ‘‘retained worker’’ means any individual whom the business hired under the conditions (e.g. was unemployed) that allowed the business to claim the tax forgiveness. The worker must be employed by the taxpayer for a period of not less than 52 consecutive weeks, and whose wages for such employment during the last 26 weeks of such period equaled at least 80 percent of such wages for the first 26 weeks of such period.

Relatives Need Not Apply

I do not want to make a big deal of it given that in the scope of things, it is a "relatively" minor matter (pun intended) but the provision that prevents you from hiring a relative to take advantage of the forgiveness/credit is a classic tax code confusion illustration.

The story starts off with the fact one would not even know there is such a prohibition by just looking at the law. It states, the new employee "is not an individual described in section 51(i)(1) (applied by substituting 'qualified employer' for 'taxpayer' each place it appears)."

If you go to Internal Revenue Code Section 51, you get your first clue that it prohibits employing a relative. Then that section refers you to another that actually sets forth the definition of a relative, and to another section to find out who is a majority owner of a non-corporate entity.

Who is a majority owner? If the employer is a corporation, an individual who owns, directly or indirectly, more than 50 percent in value of the outstanding stock of the corporation, or, if the employer is an entity other than a corporation, any individual who owns, directly or indirectly, more than 50 percent of the capital and profits interests in the entity. (Yes there is a definition of what constitutes "capital and profits interests" but let's not go there)

Who is related? A child or a descendant of a child; a brother, sister, stepbrother, or stepsister; the father or mother, or an ancestor of either; a stepfather or stepmother; a son or daughter of a brother or sister of the taxpayer; a brother or sister of the father or mother of the taxpayer; a son-in-law, daughter-in-law, father-in-law, mother-in- law, brother-in-law, or sister-in-law.

Direct Expensing

The HIRE Act, Public Law111-147, increases temporarily the direct expensing allowance found in Internal Revenue Code Section 179. Section 179 allows a business to write off small amount of annual investment in capital assets such as machinery in the year of purchase in lieu of depreciating the investment over a number of years.

While it commonly referred to as a small business provision, there is no size limitation on business eligibility. The allowance is reduced and eliminated completely the more capital assets a business buys during the year. As a result, the provision is generally not used by large businesses that make significant investments in equipment and machinery each year.

(If the cost of your qualifying section 179 property placed in a service in 2010 is more than $800,000, you must reduce the dollar limit (but not below zero) by the amount of cost over $800,000. For example, if in 2010 a taxpayer placed in service machinery costing $875,000, this cost is $75,000 more than $800,000, so the taxpayer must reduce the dollar limit to $175,000 ($250,000 - $75,000). If the cost of your section 179 property placed in service during 2010 is $1,050,000 you cannot take a section 179 deduction.)

When originally enacted, the amount a business could write off was $25,000 and if the business spent more than $200,000 in a year on capital assets, the ability to use the direct expensing option phased out.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) included a temporary increase that raised the direct expensing allowance for business from $25,000 to $100,000 for 2003, 2004, and 2005. The provision's phase-out threshold was increased from $200,000 to $400,000 over the same time period.

In 2004, the American Jobs Creation Act of 2004 extended for two years, through 2007, the increases in the direct expensing allowances and the phase-out threshold.

In 2007 the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act increased the $100,000 and $400,000 limits to $125,000 and $500,000, respectively, for taxable years beginning in 2007 through 2010. These amounts were indexed for inflation in taxable years beginning after 2007 and before 2011.

In 2008, the Economic Stimulus Act of 2008 increased the indexed $128,000 and $510,000 amounts under section 179 for taxable years beginning in 2008 to $250,000 and $800,000, respectively.

In 2009, the American Recovery and Reinvestment Act (ARRA) extended the temporary increases of 2008 through 2009.

At the beginning of 2010, the amounts returned to the 2007 levels of $125,000 and $500,000 indexed.

The new law, the Hiring Incentives to Restore Employment Act, extends the temporary increases of $250,000 for the allowance and $800,000 for the overall cap through the end of 2010.

(PS: In 2011, the amounts revert to pre-2003 levels of $25,000 and $200,000 and they are not indexed.)

HEALTH CARE REFORM

We now have a health care reform bill originally developed by the Senate that has been passed by the Senate and the House. All they have to do is enroll it by printing it on parchment and having it signed first by the Speaker of the House and secondly by the President of the Senate, or the formally designated Senate presiding officer and send it to the President for signature and it becomes law. The bill is H.R. 3590, the Patient Protection and Affordable Care Act (PPACA), the bill passed by the Senate on Christmas Eve, 2009 and passed by the House yesterday, March 21, 2010. It includes most of the features of our new health care system.

Yesterday, the House also passed a reconciliation bill, H.R. 4872, the Health Care and Education Affordability Reconciliation Act (HCEARA) that modifies aspects of PPACA. The Senate still needs to pass HCEARA. If the Senate Parliamentarian rules that the provisions fit within reconciliation rules, only a simple majority vote will be required in the Senate. If not, the Democrats would have two options – leave PPACA in place, or try to fix the reconciliation bill. I don't think the answer to that choice is carved in stone.

The President is probably going to sign PPACA into law this week so that the clock can begin ticking on some of the insurance reform provisions tied to date of enactment which will not be altered by the reconciliation bill.

The two-bill phenomenon does create an interesting situation. If the Senate does not pass the reconciliation bill, we could be living with the health care system built by the Senate when it developed PPACA. Failing to pass HCEARA does not turn the clock all the way back. I suppose there will be some saying Congress should wait to see what the outcome in the Senate on HCEARA is, before sending PPACA to the President, but that seems like a less likely scenario to me. So, if you are Republicans in the Senate, I suspect you will still try to hold up the reconciliation bill to make the point, but on the substance, are you better or worse off with PPACA as is, pre-reconciliation?

I am going with the references to PPACA and HCEARA to try to explain some of the more significant changes of interest to small business.

Individual Mandates

HCEARA changes the individual mandate penalty found in PPACA slightly. It lowers the minimum penalty and increases the maximum penalty. The requirement begins in 2014 with a $95 minimum penalty. PPACA increased the penalty in subsequent years. HCEARA lowers those minimum penalties from $495 under PPACA to $325 in 2015 and from $750 under PPACA to $695 in 2016.

It raises the percent of income that is an alternative payment amount from 0.5 to 1.0 percent in 2014, 1.0 to 2.0 percent in 2015, and 2.0 to 2.5 percent for 2016 and subsequent years to make the assessment "more progressive" in the words of the authors.

Employer Mandates

Technically, the employer requirement approach is still the "soft mandate" of PPACA which means that it might be theoretically possible for a large employer not to provide coverage and not to pay a fee to the government if somehow none of the employees receive a government subsidy to obtain health care directly from a health care exchange.

The way I look at it, call it what you want, PPACA imposes a penalty on employers with 50 or more workers that fail to provide coverage to their employees. HCEARA increases substantially the applicable payment amount for firms with more than 50 (full time equivalent – 30 hours or more) (FTE) workers that do not offer coverage, to $2,000 per full-time employee, up from $750 in PPACA. There are a variety of machinations that go in to determining calculation of the penalty so it is not as simple as stated.

HCEARA includes a provision based on a provision in the President's recent health care reform proposal to mitigate the impact. Employers with 50 or more FTE workers will be able to subtract the first 30 full time employees from the payment calculation (e.g., a firm with 51 workers that does not offer coverage will pay an amount equal to 51 minus 30, or 21 times the applicable per employee payment amount).

The PPACA language that provided a lower employee threshold for the construction industry has been dropped.

One "improvement" is that HCEARA eliminates the assessment for workers in waiting periods of more than 30 days, but HCEARA maintains the 90-day limit on the length of any waiting period beginning in 2014.

The PPACA language allowing businesses to go over the 50 employee limit for 120 days when using seasonal employees, without triggering the mandate, is retained. However, HCEARA adds a new provision for counting part-time employees. An employer shall, in addition to the number of full-time employees for any month, include for such month a number of full-time employees determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120.

Taxes

PPACA increases the Medicare Hospital Insurance (HI) trust portion) of the payroll tax to 2.35 percent from 1.45 percent (i.e. a 0.9 increase) on wages or self-employment income over $200,000 for individual return and $250,000 for a joint return. There is no limit on the amount of wages or self-employment income that is subject to the tax (unlike the social security portion of the FICA tax, which has a wage cap). This is an increase in the employee's share only. The employer would continue to pay to its 1.45 percent rate share on the employee's wages. In the case of the self-employed, they would pay "only" the additional 0.9 percent. The increase takes effect in 2013.

Since the HI applies only to earned income, HCEARA creates a new "Unearned Income Medicare Contribution" (UIMC) tax. As I understand it, this would be calculated separately from the HI tax and would apply to "net investment income" which is interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than property held in a trade or business). The rate is 3.8 percent. The UIMC tax on net investment income would not apply if modified adjusted gross income is less than $250,000 in the case of a joint return, or $200,000 in the case of a single return. The UIMC tax takes effect in 2013.

PPACA will impose an excise tax of 40 percent on health insurers and health plan administrators for coverage that exceeds certain thresholds ($8,500 single coverage and $23,000 for family coverage in 2013). Health insurance coverage subject to the excise tax is broadly defined to include not only the employer and employee premium payments for health insurance (including self-insured plans), but also premiums paid by the employee and the employer for dental and vision. In addition, tax advantaged accounts such as flexible spending accounts (FSAs), health savings accounts (HSAs) and health reimbursement accounts (HRAs) are also specified as health insurance coverage and subject to the excise tax.

HCEARA delays the application of the excise tax until 2018, increases the dollar thresholds to $10,200 for single coverage and $27,500 for family coverage ($11,850 and $30,950 for retirees and employees in high risk professions); excludes stand-alone dental and vision plans from the tax; and permits an employer to reduce the cost of the coverage when applying the tax if the employer's age and gender demographics are not representative of the age and gender demographics of a national risk pool.

The Form 1099 requirement for all vendors included in PPACA remains untouched by HCEARA and therefore appears to be well on its way into law. It would take effect in 2012.

Subsidies for Small Business

As far as I can tell, there are no changes to the short-lived tax credits for small business found in PPACA. (See the 01-04-10 Weekly for details.)

Grandfathered Plans

PPACA included an "indefinite" grandfather clause for existing plans. However, some of the provisions of the PPACA will apply to all plans such as limitations on lifetime limits or pre-existing condition exclusions. This is one of the murkier areas of PPACA.

The Future

I think anybody who has spent any time in Washington knows that the general public forgets quickly.

I suspect the Democrats will have a rough time this fall. It is a naturally occurring phenomenon in Washington that a new sitting President gets a reality check in the first congressional election so it has been trending that way anyway. There is a lot of traction that would have to dissipate between now and then to reverse the trend.

Beyond that, most of the tax increases and the major mandates in these bills do not take effect until after the next presidential election.

Can one sustain a long term campaign of "the sky will fall" if you don't vote me in to reverse it?

If history is any teacher, by the time the presidential election comes around, and perhaps even by this fall, it will be more about the general state of the economy than anything.