

**In This Issue:**

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The Hiring Incentives to Restore Employment Act or "HIRE" provides temporary, modest federal tax incentives for private sector and university employers, particularly for employers with "shovel ready" jobs.

## **HIRE Act Signed Into Law — What it Means to Employers Update – IRS Weighs in. Do you have shovel ready jobs?**

By GJ Stillson MacDonnell

In its latest effort to stimulate the economy and encourage employment, Congress passed the Hiring Incentives to Restore Employment Act ("HIRE" or "the Act"), which President Obama signed into law on March 18, 2010. HIRE provides a limited payroll tax "holiday" for employers hiring new workers, business tax credits for retaining such workers and other provisions designed to further stimulate the economy and offset the cost of the stimulus. On March 29th, the IRS issued a series of Q&A regarding the HIRE Act.<sup>1</sup> This update incorporates the IRS comments.

The tax "holiday" provision<sup>2</sup> relieves certain employers from their obligation to match the OASDI (Social Security) portion of FICA tax for certain workers hired after February 3, 2010, and before January 1, 2011 on wages paid March 19 through December 31, 2010. OASDI normally requires that employees and employers each pay 6.2% on the first \$106,800 of wages for the calendar year.<sup>3</sup> There is no holiday from the second component of FICA tax covering the Medicare Hospital Insurance (HI) contribution (1.45% on all wages), which is also matched by the employer. Because the tax holiday is limited to OASDI taxes, other state and federal employer obligations, such as federal unemployment taxes (FUTA) or state unemployment (UI) or other state-level payroll taxes are not affected and will still need to be paid. No election is needed to take advantage of the tax holiday provision.

The Act also provides a business credit based on the retention of employees hired under HIRE and retained for at least 52 weeks. However, an employer utilizing the Work Opportunity Tax Credit (WOTC), which may provide more generous benefits than the tax holiday provisions, will need to opt out of HIRE for any employee otherwise covered, in order to take advantage of the WOTC.

Finally, for employers covered by the Railway Retirement Act, and not FICA, HIRE creates a comparable tax holiday and retention arrangement.<sup>4</sup>

## Covered Employers

The Act limits such tax holidays to “Qualified Employers.” Qualified Employers are private sector employers (both for profit and non-profit), as well as public higher education institutions (*i.e.*, universities). Other federal, state and local government employers and governmental instrumentalities are excluded. Consequently, it appears that a non-profit that is also considered a government instrumentality will be able to take advantage of HIRE’s provisions.

The Act provides for automatic coverage unless an otherwise Qualified Employer opts out. The Internal Revenue Service (IRS) will develop a form for opting out. Participating Qualified Employers will not be eligible to concurrently receive WOTCs on wages paid to an otherwise “Qualified Employee” during a one-year period beginning on the employee’s hiring date. WOTC<sup>5</sup> provides private sector employers hiring workers from 12 targeted groups (*e.g.*, veterans, disconnected youth) a federal tax credit of up to \$10,000 per employee. While WOTC requires state agency certification and is often hard to qualify for, if an employee does qualify, the employer is likely to receive more generous credits than HIRE provides, particularly for its low-wage employees.

The IRS Q&A’s confirm that a new business can be a Qualified Employer while household employers can not.

## Covered Employees

The Act limits the tax holiday to certain Qualified Employees who:

1. Begin work for a Qualified Employer after February 3, 2010 and before January 1, 2011;
2. Provide the employer with a signed affidavit attesting, under penalty of perjury, that the individual was employed a total of 40 hours or less during the previous 60-day period ending when employment starts;
3. Were not hired to replace another employee, unless such employee voluntarily quit or was terminated for cause; and
4. Are not a family member as defined by Internal Revenue Code (“Code”) section 51(i).<sup>6</sup>

The work performed by such new hires must be in an employer’s trade or business or in the case of a non-profit, in furtherance of activities related to the purpose or function of that IRC 501(a) organization.

## The March 29 IRS Q&A’s provide further guidance on who can be a Qualified Employee.

The IRS on April 1, released a model affidavit (IRS form W-11).<sup>7</sup> The document is a model, so an employer is free to create its own form, as long as it meets the Act’s standards. The FICA tax holiday applies to:

1. New employees, who have never worked for the employer or a related entity before;
2. Previously laid off or terminated employees of the employer or a related entity, who meets the 60-day requirement;
3. New employers who start operations and employ otherwise Qualified Employees during the period; or
4. New hires, who were students in the 60 days preceding employment, as long as such students did not work more than 40 hours during that period.

Neither the Act nor the recent IRS Q&A appear to preclude a temporary service or staffing company from being a Qualified Employer and as such provide staffing through its employees for an unrelated employer. Furthermore, employers with a seasonal or temporary needs should be able to use the FICA tax holiday exemption even though the employer does not subsequently qualify for Business Credit.

Lastly, the Act does not require full-time employment or any minimum amount of hours of work weekly for an employee to be a Qualified Employee. So part-time employees or employees who work variable hours should also qualify.

## Mechanics of Tax Holiday for the First Quarter of 2010

While the law was signed on March 18, 2010, it applies to Qualified Employees who began working after February 3, 2010, and before January 1, 2011 but only as to wages paid between March 19, 2010 and December 31, 2010. Consequently, it is likely that some otherwise Qualified Employees may have begun work before March 19, and will have been paid before April 2010. As a result, the employer may have already remitted OASDI taxes on such wages. In recognition that employers may need time to adjust payroll systems as IRS needs time to issue further guidance, the tax holiday provision does not directly apply to wages paid and reported during the first quarter of 2010. Instead, the Act provides for a credit against second quarter OASDI taxes for the first quarter wages paid to Qualified Employees.

The March 29 IRS Q&As provide further guidance as to the mechanics of FICA credit for first quarter 2010 payroll. First, the credit only applies to wages actually paid from March 19 through March 31 rather than earned. Arguably a Qualified Employee hired after February 3, 2010, could be paid on or after March 19 for work performed before March 19. Consequently, the actual amount of wages that may be subject to the tax holiday for the first quarter 2010 may cover a period of more than the period beginning March 19, depending on the employer's pay period structure.

As to first quarter 2010 FICA credit, the claim for credit is to be made on Form 941 for second quarter 2010. So quarter credit for March wages will not be immediate but will not be available until the second form is filed in July. While wages paid in April and beyond will be credited on a payroll by payroll period basis.

## Business Credit for Retained New Hires

Beyond 2010, continued retention of Qualified Employees allows a Qualified Employer to receive a one-time "Business Credit"<sup>8</sup> under Code section 38(b). The Act provides a credit for a retained worker, provided the worker:

1. Is employed on any date during the tax year;
2. Continues to be employed by the employer for a period of not less than 52 consecutive weeks; and
3. Receives wages as defined in Code section 3401(a) for such employment during the last 26 weeks of the period that are at least 80% of the wages during the first 26 weeks of the period.

The Act excludes those categories of employees who are not subject to income tax withholding at the source, such as household employees, certain agricultural labor and potentially ex pats working abroad where foreign taxes are withheld.

Subject to the above conditions, the tax credit for the Qualified Employer would be the lesser of \$1,000 or 6.2% of section 3401(a) wages. Therefore, for the tax year ending after the enactment date, the Business Credit for the current year can be increased for each of the retained Qualified Employees once each such employee has been employed for a 52 consecutive-week period. For a calendar tax year employer, this credit will be available for 2011. For any other fiscal tax year employer, the credit may be spread over two years. While Business Credits can generally be carried back, under the Act, this credit cannot be utilized in a tax year beginning before the enactment date.<sup>9</sup>

In order for the full \$1,000 to apply, a Qualified Employee will need to be paid more than \$16,129.03, a relatively low threshold. This Business Credit feature is clearly designed to provide a long-term incentive for sustained employment. Whether this incentive will be useful to an employer who has seasonal or short-term staffing needs or is in the staffing business (at least with regards to temporary workers) remains to be seen.

## What Does HIRE Really Do?

The payroll incentives of HIRE are designed to encourage employment by giving a Qualified Employer a break on part of its FICA taxes

plus the potential for further Business Credit for retaining each Qualified Employee for at least 52 weeks. As the initial tax holiday only applies to those hired in 2010, and only for wages paid February 3, 2010 or after, to maximize the benefits of HIRE, an employer should be in the position to hire quickly. Consequently, only employers with existing needs and a capacity to quickly recruit and hire employees will be in a position to take full advantage of the Act's tax holiday features.

Assuming that a highly compensated employee is hired as of April 1, 2010 and will be paid \$106,800 (OASDI wage base) in 2010, then OASDI tax savings to the employer would be \$6,621.60 (6.2% x \$106,800). However, all other payroll taxes, absent further state and/or federal legislation, still impose substantial tax liability on the employer. In this example, in addition to paying \$106,800 in wages, the employer must match HI (1.45% on \$106,800 or \$1,548.60) plus contribute FUTA and SUTA. For example, for an employer in California, this would add \$434 for SUTA (6.2% x \$7,000) and \$21 for FUTA (.3% x \$7,000), assuming the employer is subject to highest state rate.

Alternatively, an employee who earns only \$8.00 per hour working 40 hours a week from April 1, 2010, the net OASDI tax savings for the year would be \$773.76 on \$12,480 wages (\$320 x 39 weeks x 6.2%). So the OASDI tax savings from the employer's perspective is, under either model, relatively modest given the overall financial commitment of adding an employee.

While the Act clearly seems intended to benefit an existing employer ready to hire, as the IRS Q&A has confirmed, it does not preclude a brand new business from taking advantage of the Act to hire its initial workforce.

The requirement that a Qualified Employee be unemployed for at least 60 days allows Qualified Employers who had previously laid off employees to recall those employees to take advantage of the tax holiday and, potentially, the Business Credit. Workers who within the 60-day period tried self-employment and worked at least 40 hours, however, would appear not to qualify for such status.

Overall, the payroll tax provisions of the Act providing an incentive to hire need to be weighed against the employer's need for long-term employees.

Apart from the payroll provisions, there are other business incentives in the Act, including funding for major transportation projects, that are likely to more substantially contribute to increasing employment.

## Checklists for Considering Tax Benefits of HIRE

The first step to evaluating the Act and deciding whether to pursue hiring under the Act, is to designate someone to coordinate a review of the law and assemble a team including representatives of HR, benefits, payroll and corporate tax to consider its obligations and benefits.

Any employer evaluating whether to use the credits available under HIRE should initially consider the following steps:

1. Determine if the employer is "qualified;"
2. Identify potential positions that are ready to fill;
3. Evaluate the overall cost of employment vs. the tax benefits provided by the Act and/or WOTC, if it is an option;
4. Consider prioritizing hiring objectives to identify positions ready to be filled, the availability of qualified candidates, the speed with which the recruiting and hiring process can be completed and the employer's long-term business needs;
5. Observe all existing state and federal antidiscrimination laws when making any hiring decisions.

When filling any position, the employer should:

1. Consider whether the tax benefits of HIRE outweigh the benefits of WOTC;

2. If new hire is a Qualified Employee obtain affidavit no later than first day of employment;
3. If a new hire is WOTC qualified, consider formally electing out of HIRE for the employee (IRS should provide form);
4. Alert the payroll department (and any payroll service provider) when a Qualified Employee is hired;
5. Create and retain HIRE-specific records that document each Qualified Employee's date of employment and the 52-week mark for use in establishing Business Credit eligibility;
6. Alert the payroll department regarding any Qualified Employees hired after February 3, 2010 and before April 1, 2010, so appropriate OASDI credit can be taken in the second quarter for first quarter employer-paid OASDI;
7. Advise the corporate tax department (or other corporate tax preparers) when a Qualified Employee meets the 52-week service requirement so the appropriate credit can be calculated and taken;
8. Remember that hiring and retention decisions should be secondary to employment law compliance considerations.

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<sup>1</sup> <http://www.irs.gov/business/small/article/0,,id=200747,00-220750,00.html>

<sup>2</sup> HIRE Act § 101.

<sup>3</sup> The \$106,800 is for 2010, but generally changes from year to year.

<sup>4</sup> HIRE Act § 101(d).

<sup>5</sup> IRC § 51.

<sup>6</sup> Code section 51(i) generally includes significant stockholders or beneficiaries as well as an employer's children and their descendants, siblings, parents, and other relatives, including in-laws and "step" relatives.

<sup>7</sup> The affidavit will likely be available on the IRS webpage related to the Hire Act at <http://www.irs.gov/businesses/small/article/0,,id=220746,00.html>. There are several FAQs and other helpful information for employers on this web page.

<sup>8</sup> HIRE Act § 102.

<sup>9</sup> HIRE Act § 102(c).